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Student Comments

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STUDENT COMMENTS

I. Constitutional Law

CIVIL RIGHTS—CIVIL ACTION FOR DEPRIVATION OF RIGHTS—NEGLIGENCE OF STATE OFFICIALS IS INSUFFICIENT TO STATE A CAUSE OF ACTION UNDER 42 U.S.C. § 1983

*Bonner v. Coughlin**

Introduction

In *Bonner v. Coughlin*, the United States Court of Appeals for the Seventh Circuit faced the question of whether an allegation of negligent conduct on the part of state officials resulting in the deprivation of an individual's constitutional rights is sufficient to state a claim under 42 U.S.C. § 1983.¹ This provision of the Civil Rights Act of 1871² provides a private federal remedy for the deprivation of federal civil rights under color of state authority. The scope of § 1983 has long been the subject of considerable dispute among the courts. Indeed, a diversity of opinion currently exists among the various circuit courts of appeals with regard to the issue presented in *Bonner*.³ Moreover, several Seventh Circuit cases decided prior to *Bonner* had created an aura of uncertainty with respect to this court's own opinion as to the type of state action proscribed by the statute.⁴ Any doubt as to the Seventh Circuit's position on this question has been dispelled by the court's en banc decision in *Bonner*. According to the court, 42 U.S.C. § 1983 provides a remedy only for intentional or reckless conduct by state officials which results in constitutional deprivations; thus, the statute's protection does not extend to state action that is merely negligent.

Section 1983 of the Civil Rights Act has been used with increasing frequency in recent years by individuals seeking to redress violations of constitutionally protected rights.⁵ Thus, the position adopted by the Seventh Circuit in *Bonner* with regard to the applicability of common law tort concepts to determine the merit of § 1983 claims is of more than purely academic interest.

The Seventh Circuit's en banc decision originated with a complaint filed by a state prisoner against the acting director of the Illinois Department of Corrections, the warden of the Illinois State Penitentiary, and two prison guards. Bonner alleged that his constitutionally protected interests in privacy and prop-

* 545 F.2d 565 (7th Cir. 1976) (*en banc*).

1 42 U.S.C. § 1983 (1970) 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.

2 Civil Rights Act of 1871, ch. 22, 17 Stat. 13 (1871). Entitled "An Act to enforce the Provisions of the Fourteenth Amendment to the Constitution of the United States, and for other Purposes," this legislation "was one of the means whereby Congress exercised the power vested in it by § 5 of the Fourteenth Amendment to enforce the provisions of that Amendment." *Monroe v. Pape*, 365 U.S. 167, 171 (1961).

3 See notes 40-42 *infra* and accompanying text.

4 See note 44 *infra*.

5 Section 1983 is one of the most heavily litigated sections in the United States Code.

erty had been violated by a "shakedown" security search of his prison cell. The search, which was conducted in Bonner's absence, resulted in the loss of his copy of the transcript of the trial at which he had been convicted of murder.⁶

Bonner presented alternative allegations concerning the incident in his complaint: either the defendants had intentionally taken the transcript from his cell, or their negligence in failing to close his cell door after concluding the search had been the proximate cause of the removal of the transcript by some unknown person. The defendants admitted that the two guards had conducted the shakedown of Bonner's cell, pursuant to a regulation of the Department of Corrections which authorized such searches. The defendants also did not dispute Bonner's allegation that the guards had negligently left the cell door open.

Bonner asserted a federal right under 42 U.S.C. § 1983 to recover damages against the defendants for depriving him of his transcript. In support of his claim, he advanced three separate theories of recovery: (1) that his transcript had been taken during the course of a search that violated his fourth amendment rights; (2) that the taking of the transcript constituted a deprivation of his property prohibited by the due process clause of the fourteenth amendment; and (3) that the defendants had interfered with his right of access to the courts protected by the sixth and fourteenth amendments.

The district court held that Bonner had established no right of relief against the defendants. Accordingly, the district court granted the defendants' motion for summary judgment, on the grounds that Bonner had suffered no compensable injury as a result of the temporary deprivation of his transcript. Alternatively, the court held that the prison guards' reliance on a valid prison regulation established a defense of good faith.⁷

On appeal,⁸ the Seventh Circuit vacated the district court's summary judgment and remanded the case. The Seventh Circuit considered in turn each of Bonner's theories of recovery and determined that he had stated a claim under 42 U.S.C. § 1983 on fourth⁹ and sixth amendment¹⁰ grounds. The court, however, rejected Bonner's due process claim.¹¹

The Seventh Circuit specifically chose not to decide on appeal "the broad,

6 The search of Bonner's cell took place on November 28, 1972. At the time of the incident, Bonner was in the process of preparing documents in order to obtain review of his conviction. Although his original transcript was never returned to him, Bonner was provided with another copy on December 5, 1973. The Illinois Appellate Court affirmed Bonner's conviction on May 29, 1973 (12 Ill. App. 3d 245 (1973)).

7 The Supreme Court established the availability of good faith as a defense in § 1983 actions in *Pierson v. Ray*, 386 U.S. 547 (1967).

8 *Bonner v. Coughlin*, 517 F.2d 1311 (7th Cir. 1975).

9 The court held "that a prisoner enjoys the protection of the Fourth Amendment against unreasonable searches, at least to some minimal extent," *id.* at 1317, although this protection "does not rise to that possessed by the unincarcerated members of society." *Id.* See *Wolff v. McDonnell*, 418 U.S. 539, 555-56 (1974) in which the Supreme Court stated that "There is no iron curtain drawn between the Constitution and the prisons of this country."

10 The court held that a serious factual dispute existed with regard to the question of whether the temporary deprivation of Bonner's transcript constituted an interference with his right of access to the courts protected by the sixth and fourteenth amendments. 517 F.2d at 1320-21.

11 The court held that Bonner had not alleged the breach of a constitutional duty derived from the fourteenth amendment. *Id.* at 1320. The panel reasoned that the availability of an adequate state remedy to redress any damage that had been inflicted by the defendants "forestalls the conclusion that there has been any deprivation of plaintiff's property without due process of law within the meaning of the Fourteenth Amendment." *Id.*

and somewhat abstract, question whether negligence by the defendant may ever be sufficient to justify relief in a § 1983 case.¹² Subsequently, however, the court granted a rehearing en banc to consider the viability of Bonner's due process claim. The sole question before the Seventh Circuit on rehearing was whether Bonner could recover damages under 42 U.S.C. § 1983, for the loss of his copy of the trial transcript, as a result of the prison guards' negligent failure to close the cell door after the security search. The panel's findings on the fourth and sixth amendment issues were not reviewed en banc.

The Seventh Circuit's En Banc Decision

The en banc majority in *Bonner* reversed the panel opinion and affirmed the judgment of the district court granting summary judgment for the defendants on Bonner's alternative claim of negligence under § 1983. The Seventh Circuit asserted that the United States Supreme Court in the recent case of *Paul v. Davis*¹³ had stated that negligent state action could not provide the basis for a "constitutional tort" claim under the statute. On the basis of *Paul*, the Seventh Circuit held that Bonner had "pointed to no specific constitutional guarantee against the negligence of the two prison guards, even though they might be tortfeasors under Illinois law."¹⁴ The *Bonner* majority concluded that "If Section 1983 is to be extended to cover claims based on mere negligence, the Supreme Court should lead the way."¹⁵

According to the Seventh Circuit, the negligence of the guards resulting in the loss of Bonner's transcript did not constitute a deprivation by the state without due process of law under the fourteenth amendment "because any state action ended when the guards left the cell after the security search."¹⁶ Likewise, the court declared that the taking of the transcript by some unknown person did not represent action "under color of state law" within the meaning of § 1983, "because it was neither encouraged nor condoned by state agents."¹⁷ Therefore, the guards' culpability "was not of sufficient magnitude to constitute a deprivation of rights under Section 1983."¹⁸

An obvious intention of Congress in passing the Civil Rights Act had been to deter official misconduct.¹⁹ Extension of the statute to cases of simple negligence, asserted the court, "would not deter future inadvertence as much as in the case of intentional or reckless conduct."²⁰ Indeed, the court found no indication of congressional intent to include mere negligence claims within the scope of the statute's protection.²¹

12 *Id.* at 1318.

13 424 U.S. 693 (1976).

14 545 F.2d at 567.

15 *Id.*

16 *Id.*

17 *Id.*

18 *Id.*

19 *See generally* CONG. GLOBE, 42d Cong., 1st Sess. 390 (1871). *See also* the discussion of the legislative history of the Civil Rights Act in *Monroe v. Pape*, 365 U.S. 167, 172-87 (1961).

20 545 F.2d at 568.

21 In this context, the *Bonner* majority expressed fear of a proliferation of § 1983 cases based on negligence. *Id.*

However, a minority of other circuits, cited by Bonner, have held that negligence is actionable under § 1983.²² The Seventh Circuit disregarded these decisions as well as several of its own earlier decisions. The court stated that its pre-Bonner decisions regarding § 1983 were consistent with the result in the instant case, although the prior cases contained several statements of "broad dicta" helpful to Bonner.²³ The court placed its strongest emphasis, however, on the observation that all case law cited by Bonner in support of his position was inapposite since it had been rendered prior to *Paul v. Davis*.

The Bonner Court's Interpretation of Paul v. Davis

The Bonner majority believed that further dispute as to the scope of § 1983 was precluded by the Supreme Court's decision in *Paul*. The majority interpreted *Paul* to say that a plaintiff in a § 1983 action must prove not only a deprivation of constitutional rights and action under color of state law, but also the defendant's intentional conduct or reckless disregard of the plaintiff's constitutional rights. Furthermore, according to the majority, the Supreme Court in *Paul* had shown the essential interconnection among these three elements of a cause of action under § 1983. Neither a deprivation of rights protected by the fourteenth amendment nor action under color of state law could result from negligent conduct. As Judge Swygert's dissent indicates, however, it is questionable whether *Paul* fully supports the broad propositions advanced by the majority in *Bonner*.

In *Paul*, the plaintiff based his § 1983 action on the inclusion of his name and photograph in a circular of "active shoplifters" distributed by the defendant police chiefs among local area merchants. Plaintiff Davis had been charged with shoplifting at the time the circular was prepared and distributed, although his guilt or innocence had not yet been resolved. Shortly after circulation of the flyers, the charge against Davis was dismissed.

Davis subsequently brought a cause of action under § 1983 on the grounds that the circular, prominently titled "Active Shoplifters," deprived him of "liberty" in violation of the fourteenth amendment. Davis asserted that his designation as a shoplifter would inhibit him from entering business establishments because he feared suspicion and the possibility of arrest for shoplifting. He also alleged that it would seriously impair his future employment opportunities.²⁴

The Supreme Court reversed the Sixth Circuit's determination that Davis had alleged facts sufficient to support a cause of action under § 1983. The Court held that Davis had pointed to "no specific constitutional guarantee" safe-

²² See notes 40-41 *infra*.

²³ 545 U.S. at 568. Further, the court asserted that its decision in *Bonner* was fully supported by a number of other Seventh Circuit decisions dealing with § 1983. See note 44 *infra*.

²⁴ The defendants' motion to dismiss the complaint was granted by the United States District Court for the Western District of Kentucky on the grounds that Davis had not alleged facts sufficient to establish that he had been deprived of any constitutional right. On appeal, however, the Sixth Circuit reversed and remanded. *Davis v. Paul*, 505 F.2d 1180 (6th Cir. 1974). The court concluded that Davis had set forth a valid § 1983 claim "in that he has alleged facts that constitute a denial of due process of law." *Id.* at 1182.

guarding the interest that he asserted had been invaded.²⁵ Moreover, the Court rejected Davis' contention "that the Fourteenth Amendment's Due Process Clause should *ex proprio vigore* extend to him a right to be free of injury whenever the State may be characterized as the tortfeasor."²⁶ Finally, the Court concluded that Davis' interest in reputation alone was "neither 'liberty' nor 'property' guaranteed against state deprivation without due process of law."²⁷ Thus, his claim was deemed insufficient to support a cause of action under § 1983.

On the basis of *Paul*, the Seventh Circuit concluded in *Bonner* that the fourteenth amendment does not extend to a claim of negligent state action which results in the deprivation of property without due process of law. The Seventh Circuit analogized Bonner's situation to that of the plaintiff in *Paul*, asserting that Bonner had "pointed to no specific constitutional guarantee against the negligence of the two prison guards, even though they might be tortfeasors under Illinois law."²⁸ The court characterized Bonner's claim as an assertion that substantive due process could provide the foundation for an attack on the prison guards' conduct. The *Bonner* majority responded that "[i]t was precisely such an *ex proprio vigore* extension of the substantive aspect of due process that the Supreme Court rejected in *Paul*."²⁹

However, it is doubtful that the Supreme Court in *Paul* intended totally to foreclose the possibility of a federal cause of action under § 1983 based on negligence. The focus of the Court's decision in *Paul* was not the nature of the defendants' conduct. Rather, the Court emphasized the fact that Davis had pointed to no protected liberty or property interest in his reputation cognizable under the fourteenth amendment.

The Supreme Court in *Paul* elaborated upon the rights encompassed by the due process clause as follows:

It is apparent from our decisions that there exists a variety of interests which are difficult of definition but are nevertheless comprehended within the meaning of either "liberty" or "property" as meant in the Due Process Clause. These interests attain this constitutional status by virtue of the fact that they have been initially recognized and protected by state law, and we have repeatedly ruled that the procedural guarantees of the Fourteenth Amendment apply whenever the State seeks to remove or significantly alter that protected status.³⁰

As previously noted, the Court concluded that the interest in reputation alone which Davis sought to vindicate was different from the liberty or property interests protected by the due process clause. Kentucky law did not provide any legal guarantee of present enjoyment of reputation which was altered or extinguished as a result of the defendants' actions. Rather, the Court explained, Davis' interest in reputation

25 424 U.S. at 700.

26 *Id.* at 701.

27 *Id.* at 712.

28 545 U.S. at 567.

29 *Id.*

30 424 U.S. at 710-11.

is simply one of a number which the State may protect against injury by virtue of its tort law, providing a forum for vindication of those interests by means of damages actions. And any harm or injury to that interest, even where as here inflicted by an officer of the State, does not result in a deprivation of any "liberty" or "property" recognized by state or federal law, nor has it worked any change of respondent's status as theretofore recognized under the State's laws.³¹

Since Davis could not assert the denial of any right granted him by the state and thereby protected under the fourteenth amendment, the Court held that the defendants' defamatory publications, however seriously they may have harmed Davis' reputation, did not provide the basis for a cause of action under § 1983.

In contrast, Bonner's claim was based upon the guarantee set forth in the specific language of the fourteenth amendment prohibiting the state from depriving him of his property without due process of law.³² As Judge Swygert noted, Bonner's right to possession of his property was a right accorded him by state law, in the form of prison regulations.³³ His interest in the transcript, therefore, qualified as a protected property right under the due process clause as interpreted in *Paul*, and, as a result of the prison guards' negligence, "a right or status previously recognized by state law was distinctly altered or extinguished."³⁴ In this sense, Bonner's claim was supported rather than contradicted by *Paul*. Contrary to the conclusion of the en banc majority, Bonner had indeed pointed to a specific constitutional guarantee against the loss of his property through the negligence of the prison guards.

Thus, in determining whether a plaintiff under § 1983 has satisfied the first requirement to obtain relief under the statute—deprivation of a constitutional right—an inquiry into the nature of the defendant's conduct appears misdirected. The sole concern of the court at this stage of the process should be to determine whether the right allegedly violated falls within any of the fourteenth amendment's protected categories of "life, liberty, or property." *Paul* does not appear to destroy the validity of this assertion.

A more troublesome issue, however, relates to the *Bonner* majority's suggestion that negligent conduct can never be state action for purposes of § 1983. The Seventh Circuit has adopted the position that only the common law of intentional tort should apply to allegations of § 1983 violations. *Bonner* thus raises a fundamental issue concerning this section of the Civil Rights Act—the viability of the mechanical application of common law tort concepts to determine the merits of § 1983 claims.

Section 1983 and Tort Law

The determination of the type of conduct on the part of the defendant that will support a § 1983 claim is a fundamental issue under this provision of the

31 *Id.* at 712.

32 [N]or shall any State deprive any person of life, liberty, or property, without due process of law. U.S. CONST. amend. XIV, § 1.

33 545 F.2d at 571 (Swygert, J., dissenting).

34 424 U.S. at 711.

Civil Rights Act. The language of § 1983 does not mention a state of mind requirement for the defendant.³⁵ The legislative history of the statute also is silent as to this aspect of the defendant's liability. These factors, when considered in light of several others to be discussed below, have produced a variety of interpretations among both courts and commentators with regard to the prerequisites of a cause of action under this statute.

For many years after the passage of the Civil Rights Act, it appeared that an official must have acted with a specific intent to deny a federal right in order for his conduct to be within the scope of § 1983.³⁶ Prior to 1961, courts generally read into § 1983 some sort of purposive intent requisite to liability by analogizing the statute to its criminal counterpart.³⁷

In 1961, however, the Supreme Court in *Monroe v. Pape*³⁸ rejected the contention that a specific intent to deprive an individual of a constitutional right is a prerequisite to liability under § 1983. The Court analogized to common law negligence actions in defining the elements of a cause of action under the statute. In this context, Justice Douglas, the author of the majority opinion, stated that "Section 1979 [now 1983] should be read against the background of tort liability that makes a man responsible for the natural consequences of his actions."³⁹ *Monroe* thus introduced the idea of foreseeability into the interpretation of § 1983 and originated the concept of "constitutional tort."

Justice Douglas' reference to the "background of tort liability," in connection with his discussion of the basis of liability under § 1983, has been interpreted in various ways by courts and commentators. A minority of circuits has applied this dictum literally, making traditional common law tort concepts determinative of liability under the statute.⁴⁰ In contrast, the Fifth Circuit has concluded that there is no state of mind prerequisite to liability under § 1983, creating a rule of absolute liability for constitutional deprivations by state officials.⁴¹

35 As one commentator has stated, "The language of section 1983 . . . is notable for the absence of qualification or limitation and has always held potential for lending itself to sweeping interpretations." Note, *Limiting the Section 1983 Action in the Wake of Monroe v. Pape*, 82 HARV. L. REV. 1486 (1969).

36 See, e.g., *Bottone v. Lindsley*, 170 F.2d 705 (10th Cir. 1948), in which the court stated that "to make out a cause of action under the Civil Rights Statutes, the state court proceedings must have been a complete nullity, with a purpose to deprive a person of his property without due process of law." *Id.* at 707. According to the *Bottone* court, "[t]o hold otherwise would open the door wide to every aggrieved litigant in a state court proceedings [sic], and set the federal courts up as an arbiter of the correctness of every state decision." *Id.*

37 18 U.S.C. § 242 (1970) provides in pertinent part:

Whoever, under color of any law, statute, ordinance, regulation, or custom, wilfully subjects any inhabitant of any State, Territory, or District to the deprivation of any rights, privileges, or immunities secured or protected by the Constitution or laws of the United States . . . shall be fined not more than \$1,000 or imprisoned not more than one year, or both; and if death results shall be subject to imprisonment for any term of years or for life.

In the leading case of *Screws v. United States*, 325 U.S. 91 (1945), the Supreme Court considered the proper application of this criminal counterpart of § 1983. The Court construed the word "wilfully" to mean the doing of an act with "a specific intent to deprive a person of a federal right." *Id.* at 103.

38 365 U.S. 167 (1961).

39 *Id.* at 187.

40 *Navarette v. Enomoto*, 536 F.2d 277 (9th Cir. 1976), cert. granted, 45 U.S.L.W. 3489 (U.S. Jan. 18, 1977); *McCray v. Maryland*, 456 F.2d 1 (4th Cir. 1972); *Carter v. Carlson*, 447 F.2d 358 (D.C. Cir. 1971), rev'd on other grounds sub nom., 409 U.S. 418 (1973).

41 *Whirl v. Kern*, 407 F.2d 781 (5th Cir. 1969), cert. denied, 396 U.S. 901 (1969).

However, a majority of the circuits has given *Monroe* a more restricted reading, holding that there can be no § 1983 violation as the result of negligent state action.⁴² The majority courts have apparently placed great emphasis on the admittedly intentional deprivations of rights committed by the officers in *Monroe*.⁴³ On this basis, they have interpreted Justice Douglas' reference to tort liability to mean that the common law of intentional tort should apply by analogy to determine the type of conduct proscribed by § 1983. This interpretation of *Monroe* was adopted by the en banc majority in *Bonner*.⁴⁴

Judge Swygert, however, criticized as "neither logical nor just" the *Bonner* majority's suggestion that negligent conduct can never be sufficient to satisfy the second essential element of a claim under § 1983—action "under color of state law." Judge Swygert noted:

State action in constitutional law is a concept that is similar to legal or proximate cause in tort law. Whether the presence of the state is great enough to justify the sanctions of section 1983 must be decided by how much the conduct of the state was in fact related to the plaintiff's injury rather than by whether the state intended that conduct.⁴⁵

⁴² *Williams v. Vincent*, 508 F.2d 541 (2d Cir. 1974); *Page v. Sharpe*, 487 F.2d 567 (1st Cir. 1973); *Brown v. United States*, 486 F.2d 284 (8th Cir. 1973); *Howell v. Cataldi*, 464 F.2d 272 (3d Cir. 1972); *Puckett v. Cox*, 456 F.2d 233 (6th Cir. 1972); *Daniels v. Van De Venter*, 382 F.2d 29 (10th Cir. 1967).

⁴³ As one commentator has noted, "If tort concepts are applied to the alleged facts in *Monroe*, the defendants probably committed intentional torts such as assault, battery, false imprisonment, intentional infliction of mental distress, and invasion of privacy." Nahmod, *Section 1983 and the "Background" of Tort Liability*, 50 IND. L.J. 1, 6 (1974).

⁴⁴ *Bonner* contended that three post-*Monroe* Seventh Circuit decisions supported the minority view. In each of the cases cited by *Bonner*, the court made some reference to, but did not decide, the question of the sufficiency of an allegation of negligence to state a claim under § 1983.

In *Joseph v. Rowlen*, 402 F.2d 367 (7th Cir. 1968), the court concluded that where a police officer makes an unlawful arrest that violates the Constitution because of a lack of a warrant or probable cause, the officer is liable for damages. The court asserted that "Additional circumstances coloring the officer's action as flagrant or malevolent are not required." *Id.* at 370.

In *Byrd v. Brishke*, 466 F.2d 6 (7th Cir. 1972), the court cited approvingly *Whirl v. Kern*, 407 F.2d 781, in which the Fifth Circuit held, on the basis of *Monroe*, that negligent nonfeasance was a proper basis for the imposition of tort liability under § 1983. In *Byrd*, the defendants were police officers who failed to stop other unidentified police officers from beating plaintiff in defendants' presence. The Seventh Circuit concluded that a refusal to allow the plaintiff's claim under § 1983 would be to insulate the officers from "liability for reasonably foreseeable consequences of the neglect of their duty to enforce the laws and preserve the peace." *Id.* at 11.

Similarly, in *Spence v. Staras*, 507 F.2d 554 (7th Cir. 1974), the court held that the alleged failure of the employees of a mental hospital to protect one of the patients from a beating inflicted by other patients "was of sufficient magnitude to constitute a deprivation of rights under § 1983." *Id.* at 557.

However, the *Bonner* court refused to recognize inconsistency between these three cases and its decision in *Bonner* that negligence cannot support a claim under § 1983. The court asserted that these cases involved either affirmative conduct by the defendant resulting in a purposeful violation of the plaintiff's constitutional rights (*Joseph v. Rowlen*) or the defendant's purposeful failure to act when he owed this duty to the plaintiff (*Byrd v. Brishke*, *Spence v. Staras*).

In further response to *Bonner's* contention, the Seventh Circuit asserted that its holding in *Bonner* was supported by other post-*Monroe* decisions of the court. See *Kimbrough v. O'Neil*, 523 F.2d 1057 (7th Cir. 1975), *aff'd on rehearing*, 545 F.2d 1059 (1976) (*en banc*); *Carroll v. Sielaff*, 514 F.2d 415 (7th Cir. 1975); *Gutierrez v. Department of Public Safety*, 479 F.2d 701 (7th Cir., 1973), *cert. denied*, 414 U.S. 1146 (1974).

⁴⁵ 545 F.2d at 572 (Swygert, J., dissenting).

The *Bonner* majority's conclusion regarding state action under § 1983 is equivalent to an assertion that negligence can never be the legal or proximate cause of an individual's loss of rights secured by the Constitution.

As applied to the facts in *Bonner*, the majority's holding that the negligence of the guards was not sufficiently connected to the loss of the transcript, so as to be considered state action, necessarily implies that the guards' conduct was not the legal or proximate cause of Bonner's loss. Yet as Judge Swygert noted, this conclusion is illogical. As a matter of tort law, the loss of the transcript would not have occurred "but for" the failure of the guards to lock the door to Bonner's cell and was a foreseeable result of that failure.⁴⁶ Nor does the majority opinion provide support for its broad statement that the taking of Bonner's transcript was not under color of state law "because it was neither encouraged nor condoned by state agents." Indeed, it was settled in *Monroe* that the color of law requirement under § 1983 is satisfied whenever a state official deprives a person of a protected right, whether the defendant acts in accordance with state law or contrary to it.⁴⁷

Judge Swygert's dissatisfaction with the majority's decision in *Bonner* indicates the difficulties which result from a mechanical application of tort law concepts in a § 1983 context. The *Bonner* majority adopted the view that the common law of intentional tort should apply to allegations of § 1983 violations. This conclusion was grounded to a large extent on the court's belief that the sole function of the statute is deterrence and on the court's fear of a proliferation of § 1983 cases based on negligence.⁴⁸

Conclusion

It is difficult to specify with certainty the policy objectives of § 1983.⁴⁹ As the *Bonner* court observed, deterrence of official misconduct was certainly one of the primary benefits contemplated by the supporters of the Civil Rights Act.⁵⁰ Yet, so far as appears from the legislative history, compensation is also a function

46 See generally W. PROSSER, HANDBOOK OF THE LAW OF TORTS, 236-70 (4th ed. 1971).

47 365 U.S. at 182-87. The Court cited *United States v. Classic*, 313 U.S. 299 (1941) for the proposition that "[m]isuse of power, possessed by virtue of state law and made possible only because the wrongdoer is clothed with the authority of state law, is action taken 'under color of state law.'" *Id.* at 326. This view of the meaning of the words "under color of" state law was reaffirmed in *Screws v. United States*, 325 U.S. 91, 108-13 (1945) and *Williams v. United States*, 341 U.S. 97, 99 (1951).

48 "In enacting the Civil Rights Act, Congress was obviously intending to provide a deterrent for the type of conduct proscribed. If an officer intentionally causes a property loss, a remedy under Section 1983 might deter similar misconduct. On the other hand, extending Section 1983 to cases of simple negligence would not deter future inadvertence as much as in the case of intentional or reckless conduct. . . . Otherwise the federal courts would be inundated with state tort cases in the absence of Congressional intent to widen federal jurisdiction so drastically." 545 F.2d at 568.

49 In *Monroe*, Justice Douglas suggested three purposes of § 1983: to "override certain kinds of state laws," to provide "a remedy where state law was inadequate," and "to provide a federal remedy where the state remedy, though adequate in theory, was not available in practice." 365 U.S. at 173-74.

50 The passage of the Civil Rights Act was in large part a reaction to the situation of widespread violence in the South following the end of the Civil War, principally as the result of the activities of the Ku Klux Klan, and the virtual breakdown of law and order resulting from the relative inaction of Southern state and local governments in the face of the problem. The relevant legislative history is set out in *Monroe*, 365 U.S. at 172-87.

of § 1983.⁵¹ The *Bonner* court's decision to foreclose this federal remedy in the case of negligent deprivations of constitutional rights, therefore, achieves judicial efficiency in dealing with § 1983 claims at the cost of screening out cases for which Congress intended to provide a remedy through § 1983.

There is no easy solution to the question presented in *Bonner*. It is clear that the language of § 1983 is broad enough to accommodate an argument that there should be absolute liability for constitutional deprivations by state officials. Yet it is also evident from the distinct historical background of the Civil Rights Act that the overriding concern of the legislature was to provide a federal remedy for the more egregious violations of civil rights which threatened a substantial part of the nation with anarchy in the years following the Civil War. In this latter respect, extension of § 1983 to cases of negligent deprivations of constitutional rights may not be justified by congressional intent.

Nevertheless, a mechanical application of tort law concepts is an unsatisfactory means of determining the merits of claims under the statute because it fails to give due consideration to the policy objectives of the statute and the possibility that the purposes of § 1983 and tort law may conflict.⁵² Moreover, an inquiry into the nature of the defendant's conduct tends to detract the court's attention from the threshold concern in all § 1983 cases—whether there has been a violation of a right secured by the Constitution. The defendant's state of mind should play no part in the court's consideration of this question.

An individual's claim to access to the federal courts for relief from the misuse of state authority should not hinge upon the actor's intent. This treatment of claims arising under § 1983 is neither logical nor just, and may in certain circumstances produce results inconsistent with the federal policy underlying the statute. Instead, the courts must be cautious about extrapolating broad general rules from particular holdings and must realize that proper implementation of the purposes underlying § 1983 will require that standards of care be defined differently for different constitutional duties.

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51 It should be noted, however, that the Supreme Court emphasized in *Monroe* that even where the plaintiff has adequate recourse against a state official under state law for a deprivation of constitutional rights, "[t]he federal remedy is supplementary to the state remedy, and the latter need not be first sought and refused before the federal one is invoked." 365 U.S. at 183. This indicates that compensation was not thought by the Court to be the major function of § 1983.

52 Whereas § 1983 basically represents a Congressional attempt to protect federal rights against infringement by state officials, tort law principles were developed in other contexts for other purposes. See generally Nahmod, *Section 1983 and the "Background" of Tort Liability*, 50 IND. L.J. 1 (1974).

SEX DISCRIMINATION—TIMELINESS OF TITLE VII ACTION—WHEN FACIALLY NEUTRAL SENIORITY POLICY PERPETUATES EFFECTS OF A PAST SEX DISCRIMINATION, STATUTORY TIME LIMITS DO NOT BAR ACTION.

*Evans v. United Air Lines, Inc.**

Introduction

As a result of the vigorous enforcement of the Civil Rights Act of 1964,¹ many discriminatory racial and sexual employment practices have been eliminated. While there is a comparatively long history of litigation brought against blatantly discriminatory policies, the Civil Rights Act has only recently been used as a weapon against more subtle forms of intentional and unintentional discrimination. Provisions of the Act are now being employed to combat the lingering effects of prior discriminatory practices which are perpetuated by policies of an otherwise nondiscriminatory nature.

Such an application of the Act was raised before the Seventh Circuit in *Evans v. United Air Lines, Inc.*,² where the court held that a nondiscriminatory seniority policy could violate the Civil Rights Act if it perpetuated the adverse effects of an employer's prior sex discrimination. In reaching its decision, the court relied on developing authority that the operation of such a neutral policy constitutes a continuing violation of the Civil Rights Act. *Evans* is distinctive, however, in that it permits such suits to be brought without regard to the length of time between the original discriminatory act and the point at which the effects of the practice are felt through the operation of an otherwise lawful company policy. In permitting a suit based upon an act of sex discrimination which took place five years earlier, the court in *Evans* has extended the continuing violation theory beyond previous applications.

This comment will analyze the continuing violation concept, and will evaluate the applicability of that theory to the particular facts of *Evans*. Additionally, ramifications of the decision will be explored, and possible means of avoiding those inequities which result from the application of the doctrine will be suggested.

Until 1968, United Air Lines, Inc. required its stewardesses to remain unmarried³ during the tenure of their flight-related employment.⁴ If a stewardess decided to marry, she could be forced to resign her flight position, though she might be employed in a nonflight capacity. Controversy concerning these rules, however, ultimately forced United to abandon the no-marriage requirement pursuant to a 1968 agreement with an employee union. As part of that agreement, United began reinstating former stewardesses who were dismissed under the policy, provided they had filed grievances with the union.⁵

* 534 F.2d 1247 (7th Cir.), cert. granted, 97 S. Ct. 308 (1976).

1 42 U.S.C. § 2000e et seq. (Supp. II 1972).

2 534 F.2d 1247 (7th Cir.), cert. granted, 97 S. Ct. 308 (1976).

3 Delta Air Lines, Inc. had a similar no-marriage rule. See *Stroud v. Delta Air Lines, Inc.*, 544 F.2d 892 (5th Cir. 1977); so did Pan American World Airways, Inc., see *Kennan v. Pan American World Airways, Inc.*, No. C-76-1245 (N.D. Cal., decided Nov. 22, 1976).

4 534 F.2d at 1247.

5 *Id.* at 1248 n.2.

Carolyn J. Evans was employed as a stewardess for United Air Lines from November, 1966, to February, 1968, when her marriage forced her resignation under the then applicable no-marriage rule.⁶ However, she failed to file the requisite grievance, and thus was not reinstated under the union agreement of 1968.

On February 16, 1972, Evans was rehired by United and began work as a stewardess after undergoing a four-week training program for new employees. Pursuant to United's general policy, she received no seniority for her previous employment. It was the practice of United to compute seniority solely on the basis of continuous time, rather than total time, in service.⁷ One year after being rehired, Evans filed charge with the Equal Employment Opportunity Commission (EEOC), under Title VII of the Civil Rights Act of 1964, to recover her lost seniority, as well as back pay and other benefits allegedly lost as a result of the termination of her employment in 1968.⁸

Evans' charge asserted that United Air Lines, Inc. unlawfully discriminated against her in 1968 when it forced her to resign. Furthermore, United's current procedure for determining seniority benefits served to perpetuate the adverse effects of that original unlawful termination. Evans claimed that United's seniority policy, though neutral on its face with respect to sex, was nevertheless unlawful as it allowed prior discrimination to reach into the present and thus prolong the effects of the 1968 termination.⁹ United, however, contended that the only actionable injury suffered by Evans was the 1968 termination,¹⁰ and, since Evans had failed to file a charge with the EEOC within 90 days of her termination, as then required by 42 U.S.C. § 2000e-5(e) of the Civil Rights Act,¹¹ her suit was barred.¹²

In response to the statute of limitations defense raised by United, Evans argued that the filing time provision was not applicable to her particular situation. The effects of the previous termination were presently being felt through the operation of United's seniority system; thus the 1968 violation was a continuing violation. Consequently, since she had filed her complaint during the operation of the seniority policy, she had timely filed her charge.¹³

In an unreported opinion, the United States District Court for the Northern District of Illinois found for United Air Lines, indicating in the dismissal of

6 *Id.* at 1247.

7 *Id.* at 1249 n.6.

8 It is not clear from the report whether Evans is demanding full seniority from November 1966 when she originally started work with United Air Lines or whether she is demanding seniority and back pay from February, 1968, when she was terminated under the no-marriage rule. *Id.* at 1249.

9 *Id.* at 1248.

10 *Id.* at 1249.

11 42 U.S.C. § 2000e-5(e) (1970) originally provided:

If within thirty days after a charge is filed with the Commission or within thirty days after expiration of any period of reference under subsection (c) of this section (except that in either case such period may be extended to not more than sixty days upon a determination by the Commission that further efforts to secure voluntary compliance are warranted), . . . the Commission shall so notify the person aggrieved and a civil action may, within thirty days thereafter, be brought against the respondent named in the charge. . . .

The section was amended to allow 180 days for filing, 42 U.S.C. § 2000e-5(e) (Supp. II 1972).

12 534 F.2d at 1249.

13 *Id.* at 1248.

Evans' suit that there was no "continuing violation."¹⁴ The United States Court of Appeals for the Seventh Circuit initially affirmed the dismissal¹⁵ but, on rehearing, reversed its earlier decision and remanded the case to the district court for further proceedings.¹⁶ United's petition for a writ of certiorari was granted by the United States Supreme Court on November 1, 1976.¹⁷

The Seventh Circuit's Treatment of Evans

1. The Original Decision

When the Seventh Circuit originally dismissed Evans' appeal, it agreed with United's contention that the statutory filing time for the 1968 violation had elapsed.¹⁸ The court relied on the decision of the Ninth Circuit in *Collins v. United Air Lines, Inc.*¹⁹ In that case, Doris R. Collins, a former stewardess who had been required to resign because she married, sued United after being denied reinstatement several years later. Although her employment had been terminated in 1967, Collins did not file a charge with the EEOC until 1971. The Ninth Circuit, finding that the charge had not been timely filed, held that the three years during which plaintiff was not employed did not constitute a continuing violation.²⁰

The *Collins* court noted that

the alleged unlawful act or practice—not merely its effects—must have occurred within [the statutory period] preceding the filing of charges before the EEOC. Were we to hold otherwise, we would undermine the significance of the congressionally mandated 90 day limitation period.²¹

Adopting the *Collins* interpretation of the statutory filing limit, the Seventh Circuit held that the filing period had expired 90 days after Evans' employment was terminated in 1968.²²

The Seventh Circuit further relied upon *Waters v. Wisconsin Steel Works*,²³ a 1974 class action in which it was held that a racially neutral seniority system did not perpetuate a company's prior racially discriminatory hiring policies. In that case, one of the plaintiffs, a black bricklayer hired in July, 1964, was laid off during a slack period two months later, pursuant to a "last-hired, first-fired" seniority policy. The *Waters* court denied a remedy to the bricklayer, holding that the

¹⁴ *Id.* at 1248.

¹⁵ *Evans v. United Air Lines, Inc.*, [1976] 11 Empl. Prac. Dec. ¶ 10,665 (7th Cir. Jan. 29, 1976).

¹⁶ *Id.* at 1251.

¹⁷ *United Air Lines, Inc. v. Evans*, 97 S. Ct. 308 (1976).

¹⁸ *Evans v. United Air Lines, Inc.*, [1976] 11 Empl. Prac. Dec. ¶ 10,665 (7th Cir. Jan. 29, 1976).

¹⁹ 514 F.2d 594 (7th Cir. 1975).

²⁰ *Id.* at 596.

²¹ *Id.* The *Evans* court also cited *Buckingham v. United Air Lines, Inc.*, [1976] 11 Fair Empl. Prac. Cases 344 (C.D. Cal. June 12, 1975), decided independently of *Collins*. The *Buckingham* court stated, "[e]mployer action . . . such as the termination of an employee . . . constitutes a 'completed act' at the time it occurs, and unless a charge of discrimination is filed with the Equal Employment Opportunity Commission within the statutory time period following the completed act, an action under title VII is barred." [1976] 11 Fair Empl. Prac. Cases, at 349.

²² [1976] 11 Empl. Prac. Dec., at 6813.

²³ 502 F.2d 1309 (7th Cir. 1974).

employer's seniority system was not racially discriminatory and did not perpetuate prior racial discrimination in violation of Title VII.²⁴ From *Waters*, the *Evans* court concluded without elaboration that United's facially neutral seniority policy "cannot be said to perpetuate past discriminations in the sense required to constitute a current violation of Title VII," and thus affirmed the district court's dismissal of Evans' complaint.²⁵

2. *Evans* on Rehearing

On rehearing,²⁶ the Seventh Circuit reversed its prior decision, holding that the facts alleged in Evans' complaint would, if true, constitute a continuing violation of the Civil Rights Act.²⁷ The court based its reversal primarily upon the Supreme Court's decision in *Franks v. Bowman Transportation Co., Inc.*,²⁸ which was handed down after the original *Evans* decision. In *Franks*, the Supreme Court ruled that it is appropriate under 42 U.S.C. § 2000e-5(g) to grant retroactive seniority and back pay, despite a facially neutral seniority policy, when the individual complainant can prove that he has been deprived of such benefits because of an employer's prior discriminatory practices.²⁹

Plaintiffs in *Franks* had joined in a 1971 class action against their employer trucking firm and certain unions for racially discriminatory employment practices in violation of Title VII. Both named petitioners had filed charges with the EEOC within several days of their terminations, and thus timely filing was not an issue in the case.³⁰ Instead the Court focused primarily on the nature of the relief sought by the plaintiffs. The defendant employer asserted 42 U.S.C. §

24 *Id.* at 1318.

25 [1976] 11 *Empl. Prac. Dec.*, at 6813. In his dissent, Judge Cummings pointed out that the EEOC had considered Evans' charge to be timely, since it had authorized her to sue. He argued that the EEOC's interpretation of timely filing "deserves deference." *Cox v. United States Gypsum Co.*, 409 F.2d 289, 291 (7th Cir. 1969). Cummings also argued that the court should have adopted the reasoning in *Burwell v. Eastern Air Lines, Inc.*, 394 F. Supp. 1361 (E.D. Va. 1975), where a stewardess was found to be suffering from a continuing violation which had originated at the time of her reinstatement after pregnancy three years before. *Id.* at 6813-14 (Cummings, J., dissenting).

26 534 F.2d 1247 (7th Cir. 1976).

27 *Id.* at 1250. Although this appeal technically concerned only the sufficiency of Evans' complaint, the Seventh Circuit appeared to leave very little to the trial court to determine on remand. See text accompanying note 38, *infra*.

28 424 U.S. 747 (1976).

29 *Id.* at 764-66, where the *Franks* Court stated, "Adequate relief may well be denied in absence of a seniority remedy slotting the victim in that position in the seniority system that would have been his had he been hired at the time of his application." The Court continued, *Id.* at 767: "Obviously merely to require Bowman to hire the class 3 victim of discrimination falls far short of a 'make whole' remedy. [footnote omitted] A concomitant award of seniority credit he presumptively would have earned but for the wrongful treatment would also seem necessary in the absence of justification for denying that relief." Plaintiffs in *Franks* sought both "benefit"-type seniority and "competitive"-type seniority. Benefit-type seniority "determines pension rights, length of vacations, size of insurance coverage and unemployment benefits, and the like. . . ." *Id.* at 786-87 (Powell, J., dissenting). Competitive-type seniority "determines an employee's preferential rights to various economic advantages at the expense of other employees . . . [such as] order of layoff and recall of employees, job and trip assignments, and consideration for promotion." *Id.* at 787.

30 In *Franks v. Bowman Transportation Co.*, 495 F.2d 398, 405 (5th Cir. 1974), the Fifth Circuit noted, "For *Franks*' individual claim the statute began running on the date of his dismissal, May 10, 1968. The running of the limitations period was tolled by the filing of a complaint with the EEOC on May 13, 1968, three days later." Likewise, the other named petitioner in *Franks* filed an EEOC charge against the employer one day after his dismissal. *Id.* at 406-07.

2000e-2(h) as a bar to the complainants' claims for retroactive seniority. That section reads:

Notwithstanding any other provision of this subchapter, it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority system . . . provided that such differences are not the result of an intention to discriminate because of race, color, religion, sex or national origin.

The Supreme Court determined from the legislative history of § 2000e-2(h) that Congress intended it to be a narrow exception to the Act's two general purposes: to prohibit unlawful discriminatory employment practices and "to make persons whole for injuries suffered" on account of such discrimination.³¹ The Court ruled that § 2000e-2(h) bars charges stemming only from discriminatory acts committed prior to July 2, 1965, the effective date of the Civil Rights Act. Since the acts complained of in *Franks* occurred after that date, the provision was found to be no defense to the charges made. The Court, relying on the language of 42 U.S.C. § 2000e-5(g), concluded that retroactive seniority is an appropriate form of relief. Section 2000e-5(g) reads:

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 . . . 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. . . .

Despite the fact that retroactive seniority is not specifically mentioned in § 2000e-5(g), the Court asserted that seniority is just as important as back pay in any court's attempt to make whole a victim of discrimination.³² Quoting from *Albemarle Paper Co. v. Moody*,³³ the *Franks* Court warned that retroactive seniority, like back pay, should be denied

only for reasons which, if applied generally, would not frustrate the central statutory purposes of eradicating discrimination throughout the economy and making persons whole for injuries suffered through past discrimination.³⁴

The *Evans* court specifically relied on *Franks* in reaching two of its conclusions. First, it found that the Supreme Court's interpretation of § 2000e-2(h) was sufficient to dismantle United's bona fide seniority system defense.³⁵ Second,

31 424 U.S. at 763.

32 *Id.* at 771.

33 422 U.S. 405, 421 (1975).

34 424 U.S. at 771.

35 It is unclear whether United Air Lines actually raised 42 U.S.C. § 2000e-2(h) to defend its seniority system against Evans' complaint. The Seventh Circuit in *Evans* ambiguously stated, "United's argument would appear to rest, *sub silentio*, on the protection afforded bona fide seniority systems by section 2000e-2(h)." 534 F.2d at 1249. No mention of § 2000e-2(h) was made in the original *Evans* opinion.

it adopted *Franks*' holding that retroactive seniority can be an appropriate remedy under § 2000e-5(g), thus making such a remedy available to Evans.

