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Notes

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NOTES

Antitrust Law—Limitation of Actions—A Liberal Interpretation to Save the Private Plaintiff

In accord with its emphasis on the role of the private prosecutor in antitrust enforcement, the Supreme Court, in a recent case, *Zenith Radio Corp. v. Hazeltine Research, Inc.*,[1] has increased the protection afforded the private plaintiff against statutory limitations on his treble damage action. That case, which was before the Court for the second time, was initiated with a patent infringement action by Hazeltine Research, Inc. (HRI) in 1959. In 1963 Zenith filed a counterclaim alleging certain violations of the Sherman and Clayton Acts arising out of HRI's participation in patent pools in Canada, Great Britain, and Australia and claimed damages sustained during the previous four year period. The conspiracy of which HRI was alleged to be a member had been the subject of a government suit from November 24, 1958, to November 1, 1963, but HRI was not named in that action.

The trial judge entered preliminary findings of fact and conclusions of law in favor of Zenith on its counterclaim[2] and at this point HRI attempted to reopen the record and present evidence on its limitations defense,[3] which had not been alleged at any earlier point. The trial judge allowed the filing of the motions but refused to modify his findings of fact and conclusions of law concerning HRI's activities in barring Zenith from the Canadian market. The Court of Appeals for the Seventh Circuit reversed on the ground that Zenith had failed to prove injury to its business,[4] but the Supreme Court in an earlier decision held that Zenith had proved its damages from its exclusion from the Canadian market.[5] The Court noted at that time that the trial judge either had rejected the limitations defense on the merits or had deemed it waived, and the Court did not consider the question of whether damages sustained during the

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[1] 91 S. Ct. 795 (1971).

[2] Hazeltine Research, Inc. v. Zenith Radio Corp., 239 F. Supp. 51 (N.D. Ill. 1965).

[3] The statute of limitations on antitrust actions is contained in 15 U.S.C. § 15(b) (1964). This section provides that "[a]ny action . . . shall be forever barred unless commenced within four years after the cause of action accrued."

[4] Hazeltine Research, Inc. v. Zenith Radio Corp., 388 F.2d 25 (7th Cir. 1967).

[5] Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969).

statutory period that were caused by pre-period conduct could be recovered.[6]

On remand the court of appeals found that the trial judge had not held the defenses to be waived, but rather had erroneously rejected the limitations defense on the merits. This court held that the statute was not tolled by the prior government action since HRI was not named as a defendant and remanded the case for a determination of the extent of the reduction of damages that would result if the defenses were sustained.[7] Zenith petitioned for certiorari[8] and this time the Court heard argument solely on the limitations issues.

Section 4B of the Clayton Act provides that all antitrust actions will be barred unless they are brought within four years from the *accrual of the cause of action.*[9] Section 5B of the Clayton Act[10] gives some relief to the antitrust litigant by providing for the tolling of the statutory period during the pendency of a government suit based in whole or in part on the matter involved in the plaintiff's claim. This statute of limitations has caused considerable difficulties for the federal courts because of the complex nature of antitrust litigation, the amorphous nature of commercial conspiracy, and the difficulty of showing the cause and the effect of individual acts of the defendant.

The application of the statutory period in this case would of course be determinative on the issue of the damages recoverable by Zenith. If the statute were tolled by the government action from November 24, 1958, until November 1, 1963, when a consent decree was entered against the last defendant in the government action, Zenith would have been entitled to recover any damages to its business occurring as a result of the conspiracy conduct at any time after November 24, 1954. The problem in *Zenith* arose because HRI alleged that part of the damage suffered by Zenith from 1959 until 1963 resulted from pre-1954 conduct. It was in this posture that the Court was called upon to decide the issue of waiver of the limitations defense by HRI, the tolling of the statute by a government suit that neither named HRI as a defendant nor as a co-conspirator, and the date of the accrual of the cause of action for purposes of the statute of limitations.

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[6] *Id.* at 117 n.13.
[7] Hazeltine Research, Inc. v. Zenith Radio Corp., 418 F.2d 21 (7th Cir. 1969).
[8] Zenith Radio Corp. v. Hazeltine Research, Inc., 397 U.S. 979 (1970).
[9] 15 U.S.C. § 15(b) (1964).
[10] 15 U.S.C. § 16(b) (1964).

The entire Court agreed that the trial judge would not have abused his discretion under Federal Rule of Civil Procedure 15(a)[11] if, instead of allowing the plaintiff leave to amend his pleadings and incorporate his statutory defenses, the judge had held that the defenses were waived under Federal Rule of Civil Procedure 12(h).[12] Justice Harlan, joined by Justice Stewart, rested his decision on this basis alone.[13] The majority, finding that the record was unclear on the waiver issue, refused to remand the case for another round of proceedings and decided the statutory defenses on the merits.

The court of appeals had held that tolling takes place only with respect to the parties to a government suit.[14] The Supreme Court refused to follow such a restrictive interpretation of the tolling provision and held that Zenith, although suing HRI, which was named neither as a party nor as a coconspirator in the government suit, was not barred from obtaining the benefits of the tolling statute, since Zenith had shown that the conspiracy in which HRI participated was at least in part the same conspiracy as was the object of the government suit. The Court cited this holding as consistent with and a logical extension of its earlier decisions in *Minnesota Mining & Manufacturing Co. v. New Jersey Wood Finishing Co.*[15] and *Leh v. General Petroleum Corp.*[16]

Once it had passed the tolling hurdle, the Court was faced with the problem of the post-1959 damages caused by the pre-1954 conduct of the conspiracy. The courts have devised many methods for avoiding the harsh result of too strict an interpretation of the statute of limitations. Such

[11] FED. R. CIV. P. 15(a). This rule provides that with two exceptions a party may amend his pleadings only by leave of the court or by written consent of the adverse party. HRI had argued before the Court that leave to amend should have been granted in this case because justice so required.

[12] FED. R. CIV. P. 12(h). Prior to the 1966 amendments rule 12(h) provided that "[a] party waives all defenses and objections which he does not present either by motion . . . or, if he has made no motion, in the answer or reply . . . ."

[13] 91 S. Ct. at 811 (concurring opinion).

[14] 418 F.2d at 25 n.3.

[15] 381 U.S. 311 (1965).

[16] 382 U.S. 54 (1965). In *Leh* the Court had held that a private litigant was entitled to the benefit of the tolling statute even though the conspiracy he alleged covered a different time, named additional parties, and excluded some parties named in the prior government suit. The Court in *Zenith* admitted that *Leh* did not decide the precise issue now before the Court, *i.e.*, tolling of the statute against a defendant not named as either a defendant or coconspirator in the prior government action. 91 S. Ct. at 805. *See generally* Korman, *The Antitrust Plaintiff Following in the Government Footsteps*, 16 VILL. L. REV. 57 (1970); Comment, *Section 5(b) of the Clayton Act: The Tolling Effect of Government Antitrust Actions on Unnamed Parties*, 34 U. CHI. L. REV. 906 (1967); 65 MICH. L. REV. 1661 (1967).

theories as fraudulent concealment of the conspiracy,[17] continuing invasion of the plaintiff's rights,[18] and an overt act occurring within the statutory period[19] have saved private plaintiffs from the strictures of the statute.

Previous decisions on this issue have emphasized the continuing conduct of the defendant and the causal effect of that conduct, *i.e.*, damages to the antitrust plaintiff. As long as some conduct during the statutory period that causes damages can be attributed to the defendant, the courts have not hesitated to deny any statutory defenses. In *Zenith*, however, the Court appears to take a different tack on this issue. As the basis for its decision the Court looked to the language of the statute, specifically to the phrase "accrual of the cause of action." The Court held that the cause of action cannot accrue with regard to future damages until those damages can be proved with some degree of certainty by the plaintiff. If the plaintiff only has speculative damages, he cannot prove those damages in court and therefore has no cause of action with regard to such damages.[20] In the principal case, Zenith's sole proof with regard to damages was its showing of a hypothetical market that it could have obtained in Canada were it not for the conspiracy which denied Zenith entry. Moreover, in 1954 there were other factors barring Zenith's entry into the Canadian market, including a foreign government prohibition. The Court concluded that Zenith, as a plaintiff in 1954, could not possibly show what its damages would be for the period from 1959 until 1963 so those damages must have been speculative, *i.e.*, no cause of action had accrued with regard to those damages. The Court does not isolate the point in time that the cause of action did accrue as to these damages, but nevertheless it concluded that Zenith had filed its counterclaim well within the statutory period.

[17] *E.g.*, Atlantic City Elec. Co. v. General Elec. Co., 312 F.2d 236 (2d Cir. 1962); Crummer Co. v. duPont, 223 F.2d 238 (5th Cir. 1955). The fraudulent-concealment doctrine provides that the statute of limitations does not begin to run until the plaintiff is aware or should be aware of the conspiracy. This equitable doctrine is generally applied to all statutory limitations.

[18] *See* Hanover Shoes, Inc. v. United States Shoe Mach. Co., 392 U.S. 481 (1968). This case involved the defendant's continuing policy of only leasing his machines rather than offering them for sale. For a more restrictive approach, See Manok v. Southeast Dist. Bowling Ass'n, 306 F. Supp. 1215 (C.D. Cal. 1969), in which the court held that the original suspension of the plaintiff from the defendant association started the running of the statute of limitations and that the subsequent denials of readmittance were not overt acts and did not involve a continuing invasion of the plaintiff's rights. *See also* Highland Supply Corp. v. Reynolds Metal Co., 327 F.2d 725 (8th Cir. 1964).

[19] *E.g.*, Steiner v. 20th Century-Fox Film Corp., 232 F.2d 190 (9th Cir. 1956).

[20] 91 S. Ct. at 806.

The case raises serious problems, and a liberal interpretation of the opinion without due consideration of the facts out of which it arose will effectively gut the four year statute of limitations as a statute of repose for the antitrust defendant. There are several facets of the case missing in the opinion of the Court which might dictate a more restrictive approach in similar but not identical situations. It should be pointed out that the Court was dealing with only one aspect of the statute of limitations, its function as a limitation on the extent of recoverable damages. The function of the statute as a complete bar to suit is not raised by the case and was not discussed by the Court. It was found in the lower court that there was a continuing conspiracy after 1954 that caused damages during the statutory period, and therefore the suit by Zenith could not be completely barred by the statute. The continuation of the conspiracy after 1954 and any overt acts committed after that date become irrelevant in any event since the Court focused on the plaintiff and his ability to prove his damages rather than on the conduct of the defendant. Since *some* damages could be recovered by Zenith even under traditional learning, the real problem with the Court's rationale is not raised in *Zenith.*

The objection to the rationale of the Court would arise if the conspiracy had terminated in all respects in 1954 or before. Zenith, as a plaintiff in 1954, would have the same difficulty in establishing its damages for future years since it could not forecast the percentage of the Canadian market that it would lose as a result of the delayed entry caused by the conspiracy. If the rationale of the principal case were adopted in this situation, Zenith would not be required to bring suit until it could prove its damages with some degree of certainty. At any point in the future, Zenith could bring an action, establish the fact of violation, and recover damages incurred during the previous four years along with any future damages that it could prove. This result would not be violative of the policy supporting the statute of limitations if the only effect would be as it was in *Zenith,* an increase in the amount of damages that the plaintiff could recover. However, the policy behind the statute of limitations as a statute of repose with regard to the *fact* of violation would be destroyed. The plaintiff, in the hypothetical situation, would not be required to establish the antitrust violation until some future point which could be ten or fifteen years from the termination of the conspiracy. All the arguments that are normally used to justify any statute of limitations, such as staleness of the evidence and the unavailability of witnesses, apply with full force to this situation. The antitrust defendant would never be

free from suit arising out of his conduct so long as the possibility existed that some plaintiff at some later point would be injured by that conduct.

This result may be justified on policy grounds because of the role of the private prosecutor in enforcing the antitrust laws[21] and the fact that this future plaintiff has suffered real harm from the defendant's violations of those laws. However, the reasoning of the Court breaks down when confronted with another plaintiff in a different situation who is equally deserving of the Court's protection. If the conspiracy in the principal case had terminated in 1954 and at that point Zenith could have proved its damages during the future period, then its later action would have been barred. Such a plaintiff who can show his future damages with some degree of certainty must bring his action within the four year period or be forever barred. The distinction between this plaintiff and one who cannot prove his damages seems dubious when one considers the fact that both plantiffs will have suffered the same damages at the hands of the same defendant. Such a distinction is apparently unjustified.

Future litigants should be forewarned that *Zenith* turns on very special facts. Factors that may have influenced the decision of the Court include the late assertion of the defenses by HRI. There was some evidence that HRI may have deliberately saved its statutory defenses until after the findings of fact and conclusions of law by the trial judge since any attempt to raise the defenses at an earlier stage may have involved admissions of HRI's participation in the conspiracy. The late filing by HRI had precluded Zenith from even introducing evidence on the statutory defenses, and the Court, desiring to prevent a remand of a case already eleven years in duration, may have concluded that Zenith could show acts by HRI that would bring the case within the statutory period under traditional theories. In addition, the fact of antitrust violation was clearly shown in the lower court by Zenith.

The application of the *Zenith* rationale in later litigation should not be viewed by plaintiffs' attorneys as an opportunity for delay. The attorney must now decide if the damages that will occur to the plaintiff are provable at the time when the violation becomes apparent. If the damages are not provable, the plaintiff can delay his suit. This determination by the attorney of the speculative nature of the damages is of course subject to review by the courts, and the lower federal judges, including the court of appeals in the principal case, have not been quite so liberal in construing

[21] *See* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 139 (1968).

the statutes as the Supreme Court has been. The safest course and the one the attorney would most likely take would be to bring the action at an early date. However, a not unusual situation can arise, as it did in *Zenith*, where a litigant will await an action for infringement or similar relief by the violating party before filing his "automatic" counterclaim for treble damages. Such a litigant may hope to find salvation in the *Zenith* decision.

Because of the unsupportable results that obtain from an application of an expanded interpretation of *Zenith*, the rationale of the case should not be extended to exempt a plaintiff from having to show the fact of violation within the statutory period. Such a plaintiff should not be accused of splitting his cause of action since the extent of future damages cannot be proved at the time of the first action.[22] Requiring the plaintiff to prove the fact of violation within the statutory period would not produce harsh results since antitrust litigation is not a summary proceeding and the plaintiff will have an extended period of trial time to show his anticipated damages. In addition the lower courts have tremendous flexibility and could retain jurisdiction of the case and allow the plaintiff to come in at a later date and show the extent of his damages. Furthermore, a recovery in the first suit should not bar later action for subsequent damages.[23] By requiring the plaintiff to show the fact of violation during the four year statutory period, the interests of the defendant will be protected in that he will not have to defend his conduct under the antitrust laws after the expiration of the four year period. The interests of the plaintiff will be protected in that he will not be denied recovery for any future damages incurred as a result of the defendant's conduct.

Zenith reflects the concern of the Court over the role of the private prosecutor in antitrust litigation. This attitude of the Court, reflected in its abolition of the *in pari delicto* defense[24] and the licensee estoppel defense,[25] is commendable in that the private plaintiff serves a useful if not vital role in the enforcement of the antitrust statutes. In this process, however, the Court should be wary of dubious distintions that only com-

[22] *See* RESTATEMENT OF JUDGMENTS §§ 49, 65(2) (1942). A second action should clearly be allowed in pursuit of a remedy which could not be obtained in the first action. This may, however, require a finding by the trial court on the basis of its decision denying future damages. Such a finding would distinguish a case where the future damages were speculative and therefore not recoverable and one where the trial judge finds that the plaintiff will suffer no future damages.

[23] *Id.*

[24] Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968).

[25] Lear, Inc. v. Adkins, 395 U.S. 653 (1969).

plicate the already impossible task of lawyers and judges involved in antitrust litigation. It is regrettable that the Court picked such a complex vehicle as *Zenith*, which could have been decided on the issue of waiver alone,[26] to continue its policy of protection of the private plaintiff.

LANNY B. BRIDGERS

Bankruptcy—Wage Earner's Vacation Pay Held Not to Be Property Under Section 70a(5)

In *Lines v. Frederick*,[1] the Supreme Court has held that the accrued vacation pay of two bankrupt wage earners does not pass to a trustee in bankruptcy as "property" under section 70a(5) of the Bankruptcy Act.[2] The referee in each case had ordered the wage earner to turn over his vacation pay to the trustee on receipt, less an amount exempt under applicable California law.[3] On appeal the district court affirmed, but the Ninth Circuit Court of Appeals reversed, maintaining that the accrued vacation pay was not "property" within the coverage of section 70a(5).[4]

[26] See the concurring opinion of Mr. Justice Harlan. 91 S. Ct. at 811.

[1] 400 U.S. 18 (1970) (per curiam).

[2] Bankruptcy Act § 70a, 11 U.S.C. § 110a (1964), provides:

> The trustee of the estate of a bankrupt . . . shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition . . . except insofar as it is to property which is held to be exempt, to all the following kinds of property wherever located . . . (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him . . . . *Provided*, That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt . . . shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process . . . .

[3] CAL. CIV. PRO. CODE § 690.11 (West 1955) provided that the following shall be exempt from the claims of creditors:

> One-half of the earnings of the defendant or judgment debtor received for his personal services within 30 days next preceding the levy of attachment or execution where such one-half is necessary for the use of the debtor, or his family supported in whole or in part by such debtor.

This California statute was repealed in 1970 by Ch. 1323, § 27, [1970] CAL. STATS. —, but substantially the same provision can be found in CAL. CIV. PRO. CODE § 690.6 (West Supp. 1971). Accordingly, under California law creditors could reach all but a small portion of the accrued vacation pay in *Lines*. This would suffice to pass the nonexempt portion under section 70a(5), assuming that vacation pay would be considered "property."

[4] 400 U.S. at 18. Earlier the fifth circuit had reached an opposite conclusion in Kolb v. Berlin, 356 F.2d 269 (5th Cir. 1966).

In its per curiam opinion, the Supreme Court emphasized that the basic purpose of the Bankruptcy Act is "to give the debtor a 'new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,' "[5] and that this basic purpose circumscribes any judicial definition of property under section 70a(5).[6] The Court reasoned that since vacation pay is a part of workers' weekly earnings, and functions "to support the basic requirements of life for them and their families during brief vacation periods or in the event of layoff," it is essential to bankrupt wage earners in making a "fresh start" and should not pass to the trustee.[7]

Section 70a of the Bankruptcy Act enumerates different kinds of interests which automatically vest in the trustee upon the filing of the petition, unless exempt under applicable state law. Under section 70a(5), as pertinent here, property passes if prior to the filing of the petition it was either transferable by the bankrupt or could have been levied upon and sold under judicial process against him.[8] Ordinarily, federal courts follow local statutory or decisional law "upon the question of whether particular property is endowed with the legal attributes and incidents of transferability or susceptibility to sale by judicial process."[9] In *Lines*, however, the Court never reached the question of whether, under California law, accrued vacation pay is transferable or leviable. Such an inquiry, which predominates in most cases involving section 70a(5), was obviated by the Court's determination that the vacation pay was not "property" and hence did not vest regardless of local law concerning its transferability or leviability.

The traditional scope of section 70a(5) was stated earlier by the Court in *Segal v. Rochelle*:[10]

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[5] 400 U.S. at 19, *quoting* Local Loan Co. v. Hunt, 292 U.S. 234, 245 (1934).

[6] 400 U.S. at 19.

[7] *Id.* at 20.

[8] *See* note 2 *supra*. The proviso in section 70a(5) states that rights of action for certain types of personal injuries will not pass to the trustee, unless subject to judicial process.

[9] Annot., 16 A.L.R.2d 839 (1951). *See, e.g.*, Taylor v. Voss, 271 U.S. 176 (1926) (state law determines whether a wife's interest in the bankrupt's property passed to the trustee); Hewit v. Berlin Mach. Works, 194 U.S. 296 (1904) (state law determines whether vendor's title upon a conditional sale was valid and subject to pass to trustee); Danning v. Lederer, 232 F.2d 610, 613 (7th Cir. 1956) (state law controls whether a bankrupt's interest in a spendthrift trust will pass); Cullom v. Kearns, 8 F.2d 437 (4th Cir. 1925) (state law determines whether a bankrupt's interest in an estate held by the entirety passes).

[10] 382 U.S. 375, 379 (1966).

> The main thrust of § 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term "property" has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed.

Ordinarily federal courts have chosen to follow state court rulings on various types of property interests. Where federal courts have not followed local rulings, the reason has been that the state courts had defined "property" too narrowly and had thereby prevented the passing of assets intended to be within the reach of section 70(5).[11] As was observed by the Court in *Board of Trade v. Johnson*,[12]

> Congress derives its power to enact a bankruptcy law from the Federal Constitution, and the construction of it is a federal question. Of course, where the bankruptcy law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts; but when the language of Congress indicates a policy requiring a *broader* construction of the statute than the state decisions would give it, federal courts can not be concluded by them.

The Court in *Lines* interposes its own definition of "property" without regard to state law, but it does not do so in order to secure assets for creditors through a "broader construction of the statute." In fact, it is the Court itself in *Lines* which is narrowly defining "property" so as to prevent the passing of assets clearly alienable or leviable under state law.[13] Thus, the Court subverts its traditional policy of sweeping all assets of value into the bankruptcy estate to its concern for giving the debtor a "fresh start" after bankruptcy. Indeed, a definitional approach formerly employed by the federal courts in furtherance of one policy is being used in *Lines* to serve an entirely different objective.

In *Wetmore v. Markoe*,[14] which appears to be the seminal case articulating the "fresh start" rationale, the Court stated that

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[11] *See, e.g.*, Board of Trade v. Johnson, 264 U.S. 1 (1924) (seat on stock exchange passes as transferable property, notwithstanding prior state court determination that such was not "property"); Young v. Handwork, 179 F.2d 70 (7th Cir. 1949) (bankrupt's interest in trust passes although Illinois law provided that creditors cannot reach a debtor's interest in trusts created by others and state court had interpreted this law to prevent passage to the trustee).

[12] 264 U.S. 1, 10 (1924) (emphasis added).

[13] *See* note 3 *supra* & note 26 *infra*.

[14] 196 U.S. 68, 77 (1904) (emphasis added).

> [s]ystems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a *fresh start* in business or commercial life, freed from the obligation and misfortunes which may have resulted from business responsibilities.

It was in furtherance of such a design that the Court in *Local Loan Co. v. Hunt*[15] ruled that a state court could not enforce an assignment of future wages that a bankrupt had made before declaration of bankruptcy. There the Court said:

> The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emanicipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to bankruptcy.[16]

The Court also noted that "wages earned after the adjudication became the property of the bankrupt clear of the claims of all creditors" and that an individual's earning capacity is not "property within the meaning of the bankruptcy act."[17] Although it is easily seen that a wage earner in the *Local Loan Co.* situation could hardly make a "fresh start" if deprived of his earnings subsequent to discharge, to hold as the Court does in *Lines* that vacation pay *already accrued* is not property within the meaning of the Bankruptcy Act goes far beyond the "fresh start" rationale as articulated in *Local Loan Co. v. Hunt.*

It is well-settled that compensation owed to a bankrupt for services fully performed by the time bankruptcy is declared passes to the trustee under section 70a(5),[18] even though payment is not to be made until after discharge.[19] In *Legg v. St. John*,[20] a case arguably similar to *Lines*, the Supreme Court held that the accrued right of a bankrupt to receive disability benefits in the future under an insurance contract does pass to the trustee. There the Court noted that

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[15] 292 U.S. 234 (1934).

[16] *Id.* at 245. *See also* the concurring opinion of Judge Brown in Kolb v. Berlin, 356 F.2d 269, 272 (5th Cir. 1966).

[17] 292 U.S. at 243.

[18] *In re* Hannan, 127 F.2d 894 (7th Cir. 1942); Florance v. Kresge, 93 F.2d 784 (4th Cir. 1938). *See generally* 9 AM. JUR. 2d *Bankruptcy* § 912 (1963).

[19] *In re* Leibowitt, 93 F.2d 333 (3d Cir. 1937).

[20] 296 U.S. 489 (1936).

> [t]he right to receive disability benefits in the future does not differ from any other right acquired before adjudication to receive money thereafter. . . . Like other property, it passed to the trustee, unless exempted by the law of the bankrupt's domicile. *The principle declared in Local Loan Co. v. Hunt . . . is not applicable here.*[21]

This case would seem to be strong authority for the proposition that accrued vacation pay should pass as property, since the right to the money vests before adjudication.[22]

In other cases involving interests similar to accrued vacation pay, the lower federal courts have consistently arrived at conclusions different from that reached in *Lines*. The Fifth Circuit Court of Appeals has held that both money due for annual leave[23] and the right to receive a lump sum payment of a retirement fund contribution[24] are "property" passing under section 70a(5). Moreover, there are two recent federal court decisions in California which have concluded that accrued vacation pay does pass. *In re Kuether*[25] held that accrued vacation pay passed to the trustee since under California law such an interest was clearly assignable.[26] The bankruptcy court in *In re Cohen*[27] found that a bankrupt school teacher's right to receive summer vacation pay as part of a prorated twelve month salary, but for which no additional services were required, was "property" within the reach of section 70a(5). These cases and others

[21] *Id.* at 495-96 (emphasis added).

[22] *Cf. In re* Wright, 157 F. 544 (2d Cir. 1907) (bankrupt insurance agent's right to receive renewal premiums passes even though bankrupt had to continue present employment in order to receive the payments).

[23] Kolb v. Berlin, 356 F.2d 269 (5th Cir. 1966).

[24] Hill v. Schaefer, 221 F.2d 914 (5th Cir. 1955).

[25] 203 F. Supp. 223, 224 (N.D. Cal. 1962).

[26] The Court's conclusion that the right to receive accrued vacation pay is an assignable interest under California law is clearly correct. CAL. CIV. CODE § 1044 (West 1954) provides that "[p]roperty of any kind may be transferred, except as otherwise provided by this Article." CAL. CIV. CODE § 1045 (West 1954) adds that "[a] mere possibility, not coupled with an interest, cannot be transferred." The California courts have consistently held, however, that under these two sections even future wages or money to become due in the future upon the happening of a contingency are assignable. *See* Baumgarten v. California Pac. Title & Trust Co., 127 Cal. App. 649, 16 P.2d 332 (Dist. Ct. App. 1926). There can be little doubt that had the Supreme Court in *Lines* considered the question, it would have found accrued vacation pay to be assignable under California law. Note 3 *supra* concludes that most of the accrued vacation pay in *Lines* could have been reached by creditors. Thus the vacation pay could have passed to the trustee by satisfying either or both of the conditions of section 70a(5).

[27] 276 F. Supp. 889, 892 (N.D. Cal. 1967).

suggest that under case law prior to *Lines* accrued vacation pay passes as "property" so long as it is alienable or leviable under applicable state law.

Lines can be viewed as the latest of a series of decisions in which the Supreme Court has asserted that a bankruptcy proceeding is of an equitable nature.[28] In *Pepper v. Litton*[29] the Court noted that

> by virtue of [section 2a of the Bankruptcy Act] a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred [upon the court] by the Act, it applies the principles and rules of equity jurisprudence . . . . [E]quitable powers have been invoked to the end that fraud will not prevail, substance will not give way to form, technical considerations will not prevent substantial justice from being done.

Easily seen here is the Court's implicit warning that it may look increasingly to equitable principles for the solution to problems arising out of the administration of the Bankruptcy Act.

Unfortunately, the Court at times has exercised its equitable powers at the expense of disregarding clear statutory language in the Act. In *Bank of Marin v. England*,[30] a bank had honored checks drawn by a depositor after his declaration of bankruptcy. Despite the fact that section 70d(5) specifically invalidates any transfer made by or in behalf of the bankrupt after filing,[31] with certain exceptions not applicable in *Bank of Marin*,[32] the Court ruled that the trustee was liable for the amount of the checks. The Court concluded that payment in this instance was not a "transfer" within the meaning of the statute because "it would be inequitable to hold liable a drawee" under these circumstances.[33] The result here, as noted by Justice Harlan in dissent,[34] may seem equitable but nonetheless contravenes clear statutory language.

A similar criticism can be leveled at the Court's decision in *Reading*

[28] *See* Aug, *Recent Trends in the Application of Equitable Principles of Bankruptcy*, 43 REF. J. 109 (1969).

[29] 308 U.S. 295, 304-05 (1939).

[30] 385 U.S. 99 (1966).

[31] Bankruptcy Act § 70d(5), 11 U.S.C. § 110d(5) (1964), provides:
A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided . . . no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee . . . .

[32] For exceptions to this rule, see Bankruptcy Act §§ 21g, 70d(1)-(5), 11 U.S.C. §§ 44g, 110d(1)-(5) (1964).

[33] 385 U.S. at 103.

[34] *Id.* at 103-11.

Co. v. Brown,[35] in which a tort claimant sued a bankrupt estate on the basis of an injury caused by the negligence of the receiver. The Court held that the claim was an "actual and necessary" cost of administration[36] and accorded the claim first priority under section 64a of the Bankruptcy Act.[37] The Court noted: "The Act does not define 'actual and necessary' nor has any case directly in point been brought to our attention. We must, therefore, look to the general purposes of Section 64a, Chapter XI, and the Bankruptcy Act as a whole."[38] Thereupon, the Court felt free to exercise its equitable powers in defining "actual and necessary" so as to achieve the basic objective of "fairness to all persons having claims against an insolvent."[39] For the Court to regard a tort claim as an actual and necessary cost and expense of preserving the estate taxes the language of the statute, especially in view of the effect of according such a claim first priority status.[40]

This technique of reaching what the Court considers a "fair" result by selective definition of key words in the Bankruptcy Act provisions is applied in *Lines*, as it was in *Bank of Marin* and *Reading*. One problem surrounding the application of this technique is that it tends to make the bankruptcy court a "place for a disregard or in effect a repealing of the express provisions of statutory law."[41] The possibilities for a complete judicial overhaul of the entire area of bankruptcy administration in the name of "equity," or "fairness," or to "assure the debtor a fresh start" would appear limitless in light of the *Marin-Reading-Lines* line of decisions.

Also in *Lines*, the Court, in its determination to assure the bankrupt a "fresh start," virtually ignored the other basic purpose of the Act of securing all of the bankrupt's assets and dividing them among his creditors.

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[35] 391 U.S. 473 (1968).

[36] *Id.* at 476.

[37] Bankruptcy Act § 64a, 11 U.S.C. § 104a (1964), provides:

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . . .

[38] 391 U.S. at 476.

[39] *Id.*

[40] In *Reading*, because of the limited assets of the estate in bankruptcy, the effect of according first priority status to the tort claimant was to prevent the other creditors from recovering any amount on their claims. See the dissent of Chief Justice Warren. 391 U.S. at 486-91.

[41] Aug, *supra* note 28, at 112.

There is authority suggesting that the congressional intent in passing the Act in 1898 to afford the debtor a "fresh start" through discharge in bankruptcy was subordinate to that of providing a procedure for the collection and distribution of all the bankrupt's assets among his creditors.[42] But, setting the historical argument aside, the Court in deciding any close question in bankruptcy administration should always weigh the rights of both creditor and debtor; the *Lines* opinion would appear to stand as a notable example where this has not been done, to the detriment of the creditor.

Furthermore, in allowing the bankrupt to retain his vacation pay accrued prior to filing, the Court goes beyond its stated objective of providing the discharged debtor with a "fresh start." The point is cogently made by the dissenting Justice Harlan when he argued that the majority opinion in *Lines* in effect gives the bankrupt a *head start* over his hypothetical counterpart who begins work for the first time on the day after bankruptcy is declared.[43] The Court summarily attempts to justify this by noting that accrued vacation pay, as a part of wages, is a " 'specialized type of property' "[44] within the ambit of its decision in *Sniadach v. Family Finance Corp.*[45] This treatment is hardly satisfactory. In *Sniadach* the Court was concerned with a state garnishment procedure whereby a creditor could freeze all of a debtor's wages by service of a complaint upon both employee and garnishee.[46] These wages would remain frozen until adjudication of the complaint, although the garnishee was required under state law to pay the worker a subsistence allowance of at least twenty-five dollars but not exceeding fifty per cent of the latter's owed

[42] *See In re* Leslie, 119 F. 406, 410 (N.D.N.Y. 1903). Judge Ray, the deciding judge, had been a member of the House Judiciary Committee during the passage of the Bankruptcy Act of 1898 and had served as chairman of that committee during the passage of the 1903 amendment. 1 H. REMINGTON, BANKRUPTCY 18 (4th ed. 1934). Judge Ray made these comments on the spirit of the Bankruptcy Act of 1898:

> The main purpose of the bankrupt law is to prevent preferences, and secure a fair and an equitable division of the bankrupt estate among the creditors, not to grant discharges. This end accomplished, the bankrupt is granted a discharge from all his debts. The attainment of the first is not to be sacrificed to the accomplishment of the last.

119 F. at 410.

[43] 400 U.S. at 21-22.

[44] *Id.* at 21.

[45] 395 U.S. 337 (1969).

[46] *Id.* at 338-39. *See also* Note, *Poverty Law—Garnishment—Protection of Debtors' Rights*, 48 N.C.L. REV. 164 (1969).

wages.[47] The effect of this procedure was to deprive the employee of at least half of his earnings before he was given an opportunity to be heard.[48] Emphasizing the severe hardship imposed upon wage earners by such prejudgment garnishment and noting the special nature of wages,[49] the Court struck down the state procedure as violative of due process.[50] It is apparent in *Sniadach* that the procedure there could indeed "drive a wage-earning family to the wall."[51] But there is certainly less hardship imposed upon the wage earner in the position of the bankrupt in *Lines* who is being deprived only of his accrued vacation pay representing a small fraction of his wages. The Court, however, makes no attempt to distinguish the compelling considerations that prompted its decision in *Sniadach* from those in *Lines*.[52]

In effect, the Court in *Lines* has subjected the Bankruptcy Act to the Court's own conception of a national exemption policy with regard to accrued vacation pay, thereby superseding applicable state exemption laws. Moreover, by implication, no form of accrued wages would pass under section 70a(5). This significantly overturns a long-established judicial policy in conjunction with section 6 of the Bankruptcy Act[53] of leaving

[47] Ch. 507, § 1, [1965] Wis. Sess. L. —. This statute is former WIS. STAT. ANN. § 267.18(2)(a), which was repealed and recreated by Ch. 127, § 10, [1969] Wis. Sess. L. —. This new statute is codified as WIS. STAT. ANN. § 267.18(2)(a) (Supp. 1970-71).

[48] 395 U.S. at 339.

[49] *Id.* at 340.

[50] *Id.* at 342.

[51] *Id.* at 341-42.

[52] The Court in *Lines* observed that "[w]here the minimal requirements for the economic survival of the debtor are at stake, legislatures have recognized that protection which may be unnecessary or unwise for other kinds of property may be required." 400 U.S. at 20. The Court cites the Consumer Credit Protection Act § 301, 15 U.S.C. § 1671 (1970), as an example of such legislative recognition. 400 U.S. at 20. Section 1673 of the Consumer Credit Protection Act restricts the garnishment of any disposable earnings of a wage-earner to the lesser amount of twenty-five per cent of his weekly earnings or thirty times the minimum hourly wage. Consumer Credit Protection Act § 303, 11 U.S.C. § 1673 (1970). Arguably these restrictions on garnishment would operate to exempt from passage to the trustee a large portion not only of a bankrupt's future wages, but also of any accrued wages, including vacation pay. See Comment, *Title to Property—Employee Bankrupt Vacation Pay*, 45 AM. BANKR. L.J. 115, 119 (1971) [hereinafter cited as AM. BANKR. L.J.]. There is nothing in the legislative history of the Consumer Credit Protection Act, however, to suggest that Congress intended the restrictions in section 1673 to extend beyond the creditor's remedy of garnishment.

[53] Bankruptcy Act § 6, 11 U.S.C. 24 (1964), provides: "This title shall not affect the allowance to the Bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws . . . ."

the matter of exemptions exclusively to the states.[54] The prospect of the Court, and not the Congress, fashioning a "national, uniform exemption policy by placing limitations on the meaning of the word 'property' as used in section 70a(5) of the Act"[55] on a piecemeal basis is hardly appealing. Unfortunately, however, such a prospect would appear likely in the wake of the *Lines* decision.

E. CADER HOWARD

Conflict of Laws—Enforcement of Foreign Judgments in Federal Courts

In *Somportex Ltd. v. Philadelphia Chewing Gum Corp.*,[1] a federal court was recently called upon to decide whether to apply the state or federal rule on enforcement of foreign judgments. The court had jurisdiction by reason of international diversity,[2] held that the choice of law was governed by *Erie Railroad Co. v. Tompkins*,[3] and applied the state rule. This note will explore the issue of whether *Erie* should be controlling with respect to enforcement of foreign judgments when the court has jurisdiction by reason of international, as opposed to intra-national, diversity of citizenship.

The *Somportex* case has a rather complex background. Somportex originally brought suit against Philadelphia Chewing Gum Corporation for an alleged breach of contract. The suit was brought in England, and the defendant was served at its offices in Pennsylvania. The defendant made a conditional appearance in the English court and sought an order

[54] AM. BANKR. L.J. 117. *See* United States v. Sharpnack, 355 U.S. 286 (1958); Eaton v. Boston Trust Co., 240 U.S. 427 (1916); Dixon v. Koplar, 102 F.2d 295 (8th Cir. 1939). In the last case it was observed that

> the rights of a bankrupt to property as exempt are those given him by the state statutes; and the federal courts, sitting as courts in bankruptcy, will determine exemptions according to those statutes, and the decisions of the courts of last resort of the states construing and applying those statutes.

