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# Notes

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# NOTES

## Antitrust Law—State Action Immunity and State "Neutrality" in Regulated and Compelled Activities

In *Parker v. Brown* the United States Supreme Court held that there was nothing "in the language of the Sherman Act or in its history to suggest that its purpose was to restrain a state or its officers or agents from activities directed by its legislature."[1] The state action exemption[2] recognized in *Parker* faced one of its rare Supreme Court tests in *Cantor v. Detroit Edison Co.*[3] This review was particularly timely in light of several recent analyses of the *Parker* doctrine,[4] the apparent confusion among lower federal courts about the scope of the exemption,[5] and the absence of a definitive statement setting the parameters of the doctrine in its most recent pre-*Detroit Edison* test.[6] While *Detroit Edison* did not overrule *Parker*, it did eliminate an exemption

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1. 317 U.S. 341, 350-51 (1943). *Parker* dealt with the Sherman Act, 15 U.S.C. §§ 1-7 (1970). Specific attention was paid to §§ 1 & 2, which provide:

> 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . . Every person who shall make any contract or engage in any combination or conspiracy declared by sections 1 to 7 of this title to be illegal shall be deemed guilty of a misdemeanor . . . .
>
> 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor . . . .

2. For a summary of the range of additional exemptions, see P. AREEDA, ANTITRUST ANALYSIS 102-20 (2d ed. 1974).

3. 96 S. Ct. 3110 (1976). The *Parker* doctrine was also at issue in Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951), and Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975). *See* text accompanying notes 27-41 *infra.*

4. *See, e.g.*, Donnem, *Federal Antitrust Law Versus Anticompetitive State Regulation*, 39 A.B.A. ANTITRUST L.J. 950 (1970); Handler, *The Current Attack on the Parker v. Brown State Action Doctrine*, 76 COLUM. L. REV. 1 (1976); Posner, *The Proper Relationship Between State Regulation and the Federal Antitrust Laws*, 49 N.Y.U. L. REV. 693 (1974); Simmons & Fornaciari, *State Regulation as an Antitrust Defense: An Analysis of the Parker v. Brown Doctrine*, 43 U. CIN. L. REV. 61 (1974); Slater, *Antitrust and Government Action: A Formula for Narrowing Parker v. Brown*, 69 NW. U.L. REV. 71 (1974); Verkuil, *State Action, Due Process and Antitrust: Reflections on Parker v. Brown*, 75 COLUM. L. REV. 328 (1975).

5. *Compare* Gas Light Co. v. Georgia Power Co., 440 F.2d 1135 (5th Cir. 1971), *cert. denied*, 404 U.S. 1062 (1972), *and* Marnell v. United Parcel Serv. of America, Inc., 260 F. Supp. 391 (N.D. Cal. 1966), *with* Washington Gas Light Co. v. Virginia Elec. & Power Co., 438 F.2d 248 (4th Cir. 1971). *See also* Verkuil, *supra* note 4, at 331 n.17.

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

based solely on state action in areas in which state policy is defined by the Court to be neutral—areas in which the *Detroit Edison* Court recognized an exemption based essentially on economic criteria.[7]

At issue in *Detroit Edison* was the practice of the Detroit Edison Company[8] of supplying light bulbs to its customers in exchange for their burned-out bulbs. The company supplied, at no extra charge, approximately fifty percent of the bulbs of the kinds most frequently used by its residential customers.[9] The program purported to increase the consumption of electricity. Antitrust action was brought by the owner of a drug store who alleged that the light bulb exchange program had damaged his business.[10] The defense offered by Detroit Edison was that its activity fell within the *Parker v. Brown* state action exemption: the company argued that the program had been approved by the Michigan Public Service Commission[11] and it was powerless to discontinue the service without further approval. In other words, the program had become compulsory and therefore was within the realm of state action.

The district court granted summary judgment for defendant on *Parker v. Brown* grounds.[12] The decision was affirmed by the Sixth Circuit Court of Appeals,[13] and the Supreme Court granted certiorari.[14] The Court, in a six to three decision, reversed the holding of the lower court and found that a *Parker v. Brown* exemption was not

7. The Court was severely divided. While the holding was supported by a clear six to three majority, it is difficult to ascertain a majority rationale. *See* text accompanying notes 51-63 *infra*.

8. The Detroit Edison Company is the sole supplier of electricity in southeastern Michigan. Its marketing area includes about five million people. 96 S. Ct. at 3113.

9. The cost of the light bulbs was included (in an accounting to the Michigan Public Service Commission) as an expense of Detroit Edison. Since utility rates were calculated on an average cost basis, the bulbs were obviously not free. However, no profit was recorded as arising directly from the exchange program. 96 S. Ct. at 3113-14.

10. Plaintiff originally asserted that the program violated § 2 of the Sherman Act, 15 U.S.C. § 2 (1970), and § 3 of the Clayton Act, 15 U.S.C. § 14 (1970). 96 S. Ct. at 3112-13 n.3.

11. The Commission is vested with complete power to regulate all utilities in Michigan including "rates, fares, fees, charges, *services*, rules and conditions of service . . . ." MICH. STAT. ANN. § 22.13(6) (1970) (emphasis added).

12. 392 F. Supp. 1110 (E.D. Mich. 1974). The district court relied heavily on the language in *Parker* to the effect that a price fixing agreement among California raisin growers was not in violation of federal antitrust laws as long as it " 'derived its authority and its efficacy from the legislative command of the state and was not intended to become effective without that command.' " *Id.* at 1111 (quoting 317 U.S. at 350).

13. 513 F.2d 630 (6th Cir. 1975) (mem.).

14. 423 U.S. 821 (1975).

applicable.[15] The case was remanded for determination of whether the program, stripped of its state action immunity, was in fact a Sherman Act violation.[16] While this holding was supported by a clear majority of the Court, the six Justices favoring reversal were split in such a manner as to make it difficult to discern a common rationale.[17] The implications of the holding, the split within the Court, and the problems that are almost certain to be faced by lower courts in their attempts to apply *Detroit Edison* are best understood in the context of *Parker v. Brown* and its subsequent interpretations.

The dispute in *Parker* was the result of actions taken pursuant to the California Agricultural Prorate Act of 1933.[18] The Act established procedures within which price stabilization programs for agricultural commodities could be instituted.[19] These programs utilized price floors and production controls and involved the withholding of excess output from market. One such program, initiated for regulation of raisin production, was challenged by Brown, a California producer, who sought to enjoin Parker, the State Director of Agriculture, from enforcing it.[20] In a unanimous decision the Court declared the Sherman Act to be inapplicable. It did not evaluate the program in light of the Sherman Act but made, in essence, a jurisdictional decision. In writing for the Court, Justice Stone indicated that once the program was estab-

15. 96 S. Ct. at 3123.

16. *Id.* at 3121 n.38, 3123.

17. Justice Stevens wrote the plurality opinion for himself and Justices Brennan, Marshall and White. Chief Justice Burger and Justice Blackmun wrote separate concurring opinions. Justice Stewart filed a dissenting opinion in which Justices Powell and Rehnquist joined.

18. 317 U.S. at 344.

19. The Act created the Agricultural Prorate Advisory Commission, which, upon the petition of ten producers of a particular commodity (in this case raisins), would hold public hearings and determine whether the establishment of a prorate marketing plan for the commodity in a specified zone would "prevent agricultural waste and preserve agricultural wealth." *Id.* at 346. When it was determined that a program was advisable, the Commission was authorized to select a committee to formulate the specifics of the plan. Upon consent of 65% of the zone's producers who jointly owned at least 51% of the acreage devoted to the regulated crop, the plan would become effective. The program was enforced by fines levied against any producer who sold or any handler who received "without proper authority" a commodity for which a program was in effect. *Id.* at 347.

20. The case originated as a challenge to the constitutionality of the statute authorizing the price fixing program. Brown v. Parker, 39 F. Supp. 895 (S.D. Cal. 1941). Upon appeal from the district court the United States Supreme Court thought it appropriate that the Sherman Act inquiry be made. Justice Stewart indicated that this inquiry was probably in response to an interim decision, Georgia v. Evans, 310 U.S. 159 (1942), which held that a state is a "person" within the meaning of § 7 of the Sherman Act and reflected the concern of the Court with the relationship of states to federal antitrust legislation. 96 S. Ct. at 3115.

lished as being a product of state legislation, the Sherman Act would not have preemptive effect.[21] The fundamental consideration of the Court is clear from its statement that "in a dual system of government in which . . . the states are sovereign . . . an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress."[22] The Court, however, refused to permit states to give immunity "to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[23] Thus, the Court distinguished actions that "derived [their] authority and efficacy from the legislative *command* of the state"[24] from actions of a predominately private nature. In light of the *Detroit Edison* plurality opinion that *Parker* is distinguishable from *Detroit Edison* on the basis of defendant's status as a state official,[25] it is essential to note that the *Parker* Court did not indicate whether it would have ruled differently had defendant not been a state official.[26]

In the post-*Parker* era the United States Supreme Court has only twice decided cases in which some clarification of the state action exemption doctrine was required.[27] In *Schwegmann Brothers v. Calvert Distillers Corp.*[28] the Court considered the 1937 Miller-Tydings amendment to the Sherman Act,[29] which exempted from the Act "contracts or agreements prescribing minimum prices for . . . resale" when such contracts are lawful under local law.[30] The fact that Louisiana statutes permitted resale price maintenance agreements exempted such agreements from the Act;[31] additionally, Louisiana law in-

21. 317 U.S. at 350. It should be noted that the exemption of "state action" from antitrust legislation does not foreclose the possibility of obtaining the sought-after relief on a procedural due process basis. *See* Verkuil, *supra* note 4, at 330, 354-56.

22. 317 U.S. at 351. *Parker* was not the first case to recognize this policy with regard to the Sherman Act. *See* Olsen v. Smith, 195 U.S. 332 (1904); Lowenstein v. Evans, 69 F. 908 (C.C.D.S.C. 1895). These cases are cited and discussed by Handler, *supra* note 4, at 8, 9.

23. 317 U.S. at 351.

24. *Id.* at 350 (emphasis added).

25. *See* text accompanying note 51 *infra.*

26. At least two commentators have interpreted the *Parker* decision as allowing for state action exemptions even when defendant is not a state official. *See* Handler, *supra* note 4, at 8-9; Rahl, *Resale Price Maintenance, State Action, and the Antitrust Laws: Effect of Schwegmann Brothers v. Calvert Distillers Corp.*, 46 ILL. L. REV. 349, 366 (1951).

27. *See* note 3 *supra.*

28. 341 U.S. 384 (1951).

29. Ch. 690, tit. VIII, § 1, 50 Stat. 693 (codified at 15 U.S.C. § 1 (1970)).

30. *Id.*

31. NOW LA. REV. STAT. ANN. § 51:392 (West 1965).

cluded a "nonsigner" proviso[32] that bound retailers who were not party to a price maintenance agreement to the same resale terms as contracting retailers. Calvert Distillers brought suit to enjoin Schwegmann Brothers, a nonsigning retailing chain, from selling at prices below the agreed-upon minimum. Schwegmann Brothers contended that the nonsigner proviso was beyond the scope of the Miller-Tydings amendment. A divided Court agreed that the amendment was not so expansive as to permit enforcement of the nonsigner clause.[33] The Court further held that Calvert Distillers was not acting within an area afforded *Parker v. Brown* protection. The Court reasoned that although nonsigner compliance was compelled by the state and therefore arguably protected by *Parker v. Brown*, the original price fixing agreement between Calvert and the signing retailers was voluntary.[34] Thus, Louisiana laws permitted but did not compel the original agreement; neither did they compel the effect of the nonsigner provision. While there has been disagreement about whether *Schwegmann* modified or simply clarified *Parker*,[35] the holding is clearly to the effect that the *Parker* exemption calls for state compulsion or a high degree of state participation.

The *Parker v. Brown* doctrine was applied again by the Court in 1975 in *Goldfarb v. Virginia State Bar*.[36] In *Goldfarb* a unanimous Court found that enforcement by the Virginia State Bar of a minimum fee schedule for lawyers established by the Fairfax County Bar Association was in violation of the Sherman Act.[37] Although the Virginia legislature had authorized the Virginia Supreme Court to "regulate the practice of law"[38] and designated the State Bar to act as an administrative agency of the court,[39] the United States Supreme Court ruled that

32. The nonsigner clause read as follows:

> Willfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provision of section 1 [§ 9809.1] of this act, *whether the person so advertising, offering for sale, or selling is or is not a party to such contract,* is unfair competition and is actionable at the suit of any person damaged thereby.

341 U.S. at 387 n.2 (emphasis by the Court). It currently appears in substantially the same form as LA. REV. STAT. ANN. § 51:394 (West 1965).

33. 341 U.S. at 388-89.

34. 341 U.S. at 389. This analysis is taken from Simmons & Fornaciari, *supra* note 4, at 66-67.

35. *Compare* Simmons & Fornaciari, *supra* note 4, at 67, *with* Rahl, *supra* note 26, at 366.

36. 421 U.S. 773 (1975).

37. *Id.* at 793.

38. *Id.* at 788.

39. VA. CODE § 54-49 (1974).

this authorization was not sufficient for the price fixing activity to be deemed "state action." Chief Justice Burger, writing for the Court, indicated that the "threshold inquiry in determining if an anticompetitive activity is state action of the type the Sherman Act was not meant to proscribe is whether the activity is *required* by the State acting as sovereign."[40] The fact that anticompetitive activity was "prompted" by the state was not to be equated with compulsion by the state.[41] The Court in *Goldfarb* did not consider the question of whether a *Parker* exemption was only applicable in suits in which state officials are defendants. Whether the Court simply preferred to make its decision on other grounds or regarded the employment affiliation of defendant as inapposite is not clear.

Lower federal court interpretations of *Parker* have not been uniform. In the context of *Detroit Edison*, it is most instructive to compare the interpretation of the Fourth Circuit Court of Appeals in *Washington Gas Light Co. v. Virginia Electric & Power Co.*[42] with that employed by the Fifth Circuit in *Gas Light Co. v. Georgia Power Co.*[43] In both cases the practices of state regulated utilities were challenged as violative of section 1 of the Sherman Act.[44] In both cases defendants claimed an exemption based on *Parker v. Brown*. In *Washington Gas Light* plaintiff argued that no inference of state approval could be made since there had been no investigation or affirmative approval by the relevant regulatory commission;[45] however, the Fourth Circuit indicated its willingness to infer consent from silence and ruled that *Parker* was applicable.[46]

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40. 421 U.S. at 790 (emphasis added).

41. *Id.* at 791.

42. 438 F.2d 248 (4th Cir. 1971).

43. 440 F.2d 1135 (5th Cir. 1971), *cert. denied*, 404 U.S. 1062 (1972).

44. At issue in *Washington Gas Light* were promotional practices of Virginia Electric & Power Company (VEPCO). The company compensated builders through the use of a rebate program for the costs of installing underground transmission lines. The amount of the rebate was a function of the degree to which a home was "all electric." 438 F.2d at 250. Rebate programs similar to those in *Washington Gas Light* were also at issue in *Gas Light Co.* In addition plaintiff challenged a quantity discount rate system and a plan allowing consumers to pay their bills in 12 equal installments. 440 F.2d at 1137.

45. 438 F.2d at 252.

46. *Id.* In *Washington Gas Light* the court expressed concern that plaintiff did not exhaust the remedies available through the state regulatory commission, indicating that this consideration may have been a factor in the decision. This is noted in Kinter & Kaufman, *The State Action Antitrust Immunity Defense*, 23 AM. U.L. REV. 527, 532 (1974), and Verkuil, *supra* note 4, at 337-38. The Fifth Circuit has rejected an exhaustion of state remedies requirement. *See* Woods Exploration & Producing Co. v. Aluminum Co. of America, 438 F.2d 1286, 1296 (5th Cir. 1971), *cert. denied*,

In *Gas Light Co.* the Fifth Circuit rejected the "consent by silence" reasoning of the Fourth Circuit. While the court found enough active state supervision in the form of full adversary hearings[47] to find *Parker* applicable, it drew limits, stating, "it is not necessary for us to extend the *Parker* exclusion to the point of its extension in *Washington Gas Light* and we do not do so."[48] Of these two approaches it is clear that the Fifth Circuit's stricter requirement of greater than general supervision is more typical than the approach employed by the Fourth Circuit in *Washington Gas Light*.[49] Of equal importance in view of the likely repercussions of *Detroit Edison* is the uniform tendency of the lower federal courts to avoid substantive economic analysis in making a *Parker v. Brown* decision.[50]

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404 U.S. 1047 (1972), *cited in* Kinter & Kaufman, *supra*, at 532 n.32. In addition, the decision may be partially explained by the tendency of the courts to view state regulated utilities in a more favorable light with respect to the *Parker* exemption than private enterprises. According to Professor Verkuil, "The rationale of that case [*Washington Gas Light*] is firmly rooted in the public utility/public calling context." Verkuil, *supra* note 4, at 353.

47. 440 F.2d at 1140.

48. *Id.*

49. *See, e.g.*, Norman's on the Waterfront, Inc., v. Wheatley, 444 F.2d 1011 (3d Cir. 1971); United States v. Oregon State Bar, 385 F. Supp. 507 (D. Ore. 1974); United States v. Pacific Southwest Airlines, 358 F. Supp. 1224 (C.D. Cal. 1973); Marnell v. United Parcel Serv. of America, Inc., 260 F. Supp. 391 (N.D. Cal. 1966). *See also* Kinter & Kaufman, *supra* note 46, at 533. While the degree of supervision has been the overriding issue in many lower court cases, the courts also have looked to the legitimacy of the state purpose and evidence of legislative compulsion. *See, e.g.*, Hecht v. Pro-Football, Inc., 444 F.2d 931 (D.C. Cir. 1971), *cert. denied*, 404 U.S. 1047 (1972); Woods Exploration & Producing Co. v. Aluminum Co. of America, 438 F.2d 1286 (5th Cir. 1971); George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc., 424 F.2d 25 (1st Cir.), *cert. denied*, 400 U.S. 850 (1970). These cases are cited in Note, *Antitrust Law—The Sherman Act and Minimum Legal Fee Schedules: Learned Professions and State-Action Immunity*, 53 N.C.L. REV. 399, 406 nn.53-55 (1974).

50. *See* cases cited note 49 *supra*. As will be discussed, the Court's decision in *Detroit Edison* may force the lower federal courts to make substantive economic analyses. *See* text accompanying notes 62-63 *infra*. The decision of the First Circuit Court of Appeals in George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc., 424 F.2d 25 (1st Cir.), *cert. denied*, 400 U.S. 850 (1970), provides a good example of the careful reasoning required to make a *Parker v. Brown* analysis without becoming involved in economic policy. In *Whitten* both parties were involved in competitive bidding for contracts to build swimming pools and supply swimming pool equipment for public and quasi-public institutions. The bids were based on specifications that were drafted by an architect employed by the buyers. Paddock Pools, Inc., had experienced a great deal of success in influencing the architect to adopt plans that were particularly well suited to Paddock's prefabricated filtering systems, thus placing Paddock in an advantageous competitive position. Paddock contended that its practices were afforded a *Parker v. Brown* state action exemption as a result of adoption of its plans by the public body. In vacating the summary judgment for Paddock Pools granted by the district court, the First Circuit indicated that *Parker* was applicable only in cases in which "government determines that competition is not the *summum*

Given the importance of the decision to grant a state action exemption and the various standards employed by the lower federal courts, the decision in *Detroit Edison* deserves careful examination as a possible guidepost to future decisions. The plurality opinion, written by Justice Stevens, viewed the light bulb exchange program as falling outside of *Parker v. Brown*, and offered an alternative method of determining whether an activity is to be afforded an exemption. Justice Stevens distinguished *Detroit Edison* by indicating that, unlike *Parker*, defendant in the original suit was not a state official; hence, *Parker* was not controlling. The plurality considered it an open question whether *Parker* might have been decided differently if charges had been brought against private parties implementing state programs rather than against state officials.[51]

Justice Stevens offered for the plurality a two-step analysis for determining whether an activity qualifies for a Sherman Act exemption. First, the fairness of not applying a *Parker* exemption to activity compelled by state law was examined.[52] This inquiry was particularly relevant in light of the possibility of treble damages. On this point Justice Stevens did not distinguish a state regulated utility from a private business (as in *Schwegmann*). The plurality reasoned that Detroit Edison, by playing a dominant role in the decision to maintain the light bulb exchange program, did not qualify for immunity under a "state action" rationale. The plurality distinguished this case from others in which the private party actually obeyed a state order or in which the state's role was so dominant that it would be unfair to hold the private party responsible. In short, while Detroit Edison was compelled to continue the program, it was not compelled to initiate the program. As a result of this exercise of free choice in implementation of the program the threat of treble damages was not regarded as unfair.[53]

The second step of the plurality's analysis concerned the appropriateness of superimposing federal antitrust regulations on state utilities regulations.[54] The plurality rejected the contention that federal antitrust laws should not be applied in areas already regulated by state

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*bonum* in a particular field and deliberately attempts to provide an alternate form of public regulation." *Id.* at 30. The existence of a bidding program was regarded as clear evidence that there had been no decision to eliminate competition. *Id.* at 31.

51. 96 S. Ct. at 3122.
52. *Id.* at 3117-19.
53. *Id.* at 3118-19.
54. *Id.* at 3117, 3119.

agencies. Instead, the plurality declared that federal interests are not to be "inevitably . . . subordinated to the State's."[55] Thereby, the plurality exhibited a willingness to consider each activity of the public utility on an individual basis.[56] Finding no evidence that the Michigan legislature or the regulatory commission desired to regulate actively the light bulb market, the plurality regarded the state's policy as neutral.[57] While this neutrality was regarded as sufficient to preclude a "state action" exemption, it was not considered necessary. Thus, once a firm has ventured into a field in which it is not a natural monopoly, or when there is no other economic basis for an antitrust exemption, the plurality has indicated its willingness to deny a state action exemption, even if there is state regulation.[58] Acording to Justice Stevens, the "Court has consistently refused to find that regulation gave rise to an implied exemption without first determining that exemption was necessary in order to make the regulatory act work, 'and even then only to the minimum extent necessary.' "[59] The basis of this declaration was the belief that the relationship between federal laws and state regulation should parallel that found between federal laws and federal regulation.[60]

Two facets of *Detroit Edison* are particularly important for future applications of *Parker v. Brown*. First, a majority of the Court definitively rejected the notion that *Parker* applies solely to suits against state officials.[61] A second conclusion may be derived by joining the plurality's willingness to make substantive economic analyses in almost all areas of state activity[62] with the Chief Justice's willingness to make

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55. *Id.* at 3119.

56. *Id.* To support this willingness to inquire into the individual activities of state-regulated utilities the plurality offered its interpretation of the "threshold inquiry" language of *Goldfarb*. According to the pluality, the "threshold inquiry" of whether anticompetitive activity is required by a state is *not* dispositive with respect to an antitrust exemption. Instead, it is only the initial step. 96 S. Ct. at 3121-22.

57. *Id.* at 3114.

58. *Id.* at 3119-20.

59. *Id.* at 3120 (footnote omitted) (quoting Otter Tail Power Co. v. United States, 410 U.S. 366, 391 (1973), which was quoting Silver v. New York Stock Exch., 373 U.S. 341, 357 (1963)).

60. 96 S. Ct. at 3120.

61. Only the four members of the plurality were willing to narrow *Parker* to this extent.

62. It must be recalled that the plurality recognized what it regarded as state neutrality vis-à-vis the light bulb exchange program, but did not regard neutrality as necessary to preclude Sherman Act exemption. It would instead apply a form of substantive economic analysis. It would allow exemptions in cases of natural monopoly and, perhaps, in agricultural programs similar to the one in *Parker*. *See* text accompanying notes 54-59 *supra*. At this point the plurality really no longer spoke in terms of a *Parker v. Brown* exemption. The *Parker* Court reasoned that there was no evi-

the same type of analysis in areas he regards as neutral vis-à-vis state policy.[63] This "majority" indicated that approval of a program by a

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dence that Congress intended to apply the Sherman Act to restrain "a state or its officers or agents from activities directed by its legislature." 317 U.S. at 350-51. There was no economic analysis to be made. *Parker* was based on the nature of the federal system, *see* text accompanying notes 21-24 *supra*, and simply stated that state legislative command was not to be preempted by the Sherman Act; therefore, it is inappropriate to label an exemption based on an economic rationale as a *Parker* exemption.

63. Although the Chief Justice joined with the plurality in holding that the light bulb exchange program was beyond *Parker v. Brown* protection, he disagreed with that part of the plurality opinion that would narrow *Parker* to suits against state officials. 96 S. Ct. at 3123. The Chief Justice pointed out that the emphasis in *Parker v. Brown* was not on individuals per se, but on activities. According to the Chief Justice, if the plurality's reading of *Parker* had been applied in *Goldfarb*, the decision in that case could have been based on no more than finding that the Virginia Bar was a voluntary organization, not a state agency. Thus, the plurality approach was deemed inconsistent with that employed just one year earlier in which the Court viewed the degree of state supervision as decisive. *Id.*

The Chief Justice's concurrence with the holding of the plurality was based on what he agreed was a state policy of neutrality with respect to the light bulb exchange program. *Id.* at 3124. Whether he would go as far as the plurality in allowing federal intrusion in cases of nonneutrality is not entirely clear. On one hand he expressed general agreement with those parts of the plurality opinion that called for this more intrusive analysis, yet when discussing the specifics of his rationale, he spoke only in terms of "neutrality" or the need for an "independent regulatory purpose." *Id.* It is essential to note that the "neutrality" in *Detroit Edison* is quite different from that involved in Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951). *Schwegmann* took place in the context of a private business and involved individual conduct that was *permitted* by Louisiana law. The state took no active role and the individual found that taking advantage of a law that permitted certain conduct was no assurance that the conduct would be exempt from the Sherman Act. In *Detroit Edison* the conduct was by a state regulated utility that had to have the express approval of the state regulatory agency.

Justice Blackmun also rejected the plurality's narrowing of *Parker* to suits against state officials. *Id.* at 3128 n.5. His agreement with the holding of the court is based on what he regarded as evidence of congressional intent for the Sherman Act to have preemptive effect with respect to inconsistent state laws. Citing congressional action to exempt specific activities from the Sherman Act, Justice Blackmun concluded that if a general state action exemption were desired Congress would have provided for it. *Id.* at 3125-26.

The dissenting Justices, led by Justice Stewart, agreed with the Chief Justice that the "state officials only" interpretation of *Parker* offered by the plurality was entirely too narrow. *Id.* at 3129. They would have disposed of the case through a two-step analysis. First, the actions of Detroit Edison in proposing what may have been an anticompetitive program would not be subject to the Sherman Act under Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961), *cited in* 96 S. Ct. at 3133. In *Noerr* the Court held that the Sherman Act "does not prohibit two or more persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint or a monopoly.". 365 U.S. at 136. Second, once the plan was approved, and Detroit Edison was in effect required to continue it, the activities were protected by *Parker*. 96 S. Ct. at 3133.

In supporting its own conclusion that all the activities of Detroit Edison were beyond the Sherman Act, the dissent relied on the legislative history of the Act and

state regulatory agency is not necessarily to be regarded as sufficient evidence of affirmative (or nonneutral) state policy deserving a *Parker* exemption; therefore, it is clear that an approach like that employed by the Fourth Circuit in *Washington Gas Light* would now be inappropriate.

Precisely what constitutes "nonneutrality" after *Detroit Edison* is not clear; therefore, the lower federal courts are faced with continuing problems of interpretation. First, is state policy neutral? Clearly, approval by state agencies is not sufficient to find nonneutrality. Secondly, if state policy is neutral, does the activity have validity in terms of the state's regulatory goals? This question, of course, opens the door to economic analysis. In answering this question the courts will have to determine whether a natural monopoly does exist or whether there is some other economic basis for anticompetitive activity. Market analysis, the weighing of competing economic interests and detailed examination of regional economic conditions may be required just to determine whether the activity should be open to Sherman Act review.

Underlying the reasoning of a majority of the Court is an apparent desire to treat the relationship between federal legislation and state regulation in the same manner as the relationship between federal legislation and federal regulation.[64] In order to permit this analogous treatment the majority either ignored *Parker*'s role in balancing federal and state interests or felt that the federalism justification for *Parker* must be subordinated to the public interest in efficient allocation of economic

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an analysis of the historical context of *Parker v. Brown*. The dissent cited language from the legislative history of the Sherman Act indicating that the Act was not intended "'*to invade the legislative authority of the several States or even to occupy doubtful grounds.*'" *Id.* at 3137 (emphasis added by the Court) (quoting H.R. REP. No. 1707, 51st Cong., 1st Sess. 1 (1890)). It then described the post-1890 period as one of "retroactive" expansion of the jurisdictional reach of the Sherman Act due in large part to expanded interpretation of the commerce clause. *Id.* at 3138. According to the dissent, without this expanded interpretation of the commerce clause and the parallel expansion of the Sherman Act, *Parker v. Brown* would not have arisen. Once it did arise, though, the dissent viewed the decision as the "best possible" accommodation of the original Sherman Act intent and its post-1890 commerce clause expansion. *Id.* at 3139.

64. The exact language of the plurality is: "Congress could hardly have intended state regulatory agencies to have broader power than federal agencies to exempt private conduct from the antitrust laws." 96 S. Ct. at 3120. As the dissent correctly notes, the premise that state regulatory agencies could provide exemptions to federal legislation is itself invalid under the supremacy clause of the United States Constitution. *Id.* at 3135.

resources.[65] Either way, *Parker* was not carefully considered in the majority's balance..

The decision in *Detroit Edison* is also clear evidence that the Court stands firm in its willingness to provide a forum for review collateral to that available through state and federal regulatory agencies.[66] By lowering the *Parker v. Brown* barrier the Court seems to have increased the role of the lower federal courts in this area. To the extent that the doctrine of primary jurisdiction[67] is part of the process of balancing state and federal interests in a dual system of government, a broad interpretation of *Parker* would seem to further this objective by forcing plaintiffs to place primary reliance on remedies available through *state* regulatory agencies.[68] Here again the Court seemed to assign relatively little importance to this facet of *Parker.*

One additional aspect of the *Detroit Edison* opinion must be underscored: it is entirely conceivable that a utility could go through the entire regulatory process and, after gaining state approval of its rates and proposed programs, find that it is liable for treble damages in an antitrust action. The decision in *Detroit Edison* would not permit this result "if a private citizen has done nothing more than obey the command of his state sovereign."[69] However, the Court did not equate continuing practices that defendant proposed and have become compulsory with obeying the initial command of the state. As a result, when formulating proposals, state regulated utilities must be conscious of federal antitrust legislation as well as state regulatory policies.

In *Detroit Edison* the Court calls for economic justification for Sherman Act exemptions in those areas of activity in which state policy is deemed to be "neutral." Neutrality was found to exist even though the program in question was that of a regulated utility and had been approved by the state regulatory agency. The Court seemed to discount the role *Parker v. Brown* has played in the delicate process of balancing federal and state interests. If one views *Parker*'s role in bal-

65. In the case of federal law/state regulation, this objective runs directly into the constitutional issue of the allocation of power between federal and state interests. *See* Note, *Parker v. Brown: A Preemption Analysis,* 84 YALE L.J. 1164 n.8 (1975).

66. *Accord,* Nader v. Allegheny Airlines, Inc., 96 S. Ct. 1978 (1976).

67. According to Professor Verkuil, "Primary jurisdiction directs a federal court to dismiss or stay an antitrust action pending a resolution of the challenged conduct by the appropriate administrative agency." Verkuil, *supra* note 4, at 348-49 (footnote omitted).

68. *See* Handler, *supra* note 4, at 13-14; Verkuil, *supra* note 4, at 340-50.

69. 96 S. Ct. at 3117.

ancing these interests as transcending the public interest in allocative efficiency, the decision may represent injudicious tampering. On the other hand, if one views the balancing process and the benefits of allocative efficiency as concerns of comparable magnitude, then the net benefit from the tradeoff may not be apparent for some time.

JEFFREY LYNCH HARRISON

## Civil Procedure—Collateral Estoppel: The Fourth Circuit Squeezes an Oversized Judgment Through a Narrow Issue

Collateral estoppel[1] is a procedural doctrine whereby essential issues that have been decided in a prior action are treated as conclusive in any subsequent proceeding, thus foreclosing a party from relitigating the same issue.[2] Among the policy objectives collateral estoppel furthers are safeguarding against inconsistent results and avoiding needless litigation. The seductiveness of these ends, however, should never obscure the necessity for careful analysis of whether the issue asserted as collaterally estopped was both actually determined and substantially identical with the present one, lest a litigant be unfairly denied his day in court. In *Azalea Drive-In Theatre, Inc. v. Hanft*,[3] the Fourth Circuit held that a seemingly ambiguous finding by a state court in an action to recover on a promissory note that an affirmative defense of duress based upon an alleged threat of a group boycott had not been established was conclusive as to whether the threat was in fact made in a subsequent affirmative antitrust action brought by the defendant in a federal district court.

Azalea Drive-In Theatre, plaintiff in the federal action, leased films from defendant distributors under agreements providing for payment of a percentage of the box office receipts. These agreements also authorized periodic inspections to insure that the theatre was not

1. Also known as a species of res judicata or issue preclusion.

2. *The Restatement of Judgments* defines the rule as follows: "When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim." RESTATEMENT (SECOND) OF JUDGMENTS § 68 (Tent. Draft No. 1, 1973).

3. 540 F.2d 713 (4th Cir. 1976).

underreporting its receipts. Such inspections were performed by the accountant for the distributors' law firm, who concluded that the theatre had misrepresented its receipts by as much as $240,000. The parties managed to negotiate a settlement for $70,000, and Azalea executed a promissory note for this purpose.[4]

When Azalea failed to make the first payment, the distributors initiated a suit in a Virginia state court to recover on the note.[5] Azalea set forth three affirmative defenses: (1) that the note was given without consideration, (2) that it was given by their president under duress, he having been threatened by the accountant with a group boycott by the distributors unless he agreed to the settlement, and (3) that the note was obtained in violation of federal antitrust laws.[6] The state judge struck the third defense and an antitrust counterclaim on the ground that the enforcement of the antitrust laws was under exclusive federal jurisdiction. He then tried the case without a jury, and received testimony from both sides on whether a group boycott had in fact been threatened.[7]

In the judge's findings of fact and conclusions of law he framed one of the questions of ultimate fact to be: "Was there sufficient and convincing evidence of duress on the part of the plaintiffs to the detriment of the defendants?"[8] For all questions posed, including the preceding, he gave only the general answer, "[a]s the trier of the facts, the Court decides same in favor of the plaintiffs,"[9] and granted judgment for plaintiffs.

Meanwhile, Azalea had filed a claim in the Federal District Court for the Eastern District of Virginia against the distributors charging a Clayton Act violation and the use of "monopolistic and economic threat, coercion and duress" in obtaining the note.[10] After the state court rendered its judgment, the distributors amended their answer to assert that Azalea was collaterally estopped from again litigating the question of the alleged threat and attendant duress. The district court, noting the lack of specific findings, ruled that the doc-

4. *Id.* at 714.

5. *Id.* The state trial court decision is unreported. The statement of facts concerning that proceeding is taken from the summary by the Fourth Circuit.

6. *Id.*

7. *Id.*

8. *Id.* at 716 n.2.

9. *Id.*

10. *Id.* at 714; Azalea Drive-In Theatre, Inc. v. Sargoy, 394 F. Supp. 568 (1975) (mem.).

trine should not apply since it was possible that the state judge found that a threat was made without finding that it constituted duress.[11] Azalea then prevailed in the jury trial.

On appeal, the Fourth Circuit, through Chief Judge Haynsworth, reversed on the ground that the core factual dispute, namely whether or not a threat of group boycott had been made, was the same in each suit.[12] Believing that the state judge in deciding the facts for the distributors must have found that no threat had been made, the court concluded that under established principles collateral estoppel should have been invoked. The court also rejected Azalea's claim that application of collateral estoppel in the federal suit would compromise its seventh amendment right to a jury trial since no such right had been available in the former suit on the note by determining that the policies underlying collateral estoppel are not overborne simply because the form of the fact finding process in the first forum is unlike that of the second.[13]

Judge Butzner vigorously dissented on three separate grounds. He based the first on an analysis of the difference between the state claim of duress and the federal claim of an antitrust violation: to prove duress Azalea had to establish not only that the accountant threatened a group boycott, but also that such a threat was unlawful under state law and "was sufficient to overcome the will of a person of ordinary firmness,"[14] while to make out a per se antitrust violation only a threat of a group boycott need be proven. Since the ground of decision was unclear on the record, the judge could have found that no threat had been made, or, alternatively, that the threat had been made but that it was not unlawful or that it fell short of overcoming the will of Azalea's president. Thus collateral estoppel should not apply for the reason that the dispositive matter litigated and determined might have been only one of several possibilities, and it had not been clearly shown to be only the existence or not of the threat. A second factor that he asserted to weigh against collateral estoppel was the fact that Azalea had to prove by "clear and convincing" evidence the duress defense while the antitrust claim entailed only the ordinary civil burden of proof of a preponderance of

11. 540 F.2d at 714; 394 F. Supp. at 575.
12. 540 F.2d at 714.
13. *Id.* at 715.
14. *Id.* at 716 (Butzner, J., dissenting).

the evidence.[15] Lastly, Judge Butzner asserted that the application of collateral estoppel would be a compromise of Azalea's seventh amendment right to a jury trial on the antitrust claim.[16]

Prior cases illustrate those situations in which the invocation of collateral estoppel is deemed inappropriate. *Russell v. Place*,[17] cited by the dissent,[18] refused to allow collateral estoppel to foreclose a party who had been found guilty of infringement of a patent from contesting the validity of that patent in a subsequent suit when the patent consisted of two claims and it could not be discerned on which claim the first judgment had been rendered. The rule stated in its holding has never been questioned:

> [I]t must appear, either upon the face of the record or be shown by extrinsic evidence, that the precise question was raised and determined in the former suit. If there be any uncertainty on this head in the record,—as, for example, if it appears that several distinct matters may have been litigated, upon one or more of which the judgment may have passed, without indicating which of them was thus litigated, and upon which the judgment was rendered,—the whole subject-matter of the action will be at large, and open to a new contention, unless this uncertainty be removed by extrinsic evidence showing the precise point involved and determined.[19]

Thus, reasoning by speculative inference from an ambiguous record is not permitted to show that the issues are the same. There must be demonstrable evidence from which such a conclusion, and no other, necessarily follows.

Closely related to this concept is the mirror situation in which the first judgment rests on alternative grounds, either of which by itself would justify the result, and the determination of each or all of them is evident from the record. Under these circumstances, unlike the *Russell* situation, what issues were actually decided is known. Although this knowledge might seem to vitiate the argument against collateral estoppel based on uncertainty, the recent trend is to deny preclusion in this situation also. The Tentative Draft of the *Restatement (Second) of Judgments*, contrary to the first *Restatement*,[20] takes the view that neither of two alternative determinations by itself should be

15. *Id.* at 717.
16. *Id.* at 718.
17. 94 U.S. 606 (1876).
18. 540 F.2d at 715.
19. 94 U.S. at 608.
20. RESTATEMENT OF JUDGMENTS § 68, Comment n (1942). "Where the judg-

conclusive in a subsequent suit.[21] The recent case of *Halpern v. Schwartz*[22] refused to give collateral estoppel effect in an action for objections to discharge of a party who had been adjudicated bankrupt on three separate grounds, any one of which would have been conclusive standing alone, when only one of the grounds required a finding of actual intent to defraud, which was the issue in the second suit. After surveying the authorities and concluding that they were not overwhelmingly compelling either way on this close question, the court offered the rationale that, "if the court in the prior case were sure as to one of the alternative grounds and this ground by itself was sufficient to support the judgment, then it may not feel as constrained to give rigorous consideration to the alternative grounds,"[23] implying that in such a situation the "full and fair consideration" generally required of the issue in the first instance may be lacking.[24]

Another limiting factor in regard to collateral estoppel is a change in the burden of proof. Usually this circumstance arises when the first action is criminal in nature and the second civil; an acquittal in the former under the "beyond a reasonable doubt" standard will not preclude relitigation of the issues in the latter under the "preponderance of the evidence" standard.[25] In *Helvering v. Mitchell*[26] a defendant who had been acquitted on a criminal tax evasion charge was held not to be immune from a civil suit to collect a deficiency based on

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ment is based upon the matters litigated as alternative grounds, the judgment is determinative on both grounds, although either alone would have been sufficient to support the judgment." *Id.* See Scott, *Collateral Estoppel by Judgment*, 56 HARV. L. REV. 1 (1942), for support of the first *Restatement* position.

21. RESTATEMENT (SECOND) OF JUDGMENTS § 68, Comment i (Tent. Draft No. 1, 1973). "If a judgment of a court of first instance is based on determinations of two issues, either of which standing independently would be sufficient to support the result, the judgment is not conclusive with respect to either issue standing alone." *Id.*

22. 426 F.2d 102 (2d Cir. 1970).

23. *Id.* at 105.

24. *But cf.* Irving Nat'l Bank v. Law, 10 F.2d 721 (2d Cir. 1926).

> The defendant's position comes to this: That a finding is not res judicata, if the court could have reached the same result by other reasoning. . . . But the principle has never been carried so far as to discredit findings which are collateral only if the cause had been disposed of upon other principles than those which the court had a mind to apply. On the contrary, if a court decides a case on two grounds, each is a good estoppel.

*Id.* at 724. Judge Learned Hand's last sentence could be taken as standing for the contrary view, but the case may be distinguished in that the alternative ground asserted by the defendant was only a hypothetical one, and not included in the first court's findings. *See* Halpern v. Schwartz, 426 F.2d 102, 107 n.4 (2d Cir. 1970).

25. A conviction, however, may serve as an estoppel, since satisfaction of the higher burden of proof must necessarily logically include satisfaction of the lower one.

26. 303 U.S. 391 (1938).

the same set of alleged facts. The court stated that "[t]he difference in degree of the burden of proof in criminal and civil cases precludes application of the doctrine of *res judicata.* The acquittal was 'merely . . . an adjudication that the proof was not sufficient to overcome all reasonable doubt of the accused.' "[27] This principle has also been applied further down the burden of proof spectrum when an administrative proceeding follows a civil suit.[28]

A corollary to this precept is that a party who loses on a claim in which one element to be proven is some specific intent or other subjective state on the part of his adversary will not be estopped from litigating a different claim based on the same act, but in which intent is immaterial. In *One Lot Emerald Cut Stones & One Ring v. United States,*[29] a case also illustrating the criminal-civil dichotomy,[30] the Government was not estopped from pressing a civil forfeiture proceeding for imported merchandise not included in a declaration and entry under the tariff laws even though defendant had been acquitted on criminal charges stemming from the same importation. The court reasoned that for a criminal conviction the Government had to prove a willful intent to defraud as well as the act of unlawful importation. An acquittal could have entailed a finding that the act was done but that the intent was lacking. Since in a forfeiture action the Government had only to prove that the property was imported without a declaration, the criminal acquittal could not be accepted as a conclusive

27. *Id.* at 397 (quoting Lewis v. Frick, 233 U.S. 291, 302 (1914)). *See also* Harper v. Blasi, 112 Colo. 518, 151 P.2d 760 (1944), noting that the same testimony might be insufficient to support a guilty verdict against a criminal defendant but nevertheless suffice to discharge the lower burden of proof necessary for a verdict against a civil defendant. *Id.* at 521-22, 151 P.2d at 761. *But see* Coffey v. United States, 116 U.S. 436, 443 (1886), in which the Government was estopped from litigating a civil action for seizure of untaxed liquor after it had failed to obtain a conviction in a criminal trial for attempt to defraud the United States of the tax on it.

28. In Young & Co. v. Shea, 397 F.2d 185 (5th Cir. 1968), a longshoreman first sued a shipowner for negligence in connection with injuries sustained aboard ship. The shipowner impleaded the employer, and it was determined that the longshoreman had in fact sustained no injury when he fell. The court held that collateral estoppel should not apply on the question of injury when the longshoreman subsequently sought compensation from his employer under the Longshoremen's and Harbor Workers' Compensation Act because a lesser quantum of proof is necessary to establish a claim in that proceeding and the administrative policy is to resolve all doubtful fact questions in favor of the injured employee. Strictly speaking, the court did not base its holding solely on the difference in burden of proof, but also because the nature of evidence and procedural rules are in general more "free-wheeling" in administrative proceedings. *Id.* at 188.

29. 409 U.S. 232 (1972).

30. *Id.* at 235.

finding that this act was not done.[31] A slight modulation on this theme is when the intent must still be proven in the second suit, but the burden of proof is less. The proposed *Restatement*, which supports the general rule of excepting collateral estoppel in the case of a changed burden of proof,[32] provides a hypothetical illustration:

> A brings an action against B to recover on a promissory note. B defends on the ground that he was induced by A's friend to give this and other notes in the series, but fails to establish fraud by clear and convincing evidence as required by law. After judgment for A, the law is changed to provide that in such cases fraud need be proved only by a preponderance of the evidence. In an action by A on another note in the series, B is not precluded from asserting the defense of fraud.[33]

Thus, the requirement of proof of intent in the first suit not only aborts an estoppel in the second suit when by a qualitative change in the burden of proof intent is not an essential element, but also when by a quantitive change intent is still an essential element, but the necessary quantum of proof is less.

The underlying justification for denying collateral estoppel when the burden of proof changes is that the policy of preventing inconsistent results is inoperative in such a case.[34] Differing results under differing burdens of proof are neither contrary to logic nor repugnant to considerations of fairness; indeed, considerations of procedural integrity may occasionally compel a different result in such a case.

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31. *Id.* at 234-35. The concern in this analysis with the ambiguity of the first determination also echoes the rule of Russell v. Place, 94 U.S. 606 (1876). *See* text accompanying notes 17-19 *supra.*

32. RESTATEMENT (SECOND) OF JUDGMENTS § 68.1 (Tent. Draft No. 1, 1973) provides:

> Exceptions to the General Rule of Issue Preclusion.
>
> . . . .
>
> (d) The party against whom preclusion is sought had a significantly heavier burden of persuasion with respect to the issue in the initial action than in the subsequent action; the burden has shifted to his adversary; or the adversary has a significantly heavier burden than he had in the first action
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> . . . .

33. *Id.* § 68.1, Comment on Clause (d), Illustration 11.

