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FEDERAL SECURITIES REGULATION — RULE 10b-5 — *In Pari Delicto* IS A DEFENSE IN SUITS BROUGHT UNDER RULE 10b-5 BY A TIPPEE AGAINST A TIPPER.

Tarasi v. Pittsburgh National Bank (1977)

Plaintiffs Tarasi and Sampas (tippees) alleged that they were informed by defendant Mialki (tipper), an officer of defendant Pittsburgh National Bank, that a merger between two corporations — Meridian Industries and Paragon Plastics — was going to occur and that executives of defendant bank were making large investments in the securities of both corporations.[1] Purportedly advised by Mialki that it would be beneficial to invest in Meridian Industries,[2] plaintiffs purchased stock of the corporation without disclosing this inside information.[3] The merger between the two corporations did not take place and the value of the plaintiffs' stock declined.[4] Plaintiffs brought suit against Mialki and the bank under section 10(b) of the Securities Exchange Act of 1934 (Act)[5] and rule 10b-5[6] promulgated

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1. Tarasi v. Pittsburgh Nat'l Bank, 555 F.2d 1152, 1154 (3d Cir. 1977). Mialki, Tarasi's personal banker, originally gave this information to Tarasi and told him not to repeat it to anyone. *Id.* However, Tarasi and Mialki later disclosed the information to Sampas. *Id.* A third plaintiff, Virginia Harrigan, alleged that she received similar information from Mialki. *Id.* at 1155. Tarasi and Mialki met with Harrigan and indicated to her that Meridian was "good stock" and the bank was behind it. *Id.* The record, however, indicates that the proposed merger was not mentioned to Harrigan. *Id.*

2. *Id.* at 1154-55. Mialki indicated that it was too late to invest in Paragon Plastics to obtain a benefit. *Id.* at 1154.

3. *Id.* at 1154-55. Tarasi purchased 1200 shares of common stock on the open market; Harrigan purchased 100 shares of common stock. *Id.* Sampas purchased numerous three-month "call" options. *Id.* at 1155.

4. *Id.* at 1156. At the time of the purchases the stock was trading at approximately eight dollars per share. *Id.* at 1154. When the merger did not occur, this value dropped to about one dollar per share. *Id.* at 1156.

5. The Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1976). Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
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> . . . .
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

6. 17 C.F.R. § 240.10b-5 (1977). Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or,

thereunder, alleging that they had purchased stock on the basis of false and misleading information supplied by Mialki, resulting in losses of $22,000.[7] The United States District Court for the Western District of Pennsylvania granted the defendants' motion for summary judgment[8] on the ground that the plaintiffs were *in pari delicto*[9] and therefore could not recover.[10] On appeal, the United States Court of Appeals for the Third Circuit[11] affirmed, *holding* that *in pari delicto* is an appropriate defense in suits brought under section 10(b) and rule 10b-5 where the plaintiff's fault is substantially equal to that of the defendant and policy considerations support the sustaining of the defense. *Tarasi v. Pittsburgh Nat'l Bank,* 555 F.2d 1152 (3d Cir. 1977).

The preamble of the Securities Exchange Act of 1934 states that the Act's provisions are designed to "provide for regulation and control of [transactions on securities exchanges], . . . and to insure the maintenance of fair and honest markets. . . ."[12] This broad statement of purpose, in conjunction with the sparse legislative and administrative history,[13] has left much of the development of section 10(b) and rule 10b-5, which prohibit fraudulent or manipulative devices in the purchase or sale of securities, to the discretion of the courts.[14]

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

7. 555 F.2d at 1154. Tarasi reimbursed Harrigan for her losses when the stock declined. *Id.* at 1156. The effect of this reimbursement upon Harrigan's claim was not discussed by the United States Court of Appeals for the Third Circuit. *Id.* at 1156 n.7.

8. *Id.* at 1156. The lower court opinion is unreported.

9. *See* text accompanying note 44 *infra.*

10. 555 F.2d at 1156.

11. The case was heard by Judges Adams, Kalodner and Hunter. Judge Adams wrote the opinion.

12. 15 U.S.C. § 78b (197). *See also,* H.R. REP. No. 1383, 73d Cong., 2d Sess. 1-2 (1934) and S. REP. No. 792, 73d Cong., 2d Sess. 1-2 (1934) wherein President Roosevelt's message delivered prior to passage of the Act, which contains a similar statement of purpose, is reported.

13. *See* A. JACOBS, *The Impact of Rule 10b-5* § 5 (1st rev. ed. 1977).

14. *Id.* § 6.01. In analyzing the policies underlying rule 10b-5, Jacobs stated: "[case law] refer[s] to no less than eight policies underlying the Rule: (1) maintaining free securities markets; (2) equalizing access to information; (3) insuring equal bargaining strength; (4) providing for disclosure; (5) protecting investors; (6) assuring fairness; (7) building investor confidence; and (8) deterring violations while compensating victims." *Id.* Since these policies overlap, a court may cite and rely upon several of them in reaching a decision regarding the purposes of § 10(b) and rule 10b-5. *Id. See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235-37 (2d Cir. 1974) (equalizing access to information, providing for disclosure, protecting investors, assuring fairness); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 *passim* (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969) (fairness, equal access, deterrence, free markets, disclosure, and protecting the investing public); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 *passim* (N.D. Ind. 1966), *aff'd,* 417 F.2d 147 (7th Cir. 1969), *cert. denied,* 397 U.S. 989 (1970) (deterring violations while compensating victims, disclosure, assuring fairness, protecting investors); Speed v. TransAm Corp., 99 F. Supp. 808, 829, 831 (D. Del. 1951) (insuring equal bargaining strength, disclosure, assuring fairness, protecting investors, deterring violations while compensating victims).

Although neither section 10(b) nor rule 10b-5 specifically provides for a private cause of action arising out of an alleged 10b-5 violation,[15] since *Kardon v. National Gypsum Co.*,[16] the judiciary has implied such a cause of action.[17] Suits brought pursuant to this judicially implied cause of action have occasionally raised the question of whether the plaintiff's own illegal behavior is a defense in 10b-5 actions, when it is a substantial cause of his injury.[18]

The Supreme Court's most thorough analysis of the propriety of the *in pari delicto* defense in a suit brought to enforce a regulatory statute occurred in *Perma Life Mufflers, Inc. v. International Parts Corp.*[19] In *Perma Life,* dealers brought a treble damage suit against their franchisor and others, alleging that their contracts violated the federal antitrust laws.[20] The Court

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15. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). The argument has been advanced that, in light of the sections of the Act that specifically provide for a private cause of action, the absence of such a provision in § 10(b) or rule 10b-5 is conspicuous. Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). *Compare* 15 U.S.C. § 78j(b) (1976) with 15 U.S.C. §§ 78i, 78p, 78r (1976). The courts, however, have consistently rejected this argument, referring generally to the broad purposes of the Act and the well settled principles of judicial interpretation of legislation. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235 (2d Cir. 1974); Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 680 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (1969), *cert. denied,* 397 U.S. 989 (1970); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

16. 69 F. Supp. 512 (E.D. Pa. 1946).

17. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Robinson v. Difford, 92 F. Supp. 145 (E.D. Pa. 1950).

> The reason for implying a private cause of action was explained in *Fratt*:
> We can think of nothing that would tend more toward discouraging trading off the established business markets and out of governmental regulation or that would more certainly tend to deter fraudulent practices in security transactions and thus make the Act more "reasonably complete and effective" than the right of defrauded sellers or buyers of securities to seek redress for damages in federal courts.

203 F.2d at 632. *See also* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 139 (1968) (private cause of action in antitrust suit); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963) (private cause of action to enforce Investment Advisors Act of 1940); Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970) (private cause of action for broker violation of margin requirements section of Securities Exchange Act of 1934). *See generally* 78 HARV. L. REV. 1241 (1965).

18. In securities cases, courts have been divided as to the applicability of the defense. *Compare* Nathanson v. Weis, Voisin, Cannon, Inc., 325 F. Supp. 50 (S.D.N.Y. 1971) (defense not available to tippers against tippees) *with* James v. Du Breuil, 500 F.2d 155 (5th Cir. 1974) (*in pari delicto* precludes seller from recovering against buyer in suit for alleged violation of securities antifraud provision); Kuehnert v. Texstar Corp., 412 F.2d 700 (5th Cir. 1969) (*in pari delicto* defense bars recovery by tippee from tipper). *See also* Wohl v. Blair Co., Inc., 50 F.R.D. 89 (S.D.N.Y. 1970) (*in pari delicto* defense not stricken on pretrial motion).

19. 392 U.S. 134 (1968). In antitrust cases, the Supreme Court has consistently denied *in pari delicto* as a defense. *See* Simpson v. Union Oil Co., 377 U.S. 13 (1964); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951).

20. 392 U.S. 134, 135. Plaintiffs alleged defendants had violated § 1 of the Sherman Act, 15 U.S.C. § 1 (1976), and §§ 2-3 of the Clayton Act, 15 U.S.C. §§ 13, 14

held that "the doctrine of *in pari delicto*, with its complex scope, contents, and effects, is not to be recognized as a defense to an antitrust action."[21] The Court's analysis consisted of two parts. First, the *Perma Life* Court considered the policy behind the antitrust treble damage suit and the effects the defense of *in pari delicto* might have upon effectuating those policies.[22] Noting "the inappropriateness of invoking broad common law barriers to relief when a private suit serves important public purposes,"[23] the Court concluded that the private action must remain a vital force "to deter anyone contemplating business behavior in violation of antitrust laws [and] to further the overriding public policy in favor of competition."[24]

In the second part of its analysis, the Court dismissed the franchisor's argument that *in pari delicto* was an appropriate defense, concluding that the contention that the dealers actively supported the entire restrictive program, participated in its formulation, and encouraged its continuation was "utterly refuted by the record."[25] However, the Court expressly left open the question of "whether . . . truly complete involvement and participation in a monopolistic scheme could ever be a basis . . . for barring a plaintiff's cause of action."[26] In separate concurring opinions, four justices contended, in essence, that a plaintiff should be barred from recovering if his fault was substantially equal to that of the defendant.[27]

The federal courts that have attempted to apply *Perma Life* to *in pari delicto* defenses raised in private suits under rule 10b-5 have reached different results. In *Kuehnert v. Texstar Corp.*,[28] the Fifth Circuit held that *in pari delicto* barred a suit by a tippee against a tipper[29] under section 10(b)

(1976), by requiring dealers to execute contracts, prepared by Midas, which required dealers to purchase all mufflers from Midas at a fixed price, and prevented them from selling outside designated territories before dealers could get a franchise. 392 U.S. at 136-37. The Court of Appeals for the Seventh Circuit held plaintiffs were barred by *in pari delicto* because the plaintiffs had sought the contracts, made profits, and had voluntarily entered into additional franchise agreements, all while fully aware of the restrictions. *Id.* at 138, *citing* Perma Life Mufflers, Inc. v. International Parts Corp., 367 F.2d 692, 699 (7th Cir. 1967).

21. 392 U.S. at 140.

22. *Id.* at 138-39.

23. *Id.* at 138.

24. *Id.* at 139. The Court further commented: "A more fastidious regard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement." *Id.*

25. *Id.* at 140. The Court also noted that although the plaintiffs might be subject to criticism for taking part in the illegal scheme and partaking in profit, "their participation was not voluntary in any meaningful sense." *Id.* at 139. The Court stated: "Petitioners apparently accepted many of these restraints [contractual clauses about which petitioners complained] solely because their acquiescence was necessary to obtain an otherwise attractive business opportunity." *Id.*

26. *Id.* at 140.

27. *Id.* at 146 (White, J., concurring). *See id.* at 147 (Fortas, J., concurring) (equality of position analysis); *id.* at 153 (Marshall, J., concurring) (respective fault approach); *id.* at 153 (Harlan, J., concurring and dissenting) (equally liable standard).

28. 412 F.2d 700 (5th Cir. 1969).

29. In *Tarasi*, the Third Circuit defined a tipper as "a person who has possession of material inside information and who makes selective disclosure of such

and rule 10b-5.[30] The *Kuehnert* court's discussion of the character of the plaintiff's participation and the policy considerations involved[31] paralleled the analysis developed in *Perma Life*.[32] Analyzing plaintiff's involvement, the court reduced the problem to "an accounting between joint conspirators," stating that "the degree of public interest is not comparable to that made apparent by the triple damage provision of antitrust legislation."[33] Although the court recognized that the plaintiff was in fact a dupe, it noted that he acted voluntarily[34] and was therefore equally at fault as the defendant.[35]

Turning to the policy considerations, the *Kuehnert* court concluded that the defense should be allowed in light of the need to put deterrent pressure on the tippee[36] and to prevent what would otherwise provide tippees with "an enforceable warranty that secret information is true."[37]

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information for trading or other personal purposes," and a tippee as "one who receives such information from a 'tipper.'" 555 F.2d at 1154 n.1.

30. 412 F.2d 700 (5th Cir. 1969). *See* notes 5 & 6 *supra*. In *Kuehnert*, plaintiff bought stock in Texstar Corporation on the basis of information supplied by Rhame, a former president of the corporation. Rhame informed the plaintiff that Texstar Corporation was about to merge with Coronet Petroleum Company and that the value of Texstar stock would greatly increase as a result. 412 F.2d at 702. The plaintiff did not disclose this information when he purchased the stock. When he later found out that the information was false and that Rhame had duped him in an attempt to gain control of Texstar Corporation, the plaintiff brought suit against Rhame and the corporation. *Id.* The corporation raised as a separate defense that Rhame's actions were his own personal affair and were not authorized by it, but this issue was not reached by the district court. *Id.* at 701.

31. *Id.* at 703.

32. *See* notes 20-27 and accompanying text *supra*.

33. 412 F.2d at 703. To support this position, the Fifth Circuit pointed to the availability of the "unclean hands" defense — the equitable counterpart of *in pari delicto* — in actions involving the Securities Exchange Commission's proxy requirements. *Id.* Further, the court noted that true co-conspirators may be deprived of recovery even under the Sherman Act. *Id. See* notes 26 & 27 and accompanying text *supra*; note 53 *infra*.

34. 412 F.2d at 702.

35. *Id.* at 704. The court remarked that technically the plaintiff knew nothing, concealed nothing, and hence did not defraud his vendors. *Id.* Yet, the Fifth Circuit held: "The statutory phrase 'any manipulative or deceptive device' . . . seems broad enough to encompass conduct irrespective of its outcome . . . . The absence of actual harm to his vendors, as far as the plaintiff was concerned, was a pure fortuity." *Id.* (citations omitted).

36. *Id.* at 705. The court stated:

> [I]n view of the substantial deterrent pressures already felt by the corporate insider, . . . we think it important that tippees, who present the same threat to the investing public as do insiders themselves, should be offered appropriate discouragement. We conclude that the better choice is to leave upon persons believing themselves tippees the restraint arising from the fear of irretrievable loss should they act upon a tip which proves to have been untrue. Hence the loss must lie where it falls.

Id. (citation omitted).

37. *Id.* at 705. The court recognized that "if a tippee has no remedy against an insider's private falsehoods, little deterrent against such conduct will exist . . . ." *Id.* Nonetheless, the court maintained that allowing the tippee to sue would give him a "free rein," stating: "[I]f what [the tippee] is told is false, he can recover against his

Confronted with the same issue as in *Kuehnert,* the United States District Court for the Southern District of New York held, in *Nathanson v. Weis, Voisin, Cannon, Inc.,*[38] that *in pari delicto* was not a defense to a suit by tippees against a tipper.[39] In its analysis, the court noted that plaintiffs' conduct constituted a fraudulent practice since they took advantage of unknowledgeable stockholders.[40] However, the court's consideration of the impact the *in pari delicto* defense would have on the investment market led it to conclude that the tipper should be held responsible for his actions.[41] Specifically, the *Nathanson* court determined that the private suit under rule 10b-5 is necessary to enforce the policies of the rule and the Act itself "as a means not only of redressing a private wrong, but also of protecting the public interest."[42]

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informer. If it is true, he will . . . be liable to his vendors or vendees, but here he may well be protected by the difficulties of discovery." *Id.*

In a dissenting opinion, Judge Godbold took issue with the majority's policy analysis. *Id.* at 705 (Godbold, J., dissenting). Judge Godbold believed that the *in pari delicto* defense would stifle the private suit in 10b-5 cases, noting that such a suit is a "major weapon — and may be the most important weapon — in attainment of the policies exemplified by the Act and the rule." *Id.* at 706 (Godbold, J., dissenting). In general, Judge Godbold thought tippers should be held liable since they are the source and the first step in the chain of dissemination of information harmful to the securities market. *Id.*

38. 325 F. Supp. 50 (S.D.N.Y. 1971).

39. *Id.* at 53. In *Nathanson,* plaintiffs bought stock in TST Industries, Inc. (TST) on the basis of inside information, supplied by an employee of the defendant brokerage firm, which indicated that upon a merger with Elgin National Watch Co. (Elgin), the TST stock would be exchanged for Elgin stock, which was worth about twice as much as TST stock, on a one-for-one basis. *Id.* at 51. The exchange never occurred and plaintiffs brought suit against the firm under § 10(b) and rule 10b-5. *Id.*

40. *Id.* at 55.

41. *Id.* at 57. The court stated:

> If the prophylactic purpose of the law is to restrict the use of all material inside information until it is made available to the investing public, then the most effective means of carrying out this policy is to nip in the bud the source of the information, the tipper, by discouraging him from "making the initial disclosure which is the first step in this chain of dissemination."

Id., quoting Kuehnert v. Texstar Corp., 412 F.2d at 706 (Godbold, J., dissenting). *See* note 37 *supra.*

42. 325 F. Supp. at 54 (footnote omitted). The court observed that the Act was designed "to prevent inequitable and unfair practices and to insure fairness in securities transactions generally . . . ." *Id.* at 53, *quoting* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir.), *cert. denied,* 394 U.S. 976 (1968). In addition, the court noted that rule 10b-5 "is based in policy on the justifiable expectation of the securities market place that all investors . . . have relatively equal access to material information . . . ." *Id.*

Recognizing the "surface appeal" of the argument that tippee suits would supply tippees with an indemnity against loss, the *Nathanson* court maintained that the tippee is subject to prosecution by those he defrauded and discounted the difficulties of locating tippees for such purposes. *Id.* at 55 n.26. *See* note 37 and accompanying text *supra.* Furthermore, while the court did not ignore plaintiffs' participation in an illegal act, it observed that tippees and tippers were in inherently unequal positions. 325 F. Supp. at 57. The court observed:

> The true insider . . . is at the fountainhead of the confidential information, whereas the tippee . . . may be only one of many who innocently or otherwise

Against this conflicting background, the Third Circuit confronted the question "whether the defense of *in pari delicto* stands as a bar to a lawsuit brought by 'tippees' against a 'tipper' pursuant to section 10(b) and rule 10b-5 promulgated thereunder."[43] After defining *in pari delicto* as that doctrine which bars a party "from recovering damages if his losses are substantially caused by 'activities the law forbade *him* to engage in,' "[44] the court examined *Perma Life,*[45] *Kuehnert,*[46] and *Nathanson*[47] and announced that the test for the applicability of the defense would be whether the plaintiff's fault was "substantially equal" to that of the defendant.[48]

In applying the analytical framework of *Perma Life,* the Third Circuit first discussed whether the plaintiffs' conduct justified the application of *in pari delicto.*[49] The court noted that the plaintiffs, by failing to disclose the inside information before purchasing securities in Meridian Industries, clearly violated the securities laws.[50] Furthermore, the court emphasized that these illegal acts were committed by the plaintiffs voluntarily[51] and "may fairly be said to be a *sine qua non* of their losses."[52] The Third Circuit therefore concluded "that the prohibited conduct of the plaintiffs is of

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receives a tip, and whose potential for harm is minimal as compared to that of the original source of the information. While it is true that each is in a position to take advantage of the public investor, the greater threat to the investor is posed by the original insider . . . ."

Id. This factor, coupled with the strong policy arguments against barring private suits to enforce regulatory statutes, precluded the tipper from benefiting from the *in pari delicto* defense. *Id.* at 56-58. The court stated:

> [I]t appears that the fundamental purpose of the securities acts in the prevention of fraud, manipulation or deception in connection with securities transactions and in compelling adherence by insiders to their duty to disclose material inside information before action upon it, would better be achieved by disallowing rather than allowing the defense.

Id. at 56-57.

43. 555 F.2d at 1154 (footnotes omitted). Also before the court was plaintiffs' argument that summary judgment should not have been granted by the district court because there were material facts at issue. *Id.* at 1156. The court rejected this argument, concluding that there was no dispute as to the factual matters bearing on the defense of *in pari delicto. Id.* The court stated that "if the defense . . . is applicable in securities fraud cases, . . . the defendants would still be entitled to a verdict as a matter of law even if plaintiffs prevailed as to every disputed factual issue." *Id.*

44. *Id.*, (emphasis in original) *quoting* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. at 154.

45. 555 F.2d at 1157-59. *See* notes 20-27 and accompanying text *supra.*

46. 555 F.2d at 1159-60. *See* notes 28-37 and accompanying text *supra.*

47. 555 F.2d at 1160-61. *See* notes 38-42 and accompanying text *supra.*

48. 555 F.2d at 1161.

49. *Id.*

50. *Id. See* notes 5 & 6 *supra.*

51. 555 F.2d at 1161. The court distinguished *Perma Life* by noting that in antitrust transactions there is usually some form of an agreement between the parties, whereas in securities transactions there is no such relationship which predicates the allegations of fraud. *Id.* The court concluded, however, that the case before them "contain[ed] an important element, absent in *Perma Life,* that, we believe, makes it an instance of joint participation in wrong-doing — specifically, voluntary illegal conduct on the part of the plaintiffs." *Id. See* note 25 and accompanying text *supra.*

52. *Id.* at 1162.

sufficient magnitude and has a sufficient causal relation with their losses to bring into play the concept of *in pari delicto* . . . ."[53]

Reaching the question of the impact of the *in pari delicto* defense upon the enforcement of the regulatory system,[54] the court noted that the concern of enforcement "cuts both ways"[55] since both parties violated rule 10b-5 and disallowing or applying the defense would have a deterrent impact on one of the parties.[56] Nonetheless, the court concluded that "the enforcement pressure that non-recognition of *in pari delicto* would engender through incremental deterrence of 'tippers' [was] outweighed by the prophylactic impact on the use of inside information that allowance of the defense will lead to."[57] The court noted three major factors to support this conclusion: 1) if the *in pari delicto* defense were not allowed, only tippers believing their information to be false would be deterred;[58] 2) the *in pari delicto* defense would "eliminate the warranty of the accuracy of the tip";[59] and 3) other deterrents against tippers are available.[60]

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53. *Id.* The *Tarasi* court, in its analysis, seemed to adopt the test of the concurring justices in *Perma Life*, noting that the Court itself had "diluted" its holding by reserving "the point 'whether truly complete involvement and participation in a monopolistic scheme' could form the basis of a defense." *Id.* at 1158, *quoting* 392 U.S. at 140. *See* note 27 and accompanying text *supra*. The *Tarasi* court noted that, the five justices who did concur "explicitly concluded that they would hold, in some circumstances, that illegal conduct on the part of a plaintiff would prevent him from recovering." 555 F.2d at 1158. *See The Supreme Court 1967 Term,* 82 HARV. L. REV. 63, 260-61 (1968). *But see* 60 CALIF. L. REV. 572, 575 (1972), where it was stated that Justice Black, writing for the *Perma Life* Court, "made no attempt . . . to balance the competing interests of eliminating anticompetitive schemes and investigating the moral worth of the plaintiffs. In his view, such balancing inhibits the effectiveness of the private action, which is the basis of antitrust enforcement." *Id.*

54. 555 F.2d at 1162.

55. *Id.* at 1163.

56. *Id.*

57. *Id. See* 69 DUKE L.J. 832 (1969) and 50 B.U.L. REV. 87 (1970), which agree with the analysis of the *Kuehnert* court and the conclusion that "to bar recovery by a defrauded tippee seems the more effective method to protect that policy." 69 DUKE L.J. 832, 840 (1969).

In addition to its discussion of the impact of the *in pari delicto* defense on securities law, the *Tarasi* court also took into consideration the two factors that provide the basis for *in pari delicto*: augmenting the integrity of the court, and preventing unjust enrichment. 555 F.2d at 1165. Furthermore, the court noted that since the private cause of action under rule 10b-5 is judicially implied, it is appropriate that "limited, judicially fashioned" defenses be engrafted as well. *Id.*

58. *Id.* at 1163. The court noted: "[P]articularly in light of the [rule] that a showing of scienter is a prerequisite to private recoveries under rule 10b-5, it is questionable whether such tippers would be forestalled from spreading inside information by the threat of 'tippee' suits." *Id.* (footnote omitted).

59. *Id.* at 1163-64. The court referred to the Fifth Circuit's opinion in *Kuehnert* and noted that "the danger of eliminating *in pari delicto* is that such a stance would give 'tippees' almost no incentive to forebear from using inside information." *Id.* at 1163.

60. *Id.* at 1164. The court relied on *Kuehnert* in stating that "substantial deterrents to 'tippers' are provided by the possibility of SEC and criminal actions and private suits by non-'tippee' purchasers and sellers who have been adversely affected by the dissemination of inside information." *Id.*

The *Tarasi* court based its holding that the defense of *in pari delicto* was allowed upon two observations. Initially, the court asserted that allowing the defense would "best serve the policies that undergird the securities law."[61] It is submitted that this assertion does not accord proper importance to the function tippee suits serve in revealing the tipper.[62] By barring tippee suits, it may now be possible for tippers to dispense information in anonymity, with no great risk of prosecution by the Securities Exchange Commission (SEC), since the SEC is largely dependent on private actions in uncovering violations.[63]

The *Tarasi* court also observed that tippee violations would be deterred if *in pari delicto* were applied.[64] Implicit in this observation is the assumption that tippees will be hesitant to act on inside information absent protection from loss should the information be faulty. It is submitted, however, that prior to acting upon inside information, a tippee does not often consider the possibility of suing his source if the information is wrong.[65]

The impact of the *Tarasi* decision on litigation under rule 10b-5 is unclear. Although the *Tarasi* court's ultimate conclusion accorded with the decision in *Kuehnert,*[66] in examining the fault of the parties, the Third Circuit created an uncertain standard to be employed in determining whether the defense of *in pari delicto* is applicable. At the outset of its analysis, the *Tarasi* court stated the test to be whether the plaintiffs' fault was "substantially equal"[67] to that of the defendant. The court later determined, however, that the plaintiffs' illegal activities were "of sufficient magnitude and [had] a sufficient causal relation with their losses to bring into play the concept of *in pari delicto* . . . ."[68] As a result of these different and ambiguous standards, it is submitted that courts will have difficulty in applying *Tarasi* consistently, and may reach different decisions depending on the standard they employ.

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61. *Id.* at 1163.

62. Even the *Kuehnert* court, which denied suit by allowing *in pari delicto*, recognized that if "tippee suits were barred, there would be little deterrent against the tipper." 412 F.2d at 705.

63. Comment, *Rule 10b-5: The In Pari Delicto And Unclean Hands Defense.* 58 CALIF. L. REV. 1149 (1970). Conceding that heavy trading is fairly easy to detect, one commentator maintained that "less spectacular cases may be nearly impossible to uncover without extremely costly and undesirable federal invasions of privacy . . . . The SEC cannot be expected to dissipate its energies chasing down a multitude of disconnected two party transactions . . . ." *Id.* at 1159.

64. 555 F.2d at 1163. *See* notes 57-60 and accompanying text *supra.*

65. *See* Comment, *supra* note 63. As this commentator stated:

> It is questionable . . . whether barring the tippee's action against the insider will effectively provide the deterrence the courts assumed that it would. . . . In most instances, tippees will have taken the tip from someone they trust, and therefore will not doubt the person's word. The tippee just wants to make money and does not think of possible adverse consequences.

Id. at 1159.

66. *See* notes 28-37 and accompanying text *supra.*

67. 555 F.2d at 1161.

68. *Id.* at 1162.

In *Tarasi,* the Third Circuit joined the Fifth Circuit in limiting the parties who can bring suits to enforce rule 10b-5.[69] In other areas in which private suits are used to enforce a regulatory scheme, common law barriers, including the *in pari delicto* defense, have been rejected because they hinder implementation of legislative and administrative policies.[70] Until the Supreme Court provides guidance, it is unclear whether the trend established by *Kuehnert* and *Tarasi* in 10b-5 litigation will be continued.

Kathleen M. Donahue

FEDERAL SECURITIES REGULATION — FRAUDULENT ACTIVITY MUST OCCUR "IN CONNECTION WITH" PURCHASE OR SALE OF SECURITIES TO VIOLATE SECTION 10(b).

Ketchum v. Green (1977)

Babb, Inc. (Babb), a close corporation engaged in the insurance brokerage business,[1] suffered from internal corporate dissension which resulted in the dismissal of its chairman of the board and its president.[2] The

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69. *See* note 53 and accompanying text *supra.*

70. *See* note 19 and accompanying text *supra. See also* 60 CALIF. L. REV. 572 (1972) in which the author comments on the rationale behind the majority opinion in *Perma Life* stating that the approach taken by Justice Black revealed the "basic perspective that the judiciary should use all reasonable means to eliminate anticompetitive business conduct." *Id.* at 575. This viewpoint was recognized by the *Nathanson* court and the dissenting judge in *Kuehnert* who stated that allowing the *in pari delicto* defense "as a judicially imposed restraint on 10b-5 litigation will hinder the effective weapon of the private suit." 412 F.2d at 706 (Godbold, J., dissenting). *See* 325 F. Supp. 50 (S.D.N.Y. 1971); 44 TUL. L. REV. 618 (1970). Here the *Kuehnert* court was criticized in the following manner:

> It is submitted that, in a 'tipper-tippee' relationship as in [*Kuehnert*], the doctrine of . . . *in pari delicto* [has] no place as [a] defense to violations of section 10(b) and rule 10b-5. . . . [T]he importance of the private action under section 10(b) and rule 10b-5 is only now at its first stage of serious development.

Id. at 624-25. This commentator also felt that judicially imposed restraints such as *in pari delicto* will only obstruct the remedial purposes of those regulations. *Id.* at 625.

1. Babb, Inc., is incorporated in Pennsylvania and conducts its brokerage business in Pittsburgh, Cleveland and Philadelphia. Ketchum v. Green, 415 F. Supp. 1367, 1368 (W.D. Pa. 1976), *aff'd,* 557 F.2d 1022 (3d Cir.), *cert. denied,* 434 U.S. 940 (1977).

2. *See* note 4 *infra.*

ousted officers, Chandler Ketchum and Harold Bigler, brought suit against other officers and directors of Babb[3] to enjoin their dismissal.[4]

Although the defendants constituted a majority of the board of directors,[5] they collectively held only about forty-eight percent of the outstanding stock.[6] Ketchum and Bigler, on the other hand, owned forty-four percent of the shares and, with the proxies they had obtained from minority shareholders, held the controlling block of stock.[7]

Several months before Babb's annual shareholders' meeting scheduled for April 1976, the defendants determined to oust Ketchum and Bigler from their posts.[8] However, the defendants had to be reelected to their position of dominance on the board of directors in order to legitimately exercise the function of appointing company executives.[9] To ensure their reelection, the defendants found it prudent not to reveal their intentions to plaintiffs who, as controlling shareholders, had the ultimate power to determine the board's composition.[10] Thus, at the annual meeting when a nominating committee submitted to the shareholders a slate of the incumbent board members, which included the defendants and the unsuspecting plaintiffs,[11] the slate was approved by a unanimous vote.[12] The newly reelected board immediately met to choose officers.[13] In accordance with the expectations of all parties, the nominating committee then submitted the names of Ketchum and Bigler for the offices of chairman of the board and president.[14] The defendants, now reentrenched as the majority on the board, rejected the proposed slate and instead elected their own nominees.[15] Ketchum and Bigler were then terminated as employees by action of the board.[16]

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3. 415 F. Supp. at 1368. At the time of the ouster there were eleven members of the board of directors. *Id.* at 1369 n.1. The seven directors who voted to oust the plaintiffs were Waugh, Livingston, Steele, Green, McCutchen, Roof and Hiltz. *Id.* These seven were named as defendants. *Id.* Directors Whitridge and Hainsfurther voted in favor of the plaintiffs and were not made parties to the suit. *Id.* The corporation itself was also made a defendant. *Id.* at 1370.

4. *Id.* at 1370. Both Ketchum and Bigler had assumed active management of Babb in 1967, along with certain of the defendants, and the corporation had initially prospered under their stewardship. *Id.* at 1368. However, Babb had not shown a profit for at least the preceding three years. *Id.* Several of the defendants became dissatisfied and complained that plaintiffs had wastefully diverted corporate resources into losing ventures and had repeatedly disregarded the board of directors in the formulation of corporate policy. *Id.* at 1368-69.

5. *Id.* at 1369 n.1.

6. *Id.*

7. *Id.*

8. *Id.* at 1369. *See* note 4 *supra.*

9. 415 F. Supp. at 1369 n.1.

10. *Id.*

11. *Id.* at 1369.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

Under the terms of a stock-retirement agreement, all Babb shareholders were required to be employees.[17] Thus, having lost their employment status, plaintiffs could no longer hold Babb stock, and the board authorized its purchase and tendered payment.[18] Ketchum and Bigler refused to surrender their shares.[19] Instead, they sought to enjoin their dismissal as officers and shareholders of Babb and to secure damages,[20] claiming that their dismissal had been fraudulently obtained in violation of section 10(b) of the 1934 Securities Exchange Act (1934 Act)[21] and of rule 10b-5.[22] The United States

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17. *Id.* The shareholders' agreement, dated November 18, 1968, required a shareholder or his representative to surrender his stock upon death, retirement, or disability at a price determined by a formula relating to corporate income. *Id.* at 1369-70 nn.2 & 3. The agreement, which was drafted at the instruction and with the participation of the plaintiffs, had been consistently enforced. *Id.* at 1369. If the employee was terminated for any reason other than death, retirement, or disability, one-third of the formula price was paid. Ketchum v. Green, 557 F.2d 1022, 1023 (3d Cir.), *cert. denied,* 434 U.S. 940 (1977). Plaintiffs claimed that during this period the stock was worth $15.00 per share. 557 F.2d at 1023 n.1. At the time of the lawsuit the repurchase price for death, retirement, or disability was $7.90 per share and the price for other forms of termination was $2.63 per share. *Id.*

18. 415 F. Supp. at 1369-70.

19. *Id.* at 1370.

20. 557 F.2d at 1024.

21. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976). Section 10(b) of the 1934 Act provides, *inter alia*:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . .
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1976).

The Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976), and the 1934 Act were passed by Congress in an attempt to restore order in the market after the financial crash of 1929 through federal regulation of securities. S. REP. No. 792, 73d Cong., 2d Sess. 3 (1934). "The 1934 Act was intended principally to protect investors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over-the-counter markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976), *citing* S. REP. No. 792, 73d Cong., 2d Sess., 1-5 (1934). The Securities and Exchange Commission was provided with "an arsenal of flexible enforcement powers" to carry out the 1934 Act. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

22. 17 C.F.R. §§ 240.10b-5 (1977). Rule 10b-5 was promulgated in 1942 to enforce section 10(b). *See* note 21 *supra.* The rule states:

> It shall be unlawful for any person, directly or indirectly, . . .
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person
>
> in connection with the purchase or sale of any security.

17 C.F.R. §§ 240.10b-5 (1977). For purposes of this note, references to section 10(b) are meant to encompass rule 10b-5, the administrative derivative of the statute.

Ketchum and Bigler claimed that the defendants were able to maintain their majority position on the board of directors despite their minority position as

District Court for the Western District of Pennsylvania dismissed the action for failure to state a claim under these provisions.[23]

The United States Court of Appeals for the Third Circuit[24] affirmed, *holding* that any fraudulent activity by the defendants did not occur "in connection with" the surrender of plaintiffs' stock to the company and that consequently there was no basis for recovery under section 10(b). *Ketchum v. Green,* 557 F.2d 1022 (3d Cir.), *cert. denied,* 434 U.S. 940 (1977).

Although a clear-cut test for determining the elements of a section 10(b) cause of action has not yet been enunciated, there are common areas of inquiry that courts repeatedly examine in determining whether a violation has occurred.[25] A nonexhaustive list includes questions regarding the existence of a fraud or a manipulative or deceptive device,[26] the requirement

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stockholders by failing to disclose their intention to oust the plaintiffs in the officership election. 415 F. Supp. at 1370. The plaintiffs maintained that defendants' misrepresentations tainted the subsequent actions that culminated in the activation of the stock retirement agreement. *Id.* at 1370-71. Their argument proceeded as follows: The defendants could not gain control of Babb unless the plaintiffs could be divested of the stock; Ketchum and Bigler could not be forced to surrender their stock unless they were discharged as employees and this could not be achieved unless the defendants had control of the board; the defendants could not gain control of the board unless they were reelected as directors; the reelection depended on the concealment of their intention to oust Ketchum and Bigler; therefore, the misrepresentation *was* undertaken with the objective of fostering the surrender of the stock. *Id.* at 1370-71.

23. 415 F. Supp. at 1373. The district court held that "the 'in connection with' language of Rule 10b-5 requires a showing of causation between the alleged fraud and a plaintiff's sale (or purchase) of a security," *id.* at 1371, and that plaintiffs had failed to show the "requisite causation." *Id.* at 1372. *See* notes 64-68 and accompanying text *infra.* In addition, the court observed that "plaintiffs' complaint goes to the propriety of their ouster and discharge, and not to the sale or purchase of their Babb stock." *Id.* at 1373. *See* note 56 *infra.*

24. The case was argued before Judge Markey, Chief Judge, Court of Customs and Patent Appeals (sitting by designation), and Judges Aldisert and Adams. Judge Adams wrote the opinion.

25. *See* A. JACOBS, THE IMPACT OF RULE 10b-5, § 36 (Sec. L. Serv. rev. ed. 1977); Note, *Securities Regulation — Rule 10b-5 — The Supreme Court's Holding in* Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), *May Force a Renewed Search for a Limiting Doctrine for Rule 10b-5 Liability,* 50 TEX. L. REV. 1273 (1972).