Id. at 297.

[55] AM. BANKR. L.J. 117.

[1] 318 F. Supp. 161 (E.D. Pa. 1970).

[2] "The district court shall have original jurisdiction of all civil actions . . . between—(1) citizens of different States; (2) citizens of a State, and foreign states or citizens or subjects thereof. . . ." 28 U.S.C. § 1332 (1964). The first clause provides for intra-national diversity jurisdiction, and the second for international diversity jurisdiction.

[3] 304 U.S. 64 (1938). In *Erie*, the Court held that in a diversity case a federal court must apply the substantive law of the state in which it is sitting.

setting aside the original writ for lack of jurisdiction,[4] alleging that none of the English grounds for extraterritorial service of process existed. The defendant then withdrew from his own hearing and suffered a default judgment on the issue of jurisdiction. When the defendant petitioned to withdraw his original conditional appearance because of mistake, he won in the lower court but lost on the plaintiff's appeal. Thereupon the defendant completely withdrew from the case and suffered a default judgment on the merits.[5] *Somportex* involved the plaintiff's attempt to enforce this judgment in the federal court.

The *Somportex* court analyzed this situation as one in which the default judgment was based on personal jurisdiction over the defendant obtained through his appearance in the English court.[6] Therefore, the English court's determination that the defendant made a knowing appearance was given full effect.[7]

The court then held state law controlling as to whether reciprocity was required for enforcement of foreign judgments,[8] and "found" that, were the state court to be confronted with this problem, it would not require reciprocity.[9] Finding no genuine issue as to any material fact, the court

[4] 318 F. Supp. at 162.

[5] *Id.* at 163.

[6] The court characterized the fact situation in *Somportex* as a hybrid of the two usual foreign-judgment cases. The first is the case in which a defendant has taken no action in the foreign court and is free to attack collaterally the foreign court's determination of jurisdiction. The second arises when the defendant makes a conditional appearance to litigate the issue of jurisdiction, loses on this issue, and withdraws. The court reasoned that in the latter situation the jurisdictional issue cannot be re-examined by the court asked to enforce the judgment. The court said:

> Unlike the first situation, the defendant has taken some action in England. Philadelphia Chewing Gum entered a conditional apearance, which after final litigation . . . has since become a general appearance. However, unlike the second situation, the defendant has not litigated the underlying jurisdictional basis for the suit.

318 F. Supp. at 164. The court noted that "full faith and credit" would prevent an inquiry into the issue of jurisdiction if the judgment were that of a sister state, Sherrer v. Sherrer, 334 U.S. 343 (1948), and that the RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 98 (Proposed Official Draft, May 2, 1967) called for recognition and enforcement of foreign judgments. 318 F. Supp. at 164.

[7] 318 F. Supp. at 165. Because of some unfortunate choices on the defendant's part, the plaintiff never had to prove even the jurisdictional aspects of his original suit.

[8] In Handelsbanken v. Carlson, 258 F. Supp. 448 (D. Mass. 1966), another lower federal court cited *Erie* and held that state law controlled whether a foreign judgment would be enforced without reciprocity. However, in that case the state law concurred with the federal rule, giving the foreign judgment only prima facie weight.

[9] Pennsylvania had not ruled directly on the issue of whether reciprocity was

granted the plaintiff's motion for summary judgment.[10]

The court recognized that the federal rule, as stated in *Hilton v. Guyot*,[11] requires reciprocity as a condition precedent to enforcement of foreign judgments; the United States will not enforce a foreign judgment unless a court of the nation rendering the judgment would give like effect to an American judgment. However, the court noted that *Hilton* was decided before *Erie* and went on to say: "It is clear . . . that the law governing the enforceability of foreign judgments by a federal court is the law of the state where the court is located."[12] It does not seem entirely "clear" that *Erie* requires this conclusion. *Erie* involved intra-national, rather than international, diversity jurisdiction.[13] Moreover, the question of enforcement of foreign judgments involves federal interests, and later cases explaining *Erie* have tended to limit its reach in areas involving federal interests.[14]

Thus there are two important and distinct questions which the court in *Somportex* could have considered but did not: first, whether *Erie* was intended to apply in cases of international diversity where there is a special federal interest involved; and second, whether enforcement of foreign judgments is of such federal importance that it might be considered a "federal question." Although the resolution of these two issues would involve similar considerations of the federal interest, a decision for one or the other would bring about completely different results. If it were found that *Erie* simply did not apply, the federal courts could apply federal law but the state courts could apply different state law. If this were held to be a federal question, then the federal decision would be binding on the state courts as well.[15]

Whether *Erie* should have applied in *Somportex* turns upon the reach of the *Erie* rule and the policies behind it. At first blush, not to apply the state law would seem to fly directly in the face of the *Erie* rule. In *Erie*, the Court said that where jurisdiction is based on diversity, "[e]xcept in matters governed by the Federal Constitution or by Acts of Congress, the

required, so the federal court was forced to decide as it felt the Supreme Court of Pennsylvania would. Were the Supreme Court of Pennsylvania to confront this problem later and reach a different conclusion, the federal courts in Pennsylvania would then be bound by that decision.

[10] 318 F. Supp. at 169.

[11] 159 U.S. 113 (1895).

[12] 318 F. Supp. at 167.

[13] Erie R.R. v. Tompkins, 304 U.S. 64, 65 (1938).

[14] *See, e.g.*, Byrd v. Blue Ridge Rural Elec. Coop., 356 U.S. 525 (1958).

[15] C. WRIGHT, LAW OF FEDERAL COURTS § 60 (2d ed. 1970).

law to be applied in any case is the law of the State."[16] There was no exclusion for international diversity and an examination of the policies underlying *Erie* shows that such an exclusion would normally be undesirable.[17] The *Erie* Court wanted to prevent nonresidents from having a choice of law which they could exercise simply by bringing suit in the most favorable forum, whether state or federal. If the court in *Somportex* had not applied the state law as to reciprocity, it would have created a situation in which a nonresident could choose between a federal and state forum and thus decide whether reciprocity would be required.[18] However, with respect to the enforcement of foreign judgments, there may be a federal interest sufficient to justify the application of federal law. Although in *Erie* the Court felt that uniformity of the substantive law applied by the courts located in a state was more important than national federal uniformity,[19] in a *Somportex* situation the Court might feel otherwise. The inequities of forum shopping within a state may be outweighed by the desire to have a uniform federal rule in international dealings.[20] The Court in *Erie* said that the state law "rests expressly on a local policy . . . dictated by local conditions."[21] A state law dealing with enforcement of foreign judgments obviously has other than local ramifications.

Several cases decided subsequent to *Erie* have shed light on the question of whether *Erie* should apply. *Klaxon Co. v. Stentor Electric Manufacturing Co.*,[22] cited in *Somportex*,[23] held that the federal courts must apply state choice-of-law rules when jurisdiction is based on diversity of citizenship. In *Guaranty Trust Co. v. York*[24] the Court interpreted the *Erie* rule very broadly and held that the federal courts in diversity cases

[16] 304 U.S. at 78.

[17] The fact that diversity between the parties was international rather intranational should not, in itself, require a different choice of law rule. In the ordinary contracts action, as opposed to one for the enforcement of a foreign judgment, there is no rational reason for having a different choice of law in the federal court simply because one of the parties is an alien.

[18] If the nonresident brought the suit in state court, the resident defendant could not remove if jurisdiction was based on diversity. 28 U.S.C. § 1441(b) (1964).

[19] 304 U.S. at 75.

[20] Reciprocity in enforcement of the judgments of the United States and a foreign country would best be obtained by a treaty. Then the supremacy clause of the Constitution would require all courts in the United States to give that treaty effect. U.S. CONST. art. VI. However, if state law controls both the state and federal courts, and state laws do not require reciprocity, there will be little incentive to a foreign country to make any such treaty.

[21] 304 U.S. at 68.

[22] 313 U.S. 487 (1941).

[23] 318 F. Supp. at 164.

[24] 326 U.S. 99 (1945).

must operate as just another court of the state in which the federal courts are situated. *Guaranty Trust* introduced the "outcome-determinative" test for deciding when state law must be applied—whenever the use of a particular rule can significantly affect the outcome of the litigation, state law must be applied.[25] *Klaxon* and *Guaranty Trust* tend to support the proposition that *Erie* should apply, but later cases have defined the *Erie* rule more narrowly and have expanded the situations in which federal courts will use federal law. *Byrd v. Blue Ridge Electric Cooperative*[26] held that outcome is not the only consideration, and that when there is a strong federal policy against the application of the state rule the federal court may apply the federal rule, even though it has an effect on the outcome. Then, in *Hanna v. Plumer*,[27] the Court held that the Federal Rules of Civil Procedure are controlling on the federal courts, even in the face of conflicting and outcome-determinative state rules. In *Hanna* the Court cited *Byrd* for the proposition that the *Guaranty Trust* outcome-determinative test "was never intended to serve as a talisman,"[28] and that the choice between federal and state law can not be made by " 'litmus paper' criterion but rather by reference to the policies underlying the *Erie* rule."[29] This statement and the *Byrd* holding (permitting the application of outcome-determinative federal rules in some instances) indicate that in the Court's view the *Erie* policies do not foreclose the application of federal law just because to do so might encourage forum shopping between the state and federal courts.

In *Clearfield Trust Co. v. United States*,[30] the Court held that federal courts do not have to apply state law regarding liability on commercial paper issued by the United States because, on the *Clearfield* facts, the "application of state law . . . would subject the rights and duties of the United States to exceptional uncertainty,"[31] and "[t]he desirability of a uniform rule is plain."[32] The jurisdiction in *Clearfield* was based on the United States being a party and thus the federal interest is more readily apparent, but *Clearfield* still tends to show that the Court does not mean for *Erie* to apply where national uniformity is an important factor. Therefore, if enforcement of foreign judgments were considered by the

[25] *Id.* at 109.
[26] 356 U.S. 525 (1958).
[27] 380 U.S. 460 (1965).
[28] *Id.* at 466-67.
[29] *Id.* at 467.
[30] 318 U.S. 363 (1943).
[31] *Id.* at 367.
[32] *Id.*

Court to be an area of substantial federal concern, in which federal uniformity was an important consideration, *Byrd* and *Clearfield* could be cited to support the contention that *Erie* is inapplicable in that area. However, the fact remains that to allow federal courts to apply federal law is an affront to the most basic policy of *Erie*—discouraging forum shopping.

Finally, it must be considered whether the reciprocity issue is a federal question. As previously noted, this inquiry involves many of the same considerations underlying the issue of whether *Erie* applies at all, but it is different in effect. If the issue of whether to require reciprocity for enforcement of foreign judgments is a federal question, the rule of decision would be the same in all courts of the nation—state and federal—and forum shopping would be eliminated entirely.

The reciprocity issue certainly does not fit the classical mold of a federal question, since it is not controlled by the Constitution and there is no applicable federal statute or treaty.[33] Therefore, if federal law is to control it must be federal common law, which the Court has applied in several other instances. On the same day that *Erie* was handed down, the Court held in *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*[34] that federal common law must be applied to determined the rights of two states through which an interstate stream passed. Federal common law was used in *Clearfield*, in which the United States was a party and government paper was involved. In *Sola Electric Co. v. Jefferson Electric Co.*[35] and *Textile Workers Union of America v. Lincoln Mills*,[36] the Court applied federal common law in areas related to those dominated by federal statutory law. And, in cases of admiralty and maritime law, the Court has used federal common law to achieve uniformity.[37]

The case closest to the *Somportex* fact pattern in which the court has applied federal common law is *Banco Nacional de Cuba v. Sabbatino*.[38] Therein the Court refused to be bound by *Erie* and made its own interpretation of the "act of state" doctrine,[39] saying, "the Court did not have

[33] Note 20 *supra*. Judgment-enforcing treaties are clearly legal under international law. France has several, though none with the United States. Lorenzen, *The Enforcement of American Judgments Abroad*, 29 YALE L.J. 188, 194 n.33 (1919).

[34] 304 U.S. 92 (1938).

[35] 317 U.S. 173 (1942).

[36] 353 U.S. 448 (1957).

[37] *E.g.*, Southern Pac. Co. v. Jensen, 244 U.S. 205, 215-17 (1917).

[38] 376 U.S. 398 (1964).

[39] The "act of state" doctrine has it that " 'the courts of one country will not

rules like the act of state doctrine in mind when it decided *Erie R. Co. v. Tompkins*."[40] The Court also stated that "an issue concerned with a basic choice regarding the competence and function of the Judiciary and the National Executive in ordering our relationships with other members of the international community must be treated exclusively as an aspect of federal law."[41] There is in this statement at least the implication that questions concerning foreign relations are issues of federal common law.[42]

Arguably, *Banco Nacional* affords a springboard for the application of federal common law in *Somportex*. The Court in *Banco Nacional* used federal common law because the rule it was concerned with affected our affairs with foreign nations, and it saw in the Constitution and federal laws a concern for uniformity in this area.[43] *Somportex*, too, could be thought to have international ramifications. Encouraging nations to give our judgments effect in their courts is a legitimate federal objective which would be advanced by a national policy of reciprocity. In *Banco Nacional*, there was no federal law directly involved nor any firm indication from Congress that federal decisions were desired in this area, but the Court applied federal common law nevertheless.[44]

If the court in *Somportex* had considered the course indicated by *Banco Nacional*, it could have decided that the issue of whether to require reciprocity for enforcement of foreign judgments is a federal question. The states would then be bound by the federal rule, forum shopping would be prevented, and a uniform approach in an area of national interest would be facilitated.

BRUCE J. DOWNEY, III

Constitutional Law—Equal Protection and Residence Requirements

The United States Supreme Court in *Shapiro v. Thompson*[1] held that a one-year residence requirement which denied otherwise qualified

sit in judgment on the acts of the government of another done within its own territory.'" *Id.* at 416.

[40] 376 U.S. at 425.

[41] *Id.*

[42] See Comment, *Federal Common Law and Article III: A Jurisdictional Approach to Erie*, 74 YALE L.J. 325 (1964).

[43] 376 U.S. at 427 n.25.

[44] *Id.* at 416-27.

[1] 394 U.S. 618 (1969).

applicants welfare benefits was unconstitutional as an impermissible burden on interstate travel. The Court specifically left unresolved the validity of other state residence requirements including residence for the bar.[2] Recently, however, in *Keenan v. Board of Law Examiners*[3] a three-judge federal court used a two-fold equal protection approach[4] involving "traditional" equal protection on the one hand and the *Shapiro* rationale on the other to find North Carolina's one-year residence requirement for the state bar examination unconstitutional.[5] The purpose of this note is to examine the decision in *Keenan* and to relate both *Keenan* and *Shapiro* to some other North Carolina waiting periods and residence requirements.

Keenan was a class action seeking a declaratory judgment that Rule VI(6) of the Rules Governing Admission to the Practice of Law in North Carolina, which required one year's residence in North Carolina prior to the date of the bar examination, was unconstitutional.[6] The two successful plaintiffs were graduates of accredited law schools and had been admitted to and had practiced before the bar in other states.[7] Following the order of a preliminary injunction, the North Carolina Board of Law Examiners treated the plaintiffs' applications as though the plaintiffs were in compliance with the residence requirements and admitted them to the bar examination since they were otherwise qualified.[8]

The first standard of review used by the court[9] was the "traditional" equal protection standard which required that the distinctions drawn by a state's classification have "*some relevance* to the purpose for which the

[2] "We imply no view of the validity of waiting-period or residence requirements determining eligibility to vote, eligibility for tuition-free education, to obtain a license to practice a profession, to hunt or fish, and so forth." *Id.* at 638 n.21.

[3] 317 F. Supp. 1350 (E.D.N.C. 1970).

[4] *See* text at notes 9 & 20 *infra.*

[5] Another three-judge federal court held that Georgia's one-year residence requirement for admission to the bar was so discriminatory in light of the meager state interest served as to deny due process and equal protection of the laws. Webster v. Wofford, 39 U.S.L.W. 2382 (N.D. Ga. Dec. 31, 1970).

[6] Comity applicants for the bar were also required to be residents of North Carolina for one year prior to the approval of their applications. This rule was not challenged in *Keenan* but was subsequently changed to a sixty-day residence requirement. *See* THE BOARD OF LAW EXAMINERS, RULES GOVERNING ADMISSION TO THE PRACTICE OF LAW IN THE STATE OF NORTH CAROLINA, Rule VII, § 1(4) (1970) [hereinafter cited as LAW EXAMINERS].

[7] A third plaintiff failed to apply for the examination as required by another unchallenged requirement. 317 F. Supp. at 1352.

[8] *Id.*

[9] *Id.* at 1359. *See Developments in the Law: Equal Protection*, 82 HARV. L. REV. 1065 (1969).

classification is made."[10] Borrowing language from the Supreme Court in *Schware v. Bar Examiners*[11] the court in *Keenan* pointed out that

> [i]n licensing attorneys there is but one constitutionally permissible state objective: the assurance that the applicant is capable and fit to practice law and that . . . [w]hile a state can require high standards of qualification . . . before it admits an applicant to the bar, *any qualification must have a rational connection with the applicant's fitness or capacity to practice law.*[12]

Using this standard the court was unable to find a sufficient connection between the reasons given for the residence requirement and "fitness or capacity to practice law."

The first reason offered by the state in relating the rule to the proper objective was that a residence period allowed the applicant to acquire "a modicum of knowledge about the state's governmental structure and its local customs."[13] Suggesting that "legal usage and practices" are mostly learned in active practice, the court brushed aside any relevance of knowledge of local custom with the statement that "[n]either legal competence nor ethical fitness depends upon cultural provincialism."[14]

The second reason advanced by the state was that one-year local residence gives fellow residents an opportunity "to observe the applicant 'in action' " before judging his character and moral reputation. The state felt "that those most capable of judging and passing upon the character of an individual are those who actually live in the community where the

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[10] Rinaldi v. Yeager, 384 U.S. 305, 309 (1966) (emphasis added).

[11] 353 U.S. 232, 239 (1957).

[12] 317 F. Supp. at 1359 (emphasis by the court). *See also* Konigsberg v. State Bar, 366 U.S. 36 (1961).

[13] 317 F. Supp. at 1359.

[14] *Id.* In view of the growing demand for more local control of government and for policemen to live within their department's district, knowledge of local custom and conditions probably has more relevance to the practice of law than the court acknowledges. Indeed, the Hawaii Supreme Court has recently upheld a three-year residence requirement for state legislators on these grounds and noted that at least three states have residence requirements of five years for candidates for their state legislatures. Hayes v. Gill, — Hawaii —, —, 473 P.2d 872, 878 (1970), *appeal dismissed as moot sub nom.* Hayes v. Lieutenant Gov. of Hawaii, 91 S. Ct. 1200 (1971). In another case the Supreme Court affirmed a ruling holding Alabama's requirement that state circuit judges reside in the circuit one year prior to their election constitutional. Hadnot v. Amos, 320 F. Supp. 107 (M.D. Ala. 1970), *aff'd*, 91 S. Ct. 1189 (1971). Nonetheless it is also true, as the court in *Keenan* and the dissent in *Hayes* conclude, that regardless of whether or not the knowledge is relevant, residence is not adequate as a test of whether a particular applicant has the knowledge, 317 F. Supp. at 1359; — Hawaii at —, 473 P.2d at 884.

applicant resides."[15] The court rejected this argument and found that there were less onerous and more effective methods of determining character. Acknowledging the nationwide investigating service of the National Conference of Bar Examiners, and the bar examiners' power to require the applicant's cooperation, the court concluded that a nonresident's fitness to practice law "can be accurately determined in each case only by investigation of the applicant's out of state background."[16] Thus, since an out-of-state background investigation would be necessary, the court suggested that a "reasonable" fee could be charged the nonresident applicant to cover the additional costs and that the date for filing applications could be set far enough in advance of the examination to insure adequate time for review.[17]

The third reason for the one-year residence rule was that it "evidences a bona fide intent to become a permanent resident of the community, such permanence being desirable for an attorney."[18] Here the court did not dispute the desirability of permanence but rather discounted the value of the requirement since "[i]n our highly mobile society, one who has lived in a particular locale for one year may be firmly rooted in the community or he may be ready to move on tomorrow."[19]

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[15] Supplemental Memorandum for Defendant at 17.

[16] 317 F. Supp. at 1362. *See* Cohen v. Hurley, 366 U.S. 117 (1961); Konigsberg v. State Bar, 366 U.S. 36 (1961). Viewed against the arguments of those who suggest that the only purpose of such residence requirements is to protect the economic interests of the local attorneys, the state's arguments for the rule seem even weaker. *See* 317 F. Supp. at 1360 n.12; State v. Johnston, — Hawaii —, —, 456 P.2d 805, 812 (1969) (dissenting opinion); Barron, *Business and Professional Licensing—California, A Representative Example*, 18 STAN. L. REV. 640 (1966); Mann, *Not for Lucre or Malice: The Southern Negro's Right to Out-of-State Counsel*, 64 NW. U.L. REV. 143 (1969); Note, *Attorneys: Interstate and Federal Practice*, 80 HARV. L. REV. 1711 (1967); Note, *Admission to the Bar: By-Product of Federalism*, 98 U. PA. L. REV. 710 (1950).

[17] 317 F. Supp. at 1360-61. The Board of Law Examiners has adopted both measures. *See* LAW EXAMINERS Rule V, § 2 (moving filing date ahead two months to six months before the bar examination) and Rule V, § 3 (authorizing fee).

[18] 317 F. Supp. at 1359.

[19] *Id.* Interestingly, the best example of the problem is James Keenan, one of the plaintiffs. After six months residence he was admitted to the bar in Texas on May 13, 1969, but only several days later left the state to work for an OEO Office in New Orleans. *See* Supplementary Memorandum for Defendant at 19. The answer for the state is to restrain or punish those who interfere with the court system after their admission to the bar rather than trying to anticipate which bar applicants will become transients. *See* LAW EXAMINERS Rule VI(6); Mann, *supra* note 16, at 154; Note, *Constitutional Right to Engage an Out-of-State Attorney*, 19 STAN. L. REV. 856 (1967). Sanctions against transients can be insured by requirements of bonding and the use of long arm statutes. *See, e.g.*, N.C. GEN. STAT. § 85-2 (1965) (requiring bonding for resident auctioneers); N.C. GEN. STAT.

The second standard used to review the issue of equal protection was the more stringent rule requiring a "compelling" state interest to be shown to justify a regulation infringing on a constitutional right.[20] In this case the court found that the one-year residence requirement undoubtedly deterred attorneys from other states from exercising their right to interstate travel while, as noted above, it did not promote a compelling state interest or objective.[21] Indeed the residence requirement in *Keenan* is in many respects a greater infringement on the right to travel than the residence requirement in *Shapiro*. An indigent does not necessarily expect welfare in a new state and may have other reasons for moving there which will cause him to remain even without welfare. A lawyer on the other hand expects to practice law and is unlikely to move to or remain where he cannot practice.

The court in *Keenan* noted other residence requirements for the bar such as residence at the time of examination, at the time of admission, or for a short term before admission to insure personal interviews and contact with the applicant, but specifically withheld an opinion as to their validity.[22] Thus the door was not completely closed on state regulation in the form of some lesser residence requirement.

The North Carolina Board of Law Examiners meet and pass on all of the applications during a six-to-eight-week period before the bar examination. Under their rules all applications must be complete by January 10th of the year of the examination in order that preliminary investigation may be completed before the whole board meets.[23] Since *Keenan*, a new rule requires that a general applicant shall:

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§ 84-4.1(3) (Supp. 1969) (requiring out-of-state attorneys practicing in North Carolina to submit to service of process within the state).

[20] 317 F. Supp. at 1361-62. *See* Shapiro v. Thompson, 394 U.S. 618, 634 (1969); *Developments in the Law: Equal Protection*, 82 HARV. L. REV. 1065 (1969).

[21] 317 F. Supp. at 1361-62.

[22] *Id.* at 1362 n.17. Residence after admission to the bar is not required by North Carolina so it is difficult to imagine a state interest in requiring residence at the time of admission to the bar. Residence for the bar examination or to insure presence for interviews, in either case, serves only administrative convenience and that only indirectly. While the Bar Examiners can clearly require in-state presence for the exams and interviews, to require the applicant to move his residence before he knows he will be admitted to the bar is an intolerable burden on the applicant when compared to the meager benefit to the state. One plaintiff in *Keenan* suggested that the rule requiring residence but not permitting the practice of law was a burden not only on his family but also on his future clients. The ambiguity of insuring the quality of attorneys in this fashion does not seem to have occurred to the Law Examiners. Affidavit of Loren Mitchell, Plaintiff's Exhibit E.

[23] Supplemental Memorandum for Defendant at 11.

> Be and *continuously* have been domiciled and *physically* present in the State of North Carolina from the 15th day of June to the 15th day of August of the year in which the applicant takes the bar examination.[24]

Obviously the Board wants the applicants available for interviews during final consideration of their applications, and the rule is written strictly to impress upon the applicant the importance of the interview. But while the harshness of the rule is mitigated by the fact that those taking the bar examination will probably be in North Carolina anyway, attending a bar review course which begins the first week in June, the rule would seem clearly unconstitutional. Mere domicile and presence within the state does not necessarily make one more accessible to the Board of Examiners. An applicant from South Hill, Virginia, is more accessible than one who lives on the Outer Banks of North Carolina. Furthermore, no legitimate state interest is served by preventing, for example, weekend trips to Myrtle Beach, South Carolina. A more reasonable interpretation of the rule would be that the Board will require the applicant to be physically available at specific times and will send notice to an in-state location where the applicant is to be "constructively" present for the entire review period. Whatever the Board's intent the rule should be rewritten to make its meaning clear to all bar applicants.

Residence requirements for other professions are as suspect as those for the bar. North Carolina, for example, has a one-year residence requirement before one can take the examination administered by the Board of Certified Public Accountant Examiners.[25] As in all occupational licensing, the state's interest in licensing accountants is in protecting the public by certifying those with the "capacity and fitness" to practice as an accountant.[26] The residence requirement for accountants, like the residence requirement for the bar, does not test the applicant's "capacity or fitness" to practice. Indeed the Florida Supreme Court has already struck down a similar residence requirement for public accountants in that state.[27]

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[24] LAW EXAMINERS Rule VI(6) (emphasis added). The rule for comity applicants requires only continuous residence and bona fide citizenship. LAW EXAMINERS Rule VII(4).

[25] N.C. GEN. STAT. § 93-12(5) (1965). North Carolina also has a two-year residence requirement for auctioneers, N.C. GEN. STAT. § 85-2 (1965), and a one-year requirement for bail bondsmen, N.C. GEN. STAT. § 85A-11 (1965). Other residence requirements for other occupational licenses are not statutory, but, like the bar requirement, are set by the licensing boards.

[26] *See* COUNCIL OF STATE GOVERNMENTS, OCCUPATIONAL LICENSING LEGISLATION IN THE STATES 1-4 (1952); W. HOROWITZ, OCCUPATIONAL LICENSING IN ARIZONA 7-10 (1966).

[27] Mercer v. Hemmings, 194 So. 2d 579 (Fla. 1967) (two-year requirement).

Other residence requirements for occupational licenses have the same failings and should continue to be struck down.[28]

Most other state residence requirements are designed to prevent overloading of state programs by an influx of out-of-state residents. North Carolina, for example, formerly imposed a four-month residence requirement before a woman could obtain a therapeutic abortion[29] apparently to prevent the overloading of its hospitals. Since the Supreme Court in *Shapiro* said that "a State may no more try to fence out those indigents who seek higher welfare benefits than it may try to fence out indigents generally,"[30] it would seem that a state cannot discriminate against those who *may* have entered the state for the public benefits it offers. Indeed, the recent decision in *Corkey v. Edwards*,[31] striking down the residence requirement of the North Carolina abortion statute, pointed out that it was an undue infringement on the right to travel that penalized those with the bona fide intent of making the state their permanent residence, which effect was not outweighed by a legitimate state interest. The decision in *Corkey* was influenced by the realization that the state's abortion statute, while being progressive, would still not draw a large number of out-of-state patients.[32] It is nonetheless consistent with the declaration in *Shapiro* that "deterrence of indigents from migrating to the state . . . is [not] a constitutionally permissible state objective."[33]

As state welfare benefits continue to improve at different rates and

[28] State *ex rel.* James v. Gerrell, 137 Fla. 324, 188 So. 812 (1939) (striking down requirement for auctioneers); Wormsen v. Moss, 177 Misc. 19, 29 N.Y.S.2d 798 (Sup. Ct. 1941) (striking down requirement for massage parlor operators).

[29] N.C. GEN. STAT. § 14-45.1 (1969).

[30] 394 U.S. at 631.

[31] 322 F. Supp. 1248 (W.D.N.C. 1971).

[32] "The state expresses a fear that has not materialized: taxation of our hospital facilities by an influx of out-of-state patients seeking abortions. We think our law is not so liberal." *Id.* at 1254. There was, however, a very liberal abortion statute before the state legislature which would have permitted termination of pregnancy during the first twelve weeks of pregnancy on request of the mother. The proposed statute would have required the mother to have been a resident for thirty days before the abortion, thereby precluding those who might have come to the state for the sole purpose of obtaining an abortion. H. 5 (1971 Sess.) (now tabled in the Senate). This statute would have been liberal enough to draw sufficient numbers of patients to overburden the state's hospital facilities, in addition to adversely affecting the abortion policies of neighboring states. The state's interests in this residence requirement were greater than in *Corkey* but the statute would still have unreasonably discriminated against new bona fide residents as does a proposed thirty-day residence requirement offered to replace the one struck down in *Corkey*. H. 626 (1971 Sess.).

[33] 394 U.S. at 633.

residence requirements for different programs are struck down,[34] the problem of new residents overloading welfare systems will continue to grow. However, as long as the Court is willing to sustain its declaration in *Shapiro*, states will have to find methods for reducing the burden other than by imposing durational residence requirements.[35]

Another state program which has durational residence requirements is higher education. The University of North Carolina, for example, requires six-months residence preceding enrollment to entitle a student to the lower in-state tuition rate.[36] The state's interest is to protect its facilities from an influx of nonresidents attracted by the low tuition costs.[37] Here again the problem with the durational residence requirement is that it discriminates against those residents who enter the state with the bona fide intent of making the state their permanent residence. In several states this discrimination is limited to one year after which the student may present evidence that he is a bona fide resident.[38] In North Carolina, however, the student must prove six-months residence "preceding the date of enrollment or re-enrollment, exclusive of any time spent in attendance at *any* institution of higher education."[39]

[34] Programs for which durational residence requirements have been struck down include: King v. Housing Auth., 314 F. Supp. 427 (S.D.N.Y. 1970) *and* Cole v. Housing Auth., 312 F. Supp. 692 (D.R.I. 1970) (public housing); Richardson v. Graham, 313 F. Supp. 34 (D. Ariz. 1970) *and* Sheard v. Department of Social Welfare, 310 F. Supp. 544 (N.D. Iowa 1969) (old age benefits); Crapps v. Hospital Auth., 314 F. Supp. 181 (M.D. Fla. 1970) *and* Board of Supervisors v. Robinson, 10 Ariz. App. 238, 457 P.2d 951 (1969) (indigent hospital care).

[35] The Governor of New York recently asked that state's legislature to enact a one-year residence requirement for welfare benefits which would be effective only during a five-year "emergency" period. The Governor, recognizing the Supreme Court ruling in *Shapiro*, asserted that the conditions that now exist in that state, which has the highest tax burden in the country and an acute housing shortage, constitute a "compelling" state interest for the imposition of such a requirement. He concluded that "[t]his step is essential to protect the state's economic and social viability." N.Y. Times, Mar. 28, 1971, § 1, at 1, col. 1.

[36] RECORD OF THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL, SCHOOL OF LAW 18-19 (1970) [hereinafter cited as RECORD].

[37] For example, tuition for the Law School is 112.50 dollars per semester for residents and 475 dollars per semester for nonresidents. *Id.* at 18.

[38] *See* Kirk v. Board of Regents, 273 Cal. App. 2d 430, —, 78 Cal. Rptr. 260, 267 (1969), *appeal dismissed*, 396 U.S. 554 (1970); COLO. REV. STAT. ANN. § 124-18-3 (Supp. 1967); Comment, *Residency, Tuition, and the Twelve-Month Dilemma*, 7 HOUSTON L. REV. 241 (1969). *But see* Comment, *Nonresident Tuition Charged By State Universities in Review*, 38 U.M.K.C.L. REV. 341 (1970).

[39] RECORD 19 (emphasis added). This rule applies to students over twenty-one. Under this rule one who comes to the state to attend Duke University undergraduate and law schools would still be considered a nonresident for tuition purposes if he then entered graduate school at the state university even though he had been a resident of North Carolina for seven years. There is a different set of rules for minors. *Id.* at 18.

Since the state's main bulwark against an influx of nonresidents is to impose quotas on nonresident students by a set percentage, or to enforce higher admission standards for such students, it is hard to justify the strictness of the North Carolina rule. In fact courts have generally looked with disfavor on this kind of rule. In *Newman v. Graham*[40] the Idaho Court of Appeals struck down a rule nearly identical to North Carolina's as arbitrary, capricious and unreasonable.[41] While one court may have ruled out *any* durational requirement for in-state tuition,[42] the Supreme Court has summarily affirmed a district court decision upholding the residence requirement at the University of Minnesota.[43] This rule required one-year in-state residence to qualify for the lower tuition rate, but did not preclude a student from attaining resident status while attending school.[44] Another court has justified such a rule on the grounds that it is a "reasonable attempt to achieve a partial cost equalization by collecting lower tuition fees from those persons who, directly or indirectly, have recently made some contribution to the economy of the state . . . ."[45] However, if the holding in *Shapiro* that state benefits cannot be apportioned on the basis of the individual's tax contribution to the state is to be upheld,[46] a durational residence requirement for tuition purposes is difficult to justify.[47]

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[40] 82 Idaho 90, 349 P.2d 716 (Ct. App. 1960).

[41] *Id.* at 95, 349 P.2d at 719. *But see* Landwehr v. Board of Regents, 156 Colo. 1, 396 P.2d 451 (1964). *Landwehr* is probably distinguishable since the plaintiff was challenging the statute in an action for back tuition after he had already completed school.

[42] Unreported lower court decision in Arizona.

[43] Starns v. Malkerson, 91, S. Ct. 1231 (1971).

[44] The completion of a year's stay in Minnesota does not in and of itself establish residence for University purposes; a person who moves to Minnesota coincident with attending school may not be able to demonstrate that he is acquiring Minnesota residence.

The student from out of state who proposes to establish residence must assume the burden of proving conclusively that he has been a resident the required time and intends to make his permanent home in the state.

UNIVERSITY OF MINNESOTA, DULUTH BULLITIN, June 30, 1970, at 29.

[45] Kirk v. Board of Regents, 273 Cal. App. 2d 430, —, 78 Cal. Reptr. 260, 269 (1969), *appeal dismissed*, 396 U.S. 554 (1970).

[46] 394 U.S. at 632.

[47] Indeed the Supreme Court appeared to speak directly to the North Carolina situation when it said that there is "[n]o need for a state to use the one-year waiting period as a safeguard against fraudulent receipt of benefits; for less drastic means are available and are employed, to minimize that hazard." 394 U.S. at 637. The lack of a reported opinion in *Starns* makes it difficult to distinguish it from *Shapiro*. A better solution would be to make nonresidence a rebuttable presumption. That is, all newcomers to the state are presumed nonresidents for a period of time unless otherwise shown to be residents. *See* Clark v. Redeker, 259 F. Supp. 117 (S.D. Iowa 1966). The problem with this kind of provision is that rebuttal often

The one area where residence requirements have been recognized as relevant to the state's interests is in voting requirements. North Carolina, for example, requires one year's residence in the state and thirty days in the precinct preceding an election.[48] Such a rule seems relevant to the purposes of identifying the voter, protecting against fraud, and insuring that the voter " '[w]ill in fact become a member of the community and as such have a common interest in all matters pertaining to its government.' "[49] Maryland's similar requirements have so been sustained by a three judge federal court.[50] Since *Shapiro* and other challenges to residence requirements, however, such residence requirements have come under even greater challenge. At least three courts have held that a rule setting different requirements for interstate travelers discriminates against the interstate travelers and therefore is unconstitutional.[51] One who moves from Charlotte, North Carolina, to Raleigh, North Carolina, will not necessarily understand local conditions faster than someone who moves to Raleigh from Richmond, Virginia.[52] Accordingly, those legitimate state interests which are served by a residence requirement for voting can be served as well by a uniform requirement which does not discriminate against the individual who moves across a state line.[53]

Durational residence requirements seek to forecast future behavior on the basis of past residence alone; yet as to this objective, they are highly inaccurate and tend only to penalize the new bona fide permanent resident.

becomes a mere test of the applicant's ingenuity in finding ways to demonstrate residence.

[48] N.C. GEN. STAT. § 163-55 (Supp. 1970).

[49] Drueding v. Devlin, 234 F. Supp. 721, 724 (D. Md. 1964).

