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Real Property -- Implied Warranties in New Housing

Richard L. Burrows

submission of the state law question to state determination."[51] This indiscriminate use of the abstention technique and the consequent time and expense involved in getting back into federal court assuredly amount to a partial abdication of federal jurisdiction.[52] The use of the federal courts in these situations is effectively removed from those who do not have the time or the money for such a long, expensive effort. The abstention doctrine is so entrenched today that it is doubtful that any changes will be made in its application despite the objectionable features mentioned here. The lawyer, however, should keep these possible results in mind and let them be his guideposts in deciding whether or not to carry his case to the federal courts.

ROBERT B. LONG, JR.

Real Property—Implied Warranties in New Housing

In a recent Colorado case,[1] the purchaser of a house brought suit against the vendor-builder for loss suffered as a result of the defective condition of the house. Prior to the purchase of the then incompleted house, plaintiff inspected the property and noted that caissons were being constructed for the foundation of the adjoining house. Upon inquiry about soil conditions, defendant assured plaintiff that similar precautions had already been taken in the construction of his house. After accepting the deed and entering into possession, plaintiff-vendee discovered that the foundation was inadequate for the type of soil involved. The Supreme Court of Colorado held the builder liable for breach of a implied warranty of fitness for habitation.[2]

[51] Louisiana Power & Light Co. v. City of Thibodaux, 360 U.S. 25, 28 (1959).

[52] "Delay which the *Pullman* doctrine sponsors, keeps the *status quo* entrenched and renders 'a defendant's judgment' even in the face of constitutional requirements.... [L]itigants seeking the protection of the federal courts for assertion of their civil rights will be ground down slowly by the passage of time and the expenditure of money in state proceedings, leaving the ultimate remedy here, at least in many cases, an illusory one." England v. Louisiana State Bd. of Medical Examiners, 375 U.S. 411, 436-37 (1964) (concurring opinion).

[1] Glisan v. Smolenske, — Colo. —, 387 P.2d 260 (1963). The defendant-vendor was held liable for breach of an implied warranty of fitness for habitability when cracks began appearing in the surfaces of the house.

[2] The principal case involved a contract to purchase a house then in the process of construction; however, although the court allowed recovery

In the past and to a large extent today, the purchaser of a house that proves unsuitable for habitation[3] finds his effort to redress the wrong blocked by the common law doctrine of *caveat emptor*.[4] Although this doctrine has for all practical purposes disappeared from the law of sales involving chattels,[5] a purchaser of real property who fails or is unable to obtain an express warranty of fitness in the deed is faced with "the almost universal rule the country over . . . that in the sale of . . . [real property] there is no implied warranty on the part of the vendor of fitness, condition or quality."[6]

Realizing that the objective of the vendee in purchasing the house is to live in it, and recognizing that the essence of the contract is that the house should be fit for habitation, some courts have allowed recovery on the basis of implied warranty despite the strictures of *caveat emptor*.[7] In liberalizing the traditional doctrine, however, these courts have restricted implied warranties to cases where the contract was for the construction of a house or for the purchase of a house in the process of construction.[8] Conversely, the doctrine of *caveat emptor* is applied where the contract involves the purchase

on the basis of an implied warranty, their reasons for doing so leaves some doubt as to possible future applications. The court emphasized and seemed to accord a great deal of weight to the fact that the contract, by its provisions, set out an express warranty of workmanship, *i.e., "house to be completed in workmanlike manner."* — Colo. at —, 387 P.2d at 261. This leaves open the question of whether it would hold the same way in the absence of such a contract.

[3] Although a few courts distinguish an implied warranty of "fitness" from one of "habitability" when a sale of chattels is involved, for the purpose of this note they are used interchangeably as applied to real property. Both refer to whether or not the dwelling is reasonably fit for occupancy as a dwelling.

[4] See generally 4 WILLISTON, CONTRACTS § 926, (rev. ed. 1936).

[5] See UNIFORM SALES ACT §§ 13-16; UNIFORM COMMERCIAL CODE §§ 2-314, 2-315.

