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Notes

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NOTES

Agency—Apparent Authority and Agency by Estoppel: Emerging Theories of Oil Company Liability for Torts of Service Station Operators

The average American motorist has no way of knowing what business arrangement exists between the operator of the local service station he patronizes and the "brand name" oil company whose products the station sells. Yet, in the past the nature of this business relationship has been determinative on the issue of the liability of the oil company for the torts of its operators because courts have consistently refused to hold the oil company liable unless a master-servant or principal-agent relationship invoking respondeat superior could be established.[1] Recently, however, in *Gizzi v. Texaco, Inc.*[2] the court of Appeals for the Third Circuit looked to the apparent relationship between the oil company and dealer and upheld apparent authority and agency by estoppel[3] as grounds for jury consideration of oil company liability.

In *Gizzi* plaintiffs Gizzi and Giaccio (a passenger) were injured in an expressway collision when the brakes failed on a van bought by Gizzi from a Texaco operator on the day of the accident. As an incident to the sale of the van, the Texaco dealer had repaired the brakes. Both plaintiffs sued Texaco[4] for personal injury under theories of apparent agency and agency by estoppel[5] citing Texaco's national advertising portraying its dealers as being skilled in automotive servicing, evidence of acquiescence by Texaco in the sale of used cars by this and other dealers, and evidence of a sign on the premises that indicated the pres-

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[1]Annot., 83 A.L.R.2d 1282 (1962); *see* Annot., 116 A.L.R. 470 (1938).

[2]437 F.2d 308 (3d Cir.) (2-1 decision), *cert. denied*, 92 S.Ct. 65 (1971).

[3]For purposes of this note, no attempt is made to distinguish between theories of apparent authority and agency by estoppel. Some writers contend that apparent authority is based on estoppel and that the two theories are substantially coextensive. P. MECHEM, OUTLINES OF THE LAW OF AGENCY §§ 85-90 (4th ed. 1952). Others argue that apparent authority is founded upon the objective theory of contracts and that apparent authority and agency by estoppel are distinguishable on grounds such as the estoppel requirement of change of position (for example, executory contracts are said to be enforceable under apparent authority but not estoppel); the origins of estoppel being in tort, apparent authority in contract; and enforceability by the principal. RESTATEMENT (SECOND) OF AGENCY § 8, comment *d* at 32-33 (1957) [hereinafter cited as RESTATEMENT]; W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 8E (1964). However, all seem to agree that in most cases the elements of both theories are present and any differences are immaterial. RESTATEMENT § 8, comment *d* at 32-33.

[4]The station operator was not a defendant in the action. 437 F.2d at 309.

[5]The plaintiffs also alleged actual agency, but no actual authority for the sale of the van was found by the trial court or the appellate court. *Id.*

ence there of an "Expert foreign car mechanic."[6] Especially singled out was Texaco's slogan "Trust your car to the man who wears the star."[7] The district court ruled that plaintiffs had not introduced sufficient evidence to warrant submission of the issues of apparent authority (or actual authority) to the jury and directed a verdict in favor of Texaco. On appeal the Third Circuit, in viewing the evidence in a light most favorable to plaintiffs, found that reasonable men could differ as to whether Texaco had clothed its dealer with apparent authority to repair and sell vehicles and remanded the case to allow the jury to consider this question of fact.[8]

Prior to the *Gizzi* decision, in cases involving the asserted liability of oil companies for acts of their service station operators, the courts had relied exclusively upon the doctrine of respondeat superior.[9] Under this doctrine the courts examine the degree of "control"[10] or "right to control"[11] between the company, as master or principal, and the dealer, as servant or agent. The focal points in the respondeat superior analysis are the written contract and, with varying emphasis, the working relationship. Relevant factors include who owns title to the business, how the dealer is compensated, who controls the retail price, and whether the oil company has the power to terminate the sales agreement, to withdraw essential equipment, or to control the station employees (especially in their day-to-day conduct).[12] Findings vary widely[13] because of differences of opinion as to how much control is necessary to invoke respon-

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[6] *Id.* at 310.

[7] *Id.*

[8] In remanding for jury consideration the issues of apparent authority and agency by estoppel, the court made clear that it found no "overwhelming case of liability." *Id.*

[9] Annot., 83 A.L.R.2d 1282 (1962); *see* Annot., 116 A.L.R. 470 (1938).

[10] A distinction is typically drawn between control over details of the work and mere control over the result to be achieved. *See, e.g.,* Miller v. Sinclair Ref. Co., 268 F.2d 114, 118 (5th Cir. 1959).

[11] "One of the main criterions, if not the chief one, as to whether the relationship of respondeat superior exists, is the right to control, and it is not a question as to whether that control is actually assumed but whether it exists." Greene v. Spinning, ___ Mo. App. ___, ___, 48 S.W.2d 51, 57 (1931).

[12] Comment, *Master and Servant—The Filling Station Operator as an Independent Contractor,* 38 MICH. L. REV. 1063, 1070 (1940); Annot., 83 A.L.R.2d 1282, 1284-85 (1962).

[13] For the purpose of tort liability the courts seem to differ over the extent to which they will be influenced by the factors surrounding the relationship de hors the written contract between the [filling station operator and the oil company] . . . . The myriad factual combinations possible with varying degress of economic control complicate the problem of forecasting the result in any particular situation.

Comment, 38 MICH. L. REV., *supra* note 12, at 1072.

deat superior and because of the profusion of types of arrangements between oil companies and dealers.[14]

The courts were consistent prior to the *Gizzi* decision in not accepting apparent authority or agency by estoppel as grounds for oil company liability. Before 1952, according to one authority,[15] no oil company had ever been held liable under an estoppel theory arising from its apparent ownership of its service stations.[16] Nor has the pattern changed: no plaintiff has been successful in recovering from the oil company purely under theories of apparent authority or agency by estoppel since then. The courts rejected these theories on various grounds such as the fact that no evidence existed as to why plaintiff patronized the station and hence there was no evidence of reliance;[17] that it was common knowledge that trademark signs were displayed by independent contractors;[18] that signs were not a "holding out" by the oil company but only an indication that its products were sold;[19] and that newspaper advertisements referred only to the sale of specific products depicted and created no apparent authority or agency by estoppel with respect to brake repairs.[20] *Cawthon v. Phillips Petroleum Co.*[21] is perhaps a representative case and was based on facts not unlike those in *Gizzi.* In *Cawthon* plaintiff sued under theories of apparent authority and agency by estoppel (in addition to the usual actual agency theory) for injuries resulting from a faulty repair of his brakes. Plaintiff stressed the display of oil company signs, signs indicating "Brake Service" and "Mechanic on Duty," general advertising, and especially the slogan "Come to your Phillips 66 Dealer for *all* the things you need to help your car perform

[14]For example, Texaco owns and operates stations, leases land owned by Texaco to "independent dealers," and leases land from third parties for operation of service stations by "independent dealers." In other situations, the dealer leases land directly from the third party. Brief for Appellants at 16-17, Gizzi v. Texaco, Inc., 437 F.2d 308 (3d Cir. 1971). All of these basic arrangements are subject to further variation in the individual contracts.

[15]P. MECHEM, *supra* note 3, § 442.

[16]Actually in Standard Oil Co. v. Gentry, 241 Ala. 62, 1 So. 2d 29 (1941), an isolated case, the court in affirming a judgment against the oil company held that it was for the jury to determine whether or not the oil company was estopped from denying liability. However, special facts existed in that case in that plaintiff had patronized the station previously when it was operated by the oil company, and his testimony tended to show that his reason for transferring his business back to this station was "an unsatisfactory experience with an independent operator and a desire to do business with a more responsible party." *Id.* at 64, 1 So. 2d at 31.

[17]Miller v. Sinclair Ref. Co., 278 F.2d 114, 118 (5th Cir. 1959).

[18]Reynolds v. Skelly Oil Co., 227 Iowa 163, 171, 287 N.W. 823, 827 (1939).

[19]Sherman v. Texas Co., 340 Mass. 606, 608, 165 N.E.2d 916, 917 (1960).

[20]Cawthon v. Phillips Petroleum Co., 124 So. 2d 517, 521 (Fla. Ct. App. 1960).

[21]124 So. 2d 517 (Fla. Ct. App. 1960).

at its best." The photograph that accompanied Phillips' advertisement in which the slogan was used depicted only products sold outright by Phillips to the dealers, and the court found any representation to be limited to "things" for sale. The court found neither a solicitation of mechanical or repair services nor an assertion of agency in Phillips' advertising and affirmed a summary judgment in favor of the oil company.

While *Gizzi* breaks this pattern of rejection of apparent authority and agency by estoppel, its handling of the traditional elements of the two theories poses some problems. *Gizzi* is somewhat at odds with apparent authority cases in other business settings in its handling of the reliance factor (in this case plaintiffs' belief and reliance on Texaco's "standing behind" the sale and repair of the vehicle by its dealer). Traditionally, the plaintiff must have relied upon the principal's indicia of authority[22] (in *Gizzi* upon Texaco's advertising, signs, and the "foreign mechanic" sign). Proof that his reliance is justifiable and reasonable is an essential element of the plaintiff's case[23] and he has the burden of proof.[24] The court did make a cursory reference to reliance by plaintiff Gizzi[25] but there was no mention of reliance by plaintiff Giaccio (the passenger) at all in the opinion.[26] Allowing Giaccio to take his case to the jury on remand, riding the coattails of Gizzi's reliance, would seem to broaden the scope of potential oil company liability beyond that encompassed by traditional concepts of apparent authority.[27]

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[22]Bowman v. Home Life Ins. Co. of America, 260 F.2d 521, 523 (3d Cir. 1958).

[23]RESTATEMENT §§ 27, 267. The court in *Gizzi* cites § 267 with respect to reliance:

> One who represents that another is his servant or other agent and thereby causes a third person justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.

RESTATEMENT § 267.

[24]"However, it is part of plaintiff's case to prove some element of reasonable reliance." W. SEAVEY, *supra* note 3, § 90.

[25]"Appellant Gizzi testified that he was aware of the advertising engaged in by Texaco and that it had instilled in him a certain sense of confidence in the corporation and its products." 437 F.2d at 310.

[26]The only references to Giaccio in appellants' brief aside from general references of reliance by "plaintiffs" are that Giaccio also patronized the service station in question, was present when there were discussions in regard to the vehicle purchased, and was at the station when the vehicle was actually picked up. Brief for Appellants at 27, 32.

[27]RESTATEMENT § 8, comment *e* at 35, illustration 11, gives this example:

> The Ace Taxi Company employs no drivers but merely receives orders from prospective passengers and puts "Ace Taxi Company" on cabs owned and operated by independent drivers. One of those drivers collides negligently with another automobile, damaging one of its passengers who reasonably believes the Taxi Company to be the

Closely related to the reliance issue is a problem raised by *Gizzi* with regard to scope of apparent authority. That is, based upon the representations of the oil company to the public, what range of activities by the dealer might a motorist reasonably surmise to be authorized by the company? This aspect of *Gizzi* seemed most to bother the trial judge[28] and the dissenting judge[29] who felt that no reasonable man could believe that Texaco would authorize and stand behind the repair and sale of a used vehicle and, therefore, that the case should not go to the jury. What constitutes a sufficient factual issue to take the case to the jury is perhaps the critical question in all apparent authority cases reaching for a "deep pocket." In a recent case, *Wallach v. Williams*,[30] the New Jersey Supreme Court affirmed a decision that no factual issue of apparent authority was posed for the jury when a motorist fueling his car at a service station was struck by an automobile negligently driven by a station attendant. The court, however, specifically reserved for determination in an "appropriate" case the question whether the negligence of an independent contractor or his employees[31] might be

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employer. The Taxi Company is liable to the passenger but not to the owner of the other automobile.

[28]The Third Circuit opinion quoted the district court judge:

> "In short, nobody could reasonably interpret any of these slogans or representations or indicia of control as dealing with anything more than the servicing of automobiles, and to the extent of putting gas in them and the ordinary things that are done at service stations.
>
> "That 'Trust your car to the man who wears the star' could not possibly be construed to apply to installing new brake systems or selling used cars."

437 F.2d at 310 (district court opinion unreported).

[29]The majority relied in part on RESTATEMENT § 267. The dissenting judge stressed the last part of comment *a* to § 267:

> "This rule normally applies where the plaintiff has submitted himself to the care or protection of an apparent servant in response to an apparent invitation from the defendant to enter into such relations with such servant. A manifestation of authority constitutes an invitation to deal with such servant and to enter into relations with him *which are consistent with the apparent authority.*"

437 F.2d at 311, *quoting* RESTATEMENT § 267, comment *a* at 578 (emphasis by the judge).

[30]52 N.J. 504, 246 A.2d 713 (1968).

[31]If apparent authority is relied on, it follows that oil companies would be liable for torts of employees of the service station operator (and not just the operator), since it is the motorist's reliance on the oil company's indicia of authority or invitation that establishes liability. Under the respondeat superior approach, if a principal-agent or master-servant relationship is found between the oil company and the service station operator, the oil company is likewise liable for subemployees:

> Where the immediate question is the status of some subemployee or subagent of the [service station operator], it is generally true that his status, in relation to the producing company, follows that of the . . . service station operator, the same general

imputed to an oil company when it appears to the ordinary motorist that the oil company is operating the station or is sufficiently in control to extend an invitation to the public to buy the products or services there.[32]

Policy grounds underlying apparent authority and estoppel as opposed to respondeat superior seem distinguishable in certain areas. One writer cites what he calls the "lip service" paid by the courts to the control test as the basis for respondeat superior as "an attempt to correlate the doctrine with the general rule of tort liability, that of fault."[33] Apparent authority and estoppel have no such connection with fault: "Like apparent authority, [estoppel] is based on the idea that one should be bound by what he manifests irrespective of fault ...."[34] The "enterpriser's risk"[35] theory of respondeat superior contrasts with both the apparent-authority idea of a party's being bound by the reasonable expectations he creates[36] and the similar (some say identical) estoppel notion that as beteween two innocent parties the burden is placed on the one whose misleading manifestations have created reliance and change of position. However, the "deep pocket" rationale, which is often characterized as the true explanation behind the doctrine of respondeat superior, might be said to apply equally to apparent authority and agency by estoppel, at least in the oil company setting. Thus apparent authority could be a second avenue to achieve a social policy of risk distribution with respect to injury caused by service station operators. The oil company is clearly in the best position to assess the business risks of social harm involved in its operation and to distribute the risk to the public through its prices. Indeed, the dealer ordinarily has no capacity to allocate the risk to the public through what he charges. Prices are usually governed by the oil company with the dealer receiving a commission based on sales. The advantage of apparent authority as a

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factors being determinative.

Annot., 83 A.L.R. 2d 1282, 1285 (1962).

[32] The court cited RESTATEMENT § 8, comment *e* at 35, illustration 11. 52 N.J. at 506, 246 A.2d at 714. Illustration 11 is set out in note 27 *supra*.

[33] Comment, 38 MICH. L. REV., *supra* note 12, at 1064-65.

[34] RESTATEMENT § 8, comment *d* at 33.

[35] "Society imposes vicarious liability on the employer because his selection and direction has put the employee in a situation where the wrong occurs and because he is the enterpriser who has assumed the risks of gain or loss from the employee's work activities." Conant, *Liability of Principals for Torts of Agents: A Comparative View*, 47 NEB. L. REV. 42 (1968).

[36] Apparent authority "is that authority which, through [sic] not actually delegated to the agent, the principal intentionally or inadvertently causes third persons to believe the agent to possess." Conant, *The Objective Theory of Agency: Apparent Authority and the Estoppel of Apparent Ownership*, 47 NEB. L. REV. 678, 681 (1968).

means of reaching the "deep pocket" is that problems occasioned by the "control" test of untangling complex oil company-dealer relationships are avoided.

On the other hand, as Texaco argued, allowing an issue of apparent authority to go to the jury on the quantum of evidence presented in *Gizzi* may require oil companies not only to revamp their national advertising but also to refuse to allow their dealers to repair or sell autos unless those activities are stringently controlled by the oil companies. "For if Texaco and other companies must become the guarantors of the non-negligent performance of such services, then they must exercise control over the conduct of their dealers in performing them."[37] Such control would seem to violate a federal policy of preserving the independence of the retail service station dealer,[38] and the oil companies might run the risk of antitrust prosecution if the dealer had no voice in determining what products or services he would offer.[39] These arguments notwithstanding, the oil company should not enjoy the benefits of chain-store marketing methods and national identification with its station operators without assuming concomitant social responsibilities. Moreover, it is debatable whether the dealer is truly independent today. In addition, liability has long been imposed on grounds of apparent authority and estoppel in other business contexts.[40]

In summary, one might conclude that apparent authority and agency by estoppel do represent appropriate theories of oil company liability. *Gizzi* breaks with the traditional pattern in recognizing that the jury should have the opportunity to consider apparent authority in addition to the "control" arguments of respondeat superior. The problem is that *Gizzi* may represent an outer limit with respect to what reasonable men could agree on as being within the apparent authority created by the oil company's manifestations to the public. It cannot reasonably be assumed that the oil company "holds out" its dealer with respect to

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[37]Petitioner's Brief for Certiorari at 6-7, Gizzi v. Texaco, Inc., 437 F.2d 308 (3d Cir.), *cert. denied*, 92 S.Ct. 65 (1971).

[38]The importance of the small retailer in our economy is difficult to overstate. In the gasoline industry, he is the competitive entity that bears the greatest proportionate risk and earns the lowest return on investment. As a small businessman, an individual entrepreneur, his welfare is of particular concern to this Commission. Interference with his right to compete as he chooses and unlawful practices that blunt the effect of his efforts and tend to cause his elimination are matters calling for public intervention.

FTC, REPORT ON ANTICOMPETITIVE PRACTICES IN THE MARKETING OF GASOLINE 40 (1967).

[39]Petitioner's Brief for Certiorari at 9.

[40]P. MECHEM, *supra* note 3, §§ 424-25, 442.

each and every activity the dealer undertakes, and the sale and repair of a used vehicle would seem to be on the borderline. Likewise, sending the passenger's (Giaccio's) case to the jury without any showing of reliance on his part seems unjustified under traditional approaches to apparent authority. Whatever the jury outcome on remand (assuming *Gizzi* is not later overturned), the Third Circuit has now cracked the door that had barred from the jury plaintiffs suing oil companies under theories of apparent authority and agency by estoppel. In so doing, it has removed the greatest obstacle to recovery from the oil companies under those long dormant theories.

CHARLES R. BRITT

Bankruptcy—Filing Fee Subjected to Constitutional Test

In 1892 Congress faced "the question whether this Government, having established courts to do justice to litigants, will admit the wealthy and deny the poor entrance to them."[1] Congress responded by enacting an in forma pauperis statute granting indigents access to federal courts without prepayment of fees or costs.[2] When Congress later adopted the present Bankruptcy Act in 1898,[3] it made specific provision for an in forma pauperis proceeding.[4] This allowed an indigent debtor[5] to file a voluntary petition in bankruptcy and receive a discharge from his debts without payment of the filing fee. In 1946, however, Congress

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[1]H.R. REP. No. 1079, 52d Cong., 1st Sess. 1 (1892).

[2]Act of July 20, 1892, ch. 209, 27 Stat. 252 (now 28 U.S.C. § 1915(a) (1970)). For a general discussion of this statute, see Duniway, *The Poor Man in the Federal Courts,* 18 STAN. L. REV. 1270 (1966).

[3]Bankruptcy Act of 1898, ch. 541, 30 Stat. 544.

[4]Bankruptcy Act of 1898, ch. 541, §§ 40a, 51(2), 30 Stat. 556, 558; General Order 35(4), 172 U.S. 665 (1898). The General Orders in Bankruptcy, adopted by the Supreme Court in 1898 pursuant to § 30 of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 554, are designed to explain, amplify, and apply the provisions of the Bankruptcy Act and have the full force of law except as they conflict with the Act. The General Orders may be found as amended to December 31, 1970, in the appendix to 11 U.S.C. (1970).

[5]The in forma pauperis provision in the Bankruptcy Act from the beginning seems to have been generally interpreted as meaning that a pauper is one totally without assets and available credit. *See, e.g., In re* Medearis, 291 F. 709 (W.D. Tex. 1923); *In re* Collier, 93 F. 191 (W.D. Tenn. 1899). However, somewhat different standards of indigency were applied in Sellers v. Bell, 94 F. 801 (5th Cir. 1899), and *In re* Plimpton, 103 F. 775 (D. Vt. 1900). *See* 2 COLLIER ON BANKRUPTCY ¶ 51.04, at 1876-77 (14th ed. 1971). For a general discussion on in forma pauperis petitions in bankruptcy, see Shaeffer, *Proceedings in Bankruptcy in Forma Pauperis,* 69 COLUM. L. REV. 1203 (1969).

abolished these pauper petitions in bankruptcy[6] and added a provision allowing the petitioner to pay the filing fee in installments over a six- to nine-month period.[7] Congress further provided that all installments must be paid in full before the bankrupt is eligible for a discharge.[8] In a recent district court case, *In re Kras,*[9] the validity of this mandatory fee scheme was successfully challenged on due process grounds.[10]

At present, a filing fee of fifty dollars must accompany each voluntary bankruptcy petition. This figure represents the sum of three separate filing-fee provisions found in the Bankruptcy Act: section 40c(1)[11] provides that a thirty-seven dollar filing fee shall go into the Referees' Salary and Expense Fund;[12] section 48c[13] provides that a filing fee of ten dollars shall be paid to the trustee of the bankrupt's estate for the

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[6]Act of June 28, 1946, ch. 512, 60 Stat. 323. Congress abolished the pauper petitions in bankruptcy by deleting § 51(2) of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 558; General Order 35(4), 172 U.S. 665 (1898).

[7]Act of June 28, 1946, ch. 512, 60 Stat. 323. Provisions for paying the filing fee in installments are now found in the Bankruptcy Act § 40c(1), 11 U.S.C. § 68(c)(1) (1970); General Order 35(4). Although § 40c(1) does not even mention in forma pauperis petitions, it is sometimes cited as support for the contention that Congress intended to abolish the informa pauperis procedure in bankruptcy proceedings. *See, e.g.*, S. REP. NO. 959, 79th Cong., 2d Sess. 6-7 (1946).

[8]Bankruptcy Act §§ 14b, 14c(8), 40c(1), 59g, 11 U.S.C. § 32(b), 32(c)(8), 68(c)(1), 95(g) (1970); General Order 35(4). The preceding sections have been collectively interpreted as making the payment of the filing fee a prerequisite to receiving a discharge, even in the case of an indigent who is unable to pay such a fee. Some of the sections were amended after 1946 so to provide.

[9]331 F. Supp. 1207 (E.D.N.Y. 1971), *prob. juris. noted,* 92 S. Ct. 955 (1972) (No. 71-749).

[10]The actual holding in *In re Kras* was that the mandatory fee scheme deprived the indigent petitioner of "his Fifth Amendment right of due process, including equal protection." *Id.* at 1212. Three other decisions involving the same issue as *In re Kras* have made similar reference to "equal protection" even though a federal statute—the Bankruptcy Act—was involved. In *In re* Smith, 323 F. Supp. 1082, 1088 (D. Colo. 1971), the court noted that

> [b]y characterizing the problem presented in this case as one of equal protection, we do not mean to suggest that fifth amendment due process takes in all of fourteenth amendment equal protection. It is enough to note that fifth amendment due process does include an equal protection principle . . . .

In *In re* Garland, 428 F.2d 1185 (1st Cir. 1970), *cert. denied,* 402 U.S. 966 (1971), the court noted that although the petitioner alleged a denial of due process, it would consider this allegation in terms most favorable to the petitioner by regarding it as a "claim of lack of equal protection." *Id.* at 1186. And in *In re* Naron, 334 F. Supp. 1150 (D. Ore. 1971), the court simply based its holding on equal protection principles without referring to the fifth amendment. *Id.* at 1151. For Supreme Court cases suggesting the existence of equal protection principles in the fifth amendment, see Shapiro v. Thompson, 394 U.S. 618, 624-42 (1969); Schneider v. Rusk, 377 U.S. 163, 168 (1964); Bolling v. Sharpe, 347 U.S. 497, 499 (1954).

[11]Bankruptcy Act § 40c(1), 11 U.S.C. § 68(c)(1) (1970).

[12]See text accompanying note 23 *infra.*

[13]Bankruptcy Act § 48c, 11 U.S.C. § 76(c) (1970).

services the trustee renders;[14] and section 52a[15] provides that a filing fee of three dollars shall be paid to the clerk of the bankruptcy court.[16] This substantial filing fee is in keeping with the traditional and continued congressional expectation that the federal bankruptcy system be entirely self-supporting.[17]

Until the Bankruptcy Act was amended in 1946 by the passage of the Referees' Salary Bill,[18] referees were not paid for their services from public funds but rather were directly compensated by their statutory share of this filing fee. Under this so-called fee system, a debtor was permitted to file a voluntary petition without the payment of the usual filing fee if his petition was accompanied by an affidavit stating that he was without and could not obtain the money to pay such a fee. However, he could ultimately be ordered to pay the filing fee if later there were satisfactory proof that he could pay or obtain the money to pay.[19] This

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[14]General Order 15 provides that a trustee need not be appointed in no-asset cases. In the districts where this is followed, the fee would be only $40 in no-asset cases. Bankruptcy Act § 48c, 11 U.S.C. § 76(c) (1970); General Order 15. In some jurisdictions, the $10 is simply refunded to the bankrupt. Silverstein, *A Proposal to Waive Bankruptcy Fees in Certain No-Asset Cases*, 52 A.B.A.J. 649 (1966).