[50] *Id.*

[51] Hadnot v. Amos, 320 F. Supp. 107 (M.D. Ala. 1970), *aff'd*, 39 U.S.L.W. 3413 (U.S. Mar. 23, 1971); Ellington v. Blumstein, — F. Supp. — (M.D. Tenn. Sept. 9, 1970), *jurisdiction noted*, 91 S. Ct. 920 (1971). Canniffe v. Burg, 315 F. Supp. 380 (D. Mass. 1970), *appeal filed*, 39 U.S.L.W. 3229 (U.S. Oct. 6, 1970) (No. 811). *Contra*, Fitzpatrick v. Board of Election Comm'rs, 39 U.S.L.W. 2356 (N.D. Ill. Dec. 15, 1970), *appeal filed*, 39 U.S.L.W. 3362 (U.S. Feb. 12, 1971) (No. 1344). *Compare* Kohn v. Davis, 320 F. Supp. 246 (D. Vt. 1970), *appeal filed*, 39 U.S.L.W. 3347 (U.S. Feb. 10, 1971) (No. 1336) (striking down Vermont's one-year residence requirement for voting), *and* Bufford v. Holton, 319 F. Supp. 843 (E.D. Va.), *appeal filed*, 39 U.S.L.W. 3333 (U.S. Jan. 25, 1970) (No. 1270) (holding Virginia's one-year residence requirement for voting unconstitutional), *with* Pope v. Williams, 193 U.S. 621 (1904) (upholding the constitutionality of Maryland's one-year residence requirement for voting), *and* Cocanower v. Marston, 318 F. Supp. 402 (D. Ariz.), *appeal filed*, 39 U.S.L.W. 3229 (U.S. Oct. 3, 1970) (No. 799) (upholding Arizona's one-year residence requirement for voting).

[52] *See* 317 F. Supp. at 1359 & note 14 *supra.*

[53] *See* Carrington v. Rash, 380 U.S. 89 (1965).

In light of the decisions in *Shapiro* and *Keenan* and the questions raised therein, the states should re-examine all of their residence requirements, especially those for professional licenses, to insure that they protect not only legitimate state interests but also the rights of new residents.

ANTHONY B. LAMB

Constitutional Law—Prejudgment Attachment and Garnishment—The Progeny of the Sniadach-Kelly Marriage

In the summer of 1969, the Supreme Court held in *Sniadach v. Family Finance Corp.*[1] that a prejudgment garnishment of wages under the facts involved in the case constituted a taking of property without due process of law unless the wage earner was afforded a hearing prior to the garnishment. The Wisconsin garnishment procedure involved in *Sniadach* entitled one with a claim against a wage earner to a court order freezing one half of the worker's wages until the merits of the claim could be litigated.[2] Mr. Justice Douglas, speaking for the Court, stated that "[s]uch summary procedure may well meet the requirements of due process in extraordinary situations. . . . But in the present case no situation requiring special protection to a state or creditor interest is presented by the facts . . . ."[3] The opinion noted that "[w]e deal here with wages —a specialized type of property presenting distinct problems in our economic system,"[4] stressed the serious harm that wage garnishment could cause, and concluded that the Wisconsin garnishment procedure and others like it "may as a practical matter drive a wage-earning family to the wall."[5]

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[1] 395 U.S. 337 (1969).

[2] The statutes involved in *Sniadach* were Ch. 507, [1965] Wis. Sess. L. — which were codified as WIS. STAT. ANN. §§ 267.01-.24 (Supp. 1969). These statutes have been amended and are presently codified as WIS. STAT. ANN. §§ 267.01-.24 (Supp. 1970).

[3] *Id.* at 339. As examples of "extraordinary circumstances" which would justify summary procedures, Justice Douglas cited Ewing v. Mytinger & Casselberry, Inc., 339 U.S. 594 (1950) (federal statute authorizing seizure of misbranded articles without a prior hearing); Fahey v. Mallonee, 332 U.S. 245 (1947) (appointment of a conservator to take possession of a federal savings and loan association prior to a hearing); Coffin Bros. v. Bennett, 277 U.S. 29 (1928) (state statute authorizing prejudgment liens on the property of stockholders of insolvent banks); Owenby v. Morgan, 256 U.S. 94 (1921) (state statute conditioning the opportunity to appear and defend in foreign attachment proceedings upon the posting of a bond).

[4] *Id.* at 340.

[5] *Id.* at 341-42.

The vagueness of the *Sniadach* opinion and the summary fashion in which Justice Douglas disposed of the problem have resulted in confusion and disagreement among courts and legal commentators. Some have argued that because of the opinion's pointed emphasis on the damaging effects of wage garnishment and its repeated references to the possibilities of abuse of summary garnishment procedures, the decision was in reality based on substantive due process grounds.[6] Others have contended that since only the wages of the poor are subjected to garnishment, the opinion must have been based in part upon the equal protection clause.[7] There is also disagreement as to the scope of *Sniadach*, some asserting that Justice Douglas limited application of the decision exclusively to wage garnishment[8] and others arguing that the characterization of wages as a "specialized type of property" was not intended to limit the scope of the decision.[9]

Much of the confusion and disagreement attributable to the *Sniadach* opinion can be resolved by superimposing on Justice Douglas' rather cryptic language traditional constitutional principles developed to deal with procedural due process problems. The Court restated and summarized these principals in *Goldberg v. Kelly*,[10] decided after *Sniadach*. Considering the question of whether due process required a hearing prior to the termination of welfare benefits, Mr. Justice Brennan said:

> The extent to which procedural due process must be afforded the recipient is influenced by the extent to which he may be "condemned to suffer grievous loss" . . . and depends upon whether the recipient's interest in avoiding that loss outweighs the governmental interest in summary adjudication.[11]

Thus, resolution of due process problems ordinarily requires a weighing of the harm caused to the individual by the challenged procedure against the "interest of society served by quick and decisive action."[12]

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[6] *E.g.*, *id.* at 345 (Black, J., dissenting).

[7] *E.g.*, Note, *Some Implications of Sniadach*, 70 COLUM. L. REV. 942, 954 (1970).

[8] *E.g.*, Termplan Inc. v. Superior Court, 105 Ariz. 270, —, 463 P.2d 68, 70 (1969).

[9] *E.g.*, Larson v. Fetherston, 44 Wis. 2d 712, 718, 172 N.W.2d 20, 23 (1969).

[10] 397 U.S. 254 (1970).

[11] *Id.* at 262-63, *quoting* Joint Anti-Facist Refugee Comm. v. McGrath, 341 U.S. 123, 168 (1951) (Frankfurter, J., concurring). For examples of other cases employing similar language see Cafeteria Workers, Local 473 v. McElroy, 367 U.S. 886, 895 (1961); Frank v. Maryland, 359 U.S. 360, 363 (1959); Wasson v. Trowbridge, 382 F.2d 807, 811 (2d Cir. 1967).

[12] Hall v. Garson, 430 F.2d 430, 440 (5th Cir. 1970).

In *Sniadach*, Justice Douglas followed this traditional approach although he failed to articulate adequately the balancing test and to consider fully each of the test's components. The opinion vividly demonstrated that summary garnishment procedures might cause the wage earner to be deprived of the essentials of life on the basis of an invalid claim, resulting perhaps in capitulation to the claim in order to survive. And this harm directly results from the peculiar attributes of wages—the fact that wages are generally used for present consumption. The opinion, however, failed to weigh against this harm to the wage earner any interests which the state might have in summary wage garnishment.[13] This failure is perhaps due to Justice Douglas' tacit assumption that the harm was so great that it could be outweighed only in the extraordinary situations which he mentioned.[14] At any rate, *Sniadach* represents neither a break with long-established constitutional principles nor a rejection of the procedural due process balancing test. Instead, it adopts and applies that test, although it does so inartfully.

Klim v. Jones,[15] a recent example of the application of *Sniadach* in a non-wage context, demonstrates more fully the operation of the balancing test. The statutory procedure involved in the case granted to innkeepers liens upon the personal property of tenants who failed to pay their rent and authorized self-help tactics in seizing the property subject to the lien.[16] Pursuant to this law Jones seized Klim's belongings, including clothes, tools, and identification papers. Klim filed a complaint seeking a declaration that the law was unconstitutional, an injunction against enforcement of the law, a return of the seized property, and certain damages. In

[13] One writer has suggested that the public interests in summary garnishment statutes are (1) ensuring that valid claims will be collectible and (2) promoting the extension of credit. He contends, however, that this second interest must be discounted by the risk of encouraging, through facile collection devices, unwise credit extension. Note, *Attachment and Garnishment—Constitutional Law—Due Process of Law—Garnishment of Wages Prior to Judgment Is a Denial of Due Process: The Sniadach Case and Its Implications for Related Areas of the Law*, 68 MICH. L. REV. 986, 996-97 (1970). Unless otherwise stated, this note will proceed on the theory that such are the public interests in all attachment and garnishment statutes.

[14] *Id.* at 997-98. *See* note 3 *supra*.

[15] 315 F. Supp. 109 (N.D. Cal. 1970).

[16] CAL. CIV. CODE § 1861 (West Supp. 1971). Arguably this statute and many prehearing attachment statutes authorize constitutionally impermissible searches and seizures. *Compare* Fuentes v. Faircloth, 317 F. Supp. 954 (S.D. Fla. 1970), *with* Laprease v. Raymours Furniture Co., 315 F. Supp. 716 (N.D.N.Y. 1970). In *Fuentes* motion for leave to proceed in forma pauperis has been granted and probable jurisdiction noted. 91 S. Ct. 893 (1971). The search and seizure issue, however, is beyond the scope of this note and will receive no further consideration.

granting plaintiff's motion for summary judgment on the constitutional issue, the court concluded that the lien statute imposed even greater economic hardships than prejudgment wage garnishment. And the court found no public interest in the summary procedure sufficient to outweigh those hardships. The interest offered to justify the law—the use of the lien to obtain in personam jurisdiction over transient tenants—was discounted by the court because the threat of the lien provided no "iron-clad safeguard for the California proprietor"[17] against absconding tenants and because "the danger of a non-paying transient leaving the state just to avoid a lodging bill does not seem to be at all common"[18] since many of the establishments employing the lien device catered to lodgers who stayed for significant periods of time. Furthermore, the court noted that it was not abolishing the innkeeper's lien altogether but was only requiring certain procedural safeguards in its use, and that the innkeeper had an alternative protective device available—advance payment.

The due process balancing test worked exceptionally well in *Klim* and resulted in a holding which seems unquestionably correct. Two other recent cases, however, provide examples of situations where the balancing test operates much less smoothly. In *Fuentes v. Faircloth*[19] and *Laprease v. Raymours Furniture Co.*,[20] the statutes under consideration entitled a plaintiff in a replevin action to a writ of replevin and seizure of the subject matter of the suit without any prior notice to the defendant and without a hearing before the seizure.[21] In *Fuentes* a stove and a stereo set had been seized and in *Laprease* the seized property included a stove, a refrigerator, a bed, a rug, and a record player. In both cases the merchandise had been purchased under conditional sales contracts.

The three-judge court in *Fuentes* held that the replevin procedure comported with the requirements of due process. The court seemed to base its holding on two alternative grounds: first, that the balancing test of *Sniadach* and *Kelly* did not apply since the wage garnishment and welfare situations "[are] not at all comparable to a private contract providing for enforcement of a security interest";[22] and second, that even if the balancing test did apply "[t]he hardships facing the welfare recipient,

[17] 315 F. Supp. at 124.
[18] *Id.*
[19] 317 F. Supp. 954 (S.D. Fla. 1970).
[20] 315 F. Supp. 716 (N.D.N.Y. 1970).
[21] The statutes involved in *Fuentes* were FLA. STAT. ANN. §§ 78.01, .04, .07, .08 (Supp. 1971). The statute involved in *Laprease* was N.Y. CIV. PRAC. LAW §§ 7101-02 (McKinney 1963).
[22] 317 F. Supp. at 958.

like those facing one whose wages are garnished, are not present in the instant situation where goods purchased are replevied."[23]

The three-judge court in *Laprease* reached exactly the opposite result. The opinion stated that the factual difference between *Sniadach* and the case under consideration—that one dealt with an unsecured interest while the other involved a secured interest—"dissolves before the purchasers' claims that there were no defaults and no right to repossession."[24] Applying the balancing test, the court concluded that "[l]ack of refrigeration, cooking facilities and beds create hardships . . . equally as severe as the temporary withholding of [one-half] of Sniadach's pay,"[25] and that no counterbalancing public interest in the summary procedure existed.[26]

Neither *Fuentes* nor *Laprease* appears to be precisely correct. The suggestion in *Fuentes* that the presence of a security interest will remove a case from the operation of the *Sniadach-Kelly* balancing approach is without justification. As the dissenting judge in the case noted, "when one signs a contract which includes the words 'in the event of default of any payment or payments, seller at its option may take back the merchandise,' he does not waive his Fourteenth Amendment right to 'due process of law.' "[27] The *Fuentes* court likewise erred when it concluded that seizure of the stove presented no hardships comparable to those suffered by the plaintiffs in *Sniadach* and *Kelly*. The loss of an appliance as necessary as a stove for the preparation of food can produce harm quite as serious as the loss of one-half of one's wages or the loss of welfare benefits. At any rate, since the loss of the stove obviously produced *some* harm, the question with which the court should have concerned itself was whether that harm was outweighed by the public interest in the summary procedure.

The *Laprease* court avoided the errors discussed above but became so immersed in the question of whether the replevin of essential items like stoves, beds, etc., violated due process that it overlooked the fact that the propriety of the summary seizure of such non-essential items as a rug and a phonograph was at issue as well. Loss of a phonograph or a rug causes harm much less severe than that caused by the loss of a stove or refrigerator, and, had the court applied the due process balancing test to the seizure of the non-essential items, it might have concluded that the

[23] *Id.*
[24] 315 F. Supp. at 723.
[25] *Id.* at 723-24.
[26] *Id.* at 723.
[27] 317 F. Supp. at 959 (Eaton, J., dissenting).

summary procedure as applied to those items was constitutionally permissible.

The *Fueutes* and *Laprease* opinions, with all their imperfections, and the *Klim* decision demonstrate many of the problems with the *Sniadach-Kelly* balancing approach.[28] One of the most serious of these problems is that where the public interest in a summary procedure and the harm precipitated by the procedure appear to be nearly evenly balanced, as where non-essential items are replevied without a prior hearing, any conclusion as to which interest preponderates is no more than a highly subjective value judgment. Not only is this intellectually unsatisfying; it also militates against any certainty in the law on procedural due process questions.

Most of the other problems with the due process balancing test stem from the fact that the test must be applied on a case-to-case basis. The type of property involved as well as the individual circumstances of the person whose property is summarily interfered with must be considered before any balancing can take place. This means that any procedure authorizing interference with one's property without the normal due process safeguards will be open to attack in every case where the procedure is employed, and that no amount of case law can limit these attacks since the property owner in every instance can argue that his is a special case. It also means that state legislators will find it most difficult, if not impossible, to draft statutes authorizing summary attachment or garnishment procedures which will pass muster under the balancing approach.[29]

Notwithstanding these difficulties, there is no reason to believe that the Supreme Court will discard or modify the due process balancing test. It is too well grounded in precedent and too well suited to the recognition of the competing interests involved in due process questions to be tossed aside. Prognostication in this area is wholly speculative but it is not altogether unreasonable in this day of consumer protection to wonder if

[28] One initial problem with the balancing approach is that it does not answer the question of what type of hearing, if any, must be granted prior to the seizure. Considerable controversy over this question existed after *Sniadach.* See, *e.g.*, Note, *Poverty Law—Garnishment—Protection of Debtors' Rights,* 48 N.C.L. REV. 164, 170-71 (1969). Goldberg v. Kelly, 397 U.S. 254 (1970), seems to have resolved this controversy by requiring that the hearing determine only the probable validity of the claim. *Id.* at 266-67.

[29] This problem will become especially acute if—as suggested in *Sniadach,* 395 U.S. at 339, and in *Laprease,* 315 F. Supp. at 723—any statute not narrowly drawn to meet situations where the public interest outweighs the individual harm will be held impermissible.

legislatures, perhaps with a shove from the courts, might not abolish prehearing attachment and garnishment procedures altogether or at least limit their use to the "extraordinary situations" referred to in *Sniadach*.[30]

FRED H. MOODY, JR.

Constitutional Law—Racial Imbalance in Public Schools: The Affirmative Duty to Integrate Administrators

On May 28, 1968, the Board of Education of Newark, New Jersey voted to invalidate a promotional list which was formerly the sole criterion in the appointment of grade-school administrators.[1] The action by the Board of Education admittedly was motivated by a desire to promote racial balance in the school system.[2] The Negro student population in Newark was 72.5%, yet there were only two Negroes on the promotional list.[3] Moreover, of 249 administrators in the city school system, only twenty-seven were Negro.[4] In lieu of appointments from the list, the Board of Education appointed seven new grade-school administrators—six Negro and one white.[5] As a result, ten white teachers[6] brought a suit seeking money damages and injunctive relief under the fourteenth amendment and the Civil Rights Act of 1964.[7] The principal issue raised

[30] See note 3 *supra*.

[1] The contract entered into between the plaintiffs and the defendant on February 1, 1967 reads in part:

> The positions of principal, vice principal, head teacher, department chairman and counsellor shall be filled in order of numerical ranking from the appropriate list, which ranking shall be determined by written and oral examination. Appointments to the position of teacher to assist the principal (formerly called Administrative Assistant) shall be made annually on a temporary basis if the Superintendent determines that such a position is necessary or desirable, and all appointments to such positions shall be made in order of numerical ranking from the appropriate vice principal's list if such list exists.

Porcelli v. Titus, 431 F.2d 1254, 1256 n.2 (3d Cir. 1970), *cert. denied*, 39 U.S.L.W. 3486 (U.S. May 4, 1971) (No. 850).

[2] Record at 89, 95, 98, Porcelli v. Titus, 302 F. Supp. 726 (D.N.J. 1969).

[3] Porcelli v. Titus, 431 F.2d 1254, 1255-56 (3d Cir. 1970).

[4] *Id.*

[5] *Id.* at 1256 n.3. Since the purpose in deviating from the list was to promote racial balance, it is curious that the Board of Education chose to make a white appointment. No particular reason can be discovered.

[6] Four of the plaintiffs—Hickey, Dunne, LaRusso, and Chagnon—had taken only the first of two stages of the examination to qualify for the list when the list was suspended. 302 F. Supp. at 728 n.1.

[7] 42 U.S.C. § 1983 (1964). The provision reads:

by the complaint was the constitutional limitation on the power of a state agency to consider color in the selection and promotion of its employees. The district court in New Jersey dismissed the complaint,[8] and the Court of Appeals for the Third Circuit, in *Porcelli v. Titus*, affirmed per curiam.[9]

Several federal court decisions have held that the mandate of *Brown v. Board of Education*[10] applies not only to the integration of students in the public schools, but also to the integration of faculties[11] within both a single school and a school system, and of administrators[12] within a system. In those cases, however, the courts have reasoned that the duty to integrate arises upon a showing of past, intentional discrimination. In *Porcelli* the dispute arose in the absence of proof of past, intentional discrimination, and that absence was noted by the district court.[13] Nevertheless, in *Porcelli* the court found a duty to integrate even if the existing imbalance was not the result of prior discrimination.

> It would therefore seem that the Boards of Education have a very definite *duty to integrate* school faculties[,] and to permit a great imbalance in faculties—as obtained on August 22, 1968, when a new plan was proposed to the school board in Newark for the increasing of qualified Negro administrators—would be in negation of the Fourteenth Amendment to the Constitution and the line of cases which have followed Brown v. Board of Education . . . .[14]

The question of whether there is a duty in this particular situation is one of first impression and should be examined.

The public schools, at least since *Brown*, have been recognized as a peculiar area of governmental interest, and it follows that decisions involving public schools will focus primarily on the effect of a particular situation on the schools themselves. This approach finds support in the following language:

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.

[8] Porcelli v. Titus, 302 F. Supp. 726 (D.N.J. 1969).

[9] Porcelli v. Titus, 431 F.2d 1254 (3d Cir. 1970). On May 4, 1971, the Supreme Court denied certiorari. 39 U.S.L.W. 3486 (U.S. May 4, 1971) (No. 850).

[10] 347 U.S. 483 (1954).

[11] Smith v. Board of Educ., 365 F.2d 770 (8th Cir. 1966).

[12] *See, e.g.*, Hobson v. Hanson, 269 F. Supp. 401, 429-30 (D.D.C. 1967).

[13] 302 F. Supp. at 736.

[14] 431 F.2d at 1257-58 (emphasis added).

> The public schools were not created, nor are they supported, for the benefit of the teachers therein, as implied by the contention of the appellant, but for the benefit of the pupils, and the resulting benefit to the parents and the community at large.[15]

Therefore, it is appropriate to direct any examination towards the cases in the *Brown* line rather than to the general run of equal employment cases.[16] Since there have previously been no cases finding a duty to remedy imbalance among school administrators in the absence of past discrimination, the most pertinent cases are those dealing with the integration of pupils.

There are numerous opinions indicating that schools need not be found guilty of intentional racial discrimination before being subject to a constitutional duty to take affirmative action to relieve the racial imbalance.[17] Typical of such decisions are those cases in which the courts have been asked to resolve disputes arising from systems of neighborhood schools.[18] Perhaps the leading case in which the court found a duty to take affirmative action is *Barksdale v. Springfield School Committee*.[19] In *Barksdale*, the neighborhoods designated to attend particular schools were, by chance, divided into black and white. The Court of Appeals for the First Circuit agreed with the defendant's contention that the resulting segregation was unintentional, yet rejected the argument that there was therefore no duty on the part of the School Committee to correct this segregated school situation. As in *Porcelli*, it was clear that racial imbalance *did* exist, and that it was the existence of the imbalance, not the manner in which it came about, which was constitutionally impermissible. Speaking directly to the point of intentional discrimination, the court noted that "[e]ducation is tax supported and compulsory, and public school educators, therefore, must deal with inadequacies within the educational

[15] Bates v. Board of Educ., 139 Cal. 145, 148, 72 P. 907, 908 (1903).

[16] The major distinction between employment cases which involve schools and those which do not is that in the school cases the court must consider not only the parties but also the effect of its decision on the children in the school. In addition, the history of equal employment legislation shows no anticipation of a situation such as the one in *Porcelli*. *See* Quarles v. Phillip Morris, Inc., 279 F. Supp. 505 (E.D. Va. 1968).

[17] *See, e.g.*, Blocker v. Board of Educ., 226 F. Supp. 208 (E.D.N.Y. 1964); Branche v. Board of Educ., 204 F. Supp. 150 (E.D.N.Y. 1962).

[18] A neighborhood school system is one in which the Board of Education divides the city into school districts, and the students living within a district must attend the school within that district.

[19] 237 F. Supp. 543 (D. Mass), *vacated and remanded on other grounds*, 348 F.2d 261 (1st Cir. 1965).

system as they arise, and it matters not that the inadequacies are not of their making."[20] Other courts considering the same question have placed particular emphasis on the public nature of state-supported schools, stressing that they are supported with tax dollars,[21] and have couched their arguments in terms of the impermissibility of tolerating what is clearly racial imbalance.[22]

There is, of course, an opposing point of view on the necessity of proving past discrimination before arriving at a duty to remedy it.[23] This position, concisely stated, is that if racial imbalance exists by mere chance, the state is under no duty to remedy it. One of the most articulate explanations of this position is found in *Deal v. Cincinnati Board of Education.*[24] The court in *Deal* initially found, as a matter of law, that in the absence of intentional action on the part of the state the fourteenth amendment does not afford relief.[25] The court went on to hold that

> a showing of harm alone is not enough to invoke the remedial powers of the law. If the state or any of its agencies has not adopted impermissible racial criteria in its treatment of individuals, then there is no violation of the Constitution. If factors outside the schools operate to deprive some children of some of the existing choices, the school board is certainly not responsible thereafter.[26]

Although the court in *Porcelli* failed to discuss any of these competing considerations, it is evident that the *Barksdale* position is now accepted by the third circuit.

Clearly, this position in *Deal* is irreconcilable with the *Barksdale* position. Until the United States Supreme Court chooses to rule on the subject, the conflict among the circuits is unlikely to be resolved, with the result that the same suit would succeed in one jurisdiction and fail in another. Yet it appears that the *Barksdale* approach finds more support in recent interpretations of *Brown.* In *Kemp v. Beasley,*[27] the eight circuit viewed the courts' role in school integration cases as being unique. The court in *Kemp* reasoned that in the normal case the court must balance

[20] 237 F. Supp. at 544.
[21] Branche v. Board of Educ., 204 F. Supp. 150, 153 (E.D.N.Y. 1962).
[22] Blocker v. Board of Educ., 226 F. Supp. 208, 222 (E.D.N.Y. 1964).
[23] *See, e.g.,* Bell v. School City of Gary, 324 F.2d 209 (7th Cir. 1963).
[24] 369 F.2d 55 (6th Cir. 1966).
[25] Action by a school board, which is a state agency, is state action. Blocker v. Board of Educ., 226 F.2d 208, 226 (E.D.N.Y. 1964).
[26] 369 F.2d at 59.
[27] 389 F.2d 178 (8th Cir. 1968).

the conflicting goals of competing parties, but in school integration cases there is only one goal—a wholly desegregated school system. Those decisions recognizing the absolute impermissibility of racial imbalance in schools regardless of how it was achieved more closely reflect the *Kemp* position. Indeed, this attitude of looking beyond the parties to the schools themselves seems to be the thread holding such decisions together.

In *Brown*, the Supreme Court based its decision largely on the psychological effects of segregation on the school children involved, particularly the black children.[28] The Court concluded that the adverse psychological effects on the black children represented a violation of the fourteenth amendment: the knowledge that they were forced to go to a school that was only for their race was a serious handicap which the white children did not have, and the blacks, therefore, were denied the equal protection of the law. It was this kind of thought that led to the conclusion that segregated schools are inherently unequal. A similar argument can be made regarding the situation in *Porcelli*. There is ample psychological data to indicate that black students dealing with only white people in positions of authority tend to identify all whites with authority.[29] At the same time the black children lose respect for the black male, who is not seen in such a position of authority.[30] The result of this identification process is a serious psychological impairment for the black child. He loses confidence in his race in general and also in himself.[31] This psychological burden, it might be argued, is as serious as the psychological burden found in *Brown*, and the same equal protection argument should apply. Viewing the problem in this way, it becomes evident that the focus must be on the equal protection of the *students*, not the administrators. It is this emphasis, if not this argument, that was recognized in both *Kemp* and *Barksdale*.

If the court in *Porcelli* found that the school board was under a duty to promote racial balance in administrative positions, then clearly the

[28] 347 U.S. 483, 494 n.11 (1954).

[29] *See generally* H. BOND, THE EDUCATION OF THE NEGRO IN THE AMERICAN SOCIAL ORDER (1966); R. COLES, CHILDREN OF CRISIS; A STUDY OF COURAGE AND FEAR (1967). *But see* I. NEWBY, CHALLENGE TO THE COURT; SOCIAL SCIENTISTS AND THE DEFENSE OF SEGREGATION, 1954-1966 (1969).

[30] M. CRAMER, SOCIAL FACTORS IN EDUCATION ACHIEVEMENT AND ASPIRATIONS AMONG NEGRO ADOLESCENTS (1966); J. Knight, The Interpersonal Values and Aspirational Levels of Negro Seniors in Totally Integrated and Segregated Southern High Schools 36-40, 65, 1970 (unpublished thesis in Wilson Library, University of North Carolina).

[31] D. DINKMEYER, READINGS IN CHILD DEVELOPMENT 394-407 (1965); I. SARNOFF, PERSONALITY DYNAMICS AND DEVELOPMENT 85-116 (1962).

Board of Education was justified in taking appropriate action.[32] There are numerous holdings that the fourteenth amendment forbids the appointment of teachers, and by inference, administrators, solely on the basis of race.[33] Yet the court in *Porcelli* noted that "state action based partly on considerations of color when color is not used per se, and in furtherance of a proper governmental objective, is not necessarily a violation of the Fourteenth Amendment."[34] In *Porcelli*, the court concluded that the Newark School Board was acting to promote a proper—indeed, a compelling—governmental interest, and therefore properly considered color.

At least one court, however, in another case involving action by a board of education to promote racial balance, has noted: "Only if specific provisions of the Plan do, in fact, discriminate against plaintiffs because of their race, could it be said to result in an infringement of their constitutional rights."[35] In that case, no discrimination was found; however, it is difficult to escape the conclusion that in Newark qualified whites were passed over in favor of qualified blacks. It is in its almost perfunctory resolution of this tricky problem of "reverse discrimination"[36] that the *Porcelli* court may well have been the most incisive. For the Court of Appeals for the Third Circuit seems to recognize that the constitutional demands, coupled with the social context in which the situation arose, outweighed the competing considerations of the plaintiffs' harm. The court has sensed that the most stringent demands of *Brown v. Board of Education* may well fall not on the states and not on the school boards, but on the white population as a whole. And that demand, as it appears to be mirrored in *Porcelli*, is for a constitutional "leap of faith."[37] The "leap" is a belief that the constitutional and social significance of racial balance at this time is worth even the harm that may be inflicted incidentally on other members of society.

It is in this regard that *Porcelli v. Titus* acts to tie together in both legal and societal terms what should be a major movement in Constitutional thought—the actual implementation of principles of equality under law. Yet because so little of this reasoning is explicit, it may well be that

[32] There is some question as to whether the action by the Board of Education would have been permissible even if the court in *Porcelli* had not adopted the *Barksdale* position.

[33] *See, e.g.*, Rolfe v. County Bd. of Educ., 391 F.2d 77 (6th Cir. 1968).

[34] 431 F.2d at 1257.

[35] Fuller v. Volk, 230 F. Supp. 25, 34 (D.N.J. 1964).

[36] This is the popular term for those situations in which whites are passed over in favor of blacks.

[37] This term was first used by Kierkegaard in, of course, a religious sense.

Porcelli will have little actual impact beyond the third circuit and the situation as it existed in Newark.

STEPHEN JAY EDELSTEIN

Consumer Protection—Credit Card Protection Under the Truth in Lending Act

On October 26, 1970, in response to widespread complaints, Congress amended[1] the Truth in Lending Act to expand consumer protection into the area of credit cards.[2] The legislation outlaws further issuance of unsolicited credit cards[3] and imposes stiff criminal penalties for the fraudulent use of cards to charge more than five thousand dollars.[4] The most important provision limits the liability of the consumer for a lost or

[1] Pub. L. No. 91-508, §§ 501-03 (Oct. 26, 1970), *amending* 15 U.S.C. §§ 1601-64 (Supp. IV, 1965-69).

[2] The tremendous upsurge in credit cards has brought an increased awareness of the abuses associated with their use. From Dec. 31, 1967, to June 30, 1969, the Federal Research Board found that credit outstanding on bank credit cards increased from 800 million dollars to 1.7 billion dollars. The year-to-year increase on oil company cards is 200 million dollars. *Hearings on S. 721 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. 30 (1969) [hereinafter cited as *1969 Hearings*]. The abuses are more often related to unsolicited cards which (1) have encouraged some consumers to spend beyond their means possibly to the point of becoming bankrupt, (2) have been burdensome to some consumers because they were hard to destroy, (3) have been an unwarranted intrusion into consumers' personal lives, (4) have encouraged crime because they were easily stolen and quite negotiable, and (5) have had a potentially inflationary impact upon the economy. Another factor common to all cards has been the possibility of unlimited liability in the event that the card was lost or stolen. S. REP. No. 91-739, 91st Cong., 2d Sess. 3-5 (1970) [hereinafter cited as 1970 S. REP.]. The statistical impact of this last point was measured in Murray, *A Legal-Empirical Study of the Unauthorized Use of Credit Cards*, 21 U. MIAMI L. REV. 811 (1967).

[3] Pub. L. No. 91-508, § 502(a) (Oct. 26, 1970). This provision is far-reaching because it also concerns renewals of existing credit cards. Renewals can be automatic, *i.e.*, without request by the holder, only if the card had been specifically requested initially. Unsolicited cards that were issued prior to the act may not be renewed unless the holder so requests. *Id.*; 1970 S. REP. 6. What impact will this have upon the firms who have used both solicited and unsolicited cards in the past and are unable to distinguish the accounts of holders using solicited cards from those using unsolicited cards? 1970 S. REP. 13. Another argument of those opposed to outlawing the unsolicited card is that this prohibition makes it impossible for new enterprises in the credit card field to get off the ground and compete since the sending of unsolicited cards is the only practical way to build up a large backlog of customers. *1969 Hearings* 24-26.

[4] Maximum of ten-thousand-dollar fine and five years in prison. Pub. L. No. 91-508, § 502(a) (Oct. 26, 1970).

stolen card to fifty dollars if the use of the card occurred after January 24, 1971.[5]

Prior to the act, according to the terms on most cards, the cardholder was to be liable for unauthorized use unless he notified the company of the loss or the theft of the card in advance of the unauthorized use.[6] In a typical case,[7] a holder of a Texaco credit card was assessed with liability for 570 dollars in automotive bills which had been charged to his card without his knowledge or consent. The first time that he used the card he neglected to retrieve it from the service station attendant. He failed to notify the company of the loss and four months later was billed for the unauthorized use. The court reasoned that the sending of the card to the individual by the oil company was an offer to contract according to the terms printed on the card, and the individual's retention and subsequent use of the card constituted an acceptance of the offer and its terms.[8] Hence, the holder was contractually[9] bound to pay the bills.[10]

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[5] *Id.* §§ 502(a), 503(2).

[6] The data of notice would vary depending on the specific wording of the contract and interpretations of notice appearing in state law. Several possibilities are the date notice is sent, the date notice is received, or some artificial date such as ten days after receipt, if the contract terms so specified.

[7] Texaco, Inc. v. Goldstein, 34 Misc. 2d 751, 229 N.Y.S.2d 51 (Mun. Ct. N.Y. City 1962), *aff'd per curiam*, 39 Misc. 2d 552, 241 N.Y.S.2d 495 (Sup. Ct. 1963).

[8] 34 Misc. 2d at —, 229 N.Y.S.2d at 56. Although the initial use of the card would normally be the act of acceptance, under some circumstances retention of the card without use might be sufficient. See Comment, *The Tripartite Credit Card Transaction: A Legal Infant*, 48 CALIF. L. REV. 459, 481 (1960). Generally, for acts of acceptance in this context see RESTATEMENT OF CONTRACTS §§ 21, 72 (1932); 1 A. CORBIN, CONTRACTS §§ 62, 70, 72 (1963). In situations where the acceptance of the instrument containing the terms constitutes acceptance of the contract, the weight of authority holds this to be assent to all the terms printed therein, whether or not they are actually read. Kergald v. Armstrong Transfer Express Co., 330 Mass. 254, 113 N.E.2d 53 (1953), and cases collected therein. Nonetheless the language of the terms should be conspicuous and understandable. See Macauley, *Private Legislation and the Duty to Read—Business Run by IBM Machine, the Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966).

[9] Some courts analyze the credit card transaction using theories of guaranty and assignment. The holder is a guarantor for others using his card while the issuer is the assignee of the merchant for collection of the claims. This preserves defenses which the holder has against the merchant, such as for defective goods, when the issuer attempts to collect on his assignment. Gulf Refining Co. v. Williams Roofing Co., 208 Ark. 362, 186 S.W.2d 790 (1945). For difficulties with the assignment theory see South, *Credit Cards: A Primer*, 23 BUS. LAW. 327, 331-32 (1968).

[10] *Accord*, Read v. Gulf Oil Corp., 114 Ga. App. 21, 150 S.E.2d 319 (1966); Sears, Roebuck & Co. v. Duke, 441 S.W.2d 521 (Tex. 1969). There has been a tendency in some jurisdictions to exact a standard of due care upon the merchant and the issuer if the holder is to be held liable. Allied Stores of N.Y., Inc. v. Funderburke, 52 Misc. 2d 872, 277 N.Y.S.2d 8 (Civ. Ct. N.Y. City 1967) (issuer violated standard of due care by permitting 237 sales slips bearing false signatures

The new federal legislation does not change the basic cause of action when the card issuer seeks to collect on unpaid bills. State courts[11] will try to ascertain the exact contractual obligations of the holder in determining what, if anything, he must remit to the issuer. These obligations are now, however, limited by the new law, and the card issuer is induced to change its tactics in order to minimize the limitations. It can allege that the use of the card was authorized, carry the burden of proof on this issue,[12] and avoid the limitation on the amount of liability. Unauthorized use is defined in the act as "a use of a credit card by a person other than the cardholder who does not have *actual, implied, or apparent authority* for such use and from which the cardholder receives no benefit."[13] Clearly, the initial test for authorized use is agency, and state law[14] must be consulted in order to resolve the issue.

Under traditional agency concepts, the cardholder is the principal and the merchant is the third party; the issuer is superimposed in the merchant's place as the collector of the account. The issuer must show that the person who used the card had the authority to bind the cardholder to obligations with third parties. *Actual* authority is created by a manifestation of consent to the agent by the principal that he may act for the principal.[15] When the act is specifically mentioned, there is express

to accumulate in thirty days because of inadequate data processing procedures); Union Oil Co. v. Lull, 220 Ore. 412, 349 P.2d 243 (1960) (question for jury on due care of merchant when address on card was in one state and the license plates on the car of user indicated another). See Note, *Contracts—Credit Cards—Liability of Holder for Unauthorized Use—Issuer's and Merchant's Duty of Due Care in Accepting Charges*, 43 N.C.L. REV. 416, 422 (1965), and Note, *Credit—Issuer's Recovery from Bona Fide Credit Card Holder for Purchases Made by Unauthorized Person Requires Showing That Due Care Was Exercised in Honoring Card*, 109 U. PA. L. REV. 266, 268 (1960), for competing policies behind such decisions.

[11] State courts handle lawsuits based on contract. Conceivably it could be tried in federal court in the event of diversity of citizenship, but a case in which the liability alleged is in excess of the ten-thousand-dollar jurisdictional amount would be unusual. 28 U.S.C. § 1332(a) (1964).

