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Recent Developments

RECENT DEVELOPMENTS

Constitutional Law—Cruel and Unusual Punishments—Eighth Amendment Prohibits Excessively Long Sentences.—Appellant Downey was convicted by a jury in an Ohio county court of two crimes: possession of marijuana for sale, and sale of marijuana. This was Downey's first drug-related offense, and the amount of marijuana involved was "very small." Nevertheless, he was sentenced to two consecutive indeterminate sentences according to the Ohio statute[1] and received a total sentence of thirty to sixty years imprisonment for the two offenses. On appeal, Downey contended that the length of his sentence constituted cruel and unusual punishment in violation of the constitutions of the United States[2] and of Ohio.[3] The Ohio Court of Appeals rejected this contention and affirmed both conviction and sentence. A motion by Downey for review by the Supreme Court of Ohio was denied, and Downey then petitioned the federal district court for a writ of habeas corpus. When the writ was denied, Downey appealed. The Sixth Circuit reversed the decision of the district court, and found that "the sentence imposed on Downey, in response to the requirements of the Ohio statute, was excessive in length and disproportionate to the nature of the offenses for which he was convicted."[4] The cause was remanded, with instructions that the writ of habeas corpus be issued. *Downey v. Perini*, 518 F.2d 1288 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975).

The issue facing the Sixth Circuit was whether a thirty to sixty year sentence for a first narcotics-related conviction of possession for sale and sale of a "small amount" of marijuana constituted cruel and unusual punishment.[5] More broadly, the court considered whether the length of a sentence might be the sole basis for a finding of cruel and unusual punishment.

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1. Ohio Rev. Code Ann. §§ 3719.99(D), (F) (Anderson 1971).

2. U.S. Const. amend. VIII: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." This prohibition has been made applicable to the states through the 14th amendment. See note 5 infra.

3. Ohio Const. art. I, § 9.

4. Downey v. Perini, 518 F.2d 1288, 1292 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975). The Supreme Court remanded the case for reconsideration in light of statutory amendments in Ohio affecting the gravity of the crime of possessing and trafficking in various amounts of controlled substances, including marijuana, and the punishments to be imposed for such crimes. See Ohio Rev. Code Ann. § 2925.03 (1975 Legis. Bull. No. 4, at 261) (Page). The Court's disposition of the case does not appear to affect the validity of the 6th Circuit's analysis of the problem of cruel and unusual punishment.

5. Since Downey contended that both the state statute and the sentence imposed under it violated the United States Constitution as well as that of Ohio, it should be noted that the eighth amendment has been incorporated into state law through the fourteenth amendment. Though the issue of incorporation was not always clear, see In re Kemmler, 136 U.S. 436, 449 (1890) (no incorporation); O'Neil v. Vermont, 144 U.S. 323, 331-32 (1892) (same; dictum); Louisiana ex rel. Francis v. Resweber, 329 U.S. 459 (1947) (incorporation accepted, dictum), the issue was settled in Robinson v. California, 370 U.S. 660 (1962).

The authors of the eighth amendment probably were concerned primarily with the prevention of barbaric forms of punishment, and therefore addressed themselves principally to the issue of mode of punishment.[6] During the first one hundred years after ratification of the eighth amendment, the question of excessiveness of punishment, as opposed to modality, did not arise before the Supreme Court in eighth amendment cases. Even when the question did come up, in *O'Neil v. Vermont,*[7] the majority failed to reach the issue of excessively long punishment.[8] In a vigorous dissent, however, Mr. Justice Field contended that the prohibition against cruel and unusual punishments should be directed to "all punishments which *by their excessive length* or severity are greatly disproportioned to the offences charged."[9] Less than twenty years later the Court faced this question squarely in *Weems v. United States,*[10] when it accepted the principle enunciated by Mr. Justice Field: the Constitution prohibits excessiveness of punishment as well as barbaric forms of punishment, and the length of punishment must be proportioned to the offense.[11] The majority declared that although the main purpose of the eighth amendment prohibition probably was to prevent physical cruelty, the drafters also must have been aware of the possibility of more subtle cruelty.[12] In any event, the court continued, "a principle to be vital must be capable of wider application than the mischief which gave it birth."[13]

Courts dealing with cases challenging individual sentences or the constitutionality of sentencing statutes have been reluctant to expand on the traditional interpretation of the eighth amendment,[14] although *Weems* gave them

6. Granucci, "Nor Cruel and Unusual Punishments Inflicted:" The Original Meaning, 57 Calif. L. Rev. 839, 860-65 (1969), cited in Downey v. Perini, 518 F.2d 1288, 1290 n.1 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975); Note, The Cruel and Unusual Punishment Clause and the Substantive Criminal Law, 79 Harv. L. Rev. 635, 636-37 (1966). But see Comment, The Eighth Amendment, Beccaria, and the Enlightenment: An Historical Justification for the Weems v. United States Excessive Punishment Doctrine, 24 Buffalo L. Rev. 783, 806-30 (1975).

7. 144 U.S. 323 (1892).

8. In O'Neil, the plaintiff had been found guilty of 307 violations of a state statute requiring a license to sell intoxicating liquor. Under the statute, he was sentenced separately for each distinct sale. The court dismissed the appeal, holding that no federal question was involved, since at the time, the eighth amendment was not considered to be applicable to the states, see note 5 supra, and all the sales took place within Vermont. Id. at 334-37.

9. Id. at 339-40 (Field, J., dissenting) (emphasis added).

10. 217 U.S. 349 (1910). The Weems case involved the conviction of a minor government officer who falsified an official document. He was sentenced to fifteen years at hard labor, constant wearing of shackles, loss of civil liberties, and surveillance for life.

11. See id. at 367, where it is suggested that it is a "precept of justice that punishment for crime should be graduated and proportioned to the offense."

12. Id. at 373.

13. Id. Interpreting Weems almost fifty years later, Mr. Chief Justice Warren said, "the words of the Amendment are not precise, and . . . their scope is not static. The Amendment must draw its meaning from the evolving standards of decency that mark the progress of a maturing society." Trop v. Dulles, 356 U.S. 86, 100-01 (1958) (footnote omitted).

14. E.g., United States v. Fiore, 467 F.2d 86, 89 n.9 (2d Cir. 1972), cert. denied, 410 U.S.

the authority to do so. By distinguishing *Weems* on its facts,[15] or by giving wide deference to legislative determinations as to what constitutes appropriate punishment,[16] courts have avoided attempts to identify the elements which constitute disproportionality between crime and sentence.

Recently, however, several states have attempted to examine sentences in the context of the *Weems* interpretation of cruel and unusual punishment by setting up criteria against which imprisonment terms may be measured.[17]

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984 (1973) (20 years without parole for sale of heroin not cruel and unusual); United States v. Avey, 428 F.2d 1159, 1164 (9th Cir.), cert. denied, 400 U.S. 903 (1970) (5 years mandatory imprisonment for concealing marijuana held not cruel and unusual); United States v. Del Toro, 426 F.2d 181, 184 (5th Cir. 1970), cert. denied, 400 U.S. 829 (1970) (mandatory five year sentence for first offender convicted of sale of heroin held not cruel and unusual); see Downey v. Perini, 518 F.2d 1288 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975); Note, The Cruel and Unusual Punishment Clause and the Substantive Criminal Law, 79 Harv. L. Rev. 635, 640 (1966); Note, The Effectiveness of the Eighth Amendment; An Appraisal of Cruel and Unusual Punishment, 36 N.Y.U.L. Rev. 846, 848-49 (1961); Comment, Marijuana and the Law: The Constitutional Challenges to Marijuana Laws in Light of the Social Aspects of Marijuana Use, 13 Vill. L. Rev. 851, 869 (1968).

In order to sustain an attack on a sentence as violative of the eighth amendment, the defendant generally must show that the statute itself is unconstitutional because the penalties provided are cruel and unusual. Ordinarily, any sentence of imprisonment which is within the limits of a valid statute is not considered cruel and unusual. See, e.g., Downey v. Perini, supra; United States v. Hatcher, 473 F.2d 321 (6th Cir. 1973); United States v. Wallace, 269 F.2d 394 (3d Cir. 1959); Black v. United States, 269 F.2d 38 (9th Cir. 1959), cert. denied, 361 U.S. 938 (1960); United States v. Maiden, 355 F. Supp. 743 (D. Conn. 1973).

15. E.g., where a defendant was convicted of leaving the state to avoid giving testimony, and sentenced under state statute to five years imprisonment, the Sixth Circuit stated, "We need not pause long to reject the invalid argument of appellant that the federal statute which he violated inflicts cruel and unusual punishment in contravention of the Eighth Amendment to the Constitution of the United States. Historically viewed, the Eighth Amendment was adopted to prevent inhuman, barbarous, or torturous punishment, though long-term imprisonment could be so disproportionate to the offense as to fall within the inhibition. We think it clear that the statutory provision for a maximum term of five years' imprisonment for fleeing a state to avoid giving testimony in a felony case, and thus obstructing justice, cannot reasonably be classified as cruel and unusual punishment within a constitutional or any other sense." Hemans v. United States, 163 F.2d 228, 237-38 (6th Cir.), cert. denied, 332 U.S. 801 (1947); see Kasper v. Brittain, 245 F.2d 92, 96 (6th Cir. 1957); United States ex rel. Darrah v. Brierley, 290 F. Supp. 960, 964 (E.D. Pa. 1968), aff'd, 415 F.2d 9 (3d Cir. 1969).

16. "The fixing of penalties for crimes is a legislative function. What constitutes an adequate penalty is a matter of legislative judgment and discretion, and the courts will not interfere therewith unless the penalty prescribed is clearly and manifestly cruel and unusual.

"Where the sentence imposed is within the limits prescribed by the statute for the offense committed, it ordinarily will not be regarded as cruel and unusual." Schultz v. Zerbst, 73 F.2d 668, 670 (10th Cir. 1934) (footnote omitted); Sansone v. Zerbst, 73 F.2d 670, 672 (10th Cir. 1934); see Crutchfield v. Commonwealth, 248 Ky. 704, 59 S.W.2d 983, 985 (1933); People v. Morehouse, 80 Misc. 2d 406, 364 N.Y.S.2d 108 (Sup. Ct. 1975); Note, The Cruel and Unusual Punishment Clause and the Substantive Criminal Law, 79 Harv. L. Rev. 635, 640 (1966).

17. Note, Drug Abuse, Law Abuse, and the Eighth Amendment: New York's 1973 Drug Legislation and the Prohibition Against Cruel and Unusual Punishment, 60 Cornell L. Rev. 638, 646 n.44 (1975).

In *People v. Lorentzen,*[18] an influential decision,[19] the Michigan Supreme Court made a careful examination of the *Weems* principle as it applied to the length of a sentence, and found that the sentence at issue was excessive.[20] In *Lorentzen,* a twenty-three year old defendant with no prior record was convicted of selling marijuana and, under the Michigan statute mandating a minimum of twenty years imprisonment, was sentenced to twenty to twenty-one years imprisonment. The Michigan court applied a three-tiered test to determine whether this sentence violated the constitutional prohibition against cruel and unusual punishment.[21] First, the court attempted to analyze the proportionality of the sentence. It compared the statutory penalty for sale of marijuana with "other Michigan statutes dealing with offenses involving the sale of various substances, or with offenses against persons or property . . . ,"[22] and concluded that these other statutes mandated significantly shorter minimum sentences than did the marijuana law.[23] The court also noted that within a month, the new statutory maximum penalty for the sale of marijuana in Michigan would be four years.[24] The court thus determined that the mandatory minimum sentence of twenty years failed to meet the test of proportionality.[25]

Secondly, the court, citing *Trop v. Dulles,*[26] measured the sentence against the "evolving standards of decency that mark the progress of a maturing society."[27] The court did this by looking

> to comparative law for guidelines in determining what penalties are widely regarded as proper for the offense in question.
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> An examination of the statutes of other states dealing with the sale of marijuana reveals that 26 states have no minimum sentence for the sale of marijuana; 3 provide a 2-year minimum; 9 have a 1-year minimum; 9 provide a 5-year mandatory minimum; and 1 provides a mandatory minimum of 10 years. Only one state, Ohio, has as severe a minimum sentence for the sale of marijuana as Michigan.[28]

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18. 387 Mich. 167, 194 N.W.2d 827 (1972).

19. Lorentzen has been cited in, e.g., United States v. Maiden, 355 F. Supp. 743, 749 (D. Conn. 1973) (distinguished); In re Lynch, 8 Cal. 3d 410, 503 P.2d 921, 105 Cal. Rptr. 217 (1972); People v. Broadie, 37 N.Y.2d 100, 332 N.E.2d 338, 371 N.Y.S.2d 471 (1975); People v. McNair, 46 App. Div. 2d 476, 363 N.Y.S.2d 151 (4th Dep't 1975).

20. 387 Mich. at 181, 194 N.W.2d at 834.

21. Id. at 173-79, 194 N.W.2d at 829-33.

22. Id. at 178, 194 N.W.2d at 832.

23. For example, the court noted that the maximum penalty for adulterating food was ninety days; for sale of explosives, five years; and for placing pins, needles, razor blades, glass or other harmful objects in food, ten years. Further, the maximum statutory penalties for crimes involving harm to people, such as manslaughter, was fifteen years, and carrying a firearm with unlawful intent, five years. Id. at 176-77, 194 N.W.2d at 831.

24. Id. at 178, 194 N.W.2d at 832.

25. Id.

26. 356 U.S. 86 (1958).

27. Id. at 101. See note 13 supra.

28. 387 Mich. at 179, 194 N.W.2d at 832. The Downey opinion, decided three years after Lorentzen, stated that Ohio's mandatory minimum sentences for sale of marijuana and possession

The court concluded that the Michigan statute did not meet the "evolving standards of decency" test.

The third tier of the test applied by the Michigan court involved the question of the purposes of imprisonment, and, specifically, whether any valid goals sought to be achieved by imposition of a prison sentence would be furthered by an affirmation of *this* sentence on *this* defendant for *this* crime. The court noted that although deterrence, protection of society, and rehabilitation of the criminal are valid goals of imprisonment, in the instant case, it was "dubious, to say the least, that now 26-year old Eric Lorentzen will be a better member of society after serving a prison sentence of at least 10 years, 7 months and 6 days."[29] The court vacated the sentence and remanded the case to the trial court for resentencing; significantly, it did not go so far as to set aside the statute as unconstitutional.[30] In separate opinions, however, two justices indicated that they would have held the statute to be violative of the eighth amendment.[31]

Shortly after the *Lorentzen* decision, a series of California opinions[32] adopted the *Weems* principle of proportionality. Further refining the *Weems* standard, these decisions required that a sentence be examined according to clearly defined criteria. In the first of the California cases, *In re Lynch*,[33] the state supreme court held that a sentence of "not less than one year"[34] was so disproportionate to the crime—a second conviction for indecent exposure—that the sentence violated the prohibition against cruel and unusual punishment.[35] The court recognized the function of the legislature to "define crimes and prescribe punishments," but warned that "legislative authority remains ultimately circumscribed by the constitutional provision forbidding the infliction of cruel or unusual punishment . . . ,"[36] the final determination of which

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for sale were the highest in the country. Downey v. Perini, 518 F.2d 1288, 1291 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975).

29. 387 Mich. at 181, 194 N.W.2d at 833 (the minimum sentence if defendant earned full credit for "good time").

30. Id. at 182-83, 194 N.W.2d at 834. This court, then, did not follow the general rule that a sentence within the limits of a valid statute cannot be set aside without striking down the statute itself. See note 14 supra.

31. 387 Mich. at 182, 194 N.W.2d at 834 (Kavanagh, J., concurring in part, dissenting in part); id. at 182-83, 194 N.W.2d at 834 (Williams, J., concurring in part, dissenting in part).

32. In re Adams, —— Cal. 3d ——, ——, 536 P.2d 473, 478-79, 122 Cal. Rptr. 73, 78-79 (1975); In re Foss, 10 Cal. 3d 910, 519 P.2d 1073, 112 Cal. Rptr. 64 (1974); In re Lynch, 8 Cal. 3d 410, 503 P.2d 921, 105 Cal. Rptr. 217 (1972); People v. Wilson, —— Cal. App. 3d ——, 123 Cal. Rptr. 663 (1st Dist. 1975); People v. Ruiz, —— Cal. App. 3d ——, 122 Cal. Rptr. 841, 845-47 (1st Dist. 1975); People v. Thomas, 45 Cal. App. 3d 749, 119 Cal. Rptr. 739 (1st Dist. 1975).

33. 8 Cal. 3d 410, 503 P.2d 921, 105 Cal. Rptr. 217 (1972).

34. For the purpose of testing the constitutionality of the sentence at issue in the case, the court considered the sentence to be the equivalent of one of life imprisonment. The court pointed out that Cal. Penal Code § 671 (West 1970) confirmed that such sentences are life sentences. 8 Cal. 3d at 419, 503 P.2d at 927, 105 Cal. Rptr. at 223.

35. 8 Cal. 3d at 419, 503 P.2d at 927, 105 Cal. Rptr. at 223.

36. Id. at 414, 503 P.2d at 923, 105 Cal. Rptr. at 219.

lies with the judiciary.[37] The court in *Lynch* examined the issue of disproportionality first by comparing length of sentence to the seriousness of the offense[38] and the character of the offender.[39] Secondly, the court compared the challenged sentence with punishments imposed within the same jurisdiction for more serious offenses.[40] Finally the court compared the challenged penalty with penalties for the same offense in other jurisdictions.[41]

There is a similarity between the Michigan and California tests. Both require comparison of the sentence at issue with statutory provisions for the same offense in other states,[42] and against the statutory punishments for more serious crimes in their own state.[43] The California test considers the danger to society created by the offense at issue. The Michigan test is broader; it attempts to determine whether any of the valid goals sought to be achieved by imposition of a term of imprisonment is served by the sentence imposed.[44]

In a recent New York Court of Appeals case, *People v. Broadie*,[45] the court applied a test not dissimilar to those in Michigan and California. In *Broadie*, appellants[46] claimed that the sentences were grossly disproportionate to the crime and for that reason alone constituted cruel and unusual punishment. The court, by Chief Judge Breitel, looked first at the gravity of the offense, especially the harm it causes society.[47] In referring to the widespread

37. Id.

38. Id. at 425, 429-37, 503 P.2d at 930, 933-39, 105 Cal. Rptr. at 226, 229-35.

39. Id. at 425, 437-39, 503 P.2d at 930, 939-40, 105 Cal. Rptr. at 226, 235-36.

40. Id. at 426, 503 P.2d at 931-32, 105 Cal. Rptr. at 227.

41. Id. at 427, 503 P.2d at 932, 105 Cal. Rptr. at 228. This three-tiered test for determining whether a sentence is disproportionate was used in another important decision, In re Foss, 10 Cal. 3d 910, 519 P.2d 1073, 112 Cal. Rptr. 649 (1974). In that case, petitioner had been convicted under a statute relating to narcotics other than marijuana. Under the provisions of the statute, he was to be denied consideration for parole for ten years because he had a prior drug conviction. The statute made no provision for determining the existence of mitigating circumstances. Applying the Lynch test to determine if any disproportionality existed, the court concluded that petitioner had been subjected to cruel and unusual punishment. Id. at 929, 519 P.2d at 1085, 112 Cal. Rptr. at 661. This finding contrasts vividly with a California Court of Appeals holding nine years earlier. In People v. Marsden, 234 Cal. App. 2d 796, 44 Cal. Rptr. 728 (2d Dist. 1965), a defendant with no prior drug involvement was sentenced to imprisonment for five years to life, with no possibility of parole for three years. The crime occurred when defendant gave one marijuana cigarette to an undercover police officer who previously had repeatedly and unsuccessfully tried to make a marijuana purchase from him. The court upheld the sentence on appeal, despite the existence of the element of entrapment. The court said that "[t]he penalty, as against the background of this particular case, may seem harsh; but the Legislature necessarily deals with criminal activity by classes and not by cases . . . ." Id. at 798, 44 Cal. Rptr. at 729.

42. See text accompanying notes 28 supra & 50 infra.

43. See text accompanying notes 23 supra & 50 infra.

44. See text accompanying notes 29 supra & 50 infra.

45. 37 N.Y.2d 100, 332 N.E.2d 338, 371 N.Y.S.2d 471 (1975).

46. The case involved appeals by eight defendants convicted in unrelated trials. The court determined that "[t]he principal issue [in all of the appeals] is whether the so-called 'drug' laws, in mandating life imprisonment and, therefore, lifetime parole on parole release, prescribe sentences so disproportionate as would constitute cruel and unusual punishment in violation of constitutional limitations . . . ." Id. at 110, 332 N.E.2d at 341, 371 N.Y.S.2d at 474.

47. Id. at 112, 332 N.E.2d at 342-43, 371 N.Y.S.2d at 476-77.

phenomenon of drug trafficking, especially in New York, and the collateral effect of drug-related criminal activity on other crimes, the court considered the crime a "grave offense of high rank."[48] Secondly, the court evaluated the "character of the offender and the gravity of the threat he poses to society."[49] Noting that these defendants, though not all hardened criminals, each played a role in the distribution of drugs, the court concluded it would not be unreasonable for the legislature to consider such defendants a serious threat to society. Thirdly, Judge Breitel examined the validity of the legislative purposes in creating a system of admittedly severe punishments. He concluded that the legislature could reasonably decide that isolation of the criminal and deterrence of drug abuse—valid goals not achieved under prior law—are furthered by harsh sentences. Finally, the court stated that the sentences must be measured against punishments for other crimes in this state, and punishment for similar crimes in other states.[50] Conceding that New York has the harshest drug laws in the country, the court nevertheless noted that the problem of drug abuse in New York is more severe than elsewhere;[51] for that reason, as well as for reasons of the seriousness of the crime itself, he concluded that the laws were not irrationally severe.[52] In noting that the legislature is entitled to wide latitude in determining the extent of punishment for criminal acts, the court stated:

> That courts may believe that the Legislature is mistaken, does not lessen the legislative power. . . .
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> In so holding, in the exercise of judicial restraint and with respect for the separation of powers, the court does not necessarily approve or concur in the Legislature's judgment in adopting these sanctions. . . . Given the present state of criminological knowledge, perhaps only time will tell whether the course pursued will prove effective or will fail as every similar effort since the Harrison Act of 1914 has failed.[53]

Thus it appears that as a practical matter, a term of imprisonment under the drug trafficking laws in New York is not likely to be overturned as disproportionate. However, the reasoning of the New York Court of Appeals indicates that New York has adopted standards for measuring sentences similar to those already discussed. On the broad question of whether a sentence may be

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48. Id. at 113, 332 N.E.2d at 343, 371 N.Y.S.2d at 477.

49. Id.

50. Id. at 115, 332 N.E.2d at 344, 371 N.Y.S.2d at 479.

51. The court indicated that California, with a drug problem almost as serious as that in New York, punishes drug trafficking almost as severely as New York does. Id. at 116, 332 N.E.2d at 345, 371 N.Y.S.2d at 480.

52. Id. at 117, 332 N.E.2d at 345, 371 N.Y.S.2d at 481.

53. Id. at 117-18, 332 N.E.2d at 346, 371 N.Y.S.2d at 481-82. A similar statement is made in People v. McNair, 46 App. Div. 2d 476, 363 N.Y.S.2d 151 (4th Dep't 1975). That court stated, "[I]t is still too soon to know for certain whether this statute will have the desired effect of helping in the solution of the drug problem in New York. More time needs to pass before that answer emerges. Subject to the test of such time, however, we conclude . . . that Chapters 276-278 of the Laws of 1973 meet the standards by which a statute, challenged as inflicting cruel and unusual punishment, is to be judged and that appellants have failed to prove this law unconstitutional beyond a reasonable doubt." Id. at 482, 363 N.Y.S.2d at 158.

violative of the prohibition against cruel and unusual punishment solely because of its length, New York has answered affirmatively.[54]

In *Downey,* the Sixth Circuit disposed of the question very clearly, stating that "a sentence which is disproportionate to the crime for which it is administered may be held to violate the Eighth Amendment solely because of the length of imprisonment imposed."[55] The court acknowledged that the Supreme Court has never found a sentence of imprisonment to constitute cruel and unusual punishment solely because of its length,[56] and that some circuits have held explicitly that such a finding is not possible.[57] Nevertheless, it cited two cases as a basis for its holding. In *Howard v. Fleming,*[58] the Supreme Court heard an eighth amendment challenge based on length of sentence alone. Although it found the sentence valid, the fact that the Court heard the challenge on the merits appeared to the Sixth Circuit to be a strong argument that the Court accepted the theory that a sentence could be overturned solely on the basis of length.[59] In *Hemans v. United States,*[60] the Sixth Circuit had stated, in dismissing appellant's eighth amendment argument, that "long-term imprisonment could be so disproportionate to the offense as to fall within the inhibition."[61] *Downey* was the first United States Court of Appeals decision to base its holdings unequivocally on such a theory.