Although rule 10b-5 does not expressly provide for a private right of action, private remedies have been established through judicial decision. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975); Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

26. The types of practices considered fraudulent, manipulative, or deceptive have been expanding. Initially, courts narrowly construed the kinds of "manipulative or deceptive device[s] or contrivance[s]" which were made unlawful by section 10(b) despite the broad language of the rule. *See* 17 C.F.R. § 240.10b-5 (1977); note 22 *supra.* A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967), held that section 10(b) prohibited all fraudulent schemes, "whether the artifices employed involve[d] a garden type variety of fraud, or present[ed] a unique form of deception." *Id.* at 397. Coverage was expanded in Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir.1968), *cert.*

of a purchase or sale of securities in order to establish standing,[27] and whether the alleged fraud was "in connection with" the purchase or sale of securities.[28] In addition, courts have explored questions of materiality,[29] of reliance upon the fraud,[30] and of the need to show scienter or intent to defraud.[31]

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denied, 395 U.S. 906 (1969), and its companion cases, Pappas v. Moss, 393 F.2d 865 (3d Cir. 1968), and Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970). Those cases enunciated a concept of "new fraud" which is not deception but rather involves the exercise of undue influence over the actions of a corporation. 405 F.2d at 218-19. *See also* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (failure of buyers to disclose position as market makers to sellers); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969) (failure to disclose material inside information equally to outsiders); A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967) (purchasing securities with no intention to pay unless their value rises).

27. The case of Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952), developed the rule that a plaintiff must have been either a purchaser or a seller of the securities involved. 193 F.2d at 463-64. Similarly, in a derivative action, the corporation on whose behalf the shareholder acted must also have either purchased or sold securities. *See, e.g.,* Herpich v. Wallace, 430 F.2d 792, 807 (5th Cir. 1970); Shell v. Hensley, 430 F.2d 819, 824 (5th Cir. 1970). This purchaser-seller rule has been generally followed in the other circuits. Smallwood v. Pearl Brewing Co., 489 F.2d 579, 589, 593 (5th Cir. 1974); Landy v. FDIC, 486 F.2d 139, 156-58 (3d Cir. 1973); Vincent v. Moench, 473 F.2d 430, 433-35 (10th Cir. 1973). However, courts have developed various exceptions. *See, e.g.,* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) (in suit for equitable relief it is not necessary to establish all elements required in suit for money damages); Fenstermacher v. Philadelphia Nat'l Bank, 493 F.2d 333, 336 n.4 (3d Cir. 1974) (claimant suing for equitable relief not required to be a buyer or seller); Eason v. General Motors Acceptance Corp., 490 F.2d 654, 661 (7th Cir. 1973), *cert. denied,* 416 U.S. 960 (1974) (nontrading plaintiff who shows defendant's fraud to be the direct cause of damage may have standing); Landy v. FDIC, 486 F.2d 139, 156 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974) (no requirement that plaintiff be a purchaser or seller in injunction actions); Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D.N.Y. 1965) (plaintiff who is damaged because he is fraudulently induced not to sell or buy and subsequently sells or buys after learning of the fraud may have standing).

The United States Supreme Court adopted the *Birnbaum* rule in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), in which Justice Rehnquist stated: "The virtue of the *Birnbaum* rule . . . is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation or omission relates." *Id.* at 747. For a discussion of *Blue Chip* and its effect on exceptions to the *Birnbaum* rule, *see* Jacobs, *Standing to Sue Under 10b-5 After Blue Chip Stamps,* 3 SEC. REG. L.J. 387 (1976).

28. *See* notes 32-51 and accompanying text *infra.*

29. *See, e.g.,* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968); List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965), *cert. denied,* 382 U.S. 811, *rehearing denied,* 382 U.S. 933 (1965).

30. In Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), the Supreme Court held that "positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Id.* at 153-54. *See also* Thomas v. Duralite Co., 524 F.2d 577 (3d Cir. 1975); Harnett v. Ryan Homes, Inc., 496 F.2d 832 (3d Cir. 1974); Rochez Bros. v. Rhoades, 491 F.2d 402 (3d Cir. 1974), *cert. denied,* 425 U.S. 993 (1976); Heit v. Wetzen, 402 F.2d 909 (2d Cir. 1968), *cert. denied,* 395 U.S. 903 (1969).

31. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The Supreme Court concluded in *Hochfelder* that section 10(b) "was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct

The area that had received the least attention in past years, the "in connection with" element, has recently been the subject of increased judicial treatment.[32] Presently the United States Supreme Court's only direct analysis of that factor is found in the 1971 case of *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*[33] The facts in that case disclosed that Manhattan Casualty Company's stock had been purchased by a defendant who then engineered the sale of U.S. Treasury Bonds held by the company, applying the proceeds to cover his check drawn for the purchase price.[34] In that way, the company's own assets had been misappropriated and used by the defendant in his scheme to buy control of the company.[35] The United States District Court for the Southern District of New York dismissed the complaint[36] and the Second Circuit affirmed[37] on the ground that section 10(b) was "limited to preserving the integrity of the securities markets."[38] The United States Supreme Court reversed.[39] In the opinion, written by Justice Douglas, the Court held that "Manhattan suffered an injury as a result of deceptive practices *touching* its sale of securities as an investor."[40] The Court stated that "[s]ection 10(b) must be read flexibly, not technically and restrictively."[41] However, Justice Douglas noted that Congress had not intended section 10(b) to govern transactions which were merely a matter of "internal corporate mismanagement,"[42] thus suggesting a limit to this broad "touching" test. Yet there is also language

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alone." *Id.* at 201. The extent of applicability of the scienter requirement is presently unresolved. *See, e.g.,* Straub v. Vaisman & Co., 540 F.2d 591 (3d Cir. 1976); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969). *See also* 22 VILL. L. REV. 1238 (1977).

32. *See* A. JACOBS, *supra* note 25, at § 38.01; Note, *SEC Rule 10b-5 — "In Connection with the Purchase or Sale of Any Security" Restriction: Need for Analytical Precision,* 5 COLUM. J.L. & SOC. PROB. 28 (1969).

33. 404 U.S. 6 (1971).

34. *Id.* The Supreme Court detailed the steps involved in the scheme:

> To complete the fraudulent scheme, Irving Trust issued a second $5,000,000 check to Manhattan which Sweeney, Manhattan's new president, tendered to Belgian-American Bank & Trust Co. which issued a $5,000,000 certificate of deposit over to New England Note Corp., a company alleged to be controlled by Bourne. Bourne endorsed the certificate over to Belgian-American Banking Corp. as collateral for a $5,000,000 loan from Belgian-American Banking to New England. Its proceeds were paid to Irving Trust to cover the latter's second $5,000,000 check.

Id. at 8 (footnotes omitted).

35. *Id.* at 7-9.

36. 300 F. Supp. 1083 (S.D.N.Y. 1969).

37. 430 F.2d 355 (2d Cir. 1970).

38. *Id.* at 361. The Second Circuit stated that "Rule 10b-5 was not intended to provide a remedy for schemes amounting to no more than 'fraudulent mismanagement of corporate affairs.'" *Id.* at 360, *quoting* Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952). The court found that the rule's purpose was to protect the securities market and the investing public, that the alleged fraud affected neither the market nor the public, and that therefore the rule could not be extended to cover the scheme. 430 F.2d at 360-61.

39. 404 U.S. 6, 14.

40. *Id.* at 12-13 (emphasis added).

41. *Id.*

42. *Id.* at 12.

in the *Bankers Life* opinion which suggests that the Court will apply section 10(b) to areas formerly reserved for state corporation law.[43] The Court was unclear in defining the scope of the "internal corporate mismanagement" exception to the "touching" test;[44] additional language suggests that a breach of fiduciary duty would not fit within the exception and might be a violation of the 1934 Act.[45]

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43. 404 U.S. at 12. "Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under § 10(b), whatever might be available as a remedy under state law." *Id.*

44. *Id.* It is not clear exactly what Justice Douglas intended to fall within his "internal corporate mismanagement" exception. *Id.* The Second Circuit had held that the *Bankers Life* scheme was nothing more than fraudulent mismanagement of corporate affairs and thus not within the purview of section 10(b). 430 F.2d at 360-61. *See* note 38 *supra.* The Supreme Court's reversal determined that the *Bankers Life* facts did not fall within the internal corporate mismanagement exception. 404 U.S. at 12. Thus, in spite of the discussion of mismanagement and fiduciary duty, the *Bankers Life* outcome appears to have been generated by the "touching" test.

The corporate mismanagement exception was applied by the Sixth Circuit in Marsh v. Armada Corp., 533 F.2d 978 (6th Cir. 1976), *cert. denied,* 430 U.S. 954 (1977) (only claims stated by minority shareholders objecting to merger with tender offeror were violations of fiduciary duty and of state statutes prohibiting transactions unfair and oppressive to shareholders).

Two cases that noted the corporate mismanagement exception but did not dismiss the 10b-5 claim on that ground were *In re* Penn Central Securities Litigation, 494 F.2d 528 (3d Cir. 1974) (reorganization of a railroad through formation of a holding company involved only an incidental exchange of shares) and Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972) (minority stockholder sought to enjoin a merger claiming that the exchange ratios were unfair to the minority). For discussions of the application of rule 10b-5 to corporate management cases, *see* Jacobs, *The Role of Securities Exchange Act Rule 10b-5 in the Regulation of Corporate Management,* 59 CORNELL L. REV. 27 (1973); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases,* 86 HARV. L. REV. 1007 (1973).

45. 404 U.S. at 12. The Court noted that the corporate entity should not be disregarded even though the creditors of the defrauded corporation may be the ultimate victims because "[t]he controlling stockholder owes the corporation a fiduciary obligation — one 'designed for the protection of the entire community of interests in the corporation — creditors as well as stockholders.'" *Id., quoting* Pepper v. Litton, 308 U.S. 295, 307 (1939).

The United States Supreme Court further explored this area of fiduciary duty and corporate management in Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977). There, the Court concluded that Congress, by enacting section 10(b), had meant to regulate only those activities that involved manipulation or deception. *Id.* at 473-74. The plaintiffs in *Santa Fe* were minority shareholders eliminated in a short-form merger who claimed that the majority had breached its fiduciary duty to deal fairly with the minority. *Id.* at 467, 473. The Court held that although the majority might have injured plaintiffs by breaching a corporate fiduciary duty, *id.* at 477, the transaction "was neither deceptive nor manipulative and therefore did not violate either § 10(b) of the Act or Rule 10b-5." *Id.* at 474.

In *Santa Fe* the Supreme Court acknowledged that some cases had held breaches of fiduciary duty violative of rule 10b-5 but stated that they were "inapposite" cases since they included some element of deception. *Id.* at 474-75 n.15. Included among these cases were: Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) (bank employees misstated material facts in order to acquire stock at less than fair value); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971) (the directors were deceived when they believed that the proceeds of the bond sale would go to the company); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2d Cir. 1974), *cert. denied,* 421 U.S. 976 (1975) (stockholder claimed damage in connection with a merger as a result of market manipulation and misrepresentation);

The Third Circuit first considered the "in connection with" requirement as it existed after *Bankers Life* in *Landy v. FDIC.*[46] The *Landy* court interpreted Justice Douglas' opinion as saying that internal corporate mismanagement could be regulated under section 10(b) as long as the "touching" test was satisfied.[47] Subsequently, in *Tully v. Mott Supermarkets, Inc.,*[48] the Third Circuit interpreted the "touching" language to mean that there must be a direct causal connection or nexus between the alleged fraud and the purchase or sale of the security.[49] Even though in *Tully* there had been a fraud contemporaneous with the purchase of stock which deprived plaintiffs of the control for which they had bargained,[50] the Third Circuit found that the requisite causal connection was lacking for a section 10(b) claim since the fraud did not lie "in the actual sale of stock" to plaintiffs.[51]

In *Ketchum,* the Third Circuit focused its analysis upon an examination of the "in connection with" requirement of section 10(b) and did not consider whether a fraud had occurred or whether the requirement of a purchase or sale of securities had been met.[52] The court pursued four analytical avenues

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Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied,* 395 U.S. 906 (1969) (majority stockholder and the board of directors deceived the minority); Pappas v. Moss, 393 F.2d 865 (3d Cir. 1968) (resolution by the board of directors contained material misrepresentations in authorizing the sale of stock to the directors at a price below fair market value).

46. 486 F.2d 139, 155 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974).

47. 486 F.2d at 155. The *Landy* court noted that the only limitation placed by *Bankers Life* on its flexible interpretation of section 10(b) was that Congress had not intended the provision to regulate transactions that were no more than internal corporate mismanagement. *Id.* "The crux of the case . . . that took it out of the realm of corporate mismanagement was that Manhattan suffered an injury, 'as a result of deceptive practices touching its sale of securities as an investor.'" *Id., quoting* 404 U.S. at 12-13.

48. 540 F.2d 187 (3d Cir. 1976).

49. *Id.* Several other courts have adopted the causal connection interpretation of "touching." *See, e.g.,* Rochelle v. Marine Midland Trust Co., 535 F.2d 523 (9th Cir. 1976); Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970); Guttman v. Brinkman, 410 F. Supp. 46 (W.D. Pa. 1976); Rich v. Touche Ross & Co., 68 F.R.D. 243 (S.D.N.Y. 1975).

50. 540 F.2d 187, 191 (3d Cir. 1976). In *Tully,* plaintiff Class A shareholders offered to purchase certain treasury shares which the corporation was offering. *Id.* Some of these shares were then sold to plaintiffs by the corporation, but the corporation refused to sell them additional shares contrary to an alleged prior agreement. *Id.* Plaintiffs alleged that this refusal was due to a secret, fraudulent scheme to deprive plaintiffs of the voting control which they otherwise had. *Id.*

51. *Id.* at 194.

52. 557 F.2d at 1025-26, 1030. *See* notes 26 & 27 and accompanying text *supra.* Because the court disposed of the case on the "in connection with" issue, it did not need to decide the other factors and assumed that defendants had engaged in a deceptive practice within the meaning of the 1934 Act. *Id.* at 1026. However, the lower court had stated that it "would have serious problems with a finding of actionable fraud on these facts." 415 F. Supp. at 1371 n.6.

Despite plaintiffs' refusal to redeem their shares, the Third Circuit noted that the purchase/sale requirement had been met. 557 F.2d at 1030 n.25. The court's rationale rested upon the express terms of the 1934 Act which defines purchase and sale to encompass "contracts" of purchase or sale, and thus includes the stock-retirement agreement here. 557 F.2d at 1030 n.25. 15 U.S.C. §§ 78c(a)(13), (14) (1976).

in reaching its conclusion that any fraudulent activity engaged in by the defendants did not occur "in connection with" the forced surrender of plaintiffs' stock to the company.[53] First, the court determined that the "internal corporate mismanagement" exception noted in *Bankers Life*[54] exempted defendants from liability since the controversy arose out of an internal corporate conflict and since "the essence of plaintiffs' claim concern[ed] their dismissal as officers of Babb, Inc."[55] and not a fraudulent securities transaction.[56]

A second reason given by the court for finding that plaintiffs did not fulfill the "connection" requirement of section 10(b) was the lack of proximity between the fraud and the sale of the securities.[57] The court noted that in *Bankers Life* "there was a fairly tight linkage"[58] between the misrepresentation and the securities transaction. Here, however, the court contrasted that linkage with the several steps between the defendants' nondisclosure of their intention to oust plaintiffs and the forced surrender of stock in accord with the stock retirement program.[59] The court buttressed its argument by comparing the defendants' purposes in the two instances.[60] It reasoned that while the *Bankers Life* bond transaction was "clearly undertaken for the purpose of making possible the practices alleged to be deceptive,"[61] the *Ketchum* defendants' misrepresentations "were undertaken with the objective of inducing the expulsion of the plaintiffs as officers and employees — not to foster the surrender of their stock."[62] The court concluded that "the deceptive practices . . . and the ultimate sale of plaintiffs' stock are not tied sufficiently tightly so as to surmount the

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53. 557 F.2d at 1025–30. The lower court had dismissed the action because it concluded that plaintiffs had not shown that the alleged fraud had caused the sale of securities. 415 F. Supp. at 1371. That court said that the causation requirement had not been met since the sale of the stock "occurred solely as a matter of contractual obligation . . . and not as the result of the allegedly tainted stockholders' vote for directors." *Id.* The district court also stated that causation could be evaluated through tests of materiality and reliance. *Id.* It viewed the stockholders retirement agreements as contractual obligations which eliminated any choice for the plaintiffs. *Id.* Thus, the district court concluded, plaintiffs could not have relied on the alleged fraud since their forced sale was decreed by the contracts. *Id.*

54. 404 U.S. at 12. *See* text accompanying note 42 *supra.*

55. 557 F.2d at 1027.

56. *Id.* Although the court conceded that the "touching" test may have been met, it determined that "the 'touch' test of *Bankers Life* would not draw this lawsuit within the coverage of § 10(b)," *id.*, if the suit involved "an instance of internal corporate mismanagement." *Id.* The court noted that while the complaint stressed the importance of the relinquishment of plaintiffs' shares under the stock-retirement agreement, the record was generally silent on that point. *Id.* The forced sale of securities was not mentioned until the concluding paragraphs of the stipulation. *Id.*

57. *Id.* at 1028.

58. *Id.* The linkage in *Bankers Life* may not have been as tight as the court suggests since there were a number of separate steps involved. *See* note 34 and accompanying text *supra.*

59. 557 F.2d at 1028.

60. *Id.*

61. *Id.*

62. *Id.*

'connection' requirement of § 10(b), even as broadly formulated in *Bankers Life*."[63]

The court derived the third reason for dismissal from the earlier Third Circuit decision in *Tully*.[64] As Judge Adams noted, the court there had required "a causal connection between the alleged fraud and the purchase or sale of stock."[65] The *Ketchum* court viewed the stock retirement agreement before it, rather than the defendants' conduct, as the direct cause of the forced sale of stock.[66] Thus, the court concluded that the retirement agreement operated as "an independent and intervening cause of such transactions — a force [serving to] disrupt the connection between the challenged conduct on the part of the defendants and the relinquishment of plaintiffs' shares."[67] Since the causal connection requirement of *Tully* was not met under this construction, the "in connection with" requirement of section 10(b) was not satisfied and therefore that claim could not be sustained.[68]

The court based its fourth reason for dismissal upon a policy argument.[69] In the court's view, section 10(b) was not "designed to preempt . . . a large number of state corporation provisions."[70] Allowing this case to proceed, the court reasoned, could possibly "foster the federalization of corporate law,"[71] despite what the court believed was the intention of Congress not to interfere with the states' regulation of corporate affairs.[72] Accordingly, the court referred the plaintiffs to Pennsylvania corporation laws for relief.[73]

Although the Third Circuit mustered four reasons for affirming the dismissal of the *Ketchum* complaint,[74] it is submitted that the policy argument against extending the scope of the 1934 Act provides the true rationale for the decision, and that further examination of the first three reasons discloses problems which may limit their application in future cases.

Because the proper application of the internal corporate mismanagement exception to Justice Douglas' "touching" test is not clear,[75] Judge Adams could easily have found that the facts before him warranted the protection of section 10(b). Arguably, the alleged fraud touched the securities transaction.[76] It would follow, under the *Landy* interpretation of *Bankers*

63. *Id.*
64. 540 F.2d 187 (3d Cir. 1976). *See* notes 48-51 and accompanying text *supra.*
65. 557 F.2d at 1028, *quoting* 540 F.2d at 194.
66. 557 F.2d at 1029.
67. *Id.*
68. *Id.* at 1028-29.
69. *Id.* at 1029-30.
70. *Id.* at 1029.
71. *Id.*
72. *Id.*
73. *Id.* at 1030.
74. 557 F.2d at 1026-30. *See* notes 53-73 and accompanying text *supra.*
75. *See* note 44 and accompanying text *supra.*
76. Indeed, the *Ketchum* court admitted that the facts may have satisfied the "touching" test. 557 F.2d at 1027. *See* note 22 *supra.*

Life,[77] that the existence of internal corporate mismanagement did not mandate dismissal of the complaint since the "touching" test was satisfied.

It is further submitted that the court's mechanical application of the proximity test[78] does not adequately distinguish the facts in this case from those of *Bankers Life* since there were arguably as many intermediate steps between the fraud and the securities transaction in *Bankers Life* as in *Ketchum*.[79] However, the Third Circuit's inquiry into the purpose of the alleged fraud[80] weakens an interpretation that the court totally relied upon a mechanistic approach in its analysis of proximity. It is unclear, however, why the court bases a discussion of proximity upon an examination of purpose, since the purpose of defendants' behavior was not a factor in the Supreme Court's finding of proximity in *Bankers Life*.[81] Regardless of the origin of this test, it is submitted that the *Ketchum* court's conclusion did not give sufficient weight to plaintiffs' dual roles as shareholders and as officers.[82] The court's finding that the defendants' objective was the expulsion of plaintiffs as officers[83] did not consider that a necessary coordinate of that objective was the forced sale of plaintiffs' stock.[84] The court should have given weight to the fact that the defendants' position could not be secure until plaintiffs were deprived of their shares.[85] It is submitted, therefore, that the close relationship between the defendants' misrepresentations and the forced sale of plaintiffs' stock satisfies the proximity requirement under both an intermediate steps analysis and a purpose analysis.

The use of the *Tully* causation standard by the Third Circuit[86] is also of questionable validity since *Tully's* rigid equation of connection and

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77. *See* text accompanying note 47 *supra*. In *Bankers Life*, the Supreme Court was faced with a factual situation that the district court had labelled a case of internal corporate mismanagement. 404 U.S. at 12. In spite of the mismanagement, the Court held that the plaintiff's claim was within the scope of section 10(b) since there was a fraud "touching" the securities transaction. *Id.*

78. 557 F.2d at 1028. *See* notes 57-63 and accompanying text *supra*.

79. *See* note 34 *supra*. The steps after the sale of the bonds in *Bankers Life* were as follows: 1) Irving Trust issued a check to Manhattan; 2) the check was tendered to Belgian-American Bank & Trust which issued a certificate of deposit to New England Note; 3) Bourne, who controlled New England, endorsed the certificate to Belgian-American Banking as collateral for a loan to New England; and 4) the proceeds of the loan were paid to Irving Trust to cover its check to Manhattan. 404 U.S. at 8.

Compare the steps involved in *Ketchum* leading up to the securities transaction: 1) the defendants misrepresented their intentions about the upcoming election of officers; 2) the incumbent board of directors was reelected; 3) the defendants then voted to replace plaintiffs as officers; and 4) since plaintiffs were no longer employees, the defendants tendered payment for plaintiffs' shares in accordance with the stock-retirement agreement. 557 F.2d at 1023-24.

80. 557 F.2d at 1028. *See* notes 60-62 and accompanying text *supra*.

81. *See* 404 U.S. at 12.

82. *See* note 17 and accompanying text *supra*.

83. 557 F.2d at 1028.

84. *See* note 17 and accompanying text *supra*.

85. *See* text accompanying notes 5-7 *supra*.

86. 557 F.2d at 1028-29. *See* notes 64-68 and accompanying text *supra*.

causation appears to be at odds with the flexible "touching" language of *Bankers Life*.[87] Nonetheless, assuming the *Tully* standard to be correct, the requisite causal connection can be shown on the *Ketchum* facts.[88] Indeed, the chain of causation appears even stronger in *Ketchum* than it was in *Bankers Life* because the defendants' alleged misrepresentations in *Ketchum* were a prerequisite to the forced sale of plaintiffs' securities[89] rather than simply a consequence of the sale as in *Bankers Life*.[90] Contrary to the Third Circuit's characterization of the stock retirement agreement as "an independent and intervening cause,"[91] it is reasonable to view the agreement as a necessary and dependent step in the chain between the misrepresentation and the defendants' goal of controlling Babb.[92] Thus, the Third Circuit may have insisted on too strict a causation standard when it affirmed the dismissal of the *Ketchum* complaint.[93]

The court's policy argument against expanding the scope of section 10(b)[94] appears to be the most solid basis for its decision. By referring the plaintiffs to Pennsylvania corporation laws for relief,[95] the court acknowledged that corporations are primarily creatures of the states and not of the federal government. The *Ketchum* court's effort to restrict the coverage of section 10(b) through strict construction of the "connection" requirement is consistent with the stance of the present Supreme Court in limiting expansion of relief available under the 1934 Act.[96]

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87. 404 U.S. at 12-13. *See* text accompanying notes 40-41 *supra*.

88. The causal connection between defendants' misrepresentations and the securities transaction can be shown in the following way: Defendants concealed their intentions in order to be reelected to the board of directors; reelection to the board was necessary in order to discharge Ketchum and Bigler as employees; their discharge was necessary in order to trigger the stock retirement agreement and to force the surrender of stock; the surrender of plaintiffs' stock was necessary in order to give defendants undisputed control of Babb. 415 F. Supp at 1370-71.

89. *See* note 22 *supra*.

90. 404 U.S. at 8-9. As the *Bankers Life* opinion indicates, the sale of the bonds in *Bankers Life* was not caused by defendants' fraud. *Id.* at 8. Rather, the fraud occurred in the conversion of the proceeds of the bond sale so that Manhattan received no compensation for the depletion of its assets. *Id.* at 10. Arguably, therefore, the *Bankers Life* fraud did not "cause" the securities transaction but was merely "connected" with it.

91. 557 F.2d at 1029.

92. *See* notes 17 & 22 *supra*.

93. 557 F.2d at 1028-29. The *Ketchum* court's analysis may be valid in light of *Tully's* causal connection requirement, but arguably *Tully* was wrong in its interpretation of the discussion of connection in *Bankers Life*.

94. 557 F.2d at 1029-30.

95. *Id.* at 1030.

96. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), where the Court restricted coverage by adopting the *Birnbaum* purchaser-seller rule. *See* note 27 *supra*. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), further narrowed the scope of section 10(b) by imposing a requirement that scienter, and not simply negligence, be alleged by plaintiffs in private damage actions. *See* note 31 *supra*. The United States Supreme Court reinforced its opposition to interference with state corporate laws in Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 477-80 (1977) (minority shareholders eliminated in a short-form merger do not have a cause of action under rule 10b-5 since that is an area of corporate conduct traditionally left to state

The *Ketchum* opinion demonstrates some of the pitfalls involved in applying the flexible *Bankers Life* standard to the "connection" requirement of section 10(b).[97] In addition, the outcome of the proximity and causation discussions depended upon the method by which the court structured the relationship between the alleged misrepresentations and the securities transaction. It would be equally tenable to interpret the triggering of the stock retirement agreement and the resultant forced sale as the *objective* of the internal corporate management struggle rather than a mere byproduct. The court's insistence upon a rigid causation standard may lead to situations where plaintiffs are forced to juggle events in order to construct the necessary causal relationship.

The contrast between the flexible "touching" language of *Bankers Life* and the strict causation standard of *Tully* and *Ketchum* is not easily resolved. Despite the Third Circuit's strained reasoning, however, the outcome in the *Ketchum* case cannot be faulted. In light of the federal courts' present reluctance to become involved in state corporate matters, the application of federal securities law to the *Ketchum* situation is inappropriate.

J. Randolph Lawlace

ANTITRUST LAW — TYING ARRANGEMENTS — CLASS ACTION — WHERE AN ACTION ALLEGING AN ILLEGAL TYING ARRANGEMENT IS BROUGHT AGAINST A LESSOR BY ITS LESSEES, PLAINTIFFS ARE NOT REQUIRED TO PROVE ACTUAL COERCION ON AN INDIVIDUAL BASIS IF PRACTICAL EFFECT OF LEASE AGREEMENTS IS TO CONDITION SALE OF ONE PRODUCT UPON PURCHASE OF ANOTHER, THEREBY PERMITTING A CLASS ACTION.

Bogosian v. Gulf Oil Corp. (1977)

Bogosian and Parisi, two independent service station operators,[1] separately initiated lawsuits[2] against their respective lessors, Gulf Oil

regulation), and in Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 40-41, *rehearing denied*, 430 U.S. 976 (1977) (no cause of action for a tender offer should be implied under section 14(e) of the 1934 Act since that is an area appropriately relegated to state law).

97. *See* text accompanying note 41 *supra*.

1. Bogosian v. Gulf Oil Corp., 62 F.R.D. 124, 127 n.2 (E.D. Pa. 1973). Paul J. Bogosian began operating a Gulf station in Watertown, Massachusetts as a lessee of Gulf Oil Company in 1957 and was still in business at the time the action commenced. *Id.* Louis J. Parisi operated an Exxon station in Philadelphia, Pennsylvania as a lessee of Exxon Corporation from July 1968 to June 1971. *Id.*

2. Bogosian v. Gulf Oil Corp., 393 F. Supp. 1046 (E.D. Pa. 1975). The two independent actions were not formally consolidated for trial but were treated together for purposes of discovery and pretrial motions. *Id.* at 1047 n.1.

Corporation and Exxon Corporation, alleging that their lease agreements violated section 1 of the Sherman Act (Section 1).[3] The plaintiffs, who also joined fifteen other major oil companies as party defendants,[4] specifically alleged that the defendants had pursued a "course of interdependent consciously parallel action" involving the illegal tying of the purchase of the lessor's gasoline to the lease of the service station site.[5] Bogosian and Parisi sought certification under subsections (b)(1), (2), or (3) of Federal Rule of Civil Procedure 23[6] to maintain a class action on behalf of all present and

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3. *Id.* at 1047. Section 1 provides:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 1 (1976).

4. Bogosian v. Gulf Oil Corp., 561 F.2d 434, 439 (3d Cir. 1977). The other defendants were Amerada Hess Corp., Hess Oil and Petroleum Division, American Oil Co., Atlantic Richfield Co., Chevron Oil Co., Cities Service Oil Co., Getty Oil Co., Humble Oil & Refining Co., Mobil Oil Co., Phillips Petroleum Co., Shell Oil Co., Standard Oil Co. of California, Standard Oil Co. of Ohio, Sun Oil Co., Texaco, Inc., and Union Oil Co. of California, Union 76 Division. *Id.*

5. 393 F. Supp. at 1054. The plaintiffs alleged that the defendants had required all dealers who leased service stations from defendants to: "(a) license the use of the lessor's trademark; (b) sell only the lessor's gasoline; and (c) not sell gasoline purchased from any other source under the licensed trademark." *Id.*

6. 62 F.R.D. at 130, Rule 23 provides in pertinent part:

> (a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.
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> (b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
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> (1) the prosecution of separate actions by or against individual members of the class would create a risk of
>
> (A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
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> (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
>
> (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation

former lessee-dealers of the defendants,[7] a class estimated by plaintiffs to include 100,000 members[8] and involving over 400 different contractual forms.[9] Certification was denied by the United States District Court for the Eastern District of Pennsylvania[10] on the ground that common questions of law and fact did not predominate over those affecting individual members,[11] since "proof of exertion of economic coercive force as to each individual dealer" would be required in order to find an illegal tie-in.[12]

With respect to the plaintiffs' individual actions, the district court granted motions for summary judgment made by the nonlessor defendants,[13] and directed the entry of judgment for all moving defendants except Gulf in the Bogosian action and Exxon in the Parisi action.[14] The district court ruled that plaintiffs' allegation of "interdependent consciously parallel action" was not a sufficient statement of concerted action necessary to state a claim under section 1.[15]

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of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

FED. R. CIV. P. 23(a)-(b).

7. 62 F.R.D. at 127.

8. *Id.* at 130 n.8. Plaintiffs estimated that the class "could possibly be less than 100,000." *Id.* The defendants estimated that the class would range between 250,000 and 2,000,000 members. *Id.*

9. *Id.* at 137.

10. *Id.* at 140. Judge VanArtsdalen heard the case. *Id.* at 127.

11. *Id.* at 132-34. The district court concluded that to prove plaintiffs' contention that "the practical economic effect of the contracts" produced the tying arrangement would require a determination "in each and every lease that there was such economic coercion in fact as to constitute an illegal tie-in agreement." *Id.* at 136-37.

The district court also found that certification under subsections (1) and (2) of Federal Rule of Civil Procedure 23(b) was inappropriate. *Id.* at 132-33. *See* note 6 *supra.*

12. 62 F.R.D. at 136-37. The district court also determined that a class action was not the superior method of adjudicating this controversy. *Id.* at 139-40. The district court decided that a class action was not superior to other possible methods for several reasons, including "possible serious conflicts of interests between present and former lessees," the ability of the class members to prosecute individual actions, and the enormous difficulties presented in managing such a class. *Id.* at 139-40. Judge VanArtsdalen mentioned three particular problems in management of the class: "(a) notice to class members; (b) processing individual damage claims and possible counterclaims and defenses; and (c) determining the nationwide liability as to all defendants in favor of the entire class." *Id.* at 140.

13. 393 F. Supp. at 1056. The motions for summary judgment filed by Atlantic Richfield were denied because they were made after plaintiffs filed their notices of appeal. 561 F.2d at 440. Cities Service did not move for summary judgment. *Id.*

14. 393 F. Supp. at 1053.

15. *Id.* The court found that a claim under § 1 of the Sherman Act required an allegation of concerted action or a contract, combination or conspiracy. *Id.* at 1050. Judge VanArtsdalen concluded that "the plaintiffs have deliberately chosen to place all of their 'concerted action' claims under the rubric of 'interdependent consciously parallel action' and this phrase fails to satisfy the Sherman Act § 1." *Id.*

The court also considered the question of whether Parisi had stated an individual claim against his lessor, Exxon. *Id.* at 1053. Exxon argued that Parisi had failed to make a tie-in claim since he had not shown that he had been compelled to purchase the unwanted tied product as required by Capital Temporaries, Inc. of Hartford v. Olsten Corp., 506 F.2d 658 (2d Cir. 1974). 393 F.2d at 1055. The district

On appeal,[16] the United States Court of Appeals for the Third Circuit[17] vacated the judgments and the order refusing class certification and remanded the cases for reconsideration, *holding* that there were common questions of law or fact suitable for class treatment since plaintiffs were not required to prove actual coercion on an individual basis and since the question of defendants' sufficient economic power to appreciably restrain competition could be demonstrated without individual examination of every service station lease. *Bogosian v. Gulf Oil Corporation,* 561 F.2d 434 (3d Cir. 1977), *cert. denied,* 98 S. Ct. 1280 (1978).

A tying arrangement has been defined by the United States Supreme Court as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[18] Tying arrangements restrain competition by requiring buyers to purchase unwanted items and by foreclosing possible competitors from the market for the tied product.[19] Because of these anticompetitive effects, tying arrangements have been declared per se illegal under section 1 of the Sherman Act.[20] The Supreme Court has articulated three requirements for the establishment of an unlawful tying arrangement under the per se rule.[21]

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court rejected that argument and stated that the *Olsten* compulsion requirement was "merely evidence of the economic power of the tying product." *Id.* In addition, the court stated that if Parisi chose to rely on the rule of reason to show a Sherman Act violation rather than on the per se rule, *Olsten* and the question of compulsion would not be relevant. *Id.* Therefore, the court concluded, Parisi had stated a claim against Exxon and summary judgment for Exxon against Parisi was not appropriate. *Id.*

16. Bogosian v. Gulf Oil Corp., 561 F.2d 434, 440 (E.D.Pa. 1977). Plaintiffs appealed, contending that the entry of judgment for defendants was an abuse of discretion and that the refusal to certify a class under Federal Rule of Civil Procedure 23(b)(3) was erroneous. *Id.*

17. The case was heard by Chief Judge Seitz and Judges Aldisert and Gibbons. Chief Judge Seitz wrote the majority opinion. Judge Aldisert filed a dissenting opinion.

18. Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958).

19. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 498-99 (1969) (Fortner I); Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958); Times-Picayune Pub. Co. v. United States, 345 U.S. 594, 605 (1953); Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949); International Salt Co. v. United States, 332 U.S. 392, 396 (1947).

20. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 498-99 (1969) (Fortner I); Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). For the text of § 1 of the Sherman Act, *see* note 3 *supra.*

In *Northern Pacific,* the Supreme Court described the basis of the principle of per se unreasonableness: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." 356 U.S. at 5. The Court noted that this approach avoided "the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved." *Id.* The *Fortner* Court stated that "[t]ying arrangements of [the traditional] kind are illegal in and of themselves, and no specific showing of unreasonable competitive effect is required." 394 U.S. at 498.

21. *See* Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 498-99 (1969) (Fortner I); Northern Pac. Ry. v. United States, 356 U.S. 1, 6 (1958).

First, the existence of a tie between a tying product and a tied product must be established.[22] Second, the plaintiff must demonstrate that the seller has sufficient economic power with respect to the tying product to appreciably restrain competition in the market for the tied product.[23] Third, the tying

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22. Fortner Enterprises Inc. v. United States Steel Corp., 394 U.S. 495, 507 (1969) (Fortner I); Times-Picayune Pub. Co. v. United States, 345 U.S. 594, 614 (1953). In *Times-Picayune,* the Supreme Court stated that "[t]he common core of the adjudicated unlawful tying arrangements is the forced purchase of a second distinct commodity with the desired purchase of a dominant 'tying' product, resulting in economic harm to competition in the 'tied' product." *Id.* The United States had charged a publishing company which owned a morning and an evening newspaper with violation of § 1 of the Sherman Act since the publishing company required advertisers to purchase combined insertions in both newspapers. *Id.* at 596-97. The Supreme Court found that the per se doctrine was not applicable to the case since only one product (advertising space) and one market (local newspaper readership) were involved. *Id.* at 613-14. Thus, there was no dominant tying product. *Id.* at 614.

The Supreme Court has also noted that "[t]here is, at the outset of every tie-in case, . . . the problem of determining whether two separate products are in fact involved." Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 507 (1969) (Fortner I). The plaintiff in *Fortner* alleged that U.S. Steel and its subsidiary, U.S. Steel Homes Credit Corp., had agreed to a tying arrangement where the purchase at artificially high prices of prefabricated houses manufactured by U.S. Steel was a condition for obtaining credit from Credit Corp. at advantageous terms. *Id.* at 497. The Court determined that two products were involved since "the credit [was] provided by one corporation on condition that a product be purchased from another corporation, and . . . the borrower contract[ed] to obtain a large sum of money over and above that needed to pay the seller for the physical products purchased." *Id.* at 507. *See* Ross, *The Single Product Issue in Antitrust Tying: A Functional Approach,* 23 EMORY L.J. 963 (1974).

23. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 499, 502-03 (1969) (Fortner I); United States v. Loew's Inc., 371 U.S. 38, 45 (1962); Northern Pac. Ry. v. United States, 356 U.S. 1, 6-7 (1958).

Various tests have been used over the years to determine if sufficient economic power over the tying product has been shown. *See* McCarthy, *Trademark Franchising and Antitrust: The Trouble with Tie-ins,* 58 CALIF. L. REV. 1085, 1096-97 (1970); Note, *Tying Arrangements and the Individual Coercion Doctrine,* 30 VAND. L. REV. 755, 758-59 (1977). Early cases required that the seller of the tying product wield "monopolistic leverage" or have a dominating position in the market. Times-Picayune Pub. Co. v. United States, 345 U.S. 594, 611 (1953). *See* United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922). This standard was lowered in *Northern Pacific,* in which the Supreme Court required only "sufficient economic power with respect to the tying product to appreciably restrain" competition in the market for the tied product. 356 U.S. at 6. In *Loew's,* the Court stated that

> [m]arket dominance — some power to control price and to exclude competition — is by no means the only test of whether the seller has the requisite economic power. Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes.