[12] This burden of proof is required by the statute. Pub. L. No. 91-508, § 502(a) (Oct. 26, 1970).

[13] *Id.* § 501 (emphasis added).

[14] If the case were tried in the federal courts, a problem could arise, at least theoretically, in the choice of federal or state law. It is highly unlikely that federal law would be applied since there is no substantial federal interest involved. See Erie R.R. v. Tompkins, 304 U.S. 64 (1938); C. WRIGHT, FEDERAL COURTS §§ 55-60 (2d ed. 1970).

[15] RESTATEMENT (SECOND) OF AGENCY § 7 (1957); W. SEAVEY, LAW OF AGENCY § 8A (1964) [hereinafter cited as SEAVEY]. The term "actual authority" is generally shortened to "authority" for purposes of clarity. *E.g.*, SEAVEY § 8A. *Contra, e.g.*, Coblentz v. Riskin, 74 Nev. 53, 57, 322 P.2d 905, 907 (1958).

actual authority to do that act; when the instructions state the general nature of the status of the agent, there is *implied* actual authority to do acts consistent with this instruction.[16] There is no distinction in the powers bestowed by express and implied actual authority—the legal effect is the same.[17] In the credit card context the former is demonstrated by the principal's command to his agent "take my card and fill the car with gasoline." An example of the latter is the situation where an employee who travels for a firm is allowed the use of a company car with a gasoline credit card in the glove compartment.

Apparent authority differs from actual authority in that it depends on manifestations by the principal to the third party rather than to the agent.[18] This authority arises when the principal leads the third party to reasonably believe that the professed agent is acting in his behalf.[19] The usual application of apparent authority is where a prior relation of principal and agent is terminated and the principal has made no effort to repudiate the status after it has in fact ceased.[20] This failure to reveal is conduct which might cause third parties to reasonably believe that the agency relationship still exists. Thus, a discharged employee might continue to use the firm's misappropriated credit card at businesses with which he had formerly dealt, and apparent authority would bind the former employer absent notification that the employee had been discharged.

Implied actual authority and apparent authority are often confused despite being based upon different types of behavior on the part of the principal. The sufficiency of the manifestations made to either the agent or to the third party is the chief concern of the court, but this is not determined through strict rules; rather, it depends upon the exact conduct of the principal and upon present and prior relations between all parties. Both doctrines might operate on the same fact situation. For example, opponents of the new law were concerned about the situation where the holder "purposely refrained from informing the issuer of misuse about which he had actual knowledge."[21] Yet this could be considered apparent authority if the card user had previously possessed actual authority, the revocation of which had not been communicated by the principal to concerned third parties such as the issuer. This behavior might also be

[16] RESTATEMENT (SECOND) OF AGENCY § 7, Comment c (1957); SEAVEY § 8C.
[17] SEAVEY § 8C.
[18] RESTATEMENT (SECOND) OF AGENCY § 8 (1957); SEAVEY § 8D.
[19] RESTATEMENT (SECOND) OF AGENCY § 8, Comment c (1957); SEAVEY § 8D.
[20] RESTATEMENT (SECOND) OF AGENCY § 8, Comment a (1957).
[21] 1970 S. REP. 11.

classified as implied actual authority if the card user knew of the principal's continued failure to object to the misuse, since he could infer consent from the principal's actions. Liability would be premised on the idea that "a reasonable person in the position of the principal knowing of unauthorized acts and not consenting to their continuance would do something to indicate his dissent."[22] However, it remains for the courts to backlog a large number of such situations upon which the presence or absence of liability is predicated before clarity will emerge.

Other doctrines, such as estoppel and inherent agency power,[23] might also be utilized by the court in identifying an agency relationship. In addition, even though agency cannot be found, the use is still characterized as authorized if it is beneficial to the holder,[24] and this possibility should not be overlooked.

In the event that the card issuer fails to establish that the use was authorized, the fifty-dollar limitation on liability becomes effective. Yet even to assure this lessened recovery the issuer must prove compliance with other parts of the act. The issuer must show that the use preceded any notification from the cardholder of the loss or theft, that it had provided the holder with a prestamped, self-addressed notification form which would be mailed if there were loss or theft, that it had provided adequate notice to the holder as to potential liability, and that the card was not an unsolicited card.[26] As of January 24, 1972, there will be added the requirement that there be a method of identifying authorized users incorporated into the transaction.[27]

It should be noted that the issuer is required to carry the burden of proof as to lack of notification prior to unauthorized use. Normally, the party taking the position that notice *was* given must produce evidence on this point and a showing, for example, that a correctly addressed letter was put in the mail creates a presumption in his favor.[28] The other party

[22] RESTATEMENT (SECOND) OF AGENCY § 26, Comment d (1957).
[23] *Id.* §§ 8A, B; SEAVEY §§ 8E, F.
[24] Pub. L. No. 91-508, § 501 (Oct. 26, 1970).
[25] *Id.* § 502(a).
[26] *Id.*
[27] *Id.*
[28] Henderson v. Carbondale Coal & Coke Co., 140 U.S. 25, 36 (1891). If the evidence which creates the presumption is not disputed by the other party, then, depending on its strength, either a prima facie case is established for the jury or the presumption is transformed into a conclusion as a matter of law. C. MCCORMICK, EVIDENCE § 308 (1954). When a presumption arises in favor of notice, it is conclusive when evidence to the contrary is not introduced. 9 J. WIGMORE, EVIDENCE § 2519(B) (1940).

then presents evidence showing lack of receipt, and the issue becomes one for the jury.[29] However, the statute puts the onus on the party alleging no receipt to carry the burden of proof on the issue. Ideally, there will be a jury instruction to this effect and the ultimate result will be that it will become easier for the sender to estabilsh notice. The precise issue, according to regulations[30] promulgated by the Federal Reserve System, is whether the holder took "such steps as might be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information . . . ."[31] The notice is "considered given at the time of receipt or, whether or not received, at the time ordinarily required for transmission, whichever is earlier."[32] This definition plainly anticipates the situation where the issuer claims not to have received notice but the finder of fact disagrees.

The issue of notice is simplified if the issuer can show the second of the requirements—the fact that the holder had been provided with the prestamped notification form. The expectation is that the holder will use this form in event of loss or theft, and thus the possibility of misaddressed letters is minimized. The presumption of receipt operates in favor of the issuer if he presents evidence such as a mailing list containing the holder's name and the testimony of an employee to the effect that all the members of the list were sent the notification form.[33] The same presumption exists on similar evidence when the issuer attempts to show compliance with the third requirement that the cardholder is to be given adequate notice[34] of his potential liability. This might have been printed on the billing statement or on the credit card; if it were sent as a printed notice then it must be followed by another notice each succeeding two years.[35]

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[29] Henderson v. Carbondale Coal & Coke Co., 140 U.S. 25, 37 (1891).

[30] FEDERAL RESERVE SYSTEM PRESS RELEASE (Jan. 20, 1971) contains amendments to Regulation Z, Part 226, the present version of which appears in 12 C.F.R. § 226 (1969) [these amendments hereinafter will be cited as Reg. Z, § 226.13].

[31] Reg. Z, § 226.13(f).

[32] *Id.*

[33] See discussion in note 28 *supra.*

[34] The act requires that the notice must set "forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning." Pub. L. No. 91-508, § 501 (Oct. 26, 1970).

[35] Reg. Z, § 226.13(c)(3). The recommended form, assuming the italicized hypothetical facts, is set out in the regulations: "You may be liable for the unauthorized use of your credit card. You will not be liable for unauthorized use which occurs after you notify *Plastic Card Company* at *Windborn, N.Y. 00000,* orally or in writing of loss, theft, or possible unauthorized use. In any case liability shall not exceed *$50.*" *Id.* § 226.13(e).

To satisfy the fourth requirement, the card issuer would simply produce the request of the cardholder in order to show that the card was requested. If the card were previously unsolicited but changed in status by a requested renewal, then this renewal form would be presented as evidence. To comply with the requirement of an identification procedure, the issuer should have no difficulty in showing that his system had been revamped in order to produce a signature card or a card with the picture of the holder appearing on it.[36]

The overall scheme of legislation reveals that Congress has erected many hurdles in order to frustrate the card issuer who is seeking recovery when the card has fallen into the hands of an unauthorized user. The strict limitation to a maximum fifty-dollar recovery obviously deters litigation when the issuer weighs the expenses of a lawsuit against expected recovery. Since arguably "[m]ore strict or complicated identification procedures . . . will discourage cardholders and merchants,"[37] it is questionable whether issuers will bother to comport with the standards necessary for even the limited recovery, for fear of losing business. The end result, perhaps justifiable, is to shift the burden of risk to the card issuer. The issuer charges interest on its accounts and assesses a collection fee against the merchant; as a matter of economics it would appear to be the party on whom the risk should fall.[38] Since in the future issuers might charge an issuance fee to offset the risk, consumers might think twice before requesting cards, thus leading to a more responsible decision on their part. Consumer costs for liability insurance are virtually wiped out by the limited liability provision,[39] although one who possesses numerous cards might seek insurance due to the increased risk factor.[40]

[36] These are the suggested methods. 1970 S. REP. 8. The regulations add fingerprint and electronic or mechanical confirmation to the possibilities. Reg. Z, § 226.13(d).

[37] Note, *Credit Cards: Distributing Fraud Loss*, 77 YALE L.J. 1418, 1429 (1968).

[38] The interest figure is set at eighteen per cent on bills not paid within thirty days and experience has shown that roughly one-half of the accounts are paid within this time. *1969 Hearings* 121. The average cost to retailers runs five per cent of purchase price. *Id.* at 138. The loss on accounts had been set at four per cent prior to the act, although some issuers had much better records. *Id.* at 120. Even with a shift in risk for unauthorized use, a carefully run credit card system would still appear to be a very profitable operation.

[39] *Id.* at 85.

[40] Obviously the fifty-dollar limitation is in effect for each card rather than for the whole lot. The term "unauthorized use" is defined as "a use . . . by a person . . . who does not have . . . authority . . . ." Pub. L. No. 91-508 § 501 (Oct. 26, 1970). The appearance of the article "a" as a modifier of "use" is unfortunate since

In short, it must be expected that very few cases will arise under the act, with the card issuer being content to bear the losses,[41] though passing them on in part to the consumer and the merchant through increased costs.

JOHN WOODWARD DEES

Criminal Procedure—Double Jeopardy: In the Interest of Public Justice

The "universal maxim of the common law,"[1] that no one should be twice vexed for the same cause, was elevated to a position of constitutional dignity by the adoption of the fifth amendment.[2] Today, it is among the most fundamental guarantees of the Bill of Rights.[3] However, before a man can "be twice put in jeopardy of life or limb"[4] there must have been initial jeopardy. The Court of Appeals for the Seventh Circuit, in *United States ex rel. Somerville v. Illinois*,[5] recently considered the problem of when and under what circumstances jeopardy is deemed to have attached so as to bar a subsequent prosecution. Petitioner Donald Somerville was indicted for theft on March 19, 1964. On November 1, 1965, his case

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the immediate implication is that the definition can apply to only one transaction and not to a series of transactions. From a pragmatic point of view, this is untenable since it would wipe out effective limitation of liability and destroy the intent to protect the cardholder which is the basis of the act. Testimony before the committee that entertained the bill reveals that the spokesman for the American Bankers Association assumed the limitation to apply to a series of unauthorized uses rather than to each unauthorized use of the card. His statement was *not* contradicted. *1969 Hearings* 107. If this assumption is not borne out in the courts, the need for liability insurance will be renewed.

[41] According to a representative of the Federal Trade Commission, earliest indications under the act point to this result since most companies are not bothering to meet the requirements. Raleigh News and Observer, Jan. 28, 1971, at 35, col. 3.

[1] 4 W. BLACKSTONE, COMMENTARIES *335.

[2] "nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb . . . ." U.S. CONST. amend. V. *See* J. SIGLER, DOUBLE JEOPARDY, THE DEVELOPMENT OF A LEGAL AND SOCIAL POLICY 1-37, 226 (1969) [hereinafter cited as SIGLER].

[3] Benton v. Maryland, 395 U.S. 784, 793-96 (1969). This case applied the double jeopardy provision of the fifth amendment to the states through the fourteenth amendment.

[4] U.S. CONST. amend. V.

[5] 429 F.2d 1335 (7th Cir. 1970). The Supreme Court has recently vacated the seventh circuit's decision in *Somerville* and remanded the case for reconsideration in light of the decisions in *United States v. Jorn*, 91 S. Ct. 547 (1971), and *Downum v. United States*, 372 U.S. 734 (1963). 39 U.S.L.W. 3436 (U.S. Apr. 6, 1971). These cases are discussed generally *infra*.

came to trial, and twelve jurors were duly impaneled and sworn. The following day the state's attorney moved for a mistrial and to *nolle prosequi* on the ground that the indictment did not allege a crime and was therefore void.[6] The motion was granted over the defendant's objection. On November 3, a corrected indictment was returned under which Somerville was subsequently convicted, his claim of double jeopardy having been rejected.[7]

Somerville filed a petition for habeas corpus asserting that jeopardy had attached upon the selection and swearing of the jury and that retrial after the discharge of the jury subjected him to double jeopardy in violation of the fifth amendment. The Court of Appeals for the Seventh Circuit affirmed the dismissal of the habeas corpus petition by the district court, holding that the discharge of a jury impaneled and sworn under an invalid indictment did not bar reprosecution on the ground of double jeopardy.[8]

Confusion has consistently surrounded the double jeopardy proscription of the fifth amendment. Although it is one of the most litigated portions of the Bill of Rights, it is extremely difficult to predict with precision the outcome of any defense predicated upon double jeopardy.[9] One of the major areas of uncertainty is that which is concerned with the attachment of jeopardy. While the Supreme Court has not yet ruled upon the question raised in *Somerville*, an examination of prior double jeopardy decisions may serve to reveal the ultimate outcome of any appeal on the issue.

A statement of what has been characterized as "the general rule" notes that "a person is not in jeopardy until he has been arraigned on a valid indictment . . . and a jury has been impaneled and sworn . . . ."[10] Decisions

[6] The indictment failed to alleged intent to deprive the owner permanently of the use or benefit of the property, an essential element of the offense sought to be charged, and its omission rendered the indictment invalid. 429 F.2d at 1336 & n.2.

[7] People v. Somerville, 88 Ill. App. 2d 212, 232 N.E.2d 115 (1967), *leave to appeal denied*, 37 Ill. 2d 627, *cert. denied*, 393 U.S. 823 (1968).

[8] United States *ex rel.* Somerville v. Illinois, 429 F.2d 1335 (7th Cir. 1970).

[9] SIGLER 226.

[10] McCarthy v. Zerbst, 85 F.2d 640, 642 (10th Cir.), *cert. denied*, 299 U.S. 610 (1936). *See also* Amrine v. Times, 131 F.2d 827, 834 (10th Cir. 1942). The rule is different in a nonjury trial. There jeopardy is not deemed to have attached until the court has begun to hear evidence. McCarthy v. Zerbst, 85 F.2d 640, 642 (10th Cir. 1936). *See also* 22 C.J.S. *Criminal Law* § 241 (1961). These rules as to the time of the attachment of jeopardy have been supported as well-founded:

> By the time the jury has been sworn or evidence introduced, the accused has been put to substantial trouble and expense and there has been considerable investment of judicial resources. To delay attachment of jeopardy to some later trial stage maximizes the risk of harassment of the accused and enables the prosecution to escape a particular jury. On the other hand, to

of the Supreme Court, however, tend to discount the importance of a valid indictment. In *United States v. Ball*,[11] the defendant was tried and acquitted under an indictment later adjudged "fatally defective."[12] A new indictment was returned against him, and he was found guilty, the court denying his plea of former jeopardy. The Supreme Court recognized that to allow a public officer, whose business it was to draw a correct indictment, to allege his own inaccuracy or neglect as a reason for a second trial was "'like permitting a party to take advantage of his own wrong,'"[13] and it held that the verdict of acquittal was conclusive notwithstanding the invalidity of the indictment. This view was recently reaffirmed in *Benton v. Maryland*,[14] in which the state's argument that one cannot be placed in jeopardy by a void indictment was characterized as "strange . . . since petitioner could quietly have served out his sentence under this 'void' indictment had he not appealed . . . ."[15]

Downum v. United States[16] represents a Supreme Court decision that is factually similar to *Somerville*. A jury had been selected and sworn when the prosecution asked that it be discharged because of the absence of a key witness. This was done over the objection of the defendant. Two days later a second jury was impaneled, and the defendant was found guilty. The Court reversed the conviction, holding that the defendant's retrial subjected him to double jeopardy. The majority in *Somerville* made no attempt to distinguish *Downum*. The dissent, however, carefully noted the similarities and criticized the majority's departure from precedent:

> Both cases were dismissed on motion of the Government because of its own fault. In Downum, it was the failure of the Government to procure the attendance of a material witness; in the instant case, it was an allegedly defective indictment for which it was responsible.[17]

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advance attachment of jeopardy to an earlier point in the proceeding . . . unduly discounts the state's legitimate interest in bringing offenders to trial. Note, *Double Jeopardy: The Reprosecution Problem*, 77 HARV. L. REV. 1272, 1275 (1964). The Model Penal Code suggests that jeopardy attach in all cases upon the swearing of the first witness, evidencing the belief that there should be no distinction between jury and nonjury trials. MODEL PENAL CODE § 1.08(4) (Proposed Official Draft 1962); MODEL PENAL CODE § 1.09, Comment (Tent. Draft No. 5, 1956).

[11] 163 U.S. 662 (1896).

[12] *Id.* at 664. The indictment had been attacked on appeal by Ball's two codefendants, who had been found guilty.

[13] *Id.* at 668.

[14] 395 U.S. 784 (1969).

[15] *Id.* at 796.

[16] 372 U.S. 734 (1963).

[17] 429 F.2d at 1338.

The "valued right [of an accused] to have his trial completed by a particular tribunal"[18] is well recognized, and a recent decision stressed this consideration, emphasizing "the importance to the defendant of being able, once and for all, to conclude his confrontation with society through the verdict of a tribunal he might believe to be favorably disposed to his fate."[19] Nevertheless, it is clear that in some instances a trial must be discontinued after the jury is impaneled and sworn but before a verdict is reached without double jeopardy barring reprosecution. *United States v. Perez*[20] enunciated a rule in 1824 that has since been scrupulously followed by the courts:

> We think, that in all cases of this nature, the law has invested Courts of justice with the authority to discharge a jury from giving any verdict, whenever in their opinion, taking all the circumstances into consideration, there is a manifest necessity for the act, or the ends of public justice would otherwise be defeated.[21]

Thus, termination prior to the verdict is no bar to retrial where the jury is unable to agree,[22] where there is a possibility of juror bias[23] or one of the jurors is disqualified,[24] where necessary for tactical reasons in a military campaign,[25] or where the mistrial was declared in the sole interest of the defendant.[26]

It seems clear that where the termination is due to "a breakdown in judicial machinery"[27] there is no constitutional bar to reprosecution.[28]

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[18] Wade v. Hunter, 336 U.S. 684, 689 (1949).

[19] United States v. Jorn, 91 S. Ct. 547, 558 (1971).

[20] 22 U.S. (9 Wheat.) 579 (1824).

[21] *Id.* at 580.

[22] Keerl v. Montana, 213 U.S. 135 (1909); Dreyer v. Illinois, 187 U.S. 71 (1902); Logan v. United States, 144 U.S. 263 (1892); United States v. Perez, 22 U.S. (9 Wheat.) 579 (1824).

[23] Simmons v. United States, 142 U.S. 148 (1891).

[24] Thompson v. United States, 155 U.S. 271 (1894).

[25] Wade v. Hunter, 336 U.S. 684 (1949). A court-martial was convened by a division of the Third Army, but rapid advancement into Germany rendered the distance of the witnesses so great that its continuation became impractical. The charges were then withdrawn and transmitted to the Fifteenth Army which conducted a second court-martial. This was held not to violate the double jeopardy provision of the fifth amendment.

[26] Gori v. United States, 367 U.S. 364 (1961). The trial judge, on his own motion and for reasons not entirely clear, declared a mistrial. The Supreme Court, inferring that the action was taken to forestall improper questioning by the prosecution, said that it was "unwilling, where it clearly appears that a mistrial has been granted in the sole interest of the defendant, to hold that its necessary consequence is to bar all retrial." *Id.* at 369.

[27] *Id.* at 372 (Douglas, J., dissenting).

[28] *See* Note, 77 HARV. L. REV., *supra* note 10, at 1276-81.

Somerville represents a much more difficult situation because the mistrial was declared at the request of the prosecution—due to its error—and over the objection of the accused. It seems doubtful that this termination would qualify under the "manifest necessity" rule outlined in *Perez*, especially when the rule is taken with Justice Story's admonition: "[T]he power [to discharge the jury] ought to be used with the greatest caution, under urgent circumstances, and for very plain and obvious causes . . . ."[29]

The foregoing indicates that the Supreme Court could easily hold Somerville's reprosecution invalid as an unconstitutional abridgment of the fifth amendment double jeopardy prohibition. But to do so would overlook the interest of society in the fair administration of justice. Though the double jeopardy doctrine has been justified as safeguarding interests of society, the accused, and the judicial system,[30] it is most often characterized as a measure for the protection of the defendant:

> The underlying idea . . . is that the State with all its resources and power should not be allowed to make repeated attempts to convict an individual for an alleged offense, thereby subjecting him to embarrassment, expense and ordeal and compelling him to live in a continuing state of anxiety and insecurity, as well as enhancing the possibility that even though innocent he may be found guilty.[31]

Despite this emphasis, the Supreme Court recognized from the beginning that the interests of public justice should be the determining factor as to whether premature termination of a trial is permissible.[32] "Where . . . the ends of substantial justice cannot be attained without discontinuing the trial, a mistrial may be declared . . . and [the defendant] may be retried consistently with the Fifth Amendment."[33] *United States v. Tateo*[34] clearly recognizes that society has an interest in determining guilt and punishing the guilty.[35]

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[29] 22 U.S. (9 Wheat.) at 580. This view was reiterated in *Downum* in which the Court quoted from an earlier opinion by Justice (then Judge) Story holding that the power to discharge the jury before it reached a verdict was to be exercised "'only in very extraordinary and striking circumstances.'" 372 U.S. at 736, *quoting* United States v. Coolidge, 25 F. Cas. 622, 623 (No. 14,858) (C.C.D. Mass. 1815).

[30] *See* Comment, *Statutory Implementation of Double Jeopardy Clauses: New Life for a Moribund Constitutional Guarantee*, 65 YALE L.J. 339, 340-41 (1956); Note, 77 HARV. L. REV., *supra* note 10, at 1274.

[31] Green v. United States, 355 U.S. 184, 187-88 (1957).

[32] *See* text accompanying note 21 *supra*.

[33] Gori v. United States, 367 U.S. 364, 368 (1961).

[34] 377 U.S. 463 (1964).

[35] *Id.* at 466. "It would be a high price indeed for society to pay were every

Once the need to consider the interests of both parties is recognized, a balancing of these interests must inevitably follow. It is submitted that the exact point of the attachment of jeopardy is of no moment and that the controlling consideration when determining whether or not reprosecution of the defendant is permissible should be the overall interest of public justice, properly evaluated, giving due consideration to both the rights of the accused and the interests of society. In a sense a defendant is prejudiced from the moment suspicion focuses, and our heritage of sensitivity for the rights of the individual demands an acute awareness of this, but the value of an adjudication of guilt on the merits must not be underestimated.[36]

The policies underlying the double jeopardy provision of the Constitution were not sufficiently implicated in *Somerville* to preclude his reprosecution. Only two days had elapsed between the beginning of the first trial and the reindictment. This was not a case of "repeated attempts to convict . . . enhancing the possibility that even though innocent he may be found guilty,"[37] nor was it a harassing maneuver. The prosecutor acted in good faith at all times.

A holding that the discharge of a jury impaneled under an invalid indictment automatically erects a double jeopardy bar to reprosecution could force a useless proceeding at the expense of all concerned. Any attempt by the prosecution to correct an indictment the validity of which came under doubt after the seating of the jury would be discouraged, and any doubts of the defense would be reserved as a ground upon which to seek a new trial in the event of an unfavorable verdict.[38] The result would be a wasted initial effort in the event a later challenge to the validity of the indictment was sustained. Many of the fears the double jeopardy protection seeks to shield the defendant from would be realized, *i.e.*, the additional expense of an unnecessary proceeding and unduly prolonged embarrassment, anxiety, and insecurity.

The rule that jeopardy attaches when the jury is impaneled and sworn

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accused granted immunity from punishment because of any defect sufficient to constitute reversible error in the proceedings leading to conviction." *Id.* *See also* United States v. Jorn, 91 S. Ct. 547, 554 (1971); Wade v. Hunter, 336 U.S. 684, 689 (1949).

[36] The defendant himself, in addition to society in general, has a positive interest in having the question of his guilt settled by a determination on the merits.

[37] *See* text accompanying note 31 *supra.*

[38] Retrial would clearly have been permissible had the trial proceeded to its conclusion and the defendant's challenge of the validity of the indictment been sustained. *See* United States v. Ball, 163 U.S. 662 (1896).

cannot, by necessity, preclude retrial in every instance where the jury is discharged prior to the verdict.[39] If the rule is retained, as it appears that it will be, there remains the necessity of determining under what circumstances retrial is precluded.[40] Under *Perez*, anytime the discharge is necessary in the interest of public justice reprosecution is constitutionally permissible. But society's interest in determining the guilt of an accused on the merits may be too easily subordinated to the rights of the accused by a protective court. Care must be taken to see that these competing interests are recognized and properly evaluated. Courts must see that retrial following a discharge of the jury does not violate policies undergirding the double jeopardy provision of the Constitution, but this determination must be made in light of the competing interests of society and the accused, and in the overall interest of justice. Overzealous concern for the rights of the defendant must not be allowed to present an "obstacle to the administration of justice in many cases in which there is no semblance of the type of oppressive practices at which the double-jeopardy prohibition is aimed."[41]

JOHN E. HODGE, JR.

Criminal Procedure—State Hearsay Exception for Co-conspirator's Statement Held not to Violate Sixth Amendment Confrontation Clause

The hearsay rule,[1] because of its many exceptions,[2] abounds with controversy more than any other area in the law of evidence.[3] A particularly

[39] *See* United States v. Jorn, 91 S. Ct. 547, 554-55 (1971); SIGLER 74.

[40] *See* United States v. Jorn, 91 S. Ct. 547, 554-55 (1971). It has been suggested that the problem of attachment of jeopardy could be eliminated by the adoption of the English rule which requires a final judgment of acquittal or conviction to constitute prior jeopardy. SIGLER 223.

[41] Wade v. Hunter, 336 U.S. 684, 688-89 (1949).

[1] The hearsay rule has been defined as the exclusion "of testimony in court or written evidence, of a statement made out of court, such statement being offered as an assertion to show the truth of matters asserted therein, and this resting for its value upon the credibility of the out-of-court assertion." C. MCCORMICK, LAW OF EVIDENCE § 225 (1954).

Historically there are several rationales for the rule, the most significant ones being that the adversary should have full opportunity for cross-examination; that testimony should be given under oath; that the trier of fact should have an opportunity to observe the demeanor of the witness; and that errors in transmission are nonexistent when the declarant is in court. *Id.* § 224.

[2] Under the hearsay exceptions the courts have admitted into evidence out-of-court statements to prove the truth of what was asserted. 5 J. WIGMORE, EVIDENCE § 1420 (3d ed. 1940) [hereinafter cited as WIGMORE].

[3] It has been estimated that the hearsay rule accounts for at least one third of

acute problem in this area stems from the conflict between the goals of the hearsay-rule exceptions and those of the confrontation clause of the sixth amendment.[4] The Supreme Court has cogently stated the purposes of the confrontation clause[5] as being

> to prevent depositions or ex parte affidavits . . . [from] being used against the prisoner in lieu of a personal examination and cross-examination of the witness in which the accused has an opportunity, not only of testing the recollection and sifting the conscience of the witness, but of compelling him to stand face to face with the jury in order that they may look at him, and judge by his demeanor upon the stand and the manner in which he gives his testimony whether he is worthy of belief.[6]

On the other hand, the hearsay-rule exceptions—grounded in theory upon shifting combinations of necessity and circumstantial trustworthiness[7]—frequently have been invoked to admit evidence of the out-of-court statements of declarants not present in court and thus a fortiori not available for confrontation.[8] The Supreme Court recently analyzed this obvious conflict in *Dutton v. Evans*,[9] but left the ultimate resolution of the issue unclear.

Evans, the petitioner in *Dutton*, along with Truett and Williams were jointly indicted in a Georgia court for the murders of three police officers, but Evans pleaded not guilty and exercised his right under Georgia law to a separate trial.[10] He was convicted of murder and sentenced to death.[11] Evans then brought a habeas corpus proceeding in a federal district court, alleging that he had been denied the constitutional right of confrontation

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all evidentiary problems in the courts today. Note, *Erosion of the Hearsay Rule*, 3 U. RICH. L. REV. 89, 92 (1968).

[4] "In all criminal prosecutions, the accused shall enjoy the right . . . to be confronted with the witnesses against him . . . . U.S. CONST. amend. VI. This clause applies to the states through the fourteenth amendment. Pointer v. Texas, 380 U.S. 400, 403 (1965).

[5] The similarity of the goals of the confrontation clause and the hearsay rule might suggest that the two can be equated. However, the Supreme Court does not accept this view. "While it may readily be conceded that hearsay rules and the Confrontation Clause are generally designed to protect similar values, it is quite a different thing to suggest that the overlap is complete . . . ." California v. Green, 399 U.S. 149, 155 (1970).

[6] Mattox v. United States, 156 U.S. 237, 242-43 (1895).

[7] 5 WIGMORE §§ 1421-22.

[8] Mattox v United States, 156 U.S. 237, 243 (1895); Tracey v. State, 97 Ill. 101, 106 (1880).

[9] 400 U.S. 74 (1970).

[10] *Id.* at 76.

[11] *Id.*

at his trial by the admission into evidence of a statement allegedly made by Williams to a fellow prisoner named Shaw.[12] Williams never appeared at Evans' trial. However, at the trial Shaw was permitted to testify that he had asked Williams the result of Williams' arraignment proceeding, whereupon Williams had remarked: "If it hadn't been for that dirty son-of-a-bitch Alex Evans, we wouldn't be in this now."[13] The Georgia Supreme Court upheld the admission of Shaw's testimony under a Georgia statute permitting the admission into evidence against a defendant of statements made by the defendant's co-conspirators, provided the conspiracy is first prima facie established.[14] The court held the statement admissible even though it was made during the concealment phase of the criminal project.[15]

The "co-conspirators" hearsay exception applied in federal courts allows admission of only those statements made by co-conspirators "in the course of and in the furtherance of the conspiracy."[16] The federal rule is thus narrower than the Georgia statutory hearsay exception,[17] but in *Dutton* the Court held this fact insufficient to invalidate the Georgia statute under the confrontation clause.[18] In reaching this result the Court stated

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[12] *Id.* at 79.

[13] *Id.* at 77.

[14] "After the fact of conspiracy shall be proved, the declarations by any one of the conspirators during the pendency of the criminal project shall be admissible against all." GA. CODE ANN. § 38-306 (1954 rev.).

[15] Evans v. State, 222 Ga. 392, 396-97, 150 S.E.2d 240, 244-45 (1966). The Georgia court found a conspiracy to exist because at the time the statement was made by Williams, Evans and Williams "were still concealing their identity, keeping secret the fact they had killed the deceased, if they had, and denying their guilt. There was evidence sufficient to establish a prima facie case of conspiracy to steal the automobile . . . ." *Id.* at 402, 150 S.E.2d at 248. However, a more accurate view seems to be that of Justice Marshall, dissenting in *Dutton:* "It is difficult to conceive how Williams could be part of a conspiracy to conceal the crime when all the alleged participants were in custody and he himself had already been arraigned." 400 U.S. at 106 n.8.

[16] 400 U.S. at 81.

[17] As was stated by the plurality in *Dutton:*

> It is settled that in federal conspiracy trials the hearsay exception that allows evidence of an out-of-court statement of one conspirator to be admitted against his fellow conspirators applies only if the statement was made in the course of and in furtherance of the conspiracy, and not during a subsequent period when the conspirators were engaged in nothing more than concealment of the criminal enterprise. . . . The hearsay exception that Georgia applied in the present case, on the other hand, permits the introduction of evidence of such an out-of-court statement even though made during the concealment phase of the conspiracy.

Id.

[18] When used in the discussion of the *Dutton* case, "the Court" refers to Justice Stewart's plurality opinion. This was a four-one-four decision; Justice Harlan,

that it "has never indicated that the limited contours of the hearsay exception in federal conspiracy trials are required by the Sixth Amendment's Confrontation Clause. To the contrary, the limits of *this* hearsay exception have simply been defined by the Court in the exercise of its rule-making power in the area of the federal law of evidence."[19] In so holding, the Court has deviated from its position in earlier cases, and a brief survey of recent cases concerning confrontation and hearsay problems illustrates the shift which the Court has made.

In *Pointer v. Texas*[20] the Court held that the sixth amendment rights of defendants in criminal trials to confront and cross-examine adverse witnesses extended to state trials.[21] Pointer was accused of robbing one Phillips. At a preliminary hearing, witnesses were examined by an assistant district attorney. Among those questioned was Phillips, who identified Pointer as the robber. Pointer was not represented by counsel at the preliminary hearing, and he did not avail himself of his opportunity to cross-examine the witness. Before the trial Phillips moved to another state, and the prosecutor offered the transcript of Phillips' testimony into evidence against Pointer. The Court held that Pointer had not been afforded a realistic opportunity to cross-examine Phillips, and that the introduction of the evidence was a denial of the defendant's right to confrontation guaranteed by the sixth amendment.[22] The facts in *Dutton* are somewhat similar to those in *Pointer*, although *Dutton* involved an out-of-court statement rather than a formal transcript from a preliminary hearing. However, this factual difference, if justifying different results in the two cases at all, would seem to dictate results contrary to the actual holding. Preliminary hearing testimony, given in defendant's presence,

representing the "one," concurred in the result but not the means of achieving it. He did not see the sixth amendment as being well suited for taking into account the many factors involved in weighing the appropriateness of evidentiary rules, and thought that application of the due-process-of-law mandate was the correct procedure for the adjudication of such issues. *Id.* at 97. One writer has sharply disagreed with Justice Harlan's view, noting that "[a] certain notion of fairness has already pervaded the courts' general treatment of evidence in criminal trials," and asserting that to suggest that the accused is "sufficiently protected by the due process clause would be to regard the confrontation clause merely as a constitutional anachronism." Note, *Preserving the Right to Confrontation—A New Approach to Hearsay Evidence in Criminal Trials*, 113 U. PA. L. REV. 741, 743 (1965).

[19] 400 U.S. at 82 (emphasis added).

[20] 380 U.S. 400 (1965).

[21] *Id.* at 403.

[22] If a federal standard could be gleaned from this and similar cases discussed *infra*, it would be that the right of confrontation gives a criminal defendant a chance "to face and effectively cross-examine the witness testifying against him." Note, 113 U. PA. L. REV., *supra* note 18, at 745.

obviously presents a stronger case for admission than the simple extra-judicial statement involved in *Dutton*. This seems true even if the latter statement was in fact made—a matter which is open to considerable doubt.[23]

In *Douglas v. Alabama*[24] the court followed the *Pointer* reasoning. Douglas had been convicted in a state court of assault with intent to murder.[25] Loyd, Douglas's alleged accomplice who had been convicted in a prior trial, invoked the fifth amendment privilege against self-incrimination when called as a witness by the prosecution in Douglas's trial.[26] The prosecutor, examining Loyd as a hostile witness, read from Loyd's confession—which implicated Douglas—in order to "refresh" Loyd's memory.[27] After reading each sentence the prosecutor asked the witness if the statement was his. Loyd firmly declined to answer these questions, even when ordered to do so by the trial judge and faced with a contempt citation.[28] The Court held that the lack of opportunity to cross-examine Loyd denied Douglas his constitutional right to confrontation.[29] On the facts *Douglas* and *Dutton* are strikingly similar—yet the Court reached different results. In both cases the state charged two defendants with a crime and tried them separately. In both the state first prosecuted one defendant and then used the first defendant's out-of-court statement in the trial of the second defendant. In *Douglas* the Court disapproved such use because the declarant, though in court, could not be cross-examined on the statement imputed to but not admitted by him. In *Dutton* the prosecution did not even call the declarant to the stand.[30] If the right to cross-examine is a standard in this context, as some writers have argued,[31] it was inexplicably denied in *Dutton*.