Finally, the court reversed its earlier holding that Evans' cause of action had expired under § 2000e-5(e) due to her failure to file a charge with the EEOC within 90 days of her 1968 termination. The court found that,

[i]f the prior discharge was itself a discriminatory one, then United's seniority policy is an instrument that extends the impact of past discrimination, albeit unintentionally. Consequently, the present application is deemed to be discriminatory.³⁶

To support this conclusion, the court cited several cases in which the employers' inherently neutral seniority policies were held to violate Title VII if their effect is "to perpetuate disadvantages accruing from prior discrimination."³⁷

However, the actual role of the *Franks* case in the Seventh Circuit's reversal of *Evans* is unclear. Although the court offered *Franks* to support its denial of United's defense, and to allow retroactive seniority to remedy employment discrimination, neither conclusion was crucial to the ultimate decision. While *Franks* involved an EEOC charge filed within the statutory 90-day period, Evans by contrast involved an alleged continuing violation, and the relation of that continuing violation to the timely filing requirements of the 90-day statute.

Also puzzling is the fact that the court held that United's policies constituted a continuing violation, without discussion of the threshold question of whether Evans' unusually long delay in filing an EEOC charge was so unreasonable as to bar—or at least limit—her action. No attempt was made to establish guidelines indicating the extent to which courts should allow an allegedly continuing discrimination to continue before a plaintiff must file a charge. The court similarly failed to consider the equitable interests of parties other than the victim of the discrimination: namely, the incumbent employees and the employer, both of whose interests are increasingly jeopardized if charges are not timely filed and adjudicated.

Additionally, it is significant that the Seventh Circuit appears to have decided an appeal on the sufficiency of Evans' complaint as if it were an appeal on the merits of the case. The action was remanded to the trial court, but it is not clear from the opinion whether the appellate court left any significant issues, apart from a determination as to damages, to be determined by the district court. Although the Seventh Circuit did leave it to the trial court to decide "if the prior discharge was itself a discriminatory one, . . ."³⁸ discrimination appears here to be a foregone conclusion, since the no-marriage rule by which Evans was terminated was declared unlawfully discriminatory by the Seventh Circuit in *Sprogis v. United Air Lines, Inc.*, in 1971.³⁹

36 534 F.2d at 1250. From this passage it is unclear whether the Seventh Circuit was framing the issue to be decided at trial, or actually was deciding the merits of the case. See text accompanying note 38, *infra*.

37 *Id.* at 1250-51 n.15.

38 *Id.* at 1250.

39 444 F.2d 1194 (7th Cir.), *cert. denied*, 404 U.S. 991 (1971).

The Continuing Violation Theory

In holding that application of United's seniority policy violated the Civil Rights Act,⁴⁰ the Seventh Circuit recognized that:

[Evans'] charge would not be timely and the jurisdictional prerequisites to a civil action would not be fulfilled under the Civil Rights Act . . . unless her theory of a continuing violation is valid.⁴¹

A critical issue in *Evans*, therefore, is whether the facts warrant a finding of a continuing violation. If they do not, the jurisdictional requirements of Title VII have not been met.

Examination of continuing violation cases indicates that the theory is most often applied in three distinct situations. In each, courts have modified the filing requirements of § 2000e-5(e) in an effort to advance the specific purposes of the Civil Rights Act: the elimination of both unlawful discrimination and its effects.⁴² Toward this goal, one type of continuing violation has been found in those cases in which unlawful practices actually are continued, so that filing against the first occurrence is equivalent to filing against the last occurrence of the practice. For example, when an employer unlawfully continues to refuse to hire or promote a person,⁴³ that employer continually violates the Act. In these cases, the actual practice "continues," therefore filing within 90 days of the last discriminatory occurrence is sufficient to uphold a charge against the prior occurrence as well.⁴⁴

The second category of cases in which courts have found the theory applicable involves a violative practice which has ceased but which is replaced by

⁴⁰ 534 F.2d at 1250. The court stated:

If the prior discharge was itself a discriminatory one, then United's seniority policy is an instrument that extends the impact of past discrimination, albeit unintentionally. Consequently, the present application of United's seniority policy is deemed to be discriminatory.

⁴¹ *Id.* at 1249.

⁴² Underlying policy reasons were addressed in *United States v. N.L. Indus., Inc.*, 479 F.2d 354, 360-61 (8th Cir. 1973) and in *United States v. Dillon Supply Co.*, 429 F.2d 800, 803-04 (4th Cir. 1970).

⁴³ See *Belt v. Johnson Motor Lines*, 458 F.2d 443 (5th Cir. 1972), where black drivers were continually denied more lucrative "over-the-road" driving assignments. As the District Court for the Northern District of Georgia explained:

[A] judicially evolved exception to this timely charge requirement has developed where practices complained of are "continuing" in nature. . . . The obvious rationale behind this exception is that there is no single isolated discriminatory act from which the limitation might run.

Healen v. Eastern Airlines, Inc., [1975] 8 Fair Empl. Prac. Cases 917, at 920 (N.D. Ga. Dec. 26, 1973).

⁴⁴ In *Bartness v. Drewrys USA, Inc.*, 444 F.2d 1186 (7th Cir.), *cert. denied*, 404 U.S. 939 (1971), women were required to retire at age 62 whereas men were retired at age 65. The court said the practice continued so as to allow timely filing when a woman filed an EEOC charge more than 90 days after her retirement; similarly in *Mixson v. Southern Bell Tel. & Tel.*, 334 F. Supp. 525 (N.D. Ga. 1971), a widow was denied a company annuity when her husband died at age 59 years, 10 months, thereby failing to qualify for the annuity at age 60. Plaintiff-widow argued the annuity was given to women workers at age 55 and therefore that the differentiation was sex discriminatory. The court allowed suit stating that the practice was continuing, making filing timely even though filed more than 90 days after the death of plaintiff's husband; in *Banks v. Lockheed-Georgia Co.*, 46 F.R.D. 442 (N.D. Ga. 1968), a black was permitted to sue because he was continually excluded from a governance committee of a company employee club; suit was likewise allowed though filed more than 90 days after a lay-off, when the court in *Sciaraffa v. Oxford Paper Co.*, 310 F. Supp. 891 (S.D. Me. 1970), held that a union continually failed to press grievances of women members who claimed their lay-offs were unlawfully discriminatory.

a second unlawful practice continues the discrimination. Thus, in *King v. Georgia Power Co.*,⁴⁵ for example, an employer discontinued a practice of making discriminatory job assignments but instituted a discriminatory testing procedure in its place, thereby continuing the original discriminatory practice. Again, then, filing against the later occurrence of discrimination is equivalent to filing against the first occurrence. Similarly, in other cases, a discriminatory recall of men over women has been held to continue a previous practice of refusing original employment to women.⁴⁶

Recent decisions indicate the emergence of a third type of continuing violation justifying modification of 42 U.S.C. § 2000e-5(e)'s time requirement. In these cases, the original discriminatory practice has ceased but the discrimination is deemed to continue because adverse effects of that original practice are perpetuated by an otherwise nondiscriminatory company policy. This third type of continuing violation is most often found when seniority policies operate to the disadvantage of employees formerly subjected to a discriminatory practice of the employer. An example, in *United States v. N.L. Industries*,⁴⁷ a company's policy of assigning blacks to one relatively undesirable department had been discontinued because of its discriminatory nature. Nonetheless, under a seniority system that based promotions on time spent in a department, rather than on total time employed with the company, the effects of the discriminatory practice were found to be perpetuated far beyond its actual tenure. Consequently, the continuing nature of the violation made the action timely filed. Thus, a neutral policy can become unlawful if it serves to continue the lingering effects of prior discriminatory practices.⁴⁸

45 295 F. Supp. 943 (N.D. Ga. 1968).

46 *Cox v. United States Gypsum Co.*, 409 F.2d 289 (7th Cir. 1969); and *Tippett v. Liggett & Meyers Tobacco Co.*, 316 F. Supp. 292 (M.D.N.C. 1970).

47 479 F.2d 354 (8th Cir. 1973); see also Section by Section Analysis of H.R. 1746, accompanying the Equal Employment Opportunity Act of 1972—Conference Report, 118 CONG. REC. 7166-68 (1972), where Congress noted and accepted these two types of continuing violation cases when it stated:

Court decisions under the present law have shown an inclination to interpret this time requirement so as to give the aggrieved person the maximum benefit of the law. . . . Existing case law which has determined that certain types of violations are continuing in nature, thereby measuring the running of the required time period from the last occurrence of the discrimination is continued and other interpretations of the courts maximizing the coverage of the law are not affected by [these amendments].

48 In *Acha v. Beame*, 531 F.2d 648 (2d Cir. 1976), the court held a facially neutral last hired-first fired seniority system perpetuated adverse effects of New York City Police Department's previous discriminatory hiring practices toward women; in *Palmer v. General Mills, Inc.*, 513 F.2d 1040 (6th Cir. 1975) a neutral seniority plan that provided that advancement in a department was dependent on seniority in that department was held to perpetuate effects of previous sex discrimination; similarly a black in *Gilmore v. Kansas City Terminal Ry. Co.*, 509 F.2d 48 (8th Cir. 1975) successfully argued that past discrimination presently affected his chances for promotion; the court said at 52:

[It is] open to plaintiff to demonstrate a violation of Title VII on either of two independent bases: that the employment policies reflect present discriminatory conduct or that current policies, though neutral on their face, carry forward vestiges of past discrimination. This represents the traditional dual focus in civil rights litigation upon purpose, as well as effect.

In *Pettway v. American Cast Iron Pipe Co.*, 494 F.2d 211, 236 (5th Cir. 1974), effects of discriminatory educational testing procedures were carried forward by operation of a seniority program; likewise, job advancement for production line workers was affected by previous discriminatory entry-line limitations in *Local 189, United Papermakers v. United States*, 416 F.2d 980 (5th Cir. 1969).

Stewardess cases brought under Title VII readily fall within this third type of continuing violation.⁴⁹ Foremost among these cases are ones involving discriminatory maternity terminations which have been found to be perpetuated by the operation of seniority policies as to reinstated stewardesses.⁵⁰ Courts generally find that such a neutral seniority policy's operation impermissibly continues the prior discriminatory termination, using essentially the reasoning employed by the court in *Evans* to allow suit.⁵¹

However, one factor in *Evans* distinguishes it from previous continuing violation cases. In *Evans*, four years had elapsed between the time Evans was terminated by the unlawful practice and the time she experienced its effect through the operation of the seniority policy. The Seventh Circuit failed to note or discuss the significance of this time lapse when it applied the continuing violation theory. Perhaps it would have been at least conceptually more precise if the court had created a new theory: namely, that the effects of the old discriminatory practice were revived, rather than continued, under operation of the seniority policy of United. Nevertheless, the court applied the continuing violation theory and by so doing seemingly decided that the interruption between practice and effect was irrelevant. Thus, *Evans* represents a dramatic extension of the continuing violation concept.

An Evaluation of the Continuing Violation Theory Applied In Evans

Evans is illustrative of the conflict between the social policies underlying the continuing violation theory and the long-recognized policies favoring speedy prosecution of claims. The case presents the question of whether a plaintiff's delay in pressing a Title VII claim should be allowed to prejudice unduly the interests of later-hired employees who stand to lose substantial competitive seniority benefits, and of employers who could face unreasonably long periods of liability to potential claimants.

1. The Rights of Other Employees

The *Evans* decision reflects an underlying theme of the Supreme Court in *Franks*: the burdens of past discrimination must be shared if victims of employment discrimination are to be restored those rights of which they have been unlawfully deprived.⁵² Since in a case like *Evans* the aggrieved employee is restored at the expense of other employees, it is important to consider the interests of those other employees.

49 Courts appear to disagree as to whether various practices of airline companies violate the Civil Rights Act. See, e.g., 544 F.2d 892 and 444 F.2d 1194 where courts disagreed over how no-marriage rules violated the Act; additionally see *Inda v. United Air Lines, Inc.*, 405 F. Supp. 426 (N.D. Cal. 1975), in which the court held refusal to reinstate former stewardesses terminated under a no-marriage rule was itself discriminatory and awarded \$41,917 and \$57,843 to the plaintiffs; but see, *Collins v. United Air Lines, Inc.*, 514 F.2d 594 (9th Cir. 1975), in which refusal to reinstate rule terminated stewardesses was not found unlawful.

50 See *Burwell v. Eastern Air Lines, Inc.*, 394 F. Supp. 1361 (E.D. Va. 1975); *Healen v. Eastern Air Lines, Inc.*, [1975] 8 Fair Empl. Prac. Cases 917 (5th Cir. Dec. 26, 1973); and EEOC Dec. No. 71-413, [1972] 3 Fair Empl. Prac. Cases 233 (Nov. 5, 1970).

51 See note 50 *supra*.

52 424 U.S. at 777: "We are of the view . . . that a sharing of the burden of the past discrimination is presumptively necessary. . . ."

Reinstatement of a discrimination victim with retroactive competitive seniority benefits⁵³ results in the disruption of the vested competitive seniority rights of other employees. In effect, the displaced employees are made to pay for their employer's discrimination.⁵⁴ As Chief Justice Burger has noted, the awarding of competitive seniority benefits in such situations is like "robbing Peter to pay Paul."⁵⁵ Moreover, the offending employer is not punished when one employee is put ahead of another on a promotion or layoff list, since such a remedy requires the employer merely to rearrange its workers without increasing its costs.⁵⁶

In the event that the district court is faced with the task of fashioning a remedy for Evans, it may do so in such a way as to consider the interests both of Evans and of other employees. This could be accomplished by awarding "front pay" to Evans, rather than retroactive competitive seniority benefits. Front pay is advance payment made as restitution when full reinstatement with seniority is impossible or impractical.⁵⁷ For instance, in *Hyland v. Kenner Products Co.*,⁵⁸ six months' front pay was awarded to a female employee in lieu of reinstatement when the court found that antagonism between her and her employer made reinstatement an unworkable remedy. Similarly, in *White v. Carolina Paperboard Corp.*,⁵⁹ front pay was deemed an appropriate remedy when several black employees brought a class action challenging certain discriminatory company policies. By the time of suit, most of the plaintiffs in *White* had become too old to perform adequately the positions which the court found they deserved. Consequently, plaintiffs were awarded three years' front pay to compensate them for anticipated losses of earnings and job seniority. The court justified its award of front pay, saying:

Front pay or prospective relief is essential here because of the historical discrimination by the company, the continuing present effects of these practices, the limited number of vacancies in better paying job positions and the ages and physical limitations of the plaintiffs and members of their class. *Such relief is also necessary to avoid the necessity of "bumping" white employees to put the plaintiffs in their rightful positions.*⁶⁰

⁵³ See note 29, *supra*.

⁵⁴ 424 U.S. at 788-89 (Powell, J., dissenting).

⁵⁵ *Id.* at 781 (Burger, C.J., dissenting). The Chief Justice also stated in his dissenting opinion that "in every respect an innocent employee is comparable to a 'holder in due course' of negotiable paper or a bona fide purchaser of property without notice of any defect in the seller's title."

⁵⁶ *Id.* at 788-89 (Powell, J., dissenting). At least one court has attempted to prevent this inequitable result by recognizing the interests of other employees. The Sixth Circuit in *Meadows v. Ford Motor Co.*, 510 F.2d 939 (6th Cir. 1975), urged that representatives of present employees be allowed to intervene in employment discrimination disputes so that courts "in dealing with job seniority [might better] consider the interests of the workers who might be displaced." *Id.* at 949.

⁵⁷ Front pay is a form of restitution, and thus is an equitable, not legal, remedy. *Cf. Curtis v. Loether*, 415 U.S. 189 (1974), cited in *Hyland v. Kenner Products Co.*, [1976] 11 Empl. Prac. Dec. ¶ 10,926, at 7912 (S.D. Ohio May 5, 1976), *aff'd as to damages*, [1976] 13 Empl. Prac. Dec. ¶ 11,427 (E.D. Va. Oct. 26, 1976).

⁵⁸ [1976] 11 Empl. Prac. Dec. ¶ 10,926 (S.D. Ohio May 5, 1976). See also *Lewis v. Philip Morris, Inc.*, [1976] 13 Empl. Prac. Dec. ¶ 11,350 (E.D. Va. Sept. 2, 1976).

⁵⁹ [1975-76] 10 Empl. Prac. Dec. ¶ 10,470 (W.D.N.C. Sept. 15, 1975).

⁶⁰ *Id.* at 6019. [emphasis added] See also *Patterson v. American Tobacco Co.*, 535 F.2d 257, 267-70 (4th Cir. 1976).

Front pay, therefore, is an alternative available to courts which can be utilized to avoid unfair treatment of present employees when fashioning a remedy for a discrimination victim.

Moreover, it is arguable that Congress intended that courts should use equitable discretion in fashioning remedies so that other employees are not treated unfairly in the process. Three provisions of the Civil Rights Act indicate Congress' concern for persons other than the discrimination victim.

Section 2000e-2(h)⁶¹ of the Civil Rights Act, previously discussed, was inserted to preserve the legitimate seniority rights vested in employees as of the date the Civil Rights Act took effect in July, 1965. As Senators Clark and Case stated in an interpretive memorandum presented to Congress, "Title VII would have no effect on established seniority rights. Its effect is prospective and not retrospective."⁶² Thus, incumbent employees' seniority rights existing at the time of the Act were granted at least some measure of protection from potential Title VII claimants.

Another provision, 42 U.S.C. § 2000e-2(j),⁶³ prohibits employers from granting preferential treatment to minority individuals at the expense of other employees. Senator Clark, responding to arguments by Senator Hill that Title VII would cause reverse discrimination in favor of minorities, noted:

There is no provision, either in title VII or in any other part of this bill, that requires or authorizes any Federal agency or Federal court to require preferential treatment for any individual or any group for the purpose of achieving racial balance. . . . On the contrary, any deliberate attempt to maintain a given balance would almost certainly run afoul of title VII because it would involve a failure or refusal to hire some individual because of his race, color, religion, sex, or national origin. What title VII seeks to accomplish, what the civil rights bill seeks to accomplish is equal treatment for all.⁶⁴

61 42 U.S.C. § 2000e-2(h) (1970) provides in pertinent part:

Notwithstanding any other provision of this title it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system . . . provided that such differences are not the result of an intention to discriminate because of race, color, religion, sex or national origin

62 110 CONG. REC. 7213 (1964). The full text of the interpretive memorandum pertaining to seniority states:

Title VII would have no effect on established seniority rights. Its effect is prospective and not retrospective. Thus, for example, if a business has been discriminating in the past and as a result has an all-white working force, when the title comes into effect the employer's obligation would be simply to fill future vacancies on a nondiscriminatory basis. He would not be obliged—or indeed, permitted—to fire whites in order to hire Negroes, or to prefer Negroes for future vacancies, or, once Negroes are hired, to give them special seniority rights at the expense of the white workers hired earlier. (However, where waiting lists for employment or training are, prior to the effective date of the title, maintained on a discriminatory basis, the use of such lists after the title takes effect may be held an unlawful subterfuge to accomplish discrimination.)

63 42 U.S.C. § 2000e-2(j) (1970) reads:

Nothing contained in this subchapter shall be interpreted to require any employer . . . to grant preferential treatment to any individual or to any group because of the race, color, religion, sex, or national origin of such individual or group on account of an imbalance which may exist with respect to the total number or percentage of persons of any race, color, religion, sex or national origin . . . in comparison with the total number or percentage of persons of such race, color, religion, sex, or national origin in any community, State, section, or other area, or in the available work force in any community, State, section or other area.

64 110 CONG. REC. 7207 (1964).

Finally, § 2000e-5(g)⁶⁵ was amended in 1972 to limit back pay accrual to two years before a charge of continuing violation is filed with the EEOC. By placing the two-year limit on back pay awards, Congress implicitly recognized that the court's discretion in restoring an aggrieved employee must take into account other interests, and that total restoration of one employee might not be equitable to all parties involved.⁶⁶

It appears, therefore, that Congress intended that the interests of other employees as well as the interests of the victim of the discrimination be considered in shaping remedial awards in discrimination cases. However, the Supreme Court appears to disagree with this interpretation of the congressional intent underlying the Civil Rights Act. In *Franks*, as noted above, the Court stated that full retroactive seniority is presumed to be appropriate relief for employees fired for discriminatory reasons.⁶⁷ This principle was adopted by the Seventh Circuit in *Evans*.⁶⁸ Such a presumption in favor of plaintiffs, however, arguably interferes with the district court's statutory discretion to consider the equitable interests of later-hired employees.

2. Prejudice To The Employer

The Seventh Circuit in *Evans* additionally failed to consider the implications of its decision with regard to the interests of the employer. By permitting the claim to be brought, the court may have subjected United to liability for an unreasonably long period of time.

Statutes of limitation and the equitable doctrine of laches protect the interests of defendants from threats of indefinite liability. The policy justifying both concepts is that it is inequitable for an injured party not to put an adversary on notice of his claim.⁶⁹ By placing various time limits in Title VII, Congress expressly indicated its intention to prevent plaintiffs from bringing "second thought," or stale complaints.⁷⁰ Almost all jurisdictions have held that timely filing of an EEOC charge within the limits prescribed by § 2000e-5(e) is a jurisdictional prerequisite to bringing suit under Title VII.⁷¹ However, as noted in previous discussion, judicial exceptions to the time requirements have evolved in continuing violation cases.⁷²

Even if *Evans*' situation falls within one of the judicial exceptions to the

65 42 U.S.C. § 2000e-5(g) (Supp. II 1972) reads in pertinent part as follows:

Back pay liability shall not accrue from a date more than two years prior to the filing of a charge with the Commission. Interim earnings or amounts earnable with reasonable diligence by the person or persons discriminated against shall operate to reduce the back pay otherwise allowable . . .

66 424 U.S. at 791 n.9 (Powell, J., dissenting).

67 See text accompanying note 52, *supra*.

68 534 F.2d at 1250.

69 *Burnett v. New York Cent. R.R. Co.*, 380 U.S. 424, 428 (1965).

70 *Culpepper v. Reynolds Metals Co.*, 421 F.2d 888, 892 (5th Cir. 1970).

71 Prior to *Evans*, many courts held that discriminatory terminations of employment were independent, single violation of the Civil Rights Act, each sufficient to start the statutory period for filing. See *Collins v. United Air Lines, Inc.*, 514 F.2d 594 (9th Cir. 1975); *Olson v. Rembrandt Printing Co.*, 511 F.2d 1228 (8th Cir. 1975); *Dudley v. Textron, Inc.*, 386 F. Supp. 620 (E.D. Pa. 1975); [1976] EEOC v. South Carolina Nat'l Bank, 11 Empl. Prac. Dec. ¶ 10,932 (S.C. Mar. 25, 1976); [1976] *Buckingham v. United Air Lines, Inc.*, 11 Fair Empl. Prac. Cases 344 (C.D. Cal. June 12, 1975).

72 See text accompanying notes 40-51, *supra*.

filing requirements of § 2000e-5(e), the delay problem cannot be ignored. Traditionally, in the absence of a statute of limitations, the equitable defense of laches has been available. The Fifth Circuit has indicated that a laches defense may be raised in Title VII actions. The court, in its treatment of *Franks v. Bowman Transportation Co., Inc.*,⁷³ stated that:

In a proper case, laches might be applied to bar a claim entirely, or it might bar only part of the remedy sought, such as the backpay award or a portion of it.⁷⁴

The defense of laches requires a showing that plaintiff's lack of diligence in asserting a claim has caused injury, prejudice or disadvantage to a defendant to the extent that it is inequitable to allow the claim to be enforced.⁷⁵

Laches was successfully used as a defense to a Title VII action in *EEOC v. South Carolina National Bank*.⁷⁶ There the court dismissed an employee's charge when the employer first received notice of the claim more than three years after it was filed.⁷⁷ The court held the delay damaged the employer's ability to respond to the charge.⁷⁸ If a continuing violation is found in *Evans*, the applicability of the equitable defense of laches to bar the action, or at least limit recovery, should be considered. The court's opinion indicates no attempt by the plaintiff to pursue the union grievance procedure in 1968⁷⁹ or to reapply for employment with United or any other airline. Moreover, Evans waited a full year after her reinstatement before complaining of loss of pay and seniority. The court made no inquiry into these matters; nor did it evaluate the legal significance of Evans' delay. A possible consequence of the *Evans* court's disregard of the four years between 1968 and 1972 might be that future employers may be subject to indefinite periods of liability to those victims of discrimination whom they have reemployed.

If Evans ultimately is allowed full retroactive seniority, each year of her delay will have served to increase the costs of restoration to both employer and employees.⁸⁰ The costs may well be unrealistic, since the relief would be based on the assumption that Evans would have remained a United stewardess from 1968 through 1972. Any number of reasons, however, might have prevented her from continuing as an employee during this entire period.

73 495 F.2d 398 (5th Cir. 1975).

74 *Id.* at 405.

75 BLACK'S LAW DICTIONARY 1016-17 (4th ed. 1968). See also 2 J. POMEROY, EQUITY JURISPRUDENCE § 419-d (5th ed. S. Symons 1941).

76 [1976] 11 Empl. Prac. Dec. ¶ 10,932 (S.C. Mar. 25, 1976).

77 On Dec. 29, 1971, seven months after the employer's allegedly discriminatory refusal to reinstate the employee following maternity leave, she filed a charge with the EEOC. The employer received bare notice on May 14, 1971, that a "hiring" charge had been filed, but the notice contained nothing more about the specific complaint. Not until Sept. 10, 1974, did the employer receive an "amended" charge identifying the former employee and her complaint. *Id.* at 7931-32.

78 *Id.* at 7933-34. See also *EEOC v. C & D Sportswear Corp.*, 398 F. Supp. 300 (M.D. Ga. 1975).

79 534 F.2d at 1248 n.2. See text accompanying note 5, *supra*.

80 A trial court might consider limiting Evans' retroactive seniority benefits to a maximum of two years before she filed her EEOC charge—such a limitation would parallel the two-year limitation on back pay in Title VII actions as provided in 42 U.S.C. § 2000e-5(g) (Supp. II 1972). See text accompanying notes 65-66, *supra*.

Finally, success of Evans' theory might have the undesirable social effect of discouraging employers from rehiring persons against whom they discriminated years ago. Employers may be unwilling to pay rehired employees additional wages, and unwilling to disrupt the seniority status of their present employees.⁸¹ In addition, if employers were to refuse to reinstate on these grounds, the applicants might be able to allege in new charges—on the basis of Evans' theory of continuing violation—that the employer's refusal to rehire them "perpetuates" the effects of the previous discrimination.⁸²

Conclusion

In *Evans*, the Seventh Circuit applied a continuing violation theory to permit a suit in 1973 based on an unlawful discrimination which occurred in 1968. Under the continuing violation theory, the filing time requirements of the Civil Rights Act of 1964 are modified to allow suits filed during the operation of an otherwise nondiscriminatory company policy, if the policy is deemed to perpetuate the effects of a prior discriminatory act. Suit is permitted even though the time period for filing against the prior unlawful practice has expired.

In *Evans*, unlike other continuing violation cases, there was a gap of four years between the time of the unlawful practice and the point at which the effects of the practice were experienced through the operation of the otherwise lawful seniority policy. The Seventh Circuit failed to accord sufficient weight to this critically distinguishing feature in its application of the continuing violation theory.

Furthermore, by ignoring the time gap in *Evans*, the court left important questions unanswered. The court did not inquire into Evans' employment activities during her four-year separation from United. The court did not question whether she sought employment during this period with United or any other employer. Further, the court did not question whether United refused to reemploy Evans at any time before 1972, and if it did, for what reason. Had these questions been addressed, it would have been easier for the court to balance the competing interests of other parties potentially affected by Evans' claim: namely, other employees hired after Evans' termination whose seniority rights would be affected by a grant of full retroactive seniority to Evans; and the employer, who may be subject to liability for an indefinite period of time for past acts of discrimination as a result of the Seventh Circuit's decision.

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81 The problem of employers' reluctance to rehire former employees with full seniority and back pay is discussed in the original *Evans* opinion, [1976] 11 Empl. Prac. Dec., at 6814 n.6.

82 See 405 F. Supp. 426 (N.D. Cal. 1975), discussed at note 49, *supra*. See also REPORT OF THE UNITED STATES COMMISSION ON CIVIL RIGHTS, LAST HIRED, FIRST FIRED: LAYOFFS AND CIVIL RIGHTS (February, 1977) at 34-35, in which the Commission urges courts to go beyond *Franks*, by awarding back pay and constructive seniority from the date individuals would have applied for work with an employer but did not because of the employer's reputation for discriminatory hiring practices. The Report recommends that these later hired employees be eligible for back pay and seniority from the date they originally would have applied for work if they can show they were finally hired by the employer, that they were a resident in the area at the time the employer engaged in discriminatory hiring practices, and that they would have applied for work earlier if not for the employer's discriminatory hiring practices.

DUE PROCESS—DUE PROCESS SAFEGUARDS ARE INVOKED WHEN A STATE SERIOUSLY INJURES THE REPUTATION OF AN EMPLOYEE IN THE COURSE OF DISCHARGING HIM FROM STATE EMPLOYMENT

*Colaizzi v. Walker**

On July 16, 1974, Illinois Governor Dan Walker dismissed state employees Samuel Colaizzi, the Superintendent of the Division of Private Employment Agencies of the Illinois Department of Labor, and Samuel Indovina, an investigator in that division. The Governor explained this action in two press releases issued that same day. According to these statements, Colaizzi and Indovina were discharged because an investigation revealed that they had abused their official positions by attempting to coerce Zenith Associates, an employment agency, into dropping or reducing charges which it had instituted against a former employee.¹ When Zenith refused to cooperate in the manner requested, Colaizzi and Indovina subjected it to a sustained period of administrative harassment.² The statement which announced the appointment of Colaizzi's successor made it clear that the two men were discharged because they had "attempted to use the power of their office to force a company under their supervision to drop possible criminal actions against an employee."³

After their dismissal, Colaizzi and Indovina filed a complaint in United States district court, alleging violations of their fourteenth amendment rights. Claiming that the allegations contained in the press releases were disseminated without notice, and that they were not given an opportunity to refute the Governor's charges,⁴ the plaintiffs contended that this procedure deprived them of a constitutionally protected liberty interest.⁵ The complaint asked for damages

* 542 F.2d 969 (7th Cir. 1976), petition for cert. filed, 45 U.S.L.W. 3437 (U.S. Dec. 21, 1976) (No. 785).

1 *Id.* at 971.

2 *Id.* This harassment consisted of the institution and subsequent abandonment of Department of Labor charges, the arrest of the owners of Zenith and abandonment of these criminal charges, and the temporary suspension of Zenith's officers from the employment agency business after the filing of new Department of Labor charges.

3 *Id.*

4 *Id.*

5 *Id.* The word "liberty" in the fourteenth amendment encompasses a multitude of personal interests which are "difficult of definition," as the Supreme Court states in *Paul v. Davis*, 424 U.S. 693, 710 (1976). Mr. Justice Brennan, in his dissent in *Paul*, collected a number of often quoted Supreme Court statements about the concept of "liberty" in an attempt to demonstrate the broad sweep of the protection it affords. *Id.* at 722-23. In *Board of Regents v. Roth*, 408 U.S. 564 (1972), the Court emphasized that "[i]n a Constitution for a free people, there can be no doubt that the meaning of 'liberty' must be broad indeed." *Id.* at 572. Earlier, in *Meyer v. Nebraska*, 262 U.S. 390 (1923), the Court noted that

the term has received much consideration and some of the included things have been definitely stated. Without doubt, it denotes not merely freedom from bodily restraint but also the right of the individual to contract, to engage in any of the common occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized . . . as essential to the orderly pursuit of happiness by free men.

Id. at 399. Thus, the discussion concerning the existence of a liberty interest in cases such as *Colaizzi* involves only a few of the values which may, as aspects of "liberty," be protected from state infringement under the fourteenth amendment. See note 55 *infra*, for the Supreme Court's distinction between liberty interests which invoke procedural safeguards and those which act as substantive restraints on state actions.

and injunctive relief against Governor Walker and two members of the state Office of Special Investigations. This prayer for relief was based on 42 U.S.C. § 1983, one of the Civil Rights Acts of 1871, which provides a remedy at law or in equity against persons who, under color of state law, deprive a citizen of the United States of the rights guaranteed to him by the Constitution and laws of the United States.⁶ The district court dismissed this portion of the complaint because it failed to state a claim upon which relief can be granted.⁷

On appeal, the Seventh Circuit reversed this dismissal and held that the complaint did state a claim cognizable in federal court under § 1983. The court concluded that when state officials discharge a person from employment, and in the course of such termination release information which stigmatizes that person's reputation, they infringe a constitutionally protected liberty interest. The existence of this interest requires that state officials accord the employee due process, such as, for example, notice and an opportunity to be heard. Failure to comply with these safeguards results in an unconstitutional deprivation of the "liberty" protected by the fourteenth amendment.⁸

In reaching its conclusion, the Seventh Circuit relied primarily on two Supreme Court decisions, *Wisconsin v. Constantineau*⁹ and *Board of Regents v. Roth*,¹⁰ and on a Seventh Circuit case, *Adams v. Walker*.¹¹ In so deciding, the court was forced to distinguish *Paul v. Davis*,¹² a recent Supreme Court case.¹³

This comment will consider the holding in *Colaizzi* in light of the body of

6 42 U.S.C. § 1983 (1970) 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.

7 542 F.2d at 972. The complaint contained four counts. Count I contained this charge against Governor Walker and the Office of Special Investigations employees; the claim was based not only on 42 U.S.C. § 1983, but also on 42 U.S.C. §§ 1981 and 1985 (1970). The district court dismissed this count for failure to state a claim, and the Seventh Circuit upheld the dismissal as it concerned §§ 1981 and 1985. *Id.* The body of this comment deals with the Seventh Circuit's disposition of the § 1983 claim.

Count II was a defamation action against the same three defendants based on the federal court's pendent jurisdiction. The district court also dismissed this count for failure to state a claim. The Seventh Circuit affirmed this dismissal against the Governor and one of the employees because of their immunity from suit under state law. The defamation claim against the other employee of the Office of Special Investigations was remanded for further findings of fact. *Id.* at 971, 974.

Count III alleged a conspiracy among the three defendants already mentioned, plus two employees of Zenith, the employment agency involved in the case. The trial court dismissed the count, for failure to state a claim, with regard to the first three defendants, and granted judgment on the pleadings to the other two defendants. On appeal, the Seventh Circuit, without extensive discussion, reversed, stating that a claim was presented under 42 U.S.C. § 1983. *Id.*

Count IV was also a defamation action, against the two employees of the employment agency and the agency itself. The district court entered judgment on the pleadings for the defendants. The Court of Appeals reversed, on the grounds that the district court would consider this count pendent to Count III. *Id.*

8 *Id.* at 972. The Seventh Circuit simply decided that the complaint stated a cause of action. The court did not specify the particular procedures which must be followed in order to satisfy the due process requirement.

9 400 U.S. 333 (1971).

10 408 U.S. 564 (1972).

11 492 F.2d 1003 (7th Cir. 1974).

12 424 U.S. 693 (1976).

13 See 542 F.2d at 972.

case law which grew out of decisions such as *Constantineau* and *Roth*. It will also discuss the impact of *Paul* on this body of law. The Seventh Circuit's decision in *Colaizzi* is clearly consistent with the law prior to *Paul*, and is arguably within the scope of *Paul*. Although the Supreme Court has never squarely addressed the issue presented in *Colaizzi*, there is language in *Paul* which the Seventh Circuit used, correctly it seems, to distinguish those two cases. The implications of *Paul*, however, pervade this whole area of the law. These implications raise questions about the vitality of *Colaizzi*, and suggest that, even if *Colaizzi* itself is correct on its narrow facts, its rationale will not extend beyond these facts. The very narrowness of *Colaizzi* serves as a reminder that *Paul* casts doubt on the continued viability of some of the earlier broader holdings of the Seventh Circuit. The decision in *Colaizzi* and the questions it raises also illustrate that an exact definition of the "liberty" which will call forth the procedural due process safeguards of the fourteenth amendment has not yet been successfully formulated.

Constantineau and Roth

A full understanding of the decision in *Colaizzi* requires an examination of the two cases which are primarily responsible for the development of the "liberty interest" concept involved in cases such as *Colaizzi*. The roots of the concept that due process guarantees are invoked when a state seriously impairs the reputation of a person in the course of terminating his state employment lie in the 1971 decision of the Supreme Court in *Wisconsin v. Constantineau*.¹⁴ That case involved a state statute which authorized certain individuals, mostly local officials, to prohibit persons, who were thought to be troublesome to the community because of "excessive drinking," from buying or receiving liquor.¹⁵ Acting pursuant to the authority granted in this statute, a police chief circulated notices in retail liquor outlets which forbade the sale or gift of liquor to appellee for a year. The chief implemented this prohibition without notifying appellee or giving her the opportunity to be heard.¹⁶

The Supreme Court affirmed a lower court decision that the Wisconsin statute which established this procedure was unconstitutional because it denied to persons such as appellee the rudiments of due process. The Court concluded that, "When a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential."¹⁷

The Supreme Court elaborated on this concept in its decision the next year

14 400 U.S. 333 (1971).

15 *Id.* at 434.

16 *Id.* at 435.

17 *Id.* at 437. This sentence was quoted by the Seventh Circuit in *Colaizzi*. 542 F.2d at 972. One portion of the opinion in *Constantineau* which is relevant in light of the restrictive reading given to *Constantineau* by the Supreme Court in *Paul* is the following statement of the issue: "The only issue present here is whether the label or characterization given a person by 'posting,' though a mark of serious illness to some, is to others such a stigma or badge of disgrace that procedural due process requires notice and an opportunity to be heard." 400 U.S. at 436. Mr. Justice Brennan points out, in his dissent in *Paul*, that the *Paul* Court was effectively denying that this was the "only issue" involved in *Constantineau*. 424 U.S. at 730. For a discussion of *Paul*, see notes 42-49, *infra* and accompanying text.

in *Board of Regents v. Roth*.¹⁸ Roth was a non-tenured teacher at a state university. He received notice from the university president that he would not be rehired for the following year; the president gave no reasons for this action. Roth was not afforded an opportunity to seek administrative or judicial review of the decision, and brought suit claiming that this procedure denied him his fourteenth amendment rights.¹⁹

The Supreme Court held that this summary procedure for discharging non-tenured teachers did not violate any constitutional rights. No "property" or "liberty" right recognized by the fourteenth amendment was involved. Therefore, procedural due process did not come into play.²⁰ In the course of its decision the Court nevertheless intimated that there "might" be circumstances in which refusal to rehire an employee could infringe a liberty interest. It employed a two-tiered approach to determine whether such an infringement had occurred; later courts have used this approach as a standard for determining whether or not a protected liberty interest exists. First, the Court noted that since no serious allegation against Roth accompanied the decision not to rehire him, there was no impairment of his reputation in the community.²¹ Here the Court quoted the passage in *Constantineau* which required that notice and an opportunity to be heard be given when the state impugns a person's "good name, honor, reputation, or integrity."²² Second, the Court concluded that there had been no action on the part of the state which would substantially hinder Roth's search for future employment.²³ The *Roth* Court did not expressly state that the presence of either of these conditions would necessarily invoke a liberty interest.²⁴ Later courts, however, have interpreted this language as providing guidelines useful in deciding whether a person has been deprived of a liberty interest without due process. *Constantineau* and *Roth* thus provide the theoretical framework which the Seventh Circuit has used in deciding cases such as *Colaizzi v. Walker*.

Application of the Principle: The Seventh Circuit

In *Lipp v. Board of Education of City*,²⁵ the Seventh Circuit applied the principles enunciated by the Supreme Court in *Constantineau* and *Roth*. There, plaintiff was a substitute schoolteacher. He alleged that the procedure used to evaluate his performance violated the due process requirements

18 408 U.S. 564 (1972).

19 *Id.* at 566-8.

20 In deciding that no "property" interest was involved, the Court noted that the Constitution does not create property interests. Rather, they are defined by "an independent source such as state law." 408 U.S. at 577. Roth's status as a non-tenured teacher in Wisconsin meant that he had "absolutely no interest in re-employment for the next year," and thus no cognizable fourteenth amendment "property" right. *Id.* at 578. Property rights are not at issue in *Colaizzi*, since there was no allegation of any infringement of a property right. 542 F.2d at 972.

21 408 U.S. at 573. "The State, in declining to rehire the respondent, did not make any charge against him that might seriously damage his standing and associations in the community."

22 See note 17, *supra*.

23 408 U.S. at 573. "Similarly, there is no suggestion that the State, in declining to re-employ the respondent, imposed on him a stigma or other disability that foreclosed his freedom to take advantage of other employment opportunities."

24 *Id.* at 573-4. The Court did indicate that if either of these factors had been present in *Roth*, it "would be a different case."

25 470 F.2d 802 (7th Cir. 1972).

of the fourteenth amendment.²⁶ Lipp's efficiency rating, compiled by his principal, noted that Lipp exhibited a "negative attitude toward the school" and an "anti-establishment obsession." The court of appeals rejected the contention that this statement violated a "liberty" interest and thus invoked the protection of the fourteenth amendment. In so doing, the court employed the two-level inquiry first utilized in *Roth* to determine whether a liberty interest existed.²⁷ First, the court concluded that the "anti-establishment" label did no "serious damage" to Lipp's "standing and associations" in the community.²⁸ To complete its analysis, the Seventh Circuit reasoned that the inclusion of this unfavorable information in a report which otherwise expressed satisfaction with Lipp did not sufficiently infringe his "freedom to take advantage of other employment opportunities" to warrant the imposition of procedural due process safeguards.²⁹

Implementing this same test in *Suarez v. Weaver*,³⁰ the Seventh Circuit concluded that a liberty interest had been infringed. That case involved a doctor, who had participated in the medical assistance program of the Illinois Department of Public Aid. He was discharged from the program because there was evidence that he had written an excessive number of prescriptions for dangerous narcotics. This information was conveyed to the doctor in a letter, and was also forwarded to the state agency in charge of licensing and regulating physicians in Illinois.³¹ The doctor was afforded no opportunity to rebut the damaging evidence, nor was he notified prior to his discharge.

The Seventh Circuit held that under these circumstances the state had deprived the doctor of his constitutional right to procedural due process. The court noted that the boundary between allegations that "trigger procedural protection" and those that do not was as yet uncertain. However, it suggested that "past cases establish that charges which may become public and which suggest immorality, dishonesty, mental deficiency, or abnormal emotional imbalance invoke due process considerations."³² While the court did not work through the two-level analysis which it had utilized in *Lipp*, it concluded that the charge against the doctor, which was communicated to the licensing body, "sufficiently implicate[d] plaintiff's reputation as a practicing doctor and as a citizen" to warrant the invocation of procedural safeguards such as an administrative hearing.³³

The Seventh Circuit made a further attempt to flesh out these standards in *Adams v. Walker*,³⁴ a 1974 case cited in *Colaizzi*.³⁵ In *Adams*, the Governor

26 *Id.* at 803.

27 See notes 21 and 23, *supra*.

28 470 F.2d at 805, quoting in part the *Roth* test, 408 U.S. at 573.

29 *Id.* A similar Seventh Circuit case, in which failure to rehire a non-tenured teacher, not accompanied by any serious charges against her, was held not a circumstance in which procedural due process was required, is *Shirck v. Thomas*, 486 F.2d 691 (7th Cir. 1973).

30 484 F.2d 678 (7th Cir. 1973).

31 *Id.* at 679.

32 *Id.* at 680-81.

33 *Id.* at 679, 681. This decision seems consistent with the current state of the law after *Paul*, since the episode occurred in the course of his discharge from employment. However, one statement of the court in *Suarez* has definitely been invalidated by the Supreme Court's decision in *Paul*. The Seventh Circuit in *Suarez* prefaced its discussion with the remark that reputation is sufficient to trigger procedural due process protection. *Id.* at 680. *Paul* flatly rejected this proposition. See notes 42-49, *infra* and accompanying text.

34 492 F.2d 1003 (7th Cir. 1974).

35 542 F.2d at 972, 974.

of Illinois dismissed the chairman of the Illinois Liquor Control Commission, stating in a telegram to the chairman that the removal was based on "incompetence, neglect of duty and malfeasance in office. . ."³⁶ Adams, the discharged official, claimed that the action violated a constitutionally protected liberty interest.

The Seventh Circuit rejected this contention after considering both prongs of the *Roth* test. It concluded that an "unelaborated charge" of the sort made against Adams does not involve sufficient implications of dishonesty, immorality, or similar faults to meet the first half of the test. While words such as "malfeasance" might indeed appear to seriously impair a person's reputation, the court admonished against reading such language out of context.³⁷ The words used in the telegram to Adams constituted a "talismanic phrase" laid out in a state constitutional provision dealing with the removal of certain state officers by the governor. The Illinois courts had interpreted this particular provision as imposing no specific requirements on the governor in determining to discharge an employee for incompetence or malfeasance; no objective standards exist to limit his decision.³⁸ Thus, the Seventh Circuit read the governor's recitation of the required language as a mere statement that "I am dismissing you because I think I can find a better liquor commissioner."³⁹ Such a statement, according to the court, did not impugn Adams' integrity in such a way as to infringe a liberty interest.

Although the court recognized that there was substantial "overlap" between the two prongs of the *Roth* test, it nevertheless proceeded to inquire as to whether Adams would thereby be foreclosed from taking advantage of other employment opportunities. The court noted that Adams was not disqualified from future government employment, nor was there the danger that existed in *Suarez*, in which potentially devastating charges were sent to plaintiff's professional licensing body.⁴⁰ Since neither aspect of the *Roth* test was met, the court concluded that no liberty interest protected by the fourteenth amendment had been infringed.