371 U.S. at 45 (footnote omitted). Various tying products have been considered sufficiently unique or desirable to provide evidence of economic power to satisfy the per se test. *See, e.g.,* Northern Pac. Ry. v. United States, 356 U.S. 1, 7-8 (1958) (land); International Salt Co. v. United States, 332 U.S. 392 (1947) (patents); United States v. Loew's Inc., 371 U.S. 38, 45 (1962) (copyrights); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948) (copyrights); Siegel v. Chicken Delight, Inc., 448 F.2d 43, 50 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972) (trademark); Warriner Hermetics, Inc. v. Copeland Refrigeration Corp., 463 F.2d 1002, 1005 (5th Cir.), *cert. denied,* 409 U.S. 1086 (1972) (trademark).

More recently, the Supreme Court has broadened the test further by defining the basic question as "whether the seller has the power to raise prices, or impose other

arrangement must be shown to affect a not insubstantial amount of commerce.[24]

Several lower courts have added a fourth element to the test of an illegal tie by requiring the buyer to demonstrate that he was coerced into accepting the arrangement.[25] These courts reason that even though the seller may possess sufficient economic power to restrain competition, that power is not illegal unless the buyer was coerced into the purchase of an unwanted product.[26] The coercion requirement has a particularly marked impact on

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burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market." Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 504 (1969) (Fortner I). The Court clarified this "appreciable number" language by recognizing that there may be reasons other than economic power that explain a seller's success in convincing an appreciable number of buyers to accept a burdensome term. Fortner Enterprises, Inc. v. United States Steel Corp., 429 U.S. 610 (1977) (Fortner II). The *Fortner II* Court declared that a seller must have "some advantage not shared by his competitors in the market for the tying product" before his product will be labeled unique for purposes of the tying analysis. *Id.* at 618.

24. Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 501 (1969) (Fortner I); United States v. Loew's Inc., 371 U.S. 38, 49 (1962); International Salt Co. v. United States, 332 U.S. 392, 396 (1947). The *Fortner I* Court stated that in determining whether a not insubstantial amount of commerce is involved "normally the controlling consideration is simply whether a total amount of business, substantial enough in terms of dollar-volume so as not to be merely *de minimis*, is foreclosed to competitors by the tie . . . ." 394 U.S. at 501. The Court rejected the defendant corporation's contention that $200,000 worth of annual purchases involved in the alleged tying arrangement was insubstantial. *Id.* at 501-02. In *Loew's*, payments of $60,800 were found to satisfy the substantiality test. *Id.* at 499.

25. *See, e.g.*, Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307, 1327 (5th Cir. 1976); Capitol Temporaries, Inc. v. Olsten Corp., 506 F.2d 658, 661-63 (2d Cir. 1974); American Mfrs. Mut. Ins. Co. v. American Broadcasting-Paramount Theatres, Inc., 446 F.2d 1131, 1137 (2d Cir. 1971), *cert. denied*, 404 U.S. 1063 (1972); Halverson v. Convenient Food Mart, Inc., 69 F.R.D. 331, 336 (N.D. Ill. 1974); Thompson v. T.F.I., 64 F.R.D. 140, 146-47 (N.D. Ill. 1974); Abercrombie v. Lum's, Inc., 345 F. Supp. 387, 391-92 (S.D. Fla. 1972).

In *Olsten*, the United States Court of Appeals for the Second Circuit addressed the question of coercion. 506 F.2d at 658. The licensee of an employment service business alleged that he was required to operate a blue collar employment service under the "Handy Andy" trademark in order to obtain an exclusive license for the white collar Olsten franchise. *Id.* at 661. The Second Circuit reviewed cases discussing tying arrangements and concluded that

> the plaintiff must establish that he was the unwilling purchaser of the tied product. If he was not coerced by the economic dominance of the seller, he at least must show that he was compelled to accept the tied product by virtue of the uniqueness or desirability of the tying product . . . .

Id. at 663. The court rejected the argument that the use of a trademark provided the requisite economic power, finding that the plaintiff had not shown that he was coerced into accepting the blue collar business and that "the tying alleged here [was] ersatz at best." *Id.* at 667.

26. *See, e.g.*, Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307 (5th Cir. 1976). The Fifth Circuit stated that in order to show an illegal tie "it is not enough to show that the seller has sufficient economic power and that two products were purchased together. In addition, it must be shown that the purchaser was coerced into purchasing an unwanted product." *Id.* at 1327. *See* American Mfrs. Mut. Ins. Co. v. American Broadcasting-Paramount Theatres, Inc., 446 F.2d 1131, 1137 (2d Cir. 1971), *cert. denied*, 404 U.S. 1063 (1972).

class action antitrust suits.[27] If every potential class member were required to prove individual coercion by the seller, the action would no longer be suitable for class treatment under Federal Rule of Civil Procedure 23(b)(3),[28] since common questions of law or fact would be outweighed by individual questions on the coercion issue.[29]

The Third Circuit considered the problem of coercion in a class action context in *Ungar v. Dunkin' Donuts of America, Inc.*[30] In *Ungar,* a group of franchisees brought suit against their franchisor alleging that it was Dunkin' Donuts' policy to grant licenses to use its trademark only on condition that the franchisees also purchase other items.[31] The district court concluded that common questions of law and fact predominated over individual questions and granted class certification under Federal Rule of Civil Procedure 23(b)(3).[32] The Third Circuit reversed,[33] *holding* that proof of individual coercion was necessary to show a prima facie case of illegal tying since there was no express contractual tie-in.[34] While listing the Supreme Court's three requirements for proving a per se illegal tie-in,[35] the *Ungar* court stated further that in the absence of an agreement, the plaintiff must show that his purchase of both the tying product and the tied product was not voluntary.[36] The Third Circuit commented that in establishing the existence of the elements of a tie-in "[p]roof of economic power must . . . focus on the seller; but proof of a tie-in must focus on the buyer, because a

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27. *See* Note, *supra* note 23, at 763-67.

28. For the text of rule 23(b)(3), *see* note 6 *supra.*

29. *See, e.g.,* Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211, 1224-26 (3d Cir.), *cert. denied,* 429 U.S. 823 (1976); Abercrombie v. Lum's Inc., 345 F. Supp. 387, 391-93 (S.D. Fla. 1972). *Cf.,* Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307 (5th Cir. 1976) (directed verdict on tying claim was proper since plaintiffs failed to establish that their decision to purchase tied product was coerced by franchisor).

30. 531 F.2d 1211 (3d Cir.), *cert. denied,* 429 U.S. 823 (1976), *noted in* the Third Circuit Review, 22 VILL. L. REV. 822 (1977).

31. 531 F.2d at 1212, 1215. Specifically, the plaintiffs alleged that Dunkin' Donuts pursued a policy of granting a license to use its trademark only on condition that the franchisee accept real estate, equipment, signs, and supplies from Dunkin' Donuts. *Id.* at 1215. The franchise agreements allowed franchisees to purchase the items from approved vendors, but the plaintiffs argued that these vendors paid Dunkin' Donuts in return for being approved and then passed along the cost of the payments to the franchisees, thus eliminating any possible economic savings. *Id.* at 1216. The plaintiffs "emphasized that the focus of their case was not individual instances of illegal conduct, but a pervasive company policy, 'firm and resolutely enforced,' " to tie the license to the other items. *Id.*

32. Ungar v. Dunkin' Donuts of America, Inc., 68 F.R.D. 65 (E.D. Pa. 1975), *rev'd,* 531 F.2d 1211 (3d Cir.), *cert. denied,* 429 U.S. 823 (1976).

33. 531 F.2d 1211, 1226-27 (3d Cir. 1976).

34. *Id.* at 1226.

35. *Id.* at 1223-24.

36. *Id.* at 1224. The Third Circuit contended that the United States Supreme Court had set forth a coercion requirement in tying cases and that this coercive element was lacking in the district court's analysis. *Id.* at 1219. The court noted that under the district court's rule a tie-in could be established if a plaintiff showed that a seller-franchisor with dominant economic power over a buyer-franchisee had exercised salesmanship and sold two products. *Id.* at 1224.

voluntary purchase of the products is simply not a tie-in."[37] The court concluded that since each franchisee must prove that he was individually coerced into accepting the tie-in, common questions of law and fact did not predominate and the class should not have been certified.[38]

Facing a similar situation in *Bogosian,* the court disposed of several procedural issues[39] before focusing upon the district court's refusal to certify a class under rule 23(b)(3).[40] The court determined that it "must decide whether the 23(a) prerequisites [had] been met, whether the district court correctly identified the issues involved and which [were] common, and whether it properly identified the comparative fairness and efficiency criteria."[41] The *Bogosian* court acknowledged that if a district court properly applied the relevant criteria for class certification, the Third Circuit would "'ordinarily defer to its exercise of discretion.'"[42]

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37. *Id.* at 1224.

38. *Id.* at 1226.

39. 561 F.2d at 440-42. The court first considered the appealability of the judgments and found that the district court was empowered to enter final judgment under Federal Rule of Civil Procedure 54(b) and had not abused its discretion in so doing. *Id.* at 440-42. The court then considered the district court's ruling that plaintiffs had failed to state a claim. *Id.* at 444-47. Writing for the majority, Chief Judge Seitz concluded that the complaint, read as a whole, did allege a combination and that this, joined with a statement of the specific activities alleged to be unlawful, did state a claim. *Id.* at 445. Therefore, the court concluded, "the ruling that the specific allegation of interdependent consciously parallel action made here fails to state a claim should be vacated so that the issue can be decided, if necessary, after the relevant facts are fully developed." *Id.* at 447. Finally, the Third Circuit agreed with the district court that plaintiffs did not lack standing. *Id.*

40. *Id.* at 448.

41. *Id.* The court adhered to the analysis previously articulated in Katz v. Carte Blanche Corp., 496 F.2d 747 (3d Cir. 1974) (*en banc*), *cert. denied,* 419 U.S. 885 (1974). *Id.* The *Katz* court held that a class action could be maintained under rule 23(b)(3) only if the district court also found 1) that the questions of law or fact predominate over any questions which affect only individual class members, and 2) that a class action is superior to other available methods for the fair and efficient adjudication of the issue. 496 F.2d at 756. The *Katz* court stated that if it determined that the district court had properly identified the individual and common issues it would defer to the lower court's determination as to predominance "since that requirement relates to the conservation of litigation effort, and the trial court's judgment probably will be as good as ours." *Id.*

42. 561 F.2d at 448, *quoting* Katz v. Carte Blanche Corp., 496 F.2d 747, 757 (3d Cir. 1974). In *Katz,* the Third Circuit listed three components of a decision on the superiority of a class action: 1) consideration of alternative methods of adjudication of the issues; 2) comparison of the fairness of each method to all of the parties involved; and 3) comparison of the efficiency of adjudication of each method. 496 F.2d at 757.

The court first determined that the prerequisites of rule 23(a) had been met.[43] Next, the court addressed the identification of common questions[44] and rejected the defendants' argument that *Ungar* required proof of coercion in all tying cases and stated that only the three elements listed by the Supreme Court were necessary to establish a per se violation.[45] The purpose of the rule against tying, the court reasoned, is to allow the buyer to make a free choice based upon the merits of the tied product;[46] to achieve that free choice the seller must not be allowed to condition sale of one product upon purchase of another.[47] Thus, the court maintained that "[t]he issue [was] whether the seller acted in a certain way, not what the buyer's state of mind would have been absent the seller's action."[48] Based upon this finding, the court concluded that a plaintiff need not prove coercion once he has shown that the seller conditioned the sale of one product upon purchase of another.[49] The reason coercion was required in *Ungar,* according to the court, was that the necessary conditioning "was not reflected in the agreement or in the operation of its terms."[50]

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43. 561 F.2d at 448. For the text of rule 23(a), *see* note 6 *supra.* The court found that the prerequisite of numerosity was met since estimates of the number of class members varied between 100,000 and 2,000,000. 561 F.2d at 448. The court referred to the next section of its opinion for a discussion of the common issues involved. *Id.* The typicality requirement was satisfied since the claims of the representatives were found to be identical with those of the rest of the class. *Id.* at 449. Finally, the Third Circuit noted two aspects of the prerequisite of adequacy of representation in rule 23(a)(4). *Id.* The first concern was found to be satisfied by the competency of counsel to the class. *Id.* The court mentioned the district court's additional concern that there might be a divergence of interests between former and present lessees, but concluded that rule 23(d) provided adequate means, including certification of subclasses, for dealing with this situation and that consequently there was no basis for denying class certification on the grounds of inadequacy of representation. *Id.*

44. 561 F.2d at 449.

45. *Id. See* notes 21-24 and accompanying text *supra.*

46. 561 F.2d at 449-50.

47. *Id.* at 450.

48. *Id.*

49. *Id.*

50. *Id.* The court noted that in some cases the existence of a tie-in had been proven on the basis of business conduct where the dominant party persuaded the economically dependent party to buy certain products together with the products the dependent party originally sought. *Id. See, e.g.,* Advance Business Systems & Supply, Inc. v. SCM Corp., 415 F.2d 55, 64 (4th Cir. 1969), *cert. denied,* 397 U.S. 920 (1970); Osborn v. Sinclair Refining Co., 286 F.2d 832 (4th Cir. 1960). The *Bogosian* court identified *Ungar* as one of those cases since in *Ungar* the franchisee claimed that the franchisor had "created an economic arrangement in which the perceived threat of termination buttresses the franchisor's salesmanship." *Id. See* notes 30-38 and accompanying text *supra.*

The court pointed to several cases in which coercion was discussed as an element of a tying claim because the tie-in was sought to be shown "on the basis of a request or suggestion coupled with pressure, intimidation, in short — coercion." 561 F.2d at 451 (footnote omitted), *citing* Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307, 1326-31 (5th Cir. 1976), Davis v. Marathon Oil Co., 528 F.2d 395 (6th Cir. 1975), Belliston v. Texaco, Inc., 445 F.2d 175 (10th Cir. 1972), *and* American

The *Bogosian* court next evaluated the plaintiffs' claim that it was illegal to require a lessee to purchase gasoline only from the lessor as a condition to the leasing of a gas station site.[51] The court noted that, although no single contractual clause imposed that condition, plaintiffs pointed to "a constellation of lease provisions" that accomplished the same result.[52] Since this claim was based on the terms of the agreement, the court reasoned that, unlike *Ungar,* no proof of coercion was required.[53] The Third Circuit recognized that evaluating the claim would be a difficult process since examination of the various lease agreements used by defendants would be necessary, but concluded that "the factual and legal questions presented in this phase will be precisely the same in a class action as they would be in an individual suit."[54]

Mfrs. Mut. Ins. Co. v. American Broadcasting-Paramount Theatres, Inc., 446 F.2d 1121 (2d Cir. 1971).

The court also noted that the claim that actual coercion was necessary to show a tie-in had been rejected in several cases because the seller had expressly conditioned sale of one product upon another. 561 F.2d at 451, *citing* Hill v. A-T-O, Inc., 535 F.2d 1349 (2d Cir. 1976), Aamco Automatic Transmissions, Inc. v. Tayloe, 407 F. Supp. 430 (E.D. Pa. 1976), *and* Esposito v. Mister Softee, Inc., 1976-1 Trade Cas. ¶ 60,887 (E.D.N.Y. 1976).

51. 561 F.2d at 451-52.

52. *Id.* at 452. For example, the plaintiffs cited clauses which provided that the lease would expire in six or twelve months, that no alterations could be made to the leasehold without the lessor's approval, that the lessee must license the use of the lessor's trademark, that the lessee could not sell gas other than the lessor's from pumps bearing the lessor's trademark, that the lessee would pay rent as a percentage of gas volume sales subject to a minimum rent, and that if the lessee failed to purchase a stated quantity of gasoline the lease would terminate. *Id.*

53. *Id.* The court mentioned that the defendant oil companies agreed that the only way a lessee could sell other brands of gasoline under the terms of the leases would be to install his own pumps and tanks. *Id.* The court noted that whether this was a realistic option for a short-term lessee was a common question of fact to be developed by expert testimony. *Id.* The majority stated that for the plaintiffs to show that the purchase of gasoline was tied to the lease, they would have to show "that the lease agreements in use by all defendants [had] similar clauses which [had] the practical economic effect of precluding sale of other than the lessor's gasoline." *Id.*

54. *Id.* at 453. The court also found that common questions existed in plaintiffs' trademark claim, in the element of sufficient economic power over the tying product to appreciably restrain competition in the tied product, and in proof of fact of damages. *Id.* at 453-56. The court noted that there were two aspects to proving fact of damage in antitrust cases. *Id.* at 454. The first is the element of "standing," where the courts have limited the private action to plaintiffs whose injury is not too indirect a consequence of the antitrust violation. *Id. See, e.g.,* Cromar Co. v. Nuclear Material Equip. Corp., 543 F.2d 501, 506-09 (3d Cir. 1976); Billy Baxter, Inc. v. Coca-Cola Co., 431 F.2d 183, 187 (2d Cir. 1970), *cert. denied,* 401 U.S. 923 (1971). The second element is a showing that a causal relationship existed between the violation and the loss to plaintiff. 561 F.2d at 454. The *Bogosian* court concluded that if an antitrust violation has affected a class of persons who do have standing, "there is no reason in doctrine why proof of the impact cannot be made on a common basis so long as the common proof adequately demonstrates some damage to each individual." *Id.* Thus, the court stated that proving the fact of damage would depend on the facts of each case. *Id.*

The court suggested that the district court might conclude that it should bifurcate the trial by having one jury consider violation and another jury consider fact of damage and damages. *Id.* at 455.

Finally, the court considered the comparative fairness and efficiency of a class action[55] and rejected the district court's reasons for concluding that a class action was not appropriate.[56] Having determined that the district court erred in identifying issues common to the class and in evaluating the comparative fairness and efficiency of a class action, the court vacated the order refusing class certification.[57] Chief Judge Seitz then remanded the cases for reconsideration of the class certification and for further proceedings consistent with the court's opinion.[58]

In his dissent, Judge Aldisert argued that the district court's holding should have been affirmed.[59] In particular, Judge Aldisert disagreed with the majority's treatment of class certification.[60] He noted that *Bogosian* did not present an ordinary class action since the proposed class was "truly titanic,"[61] and "the size and diversity of the asserted class raise[d] serious questions about the propriety of class action treatment."[62] Judge Aldisert took exception to the majority's determination that common questions were presented and that individualized proof of coercion was not necessary,[63] reasoning that the evaluation of the practical economic effects of the "constellation of lease provisions" would present diverse questions not appropriate to class treatment.[64] The dissent contended that while there

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55. 561 F.2d at 456.

56. *Id.* The Third Circuit did not feel compelled to address or even present the district court's reasons. *Id.* Instead, the court stated simply that "our disagreement with each [reason] is both complete and fundamental." *Id.* The majority expressly commented upon the district court's conclusion that compliance with the notice provision of rule 23(b)(3) presented significant problems of manageability. *Id.* The court agreed with the plaintiffs that individual notice could be sent to the present lessees along with regular correspondence dispatched by the defendants and directed the plaintiffs to send individual notices to the former lessees as well. *Id.*

57. *Id.* at 456-57.

58. *Id.* at 457.

59. *Id.* at 457-62 (Aldisert, J., dissenting). Judge Aldisert would have affirmed the district court's finding that plaintiffs had failed to state a claim. *Id.* at 460 (Aldisert, J., dissenting). He attacked the majority's holding that the relevant facts should be developed before the district court decided whether plaintiffs had stated a claim when they alleged interdependent consciously parallel action. *Id.* at 457 (Aldisert, J., dissenting). In Judge Aldisert's view, a bare allegation of interdependent consciously parallel action did not state a claim under § 1 of the Sherman Act. *Id.* at 458 (Aldisert, J., dissenting), *citing* Theater Enterprises, Inc. v. Paramount Film Distributing Corp., 346 U.S. 537 (1954). Therefore, Judge Aldisert would have affirmed the entry of summary judgment. 561 F.2d at 460 (Aldisert, J., dissenting).

60. 561 F.2d at 460-62 (Aldisert, J., dissenting).

61. *Id.* at 460 (Aldisert, J., dissenting).

62. *Id. See* notes 7 & 8 and accompanying text *supra.* Judge Aldisert decided that it would not be economically impractical to prosecute individual actions since the class members were "businessmen . . . with significant and definite financial interests in the litigation." 561 F.2d at 460 (Aldisert, J., dissenting).

63. 561 F.2d at 461 (Aldisert, J., dissenting).

64. *Id.* Judge Aldisert was of the opinion that "[e]ven if there were only one defendant oil company and only one form contract, the practical economic effect would vary from dealer to dealer, city to city, and region to region." *Id.*

The dissent argued that the question of market power in the tying product also presented diverse questions, *id.*, and rejected the majority's assertion that market

were certain common questions, the fundamental question was "whether the district court abused its discretion in concluding that common questions would not predominate."[65] Concluding that the district court's finding that a class action was not superior to individual actions was well within the lower court's wide range of discretion,[66] Judge Aldisert would therefore have affirmed the denial of class certification.[67]

It is submitted that the majority's discussion of class certification in *Bogosian* and particularly its treatment of coercion as an element of tying are not entirely consistent with the Third Circuit's previous holding in *Ungar*.[68] Subsequent to these decisions, ambiguity remains regarding what proof is necessary to show the existence of a tie-in. In *Ungar* the Third Circuit stated that, in the absence of reliance by the franchisee on express contractual tie-ins, the existence of a tie-in could be shown only by proof that the buyer had been coerced into buying the tied product.[69] The *Bogosian* court, however, insisted that the buyer's state of mind played no role in determining the existence of a tie-in which could be proven only by showing that the seller had conditioned the sale of one product upon purchase of another.[70] Although the *Bogosian* court viewed coercion as a means of showing a tie-in where no express agreement existed,[71] the court appeared to curtail the role of coercion by shifting the focus from the buyer to the seller, since a plaintiff would have to provide proof of the seller's conditioning rather than the coercive effect of the conditioning upon the buyer. Coercion could then be a factor in demonstrating the existence of sufficient economic power to restrain competition.[72]

It is also suggested that the *Bogosian* court's attempt to distinguish *Ungar* on the grounds that the alleged tie-in in *Bogosian* was based upon an express agreement while the *Ungar* tie was not does not adequately explain

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power could be demonstrated by showing that defendants controlled most existing stations and that zoning restrictions and high capital costs made new development difficult. *Id.* In Judge Aldisert's view, zoning and capital costs could not be established by common proof since they would vary from place to place. *Id.*

65. *Id.*

66. *Id.* at 462 (Aldisert, J., dissenting).

67. *Id.*

68. *See* notes 30-38 and accompanying text *supra*. The *Ungar* decision provoked comments by several observers who argued that the individual coercion doctrine was inconsistent with the basic principles of the law of tying and with the general purposes of antitrust law. *See* Note, *supra* note 23; 9 CONN. L. REV. 164 (1976); 55 TEX. L. REV. 343 (1977); 22 VILL. L. REV. 822 (1977).

69. 531 F.2d at 1226. *See* text accompanying notes 36-37 *supra.*

70. 561 F.2d at 450. *See* text accompanying note 48 *supra.*

71. 561 F.2d at 450.

72. *See* note 23 *supra*. For example, a plaintiff could show that he was coerced into buying the tied product as evidence that the seller had the economic power to impose a burdensome term. *See* Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969) (Fortner I); Fortner Enterprises, Inc. v. United States Steel Corp., 429 U.S. 610 (1977) (Fortner II).

the different treatment given the two cases.[73] It is difficult to perceive why individual issues predominate in *Ungar* where there were 600 potential class members[74] but do not predominate in *Bogosian* where the court was faced with 15 defendant companies, over 400 different contractual forms and a minimum of 100,000 potential class members.[75] In addition, the *Bogosian* court's suggestion that the plaintiffs prove the existence of a tie-in by showing "the practical economic effect" of the leases on the lessees' ability to sell gasoline[76] raises serious questions about the predominance of common questions. As Judge Aldisert noted in his dissent, the practical economic effect of one lease from one oil company may vary according to the location of the station and the volume of business.[77] This varying effect would appear to require a myriad of individual questions which are arguably not suitable for treatment on a class basis.

Other questions are raised by the majority's treatment of the question of the superiority of a class action over individual actions.[78] First, it can be argued that the Third Circuit should have deferred to the district court on this determination since it had "properly applied the relevant criteria to the facts of the case."[79] Furthermore, the *Bogosian* court did not address the "possible serious conflicts of interests between present and former lessees" identified by the district court[80] nor did it consider the disadvantages of class treatment foreseen by the district court.[81] Finally, although the district court had specifically noted the difficulties involved in processing individual damage claims, counterclaims and defenses, and in determining nationwide liability of all defendants in favor of the class of plaintiffs,[82] the only manageability factor mentioned by the Third Circuit was notice to class members.[83] It is submitted that these factors indicate that the Third Circuit should have deferred to the district court's decision that a class action was not superior to individual actions, despite any errors made by the lower court in identifying issues common to the class.

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73. 561 F.2d at 450-51. *See* text accompanying note 34 *supra*. The *Ungar* plaintiffs argued that it was a pervasive company policy to enforce the tie. 531 F.2d at 1216. Presumably, the franchisor employed the leverage given it by virtue of the franchise agreements to enforce that policy, even if the agreements did not themselves specifically impose a tie. *Id.* The *Ungar* plaintiffs could arguably have set forth a constellation of lease provisions that would have satisfied the *Bogosian* court that the tie-in claim was based on the terms of the agreement. *See* 561 F.2d at 452; note 52 *supra*.

74. 531 F.2d at 1215.

75. *See* notes 4-9 and accompanying text *supra*.

76. 561 F.2d at 452.

77. *Id.* at 461 (Aldisert, J., dissenting).

78. *See* notes 55-58 and accompanying text *supra*.

79. 561 F.2d at 460 (Aldisert, J., dissenting). *See* notes 41 & 42 and accompanying text *supra*.

80. *See* 62 F.R.D. at 139.

81. *Id.* at 139-40. *See* note 12 *supra*.

82. *See* 62 F.R.D. at 140.

83. 561 F.2d at 456.

One consequence of the discussion of coercion in *Bogosian* may be the encouragement of the use of class actions in attacking alleged antitrust violations. The court's statement that proof of individual coercion is required only where the alleged tie-in is not based on an express agreement appears to reaffirm the Third Circuit's adherence to the Supreme Court's three-step analysis of per se violations.[84] The deemphasis of coercion may make it easier for plaintiffs to show the existence of a tie-in.

It is submitted that the Third Circuit's refusal to defer to the lower court's discretionary determination that a class action was not superior to individual actions will create enormous problems for the lower court.[85] The management of this action which involves both a "truly titanic"[86] class and an extremely complex task of determining "the practical economic effect" of the lease agreements[87] may cause this litigation to linger for decades with no benefit to the class and with no respite for the defendants. Furthermore, the implication of a final resolution of this claim in favor of the plaintiffs would extend beyond the radical alteration of the nationwide system of gasoline distribution to the root of the franchising system.

J. Randolph Lawlace

CIVIL RIGHTS — SECTION 1981 — A MUNICIPALITY CAN BE HELD VICARIOUSLY LIABLE FOR DAMAGES UNDER 42 U.S.C. § 1981 FOR THE UNCONSTITUTIONAL BEHAVIOR OF ITS POLICE OFFICERS.

Mahone v. Waddle (1977)

Plaintiffs, two black citizens, brought suit for damages against two police officers individually and their employer, the City of Pittsburgh (City).[1] The plaintiffs claimed that they were stopped without probable cause for a supposed traffic violation,[2] and further alleged that, because they were black, plaintiffs were mistreated by the two police officers throughout the subsequent arrest, incarceration, and hearing.[3] The suit against the City

84. *See* notes 21-24 and accompanying text *supra*.
85. *See* note 12 *supra*.
86. 561 F.2d at 460 (Aldisert, J., dissenting).
87. *Id.* at 452.

1. Mahone v. Waddle, 564 F.2d 1018, 1020 (3d Cir.), *petition for cert. filed sub nom.* City of Pittsburgh v. Mahone, 46 U.S.L.W. 3420 (U.S. Nov. 22, 1977) (No. 77-731). The district court opinion is not reported.

2. 564 F.2d at 1020. Plaintiffs claimed they were charged with driving too fast for conditions and following too closely. *Id.*

3. *Id.* The alleged mistreatment of plaintiffs included their subjection to "racial epithets, verbal harassment, and physical abuse by hands, fists, and nightsticks" during the arrest and transportation to the police station. *Id.* In addition, defendants allegedly played a part in plaintiff's subsequent conviction by giving false testimony in the proceeding before a city magistrate. *Id.*

asserted three grounds for relief.[4] Plaintiffs contended that the City was vicariously liable for the misconduct of its officers under the fourteenth amendment[5] and under section 1981 of the Civil Rights Act of 1866 (1866 Act).[6] They also maintained that the City was directly liable "for its alleged negligence or wanton recklessness in failing to train and supervise the two individual defendants and in permitting them to act as police officers notwithstanding the City's prior knowledge of their propensity to harass and mistreat black citizens."[7]

The United States District Court for the Western District of Pennsylvania granted the City's motion to dismiss all claims against it,[8] finding that the City was entitled to immunity from prosecution for damages under the fourteenth amendment as well as from claims for damages under section 1981.[9] On appeal, the United States Court of Appeals for the Third Circuit[10] affirmed the dismissal of the fourteenth amendment claim but reversed the dismissal of the other claims, *holding* that section 1981 could be asserted by a private individual to bring a civil claim for compensatory and punitive damages against a municipality. *Mahone v. Waddle,* 654 F.2d 1018 (3d Cir.), *petition for cert. filed sub nom.* City of Pittsburgh v. Mahone, 46 U.S.L.W. 3420 (U.S. Nov. 22, 1977) (No. 77-731).

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4. *Id.* at 1021. The individual defendants were sued for alleged violations under the fourteenth amendment and 42 U.S.C. §§ 1981, 1983, 1985 (1970). *Id.*

5. *Id.* at 1021. The fourteenth amendment states, in part:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the law.
>
> . . . .
>
> The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

U.S. CONST. amend. XIV, §§ 1, 5.

6. 564 F.2d at 1021. Section 1981 provides:

> All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, to be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like punishment, pains, penalties, taxes, licenses, and exactions of every kind, and to no other.

42 U.S.C. § 1981 (1970) (originally enacted as Act of April 9, 1866, ch. 31, § 1, 14 Stat. 27; reenacted in Act of May 31, 1870, ch. 114, §§ 16, 18, 16 Stat. 140, 144).

7. 564 F.2d at 1021. Jurisdiction for the federal claims was based upon 28 U.S.C. §§ 1331, 1343(3) (1970), with pendent jurisduction over the state law claims. *Id.* For the text of § 1331, *see* note 36 *infra.* For the text of § 1343(3), *see* note 72 *infra.*

8. 564 F.2d at 1021. The district court dismissed the federal claims against the City, pursuant to Federal Rule of Civil Procedure 12(b)(6), for failure to state a claim for which relief could be granted. *Id.* In the absence of jurisdiction based upon federal law, the court was unwilling to exercise derivative, pendent jurisdiction over the state law claims and consequently dismissed them also. *Id.*

9. *Id.* The district court's rationale was that the municipal immunity available under 42 U.S.C. § 1983 (1970) extended to claims brought under the fourteenth amendment and to those based upon 42 U.S.C. § 1981 (1970). *Id.* In addition, the court found that the facts were insufficient to grant relief under § 1981. *Id.*

10. The case was first heard by Judges Rosenn, Kalodner, and Garth, and later by Judges Gibbons, Rosenn, and Garth. Judge Rosenn wrote the majority opinion, and Judge Garth wrote a lengthy dissent.

A modern repercussion of the passage of the Civil Rights Acts[11] during Reconstruction has been federal law suits[12] by individual citizens attempting to hold municipalities liable for damages caused by their employees' conduct.[13] These suits generally have been unsuccessful,[14] because the legislative history of the Civil Rights Act of 1871 (1871 Act)[15] demonstrated Congress' concern that it lacked "constitutional power to impose liability on political subdivisions of the States."[16] The municipal immunity concept was

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11. In the decade following the Civil War, Congress enacted five statutes which are collectively known as the Civil Rights Acts. *See* Act of April 9, 1866, ch. 31, 14 Stat. 27 (current version at 42 U.S.C. §§ 1981, 1988 (1970)); Act of May 31, 1870, ch. 114, 16 Stat. 140 (current version at 42 U.S.C. § 1971 (1970)); Act of Feb. 28, 1871, ch. 99, 16 Stat. 433 (repealed 1894); Act of April 20, 1871, ch. 22, 17 Stat. 13 (current version at 42 U.S.C. §§ 1983, 1985 (1970)); Act of March 1, 1875, ch. 114, §§ 3-5, 18 Stat. 336, 337 (current version at 10 U.S.C. §§ 3061, 8061 (1976); 18 U.S.C. § 243 (1976); 42 U.S.C. § 1985 (1970)). Although not reflected in the United States Code, parts of the 1866 Act and the 1870 Act have been traced by the Supreme Court to 18 U.S.C. §§ 241, 242 (1976). *See* Adickes v. Kress & Co., 398 U.S. 144, 206 & n.17 (1970).

12. That suits against government employees and municipalities may be brought in *state* courts has been recognized traditionally. *See, e.g.,* 564 F.2d at 1041 (Garth, J., dissenting).

13. *See* Kates & Kouba, *Liability of Public Entities Under Section 1983 of the Civil Rights Act,* 45 S. CAL. L. REV. 131 (1972); Note, *Constitutional Law: "Under Color of" Law and the Civil Rights Act,* 1961 DUKE L.J. 452, 455.

Cases discussing individual and municipal liability for violations of citizens' constitutional and civil rights indicate that any level governmental employee may be held liable under § 1983 for direct wrongdoing, with certain narrowly drawn exceptions. *See, e.g.,* Santiago v. City of Philadelphia, 435 F. Supp. 136 (E.D. Pa. 1977). In *Santiago,* Chief Judge Lord described various forms of individual immunity that might bar § 1983 claims. State judges, for example, are immune from damage suits under that statute "for actions done in the performance of their judicial function." 435 F. Supp. at 146, *citing* Pierson v. Ray, 386 U.S. 547 (1967). Judge Lord noted, however, that judges are not immune from suits for equitable relief. 435 F. Supp. at 146, *citing* Boyd v. Adams, 513 F.2d 83, 86-87 (7th Cir. 1975). He also remarked that judicial immunity does not extend to nonjudicial functions of judicial officers. 435 F. Supp. at 146, *citing* Lynch v. Johnson, 420 F.2d 818, 820 (6th Cir. 1970).

Similarly, Judge Lord stated that absolute immunity may be afforded government officials for functions that relate to the judicial process, but that merely a good faith defense exists for all other supervisory and nonsupervisory government employees. 435 F. Supp. at 147, *citing* Imbler v. Pachtman, 424 U.S. 409 (1976) (absolute immunity for actions related to judicial functions); Wood v. Strickland, 420 U.S. 308 (1975) (good faith defense for school board officials acting in an adjudicatory capacity).

14. *See, e.g.,* cases cited in notes 21 & 23 *infra.* Prior to the Supreme Court's decision in Monroe v. Pape, 365 U.S. 167 (1961), holding state officers and employees individually liable for violations of plaintiffs' federally protected rights under § 1983, that section had been applied restrictively by lower federal courts even in suits that did not join municipalities as defendants. *See* Note, *The Supreme Court 1960 Term,* 75 HARV. L. REV. 40, 213-14 (1961). *See generally* Note, *supra* note 13.

15. Act of April 20, 1871, ch. 22, § 1, 17 Stat. 13 (codified at R.S. § 1979 (1874), current version at 42 U.S.C. §§ 1983, 1985 (1970)).

16. Moor v. County of Almeda, 411 U.S. 693, 708 (1973) (footnote omitted). *See* CONG. GLOBE, 42d Cong., 1st Sess. 788 (1871) (remarks of Rep. Kerr); *id.* at 791 (remarks of Rep. Willard); *id.* at 793 (remarks of Rep. Poland); *id.* at 795 (remarks of Rep. Blair); *id.* at 798 (remarks of Rep. Bingham).

The 1871 Act was proposed and enacted as a result of the rising violence and destruction in the South after the Civil War, and the apparent reluctance or inability of state governments to control the situation by effective enforcement of state law. *See*

judicially established in *Monroe v. Pape*,[17] in which the Supreme Court held that a municipality is not a "person," subject to liability under section 1983 of the 1871 Act.[18] The *Monroe* Court emphasized the reluctance of Congress to impose civil liability upon the "mere instrumentalit[ies] for the administration of state law."[19]

Lower federal courts responded to *Monroe* and subsequent Supreme Court decisions that further limited the scope of section 1983[20] in two general

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District of Columbia v. Carter, 409 U.S. 418, 425-27 (1973); Monroe v. Pape, 365 U.S. 167, 175-80 (1960). The solution attempted by the 42d Congress in the 1871 Act, was to create federal jurisdiction over official state infringement of federally guaranteed rights, since "Congress had neither the means nor the authority to exert any direct control, on a day-to-day basis, over the actions of state officials. . . ." 409 U.S. at 427.

The 42d Congress debated a proposal that expressly created municipal liability. *See* CONG. GLOBE, 42d Cong., 1st Sess. 663 (1871). The proposal, known as the Sherman Amendment, would have required "the inhabitants of the county, city, or parish in which any of the said offenses shall be committed . . . to pay full compensation to the person or persons damnified by such offenses . . . ." *Id.* Although the Senate adopted the Sherman Amendment, the House rejected it. *Id.* at 704-05, 725.

The supporters of the Sherman Amendment argued that imposition of liability upon municipalities for their employees' wrongdoings would provide "a safeguard [against civil rights violations] which no police arrangement [could] make, one more effective than any other . . . ." *Id.* at 794 (remarks of Rep. Kelley). For a discussion of the scope of the Sherman Amendment and the significance of its rejection, *see* Kates & Kouba, *supra* note 13, at 133-36, 147-48.

The events, social and political climate, legislation, and judicial actions of the Reconstruction era have been discussed by a number of historians. *See, e.g.*, 6 C. FAIRMAN, HISTORY OF THE SUPREME COURT OF THE UNITED STATES: RECONSTRUCTION AND REUNION, 1864-88 (1971); H. FLACK, THE ADOPTION OF THE FOURTEENTH AMENDMENT (1908); A. NEVINS, THE EMERGENCE OF MODERN AMERICA, 1865-1878 (1927); B. SCHWARTZ, STATUTORY HISTORY OF THE UNITED STATES: CIVIL RIGHTS (pt. 1) (1970); K. STAMPP, THE ERA OF RECONSTRUCTION, 1865-1877 (1965); J. TENBROEK, EQUAL UNDER LAW (rev. ed. 1965); Bickel, *The Original Understanding and the Segregation Decision*, 69 HARV. L. REV. 1 (1955); Frank & Munro, *The Original Understanding of "Equal Protection of the Laws,"* 50 COLUM. L. REV. 131 (1950); Graham, *Our "Declaratory" Fourteenth Amendment*, 7 STAN. L. REV. 3 (1954); Gressman, *The Unhappy History of Civil Rights Legislation*, 50 MICH. L. REV. 1323 (1953).