After *Douglas* was decided the Court developed the proposition that while the confrontation clause and the basic hearsay rule are analogous in numerous respects, it is still possible for hearsay to be admissible in exceptional circumstances, pursuant to established rules of evidence,

[23] *See* note 39 *infra*.
[24] 380 U.S. 415 (1965). *Douglas* and *Pointer* were decided on the same day.
[25] *Id.* at 417.
[26] *Id.* at 416. At the time of Douglas's trial, Loyd had an appeal pending and decided not to testify in order not to compromise his own case.
[27] *Id.*
[28] *Id.* at 416 & n.1. The judge did not in fact hold Loyd in contempt, but he interrupted Douglas's trial to sentence Loyd to twenty years in prison. *Id.*
[29] *Id.* at 419.
[30] 400 U.S. at 102.
[31] *See* note 22 *supra*.

despite the resultant departure from the most stringent possible interpretation of the confrontation clause.[32] *Barber v. Page*[33] is a striking example of this development. Barber and Woods were charged jointly with armed robbery in a state court, Woods having given the testimony that incriminated Barber at a preliminary hearing. By trial time Woods was in prison in another jurisdiction, and his statement was admitted in Barber's trial because Woods was not available to testify. Barber was convicted and sought habeas corpus, claiming that the use of the transcript of Woods's testimony deprived him of his right of confrontation. The Supreme Court agreed that Barber was entitled to a new trial but did not hold that the confrontation requirement barred the testimony in any event. It decided only that unavailability was not sufficiently shown in the absence of a good faith attempt to secure the presence of the witness.[34]

If Woods was "not unavailable," one wonders why Williams was "available" in *Dutton*. In *Dutton* the state made no attempt to call Williams, and it is possible that he would have testified had he been called. He had already been convicted and possibly would not have asserted his right against self-incrimination as did Loyd in *Douglas*. Pondering the result of the state's calling Williams to the stand is a purely academic exercise, but the fact remains that under the earlier cases the state either had to confront the defendant with the witnesses against him, or (at the least, under *Barber*) prove frustration of a good faith effort to procure his presence. In *Dutton* the state was permitted to introduce damaging evidence[35] without bearing the risk of trial confrontation. By *Barber* standards, which require a showing of ample opportunity to cross-examine at a prior stage of the proceedings and also of a good faith effort to procure the presence of the declarant at the trial, apparently *Dutton* was decided incorrectly. Arguably, unavailability—the requirement of the hearsay rule exception—was established in *Barber*;[36] yet the

[32] Note, *Constitutional Law—Witnesses—The Confrontation Clause of the Sixth Amendment Requires State Authorities to Make a Good Faith Effort to Produce Out of State Witnesses at Trial*, 47 TEX. L. REV. 331, 335 (1969).

[33] 390 U.S. 719 (1968).

[34] *Id.* at 724-25.

[35] For a contrary view of the quality of the evidence in question, see Justice Blackmun's concurring opinion in *Dutton*, 400 U.S. at 90.

[36] Various courts and commentators have in the past assumed that the mere absence of a witness from the state was sufficient grounds for dispensing with confrontation. *See* the cases collected in 5 WIGMORE § 1404, at n.5 (Supp. 1970). *See also, e.g.*, MCCORMICK, *supra* note 1, § 234. However, this is now a questionable theory because of the increased cooperation among the states themselves and between the states and the federal government. When a prospective witness is in federal custody, 28 U.S.C. § 2241(c)(5) (1964), gives federal courts "the power

Court again recognized that the hearsay exceptions must be applied in the context of constitutional limitations.[37]

In *Dutton* the question arises why the prosecution even used the controversial evidence. Arguably it was crucial and damaging evidence, for under Georgia law Evans could not have been convicted on the uncorroborated testimony of his accomplice, Truett.[38] Corroboration was a key element in Evan's conviction, and that corroboration could well have been Shaw's questionable testimony. However, there were eighteen other witnesses besides Shaw and Trutt, the eyewitness. Surely one of the eighteen could have supplied the required testimony. The Court of Appeals noted that there was grave doubt that Williams had made the statement attributed to him,[39] and stated that Shaw's account of his conversation with Williams was notable for "its basic incredibility."[40] In addition, the veracity of the statement, if made, was at best dubious.[41] It is clear that the statement was neither necessary nor reliable, and the prejudice to Evans was in fact real. Indeed, the dissent in *Dutton* questioned whether "Williams' accusation relate[d] to Evans as a man with powerful and unscrupulous enemies, or Evans as a murderer."[42] The plurality apparently

to issue writs of habeas corpus *ad testificandum* at the request of state prosecutorial authorities." Barber v. Page, 390 U.S. 719, 724 (1968).

[37] The doctrinal distinction between *Dutton* on the one hand, and *Pointer, Douglas,* and *Barber* on the other, seems tenuous at best. In the latter cases there was no mention of a conspiracy. Therefore, the hearsay exception involved was not that of a co-conspirator's statement as in *Dutton.* The sixth amendment in those cases was held to exclude the questionable evidence in issue. However, in *Dutton,* where the facts were similar—the only difference of any significance being the hearsay exception involved—the evidence in issue was admitted. Should different results obtain merely because of the co-conspirator label? The results of an affirmative answer would be startling, for if the state only has to establish a conspiracy (often an easy thing to accomplish), and if upon such a finding hearsay evidence can be admitted on the tails of the co-conspirator exception, then the constitutional right of confrontation can be effectively abrogated.

[38] 400 U.S. at 108.

[39] In the court's words,

> Shaw's testimony was somewhat incredible. He testified that Williams was talking to him in a normal voice through a ten-by-ten plateglass window in a prison hospital door, while Williams was lying on a bed in the room and Shaw was standing in the hall. Shaw had stated in the Williams trial that the window was covered only by wire mesh. The fact that it was covered by a pane of plate glass was brought out in Evans' trial. Moreover, evidence was submitted but rejected by the trial court which tended to show that Shaw's testimony may have been compensation for a respite from the dull routine of prison life.

Evans v. Dutton, 400 F.2d 826, 828 n.4 (5th Cir. 1968).

[40] *Id.*

[41] *See* note 39 *supra.*

[42] 400 U.S. at 104.

adopted the latter interpretation, but the fact remains that without cross-examination of Williams himself, "the jury was left with only the unelucidated, apparently damning, and patently damaging accusation as told by Shaw."[43]

The Court has labored to discover the reach of the confrontation clause when measured against conflicting demands of the hearsay exceptions. One solution to the dilemma, wholly consistent with the decision in *Barber*, would be to read the confrontation clause as a canon of prosecutorial conduct. So read, the confrontation clause would require prosecutors to make good faith attempts to procure people to testify, and to allow hearsay only when necessity, trustworthiness and fairness—arguably absent in *Dutton*—are present. Interpreted in this fashion, the confrontation clause would bind the prosecutor, notwithstanding that an exception to the hearsay rule would permit admission of the questionable statement.[44] A confrontation clause construed as a standard of prosecutorial conduct might reasonably have resulted in a contrary holding in *Dutton*. In addition, such a construction would afford improved prosecutorial behavior and more ascertainable standards.

ROBERT D. RIZZO

Criminal Procedure—Voluntariness of Guilty Pleas in Plea Bargaining Context

One of the basic purposes of our system of justice is to separate the guilty defendant from the innocent.[1] The formal trial process and the guilty plea process are the only means used to accomplish this end. The formal trial process is laced with procedural, evidentiary, and other safeguards to protect against conviction of the innocent and to ensure that the accused are better able to defend against the power and the resources of the state.[2] However, the guilty plea process contains far fewer safeguards, and the safeguards that do exist vary from jurisdiction to jurisdiction.[3]

[43] *Id.*
[44] Barber v. Page, 390 U.S. 719, 724 (1968).

[1] D. NEWMAN, CONVICTION: THE DETERMINATION OF GUILT OR INNOCENCE WITHOUT TRIAL 10 (1966).
[2] See L. MAYERS, THE AMERICAN LEGAL SYSTEM 11-150 (rev. ed. 1963) for a general discussion of the safeguards available at all stages of the procedure.
[3] D. NEWMAN, *supra* note 1, at 10.

In the recent case of *North Carolina v. Alford*,[4] the United States Supreme Court significantly expanded the instances in which a guilty plea may be determined to be voluntary while upholding the constitutionality of the plea bargaining process.

On December 2, 1963, Alford was indicted for first-degree murder, a capital offense in North Carolina.[5] Eight days later, on the recommendation of his court-appointed counsel, he pleaded guilty to a charge of second-degree murder, a noncapital offense.[6] Before accepting the plea, the trial judge heard incriminating testimony from three witnesses.[7] Alford himself testified that he had not committed the murder but that he had pleaded guilty because "they said if I didn't they would gas me for it . . . ."[8] While Alford was on the stand his attorney established by questioning that Alford had been informed of his rights and of the alternatives available to him.[9] At this point in the proceedings, Alford stated, "I'm not guilty but I plead guilty."[10] Then the court asked Alford if, in light of his denial of guilt, he still wished to plead guilty, and Alford replied in the affirmative. Thereupon the trial court sentenced him to thirty years imprisonment for second-degree murder.[11] At the state post-conviction hearing in 1965, Alford's attorney testified that Alford had told the attorney that he was innocent,[12] but the state court found that the guilty plea was "willingly, knowingly, and understandingly made on the advice of competent counsel."[13] Alford's subsequent petition for a writ of habeas corpus was denied in both the district court and the court of appeals on the basis that the plea was voluntarily and knowingly entered.[14] On Alford's second petition for a writ of habeas corpus[16] the Court of Appeals for the Fourth Circuit, relying on *United States v. Jackson*,[15] held that Alford's guilty

[4] 400 U.S. 25 (1970).

[5] N.C. GEN. STAT. § 14-17 (1969).

[6] *Id.*

[7] The general testimony of the witnesses was that on the day of the killing when Alford took his gun from his house he stated that he intended to kill the victim and when he returned home he stated that he had carried out his purpose. 400 U.S. at 28.

[8] *Id.* at n.2.

[9] Brief for Appellee at 4, North Carolina v. Alford, 400 U.S. 25 (1970).

[10] 400 U.S. at 28 n.2.

[11] This was and remains the maximum penalty available for second-degree murder in North Carolina. N.C. GEN. STAT. § 14-17 (1969).

[12] Brief for Appellee at 4.

[13] 400 U.S. at 29.

[14] *Id.* at 29-30.

[15] 390 U.S. 570 (1968). See discussion pp. 797-98 *infra*.

[16] Alford v. North Carolina, 405 F.2d 340, 347 (4th Cir. 1968).

plea was involuntary because its principal motivation was the fear of death. The Supreme Court reversed, holding that *Jackson* had not established a new test for the validity of guilty pleas, *and* that a guilty plea accompanied by protestations of innocence constitutionally may be accepted if an inquiry into the factual basis for the plea discloses strong evidence of actual guilt.

In *Jackson* the Court held that the death penalty clause of the Federal Kidnaping Act[17] constituted an impermissible burden on the assertion of the constitutional rights to trial by jury and against self-incrimination.[18] Under the Act a person accused of kidnaping, and failing to release the victim unharmed, could avoid the possibility of capital punishment only by pleading guilty or by pleading not guilty and waiving his right to a jury trial. This choice arose as a result of a section of the Act that allowed only the jury to impose the death penalty.[19] The Court reasoned that since the death penalty could apply only to those defendants who contest their guilt before a jury, the statute had a chilling effect on the exercise of the sixth amendment right to a jury trial.[20] The Court further found that the statutory scheme encouraged guilty pleas and in doing so infringed upon the fifth amendment right against self-incrimination. The court of appeals evaluated the North Carolina statute and found that it

> does not permit an accused who pleads not guilty to waive a jury trial. The accused may avoid a jury trial only if he pleads guilty and, by statute, a plea of guilty may not result in a punishment more severe than life imprisonment. Thus a person accused of a capital crime in North Carolina is faced with the awesome dilemma of risking the death penalty in order to assert his rights to a jury trial and not to plead guilty, or, alternatively, of pleading guilty to avoid the possibility of capital punishment.[21]

The court of appeals concluded that though the *Jackson* doctrine did not require the automatic invalidation of guilty pleas entered under the North Carolina statutes, a prisoner is entitled to relief if he can demonstrate that his plea was in fact a product of impermissible burdens of the statutory scheme.[22] However, the Court's own interpretation of *Jackson* does not

[17] 18 U.S.C. § 1201(a) (1964).
[18] 390 U.S. at 572.
[19] 18 U.S.C. § 1201(a)(1) (1964).
[20] "[T]he evil in the federal statute is not that it necessarily *coerces* guilty pleas and jury waivers but simply that it needlessly *encourages* them." 390 U.S. at 583.
[21] 405 F.2d at 344.
[22] *Id.* at 347.

go that far. In *Brady v. United States*[23] the Court determined that *Jackson* does not require the invalidation of every guilty plea induced by a fear of the death penalty. By inference it appears that some guilty pleas induced by fear of the death penalty may be invalidated as coerced. The *Jackson* rationale would seem to support the court of appeals' holding that Alford's plea was the exceptional, coerced type. Since the Court in *Jackson* held the statute unconstitutional because it may tend to coerce guilty pleas, it is reasonable to conclude that the *Jackson* doctrine must apply where the plea was in fact coerced by the presence of the statute. However, in *Alford* the Supreme Court limited *Jackson* to its exact facts and stated that the standard applied by the Fourth Circuit would result in the invalidation of all guilty pleas entered on the fear of a death sentence without regard to the statutory scheme involved.[25]

Having determined that the court of appeals had misconstrued the scope of *Jackson*, the Court found it necessary to inquire into the effect of Alford's contemporaneous protestations of innocence. After noting that state and lower federal courts were divided on the isssue of whether a guilty plea can be accepted when it is accompanied by protestations of innocence and hence contains a waiver of trial but no admission of guilt,[26] the Court gleaned "relevant principles" from two prior dissimilar decisions. In the first case, *Lynch v. Overholser*,[27] a trial judge refused to accept a defendant's guilty plea because the judge had in his possession a psychiatric report which indicated that the defendant possibly was not guilty by reason of insanity. At the subsequent trial, though the defendant did not rely on the defense of insanity, he was found not guilty for that reason and committed to a mental institution. The Supreme Court ordered his release and implied that the judge could have accepted the plea even though he was aware of a defense. The second case relied on by

[23] 397 U.S. 742 (1970).

[24] *Id.* at 747. *Brady* is distinguishable on the facts from *Alford* since Brady expressly admitted guilt.

[25] 400 U.S. at 31.

[26] The cases cited by the Court do not support this conclusion. In no case in which a guilty plea was allowed did the defendant declare that he was not guilty as in *Alford*. The true split of authority occurs when the accused is unwilling to deny guilt or assert innocence because of total lack of recall as to the events surrounding the act of which he is accused. *Compare* Hulsey v. United States, 369 F.2d 284, 287 (5th Cir. 1966), *and* State v. Levba, 80 N.M. 190, 453 P.2d 211 (1969), *with* State v. Martinez, 89 Idaho 129, 403 P.2d 597 (1965), State *ex rel.* Crossley v. Tahash, 263 Minn. 299, 116 N.W. 666 (1962), *and* Commonwealth v. Cottrell, 433 Pa. 177, 249 A.2d 294 (1969).

[27] 369 U.S. 705 (1962).

the Court, *Hudson v. United States*,[28] established that federal courts have the power to impose a prison sentence after accepting a plea of nolo contendere. In *Alford*, the Court reasoned that since a prison sentence may be imposed under a plea of nolo contendere an express admission of guilt is not constitutionally required even though a guilty plea normally consists of both a waiver of trial and an express admission of guilt.[29] Thus, the two cases appear to establish that even though a defendant is unwilling to admit guilt he may be sentenced to prison by a judge who is aware of an available defense. However, Alford did more than acquiesce in the entrance of a guilty plea; he affirmatively denied committing the crime of which he was accused. Stating that there is no material difference between refusing to admit commission of a criminal act and affirmatively denying it, the Court held that, in view of the overwhelming evidence against Alford, he had made an intelligent choice between a trial for first-degree murder and a plea of guilty to second-degree murder.[30]

It appears that both the trial court and the Supreme Court placed too much reliance on the presentation of facts at the trial. In a situation such as that in *Alford* where there is real doubt as to the voluntariness of the plea, it is at best questionable to allow the balance to tip in favor of acceptance of the plea on the basis of unchallenged testimony, when the counsel for the defense neither cross-examined the witnesses nor presented a rebuttal of their testimony. The primary purpose for the evidentiary inquiry is to determine if there is a factual basis for the plea of guilty.[31] It is suggested that the defendant's denial of guilt should negate any probative value of the testimony received. A contrary conclusion results in a determination of guilt when there is a genuine dispute between the state and the accused without the constitutional and procedural safeguards inherent in a formal plenary trial.

It is submitted that the cases from which the Court derived its guidelines are distinguishable not only in fact but also in principle. *Lynch* is

[28] 272 U.S. 451 (1926).
[29] 400 U.S. at 37. *See* Brady v. United States, 397 U.S. 742, 748 (1970).
[30] 400 U.S. at 37. See note 7 *supra*.
[31] FED. R. CRIM. P. 11. The term "factual basis" is ambiguous. It could possibly be held to mean that the factual situation is clear in the mind of the accused. However, the broader and more generally accepted definition is that it is the relationship between the acts and the law and the determination that the accused's conduct falls within the charge. *Compare* McCarthy v. United States, 394 U.S. 459, 467 (1969), *with* Griffin v. United States, 405 F.2d 1378, 1380 (D.C. Cir. 1968). See also Note, *Criminal Procedure—Requirements for Acceptance of Guilty Pleas*, 48 N.C.L. REV. 352 (1970).

qualified by the fact that the defendant did not want to rely on the defense of which the judge was aware, whereas Alford appeared to have been willing to assert any defense available. *Hudson* means simply that if a defendant is unwilling to admit guilt, but does not desire to contest the assertions of the state, he may be treated as though he is guilty.[32] Alford, too, was unwilling to admit guilt, but his contemporaneous statements indicate that he did, in fact, wish to contest the assertion of the state that he was guilty. It is difficult to accept the Court's conclusion that there is no difference between a plea which refuses to admit guilt and a plea that expressly denies guilt. If there were in fact no difference, there would have been no reason for the development of the plea of nolo contendere.[33]

Assuming that there is sufficient precedent to justify acceptance of a guilty plea accompanied by protestations of innocence, the question of the voluntariness of the guilty plea in *Alford* remains. Under the North Carolina statutory scheme as it existed at the time of the plea, Alford had a choice of going before a jury under what his counsel called "aggravated circumstances" and receiving what Alford considered a certain death penalty[34] or pleading guilty and facing a maximum penalty of life imprisonment.[35] The added influence of an apparent promise by the prosecutor that he would accept a plea to a lesser offense and the constant urgings by counsel combined to create an irresistible decision by Alford that if he did not plead guilty he would face certain death.[36]

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[32] It should be noted that the Court in *Hudson* did not consider whether a plea of nolo contendere would be accepted if accompanied by protestations of innocence. The same arguments that apply to not allowing a plea of guilty in those circumstances also apply to a plea of nolo contendere. Under the Federal Rules of Criminal Procedure the judge need not determine if there is a factual basis for a plea of nolo contendere. FED. R. CRIM. P. 11. However, North Carolina does require that the trial judge examine an accused and insure that he is aware of the consequences of his plea. State v. Payne, 263 N.C. 77, 138 S.E.2d 765 (1964).

[33] City of Burbank v. General Elec. Co., 329 F.2d 825, 835 (9th Cir. 1964) (dictum). For a discussion of the development of the plea of nolo contendere see Lenvin & Meyers, *Nolo Contendere: Its Nature and Implications*, 51 YALE L.J. 1255 (1942).

[34] The alleged killing took place after an argument over a white woman who was accompanying Alford at the time. Since both Alford and the decedent were Negroes, Alford's attorney advised him that a jury in the southern city where the incident took place could include prejudiced persons. Supplemental Brief for Appellee at 3, North Carolina v. Alford, 400 U.S. 25 (1970). See L. MAYERS, *supra* note 2, at 117.

[35] Ch. 616, [1953] N.C. SESS. L. 461, which allowed a plea of guilty to capital offenses, was repealed by ch. 117, [1969] N.C. SESS. L. 104.

[36] Alford did have considerable knowledge of the sentencing process based on his long criminal record, which included one conviction for murder, nine for armed robbery, and various other convictions. 400 U.S. at 29 n.4.

The Court did not specifically mention the apparent promise by the prosecutor. However, it did, through its language to the effect that Alford had a choice of alternatives, recognize that the agreement probably was made. Apparently the Court assumed that the widespread practice of plea-bargaining[37] is constitutional and was concerned merely with the extent of its application.[38] It is unquestionably sound policy that allows a person accused of a crime to plead guilty after rationally considering the alternatives available to him.[39] However, it is submitted that the Court should have considered all of the elements affecting this rationality in combination as an aggregate force instead of weighing each one separately. This mode of analysis would have provided a realistic appraisal of whether the accused's plea was in fact voluntary. The combination of a questionable statute, constant urgings of counsel, and a tempting offer of a lesser charge with the constant, unequivocal assertions of innocence should convince a court that a plea was not voluntarily rendered.

It is submitted that the *Alford* decision is due at least in part to the crowded-docket anxiety, the fear that the courts will be overwhelmed unless the instances in which the plea of guilty is allowed are increased. But the cure for the problem of the crowded docket is legislative and administrative reform, not an undermining of the very rights that the courts are designed to protect. The logical result of *Alford* is that in the future it will be virtually impossible for a defendant to show coercion. It will be of no avail to show that he was forced by statute to face a death penalty in order to receive a jury trial. It will do him no good to show that he did not want to plead guilty and that he protested his innocence from the outset. If an accused is told by his counsel that there is a possibility of a death sentence, that the situation is aggravated, and that the prosecutor is willing to accept a guilty plea to a lesser charge and he is compelled by this to plead guilty, he will have no recourse in the courts of the United States.

TIMOTHY J. SIMMONS

[37] See generally Comment, *Guilty Plea Bargaining: Compromises By Prosecutors to Secure Guilty Pleas*, 112 U. PA. L. REV. 865 (1964).

[38] For a thorough discussion of the major objections to plea bargaining and the alternatives available, see Comment, *The Unconstitutionality of Plea Bargaining*, 83 HARV. L. REV. 1387 (1970). A discussion of the broader ramifications of bargain justice appears in Newman, *Pleading Guilty for Considerations: A Study of Bargain Justice*, 46 J. CRIM. L.C. & P. 780, 790 (1956).

[39] Note, *Criminal Procedure—Requirements for Acceptance of Guilty Pleas*, 48 N.C.L. REV. 352, 359 (1970).

Evidence—Good Cause and the Attorney-Client Privilege in Shareholder's Suits

The applicability of the attorney-client privilege to corporations has long been taken for granted.[1] Surprisingly, however, few cases have expressly considered the merits of the availability of the privilege to corporations, and it was not until 1962 that the first major case[2] presenting the issue was decided. In *Garner v. Wolfinbarger*,[3] a shareholder's derivative suit, the Court of Appeals for the Fifth Circuit took advantage of the flexibility afforded by the paucity of weighty precedent and declined an automatic extension of the privilege—originally created for the protection of individuals—to the modern corporation.[4]

In *Garner*, several stockholders of First American Life Insurance Company of Alabama brought a class action against the corporation, various directors and controlling persons alleging violations of federal and state security laws and common law fraud.[5] The plaintiffs sought to recover the purchase price which they and others had paid for their stock in First American.[6] Schweitzer had served as attorney for the corporation in connection with the first issuance of First American stock, and later

[1] United States v. Louisville and Nashville R.R., 236 U.S. 318, 336 (1915); Schwimmer v. United States, 232 F.2d 855 (8th Cir. 1956), *cert. denied*, 352 U.S. 833 (1956); Belanger v. Alton Box Board Co., 180 F.2d 87, 93-94 (7th Cir. 1950); CAB v. Air Transp. Ass'n, 201 F. Supp. 318 (D.D.C. 1961).

[2] Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771 (N.D. Ill.), *rev'd*, 320 F.2d 314 (7th Cir. 1962), *cert. denied*, 375 U.S. 929 (1963). The lower court's decision denying absolutely the assertion of the privilege against the shareholders brought a flurry of criticism. See, *e.g.*, Note, 48 CORNELL L.Q. 551 (1963); Note, 51 GEO. L.J. 399 (1963); Note, 76 HARV. L. REV. 655 (1963); Note, 37 N.Y.U.L. REV. 955 (1962).

[3] 430 F.2d 1093 (5th Cir. 1970).

[4] There are two other interesting questions involved in this case not dealt with in this note: first, whether state law dealing with privilege is substantive for purposes of Erie R.R. v. Tompkins, 304 U.S. 64 (1938) (see Wright, *Procedural Reform: Its Limitations and Its Future*, 1 GA. L. REV. 563, 571-74 (1967); Comment, *California Law as to Scope of Attorney-Client Privilege Held Applicable In Federal Non-Diversity Proceedings.—Baird v. Koerner* (9th Cir. 1960), 49 CALIF. L. REV. 382 (1961)); and second, assuming that state law is applicable, should English common law control instead of state statutes dealing with attorney-client privilege (see Comment, *Attorney-Client Privilege in Shareholders' Suits*, 69 COLUM. L. REV. 309, 314 (1969)).

[5] 430 F.2d at 1095.

[6] The shareholders also claimed damages derivatively on behalf of the corporation, but the district court apparently made no distinction between the two types of action. 280 F. Supp. at 1018. Arguably, the capacity in which the shareholders sue is irrelevant to the issue of whether the privilege should be available.

had become its president. On deposition, Schweitzer was asked several questions concerning advice given by him to the corporation about various aspects of the issuance and sale of the stock and related matters.[7] All questions related to times at which Schweitzer acted as attorney, before he became an officer of the company, and before the suit was filed.[8] Both the corporation, through its counsel, and Schweitzer himself asserted that the attorney-client privilege barred him from revealing the communications between him and the corporation. The court of appeals vacated the district court's summary disallowance of the privilege claim and held that the attorney-client privilege is available to a corporate client—subject,

[7] The shareholders also sought discovery of several related documents, and the attorney-client privilege was claimed as to them. 430 F.2d at 1096. Assuming the attorney-client privilege were *not* made available to corporations, one possible area of confusion would involve distinguishing what is "work product" from what would have been privileged under the attorney-client rule. This distinction would gain a new significance since "work product" would be available only if the requirements of the *Hickman v. Taylor* rule were met, while other communications would be available without restriction. Hickman v. Taylor, 329 U.S. 495 (1947). Judge Campbell, in his decision in *Radiant Burners*, recognized a need to distinguish between "work product," which he felt was legitimately protected, and material subject to the attorney-client privilege. Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771, 776 (N.D. Ill. 1962).

In view of the fact that Schweitzer soon became president of First American, some question is presented as to whether he was acting in the capacity of business adviser rather than counsel. The privilege does not exist, for example, where the attorney was acting in capacity of corporate director. United States v. Vehicular Parking, Ltd., 52 F. Supp. 751, 753-54 (D. Del. 1943). The line is not easily drawn, particularly when, as often happens, the attorney performs duties in both capacities. Whether to approach the communication between the corporation and the lawyer as an individual communication or to determine if the preponderance of his duties is the giving of legal advice has been the choice confronting the courts in attempting to establish a rule for deciding in which capacity the attorney acts. United States v. United Shoe Mach. Corp., 89 F. Supp. 357 (D. Mass. 1950); Zenith Radio Corp. v. Radio Corp. of America, 121 F. Supp. 792 (D. Del. 1954); American Cyanamid Co. v. Hercules Powder Co., 211 F. Supp. 85 (D. Del. 1962). Approaching each communication individually and allowing the judge to decide, on the facts of each case, in which capacity the attorney was acting is to be preferred. See Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 952, 969 (1955); Annot., 98 A.L.R.2d 228, 247-53 (1964). The court in *Garner* did not deal with this issue, however, stating in the facts that all communications involved were made to Schweitzer in his capacity as counsel before he became a director.

[8] The fact that Schweitzer was serving as *house counsel* rather than an independent practitioner complicates the decision on capacity due to the routine assignment of both business and legal tasks to one in such a position. The court expressly refused to find this determinative, which is probably the better view. Georgia-Pacific Plywood Co. v. United States Plywood Corp., 18 F.R.D. 463 (S.D.N.Y. 1956). Not to allow this privilege would be to discriminate against the larger corporations, since they alone have the resources and work load necessary to retain house counsel.

however, to the right of the stockholders to show cause why it should not be invoked.

The attorney-client privilege as applied to *individuals*[9] is one of the most favored of all privileges. Although some commentators are taking a long, hard look at this privilege in its modern context,[10] it is generally felt that the impediment to fact finding is outweighed by the benefits of franker disclosure in the lawyer's office.[11] Nevertheless,

> the privilege remains an exception to the general duty to disclose. Its benefits are all indirect and speculative; its obstruction is plain and concrete. . . . It is worth preserving for the sake of a general policy but it is nonetheless an obstacle to the investigation of the truth. It ought to be strictly confined within the narrowest possible limits, consistent with the logic of its principle.[12]

It was with these considerations in mind that the court in *Garner* approached the attorney-client privilege. Previous decisions dealing with the availability of the privilege to corporations were concerned largely with various legalistic and somewhat conceptual arguments.[13] Thus it has been asserted that since the corporation is a legal entity, it should be able to claim the privilege; however, it has been argued in retort that since the corporation is a creature of the state, rather than an individual for whom the privilege was historically designed,[14] it must be given the privilege by statute. The attorney-client privilege has also been analogized to the privilege against self-incrimination,[15] which is denied to corporations

[9] One commonly used statement of the requirements for the attorney-client privilege is found in Professor Wigmore's treatise:

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

8 J. WIGMORE, EVIDENCE § 2292 (rev. ed. 1961) [hereinafter cited as WIGMORE].

[10] *See, e.g.*, C. MCCORMICK, EVIDENCE § 91, at 182 (1954). "If one were legislating for a new commonwealth, without history or customs, it would be hard to maintain that a privilege for lawyer-client communications would facilitate more than it would obstruct the administration of justice." *See also* Gardner, *A Re-Evaluation of the Attorney-Client Privilege*, 8 VILL. L. REV. 279 (1963). Radin, *Lawyer and Client*, 16 CALIF. L. REV. 487 (1928).

[11] C. MCCORMICK, EVIDENCE § 91, at 181 (1954).

[12] 8 WIGMORE § 2291, at 554, *cited* by the court in Garner. 430 F.2d at 1100.

[13] The most notable of these is Judge Campbell's decision in Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771 (N.D. Ill. 1962).

[14] *Id.* at 773.

[15] The bases of the attorney-client privilege and the privilege against self-incrimination are completely different. Briefly, while the former is to encourage

because of its personal nature.[16] A further example of the mechanistic, conceptual approach concerns the confidential nature of privileged communications. To be privileged, communications must have been made in confidence. The directors of a corporation, who usually are the agents claiming the privilege for it, often have business interests outside the corporation. Thus they are not likely to preserve the confidentiality of a communication if disclosure would benefit their outside interest. Therefore, it has been argued that since few communications are confidential, the privilege should be disallowed as to all.[17] Furthermore, it also has been asserted that when a *public* corporation is formed, confidentiality should be surrendered in favor of giving the stockholders access to communications relating to the management of the corporation.[18]

All these approaches, however, serve only as a peg upon which to hang a decision after the judge has balanced the circumstances involved. But as Judge Godbold said in *Garner*, "[c]onceptualistic phrases . . . are not useful tools of analysis."[19] And even though many of these ingenious arguments are indicative of the basic problems involved in an extension of the privilege, it would be preferable to deal straightforwardly with those problems. In *Garner* the conflicting policies are set forth, as are the particular circumstances to be appraised in striking a balance between a corporation's right to invoke the privilege and the stockholder's right to reach the information.

Certain policies historically set forth as justifications for granting the privilege to individuals readily lend themselves to application within the corporate setting. Due to the complexity of guiding the corporation through the growing maze of state and federal regulations, the corporation as directed by management is in need of legal counsel.[20] It is in the interest of all concerned that management be encouraged to seek counsel without

free disclosure between the attorney and client, the latter is a *personal right* granted by the constitution. Thus the analogy is quite imperfect. See Comment, *The Lawyer-Client Privilege: Its Application to Corporations, the Role of Ethics, and Its Possible Curtailment*, 65 NW. U.L. REV. 235, 241 (1961).

[16] United States v. White, 322 U.S. 694 (1944).

[17] Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771, 774 (N.D. Ill. 1962).

[18] *Id.* at 775.

[19] 430 F.2d at 1101.

[20] American Cyanamid Co. v. Hercules Powder Co., 211 F. Supp. 85, 88 n.12 (D. Del. 1962); A.B. Dick Co. v. Marr, 95 F. Supp. 83, 102 (S.D.N.Y. 1950); Comment, *Evidence: Federal Rules of Civil Procedure: Attorney-Client Privilege as Applied to Corporations: Radiant Burners, Inc. v. American Gas Ass'n*, 207 F. Supp. 771 (N.D. Ill. 1962); *Philadelphia v. Westinghouse Elec. Corp.*, 210 F. Supp. 483 (E.D. Pa. 1962), 48 CORNELL L.Q. 551, 564 (1963).

hesitation.[21] Therefore, the encouragement of freedom of disclosure, the main justification for the availability of the privilege to the individual, should also be the main justification when a corporation is involved.[21]

A second justification for the extention of the privilege is also related to the effectiveness of corporate operation. Management should be free to exercise their sound judgment without being harrassed by a few dissatisfied shareholders, who in bad faith seek to disrupt the smooth operations of the company at the expense of the other shareholders.[22] The cost of litigating or settling these "strike suits" is, of course, born by all the shareholders of the corporation. A strong public policy dictates that the dissident few should not be given an added incentive to initiate such actions by allowing them to discover what has been disclosed in confidence to counsel in an effort to manage the corporation more effectively. This consideration is not found in the situation involving an individual and lends strong support to those who advocate that the privilege be made available to corporations.

Nevertheless, the policy of allowing full discovery of essential facts weighs heavily against the granting of the privilege to corporations, perhaps even more so than in the individual attorney-client situation.[23] Management already has the ability to obscure much of what they do and yet remain within legitimate managerial practices.[24] Allowing this privilege gives the corporation an additional method to effectuate this zone of silence.[25] Although it is true that the mere presence of an attorney at a board meeting, for example, would never shield what transpired there,[26] the corporation nevertheless would have considerable leeway in which to conceal important information under the guise of privilege.

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[21] *See* text at note 11 *supra.*

[22] As the court in *Garner* said:

> Due regard must be paid to the interest of nonparty stockholders, which may be affected by impinging on the privilege, sometimes injuriously (though not necessarily so—in some situations shareholders who are not plaintiffs may benefit). The corporation is vulnerable to suit by shareholders whose interests or intention may be inconsistent with those of other shareholders, even others constituting a majority.

430 F.2d at 1101 n.17.

[23] See text at note 12 *supra.*

[24] By utilizing complicated organizational structures, vast number of agents, and advantageous accounting procedures, management can be very successful in hiding from the lay investor exactly what it is doing.

[25] *See* Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771, 774 (N.D. Ill. 1962), *quoting* Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953, 955-56 (1956).

[26] With regard to privileged written communications, see Radiant Burners, Inc. v. American Gas Ass'n, 320 F.2d 314, 324 (7th Cir. 1963).

A further consideration not present in the individual attorney-client privilege situation involves the special relationship of corporate management to the stockholders.[27] As Judge Godbold said in *Garner*, "it must be borne in mind that management does not manage for itself and that the beneficiaries of its action are the stockholders."[28] This fiduciary relationship has been the basis of attempts to apply the joint-client exception to the attorney-client privilege to corporations.[29] The basis for this exception is that parties jointly seeking legal advice have a common interest, and therefore do not intend the communication to be privileged in a suit by one against the other. It is arguable that this exception does not apply in the corporate situation because the identity of interest is missing. As the court in *Garner* recognized, the corporation and management may have interests adverse to the shareholders.[30]

The special duty that management owes to the shareholders has ramifications broader than its use merely as a basis for applying the joint-client exception. It is, in fact, the most compelling argument against making the privilege available to corporations. In view of management's general fiduciary capacity, perhaps it would be preferable as a matter of public policy to allow the decisions as well as the information upon which they were based to stand on their merits instead of permitting management to hide behind the attorney-client privilege.[31] This is particularly applicable in the *Garner* case since the communications with counsel dealt with what possibly was criminal activity. "To grant the corporate management plenary assurance of secrecy for opinions received is to encourage it to disregard with impunity the advice sought."[32]

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[27] *See* H. HENN, CORPORATIONS § 235 (2d ed. 1970).

[28] 430 F.2d at 1101.

[29] When "the same attorney acts for two parties having a common interest, and each party communicates with him [,] . . . . they are not privileged in a controversy between the two original parties." 8 WIGMORE § 2312.

[30] 430 F.2d at 1101. One problem resulting from this fiduciary relationship is that funds of the corporation are used to compensate counsel utilized by management. At first blush, it appears that the shareholders are bearing the burden of compensation, yet are denied access to the information thereby attained. This seemingly unjust result is easily understood by viewing these expenditures as necessary for the effective operation of the business. The alternative would be to force management to obtain private counsel, but that would be unduly burdensome and the cost would ultimately be borne by the shareholders in the form of increased salaries. See Comment, *The Attorney-Client Privilege in Shareholders' Suits*, 69 COLUM. L. REV. 309, 319 (1969).

[31] 430 F.2d at 1101.

[32] 430 F.2d at 1102. "It has been agreed from the beginning that the privilege can not avail to protect the client in concerting with the attorney a *crime* or other evil enterprise. This is for the logically sufficient reason that no such enterprise

In *Garner*, the court applied Professor Wigmore's test requiring a balancing of "injury" against "benefit derived"[33] to determine whether the privilege should be granted. Under that test a balance already delicate when the client is an individual is made even more so because of the danger of abuse[34] in the corporate setting and the special fiduciary role of corporate management.[35] The presence or absence of a single fact or circumstance may be crucial when the balancing test is used. On the other hand, a rigid rule either allowing or disallowing the privilege in the corporate situation would foreclose taking the crucial fact into consideration and might well lead to an inequitable result. Obviously this criticism is mollified to a certain extent by judicially imposed restrictions on the application of an absolute rule.[36] But even with these restrictions, neither absolute rule has the flexibility necessary to deal effectively with this delicate balance. It is here—as well as in the refusal to base the privilege

falls within the just scope of the relation between legal adviser and client." 8 WIGMORE § 2298, at 572. The shareholders' complaint alleged that the First American Prospectus—carrying Schweitzer's name, and about which Schweitzer had been consulted—failed to disclose the price actually paid by one of First American's directors for shares of stock and take-out agreements guaranteeing certain directors a profit. Reply Brief For Appellants-Petitioners and Cross-Appellees at 6, Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970). Arguably then, the court could have found that the privilege was not applicable because Schweitzer was consulted as to illegal acts or fraud. Instead, the court used this merely as one factor to be considered in deciding whether the privilege should apply.