34. *But cf.* Harding v. Carr, 79 R.I. 32, 83 A.2d 79 (1951). In this action for injuries sustained in an auto accident, plaintiff was estopped from asserting that the driver of defendant's car had his permission, when in an earlier suit against defendant's insurer plaintiff failed to show such permission. Collateral estoppel was applied over a dissent, even though in the second action the burden would have shifted entirely to the owner to rebut the presumption of permission. The court stated: "The principle of estoppel as here involved is based on the *adjudication* of an identical and ultimate issue and not on the question of which party may legally have the burden of proving or disproving such issue." *Id.* at 43, 83 A.2d at 84.

Another situation in which collateral estoppel may be denied, which entails consideration of policies extrinsic to the general policies of collateral estoppel, and concerning which there is less agreement, is when a right to jury trial attaches to the second suit but not the first. In *Rachal v. Hill*[35] the Fifth Circuit concluded that the reasoning of the Supreme Court's ruling in *Beacon Theatres, Inc. v. Westover*[36]—that the seventh amendment right to jury trial requires that legal issues must be tried first before a jury when both legal and equitable issues are to be tried in the same suit—also mandates that the right to jury trial may not be lost by operation of collateral estoppel to issues in an entirely separate suit.[37] Thus, Rachal, who had been issued an injunction in connection with a manipulative stock scheme in an action initiated by the Securities and Exchange Commission, was not estopped from litigating the issue of the scheme when stockholders subsequently pressed forward a derivative suit against him averring the same scheme.[38]

The *Rachal* decision has been generally disapproved. Only one case appears to have followed it.[39] The *Restatement*, probably in response, has taken the contrary position.[40] *Crane Co. v. American Standard, Inc.*,[41] though distinguishing *Rachal* on the facts in that the estoppel in *Crane* was mutual, questioned in dictum the correctness

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35. 435 F.2d 59 (5th Cir. 1970).

36. 359 U.S. 500 (1959).

37. 435 F.2d at 64.

> In light of the great respect afforded in *Beacon Theatres* . . . and its progeny, for a litigant's right to have legal claims tried first before a jury in an action where legal and equitable claims are joined, it would be anomalous to hold that the appellants have lost their right to a trial by jury on the issue of whether they are liable to respond in damages for violations of the security laws because of a prior adverse determination by the district court of the same issue in an action in which their present adversary was not a party and which arose in a different context from the present action.

*Id.*

38. The court seemed to narrow its holding by emphasizing that the asserted estoppel was non-mutual, *i.e.*, the party seeking to assert it was not an adversary in the first suit. *See* note 37 *supra*. It is fair to read *Rachal* as signifying that when the estoppel is mutual, then the jury trial issue should not abort it. The distinction seems rather cabalistic; perhaps the court thought that the right to jury trial somehow renews itself at the appearance of new adversaries.

39. Cannon v. Texas Gulf Sulphur Co., 323 F. Supp. 990 (S.D.N.Y. 1971). This holding appears even broader than *Rachal*, since a right to jury trial was present in the first suit, but was waived.

40. RESTATEMENT (SECOND) OF JUDGMENTS § 68, Comment d (Tent. Draft No. 1, 1973). "The determination of an issue by a judge in a proceeding conducted without a jury is conclusive in a subsequent action whether or not there would have been a right to a jury in that subsequent action if collateral estoppel did not apply." *Id.*

41. 490 F.2d 332 (2d Cir. 1973).

of the *Rachal* holding.[42] In addition, two cases whose factual patterns seemed to be appropriate for a *Rachal* analysis did not even refer to the issue.[43] One article has attacked the *Rachal* holding as a leap of faith from the Supreme Court's interpretation of the seventh amendment that does unwarranted violence to the policies of collateral estoppel.[44]

One consideration not directly raised in the *Azalea* opinion is that the policies underpinning the grant of exclusive jurisdiction to the federal courts of the administration of the antitrust laws mandate, under the rule announced by Learned Hand in *Lyons v. Westinghouse Electric Corp.*,[45] that determination of antitrust issues decided in state court proceedings not be binding on the federal courts. In *Lyons* defendant in a state court breach of contract action lost on a defense alleging antitrust violations in the marketing of lamps. Defendant then sued in federal court, averring the same antitrust violations. Although acknowledging that the state court determination would ordinarily be treated as an estoppel,[46] the court nevertheless stated:

> [T]he grant to the district courts of exclusive jurisdiction over the action for treble damages should be taken to imply an immunity of their decisions from any prejudgment elsewhere; at least on occasions, like those at bar, where the putative estoppel includes the whole nexus of facts that make up the wrong.[47]

The policy reason offered for this distinction was that the grant of exclusive jurisdiction evidenced a congressional intent that the antitrust laws be uniformly administered,[48] even though it may be permissible

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42. *Id.* at 343 n.15.

43. Painters Dist. Council No. 38 v. Edgewood Contracting Co., 416 F.2d 1081 (5th Cir. 1969), and Paramount Transp. Sys. v. Local 150, Int'l Bhd. of Teamsters, 436 F.2d 1064 (9th Cir. 1971) (per curiam), both allowed collateral estoppel on the issue of liability in damage actions under the National Labor Relations Act after the unions had been found guilty of secondary boycotts under the Act by the National Labor Relations Board in actions for injunctions. The Fifth Circuit in *Rachal* did not bother to distinguish its own decision in *Painters*. The Ninth Circuit was probably not yet aware of *Rachal* when it handed down *Paramount*.

44. Shapiro & Coquillette, *The Fetish of Jury Trial in Civil Cases: A Comment on Rachal v. Hill*, 85 HARV. L. REV. 442 (1971). The authors stress the waste of judicial resources incurred by retrying complex issues in arguing that neither the seventh amendment as interpreted by the Supreme Court nor considerations of fairness should produce such a result. *Id.* at 458.

45. 222 F.2d 184 (2d Cir.), *cert. denied*, 350 U.S. 825 (1955).

46. *Id.* at 188.

47. *Id.* at 189; *cf.* Scott, *supra* note 20, at 18-19 (litigants should not be precluded from retrying issues in a court having jurisdiction over the matter when such issues were incidentally decided by a court that would not have had jurisdiction to decide such issues in an action brought expressly to determine them, even though the judgment in the initial suit is still valid).

48. 222 F.2d at 189.

for state courts incidentally to decide antitrust issues when they arise in a defense to a contract action.[49] One commentator has also cited the seventh amendment right to jury trial, setting the burden of proof, and the choice of forum as important legislative considerations in the federal administration of antitrust law.[50]

A cursory reading of *Lyons* might imply that collateral estoppel by a state court judgment is never appropriate in a federal antitrust action. In distinguishing the situation in *Lyons* from that in *Becher v. Contoure Laboratories, Inc.*,[51] however, Hand seemed to concede that prior state court determinations of pure fact, as opposed to those of law or mixed fact and law, may be conclusive. After quoting from *Becher* that " '[e]stablishing a fact and giving a specific effect to it by judgment are quite distinct,' "[52] he made the somewhat cryptic ob-

49. *Id.* at 190. Of course, the *Azalea* case may be distinguished in that the trial judge refused to entertain the antitrust defense, citing the federal courts' exclusive jurisdiction in the area. Although counterclaims and affirmative treble damages suits based on the federal antitrust laws cannot be heard in state courts, such courts may nevertheless, in their discretion, entertain defenses based on them. As the court stated in *Lyons v. Westinghouse*: "We think that the state court had undoubted jurisdiction, notwithstanding § 15 of Title 15, U.S.C.A., to decide the merits of the first defence . . . ." 222 F.2d at 187. Such defenses are appropriate only when the alleged antitrust violations "inhere" in the contract itself and the contract is intrinsically illegal. *Id.* at 187-88. *See* Bruce's Juices, Inc. v. American Can Co., 330 U.S. 743, 755 (1947). Nevertheless, state courts are not bound to entertain such defenses in any case, since, "[o]bviously, state law governs in general the rights and duties of sellers and purchasers of goods . . . ." Kelly v. Kosuga, 358 U.S. 516, 519 (1958). It appears that if in the instant case the note would not have been obtained but for a threat of group boycott, a per se antitrust violation, *see* Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 & n.5 (1959), then it could plausibly be argued that the illegality "inhered" in the note itself. Nevertheless, the decision by the Virginia Supreme Court on appeal in Azalea Drive-In Theatre, Inc. v. Sargoy, 215 Va. 714, 720, 214 S.E.2d 131, 136 (1975), that "[t]he alleged federal antitrust violation was collateral to the main issue in plaintiff's motion for judgment, and it was not a viable defense in this action" rendered the matter moot. *Cf.* Medusa Corp. v. Gordon, 496 F.2d 249 (6th Cir. 1974) (violation of antitrust laws held not to be a valid defense under Michigan law).

50. Note, *Res Judicata: Exclusive Federal Jurisdiction and the Effect of Prior State-Court Determinations*, 53 VA. L. REV. 1360, 1365, 1383 n.85 (1967).

51. 279 U.S. 388 (1928). *Becher* involved a machinist's contract to construct a machine, whereby he agreed to keep information entrusted to him secret and not to make use of it himself. He breached this trust by obtaining a patent for the invention on his own, and his employer obtained from a New York court a decree holding the machinist a trustee *ex maleficio* of the invention and commanding him to assign the patent to the employer. When the machinist turned around and sued the employer for infringement of the patent, the Supreme Court held that he was estopped from asserting the claim by the state decree. One ground of distinction from *Lyons* could have been that the court ruled that the suit was not one arising under the patent laws at all. The court stated that the cause of action was based on either breach of contract or wrongful disregard of confidential relations, both of which are independent of the patent law. *Id.* at 391.

52. 222 F.2d at 188 (quoting 279 U.S. at 391).

servation that this proposition suggests that "the distinction [is] between the finding of one of the constituent facts that together make up a claim and the entire congeries of such facts, taken as a unit; an estoppel is good as to the first but not as to the second."[53] The upshot of this statement seems to be that state court determinations of discrete, concrete facts, separable from the major premise of a legal theory based on antitrust law, may properly be invoked for estoppel, since such determinations are made independently of an issue of law under exclusive federal jurisdiction, and the federal court may still exercise its prerogative to apply the federal law to the established facts in order to rule on the merits of the claim as a whole.[54]

If the majority decision in *Azalea* is deemed to have impliedly rejected the countervailing arguments presented by the dissent, then the decision may retard the developing law of collateral estoppel as well as undermine already firmly established principles. The statement that "the factual dispute in the federal court was exactly the same as the factual dispute in the state court"[55] is misleading. Certainly whether a threat of group boycott was made was a threshold question in both. But stating the obvious does not develop the analysis far enough; it must also be conclusively shown that the factual question was actually decided in the former. In view of the ambiguity of the trial judge's findings, the conclusion that "[w]hen the state trial judge stated that he found the facts in the plaintiff's favor, he must have found that no threat had been made,"[56] simply does not necessarily follow from the premise that the factual dispute was the same.

The state judge's findings are only a bit more enlightening than a general verdict.[57] His finding for plaintiffs on the stated issue—"Was there sufficient and convincing evidence of duress on the part of the

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53. *Id.* The distinction may be made more lucidly by the *Becher* opinion itself:

> That decrees validating or invalidating patents belong to the Courts of the United States does not give sacrosanctity to facts that may be conclusive upon the question in issue. A fact is not prevented from being proved in any case in which it is material, by the suggestion that if it is true an important patent is void—and . . . we can see no ground for giving less effect to proof of such a fact than any other.

279 U.S. at 391-92.

54. *See* Note, *supra* note 50, at 1384, pointing out that limiting collateral estoppel effect to factual determinations safeguards against contravention of any substantial federal interest.

55. 540 F.2d at 714.

56. *Id.*

57. General verdicts, with their lack of specific findings, are a great impediment to the application of collateral estoppel. This could be remedied by a more widespread use of special verdicts and interrogatories.

plaintiffs to the detriment of the defendants?"[58]—though framed as a single issue, must be viewed as a multiple finding. Admittedly, it could mean that no threat was made, but it could also mean that the threat was not unlawful under state law,[59] that the threat was insufficient to overcome the will of a person of ordinary firmness,[60] that defendants' proof was not sufficiently clear and convincing on the elements of the defense,[61] or some combination of these variables. If the finding is viewed as intending only one or several of these possible conclusions, then it should come squarely within the rule of *Russell v. Place* that collateral estoppel effect should not be given to ambiguous findings.[62] Even if it is viewed as implying all of them, including that no threat was made, the rule of *Halpern v. Schwartz*, that a putative estoppel based on any of alternative sufficient determinations should not be allowed,[63] still should preclude any estoppel. The requirement that Azalea prove not only that a threat was made, but also that such threat was sufficient to overcome its vice-president's will, makes the situation analogous to that of *One Lot Emerald Cut Stones*, in which it was held that if a subjective element is essential to the first claim, but not the second, no estoppel will attach.[64] Aside from any ambiguity in the findings, the difference in burden of proof

58. 540 F.2d at 716 n.2.

59. This finding was explicitly made by the Virginia Supreme Court on appeal, 215 Va. at 721, 214 S.E.2d at 136. *See* note 49 *supra*.

60. This term of art is generally considered to be an essential element of duress. *See* United States v. Huckabee, 83 U.S. (16 Wall.) 414 (1872). "Unlawful duress is a good defense to a contract if it includes such degree of constraint or danger, either actually inflicted or threatened and impending, as is sufficient in severity or apprehension to overcome the mind and will of a person of ordinary firmness." *Id.* at 432. The judge might well have concluded that to threaten a boycott is simply a good business tactic, which an ordinary businessman should be able to take in stride.

61. Duress usually requires the higher burden of "clear and convincing" evidence, rather than the ordinary civil burden of a "preponderance" of the evidence. Virginia state law appears to adhere to this requirement. "One who seeks to cancel a contract for fraud and duress must carry the burden of proof and furnish clear and full proof of such fraud and duress." Scott v. Scott, 142 Va. 31, 39, 128 S.E. 599, 601 (1925) (per curiam) (quoting the trial court). The judge's use of the word "convincing" indicates that this was the standard he was applying.

62. *See* Russell v. Place, 94 U.S. 606, 608 (1876).

63. 426 F.2d at 105.

64. 409 U.S. at 234. *One Lot Emerald Cut Stones* is distinguishable from *Azalea* in that in the former the party against whom the estoppel was asserted had failed to establish fraudulent intent on the part of its adversary, whereas in the latter Azalea had failed to establish that its own will had been overcome. Nevertheless, it should make no difference which party is looking into whose head; an element of proof in addition to the establishment of the objective act is required either way. To establish the antitrust claim, Azalea had only to show that a threat of a group boycott had been made, such a threat being a per se antitrust violation. *See, e.g.*, Klor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212 (1959) and cases cited *id.* at 212 n.5.

alone dictates that estoppel is inappropriate, according to *Helvering v. Mitchell* and the other cases discussed above.[65]

One consideration briefly addressed and summarily dismissed by the *Azalea* opinion is that of collateral estoppel compromising the right to jury trial under the antitrust claim. The court stated that "the rules foreclosing relitigation of factual issues between the same parties serve such important policies that relitigation should not be allowed though the fact finding processes in the first tribunal were unlike those which otherwise would be available in the second."[66] Although this declaration could be taken as direct disapproval of the ill-conceived rule of *Rachal v. Hill*,[67] it persuasiveness is diluted by the omission of any citation to that case, by the fact that the estoppel in *Azalea*, being mutual, is thus readily distinguishable, and by the failure to weigh the "important policies" of collateral estoppel against those of the right to jury trial in any sort of analytical discussion.

While *Lyons v. Westinghouse Electric Corp.*[68] is not directly apposite by virtue of the state court's refusal to hear the antitrust defense, the inference remains strong that if it had ruled on the merits of the defense and simply found against Azalea without clearly indicating that a threat of group boycott had not been made, a *Lyons* analysis would have dictated that the federal court not be bound.[69] Thus it seems anomalous that the federal court should be bound by a judgment based on a different major premise (duress), when it would not have been bound by a judgment based on the same major premise (antitrust).

Except for the jury trial issue, any one of the above considerations standing alone should have mandated that collateral estoppel be refused in the instant case. All are corollaries of the fundamental axiom that the issue in the first suit must be substantially identical to the issue in the second, and, taken together, weigh so heavily against the *Azalea* opinion that it must be said that the case was wrongly decided.[70] The

65. 303 U.S. at 397; *see* notes 26-28 and accompanying text *supra*.

66. 540 F.2d at 715.

67. *See* notes 35-39 and accompanying text *supra*.

68. *See* notes 45-54 and accompanying text *supra*.

69. This is not to say that if such a specific factual finding were made, the federal court should disregard it. Such a finding would be collateral estoppel in re the existence of the threat, and since the merits of the antitrust claim depend on this fact, it would require that the claim be dismissed. This would be an example of collateral estoppel by a "constituent" fact, as opposed to "congeries" of fact represented by a general finding on the claim. *See* notes 51-54 and accompanying text *supra*.

70. The doctrine of collateral estoppel is flexible in its allowance of extrinsic

glaring defect in the court's analysis is that it treats the state finding as one of a singular factual issue, rather than as an issue of fact so entangled with an overlay of legal issues that it is impossible to extract with confidence the one factual finding relevant to the second suit. The state court issue was decided as one of mixed fact and law; the federal court issue was one of fact alone. Therefore the issues were not the same in both suits. The issues being different, no estoppel should have attached.[71]

FRANK LANE WILLIAMSON

## Civil Procedure—Kidd v. Early: Summary Judgment on Testimonial Evidence in North Carolina

In *Cutts v. Casey*[1] the North Carolina Supreme Court held that any testimonial evidence submitted in support of a motion for a directed verdict created an issue of credibility to be presented to the jury. This holding gave rise to dire predictions[2] that the North Carolina summary judgment procedure would be crippled. The North Carolina Supreme Court, however, has narrowed the scope of *Cutts* by setting guidelines for determining when an issue of credibility actually arises.

In *Kidd v. Early*[3] the court granted summary judgment[4] for the

evidence to show what was decided in the first suit. The holding in the instant case thus could possibly have been redeemed if the court had examined the trial record and, say, found the level of evidence against a threat having been made so overwhelming as to support a partial directed verdict in an antitrust trial. With such a demonstration, the ambiguity of the judge's findings could justifiably have been disregarded.

71. The instant case should at least remind us that the "lesson" preached by Professor Vestal has not been thoroughly learned: "One of the lessons which must be learned is that great exactness must be used in determining the issues decided in Suit I and to be decided in Suit II. . . . In the years ahead, it will be necessary to use more finesse in the area." Vestal, *Preclusion/Res Judicata Variables: Nature of the Controversy*, 1965 WASH. U.L.Q. 158, 192 (1965). The basic value of *Azalea* is to point out that refinement of collateral estoppel technique is needed to insure that the "fit" between issues is a close one.

1. 278 N.C. 390, 180 S.E.2d 297 (1971).

2. Louis, *A Survey of Decisions Under the New North Carolina Rules of Civil Procedure*, 50 N.C.L. REV. 729 (1972); Note, *Civil Procedure—Cutts v. Casey Extended to Summary Judgment*, 54 N.C.L. REV. 940 (1976).

3. 289 N.C. 343, 222 S.E.2d 392 (1976).

4. Pursuant to N.C.R. CIV. P. 56. The North Carolina Rules of Civil Procedure were enacted in 1970. Rule 56 enables a court to grant final judgment for a

party bearing the burden of proof at trial who supported his motion with depositions and affidavits, while the non-moving party failed to produce any evidence to support his opposition to the motion. For the first time in North Carolina, the court held that testimonial evidence does not automatically trigger an issue of credibility which must go to the jury, but may be afforded credibility as a matter of law if it is disinterested, unimpeached and uncontradicted.

The parties stipulated that on August 4, 1972, plaintiffs, Dr. Claude Kidd, Thomas H. Collins and David P. Dillard,[5] purchased a thirty-day renewable option to purchase farm land in Guilford County, North Carolina from defendant, C.F. Early. The option agreement failed to specify any time or method of payment.

On September 28, 1972, plaintiffs executed a written offer to purchase and delivered it to defendant, who refused to accept their terms for payment.[6] The next day plantiffs mailed a letter to defendant exercising the option,[7] and delivered a check for $119,000 to their attorney to hold until the deed was delivered.[8] Defendant found these terms unacceptable and refused to convey the property.

After further negotiations, the parties continued to disagree on the method of payment and the purchasers filed suit seeking specific performance of the option contract. After the pleadings were filed, both parties moved for summary judgment under rule 56. The trial court granted summary judgment for the vendor, and the purchasers ap-

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party before trial when there remains no genuine issue of material fact. The court applies the law to the undisputed facts and grants summary judgment for the party entitled to it as a matter of law.

5. Plaintiff Kidd originally purchased the option with Howard M. Coble, who later sold his interest to Kidd. Later, Kidd assigned one-third of his interest to Collins and one-third of his interest to Dillard. 289 N.C. at 347, 222 S.E.2d at 396.

6. Defendant Early learned from talking with his CPA that he would gain a substantial tax advantage if he were paid in installments rather than in cash on delivery of the deed. *Id.* at 348-49, 222 S.E.2d at 397.

7. The letter read in part:

> The option granted by you on September 1, 1972, for the purchase of 200 acres more or less of the C. F. Early farm . . . is hereby exercised by delivery of a check to your joint order in the sum of $119,000 to my attorneys . . . to be held in trust for you and given over to you upon the occurrence of the following conditions:
>
> (1) The furnishing of a new survey by you of the land being sold as provided in the option agreement;
>
> (2) Delivery by you of a good and marketable warranty deed in fee simple absolute, free of all encumbrances, to the property covered by the option agreement.

*Id.* at 349-50, 222 S.E.2d at 397-98.

8. At the time the check was delivered, the balance in the account from which the check was drawn was only $17,173. *Id.* at 350, 222 S.E.2d at 398.

pealed. The North Carolina Court of Appeals reversed by finding that there was a genuine issue of material fact that required a jury trial. The court affirmed the denial of summary judgment for the purchasers and remanded the case for jury trial.[9]

On appeal the North Carolina Supreme Court determined that the undisputed facts established every essential element except the purchasers' willingness and ability to perform the contract at the time they exercised the option.[10] To meet their burden of proof on this remaining issue, the purchasers submitted their own affidavits, loan applications and financial statements[11] showing that their net worth was between $261,000 and $364,494 at the time the option was exercised. They also submitted the affidavit of the president of the Federal Land Bank Association of Winston-Salem that stated that he was prepared to issue a firm commitment loan of $100,000 to the purchasers using the farmland as security. The vendor made no response to these materials.

Since the vendor failed to present any evidence in opposition to the purchaser's evidence in support of the motion, the court determined that rule 56(e) would allow summary judgment if the purchasers met their burden of production and succeeded on their own evidence.[12] The court held that any credibility problems were minimal and that only latent doubts existed about the accuracy of the pur-

9. Kidd v. Early, 23 N.C. App. 129, 135, 208 S.E.2d 511, 516 (1974).

10. Defendant asserted three defenses to the motion for summary judgment, based upon the uncontested facts of the case: (1) the description of the property was insufficient to meet the Statute of Frauds; (2) the option was void because the parties had failed to agree upon an essential term—the method of payment; and (3) plaintiffs failed to tender payment within the option period. The North Carolina Supreme Court rejected all three affirmative defenses and denied defendant's motion for summary judgment since he was not entitled to judgment as a matter of law under N.C.R. Civ. P. 56(c). 289 N.C. at 364-65, 222 S.E.2d at 407.

11. N.C.R. Civ. P. 56(e) states that:

> Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, the opposing party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him.

The court may also consider oral testimony at a summary judgment proceeding under N.C.R. Civ. P. 43(e).

12. 289 N.C. at 365-66, 222 S.E.2d at 407.

chasers' proof. As a result, the purchasers were held to have met their burden of production on the remaining factual issue and were granted summary judgment.[13]

Summary judgment[14] is a means of looking beyond the pleadings to determine whether a genuine issue of material fact exists.[15] Both parties may move for summary judgment[16] regardless of which party carries the burden of proof at trial,[17] but the burden is upon the moving party to establish the lack of any triable issue of fact.[18] The evidence presented to meet this burden may not be sufficient even if the opposing party fails to present any materials in opposition to the motion;[19] any doubt about the existence of a material issue of fact is resolved against the moving party.[20] Once the moving party meets the initial

13. *Id.* at 372, 222 S.E.2d at 411. Quoting from Professor Louis' article, the court stated that the standard for determining the sufficiency of the moving party's evidence is as follows:

> (1) [T]he [movant's] supporting evidence is self-contradictory or circumstantially suspicious or the credibility of a witness is inherently suspect either because he is interested in the outcome of the case and the facts are peculiarly within his own knowledge or because he has testified as to matters of opinion involving a substantial margin for honest error, (2) there are significant gaps in the movant's evidence or it is circumstantial and reasonably allows inferences inconsistent with the existence of an essential element, or (3) although all the evidentiary or historical facts are established, reasonable minds may still differ over their application to some principle such as the prudent man standard for negligence cases.

289 N.C. at 366-67, 222 S.E.2d at 408 (quoting Louis, *supra* note 2, at 738-39). Only one standard was not met: the affidavits were presented by interested parties and the facts were peculiarly within their own knowledge.

14. *See* note 4 *supra*.

15. *See, e.g.*, First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

16. *See, e.g.*, McNair v. Boyette, 282 N.C. 230, 192 S.E.2d 457 (1972). N.C.R. Civ. P. 56(a) & (b) state that either the "claimant" or the "defending party" may move for summary judgment.

17. *See, e.g.*, First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972). There is a greater reluctance, however, to grant summary judgment for the party bearing the burden of proof at trial. *See* Louis, *Federal Summary Judgment Doctrine: A Critical Analysis*, 83 YALE L.J. 745, 748, 755 n.42 (1974).

18. *See, e.g.*, Whitley v. Cubberly, 24 N.C. App. 204, 210 S.E.2d 289 (1974); Pridgen v. Hughes, 9 N.C. App. 635, 177 S.E.2d 425 (1970).

19. *See, e.g.*, Lineberger v. Colonial Life & Accid. Ins. Co., 12 N.C. App. 135, 182 S.E.2d 643 (1971); Robinson v. McMahon, 11 N.C. App. 275, 181 S.E.2d 147 (1971). *See also* N.C.R. Civ. P. 56(e), set forth in note 11 *supra*. The North Carolina courts have interpreted the meaning of the rule to be that even if the non-moving party fails to present any evidence, the moving party's materials may not be enough to entitle the moving party to summary judgment.

20. Zimmerman v. Hogg & Allen, P.A., 286 N.C. 24, 29, 209 S.E.2d 795, 798 (1974); *see* Millsaps v. Wilkes Contracting Co., 14 N.C. App. 321, 188 S.E.2d 663 (1972). "[T]he Court in considering the motion carefully scrutinizes the papers of the moving party and, on the whole, regards those of the opposing party with indulgence." 289 N.C. at 29, 209 S.E.2d at 798.

burden by showing a lack of any triable issue of fact,[21] the opposing party must come forward with some evidence tending to show a triable issue of fact or explain his failure to do so under rule 56(f).[22]

The North Carolina courts view the summary judgment procedure as a drastic remedy to be granted with caution.[23] The procedure does not entitle the court to decide an issue of fact, but merely to determine whether an issue of fact exists.[24] The procedure is not designed to constitute a trial by affidavits in which the court weighs the sufficiency of evidence or weighs the credibility of testimony,[25] since these are traditionally the province of the jury.

Although the North Carolina courts agree that all issues of credibility must be presented to the jury, the courts have not applied a uniform evidentiary standard for determining when an issue of credibility arises. In *Cutts*[26] the North Carolina Supreme Court indicated that all

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21. *See* N.C.R. Civ. P. 56(e), set forth in note 11 *supra*.

22. N.C.R. Civ. P. 56(f) states in full:

> *When Affidavits are Unavailable.*—Should it appear from the affidavits of a party opposing the motion that he cannot for reasons stated present by affidavit facts essential to justify his opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

The courts have excused the failure to present materials when the evidence was within the moving party's own knowledge and not available to the non-moving party. Lee v. Shor, 10 N.C. App. 231, 178 S.E.2d 101 (1970).

23. First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 52, 191 S.E.2d 683, 688 (1972); W. Shuford, North Carolina Practice and Procedure § 56-3, at 467-68 (1975). Shuford also suggests that numerous North Carolina practitioners are taking advantage of the new rule, and that more summary judgment motions have been appealed than any other procedure made available by the new North Carolina Rules of Civil Procedure. *Id.*

24. Caldwell v. Deese, 288 N.C. 375, 218 S.E.2d 379 (1975); Zimmerman v. Hogg & Allen, P.A., 286 N.C. 24, 209 S.E.2d 795 (1974); Houck v. Overcash, 282 N.C. 623, 193 S.E.2d 905 (1973). The courts should not decide which affidavits are true when there is a conflict in the evidence presented.

25. Lee v. Shor, 10 N.C. App. 231, 235, 178 S.E.2d 101, 104 (1970); *see* Mitchell v. Mitchell, 12 N.C. App. 54, 182 S.E.2d 627 (1971).

26. 278 N.C. 390, 180 S.E.2d 297 (1971). Although *Cutts v. Casey* is a directed verdict case, the standards for directing a verdict and granting summary judgment are essentially the same. *See* Millsaps v. Wilkes Contracting Co., 14 N.C. App. 321, 188 S.E.2d 663, *cert. denied*, 281 N.C. 623, 190 S.E.2d 466 (1972); Coakley v. Ford Motor Co., 11 N.C. App. 636, 182 S.E.2d 260, *cert. denied*, 279 N.C. 393, 183 S.E.2d 244 (1971). In *Cutts v. Casey* both parties claimed title to the same piece of property. Each party presented a survey showing that he owned the land in question, relying partly upon testimonial evidence to establish his claim. The North Carolina Supreme Court stated: "The established policy of this State—declared in both the constitution and the statutes—is that the credibility of testimony is for the jury, not the court, and that a genuine issue of fact must be tried by the jury unless this right is waived." 278 N.C. at 421, 180 S.E.2d at 314.

testimonial evidence creates a credibility issue that must be resolved by a jury. In reinstating a jury verdict after the trial judge granted a judgment n.o.v., the court stated that testimonial evidence could never support a directed verdict:[27] to do so would violate the opposing party's right to jury trial, which is guaranteed by the North Carolina Constitution.[28] The *Cutts* rationale is based on the premise that "the right to determine the credibility of witnesses lies at the core of the jury's factfinding function."[29] Since affidavits are not subject to cross-examination, and since no one can observe the behavior of the affiant making his statement, affidavits are generally considered to be "the least satisfactory form of evidentiary materials."[30] Depositions are also regarded with skepticism, even though the witness was cross-examined, since the court is unable to observe the demeanor of the witness.[31] The observation of the demeanor of a witness is necessary, because the witness can be either lying intentionally or mistaken about the facts.[32]

The *Cutts* rationale was applied to a motion for summary judgment in *Shearin v. National Indemnity Co.*[33] The North Carolina Court of Appeals held that an uncontradicted eyewitness' statement raised an issue of credibility, which the jury must resolve. The court, however,

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27. 278 N.C. at 421, 180 S.E.2d at 314.

28. N.C. CONST. art. I, § 25 was relied upon by the court in its opinion. It reads: "In all controversies at law respecting property, the ancient mode of trial by jury is one of the best securities of the rights of the people, and shall remain sacred and inviolable."

29. Cooper, *Directions for Directed Verdicts: A Compass for Federal Courts*, 55 MINN. L. REV. 903, 928 (1971).

30. 6 (pt. 2) MOORE'S FEDERAL PRACTICE ¶ 56.15[4], at 514 (2d ed. 1975).

31. *See* Cooper, *supra* note 29, at 929-40.

32. *Id.* The validity of these checks on credibility does not go unquestioned. To reach conclusions solely on the basis of demeanor is a very weak foundation for a judgment, especially since it may be that juries form less accurate decisions when they base them on the observation of witnesses. The demeanor of a witness can be misleading because many factors combine to make the witness behave the way he does on a witness stand. For example, the witness may appear nervous either because he is lying or because he feels uncomfortable speaking in front of a large group of people; or his nervousness may be merely a mannerism. The jury is just as likely to distort the truth since they too are witnesses. Since the jury must rely upon demeanor evidence alone if the testimony goes uncontradicted and unimpeached by the non-moving party, the accuracy of the appraisal is highly suspect. And if the non-moving party fails to present opposing evidence at the summary judgment level, it is unlikely that he will obtain the necessary evidence by the time the trial begins. Therefore if the court determines that the evidence is so strong that the jury cannot disbelieve the testimony merely on the basis of demeanor, then the court should be able to assign credibility as a matter of law and avoid a long unnecessary trial.

33. 27 N.C. App. 88, 218 S.E.2d 207 (1975); *accord*, Lowe's of Greensboro, Inc. v. Curry, 29 N.C. App. 229, 223 S.E.2d 909 (1976); Van Poole v. Messer, 19 N.C. App. 70, 198 S.E.2d 106 (1973); Wyche v. Alexander, 15 N.C. App. 130, 189 S.E.2d 608, *cert. denied*, 281 N.C. 764, 191 S.E.2d 361 (1972).

stated that but for the *Cutts* opinion, summary judgment would have been appropriate.[34]

Other cases deny summary judgment for the moving party when the testimonial evidence is presented by an interested party and the facts were within his own knowledge. In three cases, the witness was held to be interested because of an economic relationship with the moving party. In *Lee v. Shor*[35] and *Shook Builders Supply Co. v. Eastern Associates, Inc.*[36] the affiants were either the directors or the president of the company that was moving for summary judgment. As a result of this relationship, the parties were interested, and "[The affiant's] credibility itself may be such an issue of fact as will take the case to trial."[37] In *Norfolk & Western Railway v. Werner Industries Inc.*[38] the sole eyewitness to the accident over which the dispute arose was an employee of the moving party. The court denied summary judgment on this basis, and on the basis that conflicting inferences arose from the evidence presented.

Other cases, however, have completely ignored the *Cutts* requirement that all testimonial evidence be presented to the jury. In *Brooks v. Smith*[39] and *Bogle v. Duke Power Co.*[40] defendants used testimonial evidence to meet the burden of production to establish their affirmative defenses of contributory negligence on motions for summary judgment. In both cases the evidence was deemed sufficient since the affiants were disinterested and plaintiff failed to contradict or impeach the testimony.

The court in *Kidd* rejected the *Cutts* rule that all testimonial evidence must be presented to the jury even though it may be extremely credible. In explaining the different results reached under *Kidd* and *Cutts* the court stressed the factual differences between the two cases, rather than basing the distinction upon the differences between a directed verdict and a motion for summary judgment.[41] In *Cutts* the

34. 27 N.C. App. at 91-92, 218 S.E.2d at 210. The court, in deciding whether summary judgment would be appropriate for the party bearing the burden of proof at trial who used testimonial evidence to meet his burden of production, stated that "on authority of *Cutts v. Casey*, . . . we conclude the answer is No." 27 N.C. App. at 91, 218 S.E.2d at 210.

35. 10 N.C. App. 231, 178 S.E.2d 101 (1970).

36. 24 N.C. App. 533, 211 S.E.2d 472 (1975).

37. *Id.* at 537, 211 S.E.2d at 475.

38. 286 N.C. 89, 209 S.E.2d 734 (1974).

39. 27 N.C. App. 223, 218 S.E.2d 489 (1975).

40. 27 N.C. App. 318, 219 S.E.2d 308, *cert. denied*, 289 N.C. 296, 222 S.E.2d 695 (1976).

41. 289 N.C. at 370, 222 S.E.2d at 410. For a discussion of the differences

court noted that the facts presented by testimonial evidence were vigorously attacked by the opposing party. The credibility issue arose *not* because the evidence was testimonial, but because the testimonial evidence was challenged. In making the distinction, the court indicated that *Cutts* was never meant to stand for the proposition that all testimonial evidence must go to the jury. Instead, *Cutts* is to be read as saying that if testimonial evidence is contradicted, then a credibility issue arises for the jury to consider.[42]

Therefore, *Kidd* and *Cutts* fall squarely within the federal interpretation of rule 56 of the Federal Rules of Civil Procedure.[43] The federal courts may assign credibility as a matter of law when the evidence is not contradicted or impeached.[44] Even if the witness is interested in the outcome of the case, if the facts necessary to oppose the

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between directed verdict and summary judgment, see Note, *Civil Procedure—Cutts v. Casey Extended to Summary Judgment*, 54 N.C.L. REV. 940, 948 n.45 (1976).

42. Cutts v. Casey, 278 N.C. at 423, 180 S.E.2d at 319 (Huskins, J., concurring in result); *see* Fidelity & Deposit Co. v. United States, 187 U.S. 315, 320 (1902); 2 A. MCINTOSH, NORTH CAROLINA PRACTICE AND PROCEDURE § 1488.20 (Phillips Supp. 1970); 10 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2714 (1973); Scott, *Trial by Jury and the Reform of Civil Procedure*, 31 HARV. L. REV. 669, 690-91 (1918).

It is clear that the summary judgment procedure itself does not deprive a party of his constitutional right to jury trial, but it is arguable that testimonial evidence does always create an issue of fact for the jury since it is always possible for the witness to lie. Some federal courts applied this evidentiary standard. *See* Colby v. Klune, 178 F.2d 872 (2d Cir. 1949); Arnstein v. Porter, 154 F.2d 464 (2d Cir. 1946). However, this test has not been followed even within the Second Circuit. *See* Dyer v. MacDougall, 201 F.2d 265 (2d Cir. 1952); 10 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2726, at 523 (1973). Prior to *Kidd*, the North Carolina Court of Appeals considered itself to be bound to that standard as a result of *Cutts*. *See* Note, *Civil Procedure—Cutts v. Casey Extended to Summary Judgment*, 54 N.C.L. REV. 940, 942 (1976). *But see* cases cited notes 39 & 40 and accompanying text *supra*. According to Robert Doge, one of the original members of the Advisory Committee on the Federal Rules of Civil Procedure:

> In reality, the rule does not interfere in the slightest degree with the right to trial by jury, because the court can not, of course, enter a summary judgment if there is any issue of fact to be tried, and if the court erroneously orders a summary judgment, the right of appeal will protect the party.
>
> The judge is not to weigh affidavits, is not to determine which affidavit is right and which is wrong. He is simply to see whether upon the affidavits there is a real issue of facts between the parties.

ABA PROCEEDINGS OF THE INSTITUTE (ON THE FEDERAL RULES OF CIVIL PROCEDURE) AT WASHINGTON, D.C., October 6-8, at 176 (1938).

43. For an analysis of the federal rule see Louis, *Federal Summary Judgment Doctrine: A Critical Analysis*, 83 YALE L.J. 745 (1971).

44. The fact that a witness is interested in the outcome of the case is sufficient to create a credibility problem for the jury to resolve. Sonnentheil v. Christian Moerlein Brewing, Inc., 172 U.S. 401 (1899). Some federal courts, however, limit this rule to cases in which the facts are peculiarly within the moving party's own knowledge, *see* Poller v. CBS, 368 U.S. 464 (1962), or when conflicting inferences arise from the evidence presented, United States v. Perry, 431 F.2d 1020 (9th Cir. 1970).

motion are readily available to the non-moving party through discovery, then credibility should be assigned as a matter of law if the non-moving party presents no opposing evidence. It is assumed that the opponent obtained, or could have obtained, the information necessary to contradict the witness. If he failed to utilize discovery, then he loses because he was too lazy to establish his case; if he utilizes the discovery procedure and finds nothing to support his opposition to the claim, then there is no reason to question the veracity of the moving party's witness. It would be a waste of time to require a full jury trial when the opposing party cannot, or will not, present any evidence to raise doubts about the credibility of the witness in the mere hope[45] that something will turn up at trial.

The North Carolina Supreme Court in *Kidd*, however, went beyond the federal standard by determining whether a credibility issue actually arose from the facts presented. The court held that the testimonial evidence was presented by an interested party; the court found some of the facts peculiarly within the knowledge of that party and thus not discoverable by the vendor. Under a strict construction of the "interested party" rule this evidence would have been enough to create a credibility problem that would have required a determination by the jury. The court rejected strict application of the rule, stating that "it is quite clear that it would be futile to attempt to state a general rule which would determine whether a 'genuine issue of fact' exists in a particular case"[46] and granted summary judgment for plaintiff because only latent doubts about the credibility of his evidence existed.

The result reached by the court on the facts of *Kidd* is both practically and logically correct. The bank president's affidavit did not create a credibility problem because the bank president had no reason to lie about his willingness to grant a loan. The circumstances were not suspicious since the bank was using the land as security and would only grant the loan if the title were good. Even if it could be argued

45. Rifiieri v. Scanlon, 254 F. Supp. 469 (S.D.N.Y. 1966). The federal courts clearly reject the idea that the non-moving party can go to trial on the mere hope that some evidence will turn up, or the jury will disbelieve the testimony presented. *Compare* Poller v. CBS, 368 U.S. 464 (1962) (holding that since motive was a crucial issue, there was more than a mere hope that additional evidence would result from a full jury trial) *with* Lundeen v. Cordner, 354 F.2d 401 (8th Cir. 1966) (holding that a non-moving party cannot force a trial on the vague supposition that by cross-examining a disinterested party he might be able to produce additional evidence).

46. 289 N.C. at 368, 222 S.E.2d at 409; *see* 6 (pt. 1) MOORE'S FEDERAL PRACTICE ¶ 56.15[1.-0], at 401 (2d ed. 1975).

that there was an economic relationship between the parties, it would have been too attenuated to cast doubts upon the witness' veracity without some specific facts to show a closer relationship.

Plaintiff's affidavits, however, were presented by an interested party and so should be viewed with more skepticism. In this case, however, it would have been a simple matter for defendant to use the discovery procedure to get a look at the bank books, check the credit rating of plaintiffs and appraise the value of plantiffs' personal property. The court is willing, under these circumstances, to shift the burden of producing evidence to the non-moving party in the interests of judicial expediency. By enabling the moving party to meet his initial burden of proof with testimonial evidence when the opposing party has access to the evidence, the court can make certain that the opposing party has some specific evidence to get to the jury. If he fails to provide these facts, then summary judgment should be granted for the moving party.

Some of the testimony presented by the moving parties was used to establish a subjective fact—their willingness to pay the purchase price. Since it is impossible to discover the innermost thoughts and feelings of an opposing party, the only way to attack his statement of events is to impeach his credibility. Such a situation of impossibility provides sufficient excuse under rule 56(f) for failing to present opposing materials. As a result, a jury question is normally created and summary judgment becomes inappropriate.

Nevertheless, the court in *Kidd* was willing to grant summary judgment for the purchasers, probably because in the entire four years of the dispute, the purchasers never gave any indication that they did not want to perform the contract. Indeed, it is undisputed that the purchasers suggested several methods of payment in order to find some terms that the vendor would accept, and on several occasions voiced their desire to purchase the land. The purchasers also exercised the option, which bound them to the contract if defendant sought to enforce it. On the basis of these manifestations, the purchasers' testimony achieved credibility in the absence of a showing by defendants of some specific facts demonstrating the purchasers' intent to renege on the agreement.

As a result of the *Kidd* opinion, North Carolina attorneys who are faced with a motion for summary judgment by the party who bears the burden of proof at trial must make some effort to gather specific facts to contradict or impeach the witness before the hearing on the motion.

If the attorney cannot get the necessary information because of witness hostility or because the moving party has sole control over the information, then he must move for a protective order under rule 56(f). Otherwise, he runs the risk that the testimonial evidence will be afforded credibility as a matter of law and that summary judgment will be granted for the moving party.

In *Kidd v. Early* the North Carolina Supreme Court set out a flexible standard for determining the sufficiency of testimonial evidence on a motion for summary judgment. With the help of this standard, the courts can now determine with greater accuracy whether testimonial evidence has created an issue of fact that must be presented to the jury. This promotes judicial expediency by weeding out cases that contain no factual disputes at the summary judgment level, without jeopardizing the parties' right to a jury trial.

REBECCA WEIANT

## Consitutional Law—Property and Liberty Interests in Public Employment

The proposition that a government cannot unreasonably restrict the exercise of constitutional rights by its employees has become a basic tenet of constitutional law.[1] However, in the absence of a specific statute or regulation to the contrary, a government's authority to dismiss its employees for purely arbitrary reasons, or for no reason at all, has remained essentially unchallenged.[2] Except for situations in which the government appears motivated by a desire to stifle constitutional privileges, the maximum protection afforded a public employee against discharge has been some form of hearing at which he can appeal the decision. Moreover, the United States Supreme Court, in the companion

1. *See* Keyishian v. Board of Regents, 385 U.S. 589 (1967); Elfbrandt v. Russell, 384 U.S. 11 (1966); Baggett v. Bullitt, 377 U.S. 360 (1964); Cramp v. Board of Pub. Instruction, 368 U.S. 278 (1961).

2. The United States Supreme Court noted in Cafeteria Workers v. McElroy, 367 U.S. 886 (1961) that "[t]he Court has consistently recognized that . . . the interest of a government employee in retaining his job can be summarily denied. It has become a settled principle that government employment, in the absence of legislation, can be revoked at the will of the appointing officer." *Id.* at 896.

cases of *Board of Regents v. Roth*[3] and *Perry v. Sinderman*,[4] held that not all employees are entitled to such protection. The discharged employee must show that the loss of his job will deprive him of "liberty" or "property" before he qualifies for the fifth and fourteenth amendments' guarantees of due process.[5]

In determining whether a public employee who is threatened with dismissal has a right to due process, the Supreme Court's standard of inquiry, as set out in *Roth* and *Perry* and reaffirmed in the recent case of *Bishop v. Wood*,[6] is whether the employee has acquired either a liberty or property interest in his employment. Under this test, there are two classes of public employees—those with a sufficient interest in their jobs to warrant some due process protection and those whose claims are inadequate to merit any constitutional consideration. Only after an employee overcomes the threshold barrier of demonstrating a "legitimate interest in employment" is he entitled to any protection at all, and then the form of his due process protection may be far short of a formal adversary proceeding. The required degree of protection will be decided by the court in each case by balancing the employee's interests against those of the government.[7] Although the majority in *Bishop* utilized the *Roth-Perry* test in adjudicating the plaintiff-employee's claim to a due process pretermination hearing, the result reached in that case may indicate a significant reduction in the scope of judicial review of government personnel decisions.

In *Bishop*, officer Carl Bishop, after serving for almost three years on the Marion, North Carolina police force, was dismissed in 1972 by the city manager of Marion upon the recommendation of the chief of police. A city ordinance specified four possible grounds for the dismissal of a "permanent employee," such as Bishop, and further provided that upon request, any dismissed employee could obtain written notice of the date of and reasons for his discharge.[8] The ordinance

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3. 408 U.S. 564 (1972).