Downey also involved the narrower question of whether a thirty to sixty year sentence of imprisonment for possession for sale and sale of a small amount of marijuana was so disproportionate to the offense as to offend the eighth amendment. This question did not involve a challenge to the right of the legislature to regulate conduct involving marijuana; rather the question, based on the standard enunciated in *Weems,* was this: considering the relative harmlessness of marijuana, was the length of the sentence of imprisonment so disproportionate to the crime as to be not logically related to it?[62]

Until *Downey,* courts have "consistently dismissed such challenges out of

54. 37 N.Y.2d at 111, 332 N.E.2d at 341, 371 N.Y.S.2d at 475.

55. Downey v. Perini, 518 F.2d 1288, 1290 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975).

56. Id.

57. Id. The court cited Rener v. Beto, 447 F.2d 20, 23 (5th Cir. 1971), cert. denied, 405 U.S. 1051 (1972) (thirty year sentence for second offense of marijuana possession did not constitute cruel and unusual punishment); Anthony v. United States, 331 F.2d 687, 693-94 (9th Cir. 1964) (consecutive sentences totaling forty years imprisonment and fine for two sales of marijuana were not excessive and did not constitute cruel and unusual punishment); Smith v. United States, 273 F.2d 462, 467-68 (10th Cir. 1959), cert. denied, 363 U.S. 846 (1960) (fourteen consecutive sentences totaling fifty-two years for offenses involving possession and sale of marijuana and heroin did not constitute cruel and unusual punishment although the sentence was excessive under the circumstances).

58. 191 U.S. 126 (1903).

59. Downey v. Perini, 518 F.2d 1288, 1290 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975).

60. 163 F.2d 228 (6th Cir.), cert. denied, 332 U.S. 801 (1947).

61. Id. at 237.

62. See generally Downey v. Perini, 518 F.2d 1288, 1289-90 (6th Cir.), vacated and remanded, 44 U.S.L.W. 3330 (U.S. Dec. 2, 1975).

hand, refusing to look at any empirical evidence as to the relative harmlessness of marijuana, and generally without giving any substance to the constitutional prohibition against 'excessive' penalties."[63]

Although a few courts have shown concern with the harshness of the penalties for marijuana offenses,[64] it was not until the *Lorentzen* decision that a comprehensive examination of the specific problem was made and a marijuana sentence was overturned as cruel and unusual.[65] In a recent California case,[66] a sentence imposed upon a defendant for possession of marijuana was revoked, and the underlying statute found unconstitutional because it did not provide for eligibility for parole until five years after sentencing. The court found that since the statute precluded parole " 'without regard to the existence of . . . possible mitigating circumstances' "[67] it was violative of the cruel and unusual punishment prohibition.[68] The court reached this conclusion by applying the standards enunciated in *Lynch*.[69]

In overturning as cruel and unusual a sentence of imprisonment for a marijuana offense, the federal circuit court in *Downey* applied the criteria that are common to both the Michigan and California tests; specifically the court compared the statutory penalty at issue with those in other jurisdictions for the same offense, and with penalties for other, more serious crimes in the same jurisdiction.[70] The court's survey of the minimum penalties imposed in other states revealed that Ohio had the most severe punishment, its minimum penalty for the offense far exceeding the minimums in other states.[71] Similarly, the examination of Ohio's penalties for other crimes showed that at the time of the *Downey* decision, the penalties for the crimes at issue "far exceed those provided for other offenses, including crimes involving violence."[72]

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63. Soler, Of Cannabis and the Courts: A Critical Examination of Constitutional Challenges to statutory Marijuana Prohibitions, 6 Conn. L. Rev. 601, 686-87 (1974) [hereinafter cited as Soler]. See text accompanying footnotes 14-16, where it is suggested that this approach is not limited to marijuana challenges. See also People v. Morehouse, 80 Misc. 2d 406, 364 N.Y.S.2d 108 (Sup. Ct. 1975) (cruel and unusual punishment challenge to marijuana sentence rejected summarily; court showed great deference to the legislature).

64. E.g., People v. Gonzales, 25 Ill. 2d 235, 184 N.E.2d 833 (1962), cert. denied, 372 U.S. 923 (1963) (court commented that penalty was severe for a first marijuana offense); cf. United States v. Kleinzahler, 306 F. Supp. 311 (E.D.N.Y. 1969) (court noted that marijuana penalties are unique and severe).

65. Soler, supra note 63, at 690.

66. People v. Ruiz, —— Cal. App. 3d ——, 122 Cal. Rptr. 841 (1st Dist. 1975).

67. Id. at ——, 122 Cal. Rptr. at 846, quoting In re Foss, 10 Cal. 3d 910, 929, 519 P.2d 1073, 1085, 112 Cal. Rptr. 649, 661 (1974).

68. The court relied on In re Foss, 10 Cal. 3d 910, 519 P.2d 1073, 112 Cal. Rptr. 649 (1974); In re Lynch, 8 Cal. 3d 410, 503 P.2d 921, 105 Cal. Rptr. 217 (1972).

69. See text accompanying notes 33-41, and note 41 supra.

70. 518 F.2d at 1291-92.

71. Id. at 1291.

72. Id. at 1292. The Ohio Legislature had "drastically" reduced the penalties for nearly all other crimes so that, for example, the crime of kidnapping, which formerly carried a sentence of twenty years to life, now has a minimum term of four to seven years. In fact, under the new Ohio statutes, the only offenses, other than drug-related ones, which impose a minimum penalty of

It appears likely that the holding in *Downey,* coming from a federal circuit court, will influence other courts to examine in some depth eighth amendment challenges based upon a claim of disproportionality. It is possible that this opinion might form the basis for a successful challenge to New York's statutory punishment for marijuana offenses. At the very least the *Downey* decision represents a significant development in the evolving interpretation of the eighth amendment.

Debora Grobman

Constitutional Law—Statute Permitting Adoption of Illegitimate Child Without Father's Consent Is Not Violative of Equal Protection.—Hector Orsini and Corrine Caberti, an unmarried couple, lived together for nearly three and one-half years during which time a child was born. Soon after the couple's separation in 1972, Orsini admitted paternity in a New York Family Court proceeding whereupon he was directed by the court to make support payments and was granted visitation rights. When Caberti married in early 1973, her husband filed a petition for approval of his adoption of the child. Orsini was given notice and appeared to protest the adoption. The Westchester Family Court granted the order of adoption over Orsini's opposition, finding that New York Domestic Relations Law section 111(3)[1] did not require the consent of the natural father to the adoption of his illegitimate child.

Relying on the grounds that section 111(3) was unconstitutional under the due process and equal protection clauses, Orsini appealed directly to the New York Court of Appeals.[2] He contended that the statute discriminated against him and other "unwed fathers," subjecting them to invidious classifications based on sex and legitimacy.[3] Although he had notice and an opportunity to be heard at the proceeding to determine the best interests of the child, Orsini claimed that he had not been accorded full parental status under the statute which would have made his consent a prerequisite to the adoption.[4] Rejecting appellant's equal protection and due process arguments,

more than four to seven years are murder, aggravated murder, and forcible rape of a person under thirteen years of age. On the basis of these facts, the court found that the statute under which Downey was sentenced fell below the standard of Weems. Id. at 1291-92.

1. N.Y. Dom. Rel. § 111(3) (McKinney Supp. 1975) (requires consent "[o]f the mother, whether adult or infant, of a child born out of wedlock . . . .")

2. The court takes direct appeals from courts of original jurisdiction when the validity of a state or federal statute is challenged. N.Y. Const. art. 6 § 3(b)(2).

3. New York requires the consent of both natural parents for the adoption of their legitimate child, N.Y. Dom. Rel. Law § 111(2) (McKinney Supp. 1975), but only the consent of the natural mother for adoption of an illegitimate child. Id. § 111(3).

4. Id. 111(2). However, the consent of a parent who has neglected or abandoned the child is not required. Id. § 111(4) (McKinney Supp. 1975). Additional grounds for dispensing with the parent's consent under this section include: surrender of the child to an authorized agency for adoption; judicial declaration that the child is destitute or dependent; judicial declaration that the

the Court of Appeals upheld the constitutionality of section 111(3) and affirmed the decision of the lower court. *In re Malpica-Orsini*, 36 N.Y.2d 568, 331 N.E.2d 486, 370 N.Y.S.2d 511 (1975).

Prior to 1972, New York law required only the consent of the mother to the adoption of an illegitimate child.[5] The courts had held repeatedly that notice of the pending proceeding need not be given to the unwed father.[6] Indeed, it was sometimes asserted that he lacked standing to make any objection whatsoever to the child's adoption.[7] As late as 1971, the Appellate Division concluded that the natural father had "no parental rights with respect to a child born out of wedlock."[8] This minimal parental status accorded unwed fathers in New York adoption proceedings accurately reflected, for the most part,[9] their treatment in similar proceedings[10] in other states.[11]

In 1972, however, the landmark Supreme Court decision in *Stanley v. Illinois*[12] "changed the rules of the game."[13] In *Stanley*, an unmarried man

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parent is insane, incompetent, mentally retarded or an habitual drunkard; deprivation of a parent's civil rights. For purposes of this discussion the foregoing grounds will simply be referred to as "parental unfitness."

5. Id. § 111(3) (McKinney 1964), as amended, (McKinney Supp. 1975); see Doe v. Roe, 37 App. Div. 2d 433, 326 N.Y.S.2d 421 (2d Dep't 1971); In re Anderson, 187 Misc. 740, 65 N.Y.S.2d 169 (Child. Ct. 1946); In re Anonymous, 178 Misc. 142, 33 N.Y.S.2d 793 (Sur. Ct. 1942).

6. Doe v. Roe, 37 App. Div. 2d 433, 326 N.Y.S.2d 421 (2d Dep't 1971); In re Brousal, 66 Misc. 2d 711, 322 N.Y.S.2d 28 (Sur. Ct. 1971).

7. Doe v. Roe, 37 App. Div. 2d 433, 326 N.Y.S.2d 421 (2d Dep't 1971); In re Brousal, 66 Misc. 2d 711, 322 N.Y.S.2d 28 (Sur. Ct. 1971).

8. Doe v. Roe, 37 App. Div. 2d 433, 436, 326 N.Y.S.2d 421, 424 (2d Dep't 1971).

9. There were exceptions. See, e.g., Ark. Stat. Ann. § 56-106 (c) (1971) (requiring the father's consent where paternity has been judicially established).

10. Less favored treatment has not been limited to adoption proceedings. State laws also have discriminated against the unwed father regarding such basic parental privileges as custody of the child and visitation rights. Comment, The Emerging Constitutional Protection of the Putative Father's Parental Rights, 70 Mich. L. Rev. 1581, 1581-85 (1972). In recent years New York courts have granted the natural father visitation rights where he has lived with the illegitimate child, acted as its father, and supported it in accordance with his means. In re Anonymous, 12 Misc. 2d 211, 172 N.Y.S.2d 186 (Sup. Ct. 1958). The unwed mother has a right to custody superior to that of the unwed father unless she is proved unfit. Roe v. Doe, 58 Misc. 2d 757, 296 N.Y.S.2d 865 (Family Ct. 1968). But see Godinez v. Russo, 49 Misc. 2d 66, 266 N.Y.S.2d 636 (Family Ct. 1966) (criticizing this presumption and awarding the child to the father where the best interests of the child so warranted).

11. See, e.g., Cal. Civ. Code § 224 (West 1954); Mass. Ann. Laws ch. 210, § 2 (Supp. 1975); Mich. Comp. Laws Ann. § 710.3 (1968), as amended, Mich. Comp. Laws Ann. § 710.31 (Supp. 1975); N.J. Stat. Ann. §§ 9:3-18(f), -19.1 (1960).

12. 405 U.S. 645 (1972).

13. Doe v. Department of Social Servs., 71 Misc. 2d 666, 670, 337 N.Y.S.2d 102, 107 (Sup. Ct. 1972). Stanley concerned a guardianship, rather than an adoption proceeding. This court stated that "the same considerations in determining the father's status are applicable" in both proceedings and "[t]his purported differentiation is without substance." Id. at 669, 337 N.Y.S.2d at 106. High state court rulings in other adoption cases have implicitly agreed with this rationale. See notes 19-28 infra and accompanying text. There are, however, significant distinctions which will be discussed herein. See notes 77-80 infra and accompanying text.

and woman lived together for eighteen years during which time they raised their three illegitimate children. Upon the woman's death, the state of Illinois deprived Stanley of the custody of his two youngest children by declaring them to be without a parent or legal guardian and hence dependent on the state pursuant to a state statute[14] that defined parent so as to exclude natural fathers of illegitimate children. The state was not burdened, therefore, with the necessity of proving Stanley's parental unfitness, which was required to remove children from the care of a nonconsenting "parent" under the statute.[15] On appeal, the Illinois Supreme Court rejected Stanley's claim that the statutory discrimination between unwed fathers and all other parents denied him equal protection.[16] The Supreme Court reversed the Illinois judgment, holding that due process entitled Stanley to a hearing on his fitness as a parent before his children were taken from him, and that the denial to unwed fathers of the fitness hearing afforded to all other parents constituted a violation of equal protection.[17]

Relying almost totally on a due process analysis to reach its decision in *Stanley*,[18] the Supreme Court never clearly delineated the equal protection standard which it deemed applicable to the case. However, the broad language used by the Court to describe the importance of the natural father-child relationship,[19] coupled with the equal protection holding, soon prompted reversals in adoption cases in Wisconsin and Illinois.[20]

In *State ex rel. Lewis v. Lutheran Social Services*,[21] the Wisconsin Supreme Court upheld the statutory denial to the unwed father of the right to notice and an opportunity to be heard concerning the adoption of his children. However, the United States Supreme Court vacated and remanded the decision for reconsideration in light of the ruling in *Stanley*.[22] On remand, the Wisconsin Supreme Court ordered a new hearing at which the natural father's

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14. Ill. Ann. Stat. ch. 37, § 701-14 (Smith-Hurd 1972). Parents, under the statute, included the mother of an illegitimate child, both parents of a legitimate child, and adoptive parents.

15. Id. ch. 4, § 9.1-8 (Smith-Hurd 1975). Stanley received notice, but the only question to which he was permitted to address himself at the hearing was whether he had ever been legally married to the deceased mother. 405 U.S. at 646-47.

16. In re Stanley, 45 Ill. 2d 132, 134, 256 N.E.2d 814, 815 (1970). The court found that the distinction between unwed mothers and unwed fathers was rationally related to the purposes of the Juvenile Court Act, i.e., to secure the child care and guidance that would serve his moral, emotional, mental, and physical well being. Ill. Ann. Stat. ch. 37, § 701-2 (Smith-Hurd 1972).

17. 405 U.S. at 658.

18. Id. at 649-58. The Court's due process analysis formed the basis of Chief Justice Burger's dissent. Burger accused the majority of reaching out to find a due process issue which had never been asserted in the lower courts. Thus, he maintained, the Court decided Stanley by improperly expanding its jurisdiction. Id. at 659-62.

19. Id. at 651-52.

20. People ex rel. Slawek v. Covenant Child. Home, 52 Ill. 2d 20, 284 N.E.2d 291 (1972); State ex rel. Lewis v. Lutheran Social Servs., 59 Wis. 2d 1, 207 N.W.2d 826 (1973).

21. 47 Wis. 2d 420, 178 N.W.2d 56 (1970), vacated sub nom. Rothstein v. Lutheran Social Servs., 405 U.S. 1051 (1972).

22. Rothstein v. Lutheran Social Servs., 405 U.S. 1051 (1972).

rights to his child could only be terminated on the same grounds upon which Wisconsin could terminate any parent's rights.[23] In addition the court declared unconstitutional the state statute which provided for adoption of an illegitimate child after consent by the natural mother alone.[24] It concluded that until the legislature devised statutes consistent with *Stanley*, "[c]onsent of both the unwed mother and the unwed father, or consent of one parent with proper termination of the parental rights of the other . . . ."[25] would be a prerequisite to adoption.

Stanley precipitated a similar reevaluation of the treatment of unwed fathers in Illinois adoption proceedings. The Illinois Supreme Court in *People ex rel. Slawek v. Covenant Children's Home*[26] awarded an unwed father custody of his son after the child's adoption had been finalized without consent of, or notice to, the natural father. The court interpreted *Stanley* as recognizing "that the interests of the father of an illegitimate child are no different from those of other parents."[27] Thus, the court continued:

> State laws which deny a hearing to determine the fitness of a father for the custody of his children born out of wedlock while extending this right to other parents are based upon an unreasonable distinction and violate equal-protection principles.[28]

Responding to this judicial stimulus, the Wisconsin and Illinois legislatures have recently amended their states' adoption statutes to require notice to the unwed father and his consent to the adoption of his illegitimate child.[29] A similar enactment followed a decision in Washington[30] while other state

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23. 59 Wis. 2d 1, 10-11, 207 N.W.2d 826, 830 (1973). Grounds for termination of parental rights in Wisconsin include abandonment, neglect, and unfitness. Wis. Stat. Ann. § 48.40 (Supp. 1975). The Wisconsin Supreme Court later terminated Rothstein's parental rights on the basis of his repeated denials of paternity during the mother's pregnancy and his total disregard for the quality of the mother's prenatal care. State ex rel. Lewis v. Lutheran Social Servs., 68 Wis. 2d 36, 227 N.W.2d 643 (1975).

24. 59 Wis. 2d at 9, 207 N.W.2d at 830; Wis. Stat. Ann. § 48.84 (1957), as amended (Supp. 1975).

25. 59 Wis. 2d at 9, 207 N.W.2d at 830.

26. 52 Ill. 2d 20, 284 N.E.2d 291 (1972).

27. Id. at 22, 284 N.E.2d at 292.

28. Id. The judgment in Slawek was foreshadowed by an opinion of the Illinois Attorney General that after Stanley, consent to an illegitimate child's adoption would have to be obtained from both the natural mother and father. 1972 Op. Att'y Gen. Ill. 142-43; see Vanderlaan v. Vanderlaan, 9 Ill. App. 3d 260, 292 N.E.2d 145, vacated & remanded, 405 U.S. 1051 (1972) (on reconsideration in light of Stanley the Illinois Supreme Court held that the best interests of two illegitimate children would be served by granting custody to the natural father).

29. Ill. Ann. Stat. ch. 4, §§ 9.1-1 E, 9.1-8(a) (Smith-Hurd 1975); Wis. Stat. Ann. § 48.84 (Supp. 1975).

30. In re Harp, 6 Wash. App. 701, 495 P.2d 1059 (1972). Wash. Rev. Code Ann. § 26.32.030 (Supp. 1975) provides that written consent to the adoption must be obtained from the mother and father of an illegitimate child. The Oregon legislature has not yet reacted to a Ninth Circuit decision that declared that state's adoption consent statute unconstitutional due to its discrimination against the unwed father. Miller v. Miller, 504 F.2d 1067 (9th Cir. 1974) (per curiam).

legislatures have initiated such amendments in the wake of *Stanley* without judicial insistence.[31]

The New York courts, on the other hand, have tended to construe *Stanley* more narrowly than other jurisdictions. In *Doe v. Department of Social Services*,[32] a New York court for the first time considered the impact of *Stanley* on New York adoption law. In that case, a putative father brought a habeas corpus action to contest the adoption of his daughter. The petitioner had not received notice or a hearing although he had acknowledged paternity and supported the child for half of her life. The court found that, in view of *Stanley*'s recognition of the unwed father's cognizable and substantial interests in his child, the long standing precedents for denying the putative father any status to contest adoption were no longer viable.[33] The court concluded that section 111(3) must be read to provide that "the mother's exclusive or sole consent suffices only where there has been no formal or unequivocal acknowledgment or recognition of paternity by the father."[34] Yet the court continued cautiously:

> It is not that the [unwed] father's consent is now necessary as a condition precedent to adoption, but rather that he be served with 'notice' [and be allowed the opportunity] to present facts for the court's consideration in determining what is in the best interests of the child.[35]

In so construing the mandate of *Stanley*, the court perpetuated a crucial statutory distinction between unwed fathers and other parents. Though assuring the natural father of notice and a hearing at which his parental fitness would be a factor considered in arriving at a disposition in the child's "best interests," the court refrained from conferring upon the unwed father the "veto power" against the adoption held by any other parent under the statute.[36] This interpretation of *Stanley* was accepted in several subsequent New York decisions[37] although some New York courts expressed uncertainty over whether such a conservative revision of the present statute was consistent with *Stanley*'s equal protection holding.[38] However, New York's highest court did not address the issue until *Orsini*.

The primary question[39] presented to the New York Court of Appeals in

31. See, e.g., Conn. Gen. Ann. § 45-61(i) (Supp. 1975); Mich. Comp. Laws Ann. § 710.31 (Supp. 1975); Va. Code Ann. § 63.1-225 (Supp. 1975).

32. 71 Misc. 2d 666, 337 N.Y.S.2d 102 (Sup. Ct. 1972).

33. Id. at 670, 337 N.Y.S.2d at 107.

34. Id. at 671, 337 N.Y.S.2d at 107.

35. Id.

36. N.Y. Dom. Rel. Law § 111(3) (McKinney Supp. 1975).

37. In re Anonymous, 78 Misc. 2d 1037, 359 N.Y.S.2d 220 (Sur. Ct. 1974); Pierce v. Yerhovich, 80 Misc. 2d 613, 616, 363 N.Y.S.2d 403, 404 (Family Ct. 1974).

38. In re Male L., ___ Misc. 2d ___, ___, 369 N.Y.S.2d 273, 276 (Sur. Ct. 1975); People ex rel. Blake v. Charger, 76 Misc. 2d 577, 580, 351 N.Y.S.2d 322, 327 (Family Ct. 1974); see In re Dionisio, 81 Misc. 2d 436 n.1, 366 N.Y.S.2d 280, 282 n.1 (Family Ct. 1975); text accompanying notes 19-28 supra.

39. Although Orsini claimed that he was denied due process as well as equal protection, there was no disagreement among the judges of the Court of Appeals that the notice and hearing which Orsini received satisfied the due process requirements outlined in Stanley, since he was given an

Orsini was whether *Stanley* further dictated that the consent of the unwed father, like that of all other parents, must be made a prerequisite to adoption.[40] Since Orsini's complaint was based on the discriminatory statutory classification of unwed fathers, the Court of Appeals focused its inquiry on the appropriate standard of equal protection review.[41] The court noted the general dissatisfaction with the traditional two-tier equal protection standard.[42] *Stanley* provided no clarification of this issue since the Supreme Court in that case reached its equal protection holding by a due process rationale.[43] Nor did the post-*Stanley* state court decisions offer a guideline for *Orsini* since those courts based their rulings squarely on *Stanley's* precedent rather than developing an equal protection standard for the case at hand.[44] The court therefore looked to the Supreme Court's analysis in *Weber v. Aetna Casualty & Surety Co.*[45] that "'mark[ed] one of the most overt attempts by the Court to escape the rigid two-tier framework . . . .'"[46] The Court of Appeals also noted that the *Weber* analysis was the most appropriate for the particularly sensitive problems in legitimacy cases since it goes to "'the merits of the particular controversy at hand . . . . allow[ing] a realistic examination of conflicting policies and interests in a challenged statute . . . .' "[47] The *Weber* test involves a dual inquiry: What "legitimate state interest does the classification promote," and what "fundamental personal rights" does the classification endanger?[48] Using this twofold measure and emphasizing that the child's welfare was the paramount consideration in review of adoption procedures, the *Orsini* court then reiterated its preliminary conclusion that the statute served the legitimate state purpose of securing a normal home for the child and that the discriminatory classification of the unwed father bore a significant relationship to this recognized purpose.[49]

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opportunity to present evidence concerning his fitness as a parent before his parental rights were terminated. 36 N.Y.2d at 577, 331 N.E.2d at 492, 370 N.Y.S.2d at 520.

40. Id. at 576, 331 N.E.2d at 492, 370 N.Y.S.2d at 519.

41. The task is especially difficult when, as in the instant case, the challenged classification touches upon illegitimacy or sex. Recent Supreme Court decisions in these areas have reflected the rapidly changing attitudes toward the role of marriage and women in our society. See Stanley v. Illinois, 405 U.S. 645 (1972); Levy v. Louisiana, 391 U.S. 68 (1968). Compare Hoyt v. Florida, 368 U.S. 57 (1961) with Frontiero v. Richardson, 411 U.S. 677 (1973). The law is still in a state of ferment and no clear cut new equal protection standards of review have yet emerged. See Comment, Illegitimacy and Equal Protection, 49 N.Y.U.L. Rev. 479, 480-89 (1974); Note, The Emerging Bifurcated Standard for Classifications Based on Sex, 1975 Duke L.J. 163, 174-77.

42. See Gunther, The Supreme Court, 1971 Term—Forward: In Search of Evolving Doctrine on a Changing Court: A Model for a Newer Equal Protection, 86 Harv. L. Rev. 1 (1972); Comment, Equal Protection in Transition: An Analysis and a Proposal, 41 Fordham L. Rev. 605 (1973).