17. 365 U.S. 167 (1960).

18. *Id.* at 191. Section 1983 provides:

> 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 proceeding for redress.

42 U.S.C. § 1983 (1970).

19. 365 U.S. at 190, *quoting* CONG. GLOBE, 42d Cong., 1st Sess. 804 (1871). The *Monroe* Court expressly declined to comment upon certain policy considerations raised by the facts of the case such as the ineffectiveness of private remedies against police officers and the projected beneficial results of municipal liability. 365 U.S. at 190. Moreover, the Court did not reach the constitutional issue "whether Congress has the power to make municipalities liable for the acts of its officers that violate the civil rights of individuals." *Id.* at 191. *See* Note, *Damage Remedies Against Municipalities for Constitutional Violations*, 89 HARV. L. REV. 922, 939-40 (1976).

20. *See* City of Kenosha v. Bruno, 412 U.S. 507, 513 (1973); Moor v. County of Almeda, 411 U.S. 693, 710 (1973). The *Moor* Court held that a county is not a "person"

manners: 1) by concentrating upon the definitional nature of the cases, in order to determine when a particular defendant is a "person;"[21] and 2) by reading the cases and history of section 1983 as evidencing a congressional mandate for municipal immunity in civil rights cases.[22] Under either, or a combined approach, the impact of *Monroe* and the Court's subsequent restrictions on section 1983 availability has been the effective destruction of

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for § 1983 purposes. 411 U.S. at 710. The *Bruno* Court applied § 1983 exclusion of cities and counties to requests for equitable relief as well as to damage claims. 412 U.S. at 513. Prior to the Court's limitation of § 1983 in *Bruno,* many lower federal courts had interpreted *Monroe* and *Moor* as presenting no barrier against equitable relief under the statute. *See, e.g.,* Harkless v. Sweeney Ind. School Dist., 427 F.2d 319, 320 (5th Cir. 1970), *cert. denied,* 400 U.S. 991 (1971); *see also* Note, *Civil Rights Jurisdiction Under 28 U.S.C. § 1343(3) Not Available When Equitable Monetary Relief Sought Under 42 U.S.C. § 1983 Would Stem Directly from Municipal Funds,* 47 MISS. L.J. 799, 802 & n.20 (1976).

21. *See, e.g.,* Ingraham v. Wright, 525 F.2d 909 (5th Cir. 1976), *aff'd.,* 430 U.S. 651 (1977) (school board is not a "person"); Wright v. Arkansas Activities Assoc., 501 F.2d 25 (8th Cir. 1974) (voluntary athletic association is not a "person"); Cheramie v. Tucker, 493 F.2d 586 (5th Cir.), *cert. denied,* 419 U.S. 868 (1974) (state highway department and other arms of state government are not "persons"); Blanton v. State Univ., 489 F.2d 377 (2d Cir. 1973) (state university is not a "person"); Lehman v. City of Pittsburgh, 474 F.2d 21 (3d Cir. 1973) (municipal civil service commission is not a "person"); Henschel v. Worchester Police Dept., 445 F.2d 624 (1st Cir. 1971) (per curiam) (city police department is not a "person"); Madden v. New Jersey State Parole Bd., 438 F.2d 1189 (3d Cir. 1971) (parole board is not a "person"); Gittlemacker v. County of Philadelphia, 413 F.2d 84 (3d Cir. 1969), *cert. denied,* 396 U.S. 1046 (1970) (city hospital is not a "person"); Christian v. Anderson, 381 F. Supp. 168 (D. Okla. 1974) (state of Oklahoma is not a "person"); Edwards v. Philadelphia Electric Co., 371 F. Supp. 1313 (E.D. Pa.), *aff'd,* 510 F.2d 696 (3d Cir. 1974) (public utilities commission is not a "person"); Sams v. New York State Bd. of Parole, 352 F. Supp. 296 (S.D.N.Y. 1972) (state parole board is not a "person"). *Cf.* Bosley v. City of Euclid, 496 F.2d 193, 195 (6th Cir. 1974) (municipality is not a "person" under 42 U.S.C. § 1985 (1970)).

In Muzquiz v. City of San Antonio, 520 F.2d 993 (5th Cir.), *aff'd en banc on other grounds,* 528 F.2d 499 (1976), the Fifth Circuit held a pension fund board of trustees to be a "nonperson." 520 F.2d at 998. In his dissent, Judge Godbold enunciated the following test for determining when an entity should be included in the § 1983 "person" category: "[W]hether the public body is so connected — administratively, functionally, fiscally, and in other ways — to a state, city, or county . . . that it is in effect an arm . . . of the state, city, or county." *Id.* at 1005 (Godbold, J., dissenting).

22. *See, e.g.,* Redding v. Medica, 402 F. Supp. 1260, 1261 (W.D. Pa. 1975); Hines v. D'Artois, 383 F. Supp. 184, 189-90 (W.D. La. 1974); Bennett v. Gravelle, 323 F. Supp. 203, 215 (D. Md. 1974), *aff'd,* 451 F.2d 1011 (4th Cir. 1971), *cert. denied,* 407 U.S. 917 (1972); Note, *supra* note 19, at 939.

In *Hines,* the court disposed of plaintiffs' vicarious liability claims against the municipal corporation for the actions of police officers, maintaining that "[t]o hold otherwise would punish the entire community, the innocent with the guilty, and run counter to the congressional intent in adopting the Civil Rights Acts, reflected by the history of their evolution as described in *Monroe* . . . and *City of Kenosha* . . . ." 383 F. Supp. at 190.

In a slightly different approach, the *Bennett* court noted that the purpose of § 1983 was to create a remedy for aggrieved individuals by allowing them to bring damage actions against the wrongdoing municipal employees, but that municipal liability was rejected by the 42d Congress as antagonistic to its own policies. 323 F. Supp. at 215. Thus, according to the *Bennett* court, to allow a damage claim against a city under § *1981* would also "[deprive] section 1983 of its essential significance." *Id.*

potential federal remedies against local governmental entities for their direct and indirect violations of section 1983.[23]

An alternate theory for reaching municipal coffers for harm inflicted by city employees has been to bring claims directly under the fourteenth amendment,[24] alleging direct and, more commonly, vicarious liability of the municipal corporation.[25] This approach gained popularity after the Supreme Court's decision in *Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics,*[26] in which the injured plaintiff was allowed to bring a damage claim directly under the fourth amendment against federal officers for their unconstitutional conduct.[27] While *Bivens* arguably was a narrow decision confined to its facts,[28] it has been asserted that the *Bivens* doctrine should be given broad application,[29] as *implied* in two subsequent Supreme Court cases.[30] In *District of Columbia v. Carter,*[31] Justice Brennan, writing for the majority, noted that a *Bivens*-based remedy might be available to redress unconstitutional harm inflicted upon the plaintiff by a police officer,[32] even though section 1983 was held not to apply in the District of Columbia.[33] In *City of Kenosha v. Bruno,*[34] the Court held that municipal

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23. *See, e.g.,* Eisen v. Eastman, 421 F.2d 560 (2d Cir. 1969); Diamond v. Pitchess, 411 F.2d 565 (9th Cir. 1969); Brown v. Town of Caliente, Nevada, 392 F.2d 546 (9th Cir. 1968); Fischer v. City of New York, 312 F.2d 890 (2d Cir.), *cert. denied,* 374 U.S. 828 (1963); Westberry v. Fisher, 309 F. Supp. 12, 18 (S.D. Me. 1970); Davis v. Hartman, 306 F. Supp. 610 (E.D. Tenn. 1969); Johnson v. Hackett, 284 F. Supp. 933 (E.D. Pa. 1968); Baxter v. Parker, 281 F. Supp. 115 (N.D. Fla. 1968). *But see* Note, *Developing Governmental Liability Under 42 U.S.C. § 1983,* 55 MINN. L. REV. 1201, 1222 (1971) (growing number of federal courts limiting municipal immunity).

24. This method of reaching municipal coffers often utilizes § 1331 of the federal judicial code, 28 U.S.C. § 1331 (1970), as the jurisdictional counterpart to the fourteenth amendment. Section 1331 cases necessarily require a showing that more than $10,000 is at stake. *See* cases cited in note 25 *infra.* For the text of § 1331, *see* note 36 *infra.*

25. *See, e.g.,* Cox v. Stanton, 529 F.2d 47, 50 (4th Cir. 1975); Brault v. Town of Milton, 527 F.2d 730, 732 (2d Cir.), *rev'd,* 527 F.2d 736, 739 (2d Cir. 1975) (en banc); Fitzgerald v. Porter Memorial Hosp., 523 F.2d 716, 718-19 n.7 (7th Cir. 1975); Braden v. University of Pittsburgh, 477 F.2d 1, 7 n.10 (3d Cir. 1973) (dictum); Owen v. City of Independence, 421 F. Supp. 1110, 1119 (W.D. Mo. 1976); Mejia v. School City of Gary, 415 F. Supp. 370, 373-74 (N.D. Ind. 1976); Williams v. Brown, 398 F. Supp. 155, 156 (N.D. Ill. 1975); Patterson v. City of Chester, 389 F. Supp. 1093, 1095-96 (E.D. Pa. 1975); Perzanowski v. Salvio, 369 F. Supp. 223, 229 (D. Conn. 1974); Dupree v. City of Chattanooga, 362 F. Supp. 1136, 1139 (E.D. Tenn. 1973); *but see, e.g.,* Perry v. Linke, 394 F. Supp. 323, 326 (N.D. Ohio 1974); Bennett v. Gravelle, 323 F. Supp. 203, 217 (D. Md.), *aff'd,* 451 F.2d 1011 (4th Cir. 1971), *cert. denied,* 407 U.S. 917 (1972).

26. 403 U.S. 388 (1971).

27. *Id.* at 397.

28. *See* 564 F.2d at 1058-59 (Garth, J., dissenting).

29. *See, e.g.,* Dahl v. City of Palo Alto, 372 F. Supp. 647, 651 (N.D. Cal. 1974); Hundt, *Suing Municipalities Directly Under the Fourteenth Amendment,* 70 NW. U. L. REV. 770, 771-73 (1975).

30. *See* Lehmann, *Bivens and its Progeny: The Scope of a Constitutional Cause of Action for Torts Committed by Government Officials,* 4 HASTINGS CONST. L.Q. 531, 542 (1977).

31. 409 U.S. 418 (1973).

32. *Id.* at 432-33.

33. *Id.* at 432.

34. 412 U.S. 507 (1973).

immunity existed in equity claims, thus foreclosing the use of section 1983 against the City for that purpose.[35] Although the majority did not specifically refer to *Bivens* as providing the substantive basis for a suit against the municipality, the *Bruno* Court suggested that, if the injured parties could satisfy the amount-in-controversy requirement, jurisdiction over the municipality might be conferred under section 1331 of the federal judicial code.[36] Justice Brennan and Justice Marshall, in their joint concurrence, expressly noted that a *Bivens* remedy was available.[37]

The Supreme Court has not decided if a *Bivens*-type remedy could be extended to other constitutional provisions to bring damage actions against a municipality for its direct and indirect violations.[38] Lower federal courts have split on the issue.[39]

Another theory for damage actions against a municipality for direct and vicarious violations of civil rights is to rely upon section 1981 of the 1866 Act as the basis for such relief.[40]

The 1866 Act was passed to enforce the newly enacted thirteenth amendment.[41] Accordingly, section 1981 has become an important vehicle

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35. *Id.* at 513. *See* note 20 *supra.*

36. 412 U.S. at 513-14. Section 1331(a) provides in pertinent part: "The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000 exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States . . . ." 28 U.S.C. § 1331 (1970).

37. *Id.* at 516 (Marshall & Brennan, J.J., concurring).

38. *See* Bodensteiner, *Federal Court Jurisdiction of Suits Against "Non-Persons" for Deprivation of Constitutional Rights,* 8 VAL. L. REV. 215, 221-22 (1974); Note, *supra* note 19, at 926-29.

39. For a thorough discussion of lower federal courts' disposition of fourteenth amendment damage claims against municipalities, *see* Lehmann, *supra* note 30, at 544-97. Several lower federal courts have premised their decisions of *Bivens'* claims upon numerous procedural and substantive issues. *Id.* However, the most frequent considerations are whether implication of a direct constitutional remedy is necessary or appropriate in view of the availability of § 1983 and whether legislative history of that statute established municipal immunity against fourteenth amendment claims. *See* Note, *supra* note 19, at 922-24, 927, 945-52; Comment, *Implying a Damage Remedy Against Municipalities Directly Under the Fourteenth Amendment: Congressional Action as an Obstacle to Extension of the Bivens Doctrine,* 36 MD. L. REV. 123, 125 (1976).

Implication of a *Bivens*-type remedy is not necessary, of course, in suits against individual *state* government officials, because § 1983 specifically provides for federal relief in such situations. *See* Chavez-Salido v. Cabell, 427 F. Supp. 158, 165 (C.D. Cal. 1977).

40. For the text of § 1981, *see* note 6 *supra.*

41. *See* B. SCHWARTZ, *supra* note 16 at 99. The thirteenth amendment states:

> Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.
>
> Congress shall have power to enforce this article by appropriate legislation.

U.S. CONST. amend. XIII.

Section 2 of the thirteenth amendment purportedly allowed Congress to pass legislation necessary to give life to the amendment. *See, e.g.,* Casper, *Clio, Bemused and Confused Muse,* 1968 SUP. CT. REV. 89, 101. The Civil Rights Act of 1866 was the survivor of two Reconstruction statutes discussed during the session-long debate of the 39th Congress between the certification of the thirteenth amendment, December

for establishing federal causes of action in modern civil rights litigation.[42] Although a majority of claims brought under section 1981 have focused upon its "contract" guarantee,[43] the sweeping scope of the 1866 Act has

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18, 1865, and the delivery of the fourteenth amendment, June 13, 1866. *See* Bickel, *supra* note 16 at 7-29. Much of the debate over the 1866 Act focused upon defining "civil rights," and the formula eventually adopted is represented by the enumerated rights in § 1 of the 1866 Act: "to make and enforce contracts, to sue, be parties, and give evidence, to inherit, purchase, lease, sell, hold, and convey real and personal property, and to full and equal benefit of all laws and proceedings for security of person and property . . . ." Act of April 9, 1866, ch. 31, § 1, 14 Stat. 27. *See* Bickel, *supra* note 16, at 20-24.

The sponsor of the 1866 Act, Senator Trumbull, "described its objectives in terms that belie any attempt to read it narrowly." Jones v. Alfred H. Mayer Co., 392 U.S. 409, 431 (1968). Senator Trumbull introduced the Act as "the most important measure that ha[d] been under [the Senate's] consideration since the adoption of the constitutional amendment abolishing slavery [thirteenth amendment]" and as a device "to give effect to that declaration and secure to all persons within the United States practical freedom." CONG. GLOBE, 39th Cong., 1st Sess. 474 (1866) (remarks of Sen. Trumbull). The sweeping effect of the bill was recognized by the members of the 39th Congress, and "was disputed by none." Jones v. Alfred H. Mayer Co., 392 U.S. 409, 433 (1968), *citing* CONG. GLOBE, *supra,* at 504 (remarks of Sen. Cowan), *id.* at 504 (remarks of Sen. Howard), *and id.* at 601 (remarks of Sen. Hendricks).

The broad scope of the 1866 Act has been acknowledged by the Supreme Court repeatedly. *See, e.g.,* District of Columbia v. Carter, 409 U.S. 418, 425 (1973). It has been argued, however, that closer reading of the legislative debates — with the contemporary politics in mind — does not warrant the "universal" application employed by the Court. *See* Casper, *supra,* at 104-22.

42. *See, e.g.,* McDonald v. Sante Fe Trail Transp. Co., 427 U.S. 263 (1976); Runyon v. McCrary, 427 U.S. 160 (1976); Johnson v. Railway Express Agency, 421 U.S. 454 (1975); Tillman v. Wheaton-Haven Recreation Ass'n, Inc., 410 U.S. 431 (1973); Penn v. Schlessinger, 490 F.2d 700 (5th Cir. 1973); Young v. International Tel. & Tel. Co., 438 F.2d 757 (3d Cir. 1971); Maybanks v. Ingraham, 378 F. Supp. 913 (E.D. Pa. 1974).

The companion statute to § 1981 — 42 U.S.C. § 1982 (1970) — is also an important tool in civil rights litigation. Section 1982 reads as follows: "All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property." 42 U.S.C. § 1982 (1970).

The historical note accompanying § 1981 traces the statute to the Act of May 31, 1870, ch. 114, § 16, 16 Stat. 144 (Enforcement Act of 1870), which, as enacted, enforced aspects of the fourteenth and fifteenth amendments. *See* B. SCHWARTZ, *supra* note 16, at 443-45. The historical note fails to reflect, however, that the 1866 Civil Rights Act was the source of § 16 and § 17 of the 1870 Act and was specifically reenacted in § 18. *See* Act of May 31, 1870, ch. 114, §§ 16 & 17, 18, & 16 Stat. 144. The Supreme Court acknowledged this in Runyon v. McCrary, 427 U.S. 160, 168-70 n.8 (1975), and found "no basis for inferring that Congress did not understand the draft legislation which eventually became 42 U.S.C. § 1981 to be drawn from both § 16 of the 1870 Act and § 1 of the 1866 Act." *Id.* at 169 n.8. *See also* Sethy v. Almeda County Water Dist., 545 F.2d 1157, 1160 n.4 (9th Cir. 1976); Note, *Section 1981 and Private Discrimination: An Historical Justification for a Judicial Trend,* 40 GEO. WASH. L. REV. 1024, 1036-39 (1972).

Even before the detailed discussion of the history of the 1866 Act in the *Runyon* footnote, the Court had recognized the common origin and "historical interrelationship" of § 1981 and § 1982. *See, e.g.,* Johnson v. Railway Express Agency, 421 U.S. 454, 471 (1975) (Marshall, J., concurring in part); Tillman v. Wheaton-Haven Recreation Ass'n, Inc., 410 U.S. 431, 440 (1973). *See also* Campbell v. Gadsen County Dist. School Bd., 534 F.2d 650, 654 n.9 (5th Cir. 1976).

43. *See, e.g.,* Patterson v. American Tobacco Co., 535 F.2d 527 (4th Cir. 1976); Waters v. Wisconsin Steel Works of Int'l Harvester Co., 427 F.2d 476 (7th Cir.), *cert.*

prompted the Supreme Court to comment that the current codifications encompass *every* form of race discrimination.[44] Thus, the Court has held that section 1981 provides for the redress of *private* discrimination, in addition to civil rights violations under color of state law,[45] and that the statute protects aliens[46] and whites as well as blacks.[47]

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denied, 400 U.S. 911 (1970); Long v. Ford Motor Co., 352 F. Supp. 135 (E.D. Mich. 1972); Bennett v. Gravelle, 323 F. Supp. 203 (D. Md.), *aff'd,* 451 F.2d 1011 (4th Cir. 1971), *cert. denied,* 407 U.S. 917 (1972).

44. *See* Jones v. Alfred H. Mayer Co., 392 U.S. 409, 436 (1967). In *Jones,* after a detailed discussion of the 1866 Civil Rights Act, Mr. Justice Stewart, writing for the majority, stated:

> In light of the concerns that led Congress to adopt it and the contents of the debates that preceded its passage, it is clear that the Act was designed to do just what its terms suggest: *to prohibit all racial discrimination,* whether or not under color of law, with respect to the rights enumerated therein . . . .

Id. (emphasis added). *See also* Sullivan v. Little Hunting Park, 396 U.S. 229, 237 (1969), *citing* Jones v. Alfred H. Mayer Co., 392 U.S. 409, 422-37 (1967).

45. *See* Runyon v. McCrary, 427 U.S. 160 (1976); Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968). Applying § 1981 and § 1982 to acts of private discrimination became possible only after the Supreme Court began to enforce the statutes literally in *Jones. See* Larson, *The Development of Section 1981 As a Remedy for Racial Discrimination in Private Employment,* 7 HARV. C.R.-C.L.L. REV. 56, 57 & n.6 (1972). Before that time, the "original state action doctrine," read into the thirteenth amendment in the Civil Rights Cases, 109 U.S. 3, 16-17 (1883), was also read into § 1981 and § 1982, since they were designed to enforce the constitutional provision. *See* Goldstein, *Death and Transfiguration of the State Action Doctrine* — Moose Lodge v. Irvis *to* Runyon v. McCrary, 4 HASTINGS CONST. L. Q. 1, 2-3 (1977).

In *Jones,* which involved discriminatory refusals to sell real estate, the Court rejected dicta to the contrary in earlier cases and held that § 1982 applied to private individuals as well as to state officials. 392 U.S. at 437-44. The Court's decision was based upon a literal interpretation of the statute and upon a detailed analysis of legislative history. *Id.* at 422-37. Citing *Jones* as precedent, the Court subsequently held that § 1981 protected against racially discriminatory exclusion from private schools in *Runyon.* 427 U.S. at 173. In addition, the *Jones* rationale has provided the basis for several circuit court decisions that held that § 1981 can be used to redress racial discrimination in nonpublic employment. *See, e.g.,* Brady v. Bristol-Meyers, Inc., 459 F.2d 621, 622-23 (8th Cir. 1972); Young v. International Tel. & Tel. Co., 438 F.2d 757, 758-60 (3d Cir. 1971); Sanders v. Dobbs Houses, Inc., 431 F.2d 1097, 1099-1100 (5th Cir.), *cert. denied,* 401 U.S. 948 (1971); Waters v. Wisconsin Steel Works of Int'l Harvester Co., 427 F.2d 476, 481-85 (7th Cir.), *cert. denied,* 400 U.S. 911 (1970). *See generally* Brooks, *Use of the Civil Rights Acts of 1866 and 1871 to Redress Employment Discrimination,* 62 CORNELL L. REV. 258 (1977); Casper, *supra* note 41; Larson, *supra.*

In *Jones,* the Court granted the requested injunctive relief. 392 U.S. at 413. To the extent that the availability of legal remedies was left open, the question was settled in Sullivan v. Little Hunting Park, 396 U.S. 229 (1969), in which damages were awarded under § 1982. *Id.* at 239. The Supreme Court subsequently recognized the appropriateness of monetary relief in § 1981 cases. *See, e.g.,* Johnson v. Railway Express Agency, 421 U.S. 454, 460 (1975). *Accord,* Young v. International Tel. & Tel. Co., 438 F.2d 757, 760 (3d Cir. 1971); Maybanks v. Ingraham, 378 F. Supp. 913, 918 (E.D. Pa. 1974).

46. *See, e.g.,* Graham v. Richardson, 403 U.S. 365, 377 (1971); Guerra v. Manchester Terminal Corp., 498 F.2d 641 (5th Cir. 1974); Roberto v. Hartford Ins. Co., 177 F.2d 811 (7th Cir. 1949), *cert. denied,* 339 U.S. 920 (1950); Chavez-Salido v. Cabell, 427 F. Supp. 158 (C.D. Cal. 1977).

47. *See, e.g.,* McDonald v. Santa Fe Trail Transp. Co., 427 U.S. 273, 286-96 (1977); Central Presbyterian Church v. Black Liberation Front, 303 F. Supp. 894, 898-99 (E.D. Mo. 1969).

The Supreme Court has not decided if a municipal corporation could be held liable for damages under section 1981.[48] Two United States circuit courts of appeal[49] and several district courts,[50] however, have decided that question affirmatively. In contrast, a number of district courts have not allowed damage actions against municipalities under section 1981.[51]

In *Mahone,* the Third Circuit assumed, without actually finding, that the individual defendants' conduct violated section 1983,[52] and that, while the City would be liable under the doctrine of *respondeat superior* in other contexts, the doctrine's application here was precluded by section 1983 and *Monroe.*[53] The court also explored the possibility that the fourteenth amendment gave rise to a cause of action against the City,[54] but, after outlining the opposing viewpoints on the subject,[55] the majority declined to join the debate,[56] reasoning that its decision with respect to the availability of section 1981 made a determination of the constitutional issue unnecessary.[57]

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48. *See* Moor v. County of Almeda, 411 U.S. 693 (1973); Monroe v. Pape, 365 U.S. 167 (1961).

49. United States v. City of Chicago, 549 F.2d 415, 425 (7th Cir. 1977); Sethy v. Almeda County Water Dist., 545 F.2d 1157, 1161 (9th Cir. 1976).

50. Chavez-Salido v. Cabell, 427 F. Supp. 158, 162-65 (C.D. Cal. 1977); Skyers v. Port Auth. of N.Y. & N.J., 431 F. Supp. 79, 84 (S.D.N.Y. 1976); Gomez v. Pima County, 426 F. Supp. 816, 817-18 (D. Ariz. 1976); Rafferty v. Prince George's County, 423 F. Supp. 1045, 1058-61 (D. Md. 1976); League of United Latin Am. Citizens v. City of Santa Ana, 410 F. Supp. 873, 908 (C.D. Cal. 1976); Robinson v. Conlisk, 385 F. Supp. 529, 530 (N.D. Ill. 1974); Maybanks v. Ingraham, 378 F. Supp. 913, 916 (E.D. Pa. 1974); U.S. *ex rel.* Washington v. Chester County Police Dept., 300 F. Supp. 1279, 1280-81 (1969) (motion to dismiss), 294 F. Supp. 1157, 1159 (E.D. Pa. 1969) (motion to proceed *in forma pauperis). Cf.* Wade v. Mississippi Cooperative Extension Serv., 528 F.2d 508 (5th Cir. 1976) (remanded to determine, *inter alia,* whether state and county corporate defendants can be sued under § 1981); Booth v. Prince George's County, 66 F.R.D. 466, 470 & n.3 (D. Md. 1975) (postponement of consideration of § 1981 until claim for damages arises).

51. Redding v. Medica, 402 F. Supp. 1260, 1261 (W.D. Pa. 1975); Black Bros. v. City of Richmond, 386 F. Supp. 147, 148 (E.D. Va. 1974); Bennett v. Gravelle, 323 F. Supp. 203, 215 (D. Md.), *aff'd,* 451 F.2d 1011 (4th Cir. 1971), *cert. denied,* 407 U.S. 917 (1972).

52. 564 F.2d at 1021.

53. *Id.*

54. *Id.* at 1022.

55. *Id.* at 1022-24. The City contended that the fourteenth amendment did not provide an independent cause of action. *Id.* at 1022-23. Moreover, it claimed that § 1983 manifested "a congressional policy against municipal liability" and that finding a direct cause of action under the amendment would circumvent the congressional policy. *Id.*

Plaintiffs, on the other hand, argued that a claim for which relief could be granted could be implicitly found in the fourteenth amendment, as had been done by the Court in *Bivens.* 564 F.2d at 1023. *See* notes 24-37 and accompanying text *supra.*

56. 564 F.2d at 1024.

57. *Id.* at 1024-25. The majority noted that in *Bivens* the Court implied a cause of action directly under the fourth amendment because no "effective and substantial federal statutory remedy for plaintiffs" existed. *Id.* In contrast, the Third Circuit did find an effective federal statutory remedy under § 1981. *Id.* at 1027-30. Thus, the court emphasized that it "express[ed] no opinion . . . on the issue whether a fourteenth amendment remedy may or should be implied in other cases where the plaintiffs have no effective federal statutory remedy." *Id.* at 1025.

In discussing the section 1981 claim, the court found a noticeable lack of judicial interpretation of the "equal benefits-like punishment" language of section 1981 relied upon by plaintiffs.[58] The court therefore conducted an independent examination of section 1981 and concluded that "[d]espite the sparsity of precedent, a natural and common sense reading of the statute compels the conclusion that section 1981 has broad applicability beyond the mere right to contract."[59] According to the *Mahone* court, the injury alleged by the plaintiffs fell "within the broad language of both the equal benefits and like punishment clauses of section 1981."[60] The court noted that the 1866 Act was intended as "a complete statutory analog to the thirteenth amendment,"[61] and was designed to "eradicate *all* discrimination against blacks and to secure for them full freedom and equality in civil rights."[62]

The court refuted the City's contention that a broad reading of the "equal benefits-like punishment" language, combined with the recent Supreme Court determinations that some private discrimination may be actionable under section 1981,[63] would result in a federal court action under that statute "whenever a white man strikes a black in a barroom brawl."[64] Rather, the court interpreted the "equal benefits-like punishment" language as implicitly involved in "relations between the individual and the state, not between two individuals," because "[t]he state, not the individual, is the sole source of law, and it is only the state acting through its agents, not the private individual, which is capable of denying blacks the full and equal benefit of law."[65]

The court next turned to the question whether the district court had jurisdiction to hold the City liable under section 1981.[66] The majority refused to extend section 1983 municipal immunity to section 1981.[67] The court noted that, whereas the word "person" in section 1983, defined in *Monroe* as

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58. *Id.* at 1027. The court cited only three cases that construed the "equal benefits-like punishment" language of § 1981. *Id., citing* Strauder v. West Virginia, 100 U.S. 303 (1879); Rafferty v. Prince George's County, 423 F. Supp. 1054 (D. Md. 1976); and Central Presbyterian Church v. Black Liberation Front, 303 F. Supp. 894 (E.D. Mo. 1969). *See* note 6 *supra.*

59. 564 F.2d at 1028. The court's conclusion was based entirely upon the language of § 1981. After paraphrasing the enumerated rights in § 1981, the court stated that "[t]he statute can be read in no other way. To read the language of the statute as applying only to the right to contract ignores the clear and vital words of the majority of its provisions." *Id.*

60. *Id.*

61. *Id.*

62. *Id.* (footnote omitted) (emphasis in original).

63. *See* note 45 and accompanying text *supra.*

64. 564 F.2d at 1029 (footnote omitted).

65. *Id.* at 1029. By contrast, the reverse argument — that the right to contract inherently involves relations between two private individuals — is the basis for finding private discriminatory acts subject to § 1981, under the contract language. *Id.* at 1029–30. *See* Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968). *See also* Note, *Federal Power to Regulate Private Discrimination: The Revival of the Enforcement Clauses of the Reconstruction Era Amendments,* 74 COLUM. L. REV. 449 (1974).

66. 504 F.2d at 1030.

67. *Id.*

excluding municipalities,[68] describes those who may be found liable for improper conduct, the word "persons" in section 1981 applies to those *protected* by the statute.[69] The court found no evidence of congressional intent to create such municipal immunity.[70] The majority further concluded that sections 1981 and 1983 derived from different legislative enactments and were created to enforce different constitutional provisions, and that section 1981 was not in any way expressly or implicitly modified or repealed by the subsequent congressional adoption of section 1983.[71]

Finding that no bar to suit against municipalities existed in section 1981, the majority held that section 1343(3) of the federal judicial code provided the necessary jurisdictional component.[72] The majority asserted

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68. *See* notes 17-19 and accompanying text *supra*.

69. 564 F.2d at 1030. For the text of § 1981 and § 1983, *see* notes 6 & 18 *supra*.

70. 564 F.2d at 1030.

71. *Id.* at 1030-31. In its historical analysis, the majority noted that § 1981, although originally enacted as part of the Act of 1866, was reenacted in the Act of May 31, 1870, ch. 114, §§ 16, 18, 16 Stat. 144. *Id.* at 1030. Thus, the court concluded that "[d]ue to its unusual history, section 1981 can fairly be said to rest not only on the fourteenth amendment but also on the foundation provided by the thirteenth amendment. *Id., citing,* Runyon v. McCrary, 427 U.S. 160, 189 (1976) (Stevens, J., concurring). Section 1983, according to the *Mahone* court, was enacted to enforce the fourteenth amendment, and the Supreme Court has made clear that "[d]ifferent problems of statutory meaning are presented by two enactments deriving from different constitutional sources." 564 F.2d at 1030, *quoting,* District of Columbia v. Carter, 409 U.S. 418, 423 (1972). Similarly, the *Mahone* court acknowledged that the 1871 congressional debates demonstrated an "intent to temper the protection of civil rights against encroachment by the states with countervailing concerns of federalism," whereas the 1866 Act "manifest[ed] Congress' purpose to enact sweeping legislation . . . to abolish all the remaining badges and vestiges of the slavery system." 564 F.2d at 1030 (footnote omitted).

Furthermore, the *Mahone* majority rejected the argument that § 1983, enacted five years after § 1981, constituted an implied repeal of the earlier statute. *Id.* at 1031. Specifically, the court viewed the proposed but rejected municipal liability provision in the 1871 Act as creating "collective responsibility for a single individual's *private* act of violence against blacks which occurred within the city's borders," and therefore did not affect a municipal corporation's liability for wrongdoings of its employees performed under color of state law. *Id.* (emphasis in original). This distinction of the proposed amendment to the 1871 Act has been made by other courts. *See, e.g.,* Sanbria v. Village of Monticello, 424 F. Supp. 402, 409 (S.D.N.Y. 1976).

The Third Circuit cited Sethy v. Almeda County Water Dist., 545 F.2d 1157 (9th Cir. 1976) (en banc), as supporting its view that municipal immunity under § 1983 and *Monroe* was not properly extended to § 1981. 564 F.2d at 1030.

72. 564 F.2d at 1034. Section 1343(3) provides in pertinent part:

> The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person:
>
> (3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any privilege or immunity secured by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens . . . .

28 U.S.C. § 1343(3) (1970).

The majority discussed § 1343(3) in response to the dissent's assertion that the section was not available in actions brought under § 1981. 564 F.2d at 1050-51 (Garth, J., dissenting).

that section 1343(3) derived from the same source as section 1981 and was, therefore, its historical jurisdictional counterpart.[73]

Judge Garth, dissenting in part and concurring in part, submitted that the 1866 Act did not "enable aggrieved persons to initiate suit in federal court."[74] He maintained that the jurisdictional basis for a private federal cause of action was not provided until the enactment of the 1871 Act[75] and concluded that all 1866 Act claims, including section 1981 actions, are affected by the jurisdictional limitations of the 1871 Act and section 1983.[76] Since municipalities are not liable under section 1983, Judge Garth concluded that municipal immunity must be extended to suits brought pursuant to section 1981.[77]

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73. 564 F.2d at 1033. The court cited footnotes in two Supreme Court cases to show the common derivation of § 1981 and § 1343(3). *Id., citing* Hague v. CIO, 307 U.S. 476, 508 n.10 (1939) and Lynch v. Household Fin. Corp., 405 U.S. 538, 543-44 n.7 (1972). *See* note 76 *infra.*

74. *Id.* at 1041 (Garth, J., dissenting), *citing* CONG. GLOBE, 39th Cong., 1st Sess. 1271 (1866) (remarks of Rep. Bingham). Judge Garth noted that a proposed amendment to the 1866 Act would have provided for private damage actions. *Id.* at 1039 (Garth, J., dissenting). The proposal, made in the form of recommended instructions to the House Judiciary Committee, was defeated. CONG. GLOBE, 39th Cong., 1st Sess. 1271 (1866). Judge Garth stated that "if the Act had already provided for a private cause of action in the federal court," the proposal would not have been necessary. 564 F.2d at 1040 (Garth, J., dissenting).

75. 564 F.2d at 1040 (Garth, J., dissenting). Whether or not civil rights jurisdiction in the federal courts had first been created by the 1866 Act was at the heart of the dispute between the majority and dissent in *Mahone.* The disputed language of the Act is as follows:

> And be it further enacted, *That the district courts of the United States,* within their respective districts, *shall have,* exclusive of the several States, *cognizance* of all crimes and offenses committed against the provisions of this act, and also, concurrently with the circuit courts of the United States, *of all causes, civil and criminal, affecting persons who are denied* or cannot enforce in the courts or judicial tribunals of the State or locality where they may be *any of the rights secured to them by the first section of this act* . . . .

Act of April 9, 1866, ch. 31, § 3, 14 Stat. 27 (emphasis added by the court). The dissent interpreted the above statutory language as only providing federal jurisdiction in removal cases. *Id.* at 1044-47 (Garth, J., dissenting).

76. 564 F.2d at 1043 (Garth, J., dissenting). In addition to the substantive bar of § 1981 claims against municipalities, Judge Garth argued that a procedural barrier also existed, since § 1343(3) was enacted in the 1871 Act as the jurisdictional counterpart to § 1983. *Id.* at 1050-51 (Garth, J., dissenting). He distinguished the *Lynch* footnote relied on by the majority (*see* note 73 *supra*) by asserting that the Court meant only that the 1866 Act had served as the *model* for the 1871 Act, not that the 1866 Act included the substance of § 1343(3). *Id.* at 1049 (Garth, J., dissenting). Thus, he reasoned that § 1343(3) provided jurisdiction for § 1983 claims only. *Id., discussing* City of Kenosha v. Bruno, 412 U.S. 507 (1973).

Finally, Judge Garth discussed the availability of federal jurisdiction under § 1331 or under § 1343(4) as an alternative to § 1343(3). 564 F.2d at 1051-52 (Garth, J., dissenting). Noting that the former two statutes were enacted without specific congressional consideration of the municipal immunity-liability question, Judge Garth reasoned that the decision of the 42d Congress when enacting the 1871 Act "has remained without change and accordingly it still binds us." *Id.* at 1052 (Garth, J., dissenting). For a discussion of the 42d Congress' rejection of municipal liability under the 1871 Act, *see* note 16 *supra.*

77. 564 F.2d at 1043 (Garth, J., dissenting).

Whereas the majority found it unnecessary to decide if a cause of action for damages could be asserted against a municipal corporation under the fourteenth amendment,[78] the dissent addressed that issue and decided against the plaintiffs.[79] Judge Garth's analysis began with the apparent presumption in *Bivens* that "it is appropriate for federal courts to recognize damage claims asserted directly under provisions of the Constitution guaranteeing individual rights."[80] Noting that the *Bivens* Court carefully pointed out that no "special factors counselling hesitation" existed, Judge Garth distinguished the instant case by enunciating four such "special factors."[81] First, the fourteenth amendment included its own enforcement mechanism in section five, which provides that "*Congress* shall have power to enforce, by appropriate legislation, the provisions of this article."[82] Second, section 1983 represented Congress' method of enforcing the fourteenth amendment.[83] Third, Congress has not overruled *Monroe,* via legislative action, to allow municipal liability, even though such action has been proposed.[84] Fourth, whereas the plaintiff in *Bivens* would have

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78. 564 F.2d at 1024.

79. *Id.* at 1052. (Garth, J., dissenting).