4. 408 U.S. 593 (1972).

5. "[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . . ." U.S. CONST. amend. XIV, § 1.

6. 96 S. Ct. 2074 (1976).

7. Board of Regents v. Roth, 408 U.S. at 570.

8. The Personnel Ordinance of the city of Marion provides:

> *Dismissal.* A permanent employee whose work is not satisfactory over a period of time shall be notified in what way his work is deficient and what he must do if his work is to be satisfactory. *If a permanent employee fails to perform work up to the standard of the classification held, or continues to be negligent, inefficient, or unfit to perform his duties, he may be dismissed by the City Manager.* Any discharged employee shall be given

made no provision for any type of pretermination hearing at which an employee might contest the sufficiency of the alleged cause for his termination, and accordingly, Bishop received no such hearing.

Relying on 42 U.S.C. section 1983, Bishop brought suit against the city manager, chief of police, and city of Marion[9] seeking reinstatement and back pay. In his complaint, he contended that as a "permanent employee" he had a constitutional right to a due process pretermination hearing. The district court granted defendant's motion for summary judgment, holding that Bishop had failed to demonstrate a sufficient liberty or property interest in his job to invoke due process protection.[10] On appeal, the Fourth Circuit Court of Appeals affirmed,[11] and certiorari was granted. The Supreme Court, per Mr. Justice Stevens, upheld Bishop's dismissal and affirmed the district court's view that under the Marion ordinance and North Carolina law, Bishop " 'held his position at the will and pleasure of the city.' "[12] A clear understanding of how the Court disposed of Bishop's claim to property and liberty interests in his job can best be obtained by separate consideration of those issues.

## PROPERTY

According to *Roth*, a discharged employee must have "a legitimate claim of entitlement" to continued employment before he has been deprived of "property" under the fourteenth amendment.[13] Such a claim of entitlement cannot be based upon the employee's mere subjective expectations, but must be founded upon "existing rules or understandings"[14] with his employer (the state), as set forth in a statute, ordinance, or contractual provision establishing a definite duration for

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written notice of his discharge setting forth the effective date and reasons for his discharge if he shall request such a notice.

96 S. Ct. at 2077 n.5 (quoting art. II, § 6 of the Ordinance).

The ordinance also provided that all city employees would be considered "probationary" employees when first hired, but could attain the status of a "permanent" employee after six months' satisfactory employment. *See* 96 S. Ct. at 2082 n.5 (dissenting opinion).

9. Justice Stevens' majority opinion points out that the city was not a proper defendant, not being a "person" within the meaning of § 1983. 96 S. Ct. at 2077 n.1. For a more complete analysis of this issue, see Note, *Federal Jurisdiction—The Status of Public Officials as "Persons" Under 42 U.S.C. Section 1983*, 54 N.C.L. REV. 1062 (1976).

10. Bishop v. Wood, 377 F. Supp. 501 (W.D.N.C. 1973).

11. 498 F.2d 1341 (1973).

12. 96 S. Ct. at 2078 (quoting 377 F. Supp. at 504). The decision was five to four, with Justices Brennan, White and Blackmun authoring dissenting opinions. Justice Marshall concurred with the Brennan and White dissents.

13. 408 U.S. at 577.

14. *Id.*

the employment or granting of tenure by some other method. The Court[15] further noted that the Constitution did not create property interests but only extended protection to already existing interests whose "dimensions are defined by existing rules or understandings that stem from an independent source such as state law."[16] Thus, the approach adopted by the Court in *Roth* requires an initial examination of "an independent source such as state law"[17] to characterize the nature of the relationship that exists between the government employer and employee. This relationship, as defined by state law, is then examined under federal law to determine whether it constitutes a protected property interest.[18]

*Perry* established that an employee who has no written statutory or contractual entitlement to tenure can still claim due process protection by demonstrating the existence of an implied contract or an informal, but widely understood rule of the work-place "that certain employees shall have the equivalent to tenure."[19] With the addition of this "constructive tenure" concept, the *Roth-Perry* standard for determining when an employee has a property interest in his job was left sufficiently nebulous to allow the lower federal courts considerable latitude in applying it. As a result, the large number of suits initiated by public employees claiming a right to a pretermination hearing have received inconsistent treatment.[20]

15. Justice Stewart delivered the opinion of the Court. The vote was five to three, with Justices Douglas, Brennan and Marshall dissenting and Justice Powell taking no part in the case.

16. 408 U.S. at 577.

17. *Id.*

18. Plaintiff in *Roth* was a teacher at Wisconsin State University whose one-year employment contract was not renewed. The Court ruled that the Wisconsin statutes regarding tenure of state university professors and the specific terms of plaintiff's appointment created and controlled any interest Roth might have in his job. *Id.* at 576-78. Since neither the statute nor the contract could support a claim of entitlement to reemployment, the Court concluded that he had no constitutionally protected property interest in being rehired and therefore could not demand a due process hearing reviewing the decision not to renew his contract. *Id.* at 578.

19. *Perry* involved a state college professor who received neither notice, explanation nor a hearing upon his release after the conclusion of the last of four one-year contracts with the university. The college system in which Perry was employed had no official or statutory tenure system for its professors. Perry claimed, however, that the college had a de facto tenure program (the existence of which was intimated in the school's faculty guide), and that he had tenure under that program. Although the Court did not immediately grant him a due process hearing on these grounds, it remanded the case to the district court to give Perry an opportunity to prove that the school's policies were as he alleged. If he could successfully demonstrate a property interest upon remand, then he was to receive a hearing at which he could challenge the sufficiency of the reasons for his release. 408 U.S. at 602-03.

20. In some cases this inconsistency has been manifested by the varying results

The uncertainty generated by the Supreme Court in its formulation of the pliable *Roth-Perry* property interest test was by no means dissipated in its next pronouncement regarding a dismissed public employee's rights to due process. In *Arnett v. Kennedy*,[21] five Justices wrote opinions that displayed widespread disagreement.[22] Justice Rehnquist, writing for the plurality, seemingly abandoned the second criterion in the bifurcated *Roth-Perry* approach, which initially determines *whether* an employee has a sufficient liberty or property interest to merit due process, and then ascertains what level of due process the Federal Constitution requires in the given situation.[23] He concluded that even when a government has accorded its employees a property interest in their jobs, it is not bound by federal notions of due process but still retains the right to set up any type of procedure it desires, no matter how minimal, to safeguard that interest.[24] Under Justice Rehnquist's view, since an employee's entitlement to his job arises under a statute, it may be conditioned by a statutory limitation upon procedural due process protection.

Six of the Justices in *Arnett* rejected the plurality approach and adhered largely to the *Roth-Perry* view. Justice White noted:

> The fact that the origins of the property right are with the State makes no difference for the nature of the procedures required. While the State may define what is and what is not property, once having defined those rights the Constitution defines due

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achieved under this test within a single court. For instance, the Fourth Circuit Court of Appeals (which affirmed the district court opinion in *Bishop*) has vacillated significantly. It strictly construed an employment contract in Kota v. Little, 473 F.2d 1 (1973), and a statute in Brown v. Hirst, 443 F.2d 899 (1971), to deny public employees access to a due process hearing, but liberally found a property interest even in the absence of statutory tenure in Thomas v. Ward, 529 F.2d 916 (1975). Moreover, in Johnson v. Fraley, 470 F.2d 179 (1972), the Fourth Circuit found that under the *Roth-Perry* test, "continuous employment over a significant period of time—such as appellant's 29 years—can amount to the equivalent of tenure." *Id.* at 181. Only two years later, however, the United States District Court for the Middle District of North Carolina refused to follow *Fraley* and held that a teacher with 19 years' service did not have tenure and that "longevity of employment" alone does not establish the existence of a property interest. Cannady v. Person County Bd. of Educ., 375 F. Supp. 689 (1974).

21. 416 U.S. 134 (1974).

22. Justice Rehnquist wrote for the plurality. *Id.* Justice Powell filed a concurring opinion. *Id.* at 164. Justice White concurred in part and dissented in part. *Id.* at 171. Justices Douglas and Marshall filed separate dissents. *Id.* at 203 (Douglas); *id.* at 206 (Marshall).

23. *See* text accompanying note 7 *supra*.

24. 416 U.S. at 152.

> process, and as I understand it six members of the Court are in agreement on this fundamental proposition.[25]

A number of other issues were also under consideration in *Arnett*,[26] and the Court reached such diverse results that Justice Stevens' remark in *Bishop* that "*Arnett* sheds no light on the problem presented by this case"[27] is understandable. It is also evasive, however, since six of the Justices specifically agreed that a statute[28] guaranteeing continued employment absent cause for discharge creates a legitimate claim of entitlement to the job and affords the employee the right to a due process hearing.[29]

Given the facts of *Bishop*, a reasonable application of the *Roth-Perry* standard could easily have justified a finding that Bishop had a legitimate property interest in his job. Under the Marion personnel ordinance, not only was he classified as a "permanent employee," but his removal was conditioned upon the presence of certain enumerated causes.[30] In light of the *Arnett* case, this "for cause" qualification of the ordinance certainly could provide a strong basis for concluding that a property right was present.[31] Although Justice Stevens, in writing for the majority, conceded that the Marion ordinance could be read as creating a property interest in employment,[32] he declined to do so, but relied instead upon the district court's interpretation.

The district court's analysis of Bishop's claim to a property right was less than exhaustive. First, it noted that Bishop had no written contract that conferred tenure and that the city personnel resolution made no express guarantee of tenure or continued employment. The court then ended its review of the case's circumstances and turned to state law for guidance in interpreting the ordinance. Citing *Still v. Lance*,[33] the court found that in North Carolina, a contract for em-

25. *Id.* at 185.

26. The Court also considered whether the applicable personnel statute was unconstitutionally vague, and addressed several questions relating to the nature and timing of the employee's evidentiary due process hearing.

27. 96 S. Ct. at 2078 n.8.

28. The statute involved in *Arnett* provided that a permanent employee could not be removed other than for "such cause as will promote the efficiency of the service." 416 U.S. at 151-52.

29. *See* opinion of Justice White, *id.* at 181, and opinion of Justice Powell, *id.* at 166.

30. *See* note 8 *supra.*

31. *See* note 28 and accompanying text *supra.*

32. 96 S. Ct. at 2078.

33. 279 N.C. 254, 182 S.E.2d 403 (1971). In a short, but well reasoned dissent, Justice Blackmun questioned the applicability of this case to the facts of *Bishop*. 96 S. Ct. at 2085.

ployment with no provision regarding duration or date of termination is terminable at the will of either party and gives an employee no legitimate expectation of continued employment.[34] Thus, the district court ignored Bishop's argument that the ordinance created a property right by providing for dismissal upon *cause*, and held that since there was no express statutory or contractual grant of tenure, he held his job "at the will and pleasure of the city."[35]

By upholding the district court's "tenable" reading of the ordinance even though admitting that its own independent examination of the ordinance "might have justified a different conclusion,"[36] the majority in *Bishop* appears to have significantly narrowed the scope of federal court review of public employee dismissals. Although the *Roth-Perry* test contemplates reference to state law as an aid in defining the nature of the employment relationship in a given context, it is doubtful that the Supreme Court in those cases intended to foreclose further examination of the facts and their logical implications.[37] Indeed, *Roth* and *Perry* allow the court to determine whether the employment relation, as defined by state law, does or does not create a property right.[38]

By discarding the *Roth* rationale as a justification for an active role for federal courts in defining property interests in public employment, the majority in *Bishop* has opted for a more restrained approach. *Bishop* emphasizes that the federal court's primary duty is to look to the intent of the legislature that created the job from which an employee has been removed in order to determine if a property interest has been created. When the statutes are unclear on this issue, *Bishop*

34. 377 F. Supp. at 504.

35. *Id.*

36. 96 S. Ct. at 2078.

37. At least several lower courts have not felt compelled to do so. *See* Vance v. Chester County Bd. of School Trustees, 504 F.2d 820, 824 n.1 (4th Cir. 1974); McNeill v. Butz, 480 F.2d 314, 320 (4th Cir. 1973); Zimmerer v. Spencer, 485 F.2d 176 (5th Cir. 1973). *See also* note 20 *supra.*

38. Justice Brennan's dissent argues that *Perry* and *Roth* require court review of such circumstances as the common practices of the employer and expectations of the employee that are based on those practices or upon his probable understanding of the local ordinance. He contends that "at least before a state law is definitively construed as not securing a 'property' interest, *the relevant inquiry is whether it was objectively reasonable for the employee to believe he could rely on continued employment.*" 96 S. Ct. at 2082 (emphasis added).

Justice Brennan's view, that a unilateral expectancy of continued employment creates a property right when objective circumstances justify that expectation, was rejected by the majority and characterized by Justice Stevens as a "remarkably innovative suggestion that we develop a federal common law of property rights . . . ." 96 S. Ct. at 2080 n.14.

suggests that the court defer to state cases for clarification rather than indulge in its own interpretations. Obviously, such an approach will minimize independent examination of the facts in search of a constructive property interest as was found in *Perry*. Thus, Bishop's contention that his understanding of the city ordinance and of his "permanent" status induced a reasonable belief that he enjoyed tenure was given no weight by the court in the absence of specific allegations that such belief was widely held among Marion policemen or fostered by his employer.

If the method of deferring to state law employed by *Bishop* is utilized in the future, it would be difficult for the courts to recognize a property right to employment in many cases even when an ordinance is not worded ambiguously. The common law of almost every state coincides with *Still v. Lance* in construing contracts of employment that mention no period of duration to be terminable at the will of either party.[39] Moreover, since few state legislatures or city councils were aware at the time they created a job that an employee's rights to due process could depend upon their intent, most statutes and ordinances are probably unclear on this issue.[40]

In his dissenting opinion, Justice White accused the majority of adopting Justice Rehnquist's *Arnett* position, previously rejected by a majority of the Court.[41] White read the majority opinion as holding that when the state creates an entitlement to employment, it also has the power to establish any procedure it desires to effect that entitlement, even if such procedure does not meet minimum standards of due process. This interpretation appears somewhat strained. The majority held that Bishop never acquired a property interest and thus had no occasion to determine whether Marion's procedure was adequate for safeguarding such an interest.[42] However, by holding that the ultimate authority to define "property" for purposes of the fourteenth amend-

39. *E.g.*, Land v. Delta Air Lines, Inc., 130 Ga. App. 231, 203 S.E.2d 316 (1973); Lorson v. Falcon Coach, Inc., 214 Kan. 670, 522 P.2d 449 (1974); *see* Annot., 161 A.L.R. 706, 707 (1946).

40. Note, *The Due Process Rights of Public Employees*, 50 N.Y.U. L. REV. 310, 348 (1975).

41. 96 S. Ct. at 2083; *see* text accompanying notes 25-27 *supra*. Justice White based his accusation upon language used by both Justice Stevens and the district court to the effect that Bishop's rights were not abrogated since the procedure established in the ordinance—*i.e.*, sending written notice of the date of dismissal, etc.—was followed. 96 S. Ct. at 2083.

42. What *Bishop* does appear to conclude is that if an ordinance provides for any type of dismissal procedure, even if it does not confer a property right, then the government-employer must still comply with the procedure. *See* 96 S. Ct. at 2077-79.

ment resides with the states, the majority clearly intimates that government employers may now avoid any due process limitation upon their powers to fire their employees merely by deciding that the jobs do not constitute "property."[43]

### LIBERTY

*Board of Regents v. Roth*[44] also developed the Supreme Court's standard for determining when an interest in "liberty" has been impaired to the extent that due process protection is mandated. According to *Roth*, a public employee is entitled to a due process hearing if the dismissal imposes a social stigma upon him or is carried out in a manner that may deprive him of future employment. That this two-pronged test has proved as difficult to apply with exactness as the *Roth-Perry* deprivation of property standard is evidenced by the widely divergent results reached in the lower courts.[45]

For discharge to amount to a social stigma, the employer must make charges against the employee "that might seriously damage his standing and associations in his community."[46] Although *Roth* did not provide a definite indication of what degree of stigma requires a hearing affording the employee a chance to clear his name,[47] it did clearly require that some potentially damaging reason for dismissal be given. This requirement seemingly furnishes employers with an incentive for not notifying the employee of the reasons for his dismissal, since in the Court's view there can be no social stigma when there are no allegations made.[48] In applying this "social stigma" test to the facts of *Bishop*, Justice Stevens found that Bishop could not claim that his good name was stigmatized since there was no public disclosure of the reasons for his dismissal.[49]

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43. *See* dissenting opinion of Justice Brennan, *id.* at 2082 n.4.

44. 408 U.S. 564 (1972).

45. For a survey of cases representing this disparity, see Note, *supra* note 40, at 330-35.

46. 408 U.S. at 573. The Court indicated that allegations of dishonest or immoral conduct would constitute such charges. *Id.*

47. The Court gave no more precise statement of what would constitute social stigma than a quotation from *Wisconsin v. Constantineau*: " 'Where a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential.' " 408 U.S. at 573 (quoting 400 U.S. 433, 437 (1971)).

48. *But see* Suarez v. Weaver, 484 F.2d 678 (7th Cir. 1973), in which the court noted that "silence will often work greater damage to the dismissed person's reputation than the worst of reasons." *Id.* at 680.

49. The alleged reasons for Bishop's dismissal—insubordination, causing low

The second type of situation in which dismissal can violate an employee's right to liberty as described by *Roth* occurs when the termination "imposed on him a stigma or other disability that foreclosed his freedom to take advantage of other employment opportunities."[50] To meet this standard, a dismissed employee's proof must go beyond a mere showing that he is "somewhat less attractive to other employers"[51] as a result of being fired. The majority opinion in *Bishop* omitted any discussion of this "harm to future employment" test and focused exclusively upon the question of disclosure to the general public. Justice Brennan's dissent pointed out this omission and argued that disclosure of the damaging reasons for Bishop's dismissal[52] would probably be made to future employers. Consequently, he reasoned that Bishop was thus entitled to a hearing at which he could challenge the merits of the accusations against him.

The effectiveness of Justice Brennan's incisive argument may have been diluted by the apparent lack of proof at the trial level that other police departments routinely request the reasons for a potential employee's prior dismissal or that the city of Marion would disclose those reasons.[53] Clearly, such proof would have provided Bishop a strong basis for arguing deprivation of liberty under the "harm to future employment" test. If the omission of that test means that the Supreme Court has dropped the second tier from the *Roth* liberty test sub silentio, then the implications for public employees may be grave indeed. Obviously, substantial damage to future employment opportunities can occur if stigmatizing reasons for dismissal are disclosed to potential employers.[54] Although many states have enacted legislation that protects the privacy of state and local government employee personnel re-

morale and poor attendance at training classes—were privately communicated to him by the city manager. Even though these reasons did eventually become public as the result of Bishop's lawsuit, the Court held that the disclosure must precede the filing of the claim. 96 S. Ct. at 2080.

50. 408 U.S. at 573.

51. *Id.* at 574 n.13.

52. See note 49 *supra* for a list of those reasons, the gravity of which prompted Justice Brennan to remark: "It is difficult to imagine a greater 'badge of infamy' that could be imposed on one following petitioner's calling; in a provision [*sic*] in which prospective employees are invariably investigated, petitioner's job prospects will be severely constricted by governmental action in this case." 96 S. Ct. at 2080.

53. Justice Brennan based his speculations on "common sense." 96 S. Ct. at 2081 n.2.

54. *Roth* held that such a disclosure was a deprivation of liberty and emphasized the seriousness of the consequences by quoting *Joint Anti-Fascist Refugee Comm. v. McGrath*: " 'To be deprived not only of present government employment but of future opportunity for it certainly is no small injury.' " 408 U.S. at 574 (quoting 341 U.S. 123, 185 (1951)).

cords,[55] such statutes often contain exceptions that permit inspections of these records by other governmental units.[56] Moreover, some states still classify personnel files as "public documents," and thus place no restrictions upon the number of people who can discover the reasons for an employee's discharge.[57]

As a final argument petitioner Bishop alleged that he was dismissed on the grounds of false accusations. He submitted affidavits of fellow officers specifically refuting the charges made by the chief of police; the Supreme Court, in considering defendant's motion for summary judgment, had to accept the statements contained therein as true. Nonetheless, the majority concluded that even if he were fired for false or erroneous reasons, Bishop had no claim to judicial relief since the false statements were never released to the public. In explaining this holding, Justice Stevens revealed a fear that appears to underlie the majority's philosophy in *Bishop*—that federal courts may be inundated by an ever-increasing tide of lawsuits by discharged public employees. As to Bishop's argument regarding the falsity of the reasons for his dismissal, Justice Stevens observed: "A contrary evaluation of his contention would enable every discharged employee to assert a constitutional claim merely by alleging that his former supervisor made a mistake."[58] Justice Stevens acknowledged that public employers will always make "incorrect or ill-advised personnel decisions," but that "the federal court is not the appropriate forum" for granting relief to the victims of such decisions.[59]

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55. *E.g.*, N.C. GEN. STAT. § 160A-168 (Cum. Supp. 1975); *see* CONN. GEN. STAT. ANN. § 5-199 (West Cum. Supp. 1976).

56. For instance, N.C. GEN. STAT. § 160A-168(c)(5) (Cum. Supp. 1975) provides:

> An official of an agency of the State or federal government, or any political subdivision of the State, may inspect any portion of a personnel file when such inspection is deemed by the official having custody of such records to be inspected to be necessary and essential to the pursuance of a proper function of the inspecting agency . . . .

Thus, if an employee who was dismissed by one city applied for employment in another city, the first city could find that it is "necessary . . . to the pursuance of a proper function" of the personnel office of the second city to allow inspection of the employee's file. *See id.*

57. *See, e.g.*, FLA. STAT. ANN. §§ 119.01, .012 (Harrison 1975 & Cum. Supp. 1975). Florida's Attorney General has interpreted the Florida Public Records Act to require that personnel files of public employees be maintained as public records, open to inspection by all. OP. ATT'Y GEN. FLA. 073-212, 073-51 (1973). *See generally* Note, *Privacy of Information in Florida Public Employee Personnel Files*, 27 U. FLA. L. REV. 481 (1975).

58. 96 S. Ct. at 2080.

59. *Id.*

## CONCLUSION

To effectuate its desire to reduce federal court involvement in public employee personnel cases, the Supreme Court in *Bishop* established that state law is the final arbiter of a public employee's status. *Bishop* did not completely abandon the principles of *Roth* and *Perry*, but attempted to streamline the courts' application of those principles by deferring to state law as a substitute for independent federal court analysis of a plaintiff's "property interest" in his employment. Furthermore, it narrowed the scope of an employee's loss of "liberty" to situations where potentially damning reasons for dismissal are made public.[60] Although *Bishop* plainly reaffirms the settled principle that absent special circumstances, a public employee's general interest in keeping his job is not sufficient to entitle him to due process of law, government employers, by avoiding public disclosure of "stigmatizing" reasons for dismissal, and by wording their personnel ordinances unambiguously either to guarantee or to deny employees a property right to their jobs, can determine the legal rights of their employees. Hopefully, in making these choices, government employers will be motivated by principles of fairness and good personnel management rather than merely a desire to comply with the now minimal Supreme Court requirements.

Removal of judicial checks upon the government's power to dismiss its employees could lead to abuses; and if employees have only a limited right to question the grounds for a dismissal, employee fear of being disciplined arbitrarily may inhibit their activities in areas of their lives where the government has no right to be. Although the Court still recognizes its duty to prevent dismissals of public employees that are based on the employer's desire "to curtail or to penalize the exercise of an employee's constitutionally protected rights,"[61] its decision in *Bishop* could indirectly result in such curtailments by creating a "chilling effect" upon the exercise of the freedoms of speech, religion, or association.

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60. The notion that free grants of tenure to public employees could reduce efficiency and promote elitism may have been an underlying consideration in the Court's approach, although its primary motive apparently was to insure that federal courts do not become "super-legislatures" with power over state and local personnel policies.

61. 96 S. Ct. at 2080.

## Constitutional Law—Prison Disciplinary Proceedings and the Fifth Amendment Privilege Against Self-Incrimination

Any determination of the rights retained by prison inmates is complex because of the conflict between the interest in maintaining the basic fair treatment assured all individuals by constitutionally guaranteed freedoms and protections and the competing interest of the state in allowing prison officials sufficient discretion to administer a safe and effective prison system.[1] Prison disciplinary proceedings, in which officials can impose removal of good time credits,[2] punitive segregation[3] or other lesser punishments[4] for infractions of prison regulations, bring this problem into still sharper focus. The prisoner is in danger of a substantial loss of liberty in a procedure in which he is unprotected by the rights guaranteed to a defendant outside prison walls. Prison authorities, on the other hand, confront an individual suspected of rejecting their regulations and controls and therefore posing a serious threat to order and security within the institution.

In a 1974 case, *Wolff v. McDonnell*,[5] the United States Supreme Court examined prison disciplinary hearings for the first time and held that the due process rights of inmates are limited to those that pose little or no threat to the prison administration or the state's interest.[6] In *Baxter v. Palmigiano*[7] the Court was presented with the issue whether the

1. Discretion is necessary primarily to allow prison officials to act quickly to preserve control and to provide effective rehabilitation, security and a safe environment for prison employees as well as inmates. Wolff v. McDonnell, 418 U.S. 539, 561-63 (1974).

2. Good time credits are granted in many prison systems for time served in prison without disciplinary sanctions, and reduce the length of sentence remaining to be served. Note, *Constitutional Law—Procedural Due Process in Prison Disciplinary Proceedings—The Supreme Court Responds*, 53 N.C.L. REV. 793, 793-94 (1975). *See generally* McGinnis v. Royster, 410 U.S. 263 (1973).

3. Punitive segregation or solitary confinement generally consists of restriction to a cell either full time or for most of each day, without opportunities for recreation or exercise and sometimes with a reduced diet and reduced access to reading matter. U.S. PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE, TASK FORCE REPORT: CORRECTIONS 50 (1967).

4. The lesser punishment most commonly used is loss of privileges for a given period of time. *Id. See also* Proposed Regulations Governing Procedures at the Adult Correctional Institutions, Rhode Island, *reprinted in* Morris v. Travisono, 310 F. Supp. 857, 874 app. (D.R.I. 1970).

5. 418 U.S. 539 (1974).

6. *See* text accompanying notes 40-44 *infra*.

7. 96 S. Ct. 1551 (1976).

fifth amendment privilege against self-incrimination[8] forbids the taking of a negative inference from the silence of a prisoner at a disciplinary hearing to which the privilege against self-incrimination applies.[9] In holding that such an inference is permissible,[10] the Court decreased the protection provided by the fifth amendment in the prison context, and in so doing took a further step in the process of limiting the rights of imprisoned individuals.

In *Baxter* the Court jointly considered two United States Court of Appeals cases challenging the constitutionality of prison disciplinary proceedings under 42 U.S.C. section 1983.[11] The first, *Clutchette v. Procunier*,[12] was an action brought by inmates of the California penal institution at San Quentin. The United States District Court for the Northern District of California found that the disciplinary proceedings violated the due process clause of the fourteenth amendment because they denied counsel to prisoners. Because of this denial the prisoners were forced to give up their constitutional privilege against self-incrimination in order to present a defense that could otherwise have been presented for them by a lawyer while they remained silent.[13] In its final consideration of the case,[14] the Court of Appeals for the Ninth Circuit affirmed, holding that an inmate faced with any form of discipline was entitled to notice of claimed violations, an opportunity to be heard and present witnesses, a hearing before a detached and neutral body, and a decision based on evidence introduced at the hearing.[15] The court also held that prison officials could, in their discretion, refuse

8. U.S. CONST. amend. V in pertinent part provides: "[N]or shall [any person] be compelled in any criminal case to be a witness against himself . . . ."

9. 96 S. Ct. at 1556.

10. *Id.* at 1558-59. Justice White wrote the opinion for the majority, with Justices Brennan and Marshall concurring in part and dissenting in part. Justice Stevens did not take part in the decision.

11. 42 U.S.C. § 1983 (1970) states:

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

12. 328 F. Supp. 767 (N.D. Cal. 1971).

13. *Id.* at 777-78.

14. The Court of Appeals for the Ninth Circuit originally held that the minimum due process requirements for parole and probation revocations applied to disciplinary proceedings as well. 497 F.2d 809 (9th Cir. 1974). After the Supreme Court decision in Wolff v. McDonnell, 418 U.S. 539 (1974), rehearing was granted and the court of appeals' final decision was reported at 510 F.2d 613 (9th Cir. 1975).

15. 510 F.2d at 614, *aff'g in part* 497 F.2d 809 (9th Cir. 1974).

to provide an opportunity for confrontation and cross-examination, but written reasons for that denial were to be given to the prisoner or the denial would act as "prima facie evidence of abuse of discretion."[16] Finally, the court affirmed the district court's holding that *Miranda v. Arizona*[17] secured a prisoner's right to counsel in a disciplinary proceeding for activity violating state criminal laws as well as prison regulations.[18]

In the second case, Nicolas A. Palmigiano, an inmate of the Rhode Island Correction Institution, faced a disciplinary hearing for inciting a disturbance within the prison.[19] Prior to the hearing Palmigiano was informed that he might be prosecuted for a violation of Rhode Island criminal law, and that he could consult with his attorney but that the attorney could not be present during the hearing itself. He was also advised that he had a right to remain silent but that his silence would be held against him in the proceeding. Following the disciplinary hearing at which he remained silent, Palmigiano was placed in solitary confinement for thirty days and had his classification status downgraded. Palmigiano sued, claiming the proceeding violated his rights under the due process clause of the fourteenth amendment to the Constitution.[20] The United States District Court denied relief.[21] The original decision of the Court of Appeals for the First Circuit,[22] a reversal of the district court, was vacated by the Supreme Court in view of its decision in *Wolff*.[23] On remand, the First Circuit reaffirmed its initial holding,[24] finding that Palmigiano's fourteenth amendment due process rights were violated by the disciplinary procedure.[25] Furthermore it held that the protections required by *Miranda* and *Mathis v. United States*[26] to safeguard the privilege against self-incrimination in a custodial interrogation,

16. 510 F.2d at 616.
17. 384 U.S. 436 (1966).
18. 510 F.2d at 616.
19. Palmigiano, an inmate serving a life sentence for murder, was charged with urging other prisoners not to return to their cells for lock-up in the evening in order to register protest for the failure of the prison administration to provide medical assistance for a fellow prisoner who was violently ill. Palmigiano v. Baxter, 487 F.2d 1280, 1281 (1st Cir. 1973).
20. 96 S. Ct. at 1555.
21. *Id.* The district court decision is unreported.
22. Palmigiano v. Baxter, 487 F.2d 1280 (1st Cir. 1973).
23. 418 U.S. 908 (1974).
24. 510 F.2d 534 (1st Cir. 1974) (per curiam).
25. *Id.* at 537.
26. 391 U.S. 1 (1968). *See* text accompanying note 69 *infra*.

including the presence of counsel, should have been provided to Palmigiano in light of the possibilities of future criminal prosecution.[27]

The Supreme Court reversed in both cases,[28] stating that *Wolff*'s limitation of the right to counsel at prison disciplinary hearings encompassed all such hearings, regardless of the possibility of future criminal prosecutions, and that neither *Miranda* nor *Mathis* was applicable since disciplinary proceedings are "not part of a criminal prosecution."[29] The Court further held that the practice of informing a prisoner of his right to remain silent but stating also that his silence would be used against him is invalid neither per se nor as applied in a civil proceeding of this sort.[30] The Court first reasoned that the fifth amendment does not apply to prevent the taking of adverse inferences from silence in civil actions, although it does forbid such an inference in a criminal case.[31] The Court then rejected the argument that *Baxter* fit within a group of civil cases[32] in which an inference of guilt taken from defendants' fifth amendment silence in the face of official questions had been invalidated, differentiating between those civil cases and the instant case on the ground that Palmigiano's silence alone did not automatically subject him to discipline.[33] Finally, the Court reiterated that "[m]utual accommodation between institutional needs and objectives and the provisions of the Constitution that are of general application" is necessary, and that this accommodation will limit the standard of rights necessary to constitute due process in all prison disciplinary hearings.[34]

The Supreme Court first utilized the "mutual accommodation" balancing process in the area of prison-related discipline in *Morrissey v.*

27. 510 F.2d at 536-37.

28. 96 S. Ct. at 1560-61.

29. *Id.* at 1556, *citing* Wolff v. McDonnell, 418 U.S. 539, 566 (1974).

30. 96 S. Ct. at 1558-59.

31. *Id.* at 1557-58.

32. Lefkowitz v. Turley, 414 U.S. 70 (1973); Gardner v. Broderick, 392 U.S. 273 (1968); Sanitation Men v. Sanitation Comm'r, 392 U.S. 280 (1968); Garrity v. New Jersey, 385 U.S. 493 (1967). *See* text accompanying notes 55-59 *infra.*

33. 96 S. Ct. at 1556-57. The majority opinion also reexamined the due process issue presented in *Wolff* in this changed context and reaffirmed the denial of cross-examination and confrontation to prisoners, refusing to require prison officials to provide written explanation of their discretionary decisions to forbid such actions. *Id.* at 1559. Further, the Court held unanimously that any holding regarding minimum due process standards when inmates are threatened with loss of privileges rather than the more serious forms of discipline would be premature on these facts. *Id.* at 1560. The Court also held that the district court inappropriately treated *Clutchette v. Procunier* as a class action within the contemplation of rules 23(c)(1) and 23(c)(3) of the Federal Rules of Civil Procedure without certifying it as such and identifying the class. *Id.* at 1554 n.1.

34. *Id.* at 1559, *citing* Wolff v. McDonnell, 418 U.S. 539, 556 (1974).

*Brewer*.[35] The Court found in that case that due process applies to parole revocation hearings. After weighing and balancing governmental interests in efficient, inexpensive proceedings, as well as in the parolee's rehabilitation,[36] with the parolee's private interest, the parolee's due process rights were found to include: (1) preliminary and final hearings before neutral and detached bodies, (2) written notice of alleged violations, (3) the opportunity to be heard in person and to present witnesses and documents, (4) the opportunity to confront and cross-examine adverse witnesses, and (5) a written statement of the evidentiary basis and reasons for revocation.[37] *Gagnon v. Scarpelli*[38] applied similar due process requirements to probation revocation actions.[39]

In *Wolff v. McDonnell*[40] the Court declined to extend the full range of *Gagnon-Morrissey* due process requirements to disciplinary procedures for acts occurring within the prison that could lead to confinement in disciplinary cells and deprivation of good-time credits.[41] In view of the state's strong interest in maintaining order within the prison and in the rehabilitation of prisoners[42] the process of mutual accommodation in such instances creates less stringent due process requirements: (1) notice of the charges in sufficient time to prepare a defense, (2) opportunity to present witnesses and documentary evidence if it will not be hazardous to the safety or correctional goals of the prison, and (3) a written statement of findings of fact and reasons for the imposition of discipline.[43] The right of confrontation and cross-examination and the

35. 408 U.S. 471 (1972).

36. The government interest in rehabilitation can be used not only to cut down on the absolute right to counsel in order to make disciplinary hearings more adversary and less corrective, but also to support a great many other due process rights on the grounds that unfair treatment will have a negative effect on a parolee's attitudes and greatly decrease his chances of successful rehabilitation. 408 U.S. at 484. *See also* U.S. PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND THE ADMINISTRATION OF JUSTICE, TASK FORCE REPORT: CORRECTIONS 83 (1967); Hirschkop & Millemann, *The Unconstitutionality of Prison Life*, 55 VA. L. REV. 795, 830 (1969).

37. 408 U.S. at 489.

38. 411 U.S. 778 (1973).

39. *Gagnon* also added a requirement of counsel when the state authorities found a trained advocate would be necessary to present fairly the probationer's side of the case. Right to counsel is presumed in a number of situations. *Id.* at 783-91.

40. 418 U.S. 539 (1974).

41. *Id.* at 563-72.

42. In *Baxter* the state goal of rehabilitation was used by the Court solely as a rationale for cutting back the due process requirements. The arguments of note 36 *supra* seem to have been abandoned on the ground that rehabilitation is best promoted by a rapid, non-adversary hearing, even though the prisoner's belief in the fairness of the proceeding may be decreased.

43. 418 U.S. at 564-67. For criticism of this view see Millemann, *Prison Disciplinary Hearings and Procedural Due Process*, 31 MD. L. REV. 27, 42 (1971).

right to counsel were found not to be required by due process on the grounds that these rights would produce delay, put an adversary cast on the proceeding that would reduce its rehabilitative value, and limit the discretion of the prison administration in such a way as to compromise the security of the institution.[44]

Although the rights of prisoners have only been considered by the Supreme Court in the recent past,[45] the fifth amendment privilege against self-incrimination has a long history of protection by the federal courts.[46] According to its language, the fifth amendment applies only to criminal trials.[47] One of its primary purposes is to protect against inquisitorial abuses of widespread government interrogation and investigation.[48] If the criminal limitation were strictly applied, however, the fifth amendment would be robbed of its effectiveness since incriminatory answers could be demanded in non-criminal "investigatory" procedures and then utilized in a criminal trial with the very effect that the amendment is designed to avoid.[49] Theoretically, the privilege against self-incrimination should protect any person who is being coerced by governmental authorities to testify to matters that might tend to incriminate him.[50] The protection extends not only to questions whose answers are incriminating per se, but to those whose answers would contain information that could either constitute a "link in the chain" of evidence that might incriminate defendant or give the authorities information that could reasonably be expected to lead to the discovery of such evidence.[51]

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44. 418 U.S. at 567-70.

45. The federal courts have traditionally been reluctant to respond to inmate complaints and interfere with prison administration. *See generally* Comment, *Beyond the Ken of the Courts: A Critique of Judicial Refusal to Review the Complaints of Convicts*, 72 YALE L.J. 506 (1963); Note, *Constitutional Rights of Prisoners: The Developing Law*, 110 U. PA. L. REV. 985 (1962).

46. *See, e.g.*, Arndstein v. McCarthy, 254 U.S. 71 (1920); Counselman v. Hitchcock, 142 U.S. 547 (1892); United States v. Burr, 25 F. Cas. 38 (C.C.D. Va. 1807).

47. *See* note 8 *supra* for the relevant text. The fifth amendment protection against self-incrimination was made applicable to the states through the fourteenth amendment in Malloy v. Hogan, 378 U.S. 1 (1964).

48. Ratner, *Consequences of Exercising the Privilege Against Self-Incrimination*, 24 U. CHI. L. REV. 472, 484 (1957). The privilege originated in England as a response to the procedures of the Star Chamber, which not only demanded that defendants give testimony that would lead to their convictions, but which tortured those who refused to speak under oath. E. GRISWOLD, THE FIFTH AMENDMENT TODAY 2-4 (1955).

49. Note, *Use of the Privilege Against Self-Incrimination in Civil Litigation*, 52 VA. L. REV. 322, 323 (1966).

50. Counselman v. Hitchcock, 142 U.S. 547 (1892): *See also* Ratner, *supra* note 48, at 493.

51. Maness v. Meyers, 419 U.S. 449 (1975); Murphy v. Waterfront Comm'n, 378 U.S. 52 (1964); Blau v. United States, 340 U.S. 159 (1950); Counselman v. Hitchcock, 142 U.S. 547 (1892).

The protection does not extend to prevent a defendant who remains silent from being damaged by the presence of unrefuted evidence tending to show his guilt. The natural inference arising out of the presence of such evidence[52] creates a dilemma for the defendant who must choose between presenting a defense and exercising his self-incrimination privilege. However, the inference taken from unrefuted evidence has generally been considered to be insufficiently coercive to create a threat to the fifth amendment privilege. Commentators have suggested that the inference is constitutionally acceptable because it arises out of the strength of the evidence presented and not out of defendant's exercise of his constitutional right.[53]

The fifth amendment does not forbid self-incrimination altogether. Rather, it forbids any governmental action that would coerce a citizen to incriminate himself involuntarily.[54] The Supreme Court has recently invalidated two types of behavior that impermissibly threatened the free use of the fifth amendment privilege. In *Griffin v. California*[55] the Court held it to be unconstitutionally coercive to advise juries that they can draw an unfavorable inference from defendant's silence at his criminal trial. Such an inference would not only be a coercive penalty making the "assertion of the Fifth Amendment privilege 'costly,' "[56] but would effectively negate the application of the privilege as a protection both for the innocent who fear that ambiguous answers to selected questions or their nervous appearance on the witness stand would tend to incriminate them and for the guilty who want to leave the full burden of

52. Some states allow comment on the use of the privilege in civil litigation. *See, e.g.*, Morris v. McClellan, 154 Ala. 639, 45 So. 641 (1908), *cited with approval in* Hinton & Sons v. Strahan, 266 Ala. 307, 96 So. 2d 426 (1957). The majority do not permit comment, but do allow the jury to draw an inference from a party's silence. *See, e.g.*, Ikeda v. Curtis, 43 Wash. 2d 449, 261 P.2d 684 (1953).

53. *See, e.g.*, Ratner, *supra* note 48, at 476; Comment, *The Privilege Against Self-Incrimination in Civil Litigation*, 1968 U. ILL. L.F. 75, 79.

54. In Boyd v. United States, 116 U.S. 616 (1886), the Court stated its policy as follows:

> [I]llegitimate and unconstitutional practices get their first footing . . . by silent approaches and slight deviations from legal modes of procedure. This can only be obviated by adhering to the rule that constitutional provisions for the security of person and property should be liberally construed. A close and literal construction deprives them of half their efficacy, and leads to gradual depreciation of the right, as if it consisted more in sound than in substance. It is the duty of the courts to be watchful for the constitutional rights of the citizen, and against any stealthy encroachments thereon.

*Id.* at 635. This statement was quoted with approval in Spevack v. Klein, 385 U.S. 511, 515 (1967).

55. 380 U.S. 609 (1965).

56. Spevack v. Klein, 385 U.S. 511, 515 (1967), *citing* Griffin v. California, 380 U.S. 609, 614 (1965).

proving their criminal activity on the state.[57] Any inference taken from silence amounts to an assumption that those who avail themselves of the privilege are either guilty or are perjurors who are using the privilege to block investigations and protect others although they have no personal fear of incrimination.[58]

The second form of coercion was discussed in a group of civil cases, two of which were *Garrity v. New Jersey*[59] and *Lefkowitz v. Turley*.[60] These cases concerned economically oriented civil sanctions that were automatically imposed on those claiming the privilege against self-incrimination before a government investigation.[61] Such penalties were not actual inferences of guilt taken at the hearings where defendants' testimony was desired, but rather cousins to such inferences—assumptions that any person who could not testify freely and fully was guilty of something and therefore an unsuitable employee who should be removed from his or her job. The Supreme Court held that these collateral inferences were coercive in their non-rebuttable, automatic nature, and that the privilege may not be "condition[ed] by the exaction of a price."[62] Arguably the common factor in these cases is that the government acted in all of them both as interrogator and imposer of penalties.[63] Protection against such a use of governmental power harks back to the fifth amendment's original purpose of protection from government inquisition

57. Slochower v. Board of Higher Educ., 350 U.S. 551, 557-58 (1956), *modified*, 351 U.S. 944 (1956) (per curiam).

58. *Id.* at 557.

59. 385 U.S. 493 (1967).

60. 414 U.S. 70 (1973). The other cases in the group are: Gardner v. Broderick, 392 U.S. 273 (1968); Spevack v. Klein, 385 U.S. 511 (1967); Slochower v. Board of Higher Educ., 350 U.S. 551 (1956).

61. In *Slochower*, a statute required termination of employment of any city employee who did not answer questions related to official conduct. *Garrity* involved police who were forced to answer questions or lose their jobs. *Spevack* involved an attempt at automatic disbarment of a lawyer who claimed the privilege. In *Gardner*, discharge of policemen was threatened if they failed to sign waivers of immunity before appearing before a grand jury. Finally, the New York contracts in issue in *Lefkowitz* required contractors to waive immunity and answer questions concerning state contracts or lose the right to contract with the state for five years.

62. Garrity v. New Jersey, 385 U.S. 493, 500 (1967). This line of cases had two related holdings: first, that such coerced testimony could not be used at a subsequent criminal trial, and second, that it was not permissible to penalize someone for remaining silent despite coercion to talk. *Compare id.* at 497-98, *with* Slochower v. Board of Higher Educ., 350 U.S. 551, 557-58 (1956).