[15]Bankruptcy Act § 52a, 11 U.S.C. § 80(a) (1970).

[16]Bankruptcy law is administered by the federal district courts which sit as "courts of bankruptcy." Bankruptcy Act § 1(10), 11 U.S.C. § 1(10) (1970). The filing of a voluntary petition operates as an automatic adjudication of bankruptcy, Bankruptcy Act § 18f, 11 U.S.C. § 41(f) (1970), and as an application for a discharge (although a formal application for a discharge is required for corporate debtors, it is not required for individual petitioners), Bankruptcy Act § 14a, 11 U.S.C. § 32(a) (1970). Traditionally, federal bankruptcy proceedings have served two principal purposes: (1) the equitable distribution of the debtor's assets among his general creditors, and (2) the release of the honest but unfortunate debtor from his debts, in order to afford the debtor a fresh start in life. *See* Note, *Discharge Provisions in Consumer Bankruptcy: The Need for a New Approach*, 45 N.Y.U.L. REV. 1251 (1970). This latter purpose is accomplished by means of a discharge, a term defined in the Bankruptcy Act § 1(15), 11 U.S.C. § 1(15) (1970). The court will grant a discharge to a petitioner unless a creditor of the bankrupt, the trustee, or a representative of the United States Attorney General, Bankruptcy Act § 14b(2), 11 U.S.C. § 32(b)(2) (1970), raises a timely objection and establishes one of the eight exclusive statutory reasons for denying a discharge that are found in the Bankruptcy Act § 14c, 11 U.S.C. § 32(c) (1970).

[17]Sheaffer, *supra* note 5, at 1206.

[18]Act of June 28, 1946, ch. 512, 60 Stat. 323. For a general discussion of the bill see Horsky, *The Referee Salary Bill of 1946*, 52 COM. L.J. 7 (1947). Before 1946 the referee's compensation consisted of his share of the filing fee and a percentage of the bankrupt's assets, if any, that were to be distributed to creditors. Herzog, *The Referee in Bankruptcy: A Judge in Search of a Name*, 75 COM. L.J. 37 (1970). Also, an indemnity fund provided reimbursement to the referees for actual expenditures in operating their offices; however, this fund was often depleted and some referees were forced to finance their offices with personal funds. H.R. REP. No. 1937, 79th Cong., 1st Sess. 1-2 (1945).

[19]Bankruptcy Act of 1898, ch. 541, § 51(2), 30 Stat. 558; General Order 35(4), 172 U.S. 665 (1898). It was also recognized that the filing fee might be waived altogether in an appropriate case. *E.g.*, Sellers v. Bell, 94 F. 801, 817 (5th Cir. 1899).

latter procedure was intended to prevent abuse of the pauper petition by the bankrupt. In practice, however, it was used by many referees to demand payment of their fees before they would grant a discharge,[20] whether the bankrupt was able to pay or not. But in all cases the old fee system placed a referee in the unfair position of having to make a decision—whether to demand or waive the filing fee—that would directly affect his own compensation.[21]

The Referees' Salary Bill of 1946 abolished this fee system[22] and provided that as of 1947 all filing fees that formerly went directly to individual referees would go instead into a centrally operated fund[23] out of which each referee would be paid an annual salary. Thus the total fees collected by each referee became unrelated to his individual income.[24] This bill did not, however, alter the well-established self-supporting aspect of the bankruptcy system; it simply shifted the financing from the unit of the individual referee's office to a central fund that would operate on a nationwide basis.

In the same legislation, Congress noted the deficiencies of the pauper petition provision and decided that in lieu of the "widespread practice of [referees] demanding payment ultimately," it would be more appropriate to abolish pauper petitions and "to provide for installment

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[20]*See* S. REP. No. 959, 79th Cong., 2d Sess. 7 (1946). One may often encounter the phrase "the judge may order," when in fact statutory amendments to the Bankruptcy Act now allow either the referee or the judge of the district court to make such an order. For an interesting discussion of both the history and the present roles of the judge and referee in bankruptcy, see Herzog, *supra* note 18.

[21]H.R. REP. No. 1037, 79th Cong., 1st Sess. 1-2 (1945).

[22]Mr. Royal E. Jackson, the Chief of the Division of Bankruptcy in the Administrative Office of the United States Courts, has noted:

> Is there any logical reason why the expense of a protracted antitrust case shall be paid out of general funds of the Treasury, yet a bankruptcy . . . proceeding, large or small, must pay its own way? There is none. But it was the only system the Congress would buy in 1946. The proponents of the Act recognized this, and they designed a system that would work well in normal (non-inflationary) times.

Jackson, *Bankruptcy Administration Then and Now*, 45 AM. BANKR. L.J. 249, 275 (1971).

[23]The 1946 bill actually established two centrally operated funds that were consolidated into the Referees' Salary and Expense Fund by a 1959 amendment, Act of July 28, 1959, Pub. L. No. 86-110, 73 Stat. 259. *See* H.R. REP. No. 242, 86th Cong., 1st Sess. 1-3 (1959).

[24]One writer has observed that even though the referees were placed on annual salaries, the self-supporting system still burdened the referee with a pecuniary interest in every case coming before him. He is never permitted to forget that the bankrupts' filing fees and the assets of the bankrupt estate are paying his salary; and he is reminded by the Judicial Conference that unless he collects what is due the Referees' Salary and Expense Fund, he will be regarded as personally liable for the omission.

Jackson, *supra* note 22, at 274-75.

payments in meritorious cases."[25] Although Congress may have anticipated that providing for payment by installments would help some "meritorious" bankrupts, today most referees dislike the prospect of collecting fees in installments and therefore restrict the availability of this method of payment as much as possible.[26] But even the bankrupt who is allowed to pay in installments runs the risk that if for any reason he misses a payment on one of the scheduled dates, his petition will be dismissed.[27]

With these 1946 congressional changes, bankruptcy courts became the only federal courts in which filing fees could not be waived upon a showing of poverty.[28] Moreover, because they are unique as the only federal courts required by Congress to operate on a financially self-sustaining basis,[29] the filing fee exacted of the bankruptcy petitioner greatly exceeds that charged for instituting any other type of proceeding in the federal courts,[30] despite the fact that bankruptcy proceedings exist primarily for the purpose of affording relief to those who are insolvent or unable to pay their debts as they mature.

Three federal courts[31] have recently been confronted with the statutory argument that by its own language the general federal in forma pauperis statute should apply to bankruptcy proceedings. Further, it

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[25]S. REP. No. 959, 79th Cong., 2d Sess. 7 (1947). This reasoning has been criticized because "it ignores the fact that with the fee system gone, there would be no reason for a 'widespread practice of demanding payment ultimately.'" Shaeffer, *supra* note 5, at 1209.

[26]Fullerton, *Filing Fees in Installments*, in PROCEEDINGS OF THE FIFTH SEMINAR FOR REFEREES IN BANKRUPTCY 527 (1968).

[27]Bankruptcy Act § 59g, 11 U.S.C. § 95(g) (1970); General Order 35(4). A referee has no discretion to extend the time for installment payments beyond the nine-month maximum period as provided in General Order 35(4)a. *See, e.g., In re* Barlean, 279 F. Supp. 260, 261 (D. Mont. 1968).

[28]The general federal in forma pauperis statute, 28 U.S.C. § 1915(a) (1970), applies to all other types of proceedings in the federal courts.

[29]A recent Brookings Institute study on bankruptcy has noted:

> Bankruptcy alone among [federal judicial] proceedings is self-supporting of salaries and other administrative expenses . . . .
>
> The general pattern of financing court proceedings in the United States since about 1800 has been to have the public assume the costs of maintaining the courts. . . . We can only conclude that, as long as bankruptcy is a judicial process and as long as other judicial processes are conducted at public expense, it is manifestly unfair for the parties in bankruptcy to bear the costs.

D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEMS, PROCESS, REFORM 192-93 (1971).

[30]The typical filing fee in civil cases is set at $15 by 28 U.S.C. § 1914(a) (1970).

[31]*In re* Garland, 428 F.2d 1185 (1st Cir. 1970), *cert. denied*, 402 U.S. 966 (1971); *In re* Kras, 331 F. Supp. 1207 (E.D.N.Y. 1971), *prob. juris. noted*, 92 S. Ct. 955 (1972) (No. 71-749); *In re* Smith, 323 F. Supp. 1082 (D. Colo. 1971).

was argued, the Bankruptcy Act should be liberally construed because of its broad remedial purpose. And since the Bankruptcy Act fails to provide for those who are unable to pay the filing fee and also nowhere expressly prohibits in forma pauperis proceedings, the courts should construe the general in forma pauperis statute as being applicable in bankruptcy.[32] All three courts rejected this argument, concluding that both the intention of Congress[33] and a reading of the Bankruptcy Act itself[34] dictate that the filing fee must be paid in full before any bankrupt is eligible for a discharge.

These same three courts next considered the constitutionality of this mandatory fee scheme as applied to indigents seeking a discharge in bankruptcy. *In re Kras*[35] is the latest in this recent series of federal court rulings on this constitutional question. *In re Garland*,[36] a court of appeals decision, came first, followed by a district court opinion in *In re Smith.*[37] Each case came from a different judicial circuit.[38] The essential facts and arguments presented in *Garland, Smith,* and *Kras* are identical. In each an indigent petitioner stated that he presently did not have the requisite filing fee and that he could not honestly promise to pay it in installments over a nine-month period.

The court in *Garland* noted that it regarded bankruptcy as being basically an administrative rather than a judicial proceeding and that the filing fee was a reasonable expenditure for the financial services rendered the petitioner in bankruptcy. The court rejected the petitioner's due process argument[39] and held that a bankruptcy discharge was not a fundamental right but rather a privilege[40] Congress had chosen to

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[32]Arguments along this same line have also been suggested in Shaeffer, *supra* note 5, at 1203 n.5; 2 COLLIER ON BANKRUPTCY ¶ 51.01, at 1873-74 (14th ed. 1971).

[33]H.R. REP. NO. 1037, 79th Cong., 1st Sess. 6 (1945); S. REP. No. 959, 79th Cong., 2d Sess. 7 (1946).

[34]Bankruptcy Act §§ 14b, 14c(8), 40c(1), 59g, 11 U.S.C. §§ 32(b), 32(c)(8), 68(c)(1), 95(g) (1970); General Order 35(4). See note 8 *supra.*

[35]331 F. Supp. 1207 (E.D.N.Y. 1971), *prob. juris. noted, 92 S. Ct. 955 (1972) (No. 71-749).*

[36]428 F.2d 1185 (1st Cir. 1970), *cert. denied,* 402 U.S. 966 (1971).

[37]323 F. Supp. 1082 (D. Colo. 1971).

[38]Since *In re Kras* was decided, another district court from still a different judicial circuit was confronted with the same constitutional attack on the mandatory filing fee in bankruptcy proceedings. That court, relying heavily on the reasoning of *Smith* and *Kras*, ruled that the filing fee, as applied to the indigent petitioner before it, "violates the principles of equal protection of the laws." *In re* Naron, 334 F. Supp. 1150, 1151 (D. Ore. 1971).

[39]428 F.2d at 1187. The court indicated that it would have reached the same result had the caes been argued on equal protection grounds. *Id.* at 1186. See note 10 *supra.*

[40]In several cases the Supreme Court has rejected the right-privilege dichotomy as a significant factor for determining the constitutionality of a statute. *E.g.,* Goldberg v. Kelly, 397 U.S. 254,

bestow on those willing to "experience some slight burden in return."[41]

The *Smith* court pointed out that the main purpose of our bankruptcy system is to enable debtors to obtain a judicially approved discharge from their obligations. Noting that the fifth amendment includes an equal protection principle, the court expressly rejected *Garland's* reasoning and held that the mandatory filing fee as applied to an indigent petitioner was a violation of equal protection.[42] The court conceded that although bankruptcy, standing alone, may not be a fundamental right, "what is at stake here is not simply bankruptcy, but access to court. So viewed, the question takes on a greater significance, at least for those of us who are trained in the law and who regard the legal system as fundamental to our way of life."[43] Continuing, the court noted that

> if a state or the federal government were to condition the enforcement of all statutory and common law rights upon the payment of a $5,000 filing fee, access to court as we now conceive it would be severely impaired. . . . Since to a person without funds, $50 may foreclose access as surely as $5,000 [,] the amount of the fee is of no particular meaning unless *de minimus* [*sic*].[44]

Kras, which reached the same result as *Smith,* has special significance in this series of three cases because only it was decided after *Boddie v. Connecticut.*[45] In *Boddie* the Supreme Court ruled that it was a denial of due process for a state to deny indigents access to the state's divorce courts solely because of their inability to pay filing fees and

262 (1970); Shapiro v. Thompson, 394 U.S. 618, 627 n.6 (1969); Sherbert v. Verner, 374 U.S. 398, 404 (1963). *See also* Van Alstyne, *The Demise of the Right-Privilege Distinction in Constitutional Law,* 81 HARV. L. REV. 1439 (1968).

[41] 428 F.2d at 1188. The *Garland* decision seemed to be grounded on what the First Circuit apparently considers to be at stake in a bankruptcy proceeding:

> The primary question must be why an individual admitting no assets has need for a discharge. If he has nothing . . . it would seem that his creditors would find it pointless to pursue him. If they should pursue, one would wonder what the debtor could have to be concerned about. We can think of only two classes of seemingly assetless persons who might want a discharge: those who in fact have assets, but hope to conceal them, and those who have none, but . . . expect future assets, and wish to be rid of their creditors first. The first category deserves, of course, no consideration. We do not think the claim of the second so compelling that they must be constitutionally entitled to a free discharge.

Id. at 1187-88.

[42] 323 F. Supp. at 1086-89. See note 10 *supra.*

[43] *Id.* at 1087.

[44] *Id.* at 1089.

[45] 401 U.S. 371 (1971).

process costs. Justice Harlan, writing for the majority, observed that "this court has seldom been asked to view access to the court as an element of due process."[46] But, he added, due process requires "that absent a countervailing state interest of overriding significance," a state must grant access to its courts to persons who are forced to resort to the judicial process for resolution of their claims.[47]

Although the court in *Kras* was free to make its own assessment of what a proper interpretation of *Boddie* would require with respect to the indigent petitioner before it, the court was nevertheless confronted with the Supreme Court's post-*Boddie* refusal to review *In re Garland.*[48] The *Kras* court simply stated that the Supreme Court's denial of certiorari was not to be taken as a decision of *Garland* on the merits[49] and that it remained "free to chart its own course." The court in *Kras* noted, however, that this course was not "without guideposts, particularly in view of the statements"[50] of Justices Black and Douglas, who had dissented (along with Justice Brennan) from the denial of certiorari in *Garland.*[51]

Justice Black suggested that the Supreme Court's unwillingness to review *Garland* only two months after *Boddie* had been handed down perhaps was prompted by a desire to proceed "slowly step by step, so that the country will have time to absorb [*Boddie*'s] full import."[52] But both Justice Black and Justice Douglas were for reversing *Garland*'s holding outright, Justice Black noting that *Boddie* was grounded on the sole premise that no person should be denied access to any court solely because of his inability to pay a fee.[53] Justice Douglas expressed his approval of the majority's conclusion in *Boddie* that marriage and its dissolution were so fundamental as to require the states to allow indi-

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[46] *Id.* at 375.

[47] *Id.* at 377. Justice Brennan, in a concurring opinion, disagreed with that part of the majority opinion which attempted to limit the holding in *Boddie* to similar divorce actions. He noted that such a limitation would not withstand analysis, because "[i]f fee requirements close the courts to an indigent he can no more invoke the aid of the courts for other forms of relief than he can escape the legal incidents of marriage." *Id.* at 387. *See also The Supreme Court, 1970 Term,* 85 HARV. L. REV. 40, 104, 113 (1971).

[48] 402 U.S. 966 (1971).

[49] *Accord,* C. WRIGHT, HANDBOOK OF THE LAW of FEDERAL COURTS 495 (2d ed. 1970) (a denial of certiorari "means [only] that, for whatever reason, there were not four members of the Court who wished to hear the case").

[50] 331 F. Supp. at 1211.

[51] Meltzer v. C. Buck LeCraw & Co., 402 U.S. 954 (1971).

[52] *Id.* at 956.

[53] *Id.* at 955-56.

gents access to divorce courts without paying costs, but he expressly disavowed establishing a "hierarchy of interests" when indigency is involved. Thus Justice Douglas concluded that *Garland* should have been reversed, since obtaining a fresh start in life through bankruptcy is an equally fundamental interest that should come under the shelter of the equal protection clause.[54]

The court in *Kras* agreed with the above reasoning of Justices Black and Douglas and with the *Smith* court's proposition that the interest at stake was the fundamental one of access to court, and concluded "that a proper interpretation of *Boddie* requires that, as applied to petitioner herein, the statutory requirement of prepayment of a filing fee to obtain a discharge in bankruptcy violated his Fifth Amendment right of due process, including equal protection."[55]

The appellants seeking a divorce in *Boddie* were allowed to proceed without payment of any fees. The courts in *Kras* and *Smith* granted the petitioner the same relief but with the qualification that the referee below should provide for the survival of the petitioner's obligation to pay the filing fee since indigency is not necessarily a permanent condition. The court in *Smith* thought that this continuing obligation to pay not only was appropriate and constitutionally permissible "but [also would] further the congressional purpose of making the bankruptcy system, insofar as possible, self-supporting."[56]

Although *Kras* and *Smith* represent a partial departure from the expectation of Congress that the bankruptcy system be self-supporting, it should be noted that since 1965 the system has not in fact supported itself. It was predicted that in the fiscal year of 1971 the deficit in the Referees' Salary and Expense Fund would amount to 4,750,000 dollars, twice that of the 1969 fiscal year.[57] The Judicial Conference of the United States recently advocated the abolition of the self-financing system in bankruptcy, noting that this aspect of bankruptcy is "outdated

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[54] *Id.* at 961.

[55] 331 F. Supp. at 1212. Although another district court in *In re* Naron, 334 F. Supp. 1150 (D. Ore. 1971), agreed that access to court was a fundamental interest and based its similar holding on equal protection, it noted that even though *Boddie* had been grounded on due process, it could "think of no relevant due-process reason for attempting to distinguish between the right to be judicially freed from an unwanted spouse and the right to be judicially liberated from harassment by general creditors." *Id.* at 1152. See notes 10, 38 *supra*.

[56] 323 F. Supp. at 1093.

[57] REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 24, 201 (1970).

and that it is no longer possible to maintain adequate payments into the [Referees' Salary and Expense Fund] without placing an inordinate burden upon bankrupts and the assets of bankrupt estates."[58] Given the obvious circumstance that bankruptcy, by its very nature, is the least likely among the types of civil proceedings to be able to take on any additional "burden," the steps taken by the courts in *Kras* and *Smith* seem desirable in that this burden is shifted to society in general, bringing bankruptcy in line with other civil actions in which the smaller fees collected only begin to cover the cost of operating the federal courts.[59]

Congress presently has before it legislation that would abolish the self-financing aspect of bankruptcy.[60] Enactment of this legislation could possibly open the door to future congressional action aimed at alleviating the indigent petitioner's plight in bankruptcy proceedings. If, however, Congress refuses to change the already faltering self-supporting policy of the present bankruptcy system, it seems reasonable that this policy could be adequately served by statutorily excluding the government's claim for these administration costs from the scope of a discharge without making nonpayment a ground for denying the bankrupt relief from his other obligations. The government already protects its own interest in certain taxes owed it by the bankrupt by including these taxes in section 17a's list of "exceptions" to a discharge—debts that remain outside of and thus not affected by a discharge.[61] In sharp contrast to the treatment afforded taxes, nonpayment of the filing fee is presently included in section 14c's list of "objections" to a discharge—the effect of a valid objection being that the petitioner is not entitled to a discharge at all.[62] The government's interest in taxes is analogous to its interest in the administration costs in bankruptcy that are provided by the filing fee. Since the government already protects its interest in taxes by providing that taxes remain outside a discharge, it seems reasonable that it could similarly protect its interest in these administration costs. Thus the government's claim for the filing fee could be treated simply as an additional exception to a discharge under

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[58] *Id.* (1969), at 23-24.

[59] Silverstein, *supra* note 14, at 650.

[60] H.R. 4816, 92d Cong., 1st Sess. (1971); S. 1394, 92d Cong., 1st Sess. (1971); *see* Jackson, *supra* note 22, at 275.

[61] Bankruptcy Act § 17a, 11 U.S.C. § 35(a) (1970).

[62] Bankruptcy Act § 14c, 11 U.S.C. § 32(c) (1970). See note 16 *supra.* If any *one creditor* prevails with a § 14c objection to a discharge, the debtor will not get any discharge at all. In contrast, a § 17a exception to a discharge affects *only* that creditor whose claim qualifies under § 17a, and the debtor is given a discharge from all his other creditors.

section 17a rather than as a section 14c objection to a discharge. This is, in effect, what the courts in *Kras* and *Smith* have done, and these two cases are an important step toward making the bankruptcy discharge the substantial debtor remedy it was intended to be.

SIDNEY L. COTTINGHAM

Communications—The Fairness Doctrine: A Continuing Advance into Product Advertising

The fairness doctrine, a product of administrative regulation and judicial decision, has long served to guarantee full discussion of public issues in the nation's communications media.[1] Briefly stated, the doctrine imposes an affirmative obligation upon licensed radio and television stations to present information advocating all points of view in the discussion of controversial issues of public importance.[2] A salient force for many years, the fairness doctrine has acquired increasing relevance and expanded meaning during the past decade.

In *Friends of the Earth v. FCC*[3] the Court of Appeals for the District of Columbia Circuit[4] recently continued this judicial trend by holding the fairness doctrine applicable to the presentation of television commercials advertising high-powered automobiles and leaded gasoline. The petitioning environmentalists[5] contended that the advertisements advanced the opinion that use of these products leads to a richer and more enjoyable life. Facing undisputed scientific evidence of the environmental dangers resulting from this use, the court overturned a decision of the Federal Communications Commission (FCC) and held that the commercials presented one point of view upon a controversial public issue and therefore called for application of the fairness doctrine. The case was then remanded to the Commission for a determination of whether the particular television station[6] under attack had met its

[1]See text accompanying notes 19-37 *infra*.

[2]Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 369, 380 (1969); Obligations of Broadcast Licensees Under the Fairness Doctrine, 23 F.C.C.2d 27 (1970); Editorializing Report, 13 F.C.C. 1246, 1251 (1949).

[3]449 F.2d 1164 (D.C. Cir. 1971).

[4]47 U.S.C. § 402(b) (1970) provides for the direct appeal of most decisions of the Federal Communications Commission to the District of Columbia Circuit.

[5]Petitioners included Friends of the Earth, a national organization dedicated to environmental protection, and its executive director. 449 F.2d at 1164.

[6]The station challenged in the action was New York City's WNBC-TV. 449 F.2d at 1164.

fairness-doctrine obligations.

In order to understand properly the significance of *Friends of the Earth*, it is necessary to survey the development of federal regulation of the communications media, the evolution of the fairness doctrine, and the applicability of that doctrine to commercial advertising. Before 1927 radio stations were largely unregulated and could broadcast at any frequency, power, or time desired.[7] The resulting chaos severely diminished the constructive value of the media.[8] In response to this situation, Congress enacted the Radio Act of 1927,[9] which created the Federal Radio Commission. Under the terms of the Act, the Commission was empowered to allocate frequencies among applicants in a manner promoting the "public convenience, interest, or necessity."[10] Seven years later Congress passed the Communications Act of 1934,[11] which was largely based on earlier legislation. The Act created the FCC and prohibited broadcasting without a license issued by that agency. It also established a comprehensive regulatory scheme which serves as the statutory basis for the Commission's activities today. As with the earlier Radio Act, the FCC's standard for action was stated to be the "public convenience, interest, or necessity."[12]

While the Communications Act is otherwise silent on the issue, this public-interest standard has provided the basis for the Commission's regulation of radio and television program content.[13] Although this power is limited to a degree by first amendment restrictions,[14] it has

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[7]The Radio Communications Act of 1912, ch. 287, 37 Stat. 302, which conferred upon the Secretary of Commerce the power to regulate frequencies and broadcast hours, was almost totally emasculated by judicial decision. Hoover v. Intercity Radio Co., 286 F. 1003 (D.D.C. 1923), *cert. dismissed*, 266 U.S. 636 (1924), held that the Secretary had no discretion in granting licenses. Three years later it was held that the Secretary also lacked the power to regulate frequencies, power, or broadcast hours. United States v. Zenith Radio Corp. 12 F.2d 614 (N.D. Ill. 1926).

[8]By 1927 almost 200 radio stations were in operation and "with everybody on the air, nobody could be heard." National Broadcasting Co. v. United States, 319 U.S. 190, 212 (1943). *See* Comment, *Fairness Doctrine: Personal Attacks and Public Controversies*, 56 GEO. L.J. 547, 547 n.1 (1968).

[9]Radio Act of 1927, ch. 169, 44 Stat. 1162.

[10]*Id.* § 4.

[11]Communications Act of 1934, ch. 652, 48 Stat. 1064, *as amended*, 47 U.S.C. §§ 151-609 (1970).

[12]47 U.S.C. § 307 (a) (1970).