80. *Id.* at 1058-59 (Garth, J., dissenting), *citing* Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics, 403 U.S. 388, 396 (1972).

Before reaching *Bivens,* Judge Garth distinguished Supreme Court cases allowing injunctive relief directly under the fourteenth amendment and other constitutional provisions, as flowing from the uncontroverted equitable power of the federal courts. 564 F.2d at 1056-57 (Garth, J., dissenting), *citing* Griffin v. County School Bd., 377 U.S. 218, 232-34 (1964). In addition, Judge Garth refuted plaintiffs' assertions that the Third Circuit had previously decided that fourteenth amendment damage actions were maintainable against municipalities; the dissent characterized the disputed cases as merely deciding that *jurisdiction* in such claims might be conferred by § 1331. 564 F.2d at 1057-58 (Garth, J., dissenting), *discussing* Rotolo v. Borough of Charleroi, 532 F.2d 920 (3d Cir. 1976); McCullough v. Redevelopment Auth., 522 F.2d 858 (3d Cir. 1975); Skeehan v. Board of Trustees of Bloomsburg State College, 501 F.2d 31 (3d Cir.), *vacated and remanded on other grounds,* 421 U.S. 983 (1973), *on remand,* 538 F.2d 53 (3d Cir. 1976).

81. 564 F.2d at 1059 (Garth, J., dissenting), *quoting* Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics, 403 U.S. 388, 396 (1972).

82. 564 F.2d at 1059 (Garth, J., dissenting), *quoting,* U.S. CONST. amend. XIV, § 5.

83. 564 F.2d at 1059 (Garth, J., dissenting). Judge Garth elaborated: "For the federal courts to create a cause of action directly under the Fourteenth Amendment for the sole purpose of overruling Congress's decision to exempt municipalities from suit is hardly the deference to congressional choice which section 5 of the Fourteenth Amendment demands." *Id.*

84. *Id.* at 1059-60 (Garth, J., dissenting). The circumvention of *Monroe* could have been achieved if any of the various proposed legislation had been enacted. *See, e.g.,* H.R. 11827, 93d Cong., 1st Sess. (1973); H.R. 10876, 90th Cong., 1st Sess. (1967); H.R. 5427, 89th Cong., 1st Sess. (1965); H.R. 6334, 88th Cong., 1st Sess. (1963); H.R. 6030, 88th Cong., 1st Sess. (1963); H.R. 3932, 88th Cong., 1st Sess. (1963); S. 1215, 88th Cong., 1st Sess. (1963); S. 2983, 87th Cong., 2d Sess. (1962); H.R. 10120, 87th Cong., 2d Sess. (1962); H.R. 10951, 87th Cong., 2d Sess. (1962). *See also* U.S. COMM'N ON CIVIL RIGHTS, LAW ENFORCEMENT — A REPORT ON EQUAL PROTECTION IN THE SOUTH 179 (1965); U.S. COMM'N ON CIVIL RIGHTS, 1961 COMMISSION REPORT ON CIVIL RIGHTS — JUSTICE 113 (1961).

A bill, currently before Congress, would allow damage actions to be brought against municipalities for the unconstitutional conduct of their employees. *See* Civil Rights Improvement Act, S. 35, 95th Cong., 1st Sess., 123 CONG. REC. S. 201-05 (daily

encountered formidable difficulties in suing federal agents individually in state court, and would have been thwarted by the sovereign immunity barrier, if suing the agents' employer — the United States — those obstacles were absent in the instant case.[85] For these reasons, Judge Garth concurred with the majority's dismissal of the fourteenth amendment claim "on the ground that no fourteenth amendment cause of action for damages is available against a city."[86]

Although the authorities disagree on the facts surrounding the political and legislative activity in the post-Civil War era,[87] it is clear that the major goal of the Reconstruction Congresses was the protection of civil rights against race-based discrimination.[88] Since the incorporation of freed slaves into society was threatened by a variety of barriers and was to have a profound social impact,[89] the contemporary legislation and constitutional reform reflected both reiteration of general policy and responses to specific difficulties in implementing the new policy.[90] The *Mahone* court correctly recognized that section 1981 exemplified the former type of legislative

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ed. Jan. 10, 1977) (remarks of Sen. Mathias). The proposed legislation expressly amends § 1983 by defining "person" as "any individual, State, municipality, or any agency or unit of government of such State or municipality," although certain, arguably broad, exceptions to municipal liability are also created by the Civil Rights Improvement Act. *See Id.* at S. 204.

In contrast to congressional inaction with respect to municipal immunity, Judge Garth noted the quick response of Congress to overrule a Supreme Court decision holding that attorney's fees could not be awarded under original civil rights legislation, by enacting the Civil Rights Attorney's Fee Awards Act of 1976, P.L. 94-559, § 2 (Oct. 19, 1976). 564 F.2d at 1060 (Garth, J., dissenting). *See* Alyeska Pipeline Service Co. v. Wilderness Soc'y, 421 U.S. 240, 264 (1975).

85. 564 F.2d at 1060-61 (Garth, J., dissenting). Specifically, Judge Garth explained that § 1981 and § 1983 provided access to federal courts for plaintiff to sue the police officers as individuals. *Id.* Moreover, claims against both the individual and municipal defendants could be brought in state courts, since immunity of local governmental units had been abolished in Pennsylvania. *Id.* at 1061 *citing* Ayala v. Board of Pub. Educ., 453 Pa. 584, 305 A.2d 877 (1973).

86. 564 F.2d at 1060. (Garth, J., dissenting).

87. *See, e.g.,* Graham, *The Early Antislavery Background of the Fourteenth Amendment,* 1950 WIS. L. REV. 479, 481-83.

88. *See, e.g.,* Runyon v. McCrary, 427 U.S. 160, 170-71 (1976); Johnson v. Railway Express Agency, 421 U.S. 454, 459-62 (1975); Jones v. Alfred H. Mayer Co., 392 U.S. 409, 422 (1968); C. FAIRMAN, *supra* note 16, at 1127; J. McPHEARSON, THE STRUGGLE FOR EQUALITY 330-35 (1964); K. STAMPP, *supra* note 16, at 7-76, 131-33; J. tenBROEK, *supra* note 16, at 177-81.

89. *See, e.g.,* Gressman, *supra* note 16, at 1323-24. The post-Civil War legislation and constitutional amendment was expected to cause a "profound shift" in the relationship between the federal government and the states, reversing the nature of the national entity from "the prime threat to civil liberties" to their principal protector. *Id.* at 1342.

90. The thirteenth amendment exemplified congressional formulation of general, antislavery policy. *See, e.g.,* Civil Rights Cases, 109 U.S. 3, 20 (1883); tenBroek, *Thirteenth Amendment to the Constitution of the United States — Consumation to Abolition and Key to the Fourteenth Amendment,* 39 CALIF. L. REV. 171, 171-73, 185 (1951). In contrast, the 1871 Act was prompted by President Grant's request for federal legislation to deal with the organization of the Ku Klux Klan and subsequent rise in murders and assaults of blacks and Union sympathizers in the South. *See* District of Columbia v. Carter, 409 U.S. 418, 425-26 (1972).

action, as evidenced by the statute's clear, sweeping language and — to the extent relevant[91] — its history. It is submitted that the court's approach was warranted not only by general notions of statutory interpretation,[92] but was also consistent with the original and continuing goal of civil rights legislation.[93]

The issue of the existence of municipal immunity, flowing from the projected intent of the forty-second Congress in 1871,[94] was also correctly decided by the *Mahone* court. The Third Circuit's refusal to apply the intent of the forty-second Congress to the 1866 Act was arguably mandated by the Supreme Court's comments and reasoning in a number of civil rights cases.[95] Most illustrative is the Court's opinion in *District of Columbia v.*

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91. *See* note 92 *infra.*

92. While there are no "black letter" laws of statutory construction, certain basic concepts have been recognized as useful tools for judicial interpretation and application. *See* DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 1-6 (1975). Among the most frequently noted concepts is that "when language is clear and unambiguous it must be held to mean what it plainly expresses, and no room is left for construction." Swarts v. Siegel, 117 F. 13, 18-19 (8th Cir. 1902), *citing,* Railway Co. v. Phelps, 137 U.S. 528 (1890); United States v. Fisher, 6 U.S. (2 Cranch) 358, 399 (1805); St. Paul, M & M Ry. v. Sage, 71 F. 40, 47 (8th Cir. 1895); Knox v. Morton, 68 F. 787, 789 (8th Cir. 1895).

The *Mahone* opinion exemplifies the use of the plain meaning rule since the holding was based upon explicit examination of the words in § 1981 and their "commonsense" significance. *See* note 59 and accompanying text *supra.*

Exclusive reliance upon the plain meaning rule, however, is not without criticism, since isolated words are devoid of intrinsic meaning. *See* 2A C. SANDS, STATUTES AND STATUTORY CONSTRUCTION 51, 182 (1973). Judicial consideration of certain extrinsic aids, has thus been traditionally accepted by the courts as a vehicle of legislative interpretation. *Id.* at 181. Legislative history has been especially significant for that purpose. *Id.* at 181-82. Therefore, although it may have been justified in ignoring the legislative history of the 1866 Act and confining the basis of its holding to literal interpretation, the *Mahone* court's exploration of congressional intent was certainly not controversial. *See, e.g.,* FCC v. Cohn, 154 F. Supp. 899, 910 (S.D.N.Y. 1957).

The danger of courts' extensive use of legislative history, especially when that history is ambiguous or inconclusive is that "judicial legislation in the course of judging as to the pertinence and probative force of the historical evidence" will result. C. SANDS, *supra,* at 186. That risk seems possible in the instant case due to the voluminous and disparate nature of the Reconstruction era civil rights legislative history. *See* note 87 and accompanying text *supra.* Hence, the *Mahone* court's avoidance of a very detailed dissection of the congressional debates and other available materials, in order to determine a hypothesized understanding of the members of the 39th Congress, seems appropriate. *See* C. SANDS, *supra,* at 216-17, 221-24.

93. *See, e.g.,* H.R. REP. NO. 914, 88th Cong., 2d Sess. 46, *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 2415. The Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 253 (codified at 42 U.S.C. §§ 2000e-2000e-15 (1970)) was premised on the notion that "Congress can and should take action within its constitutional powers and sphere of authority to carry out our national policy against discrimination by reason of race or color . . . ." H.R. REP. NO. 914, 88th Cong., 2d Sess. 46 (1964).

94. *See* notes 14-16 and accompanying text *supra.*

95. *See, e.g.,* Runyon v. McCrary, 427 U.S. 160 (1976); Johnson v. Railway Express Agency, 421 U.S. 454 (1975); Jones v. Alfred H. Mayer Co., 392 U.S. 409 (1968).

Carter,[96] in which the Court noted that the context of the language and the constitutional origin of the 1871 and 1866 Civil Rights Acts were so distinguishable as to require separate consideration of the modern versions of the two bills.[97] It is therefore submitted that the *Mahone* opinion was correct in viewing section 1981 as an independent statutory entity, the language and purpose of which supported the award of damages against a municipal corporation.[98]

While the Third Circuit's literal interpretation of section 1981 resulted in affirmative relief for the plaintiffs in *Mahone*, it is unlikely that all problematic aspects of section 1981 claims against municipalities have been removed. Notably, the *Mahone* court's failure to examine the relationship between substantive and procedural jurisdictional requirements[99] or to discuss alternate jurisdictional bases will not remedy the apparent confusion of lower federal courts.[100] In the instant case, section 1331[101] jurisdiction was available because the plaintiffs alleged the requisite amount-in-controversy and the claim arose under a law of the United States.[102] Since the Supreme Court has suggested[103] and several circuit and district courts have held[104] that no substantive bar such as immunity exists

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96. 409 U.S. 418 (1972). *See* notes 31-33 and accompanying text *supra*.

97. 409 U.S. at 423. In *Carter*, the Court compared the 1866 and 1871 Acts for the purpose of determining if the District of Columbia was a "state" under § 1983. *Id.* at 420. Since the Court had previously decided the same question under § 1982 and concluded that the District was a state for the purpose of that statute, it was argued that a similar result was compelled in *Carter*. *Id.* at 420-21, *citing* Hurd v. Hodge, 334 U.S. 24, 31 (1948). The *Carter* Court, however, maintained that the same word — "state" — used in different statutes and different contexts should not necessarily be given identical meanings. 409 U.S. at 423. With the objective of determining if "state" was to be given the same definition in § 1982 and § 1983, the Court conducted a thorough comparison of the 1866 and 1871 Acts and concluded that the purpose and scope of the Acts were so distinct as to prevent one from being applied to the other. *Id.* at 423-24.

98. *See* 564 F.2d at 1028-30.

99. The Supreme Court has emphasized the bifurcated nature of meeting jurisdictional requirements in federal courts, distinguishing between a claim for which relief could be granted and a statutory grant of federal court power to hear the claim, and has required that both be demonstrated. *See* Bell v. Hood, 327 U.S. 678, 682 (1946). Section 1981, according to the *Mahone* court, provided the former requirement in actions against municipalities. 564 F.2d at 1029-30. Satisfaction of the second requirement presumably flowed from that finding, under either § 1331 federal question jurisdiction, if the requisite amount-in-controversy existed, or under § 1343, since the claim arose under federal statute and from federal legislation designed to protect civil rights. *See* Bodensteiner, *supra* note 38, at 223-34.

100. *See* notes 49-51 and accompanying text *supra*.

101. For the pertinent text of § 1331, *see* note 36 *supra*.

102. 564 F.2d at 1021.

103. *See* text accompanying note 36 *supra*.

104. *See, e.g.*, Reeves v. City of Jackson, 532 F.2d 491, 495 (5th Cir. 1976); Cox v. Stanton, 529 F.2d 47, 50 (4th Cir. 1975); Hostrop v. Board of Jr. College Dist. No. 515, 523 F.2d 569, 576-77 (7th Cir. 1975), *cert. denied*, 425 U.S. 963 (1976); Gray v. Union County Intermediate Educ. Dist., 520 F.2d 803, 805 (9th Cir. 1975); Hanna v. Drobnick, 514 F.2d 393, 398 (9th Cir. 1975); Shifrin v. Wilson, 412 F. Supp. 1282, 1305 (D.C.C. 1976); Waltenberg v. New York City Dep't of Correction, 376 F. Supp. 41, 44 (S.D.N.Y. 1974).

to prevent the use of section 1331 against municipalities, the *Mahone* court could have structured its opinion so that it merely acknowledged that an action pursuant to section 1981 provided the necessary "arising under" jurisdiction.[105] The court, however, concluded its analysis by finding that section 1343(3)[106] jurisdiction was available to support the section 1981 claim against the municipality.[107] The difficulty with that conclusion was enunciated by dissenting Judge Garth who noted that, unlike sections 1981, 1983 and 1331, which derived from three distinct statutory sources,[108] section 1343(3) and section 1983 both were originally enacted in section one of the 1871 Civil Rights Act.[109] Thus, even under the majority's reasoning, it is submitted that the legislative history of the 1871 Act creates the same substantive limitation with respect to municipal liability in section 1343(3) as has been applied to section 1983.[110] If use of section 1343(3) were limited by excluding municipal liability, it would not necessarily follow that only claims against cities in which damages of more than $10,000 were alleged — thus satisfying the requirements of section 1331 — could be brought under section 1981. Rather, section 1343(4) of the federal judicial code,[111] under which no minimum amount in controversy is required, could be used as a jurisdictional basis for section 1981 claims.[112]

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105. For the text of § 1331, *see* note 36 *supra*. Section 1331 creates general federal question jurisdiction whenever at least $10,000 is in controversy and when the plaintiff's cause of action "arises under" federal law. *See* 28 U.S.C. § 1331 (1970). The thrust of the *Mahone* court's holding was to interpret the "equal benefits-like punishment" language of § 1981 as creating a cause of action against a municipality. *See* notes 60-62 and accompanying text *supra*. Since § 1981 is a federal statute, the court's finding leads to the conclusion that plaintiffs' claims "arise under" federal law. *See* The Fair v. Kohler Die & Specialty Co., 228 U.S. 22, 25 (1913) (patent law); Aycock, *Introduction to Certain Members of the Federal Question Family*, 49 N.C.L. REV. 1, 5-7 (1970); Cohen, *The Broken Compass: The Requirement That a Cause of Action Arise "Directly" Under Federal Law*, 115 U. PA. L. REV. 890, 905-06 (1967).

106. For the text of § 1343(3), *see* note 72 *supra*.

107 564 F.2d at 1033-34.

108. For the derivation of § 1983 and § 1981 *see* notes 16 & 41 *supra*. Section 1331 originally appeared in the Act of March 3, 1875, ch. 137, § 1, 18 Stat. 470. *See generally* Wiecek, *The Reconstruction of Federal Judicial Power, 1863-1875*, 13 AM. J. LEG. HIST. 333 (1969).

109. 564 F.2d at 1048 (Garth, J., dissenting), *citing* Lynch v. Household Fin. Corp., 405 U.S. 538, 543 n.7 (1972); Adickes v. Kress & Co., 398 U.S. 144, 162-63 (1970); Monroe v. Pape, 365 U.S. 167, 171, 183-85 (1960).

110. *See* 564 F.2d at 1033. The *Mahone* majority erroneously noted that § 1343(3) and § 1981 derived from the same source and then concluded that § 1343(3) provided federal jurisdiction for § 1981 claims. *Id. See* note 73 *supra*. Had the court determined that § 1343(3) actually originated in the 1871 Act, presumably it would have found that congressional intent to exclude municipalities from § 1983 liability precluded the use of § 1343(3) to circumvent that congressional determination. *See id.* at 1021.

111. Section 1343(4) states: "[The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person:] To recover damages or to secure equitable or other relief under any Act of Congress providing for the protection of civil rights, including the right to vote." 28 U.S.C. § 1343(4) (1970).

112. *See, e.g.*, Munoz v. International Alliance of Theatrical Stage Employees, 563 F.2d 205 (5th Cir. 1977); Allen v. Veterans Admin., 542 F.2d 176 (3d Cir. 1976); Hackett v. McGuire Bros., Inc., 445 F.2d 442 (3d Cir. 1971); Philadelphia Council of Neighborhood Orgs. v. Coleman, 437 F. Supp. 1341 (E.D. Pa. 1977); NAACP v. Levi, 418 F. Supp. 1109 (D.D.C. 1976).

A more unsettling deficiency of the *Mahone* opinion is its failure to discuss the merits of the municipal immunity-liability question. It has been noted frequently that serious weaknesses exist in the use of damage actions against individual officers which prevent these actions from being an effective remedy for injured plaintiffs.[113] Accordingly, it has been claimed that the availability of damage actions against municipal corporations not only provides financially responsible defendants[114] but also serves as a prophylactic measure against unconstitutional behavior of municipal employees.[115] These policy considerations favoring imposition of municipal liability have been countered with the argument that the result of dispensing with municipal immunity would be the disruption of governmental efficiency, destruction of employee morale, and flooding federal court dockets.[116] Although the *Mahone* decision, which confined itself to the language and history of section 1981 as a separate civil rights statute, may not have logically *required* discussion of municipal liability,[117] it is likely that the adherence to pervasive municipal immunity notions displayed by many lower federal courts stems more from a positive belief in the value of such immunity than from a desire to comply with the legislative history of the provision.[118] Thus, a discussion of the value of municipal liability might have added persuasiveness to the Third Circuit's opinion and preempted possible arguments that the decision stemmed solely from a mechanical statutory construction.[119] Furthermore, it is submitted that the Third Circuit's failure to respond to the diverse positions on municipal liability-immunity may perpetuate the debate and reduce the matter to a pleadings game — if the right combination of substantive and jurisdictional requirements are satisfied, the city's coffers will be accessible to the injured plaintiff.

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113. *See, e.g.,* Note, *supra* note 19 at 926; Comment, *Section 1983, The Eleventh Amendment, and General Principles of Tort Immunities and Defenses: Who Is Left to Sue?*, 45 U. MO. K. C. L. REV. 29, 30-32 (1976).

114. *See, e.g.,* Hundt, *supra* note 29 at 779; Kates & Kouba, *supra* note 13, at 142-46.

115. *See, e.g.,* Note, *supra* note 19, at 927.

116. *See* Kates & Kouba, *supra* note 13, at 142. Specifically, the argument suggests that subjection of municipalities to vicarious liability for their employees' wrongdoings would reduce the employees' sense of responsibility and result in vexatious litigation as well as burden the financial stability of the governmental unit. *Id.* Moreover, it is argued that substituting personal liability with municipal liability under § 1983 would be contrary to the congressional policy that the *exclusive* remedy for injured plaintiffs be the existence of § 1983 actions against the individuals directly responsible, and could make municipal employees less hesitant to commit "constitutional torts." *See* Hundt, *supra* note 29, at 783-84. Those arguments are countered, however, by the allowance of simultaneous municipal and individual liability and by the natural check of employee performance inherent in most firing policies. *See id.* at 783-85.

117. *See* note 92 *supra.*

118. *See* Kates & Kouba, *supra* note 13, at 132-45, in which the authors define the traditional arguments supporting municipal immunity.

119. *Cf. id.* at 132-36. (Criticism of *Monroe* Court's failure to reach the policy considerations involved in the municipal liability-immunity debate by opting to decide the issue on narrow, definitional grounds). *See also* Note, *supra* note 20, at 803-05.

Far more significant than any shortcomings of the *Mahone* opinion is the effect that the holding will have upon future race-discrimination cases against municipalities. A *Bivens*-type cause of action under the fourteenth amendment for the recovery of damages from municipal corporations[120] is controversial and lacks clarification by the Supreme Court.[121] On the other hand, use of section 1981 to sue cities directly is arguably warranted by its express language,[122] statutory history,[123] and interpretation in other contexts by the Supreme Court.[124] Moreover, the section 1981 approach is necessarily confined to claims of race related discrimination,[125] whereas the fourteenth amendment reaches other forms of discrimination.[126] Thus, it is submitted that *Mahone* appears to mark the more desirable method, as between section 1981 and *Bivens*, for redressing the problem of unconstitutional police action and creating a viable solution to a previously insoluble problem.

Joni J. Berner

CIVIL RIGHTS — EMPLOYMENT DISCRIMINATION — PUNITIVE DAMAGES ARE NOT RECOVERABLE UNDER THE EQUAL EMPLOYMENT OPPORTUNITY ACT OF 1972.

Richerson v. Jones (1977)

Dionysius Richerson, a black engineer employed by the Philadelphia Naval Shipyard, instituted an employment discrimination action pursuant to section 717 of the Equal Employment Opportunity Act of 1972 (EEOA)[1]

120. *See* cases cited in note 25 *supra*.
121. *See generally* Lehmann, *supra* note 30; *see* note 24-38 and accompanying text *supra*.
122. *See* notes 44, 59 & 65 and accompanying text *supra*.
123. *See* notes 41-42 & 61-62 and accompanying text *supra*.
124. *See* notes 45-47 and accompanying text *supra*.
125. *Cf.* League of Academic Women v. Regents of Univ. of Cal., 343 F. Supp. 636 (N.D. Cal. 1972) (sex discrimination claims not actionable under § 1981); *accord,* Fitzgerald v. United Methodist Community Center, 335 F. Supp. 965 (D. Neb. 1972).
126. *See, e.g.,* Massachusetts Bd. of Retirement v. Murgia, 427 U.S. 307 (1976) (age); Reed v. Reed, 404 U.S. 71 (1971) (gender); Levy v. Louisiana, 391 U.S. 68 (1968) (illegitimacy).

1. Richerson v. Jones, 551 F.2d 918 (3d Cir. 1977). Section 717 provides in part:
> All personnel actions affecting employees or applicants for employment . . . in military departments, . . . in executive agencies, . . . in the United States Postal Service and the Postal Rate Commission, in those units of the Government of the District of Columbia having positions in the competitive service, and in those units of the legislative and judicial branches of the Federal

against the United States Department of the Navy,[2] alleging that he had been denied promotions solely on the basis of his race.[3] The United States District Court for the Eastern District of Pennsylvania found that Richerson had been the victim of discrimination and awarded him retroactive promotions with corresponding backpay,[4] interest, attorney's fees and expenses but denied the plaintiff's request for punitive damages.[5] On appeal,[6]

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government having positions in the competitive service, and in the Library of Congress shall be made free from any discrimination based on race, color, religion, sex, or national origin.

42 U.S.C. § 2000e-16(a) (Supp. V 1975).

2. 551 F.2d at 920. Plaintiff Richerson named the commanding officer at the shipyard, Captain Gerald R. Jones, as nominal defendant as required by § 717 of the EEOA which provides that the aggrieved "may file a civil action as provided in section 2000e-5 of this title, in which civil action the head of the department, agency, or unit as appropriate, shall be defendant." 42 U.S.C. § 2000e-16(c) (Supp. V 1975). Since the United States is the real defendant, references hereinafter made to the defendant will be in terms either of the Government or the United States. The lower court opinion was not reported.

3. 551 F.2d at 921.

4. *Id.* The district court awarded Richerson three retroactive promotions with backpay. *Id.* at 923. Specifically, the district court directed that Richerson be promoted to GS-9 effective November 15, 1970, to GS-11 effective November 15, 1972, and to GS-12 effective November 15, 1974. *Id.*

5. *Id.* at 921.

6. *Id.* The district court made three orders which form the bases of the appeal. *Id.* On December 18, 1975, the district court entered judgment for plaintiff Richerson and against the United States. *Id.* On March 12, 1976, the district court awarded Richerson retroactive promotions, backpay, and interest but did not include any reference to attorney's fees. *Id.* On April 29, 1976, the court ordered an award of attorney's fees to Richerson. *Id.*

Richerson appealed from the order of April 29, 1976, because the district court denied his request for punitive damages. *Id.* The United States appealed from the first two orders contending that Richerson's retroactive promotion from GS-11 to GS-12 was not supported by the evidence and that the lower court erred in assessing interest against the United States. *Id.*

Before the Third Circuit could resolve the substantive issues raised on appeal the court first had to establish the requisite jurisdiction. *Id.* at 921-23. Ordinarily the courts of appeals have jurisdiction only on appeals from final orders of the district courts under § 1291 of the Judicial Code which states: "The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands . . . ." 28 U.S.C. § 1291 (1970).

Richerson's appeal was from the final order of April 29 and therefore presented no jurisdictional issue to be resolved by the Third Circuit. 551 F.2d at 922. The United States, however, maintained appeals from the first two orders only, and the Third Circuit determined that neither of these appeals was from a final order as defined by the Supreme Court. *Id. See, e.g.,* Catlin v. United States, 324 U.S. 229, 233 (1945) (test of appealability is whether the order of the court terminates the litigation on the merits). Although the Government had not appealed from a final order, the Third Circuit held that it had jurisdiction over the Government's appeal, explaining that "a premature appeal taken from an order which is *not final* but which is followed by an order that *is final* may be regarded as an appeal from a final order in the absence of a showing of prejudice to the other party." 551 F.2d at 922. (emphasis in original) (citations omitted). Since Richerson never claimed that his rights would be prejudiced, the Third Circuit assumed jurisdiction over the Government's appeal. *Id.* at 923.

the United States Court of Appeals for the Third Circuit[7] affirmed the district court's order denying punitive damages,[8] *holding* that the EEOA precluded the award of punitive damages. *Richerson v. Jones,* 551 F.2d 918 (3d Cir. 1977).

In order to establish a comprehensive program to combat employment discrimination,[9] Congress enacted Title VII of the Civil Rights Act of 1964 (Title VII),[10] which created "statutory rights against invidious discrimination in employment and establish[ed] a comprehensive scheme for the vindication of those rights."[11] In response to criticism that the objectives of

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7. The case was heard by Judges Rosenn, Kalodner, and Garth. Judge Garth wrote the opinion.

8. In addition to affirming the district court on the issue of punitive damages, the Third Circuit vacated Richerson's retroactive promotion to GS-12 and remanded for additional fact finding concerning that promotion and the award of attorney's fees. 551 F.2d at 921. The court also reversed the district court's order granting Richerson interest against the United States. *Id.*

In order for the district court to award retroactive promotions with backpay, the Third Circuit explained that it must be established that, but for the discriminatory practice, the aggrieved party would have received the position. *Id.* at 923. *See* Day v. Mathews, 530 F.2d 1083, 1085 (D.C. Cir. 1976). In addition, the court noted that Federal Rule of Civil Procedure 52(a) requires that the district court "find the facts specially and state separately its conclusions of law thereon . . . ." 551 F.2d at 924, *quoting* FED. R. CIV. P. 52(a). In *Richerson,* Judge Garth observed that the findings of the district court would justify only a retroactive promotion to GS-9 level. 551 F.2d at 924. The Third Circuit therefore remanded to the district court with instructions to make the requisite findings of fact. *Id.* at 921.

Finally, the Third Circuit held that the district court erred in ordering the United States to pay prejudgment and post-judgment interest on the award of backpay. *Id.* at 925. The basis for this holding was a Supreme Court ruling which provided that interest on claims against the United States cannot be recovered absent an express provision within the applicable statute. *See* United States v. Tillamooks, 341 U.S. 48, 49 (1951). The Third Circuit observed that, although Jones was the nominal defendant in the action brought by Richerson, "in reality Richerson's claim was against the United States." 551 F.2d at 925; *see* note 2 and accompanying text *supra.* In addition, the court noted that the EEOA contains no provisions expressly allowing interest on claims against the United States. 551 F.2d at 925. Therefore, the Third Circuit ruled that the district court had erred in awarding interest to Richerson and against the United States. *Id.* at 921.

9. *See generally* Vaas, *Title VII: Legislative History,* 7 B.C. INDUS. & COM. L. REV. 431 (1966).

10. 42 U.S.C. §§ 2000e-1 to 15 (1970).

11. Johnson v. Railway Express Agency, Inc., 421 U.S. 454, 457-58 (1975). The principal enforcement organ provided for by Title VII is the Equal Employment Opportunity Commission (EEOC). 42 U.S.C. § 2000e-4 (Supp. V 1975). When an individual files a complaint with the EEOC alleging that he has been the victim of an unlawful employment practice, the EEOC must investigate the charge and, if it determines that the charge is true, must "endeavor to eliminate any such alleged unlawful employment practice by informal methods of conference, conciliation, and persuasion." *Id.* § 2000e-5(b).

If the EEOC fails to obtain voluntary compliance with its findings, the aggrieved claimant may bring a civil action against the employer. *Id.* § 2000e-5(e). If the district court finds that the claimant has been the victim of some unlawful employment practice, "the court may enjoin the respondent from engaging in such unlawful employment practice and order such affirmative action as may be appropriate . . . ." *Id.* § 2000e-5(g).

Title VII were not being realized,[12] Congress attempted to strengthen the remedial machinery of Title VII by adding the EEOA in 1972.[13] Under the provisions of the EEOA, the Equal Employment Opportunity Commission (EEOC) was granted greater authority to halt discriminatory practices and to achieve conciliation between the aggrieved and the wrongdoer,[14] the coverage of Title VII was expanded to include a wider class of persons adversely affected by unlawful practices,[15] and the federal district courts were provided with additional discretion to fashion remedies consistent with the intention of Congress.[16]

Specifically, section 706(g) of the EEOA[17] establishes the parameters of the district court's authority to redress past discrimination, providing in pertinent part:

> If the court finds that the respondent has intentionally engaged in or is intentionally engaging in an unlawful employment practice charged in the complaint, the court may enjoin the respondent from engaging in such unlawful employment practice, and *order such affirmative action as may be appropriate,* which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay . . . *or any other equitable relief as the court deems appropriate.*[18]

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12. *See, e.g.,* H.R. REP. NO. 238, 92d Cong., 1st Sess. 1, *reprinted in* [1972] U.S. CODE CONG. & AD. NEWS 2137, in which the House Committee on Education and Labor stated:

> The time has come to bring an end to job discrimination once and for all, and to insure every citizen the opportunity for the decent self-respect that accompanies a job commensurate with one's abilities. The hopeful prospects that Title VII offered millions of Americans in 1964 must be revived.

Id. at 5, *reprinted in* [1972] U.S. CODE & AD. NEWS at 2141.

13. *Id.* at 3, *reprinted in* [1972] U.S. CODE & AD. NEWS at 2139. The EEOA amended Title VII which is codified at 42 U.S.C. §§ 2000e-1 to 15 (Supp. V 1975) and added 42 U.S.C. § 2000e-16 (Supp. V 1975) to Title VII. For pertinent portions of this addition, *see* notes 1 & 2 *supra.*

14. *See* 42 U.S.C. § 2000e-5(a)-(f) (Supp. V 1975). The amendments to Title VII were designed to improve the operations of the EEOC. *Id.* Through the amendments the EEOC was given authority to bring a civil action in the federal district court, investigatory powers similar to the National Labor Relations Board (NLRB), and the power to intervene with the court's permission in a suit filed by an aggrieved person if the action is of general public importance. *Id.* § 2000e-5(b), (f). *See also* H.R. REP. NO. 899, 92d Cong. 2d Sess. 1 (1972).

15. The amendments to Title VII expand the coverage of Title VII from employers with 25 or more employees to those with 15 or more employees, from labor unions with 25 or more members to those with 15 or more members, to state and local employees subject to civil service laws, and to nonreligious schools with respect to teachers and other school personnel. *See* 42 U.S.C. § 2000e-2 (Supp. V 1975). In addition, the EEOA proscribes discriminatory practices by the federal government. *Id.* § 2000e-16(a). *See* note 1 *supra.*

16. *See* 42 U.S.C. § 2000e-5(g) (Supp. V 1975). The remedial provisions of Title VII are applicable in a civil action brought by a federal employee under § 717 of the EEOA which provides: "The provisions of section 2000e-5(f) through (k) of this title, as applicable, shall govern civil actions hereunder." *Id.* § 2000e-16(d) (Supp. V 1975). For the text of the pertinent remedial section, *see* text accompanying note 18 *infra.*

17. 42 U.S.C. § 2000e-5(g) (Supp. V 1975).

18. *Id.* (emphasis added).

In determining the scope of their remedial powers in suits instituted under Title VII, federal courts have been confronted with the issue of whether the provision in section 706(g) concerning "any other equitable relief" empowered a district court to award punitive damages to an aggrieved employee.[19] Since the legislative intent is uncertain,[20] courts have struggled to determine whether their remedial powers are limited to the equitable remedies provided by the statute, or whether they have authority to provide legal remedies for unlawful employment practices.[21]

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19. The district courts have split on the issue of whether the remedial provisions permit the awarding of punitive damages. The majority of the courts have held that punitive damages are *not* available. *See, e.g.,* Presseisen v. Swarthmore College, 71 F.R.D. 34, 45-46 n.12 (E.D. Pa. 1976); Whitney v. Greater N.Y. Corp. of Seventh-Day Adventists, 401 F. Supp. 1363, 1370-71 (S.D.N.Y. 1975); Loo v. Gerarge, 374 F. Supp. 1338, 1341-42 (D. Haw. 1974); Van Hoomissen v. Xerox Corp., 368 F. Supp. 829, 838 (N.D. Cal. 1973).

Punitive damages were awarded in Claiborne v. Illinois Central R.R., 401 F. Supp. 1022, 1023 (E.D. La. 1975). For a discussion of this decision, *see* text accompanying notes 32-36 *infra*. In addition, pretrial motions to strike prayers for punitive damages were denied in Dessenberg v. American Metal Forming Co., 6 Fair Empl. Prac. Cas. (BNA) 159, 161 (N.D. Ohio 1973); Tooles v. Kellogg Co., 336 F. Supp. 14, 18 (D. Neb. 1972).

20. In Van Hoomissen v. Xerox Corp., 368 F. Supp. 829 (N.D. Cal. 1973) the district court observed:

> In one breath the Senators note that the equitable powers given to the courts are extremely broad; in the next they speak rather imprecisely of making a person "whole". What is intended by that second goal? The problem mirrored here has been a source of confusion among the district courts.

Id. at 837.

The confusion as to the congressional intent behind Title VII was foreseen by Senator Wayne Morse. In attempting to have this legislation referred to committee, Senator Morse stated: "If I ever saw a bill that needed to be clarified for the courts by way of a committee report, the argument which has taken place on the floor of the Senate in the past 14 days has shown that bill to be the one before the Senate." 110 CONG. REC. 6419 (1964) (remarks of Sen. Morse).

21. *E.g.,* Van Hoomissen v. Xerox Corp., 368 F. Supp. 829, 836 (N.D. Cal. 1973). Included within the parameters of legal remedies are compensatory and punitive damages. D. DOBBS, REMEDIES § 3.1 at 135 (1973). Compensatory damages are awarded to the injured plaintiff to make up for some loss caused by the defendant. *Id.* Punitive damages are separate from compensation; they are awarded to punish or deter the aggravated misconduct of the defendant. *Id.* at 204.

Section 706(g) of EEOA does provide that a district court may award backpay to compensate a victim of discriminatory employment practices. 42 U.S.C. § 2000e-5(g) (Supp. V 1975). Once an unlawful employment practice has been established, the district court may award backpay to the aggrieved unless the defendant can demonstrate some justification for the particular practice. *See* Griggs v. Duke Power Co., 401 U.S. 424 (1971).

Although backpay provides monetary relief to the aggrieved, many courts consider such a remedy to be a form of restitution. *See* Albemarle Paper Co. v. Moody, 422 U.S. 405, 418-19 (1975); EEOC v. Detroit Edison Co., 515 F.2d 301, 308-09 (6th Cir. 1975); Johnson v. Goodyear Tire & Rubber Co., 491 F.2d 1364, 1367 (5th Cir. 1974); Robinson v. Lorilland Corp., 444 F.2d 791, 802 (4th Cir. 1971). In Rosen v. Public Service & Gas Co., 477 F.2d 90 (3d Cir. 1973), the Third Circuit affirmed the award of compensation for wrongfully withheld pension funds based on a Title VII suit. *Id.* at 95-96. The *Richerson* court reasoned that the award in *Rosen* was a form of restitution recoverable in an action based on Title VII rather than a type of compensatory damages. 551 F.2d at 926-27 n.13.

The majority of courts have held that punitive damages are not available under section 706(g).[22] For example, in *Van Hoomissen v. Xerox Corp.*,[23] an employee sued to redress the effect of his employer's unlawful employment practices.[24] The United States District Court for the Northern District of California refused to award punitive damages concluding that such relief was excluded by the specific language of section 706(g)[25] and by the section's legislative history which restricted the court's remedial authority to equitable relief.[26]

Prior to the instant case, only one federal court of appeals had ruled on this specific issue. In *EEOC v. Detroit Edison Co.*,[27] the Sixth Circuit reversed an award of punitive damages, holding that such an award was beyond the scope of the relief provisions of Title VII.[28] The court determined that the phrase, "other equitable relief as the court deems appropriate," is limited "to relief of the same kind as that specifically enumerated" in section

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22. *See* note 19 *supra*.