[6] Coutrakon v. Adams, 39 Ill. App. 2d 290, 300, 188 N.E.2d 780, 785 (1963). In the absence of express warranties in the deed, or of fraud or concealment, a builder who sells a completed house is thereafter not liable to the purchaser for damages resulting from latent defects. Gilbert Constr. Co. v. Gross, 212 Md. 402, 129 A.2d 518 (1957); Levy v. C. Young Constr. Co., 46 N.J. Super 293, 134 A.2d 717 (App. Div. 1957); Vanderschrier v. Aaron, 103 Ohio App. 340, 140 N.E.2d 819 (1957); Shapiro v. Kornicks, 103 Ohio App. 49, 124 N.E.2d 175 (1955); Steiber v. Palumbo, 219 Ore. 479, 347 P.2d 978 (1959).

[7] Glisan v. Smolenske, — Colo. —, 387 P.2d 260 (1963); Weck v. A:M Sunrise Constr. Co., 36 Ill. App. 2d 383, 184 N.E.2d 728 (1962); Laurel Realty Co. v. Himelfarb, 191 Md. 462, 62 A.2d 263 (1948); Vanderschrier v. Aaron, 103 Ohio App. 340, 140 N.E.2d 819 (1957); Banks v. City of Ardmore, 188 Okla. 611, 112 P.2d 372 (1941).

[8] *E.g.*, Gilbert Constr. Co. v. Gross, 212 Md. 402, 129 A.2d 518 (1957); Hill v. Polar Pantries, 219 S.C. 263, 64 S.E.2d 885 (1951).

of a fully completed structure, whether "new" or secondhand.[9] The courts reason that the vendee of an incomplete structure is unable to inspect it and therefore must rely entirely upon the vendor-builder's representations, whereas the vendee of a fully completed structure has an opportunity to inspect the premises himself and thus need not rely upon the vendor's representations.[10]

When a court desires to allow recovery but is reluctant to overrule the well established principle of *caveat emptor*,[11] the major obstacle to recovery under a warranty theory is that the provisions of the antecedent contract are ordinarily merged in the deed upon its acceptance and thereby constitute prima facie the final and entire obligation of the parties.[12] The doctrine of merger is supported on the theory that had the parties intended to provide warranties, the deed would or should have provided written stipulations to that effect.[13] If it appears that the deed purported to cover the subject-matter of the contract, although possibly inconsistent with it, merger should occur. This follows because, as a rule, the acceptance of a deed is prima facie an execution of the antecedent contract.[14] The

[9] *E.g.*, Coutrakon v. Adams, 39 Ill. App. 2d 290, 188 N.E.2d 780 (1963); Shapiro v. Kornicks, 103 Ohio App. 49, 124 N.E.2d 175 (1955).

[10] That the ability to inspect a fully completed or a secondhand house is at best a somewhat dubious distinction is shown by the following cases, which allowed recovery despite the fact that various contracts for purchase contained recitals of inspection and nonreliance on representations. Rothstein v. Janss Inv. Corp., 45 Cal. App. 2d 64, 113 P.2d 465 (1941); Cohen v. Vivian, 141 Colo. 443, 349 P.2d 366 (1960); Wolford v. Freeman, 150 Neb. 537, 35 N.W.2d 98 (1948). The reasoning of these cases was that the ability to inspect gave the vendee no more assurance than failure to inspect would, because normally a vendee is unable to discover such defects as insufficient foundations, leaking roofs, or defective material at the time the contract was entered into.

[11] For a discussion of the doctrine of *caveat emptor*, see Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133 (1931).

[12] Ridley v. Moyer, 230 Ala. 517, 161 So. 526 (1935); Duncan v. McAdams, 222 Ark. 143, 257 S.W.2d 568 (1953); Percifield v. Rosa, 122 Colo. 167, 220 P.2d 546 (1950); Gabel v. Simmons, 100 Fla. 526, 129 So. 777 (1930); Levin v. Cook, 186 Md. 535, 47 A.2d 505 (1946); Huffman v. Landes, 163 Va. 652, 177 S.E. 200 (1934); Dunseath v. Hallauer, 41 Wash. 2d 895, 253 P.2d 408 (1953).

[13] This reasoning assumes that the parties intended to do so and that the vendee could afford to pay for the inclusion of such warranties in the deed. Such warranties might well make the cost so prohibitive so as to prevent their inclusion.