[13]*See* National Broadcasting Co. v. United States, 319 U.S. 190, 217 (1943); Retail Store Employees Local 880 v. FCC, 436 F.2d 248, 256 (D.C. Cir. 1970). The FCC's regulation of program content is exercised through its power to grant and renew broadcast licenses. *See* FCC, PUBLIC SERVICE RESPONSIBILITIES OF BROADCAST LICENSEES 10 (1946).

[14]47 U.S.C. § 326 (1970) forbids censorship on the part of the FCC or interference with the first amendment rights of licensees. However, in National Broadcasting Co. v. United States, 319

been recognized to exist almost since the inception of the federal regulatory scheme.[15] In *National Broadcasting Co. v. United States*[16] the Supreme Court directly confronted a contention that the Commission's regulatory powers are statutorily limited to the technical aspects of the communications media, such as frequency allocation and the prevention of interference. In upholding the FCC's power to deal with program content, the Court noted: "The Commission's licensing function cannot be discharged . . . merely by finding that there are no technological objections to the granting of a license."[17] In addition, the Court emphasized that "the [Communications] Act does not restrict the Commission merely to supervision of the traffic. It puts upon the Commission the burden of determining the composition of that traffic."[18]

Almost as soon as control over program content was assumed, the fairness doctrine was born. As early as 1929 the Federal Radio Commission stated that the "public interest requires ample play for the free and fair competition of opposing views, and the Commission believes that the principle applies . . . to all discussions of issues of importance to the public."[19] Thus, although not yet expressly labeled, the fairness doctrine preceded the comprehensive regulatory scheme enacted by Congress in 1934. With the restatement of the "public interest standard"[20] in the Communications Act, the fairness doctrine experienced continuing development in the decisions of the FCC. In 1938 the Commission expressly approved the doctrine in *Young People's Association for the Propagation of the Gospel.*[21] The real strength of the fairness

U.S. 190, 226-27 (1943), the Court upheld the FCC's reasonable regulation of programming content in the face of a first amendment attack. Since radio broadcasting was not available to all because of the limited number of available frequencies, it was reasoned that those possessing a license to broadcast must be subject to public regulation.

Notwithstanding the protection the first amendment affords television and radio licensees, it has been construed to guarantee certain rights to the viewing public that are paramount to those of broadcasters. Red Lion Broadcasting Co. v. FCC, 396 U.S. 367, 386-90 (1969). This principle was logically extended recently to strike down a licensee's flat refusal to broadcast paid announcements of an issue-oriented nature. Business Executives' Move for Vietnam Peace v. FCC, 450 F.2d 642 (D.C. Cir. 1971), *cert. granted*, 92 S. Ct. 1174 (1972) (No. 71-864).

[15] *See, e.g.*, FCC v. Pottsville Broadcasting Co., 309 U.S. 134, 137-39 (1940).

[16] 319 U.S. 190 (1943).

[17] *Id.* at 216.

[18] *Id.* at 215-16.

[19] Great Lakes Broadcasting Co., 3 F.R.C. 32 (1929), *rev'd on other grounds*, 37 F.2d 993 (D.C. Cir.), *petition for cert. dismissed*, 281 U.S. 706 (1930).

[20] *See* note 12 and accompanying text *supra*.

[21] 6 F.C.C. 178 (1938). Here the FCC denied an application for a station construction permit because the applicant allowed only those with views similar to his own to use the facilities.

principle was evidenced, however, in the 1941 *Mayflower Broadcasting Corp.*[22] ruling, which forbade licensees to editorialize or specifically endorse political candidates. Such practices were felt to violate the policies formulated by the Communications Act. Naturally, this holding was roundly criticized by licensed stations. Despite its earlier history, a number of authorities officially date the fairness doctrine from the *Mayflower* decision.[23]

The controversy precipitated by the holding in *Mayflower* resulted in a modified statement of policy on the part of the Commission. *Editorializing By Broadcast Licensees,*[24] a report released in 1949, was in fact the Commission's first definitive statement of the fairness doctrine. Noting that the doctrine was designed to foster "an informed public opinion through the public dissemination of news and ideas concerning the vital public issues of the day,"[25] the Commission approved editorial broadcasting but expressly subjected it to the restrictions of the fairness doctrine. This statement of policy currently stands as the Commission's basic description of the fairness doctrine.

As set forth by the Commission's 1949 report and developed in subsequent decisions, the fairness doctrine today actually imposes a dual obligation on broadcast licensees. "The broadcaster must give adequate coverage to public issues . . . and coverage must be fair in that it accurately reflects the opposing views."[26] If a sponsor cannot be found to finance the presentation of this differing viewpoint, the broadcast must be made at the licensee's expense.[27] Further, the programs advocating such opinion must be prepared by the licensee on his own initiative if unavailable from other sources.[28]

In addition to the general provisions of the fairness doctrine, specific variations of that principle have developed to provide equal air time for political candidates[29] and to deal with personal attacks broadcast by

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[22]8 F.C.C. 333 (1940).

[23]*See, e.g.*, Robinson, *The FCC and the First Amendment: Observations on 40 Years of Radio and Television Regulation*, 52 MINN. L. REV. 67 (1967).

[24]13 F.C.C. 1246 (1949).

[25]*Id.* at 1249.

[26]Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 377 (1969). Business Executives' Move for Vietnam Peace v. FCC, 450 F.2d 642 (D.C. Cir. 1971), *cert. granted*, 92 S. Ct. 1174 (1972) (No. 71-864), reaffirmed the recognized duty on the part of licensees to discuss controversial issues in holding that a station's flat ban on paid public-issue announcements violated the first amendment. *See* note 14 *supra*.

[27]Cullman Broadcasting Co., 40 F.C.C. 576 (1963).

[28]Governor John J. Dempsey, 40 F.C.C. 445 (1950).

[29]Section 315 (a) of the Communications Act, 47 U.S.C. § 315(a) (1970), requires broadcasters

licensed stations.[30] The constitutionality of the fairness doctrine and the personal attack rules was most recently challenged in *Red Lion Broadcasting Co. v. FCC.*[31] Noting the broad powers available to the Commission to assure protection of the public interest, the Supreme Court upheld the FCC's rule-making power. It also interpreted the 1959 amendment of the Communications Act's provision affording equal time to political candidates as embodying congressional acceptance and adoption of the fairness doctrine.[32]

While the fairness doctrine is thus sanctioned by Congress and the Supreme Court, the actual details of its application and implementation have never been delineated by the Federal Communications Commission. To a great extent, this has been left to the individual stations. As recently stated by the Commission, "it is within the discretion of the licensee, acting reasonably and in good faith, to choose the precise means of achieving fairness."[33] Prior to implementation of the doctrine, a decision must be made as to its applicability. Application, in turn, depends upon a finding that a controversial issue of public importance has been discussed by a station presentation. Although the Commission has yet to set forth a test to determine whether a given issue is "controversial," it has noted that such a finding is usually to be made by the licensee, who is to use "reasonable judgment in good faith on the facts in each situation."[34] Of course, this determination by the licensee

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to "afford equal opportunities" to all legally qualified political candidates for a given office if a single such candidate has been allowed to use the broadcaster's station. Specifically exempted from the section's coverage are appearances by candidates in bona fide newscasts, interviews, documentaries, and on-the-spot coverage of news events. *Id.*

[30]Regulations promulgated by the FCC require that in the event of a personal attack upon "an identified person or group," the station broadcasting such material must furnish the person or group attacked a transcript of the presentation. Further, it must make available to that individual or group "a reasonable opportunity to respond over the licensee's facilities." Bona fide newscasts, interviews, and on-the-spot coverage of news events are exempt from the regulation. 47 C.F.R. §§ 73.123, 73.300, 73.598, 73.679 (1971) (all identical).

[31]395 U.S. 367 (1969).

[32]The Court stated:

> In 1959 the Congress amended the statutory requirement of § 315 that equal time be accorded each political candidate to except certain appearances on news programs, but added that this constituted no exception "*from the obligation imposed upon* [stations] *under this Act to operate in the public interest and to afford reasonable opportunity for the discussion of conflicting views on issues of public importance.*" Act of September 14, 1959, § 1, 73 Stat. 557, amending 47 U.S.C. § 315 (a) . . . .

Id. at 380 (emphasis by the Court).

[33]Letter to Mid-Florida Television Corp., 40 F.C.C. 620, 621 (1964), *quoted with approval in* Obligations of Broadcast Licensees Under the Fairness Doctrine, 23 F.C.C.2d 27, 28 (1970).

[34]FCC Public Notice: Applicability of the Fairness Doctrine in the Handling of Controversial

is subject to review by the FCC. It has been held by the Commission that determination of whether an issue is "controversial" is not bound by the manner of its presentation,[35] the degree of coverage by other communications media,[36] or characterization of the issue as local rather than national in nature.[37]

The FCC has long recognized that product advertising, even though specialized programming in nature, can raise controversial public issues and thus precipitate application of the fairness doctrine. As a 1946 Commission decision expressly notes, "[t]he fact that the occasion for the controversy happens to be the advertising of a product cannot serve to diminish the duty of the broadcaster to treat it as such an issue."[38] Notwithstanding this recognition, the Commission has continuously expressed an unwillingness to extend the fairness doctrine to individual product commercials. *Television Station WCBS-TV*[39] marked the FCC's first actual decision so to apply the doctrine. This ruling held that cigarette commercials presenting a favorable view of smoking raised a controversial issue of public importance, voiced an opinion on the issue, and thus created a situation calling for application of the fairness doctrine.

This decision was bitterly fought,[40] but on appeal the Court of Appeals for the D.C. Circuit affirmed the Commission in *Banzhaf v. FCC*.[41] Although the court recognized that "public interest" was a vague criterion for FCC action, it nonetheless concluded that "the pub-

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Issues of Public Importance, 29 Fed. Reg. 10415, 10416, 40 F.C.C. 598, 599 (1964).

[35]Sam Morris, 11 F.C.C. 197 (1946).

[36]WSOC Broadcasting Co., 17 P & F Radio Reg. 548 (FCC 1968).

[37]*See* Note, *Regulation of Program Content by the FCC*, 77 HARV. L. REV. 701 (1964). The FCC has determined a number of issues to be controversial, thus calling for application of the fairness doctrine. These include civil rights, racial integration, the banning of nuclear testing, medical advice, and pay television. FCC Public Notice: Applicability of the Fairness Doctrine in the Handling of Controversial Issues of Public Importance, 29 Fed. Reg. 10415, 40 F.C.C. 598 (1964).

[38]Sam Morris, 11 F.C.C. 197, 199 (1946). Here the Commission held that a radio station located in the temperance belt could not under the fairness doctrine advertise alcoholic beverages without accepting anti-liquor material from temperance organizations. The Commission noted: "[I]t can at least be said that the advertising of alcoholic beverages . . . can raise substantial issues of public importance." *Id. See also* Head v. New Mexico Bd. of Examiners in Optometry, 374 U.S. 424, 437-41 (1963).

[39]9 F.C.C.2d 921 (1967).

[40]Participants in the action included the American Tobacco Co., Liggett and Myers Tobacco Co., R.J. Reynolds Tobacco Co., American Broadcasting Co., National Broadcasting Co., The National Tuberculosis Association, and the Heart Disease Research Foundation. *See* Banzhaf v. FCC, 405 F.2d 1082 (D.C. Cir. 1968).

[41]405 F.2d 1082 (D.C. Cir. 1968).

lic interest indisputably includes the public health."[42] In short, protection of the public health more than justified heightened governmental involvement on the administrative level. Important to this result were three unique characteristics attributed to cigarettes by the court: the product threatens the health of a substantial part of the population, the danger arises from the normal use of the product, and the danger is statistically recognized by both governmental and independent research groups.[43]

Banzhaf, besides accepting unprecedented FCC action, was unique in another respect because it claimed to be self-limiting—the court agreed with the Commission that it was not aware of a comparable product warranting a similar ruling.[44] Yet not three years later the same circuit decided *Friends of the Earth* and based the decision primarily on *Banzhaf*. Developments in the interim, largely changes in the Commission's thinking, greatly shaped this result.

Following *Banzhaf*, the Commission showed initial reluctance to extend the cigarette decision's rationale to other situations. Thus in *WFMJ Broadcasting Co.*[45] it refused to hold the fairness doctrine applicable to commercials advocating the patronage of a department store that was the site of a strike and boycott. On appeal the D.C. Circuit reversed,[46] noting that a viewpoint set forth by an advertisement may be implicit rather than explicit, and held it irrelevant in respect to the fairness doctrine's application that the commercials in question failed to mention the pending strike. The court directed the FCC to consider more fully the charge that the commercials were primarily designed to serve as a weapon in a labor-management dispute rather than as advertising for standard purposes. The self-imposed restrictions of *Banzhaf* were deemed without force in the face of a commercial presenting what truly might be termed a controversial issue of public importance.[47]

Despite this hint from the Court of Appeals for the D.C. Circuit, the Commission's reluctance to extend the doctrine persisted in its initial treatment of the *Friends of the Earth* complaint. However, while this ruling was in the process of appeal, the FCC demonstrated growing awareness of the implications in *Banzhaf*. In a *National Broadcasting*

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[42] *Id.* at 1096 (footnote omitted).
[43] *Id.* at 1097.
[44] *Id.* at 1097 n.63.
[45] 14 F.C.C.2d 423 (1968).
[46] Retail Store Employees Local 880 v. FCC, 436 F.2d 248 (D.C. Cir. 1970).
[47] *Id.* at 258.

Co. ruling (*Chevron*),[48] it confronted the question of whether commercials claiming that a particular gasoline substantially reduced air pollution, when faced with contentions to the contrary, required application of the fairness doctrine. Although the FCC ruled that this was only a claim of product efficiency and did not raise a controversial issue of public importance, it did recognize the possibility that a product commercial could, under somewhat closely defined circumstances, raise controversial public issues.[49] Shortly after this first admission by the FCC that application of the fairness doctrine could extend to product advertising beyond cigarette commercials, another *National Broadcasting Co.*[50] decision (*Esso*) was handed down. In *Esso* the Commission studied commercials presented by an oil company advocating the development and transportation of Alaskan oil. Finding the presence of a controversial issue of public importance—the necessity of immediate development of Alaskan oil preserves and the capability of oil companies to pursue this development without environmental damage—the FCC directed the licensee to satisfy its obligations under the fairness doctrine.

Both *Chevron* and *Esso* were utilized by the court in *Friends of the Earth*, which marks the first judicial decision since *Banzhaf* to find definitely that an advertisement advocating the purchase of a given product raises a controversial public issue and merits application of the fairness doctrine. Although this perhaps was not unexpected in light of the new FCC thinking, it nonetheless stands as the first instance in which a court in construing the fairness doctrine has judicially recognized the controversial nature of an issue dealing with environmental protection. Perhaps most important of all, the decision evidences renewed recognition that a controversial public issue may be implicit in a product commercial and need not be explicit on the face thereof. Such action can be interpreted as a preview of the fairness principle's increasing utilization in the area of media advertising—notwithstanding advertising's financial importance to broadcasting.[51]

While in many respects *Friends of the Earth* clarifies what undoubtedly is an uncertain area of the law, it fails to provide specific

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[48]National Broadcasting Co., 29 F.C.C.2d 807, 21 P & F RADIO REG. 2d 1097 (1971).

[49]29 F.C.C.2d at ___, 21 P & F RADIO REG. 2d at 1103 (1971).

[50]National Broadcasting Co., 30 F.C.C.2d 643, 22 P & F RADIO Reg. 2d 407 (1971).

[51]Even with the current limited application of the fairness doctrine to commercial advertising, it appears that the doctrine has a weighty effect upon broadcasting revenue. One periodical recently reported that "major television networks have rejected over a million dollars in advertising revenue on no-fault insurance for fear of having the 'fairness doctrine' invoked . . . ." TRIAL, January-February 1972, at 3.

guidelines for the difficult task of identifying product commercials raising "controversial issues of public importance" and thus requiring resort to the fairness doctrine. Despite this shortcoming *Friends of the Earth,* as supplemented by several recent developments,[52] provides valuable assistance in formulating a rough test which can be utilized in resolving the question of the doctrine's applicability. The test can be stated as follows: Does a commercial explicitly or implicitly raise an issue (1) regarding which there currently are clearly recognized and contrasting substantiated viewpoints and (2) by which, or through the condition with which it deals, a relatively large number of people either on the national or local level are substantially affected?

In looking beyond the face of a commercial message and applying the fairness doctrine as a result of issues that are raised implicitly, this standard adopts the approach utilized in *Friends of the Earth.*[53] It is only through such a liberal construction that the fairness doctrine can serve its ultimate purpose, that of exposing the public to all viewpoints surrounding controversial issues. More narrowly to construe the doctrine would be to ignore the subtle means of communication available to our media.

The two inquiries proposed by the test seek to guarantee that an issue be both "controversial" and "public" in nature before demanding consideration of the fairness principle. In requiring that there be "sub-

[52]During June, July, and August of 1971 no fewer than four decisions relevant to the fairness doctrine and commercial advertising were handed down by federal appellate courts in addition to *Friends of the Earth.* Green v. FCC, 447 F.2d 323 (D.C. Cir. 1971), and Neckritz v. FCC, 446 F.2d 501 (9th Cir. 1971), refused to hold the doctrine applicable to military recruitment advertisements. In both cases appellants were unsuccessful in urging that such commercials raise the admittedly controversial issues of the draft and the Vietnam War. Larus & Brother v. FCC, 447 F.2d 876 (4th Cir. 1971) affirmed an FCC ruling that certain anti-smoking messages did not raise fairness-doctrine considerations because "it would be reasonable for a broadcaster to determine that the health hazards of smoking no longer present a controversial issue." *Id.* at 878 (footnote omitted). Finally, the Court of Appeals for the D.C. Circuit in Business Executives' Move for Vietnam Peace v. FCC, 450 F.2d 642 (D.C. Cir. 1971), *cert. granted,* 92 S. Ct. 1174 (1972) (No. 71-864), overturned as violative of the first amendment a licensee's flat ban on commercial messages raising "controversial issues."

[53]This approach was also purportedly utilized by the Court of Appeals for the D.C. Circuit in Green v. FCC, 447 F.2d 323 (D.C. Cir. 1971), in which the court dealt with a claim that military recruitment advertisements raised controversial issues of public importance—namely the draft and the Vietnam War—and therefore required application of the fairness doctrine. The court noted that "the first issue, military manpower recruitment by voluntary means, is all that was implicit in virtually all the Armed Services recruitment announcements" and that this does not constitute a controversial issue. *Id.* at 329. The court, however, did find that as to both the draft and the Vietnam War fairness doctrine standards had been satisfied as a result of the numerous viewpoints broadcast on both issues. *Id.*

stantiated viewpoints currently surrounding the issue," the standard follows the reasoning of the Fourth Circuit Court of Appeals in *Larus & Brother v. FCC.*[54] In that decision the court expressly refused to hold the fairness doctrine applicable to certain anti-smoking messages for the reason that the detrimental effects of cigarette smoking are now clearly established beyond controversy. Such an application of the fairness doctrine avoids the required presentation of viewpoints totally lacking in present credibility although once perhaps strongly advocated. The test's second requirement, that the issue affect "a relatively large number of people," is designed to justify application of the fairness doctrine with its accompanying demands upon both licensees and the public.

In short, this analysis is designed to bring only those media commercials raising truly significant public issues within the ambit of the fairness doctrine. With this goal in mind, the proposed test is believed to satisfy both the demands of the public interest and the practical requirement that commercial advertising be sustained as a means of providing revenue for the broadcast industry. Simultaneously, the test recognizes the importance of bringing increased certainty to a crucially significant area of the law.

LACY H. REAVES

Constitutional Law—Due Process and Compliance with Processing Requirements for Welfare Applications

Judicial impetus to welfare reform has appeared recently as a potent force in the effort to resolve the complex problems surrounding welfare administration. The source of these problems is the conflict between the need to reconcile idealistically conceived welfare programs with the grass-roots practicalities of welfare administration.[1] In 1970 the

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[54] 447 F.2d 876 (4th Cir. 1971).

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[1] The inability of the courts to establish workable guidelines in the area of welfare administration may be attributed to the fact that the protections of procedural due process have only recently been extended to welfare proceedings. The delay in instituting these safeguards into the framework of the welfare system can be traced to the attitude that welfare is synonymous with charity and to the ever present controversy over the "right-privilege" dichotomy.

Recent Developments, *Constitutional Law—Public Assistance—Due Process Clause Requires an Evidentiary Hearing to Precede the Termination of Benefits to Welfare Recipients,* 16 VILL. L. REV. 587, 589-90 (1971).

Supreme Court assumed a vital position in the resolution of this problem by holding in *Goldberg v. Kelly*[2] that procedural due process requires that an evidentiary hearing be held before public-assistance payments to welfare recipients may be discontinued. In the recent case of *Like v. Carter*[3] the Eighth Circuit Court of Appeals extended the due process analysis of *Kelly* to situations in which state welfare officials administering federal public-assistance funds[4] failed to act upon public-assistance applications within the statutorily required time period of thirty days.[5]

The court in *Like* held that such a delay was a denial of the applicants' due process rights and paid little heed to the large volume of welfare applications and the insufficient number of competent workers in the Missouri Welfare Department.[6] Rather, the Eighth Circuit noted that the delay in applications was not a result of any fault of the applicants and that the Missouri Welfare Department could have greatly minimized the delays.[7] The court indicated that the state excep-

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[2]397 U.S. 254 (1970).

[3]448 F.2d 798 (8th Cir. 1971). Jurisdiction in *Like* was based upon 28 U.S.C. §§ 1343(3)-(4) (1970). This issue in itself is an intriguing one but one with which the Eighth Circuit had little difficulty. The court relied on Johnson v. Harder, 438 F.2d 7 (1971), for the proposition "that where colorable constitutional (equal protection and due process) claims have been raised, jurisdiction will lie." 448 F.2d at 801. Similarly, the court rejected defendants' assertions that jurisdiction was lacking "by reason of plaintiffs' failure to exhaust available state administrative remedies." *Id.* Nor were the defendants persuasive in their contention that jurisdiction was barred under the eleventh amendment. *Id.* at 802.

[4]The State of Missouri cooperates in the following federal programs under the United States Social Security Act, 42 U.S.C. §§ 301-1396 (1970): Old Age Assistance (OAA), 42 U.S.C. §§ 301-306 (1970); Aid to Families with Dependent Children (AFDC), 42 U.S.C. §§ 601-610 (1970); Aid to the Blind (AB), 42 U.S.C. §§ 1201-1206 (1970); Aid to the Permanently and Totally Disabled (APTD), 42 U.S.C. §§ 1351-1355 (1970); and Aid to the Aged, Blind or Disabled (AABD), 42 U.S.C. §§ 1381-1385 (1970). 448 F.2d at 800.

[5]The applicable federal provision is found in HEW, HANDBOOK OF PUBLIC ASSISTANCE ADMINISTRATION, pt. IV, § 2200(b)(3) (1970), which provides:

> A state plan for OAA, AFDC, AB, APTD must provide that:
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> . . . .
>
> (b)(3) prompt action will be taken on each application, within reasonable state-established time standards (which, effective July 1, 1968, will not exceed 30 days in AFDC, OAA, and AB . . . .

The pertinent Missouri provision is found in Missouri Division of Welfare Regulation No. 4.1 (1968):

> For the OAA, ADC, and AB assistance applications (unless there are unusual or extreme circumstances), prompt disposition means that there shall not be more than 30 days between date of application and (a) the date of approval if eligible; or (b) date of rejection, if ineligible.

[6]448 F.2d at 803.

[7]*Id.* at 804.

tion that excused compliance with the thirty-day requirement in the case of unusual or extreme circumstances was inconsistent with the federal statute and therefore contravened the supremacy clause.[8] In awarding the decision to the plaintiff-applicants, the court was satisfied

> that the plaintiffs as a minimum are entitled to a declaratory judgment determining that the applications . . . must be acted upon and the first payment made to eligible applicants within thirty days . . . and that eligible applicants whose claims have not been passed upon within thirty days are entitled to have retroactive benefits. . . .[9]

The focal points of this analysis will be the impact of this decision upon state welfare administration and the applicability of the *Kelly* balancing test of due process.

The due process implications of state-caused delay in the processing of welfare applications were not unforeseen by the judiciary. Justice Black, writing in dissent in *Kelly,* contended that

> the inevitable result of such a constitutionally imposed burden[the right to a pretermination hearing] will be that the government will not put a claimant on the rolls initially until it has made an exhaustive investigation to determine his eligibility. While this Court will perhaps have insured that no needy person will be taken off the rolls without a full "due process" proceeding, it will also have insured that many will never get on the rolls, or at least that they will remain destitute during the lengthy proceedings followed to determine initial eligibility.[10]

The court in *Like v. Carter,* therefore, was readily able to anticipate the due process problem and to apply appropriately the *Kelly* solution. Yet, in its haste to find a denial of due process, the Eighth Circuit glossed over the requisite balancing of governmental interests against the rights of the individual welfare recipient and made only conclusory application of the *Kelly* test of due process.[11] That *Kelly* and *Like* both involved

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[8]*Id.* at 803. An obvious prerequsite to invocation of the supremacy clause is that there be, in fact, a federal law that will override the state law in question. That the supremacy clause applied in *Like* was established by the judicial acknowledgement that the HEW HANDBOOK OF PUBLIC ASSISTANCE ADMINISTRATION (1970) has the force and effect of law and therefore that the regulations and *exceptions* promulgated therein must prevail over contrary state provisions. *Id.* at 803-04.

[9]*Id.* at 805.

[10]397 U.S. at 279 (1970) (Black, J., dissenting); *see also id.* at 284-85 (Burger, C.J., dissenting).