23. 368 F. Supp. 829 (N.D. Cal. 1973).

24. *Id.* at 831. Plaintiff Van Hoomissen alleged various acts of employer retaliation, such as denial of job advancement opportunities, demotions, and termination, in response to his attempts to change the hiring practices of Xerox Corp. *Id.* These practices allegedly discriminated against Mexican Americans. *Id.* With respect to the issue of punitive damages, plaintiff argued that such an award, although not authorized by the pertinent statute, should be permitted where it would effectuate the purpose of the statute. *Id.* at 838.

25. *Id.* In refusing to award punitive damages, the district court stated: "In the present case . . . we have a statute which is quite specific in the remedies it provides. This Court believes it would be beyond the scope of its power to find other remedies contained in that statute where none seemingly exists." *Id.*

26. *Id.* at 836. The *Van Hoomissen* court recognized that, although the discussion in Congress regarding § 2000e-5(g) is "not terribly illuminating," there was a basis upon which to exclude punitive damages as an appropriate remedy under Title VII. *Id.* Therefore, the court found that Congress intended to establish equality of employment opportunities through "a wide panorama of equitable tools" rather than the imposition of punitive damages. *Id.*

In addition to this legislative history, the district court found other legislative factors to support its conclusion. Specifically, the court utilized the analogous provisions of the National Labor Relations Act (NLRA), which do not provide for punitive damages, as indicating that a similar scope applies to the remedial provisions of Title VII. *Id.* at 837. Furthermore, the court noted:

> Perhaps even more illuminating on the question of the scope of damages in Title VII is the fact that Title VIII, which deals with fair housing and is part of the 1968 Civil Rights Act, specifically provides for punitive damages . . . . When the 1972 amendment was made to Title VII, Title VIII was already law, yet no such parallel provision for punitive damages was included, even though *other amendments* to the remedies section were made.

Id. at 837-38 (emphasis in original).

27. 515 F.2d 301 (6th Cir. 1975), *vacated on other grounds*, 431 U.S. 951 (1977).

28. 515 F.2d at 308-09. After analyzing the language of section 706(g), the Sixth Circuit stated: "We find no authority in the quoted language for the award of punitive damages. We know of no authority which holds that the awarding of punitive damages is equitable relief." *Id.*

The district court had based its award of punitive damages on a finding of malice against the defendants. Stamps v. Detroit Edison Co., 365 F. Supp. 87, 124 (E.D. Mich. 1973). The court noted that the defendants had repeatedly disregarded plaintiffs' requests that Edison alter its hiring practices and that the union afford blacks fair representation. *Id.*

706(g).[29] The *Edison* court explained that "[w]hile affirmative action may not be limited to the reinstatement or hiring of employees with or without back pay, we believe that it is limited to relief of the same general kind, that is, equitable relief in the form of restitution."[30]

Several district courts, however, have suggested that punitive damage awards may be appropriate under Title VII,[31] and one court has awarded punitive damages in a Title VII suit. In *Claiborne v. Illinois Central Railroad*,[32] the United States District Court for the Eastern District of Louisiana engaged in an extensive historical analysis of Title VII and the pertinent amendments embodied in the EEOA[33] and sustained an award of punitive damages.[34] The court noted that "[t]here is no indication that punitive damages are unavailable. Indeed, punitive damages can play a useful role in making the victim 'whole' by providing compensation for intangibles, *e.g.*, mental suffering. . . . Punitive damages can provide additional relief from such uncompensated losses."[35] Additionally, the *Claiborne* court suggested that the availability of punitive damages would further the objectives of Title VII by creating an effective deterrent to violations and by providing an incentive for plaintiffs to initiate suits.[36]

The Third Circuit began its analysis of whether punitive damages are an available remedy in EEOA suits by focusing on the applicable remedial provisions of Title VII.[37] The *Richerson* court concluded that the phrase, "any other equitable relief as the court deems appropriate," precluded

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29. 515 F.2d at 309. The Sixth Circuit applied the *ejusdem generis* rule of construction to determining the type of relief available under section 706(g). *Id.* See note 39 and accompanying text *infra.*

30. 515 F.2d at 309.

31. *See* note 19 *supra.* The Third Circuit distinguished the holdings of Tooles v. Kellogg Co., 336 F. Supp. 14 (D. Neb. 1972), and Dessenberg v. American Metal Forming Co., 6 Fair Empl. Prac. Cas. (BNA) 159 (N.D. Ohio 1973) with respect to the issue of punitive damages on the ground that these decisions were based, in part, on the reluctance of the district courts to strike claims for punitive damages at a preliminary stage of the proceedings. 551 F.2d at 926 n.13.

32. 401 F. Supp. 1022 (E.D. La. 1975).

33. *Id.* at 1023-24. The *Claiborne* court recognized initially that the legislative history of Title VII was not conclusive and therefore offered little support for a denial of punitive damages. *Id.* at 1024. The district court rejected the analogy between the NLRA and Title VII utilized by other courts to support the restriction of relief to equitable remedies. *Id.* at 1024-25. Concluding that it must follow the statute's general purpose of "creating broad and effective remedies," the court awarded punitive damages. *Id.* at 1026, *quoting* Sape & Hart, *Title VII Revisited: The Equal Employment Opportunity Act of 1972,* 40 GEO. WASH. L. REV. 824, 880 (1972).

34. 401 F. Supp. at 1027.

35. *Id.* at 1024.

36. *Id.* at 1026. Some commentators have suggested that punitive damages may be an appropriate remedy under Title VII. *See* Richards, *Compensatory and Punitive Damages in Employment Discrimination Cases,* 27 ARK. L. REV. 603, 616-20 (1973); Sape & Hart, *supra* note 33, at 880 (1972); *Developments in the Law: Employment Discrimination and Title VII of the Civil Rights Act of 1964,* 84 HARV. L. REV. 1109, 1259-64 (1971); Comment, *Employment Discrimination Litigation: The Availability of Damages,* 44 U.M.K.C. L. REV. 497, 508-11 (1976).

37. 551 F.2d at 926. For the pertinent provisions of this statute, *see* text accompanying note 18 *supra.*

district courts from awarding punitive damages on the grounds that punitive damages "are a 'traditional form of relief offered in the courts of law', not in the courts of equity."[38] In addition, the Third Circuit examined the phrase, "such affirmative action as may be appropriate," and, by applying the *ejusdem generis*[39] doctrine of construction determined that it referred to the use of equitable remedies such as injunctions rather than to the application of any legal remedy.[40]

To support its interpretation of the remedial provisions of Title VII, the Third Circuit scrutinized the legislative history of section 706(g) and compared the section to similar provisions of analogous legislation.[41] The *Richerson* court stated that the Supreme Court had noted that section 706(g) is modeled, in part, on the provisions of the National Labor Relations Act (NLRA).[42] Furthermore, the court emphasized that several of the proponents of Title VII stated that its relief provisions would function similarly to the corresponding provisions of the NLRA.[43] Since the remedial provisions of the NLRA did not provide for punitive damages,[44] the *Richerson* court concluded that this was "additional evidence that Congress did not intend to authorize the award of punitive damages under Title VII."[45]

Seeking to further substantiate its construction of section 706(g), the *Richerson* court examined the remedial provisions of Title VIII of the Civil Rights Act of 1968 (Title VIII)[46] which was enacted to prohibit discrimination in housing and to provide adequate relief to those injured by such discrimination.[47] Remarking that " 'where a statute with respect to one subject contains a given provision, the omission of such provision from a similar statute is significant to show a different intention existed' "[48] the

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38. 551 F.2d at 927, *quoting* Curtis v. Loether, 415 U.S. 189, 196 (1974).

39. The principle of *ejusdem generis* suggests that "[w]here general terms in a statute follow an enumeration of terms with specific meaning, the general terms can be expected to apply to matters similar to those specified." diLeo v. Greenfield, 541 F.2d 949, 954 (2d Cir. 1976).

40. 551 F.2d at 927. The court first examined the type of relief expressly provided for in § 706(g) such as injunctions and reinstatement with or without backpay. *Id.* From this examination, the court concluded that these were examples of the kind of equitable relief that Congress "had in mind." *Id.*

41. *Id.* at 927-28.

42. *Id.* at 927, *citing* Albemarle Paper Co. v. Moody, 422 U.S. 405, 419 & n.11 (1975). Section 10(c) of the NLRA provides that, if the NLRB finds that an employer has engaged in unfair labor practices, the NLRB may issue cease and desist orders, and may "take such affirmative action including reinstatement of employees with or without back pay." 29 U.S.C. § 160(c) (1970).

43. 551 F.2d at 927, *citing* 110 CONG. REC. 6549, 7214 (1964) (remarks of Sen. Humphrey, memorandum of Senators Clark and Case).

44. *See* Consolidated Edison Co. v. NLRB, 305 U.S. 197, 235-36 (1938); note 42 *supra.*

45. 551 F.2d at 927. The *Richerson* court noted the maxim that "when Congress adopts the wording of a previously enacted statute, that adoption will usually carry with it the previous judicial interpretations of the wording." *Id.* at 927 n.17, *citing* Carolene Products Co. v. United States, 323 U.S. 18, 26 (1944).

46. 42 U.S.C. §§ 3601-31 (1970).

47. *Id.* § 3612.

48. 551 F.2d at 928, *citing* General Elec. Co. v. Southern Constr. Co., 383 F.2d 135, 138 n.4 (5th Cir. 1967).

Third Circuit observed that Title VIII expressly provided injured plaintiffs with an opportunity to recover punitive damages.[49] Reasoning that the absence of such a remedial provision in the 1972 amendment to Title VII[50] was "strong evidence that Congress did not intend to provide for punitive damages" in employment discrimination suits,[51] the Third Circuit sustained the district court's refusal to award punitive damages.[52]

By determining that section 706(g) prohibits awards of punitive damages for employment discrimination, the Third Circuit joined the majority of the federal courts that have confronted this issue.[53] The *Richerson* court's interpretation of the phrase, "any other equitable relief as the court deems appropriate," as limiting the court's remedial discretion closely paralleled that of the Sixth Circuit in *Edison*.[54] Both circuits supported the conclusion that section 706(g) precluded awards of punitive damages by applying the *ejusdem generis* rule of construction to limit the type of "affirmative action" authorized by the statute to equitable remedies.[55]

It is submitted that the *Richerson* court's analogy to the relief provisions of the NLRA to corroborate its interpretation of section 706(g) should be tempered in its application. Although the language of section 706(g) closely resembles the remedial provisions of the NLRA,[56] the two statutes have dissimilar objectives[57] and enforcement schemes.[58] Thus, although section

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49. 551 F.2d at 928. Section 812(c) of Title VIII provides:

> The court may grant as relief, as it deems appropriate, any permanent or temporary injunction, temporary restraining order, or other order, and may award to the plaintiff actual damages, and not more than $1000 punitive damages, together with court costs and reasonable attorney fees in the case of a prevailing plaintiff: *Provided,* That the said plaintiff in the opinion of the court is not financially able to assume said attorney's fees.

42 U.S.C. § 3612(c) (1970).

50. 42 U.S.C. § 2000e-5(g) (Supp. V 1975). For the text of this statute *see* text accompanying note 18 *supra*.

51. 551 F.2d at 928.

52. *Id.*

53. *See* note 19 *supra*.

54. *Compare* notes 27-30 and accompanying text *supra with* notes 38-40 and accompanying text *supra*.

55. *See* notes 29-30 & 40 and accompanying text *supra*.

56. *See* note 42 *supra*.

57. *See* 401 F. Supp. at 1025. The *Claiborne* court explained that the objectives of the NLRA and Title VII differed greatly and therefore reduced the reliability of any analogy developed. *Id.* at 1024-25. The district court noted that the NLRA was designed to achieve conciliation and cooperation in settling disputes between management and labor whereas Title VII was enacted to eliminate discrimination from employment practices. *Id.* at 1025.

58. *See id.* at 1024. Through the NLRA, the NLRB was granted cease and desist powers to enforce its determination where conciliation and negotiation failed. *Id.* The EEOC was limited to mediation and conciliation and, through the 1972 amendments, was granted authority to bring "pattern and practices" suits, yet was denied cease and desist powers. *Id.* Noting this distinction, the *Claiborne* court concluded:

> Congress, in denying cease and desist powers to the EEOC, rejected rather than adopted the NLRB scheme originally proposed. It is illogical to conclude from

706(g) was modeled after the remedial provisions of the NLRA,[59] it is not apparent that Congress intended to deny the award of punitive damages in Title VII suits simply because it made punitive damages unavailable under the NLRA.[60]

The *Richerson* court's decision to deny the availability of punitive damages under Title VII may lessen the statute's effectiveness in achieving Congress' two-fold purpose of eradicating discriminatory employment practices and creating remedies for injured plaintiffs.[61] Some commentators have argued that awards of punitive damages would be appropriate and consistent with this legislative purpose.[62] It has also been suggested that without the opportunity to obtain punitive damages, claimants, believing that adequate monetary compensation is unavailable, may be reluctant to institute suits.[63] This would make the statute a less potent tool against discrimination in employment since "the effectiveness of Title VII is dependent on the initiative of the complainant."[64]

Despite the unavailability of punitive damages under Title VII, it is submitted that the statute provides courts with authority sufficient to compensate injured employees and effectuate the two-fold congressional purpose. The Supreme Court has recognized that section 706(g) vests "broad equitable discretion in the federal courts" to eliminate discrimination from employment practices.[65] District courts are empowered to enjoin violations of Title VII and to order rehiring, promotion, and backpay.[66] Additionally, Chief Justice Burger has suggested that it may be proper for a district court to award "front pay" as an alternative to seniority relief.[67]

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such Congressional action that Congress intended to limit Title VII remedies to those allowed under the N.L.R.A., 29 U.S.C. § 160(c), when it rejected the N.L.R.A. as a model for Title VII enforcement procedures.

Id.

59. Albemarle Paper Co. v. Moody, 422 U.S. 405, 419 (1975).

60. *See* 401 F. Supp. at 1025.

61. *See* H.R. REP. NO. 914, 88th Cong., 1st Sess. 1, 9-10, *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 2401, 2405.

62. *See, e.g.,* Comment, *supra* note 36, at 508-11. One commentator has stated: "[T]he awarding of punitive damages would further the purpose underlying Title VII — ending certain types of employment discrimination." Richards, *supra* note 36, at 619. *See also* Comment, 5 CAL. W. L. REV. 252, 256-57 (1969), in which the author argued that if the legislative purpose is to be effectuated, some damages must be obtainable by successful litigants.

63. *See, e.g.,* Claiborne v. Illinois Central R.R., 401 F. Supp. 1022 (E.D. La. 1975). In *Claiborne,* the district court recognized that punitive damages can provide additional relief for uncompensated losses. *Id.* at 1024. The court reasoned that punitive damages would encourage plaintiffs to litigate and that this litigation would serve as a deterrent to future discriminatory practices. *Id.*

64. Comment, *supra* note 62, at 259.

65. Franks v. Bowman Transp. Co., Inc., 424 U.S. 747, 762 (1976).

66. *See* text accompanying notes 17 & 18 *supra.*

67. Franks v. Bowman Transp. Co., Inc., 424 U.S. 747, 781 (1976). Chief Justice Burger, concurring in part and dissenting in part, argued that competitive-type seniority relief, in which the aggrieved employee is given certain seniority promotions, is not an equitable solution where it is done at the expense of other innocent employees. *Id.* at 780-81. Front pay would be monetary relief to the injured employee which provides him with compensation at the expense of the discriminating employer and not an employee. *Id.* at 781. The Chief Justice stated: "[S]uch monetary

Notwithstanding the ambiguous legislative history of Title VII and the EEOA[68] and the potential problems arising from the comparison between the remedial provisions of the NLRA and Title VII,[69] it is submitted that the Third Circuit's determination that punitive damages are not recoverable in actions brought pursuant to the remedial provision which allows "equitable relief as the court deems appropriate" is consistent with the purpose of the legislation.[70] Although some district courts and commentators indicate that punitive damages are essential to eliminate discriminatory practices from employment opportunities,[71] it would seem that effective use of the equitable powers available to the district courts will encourage aggrieved persons to litigate, thereby advancing the fundamental purpose of Title VII and the EEOA.

Daniel J. Callaghan

FEDERAL JURISDICTION — THE SUPREMACY CLAUSE, IN NOT SECURING RIGHTS TO INDIVIDUALS, DOES NOT CONSTITUTE A CONSTITUTIONAL BASIS FOR A FEDERAL CLAIM UNDER SECTIONS 1983 AND 1343(3). AND THE SOCIAL SECURITY ACT, IN NOT PROVIDING FOR EQUAL RIGHTS OR THE PROTECTION OF CIVIL RIGHTS, DOES NOT CONSTITUTE A STATUTORY BASIS FOR A FEDERAL CLAIM UNDER SECTIONS 1983 AND 1343.

Gonzalez v. Young (1977)

Julia Gonzalez, a recipient under the federal Social Security Act's Aid to Families with Dependent Children program (AFDC),[1] was denied emergency

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relief would serve the dual purpose of deterring wrongdoing by the employer or union — or both — as well as protecting the rights of innocent employees." *Id.*

68. *See* note 20 and accompanying text *supra.*

69. *See* notes 56-59 and accompanying text *supra.*

70. *See* notes 65-67 and accompanying text *supra.*

71. *See* notes 62 & 63 and accompanying text *supra.*

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1. 42 U.S.C. § 601-610 (1970 & Supp. V 1975). The AFDC is one of four categories of assistance established by the Social Security Act. *See id.* §§ 301-306, 601-610, 1201-1206, 1351-1355 (1970 & Supp. V 1975). *See also* Note, *Federal Jurisdiction Over Challenges to State Welfare Programs,* 72 COLUM. L. REV. 1404 & n.4 (1972) [hereinafter cited as *Welfare Challenges*]. Categorical assistance is the predominant source of public welfare in most states, with the programs providing for the receipt by states of matching funds from the federal government. *Id.* at 1404. The federal government pays a substantial part of AFDC grants under a federal matching program, which states qualify for by complying with requirements of the Social Security Act. 42 U.S.C. § 602(a) (1970 & Supp. V 1975). *See* Note, *The Outlook For Welfare Litigation in the Federal Courts:* Hagans v. Lavine & Edelman v. Jordan, 60 CORNELL L. REV. 897 (1975) [hereinafter cited as *Outlook for Welfare Litigation*]. For a general analysis of the AFDC program, *see* Lurie, *Major Changes in the Structure of*

assistance[2] by a local New Jersey welfare board, because she did not satisfy the state's eligibility conditions.[3] Alleging that the New Jersey welfare regulations conflicted with the applicable federal AFDC rules[4] and deprived her of the right to receive federally mandated benefits,[5] Gonzalez brought an action against state welfare officials in the United States District Court for the District of New Jersey.[6] Federal jurisdiction for the complaint was predicated upon the substantive section 1983 of Title 42 of the United States

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the AFDC Program Since 1935, 59 CORNELL L. REV. 825 (1974); Note, *1974 Developments in Welfare Law — Aid to Families with Dependent Children,* 60 CORNELL L. REV. 857 (1975).

2. Gonzalez v. Young, 418 F. Supp. 566, 568 (D.N.J. 1976), *vacated and remanded,* 560 F.2d 160 (3d Cir. 1977). Plaintiff, Julia Gonzalez, who resided with her two children in Jersey City, New Jersey, received a monthly check from the Hudson County Welfare Board in the amount of $235.00, issued pursuant to the AFDC program. On February 2, 1976, after cashing her AFDC check, her pocketbook was stolen, and the following day Gonzalez requested $163.00 in emergency assistance funds to cover rent and utility bills. *Id.* at 567-68. Based upon a determination made by a caseworker who had received verbal assurances from the plaintiff's utility company and landlord that no steps would be taken against the Gonzalez family, the request for emergency assistance was denied. *Id.*

3. *Id.* at 568. *See* 42 U.S.C. § 606(e)(1) (1970) and its accompanying regulation, 45 C.F.R. § 233.120 (1976). Section 606(e)(1) provides that emergency assistance to needy families with children embraces cases

> where [an eligible] child is without available resources, the payments, care, or services involved are necessary to avoid destitution of such child or to provide living arrangements in a home for such child, and such destitution or need for living arrangements did not arise because such child or relative refused without good cause to accept employment or training for employment.

42 U.S.C. § 606(e)(1) (1970). In order to receive the funding, however, a state must devise a state plan specifying the eligibility conditions to be imposed for receipt of emergency assistance. 45 C.F.R. § 233.120(a)(1) (1976). With respect to emergency assistance payments, New Jersey has promulgated the following regulations:

> [W]hen because of an emergent situation over which they have had no control or opportunity to plan in advance the eligible unit is in a state of homelessness, and the county welfare board determines that the providing of shelter and/or food and/or emergency clothing and/or minimum essential house furnishings are necessary for health and safety, such needs may be recognized in accordance with the regulations and limitations in the following sections.

N.J. ADMIN. CODE 10:82-5.12(c) (1969). Failure of a state to comply with the federal government's requirements under the AFDC program can result in the loss of federal matching funds. 42 U.S.C. § 604(a)(2) (1970). Because of the assurances given to plaintiff's caseworker by her utility company and landlord that they would not take action against the plaintiff for failure to pay her bills, it was determined that she was not " 'in a state of homelessness' ", as required by the state regulation. Gonzalez v. Young, 560 F.2d 160, 163 (3d Cir. 1977); *see* note 2 *supra.*

4. 418 F. Supp. at 569. In her complaint to the district court, Gonzalez contended that the state welfare officials had violated 42 U.S.C. § 606(e)(1) (1970) and its accompanying regulation by refusing her request for emergency assistance, when she allegedly was entitled to benefits under federal law. 418 F. Supp. at 568 (D.N.J. 1976); *see* note 3 *supra.*

5. *See* 418 F. Supp. at 568 (D.N.J. 1976). For the pertinent text of the federal legislation, *see* note 3 *supra.*

6. Gonzalez v. Young, 418 F. Supp. 566 (D.N.J. 1976). The named defendants were the Director of the Hudson County, New Jersey Welfare Board, and the Director of the New Jersey Division of Public Welfare. *Id.* at 566.

Code[7] and the jurisdictional sections 1331 and 1343 of Title 28.[8] The district court found that the court's exercise, under section 1343, of jurisdiction over Gonzalez' section 1983 claim was appropriate under the rationale that all section 1983 claims, whether wholly or partially statutory, automatically fall within the reach of section 1343.[9] On appeal, the United States Court of Appeals for the Third Circuit[10] vacated the lower court's decision and remanded for a dismissal of the complaint, *holding* that a section 1983 allegation that state law conflicts with a federal statute does not give rise to a sufficient constitutional or statutory claim to establish federal jurisdiction under section 1343. *Gonzalez v. Young,* 560 F.2d 160 (3d Cir. 1977).

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7. 42 U.S.C. § 1983 (1970). Section 1983 provides:

> 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.

Id. (emphasis added). For a further discussion of this issue, *see* Note, *Federal Judicial Review of State Welfare Practices,* 67 COLUM. L. REV. 84, 96 (1967).

8. 418 F. Supp. at 569. Since § 1331, 28 U.S.C. § 1331 (1970), requires a minimum jurisdictional amount of $10,000, the district court rejected a claim of jurisdiction under this section because Gonzalez sought only $163.00 in damages. 418 F. Supp. at 569–70.

Section 1343, 28 U.S.C. § 1343 (1970), provides in pertinent part:

> The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person:
>
> (3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, or any *right,* privilege or immunity *secured by the Constitution* of the United States or by any Act of Congress *providing for equal rights* of citizens or of all persons within the jurisdiction of the United States;
>
> (4) To recover damages or to secure equitable or other relief under an Act of Congress *providing for the protection of civil rights,* including the right to vote.

Id. (emphasis added).

9. 418 F. Supp. at 570–71. In reaching this conclusion the district court relied wholly upon the rationale of Vazquez v. Ferre, 404 F. Supp. 815 (D.N.J. 1975). *Vazquez* had maintained that:

> An analysis of the legislative history, . . . leads to the conclusion that this language [of § 1343(3)] was not intended to reduce the jurisdiction of federal district courts over § 1983 actions. Rather, the term "equal rights," which first appeared in the 1875 revision of the Civil Rights Act of 1871, had a broader meaning than it does today. The purpose of the 1875 revision was not to effect substantive changes in the 1871 Act, but instead merely sought to divide it into separate jurisdictional and substantive statutes.

404 F. Supp. at 824, *citing* Blue v. Craig, 505 F.2d 830, 838–39 (4th Cir. 1974). For a discussion of the statutory aspects of § 1983 and § 1343, *see* notes 15–25 and accompanying text *infra.*

By regarding the question as resolved by *Vazquez,* the district court in *Gonzalez* found it unnecessary to decide whether the " 'secured by the Constitution' language of § 1343(3) should be construed to include supremacy clause issues." 418 F. Supp. at 571 (D.N.J. 1976), *quoting* 28 U.S.C. § 1343(3)(1970). For further discussion of the supremacy clause issue, *see* notes 30–37, 39–40 & 46–55 and accompanying text *infra.*

10. The instant case was decided by Judges Aldisert, Rosenn, and Hunter. Judge Aldisert wrote the opinion.

Selecting the proper federal jurisdictional basis for welfare claims has been a subject of controversy among the circuits.[11] A common technique used by welfare claimants has been to assert a cause of action under section 1983, and federal jurisdiction under sections 1331 and 1343(3) and (4).[12] Because welfare claims seldom involve an amount in controversy exceeding $10,000, section 1331 frequently is inapplicable.[13] Thus, the major questions have arisen in determining whether the use of sections 1983 and 1343(3) and (4) are appropriate.[14]

With respect to a welfare claimant's position that a valid statutory section 1983 claim is sufficient to invoke the jurisdictional protection of sections 1343(3) or (4), a reconciliation of the differing language in sections 1983 and 1343 is necessary.[15] While section 1983 furnishes a remedy for "the deprivation of *any rights,* privileges, or immunities secured by the Constitution and [federal] laws,"[16] section 1343 extends its application only to rights secured by the Constitution and those federal laws "providing for *equal rights* of citizens"[17] or "providing for the protection of *civil rights.*"[18] The more restrictive language of section 1343, therefore, sometimes has been characterized as a limitation,[19] leading some courts, including the Second

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11. *See* text accompanying notes 34-42 *infra.*

12. *See Outlook for Welfare Litigation, supra* note 1, at 898-99. For the pertinent text of §§ 1983, 1331, and 1343, *see* notes 7-8 *supra.*

13. *See* Herzer, *Federal Jurisdiction Over Statutorily-Based Welfare Claims,* 6 HARV. C.R.-C.L.L. REV. 1, 1-2 (1970); *Welfare Challenges, supra* note 1, at 1405-06; Note, *supra* note 7, at 111.

14. *See generally* Herzer, *supra* note 13.

15. The contemporary jurisdictional dilemma facing courts basically evolves from a discrepancy between the language of § 1983 and § 1343(3), § 1343(3) appearing to be narrower than its remedial counterpart. *See* Herzer, *supra* note 13, at 11; *Welfare Challenges, supra* note 1, at 1406-26. *See also* text accompanying notes 16-18 *infra.*

16. 42 U.S.C. § 1983 (1970) (emphasis added). For the pertinent text of § 1983, *see* note 7 *supra.*

17. 28 U.S.C. § 1343(3) (1970) (emphasis added). For the pertinent text of § 1343(3), *see* note 8 *supra.*

18. 28 U.S.C. § 1343(4) (1970) (emphasis added). For the pertinent text of § 1343(4), *see* note 8 *supra.*

19. *See* Lynch v. Household Fin. Corp., 405 U.S. 538, 544 n.7 (1972) ("equal rights" language of § 1343(3) is a limitation). It should be noted, however, that in *Lynch* the Supreme Court referred to § 1983 and § 1343(3) as jurisdictional counterparts. *Id.* at 540, 543.

Both § 1343 and § 1983 are the progeny of § 1 of the Civil Rights Act of 1871, ch. 22, § 1, 17 Stat. 13. The Civil Rights Act became positive law in 1874 as part of the Revised Statutes Act of June 20, 1874, ch. 333, § 2, 18 Stat. 113 (1875) (current versions at 28 U.S.C. § 1343 (1970) and 42 U.S.C. § 1983 (1970)). It has been noted that the Revised Statutes, as positive law, repeal and supersede all previous statutes at large. *Welfare Challenges, supra* note 1, at 1418. Thus the authoritative Civil Rights Act language is that of the Revised Statutes — now codified into § 1983 — and not that of the original 1871 enactment. *Id.* Section 1983 provides individual civil liability for the deprivation of constitutional rights. *Id.* at 1407. *See* note 7 *supra.* Section 1343(3) grants federal courts the power to hear "any civil action authorized by law" to remedy such deprivation. *See* note 8 *supra.* It must be noted that § 1983 does not in itself confer federal jurisdiction, but merely creates a cause of action; it is the 'functional prerequisite' to establishing jurisdiction under § 1343(3). *Welfare Challenges, supra* note 1, at 1407. *See* text accompanying note 43 *infra.*

Circuit in *Andrews v. Maher,*[20] to the conclusion that Congress created a federal cause of action without granting federal jurisdiction in all instances.[21] Other courts, including the Fourth Circuit in *Blue v. Craig,*[22] have maintained that, although the language is different, the statutory predecessors of sections 1983 and 1343(3) were considered to be coextensive,[23] thus attributing the discrepancy in language to inadvertence.[24] Courts supporting the more restrictive approach have held that a statutory claim based upon a violation of a right secured by the Social Security Act cannot satisfy section 1343 requirements, since the welfare statute was not designed to provide for the equal rights of citizens.[25]

Several United States Supreme Court decisions, including *Hagans v. Lavine,*[26] have established the broad rule that *statutory welfare claims that are joined with substantial constitutional questions* may obtain section 1343 jurisdiction over the statutory claims through the pendent jurisdiction doctrine.[27] However, although subsection 1343(3) has been held to grant federal jurisdiction over challenges to state welfare programs under the fourteenth amendment of the United States Constitution,[28] welfare recip-

20. 525 F.2d 113 (2d Cir. 1975); *see* notes 39-42 and accompanying text *infra.*

21. *See, e.g.,* 525 F.2d at 118.

22. 505 F.2d 830 (4th Cir. 1974); *see* notes 34-38 and accompanying text *infra.*

23. *See, e.g.,* 505 F.2d at 837. *See also* Lynch v. Household Fin. Corp., 405 U.S. 538, 543-44 n.7 (1972); P. BATOR, P. MISHKIN, D. SHAPIRO & H. WECHSLER, HART & WECHSLER'S THE FEDERAL COURT AND THE FEDERAL SYSTEM 961 (2d ed. 1973); Herzer, *supra* note 13, at 11 n.46; *Welfare Challenges, supra* note 1, at 1426.

24. *See* 505 F.2d at 837; for a discussion of *Blue, see* notes 34-38 and accompanying text *infra.*

It has been noted by one author that there is no explanation in the Revised Statutes for the difference in language between § 1983 and § 1343(3), and that there was no indication in the legislative history that the difference was intentional. *Welfare Challenges, supra* note 1, at 1421. *See also* text accompanying notes 15-18 *supra.* In an exhaustive examination of the purpose and intent underlying the predecessors of § 1983 and § 1343(3), that commentator attributes the difference in language to possibly careless drafting. *Welfare Challenges, supra* note 1, at 1423. *Accord,* Cover, *Establishing Federal Jurisdiction in Actions Brought to Vindicate Statutory (Federal) Rights When No Violations of Constitutional Rights Are Alleged,* 2 CLEARINGHOUSE REV. 5, 7 (1969).

25. *E.g.,* Andrews v. Maher, 525 F.2d 113, 118 (2d Cir. 1975). For an analysis of *Andrews, see* notes 39-42 and accompanying text *infra.*

26. 415 U.S. 528 (1974). *See also* Rosado v. Wyman, 397 U.S. 397 (1970); King v. Smith, 392 U.S. 309 (1968); UMW v. Gibbs, 383 U.S. 715 (1966).

27. *See, e.g.,* 415 U.S. 528, 543-50 (1974); Rosado v. Wyman, 397 U.S. 397, 403-04 (1970); King v. Smith, 392 U.S. 309, 312 n.4 (1968); UMW v. Gibbs, 383 U.S. 715, 726 (1966). In *Hagans,* recipients of public assistance funds under the federal-state AFDC program brought an action in federal court challenging a state regulation that governed the administrative recoupment of certain payments. 415 U.S. at 530-31. The action was based on the contentions that the regulation violated the equal protection clause of the fourteenth amendment of the Constitution and was in conflict with the Social Security Act and its regulations. *Id.* at 531. The majority of the Supreme Court held, *inter alia,* that the fourteenth amendment claim was sufficiently substantial to confer jurisdiction under § 1343(3), and that, under the pendent jurisdiction doctrine, the district court could also hear the claim involving the inconsistency between the regulation and the Social Security Act. *Id.* at 543-50.

28. *See, e.g.,* 415 U.S. at 543-50 (1974); To date, the Supreme Court has allowed jurisdiction under § 1343 only in cases that involved a *substantial* fourteenth amendment claim. *See id.* at 536-43 (1974); Rosado v. Wyman, 397 U.S. 397, 402-05 (1970); King v. Smith, 392 U.S. 309, 320-34 (1968). *See also* White v. Beal, 413 F. Supp.

ients often have no nonfrivolous fourteenth amendment claim upon which to append their statutorily based grievances.[29] Thus, the welfare litigant who is unable to fashion a more substantial fourteenth amendment issue is left solely with the allegation that there is a conflict between the state and the federal law, which is governed by the supremacy clause of the Constitution.[30] In a widely cited footnote passage,[31] the *Hagans* Court suggested that where the Court has determined state AFDC laws to be inconsistent with their federal counterparts, the state laws have been invalidated under the supremacy clause.[32] Two other Supreme Court cases have also declined to address directly the question whether a conflict between federal and state law is of sufficient constitutional substance to confer jurisdiction under section 1343(3).[33]

The circuit courts are not in agreement over the sufficiency of the supremacy clause to provide a constitutional base, for federal jurisdiction. In *Blue v. Craig*,[34] the Fourth Circuit held that the "secured by the Constitution" language of section 1343 should not be construed to exclude supremacy clause issues, concluding that an allegation that a state regulation is inconsistent with federal law does present a constitutional issue for section 1343 purposes.[35] Therefore, the *Blue* court recognized

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1141 (E.D. Pa. 1976); Almenares v. Wyman, 334 F. Supp. 512 (S.D.N.Y.), *modified on other grounds*, 453 F.2d 1075 (2d Cir. 1971), *cert. denied*, 405 U.S. 944 (1972).

29. *See* Herzer, *supra* note 13, at 2; *Welfare Challenges, supra* note 1, at 1406.

30. U.S. CONST. art. VI, cl. 2. *See Outlook for Welfare Litigation, supra* note 1, at 899-903.

31. *See, e.g.*, Blue v. Craig, 505 F.2d 830, 843 (4th Cir. 1974). *See also* notes 34-38 & 53-55 and accompanying text *infra*.

32. 415 U.S. at 533-34 n.5. The *Hagans* passage stated in pertinent part:

> In view of our disposition of this case, we do not reach the question whether, wholly aside from the pendent jurisdiction rationale, ... other valid grounds existed for sustaining its jurisdiction to entertain and decide the claim of conflict between federal and state law. It has been suggested, for example, that the conflict question is itself a constitutional matter within the meaning of § 1343(3) . . . . [The Court] itself [has] recognized that a suit to have a state statute declared void and to secure the benefits of the federal statute with which the state law is allegedly in conflict cannot succeed without ultimate resort to the Federal Constitution — "to be sure, any determination that a state statute is void for obstructing a federal statute does rest on the Supremacy Clause of the Federal Constitution." . . . Moreover, when we have previously determined that state AFDC laws do not conform to the Social Security Act or HEW regulations, they have been invalidated under the Supremacy Clause.

Id. quoting Swift & Co. v. Wickham, 382 U.S. 111, 125 (1971) (citations omitted). Thus, petitioners in *Hagans* urged that the "secured by the Constitution" language of § 1343(3) should be construed to include supremacy clause issues. *Id.* The Court left this question "for another day." *Id. See also* notes 34-38, 53-55 & 64-69 and accompanying text *infra*.

33. Rosado v. Wyman, 397 U.S. 397 (1970); King v. Smith, 392 U.S. 309 (1968).

34. 505 F.2d 830 (4th Cir. 1974).

35. *Id.* at 844. In *Blue*, the Fourth Circuit was faced with a claim that a state plan for medical assistance deprived recipients of civil rights secured to them by the Social Security Act. *Id.* at 832. The plaintiffs predicated their federal right of action primarily upon § 1983 and § 1343(3). *Id.* The court maintained that the separation of § 1983 and § 1343 into distinct substantive and jurisdictional sections was not intended to alter the interrelation of the two as they had previously existed in the original 1871 Act. *Id.* at 837-38. *See* note 19 *supra*.

jurisdiction over a constitutionally based section 1983 claim involving purely statutory rights under subsection 1343(3).[36] The *Blue* court acknowledged the supremacy clause as a basis for jurisdiction by a logical extension of recent Supreme Court decisions that maintained that a determination that a state statute is void for obstructing a federal statute "rests on" the supremacy clause.[37]

The Fourth Circuit also allowed the statutory claim as a jurisdictional basis. After an exhaustive analysis of the legislative history the *Blue* court concluded that section 1343(3)'s grant of jurisdiction to redress deprivations of rights secured by federal laws that provided for "equal rights" is coextensive with section 1983's creation of a cause of action for deprivations of *any* right secured by federal laws.[38]

The Second Circuit, when faced with the same issues in *Andrews v. Maher*,[39] refused the supremacy clause as a basis for jurisdiction since that clause does not itself secure rights to individuals.[40] The *Andrews* court also rejected the statutory issue as providing a basis for jurisdiction, concluding that subsection 1343(3) was not coextensive with section 1983 in actions

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36. 505 F.2d at 837-38.

37. *Id.* at 843-44 *citing* Hagans v. Lavine, 415 U.S. 528 (1974); Carleson v. Remillard, 406 U.S. 598 (1972); Townsend v. Swank, 404 U.S. 282 (1971), and Swift & Co. v. Wickham, 382 U.S. 111 (1965). The *Blue* court concluded that "a claim that a state statute or regulation is inconsistent with Federal law poses a *constitutional issue* under the supremacy clause, jurisdictionally cognizable under § 1343(3)." 505 F.2d at 844 (emphasis added). *See also* Stuart v. Canary, 367 F. Supp. 1343, 1345 (N.D. Ohio 1973) (Ohio policy of denying AFDC benefits, since inconsistent with Social Security Act, was violative of supremacy clause, which gave court federal jurisdiction under § 1343(3)). *See generally* Swift & Co. v. Wickham, 382 U.S. 111, 125 (1965). *But see* Andrews v. Maher, 525 F.2d 113 (2d Cir. 1974). The Second Circuit in *Andrews* held that the supremacy clause does not secure *rights to individuals* but rather states a fundamental structural principle of federalism. *Id.* at 118. *See also* notes 39-40 & 62-69 and accompanying text *infra*.