[33] The court cited Wigmore's four requirements for the establishment of any privilege:

> (1) The communications must originate in a *confidence* that will not be disclosed. (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relationship between the parties. (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*. (4) The injury that would inure to the relation by the disclosure of the communications must be be *greater than the benefit* thereby gained for the correct disposal of litigation.

As applied to the attorney-client privilege, "all four conditions [were] present, with the only condition open to any dispute being the fourth." 430 F.2d at 1100, *citing* 8 WIGMORE § 2285, at 527-28.

[34] *See* text at note 25 *supra*.

[35] *See* text at note 28 *supra*.

[36] *E.g.*, Radiant Burners, Inc. v. American Gas Ass'n, 207 F. Supp. 771, 775-76 (N.D. Ill. 1962) ("trade secrets" as well as "work product" should be privileged); United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 360 (D. Mass. 1950) (strict confidentiality requirement); Philadelphia v. Westinghouse Elec. Corp., 210 F. Supp. 483 (E.D. Pa. 1962) (only those in a control position may claim the privilege for the corporation); Grant v. United States, 227 U.S. 74, 79 (1913) (regular business documents not privileged); *see* Zenith Radio Corp. v. Radio Corp. of America, 121 F. Supp. 792 (D. Del. 1954); see Comment, *The Lawyer-Client Privilege: Its Application to Corporations, The Role of Ethics, and Its Possible Curtailment*, 56 NW. U.L. REV. 235, 241-44 (1961).

on a conceptual, mechanistic argument—that the court in *Garner* strikes out on a new approach.[37]

> [W]here the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.[38]

That the attorney-client privilege in the corporate setting is still viable is expressly accepted by the court. Furthermore, the court rejected the argument that the fiduciary relationship is in itself a sufficient basis for denial.[39] More is needed, and it is expressed in terms of "good cause."

It is the utilization of "good cause" that gives the *Garner* decision its flexibility. The decision sets out several largely self-explanatory factors necessary for "good cause."[40] The general import behind the major category is the prevention of the "strike suit." If many shareholders are involved in a suit, and a large percentage of stock is represented, it is unlikely that the suit is for nuisance value only. The nature of the claim of the shareholders is also relevant. If the claim is obviously colorable, a court will be less likely to refuse the privilege than if fraud or criminal conduct is involved. In the latter situation public policy would also dictate that the privilege not be granted. Furthermore, the burden should be on the shareholder to show that the information is necessary and its availability from other sources is limited. One of the main justifications for granting the attorney-client privilege is that only the attorney is silenced; the client is still available for questioning on all matters other than the communication itself.[41] However, in *Garner*, for example, several of the people involved in the alleged wrong-doing exercised their privilege against

[37] The court does try to deemphasize the originality of its approach by comparing it to the approach prescribed for inspection of corporate records by stockholders. 430 F.2d at 1104 n.21. The main reason for requiring good cause in record inspection is to prevent nuisance and harassment; this reason is also involved in the privilege situation, but the main justification for the attorney-client privilege is the promotion of freedom of disclosure. Thus allowing good cause to be shown to prevent the invocation of the attorney-client privilege goes further than requiring a showing of good cause in record inspection and is a new approach.

[38] 430 F.2d at 1103-04.

[39] 430 F.2d at 1103.

[40] 430 F.2d at 1104.

[41] Usually, the allowance of the attorney-client privilege would cause a relatively small loss of relevant information, since the party claiming the privilege could be called under oath and freely interrogated. Assuming that the claiming party will not perjure himself, very little could be added by questioning the attorney as to what was said. See 8 WIGMORE § 2291, at 554.

self-incrimination, and were unavailable as sources of information.[42] The final factor in this category deals with whether the information is identifiable and not just the object of a fishing expedition.

The second and third categories concern the protection of an attorney's "work product" and communications with respect to trade secrets. "Work product" is protected by the decision in *Hickman v. Taylor*,[43] and trade secrets by the trial judge's use of discretion; nevertheless, the court in *Garner* makes it abundantly clear that its decision does not infringe upon these areas. Therefore, communication and advice concerning the litigation itself will not be made available even if the privilege is held not to apply. The court in *Garner* suggests the use of *in camera* inspection to facilitate the examination of the above factors in order to prevent harm to the interests of the corporation.

As in the application of any flexible rule, the court involved will be called upon to make a case-by-case application. It has been argued that to require a court to make this judgment would place an additional burden on our already overburdened court system,[44] whereas an absolute rule could be easily administered. However, an absolute rule—disallowing the privilege, for example—could lead to even more of a burden, since it might encourage stockholders' suits motivated solely by curiosity. It could also be argued persuasively that a flexible rule would lead to erratic decisions.[45] Nevertheless, the benefit of having a flexible rule arguably outweighs this potential harm. Finally there is the question of whether management's knowledge that communications made to counsel may later

[42] Reply Brief for Appellants-Petitioners and Cross-Appellees at 9, Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).

[43] 329 U.S. 495 (1947). The court noted that documents in the possession of the attorney can be beyond the reach of the opposing party either because of the invocation of the attorney-client privilege or because it is a product of the attorney's preparation for the litigation. *Id.* at 508-10. The latter is protected for reasons wholly different from the policies behind the attorney-client privilege. "Work product" can be obtained by the showing of the good cause, but privileged documents were formerly unobtainable regardless of good cause. Comment, *The Attorney-Client Privilege in Shareholders' Suits*, 69 COLUM. L. REV. 309, 315 n.29 (1969). The decision in *Garner* could well be read to put privilege and "work product" on an equal footing.

[44] Petitioner's Brief for Certiorari at 10, Garner v. Wolfinbarger, — U.S.L.W. — (U.S. 1971).

[45] FED. R. CIV. P. 34 was amended in 1970 to exclude the requirement of good cause for the production of documents. When the deletion was originally proposed, one of the reasons given was to elimnate uncertain and erratic protection to the parties from whom production was sought. Advisory Committee on the Federal Rules of Civil Procedure, Proposed Amendments to The Federal Rules of Civil Procedure Relating to Discovery, 48 F.R.D. 487, 526 (1969) (Advisory Committee's Note).

be divulged will curtail freedom of consultation with legal advisers.[46] The *Garner* decision should have limited impact, since the privilege would be denied only when a corporation is involved in a suit with its shareholders and the shareholders can show "good cause" why it should not be extended. Since the need for counsel is still eminent, full disclosure by honest management should not be affected.

MICHAEL D. MEEKER

Federal Estate Taxation—The State Street Trust Doctrine, 1959-1970: R.I.P.

In March, 1970, the Court of Appeals for the First Circuit buried one of the most vexatious concepts in the field of estate taxation. The court, in *Old Colony Trust Co. v. United States*,[1] specifically overruled *State Street Trust Co. v. United States*[2] by holding that "no aggregation of purely administrative powers"[3] would cause the corpus of a trust to be included in the settlor's estate under sections 2036(a)(2) and 2038 of the Internal Revenue Code of 1954.[4] In *State Street* the court held that when a decedent-settlor had retained as trustee broad powers of administration which permitted him to exchange trust property without reference to value, to invest in securities yielding either high income or no income at all (specifically including wasting investments) and to allocate assets to income or principal in all cases (whether state law as to proper alloca-

[46] *See* Comment, *The Lawyer-Client Privilege: Its Application to Corporations, The Role of Ethics, and Its Possible Curtailment*, 56 NW. U.L. REV. 235, 256-59 (1961).

[1] 423 F.2d 601 (1st Cir. 1970).
[2] 263 F.2d 635 (1st Cir. 1959).
[3] 423 F.2d at 603.
[4] INT. REV. CODE of 1954, §§ 2036(a)(2), 2038. Section 2036 of the Code includes in a decedent's estate property transferred to another in which the decedent retained a life estate. Specifically included is property with respect to which the decedent retained "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." This section is only applicable to transfers made after March 3, 1931. Section 2036 includes the total amount of the property transferred. Section 2038 includes within a decedent's estate transferred property subject to the power of the decedent to "alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death." It makes no difference under section 2038 whether the decedent ever owned the property subject to the power; it is only necessary that the decedent had the power on the date of his death or had transferred it in contemplation of his death. Both sections 2036(a)(2) and 2038 include property even if the power is exercisable only in a fiduciary capacity. Treas. Reg. §§ 20.2036-1(b)(3), 20.2038(a) (1958).

tion was in doubt or not), then the settlor-trustee had retained the right to "designate the persons who shall possess or enjoy the property or the income therefrom" under section 2036(a)(2) and the power "to alter, amend, revoke, or terminate" under section 2038.[5]

The *State Street* trust was administered under the laws of Massachusetts subject to the supervision of the state courts of equity. The first circuit felt that although these state courts would intervene should the trustee act in utter disregard of a beneficiary by putting "all, or nearly all, of the trust assets in wasting investments [or] in a property yielding little or even no income,"[6] nonetheless, a trustee who possessed broad management powers could substantially shift the benefits of such a trust between the life tenants and remaindermen.[7] The decision was grounded in the idea that the state courts had no ascertainable standard by which to enforce the rights of beneficiaries with adverse interests.[8] The effect of this holding was to throw considerable doubt on the tax consequences of irrevocable inter vivos trusts incorporating wide administrative powers.[9]

Sound drafting practices until *State Street* had called for broad discretionary powers in the trustees to prevent the trust from being crippled by delay and expense of frequent court approval.[10] It was not surprising therefore that, at the next opportunity, the Massachusetts Supreme Judicial Court launched an attack on the decision and began to demonstrate the degree of supervision that the state courts would impose over fiduciaries. The newly militant posture was evident in *Boston Safe Deposit & Trust Co. v. Stone*,[11] which involved the power of the trustees to determine reasonably the value of assets for distribution.[12] The supreme court, in finding that the trustees had valued the assets reasonably, pointed out that " 'a court of equity may control a trustee in the exercise of a fiduciary discretion if it acts beyond the bounds of a reasonable judgment or unreasonably disregards usual fiduciary principles, or the purposes of the trust, or

[5] 263 F.2d at 637-39. Both sections 2036 and 2038 are applicable regardless of whether the settlor-trustee holds the power alone or with another as long as the cotrustees do not have substantial adverse interests. It is necessary that the settlor hold the power in a fiducial capacity either as trustee or by implication from the trust instrument.

[6] *Id.* at 638-39.

[7] *Id.*

[8] *Id.* at 639.

[9] See Barrett, *The Marital Deduction*, 50 MASS. L.Q. 18 (1965).

[10] *See generally* Note, 45 IOWA L. REV. 426 (1960).

[11] 348 Mass. 345, 203 N.E.2d 547 (1965).

[12] The facts found by the lower court indicate that this was a clear case of reasonable and impartial determination of value.

if it fails to observe standards of judgment apparent from the applicable instrument.' "[13] The court pointedly asserted that it disagreed with the suggestion to the contrary by the majority in *State Street.*[14]

The Massachusetts court made an even more telling attack in *Old Colony Trust Co. v. Silliman.*[15] The trust in this case was set up to benefit an intervening life estate with a charitable remainderman and included the power of the trustee to decide whether to treat accretions and expenses as income or principal. The court held that the power to allocate accretions as disbursements between income and principal would defeat the intent of the trust if the trustee could substitute his uncontrolled discretion for the established rules and, as in *Boston Safe,* Massachusetts courts would hold a fiduciary to "reasonable regard of usual fiduciary principles" when applying discretionary powers.[16] "Reasonable regard" was interpreted to mean that established rules would be applied.[17] *Boston Safe* and *Silliman* both cited with specific approval Judge McGruder's dissent in *State Street* and substantially clarified the degree of supervision that Massachusetts courts would exercise over fiduciaries.[18]

The United States Tax Court, which at the time of *State Street* was not obligated to consider the holdings of other federal courts,[19] supported the position of the Massachusetts court in two significant decisions.

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[13] 348 Mass. at 351, 203 N.E.2d at 552.

[14] As Chief Judge Magruder indicated . . . in his dissent [in *State Street*] . . . . a Massachusetts Court of Equity will 'supervise the administration of . . . trusts so as to control any attempt to shift the incidence of their enjoyment.' Even broadly expressed administrative and management powers . . . 'are limited by standards which the Massachusetts court of equity could and would apply to supervise effectively . . . [proper trust] administration.' We disagree with any suggestion to the contrary . . . in the majority opinion in that case . . . .

Id. at 351 n.8, 203 N.E.2d at 552 n.8.

[15] 352 Mass. 6, 223 N.E.2d 504 (1967).

[16] *Id.* at 10, 223 N.E.2d at 507.

[17] *Id.*

[18] *See also* Briggs v. Crowley, 352 Mass. 194, 224 N.E.2d 417 (1967) (trust provisions purporting to relieve trustees from duty of accounting except to donor ineffective as against public policy to deprive beneficiary standing to compel accounting); Holyoke Nat'l Bank v. Wilson, 350 Mass. 223, 214 N.E.2d 42 (1966) (trustees are required to exercise power to invade corpus for beneficiary's comfort, maintenance, and support with proper regard to accepted fiduciary principles); Copp v. Worcester Co. Nat'l Bank, 347 Mass. 548, 199 N.E.2d 200 (1964) (discretionary power of the trustee to invade corpus of trust to the extent of five hundred dollars for the proper maintenance of the settlor's wife had to be exercised in accordance with fiduciary standards).

[19] The Tax Reform Act of 1969 changed the United States Tax Court from an administrative agency to a court deriving its powers from article I of the Constitution. Tax Reform Act of 1969, 26 U.S.C. § 7441 (Supp. V, 1965-69).

Estate of Edward E. Ford[20] involved in inter vivos trust administered under the laws of New York. The settlor had named himself sole trustee and had retained the power to invade the corpus "for the purpose of defraying expenses occasioned by illness, infirmity or disability, either mental or physical, or for his support, maintenance, education, welfare and happiness."[21] He also had retained the administrative powers to allocate receipts, losses, and expenses to either income or principal and to invest in such classes of property as the trustee might in his discretion select. The classes of property specifically included investments not normally considered appropriate for trusts.[22] The court held as to the invasion power, that although "happiness" does not normally provide an ascertainable standard, in this case the power was circumscribed by the requirement that the beneficiary be in "need" of funds. This requirement so limited the definition of "happiness" that a New York court of equity would be able to find the requisite external standard to enforce the beneficiaries' rights.[23] The court rationalized the administrative powers as being "commonly included in trust instruments," noting that abuse of discretion "would be subject to equity court of review."[24] Further, the majority specifically found that since each of these powers was subject to supervision by the equity court, the *State Street* rule that the powers, when viewed in the aggregate, would require inclusion under sections 2036 and 2038, did not apply.[25]

Ford was decided by a split court with five judges dissenting, but in the following year a united court decided the case of *Estate of Phyllis W. McGillicuddy*[26] on similar grounds. This case involved the validity of a charitable deduction from the taxable estate. The Commissioner's position was that the trustee's powers were so broad that he could shift the beneficial interests between the income beneficiary and the charitable remainderman, thus rendering the value of the remainder interest unascertainable.[27] The powers involved were the trustee's right to invest in regulated securities companies and to determine all questions of income or principal. The latter power was not restricted to those areas of the law

[20] 53 T.C. 114 (1969).
[21] *Id.* at 121.
[22] *Id.* at 128.
[23] *Id.* at 126-27.
[24] *Id.* at 127-28.
[25] *Id.* at 127-29.
[26] 54 T.C. 315 (1970). This trust was also administered under the laws of Massachusetts.
[27] *Id.* at 320-21.

in doubt.[28] The court simply relied on the statement of Massachusetts law contained in *Silliman*[29] that the power to allocate accretions and expenses between income and principal was primarily a management power allowing the trustee to use good faith in instances of doubt and that the granting of such power would not authorize the favoring of either the life beneficiary or the remainderman.[30]

The principal case, *Old Colony Trust Co. v. United States*,[31] involved an inter vivos trust administered under the laws of Massachusetts for the benefit of the son of the settlor-trustee. The settlor had retained the power to decrease payments of income to the beneficiary when "the stoppage of such payments is for his [the beneficiary's] best interests."[32] The trustee also had broad administrative powers including the power to make investments not normally considered safe for trustees, and to "determine, what was to be charged or credited to income or principal."[33] Here again the government sought to include the entire corpus of the trust in the decedent's taxable estate on the basis that both the power of distribution and of management gave the settlor-trustee the right to designate who should enjoy the property under section 2036(a)(2).[34] Turning first to the management powers, the first circuit made short work of the government's argument. Citing the chain of cases discussed above, the court came to the conclusion that *State Street* was wrong in concluding that even though each individual power would be subject to control by a Massachusetts probate court, the aggregate of the powers gave the trustees such control over the corpus as to be equated with substantial ownership.[35] The mere existence of purely administrative powers was deemed insufficient in itself to work an inclusion under either section 2036(a)(2) or 2038(a)(1) for trusts administered in Massachusetts.

The inquiry into the power over distribution centered on a search for an ascertainable standard in the body of the trust instrument.[36] Words authorizing distribution as needed to maintain the beneficiary's way of life would have provided such a standard.[37] However, the authorization

[28] *Id.* at 318-19.
[29] See p. 813 *supra*.
[30] 54 T.C. at 323.
[31] 423 F.2d 601 (1970).
[32] *Id.* at 602.
[33] *Id.*
[34] *Id.*
[35] *Id.* at 603.
[36] *Id.* at 603-04.
[37] *Id.* at 604.

to withhold payments when in the "best interests" of the settlor's son was clearly an unascertainable standard; this result was reinforced by the parent-child relationship between the trustee and beneficiary.[38] Although the absence of "best interests" criteria resulted in the taxpayer losing his case, he did nonetheless establish an important change in existing tax law.

The undeniable effect of *Old Colony* is to prevent the corpus of a trust from being included in a decedent-trustee's estate under sections 2036(a)(2) and 2038(1)(b) solely because of broad discretionary administrative powers. But since the decision was based on the degree of supervision over fiduciaries by Massachusetts courts, the government's position is not entirely vitiated as to other jurisdictions. It is appropriate therefore to consider the probable result of such an argument in light of the supervision provided by North Carolina courts.

Unfortunately, it is not clear that North Carolina courts of equity will exercise their jurisdiction to control the discretionary powers of trustees under circumstances that would prevent a *State Street* inclusion. When the powers are restricted by a court, the two most commonly employed means are by finding an abuse of discretion[39] and by finding protection for remaindermen and/or beneficiaries in interpretation of the settlor's intent.[40] The scope of control exercised by courts with respect to abuse of discretion depends upon judicial definition of terms such as "improper motive" and "reasonable judgment." Interpretation of intent often does not give such leeway, however, since in many cases the plain wording of the instrument makes clear the settlor's intent to provide unbridled discretion in the trustee in administration of the trust.[41] In any event, the

[38] *Id.* The parent-child relationship between the trustee-settlor and the beneficiary makes the "best interests" requirement even more vague since each parent has his own opinion as to what is in the best interest of a child.

[39] The courts find abuse of discretion of the trustee "if he acts dishonestly, or if he acts with improper even though not dishonest motive, or if he fails to use his judgment, or if he acts beyond the bounds of reasonable judgment." Woodward v. Mordecai, 234 N.C. 463, 471, 67 S.E.2d 639, 644 (1951); RESTATEMENT OF TRUSTS § 187 (1935); 65 C.J. *Trusts* § 539 (1933).

[40] Little v. Wachovia Bank & Trust Co., 252 N.C. 229, 113 S.E.2d 689 (1960); Carter v. Kempton, 233 N.C. 1, 62 S.E.2d 713 (1950); Hester v. Hester, 16 N.C. 328 (1829).

[41] *See, e.g.*, State Street Trust Co. v. United States, 263 F.2d 635 (1st Cir. 1959). In order to find an intent that is contrary to the plain words of the instrument, the court would have to find ambiguity in the mere existence of classes of beneficiaries with adverse interests. It is entirely possible for the court to conclude that the scope actually intended by the settlor was uncontrolled discretion and then the question is clearly put as to where the external standard of control is that will provide guidance to both trustee and the courts.

key is an external standard of control that will prevent the corpus from being included in the decedent-settlor's taxable estate.

The North Carolina Supreme Court in *Lichtenfels v. North Carolina National Bank*[42] determined that where the trustee had broad investment powers, including specifically the power not to diversify, the court would not surcharge the trustee for failure to diversify. The court stated that "the directives of a Will are honored and given effect unless some overriding and compelling reason requires deviation."[43] The court on several occasions has expressed a willingness to intervene in the management of a trust but these have been, by and large, cases of gross abuse of discretion amounting to bad faith or fraud.[44] There are no cases dealing squarely with court supervision of powers as broad as those granted in *State Street* or as would be available if the trust incorporated the statutory powers of the North Carolina Powers of Fiduciaries Act.[45] In short there does not appear to be a judicially enforced external standard other than one for gross abuse of discretion.

Nonetheless, the supreme court on occasion has expressed an attitude towards discretionary powers that is strongly reminiscent of the language used by the Massachusetts Court in *Silliman*.[46] An excellent example, *Campbell v. Jordan*,[47] dealt with the discretionary power to distribute trust principal. This case held that where the trustee has the power to distribute to lifetime beneficiaries limited by the requirement that the distribution be "necessary and best" for the beneficiary and consistent with the welfare of the trust estate and the testator's family, the trustee could not distribute un-

[42] 268 N.C. 467, 151 S.E.2d 78 (1966).

[43] *Id.* at 479, 151 S.E.2d at 85.

[44] Kuykendall v. Proctor, 270 N.C. 510, 155 S.E.2d 293 (1967) (trustee was the guardian of the incompetent life beneficiary and was also the remainderman under the terms of the trust); Erickson v. Starling, 233 N.C. 539, 64 S.E.2d 832 (1951) (self-dealing for profit on part of trustee); Lightner v. Boone, 222 N.C. 205, 22 S.E.2d 426 (1942) (trustee accused of using trust funds to speculate in his own name).

[45] N.C. GEN. STAT. §§ 32-25 to -27 (1966 & Supp. 1969). This statute includes a variety of specific powers but the following are those commonly considered to have adverse estate tax consequences: the power to sell and exchange property [§ 32-27(2)], to invest [§ 32-27(3)], and to allocate receipts and expenses between income and principal [§ 32-27(29)]. For these adverse consequences to occur the trust must, of course, be inter vivos with the settlor retaining the condemned powers to himself personally or as a fiduciary. If there is a possibility that the settlor may become a trustee, the powers may also result in adverse consequences. Treas. Reg. § 20.2036-1(b)(3).

[46] See p. 813 *supra*.

[47] 274 N.C. 233, 162 S.E.2d 545 (1968).

less the beneficiary could show that these conditions were met.[48] After holding the trustee's powers so limited on these facts, the opinion cited a Maine case[49] defining discretion "as deliberate judgment,—the discernment of what is right and proper. It implies soundness of judgment—judgment directed by circumspection." The court in *Campbell* then quoted the Restatement of the Law of Trusts for the proposition that where a trust is created for sucessive beneficiaries, the trustees must act with due regard for their interests.[50] *Kemp v. Paterson*,[51] a New York case which restricted the power of the trustee to invade the corpus for the best interests of the beneficiary, also found favor with the North Carolina court. The *Kemp* decision held that best interest of the beneficiary meant " 'best interests' . . . within the framework of the status bestowed upon her by the settlor, the status of a life beneficiary, not of a recipient of the entire trust res."[52] Such language, if applied to broad administrative powers, would probably be sufficient to remove them from tax liability even under *State Street.* This position is anything but certain, however, since the language in *Campbell* is only dicta.

The first circuit in *State Street*, whether by design or not, was recognizing that a trustee with broad management powers is in fact able to shift the benefits of a trust between life beneficiaries and remaindermen. These shifts can be significant to parties with adverse interests even if not for tax purposes. Yet the trend today continues toward broad trustee discretion in the interest of sound estate management[53] despite the possibility, or even probability, of a corresponding loss of fiduciary responsibility and loyalty.[54] The holding in *Old Colony* presents an opportunity to the North

[48] *Id.* at 241; 162 S.E.2d at 551.

[49] *In re* Murray, 142 Me. 24, 30, 45 A.2d 636, 638 (1946). The power involved in this case was the power to invade for the comfortable support and maintenance of the life beneficiary. The court held that the trustee's discretion was not absolute and that he must act with due regard to the interests of successive beneficiaries.

[50] 274 N.C. at 242, 162 S.E.2d at 551.

[51] 4 App. Div. 2d 153, 163 N.Y.S.2d 245, *aff'd*, 6 N.Y.2d 40, 159 N.E.2d 661, 188 N.Y.S.2d 161 (1959).

[52] *Id.* at —, 163 N.Y.S.2d at 248. "Best interests" in this case amounted to terminating the trust to avoid a fifty-six per cent British estate tax. It was clear that the trustees were acting honestly and in good faith. The remaindermen were the children of the life beneficiary. This case represents protection with a vengeance of remainder interests from trustee discretion. As a practical matter, the infant remaindermen would have benefited by the termination of the trust.

[53] Fratcher, *Trustees' Powers Legislation*, 37 N.Y.U.L. REV. 627 (1962); Horowitz, *Uniform Trustees' Powers Act*, 41 WASH. L. REV. 1 (1966).

[54] Note, *Trusts—The North Carolina Fiduciary Powers Act and the Duty of Loyalty*, 45 N.C.L. REV. 1141 (1967).

Carolina General Assembly to achieve the dual objective of insuring that trustees maintain a high standard of responsibility and at the same time assist North Carolina taxpayers in contests with the government.

The General Assembly has demonstrated its awareness of the possible tax consequences to the settlor who incorporates all of the powers in North Carolina General Statutes section 32-27. But the admonition that "[n]o power . . . shall be exercised by such fiduciary in such a manner as, in the aggregate, to deprive the trust or the estate . . . of [a] tax exemption, deduction or credit . . . ,"[55] is probably totally ineffective as a tax avoidance device because it not only provides no standard by which the trustee may govern his conduct but also provides no standard by which the courts may supervise a fiduciary's management of a trust.

Any statute that would limit the discretionary powers of a trustee to compliance with usual or common law fiduciary principles or which would impose active supervision of trusts by the courts is bound to negate part of the freedom that many estate planners seek in setting up trusts with broad management powers. Yet when one considers the need for continued fiduciary responsibility and the added incentive of protection from tax liability, the price may not be high at all.

MIKE CRUMP

Federal Jurisdiction—The Property Rights Exception to Civil Rights Jurisdiction Under Section 1343(3)

Section 1343 of Title 28 of the United States Code vests the federal district courts with

> original jurisdiction of any civil action authorized by law to be commenced by any person:
>
> . . . .
>
> (3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any right, privilege or immunity secured by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States . . . .[1]

Section 1343(3), available regardless of the amount in controversy, is important to potential litigants who desire a federal forum for the

[55] N.C. GEN. STAT. § 32-26(b) (1966).

[1] 28 U.S.C. § 1343 (1964).

resolution of constitutional issues but are unable to meet the threshold jurisdictional amount requirement of the general federal question jurisdictional grant.[2] The most problematical aspect of section 1343(3) is the restriction, spawned by Justice Stone in *Hague v. CIO*,[3] excluding suits to redress deprivations of "property rights."[4] That restriction, not found in the language of the statute, has plagued the federal courts since its inception in 1939;[5] has driven some courts to great lengths to avoid dealing with the issue;[6] and has led to directly contradictory results.[7] This note examines the origin and development of the "property rights" exception.

Although originating in the Civil Rights Act of April 20, 1871,[8] section 1343(3) was first subjected to meaningful scrutiny by the Supreme Court in *Hague*, in which jurisdiction was sustained under that statute in an action brought to enjoin interference by city officials with dis-

[2] The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000 exclusive of interest or costs, and arises under the Constitution, laws or treaties of the United States.

28 U.S.C. § 1331(a) (1964). Section 1331(a) is derived from the Act of March 3, 1875, ch. 137, § 1, 18 Stat. 470. For a general discussion of the Act of 1875, see Aycock, *Introduction to Certain Members of the Federal Question Family*, 49 N.C.L. REV. 1, 23 (1970).

[3] 307 U.S. 496 (1939).

[4] *See* p. 821-22 *infra*.

[5] In Eisen v. Eastman, 421 F.2d 560 (2d Cir. 1969), after reviewing the cases in the area, Judge Friendly remarked: "We must confess we are not altogether clear just where this leaves us." *Id.* at 565.

[6] *E.g.*, in Hall v. Garson, 430 F.2d 430 (5th Cir. 1970), the court characterized a landlord's lien statute as authorizing unreasonable invasions of the human right of privacy in order to avoid the "property rights" jurisdictional issue, while never mentioning the privacy consideration in the discussion of the merits of the constitutional attack on the statute.

[7] *Compare, e.g.*, Euge v. Trantina, 422 F.2d 1070 (8th Cir. 1970), *with* Blume v. City of Deland, 358 F.2d 698 (5th Cir. 1966).

[8] Act of April 20, 1871, ch. 22, § 1, 17 Stat. 13. The substantive provision of this Act is now found in 42 U.S.C. § 1983 (1964). For a general discussion of section 1983, see Note, *The Civil Rights Act of 1871: Continuing Vitality*, 40 NOTRE DAME LAW. 70 (1964).

Most courts agree that section 1343(3) is the jurisdictional companion of section 1983. and that the two sections are coextensive, at least in the sense that section 1343(3) will afford jurisdiction for any suit brought under section 1983. *See, e.g.*, AFL v. Watson, 327 U.S. 582, 590 (1946) (dictum); National Land & Inv. Co. v. Specter, 428 F.2d 91, 93-100 (3d Cir. 1970). If sections 1343(3) and 1983 are coextensive, any restriction on section 1343(3) would also be a restriction on the substantive section 1983. But see McCall v. Shapiro, 416 F.2d 246, 250 (2d Cir. 1969), indicating that section 1343(3) may be narrower than section 1983. See also Rosado v. Wyman, 397 U.S. 397, 403 (1970), and Hall v. Garson, 430 F.2d 430, 438 (5th Cir. 1970), which indicate that 28 U.S.C. § 1343(4) (1964) affords jurisdiction for suits under section 1983.

semination of literature concerning, and assembly for discussion of, the National Labor Relations Act.[9] In his concurring opinion,[10] Justice Stone viewed the jurisdictional issue as requiring definition of the extent of the overlap[11] between the 1871 Act and the Act of 1875,[12] which had extended general federal question jurisdiction to the lower federal courts. Justice Stone reasoned that neither statute should be taken as abrogating the other, and in his attempt to harmonize them he initially stated that this was best done by construing section 1343(3) to confer "federal jurisdiction of suits brought under the Act of 1871 in which the *right asserted is inherently incapable of pecuniary valuation.*"[13] Precedent supporting this distinction was found by comparing *Holt v. Indiana Manufacturing Co.*,[14] in which the Court had denied jurisdiction under section 1343(3) in a suit to enjoin taxation of patent rights, with *Truax v. Raich*,[15] in which the Court had sustained section 1343(3) jurisdiction in an action brought by an alien employee to enjoin enforcement against his employer of a statute prohibiting employment of work forces comprised of more than twenty per cent aliens.[16] Had Justice Stone concluded his opinion without more, one might logically have thought that the crucial aspect of *Truax* was the discrimination against aliens. But Justice Stone proceeded to approve *Crane v. Johnson*,[17] in which the Court sustained section 1343(3) jurisdiction in a suit brought by a doctor, who healed by mental suggestion, to enjoin enforcement of a statute requiring examination for licensing. The statute was alleged to deny equal protection by exempting certain practitioners who used prayer to heal. At this

[9] 307 U.S. at 501-04.

[10] Unfortunately, there was no opinion of the Court on the jurisdictional issue, or on the merits, for that matter. Justice Roberts, with whom Justice Black concurred, thought that section 1343(3) originated in the Civil Rights Act of April 9, 1866, ch. 31, 14 Stat. 27, and that it afforded jurisdiction in suits by United States citizens to redress deprivations of their rights, privileges, and immunities as such. Finding a claim set out under the privileges and immunities clause of the fourteenth amendment, Justice Roberts had little difficulty sustaining jurisdiction. 307 U.S. at 508 & n.10, 512. The dissenters did not discuss jurisdiction. *Id.* at 532-33.

[11] 307 U.S. at 529-30. Justice Stone noted that the language of the Act of 1871 extended broadly to secure to all persons—whether citizens or not—any right, privilege, or immunity secured by the Constitution, and rejected the argument that the term "secured" in section 1343(3) means created rather than protected. *Id.* at 519, 525-27.

[12] *See* note 2 *supra.*

[13] 307 U.S. at 530 (emphasis added).

[14] 176 U.S. 68 (1900).

[15] 239 U.S. 33 (1915).

[16] 307 U.S. at 530-31.

[17] 242 U.S. 339 (1917).

point one might have concluded that to Justice Stone the common denominator in *Crane* and *Truax* was the right to work, which, surprisingly, was viewed as being incapable of pecuniary valuation. However, after citing *Crane* with approval Justice Stone shifted the emphasis from the ability to assign a monetary value to the right to the personal nature of that right; he thought it important to note that in both *Crane* and *Truax* the right asserted was one of "personal freedom" arising under the equal protection clause, and that "in both the gist of the cause of action was not damage or injury to property, but unconstitutional infringement of a right of personal liberty not susceptible of valuation in money."[18] The shift was completed when Justice Stone ended his opinion with the assertion that

> [t]he conclusion seems inescapable that the right conferred by the Act of 1871 to maintain a *suit in equity in the federal courts* to protect the suitor against a deprivation of rights or immunities secured by the Constitution, has been preserved, and that whenever the right or immunity is one of *personal liberty, not dependent for its existence upon the infringement of property rights,* there is jurisdiction in the district courts under [section 1343(3)] to entertain it without proof [of an] amount in controversy . . . .[19]

Although Justice Stone's distinction has been expressly rejected in isolated cases,[20] and, more frequently, ignored[21] or prudently circumvented,[22] the majority of the lower courts have attempted to discern and follow his principle, with the consequent expenditure of a great deal of judicial time and energy. Unfortunately, the result is a general state of confusion flowing from a basic failure to agree on what "property rights" are.[23] For the

[18] 307 U.S. at 531.

[19] *Id.* at 531-32 (emphasis added).

[20] *E.g.*, in Joe Louis Milk Co. v. Hershey, 243 F. Supp. 351 (N.D. Ill. 1965), the court remarked that "[n]o difference in constitutional protection between property rights and human rights is expressed in the language of § 1343 itself," and that "[n]either logic nor policy compels the conclusion that property rights are less deserving of protection under the Constitution and Civil Rights Act than are human freedoms . . . ." *Id.* at 354.

[21] *E.g.*, Blume v. City of Deland, 358 F.2d 698 (5th Cir. 1966); Cobb v. City of Malden, 202 F.2d 701 (1st Cir. 1953).

[22] *E.g.*, McGuire v. Sadler, 337 F.2d 902 (5th Cir. 1964).

[23] At least one potential issue has been resolved, for it seems settled that section 1343(3) affords jurisdiction in suits for damages as well as in those for injunctive relief. *E.g.*, Adickes v. S.H. Kress & Co., 398 U.S. 144 (1970). This balm exists despite the fact that both Justice Stone's opinion in *Hague* and section 1343 itself could be read as implying exclusion of damage actions. Justice Stone spoke of the maintenance of a "suit in equity" and of rights "not susceptible of valuation in

most part individual courts have seized upon one or the other, but not both, of Justice Stone's apparently nonidentic initial and final formulations of his distinction as the correct expression of the section 1343(3) jurisdictional grant. Thus one of the two prevailing statements of the section 1343(3) test requires the right asserted to be "incapable of pecuniary valuation,"[24] and the other formulation demands that the right be one of " 'personal liberty, not dependent for its existence upon the infringement of property rights.' "[25] In addition, differently phrased tests have been applied,[26] and the confusion is compounded by the occasional interchangeable use of the tests[27] and by the tendency of courts to give the complaint an expansive or narrow reading depending on what result seems desirable.[28]

As is to be expected, uniform results generally obtain in cases in which the right asserted passes muster under *either* or *neither* of the two principal tests. Thus when the action is for damages for a mere economic loss, section 1343(3) jurisdiction is denied.[29] On the other extreme, when the suit is brought for injunctive relief against unconditional denials of rights traditionally denominated "civil," such as the rights of free speech and assembly involved in *Hague*, the courts find no difficulty in sustaining jurisdiction.[30] The midpoint is marked by the troublesome cases in which either test may reasonably be thought to require either a finding

money." 307 U.S. at 331-32. Sections 1343(1) and (2) grant jurisdiction in suits "to recover damages." Section 1343(4) grants jurisdiction in suits to "recover damages or to secure equitable or other relief." But section 1343(3) affords jurisdiction in suits "to redress" deprivations of rights. 28 U.S.C. § 1343 (1964).