[11]For the application of this test in *Kelly,* see 397 U.S. at 261-66. Upon implementation of the balancing test,

> the Court prefers to look closely at the particular benefit at stake, weighing factors such as the nature of government function involved, the extent of the possible injury, the

rights under a state-administered public-assistance program did not obviate the need for the Eighth Circuit to implement the *Kelly* balancing test. It was essential to ascertain what in fact were the interests of both government and welfare applicant and whether the applicant's interest in receiving payments outweighed the government's interest in delay. Such a balancing test is required in every instance of alleged denial of due process as one must recognize from the fact that every violation of a state welfare regulation does not automatically constitute an abridgement of due process.[12] Nor is the scope of *Kelly* so broad that one may equate without scrutiny the rights of welfare recipients who have realized financial assistance with those of welfare applicants who have yet to benefit from a public-assistance program. Therefore, the court in *Like* should have considered the following factors: the nature of the governmental function, the rationale for a particular procedure or regulation, the extent of potential injury, and the available methods of adhering to current procedures.[13]

The fundamental nature of the governmental function of financially assisting the nation's impoverished was best described by Justice Brennan in *Kelly*:

> From its founding the Nation's basic commitment has been to foster the dignity and well-being of all persons within its borders. We have come to recognize that forces not within the control of the poor contribute to their poverty. This perception, against the background of our traditions, has significantly influenced the development of the contemporary public assistance system. Welfare, by meeting the basic demands of subsistence, can help bring within the reach of the poor the same opportunities that are available to others to participate meaningfully in the life of the community. At the same time, welfare guards against the societal malaise that may flow from a widespread sense of unjustified frustration and insecurity. Public assistance, then, is not mere charity, but a means to "promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity."[14]

The tenor of the Constitution, if not its letter, thus appears to mandate

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> reason for the particular procedure, and the available alternatives before determining the applicability of the due process clause.

The Supreme Court, 1969 Term, 84 HARV. L. REV. 32, 103 (1970).

[12] The dissent of Chief Justice Burger in *Kelly* illustrates this point by questioning whether a welfare recipient must be accorded a hearing when his public assistance is merely reduced and not completely terminated. 397 U.S. at 284-85.

[13] *See* note 11 *supra*.

[14] 397 U.S. at 264-65, *quoting* U.S. CONST. Preamble.

the role that the government must play in public assistance.[15] However, the absence of a specific constitutional obligation on the federal or state governments to provide funds for welfare does not remove the right to survive from that category of rights that are denominated "fundamental."[16]

The thirty-day maximum limitation on the application processing period is not an irrational guideline for the administration of welfare funds. Rather, it is a necessary corollary to the governmental recognition of the individual's right to survive and of the prominent position that government must assume in the protection of that right.[17] However, the thirty-day requirement in itself was not the central issue in *Like,*[18] since the state regulation conformed to the federal standard except for a clause in the state provision that read "unless there are unusual or extreme circumstances."[19] On the basis of a broad interpretation of this clause, the defendants in *Like* contended "that the large volume of applications and the inability of the state welfare department to employ a sufficient number of competent case workers excuses compliance with the thirty-day requirement."[20] The rationality of such an interpretation is highly doubtful. To excuse delay where the applicant was not at fault or where there was no uncontrollable administrative or emergency delay (the recognized exceptions under the federal act[21]) would nullify the provisions of both the state and federal statute requiring reasonable

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[15]The Court relied in *Kelly* upon the language of the preamble to the Constitution for positive proof of some "fundamental" quality to the administration of public assistance. 397 U.S. at 265. The courts have clearly established that there is no constitutional obligation on the states or the federal government to furnish welfare funds. Westberry v. Fisher, 297 F. Supp. 1109, 1115 (D. Me. 1969); Smith v. King, 277 F. Supp. 31, 40 (M.D. Ala. 1967), *aff'd on nonconstitutional grounds,* 392 U.S. 309 (1968).

[16]*E.g.*, Brown v. Board of Education, 347 U.S. 483, 494 (1954), established the essential and fundamental nature of the right to primary and secondary education without any allusion to constitutionally imposed obligations.

[17]448 F.2d at 803, 804.

[18]*Id.* at 803.

[19]Missouri Division of Welfare Regulation No. 4.1 (1968).

[20]448 F.2d at 803.

[21]HEW, HANDBOOK OF PUBLIC ASSISTANCE ADMINISTRATION, pt. IV, § 2300(b)(6) (1970) provides:

> Agency policies on standards of promptness for acting on applications are not used as a basis for denying applications; they are exceeded in practice only in unusual situations (e.g., where the agency cannot reach a decision because of failure or delay on the part of the applicant or an examining physician to provide needed information) and in a small percentage of cases, and in such instances, the case record clearly shows that the delay results either from circumstances within the claimant's control or from some administrative or other emergency that could not reasonably be controlled by the agency.

promptness in application processing.[22]

The potential for injury caused by processing delay is strikingly apparent. The withholding of aid beyond the thirty-day period for determining the applicant's eligibility "may deprive an *eligible* recipient of the very means by which to live while he waits. Since he lacks independent resources, his situation becomes immediately desperate."[23] Furthermore, the failure to alleviate promptly an applicant's need for subsistence commodities may engender indignation, frustration, and resentment.[24] These natural reactions to a government irresponsive to the needs of the impoverished may deepen social alienation of large groups of deprived citizens—an evil that is certainly more fatal to the social fabric than the travail of a particular welfare petitioner whose application has been unreasonably delayed in processing.

Finally, the reasonable methods of meeting the state and federal mandate of thirty days must be considered. If there are none, then perhaps the original requirement was ill-conceived and the proper remedy is not to find a denial of due process but rather to revamp the guidelines to welfare administration. The court in *Like,* however, did conclude that several alternatives to prolonged delay in processing did exist. Specifically noted was the possibility that "more aggressive and effective action could be taken in the investigative procedure."[25] Further cited was the excessive "twelve-day processing period after certification elapses before the issuance of a check."[26] Also ill-received was the State Welfare Department's assertion that a prolonged processing period was required to screen out applications that were allowed on the basis of the false representations of the applicant. The court indicated that the proper remedies were the invocation of termination proceedings and the implementation of criminal penalties rather than the wholesale delay in processing of applications that were substantially non-fraudulent.[27]

The conclusion to be reached under the foregoing application of the factors involved in the balancing test of *Kelly* is that due process was indeed denied the welfare applicants in *Like.* The governmental function involved was that of dispensing aid necessary for the subsistence of the impoverished. The governmental duty of *promptly* administering such

[22]448 F.2d at 804.
[23]Goldberg v. Kelly, 397 U.S. 254, 264 (1970).
[24]*Id.* at 265.
[25]448 F.2d at 804.
[26]*Id.*
[27]*Id.*

relief and the individual right to secure welfare benefits are organically attached to that body of principles that control our society. The state interpretation of acceptable exemptions from the explicit thirty-day processing requirement was clearly illogical in view of the general policy of prompt administration of welfare to those who require it. Furthermore, the potential damage that results from protracted periods of processing is acute at both the individual and societal level. And finally, the State Welfare Department did not pursue the available alternatives to relieve the hardships incurred by excessive delays. The result of weighing these factors is that the scales of due process come down heavily on the side of the individual's interests and compel proper state action to remedy the aggravated conditions present in *Like*.

The significance of *Like v. Carter* for welfare administration is demonstrated in the Eighth Circuit's recognition of the demise of the "right-privilege" dichotomy and the vitality of the "new property" concept.[28] *Like* clearly represents the trend away from the "benevolent-gratuity argument as a basis for insulating agency action from due process requirements."[29] This traditional view precludes protection of the due process clause when a privilege rather than a right is involved.[30] This concept has been substantially eroded by two distinct theories. One theory suggests that despite the characterization of welfare as a privilege, it must nonetheless be accorded due process protection.[31] The other theory, which has become the prevalent one, regards welfare as a *right*.[32] This latter theory rests on the premise that "[s]uch benefits are a matter of statutory entitlement. . . ."[33] Judicial recognition of this premise is effectively an acceptance of Professor Reich's concept of "new property,"[34] which the *Kelly* Court acknowledged by noting that "[i]t may be realistic today to regard welfare entitlements as more like

[28]*See* Reich, *Individual Rights and Social Welfare: The Emerging Legal Issues*, 74 YALE L.J. 1245 (1965); Van Alstyne, *The Demise of the Right-Privilege Distinction in Constitutional Law*, 81 HARV. L. REV. 1439 (1968).

[29]Recent Developments, 16 VILL. L. REV., *supra* note 1, at 592.

[30]The traditional view was espoused in Flemming v. Nestor, 363 U.S. 603 (1960), in which the Supreme Court held that insurance benefits under the Social Security Act were not "accrued property rights." *Id.* at 610. *See also* Barsky v. Board of Regents, 347 U.S. 442 (1954); Hamilton v. Regents of Univ. of Cal., 293 U.S. 245 (1934).

[31]*E.g.*, Shapiro v. Thompson, 394 U.S. 618 (1969); Sherbert v. Verner, 374 U.S. 398 (1963); Homer v. Richmond, 292 F.2d 719 (D.C. Cir. 1961).

[32]*E.g.*, Goldberg v. Kelly, 397 U.S. 254 (1970); Goliday v. Robinson, 305 F. Supp. 1224 (N.D. Ill. 1969).

[33]Goldberg v. Kelly, 397 U.S. 254, 262 (1970).

[34]Reich, *The New Property*, 73 YALE L.J. 733 (1964).

'property' than a 'gratuity.' Much of the existing wealth in this country takes the form of rights that do not fall within traditional common-law concepts of property."[35] That the classical "right-privilege" dichotomy is extinct and that the "entitlement" theory of Reich's "new property" enjoys complete judicial acquiescence is conclusively established by the Eighth Circuit's total unconcern in *Like* over the applicability of due process protection to the traditional notion of "accrued property rights."[36]

The remedies fashioned by the Eighth Circuit in *Like* will have significance not only for the aggrieved applicants but also for the entire concept of state administration of welfare funds. *Kelly* and *Like* establish that the state is no longer a distinct, separate governmental entity that exercises its reasonable discretion in the administration of federal public assistance. The two cases demonstrate that the imposition of federal guidelines, through the power of the supremacy clause, upon the state administration of welfare funding has resulted in the atrophy of state discretionary powers in the area of public assistance. The state has become a mere appendage of the federal government in the management of welfare funds. Yet the alternative to state acquiescence in a welfare program funded by the federal government is greatly diminished revenue sources for public-assistance funding, which would be potentially more devastating to a state than the mere curtailment of its discretion. On the other hand, the question remains unresolved as to whether a state government, having once accepted federal funds, has made an irrevocable election to accept federal assistance in the future even if faced with burdensome capital outlays to revamp the entire welfare program in order to conform to federal provisions.

The judicial response to the foregoing question is problematical although not altogether unpredictable. The courts appear to be concerned with the practical effects that a controverted state action—such as the rejection of federal welfare funds—might have on the well-being of the individual.[37] Indeed such an emphasis is but a manifestation of the due process balancing test of *Kelly,* weighing governmental interests against those of the individual. The specific interests to be balanced are the state's concern in maintaining a reasonable degree of discretion over welfare administration and the individual's ability to survive on a sub-

[35] 397 U.S. at 262 n.8.
[36] Flemming v. Nestor, 363 U.S. 603, 610 (1960).
[37] *E.g.*, Palmer v. Thompson, 403 U.S. 217, 224-25 (1971).

stantially diminished allocation of total welfare funds. It is difficult to envision that a federal court, having recognized the fundamental duty of the government to "provide for the general welfare," would permit the state concern over preservation of its dignity, identity, and discretion to prevail over the individual's natural need to subsist where the state has no source of necessary revenue other than federal funds. But perhaps such a difficulty is not shared by all. Chief Justice Burger, dissenting in *Kelly*, indicated his doubts over the broad applicability of the due process concept as developed in that case:

> Does the Court's holding embrace welfare reductions or denial of increases as opposed to terminations, or decisions concerning initial applications or requests for special assistance? The Court supplies no distinguishable considerations and leaves these crucial questions unanswered.[38]

The Court in *Kelly* did supply identifiable standards for resolving this issue in the four factors that comprise the majority's due process balancing test. One of the crucial questions alluded to by Chief Justice Burger has now been answered by *Like*. The Court in *Like* applied the *Kelly* balancing test, though not in a conspicuous fashion, and determined that the petitioning applicants were denied due process by state noncompliance with the thirty-day requirement. In the wake of *Like* it is neither illogical nor unforeseeable to predict that the courts' next step may entail an application of the *Kelly* due process balancing test to the situation in which the state has reduced welfare payments by voluntary non-participation in federal programs. The outcome of such a case would depend on too many variables—degree of reduction, potential economic impact, and availability of alternatives—to hazard a general prediction as to whether the individual's interests will prevail as they did in *Kelly* and *Like*. Although the eventual position that the courts will assume when faced with this situation is not altogether apparent, the path that they will tread to reach that conclusion is clear. For the standard of due process adopted in *Kelly*, and extended in *Like*, is not a panacea for all the ills that beset welfare administration but a guideline to the priorities and interests that must be recognized if welfare is ever to function in a manner responsive to the needs of those individuals whose very existence depends on it.

MICHAEL CHARLES EBERHARDT

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[38] 397 U.S. at 284-85.

Constitutional Law—Wyman v. James: The Fourth Amendment in The Balance

Throughout American history the fourth amendment[1] has stood as the basic safeguard of the privacy and security of individuals in our free society against arbitrary invasions by agents of the national government. Because this protection is implicit in the "concept of ordered liberty,"[2] its explicit terms were held applicable through the fourteenth amendment to acts of state officials as well.[3] The fourth amendment has been applied in three distinct situations: (1) traditional criminal cases,[4] (2) civil forfeiture cases,[5] and (3) criminal actions for refusal to permit an administrative investigation.[6] Recently, in *Wyman v. James,*[7] the Supreme Court eschewed the opportunity to enlarge this third category to include non-criminal state sanctions for an individual's refusal to consent to administrative intrusions into his home.

In May, 1967, shortly before her son was born, Barbara James applied for Aid to Families with Dependent Children (AFDC),[8] and after a caseworker visited her in her apartment, assistance was authorized. Two years later, upon being notified that a caseworker would again visit her home, Mrs. James refused to permit the visit, offering instead to meet elsewhere to give all pertinent information. She was warned that her refusal would, under the New York welfare laws,[9] result in termination of the assistance, but permission to visit was still denied. Assistance was terminated after a Department of Social Services hearing, but Mrs. James sought and received a temporary restraining order[10] and, later, a

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[1]The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. CONST. amend. IV.

[2]Palko v. Connecticut, 302 U.S. 319, 325 (1937).

[3]Wolf v. Colorado, 338 U.S. 25, 27-28 (1949). In Mapp v. Ohio, 367 U.S. 643 (1961), the exclusionary rule was also held to be applicable to the states.

[4]*E.g.*, Johnson v. United States, 333 U.S. 10 (1948).

[5]Boyd v. United States, 116 U.S. 616 (1886). Because of their quasi-criminal nature civil forfeiture cases have been treated as criminal cases and, therefore, this category will not be separately discussed.

[6]Camara v. Municipal Court, 387 U.S. 523 (1967).

[7]400 U.S. 309 (1971).

[8]AFDC is embodied in Social Security Act §§ 401-10, 42 U.S.C. §§ 601-10 (1970); N.Y. SOC. WELFARE LAW, §§ 343-62 (McKinney 1966) (now N.Y. SOC. SERVICES LAW).

[9]N.Y. SOC. WELFARE Law § 134 (McKinney 1966) (now N.Y. SOC. SERVICES LAW).

[10]James v. Goldberg, 302 F. Supp. 478 (S.D.N.Y. 1969).

permanent injunction from a divided three-judge district court.[11] On appeal, the Supreme Court reversed the district court, holding that the authorized home visit was not a search,[12] and even if it were it would not be unreasonable within the meaning of the fourth amendment.[13] This note will examine the Court's latter determination[14] after first developing general fourth amendment theory, especially in the realm of the administrative search.

For analytical purposes, the fourth amendment has frequently been broken down into two clauses: the guarantee against unreasonable searches and seizures and the requirement of a warrant based on probable cause.[15] The Supreme Court has debated for some years the relationship between the clauses. One position is that the warrant clause states an independent constitutional requirement that "law enforcement agents must secure and use a search warrant whenever reasonably practicable";[16] the other is that the existence of a search warrant is only one factor among many to be considered in assessing whether the search in question was reasonable.[17] In recent years the trend has been in the direction of requiring a warrant, so that "searches conducted outside the judicial process, without prior approval by judge or magistrate are unreasonable *per se* under the Fourth Amendment—subject only to a few specifically established and well-delineated exceptions."[18] Searches have been exempted from warrant requirements when they are (1) of vehicles,[19] (2) to prevent destruction of the evidence, such as taking a blood sample from a man suspected of drunken driving,[20] (3) in hot pursuit of a suspected criminal,[21] (4) incident to a lawful arrest,[22] (5) at interna-

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[11]James v. Goldberg, 303 F. Supp. 935 (S.D.N.Y. 1969).

[12]400 U.S. at 317.

[13]*Id.* at 318.

[14]This note will not discuss whether the authorized visit constituted a "search," *id.* at 317, and whether the required termination of assistance for refusal to permit a home visit was an unconstitutional condition, *id.* at 326-37 (Douglas, J., dissenting). The reader should note that the precise holding of *James* is that the home visit does not constitute a "search", *id.* at 317-18, and therefore, the point this note explores is technically dictum. Because it is felt that the major importance of the case lies in its importation of the balancing technique into fourth amendment analysis, the scope of this note is limited to that point.

[15]*See* note 1 *supra.*

[16]Trupiano v. United States, 334 U.S. 699, 705 (1948). This case was overruled in United States v. Rabinowitz, 339 U.S. 56, 65-66 (1950).

[17]United States v. Rabinowitz, 339 U.S. 56 (1950).

[18]Katz v. United States, 389 U.S. 347, 357 (1967).

[19]Carroll v. United States, 267 U.S. 132 (1925).

[20]Schmerber v. California, 384 U.S. 757, 766-72 (1966).

[21]Warden v. Hayden, 387 U.S. 294, 298-99 (1967). *But see* Vale v. Louisiana, 399 U.S. 30

tional borders,[23] and (6) of those suspected of criminal conduct for the protection of the police officer ("stop and frisk" situations).[24]

In 1967 the Supreme Court, in *Camara v. Municipal Court*,[25] brought the area of administrative code enforcement inspections involving criminal sanctions for refusal of permission to inspect under the warrant requirement, but reduced the standard of probable cause to something less than that required in a criminal case. The Court held that area inspections were reasonable when the need to search outweighed the invasion the search entailed, but whenever he owner of a particular dwelling would not consent to the inspection, a warrant must be obtained to enter the premises.[26] The Court noted that "the warrant procedure is designed to guarantee that a decision to search private property is justified by a reasonable governmental interest,"[27] by requiring a prior determination of reasonableness rather than *post hoc* judicial review.

Although *Camara* would seem to control *James*, the Court distinguished *Camara* on the ground that Mrs. James had not been subjected to criminal prosecution for denying the visit and, in fact, no criminal prosecution was even authorized.[28] The *James* case presented four alternative resolutions for the Court: (1) that mere time and place notice satisfied the reasonableness test, (2) that closely regulated inspections are reasonable, (3) that a warrant is required, but on a lesser standard of probable cause, or (4) that a warrant obtained on a traditional showing of probable cause is required. Of these, the Court chose the second alternative and thereby created another exception to the warrant requirement.

The reasoning behind this choice is significant because it is somewhat foreign to traditional fourth amendment analysis. By creating the

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(1969); Johnson v. United States, 333 U.S. 10 (1948).

[22]Chimel v. California, 395 U.S. 752, 762-63 (1969).

[23]Carroll v. United States, 267 U.S. 132, 153-54 (1925) (dictum).

[24]Terry v. Ohio, 392 U.S. 1 (1968).

[25]387 U.S. 523 (1967). *Camara* overruled Frank v. Maryland, 359 U.S. 360 (1959), which had held, based on the reasonableness clause, that so long as administrative investigations were statutorily limited as to time and manner, they were not unreasonable. The Court in *Frank* had reasoned that of the two interests it found protected by the fourth amendment—privacy and self-protection—the latter was more intense, thus making the reach of the fourth amendment depend, to a large extent on whether the search was part of a criminal investigation.

[26]In a companion case to *Camara*, See v. City of Seattle, 387 U.S. 541 (1967), the Court applied the same rationale to administrative searches of business premises.

[27]387 U.S. at 539.

[28]400 U.S. at 325. Mr. Justice Marshall, in dissent, argued that there should be no such distinction. *Id.* at 340-41.

new exception the Court, in its determination of the reasonableness of the "visit" in *James,* eliminated both the need for a warrant and the necessity of probable cause to search. This has been before only in the border search[29] and "stop and frisk"[30] exceptions. Since the enactment of the first border search statute in 1789,[31] customs officers have been authorized to carry out such searches on the mere suspicion that illegal or dutiable goods are being concealed. The basis of this exemption is threefold. First, this type of search historically has not been considered to be controlled by the fourth amendment because the first border search statute was enacted by the same Congress that proposed the Bill of Rights.[32] Secondly, the occasion for the search arises quickly. Thirdly, there is a strong national interest in prevention of smuggling, especially of narcotics.[33] *Terry v. Ohio*[34] eliminated the need for either a warrant or probable cause in police "stop and frisk" encounters with individuals who may be armed and dangerous on the ground that such police conduct as a practical matter could not be subjected to the warrant procedure. In that situation the exclusionary rule is ineffective because the police are not interested in prosecuting or are willing to forego successful prosecution to achieve some other goal such as self-protection.[35] Welfare "visits," however, would not seem to qualify for exception from warrant and probable cause requirements on any of the above bases, and other reasons which can support such an exception are insubstantial. The governmental interest in the administration of AFDC is not as important as the national interest in stemming the international narcotics traffic as in border searches; the occasion for the search does not arise quickly as in border searches or "stop and frisk" situations; and, unlike the "stop and frisk" situation, the warrant procedure would be effective to prevent unjustified invasions of the homes of welfare recipients because the caseworker has no "other goals" to further by an unwarranted "visit." Thus the Court in *James* has made a significant departure from past fourth amendment analysis.

The most important aspect of this departure is the Court's use of "balancing of interests" to determine the reasonableness of the "visit."

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[29]Carroll v. United States, 267 U.S. 132, 153-54 (1925) (dictum).

[30]Terry v. Ohio, 392 U.S. 1 (1968).

[31]Act of July 31, 1789, ch. 5, § 24, 1 Stat. 43 (1789).

[32]Boyd v. United States, 116 U.S. 616, 623 (1886).

[33]Comment, *Border Searches and the Fourth Amendment,* 77 YALE L.J. 1007, 1011-12 (1968).

[34]392 U.S. 1 (1968).

[35]*Id.* at 14.

Camara introduced balancing in the area of administrative inspections. Though the warrant clause was clearly at issue there, the Court said that the reasonableness of the inspection was to be determined by "balancing he need to search against the invasion the search entails."[36] *Terry* adopted the *Camara* balancing test, holding that the governmental interests in effective prevention and detection of crime and protection of the officer in the street outweighed the brief, limited intrusion upon individual rights, and therefore, the protective pat-down for weapons was reasonable.[37] The Court in *James* cited *Terry* for the propositions that reasonableness is the fourth amendment's standard and that its specific content is to be determined by the particular context in which it is asserted.[38] The Court concluded that the governmental interests in aiding dependent children, fulfilling the public trust, and administering AFDC outweighed the limited intrusion upon Mrs. James' right of privacy.[39]

The Court apparently borrowed its technique of balancing from a line of first amendment cases. When the balancing test is applied in the first amendment area it introduces substantial flexibility into interpretation of the amendment; the result of the balancing process depends on what factors are fed into the "balance." For example, in *Barenblatt v. United States*[40] where a witness before a Congressional investigation refused to answer questions concerning his political activities, the majority of the Court weighed broadly defined governmental interests—society's interest in preservation of the government and having well informed lawmakers—against the narrowly defined individual interest of the witness in refraining from revealing his political affiliations and found the balance in favor of the government. Mr. Justice Black, in his dissenting opinion, defined the individual interest more broadly, as being the interest of society as a whole in being able to join organizations and advocate causes free from fear of governmental penalties, and reached a conclusion opposite that of the majority of the Court.

In *James,* as in the first amendment cases, the balance came out in favor of the state largely because the state interest was defined broadly while the individual interest was defined narrowly. On the

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[36] 387 U.S. at 537.

[37] 392 U.S. at 21-27.

[38] 400 U.S. at 318.

[39] *Id.* at 326.