[14] In Continental Life Ins. Co. v. Smith, 41 N.M. 82, 64 P.2d 377 (1936), it was stated, "in the absence of fraud, mistake, etc., the following stipulations in contracts for the sale of real estate are conclusively presumed to be merged in a subsequently delivered and accepted deed made in pursuance of such contract, to wit: (1) Those that inhere in the very subject-matter

fact that some of the contract provisions were incorporated in the deed, while others were modified or left out, lends even more weight to the existing prima facie case in that the parties dealt with these antecedent agreements selectively.[15]

Some jurisdictions have held that such a merger does not occur.[16] They reason that it was not within the contemplation or intention of the parties that the antecedent contract be entirely merged or superceded.[17] Thus, when the antecedent contract contains provisions relating to quality, fitness or conditions which impose obligations on the vendor collateral to the provisions concerning title, possession, quantity, or emblements, provisions normally found in deeds, so as to indicate that their omission from the deed was not intended as a release of the vendor's obligation, such collateral provisions should not be merged. Since an implied warranty that the house will be reasonably fit for its intended purpose is a part of the antecedent contract by implication of law, it follows that such an implication is "collateral" to the deed and should survive acceptance thereof.[18]

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of the deed, such as title, possession, emblements . . . ; (2) those carried into the deed and of the same effect; (3) those of which the subject-matter conflicts with the same subject-matter in the deed. In such cases, the deed alone must be looked to in determining the rights of the parties." *Id.* at 88, 64 P.2d at 381. RESTATEMENT, CONTRACTS § 413 (1932) states that "the acceptance of a deed of conveyance of land . . . discharges the contractual duties of the seller to the party so accepting . . ." except such duties as are "collateral" to the main purpose of the contract.

[15] *E.g.*, Duncan v. McAdams, 222 Ark. 143, 257 S.W.2d 568 (1953); Gabel v. Simmons, 100 Fla. 526, 129 So. 777 (1930); Huffman v. Landes, 163 Va. 652, 177 S.E. 200 (1934).

[16] The following promises survived acceptance of the deed as they were held to be "collateral" and not intended by the parties to be merged therein: South Texas Land Co. v. Sorensen, 199 Iowa 699, 202 N.W. 552 (1925) (improvements); Saville v. Chalmers, 76 Iowa 325, 41 N.W. 30 (1888) (warranty of quality of the soil); Edison Realty Co. v. Bauernschub, 191 Md. 451, 62 A.2d 354 (1948) (warranty of description); Levin v. Cook, 186 Md. 535, 47 A.2d 505 (1946) (warranty of fitness of heating plant); Hill v. Polar Pantries, 219 S.C. 263, 64 S.E.2d 885 (1951) (warranty of fitness of freezer plant); Loma Vista Dev. Co. v. Johnson, 177 S.W.2d 225 (Tex. Civ. App.) (warranty of sufficiency of foundation), *rev'd*, 142 Tex. 686, 180 S.W.2d 922 (1944). See note 20 *infra*.

[17] *E.g.*, Hill v. Polar Pantries, 219 S.C. 263, 64 S.E.2d 885 (1951).

[18] "[I]f the delivery of the deed is only one of a number of things to be performed under the terms of the contract, the delivery of the deed constitutes part performance, and the other matters to be performed remain obligatory." Glisan v. Smolenske, — Colo. —, 387 P.2d 260, 263 (1963). However, in Robbins v. C. W. Myers Trading Post, Inc., 251 N.C. 663, 111 S.E.2d 884 (1960), the court allowed recovery for breach of contract, thereby avoiding the question of whether or not the provisions of the antecedent contract were merged in the deed. This theory of recovery seems well established in

Two courts have faced this problem of defective housing squarely, refusing to allow the complications of *caveat emptor* and merger to obscure the need for effective relief.[19] In *Loma Vista Dev. Co. v. Johnson*,[20] a case involving a new house completed before the contract to purchase, the court implied a warranty, saying, "by offering the house for sale as a new and complete structure... [the vendor-builder] impliedly warranted that it was properly constructed and of good material...."[21] This case is a notable departure from the normal holding because it extends implied warranty to its logical extreme to include a completed dwelling as well as a dwelling in the process of construction, and it implied the warranty without the aid or effect of any express provisions in the contract.