Thus, in the years following *Constantineau* and *Roth*, the Seventh Circuit gradually developed a body of case law useful in determining whether or not particular state conduct violated a liberty interest, as that concept had been defined in *Constantineau* and *Roth*. Were it not for the intervening decision in *Paul*, *Colaizzi* simply would have been another in this continuing line of cases. As the court stated in *Colaizzi*, "The charges contained in the press release . . . charged sufficiently reprehensible conduct so as to impugn the good name and reputation of Colaizzi and Indovina, and thus appear to fall squarely within the language of *Constantineau*."⁴¹ However, the Seventh Circuit realized that its task in *Colaizzi* was somewhat complicated by the Supreme Court's decision in *Paul v. Davis*, and it proceeded to confront the implications of that case.

36 492 F.2d at 1004.

37 *Id.* at 1007.

38 *Id.* at 1004-5.

39 *Id.* at 1008.

40 *Id.* at 1008-09. In the court's words, there was no indication of a "legal barrier to future employment." This "legal barrier" interpretation of the *Roth* test will be discussed later, see notes 81 and 82 *supra* and accompanying text.

41 542 F.2d at 972.

Paul v. Davis

In *Paul*, police in Louisville, Kentucky, circulated among local merchants the names and pictures of persons designated by the police as "active shoplifters." Respondent Davis' name appeared on that list. Although Davis had been arrested at one time for shoplifting, he had never been convicted of that offense, the charge against him having been "filed away with leave [to reinstate]."⁴² Based on these facts, Davis filed suit under § 1983 claiming that the liberty guaranteed him by the fourteenth amendment had been infringed without due process of law.⁴³ The Supreme Court reversed a Court of Appeals decision in favor of Davis, in part because the word "liberty" does not "single out reputation as a candidate for special protection over and above other interests that may be protected by state law."⁴⁴ In other words, mere stigmatization of a person's character by a state does not warrant the invocation of procedural due process protection. Thus, Davis would have to establish more than injury to reputation in order to state a claim.

This holding seems clearly antagonistic to the underlying spirit of *Constantineau*.⁴⁵ Nonetheless in *Paul* the Supreme Court distinguished, rather than overruled, its earlier holding in *Constantineau* that "[w]hen a person's good name, reputation, honor, or integrity is at stake *because of what the government is doing to him*, notice and an opportunity to be heard are essential."⁴⁶ According to the Court's analysis in *Paul*, this does not mean due process safeguards must be applied whenever the state defames an individual. Rather, the Court read the clause, "because of what the government is doing to him," as referring not only to a detrimental characterization by the state but also to a simultaneous deprivation of a "right" or "status" previously accorded the defamed person. Thus, according to *Paul*, the constitutional claim in *Constantineau* arose not solely from plaintiff's being designated a drunkard, but from the fact that Constantineau, in the course of being so labelled, was deprived of her right to buy liquor. Thus, "it was the alteration of legal status which, combined with the injury resulting from the defamation, justified the invocation of procedural safeguards."⁴⁷

The Court similarly characterized the *Roth* inquiry as having sprung not from a mere concern that the state might have damaged Roth's reputation, but from the fact that any stigmatization would "occur in the course of the termination of employment."⁴⁸

From this analysis the Court drew the conclusion that the state must do more than seriously damage a person's reputation before it is constitutionally required to comply with due process safeguards. In *Constantineau* and *Roth* the added requirement was satisfied by the "alteration of legal status" which accompanied the injury to reputation. The *Paul* Court did not list all of the state

42 424 U.S. at 695-96.

43 *Id.* at 696, 701.

44 *Id.* at 701.

45 See note 17, *supra*.

46 424 U.S. at 708 (emphasis supplied in *Paul*).

47 *Id.* at 708-09.

48 *Id.* at 710.

activities which might satisfy this test, but it did indicate that "tangible interests" must thereby be affected.⁴⁹

Paul and Colaizzi

A restrictive attitude toward the concept of a "liberty" interest pervades the decision in *Paul*. Nevertheless, the Seventh Circuit's approach in *Colaizzi* appears consistent with the Court's delineation in *Paul* of such interests. In distinguishing *Roth*, the Supreme Court noted that a liberty interest would be found in such cases only when stigmatization actually occurred in the course of termination of state employment.⁵⁰ This analysis perhaps signals a more restrictive interpretation of *Roth* than had previously prevailed. However, it also recognizes that *some* state-inflicted injury to reputation can infringe a constitutionally protected right, provided that the facts fit into the rigid formula enunciated in *Paul*. The essence of *Paul* is that mere injury to reputation, even though state inflicted, is insufficient to invoke a liberty interest. This attitude is demonstrated by the Court's description of the vital element lacking in *Davis*' case; the Court noted that the only value involved was reputation, "apart from some more tangible interests such as employment."⁵¹ The clear implication of such language is that serious injury to reputation, occurring in the context of termination of government employment, would be an infringement of liberty that would invoke the procedural safeguards of the fourteenth amendment.

In distinguishing *Paul* from the result reached in *Colaizzi* the Seventh Circuit emphasized this language. After examining the *Paul* Court's reading of *Roth*, the court concluded that the loss of employment which accompanied the injury to the reputations of Colaizzi and Indovina sufficed to distinguish *Colaizzi* from *Paul*.⁵² In other words, there was much more in this case than the mere injury to reputation which was found insufficient in *Paul*. The requirement that a tangible loss accompany the injury to reputation was satisfied.

Thus, according to the Seventh Circuit, *Colaizzi v. Walker* is perfectly consistent with the rationale of *Paul*. This conclusion appears valid given the specific language in *Paul* indicating that employment is a sufficient tangible interest.⁵³ There is, however, other language in *Paul* which makes the conclusion that *Colaizzi* is squarely within its scope less certain. The difficulty arises from the Supreme Court's definition of the type of harm which must occur in order to

49 *Id.* at 701, 710.

50 *Id.* at 709. See note 48, *supra* and the accompanying text.

51 *Id.* at 701 quoted in *Colaizzi*, 542 F.2d at 973.

52 542 F.2d at 973-74.

53 In *Stretten v. Wadsworth Veterans Hospital*, 537 F.2d 361 (9th Cir. 1976), the Ninth Circuit noted that *Paul* had not eliminated the concept of the constitutionally protected "liberty" interest. The court considered the loss of a residency position by a doctor as a sufficient "tangible loss" to fulfill the *Paul* requirements. *Id.* at 365. Similarly, the Second Circuit in *Huntley v. Community School Bd.*, 543 F.2d 979 (2d Cir. 1976), *petition for cert. filed*, 45 U.S.L.W. 3101 (U.S. Aug. 3, 1976) (No. 104) read *Paul* as a reiteration of the concept that "the protections of the Fourteenth Amendment are available whenever the state, in terminating an individual's employment, makes charges against him that will seriously impair his ability to take advantage of other employment opportunities." 543 F.2d at 985.

A recent commentary on this issue concluded that *Paul* does not remove the protection of procedural due process from state employees who are wrongfully dismissed from their positions. Lowy, *Constitutional Limitations on the Dismissal of Public Employees*, 43 BROOKLYN L. REV. 1, 12 (1976).

infringe a "property" or "liberty" interest and thus invoke fourteenth amendment safeguards. The *Paul* Court characterized this harm as a combination of a tangible loss occurring with injury to plaintiff's reputation, and concluded that Davis' claim must fail because there was not the requisite "denial of any right vouchsafed to him by the State and thereby protected under the Fourteenth Amendment."⁵⁴ Earlier in the opinion the Court indicated that the "liberty" and "property" which must be infringed in order to invoke the procedural safeguards of the fourteenth amendment derive their special status from the fact that they have either been "recognized and protected by state law" or applied to the states through the process of incorporation of provisions of the Bill of Rights.⁵⁵

This language raises a problem which the Seventh Circuit failed to address in *Colaizzi*. Although the Supreme Court clearly implied in *Paul* that injury to reputation occurring in the course of discharge from employment infringes a liberty interest and thus invokes due process safeguards, it is not clear that this combination of circumstances will always fit within the *Paul* Court's definition of liberty interests. In its opinion the Court stated that in order for a liberty interest claim to succeed, there must be deprivation of a right "vouchsafed . . . by the State." It appears that, under state law, the Governor was free to fire *Colaizzi* and *Indovina* without notice or an opportunity to be heard. In light of this aspect of their employment, it is difficult to see how the Governor's action deprived them of any protected right. While such employment may be a "status" that is "recognized" by a state, it is not readily apparent that this position is "protected by state law" in such a way as to fit within the limited range of protection announced by the Supreme Court. The *Paul* Court interpreted the decision in *Roth* as an indication that injury to reputation, accompanied by loss of a "tangible" interest such as employment, would be an infringement of a protected liberty interest. It is clear that damage to reputation is not an alteration of a right "protected by state law." As the Court noted in *Paul*, "Kentucky law does not extend to respondent any legal guarantee of present enjoyment of reputation. . . ."⁵⁶ It is not clear that the addition of the factor of discharge from employment will always suffice to bring the plaintiff within the Court's definition of liberty interests. When there is doubt as to whether particular employment is "protected by state law," there necessarily seems to be uncertainty about the conclusion that loss of this employment, coupled with state-inflicted injury to reputation, infringes a liberty interest. While this limited enumeration appears to cast doubt upon the Supreme Court's suggestion that loss of employment, coupled with impairment of reputation, warrants constitutional protection, neither the Supreme Court in *Paul* nor the Seventh Circuit in *Colaizzi* attempted to reconcile any of this potentially conflicting language.

Thus, while the result in *Colaizzi* appears to be supported by *Paul*, given the Supreme Court's specific allusion to employment as a sufficient tangible interest, the more restrictive language discussed above suggests some uncertainty

⁵⁴ 424 U.S. at 712.

⁵⁵ *Id.* at 710-11. The Court specifies that this enumeration does not circumscribe the "substantive limitations" on state action necessitated by the word "liberty," but only applies to those liberty interests which invoke procedural safeguards.

⁵⁶ *Id.* at 711.

as to the exact scope of such interests. Indeed, when the facts of *Colaizzi* are analyzed according to the *Paul* Court's definition of liberty interests, it is questionable whether such a liberty interest is, in fact, present. Yet, the circumstances in *Colaizzi* do seem to fall squarely within the example of a liberty interest provided by *Paul* in its discussion of *Roth*. Because of this fact, the court of appeals did not feel compelled to examine the facts in *Colaizzi* under the more limited definition. The emphasis in *Paul* on employment, as well as the uncertain significance of the *Paul* Court's unelaborated definition of liberty, appear to justify the *Colaizzi* court's interpretation of *Paul*.⁵⁷ Furthermore, the Seventh Circuit's analysis is consistent with recent cases in other Circuits. In those cases, loss of state employment was enough to satisfy the tangible deprivation requirement.⁵⁸ However, it should be recognized that any attempt to expand the principle of *Colaizzi* beyond the loss of employment context might fail if the restrictive language in *Paul* is applied.

The conclusion of the *Colaizzi* court that the discharge from employment sufficed to distinguish the instant case from *Paul* was not in itself dispositive of the appeal. The Seventh Circuit also had to determine that the injury to reputation was itself sufficient in light of established standards. The court noted that these allegations of abuse of authority were serious enough to "gravely stigmatize" the reputations of the two state employees.⁵⁹ Such charges clearly meet the test which has developed from *Constantineau* and *Roth*, and the Supreme Court in *Paul* did not intimate any disapproval of these standards. *Paul* enunciated the requirement that for a state-induced stigma to reputation to be actionable it must occur in conjunction with a tangible loss of some sort. *Paul* did not, however, alter the criteria used to determine if a sufficient stigma exists in the first place. In this sense, the interpretation of *Constantineau* and *Roth* seems unchanged. Having found this combination of "stigma plus discharge," the Seventh Circuit concluded that the complaint did state a cause of action "for deprivation of a Fourteenth Amendment liberty interest without due process."⁶⁰

Unanswered Questions

The continued vitality of cases such as *Colaizzi* thus depends to some extent upon whether the facts in each particular instance will fit into the theoretical structure created over the years by *Constantineau*, *Roth*, and *Paul*. However, the very nature of such litigation necessarily involves competing values. Thus, the claims of plaintiffs cannot be successfully resolved by the mere declaration that

57 In his dissent in *Paul*, Justice Brennan attacked this narrow view of the notion of liberty. He claimed that "we have never restricted 'liberty' interests in the manner the Court today attempts to do." 424 U.S. at 722 n.10. In a footnote to the *Huntley* case, discussed in note 53, *supra*, the Second Circuit raised the issue of this restrictive wording in *Paul*. The court concluded that liberty and property interests must "ordinarily" derive from state law or from the Constitution itself, but that "this need not always be the case." 543 F.2d at 986 n.8.

In *Mitchell v. King*, 537 F.2d 385 (10th Cir. 1976), the Tenth Circuit stressed the fact that the definition in *Paul* includes both state rights and Bill of Rights protections which have been incorporated into the fourteenth amendment. However, the court did not speculate as to whether constitutional protection extended beyond this range. *Id.* at 390-92.

58 See note 53, *supra*.

59 542 F.2d at 973-74.

60 *Id.* at 973.

a certain set of facts implicates constitutionally protected rights. Rather, courts must be cognizant of the interests which underpin such disputes and attempt to balance these various interests.⁶¹ Defendants in cases such as *Colaizzi* and *Paul* can usually cite legitimate interests which their disputed action was designed to protect, and which purportedly will suffer from a holding in favor of the plaintiff. A decision that a case involves a liberty interest should signal only the beginning of an attempt to design a remedy which will reconcile the clashing values. The Seventh Circuit in *Colaizzi* was not obliged to balance the various interests and to decide the extent or the form of the necessary procedural protections. Although the court did cite the portion of *Constantineau* requiring "notice and an opportunity to be heard . . .,"⁶² its holding was simply that the complaint stated a claim for relief.⁶³ It remains for the district court to reach a justifiable accommodation of the competing values involved. State government employees certainly have a valid interest in being informed of serious allegations which result in their immediate discharge, and in being afforded an opportunity to refute such allegations. However, state officials, such as Governor Walker, also have an interest in maintaining the integrity of the body of public servants. Expedient removal of persons who have flagrantly abused their positions of authority is necessary in order to maintain public confidence in state government. Both interests are valid in a democratic society, but it does not seem that the power of officials such as Governor Walker will be emasculated if employees are afforded minimum due process safeguards such as notice and an opportunity to be heard. Government employers could comply with these protections and still effectively deal with employees such as *Colaizzi* and *Indovina*. The Supreme Court has stated that no liberty interest is infringed unless there is public announcement of the allegations against the employee.⁶⁴ Thus, there would seem to be no constitutional objection to temporary, summary suspension of alleged wrongdoers, provided that permanent discharge and public announcement of the reasons for it are made only after the accused has been afforded a hearing. In *Arnett v. Kennedy*,⁶⁵ the Supreme Court held that "administrative appeal procedures" which allow recourse to an employee only after the discharge, satisfy the due process requirement.⁶⁶ This decision further evidences the leeway available to employers in such situations. As a result of this decision, a governor could, apparently, fire the suspected employee and announce the reasons immediately, as long as a hearing giving the employee an opportunity to clear his name followed.

Thus, the district court on remand must look beyond the declaration that a

61 One of the criticisms that Mr. Justice Brennan advanced in his dissent in *Paul* was that the Court made an over-broad generalization that reputation alone is *never* a sufficient interest to warrant the invocation of procedural due process safeguards. The proper approach, according to Brennan, would have been to "analyze the question as one of reconciliation of constitutionally protected personal rights and the exigencies of law enforcement." 424 U.S. at 720-21.

62 542 F.2d at 972.

63 *Id.* at 972-73.

64 *Bishop v. Wood*, 96 S. Ct. 2074 (1976). The Seventh Circuit had already recognized this principle in *Shirck v. Thomas*, 486 F.2d 691 (7th Cir. 1973).

65 416 U.S. 134 (1974).

66 *Id.* at 157. "Since the purpose of the hearing in such a case is to provide the person an 'opportunity to clear his name,' a hearing afforded by administrative appeal procedures after the actual dismissal is a sufficient compliance with the requirements of the Due Process Clause."

liberty interest is involved in order to arrive at a conclusion that serves these competing interests well.⁶⁷ The extent of the requisite due process safeguards, and the manner in which they must be observed, are thus not yet certain. However, it appears that affording notice and an opportunity to be heard to persons such as Colaizzi and Indovina protects their legitimate interests without unduly handicapping authorities in the performance of their duties.

Other unanswered questions exist after *Colaizzi* which extend beyond the particular litigation which gave rise to this decision. As noted earlier, *Colaizzi* seems to be supported by the Supreme Court's opinion in *Paul*. However, the narrowness of the Seventh Circuit's decision raises questions concerning the future applicability of the liberty interest concept. As discussed above, the court in *Colaizzi* successfully distinguished *Paul* because there the Supreme Court made specific reference to employment as a tangible interest, deprivation of which is sufficient, when accompanied by state-inflicted defamation, to infringe a liberty interest. The Seventh Circuit thus avoided inquiring into the Supreme Court's apparently new definition of liberty interests. The full significance of the suggestion that such interests may arise only from infringement of rights guaranteed by the state or incorporated from the Bill of Rights into the fourteenth amendment is not yet known.⁶⁸ Cases are likely to arise when an individual who is not being discharged from state employment is defamed by the state; such cases will force the Seventh Circuit to confront this requirement.⁶⁹ One area of uncertainty, for example, concerns the distinction between this "liberty" and the "property" which is similarly protected by the fourteenth amendment. In order for liberty to be involved, the deprivation apparently must be one which alters a "status" or "right" protected by the state. However, the Supreme Court has held that "property" rights also have their origins in state law.⁷⁰ After *Paul*, it is not clear how these interests are to be distinguished.

This narrow basis of the decision in *Colaizzi* also suggests that the opinion will be of limited assistance to the Seventh Circuit in future attempts to apply *Paul*. The Seventh Circuit's task in *Colaizzi* was expedited by the fact that the injury to reputation was clearly inflicted in the immediate course of discharge from employment. As the connection between the stigma and the tangible deprivation required by *Paul* becomes more tenuous, it is conceivable that a court will characterize state-inflicted stigma as mere injury to reputation and thus not constitutionally protected.

The *Lipp* case previously discussed provides an example of a situation in which this problem might arise.⁷¹ There, the Seventh Circuit analyzed the rating

67 The particular litigation which gave rise to the *Colaizzi* decision contains some other unresolved issues. The Seventh Circuit, for example, did not decide the extent to which a qualified good faith immunity would apply to the defendants. The effect which proof of the truth of the allegations would have was not discussed at any length. Also, the court refused to consider in this appeal the claim that an unemployment compensation hearing, which determined that the plaintiffs had abused their positions, satisfied the due process requirement. 542 F.2d at 974-5.

68 See notes 54 and 55, *supra* and accompanying text.

69 In *Sullivan v. Brown*, 544 F.2d 279 (6th Cir. 1976), the Sixth Circuit distinguished transfer of a schoolteacher from outright dismissal. The teacher had been reprimanded, with the reprimand becoming a part of her record, and then transferred to another school. The court found that no liberty interest was implicated. *Id.* at 283-84.

70 For the *Roth* Court's discussion of "property" interests, see note 20, *supra*.

71 See note 25, *supra*.

procedures used to evaluate teachers in light of the *Roth* criteria. Although immediate dismissal may not always result from an extremely unfavorable report, the ratings are related certainly to the continued employment of teachers. In fact, Lipp's rating contained a recommendation that he not be retained.⁷² The Seventh Circuit in *Lipp* concluded that the *Roth* test had not been satisfied. After *Paul*, this inquiry would be made only after a showing of a sufficient link between these allegations and some loss of status. Before the formulation of the *Paul* requirement that some "tangible" loss must accompany the injury to reputation, courts did not focus on the connection between the stigmatization and discharge from employment. Although most prior "liberty" cases involved teachers or other government employees, the decisions centered on the allegations made against the plaintiffs rather than upon their status as employees. It is clear today that a change in this status, occurring in the course of the infliction of injury to reputation, is a prerequisite to any action for deprivation of liberty without due process. Thus, if a teacher such as Lipp were retained in his position despite allegations contained in a rating, there would be no infringement of liberty even if the rating were openly defamatory. It is not as clear, however, exactly how closely related the stigma and the tangible loss must be. If a loss of employment did not occur until some time after the injury to reputation, or if the allegations appear to have played a minor role in the discharge, a court might hold that the tangible loss was not sufficiently connected with the stigma. These questions of proximate cause and of timing were not at issue in cases such as *Lipp*. If a similar case were before the Seventh Circuit today, the court would have to confront such issues before it could even consider the nature of the charges under the *Roth* test.⁷³

Another uncertainty which remains after *Colaizzi* stems from the fact that there has been no uniform determination in the various circuits of what type of charges satisfy the *Roth* test. Thus, even if *Colaizzi* was correct in holding that a liberty interest is infringed whenever serious damage to reputation is accompanied by loss of state employment, it did not provide any guidance in determining just how serious, and of what sort, these charges must be. The *Roth* categorization, discussed earlier, has two components.⁷⁴ The state infringes a liberty interest when it makes charges that (1) so damage reputation as to impair the person's standing and associations, or (2) foreclose the person's freedom to procure future employment. Charges such as those made against *Colaizzi* and *Indovina* so obviously impugn their integrity and honesty that the Seventh Circuit could proclaim the test satisfied by merely citing *Constantineau* and *Roth*.⁷⁵ There was no real need for a sharp differentiation between the two aspects of *Roth*; thus, the Seventh Circuit was spared the necessity of inquiring into the exact scope of these branches.⁷⁶

If, however, the charge is one which does not sufficiently impugn a person's

72 470 F.2d at 803.

73 In *Lipp* itself, there was not even a delayed discharge. In fact, Lipp was re-hired for the following year. 470 F.2d at 805.

74 See notes 21 and 23, *supra*.

75 542 F.2d at 972, 974.

76 Such was also the situation in the *Suarez* case involving the doctor discharged for excessively prescribing narcotics. 484 F.2d at 680-81. The Seventh Circuit discussed this frequent "overlap" in the *Adams* case. 492 F.2d at 1008.

character to satisfy the first aspect of the *Roth* test, it is not clear whether such an allegation will ever be held to foreclose one's opportunities for future employment. In other words, the scope of the second half of the *Roth* test, in those cases in which it must stand apart from the first half, has not been established. Before *Paul* the Seventh Circuit appeared to interpret this standard as encompassing only those state-inflicted injuries which operated to create a "legal disability" which would prevent the plaintiff from pursuing future employment. The court first phrased the test in that manner in *Shirck v. Thomas*,⁷⁷ and pointed to a particular sentence in *Roth* as the basis for this conclusion. By way of illustrating an action which would satisfy the second half of its analysis in *Roth*, the Supreme Court had noted that "[t]he State, for example, did not invoke any regulations to bar the respondent from all other public employment in State universities."⁷⁸

In *Adams v. Walker*, a Seventh Circuit case previously discussed,⁷⁹ the court similarly indicated that no foreclosure of employment opportunity would be found unless the state action involved the erection of a "legal barrier" to the pursuit of future employment.⁸⁰ The court's language on this point is vague, however. It is not entirely clear whether this requirement means that the state must actually disqualify a person from future employment before a liberty interest arises, or whether the initiation of charges that are likely to result in such legal disqualification will suffice.⁸¹ No case has as yet posed this issue; indeed, the Seventh Circuit has never expressly held that the demonstration of a "legal barrier" is the only way the second part of the *Roth* test can be satisfied.⁸² As noted earlier, *Colaizzi* does not resolve this uncertainty. Because the Governor's charges clearly impaired plaintiffs' reputations, the court declared that the stigmatization was sufficient without undertaking an analysis of the two branches of the *Roth* test.⁸³

77 486 F.2d 691 (7th Cir. 1973). See note 29, *supra*.

78 *Id.* at 692, quoting *Roth*, 408 U.S. at 573.

79 See note 34, *supra* and accompanying text.

80 492 F.2d at 1009.

81 One of the cases cited in *Adams* was *Suarez*, where information concerning excessive narcotics prescriptions was sent to the state licensing body. See note 30, *supra* and accompanying text. If the result in this case could be clearly traced to the second branch of the *Roth* test, it would support the proposition that the mere possibility of a future legal barrier as a result of the state-initiated injury to reputation would satisfy the test. However, the charge in *Suarez* impugned the plaintiff's character so severely that the court could declare the test satisfied without differentiating between the two tests. 484 F.2d 680-81. See note 76, *supra*.

82 In *Weathers v. West Yuma County School Dist.*, 530 F.2d 1335 (10th Cir. 1976), the Tenth Circuit stated that a "practical test" was the proper method to determine foreclosure of future employment opportunities. In *Weathers*, however, there was no announcement of any stigmatizing reasons for the failure to rehire; thus, the court had no opportunity to utilize this "practical test." *Id.* at 1339.

83 The Supreme Court may provide a clarification of this uncertainty with a decision in *Velger v. Cawley*, 525 F.2d 334 (2d Cir. 1975), *cert. granted*, 96 S. Ct. 3188 (1976). In *Velger* the Second Circuit found that a probationary police officer's liberty had been infringed because of the circumstances surrounding his discharge from employment. He was released without a hearing or notice of any charges against him; his record, which was readily made available to prospective employers, showed that his dismissal was due to an "apparent suicide attempt." *Id.* at 335. While such a charge appears to satisfy the first branch of *Roth*, the Second Circuit focused instead on plaintiff's demonstration of the difficulty he had subsequently experienced in finding employment. The decision seems to be based on this foreclosure. Hopefully, a Supreme Court decision would indicate whether such a practical foreclosure, as opposed to a legal barrier, suffices under the second branch of *Roth*. The Court may also decide whether the practice of placing the charge on the record and then making this available to prospective employers, is sufficient public announcement to infringe a liberty interest. See *Bishop v. Wood*, 96 S. Ct. 2074 (1976). See note 64 *supra*.

Conclusion

The Seventh Circuit's decision in *Colaizzi v. Walker* appears to be a proper reading of the precedent provided originally in *Constantineau* and *Roth* as modified by *Paul*. Much, however, is left unresolved. The Seventh Circuit merely decided that the complaint stated a claim for which relief can be granted. On remand, the district court must attempt to reconcile the competing interests at stake and to answer the other questions left open by the court of appeals.⁸⁴ In addition, the troublesome and somewhat restrictive definition in *Paul* of the interests protected by the fourteenth amendment concept of liberty, which was not discussed in *Colaizzi*, looms as a possible limitation on the future application of the due process safeguards. Even if the *Colaizzi* interpretation of *Paul* triumphs, as seems likely, the question of how closely state-inflicted injury to reputation must be linked to the termination of employment remains. Also, the *Roth* test awaits future clarification. Because of the facts of *Colaizzi*, the Seventh Circuit's focus was necessarily narrow; thus, these questions, concerning this evolving body of the law, are left to be resolved at a future time.

Mark McLaughlin

⁸⁴ See note 67, *supra* and the accompanying text.

EQUAL PROTECTION—DOUBLE JEOPARDY—EQUAL PROTECTION
REQUIRES THAT PRE-SENTENCE CONFINEMENT BE CREDITED; HOWEVER,
FAILURE TO CREDIT DOES NOT VIOLATE DOUBLE JEOPARDY WHEN THE
TOTAL TIME OF INCARCERATION FALLS WITHIN THE STATUTORY MAXIMUM

*Faye v. Gray**

The crowded American criminal dockets have raised a complex of issues concerning the effective administration of justice in the United States. An area of growing concern to the courts, legislatures, and legal scholars is the related problem of jail time spent by defendants while awaiting trial and sentencing. This concern has resulted in an increasing awareness of the constitutional implications of pre-sentence confinement.¹

In *Faye v. Gray*,² the Seventh Circuit was presented with the question of whether a convicted defendant has a constitutional right to have pre-sentence jail time subtracted from his sentence. The petitioner asserted that such a right exists under both the equal protection and double jeopardy clauses of the United States Constitution. In response, the court affirmed the general proposition that these constitutional guarantees do require pre-sentence confinement credit under certain circumstances.

However, the *Faye* decision is seriously flawed in two respects. First, the decision suffers from the court's inconsistent treatment of the two constitutional issues. Second, and more important, the court improperly limited the practical impact of these constitutional credit requirements by failing to reject the application of a presumption of credit when the total time of incarceration is less than the statutory maximum period allowable for a given offense. This comment examines both the defective reasoning and the erroneous result reached by the Seventh Circuit in *Faye*, and suggests the course which should have been adopted by the court.

Statement of the Case

Frank J. Faye, Jr. was arrested on July 7, 1971 in York, Nebraska. He was transported to Omaha, Nebraska and remained in jail pending extradition to Wisconsin. Faye was financially unable to post the \$10,000 bond which was set at a hearing on August 14, 1971. Thus, he remained in the custody of Nebraska officials until September 1, 1971, when he was extradited to Milwaukee, Wisconsin. A \$10,000 bail was also set in Wisconsin; still unable to post bond, Faye remained in custody in the Milwaukee County Jail until his conviction on two counts of rape on November 16, 1971.

Subsequently, Faye was incarcerated at the Wisconsin Central State Hospital

* 541 F.2d 665 (7th Cir. 1976).

1 See generally Schornhorst, *Presentence Confinement and the Constitution: The Burial of Dead Time*, 23 *HAST. L.J.* 1041 (1972); Stacy, *Constitutional Right to Sentence Credit for Pre-trial Incarceration*, 41 *U. CIN. L. REV.* 823 (1972); Note, *Sentence Crediting for the State Criminal Defendant—A Constitutional Requirement*, 34 *OHIO ST. L.J.* 586 (1973).

2 541 F.2d 665 (7th Cir. 1976).

for pre-sentence examination to determine the need for specialized treatment under the Wisconsin Sex Crimes Act. Faye remained in the hospital until January 11, 1972, when he was returned to the Milwaukee County Jail to await sentencing. On January 18, 1972, after having spent a total of 176 days in confinement, Faye was sentenced to concurrent terms of seven years on two counts of rape. Each rape conviction carried a possible maximum sentence of 30 years under Wisconsin law.

Faye filed a pro se motion in the sentencing court for a reduction in sentence to reflect credit for his 176 day period of pre-sentence confinement. Upon denial of the motion by the sentencing judge, Faye filed a petition for a writ of habeas corpus in the United States District Court for the Eastern District of Wisconsin.

Faye's petition set forth two constitutionally premised arguments. First, it alleged that since his pre-sentence confinement was the direct result of his financial inability to post bond, his right to equal protection of the laws had been violated by the sentencing court's refusal to credit this period against the sentence imposed. The district court rejected this contention, holding that a presumption arises that the sentencing judge has in fact credited the pre-sentence time when the period of pre-sentence confinement, together with the sentence imposed, is less than the statutory maximum penalty allowed for the offense. The court noted that Faye had failed to overcome this presumption, and concluded that his right to equal protection had not been violated.

Faye further urged that the county court's refusal to credit his pre-sentence confinement was unconstitutional under the fifth amendment. The district court rejected this argument as well, and held that the double jeopardy prohibition is not violated when the period of pre-sentence confinement together with the sentence imposed does not exceed the statutory maximum penalty. Finding no merit in either constitutional challenge to the action of the sentencing court, the district court dismissed Faye's petition.

Faye appealed the district court's decision to the Court of Appeals for the Seventh Circuit. Again, Faye argued that the circuit court for Milwaukee County had violated his rights under the fifth and fourteenth amendments to the United States Constitution by failing to credit the 176 days of pre-sentence confinement when sentence was imposed following his conviction.

Equal Protection and the Denial of Pre-sentence Confinement Credit

Faye's argument that failure to credit pre-sentence jail time violates equal protection was based upon a developing line of federal decisions recognizing the constitutional implications of indigency. As early as 1956,³ the United States Supreme Court invoked the equal protection clause to ensure that indigent defendants are afforded equality of treatment in the criminal process. Although the Court has not as yet addressed the precise issue of a constitutional right to pre-sentence confinement credit on equal protection grounds, the general equal protection rationale has been extended to related areas of sentencing procedure.

³ See, e.g., *Douglas v. California*, 372 U.S. 353 (1963); *Gideon v. Wainwright*, 372 U.S. 335 (1963); *Griffin v. Illinois*, 351 U.S. 12 (1956).

This extension has served as the basis for the express recognition of such a right by other federal courts.

The equal protection implications of sentencing and indigent prisoners were first addressed by the Supreme Court in *Williams v. United States*.⁴ In that case, the Court struck down the Illinois practice of incarcerating beyond the maximum term those individuals unable to pay a fine. In reaching its decision, the Court emphasized that the equal protection clause of the fourteenth amendment "requires that the statutory ceiling placed on imprisonment for any substantive offense be the same for all individuals irrespective of their economic status."⁵

A subsequent case, *Morris v. Schoonfield*,⁶ also concerned the sentencing of an indigent defendant. In *Morris*, the petitioner's sentence did not exceed the maximum term. However, his financial inability to pay an accompanying fine resulted in a longer sentence than would have been imposed had he been able to make payment. The Court remanded the case with the direction that it be rendered consistent with its recent *Williams* decision. Of greater significance, however, is Mr. Justice White's concurring opinion, which emphasized that an arbitrary extension of a man's sentence solely because he lacks economic means is constitutionally intolerable:

The same constitutional defect condemned in *Williams* also inheres in jailing an indigent for failure to make immediate payment of any fine, whether or not the jail term of the indigent extends beyond the maximum term that may be imposed on a person willing and able to pay a fine. In each case, the constitution prohibits the state from imposing a fine as a sentence and then automatically converting it into a jail term solely because the defendant is indigent and cannot forthwith pay in full.⁷

Mr. Justice White's general position was ultimately adopted by the Court in *Tate v. Short*.⁸ In *Tate*, the United States Supreme Court considered the constitutionality of a sentencing scheme in which a convicted defendant was obliged to pay a fine *or* to spend time in jail "working off" the fine—the classic "30 days or 30 dollars" sentence. The Court ruled that to transform a statutorily prescribed fine into a jail term because the defendant is unable to pay violates equal protection.

Following these Supreme Court decisions, many federal courts have recognized that denial of sentencing credit to an indigent prisoner for time spent in jail, due to his inability to post bond, raises similar constitutional questions. Several of these courts have expressly held that it is a denial of equal protection to deny credit for such pre-sentence confinement.⁹ Unfortunately, a number of these decisions have interpreted *Williams* as holding that equal protection is violated only when the period of pre-sentence confinement, together with the sentence imposed, exceeds the statutory maximum allowed for the offense.¹⁰

⁴ 399 U.S. 235 (1970).

⁵ *Id.* at 244.

⁶ 399 U.S. 508 (1970).

⁷ *Id.* at 509 (White, J., concurring).

⁸ 401 U.S. 395 (1971).

⁹ *See, e.g.,* *King v. Wyrick*, 516 F.2d 321 (8th Cir. 1975); *Ham v. North Carolina*, 471 F.2d 406 (4th Cir. 1973); *White v. Gilligan*, 351 F. Supp. 1012 (S.D. Ohio 1972).

¹⁰ *See, e.g.,* *Parker v. Estelle*, 498 F.2d 625 (5th Cir. 1974); *Hook v. Arizona*, 496 F.2d 1172 (9th Cir. 1974); *Hill v. Wainwright*, 465 F.2d 414 (5th Cir. 1971).

In contrast, some decisions have interpreted *Williams* more broadly, and require credit for any period of pre-sentence confinement due to indigency regardless of whether the aggregated period would exceed the statutory maximum.¹¹ As the Eighth Circuit asserted in *King v. Wyrick*:¹²

It is obvious . . . that equal protection considerations obtain as well in the case of an indigent prisoner who is denied jail time credit on a prison term less than the allowable maximum prescribed by statute. He still must serve a longer term in connection with the offense than would a wealthier prisoner who is sentenced to the same term but who is able to meet bail to avoid incarceration before trial and sentencing.¹³

These decisions have apparently adopted the reasoning set forth in Mr. Justice White's concurring opinion in *Morris v. Schoonfield*,¹⁴ and view the question of whether the aggregated period extends beyond the maximum term as constitutionally irrelevant.

Although these latter decisions appear to support the petitioner's contention in *Faye*, this expansive interpretation of *Williams* has been diluted in many cases by a qualifying presumption which renders this support illusory. Most decisions on point do support *Faye*'s argument by asserting the unqualified proposition that equal protection is violated whenever pre-sentence confinement is not fully credited.¹⁵ However, many courts have severely limited the practical impact of this proposition by simultaneously holding that if the total time of incarceration is less than the statutory maximum period, it is presumed that the sentencing court in fact credited the pre-sentence time.¹⁶ In *Faye*, since the petitioner's total jail time was less than the statutory maximum, the strength of his equal protection argument depended on whether the Seventh Circuit would adopt the presumption of credit.

This presumption apparently derives from the District of Columbia Circuit's opinion in *Stapp v. United States*,¹⁷ which construed a portion of the federal sentence crediting statute, 18 U.S.C. § 3568.¹⁸ This act provides in pertinent part that:

[T]he Attorney General shall give any . . . person credit toward the service of his sentence for any days spent in custody prior to the imposition of sentence . . . for want of bail set for the offense for which sentence was imposed where the statute requires the imposition of a minimum mandatory sentence.¹⁹

In *Stapp*, the defendant had received the maximum sentence allowable, but

11 *See, e.g.*, 516 F.2d 321; 471 F.2d 406; *Monsour v. Gray*, 375 F. Supp. 786 (E.D. Wis. 1973); 351 F. Supp. 1012.

12 516 F.2d 321 (8th Cir. 1975).

13 *Id.* at 323.

14 *See* text accompanying note 7, *supra*.

15 *See, e.g.*, 471 F.2d 406; 351 F. Supp. 1012.

16 *See* 516 F.2d 321; 375 F. Supp. 786; *Withers v. North Carolina*, 328 F. Supp. 1152 (W.D.N.C. 1971).

17 367 F.2d 326 (D.C. Cir. 1966).

18 Act of September 2, 1960, Pub. L. No. 86-691, § 1(a), 74 Stat. 738, *as amended*, 18 U.S.C. § 3568 (1970).

19 *Id.*

the offense did not carry a minimum term. Thus, he was not eligible under the act for credit for his period of pre-sentence confinement. Protesting his ineligibility, Stapf challenged the act's "minimum mandatory sentence" limitation, and claimed that the district court had erred in refusing to credit his pre-sentence jail time against the maximum sentence. The District of Columbia Circuit agreed, holding that Congress, in providing an automatic credit of pre-sentence time served for minimum sentences, also intended to accord such a credit if the maximum sentence under the law is imposed.²⁰ The court concluded that sentencing courts are under a duty "to provide credit for pre-sentence custody for want of bail to all defendants not granted credit administratively by virtue of the [minimum mandatory sentence] provision of § 3568."²¹

This sweeping statement was limited, however, by the court's procedural qualification that whenever it is possible, as a matter of mechanical calculation, that credit was given, a reviewing court will conclusively presume that it was in fact granted by the sentencing court.²² Thus, whenever the total time of incarceration faced by a prisoner is less than the statutorily allowable maximum, it is irrebuttably presumed that this fact reflects credit for any pre-sentence confinement. The *Stapf* court's sole justification for the application of this presumption was that the time and cost involved in the adjudication of individual claims for credit under the statute "outweighs any possible unfairness."²³ Accordingly, other federal courts, including the Seventh Circuit, adopted and applied the *Stapf* presumption in subsequent cases involving § 3568.²⁴

The *Stapf* presumption, as applied to federal statutory claims for credit under § 3568, was ultimately extended to constitutional claims for credit by state prisoners.²⁵ However, this extension has not gone unchallenged. In *King v. Wyrick*,²⁶ for example, the Eighth Circuit applied the presumption of credit, but not without questioning its appropriateness in a habeas corpus action presenting a constitutional claim for sentence credit as distinguished from a statutory claim under § 3568.²⁷ Moreover, when applied to constitutional claims for sentence credit, the presumption has never been accorded the conclusiveness associated with its statutory application.²⁸

These concerns were amplified by the petitioner in *Faye*. Faye expressly raised the issue of whether it is constitutionally permissible to presume that the sentencing judge had credited his pre-sentence jail time. However, the Seventh Circuit evaded the issue, stating:

20 367 F.2d at 328.

21 *Id.* at 330.

22 *Id.* However, some courts have refused to adopt the District of Columbia Circuit's holding as to the conclusive nature of the presumption. *See, e.g.,* United States v. Downey, 469 F.2d 1030 (8th Cir. 1972).

23 *Id.*

24 *See, e.g.,* Swift v. United States, 436 F.2d 390 (8th Cir. 1970), *cert. denied*, 403 U.S. 920 (1971); Holt v. United States, 422 F.2d 822 (7th Cir. 1970); Brotherton v. United States, 420 F.2d 1357 (10th Cir. 1970); *but see* Padgett v. United States, 387 F.2d 649 (4th Cir. 1967).

25 516 F.2d 321; 375 F. Supp. 786; 328 F. Supp. 1152.

26 516 F.2d 321 (8th Cir. 1975).

27 *Id.* at 324.

28 *See id.*; 375 F. Supp. at 788. These decisions reject the application of any presumption when the record clearly indicates that credit was not in fact given.

We . . . need not address the specific question of whether the *Staff* presumption should appropriately be utilized where the claim for sentence credit is constitutionally rather than statutorily based, for we believe any presumption is thoroughly rebutted when the sentencing judge clearly indicates that *he in fact did not credit such pre-sentence time in sentencing the petitioner.*²⁹

Thus, the *Faye* court avoided the central question by reasoning that even if the application of the presumption were upheld, it had been "clearly rebutted by the sentencing judge's own words."³⁰ Accordingly, the Seventh Circuit reversed the district court with respect to its finding that the presumption had not been overcome in the instant case.

In summary, there are numerous federal decisions supportive of a constitutional right to pre-sentence confinement credit on equal protection grounds. However, some of these decisions have extended the *Staff* presumption to equal protection claims for credit when the total jail time facing a prisoner is less than the statutory maximum. In this context, the most critical question facing the *Faye* court was whether it would follow the Eighth Circuit in applying this presumption to constitutional claims for credit as distinguished from statutory claims under § 3568. Yet the court evaded this issue, and decided that *Faye* was entitled to re-sentencing on the narrower grounds that even if the presumption were adopted, it had been clearly rebutted in the case before it.

Denial of Pre-sentence Confinement Credit as Violative of Double Jeopardy

In addition to his equal protection argument, *Faye* contended that the sentencing judge's failure to credit his pre-sentence jail time violated the constitutional prohibition against double jeopardy.³¹ This second argument was based upon the Supreme Court's holding in *North Carolina v. Pearce*.³² In *Pearce*, the petitioner had been convicted of assault with intent to commit rape and sentenced to a prison term. Several years later, he initiated a state post-conviction proceeding which culminated in the reversal of his conviction by the Supreme Court of North Carolina. *Pearce* was subsequently retried and convicted of the same offense, and sentenced by the trial judge to an eight year prison term. However, the trial judge refused to credit the time served by *Pearce* pursuant to his first conviction, and *Pearce* challenged the constitutionality of this denial of credit before the United States Supreme Court.

The *Pearce* Court determined that the petitioner was entitled to have his time served pursuant to the reversed conviction fully subtracted from the new sentence, since to deny such credit would result in an element of "multiple punishment" which is constitutionally impermissible.³³ The Court concluded by holding that the fifth amendment's guarantee against double jeopardy "is violated when punishment already exacted for an offense is not fully 'credited' in imposing

29 541 F.2d at 668-69 (emphasis added).

30 *Id.* at 669.

31 The United States Supreme Court held that the fifth amendment's guarantee against double jeopardy is enforceable against the states through the fourteenth amendment in *Benton v. Maryland*, 395 U.S. 784 (1969).

32 395 U.S. 711 (1969).

33 *Id.* at 717-18.

sentence upon a new conviction for the same offense."³⁴

Although the *Pearce* Court only addressed the constitutional implications of time served pursuant to a conviction which has been reversed, other federal courts have interpreted its rationale to require credit for pre-trial incarceration as well.³⁵ As the District Court for the Western District of North Carolina noted in *Culp v. Bounds*:³⁶ "[A prisoner's pre-trial] incarceration is indistinguishable in effect from that of one, such as Pearce, who is retried after obtaining post-conviction relief."³⁷ These decisions proceed on the assumption that since there is no real distinction between pre-trial and post-sentence detention, the *Pearce* decision mandates that credit must be extended for time spent in custody prior to commitment.³⁸

Relying on *Pearce* and the related pre-sentence confinement cases which followed it, Faye argued that the constitutional prohibition against double jeopardy required the crediting of the entire 176 day period of his own pre-sentence jail time. The Seventh Circuit rejected this contention, and held that a failure to credit violates the double jeopardy clause of the fifth amendment only when pre-sentence time, together with the sentence imposed, exceeds the statutory maximum penalty allowed for the offense. The *Faye* court asserted that when the total time of incarceration falls within the single maximum period of punishment set by the legislature, no grounds exist for finding the element of "double punishment" proscribed by *Pearce*.³⁹

This assertion, however, is constitutionally suspect. The difficulty stems from the fact that the Seventh Circuit's holding in *Faye* is inconsistent with the actual "multiple punishment" prohibition established by the Supreme Court in *North Carolina v. Pearce*.⁴⁰

In *Pearce*, the Supreme Court illustrated the notion of constitutionally prohibited "multiple punishment" with an example in which a prisoner's total jail time exceeds the statutory maximum.⁴¹ However, the Court went on to emphasize that:

Though not so dramatically evident, the same principle obviously holds true whenever punishment already endured is not fully subtracted from any new sentence imposed.⁴²

Thus, the *Faye* court erroneously inferred that *Pearce* is violated only when total jail time exceeds the statutory maximum. While this is the most "dramatically evident" example of multiple punishment, it is not the only situation envisioned by the *Pearce* Court in which a denial of credit violates double jeopardy. A prisoner's total jail time might well be within the statutory maximum, but he is still subjected to multiple punishment if pre-trial detention already endured is

34 *Id.* at 718.