[40] 360 U.S. 109 (1959). *See also* Konigsberg v. State Bar, 366 U.S. 36 (1961); *In re* Anastaplo, 366 U.S. 82 (1961).

state's side of the balance was placed the alleged necessity of the home visit as an administrative tool to assure the fulfillment of the public's interest in aiding dependent children, to carry out the public trust, and to know that its tax funds are properly expended.[41] Against this the Court weighed not the social interest in protecting homes from unwarranted invasions of privacy, but Mrs. James' personal interest in the privacy of her own home from the prearranged welfare visit.[42]

The Court's weighing of interests becomes even more questionable upon a closer investigation of the alleged necessity of the home visit. No statutory requirement for home visits exists.[43] The federal regulations require only a periodic redetermination of eligibility,[44] with field investigations required only in a selected sample of cases.[45] Even if one assumes authority for the procedure, it is difficult to see what would be accomplished by a home visit. The child does not have to be present when the caseworker visits,[46] and, when a school-age child is involved, it is unlikely that he would be present. There is no need to visit to see if there is a man in the house since the presence of a "substitute father"—one cohabiting with the mother, but owing no duty of support to the child—has been held to be immaterial in establishing eligibility for AFDC.[47] Moreover, a congressional committee has found that the home visit is ineffective as a means of veryfying eligibility,[48] while it has been reported that the incidence of ineligibility has not increased when the affidavit system is used.[49] It should also be noted that the public interest in aiding dependent children is undercut by termination of all AFDC

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[41]400 U.S. at 318-24.

[42]*Id.* at 321-22.

[43]*Id.* at 319 n.6; *id.* at 345-47 (Marshall, J., dissenting). In other areas of social welfare law, state regulations authorizing termination of AFDC benefits because of the mother's refusal to cooperate have been struck down as impositions of additional conditions on eligibility not *required* by the Social Security Act. *See* Weaver v. Doe, 92 S.Ct. 537, *aff'g mem.* Doe v. Swank, 332 F. Supp. 61 (N.D. Ill. 1971). (mother required to name putative father and aid in obtaining child support); Carleson v. Taylor, 92 S. Ct. 446, *aff'g mem.* Taylor v. Martin, 330 F. Supp. 85 (N.D. Cal. 1971) (mother required to sign criminal non-support claim against absent father); Doe v. Shapiro, 302 F. Supp. 761 (D. Conn. 1969), *appeal dismissed,* 396 U.S. 488 (1970) (mother required to name father of illegitimate children).

[44]400 U.S. at 319, 342.

[45]400 U.S. at 319 n.6.

[46]Brief for Social Service Employees' Union Local 371 as Amicus Curiae at 4, Wyman v. James, 400 U.S. 309 (1971).

[47]Lewis v. Martin, 397 U.S. 552 (1970); King v. Smith, 392 U.S. 309 (1970).

[48]Brief for Social Service Employees' Union Local 371 as Amicus Curiae at 8-13, Wyman v. James, 400 U.S. 309 (1971).

[49]*Id.* at 12.

benefits to the child as the state did in *James*.

Ad hoc balancing as practiced in *James* enables the Court to make any determination it wishes without regard for consistency and without any assurance of impartiality.[50] Thus the use of balancing in the *James* category of cases, if applied to the fourth amendment generally, would pose a serious threat to the substantive rules governing police conduct that have evolved in the traditional criminal cases as protections of an individual's privacy. If balancing is to be used in the fourth amendment area, the Court should not follow the first amendment technique, but should strive for a proper balance by only weighing interests of the same level.[51] A proper balancing of the interests in *James* would weigh only particular interests in a specific situation: the state's need to go into the home of a welfare recipient to verify eligibility when the recipient has agreed to furnish all relevant information elsewhere against the particular individual's interest in not being bothered by the type of invasion of hr privacy that a home visit would entail.

Even if proper balancing techniques are used, an individual's fourth amendment right to privacy from governmental intrusion should not be diluted through the balancing of competing interests. In an era of increasing government paternalism, protection of an individual's privacy can only be assured through the traditional warrant procedure.[52] This is especially true in personalized welfare administration as opposed to impersonal area inspections for the enforcement of municipal codes. The restrictions of the traditional probable cause standard in area housing inspections are not present in a case such as *James* where the caseworker makes a visit to a specific home. Moreover, because one purpose of a home visit is to guard against violations of the welfare code and child abuse, both of which are felonies,[53] no less than full probable cause to search should be tolerated. One must consider the ease with

[50]*See* M. SHAPIRO, FREEDOM OF SPEECH 161-62 (1966); Frantz, *The First Amendment in the Balance*, 71 YALE L.J. 1424, 1440-48 (1962).

[51]M. SHAPIRO, FREEDOM OF SPEECH 83-84 (1966). Balancing of interests seems to be derived from Roscoe Pound's theories of social engineering which reasoned that all public or social interests are actually individual interests viewed from different perspectives for purposes of clarity. Therefore, if the system is to work, balances must be struck only by weighing carefully labelled claims of the same level (i.e. social interests v. social interests, not social interests v. individual interests). *Id.*

[52]*See* LaFave, *Administrative Searches and the Fourth Amendment: The* Camara *and* See *Cases*, 1967 SUP. CT. REV. 1, 37, for a discussion of the inadequacies of the area probable cause warrant procedure.

[53]400 U.S. at 339 (Marshall, J., dissenting).

which the warrant procedure could be carried out. If the recipient refuses to consent upon notice of an upcoming visit, application for a warrant could be made. If the caseworker could articulate facts that suggested that violations or child abuse had been committed the warrant would issue. If not, the home visit would not be necessary. In short, the decision should be for an impartial magistrate, not for the caseworker in the field.

GEORGE R. HODGES

Contracts—Partial Enforcement of Restrictive Covenants†

A restrictive covenant in an employment contract which unduly restricts the covenantor will be closely scrutinized by the courts because it violates the public policy against restraint of trade. According to the traditional view as stated in the *Restatement of Contracts,*[1] if the covenant can be construed to be reasonable it will stand but if not[2] it falls; to do otherwise would be to rewrite the contract for the parties. In *Ehlers v. Iowa Warehouse Co.*[3] the Supreme Court of Iowa has overruled prior cases based on the *Restatement* rule and joined the growing minority of states which have adopted the "partial-enforcement" doctrine long advocated by Professors Williston[4] and Corbin.[5]

The plaintiff in *Ehlers,* a former employee of the defendant truck rental company, sought a declaratory judgment that two restrictive covenants in his employment contract with the defendant were unreasonably broad. The company counterclaimed for an injunction against viola-

†The following closely related materials have appeared in this Review: Note, *Covenants Not To Compete,* 38 N.C.L. REV. 395 (1960); Note, *Restraints on Trade—Covenants in Employment Contracts not to Compete within the Entire United States,* 49 N.C.L. REV. 393 (1971); 26 N.C.L. REV. 402 (1948).

[1]Where a promise in reasonable restraint of trade in a bargain has added to it a promise in unreasonable restraint, the former promise is enforceable unless the entire agreement is part of a plan to obtain a monopoly; but if full performance of a promise indivisible in terms, would involve unreasonable restraint, the promise is illegal and not enforceable even for so much of the performance as would be a reasonable restraint.

RESTATEMENT OF CONTRACTS § 518 (1932) [hereinafter cited as RESTATEMENT].

[2]*See* RESTATEMENT § 515.

[3]___ Iowa ___, 188 N.W.2d 368 (1971).

[4]S. WILLISTON & G. THOMPSON, A TREATISE ON THE LAW OF CONTRACTS § 1660 (rev. ed. 1937) [hereinafter cited as WILLISTON].

[5]6A A. CORBIN, CORBIN ON CONTRACTS § 1390 (1962) [hereinafter cited as CORBIN].

tion of the covenants. The first covenant at issue prohibited the plaintiff from disclosing his list of the company's customers to third parties or from using it in a competitive truck rental business after the termination of his employment. There was no time limit as to the duration of the restriction. The second restrictive covenant prohibited the plaintiff from engaging in a competitive business within a 150-mile radius of Waterloo, Iowa, for a period of two years.

In the course of the plaintiff's employment he had made contacts on behalf of the company in many—but not all—of the towns around Waterloo. The plaintiff was the company's principal representative, and in some instances he was the company's only contact with the customers. While still employed by the company and without its knowledge, the plaintiff, in direct violation of both restrictive covenants in his contract, secured verbal commitments from twenty-five per cent of the company's customers to do business with him after the termination of his employment.

The defendant showed the need to enforce the covenants to some extent since the plaintiff, while employed by the company, had gained access to and influence over the customers.[6] Secondly, the truck rental business in the area was highly competitive, and therefore there was no danger of violating the public policy against monopolies by enforcing the covenants.[7] A permanent restriction would have been unreasonable, but rather than completely rejecting the first covenant the court applied a two-year limitation. Since a period of two years was mentioned in the second covenant the court had evidence of what the defendant felt was reasonably necessary to protect itself. By partially enforcing the covenants the Supreme Court of Iowa reversed its former position which was in line with the so-called majority rule.[8] Since the court applied the "partial enforcement" doctrine,[9] it implicitly decided that the first covenant would have been held reasonable and thus enforceable had it originally contained a two-year restriction.

The second covenant was also held to be overly broad. The court's concern was to protect the defendant from an unfair advantage, but it determined that to enforce the 150-mile geographic limitation would have been unfair to the plaintiff. The geographic limitation was consid-

[6] The burden is on the employer to show this need if the covenant is to be enforced at all. ____ Iowa at ____, 188 N.W.2d at 373.

[7] *Id.*

[8] The majority rule is expressed in *Brecher v. Brown*, 235 Iowa 627, 17 N.W.2d 377 (1945).

[9] ____ Iowa at ____, 188 N.W.2d at 370.

ered to be unreasonable since it was not necessary to protect the defendant in cities where the plaintiff had not done business during his employment. Rather than reject the entire covenant the court enforced what it found to be a reasonable restriction: the court enjoined the plaintiff from doing business with those persons or firms which he had contacted while in the defendant's employ—but left the plaintiff free to contact those firms, regardless of their location, with which he had had no business dealings while he represented the defendant.

Restrictive covenants in employment contracts are closely scrutinized by the courts because the law frowns on contracts in restraint of trade;[10] in fact the oldest English cases voided all such covenants.[11] The classical notion was that a man cannot barter away his life and freedom,[12] but the modern cases have recognized that some restrictions are necessary to protect the parties. Restrictive covenants are now generally enforced if the court finds the restraint reasonably necessary to protect a legitimate interest of the covenantee in view of its effect on the covenantor and the public interest.[13] For example, where *A* promises *B* that he will not work in Chicago but *B* does business only in New York, the promise is unreasonable because it does not protect a legitimate interest of *B*.[14] Moreover, the legitimate interest of the covenantee must be weighed against the possible detriment to the covenantor.[15] One who sells a window-cleaning business does not by working as a janitor with some window-washing duties violate a covenant against competition, since to enforce the promise would deprive the seller of his right to work while enforcing only a questionable interest of the covenantee.[16] In addition, agreements not to compete are contrary to the public interest unless they are ancillary to another agreement such as an employment contract or the sale of a business.[17] Even when construed to be reasona-

[10]Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 646-51 (1960).

[11]*E.g.*, Dyer's Case, Y.B. Mich. 2 Hen. 5, f. 5, pl. 26 (1414). *See also* 5 WILLISTON § 1634.

[12]5 WILLISTON § 1652. *See* RESTATEMENT § 591; Pechon v. National Corp. Serv., Inc., 234 La. 397, 100 So. 2d 213 (1958) (employment contract for life held no more than employment at will).

[13]5 WILLISTON § 1636; RESTATEMENT §§ 515-16.

[14]5 WILLISTON § 1636, at 4581; *see* Carpenter & Hughes v. DeJoseph, 217 Misc. 2d 1003, 213 N.Y.S.2d 856 (Sup. Ct. 1960), *modified and aff'd*, 13 App. Div. 2d 611, 213 N.Y.S.2d 860 (1961) where a city-wide covenant not to compete with a former employer was held unenforceable, but the employee was forbidden to solicit his former employer's patients.

[15]___ Iowa at ___, 188 N.W.2d at 373-74; 5 WILLISTON § 1636, at 4581.

[16]Mitchell v. National Window Cleaning Co., 155 Ga. 215, 116 S.E. 532 (1923).

[17]Purchasing Associates, Inc. v. Weitz, 13 N.Y.2d 267, 273, 196 N.E.2d 245, 248, 246 N.Y.S.2d 600, 604-05 (1963); Wetzel, *Employment Contracts and Noncompetition Agreements*, 1969 U. ILL. L.F. 61.

ble these agreements are strictly interpreted, and courts are inclined to find that an act does not violate a restrictive covenant.[18] In the United States the courts are less likely to enforce restrictive covenants in employment contracts than those in sales contracts because the former are more likely to injure the promisor and the public.[19]

An unreasonable covenant does not necessarily invalidate the entire contract.[20] There are three theories as to the extent of enforceability of unreasonable covenants. The "all or nothing at all" view, the strictest of the three, holds that an unreasonable covenant fails completely. For example, where a covenant prohibited an employee from engaging in similar work for five years either in the city in which she worked or in any other city in which the company did business or intended to do business the court found the restriction to be unreasonable and the entire covenant failed.[21] The geographic limitation was simply too broad to be enforced by the court.

According to another theory, the covenant fails unless the offensive term is severable from the rest of the covenant.[22] If the restrictions are separate and distinct so that if the unreasonable term is removed a gramatically meaningful covenant is left, then the court will enforce the reasonable term while voiding the "blue-pencilled" term. The Supreme Court of North Carolina has adopted the "blue-pencil" test. In a case in which the promise was not to compete in Fayetteville, any other town in North Carolina, or any other town in the United States where the company was doing business or intended to do business, the lower court's application of the "all or nothing at all" rule was reversed. The North Carolina Supreme Court held that while the nation-wide restrictions were clearly unreasonable and unenforceable the city-wide and state-wide restrictions were severable, and the lower court was ordered to make a separate determination of their enforceability.[23] On the other hand, an employee's promise not to engage in a business anywhere in the state except in one city was held indivisible according to the language used by the parties since there were no county or city boundaries along which the covenant could be divided. Therefore the blue-pencil

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[18] Purchasing Associates, Inc. v. Weitz, 13 N.Y.2d 267, 272, 196 N.E.2d 245, 247-48, 246 N.Y.S.2d 600, 604 (1963); 5 WILLISTON § 1636, at 4583.

[19] ___ Iowa at ___, 188 N.W.2d at 375; 5 WILLISTON § 1643.

[20] Kelly v. Kosuga, 358 U.S. 516, 521 (1959); 5 WILLISTON § 1659.

[21] Welcome Wagon, Inc. v. Morris, 224 F.2d 693 (4th Cir. 1955).

[22] This is the majority view. Brecher v. Brown, 235 Iowa 627, 17 N.W.2d at 370.

[23] Welcome Wagon Int'l, Inc. v. Pender, 255 N.C. 244, 120 S.E.2d 739 (1961).

test was not met and the entire covenant was held void.[24] Similarly, an agreement not to engage in any business whatsoever would be indivisible and totally invalid.[25]

An increasing number of states as well as leading scholars have rejected the all-or-nothing and blue-pencil tests in favor of the "partial-enforcement" doctrine.[26] This doctrine was expressed by the *Ehlers* court as follows: "[U]nless the facts and circumstances indicate bad faith on the part of the employer we will enforce noncompetitive covenants to the extent they are reasonably necessary to protect his legitimate interests without imposing undue hardship on the employee when the public interest is not adversely affected"[27] without regard to the divisibility of the covenant.

The extent of the relief that will be granted depends upon the relative equities in each case. In one case a promise by an employee not to compete with his employer's laundry business for ten years was held to be unreasonable, but the court enforced a restraint against soliciting customers for a period of nine months as being reasonable based on fairness and justice.[28] Similarly, where a defendant had managed the plaintiff's lumberyard under an employment contract containing a covenant not to work for another lumberyard within fifteen miles for ten years after the termination of employment and the defendant opened a competing business in the same town, the Supreme Court of Wisconsin decided that a three-year limitation would probably be sufficient to protect the plaintiff's interests.[29] The courts that follow the older theories refuse to look beyond the terms which the parties themselves have written, while under the partial-enforcement doctrine the courts feel free to modify the agreement and enforce instead a restriction that is reasonable.

The proponents of the older theories believe that the partial-enforcement doctrine ignores certain fundamental contract principles. It has been argued that there is a basic presumption against agreements in restraint of trade and that when a restrictive term is unreasonable it is because a party has grasped for too much. Therefore, according to

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[24]Consumers' Oil Co. v. Nunnemaker, 142 Ind. 560, 41 N.E. 1048 (1895); 5 WILLISTON § 1659, at 4680-81.

[25]5 WILLISTON § 1659, at 4681.

[26]*Id.* § 1660; 6A CORBIN § 1390. The major cases are listed in *Ehlers*. ___ Iowa at ___, 188 N.W.2d at 370.

[27]___ Iowa at ___, 188 N.W.2d at 370.

[28]Schmidl v. Central Laundry & Supply Co., Inc., 13 N.Y.S.2d 817 (Sup. Ct. 1939).

[29]Fullerton Lumber Co. v. Torborg, 270 Wis. 133, 70 N.W.2d 585 (1955)

this view, it is better to eliminate the restriction altogether.[30] According to the blue-pencil test the covenant reflects the intent of the contracting parties, and the court's modification of an indivisible covenant is, in effect, the imposition of what the court feels is "right" for the parties. The court virtually rewrites the contract.[31] The partial-enforcement doctrine dilutes these basic contract principles and allows the employer to overreach, secure in the knowledge that the covenant will be enforced to some extent.[32] This knowledge impairs the ideal situation because it destroys the bargaining power of the employee; that is, the employer will know that he runs no risk and therefore will insist upon the harshest terms.[33] The older views insist that when the court is allowed to rewrite the contract the result will depend on subjective considerations that can only lead to vagueness and uncertainty as to the respective duties of the parties. According to *Ehlers* a court must find what is *reasonably* necessary to protect the employer's *legitimate* interests without *undue* hardship to the employee and without *adversely* affecting the public interest.[34] A test under which these factors are weighed is so vague and open-ended as to be likely to result in a manifestation of the court's values and not the parties' intention.

On the other hand, advocates of the partial-enforcement doctrine have argued that its application leads to more equitable results without disregarding the intentions of the parties. The blue-pencil rule has been attacked as legalistic, mechanical, and leading to contradictory results.[35] The legality of contracts ought not depend solely on form. Under the blue-pencil rule it is argued that two contracts could have the same meaning but only one would be enforceable because the writing happened to be susceptible to deletion of the offensive terms while leaving a grammatically meaningful promise.[36]

One authority has noted that most unreasonable covenants, although illegal and unenforceable, are not the product of moral turpitude; rather they result usually from a desire, however overly zealous, to protect a party's own interests. Therefore there is no reason to punish the party by throwing out the entire covenant and affording him no

[30] *See* ___ Iowa at ___, 188 N.W.2d at 376 (Becker, J., dissenting).

[31] *Id.* (interpretation should not involve rewriting contract); *see* Hamilton v. Wosepka, 261 Iowa 299, 312-13, 154 N.W.2d 164, 168 (1967).

[32] ___ Iowa at ___, 188 N.W.2d at 376-77; 5 WILLISTON § 1660, at 4685.

[33] ___ Iowa at ___, 188 N.W.2d at 376.

[34] ___ Iowa at ___, 188 N.W.2d at 370.

[35] ___ Iowa at ___, 188 N.W.2d at 371; 6A CORBIN § 1390, at 67.

[36] 5 WILLISTON § 1660, at 4683.

protection at all.[37]

The advocates of the all-or-nothing doctrine argue that the partial-enforcement doctrine ignores the intent of the parties, but this argument has two sides. The courts should not destroy a freely bargained contract any more than is necessary to satisfy the various public policies.[38] The partial-enforcement doctrine gives effect to the parties' intentions to the extent that the law would allow. It is further argued that the public interest is best served and the sanctity of the contract is best preserved by reducing the restriction to an enforceable level. The dividing line between the unreasonable covenant and the enforceable covenant is easily ascertainable.[39] Even under the all-or-nothing doctrine the courts must decide that the restriction is too severe to be reasonable.[40] Under the partial-enforcement doctrine the standard of reasonableness is enforced rather than just used as the standard of enforceability.

The partial-enforcement doctrine does not totally disregard the intentions of the parties. When a party accepts a restraint, for instance, over an unenforceably large area it is obviously reasonable to treat him as having accepted a lesser and reasonable geographical restriction.[41] Arguably, then, the application of the partial-enforcement doctrine does not involve rewriting the contract in contravention of the intention of the parties.[42] In *Ehlers,* for example, by applying the two-year limitation already contained in the second covenant to the first covenant, which otherwise was unreasonable because it was of indefinite duration, the court enforced a standard that the parties had implicitly agreed upon. A similar result was reached when the court enforced the geographical restriction only as to a class of customers and not as to all customers within the 150-mile radius.

The inflexible all-or-nothing and blue-pencil theories allow parties to escape their contractual responsibilities.[43] When an overly broad covenant falls entirely the covenantee is left without any protection, while the covenantor is permitted to retain the entire contract considera-

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[37]Corbin, *A Comment on Beit v. Beit,* 23 CONN. B.J. 43, 47 (1949).

[38]Williston, *A Note on Beit v. Beit,* 23 CONN. B.J. 40, 42 (1949).

[39]Corbin, *supra* note 37, at 47.

[40]The concept of reasonableness must be an underlying value in any such determination. When a court decides that a covenant is reasonable it also decides that it is not unreasonable. Similarly, when the court decides that a covenant is unreasonable, it can easily go one step further and decide what is reasonable.

[41]Solari Industries, Inc. v. Malady, 55 N.J. 571, 582, 264 A.2d 53, 59 (1970).

[42]Corbin, *supra* note 37, at 50.

[43]*Id.* at 47.

tion unless separate consideration was exacted for the covenant. He would then be free to open a business next-door to his former employer.[44]

A final argument in favor of the partial-enforcement doctrine is that it does not involve rewriting the contract any more than does the majority blue-pencil rule.[45] Under each theory the contract is modified by the court to make it enforceable. The blue-pencil theory involves a mere mechanical excission of the offending term, while the partial-enforcement doctrine goes one step further and assures that the rewriting by the court leads to the most equitable results under the circumstances.

The conflicting views will certainly collide when the American Law Institute reconsiders the blue-pencil rule set out in section 518 of the *Restatement of Contracts.* If the ALI adopts the partial-enforcement rule, as it likely will, another issue that must be resolved is whether that rule should apply only to employment contracts and not to contracts of sale. The *Ehlers* court endorsed such a limitation, but the present section 518 makes no such distinction.

An employment contract is likely to be a contract of adhesion with the parties in positions of unequal bargaining power.[46] In the sales situation the parties are more likely to have bargained for each term. Some have argued that for this very reason the all-or-nothing doctrine should be applied to contracts of employment to prevent the employer from overreaching with the expectation of at least partial enforcement.[47] This argument is countered by the requirement of the partial-enforcement doctrine that the covenant be made in good faith if it is to be enforced at all.[48] Since the concept of reasonableness is equally ascertainable in the sales and employment situations, there would seem to be no need for a distinction if the premises of the partial-enforcement doctrine are sound. The partial-enforcement doctrine requires an examination by the court of the surrounding circumstances so that whatever considerations are peculiar to either the sales or the employment situation will be considered when deciding what is reasonable and enforceable in each case.[49]

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[44] *Id.* at 50; *see* Beit v. Beit, 135 Conn. 195, 63 A.2d 161 (1948); 6A CORBIN § 1390, at 76.

[45] 6A CORBIN § 1390, at 68-69.

[46] *Id.* § 1394, at 89.

[47] ___ Iowa at ___, 188 N.W.2d at 376-77 (Becker, J., dissenting); 5 WILLISTON § 1660, at 4685.

[48] *See* ___ Iowa at ___, 188 N.W.2d at 370.

[49] In the sales situation the UNIFORM COMMERCIAL CODE § 2-302(1) allows an unconscionable

If adopted the partial-enforcement doctrine will support the equities of each situation rather than mechanically apply legalistic rules of interpretation. As stated in *Ehlers,* the result will be that the legitimate interests of the covenantee will be protected without undue hardship to the covenantor when the public interest is not adversely affected.[50] This balancing of conflicting interests will enable the courts to dispense justice rather than act as legal technicians.

DAVID M. RAPP

Sales—Strict Liability For Breach of Warranty: *Gore v. George J. Ball, Inc.*

As a general rule two parties may deal with each other as they wish, and if their ensuing agreement is voluntarily and fairly entered into, it will be enforceable in a court of law. However, this fundamental right of freedom of contract is subject to the limitation, *inter alia,* that the agreement may not be against public policy. The vague and somewhat amorphous concept of public policy has been applied by courts to invalidate contracts which in the opinion of the court tend to be injurious to the public welfare, to sound morality, or to the interests of society.[1] In *Gore v. George J. Ball, Inc.*,[2] the North Carolina Supreme Court refused to enforce a limitation-of-damages clause in a contract between a seed seller and a farmer because such a provision "is contrary to the public policy of this State."[3]

In 1965, using an order blank obtained from a George J. Ball, Inc. catalogue, C. O. Gore ordered four ounces of Heinz 1350 tomato seeds at a cost of five dollars. Shortly thereafter Gore received from Ball several packets of seed labeled "Heinz 1350 Tomato Seed." Included

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contract or clause to be enforced according to any one of the three theories:

> If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

[50] *See* text accompanying note 27 *supra.*

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[1] *E.g.,* Pope Mfg. Co. v. Gormully, 144 U.S. 224 (1892); Perkins v. Hegg, 212 Minn. 377, 3 N.W.2d 671 (1942).

[2] 279 N.C. 192, 182 S.E.2d 389 (1971).