Because of the difficulty in applying the merger rule,[22] the harshness of *caveat emptor*, and a hesitancy to invoke the apparently limitless theory of implied warranties,[23] some courts have adapted such accepted theories as fraud, mistake or misrepresentation to hold a vendor liable where the vendee has been led to accept a house

North Carolina in that the *Robbins* case cited and followed earlier cases also allowing recovery for breach of contract. See also Childress v. C. W. Myers Trading Post, Inc., 247 N.C. 150, 100 S.E.2d 391 (1957).

[19] Sterbcow v. Peres, 222 La. 850, 64 So. 2d 195 (1953); Loma Vista Dev. Co. v. Johnson, 177 S.W.2d 225 (Tex. Civ. App.), *rev'd*, 142 Tex. 686, 180 S.W.2d 922 (1944). See note 20 *infra*. In *Sterbcow* it was held that an implied warranty was created by all sales unless expressly excluded, or the defect was discoverable by a reasonable inspection. However, in taking a position contrary to the common law view of *caveat emptor*, the court was guided by a statute which permitted "the avoidance of a sale on account of some vice or defect in the thing sold, which renders its use so inconvenient and imperfect, that it must be supposed that the buyer would not have purchased it, had he known of the vice." LA. CIV. CODE ANN. art. 2520 (1952).

[20] 177 S.W.2d 225 (Tex. Civ. App.), *rev'd*, 142 Tex. 686, 180 S.W.2d 922 (1944). Here, the trial court entered judgment for the purchaser. The court of civil appeals remanded because there was no proof of a legal measure of damages, but held that the builder's agent had authority to represent facts in regard to the foundation because the builder "impliedly warranted that it was properly constructed and of good material...." 177 S.W.2d at 227. The supreme court reversed both lower courts, holding that the agent had no authority to represent facts in regard to the foundation. It failed to discuss the implied warranty found by the court of civil appeals.

[21] *Id.* at 227. See note 20 *supra*.

[22] See notes 12-18 *supra* and accompanying text. It is not evident in those cases in North Carolina that allow recovery for breach of contract that the court is circumventing the merger rule, as it is never discussed.

[23] 42 N.C.L. REV. 468 (1964). This note shows to some extent the apparently unlimited applications of the warranty theories by holding a cigarette manufacturer liable for lung cancer.

which varies from the contract stipulations.[24] North Carolina is among these states.[25]

A typical statement of the North Carolina view is as follows: "ordinarily, the maxim of *caveat emptor* applies equally to sales of real and personal property, and will be adhered to where there is no fraud."[26] The fraud necessary for vendor liability may be committed by a suppression of the truth as well as by a false representation or suggestion.[27] The crux of the problem in respect to fraud in housing construction has been the question of how much the

[24] See cases cited in 23 AM. JUR. *Fraud and Deceit* § 169 (1939).

[25] Brooks v. Ervin Constr. Co., 253 N.C. 214, 116 S.E.2d 454 (1960).

[26] Smathers v. Gilmer, 126 N.C. 757, 759, 36 S.E. 153, 154 (1900).