63. Comment, *The Privilege Against Self-Incrimination in Civil Litigation*, 1968 U. ILL. L.F. 75; *cf.* Comment, *Constitutionality of Administrative or Statutory Sanctions Upon the Exercise of the Privilege Against Self-Incrimination*, 36 FORD. L. REV. 593 (1968).

and abuse of governmental power to punish those who failed to cooperate.[64]

The fifth amendment right was extended to situations of custodial interrogation by the Supreme Court's decision in *Miranda v. Arizona*.[65] Because of the inherently coercive nature of custodial interrogation, *Miranda* required that the individual subject to such questioning be first informed of his right to remain silent and the fact that any statement made can be used against him in a criminal trial.[66] To ensure that defendant is aware of his fifth amendment right and is not coerced into giving up his opportunity to exercise it, he was granted the right to consult a lawyer and to have him present at any time during questioning.[67] *Mathis v. United States*[68] applied the *Miranda* procedures to custodial interrogation when the reason for custody was unrelated to the investigation taking place and when the investigation itself was routine rather than accusatory.[69] Failure to give *Miranda* warnings produces the immediate result of barring any self-incriminating evidence from use at a future criminal trial unless the government can prove a voluntary waiver of fifth amendment rights.[70]

In *Baxter* the Supreme Court looked for the first time at the relationship between the fifth amendment privilege against self-incrimination and prison disciplinary hearings. In reconsidering the due process issue of confrontation and cross-examination, the Court rejected the argument that the accommodation reached in *Wolff*[71] should be modified because

64. Ratner, *supra* note 48, at 484-87.
65. 384 U.S. 436 (1966).
66. *Id.* at 467-69.
67. *Id.* at 469.
68. 391 U.S. 1 (1968).
69. *Id.* at 4-5. Mathis was in prison serving a state sentence when subjected to a routine federal tax investigation. Although he was incarcerated on a different charge, and it was possible that no criminal charges would arise out of the investigation, the Court found that the protective rights of *Miranda* applied and that any information given in that investigation was barred from future prosecution. *Id.* at 5.
70. Miranda v. Arizona, 384 U.S. 436, 476 (1966). The theory behind this action is that the coercive nature of the situation itself endangers the fifth amendment privilege. Barring the use of coercively obtained evidence is only a partial solution in view of the intention of *Miranda* to protect the fifth amendment privilege. It is arguable that exclusion of tainted evidence is insufficient and that any jurisdiction failing to utilize the *Miranda* procedures or their equivalent to protect the fifth amendment could be directed to extend immunity to those who had been coerced into incriminating themselves. The idea of deliberate defiance of *Miranda* on the assumption that the evidence would be inadmissible at a crminal trial but might be of other value presents an entirely different set of problems. *See generally* Turner & Daniel, *Miranda in Prison: The Dilemma of Prison Discipline and Intramural Crime*, 21 BUFFALO L. REV. 759, 770-71 (1972).
71. For a discussion of *Wolff*, see text accompanying notes 40-44 *supra*.

an inmate's interest is weightier when he is faced with possible criminal prosecution. The Court found instead that the interest of the state still outbalanced individual interests, and that prison officials must be left with full discretion in these areas.[72]

Although recognizing that the fifth amendment privilege was applicable to the *Baxter* interrogation despite its civil nature because of the possibility of future criminal proceedings,[73] the Court found that the disciplinary proceeding was neither criminal in itself nor as a stage of a pending criminal prosecution. The type of coercive inference forbidden from criminal trials by the strict holding of *Griffin* was therefore correctly found to be inapplicable in this circumstance.[74]

In addition, Justice White, writing for the majority, saw *Baxter* and the *Garrity-Lefkowitz* line of decisions as analytically separable.[75] In those cases the refusal to testify alone resulted in a governmental sanction. In *Baxter*, by contrast, silence was assumed to have a connotation but would not result in discipline in the absence of other evidence.[76] Justice Brennan, in the dissenting portion of his opinion, asserted that *Baxter* demonstrates the same use of an impermissible government sanction as a penalty for the use of the fifth amendment found in the earlier cases.[77]

Neither of these arguments is lacking in logic. *Baxter* is indeed a very different type of case from *Garrity*, and is not only distinguishable but should be distinguished on the grounds mentioned by White. There is a difference between a statute or contract that invalidly provides a set penalty for constitutionally protected action and an administrative hearing, similar in many ways to a trial, in which some inference taken from an inmate's silence will become part of the evidence that might result in disciplinary action. This difference prevents *Garrity* and the cases following it from serving as adequate precedent for a decision striking down the *Baxter* procedures.

The analysis of Justice Brennan, although it erroneously attempts to tie *Baxter* into this group, shows a deeper insight into the problem

72. 96 S. Ct. at 1559-60.

73. Both the majority opinion and the dissent agree that the fifth amendment applied to Palmigiano. *Compare* 96 S. Ct. at 1557 (majority opinion), *with* 96 S. Ct. at 1561 (dissenting opinion).

74. 96 S. Ct. at 1557. For a discussion of the philosophy behind the *Griffin* holding, see text accompanying notes 52-58 *supra*.

75. 96 S. Ct. at 1557.

76. *Id.*

77. *Id.* at 1562-65 (Brennan, J., dissenting in part).

presented. The question before the Court was not whether the situation presented in *Baxter* involves the *Garrity-Lekowitz* type of coercion,[78] but rather whether the procedure used there was impermissibly coercive in itself. The majority made no comment on the relationship of the facts of *Baxter* to the philosophy espoused in *Griffin*,[79] which forbade any action that will make the exercise of the fifth amendment "costly." Nor did the Court recognize the apparent inequity of considering constitutionally protected silence to be an inference of guilt when it was intended to benefit the innocent.

Moreover, the Court failed to distinguish between an inference of guilt arising out of the silence itself—an inference that would be in apparent conflict with the history of the fifth amendment privilege and with its purpose and philosophy as expressed in *Griffin*—and an inference arising out of unrefuted evidence.[80] If the inference was taken from defendant's silence, the majority did not adequately explain its approval. The assumption was made that the fifth amendment permits the taking of an inference against a party in a civil action who refuses to testify,[81] although the Supreme Court had never previously approved this practice. No recognition was given to the idea that such inferences are permissible only because they are taken from unrefuted evidence, which is not protected by the fifth amendment, and not from the silence itself.[82] Furthermore, the knowledge that Rhode Island disciplinary decisions "must be based on substantial evidence manifested in the record of the disciplinary proceeding"[83] did not settle the question since it is unclear whether silence was or was not evidence manifested in the record. If the *Baxter* inference was an inference solely from the weight of the unrefuted evidence and therefore permissible, the facts of the case demand an investigation both of the sufficiency of the other evidence to support the decision of the disciplinary board[84] and of the coercive

78. For a discussion of the coercion involved in those cases, see text accompanying notes 59-64 *supra*.

79. 380 U.S. at 614.

80. *See* text accompanying notes 53-58 *supra*.

81. 96 S. Ct. at 1558.

82. *See* Comment, *Penalizing the Civil Litigant Who Invokes the Privilege Against Self-Incrimination*, 24 U. FLA. L. REV. 541, 549 (1972); Comment, *The Privilege Against Self-Incrimination in Civil Litigation*, 1968 U. ILL. L.F. 75, 79 (1968). *Cf.* Note, *Use of the Privilege Against Self-Incrimination in Civil Litigation*, 52 VA. L. REV. 322, 340-41 (1966).

83. 96 S. Ct. at 1557, *quoting* Morris v. Travisono, 310 F. Supp. 857, 873 (D.R.I. 1970).

84. The disciplinary board's decision was based on reports of prison officials and Palmigiano's silence. The majority speaks as if the silence did carry some independent

and misleading nature of the statement that Palmigiano's silence "would be held against him."[85] The Court's decision was apparently made without consideration of any of these problems.

The application of *Miranda* and *Mathis*[86] to prison disciplinary proceedings was summarily dismissed in the Court's consideration of the availability of counsel. The assurance of counsel was not considered a fifth amendment protection at all, although both the First and Ninth Circuits had based their decisions on the theory and rule of *Miranda* and *Mathis*.[87] As the courts of appeals found, the situation in *Baxter* approximated that found inherently coercive in *Mathis*. In both cases officials questioned a man in prison whose custody was based on a charge other than that involved in the questioning. In both cases the questions were part of an investigation that could conceivably lead to criminal charges, but no criminal charges had yet been brought in either, and there was a possibility in each that no prosecution would ever begin. In *Mathis*, the Court found that the possibility that criminal prosecutions might result was sufficient to require full *Miranda* protections, including the presence of counsel to guard against erosion of the fifth amendment privilege.[88] In *Baxter*, on the other hand, the Court held that the interrogations were not part of a criminal proceeding.[89] This analysis is insufficient to distinguish *Baxter* from *Mathis*, which applied full *Miranda* protections to a custodial interrogation although the investigation was a routine one unrelated to the reason for defendant's imprisonment. Further, it ignores the fact that the essence of *Mathis* and *Miranda* was the protection of the fifth amendment privilege against self-incrimination, not the assurance of the right to counsel under the sixth and fourteenth amendments.[90]

The Court had previously held that custodial interrogation is inherently coercive and produces a clear threat to the fifth amendment

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weight, although they assume that it would be insufficient in itself for a decision to discipline. *See* 96 S. Ct. at 1559 n.4, 1564-65 n.6.

85. *Id.* at 1555. Some indication of the Court's inattention to the power of this phrase is that the decision initially described the pronouncement as being that the inmate's silence *would* be held against him, and later said that Palmigiano was told that his silence *could* be held against him—a considerably weaker, less intimidating, less coercive warning. *Compare id.* at 1555 *with id.* at 1556.

86. *See* text accompanying notes 65-70 *supra* for a discussion of these cases.

87. 96 S. Ct. at 1556.

88. 391 U.S. at 4-5.

89. 96 S. Ct. at 1556.

90. *See* Mathis v. United States, 391 U.S. 1, 4-5 (1968); Miranda v. Arizona, 384 U.S. 436, 458-66 (1966).

privilege any time an individual faces the possibility of self-incrimination at future criminal proceedings. *Baxter* was a case of custodial interrogation, and the consensus of the Court was that the fifth amendment applied.[91] It therefore defies logic to decide that the *Miranda* rights, set up as protections against threats to the privilege and affirmed in a similar situation in *Mathis,* do not apply in *Baxter.* When the Court eliminated the requirement of counsel in *Wolff,* it did so through the use of a balancing test appropriate to limit the reach of the sixth amendment through the due process clause. In *Baxter* the Court erroneously extended the sixth amendment/due process balancing test to a situation where the presence of counsel was required as a protection for the fifth amendment privilege against self-incrimination. Utilization of a valid limitation of the due process clause to remove any portion of the privilege against self-incrimination tarnishes the respected position of broad construction and expansive application it has occupied throughout its history.

The privilege against self-incrimination has always been liberally construed because a strict construction limits its effectivness.[92] In its treatment of prison disciplinary hearings, the Supreme Court cut sharply into the philosophic underpinnings of the privilege by yielding to the assumption that a party claiming that privilege is guilty or is committing perjury.[93] *Baxter* affects a small class of people, but for those prisoners the Court has taken action that could reduce the privilege to "a hollow mockery."[94] Moreover, the area in which the Court has chosen to limit severely both the absolute application and the effectiveness of the fifth amendment is one in which the privilege is probably the most necessary:

> Innocent men are more likely to plead the privilege in secret proceedings, where they testify without advice of counsel and without opportunity for cross-examination, than in open court proceedings, where cross-examination and judicially supervised procedures provide safeguards for the establishing of the whole, as against the possibility of merely partial, truth.[95]

The Court held in *Wolff* that prisoners faced with disciplinary hearings were denied the instrumentalities of confrontation, cross-examination, and counsel necessary to present a defense. After *Baxter,* an inmate is

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91. *See* note 73 and accompanying text *supra.*

92. Garrity v. New Jersey, 385 U.S. 493, 515 (1967), *quoting* Boyd v. United States, 116 U.S. 616, 635 (1886).

93. Slochower v. Board of Higher Educ., 350 U.S. 551, 557-59 (1956).

94. *Id.* at 557.

95. Grunewald v. United States, 353 U.S. 391, 422-23 (1957).

forced to speak and risk incriminating himself both at the disciplinary hearing and possibly in future criminal proceedings[96] or to keep silent and accept the burden of giving up his defense while presenting an admission of his guilt to the disciplinary board.[97] The combined effect of the two decisions is to place the prisoner in a procedural vise from which there is no foreseeable release.

ELLEN KABCENELL WAYNE

## Equal Credit Opportunity Act Amendments of 1976—An Overview of the New Law

As the American consumer credit industry has grown, lawmakers repeatedly have turned to legislation and regulation in an effort to control abuse and discourage the development of unfair credit policies.[1] Part of this effort is represented by the Equal Credit Opportunity Act Amendments of 1976,[2] passed in March, 1976, only five months after the original legislation became effective.[3] The most ambitious and controversial amendments expand the existing ban on discriminatory credit-granting procedures, impose new disclosure requirements on lending institutions and increase the statutory limits on creditor liability. Creditors insist that these amendments and the corresponding regu-

96. In light of the Court's view that *Miranda* is completely inapplicable to this situation, it is unclear whether the absence of protection for the fifth amendment privilege would cause self-incriminatory testimony given at a disciplinary procedure to be excluded from a later criminal trial.

97. 328 F. Supp. at 778.

1. Legislation in this area includes the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 1730f, 1831b, 2601-2617 (Supp. V 1975), and the Consumer Credit Protection Act, 15 U.S.C.A. §§ 1601-1691f (West 1974, Cum. Supp. 1976, Supp. Pamphlet No. 1 1976, & Supp. Pamphlet No. 2, pt. 1 1976). The latter encompasses the Truth in Lending Act, 15 U.S.C.A. §§ 1601-1667e (West 1974, Cum. Supp. 1976, Supp. Pamphlet No. 1 1976, & Supp. Pamphlet No. 2, pt. 1 1976), the Fair Credit Billing Act, 15 U.S.C.A. §§ 1666-1666j (West Cum. Supp. 1976 & Supp. Pamphlet No. 2, pt. 1 1976), and the Equal Credit Opportunity Act, 15 U.S.C.A. 1691-1691f (West Cum. Supp. 1976 & Supp. Pamphlet No. 2, pt. 1 1976).

2. Pub. L. No. 94-239, 90 Stat. 251 (codified at 15 U.S.C.A. §§ 1691-1691f (West Supp. Pamphlet No. 2, pt. 1 1976)) (amending Equal Credit Opportunity Act of 1974, 15 U.S.C. §§ 1691-1691e (Supp. V 1975)) [hereinafter cited as amendments].

3. The original Equal Credit Opportunity Act, 15 U.S.C. §§ 1691-1691e (Supp. V 1975), became effective Oct. 28, 1975. Pub. L. No. 90-321, § 707, 88 Stat. 1525 (1974).

lations will create a new maze of paperwork and increase the threat of capricious lawsuits, thus making credit more expensive and less available to those in need, while driving the smaller creditor from the market. Consumer advocates see the legislation as a way to extend credit to worthy persons struggling in an economic system that makes credit a necessity of life. It is too early to determine the precise impact of the amendments on either consumers or the credit industry as a whole. It is possible, however, to outline those key provisions that are most likely to bring about change in current credit-granting procedures. An evaluation of those provisions must consider not only the policy issues behind congressional action but also any potentially counterproductive results of the new law.

Despite the massive and complex credit legislation Congress has passed since 1968 there has been little protection for the consumer who is denied credit on grounds not logically related to the evaluation of a good credit risk. Testimony at congressional hearings in 1973 revealed unsurprising patterns of inherently discriminatory credit-granting procedures, particularly with regard to women and the elderly.[4] Some of the criticized procedures were clearly offensive;[5] others, though neutral in motive, were discriminatory in effect.[6] Congress responded to the hearings, and to extensive lobbying pressure from women's groups, by passing the Equal Credit Opportunity Act of 1974 (the Act).[7] The Act barred discrimination on the basis of sex or marital status but omitted several significant protection and enforcement provisions considered crucial by consumer advocates.[8]

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4. *Hearings on the Economic Problems of Women Before the Joint Economic Comm.*, 93d Cong., 1st Sess. (1973) [hereinafter cited as *Joint Comm. Hearings*]; *Hearings on H.R. 14856 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking and Currency*, 93d Cong., 2d Sess. (1973).

5. There have been reports that when a married couple applied for a home loan, some loan officials discounted the wife's income unless the wife had had a hysterectomy. *Joint Comm. Hearings, supra* note 4, at 192 (setting forth the practice of Veterans Administration loan officials as an example).

6. It was also common practice to discount a mortgage applicant's part-time income as unreliable; this has had an adverse effect on women who make up a great percentage of the part-time work force. Comment, *Equal Credit: Promise or Reality?*, 11 HARV. C.R.-C.L. L. REV. 186, 196-97 (1976).

7. 15 U.S.C. §§ 1691-1691e (Supp. V 1975). An overview of the law is provided in Note, *Consumer Protection: The Equal Credit Opportunity Act*, 28 OKLA. L. REV. 577 (1975). The impact of the 1974 Act and accompanying regulations on lenders is discussed in Mortimer, *A Creditor's Preliminary Look at Regulation B*, 93 BANKING L.J. 417 (1976). The impact of the Act on low-income persons is discussed in Baker & Taubman, *The Equal Credit Opportunity Act: The Effect of the Regulations on the Poor*, 9 CLEARINGHOUSE REV. 543 (1975).

8. For instance, in noting the Federal Reserve Board's failure to include a re-

The ensuing attempt by the Federal Reserve Board (the Board) to promulgate regulations implementing the 1974 Act produced hard-fought debate of the kind that might well have preceded the drafting of the bill itself.[9] The regulations as finally promulgated were a disappointment to many consumer advocates who had hoped the Board might take the broadest possible view of the legislation by requiring more affirmative activity on the part of creditors. In addition to their displeasure with the regulations, some congressmen and consumer groups were still committed to expanding the legislation's coverage to protect other groups historically denied credit for irrelevant reasons.[10] To incorporate these needs into the existing legislative framework, Congress in 1975 instituted a new round of hearings,[11] which culminated in the passage of the Equal Credit Opportunity Act Amendments of 1976.

Once again, the Federal Reserve Board must implement this legislation; proposed rules are currently in print[12] and hearings are being held to solicit public and industry reaction.[13] The expanded scope of the Act along with new procedural and enforcement devices provided by the amendments unfortunately has created new ambiguities. In an effort to address these ambiguities the Board has proposed detailed rules that may create traps even for the creditor who in good faith attempts to comply with the law.[14] Such a maze of complex rules also

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quirement for explanation of denial of credit by the creditor, Representative Patterson said, "These regulations . . . almost make it impossible for the system designed by the Congress to be used at all." 121 CONG. REC. E5351 (daily ed. Oct. 8, 1975).

9. Proposed rules were published in April, 40 Fed. Reg. 18,183 (1975), but were not satisfactory to creditors so a revised version was published a few months later, 40 Fed. Reg. 42,030 (1975). Women's groups and consumer advocates found these rules too weak and urged that further changes be made. The final regulations, 40 Fed. Reg. 49,298 (1975)—published one week before the deadline set by the legislation—represent an attempt at compromise.

10. A bill introduced by Senator Biden also would have prohibited discrimination on the basis of "political affiliation," and would have given the Board authority to establish "such other classifications" as were found appropriate. S. 1927, 94th Cong., 1st Sess. § 701, *reprinted in Equal Credit Opportunity Act Amendments and Consumer Leasing Act—1975: Hearings on S. 483, S. 1900, S. 1927, S. 1961 and H.R. 5616 Before the Subcomm. on Consumer Affairs of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. (1975) [hereinafter cited as *1975 Hearings*].

11. *1975 Hearings, supra* note 10.

12. 41 Fed. Reg. 29,877 (1976).

13. *Id.* at 29,870.

14. For instance, in an effort to protect married women from being unfairly penalized in a credit scoring scheme because they do not have phone listings, the proposed rules stipulate that a creditor "shall not take into account the existence of a telephone listing in the name of the applicant" but may consider "the existence of a telephone

makes it difficult to identify consumer rights and remedies under the law. In order to construe the amendments and the rules in the face of this potential confusion it is important to identify the policy considerations underlying the legislation: Therefore, a review of the amendments' most significant provisions must focus upon their intended impact and attempt to identify potential pitfalls facing consumers and creditors.

## THE "STATEMENT OF REASONS" CLAUSE

Potentially the most significant provision of the 1976 amendments is the "statement of reasons" clause.[15] As approved, this provision states that creditors are obligated to provide any rejected credit applicant who so requests with "specific reasons" explaining the denial. In contrast, the original Senate bill, which received the support of many consumer advocates, would have required that such reasons be given automatically to the rejected applicant at the time he or she was informed of the adverse action.[16]

Although resigned to some degree of additional regulation, creditors fought at least to limit the proposed legislative provisions; the modified "statement of reasons" clause represents one of their victories. However, examination of the motives behind the opposition to this section indicate that the "victory" may be less important than it seemed.

Creditors have cited increased cost as the main reason for their objections to the clause,[17] but in light of other legislative requirements

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in the residence of an applicant . . . ." 41 Fed. Reg. 29,881 (1976) (proposed rule § 202.6(b)(3)).

15. (2) Each applicant against whom adverse action is taken shall be entitled to a statement of reasons for such action from the creditor. A creditor satisfies this obligation by—

(A) providing statements of reasons in writing as a matter of course to applicants against whom adverse action is taken; or

(B) giving written notification of adverse action which discloses (i) the applicant's right to a statement of reasons . . . .

(3) A statement of reasons meets the requirements of this section only if it contains the specific reasons for the adverse action taken.

15 U.S.C.A. § 1691(d)(2), (3) (West Supp. Pamphlet No. 2, pt. 1 1976).

16. "A creditor shall promptly furnish each applicant who has applied for credit and to whom credit is denied or terminated a clear and meaningful statement in writing of the reasons for the denial or termination." S. 1927, 94th Cong., 1st Sess. § 701(d), *reprinted in 1975 Hearings, supra* note 10, at 148.

17. Sears, Roebuck and Co. prepared data indicating that each letter of rejection could cost over $5.00 to prepare, and that multiplied by the new account rejections in 1974, the cost of sending such letters would be over $8 million. *1975 Hearings, supra* note 10, at 402. This assumes that each letter would be individually drafted and typed.

this reason may not be valid. For example, creditors are required to inform rejected applicants in writing of adverse action taken on any applications.[18] Thus, if an applicant requests an explanation of the credit denial the lendor is required to write a second time, providing the statement of reasons. This statement may take the form of a prepared checklist[19] on which the creditor would check appropriate explanatory phrases. By automatically including this statement with the first letter, the lender saves the time, effort and expense of preparing a second response.

The advantages of such a checklist may convince creditors to go beyond the minimal response required by the legislation; indeed some creditors already are employing this system.[20] Direct and honest communication with a potential customer is likely to produce public good will, which is particularly important to a service industry whose community reputation is a critical business consideration.[21] An individual applicant may respond favorably to a clear explanation of his or her failure to qualify for credit and may be encouraged to reapply after meeting the appropriate requirements.

The automatic statement also decreases the likelihood that an applicant will deny having received a response to his or her request for a written explanation of the adverse action. Thus it seems possible that from a business standpoint, creditors may be convinced to go beyond the requirements of the law, despite their prior vigorous opposition to the "statement of reasons" section. The advantages of incurring the additional expense involved may be more convincing if substantial judgments are awarded against lenders who violate this provision of the law.

18. A creditor must give the applicant a written statement of the reasons for the rejection or notify the applicant in writing of his or her right to have such a statement. 15 U.S.C.A. § 1691(d)(2), (3) (West Supp. Pamphlet No. 2, pt. 1 1976), *quoted in* note 15 *supra*.

19. The Board's proposed rules include a sample checklist which, if properly completed by the creditor, establishes compliance with the "specific reasons" requirement. 41 Fed. Reg. 29,882 (1976) (proposed rule § 202.9(b)(2)).

20. Representatives of National BankAmericard testified at congressional hearings that in the interest of public relations, member banks are encouraged to employ alternative form letters and inform the rejected applicant of why he or she was not awarded credit. *1975 Hearings, supra* note 10, at 367. Informal inquiry by the author reveals that North Carolina Wachovia banks offering MasterCharge are instructed to include a checklist explanation when informing a customer that his or her MasterCharge application is not being accepted.

21. "[F]or the most part there is no national market for consumer credit. Consumers seldom shop for credit outside their town or city . . . ." NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 11 (1972) [hereinafter cited as NCCF REPORT].

Although it is difficult to predict, it seems unlikely that large numbers of credit applicants will request the written explanation to which they are entitled.[22] In light of this fact, it would seem that the goal of establishing a more critical and informed class of consumers would have been better achieved by requiring automatic disclosure of the reasons for rejection. Nevertheless, the "specific reasons" clause establishes the principle that a credit applicant is entitled to know why a lending institution did not find him to be an acceptable credit risk. Recognition of this principle is, in itself, an important development, even if the legislation's precise language does not go far enough toward encouraging the growth of an informed class of credit consumers.[23]

### CLASSIFICATION OF BORROWERS

Less concrete protection for the credit consumer is found in the statute's specification of particular categories of people against whom creditors cannot discriminate.[24] Although the categories of race,[25] color, religion and national origin are potentially important, the inclusion of a prohibition on age discrimination has proved to be the most controversial. Here again, industry representatives achieved their objectives by convincing legislators that if the category of age were added as a protected classification, it should not be barred from use as a factor

22. While not definitive, an informal questionnaire mailed to selected member banks by National BankAmericard indicated that 10-15% of rejected applicants contact the bank for further information when invited to do so; for those banks that did not invite inquiry only 1% inquired. *1975 Hearings, supra* note 10, at 375-82.

23. By including the "statement of reasons" provision Congress also expressed a desire to provide a victim of credit discrimination with potential courtroom evidence. Although a creditor is not going to explain the applicant's rejection in terms of discriminatory motives, a rejection statement based on clearly inappropriate reasons will make better legal ammunition than no statement at all. *See* SENATE REP. No. 94-589, 94th Cong., 2d Sess. 8, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 635, 642.

24. 15 U.S.C.A. § 1691(a) (West Supp. Pamphlet No. 2, pt. 1 1976) reads as follows:

> (a) It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction—
>
> (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);
>
> (2) because all or part of the applicant's income derives from any public assistance program; or
>
> (3) because the applicant has in good faith exercised any right under this chapter.

25. A 1975 pilot survey confirmed the existence of racial discrimination by showing that black applicants for mortgage loans are turned down almost twice as frequently as white applicants of similar economic circumstances. COMPTROLLER OF THE CURRENCY, ADMINISTRATOR OF NATIONAL BANKS FAIR HOUSING PRACTICE PILOT PROJECT, 1975, *reprinted in 1975 Hearings, supra* note 10, at 481-526.

in credit scoring schemes. In effect, the amendments ban only the arbitrary use of age when making credit decisions.[26] For instance, the young person having difficulty obtaining a loan because he or she lacks a credit rating may find this legislation of little help; creditors still will be able to deny credit on that ground.[27] The new law would appear to prohibit some of the discriminatory practices cited in the legislative record,[28] though creditors can inquire about age in relation to other "valid" credit factors such as credit history and employment record. If the amendments do result in credit extension to some elderly persons presently denied credit in an arbitrary manner, creditors should not foresee economic loss. Studies suggest[29] and common sense reinforces the notion that persons over sixty-five often are better able to assess their ability to repay loans, have better credit histories and are in general more conservative about assuming debts.

The prohibition of age discrimination was particularly intended to protect the elderly; however, the effects of expanding the law's coverage to additional groups (the terms "race," "color," "religion," "national origin" and "age" are new) may well go beyond protection of each individual classification. Because the persons now protected from discriminatory credit-granting practices include those Americans historically denied equal opportunity in many social and economic spheres, the language suggests that Congress would favor broad and inclusive judicial construction of the equal credit opportunity legislation.[30]

26. The amendments prohibit discrimination on the basis of age but provide that the creditor may make inquiries concerning age to determine "probable continuance of income levels [or] credit history." 15 U.S.C.A. § 1691(b)(2) (West Supp. Pamphlet No. 2, pt. 1 1976). Age may be considered in an "empirically derived credit system" if such a system does not operate so that the age of an elderly applicant is given a "negative factor or value." *Id.* §§ 1691(b)(2), (3). These quoted terms are defined by the Board in the proposed rules at 41 Fed. Reg. 29,872 (1976) (proposed rules § 202.2(o) & (u)). At least one commentator has suggested that the legislation will "preclude age as a meaningful component of a credit scoring system" because whenever one age bracket is given favorable treatment the result is to "discriminate" against other age groups. Comment, *The 1976 Amendments to the Equal Credit Opportunity Act*, 28 BAYLOR L. REV. 633, 641 (1976).

27. If a rejected applicant could establish that basing credit denials on lack of credit rating results in disproportionate rejection of persons under age 26, it seems likely that a creditor would be able to justify his position by showing that lack of credit rating has a "manifest relationship to creditworthiness," as this phrase is used in the Board's proposed rules. 41 Fed. Reg. 29,879, 29,880 n.7 (1976) (proposed rule § 202.1(x), .6(a)). For another proposed rule on this issue, see note 42 *infra*.

28. Apparently many creditors, particularly banks offering credit checking accounts, automatically terminate credit extension when the customer reaches age 65. *1975 Hearings, supra* note 10, at 78-92.

29. *1975 Hearings, supra* note 10, at 438.

30. On the other hand, a specific test as opposed to a more general prohibition of "discrimination based on immaterial grounds" leaves unprotected specific groups of

CIVIL LIABILITY

Broad construction and successful consumer litigation will not alone deter those creditors who are determined to continue violating the letter and the spirit of the law. In those cases, it seems that only severe financial penalties will provide an effective deterrent; the amendments' liability provisions represent an effort to create such a deterrent. In addition to actual damages, costs and attorneys' fees, an individual may recover up to $10,000 in punitive damages; for class actions, punitive damages are limited to $500,000 or one percent of the creditor's net worth, whichever is less.[31] It should be noted that these terms represent a considerable concession to the industry. The originally proposed limits—$50,000 or one percent of net worth, whichever was greater[32]—were rejected, presumably because committee members did not favor multi-million dollar recoveries of punitive damages.[33]

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persons such as the physically handicapped. The committee rejected a provision in the Senate bill that would have allowed the Board to add new classifications, presumably on the ground that such a grant of authority would permit an executive body to exercise powers reserved to the legislature. S. 1927, 94th Cong., 1st Sess. § 701(a)(b) (1975), *reprinted in 1975 Hearings, supra* note 10, at 147.

31. 15 U.S.C.A. § 1691e (West Supp. Pamphlet No. 2, pt. 1 1976) reads in part as follows:

> (a) Any creditor who fails to comply with any requirement imposed under this subchapter shall be liable to the aggrieved applicant in an amount equal to the sum of any actual damages sustained by such applicant acting either in an individual capacity or as a representative of a class. . . .
>
> (b) Any creditor . . . who fails to comply . . . shall be liable to the aggrieved applicant for punitive damages in an amount not greater than $10,000 . . . except that in the case of a class action the total recovery under this subsection shall not exceed the lesser of $500,000 or 1 per centum of the net worth of the creditor. . . .
>
> . . . .
>
> (d) In the case of any successful action . . . the costs of the action, together with a reasonable attorney's fee as determined by the court, shall be added to any damages awarded . . . .

32. S. 1927, 94th Cong., 1st Sess. § 706(b) (1975), *reprinted in 1975 Hearings, supra* note 10, at 150.

33. The proposed and adopted provisions produce vastly different results, as an example will illustrate. Assume a successful class action is brought against Sears, Roebuck Acceptance Corporation (net worth approximately $707,000,000). Under the provisions as proposed, liability could be as high as $7,070,000. As adopted, the legislation would limit liability to $500,000. Actual damages, costs and fees must be added to these figures.

The results are also significantly different in relation to a small creditor, whose net worth is, for instance, $50,000. Under the section as proposed, he could lose his entire business in a successful class action suit. As the law now stands, liability for punitive damages could not exceed $500 in his case. These larger awards could be limited if the class did not include enough members, since no individual can recover more than $10,000. (Sears Roebuck Acceptance Corporation net worth figures for 1974 appear in *1975 Hearings, supra* note 10, at 281.)

The compromise $500,000 figure (increased from $100,000 in the Equal Credit Opportunity Act[34]) was designed to provide incentive for class actions while discouraging the frivolous litigation some feared would occur if recovery were limited only by the one percent ceiling. While this may discourage class actions when the class includes more than fifty persons,[35] commentators have pointed out that class actions may not be the appropriate remedy for so personal and subjective an act as discrimination.[36]

Only a class action, however, can result in the tremendous financial sanctions that would deter a creditor from repeatedly violating the law. Individual actions, which are limited to a $10,000 recovery,[37] provide a remedy for the applicant but at small relative cost to the creditor. It is the threat of larger losses that, in theory, creates the motivation to comply. This motivation is inevitably weakened by limiting the scope of the class action. The conflict over the liability provisions reflects a broader controversy surrounding the class action device itself.[38] While imperfect, and vulnerable to attorney abuse, the class action remains the most significant private tool available for challenging a discriminatory credit practice that violates numerous persons' rights under the law but does not result in actual damages.[39]

However, creditors were quick—and correct—to point out that the amendments do not limit recovery of punitive damages to situations of intentional or knowing violation of the law.[40] The committee report

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34. 15 U.S.C. § 1691e(c) (Supp. V 1975) (amended 1976).

35. In theory, this is because an individual could not recover the maximum individual award of $10,000 if the maximum class action award had to be split into more than 50 shares.

36. *See 1975 Hearings, supra* note 10, at 627; Note, *Consumer Protection: The Equal Credit Opportunity Act*, 28 OKLA. L. REV. 577 (1975). On the other hand, the class action would seem the perfect way to attack a policy that arbitrarily puts a blanket end to credit checking accounts when customers reach the age of 65. *See* note 28 *supra*.

37. *See* note 31 *supra*.

38. Discussion of the class action as a consumer tool is found in Fetterly, *The Application of the Class Action to Consumer Litigation*, 24 FED'N INS. COUNSEL Q. 4 (1973); Landers, *Of Legalized Blackmail and Legalized Theft: Consumer Class Actions and the Substance-Procedure Dilemma*, 47 S. CAL. L. REV. 842 (1974).

39. In addition to private civil actions, the amendments authorize the Attorney General to bring civil suits "whenever he has reason to believe that one or more creditors are engaged in a pattern or practice in violation [of the law]." 15 U.S.C.A. § 1691e(h) (West Supp. Pamphlet No. 2, pt. 1 1976).

40. 15 U.S.C.A. § 1691e(b) (West Supp. Pamphlet No. 2, pt. 1 1976) provides that

> [i]n determining the amount of [punitive] damages in any action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the cred-

suggests that liability should be determined by applying the now famous "effects test," which grew out of employment discrimination cases.[41] This would shift to the creditor-defendant the burden of proving that credit practices that result in rejection of disproportionate numbers of persons in protected classes are material to making sound credit decisions. Translating these courtroom burdens of proof into business procedures designed to avoid litigation suggests the employment of a scheme of affirmative review by creditors. Such a scheme would require a review of application procedures to determine if disproportionate numbers of persons in protected classifications were being rejected as poor credit risks.[42] If this were occurring, the creditor would have to determine if the application qualifications responsible for this result were necessary to assess credit risks validly. Even if such qualifications were materially related to assessing credit risks, a broad application of the "effects test" would seem to require that the creditor make some effort to devise other qualifications that would further the desired evaluation process without producing the accompanying discriminatory effect.

Whether creditors seek to avoid litigation by instituting such an affirmative review system will depend on how aggressively consumers pursue their rights (particularly in the form of class actions) and also on how broadly courts apply the "effects test" as outlined in race discrimination and employment cases. By suggesting that the courts examine impact in addition to intent, it would seem that Congress has expressed support for procedural devices that will spread the costs of

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itor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional.

The proposed rules indicate that an "inadvertent error" is not a violation of the "statement of reasons" requirement, 41 Fed. Reg. 29,883 (1976) (proposed rule § 202.9(e), but "inadvertent error" is narrowly defined. 41 Fed. Reg. 29,883 (1976) (proposed rule § 202.10(c)).

41. In determining the existence of [unlawful] discrimination . . . courts or agencies are free to look at the effects of a creditor's motives or conduct in individual transactions. Thus judicial constructions of anti-discrimination legislation in the employment field in cases such as *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), and *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975) are intended to serve as guides in the application of this act . . . .

SENATE REP. No. 94-589, 94th Cong., 2d Sess. 4-5, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 635, 638.

42. The proposed rule specifically proscribes in several instances . . . the use of insufficiently refined general information which is accordingly not causally related to a determination of creditworthiness where the effect of using such information would be to discriminate against an applicant on a prohibited basis, even though the creditor may have no intent to discriminate.

41 Fed. Reg. 29,880 n.7 (1976) (proposed rule § 202.6(b)).

correcting social problems among businesses and industries that have profited from the advantages of the American market.

### POTENTIAL PROBLEMS

The "effects test," however, has been developed and expanded on a case by case basis over time.[43] It is the prospect of having to employ legal counsel to interpret the test's requirements that prompts creditors to complain of overregulation and unwarranted government intrusion. Even if actual costs of disclosure and application-form revision are kept to a minimum, there is still an expressed fear that the additional regulation and its accompanying legal complexities could force the small lender out of the credit business.[44] In an effort to address this concern Congress included a provision exempting the very small creditor from the "statement of reasons" requirement.[45] Nonetheless, many creditors have seemed overwhelmed by the complexity of the new law, the increasing need for legal advice in order to comply with its provisions and the potential for litigation.[46] Even the most clearly worded regulations may not dispel this fear, given the complex nature of the credit industry.[47] At worst this development could mean a reduction in the number of middle-level creditors as they relinquish their share of the market to the giants of the industry. For instance, a businessman who extends credit as part of a small retail operation may opt for a major credit card arrangement to avoid potential litigation.

A reduction in the number of small creditors would work against consumer interests, if only because there would be fewer alternative

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43. *See* Boston Chapter NAACP v. Beecher, 504 F.2d 1017, 1019 (1st Cir. 1974), *cert. denied*, 421 U.S. 910 (1975), in which the court found that particular employment requirements were not sufficiently job-related to justify their discriminatory effects. *But see* Parrish v. Board of Comm'rs, 533 F.2d 942, 949 (5th Cir. 1976), in which the court ruled that although the state bar examination resulted in disproportionate rejection of black applicants, the test as administered was a legitimate evaluation of job-related skills.

44. *See* note 46 *infra*.

45. 15 U.S.C.A. § 1691(d)(5) (West Supp. Pamphlet No. 2, pt. 1 1976) exempts from the "statement of reasons" requirement those creditors "who did not act on more than one hundred and fifty applications during the calendar year preceding the calendar year in which the adverse action is taken."

46. This concern was expressed by a small retailer from Massachusetts; that state has enacted credit legislation similar to the federal law. MASS. ANN. LAWS ch. 151B, § 4(3B), (4), (10), (12), (14), (15) (Michie/Law. Co-op 1976). The retailer said that in his town in one month alone "11 independent retailers went from their own charge into Bank charges because they felt they couldn't comply with the Massachusetts regulations." *1975 Hearings, supra* note 10, at 387.

47. NCCF REPORT, *supra* note 21, at 207.

lending schemes available. It seems likely that a nationwide credit and finance company would establish less flexible policies than a local merchant familiar with his market and more willing to extend credit to a local resident. With fewer existing systems of assessing credit charges, the consumer is less able to fit payment plans to his or her individual needs.[47] And fewer creditors means, at least in theory, less competition to keep down the price of money.[48]

Whether a reduction in the number of small creditors will be an inevitable result of increased industry regulation is difficult to predict, because it depends on small lenders' perception of the law as much as on the law itself. However, this legislation is only a small part of the overall problems faced by small businesses today. It is unlikely that repeal of the amendments would help a small businessman as much as would clear regulations setting forth for the well-intentioned creditor a plan or policy that would establish compliance with the law.[49] Ultimately, some degree of complexity will be inevitable and must be accepted as part of an increasingly interdependent and technologically sophisticated society. Although the legislators were made aware of the small businessman's problems, the committee report accompanying the amendments leads to the conclusion that Congress' overwhelming priority was to halt the policies that have made it virtually impossible for some American credit consumers to participate in the existing American economic framework.[50]

In order to predict how successful the amendments will be in achieving this congressional goal it is important to recognize the limitations of the legislation. The amendments represent an attempt to re-

48. Less competition would mean the possibility of collective price setting, less service for high-risk customers and prevention of entry into the market by potential competitors. *Id.* at 209-11.

49. For instance, use of the Board's proposed checklist of credit criteria constitutes compliance with the "statement of reasons" requirement. *See* note 19 *supra.* If extended too far, however, this device could be used to shift the risk of noncompliance to the Board; it is therefore important that the Board make clear, as it has in its proposed rules, that Board members will not have "authority to approve particular creditors' forms in any manner." 41 Fed. Reg. 29,878 (1976) (proposed rule § 202.1 (c)(5)).

50. Senator Jesse Helms did not share the view that federal legislation is the best way to achieve the stated goals:

> These amendments are just one more nail in the coffin of the right of the individual to have local matters determined by the State legislatures. . . .
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> . . . .
>
> Not only has the Congress been encroaching on [the] right[s] of the States . . . it has also usurped much of the vital decisionmaking power formally exercised by business and consumers in a free market.

122 CONG. REC. S1021 (daily ed. Feb. 2, 1976).

dress grievances that are inextricably wound with much larger social, political and economic problems. While outlawing certain discriminatory credit-granting practices, the amendments do not challenge the catch-22 of the underlying economic system. Credit is often denied because the applicant does not have a credit history; for many this vicious circle cannot be broken. Persons with low incomes are often unable to obtain loans though they may be perfectly capable of slowly repaying a small loan. And because credit has become so integral a part of the American economic system[51] the individual defined as a "bad" credit risk all too frequently turns to the thriving underworld of loan sharks and extortionists.

And yet if credit is going to remain an important tool for improving the standard of living, as well as for aiding the individual through temporary periods of financial difficulty, it is imperative that such a tool be universally available. If the amendments result in efforts on the part of lending institutions to reassess established credit scoring schemes, as well as in greater consumer understanding of creditors' lending criteria, they should be called a success.[52]

DONNA HELEN TRIPTOW

## Federal Jurisdiction—Environmental Law—Do Private Citizens Have a Right To Bring Action To Abate Water Pollution Under Federal Common Law?

The Federal Water Pollution Control Act Amendments of 1972[1] set a goal of ending all pollutant discharges into navigable waters by 1985.[2] This lofty goal will be difficult to obtain[3] even with congres-

51. "Between . . . 1950 and 1971 consumer credit outstanding rose from $21.5 billion to $137.2 billion, an increase of over five times . . . ." NCCF REPORT, *supra* note 21, at 5.

52. The legislation, however, does not address the problems created by an ever-increasing national, corporate and individual debt. This increased debt is one manifestation of the "rising expectations" politicians have taught us to fear, but we are continually urged to "relax" and "charge it."

1. 33 U.S.C. §§ 1251-1376 (Supp. V 1975).

2. *Id.* § 1251(a)(1).

3. McThenia, *An Examination of the Federal Water Pollution Control Act Amendments of 1972*, 30 WASH. & LEE L. REV. 195, 208 (1973).

sionally mandated state and federal cooperation.[4] In *Committee for the Consideration of the Jones Fall Sewage System v. Train*,[5] the Fourth Circuit Court of Appeals turned down an opportunity to become involved in pollution control by further judical expansion of "specialized federal common law."[6] The court held that private citizens have no federal common law right to enjoin intrastate water pollution that is not enjoinable under the Federal Water Pollution Control Act Amendments of 1972.[7]

The Committee for the Consideration of the Jones Falls Sewage System complained that the city of Baltimore was discharging sewage into Jones Falls Stream. Plaintiffs first sought injunctive relief under the federal water pollution statutes,[8] but it soon appeared that they had no cause of action under the statutes because the city had submitted an application for a discharge permit under 33 U.S.C. § 1342(k),[9] which provides that discharges will not be a statutory violation during the pendency of a proper application. The authorizing agency found that the city was meeting the statutory standards and a permit was issued during the pendency of the litigation. The issuance of the permit prevented any relief under the federal statute, so plaintiffs amended their complaint to allege a federal common law right of action for an injunction[10] against additional connections to the sewer system that

4. *See* 33 U.S.C. § 1251(b) (Supp. V 1975).

5. 539 F.2d 1006 (4th Cir. 1976).

6. For a discussion of the development of "specialized federal common law" since the ban on "generalized federal common law" in Erie R.R. v. Tompkins, 304 U.S. 64 (1938), see Friendly, *In Praise of Erie—and the New Federal Common Law*, 39 N.Y.U. L. REV. 383 (1964).

7. 539 F.2d at 1007.

8. *Id.*

9. (Supp. V 1975). This section states in part:

> Compliance with a permit issued pursuant to that section shall be deemed compliance [with all statutory standards, except those imposed] for a toxic pollutant injurious to human health. Until December 31, 1974, in any case where a permit for discharge has been applied for pursuant to this section, but final administrative disposition of such application has not been made, such discharge shall not be a violation of [statutory standards], unless the Administrator or other plaintiff proves that final administrative disposition of such application has not been made because of the failure of the applicant to furnish information reasonably required or requested in order to process the application.

10. Injunctions for abatement of pollution have been granted on federal common law grounds. *See, e.g.*, Illinois v. Milwaukee, 406 U.S. 91 (1972); Texas v. Pankey, 441 F.2d 236 (10th Cir. 1971). *Illinois* involved a state seeking an injunction against a city of another state to abate water pollution. The Court felt that the national interest in pollution control and the interstate nature of the parties made it inappropriate to subject either party to the laws and processes of a foreign state, and consequently applied federal common law to permit the injunctive relief. 406 U.S. at 101-08.

was discharging pollutants into the stream.[11]

In the district court defendants moved to dismiss the complaint, alleging that the district court lacked subject matter jurisdiction or if jurisdiction was found, that the district court should elect not to exercise it under the doctrine of primary jurisdiction.[12] Defendants based their allegation of lack of subject matter jurisdiction on two premises: (1) that private citizens could not invoke federal common law to abate intrastate pollution of navigable waters, and (2) that the 1972 amendments to the Federal Water Pollution Control Act preempted the federal common law.[13] The district court held that only governmental units could invoke the federal common law cause of action to abate pollution of navigable waters,[14] and thus found it unnecessary to consider whether the 1972 amendments preempted the federal common law.[15]

The Fourth Circuit Court of Appeals affirmed the district court's decision and concluded that the amended complaint stated no claim upon which relief could be granted.[16] In reaching its decision the court of appeals indicated four reasons for not recognizing a body of federal common law conferring rights upon private citizens to enjoin pollution of intrastate waters not enjoinable under the Federal Water Pollution Control Act Amendments of 1972. The court first relied upon the *Erie Railroad v. Tompkins*[17] ban on general federal common law.[18] The

11. 539 F.2d at 1008.

12. Committee v. Train, 375 F. Supp. 1148, 1149 (D. Md. 1974). The doctrine of primary jurisdiction is often invoked when an administrative agency has been created to deal with problems that arise in a particular area, such as pollution control. The court will invoke that doctrine to deny jurisdiction to a plaintiff when it feels that the administrative agency is the proper body to decide the particular claim, or that plaintiff should exhaust any possible administrative remedies before the court grants jurisdiction. For a good discussion of the doctrine of primary jurisdiction in environmental litigation, see Hoffman, *The Doctrine of Primary Jurisdiction Misconceived: End To Common Law Environmental Protection?*, 2 FLA. ST. U.L. REV. 491 (1974). Neither the district court nor the court of appeals in *Committee v. Train* discussed or relied upon the doctrine of primary jurisdiction in its decision.

13. 539 F.2d at 1011 (dissenting opinion); 375 F. Supp. at 1153-55.

14. 375 F. Supp. at 1153-54. The district court felt that the federal common law respecting waters should be limited to governmental entities because it developed in disputes between states and the rationale of preventing subjection of one state to the laws and courts of another did not apply to disputes between citizens. *Id.*

15. 539 F.2d at 1011 (dissenting opinion); 375 F. Supp. at 1155.

16. 539 F.2d at 1010.

17. 304 U.S. 64 (1938). Justice Brandeis concluded that there was "no federal general common law." *Id.* at 78. Brandeis' decision was based upon considerations of the allocation of power in a federal system. Friendly, *supra* note 6, at 394-95; Monaghan, *The Supreme Court 1974 Term—Foreword: Constitutional Common Law*, 89 HARV. L. REV. 1, 10 (1975).