[3] *Id.* at 203, 182 S.E.2d at 395.

on each package of seed, on the invoice delivered to Gore, and in the seed catalogue was a clause purporting to limit Ball's liability for any breach of warranty to the return of the buyer's purchase price. Gore planted the tomato seeds, but when they germinated they produced not Heinz 1350 tomatoes but a completely different variety "wholly unsuited for sale for table use and useful only in the production of tomato paste."[4] After refusing to accept a refund of his five-dollar purchase price, Gore filed suit against Ball alleging breaches of an express warranty of description and of the implied warranty of fitness and seeking to recover consequential damages, including lost profits.[5]

Justice Lake, writing for the North Carolina Supreme Court, found that the defendant seed seller had warranted the seed contained in the packets to be "Heinz 1350 tomato seed" and that delivery of a different variety of seed by defendant constituted a breach of its contract.[6] The court made no specific finding as to whether the limitation-of-damages clause was incorporated into the contract but stated that even if it were a part of the contract, it would not be enforceable because it was contrary to the public policy of North Carolina.

The *Gore* court noted that an agreement is against public policy when it "tend[s] to the violation of a statute."[7] In support of this proposition the court cited *Cauble v. Trexler*,[8] a case in which the North Carolina Supreme Court refused to allow a foreclosure of a second mortgage on farmland because the mortgage was violative of the purpose of the Emergency Farm Mortgage Act of 1933.[9] In that case a federal land bank agreed to lend to a mortgagor-farm owner 2,600 dollars on the condition that the mortgagee would agree to accept this amount as a full satisfaction of the farmer's debt. The mortgagee agreed in writing to scale down the amount owed, but after receiving the money he coerced the owner of the farm into giving him a second mortgage on the balance of the debt. The North Carolina Supreme Court noted that

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[4] *Id.* at 195, 182 S.E.2d at 390.

[5] The court noted that plaintiff's complaint was not a "model of clarity and precision as to the theory upon which he relied." 279 N.C. at 198, 182 S.E.2d at 392. Plaintiff appears to have alleged that defendant expressly warranted the seeds to be a specific kind and variety. In addition plaintiff alleged the breach of an implied warranty of fitness for a particular purpose. Both these warranties must have arisen under the common law of North Carolina, if at all, because the *Uniform Commercial Code* had not been enacted in North Carolina at the time of the transaction in issue.

[6] 279 N.C. at 200, 182 S.E.2d at 393.

[7] *Id.* at 203, 182 S.E.2d at 395.

[8] 227 N.C. 307, 42 S.E.2d 77 (1947).

[9] Act of May 12, 1933, ch. 25, § 32, 48 Stat. 31.

the primary object of the federal statute was to relieve farmers from their load of oppressive debts, and thus any agreement in contravention of the statute was void as against public policy.[10] In another North Carolina case, *Courtney v. Parker*,[11] the court refused to allow recovery by a building materials company on a contract because the company was transacting business under an assumed name in direct violation of a statute. The court stated:

> It is well established that no recovery can be had on a contract forbidden by the positive law of the state, and the principle prevails as a general rule whether it is forbidden in express terms or by implication arising from the fact that the transaction in question has been made an indictable offense or subjected to the imposition of a penalty.[12]

In *Gore* the court held that the limitation-of-damages clause was contrary to the purpose of the North Carolina Seed Law.[13] This act makes it unlawful

> to sell, offer for sale or expose for sale within this State . . . vegetable seeds . . .
> c. Not labeled in accordance with the provisions of this article or having a false or misleading labeling or claim.
> . . . .
> j. To which there is affixed names or terms that create a misleading impression as to the . . . kind and variety, . . . quality or origin of the seeds.[14]

The violation of any provision of the act is a misdemeanor punishable by a fine of not more than five hundred dollars.[15] According to the court, this statute was intended to protect farmers against the disastrous consequences of the sale and delivery to them of falsely labeled seed.[16] Thus, the underlying policy of the statute would forbid enforcement of a limitation-of-damages clause in a seed sales contract.

The court in *Gore* could have grounded its refusal to enforce the objectionable clause on alternative legal theories. It might have said as the South Carolina Supreme Court did in *Stevenson v. B. B. Kirkland*

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[10] 227 N.C. at 311, 42 S.E.2d at 80-81.
[11] 173 N.C. 479, 92 S.E. 324 (1917).
[12] *Id.* at 480, 92 S.E. at 324.
[13] N.C. GEN. STAT. § 106-277 to -277.28 (1966), *as amended*, (Supp. 1971).
[14] *Id.* § 106-277.9(1) (1966).
[15] *Id.* § 106-277.24 (1966).
[16] 279 N.C. at 204, 182 S.E.2d at 396.

Seed Co.[17] that the limitation-of-damages clause was not a part of the agreement between the two parties. In *Stevenson,* in an analogous fact situation, the South Carolina court stated that "the nonwarranty clause printed in appellant's catalogue, on its invoice sheets, and on cards inserted in its seed bags is immaterial. For such a clause to be applicable in any case, it must be shown that it was brought to the attention of the purchaser."[18] The court in *Gore* refused to decide that as a matter of law the clause did not become a part of the agreement, stating that even if it were a part of the contract it would be invalid.

The *Gore* court also rejected the reasoning of a Washington case, *Nakanishi v. Foster,*[19] in which defendant had sold mislabeled lettuce seed. The court in *Nakanishi* found that the seller had violated the provisions of a state statute (similar to the North Carolina Seed Law) that regulated the selling and labeling of seed. Since the Washington act was penal in nature and was enacted for the protection of the farmer, the court found that defendant's violation of the statute constituted negligence per se.[20] The *Gore* decision disagreed with this analysis and held that defendant's violation of the seed act could not be negligence per se because the North Carolina Seed Law was not a safety statute.[21]

The North Carolina court in *Gore* avoided the reasoning in *Stevenson* and *Nakanishi* in order to hold specifically that a limitation-of-damages clause included by a seed seller in a sales contract is against public policy. The court's holding, however, is based on a questionable interpretation of the North Carolina Seed Law. The act explicitly exempts from liability any person who sells

> vegetable seeds which were incorrectly labeled or represented as to origin, kind or variety when such seeds cannot be identified by examination thereof unless such person has failed to obtain an invoice or

[17] 176 S.C. 345, 180 S.E. 197 (1935).

[18] *Id.* at 355, 180 S.E. at 201.

[19] 64 Wash. 2d 647, 393 P.2d 635 (1964).

[20] *Id.* at 656, 393 P.2d at 641; *accord,* Hoskins v. Jackson Grain Co., 63 So. 2d 514, 515 (Fla. 1953) (en banc).

[21] 279 N.C. at 198, 182 S.E.2d at 392. The North Carolina court on numerous occasions has stated that violation of a safety statute constitutes negligence per se. However, the violation must be the proximate cause of the plaintiff's injury. *E.g.,* Bell v. Page, 271 N.C. 396, 156 S.E.2d 711 (1967); Reynolds v. Murph, 241 N.C. 60, 84 S.E.2d 273 (1954). A safety statute as defined by the court is a law designed to protect the public from physical injury to person or property. *See* Byrd, *Proof of Negligence in North Carolina,* 48 N.C.L. REV. 731, 746 (1970). The North Carolina Seed Law, which the court itself says was designed to "protect farmers from . . . disastrous consequences," 279 N.C. at 204, 182 S.E.2d at 396, is not a safety statute apparently because its purpose is only to protect an economic interest.

grower's declaration giving origin, kind and variety or to take such precautions as may be necessary to insure the identity to be that stated.[22]

Ball's conduct fell within this exemption as the seed of the two varieties of tomatoes were not distinguishable by physical inspection and Ball had obtained from the grower an invoice showing the variety of the seed to be Heinz 1350.[23] The court admitted that defendant's activity was not in violation of the statute. It stated, however, that the "provision exempting the vendor, under the circumstances designated, from the penalties imposed by the Act is not intended to absolve him from liability to the purchaser for breach of contract."[24] This answer is unsatisfactory because the question before the court was not whether defendant was liable for his breach of contract, but whether he could successfully limit his damages once the breach was established.[25] The fact that the legislature exempted some activities from the penalties of the statute would seem to imply that such conduct is not against the public policy of North Carolina. In fact it is arguable that the legislature was explicitly providing a means by which seed retailers could comply with the provisions of the statute and concomitantly protect themselves from liability.

Although *Gore's* conclusion that the limitation-of-damages clause contravenes public policy is debatable, the court's analysis is significant because it focuses attention on the inequitable nature of the contract. Perhaps the court was suggesting that in the future such oppressive terms will not be enforced in North Carolina. In essence, the *Gore* opinion declares the limitation-of-damages clause to be unconscionable. Such a result could be reached directly under the provisions of the *Uniform Commercial Code,* which had not been enacted in North Carolina at the time of the transaction between Gore and Ball.[26] The court

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[22]N.C. GEN. STAT. § 106-277.10(e) (1966).

[23]Gore v. George J. Ball, Inc., 10 N.C. App. 310, 312, 178 S.E.2d 237, 239 (1971). The court of appeals in its discussion of negligence per se bypassed the question of whether the North Carolina Seed Law was a safety statute and instead predicated its holding on the fact that defendant did not violate the seed law. *Id.* at 313, 178 S.E.2d at 240.

[24]279 N.C. at 205-06, 182 S.E.2d at 397.

[25]*But see* Zicari v. Joseph Harris Co., 33 App. Div. 2d 17, ——, 304 N.Y.S.2d 918, 924-25 (1969), in which a New York court similarly confused the separate issues of liability for breach of warranty and ability to contractually limit damages.

[26]The *Uniform Commercial Code* was enacted into positive law in North Carolina by the 1965 legislature and became effective on July 1, 1967. Ch. 700, §§ 1-11, [1965] N.C. Sess. L. 768 (codified as N.C. GEN. STAT. § 25-1-101 to -10-107 (1965), *as amended,* (Supp. 1971)). The numbering of sections in the North Carolina Code corresponds to that used in the 1962 Official Text of the *Uniform Commercial Code,* except that each number is preceded by the chapter

in *Gore*, unable to rely on the statutory authority of the *Code*, had to use the only tools it had available, and thus it declared the agreement to be contrary to public policy.[27]

The *Uniform Commercial Code* allows a vendor and purchaser to limit contractually the remedies available to the buyer for a breach of warranty by the seller.[28] The *Code* specifically states that the measure of damages may be altered "by limiting the buyer's remedies to return of the goods and repayment of the price."[29] This is precisely the *Gore* situation. According to the *Code*, such a provision is binding on the parties "unless the limitation or exclusion is unconscionable."[30] Section 2-302 allows a court to find as a matter of law that the entire contract or any clause in the contract is unconscionable.[31] The Official Comments to the *Code* note that section 2-302 was intended to allow a court to pass directly on the unconscionability of a contract. "In the past such

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number, "25." Thus, § 2-302 of the *Uniform Commercial Code* is § 25-2-302 of the North Carolina Code. The Official Comments to the *Code* have never been enacted into positive law in North Carolina. They are recorded in chapter 25 of the *General Statutes*, however, and presumably are used by North Carolina courts in interpreting specific sections of the Code.

[27]The court was probably correct in its determination that it lacked the statutory authority to directly invalidate a contract as unconscionable. At least one court, however, has held as a matter of common law that an unconscionable contract is unenforceable. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

Courts of equity have consistently refused to enforce unconscionable provisions in contracts. *See, e.g.*, Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948). Professor Pomeroy in his treatise on equity jurisprudence states that

> [t]he specific performance of a contract will be refused when . . . the contract itself is unfair, one-sided, unconscionable, or affected by any other such inequitable feature, and where the specific enforcement would be oppressive or harsh upon the defendant, or would prevent the enjoyment of his own rights, or would in any manner work injustice.

4 J. POMEROY, EQUITY JURISPRUDENCE § 1405(a) (5th ed. 1941).

[28]UNIFORM COMMERCIAL CODE § 2-316(4) [hereinafter cited as UCC].

[29]UCC § 2-719(1)(a).

[30]UCC § 2-719(3). It may have been possible to invalidate the suspect clause in the *Gore* contract without resorting to the unconscionability section of the *Code*. Section 2-719(2) imposes a limitation of reasonableness on any damages which the parties have undertaken to regulate consensually. This limitation applies "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose." UCC § 2-719(2). The Official Comment notes that the very essence of a sales contract requires "that at least minimum adequate remedies be available." UCC § 2-719, Comment 1. Arguably, the purchaser in *Gore* would be deprived of the entire benefit of his bargain if the limitation-of-damages clause were enforced, and thus he would not have the minimum adequate remedies which the *Code* requires. *See also* 1 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 174-75 (1964).

[31]UCC § 2-302. This section was deleted when the *Uniform Commercial Code* was initially enacted in North Carolina. However, the 1971 legislature incorporated the provision into the statute and it became effective on October 1, 1971. Ch. 1055, § 1, [1971] N.C. Sess. L.— (codified as N.C. GEN. STAT. § 25-2-302 (Supp. 1971)).

policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or *by determinations that the clause is contrary to public policy* or to the dominant purpose of the contract."[32]

The *Code* offers no explicit definition of unconscionability, but the Official Comment states that the principle is one of "prevention of oppression and unfair surprise."[33] Since these two abuses appear most often in contracts between two parties with unequal bargaining power, it may be helpful to analyze unconscionability in terms of disparate bargaining power. An oppressive contract may be defined as one in which a stronger party forces a weaker party to accept terms which are both burdensome and unjustified by commercial necessities. The weaker party accepts the oppressive terms, although aware of the consequences, because his bargaining power is such that he must do business on those terms or not at all.[34] In *Henningsen v. Bloomfield Motors, Inc.*,[35] a case discussed in the *Gore* opinion, the New Jersey Supreme Court refused to enforce this type of oppressive clause. In that case an automobile owner sued the dealer and manufacturer to recover for personal injuries and consequential damages to the auto incurred in an accident caused by a defect in the car's steering mechanism. The defense was based largely on a provision in the sales contract that limited the manufacturer's liability for breach of warranty to the replacement of defective parts. The type of disclaimer in question was used not only by defendant, Chrysler Corporation, but also by every other automobile manufacturer in the country.[36] Thus, the automobile buyer lacked any meaningful choice in the matter; he could either purchase a car and accept the limitation clause or purchase no car at all. The *Henningsen* court relied heavily on this factor in reaching its decision:

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[32]UCC § 2-302, Comment 1 (emphasis added). *See also* Spanogle, *Analyzing Unconscionability Problems*, 117 U. PA. L. REV. 931 (1969), where the author states:

> Unconscionable contracts and clauses have been surreptitiously invalidated for decades. But surreptitious invalidation created problems. The courts did not usually invalidate on the express ground that a particular clause or contract was unconscionable. Their regard for "freedom of contract" prevented such a straightforward approach or any explicit recognition of judicial control over the terms of a bargain. Instead, the courts resorted to various formal, technical devices to achieve their ends.

Id. at 934 (footnote omitted).

[33]UCC § 2-302, Comment 1.

[34]*See* Comment, *Bargaining Power and Unconscionability: A Suggested Approach to UCC Section 2-302*, 114 U. PA. L. REV. 998, 999 (1966).

[35]32 N.J. 358, 161 A.2d 69 (1960).

[36]*Id.* at 390-91, 161 A.2d at 87.

> [The standardized mass contract] is used primarily by enterprises with strong bargaining power and position. "The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms, either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses. His contractual intention is but a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood in a vague way, if at all."[37]

In the seed-sale situation a buyer also has no meaningful choice. Apparently all seed growers and retailers rely on the same or similar limitation-of-damages provisions in their sales contracts.[38] Thus, the farmer in *Gore* was in a worse position than the auto buyer in *Henningsen* because he could not afford the luxury of forgoing his purchase. Economic realities dictated that he buy the seeds on whatever terms they were available. The court noted that a breach of warranty for an automobile part would not automatically cause harm to the consumer, but the mislabeling of seed would unavoidably cause injury to a farmer.[39] "Loss of the intended crop is inevitable; the extent of the disaster is measured only by the size of the farmer's planting."[40]

The second element of unconscionability, unfair surprise, is perhaps best demonstrated by the fine print contract that contains a labyrinth of words and expressions defining the rights and obligations of each party. In most situations the non-drafting party either fails to read the fine print or is unable to comprehend the technical legal language. In *Henningsen* the limitation-of-damages clause appeared on the back of a sales contract and the buyer's attention was directed to it by the smallest, least legible print in the entire document.[41] The court concluded that even if the consumer had read the clause, he would not

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[37] *Id.* at 389, 161 A.2d at 86.

[38] 279 N.C. at 202, 182 S.E.2d at 395.

[39] *Id.* at 208, 182 S.E.2d at 398. Of course it is possible that a better crop would result because of the inadvertent supplying of a superior strain of seed which responds well to similar cultivation methods.

The *Gore* court also failed to consider the fact that *Henningsen* dealt primarily with personal injury. Traditionally, personal injury has been thought to be a much greater wrong than mere economic injury. This distinction is evidenced by the fact that § 2-719(3) of the *Code* makes limitation-of-damages for a personal injury prima facie unconscionable, but such a contractual provision for commercial losses is allowed unless proved unconscionable.

[40] 279 N.C. at 208, 182 S.E.2d at 398.

[41] 32 N.J. at 365, 161 A.2d at 73. The *Henningsen* court caustically remarked that "[t]he draftsmanship is reflective of the care and skill of the Automobile Manufacturers Association in undertaking to avoid warranty obligations without drawing too much attention to its effort in that regards." *Id.* at 400, 161 A.2d at 93.

understand its legal ramifications. The *Gore* court questioned whether a prospective seed purchaser would notice the suspect clause and understand its legal implications. The opinion conceded that an experienced lawyer would have understood the significance of the provision, but the court felt that "most retail purchasers of seed are not experienced in the art of discovering such phrases in the midst of language relating to other matters."[42] While both *Henningsen* and *Gore* held the limitation-of-damages clause to be against public policy, the citation of section 2-302 by the *Henningsen* court suggests that it felt the case presented the type of abuses which that section of the *Code* was intended to prevent.[43]

A limitation-of-damages clause may be considered a means of allocating unknown or undeterminable risks between two contracting parties. Arguably, in a *Gore*-type situation the parties are merely allocating this burden. The seed retailer sells his goods at a relatively low price because he is not guaranteeing them. The farmer is willing to accept virtually any risk in order to avoid having to pay a higher price for the seeds. Some courts have been persuaded by this logic and have consequently upheld limitation-of-damages clauses in seed-sale cases.[44] For example, in *Hoover v. Utah Nursery Co.*[45] the court reasoned that

> [t]he purchase price of a parcel of seed is usually insignificant as compared with the value of the crop that may be raised therefrom. For this small price the seed merchant may feel that he cannot afford to warrant. Crops are destroyed or impaired by many causes, [some of which are] hard to identify. The law, considering these larger facts and circumstances, gives validity to these disclaimers . . . .[46]

In *Gore* the North Carolina Supreme Court did not mention these considerations, perhaps recognizing that there was no mutually understood, bargained-for allocation of the risk. Any pre-litigation thought as to who should bear the burden apparently was engaged in only by the retailer, who had drafted the provision. The buyer probably never even considered the question. The *Gore* court, by invalidating the limitation-of-damages clause, may have been making a policy decision that as between the two parties the seed retailer was better able to absorb the cost of accepting the risks.

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[42] 279 N.C. at 202, 182 S.E.2d at 395.

[43] 32 N.J. at 404, 161 A.2d at 95.

[44] *E.g.*, Asgrow Seed Co. v. Gulick, 420 S.W.2d 438 (Tex. Civ. App. 1967); Hoover v. Utah Nursery Co., 79 Utah 12, 7 P.2d 270 (1932).

[45] 79 Utah 12, 7 P.2d 270 (1932).

[46] *Id.* at 17, 7 P.2d at 273.

Two other courts recently presented with cases quite similar to *Gore* ruled that the limitation-of-damages clause was against public policy.[47] These decisions did not go nearly as far as *Gore*, however, because in each case the defendant was found to have been culpable in some degree. In one instance the seed grower was actually negligent,[48] and in the other, he fraudulently misrepresented the kind and quality of the seeds.[49] In contrast, the defendant in *Gore* was free of fault. The result of the court's decision in *Gore* is that seed growers and retailers are strictly liable for selling mislabeled products in North Carolina. Under the *Uniform Commercial Code*, now in force in this state, the seller by labeling his seeds to be a specific variety has given an express warranty of description[50] that may not be disclaimed by any inconsistent terms in the sales contract.[51] While the *Code* permits contractual limitation of damages, the *Gore* opinion would forbid such a modification, at least if the damages were limited to the return of purchase price. Thus, under the *Code*, a seed seller may not disclaim his liability for breach of an express warranty and under *Gore* he may not limit his damages.

ERNEST S. DELANEY, III

Securities Regulation—A Little Light and More Obfuscation on Rule 10b-5

For a decade or more there has been a prolific development of federal case law involving private actions based on violations of section 10(b) of the Securities Exchange Act of 1934[1] and of the implementing

[47] Klein v. Asgrow Seed Co., 246 Cal. App. 2d 87, 54 Cal. Rptr. 609 (1966); Dessert Seed Co. v. Drew Farmers Supply, Inc., 248 Ark. 858, 454 S.W.2d 307 (1970). In *Dessert Seed* the court stated that the limitation-of-damages clause was "unreasonable, *unconscionable*, and against sound public policy." *Id.* at 865, 454 S.W.2d at 311 (emphasis added).

[48] Dessert Seed Co. v. Drew Farmers Supply, Inc., 248 Ark. 858, 865, 454 S.W.2d 307, 311 (1970).

[49] Klein v. Asgrow Seed Co., 246 Cal. App. 2d 87, ——, 54 Cal. Rptr. 609, 618 (1966).

[50] UCC § 2-313(1)(b).

[51] *See* UCC § 2-316(1); UCC § 316, Comment 1; UCC § 2-313, Comments 1, 4.

[1] 15 U.S.C. § 78j(b) (1970). The portion of the statute relevant to this discussion reads as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

Rule 10b-5.[2] The result has been a broadly based federal anti-fraud law which is tending to replace state remedies of common law fraud in securities transactions.[3] As this new body of law developed, the United States Supreme Court remained relatively silent on section 10(b) and Rule 10b-5.[4] This silence has been broken with *Superintendent of Insurance v. Bankers Life & Casualty Co.*[5] Unfortunately, the nature of the facts alleged in the complaint in *Bankers Life* and the questions of law presented are outside the ambit of common corporate experience. Thus, those who had hoped for much illumination of Rule 10b-5 when the Court chose to review a case will probably be more disappointed than enlightened.

Section 10(b) and Rule 10b-5 directly affect the activities of most corporations and their directors, officers, and controlling shareholders. Decisions must be made on a recurrent basis with respect to transactions in securities and in particular with respect to disclosure of information on corporate activities. The holdings of the lower federal courts have left varying degrees of uncertainty in the law governing such decisions. What is the extent of the duty to disclose material information? What information is material? Who is liable to be treated as an insider and thus be required to surrender trading profits?[6] And, finally, how are

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(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[2]17 C.F.R. § 240.10b-5 (1971):

It shall be unlawful . . .

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to [make a misleading omission] . . . or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

[3]For sympathetic discussions of this trend *see* Bloomenthal, *From Birnbaum to Schoenbaum: The Exchange Act and Self-Aggrandizement*, 15 N.Y.L.F. 332 (1969); Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations—Standing to Sue under Rule 10b-5*, 26 BUS. LAW. 1289 (1971).

[4]Rule 10b-5 was construed in SEC v. National Sec. Inc., 393 U.S. 453 (1968), but in the Court's own language "[t]he questions presented [were] narrow ones." *Id.* at 465. The case was not a private action, and the more significant question resolved was that the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (1970), reserves to the states the regulation of insurance companies with respect to their relations with policyholders but does not preempt federal regulation where securities transactions are concerned.

[5]92 S. Ct. 165 (1971).

[6]The leading case which posed these questions and which is responsible for the proliferation

remedies to be determined?[7] Cases that pose these questions are not infrequent, and the answers to these questions are of much concern to corporate managers. Fortunately, it is the rare corporate manager who must decide—like the defendants in *Bankers Life*—whether he will be vulnerable under federal law if he siphons five million dollars of assets from an insurance company. It is, then, an unhappy accident that the principal case deals with such an unusual fact situation rather than the recurrent problems exemplified by the classic case of *SEC v. Texas Gulf Sulphur Co.*[8]

In *Bankers Life*, the Superintendent of Insurance as plaintiff stood in a role analogous to that of a trustee in bankruptcy of the defrauded and insolvent Manhattan Casualty Company.[9] The complaint alleged that certain of the defendants devised and executed a scheme whereby they bought all of the common stock of Manhattan through the use of its own assets to meet the purchase price. As a result, the company's assets were depleted by five million dollars, it was apparently rendered insolvent thereby, and creditors and policyholders were allegedly left vulnerable.[10] The fact that the complaint was evidently unclear and incomplete[11] together with the circumstance that the case arose on a motion to dismiss makes for some unfortunate speculation on the facts. Despite this, it is at least relatively clear that there were three distinct sets of transactions which made up the composite fraudulent scheme.[12] First, one of the individual defendants purchased all of the common stock of Manhattan from Bankers Life and Casualty Co. with a five-

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of Rule 10b-5 cases is SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). In that case officers, directors, and management personnel of the company who had knowledge of a significant mineral discovery were held to have violated Rule 10b-5 by trading in the securities of the company in advance of public disclosure. In addition, the company itself was found to have committed a violation by releasing an equivocal news item underplaying the discovery.

[7]*See* Weiskopf, *Remedies under Rule 10b-5*, 45 ST. JOHN'S L. REV. 733 (1971).

[8]401 F.2d 833 (2d Cir. 1968).