35 *See, e.g.*, Taylor v. Gray, 375 F. Supp. 790 (E.D. Wis. 1974); Parker v. Bounds, 329 F. Supp. 1400 (E.D.N.C. 1971); Culp v. Bounds, 325 F. Supp. 416 (W.D.N.C. 1971).

36 325 F. Supp. 416.

37 *Id.* at 419.

38 *See, e.g.*, 375 F. Supp. at 793; 329 F. Supp. at 1401-02; 325 F. Supp. at 419.

39 541 F.2d at 667.

40 395 U.S. 711 (1969).

41 *Id.* at 718.

42 *Id.* (emphasis added).

not fully subtracted from the sentence imposed.⁴³

The Presumption of Credit: "Now You See It, Now You Don't"

The manifest logical weakness of the Seventh Circuit's treatment of the double jeopardy issue in *Faye* raises the question of the actual rationale of the court's decision. It is apparent that the court's specious "avoidance" of *Pearce's* multiple punishment prohibition cannot support the conclusion reached in *Faye*. Rather, the underlying basis of the Seventh Circuit's rejection of *Faye's* double jeopardy argument appears to be a judicial presumption that when total incarceration time is less than the statutory maximum, a reviewing court will presume that credit was in fact given by the sentencing judge to avoid multiple punishment.

This implicit presumption, as applied to double jeopardy claims for credit, is virtually indistinguishable from the *Stapp* presumption which has been applied to equal protection claims. The Seventh Circuit cited *Culp v. Bounds*⁴⁴ as authority for the proposition that *Pearce* holds that a failure to credit violates the guarantee against double jeopardy only when total jail time exceeds the statutory maximum. However, in *Culp*, the North Carolina district court explained its restrictive interpretation of *Pearce* as follows:

This court assumes, without deciding, that where the time spent in custody before commitment when added to the sentence given after trial is less than the statutory maximum, no constitutional issue is presented. In that situation, this court . . . is reluctantly inclined to indulge the fiction that the trial judge who imposes sentence has given the defendant credit for time served before commitment. See the order in *Withers v. North Carolina* . . . , and cases cited therein.⁴⁵

This explanation makes clear that the basis of the Seventh Circuit's limited interpretation of *Pearce* is indeed a *presumption* of credit. Moreover, the *Culp* court's reference to *Withers v. North Carolina*,⁴⁶ an equal protection case, indicates that the ultimate source of this presumption, as applied to double jeopardy claims for credit, is the *Stapp* presumption itself.

Hence, it is evident that the Seventh Circuit's treatment of *Faye's* two arguments are in conflict. While the court avoided addressing the applicability of the

43 For example, suppose that two defendants, Jones and Smith, are arrested and charged with the same offense. The offense carries a maximum sentence of 1 year. Jones posts bond and is released pending the outcome of his trial, but Smith remains in custody. Three months after the date of their arrests, both are convicted and sentenced. The sentencing judge determines that in both cases an appropriate sentence is six months. Thus, Smith's total time of detention remains within the statutory maximum. Nevertheless, unless the sentencing judge credits Smith's pre-sentence time, he will spend a total of nine months in custody, whereas Jones will spend only six months. Since the sentencing judge determined that six months was an appropriate sentence (as substantiated by Jones' sentence), the extra three months Smith must endure is tantamount to "multiple punishment." The *Faye* court, however, would deny that Smith is entitled to credit on double jeopardy grounds since his pre-sentence jail time when added to the sentence imposed does not exceed the statutory maximum. This result is neither consistent with common sense nor with *Pearce*.

44 325 F. Supp. 416 (W.D.N.C. 1971).

45 *Id.* at 419 n.1.

46 328 F. Supp. 1152 (W.D.N.C. 1971).

Stapf presumption because of the admissions of the sentencing court, it simultaneously applied the identical presumption to Faye's double jeopardy contention.

In addition, the *Faye* opinion reveals two inconsistent positions concerning the conclusiveness of these presumptions. With respect to the applicability of the *Stapf* presumption in equal protection cases, the *Faye* court effectively adopted the Eighth Circuit's position in *King v. Wyrick*⁴⁷ to the effect that, in constitutional claims for credit, "any such presumption must be rebuttable."⁴⁸ In contrast, the implicit double jeopardy presumption imposed by the Seventh Circuit in *Faye* is apparently conclusive: if the total aggregate jail time is less than the statutory maximum, it is conclusively presumed that there has been no element of "double punishment."

These inconsistencies in *Faye* compound the error of the Seventh Circuit in avoiding the issue of whether the *Stapf* presumption is appropriate when claims for credit are of constitutional dimension. Logical consistency would have required the court to address the issue of the applicability of a presumption of credit when the claim is constitutionally based. Further, the constitutional dimension of such claims should have compelled the court to reject the application of any presumption, whether express or implied, unless squarely within *Stapf's* statutory context.

The *Stapf* presumption, even as applied to statutory claims for credit under 18 U.S.C. § 3568, is subject to challenge since no federal court has ever offered any factual support for its imposition. There has been no evidence advanced which tends to establish the existence of a nationwide judicial practice of taking pre-sentence custody into account at the time of sentencing.⁴⁹ Rather, the sole reason advanced for the adoption of the presumption is the inconvenience that would be experienced by the courts in adjudicating individual claims for credit.⁵⁰

While such a justification might warrant the application of presumptive credit to claims brought under the statute, it is certainly not sufficient when balanced against a defendant's constitutional rights. As one legal writer persuasively argues:

It would seem that administrative convenience, not to mention justice, would be served better by a contrary rule; that is, unless the record is clear that the trial judge did indeed award full credit . . . , the presumption should be that credit was not given and the state should bear the burden of proving the contrary. In other words, if the requirement of credit is of constitutional dimension, it can hardly be satisfied by an unsubstantiated "presumption" that a trial judge complied with the rule.⁵¹

These inherent difficulties with the *Stapf* presumption, particularly when applied to constitutional claims for pre-sentence credit, should have been addressed by the Seventh Circuit in *Faye v. Gray*. This case provided the court with an opportunity to ensure that "dead time," or pre-sentence confinement, is duly

47 516 F.2d 321, 324 (8th Cir. 1975).

48 541 F.2d at 668.

49 See Schornhorst, *supra* note 1, at 1063-64.

50 *Stapf v. United States*, 367 F.2d at 330.

51 Schornhorst, *supra* note 1, at 1063.

credited in compliance with constitutional requirements. Any presumptive credit device poses a serious obstacle to a sound pre-sentence confinement policy which is consistent with a defendant's constitutional guarantees. In *Faye*, the Seventh Circuit should have firmly rejected the application of any presumption of credit when a denial of pre-sentence confinement credit is in potential conflict with the Constitution.

Instead, the court refused to address the petitioner's challenge to the *Stapp* presumption, and in effect voiced approval of an implicit presumption of credit in response to Faye's double jeopardy argument. Thus, the Seventh Circuit's decision in *Faye v. Gray* is doubly vexing: the court not only failed to address the central issue, but forfeited sound judicial reasoning and jeopardized constitutional rights in the process. It can only be hoped that either the Seventh Circuit or the Supreme Court will soon affirmatively address the applicability of the *Stapp* presumption to claims for credit of constitutional dimension, and thereby correct the mistaken approach adopted in *Faye*.

Joseph F. Winterscheid

DOUBLE JEOPARDY—INTRODUCTION OF EVIDENCE AT TRIAL
BASED ON BAD INFORMATION DOES NOT BAR RETRIAL

*United States v. Lee**

Introduction

The double jeopardy clause of the fifth amendment prevents the individual from being tried more than once for the same offense.¹ Thus, if the government fails to prove a defendant's guilt, it cannot continually try the defendant until a guilty verdict is reached. Difficulties arise, however, in determining whether retrial is violative of the fifth amendment, when a trial is aborted or dismissed. In *United States v. Lee*, the information was found to be defective after all the evidence had been presented but before a verdict had been rendered. The Seventh Circuit was asked to determine whether the double jeopardy clause barred retrial.

Phillip Jerome Lee was arrested and charged by an information with theft while on property under the jurisdiction of the federal government.² At the beginning of his bench trial, Lee moved for dismissal of the information because it failed to allege one of the statutory elements of the crime: that the offense was committed knowingly and with the intent to deprive the owner of the use and benefit of the property.³ This defect, obvious on the face of the information, would render voidable a conviction based on that information.⁴ However, instead of acting on Lee's motion at that time, the district court judge took this motion under advisement and proceeded with the trial to the conclusion of the government's case.⁵ Only after Lee again moved for dismissal did the district court judge dismiss the information, stating:

No such allegation [that the offense was committed knowingly and with intent] is contained, no matter how I stretch my imagination when I read the Information. There is nothing here that even smacks of an element of intent.⁶

A grand jury subsequently returned an indictment charging Lee with the same crime as that alleged in the information.⁷ Lee was tried and found guilty.

* 539 F.2d 612 (7th Cir. 1976).

1 The pertinent portion of the fifth amendment reads: "nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb." The obvious purpose of this double jeopardy clause is to prevent the government from trying an individual more than once for the same offense. *United States v. Wilson*, 420 U.S. 332, 339 (1975).

2 The statutes involved were 18 U.S.C. § 13 (1970) and IND. CODE § 10-3030 (1975).

3 1st Trial Transcript at 3-5, *United States v. Lee* (N.D. Ind. 1974).

4 *Ball v. United States*, 140 U.S. 118 (1891). In this case, the Supreme Court overturned the convictions of two men who were tried on a defective indictment. They were tried again and found guilty along with a third man who was found not guilty at the first trial. Their case again went to the Supreme Court in *United States v. Ball*, 163 U.S. 662 (1896).

5 1st Trial Transcript at 3-5, *United States v. Lee* (N.D. Ind. 1974).

6 1st Trial Transcript at 67-68, *United States v. Lee* (N.D. Ind. 1974). Under Federal Rule of Criminal Procedure 7(e), the United States Attorney could have amended the information at any time before the verdict.

7 *United States v. Lee*, 539 F.2d 612 (7th Cir. 1976).

On appeal, the Seventh Circuit affirmed Lee's conviction, holding that double jeopardy protection did not apply to his case.⁸ Lee's petition for *certiorari* was granted by the Supreme Court on January 10, 1977.

A proper understanding of this case requires an explanation of how the double jeopardy clause protects the individual criminal defendant, and an explanation of what situations fall under that protection. It will then be possible to make clear the uniqueness of the facts of this case and the importance of the Seventh Circuit's holding.

The Double Jeopardy Clause

Claims of double jeopardy can arise in at least six situations. First, the initial trial stops short of a verdict, and the defendant is convicted on retrial.⁹ Second, the first trial ends in an acquittal, and the defendant is tried again.¹⁰ Third, the first trial ends in a conviction, which is overturned on defendant's appeal and he is convicted on retrial of a greater offense, or of the same offense along with other counts arising out of the same transaction but not charged against him in the first trial.¹¹ Fourth, the first trial ends in a conviction, and the defendant is then tried on charges technically different from the charges in the first trial but arising out of the same transaction.¹² Fifth, the defendant is tried for the same offense by two or more different sovereigns (federal government, state government, military court martial).¹³ Sixth, the defendant may have committed in one transaction a crime against several people or objects and may be tried individually for the crime against each person or object.¹⁴

Lee falls within the first type of double jeopardy claim; his first trial ended prior to the rendering of a verdict, and on retrial he was convicted. Existence of such circumstances does not always invoke the fifth amendment's double jeopardy protection. Before the second trial can amount to double jeopardy it must be found that: 1) the defendant was in jeopardy at the first trial; and, 2) there was no "manifest necessity" to declare a mistrial or a dismissal before the verdict.

1. When Does Jeopardy "Attach"?¹⁵

According to the United States Supreme Court in *Serfass v. United States*:

[I]n the case of a jury trial, jeopardy attaches when a jury is impanelled and sworn. . . . In a non-jury trial, jeopardy attaches when the court begins to hear evidence.¹⁶

⁸ *Id.*

⁹ *See* *Illinois v. Somerville*, 410 U.S. 458 (1973).

¹⁰ *See* 163 U.S. 662.

¹¹ *See* *McCarthy v. Zerbst*, 85 F.2d 640 (10th Cir. 1936).

¹² *See* *Burton v. United States*, 202 U.S. 344 (1906).

¹³ *See* *United States v. Furlong*, 18 U.S. (5 Wheat.) 184 (1820).

¹⁴ *See* *Hoag v. New Jersey*, 356 U.S. 464 (1958).

¹⁵ The word jeopardy is derived from the Old French "jeu parti," which literally means "divided game." *American Heritage Dictionary* at 702-03 (1969). The idea behind the word is that once both parties have entered into the trial, they are each entitled to continue until one wins and one loses, because it is unfair for one side to stop when it appears that he is losing, and then be allowed to start over again before a different referee.

¹⁶ 420 U.S. 377, 388 (1975).

Hence, in *Lee*, jeopardy did attach. The *Lee* court, in a non-jury trial, heard all of the prosecutor's evidence and offered the defendant an opportunity to put on evidence before the district court judge dismissed the case. The *Serfass* test was passed as soon as the district court judge heard the first word spoken by the first witness.

2. Manifest Necessity to Dismiss and Retry

Manifest necessity to dismiss or to declare a mistrial and to retry the defendant has been found in the following situations: when it was discovered that a juror was acquainted with the accused;¹⁷ when a defect in the indictment or information is discovered;¹⁸ or when the exigencies of a military trial on the battlefield command the end of the proceedings.¹⁹ This is the same type of determination which was made by the district court judge and upheld by the Seventh Circuit in *Lee*.

The doctrine of manifest necessity is simply a recognition that it is impossible to expect every trial, once it has begun, to result in a verdict.²⁰ There are occasions when the trial judge will decide to end the proceedings, such as when a juror's bias is discovered during the trial. In these cases, barring inappropriate governmental activity, the government will not be barred from trying the defendant again.²¹ However, before the trial judge comes to that conclusion, he must carefully consider the alternatives. He must balance the rights and interests of the government against the rights and interests of the individual criminal defendant. The defendant has a right to proceed before the first tribunal to face him because that tribunal represents to him an opportunity to be acquitted. It is true that every tribunal represents that opportunity, but it is also true that a defendant's chances before one jury can be greater or worse than his chances before another. If it is a trial by jury, which the defense counsel helped to select, that same jury may be unavailable to the defendant again, and that jury might have been the one that would have acquitted the defendant, whereas the next jury may not. More important, however, may be the fact that the defendant may have revealed his defense strategy to the prosecutor. Once the prosecutor has run through this full dress rehearsal, he should be well prepared both to present his case in its best light and to counter the defendant's evidence at the next trial.

There are times when the government has an interest in ending the proceeding if nothing of value to the government can come of it or if there are unusual circumstances.²² If, for example, the trial is proceeding on a faulty indictment, only an acquittal or a conviction is possible if the trial is pursued to a verdict, neither of which can benefit the government. An acquittal would bar the defendant's possible retrial, according to the principles of the double jeopardy

17 *Simmons v. United States*, 142 U.S. 148 (1891).

18 *Lovato v. New Mexico*, 242 U.S. 199 (1916).

19 *Wade v. Hunter*, 336 U.S. 684 (1949).

20 *United States v. Perez*, 22 U.S. (9 Wheat.) 579 (1824).

21 *Id.*

22 Nothing of value can come from a trial based on a faulty indictment. Also if the prosecutor suddenly becomes ill, dismissal may be the only viable alternative.

clause. Alternatively, a conviction based on a faulty indictment would likely be overturned on appeal requiring the government to begin the criminal process again or give up.

In weighing the interests of the government and the defendant, trial judges have the authority to:

discharge a jury from giving any verdict, whenever, in their opinion, taking all the circumstances into consideration, there is a manifest necessity for the act, or the ends of public justice would otherwise be defeated.²³

It is important to understand the meaning and effect of what the trial judge does when he declares a mistrial in one of these situations. First, he has, either explicitly or impliedly, found a manifest necessity to dismiss the case. The corollary to such a decision has always been that the double jeopardy clause does not bar retrial. This decision, however, does not deny the fact that jeopardy has attached to the first proceeding, for, according to *Serfass*, once the jury has been impanelled and sworn, or once the trial judge, as trier of fact, has begun to hear the evidence, jeopardy has attached.²⁴ Indeed, if jeopardy had not attached to the first proceeding, no balancing of interests would be required because no double jeopardy protection would be implicated. So, when a trial judge finds manifest necessity to dismiss the first trial and retry the defendant, he is, in effect, deciding that this situation is an exception to the double jeopardy protection.²⁵ The importance of *Lee* does not lie in whether the trial judge was correct in finding manifest necessity to dismiss. There is no doubt that dismissal was manifestly necessary because nothing binding could result from a trial on a defective information except an acquittal. Rather, *Lee* challenged the traditional corollary, that retrial is not barred by the double jeopardy clause. *Lee* did not seek to completely overturn that corollary, but only to make an exception to it based on the unique facts of his case, the most important fact consisting of the district court judge's unnecessary pursuit of a useless trial.

3. Seventh Circuit: Jeopardy Attached, Manifest Necessity Existed

The Seventh Circuit recognized that, under *Serfass v. United States*, jeopardy attached to the first trial at the point at which the district court judge began to hear the evidence.²⁶ The mere fact, however, that jeopardy has attached to a proceeding does not, under the fifth amendment double jeopardy clause, necessarily mean that a retrial is barred.²⁷ Only in cases where the first proceeding produced an acquittal is a retrial absolutely barred by the fifth amendment double jeopardy clause.²⁸ Considering the procedural possibilities, if the trial fails to reach a verdict and is not disposed of on the merits of the case, then a dismissal or a mistrial must have been declared. A question then arises as to

23 22 U.S. (9 Wheat.) at 580.

24 420 U.S. at 377, 388.

25 See 22 U.S. (9 Wheat.) 579.

26 420 U.S. at 377, 388.

27 410 U.S. 458.

28 See 163 U.S. 662.

whether the mistrial was manifestly necessary in order to meet the ends of public justice.²⁹ The ends of public justice demand that the government prosecute suspected criminals efficiently in order that the guilty be convicted and properly dealt with. If this end cannot be accomplished in a proceeding, then the possible need to dismiss the case presents itself. A balance must then be struck between the public's interest in prosecuting a suspected criminal successfully, and the defendant's interest in carrying forward with the first trial. This balance is not to be weighed by the mechanical application of rules, but rather should turn on the facts of each individual case.³⁰

In support of the court's conclusion that Lee's retrial did not violate the fifth amendment double jeopardy clause, the Seventh Circuit relied upon the Second Circuit's opinion in *United States v. Velazquez*.³¹ Velazquez was indicted for failure to report for induction and a plea of not guilty was entered. After reading the defendant's fourteen pretrial motions and portions of the defendant's Selective Service record, the trial judge dismissed the indictment. The government appealed this dismissal, and the defendant opposed that appeal claiming it violated his fifth amendment protection against double jeopardy. According to this defendant, the trial judge had acquitted him on the merits of the case, notwithstanding the fact that the judge had styled his order a dismissal.³² An acquittal is a verdict, that is, a determination made by the trier of fact that the defendant is not guilty; such a decision bars retrial.³³ A dismissal, on the other hand, is not a decision on the merits of the case, but only a procedural decision not to continue with this proceeding to a verdict. If this procedural decision is required by manifest necessity, retrial is not barred.³⁴ By contrast, if this decision is not required by manifest necessity, then retrial is barred by the double jeopardy clause. The Second Circuit determined that:

Velazquez was not placed in jeopardy by the determination of the trial court when it based the dismissal of the indictment against him solely on motion papers submitted prior to trial, before either the selection or waiver of a jury and without any opportunity for counsel on either side to be heard.³⁵

It is not clear why the Seventh Circuit cited and discussed this case for it is easily distinguishable from *Lee*. Unlike *Lee*, Velazquez never faced an impanelled and sworn jury or the hearing of evidence in an adversary trial setting. Consequently, jeopardy never attached to the first *Velazquez* proceeding; thus the second *Velazquez* proceeding could not constitute double jeopardy. Of course, jeopardy did attach in *Lee* as soon as the district court judge began to hear the evidence.

After comparing *Lee* with *Velazquez*, the Seventh Circuit found that the

²⁹ 22 U.S. (9 Wheat.) 579.

³⁰ *Id.* at 580. Although the Seventh Circuit did not cite *Perez* on this matter or specifically state that this was their approach, it can be inferred that the Seventh Circuit applied this balancing test.

³¹ 490 F.2d 29 (2d Cir. 1973). The Seventh Circuit's opinion misspelled Velazquez as "Velazquez."

³² *Id.*

³³ 163 U.S. 662.

³⁴ 22 U.S. (9 Wheat.) 579. *Lee* is seeking to create an exception to that rule.

³⁵ 490 F.2d at 33.

double jeopardy protection did not apply in *Lee*. According to the court, the dismissal of the trial was not based on the evidence adduced at the trial so it was not an acquittal based on the merits of the case. In addition, the court thought it significant that Lee's counsel did not object to going forward with the trial, even though he had moved for dismissal before the trial began. This point should be of minor importance, however. The protection of the double jeopardy clause, if it applies, cannot be waived as an appealable issue. But even if such a waiver was possible, the facts here would not support such a waiver argument because Lee's counsel moved for dismissal, thus preserving the issue for appeal.

The Seventh Circuit concluded its opinion by considering the legal effect of a hypothetical conviction on Lee's first trial. In doing so the court compared *Lee* to an early United States Supreme Court case, *Ball v. United States*.³⁶ In *Ball* the defendant was indicted with two others for murder. The indictment failed to state when and where the victim died. Such a defect would, like the one in *Lee*, have rendered any conviction based on that indictment void or voidable.³⁷ Ball was acquitted, but the other two defendants were convicted. These convictions were later overturned by the United States Supreme Court.³⁸ Subsequently, all three defendants were re-indicted under an adequately worded indictment. Ball pleaded former jeopardy and former acquittal; the other two defendants pleaded former jeopardy by reason of former trial and conviction. All three defendants were in jeopardy at the first trial in the sense that jeopardy had attached to the first proceeding when the jury was impanelled and sworn. Former acquittal, as pointed out earlier, always bars retrial, whereas a former conviction does not. No manifest necessity balance was necessary in *Ball* because a verdict was obtained. Despite the protection that the double jeopardy clause should have afforded Ball, he was convicted with the other two defendants at the second trial. The Supreme Court held that:

a general verdict of acquittal upon the issue of not guilty to an indictment undertaking to charge murder, and not objected to before the verdict as insufficient in that respect, is a bar to a second indictment for the same killing.³⁹

Clearly such a decision comports with the underlying policy of the double jeopardy protection: once a person is acquitted of a charge he may not be charged again for the same alleged offense.

Accordingly, Ball's conviction was reversed, but the convictions of the other two defendants, who were convicted at the first trial, were affirmed on the theory that the convicted defendants impliedly waived their double jeopardy protection. When a criminal defendant overturns his conviction on appeal, he implicitly waives his fifth amendment protection against being tried again for that same offense. This waiver theory is supported by the fact that, while the defendant has a right to appeal an illegal conviction, the ends of justice are defeated by allowing a convicted criminal to escape the consequences of his act because of

36 163 U.S. 662.

37 140 U.S. 118.

38 *Id.*

39 163 U.S. at 669.

a mistake on the government's part or because of an unavoidable circumstance. So the defendant may appeal, but he thus opens the door to a retrial.

Relying on *Ball*, the Seventh Circuit pointed out that if Lee had been found guilty at the first trial "his appeal would likely have resulted in a reversal and . . . a new trial would not constitute double jeopardy."⁴⁰ This is probably true because Lee's counsel knew of the defect in the information and should have known its legal effect. *Ball*, however, is distinguishable from *Lee* as was *Velazquez*. In *Ball* there was a verdict, which means that either the defendant was acquitted and could not be retried, or that the defendant was convicted and retrial would be allowed, on the waiver theory, after the conviction is overturned on appeal. However, in *Lee*, there was no verdict. In altering the facts of *Lee* in order to compare the case with *Ball*, the Seventh Circuit apparently did not consider the fact that, had Lee been acquitted at the first trial, a retrial would have been barred.

The real basis of the Seventh Circuit's holding was that manifest necessity to dismiss the first trial and retry Lee existed, based on an analogy with a recent Supreme Court case, *Illinois v. Somerville*.⁴¹ There, the defendant was indicted for theft by an Illinois grand jury. A jury was impanelled and sworn, but before any evidence was presented, the prosecutor moved for dismissal because of a jurisdictional defect in the indictment. After the indictment was dismissed, another indictment was issued which, on the basis of double jeopardy, the defendant moved to quash. This claim was overruled and the defendant was convicted. The Supreme Court upheld the conviction, stating that the facts fulfilled the manifest necessity requirement. The trial court could reasonably conclude that the ends of justice would have defeated by allowing the trial to continue because no valid conviction could have resulted from that indictment.⁴² If the ends of public justice require the government to exert its efforts to convict suspected criminals, pursuit of such a trial would defeat those ends.

The comparison between *Lee* and *Somerville*, however, is tenuous. In *Somerville*, the dismissal was granted before any evidence was presented, whereas, in *Lee*, the dismissal was granted only after the government's case had been presented. It is admittedly true that, in *Lee*, justice demanded that the district court judge dismiss the information before the trial began, jeopardy attached, because, as in *Somerville*, no valid conviction could have been based on the information as it appeared.⁴³ But that decision on Lee's motion for dismissal should have been made before the trial began. This was the proper procedure which allowed a finding of manifest necessity in *Somerville*. If the district court judge was unsure on how to rule, he could have called a continuance in order to resolve the issue. Instead, he took the motion under advisement and proceeded to hear all the evidence offered by the prosecution. In effect, the district court judge put Lee through all the psychological trauma of a criminal

40 539 F.2d at 614.

41 410 U.S. 458.

42 *Id.* at 471.

43 140 U.S. 118.

trial when there was no hope of gaining a conviction from this proceeding.⁴⁴

Since the trial proceeded to the conclusion of the government's case, it becomes more difficult to determine what the ends of public justice demand. If one assumes that a verdict of guilty would have been inevitable, then dismissal, even at this late point in the trial, was the only appropriate action; therefore, there was manifest necessity to dismiss. Apparently, the Seventh Circuit did assume that a verdict of guilty was inevitable.⁴⁵ However, a not-guilty verdict is always possible. Whether the trial judge should declare a mistrial at this point in the trial, therefore, becomes more difficult, and the prejudice to the defendant caused by the error in proceeding to this point under a bad information is increased. The prosecutor has had his complete dress rehearsal, and the defendant, having divulged his defense strategy, has lost his first opportunity for acquittal.

The Seventh Circuit failed to recognize this case as a unique fact pattern which does not fall precisely within any of the previously defined double jeopardy claims.⁴⁶ Just as it is possible for the defendant to waive the protection of the double jeopardy clause when he appeals a conviction, so, perhaps, can the government be estopped from trying a defendant a second time if the judge, or the prosecutor, have abused their discretion in creating a situation where jeopardy attaches but no verdict is obtained.⁴⁷ All the parties in a criminal proceeding are obliged to live up to minimum standards of professional conduct. When the judge or the prosecutor fail to live up to those standards, and in so failing cause prejudicial error to the defendant, the defendant deserves a remedy, and the fifth amendment's protection against retrial seems to be the most appropriate remedy for such a situation.

The Supreme Court has recognized the double jeopardy protection as the appropriate remedy when the judge or the prosecutor abuses his discretion in causing a premature termination of the defendant's trial. In *Downum v. United States*, the Supreme Court held that there was no manifest necessity to dismiss the defendant's first trial when the key witness for the prosecution failed to appear due to the prosecutor's negligence.⁴⁸ The defendant was indicted for stealing checks from the mail, and forging and uttering those checks. After a jury was selected and sworn, the prosecutor asked the judge to discharge the jury because his key witness was not present. Thereupon the defendant moved for dismissal, which motion was denied, and the judge granted the prosecutor's motion to

44 This argument may appear to sound in due process rather than in double jeopardy, but one should not be misled by the nature of the prejudice suffered by Lee or by the unusual cause of the apparent double jeopardy. The fact that Lee went through two trials, to which jeopardy attached, because of the abuse of discretion on the part of the district court judge, while raising a possible due process argument, does not diminish the double jeopardy aspect of this case. The same abuses and the same prejudice can be depended upon, and the same remedy demanded, under both theories. See *Brock v. North Carolina*, 344 U.S. 424 (1953). The propriety of the judge's decisions, and their effect upon the defendant's right to one fair trial must be weighed against the ends of public justice under either theory.

45 539 F.2d at 614.

46 See text accompanying notes 12-17 *supra*.

47 There is no authority for this estoppel theory. However, there is authority for the proposition that if the prosecutor or the trial judge abuses his discretion in ending the trial prematurely (without manifest necessity) over the defendant's objection, then retrial is barred. *United States v. Jorn*, 400 U.S. 470 (1971); *Downum v. United States*, 372 U.S. 734 (1963). These cases were not presented to the Seventh Circuit for consideration in either the Appellee's or the Appellant's brief.

48 372 U.S. 734.

discharge the jury. Two days later, the case was called again and a second jury impanelled. The defendant's plea of former jeopardy was overruled, and the trial resulted in a guilty verdict. The Fifth Circuit affirmed the conviction, but the Supreme Court reversed.

The Court held that there was no manifest necessity to declare a mistrial since there were other options that the court could have chosen.⁴⁹ For example, the trial court could have granted a continuance or the prosecutor could have amended the information before the verdict.⁵⁰ The Supreme Court's opinion also hints that the district attorney's negligence weighed against the government in the manifest necessity balance.⁵¹ Thus, in this case, the defendant's right to have a decision from the first tribunal to face him outweighed the government's interest in aborting the first trial and having a retrial. The facts simply did not fulfill the requirement of manifest necessity, and the double jeopardy protection barred retrial.

The same result was reached in *United States v. Jorn*.⁵² There, the defendant was charged with filing fraudulent tax returns. After a jury was chosen and sworn, but before any evidence was presented, the trial judge became concerned about the right of the witnesses to avoid incriminating themselves. After attempting to explain to the witnesses their constitutional rights, the trial judge decided that they should all talk to their own attorneys, whereupon, he aborted the trial. When defendant Jorn was brought back for retrial, the same judge dismissed the information on the ground of former jeopardy, thereby implicitly finding that there had been no manifest necessity to dismiss the first trial.

The government appealed directly to the Supreme Court, which held that, on occasion, a mistrial is necessary and a retrial should not be barred.⁵³ According to the Court, however, the discretion which allows such a necessary evil must weigh one important factor: "the need to hold litigants on both sides to standards of responsible professional conduct in the clash of an adversary criminal process."⁵⁴ Again, the fact that the trial judge had other options besides aborting the trial was an important factor in the court's decision against the finding of manifest necessity.

It is apparent from the record that no consideration was given to the possibility of a trial continuance. . . . [I]t seems abundantly apparent that the trial judge made no effort to exercise a sound discretion to assure that, taking all the circumstances into account, there was a manifest necessity for the *sua sponte* declaration of this mistrial.⁵⁵

49 *Id.* at 737.

50 *See* *Ungar v. Sarafite*, 376 U.S. 575, 589 (1964); FED. R. CRIM. P. 7(e).

51 372 U.S. at 738 n.1. The opinion quoted from an earlier Court of Appeals case, *United States v. Watson*, 28 F. 499, 500-01 (1856).

The mere illness of the district attorney, or the mere absence of witnesses for the prosecution, under the circumstances disclosed by the record in this case, is no ground upon which, in the exercise of a sound discretion, a court can, on the trial of an indictment, properly discharge a jury, without the consent of the defendant, after the jury has been sworn and the trial has thus commenced.

52 400 U.S. 470.

53 *Id.* at 485.

54 *Id.* at 486.

55 *Id.* at 487.

The court concluded that a second prosecution of this defendant would violate the double jeopardy clause of the fifth amendment.

Downum and *Jorn* can be distinguished from *Lee* in that the dismissal in *Lee* was required by manifest necessity and the ends of public justice, and was requested by the defendant.⁵⁶ The only common thread in *Lee* and *Jorn* and *Downum* lies only in the abuse of discretion on the part of the judge and the prosecutor in not rectifying the problem when the defendant requested appropriate action.⁵⁷

Conclusion

Since *Lee* went through two proceedings concerning the same occurrence, and since jeopardy attached to both of those proceedings, the claim of double jeopardy is properly presented. The question of whether the claim should be upheld or not turns upon whether there was manifest necessity to dismiss and to retry. The doctrine of manifest necessity would have supported the district court judge's action had he taken that action when the manifest necessity first appeared: when *Lee*'s counsel first moved for dismissal. Since he did not, a novel question is now before the Supreme Court. Its decision ultimately rests on the balance between society's need to bring criminals to justice and the criminal defendant's right to undergo only one trial experience. In this unique situation, the balance tips in favor the individual's rights, and the Seventh Circuit's decision should be reversed.

Frederick R. Daniel

⁵⁶ 539 F.2d 613.

⁵⁷ This is the basis of the argument presented by the petitioner *Lee* to the Supreme Court.

SELF-INCRIMINATION—PRIVILEGE AGAINST SELF-INCRIMINATION
PRECLUDES CONVICTION FOR MISPRISION OF A FELONY WHEN THE
DEFENDANTS ARE SIMULTANEOUSLY INVOLVED IN THE CONCEALED CRIMINAL
CONDUCT

*United States v. Kuh**

Introduction

A fundamental conflict often exists between the exercise of the fifth amendment privilege against self-incrimination and the federal statutory prohibition against concealment of information relating to felonies defined in the federal Misprision Act.¹ While the governmental interest in compelling the reporting of known felonies is clear, it is limited by the fifth amendment privilege which affords protection against compulsory self-incrimination in the face of a possibility of criminal penalty. The necessity for resolution of this basic conflict was presented to the Seventh Circuit recently in *United States v. Kuh*.² Specifically, *Kuh* raised the question of whether the fifth amendment privilege may defeat liability for misprision for failing to disclose information for fear of potential liability under the federal Bank Robbery Act.³ Recognizing the Government's misinterpretation of the elements required to prove a violation of the federal Bank Robbery Act, the Seventh Circuit found that, in light of genuine jeopardy, the defendants' fifth amendment privilege precluded any conviction which might result for misprision of a felony.

In reviewing this case, the Seventh Circuit enunciated its view on the correct scope to be afforded the fifth amendment privilege when its exercise abrogates the affirmative disclosure requirements of the federal Misprision Act. Although the constitutional problem arose from what appears to be a misunderstanding by the government of the elements of the underlying substantive offense, the court's opinion is significant in that it reveals the Seventh Circuit's view on the constitutionality of the Misprision Act as applied to criminal defendants involved in prior criminal conduct.

This comment will examine the Seventh Circuit's view of the scope of the fifth amendment privilege to determine whether this view is in accord with the fifth amendment's underlying policy, as promulgated by the Supreme Court. In so doing, this comment will maintain that the court's resolution of the conflict between the fifth amendment and the misprision statute follows closely that judicial precedent. However, it will be seen that the Seventh Circuit's refusal to overrule its prior holding in *United States v. Daddano*,⁴ based on its conclusion that the case is factually and legally distinguishable from *Kuh*, serves both to

* 541 F.2d 672 (7th Cir. 1976).

1 18 U.S.C. § 4 (1970) reads as follows:

Whoever, having knowledge of the actual commission of a felony cognizable by a court of the United States, conceals and does not as soon as possible make known the same to some judge or other person in civil or military authority under the United States, shall be fined not more than \$5000 or imprisoned not more than three years or both.

2 541 F.2d 672 (7th Cir. 1976).

3 18 U.S.C. § 2113 (1970).

4 432 F.2d 1119 (7th Cir. 1970), *cert. denied*, 402 U.S. 905 (1971).

obfuscate its holding in the present case and to deny lower courts a clear and precise test for future resolution of fifth amendment conflicts.

On July 11, 1975, an armored truck en route to the South Suburban Federal Savings and Loan Association, located in Harvey, Illinois, was robbed of \$150,000. Subsequently, FBI agents arrested Irwin Berndt and Edward Howard and charged them with the robbery. Some thirteen days later, the defendants, James Kuh and Howard Rea, informed an FBI agent that \$70,100 of the stolen money had been buried near Monee, Illinois. Four days later, Kuh and Rea were arrested on a complaint alleging that they had unlawfully and knowingly received and concealed the money, knowing it to have been taken from a bank, in violation of 18 U.S.C. § 2113(c).⁵ While the facts given in the Seventh Circuit's opinion do not make clear the extent of the defendants' involvement, if any, in the actual theft, it appears both from the complaint and from later statements by the prosecutor that the Government did not have sufficient proof to inculcate the defendants as either aiders and abettors or accessories before the fact. Consequently, the Government proceeded to seek conviction under the provision for unlawful receipt and concealment of the proceeds of a bank robbery.

In early September, a hearing was held on the complaint which resulted in a finding of probable cause and a forwarding of the matter to the grand jury for consideration. On October 28, 1975, the grand jury returned a two-count indictment. Count one of the indictment charged Berndt and Howard with bank robbery in violation of 18 U.S.C. § 2113(b).⁶ Count two of the indictment, however, charged defendants Kuh and Rea with misprision of a felony in violation of 18 U.S.C. § 4, in that, after learning of the felony, they possessed and concealed a portion of the stolen money and did not, as soon as possible, disclose to federal authorities their information regarding the bank robbery.⁷ The decision by the Government to seek conviction under § 4, rather than the receiving provision of the federal Bank Robbery Act (18 U.S.C. § 2113(c)), was apparently the result of the Government's conclusion that § 2113(c) required proof of intent to steal, which could not be established in Kuh or Rea's case.

Kuh and Rea subsequently filed a motion to quash the misprision count of the indictment. During a hearing on the motion, the assistant U.S. attorney trying the case stated, in response to a question from the district court as to the nature of the Government's evidence, that he felt it was necessary for the Government to prove both the failure to disclose knowledge of the felony and the

5 18 U.S.C. § 2113(c) (1970) reads as follows:

Whoever receives, possesses, conceals, stores, barter, sells, or disposes of, any property or money or other thing of value knowing the same to have been taken from a bank, credit union, or a savings and loan association, in violation of subsection (b) of this section shall be subject to the punishment provided in said subsection (b) for the taker.

6 18 U.S.C. § 2113(b) (1970), in relevant part, reads as follows:

Whoever takes and carries away, with intent to steal or purloin, any property or money or any other thing of value exceeding \$100 belonging to, or in the care, custody, control, management, or possession of any bank, credit union, or any savings and loan association, shall be fined not more than \$5,000 or imprisoned not more than 10 years, or both. . . .

7 541 F.2d at 674.

concealment of the stolen money.⁸ The district court accepted this in-court statement as a binding representation of both the Government's meaning in count two and what it would attempt to prove under the count. Consequently, the defendants contended that the burying of the money with knowledge of its stolen nature amounts to a violation of 18 U.S.C. § 2113(c) which provides:

Whoever receives, possesses, conceals, stores, barter, sells, or disposes of, any property or money or other thing of value knowing the same to have been taken from a bank, credit union, or a savings and loan association, in violation of subsection (b) of this section shall be subject to the punishment provided in said subsection (b) for the taker.⁹

On this basis, the defendants argued that their fifth amendment privilege relieved them of any obligation to reveal information which might tend to show that they had committed the crime. Accepting this argument, the district court dismissed count two of the indictment.

The case reached the Seventh Circuit on an appeal by the Government under 18 U.S.C. § 3731. In an opinion by Judge Pell, the Seventh Circuit affirmed the decision of the district court dismissing the misprision count. The court noted, however, that nothing in its opinion prevents the Government from prosecuting the defendants under § 2113(c).

The Elements of a § 2113(c) Offense

The action of the Government in seeking and obtaining indictments against the defendants for misprision of a felony was the result of the prosecutor's misinterpretation of the interrelationship between subsections (b) and (c) of the federal Bank Robbery Act. In addition to believing that the defendants' conduct did not amount to "aiding and abetting" the prior robbery,¹⁰ the Government also concluded that the defendants were not liable for receiving the proceeds of the robbery under § 2113(c).¹¹ Relying on language in the Fourth Circuit case of *United States v. Harris*,¹² the Government contended that the words "in violation of subsection (b)" as used in § 2113(c) required that the money be concealed with intent to steal or purloin.¹³ The Government, believing that the defendants had no such intent, concluded that they were liable only for misprision and, therefore, could not claim a reasonable fear of incrimination. Thus, the Government believed that the fifth amendment would not bar punishing the defendants for failing to disclose their knowledge of the felony.

In order to invoke the fifth amendment privilege, a defendant must have a reasonable fear that his communication may incriminate.¹⁴ Whether the defendants in *Kuh* could have reasonably feared incrimination had they made the communications sought by the misprision statute depends on an analysis of the

⁸ The government's attorney acknowledged that the indictment had made no mention of the burying of the money; however, he stated a bill of particulars adding the fact of the burial had been provided to the defense. *Id.*

⁹ 18 U.S.C. § 2113(c) (1970).

¹⁰ 541 F.2d at 674.

¹¹ *Id.* at 675.

¹² 346 F.2d 182 (4th Cir. 1965).

¹³ 541 F.2d at 675.

¹⁴ *Hoffman v. United States*, 341 U.S. 479 (1950); *Mason v. United States*, 244 U.S. 362 (1917); 81 Am. Jur. 2d, *Witnesses* § 39 (1936).

required elements of a violation of § 2113. Subsection (b) proscribes the taking and carrying away, with the specific intent to steal or purloin, monies exceeding \$100 from any of the designated financial institutions.¹⁵ Subsection (c) proscribes the receiving or concealing of monies taken in violation of subsection (b), knowing them to have been so taken.¹⁶ Not clear from the language of the two subsections, however, is the nature of the relationship, if any, between them.

In 1959, the Supreme Court addressed this question in *Heflin v. United States*.¹⁷ There, the defendant had been charged with violations of both subsections (b) and (c) and, upon conviction of both counts, had been sentenced to two consecutive terms of imprisonment. After reviewing the scant legislative history surrounding § 2113 (c),¹⁸ the Court, per Justice Douglas, struck down the consecutive sentences, concluding that subsection (c) was inapplicable to the defendant. The congressional intent underlying subsection (c), according to the Court, is to reach a second group of wrongdoers, those receiving the loot, and not to pyramid the offenses of the bank robbers themselves.¹⁹

The *Heflin* decision was followed two years later by *Milanovich v. United States*.²⁰ In that case, the Court again reviewed a conviction for both theft and the receipt of the property allegedly stolen. Although in *Milanovich* the Court dealt with a crime which was committed on a Naval base, and thus prohibited under a different statute,²¹ it found no difference between the two statutes or their legislative histories to justify differing interpretations.²²

The defendants in *Milanovich*, husband and wife, transported three others to a Navy commissary under an arrangement whereby the three were to break into the commissary safe. The defendants, who were to remain outside as both getaway drivers and lookouts, departed before the three thieves returned from the building. Upon their exit with the proceeds of the theft, the three thieves, finding no getaway car, buried their loot and proceeded on foot. Approximately three weeks later, the wife received part of the booty from the robbers.

The Supreme Court, in reviewing the wife's conviction for both the original theft and the subsequent receiving, held that the conviction for receiving stolen property could not stand. The Court concluded, over a dissent by Justice Frankfurter,²³ that the fact that the taking and the receiving were distinct transactions, both in time and place, would not distinguish the case from *Heflin*.²⁴ Furthermore, the fact that the wife was liable as a principal in the larceny only by way of

15 See note 6 *supra*.

16 18 U.S.C. § 2113(c) (1970).

17 358 U.S. 415 (1959).

18 During that inquiry, the court referred to H.R. REP. No. 1668, 76th Cong., 2d Sess., 1, which noted that the law prior to the adoption of subsection (c) did not proscribe as a "separate substantive offense" the receiving or possessing of the Federal Bank Robbery Act.

19 358 U.S. at 420.

20 365 U.S. 551 (1961).

21 18 U.S.C. § 641 (1970).

22 365 U.S. at 554.

23 In his dissent, Justice Frankfurter argued that the common law doctrine of merger of offenses as well as the commonsensical reason that a man who takes property does not *at the same time* give himself the property he has taken forms the theoretical base for the *Heflin* decision and that such concepts are inapplicable to transactions, such as were present in *Milanovich*, which were neither coincidental nor contemporaneous. *Id.* at 559 (Frankfurter, J., dissenting).