18. 539 F.2d at 1008. Until the *Erie* decision federal courts were often developing generalized federal common law to settle disputes, and this practice spread to substantive areas where no congressional action had been taken. *Erie* stopped the advance-

court of appeals acknowledged that a body of "new federal common law"[19] respecting waters has developed,[20] but it distinguished the *Committee v. Train* case from earlier cases[21] that had recognized a federal common law right to abate water pollution. As a second reason for denial of plaintiff's requested relief, the court recognized a distinction between governmental entity plaintiffs[22] in the earlier cases and private citizen plaintiffs in *Committee v. Train.*[23] The court's third ground for not applying the federal common law respecting waters was that *Committee v. Train* involved an intrastate stream rather than interstate waters.[24] The fourth reason given by the court of appeals was that the 1972 act of Congress preempted[25] any federal common law that would proscribe conduct permitted under the Act.[26]

An understanding of the development of federal common law since the *Erie* decision is necessary to analyze properly the basis for the court of appeals' decision in *Committee v. Train.* On the same day that *Erie* banned federal common law, the Supreme Court in *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*[27] began to develop "spec-

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ment of federal common law into areas of state rather than federal concern, but soon after *Erie* the federal courts began to develop specialized federal common law in areas of federal concern. *See* Monaghan, *supra* note 17, at 10-14. *See generally* Friendly, *supra* note 6.

19. Friendly, *supra* note 6.

20. 539 F.2d at 1008-09; *see* Illinois v. Milwaukee, 406 U.S. 91 (1972); Texas v. Pankey, 441 F.2d 236 (10th Cir. 1971).

21. Illinois v. Milwaukee, 406 U.S. 91 (1972); Texas v. Pankey, 441 F.2d 236 (10th Cir. 1971); United States v. Ira S. Bushey & Sons, Inc., 363 F. Supp. 110 (D. Vt.) *aff'd mem.*, 487 F.2d 1393 (2d Cir. 1973); United States *ex rel.* Scott v. United States Steel Corp., 356 F. Supp. 556 (N.D. Ill. 1973).

22. *See* cases cited note 21 *supra.*

23. 539 F.2d at 1009.

24. *Id.* at 1009-10.

25. *Id.* For a summary of the statutory provision legitimatizing discharges pursuant to a permit, see note 9 *supra.*

26. 539 F.2d at 1009. In a dissenting opinion Judge Butzner stated that there is a federal interest in ending pollution in Jones Falls Stream because of its effect on the Chesapeake Bay and because it is within the broad definition of navigable waters that Congress and the courts have determined to be under federal control. *Id.* at 1011-13. Butzner argued that the 1972 amendments are further evidence of a national interest in allowing plaintiffs relief in that the amendments provide private citizens with the right to bring suits to enforce effluent standards and preserve any common law cause of action. *Id.* Butzner recognized the specific statement in *Illinois v. Milwaukee* that federal common law applied to "navigable waters" rather than just interstate waters, and that *Illinois* was not limited to suits brought by states. *Id.* at 1013. The dissenting opinion emphasized the fact that it would be inconsistent to allow state courts to fill federal interstices. *Id.* at 1014. After concluding that plaintiffs had standing because of their particular injuries, Judge Butzner said that any preemption question should be decided only upon a consideration of the merits. *Id.* at 1014-16.

27. 304 U.S. 92 (1938).

ialized federal common law."[28] In resolving a controversy concerning interstate waters, the Court in *Hinderlider* concluded that federal courts should fashion federal common law when the interstate nature of a dispute makes it inappropriate that the law of either state should govern.[29]

In *Illinois v. Milwaukee*[30] the Supreme Court relied partially on federal common law respecting disputes among the states, developed in *Hinderlider* and subsequent cases,[31] to recognize a federal common law cause of action to abate pollution of navigable waters.[32] The state of Illinois sought an injunction to abate pollution of Lake Michigan by the city of Milwaukee.[33] The Court felt the interstate nature of the dispute and the national interest in pollution control merited relief under the federal common law.[34] The basic rationale behind the generation of federal common law to govern interstate disputes was said to be the necessity for avoiding subjection of one state's rights to an adjudication in the forum of another state or under the laws of another state.[35]

Many other areas of specialized federal common law have developed[36] since *Hinderlider*. Much of the federal common law has developed in response to a broad exception contained in *Erie* itself:

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28. Friendly, *supra* note 6, at 405.

29. 304 U.S. at 110.

30. 406 U.S. 91 (1972).

31. *See, e.g.*, Vermont v. New York, 417 U.S. 270, 277 (1974); Texas v. New Jersey, 379 U.S. 674, 677 (1965). *See generally* Monaghan, *supra* note 17, at 14.

32. Illinois v. Milwaukee, 406 U.S. 91, 104-05 (1972); Texas v. Pankey, 441 F.2d 236, 239-40 (10th Cir. 1971).

33. 406 U.S. at 93-94.

34. *Id.* at 105-08.

35. *See id.* at 104-05; Georgia v. Tennessee Copper Co., 206 U.S. 230, 237 (1907); Missouri v. Illinois, 180 U.S. 208, 241 (1901); Monaghan, *supra* note 17, at 14.

36. *See, e.g.*, Moragne v. States Marine Line, Inc., 398 U.S. 375, 381-403 (1970) (maritime law); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 421-27 (1964) (foreign relations); Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943) (overriding national interest).

A simple classification of the areas in which federal common law has developed is not easy to obtain. In Note, *The Federal Common Law*, 82 HARV. L. REV. 1512, 1519-26 (1969), one commentator has listed three categories of federal common law. The first category contains those cases that developed federal common law from the concept of national sovereignty, such as Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964). A second category includes those cases that developed federal common law because Congress has expressly or impliedly authorized the courts to develop law in an area. Examples of express authorization to the courts to develop law in an area are the Rules Enabling Acts, 28 U.S.C. §§ 2071-2072 (1970). The third category includes those cases that have created federal common law to formulate remedies for the breach of duties imposed by federal laws. An example of a court-created remedy for a breach of a duty imposed by federal legislation is the creation

"*Except in matters governed by the Federal Constitution or by the Acts of Congress,* the law to be applied in any case is the law of the State."[37] The most significant expansion of specialized federal common law has been in matters governed by acts of Congress.[38] Federal courts used specialized federal common law to fulfill legislative intent and fill federal statutory interstices.[39]

In *Committee v. Train* the Fourth Circuit observed that *Erie* had banned general federal common law and stated that the facts presented did not justify the application of specialized common law that had developed since *Erie.*[40] In particular, the court examined and rejected the line of cases that had evolved to settle interstate disputes.[41] The court noted that the rationale of protecting one state from subjection to another state's laws or courts[42] applied only to cases involving governmental entities complaining of pollution that was of an interstate character,[43] and not to cases involving private citizens complaining of pollution of a local nature.[44] The court's distinction between the *Committee v. Train* case and many earlier cases[45] that had applied federal common law to solve interstate disputes is sound; however, the court failed to consider other areas of federal common law development that might have been appropriate in the *Committee v. Train* context. Although the court was correct when it stated that the Supreme Court in *Illinois* had given the interstate nature of the

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of a private cause of action in Reitmeister v. Reitmeister, 162 F.2d 691, 694 (2d Cir. 1947), against a violation of an act of Congress making it a crime to intercept and divulge a telephone conversation.

37. Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938) (emphasis added).

38. Monaghan, *supra* note 17, at 10-14; *see* Friendly, *supra* note 6, at 405-22.

39. *See, e.g.,* Textile Workers v. Lincoln Mills, 353 U.S. 448, 456-57 (1957) (contracts between employers and labor organizations affecting interstate commerce); DeSylva v. Ballentine, 351 U.S. 570, 580 (1956) (patents and copyrights); Francis v. Southern Pac. Co., 333 U.S. 445, 450 (1948) (interstate carrier statutes); Huber Baking Co. v. Stroehmann Bros. Co., 252 F.2d 945, 952-53 (2d Cir. 1958) (unfair competition affecting interstate commerce).

40. *See* text accompanying notes 17-24 *supra.*

41. 539 F.2d at 1011 (dissenting opinion).

42. *See* text accompanying note 35 *supra.*

43. *See* Illinois v. Milwaukee, 406 U.S. 91 (1972); Reserve Mining Co. v. EPA, 514 F.2d 492, 520, 521, 532 (8th Cir. 1975); Texas v. Pankey, 441 F.2d 236 (10th Cir. 1971); United States v. Ira S. Bushey & Sons, Inc., 363 F. Supp. 110 (D. Vt.), *aff'd mem.,* 487 F.2d 1393 (2d Cir. 1973). *But see* United States *ex rel.* Scott v. United States Steel Corp., 356 F. Supp. 556 (N.D. Ill. 1973), in which it was held that Illinois, as well as the United States, has a right of action to abate water pollution even when no interstate effect was alleged. Illinois was allowed to rely on federal common law to abate pollution discharges from its own banks into Lake Michigan.

44. 539 F.2d at 1008-10.

45. *See* cases cited note 43 *supra.*

dispute and parties as a reason for its decision,[46] it failed to note that in that decision the Supreme Court also put great emphasis upon the national interest in water pollution control in its determination that there was a federal common law with respect to water pollution.[47]

An analysis of the Federal Water Pollution Control Act Amendments of 1972 and the history behind those amendments might have convinced the court that the pollution of Jones Falls Stream was a proper situation for application of specialized federal common law to fulfill federal legislative intent or to fill federal statutory interstices.[48] The goals of the 1972 amendments[49] are even stronger evidence of the national interest in pollution control than the water pollution legislation existing at the time of *Illinois*.[50] The court's concern in *Committee v. Train* that the pollution was not interstate might have been nullified by investigation into what waters are now considered subject to congressional control. The 1972 amendments apply to "navigable waters," which are defined as "waters of the United States, including the territorial seas."[51] Legislative history discloses that Congress intended "navigable waters" to "be given the broadest possible constitutional interpretation,"[52] and the Environmental Protection Agency has stated that the Act extends to tributaries of navigable waters.[53] With this broad range of waters encompassed by the statute it may logically be asserted that Congress intended to reach pollutant discharges in the waters of Jones Falls Stream that eventually flow into the Chesapeake Bay;[54] otherwise, the congressional goal of elimination of pollution in navigable waters by 1985 would be jeopardized.

The court's distinction in *Committee v. Train* between citizen plaintiffs and governmental entity plaintiffs[55] is also weakened by an analysis of the portion[56] of the 1972 amendments that authorizes citizens' suits to enforce certain provisions of the Act. This extension of federal rights to individual citizens could have been relied upon by

46. 406 U.S. at 103-05.
47. *Id.* at 101-04. The Supreme Court felt that federal legislative attempts to limit water pollution demonstrated the national interest in pollution control.
48. *See* text accompanying notes 37-39 *supra.*
49. *See* text accompanying notes 1-3 *supra.*
50. *See* text accompanying note 47 *supra.*
51. 33 U.S.C. § 1362(7) (Supp. V 1975).
52. S. REP. No. 92-1236, 92d Cong., 2d Sess. 144, *reprinted in* [1972] U.S. CODE CONG. & AD. NEWS 3776, 3822.
53. 40 C.F.R. § 125.1(p)(2) (1976).
54. 539 F.2d at 1011 (dissenting opinion).
55. *See* text accompanying notes 22-23 *supra.*
56. 33 U.S.C. § 1365 (Supp. V 1975).

the court as demonstrating a congressional intention that citizens be allowed the same rights as governmental entities under federal pollution laws, whether they be statutory laws or decisional common laws. The provision for citizen suits should be evidence of a national interest in allowing citizens to enter the fight against pollution. The validity of the distinction between the citizen plaintiff and the governmental entity plaintiffs is further weakened by the Supreme Court's refusal in *Illinois* to base its application of federal common law solely upon the nature of the parties in the disputes.[57]

The court's holding that the 1972 amendments preempted any federal common law right[58] must also be considered largely in light of the legislative intent. The court's reasoning that federal common law could not prohibit something that had been specifically permitted by Congress seems to be sound logically, but further investigation reveals some support for the continued viability of the federal common law. First, it should be noted that 33 U.S.C. § 1342(k) provides that pollutant discharges allowed under a permit are not violation of the statute,[59] but nothing within that provision says that compliance with the statute is compliance with the federal common law.[60] As is characteristic of environmental legislation, the 1972 amendments preserve "any right which any person (or class of persons) may have under any statute or common law."[61] This statutory clause preserves federal common law rights as well as state common law rights.[62] In *Illinois*

57. "[I]t is not only the character of the parties that requires us to apply federal common law." 406 U.S. at 105 n.6.

58. *See* text accompanying note 25 *supra*.

59. 33 U.S.C. § 1342(k) (Supp. V 1975).

60. At least two commentators believe that satisfaction of pollution control standards established by a legislature does not create a defense to a common law action to abate a nuisance. Hoffman, *supra* note 12, at 505-07; Maloney, *Judicial Protection of the Environment: A New Role for Common-Law Remedies*, 25 VAND. L. REV. 145, 156-57 (1972). Hoffman cites, *inter alia*, the following cases as supportive of his view: Illinois v. Milwaukee, 406 U.S. 91 (1972); Eastern Shore Natural Gas Co. v. Staufer Chem. Co., — Del. —, 298 A.2d 322 (1972); State *ex rel.* Shevin v. Tampa Elec. Co., 291 So. 2d 45 (Fla. Dist. Ct. App.), *cert. denied*, 297 So. 2d 571 (Fla. 1974); J.D. Jewell, Inc. v. Hancock, 226 Ga. 480, 175 S.E.2d 847 (1970); Lexington v. Cox, 481 S.W.2d 645 (Ky. 1972). Maloney compared the effect of statutory pollution control standards to that of statutory standards in negligence cases, saying that just as in negligence cases compliance with the statutory standard should not acquit the defendant of any charges based upon an alleged violation of common law standards. Maloney cited the following cases for his position that compliance with statutory standards is not conclusive on the question whether reasonable care has been exercised: Mitchell v. Hotel Berry Co., 34 Ohio App. 259, 171 N.E. 39 (1929); Curtis v. Perry, 171 Wash. 542, 18 P.2d 840 (1933).

61. 33 U.S.C. § 1365(e) (Supp. V 1975).

62. 539 F.2d at 1011 (dissenting opinion). For support of this view see note 60 *supra* and cases cited therein.

the Supreme Court said that the use of federal common law to abate pollution of navigable waters is permissible even though the remedy sought was not within the scope of remedies prescribed under the Federal Water Pollution Control Act.[63] In *United States v. Ira S. Bushey and Sons, Inc.*,[64] the court stated:

> What is important about *Illinois v. City of Milwaukee* . . . is the declaration there that the numerous laws Congress has enacted to prohibit or control pollution of interstate or navigable waters do not establish in themselves the exclusive means by which the federal policy concerning, and interest in, the quality of waters under federal jurisdiction may be protected in the federal courts.[65]

*Committee v. Train* is a significant limitation on the judicial expansion of specialized federal common law. Several commentators have expressed concern that federal courts are increasingly asserting federal common law in new and unusual areas.[66] The fear of expanding federal common law arises because such decisions bind state courts through the supremacy clause and allow judicial action in areas where power had been delegated only to Congress.[67]

*Committee v. Train* is also significant because of its possible adverse effect on pollution enforcement and the realization of the goals set by the Water Pollution Control Act Amendments of 1972. While the decision involved intrastate parties that arguably should be subject to state common law, the holding of the court seems to deny all private citizens access to the federal common law respecting water pollution. This denial may not be so harsh when the alleged nuisance is nearby and within the same state, but when a private citizen of one state is injured by a nuisance originating in another state, the denial of any access to federal common law to the injured individual and the consequent subjection of that individual to the laws and courts of the state where the nuisance originates appear harsh indeed. An injured individual's rights to a remedy should not be any different from the right

63. 406 U.S. at 103. It should be noted that the *Illinois* decision also said that future federal laws might preempt the federal common law. *Id.* at 107. The 1972 amendments, however, specifically preserve common law rights. 33 U.S.C. § 1365(e) (Supp. V 1975).

64. 346 F. Supp. 145 (D. Vt. 1972).

65. *Id.* at 149.

66. Monaghan, *supra* note 17, at 10-11; Note, *The Federal Common Law*, 82 HARV. L. REV. 1512 (1969).

67. Monaghan, *supra* note 17, at 10-11. Monaghan expresses concern that the federal courts are allowed to act in areas normally left only to Congress, but are not subject to the political checks imposed on Congress. *Id.* at 11.

of an injured state. Even if the courts and laws of the injured individual's state were allowed to adjudicate the matter "under modern principles of the scope of subject matter and in personam jurisdiction,"[68] the right of the alleged polluter would be determined by the laws and courts of another state. In either case, one citizen would be subjected to the laws and courts of a state where he had not performed any act. Furthermore, this subjection could be particularly ominous in the area of nuisance law, which normally involves balancing of interests.[69]

In addition to any problems that an injured individual might face in asserting jurisdiction over a nonresident, there is always the problem of enforcing extraterritorial injunctive decrees, especially when there is suspicion of partiality of judgment.[70] All these problems arising from an interstate pollution dispute suggest that the *Committee v. Train* denial of a federal common law cause of action to allow private citizens to abate pollution should be limited to its particular facts of intrastate citizens and should not extend to private citizens of different states.[71]

The court of appeals could have expanded the specialized federal common law to accommodate the private plaintiffs in *Committee v. Train* and supported that decision with an interpretation of legislative intent and a statement of national interest in water pollution abatement. It seems that the court balanced the evil of invading further the ideology of *Erie* and opposing specific statements of the Water Pollution Control Amendments of 1972 with the possible benefit that allowing citizens suits under federal common law might have on ending certain types of water pollution. Apparently, it concluded that it was better to avoid the evils rather than pursue the uncertain benefit.

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68. Ohio v. Wyandotte Chem. Corp., 401 U.S. 493, 500 (1971). Mr. Justice Harlan suggested that the courts of the injured party's state would have jurisdiction and the laws of the injured party's state would apply in a suit by an injured party against a polluter of another state.

69. Note, *Federal Jurisdiction—Environmental Law—Nuisance—State Ecological Rights Arising Under Federal Common Law*, 1972 WIS. L. REV. 597, 608-09.

70. "[T]he efficacy of any relief granted too often depends on the cooperation of a sister state's legal machinery in carrying out the injunction." *Id.* at 609 n.60.

71. The denial of access to the federal common law to private citizens also will hinder the achievement of uniformity of laws in an area of express national interest and concern.

## Labor Law—Superseniority for Union Stewards Held a Violation of the National Labor Relations Act

Employee seniority has been recognized by Congress and the courts as a legitimate part of the industrial structure,[1] despite its well-publicized abuses.[2] A variation of the practice, commonly labelled superseniority, involves granting additional credits or top seniority to selected employees. When used in an unarbitrary, nondiscriminatory manner and as part of a legitimate employment arrangement, superseniority has been held to be a valid employment practice.[3] In *NLRB v. Milk Drivers & Dairy Employees Local 338 (Dairylea)*[4] the application of superseniority to a selected union representative was found to have unlawfully encouraged union membership and thus violated the National Labor Relations Act (the Act).[5] Theoretically, the analysis and rationale of *Dairylea* could be applied to preclude any job-related benefit granted to union representatives by an employer in the absence of business justifications. Employers[6] and labor organizations,[7] however, can minimize the impact of *Dairylea* with careful drafting of collective bargaining provisions and a modicum of recordkeeping to loosen the unlawful linkage between union membership and job benefits.

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1. *See, e.g.*, Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521, 526 (1949). *See also* 42 U.S.C. § 2000e(h) (1970); 50 U.S.C. app. § 459 (1970). Seniority is regularly defined as the length of service that determines the relative equities and claims to jobs and prerogatives related to employment. For a discussion of seniority, see Poplin, *Fair Employment in a Depressed Economy: The Layoff Problem*, 23 U.C.L.A. L. REV. 177, 196-99 (1975).

2. For attacks on employee seniority under the National Labor Relations Act, 29 U.S.C. §§ 141-187 (1970), see Barton Brands Ltd. v. NLRB, 529 F.2d 793 (7th Cir. 1976); Monolith Portland Cement Co., 94 N.L.R.B. 1358 (1951). For cases arising under the Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (codified in scattered sections of 28, 42 U.S.C.), see Robinson v. Lorillard Corp., 444 F.2d 791 (4th Cir.), *cert. dismissed*, 404 U.S. 1006 (1971); Quarles v. Phillip Morris, Inc., 279 F. Supp. 505 (E.D. Va. 1968).

3. *See* NLRB v. Erie Resistor Corp., 373 U.S. 221 (1963).

4. 531 F.2d 1162 (2d Cir. 1976). The case is popularly known as *Dairylea*, after the charged employer that did not appeal the Board's decision in 219 N.L.R.B. ___, 89 L.R.R.M. 1737 (1975).

5. 29 U.S.C. §§ 141-187 (1970). 531 F.2d at 1166.

6. Section 2(2) of the Act defines an employer to include "any person acting as an agent of an employer, directly or indirectly . . . ." 29 U.S.C. § 152(2) (1970).

7. Section 2(5) of the Act defines labor organizations as follows:

> The term "labor organization" means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.

29 U.S.C. § 152(5) (1970).

In December, 1972, a highly profitable milk delivery route became vacant in the plant of Dairylea Cooperative, Inc. (the Employer). Rosengrandt, a union steward, and Daniels, an employee with twenty-four more years of service with the Employer than Rosengrandt, both applied for the job. The Employer was required by a collective bargaining agreement[8] to assign the job to the applicant with the greatest seniority. Since another provision of the contract designated the steward the "Senior Employee," the Employer awarded the job to Rosengrandt.

A charge was filed and a complaint issued by the National Labor Relations Board (the Board) against the Employer and Local 338[9] alleging unlawful encouragement of union membership in violation of sections 8(a)(1),[10] 8(a)(3),[11] 8(b)(1)(A),[12] and 8(b)(2)[13] of the Act resulting from the maintenance and enforcement of the collective bargaining agreement. The parties waived an evidentiary hearing and submitted the case on stipulations directly to the Board. The Board, however, refused to accept the stipulations and remanded the case for an evidentiary hearing before an administrative law judge to determine the purpose behind, operation of and justification for the superseniority clause.[14]

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8. The contract provision in question was also contained in collective bargaining agreements with Local 338 and seven other employers. The Employer and Local 338 had originally entered into a contract with this provision in 1937. The contract also contained a valid union security clause. 531 F.2d at 1164-65.

The agreement provided that the union steward be selected by Local 338 from the employees at the plant location and that "'[t]he steward shall be considered the Senior employee in the craft in which he is employed.'" Dairylea Coop., Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1737 (1975). The parties conceded that this clause gave a steward top seniority with respect to layoff and recall and such contractual benefits as assignment of overtime, selection of vacation period and assignment of driver routes and other positions. 531 F.2d at 1164.

9. Milk Drivers and Dairy Employees, Local 338, International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America. 531 F.2d at 1162.

10. 29 U.S.C. § 158(a)(1) (1970). This section states that "[i]t shall be an unfair labor practice for an employer to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7 [section 157 of the Code] . . . ."

11. 29 U.S.C. § 158(a)(3) (1970). This section states in relevant part that "[i]t shall be an unfair labor practice for an employer— . . . (3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization . . . ."

12. 29 U.S.C. § 158(b)(1)(A) (1970). This section states in part that "[i]t shall be an unfair labor practice for a labor organization or its agents to restrain or coerce employees in the exercise of the rights guaranteed in section 7 [section 157 of the Code] . . . ."

13. 29 U.S.C. § 158(b)(2) (1970). This section states in relevant part that "[i]t shall be an unfair labor practice for a labor organization or its agents to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a) (3) . . . ."

14. "The purpose of the remand . . . was, inter alia, to accord Respondent Union

Once again, the parties waived a hearing, stipulating that no evidence was available regarding the intent of the framers of the provision and resubmitted the case to the Board.

The Board en banc found that by maintaining and enforcing the superseniority clause and awarding the route to the steward instead of to the otherwise senior employee, the Employer had violated sections 8(a)(1) and 8(a)(3) of the Act and that Local 338 was guilty of violations of sections 8(b)(l)(A) and 8(b)(2).[15] It ordered both to refrain from enforcing such clauses in the future and to reimburse Daniels for sustained losses.[16] The Board determined that the clause gave unions a wide range of on-the-job benefits that could only be achieved by an employee who was a "good, enthusiastic unionist"[17] and thus illegally tied job rights and benefits to union activities. Therefore, the Board held that superseniority not limited on its face to layoff and recall was presumptively unlawful, with the party asserting its legality assuming the burden of proof.[18]

The Second Circuit Court of Appeals enforced the Board's order, finding violations of only sections 8(a)(l), 8(a)(3) and 8(b)(2) of the Act.[19] Recognizing the power of the Board as trier of fact to draw reasonable inferences from the evidence before it, the court sustained the conclusion that the disparate treatment accorded stewards and nonstewards as to on-the-job benefits aside from layoff and recall resulted in unlawful encouragement of union membership. Such activity fell within the prohibition of section 8(a)(3) whose scope encompasses not only actual discrimination that induces workers to join a union, but also conduct that encourages employees to become enthusiastic union members or merely to decide to support it, assist it or participate in

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or any of the other parties a full opportunity to establish a proper justification for the super seniority clauses here under attack." Dairylea Coop., Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1739 n.9 (1975).

15. *Id.* at —, 89 L.R.R.M. at 1740. See notes 10-13 *supra* for the relevant text of these sections.

16. 219 N.L.R.B. at —, 89 L.R.R.M. at 1739.

17. *Id.* at —, 89 L.R.R.M. at 1738.

18. *Id.* at —, 89 L.R.R.M. at 1739. Member Fanning dissented and would have dismissed the complaint on the basis of Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521 (1949). He stated that the provision did encourage union stewardship, but he equated that with encouraging a public service. He believed that the general counsel had not met his burden of proof since the evidence in the case did not show that stewards were selected on any basis other than ability. Dairylea Coop., Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1741 (1975).

19. NLRB v. Milk Drivers & Dairy Employees Local 338, 531 F.2d 1162, 1165 & n.3 (2d Cir. 1976).

its activities.[20] Noting the failure of Local 338 to present legitimate and substantial business justifications for superseniority,[21] the Second Circuit rejected the union's abandoned claim that these provisions encourage the service of qualified persons and suggested that alternatives to superseniority in the form of a union-paid salary or other non-job benefits be used to recruit able stewards.[22]

The launching point for cases arising under the Act is section 7, the heart of the Act, which recognizes the right of employees to "form, join, or assist labor organizations, . . . [or] refrain from any or all of such activities . . . ."[23] It is an unfair labor practice for an employer or labor organization to restrain or coerce employees in the exercise of their section 7 rights to engage or not to engage in concerted activities.[24]

A provision contained in a collective bargaining agreement is not sacrosanct simply because it has been included in the contract. If it concerns a condition of employment, such as seniority, it is required to conform to the provisions of the Act.[25]

In *Radio Officers' Union v. NLRB*,[26] the Supreme Court heard three cases dealing with the issue of unlawful encouragement of union activity. In the first instance, the union had caused an employer to reduce an employee's seniority for delinquency in paying dues. In the second, the union had suspended an employee for "bumping" a fellow employee and taking a job without its clearance. The third case involved an employer who granted retroactive wage increases and vacation payments solely to members of the union. Finding violations of the Act in all three cases, the Supreme Court recognized that "[i]t is common experience that the desire of employees to unionize is raised or lowered by the advantages thought to be attained by such action. Moreover, the Act does not require that the employees discriminated against be the ones encouraged for purposes of violations of § 8(a)(3)."[27] The Court further observed that no specific proof of unlawful intent need be shown so long as the natural and foreseeable conse-

20. *Id.* at 1165; *see* Radio Officers' Union v. NLRB, 347 U.S. 17, 39-42 (1954).
21. 531 F.2d at 1166 (citing NLRB v. Great Dane Trailers, Inc., 388 U.S. 26, 34 (1967)).
22. 531 F.2d at 1166.
23. 29 U.S.C. § 157 (1970).
24. *Id.* §§ 158(a)(1), (b)(1)(A).
25. *E.g.*, United Steelworkers Local 1070, 171 N.L.R.B. 945, 946 (1968).
26. 347 U.S. 17 (1954).
27. *Id.* at 51.

quences of discriminatory conduct serve to encourage or discourage union membership.[28]

In *Local 357, International Brotherhood of Teamsters v. NLRB*,[29] the Supreme Court limited *Radio Officers'* by rejecting the Board's contention that union hiring halls were per se unlawful. Although the very existence of hiring halls might encourage union membership, the Court determined that the Act was intended to ban only specific encouragement brought about by discrimination and not the encouragement offered by a negotiated plan that was nondiscriminatory on its face.[30]

Thereafter, in cases applying *Radio Officers'* as modified by *Local 357*, it was held that the insistence of a union that an employer reduce the seniority of an employee-union member because he had been delinquent in paying his dues unlawfully strengthened the union's control of its members and encouraged nonmembers to join, in violation of sections 8(a)(3) and 8(b)(2).[31] In other cases, the union's insistence that the employer discharge all of its employees and hire new ones through the union's hiring hall as a precondition to signing a contract[32] and the refusal to refer a member[33] were found to be violations of the Act because they involved the union's influence over employees and its power to affect their livelihood. Such influence, in the absence of any union contention that its actions were necessary to represent its members effectively violated the Act.[34]

*Local 357* indicated that not all encouragement of union membership constitutes a violation of sections 8(a)(3) and 8(b)(2).[35] Furthermore, in *NLRB v. Great Dane Trailers*,[36] the Supreme Court's holding indicated that presumptive invalidity or unlawfulness under the Act could be rebutted with evidence of a legitimate and substantial

28. *Id.* at 45; *see* Republic Aviation Corp. v. NLRB, 324 U.S. 793 (1944).
29. 365 U.S. 667 (1961).
30. *Id.* at 675-76.
31. *E.g.*, Seafarers Int'l Union, 202 N.L.R.B. 657, 659 n.13 (1973), *enforced*, 496 F.2d 1363 (5th Cir. 1974).
32. Austin & Wolfe Refrig., Air Cond. & Heating, Inc., 202 N.L.R.B. 135 (1973). *Local 357* did not sanction this use of hiring halls.
33. Local 1437, United Bhd. of Carpenters, 210 N.L.R.B. 359 (1974) (other employees' perception of the union's arbitrary exercise of power necessarily encouraged their union membership).
34. Operating Eng'rs Local 18, 204 N.L.R.B. 681 (1973), *remanded per curiam*, 496 F.2d 1308 (6th Cir. 1974), *aff'd on rehearing*, 90 L.R.R.M. 1478 (1975) (members' failure to pay a fine imposed for disrupting a hiring hall and internal election did not justify removal from seniority list).
35. 365 U.S. at 675-76.
36. 388 U.S. 26 (1967).

business justification in the absence of unlawful intent.[37] In *Great Dane* the Court held that the actions of an employer who had refused to pay accrued vacation benefits to striking employees under a terminated collective bargaining agreement while paying them to replacement workers, returning strikers and nonstrikers violated section 8(a)(3).[38] *Great Dane* is equally applicable to a situation that involves violations of both sections 8(a)(3) and 8(b)(2). It merely restates the Board's earlier policy of accepting union "interference" with the employment relationship, if the union had a business or collective bargaining purpose for all represented employees.[39]

On the authority of *Great Dane*, the Supreme Court recognized the union's traditional function of serving the economic interests of the bargaining unit as a whole and upheld a union fine levelled against a member who had exceeded a piecework ceiling.[40] Similarly, in another case, the Board found that the need for a union to perform its tasks more effectively for the benefit of all permitted an employer to compensate union members for time spent on union work.[41]

The Second Circuit's insistence that unions reward prospective stewards with only non-job incentives leaves the door open for future attacks on superseniority clauses that are in any manner job-related. The seniority concept,[42] recognized by Congress,[43] is a legitimate union interest that ought not hastily be deemed discriminatory. Not even clauses that offer stewards protection from layoff, however, are immune from attack on the basis of *Dairylea*. But these clauses have a justifiable use.[44] As a term or condition of employment, seniority

37. *Id.* at 27. Prior to *Great Dane*, the Board had upheld a union's solicitation of the discharge of an employee who had refused a night job in violation of the contract. Houston Typographical Union No. 87, 145 N.L.R.B. 1657 (1964). It also upheld the fine of a union member who had not accepted a contractual subsistence allowance. Millwrights' Local 1102, 144 N.L.R.B. 798 (1964).

38. 388 U.S. at 27.

39. Austin & Wolfe Refrig., Air Cond. & Heating, Inc., 202 N.L.R.B. 135, 137 (1973) (Miller, Chairman, dissenting).

40. Scofield v. NLRB, 394 U.S. 423, 431-36 (1969).

41. Sunnen Prod., Inc., 189 N.L.R.B. 826 (1971); *see* IBEW Local 592, 92 L.R.R.M. 1159 (1976) (union refused to refer member who had not passed union-administered test); International Ass'n of Machinists Lodge 68, 205 N.L.R.B. 132 (1973), *vacated*, 503 F.2d 1044 (9th Cir. 1975) (union reduced seniority standing of employee on extended leave of absence); Millwright Local 1080, 201 N.L.R.B. 882 (1973) (union refused to refer self-employed member).

42. *See* note 1 *supra*.

43. *See* Ford Motor Co. v. Huffman, 345 U.S. 330, 339-41 (1953); Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521, 527 (1949).

44. Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521, 528 (1949); *accord*, Dairylea Coop., Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1738 (1973).

is tailored to each shop and it is only reasonable to assume that variations in seniority practices will develop in individual plants.[45] The union, meanwhile, has a duty of fair representation of all unit employees.[46] It also has the obligation to see that the contract is preserved as part of the continuous collective bargaining process.[47]

In order to preserve its vitality, the union needs continuity of its officials within their jobs. Without the assurance that its elected representatives will be present to maintain the collective bargaining agreement as a living document and to see that grievances are promptly and properly adjusted at their source,[48] the union loses legitimacy in the eyes of the employer and the support of employees who question the validity of their representation. The Supreme Court recognized the validity of this union interest in *Aeronautical Industrial District Lodge 727 v. Campbell*[49] and *Ford Motor Co. v. Huffman*[50] and allowed specific superseniority for union chairmen and stewards despite a provision of the Selective Service Act that mandated restoration of seniority for returning veterans of World War II.[51] While neither of these cases arose under the Act, the Board has sanctioned seniority variations in other cases, including "superseniority" for stewards as an exercise of a union's discretion.[52]

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45. *See, e.g.*, Ford Motor Co. v. Huffman, 345 U.S. 330, 337-38 (1953).

46. *Id.* at 337; *see* Steele v. Louisville & N.R.R., 323 U.S. 192, 198-99 (1944). *See also* IATSE Local 659, 197 N.L.R.B. 1187 (1972), *enforced per curiam*, 83 L.R.R.M. 2527 (D.C. Cir. 1973); Miranda Fuel Co., 140 N.L.R.B. 181, *enforcement denied*, 326 F.2d 172 (2d Cir. 1963).

47. Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521, 528 (1949).

48. *See id.* at 527.

49. 337 U.S. 521, 528 (1949); *see* text accompanying notes 1, 43 & 44 *supra*.

50. 345 U.S. 330 (1953).

51. *Id.* at 342; Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. at 529 (1949). The Act provided:

> SEC. 8. . . .
>
> (b) In the case of any such person who, in order to perform such training and service, has left or leaves a position, other than a temporary position, in the employ of any employer and who (1) receives such certificate [of satisfactory completion of his period of training and service], (2) is still qualified to perform the duties of such position, and (3) makes application for reemployment within forty days after he is relieved from such training and service—
>
> . . . .
>
> (B) if such position was in the employ of a private employer, such employer shall restore such person to such position or to a position of like seniority, status and pay unless the employer's circumstances have so changed as to make it impossible or unreasonable to do so; . . . .

Selective Training and Service Act of 1940, ch. 720, § 8, 54 Stat. 890 (current version at 50 U.S.C. app. § 459(b) (1970)).

52. *See, e.g.*, Bethlehem Steel Co., 136 N.L.R.B. 1500, 1503 (1962), *enforcement denied on other grounds*, 320 F.2d 615 (3d Cir. 1963). *See generally* Barton Brands

Although *Ford* and *Campbell* involved limited exceptions to plant-wide seniority rules for the limited purpose of protection against layoff and are therefore distinguishable from the more general clauses seen in *Dairylea*, their absence from the Second Circuit's consideration can be read to put into question the concept of limited superseniority for union stewards. Provision of employment is the foremost job-related benefit. Protection against layoff and the right of first recall are essential to maintain the steward's representation of the bargaining unit.

The Second Circuit implied that non-job benefits and union-paid salaries to attract qualified stewards constitute the only permissible alternatives not violative of the Act.[53] The suggestion that the union pay its stewards a salary in lieu of contractual benefits may prove to be unrealistic. Smaller locals are often financially pressed and the burden of paying stewards could possibly bankrupt them. In larger employment situations, the sheer number of stewards and the cost of a union salary for each of these workers could be prohibitive. On the other hand, the employer, with greater resources and control over terms and conditions of employment, receives benefits from the service of union stewards.[54] It would be more in keeping with the purpose of the Act to maintain industrial stability[55] to allow employees and labor organizations to devise their own ways of rewarding stewards, since in theory, at least, stewards aid both parties.[56]

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Ltd., 213 N.L.R.B. 640, 645 (1974) (Jenkins dissenting); Campbell Sixty Six Express, Inc., 200 N.L.R.B. 1126 (1972); Wanzer Dairy Co., 154 N.L.R.B. 782 (1965); Armored Car Chauffeurs & Guards Local 820, 145 N.L.R.B. 225 (1963); Florida Power & Light Co., 126 N.L.R.B. 967 (1960); Armour & Co., 123 N.L.R.B. 1157 (1959).

53. 531 F.2d at 1166.

54. These employees, commonly labelled grievance chairmen or shop stewards, provide a service to the bargaining unit, as well as to the employer and to the upholding of national labor policies, by promoting industrial stability and certainty and the speedy resolution of disputes that might otherwise cause work delays. Therefore, for them, superseniority should not be denied. *See* Aeronautical Indus. Dist. Lodge 727 v. Campbell, 337 U.S. 521, 528-29 n.5 (1949).

55. *See* Steelworkers v. Warrior & Gulf Co., 363 U.S. 574, 578 (1960).

56. In *Dairylea*, the collective bargaining agreement contained a lawful union-security clause that required all employees, after a period of time, to become union members. There still exists, however, the possibility in situations without such a clause that there may be senior non-union employees who will suffer in comparison to "super-senior" stewards. In those instances, the argument can be made that even the presence of superseniority for union stewards limited to layoff and recall is violative of the Act since it would discriminate against non-union employees.

This disingenuous argument is appealing, no doubt, but in balance, superseniority would still prevail. The damage to the interests of employees who exercise their statutorily protected right to refrain from union membership is outweighed by the benefits to the unit, the employer and the national economy provided by collective bargaining that were recognized initially by the framers of the National Labor Relations Act

Employers and labor organizations should again note that Local 338 "was accorded ample opportunity to introduce evidence of its steward selection policies to rebut the Board's conclusion"[57] of presumptive invalidity of the contract clause but waived opportunities for evidentiary hearings. On appeal, it asserted its collective bargaining agreement as the sole justification for the superseniority clause and presented no evidence of any other legitimate or substantial business reason.[58] Thus, the Second Circuit merely enforced an order based on prima facie violations of the Act.[59]

In the face of the Board's persistent refusal to exercise its rulemaking powers,[60] the application of *Dairylea* and with it, the fate of superseniority, will rest largely in the hands of the Board's general counsel. He is given the statutory authority to decide whether to issue a complaint following the filing of each charge with the Board.[61] In unionized industries, seniority is most likely to be a deeply ingrained practice, so that when employer and union representatives sit down to negotiate or renegotiate an agreement, they should be mindful of the general counsel's interpretation of superseniority in order to diminish the likelihood of costly future proceedings. This vigilance in adjusting superseniority clauses should insulate them from future attack by the Board.

Thus, the practical impact of *Dairylea* is greatest at the contract negotiation level.[62] The parties will seek to have seniority arrangements conform to the bounds of the law, with the slightest possible disruption of established practices. In drafting a superseniority clause the parties will have to stay within two basic strictures. First, a nexus between collective bargaining and the employee receiving the rewards

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and the courts for 40 years thereafter. If the benefit afforded stewards is necessary for the proper carrying out of their responsibilities as stewards, which in turn is necessary in the application of the collective bargaining agreements, then this countervailing consideration should prevail.

57. 531 F.2d at 1166.

58. *See generally* text accompanying note 25 *supra.*

59. 531 F.2d at 1167.

60. The Board has continuously refrained from exercising its rulemaking powers under section 6 of the Act, 29 U.S.C. § 156 (1970). *See, e.g.*, NLRB v. Bell Aerospace Co. Div. of Textron, 416 U.S. 267 (1974); NLRB v. Wyman-Gordon Co., 394 U.S. 759 (1969).

61. 29 U.S.C. § 153(d) (1970). This section provides that the general counsel "shall have final authority, on behalf of the Board, in respect of the investigation of charges and issuance of complaints under section 160, and in respect of the prosecution of such complaints before the Board . . . ."

62. If the Supreme Court hears *Dairylea*, its standard of review may be limited to whether or not the Board could reasonably have inferred that the superseniority clause spurred workers to become good unionists and was thus a violation of the Act.

should initially be established. While *Campbell* spoke of a "benefit to the whole *Union*,"[63] decisions under the Act emphasize that a labor organization, as the representative of all employees, union and non-union, must make its benefits available to every member of the bargaining unit.[64] The employee favorably affected by additional seniority must be in a position to aid the entire unit. Such employees include primarily officials who see that grievances are promptly heard and adjusted, or those who have the duty to see that the collective bargaining agreement is upheld. These individuals provide services to both the bargaining unit and the employer as well as promote national labor policies. Therefore, superseniority for them should not be denied.[65]

To withstand attack, the benefits that are provided appropriate officials must also be limited in scope. Top seniority for all benefits connected to the job cannot be upheld in most instances since it attaches union membership to the terms and conditions of employment in too forceful a manner.[66] In the extraordinary instance where it can be documented that superseniority for unlimited purposes is the only means available to attract qualified personnel, and then, only after repeated failure with other inducements, the Board will probably give its approval to the arrangement.[67] Despite the Second Circuit's oblique reference to layoff and recall provisions, it must be noted that the general counsel and Board share the position that such limited superseniority for similar purposes is not contrary to the policies of the Act.[68] Thirty years of precedent appear to support that proposition and it would unfairly disrupt most industrial settings to rule now that this benefit violates the Act.[69]

If charges are filed, the burden on employers and unions to justify superseniority is not heavy. A minimum of notes and records need

63. 337 U.S. at 527 (emphasis added).

64. *E.g.*, Radio Officers' Union v. NLRB, 347 U.S. 17, 47 (1954).

65. *See* Dairylea Coop., Inc., 219 N.L.R.B. —, 89 L.R.R.M. 1737 (1975). Union officials who do not administer the collective bargaining agreement and those who take part in contract negotiations only at specified intervals will be harder to justify as integral links to the unit. *Id.* at —, 89 L.R.R.M. at 1738.

66. *See* Radio Officers' Union v. NLRB, 347 U.S. 17, 39-42 (1954).

67. Dairylea Coop., Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1738 (1975) (dictum).

68. *Compare id. with* NLRB v. Milk Drivers & Dairy Employees Local 338, 531 F.2d 1162, 1166 n.7 (1976). Both the general counsel and the Board appear to agree that protection from layoff is justified in a union's need for continuity in order to provide substantive representation to all unit employees.

69. Dairylea Coop, Inc., 219 N.L.R.B. —, —, 89 L.R.R.M. 1737, 1738 n.6 (1975) (citing the "relevance of the Court's reasoning" in *Campbell*).

to be kept to provide the basis to document a *Great Dane* justification. The Board has flexibly examined asserted union justifications in prior 8(b)(1)(A) and 8(b)(2) cases and so long as the union's reasons for a superseniority clause are not to avoid or circumvent the impact of another statute[70] or are not based on suspect classifications such as alienage,[71] race[72] or union membership,[73] they should suffice, if properly documented.

In *Dairylea*, the Second Circuit held that superseniority clauses for union stewards that apply for unlimited purposes on the job fly in the face of the policy of section 7 of the Act by tying employment benefits to union activity and unlawfully encouraging union membership. The decision involved, however, the unlikely prospect of a union that did not assert any justification for its questioned superseniority clause. If it had asserted that such a clause was necessary to enable it to represent the bargaining unit better, the union would have stood a greater chance of succeeding. The lack of justification for the contractual provision allowed the Second Circuit not only to declare it presumptively unlawful, but also impliedly to threaten even the limited application of superseniority to any union representative. This threat, however, is diminished by the court's failure to deal with prior cases that had sanctioned a limited use of superseniority. This limitation, coupled with the relative ease with which the court's presumption can be rebutted, and buttressed by the practicalities of the Act's enforcement, may mean that *Dairylea* will provide little, if any, threat to traditional industrial practices.

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70. Austin & Wolfe Refrig., Air Cond. & Heating, Inc., 202 N.L.R.B. 135 (1973); American News Co., 55 N.L.R.B. 1302 (1944).

71. NLRB v. Local 1581, ILA, 489 F.2d 635 (5th Cir. 1974), *cert. denied*, 419 U.S. 1040 (1974), *enforcing* 196 N.L.R.B. 1186 (1972).

72. *See* Steele v. Louisville & N.R.R., 323 U.S. 192 (1944); NLRB v. Local 1367, ILA, 368 F.2d 1010 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967); Local 12, United Rubber Workers, 150 N.L.R.B. 312 (1964), *enforced*, 368 F.2d 12 (5th Cir. 1966), *cert. denied*, 389 U.S. 837 (1967).

73. *See* Truck Drivers & Helpers Local 568 v. NLRB, 379 F.2d 137 (D.C. Cir. 1967); Local 631, International Bhd. of Teamsters, 213 N.L.R.B. 600 (1974); Boilermakers Local 169, 209 N.L.R.B. 140 (1974); Local 167, Progressive Mine Workers, 173 N.L.R.B. 1237, *enforced*, 422 F.2d 538 (7th Cir.), *cert. denied*, 399 U.S. 905 (1970); Local 17, ILA, 173 N.L.R.B. 594, *enforced per curiam*, 434 F.2d 620 (9th Cir. 1970); Local 383, Lathers, 176 N.L.R.B. 410 (1969).