43. See note 18 supra and accompanying text.

44. See notes 19-28 supra and accompanying text.

45. 406 U.S. 164 (1972).

46. 36 N.Y.2d at 575, 331 N.E.2d at 491, 370 N.Y.S.2d at 518.

47. Id.

48. 406 U.S. at 173.

49. 36 N.Y.2d at 575, 331 N.E.2d at 489, 370 N.Y.S.2d at 519. In a seemingly illogical juxtaposition of its arguments on the equal protection issue, the court found the classification in

The court based its conclusion that the statute was reasonable on a number of arguments which do not seem to withstand critical scrutiny. The court's conclusion that administrative and economic efficiency justified the statute's discriminatory treatment of unwed fathers is the very contention which was dismissed by the Supreme Court in *Stanley* as both illusory and unpersuasive because of the important personal interests involved in such a case.[50] The court's fear that a reclassification would continue to visit the stigma of illegitimacy on the child[51] is also cast into doubt by *Stanley*. In that case, the Supreme Court questioned whether such a stigma is so pervasive as to warrant " 'permanent termination of a subsisting relationship with the child's father.' "[52] The Supreme Court further stated that it had not refused to recognize those family relationships unlegitimized by a marriage ceremony since the interpersonal bonds in such cases "were often as warm, enduring, and important as those arising within a more formally organized family unit."[53] The Court of Appeals also asserted that making the unwed father's consent a prerequisite to adoption would provide him with an opportunity for extortion and hence, contribute to the black market for adoptive children.[54] Yet if such a danger exists, surely a more appropriate remedy lies in the enforcement of severe penalties aimed at the abuse itself.[55] The possibility envisioned by the court that couples would be dissuaded from adoption by the potential for harassment by the natural father[56] ignores current statutory and case law which provides for such a contingency by ensuring prospective parents complete anonymity throughout the adoptive process.[57] The court stated that elimination of the present statutory presumption would create difficulties in determining which unwed fathers were deserving of co-equal parental status in the adoption proceeding.[58] Other states have dealt with this problem by devising statutes which grant the natural father parental status only if he has previously acknowledged paternity and can demonstrate to the court's satisfaction that he has properly exercised his parental duties.[59] In

N.Y. Dom. Rel. Law § 111(3) (McKinney Supp. 1975) "reasonable" and "justified" even before selecting the analytical method by which the statute was ostensibly to be tested. 36 N.Y.2d at 574, 331 N.E.2d at 491, 370 N.Y.S.2d at 517; see notes 64-68 infra and accompanying text.

50. 405 U.S. at 656-57.

51. 36 N.Y.2d at 572, 331 N.E.2d at 489, 370 N.Y.S.2d at 516.

52. 405 U.S. at 654-55 n.7, quoting In re Mark T., 8 Mich. App. 122, 146, 154 N.W.2d 27, 39 (1967).

53. 405 U.S. at 652.

54. 36 N.Y.2d at 573, 331 N.E.2d at 490, 370 N.Y.S.2d at 516-17.

55. See, e.g., N.Y. Penal Law § 155.05 (McKinney 1975) (extortion).

56. 36 N.Y.2d at 572-73, 331 N.E.2d at 489-90, 370 N.Y.S.2d at 516.

57. People ex rel. Scarpetta v. Spence-Chapin Adoption Serv., 28 N.Y.2d 185, 195, 269 N.E.2d 787, 793, 321 N.Y.S.2d 65, 73, cert. denied, 404 U.S. 805 (1971) (court found that the public policy favoring anonymity is reflected in N.Y. Soc. Serv. Law). The Social Services Law provides that contact is to be exclusively between parents and the adoption agency. The agency, therefore, acts as an "insulating intermediary" to ensure the separation of natural parents and prospective adoptive parents. Id.; see N.Y. Soc. Serv. Law §§ 383-84 (McKinney Supp. 1975).

58. 36 N.Y.2d at 576, 331 N.E.2d at 492, 370 N.Y.S.2d at 519.

59. See, e.g., Mich. Comp. Laws Ann. § 710.33 (Supp. 1975). Another alternative would be

maintaining that marriage would be discouraged if the unwed father's consent were a condition precedent to adoption,[60] the court overemphasized the formalistic aspects of the marital bonds at the expense of concern for the enduring parent-child relationship that is the *raison d'être* for the institution of marriage.[61] Moreover, this objection, like every other argument advanced by the majority in support of the statutory bias against unwed fathers, can also be put forward, *mutatis mutandis,* to justify such treatment for unwed mothers and divorced fathers.[62] The court set forth no specific justifications for the statutory denial of the unwed father's consent as a prerequisite when such a requirement is categorically awarded by the statute to all other parents.[63]

Moreover, an examination of the majority reasoning suggests that, notwithstanding the court's pronouncement that it was employing *Weber*'s ad hoc balancing test, *Orsini* was actually decided by a rational basis test.[64] Under *Weber,* the extensive presumptions of rationality and validity accorded the statute[65] would not seem to be warranted, since it had not yet been determined whether the interests at issue were of sufficient import to negate such presumptions.[66] Furthermore, although the court posited that *Weber*'s "dual

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to dispense with the necessity of the unwed father's consent if he did not respond promptly upon receipt of notice to contest the proceeding. Such a provision would eliminate most of those natural fathers having no serious concern for the welfare of their offspring. See Stanley v. Illinois, 405 U.S. 645, 657 n.9 (1972); Catholic Charities v. Zalesky, 232 N.W.2d 539 (Sup. Ct. Iowa 1975) (state statute permitting adoption without consent of father of illegitimate child upheld where statute distinguished between the caring and non-caring parent rather than classifying parents by sex or legitimacy); Ill. Ann. Stat. ch. 4, 9.1-12a(4) (Smith-Hurd 1975) (putative father need not be made a party to the proceeding if he fails to come forward within thirty days after service of notice).

60. 36 N.Y.2d at 573, 331 N.E.2d at 490, 370 N.Y.S.2d at 517. The court reasoned that potential husbands would refrain from involving themselves in family situations where they could only reasonably hope to be foster parents. Id.

61. See Stanley v. Illinois, 405 U.S. 645, 651-52 (1972); In re Donna P., 80 Misc. 2d 129, 131-32, 362 N.Y.S.2d 370, 373 (Family Ct. 1974).

62. See Krause, Equal Protection for the Illegitimate, 65 Mich. L. Rev. 477, 492-95 (1967).

63. The equal protection clause requires at a minimum that all those similarly situated in relation to the purpose of the legislation receive equal treatment. Evans v. Newton, 382 U.S. 296 (1966). The Orsini court found that the purpose of the statute was to promote the child's best interests by securing a stable home environment and engendering strong parental relationships. 36 N.Y.2d at 575, 331 N.E.2d at 491, 370 N.Y.S.2d at 519. Yet the court did not explain how the distinction between unwed fathers and unwed mothers or divorced fathers related to this legislative purpose. Thus the statute may be viewed both as overinclusive, since it grants veto power over the adoption to many unwed mothers and divorced fathers who have not proven themselves worthy to maintain a relationship with their child, and underinclusive, since it denies this veto power to those unwed fathers who are deserving of full parental status as well as those who should not be so entitled. See Note, Developments in the Law—Equal Protection, 82 Harv. L. Rev. 1065, 1082-87 (1969).

64. 36 N.Y.2d at 580, 331 N.E.2d at 495, 370 N.Y.S.2d at 523 (Jones, J., dissenting).

65. Id. at 570-71, 331 N.E.2d at 488, 370 N.Y.S.2d at 514.

66. See note 49 supra.

inquiry" was central to its analysis,[67] the majority never discussed whether the statute represented an infringement on the basic personal right of the natural father and his child to maintain their relationship. The *Weber* test may be the appropriate mode of analysis for the important parental interests defined by *Stanley*, since *Weber* allows for heightened scrutiny "when state statutory classifications approach sensitive and fundamental personal rights . . . ."[68] Yet the majority failed to apply the strictures of the very test which it had purportedly adopted.

The dissent, on the other hand, found that the parent-child relationship in *Orsini* was a fundamental interest which would require the state to demonstrate that the statutory classification was necessary to promote a compelling governmental interest.[69] While noting the Supreme Court's reluctance to expand the number of those rights labeled fundamental for equal protection purposes, the dissent pointed out that the language of *Stanley,* which termed the rights of a man in the child he has sired and raised as " 'essential . . . basic civil rights . . . far more precious . . . than property rights,' "[70] compelled such a determination. The minority recognized that the welfare of illegitimate children is undeniably a "compelling state interest," but believed that the legislature could have fashioned less drastic and more appropriate means to achieve the desired goal.[71] The statute was unconstitutionally overbroad, concluded the dissent, because it unnecessarily burdened and restricted the fundamental right of an unwed father to maintain the natural parent-child relationship.[72]

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67. 36 N.Y.2d at 574-75, 331 N.E.2d at 490-91, 370 N.Y.S.2d at 517-18.

68. 406 U.S. at 172.

69. 36 N.Y.2d at 581-82, 331 N.E.2d at 495-96, 370 N.Y.S.2d at 524-25 (Jones, J., dissenting); see note 40 supra. It has been suggested that the Stanley court created a fundamental interest in the unwed parent-child relationship for equal protection purposes. See People v. Olague, 31 Cal. App. 3d 5, 7, 106 Cal. Rptr. 612, 614 (Super. Ct. 1973) (dictum). However, no court has expressly so held. See notes 19-28 supra and accompanying text.

70. 405 U.S. at 651 (citations omitted).

71. 36 N.Y.2d at 587, 331 N.E.2d at 499, 370 N.Y.S.2d at 529-30 (Jones, J., dissenting).

72. Id.; see Comment, The Emerging Constitutional Protection of the Putative Father's Parental Rights, 70 Mich. L. Rev. 1581, 1590 (1972). Less persuasive is Judge Fuchsberg's contention that the sex discrimination of section 111(3) provided an independent ground for a declaration of the unconstitutionality of the statute. 36 N.Y.2d at 591, 331 N.E.2d at 502, 370 N.Y.S.2d at 533 (Fuchsberg, J., dissenting). A majority of the Supreme Court has yet to find sex a suspect class. See Frontiero v. Richardson, 411 U.S. 677 (1973) (only plurality considered sex a suspect class). Moreover, adoption is a process of purely legislative origin which affects a great many fragile human relationships. Taking these factors into account, it would seem a questionable exercise of discretion for the Court of Appeals, as Fuchsberg suggests, to use Orsini as a vehicle to launch a new, stricter New York state equal protection standard.

However, in recent sex classification cases, it has been suggested that the Supreme Court has employed a "strict rationality" test. Berkelman v. San Francisco Unified School Dist., 501 F.2d 1264, 1269 (9th Cir. 1974) (interpreting Reed v. Reed, 404 U.S. 71 (1971) as utilizing this approach). The fact that the statute in Orsini dealt with this sensitive area should, at the very least, have provided an additional inducement for the court to weigh the interests involved carefully under the Weber test.

A broad reading of *Stanley* lends some support to the dissenting position, but the majority's reticence to deal with Orsini's personal relationship with his child as a "fundamental interest" seems justified, given the Supreme Court's reluctance to so designate the father-child relationship in *Stanley*. However, a forthright acknowledgment by the court of the essential human rights at issue in *Orsini*, and a correspondingly rigorous review of the statute under the *Weber* test, would have been more consistent not only with the spirit of the Supreme Court's language in *Stanley*,[73] but also with the holdings of the Court of Appeals itself.[74] The Court of Appeals has often described a parent's concern for the care and control of his child as a "fundamental interest" and a "paramount" right.[75] In a 1974 decision reversing a lower court termination of the parental rights of a divorced father, the Court of Appeals stated: "Even where the flame of parental interest is reduced to a flicker the courts may not properly intervene to dissolve the parentage. The relationship between minor children and their natural parents is jealously guarded . . . ."[76]

Having found section 111(3) valid under its equal protection analysis, the court next distinguished the equal protection in *Stanley* from the situation in the case at the bar. *Orsini* differed from *Stanley*, declared the court, since there were "compelling reasons supporting a different legislative classification . . . ."[77] for unwed fathers in adoption proceedings. The opinion, however, did not articulate the compelling reasons which warranted the distinction. The court's failure to elaborate on this point is curious in view of those state court rulings which explicitly or implicitly have equated the considerations involved in *Stanley* with those in adoption proceedings.[78] Nonetheless, certain distinctions between cases can be made.

In *Stanley*, the state intervened to disrupt an existing family unit within which the natural father was rearing his children. Orsini, on the other hand, sought not custody of his child, but maintenance of minimal parental ties to his daughter who was living within the family structure established by the

73. 405 U.S. at 650-52.

74. Susan W. v. Talbot G., 34 N.Y.2d 76, 312 N.E.2d 171, 356 N.Y.S.2d 34 (1974); In re Ella B., 30 N.Y.2d 352, 285 N.E.2d 288, 334 N.Y.S.2d 133 (1972); Spence-Chapin Adoption Serv. v. Polk, 29 N.Y.2d 196, 274 N.E.2d 431, 324 N.Y.S.2d 937 (1971).

75. Spence-Chapin Adoption Serv. v. Polk, 29 N.Y.2d 196, 203, 274 N.E.2d 431, 435, 324 N.Y.S.2d 937, 943 (1971); see the cases cited in 36 N.Y.2d at 585, 331 N.E.2d at 498, 370 N.Y.S.2d at 527-28.

76. Susan W. v. Talbot G., 34 N.Y.2d 76, 80, 312 N.E.2d 171, 174, 356 N.Y.S.2d 34, 38 (1974). It should be noted, however, that a growing number of lower court cases have challenged the emphasis placed by the Court of Appeals in this case on the rights of a natural parent to his or her child. These decisions hold that far greater weight should be given to the child's right to a permanent, stable environment. These courts, therefore, have rejected any presumption that the child's welfare lies with the biological parents, maintaining rather that the child's best interests are served by placement in the most secure and loving home. People ex rel. Blake v. Charger, 76 Misc. 2d 577, 351 N.Y.S.2d 322 (Family Ct. 1974); In re Catherine S., 74 Misc. 2d 154, 347 N.Y.S.2d 470 (Family Ct. 1973); Godinez v. Russo, 49 Misc. 2d 66, 266 N.Y.S.2d 636 (Family Ct. 1966).

77. 36 N.Y.2d at 577, 331 N.E.2d at 493, 370 N.Y.S.2d at 520.

78. See notes 13 & 19-28 supra and accompanying text.

appellee and his wife. While the enforced separation of the children from their father that occurred in *Stanley* could hardly be expected to promote the children's welfare,[79] the severance of the far less substantial, noncustodial ties between Orsini and his daughter has been approved by some psychologists as contributing to the child's necessary sense of living within a secure and permanent familial framework.[80]

While this difference between *Stanley* and *Orsini* may distinguish *Stanley* as precedent, it offers little additional insight into why the different standards which prevail in adoption proceedings must weigh so heavily upon unwed fathers alone. Thus the distinction suggests no further justification for the present disparity of treatment under the statute.

The Court of Appeals in *Orsini* has chosen to restrict *Stanley*'s application to the New York adoption process.[81] *Orsini* is not the first state court since *Stanley* to defer revision of the adoption consent statute to the wisdom of the legislature.[82] *Orsini* is the first case since *Stanley,* however, in which the highest state court has fully sustained an adoption consent which discriminated against the parental rights of the unwed father.

Throughout its opinion, the majority in *Orsini* emphasized that the primary concern expressed by the legislature in section 111(3) was the "welfare of the children involved rather than with the allocation of rights between the mother and the usually uncertain and reluctant father of the children born out of wedlock."[83] The infirmity of section 111(3) is that in pursuit of the admirable goal of the child's best interests, the legislature has unnecessarily demeaned the basic rights of the unwed father to the maintenance of his relationship with a child he has sired and raised. Ironically, under the ironclad presumptions of the present statute, the consent of the unfeeling and irresponsible unwed mother or divorced father is a prerequisite to adoption while the constructive and loving contact between an unwed father and his child is

79. J. Goldstein, A. Freud & A. Solnit, Beyond the Best Interests of the Child 31-34 (1974).

80. Id. at 25, 38. But the sword cuts both ways. Judge Fuchsberg, in his dissent, cited the same authority to support the proposition that a severance of the bonds between the natural father and child could well have devastating effects upon the child's personality. 36 N.Y.2d at 591, 331 N.E.2d at 502, 370 N.Y.S.2d at 533. The clear preference of the authors, however, is for the least detrimental alternative for the child in such a situation. J. Goldstein, A. Freud & A. Solnit, Beyond the Best Interests of the Child 53 (1974).

81. An issue unresolved by Orsini is whether Stanley necessitates notice to all putative fathers, including those whose paternity has neither been admitted nor judicially established. The language of Stanley, which speaks of the interest "of a man in the children he has sired and raised" is susceptible to two interpretations. It can be taken to mean that the blood relationship alone constitutes the natural father's substantial interest or that such an interest is only established through continued personal interaction between the father and his child. In any event, unwarranted delays in the adoptive process can be avoided by a statutory scheme providing for "reasonable efforts" to notify the father and for termination of parental rights if the natural father fails to assert his interest within a specified time period. See Ill. Ann. Stat. ch. 4, § 9.1-12a(4) (Smith-Hurd 1975); Comment, The Emerging Constitutional Protection of the Putative Father's Parental Rights, 70 Mich. L. Rev. 1581, 1606-07 (1972).

82. In re Harp, 6 Wash. App. 701, 495 P.2d 1059 (1972).

83. 36 N.Y.2d at 578, 331 N.E.2d at 493, 370 N.Y.S.2d at 521.

terminable by adoption without the father's consent. In this way the statute can frustrate the very purposes for which it was designed.[84]

So long as the legislature chooses to retain the present statutory scheme, the continued denial of full parental status to the unwed father who has assumed parental responsibility for his child is unjustified. If the legislature is persuaded, however, that parental veto power over a child's adoption is too often responsible for "denying homes to the homeless and . . . depriving innocent children of the other blessings of adoption . . . ."[85] the Arizona statute[86] discussed by Judge Jones in his dissent offers a far more equitable solution than the present New York law. That statute requires the unwed father's consent to the adoption in the same manner as any other parent if he has officially acknowledged paternity or his paternity has been established in a judicial proceeding.[87] The court can waive the consent requirement of *any* parent, however, if it finds adoption to be in the best interests of the child.[88]

Michael J. Malone

Constitutional Law—Zoning Ordinance Which Classifies and Regulates Adult Movie Theatres and Bookstores Solely on the Basis of the Content of the Materials Which They Purvey Held Violative of Equal Protection Clause.—In 1962 the city of Detroit adopted an Official Zoning Ordinance which prohibited certain types of businesses from concentrating, requiring them to maintain minimum distances from each other. In 1972, in an attempt to control the emerging concentrations of adult-type entertainment businesses, the city adopted a series of amendments to the Official Zoning Ordinance which added "adult" movie theatres and bookstores, together with "go-go" establishments and topless bars, to the list of regulated businesses[1]

84. See In re Tyease, __ Misc. 2d __, 373 N.Y.S.2d 447 (Sur. Ct. 1975). In that case, the court applauded Orsini as a vindication of the child's constitutional right to a permanent, stable home. See note 76 supra. The court acknowledged, however, that the Court of Appeals only reached the result in Orsini by upholding an outmoded legislative structure greatly in need of revision. The court was amenable to a statutory amendment similar to the Arizona statute discussed in the text. Id. at __, 373 N.Y.S.2d at 450-51; see text accompanying notes 85-88 infra.

85. 36 N.Y.2d at 572, 331 N.E.2d at 489, 370 N.Y.S.2d at 516.

86. Ariz. Rev. Stat. Ann. § 8-106 (1974).

87. Id. § 8-106(A)(1)(d) (1974).

88. Id. § 8-106(C) (1974).

1. The list included hotels or motels, pawnshops, pool or billiard halls, public lodging houses, secondhand stores, shoeshine parlors, and taxi dance halls. American Mini Theatres, Inc. v. Gribbs, 518 F.2d 1014, 1016 (6th Cir. 1975), cert. granted, 44 U.S.L.W. 3234 (U.S. Oct. 21, 1975) (No. 75-312). "[T]here are some uses which, because of their very nature, are recognized as having serious objectionable operational characteristics, particularly when several of them are concentrated under certain circumstances . . . . Special regulation of these uses is necessary to insure that these adverse effects will not contribute to the blighting or downgrading of the surrounding neighborhood. . . . The primary control or regulation is for the purpose of

which, by their very nature, were considered to have a deleterious effect upon the neighborhoods. The ordinance regulated the location of these businesses by prohibiting more than two such uses within one thousand feet of each other, and by making it unlawful to establish any adult theatre, adult bookstore or Class D cabaret[2] within five hundred feet of a residential, dwelling or rooming unit.[3] Plaintiffs were lessees and operators in the city of Detroit of so-called adult motion picture theatres and an adult bookstore which were directly affected by the zoning ordinances.

Plaintiffs asserted that these city ordinances deprived them of their fourteenth amendment right to equal protection of the law granted to other theatre operators and bookstores, and that the ordinances violated the first amendment.[4] Plaintiffs sought declaratory and injunctive relief. The district court declared those portions of the ordinances which prohibited such uses within five hundred feet of a dwelling unit invalid, but declared the prohibition against two or more regulated uses within one thousand feet of one another to be valid.[5] The Court of Appeals for the Sixth Circuit, in a split decision, reversed the judgment of the district court and declared that the 1972 ordinances were invalid under the equal protection clause of the fourteenth amendment.[6] *American Mini Theatres, Inc. v. Gribbs,* 518 F.2d 1014 (6th Cir. 1975), *cert. granted,* 44 U.S.L.W. 3234 (U.S. Oct. 21, 1975) (No. 75-312).

The complexities of modern life demand that the legislature be allowed to establish zoning ordinances which classify property according to the uses to which it is put and to regulate such uses.[7] In *Village of Euclid v. Ambler Realty Co.*[8] the Supreme Court upheld a comprehensive zoning ordinance which provided for the creation and maintenance of residential districts from which commercial and industrial uses were barred. The Court reviewed the

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preventing a concentration of these uses in any one area (i.e. not more than two such uses within one thousand feet of each other which would create such adverse effects)." Id.

2. Under the ordinance, adult bookstores and adult theatres are "distinguished or characterized by an emphasis on matter depicting, describing or relating to 'Specified Sexual Activities' or 'Specified Anatomical Areas' . . . ." Id. at 1015. Class D cabarets feature topless dancers, exotic dancers, strippers and similar entertainers. Id. at 1016.

3. Nortown Theatre Inc. v. Gribbs, 373 F. Supp. 363, 365-66 (E.D. Mich. 1974), rev'd sub nom. American Mini Theatres, Inc. v. Gribbs, 518 F.2d 1014 (6th Cir. 1975), cert. granted, 44 U.S.L.W. 3234 (U.S. Oct. 21, 1975) (No. 75-312).

4. Plaintiffs argued that the ordinances abridged their right to disseminate materials presumably protected by the free speech clause. They also claimed violation of the due process clause in that the ordinances contained overly vague language and did not provide procedural safeguards. 373 F. Supp. at 365. However, the court of appeals did not discuss the merits of the due process challenges. American Mini Theatres, Inc. v. Gribbs, 518 F.2d 1014, 1019 (6th Cir. 1975), cert. granted, 44 U.S.L.W. 3234 (U.S. Oct. 21, 1975) (No. 75-312).

5. 373 F. Supp. at 371.

6. Only the ordinance's provision relating to the one thousand foot prohibition was before the court on appeal. 518 F.2d at 1021 n.2 (Celebrezze, J., dissenting).

7. See 8 E. McQuillin, Municipal Corporations § 25.02 (3d ed. 1965) [hereinafter cited as McQuillin].

8. 272 U.S. 365 (1926).

purposes of zoning[9] and concluded that the ordinance must find its justification in the legitimate exercise of the state's police power asserted for the general welfare.[10] The role of the courts in reviewing challenges to the constitutionality of such statutes is well settled,[11] and, in general, the scope of judicial review of zoning ordinances is limited.[12] If it is not clear that the zoning authorities abused their power or acted ultra vires, then the court will not superimpose its judgment on legislative discretion.[13]

Zoning ordinances, by their very nature, must delineate boundaries, make distinctions, and establish classifications. Since zoning laws are clearly subject to the limitations of the equal protection clause of the fourteenth amend-

9. Id. at 394. For additional purposes of zoning, see Buchanan v. Warley, 245 U.S. 60, 73-74 (1917); N.Y. Town Law § 263 (McKinney 1965); N.Y. Village Law § 7-704 (McKinney 1973); D. Hagman, Urban Planning and Land Development Control Law §§ 41-52 (1971); McQuillin, supra note 7, § 25.17; Note, Zoning: Permissible Purposes, 50 Colum. L. Rev. 202 (1950).

10. 272 U.S. at 387.