24 365 U.S. at 554.

accessorial liability would not serve to distinguish the two cases.²⁵ Thus, the *Heflin* and *Milanovich* decisions leave little doubt that convictions under §§ 2113(b) and (c) are mutually exclusive.

With these cases as precedent, the Seventh Circuit turned to an analysis of the Government's view of the required elements of a § 2113(c) violation. In arguing that subsection (c) required concealment with the intent to steal or purloin, the Government placed substantial reliance on *Harris*. In that case, the Fourth Circuit reviewed a conviction for both stealing and knowingly receiving the proceeds of the same robbery; a clear violation by the trial court of the *Heflin* and *Milanovich* rules. In *Harris*, the court, noting that the indictment was defective for failing to allege that the monies concealed had been taken originally with the intent to steal, stated: "only possession and concealment of money taken with that intent [i.e. the intent to steal or purloin] is criminal."²⁶ It was this language which the Government interpreted as requiring that the money be concealed with the intent to steal.

In response to this position, the Seventh Circuit correctly recognized that the *Harris* court was merely holding that an indictment under § 2113(c) must allege that a defendant has possessed and concealed money taken originally by someone who had the requisite intent to steal or purloin.²⁷ In support of its interpretation of *Harris*, the Seventh Circuit relied on language of the Supreme Court in *United States v. Gaddis*.²⁸ *Gaddis* was, however, primarily directed at resolving conflicts among the circuits as to the proper appellate remedy for a district judge's error in permitting convictions under both §§ 2113(b) and (c). Insofar as it was relevant to the Government's contention in the present case, it merely reaffirmed the doctrine already promulgated in both *Heflin* and *Milanovich*. Namely, that possession of the proceeds of a bank robbery in violation of § 2113(c) is not a lesser included offense of the robbery statute but is, rather, intended to reach "those who receive the loot from the robber."²⁹ In evaluating the requirements of § 2113(c), the Seventh Circuit determined that the Government's contention that the defendants could not reasonably fear conviction under that statute was without merit. It was this determination which raised the conflict between the misprision statute and the fifth amendment privilege.

The Elements of Misprision and the Fifth Amendment Privilege

The Government's assumption, albeit faulty, that the defendants could not be convicted of either a violation of 18 U.S.C. § 2113(c) or of 18 U.S.C. § 3, punishing accessories after the fact,³⁰ led to the conclusion that the misprision

25 *Id.*

26 346 F.2d at 184.

27 541 F.2d at 675.

28 96 S. Ct. 1023 (1976).

29 *Id.* at 1027.

30 18 U.S.C. § 3 (1970) states:

"Whoever, knowing that an offense against the United States has been committed, receives, relieves, comforts or assists the offender in order to hinder or prevent his apprehension, trial or punishment, is an accessory after the fact." The government apparently concluded that conviction under this section was precluded as the defendants did not receive the money in order to hinder or prevent the apprehension of the robbers.

See generally *Skelly v. United States*, 76 F.2d 483 (10th Cir.), cert. denied 295 U.S. 757 (1934).

statute could constitutionally be applied to the defendants. The validity of the Government's argument that the defendants could not claim a reasonable fear of incrimination under § 2113(c) disappeared with the Seventh Circuit's correct interpretation of the requirements of that section.

However, in further support of its belief that the misprision statute was applicable, the Government argued that 18 U.S.C. § 4 does not purport to attach a penalty to the mere failure to communicate knowledge of the commission of a felony; rather, it also requires an affirmative act of concealment.³¹ Thus, the Government contended that although the fifth amendment might proscribe the attachment of criminal sanctions to the mere failure to disclose on the part of a person fearing incrimination, the penalizing of failure to disclose, when coupled with proof of an affirmative act of concealment, removes the statute from the scope of the fifth amendment's protection.

While it is true that the federal courts, in interpreting 18 U.S.C. § 4, have held that the statute's conjunctive language, "[w]hoever . . . conceals and does not disclose,"³² requires both an affirmative act of concealment and a failure to disclose,³³ there is no doubt that the statute seeks to compel communications of a testimonial nature. It would seem that so long as the failure to disclose is an essential element of the statute, and the required disclosure has a self-incriminating potential, the fifth amendment would prohibit conviction under that statute. Nevertheless, in support of its conclusion that the added element of active concealment prevents the application of fifth amendment protection in the present case, the Government cited the Seventh Circuit case of *United States v. Daddano*.³⁴

In *Daddano*, several persons conspired to and robbed a Chicago bank. Later, four members of the group were arrested for the robbery. While they were in custody, one of the other members approached a bail bondsman, Montagna, and provided him with a portion of the proceeds of the robbery so that he might arrange bail for the four who were incarcerated. It was clear from the evidence that Montagna knew that the money had come from the robbery.³⁵ After arranging bail for the four, Montagna was again approached by members of the group, who expressed concern that some among their midst might be divulging information to the authorities. Consequently it was decided that, in an attempt to locate the leak, all the members of the group would take a polygraph exam.³⁶ Montagna's involvement both in the planning of the polygraph exams and in delivering their results was clearly shown by the evidence. Subsequently, Montagna and the other members of the group were arrested, tried and convicted for, *inter alia*, misprision.

31 541 F.2d at 676.

32 See *Lancy v. United States*, 356 F.2d 407 (9th Cir. 1966), *cert. denied*, 385 U.S. 922; *Neal v. United States*, 102 F.2d 643 (8th Cir. 1939); *Bratton v. United States*, 73 F.2d 795 (10th Cir. 1934); *United States v. Farrar*, 38 F.2d 515 (1st Cir. 1930), *aff'd*, 281 U.S. 624 (1931).

33 See note 1 *supra*.

34 432 F.2d 1119 (7th Cir. 1970), *cert. denied*, 402 U.S. 905 (1971).

35 *Id.* at 1122.

36 It was stated in the state's evidence that anyone failing the tests would be "silenced." The inference drawn from this evidence was that any member of the group could shoot the one failing the test. Apparently, no one failed. *Id.*

On appeal to the Seventh Circuit, Montagna argued that the fifth amendment prohibited the application of the misprision statute to him. He contended that if he had reported information about the bank robbery, he would have reasonably feared that that information would lead to his own conviction, either as an accessory after the fact or for having knowingly received part of the proceeds of the robbery. In responding to this claim the Seventh Circuit stated:

We think the answer to this argument . . . is that the offense of misprision as defined in 18 U.S.C. § 4 consists of an act of concealment in addition to failure to disclose. Thus the statute does not purport to punish one solely for failure to report facts which he has reasonable fear might lead to his conviction of a crime.³⁷

It was this portion of the holding in *Daddano* on which the Government sought to rest its argument that the defendants in *Kuh* could constitutionally be charged with misprision despite their potential liability under § 2113(c).

Distinguishing Daddano: Confusion by Clarification

In the present case, the Seventh Circuit, confronting the Government's reliance on *Daddano*, concluded that the cases are factually and legally distinguishable.³⁸ While there can be no doubt that *Daddano* is factually distinguishable,³⁹ the court's assertion that it represents a valid legal distinction may well raise constitutional objections. The legal distinction found by the court appears premised on two different lines of reasoning. First, the Seventh Circuit pointed out that in *Daddano* the affirmative act of concealment was the administering of the polygraph exams in a context obviously meant to stifle communications to the authorities. This, the court noted, amounted to a distinct and separate act of concealment, not itself a part of the original offense. In contrast, the court stated that the concealment in *Kuh*, while incidentally cloaking the felony, was itself the violation of § 2113(c). The court thus appears to be stating that the fifth amendment privilege will bar prosecution under the misprision statute only when the act of concealment is itself a felony.

Second, the court observed that the *Daddano* indictment charged the defendant with misprision in concealing the original bank robbery by the administration of the polygraph exams. The defendant was not charged with the misprision of receiving and concealing part of the proceeds of the robbery. Thus, the court stated that the rejection of the fifth amendment privilege in *Daddano* centered on Montagna's fear of being convicted as an accessory after the fact by arranging for the polygraphs. In this distinction, the court is apparently holding that it is the nature of the affirmative act alleged in the indictment, and not the self-incriminating potential of the sought-after communication, that will control with respect to the claim of privilege under the fifth amendment. This

³⁷ *Id.* at 1125.

³⁸ 541 F.2d at 677.

³⁹ As the court noted in *Daddano*, and recounted in *Kuh*, the facts confronting the *Daddano* court were undeniably unique.

is borne out by the fact that in *Daddano* both the misprision by polygraph, and the misprision by receipt of the stolen money, involve, as an essential element of proof, the failure to disclose identical information regarding the same bank robbery.

Both of these premises seem to ignore the similarity, for purposes of constitutional analysis, between the self-incriminating potential of the sought-after communications in each case. In both *Daddano* and the instant case, at the time the duty to disclose arose, the defendants were involved in and could reasonably apprehend that their information would lead to liability for criminal conduct. While the Seventh Circuit acknowledged that the rejection of the privilege in *Daddano* took place in the context of Montagna's fear of conviction as an accessory after the fact, it is unlikely that the fear of accessorial liability related to his prior receipt of the stolen money. Instead, in rejecting Montagna's claim, the court appears to have focused only on his fear of accessorial liability by reason of administering the polygraphs. Thus, it appeared to the court that Montagna was claiming the fifth amendment privilege because his act of concealment (the polygraphs) also amounted to a violation of 18 U.S.C. § 3. In other words, the *Daddano* court refused to accord the privilege to a defendant who claimed a fear of being incriminated under a different statute (18 U.S.C. § 3) for those very same acts of concealment alleged in the misprision indictment. The confusion surrounding the court's attempt to distinguish the case from *Kuh* is that, even under the court's own analysis, *Kuh* and *Rea*'s claim of privilege based on a fear of incrimination under a different statute (18 U.S.C. § 2113(c)) for the same acts of concealment alleged in the misprision indictment was upheld.⁴⁰

Thus, the constitutional problems flowing from the *Daddano* holding, as well as from the Seventh Circuit's present effort to distinguish that case, remain unresolved. By focusing so narrowly on Montagna's involvement with the polygraphs, the *Daddano* court failed to recognize that the information he did not disclose would have, if disclosed, provided the Government with substantial assistance in prosecuting him for a crime committed prior to, or simultaneously with, his acquisition of that very information. The court's holding in *Daddano*, even if viewed only as establishing liability for misprision for a separate act of concealment committed after the acquisition of information regarding the felony, would seem constitutionally suspect as it ignores the fact that liability for this later misprision still involves punishment for failure to disclose incriminating information. This calls into question the Seventh Circuit's view as to the scope of the fifth amendment privilege.

In the present case, the Seventh Circuit began its examination by inquiring into the incriminating potential of the sought-after communication. The Seventh Circuit correctly realized that, before communications come within the protection of the fifth amendment, there must be a showing that the danger of incrimination is both real and appreciable in the course of the ordinary operation of law.⁴¹ In the present case, the failure to communicate information which the Government is seeking is, under the correct interpretation of § 2113(c), sufficient

40 541 F.2d at 677.

41 See note 14 *supra*.

to convict on that charge. Whether proof of the added element of an affirmative act of concealment would have sustained a conviction under either 18 U.S.C. § 3 or § 2113(c), the fact remains that the communication sought by 18 U.S.C. § 4 would have subjected the defendants, Kuh and Rea, to a real, appreciable danger of conviction for criminal conduct engaged in prior to or simultaneous with their acquisition of knowledge of the felony. This is no less true in *Daddano*. In *Hoffman v. United States*,⁴² the Supreme Court stated that the fifth amendment privilege extends not only to answers that would in themselves support a conviction under a criminal statute, but also to those which would furnish a link in the chain of evidence needed to prosecute the claimant for a crime.⁴³ In *Daddano*, as in the instant case, the defendants clearly had reason to apprehend that the sought-after communications would provide such a link.

If the Seventh Circuit, by distinguishing *Daddano*, intends to differentiate between cases, such as the present one, in which the affirmative act of concealment alleged in the indictment is itself a criminal act which only incidentally intended to conceal, and cases, such as *Daddano*, in which the act of concealment is distinct from the concealed crime and is done for the sole purpose of concealment, it is not supported by either the fifth amendment or its interpretive case law. If, however, by distinguishing *Daddano*, the Seventh Circuit intends to differentiate between cases in which the defendant, by complying with the disclosure requirements of the misprision statute, would incriminate himself with respect to criminal conduct engaged in prior to or simultaneously with his acquisition of knowledge of the felony; and cases in which the defendant's only fear of incrimination relates to conduct engaged in after his acquisition of knowledge of the felony, then it is in accord with the fifth amendment, which does not protect against communications regarding future offenses.⁴⁴ The problem with this interpretation of the *Daddano* distinction, however, is that *Daddano* is an instance in which the defendant was involved in criminal conduct prior to or simultaneously with his acquisition of the information he failed to report; this involvement would have been revealed had he complied with the requirement of the statute to disclose that same information to the Government.

Attaching the possibility of criminal liability to the failure to communicate information regarding criminal conduct to the Government will, regardless of whatever other elements may be required to sustain a conviction, run afoul of the fifth amendment whenever the sought-after communication has a self-incriminating potential at the time the duty to disclose arises. The Seventh Circuit itself noted in the present case that it is difficult to understand how a criminal conviction could be substantiated when the duty to notify authorities is precluded by constitutional privilege.⁴⁵

Conclusion

The Seventh Circuit, in *United States v. Kuh*, correctly delineated the re-

42 341 U.S. 479 (1950).

43 *Malloy v. Hogan*, 375 U.S. 1 (1963).

44 *See United States v. Prior*, 381 F. Supp. 870 (D. Fla. 1974); 21 AM. JUR. 2d, *Criminal Law* § 353 (1970).

45 541 F.2d at 677.

quirements of 18 U.S.C. § 2113(c) and applied them to the defendants' claim of fifth amendment privilege. The court recognized and resolved the conflict between the duty to disclose under 18 U.S.C. § 4 and the privilege against self-incrimination. In affirming the lower court's dismissal of the misprision count, the Seventh Circuit afforded protection to the constitutional rights of the defendants while recognizing that nothing in its opinion restricts the Government from prosecuting the defendants under a correct interpretation of § 2113(c).

However, the court's attempt to distinguish *Daddano* leaves in doubt whether it intends to perpetuate the more limited scope of privilege in misprision cases promulgated there. Additionally, the near identical requirements of 18 U.S.C. § 4, interpreted as requiring an affirmative act of concealment, and 18 U.S.C. § 3, penalizing accessories after the fact, when coupled with Montagna's fear of incrimination under § 3, calls into question whether the *Daddano* court misinterpreted their single distinguishing element, the failure to disclose. The court may thus have failed to accord correct deference to the fifth amendment privilege in the face of a statutory duty to disclose information which may be incriminating.⁴⁶

In evaluating the scope of the fifth amendment privilege *vis-à-vis* misprision, it should make little difference whether the act of concealment is separate and distinct from the concealed felony or is itself the essence of the defendant's felony. To dismiss a claim of privilege in the former case, and sustain it in the latter, is to create an artificial distinction not inherent in the fifth amendment. It would appear that the only correct distinction is between cases in which disclosure, at the time the defendant acquired information concerning the felony, would incriminate him and those in which it would not. Both *Daddano* and *Kuh* fall into the earlier category. Thus, the Seventh Circuit's refusal to overrule *Daddano* leaves in doubt the scope of its holding in the present case as there appear to be no constitutionally significant grounds for distinguishing the two cases.

Michael Craig Donovan

⁴⁶ Of course, it is necessary that there be an element of compulsion before the privilege against compulsory self-incrimination will apply. In the instant case that compulsion is apparent on the face of the statute, as it purports to attach a penalty to the failure to disclose. *Michigan v. Tucker*, 417 U.S. 433 (1973); *Hofstra v. United States*, 385 U.S. 293 (1966).

Indeed, just such considerations have led the drafters of both the Model Penal Code and the federal Comprehensive Criminal Justice Reform Act of 1975 to eliminate the offense of misprision altogether and rely only on the general accessory and obstruction of justice offenses. See Model Penal Code § 208.32A, commentary (Tent. Draft No. 9, 1959); REPORT OF THE COMMITTEE ON THE JUDICIARY TO ACCOMPANY S. 1, S. DOC. NO. 94-00, 94th Cong., 2d Sess., 326 (1976).

II. Federal Procedure

CIVIL PROCEDURE—RULE 23—CLASS ACTIONS—THE FINAL JUDGMENT RULE—APPEALABILITY OF CLASS ACTION DETERMINATIONS

*Weit v. Continental Illinois National Bank & Trust Co.**
*Anschul v. Sitmar Cruises, Inc.***

The appealability of district court interlocutory orders granting or denying class action status is an area of considerable complexity and controversy. The accepted rule has been that these interlocutory orders cannot be reviewed on appeal until after the litigation has proceeded to final judgment in the lower court.¹ *Weit v. Continental Illinois National Bank & Trust Co.*² and *Anschul v. Sitmar Cruises, Inc.*³ adhere to this traditional rule, but raise significant questions concerning matters of judicial economy. The specific questions posed are whether the policies of the final judgment rule are well served in complex, lengthy class actions by denying immediate review of interlocutory class determination orders and whether their denial increases the potential of relitigation and jeopardizes the rights of parties and non-parties. These issues will be examined in the context of these two recent Seventh Circuit decisions which explored statutory and judicial exceptions to the final judgment rule and the rationale supporting their use.

Weit v. Continental Illinois National Bank & Trust Co.

Jack Weit and two other credit cardholders brought an antitrust class action against five Chicago banks and the Midwest Bank Card System alleging violations of the Sherman Act. Counts I and II of the complaint charged that defendant banks had conspired to fix the interest rate charged to cardholders. Moreover, counts III and IV alleged that defendant banks had conspired with correspondent banks to fix the interest rate charged cardholders. Finally, counts V and VI claimed that defendant banks had conspired with their correspondent banks to fix the discount charged to merchants, thereby raising the price of the merchant goods sold to the cardholders. Plaintiffs sought treble damages, totaling more than three billion dollars, and an injunction to require all cardholder interest rates and merchant discount rates to be renegotiated on an individual basis. The district court granted plaintiff class status for counts I-IV, but denied plaintiff class status for counts V and VI. The court also denied plaintiffs' motion to certify a defendant class for counts I-IV.⁴ Plaintiffs appealed both orders. A third order prescribing the method for notifying the plaintiff class was also ap-

* 535 F.2d 1010 (7th Cir. 1976).

** 544 F.2d 1364 (7th Cir. 1976).

1 Traditionally, interlocutory class determination orders—the district court's ruling on whether litigation will proceed as a class action or individual action—are denied access to appellate review at the initial or intermediate stages of the proceedings.

2 535 F.2d 1010 (7th Cir. 1976).

3 544 F.2d 1364 (7th Cir. 1976) (per curiam).

4 Plaintiffs sought to have a defendant class certified apparently to broaden the scope of available injunctive relief.

pealed and later consolidated with plaintiffs' two former appeals.⁵ Defendant moved to dismiss the appeals for want of appellate jurisdiction. The Court of Appeals for the Seventh Circuit granted defendants' motion on the grounds that none of the orders qualified for appellate review under the final judgment rule.

Anschul v. Sitmar Cruises, Inc.

Simon Anschul, a passenger aboard one of defendant's cruises, sought to bring a class action on behalf of himself and all other passengers. The action was initiated to recover: (a) the difference between the price of the cruise as advertised and the actual cruise (which was curtailed due to the fuel crisis); or, (b) the amount by which defendant was unjustly enriched. Plaintiff appealed the district court's denial of class status. The Seventh Circuit held that it lacked jurisdiction to review the appeal because the order did not qualify as a final decision.

The Final Judgment Rule

At common law a rule developed that appeals could be taken only from a final judgment; this rule has since been codified in 28 U.S.C. § 1291.⁶ The underlying purpose of this rule is that: Finality as a condition of review is an historic characteristic of federal appellate procedure [to forbid] piecemeal disposition on appeal of what for practical purposes is a single controversy.⁷

Consistently, courts have held that orders granting or denying class action status are not final within the meaning of § 1291.⁸ Such orders do not dispose of the litigation; are primarily procedural in nature; and are subject to review after final adjudication on the merits.⁹ Several exceptions to the final judgment rule of § 1291, however, have been established and may be applicable in a class action context.

Statutory Exceptions: Application to Weit and Anschul

1. Appealability Under § 1292(a)(1)

The plaintiff in *Weit* sought to bring the appeal of the two orders denying class certification within the scope of 28 U.S.C. § 1292(a)(1) which provides:

The court of appeals shall have jurisdiction of appeals from: (1) Interlocutory orders of the district courts . . . , or of the judges thereof, granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions. . . .

⁵ FED. R. CIV. P. 23(c)(2) requires that "the court shall direct to the members of the class the best notice practicable . . . , including individual notice to all members who can be identified through reasonable effort."

⁶ "The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . . , except where a direct review may be had in the Supreme Court." 28 U.S.C. § 1291.

⁷ *Cobbledick v. United States*, 309 U.S. 323, 324-25 (1940).

⁸ *See Kohn v. Royall, Koegel & Wells*, 496 F.2d 1094, 1097 (2d Cir. 1974).

⁹ *Williams v. Mumford*, 511 F.2d 363, 366 (D.C. Cir. 1975).

This method for obtaining immediate appellate review of interlocutory orders is available only when injunctive relief is sought. Since the *Anschul* plaintiff was seeking solely monetary damages, the class action order was not reviewable under this section.

By contrast, the *Weit* plaintiffs sought both monetary damages and injunctive relief. They argued that the district court's class action orders narrowed the scope of injunctive relief sought in their complaint, thereby bringing the order within § 1292(a)(1). This argument had been successful in several civil rights cases where broad injunctive relief was sought to curtail discriminatory or abusive practices.¹⁰ For example, plaintiffs in *Brunson v. Board of Trustees*¹¹ alleged that dual, bi-racial school systems were being concurrently maintained by the defendant school board. The plaintiffs requested broad injunctive relief, including a reorganization of the school system. The lower court's order denied certification of a plaintiff class. On appeal, the Fourth Circuit held that this order was immediately reviewable under § 1292(a)(1) because it effectively limited the scope of injunctive relief.¹² The injunctive relief obtainable from continuing the litigation would require the admission of only the named plaintiff (and not necessarily the other students in plaintiff's class) to the school of his choice.¹³ Since a reorganization of the school could not be accomplished through individual actions, the court concluded that the requested injunctive relief had been effectively curtailed by denying certification of a plaintiff class.

In *Williams v. Mumford*,¹⁴ the District of Columbia Circuit criticized the *Brunson* holding as an "unwarranted expansion of the statutory language."¹⁵ *Williams* involved an action for alleged discrimination in the employment practices of the Library of Congress brought by two black employees on behalf of themselves and other blacks employed by the Library. The District of Columbia Circuit rejected the *Brunson* premise: that refusal to grant class status was a modification or refusal to issue an injunction since the order eventually would affect the scope of equitable relief.¹⁶ According to this court, refusal to grant class status was "neither issuance nor denial of an injunction."¹⁷ Clearly, the court was reluctant to extend a statute which it perceived as a limited exception to the final judgment rule.¹⁸

Both *Brunson* and *Williams* confirm that an interlocutory order denying class status might restrict the relief available at a later stage of the proceeding. *Williams*, however, would restrict appeals under § 1292(a)(1) to orders directly impinging issuance of injunctions, apparently assuming that any restriction on injunctive relief caused by dismissing the class action order may be adequately remedied by appealing the class action determination after final judgment.

The *Weit* court was confronted with a situation which, though analogous

10 The court determined that this argument should not be extended to antitrust litigation. Rationale in support of this conclusion, however, was not proffered by the court.

11 311 F.2d 107 (4th Cir. 1962) (per curiam), cert. denied, 373 U.S. 933 (1963).

12 *Id.* at 108-09.

13 *Id.* at 108.

14 511 F.2d 363 (D.C. Cir. 1975).

15 *Id.* at 369.

16 *Id.*

17 *Id.*

18 *Id.* at 370.

to *Williams* and *Brunson*, was more complex because two orders were involved. The first order denied a defendant class for counts I-IV.¹⁹ The second order denied a plaintiff class for counts V-VI.²⁰ The questions raised were: (1) whether an injunction against the named defendants would act as an injunction against the entire defendant class; and, (2) whether an injunction inuring to the benefit of a single plaintiff would adequately protect the entire plaintiff class. The Seventh Circuit concluded that any injunctive relief "would, for all practical purposes"²¹ result in the elimination of the enjoined practices for each of the banks involved; and that an injunction in favor of one plaintiff would provide "as a practical matter"²² adequate relief to the entire class.²³

The majority's conclusion appears sound. Changes in policies or regulations imposed on one bank would certainly have a similar impact upon its correspondents. Policy changes necessitated by dealing with one customer also would flow to the benefit of other customers or credit cardholders. Further, the apparent restriction on injunctive relief could be remedied by appealing the class determination order after final judgment. Giving the requirements of § 1292(a)(1) a practical construction, it appears that the majority's action in denying the order was correct at least within the limits of § 1292(a)(1).

2. Appealability Under § 1292(b)

The orders sought to be appealed in *Anschul* and *Weit* were not certified for appellate review by the district judge. The *Anschul* court, perhaps seeking to mollify the harshness of its refusal to hear plaintiff's appeal, does discuss the possibility of review under 28 U.S.C. § 1292(b).²⁴ Under § 1292(b), the district judge can certify interlocutory orders for appellate review when there is: (1) a controlling question of law; (2) substantial grounds for difference of opinion; and (3) when acceleration of the litigation would result from an immediate appeal. This approved method ensures that parties are not prejudiced in those areas where the law is uncertain and when an immediate review of an interlocutory order would expedite rather than delay the litigation.

Since the appellate court retains discretion to deny review for certifications improvidently granted or if the appellate docket is overcrowded,²⁵ § 1292(b) is an appropriate device for obtaining appeals from interlocutory orders. The potential for inundation of the appellate docket is effectively negated by this appellate right of refusal. Generally, the Seventh Circuit has encouraged the

19 535 F.2d at 1012.

20 *Id.*

21 *Id.* at 1013.

22 *Id.*

23 The *Weit* dissent was troubled by the "vague and uncertain" measure which the majority had employed—the "practical" criterion—in reaching its decision. *Id.* at 1015 (Swygert, J., dissenting).

24 "When a district judge, in making . . . an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal. . . ." 28 U.S.C. § 1292(b) (1970).

25 *Katz v. Carte Blanche Corp.*, 496 F.2d 747, 754 (3d Cir. 1974).

use of such certifications.²⁶ Apparently, this is in recognition of the fact that there is a definite need to review interlocutory class action orders under certain circumstances. Of course the district judge may decide not to grant the aggrieved party's request for certification²⁷ since certification of interlocutory orders for appellate review under § 1292(b) is within the discretion of the district judge. This illustrates one of § 1292(b)'s inherent limitations: the appellate court cannot of its own accord issue the certification, but must select another jurisdictional basis (another statutory or a judicial exception)²⁸ to review meritorious appeals from orders which the district judge has refused to certify.

3. Appealability Under the All Writs Act

The *Anschul* court embraces the position that a writ of mandamus may be utilized for any arbitrary refusal by the district court to certify an order for appeal under § 1292(b).²⁹ However, this contention is not well supported by existing case law. Historically, the courts have circumscribed carefully the role of the great writs. Indeed, the Supreme Court has ruled that such writs may not be used "merely as a substitute for the appeal procedure,"³⁰ nor to "thwart the Congressional policy against piecemeal appeals."³¹ In light of this view, the Second Circuit has stated: "Mandamus does not lie to review mere error . . . but only to redress a clear-cut abuse of discretion."³² The character of the writ is then "drastic and extraordinary";³³ there must be "a clear showing of abuse of discretion . . . , and the right to such relief must appear clear and undisputable."³⁴

Thus, there is obvious judicial hesitancy to employ mandamus in a class action context even when the lower court's performance is undeniably questionable. *Interpace Corp. v. City of Philadelphia*³⁵ concerned an order by the district court allowing nine antitrust actions against the defendant corporation to be maintained as class actions. Defendant sought a writ of mandamus that would have compelled the district court to vacate the class action order. Defendant argued that plaintiff did not meet the necessary prerequisites for a class action under FED. R. Civ. P. 23.³⁶ Moreover, the defendant contended that the district court was required to state the findings which supported its order granting class status. Upon appeal, the Third Circuit ruled that a district court is not required to articulate its findings regarding the certification or denial of class action status.³⁷ The court, however, did not indicate how the propriety of class action

26 See *King v. Kansas City S. Indus., Inc.*, 479 F.2d 1259 (7th Cir. 1973) (per curiam); *Thill Sec. Corp. v. N.Y. Stock Exch.*, 469 F.2d 14 (7th Cir. 1972); See also *Parkinson v. April Indus., Inc.*, 520 F.2d 650 (2d Cir. 1975).

27 See, e.g., *Allegheny Airlines, Inc. v. LeMay*, 448 F.2d 1341 (7th Cir.) (per curiam) cert. denied, 404 U.S. 1001 (1971).

28 For example, § 1292(a)(1), the *Cohen* doctrine or the death knell doctrine discussed *infra*.

29 544 F.2d at 1369.

30 *Roche v. Evaporated Milk Assn.*, 319 U.S. 21, 26 (1943).

31 *Id.* at 30.

32 *A. Olinick & Sons v. Dempster Bros., Inc.*, 365 F.2d 439, 445 (2d Cir. 1966).

33 *Texas Gulf Sulphur Co. v. Ritter*, 371 F.2d 145, 146 (10th Cir. 1967).

34 *Id.* at 146-47.

35 438 F.2d 401 (3d Cir. 1971).

36 *Id.* at 404.

37 The *Interpace* majority added the caveat that it was desirable to articulate these findings. The dissenting opinion asserts that it is mandatory.

determinations could be adequately reviewed on appeal if the requisite findings for making such a determination remain unstated by the lower court.

Clearly, a writ of mandamus cannot be relied upon to resolve abuses of discretion in failing to certify an interlocutory order for appellate review under § 1292(b). Since certification is purely within the discretion of the district judge, it is effectively insulated from appellate scrutiny. Until district judges become inclined to find controlling questions more as a matter of course, § 1292(b) represents an attractive but limited form of obtaining review. By itself, it is not sufficient to guarantee adequate review of meritorious appeals.

Since the class determination orders sought to be appealed in *Anschul*³⁸ and *Weit* could not be reviewed under statutory exceptions to the final judgment rule, it is necessary to examine whether such orders fall within the scope of recognized judicial exceptions.

Judicial Exceptions: Application to Weit and Anschul

1. The *Cohen* Doctrine

The *Weit* and *Anschul* plaintiffs sought to bring their appeals within the ambit of the *Cohen* doctrine.³⁹ The *Cohen* or "collateral order doctrine" was forged by the Supreme Court in *Cohen v. Beneficial Loan Corp.*⁴⁰ The *Cohen* plaintiff brought a stockholders derivative action against defendant corporation. Defendant's motion, which would have required plaintiff to post security for litigation expenses in the event plaintiff did not prevail, was denied by the district court. The district court order however, did not comply with a state statute expressly requiring the posting of such security upon commencement of the suit. Defendant was denied, therefore, the benefit of the legislation. The Supreme Court determined that this decision:

[A]ppears to fall in that small class which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated.⁴¹

The Court added that it had long given the final judgment provision a "practical rather than a technical construction."⁴² The *Cohen* order was appealable as a "final disposition of a claimed right which is not an ingredient of the cause of action. . . ."⁴³ The *Cohen* doctrine is applicable, therefore, if an order affects rights: (1) collateral to the cause of action; (2) too important to be denied review; and, (3) too independent to be adequately reviewed and corrected after final judgment.

The *Anschul* court examined this doctrine and the order denying plaintiff

38 It is unclear from the opinion whether the *Anschul* plaintiff requested a § 1292(b) certification. If requested, the district judge denied it. The court merely states that it cannot consider plaintiff's claim "since it was not raised under § 1292(b)." 544 F.2d at 1369.

39 The *Anschul* appeal concerned the refusal to grant class status; the *Weit* appeal requested relief from the order specifying the method of notifying the plaintiff class.

40 337 U.S. 541 (1949).

41 *Id.* at 546.

42 *Id.*

43 *Id.* at 546-47.

class certification in light of the Supreme Court's recent decision in *Eisen v. Carlisle & Jacquelin*.⁴⁴ The *Eisen* plaintiff had brought a class action on behalf of himself and all other odd-lot traders on the New York Stock Exchange alleging violations of the antitrust and security laws. The Supreme Court reaffirmed that the order in *Cohen* had been appealable on two grounds: (1) the finding was not "tentative, informal, or incomplete"; and, (2) the decision was not a "step toward final disposition of the merits of the case."⁴⁵ Rather, the Court concluded that *Cohen* concerned a collateral matter not reviewable on appeal from final judgment. The order central to the *Eisen* appeal would have imposed 90% of the costs involved in notifying the plaintiff class upon the defendant. The notification order appeared final since it would have been difficult for the corporate defendant to obtain reimbursement from the individual plaintiff for the substantial notification costs after final judgment. Moreover, the notification order was not part of the cause of action and did not affect the merits. Therefore, the notification order was appealable under the *Cohen* exception.

The *Anschul* court rejected plaintiff's attempt to fit the class action order within the *Cohen* exception.⁴⁶ The Seventh Circuit noted that there was no question of notice cost as in *Eisen*; thus the class certification decision was reviewable only after final judgment. The court, however, did not discuss the *Cohen* doctrine's other viable ingredients—whether the decision constituted a "step toward final disposition of the merits" or was not "tentative, informal or incomplete"—enunciated in *Cohen* and reaffirmed in *Eisen*. Technically, the class action order is a tentative and informal order because it is subject to change at the discretion of the district judge. As a practical matter, however, the *defendant* may not have the luxury of treating an order certifying a plaintiff class as tentative. Rather, he must mount a defense sufficient to protect himself from liability to a class even though it may later be decertified. The named *plaintiff*, as in *Anschul*, cannot accrue substantial expenses on the assumption that a "class" denied status may later reappear to help absorb litigation costs. Parties in such situations must treat the orders as final, rather than tentative, to adequately protect their rights.

Clearly, the class determination order in *Anschul* was also "collateral" and "not an ingredient of the cause of action." The pivotal issue is whether it would be reviewable after final judgment. Even assuming that a plaintiff would pursue the action, an appellate court may be unwilling to inject additional parties into the litigation after final judgment.⁴⁷

⁴⁴ *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974) [Eisen IV].

⁴⁵ *Id.* at 171.

⁴⁶ The original reviewing panel voted 2-1 to hear the appeal, a decision that would have reversed the Seventh Circuit's historical position. The opinion was circulated to all active members of the court however, who voted against allowing review of the appeal.

⁴⁷ *Herbst v. International Tel. and Tel. Corp.*, 495 F.2d 1308 (2d Cir. 1974). "Candor compels us to add that as appellate judges we would be reluctant to hold that a class action had been improper after the district court and the parties had expended much time and resources although we might have had serious doubts if we had reviewed the question at the inception of the action." *Id.* at 1313. This heretofore unstated policy and the related policy encouraging appellate courts to withhold jurisdiction on interlocutory appeals (because most class actions will be settled before final judgment) are unacceptable in terms of giving Rule 23 its full effect. The end result of such policies would be to effectively deny any appeal from the orders by insulating them from appellate scrutiny. Those corporate defendants forced to settle spurious claims because of prohibitive litigation costs would be especially hard hit.

The doctrine of "irreparable harm" also emerged from the *Cohen* opinion and should have been considered by the *Anschul* court. The *Cohen* court reasoned that by the time a case had been finally adjudicated it might be "too late effectively to review the present order, and the rights conferred by the statute . . . , will have been lost, probably irreparably."⁴⁸ Since the *Anschul* plaintiff probably could not maintain the litigation by himself, the order denying class status effectively would prevent both *Anschul* and the absent members of the class from having their day in court. Both, therefore, would be left without an effective remedy; the irreparable harm that would result is unavoidably apparent.

Generally, the restrictive interpretation the *Anschul* court imposed on the *Cohen* doctrine comports with the treatment it receives in the other circuits.⁴⁹ The concern has been that an overly liberal use of the doctrine will greatly increase the number of appeals from interlocutory orders.⁵⁰ The limiting phrase "small class" that originally appeared in *Cohen* and subsequently was approved in *Eisen*, has stayed courts from drifting toward a more liberal application of that doctrine. Today, the several hundred class actions pending in many of the circuits illustrate that a wider application of the doctrine to review class determination orders would violate the restricted use apparently contemplated by the *Cohen* court. Thus, although the denial of class action status in *Anschul* showed substantial promise of irreparable harm, the *Cohen* doctrine was not misapplied within its own self-restricting perimeter.

One of the three *Weit* orders did concern a question of notice as with *Eisen*. The *Weit* dissent pressed for broad appealability arguing that defects in the form and content of the notice could not be rectified after final judgment. The plaintiff's primary concern, however, apparently was the increased cost that would result from the use of the notice system adopted by the court.⁵¹ Unlike *Eisen*, such a cost differential would be recoverable from the corporate defendants after final judgment, thereby not prejudicing plaintiffs unduly. The majority correctly notes that if this appeal were not refused, all such orders specifying the form and content of notice would be appealable. In many instances, this would severely undermine the policy of the final judgment rule without providing a significant benefit to the parties. The majority's denial of appealability in *Weit* appears proper; the order by itself is not of sufficient stature or import to the parties to override the final judgment rule.

2. The Death Knell Doctrine

The *Anschul* plaintiff's personal claim against defendant seemingly was of an amount that would have brought the case under the "death knell" doctrine

48 337 U.S. 541, 546 (1949).

49 See, e.g., *Hackett v. General Host Corp.*, 455 F.2d 618 (3d Cir. 1972). "[W]e have not been overly hospitable to requests for its [the collateral order doctrines] extension." *Id.* at 621.

50 See, e.g., *Weight Watchers of Phil., Inc. v. Weight Watchers Int'l, Inc.*, 455 F.2d 770 (2d Cir. 1972). "We have often indicated that *Cohen* must be kept within narrow bounds, lest this exception swallow the salutary 'final judgment' rule." *Id.* at 773.

51 "[Plaintiff's proposal] would have greatly reduced the costs of notice to the plaintiffs." 535 F.2d at 1014.

within the Second Circuit.⁵² The death knell doctrine is another judicial exception to the final judgment rule which transforms interlocutory orders denying class status into final and appealable orders. This doctrine, which first emerged in *Eisen*,⁵³ applies to those situations in which the plaintiff would be unlikely to bear litigation expenses by himself because of the diminutive size of his own claim.

The *Eisen* plaintiff, who had a personal claim of only \$70, brought a class action for damages resulting from defendant brokerage firm's alleged violations of the antitrust and securities laws. In considering an appeal from the order denying class status, the Second Circuit noted the amount of plaintiff's claim and concluded that no reasonable lawyer would undertake this complex and costly case to recover \$70:

Dismissal of the class action . . . will irreparably harm Eisen and all others similarly situated [and would] for all practical purposes terminate the litigation. Where the effect of a district court's order, if not reviewed, is the death knell of the action, review should be allowed.⁵⁴

Clearly, the touchstone for the doctrine has been the amount of plaintiff's claim, although the complexity and probable expense of the litigation may also be relevant.⁵⁵ For example, the doctrine has not been applied when plaintiff's claim was \$150,000,⁵⁶ \$8,500,⁵⁷ or even as low as \$7,482,⁵⁸ based on the rationale that any plaintiff with a claim approaching the \$10,000 jurisdictional minimum would have sufficient reason to continue the litigation.⁵⁹ One thousand dollars or less apparently represents that amount under which plaintiffs generally would not press forward.⁶⁰

Despite its superficial appeal, the death knell doctrine has not been widely applied outside of the Second Circuit.⁶¹ Although it has been considered in class action litigation within the Second,⁶² Fifth,⁶³ Ninth,⁶⁴ and District of Columbia Circuits,⁶⁵ the Third⁶⁶ and Seventh⁶⁷ Circuits have rejected it outright.

The *Anschul* court elected to follow its own line of Seventh Circuit decisions denying effect to the doctrine. The court, concerned with erosion of the final

52 The amount of plaintiff's claim is not given. It can be inferred, however, from the nature of the alleged damages and the court's discussion of the death knell doctrine, that plaintiff's individual claim was nominal in amount. The death knell doctrine is considered for application only when the plaintiff's claim is small in size, e.g., less than \$1000.

53 370 F.2d 119 (2d Cir. 1966) [*Eisen I*], cert. denied, 386 U.S. 1035 (1967).

54 *Id.* at 121.

55 See *Graci v. United States*, 472 F.2d 124, 126 (5th Cir. 1973).

56 *Caceres v. International Air Transp. Ass'n.*, 422 F.2d 141 (2d Cir. 1970).

57 *Milberg v. Western Pac. R. R. Co.*, 443 F.2d 1301 (2d Cir. 1971). Husband and wife had a combined claim of \$8500.

58 *Shayne v. Madison Square Garden Corp.*, 491 F.2d 497 (2d Cir. 1974).

59 *Korn v. Franchard Corp.*, 443 F.2d 1301, 1307 (2d Cir. 1971).

60 *Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968) cert. denied, 395 U.S. 977 (1969).

61 *But see Miller v. Mackey Int'l, Inc.*, 452 F.2d 424, 427 n.3 (5th Cir. 1971).

62 *City of N.Y. v. International Pipe & Ceramics Corp.*, 410 F.2d 295 (2d Cir. 1969); The *Korn*, *Milberg*, *Caceres*, *Green* and *Shayne* decisions also involved a determination concerning the applicability of the death knell doctrine.

63 See note 61 *supra*.

64 *Weingartner v. Union Oil Co.*, 431 F.2d 26 (9th Cir. 1970).

65 *Williams v. Mumford*, 511 F.2d 363 (D.C. Cir. 1975).

66 *Hackett v. General Host Corp.*, 455 F.2d 618 (3d Cir. 1972).

67 *King v. Kansas City S. Indus., Inc.*, 479 F.2d 1259 (7th Cir. 1973).

judgment rule, echoed the criticisms of other circuits in supporting its rejection. The opposition to the doctrine is illustrated by *Hackett v. General Host Corp.*,⁶⁸ a case originating in the Third Circuit. The *Hackett* plaintiff, who had an individual claim of only nine dollars, sought to recover damages from an alleged price fixing conspiracy involving a group of bakers. The district court refused to certify a potential plaintiff class of some six million consumers. In affirming this decision, the *Hackett* court rejected the death knell doctrine and attacked its basic premise that counsel for individual plaintiffs will not continue costly and protracted litigation to recover negligible amounts.

If the public interest issue . . . is so insignificant that neither a private nor a public attorney deems it worthy of pursuit, despite the . . . award of attorney's fees in the event of success . . . then the public interest issue may well be so insignificant that the redress of a nine-dollar wrong should . . . be left to the realm of private ordering.⁶⁹

The decision clearly reflects the Third Circuit's opposition to any breach of the final judgment rule. A more valid criticism of this doctrine is that it discriminates against appeals by defendants, or plaintiffs with claims approaching the \$10,000 jurisdictional threshold.⁷⁰

The unpopular character of the death knell doctrine and the restrictions of *Cohen* signal the necessity of identifying alternative means for securing immediate review to protect party and non-party rights in future cases similar to *Anschul*. Since "the need for review of class action orders turns on the facts of a particular case,"⁷¹ the balancing of interests long advocated by the Supreme Court⁷² may supply the courts with a practical, non-mechanical means of reviewing meritorious appeals from class orders.

Judicial Economy v. Rights of Parties and Non-Parties

1. Judicial Economy

The primary function of the final judgment rule is to promote judicial economy by denying immediate review to orders that may be reviewed effectively

68 455 F.2d 618 (3d Cir. 1972).

69 *Id.* at 625-26.

70 See *Korn v. Franchard Corp.*, 443 F.2d 1301, 1307 (2d Cir. 1971) (Friendly, J., concurring). In an attempt to mute this criticism, the Second Circuit unveiled the "three-pronged test," a new approach designed to assist in evaluating the appealability of orders granting class status. The test was developed in *Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005, 1007 n.1 (2d Cir. 1973) [*Eisen III*], and applied in *Herbst v. International Tel. and Tel. Corp.*, 495 F.2d 1308 (2d Cir. 1974): (1) whether the class action determination is "fundamental to the further conduct of the case," (2) whether review of that order is "separable from the merits," (3) whether that order will cause "irreparable harm to the defendant in terms of time and money spent in defending a huge class action." *Id.* at 1312. In subsequent cases, including *Parkinson*, and *Kohn*, the Second Circuit has demonstrated a reluctance to employ either this new formula or the death knell in reviewing the interlocutory orders. *Parkinson* in particular has stressed that the newly created three-pronged test should be given a narrow construction. *Id.* at 658. The concurring opinion advocated abandoning the death knell and the three-pronged test in favor of reversion to the use of § 1292(b). *Id.* at 660 (Friendly, J., concurring).

71 520 F.2d 650, 660 (2d Cir. 1975).