38. 505 F.2d at 836-42. With respect to the "equal rights" language of § 1343(3), the Fourth Circuit maintained that it should be construed not so much as a term of limitation, "but rather as a term intended to spread the jurisdictional umbrella of the federal courts over any actions authorized under statutes enacted to give effect to the Fourteenth Amendment, including specifically § 1983." *Id.* at 838.

39. 525 F.2d 113 (2d Cir. 1975).

40. *Id.* at 119. In *Andrews*, the court was presented with a claim that a Connecticut regulation violated various provisions of the Social Security Act, as well as regulations of the U.S. Department of Health, Education and Welfare that required that AFDC aid be furnished uniformly to all those who were eligible within the state. *Id.* at 115-16. The plaintiffs contended that, since the claim required ultimate resort to the supremacy clause, it was cognizable under § 1343(3) as a deprivation of rights "secured by the Constitution." *Id.* at 118. The court rejected this contention, stating that such a theory "transforms statutory claims into constitutional claims by verbal legerdemain." *Id.* at 118-19. Although the supremacy clause invalidates state laws that conflict with federal statutes, *Andrews* maintained that it was the federal statute, and not the supremacy clause, that conferred the individual's rights. *Id.* Furthermore, the court stated that the language of § 1343(3) clearly pointed to a "distinction between rights secured by the Constitution and rights secured by 'any Act of Congress.'" *Id. citing* 28 U.S.C. § 1343(3) (1970). The court reasoned: "If the latter were just one variety of the former, it would be unnecessary to mention it as a separate situation." 525 F.2d at 119.

based upon purely statutory rights.[41] The court posited that, since it was the federal statute that conferred the individual's rights, and the Social Security Act was not an act "providing for equal rights" within the meaning of section 1343(3), there was no jurisdiction over claims that a state had violated the Social Security provisions.[42]

Faced with these difficult jurisdictional contentions, the Third Circuit began its analysis in *Gonzalez* by positing that, since section 1983 is a remedial and not a jurisdictional statute, the plaintiff had to assert a further jurisdictional basis upon which the case was appropriately in federal court.[43] After summarily disposing of plaintiff's claim of jurisdiction under section 1331 for lack of a sufficient amount in controversy,[44] the court then focused upon the constitutional claim that Gonzalez had asserted under subsection 1343(3).[45]

In addressing this question, the court first determined that the sole constitutional claim presented was " 'that the alleged conflict between the state and federal statutes and regulations violates rights secured . . . by the supremacy clause.' "[46] Using the Supreme Court's approach in *Hagans*,[47] the court questioned whether the alleged constitutional claim was of "sufficient substance,"[48] to meet the section 1343(3) requirements.[49] The Third Circuit

41. 525 F.2d at 118. *See* notes15 & 19 *supra*. *See also* McCall v. Shapiro, 416 F.2d 246 (2d Cir. 1969). The Second Circuit there explicitly rejected plaintiff's argument that § 1983 and § 1343 should be coextensive in order to provide a comprehensive federal remedy. *Id.* at 250. *McCall* was an action challenging the state welfare commissioner's decision to deduct from plaintiff's AFDC payments reimbursement for amounts paid to a child also receiving Old Age Survival and Disability Insurance. *Id.* at 247-48. Noting the difference in language between the two sections, the court concluded that there is no indication of congressional intent to provide § 1343 jurisdiction for all suits under § 1983. *Id.* at 250.

42. 525 F.2d at 118.

43. 560 F.2d at 164.

44. *Id.* The district court had taken the same approach with respect to the § 1331 claim. *See* note 8 *supra*.

45. 560 F.2d at 164.

46. *Id.* at 165, *quoting* Gonzalez v. Young, 418 F. Supp. 566, 569 (D.N.J. 1976).

47. 560 F.2d at 164. For a discussion of the *Hagans* "substantiality" approach, *see* notes 26-27 & 32 and accompanying text *supra*.

48. 560 F.2d at 164-66. The *Gonzalez* court set forth at length the issues that had not been reached by the Supreme Court. *Id.* at 164-65, *citing* Hagans v. Lavine, 415 U.S. 528, 533-34 n.5 (1974), *and* King v. Smith, 392 U.S. 309, 312 n.3 (1968). After evaluating and rejecting the various alleged bases for jurisdiction, the court ended its analysis by harmonizing the *Hagans* standard with Third Circuit precedent, maintaining that courts could still afford a litigant an opportunity to press statutory § 1983 claims in the same action, if there was a substantial constitutional claim. 560 F.2d at 168. For example, in Williams v. Wohlgemuth, 540 F.2d 163 (3d Cir. 1976), state provisions of the AFDC emergency assistance program were challenged as violative of the fourteenth amendment. *Id.* at 166. Based upon *Hagans*, the Third Circuit allowed district court jurisdiction over the case. *Id. See* 560 F.2d at 168-69. In *Gonzalez*, the court noted that the complaint in the instant case contained vague constitutional overtones relating to the supremacy clause, whereas the complaint filed in *Williams* had alleged violations of the equal protection and due process clauses. 560 F.2d at 168-69. *See also* Almenares v. Wyman, 453 F.2d 1075 (2d Cir. 1971), *cert. denied*, 405 U.S. 944 (1972) (jurisdiction over claim that state procedures for terminating AFDC benefits were contrary to federal regulations permitted where complaint also stated a substantial due process claim).

49. 560 F.2d at 165-66.

expressed its complete agreement with the Second Circuit's position in *Andrews*,[50] that the supremacy clause does not " 'secure rights to individuals' "[51] and, therefore, that the plaintiff's claim was statutory and not constitutional in nature.[52] Acknowledging that its decision conflicted with the Fourth Circuit's holding in *Blue*,[53] the Third Circuit criticized *Blue* for placing its reliance upon the *Hagans* passage[54] when the Supreme Court there had specifically left the question open.[55]

Having rejected the supremacy clause as a constitutional basis for jurisdiction, and thus reducing the plaintiff's claim to a statutory question, the *Gonzalez* court next considered whether the denial of welfare benefits resulting from the discrepancy between state and federal laws could provide an independent basis for jurisdiction under section 1343.[56] Maintaining that Gonzalez claimed deprivation of a right under the Social Security Act which contains the AFDC provisions, the court adopted the more restrictive *Andrews* approach — that the Social Security Act simply was not designed to provide for the "equal rights of citizens" for purposes of section 1343(3).[57] In doing so, the Third Circuit again was rejecting the approach advocated in

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50. *Id.* at 165. For a discussion of the *Andrews* court's resolution of the question whether an allegation that a state law conflicts with federal law establishes a sufficient constitutional claim under the supremacy clause to establish § 1343(3) jurisdiction, *see* notes 39-40 and accompanying text *supra*.

51. 560 F.2d at 166, *quoting* Andrews v. Maher, 525 F.2d 113, 118-19 (2d Cir. 1975).

52. 560 F.2d at 166.

53. *Id.* For a discussion of the Fourth Circuit's holding in *Blue* that a claim that a state statue is void as contrary to a federal statute rests in the supremacy clause, *see* notes 34-37 and accompanying text *supra*.

54. 560 F.2d at 166. For the pertinent text of the *Hagans* passage, *see* note 32 *supra*.

55. 560 F.2d at 166. The Third Circuit asserted that "[a] statement which specifically does not meet a question cannot be cited as authority for answering it." *Id. See* note 32 *supra*.

56. 560 F.2d at 166.

57. *Id., quoting* 28 U.S.C. § 1343 (1970). The court rejected plaintiff's contention that the qualifying language of § 1343(3) was superfluous, noting the discrepancy in language between § 1983 and § 1343. *Id.* For a discussion of this discrepancy, *see* notes 15-25 and accompanying text *supra*. For discussion of AFDC as a category of assistance adminstered under the Social Security Act, *see* note 1 *supra*.

The *Gonzalez* court stated: "[A]bsent convincing evidence to the contrary, . . . we must believe that Congress intended to separate the jurisdictional section from the section fashioning a remedy, which it did, and that 'equal rights' does have a meaning of its own." 560 F.2d at 167, *quoting* 28 U.S.C. § 1343(3) (1970). The *Gonzalez* court also rejected the contention that the Social Security Act is one "providing for the protection of civil rights," so as to bring this action under § 1343(4). 560 F.2d at 167, *quoting* 28 U.S.C. § 1343(4) (1970).

Plaintiff made an ancillary argument that "section 1983 itself provides a jurisdictional basis under section 1343(4) by virtue of its very existence as a statute protecting " 'rights, privileges and immunities.' " 560 F.2d at 167-68, *quoting* 42 U.S.C. § 1983 (1970). *See* Gomez v. Florida State Employment Serv., 417 F.2d 569, 580 n.39 (5th Cir. 1969). The court rejected this approach, stating that § 1983 does not in and of itself create or secure any substantive rights, but merely authorizes a cause of action when rights secured by another source have been infringed. 560 F.2d at 168. *See* note 19 *supra*.

Blue, where the Fourth Circuit had interpreted all wholly statutory 1983 claims as within the jurisdictional protection of section 1343.[58]

Finally, with regard to the policy considerations that a federal forum is best suited for adjudicating a claim of this type,[59] the Third Circuit maintained that it had no choice but to act within its jurisdictional limits.[60] The court also suggested that, until Congress mandated otherwise, claims such as that pressed by Gonzalez could be adjudicated in federal court only when pendent to a sufficient constitutional claim in the same action.[61]

With respect to plaintiff's claim that the alleged conflict between state and federal law violated her rights under the supremacy clause,[62] the *Gonzalez* court conceded that the *Blue* court had been correct in finding that such a conflict does rest within the supremacy clause.[63] However, the Third Circuit rejected the *Blue* court's recognition of jurisdiction from this finding because of *Blue's* reliance upon the *Hagans* passage, which specifically stated that it was not directly addressing the issue.[64] It is submitted however, that although the *Hagans* passage did not directly address the issue of section 1343 jurisdiction over supremacy clause claims, it may be inferred from that passage that the Court's ultimate disposition of this issue will be in the affirmative.[65]

The *Hagans* passage had noted that a suit to invalidate a state policy that conflicts with a federal statute cannot succeed without resort to the Constitution.[66] The aspect of *Blue* that is subject to criticism lies in the Fourth Circuit's leap from the recognition that such a claim is an *issue* under the supremacy clause to the assumption that the issue is a *right*

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58. 560 F.2d at 167, *citing* Blue v. Craig, 505 F.2d 830 (4th Cir. 1974).
59. 560 F.2d at 169.
60. *Id.* The court stated:

> We are not unmindful of the merits of the argument that a federal forum is best suited for adjudicating a claim that federal monies are not being allocated according to a mandatory federal scheme. . . . It may well be that a federal forum has the necessary sensitivities to handle these claims, but it is for Congress to so determine.

Id.

The court noted that Congress had not provided for enforcement of the AFDC program without regard to jurisdictional amount. *Id.* The Third Circuit substantiated its position with reference to various authorities, including the American Law Institute, which had, in 1969, recommended amending § 1331 to provide original jurisdiction without regard to jurisdictional amount. *Id. See* ALI STUDY ON THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS (1969) [hereinafter cited as ALI STUDY]. The court also noted a statement by Senator Quentin Burdick in support of the recommendation to the effect that " '[t]he need for a federal forum is no less in small cases than in large cases.' " 560 F.2d at 169, *quoting* 119 CONG. REC. 16,679 (1973) (remarks of Sen. Burdick). Nevertheless, the Third Circuit concluded that "until Congress acts we are not in a position to adjudicate claims" such as that pressed by Gonzalez. *See* text accompanying notes 91-92 *infra.*

61. 560 F.2d at 169.
62. *See* text accompanying note 46 *supra.*
63. 560 F.2d at 166; *see* notes 34-37 and accompanying text *supra.*
64. *See* notes 54 & 55 and accompanying text *supra.*
65. *See Outlook for Welfare Litigation, supra* note 1, at 902-03.
66. *See* note 32 *supra.*

"jurisdictionally cognizable under section 1343(3)".[67] This leap, however, may be warranted by the *Hagans* passage itself, since all of the decisions cited therein albeit in slightly different contexts, found the supremacy clause to be an appropriate basis for jurisdiction.[68] Moreover, at least one commentator has interpreted *Hagans* as suggesting that a supremacy clause question "is itself a constitutional matter over which the federal courts have jurisdiction under section 1343(3) . . . ."[69] *Blue's* reliance upon *Hagans,* it is therefore submitted, was not as farfetched as the Third Circuit apparently supposes.

The Third Circuit's analysis of the statutory aspect of the plaintiff's claim is also subject to criticism. Federal jurisdiction of nonconstitutional challenges to welfare regulations requires a separate analysis and depends upon the construction of the scope of sections 1983 and 1343.[70] Although some courts and commentators have concluded that, "when analyzed in light of [the] legislative history and statutory purpose [section 1343] should

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67. 505 F.2d at 844 (emphasis added). For a discussion of the Fourth Circuit's conclusion, *see* notes 34-37 & 53-55 and accompanying text *supra.*

68. *See* note 32 *supra*; Townsend v. Swank, 404 U.S. 282, 286 (1971) (previous determination by Court that state AFDC laws do not conform to Social Security Act invalidated state laws under supremacy clause); Swift & Co. v. Wickham, 382 U.S. 111, 125 (1965) (determination that state statute is void as contrary to federal statute is governed by supremacy clause); Connecticut Union Welfare Employees v. White, 55 F.R.D. 481, 486 (D. Conn. 1972); ("If the state policy is in conflict with the federal statute, . . . this would deny plaintiffs a right secured by the Constitution — namely, the right to secure the benefit of the Supremacy Clause"). It is clear, therefore, that the *Blue* court's reliance upon *Hagans* rested indirectly upon other Supreme Court cases as well. *See also* Stuart v. Canary, 367 F. Supp. 1343, 1345 (N.D. Ohio 1973).

It is also interesting to note that one court, while feeling compelled to follow *Andrews,* hinted that that Second Circuit decision might not be permanent law. *See* Aitchison v. Berger, 404 F. Supp. 1137 (S.D.N.Y. 1975). The *Aitchison* court stated: "Although the Supreme Court has left open the issues of whether all Supremacy Clause and § 1983 claims are cognizable under 28 U.S.C. §§ 1343(3) and/or (4), the Second Circuit [in *Andrews*] has, *at least temporarily,* resolved those same issues against jurisdiction". *Id.* at 1143 n.16 (emphasis added). *See also* Hundt, *Suing Municipalities Directly Under The Fourteenth Amendment,* 70 NW. U.L. REV. 770, 772 n.12 (1975), *citing* Blue v. Craig, 505 F.2d 830 (4th Cir. 1974) ("Any federal statutory right may be enforced under section 1983, *in addition to any constitutional right*") (emphasis added).

69. *See Outlook for Welfare Litigation, supra* note 1, at 903. The author's full reasoning is as follows:

> Although in recent years the Supreme Court has consistently refused to decide whether this conflict question is itself a constitutional matter over which the federal courts have jurisdiction under section 1343(3), the *Hagans* court suggested that the question may ultimately be answered in the affirmative. The court noted that a suit to invalidate a state policy which conflicts with a federal statute cannot succeed without resort to the federal Constitution. It further acknowledged that such a claim, "although denominated 'statutory,' [was] in reality a constitutional claim arising under the supremacy clause."
>
> One can present a compelling argument that section 1343(3) provides a proper jurisdictional basis for a federal court to entertain an independent supremacy clause claim. Accordingly, whenever a welfare litigant is unable to fashion an alternative colorable constitutional issue, the allegation that there is a conflict between state and federal law should be presented in this manner.

Id. (Footnotes omitted).

70. *See* text accompanying notes 15-25 *supra.*

provide the welfare litigant a path into the courthouse,"[71] the *Gonzalez* decision indicates that this viewpoint is not being universally recognized.[72]

Part of the disagreement on this point is attributable to the fact that it is difficult to draw firm conclusions specifically regarding welfare litigation from the legislative history of the statutes.[73] But a respectable number of authorities, including the Fourth Circuit in *Blue,* have agreed that there is *no* congressional intent that section 1343(3) should be interpreted more narrowly than section 1983.[74] It is submitted, therefore, that the Third Circuit's decision regarding the statutory issue may be criticized for rejecting plaintiff's statutory claim under the rationale that the Social Security Act is not a statute providing for the protection of equal rights or civil rights within the meaning of section 1343.[75] Unlike the *Blue* court, the Third Circuit did not take into account the legislative history and scope of the general statutes at issue.[76] In fact, the *Gonzalez* court summarily disposed of *Blue's* in-depth discussion of the congressional intent and legislative history of sections 1983 and 1343,[77] as well as the numerous authorities that also have maintained that the "equal rights" language of section 1343(3) was not meant as a limitation on section 1983, but that the substantive and jurisdictional statutes were clearly intended to complement one another.[78] As stated by one commentator,[79] there is no indication that Congress intended that there be section 1983 actions that could not be reached jurisdictionally by section 1343, and, rather than resorting to technical language in section 1343(3) to thwart a federal remedy, courts should give the statutes a coextensive construction to afford the litigant a federal remedy, as Congress had contemplated.[80] Even the Second Circuit in *Andrews* acknowledged both the propriety of a federal forum in that case and the hypertechnicality of permitting "subtle analysis of jurisdictional

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71. Herzer, *supra* note 13, at 1. *See also* 505 F.2d at 837.

72. *See* Herzer, *supra* note 13, at 1. *But see* Aitchison v. Berger, 404 F. Supp. 1137 (S.D.N.Y. 1975). The court in *Aitchison* stated: "Jurisdiction in welfare cases is a recurrent issue, regularly resolved for plaintiffs." *Id.* at 1142 (footnote omitted).

73. For an analysis of the conflicting interpretations drawn from the legislative history of § 1983 and § 1343, *see* notes 15-25 and accompanying text *supra. See also* Herzer, *supra* note 13 at 7.

74. *See* notes 22-24 and accompanying text *supra*; note 82 and accompanying text *infra.*

75. *See* 560 F.2d at 166.

76. *See id.* at 166-67.

77. *Id.*

78. *Id.* For a discussion of the authorities supporting this theory, *see* notes 22-24 and accompanying text *supra*; note 82 and accompanying text *infra.* The *Gonzalez* court rejected the lengthy discussion of the scope of § 1983 and § 1343 as examined in *Blue* and in commentaries cited therein by stating: "[*A*]*bsent convincing evidence to the contrary,* . . . we must believe that Congress intended to separate the jurisdictional section from the section fashioning a remedy". 560 F.2d at 166-67 (emphasis added). In light of this issue, which has invoked much scholarly comment, it is difficult to comprehend how the Third Circuit could so lightly reject the construction given to the statutes by such authorities by merely stating "*absent convincing evidence to the contrary* . . . ." *Id.* at 16 (emphasis added).

79. *See* Cover, *supra* note 24.

80. *Id.* at 24-25.

statutes to accomplish a result which, on policy grounds, [it] found uncongenial."[81] Thus, where the specific legislative intent regarding jurisdiction over the underlying statute is unclear, it is a disturbing result to permit the frustration of individuals' rights on mere jurisdictional technicalities that are premised upon statutory construction.[82]

Finally, and most significantly, there are multifaceted policy considerations in favor of federal courts entertaining jurisdiction over statutory welfare claims.[83] First, a federal forum is most appropriate for claims such as that in *Gonzalez* because federal concepts are at issue. Most of the legal questions presented by welfare cases are federal in nature, the central focus being upon whether the state statute violates the United States Constitution or is contrary to the Social Security Act, a federal statute.[84] Moreover, categorical assistance programs such as the one in *Gonzalez* are federally funded, making a federal forum necessary to protect federal fiscal interests against massive expenditures by possibly invalid state programs.[85]

Furthermore, proper adherence to uniform standards is an important consideration in determining the validity of state categorical assistance programs.[86] Since the determination of their validity depends frequently upon federal law, the federal courts are more likely than the state courts to interpret the programs in a uniform, effective manner.[87]

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81. 525 F.2d at 120. For a discussion of the many policy considerations favoring federal jurisdiction, *see* notes 83-90 and accompanying text *infra*.

82. *See* Cover, *supra* note 24, at 25. The author there expressed the same idea in very strong language: "It would be idiotic to permit subtle distinctions in language where there is no evidence of any intent to make distinctions in meaning accomplish a result which would be deplorable in any event." *Id. See also* H. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 123 (1973).

83. *See generally* Herzer, *supra* note 13, at 9.

84. *See Note, supra* note 7, at 95; 59 MINN. L. REV. 761, 772 (1975). For the *Gonzalez* court's recognition of this point, *see* 560 F.2d at 169. *See also Welfare Challenges, supra* note, at 1413.

85. *See* note 1 *supra*. *See also* Rosado v. Wyman, 397 U.S. 397 (1970). In *Rosado,* the Supreme Court examined the policy considerations in favor of federal jurisdiction over welfare claims. Mr. Justice Harlan, speaking for the Court, concluded:

> [W]e find not the slightest indication that Congress meant to deprive federal courts of their traditional jurisdiction to hear and decide federal questions in this field. It is . . . peculiarly part of the duty of this tribunal, no less in the welfare field than in other areas of the law, to resolve disputes as to whether federal funds allocated to the States are being expended in consonance with the conditions that Congress has attached to their use. As Mr. Justice Cardozo stated, . . . "[W]hen [federal] money is spent to promote the general welfare, the concept of welfare or the opposite is shaped by Congress, not the states."

Id. at 422-23, *quoting* Helvering v. Davis, 301 U.S. 619, 645 (1937). *See generally Welfare Challenges, supra* note 1, at 1405; 59 MINN. L. REV. 761, 772 (1975).

86. *See* 59 MINN. L. REV. 761, 772 (1975).

87. *See* Hagans v. Lavine, 415 U.S. 528, 550 (1973); United Mine Workers v. Gibbs, 383 U.S. 715, 727 (1966). *See also Welfare Challenges, supra* note 1, at 95; 59 MINN. L. REV. 761, 772 (1975). One author further noted that a state court's holding that a state statute is invalid has a less forceful impact on a state agency to effectuate changes than does a similar federal decision. Note *supra* note 7, at 96. *Accord,* Herzer, *supra* note 13, at 10.

Lastly, from a practical standpoint, a federal court is simply a better forum for the needy welfare recipient. The federal judiciary generally is regarded as more impartial than the state courts, and thus may have more regard for constitutional liberties.[88] In keeping with this point is also the consideration that a narrow construction of the jurisdictional statute under which section 1983 claims are brought[89] would defeat the congressional purpose of section 1983 to create a federal cause of action with its accompanying federal remedies, regardless of the existence of state judicial remedies.[90]

Not unmindful of the suitability of a federal forum,[91] the Third Circuit simply would not extend jurisdiction beyond what it considered to be its jurisdictional limits.[92] If the Third Circuit is to be criticized, there is no doubt that much of the blame for the results in *Gonzalez* must be placed on Congress, which has not provided for the enforcement of AFDC benefits without regard to jurisdictional amount,[93] and on the Supreme Court, for

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88. *See* Herzer, *supra* note 13, at 10; 59 MINN. L. REV. 761, 772 (1975).

89. For an explanation of the narrow construction imposed on § 1343, *see* text accompanying notes 20-21, 25 & 39-42 *supra*.

90. *See* Note, *supra* note 7, at 114. According to its author, the purpose of § 1983 is to provide a federal judicial remedy for deprivations of rights under color of state law, regardless of whether or not the state courts provide a remedy. *Id.*

91. 554 F.2d at 169. *See* notes 65-66 and accompanying text *supra*. *See also* Herzer, *supra* note 13, at 19. Professor Herzer commented: "Federal courts, concerned with federal rather than state development of the congressional vision of the general welfare, should interpret their powers to extend to the claims of the welfare plaintiff". *Id.*

See also H. FRIENDLY, *supra* note 82, at 123. In discussing the present "patchwork structure" of federal question cases, Judge Friendly maintained that Congress should move in one direction or another to alleviate judicial inconvenience, stating:

> The distinction whereby no jurisdictional amount is required for actions challenging acts of state officers as violating the Constitution but is required when they are claimed only to have violated a statute has proved particularly troublesome in the growing field of welfare litigation. In one opinion of mine, the discussion of jurisdictional problems required six printed pages which must be as tiresome to read as they were to write; when we finally reached the merits, only half a page was needed to sustain the plaintiffs' claim that New York's practices with respect to terminating benefits under federally assisted programs, although not unconstitutional, violated valid federal regulations. Clearly the case was appropriate for a federal court, and we should have been able to reach the substantive issue without delay.

Id. citing Almenares v. Wyman, 453 F.2d 1075 (2d Cir. 1971), *cert. denied*, 405 U.S. 944 (1972).

92. 560 F.2d at 169. *See* text accompanying note 60 *supra*.

93. 560 F.2d at 169. In 1958, amendments to § 1331 were enacted which merely changed the amount in controversy requirement and prohibited removal of workmen's compensation cases. *See* Act of July 25, 1958, Pub. L. No. 85-554, § 1, 72 Stat. 415 (codified in 28 U.S.C. § 1331 (1970)). *See* 59 MINN. L. REV. 761, 778-79 & n.118 (1975). The author there criticizes the lack of congressional action in his discussion of *Hagans*, stating that Congress had not reviewed federal court jurisdiction in any depth in almost twenty years. *Id.* The author suggests that if Congress had acted upon the proposals for legislative reform in this area made by the ALI in 1969, the

failing to provide adequate guidance in this complex jurisdictional field.[94] The *Hagans* footnote passage has not provided a clear precedent. But in view of the fact that recent cases and commentaries have given that passage a positive inference,[95] it is possible that other courts will follow.[96] Nevertheless, until the Third Circuit determines to do so, future welfare litigants with *Gonzalez* claims will encounter a "significant roadblock"[97] to federal courts and will have to remain satisfied with a state forum.[98]

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need for the rulings in *Hagans* would have been obviated. *Id.* at 779. *See* ALI STUDY, *supra* note 60 at 489-491. Since the writing of that Note, Congress passed an amendment to § 1331 that eliminated the amount in controversy requirement in suits against "the United States, any agency thereof, or any officer or employee thereof in his official capacity." Act of October 21, 1976, Pub. L. No. 94-574, § 2, 90 Stat. 2721 (amending 28 U.S.C. § 1331 (1970)). Although this indicates a step in the right direction, it should be apparent that Congress should aid the courts in solving the jurisdictional complexity with respect to § 1343, or further amend § 1331.

94. *See* notes 31-33 and accompanying text *supra*. *See also* Andrews v. Wyman, 525 F.2d 113 (2d Cir. 1974). The court there stated: "We prefer to await guidance on these jurisdictional issues, on which there is now a clear conflict among the circuits, either from higher authority or from Congress." *Id.* at 120.

95. *See* notes 68-69 & accompanying text *supra*.

96. There has been a marked reluctance of federal courts to address this issue. *See, e.g.*, Gurley v. Wohlegemuth, 421 F. Supp. 1337, 1340 n.6 (E.D. Pa. 1976) ("we need not reach these additional and difficult jurisdictional contentions"); Mathes v. Nugent, 411 F. Supp. 968, 970-71 n.3 (N.D. Ill. 1976) ("Although we are impressed by [*Blue's*] reasoning, we need not decide this question here").

97. Herzer, *supra* note 13, at 11.

98. Wherever the blame for this confusing situation is placed, the fact remains, as one writer has observed, that future welfare litigants who "merely seek compensation for desperately needed benefits that have been . . . withheld are left to either the beneficence of the less-than-friendly state courts or the make-shift measures currently being initiated by the federal courts." *Outlook for Welfare Litigation, supra* note 1, at 917.

FEDERAL ESTATE TAXATION — SECTION 2042(2) — POWER TO ELECT A SETTLEMENT OPTION IN A GROUP TERM LIFE INSURANCE POLICY IS NOT AN INCIDENT OF OWNERSHIP WITHIN MEANING OF SECTION 2042(2).

Estate of Connelly v. United States (1977)

Prior to his death, John J. Connelly, Sr., a retired employee,[1] had been covered by a noncontributory group term life insurance policy.[2] The only power which the decedent possessed with respect to this policy was the power to elect an alternate mode of payment to the beneficiary[3] by arranging to have the monthly payments reduced by a selected percentage, thereby extending the time period over which these payments were to be made.[4] The Commissioner of the Internal Revenue Service (Commissioner) claimed that the possession of this power was an incident of ownership and included the proceeds of the life insurance policy in the gross estate of the

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1. Estate of Connelly v. United States, 398 F. Supp. 815, 816 (D.N.J. 1975), *aff'd*, 551 F.2d 545 (3d Cir. 1977). The district court mentioned that since Connelly was retired, he could not quit his employment and terminate his coverage. 398 F. Supp. at 816.

2. 398 F. Supp. at 816. For a reproduction of the policy, *see* Estate of Lumpkin v. Commissioner, 56 T.C. 815, 817-21 (1971), *rev'd*, 474 F.2d 1092 (5th Cir. 1973). The policy, which had been paid for solely by the employer as part of a survivor benefit plan, provided for a lump-sum payment at the death of the employee plus an annuity for the next 50 months. 398 F. Supp. 816, 818. Because it was a group term policy, Connelly could not obtain a loan against the policy or redeem it for a cash surrender value. *Id.* at 817. Moreover, Connelly could not convert the policy to individual insurance. *Id.* In addition, according to the law of the jurisdiction at that time, the policy could not be assigned. *Id.* The beneficiaries of the policy had been irrevocably fixed and, according to its terms, the surviving spouse was to receive the benefit payments. *Id.* at 816. If there were no surviving spouse or if she died before receiving all the payments, the next of three classes would receive the balance. *Id.* Specifically, the payments would be made to the "preference relatives" of the insured. *Id.* First, the proceeds would go to the minor children of the insured and then to his parents. *Id.* If no preference relatives existed, then the payments would be made to other "dependent relatives" of the insured. *Id.* If no eligible beneficiaries lived to receive the payments, Connelly's estate would not be entitled to receive any payments from the insurer. *Id.* Since Connelly died a widower, his son Robert became entitled to the proceeds of the policy. *Id.*

3. 398 F. Supp. at 816. The election of the option plan required the mutual agreement of Connelly, his employer, and the insurance company. *Id.* at 818. If Connelly had a surviving spouse, however, he alone could have selected a different mode of payment to his wife without the consent of the employer or the insurance company. Estate of Connelly v. United States, 551 F.2d 545, 547 n.5 (3d Cir. 1977). Similarly, if his spouse had survived him, she could have elected the settlement option after his death with the consent of the employer and the insurance company. *Id.* at 547 n.5. Connelly's exclusive right to change the settlement option thus terminated on his wife's death. *Id.*

4. 398 F. Supp. at 816. If this plan had been adopted and the beneficiary had died before completion of the payments, the estate of the beneficiary would have received the balance of the payments as if the option had not been elected. *Id.* at 816-17. Thus, the amount that any beneficiary would receive remained constant and could not be changed by the insured. *Id.*

decedent[5] under section 2042(2) of the Internal Revenue Code (Code).[6] After a claim for a refund was filed and denied,[7] the executrix instituted this action in the United States District Court for the District of New Jersey seeking a refund of the federal estate tax which had been paid under protest.[8] The district court granted the taxpayer's motion for summary judgment,[9] concluding that the decedent did not possess at the time of his death any incidents of ownership in the policy.[10] On appeal, the United States Court of Appeals for the Third Circuit[11] affirmed, *holding* that since the decedent's power gave him no rights to the economic benefits of the policy, he did not possess any incidents of ownership, and therefore the proceeds should not have been included in his gross estate. *Estate of Connelly v. United States,* 551 F.2d 545 (3d Cir. 1977).

The Revenue Act of 1918[12] was the first estate tax law specifically requiring inclusion in the gross estate of proceeds from insurance policies[13] which had been "taken out" by a decedent and payable to beneficiaries other than his estate.[14] In an attempt to clarify the precise meaning of "taken out," the Internal Revenue Service (Service) formulated the payment of

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5. *Id.* at 815.

6. I.R.C. § 2042(2). Section 2042 provides in pertinent part:

> The value of the gross estate shall include the value of all property—
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> . . . .
>
> (2) Receivable by other beneficiaries. — To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

Id.

7. 398 F. Supp. at 816.

8. *Id.* Jurisdiction was pursuant to 28 U.S.C. § 1346(a)(1) (1970). 398 F. Supp. at 816.

9. 398 F. Supp. at 828.

10. *Id.* at 827.

11. The appeal was heard by Circuit Judges Rosenn, Forman, and Garth. Judge Forman wrote the opinion.

12. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098 (current version at I.R.C. § 2042).

13. *Id.* If a beneficiary to a policy had been designated prior to the passage of this provision, the proceeds of the policy were not includible in the decedent's gross estate for estate tax purposes. *See* Lewellyn v. Frick, 268 U.S. 238 (1925). The act's legislative history reveals congressional awareness that "[a]gents of insurance companies" had "openly urged persons of wealth to take out additional insurance payable to specific beneficiaries for the reason that such insurance would not be included in the gross estate." H.R. REP. NO. 767, 65th Cong., 2d Sess. 22 (1918).

14. Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098 (current version at I.R.C. § 2042). The statute stated that the insurance proceeds were taxable

> [t]o the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

Id.

Since 1918, the only change with respect to insurance payable to the executor has been the deletion of the requirement that the insurance be "taken out" by the decedent. *See* I.R.C. § 2042(1).

premiums test which equated the insured's taking out a policy with his paying the premiums.[15] As a result of a decision of the United States Supreme Court in 1929,[16] the applicable standard was changed and insurance proceeds were taxable if, in addition to paying the premiums on the policy, the insured possessed certain incidents of ownership in the policy.[17] Under the subsequent Revenue Act of 1942,[18] however, the proceeds

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15. *See* Treas. Reg. 37, art. 32 (1919). Thus, insurance was "taken out" by the decedent whether or not he had made the technical application so long as he had paid the premiums. *Id.* Where the policy was payable to beneficiaries other than the gross estate of the insured, the proceeds were taxable only where the insured had paid the premiums and the proceeds payable to these beneficiaries exceeded $40,000. *Id.*

16. Chase Nat'l Bank v. United States, 278 U.S. 327 (1929). In *Chase,* the insured had named his wife as the beneficiary on several insurance policies. *Id.* at 332. Although the executor of the estate argued that the termination at death of the power of the insured to change beneficiaries and the resultant passing to the designated beneficiaries of all rights under the policies was not a legitimate subject of a transfer tax, the Court stated:

> A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them and their proceeds for his own benefit during his life which subjects them to the control of a bankruptcy court for the benefit of his creditors, . . . and which may, under local law applicable to the parties here, subject them in part to the payment of his debts, . . . is by no means the least substantial of the legal *incidents of ownership,* and its termination at his death so as to free the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death.

Id. at 335 (citations omitted) (emphasis added).

17. *See* Treas. Reg. 70, arts. 25, 27 (1929). By 1934, however, the Treasury issued another regulation which made payment of premiums and incidents of ownership alternative tests rather than conjunctive ones. Treas. Reg. 80, arts. 25, 27 (1934). *See also* Treas. Reg. 80, arts. 25, 27 (1937).

In Eisenstein, *Estate Taxes and The Higher Learning Of The Supreme Court,* 3 TAX L. REV. 395 (1948), the author stated:

> The words "taken out" had three independent meanings, yet only one of these meanings was really significant. Insurance receivable by specific beneficiaries was not taxable unless "the decedent possessed at the time of his death any of the legal incidents of ownership." But under the regulations a decedent who possessed any of these incidents had necessarily "taken out" the insurance. It was therefore immaterial whether he or someone else had paid the premiums.

Id. at 518-19 (footnote omitted), *quoting* Treas. Reg. 80, art. 27 (1934).

During this period, the courts struggled to determine the meaning of the ambiguous term "taken out" in a variety of complex situations. For example, one court looked to statutory construction and decided that "where life insurance proceeds are involved, the initial inquiry is as to what, if anything, has passed *from the decedent* because of his death." Walker v. United States, 83 F.2d 103, 107 (8th Cir. 1936) (emphasis in original). For cases dealing with insurance which had been paid out of community property, *see, e.g.,* Lang v. Commissioner, 304 U.S. 264 (1938); Bank of America Nat'l Trust & Sav. Ass'n v. Commissioner, 90 F.2d 981 (9th Cir. 1937); Newman v. Commissioner, 76 F.2d 449 (5th Cir.), *cert. denied,* 296 U.S. 600 (1935). *See also* Helvering v. Reybine, 83 F.2d 215 (2d Cir. 1936) (part of premiums paid by both beneficiary and insured); Wilson v. Crooks, 52 F.2d 692 (W.D. Mo. 1931) (policy premiums paid by corporation).

Recognizing this confused situation, in 1941 the Treasury restored the premium payment test and insurance proceeds once again became taxable whether or not the insured possessed any incidents of ownership at his death. *See* T.D. 5032, 1941-1 C.B. 427.

18. Int. Rev. Code of 1942, ch. 619, § 404, 56 Stat. 944 (current version at I.R.C. § 2042).

were included in the gross estate if the insured either paid the premiums *or* possessed incidents of ownership in the policy.[19] Ultimately, the Revenue Act of 1954 adopted the incidents of ownership test as the sole criteria for taxability.[20]

Absent a statutory definition,[21] the courts have determined that incidents of ownership include[22] the power to change the beneficiary of the

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19. *Id.* The $40,000 exemption and the terminology "taken out" were removed. *Id. See* note 14 *supra.* In addition, insurance policies were now taxable

> [t]o the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

Int. Rev. Code of 1942, ch. 619, § 404, 56 Stat. 944 (current version at I.R.C. § 2042).

20. I.R.C. § 2042(2). *See* note 6 *supra.*

21. Although the Code does not define "incidents of ownership," the Treasury Regulations state:

> [T]he term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc.

Treas. Reg. § 20.2042-1(c)(2), T.D. 7312, 1974-1 C.B. 277. This language apparently originated from Congress's attempt to enumerate those incidents of ownership that will render a policy taxable:

> Examples of such incidents are the right of the insured or his estate to the economic benefits of the insurance, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign it, the power to revoke an assignment, the power to pledge the policy for a loan, or the power to obtain from the insurer a loan against the surrender value of the policy. Incidents of ownership are not confined to those possessed by the decedent in a technical legal sense.