[27] Where liability is based on "suppression of the truth," the rule generally followed is that "where material facts are accessible to the vendor only, and he knows them not to be within the reach of diligent attention, observation and judgment of the purchaser, the vendor is bound to disclose such facts, and make them known to the purchaser." Brooks v. Ervin Constr. Co., 253 N.C. 214, 217, 116 S.E.2d 454, 457 (1960). Fraud may also be committed by means of deceptive statements or conduct which are intended to create an erroneous impression in another's mind to thereby induce some act or forebearance with reference to property rights to his disadvantage. Mitchell v. Strickland, 207 N.C. 141, 176 S.E. 468 (1934). Thus "half-truths" which are meant to be and are reasonably relied upon fall within this category. Whitehurst v. Life Ins. Co., 149 N.C. 273, 62 S.E. 1067 (1908). When, however, a vendor represents or implies that the house has been constructed according to specifications agreed to by the vendee, North Carolina applies a different test to determine whether or not the representation or implication is such as will allow recovery. Assuming falseness established, in order to recover under this theory the vendee would have to show that: (1) he reasonably relied on the false representation to his detriment; (2) they constituted a material inducement to the contract; and (3) he acted with ordinary prudence. Smathers v. Gilmer, 126 N.C. 757, 36 S.E. 153 (1900). In addition, if the vendee could further prove that the vendor had by some artifice concealed the defect, his case would be materially strengthened. In Walsh v. Hall, 66 N.C. 233 (1872), it was stated that if the defect is patent and the vendee accepts the representation and acts upon it "with his eyes open," the rule of *caveat emptor* applies "unless... [the vendee] has been prevented from making proper inquiry by some artifice or contrivance of the other party." *Id.* at 239. *Accord,* Leonard v. Southern Power Co., 155 N.C. 10, 70 S.E. 1061 (1911). An important factor to be noted is that it is necessary for the vendee to prove that the representations were not merely expressions of commendation, opinion or extravagant statements as to value. Such "puffing" generally does not constitute sufficient fraud so as to impose liability. Frey v. Middle Creek Lumber Co., 144 N.C. 759, 57 S.E. 464 (1907); National Cash Register Co. v. Townsend, 137 N.C. 652, 50 S.E. 306 (1905); Stovall v. Newell, 158 Ore. 206, 75 P.2d 346 (1938). By applying this test to the principal case of Glisan v. Smolenske, — Colo. —, 387 P.2d 260 (1963), where the purchaser discovered the soil condition prior to contracting to purchase the house, North Carolina would deny recovery on the ground that there was no further duty owed the vendee since the necessary elements are not present. See Brown v. Gray, 51 N.C. 103 (1858) (knowledge of the defect by the vendor); Cobb v. Fogalman, 23 N.C. 440 (1841) (lack of knowledge by the vendee).

vendor-builder is required to disclose when making sales. Generally, courts have shown a liberal tendency to require "that full disclosure of all material facts must be made whenever elementary fair conduct demands it."[28] In *Brooks v. Ervin Constr. Co.*,[29] North Carolina's leading case in this area, the evidence showed that the builder had filled a large hole on the lot with trees, stumps, and limbs, then covered the hole over without disclosing the fact. When the plaintiff entered into possession without knowledge of the filled conditions, the house began to settle causing doors to jam and the ceiling to crack. The court found that such evidence made out a case of actionable fraud sufficient to carry the case to the jury since the defect was not apparent to the purchasers and was not within the reach of their diligent attention and observation. The court stated that "where material facts are accessible to the vendor only, and he knows them not to be within the reach of the diligent attention... [and] observation of the... [vendee],"[30] the vendor is required to disclose such facts to the vendee.

It has been held, however, that the purchaser's knowledge of the conditions of the property prior to the sale absolves the seller of any liability for concealing the conditions from the purchaser.[31] When such a situation arises, the doctrine of implied warranty for fitness would seem to add a useful theory for the vendee who cannot establish actionable fraud.[32] The vendee in the principal case was faced with such a situation.[33] He had knowledge of the conditions of the soil, but the measures taken to compensate for these conditions were inadequate; thus, the plaintiff's only avenue of relief lay in implied warranty.

Where recovery is based on fraud, mistake or misrepresentation, it is apparent that such distinctions as whether the contract is for the construction of a house, for a house in the process of construc-

[28] PROSSER, TORTS § 87, at 535 (2d ed. 1955).
[29] 253 N.C. 214, 116 S.E.2d 454 (1960).
[30] *Id.* at 217, 116 S.E.2d at 457.
[31] Haddad v. Abel, 186 Cal. App. 2d 292, 8 Cal. Rptr. 774 (1960).
[32] In Cohen v. Vivian, 141 Colo. 443, 349 P.2d 366 (1960), where the purchasers were elderly women and the vendor failed to disclose that the property consisted of filled land, the vendor was held liable for fraud. In the principal case, however, because the vendee discovered the soil condition prior to entering into the contract, he would be unable to recover under a fraud theory. Nevertheless, he could recover for breach of an implied warranty of fitness.
[33] Glisan v. Smolenske, — Colo. —, 387 P.2d 260 (1963).

tion, or for a new or secondhand dwelling, are no longer necessary.[34] In view of the large sales volume of houses already completed before the sale and sold as "new" or secondhand dwellings, the theory of implied warranty, unless applied without restriction,[35] does not go far enough to give adequate protection to the vendee. It is submitted that the traditional theories of fraud, mistake or misrepresentation afford a vendee adequate relief, place a more substantial burden on the vendor-builder, and effectively blunt the harshness of the common law doctrine of *caveat emptor*. On the other hand, the principal case indicates that the requirements for actionable fraud remain strict and in many cases difficult to prove. In such a case recent decisions in the area of implied warranties offer a promise of relief for unwary purchasers of defective housing.