[24] Alterman Transp. Lines, Inc. v. Public Serv. Comm'n, 259 F. Supp. 486, 492 (M.D. Tenn. 1966), *aff'd per curiam*, 386 U.S. 262 (1967).

[25] Eisen v. Eastman, 421 F.2d 560, 564 (2d Cir. 1969), *quoting* Hague v. CIO, 307 U.S. 496, 531 (1939).

[26] *E.g.*, Escalera v. New York City Housing Auth., 425 F.2d 853, 864 (2d Cir.), *cert. denied*, 39 U.S.L.W. 3149 (U.S. Oct. 13, 1970) ("civil rights"); Ream v. Handley, 359 F.2d 728, 731 (7th Cir. 1966) (no section 1343(3) jurisdiction to protect "property or monetary rights").

[27] *E.g.*, McCall v. Shapiro, 416 F.2d 246, 249-50 (2d Cir. 1969).

[28] *E.g.*, in Escalera v. New York City Housing Auth., 425 F.2d 853 (2d Cir.), *cert. denied*, 39 U.S.L.W. 3149 (U.S. Oct. 13, 1970), a suit to enjoin eviction from public housing, the court characterized the claim as being the deprivation of "procedural due process, a civil right, which may ultimately lead to the loss of a property right, to wit, tenancy in public housing projects." *Id.* at 864.

[29] *E.g.*, City of Boulder v. Snyder, 396 F.2d 853 (10th Cir. 1968), *cert. denied*, 393 U.S. 1051 (1969); Ream v. Handley, 359 F.2d 728 (7th Cir. 1966).

[30] *E.g.*, Schnell v. City of Chicago, 407 F.2d 1084 (7th Cir. 1969) (interference by policemen with photographers' right to record news); Dawley v. City of Norfolk, 260 F.2d 647 (4th Cir. 1958), *cert. denied*, 359 U.S. 935 (1959) (suit to compel removal of the word "colored" from courthouse restrooms).

or denial of jurisdiction. One example is *Gold v. Lomenzo*,[31] in which section 1343(3) jurisdiction was sustained in an action to enjoin the suspension of a real estate brokerage license. In *Gold*, Judge Friendly remarked that "a challenge to the revocation of a license to engage in an occupation 'can be viewed about equally well as complaining of a deprivation of the personal liberty to pursue a calling of one's choice or of the profits or emoluments deriving therefrom.' "[32] Judge Friendly's statement was rendered in the context of his application of the test requiring the right asserted to be one of "personal liberty."[33] However, if the right in *Gold* is not viewed merely as the deprivation of economic benefits, it may be classified as incapable of monetary valuation as well as a right of personal liberty. Some courts have aided their inquiry in close cases by drawing a distinction according to plaintiff's purpose in bringing the suit,[34] although the great majority of the cases never mention that purpose, and it has been said to be irrelevant.[35]

Notwithstanding the general confusion, results may be accurately predicted in several specific analytical categories of cases.[36] One instance is the area of state taxation, where Justice Stone's distinction and the result in *Holt* have clearly prevailed, although not wholly without resistance.[37] Since 1962, the Supreme Court has affirmed, without comment, three district court decisions applying the property rights exception to deny section 1343(3) jurisdiction in suits attacking, respectively, the application of income taxation,[38] the application of ad valorem taxation,[39]

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[31] 425 F.2d 959 (2d Cir. 1970).

[32] *Id.* at 961, *quoting* Eisen v. Eastman, 421 F.2d 560, 565 (2d Cir. 1969).

[33] In Eisen v. Eastman, 421 F.2d 560 (2d Cir. 1969), decided before *Gold*, Judge Friendly had concluded that the proper section 1343(3) test is whether the "right asserted is one of personal liberty." *Id.* at 564 & n.7.

[34] *E.g.*, Pierre v. Jordan, 333 F.2d 951, 957-58 (9th Cir. 1964), *cert. denied*, 379 U.S. 974 (1965).

[35] Adams v. City of Colorado Springs, 308 F. Supp. 1397, 1401-02 (D. Colo.), *aff'd per curiam*, 399 U.S. 901 (1970).

[36] Several important classes of suits other than those discussed in the text are well settled. Thus, section 1343(3) affords jurisdiction in suits to apportion, Baker v. Carr, 369 U.S. 186 (1962); to protect the right to attend integrated schools, McNeese v. Board of Educ., 373 U.S. 668 (1963); and to protect the right of residents of a federal enclave to vote, Evans v. Cornman, 398 U.S. 419 (1970).

[37] Chief Judge Johnson, dissenting in Hornbeak v. Hamm, 283 F. Supp. 549 (M.D. Ala. 1968), *aff'd per curiam*, 393 U.S. 9 (1969), felt that denying jurisdiction in an action to compel uniform assessment and valuation for ad valorem taxation purposes was tantamount to finding that state taxation procedures are not subject to the fourteenth amendment. *Id.* at 556.

[38] Abernathy v. Carpenter, 208 F. Supp. 793 (W.D. Mo. 1962), *aff'd per curiam*, 373 U.S. 241 (1963).

[39] Alterman Transp. Lines, Inc. v. Public Serv. Comm'n, 259 F. Supp. 486 (M.D. Tenn. 1966), *aff'd per curiam*, 386 U.S. 262 (1967).

and the administration of ad valorem taxation.[40] The lower courts have followed these results.[41]

There is an obvious overlap between income or ad valorem taxation and a requirement of a license, purchased for a fee, as a condition precedent to a specified activity. But there seems to be a crucial difference in the two under section 1343(3), just as there is a constitutional difference under the commerce clause.[42] In *Douglas v. City of Jeannette*,[43] the Court sustained jurisdiction under section 1343(3) in a suit brought by Jehovah's Witnesses to enjoin the application to them of a license tax on door-to-door solicitation as a denial of freedom of religion, speech, and press. Since the license could have been purchased for money, *Douglas* may be read as casting doubt on the validity of the "incapable of pecuniary valuation" test, and thus as lending credence to the "personal liberty" test. On the other hand, if the rights asserted in *Douglas* are classified simply as freedom of religion, speech, and press, jurisdiction would probably be sustained under either of the two tests. Thus *Douglas* may also be read as requiring an expansive reading of the complaint in identifying the right asserted and a disregard of the nature of the invasion of that right. After *Douglas*, the courts properly have had little difficulty sustaining jurisdiction in actions attacking the denial of licenses required for noncommercial pursuits;[44] section 1343(3) jurisdiction also has been sustained in the cases seeking to enjoin denials of licenses and permits required for *commerical* activities.[45]

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[40] Hornbeak v. Hamm, 283 F. Supp. 549 (M.D. Ala. 1968), *aff'd per curiam*, 393 U.S. 9 (1969).

[41] *E.g.*, Bussie v. Long, 383 F.2d 766 (5th Cir. 1967); Gray v. Morgan, 371 F.2d 172 (7th Cir. 1966), *cert. denied*, 386 U.S. 1033 (1967).

With respect to the taxation cases, it should be remembered that ordinarily *all* of the subject property would never be taken. In addition, the strong policy against interference with state taxation, embodied in 28 U.S.C. § 1341 (1964), must be considered.

Fuller v. Volk, 351 F.2d 323 (3d Cir. 1965), raises an interesting issue. Therein jurisdiction was denied under section 1343(3) in a suit by taxpayers and parents to enjoin a school board plan to eliminate de facto segregation and to enjoin expenditures to implement the plan. Would a suit brought by one who has standing only as a taxpayer ever nestle into section 1343(3)? The answer would probably be *yes* in at least one situation. When the attack is under the establishment of religion clause of the first amendment, the essence of the objection would be the use to which the money is put, rather than the taking of it. *See, e.g.*, Walz v. Tax Comm'n, 397 U.S. 664 (1970).

[42] *Compare* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), *with* Nippert v. Richmond, 327 U.S. 416 (1946).

[43] 319 U.S. 157 (1943).

[44] *E.g.*, Wall v. King, 206 F.2d 878 (1st Cir.), *cert. denied*, 346 U.S. 915 (1953) (suspension of driver's license).

[45] *E.g.*, Gold v. Lomenzo, 425 F.2d 959 (2d Cir. 1970) (license for real estate

Somewhat the same considerations obtain in the employment cases as in those concerning permits for commercial activities. Both recognize, impliedly or expressly,[46] that the right to pursue one's chosen occupation is not a "property right." Thus section 1343(3) jurisdiction has been upheld in actions to compel reinstatement after alleged racial discrimination in the failure to renew employment contracts,[47] and after dismissal alleged to have denied procedural due process.[48] The difference that has been recognized at least once between dismissal and a mere reduction in salary[49] suggests that the problem may be one of degree. However, a more obvious distinction is that dismissal operates to preclude the income-producing conduct itself, while a salary reduction merely makes the conduct less economically beneficial.

Like the employment cases, the welfare cases involve loss of economic benefits. Yet jurisdiction under section 1343(3) is uniformly upheld in them. Unfortunately, the Supreme Court has not seen fit to discuss the scope of section 1343(3) in the recent rash of welfare cases decided by it, other than to render an occasional general remark. In *Goldberg v. Kelly*,[50] the Court sustained section 1343(3) jurisdiction in an action brought to redress the alleged denial of procedural due process in the termination of welfare benefits. Although section 1343(3) was not discussed, the Court did take note of the potential deprivation of "essential food, clothing, housing, and medical care," and of the fact that such terminations "may deprive an *eligible* recipient of the very means by which to live."[51] In *Dandridge v. Williams*[52] the Court, without comment, sustained jurisdiction in a suit attacking, on equal protection grounds, a ceiling placed on welfare benefits without regard to actual need or family size. Finally, in *Rosado v. Wyman*[53] the Court sustained jurisdiction under section 1343(3) in an action challenging, on equal pro-

brokerage); Parks v. Allen, 409 F.2d 210 (5th Cir. 1969) (license for operation of a retail liquor store).

[46] *E.g.*, in Penn v. Stumpf, 308 F. Supp. 1238 (N.D. Cal. 1970), the court remarked that even if the property rights exception is accepted, "plaintiff's claim to a denial of employment is in the nature of a right far more precious than 'mere property' and certainly incapable of precise pecuniary measure." *Id.* at 1245-46.

[47] Harkless v. Sweeny Indep. School Dist., 427 F.2d 319 (5th Cir. 1970), *cert. denied*, 39 U.S.L.W. 3297 (U.S. Feb. 12, 1971).

[48] Taylor v. New York City Transit Auth., 433 F.2d 665 (2d Cir. 1970).

[49] Kochhar v. Auburn Univ., 304 F. Supp. 565 (M.D. Ala. 1969).

[50] 397 U.S. 254 (1970).

[51] *Id.* at 264.

[52] 397 U.S. 471 (1970).

[53] 397 U.S. 397 (1970).

tection grounds, a New York statute providing for smaller welfare payments to Nassau County residents than to New York City residents. These cases would support the proposition that the circumstances and probable effect of a "taking of property" are entitled to consideration in determining section 1343(3) jurisdiction, and clearly recognize the reality that a "taking of property" always interferes with "personal rights" to some degree. Moreover, since *Dandridge* and *Rosado* did not involve complete withdrawal of benefits, it is arguable that the degree of interference is immaterial in sensitive areas such as welfare administration.

Eviction from and termination of leases in public housing are apt to visit the same type of hardship on the plaintiff as denial of welfare benefits, although perhaps statistically to a lesser degree. Here, too, section 1343(3) jurisdiction has been sustained.[54]

Thus, the cases discussed, as well as others,[55] indicate that one may, with some confidence, consider plaintiff's personal circumstances in determining whether plaintiff has been denied a "personal right" *because of* the deprivation of a "property right." Yet the crucial issue remains: how is it to be determined whether the right allegedly denied is a "personal" one within the protection of section 1343(3)?

Obviously it is not enough that plaintiff alleges a violation of broad and general prohibitions, such as the due process and equal protection clauses of the fourteenth amendment. The Supreme Court has both sustained and denied section 1343(3) jurisdiction when the plaintiff was relying on the equal protection clause,[56] and the same is true with respect

[54] *E.g.*, Caulder v. Durham Housing Auth., 433 F.2d 998 (4th Cir. 1970), *petition for cert. filed*, 39 U.S.L.W. 3314 (U.S. Jan. 19, 1971) (No. 1227); Escalera v. New York City Housing Auth., 425 F.2d 853 (2d Cir.), *cert. denied*, 39 U.S.L.W. 3149 (U.S. Oct. 13, 1970).

[55] *E.g.*, in Eisen v. Eastman, 421 F.2d 560 (2d Cir. 1969), a suit to enjoin the lowering of rent ceilings under a city rent control law, Judge Friendly, after concluding that the proper test was whether the "right asserted is one of personal liberty," *id.* at 564 & n.7, held that section 1343(3) did not afford jurisdicton because plaintiff had *alleged only the loss of money*. *Id.* at 566. On the other hand, in Klim v. Jones, 315 F. Supp. 109 (N.D. Cal. 1970), a suit brought by a painter to redress the seizure of personal papers and painting implements by his landlord under an innkeepers' lien law, the court sustained section 1343(3) jurisdiction, reasoning that plaintiff's "claim is not for 'mere' property, but rather for property which is his means of employment and support and hence is incapable of pecuniary measure." *Id.* at 115. *See also* Hall v. Garson, 430 F.2d 430 (5th Cir. 1970). *But see* Lynch v. Household Finance Corp., 318 F. Supp. 1111 (D. Conn. 1970).

[56] *Compare, e.g.*, Hornbeak v. Hamm, 393 U.S. 9 (1969), *aff'g per curiam* 283 F. Supp. 549 (M.D. Ala. 1968), *with* Rosado v. Wyman, 397 U.S. 397 (1970).

to the due process clause.[57] Thus, under the prevailing approach, the court must first characterize the right asserted in terms more narrow than the broad prohibition underlying the right, and then apply its test to determine whether the right is one of "personal liberty" or "property."

The difficulties attendant to such an analysis are amply illustrated by *Adams v. City of Colorado Springs*.[58] Therein property owners and voters sued to enjoin a proposed annexation on the ground that the statute establishing the annexation procedure denied equal protection when it afforded prospective annexees in certain areas a vote on the proposal but denied it to those in other areas. Although defendants asserted that plaintiffs were concerned only with increased taxation, the district court characterized the complaint as setting up the deprivation of "a substantial personal right—the right to equal treatment in the distribution of the voting franchise," and upheld jurisdiction under section 1343(3).[59] Since some persons were permitted to vote because they were property owners, the right asserted in *Adams* could be characterized as the right to exercise the incidents of ownership of property. Or, as defendants wished, it could be described as the right not to pay increased taxes for unwanted city services. It is obvious that in any case there is a wide range of possible descriptions of the right involved. And in many cases that range could include both those that seem "personal" or "incapable of pecuniary valuation" and those that seem to be "property rights."[60] Such is the present potential for uncertainty and inconsistency.

A suggestion for avoidance of the unsatisfactory existing approach may be found in the very origin of the problem—Justice Stone's opinion in *Hague*. Unfortunately, the courts have neglected that portion of the opinion in which Justice Stone discussed *Truax* and *Crane*. Arguably, Justice Stone used his phrases in the disjunctive and thought that a complaint sets out "a right of personal liberty not susceptible of valuation in money" whenever "the *gist of the cause of action is not damage or injury to property*."[61] Adoption of the latter phrase as the section 1343(3) test would immediately eliminate the disparity in results due to the real or supposed differences in the "personal liberty" and "incapable of pecuniary valuation" tests. Moreover, by recognizing, as the welfare cases clearly

[57] *Compare, e.g.*, Alterman Transp. Lines, Inc. v. Public Serv. Comm'n, 386 U.S. 262 (1967), *aff'g per curiam* 259 F. Supp. 486 (M.D. Tenn. 1966), *with* Douglas v. City of Jeannette, 319 U.S. 157 (1943).

[58] 308 F. Supp. 1397 (D. Colo.), *aff'd per curiam*, 399 U.S. 901 (1970).

[59] *Id.* at 1401-02.

[60] *See* p. 824 & note 32 *supra*.

[61] *See* p. 822 & note 18 *supra*.

suggest, that the gist of a cause of action may be something other than a mere wrongful reduction in plaintiff's net economic worth *because of the effect of a "taking of property,"*[62] this rule would offer the distinct advantage of reconciling many of the otherwise apparently inconsistent results.

It is submitted that the rule suggested is to be preferred over the existing state of disagreement and confusion. It is not at all clear that Justice Stone did not have it in mind, and it should be remembered that for the most part Justice Stone was arguing positively to sustain jurisdiction in *Hague*, rather than negatively to deny it.[63] As noted earlier, the language of section 1343(3) does not require the property rights exception.[64] Moreover, the Supreme Court has broadly interpreted 42 U.S.C. § 1983—the substantive companion of section 1343(3)—[65] to embrace all rights guaranteed by the fourteenth amendment.[66] Finally, it is arguable that the Civil Rights Acts themselves cast doubt on the property rights exception.[67]

Even the need to harmonize sections 1331 and 1343(3), which concerned Justice Stone, is more apparent than real. The most expansive reading of section 1343(3) would not make section 1331 superfluous, since by its terms section 1343(3) extends only to state, not federal, action. Moreover, the total repeal of the jurisdictional amount requirement in section 1331 has been forcefully advocated,[68] since its application is virtually limited to cases involving state action,[69] for which federal

[62] *See* pp. 826-27 *supra*.

[63] 307 U.S. at 527-32.

[64] One recent case seems to have arrived at a correct result guided solely by the language of the statute. *See* Caulder v. Durham Housing Auth., 433 F.2d 998 (4th Cir. 1970), *petition for cert. filed*, 39 U.S.L.W. 3314 (U.S. Jan. 19, 1971) (No. 1227).

[65] *See* note 8 *supra*.

[66] Monroe v. Pape, 365 U.S. 167, 171 (1961).

[67] *E.g.*, section two of the Act of 1871 specifically punished conspiracies aimed at preventing enforcement of the Act by injuring the *property* or person of a United States officer, juror, etc., charged with a duty under the Act. Act of April 20, 1871, ch. 22, § 2, 17 Stat. 13. Therefore, section one, from which section 1343(3) is derived and which is broader than section two, should be construed to protect property also. For arguments that the Civil Rights Acts preclude recognition of the property rights exception see Laufer, *Hague v. C.I.O.: Mr. Justice Stone's Test of Federal Jurisdiction—A Reappraisal*, 19 BUFFALO L. REV. 547, 559-61 (1970); Note, *The "Property Rights" Exception to Civil Rights Jurisdiction—Confusion Compounded*, 43 N.Y.U.L. REV. 1208, 1211 (1968).

[68] ALI STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 489-92 (1969); Wright, *Federal Question Jurisdiction*, 17 S.C.L. REV. 660, 661-64 (1965).

[69] Wright, *supra* note 68, at 663-64.

courts are especially appropriate, and its elimination would have no significant impact on the workload of the federal courts.[70]

Finally, the rule suggested offers an opportunity to settle this area of conflict quickly and with certainty. As Justice Brandeis once remarked, "in most matters it is more important that the applicable rule be settled than that it be settled [correctly] . . . ."[71] The Supreme Court should take advantage of one of the opportunities certain to arise to establish a definite rule. And if it fails to do so, Congress should.

R. B. TUCKER, JR.

Municipal Corporations—Public Purpose—Taxation and Revenue Bonds to Finance Low-Income Housing

In *Martin v. North Carolina Housing Corp.*[1] the North Carolina Supreme Court upheld the statute establishing the Housing Corporation as a "public agency . . . empowered to act on behalf of the State . . . for the purpose of providing residential housing 'for sale or rental to persons and families of lower income.' "[2] In so holding, the court resolved in favor of the Housing Corporation challenges regarding public purpose, lending of credit, creation of debt, delegation of legislative authority, and property tax exemption, arising under various sections of the North Carolina Constitution.[3]

The dissent singled out the noteworthy holdings of the case: public purpose and tax exemption. In the latter regard the court in *Martin* upheld the statutory tax exemption of the bonds to be issued by the Housing Corpo-

[70] *Id.*

[71] Burnet v. Coronado Oil & Gas, 285 U.S. 393, 406 (1932).

[1] 277 N.C. 29, 175 S.E.2d 665 (1970).

[2] *Id.* at 34, 175 S.E.2d at 667. The Housing Corporation was to issue self-liquidating, tax-exempt revenue bonds and use the proceeds to purchase federally insured mortgage and construction loans. The Housing Corporation would also establish a housing development fund with grants and loans from industry, foundations, and government to be used for project development loans, downpayment assistance to needy families, and uninsured loans to builders and developers for land development and residential construction. N.C. GEN. STAT. §§ 122A-1 to -23 (Supp. 1969).

[3] N.C. CONST. art. V, § 3, limiting the power of taxation to public purposes; art. VII, § 6, limiting the power of a municipal corporation to pledge its faith; art. V, § 4, limiting the power of the General Assembly to lend the credit of the State; art. I, § 8, defining the separation of the powers of government; and, art. V, § 5, defining the scope of the exemption of property from taxation.

ration. Article V, section 5 of the North Carolina Constitution provides that "[p]roperty belonging to the State, counties and municipal corporations shall be exempt from taxation," and that the General Assembly may exempt certain enumerated properties, but does not include in the list bonds issued by the state or an agency of the state. The majority, in finding the exemption permissible,[4] simply reaffirmed *State Education Assistance Authority v. Bank of Statesville*,[5] in which the court had held that the General Assembly could exempt revenue bonds from taxation by the state and its subdivisions "[s]ince the tax-exempt feature makes possible a more favorable sale of revenue bonds and thereby contributes substantially to the accomplishment of the public purpose for which they are issued."

The dissent noted that the court previously had upheld the exemption of state, county, and municipal bonds on the rationale that the exemption would reduce the interest that the issuer would have to pay on the bonds and thus achieve approximately the same effect as if the bonds were taxed and the higher interest paid. Since these were revenue bonds and *not* obligations of the state, the dissent argued that such reasoning did not apply in this case.[6] However, as in previous cases,[7] the promotion of the public purpose of the organization issuing the bonds was a dispositive factor. The court in *Martin* thus reinforces the exemption of bonds issued by state agencies not merely where the savings in interest will accrue directly to the state, but also where it serves to advance the public purpose of the particular program.

On the issue of public purpose, the court took notice of the legislative findings of a shortage of decent, safe, and sanitary housing for low-income families, and the inability of the private sector to meet the need;[8] it further noted the authority of the General Assembly to legislate for "the protection of the public health, safety, morals and general welfare of the people."[9] By having more decent housing, the court reasoned, families and persons of low income, who might not otherwise obtain such accommodations, would acquire a stake in the preservation of society and

[4] 277 N.C. at 57-58, 175 S.E.2d at 681-82.
[5] 276 N.C. 576, 589, 174 S.E.2d 551, 560 (1970).
[6] 277 N.C. at 65, 175 S.E.2d at 686. *See also* Pullen v. Corporation Comm'n, 152 N.C. 548, 565, 68 S.E. 155, 163 (1910) (dissenting opinion).
[7] State Educ. Assistance Auth. v. Bank of Statesville, 276 N.C. 576, 589, 174 S.E.2d 551, 560 (1970); Webb v. Port Comm'n of Morehead City, 205 N.C. 663, 674-75, 172 S.E. 377, 383 (1934).
[8] 277 N.C. at 49, 175 S.E.2d at 676.
[9] *Id.* at 45, 175 S.E.2d at 674.

institutional stability. On this basis the activities of the Housing Corporation were found to be for a public purpose.[10]

Implicit in the "spirit of American Constitutions" is the idea that the government shall always confine itself to the proper business or function of government.[11] Thus, in finding the activities of the Housing Corporation to be within the ambit of public purpose, the court considered them to embody a proper object of government.[12] This general limit on the activities of government is defined by the scope of the three major forms of governmental power: the power to tax for public purposes,[13] specifically limited in the North Carolina Constitution;[14] the power of eminent domain for public uses;[15] and the police power for promoting the public health, safety, morals, and general welfare.[16] The definition of the proper function of government is dependent also upon changing times and conditions.[17] Since the three powers all relate to the proper conduct of the business of government, and are so interrelated, an evaluation of the realm of public purpose requires an examination of the definition of governmental function in all three areas.

Types of activities which at some time had been held by the North Carolina courts to embrace a public purpose were listed by one writer in 1947 to include the following: "aid to railroads, aid to establish a teachers training school, railway terminal facilities, public auditorium, World War I Veteran's Loan Fund, the state fair, a park, a municipal hospital, an airport, port terminal facilities, public housing authority under federal housing acts, playgrounds and recreational facilities, public libraries, and schools."[18] Subsequently the North Carolina Supreme Court has ruled within the ambit of public purpose the expenditure of tax revenues by a municipality for a policeman to attend a training course,[19] a voter-approved sale of municipal bonds for the construction of an armory outside the

[10] *Id.* at 49-50, 175 S.E.2d at 677.

[11] 38 AM. JUR. *Municipal Corporations* § 395 (1941).

[12] The North Carolina Supreme Court has held a tax to be for a public purpose if it is for the support of a recognized object of government. Green v. Kitchin, 229 N.C. 450, 455, 50 S.E.2d 545, 549 (1948).

[13] 51 AM. JUR. *Taxation* §§ 6, 321, 326 (1944).

[14] N.C. CONST. art. V, § 3.

[15] 26 AM. JUR. 2d *Eminent Domain* § 25 (1966).

[16] State v. Brown, 250 N.C. 54, 56, 108 S.E.2d 74, 76 (1959).

[17] Fawcett v. Town of Mt. Airy, 134 N.C. 125, 45 S.E. 1029 (1903). *See also* Albritton v. City of Winona, 181 Miss. 75, 178 So. 799, *appeal dismissed*, 303 U.S. 627 (1938).

[18] Note, *Municipal Corporations—Taxation—Meaning of Public Purpose*, 25 N.C.L. REV. 504, 506 (1947) (numbering omitted).

[19] Green v. Kitchin, 229 N.C. 450, 50 S.E.2d 545 (1948).

corporate limits,[20] municipal revenue bonds for the purchase of a lake and a generating plant,[21] and a state revenue-bond issue for loans to residents of slender means to facilitate their post-secondary education.[22]

However, the court has declined to include within the scope of public purpose activities less directly related to the function of government or representing a greater intrusion into the private sector. In *Nash v. Town of Tarboro*[23] the court rejected the levy of tax and issue of bonds for the construction of a hotel, feeling that such public benefits as might accrue would be "too incidental to justify the expenditure of public funds." An appropriation of municipal tax revenues to a Chamber of Commerce to be spent at its discretion to encourage industrial plants to locate near the city was struck down by the court in 1923 on the ground that the members of the Chamber of Commerce exercise no governmetal duty.[24] Nearly forty years later the court found a sufficient public purpose in a municipal appropriation to the Chamber of Commerce to advertise advantages of the city.[25] However, the court limited its approval to the use of nontax revenues and took emphatic note of the provisions for an advance budget to insure that the advertising would promote the general welfare of the city. In summary, while the court has recognized a wide range of government functions and approved activities pursuant thereto as being for a public purpose, it has exerted restraint on intrusions into the private sphere to compete with or to aid particular business ventures.

This reluctance to intrude into the private sector is reflected in *Mitchell v. North Carolina Industrial Development Financing Authority*,[26] relied upon by the plaintiff in *Martin*. The plaintiff in *Mitchell* had sued to enjoin the expenditure of the tax funds allocated to the Authority. Asserting that "for a use to be public . . . the ultimate net gain or advantage must be the public's as contradistinguished from that of an

[20] Morgan v. Town of Spindale, 254 N.C. 304, 118 S.E.2d 913 (1961).

[21] Keeter v. Town of Lake Lure, 264 N.C. 252, 141 S.E.2d 634 (1965). The acquisition of the property was to preserve the existence of a town that was dependent upon the tourist trade attracted to the lake.

[22] State Educ. Assistance Auth. v. Bank of Statesville, 276 N.C. 576, 174 S.E.2d 551 (1970).

[23] 227 N.C. 283, 289-90, 42 S.E.2d 209, 214 (1947).

[24] Ketchie v. Hedrick, 186 N.C. 392, 119 S.E. 767 (1923).

[25] Dennis v. City of Raleigh, 253 N.C. 400, 116 S.E.2d 923 (1960).

[26] 273 N.C. 137, 159 S.E.2d 745 (1968). The Authority was established to promote industry, increase employment, and advance the economy by providing facilities for private operators for industrial and research pursuits. Revenue bonds were to be issued for particular projects and the constructed facilities were then leased to private interests. *Id.* at 138-39, 159 S.E.2d at 746-47.

individual or private entity,"[27] and citing *Nash* for the proposition that it is not the function of government to engage in private business, the court in *Mitchell* held that the function of the Authority—acquiring sites and equipping facilities for private industry—was not a public purpose.[28]

The scope of governmental function found in public purpose has its counterpart in the public-use requirement for the exercise of the power of eminent domain. In *Mitchell* the court acknowledged that "'[f]or the most part the term "public purpose" is employed in the same sense in the law of taxation and in the law of eminent domain.'"[29] This view comes in the context of two basic meanings ascribed to public use: public employment and public advantage. While the traditional meaning of public use has been "use by the public," the trend, as reflected in the dictum in *Mitchell*, has been toward a liberalized view embracing "advantage to the public."[30] For example, the court has upheld a condemnation proceeding for an access road to a large private business on the basis that the road would be used by a substantial number of people to reach their place of work or to transact business.[31] One comment writer suggests that this holding emphasized the "public benefit" test of public use for eminent domain.[32]

Since a public "purpose" for eminent domain is generally one for which taxes may also be levied,[33] the activities of the Housing Corporation in *Martin* may profitably be compared with those of housing authorities and redevelopment commissions whose exercise of the power of eminent domain has been sustained. In these areas, however, the government exercise of eminent domain power is affected by the scope of its

[27] 273 N.C. at 144, 159 S.E.2d at 750.

[28] *Id.* at 159, 159 S.E.2d at 761. *Contra,* Albritton v. City of Winona, 181 Miss. 75, 178 So. 799 (1938), *noted in* 20 VAND. L. REV. 685 (1967). Here the plaintiff taxpayer objected to the issue of bonds and the levy of a tax approved by the voters of the city for the acquisition of land and construction of plants to be leased to new industries. The court held that the authorizing statute sought to promote the public welfare since its aims were to create jobs, to process natural resources, and to promote agriculture.

[29] 273 N.C. at 158, 159 S.E.2d at 760, *quoting* 1 COOLEY, THE LAW OF TAXATION § 176 (4th ed. C. Nichols 1924). *See also* 51 AM. JUR. *Taxation* § 324 (1944).

[30] Comment, *Eminent Domain—The Meaning of the Term "Public Use"—Its Effect on Excess Condemnation,* 18 MERCER L. REV. 274, 275 (1966). *See also* Note, *"Public Use" as a Limitation on the Exercise of Eminent Domain Power by Private Entities,* 50 IOWA L. REV. 799, 810-12 (1965).

[31] State Highway Comm'n v. Thornton, 271 N.C. 227, 243-45, 156 S.E.2d 248, 260-61 (1967).

[32] Comment, *The Public Use Doctrine: "Advance Requiem" Revisited,* 1969 LAW & SOC. ORDER 688, 694-95.

[33] Note, 25 N.C.L. REV., *supra* note 18, at 507.

police power.[34] This is seen in *Berman v. Parker*,[35] which has been viewed by some authorities as a "fundamental pronouncement [by the United States Supreme Court] of the merger of the police power and eminent domain into a single legal entity . . . ."[36] In *Berman* the plaintiff sought to enjoin the condemnation of his property under the District of Columbia Redevelopment Act. The Court noted a Congressional finding that the ends sought—the elimination of conditions injurious to the public health, safety, morals, and welfare—could not be obtained by ordinary private operations alone but also required public participation,[37] and it concluded that the power of eminent domain was simply a means to the end which was for "Congress alone to determine, once the public purpose has been established."[38] The Court further declined to restrict to public ownership the methods of attaining the public purpose of community development projects.[39]

The determination of public purpose by the court in *Martin* arose in the context of its earlier decisions regarding the exercise of eminent domain to improve housing and to redevelop cities. In *Wells v. Housing Authority*,[40] the court appears to have anticipated the *Berman* merger of the police and eminent domain powers in upholding the public purpose of the Housing Authorities Act to accomplish "slum clearance." This was based on the function of government to promote the health, safety, and morals of its citizens and the execution of this function by the elimination of conditions conducive to disease and disorder. In *Martin* the court looked also to *Redevelopment Commission v. Security National Bank*,[41] which upheld the condemnation of land pursuant to a redevelopment plan to eradicate "blighted areas." The definition of governmental function in the exercise of the merged eminent domain and police powers serves as

[34] The North Carolina Supreme Court has recognized the scope of the police power to embrace the protection of the public health, safety, morals, and general welfare. *E.g.*, S.S. Kresge Co. v. Tomlinson, 275 N.C. 1, 165 S.E.2d 236 (1969); Town of Wake Forest v. Medlin, 199 N.C. 83, 154 S.E. 29 (1930).

[35] 348 U.S. 26 (1954).

[36] Gormley, *Urban Redevelopment to Further Aesthetic Considerations: The Changing Constitutional Concepts of Police Power and Eminent Domain*, 41 N.D.L. REV. 316, 317 (1965).

[37] 348 U.S. at 29.

[38] *Id.* at 33.

[39] *Id.* at 35.

[40] 213 N.C. 744, 197 S.E. 693 (1938); *accord*, Cox v. City of Kinston, 217 N.C. 391, 8 S.E.2d 252 (1940). Mallard v. Housing Auth., 221 N.C. 334, 20 S.E.2d 281 (1942), reaffirmed the finding of a governmental function under the police power in the elimination of unsanitary dwellings.

[41] 252 N.C. 595, 114 S.E.2d 688 (1960).

a guide for the definition of governmental function for the exercise of the taxing power in *Martin* since "[w]hatever is necessary for the preservation of the public health and public safety is a public purpose for which taxes may be collected."[42]

Having recognized the interrelationship of the powers of police, eminent domain, and taxation, the court in *Martin* was still faced with the task of determining whether the activities of the Housing Corporation were pursuant to a proper governmental function for which the taxing power could be exercised. The two cases cited by the court had involved the physical elimination of poor housing. The public purpose in *Wells* was "slum clearance,"[43] while the public purpose in *Security National Bank* was the eradication of "blighted areas."[44] However, in *Martin* the object was to remedy the shortage of decent, low-cost housing by fostering the construction and financing of modest housing not otherwise available.[45] The court in *Mitchell* had not found a public purpose in the Authority's function of constructing and equipping facilities for private industry.[46] The dissent in *Martin*[47] considered the purpose of the Housing Corporation—assisting individuals in acquiring housing—distinguishable from the more direct elimination of a menace to the public health and safety in *Wells* and *Security National Bank* and indistinguishable from aiding individuals in housing businesses, which was not sustained by the court in *Mitchell*. The majority in *Martin*, however, distinguished *Mitchell* as involving the subsidizing of "particular private industries which were in competition with other unsubsidized industries."[48] Thus the presence of a governmental function in *Martin* appears to turn in part on the way the purpose of the activity is described[49] and the directness of its relation to the elimination of inadequate housing, which would be a proper exercise of the police power.[50]

However, there is an additional element by which these cases can be

[42] 51 AM. JUR. *Taxation* § 328 (1944).
[43] 213 N.C. at 747, 197 S.E.2d at 695.
[44] 252 N.C. at 604, 114 S.E.2d at 695.
[45] 277 N.C. at 48, 175 S.E.2d at 676.
[46] 273 N.C. at 159, 159 S.E.2d at 761.
[47] 277 N.C. at 60-63, 175 S.E.2d at 683-85.
[48] *Id.* at 50, 175 S.E.2d at 677.
[49] The majority view of eliminating the shortage of adequate housing is set against the dissenting view of aiding individuals.
[50] The majority view of attacking the shortage of adequate housing by fostering the planning, construction, and financing of low-cost housing is set against the dissenting view of inadequately relating the activities of the Housing Corporation to the elimination of slums.

reconciled. In each the court deals with the question of the proper role of government in relation to a private economy. How are the two to function in meeting particular problems? When is government intruding too far and threatening private capitalism? When is some degree of intrusion ever justified? It has been suggested that the term "public purpose" simply distinguishes those things for which the government is to provide from those to be left to private support. The determination of what is public or private frequently is a matter of policy and wisdom decided in light of the public welfare.[51] Concern for the relation of governmental and private activity is seen in *Mitchell*,[52] where the court cited *Nash* for the proposition that it is not the function of government to engage in private business. The court also noted the observation in *Wells* that the existence of slums shows the impotency or unwillingness of private enterprise to deal with the problem, thus impelling government to act where community initiative has failed. The opinion likewise addresses the concern with private activity by explicit reference to the legislative finding of the inability of unassisted private enterprise to meet the need for low-cost, safe, and sanitary housing.[53] Thus the finding of a governmental function in *Martin* appears to be based in part on the noninterference with the private sector by the activities of the Housing Corporation.

The concern of the dissent for the benefit accruing to the individual homeowners resolves itself in large measure in how the activities of the Housing Corporation are described. If taken to be for the purpose of eliminating the shortage of adequate housing and thus promoting the public health, safety, morals, and welfare, the activity should be sustained. The court has held in *State Education Assistance Authority v. Bank of Statesville*[54] that "the fact that the individual obtains a private benefit cannot be considered sufficient ground to defeat the execution of 'a paramount public purpose.'" The activities of the Housing Corporation would certainly inure to the benefit of individuals, while achieving the public purpose of fostering the construction of adequate housing. Individuals also

[51] 51 AM. JUR. *Taxation* § 326 (1944). *See also* Note, *"Public Use" as a Limitation on the Exercise of the Eminent Domain Power by Private Entities*, 50 IOWA L. REV. 799, 815 (1965); Note, *Industrial Revenue Bonds*, 4 WILLIAMETTE L.J. 517, 521 (1967).