H.R. REP. No. 2333, 77th Cong., 1st Sess. 491 (1942); S. REP. No. 1631, 77th Cong., 2d Sess. 677 (1942). Thus, while the regulations state that the term involves the right "to the economic benefits of the policy," the congressional reports merely list the right to economic benefits an an example of an incident of ownership. *Id.* This difference in language was interpreted in one case to signify that the insured himself must have the power to benefit economically from the policy. Estate of Skifter v. Commissioner, 468 F.2d 699, 701-02 (2d Cir. 1972). One commentator has noted that "such a conclusion is difficult to reach from what may have been an unintentional change in language." Note, *Estate Taxation of Life Insurance Policies Held by the Insured as Trustee,* 32 MD. L. REV. 305, 310-11 n.23 (1972).

22. The courts have also held that certain rights are not to be considered incidents of ownership. For example, the power to cancel a group term life insurance policy simply by terminating employment is not an incident of ownership. *See* Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969); Rev. Rul. 72-307, 1972-1 C.B. 307. In *Landorf,* the court stated:

> [W]e do not believe that Congress intended to include the power to terminate employment, a right which everyone can exercise at any time, to be an "incident of ownership" in property simply because the property involved is somehow

policy,[23] to surrender or cancel the policy,[24] to pledge the policy as collateral for a loan,[25] to obtain a loan against the surrender value of the policy,[26] to assign or revoke an assignment of the policy,[27] and to regain a reversionary

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related to the employment. The exercise of the right to terminate employment in no way derogates the rights in the property assigned.

408 F.2d at 469.

In addition, the right to receive dividends on a policy has been deemed to be only a reduction in premiums and therefore not an incident of ownership. *See, e.g.,* Estate of Chester H. Bowers, 23 T.C. 911, 917 (1955), *acq.* 1955-2 C.B. 4; Estate of Louis J. Dorson, 4 T.C. 463, 469 (1944), *acq.* 1945 C.B. 3. *See also* Cowles v. United States, 152 F.2d 212, 214 (2d Cir. 1945) (insured's ability to allow the policy to lapse for failure to pay premiums not considered an incident of ownership); Estate of Jordahl v. Commissioner, 65 T.C. 92, 96-97 (1975), *acq.* 1977-1 C.B. 1 (decedent's privilege to substitute policies of equal value into trust agreement does not require inclusion of policy's proceeds in gross estate).

23. *See* Chase Nat'l Bank v. United States, 278 U.S. 327, 334-35 (1929); Hall v. Wheeler, 174 F. Supp. 418, 421 (D. Me. 1959). This right alone is enough to require the inclusion of the policy's entire proceeds in the gross estate. *See* Singer v. Shaughnessy, 198 F.2d 178, 181 (2d Cir. 1952).

Furthermore, where the insurance policies are held in an irrevocable trust and the insured retains the right to change the beneficiaries, such power will be considered an incident of ownership. *See* Farwell v. United States, 243 F.2d 373 (7th Cir. 1957). One court has held, however, that where the beneficiaries had been irrevocably designated and had themselves paid all the premiums, the insured did not possess an incident of ownership. *See* Morton v. United States, 457 F.2d 750, 753-55 (4th Cir. 1972).

Where an insured merely retains a veto power over an attempted beneficiary change on a policy owned by his employer, he still possesses an incident of ownership. *See* Schwager v. Commissioner, 64 T.C. 781, 792 (1975). The *Schwager* court noted: "The fact that his power was one of a negative cast makes it no less an incident of ownership . . . ." *Id.* at 791. *See also* Rev. Rul. 75-70, 1975-1 C.B. 301.

Moreover, where the right to change the beneficiary is reserved by a corporation in which the insured is the sole stockholder, the policy proceeds may be included in the gross estate of the insured. *See* Cockrill v. O'Hara, 302 F. Supp. 1365 (M.D. Tenn. 1969); Estate of Huntsman v. Commissioner, 66 T.C. 861 (1976), *acq.* 1977-1 C.B. 1. *See also* T.D. 7312, 1974-1 C.B. 277.

24. *See* Liebmann v. Hassett, 148 F.2d 247, 249 (1st Cir. 1945). In addition, courts have ruled that where the insured created an irrevocable trust and retained the right to either surrender or cancel the insurance policies, the retention of this power was an incident of ownership. *See, e.g.,* St. Louis Union Trust Co. v. United States, 262 F. Supp. 27, 29 (E.D. Mo. 1966); Estate of Myron Selznick, 15 T.C. 716, 729 (1950), *aff'd per curiam,* 195 F.2d 735 (9th Cir. 1952).

The power of a New York Stock Exchange member to sell his seat and obtain the surrender value, thereby divesting his wife's potential death benefits of $20,000, has been adjudicated to be an incident of ownership. *See* Commissioner v. Treganowan, 183 F.2d 288, 292-93 (2d Cir.), *cert. denied,* 340 U.S. 853 (1950).

25. *See, e.g.,* Prichard v. United States, 397 F.2d 60, 63-64 (5th Cir. 1968); Ballard v. Helburn, 9 F. Supp. 812, 814 (W.D. Ky. 1933), *aff'd per curiam,* 85 F.2d 613 (6th Cir. 1936); Estate of Krischer v. Commissioner, 32 T.C.M. (CCH) 821, 825 (1973).

26. *See* Fried v. Granger, 105 F. Supp. 564, 566-68 (W.D. Pa. 1952), *aff'd per curiam,* 202 F.2d 150 (3d Cir. 1953).

27. *See, e.g.,* Commissioner v. Estate of Noel, 380 U.S. 678, 682-84 (1965); Caldwell v. Jordan, 119 F. Supp. 66, 68 (N.D. Ala. 1953); Fried v. Granger, 105 F. Supp. 564, 566-68 (W.D. Pa. 1952), *aff'd per curiam,* 202 F.2d 150 (3d Cir. 1953). It should be noted that an effective assignment of a group term life insurance policy may remove the proceeds of the policy from the gross estate for estate tax purposes. *See* Landorf v. United States, 408 F.2d 461, 465-68 (Ct. Cl. 1969); Estate of Max J. Gorby, 53 T.C. 80, 91 (1969), *acq.* 1970-1 C.B. xvi; Rev. Rul. 69-54, 1969-1 C.B. 221.

interest in the policy.[28] If any of these incidents are possessed by the insured[29] and are "exercisable either alone or in conjunction with any other person,"[30] the proceeds of the policy will be included in his gross estate.[31] In

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28. *See* Landorf v. United States, 408 F.2d 461 (Ct. Cl. 1969). *See also* I.R.C. § 2042(2); Treas. Reg. § 20.2042-1(c)(3) (1958).

29. Actual physical possession of the policy is not a determinative factor since some rights of the insured may be exercisable without physical control of the policy. *See* United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 11 (1st Cir. 1966) (son's policy was included in his gross estate even though father, as beneficiary, applied for policy, paid premiums, and kept the policy); Estate of Piggott v. Commissioner, 340 F.2d 829, 835 (6th Cir. 1965) (company's possession of policy was not conclusive on issue whether proceeds were included in decedent's gross estate); Fried v. Granger, 105 F. Supp. 564, 566-68 (W.D. Pa. 1952), *aff'd per curiam,* 202 F.2d 150 (3d Cir. 1953) (although decedent did not retain possession or pay the premiums, policy was included in his gross estate).

As the *Rhode Island Hospital* court explained: "Power can be and is exercised by one possessed of less than complete legal and equitable title. The very phrase 'incidents of ownerships' connotes something partial, minor, or even fractional in its scope. It speaks more of possibility than of probability." 355 F.2d at 10.

Similarly, the physical impossibility of exercising authority over the policy is not controlling. In Commissioner v. Estate of Noel, 380 U.S. 678 (1965), a flight insurance policy on the husband's life was in the physical possession of the wife who was the beneficiary. *Id.* at 679-80. The Supreme Court stated: "[E]state tax liability for policies 'with respect to which the decedent possessed at his death any of the incidents of ownership' depends on a general, legal power to exercise ownership, without regard to the owner's ability to exercise it at a particular moment." *Id.* at 684, *quoting* I.R.C. § 2042(2). *Cf.* Estate of Dawson v. Commissioner, 57 T.C. 837 (1972), *aff'd mem.,* 480 F.2d 917 (3d Cir. 1973) (where wife died leaving will naming husband as residuary legatee and husband died one hour later, court held that husband had no powers of disposition and therefore no incidents of ownership).

30. I.R.C. § 2042(2). *See* note 6 *supra.* As to the meaning of this requirement, one court has stated:

> It makes no difference whether under the trust instrument the decedent may initiate charges or whether he must merely consent to them. In either case only the three parties acting together can modify the trust. If the decedent acting with others can effectively change the beneficiary of the policy, he possesses an incident of ownership.

Commissioner v. Estate of Karagheusian, 233 F.2d 197, 199 (2d Cir. 1956) (citations omitted). In *Karagheusian,* the wife placed a policy on her husband's life in a trust, and retained the power to modify the trust only upon the consent of her husband and their daughter or the survivor of them. *Id.* at 198-99. Therefore, the court included the proceeds of the policy in the husband's gross estate. *Id.* at 200. *See, e.g.,* Nance v. United States, 430 F.2d 662 (9th Cir. 1970) (insured could change beneficiary of policies only with beneficiary's consent); Altshuler v. United States, 169 F. Supp. 456 (S.D. Mo. 1958) (consent of pension committee and trustee required for insured to designate or change beneficiary); Goldstein's Estate v. United States, 122 F. Supp. 677 (Ct. Cl. 1954), *cert. denied,* 348 U.S. 942 (1955) (consent of insured and beneficiary was essential to make any change in policy). *But see* Morton v. United States, 457 F.2d 750, 753-55 (4th Cir. 1972) (under West Virginia law, insured did not possess any incidents of ownership since irrevocably designated beneficiary who paid all premiums could act without the consent of the insured).

For an application of this principle to a partnership agreement, *see* Estate of Infante v. Commissioner, 29 T.C.M. (CCH) 903 (1970); Estate of Fuchs, 47 T.C. 199 (1966), *acq.* 1967-1 C.B. 2. *See generally* Flannery, *The Case of* Est. of Howard Infante *Denied Validity by IRS Internal Ruling,* 55 TAXES 146 (1977).

For an overall discussion of when an insured has possession, either alone or in conjunction with another person, *see generally* Eliasberg, *IRC Section 2042 — The Estate Taxation of Life Insurance: What Is an Incident of Ownership?,* 51 TAXES 90, 94-106 (1973).

31. I.R.C. § 2042(2).

determining whether the insured retained any of these powers, most courts will not look at the intent of the parties involved, but rather will confine their inquiry to the actual terms of the policy.[32]

In *May Billings*,[33] a case decided in 1937, the Board of Tax Appeals was confronted with another possible incident of ownership — the power to elect a settlement option.[34] The Board determined that the insured did not have control of the proceeds and excluded the insurance policies from his gross estate.[35] The Board concluded that "[t]he mere right to say when the proceeds of the insurance policies should be paid to the beneficiary does not amount to a control of the proceeds."[36]

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32. Most courts have held "'policy facts' (reservation of rights in the policy) impregnable to attack from 'intent facts.'" United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7, 12 (1st Cir. 1966) (citations omitted) (although the son treated the policy as his father's property, the terms of the policy provided that the son retained control and the policy was included in the son's gross estate). *See* Nance v. United States, 430 F.2d 662 (9th Cir. 1970) (extrinsic evidence as to custom and practice of insurer was neither relevant nor admissible to rebut "policy facts"). This situation often arises where a corporation retains physical custody over the policy, records it as a corporate asset, and borrows on the policy. *See, e.g.*, Cockrill v. O'Hara, 302 F. Supp. 1365, 1367-69 (M.D. Tenn. 1969); Kearns v. United States, 399 F.2d 226, 228-30 (Ct. Cl. 1968).

In *Rhode Island Hospital*, however, the court commented:

> To the principle of heavy predominance of the "policy facts" over the "intent facts" there must be added the caveat that, where the insurance contract itself does not reflect the instructions of the parties, as where an agent, on his own initiative, inserts a reservation of right to change a beneficiary contrary to the intentions which had been expressed to him, no incidents of ownership are thereby created.

United States v. Rhode Island Hosp. Trust Co., 355 F.2d at 13 (citations omitted). *See also* Schongalla v. Hickey, 149 F.2d 687 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945); National Metropolitan Bank v. United States, 87 F. Supp. 773 (Ct. Cl. 1950); Estate of Bert L. Fuchs, 47 T.C. 199 (1966), *acq.* 1967-1 C.B. 1.

Additionally, some courts have decided that while the policy itself is a relevant factor in determining ownership, extrinsic evidence and the parties' actual intent must also be examined. *See, e.g.*, Prichard v. United States, 397 F.2d 60 (5th Cir. 1968); First Nat'l Bank v. United States, 358 F.2d 625 (5th Cir. 1966).

For an informative discussion of this issue, *see generally* Eliasberg, *supra* note 30, at 116-24.

33. 35 B.T.A. 1147 (1937), *acq.* 1937-2 C.B. 3, *nonacq.* 1972-1 C.B. 3. *Billings* was decided in accordance with the "taken out" requirement of the Revenue Act of 1926, ch. 27, § 302(g), 44 Stat. 71 (current version at I.R.C. § 2042). 35 B.T.A. 1151-52.

34. 35 B.T.A. at 1149. In three of the 32 life insurance policies possessed by the insured in *Billings*, he had retained the right to select among several settlement plans without the consent of the beneficiary. *Id.* In two of these policies, the insured could direct that the proceeds be retained until the death of the beneficiary, at which time the proceeds would be paid to the executor or the administrator of the beneficiary. *Id.* In all three of these policies, the insured could direct payment either in fixed annual installments or in installments calculated upon the life expectancy of the beneficiary. *Id.*

35. *Id.* at 1152.

36. *Id.* Although these three policies were taken out prior to the Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098 (current version at I.R.C. § 2042), the court noted that it would have included the proceeds in the gross estate had the decedent possessed control over the policies at the date of his death. 35 B.T.A. at 1150-52.

In recent decisions, some courts have formulated an economic benefit test to determine whether the insured possessed any of these incidents of ownership.[37] In *Fruehauf v. Commissioner*,[38] the insured was co-executor and co-trustee of a trust created as a result of his wife's death which contained life insurance policies.[39] The Sixth Circuit included the policies in his gross estate,[40] holding that since the insured could surrender the policies for their cash value, he could exercise this power for his own economic benefit.[41] This economic benefit rationale was followed by the Second Circuit in *Estate of Skifter v. Commissioner*,[42] which involved an insured who had been granted broad fiduciary powers as a trustee.[43] In holding that these powers were not incidents of ownership,[44] the court focused upon the fact that the insured could not exercise his powers to derive any economic benefit for himself.[45]

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37. *See* notes 38-45 and accompanying text *infra*.

38. 427 F.2d 80 (6th Cir. 1970).

39. *Id.* at 82. According to the provisions of the will, the husband was also named income beneficiary of the trust. *Id.* The insured possessed, in a fiduciary capacity as co-trustee and co-executor, the powers to surrender any of these policies for their cash value and to exercise privileges of conversion. *Id.*

40. *Id.* at 84-85. The Tax Court had also included the proceeds in his estate, reasoning that the possession of powers constituting incidents of ownership, regardless of the capacity in which they are held, always requires inclusion in the gross estate. Estate of Harry R. Fruehauf, 50 T.C. 915, 924-26 (1968). The Sixth Circuit rejected this "per se" rule, however, noting that the Tax Court had ignored the fundamental nature of the fiduciary relationship recognized in earlier Tax Court cases. 427 F.2d at 85. *See, e.g.*, Estate of Bert L. Fuchs, 47 T.C. 199 (1966); Estate of Newcomb Carlton, 34 T.C. 988 (1960), *rev'd on other grounds*, 298 F.2d 415 (2d Cir. 1962).

41. 427 F.2d at 86. Although the decedent, at the time of his death, had not yet been formally appointed trustee by the probate court, the Sixth Circuit did not find this significant. *Id.* at 85-86.

42. 468 F.2d 699, 704 (2d Cir. 1972).

43. *Id.* at 701. The insured had assigned his interest in nine life insurance policies on his life to his spouse. *Id.* She predeceased him, however, and by her will appointed her husband as trustee of her residuary estate which included these policies. *Id.* In his capacity as trustee, the insured could distribute the principal of the trust at any time to the current income beneficiary, thereby eliminating the share of the remaindermen in the trust corpus. *Id.* Also, the insured had broad powers of manugement and control over the corpus of the trust, including the powers to sell or mortgage the trust property and to invest or reinvest the proceeds. *Id.*

44. *Id.* at 705.

45. *Id.* at 702-03. The Second Circuit, in its analysis, noted the difference in language between the Treasury Regulation and the congressional committee reports. *Id. See* note 21 *supra*. The Second Circuit stated:

> It seems significant to us that the reference point in the regulation for "incidents of ownership" is "the right . . . to the economic benefits of the policy," since there was no way in which Skifter could have exercised his powers to derive for himself any economic benefits from these insurance policies.

Estate of Skifter v. Commissioner, 468 F.2d 699, 702 (2d Cir. 1972), *quoting* Treas. Reg. § 20.2042-1(c)(2) (1958).

In concluding that the insured could not derive any economic benefit, the court noted:

> [I]t was the intent of Congress that § 2042 should operate to give insurance policies estate tax treatment that roughly parallels the treatment that is given to other types of property by § 2036 (transfers with retained life estate), § 2037

Despite these decisions, in *Estate of Lumpkin v. Commissioner,*[46] the Fifth Circuit inferred that Congress intended life insurance proceeds to be taxed when "the insured at death still possessed a substantial degree of control" over the policy.[47] The power which the insured possessed in *Lumpkin* was the right to alter the time and manner of enjoyment of the proceeds of a group life insurance policy.[48] The court, relying on two trust cases, reasoned that this power constituted a substantial degree of control and therefore held that it was an incident of ownership.[49]

(transfers taking effect at death), § 2038 (revocable transfers), and § 2041 (powers of appointment).

468 F.2d at 702. The court reached this result from an examination of the legislative history of the 1954 Code which rejected the premium payment test for determining whether insurance policies are includible in the gross estate of the decedent for estate tax purposes. *Id.* (citation omitted). At that time, Congress had declared that: "No other property is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the property and to discriminate against life insurance in this regard is not justified." S. REP. No. 1622, 83rd Cong., 2d Sess. 124, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621, 4757. In addition, the Second Circuit relied upon the inclusion of a reversionary interest rule by Congress:

> The House and your committee's bill retains the present rule including life-insurance proceeds in the decedent's estate if the policy is owned by him or payable to his executor, but the premium test has been removed. To place life-insurance policies in an analogous position to other property, however, it is necessary to make the 5-percent reversionary interest rule, applicable to other property, also applicable to life insurance.

468 F.2d at 702, *quoting* S. REP. No. 1622, 83rd Cong., 2d Sess. 124, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621, 4757.

Applying this reasoning to the factual situation involved in *Skifter,* the Second Circuit concluded that since the insured had not retained powers over the trust, but merely was the transferee of such powers, "it is difficult to construe this arrangement as a substitute for a testamentary disposition by the decedent." 468 F.2d at 704. Therefore, since the powers would not be taxable under the court's interpretation of § 2038 of the Code relating to revocable transfers, (*see* I.R.C. § 2038), the powers could not be considered an incident of ownership. 468 F.2d at 703-04. The court concluded that Treas. Reg. § 20.2042-1(c)(4) (1958), dealing with incidents of ownership and trusts, must apply only to powers reserved by the transferor as trustee. *Id.* at 705. *See generally* Note, *supra* note 21.

46. 474 F.2d 1092 (5th Cir. 1973).

47. *Id.* at 1095 (footnote omitted). The Fifth Circuit acknowledged, as did the *Skifter* court, that Congress intended to tax life insurance policies in a manner equivalent to other types of property. *Id.* at 1095 n.9; Estate of Skifter v. Commissioner, 468 F.2d 699, 702 (2d Cir. 1972). However, the *Lumpkin* court also declared that, with respect to other types of property in a decedent's gross estate, substantial control was often the determining factor. 474 F.2d at 1095-96.

48. 474 F.2d at 1095. The terms of this policy were identical to the insurance policy involved in *Connelly. See* notes 2-4 and accompanying text *supra.* However in contrast to *Connelly,* the insured in *Lumpkin* was still employed at the time of his death. 474 F.2d at 1092. In addition, the Fifth Circuit noted that although the insured in *Lumpkin* had no right to designate the beneficiaries under the optional settlement provision, he could have assigned all the rights which he had been granted under the policy. *Id.* at 1094. *See* note 85 and accompanying text *infra.*

49. 474 F.2d at 1096-97. The Tax Court, in holding that this power was *not* an incident of ownership, had relied in part upon the *Billings* decision. Estate of Lumpkin v. Commissioner, 56 T.C. 815, 824 (1971), *citing* May Billings, 35 B.T.A. 1147 (1937), *acq.* 1937-2 C.B. 3, *nonacq.* 1972-1 C.B. 3. For a discussion of *Billings, see* notes 33-36 and accompanying text *supra.* To offset the impact of *Billings,* the Fifth

Against this conflicting background, the *Connelly* court began its analysis by rejecting the Commissioner's contentions that the decedent's power to elect a settlement option and the right to assign this power constituted incidents of ownership.[50] Following its discussion of the *Billings, Fruehauf,* and *Skifter* decisions,[51] the Third Circuit sought to distinguish the factual situation in *Connelly* from that in *Lumpkin.*[52] The court noted that since Connelly was retired, unlike the insured in *Lumpkin,* he could not quit his job and thereby cancel the policy.[53] Also, since Connelly was not

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Circuit analyzed a case in which the trustee of an irrevocable trust retained the right to determine when the trust corpus would be enjoyed. 474 F.2d at 1096-97, *citing* Lober v. United States, 346 U.S. 335 (1953). In *Lober,* the United States Supreme Court stated: "'A donor who keeps so strong a hold over the actual immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which § 811(d)(2) [now I.R.C. § 2038] requires in order to avoid the tax.'" Lober v. United States, 346 U.S. at 337, *quoting* Commissioner v. Estate of Holmes, 326 U.S. 480, 487 (1946). *See* I.R.C. § 2038 (relating to the power to alter, amend, revoke, or terminate a trust).

The *Lumpkin* court also discussed another Supreme Court trust case, United States v. O'Malley, 383 U.S. 627 (1966), in determining whether a substantial degree of control constituted an incident of ownership. 474 F.2d at 1096-97. The trustee in *O'Malley* had the power to determine when the income from the trust would be enjoyed by the beneficiaries. United States v. O'Malley, 383 U.S. at 629. As in *Lober,* the Court in *O'Malley* determined that the proceeds of the policy were includible in the gross estate of the deceased. *Id.* at 633.

In view of the congressional intention to treat insurance like other types of property, the *Lumpkin* court reasoned that it would be anomalous to conclude that such a power over an insurance policy was not an incident of ownership. 474 F.2d at 1097. *See* note 45 *supra.* Furthermore, the Fifth Circuit, contrary to the reasoning of the Second Circuit in *Skifter,* stated that "it is enough if at death the decedent merely *possessed* an incident of ownership, the means by which he came into possession being irrelevant." 474 F.2d at 1097 (footnote omitted) (emphasis in original). *See* note 45 *supra.* For a criticism of *Lumpkin, see generally* 52 N.C.L. REV. 671, 681-84 (1974).

In two recent decisions, the Fifth Circuit has extended the rationale of *Lumpkin* to trust situations. *See* Terriberry v. United States, 517 F.2d 286 (5th Cir. 1975), *cert. denied,* 424 U.S. 977 (1976) (although trust provision prohibited insured as trustee from exercising any incidents of ownership, since insured could elect settlement options, court held he possessed incidents of ownership); Rose v. United States, 511 F.2d 259 (5th Cir. 1975) (since insured, by exercising his rights as trustee, could alter the time and manner of enjoyment of the policy proceeds, court found a substantial degree of control and included the proceeds in his gross estate).

The Service has recently announced that it would not follow the *Skifter* court's holding that the regulations apply to reservations of powers by the transferor as trustee, but rather would adopt the holdings in *Lumpkin, Rose,* and *Terriberry.* Rev. Rul. 76-261, 1976-2 C.B. 276. *See generally* Munch, *Incidents of Ownership in Life Insurance: Courts Disagree,* 115 *Trusts & Est.* 720 (1976).

50. 551 F.2d at 548.

51. *Id.* at 548-49. *See* notes 33-45 and accompanying text *supra.* The Third Circuit disregarded the Commissioner's assertion that *Billings* did not control the situation in *Connelly.* 551 F.2d at 548 n.9. The court noted that several of the policies in *Billings* were taken out before 1918 and that the statutory incident of ownership test had not yet been enacted. *Id.* However, both the Supreme Court, in Chase Nat'l Bank v. United States, 278 U.S. 327 (1929) and the Treasury in its regulations had applied this test prior to the *Billings* decision. 551 F.2d at 548 n.9. *See* notes 16 & 17 and accompanying text *supra.*

52. 551 F.2d at 549-52. *See* notes 46-49 and accompanying text *supra.* Additionally, the *Connelly* court recognized that *Lumpkin* involved the same insurance policy as the case *sub judice.* 551 F.2d at 549.

53. 551 F.2d at 549.

survived by his spouse, he could not unilaterally exercise a settlement option.[54] Finally, the court recognized that Connelly did not have the legal right, as did the insured in *Lumpkin,* to assign his power.[55] Although the Commissioner argued that *Lumpkin* controlled the instant case, the Third Circuit rejected this contention.[56] The court stated that *Lumpkin* did "not accurately reflect the applicable law" and that Lumpkin's powers "were greater than those possessed by" Connelly.[57]

The Third Circuit further reasoned that since Connelly had not purchased the insurance, the power to select a settlement option was not a substitute for a testamentary disposition which would avoid the estate tax.[58] The court explained that if the Fifth Circuit in *Lumpkin* was correct in determining that Congress intended to tax all types of property equally, then "it would certainly seem more logical that Congress intended to equate incidents of ownership with the right to economic benefits of the policy."[59] Noting that the language of the applicable Treasury Regulation expressly states that "incidents of ownership" refers "to the right of the insured or his estate to the economic benefits of the policy,"[60] the court concluded that Connelly "had no rights whatsoever to the economic benefits of the policy."[61]

The Third Circuit also contended that the Fifth Circuit in *Lumpkin* had misinterpreted *Skifter,* stating that "*Skifter* properly required that the

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54. *Id.*

55. *Id.* In so concluding, the Third Circuit relied upon the applicable state law which, at the time of Connelly's death, did not allow assignments of any of his rights under the insurance policy involved in the instant case. *Id.* at 549 & n.15.

56. *Id.* at 550.

57. *Id.* The court remarked that even if *Lumpkin* was the controlling law, its impact could be easily avoided by drafting provisions which required "employees to make an irrevocable election at the inception of their coverage." *Id.* at 550 n.19, *citing* 10 HOUS. L. REV. 984, 986 (1973).

58. 551 F.2d at 551. The court stated: "The federal estate tax is imposed on the privilege of transferring property at death coupled with 'taxes upon other types of transfers that have some of the aspects of a testamentary transfer and would otherwise be resorted to in order to escape a tax limited to strictly testamentary transfers.'" *Id., quoting Lowndes, An Introduction to the Federal Estate and Gift Taxes,* 44 N.C.L. REV. 1, 4 (1965).

59. 551 F.2d at 551. The court noted that "a long line of cases" have made this equation. *Id. See, e.g.,* Chase Nat'l Bank v. United States, 278 U.S. 327 (1929); Prichard v. United States, 397 F.2d 60 (5th Cir. 1960). In reaching this result, the *Connelly* court stated:

> *Lumpkin's* construction of § 2042 would make it the only section in the Code that could reach property in which the decedent had no beneficial interest and over which he had no power exercisable for his own benefit. It is clear that Congress does not consider life insurance to be inherently testamentary.

551 F.2d at 551 (footnotes omitted). It is interesting to note that a minority of the House Ways and Means Committee had unsuccessfully argued that "life insurance is not like other property. It is inherently testamentary in nature. It is designed, in effect, to serve as a will, regardless of its investment features." H. R. REP. NO. 1337, 83rd Cong., 2d Sess. B14, *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4017, 4608.

60. 551 F.2d at 551, *quoting* Treas. Reg. § 20.2042-1(c)(2), T.D. 7312, 1974-1 C.B. 277. *See* note 21 *supra.*

61. 551 F.2d at 551.

nature and source of the power, the way in which it is held, and whether the retention of power is a substitute for testamentary disposition of the property, be examined."[62] In addition, the *Connelly* court expressed its disapproval of the Fifth Circuit's reliance on two trust cases.[63] The court, in distinguishing these two cases, recognized that Connelly could only alter the time at which the proceeds would be received.[64] Connelly could not change the beneficiaries themselves or the amount any beneficiary would receive.[65] Although Connelly could attempt to ensure that a beneficiary's estate, rather than the beneficiary himself, would receive a portion of the insurance proceeds, the *Connelly* court considered this "speculative power" insignificant as compared with the power to change beneficiaries possessed by the decedents in the trust cases.[66]

Ultimately, the court concluded that "Connelly's sole power to select a settlement option with the mutual agreement of his employer and the insurer did not give him a substantial degree of control sufficient to constitute an incident of ownership."[67] Therefore, relying on *Billings,* the Third Circuit determined that the proceeds should have been excluded from the decedent's gross estate.[68]

It is submitted that the Third Circuit's analysis in *Connelly* was internally inconsistent.[69] In adopting the economic benefit test, the Third Circuit reasoned that if Congress intended that the treatment given life insurance conform to the treatment given other types of property, it must have intended to equate incidents of ownership with the right to economic benefits.[70] This reasoning, however, ignores the fact that the congressional

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62. *Id.* According to the Third Circuit, the *Lumpkin* court had entirely ignored the distinctions between the different types of property which would be taxed under other sections of the Code. *Id. See* notes 46-49 and accompanying text *supra.*

63. *Id.* at 551-52. *See* note 49 and accompanying text *supra.* The *Connelly* court commented that both these decisions were controlled by explicit regulations not involved in the case *sub judice.* 551 F.2d at 551-52.

64. 551 F.2d at 552.

65. *Id. See* notes 2 & 4 *supra.*

66. 551 F.2d at 552. *See* note 49 *supra. See also* note 4 and accompanying text *supra.*

67. 551 F.2d at 552 (citations omitted).

68. *Id.* The Third Circuit stated: "Notwithstanding withdrawal of acquiescence by the Commissioner, *Billings* remains viable and controls the instant case as held by the District Court." *Id.* (footnote omitted). For a discussion of *Billings, see* notes 33-36 and accompanying text *supra.*

69. It is interesting to note that the court's analysis was strikingly similar to that suggested in 52 N.C.L. REV. 671 (1974).

70. 551 F.2d at 551. In its analysis, the *Connelly* court stated that "Congress does not consider life insurance to be inherently testamentary." *Id.* (footnote omitted). Arguably, however, life insurance is testamentary since

> [t]he purchase of life insurance on one's own life is made for the avowed purpose of providing for a fund of money to pass at death to the object of one's bounty. Life insurance was devised and perpetuated in popularity as an effective mechanism for creating this fund of money. The basic concept of life insurance is the accomplishment of this goal, and all other attributes of a life insurance contract are secondary in importance.

Groll, *Some Federal Tax Aspects of Life Insurance,* 15 DE PAUL L. REV. 48, 55 (1965) (footnote omitted). *See* note 59 *supra.*

reports list the right to economic benefits as merely an example of an incident of ownership.[71] In accepting the approach taken by the Treasury Regulation which, unlike the congressional reports, provides that all incidents of ownership have reference to the right to economic benefits,[72] the court failed adequately to explain this discrepancy.[73] While it is true that a regulation must be sustained unless it is clearly inconsistent with the statute,[74] the Third Circuit, in adopting the economic benefit test, seemingly ignored the intent of Congress. Moreover, in light of a recent Revenue Ruling which seems to require the inclusion of life insurance proceeds in the gross estate even if the decedent does not have rights to any economic benefits,[75] the court did not provide any new analysis to dispute this position.[76]

In its criticism of *Lumpkin,* the Third Circuit properly noted the failure of the Fifth Circuit to recognize the distinction under the Code between life insurance and other types of property.[77] However, after recognizing that

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71. *See* note 21 *supra.*

72. 551 F.2d at 551. For the text of this regulation, *see* note 21 *supra.*

73. *See* 551 F.2d at 547 n.7.

74. Bingler v. Johnson, 394 U.S. 741 (1969). In *Bingler,* the Supreme Court stated that "it is fundamental, of course, that as 'contemporaneous constructions by those charged with administration of' the Code, the Regulations 'must be sustained unless unreasonable and plainly inconsistent with the revenue statutes,' and 'should not be overruled except for weighty reasons.'" *Id.* at 749-50, *quoting* Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948).

75. Rev. Rul. 76-261, 1976-C.B. 276, 277. Recognizing Congress' intent to parallel the statutory scheme governing other types of property, this ruling states: "Under these sections, it is the decedent's power at the time of death to affect the beneficial interest or enjoyment of the property, or the income therefrom, that requires inclusion, even though the decedent had no right to receive any of the economic benefits." *Id.* For further support of this noneconomic benefit approach, *see* United States v. Rhode Island Hosp. Trust Co., 355 F.2d 7 (1st Cir. 1966). Referring to those incidents of ownership noted by Congress, the *Rhode Island Hospital* court stated: "All of these are powers which may or may not enrich decedent's estate, but which can affect the transfer of the policy proceeds." *Id.* at 11. For a further discussion of *Rhode Island Hospital,* see notes 29 & 32 *supra.* Since this recent revenue ruling is inconsistent with Treas. Reg. § 20.2042-1(c)(2), T.D. 7312, 1974-1 C.B. 277, it is possible that this regulation may be the subject of a forthcoming revision. For the text of this regulation, *see* note 21 *supra.*

76. Several authors have suggested that, in determining whether the decedent possessed any incidents of ownership, different standards should be used depending on the origin of the life insurance. *See* R. STEPHENS, G. MAXFIELD, & S. LIND, FEDERAL ESTATE & GIFT TAXATION 4-223 (3d ed. 1974) [hereinafter cited as R. STEPHENS]. For an extensive discussion of a similar "bifurcation theory," *see* Note, *Federal Estate Tax: Application of the Section 2042 Incidents of Ownership Concept to the Insured's Fiduciary Estate,* 60 IOWA L. REV. 1319, 1352-64 (1975).

77. 551 F.2d at 552. For an analysis which considers these factual differences, *see generally* R. STEPHENS, *supra* note 76, at 4-218.

Although Congress arguably intended to treat life insurance in a manner no less favorable than other types of property, it is suggested that the *Lumpkin* court extended this analogy beyond the meaning of *Skifter* by discriminating against life insurance. In Rose v. United States, 511 F.2d 259 (5th Cir. 1975), a case in which the *Lumpkin* rationale was adopted, the court remarked: "Sections 2036, 2037, 2038, 2041, and 2042 may be consanguineous, but each has an individual personality with genetic

Lumpkin had erroneously relied upon two trust cases,[78] the *Connelly* court developed an unnecessary comparison of the power possessed by the decedents in those irrelevant cases and the power possessed by Connelly.[79] Furthermore, despite the statement by the Third Circuit that *Lumpkin* was not the applicable law,[80] the court utilized the language of the test formulated in *Lumpkin* in determining that Connelly's powers "did not give him a *substantial degree of control* sufficient to constitute an incident of ownership."[81] It is suggested that this result is difficult to reconcile with the Third Circuit's apparent acceptance of the economic benefit test.

In addition, the court's attempt to distinguish the *Lumpkin* case factually was not particularly convincing.[82] Although the Third Circuit emphasized that the decedent in *Lumpkin* was employed and could therefore still quit and terminate his policy,[83] even the tax court in *Lumpkin* itself had rejected this power as an incident of ownership.[84] Furthermore, the fact that the decedent in *Lumpkin* could assign his policy was mentioned by the Fifth Circuit only after it had first concluded that the power to elect a settlement option was an incident of ownership.[85] Finally, the Third Circuit's awareness that Connelly, unlike the decedent in *Lumpkin*, had died a widower and thus could not exercise a settlement option unilaterally was not a valid distinction since Connelly still possessed the power to select the settlement option "in conjunction with any other person."[86]

It is submitted that the decision in *Connelly* will widen the gulf between the Second, Third, and Sixth Circuits, which support the economic benefit

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variations. . . . Life insurance is a specie of its own, it occupies a special place in the tax field, and we cannot simply graft terms from one provision onto another." *Id.* at 265. Nonetheless, it is submitted that the *Lumpkin* court did precisely that by stating that "somewhat of an anomaly would be created if power over the time and manner of enjoyment was said to impart enough control to activate §§ 2036 and 2038 yet not enough to make it an 'incident of ownership' within the context of § 2042." Estate of Lumpkin v. Commissioner, 474 F.2d 1092, 1097 (5th Cir. 1973). The district court in *Connelly* had criticized *Rose*, stating that "[i]f *Rose* were to stand, no individual could safely serve as trustee of a trust." Estate of Connelly v. United States, 398 F. Supp. 815, 828 (D.N.J. 1975). The Third Circuit, however, neglected to discuss this case in its analysis.

78. 551 F.2d at 551.

79. *Id.* *See* notes 63-66 and accompanying text *supra.*

80. 551 F.2d at 550.

81. *Id.* at 552 (citations omitted) (emphasis added). *See* text accompanying note 47 *supra.*

82. *See* text accompanying notes 53-55 *supra.*

83. 551 F.2d at 549. *See* note 22 *supra.*

84. *See* Estate of Lumpkin v. Commissioner, 56 T.C. 815, 825 (1971).

85. Estate of Lumpkin v. Commissioner, 474 F.2d 1092, 1097-98 (5th Cir. 1973). The *Lumpkin* court stated at the end of its opinion that "Lumpkin could easily have assigned the right to elect optional settlements, thereby completely divesting himself of control over the insurance proceeds and avoiding inclusion of their value within his gross estate. Since he did not, his estate must suffer the consequences." *Id.*

86. I.R.C. § 2042(2). *See* note 6 *supra.*

test,[87] and the Fifth Circuit which supports the substantial control test.[88] This polarity will undoubtedly continue until the Supreme Court expresses its opinion as to what constitutes an incident of ownership sufficient to require the inclusion of insurance policy proceeds in a decedent's gross estate.[89]

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87. *See* notes 37-45 & 59-61 and accompanying text *supra*.
88. *See* notes 46-49 and accompanying text *supra*.
89. *See* G. MAXFIELD & B. COMERFORD, FEDERAL ESTATE & GIFT TAXATION 4448 (3d ed. Supp. 1977). These authors stated: "It seems that the controversy over the concept of an incident of ownership is sufficiently mature for determination by the Supreme Court . . . ." *Id.*