Underlying the entire area of implied warranties and the retreat from the harshness of *caveat emptor* as applied to the sale of real property is a revolution in the production of housing analogous to earlier changes in the production of chattels which culminated in the mass production methods we know today.[36] Coinciding with the movement toward mass production of chattels was a change in sales law from *caveat emptor* toward a warranty imposed by reason of the common or implied understanding that the article purchased would be merchantable or of fair average quality where the buyer relied upon the seller for determination of this fact.[37] With the increased industrialization of the building industry, the mass construction of housing and corresponding demand, vendees are turning to the courts for relief similar to that which courts were asked to give when an improved technology first permitted the production of chattels in large quantity.[38] Courts should be frank to admit that the

[34] See notes 6-10 *supra* and accompanying text.

[35] See Loma Vista Dev. Co. v. Johnson, 177 S.W.2d 225 (Tex. Civ. App.), *rev'd*, 142 Tex. 686, 180 S.W.2d 922 (1944). See note 20 *supra*.

[36] See note 11 *supra*.

[37] Because of a cursory inspection or a lack of knowledge of what to inspect, many latent but material defects are not discovered. Nonetheless, whether the defect be found in a chattel or in real property, if a court should find it discoverable by reasonable inspection, recovery will be denied. Stevens v. Milestone, 190 Md. 61, 57 A.2d 292 (1948). See generally 1 WILLISTON, SALES § 207 (rev. ed. 1948).

[38] In Voight v. Ott, 86 Ariz. 128, 341 P.2d 923 (1959), in order to avoid the problem of property warranties and *caveat emptor*, the vendee of a new house contended that the defective heating and air conditioning system that had been installed in the house was personalty and not realty and was therefore governed by sales law. This theory was rejected by the court on

old doctrines and distinctions are simply not adequate to meet the needs of the changing technology of the building industry and the corresponding needs of purchasers. A realistic appraisal will reveal that the doctrine of implied warranty offers a solution to a growing problem.

RICHARD L. BURROWS

Securities Regulation—"Fraud" to Include Nondisclosure

Section 206 of the Investment Advisers Act of 1940 makes it unlawful for an investment adviser, by the use of the mails or facilities of interstate commerce, "(1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client...."[1] Section 209(e) of the Act gives the Securities and Exchange Commission the power to bring an action for injunction, and the district courts power to enjoin such activities, when it has been shown that "any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of... [such] provision...."[2]

Because of the general language of the antifraud provision quoted above, it was not known what fraudulent and deceptive activities were prohibited by this act or to what extent the Commission was limited in this area by common law concepts of fraud and deceit,[3] which would include proof of: (1) false representation of a material fact; (2) an intent to induce reliance; (3) actual reliance on the false representation; and (4) damage suffered as a result.[4]

The meaning of the statute was clarified in the recent case of *SEC v. Capital Gains Research Bureau, Inc.*[5] The Commission sought to obtain a preliminary injunction under section 206 to compel an investment advisory service and its president to disclose to

the ground that the system was a fixture and therefore governed by the applicable realty laws.

[1] Investment Advisers Act of 1940, §§ 206(1)-(2), 54 Stat. 852, as amended, 15 U.S.C. §§ 80b-6(1)-(2) (Supp. IV 1963).

[2] Investment Advisers Act of 1940, § 209(e), 54 Stat. 853, as amended, 15 U.S.C. § 80b-9(e) (Supp. IV 1963).

[3] S. REP. No. 1760, 86th Cong., 2d Sess. 8 (1960); H. REP. No. 2179, 86th Cong., 2d Sess. 7 (1960).

[4] 3 Loss, SECURITIES REGULATION 1430 (2d ed. 1961); S. REP. No. 1760, 86th Cong., 2d Sess. 8 (1960).

[5] 375 U.S. 180 (1963).