[52] 273 N.C. at 156-58, 159 S.E.2d at 758-59.

[53] 277 N.C. at 49, 175 S.E.2d at 676. The court also quotes from the Act passages indicating that many of the loans to be made by the Housing Corporation were to be made only upon the determination that they were not otherwise available from private lenders on reasonably equivalent terms.

[54] 276 N.C. 576, 588, 174 S.E.2d 551, 560 (1970).

benefit when a housing authority eliminates a slum, but this activity has been considered a public purpose in North Carolina since *Wells* was decided in 1938.

The dissent's concern with the indirectness of the efforts of the Housing Corporation in eliminating inadequate housing is likewise answered in part by the existing case law. The court has upheld the discretion of housing authorities in locating their projects on sites not presently in a slum area.[55] Thus the court has not insisted in every instance on the most direct attack on the slum to sustain a finding of public purpose. This view is consistent with the development of the law following *Berman* whereby "[h]ousing projects for persons of low income alone, without provisions for slum clearance, became objects for which the power of eminent domain could be exercised."[56] In *Martin* the court found sufficient nexus between the activities of the Housing Corporation and the elimination of the shortage of low cost housing, and such minimal intrusion into the private arena that the activities could be sustained as pursuant to a proper governmental function and thus for a public purpose. In so holding the court acted in the context of existing case law without overruling *Mitchell*, which can be seen as blocking deep-seated involvement in the affairs of private enterprise. Nevertheless, the analytical tools of *Martin* afford the means to modify the *Mitchell* result should the purpose sought be of sufficient social importance, the means chosen sufficiently direct, and the degree of intrusion into the private sphere sufficiently circumscribed.

KENNETH C. DAY

Personal Jurisdiction—Jurisdiction Over Foreign Corporation Based Upon Making a Contract in North Carolina

Courts can obtain personal jurisdiction over nonregistered foreign corporations by the use of long-arm statutes.[1] *International Shoe Co. v.*

[55] *E.g.*, Housing Auth. v. Wooten, 257 N.C. 358, 126 S.E.2d 101 (1962); *In re* Housing Authority, 233 N.C. 649, 65 S.E.2d 761 (1951).

[56] Comment, 1969 LAW & SOC. ORDER, *supra* note 32, at 697.

[1] For a brief review of the development of the long-arm statute, see McGee v. International Life Ins. Co., 355 U.S. 220 (1957). The important thing to remember about long-arm statutes is that the mere ability to fit a situation within a statute's language does not mean that jurisdiction will always be proper. The ultimate test is the due process clause of the fourteenth amendment—not the wording of the long-arm statute. *Id.* at 222.

Washington[2] and cases which have followed[3] have expanded in personam jurisdiction, especially over foreign corporations. However, problems still arise out of situations involving a single contract made by a foreign corporation within the forum state. The North Carolina Supreme Court considered such a situation in *Goldman v. Parkland of Dallas, Inc.*[4] Plaintiff Goldman, a North Carolina resident, sued Parkland, a Texas corporation, for breach of contract. Under the contract, Goldman was to serve as manufacturer's representative for Parkland in the sale of dresses in several Southeastern states, including North Carolina.[5] The contract terms were discussed in Atlanta, but the court found that the contract was executed when Goldman signed an offer sent to him by Parkland and dropped it into a mailbox in North Carolina.[6] Parkland never had a representative in North Carolina other than Goldman. The contract's connections with North Carolina were that it was executed there, and by its terms was to be performed there to some extent. Goldman alleged that he had performed under this contract for several months prior to Parkland's breach, had done most of his work in North Carolina, and had sold a quantity of the dresses there.[7] The court found these contacts sufficient to satisfy the long-arm statute.[8]

North Carolina's long-arm statute seems to provide two conditions which can give rise to jurisdiction over foreign corporations making contracts with state residents. The statute subjects them to suit in the state on any cause of action arising "out of any contract [either] made in this State or to be performed in this State."[9] In *Goldman* the court avoided decision of a constitutional question—whether either condition alone will

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[2] 326 U.S. 310 (1945).

[3] *E.g.*, Hanson v. Denckla, 357 U.S. 235 (1958); McGee v. International Life Ins. Co., 355 U.S. 220 (1957).

[4] 277 N.C. 223, 176 S.E.2d 784 (1970).

[5] The terms of the contract are presented in some detail in the opinion of the Court of Appeals, Goldman v. Parkland of Dallas, Inc., 7 N.C. App. 400, 173 S.E.2d 15 (1970).

[6] 277 N.C. at 227, 176 S.E.2d at 787.

[7] *Id.* at 229, 176 S.E.2d at 788.

[8] *Id.*

[9] N.C. GEN. STAT. § 55-145(a) (1965) provides:

> Every foreign corporation shall be subject to suit in this State, by a resident of this State or by a person having a usual place of business in this State, whether or not such foreign corporation is transacting or has transacted business in this State and whether or not it is engaged exclusively in interstate or foreign commerce, on any cause of action arising as follows:
> (1) Out of any contract made in this State or to be performed in this State....

satisfy the requirements of due process—by declining to base jurisdiction solely upon the contract's being made in North Carolina.

After deciding that the contract was executed in North Carolina, the court in *Goldman* turned to the issue of whether the contract had a "substantial connection" with the state. That particular phrase had been used previously to interpret the second condition of the statute: "contracts to be performed in this State." In those cases in which the contracts had been made in other states,[10] the courts needed to determine to what extent the performance itself had to be within North Carolina before the statute and due process were satisfied. In *Byham v. National Cibo House Corp.*,[11] the court decided that "[i]t is sufficient for the purposes of due process if the suit is based on a contract which has substantial connection with the forum state,"[12] or in other words, is to be performed substantially within North Carolina. *Goldman* seems to stand for the proposition that whether a contract is made within the state is one of the factors to be considered in deciding if the contract has a "substantial connection" with the state,[13] and thus whether due process requirements are met. The decision merges execution and performance into factors of a single test, rather than considering them separate tests as a reading of the statute might suggest.

The *Goldman* opinion is not particularly illuminating as to how the factors making up a "substantial connection" are to be weighed. As noted above, the North Carolina statute allows jurisdiction based upon contracts which were not made within the state.[14] But it is not a logical step to say that the court would allow jurisdiction based upon a contract

[10] *E.g.*, Bowman v. Curt G. Joa, Inc., 361 F.2d 706 (4th Cir. 1966); Byham v. National Cibo House Corp., 265 N.C. 50, 143 S.E.2d 225 (1965).

[11] 265 N.C. 50, 143 S.E.2d 225 (1965).

[12] *Id.* at 57, 143 S.E.2d at 232.

[13] The Supreme Court, in McGee v. International Life Ins. Co., 355 U.S. 220, 223 (1957), used the phrase "substantial connection" in describing all aspects of the contract's connection with the forum state. The language in the *Goldman* opinion indicates the term is used broadly:

> In the instant case the contract in question clearly met the requirement of "substantial connection" with North Carolina. It was made in this State. Plaintiff, under the terms of the contract, solicited business in thirty or more North Carolina cities and towns . . . . He devoted a larger part of his time to promoting defendant's business in North Carolina than in any other state and did in fact sell a quantity of dresses manufactured by the defendant to customers within this State.

277 N.C. at 229, 176 S.E.2d at 788.

[14] *See* note 10 and accompanying text *supra.*

which was made in North Carolina but not to be performed there, since the requirements of due process read additional standards into the statute.

There is, as yet, no North Carolina decision concerned with whether the making of a contract within the state is, in itself, a sufficient connection to subject the foreign corporation to suit there.[15] A somewhat similar problem was before the United States Supreme Court in *McGee v. International Life Insurance Corp.*,[16] where the Court allowed California to exercise personal jurisdiction over an Arizona insurance company which had solicited a California resident's business by mail. But *McGee* cannot be cited for the proposition that the making of *any* commercial contract within a forum state is sufficient to satisfy the minimum contacts required for due process, because, as the Court stressed in *Hanson v. Denckla*,[17] insurance is "an activity that the State treats as exceptional and subjects to special regulation."[18] Indeed, in *Hanson* the Court stated that "it is a mistake to assume that this trend [toward relaxation of minimum contacts requirements] heralds the eventual demise of all restrictions on the personal jurisdictions of state courts."[19] Minimal contacts are still a prerequisite.

The touchstone case involving the North Carolina long-arm statute is *Erlanger Mills, Inc. v. Cohoes Fibre Mills, Inc.*[20] There the contract was made in New York and called for a single shipment of goods from New York to North Carolina. The Fourth Circuit Court of Appeals held that the requisite minimum contacts were not present in this situation. In the course of its opinion, the court discussed[21] *Compania de Astral,*

[15] The *Goldman* opinion is elusive on this point. Although the court is careful to set out the extent of the performance (both actual and contemplated) within North Carolina, the point is made that

> clearly the North Carolina Legislature, by the express words of the statute authorizing such service on a foreign corporation *when the contract was made in North Carolina,* sought to give its courts the power to assert jurisdiction over nonresident defendants to the full extent permitted by the due process amendment.

277 N.C. at 229-30, 176 S.E.2d at 788-89 (emphasis added). This latent ambiguity may allow the case to be cited as a chameleon precedent—assuming the color either of an argument that a contract alone is enough, or that more is required.

[16] 355 U.S. 220 (1957).

[17] 357 U.S. 235 (1958).

[18] *Id.* at 252. The discussion of *McGee* in *Goldman* does not explicitly recognize this distinction. Jurisdiction based upon a single contract may turn on a number of factors. See Annot., 23 A.L.R.3d 551 (1969).

[19] 357 U.S. at 251.

[20] 239 F.2d 502 (4th Cir. 1956).

[21] *Id.* at 508.

S.A. v. Boston Metals Co.,[22] which had been cited by the plaintiff for the proposition that the mere making of a contract within the forum state is a sufficient basis for jurisdiction when the long-arm statute so allows. In *Erlanger* the court said that *Astral* does not rest on that basis.[23] The inference would seem to be that the court would not be impressed simply by the execution of a contract within the state without more. The *Erlanger* court, in explaining its holding, said:

> The orderly and fair administration of the laws throughout the nation is a highly important factor to consider. We cannot shut our eyes to the disorder and unfairness likely to follow from sustaining jurisdiction in a case like this. It might require corporations from coast to coast having the most indirect, casual and tenuous connection with a State to answer frivolous law suits in its courts. To permit this could seriously impair the guarantees which due process seeks to secure.[24]

Does it make sense to say that the connections with North Carolina would be substantially less "indirect, casual and tenuous" if the *Erlanger* contract had been made in the state upon its deposit into a mailbox? To base a decision on that ground would be to ignore the reasons behind the requirement of minimal contacts with the forum state. Contracts with foreign corporations would involve "battles of the forms" in which the out-of-stater would design its paperwork so that the last act would have to be done in its own state.[25]

Byham v. National Cibo House Corp.[26] is very similar to *Goldman* on its facts. In *Byham*, a North Carolina resident sued a foreign corporation on a cause of action arising from a franchise contract. The contract was made in Tennessee and authorized a pizza house in North Carolina under the defendant's franchise. The defendant sent a representative to

[22] 205 Md. 237, 107 A.2d 357 (1954), *cert. denied*, 348 U.S. 943 (1955). A dissenting opinion is found at 108 A.2d 372 (1954).

[23] 239 F.2d at 508 n.4. In *Astral* the Maryland court allowed personal jurisdiction, pursuant to its statute, over a Panamanian corporation. The suit was based on the breach of a contract made in Maryland for the sale of three ships. However, to find jurisdiction, the court did not look just to the fact that the contract was made there. Instead, it also noted that the ships in question were in Maryland and that the funds for the purchase were held in escrow in Baltimore. It concluded that there was "considerable contact with this State and considerable reliance upon its laws and the protection which they afforded." 205 Md. at 261-62, 107 A.2d at 367.

[24] 239 F.2d at 507 (citations omitted).

[25] *See* Golden Belt Mfg. Co. v. Janler Plastic Mold Corp., 281 F. Supp. 368 (M.D.N.C. 1967), *aff'd per curiam*, 391 F.2d 266 (4th Cir. 1968).

[26] 265 N.C. 50, 143 S.E.2d 225 (1965).

help find a location for the business. The court found a "substantial connection" with North Carolina on these facts.[27] In *Goldman* the contract was made within the state but no representative entered. Parkland's activities in the state came about through the actions of its agent, Goldman. At first blush it appears that Goldman, by his own actions, created personal jurisdiction over Parkland. But this was done pursuant to an agreement with the foreign corporation, which was the beneficiary of the activities. And the agreement (just as the one in *Byham*) contemplated a continuing relationship between the parties, not just a single transaction as in *Erlanger*. Considering the two cases together, it is unrealistic to say that just the making of a contract within the state in *Goldman* takes the place of the temporary entry of a representative in *Byham* to supply the substantial connection. This area of the law depends heavily on a case by case analysis and does not lend itself to facile comparisons. But it seems apparent that the North Carolina court views the place of the contract's completion as only one factor to be considered in finding a substantial connection between the contract (and thus the foreign corporation) and the state. The inference from *Goldman* and the other cases discussed herein seems to be that the mere fact that the contract on which the cause of action arises was made within the state is not enough by itself to sustain jurisdiction over a foreign corporation.[28]

ELMER LISTON BISHOP, III

Professional Responsibility—Canon 6 and the Lender's Attorney

An ethical problem recently arose in a situation in which an attorney was employed by a lending institution to make a title search and close a secured loan. The transaction was completed and the note and deed of trust

[27] *Id.* at 61, 143 S.E.2d at 234.

[28] A holding that execution in North Carolina is alone sufficient for jurisdiction would be inconsistent with the other phrase of N.C. GEN. STAT. § 55-145(a)(1) (1965), which subjects foreign corporations to suit within the state on causes of action based on contracts "to be performed in this State." *See* note 9 and accompanying text *supra*. This has been construed to mean performance to a substantial degree. Bowman v. Curt G. Joa, Inc., 361 F.2d 706 (4th Cir. 1966); *accord*, Golden Belt Mfg. Co. v. Janler Plastic Mold Corp., 281 F. Supp. 368 (M.D.N.C. 1967), *aff'd per curiam*, 391 F.2d 266 (4th Cir. 1968). It would be anomalous for the court to allow the mere fact of execution in North Carolina, no matter how fortuitous the circumstances, to be a sufficient basis for jurisdiction while insisting that otherwise a substantial degree of performance within the state must be shown.

were assigned. After several years, the assignee of the note foreclosed on the securing deed of trust. This action prompted the borrower to request an investigation by the Consumer Protection Division of the North Carolina Attorney General's office as to possible usury. The investigation was initiated and inquiries were directed to the attorney who had handled the original transaction. Unsure of the nature of his relationship to the parties, he requested advice from the Council of the North Carolina State Bar as to what course of action he should pursue in response to the inquiries.

The answer to this request was supplied by Ethics Opinion 715,[1] in which the Council held that the attorney was employed by the lending institution to search the title to the land which was to secure the proposed loan, and therefore he could not disclose the possibility of usurious interest rates to the borrower. The basis for the holding was that such a disclosure by the attorney would be a violation of Canon 37 of the Canons of Professional Ethics, because it would breach the "Confidences of a Client,"[2] the lending institution.

Thus the Council affirmatively held, despite some unreconciled prior language to the contrary,[3] that the attorney who is employed by the lender to search title incident to a secured loan transaction represents the lender and not the borrower even though the usual practice is for the borrower to pay the attorney's fee. The lender's practice of using its attorney to search title and requiring that his fee be paid by the borrower has been upheld as not unethical in a series of opinions by the Council of the North Carolina State Bar.[4] The rationale of these opinions is not given, but there are at least two alternatives. One is that *only* the lending institution

[1] N.C. STATE BAR COUNCIL, OPINIONS, No. 715 (1970), *reported*, 17 THE NORTH CAROLINA BAR no. 3 at 11 (1970) [hereinafter cited as N.C. BAR].

[2] N.C. CANONS OF PROFESSIONAL ETHICS No. 37, *reported*, THE NORTH CAROLINA STATE BAR, STATUTES, RULES AND REGULATIONS, CANONS OF ETHICS AND OPINIONS VI-67 (Melott ed. 1970) [hereinafter cited as Melott].

[3] N.C. STATE BAR COUNCIL, OPINIONS, No. 395 (1962), *reported*, Melott II-95, is cast in terms of "duty to the borrower." This opinion is more fully explored at notes 8-10 *infra*.

[4] N.C. STATE BAR COUNCIL, OPINIONS, No. 370 (1962); No. 291 (1959); No. 153 (1955); No. 43 (1947), *respectively reported*, Melott II-85, -64, -27, -7. In these opinions the central ethical question involved the impact of Canon 6 of the Canons of Professional Ethics in the secured loan situation. Canon 6, *reported*, Melott VI-8, is entitled "Adverse Influences and Conflicting Interests," and states in pertinent part: "It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts."

The ABA Committee on Professional Ethics has also considered, and found no impropriety in, the identical practice. See ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 837 (INFORMAL).

is the client and that the attorney does not represent the borrower.[5] If this is the position taken, then the holdings indicate that Canon 6, which proscribes representation of conflicting interests,[6] does not apply in the secured loan situation, for that Canon contemplates representation of two interests by the same attorney. Another possible rationale for these opinions is that the attorney is representing both the lender and the borrower, but that since each has the same interest in ascertaining title to the land there is no actual conflict of interest.[7] Under this theory Canon 6 applies but is not violated. Since none of these opinions involved an actual conflict of interest, it was unnecessary for the Council to clarify the basis of its holdings.

In Opinion 395[8] such a conflict was present. There the attorney searching title for a lender discovered that the proposed loan would be usurious and requested advice as to the extent of his duty to the borrower. The Council held that he had discharged his duty to the borrower by furnishing him, upon request, a disbursement sheet which disclosed on its face the usurious interest rates.[9] By speaking in terms of duty to the borrower the Council apparently rejected the theory that the borrower is not represented. Had this theory been the basis of the prior

[5] N.C. STATE BAR COUNCIL, OPINIONS, No. 42 (1947), *reported*, Melott II-7, states: "There is nothing improper in *Banks* [*sic*] *employing* counsel in title matters connected with loans made by it, his fee being paid by the borrower" (emphasis added). This language seems to regard the lender (Bank) as the client.

[6] N.C. CANONS OF PROFESSIONAL ETHICS No. 6, *reported*, Melott VI-8. See note 4 *supra*.

[7] More recently the Council has recognized, in N.C. STATE BAR COUNCIL, OPINIONS, No. 712 (1970), *reported*, N.C. BAR at 9, that the mere *potential* for conflict may be sufficient to find a violation of Canon 6. The Council said:

> There are few situations in which a lawyer would be justified in representing in litigation multiple clients with potentially differing interests. This is so because when the interests move from being potentially differing to actually differing, the attorney is required to withdraw from employment which might well result in a hardship and burden on the client.

See note 10 *infra* for a related opinion.

However, Opinion 712 deals with litigation. The Council may be reluctant to extend its reasoning to the secured loan transaction, either because it feels that there is a fundamental difference in representation during litigation and representation in the course of ordinary business affairs, or because it is willing to tolerate potential conflict in the secured loan situation since it views that potentiality as an inevitable result of a necessary method of handling the transaction.

[8] N.C. STATE BAR COUNCIL, OPINIONS, No. 395 (1962), *reported*, Melott II-95.

[9] In practical effect the duty to the borrower recognized here is more apparent than real because the disbursement sheet normally would have been furnished to the borrower as an incident of the transaction. In fact, even after it is furnished the borrower most likely remains uninformed as to the ultimate interest rate. Only extended calculation would reveal this figure, and even if the borrower made a correct determination he probably would be unaware that it is usurious.

opinions, the holding in Opinion 395 would have been that there was *no* duty to the borrower since no duty is owed by an attorney to one who is not his client. However, although seemingly rejecting the one alternative, the Council did not fully espouse the other. Had the basis of the prior holdings been that the attorney represents both parties, the Council would have ordered his withdrawal in the instant situation since Canon 6 precludes further representation of either party once a conflict has arisen between their separate interests.[10] Thus the holding in Opinion 395 seems to indicate that there is a primary duty to the lender, with only a secondary duty to the borrower. Whatever it may say about the scope of this duty to the borrower, it does indicate that he is represented to some extent.

Opinion 715, without reconciling Opinion 395, denied any role for Canon 6 in this situation. Its holding that information as to usury is privileged between the lender and its attorney is clearly based on the premise that only the lender is the client. Thus, the Council found no duty of disclosure to the borrower, and, moreover, that voluntary disclosure would violate Canon 37. This holding leaves the borrower completely unprotected[11] despite the fact that he pays the fee and as a result may well believe that his interests are represented.[12] Such a belief would be erroneous at present but nothing in the opinions requires that the error be brought to the borrower's attention.

However, by holding that only the lender is the client, the Council properly rejected the alternative holding that *both* the lender and the borrower are represented. In doing so, it avoided the application of Canon

[10] See N.C. STATE BAR COUNCIL, OPINIONS, No. 558 (1967), *reported*, Melott II-149. This opinion allows representation of two clients after full disclosure as long as no conflict exists or arises between them, but requires withdrawal if conflict does arise. See also N.C. STATE BAR COUNCIL, OPINIONS, No. 712 (1970), *reported*, N.C. BAR at 9; No. 709 (1970), *reported*, N.C. BAR at 11.

[11] Although the ruling in Opinion 395 afforded only minimal affirmative protection, it did not preclude further action on the borrower's behalf by the attorney; the opinion required merely that the attorney furnish a disbursement sheet upon request, but did not forbid him to do more if his conscience dictated that he must. However, under Opinion 715, even if the attorney feels morally obligated further to protect the borrower he cannot.

[12] Whether borrowers routinely make this assumption is a question this writer is unprepared to answer. Informal talks with practicing attorneys and real estate brokers have revealed that on occasion borrowers have done so. One attorney commendably noted that as a matter of personal feeling he routinely makes certain that the borrower is not misled even though he is not required to do so. It is doubtful whether all attorneys feel a similar obligation. Therefore, if only one borrower is misled and thereby damaged, both he and the whole legal profession suffer. The possibility of reliance is sufficient to call for ameliorative measures, whatever the actual incidence may be.

6 and therefore did not confront the central difficulty faced in Opinion 395—the necessity of choosing among the unpalatable remedies available for a violation of that canon.[13]

But was the Council justified in refusing to find that since there is a possibility of reliance the *borrower* is the client? In theory, the result of such a hypothetical holding would be that only the borrower would be protected in the event of actual conflict. The practical result, however, probably would be an immediate change in the handling of the secured loan transaction. Since the problem originally arose only because there was no understanding between the parties as to who was the client, if the lender were to reach an agreement with the borrower that the attorney represented only the lender, this consent by the borrower would remove the situation from the ambit of the hypothetical ruling. By obtaining such consent, the lender would easily vitiate this attempt to protect the borrower from injury occuring as a *result* of an actual conflict. However, as a fortuitous consequence of such an informed consent the borrower would be able *to protect himself* from the *possibility* of such conflict. After the disclosure the borrower would be aware that he was unrepresented, and, therefore, presumably cognizant of the risk that he would be running in remaining so—the risk that the loan is in any manner unfavorable to him. Thus he would be able to make a knowledgeable choice as to whether to hire his own attorney,[14] or to save the additional fee and assume the risk of an unfavorable loan. Since the duties of a second attorney would be only to check the abstract of title and approve the terms of the loan, his fee should be minimal. In sum, although a holding that the borrower is the client probably would not achieve its intended result of full protection for the borrower,[15] it would bring about the more practical result of insuring —because of the full disclosure and consent—that the borrower is not misled into believing that he is represented.

Thus, it might seem that it would have been preferable to find the bor-

[13] These alternatives include the burdensome remedy of withdrawal, see notes 7 & 10 *supra*, and the anomalous principle of permitting unequal representation of conflicting interests, see N.C. STATE BAR COUNCIL, OPINIONS, No. 395 (1962), *reported*, Melott II-95, discussed pp. 845-46 *supra*.

[14] Under the current practice, the borrower clearly has a right to hire an additional attorney. See, *e.g.*, ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 837 (INFORMAL). However, since he is not made aware that he is unprotected, he is also unaware of the possibility that he may *need* such an attorney. Therefore, this right is meaningless because he has no reason to know that he may need to exercise it.

[15] Such full protection probably could not be achieved without the economically wasteful expedident of requiring each party to retain an attorney.

rower to be the client in order to protect him from the possibility of mistaken reliance. Such a finding would be more attractive than the present situation. Yet there may be an alternative even more appealing than this proposal. Since the protection afforded therein would be only a proximately caused consequence of such a holding, and not an *ethically required* result, the Council would be resolving an ethical problem simply by sanctioning that choice of practices which would *tend* to produce an ethical result. Ideally, the Council should *require* an ethical result, not merely structure the situation so that such a result would rationally follow.

The additional alternative would be to continue to hold that the lender is the client but to *require* that this fact be made absolutely clear to the borrower. Some sort of knowledgeable consent must be required; the borrower must be made aware that he is not the client[16] even though he is paying for the attorney and is receiving incidental benefits therefrom in the form of a title search. The present holdings not only leave the borrower unprotected, but also unaware that he is unprotected; yet the nature of present practices may well mislead him into the opposite belief. The proposed warnings would insure that every borrower be able to *choose* whether to assume the risk of an unfavorable loan. Probably many would choose to assume that risk rather than pay the additional fee, but this infrequency is no argument against disclosure, since the burden of that disclosure is only negligible.

Perhaps an even more desirable alternative would be to require not only that this initial disclosure be made, but also that the lender pass the attorney's fees along to the buyer in the form of a built-in cost of the loan. Including the fee in the cost of the loan would render the borrower unaware that he is paying it, thus further removing the possibility that he will be mislead into believing that he is fully represented.

In conclusion, the Ethics Opinions of the Council of the North Carolina State Bar now leave the secured-loan borrower in a deceptively unprotected position. It is strongly urged that the Council adopt at least

[16] In N.C. STATE BAR COUNCIL, OPINIONS, No. 709 (1970), *reported*, N.C. STATE BAR at 11, the council held that an attorney employed by an insurance company to defend its insured could also represent the insured in his counterclaim. However, the attorney was required to make a full disclosure to the insured of the effect that an exercise of the insurance company's right to settle the suit would have on the counterclaim. The council added that if it appeared that the insurance company might desire to settle, the attorney should not represent the insured in his counterclaim.

Though not strictly analogous because it deals with the litigation situation, the opinion does lend some support to a full disclosure argument in a non-litigious context.

one of the proposed alternatives—preferably the latter—to insure that no borrower be unfairly misled.

W. LUNSFORD LONG, III

Uniform Commercial Code—Protection for the Purchase Money Secured Party Under Section 9-312

The basic section of the Uniform Commercial Code dealing with the problem of priorities among conflicting security interests in the same collateral is section 9-312. Subsection (4) extends special protection to purchase money security interests in collateral other than inventory by giving such an interest priority over a conflicting security interest "if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter." In the recent case of *Brodie Hotel Supply, Inc. v. United States*,[1] the Court of Appeals for the Ninth Circuit has unduly extended the scope of this protection.

In 1959 Brodie sold some restaurant equipment to a company that later went bankrupt. Brodie repossessed the equipment but left it in the restaurant. On June 1, 1964, Lyon took possession of the restaurant and equipment and began operating the restaurant while negotiating the price and terms under which he would purchase the equipment from Brodie. On November 2, 1964, Lyon borrowed seventeen thousand dollars from the National Bank of Alaska and gave the bank as security a chattel mortgage on the equipment. The bank assigned the mortgage to the Small Business Association (SBA), and on November 4, 1964, filed a financing statement showing the SBA as assignee. On November 12, 1964, Brodie gave to Lyon a bill of sale for the equipment, and Lyon gave Brodie a chattel mortgage on the equipment to secure the unpaid purchase price. Brodie filed a financing statement on November 23, 1964.[2] Thus the crucial dates in the case are the following: June 1, when Lyon took possession of the equipment; November 4, when the bank filed; November 12, when the debtor-creditor relationship was entered into by Brodie and Lyon; and November 23, when Brodie filed. Subsequently, the SBA sold the equipment to satisfy its mortgage,[3] and Brodie sued to determine

[1] 431 F.2d 1316 (9th Cir. 1970). The court in this case applied the Alaska version of the Code. However, for ease of discussion, the general Code provisions, rather than the Alaska enumeration thereof, will be cited.

[2] All of the above facts are set forth in the opinion.

[3] Brief for Appellant at 2, Brodie Hotel Supply, Inc. v. United States, 431 F.2d 1316 (9th Cir. 1970).

whether it or the SBA should have priority over the proceeds of the sale.[4] The district court granted summary judgment without opinion for Brodie,[5] and the United States appealed.[6]

The court of appeals, in affirming the summary judgment, held that where a party obtains possession of goods before becoming a debtor in a security agreement covering the goods, the ten-day period in section 9-312(4) dates from the time of the creation of the debtor-creditor relationship rather than from the time the debtor actually comes into possession. The court based its opinion on two grounds. First, it read into section 9-312(4) the code definition of "debtor"[7] and held that Lyon was not a "debtor" within the meaning of section 9-312(4) until November 12;[8] therefore, the filing by Brodie was within the ten-day period.[9] Second, the court recognized the "specially favored position"[10] given by the Code to the holder of a purchase money security interest and concluded:

> The protection which the Code confers upon a purchase-money interest in non-inventory collateral is not unduly extended by a decision giving priority to Brodie's interest. Although it is true that Brodie could have filed a financing statement as soon as Lyon went into possession and thus protected itself, it is also true that the bank, SBA's assignor, could have protected itself by inquiring into Lyon's interest in the equipment before accepting his chattel mortgage. Due to the favored status given by the Code to the holder of a purchase-money interest in non-inventory collateral, we are not convinced that the trial court erred in refusing to impose this burden on Brodie.[11]

In short, the court seemed to feel that its decision was based both on sound statutory interpretation and on a sound reading of the policies underlying the Uniform Commercial Code. The contention of this note is that the court improperly read section 9-312(4) and that, in so doing, it gave too

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[4] *Id.*

[5] *Id.* at 5.

[6] *Id.*

[7] UNIFORM COMMERCIAL CODE § 9-105(1)(d) defines "debtor," in part, as "the person who owes payment or other performance of the obligation secured . . . ."

[8] 431 F.2d at 1319.

[9] *Id.* There are eleven days between November 12 and November 23. However, ALASKA STAT. § 01.10.080 (1964) provides that in computing time, the first day is excluded and the last day is included unless the last day is a holiday, in which case it is excluded. Apparently the filing was timely under this statute.

[10] 431 F.2d at 1319. For a detailed treatment of purchase money interest priority, see II G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 28.1-.7 (1965) [hereinafter cited as GILMORE].

[11] 431 F.2d at 1319.

much protection to, and imposed too little responsibility upon, a secured party with a purchase money security interest.

In fairness to the court, it should be noted that the language of section 9-312(4) is ambiguous since it refers to the "time the *debtor* receives possession."[12] It is not clear whether "debtor" is used merely to identify the party or whether it is also used to establish the time at which the ten-day period begins to run. However, the Code itself calls for construction of language so as to "promote its underlying purposes and policies."[13] In attempting properly to construe section 9-312(4), therefore, it will be helpful to look first at the purposes and policies embodied by the section.

A long-standing problem in the area of chattel security law has been the possibility that a debtor could continue to get credit on property that he apparently owned but which, in fact, was subject to other security interests.[14] Over the years, the development has been away from secrecy in secured transactions and toward a system providing notice to possible later creditors.[15] "The modern tendency is to require formal public notice in an increasing number of situations, but there is a current relaxation in the requirements of formality in the notice given . . . ."[16] The fact that this modern trend is embodied in the Code was recognized in *National Cash Register Co. v. Firestone & Co.*,[17] in which the court said, "The framers of the Uniform Commercial Code, by adopting the 'notice filing' system, had the purpose to recommend a method of protecting security interests which at the same time would give subsequent potential creditors . . . information and procedures adequate to enable the ascertainment of the facts they needed to know."[18] In most cases this method involves withholding "perfected" status from security interests until a financing statement has been filed.[19] However, in the case of purchase money security interests in non-inventory collateral, the Code in section 9-312(4) allows

[12] Emphasis added.

[13] UNIFORM COMMERCIAL CODE § 1-102. The ensuing comment reiterates this point and adds that "the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved."

[14] Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 COLUM. L. REV. 1, 19 (1963).

[15] Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289-90 (1962).

[16] *Id.* at 290.

[17] 346 Mass. 255, 191 N.E.2d 471 (1963).

[18] *Id.* at 261, 191 N.E.2d at 474.

[19] UNIFORMAL COMMERCIAL CODE § 9-303.

ten additional days during which the secured party may perfect. In his treatise on secured transactions, Professor Gilmore points out that this grace period was included in pre-1956 drafts, omitted in the 1956 draft, and then restored in the 1958 and subsequent drafts.[20] The reason for finally including the grace period, according to Gilmore, was to enable the purchase money financer to keep his priority even where the debtor-purchaser demands delivery of the goods immediately.[21]

Under the Code, filing may be done at any time[22]—even before a security agreement is in existence[23]—and the filing requirement may be met with an extremely simple financing statement.[24] Brodie could easily have filed a statement at any time after June 1, and this would have protected it against a subsequent creditor. Because of Brodie's failure to file, the bank had no notice of the existence of Brodie's interest. Furthermore, since the collateral consisted of some 159 separate types of items, ranging from a refrigerator and a dishwasher to spoons, forks, cups, ladles, pots, and other small items,[25] there was nothing the bank could have done to determine with absolute certainty whether Lyon was the owner of the items. Surely this is a ludicrously difficult burden of risk to place upon a party when the other party could both protect itself and give notice to later parties by the simple expedient of filing a statement.

Nevertheless, the court maintains that the bank "could have protected itself by inquiring into Lyon's interest,"[26] but it does not consider the difficulty—if not the impossibility—of such an inquiry and does not weigh against such an inquiry the ease with which the opposing party could have avoided the conflict in the first place. In addition, the court does not consider the purpose of the section stated by Gilmore—allowing for immediate delivery. This purpose is quite easily served by giving the seller ten days in which to file, but it hardly requires allowing the seller—as the court did here—more than four months in which to file, especially when the public, during this period, has no notice of the seller's interest in the goods.

The court's decision creates a considerable degree of unnecessary uncertainty with respect to all personal property. A potential secured party

[20] GILMORE § 29.5.
[21] *Id.*
[22] UNIFORM COMMERCIAL CODE § 9-402(1).
[23] *Id.*
[24] UNIFORM COMMERCIAL CODE § 9-402 requires only the signature and address of the debtor and secured party and the types of property covered by the statement.
[25] 431 F.2d at 1318.
[26] *Id.* at 1319.

cannot be certain—either through the possession of the goods by the potential debtor or through notice given him by a filed financing statement—that the goods are not subject to an arrangement that could later mature into a debtor-creditor relationship defeating the priority that the potential secured party would expect for his interest. It would seem, then, that the purposes and policies of the Code would better have been served by beginning the ten-day period on June 1 when Lyon took possession of the equipment rather than at the time the debtor-creditor relationship was entered into.

Even disregarding the Code policies, it is not at all clear that the court was correct in its reading of the actual language. The court ignored the fact that section 9-402(1), which sets forth the requirements for financing statements, also uses the term "debtor"; and its use of the term makes it clear that it is used solely for purposes of identification and *not* for any timing purposes. If the court were to read the Code definition of "debtor"[27] into section 9-402(1) as it did into section 9-312(4), it would mean that a financing statement would not be valid until a debtor-creditor relationship had been established. This reading of section 9-402(1) is clearly negated by the section itself, which contains a provision that a statement may be filed "before a security agreement is made or a security interest otherwise attaches."[28] In section 9-402(1) it would appear that the term "debtor" merely refers to a person who expects to become a debtor, at least where the financing statement is filed before a security agreement is entered into. And the same meaning can just as well be applied to the term in section 9-312(4). Gilmore apparently agrees with the reading of "debtor" as merely a word of identification, since he states that "receives possession" in section 9-312(4) "is evidently meant to refer to the moment when the goods are physically delivered at the debtor's place of business . . . ."[29]

One commentator has written:

> A history of chattel security could well be written in terms of the 400-year struggle by debtors and their secured creditors to create security interests of various sorts in the debtor's property without affording notice to buyers or other creditors, and the attendant demands

[27] See note 7 *supra*.

[28] This view is reinforced by UNIFORM COMMERCIAL CODE § 9-312(5)(a), which states that priority between conflicting security interests in the same collateral shall be "in the order of filing if both are perfected by filing, regardless of which security interest attached first . . . and whether it attached before or after filing."

[29] GILMORE § 29.3.

> by unsecured creditors generally for some kind of notice when all or part of the debtor's assets become subject to security interests. The parties favoring secrecy have, for the most part, been the losers . . . .[80]

In *Brodie* the party favoring—or at least practicing—secrecy emerged as the winner despite the fact that by a simple step he could have prevented the litigation from ever arising. In allowing this result, the court unnecessarily creates for a potential secured party an uncertainty that is difficult to justify either by the language or by the underlying policies of the Code.

LOUIS W. PAYNE, JR.

[80] COOGAN, *supra* note 15, at 289.