11. Under the general rule, zoning statutes or ordinances are presumed to be valid. E.g., City of Ann Arbor v. Northwest Park Constr. Corp., 280 F.2d 212, 223 (6th Cir. 1960). However, because zoning ordinances are in derogation of common-law property rights, they must be construed strictly against the municipality and in favor of the landowner's unrestricted use of his property. Gino's, Inc. v. City of Baltimore, 250 Md. 621, 643, 244 A.2d 218, 230 (1968); Thomson Indus., Inc. v. Incorporated Village of Port Washington N., 27 N.Y.2d 537, 539, 261 N.E.2d 260, 313 N.Y.S.2d 117 (1970); 440 E. 102nd St. Corp. v. Murdock, 285 N.Y. 298, 304, 34 N.E.2d 329, 331 (1941). See McQuillin, supra note 7, §§ 25.72-.73. An ordinance that totally prohibits a lawful enterprise will have to meet a higher standard of justification than one that merely regulates the location and operation of such an enterprise. Beaver Gasoline Co. v. Osborne Borough, 445 Pa. 571, 285 A.2d 501 (1971) (zoning ordinance which totally excluded particular business from the entire municipality must bear a more substantial relationship to the public health, safety, and welfare than an ordinance which merely confined that business to a certain area in the municipality). See McQuillin, supra note 7, § 25.119b. The provision of the Detroit ordinance which prohibited adult theatres and bookstores from locating within 500 feet of a single dwelling or rooming unit had the effect of an almost total ban on such uses. It was declared invalid by the district court because the city could not meet the higher standard of justification. Nortown Theatre Inc. v. Gribbs, 373 F. Supp. 363, 370 (1974), rev'd sub nom. American Mini Theatres, Inc. v. Gribbs, 518 F.2d 1014 (6th Cir. 1975), cert. granted, 44 U.S.L.W. 3234 (U.S. Oct. 21, 1975) (No. 75-312).

Enactment of zoning ordinances and regulations is best entrusted to local governments because of their familiarity with and proximity to local matters. "We recognize, of course, that zoning ordinances are matters within the peculiar knowledge, competency, and jurisdiction of local authorities." City of Miami v. Woolin, 387 F.2d 893, 894 (5th Cir. 1968). Cf. Gorieb v. Fox, 274 U.S. 603, 608 (1927). If the object is within the authority of the legislature, then the means by which it will be attained is also for the legislature to determine. See Berman v. Parker, 348 U.S. 26, 33 (1954).

12. Aquino v. Tobriner, 298 F.2d 674, 677 (D.C. Cir. 1961); Thomas v. Town of Bedford, 11 N.Y.2d 428, 433-34, 184 N.E.2d 285, 287, 230 N.Y.S.2d 684, 687 (1962).

13. Valley View Village, Inc. v. Proffett, 221 F.2d 412, 417 (6th Cir. 1955); see Williams v. Town of Oyster Bay, 32 N.Y.2d 78, 81, 295 N.E.2d 788, 790, 343 N.Y.S.2d 118, 121 (1973). "[W]hether that determination was an unreasonable, arbitrary or unequal exercise of power is fairly debatable. In such circumstances, the settled rule of this court is that it will not substitute its judgment for that of the legislative body charged with the primary duty and responsibility of determining the question." Zahn v. Board of Pub. Works, 274 U.S. 325, 328 (1927).

ment,[14] claims alleging unequal protection of the law inevitably arise as a result of such classification.[15]

In *Village of Belle Terre v. Boraas*[16] the Supreme Court upheld the validity of a zoning ordinance which restricted land use to one-family dwellings. The ordinance defined the word "family" as

"[O]ne or more persons related by blood, adoption, or marriage, living and cooking together as a single housekeeping unit, exclusive of household servants. A number of persons but not exceeding two (2) living and cooking together as a single housekeeping unit though not related by blood, adoption, or marriage shall be deemed to constitute a family."[17]

Affected by the ordinance were three tenants, unrelated to one another by blood, adoption, or marriage, who challenged the validity of the ordinance on the ground that it interfered with their right to travel and their rights of association and privacy. But the majority found that no fundamental rights were involved, and so they applied the rational relationship test.[18]

Similar questions have arisen in another context. In recent years many communities have attempted to check the tide of "fast-service" or "drive-in" restaurants. While many of the cases in this area were concerned with the question of whether a particular establishment was included within the zoning classification,[19] courts have upheld the special treatment of drive-in restaurants as reasonably related to the state's interest in the prevention of the noise, litter, congestion, patron misconduct, and similar problems characteristic of such establishments.[20] However, the courts still demand that the zoning

14. See, e.g., Village of Belle Terre v. Boraas, 416 U.S. 1 (1974); McQuillin, supra note 7, §§ 25.61, 25.122-.123; Tussman & tenBroek, The Equal Protection of the Laws, 37 Calif. L. Rev. 341 (1949); Comment, Equal Protection, 82 Harv. L. Rev. 1065 (1969).

15. "To decide whether a law violates the Equal Protection Clause, we look, in essence, to three things: the character of the classification in question; the individual interests affected by the classification; and the governmental interests asserted in support of the classification." Dunn v. Blumstein, 405 U.S. 330, 335 (1972). See also Weber v. Aetna Cas. & Sur. Co., 406 U.S. 164, 173 (1972).

16. 416 U.S. 1 (1974).

17. Id. at 2 (quoting statute). In Y.W.C.A. v. Board of Adjustment, 341 A.2d 356, 359-60 (N.J. Super. 1975) the court held that the board of adjustment could not distinguish between residents of group homes and natural families in determining which single-family district would be open to group homes. See also City of White Plains v. Ferraioli, 34 N.Y.2d 300, 305-06, 313 N.E.2d 756, 758, 357 N.Y.S.2d 449, 452-53 (1974).

18. 416 U.S. at 7-8. In a dissenting opinion, Mr. Justice Marshall viewed the classification as an unnecessary infringement of fundamental rights, and argued for the use of the test of close scrutiny and compelling state interest. Id. at 15 (Marshall, J., dissenting).

19. E.g., Burger King, Inc. v. Weisz, 444 S.W.2d 517 (Mo. App. 1969) (per curiam) (whether plaintiff's establishment was a "drive-in" restaurant); Vitolo v. Chave, 63 Misc. 2d 971, 314 N.Y.S.2d 51 (Sup. Ct. 1970) (whether public eating house was permitted under ordinance allowing restaurants other than drive-in restaurants). See also Annot., 82 A.L.R.2d 989 (1962).

20. Gino's, Inc. v. City of Baltimore, 250 Md. 621, 638, 244 A.2d 218, 227-28 (1968) (ordinance which required, before commencement of operation of eating establishment, the prior approval of the city council held valid); Morris v. Postma, 41 N.J. 354, 360-62, 196 A.2d 792, 796-97 (1964) (per curiam) (ordinance forbidding drive-in restaurants was validly enacted on basis

regulations not transgress "specific constitutional limitations,"[21] or deprive affected persons of their constitutional guarantees, regardless of the worth or urgency of the municipality's goal.[22]

The courts have permitted eating establishments, not properly classifiable as restaurants, under zoning ordinances allowing restaurants, tea rooms, parking lots and gas stations, when their operations were similar to and consistent with other permitted commercial uses in the area.[23] However, the mere fact that the zoning ordinance regulates or prohibits certain uses on the land or prevents the owner from obtaining the highest possible return on the land does not make the ordinance invalid.[24]

Because of the "preferred position" accorded to the right of free speech and other fundamental freedoms,[25] a statute challenged as an abridgment of these rights is not presumed valid, and the government must bear the burden of showing its constitutionality.[26] However, in the context of first amendment rights the Court has excluded some forms of expression, such as obscenity and libel, from the protection of the constitutional guarantee.[27]

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of bad experience with prior restaurant, notwithstanding the fact that plaintiff's application was submitted before enactment). See also Annot., 91 A.L.R.2d 572 (1963). For a discussion of the relationship between zoning laws and nuisance, see D. Hagman, Urban Planning and Land Development Control Law §§ 158-62 (1971); McQuillin, supra note 7, § 25.11.

21. Berman v. Parker, 348 U.S. 26, 32 (1954); see, e.g., Burger King Corp. v. Village of Larchmont, 173 N.Y.L.J., June 18, 1975, at 17, col. 5 (N.Y. Sup. Ct.) (amendment to zoning ordinance adopted while petitioner's application for a building permit was pending, which was designed to exclude petitioner's proposed use, held arbitrary and invalid); Staltac Associates v. Cohalan, 173 N.Y.L.J., March 28, 1975, at 16, col. 8 (N.Y. Sup. Ct.) (zoning ordinance prohibiting drive-in and carry-out restaurants held void for vagueness).

22. See Dunn v. Blumstein, 405 U.S. 330, 343 (1972); Buchanan v. Warley, 245 U.S. 60, 81 (1917).

23. E.g., Frost v. Village of Glen Ellyn, 30 Ill. 2d 241, 245-46, 195 N.E.2d 616, 619 (1964); Fryer v. Board of Zoning Adjustment, 359 Mo. 559, 562-63, 222 S.W.2d 761, 762 (1949) (per curiam); see Burger King Corp. v. Village of Larchmont, 173 N.Y.L.J., June 18, 1975, at 17, col. 5 (N.Y. Sup. Ct.).

24. City of St. Paul v. Chicago, St. P., M. & O. Ry., 413 F.2d 762, 767 (8th Cir.), cert. denied, 396 U.S. 985 (1969); Michaels v. Village of Franklin, 230 N.W.2d 273, 276 (Mich. App. 1975); Dauernheim, Inc. v. Town Bd., 33 N.Y.2d 468, 472, 310 N.E.2d 516, 518, 354 N.Y.S.2d 909, 913 (1974).

25. Saia v. New York, 334 U.S. 558, 562 (1948); see Palko v. Connecticut, 302 U.S. 319, 327 (1937), overruled on other grounds, Benton v. Maryland, 395 U.S. 784, 794 (1969).

26. Village of Belle Terre v. Boraas, 416 U.S. 1, 18 (1974) (Marshall, J., dissenting); Memorial Hosp. v. Maricopa County, 415 U.S. 250, 269 (1974); Speiser v. Randall, 357 U.S. 513, 525-26 (1958); Comment, Zoning, Aesthetics, and the First Amendment, 64 Colum. L. Rev. 81, 106 (1964). The landmark case of Near v. Minnesota, 283 U.S. 697 (1931), struck down a statute which imposed a prior restraint upon free speech. The state must carry a heavy burden to show a compelling or paramount governmental interest. For the Supreme Court's various characterizations of the quality of the governmental interest which must be shown, see United States v. O'Brien, 391 U.S. 367, 376-77 (1968).

27. E.g., Roth v. United States, 354 U.S. 476, 485 (1957) (obscenity); Beauharnais v. Illinois, 343 U.S. 250, 266 (1952) (libel); Breard v. Alexandria, 341 U.S. 622, 641-45 (1951) (commercial advertising); Chaplinsky v. New Hampshire, 315 U.S. 568, 571-72 (1942) (abusive epithets).

The courts have resorted to a balancing test when it is alleged that a statute infringes upon a fundamental right.[28] *American Mini Theatres* followed the guidelines enunciated in *United States v. O'Brien,*[29] where the Supreme Court upheld a conviction for the willful destruction of a Selective Service registration certificate, burned in protest against the war. When both "speech" and "nonspeech" elements are combined in the same course of action, a sufficiently important governmental interest (*i.e.* the smooth operation of the selective service system) in regulating the nonspeech element can justify an incidental limitation upon first amendment freedoms.[30] The Court also has allowed reasonable "time, place and manner" regulations necessary to further significant governmental interests,[31] but it has been much more critical of legislation that prohibited rather than merely regulated expression.[32]

The question in *American Mini Theatres* involved "a city zoning ordinance which classifies and regulates 'adult' movie theatres and bookstores solely on the basis of the content of the materials which they purvey."[33] Because the classification restrained conduct protected by the first amendment,[34] the city had to bear the heavy burden of showing that the classification was necessary to the furtherance of a compelling state interest and that its effect on protected rights was only incidental.[35]

Under the *O'Brien* test[36] both the majority and dissenting opinions agreed that the city had the power to license and zone businesses and to prohibit them from locating within certain areas, and that the city demonstrated its

28. Communist Party of the United States v. Subversive Activities Control Bd., 367 U.S. 1, 91 (1961); American Communications Ass'n v. Douds, 339 U.S. 382, 399-400 (1950).

29. 391 U.S. 367 (1968).

30. Id. at 376. "[W]e think it clear that a government regulation is sufficiently justified if it is within the constitutional power of the Government; if it furthers an important or substantial governmental interest; if the governmental interest is unrelated to the suppression of free expression; and if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest." Id. at 377.

31. Grayned v. City of Rockford, 408 U.S. 104, 115 (1972) (anti-noise ordinance prohibiting disturbances in the vicinity of a school building held constitutional); Police Dep't v. Mosley, 408 U.S. 92, 98 (1972) (ordinance prohibiting all picketing except peaceful labor picketing in the vicinity of a school held unconstitutional since it made impermissible distinction between peaceful labor picketing and other peaceful picketing); Cox v. New Hampshire, 312 U.S. 569, 576 (1941) (statute requiring license which fixed time and place for parade held constitutional).

32. See, e.g., Thornhill v. Alabama, 310 U.S. 88, 103-04 (1940) (absolute ban on peaceful picketing held invalid); Lovell v. City of Griffin, 303 U.S. 444, 450-51 (1938) (absolute ban on distribution of literature without first obtaining written permission held invalid). The district court in American Mini Theatres struck down the ordinance which prohibited the operation of certain businesses within 500 feet of any dwelling unit and recognized that the effect of such a prohibition was an almost total ban on such uses. See note 11 supra.

33. 518 F.2d at 1015; see note 4 supra and accompanying text.

34. The materials which the appellants purveyed had not been judicially declared obscene, 518 F.2d at 1019, and the city did not dispute that it was regulating matter presumably protected by the first amendment. Id. at 1018.

35. Id. at 1019-20.

36. See note 30 supra and accompanying text.

compelling interest in the preservation of its neighborhoods. The disagreement between the majority and the dissent, however, arose over the question of whether the ordinances "constitute a permissible means of achieving this end."[37]

The majority concluded that the city's interest in preserving its neighborhoods was not " 'unrelated to the suppression of free expression.' "[38] It relied upon *Police Department v. Mosley*[39] for the proposition that "government has no power to restrict expression because of its message, its ideas, its subject matter, or its contents."[40] There the city ordinance prohibited all picketing, except peaceful labor picketing, within 150 feet of any school during class hours. The Court held that it was impermissible to distinguish between labor picketing and other peaceful picketing; such a distinction, the Court reasoned, was based on the subject matter of the activity and was not neutral in regard to time, place and circumstance.[41] In this same context the court in *American Mini Theatres* distinguished *Grayned v. City of Rockford*,[42] where an ordinance prohibiting all disruptive noises or diversions near schools during class time was upheld as a reasonable "time, place and manner" regulation which was "narrowly tailored to further Rockford's compelling interest . . . and [which did] not unnecessarily interfere with First Amendment rights."[43]

American Mini Theatres declared that the Detroit ordinance was invalid under the equal protection clause because the ordinance was concerned with, and intended to control, the content of speech; it selected for special treatment particular establishments which would not have been affected under the general zoning provisions of the ordinance and classified them as regulated uses solely on the basis of the constitutionally protected materials which they supplied to the public.[44] Implicit in the majority's opinion was the belief that the governmental interest in regulating the conduct at issue arose because the *communication* integral to the conduct was considered harmful.[45] The court did not conclude, however, that the city could not try to prevent the deterioration of its neighborhoods; in fact it suggested that the city could require movie theatres and bookstores to operate only in certain areas or during certain hours.[46] But such legislation, the court reasoned, must provide

37. 518 F.2d at 1018.

38. Id. at 1023 (Celebrezze, J., dissenting, characterizing majority opinion).

39. 408 U.S. 92 (1972).

40. Id. at 95; see 518 F.2d at 1020.

41. 408 U.S. at 99.

42. 408 U.S. 104 (1972); see 518 F.2d at 1020.

43. 408 U.S. at 119. But the Grayned Court struck down as violative of the equal protection clause the anti-picketing ordinance which exempted the peaceful picketing of any school involved in a labor dispute. This ordinance was identical to the ordinance considered in Mosley. Id. at 107.

44. 518 F.2d at 1020-21.

45. Id. at 1018. While there was dispute as to whether actual property values had declined in areas in which the concentrations were located, still the plaintiffs did not rebut the city's arguments that the "quality of life" had declined and that the problems connected with the provision of municipal services had increased due to such concentrations. Id.

46. Id. at 1020. This conclusion indicates a failure to perceive that adult bookstores and

the equal protection of the law guaranteed by the fourteenth amendment.[47]

While the majority concentrated on the effect of the ordinances upon free speech, the dissent focused on the effect of the absence of such ordinances (and thus the presence of concentrations of adult businesses) upon the neighborhoods. The dissenting judge agreed with the district court that the ordinance's restriction was

'no greater than is essential to the furtherance of a legitimate governmental interest in preserving and stabilizing neighborhoods,' and that it imposed only a 'slight' and 'incidental' burden on First Amendment rights.[48]

He argued that the city was engaged not in regulating speech on the basis of its content, but in regulating "the right to locate a business based on the side-effects of its location."[49]

The dissent distinguished *Police Department v. Mosley*,[50] upon which the majority relied for its conclusion that regulation based on content was unconstitutional.[51] In *Mosley* the city's total prohibition, as opposed to mere regulation, of non-labor-related picketing near schools sought "to restrict expression because of its message, its ideas, its subject matter, or its content."[52] The dissent in *American Mini Theatres* argued that the zoning ordinance at issue was not an absolute ban on adult establishments, but rather a prohibition on their concentration.[53] The ordinance affected only new locations and left available numerous locations for the regulated uses, and so the burden on first amendment rights was slight. The purpose of the regulation, the dissent reasoned, was not to censor the "adult" materials, but to prevent the deterioration of neighborhoods caused by concentrations of the regulated businesses.[54]

It is not a control on the basis of content in which the City of Detroit is engaging. It is, instead, a justifiable distinction in neighborhood impact that underlies the differential treatment between adult and non-adult businesses. This amply distinguishes our case from *Mosley* . . . .[55]

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theatres have a clearly different impact upon the surrounding neighborhoods than do non-adult bookstores and theatres. The criterion for placing adult and non-adult businesses in different classes is the recognizable side effects of their locations, and this criterion is directly related to the state's demonstrated compelling interest. See Reed v. Reed, 404 U.S. 71, 75-76 (1971).

47. 518 F.2d at 1020-21; cf. Colorado Springs Amusements, Ltd. v. Rizzo, No. 75-1107 (3d Cir., Oct. 16, 1975) (ordinance which prohibited employees of licensed massage parlors from massaging anyone of the opposite sex held valid).

48. 518 F.2d at 1021 (Celebrezze, J., dissenting).

49. Id. at 1023.

50. 408 U.S. 92 (1972).

51. The dissent argued that the majority misinterpreted Mosley "to mean that no distinctions at all may be made between different categories of speech." 518 F.2d at 1023 n.4 (Celebrezze, J., dissenting); see text accompanying notes 39-41 supra.

52. Police Dep't v. Mosley, 408 U.S. 92, 95 (1972).

53. 518 F.2d at 1025 (Celebrezze, J., dissenting).

54. The majority recognized that the important element in determining the validity of legislation is the effect of the legislation, not its purpose or the motive behind its adoption. Id. at 1019.

55. Id. at 1024 (Celebrezze, J., dissenting).

The adult enterprises merely were regulated, and not prohibited. The public still had easy access to, and the publishers still had a convenient outlet for, adult materials. Thus the incidental restriction on free speech was no greater than was essential to achieve the city's compelling interest in preserving its neighborhoods.

The effect of the ordinance, therefore, is to prevent a concentration of adult businesses in any area of the City but not to stifle the flow of commerce between distributors and the public.[56]

It is submitted that the dissent convincingly undermined the majority's reasoning. The majority misconstrued *Mosley* as an absolute ban on all regulations based on content. *Mosley* is clearly distinguishable: it involved an absolute prohibition on picketing near schools, unless the picketing was labor-related. Moreover, in *Mosley* the city was unable to justify the differences in treatment given labor picketing as opposed to peaceful non-labor picketing.

In the instant case, the ordinance was a regulation—not a prohibition—of the location of adult entertainment businesses, which remained free to operate in numerous places within the city. Freedom of expression was affected only incidentally. The ordinance was concerned only with new locations, and so at most, the inconvenience to the public was limited to not having clusters of such businesses near at hand. The flow of constitutionally protected material from distributors to the public was hardly slowed; the regulation inherent in the ordinance principally affected the businessman's economic right to operate an enterprise wherever he wanted. In fact, a restriction on concentrations of adult businesses is even less intrusive on personal rights than the zoning ordinances which totally exclude such commercial uses from residential areas.[57] The purpose of the city ordinance was not to restrict expression because of its content or subject matter, but to control the deterioration of neighborhoods by restricting the location of businesses which have been shown to have an adverse effect on the community.[58] Detroit's ordinance was narrowly tailored, and the incidental restriction on free speech was no greater than was essential to the furtherance of the compelling governmental interest.

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56. Id. at 1025. The ordinance also contained a provision whereby "waiver of the limitation can be obtained upon proof that a business's entry into a neighborhood will not have the effect the ordinance was designed to prevent." Id. at 1021.

57. Clearly, plaintiffs would be unable to claim that they could lawfully operate a theatre or bookstore in a residentially zoned area.

58. Speaking about regulation of obscenity one commentator has stated: "The problem is no different from that raised by the physical environment, or by indecent exposure, by boisterous drunkenness, rampant prostitution, or public lovemaking. . . . [T]he same Supreme Court which decreed virtually unlimited permissiveness with regard to obscenity has not construed the Constitution so as to forbid the placing of legal restraints on architectural designs, for example, or on indecencies of public behavior. . . . The assigned reason is that the First Amendment throws special safeguards around speech and other forms of communication, which are relevant to obscenity, but does not protect conduct. The point is absurd. There is no bright line between communication and conduct. What is a live sex show—communication or conduct?" A. Bickel, The Morality of Consent 74 (1975); see id. at 73-75.

Federal Courts—Federal Common Law Created to Allow Survival of Section 1983 Action to Decedent's Executor.—In 1967, Jim Garrison, then District Attorney of Orleans Parish, Louisiana, arrested Clay L. Shaw for conspiracy to assassinate President John F. Kennedy. In 1969, Shaw was acquitted of the charges. On the first working day after the jury verdict, Garrison charged Shaw with two counts of perjury. Shaw sought, and was granted, a permanent injunction against Garrison from further prosecution of the perjury charges on the grounds that they were initiated in bad faith.[1] Shaw then filed a complaint against Garrison and others[2] for alleged deprivation of civil rights, pursuant to section 1983.[3] In August 1974, three months before the case came to trial, Shaw died and was not survived by any close relatives.

The district court permitted the executor of Shaw's will to be substituted as plaintiff, pursuant to rule 25(a)(1) of the Federal Rules of Civil Procedure.[4] Defendants objected to the substitution and moved to dismiss the complaint because the applicable Louisiana statute provided only for survival actions maintained by relatives.[5] The court, having examined the Louisiana statutes,[6] federal statutory law,[7] and traditional common law,[8] found that the cause of action would not survive. Nevertheless, the court held that a federal common

1. Shaw v. Garrison, 328 F. Supp. 390, 399-400 (E.D. La. 1971), aff'd, 467 F.2d 113 (5th Cir.), cert. denied, 409 U.S. 1024 (1972).

2. Shaw alleged that defendants Rault, Shilstone and Robertson conspired with Garrison for their "personal and political aggrandizement." Shaw v. Garrison, 391 F. Supp. 1353, 1357 (E.D. La. 1975). Shaw also claimed that defendant Dr. Fatter hypnotized defendant Russo, Garrison's key witness (for the criminal trial), to make him testify against Shaw. Id. at 1358.

3. 42 U.S.C. § 1983 (1970) provides that: "Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress."

Shaw also claimed a violation of rights under the Civil Rights Act of 1871, 42 U.S.C. § 1985 (civil action against conspirators who deny to any citizen the equal protection of the laws) & § 1986 (survival of section 1985 action to a legal representative of deceased, but not in excess of 5000 dollars damages) (1970). The court dismissed both claims against defendants because there was no racial or class-based discrimination and the alleged conspiracy occurred in state, not federal, court. 391 F. Supp. at 1369-70.

4. Fed. R. Civ. P. 25(a)(1) provides in pertinent part: "If a party dies and the claim is not thereby extinguished, the court may order substitution of the proper parties."

5. The Louisiana survival statute provides for survival of personal injury actions to only parents, spouse, children or siblings of the deceased. La. Civ. Code Ann. art. 2315 (West 1971); La. Code Civ. Pro. Ann. art. 428 (West 1960); id. art. 801 (West Supp. 1975).