72 See, e.g., *Gillespie v. United States Steel Corp.*, 379 U.S. 148 (1964); *Dickinson v. Petroleum Conversion Corp.*, 338 U.S. 507 (1950).

after final judgment. Some opinions at the appellate level have focused exclusively on the need for reducing appellate workload. The burden on the district courts also should be assessed.⁷³ Actions that would have been settled, had class action status not been improperly granted, exemplify the resource waste preventable through timely review of class determination orders. Recently, the view has been expressed that "immediate review of orders authorizing class actions will aid the district courts in disposing of these cases and promote the sound administration of justice."⁷⁴

Moreover, appellate courts should not overlook their level of involvement in ruling on the question of appealability. Both the *Weit* and *Anschul* courts must have expended considerable resources in familiarizing themselves with the facts of these cases and the law applicable to them, and in drafting opinions which accurately reflected their views concerning the appealability of the orders in question. Obviously, this involvement can sap appellate resources and undermine the efficiency which the rule was designed to promote. Years later, the *Weit* and *Anschul* courts may once again have to expend considerable effort to reach that point where the propriety of the original class determination orders may finally be reviewed. The fact that the courts may have attained this same vantage years earlier illustrates the duplication of effort that may accompany negative rulings on appealability. If the merits of the appeal cannot be reached after the court has agonized over the threshold question, the court's adherence to the rule seems merely to invoke an illusion of economy.

The potential for relitigation, resulting from improvident class action determinations, is a significant countervailing force to the policy prohibiting immediate review. If the plaintiff class is wrongfully excluded and the named plaintiff prevails on the merits, the defendant may be collaterally estopped from denying liability to all absent members of the class.⁷⁵ This would increase the defendant's liability multifold without a commensurate opportunity to defend.⁷⁶ The alternative approach of relitigation would involve considerable waste of the parties' and court's resources. Considering (a) the potential for relitigation, (b) the desirability of facilitating judicial proceedings in the district court, and, (c) the illusion of efficiency resulting from the appellate court's initial involvement in resolving the jurisdictional question, adherence to the final judgment rule may not yield the efficiency in complex multiple party suits that was obtainable at common law.

2. Rights of Parties and Non-Parties

Present statutory exceptions to the final judgment rule are limited in their

73 544 F.2d at 1370-71 (Swygert, J. and Bauer, J., dissenting).

74 495 F.2d 1308, 1312 (2d Cir. 1974).

75 See *Zdanok v. Glidden Co.*, 327 F.2d 944 (2d Cir. 1964); *United States v. United Air Lines, Inc.*, 216 F. Supp. 709 (E.D. Wash. & D. Nev. 1962), *aff'd sub nom.*, *United Air Lines, Inc. v. Weiner*, 335 F.2d 379 (9th Cir. 1964). "We affirm and adopt . . . the 'district court's treatment of . . . mutuality of collateral estoppel.'" *Id.* at 404. See also *Bernhard v. Bank of America Nat'l. Trust & Sav. Ass'n.*, 19 Cal. 2d 807, 122 P.2d 892 (1942).

76 Courts generally first satisfy themselves that the defendant had a full and fair opportunity to litigate the issues in the former action. *Graves v. Associated Transp., Inc.*, 344 F.2d 894, 900 (4th Cir. 1965). Strength of the defense, however, may be directly related to the size of the liability apparent to the defendant.

applications; judicial exceptions are equally limited or out of favor. There remains, therefore, the question of whether a broader jurisdictional basis exists for reviewing class action determinations such as those in *Weit* and *Anschul*. Several Supreme Court cases dealing with non-class actions seem to delineate a course toward greater appealability. In *Mercantile National Bank v. Langdeau*,⁷⁷ the Supreme Court was faced with the problem of whether an interlocutory order concerning venue was reviewable. A receiver had brought an action against two national banks and 143 other parties alleging a conspiracy to defraud an insurance company. A question was raised as to which state court had venue to entertain the action against the national banks. Rather than apply the final judgment rule rigidly to disallow appeal from the venue order, the Court stated:

[W]e believe that it serves the policy underlying the requirement of finality . . . , to determine now in which state court appellants may be tried rather than to subject them, and appellee, to a long and complex litigation which may be all for naught if consideration of the preliminary question of venue is postponed until the conclusion of the proceedings.⁷⁸

In so holding, the Court indicated that initial questions, with a high potential for causing relitigation, should be resolved at an early stage of the litigation.

Applying the *Mercantile* holding to *Anschul*, the question becomes whether the class determination order is comparable in relitigation potential to the venue order. If the order denying a plaintiff class in *Anschul* poses a significant risk of relitigation, presumably, it would be appealable in conformance with the underlying policy rather than the superficial construct of the final judgment rule.

Both *Weit* and *Anschul* raise the spectre of the relitigation issue: whether improperly absented class members must relitigate their claims after the named plaintiff has prevailed; or, whether the defendant is held liable to the members through the doctrine of collateral estoppel. The problem arises in *Anschul* if the named plaintiff prevails on the merits and wins an appeal of the class determination order. In *Weit*, if the plaintiff prevails and appeals the order denying certification of a defendant class, it is unclear: (a) whether the defendants will be collaterally estopped from relitigating the cause of action; or, (b) whether there will be a new trial to determine liability for each of the excluded defendants. Either alternative poses significant problems avoidable by an immediate review.

A policy suggesting that the rigidity of the final judgment rule may be tempered if the rights of parties are prejudiced seemed to underlie the Supreme Court's decision in *Gillespie v. United States Steel Corp.*⁷⁹ The *Gillespie* plaintiff was administratrix of her son's estate. The son had died while working on defendant's ship which was docked in Ohio. Plaintiff claimed a right to recover under Ohio's wrongful death statute for herself and decedent's dependent brother and sister. An additional claim was based on the Jones Act. The district court, acting upon defendant's motion to strike, limited recovery to damages under the Jones Act and denied recovery for the brother and sister. Plaintiff sought a writ of mandamus compelling dismissal of the motion to strike or, alter-

77 371 U.S. 555 (1963).

78 *Id.* at 558.

79 379 U.S. 148 (1964).

natively, a § 1292(b) certification. In reviewing the rulings below, the Supreme Court stated:

[D]elay of perhaps a number of years in having the brother's and sister's rights determined might work a great injustice on them, since claims for recovery for their benefit have been effectively cut off so long as the District Judge's ruling stands.⁸⁰

The Court also concluded that it would be appropriate to review a trial court's interlocutory order if it presented questions "fundamental to the further conduct of the case."⁸¹ The Court advocated a balancing test in deciding whether an order is final: "the inconvenience and costs of piecemeal review on the one hand and the danger of denying justice by delay on the other."⁸²

It would be unwise to unilaterally extend *Gillespie* to *Weit* and *Anschul*. The prospect of denying recovery to dependent family members is more compelling than the loss, to passengers on a cruise, of the economic benefit associated with a shortened trip. Nonetheless, the rights of the parties are at stake if they are denied their day in court.

The dissent in *Anschul* suggests that refusal to review the class order may be tantamount to denying the rights which the absent members seek to litigate.⁸³ Since the plaintiff's nominal claim could be insufficient to sustain him, the rights of the absent members to recover the alleged amount will evaporate with plaintiff's withdrawal. Additionally, the dissent notes that if plaintiff pursues the litigation and prevails, the defendant may contend that the named plaintiff no longer has standing to appeal since he has no further stake in the litigation.⁸⁴ Presumably, the defendants could also contend that as a result of their exclusion from the litigious process, absent class members lack standing to appeal. One court has suggested, however, that unknown members of the class will have standing to appeal the class action portion of the final decision even though they were not involved in the litigation.⁸⁵ Further, after final judgment the absent class members may be able to intervene to appeal the class determination, but this raises a significant question as to whether such intervention is timely.

Several of the above problems were broached in the recent Seventh Circuit decision *Romasanta v. United Airlines, Inc.*⁸⁶ Petitioner was a member of the putative class in *Romasanta*. She petitioned to intervene on behalf of herself and other airline stewardesses in her class who were discharged because of United's policy against employing married stewardesses. Her petition was filed after the *Romasanta* action had progressed to final judgment. The majority concluded that the named plaintiff, Romasanta, was still acting as the class champion upon whom putative members could rely to appeal the class determination.⁸⁷ The

80 *Id.* at 153.

81 *Id.* at 153-54.

82 *Id.* at 152-53 quoting *Dickinson v. Petroleum Conversion Corp.*, 338 U.S. 507, 511 (1950).

83 544 F.2d at 1371 (Swygert, J. and Bauer, J., dissenting).

84 *Id.*

85 431 F.2d 26, 28 n.4 (9th Cir. 1970).

86 537 F.2d 915 (7th Cir. 1976) (per curiam).

87 *Id.* at 918.

court's unstated assumption was that the named plaintiff would have standing to appeal the class determination order.⁸⁸

The *Romasanta* court allowed the petition under the permissive intervention provision of FED. R. CIV. P. 24(b)(2). The court hurdled Rule 24's requirement of a "timely" intervention by reasoning that petitioner could rely on the plaintiff to appeal the class determination after final judgment because the plaintiff had appealed the initial order.⁸⁹ Petitioner's intervention, therefore, was timely because she wasn't aware of the need to intervene until after final judgment when it became clear that plaintiff would not appeal the order. By contrast, the dissent urged that petitioner should have intervened immediately after the class denial to satisfy the "timely" requirement and to protect her rights as several members of the class had done.⁹⁰ Asserting that the defendant was aware throughout the litigation of the potential liability to the class, the court dismissed the question of prejudice. Apparently, a defendant is expected to exert the same quantum of resources and energy to defend against the named plaintiff that he would in defending against the entire class.⁹¹ This result seems to undermine Rule 23 requirements which were specifically added to afford defendants protection from multiple liabilities arising through untimely determination of class status.⁹² The future of permissive intervention as a tool to allow absent class members to appeal is, therefore, uncertain.

Applying the *Romasanta* rationale to *Anschul*, it is clear that defendants could be subjected to one-way intervention. This would result from the plaintiff classes' initial exclusion and later inclusion if the class determination order were modified after final judgment. At that point, absent class members could intervene to avail themselves of the judgment and increase defendant's liability multifold.

The situation in *Weit* is more complex. The district court certified a plaintiff class for the initial four counts, denied class status for the remaining two, and denied plaintiff's motion to certify a class of defendants. This complexity is ameliorated, however, since class certification in four of the six counts should ensure the involvement of the entire class, and not just the original plaintiffs, throughout the litigation. Plaintiff class members will not be faced, therefore, with potential difficulties in obtaining appeals; all will have standing and incentive to appeal the adverse determination after final judgment.

Finally, there is the argument presented by the *Anschul* dissent that FED. R. CIV. P. 23(c)(1) requires a determination by the appellate court as well as the district court.⁹³ This rule provides:

88 The dissent argued that after the initial class determination order, the named plaintiff was not necessarily representing the putative class interests. Accordingly, petitioner could not reasonably believe that her interests were being represented after the class allegation had been denied and the suit proceeded as an individual action. *Id.* at 921 (Pell, J., dissenting). Under this interpretation, it is uncertain whether the named plaintiff would have had standing. It is also unclear whether absent class members can rely as a rule on the prospect of intervening after final judgment to appeal the class determination.

89 By this reasoning plaintiffs would be encouraged to appeal interlocutory class determinations to protect the absent class members' right to intervene after final judgment, a result contrary to the policy of the final judgment rule.

90 537 F.2d 915, 921-22 (7th Cir. 1976) (per curiam) (Pell, J., dissenting).

91 The defendant was not even sure of the size of the class. Estimates ranged from 30 to 140 class members. *Id.* at 917.

92 *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 547 (1974).

93 544 F.2d at 1373 (Swygert, J. and Bauer, J., dissenting).

As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

Appellate determination, as the dissent suggests, would serve the spirit and purpose of this rule by finally settling the matter of class status at the initial stages of the litigation.⁹⁴

Indeed, a recent Supreme Court case lends support to this interpretation. In *American Pipe & Construction Co. v. Utah*,⁹⁵ the Court stated that Rule 23 was amended to avoid the potential for one-way intervention.⁹⁶ The classic example of this problem occurred when members of the alleged class awaited final judgment before deciding whether to intervene and benefit from the decision. The Court stated:

[T]he 1966 amendments were designed, in part, specifically to mend this perceived defect in the former Rule and to assure that members of the class would be identified before trial on the merits and would be bound by all subsequent orders and judgments.⁹⁷

If putative class members are not precluded from future initiatives as *Romasanta* suggests, they could await the outcome of the litigation before electing whether to intervene and appeal the class order. If the outcome were favorable, their subsequent intervention would approximate that of the one-way intervention sought to be avoided.⁹⁸

Three possibilities are thus suggested. First, the plaintiff, acting as the champion of the "class," would appeal the adverse class order after he has prevailed. This assumes that he has standing and will exercise that right even though no further benefit will accrue to him. Second, the putative class members will be able to intervene after final judgment. Third, if the above two alternatives are not available, the putative class simply will be denied their rights. These uncertain and undesirable effects could be avoided by allowing immediate district and appellate determination of class status to ensure that the parties to the litigation "would be identified before trial on the merits."⁹⁹

Conclusion

The *Anschul* case contrasts sharply with *Weit* in the amount of damages at stake and the complexity of party relationships. Both cases would appear, however, to present facts warranting immediate review of the class determination orders.

In *Anschul*, the potential adverse effects to the plaintiff may not seem sufficient to justify overriding the final judgment rule, since the average damage

94 *Id.*

95 414 U.S. 538 (1974).

96 *Id.* at 547.

97 *Id.*

98 See 544 F.2d at 1372 (Swygert, J. and Bauer, J., dissenting).

99 414 U.S. 538, 547 (1973).

claim appears small and the litigation should not be unduly lengthy. Yet *Anschul* falls within that zone of cases in which denial of class status may have the effect of denying the right to litigate. Depriving a party of his day in court would seem to be prejudice sufficient to warrant immediate review.

The class notification order in *Weit* illustrates the type of order that is undeserving of immediate review and which would tend to subvert the final judgment rule's worthwhile policy against piecemeal litigation. The *Weit* court appropriately assessed the importance of the notice order and accordingly denied review. Denying review of the orders refusing class status under § 1292(a)(1), while technically correct, was not as sound from a practical standpoint. Since the scope and extent of the litigation may well be immense, the better course would be to conclusively establish those participants involved in the controversy at an early stage of the proceeding. This is especially true since an appropriate statutory exception to the final judgment rule is available to supply the necessary jurisdictional basis. The complexities involved in a review after final judgment, when the rightful parties to the action have not yet been included or ascertained, would appear to effectively offset any incremental saving in workload at the initial stages of the litigation.

Despite recent dicta in the Second Circuit suggesting a more restrictive application of judicial exceptions,¹⁰⁰ a number of factors collectively signal a trend toward allowing a larger number of interlocutory appeals from class action determinations. These factors include: the development and survival of the death knell doctrine and its counterpart, the three-pronged appealability test; the reaffirmation of the *Cohen* doctrine in a recent Supreme Court decision¹⁰¹ and the sentiment expressed for a broader application of that doctrine;¹⁰² the increasing interest in the "fundamental to the further conduct" doctrine of *Gillespie*;¹⁰³ the interest balancing approach of *Dickinson*;¹⁰⁴ and the encouragement to make greater use of § 1292(b).¹⁰⁵ The *Weit* and *Anschul* dissents, therefore, appear to signal a growing trend of appellate thought towards allowing a wider latitude in appealing class determination orders. As class actions slowly proceed to conclusion, and potential adverse effects crystallize from prediction and conjecture to reality, it is probable that increasing weight will be given to the rights of litigants and non-litigants in the context of a balancing of interests approach.

Kenneth R. Martin

100 See note 70 *supra*.

101 417 U.S. 156 (1974) [Eisen IV].

102 See 544 F.2d at 1370 and 1373 (Swygert, J. and Bauer, J., dissenting); 495 F.2d 1308, 1313 n.9 (2d Cir. 1974); 70 Col. L. Rev. 1292 (1970).

103 See e.g., *General Motors Corp. v. City of N.Y.*, 501 F.2d 639, 659 n.3 (2d Cir. 1974) (Mansfield, J., concurring); *New England Power Co. v. Asiatic Petroleum Corp.*, 456 F.2d 183, 185 (1st Cir. 1972).

104 See, e.g., 544 F.2d at 1372 (Swygert, J. and Bauer, J., dissenting); 501 F.2d at 659 (Mansfield, J., concurring).

105 See text accompanying note 26 *supra*.

CRIMINAL PROCEDURE—EDITED PORTIONS OF TAPES MADE BY COMMON CARRIER DURING WIRE FRAUD INVESTIGATION ADMISSIBLE IN EVIDENCE UNDER THE OMNIBUS CRIME CONTROL ACT OF 1968 DESPITE THE FACT THAT SURVEILLANCE IS EXCESSIVE AND THEREFORE ILLEGAL.

*United States v. Auler**

In *United States v. Auler*,¹ the Seventh Circuit considered the scope of the authority of a common carrier to intercept and disclose wire communications, under the Omnibus Crime Control Act of 1968,² in the context of the prohibitions against the unauthorized publication or use of interstate wire communications set forth in the Federal Communications Act.³ The appellant, Raymond Auler, was convicted of violating the Wire Fraud Statute,⁴ and sentenced to six months' imprisonment.

While Auler argued for reversal on several grounds,⁵ the main issue before the court was the evidentiary effect of the fact that General Telephone had exceeded the scope of its statutory authorization, thereby conducting an "excessive and therefore illegal surveillance."⁶ Despite this fact, the court held that the edited tape recordings which General Telephone turned over to the F.B.I. were properly disclosed and need not be suppressed. Accordingly, the court affirmed Auler's conviction.

* 539 F.2d 642 (7th Cir. 1976).

¹ *Id.*

² 18 U.S.C. § 2511(2)(a)(i) (1970) provides that:

It shall not be unlawful under this chapter for an operator of a switchboard, or an officer, employee, or agent of any communication common carrier, whose facilities are used in the transmission of a wire communication, to intercept, disclose, or use that communication in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the carrier of such communication: *Provided*, That said communication common carriers shall not utilize service observing or random monitoring except for mechanical or service quality control checks.

³ 47 U.S.C. § 605 (1970) prohibits unauthorized publication or use of wire or radio communication:

Except as authorized by chapter 119, Title 18, no person receiving, assisting in receiving, transmitting, or assisting in transmitting, any interstate or foreign communication by wire or radio shall divulge or publish the existence, contents, substance, purport, effects, or meaning thereof, except through authorized channels of transmission or reception, (1) to any person other than the addressee, his agent, or attorney, (2) to a person employed or authorized to forward such communication to its destination, (3) to proper accounting or distributing officers of the various communicating centers over which the communication may be passed, (4) to the master of a ship under whom he is serving, (5) in response to a subpoena issued by a court of competent jurisdiction, or (6) on demand of other lawful authority. . . .

⁴ U.S.C. § 1343 (1970) prohibits fraud through the use of interstate communication:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice shall be fined not more than \$1000 or imprisoned not more than five years, or both.

⁵ In addition to the argument examined at length in the accompanying text, Auler contended that the security agents of General Telephone violated his rights under the fourth amendment; that the surveillance violated the Wisconsin Electronic Surveillance Law; and that the indictment failed to state an offense under 18 U.S.C. § 1343. The court, referring to settled case law on each point, rejected these subsidiary arguments summarily.

⁶ 539 F.2d at 647.

This somewhat enigmatic result is the focus of the present inquiry. This comment explains the Seventh Circuit's treatment of overly intrusive surveillance by common carriers from a historical perspective in an attempt to demonstrate the soundness of the approach adopted by the court.

On June 21, 1976, Gary Mattila, a security agent for General Telephone Company, was informed by an affiliated telephone company that a suspected "blue box" user had recently assumed residence in his district.⁷ The informant, Bernard G. Schlimgen of Wisconsin Telephone Company, identified the suspect as Raymond Auler, and substantiated his allegations on the basis of a recently completed investigation by Wisconsin Telephone which indicated that Auler had been utilizing a "blue box" to fraudulently place toll-free long-distance calls.

Upon receipt of this information, Mattila ordered 2600 cycle detectors (which indicate the use of a blue box device) placed on Auler's phones. After the detection of numerous 2600 cycle calls, Mattila further directed the recording of all multi-frequency tones and conversations originating from Auler's residence.

On July 30 and 31, Mattila advised F.B.I. Agent Hunter of the results of General Telephone's investigation of Auler. On the basis of this information, Agent Hunter obtained a warrant to search Auler's residence. Accompanied by Mattila, Hunter executed the warrant on August 10. During the course of the search, the two men discovered and seized a blue box as well as other electronic equipment.

Auler was subsequently tried and convicted of violating the federal Wire Fraud Statute, 18 U.S.C. § 1343.⁸ Prior to trial, Auler unsuccessfully sought to suppress any evidence which was the product of General Telephone's interception of his telephone lines.

Auler's main argument in support of his motion to suppress, as well as on appeal, asserted that the evidence secured to convict him was obtained in violation of the Communications Act of 1934, 47 U.S.C. § 605.⁹ Section 605 provides, with certain exceptions, that no person not authorized by the sender may intercept any wire or radio communication and divulge or publish the existence or contents of such intercepted communication to any person. Asserting that the monitoring of his telephone lines by General Telephone, and the subsequent disclosure of the existence and contents of intercepted communications to the F.B.I. were made in violation of § 605, Auler concluded that the information disclosed and the fruits thereof must be suppressed.

In response, the court noted that it had been asked to address the same argument in an earlier case, *United States v. Freeman*.¹⁰ Referring to its prior holding, the *Auler* court stated:

7 A blue box is used to electronically bypass a telephone company's billing equipment. After engaging a wide area telephone service system (WATS), the blue box emits a 2600 cycle tone which allows the user to remain within the toll system after the WATS line has been disconnected. Subsequently, the user "key pulses" through the blue box a series of multifrequency tones, comparable to those normally generated by a long distance call. However, the telephone company's billing equipment records only the original toll-free call. As a result, the user is not charged for the call made with the blue box.

8 See note 4 *supra*.

9 See note 3 *supra*.

10 524 F.2d 337 (7th Cir. 1975), *cert. denied*, 424 U.S. 920 (1976).

In *Freeman* we considered the scope of the exception, provided in the first sentence of section 605,^[11] as amended by the Crime Control Act of 1968,^[12] in the light of the prohibitions against disclosure of wire communications listed in the first paragraph of section 605. We held that section 2511(2)(a)(i)^[13] "must sensibly be read as an exception of telephone companies from the relevant prohibitions of 47 U.S.C. § 605, and, in a sense, as an authorization." *Freeman, supra*, at 340.

[T]herefore, we reaffirm our decision that section 2511(2)(a)(i) provides a telephone company with the power to protect its property through limited monitoring of the lines of suspected illegal users and the subsequent immunity to disclose necessary information to law enforcement agencies.¹⁴

Although reaffirming the existence of the statutory "common carrier" exception to § 605, Chief Judge Fairchild, writing for the Seventh Circuit, went on to emphasize that a telephone company's authority to intercept and disclose wire communications is not unlimited. Rather, he asserted, "it may only intercept a communication which is 'a necessary incident to the rendition of . . . service or . . . (for) the protection of the (company's) rights or property. . . .'" 18 U.S.C. § 2511(2)(a)(i).¹⁵

Given this judicial acknowledgement of the limited scope of the exception, the particular facts of the case gave Auler's argument new vitality and substance since the record indicated that General Telephone's surveillance extended beyond the scope of permissible interception outlined by the court. In fact, the Government conceded at oral argument that, during the two-week period of surveillance, General Telephone monitored and taped all outgoing calls in their entirety, whether made fraudulently or in compliance with the subscription agreement.¹⁶ Accordingly, the court was obliged to recognize "that General Telephone conducted excessive and therefore illegal surveillance."¹⁷

Despite this recognition, the Seventh Circuit held that edited portions of the tapes obtained during the course of the surveillance were properly admitted in evidence. This somewhat puzzling decision, while correct in result, was inadequately explained by the court. To remedy this inadequacy, as well as to explain the opinion's expositional paucity, it is necessary to place *Auler* in its historical context. Viewed in the light of prior cases considering the "common carrier" exception, the Seventh Circuit's treatment of the effect of exceeding the scope of the exception in *Auler* assumes value as a precedent which is not apparent on the face of the opinion.

Auler's Historical Context

In *Olmstead v. United States*,¹⁸ the first wiretap case to reach the United

11 See note 3 *supra*. This footnote corresponds with the court's note 5.

12 Pub.L.No. 90-351, Title III, § 803, 82 Stat. 223 (1968). This footnote corresponds with the court's note 6.

13 See note 2 *supra*. This footnote corresponds with the court's note 7.

14 539 F.2d at 645-46.

15 *Id.* at 646.

16 *Id.*

17 *Id.*

18 277 U.S. 438 (1928).

States Supreme Court, the police intercepted communications by placing a tap on the defendant's telephone line. In a 5-4 decision, the majority held that the police conduct in question did not constitute a search and seizure within the ambit of the fourth amendment, and that the wiretap evidence was properly admitted. However, Chief Justice Taft's majority opinion suggested that Congress had the authority to regulate wiretapping in order to "protect the secrecy of telephone messages by making them, when intercepted, inadmissible in evidence in federal criminal trials, by direct legislation."¹⁹

In apparent response, Congress enacted the Federal Communications Act of 1934,²⁰ which provided in § 605 that:

[N]o person not authorized by the sender shall intercept any communication and divulge or publish the existence, contents, substance, purport, effect, or meaning of such intercepted communication to any person.²¹

This section was first interpreted by the Supreme Court in *Nardone v. United States*.²² In that case, the Court held that § 605 prohibited the introduction in federal court of evidence obtained directly by wiretapping. In the second *Nardone* case,²³ the Court extended this prohibition to "leads" supplied by wiretapping under the "fruit of the poisonous tree" doctrine.²⁴

Despite its current use as such, the language of the statute itself does not designate § 605 as a rule of evidence. However, beginning with *Nardone*, it became, by judicial construction, a rule of evidence which read into the statute an implicit exclusionary sanction.²⁵ This resulting statutory exclusionary rule centered on judicial interpretation of the words "intercept" and "divulge" as used in the Act.²⁶ As the line of interpretive cases developed, it became increasingly clear that the basis of exclusion was not the initial intrusion or interception itself, but the explicit directive of § 605 that information thus obtained may not be disclosed without the sender's consent.²⁷

Of course, the Supreme Court ultimately reversed *Olmstead* and recognized that government agents, state or federal, who engage in electronic eavesdropping must comply with the constitutional requirements of a reasonable search under the fourth amendment.²⁸ Furthermore, any evidence, tangible or testimonial, that is seized without adherence to these constitutional safeguards must be excluded.²⁹ Nevertheless, the importance of § 605's exclusionary sanction remained

19 *Id.* at 465.

20 Act of June 19, 1934, ch. 652, 48 Stat. 1064 (1934).

21 *Id.*, § 605, 48 Stat. 1103 (1934).

22 302 U.S. 379 (1937).

23 *Nardone v. United States*, 308 U.S. 338 (1939).

24 *Id.* at 340-41. *See also* *Wong Sun v. United States*, 371 U.S. 471, 485 (1963); *Silverthorne Lumber Co. v. United States*, 251 U.S. 385, 392 (1920).

25 *See* *United States v. Sugden*, 226 F.2d 281 (9th Cir. 1955), *aff'd per curiam*, 351 U.S. 916 (1956).

26 *See generally* Decker & Handler, *Electronic Surveillance: Standards, Restrictions and Remedies*, 12 CALIF. W. L. REV. 60 (1975).

27 *See* *Upshaw v. United States*, 335 U.S. 410, 427 (1948) (Reed, J., dissenting); *Goldstein v. United States*, 316 U.S. 114, 118 (1942); *Nardone v. United States*, 302 U.S. 379, 382 (1937).

28 *Katz v. United States*, 389 U.S. 347, 359 (1967); *Berger v. New York*, 388 U.S. 41, 58-60 (1967).

29 371 U.S. at 485; *Weeks v. United States*, 232 U.S. 383, 391-92 (1914).

of continued importance as applied to private wiretapping, since private searches and seizures are not subject to fourth amendment restrictions.³⁰

Yet despite the statute's continued force and effect with respect to private wiretapping, the federal courts developed a judicial exception to its prohibitions. This exception provides that when a subscriber of a telephone system uses the system's facilities in a manner which reasonably justifies the telephone company's belief that he is violating his subscription rights, § 605 does not prohibit the telephone company from monitoring or recording the calls to the extent reasonably necessary for the company's investigation.³¹

As expressed by the courts, the rationale of the "common carrier" exception is twofold. One basis for the exception is that when the use of the communication facility itself is illegal, the protections of § 605 are inapplicable.³² The courts recognize that the statute was intended by Congress for the protection of users, and that one who fraudulently bypasses telephone billing equipment has no legal standing to attack any reasonable measures undertaken by the telephone company to protect itself.³³ The second basis of the exception is grounded in a judicial construct of the "implied consent" of the unauthorized user. Any person who chooses to use the facilities of a telephone company, reason the courts, impliedly consents to reasonable billing procedures employed by the company.³⁴ Thus, the user has no standing to challenge the company's good faith efforts in that regard.

However, these decisions invariably emphasize that the common carrier's authority is limited to "reasonable means necessary to protect its interests." Thus, in *Bubis v. United States*,³⁵ the Court of Appeals for the Ninth Circuit concluded that a telephone company's monitoring of the defendant's calls for three months, after ample evidence had been secured that he had been using a blue box, was unreasonable. Accordingly, the *Bubis* court held that the company's tapes voluntarily given to the government were inadmissible. In *Bubis*, the court explained that:

[T]he monitoring and tape recording for such length of time, after ample evidence had been secured of the illegal use by appellant of the company's facilities, was unreasonable and unnecessary. To sanction such practices on the part of the telephone company would tend to emasculate the protection of privacy § 605 was intended to protect.

In these circumstances the district court erred in admitting into evidence the tape recordings. . . .³⁶

On its face, the court's language in *Bubis* would seem to require suppression

30 *Honeycutt v. Aetna Ins. Co.*, 510 F.2d 340, 348 (7th Cir.), *cert. denied*, 421 U.S. 1011 (1975).

31 *See, e.g.*, *Brandon v. United States*, 382 F.2d 607 (10th Cir. 1967); *United States v. Beckley*, 259 F. Supp. 567 (N.D. Ga. 1965).

32 *See, e.g.*, 382 F.2d at 611; 259 F. Supp. at 571; 226 F.2d 281; *Casey v. United States*, 191 F.2d 1, 4 (9th Cir. 1951), *rev'd on other grounds*, 343 U.S. 808 (1952).

33 259 F. Supp. at 611.

34 *Id.*

35 384 F.2d 643 (9th Cir. 1967).

36 *Id.* at 648.

of all evidence secured whenever the telephone company has exceeded the permissible bounds of the judicially created exception to § 605. The rule implied by the court's language is that continued monitoring of an individual's telephone lines, after sufficient evidence has been obtained to secure an indictment for wire fraud, requires the exclusion of any and all evidence obtained by the telephone company during the course of its investigation.

However, a more critical examination of the *Bubis* decision demonstrates that such a conclusion is patently erroneous, despite the court's language. *Bubis* was under prosecution on a federal gambling charge, not the Wire Fraud Statute.³⁷ This fact weighed heavily in deciding the ultimate outcome of the case because it precluded the court from applying the traditional justifications for the common carrier exception to § 605. Obviously, there was no basis for the application of the "implied consent" doctrine, since *Bubis*' consent could only be implied with respect to "reasonable billing procedures," not for the purpose of convicting him of using interstate telephone facilities for gambling.³⁸ On the other hand, the particular facts of the case made the court reluctant to rely on the "communication illegal in itself" rationale, since to authorize wholesale intrusions on that basis "would tend to emasculate the protection of privacy § 605 was intended to protect."³⁹

Moreover, the actual holding of the Ninth Circuit in *Bubis* was quite limited. The court held only that the telephone company's continued monitoring of *Bubis*' calls for three months, after ample evidence had been secured that he had been using a blue box, was unreasonable. Thus, the court concluded, the tapes voluntarily given to the government were inadmissible in the subsequent gambling prosecution. The actual holding makes clear that the *Bubis* court was dealing only with evidence which had been secured exclusively outside the ambit of the "common carrier" exception. The court expressed no opinion as to the possible admissibility of evidence obtained during the course of the initial wire fraud investigation, but only precluded the admission of evidence secured after that time when the surveillance became "unreasonable."

Nevertheless, the language of the *Bubis* court placed the federal judiciary in a state of confusion with respect to the "common carrier" exception to § 605. Nowhere was this confusion more manifest than in *United States v. Hanna*.⁴⁰ In *Hanna*, the defendant was indicted for three separate violations of federal law: wire fraud,⁴¹ wagering by wire,⁴² and using the telephone in interstate commerce to promote an unlawful activity.⁴³ The government's evidence in its entirety had been the direct or indirect result of Southern Bell Telephone Company's investigation of *Hanna*, a suspected blue box user.

Once again, the "common carrier" exception to § 605 was at issue. The defendant argued that the statute required the exclusion of all evidence stem-

37 18 U.S.C. § 1343 (1970).

38 384 F.2d 643, 648 n.2 (9th Cir. 1967).

39 *Id.* at 648.

40 260 F. Supp. 430 (S.D. Fla. 1966), *aff'd* 404 F.2d 405 (5th Cir. 1968), *cert. denied*, 394 U.S. 1015 (1969).

41 18 U.S.C. § 1343 (1970).

42 18 U.S.C. § 1084 (1970).

43 18 U.S.C. § 1952 (1970).

ming from the interception of his telephone conversations. The United States District Court for the Southern District of Florida denied Hanna's motion to suppress.⁴⁴

On appeal to the Court of Appeals for the Fifth Circuit, however, this ruling was reversed.⁴⁵ Judge Rives denied that the telephone company necessarily had to record any parts of the conversations in order to secure payment of long distance tolls. He concluded that § 605 required the suppression of all evidence stemming from those tapes made by the company. Hence, the opinion of the court in effect denied the very existence of any "common carrier" exception to § 605.

In a special concurring opinion, on the other hand, Judge Godbold recognized the existence of the "common carrier" exception, but cited *Bubis* as requiring the exclusion of all evidence secured by Southern Bell:

[W]hatever right the telephone company may have to determine the existence of communications or the content of communications is limited by the standards of reasonableness which were exceeded in this case.⁴⁶

A third position was set forth by Judge Hughes in her dissent, which found that the telephone company's activities were properly limited and did not violate § 605.⁴⁷ Thus, she concluded that the evidence had been properly admitted, and voiced strong opposition to the views adopted by her brethren on the Fifth Circuit.

On rehearing,⁴⁸ Judge Hughes' position ultimately prevailed. Again writing the majority opinion, Judge Rives reversed his previous holding, conceding that he had been "in error both as to the facts and as to the law."⁴⁹ Accordingly, Hanna's conviction was affirmed.

As *Hanna* was being considered by the Fifth Circuit, Congress was in the process of enacting the Omnibus Crime Control Act of 1968.⁵⁰ In § 2511(2) (a)⁵¹ of that Act, Congress gave statutory recognition to the judicially created "common carrier" exception to the prohibitions of 47 U.S.C. § 605.

As explained by the Senate report:

Paragraph (2) (a) provides that it shall not be unlawful for an operator of a switchboard or employees of a common carrier to intercept, disclose, or use wire communications in the normal course of their employment while engaged in any activity which is a necessary incident to the rendition of his service or the protection of the rights or property of the carrier. *It is intended to reflect existing law.* (*United States v. Beckley*, 259 F. Supp. 567 (N.D. Ga. 1965)). (Emphasis added)⁵²

44 *Hanna v. United States*, 260 F. Supp. 430 (S.D. Fla. 1966).

45 *Hanna v. United States*, 393 F.2d 700 (5th Cir. 1968).

46 *Id.* at 708.

47 *Id.* at 709.

48 *Hanna v. United States*, 404 F.2d 405 (5th Cir. 1968), *cert. denied*, 394 U.S. 1015 (1969).

49 *Id.* at 406.

50 18 U.S.C. §§ 2510—2520 (1970).

51 18 U.S.C. § 2511(2) (a) (i), as amended (1970).

52 [1968] U.S. CODE CONG. & ADMIN. NEWS, 2182.

Given the difficulties encountered with "existing law," as made apparent in *Hanna*, the Senate's comment is somewhat ironic in retrospect. In fact, the latent ambiguities of "existing law" were recognized by Mr. Justice Fortas just one year after the passage of § 2511(2)(a)(i), in a cautionary footnote to his dissent from denial of certiorari in the *Hanna* case itself:

The Government argues that the applicability of § 605 to events such as this is now of only academic interest because of the recent enactment of § 802 of the Omnibus Crime Control and Safe Streets Act of 1968, 82 Stat. 212, 18 U.S.C. § 2510 et seq. (1964 ed., Supp. IV). That argument is untenable. . . .

It is by no means clear that the new statute would authorize this kind of conduct if a similar case occurred today. Unless it did, § 605 would still apply and the same problems that exist in this case would arise again.⁵³

The precise focus of Mr. Justice Fortas' concern was not the "common carrier" exception itself, but the effect of exceeding the scope of the exception. The "kind of conduct" in question was not properly limited investigation and disclosure, but overly intrusive telephone company surveillance which exceeded the bounds of "reasonable means necessary to protect its interests." The text accompanying the above-quoted footnote made this clear:

In a similar case, *Bubis v. United States*, 384 F.2d 643 (C.A. 9th Cir. 1967), the Ninth Circuit held that under § 605 the telephone company was not allowed to continue tapping its subscribers' lines to detect fraud "after ample evidence had been secured of the illegal use . . . of the company's facilities." 384 F.2d, at 648. The tap in *Bubis* recorded the whole conversation and not merely the first part, but an essential fact—that the interception was more extensive than necessary to detect fraud—is the same in both cases.⁵⁴

Hence, the spectre of the broad exclusionary language employed by the Ninth Circuit in *Bubis* continued to have a profound influence on federal courts considering excessive telephone company surveillance of suspected illegal users. Mr. Justice Fortas' dissent represents the best example of a misreading of *Bubis*, focusing on the language of the opinion rather than the decision's limited holding. Under this erroneous approach, *Bubis* requires the exclusion of all evidence obtained if the telephone company exceeded the scope of the "common carrier" exception. In *Hanna*, this issue had been defused since on rehearing the Fifth Circuit was satisfied that Southern Bell's surveillance had been properly limited. Nevertheless, it was clear that *Bubis* had erroneously become the basic text on the effect of exceeding the scope of the "common carrier" exception.

Despite the fact that Congress had given statutory force to the "common carrier" exception in 18 U.S.C. § 2511(2)(a)(i), the difficulties evidenced in *Bubis* and *Hanna* persisted. In fact, judicial concern over the "standards of reasonableness" was heightened as the courts sought to delineate with precision

⁵³ *Hanna v. United States*, 394 U.S. 1015, 1017 n.2 (1969) (Fortas, J., dissenting from denial of certiorari).

⁵⁴ *Id.* at 1017.

the scope of the statutory exception. For example, in the first case decided under § 2511(2)(a)(i), *United States v. Shah*,⁵⁵ the United States District Court for the Western District of Pennsylvania relied heavily on *Hanna* in its effort to define the rights and duties of the telephone company under the statute. The court noted that the statute expressly limits telephone companies to those activities which are a necessary incident to the rendition of service or to the protection of the rights or property of the carrier. To give substance to this limitation, the *Shah* court quoted the text of the *Hanna* opinion with reference to investigation of suspected illegal users. The district court relied on *Hanna* to require that recordings of illegal calls be limited to the dialing and opening salutations.⁵⁶

In its own initial consideration of § 2511(2)(a)(i), *United States v. Freeman*,⁵⁷ the Seventh Circuit also demonstrated a heightened awareness of the limited nature of the statutory authorization which it implied from the *Bubis* and *Hanna* decisions. Discussing § 2511(2)(a)(i), the court emphasized that:

In view of our interpretation of the statutory provision, we do not reach the proposition that if the use of the communication facility itself is illegal, the right of privacy does not exist, and the matter may be divulged. See, e.g., *Hanna v. United States*, 404 F.2d 405, 406 (5th Cir. 1968), *cert. denied*, 394 U.S. 1015 (1969).⁵⁸

Thus, the codification of the common carrier exception, coupled with the continuing emphasis on *Hanna*, had effectively precipitated the elimination of one of the central rationales of the pre-statute judicial exception.

Similarly, in *United States v. Clegg*,⁵⁹ the Fifth Circuit examined the restrictive implications of *Bubis* in the context of the new statute. While deciding that *Bubis* was not on point since the telephone company's surveillance had been properly limited,⁶⁰ the court suggested that *Bubis* would require the exclusion of all evidence obtained if the telephone company had recorded the entire context of the defendant's telephone calls.⁶¹

The *Clegg* court thus advanced the broad exclusionary principle which the federal courts erroneously tended to imply from *Bubis*; any surveillance which exceeded the scope of the "common carrier" exception yields no admissible evidence. Only telephone company surveillance remaining totally within the confines of § 2511(2)(a)(i) could produce evidence which could be offered at trial.

Hence, the codification of the judicially created exception to § 605 resulted in a new emphasis on the limited nature of its scope. The continued impact of *Bubis* and *Hanna* contributed to this emphasis, and simultaneously perpetuated the implicit question of the effect of exceeding the scope of the statutory exception.

55 371 F. Supp. 1170 (W.D. Pa. 1974).

56 *Id.* at 1175-76.

57 524 F.2d 337 (7th Cir. 1975), *cert. denied*, 424 U.S. 920 (1976).

58 524 F.2d at 341.

59 *United States v. Clegg*, 509 F.2d 605 (5th Cir. 1975).

60 *Id.* at 614.

61 509 F.2d at 614, n.14.

United States v. Auler:

The Question Becomes Explicit

In *United States v. Auler*, the Seventh Circuit confronted the critical question of the effect of exceeding the scope of § 2511(2)(a)(i). Having reaffirmed the fact that § 2511 provided an "exception to the relevant prohibitions of § 605,"⁶² and carefully delineating the scope of the exception,⁶³ the court was forced to concede that General Telephone's surveillance had exceeded that scope.

Although noting the possible civil and criminal consequences of this "excessive and therefore illegal surveillance," the court held that the evidence actually submitted had been properly admitted since General Telephone only disclosed to the F.B.I. the limited evidence which is permissible under § 2511(2)(a)(i). This evidence consisted of edited tape recordings containing only the tones transmitted by the blue box, the dialing signals, and the salutations of fraudulently placed calls. As the court noted:

The interception of the material recorded on these tapes may be viewed apart from those more intrusive acts of surveillance which are not immunized by § 2511(2)(a)(i). The reasonable and necessary interceptions and disclosures need not be suppressed as the "fruits" of illegal surveillance. . . .⁶⁴

Since General Telephone provided no evidence to the F.B.I. which stemmed from excessive interception, and none was offered at trial, the court concluded that the edited tapes were properly admitted.

This somewhat enigmatic result, while inadequately explained by the court, establishes a new and positive approach to "the effect of exceeding the scope of the 'common carrier' exception." The pre-2511(2)(a)(i) cases of *Bubis* and *Hanna* implied an "all or nothing" exclusionary sanction which had been echoed approvingly in many post-statute decisions as well: if the common carrier's surveillance exceeded permissible bounds, no evidence stemming from its investigation may be offered at trial. However, the Seventh Circuit's *Auler* decision did not fall prey to this misreading of *Bubis*. Instead, *Auler* reflects the more reasonable rule that although any surveillance which exceeds the scope of § 2511(2)(a)(i) subjects the telephone company to civil and criminal penalties, only information actually obtained outside that scope is properly subject to the exclusionary sanction.

The underlying rationale of the *Auler* approach can best be illustrated by way of analogy to the "plain view" doctrine. Under that doctrine, it has long been settled that objects falling within the plain view of an officer who has a right to be in the position to have that view are subject to seizure and may be introduced in evidence.⁶⁵ The fact that the officer might subsequently exceed the scope of the doctrine by overly intrusive acts has no effect on the admissibility of the evidence discovered "in plain view." Only those items secured outside

62 *United States v. Auler*, 539 F.2d 642, 645 (7th Cir. 1976).

63 *See* text accompanying note 15, *supra*.

64 539 F.2d at 646.

65 *See, e.g., United States v. Barone*, 330 F.2d 543 (2d Cir. 1964).

the scope of his unobstructed view are subject to exclusion.

So too, under the "common carrier" exception, when evidence is secured properly within the scope of the exception (i.e., where the telephone company "has a right to be" under § 2511(2)(a)(i)), the fact that the surveillance subsequently exceeds this scope does not render the fruits of its investigation inadmissible *ab initio*. Rather, only evidence actually obtained after the surveillance has become "excessive and therefore illegal" is properly subject to a meritorious motion to suppress.⁶⁶

Hence, *Auler* creates a bifurcated effect of exceeding the scope of § 2511(2)(a)(i). This approach entails two separate points of inquiry: (1) whether the surveillance was properly limited; and (2) at what point in time the particular evidence was actually secured. If the common carrier's surveillance exceeds the scope of its statutory authorization, then civil and criminal liability will result. However, for the exclusionary sanction to come into play, it is not only necessary that the common carrier exceed the proper scope of investigation, but also that the particular evidence sought to be admitted was actually secured outside that scope.