[9]Superintendent of Ins. v. Bankers Life & Cas. Co., 300 F. Supp. 1083, 1086 n.1 (S.D.N.Y. 1969).

[10]There is an issue of fact as to whether any person was indeed damaged by the defendants' acts. The Supreme Court opinion alludes to damage to creditors. 92 S. Ct. at 169. The Securities Exchange Commission speaks of damage to policyholders and creditors. Brief for SEC as Amicus Curiae at 27. Contrariwise, the defendant Irving Trust Co. points out that the policyholders were reinsured and that the Superintendent of Insurance is not asserting any creditor claims. Brief for Respondent Irving Trust Co. at 23.

[11]300 F. Supp. at 1086 n.2. The confusion centers on two issues: was anyone actually damaged? *See* note 10 *supra*. And was the board of directors in fact misled? *See* text accompanying note 25 *infra*.

[12]300 F. Supp. at 1087-92 provides a comprehensive treatment of the facts.

million-dollar check drawn on the Irving Trust Co., there being no funds on deposit with Irving to cover this check. Second, the new owner caused the sale of Manhattan's portfolio of United States Treasury obligations to cover this check. Third, there ensued an elaborate "shell game" of purchasing and pledging certificates of deposit for the purpose of showing Manhattan as payee for five million dollars to replace the sold Treasury notes. In fact, the certificates were assigned to another company controlled by the individual defendants and had no asset value to Manhattan despite their appearance on the Manhattan balance sheet.

The district court characterized the case as one of common law fraud under state law.[13] The court of appeals affirmed.[14] The Supreme Court reversed, holding that a cause of action was stated under Rule 10b-5.[15]

The first and most obvious rule that can be extracted from *Bankers Life* is that a private cause of action may be maintained on the basis of a violation of Rule 10b-5.[16] This conclusion is certainly anti-climactic in that it was clearly foretold by the holding of the Supreme Court in *J. I. Case Co. v. Borak*[17] (wherein a private cause of action was upheld for violation of other sections of the Securities Exchange Act) and had already formed the basis of decisions in substantially all of the courts of appeals.[18]

It is also clear from *Bankers Life* that the Court will place a liberal interpretation on the requirement that the Rule be confined to an "act . . . in connection with the purchase or sale of any security."[19] There were three separate transactions in *Bankers Life*. The first was the sale of the common stock of Manhattan by the defendant Bankers Life to the defendant Begole. There were two obstacles to finding a violation of section 10(b) and Rule 10b-5 solely on the basis of this transaction. First, there was no allegation that the sale was for less than the full value

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[13]*Id.* at 1102. In addition to a cause of action under state common law, it would appear that the Superintendent of Insurance could attack the transaction by statute. *See* N.Y. INS. LAW § 536 (McKinney 1966).

[14]Superintendent of Ins. v. Bankers Life & Cas. Co., 430 F.2d 355 (2d Cir. 1970).

[15]92 S. Ct. at 169-70.

[16]*Id.* at 169 n.9.

[17]377 U.S. 426 (1964). Earlier still, the apparent progenitor of private action cases under Rule 10b-5 was Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

[18]For a tally of cases and jurisdictions see 6 L. LOSS, SECURITIES REGULATION 3871-73 (Supp. 1969) (hereinafter cited as LOSS).

[19]*See* the text of Rule 10b-5 in note 2 *supra*. There had been little prior judicial interpretation of the significance of the "in connection with" phrase. There is a limited discussion in 6 LOSS 3616-17.

of the stock. Second, Manhattan was not a party to the sale of its own stock. To have allowed the plaintiff standing on the basis of this initial transaction would have meant repudiation of the so-called "*Birnbaum* rule"[20] that the plaintiff must be either a buyer or a seller to bring the action. As for the second transaction, Manhattan was a party to the sale of its portfolio of Treasury bonds but it was not alleged that Manhattan received less than full consideration for the bonds.[21] There was no fraud in connection with the sale of the bonds viewed as an independent transaction.

It is difficult to avoid the conclusion that the actual fraud occurred in the third transaction—when the certificate of deposit payable to Manhattan was assigned without consideration and thus became valueless as an asset of Manhattan. The fraud was consummated when the proceeds of the prior transaction were thus diverted. Certificates of deposit, however, are presumably not "securities" within the definition of Rule 10b-5.[22] Hence, the Rule would not have reached the fraudulent act if the Court had interpreted "in connection with" as limited to the immediate transaction which constituted the fraud. It was necessary to treat the three separate transactions as one for the purpose of finding an "act . . . in connection with the . . . sale of any security."

The second principle to be derived from *Bankers Life* would therefore seem to be that there is a violation of Rule 10b-5 such as to support a cause of action when there is a sale of securities for full consideration, followed by a fraudulent diversion of the proceeds, if the successive transactions are planned and executed contemporaneously as part of one integral fraudulent scheme. Such a broad interpretation of the "in connection with" requirement presents two problems. From a policy

[20]Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). It is possible that *Bankers Life* will be regarded by some as diluting the *Birnbaum* rule, but it should be noted that the Court was careful to avoid doing so by interpreting the transaction so as to find that the plaintiff was a "seller." The only allusion to the rule is in an ambiguous footnote. 92 S. Ct. at 169 n.10.

[21]The Treasury bonds were treated as within the definition of "securities" in 15 U.S.C. § 78c(a)(10) (1970). *Cf.* Tcherepnin v. Knight, 389 U.S. 332 (1967) (savings and loan shares included).

[22]The district court declined to rule specifically on the question of whether certificates of deposit are "securities" under Rule 10b-5, but the inference in the opinion is that they are not. 300 F. Supp. at 1099 & n.14a. In the definition of securities in the Securities Act of 1933, 15 U.S.C. § 77b(1) (1970), an "evidence of indebtedness" was covered and would presumably include certificates of deposit. The 1934 Act, however, excludes the phrase "evidence of indebtedness" and further expressly excludes "any note, draft, bill of exchange, or banker's acceptance which has a maturity . . . not exceeding nine months." 15 U.S.C. § 78c(a)(10) (1970). In the principal case, the certificates had a six month maturity. 300 F. Supp. at 1100.

perspective, it reinforces a trend toward a general federal common law governing corporate fraud based on Rule 10b-5. It also poses the practical problem of how closely related the individual transactions need be to fit into the *Bankers Life* pattern. Would the Court have found a cause of action if the diversion of the proceeds had followed the sale of the notes by one day? By one week? By one month? The opinion leaves these questions unanswered.

Another question that had not been clarified by prior case law under Rule 10b-5 was whether it was necessary that at least some of the directors or shareholders of the corporation be deceived by the alleged act or practice. Unfortunately, confusion of the facts in *Bankers Life* deprives us of a clear answer to this question. This confusion centers on the authorization of the sale of Manhattan's Treasury bonds. The Supreme Court seems to have assumed that the defendants induced the directors of Manhattan to authorize the sale and in so doing misrepresented or concealed the plan for diversion of the proceeds.[23] The district court assumed with much practical logic that the defendants installed themselves or others who were presumably privy to the scheme as officers and directors immediately upon their acquisition of the Manhattan common stock.[24] The brief for the defendant Irving Trust Company so states.[25] If the latter view is correct, there was no deception or misrepresentation. It is unlikely, however, that the outcome of the case would have differed whatever view is closer to the facts. The Court had determined that the interests of the creditors and policyholders were to be protected, and it was not likely to be deterred by the distinction as to whether any of the directors had been deceived.[26] It is thus probable that an action may be brought by the "defrauded" corporation for the purpose of protecting creditors even when the directors, the officers, and the shareholder(s) of the corporation are the perpetrators of the fraud or are privy to it. It is also apparent that it is not necessary that investors be damaged by the deceptive act or practice. Thus, a third general rule

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[23]92 S. Ct. at 167 n.1.

[24]300 F. Supp. at 1089 n.6.

[25]Brief for Respondent Irving Trust Co. at 5, Superintendent of Ins. v. Bankers Life & Cas. Co., 92 S. Ct. 165 (1971).

[26]This conclusion is not totally clear from the principal case because of the apparent assumption that some or all of the directors were deceived. Some case law supports the conclusion. *See* Shell v. Hensley, 430 F.2d 819 (5th Cir. 1970); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964) (dictum); *cf.* A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967). *But see* O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964).

may be drawn from the principal case: there is no longer any doubt that the protection of section 10(b) and Rule 10b-5 extends beyond "the integrity of the securities markets"[27] to reach the corporate entity and thereby its creditors.[28]

The Court in *Bankers Life* states that it finds support for this broad view of the class of persons to be protected in the legislative history of section 10(b) of the Securities Exchange Act.[29] Illustrative, perhaps, of the dubious value of that legislative history is the fact that the court of appeals reached the opposite conclusion,[30] while at least one eminent authority finds the legislative history cursory and inconclusive.[31]

There is a basic policy question as to the need for a general body of federal law dealing with fraudulent breaches of the fiduciary duties of directors, officers, and controlling shareholders of corporations.[32] If the answer is "yes," there is a second question as to whether such a body of law should be judge-made rather than the product of legislative codification.[33] It is certainly true that those who would answer "yes" to both of these questions will be cheered by the holding of *Bankers Life.*

Two divergent lines of case law had developed under the Rule 10b-5 umbrella. The first involved securities fraud in the pattern typified by *Texas Gulf Sulphur.* The second involved general corporate mismanagement through breaches of fiduciary duties. Conspicuous examples of the

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[27]Superintendent of Ins. v. Bankers Life & Cas. Co., 430 F.2d 355, 361 (2d Cir. 1970).

[28]*See* Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961); Macey, *Protection of Creditor's Rights Through Use of Rule 10b-5*, 76 COM. L.J. 133 (1971); *c.f.* A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

[29]92 S. Ct. at 169 & n.8.

[30]430 F.2d at 361. The court of appeals followed the general interpretation set out in the *Birnbaum* case.

[31]6 Loss 3617 approves the *Birnbaum* version of the legislative history. For an entertaining firsthand commentary on the cursory treatment given to Rule 10b-5 at the time of its adoption by the Securities Exchange Commission *see remarks of M. Freeman in Proceedings of ABA Section of Corporation, Banking and Business Law, Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 921-23 (1967). For an appraisal which concludes that no sort of civil remedy can be supported by the legislative history *see* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 NW. U.L. REV. 627 (1963).

[32]*See* 6 Loss 3631-45, 3875. On the subject of the growth of Rule 10b-5, Professor Loss has further said, "This is backdoor jurisprudence with a vengeance." Loss, *History of SEC Legislative Programs and Suggestions for a Code*, 22 BUS. LAW. 795, 796 (1967). *See*, in addition, the articles cited note 3 *supra*.

[33]*See Proceedings of ABA Section of Corporation, Banking and Business Law, Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793 (1967); Painter, *Rule 10b-5: The Recodification Thicket*, 45 ST. JOHN'S L. REV. 699 (1971); Comment, *Federal Corporation Law and 10b-5: The Case for Codification*, 45 ST. JOHN'S L. REV. 274 (1970).

latter are *Ruckle v. Roto American Corp.*,[34] where the defendant directors issued treasury stock to perpetuate their control; *Schoenbaum v. Firstbrook*,[35] in which a majority stockholder used its control to acquire additional shares for inadequate consideration; and *Hooper v. Mountain States Securities Corp.*,[36] another instance of the issuance of stock for inadequate consideration. *Bankers Life* can be seen as encouraging the use of Rule 10b-5 as it was used in these cases to allow recovery for the breach of fiduciary obligations.

Nonetheless, *Bankers Life* is an atypical case and may be more interesting for what it does not decide than for what it does. A valid argument for a federal law governing corporate fraud is that the result will be uniformity and simplified corporate decision-making. This argument for supplanting state law fails when the federal law develops helter-skelter and lacks uniformity. A major role of the Supreme Court is to help induce clarity and uniformity. Thus, if the Court decides to encourage expansion of the role of the federal courts, it can be helpful by accepting the concurrent responsibility of seeing that the expansion is orderly and consistent. *Bankers Life*, dealing as it does with a peripheral situation, may not prove to be very helpful in this respect.

In summary, *Bankers Life* foretells a broad interpretation of the requirement in Rule 10b-5 that the questioned acts must be "in connection with" the purchase or sale of securities. The case also approves the extension of the protection afforded by the Rule to creditors as well as investors. On the other hand, the Court leaves the technical "*Birnbaum* rule" undisturbed—the plaintiff must be a buyer or a seller.[37] The anomalous result is an endorsement of the letter of the *Birnbaum* case but an implied rejection of the spirit of *Birnbaum* in that the basic rationale for the *Birnbaum* rule was to confine the private cause of action to the protection of the integrity of the securities markets.

As a result, Rule 10b-5 becomes a stronger weapon for the enforcement of the general fiduciary duties of directors and controlling shareholders, apart from its narrower function of regulating securities transactions. Business lawyers and corporate managers, however, will have to wait for definitive answers to the day-to-day questions of disclosure obligations and remedies under Rule 10b-5.

ROBERT D. DARDEN, JR.

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[34]339 F.2d 24 (2d Cir. 1964).

[35]405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969).

[36]282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961).

[37]Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

Torts—Proximate Cause in Strict-Liability Cases

A recent Indiana case, *Galbreath v. Engineering Construction Corp.*,[1] represents a new approach to the problem of proximate cause in tort cases involving strict liability. Defendant in this case used dynamite to blast rock—an abnormally dangerous activity for which strict liability is imposed under Indiana law.[2] The explosion broke a high-pressure gas pipe, and the escaping gas ignited when it came into contact with a backhoe engine operating nearby. Plaintiff, who was repairing the broken pipe, was severely burned. He sought to hold defendant strictly liable for his injury, but the trial court sustained a demurrer to his complaint[3] on the ground that strict liability for blasting was limited to damage caused by vibrations or flying debris.[4] The Indiana Court of Appeals reversed and remanded, holding that strict liability should extend to any harm that is a reasonably foreseeable result of an abnormally dangerous activity.[5]

Strict liability has been gradually increasing in importance in tort law during the past century. Traditionally it has been imposed when damage is done by trespassing livestock[6] or by wild[7] or vicious[8] animals. Since the landmark case of *Rylands v. Fletcher*,[9] many courts have also imposed strict liability for harm resulting from "ultrahazardous"[10] or

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[1]___ Ind. App. ___, 273 N.E.2d 121 (1971). Defendant's petition for transfer to the Indiana Supreme Court was denied. Letters from Frank E. Tolbert, counsel for defendant, to the writer, Jan. 24, 1972, and from J.T. Hillis, counsel for plaintiff, to the writer, Jan. 25, 1972.

[2]Enos Coal Mining Co. v. Schuchart, 243 Ind. 692, 188 N.E.2d 406 (1963).

[3]Plaintiff also alleged that defendant had conducted its blasting operations negligently. On this allegation the case went to the jury, and the verdict was for defendant, but the court of appeals held that there had been error in the judge's instructions to the jury. ___ Ind. App. at ___-___, 273 N.E.2d at 129-31.

[4]*Id.* at ___, 273 N.E.2d at 122.

[5]*Id.* at ___-___, 273 N.E.2d at 124-29.

[6]*E.g.*, Page v. Hollingsworth, 7 Ind. 317 (1855); Johnson v. Robinson, 11 Mich. App. 707, 162 N.W.2d 161 (1968) (per curiam); *see* W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 76, at 496-99 (4th ed. 1971) [hereinafter cited as PROSSER]. A few courts have rejected strict liability for trespassing livestock. *E.g.*, Saldi v. Brighton Stock Yard Co., 344 Mass. 89, 92, 181 N.E.2d 687, 690 (1962); Bethune v. Bridges, 228 N.C. 623, 46 S.E.2d 711 (1948).

[7]*E.g.*, Collins v. Otto, 149 Colo. 489, 369 P.2d 564 (1962); Smith v. Jalbert, 351 Mass. 432, 221 N.E.2d 744 (1966); *see* PROSSER § 76, at 499-500. Again, a few courts have rejected strict liability in this situation. *E.g.*, Hansen v. Brogan, 145 Mont. 224, 400 P.2d 265 (1965).

[8]*E.g.*, Zarek v. Fredericks, 138 F.2d 689 (3d Cir. 1943); Hill v. Moseley, 220 N.C. 485, 17 S.E.2d 676 (1941); *see* PROSSER § 76, at 500-03.

[9]L.R. 3 H.L. 330 (1868), *aff'g* Fletcher v. Rylands, L.R. 1 Ex. 265 (1866).

[10]RESTATEMENT OF TORTS § 519 (1938).

"abnormally dangerous"[11] activities.[12] More recently, under the doctrine of *Greenman v. Yuba Power Products, Inc.*,[13] manufacturers and sellers have been held strictly liable for damage caused by defective products.[14]

Strict liability, like liability based on negligence, is limited by the requirement of actual causation. A defendant cannot be liable unless his conduct is an actual cause of the plaintiff's harm—that is, unless the plaintiff would not have been injured but for the defendant's conduct.[15] In many cases, however, both in negligence and strict liability, courts have found it necessary to adopt a further limitation, a rule that can be used to distinguish remote from proximate causes, so that a defendant will not be held responsible for every harmful result of his activities. In negligence cases, most courts have adopted foreseeability as a criterion for proximate cause: a defendant is liable only for harm that is a reasonably foreseeable result of his negligence.[16] In strict liability, on the other hand, no such consensus has developed, and courts have approached the question from several different viewpoints.

Before examining the various approaches that the courts have taken to the problem of proximate cause in strict-liability cases, it will be worthwhile to summarize the types of situations in which they have been faced with this problem. These situations may be divided roughly into two groups: a group of cases in which the plaintiff's harm did not result from the risk that led the courts to impose strict liability on the defendant, and another group in which the plaintiff's injury resulted from the defendant's conduct in an indirect manner.

Courts usually have not held the defendant liable when the plaintiff's injury does not result from the risk for which strict liability is

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[11] RESTATEMENT (SECOND) OF TORTS § 519 (Tent. Draft No. 10, 1964).

[12] *E.g.*, Guilford Realty & Ins. Co. v. Blythe Bros. Co., 260 N.C. 69, 131 S.E.2d 900 (1963); *see* PROSSER § 78, at 505-16. The rule of *Rylands v. Fletcher* is now accepted by about thirty states. *Id.* at 509. Many other states have imposed a similar strict liability for abnormally dangerous activities under an "absolute nuisance" theory. *Id.* at 512-13.

[13] 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

[14] *See* 2 L. FRUMER & M. FRIEDMAN, PRODUCTS LIABILITY § 16A (5th ed. 1970); PROSSER § 98.

Probably the most important application of strict liability is in the field of workmen's compensation. However, workmen's compensation is not within the scope of this note, as it is based on statutory provisions rather than common law. For a discussion of the limitations on the extent of liability in workmen's compensation see Note, *Workmen's Compensation—What Is the Range of Compensable Consequences of a Work-Related Injury?* 49 N.C.L. REV. 583 (1971).

[15] *See* PROSSER § 41; Byrd, *Actual Causation in North Carolina Tort Law*, 50 N.C.L. REV. 261 (1972).

[16] *See* PROSSER § 43; *cf.* Palsgraf v. Long Island R.R., 248 N.Y. 339, 162 N.E. 99 (1928).

imposed on the defendant. For example, the owner of trespassing livestock is strictly liable for damage that such animals ordinarily do, such as destruction of grass or crops,[17] or the breeding of a scrub bull with a pedigreed cow;[18] but ordinarily there is no liability for attacks on people.[19] If a person knows that an animal he owns has a vicious propensity, he is strictly liable for any damage that results from that propensity,[20] but usually not for damage caused by some other propensity of which he does not know.[21] The owner of a wild animal is not liable when it frightens other animals by its mere appearance.[22] It has been held that one who engages in an abnormally dangerous activity is strictly liable only for damage that comes within the risk that makes the activity abnormally dangerous.[23] Finally, a manufacturer or seller is usually not liable for harm resulting from a defective product if the consumer has used it in an abnormal manner.[24]

The courts have also tended to limit strict liability when the plaintiff's harm results too indirectly from the defendant's activity. For instance, when the defendant's cow trespassed in the plaintiff's barn and broke through the floor, creating a hole into which the plaintiff fell, the defendant was not held liable.[25] Courts have been especially reluctant to impose liability when there has been an intervening cause. An act of God,[26] the action of an animal other than defendant's,[27] and innocent[28]

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[17] *E.g.*, Page v. Hollingsworth, 7 Ind. 317 (1855).

[18] Crawford v. Williams, 48 Iowa 247 (1878); Kopplin v. Quade, 145 Wis. 454, 130 N.W. 511 (1911). *See also* Hilton v. Overly, 69 Pa. Super. 348, 353 (1918) ("we all know that [boars] almost invariably attack each other").

[19] Klenberg v. Russell, 125 Ind. 531, 25 N.E. 596 (1890); Leipske v. Guenther, 7 Wis. 2d 86, 95 N.W.2d 774 (1959); *cf.* Harvey v. Buchanan, 121 Ga. 384, 49 S.E. 281 (1904) (no liability when trespassing mule attacks goat); Fox v. Koehnig, 190 Wis. 528, 209 N.W. 708 (1926) (no liability when trespassing horse collides with car). *But cf.* McKee v. Trisler, 311 Ill. 536, 143 N.E. 69 (1924) (owner held liable when trespassing bull attacks mule).

[20] *E.g.*, Zarek v. Fredericks, 138 F.2d 689 (3d Cir. 1943); Hill v. Moseley, 220 N.C. 485, 17 S.E.2d 676 (1941).

[21] *E.g.*, Karlow v. Fitzgerald, 288 F.2d 411 (D.C. Cir. 1961); Fowler v. Helck, 278 Ky. 361, 128 S.W.2d 564 (1939).

[22] Bostock-Ferrari Amusement Co. v. Brocksmith, 34 Ind. App. 566, 73 N.E. 281 (1905); Scribner v. Kelley, 38 Barb. 14 (N.Y. Sup. Ct. 1862).

[23] Gronn v. Rogers Construction, Inc., 221 Ore. 226, 350 P.2d 1086 (1960); Foster v. Preston Mill Co., 44 Wash. 2d 440, 268 P.2d 645 (1954); *see* Madsen v. East Jordan Irrigation Co., 101 Utah 552, 125 P.2d 794 (1942).

[24] *See* notes 57-58 and accompanying text *infra*.

[25] Hollenbeck v. Johnson, 79 Hun 499, 29 N.Y.S. 945 (Sup. Ct. 1894).

[26] Golden v. Amory, 329 Mass. 484, 109 N.E.2d 131 (1952); Smith v. Board of County Rd. Comm'rs, 5 Mich. App. 370, 146 N.W.2d 702 (1966), *aff'd*, 381 Mich. 363, 161 N.W.2d 561 (1968); Murphy v. Gillum, 73 Mo. App. 487 (1898) (frost considered act of God); Nichols v. Marsland,

or negligent[29] or intentional[30] intervening conduct by a third person have all been held by some courts to relieve the defendant of liability.

Although these limitations on the extent of strict liability have not always been applied in a uniform manner, the approach taken by most courts, especially in cases involving animals and abnormally dangerous activities, has been a restrictive one. Courts have refused to find the defendant liable in situations that would certainly have called for liability under the foreseeability test used in negligence cases. In applying the same-risk limitation—the requirement that the plaintiff's harm result from the same risk that caused strict liability to be imposed—courts have often defined the risk narrowly so as not to include the damage suffered by the plaintiff. For example, in *Greeley v. Jameson*,[31] the defendant's horse kicked the plaintiff and broke his leg. It had bitten people in the past. The court required the plaintiff to show that the horse had a propensity to *kick* people (not just a propensity to *attack* them) and ruled that evidence of the earlier biting incidents did not subject the defendant to strict liability when the horse kicked.[32] In three cases,[33] the defendants were held not liable when their blasting operations fright-

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L.R. 2 Ex. D. 1 (1876).

[27]Madsen v. East Jordan Irrigation Co., 101 Utah 552, 125 P.2d 794 (1942); Carstairs v. Taylor, L.R. 6 Ex. 217, 220-21 (1871) (opinion of Kelly, C.B.).

[28]Kaufman v. Boston Dye House, Inc., 280 Mass. 161, 182 N.E. 297 (1932).

[29]*See* Davis v. Atlas Assurance Co., 112 Ohio St. 543, 147 N.E. 913 (1925); Langabaugh v. Anderson, 68 Ohio St. 131, 67 N.E. 286 (1903) (alternative holding). In *Davis* strict liability was imposed for fires caused by operating railroads. Heat produced by the defendant's engine set fire to gasoline fumes escaping from a railroad car that an employee of the plaintiff had opened. The defendant was relieved of liability by the intervening conduct of the plaintiff's employee. In *Langabaugh* a landlady leased her land to tenants who drilled for oil. The oil produced was stored in an elevated tank, but it escaped and flowed down a hill into some open fires. The landlady was held not liable because she had nothing to do with the storing of the oil, but the court said that even if this had not been so, still she would have been freed from liability by the tenants' negligence in failing to take measures against the escape of the oil.

[30]Cohen v. Brockton Savings Bank, 320 Mass. 690, 71 N.E.2d 109 (1947); *cf.* Kleebauer v. Western Fuse & Explosives Co., 138 Cal. 497, 71 P. 617 (1903) (case based on nuisance theory rather than strict liability); McGhee v. Norfolk & S. Ry., 147 N.C. 142, 60 S.E. 912 (1908) (same).

[31]265 Mass. 465, 164 N.E. 385 (1929).