6. 391 F. Supp. at 1361-63. Only suits for damages to property may be inherited by the legal representative. La. Civ. Code Ann. art. 2315 (West 1971). Shaw's executor argued that the action was for damages to the estate, but the court was not persuaded. 391 F. Supp. at 1362.

7. Upon examination, the court found that "[t]here is no general federal statutory law of survival governing civil rights actions." 391 F. Supp. at 1359.

8. "[T]he old common law provided that all actions abate upon the death of the parties . . . ." Id. at 1367; see W. Prosser, Torts § 126 (4th ed. 1971).

law of survival was necessary to effectuate the broad remedial goals of the federal civil rights laws. The court concluded: "[F]ederal common law requires that this pending action survive in favor of the executor of decedent's last will."[9] *Shaw v. Garrison,* 391 F. Supp. 1353 (E.D. La. 1975).

The mere substitution of a party for the deceased generally is considered procedural.[10] In *Hanna v. Plumer,*[11] the Supreme Court held that where state and federal procedural rules conflict, the state rule will not override the federal one. The Court reasoned that the *Erie* principle[12] requiring the use of state law in federal courts had no applicability to the validity of a federal procedural rule.[13] In *Iovino v. Waterson,*[14] the Second Circuit substituted an administratrix pursuant to rule 25(a)(1), notwithstanding a contrary state practice. The court pointed out that:

> the only substantive rights here are those created by the Virginia law of torts and recognized by the New York law of conflict of laws. Hence steps relating to the enforcement of these rights in New York . . . would be not substantive but procedural.[15]

Since rule 25(a)(1) permitted the substitution of personal representatives of non-resident decedents, the court held that Congress had the "power to establish uniform rules . . . for the Federal courts 'in all suits of a civil nature' including those based on diversity of citizenship . . . ."[16] and thus contravene state law.

However, rule 25(a)(1) would probably not have been held to supersede state law in *Shaw* because decisions subsequent to *Iovino* have held that, while the method of substitution is procedural, the question of whether any

9. 391 F. Supp. at 1356.

10. "The question of substitution of parties is procedural, recognized by the rules as such, and not controlled or governed by local law." Jones v. Schellenberger, 196 F.2d 852, 854 (7th Cir.), cert. denied, 344 U.S. 876 (1952).

The Federal Rules of Civil Procedure are intended to govern the procedure in federal courts. 28 U.S.C. § 2072 (1970) provides in pertinent part: "All laws in conflict with [the Federal Rules of Civil Procedure] shall be of no further force or effect after such rules have taken effect." See Hanna v. Plumer, 380 U.S. 460, 472-73 (1965) (rule 4(d)(1)); Schlagenhauf v. Holder, 379 U.S. 104, 114 (1964) (rule 35); Sylvestri v. Warner & Swasey Co., 398 F.2d 598, 606 (2d Cir. 1968) (rule 3).

11. 380 U.S. 460 (1965).

12. Erie R.R. v. Tompkins, 304 U.S. 64 (1938); see text accompanying note 35 infra.

13. 380 U.S. at 469-70. The Court said: "To hold that a Federal Rule of Civil Procedure must cease to function whenever it alters the mode of enforcing state-created rights would be to disembowel either the Constitution's grant of power over federal procedure or Congress' attempt to exercise the power in the Enabling Act." Id. at 473-74.

14. 274 F.2d 41 (2d Cir. 1959), cert. denied, 362 U.S. 949 (1960). In Iovino, the non-resident defendant died before plaintiffs served their complaint on defendant's attorney. The attorney accepted service but did not mention defendant's death. Three years later, plaintiffs learned of the death and moved to substitute the decedent's administratrix as defendant. The New York statute did not provide for substitution of personal representatives of non-resident decedents.

15. Id. at 46.

16. Id. at 48. The court based its conclusion on Article III and the necessary and proper clause of the Constitution. Id.

claim existed after decedent's death is substantive.[17] Even though the court in *Shaw* did not address itself to the apparent conflict between rule 25(a)(1) and the Louisiana survival statutes, it approached the substantive question by looking to state law which held that a personal injury action such as Shaw's abated upon death.[18]

The court began its analysis of whether the action should abate with a consideration of the federal civil rights statutes, sections 1983 and 1988.[19] Section 1988[20] provides that district courts may use state law in cases brought under the Civil Rights Acts, if the federal statutory law is deficient in furnishing suitable remedies. The court, relying principally on the Fifth Circuit's decision in *Brazier v. Cherry*,[21] determined that the failure to provide for survival in civil rights actions was precisely such a deficiency.[22] In *Brazier*, a widow was permitted to bring an action for decedent's claims against various police officers for allegedly beating her husband to death. Since the federal statutes made no reference to survival, the Fifth Circuit adopted Georgia state law pursuant to section 1988.[23]

The court in *Shaw* faced a different situation, however, because Louisiana law did not provide for survival of the action.[24] Defendants argued that the court should adopt the law of the forum state.[25] But the court pointed out

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17. Ransom v. Brennan, 437 F.2d 513, 520 (5th Cir.), cert. denied, 403 U.S. 904 (1971); Pritchard v. Smith, 289 F.2d 153, 157 (8th Cir. 1961); McManus v. Lykes Bros. S.S. Co., 275 F. Supp. 361, 364 (E.D. La. 1967); 3B J. Moore, Federal Practice ¶ 25.04 (2d ed. 1975).

18. 391 F. Supp. at 1361-63; see Austrum v. City of Baton Rouge, 282 So. 2d 434, 439 (La. 1973); J. Wilton Jones Co. v. Liberty Mut. Ins. Co., 248 So. 2d 878, 891 (La. Ct. App. 1970).

19. 42 U.S.C. §§ 1983, 1988 (1970).

20. Section 1988 provides in pertinent part: "The jurisdiction in civil . . . matters conferred on the district courts . . . for the protection of all persons in the United States in their civil rights, and for their vindication, shall be exercised and enforced in conformity with the laws of the United States, so far as such laws are suitable to carry the same into effect; but in all cases where they are not adapted to the object, or are deficient in the provisions necessary to furnish suitable remedies . . . the common law, as modified and changed by the constitution and statutes of the State wherein the court having jurisdiction of such civil . . . cause is held, so far as the same is not inconsistent with the Constitution and laws of the United States, shall be extended to and govern the said courts in the trial and disposition of the cause . . . ." Id. § 1988 (1970).

21. 293 F.2d 401 (5th Cir.), cert. denied, 368 U.S. 921 (1961). Several of the other cases cited by the Shaw court to illustrate that the lack of survival provisions in federal law was a deficiency in the civil rights laws also reflected an attempt on the part of the courts to preserve section 1983 actions through the use of section 1988. See Pritchard v. Smith, 289 F.2d 153, 157 (8th Cir. 1961) (civil rights action for damages survives against administrator of defendant's estate); Holmes v. Silver Cross Hosp., 340 F. Supp. 125, 129 (N.D. Ill. 1972) (civil rights action for blood transfusion wrongfully given to decedent survived to his personal representative); Perkins v. Salafia, 338 F. Supp. 1325, 1327 (D. Conn. 1972) (civil rights action for death of son by gunshot from state police officers survived to mother as administratrix).

22. 391 F. Supp. at 1358-61.

23. 293 F.2d at 409.

24. 391 F. Supp. at 1363.

25. The court recognized that the defendants' argument was "not without some support in the case law and in the language of § 1988 itself." Id. at 1365. However, the court concluded that "this result was not intended by Congress, is not commanded by the holding of any case binding

that the purpose of section 1988 was to compensate for any deficiency under the federal civil rights laws.[26] In cases where state law provided for survival, the court found that the adoption of state law merely remedied the deficiency.[27] But where, as here, state law provided no remedy, no purpose would be served in applying it. The court stated:

> It is undeniable that federal courts are directed by [section] 1988 to look to state law to provide relief where the federal statute is deficient. But [section] 1988 nowhere states that the federal court is bound by an inhospitable state law.[28]

In support of its conclusion, the court stressed language in section 1988 that state law was not to be applied if it were inconsistent with the purpose of the statute.[29] The court found the Louisiana practice of permitting survival of the action only for certain classes of close relatives inconsistent with federal civil rights laws.[30] It concluded, therefore, that "[section] 1988 [was] inapplicable because the state law [was] not 'suitable to carry the [federal] law into effect.' "[31] In *Brazier,* the Fifth Circuit also had addressed the problem:

> From a federal standpoint the only limitation upon the use of such adoptive state legislation, rule or decision is that it is suitable to carry the law into effect because other available direct federal legislation is not adapted to that object or is deficient in furnishing a fully effective redress.[32]

After determining that section 1988 did not require adoption of state law, the court in *Shaw* considered "whether [the] action survive[d] in favor of decedent's personal representative as a matter of federal common law."[33] In *Erie Railroad Co. v. Tompkins,*[34] Justice Brandeis, writing for the Court, concluded that: "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State

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on us, and, most importantly, is contrary to the broad remedial purposes underlying the federal civil rights laws." Id.

26. Id. at 1358-60.

27. Id. at 1360-61.

28. Id. at 1366.

29. "Under the terms of the statute, the state law is 'inconsistent with . . . the laws of the United States' because such law does not provide for survival necessitated by the policies behind the civil rights statutes, and thus need not be applied." Id.; see note 20 supra.

30. 391 F. Supp. at 1364. The court noted that every other state in the Union provides that actions which do not otherwise abate survive to legal representatives. E.g., Cal. Prob. Code § 573 (West Supp. 1975); Conn. Gen. Stat. Ann. § 52-599 (1960); Mass. Ann. Laws ch. 228, §§ 1, 4 (1974); N.J. Stat. Ann. § 2A:15-3 (Supp. 1975); id. § 2A:15-4 (1952); N.Y. Est., Powers & Trusts Law § 11-3.2 (McKinney 1967); Tex. Rev. Civ. Stat. art. 4676 (1952); id. art. 5525 (1958).

31. 391 F. Supp. at 1366; see Moor v. County of Alameda, 411 U.S. 693, 709-10 (1973) (Court held section 1988 inapplicable for the purposes of adopting the state cause of action that provided for municipal liability because it found that Congress intended to exclude such liability in the civil rights acts). In Basista v. Weir, 340 F.2d 74 (3d Cir. 1965), the court adopted a federal common law of damages contrary to the state law by determining that section 1988 was inapplicable because the federal law was not deficient. Id. at 86.

32. 293 F.2d at 409.

33. 391 F. Supp. at 1365.

34. 304 U.S. 64 (1938).

. . . . There is no federal general common law."[35] But even on the same day that *Erie* was decided, Justice Brandeis wrote another opinion in which he stated: "[W]hether the water of an interstate stream must be apportioned between the two States is a question of 'federal common law' upon which neither the statutes nor the decisions of either State can be conclusive."[36]

The original distinction between these two decisions—*Erie* was a diversity case while the latter dealt with a federal question—is no longer a clear one, since the *Erie* principle has been applied to federal question cases[37] and federal common law has been used in diversity cases.[38] Nonetheless, whether or not *Erie* governs only diversity actions in federal court, federal common law quite clearly exists, although it may be termed "independent federal judicial decision,"[39] or new,[40] specialized,[41] or true national common law.[42] Moreover, the scope of federal common law has expanded.[43]

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35. Id. at 78; see Friendly, In Praise of Erie—and of the New Federal Common Law, 39 N.Y.U.L. Rev. 383, 405-08 (1964).

36. Hinderlider v. La Plata River & Cherry Creek Ditch Co., 304 U.S. 92, 110 (1938).

37. Wichita Royalty Co. v. City Nat'l Bank, 306 U.S. 103, 106-17 (1939) (Texas law applied to suit between national bank and Texas bank); Maternally Yours, Inc. v. Your Maternity Shop, Inc., 234 F.2d 538, 540-41 n.1 (2d Cir. 1956) (trademark infringement); see 1A J. Moore, Federal Practice ¶ 0.305[3] (2d ed. 1974); Friendly, In Praise of Erie—and of the New Federal Common Law, 39 N.Y.U.L. Rev. 383, 408-09 n.122 (1974).

38. E.g., Francis v. Southern Pac. Co., 333 U.S. 445 (1948) (federal law of negligence controls wrongful death action based on diversity jurisdiction); Sola Elec. Co. v. Jefferson Elec. Co., 317 U.S. 173 (1942) (diversity action in which estoppel of licensee was question of federal law); American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 292 F.2d 640, 643-44 (9th Cir. 1961) (federal common law governs in diversity action by subcontractor against government contractor); see Note, The Competence of Federal Courts to Formulate Rules of Decision, 77 Harv. L. Rev. 1084, 1087-88 (1964).

39. "[T]here remains what may be termed, for want of a better label, an area of 'federal common law' or perhaps more accurately 'law of independent federal judicial decision,' outside the constitutional realm, untouched by the Erie decision." United States v. Standard Oil Co., 332 U.S. 301, 308 (1947) (whether United States may recover expenses for injured soldier from tortfeasor is question of federal law).

There is some ambiguity in the use of the term federal common law. See H. Hart & H. Wechsler, The Federal Courts and the Federal System 770 (2d ed. 1973); notes 22-24 infra. For purposes of this discussion, the term is used in the context of the federal nonstatutory law applied after Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

40. Friendly, In Praise of Erie—and of the New Federal Common Law, 39 N.Y.U.L. Rev. 383, 422 (1964); Note, The Federal Common Law, 82 Harv. L. Rev. 1512 (1969).

41. Federal common law may be called specialized in the sense that it is not general. "The federal courts have no general common law, as in a sense they have no general or comprehensive jurisprudence of any kind . . . . But this is not to say that wherever we have occasion to decide a federal question which cannot be answered from federal statutes alone we may not resort to all of the source materials of the common law, or that when we have fashioned an answer it does not become a part of the federal non-statutory or common law." D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 469 (1942) (Jackson, J., concurring) (emphasis omitted); see Friendly, In Praise of Erie—and of the New Federal Common Law, 39 N.Y.U.L. Rev. 383, 405 (1964).

42. Keeffe, In Praise of Joseph Story, Swift v. Tyson and "The" True National Common Law, 18 Am. U.L. Rev. 316 (1969).

43. See, e.g., United States v. Little Lake Misere Land Co., 412 U.S. 580 (1973) (federal

The reasons given for the finding of federal common law are varied.[44] The need for nationwide uniformity is an important consideration in suits between states.[45] In areas such as bankruptcy[46] and admiralty,[47] the Constitution has been held to provide the basis for federal preemption of state law. The federal courts also created federal common law to interpret certain statutes,[48] to effect the congressional intent of statutes[49] or to protect interests created by

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common law governs mineral rights of federal government); Illinois v. City of Milwaukee, 406 U.S. 91 (1972) (federal common law governs interstate pollution); Moragne v. States Marine Lines, Inc., 398 U.S. 375 (1970) (federal nonstatutory maritime law permits cause of action for wrongful death); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964) ("act of state" doctrine recognizing validity of sovereign acts of foreign country is matter of federal law); Textile Workers v. Lincoln Mills, 353 U.S. 448 (1957) (federal common law governs collective bargaining agreements); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943) (federal common law controls suits of negotiable instruments issued by United States); Hall v. Wooten, 506 F.2d 564 (6th Cir. 1974) (federal common law permits survival of section 1983 claim); United States v. Albrecht, 496 F.2d 906 (8th Cir. 1974) (federal common law governs protection of wildlife production areas); United States v. Hext, 444 F.2d 804 (5th Cir. 1971) (federal common law applied in Farmer's Home Administration loan program); City Fed. Sav. & Loan Ass'n v. Crowley, 393 F. Supp. 644 (E.D. Wis. 1975) (federal common law governs internal management of federal savings and loan associations). See generally H. Hart & H. Wechsler, The Federal Courts and the Federal System 756-832 (2d ed. 1973); C. Wright, Law of Federal Courts § 60 (2d ed. 1970); Note, The Federal Common Law, 82 Harv. L. Rev. 1512 (1969).

44. See, e.g., Hill, The Law-Making Power of the Federal Courts: Constitutional Preemption, 67 Colum. L. Rev. 1024, 1026-30 (1967); Comment, The Invalid Growth of the New Federal Common Law Dictates the Need for a Second Erie, 9 Houston L. Rev. 329, 347 (1971); Note, The Federal Common Law, 82 Harv. L. Rev. 1512, 1519-26 (1969); Note, Federal Common Law and Article III: A Jurisdictional Approach to Erie, 74 Yale L.J. 325, 327 (1964).

45. Texas v. New Jersey, 379 U.S. 674, 678 (1965) (interstate escheat dispute); West Virginia ex rel. Dyer v. Sims, 341 U.S. 22, 28-29 (1951) (interstate compact); see Illinois v. City of Milwaukee, 406 U.S. 91 (1972) (interstate pollution); Connecticut v. Massachusetts, 282 U.S. 660, 670-71 (1931) (apportionment of interstate stream).

46. "Nothing decided in Erie R. Co. v. Tompkins . . . requires a court of bankruptcy to apply . . . a local rule governing the liquidation of insolvent estates. . . . The court of bankruptcy is a court of equity . . . and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class." Prudence Realization Corp. v. Geist, 316 U.S. 89, 95 (1942); see Hill, The Erie Doctrine in Bankruptcy, 66 Harv. L. Rev. 1013, 1036-38 (1953).

47. Pope & Talbot, Inc. v. Hawn, 346 U.S. 406, 409-10 (1953); Garrett v. Moore-McCormack Co., 317 U.S. 239, 244 (1942); Chelentis v. Luckenbach S.S. Co., 247 U.S. 372, 382 (1918); Southern Pac. Co. v. Jensen, 244 U.S. 205, 214-15 (1917).

48. E.g., Clearfield Trust Co. v. United States, 318 U.S. 363, 366 (1943).

49. E.g., Textile Workers v. Lincoln Mills, 353 U.S. 448, 456 (1957). Into this category would also fall cases implying federal common law from jurisdictional grants and implying federal remedies from federal statutes. E.g., Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics, 403 U.S. 388 (1971) (federal cause of action against federal officers implied from fourth amendment); J.I. Case Co. v. Borak, 377 U.S. 426 (1964) (federal cause of action for damages implied from violation of Securities Exchange Act); Ivy Broadcasting Co. v. ATT, 391 F.2d 486 (2d Cir. 1968) (federal common law provides tort and contract remedies against

the statutes.[50] However, the court in *Shaw* assumed, without discussion, the existence of federal common law that allowed it to create a right of survival in civil rights actions.

In order to determine the federal common law, the court in *Shaw* looked to civil rights cases where federal courts provided relief even when the federal statute did not so provide.[51] In *Sullivan v. Little Hunting Park, Inc.*,[52] a homeowner sued for damages under the civil rights statute providing for equal housing rights.[53] The statute did not provide for damages but the Supreme Court held that they were a proper remedy. The Court, however, relied on section 1988 stating that "both federal and state rules on damages may be utilized, whichever better serves the policies expressed in the federal statutes."[54] The Court did not consider the problem that would arise should a state statute not grant any relief. The other case relied upon by the *Shaw* court, *Bell v. Hood,*[55] can also be distinguished from *Shaw*. In *Bell,* plaintiff sued for damages for violation of his fourth and fifth amendment rights by federal officers. The Supreme Court held that the district court had jurisdiction over the case although no federal statute specifically provided for jurisdiction. If the Court had not so held, the suit could probably not have been brought at all since the state forum would have been inappropriate to litigate a federal right against federal officers.[56] But in *Shaw,* the problem was not whether a cause of action for damages existed but whether such cause of action survived.

Finally, the court in *Shaw* found its strongest authority in a unanimous Supreme Court decision that granted relief in the absence of federal and state authority. In *Moragne v. States Marine Lines, Inc.*,[57] a widow, in a wrongful death action, charged the shipowners with maintaining an unseaworthy vessel. Notwithstanding the fact that neither federal maritime law nor Florida statutes recognized a wrongful death action based on the unseaworthiness of a ship,[58] the Supreme Court found that a cause of action did lie.[59] As the court in *Moragne* found no impediment to the creation of a federal common law of wrongful death, so the court in *Shaw* found "no impediment to the creation of

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interstate telephone company); Note, Implying Civil Remedies from Federal Regulatory Statutes, 77 Harv. L. Rev. 285 (1963).

50. E.g., Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 426 (1964).

51. 391 F. Supp. at 1366-67.

52. 396 U.S. 229 (1969).

53. 42 U.S.C. § 1982 (1970).

54. 396 U.S. at 240.

55. 327 U.S. 678 (1946).

56. See Bivens v. Six Unknown Named Agents of Fed. Bureau of Narcotics, 403 U.S. 388, 390-95 (1971); Bell v. Hood, 327 U.S. 678, 683-84 (1946); Dellinger, Of Rights and Remedies: The Constitution as a Sword, 85 Harv. L. Rev. 1532, 1534-37 (1972).

57. 398 U.S. 375 (1970).

58. Id. at 376-77.

59. Id. at 409. In an earlier case, the Supreme Court had held that a wrongful death action based on negligence did not lie under general maritime law. The Harrisburg, 119 U.S. 199 (1886), overruled, Moragne v. States Marine Lines, Inc., 398 U.S. 375 (1970).

a federal common law of survival in civil rights actions in favor of the personal representative of the deceased."[60]

Moragne, however, was a wrongful death action in admiralty,[61] brought by designated beneficiaries for their pecuniary loss resulting from the death of another.[62] On the other hand, a survival statute or rule (the question presented in *Shaw*) preserves the claims that the decedent had prior to death but does not create a new cause of action.[63] In *Moragne,* therefore, the question was whether the alleged cause of action existed, while in *Shaw* the question was whether the alleged cause of action had abated. Moreover, the law of admiralty reflects a congressional concern for the dependent position of the seaman.[64] The legislative concern in civil rights acts, however, does not reflect a concern with such a dependent relationship.[65] Nonetheless, the court in *Shaw* found that "*Moragne* stands for the proposition that creation of . . . remedies is not limited to statutory law."[66]

Thus, it relied upon the broad remedial purposes underlying the federal civil rights laws to find that a federal common law right of survival could be created.[67] By creating this remedy, the court may have been filling an interstice in the federal civil rights statutes.[68] The plaintiff would otherwise

60. 391 F. Supp. at 1368.

61. See note 47 supra and accompanying text.

62. See 2 F. Harper & F. James, Torts § 24.2, at 1285-86 (1956); W. Prosser, Torts § 127, at 902 (4th ed. 1971).

63. See 2 F. Harper & F. James, Torts § 24.2, at 1287 (1956). The court in Shaw recognized the difference between wrongful death and survival actions while discussing the Louisiana policy of limiting classes of beneficiaries. 391 F. Supp. at 1364.

64. "The character of seamen and the nature of their employment have induced Congress to provide specially for the collection of their demands. Seamen have always been considered as wards of the admiralty." 4 E. Benedict, American Admiralty § 621, at 282 (6th ed. 1940); see In re Cambria S.S. Co., 505 F.2d 517, 523 (6th Cir. 1974), cert. denied, 420 U.S. 975 (1975); Hudspeth v. Atlantic & Gulf Stevedores, Inc., 266 F. Supp. 937, 941 (E.D. La. 1967).

65. The protection afforded by the civil rights acts deals with constitutional rights of United States citizens, particularly blacks. The distinction in legislative concern between seamen and blacks is that the former are deemed not able to take care of themselves whereas the latter may be prevented from doing so because of state action. "It is abundantly clear that one reason the legislation was passed was to afford a federal right in federal courts because, by reason of prejudice, passion, neglect, intolerance or otherwise, state laws might not be enforced and the claims of citizens to the enjoyment of rights, privileges, and immunities guaranteed by the Fourteenth Amendment might be denied by the state agencies." Monroe v. Pape, 365 U.S. 167, 180 (1961); see McCormack, Federalism and Section 1983: Limitations on Judicial Enforcement of Constitutional Protections, Part I, 60 Va. L. Rev. 1, 2-7 (1974); Nahmod, Section 1983 and the "Background" of Tort Liability, 50 Ind. L.J. 5, 8 (1974); Note, Limiting the Section 1983 Action in the Wake of Monroe v. Pape, 82 Harv. L. Rev. 1486, 1491-95 (1969).

An additional distinction is that federal maritime law applies regardless of state statute. G. Gilmore & C. Black, Admiralty 48-51 (2d ed. 1975); see, e.g., Roberson v. N.V. Stoomvaart Maatschappij, 507 F.2d 994 (5th Cir. 1975) (admiralty suit not dismissed even though substitution was not effected within the time limitations set forth by the Louisiana survival statute).

66. 391 F. Supp. at 1368.

67. Id.

68. One of the grounds for justifying the creation of federal common law is the fact that

have been without a remedy. It may be asked, however, whether the remedial policies of section 1983 are served by allowing survival of the action in this case. Since Shaw did not have any close relatives,[69] the party compensated would be far removed from the injured party. Nevertheless, the court was confronted with a situation where the plaintiff was without a remedy under both federal and state law. The court's decision may be viewed as a response to this quandary.