This limited exclusionary effect represents *Auler's* most essential contribution to this area of the law, and it stands as a contribution of merit and consequence. By avoiding the pitfalls suggested in *Bubis* and *Hanna*, the Seventh Circuit's decision in *United States v. Auler* represents a break with past decisions which were laden with uncertainty and ambiguity concerning the effect of exceeding the scope of the "common carrier" exception. Hopefully, *Auler* will come to serve not only as a break with this past, but as a positive influence in future consideration of the rights and duties of common carriers under 18 U.S.C. § 2511(2)(a)(i).

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⁶⁶ In addition, adoption of the "plain view" model resolves any potential difficulties pertaining to the particular offense to which evidence disclosed by a telephone company relates. In *Bubis*, for example, the court expressed concern with the fact that the evidence secured by the telephone company related to the gambling charge rather than wire fraud. The "plain view" analogy makes this conceptual dilemma irrelevant by limiting the court's inquiry to whether the evidence secured was obtained within the proper scope of § 2511(2)(a)(i). Thus, if a telephone company's investigation is conducted within the prescribed bounds of the statute, evidence of any inadvertently discovered illegal activity may properly be disclosed to enforcement agencies and used at trial. *See, e.g., People v. Sierra*, 343 N.Y.S. 2d 196 (S.Ct. N.Y. County 1973).

EVIDENCE—HEARSAY STATEMENTS OF JOINT VENTURERS—CAUTIONARY
INSTRUCTION NOT REQUIRED AT THE TIME THIS EVIDENCE IS OFFERED

*United States v. Buschman**

In *United States v. Buschman*,¹ the Seventh Circuit considered the need for a cautionary instruction to be issued when evidence is offered pursuant to the joint venture exception to the hearsay rule. Specifically at issue was the introduction into evidence of certain incriminating statements made by two individuals who had allegedly worked with the defendant, Buschman, to transact an illegal sale of firearms.² The trial judge refused the defendant's request to give such a cautionary instruction, and the statements were admitted under the hearsay rule exception. On appeal, the Seventh Circuit rejected the contention that this was reversible error and affirmed defendant's conviction.³ This comment will consider whether a judge should give such a cautionary instruction when he is requested to do so. It will also focus on the question of who should finally determine the admissibility of hearsay, an issue which must be clearly resolved before a complete discussion of the need for an instruction can take place.

The joint venture exception to the hearsay rule is a closely related corollary to the co-conspirator exception. According to the co-conspirator exception, courts may in certain instances provide that hearsay declarations of one conspirator, made in furtherance of the goals of a presently existing conspiracy, are admissible in evidence against other alleged conspirators.⁴ Admissibility of hearsay in cases where a number of people have allegedly worked together toward criminal ends does not, however, depend upon the existence of a conspiracy count in the indictment. The exception may be utilized not only in actual conspiracy trials, but also when, although a joint venture in furtherance of criminal goals allegedly existed, the defendant against whom the evidence is admitted is on trial for substantive offenses only.⁵ This was the situation presented in *Buschman*.

The rationale for these exceptions is the existence of an imputed agency relationship among the participants in the conspiracy or joint venture.⁶ Each such participant is assumed to have approved of the acts and statements that took place in furtherance of the ends to which the members committed themselves.⁷ Accordingly, each member is responsible for the acts and statements of the others

* 527 F.2d 1082 (7th Cir. 1976).

1 527 F.2d 1082 (7th Cir. 1976).

2 Defendant was convicted of two counts of firearms violations. Count one charged defendant with knowingly engaging in the business of dealing in firearms, in violation of 18 U.S.C. § 922(a)(1), § 924(a), § 2 (1970). Count two charged him with the knowing receipt and possession of firearms after having been convicted of a felony, in violation of 18 U.S.C. § 1202(a)(1) (Appendix), § 2 (1970).

3 527 F.2d at 1083-84, 1090.

4 *Krulewicz v. United States*, 336 U.S. 440 (1949), *Glasser v. United States*, 315 U.S. 60 (1942), *Logan v. United States*, 144 U.S. 263 (1892).

5 *United States v. Jones*, 438 F.2d 461 (7th Cir. 1971), *United States v. Spencer*, 415 F.2d 1301 (7th Cir. 1969), *United States v. Lawler*, 413 F.2d 622 (7th Cir. 1969), *cert. denied*, 396 U.S. 1046 (1970); *United States v. Bernard*, 287 F.2d 714 (7th Cir.), *cert. denied*, 366 U.S. 961 (1961).

6 *United States v. Gooding*, 25 U.S. (12 Wheat.) 460 (1827). See also the joint venture cases in note 5, *supra*, particularly *Spencer* and *Bernard*.

7 144 U.S. at 308-09.

in furtherance of the undertaking. It is this "vicarious responsibility"⁸ which provides the theoretical basis for the admission of hearsay statements pursuant to these exceptions to the hearsay rule.

Courts have been required, however, to limit the use of these exceptions because of the circular nature of this reasoning: statements admitted under and exception tend to establish the existence of a conspiracy, but the existence of a conspiracy is itself a prerequisite to the admissibility of the statements. Without caution on the part of the courts, hearsay might "lift itself by its own bootstraps" into admissibility.⁹ Confronted with this dilemma, courts have allowed the exceptions to be invoked only in circumstances involving sufficient non-hearsay evidence to connect a defendant to an ongoing conspiracy or joint venture.¹⁰

When this evidence was offered by the prosecution in *Buschman*, the defendant requested a cautionary instruction. Counsel for the defendant asked the court to admonish the jury, first, that they could not consider this evidence until the Government established beyond a reasonable doubt that there had been a joint venture and, second, that proof of the existence of the joint venture could not be accomplished by means of the hearsay declarations.¹¹

The trial judge denied this request, emphasizing that in his view the question of the admissibility of this evidence was a matter for his sole determination. Thus, it was not necessary to impress upon the jury the conditional nature of the hearsay.¹² In so ruling, the judge agreed that the admissibility of this evidence was predicated upon the establishment by the prosecution of the existence of a joint venture by independent, non-hearsay evidence. The judge warned that if the prosecution, after the presentation of its case, had failed to produce sufficient independent evidence of a joint venture, a mistrial would be granted.¹³

As the trial progressed, the government produced independent evidence tending to connect Buschman to the joint venture. The judge, satisfied of the sufficiency of the evidence, submitted the case to the jury, which returned a verdict of guilty.¹⁴

On appeal, the Seventh Circuit confronted a single issue: was the trial court's refusal to give the requested cautionary instruction reversible error? Appellant's contention was that such an instruction must be given to the jury at the time hearsay testimony of one joint venturer is admitted against another.¹⁵

In affirming Buschman's conviction, the Seventh Circuit concluded, after its own review of the evidence, that there was sufficient independent evidence of defendant's participation in the scheme to render the hearsay fully admissible against him. Thus, even if the judge had erred in not giving the instruction when it was requested, this error would have been harmless in light of the fact that, ultimately, none of the hearsay was excludible.¹⁶

8 287 F.2d at 720.

9 315 U.S. at 75.

10 *Id.* at 74; 438 F.2d at 466.

11 527 F.2d at 1084 n.1.

12 *Id.* The uncertainty as to who, in fact, does finally decide whether hearsay is fully admissible against a particular defendant will be discussed at length in this comment.

13 *Id.*

14 *Id.* at 1084.

15 *Id.* at 1083.

16 *Id.* at 1084-85, 1090, and note 23, *infra*.

In light of the court's conclusion that if there was error it was harmless beyond a reasonable doubt, it could have disposed of the appeal without considering the merits of defendant's argument. Such a disposition would have been entirely proper, as it provides a sufficient rationale for affirming the conviction. Nevertheless, the court did not confine itself to this narrow principle, but discussed the merits of requiring the judge to give a cautionary instruction when the evidence is first offered. The Seventh Circuit concluded at the end of this analysis that, while it recommends that the instruction be given in most cases, it will not impose an ironclad requirement. The court thus upheld the exercise of discretion by the trial judge.¹⁷

This comment will consider the various arguments that appear in *Buschman* concerning the question of whether the cautionary instruction should be given when it is first requested.¹⁸ Crucial to the proper treatment of this question, however, is a discussion of who should finally determine the admissibility of hearsay. Admissibility of such evidence in a conspiracy or joint venture case hinges upon a finding that there is sufficient independent, non-hearsay evidence to connect the defendant to the conspiracy or joint venture. The Seventh Circuit in *Buschman* failed to indicate who must make this determination. The court did not discuss the question directly, and in the course of its opinion made statements that are either ambiguous or contradictory in terms of this issue.

The court's failure to elaborate on this basic question is unfortunate. A definitive statement on the issue of who must make this decision would have heavily influenced the whole question of when, if at all, a cautionary instruction must be given. For example, if the jury will eventually weigh the sufficiency of the dependent evidence, separated from the hearsay, then it will have to learn the details of its assignment at some point. Thus, an argument could be made that this educational process should begin when the hearsay is first offered. Others might argue that, for whatever reason, the instruction regarding the use of such hearsay should be given at the end of the trial. Regardless of which argument prevails, it is clear that the fact that the jury plays any role in determining the admissibility of hearsay is a dominant factor in shaping the respective arguments. Because of the court's failure to unequivocally decide who makes the final decision on admissibility, the extent to which these arguments are appropriate is never certain. This prevents both a full understanding of the court's existing discussion of the merit of requiring an instruction and a proper evaluation of the court's conclusion.

In addition to providing a necessary contextual basis for the court's discussion, a consideration of the issue of who must make this evaluation would have afforded the court an opportunity to reevaluate the ramifications of an established Seventh Circuit practice. Prior decisions of the Seventh Circuit indicate the use of a bifurcated procedure whereby the judge and the jury both have a role in invoking the hearsay exception.¹⁹ The government argued in

17 *Id.* at 1089.

18 See the discussion accompanying note 72, *infra*.

19 *United States v. Rizzo*, 418 F.2d 71 (7th Cir. 1969), *United States v. Allegretti*, 340 F.2d 254 (7th Cir. 1964), *cert. denied*, 381 U.S. 911 (1965), adopting earlier dissenting opinion in prior hearing, *United States v. Allegretti*, 340 F.2d 243 (7th Cir. 1964).

Buschman that this is solely a judicial decision, and cited case authority which criticized any procedure allowing the jury to take part in the evidentiary determination.²⁰ If the court had discussed the question of who should make this decision on the non-hearsay evidence, instead of summarily dismissing the issue without a consideration of the merits, the Seventh Circuit would have confronted those cases which demonstrate the weaknesses inherent in its bifurcated procedure.

The Seventh Circuit in *Buschman* could have effectively disposed of the appeal solely on the ground that if there was error it was harmless. However, the court chose to discuss the question of whether a cautionary instruction should have been given when it was requested. It is unfortunate that, in the context of this arguably unnecessary analysis, the court ignored the problem of who must ultimately decide the admissibility of the hearsay evidence, since an explicit and consistent treatment of this issue would have been valuable to the court's existing analysis of whether it should require an early instruction. In addition, this would have afforded the Seventh Circuit the opportunity to examine a procedure followed elsewhere which appears sounder, both theoretically and practically, than the practice adopted in earlier Seventh Circuit cases.

The Court's Analysis in Buschman

The actual basis of the Seventh Circuit's decision in *Buschman* is not entirely clear from the analysis offered by the court. Two possible interpretations support its ultimate determination: (1) there was no error committed when the judge refused to give the cautionary instruction, or (2) if there was error, it was harmless beyond a reasonable doubt. Much of the opinion consists of an extended analysis of policy considerations and of decisions in other cases focusing on whether the judge must give the cautionary instruction when requested. Further support of the first interpretation of the *Buschman* decision is the court's conclusion that "On the full record of the present case . . . , we hold that the trial court did not abuse its discretion in refusing to give the instruction."²¹ Added to this is the caveat that in most circumstances the trial judge would be "well advised" to give a timely cautionary instruction when hearsay is proffered.²² This segment of the opinion, standing alone, imparts the clear impression that, in the court's view, the trial judge committed no error.

However, the Seventh Circuit appears to have retreated from this position in the paragraphs following this conclusion. The court went on to state that, because the government produced ample independent evidence to connect *Buschman* with the joint venture, the hearsay statements of his co-venturers were fully admissible against him. Because of that fact, no evidence was improperly considered by the jury. These circumstances fully justify the court's later statement that, "the facts of this case establish that the trial court's refusal to grant the initial request for the cautionary instruction, if error, would be harmless

²⁰ *United States v. Ragland*, 375 F.2d 471 (2d Cir. 1967), *cert. denied*, 390 U.S. 925 (1968).

²¹ 527 F.2d at 1089.

²² *Id.*

beyond a reasonable doubt. . . ."²³ Thus, the Seventh Circuit provided another rationale for affirming the conviction, one which did not depend on an outright decision that there was no error at trial. While both rationales support the court's ultimate disposition, it is less than clear which one was determinative.

More confusing, however, is the Seventh Circuit's stance on the basic issue of whether the judge or the jury has the final responsibility for making the evidentiary decision on which the admissibility of hearsay depends. Not even the court's discussion of what must be included in the requested instruction leaves a clear indication of who has this responsibility. In its summary of the events of the trial, the court relates that defense counsel asked for a cautionary instruction that the jury could not consider hearsay testimony until the prosecution "had established" the existence of a joint venture by means of independent evidence.²⁴ Similarly, in the course of its later admonition that in most instances it would be appropriate for such an instruction to issue from the trial judge, the court stated that the instruction should emphasize that the admissibility of the hearsay depended on the condition that the defendant "be shown," by evidence independent of the hearsay, to have been a joint venturer.²⁵ Neither statement sheds light on the question of who, in the court's viewpoint, should make that decision. The requirement that defendant's status as a joint venturer be "established" or "shown" by independent evidence is ambiguous, since it is not clear to whose satisfaction this fact must be "shown."²⁶

Further uncertainty is generated by the fact that the court at various points in its opinion appears to alternately endorse the two conflicting positions. In discussing the wisdom of requiring the instruction requested by *Buschman*, the court speculated that such a requirement would unnecessarily impede conspiracy and joint venture cases "by placing a limitation upon evidence at the time admitted when, on the entire record, it would have been demonstrated that it need not have been limited at all."²⁷ This statement implicitly presupposes that it is the judge who makes the evidentiary determination. Unless the judge alone determines admissibility, he cannot be in a position at the conclusion of the trial to state that the evidence need not have been limited.

The court made a similar implication later in its opinion. In upholding the

23 *Id.* at 1090. The court makes this statement immediately after its refusal to consider the contention that the judge alone should determine the matter of admissibility. It is not clear whether the reference to harmless error was meant to apply only to the hypothetical in which the judge made the sole determination of admissibility, or whether the statement applied to the instant case, where the jury did have a role. Since, as the court concluded, there was no improper consideration of hearsay, the error would seem to be equally harmless no matter who made the determination. Whether or not this particular statement was meant to refer to the present case, the court's analysis, as discussed in this comment, supports that basis of disposition. As the court said in another part of the opinion, "the defendant can hardly allege that he was manifestly prejudiced by the court's initial decision to allow the Government to introduce hearsay statements subject to a connection requirement." *Id.*

24 *Id.* at 1084.

25 *Id.* at 1089.

26 As will be seen, prior Seventh Circuit cases have utilized a procedure whereby the judge makes the preliminary determination based on the independent evidence. If he is satisfied with the independent evidence the jury must then also separately consider such evidence before the hearsay becomes admissible. Perhaps the requested instruction should inform the jury about both aspects of the problem, but the *Buschman* court's discussion does not indicate that it had in mind this allocation of functions. The case remains ambiguous on this question.

27 527 F.2d at 1086.

judge's exercise of discretion in not giving the instruction, the court indicated that the judge, at the time the request is made, must confront the question of "whether there [is] any real need for an instruction . . .," since the prosecution could still, over the course of the trial, link Buschman to the joint venture by independent evidence.²⁸ This statement appears to be another acknowledgment of the notion that the judge alone must determine the sufficiency of the independent evidence. If the trial judge can decide that no instruction is needed, and the court here suggests that he can, then the clear implication is that the task of passing on the independent evidence is for the judge alone.

However, at other times the *Buschman* court implied that the jury retains some role in determining the admissibility of hearsay. When the court discussed the role of an appellate court in reviewing the sufficiency of the evidence in conspiracy cases, it noted that, when considering an appeal, the court must decide for itself whether sufficient independent evidence existed, "by which the jury could tie each defendant to the conspiracy."²⁹ While the clear thrust of the court's earlier statements is that it is the judge alone who is concerned with the distinction between hearsay and independent evidence, here it appears that the jury must make the separation and arrive at a preliminary factual decision.

The intimation that the jury must first separately consider the independent evidence in order to determine admissibility is bolstered by the extent of the court's discussion of cases from other circuits in which the jury is required to perform a similar task.³⁰ Concededly, the Seventh Circuit attempted to distinguish *Buschman* from these other cases. However, the court never questioned the basic premise advanced in those cases: it is ultimately the jury which must tie a defendant to a conspiracy before a co-conspirator's declarations can be admitted against him.

Prior Seventh Circuit cases, not considered by the court in *Buschman*, indicate that in the past this court has accorded to the jury a role in weighing the independent evidence.³¹ In such cases, the Seventh Circuit has employed a bifurcated procedure in which (1) the judge first makes a determination of the sufficiency of the independent evidence and admits the co-conspiratorial declarations if the independent evidence satisfies him, and then (2) the jury must also separately consider the independent evidence before it can consider the hearsay.

*United States v. Allegritti*³² illustrates this procedure. There, the district court had ruled that certain acts and statements of co-conspirators were admissible against the other conspirators. The defendants' appeal from their convictions required the Seventh Circuit to address the question of who must make the

28 *Id.* at 1089.

29 *Id.* at 1085.

30 *United States v. DeJesus*, 520 F.2d 298 (1st Cir.), *cert. denied*, 423 U.S. 865 (1975), *United States v. Honneus*, 508 F.2d 566 (1st Cir. 1974), *cert. denied*, 421 U.S. 948 (1975), *United States v. Apollo*, 476 F.2d 156 (5th Cir. 1973).

31 *See* note 19, *supra*.

32 340 F.2d 254 (7th Cir. 1964). *See* also note 19, *supra*.

33 *Id.* at 248-50. This discussion occurred in the original dissenting opinion adopted by the Seventh Circuit on rehearing. The appeal was based on the contention that in announcing to the jury that the evidence was admissible the judge conveyed the idea that the conspiracy had already been proven and thus usurped the jury's function. 340 F.2d at 249.

decision based on the independent evidence.³³ Sitting *en banc*,³⁴ the court held that in order for such evidence to be admissible the trial judge must determine, without considering the statements made by other alleged conspirators, that a conspiracy existed and that a particular defendant was a member of it. If the judge is satisfied of these facts, and also of the fact that the statement or action was in furtherance of an ongoing conspiracy, the challenged evidence is admitted by the judge without limitation.³⁵ The court re-emphasized after this analysis that, "the determination of such facts upon which admissibility depends is the province of the trial judge,"³⁶ and for this proposition it cited *United States v. Dennis* and *United States v. Carbo*.³⁷ Both of these cases agree with the position that the judge must follow such a procedure, and in so doing criticize any practice that reserves a role for the jury in the evidentiary determination.

Despite explicitly approving a rule whereby determination of this issue rests with the judge, the court in *Allegretti* proceeded to endorse a procedure whereby the jury subsequently makes another preliminary determination before the declarations of co-conspirators are considered. The *Allegretti* court quotes with approval the trial judge's charge to the jury, in which he explained (1) that acts and statements of co-conspirators, made in furtherance of the conspiracy, are admissible against any defendant only if the jury determines that there was a conspiracy and that defendant was a member of it, and (2) that in making this determination that defendant was a conspirator, "the jury are [*sic*] not to consider what others may have said or done."³⁸

This test is broader than a limitation on hearsay, since it also includes a restraint on the use of acts of others and of all statements of others, whether or not they are hearsay. Hearsay is, however, clearly within the category of, "what others may have said," and the effect of this instruction is to require the jury to make a further test to determine whether any hearsay will be admissible against a particular defendant. Thus, before the jury can consider co-conspiratorial statements against a particular defendant, it must first, without considering any such statements, connect the defendant to the conspiracy. This charge does not speak at all of "independent evidence," of "hearsay," or "admissibility."³⁹ However,

34 This was an *en banc* rehearing of the case, which had already been before the court once. On rehearing, the Seventh Circuit specifically adopted the dissenting opinion in the earlier case. See note 19, *supra*.

35 The admission of the evidence is made without limitation *on his part*. It will be seen shortly that the jury still has a voice in determining the admissibility of the evidence against a particular defendant.

36 340 F.2d at 248.

37 *Carbo v. United States*, 314 F.2d 718 (9th Cir. 1963), *cert. denied*, 377 U.S. 953 (1964), *United States v. Dennis*, 183 F.2d 201 (2d Cir. 1950), *aff'd on other grounds*, 341 U.S. 494 (1951). These cases will be discussed at length later in the comment.

38 340 F.2d at 250. By way of contrast, the procedure advocated by cases such as *Dennis* and *Carbo* (note 37 *supra*) is one whereby the judge alone separates hearsay from non-hearsay and decides whether the hearsay is admissible. Once he admits the hearsay, the jury considers it as it would other evidence, and never has to make any separation of the types of evidence.

A subsequent Seventh Circuit case, *United States v. Rizzo*, 418 F.2d 71 (7th Cir. 1969), confirms the approach taken in *Allegretti*. *Rizzo* also makes it clear that when the jury makes the determination upon which the use of co-conspiratorial acts and declarations depends, the standard of proof in this inquiry is "reasonable doubt." 418 F.2d at 82.

39 Taken as a whole, the instruction seems to be intended as a check on the possibility that a defendant will be prejudiced by an unwarranted connection with the acts and statements of other alleged conspirators. In other words, there may be some statements of other

despite the *Allegretti* court's failure to address the implications of the instruction, it is clear that the judge's determination of the admissibility is not final. Before the jury may consider co-conspiratorial declarations, it must perform its own version of the independent evidence test.⁴⁰

The trial judge in *Buschman* followed this procedure in dealing with the admissibility of the hearsay. When defense counsel requested the cautionary instruction, the judge made it clear that the preliminary decision upon which the admissibility of hearsay hinged was for him to make. At the end of the trial, the judge concluded that the independent evidence linking defendant to the joint venture was sufficient, and denied defendant's motion for acquittal.⁴¹ Nevertheless, when instructing the jury, the judge used the identical charge in *Allegretti*. In making its preliminary determination as to whether Buschman was a participant in a joint venture, the jury still had to exclude from its consideration, "what others may have said or done." Then, and only then, the instruction continued, could acts and statements of other members be used by the jury against the defendant Buschman.⁴²

Role of the Judge and Jury in the Determination of Admissibility

It is apparent that, if the Seventh Circuit in *Buschman* had dealt with the question directly, rather than by indirect and at times contradictory inference, it would have had to confront cases such as *Allegretti* in its discussion of who must make the evidentiary decision. This fact makes the court's failure to elaborate all the more regrettable. Not only would consideration of this issue have clarified the related discussion of whether an instruction should have been given, but it also would have required the Seventh Circuit to examine its past practice in the light of some of the cogent analysis offered by other circuits.

In *Buschman* the Government argued that the question of admissibility is

alleged conspirators that do not refer directly to a particular defendant, and there may be acts that are not performed in his presence or with his knowledge. It is important that such evidence not be imputed to the defendant on any agency principles unless, in fact, he was a member of the conspiracy. Thus, he should first be connected to the conspiracy by his own actions and statements, and the *Allegretti* charge requires this. 340 F.2d at 250. However, the Court's instruction goes further and requires the jury in making the connection to exclude *all* statements of other conspirators, even, apparently, hearsay statements admitted earlier by the judge. Such hearsay may refer to what the defendant in question said or did. This is evidence as to a defendant's own conduct, and, once admitted by the judge, would seemingly be eligible for use by the jury in determining whether the defendant was a conspirator. However, the hearsay is indeed something that "others . . . have said"; thus, the instruction requires the jury to ignore even this evidence and to engage, in effect, in a redetermination of the admissibility of hearsay. The instruction given in *United States v. Jacobs*, 431 F.2d 754 (2d Cir. 1970) attempts to cope with this problem.

40 It appears that the jury's version is slightly different, in form if not in substance, from the judge's task. As *Allegretti* points out, the judge must determine by means of the independent evidence both that there is a conspiracy and that this defendant was a participant in it. 340 F.2d at 248. The instruction to the jury requires it to ignore evidence of acts and statements of others in determining whether a defendant was a member of the conspiracy; the charge does not specify which evidence may be used to establish the conspiracy itself. 340 F.2d at 250-52. The difficulties discussed in this comment would seem to be the same when the jury has *any* responsibility in the admissibility determination, so that it is doubtful whether this distinction has any significance.

41 527 F.2d at 1084.

42 Defendant's Requested Instructions, at 2. This instruction is the model contained in 1 E. DEVITT & C. BLACKMAR, *FEDERAL JURY PRACTICE AND INSTRUCTIONS* § 11.15 (1970).

solely for the judge to decide. To support this proposition the Government cited *United States v. Ragland*,⁴³ a conspiracy case from the Second Circuit. In *Ragland*, the trial judge had admitted hearsay statements of co-conspirators into evidence against a particular defendant. In instructing the jury, the judge explained that it could not use these statements against the defendant unless it first found that, independently of the hearsay, a prima facie case of conspiracy had been established.⁴⁴ Thus, the jury, as in the *Allegretti* case, was required to weigh for itself the sufficiency of the independent evidence before the hearsay became fully admissible against defendant.

On appeal, the Second Circuit held that this burden on the jury was unnecessary: the judge alone determines whether there is sufficient independent evidence to admit the hearsay. Once he admits it, the jury is not required to make any further separation of the hearsay, but may consider it undifferentiated from the other evidence. The jury is not required to "second-guess" the judge's determination.⁴⁵

The rationale for this rule was developed in a group of opinions written by Judge Learned Hand. In *United States v. Nardone*,⁴⁶ defendants appealed their conviction for conspiracy and for substantive crimes relating to the smuggling of alcohol. Appellants argued for reversal because the trial judge refused to charge the jury that before they could consider declarations of a co-conspirator against another they must be convinced beyond a reasonable doubt that the particular defendant was indeed a member of the conspiracy. Commenting on the duty which would thereby be imposed on the jurors to separate the declarations from other evidence, Hand wrote:

Thus, the request was that the jury should consider the declaration only after coming to a conclusion about another fact; an admonition presupposing a mental gymnastic impossible for anyone, judge or jury, though judges have at times presumed themselves capable of it. The competency of evidence is for the judge alone; any question of fact upon which it depends he must decide; if he admits it the jury may use it like other evidence—for whatever it proves to their minds—they can have no concern with rulings about evidence which, as far as it is possible, ought to be kept from their notice.⁴⁷

Judge Hand thus questioned the practical value of such an instruction and voiced doubts that a juror could successfully compartmentalize evidence, as is required when the jury has a role in determining the sufficiency of non-hearsay evidence. In *United States v. Dennis*,⁴⁸ he indicated another problem with such a procedure. There, the trial judge had reserved the evidentiary question for the jury and, although his analysis was not necessary to dispose of the appeal, Judge Hand discussed why that procedure was not proper. He reasoned that if a jury must satisfy itself that a particular defendant was a member of the alleged conspiracy before co-conspiratorial declarations can be used against that defendant,

43 375 F.2d 471 (2d Cir. 1967), cert. denied, 390 U.S. 925 (1968).

44 *Id.* at 478-79.

45 *Id.* at 479.

46 127 F.2d 521 (2d Cir.), cert. denied, 316 U.S. 698 (1942).

47 *Id.* at 523.

48 183 F.2d 201 (2d Cir. 1950). See also note 37, *supra*.

then the declarations are useless: the case is in effect decided in the course of this preliminary determination. In other words, to decide that the declarations are admissible, the jury must first decide that the defendant is guilty of conspiracy.⁴⁹

Cognizant of these problems inherent in any approach whereby the jury participates in this evidentiary decision, the Second Circuit has firmly adhered to the course suggested by Learned Hand. The law in that circuit today is that the judge first determines, by a fair preponderance of the evidence, whether there is sufficient independent non-hearsay evidence to show that a defendant participated in the conspiracy. Once the judge is satisfied, the jury may then consider all of the evidence, hearsay and non-hearsay, in determining defendant's guilt beyond a reasonable doubt.⁵⁰

The Second Circuit is not the only court that has reached the conclusion that the jury should have no role in the independent evidence test. In *Carbo v. United States*, the Ninth Circuit, in an often-cited opinion, endorsed Hand's approach after a thorough and well-reasoned analysis of the issue.⁵¹ There the court noted that what makes the issue so delicate is that admissibility is predicated on a factual determination which is precisely the same as the ultimate factual question in the case. As the court noted, "the declarations are admissible against the defendants if they are co-conspirators. If they are co-conspirators they are guilty." If the jury must first find, beyond a reasonable doubt and solely by means of the independent evidence, that defendant participated in the conspiracy, then the hearsay, when admitted, has no value.⁵² The jury in effect has already found the defendant guilty in the preliminary inquiry; the newly admitted hearsay is therefore superfluous. The co-conspiracy exception to the hearsay rule, an exception created to allow this evidence to come before the jury, is thus negated by the very procedure which attempts to implement the exception.

The court in *Carbo* also condemned the suggestion that the problem, whereby the ultimate factual issue in the case is resolved in the evidentiary inquiry, could be avoided simply by requiring the jury to weigh the independent evidence by a lesser standard than reasonable doubt.⁵³ As an example, the *Carbo* court considered the possibility of making the admissibility of the challenged evidence depend upon the government's proving, solely by means of the independent evidence, a prima facie case.⁵⁴ The court noted that under this

49 183 F.2d at 230-31. As Hand puts the matter, "In strict logic these instructions in effect altogether withdrew the declarations from the jury, and it was idle to put them in at all."

50 In addition to *Ragland*, *Nardone*, and *Dennis*, this principle has been reiterated in *United States v. Glazer*, 532 F.2d 224 (2d Cir. 1976), *United States v. Projansky*, 465 F.2d 123 (2d Cir. 1972), *United States v. Geaney*, 417 F.2d 1116 (2d Cir. 1969), *United States v. Nuccio*, 373 F.2d 168 (2d Cir.), cert. denied, 387 U.S. 906 (1967), *United States v. Pugliese*, 153 F.2d 497 (2d Cir. 1945).

51 314 F.2d 718 (9th Cir. 1963), cert. denied, 377 U.S. 953 (1964). The Second Circuit in *Nuccio*, refers in a footnote to the "helpful discussion" provided by *Carbo*. 373 F.2d at 173 n.3. Also, in the commentary 1 E. DEVITT & C. BLACKMAR, FEDERAL JURY PRACTICE AND INSTRUCTIONS § 29.07 (1970), the editors cite the "excellent discussion" of this problem provided by *Carbo*.

52 314 F.2d at 736. The Court notes that by following such a procedure, "The district court in effect will have told the jury 'You may not consider this evidence unless you first find the defendant guilty.'"

53 *Id.* at 737.

54 *Id.*

process the jury not only would have to "compartmentalize" evidence, a difficult feat in itself, but would also be required to apply different standards depending upon which evidence it was considering at the time. The Ninth Circuit unequivocally stated that a jury could not possibly implement such a procedure successfully, and speculated that the imposition of this task might confuse the jury's perception of the necessary standard of proof. Prejudice to the defendant might well result.⁵⁵

Accordingly, the Ninth Circuit in *Carbo* reached the conclusion that has been often repeated by the Second Circuit: the judge must be the sole arbiter of the factual question to be resolved before the hearsay exception can be successfully invoked.⁵⁶

The Third Circuit has also expressed agreement with the principle enunciated by the Second Circuit and by *Carbo*.⁵⁷ Of the numerous Third Circuit cases dealing with this issue, of particular importance to this discussion is *United States v. Van Orden*.⁵⁸ In that case the court addressed a situation not explicitly covered by the cases discussed above. Each of the previously considered cases actually involved a conspiracy trial. However, in *Van Orden*, hearsay was admitted against a defendant who was convicted of substantive offenses and not of conspiracy. The situation is thus more closely analogous to *Buschman* and the other Seventh Circuit "joint venture" cases.⁵⁹

Under the circumstances, the court expressed no hesitancy in requiring the judge alone to determine the admissibility question.⁶⁰ This rule had been previously announced in the Third Circuit in a case in which there had been a conspiracy conviction,⁶¹ but the *Van Orden* court applied the principle without any discussion of the different circumstances presented by a joint venture case.⁶²

While all of the cases considered thus far have involved the conspiracy or joint venture exception to the hearsay rule, there is in the traditional rules of

55 *Id.*

56 Despite the acclaim accorded to the *Carbo* decision, a more recent Ninth Circuit case demonstrates that the policy is not consistently applied even there. The Court in *United States v. Griffin*, 434 F.2d 978 (9th Cir. 1970), upheld an instruction which gives the jury a role in much the same manner as the Seventh Circuit does. The *Carbo* case is not mentioned.

57 *United States v. Shaffer*, 520 F.2d 1369 (3d Cir. 1975), *cert. denied sub nom.*, *Vespe v. United States*, 423 U.S. 1051 (1976), *United States v. Rodrigues*, 491 F.2d 663 (3d Cir. 1974), *United States v. Van Orden*, 469 F.2d 461 (3d Cir. 1972), *United States v. Bey*, 437 F.2d 188 (3d Cir. 1971).

58 469 F.2d 461 (3d Cir. 1972).

59 *See* note 5 *supra* and the accompanying text.

60 469 F.2d at 464.

61 *United States v. Bey*, 437 F.2d 188 (3d Cir. 1971).

62 Although the situation paralleled that in *Buschman*, the Third Circuit did not use any "joint venture" language in its discussion of the exception to the hearsay rule and the mechanism by which it is invoked.

Van Orden thus adopted the *Bey* rule without extensive discussion. This result seems entirely proper, since there is no rational basis for applying a different rule in joint venture cases than in conspiracy trials. The burden on the jury of compartmentalizing evidence in order to determine the admissibility of hearsay is the same whether the hearsay is admitted under the joint venture or conspiracy doctrine. The problem of effectively finding the defendant guilty in the preliminary inquiry and thus neutralizing the hearsay exception is also present in both instances. If the jury were required to find by means solely of the independent evidence that the defendant participated in the joint venture which allegedly committed the crime, there would be nothing left to decide once the hearsay was admitted. Thus, the arguments in favor of sole judicial determination of the issue, advanced in cases such as *Carbo*, *Dennis*, and *Nardone*, apply with equal force to both the joint venture and the conspiracy exceptions.

evidence broad support for a rule whereby the judge alone decides all preliminary factual matters. This rule is not confined in its application to this particular hearsay exception. McCormick cites as rationale for this position the argument that the jury is unable and unwilling to ignore parts of the evidence they have heard and thus is incapable of properly making preliminary determinations.⁶³ McCormick further notes, however, that there is a "strain" upon this principle when the preliminary question coincides with one of the issues of fact on which the case depends. Nonetheless, he still expresses support, citing *Dennis* and *Carbo*, for a rule that leaves a judge in sole control of whether the particular evidence is admissible.⁶⁴

As noted earlier, the Seventh Circuit is not the only court which has allocated to the jury some responsibility for this evidentiary decision. In *Buschman* the court discussed cases which, although primarily concerned with establishing the requirement that a cautionary instruction be given upon request when hearsay is first introduced, also stand for the proposition that the jury must pass on the sufficiency of independent evidence before hearsay becomes fully admissible against a particular defendant.⁶⁵

Of the cases discussed in *Buschman*, *United States v. Honneus*⁶⁶ explicitly provides for the jury's participation in the evidentiary decision. In *Honneus*, the First Circuit heard an appeal from a conspiracy trial at which the judge, at the time the hearsay was offered, instructed the jury that this evidence could not be used against a defendant unless the jury found that that particular defendant was a member of the conspiracy.⁶⁷

While this instruction would seem necessarily to imply that the declarations could not be used against a defendant when the jury was making the determination of whether he was a member, the First Circuit apparently did not think that the implication was strong enough or complete enough. The court concluded that the charge did not adequately forewarn the jury that it must find both that the existence of the conspiracy and defendant's participation in it have been shown by independent evidence before the hearsay can be admitted.⁶⁸ In the First Circuit's analysis, this point must be clearly explained to the jury, since the jury is unfamiliar with distinctions drawn in the rules of evidence. Without direction from the court, "it would be most natural for the jury, in endeavoring to ascertain whether the defendants were in fact members of the

63 MCCORMICK, *HANDBOOK ON THE LAW OF EVIDENCE* § 53 (2d ed. 1972).

64 *Id.* Also the Federal Rules of Evidence, though not yet in effect at the date of *Buschman's* trial, provide a broad statement of support for the rule that the judge alone determines evidentiary matters. Rule 104(a) states that "Preliminary questions concerning . . . the admissibility of evidence shall be determined by the Court. . . ." While this rule does not contain any explicit language that the judge's determination is to be final, certainly the Rule does not encourage the use of a procedure which allows the jury to take part in the evidentiary decision after the judge has ruled on the matter. There is no indication that the words "shall be determined by the Court" envision anything other than a sole judicial determination. At the very least, courts in Circuits that have in the past allocated to the jury some function in this procedure will have to confront this statutory rule of evidence in any future consideration of the issue. *FED. R. EVID.* 104.

65 *See* note 30, *supra*.

66 508 F.2d 566 (1st Cir. 1974), *cert. denied*, 421 U.S. 948 (1975).

67 *Id.* at 576.

68 *Id.* at 576-77.

conspiracy, to consider all evidence that apparently bore thereon."⁶⁹ The court discussed this in the context of the issue of the desirability of giving a cautionary instruction when it is requested. Nevertheless, it is clear that the First Circuit has no doubt that the jury must make the final evidentiary decision. Noticeably absent in both *Honneus* and *Buschman's* discussion of *Honneus* is an analysis of the logical and practical ramifications of this assumption.⁷⁰

If the Seventh Circuit in *Buschman* had availed itself of the opportunity presented by the government's argument that *Ragland* was applicable, it could have explored some of these ramifications. As mentioned earlier, by discussing the question of who must make the ultimate determination on admissibility, the court would have added a necessary dimension to its analysis of whether an instruction should be given when requested. Perhaps more importantly, the court would have been confronted with the fact that cases which it discussed, such as *Honneus*, do not effectively come to grips with the problems posed in *Dennis*, *Nardone* and *Carbo*.⁷¹ For example, the question of whether any court can realistically expect a jury to make the necessary separation of different types of evidence would have arisen. Even if the court assumed that the jury could complete this assignment, the Seventh Circuit would still have faced a problem: the jury must effectively find the defendant guilty before the hearsay can be admitted. The exception to the hearsay rule is thus negated by assigning the jury a role in this process.

It appears that in imposing the burden of making the evidentiary determination on the jury, courts have been concerned that damaging hearsay is used too freely in conspiracy cases. Such courts, apparently, have simply assumed that this requirement would provide an adequate safeguard, without considering the problems outlined in cases such as *Nardone*, *Dennis* and *Carbo*. It would seem that a preferable way to comply with the requirement that there be independent evidence of a defendant's participation in a joint venture or conspiracy before the exception to the hearsay rule is invoked is to leave this preliminary matter solely in the hands of the trial judge.

The Requirement of a Cautionary Instruction

Although the opinion in *Buschman* is ambiguous, it is clear from an analysis of cases such as *Allegretti* that the Seventh Circuit reserves some role for the jury in determining whether hearsay is admissible against a particular defendant. This is so despite the court's failure to explicitly acknowledge that the

⁶⁹ *Id.* at 577.

⁷⁰ The Fifth Circuit also appears to require the jury to assess non-hearsay evidence before hearsay becomes fully admissible against a defendant. See *United States v. Apollo*, 476 F.2d 156 (5th Cir. 1973), a case discussed in *Buschman* because of its establishment of a requirement that the cautionary instruction be given when the hearsay is first introduced. The rationale of *Apollo* is discussed in this comment. See note 72, *infra*, and the accompanying text. On the role of the jury in the Fifth Circuit, see *Landers v. United States*, 304 F.2d 577 (5th Cir. 1962), which clearly requires the jury to find both that a conspiracy existed and that a particular defendant was a member of it before hearsay becomes admissible against that defendant. 304 F.2d at 582.

⁷¹ Hopefully, the court also would have discussed some of its own prior cases, such as *Allegretti*, and seen that these cases too are vulnerable in light of the rationale of *Dennis*, *Nardone* and *Carbo*.

jury is in effect participating in the evidentiary decision, and despite the lack of any attempt to confront the well-reasoned criticism that has been directed against this procedure. With this basic issue thus "resolved," the court's discussion can be considered in its proper context. As previously noted, at issue is whether the trial judge was required to give a cautionary instruction to the jury, upon timely request, when hearsay evidence concerning statements made by co-venturers was admitted against Buschman.

The arguments of the First and Fifth Circuits in cases such as *Honneus* and *Apollo* are applicable here. These courts acknowledged a need for an early instruction. Inasmuch as jurors are generally oblivious to evidentiary considerations, they must be admonished not to consider such statements against any conspirator or joint venturer until they are satisfied by independent evidence that the particular defendant was part of the conspiracy. As the court in *Apollo* says, "This delicately dangerous defusing must be firmly in the jury's minds when the hearsay is proffered."⁷²

In addition to this policy argument, the Fifth Circuit in *Apollo* relies on *Lutwak v. United States*,⁷³ a Supreme Court case which the Seventh Circuit has accurately interpreted as not being directly on point. In *Lutwak* the Court dealt with the necessity of limiting co-conspiratorial declarations made after the conspiracy had ended.⁷⁴ In its opinion the Court stated that not all hearsay evidence in conspiracy trials is admissible against all defendants; certain statements, such as those made after the expiration of the conspiracy, will be admissible only against the declarant and those present who assent to the statement. Immediately after making this comment, the Court noted that "these declarations," must be limited by the Court at the time they are introduced.⁷⁵ Later courts, such as the Fifth Circuit in *Apollo*, have been inclined to quote this statement as providing support for a rule requiring a judge to give early cautionary instructions in cases such as *Apollo* and *Buschman*.⁷⁶ However, the Seventh Circuit has correctly pointed out that the Supreme Court in *Lutwak* was only referring to declarations which are definitely limited to the declarant or to those present who in some way assent to the statements.⁷⁷ It is unlikely that the Supreme Court in *Lutwak* was consciously addressing itself to the problem of the instant case, in which the evidence is only limited subject to the requirement that the government at some point produce independent evidence sufficient to make the hearsay admissible. *Lutwak* is not direct authority in these circumstances.

In addition to distinguishing *Lutwak* from these factual situations, the

72 476 F.2d at 163; 508 F.2d at 577.

73 344 U.S. 604 (1953).

74 The conspiracy involved an attempt to defraud the United States in its administration of the immigration laws, by effecting the entry of three aliens as spouses of American veterans according to the provisions of the War Brides Act. The Court concluded that the conspiracy ended when the last alien entered the country; thus, statements made after this point could not be admitted under the exception to the hearsay rule, since they were not in furtherance of an ongoing conspiracy. It is *this* type of statement which the Court discusses. The conviction in *Lutwak* was affirmed, however, because only one statement was improperly admitted, and the Court concluded that this did not affect the result. 344 U.S. at 615-20.

75 344 U.S. at 619.

76 476 F.2d at 163.

77 527 F.2d at 1086 n.4. This point is also mentioned in *United States v. Halpin*, 374 F.2d 493 (7th Cir.), cert. denied, 386 U.S. 1032 (1967), an earlier Seventh Circuit case similar to *Buschman*. The court's discussion of *Lutwak* appears at 374 F.2d at 496.

Seventh Circuit in *Buschman* advanced a policy argument which, according to the court, militates against the establishment of an absolute requirement that the instruction be given. The court stated that this requirement would "unduly hamper" the progress of such trials, in that evidence would be limited when it later turned out to be fully admissible due to the sufficiency of the independent evidence. The court questioned the value of requiring an instruction when in so many instances it will ultimately be surplusage.⁷⁸

This argument is inaccurate, however, because it presupposes sole judicial determination of the sufficiency of the independent evidence.⁷⁹ The court's analysis is not appropriate in a discussion of whether an instruction should be given in those jurisdictions in which the jury has a role in determining the admissibility of hearsay. If the judge determines with finality the sufficiency of the independent evidence, then his decision that there is enough such evidence makes the earlier instruction unnecessary. The hearsay is fully admissible without any further action on the part of the jury. However, when the jury participates in determining the admissibility of hearsay, the judge's decision that the independent evidence suffices is not dispositive of the admissibility issue: the jury must also separately consider the independent evidence. At some point the judge must instruct the jury concerning the details of this task. Perhaps the Seventh Circuit would have been justified in holding that the jury is sufficiently educated by an instruction given at the end of the trial, so that an earlier instruction is unnecessary.⁸⁰ However, the court's indication that the earlier instruction might be useless in the sense that it might never have to be given is inappropriate.⁸¹

While this point, stressed by the Seventh Circuit in *Buschman*, is thus not pertinent to an assessment of the validity of requiring an instruction, there is one argument against the imposition of the requirement which appears to merit consideration. This argument suggests that if the judge must give a cautionary instruction at the time the hearsay is offered, the impact of the challenged evidence on the jury may be unduly exaggerated. Although the purpose of the instruction would be to educate the jury about the details of its function, this emphasis on the peculiar nature of the evidence also might impart to it an unwarranted prominence in the minds of the jurors. Thus, when the time comes for them to ignore the hearsay in the assessment of the independent evidence, they will be unable to do so. The hearsay will have colored all of the evidence, making compartmentalization impossible.