## Military Law—Right to Counsel at a Summary Court Martial: Middendorf v. Henry.

In a 1972 case, *Argersinger v. Hamlin*,[1] the United States Supreme Court held "that absent a knowing and intelligent waiver, no person may be imprisoned for any offense, whether classified as petty, misdemeanor, or felony, unless he was represented by counsel at his trial."[2] The Army and Air Force considered this decision to be applicable to the military and began to provide counsel to all defendants in summary courts-martial.[3] The Judge Advocate General of the Navy, however, disagreed with this position,[4] and the Navy continued the practice of denying appointed counsel to accused before summary courts.[5] In *Middendorf v. Henry*[6] a divided Supreme Court[7] upheld

1. 407 U.S. 25 (1972). For analysis of *Argersinger* and its background, see Comment, *Misdemeanants' Right to Counsel: A Retrospective View of Argersinger v. Hamlin*, 9 GONZ. L. REV. 169 (1973); Note, *The Indigent's Expanding Right to Appointed Counsel—Argersinger v. Hamlin*, 37 ALB. L. REV. 383 (1973); Note, *Constitutional Law—Right to Counsel—Rationale of Gideon v. Wainwright Extended to All Criminal Prosecutions at Which Accused Is Deprived of His Liberty*, 41 FORDHAM L. REV. 722 (1973); Note, *Criminal Law—Sixth Amendment—Right to Court-Appointed Counsel for Indigents*, 47 TUL. L. REV. 446 (1973).

2. 407 U.S. at 37.

3. Daigle v. Warner, 490 F.2d 358, 366 (9th Cir. 1974). Courts-martial fall into three categories: general, special, and summary. Uniform Code of Military Justice art. 16, 10 U.S.C. § 816 (1970). Article 20 of the Military Code states:

> Subject to section 817 of this title [article 17], summary courts-martial have jurisdiction to try persons subject to this chapter, except officers, cadets, aviation cadets, and midshipmen, for any noncapital offense made punishable by this chapter. No person with respect to whom summary courts-martial have jurisdiction may be brought to trial before a summary court-martial if he objects thereto. If objection to trial by summary court-martial is made by an accused, trial may be ordered by special or general court-martial as may be appropriate. Summary courts-martial may, under such limitations as the President may prescribe, adjudge any punishment not forbidden by this chapter except death, dismissal, dishonorable or bad-conduct discharge, confinement for more than one month, hard labor without confinement for more than 45 days, restriction to specified limits for more than two months, or forfeiture of more than two-thirds of one month's pay.

*Id.* § 820. Article 27 makes no provision for appointed counsel for the accused before a summary court. *Id.* § 827. Instead, it is the duty of the presiding officer to protect the interests of the accused as well as those of the Government. U.S. DEP'T OF DEFENSE, MANUAL FOR COURTS-MARTIAL ¶ 79a (rev. ed. 1969) [hereinafter cited as MCM]. "The functions of a summary court-martial is to exercise justice promptly for relatively minor offenses under a simple form of procedure." *Id.* Records of the proceeding and opportunity for appellate review are limited. *See* Uniform Code of Military Justice arts. 54(b), 60, 65, 69, 10 U.S.C. §§ 854(b), 860, 865, 869 (1970); MCM ¶ 79e.

4. Henry v. Warner, 357 F. Supp. 495, 499 (C.D. Cal. 1973).

5. *See, e.g.*, Middendorf v. Henry, 96 S. Ct. 1281 (1976); Betonie v. Sizemore, 496 F.2d 1001 (5th Cir. 1974); Daigle v. Warner, 490 F.2d 358 (9th Cir. 1974); United States v. Alderman, 22 C.M.A. 298, 46 C.M.R. 298 (1973).

6. 96 S. Ct. 1281 (1976), *rev'g* Henry v. Warner, 493 F.2d 1231 (9th Cir. 1974).

the Navy's procedure,' stating that "neither the Sixth nor the Fifth Amendments to the United States Constitution empower us to overturn the congressional determination that counsel is not required in summary courts-martial."[8]

Plaintiffs[9] in *Middendorf* brought a class action suit[10] "seeking habeas corpus (release from confinement), an injunction against future confinement resulting from uncounseled summary courts-martial convictions, and an order vacating the convictions of those previously convicted."[11] The district court found for plaintiffs,[12] but the Ninth Circuit Court of Appeals vacated this decision and remanded the case.[13] Upon the petition of both parties, the Supreme Court granted certiorari[14] and reversed the Ninth Circuit's decision.[15]

The Supreme Court analyzed the issues in *Middendorf* in terms of both the sixth and fifth amendments. As the standard for the application of the sixth amendment's right to counsel,[16] the Court looked

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The title of the case changed when J. William Middendorf replaced John E. Warner as Secretary of the Navy.

7. *Id.* Mr. Justice Rehnquist wrote the opinion for the Court, and Mr. Justice Blackmun joined Mr. Justice Powell in a concurring opinion. A separate dissent was filed by Mr. Justice Stewart, and Mr. Justice Brennan joined Mr. Justice Marshall in a lengthy dissent. Not taking part in the consideration or decision of the case was Mr. Justice Stevens.

8. *Id.* at 1294.

9. Plaintiffs were members of either the Navy or the Marine Corps. Most had been charged with unauthorized absence. Five men had been convicted at summary courts-martial, including two who had intervened in the suit pursuant to FED. R. CIV. P. 24(a)(2); three others had been ordered to stand trial. Henry v. Warner, 357 F. Supp. 495, 497-98 (C.D. Cal. 1973).

10. Because of the Court's decision, the issues of whether FED. R. CIV. P. 23 (concerning class actions) is applicable to petitions for habeas corpus and whether a district court's injunction is enforceable outside of the court's district remain unanswered. 96 S. Ct. at 1285.

11. *Id.*

12. The district court ordered released all Navy and Marine Corps personnel who had been or were to be tried by summary courts without counsel, enjoined the future convention of such courts, and vacated plaintiffs' convictions: 357 F. Supp. at 499.

13. 493 F.2d 1231 (9th Cir. 1974). Daigle v. Warner, 490 F.2d 358 (9th Cir. 1973), held that absent military exigencies:

> [C]ounsel must be appointed for the accused before a summary court-martial only where the accused makes a request based on a timely and colorable claim (1) that he has a defense, or (2) that there are mitigating circumstances, and the assistance of counsel is necessary in order adequately to present the defense or mitigating circumstances.

*Id.* at 365. *See* text accompanying notes 57-71 *infra.*

14. 419 U.S. 895 (1974).

15. 96 S. Ct. at 1281.

16. The relevant portion of the sixth amendment provides: "In all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." U.S. CONST. amend. VI.

to *Argersinger v. Hamlin*[17] and drew analogies between summary courts-martial and certain civilian proceedings held not to require counsel under the sixth amendment.[18] Noting from these instances that a proceeding that results in confinement is not automatically classified as a criminal prosecution,[19] the Court then emphasized "the fact that a summary court-martial occurs in the military community, rather than the civilian community."[20] The majority looked at three factors:[21] the type of offense generally adjudicated at summary court-martial,[22] the limited consequences of the penalties assessed for these offenses,[23] and the non-adversary nature of the summary court-martial.[24] A combination of these factors and "the distinctive nature of military life and discipline"[25] led to the Court's decision that the sixth amendment's requirement of counsel is inapplicable to summary courts-martial because such courts are distinguished "from the civilian misdemeanor prosecution upon which *Argersinger* focused."[26]

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17. 407 U.S. 25 (1972). See text accompanying note 2 *supra* for the holding in that case.

18. *See* 96 S. Ct. at 1287-89; Gagnon v. Scarpelli, 411 U.S. 778 (1973) (probation revocation proceeding not criminal proceeding); *In re* Gault, 387 U.S. 1 (1967) (juvenile hearing that could result in confinement not criminal proceeding). Although the sixth amendment did not apply in *Gagnon*, the Court did recognize that, in certain cases, due process "will require that the State provide at its expense counsel for indigent probationers or parolees." 411 U.S. at 790. Similarly, in *Gault*, the Court held that due process requires counsel at a juvenile hearing that can assess confinement. 387 U.S. at 34-42.

19. 96 S. Ct. at 1288-89.

20. *Id.* at 1289.

21. Justices Marshall and Brennan dissented strongly concerning this analysis. *See* 96 S. Ct. at 1297-1304.

22. The Court pointed out: "Much of the conduct proscribed by the military is not 'criminal' conduct in the civilian sense of the word." 96 S. Ct. at 1289 (citing Parker v. Levy, 417 U.S. 733, 749-51 (1974)). Most of the plaintiffs in *Middendorf* were charged with "unauthorized absence," in violation of the Uniform Code of Military Justice art. 86, 10 U.S.C. § 886 (1970), "which has no common-law counterpart and which carries little popular opprobrium." 96 S. Ct. at 1289. Furthermore, the Court felt that conviction of such an offense "would likely have no consequences for the accused beyond the immediate punishment meted out by the military," whereas conviction for certain misdemeanors in civilian courts could connote "bad character." *Id.*

23. The Court's regard of this factor was influenced by the limited scope of penalties imposable by summary courts. 96 S. Ct. at 1290. See note 3 *supra* for the text of the relevant section of the Uniform Code of Military Justice.

24. The Court believed that the presiding officer's role—" 'thoroughly and impartially [to] inquire into both sides of the matter and [to] insure that the interests of both the Government and the accused are safeguarded' "—was further evidence of the distinction between a summary court-martial and a criminal prosecution. 96 S. Ct. at 1290-91 (quoting MCM, *supra* note 3, at 79a). See MCM, *supra* note 3, at 79d for a complete description of procedure at a summary court-martial.

25. 96 S. Ct. at 1291 n.19.

26. *Id.* at 1291.

Moving to the requirements of the fifth amendment, the Court observed that plaintiffs, who could suffer losses of liberty or property as a result of summary court conviction, were entitled to that amendment's guarantee of due process of law.[27] The extent of this guarantee, however, is limited by the interests of the military regime to which plaintiffs were subject.[28] In determining the scope of military necessity that would preclude the appointment of defense counsel at summary courts-martial, the Court minimized the precedential value of the Court of Military Appeals' contrary decision in *United States v. Alderman*[29] and decided that the need for such counsel was not "so extraordinarily weighty as to overcome"[30] the Court's necessary deference[31] to "the congressional determination . . . that counsel should not be provided in summary courts-martial."[32] The availability, at the accused's option, of an alternative forum[33] with counsel[34] was the final major element in the Court's decision, and the Court dismissed objections that the choice is unconstitutional because the alternative (a general or special court-martial) subjects the accused to the possibility of more severe penalties.[35]

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27. *Id.* The fifth amendment's due process provision is as follows: "No person shall . . . be deprived of life, liberty, or property without due process of law . . . ." U.S. CONST. amend. V.

28. 96 S. Ct. at 1291. *Cf.* Wolff v. McDonnell, 418 U.S. 539, 556 (1974) (prisoners' due process rights are subject to restrictions necessitated by the nature of the regime to which they have been committed).

29. *See* 96 S. Ct. at 1291-92. United States v. Alderman, 22 C.M.A. 298, 46 C.M.R. 298 (1973), held that *Argersinger* is applicable to the military and requires counsel at summary courts-martial. Judge Quinn wrote that *Argersinger* applied to military courts just as it did to civilian courts. *Id.* at 300, C.M.R. at 300. Judge Duncan, concurring in part, applied *Argersinger* to the military only after he found no convincing evidence of military necessity that would preclude such application. *Id.* at 303, C.M.R. at 303. In disagreement with both of these views, Chief Judge Darden dissented. *Id.* at 307-08, C.M.R. at 307-08. Because only Judge Duncan dealt with the issue of military necessity and Chief Judge Darden opposed his analysis, the majority in *Middendorf* felt that the issue was not concluded. 96 S. Ct. at 1292.

30. 96 S. Ct. at 1292.

31. The Court felt obliged to defer to Congress' determination because under the Constitution, "The Congress shall have Power . . . To make Rules for the Government and Regulation of the land and naval Forces." U.S. CONST. art. I, § 8, cl. 14.

32. 96 S. Ct. at 1291. The Court found that provision of counsel at summary courts would "turn a brief, informal hearing . . . into an attenuated proceeding which consumes the resources of the military to a degree which Congress could properly have felt to be beyond what is warranted . . . ." *Id.* at 1292.

33. Uniform Code of Military Justice art. 20, 10 U.S.C. § 820 (1970). See note 3 *supra* for the text of this section.

34. Uniform Code of Military Justice art. 27, 10 U.S.C. § 827 (1970).

35. 96 S. Ct. at 1293-94. The Court analogized this choice to decisions faced by defendants in civilian criminal courts. *Id.* See Uniform Code of Military Justice arts.

In order to gain a complete understanding of *Middendorf*, it is necessary to consider previous congressional and judicial treatment of the summary court-martial. Congress has twice refused to abolish the summary court.[36] Instead, in 1956, Congress provided that a defendant could refuse trial before a summary court unless he had previously rejected nonjudicial punishment.[37] In 1968, on the second occasion, a compromise between opponents and proponents of summary courts broadened this right of refusal by eliminating the exception clause.[38] At this time, before the Supreme Court's decision in *Argersinger*, civilian defendants subject to less than six months confinement did not enjoy the right to appointed counsel.[39] Thus, it is highly improbable that Congress' decisions to preserve the summary court were based upon a determination that the demands of military necessity bar the appointment of defense counsel in summary courts-martial.[40] Indeed, none of the courts that considered the issue prior to *Middendorf* found any evidence of such a determination.[41]

Before the Supreme Court's decision in *Middendorf*, three other cases had reached either a circuit court of appeals or the Court of Military Appeals[42] with the question of *Argersinger*'s applicability to the military justice system.[43] In *Betonie v. Sizemore*,[44] the Fifth Circuit accepted *Argersinger* as establishing "the framework for Sixth Amendment analysis of military proceedings."[45] The *Betonie* court found the Army and Air Force acceptance of *Argersinger*[46] "[p]articularly significant."[47] Furthermore, the opinion rejected the Navy's attempts to distinguish military from civilian criminal justice, concluding that "both the

18-19, 10 U.S.C. §§ 818-819 (1970) for penalties imposable by general and special courts-martial.

36. 96 S. Ct. at 1292 n.21.

37. *Id.*

38. *Id.*

39. *Id.* at 1303 (Marshall & Brennan, JJ., dissenting).

40. *Id.*

41. *See* text accompanying notes 42-69 *infra.*

42. The decisions of the Court of Military Appeals are final. Uniform Code of Military Justice art. 76, 10 U.S.C. § 876 (1970).

43. Betonie v. Sizemore, 496 F.2d 1001 (5th Cir. 1974); Daigle v. Warner, 490 F.2d 358 (9th Cir. 1974); United States v. Alderman, 22 C.M.A. 298, 46 C.M.R. 298 (1973). All of these cases arose out of the same basic fact pattern: enlisted members of the Navy and Marine Corps appealed convictions imposed in summary courts-martial at which the men were denied the assistance of appointed counsel.

44. 496 F.2d 1001 (5th Cir. 1974).

45. *Id.* at 1007.

46. *See* text accompanying note 3 *supra.*

47. 496 F.2d at 1007.

Fifth and Sixth Amendments require counsel in any court-martial proceeding in which incarceration is to be imposed as a punishment."[48] The Navy's contention that the multiple functions of the summary court officer fulfill the requirements of the right to counsel was also rejected as "unconvincing,"[49] for as the court noted, "The potential conflicts of interest. . . are legion."[50]

In *United States v. Alderman*,[51] the Court of Military Appeals reached a decision quite similar to the one in *Betonie*. *Argersinger* was held applicable to the military by Judge Quinn[52] on the basis of the court's decision in *United States v. Tempia*[53] and by Judge Duncan because he found no evidence of military necessity to preclude such application.[54] The voluntary acceptance of *Argersinger* by the Army and Air Force also impressed Judge Duncan.[55] Additionally, Judge Quinn noted other extensions of the right to counsel by the military to situations not mentioned in the Uniform Code of Military Justice.[56]

In *Daigle v. Warner*[57] the Ninth Circuit used an historical approach to determine that the sixth amendment, as applied in *Argersinger*, was inapplicable to summary courts-martial.[58] This approach relied on the asserted intentions of the framers of the Bill of Rights.[59] The court noted that courts-martial are required to afford an accused due process of law under the fifth amendment.[60] Then the court

48. *Id.* at 1008. The court relied on *Argersinger*'s rule that prohibits the imposition of potentially severe punishments unless the accused has the assistance of counsel. *Id.*

49. *Id.*

50. *Id.*

51. 22 C.M.A. 298, 46 C.M.R. 298 (1973).

52. *Id.* at 299, C.M.R. at 299.

53. 16 C.M.A. 629, 37 C.M.R. 249 (1967).

54. 22 C.M.A. at 303, 46 C.M.R. at 303 (Duncan, J., concurring in part and dissenting in part).

55. *Id.*

56. *Id.* at 300, C.M.R. at 300.

57. 490 F.2d 358 (9th Cir. 1974), *rev'g* 348 F. Supp. 1074 (D. Hawaii 1972). The district court acknowledged the special attributes of military justice, but held that these attributes "cannot justify denial of basic constitutional rights, when both these rights and the needs of the military can be successfully accommodated. By applying *Argersinger* to summary courts-martial, this court is not burdening the military with an inflexible and impossible requirement." 348 F. Supp. at 1080.

58. 490 F.2d at 363-64.

59. The court accepted Colonel Wiener's analysis. *Id.* at 364 (citing Wiener, *Courts-Martial and the Bill of Rights: The Original Practice I*, 72 HARV. L. REV. 1 (1958)). For another historical approach, see Henderson, *Courts-Martial and the Constitution: The Original Understanding*, 71 HARV. L. REV. 293 (1957), which states that the framers did intend the sixth amendment's right to counsel to apply to the military.

60. 490 F.2d at 364.

looked to *Gagnon v. Scarpelli*[61] and *In re Gault*[62] as guides to determine the extent to which due process requires "counsel in situations where confinement may be imposed but the Sixth Amendment does not apply."[63] Finding the proceeding in *Gagnon* more analogous to the summary court than was the proceeding in *Gault*, the court held that a modified due process right to counsel would be sufficient for summary courts-martial.[64] This limited due process right seems to be a retreat from the courts' generally expanding notions of the right to counsel.[65] As in *Alderman*,[66] however, the Ninth Circuit found "scant support" for the Navy's argument that military necessity warrants the denial of counsel to accused before summary courts.[67] Again, the practice of the Army and Air Force was a factor in this decision.[68] Furthermore, the court felt that the Navy, by allowing private retained counsel to appear in summary courts-martial, undermined any contention of possible harm to discipline that might result from the requirement of counsel.[69]

Although the results of *Betonie*, *Alderman*, and *Daigle* reveal a conflict,[70] the common findings of the various courts are of great significance, especially in view of the Supreme Court's decision in *Middendorf*, a case that reached that Court when the Ninth Circuit reaffirmed *Daigle* in a half-page opinion.[71] None of the lower courts found evidence of military necessity that would warrant the denial of the right to appointed counsel in summary courts-martial.[72] In *Middendorf*, however, the Supreme Court relied upon military necessity, as determined by Congress, as an important element in its due process analy-

61. 411 U.S. 778 (1973). *See* note 18 *supra.*

62. 387 U.S. 1 (1967).

63. 490 F.2d at 364.

64. *Id.* at 365-66. *See* note 13 *supra.*

65. *See, e.g.*, Argersinger v. Hamlin, 407 U.S. 25 (1972); Gideon v. Wainwright, 372 U.S. 335 (1963); Johnson v. Zerbst, 304 U.S. 458 (1938); Powell v. Alabama, 287 U.S. 45 (1932); Betonie v. Sizemore, 496 F.2d 1001 (5th Cir. 1974); United States v. Alderman, 22 C.M.A. 298, 46 C.M.R. 298 (1973).

66. 22 C.M.A. 298, 46 C.M.R. 298 (1973).

67. 490 F.2d at 366. *See* text accompanying note 54 *supra.*

68. 490 F.2d at 366. *See* text accompanying notes 46-47 & 55 *supra.*

69. 490 F.2d at 366.

70. The Fifth Circuit and the Court of Military Appeals applied *Argersinger* to all summary courts-martial. The Ninth Circuit's historical analysis found both *Argersinger* and the sixth amendment inapplicable to summary courts, but the court applied the fifth amendment guarantee of due process to create a limited right to counsel in summary courts-martial. *See* text accompanying notes 42-69 *supra.*

71. Henry v. Warner, 493 F.2d 1231 (9th Cir.), *cert. granted sub nom.* Middendorf v. Henry, 419 U.S. 895 (1974).

sis.[73] In addition to being totally inconsistent with the earlier cases, this reliance was based on congressional actions[74] that gave "no indication that Congress ever made a clear determination that 'military necessity' precludes applying the Sixth Amendment's right to counsel to summary court-martial proceedings."[75] Furthermore, the Court's acceptance of the military necessity argument shows complete disregard for the obvious meaning of the use of appointed defense counsel at summary courts by the Army and Air Force. The acceptance likewise indicates an indifference to the implications that arise from the Navy's policy of allowing the use of private retained counsel at summary courts.[76] This approach to military necessity may well indicate the Court's willingness to accord "a grant of almost total deference to any Act of Congress dealing with the military."[77]

Part of the Court's sixth amendment analysis[78] also suffers from an evidentiary deficiency. In particular, the Court's belief—that a summary court conviction of a minor offense "would likely have no consequences for the accused beyond the immediate punishment meted out by the military"[79]—completely ignores the possible effects of the escalator clauses contained in the Table of Maximum Punishments of the Manual for Courts-Martial.[80] These provisions can detonate the "[e]xplosive [q]uality"[81] of a summary court conviction by empowering a later court-martial to impose considerably greater penalties than those ordinarily authorized.[82] The Marshall dissent raised this point,[83] but the majority ignored it.

After an attack on the "flimsy factual basis" of some of the majority's observations, the Marshall dissent challenged the applicability of two of the factors considered by the majority in its discussion of the sixth amendment issue.[84] *Argersinger*'s holding based the right to

72. *See* text accompanying notes 46-48, 54, 67-69 *supra.*
73. *See* notes 31-32 and text accompanying notes 29-32 *supra.*
74. *See* text accompanying notes 36-38 *supra.*
75. 96 S. Ct. at 1303 (Marshall & Brennan, JJ., dissenting). *See* text accompanying notes 36-40 *supra.*
76. *See* text accompanying note 69 *supra.*
77. 96 S. Ct. at 1304 (Marshall & Brennan, JJ., dissenting).
78. *See* text accompanying notes 16-26 *supra.*
79. 96 S. Ct. at 1289.
80. MCM, *supra* note 3, at ¶ 127c, § B.
81. Feld, *The Court-Martial Sentence: Fair or Foul?*, 39 VA. L. REV. 319, 322 (1953).
82. *See* MCM, *supra* note 3, at ¶ 127c, § B.
83. 96 S. Ct. at 1299 (Marshall & Brennan, JJ., dissenting).
84. *Id.*

counsel on the possibility of confinement, without regard for the trivial nature of the offense or the absence of consequences collateral to the conviction.[85] The majority's consideration of the latter two factors,[86] as the dissent points out, therefore conflicts with *Argersinger*.[87]

Also troublesome is the Court's implied contention that the non-adversary nature of the summary court, as exemplified by the multiple roles of the presiding officer, makes defense counsel unnecessary.[88] *Powell v. Alabama*[89] rejected the notion that a judge can serve effectively as defense counsel, citing his inability to "investigate the facts, advise and direct the defense, or participate in those necessary conferences between counsel and accused which sometimes partake of the inviolable character of the confessional."[90] It seems extremely unlikely that the presiding officer at a summary court-martial, who is a layman,[91] could perform these tasks in such a way that the rights of the accused would be adequately protected.

The practical effect of *Middendorf* is likely to be the preservation of the summary court-martial. Prior to *Middendorf*, many military lawyers expected the *Alderman*[92] decision to supply such strong evidence of the general dissatisfaction with summary courts-martial that Congress would abolish the institution.[93] Now, with *Middendorf* upholding the constitutionality of the summary court proceeding, abolition seems unlikely. It is presumable, furthermore, that the Army and Air Force will abandon their practice of providing defense counsel at summary courts-martial. If this occurs, *Middendorf* will have denied a prospective right to some and eradicated a realized right of others.

The preservation of summary courts-martial is undesirable because the weaknesses of the proceeding are frequently accentuated by the absence of defense counsel. For example, the limited record of a summary court proceeding can effectively immunize an error of the

85. *Id.* (citing Argersinger v. Hamlin, 407 U.S. 25, 37 (1972)).
86. *See* notes 22-23 and text accompanying notes 21-26 *supra*.
87. *See* 96 S. Ct. at 1299 (Marshall & Brennan, JJ., dissenting).
88. *See id.* at 1290-91; note 24 *supra*.
89. 287 U.S. 45 (1932).
90. *Id.* at 61, *quoted in part in* 96 S. Ct. at 1299-1301 (Marshall & Brennan, JJ., dissenting).
91. Lermack, *Summary and Special Courts-Martial: An Empirical Investigation*, 18 St. Louis U.L.J. 329, 354 (1974).
92. 22 C.M.A. 298, 46 C.M.R. 298 (1973). *See* text accompanying notes 51-56 *supra*.
93. *See* Lermack, *supra* note 91, at 374 n.183, 378.

summary court from review.[94] "Counsel can seek to avoid the disadvantage of the sparse record by requesting a verbatim transcript or by taking detailed notes of the proceeding. Where the record is complete, obviously the reviewer can more effectively assess the potential errors of the summary court."[95] In like manner, defense counsel can more effectively protect the accused's ability to prepare his defense in the face of the pressing demands of time that often characterize summary court proceedings.[96]

The negative image engendered by the summary court-martial is another disadvantage of the institution's continued existence.[97] Summary proceedings "are likely to contribute to the atmosphere of cynicism surrounding the entire legal process."[98] If *Middendorf* has the expected effect of causing the Army and Air Force to discontinue the appointment of defense counsel in summary courts-martial, the Supreme Court itself will have contributed to whatever additional loss of faith in the law results.

The Court's heavy reliance on the distinct qualities of the summary court-martial's military environment[99] minimizes the likelihood that the civilian community will feel *Middendorf*'s significance as a retreat from the principles established in *Argersinger* and its antecedents.[100] Nevertheless, this retreat may signal a trend for the military. By failing to rule on the Navy's practice of allowing private retained counsel at summary courts-martial, the Court left open the possibility of a suit based on concepts of equal protection.[101] It is improbable that the Court would accept such an argument without a change in the direction taken in *Middendorf*.

It is unfortunate that the Court departed from the holding of *Argersinger* to preserve the summary court-martial, in which "one finds the coincidence of the military accused least able to defend himself being tried by the military court most unsuited to insure legal rights

94. Fidell, *The Summary Court-Martial: A Proposal*, 8 HARV. J. LEGIS. 571, 586 (1971).

95. Case Comment, *Right to Counsel at a Summary Court-Martial—Daigle v. Warner*, 7 SUFFOLK U.L. REV. 719, 727 (1973) (citing Fidell, *supra* note 94, at 592).

96. *See* Lermack, *supra* note 91, at 354-55.

97. *See id.* at 373, 378.

98. *Id.* at 373.

99. *See* text accompanying notes 20-26 & 28 *supra*.

100. *See* cases cited in note 65 *supra*.

101. *Cf.* 96 S. Ct. at 1302 (Marshall & Brennan, JJ., dissenting) (because private retained counsel is permitted, only defendants who cannot afford to pay will be denied counsel).

. . . ."[102] The rule that, absent a waiver, "no person may be imprisoned . . . unless he was represented by counsel at his trial"[103] could apply to the military without undue disruption of its functions. In reaching a contrary conclusion, the *Middendorf* Court over-estimated the needs of the military and under-estimated the needs of the individual.

MARK A. STERNLICHT

## Mortgages—Use of Due on Sale Clause by a Lender Is Not a Restraint on Alienation in North Carolina

During the last seven centuries of judicial history, courts have construed restraints on alienation to be contrary to public policy and therefore void.[1] The North Carolina Supreme Court has followed this tradition by consistently holding that conditions that restrain the alienation of legal[2] and equitable[3] estates are void. In *Crockett v. First Federal Savings & Loan Association*,[4] however, the court altered its position. In departing from the traditional restraints on alienation doctrine, the court developed a new test and sustained the use of a due on sale clause[5] as a valid restraint on alienation.[6] This result was reached de-

102. Note, *Military Law—Courts-Martial—Recent Cases Defining the Right to Counsel Before Summary Courts-Martial*, 1975 B.Y.U.L. REV. 285, 292-93.

103. 407 U.S. at 37.

1. The Statute of Quia Emptores, 18 Edw. 1, cc. 1-3, was enacted in 1290. Under this statute the doctrine of subinfeudation was limited by prohibition of feudal tenures in a fee simple estate. L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 15 (2d ed. 1956). This statute laid the basis for many of the common law doctrines dealing with restraints on alienation.

2. Brooks v. Griffin, 177 N.C. 7, 97 S.E. 730 (1919); Latimer v. Waddell, 119 N.C. 370, 26 S.E. 122 (1896).

3. *E.g.*, Lee v. Oates, 171 N.C. 717, 88 S.E. 889 (1916).

4. 289 N.C. 620, 224 S.E.2d 580 (1976).

5. Mortgages that contain a due on sale clause permit the lender to withhold consent to possible transfers by the mortgagor. A mortgagor who seeks to alienate his property without the lender's consent faces the possible exercise of the clause by the lender. An exercise will force acceleration of the existing note and all principal will be due on the note at the time of sale. The clause used in *Crockett* reads:

> [O]r if property herein conveyed is transferred without the written assent of the Association, then in all or any of said events the full principal sum with all unpaid interest thereon shall at the option of Association, its successors or assigns, become at once due and payable without further notice and irrespective of the date of maturity expressed in said note.

*Id.* at 622, 224 S.E.2d at 582.

6. *Id.* at 630-31, 224 S.E.2d at 587.

spite the fact that the sole reason for the lender's decision to enforce the due on sale clause, and thus to accelerate the note, was to collect a higher interest rate.

In April of 1975, plaintiffs, Mrs. Crockett and Mr. and Mrs. Proctor, entered into a contract with defendant Association for the purchase of three apartment buildings. The agreement was conditioned on the Proctors' ability to assume the outstanding balance of the indebtedness on the buildings at the seven percent rate specified in the note.[7] Defendant Association agreed to accept the assumption agreement provided that the Proctors consented to a new interest rate of nine and three-quarters percent. If a transfer were made under any other circumstances, the Association would accelerate the note. Suit was brought by plaintiffs to restrain enforcement of the clause and for money damages. In superior court, summary judgment was granted for plaintiffs.[8] The supreme court reversed, holding that justifiable reasons exist for enforcing such clauses and that their overall effect on alienation is insignificant.[9] These justifiable reasons are not limited to security impairment but could include significant economic interests such as raising the interest rate.[10]

To evaluate the *Crockett* decision properly, it is necessary to examine prior case law dealing with the restraint on alienation doctrine and its relationship with the due on sale clause. Courts have taken three different approaches in analyzing restraints. The first two approaches deal with direct restraints on the alienability of property. The majority doctrine of direct restraints, which is the traditional view, holds all restraints invalid per se unless the restriction falls within certain recognized exceptions.[11] Under the minority doctrine of direct re-

7. Crockett had assumed the note when she purchased the apartments from Domar Corporation, the original debtor, in May of 1968. The original interest rate was seven percent. *Id.* at 635, 636, 224 S.E.2d at 590 (Lake, J., dissenting).

8. Crockett v. First Fed. Sav. & Loan Ass'n, No. 75 CVS 5941 (Super. Ct. of Mecklenburg County, Sept. 24, 1975). The issue of damages was ordered to remain upon the civil docket. 289 N.C. at 620-21, 224 S.E.2d at 581.

9. *Id.* at 630-31, 224 S.E.2d at 587. *But see* Justice Lake's dissent, in which he stated that the due on sale clause is as fundamental a restraint as is the classic promissory restraint. *Id.* at 644, 224 S.E.2d at 595 (quoting Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747 (1973)).

10. *Id.* at 630-31, 224 S.E.2d at 587.

11. *See, e.g.*, Wachovia Bank & Trust Co. v. John Thomasson Constr. Co., 275 N.C. 399, 168 S.E.2d 358 (1969) (condition annexed to creation of charitable trust an exception to restraints doctrine); Lee v. Oates, 171 N.C. 717, 88 S.E. 889 (1916) (condition preventing alienation of woman's separate equitable estate held a valid restraint). *See also* Note, *Deeds of Trust—Restraints Against Alienation—Due-On*

straints, a restraint is valid and reasonable when its purpose outweighs the actual hindrance on the property interest.[12] Under the third view only restrictions classified as indirect restraints on alienation are sustained as valid.[13] The latter two views differ noticeably from the majority direct restraint approach. Under the latter view, the court characterizes the supposed restraint either as an invalid hindrance or as an exception. This characterization is the extent of the analysis. The minority direct restraint view and the indirect view use a balancing process to determine whether justifiable purposes exist for the restriction. Most courts in considering whether the due on sale clause is a restraint on alienation have sustained the clause under either the minority doctrine of direct restraints or the indirect view.[14]

Out of this judicial balancing, several social and economic factors have emerged as salient to the decision whether a due on sale clause is a valid restriction. Most factors cited by the courts have involved security impairment[15] and the economic interests of the lender. These interests include increased interest rates,[16] reduced lending risk[17] and increased lending caused by greater turnover of loan funds.[18] In balancing the risk of security impairment against the economic interests of the lender, courts have developed three divergent views concerning the due on sale clause.[19]

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*Clause is an Unreasonable Restraint on Alienation Absent a Showing of Protection of Mortgagee's Legitimate Interests*, 47 MISS. L.J. 331 (1976).

12. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975); Gale v. York Center Community Coop., 21 Ill. 2d 86, 171 N.E.2d 30 (1960). *See generally* Bernhard, *The Minority Doctrine Concerning Direct Restraints on Alienation*, 57 MICH. L. REV. 1173 (1959).

13. L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 1112 (2d ed. 1956). An indirect restraint on alienation arises when an attempt is made to accomplish some purpose other than the restraint on alienability, but with the incidental result that the instrument if valid would restrain practical alienability. *Id.*

14. *See* Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964); Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 509 P.2d 1240 (1973).

15. *E.g.*, Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 481 S.W.2d 725 (1972); Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 66 Wis. 2d 210, 223 N.W.2d 921 (1974).

16. *E.g.*, Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970); Gunther v. White, 489 S.W.2d 529 (Tenn. 1973).

17. *E.g.*, Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *cert. denied*, 108 Ariz. 192, 494 P.2d 1332 (1972); Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969).

18. This is the ultimate result of use of the due on sale clause. A greater number of loans can be made with adequate protection given by the due on sale clause. *See* Note, *supra* note 11, at 345.

19. Most of the early case law that laid the foundation for the three views came

In one view, the impairment of security approach, mere allegation by the lender that the covenants or conditions of the loan have been violated is not enough to justify acceleration.[20] "Acceleration can occur only when the purpose of the clause has been circumvented or the lender's security jeopardized."[21] The courts following this view feel that if circumvention were not present and the clause were enforced, then the equitable powers of the court would be invoked to impose an extreme penalty on the debtor.[22] This approach is the most restrictive of the three.

A second view, the reasonable circumstances view, allows the lender to enforce the due on sale clause when his action is reasonable under the circumstances.[23] Courts using this approach usually balance the equitable factors involved.[24] Economic interests of both the borrower and the lender are also balanced under this view. An interesting development in these cases is that the lender's desire to increase the interest rate of a note is not an invalid reason per se.[25] By recognizing both the economic interest of the lender and the individual circumstances of the mortgagor, this approach leads to varied results.

The final view, the per se approach,[26] gives the lender the greatest amount of authority. Under this approach, the lender may enforce the

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from the California Supreme Court. The first of these cases was Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964), which held that the due on sale clause was a valid instrument if it served to protect justifiable interests (*e.g.*, property upkeep, integrity and character of purchaser). In Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969), the court held that lenders had discretion in the use of their money and no obligation existed to act reasonably. Later cases began to cut back on this precedent. In La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971), the court recognized that automatic enforcement of a due on encumbrance clause was unnecessary to protect security. Finally in Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974), the court severely limited *Cherry, supra*, by holding that automatic enforcement of a due on sale clause will no longer be permitted. Legitimate interests must exist before a lender will be able to exercise the clause.

20. *E.g.*, Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *cert. denied*, 108 Ariz. 192, 494 P.2d 1322 (1972).

21. *Id.* at 81, 486 P.2d at 193.

22. *See, e.g., id.*

23. *See generally* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747 (1973).

24. *E.g.*, Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 66 Wis. 2d 210, 223 N.W.2d 921 (1974).

25. *E.g.*, People's Sav. Ass'n v. Standard Indus., Inc., 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970); Gunther v. White, 489 S.W.2d 529 (Tenn. 1973).

26. *See, e.g.*, Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970). Controversy has centered around whether Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964), should be placed in this

clause for strictly economic reasons, for example: (1) lender can rid his portfolio of low yield loans and make new agreements at higher rates; (2) lender can escape arbitrary termination provisions.[27] The per se approach narrowly construes the due on sale clause in favor of the lender.[28]

In *Crockett*, the North Carolina Supreme Court appears to have rejected the majority direct restraint on alienation doctrine and moved into a balancing process. Application of this balancing process involved mixing several restraint on alienation views with the due on sale approaches. One of the main criteria used was the *Restatement of Property* definition of restraints.[29] Under this definition restraints are justified by measuring the amount of actual interference with alienation and comparing this result with the objectives sought by enforcement of the restraint. If the actual interference with alienability is insignificant, the supposed restraint will be sustained.[30] This objective-versus-restraint approach is similar to the analysis under both the minority view of direct restraints and the indirect restraint view.[31] In using a balancing approach, the court also incorporated the reasonable circumstances view of due on sale clauses used in other jurisdictions.[32] Unlike the courts in these other jurisdictions, however, the North Carolina court mentioned only a few of the many factors usually involved in due on sale decisions.

One policy consideration mentioned by the court was the failure of the lender to use prepayment penalties.[33] By not using the prepayment penalties, the lender allows the mortgagor to refinance with little difficulty when interest rates drop. Allowing the lender the same abil-

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category. Justice Lake in his dissent suggested that *Coast Bank* did follow the per se approach. 289 N.C. at 638, 224 S.E.2d at 592. Volkmer, *supra* note 23, at 774-75, suggests that Justice Traynor was trying to write *Coast Bank* under the reasonable circumstances view.

27. *See* Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 867, 313 N.Y.S.2d 804, 808 (1970).

28. *See, e.g., id.* at 863, 313 N.Y.S.2d at 804.

29. RESTATEMENT OF PROPERTY § 410, Comment a at 2429 (1944).

30. 289 N.C. at 628, 224 S.E.2d at 586.

31. *See* Bernhard, *supra* note 12. *See generally* L. SIMES & A. SMITH, *supra* note 13, at § 1112.

32. 289 N.C. at 628, 224 S.E.2d at 586.

33. *Id.* at 627, 224 S.E.2d at 585. Prepayment penalties are used by many lenders. If the mortgagor wants to pay the loan off before maturity date, he may have to pay a certain percentage fee based on the outstanding loan amount or the original debt. These fees usually run from one to two percent. *See* Comment, *Usury Law in North Carolina*, 47 N.C.L. REV. 761, 785 (1969). *See also* N.C. GEN. STAT. § 24-10 (Cum. Supp. 1975).

ity to adjust the rates seems equitable.[34] The stress put on this factor by the *Crockett* court is consistent with precedent in other jurisdictions.[35]

Another policy factor[36] mentioned by the court was the ability of plaintiff to alienate her realty absolutely without fear of penalty or forfeiture.[37] Although the mortgagor has the ability to sell his equity, the lender's decision to exercise the clause may often be as effective a "deterrent" as the issuance of an injunction barring the sale.[38] With the emergence of the interest rate as a component of real estate value,[39] the decision by the lender to exercise the clause may either reduce the proceeds of the sale or preclude it entirely.[40] Low interest rates and the ability to assume low interest loans are often major considerations in buying residential real estate.

Another element of major importance in real estate transactions is the relative experience of the parties involved. In *Crockett*, the court attached considerable importance to the principle that courts will not inquire into contractual obligations when parties are of equal competence.[41] Mrs. Crockett and Domar Corporation may have been on "equal footing" with defendant since each had engaged in some commercial property dealings before.[42] But the situation may be quite different when a commercial lender is dealing with the typical residential purchaser,[43] who is extremely naive in real estate transactions. Whether *Crockett* will be limited to its facts or will be extended to include

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34. 289 N.C. at 626, 224 S.E.2d at 585.

35. *See, e.g.*, Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *cert. denied*, 108 Ariz. 192, 494 P.2d 1322 (1972). Enforcement of an acceleration clause was denied on the ground that large prepayment penalties were involved. *Id.* at 81, 486 P.2d at 193.

36. 289 N.C. at 625, 224 S.E.2d at 584.

37. Several commentators, however, point out that the due on sale clause inhibits alienation. *See, e.g.*, Bonanno, *Due-on-Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives*, 6 U.S.F. L. REV. 267, 309 (1972); Note, *Judicial Treatment of the Due on Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109 (1975).

38. *See* Note, *supra* note 37, at 1113.

39. *See* Bonanno, *supra* note 37, at 309.

40. *See* Note, *supra* note 37, at 1113.

41. 289 N.C. at 630, 224 S.E.2d at 587. The court relied on Roberson v. Williams, 240 N.C. 696, 83 S.E.2d 811 (1954).

42. 289 N.C. at 630, 224 S.E.2d at 587 (quoting Roberson v. Williams, 240 N.C. 696, 83 S.E.2d 811 (1954)).

43. *See* Justice Lake's dissenting opinion, 289 N.C. at 642-43, 224 S.E.2d at 594-95.

all real estate purchasers is a problem that the court must face in the future.

Although impairment of security is usually the most important policy factor in due on sale cases, the *Crockett* court did not mention any of the considerations that enter the balancing process to determine whether a lender's security has been impaired. The lender's security often improves upon assumption of an existing note by a new debtor because the lender now has two sources from whom to collect. The new debtor becomes the principal obligor and the initial mortgagor becomes a surety.[44] Another consideration in determining whether security is impaired is actual physical waste or depreciation of the mortgaged premises.[45] Perhaps the most controversial element of security is the identity and personality of the borrower. Several courts have recognized the lender's maintenance of control over the mortgagor's identity and his financial responsibility as an acceptable business objective.[46] Security impairment is of major importance to both the courts and the lenders. The court in *Crockett*, however, failed to analyze the existence of that factor properly.

Because it rejected the traditional view of direct restraints in *Crockett*, the North Carolina Supreme Court had to balance the policy reasons underlying the restraints on alienation doctrine against the need to protect both the economic vitality of secured transactions and the freedom to contract.[47] Enormous policy considerations support each of these important legal concepts. In using a balancing test to determine the validity of the restriction, the court touched on several additional factors that support not only the due on sale clause, but the whole real estate industry. The *Crockett* court described due on sale clauses as conditions that *promote* alienability of property.[48] Without the due on sale clause, a lender would be encouraged to explore alternatives that could significantly reduce consumer access to the housing

44. *See* First Carolinas Joint Stock Land Bank v. Page, 206 N.C. 18, 173 S.E. 312 (1934).

45. *See, e.g.*, Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

46. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975); Peoples Sav. Ass'n v. Standard Indus., Inc., 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).

47. *See* Comment, *Mortgage Consent to Sale Clause: A Reasonable Restraint on Alienation?*, 8 J. MAR. J. PRAC. & PROC. 513, 529 (1975). These principles were appropriately called "Giants of the Law."

48. 289 N.C. at 625, 224 S.E.2d at 584.

market.[49] Higher risks, which could be alleviated by use of the due on sale clause, would force interest rates upward and make mortgage evaluation criteria much stricter. All of these factors point to a reduced supply of mortgage money, which of course restricts alienability.

In his opinion, Justice Copeland noted several economic factors that may be the real crux of *Crockett*. Sensible lenders use the due on sale clause to minimize their risks.[50] Use of the clause also permits the lender to conform his loans to the current market rate. These points can be explained by the economic history of the due on sale clause. As one commentator suggested, the due on sale clause originally developed during times of stable interest rates as a device to protect against bad credit risks.[51] However, during the past few years, home loan interest rates have become volatile. These increased rates have put the savings lender in a different position:

> The basic dilemma of the savings association business is an inability to adjust earnings upward during periods of inflation accompanied by rising interest rates. . . .[52]
>
> Clearly, if a borrower were able to pass on to a vendee the borrower's low interest rate without interference by the lender, all mortgages would continue at that rate until their original maturity date. The effect of this increased payoff time over the current average actual payoff time of eight to ten years would be to freeze a lender's income at unprofitable levels for twenty to thirty years.[53]

Lenders who do not rely on depositors for their funds, such as commercial banks, real estate investment trusts and mortgage companies, are not faced with the same dilemma. However, all lending institutions rely to a great degree on the secondary mortgage market.

These economic considerations are especially important in North Carolina. The two largest investors in the secondary market are the Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank Corporation (FHLBC). Each of these institutions' uniform loan documents contain the due on sale clause.[54] Therefore,

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49. *See* Comment, *Due on Sale and Due on Encumbrance Clauses in California*, 7 LOY. L.A. L. REV. 306, 323 (1974).

50. 289 N.C. at 627, 224 S.E.2d at 585. *See also* Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969).

51. Comment, *Use of "Due on" Clauses to Gain Collateral Benefits: A Common Sense Defense*, 10 TULSA L.J. 590, 610 (1975).

52. *Id.* at 592. *See also* UNITED STATES LEAGUE OF SAVINGS & LOAN ASS'NS, RECOMMENDATIONS OF THE COMMITTEE ON SAVINGS ASS'N NEEDS, 1970.