Finally, it is suggested that the court's decision was motivated by what it considered to be "undoubtedly one of the most bizarre episodes in American *political* and *legal* history."[70] The court noted that "Shaw surely deserves an opportunity to have his day in court and attempt to clear his name, if only posthumously."[71] Since Louisiana law denied Shaw this opportunity, the court found that it should not be applied.[72] Thus, because of this emphasis, the court's decision may be regarded as unique.

Sylvia Fung Chin

Securities—Second Circuit Clarifies the Extraterritorial Application of American Securities Laws.—When Congress passed the Securities Exchange Act of 1934,[1] it is doubtful that consideration was given to whether the protection of the Act was to extend to foreign investors.[2] With the recent increase of international activity in the securities markets, transactions affecting more than one country have become commonplace. As a result, questions have arisen as to whether, and to what extent, the securities laws of the United States should be given extraterritorial application.[3] The following

federal statutory law is by nature incomplete. "Federal law is generally interstitial in its nature. It rarely occupies a legal field completely, totally excluding all participation by the legal systems of the states. This was plainly true in the beginning when the federal legislative product (including the Constitution) was extremely small. It is significantly true today, despite the volume of Congressional enactments, and even within areas where Congress has been very active. Federal legislation, on the whole, has been conceived and drafted on an ad hoc basis to accomplish limited objectives. It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose. Congress acts, in short, against the background of the total corpus juris of the states in much the way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation." H. Hart & H. Wechsler, The Federal Courts and the Federal System 470-71 (2d ed. 1973).

69. See text accompanying notes 4 & 5 supra.

70. 391 F. Supp. at 1355 (emphasis added).

71. Id. at 1365.

72. Id.

1. 15 U.S.C. § 78a-hh (1970).

2. "The Congress that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of off-shore funds thirty years later." Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir. 1975).

3. "Extraterritorial application" is the application of the Act "to persons or events linked with other countries as well as the United States." H. Steiner & D. Vagts, Transnational Legal Problems 828 (1968).

discussion will examine the general principles underlying extraterritorial applicability particularly in view of two recent decisions in the Second Circuit, *IIT v. Vencap, Ltd.*,[4] and *Bersch v. Drexel Firestone, Inc.*[5]

A state has the power to produce legislation governing conduct within its territory and therefore has jurisdiction over such conduct.[6] Further, unless intent to the contrary clearly appears, all such legislation is presumed to apply *only* within the territory.[7] Only in the absence of express statutory language defining the intended reach of the statute in question should principles of international law come into play. With the development of modern communication and transportation facilities, the constituent elements of criminal conduct may now take place in more than one state. To deal with this situation, this territorial principle has been expanded by two conversely-related principles.[8]

The subjective territorial principle gives a state jurisdiction over conduct within its territory, whether or not the effects of the conduct are felt within its boundaries.[9] Thus a state has jurisdiction to prosecute and punish an individual for a crime which is commenced within the state but completed beyond the state's borders.[10] Although previous cases had afforded the opportunity for using the subjective territorial principle as a basis for applying the securities laws extraterritorially,[11] *Leasco Data Processing Equipment Corp. v. Maxwell*[12] was the first case to use conduct within the United States as the basis for asserting jurisdiction over a foreign securities transaction.

The state in which the effect occurs may also assert jurisdiction, based on the objective territorial principle. This principle gives a state power to

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4. 519 F.2d 1001 (2d Cir. 1975).

5. 519 F.2d 974 (2d Cir. 1975).

6. Restatement (Second) of Foreign Relations Law of the United States §§ 10(a), 17(a) (1965); Committee on International Law, Report, 21 Record of N.Y.C.B.A. 240, 244-45 (1966); Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 445, 480-84 (Supp. 1935).

7. Blackmer v. United States, 284 U.S. 421, 437 (1932); see McCulloch v. Sociedad Nacional, 372 U.S. 10 (1963).

8. Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 484-94 (Supp. 1935).

9. Restatement (Second) of Foreign Relations Law of the United States § 17(a), comment a at 45 (1965); Committee on International Law, Report, 21 Record of N.Y.C.B.A. 240, 245 (1966); Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 484-87 (Supp. 1935).

10. Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 484 (Supp. 1935).

11. Both Ferraioli v. Cantor, 259 F. Supp. 842 (S.D.N.Y. 1966), and SEC v. Gulf Intercontinental Fin. Corp., 223 F. Supp. 987 (S.D. Fla. 1963), involved conduct which took place partly in the United States and partly in a foreign country. In each case the court was of the opinion that the conduct within the United States, which was inseparable from the foreign conduct, was the basis for asserting jurisdiction based on the traditional territorial principle. 259 F. Supp. at 846; 223 F. Supp. at 994.

12. 468 F.2d 1326 (2d Cir. 1972), discussed in text accompanying notes 33-43 infra.

regulate conduct outside its territory which produces an effect within it.[13] A state therefore has jurisdiction to prosecute and punish an individual for a crime commenced beyond its borders which is consummated within its territory.[14] The courts of the United States have traditionally accepted the objective territorial principle as a legitimate basis for the exercise of jurisdiction.[15]

Federal courts in the United States have been influenced by the foregoing principles of international law in determining whether Congress intended federal legislation to have extraterritorial application.[16] Congress itself has provided some guidance on this issue within the statutory framework of the securities laws. By enacting the 1964 Amendments to the Securities Exchange Act of 1934, it has expanded the application of the registration provisions of section 12 to include foreign issuers who satisfy certain minimum requirements.[17] However, the SEC has promulgated rule 12g3-2 which exempts any foreign issuer which furnishes the SEC with whatever information the issuer has made public pursuant to the laws of the country in which it is organized, incorporated or domiciled.[18] This rule further provides that furnishing such information "shall not constitute an admission . . . that the issuer is subject to the [Securities Exchange] Act."[19]

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13. Restatement (Second) of Foreign Relations Law of the United States § 18, comment d at 49 (1965) (the Restatement does not use the term "objective territorial"); Committee on International Law, Report, 21 Record of N.Y.C.B.A. 240, 245 (1966); Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 487-94 (Supp. 1935). See Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363, 1383-84 (1971), for a discussion of the need for limiting the type of effect which will be sufficient for jurisdictional purposes.

14. Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 487-88 (Supp. 1935).

15. Justice Holmes formulated the principle in this way: "Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if he had been present at the effect, if the State should succeed in getting him within its power." Strassheim v. Daily, 221 U.S. 280, 285 (1911). See United States v. Sisal Sales Corp., 274 U.S. 268 (1927); United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945). For one commentator's critical view of the objective territorial principle, see Jennings, Extraterritorial Jurisdiction and the United States Antitrust Laws, 33 Brit. Y.B. Int'l L. 146, 175 (1957). See generally Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363, 1368-70 (1973); Note, Extraterritorial Application of the Securities Exchange Act of 1934, 69 Colum. L. Rev. 94, 95-96 (1969).

16. See, e.g., United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945): "[W]e are not to read general words, such as those in this [Sherman] Act, without regard to the limitations customarily observed by nations upon the exercise of their powers . . . ." Id. at 443.

17. 15 U.S.C. § 78l(g) (1970). This section requires every corporate issuer with assets in excess of one million dollars which is "engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce" to register each class of equity security held by more than 500 investors. Id.

18. 17 C.F.R. § 240.12g3-2 (1975). This rule also exempts any foreign issuer of a class of equity securities held by fewer than 300 United States residents.

19. Id. See Mizrack, Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934, 30 Bus. Law. 367, 382-83 (1975).

Although previous courts had been faced with the issue,[20] *Schoenbaum v. Firstbrook*[21] was the first case to hold that section 10(b) of the Securities Exchange Act of 1934[22] did have extraterritorial application. In *Schoenbaum*, an American minority shareholder of a Canadian corporation (Banff) whose stock was traded on the American Stock Exchange brought a shareholder derivative action, claiming violations of section 10(b) and rule 10b-5[23] promulgated thereunder.[24]

On appeal from a summary judgment entered for the defendants,[25] the Second Circuit affirmed but disagreed with the district court's conclusion that the Exchange Act had no extraterritorial application. It found that there was a national public interest in the maintenance of honest and fair securities markets which was sufficient to rebut "the usual presumption against extraterritorial application of legislation . . . ."[26] The court went on to state:

> We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.[27]

The court cited Justice Holmes' formulation of the objective territorial principle[28] in support of its ruling that the anti-fraud provision of section

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20. The first case to consider the issue of extraterritorial application of the Securities Exchange Act was Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960). The court dismissed the action for lack of subject matter jurisdiction since "[a]ll the essentials of these transactions occurred without the United States." Id. at 390. It held that " 'jurisdiction' as used in Section 30(b) contemplates some necessary and substantial act within the United States." Id. at 390-91.

The next case to raise the issue was SEC v. Gulf Intercontinental Fin. Corp., 223 F. Supp. 987 (S.D. Fla. 1963). The court held that there was subject matter jurisdiction over a fraudulent scheme since the securities involved had been offered within the United States. Id. at 994-95.

In the first section 10(b) case, Ferraioli v. Cantor, 259 F. Supp. 842 (S.D.N.Y. 1966), the court avoided the issue of extraterritoriality by finding that the conduct complained of had taken place within the United States. See generally Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363 (1973).

21. 405 F.2d 200 (2d Cir.), rev'd on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969).

22. 15 U.S.C. § 78j(b) (1970).

23. 17 C.F.R. § 240.10b-5 (1975).

24. 405 F.2d at 204. Plaintiff alleged that defendant Aquitaine Company of Canada, Ltd., had conspired with Banff's directors to defraud Banff by withholding inside information of a valuable oil discovery until after Aquitaine had completed a purchase of Banff's treasury shares at an artificially low market price. Id. at 205.

25. 268 F. Supp. 385 (S.D.N.Y. 1967). The district court held that it lacked subject matter jurisdiction since the Securities Exchange Act was not intended to apply extraterritorially. In any event, the court concluded, plaintiff had failed to state a cause of action.

26. 405 F.2d at 206. See note 7 supra and accompanying text.

27. 405 F.2d at 206. Some courts have held that this statement sets forth the only situations in which the Exchange Act will be given extraterritorial application. SEC v. Kasser, 391 F. Supp. 1167, 1175 (D.N.J. 1975); Finch v. Marathon Sec. Corp., 316 F. Supp. 1345, 1349 (S.D.N.Y. 1970).

28. See note 15 supra and accompanying text.

10(b) reached beyond the territorial limits of the United States to encompass fraudulent transactions, the *effects* of which were "injurious to United States investors."[29] Forced to confront squarely the question of extraterritoriality, the court declared that the Act applied to acts outside the United States "at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."[30]

The broad guidelines for the extraterritorial application of the Exchange Act laid down by the *Schoenbaum* court[31] were greatly clarified in *Leasco Data Processing Equipment Corp. v. Maxwell.*[32] Plaintiff Leasco, an American corporation, alleged a conspiracy by the defendants to cause Leasco to purchase the stock of Pergamon Press Ltd. (Pergamon)[33] at an inflated price. According to Leasco, false and misleading oral statements and financial reports were made to Leasco in meetings in New York and London, as well as during transatlantic telephone calls between Leasco and defendant Maxwell.[34]

The court of appeals conceded that enough had been alleged to show a violation of rule 10b-5 if section 10(b) could be applied to the transaction in

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29. 405 F.2d at 206.

30. Id. at 208-09. The court also ruled that section 30(b), 15 U.S.C. § 78dd(b) (1970), was not a blanket exemption which precluded the extraterritorial application of the Act to any foreign transaction. The court held that section 30(b) exempted only those foreign transactions which were part of a "business in securities." Since the instant situation involved an isolated foreign transaction not part of a "business in securities," the section 30(b) exemption did not apply and therefore it did not preclude the extraterritorial application of the Exchange Act. The court seemed to base its finding on the fact that the transaction was not part of a "business in securities." 405 F.2d at 207-08. However, in SEC v. United Fin. Group, Inc., 474 F.2d 354 (9th Cir. 1973), the court cited Schoenbaum as support for its conclusion that "jurisdiction" as used in section 30(b) did not mean "territorial limits." Id. at 357 n.8.

31. See text accompanying note 27 supra.

32. 468 F.2d 1326 (2d Cir. 1972).

33. Pergamon was a British corporation whose controlling shareholder, Robert Maxwell, a British citizen, was also a defendant in the instant action. Id. at 1330.

34. Id. at 1330-32. Leasco further alleged that it had signed an agreement in New York with Maxwell requiring it to offer to acquire the outstanding shares of Pergamon. Id. at 1332. Leasco expended some $22,000,000 in acquiring 5,206,210 such shares, using cash furnished by Leasco International N.V., a Netherlands Antilles corporation which was a wholly-owned subsidiary of Leasco. When it received data indicating that previous misrepresentations had been made, Leasco declined to proceed with the tender offer. Id. at 1332-33.

The Second Circuit adopted Leasco's version of the facts for the purpose of determining subject matter jurisdiction. If Leasco was unable at trial to prove the facts alleged, the court stated that "the principles announced in this opinion should be applied to the proven facts; the issue of subject matter jurisdiction persists." Id. at 1330.

The court rejected defendant's argument that Leasco lacked standing since it had not actually purchased the shares. The court, looking to the substance of the transaction rather than its form, found that "Leasco, the United States company, remained at all times intimately involved in the transaction; the foreign entity was accepted by both sides as the alter ego of the American." Id. at 1338 (emphasis omitted).

question.[35] The court distinguished *Schoenbaum* since in that case *"the fraudulent acts were all committed outside the United States"*[36] with an adverse *effect* on the interests of American investors as a result of a transaction in securities registered and listed on a national securities exchange. The court refused to extend *Schoenbaum's* "adverse consequences" rationale to a case involving foreign securities not traded on an organized national securities exchange where all the acts occurred abroad. The court stated that "the language of § 10(b) of the Securities Exchange Act is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security."[37]

Having rejected adverse consequences within the United States as a sufficient basis for subject matter jurisdiction, the court applied the subjective territorial principle,[38] and noted that, although the black letter of the law seemed to require that conduct within the territory relate to a thing or status within the territory,[39] a lesser requirement might in some instances be sufficient.[40] The Second Circuit found that the defendant's "abundant misrepresentations in the United States,"[41] which were "an essential link" in inducing Leasco to purchase Pergamon's stock on the open market, were "conduct within the territory" sufficient to satisfy the requirements of the subjective territorial principle.[42] The fact that the securities were those of a foreign issuer and were neither registered nor listed on an organized United States market was not considered fatal.[43]

Thus, subsequent to *Schoenbaum* and *Leasco,* the courts appeared to be willing to give extraterritorial application to securities laws where the transaction in question produced an adverse *effect* on American investors or the domestic securities market, or where there was *conduct* within the United States which was an "essential link" in the overall fraudulent scheme. However, questions remained as to the type of activity required and the nature of the adverse effect necessary to invoke extraterritorial application. In

35. Id. at 1333.

36. Id. (emphasis in original).

37. Id. at 1334.

38. See notes 9-10 supra and accompanying text.

39. The Pergamon securities, which were the "thing" or "interest" involved here, were traded in London. 468 F.2d at 1330.

40. Id. at 1334. Restatement (Second) of Foreign Relations Law of the United States § 17, comment a at 45 (1965), provides that "[a] rule of law prescribed by a state . . . may deal with the effects of conduct that occurs in its territory, whether or not such effects take place in its territory."

Illustration 2 to section 17 is illuminating: "X and Y are in state A. X makes a misrepresentation to Y. X and Y go to state B. Solely because of the prior misrepresentation, Y delivers money to X. A has jurisdiction to prescribe a criminal penalty for obtaining money by false pretenses." Restatement (Second) of Foreign Relations Law of the United States § 17 at 45 (1965), quoted in 468 F.2d at 1334 n.3.

41. Id. at 1335.

42. See notes 9, 10, & 38-40 supra and accompanying text.

43. Id. at 1336.

addition, it was unclear whether foreign nationals would be protected by American securities laws. These questions have been answered by two recent decisions in the Second Circuit, *IIT v. Vencap, Ltd.*,[44] and *Bersch v. Drexel Firestone, Inc.*[45]

In *IIT v. Vencap, Ltd.*,[46] a foreign investment trust (IIT) alleged that it had been defrauded in the purchase of 30,000 redeemable preference shares of defendant Vencap, a venture capital firm. The agreement to purchase was reached after several meetings between defendant Pistell, a United States citizen residing in the Bahamas, and the president of the corporation responsible for managing IIT.[47] At Pistell's direction, a memorandum was prepared outlining the purposes of Vencap.[48] Drafts of the memorandum were exchanged in New York by the American attorneys for IIT and Vencap. The agreement was dated September 29, 1972 and the closing occurred in the Bahamas on October 9.[49] Vencap subsequently entered into a series of transactions which resulted in channeling substantial amounts of Vencap's funds into Pistell's hands.[50] Vencap used the New York office of its attorney as the base for these transactions and maintained its records there.[51]

Plaintiffs brought an action in district court for fraud, conversion, and corporate waste and moved for a preliminary injunction and the appointment of a receiver.[52] On appeal from an order granting plaintiffs' motion, the Second Circuit stated that with respect to two possible theories of fraud[53] there was activity within the United States which might be sufficient to confer subject matter jurisdiction. The court stated that it "need[ed] further findings as to the wickedness of particular transactions and as to whether they were engineered from the United States" before it could make a final determination on the issue of subject matter jurisdiction.[54]

The court noted that section 22(a) of the Securities Act of 1933[55] and section 27 of the Securities Exchange Act of 1934[56] were the only possible bases for

44. 519 F.2d 1001 (2d Cir. 1975).

45. 519 F.2d 974 (2d Cir. 1975).

46. 519 F.2d 1001 (2d Cir. 1975).

47. Id. at 1005.

48. The text of the memorandum is set out in Appendix A to the court's decision. Id. at 1021-24.

49. Id. at 1006-07.

50. Pistell used $600,000 of Vencap's assets as collateral for a personal loan of $590,000. Vencap was also used to provide financing for certain other companies in which Pistell had an interest. Id. at 1008-10.

51. Id. at 1018.

52. Id. at 1003-04.

53. The court posited five possible theories of fraud. Id. at 1011-14. The two theories on which the court found that subject matter jurisdiction might exist were: (1) that Vencap explicitly represented itself as a bona fide enterprise when in fact it was intended to be used in Pistell's benefit; (2) that the plaintiffs were bringing a derivative suit on behalf of Vencap for the harm done to it. Id. at 1013-14, 1018.

54. Id. at 1018.

55. 15 U.S.C. § 77v (1970).

56. Id. § 78aa (1970).

jurisdiction.[57] It then found that "the perpetration of fraudulent acts themselves" within the United States would be sufficient to confer subject matter jurisdiction over a suit by a defrauded foreign individual,[58] stating that it did "not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[59] The court reasoned that since subject matter jurisdiction existed over a suit by the SEC to enjoin the export from the United States of securities frauds,[60] there would also be subject matter jurisdiction when a defrauded foreign individual sued for damages or rescission.[61] The court stated that its ruling was strictly limited to "the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries . . . ."[62]

In reaching its decision, the court indicated that the fact that one of the defendants was an American citizen was not in itself sufficient to confer subject matter jurisdiction. Characterizing the problem as one of construing " 'exercised congressional power, not the limitations upon that power itself,' "[63] the court indicated that some *effect*[64] within the United States, in addition to the defendant's United States citizenship, would be necessary for a finding of subject matter jurisdiction.[65]

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57. 519 F.2d at 1015.

58. Id. at 1017-18. A defrauded foreign individual had previously been allowed to recover damages under rule 10b-5 in a transaction in which the sale of shares of an American corporation had been effected within the United States. Wandschneider v. Industrial Incomes, Inc. of North America, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,422 (S.D.N.Y. 1972).

59. 519 F.2d at 1017.

60. SEC v. United Fin. Group, Inc., 474 F.2d 354, 356-57 (9th Cir. 1973). In this case, the Ninth Circuit's holding that there was subject matter jurisdiction was based upon defendants' conduct within the United States and the injury to American investors caused by that conduct. Although the presence of American investors and the fact that the defendant was an American corporation were factor's in the court's finding of subject matter jurisdiction, id. at 355-57, the Second Circuit was of the opinion that they were not determining factors in the court's decision. 519 F.2d at 1017. Compare SEC v. United Fin. Group, Inc., 474 F.2d 354 (9th Cir. 1973) with Investment Properties Int'l, Ltd. v. I.O.S., Ltd., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011 (S.D.N.Y. 1971) (court found subject matter jurisdiction was lacking where there was no showing of any injury to American investors). But see Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363, 1389 (1973) for one commentator's view that the nationality of the defendants was a critical factor in the court's decision in United Financial.

61. 519 F.2d at 1017-18.

62. Id. at 1018. In F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296, at 98,517 (S.D.N.Y. 1975), the court dismissed an action by a defrauded foreign corporation since the fraudulent conduct causing plaintiff's losses occurred abroad; the defendant's conduct in the United States consisted of acts in preparation of the fraud.

63. 519 F.2d at 1016, quoting Steele v. Bulova Watch Co., 344 U.S. 280, 283 (1952).

64. 519 F.2d at 1016. See F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296, at 98,517 (S.D.N.Y. 1975).

65. The court also rejected the contention that the transaction had a significant effect in the

In *Bersch v. Drexel Firestone, Inc.*,[66] an American citizen brought a class action suit on behalf of thousands of plaintiffs who had subscribed to a public offering of shares of IOS Ltd. Although there were three separate offerings, characterized by the plaintiff as the "IOS Public Offering," the shares were sold under one basic prospectus. The prospectus stated that the shares had not been offered in the United States and had not been registered under United States securities laws.[67] However, sales totaling 41,936 shares were made to twenty-two American residents who were all connected in some way with IOS or its affiliates. In addition, there were numerous meetings in New York involving the major underwriters in the Drexel Group,[68] their lawyers and accountants, and representatives of IOS.[69] Plaintiff alleged antifraud violations by the underwriters in impliedly representing IOS as a "suitable company for public ownership" when they should have known that such was not the case.

The district court ruled that the three offerings could be considered as one for the purpose of determining jurisdiction,[70] and then proceeded to find subject matter jurisdiction, based on the amount of activity in the United States, sales to Americans, and the generalized adverse effects upon the American securities market.[71]

On appeal, the Second Circuit noted that, even with the absence of certain jurisdictional elements[72] which had been present in *Schoenbaum* and *Leasco,* from the standpoint of international law, the activities within the United States[73] were sufficient to confer subject matter jurisdiction based on the subjective territorial principle.[74] However, the court was unsure whether it

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United States because United States citizens and residents were fundholders in IOS. Noting that the alleged fraud had been practiced on the trust in which Americans had invested rather than on the individual Americans themselves, the court concluded that the American interests involved were too mathematically insignificant to find "adverse effects" similar to those which had influenced the decision in Schoenbaum. The court found that the losses suffered on the $3,000,000 investment in Vencap by American investors who owned a mere 0.5% of IIT did not satify the "substantial effect" within the territory requirement of section 18 of the Restatement (Second) of Foreign Relations Law of the United States (1965), on which Schoenbaum was implicitly based. 519 F.2d at 1017. See notes 13, 14 & 27-30 supra and accompanying text.

66. 519 F.2d 974 (2d Cir. 1975).

67. Id. at 980-81.

68. The chief underwriters for the IOS Public Offering, consisting of two American banking houses and four foreign underwriting houses, were collectively referred to as the Drexel Group. Id. at 979.

69. Id. at 985 n.24.

70. Bersch v. Drexel Firestone, Inc., 389 F. Supp., 446, 451 (S.D.N.Y. 1974), aff'd, 519 F.2d 974 (2d Cir. 1975).

71. Id. at 455-58.

72. In Schoenbaum, the shares had been registered and listed on a national securities exchange, 405 F.2d at 204, whereas such registration and listing were absent in Bersch, 519 F.2d at 980-81. In Leasco, a substantial part of the misrepresentations had been made in the United States, 468 F.2d at 1335, while in this case there were no fraudulent misrepresentations made in the United States, 519 F.2d at 987.

73. 519 F.2d at 985 n.24.

74. See id. at 985; notes 9-10 supra and accompanying text.

should exercise its jurisdictional power, questioning "whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [predominantly foreign transactions] rather than leave the problem to foreign countries."[75]

The court concluded that, since the allegedly false and misleading prospectus emanated from a foreign source, there were no misrepresentations within the United States upon which the court could base jurisdiction.[76] Thus the instant situation did not fall within the ambit of *Leasco*.[77] The court also ruled that by itself, an adverse effect on the American economy or American investors generally would not constitute sufficient grounds for asserting jurisdiction based on the objective territorial principle.[78] Noting that the application of the antifraud provisions was limited to acts in connection with the offer, purchase, or sale of any security,[79] the court concluded that "there is subject matter jurisdiction of fraudulent acts relating to securities which are committed abroad only when these result in injury to purchasers or sellers of those securities in whom the United States has an interest . . . ."[80]

The court, seemingly basing its decision on the objective territorial principle, concluded that there was subject matter jurisdiction over sales to those Americans residing in the United States.[81] It noted that, since there had been a *direct effect* in the United States, conduct within the country would not be required. The relevant inquiry thus became whether the acts of the defendants had been essential to producing that effect.[82]

With respect to those American purchasers residing abroad, the court held that subject matter jurisdiction existed based on the defendants' activities within the United States.[83] It focused on the decision-making quality of

75. 519 F.2d at 985.