[32]An even more extreme case is Bennett v. Mallard, 33 Misc. 112, 67 N.Y.S. 159 (Sup. Ct. 1900), in which it was held that the owner of a horse that had kicked people before in the road was not liable when it kicked the plaintiff in its stall.

Ewing v. Prince, 425 S.W.2d 732 (Ky. 1968), held that the owner of a mare that has kicked other horses is not liable when it kicks a person. In Karlow v. Fitzgerald, 288 F.2d 411 (D.C. Cir. 1961), the court ruled that notice that a dog has bumped people is not notice that it will bite.

[33]Gronn v. Rogers Construction, Inc., 221 Ore. 226, 350 P.2d 1086 (1960); Madsen v. East Jordan Irrigation Co., 101 Utah 552, 125 P.2d 794 (1942); Foster v. Preston Mill Co., 44 Wash. 2d 440, 268 P.2d 645 (1954).

ened minks on a mink ranch and caused them to kill their young. The risk that makes blasting abnormally dangerous was defined narrowly so as not to cover the harm to the minks.[34] Just as they have often restrictively applied the same-risk limitation, the courts have taken a similar attitude toward the limitation based on indirect causation, placing an extreme emphasis on intervening causes. In *Kaufman v. Boston Dye House, Inc.*,[35] the defendant stored a highly inflammable petroleum product called varnolene on its property—an abnormally dangerous activity. The varnolene escaped into a creek and caught fire when a gasoline engine operated by a third party backfired and emitted sparks. The defendant was held not liable because of the intervening cause. In similar situations in negligence cases, liability has been found although there was an intervening negligent[36] or even intentional[37] act—whereas here the act of the third party was not even negligent.

This restrictive approach seems quite unjustified and indeed is inconsistent with the reasons justifying the concept of strict liability itself. The purpose of the same-risk limitation is to avoid holding a defendant liable without negligence when, for instance, he transports explosives and his vehicle strikes a pedestrian who suddenly darts into his path,[38] or when he stores varnolene that escapes from his premises and, instead of starting a fire, merely turns the plaintiff's grass brown—situations that could have arisen just as easily if the defendant had been transporting paper or storing ordinary paint. The purpose of the limitation is defeated when it is used to relieve a defendant from liability for damage clearly caused by the dangerousness of his activity or the viciousness of his animal. If the law requires the owner of an ill-tempered horse to confine it or pay the price, he should be held liable for all its misconduct, whether its evil disposition manifests itself by a bite or by a kick.[39] If

[34]This was the rationale used in the *Gronn* and *Foster* cases. In *Madsen* it was held that the minks' action in killing their young was an intervening cause that relieved the defendant of liability.

[35]280 Mass. 161, 182 N.E. 297 (1932). It is not entirely clear that this was the actual holding of the case rather than dictum. The court seems to have been reluctant to impose strict liability at all because it felt that the varnolene was not sufficiently dangerous. But if there was strict liability, it ruled, the plaintiff could not recover because of the intervening cause. The opinion does not make clear upon which of these two grounds the court rested its decision.

[36]*E.g.*, Watson v. Kentucky & Ind. Bridge & R.R., 137 Ky. 619, 126 S.W. 146 (1910).

[37]*E.g.*, Richardson v. Ham, 44 Cal. 2d 772, 285 P.2d 269 (1955).

[38]The illustration is from RESTATEMENT (SECOND) OF TORTS § 519, comment *e* at 54 (Tent. Draft No. 10, 1964).

[39]*See* G. WILLIAMS, LIABILITY FOR ANIMALS 302 (1939): "Would not it be much more satisfactory to say that any mischievous propensity to draw human blood . . . is enough?" Professor Williams' book is a comprehensive analysis of English animal law.

the law requires a blaster to pay for the damage his explosions cause, it should require him to do so regardless of whether the damage is to valuable houses or to valuable minks; in each case the damage was caused by the "non-natural,"[40] extraordinary nature of the defendant's blasting activity,[41] and in each case the blaster is equally able to insure against the loss or pass it on to his customers via higher prices.[42] Just as the purpose of the same-risk limitation is defeated by overly strict application, the same is true of the intervening-cause limitation. If, as in *Kaufman*, one who stores an inflammable substance is not liable when someone innocently causes it to catch fire, when will he ever be liable?[43] Fires do not ordinarily start by themselves. Such decisions, as Harper and James pointed out, "appear almost to subvert the theory of"[44] strict liability.

Because the courts enforce the limitations on strict liability so restrictively, plaintiffs often find it necessary—as did the plaintiff in *Galbreath v. Engineering Construction Corp.*[45]—to try to prove negligence on the part of the defendant even though their injuries were caused by a vicious animal or an abnormally dangerous activity. Only in this way can the chance of recovery be maximized. Surely this is an anomalous situation, for whenever the courts impose strict liability they have determined that the dangerous nature of the defendant's activity warrants holding him liable even without negligence.

While most courts have adopted a restrictive approach to proximate cause in strict-liability cases, a few cases reflect a quite different tendency in rejecting any limitations at all on strict liability. Decisions from several states have held that the owner of trespassing live-

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[40] Rylands v. Fletcher, L.R. 3 H.L. 330, 339 (1868).

[41] Possibly, however, the result reached in the mink-ranch cases can be supported on another ground—that the plaintiff's minks were abnormally sensitive to the effects of the defendants' explosions and the plaintiffs were not entitled to special protection for their abnormally sensitive activity. RESTATEMENT (SECOND) OF TORTS § 524A (Tent. Draft No. 10, 1964) provides that a plaintiff cannot recover if his harm results from the abnormally sensitive nature of his own activity. Several courts have adopted such a rule in nuisance cases. *E.g.*, Rogers v. Elliott, 146 Mass. 349, 15 N.E. 768 (1888); Amphitheaters, Inc. v. Portland Meadows, 184 Ore. 336, 198 P.2d 847 (1948).

[42] Concerning the availability of insurance as a reason for imposing strict liability *see* Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 440-41 (1944) (Traynor, J., concurring); PROSSER § 75, at 495.

[43] A similar situation has arisen in the cases involving reservoirs. *See* cases cited note 24 *supra*. The main danger involved in the storage of water in reservoirs is that the water may overflow or the dam or dike break in a heavy rainfall. If the rainfall is treated as an act of God that relieves the defendant of liability, very little is left of this area of strict liability.

[44] 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 14.5, at 811 (1956).

[45] ___ Ind. App. ___, ___, 273 N.E.2d 121, 122 (1971).

stock is liable for any damage they do, including infection of other animals with disease[46] and attacks on other animals[47] and people,[48] regardless of whether the owner had notice of their vicious propensities. Similarly, a Missouri court held the owner of a vicious dog liable when it became rabid and bit a child, even though a vicious dog is no more likely than any other dog to catch rabies.[49] Courts in Louisiana[50] and more recently in Michigan[51] have held the owners of animals strictly liable despite the presence of intervening causes. The Louisiana court explained its decision: "There must be security against [wild animals] under all contingencies."[52]

Clearly this approach is weighted as heavily on one side as the prevailing tendency is on the other. If applied consistently to cases involving abnormally dangerous activities, it would frequently produce unjust results. A truck driver transporting explosives would be held to strict liability when he struck a pedestrian who suddenly stepped out into the street. A trespassing cow or a vicious dog that went to sleep on a railroad track would subject its owner to strict liability if a train hit it and derailed. Damage of this sort has nothing to do with the danger of explosives or the viciousness of the animal, and it seems probable that if faced with such a case even the courts that have adopted this unlimited-liability approach would retreat from it.

If the majority of courts have taken an unduly restrictive approach to the limitations on the extent of strict liability, and a minority have taken an impossibly liberal approach, then there is a need for a middle ground, a third alternative that will avoid the weaknesses of both. The significance of the *Galbreath* case is that it adopts such an alternative. The *Galbreath* court could have followed the mink-ranch cases and held that only damage caused by flying debris and vibrations lie within the risk that makes blasting abnormally dangerous. Or, following *Kaufman*, it could have held that the operation of the backhoe engine was an intervening cause that relieved defendant from strict liability. But it refused to do so, holding instead that the extent of liability in

[46] Lee v. Burk, 15 Ill. App. 651 (1884).

[47] Decker v. Gammon, 44 Me. 322 (1857); Morgan v. Hudnell, 52 Ohio St. 552, 40 N.E. 716 (1895); Chunot v. Larson, 43 Wis. 536 (1878).

[48] Malone v. Knowlton, 15 N.Y.S. 506 (Sup. Ct. 1891); Nixon v. Harris, 15 Ohio St. 2d 105, 238 N.E.2d 785 (1968).

[49] Clinkenbeard v. Reinert, 284 Mo. 569, 225 S.W. 667 (1920).

[50] Vredenburg v. Behan, 33 La. Ann. 627 (1881).

[51] Johnson v. Robinson, 11 Mich. App. 707, 162 N.W.2d 161 (1968) (per curiam).

[52] Vredenburg v. Behan, 33 La. Ann. 627, 634 (1881).

strict-liability cases should be governed by the same rules that control in negligence cases.[53] Thus, instead of asking whether the burning of escaping gas was within the risk for which strict liability is imposed on blasters, it asked whether such an accident was foreseeable;[54] similarly, in dealing with the intervening cause, it asked whether the presence of an "igniting agent, such as a backhoe engine,"[55] was foreseeable. Its answer was that these occurrences were not unforeseeable as a matter of law. Therefore, it ruled, defendant's demurrer was improperly sustained and the case should have gone to the jury.[56]

The *Galbreath* court's use of the term "foreseeability" is not unprecedented. Many courts have used the terminology of negligence law in cases involving animals and abnormally dangerous activities. But *Galbreath* is the first case that has adopted the foreseeability test after careful consideration of the alternatives and proceeded to apply it with the same liberality that courts use in negligence cases.[57]

The approach that the Indiana court adopted for abnormally dangerous activities is the same approach that courts generally have followed in cases imposing strict liability for defective products. At first glance it seems surprising that courts have taken a different approach to strict liability for defective products than for other types of strict-liability cases, but the reason is not hard to find. Originally negligence was the basis of liability for defective products. Since then, products-liability law has passed from negligence to warranty to strict liability, as the courts have increased the duty of the manufacturer or seller from the ordinary duty of using reasonable care to the much more rigorous duty of actually eliminating all defects that may cause injury.[58] But while

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[53]The approach taken by the *Galbreath* court is similar to the one advocated in Harper, *Liability Without Fault and Proximate Cause*, 30 MICH. L. REV. 1001 (1932).

[54]___ Ind. App. at ___-___, 273 N.E.2d at 124-27.

[55]*Id.* at ___, 273 N.E.2d at 128.

[56]*Id.* at ___, 273 N.E.2d at 129.

[57]A few isolated cases dealing with vicious animals have applied the foreseeability test in the same realistic manner as in *Galbreath* but without the full discussion of the question that is found in the *Galbreath* opinion. Reynolds v. Hussey, 64 N.H. 64, 5 A. 458 (1886); Stamp v. Eighty-Sixth St. Amusement Co., 95 Misc. 599, 159 N.Y.S. 683 (Sup. Ct. 1916); Cockerham v. Nixon, 33 N.C. 269 (1850).

[58]This transition, like most changes in legal doctrine, has been a gradual process, and in many states it has not yet been completed. For instance, in North Carolina the strict-liability rule of *Greenman* has not been followed. Even the concept of implied warranty has been limited to cases in which the plaintiff and defendant are in privity of contract and to cases involving certain specific classes of products, including foods in sealed containers and advertised products. *Compare* Terry v. Double Cola Bottling Co., 263 N.C. 1, 138 S.E.2d 753 (1964), *with* Tedder v. Pepsi-Cola Bottling Co., 270 N.C. 301, 154 S.E.2d 337 (1967).

the level of duty has been raised substantially, the other provisions of products-liability law have not undergone great change. The rules pertaining to abnormal use and those determining when a manufacturer is relieved of liability by the seller's negligence were not found unsatisfactory in the negligence cases, and so the courts did not hesitate in carrying them over into warranty and strict liability. As a result, regardless of the theory on which liability is based, a manufacturer or seller is free from liability when the plaintiff's injury is caused by his unforeseeable abnormal use of a product[59] but not when the abnormal use can be foreseen by the defendant.[60] Again regardless of the theory used, a manufacturer is liable despite the foreseeable intervening negligence of a seller or some other third party,[61] though there may be an exception when the seller discovers the defect in the product and nevertheless delivers it to the plaintiff without warning him of the defect.[62]

Surely the approach adopted in *Galbreath* and the products-liability cases is much superior to either of the other two viewpoints the

North Carolina products-liability law has been changed by the adoption of § 2-318 of the *Uniform Commercial Code*. N.C. GEN. STAT. § 25-2-318 (1965). This section provides that the seller of any defective product is liable for resulting personal injuries to the buyer, anyone in his family or household, or any guest in his home.

[59] *E.g.*, Schfranek v. Benjamin Moore & Co., 54 F.2d 76 (S.D.N.Y. 1931) (negligence); Preston v. Up-Right, Inc., 243 Cal. App. 2d 636, 52 Cal. Rptr. 679 (1966) (strict liability); Vincent v. Nicholas E. Tsiknas Co., 337 Mass. 726, 151 N.E.2d 263 (1958) (warranty).

[60] *E.g.*, Phillips v. Ogle Aluminum Furniture, Inc., 106 Cal. App. 2d 650, 235 P.2d 857 (1951) (negligence); Dunham v. Vaughan & Bushnell Mfg. Co., 86 Ill. App. 2d 315, 229 N.E.2d 684 (1967), *aff'd*, 42 Ill. 2d 339, 247 N.E.2d 401 (1969) (strict liability); McSpedon v. Kunz, 271 N.Y. 131, 2 N.E.2d 513 (1936) (warranty).

[61] *E.g.*, Suvada v. White Motor Co., 32 Ill. 2d 612, 210 N.E.2d 182 (1965) (strict liability: plaintiff collided with bus while driving truck with defective brakes which were manufactured by defendant; passengers in bus injured and plaintiff compensated them for their injuries; held, plaintiff entitled to indemnity from defendant); Steele v. Rapp, 183 Kan. 371, 327 P.2d 1053 (1958) (negligence: defendant sold fingernail polish remover without warning that it was explosive; plaintiff injured when fellow employee negligently dropped jar of it).

[62] The seller's discovery of the defect usually has been held to relieve the manufacturer of liability for negligence. *E.g.*, Stultz v. Benson Lumber Co., 6 Cal. 2d 688, 59 P.2d 100 (1936); Ford Motor Co. v. Wagoner, 183 Tenn. 392, 192 S.W.2d 840 (1946). Virtually no warranty or strict-liability cases have dealt with the question, but Professor Prosser has suggested that the same rules will be followed in these cases as in the negligence cases. PROSSER § 102, at 668; *cf.* 2 L. FRUMER & M. FRIEDMAN, *supra* note 12, § 16.01[4], at 3-32 (criterion should always be whether the intervening conduct is foreseeable).

In California it has been held that a manufacturer cannot avoid strict liability for a defective product by delegating the final stages of manufacturing and inspection to a seller. Thus he will not be relieved of liability by the seller's discovery of a defect, or by anything else the seller "did or failed to do." Vandermark v. Ford Motor Co., 61 Cal. 2d 256, 261, 391 P.2d 168, 171, 37 Cal. Rptr. 896, 899 (1964).

courts have taken. Still, before concluding that it is the best approach and the one that all courts should follow, there is one other approach that should be examined, that adopted by the *Restatement (Second) of Torts*.[63] The *Restatement's* rules for limiting strict liability for defective products[64] and trespassing livestock[65] are fairly similar to those used in *Galbreath* and the products-liability cases. However, the *Restatement* differs from *Galbreath* in two important ways in its approach to strict liability for wild and vicious animals and abnormally dangerous activities. First, the *Restatement* restricts strict liability for abnormally dangerous activities to "the kind of harm, the risk of which makes the activity abnormally dangerous,"[66] and it limits the liability for vicious animals to "harm which results from the abnormal dangerous propensity of which the possessor knows or has reason to know";[67] in other words, it adopts the same-risk limitation that *Galbreath* rejected in favor of a foreseeability test. Secondly, the *Restatement* makes no provision for any limitation on liability based on indirectness of causation. In fact, two sections explicitly call for liability even when there is an unforeseeable intervening cause.[68]

Is there a need for a limitation based on indirectness of causation? The comments to the *Restatement* argue that because persons carrying on abnormally dangerous activities or keeping dangerous animals "have thereby for their own purposes created a risk which is not a usual incident of the ordinary life of the community,"[69] it is irrelevant whether

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[63]The sections of the *Restatement (Second) of Torts* dealing with strict liability have not yet been published in final form. Several sections are unchanged from the first *Restatement* and appear there in the third volume. The sections that have been changed are included in RESTATEMENT (SECOND) OF TORTS (Tent. Draft No. 10, 1964). *See* 41 ALI PROCEEDINGS 397-484 (1964), a transcript of the American Law Institute meeting at which the proposed changes were considered.

[64]RESTATEMENT (SECOND) OF TORTS § 402A (1965).

[65]RESTATEMENT (SECOND) OF TORTS § 504 (Tent. Draft No. 10, 1964). The changes in this section were approved by the American Law Institute. 41 ALI PROCEEDINGS 419-34 (1964).

[66]RESTATEMENT (SECOND) OFTORTS § 519(2) (Tent. Draft No. 10, 1964).

[67]*Id.* § 509(2). Strict liability for wild animals is similarly limited in RESTATEMENT OF TORTS § 507 (1938), which is unchanged in the *Restatement Second.*

[68]RESTATEMENT OF TORTS §§ 510, 522 (1938). The American Law Institute rejected the changes that Prosser, the Reporter for the *Restatement Second,* proposed in these sections. *Compare* RESTATEMENT (SECOND) OF TORTS § 510, Note to Institute at 32 (Tent. Draft No. 10, 1964), *and id.* § 522, Note to Institute at 82, *with* 41 ALI PROCEEDINGS 419-41 (1964).

In two Caveats the *Restatement* leaves open the question whether a defendant should be relieved of liability by the intentional act of a third person who deliberately sets out to cause the injury to the plaintiff which in fact occurs. RESTATEMENT OF TORTS §§ 510, 522 (1938). *See also* RESTATEMENT (SECOND) OF TORTS § 524A (Tent. Draft No. 10, 1964), holding that a defendant is not liable for harm caused by the abnormally sensitive nature of the plaintiff's activity.

[69]RESTATEMENT OF TORTS § 522, comment *a* at 48 (1938). This section is concerned specifi-

the risk materializes in a foreseeable or unforeseeable manner. In addition, a second argument can be made in support of this position. When a defendant is held liable for foreseeable harm caused by his negligence, it is because the law considers him to have acted wrongfully in failing to provide against a risk of harm to others that he has created. When he is relieved of liability for unforeseeable harm, it is because he could not be expected to provide against a risk the existence of which he could never have realized. But strict liability is based on an entirely different ground; it is in the nature of an abnormally dangerous activity that a person *cannot* provide against the risks involved—without abandoning the activity, which the law does not require him to do. Instead, strict liability is based on a requirement that the defendant make compensation for *any* harm that his activity causes. The courts allow him to engage in his dangerous activity only on condition that he pay for all harm done, a condition that has nothing to do with foreseeability.

There is an answer to these arguments, however. It is based on the belief that the courts should not deal more harshly with conduct the law allows than with conduct the law condemns. Consider a type of negligent activity, such as drunken driving. This conduct is often at least as dangerous as an abnormally dangerous activity or the keeping of an abnormally dangerous animal. When an intoxicated person drives a car, he has certainly "for [his] own purposes created a risk which is not a usual incident of the ordinary life of the community";[70] and he is unable to provide against this risk, except by ceasing to drive while drunk. In other words, he is in virtually the same situation as one who carries on an abnormally dangerous activity. The only difference is that the law does not require a person to refrain from abnormally dangerous activities, but it does require a person to refrain from driving while drunk. Yet a drunken driver is not liable for the unforeseeable results of his negligent activity. Why should a broader liability be imposed by the courts on a person whose activity is permitted because it is socially beneficial despite its risks than on a person who creates a risk that is completely unjustified? As Professor Albert A. Ehrenzweig explained, strict liability is a substitute for negligence; courts give permission to engage in an activity instead of labeling it negligent, but "strict liability is the price an entrepreneur must pay for that permission. . . . [T]hat

cally with abnormally dangerous activities. Similar language is used in connection with dangerous animals at *id.* § 510, comment *a* at 24.

[70]RESTATEMENT OF TORTS § 522, comment *a* at 48 (1938).

liability extends to all harm for the infliction of which he would be liable but for the permission . . . no less—no more."[71]

As for the *Restatement's* other difference from the *Galbreath* approach—the adoption of the same-risk limitation—this is certainly not a point in its favor. There is nothing wrong with the same-risk limitation as such, but, as discussed previously, it has been misapplied in cases such as *Greeley v. Jameson*[72] and the mink-ranch cases,[73] and thus it carries with it a series of dubious precedents. The foreseeability rule can adequately serve the same purpose as the same-risk rule (discoloring a neighbor's lawn is not a foreseeable result of storing an inflammable liquid; hitting a pedestrian who runs into the road is not a foreseeable result of transporting explosives) and it does not bear the burden of these unfortunate precedents.[74]

Thus the *Galbreath* approach is not only preferable to the restrictive and the unlimited-liability approaches; it also proves superior to that of the *Restatement* on both their points of difference. Hopefully future cases will adopt the *Galbreath* viewpoint, for that approach seems to be the best method for confining strict liability within reasonable limits while at the same time ensuring that technical and arbitrary distinctions will not deprive plaintiffs of its benefits.

ROBERT STARR GILLAM

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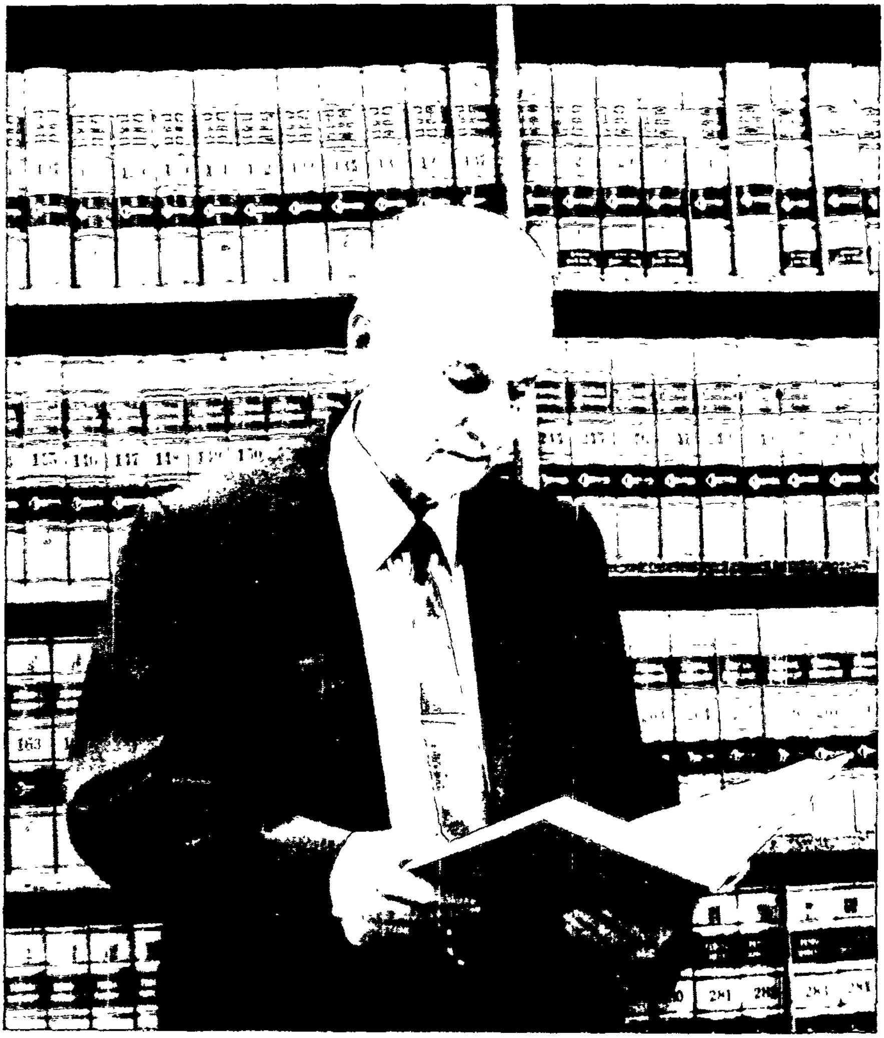
[71]A. EHRENZWEIG, NEGLIGENCE WITHOUT FAULT 50 (1951).

[72]265 Mass. 465, 164 N.E. 385 (1929).

[73]The *Restatement* endorses the mink-ranch cases. RESTATEMENT (SECOND) OF TORTS § 519, Note to Institute at 52 (Tent. Draft No. 10, 1964).

[74]It has been pointed out that the foreseeability rule is applied in a different manner in strict-liability cases than in negligence cases. In the latter, the question is whether "the risk can be foreseen at the time of the negligent act"; in strict liability, on the other hand, the defendant is liable if "the risk of harm can be seen at the time of embarking upon the activity." Note, *Strict Products Liability and the Bystander*, 64 COLUM. L. REV. 916, 935 (1964).



FRANK W. HANFT

This issue of the *North Carolina Law Review* is dedicated to Graham Kenan Professor of Law Frank W. Hanft, who is retiring this year after forty-one years at the School of Law.