53. Comment, *supra* note 51, at 592.

54. Brief for North Carolina Savings & Loan League as Amicus Curiae at 9, Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580 (1976). The uniform documents allow the lender to refuse consent to the transfer if the

as a matter of economic policy, *Crockett* is good for North Carolina. If the court had overturned the due on sale clause or construed it strictly, the two largest investors in the mortgage industry might have hesitated to buy North Carolina residential loans in the future.[55]

In addition to the economic factors mentioned by the court, the significant economic impact of the due on sale clause on both interest rates and credit availability is also an important consideration. During the last decade, this nation has witnessed a sharp rise in consumerism.[56] One area of attack by the "consumerists" has been the high interest rates charged by lending institutions. If lenders were precluded from using the due on sale clause, it would be necessary to charge a higher interest rate initially as a possible hedge against the loan continuing for a longer period of time than normal.[57] One result of *Crockett* is that the due on sale clause becomes a safety valve for both lender and borrower. The lender's liquidity is improved and his loan portfolio is kept close to the current rates, which in turn forces down the rate available to consumers.[58]

Several alternatives to adjust rates do exist that the court could have proposed for future use by North Carolina lenders. The first of these is the variable interest rate mortgage. One writer suggests that usage of these loans will render the interest rate an insignificant factor in the price of property.[59] Nevertheless, variable rates may not be the answer for North Carolina. Another financing scheme that could be used is the short term loan with a negotiable rate. However, short term loans may be against the public interest since the borrower's monthly payments are increased and he may have to refinance several times.[60]

As the shortcomings of the feasible alternatives indicate, the due

proposed purchaser and interest rate are not acceptable. Telephone interview with Gus Gesell, President of the Home Savings and Loan Association in Chapel Hill, North Carolina (Sept. 9, 1976).

55. *See* Brief for North Carolina Savings & Loan League as Amicus Curiae at 8, Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580 (1976).

56. *See generally Symposium—Consumer Protection*, 14 SANTA CLARA LAW. 447 (1974).

57. *See* Comment, *supra* note 51, at 594.

58. *See* Bonnano, *supra* note 37, at 809.

59. Brief for North Carolina Savings & Loan League as Amicus Curiae at 8, Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580. The brief states that Federal Home Loan Bank Board Regulations, 12 C.F.R. §§ 545.6-1, .6-3, 6.14 (1976), prohibit federal savings and loan companies from using variable interest rate loans while allowing state savings and loan companies to use them. These regulations would eliminate a large number of lenders in North Carolina.

60. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 509 P.2d 1240 (1970). *See also* Comment, *Tucker v. Lassen Sav. & Loan Ass'n: "Due-on" Clause Held as Restraint on Alienation*, 7 U.W.L.A. L. REV. 258, 265 (1975).

on sale clause is the best economic alternative that the court could have approved. Lenders prefer the clause as a protective device. Although one writer has suggested that the personal credit of a person is irrelevant to the lender for security purposes,[61] the lender is much more secure with a financially responsible person in possession. This ability to determine who will be in possession affords much better protection to the lender than a later foreclosure on a bad risk he was forced to accept. Another added protection provided by the due on sale clause is the lender's ability to maintain his current loan portfolio at a higher rate of interest. A more current portfolio increases lending and stimulates economic activity. Of course these added protections are in turn passed on to the borrower. Due on sale clauses allow borrowers to receive a lower rate,[62] longer terms on the mortgage contract[63] and more readily available mortgage credit.[64] *Crockett* was indeed an economic victory for both the lenders and borrowers of North Carolina.

*Crockett*, although a success economically, may have its shortcomings as a practical standard for the public to follow. Much of the language used in the opinion points to application of the reasonable circumstances view of the due on sale clause. However, little discussion of the factors that usually go into this balancing analysis was made. A possible result of this inadequate discussion may be confusion in the lending market. A lender who reads *Crockett* as adopting the per se approach[65] may want to accelerate at any time to reach the current interest rate obtainable in the market. Every possible transfer in North Carolina would be subject to the unlimited scrutiny of the lender. These transfers could occur not only by inter vivos conveyances, but also by intestacy, testamentary devise, survivorship or even declaration of trust.[66] If the lender has an unrestrained power of consent to any possible transfer, then a virtual life and death control over the property exists.[67]

On the other hand, a borrower who reads the decision as adopting

61. *See* Bonanno, *supra* note 37, at 289-90.

62. *See* Comment, *supra* note 51, at 594.

63. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 509 P.2d 1240 (1973).

64. *See* Comment, *Due on Sale and Due on Encumbrance Clauses in California*, 7 LOY. L.A. L. REV. 306 (1974).

65. Mr. Justice Lake suggests this approach in his dissent. 289 N.C. at 638, 224 S.E.2d at 592.

66. *See* Bonanno, *supra* note 37, at 290.

67. *See* Comment, *Mortgages—a Catalogue and Critique on the Role of Equity in the Enforcement of Modern-Day "Due-on-Sale" Clauses*, 26 ARK. L. REV. 485, 501 & n.71 (1973).

the reasonable circumstances view has no effective guidelines to follow. Will lenders be forced to divulge their trade secrets and give reasons to support their conclusions of who is or is not a bad credit risk? The definition of the creditworthy borrower—along with several other unresolved issues—will have to be answered in the future.[68]

Although a judicial landmark, *Crockett* will need future expansion. Nevertheless *Crockett* has laid a good foundation for adoption of the reasonable circumstances view in North Carolina.[69] The task for the courts is to build on this foundation and develop clear practical guidelines for all to follow. This task will be brought to the forefront soon, for the reasonable circumstances view of the due on sale clause will promote more litigation than either the per se approach or the impaired security view.[70]

Despite its unclear analysis and limited discussion of important factors, *Crockett* was a good result for North Carolina. Instead of involving itself in the traditional approach of restraint on alienation and merely dismissing the due on sale clause as a restraint, the court was able to recognize the significant economic policies involved in the case. Use of due on sale clauses encourages available mortgage credit, facilitates land ownership and, as a result, stimulates the alienation of property. Each of these effects is a needed and desirable stimulant for our economy. Although *Crockett* may well have damaged the traditional view of restraints on alienation, it did not destroy the doctrine. The court's awareness of the economic credit society in which we live and of the great effect lending institutions have on the public was the true basis for *Crockett*. Future North Carolina cases involving supposed restraints that do not carry these economic and public overtones will probably be decided under the traditional view of restraints.

WILLIAM ROBERT CHERRY, JR.

68. Several other factors left unconsidered are as follows: (1) the guidelines needed to measure the physical security impairment; (2) the borrowing class a certain individual is in; (3) the important variables of the money market; (4) the evidence needed to support a lender's decision regarding his loan portfolio; (5) whether the portfolio decision and requested interest rate increase will be analyzed under an objective or subjective approach. The weight to be given to these factors will have to be determined on a case-by-case basis. One court, however, has already suggested that a case-by-case basis will lead to instability in land titles. *See* Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975).

69. 289 N.C. at 630-31, 224 S.E.2d at 587. The court suggested that the circumstances of the case and the absence of other allegations supported the reasonable circumstances view.

70. *See generally* Note, *supra* note 11, at 336 & n.1.

## Professional Responsibility—North Carolina's View of the Lawyer and the Perjurious Witness

A fundamental right of an accused in our adversary system of criminal justice is the right to be represented by counsel[1] who will zealously advocate his cause against the State.[2] In fulfilling this duty of zealous advocacy the lawyer, as an officer of the court, is required by the ethical code of his profession always to function within the bounds of the law.[3] Against this background, and in the difficult context of the trial of an indigent defendant represented by a court-appointed attorney, the North Carolina Supreme Court in *State v. Robinson*[4] was forced to grapple with one of the most difficult ethical problems faced by the defense attorney: what must the lawyer do to fulfill his duties to client and court when, before trial, his client informs him of his intention to proffer perjured testimony and of his desire to call a witness who will commit perjury? The supreme court's decision was that the trial court's "compromise" solution—denying counsel's request to withdraw, but giving him no responsibility for eliciting what he believed to be perjured testimony—denied defendant a fair trial.[5] If this decision is neither limited nor overruled, the proper answer to an already perplexing question for the attorney is even more doubtful than before.

Defendant Jerome Robinson was found guilty in the Superior Court of Mecklenburg County of felonious breaking and entering and of larceny.[6] Prior to the entry of a plea to the indictment, defendant's court-appointed attorney, William Burns, moved jointly with Robinson that Burns be allowed to withdraw from the case and that substitute counsel be appointed.[7] In support of the motion, Burns informed the

1. "In all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defense." U.S. CONST. amend. VI.

2. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Canon 7 (1969); ABA STANDARDS, THE DEFENSE FUNCTION § 1.1(b) (Approved Draft, 1971) [hereinafter cited as ABA STANDARDS].

3. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Canon 7 (1969); ABA STANDARDS, *supra* note 2, at § 1.1(b).

4. 290 N.C. 56, 224 S.E.2d 174 (1976).

5. *Id.* at 67, 224 S.E.2d at 180.

6. *Id.* at 57, 224 S.E.2d at 175. A previous trial for the same offenses ended in a mistrial. Defendant Robinson was represented by William Burns, but there is no mention in the record of conflict between the two over the use of possibly perjured testimony. Brief for Defendant-Appellant at 5, State v. Robinson, 28 N.C. App. 65, 220 S.E.2d 387 (1975).

7. The motion and ensuing remarks by the judge, defense counsel and defendant on each occasion were made in the absence of either prospective or impaneled jurors. 290 N.C. at 58, 224 S.E.2d at 175.

court that a "substantial conflict"[8] had arisen because of defendant's desire, and counsel's unwillingness, to offer at trial what counsel believed would be perjured testimony by defendant and a defense witness.[9] On three subsequent occasions during the course of the trial, defendant, either joined by counsel or on his own behalf, renewed the same motion. On each occasion the motion was denied, the trial judge refusing to shift the ethical burden to another attorney who, the judge assumed, would also refuse to present false testimony.[10] Instead, Burns was left to the alternative of remaining in charge of certain portions of the trial without obligation to participate in eliciting the allegedly perjured testimony.[11]

In accordance with the court's plan, Burns remained seated at the counsel table throughout the trial and, as counsel for defendant, cross-examined the State's witnesses.[12] He called only one defense witness, Carolyn Bertha,[13] and after eliciting her responses to some preliminary questions, requested that she tell her story to the jury.[14] At the close of Bertha's statement Burns remained silent and defendant took charge of

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8. *Id.*

9. *Id.* Burns made the following statement to the court:

> The defendant has indicated to me he wishes to take the witness stand in his own behalf; which, in my opinion, is perjured testimony. He has indicated he intends to call a witness to the witness stand and elicit testimony which would be perjured testimony to that individual; and I feel that on the basis of that, substantial conflict has arisen between the defendant and myself which would prevent me from devoting my full effort to his representation in this matter; and in addition to that, I don't feel that I should participate in the matter any further because of the foregoing; and I do respectfully request that I be allowed to withdraw as counsel for the defendant.

*Id.* Burns also based his belief that the testimony would be perjurious on previous statements alleged to have been made to him by the witness and on his own independent investigation of the case. *Id.* at 62, 224 S.E.2d at 177. Defendant denied having told his lawyer that the witness' testimony would be false. *Id.* at 63, 224 S.E.2d at 178.

10. *Id.* at 59, 224 S.E.2d at 175.

11. *Id.* at 59-60, 224 S.E.2d at 176. In colloquy with defendant, the trial judge described the extent of counsel's responsibility:

> [Y]ou can defend yourself of [sic] perjured testimony if you want to; but I'm not going to ask a lawyer to; I'll let Mr. Burns sit by you and pick a jury, examine the State's witnesses in your behalf; but when it comes to your defense, if you're going to offer perjured testimony, I'm going to let Mr. Burns sit there silently and ask you nothing. When you come on the witness stand, you're on your own.

*Id.*

12. *Id.* at 60, 224 S.E.2d at 176.

13. Defendant chose not to testify in his own behalf. *Id.* at 62, 224 S.E.2d at 177.

14. *Id.* at 63, 64, 224 S.E.2d at 178. The court gave the following instructions about the examination of the witness: "I'm going to allow you to call the witness, identify her by name and address, and you can tell her to say whatever she wants to say about it and you won't have to ask her any questions about it." *Id.* at 63, 224 S.E.2d at 178.

the direct examination of the witness.[15] Counsel did not later argue the witness' testimony in a closing statement to the jury.[16]

Defendant appealed his conviction on the ground that the trial judge denied his constitutional right to effective assistance of counsel when he denied the motion to allow Burns to withdraw and refused to appoint substitute counsel.[17] The North Carolina Supreme Court held that there was no such denial.[18] The court reasoned that although an indigent defendant in a state criminal prosecution has the constitutional right to effective assistance of competent counsel appointed by the court to represent him,[19] he does not have the right to demand that counsel, appointed and representing him within the bounds of the law, be removed and replaced because of defendant's unfounded dissatisfaction with his services.[20] The representation afforded defendant did not, in the court's view, render his trial a "farce and a mockery of justice";[21] therefore, the supreme court ruled that the trial judge did not abuse his discretion in finding that Burns' refusal to participate in a fraud on the court was not a good cause for his replacement by another attorney.[22]

The court went on to hold, however, that defendant did have the right to elect to represent himself and to refuse the services of counsel with whom he was clearly in irreconcilable conflict over the course to be adopted in his defense.[23] According to the supreme court the trial court's adoption of a "middle course,"[24] although intended to provide needed assistance, served rather to convey to the jury that there was discord between defendant and his lawyer, and that counsel attached little credibility to the testimony of the only defense witness.[25] The resulting prejudice to defendant's case was therefore held to have denied

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15. *Id.* at 64.

16. Brief for Appellee at 4, State v. Robinson, 28 N.C. App. 65, 220 S.E.2d 387 (1975).

17. 290 N.C. at 58, 224 S.E.2d at 175. The court of appeals found no error. State v. Robinson, 28 N.C. App. 65, 220 S.E.2d 387 (1975).

18. 290 N.C. at 66, 224 S.E.2d at 180.

19. Gideon v. Wainwright, 372 U.S. 335 (1963); State v. Sneed, 284 N.C. 606, 201 S.E.2d 867 (1974).

20. *See* cases cited note 32 *infra.*

21. State v. Sneed, 284 N.C. 606, 612, 201 S.E.2d 867, 871 (1974). *See also* cases cited note 34 *infra.*

22. 290 N.C. at 66, 224 S.E.2d at 180. *See also* note 34 *infra.*

23. 290 N.C. at 67, 224 S.E.2d at 180. *See, e.g.*, State v. Alston, 272 N.C. 278, 158 S.E.2d 52 (1967); State v. Morgan, 272 N.C. 97, 157 S.E.2d 606 (1967); State v. Elliott, 269 N.C. 683, 153 S.E.2d 330 (1967); State v. McNeil, 263 N.C. 260, 139 S.E.2d 667 (1965).

24. 290 N.C. at 67, 224 S.E.2d at 180.

25. *Id.*

him the fair trial required by the due process clause of the fourteenth amendment.[26] Accordingly, a new trial was ordered.[27]

Cases dealing with the issue of the indigent defendant's right to counsel have uniformly held that such a defendant must accept the lawyer appointed by the court to represent him unless he wishes to proceed in his own behalf[28] or can establish a substantial reason for substitution of new counsel. The courts have also been consistent in holding that "whether to appoint a different lawyer for an indigent criminal defendant who expresses dissatisfaction with his court-appointed counsel is a matter committed to the sound discretion of the [trial] court."[29] A bare allegation of "unfounded dissatisfaction"[30] with a competent assigned lawyer, who is " 'proceeding according to his best judgment and the usually accepted canons of criminal trial practice,' "[31] will not constitute good cause for his replacement.[32] Rather, a defendant must make a sufficient showing that under the particular circumstances of his case, his constitutional right to effective assistance will be substantially impaired or denied by the court's refusal to grant his request for the appointment of another lawyer.[33]

In North Carolina there is a heavy burden on defendant, for the standard of proof is a stringent one: "[T]he general rule [is] that the

26. *Id.*

27. *Id.* At the new trial, defendant is to be represented by his current court-appointed lawyer or other competent counsel selected by the court. If such counsel is unsatisfactory to defendant, he may elect to conduct his own defense without a lawyer. *Id.*

28. *E.g.*, United States v. Young, 482 F.2d 993 (5th Cir. 1973); Brown v. United States, 264 F.2d 363 (D.C. Cir. 1959); Campbell v. State, 231 Md. 21, 188 A.2d 282 (1963) (per curiam); State v. McNeil, 263 N.C. 260, 139 S.E.2d 667 (1965); State v. Wilkinson, 12 Wash. App. 522, 530 P.2d 340 (1975). If defendant wishes to proceed in his own behalf, unsatisfactory counsel cannot be forced on him. *See* cases cited note 23 *supra*. *See also* Note, *Criminal Procedure—The Right to Proceed Pro Se: Judicial Gymnastics with the Sixth Amendment*, 54 N.C.L. REV. 705 (1976).

29. United States v. Young, 482 F.2d 993, 995 (5th Cir. 1973). *But see* Tague, *An Indigent's Right to the Attorney of His Choice*, 27 STAN. L. REV. 73 (1974).

30. State v. Moore, 6 N.C. App. 596, 598, 170 S.E.2d 568, 570 (1969).

31. State v. McNeil, 263 N.C. 260, 270, 139 S.E.2d 667, 673-74 (1965) (quoting Annot., 157 A.L.R. 1225, 1226 (1945)).

32. *E.g.*, United States v. Young, 482 F.2d 993 (5th Cir. 1973) (defendant unreasonably believed that counsel was communicating confidences to the prosecutor); Brown v. United States, 264 F.2d 363 (D.C. Cir. 1959) (counsel pessimistic about defendant's chances for a favorable verdict); United States v. Gutterman, 147 F.2d 540 (2d Cir. 1945) (counsel advised defendant to plead guilty in the face of overwhelming evidence and refused to call a witness defendant wanted to testify); State v. Gibson, 14 N.C. App. 409, 188 S.E.2d 683 (1972) (defendant desired an attorney who would do more for him); State v. Scott, 8 N.C. App. 281, 174 S.E.2d 80 (1970) (defendant dissatisfied with counsel because unreasonable bond had been set); State v. Moore, 6 N.C. App. 596, 170 S.E.2d 568 (1969) (counsel had a negative attitude).

33. For a compilation of cases see Annot., 157 A.L.R. 1225 (1945).

incompetency (or one of its many synonyms) of counsel . . . is not a Constitutional denial of [the] right to effective counsel unless the attorney's representation is so lacking that the trial has become a farce and a mockery of justice."[34] Only in extreme circumstances is it likely that such a deprivation will be found.[35]

To understand properly the significance of the court's holding that Robinson was ultimately denied a fair trial, some knowledge of the professional debate about the duties and obligations of the lawyer confronted with the perjurious witness, and of the sources to which he may turn for guidance, is essential. The official standards governing the conduct of the legal profession are contained in the Code of Professional Responsibility;[36] it is in interpreting the admonitions and pro-

34. State v. Sneed, 284 N.C. 606, 612, 201 S.E.2d 867, 871 (1974). *See, e.g.*, Snead v. Smyth, 273 F.2d 838 (4th Cir. 1959); Doss v. North Carolina, 252 F. Supp. 298 (M.D.N.C. 1966); Edgerton v. North Carolina, 230 F. Supp. 264 (E.D.N.C. 1964).

Although North Carolina still follows the farce-mockery standard first established in Diggs v. Welch, 148 F.2d 667 (D.C. Cir.), *cert. denied*, 325 U.S. 889 (1945), other jurisdictions (including the Sixth Circuit, which first decided *Diggs*) have rejected it as a standard for deciding whether an accused has been denied effective assistance of counsel. Rather, effective counsel is "counsel reasonably likely to render *and rendering* reasonably effective assistance." MacKenna v. Ellis, 280 F.2d 592, 599 (5th Cir. 1960). *Accord*, Beasley v. United States, 491 F.2d 687 (6th Cir. 1974); West v. Louisiana, 478 F.2d 1026 (5th Cir. 1973), *aff'd on rehearing*, 510 F.2d 363 (5th Cir. 1975) (per curiam); Bruce v. United States, 379 F.2d 113 (D.C. Cir. 1967). *See generally* Beaney, *The Right to Counsel: Past, Present, and Future*, 49 VA. L. REV. 1150 (1963); Note, *Criminal Defendants Entitled to Reasonably Competent Assistance of Counsel*, 12 AM. CRIM. L. REV. 193 (1974); Note, *Effective Assistance of Counsel for the Indigent Defendant*, 78 HARV. L. REV. 1434 (1965).

35. Duboise v. North Carolina, 225 F. Supp. 51, 53 (E.D.N.C. 1964). In *Duboise* the court cited Jones v. Cunningham, 297 F.2d 851 (4th Cir. 1962), as an example of such extreme circumstances. (Counsel was appointed on the day of defendant's trial, made no investigation of the case, yet advised a guilty plea because defendant had previously made a coerced confession.)

36. The Code was promulgated by the American Bar Association in 1969 to replace the Canons of Professional Ethics that had been in effect since 1908. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preface (1969).

The Code is divided into Canons, Ethical Considerations and Disciplinary Rules:

> The Canons are statements of axiomatic norms, expressing in general terms the standards of professional conduct expected of lawyers in their relationships with the public, with the legal system, and with the legal profession. They embody the general concepts from which the Ethical Considerations and the Disciplinary Rules are derived.
>
> The Ethical Considerations are aspirational in character and represent the objectives toward which every member of the profession should strive. They constitute a body of principles upon which the lawyer can rely for guidance in many specific situations.
>
> The Disciplinary Rules, unlike the Ethical Considerations, are mandatory in character. The Disciplinary Rules state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action.

*Id.* Preliminary Statement (footnote omitted). North Carolina adopted the Code (with modifications) in 1974, pursuant to a resolution of the North Carolina State Bar, 283 N.C. 783 (1973).

hibitions of the Code that members of the profession have divided.[37]

The "traditional" point of view (among whose exponents is Chief Justice Warren Burger)[38] is that although the lawyer in our adversary system of justice owes a high duty of zealous advocacy[39] and strict confidentiality[40] to his client, he is simultaneously an officer of the court who must always conduct himself within the bounds of the law.[41] Given this duty, never, under any circumstances, may a lawyer knowingly proffer perjured testimony and thereby participate in a fraud upon the court.[42] If the client reveals his intention to take the stand and to lie,[43]

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37. In an attempt to give further practical guidance to those confronting ethical problems in criminal trial practice, the American Bar Association has also adopted STANDARDS RELATING TO THE PROSECUTION FUNCTION AND THE DEFENSE FUNCTION (Approved Draft, 1971). When used in the Standards "the term 'unprofessional conduct' denotes conduct which is or should be made subject to disciplinary sanctions. Where other terms are used, the standard is intended as a guide to honorable professional conduct and performance." ABA STANDARDS, *supra* note 2, at § 1.1(f).

38. Burger, *Standards of Conduct For Prosecution And Defense Personnel: A Judge's Viewpoint*, 5 AM. CRIM. L.Q. 11 (1966).

39. "The basic duty the lawyer for the accused owes to the administration of justice is to serve as the accused's counselor and advocate, with courage, devotion and to the utmost of his learning and ability, and according to law." ABA STANDARDS, *supra* note 2, at § 1.1(b). *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY, Canon 7 (1969).

40. A lawyer is prohibited from revealing a confidence or secret of his client and from using a confidence or secret of his client to the disadvantage of the client. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 4-101(B)(1)-(2) (1969).

> "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

*Id.* DR 4-101(A). *See* ABA STANDARDS, *supra* note 2, at § 3.1(a), and Commentary.

41. Burger, *supra* note 38, at 12. *See* note 39 *supra*; ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 7-1 (1969).

The North Carolina Supreme Court, although it cites none of the authorities, appears to agree with this proposition: the lawyer "is an officer of the court and owes duties to it as well as to his client. In this there is no conflict of interest." State v. Robinson, 290 N.C. 56, 66, 224 S.E.2d 174, 179 (1976).

42. Burger, *supra* note 38, at 12. The Code provides that "[i]n his representation of a client, a lawyer shall not:

> . . . .
> (4) Knowingly use perjured testimony or false evidence.
> . . . .
> (7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.
> (8) Knowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule.

ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-102(A)(4), (7), (8) (1969).

The lawyer is subject to discipline for misconduct as provided in *id.* DR 1-102.

43. On the related issue of the lawyer's duty to reveal a fraud already perpetrated upon the court by his client, see ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-102(B) (1969); ABA COMM. ON ETHICS AND PROFESSIONAL RESPONSIBILITY, Formal Opinions, No. 341 (1975); ABA STANDARDS, *supra* note 2, at § 7.7, Commentary.

and if counsel is unable to dissuade him or to withdraw[44] from the case, counsel "*may not engage in direct examination . . . to facilitate known perjury.* He should confine himself to asking the witness to identify himself and to make a statement."[45] Neither may the lawyer argue the truth of a lying witness' testimony in his closing statement to the jury.[46] Rather, he must argue the case "on the sufficiency of the government's testimony and the other evidence offered by the defense, exclusive of the . . . perjured testimony."[47]

Critics of the traditional position are led by Dean Monroe Freedman, and it is his answer to the "perjury question" that has been the subject of heated reaction since first offered in 1966.[48] Freedman postulates that the attorney attempting to follow the ethical standards of his profession and, at the same time, to live up to his special responsibilities as partisan advocate in our adversary system finds himself in an impossible "trilemma"[49] when faced with the problem of perjured testimony.[50] "That is, the lawyer is required to know everything, to keep it in confidence, and to reveal it to the court."[51] Although the Code prohibitions that a lawyer shall not "[k]nowingly use perjured

44. The Code provides that a lawyer may seek to withdraw from a case if his client insists that he "pursue a course of conduct that is illegal or that is prohibited under the Disciplinary Rules," ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 2-110(C)(1)(c) (1969), but offers no guidance as to what the lawyer should do if withdrawal is not allowed.

Although Burger does not address the issue, others in substantial agreement with his position believe that in seeking to withdraw, the attorney may not reveal any confidences of his client (*i.e.*, the reasons for withdrawal are privileged). ABA STANDARDS, *supra* note 2, at § 7.7(c); Bress, *Standards of Conduct of the Prosecution and Defense Function: An Attorney's Viewpoint*, 5 AM. CRIM. L.Q. 24 (1966); Gold, *Split Loyalty: An Ethical Problem for the Criminal Defense Lawyer*, 14 CLEV.-MAR. L. REV. 65 (1965).

45. Burger, *supra* note 38, at 13. Although the Code gives no guidance beyond the prohibitions of DR 7-102(A)(4), (7) and (8), "the recommendations of the standard as to the steps to be taken by the lawyer when he must remain in the case after learning of his client's intent to commit perjury are regarded as appropriately avoiding violation of the Disciplinary Rules." ABA STANDARDS, *supra* note 2, at § 7.7(c), Commentary.

Burger also believes that "[s]ince this informal procedure is not uncommon with witnesses, there is no basis for saying that this tells the jury the witness is lying. A judge may infer that such is the case but lay jurors will not." Burger, *supra* note 38, at 13.

46. Bress, *supra* note 44, at 24; ABA STANDARDS, *supra* note 2, at § 7.7(c).

47. Bress, *supra* note 44, at 24.

48. Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469 (1966).

49. M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 28 (1975).

50. *Id.* at 27.

51. *Id.* at 28. "[T]he difficulties presented by those conflicting obligations are particularly acute in the criminal defense area because of the presumption of innocence, the burden upon the state to prove its case beyond a reasonable doubt, and the right to put the prosecution to its proof." *Id.*

testimony,"[52] "[c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent,"[53] or "[k]nowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule"[54] seem fairly clear, the Code does not indicate how a lawyer is to go about fulfilling his obligations when faced with a criminal defendant who proposes to testify falsely.[55]

It is Freedman's view that once the attorney has pried and cajoled all the relevant facts from a client, having assured the client that full disclosure is necessary to a successful defense[56] and "will never result in prejudice to the client by any word or action of the attorney,"[57] the attorney must honor his obligation of confidentiality.[58] If the client proposes to perjure himself

> the attorney's obligation . . . would be to advise the client that the proposed testimony is unlawful, but to proceed in the normal fashion in presenting the testimony and arguing the case to the jury if the client makes the decision to go forward. Any other course would be a betrayal of the assurances of confidentiality given by the attorney in order to induce the client to reveal everything . . . .[59]

Freedman rejects the course of withdrawal[60] as not viable, particularly in the case of the indigent defendant, since in most jurisdictions a court-appointed lawyer or public defender will not be allowed to withdraw from a case unless he establishes an extraordinary reason for moving for leave to withdraw.[61] Freedman also rejects the Burger solution of putting the witness on the stand merely to tell his story, unaided by his lawyer, and of ignoring his testimony in closing argument, as too highly

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52. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-102(A)(4) (1969).
53. *Id.* DR 7-102(A)(7).
54. *Id.* DR 7-102(A)(8).
55. M. FREEDMAN, *supra* note 49, at 29.
56. *Id.* at 30.
57. *Id.*
58. *Id.*
59. *Id.* at 31.
60. Freedman views withdrawal as an avoidance of the ethical problem, since defendant, if he is not indigent, will retain another lawyer from whom he will withhold any incriminating information or the fact of guilt. The new lawyer will be ignorant of the proposed perjury and, therefore, will be unable to discourage the client from presenting it. *Id.* at 33.
61. *Id.* Thus, the attorney must either lie to the judge about his reason for moving to withdraw or else reveal that he has received knowledge of his client's guilt. The latter alternative would violate the obligation of confidentiality, especially since in many jurisdictions the same judge who allows the lawyer to withdraw will later hear the case and sentence the defendant. *Id.* at 34.

prejudicial to defendant's case[62] because of adverse inferences a jury will draw from such a procedure.

In *Robinson* the North Carolina Supreme Court followed a clear line of precedent in rejecting defendant's sixth amendment-based claim that he was denied effective assistance of counsel.[63] The court itself, apparently motivated by a feeling that the trial afforded Robinson was less than fair, raised the due process issue that provided the basis for reversal of defendant's conviction. Unlike the lengthy analysis of the already clear limitations on the indigent's right to counsel, the court's disposition of the fair trial issue was not accompanied by an informed discussion of the intense controversy over the proper role for the lawyer who, in the course of representation, must deal with a potentially perjurious witness.[64] In finding for defendant on due process grounds, without proper regard for the complex ethical issue that the situation in *Robinson* presents, the court created a dilemma for the defense attorney who would attempt to reconcile his duties to his client with those to the code of his profession.

Not once in its opinion did the supreme court allude to or cite any of the provisions of the Code of Professional Responsibility or the American Bar Association Standards. Yet the court's assertion that Burns clearly had no duty to proffer perjured testimony[65] is consistent with the prohibitions of the Code[66] and the Standards.[67] Despite this apparent agreement with Code and Standards, the court rejected the procedure adopted by the trial court for the examination of a perjurious witness[68] (substantially the same procedure adopted by the Standards)[69] on the ground that such trial tactics inevitably prejudiced defendant's case

62. *Id.* at 37. One practical criticism Freedman offers is that a prosecutor might object to a witness' narrative since it would deprive him of the opportunity to object to inadmissible evidence before it is heard by the jury. A more serious criticism is that jurors will draw prejudicial inferences from such conduct by an attorney who, they assume, knows the truth about about the defendant's case. *Id.* Freedman adds:

> There is, of course, only one inference that can be drawn if the defendant's own attorney turns his or her back on the defendant at the most critical point in the trial, and then, in closing argument, sums up the case with no reference to the fact that the defendant has given exculpatory testimony.

*Id.* Further, if a defendant is discouraged by this procedure from taking the stand in his own behalf, as is his right, most would agree that his chances of conviction are increased. Freedman, *supra* note 48, at 1475.

63. See text accompanying notes 29-32 for a discussion of the precedent.

64. 290 N.C. at 58, 224 S.E.2d at 175.

65. *Id.* at 59-60, 224 S.E.2d at 179.

66. *See* Code provisions quoted note 42 *supra.*

67. *See* ABA STANDARDS, *supra* note 2, at § 7.5(a), and Commentary.

68. *See* notes 11 & 14 *supra.*

69. *See* ABA STANDARDS, *supra* note 2, at § 7.7(c).

in the eyes of the jury and thereby denied him a fair trial.[70] The court, surprisingly, is in substantial agreement with Freedman's estimation of the effect of limited participation by the lawyer;[71] the court, however, would surely not advocate Freedman's course of putting the lying witness on the stand, cross-examining in the conventional manner, and arguing the truth of known false statements to the jury.[72] Even Freedman would concede that the case for confidentiality and loyalty to the client is not so strong if an alibi witness, as in *Robinson*, and not defendant himself, takes the stand to lie;[73] nevertheless, the court still found prejudice. Perhaps the court was influenced by the fact that defendant's only witness against strong evidence offered by the State was made to appear incredible, and that defendant himself was deterred from testifying in his own behalf by the procedure the trial court adopted.[74]

The American Bar Association Standards and many of the commentators clearly take the position that it is a breach of the lawyer's duty of confidentiality to the client to reveal the reason—perjury—for wishing to withdraw from a case.[75] The court, with no discussion, cited Burns' actions in so doing as "commendable."[76] Neither did the court address the corollary problem of possible prejudice to defendant when the same judge who has been informed of his alleged desire to perjure himself is also called upon to sentence defendant after conviction.[77]

The *Robinson* decision is now one more factor to be weighed by the attorney at the point in time when he is informed by a client of the client's intention to commit perjury. If the client is indigent, the lawyer knows it is unlikely a court will allow him to withdraw and appoint replacement counsel.[78] Apparently, he cannot stay on the case and offer

70. 290 N.C. at 67, 224 S.E.2d at 180; *see* note 62 *supra.*

71. *See* note 62 *supra.*

72. M. FREEDMAN, *supra* note 49, at 31.

73. *Id.* at 32.

74. *See* note 11 *supra.*

75. *See* note 44 *supra.*

76. 290 N.C. at 66, 224 S.E.2d at 180.

77. Before sentencing, the trial judge addressed the following remarks to defendant Robinson:

> Why didn't you take the advice of your attorney? You're as guilty as sin, and there wasn't any doubt in anybody's mind in this courtroom, or on that jury. They didn't take five minutes to find you guilty. You're the kind that makes mockery of this system. Your attorney attempted to advise you as best he could, that you were guilty and that you should enter a plea of guilty . . . ; but you wouldn't see it that way. Your guilt was as obvious as anybody I've ever tried. Any other man in your situation would say, "I'm caught," and "Be merciful" . . . . Do you want to say anything before I sentence you?

Defendant's Statement of Case on Appeal at 49-50, State v. Robinson, 28 N.C. App. 65, 220 S.E.2d 387 (1975).

78. 290 N.C. at 66, 224 S.E.2d at 179.

the assistance the ethical norms allow since the court has by indirection rejected the solution of the American Bar Association Standards.[79] The lawyer familiar with the workings of the criminal justice system, who feels some sympathy with the plight of a defendant faced with possible imprisonment who wants and needs the guidance of a lawyer in presenting his defense, will be forced to take a hard look at his alternatives before leaving defendant to the course of self-representation.

The seeming inability or reluctance of the court to confront the hard ethical issues is apparently a reflection of the larger problem of the inadequacies and inconsistencies of the Code of Professional Responsibility itself. The new Code was long in the making and long awaited by those lawyers who found the truisms of the Canons outdated and sorely lacking in practical guidance in dealing with specific problems of professional responsibility. Experience under the revised Code would seem to indicate that many of the old problems have been rewritten into its provisions, and that the Code, too, suffers from a lack of clarity and practical guidance.

Canon 7 prohibits the lawyer's knowing use of perjured testimony.[80] Canon 2 allows him to withdraw if continued representation of a client would likely result in violation of a Disciplinary Rule.[81] Thereafter the Code is strangely silent on the subject of what the lawyer should do if permission to withdraw is denied, as is more often than not the case if the lawyer has been appointed to represent an indigent defendant. The American Bar Association Standards supply the solution, which purportedly avoids violation of the Disciplinary Rules.[82] The Standards are careful to point out that revelation of the reason for withdrawal would constitute a breach of Disciplinary Rule 4-101,[83] yet the Standards advocate the course of allowing defendant to present his perjured testimony unaided by his attorney. This solution has the practical effect of informing both judge and jury that the lawyer, because of knowledge of his client's guilt, believes the testimony to be false.[84] The North Carolina Supreme Court would seem to agree.[85]

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79. *Id.* at 67, 224 S.E.2d at 180.

80. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 7-102(A)(4) (1969). *See* note 42 *supra.*

81. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 2-110(C)(1)(c) (1969). *See* note 44 *supra.*

82. *See* note 45 *supra.*

83. *See* note 44 *supra.*

84. M. FREEDMAN, *supra* note 49, at 37.

85. 290 N.C. at 67, 224 S.E.2d at 180.

Although a lawyer is subject to disciplinary action for violation of the prohibitions of Canon 4, there is clear disagreement on how to read the exceptions to the requirement of confidentiality.[86] It would seem to be an obligation of the authors of the Code that on such an important question the language of the Rules be precise, so that a lawyer may discern what he must do in order to comply. The Standards, too, are inconsistent, at one point denouncing the idea of proffering perjured testimony in the name of confidentiality as "universally repudiated by ethical lawyers,"[87] yet later admitting that there is disagreement among experienced lawyers about how to proceed and preserve confidentiality.[88]

Those persons in a position to promulgate the Standards that are to give ethical guidance to the profession clearly must go further in defining what the limits of our adversary system are. Although we sanction the "lie" of a "not legally guilty" plea by the accused who is "guilty in fact"[89] and do not foreclose to him the opportunity to make his case to the jury even if he wishes to lie,[90] we still must decide what we wish the role of the lawyer in the system to be. Freedman seems to believe that the criminal defendant, until he is tried and convicted, remains in a totally blameless state, entitled to the undivided loyalty and full cooperation of his attorney in making his defense, even if the

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86. Canon 4 provides that a lawyer may reveal:

(2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.

(3) The intention of his client to commit a crime and the information necessary to prevent the crime.

ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 4-101(C)(2), (3) (1969).

Some would read the "may" language as permissive only, thus freeing the lawyer to exercise his discretion to reveal or not reveal a client's intention to commit perjury. The lawyer would be immune from discipline either way. *See* Callan, *Professional Responsibility and the Duty of Confidentiality: Disclosure of Client Misconduct in an Adversary System*, 29 RUT. L. REV. 332, 354 (1976). ABA COMM. ON ETHICS AND PROFESSIONAL RESPONSIBILITY, Formal Opinions, No. 287 (1953) supports the proposition that perjury is included within the definition of "crime."

Others read the DR 4-101(C)(3) exception along with ABA COMM. ON ETHICS AND PROFESSIONAL RESPONSIBILITY, Formal Opinions, No. 314 (1965), which is cited in a footnote to the Disciplinary Rule, to *require* the lawyer to exercise his discretion in certain situations and to reveal client confidences, despite the "may" language. *See* Rotunda, Book Review, 89 HARV. L. REV. 622, 626-27 (1976).

87. ABA STANDARDS, *supra* note 2, at 142. For some interesting information on what lawyers confronted with the perjury problem actually do, see Friedman, *Professional Responsibility in D.C.: A Survey*, 25 RES IPSA LOQ. 60 (1972); Reichstein, *The Criminal Law Practitioner's Dilemma: What Should the Lawyer Do When His Client Intends to Testify Falsely?*, 61 J. CRIM. L.C. & P.S. 1 (1970).

88. ABA STANDARDS, *supra* note 2, at § 7.7, Commentary.

89. Freedman, *supra* note 48, at 1471.

90. ABA STANDARDS, *supra* note 2, at 276.

defendant wishes to testify falsely and to enlist the aid of his attorney in so doing. In answer to Freedman, one commentator has aptly said:

> [T]he very existence of the special rights accorded a defendant whose liberties are at stake—appointed counsel, the fifth amendment privilege, jury trial, proof beyond a reasonable doubt, and others—militates against adding the right to compel counsel to allow the client to perjure himself and even ethically require the counsel to argue the client's false story to the jury.[91]

Although he owes his client the duty of zealous representation, the lawyer's own values, his honesty and his integrity, are also at stake. These values should not be sacrificed to the client who, by choosing to pursue an illegal course of conduct, brings on his own prejudice.

If Freedman's solution elevates the duty of confidentiality to the client at too great an expense to the lawyer, then a compromise such as the trial court's, however flawed, that attempts to preserve the lawyer's duty both to his client and to the court, is necessary. Unless the holding in *Robinson* is somehow limited to the particular facts of the case or overruled, the court would seem to have foreclosed the possibility of such a compromise solution for the North Carolina attorney.

DEBORAH A. BRIAN

## Securities Regulation—Challenging the Short Form Merger Through Rule 10b-5 and the Corporate Purpose Doctrine

In the wake of the depressed securities markets of the 1970's, a corporate phenomenon known as "going private" has become increasingly prevalent.[1] "Going private" usually entails the buying out of public minority shareholders of a corporation by a few majority shareholders so as to take the corporation outside the scope of the Securities Exchange Act of 1934 and its attendant reporting requirements.[2] The danger inherent in this mechanism, and one of the reasons it has drawn increasingly close judicial scrutiny, is that in many cases it allows a few

91. Rotunda, *supra* note 86, at 627.

1. *See* Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. REV. 987 (1974).

2. *See* Note, *Going Private*, 84 YALE L.J. 903, 904 (1975).

shareholders who took the corporation public during the stock boom of the 1960's to force minority shareholders to sell their shares at a fraction of the original purchase price.[3]

A number of devices serve as vehicles for "going private," one of the most utilized of which is the short form merger.[4] However, a recent series of cases originating in New York[5] has caused a re-evaluation of the elements essential to a valid short form merger. In *Green v. Santa Fe Industries, Inc.*,[6] the Second Circuit Court of Appeals accepted an expansive reading of rule 10b-5[7] and invalidated a short form merger that complied in every respect with state law on the ground that the majority shareholders did not come forward with any "justifiable corporate purpose" for the merger other than the elimination of the public minority shareholders. But a later New York Supreme Court case, *Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc.*,[8] in interpreting fiduciary obligations of majority shareholders in a short form merger appeared to eviscerate the corporate purpose standard enunciated in *Green* by expressing receptivity to any stated corporate purpose. The Second Circuit Court of Appeals then applied the same broad corporate purpose analysis when the same merger came before it on charges of rule 10b-5 violations in *Merrit v. Libby, McNeill & Libby*.[9] This note will suggest that a limited application of the "corporate purpose doctrine," as applied through rule 10b-5, would keep use of rule 10b-5 outside the regulation of fiduciary obligations to shareholders,[10] traditionally the prerogative of state law, and would limit its operation to situations that more directly involve

3. *See id.* at 905.

4. The short form merger statute, which exists in approximately 38 states, allows a parent corporation that owns some percentage of the stock in a subsidiary, usually 90%, to merge the two corporations and buy out the public minority shares in the subsidiary. *E.g.*, DEL. CODE ANN. tit. 8, § 253 (1974). For a list of the states that now have short form merger statutes, see Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1299 n.1 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).

5. Merrit v. Libby, McNeill & Libby, 533 F.2d 1310 (2d Cir. 1976); Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753); Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

6. 533 F.2d 1283 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).

7. 17 C.F.R. § 240.10b-5 (1976).

8. — Misc. 2d —, —, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976). It should be noted that the New York Supreme Court was limited to state fiduciary law since it did not have available the federal remedies under rule 10b-5.

9. 533 F.2d 1310 (2d Cir. 1976).

10. Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1304 (2d Cir.) (dissenting opinion), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).

*securities* fraud, rather than venturing into the vast domain of corporate mismanagement.

The short form merger statute's fundamental objective is to allow a merger to be effectuated without the supposedly needless costs of proxy solicitations and shareholder meetings when the majority shareholders are in accord and when the minority would be powerless to block a merger anyway.[11] A dissenting minority, under most short form merger statutes, must resort to an appraisal proceeding as its exclusive remedy.[12] It may be argued that the exclusivity of an appraisal remedy is the only realistic approach in modern times, especially in the face of possibly obdurate and unreasonable minorities. The fallacy in this reasoning is that the majority (in many cases the same persons who took the corporation public initially) is given the power to choose *when* that appraisal will occur. Therefore, when the price of the corporation's stock is at its nadir, the majority shareholders can decide to effect a short form merger, thereby forcing a buy-out of the minority at a relatively low price.[13] Although other criticisms have also been launched at the short form merger statutes,[14] the short form merger does provide a functional tool, when used fairly, to effectuate the will of the majority in the least expensive and quickest manner possible.

It was in the context of a short form merger that the Second Circuit decided *Green v. Sante Fe Industries, Inc.*,[15] a case that appeared to have such far-reaching and devastating effects that Judge Moore, in dissent, described it as nullifying "not only the corporate laws of Dela-

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11. *See* Hamilton, *Corporations and Partnerships*, 24 SW. L.J. 91 (1970). *But see* Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 596 (1965):

> The short merger has endured, and shows signs of flourishing, because it offers the opportunity of merger without the needless expense of holding meetings whose outcomes would be pre-determined. Such savings will be significant, however, only where the corporation is of substantial size and where the question would have to be presented at a special meeting.

*Id.* at 602.

12. The exclusivity of the dissenting shareholders' remedy has been the subject of much debate. For arguments in favor of exclusivity, see Vorenberg, *Exclusiveness of the Dissenting Shareholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964). Many of the short form merger statutes are ambiguous on their face about the dissenting shareholders' remedy, *e.g.*, KAN. STAT. § 17-6712 (1974); some specify that they are exclusive, *e.g.*, PA. STAT. ANN. tit. 15, § 1515(B) (Purdon Supp. 1974); and at least one provides that appraisal is not the exclusive remedy, N.C. GEN. STAT. § 55-113(b) (1975). For a discussion of exclusivity, see Borden, *supra* note 1, at 1023.

13. *E.g.*, Marshel v. AFW Fabric Corp., 533 F.2d 1277 (2d Cir. 1976).

14. These criticisms include such topics as tax problems created for minority shareholders whose shares are forcibly purchased. For an excellent discussion of the criticisms, see Comment, *supra* note 11.