76. Id. at 987. The court refused to extend its holding in IIT to protect the foreign plaintiffs in Bersch. It distinguished IIT on the grounds that that case involved named foreign plaintiffs and the fraudulent acts themselves had been committed in the United States whereas the instant case involved thousands of unnamed foreign plaintiffs and activities within the United States that were merely preparatory. The court also noted that the United States activities were "relatively small in comparison to those abroad." Id. However, the court implied that the activities in the United States would be a sufficient basis for asserting jurisdiction over a damage suit by foreign plaintiffs if the issuer had been a company clearly identified with the United States. Id. at 986-87.

The court also concluded that retaining the state law claims of the foreign purchasers under a theory of pendent jurisdiction would be an abuse of discretion. "In terms of the amount at stake it is almost ludicrous to speak of the claims of the foreign purchasers as 'pendent.' " Id. at 996, citing UMW v. Gibbs, 383 U.S. 715, 726-27 (1966).

77. See notes 38-43 supra and accompanying text.

78. 519 F.2d at 988-89. See notes 13-14 supra and accompanying text.

79. 15 U.S.C. § 77q (1970) (limited to acts in the "offer or sale of any securities"); id. § 78j(b) (1970) (limited to acts "in connection with the purchase or sale of any security").

80. 519 F.2d at 989 (footnote omitted).

81. Id. at 991. See notes 13-14 supra and accompanying text.

82. 519 F.2d at 991. The court concluded that the defendants' activities could be considered essential to producing the effect within the United States. It noted that this conclusion could be disproved at trial and the issue of subject matter jurisdiction would persist. Id. at 991-92, citing Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1330 (2d Cir. 1972).

83. 519 F.2d at 992; see id. at 985. n.24.

defendants' activities rather than on the quantity of physical acts. The court made it clear that the activities in the United States were a crucial element in its finding, stating that "Congress surely did not mean the securities laws to protect the many thousands of Americans residing in foreign countries against securities frauds by foreigners acting there . . . ."[84] The court noted that subject matter jurisdiction would be lacking if the defendants had not engaged in significant activities within the United States. It also indicated that the quality of activity required to trigger application of the securities laws would vary depending upon whether the injured party was an American residing abroad or a foreigner.[85]

Prior to the Second Circuit's decisions in *IIT* and *Bersch,* a court would consider three jurisdictional elements in determining the extraterritorial application of the securities laws—"(1) registration and listing, (2) conduct within the United States, and (3) adverse impact on a protected U.S. interest."[86] The protection of American investors and American securities markets was the prime reason for giving the securities laws extraterritorial application.[87]

The Second Circuit's decisions in *IIT* and *Bersch* have eliminated registration and listing on a national securities exchange as a necessary jurisdictional element[88] and have extended the extraterritorial application of the securities laws in order to protect foreign investors and American citizens residing abroad. Simultaneously, the court has been careful to limit this extension by narrowing the scope of the "conduct" and "adverse impact" which will suffice to confer subject matter jurisdiction over a predominantly foreign transaction.[89]

In determining whether there is subject matter jurisdiction, a court will now consider the nationality and location of the injured party, the location and quality of the activity involved, and the adverse effect on the particular party or interest involved.[90]

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84. Id. at 992. The court indicated that the participation of an American citizen in the foreign activities would not of itself change its conclusion. Id. This view is more explicitly stated in 519 F.2d at 1016.

85. 519 F.2d at 992. While preparatory acitivities within the United States would be a sufficient basis for jurisdiction when the injured party was an American residing abroad, such activities would not be sufficient if the injured party were a foreigner. A foreign plaintiff would be required to show that the conduct in the United States was the direct cause of his injury. Id. at 992-93; F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296, at 98,517 (S.D.N.Y. 1975).

86. Mizrack, Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934, 30 Bus. Law. 367, 379 (1975). See generally Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363 (1973).

87. E.g., Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir.), rev'd on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969). See notes 27-30 supra and accompanying text.

88. See notes 96-98 infra and accompanying text.

89. See notes 60 & 78-80 supra and accompanying text.

90. See Mizrack, Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934, 30 Bus. Law. 367, 377-79 (1975). The recent Supreme Court decision in Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), created the implication that

When a named foreign plaintiff is involved, the fraudulent activity must take place within the United States and be the direct cause of the damage suffered by the plaintiff in order for subject matter jurisdiction to exist.[91] The quality of the activity[92] within the United States will be examined to ensure that it consists of the actual perpetration of the fraud and is not merely activity of a preparatory nature.[93]

Where an American citizen is involved, his place of residence will help to determine the extent to which the securities laws will protect him. If the American citizen is residing abroad, he must show that there were acts of "material importance" committed within the United States which significantly contributed to his injury.[94] An American citizen resident in the United States need only show that he has been adversely affected by fraudulent securities activities conducted abroad in order for the securities laws to be given extraterritorial application.[95]

By eliminating registration and listing as a jurisdictional element,[96] the court has significantly broadened the protection afforded the American investor[97] in the *Schoenbaum*-type situation. Registration and listing on a national

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an arbitration clause in an international contract may be a fourth factor in the future. Id. at 512-15. For a comprehensive treatment of arbitration clauses in an international business context see Note, Arbitration and Forum Selection Clauses in International Business: The Supreme Court Takes an Internationalist View, 43 Fordham L. Rev. 424 (1974).

91. 519 F.2d at 974. See F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296, at 98,517 (S.D.N.Y. 1975); Wandschneider v. Industrial Incomes Inc., [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,422 (S.D.N.Y. 1972), discussed at note 58 supra.

92. See SEC v. United Fin. Group, Inc., 474 F.2d 354 (9th Cir. 1973), discussed at note 60 supra. The fact that the offshore mutual funds involved were "directed and controlled as an integrated whole from the United States" was one factor in the court's finding of subject matter jurisdiction. Id. at 356.

93. See F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296 (S.D.N.Y. 1975). Compare SEC v. Kasser, 391 F. Supp. 1167 (D.N.J. 1975) (use of means of interstate commerce and other miscellaneous activities within the United States not sufficient to confer jurisdiction over an essentially foreign transaction) with Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973), rev'g 331 F. Supp. 797 (E.D. Mo. 1971) (use of mails and other facilities of interstate commerce sufficient to confer subject matter jurisdiction since they were essential to the scheme to defraud plaintiffs).

94. 519 F.2d at 993.

95. Id. at 991, 993. The foreign conduct must of course satisfy the jurisdictional requisites of section 10(b)—"use of the mails or other facilities of interstate commerce." See Mizrack, Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934, 30 Bus. Law. 367, 371 (1975).

96. Garner v. Pearson, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,549 (M.D. Fla. 1974), had previously indicated the diminishing significance of registration and listing as a jurisdictional element. The court indicated that the fact that the securities involved in that case were neither registered nor listed on a national securities exchange would not preclude the assertion of jurisdiction in an appropriate case. Id. at 95,904. However, since Garner involved conduct in the United States, it appeared that registration and listing were still factors in a Schoenbaum-type case.

97. Registration and listing were not considered jurisdictional elements where foreign nation-

securities exchange had previously been considered an important factor in determining the extraterritorial application of the securities laws, particularly in those situations where the allegedly fraudulent conduct took place outside the United States.[98] Thus, subject matter jurisdiction will exist over acts committed abroad only when those acts have adversely affected a specific purchaser or seller whom the United States has an interest in protecting.[99]

Where there has been activity within the United States that has adversely affected foreigners, that activity must be assessed to determine whether it was a material part of the fraudulent scheme or merely preparatory to a fraudulent scheme.[100] For subject matter jurisdiction to exist in such a case, there must be a showing that the activity within the United States directly caused the losses suffered by the foreign parties.[101]

The Second Circuit's decisions in *Bersch* and *IIT* are positive steps forward in defining the guidelines for the extraterritorial application of securities laws. By requiring that a specifically protected United States interest be adversely affected, the new guideline will help ensure that the resources of the United States courts are not expended on transactions which could more properly be handled by the courts of the foreign country in which the transaction took place.[102] In extending protection to foreigners who have been victimized by fraudulent securities schèmes concocted in the United States and exported abroad, the court has taken a giant step to ensure that United States corporations have continued free access to foreign capital markets. This

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als were involved since the SEC "has traditionally taken the position that the registration requirements . . . are primarily intended to protect American investors." SEC Release Nos. 33-4708 and 34-7366 (July 9, 1964), 17 C.F.R. § 231.4708 (1975), 1 CCH Fed. Sec. L. Rep. ¶ 1362.

98. E.g., Mizrack, Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934, 30 Bus. Law. 367, 382-84 (1975). See text accompanying note 30 supra.

99. 519 F.2d at 989, 991. For jurisdiction to exist, there must be injury to a specific purchaser or seller of securities in whom the United States has an interest. A generalized adverse effect on American investors or the American economy will not be a sufficient basis for jurisdiction. Id. at 989. See SEC v. Kasser, 391 F. Supp. 1167 (D.N.J. 1975) (subject matter jurisdiction lacking since fraudulent Canadian transaction had no impact on domestic investors or securities markets); Manus v. Bank of Bermuda, Ltd., [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,299 (S.D.N.Y. 1971) (subject matter jurisdiction lacking since transaction occurring abroad was not detrimental to any interest protected by the Securities Exchange Act); Investment Properties Int'l, Ltd. v. I.O.S., Ltd., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011 (S.D.N.Y. 1971) (subject matter jurisdiction lacking since no showing of any injury to American investors).

100. See 519 F.2d at 1017-18.

101. 519 F.2d at 993; F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., [Current Binder] CCH Fed. Sec. L. Rep. ¶ 95,296 (S.D.N.Y. 1975).

102. 519 F.2d at 996-97. As Judge Frankel noted, when there is no impact on such a protected interest the "United States courts have no reason to become involved, and compelling reason not to become involved, in the burdens of enforcement and the delicate problems of foreign relations and international economic policy that extraterritorial application may entail." Investment Properties Int'l, Ltd. v. I.O.S., Ltd., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011 at 90,735 (S.D.N.Y. 1971) (emphasis omitted).

extension of protection will also help to promote good will within the international community.[103]

On the negative side, however, the Second Circuit has failed to provide adequate guidelines for distinguishing "mere preparatory activities" from "acts of material importance."[104] Since in the future this distinction may prove to be crucial in determining whether securities laws will be given extraterritorial application, a clear demarcation should have been drawn. It is to be hoped that the Second Circuit will avail itself of the next opportunity to provide these guidelines,[105] so that parties to international securities transactions will be able to act with even more certainty as to the potential effects of their activities.

Kevin Pacenta

Taxation—Corporate Reorganization—Withdrawable Shares of Savings and Loan Association Held To Be Debt Securities.—In January of 1956, Home Savings and Loan Association purchased for $8,031,107 in cash all the outstanding guarantee stock[1] of Pasadena Savings and Loan Association, and in March of that year, Pasadena was merged into Home. Both associations had raised capital through the sale of guarantee stock and both had issued withdrawable shares to evidence their depositors' savings accounts.[2] As was then required by California law, the merger was approved by the stockholders

103. See generally Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363, 1397, 1402 (1973), for a discussion of American and international interests which the courts should seek to promote.

104. In both IIT and Bersch, the factual issues had not yet been resolved at trial. Thus in IIT, the court stated that "we need further findings as to the wickedness of particular transactions and as to whether they were engineered from the United States." 519 F.2d at 1018. Similarly the court in Bersch stated: "[T]he question of how far the alleged defrauding of American citizens abroad resulted from acts . . . in the United States had best be left for development at a trial." 519 F.2d at 992-93. In the absence of such factual findings, it is impossible to do anything more than speculate about precisely how the court distinguished between "acts of material importance" and "mere preparatory activities."

105. See ALI Fed. Sec. Code § 1604 (Tent. Draft No. 3, 1974), and Loss and Blackstone, Codification of the Federal Securities Laws, 28 Bus. Law. 381 (1973) for two examples of proposed guidelines for the extraterritorial application of the securities laws.

1. A California savings and loan association may issue guarantee stock, the proceeds from the sale of which "shall be set aside . . . [and] shall be maintained as a fixed and permanent capital of the association." Cal. Fin. Code § 6456.1 (West Supp. 1975).

2. See id. §§ 5067, 6501 (West 1968). The total guarantee stock issue of Pasadena was 20,000 shares, and 650,252 withdrawable shares were held by Pasadena depositors prior to the merger. These shares represented $65,025,200 on deposit. Home Sav. & Loan Ass'n v. United States, 73-2 U.S. Tax Cas. ¶ 9609, at 81,959 (C.D. Cal. 1973), rev'd, 514 F.2d 1199 (9th Cir. 1975), petition for cert. filed, 44 U.S.L.W. 3150 (U.S. Sept. 23, 1975) (No. 75-396). Home had outstanding at that time 672 shares of guarantee stock and its depositors held 2,266,660 withdrawable shares. 514 F.2d at 1203.

and the shareholders of both associations.[3] The stock of Pasadena (held by Home) was then surrendered and cancelled and more than 95% of Pasadena's withdrawable shares were exchanged for withdrawable shares in Home representing the same amounts on deposit.

Upon completion of the merger, Home acquired $5,281,452.87 in bad debt reserves which Pasadena had accumulated since 1952.[4] In acquiring these reserves, Home had assumed that the transaction qualified as a corporate reorganization,[5] and in such a case the surviving party to the reorganization continues to use the accounting methods of the distributing corporation.[6] Bad debt reserves[7] established by the transferor may thus be carried over, untaxed, by the transferee.

In 1962 the Commissioner of Internal Revenue issued a Notice of Deficiency to Home, restoring these funds to income for the year 1956. Home obtained a judgment for refund of the taxes it had paid pursuant to the notice,[8] but the Ninth Circuit reversed, upholding the position of the Commissioner. The Court held that since the withdrawable shares of both associations were debt securities the continuity of interest test had not been met, and therefore the transaction could not qualify as a corporate reorganization. *Home Savings & Loan Association v. United States,* 514 F.2d 1199 (9th

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3. Ch. 269, § 2.06, [1931] Cal. Stats. 489, as amended Cal. Fin. Code § 9200 (West Supp. 1975). The amended version does not require such consent of the shareholders where an association issues both stock and shares.

4. Pasadena had eliminated its income tax liability for the years 1952-56 by claiming bad debt deductions in the amount of its total income. 514 F.2d at 1205; see Int. Rev. Code of 1954, § 593 which authorizes such deductions.

5. See note 9 infra for a discussion of the six types of reorganization set forth in Int. Rev. Code of 1954, § 368(a)(1). The transactions described in these provisions are accorded special tax treatment as compared, for example, with an outright sale of property. This is based on the theory that the old corporation continues unliquidated and thus no taxable event has occurred. The reorganization provisions are intended to defer recognition of gain or loss sustained through these "merely formal" changes in corporate structure. However, the practical effect of these technically complex rules has been to focus attention more on the form of the transaction than on its substance. See generally B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders, ¶ 14.01 (3d ed. 1971) [hereinafter cited as Bittker & Eustice].

6. Int. Rev. Code of 1954, § 381(c)(4). The term "accounting methods" as used in this section comprises bad debt reserves. See Treas. Reg. § 1.381(c)(4)-1(b)(1) (1964); Bittker & Eustice, supra note 5, ¶ 16.13 at 16-23.

7. A taxpayer may deduct from taxable income "any debt which becomes worthless within the taxable year." Int. Rev. Code of 1954, § 166(a)(1). The Code also permits, in appropriate cases, the establishment by the taxpayer of a reserve to cover that percentage of debts which are likely to become worthless. The amounts allocated to this reserve are deducted from taxable income. Id. § 166(c). Generally, determinations of the appropriateness of such a reserve, and of the reasonableness of the amounts set aside, are made by "the Secretary [of the Treasury] or his delegate" (i.e. the Internal Revenue Service). Id. The Code also regulates the size of bad debt reserves of savings and loan associations. Id. § 593.

8. Home Sav. & Loan Ass'n v. United States, 73-2 U.S. Tax Cas. ¶ 9609 (C.D. Cal. 1973), rev'd, 514 F.2d 1199 (9th Cir. 1975), petition for cert. filed, 44 U.S.L.W. 3150 (U.S. Sept. 23, 1975) (No. 75-396).

Cir. 1975), *petition for cert. filed,* 44 U.S.L.W. 3150 (U.S. Sept. 23, 1975) (No. 75-396).

To qualify for Type A[9] reorganization treatment, a transaction must not only qualify as a "statutory merger" under state law,[10] but must also meet the judicially created continuity of interest test.[11] This test requires that "the transferor corporation or its shareholders [retain] . . . a substantial proprietary stake in the enterprise represented by a material interest in the affairs of the transferee . . . ."[12] This requirement is satisfied when at least half of the former owners of the transferor corporation receive an equity interest in the transferee corporation, the value of which represents at least 50% of the total consideration paid to the transferor.[13] To decide whether this requirement has been met in cases such as *Home,* the equity holders of the transferor corporation must first be identified. Here, if the guarantee stockholders of Pasadena were its only proprietors, there could be no continuity of interest since they were paid cash and retained no interest in the transferee.[14] But if the withdrawable shareholders of Pasadena had been holders of a proprietary interest, then, if they had also received a stock interest in Home, the

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9. There are six types of corporate reorganizations, known as types A through F after Int. Rev. Code of 1954, §§ 368(a)(1)(A)-(F). In a case such as Home, if the transaction is to be treated as a reorganization, it must be Type A. Types B and C require that the transferee acquire stock or property of the transferor "in exchange solely for . . . its voting stock." The transferee in these types cannot have purchased any interest in the transferor with cash. Id. § 368(a)(1)(B)-(C). Type D requires that "the transferor or . . . its shareholders" be in control of the transferee immediately after the transaction. Id. § 368(a)(1)(D). A Type E recapitalization involves a readjustment of the "stocks, bonds or other securities of [an existing] corporation . . . as to amount, income or priority . . . ." United Gas Improv. Co. v. Commissioner, 142 F.2d 216, 218 (3d Cir.), cert. denied, 323 U.S. 739 (1944); see Int. Rev. Code of 1954, § 368(a)(1)(E). A Type F reorganization is "a mere change in identity, form, or place of organization. . . ." Id. § 368(a)(1)(F).

10. Roebling v. Commissioner, 143 F.2d 810, 812 (3d Cir.), cert. denied, 323 U.S. 773 (1944); W.H. Truschel, 29 T.C. 433, 438 (1957).

11. Treas. Reg. §§ 1.368-1(b) to -1(c) (1960); Bittker & Eustice, supra note 5, ¶ 14.11; see LeTulle v. Scofield, 308 U.S. 415, 418 (1940); Helvering v. Minnesota Tea Co., 296 U.S. 378, 384-85 (1935); Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462, 470 (1933).

12. Southwest Natural Gas Co. v. Commissioner, 189 F.2d 332, 334 (5th Cir.), cert. denied, 342 U.S. 860 (1951).

13. Schweitzer & Conrad, Inc., 41 B.T.A. 533, 539, 541-42 (1940); Rev. Rul. 224, 1966-2 Cum. Bull. 114.

14. But see Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 183 (1942), which held that there was sufficient continuity of interest even though only creditors of the transferor received stock interests in the transferee. If the withdrawable shares of Home are considered a stock interest, it might be argued on the basis of the Alabama Asphaltic case that the transaction qualified as a reorganization even though Pasadena's shares were held to be debt. In Alabama Asphaltic, however, the transferor corporation was insolvent and its creditors had taken steps to enforce their claims. The Court held that they had already "stepped into the shoes of the old stockholders," who had been excluded from the reorganization due to the insolvency. Id. at 184. The cases which have followed Alabama Asphaltic have repeated this pattern. See, e.g., Western Mass. Theatres, Inc. v. Commissioner, 236 F.2d 186 (1st Cir. 1956); Norman Scott, Inc., 48 T.C. 598 (1967).

continuity of interest test would have been met since a large majority of the former owners of the transferor would also be equity holders of the transferee.

The Ninth Circuit in *Home* held the withdrawable shares of both associations to be debt securities, thereby precluding reorganization treatment.[15] Such a holding also means that the merger has been viewed as the complete liquidation by Home of a corporation which had become its subsidiary.[16] In such liquidations, the transferor's bad debt reserves are carried over by the transferee,[17] just as in a reorganization. However, such carry-over is not allowed when as in *Home* the corporation being liquidated has become a subsidiary through the parent's purchase of most of its outstanding stock within twelve months of the liquidation.[18] Thus the court's determination that Pasadena's withdrawable shares were debt securities, and its classification of the merger as a two-step purchase by Home of Pasadena's assets, required the restoration of the bad debt reserves to taxable income.[19]

The issue of whether a given corporate interest is debt or equity has

15. Home Sav. & Loan Ass'n v. United States, 514 F.2d 1199, 1206-08 (9th Cir. 1975), petition for cert. filed, 44 U.S.L.W. 3150 (U.S. Sept. 23, 1975) (No. 75-396). The Home case also involved the merger of a third savings and loan association into Home. This association issued investment certificates to its depositors instead of withdrawable shares. Since these certificates possess fewer equity characteristics than do shares, the decision by the Ninth Circuit that shareholders are creditors and not stockholders led to a similar characterization of certificate holders. The court also agreed with the Commissioner that earned but not collected income of the two transferring institutions should be restored as taxable income to Home. Id. at 1206.

16. See Int. Rev. Code of 1954, §§ 332(b)(1)-(2).

17. Id. §§ 381(a)(1), (c)(4).

18. Id. § 381(a)(1). Section 381 allows such carry-over when there has been a reorganization or a liquidation of a long-owned subsidiary on the theory that in both cases only the form of the corporate enterprise has been changed. See note 5 supra. The latter case can be distinguished from the liquidation of a recently purchased subsidiary which is, in essence, a two-step purchase of the subsidiary's assets. Thus no carry-over is allowed when "at least 80% of the total combined voting power of all classes of stock entitled to vote . . . [is] acquired by the distributee by purchase . . . during a 12-month period . . . ." Int. Rev. Code of 1954, § 334(b)(2); Argus, Inc., 45 T.C. 63, 68-71 (1965). But see Home Sav. & Loan Ass'n v. United States, 223 F. Supp. 134 (S.D. Cal. 1963), where on facts very similar to those in the Ninth Circuit Home case, the court stated in dictum that the bad debt reserves would carry-over even if it had not decided that withdrawable shares were equity. Id. at 135-36. The court did not discuss sections 334(b)(2) and 381(a)(1) even though they would seem to be applicable since all the guarantee stock of the transferee had been purchased for cash a month before the merger was completed.

19. When there is no carry-over, it is generally held that reserves must be returned to the taxable income of the distributing corporation. Arcadia Sav. & Loan Ass'n v. Commissioner, 300 F.2d 247, 250-51 (9th Cir. 1962); Rev. Rul. 258, 1965-2 Cum. Bull. 94; see Bittker & Eustice, supra note 5, ¶ 11.62 at 11-51 to -52, ¶ 11.65 at 11-70; cf. West Seattle Nat'l Bank v. Commissioner, 288 F.2d 47, 49-50 (9th Cir. 1961). This is based on the theory that the transferor "received a tax benefit when its . . . net income escaped taxation upon being added to its reserves for bad debts and that the need for such reserves ceased following the sale of its business . . . ." 300 F.2d at 251. But cf. Nash v. United States, 398 U.S. 1 (1970). There, the restoration of bad debt reserves to income was not required where the members of a partnership chose to incorporate their business. It has been suggested that this decision may encourage taxpayers to relitigate this issue in the liquidation context. Bittker & Eustice, supra note 5, ¶ 11.65 at 11-70.

frequently been litigated by the Internal Revenue Service and corporate taxpayers.[20] In most cases, however, the corporation is seeking a debt classification[21] so that the return it pays on the investment will be a deductible interest payment[22] rather than a non-deductible dividend.[23] Many corporations, in deciding the form their securities should take, are attracted by the favorable tax consequences of debt, but are also "fear[ful] of [the] adverse effects [of heavy debt financing] on their general credit and on their solvency in hard times."[24] The result is often the creation of a hybrid security, a " 'security device' which is in truth neither stock nor bond, but the half-breed offspring of both."[25]

Congress has never defined the terms "stock" and "indebtedness,"[26] the Internal Revenue Service has refused to issue advance opinions in the area[27] and no consistent criteria for classifying hybrid interests have emerged from the myriad court decisions.[28] The factors courts have most often considered important to debt status are: (1) an unconditional obligation to repay a 'sum certain' at a specified time, (2) an obligation to pay a fixed rate of interest,[29] and (3) priority over stockholders in receiving repayment in the event of liquidation.[30] Other factors which various courts have considered relevant include the existence of voting rights, whether the corporation is thinly capitalized,[31] and the extent to which stockholders of the corporation hold the

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20. See generally Plumb, The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and a Proposal, 26 Tax L. Rev. 369 (1971) [hereinafter cited as Plumb].

21. See id. at 372-74; Stone, Debt—Equity Distinctions in the Tax Treatment of the Corporation and Its Shareholders, 42 Tul. L. Rev. 251, 252 (1968) [hereinafter cited as Stone].

22. Int. Rev. Code of 1954, § 163(a). Savings and loan associations have not had to seek a debt classification for their withdrawable shares since the Code provides that "[i]n the case of . . . savings and loan or similar associations . . . there shall be allowed as deductions in computing taxable income amounts paid to . . . depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts, if such amounts . . . are withdrawable on demand subject only to customary notice of intention to withdraw." Id. § 591.

23. Id. § 301(c)(1).

24. Plumb, supra note 20, at 405.

25. John Kelley Co. v. Commissioner, 326 U.S. 521, 535 (1946) (Rutledge, J., dissenting).

26. Plumb, supra note 20, at 369; see Stone, supra note 21, at 253.

27. See Rev. Proc. 6, 1960-1 Cum. Bull. 880, which cites the "inherently factual nature of the problems . . . ." The adoption of this procedure may have stemmed from the conclusion of the Supreme Court in John Kelley Co. v. Commissioner, 326 U.S. 521, 526-27 (1946), that the debt-equity question is one of fact to be determined by the trial court in each case.

28. See Plumb, supra note 20, at 370 & n.8.

29. See Gilbert v. Commissioner, 248 F.2d 399, 402 (2d Cir. 1957), aff'd, 262 F.2d 512 (2d Cir.), cert. denied, 359 U.S. 1002 (1957).

30. See H. Henn, Corporations § 163 (2d ed. 1970); Stone, supra note 21, at 253.

31. This factor involves comparing the respective amounts of the corporation's capital raised by the issuance of stock and debt instruments to arrive at a "debt-equity ratio." This ratio received great attention following the case of John Kelley Co. v. Commissioner, 326 U.S. 521 (1946), which indicated in dictum that in "situations [where there are only] nominal stock investments and an obviously excessive debt structure," debt classification might be precluded for a portion of the purported debt securities. Id. at 526.

purported debt instruments.[32] Congress in the Tax Reform Act of 1969[33] authorized the Secretary of the Treasury (or his delegate, the Internal Revenue Service) to formulate regulations to be used in determining whether a given interest is stock or indebtedness for all income tax purposes.[34]

The same factors found decisive in the interest deduction context have also been controlling in those cases which have considered whether the withdrawable shares of a savings and loan association are debt or equity. The three courts which have decided this question prior to the *Home* case "uniformly held that the interest of withdrawable shareholders . . . [qualified] as stock."[35] However, *Everett v. United States*[36] and *West Side Federal Savings & Loan Association v. United States,*[37] two of the cases which so held, concerned mergers of stock-issuing state savings and loan associations into federal associations. Unlike a state savings and loan association which issues guarantee stock along with its withdrawable shares, a federal association issues only withdrawable shares.[38] The proprietary interest in federal associations must therefore be attributed to its withdrawable shares.[39] As a result, the courts in *Everett* and *West Side* held that the withdrawable shares there had sufficient equity characteristics to enable the transactions to meet the continuity of interest test.

These cases differ from the *Home* case in other respects as well. In the *Everett* case, for example, the taxpayers were seeking Type C[40] reorganization treatment. To decide whether the merger in this case met the code

32. 4A J. Mertens, Federal Income Taxation §§ 26.10a, .10c (rev. ed. 1972) [hereinafter cited by volume as Mertens]. Thirty-two factors bearing on the debt-equity issue are discussed in Plumb, supra note 20, at 411-555.

33. Act of Dec. 30, 1969, Pub. L. No. 91-172, tit. 4, § 415(a), 83 Stat. 613 (codified at Int. Rev. Code of 1954, § 385).

34. Int. Rev. Code of 1954, § 385(b) suggests several factors for consideration, but the list is neither all-inclusive nor binding on the Treasury Department. S. Rep. No. 91-552, 91st Cong., 1st Sess. 138-39 (1969). These regulations, when issued, should specify the weight to be assigned to the various factors and thereby establish an authoritative standard for deciding this question. See New York State Bar Association Tax Section, Committee on Reorganization Problems, Recommendations as to Federal Tax Distinction Between Corporate Stock and Indebtedness, 25 Tax Law. 57 (1971) [hereinafter cited as Bar Ass'n], which sets forth a suggested pattern for these regulations.

35. 3 Mertens, supra note 32, § 20.67 (Supp. 1975).

36. 448 F.2d 357 (10th Cir. 1971).

37. 494 F.2d 404 (6th Cir. 1974).

38. Federal associations are prohibited by statute from issuing stock. 12 U.S.C.A. § 1464(b)(2) (Supp. 1, 1975).

39. "Assuming that there must exist in all associations a proprietary interest, such broad and uniform interest [as a depositor's share] may well serve that purpose." Home Sav. & Loan Ass'n v. United States, 514 F.2d 1199, 1208 (9th Cir. 1975), petition for cert. filed, 44 U.S.L.W. 3150 (U.S. Sept. 23, 1975) (No. 75-396); cf. Wisconsin Bankers Ass'n v. Robertson, 190 F. Supp. 90 (D.D.C. 1960), aff'd, 294 F.2d 714 (D.C. Cir.), cert. denied, 368 U.S. 938 (1961).

40. See note 9 supra. For a transaction to qualify as a Type C reorganization, there must be "the acquisition by [the transferee], in exchange solely for all or a part of its voting stock . . . of substantially all of the properties of another corporation . . . ." Int. Rev. Code of 1954, § 368(a)(1)(C).

requirements, no consideration of the withdrawable shares of the transferor, a stock-issuing association, was necessary. The court only had to decide whether the hybrid shares of the transferee federal association were sufficiently equitable to be considered "voting stock." For the purposes of the judicially created continuity of interest test which must be met in all reorganization cases,[41] the *Everett* court apparently assumed, without discussion, that the transferor's savings and full paid shares also represented a proprietary interest. More extensive rights are generally accorded withdrawable shareholders under Kansas law which applied in *Everett*.[42] In contrast with the California law applicable in *Home,* Kansas law does not expressly authorize an association to grant the guarantee stockholders control of the board of directors. The question is left for the by-laws of the individual association.[43] Furthermore, the applicable Kansas statute describes the capital of an association as being divided into shares which may be issued under various plans and states that capital may be raised in the form of "savings deposits."[44]

In *West Side,* both the guarantee stockholders and the withdrawable shareholders of the state association received the all-purpose federal shares. No cash was paid for any interest in, or property of, the transferor.[45] Thus all possible former owners of the transferor received a proprietary interest in the transferee.[46]

The 1963 case of *Home Savings & Loan Association v. United States*[47] was concerned with the merger of two stock-issuing associations. The conclusion there that withdrawable shares were equity was based solely on the limited voting rights accorded to shareholders to elect minority members to the association's board of directors,[48] and to prevent by a two-thirds vote a proposed merger.[49] However, there was no discussion of any other factor, despite the fact that the Supreme Court has pointed out that "[t]here is no one characteristic . . . which can be said to be decisive in the determination of whether . . . obligations are risk investments in the corporations or debts."[50]

41. See Treas. Reg. § 1.368-1(b) (1960).

42. In Home, the government argued this point in distinguishing Everett. 514 F.2d at 1208.

43. Kan. Stat. Ann. §§ 17-5304 to -5305 (1974).

44. Id. § 17-5401. Under California law applicable in Home, only the proceeds from the sale of guarantee stock are included in the fixed capital of an association. See Cal. Fin. Code § 6456.1 (West Supp. 1975); id. § 8500 (West 1968).

45. West Side Fed. Sav. & Loan Ass'n v. United States, 494 F.2d 404 (6th Cir. 1974).

46. It should be noted that the holding of the West Side case rejected the position set forth in Rev. Rul. 6, 1969-1 Cum. Bull. 104, which held that the equity characteristics of federal association shares were insignificant in comparison to their function as evidence of deposits.

47. 223 F. Supp. 134 (S.D. Cal. 1963).

48. As authorized by statute, the articles of incorporation or by-laws of the transferor provided that a majority of the board of directors would be elected by the guarantee stockholders. Id. at 135; see Cal. Fin. Code § 7651 (West 1968).

49. Cal. Fin. Code § 9200 (West Supp. 1975); see note 3 supra. The lower court in the present Home case also stressed the power of the withdrawable shareholders to prevent the occurrence of the merger. 73-2 U.S. Tax Cas. ¶ 9609, at 81,961.

50. John Kelley Co. v. Commissioner, 326 U.S. 521, 530 (1946). A subsequent court, implying that the earlier Home case was wrongly decided, remarked that the "reason for the

The Ninth Circuit in *Home* held that the withdrawable shareholders of both the transferor and transferee associations were creditors rather than stockholders. While noting that shares possess some equity-like features—"[t]he absence of a fixed rate of return [and] limited voting rights"[51]—the court decided not to weigh such features heavily since there was outstanding guarantee stock, which was "the true equity interest of these associations."[52] Thus the court did not consider the possibility that both the guarantee stock and the withdrawable shares could be equity interests. In the court's view, the mere presence of the guarantee stock precluded the classification of withdrawable shares as a proprietary interest.[53]

Having concluded that the withdrawable shares were debt, the court then dismissed the importance of their equitable characteristics. The court first discounted the importance of the withdrawable shareholders' voting rights by observing that California law also allows creditors of a corporation to be granted such rights.[54] Courts have often justified a grant of voting powers which stops short of giving control of corporate affairs to creditors.[55] More importantly, Pasadena's withdrawable shareholders were limited by the association's articles of incorporation to electing only a minority of the board of directors.[56] The guarantee stockholders controlled the board, and thus, the association. Since even full voting rights are seldom decisive of the debt-equity question,[57] such limited voting rights[58] may be viewed as a limited right of depositors to protect their investment, rather than a form of corporate control.[59]

Government's failure to pursue an appeal therein has not been disclosed." Estate of Heinz Schmidt, 42 T.C. 1130, 1136 n.7 (1964), rev'd, 355 F.2d 111 (9th Cir. 1966).

51. 514 F.2d at 1206. In holding the withdrawable shares to be equity, the lower court found these characteristics to be persuasive. The court there compared withdrawable shares with preferred stocks which are nonvoting and which yield a relatively fixed rate of return, yet which can qualify as equity for continuity of interest purposes. 73-2 U.S. Tax Cas. ¶ 9609, at 81,960-62.

52. 514 F.2d at 1206.

53. There appears to be no basis for the court's conclusion here. The corporate structure typically includes several layers of equity interests, with some securities such as common stock possessing more equity characteristics than others such as preferred stock. See generally H. Henn, Corporations § 160 (2d ed. 1970). In addition, earlier courts have held withdrawable shares to be equity in the context of savings and loan associations which issue guarantee stock. See notes 35-50 supra and accompanying text. It is submitted that the presence of guarantee stock should not be dispositive of the issue of classifying withdrawable shares, but should only be one of the factors considered.

54. Cal. Corp. Code § 306 (West 1955).

55. See Commissioner v. Union Mut. Ins. Co., 386 F.2d 974 (1st Cir. 1967); Commissioner v. Johnson, 267 F.2d 382, 384-85 (1st Cir. 1959).

56. 514 F.2d at 1202 & n.6.

57. Jordan Co. v. Allen, 85 F. Supp. 437, 443 (M.D. Ga. 1949); W.H. Truschel, 29 T.C. 433, 439 (1957).

58. At the time of the merger in Home, California law required consent of two-thirds of the withdrawable shareholders for such a merger. This voting right was later eliminated. See note 3 supra and accompanying text.

59. "[T]he power of purported creditors to vote on particular matters affecting their interests,

The absence of a statutory guarantee of a fixed rate of interest on withdrawable shares led the court in *Home* to point out that a relatively steady rate of return was ensured in practice through competition with commercial banks.[60] California law clearly contemplates that interest is to be paid to withdrawable shareholders subject only to the approval of the savings and loan commissioner, whose role is to insure that rates are not kept unfairly low.[61] The right to a return is not dependent on the discretion of the board of directors. They may change the rates, but they are not empowered to suspend interest payments.[62] Even when, as is not the case here, "payment of interest [as in the typical income bonds] is conditional upon corporate earnings but requires no discretionary action, the debt will normally be recognized."[63] Furthermore, there was no indication that interest payments were not regularly made by Pasadena. A history of regular interest payments made out of corporate earnings is one indication that a debtor-creditor relationship exists.[64]

A factor mentioned by the lower court in *Home* as significant in its holding that the withdrawable shares were an equitable interest was that Pasadena's shareholders supplied almost 90% of the association's assets and "thereby enabled [it] to operate . . . ."[65] This argument is a variation of the debt-

such as mergers . . . is not inconsistent with indebtedness." Plumb, supra note 20, at 448-49; cf. Baker Commodities, Inc. v. Commissioner, 48 T.C. 374, 399-400 (1967), aff'd, 415 F.2d 519 (9th Cir. 1969), cert. denied, 397 U.S. 988 (1970).

60. 514 F.2d at 1206. Implicit in the Home case was the court's belief that there was an unconditional commitment to pay interest. This would suggest that there existed an equally unconditional obligation to repay the principal. Thus, two important criteria for debt classification would seem to be fulfilled. See text accompanying note 29 supra. This indication is further strengthened by the California statute which provides that shareholders may withdraw their deposits upon six months' notice. Cal. Fin. Code § 8100 (West 1968).

61. "The rates of return on shares . . . shall be determined by the board of directors of the association [periodically] subject to the approval of the [state savings and loan] commissioner . . . ." Cal. Fin. Code § 7400 (West 1968). "The commissioner shall approve the rates of return on shares . . . unless he finds them unfair, unjust, or inequitable, having due regard to the earnings of the association . . . ." Id. § 7401.

62. See id. § 7400.

63. Plumb, supra note 20, at 432; see Lansing Community Hotel Corp. v. Commissioner, 14 T.C. 183, 189-90 (1950), aff'd, 187 F.2d 487 (6th Cir. 1951) (per curiam). See also Bar Ass'n, supra note 34, at 69 (suggested regulation § 1.385-3(a)(4)) which would accord a stock classification when there is "no specified interest rate;" but such classification would not be compelled if "the payment of what is the functional equivalent of interest" is required. Id.

64. Baker Commodities, Inc. v. Commissioner, 48 T.C. 374, 397-98, aff'd, 415 F.2d 519 (9th Cir. 1969), cert. denied, 397 U.S. 988 (1970); see Piedmont Corp. v. Commissioner, 388 F.2d 886 (4th Cir. 1968); Commissioner v. Union Mut. Ins. Co., 386 F.2d 974, 977 (1st Cir. 1967); cf. Liflans Corp. v. United States, 390 F.2d 965 (Ct. Cl. 1968). There, despite a high debt-equity ratio, the grant of an extension by the creditor on repayment of the principal, and the waiver of some interest payments, debt classification was upheld. The court, taking into account the nature of the enterprise, found that the issuance of debt was a sound business practice. Repayment, it was held, was not intended to be dependent on the success of the enterprise.

65. Home Sav. & Loan Ass'n v. United States, 73-2 U.S. Tax Cas. ¶ 9609 at 81,961 (C.D. Cal. 1973), rev'd, 514 F.2d 1199 (9th Cir. 1975), petition for cert. filed, 44 U.S.L.W. 3150 (U.S.

equity ratio concept. It is believed that a corporation must recognize that a certain percentage of its assets has been irrevocably committed to the business and that the corporation cannot realistically guarantee the return of these funds to the investor.[66] Classification of the withdrawable shares in both associations as debt securities would fix Pasadena's debt-equity ratio at almost nine to one, and while the market value of Home's 672 shares of guarantee stock was not set forth in either opinion,[67] its ratio could be considerably higher, since it had issued more than two and a quarter million withdrawable shares.[68] In the ordinary situation such thin capitalization precludes debt classification.[69]

Although this issue was not addressed by the Ninth Circuit in *Home,* a high debt-equity ratio in the context of a savings and loan association may not be fatal to debt classification. The courts have varied widely as to what ratio is unreasonably high[70] but an important consideration in this context is the corporation's type of business. It may be appropriate in most cases to hold that assets paid into a corporation should be viewed as an equity interest if they are essential to the corporation's business in the sense that the corporation "could not have been carried on without them."[71] However, most corporations need these funds for permanent capital investment in plant, equipment, inventory, etc. In the case of the savings and loan association, such funds are not in the same sense committed to the enterprise. It has been recognized that "[s]tandard ratio patterns . . . cannot well be applied to finance companies . . ."[72] since there, as is true of the savings and loan industry, "the very business . . . is the borrowing of funds at one interest rate and lending them at a higher rate."[73] The fact that in the finance industry

Sept. 23, 1975) (No. 75-396). This figure was arrived at by comparing the sale price of Pasadena's guarantee stock, over eight million dollars, with the deposits represented by its withdrawable shares, more than sixty-five million dollars. See notes 1 and 2 supra and accompanying text.

66. Schnitzer v. Commissioner, 13 T.C. 43, 62 (1949), aff'd, 183 F.2d 70 (9th Cir. 1950) (per curiam), cert. denied, 340 U.S. 911 (1951).

67. At the time of the merger California law provided that "[g]uarantee stock shall have a par value of not less than ten dollars ($10) per share," but the present version of the statute has eliminated this requirement. Ch. 364, § 6456, [1951] Cal. Stats. 1000, as amended Cal. Fin. Code § 6456 (West 1968).

68. Cal. Fin. Code § 6500 (West 1968) provides that "[w]ithdrawable shares shall be of the par value of one hundred ($100) or two hundred ($200) dollars each . . . ."

69. See note 31 supra and accompanying text.

70. See Estate of Miller v. Commissioner, 239 F.2d 729 (9th Cir. 1956). See generally Caplin, The Caloric Count of a Thin Incorporation, N.Y.U. 17th Inst. on Fed. Tax 771 (1959). For several years after the case of John Kelley Co. v. Commissioner, 326 U.S. 521 (1946), a ratio of less than four to one was considered safe for debt classification, Plumb, supra note 20, at 507-19, but the courts have not considered this figure to be a maximum.

71. Brake & Elec. Sales Corp. v. United States, 185 F. Supp. 1, 3 (D. Mass. 1960), aff'd, 287 F.2d 426 (1st Cir. 1961) (financing of auto parts business); see Stone, supra note 21, at 256.

72. Plumb, supra note 20, at 511.

73. Security Fin. & Loan Co. v. Koehler, 210 F. Supp. 603, 605 (D. Kan. 1962). "It has been held that the 'thin capitalization' doctrine has no application where the very business is the profitable utilization of borrowed funds." 4A Mertens, supra note 32, § 26.10c, at 91.

money is the corporation's "stock in trade" distorts the debt-equity ratio and makes the usual standards inappropriate.[74]

A widely accepted statement of the essential difference between stockholders and creditors is that "the stockholder's intention is to . . . [take] the risks of loss attendant upon [the corporate adventure] . . . [while] [t]he creditor . . . does not intend to take such risks so far as they may be avoided, but merely to lend his money to others who do intend to take them."[75] Thus, the court in *Home* noted that the right of the investor to repayment in the event of the dissolution of the corporation is a most important factor in the debt-equity issue.[76] The court stressed that California law does not subordinate withdrawable shareholders to the claims of creditors;[77] rather, it treats them as creditors whose claims in liquidation must be paid before certain payments can be made to others.[78] In contrast, guarantee stock in a savings and loan association is expressly subordinated to creditors, including shareholders.[79] A depositor in these associations does not intend to make a high-risk investment; his understanding is that he will receive back his deposit,[80] usually on demand,[81] together with interest.[82]

The court enumerated several other statutory provisions which influenced its holding that withdrawable shares are essentially debt instruments. It noted that the Internal Revenue Code provides that the return paid to savings and

74. Plumb, supra note 20, at 511. The New York State Bar Association suggests that an interest be accorded debt status if it is an obligation "incurred in the ordinary course of business, such as in consideration for inventory or supplies." Bar Ass'n, supra note 34, at 65 (suggested regulation § 1.385(2)(b)). This provision would be applicable to withdrawable shares if they are viewed as a promise by the association to pay for the "inventory" supplied by its depositors.

75. United States v. Title Guar. & Trust Co., 133 F.2d 990, 993 (6th Cir. 1943) (emphasis omitted).

76. 514 F.2d at 1207; see text accompanying note 30 supra.

77. 514 F.2d at 1207; see Cal. Fin. Code § 8401 (West 1968).

78. In re Pacific Coast Bldg.-Loan Ass'n, 15 Cal. 2d 134, 146-48, 99 P.2d 251, 256-57 (1940) (upon dissolution, withdrawable shareholders entitled to return of principal before interest payments are made to holders of investment certificates). This court also pointed out the "sharp distinction . . . between guarantee stock and membership shares" noting that "[t]he guarantee stockholders take the major risk, and in return have the controlling voice in management . . . . They receive all the profits over the moderate return by way of interest [paid to shareholders and others]." Id. at 142, 99 P.2d at 254. The court in Home pointed out that shareholders are treated "on the basis of substantial parity with respect to the payment of interest during liquidation" with holders of investment certificates, an interest having scant equity characteristics. 514 F.2d at 1207; see Cal. Fin. Code § 9055.5 (West 1968).

79. Cal. Fin. Code § 8450 (West Supp. 1975).

80. The return of a shareholder's deposit in a state savings and loan association is guaranteed up to $40,000 if the institution is insured by the Federal Savings and Loan Insurance Corporation. 12 U.S.C.A. §§ 1726, 1728 (Supp. 1, 1975).

81. Although California allows the association to require six months notice before withdrawal, Cal. Fin. Code § 8100 (West 1968), the court in Home noted that, at least in the case of the transferee, Home, such restrictions on withdrawal were rarely imposed. 514 F.2d at 1203.

82. See H. Russell, Savings and Loan Associations 267-305 (2d ed. 1960); cf. Affiliated Gov't Empl. Distrib. Co. v. Commissioner, 322 F.2d 872 (9th Cir. 1963), cert. denied, 376 U.S. 950 (1964).

loan association shareholders is deductible from taxable income,[83] as is interest on indebtedness generally.[84] This argument carries little weight, however, since the applicable Code provisions do not classify the withdrawable shares as debt instruments, but merely provide that the return paid on the shares, however they are classified, shall be deductible. The court further supported its holding by pointing out that California law bars shareholders from bringing a stockholder's derivative suit.[85]

The court mentioned as a "most compelling indication" that withdrawable shares are debt the fact that the value of deposits represented by such shares is designated by California law to be included among the liabilities of a savings and loan association against which the value of the outstanding stock is compared for the purpose of determining whether the capital of an association is impaired.[86] A similar argument for debt classification was made by the court in pointing out that the value of an association's shares is one of the limits imposed on the size of an association's bad debt reserve.[87] While these statutory provisions are of practical significance in classifying withdrawable shares, they are not usually among the factors considered in the debt-equity issue.[88]

The Ninth Circuit in *Home* was the first court to hold that withdrawable shares are debt securities rather than stock for the purpose of determining whether the statutory merger of savings and loan associations should be accorded reorganization tax treatment. It was also the first court to point out the difference between the all-purpose shares of a federal association which, of necessity, are assumed to be equity,[89] and the withdrawable shares of a state association where the presence of stock makes such an assumption inappropriate. The Ninth Circuit concluded without adequate analysis, however, that since the guarantee stockholders of the two associations were equity holders, the withdrawable shareholders did not hold an equitable interest. The court failed to give adequate consideration to the question whether Pasadena's withdrawable shareholders may also have been equity holders of that association.[90] In addition, the court failed to analyze the problem of Pasadena's high debt-equity ratio.[91] The Ninth Circuit's holding that Pasadena's withdrawable shares were debt instruments may have been correct, but its

83. Int. Rev. Code of 1954, § 591; see note 22 supra.

84. Int. Rev. Code of 1954, § 163(a).

85. 514 F.2d at 1207; see Cal. Fin. Code § 7616 (West 1968).

86. Cal. Fin. Code § 8500 (West 1968).

87. See Int. Rev. Code of 1954, § 593(b)(1).

88. See generally Plumb, supra note 20, at 411-555.

89. See notes 35-39 supra and accompanying text.

90. It should be noted that some of the federal statutory provisions which point toward debt classification for Pasadena's shares (e.g., the F.S.L.I.C. guarantee and limits on the size of an association's bad debt reserves based on the value of withdrawable share deposits) apply equally well to withdrawable shares in federal associations which uniformly have been held to be equity instruments.

91. See text accompanying notes 65-74 supra.

conclusion should have been based on a comparison of the relative attributes of these shares with those of other securities issued by that association, undertaken without an assumption that the association can possess only one class of equity interest.

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