15. 533 F.2d 1283 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).

ware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven states."[16] The facts can be simply stated. In 1974 Santa Fe Natural Resources (Resources) owned approximately ninety-five percent of the capital stock of Kirby Lumber Company. Resources "embarked upon a plan to effect a short-form merger pursuant to Section 253 of the Delaware Corporation Law . . . ."[17] In furtherance of this plan Forest Products, Inc. was organized. Resources transferred its ninety-five percent interest in Kirby to Forest Products in exchange for all of Forest Products' stock. The board of Forest Products then adopted a resolution under which it would merge with Kirby, with Kirby becoming the surviving corporation. The merger became effective July 31, 1974. Plaintiffs, minority shareholders in Kirby, sued to enjoin the merger as a "manipulative and deceptive device in breach of Rule 10b-5."[18] The court of appeals reversed the district court's dismissal of the complaint.[19]

The first major obstacle hurdled by the court of appeals was the historically limited application of rule 10b-5 to only those transactions in which there had been misrepresentation or lack of disclosure.[20] The court accomplished this task simply by utilizing sections (a) and (c) of the rule, sections that had virtually been read out of the statute by courts requiring misrepresentation or nondisclosure.[21] These sections prohibit "(a) . . . any device, scheme, or artifice to defraud, . . . and (c) . . . any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . ."[22] Fraud, as used in these sections, is equated by the court in *Green* with a breach of fiduciary duty by the majority against the minority shareholders.[23] *Popkin v. Bishop*,[24] an earlier Second Circuit case in which the complaint of the minority shareholders was dismissed because there was no showing of nondisclosure or misrepresentation, was distinguished on two grounds: (1) in *Popkin* a strong corporate purpose was shown,[25]

16. *Id.* at 1299 (dissenting opinion) (footnote omitted).
17. *Id.* at 1288.
18. *Id.*
19. *Id.* at 1294.
20. The cases are not entirely clear, but on their face appear to limit the application of rule 10b-5 to non-disclosure situations. *E.g.*, Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972); Kaufmann v. Lawrence, 386 F. Supp. 12 (S.D.N.Y. 1974), *aff'd per curiam*, 514 F.2d 283 (2d Cir. 1975).
21. 533 F.2d at 1287.
22. 17 C.F.R. § 240.10b-5 (1976).
23. 533 F.2d at 1287.
24. 464 F.2d 714 (2d Cir. 1972).
25. 533 F.2d at 1291.

and (2) approval of the minority shareholders was sought and given.[26] The first distinction appears valid, although it should be noted that defendants in *Green* were not required by state law to demonstrate a valid corporate purpose and therefore had no reason to provide one. The second distinction is almost totally without merit, especially in light of *Marshel v. AFW Fabric Corp.*,[27] in which the Second Circuit held, just prior to its decision in *Green*, that a long form merger under New York law violated rule 10b-5, even though it had been submitted for shareholder approval.[28] Also, submission for shareholder approval would almost assuredly be a meaningless formality since in all cases involving short form mergers, the majority already controls at least ninety percent of the stock, thereby assuring passage of any motion for merger.[29]

The finding of fraud, or breach of fiduciary duty, by the court in *Green* focused on five major factors: (1) defendants had shown no "justifiable corporate purpose"; (2) no prior notice of the merger was given to minority shareholders; (3) the minority shareholders had no opportunity to obtain injunctive relief; (4) the proposed price to be paid for the minority shares was excessively low; and (5) the shares of the minority were being purchased with corporate funds.[30] The first three factors were not required by state law and therefore defendants were not on notice that they needed to comply with any of these; the lack of justifiable corporate purpose, discussed below,[31] was heavily relied upon by the court nonetheless. The minority shareholders have a remedy for the fourth factor, excessively low purchase price, through the appraisal proceeding provided by state law.[32] The fifth factor also does not withstand close scrutiny; from the standpoint of the majority shareholders it would seem to make little difference, in an economic sense, whether the shares were purchased with corporate funds or with private shareholders' money. If the money is taken directly from corporate funds, the corporation will simply have less money once the merger is effected and the majority shareholders become the sole

26. *Id.*
27. 533 F.2d 1277 (2d Cir. 1976).
28. *Id.* at 1282. For discussion see Brodsky, *State Going-Private Laws—Dead or Alive?*, N.Y.L.J., Feb. 27, 1976, at 1, col. 2, 14, col. 1.
29. Brodsky, *supra* note 28, at 14, col. 1.
30. 533 F.2d at 1290, 1292-93.
31. The doctrine is utilized extensively by the court. For a discussion, see text accompanying notes 34-38 *infra*.
32. *See* Brodsky, *supra* note 28.

owners; realistically the money ultimately comes from the majority's pockets in either event.[33]

The predominant issue that prevailed in the aftermath of *Green* centered around the theory of "justifiable corporate purpose."[34] The theory appears to have its roots in the idea that "a scheme conceived solely for the benefit of controlling stockholders without regard to the welfare of the corporation or of the minority constitutes a breach of the fiduciary obligation";[35] thus, "the requirement that there be a showing of legitimate corporate purpose."[36] Obviously the doctrine was implemented to provide for an analysis of the motives behind the "going private" transaction.[37] It has been praised by some as providing "an equitable method of protecting the minority shareholder while at the same time giving deference to the freedom of the corporation to go private for valid business reasons."[38] But it can also be condemned as an imprecise and vague standard with which those effecting important corporate mergers must attempt to comply.

Commissioner Sommer of the SEC, who has argued for a strict interpretation of the "justifiable business purpose" standard, has expressed the view that a corporation going public "makes a commitment that, absent the most compelling business justification, management and those in control will do nothing to interfere with the liquidity of the public investment or the protection afforded the public by the federal securities laws."[39] But another leading authority, Professor Vorenberg, believes very little or no corporate purpose should be necessary in the context of a short form merger.[40]

Amid this controversy, the question still remained of how the Second Circuit would interpret its own standard. Finally, in *Merrit v. Libby, McNeill & Libby*,[41] the federal court got its chance on a complaint of securities fraud, but only after the minority shareholders had

33. *See id.*

34. *See* Brodsky, *Going Private—Is It Over?*, N.Y.L.J., March 3, 1976, at 1, col. 1, 2, col. 1.

35. Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, —, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976).

36. *Id.*

37. *See* Note, *Going Private: An Analysis of Federal and State Remedies*, 44 FORDHAM L. REV. 796, 806 (1976).

38. *Id.* at 816.

39. A. Sommer, "Going Private": A Lesson in Corporate Responsibility, *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,010, at 84,698.

40. *See* Vorenberg, *supra* note 12, at 1192-93.

41. 533 F.2d 1310 (2d Cir. 1976).

been unsuccessful in an attempt to block the same merger in the New York state courts.[42] Nestle Alimentana (Nestle), a Swiss company, had effected a short form merger between Universal Food Specialties (UFS), a wholly owned subsidiary of Nestle, and Libby, McNeill & Libby (Libby), a Maine corporation. After purchasing Libby stock for some fifteen years, Nestle and affiliates owned approximately sixty-one percent by May 1975. UFS, which controlled the Libby shares for Nestle, announced a cash tender offer for the remaining Libby shares at $8.125 per share, substantially higher than the prevailing market price. In this offer, UFS stated its intention to merge with Nestle if the former acquired at least ninety percent of the Libby stock. Just prior to the expiration of the tender offer the minority shareholders of Libby brought an abortive suit for monetary damages. Seven months later they sought injunctive relief.[43]

The New York Supreme Court in *Tanzer* was the first court to confront the merger on a motion for preliminary injunction by the minority shareholders.[44] The *Tanzer* court's scope of inquiry was limited to possible breaches of fiduciary obligations because the federal remedies afforded by rule 10b-5 were unavailable.[45] The court first distinguished *Green* on the ground that since that decision had been on a motion to dismiss, the federal court was forced to assume the veracity of the allegation of no valid corporate purpose, whereas *Tanzer* involved an application for a preliminary injunction.[46] Two additional factors that the supreme court relied upon to distinguish *Green* were that in the present case (1) there was no under-valuation of the minority shares,[47] and (2) the minority shareholders had been given notice of the proposed Libby merger.[48]

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42. Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

43. *Id.* at —, 383 N.Y.S.2d at 474-75.

44. *Id.* at —, 383 N.Y.S.2d at 478. It should also be noted that another New York state case, Schulwolf v. Cerro Corp., — Misc. 2d —, 380 N.Y.S.2d 957 (Sup. Ct. 1976), which involved a very similar issue, was decided just prior to the *Tanzer* decision. In *Schulwolf*, business reasons were advanced for the merger and the minority shareholders were not actually being frozen out, since they would receive preferred stock in the resultant corporation; but the minority shareholders did not receive the "residual equity" benefits to which common shareholders are normally entitled. Also, *Schulwolf* involved a long form merger, which could have been voted down by the public shareholders. Based on these factors, the court denied an injunction against the merger.

45. — Misc. 2d at —, 383 N.Y.S.2d at 478.

46. *Id.* at —, 383 N.Y.S.2d at 479.

47. *Id.* at —, 383 N.Y.S.2d at 480.

48. *Id.*

The court then relied upon nine stated business purposes for the merger to assuage its suspicions of fraud. These purposes can be generally grouped into two categories: (1) the merger of the two corporations would result in more efficiently operated businesses for both while also solving possible problems of conflicts of interest; and (2) the merger would result in savings on the cost of complying with the securities laws.[49] As one noted author has pointed out, the first group of purposes could be accomplished without the elimination of the minority interest since they rely only upon the combination of the two corporations.[50] The second group of purposes, while depending upon the elimination of the public minority interest, has not generally been accepted as a justifiable business purpose in and of itself.[51] Despite these criticisms of the stated purposes, it can at least be argued that the corporate purpose doctrine is not so much concerned with justifications for elimination of the minority as with preventing a "naked grab for power"[52] by placing some burden on the majority to justify their actions.

After failing to obtain any relief in the state court, the minority shareholders brought an action for preliminary injunction in federal district court. Upon denial of the injunction, the case came before the Second Circuit on appeal.[53] The court of appeals distinguished *Green*[54] in much the same manner as had the New York Supreme Court.[55] But the court had somewhat more difficulty coping with *Marshel v. AFW Fabric Corp.*[56] Since that case was in the same procedural posture as *Libby*, the court had to distinguish it factually: in contrast to *Libby*, *Marshel* involved a situation in which the same people who had taken the corporation public during the bull market of the 1960's were attempting to utilize the state short form merger statute to eliminate the minority at a low cost. This acquisition was being accomplished through the vehicle of a shell corporation and with the use of corporate funds.[57]

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49. Brodsky, *Going Private (III)*, N.Y.L.J., April 7, 1976, at 1, col. 1, 2, col. 3.
50. *Id.* at 2, col. 3.
51. *Id.*
52. Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, —, 383 N.Y.S.2d 472, 482 (Sup. Ct. 1976).
53. Merrit v. Libby, McNeill & Libby, 533 F.2d 1310, 1313 (2d Cir. 1976).
54. *Id.* at 1312.
55. *See* text accompanying note 46 *supra.*
56. 533 F.2d 1277 (2d Cir. 1976).
57. Merrit v. Libby, McNeill & Libby, 533 F.2d 1310, 1312 (2d Cir. 1976).

The court relied upon a confidential report to the board of Nestle by its president as a valid indication of the corporate purposes for the merger.[58] Two of the purposes were listed as follows:

> (1) 70% of Libby's sales were in the United States, Canada and Puerto Rico, and it had contacts with farmers which would be useful in integrated selling to the underdeveloped countries. (2) Libby had a healthy balance sheet and a cash flow slightly higher than its future investment possibilities, and its stock was valued at only a third of book value.[59]

Obviously these purposes are subject to the same criticisms as those discussed earlier in relation to the *Tanzer* decision.[60] But the president's memorandum to the board also spoke of the advantages to be gained "'in the very fact of eliminating the minority stockholders.'"[61] The court concluded that the memorandum was obviously ambiguous, but since it was not sufficient to indicate that plaintiffs would suffer "irreparable injury," they should be left to their remedy at law.[62]

Clear from analysis of the two decisions springing from the Libby merger is that the courts will be highly receptive to any stated business purpose in the face of an action by minority shareholders. The dissent in *Green*, along with a great many other critics, attacked the use of rule 10b-5 to control corporate fiduciary obligations. Judge Moore, dissenting in *Green*, pointed out that the majority "has extended to these plaintiffs an independent, substantive right totally unrelated to the antifraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity."[63] The condemnation seems credible, especially in light of *Cort v. Ash*,[64] a 1975 United States Supreme Court opinion that "may portend the Supreme Court's increased reluctance to entertain suits claiming a breach of state law fiduciary obligations brought in the guise of a violation of federal law."[65]

One of the most valid criticisms of *Green* is leveled at the court's utilization of rule 10b-5 to encroach upon an area traditionally left to state legislatures—the regulation of fiduciary obligations of majority shareholders.[66] The drawing of the line between state and federal

58. *Id.* at 1312-13.
59. *Id.* at 1313.
60. *See* text accompanying notes 50 & 51 *supra.*
61. Merrit v. Libby, McNeill & Libby, 533 F.2d 1310, 1313 (2d Cir. 1976).
62. *Id.*
63. 533 F.2d at 1307 (footnote omitted).
64. 422 U.S. 66 (1975).
65. M. Lipton & E. Steinberger, Going Private 50 (1976) (unpublished manuscript in University of North Carolina Law School Library).
66. 533 F.2d at 1304 (dissenting opinion).

control is inherently fraught with pitfalls in this area because many corporations, almost by definition, are forced to engage in securities transactions.[67] Thus, any regulation of securities transactions inevitably leads to some regulation of internal corporate affairs, a province traditionally left to state control. As a result it becomes necessary to ascertain the point at which these internal corporate transactions fall outside rule 10b-5's true purpose. When does a given transaction cease being primarily a securities transaction and therefore become a matter for state regulation?

One possible means of dealing with the problem, in the limited context of a short form merger, would begin with three assumptions: (1) rule 10b-5's primary concern is to enforce the credibility of the securities markets; (2) once the securities element of a transaction becomes only tangential, so that the primary concern of the minority shareholders is actually centered on corporate mismanagement, then deference should be given to state law; and (3) the corporate purpose doctrine, to have any true validity in a securities context, must be a more restrictive test, one of *compelling* corporate justification.[68] The implementation would be as follows: a series of transactions and objective criteria[69] would be identified that have a high degree of correlation

67. M. Lipton & E. Steinberger, *supra* note 65, at 50-51.

68. In order for the corporate purpose doctrine to continue as a viable force, it must be restrictive enough to prevent avoidance by intelligent pleading by any group of majority shareholders.

69. Possible criteria would include: (1) percentage decline in market price of the stock since the corporation first went public; (2) substantial identity of the parties who took the corporation public initially with those who later attempt to take it private; and (3) the amount of time elapsed since the corporation first went public. Marshel v. AFW Fabric Corp., 533 F.2d 1277 (2d Cir. 1976), provides a flagrant example of the first criterion. In 1968-69, in a public offering, 300,000 shares of Concord Fabrics stock were sold at $15 per share and 200,000 at $20 per share. In 1974, when the market price had reached a low of $1 per share, the majority shareholders decided to go private at $3 per share. The court blocked the merger. At the other end of the spectrum is Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, 383 N.Y.S.2d 472 (Sup. Ct. 1976), in which the price offered in the attempt to go private was $8.125 per share, a price not substantially below what the public shareholders had paid. In fact, plaintiff in the case had purchased his stock in 1973 at $6.00 per share. The problem comes in delineating the point at which the market price has declined to such a degree that any forced buy-out of the public minority would be inherently suspicious. Ascertainment of this point would necessarily involve both empirical study and a survey of shareholder and management attitudes. The second criterion would serve as a strong indicator of stock manipulation. If the same people who originally took a corporation public are now attempting forcibly to take it private, the obvious inference would be that their intention all along was to take advantage of possible market fluctuations. Again, *Marshel* provides an excellent example; there, exactly the same people who had taken the corporation public initially were attempting to take it private. Regarding the third criterion, the shorter the time

with the aim of rule 10b-5 as indicated above. Once a transaction came within one of the proscribed situations, or met a threshold number of objective criteria, the application of rule 10b-5 would be triggered with an attendant requirement of a showing of compelling corporate purpose by the majority shareholders. An archetypal example is the situation in which a group of shareholders who took the corporation public in a bull market are attempting to go private in a depressed market.[70] Thus, once plaintiffs show defendant's actions to fit one of the established categories, such as the one just described, the majority shareholders would be forced to come forward with a compelling corporate purpose for the merger. The objective of this type of structure would be two-fold. First, the implementation of rule 10b-5 would be limited to only those corporate activities inextricably intertwined with securities transactions, thus keeping its application outside the domain of state law. Therefore, the minority shareholders would be forced to resort to state remedies unless their allegations of fraud were primarily centered on a securities claim. Secondly, the use of the more restrictive compelling corporate purpose standard would give that doctrine viability.

The corporate purpose doctrine, as enunciated in *Green*, represents an attempt to balance the protection of minority interests with the need of the majority to effectuate necessary transactions in furtherance of the corporation's business. But then, in *Libby*, the Second Circuit gave strong indications that the doctrine is little more than a shell, which can be avoided through proper pleading by any defendant. A much more pragmatic use of the doctrine would be to restrict its application, in the context of rule 10b-5, to only those situations strongly correlated with securities transactions.[71] If there is to be a federal remedy

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period between the corporation's initially going public and an attempted freeze-out of the public minority, the stronger the inference that the majority shareholders are simply playing the market at the possible expense of the public minority. Again in *Marshel*, the majority shareholders were attempting to go private only six years after the corporation had gone public.

70. This practice is one that has caused a great deal of the fervor in the "going private" area. It appears to be one of many possible activities that would create distrust among the public in an already disfavored securities market.

71. *See* Borden, *supra* note 1.

> If the federal securities laws are to be pushed so far beyond their original purpose as not only to enforce recognized standards of fiduciary obligations but to create new ones in a hotly debated area without deference to state law or empirical study or any balancing of the numerous competing social interests involved, one may suppose that one day there will again be a recognition of the "mischievous result" of judicial law-making based upon an alleged "transcendental body of law outside of any particular State" which federal courts

for minority shareholders against a short form merger it should be formulated by a legislative or an administrative body taking all the relevant and unique considerations into account,[72] not by courts seeking to apply rule 10b-5 to an area with which it was never intended to deal, in a misguided effort to provide needed protection for minority shareholders.

JOHNNY REID EDWARDS

## Truth in Lending—Failure To Disclose a Right of Acceleration Held Not a Violation

The Truth in Lending Act[1] and Federal Reserve Board Regulation Z[2] provide, *inter alia*, that a creditor shall disclose to its customers any "default, delinquency, or similar charges payable in the event of late payments."[3] Confronted with the issue whether a contractual right to accelerate total indebtedness is such a charge when state law requires a rebate of the unearned portion of the finance charge, the Third Circuit Court of Appeals in *Johnson v. McCrackin-Sturman*

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in their good judgment may discern and apply. We will then have in the securities field our own *Erie v. Tompkins*.

Borden, *supra* note 1, at 1039 (footnotes omitted). This argument is relied upon heavily by defendants in *Green* in their petition for certiorari to the United States Supreme Court. Petitioner's Brief for Certiorari at 11, Santa Fe Indus., Inc. v. Green, 533 F.2d 1283 (2d Cir.), *cert. granted*, 45 U.S.L.W. 3222 (1976) (No. 75-1753).

72. It should be noted that the SEC has drafted proposed rules that would deal specifically with the application of rule 10b-5 to the types of situations discussed herein. If SEC rules are to be applied to these situations at all, it would certainly appear that the better route would be through the Commission's proposed rules. Two of these rules basically place disclosure requirements and substantive limitation on those planning to carry out transactions that would result in "going private." Proposed Rules 13e-3A & 13e-3B, Securities Act Release No. 5507 (Feb. 6, 1975), *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,104, at 85,091-93.

1. 15 U.S.C.A. §§ 1601-1667 (West 1974, Cum. Supp. 1976 & Supp. Pamplet No. 2, pt. 1 1976). The Truth in Lending Act is subchapter I of the Consumer Credit Protection Act, 15 U.S.C.A. §§ 1601-1691 (West 1974, Cum. Supp. 1976 & Supp. Pamphlet No. 2, pt. 1 1976).

2. 12 C.F.R. § 226 (1976). Regulation Z was promulgated by the Board of Governors of the Federal Reserve System pursuant to the authority granted by 15 U.S.C. § 1604 (1970). The Board's authority is designed to insure the effectiveness of the Consumer Credit Protection Act. *See* Mourning v. Family Publications Serv., Inc., 411 U.S. 356 (1973).

3. 15 U.S.C. § 1638(a)(9) (1970); 12 C.F.R. § 226.8(b)(4) (1976).

*Ford, Inc.*[4] recently held that the right of acceleration is not a "charge" and that disclosure of the acceleration right is not mandated by section 128(a)(9) of the Truth in Lending Act[5] and section 226.8(b)(4) of Regulation Z.[6]

The *McCrackin-Sturman* case arose out of a commonplace consumer transaction—financing the purchase of a used automobile through an installment loan contract.[7] The contract, executed on January 20, 1973 by plaintiffs William and Joan Johnson, was originated by McCrackin-Sturman Ford, Inc. and assigned to Ford Motor Credit Company.[8] Paragraph 20 of the contract contained a "time is of the essence" clause that specified the lender's right of acceleration upon borrower's fault.[9] A disclosure statement and a copy of the contract were delivered to plaintiffs at the time of sale. The disclosure statement provided information about certain terms of the contract, including the amount of the charges assessable in the event of late payments[10]

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4. 527 F.2d 257 (3d Cir. 1975).

5. Section 128(a)(9) provides: "(a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable: . . . (9) The default, delinquency, or similar charges payable in the event of late payments." 15 U.S.C. § 1638(a)(9) (1970).

6. Section 226.8(b)(4) provides: "(b) *Disclosures in sale and nonsale credit.* In any transaction subject to this section, the following items, as applicable, shall be disclosed: . . . (4) The amount, or method of computing the amount of any default, delinquency, or similar charges payable in the event of late payments." 12 C.F.R. § 226.8(b)(4) (1976).

7. Not all extensions of credit are covered by the Truth in Lending laws. Exempted transactions are set forth in 15 U.S.C.A. § 1603 (West 1974 & Cum. Supp. 1976).

8. Section 115 of the Consumer Credit Protection Act sets forth the following provision concerning the liability of assignees:

> Except as otherwise specifically provided in this subchapter, any civil action for a violation of this subchapter which may be brought against the original creditor in any credit transaction may be maintained against any subsequent assignee of the original creditor where the violation from which the alleged liability arose is apparent on the face of the instrument assigned unless the assignment is involuntary.

15 U.S.C.A. § 1614 (West Cum. Supp. 1976).

9. Paragraph 20 of the contract provided as follows:

> 20. DEFAULT
> Time is of the essence of this contract. *In the event Buyer defaults in any payment,* or fails to obtain or maintain the insurance required hereunder, or fails to comply with any other provision hereof, or a proceeding in bankruptcy, receivership or insolvency shall be instituted by or against Buyer or his property, or Seller deems the Property in danger of misuse or confiscation, *Seller shall have the right to declare all amounts due or to become due hereunder to be immediately due and payable* . . . .

527 F.2d at 261 (emphasis by the court).

10. The provision disclosing delinquency charges stated:

> (13) Delinquency charges: Buyer may be required to pay a delinquency charge of 2% of any installment in default for each month, or fraction thereof in excess of 10 days, that such installment is in default, plus such

and the method of computing the rebate of the unearned finance charge upon prepayment of the loan,[11] but the statement did not provide any information about the creditor's right to accelerate payment. When plaintiffs defaulted in payment on the contract,[12] Ford Motor Credit exercised its rights under paragraph 20 of the contract and repossessed the automobile.

Alleging that the disclosure statement that they received did not meet the requirements of the Truth in Lending Act and Regulation Z, plaintiffs, in June 1973, sought statutory damages[13] against McCrackin-Sturman Ford, Inc. and Ford Motor Credit in the United States District Court for the Western District of Pennsylvania. The district court granted summary judgment in favor of plaintiffs.[14] The

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expenses incurred by the seller in effecting collection under the Contract as may be allowed by law.

*Id.* at 261 n.4.

11. Paragraph 15 of the contract set forth the rebate provision:

(15) Prepayment rebate: Buyer may prepay his obligations under the Contract in full at any time prior to maturity of the final installment thereunder, and if he does so, shall receive a rebate of the unearned portion of the Finance Charge computed under the sum of the digits method subject to retention by the Seller of a minimum finance charge of $10.00. No rebate will be made if the amount is less than $1.00.

*Id.* at 261 n.5.

12. Plaintiffs failed to make any payments under the contract. *Id.* at 261.

13. Section 130 of the Consumer Credit Protection Act sets forth the damages awardable for Truth in Lending violations. In pertinent part the section provides:

(a) Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this part or part D or E of this subchapter with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A)(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction, or (ii) in the case of an individual action relating to a consumer lease under part E of this subchapter, 25 per centum of the total amount of monthly payments under the lease, except that the liability under this subparagraph shall not be tess than $100 nor greater than $1,000; or

(B) in the case of a class action, such amount as the court may allow, except as to each member of the class no minimum recovery shall be applicable and the total recovery in such action shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the creditor; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

15 U.S.C.A. § 1640 (West Supp. Pamphlet No. 2, pt. 1 1976).

14. Johnson v. McCrackin-Sturman Ford, Inc., 381 F. Supp. 153, 156 (W.D. Pa. 1974). In the district court all parties had moved for summary judgment. The motions by McCrackin-Sturman Ford and Ford Motor Credit were denied; the motion by plaintiffs was granted against McCrackin-Sturman Ford alone. Plaintiff's motion for summary judgment against Ford Motor Credit, however, was denied without prejudice. *Id.* The court noted that in the event that plaintiffs were unable to collect

court held that a right of acceleration was a "default, delinquency, or similar charge" within the purview of section 128(a)(9) of the Truth in Lending Act and section 226.8(b)(4) of Regulation Z.[15] In failing to disclose the right of acceleration, the court reasoned that defendant had not made precisely the "type of disclosure that the Truth-in-Lending Act was intended to require."[16] Allegations of other violations of the Act were not considered in the summary judgment order.

On appeal of the summary judgment order against McCrackin-Sturman,[17] the Third Circuit reversed, holding that when state law requires that the creditor rebate the unearned portion of the finance charge,[18] the right of acceleration is not a "default, delinquency, or similar charge."[19] Rather the court characterized the right as a contractual remedy,[20] and thus determined disclosure was not required by section 128(a)(9) of the Truth in Lending Act and section 226.8 (b)(4) of Regulation Z.[21] The court emphasized that it was not confronted with the issue whether a right of acceleration need be disclosed when there is no requirement that the creditor rebate the unearned portion of the finance charge.[22]

The Third Circuit rejected the district court's determination that a "charge" was simply an "obligation."[23] Characterizing its own definition of the word as the meaning utilized by the consumer credit industry, the Third Circuit defined "charge" as a specific pecuniary sum assessed in addition to the regular payments.[24] Since Penn-

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from McCrackin-Sturman, they would need to produce additional evidence to hold Ford Motor credit liable. *Id.* See note 8 *supra* for statutory provisions on the liability of assignees. Only the ruling against McCrackin-Sturman Ford was certified as an appealable final judgment pursuant to FED. R. CIV. P. 54(b). 527 F.2d at 262.

15. 381 F. Supp. at 156.
16. *Id.*
17. *See* note 14 *supra.*
18. The Pennsylvania Motor Vehicle Sales Finance Act provides in pertinent part:
> Whenever all the time balance is liquidated prior to maturity by prepayment, refinancing or termination by surrender or repossession and re-sale of the motor vehicle, the holder of the installment sale contract shall rebate to the buyer immediately the unearned portion of the finance charge. Rebate may be made in cash or credited to the amount due on the obligation of the buyer.

PA. STAT. ANN. tit. 69, § 622(B) (Purdon 1965).

19. 527 F.2d at 265.
20. *Id.* at 267.
21. *Id.* at 266-67.
22. *Id.* at 260 n.3.
23. *Id.* at 265.
24. *Id.* at 266.

sylvania law, which the court held was fully incorporated into the contract,[25] requires a rebate of any unearned finance charge upon acceleration,[26] the court reasoned that no pecuniary sum in addition to the existing contractual obligation was being assessed.[27] Thus, there was no requirement that the right of acceleration be disclosed as a "default, delinquency, or similar charge." In reaching this conclusion the Third Circuit relied heavily on a Federal Reserve Board staff opinion letter,[28] issued subsequent to the district court decision, that also concluded that a right of acceleration was not disclosable as a charge when there was a requirement that unearned interest be rebated.[29] The court rejected the contention that it should not consider Pennsylvania's statutory rebate provisions and that, by merely setting forth in the contract a right to accelerate total indebtedness, defendants had violated the disclosure requirements.[30] The court also rejected the argument that the "meaningful disclosure" standard of the Truth in Lending laws required a right of acceleration to be disclosed.[31]

The legislative intent and text of the Consumer Credit Protection Act[32] provide a backdrop against which the *McCrackin-Sturman* decision may be viewed. Enacted in 1968, the Act was developed to provide the consumer with meaningful information in order that he might intelligently "shop around" for credit sources.[33] Intended effects of the legislation included enhancement of economic stabilization and strengthening of competition among the various financial institutions.[34] Consumers litigating under the Truth in Lending laws

25. *Id.*; *see* text following note 69 *infra.*

26. PA. STAT. ANN. tit. 69, § 622(B) (Purdon 1965), set forth in note 18 *supra.*

27. 527 F.2d at 266.

28. 5 CONS. CRED. GUIDE (CCH) ¶ 31,173 (1974), *quoted in* 527 F.2d at 267 n.22.

29. 527 F.2d at 267.

30. *Id.* at 268.

31. *Id.* at 269.

32. 15 U.S.C.A. §§ 1601-1691 (West 1974, Cum. Supp. 1976 & Supp. Pamphlet No. 2, pt. 1 1976).

33. Mourning v. Family Publications Serv., Inc., 411 U.S. 356, 364 (1973); 12 C.F.R. § 226.1(a)(2) (1976) (FRB statement of purpose of Consumer Credit Protection Act); [1968] U.S. CODE CONG. & AD. NEWS 1962 (legislative history of Consumer Credit Protection Act—House Report and Conference Report). *See generally* Boyd, *The Federal Consumer Credit Protection Act—A Consumer Perspective,* 45 NOTRE DAME LAW. 171 (1970).

34. 15 U.S.C. § 1601 (1970). This section also states that the purpose of the legislation was to assure a meaningful disclosure of credit terms so that the consumer could compare the various credit terms available and thereby avoid the uninformed use of credit. *Id.* Currently within the purview of the legislation are credit billing

have generally found the provisions construed liberally in order to foster the remedial purposes of the legislation.[35]

Prior to the *McCrackin-Sturman* district court decision, the issue whether a creditor must disclose a right to accelerate had confronted the courts only in the class action of *Garza v. Chicago Health Clubs, Inc.*[36] In that case defendant had failed to disclose his right to accelerate the entire balance of the contract. Although the theory of recovery stated in the complaint was defective, the United States District Court for the Northern District of Illinois found on its own initiative a violation of the requirement of section 226.8(b)(4) of Regulation Z that requires a lender to disclose "charges payable in the event of late payments."[37] The court reflected on the informative purposes of the consumer credit statutes and held that it was clear that an acceleration of indebtedness provision should be disclosed as a "default, delinquency, or similar charge" within the meaning of sections 128(a)(9) of the Truth in Lending Act and 226.8(b)(4) of Regulation Z.[38] Relying on *Black's Law Dictionary*, the court adopted "obligation" and "claim" as synonyms for "charge."[39] The court also concluded that "charge" had been judicially defined as "a pecuniary burden or expense."[40] These definitions, later accepted by the district court in *McCrackin-Sturman*, were the gravamen of the holding in *Garza* that a right of acceleration was a disclosable "charge."[41]

Subsequent to the *McCrackin-Sturman* district court decision with its treatment of *Garza* as authoritative on the acceleration disclosure issue,[42] but prior to the Third Circuit's decision in the case, numerous opportunities to consider the matter further were presented at the district court level. The first encounter with the issue was by a special master for the United States District Court for the Northern District

practices, credit card transactions and consumer leases. 15 U.S.C.A. § 1601 (West Cum. Supp. 1976 & Supp. Pamphlet No. 2, pt. 1 1976).

35. *See, e.g.*, Thomas v. Myers-Dickson Furniture Co., 479 F.2d 740, 748 (5th Cir. 1973); Woods v. Beneficial Fin. Co., 395 F. Supp. 9, 12 (D. Ore. 1975); Johnson v. Associates Fin., Inc., 369 F. Supp. 1121, 1122 (S.D. Ill. 1974). *But see* Jones v. East Hills Ford Sales, Inc., 398 F. Supp. 402, 403 (W.D. Pa. 1975).

36. 347 F. Supp. 955 (N.D. Ill. 1972).

37. *Id.* at 959.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. Johnson v. McCrackin-Sturman Ford, Inc., 381 F. Supp. 153, 156 (W.D. Pa. 1974).

of Georgia. In *Pollack v. Avco Financial Services, Inc.*,[43] and *Barksdale v. Peoples Financial Corp.*[44] the same special master followed *Garza* and the district court *McCrackin-Sturman* opinion in concluding that a right of acceleration was a charge that required disclosure. *Barksdale* is representative of this reasoning in which the master, after noting the absence of any special meaning or legislative definition for the word "charge," reported "[a]s a matter of law that a right of acceleration is a 'charge' that must be disclosed pursuant to Regulation Z § 226.8(b)(4)."[45]

The District Court for the Northern District of Georgia further considered disclosure of acceleration clauses in the case of *McDaniel v. Fulton National Bank.*[46] In *McDaniel* the court adopted the findings of the special master[47] and developed a line of reasoning different from that of the earlier cases. Making observations about the general nature of "charges" as evidenced by sections 226.4(a) and 226.8(c) or Regulation Z,[48] the master had determined that the term "charges" referred to specific pecuniary sums that could be assessed against the customer in addition to the existing contractual obligations.[49] He concluded "that the *right* of the creditor, upon default of the debtor, to

43. 5 CONS. CRED. GUIDE (CCH) ¶ 98,766 (1974).

44. *Id.* ¶ 98,738.

45. *Id.* at 88,341. Although a report by the same master in Hall v. Sheraton Galleries, *id.* ¶ 98,737, was issued prior to the district court *McCrackin-Sturman* decision, the report cited *Garza* and concluded that a provision for collection of attorneys' fees and acceleration of indebtedness in the event of default was disclosable as a charge that may be imposed against the borrowing of money. *Id.* at 88,336.

46. 395 F. Supp. 422 (N.D. Ga. 1975).

47. *Id.* at 423. The master's findings are reported in McDaniel v. Fulton Nat'l Bank, 5 CONS. CRED. GUIDE (CCH) ¶ 98,683, at 88,263 (N.D. Ga. 1974).

48. Language in § 226.4(a) of Regulation Z is representative of that from which these observations were drawn. Charges required by this section to be included in the determination of finance charges are of the following types:

> (1) Interest, time price differential, and any amount payable under a discount or other system of additional charges.
>
> (2) Service, transaction, activity or carrying charge.
>
> (3) Loan fee, points, finder's fee, or similar charge.
>
> (4) Fee for an appraisal, investigation, or credit report.
>
> (5) Charge or premiums for credit life, accident, health, or loss of income insurance, written in connection with any credit transaction . . . .
>
> (6) Charges or premiums for insurance, written in connection with any credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property . . . .
>
> (7) Premium or other charge for any other guarantee or insurance protecting the creditor against the customer's default or other credit loss.
>
> (8) Any charge imposed by a creditor upon another creditor for purchasing or accepting an obligation of a customer if the customer is required to pay any part of that charge in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.

12 C.F.R. § 226.4(a) (1976).

49. 5 CONS. CRED. GUIDE ¶ 98,683, at 88,263.

accelerate the unpaid balance, cannot reasonably be considered a 'charge' (expense or cost) in any context inasmuch as acceleration, in and of itself, does not increase the amount of the debt by one penny."[50] Coupling the master's findings with its interpretation that Georgia law prohibited the collection of any unearned interest,[51] the district court determined that there was no need to disclose an acceleration provision as a "default, delinquency, or similar charge" since no additional tangible sum could be assessed.[52] *Garza* and the *McCrackin-Sturman* district court opinion were not considered valid precedent in *McDaniel* because the court read those cases as not involving a prohibition on the collection of unearned interest such as that which the court interpreted Georgia law to require.[53]

In *Barrett v. Vernie Jones Ford, Inc.*,[54] which also arose in the Northern District of Georgia, Chief Judge Edenfield pointed out that the court in *McDaniel* was in error in its interpretation of the Georgia law regarding collection of unearned interest.[55] The Georgia law, stated in *Vernie Jones*, was that an acceleration of total indebtedness clause was unenforceable only if it rendered the contract usurious.[56] When it considered the disclosure ramifications of a potentially enforceable acceleration clause, the *Vernie Jones* court concluded that, if a note "made no provision for rebate of unearned interest upon acceleration, the diminution of the period over which the finance charge would be spread"[57] would constitute a default charge to the consumer. In requiring disclosure of clauses that on their face provided for an acceleration of total indebtedness, the *Vernie Jones* court grounded its decision on a determination that congressional intent required that the consumer be made aware of all "charges" that *might* be assessed against him.[58] Whether the consumer would prevail in any subsequent litigation attacking the validity of the charge was not the focus of the inquiry. A supplemental opinion in *McDaniel v. Fulton National Bank* acknowledged the correct interpretation of Georgia law in the *Vernie Jones* case.[59]

50. *Id.* at 88,264.
51. 395 F. Supp. at 423.
52. *Id.* at 426.
53. *Id.* at 423.
54. 395 F. Supp. 904 (N.D. Ga. 1975).
55. *Id.* at 907.
56. *Id.* at 907-08.
57. *Id.* at 907.
58. *Id.* at 908-09.
59. *See* 395 F. Supp. at 425. The supplemental opinion reversed the court's prior

Other district courts have utilized policy arguments in the decision to require disclosure of acceleration clauses. *Meyers v. Clearview Dodge Sales, Inc.*[60] required disclosure of a right of acceleration even though Louisiana law had provisions for a rebate of unearned interest. The court reasoned that disclosure of the right of acceleration furthered important goals of the Truth in Lending laws.[61] Citing *Garza v. Chicago Health Clubs, Inc.*,[62] *Meyers* viewed a "charge" as any pecuniary burden or obligation.[63] *Woods v. Beneficial Finance Co.*,[64] noting *Meyers* with approval, referred to a meaningful disclosure standard under the spirit of the Truth in Lending laws.[65] *Woods* did, however, acknowledge that fine semantic distinctions were necessary to equate "acceleration" with "charge."[66]

Since it has been held axiomatic to judicial review that an administrative agency's interpretations of its own regulations are entitled to great deference by the courts,[67] it is hardly open to question that the Third Circuit properly relied on the Federal Reserve Board staff opinion letter that clearly interpreted "default, delinquency, or similar charges" not to include a right of acceleration when there is a require-

position and required a disclosure of the right to accelerate total indebtedness. *Id.* at 428. The opinion now reasoned that the congressional intent behind consumer credit legislation required disclosure of all charges that the lender asserts that he has a right to collect. *Id.* As in *Vernie Jones*, whether or not the state courts could be utilized to collect the charge was not a determinative issue. *Id.*

Prior to the supplemental opinion in *McDaniel*, the district court in Barksdale v. Peoples Fin., 393 F. Supp. 112 (N.D. Ga. 1975), in reliance on the initial *McDaniel* opinion, overruled the special master's recommendation that the right of acceleration be disclosed as a "charge." *Id.* at 114. The court, following the incorrect conclusion in *McDaniel* that acceleration of total indebtedness clauses were per se unenforceable in Georgia, held that since no additional sums could possibly be assessed against the borrower there was no "charge" to disclose. *Id.* at 114.

60. 384 F. Supp. 722 (E.D. La. 1974).

61. *Id.* at 726-27.

62. 347 F. Supp. 955 (N.D. Ill. 1972), *cited in* 384 F. Supp. at 726-27.

63. 384 F. Supp. at 726-27.

64. 395 F. Supp. 9 (D. Ore. 1975).

65. *Id.* at 16.

66. *Id.* In light of these distinctions, *Woods* held prospectively that it was necessary that rights of acceleration be disclosed. *Id.* One district court case that did not require disclosure of the right to accelerate was Jones v. East Hills Ford Sales, Inc., 398 F. Supp. 402 (W.D. Pa. 1975). This case was decided by another judge of the same district court that had required disclosure in *McCrackin-Sturman*. The *Jones* court, as did the Third Circuit in its disposition of *McCrackin-Sturman*, 527 F.2d at 267, afforded great weight to the Federal Reserve Board staff opinion letter (cited in note 28 *supra*), which made it clear that it was not necessary to disclose a right of acceleration as a charge when a rebate of unearned interest was required. 398 F. Supp. at 404. Interestingly, the *Jones* court did not refer to the Pennsylvania statutory rebate requirements. The court concluded that the rebate policy of the creditor involved sufficiently obviated the claim that the customer was being charged. *Id.*

67. Allen M. Campbell Co. v. Lloyd Wood Constr. Co., 446 F.2d 261, 265 (5th

ment that unearned interest be rebated.[68] Acceptance of this Federal Reserve Board position also necessarily required departure from the determination of *Garza* and its progeny that a charge is simply an "obligation" or "burden" rather than a specific additional pecuniary sum.[69] The surprising part of the *McCrackin-Sturman* opinion is its decision to incorporate the Pennsylvania rebate provision into the loan contract. To incorporate the Pennsylvania statute, the Third Circuit relied on the famous language of *Von Hoffman v. City of Quincy*: "It is also settled that the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms."[70] Reflecting on this quotation, Professor Corbin has reasoned that the general terminology of such a statement precluded it from being accepted as correct.[71] He acknowledged that the operation of a contract could only be determined with due reference to all applicable statutes but emphatically stated that the statutes were not incorporated into the contract.[72]

At first blush it seems that with proper reference to the historical interpretation and purpose of consumer credit laws, the Third Circuit should have disregarded *Von Hoffman* and concluded that the acceleration clause should have been disclosed since *on its face* it created a charge, albeit an unenforceable one under Pennsylvania law. The court would have been supported in such a decision by the prior determination in *Vernie Jones* that a rebate provision should not be read into a silent acceleration clause.[73] A pro-disclosure opinion would also have been consistent with the general philosophy of consumer credit legislation.[74] Ironically, it was the consumer oriented Penn-

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Cir. 1971); *see* Udall v. Tallman, 380 U.S. 1, 16-17 (1965); Bone v. Hibernia Bank, 493 F.2d 135 (9th Cir. 1974); N.C. Freed Co. v. Board of Governors of the Fed. Reserve Sys., 473 F.2d 1210, 1217 (2d Cir. 1972), *cert. denied*, 414 U.S. 827 (1973).

68. 5 CONS. CRED. GUIDE (CCH) ¶ 31,173 (1974), *quoted in* 527 F.2d at 267 n.22.

69. *See, e.g.*, Meyers v. Clearview Dodge Sales, Inc., 384 F. Supp. 722, 726-27 (E.D. La. 1974); Pollack v. Avco Fin. Servs., Inc., 5 CONS. CRED. GUIDE (CCH) ¶ 98,766 (N.D. Ga. 1974) (special master's report). For a discussion of the term "charge," see Morris v. First Nat'l Bank, 5 CONS. CRED. GUIDE (CCH) ¶ 98,568 (N.D. Ga. 1975); McDaniel v. Fulton Nat'l Bank, 5 CONS. CRED. GUIDE (CCH) ¶ 98,683 (N.D. Ga. 1974) (special master's report). *See also* 1 CONS. CRED. GUIDE (CCH) ¶ 4230 (1970) (definition of delinquency charge).

70. 71 U.S. (4 Wall.) 535, 550 (1886).

71. 3 A. CORBIN, CONTRACTS § 551, at 197 (1960).

72. *Id.*

73. 395 F. Supp. 904, 909 (N.D. Ga. 1975).

74. *See* Mourning v. Family Publications Serv., Inc., 411 U.S. 356, 377 (1973). *See generally* Boyd, *supra* note 33, at 174.

sylvania statute that allowed the Third Circuit to deviate from the "meaningful disclosure" standard that had often mandated disclosures in prior Truth in Lending cases.[75]

Under Georgia law, as interpreted in *Vernie Jones*, acceleration of total indebtedness clauses are not per se unenforceable.[76] That court refused to read a rebate requirement into a silent clause because there was no certainty that a rebate would be required. A rebate of unearned interest was called for only if acceleration rendered the note usurious.[77] The Pennsylvania statute involved in *McCrackin-Sturman* is an unequivocal rebate requirement.[78] If the Third Circuit had interpreted the contractual right to accelerate total indebtedness as a disclosable "charge," the court would have been in the awkward position of requiring Pennsylvania lenders to disclose to their customers that the lender was asserting a right to a "charge" that a state statute made it impossible lawfully to collect. Thus, in the specific factual context of *McCrackin-Sturman*, the decision not to require disclosure of the acceleration clause was the practical resolution of the issue. However, the incorporation of the Pennslyvania statute into the contract does raise a broad collateral problem concerning the extent to which state law provisions may permeate a Truth in Lending case.[79]

Although there is nothing really profound in the conclusion that an acceleration clause does not constitute a "default, delinquency, or similar charge" when there is a provision for rebate of any unearned interest, there is a certain gravity to a decision that disclosure of such a clause will not be required under the Truth in Lending laws. In its decision not to grasp "meaningful disclosure" as the sustaining philosophy of what would have been a technically weak position, the Third Circuit appropriately indicated that the standard of meaningful disclosure should not override the specific provisions of the Truth in Lending Act and Regulation Z. But since the opinion inevitably surfaces with an anti-consumer gloss, it is likely that *Johnson v. McCrackin-Sturman Ford, Inc.* will be viewed as a deviation from the direction that the courts have determined that consumer credit litigation must take.

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75. *See, e.g.*, Woods v. Beneficial Fin. Co., 395 F. Supp. 9, 12 (D. Ore. 1975); Johnson v. Associates Fin., Inc., 369 F. Supp. 1121, 1122 (S.D. Ill. 1974).

76. 395 F. Supp. at 909.

77. *Id.* at 910.

78. PA. STAT. ANN. tit. 69, § 622(B) (Purdon 1965). See note 18 *supra* for the provisions of the statute.

79. *See* McDaniel v. Fulton Nat'l Bank, 395 F. Supp. 422, 428 (N.D. Ga. 1975).

After a thorough consideration of the Third Circuit's opinion in *McCrackin-Sturman*, a district court recently concluded:

> [E]ven if we accept the argument that acceleration of the defaulted loan does not impose a charge under 12 C.F.R. § 226.8(b)(4), the customer should be informed of the right of acceleration and its consequences under the requirement that there be a meaningful disclosure of the terms and conditions of the credit transaction . . . .[80]

Thus, even though it is a well reasoned opinion, *Johnson v. McCrackin-Sturman Ford, Inc.* does not seem destined for the authoritative treatment it deserves.

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80. Burley v. Bastrop Loan Co., 407 F. Supp. 733, 781 (W.D. La. 1976) (supplemental opinion).