The cumulative effect of these considerations is to underscore the wisdom and simplicity of the approach of the Second and Third Circuits, whereby the evidentiary decision is made solely by the judge, with no jury participation. However, when the arguments are examined under the assumption that the jury has a role even after the judge decides to admit the evidence,⁷⁹ cases such as

78 527 F.2d at 1086, 1089-90.

79 See earlier discussion of this point in this comment (notes 27-28 and the accompanying text).

80 A related contention will be discussed in the next paragraph of the text.

81 This argument in *Buschman* is reflective of the trend, seen in *Allegretti*, whereby the final instruction dealing with acts and statement of co-conspirators (the instruction given in both *Allegretti* and *Buschman*) is not explicitly seen as giving the jury a role in determining the admissibility of hearsay. See note 39, *supra*.

Apollo and *Honneus* seem to indicate that the preferable course is to require that the instruction be given when it is requested. However, the persuasiveness of this argument is not so overwhelming, nor the likelihood of prejudice to the defendant in the absence of the early instruction so clear, as to render untenable the balance which the *Buschman* case sought to achieve by recommending but not requiring that the judge give the instruction in all cases. The court acknowledged that in most cases the instruction should be given to the jury, but left it within the discretion of the trial judge to refuse to grant the instruction.⁸² Both the expression of a preference and the reluctance to establish an ironclad rule seem appropriate.

Conclusion

In affirming *Buschman's* conviction, the Seventh Circuit could have limited itself to the conclusion that, even if the trial judge had committed an error in refusing to give the requested instruction, it was harmless beyond a reasonable doubt.⁸³ Such a disposition is justifiable in light of the fact that there was ample independent evidence to connect *Buschman* to the joint venture, so that no hearsay was improperly considered by the jury. This analysis provides a sufficient basis for affirming the conviction. Nevertheless, the court expanded the scope of its discussion beyond this point, and considered the merits of requiring the judge to give the instruction when it is requested. The court concluded with its recommendation that an instruction is warranted in most cases, followed by its refusal to require that an instruction always be given.⁸⁴ While this whole discussion was arguably unnecessary, this seems to be an appropriate resolution of the question concerning the necessity for such an instruction.

While the court's reluctance to require a judge to give the requested instruction in all cases thus seems justifiable, its discussion of this issue is open to criticism. First, the court failed to provide any indication of its stance on a pivotal question: who finally determines the admissibility of the hearsay? Such an indication was necessary to furnish a perspective from which its discussion could be viewed. In addition, the court missed an opportunity, presented to it by the government's claim that judicial determination of admissibility is the proper rule, to consider some well-reasoned arguments in favor of that principle. In the absence of any consistent indication in the opinion, it is to be assumed that the court spoke with an understanding that the two-part procedure, endorsed by its past decisions and followed by the trial judge here, was appropriate. However, the arguments of cases such as *Nardone*, *Dennis* and *Carbo*, among others, cast serious doubt on the logical and practical validity of the Seventh Circuit's practice.

In *Buschman* the appellant was not prejudiced by the incomplete discussion because the court could have disposed of the appeal by concluding that if there was error it was harmless. However, in choosing to ignore the issue of who must make the ultimate evidentiary determination, the Seventh Circuit obscured the issue which it discussed, making its analysis less valuable. More importantly, the

82 527 F.2d at 1089.

83 *Id.* at 1090.

84 *Id.* at 1089.

court lost a chance to discuss the procedure followed in the Second Circuit, which is less complex than past Seventh Circuit practice but which is nevertheless an appropriate vehicle for dealing with this delicate problem. The procedure whereby the judge alone determines the sufficiency of the independent evidence lessens the chances of jury confusion by eliminating the imposition of standards which are probably impossible for the jury to meet and which, if they are met, effectively eliminate a long-standing exception to the hearsay rule. Hopefully, the Seventh Circuit will soon be confronted with a case in which a discussion of its two-part system for determining the admissibility of statements of co-conspirators and joint-venturers is necessary, so that the well-founded criticism of this procedure can be more straightforwardly evaluated.⁸⁵

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⁸⁵ A District Court within the Seventh Circuit, before the *Buschman* case, discussed many of the issues which appear in this comment, and noted that the Court of Appeals has not adequately resolved some of the problems regarding the determination of the admissibility of hearsay. *United States v. Herrera*, 407 F. Supp. 766 (N.D. Ill. 1975).

III. Federal Statutes and Governmental Regulation

ANTITRUST—PATENT LICENSING AGREEMENT WHICH HAS THE EFFECT OF REQUIRING THE CONSENT OF MORE THAN ONE PARTY FOR THE ISSUANCE OF FUTURE LICENSES IS TO BE EXAMINED UNDER THE RULE OF REASON

*Moraine Products v. ICI America, Inc.**

Introduction

The patent law explicitly grants to a patentee the right to exclude all others from the making, using or selling of the patented item.¹ The lone patentee exercising this right will seldom encounter an antitrust problem. However, many patentees are not possessed of the expertise and capital necessary to successfully exploit their legal monopoly. Thus, in an effort to commercially exploit their monopoly market such patentees usually convey some or all of the rights granted by a patent for a fee to those who are better able to commercially market the invention. However, the conditions and restrictions attached to these conveyances have become an increasingly frequent target for antitrust attacks.

The Seventh Circuit in *Moraine Products v. ICI America, Inc.*,² was confronted with a patent licensing agreement which purported to grant an exclusive license without the right to issue sublicenses. Upholding the decision of the district court, the Seventh Circuit ruled that such an agreement was not per se illegal.³ Nonetheless, on examination of both the terms of the agreement and the conduct of the parties, the Seventh Circuit held such an arrangement was not within the scope of the patent's protection. As the district court had not subjected the agreement to a "Rule of Reason" enquiry,⁴ the Seventh Circuit remanded the case for a determination of the reasonableness of the trade restraint involved.⁵

This comment will examine both the effects of antitrust restrictions on patent licensing agreements and the economic policies underlying such antitrust restrictions. Such an examination will reveal that the Seventh Circuit's refusal to

* 538 F.2d 134 (7th Cir. 1976).

1 35 U.S.C. § 154 (1970):

Every patent shall contain . . . a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the right to exclude others from making, using or selling the invention throughout the United States

2 538 F.2d 134 (7th Cir. 1976).

3 *Id.* at 145.

4 Under a "Rule of Reason" analysis, courts engage in extensive examination of the complained-of conduct, its impact on the applicable product and geographic markets, its economic justification, its history of prior use by and within applicable markets, the size and strength of competition within the markets and the existence of any barriers to entry into the market; all in an effort to determine the reasonableness of the particular restraint of trade involved. *United States v. Topco Assocs., Inc.*, 405 U.S. 596 (1972); *White Motor Co. v. United States*, 372 U.S. 253 (1963); *DeFilippo v. Ford Motor Co.*, 378 F. Supp. 456 (W.D. Pa. 1974).

As the Seventh Circuit noted in *Moraine Products* the absence of a written opinion from the district court forces one to rely on bench pronouncements to understand its exact holding. 538 F.2d at 146. This, to some extent, obfuscates the precise nature of the examination below.

5 While the language of the Sherman Act, 15 U.S.C. § 1 (1970), prohibits literally "all contracts, combinations or conspiracies in restraint of trade," the courts have construed it as prohibiting only "unreasonable restraints." *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1 (1958).

declare per se illegal provisions of patent licensing agreements requiring the consent of more than one party for the issuance of future licenses is unsupported by the present case law and contrary to the economic theory underlying both patent and antitrust laws. The court's rejection of the per se illegality of such provisions appears to impede the achievement of maximum allocative efficiency—the goal of a well-balanced patent-antitrust interface—without increasing the possibility of the safe business use of such an agreement.

During the 1950's Dr. J. Alfred Rider, a gastroenterologist, developed a chemical composition for the relief of flatulence in human beings. His research centered around the use of both methylpolysiloxane (M.P.S.) and finely divided silica.⁶ During the same period another physician, Dr. Wolfe Harry Feinstone, filed a patent application for a simethicone-containing deflatulent.

In 1958, Moraine Products was incorporated for the purpose of promoting Rider's invention. Later that same year, the Stuart Company⁷ approached Moraine and expressed an interest in marketing deflatulents containing Rider's invention. Shortly thereafter, Stuart entered into an agreement with Moraine which called for a five percent royalty on the sale of simethicone-containing products in exchange for the assignment of Rider's invention.⁸

After Stuart began marketing Rider's deflatulent, the Feinstone patent was issued. Although not identical with the claims of the still pending Rider patent application, the Feinstone patent claims were similar enough to endanger Stuart's marketing position. Stuart feared that the production and marketing of the Rider invention might require a license under the Feinstone patent. Indeed, such fears were borne out when Plough, a corporation marketing the patented Feinstone invention, informed Stuart that the unpatented Rider deflatulent infringed the Feinstone patent. Subsequently, Stuart rescinded its agreement with Moraine to market the Rider invention and entered into a licensing agreement with Plough.

Under this licensing agreement,⁹ Plough granted to Stuart a license, ex-

6 As in the Seventh Circuit's opinion, the term "simethicone" will be used throughout this comment to refer to the combination of M.P.S. and finely divided silica. That term originated in the media advertising of "Di-Gel," one of the products involved in this case. 538 F.2d at 137 n.4.

7 The Stuart Company was later acquired by Atlas Chemical Industries which, in turn, was later acquired by ICI America. *Id.* at 136 n.1. For the sake of consistency, the defendant-appellee will hereinafter be called Stuart.

8 This agreement was to be effective whether or not a valid patent issued. *Id.* at 136.

9 The relevant portion of this agreement provided:

1. Plough grants to Stuart the right to use the Feinstone Invention and a license, exclusive except as against Plough and Block Drug Company (as provided in Paragraph 6 hereof), in the United States, its territories and possessions, and non-exclusive in foreign countries, to make, use and sell compositions covered by said Letters Patent No. 2,951,011, any extension or reissue thereof . . . Stuart does not have the right under the license granted herein to sub-license in the United States, its territories and possessions the making, using or selling of said compositions or any of them; but Stuart may grant sub-licenses to third parties in countries foreign to the United States and its territories and possessions

2. Plough reserves the right of Plough to use the Feinstone Invention and to make, use and sell compositions covered by said Letters Patent No. 2,951,011, any extension or reissue thereof, covered foreign patents, but except as to Block Drug Company as provided in Paragraph 6 hereof . . . Plough will not grant to any third party a license to make, use and sell said compositions or methods of using them in the United States, its territories and possessions.

clusive except as to Plough and one other licensee. In addition, Plough withheld from Stuart the right to issue sublicenses.

Nine years after the issuance of the Feinstone patent, the Rider patent was finally issued. Stuart subsequently challenged the validity of that patent and eventually obtained an adjudication of its invalidity.¹⁰ Moraine, the promoter of the Rider patent, then initiated the instant action asserting that the mutual agreement between Stuart and Plough to restrict the granting of licenses under the Feinstone patent exceeded the bounds of the monopoly afforded by the patent laws. Accordingly, Moraine argued that such an agreement should be judged under the general provisions of the antitrust laws and, when so judged, amounted to a "contract, combination or conspiracy in restraint of trade" in violation of § 1 of the Sherman Act. Further, Moraine contended that such agreements to restrict the granting of future licenses have such a pernicious effect on competition, and are so totally lacking in redeeming economic virtue, that they constitute a per se violation of the antitrust laws. Thus, there was no need for an elaborate inquiry into the precise harm caused or business excuse for its use.¹¹ Alternatively, Moraine argued that, even if such agreements are not illegal per se, the evidence in this case establishes that the defendants have conspired or combined to impose an unreasonable restraint on commerce.¹²

The damage Moraine alleged was the loss of royalty income from the Rider patent prior to the adjudication of its invalidity.¹³ Since potential licensees under the Rider patent also required a license under the Feinstone patent in order to practice the Rider invention, Moraine argued that the illegal provision of the Stuart-Plough licensing agreement, which restricted the number of licenses that would be granted under the Feinstone patent, necessarily reduced the number of licenses which could be granted under the Rider patent and, thereby, deprived Moraine of royalty income.¹⁴

6. Plough may grant a license under the patents . . . to Block Drug Company of Jersey City, New Jersey. Plough will exercise its best efforts to limit license to Reed & Carnick Division of Block Drug Company and to their product known as "Phazyme" . . .

10 As a condition of the settlement agreement between Moraine and Stuart for breach of the 1960 agreement between them, Stuart was given an option to obtain an exclusive license to practice the Rider invention when and if a patent issued. As soon as the Rider patent issued, Stuart exercised this option and, shortly thereafter, demanded that Moraine sue Plough for infringement. After this suit was initiated, Stuart initiated an action seeking declaratory judgment of the Rider patent's invalidity. These actions were joined and subsequently resulted in a final adjudication that the Rider patent for the use of simethicone as a human defatulent was invalid. *Atlas Chem. Indus., Inc. v. Moraine Prods., Inc.*, 350 F. Supp. 353 (E.D. Mich. 1972), *aff'd in part, rev'd in part*, 509 F.2d 1 (6th Cir. 1974).

11 The courts have long acknowledged the existence of a certain category of antitrust violations where a conclusive presumption of unreasonableness attaches to conduct because of its tendency to "necessarily produce consequences violative of the Sherman Act or to produce proscribed consequences in such an overwhelming proportion of cases that minute inquiry in every instance would be wasteful of judicial and administrative resources." *Kennedy v. Long Island R. Co.*, 319 F.2d 366 (2d Cir.), *cert. denied*, 375 U.S. 830 (1963). See note 4, *supra*.

12 See note 5, *supra*.

13 The recovery of such damages is predicated on the statutory presumption of validity which attaches to a patent grant. 35 U.S.C. § 282 (1970).

This assumes, of course, that there was no fraud in obtaining the patent or any prior knowledge of its invalidity on Moraine's part. *See, Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 465 F.2d 1253 (6th Cir. 1972), *cert. denied*, 416 U.S. 939 (1973).

14 The recovery of lost royalties would be restricted to those reasonably anticipated, based on projected market share, during the period of the patent's presumed validity. It was exactly these lost royalties that Moraine sought to have trebled under § 4 of the Clayton Act, 15 U.S.C. § 14 (1970).

In its opinion, the Seventh Circuit acknowledged the necessity for an in-depth economic analysis of the entire competitive setting surrounding the licensing of patents.¹⁵ It labelled as "truncated" the judicial focus on only the specific terms of the licensing agreement, especially when such a narrow examination is used to upset desirable commercial practices. The court's opinion is significant in that it distinguished prior cases which held per se illegal license provisions requiring the consent of more than one party for the issuance of future licenses.¹⁶ While the court accepts the contention, at least in this case, that such provisions are outside the patent's protection, it asserts that neither existing legal nor economic analysis warrants the conclusion that they are so pernicious or lacking in redeeming economic utility as to justify a presumption of per se illegality.¹⁷

Patent-Antitrust Interface

Analytically, it is important to realize that the patent consists of nothing more than the right to exclude others from making, using or selling the invention.¹⁸ In interpreting this "right to exclude others," the Supreme Court, since its earliest decisions, has consistently emphasized that the primary object of the patent system is, in keeping with its constitutional origins,¹⁹ to benefit the general public and not to exclusively benefit the inventor.²⁰ By acknowledging that the primary object of the patent law is to yield a net benefit to the public—via the grant of a temporary "incentive monopoly" to the inventor²¹—the courts have unwittingly enunciated the economic theory on which the patent law must either

15 538 F.2d at 145.

16 See notes 57 and 59 *infra*.

17 538 F.2d at 145.

18 See note 2 *supra*. The oft repeated judicial explanation that "the patentee receives nothing from the law which he did not have before and the only effect of his patent is to exclude others . . ." is only partially true. *Motion Picture Co. v. Universal Film Co.*, 243 U.S. 502, 510 (1917); *Bauer v. O'Donnell*, 229 U.S. 1, 10 (1912); *United States v. American Bell Tel. Co.*, 167 U.S. 224, 239 (1896). While it is correct to say that the inventor, prior to the enactment of the patent laws, still owned the product of his inventiveness; what he did not own was the right to prevent others from duplicating or independently inventing his creation. The reduction of this "right to exclude" to a property interest which can be bought, sold or waived for a profit is certainly an example of the patentee receiving something from the law which he did not have before. The patent grant is, thus, the reduction to a property interest of the right to invoke the government's power to prevent others from utilizing his discovery without his consent.

19 U.S. CONST. art. I, § 8, cl. 8 provides Congress with the power:

To promote the Progress of Science and the useful Arts by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

The Patent Code, 15 U.S.C. § 1 *et seq.* was enacted pursuant to this grant of authority.

20 *Kendall v. Winsor*, 62 U.S. (21 How.) 322 (1858); *Pennock v. Dialogue*, 27 U.S. (2 Pet.) 1 (1829).

21 As to the dicta, it states:

A patent is not, accurately speaking, a monopoly . . . A Monopoly takes something from the people. An inventor deprives the public of nothing which it enjoyed before his discovery, but gives something of value to the community by adding to the sum of human knowledge.

United States v. Dubilier Condenser Corp., 289 U.S. 178, 186 (1933). There can be little of substance to support it. The statement may be true as to inventions which could have been exploited without divulging the secret of their creation, and those only to the extent that another does not subsequently discover and disclose the same invention within 17 years. As to all the remaining patented inventions—about 98% of them—the patent system deprives the public of its previously enjoyed right of 17 years of a non-monopolistic price structure in the invented item.

stand or fall. That is, that the patent system effects a pattern of resource allocation under which the wealth-increasing function of commercially useful inventions²² outweighs the wealth-decreasing function of the seventeen-year monopoly.²³ Implicit in this theory is the assumption that the patentee will restrict the supply of the invented product or process only as much as is necessary to arrive at the highest possible profit margin.²⁴ In all other regards, the theory of the "incentive monopoly" is that the patentee will fully exploit his invention by attempting to meet the consumer demand.²⁵

The antitrust laws are, on the other hand, largely concerned with assuring the possibility of competition within a given product market. These laws attempt to minimize prices by instilling competition between product-alternatives.²⁶ The theory of the competitive model, engendered in the antitrust laws, is that lower product prices will result from several suppliers vying for a larger share of the existing demand.²⁷ Obviously, this helps assure that the things consumers want are produced in sufficient quantity at competitive prices.

The benefits intended to be derived by consumers from the antitrust laws, while more apparent, are, nonetheless, the same as those intended by the patent system. Producing more of what consumers want at the lowest cost with the

22 That a patent grant rewards only economically useful inventions is inherent in the very nature of a monopoly grant. The right to be the sole supplier and, thus, exact a monopoly price for an invention is of little value if the demand for the invention, itself a function of the wealth increasing potential of the invention to the consumer, is not sufficient to support a price structure from which the inventor can recoup his investment together with the desired level of profit.

23 This assumption could be measured in quantitative economic terms by subtracting the total value of decline in economic utility (benefit realized vis-à-vis cost) suffered by the public by reason of the price increases resulting from the output restrictions of a patent monopoly from the value of the total increase in economic utility realized by all the invention's users.

24 Assuming an informed consumer class, no one would pay more for an item than the dollar equivalent one individually assigns to the added value, benefits or uses made possible by the item (*i.e.*, the item's "economic utility"). Given that limitation, the incentive offered by the patent system is the ability to either choose between restricting output or totally meeting existing demand or a combination of both. Obviously, the patentee will choose that course which permits the maximum profits. In any event, the absence of competition will permit the item's price structure to approach the value of the item's economic utility to the consumer. There may, of course, be a difference between how the consumer values such things as time, leisure and prestige and how the patentee values them (as reflected in the item's price).

25 The patentee, of course, has no obligation to exploit his monopoly. *Special Equip. Co. v. Coe*, 324 U.S. 370 (1945); *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908). Nevertheless, it is clear from the very fact that a monopoly is given, that the patent system expects exploitation.

26 W. BOWMAN, *PATENT AND ANTITRUST LAW* (1973); Panel Discussion, *Patents, Technology and Antitrust Enforcement*, 42 A.B.A. ANTITRUST L.R. 78, 85 (1972); Kidwell, *Patent-Right Interchange and Antitrust Policy: Defining the Interface*, 43 U. COLO. L. REV. 360 (1972).

27 As is true with most models, the economic model of "perfect competition" is best utilized as a tool of analysis rather than a goal or substitute for reality. Under that model, the private enterprise (*i.e.*, profit-maximizing) system would, in the absence of a patent incentive, allocate those resources presently used for research and development to the production of products currently in demand. This would increase their supply of the demanded product and, thus, their profits. The problem with this theory is that it discounts the fact that, even in the absence of a patent system, a certain amount of innovation would result from the producers' desire to achieve product superiority over competitors and, thereby, maximize profits by "capturing" a larger share of the demand. Additionally, it assumes that all commercially useful inventions were developed in a quest for profits. For a succinct presentation and analysis of the theories that the patent system causes a misallocation of resources by either overrewarding or underrewarding innovation, see W. BOWMAN, *supra* note 26; Edwards, *Technological Progress and the Patent Laws*, 15 IDEA 19 (1972).

least amount of scarce resources is certainly the goal of both systems.²⁸ The patent systems approach towards this goal is to reward those inventions which have a wealth-increasing potential to consumers even at monopolistic prices.²⁹ The antitrust system attempts to achieve this goal by prohibiting output restrictive agreements in an effort to increase supply and reduce prices.

From the economic vantage point, the patent and antitrust laws are not inherently in conflict, but are rather two separate paths toward the same end (wealth-increasing benefits to consumers and efficient producers). That neither path is boundless in its means presents for resolution the legal question of where the path dividers should be placed. That the law should look to the economic ends to be attained for guidance in the placing of those dividers is, itself, patently obvious.

Judicial Interpretation: The Patent Rule of Reason

As stated earlier, most patent-antitrust conflicts arise from restrictions attached to a conveyance of some or all of the patent rights.³⁰

Generally, these conveyances take the form of a patent licensing agreement. A patent license is, in effect, a waiver of the patentee's right to sue for infringement.³¹ Under such an agreement, the licensee has neither a property right in the patent nor the right to maintain an infringement action in his own name.³² A patentee may convey by a license the right to make, the right to use, or the right to sell (or any combination thereof), the patented product or process throughout the United States. The patentee may even limit the license to a defined field of use or geographic area.³³

Often, either the royalty charged by the patentee for the license, or the peculiar nature of or limited demand for the patented item, may lead the licensee to require that no further licenses be issued before they will invest the required capital in the marketing of the item. The licensee will often view this restriction on future competition as essential to the recoument of his investment in the marketing of the item. In order to meet this requirement, the licensee may request from the licensor an exclusive license; the effect of which will prevent the

²⁸ See note 26, *supra*.

²⁹ Of course, the assumption is that in the absence of an incentive monopoly the energies and capital would not be expended on producing those inventions which have wealth increasing potential to consumers. Thus, the monopoly price is the lowest cost at which the consumer can get the benefits attendant to use of the invention. However, when an invention which would have been forthcoming anyway is patented (*i.e.*, given an incentive monopoly), the net effect to society is wealth-decreasing.

³⁰ See generally L. SULLIVAN, ANTITRUST § 183 (1977); Kadish, *Patents and Antitrust: Guides and Caveats*, 13 IDEAS 83 (1969).

³¹ 4 A. DELLER, WALKER ON PATENTS § 380 (2d ed. 1965); 60 AM. JUR. 2d *Patents* §§ 346-48 (1972).

³² *Id.* See *Virtue v. Creamery Package Mfg. Co.*, 277 U.S. 8 (1927).

³³ General Talking Pictures Corp. v. Westinghouse Electric Co., 304 U.S. 175 (1935). Of course, this is not to say that patent licenses involving field of use or territorial restrictions are totally, or even substantially, free of antitrust problems, see Adelman & Juenger, *Patent-Antitrust: Patent Dynamics and Field-of-Use Licensing*, 50 N.Y.U.L. Rev. 273 (1975). See also Kadish, *supra* note 30.

licensor from granting any license other than the one in question.³⁴ Usually, an exclusive license conveys to the licensee the right to issue sublicenses.³⁵

When a patentee, in an effort to maximize his profits from his incentive monopoly, engages in licensing part of his right to exclude, his chances of running afoul of the antitrust laws are significantly increased. Since the famous *Bath Tub Trust Case*,³⁶ it has been clear that a patent licensing agreement may not be used as a shield behind which all restrictions or conditions attached to a license may hide from antitrust inquiry. In that case, the Supreme Court stated:

Rights covered by patents are indeed very definite and extensive; but they do not give, any more than other rights, a universal license against positive prohibitions. The Sherman Law is a limitation of rights, rights which may be pushed to evil consequences and therefore restrained.³⁷

After that decision, it became necessary to determine when restrictions contained in a licensing agreement were a permissible exploitation of the patent monopoly and when they were violative of antitrust laws as contracts, combinations or conspiracies in restraint of trade. Once it was determined that the two bodies of law touched, it became necessary to define their interface.

The Supreme Court, in *United States v. General Electric*,³⁸ promulgated a test, now referred to as the "Patent Rule of Reason," which delineated the boundaries of this interface.³⁹ The Court was asked to determine the legality of a license provision which purported to set the price at which licensees of General Electric's light bulb patent could sell the patented product. In answering the question whether a patentee may restrict a licensee in the selling of a patented item by limiting the method of sale and the price, the Court stated: "We think he may do so provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentees' monopoly."⁴⁰

Examining the patentee's rights *vis-à-vis* the antitrust laws, the Court stated:

[T]he patentee may grant a license to make, use and vend, articles under the specifications of his patent for any royalty, or upon any condition the per-

34 An exclusive license involves a promise by the licensor that he will not thereafter license others. An exclusive licensee may, unlike a non-exclusive licensee, maintain an infringement action in his own name or with the patent owner, *W. Electric Co. v. Patent Reproducers Corp.*, 42 F.2d 116 (2d Cir. 1930); *A. DELLER, supra*, note 31; 60 AM. JUR. 2d *Patents* § 349 (1972).

35 The Seventh Circuit, citing *R. NORDHAUS & E. JUROW, PATENT-ANTITRUST LAW* § 122 (2d ed. rev. 1972), distinguishes between an "absolute exclusive license" which prevents the licensor from granting any other licenses and usually carries with it the authority to grant sublicenses, and "limited exclusive licenses" which are merely licenses accompanied by a covenant not to grant any further licenses without the licensee's consent. 538 F.2d at 141.

This distinction would appear to be valid as long as it is based on the fact that the consent of two parties is required under the "limited exclusive license." However, should an "absolute exclusive license" withhold the right to issue sublicense, any meaningful distinction would dissolve.

36 *Standard Sanitary Mfg. Co. v. United States*, 226 U.S. 20 (1912).

37 *Id.* at 49.

38 272 U.S. 476 (1926).

39 Actually, the Court referred to a "Rule of Reason" test for patent-antitrust conflicts in an earlier case, *Bement & Sons v. National Harrow Co.*, 186 U.S. 1058 (1902); however, the test was not expressly adopted until the *General Electric* case.

40 272 U.S. at 490.

formance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure.⁴¹

The effect of this "reasonably within the reward" standard is to delineate the "scope" of the patent monopoly and to proscribe those license restrictions which expand or extend it. The most obvious example is a license provision which purports to require the purchase or use from the licensor of an unpatented product as a condition for the licensing of the patented product. This would have the effect of extending the monopoly on the patented item to the unpatented one.⁴²

Justice's Antitrust Division: The Ancillary and Necessary Test

This "Patent Rule of Reason" test has come under considerable attack by the Patent Section of the Justice Department's Antitrust Division.⁴³ In particular, the Department's concern has centered around those license restrictions which it views as not "necessary" to the exploitation of the patent monopoly. Presently, the Justice Department advocates the following test:

The rule of reason in this area embraces . . . three principal elements: first, the restriction or limitation must be ancillary of the lawful main purpose of a contract; second, the scope and duration of the limitation must not be substantially greater than necessary to achieve the purpose; third, the limitation must be otherwise reasonable in the circumstances.⁴⁴

This approach disregards the "scope" concept and utilizes in its stead a concept of the patent exploitation as an encroachment on the competitive sphere. Under such an approach, it would seem that the problem of containing the output restrictive effects of the patent monopoly solely to the patented item is not as significant as the desire to instill as much competition as possible between the various exploiters (licensees) of the monopoly.⁴⁵ In essence, it promotes a competi-

41 *Id.*

42 For an interesting contra argument asserting that the "tied-in" product may be nothing more than a method of measuring the economic utility of the patented item to the licensee for the purpose of determining royalty, see W. BOWMAN, *supra* note 26 ch. 4.

43 Bowes, *The Patent-Antitrust Law Interface: How Should it Be Defined?*, 18 IDEA 25 (1976); Frost, *Restrictions on Fields of Use and Territories*, 42 A.B.A. ANTITRUST L.J. 633 (1974); Oppenheim, *The Patent-Antitrust Spectrum of Patent and Know-How License Limitations: Accommodation? Conflict? or Antitrust Supremacy?*, 15 IDEA 1 (1971); Panel Discussion, *supra* note 26.

44 *Address by Richard W. McLaren, The Licensing of Technology Under the United States Antitrust Laws*, 40 A.B.A. ANTITRUST L.J. 931, 936 (1971). This is essentially the same test used to determine the legality of trade restraints under an antitrust enquiry as laid down in *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899).

45 By asking whether a covenant not to license without mutual consent is "ancillary to the lawful main purpose" (*i.e.*, exploiting the monopoly), the focus is shifted from one of monopoly as an incentive to competition as the norm. Indeed, it would seem premised on the assumption that by instilling competition between the exploiters of the monopoly, the public will enjoy lower prices as both licensee and licensor will, by reason of the other's presence in the market, be seeking to produce more efficiently.

It is quite possible that the exact opposite may be true as non-licensing and the exaction of royalties may well create a stronger motive to invent around the patent and, thus, provide a product alternative to the public. Certainly, competition between alternatives is more advantageous to the public than competition by a licensee already obligated to pay royalties which are undoubtedly passed along to the consumer.

tive encroachment into the sphere of a legal patent monopoly. Such a test may result in the impairment of productive efficiencies⁴⁶ without necessarily effecting a reduction in the sale price or inherent output restrictions.⁴⁷ This approach to patent-antitrust cases fails to differentiate between legitimate, wealth-increasing profit maximization and illegal, wealth-decreasing monopoly extension.

Moraine Products: *The Need for Exclusivity*

Against the foregoing economic and legal background, the particular license restriction involved in the *Moraine* case must be examined. In relevant portion, the licensing agreement of January, 1961, between Plough and Stuart purported to grant to Stuart a license under the Feinstone patent exclusive except as against Plough and one other drug manufacturer.⁴⁸ Moreover, Plough covenanted not to grant to any other third party a license to make, use or sell the patented composition. As a consequence of this agreement, no additional licenses could be granted without the consent of both Plough and Stuart.

There are valid economic justifications for exclusive licenses.⁴⁹ Often a licensee may require exclusivity as a precondition to his investment of capital in converting the patented item to a marketable form and marketing it.

Exclusivity would be a legitimate solution to the problem of subsequent licensees unjustly utilizing both the refinements in the patented item and the consumer demand created by the initial licensee's marketing and advertising programs. Having not borne those initial costs, subsequent licensees could enter the product market with a lower price structure. Exclusivity would, in such a situation, permit the initial licensee to recoup his investment together with reasonable profit without fearing undercutting by a subsequent licensee.⁵⁰

The problems, both legal and economic, inherent in exclusive licensing are twofold: first, its tendency towards an oligopoly in the product-market; and second, its tendency to foreclose further exploitation of the patent, thereby increasing the output-restrictive, wealth-decreasing effects of the monopoly. In its opinion, the Seventh Circuit recognized and discussed in detail the oligopolistic aspects of such a licensing scheme. It acknowledged that when such a scheme is used to suppress incentives to attack patent validity or to invent around the patent, or is used to allow the licensees to divide a market among themselves and, thus, regiment an industry, there is good reason to declare such a restrictive scheme illegal.⁵¹ However, the court went on to state that there is evidence in the

46 It is nothing short of misconception to believe that even a monopolist is not motivated to produce efficiently. By reducing production costs, profits will increase whether the market be monopolized or highly competitive.

However, many royalties are computed on the amount of the patented item produced and not on the items actually sold. By insisting on competition between patent-exploiters, the "ancillary test" may actually have the effect of forcing licensees to forgo such efficient business methods as inventory accumulation and enlisting consignment dealerships in an effort to avoid paying high royalties while sales are not active. If, on the other hand, fully exploiting the monopoly (*i.e.*, meeting consumer demand) was the focus of patent licensing law, the licensor who intends to remain in the market might well be more agreeable to a flexible royalty arrangement.

47 W. BOWMAN, *supra*, note 26.

48 See note 9 *supra*.

49 Adelman & Juenger, *supra* note 33.

50 *Id.*

51 538 F.2d at 145.

record supporting both Moraine's assertion that the licensing scheme was a conspiracy to divide the market and Stuart's assertion of a sound commercial ground for desiring the license restrictions.⁵² With such a record as a basis, the Seventh Circuit concluded that the debate surrounding the patent-antitrust interface has not conclusively established the anti-competitive purpose or effect of mutual agreements not to grant sublicenses. Thus the court could not "properly eschew economic analysis and rule . . . the license contract was illegal per-se."⁵³

Analysis of the Seventh Circuit's Conclusion: The Case for Per Se Illegality

Several Supreme Court decisions dealing with the interface between patent and antitrust laws have clearly established a judicial preference for attacks on the validity of any given patent; permitting the monopoly to stand only if the patent is held valid.⁵⁴ In the instant case, the agreement, by requiring the consent of both the licensor and licensee for the issuance of future licenses, clearly makes it more difficult for third parties to obtain rights under the patent. This, the Seventh Circuit reasoned, placed such third parties in a position conducive to attempts to either challenge the patent's validity or to invent around it; actions which would have been against their economic interest had licenses been freely given. The benefits the public derives from such attempts, when coupled with the less output-restrictive effects of an oligopoly (*i.e.*, having more than one party exploiting an essentially monopolized market), are sufficient, in the Seventh Circuit's view, to overcome any argument that the agreement has a solely pernicious effect.⁵⁵

While the court's conclusion against per se illegality is arguably supportable when examined solely against the judicial policy of encouraging challenges to patent validity, it, nonetheless, loses much of its persuasive force when examined in the light of both prevailing economic theory and existing case law. Indeed, the Seventh Circuit's opinion recognized that judicial scrutiny of patent licensing agreements should go beyond a mere analysis of their terms and examine the totality of the economic impact of such agreements.⁵⁶ However, in conducting such an examination, the court apparently failed to recognize the purely output-restrictive results of permitting future licensing of patents to depend upon the mutual consent of both patentee and an exclusive licensee. While the terms of the agreement may appear to encourage third party attempts to overcome the patent monopoly, should such attempts arise it would be in the economic interest of the parties to the agreement to extend licensing options to the attacking parties. Indeed, this may be the only time their economic interests coincide. Just such considerations have led other courts to hold similar agreements per se illegal.

As early as 1951, in *United States v. Besser Manufacturing Co.*,⁵⁷ a district court, confronted with a licensing scheme which involved the granting of ex-

52 *Id.* at 148.

53 *Id.* at 145.

54 *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969) (abolishing the doctrine that licensees are stopped from challenging the validity of the patent they are licensed under).

55 538 F.2d at 145.

56 *See* note 15 *supra*.

57 96 F. Supp. 304 (E.D. Mich. 1951), *aff'd*, 343 U.S. 444 (1952).

clusive licenses and an agreement between the licensees and patentee that no future licenses would issue without mutual consent, noted that this conduct exceeded the scope of the patent. Recognizing that exclusive licenses may be valid, the *Besser* court, nevertheless, held that it was the combination, geared toward foreclosing present and future competition, which primarily invalidated the agreement.⁵⁸ The *Besser* court appreciated that the patent law, in awarding an incentive monopoly, intended that the output-restrictive effect of that monopoly should be only that which is necessary to maximize the profits of one party, the patentee.

Besser was followed five years later by *United States v. Krasnov*.⁵⁹ The *Krasnov* case involved a cross licensing agreement under which the assignee of the first patent licensed a patentee of another patent and vice versa. Each party agreed to relinquish its individual rights to license others and to act jointly in approving or disapproving license applications. Unlike *Besser*, the licenses involved in *Krasnov* were non-exclusive licenses. Citing *Besser*, the *Krasnov* court held that it was the combination of interest in an effort to restrict present and future licensing which made the agreement illegal per se.⁶⁰

While it is certainly true that both the *Besser* and *Krasnov* cases involved several other acts offensive to the antitrust laws (price fixing, pooling of patents, harassment suits, interlocking directorates, etc.), the Seventh Circuit's conclusion that those cases are distinguishable on that basis,⁶¹ and therefore not controlling on the issue of per se illegality of such license restrictions, is questionable in light of the language used by both the *Besser* and *Krasnov* courts.⁶² Indeed, proponents of both the "Patent Rule of Reason" as enunciated in the *General Electric* case, and the "Ancillary and Necessary" test as propounded by the Justice Department, have agreed that the *Besser* and *Krasnov* cases are correct in condemning purely contractual agreements requiring more than the consent of one party for the issuance of future licenses.⁶³

The Seventh Circuit correctly recognized that § 261 of the patent code,⁶⁴ granting the patentee the right to convey exclusive rights under his patent, must be construed in connection with the antitrust laws.⁶⁵ Nonetheless, the court expressed concern that such a construction should not upset desirable commercial

58 The *Besser* court stated:

We believe that the contract under question goes further than is necessary to protect the patent monopoly of [the patentees]. It may well be that an exclusive license to one party may be valid but here the patentees have joined hands with the two largest competitors . . . and have virtually made it impossible for others to obtain rights under those patents. The contract even gives [the licensees] the power to restrict competition—present and future—by requiring their joint consent before licensing others. It is this combination requiring collective action that primarily invalidates the agreement.

96 F. Supp. at 311.

59 143 F. Supp. 184 (E.D. Pa. 1956), *aff'd per curiam*, 355 U.S. 5 (1957).

60 *Id.* at 192.

61 538 F.2d at 140.

62 See notes 58 and 60 *supra*.

63 30 FOOD DRUG COSM. L.J. 545, 553 (1975); Address by Asst. Attorney General McLaren, [1969] 5 TRADE REG. REP. (CCH) ¶ 50,106; Oppenheim, *supra* note 43, at 18.

64 35 U.S.C. § 261 (1970) states, in relevant part:

The applicant, patentee, or his assigns or legal representatives may in like manner [by an instrument in writing] grant and convey an exclusive right under his application for patent, or patents, to the whole for any specified part of the United States.

65 538 F. 2d at 143.

practices without taking into account the factual and economic realities of the particular market. In rejecting the per se illegality approach, the court apparently accepted as reasonable the possibility that a licensor would utilize a licensing scheme, such as the one involved in this case, out of apprehension that he may be unable to recoup profits lost to competing licensees.⁶⁶

Assuming that a patentee will make his licensing decisions so as to maximize his profits under his incentive monopoly, the licensing of another firm to make, use and sell the patented item must be premised on the belief that the royalties generated from the increased sales made by the licensee will exceed the loss in direct profits suffered by the licensor as a result of the added competition. Of course, this analysis would hold true only when, as in this case, the licensor is himself engaged in marketing the patented item. Thus, the licensor would restrict his licensing efforts in such a way as to assure that his royalties, together with his direct profits, represent the maximum profits possible from the incentive monopoly. The issuing of more licenses would serve only to decrease his profits. This, in turn, would result in the least output-restrictive situation possible in light of the patentee's legal right to maximize his profits under his incentive monopoly.

The use of an exclusive license with no right to issue sublicenses, by a licensor who is himself engaged in marketing the patented item, results in a situation where the issuing of future licenses will depend not only on the patentee's attempts to maximize profits but also on the licensee's desire to restrict competition in an effort to increase his direct profits. The result of such an arrangement will, in most instances, be more output-restrictive than licensing programs which depend solely on the patentee's search for maximum overall profits. Moreover, the licensee's need for an exclusive license in order to recoup development and marketing expenditures would appear to be materially lessened, both by the initial presence of the licensor in the market, and by the licensee's realization that the licensor will not seek maximum competition in the market due to his own presence there.

In short, the use of exclusive licenses with covenants not to sublicense, by a licensor engaged in marketing the patented item, would seldom, if ever, be a result of a patentee's legitimate profit-maximization drive.

Conclusion

Whatever may be the Seventh Circuit's view as to the proper scope of a patent monopoly, it is clear, in light of existing legislation, that the legal propriety of a seventeen-year incentive monopoly must be recognized. However one defines the patent-antitrust interface, it is important to note that the Supreme Court has, in keeping with the language of the Constitution, consistently emphasized that the primary object of the patent system is to benefit the general public through "the progress of science and useful arts," and not to exclusively benefit the inventor.⁶⁷ Regardless of the test used to determine the interface, it is clear from an economic

⁶⁶ *Id.* at 145.

⁶⁷ See note 20 *supra* and accompanying text.

vantage point that the public benefits only when the patent monopoly is restricted to the value of the added utility made possible by the invention. The proper application of the antitrust laws would seek both to minimize output restrictions resulting from patent exploitations and to recognize the legal propriety of licensing schemes which are mainly profit-maximizing in effect.

The Seventh Circuit's rejection of the *per se* illegality argument, with respect to exclusive licenses with covenants not to issue sublicenses made by a licensor actively marketing the patented item, tends to encourage an oligopoly under which future licenses could be granted as incentives not to attack the patent's validity or to invent around it. It is difficult to foresee other circumstances in which the economic interests of the patentee and exclusive licensee in issuing future licenses would coincide. Moreover, the Seventh Circuit's rejection of *per se* illegality of such licensing provisions tends to permit an increase in the output-restrictive effects of the patent monopoly when such effects are not the direct result of the patentee's legitimate drive to maximize solely his profits.

In this case, the court's recognition that the license condition, taken together with the parties' repeated refusal to issue additional licenses, results in conduct outside the scope of the patent's protection and forms the basis of its decision to remand the case for an examination under the antitrust "Rule of Reason." This resolution, while acknowledging the possibility of an unprotected restraint of trade, fails to provide the concrete guidance so sorely needed in the quagmire of patent-antitrust conflicts.

Michael Craig Donovan

FEDERAL TAXATION—SECTIONS 71 AND 215—A HUSBAND'S FIXED INSTALLMENT PAYMENTS CAN QUALIFY AS ALIMONY IF A MARITAL SUPPORT OBLIGATION IS DISCHARGED—TERM INSURANCE PREMIUMS, UNLIKE WHOLE LIFE, CANNOT QUALIFY AS ALIMONY

*Wright v. Commissioner**

Introduction

Alimony payments made by a husband to his divorced wife are tax deductible to him and includable as income to the wife.¹ When each spouse owns separate property, the divorce decree will usually require that the parties' marital estate be divided in accordance with their respective ownership interests. Payments effectuating this division of the estate (also known as a property settlement) are neither deductible to the husband nor taxable to the wife. Proper classification is, therefore, crucial and disputes often arise over whether a particular payment is alimony or part of a property settlement.

*Wright v. Commissioner*² examined this classification issue to determine whether payments made by a husband to his divorced wife constituted alimony or were actually in the nature of a property settlement. In doing so, the Seventh Circuit concluded that certain fixed installments made by William C. Wright were periodic marital support payments and, therefore, alimony.

In *Wright*, the Seventh Circuit also dealt, for the first time, with the issue of whether term life insurance premiums, paid by a husband pursuant to a divorce decree, can also qualify as deductible alimony. The Seventh Circuit held that term premiums are not deductible even if the wife is the absolute owner and irrevocable beneficiary of the policy. The court based its decision solely on the theory that premiums for term insurance, unlike whole life insurance, convey no "ascertainable economic benefit" and, therefore, cannot be constructively received.³

This comment will explore the reasoning used by the Seventh Circuit in resolving each of the above issues. The Court's decision with respect to the alimony—property settlement issue is sound and consistent with the weight of judicial authority. The Seventh Circuit, however, erroneously denied William a deduction for the life insurance premium payments. Its distinction between term and whole life insurance is unwarranted and inconsistent with both judicial and statutory authority.

In 1967, Jean W. Wright filed a claim for divorce against her husband, William C. Wright. She sought, among other things, alimony and a division of property.⁴ The couple stipulated that their combined net worth exceeded

* 543 F.2d 593 (7th Cir. 1976).

1 The Code never specifically uses the term alimony. I.R.C. § 71(a) requires that the wife include as income periodic payments she receives pursuant to a divorce decree or written separation agreement incident to a divorce. See note 24 *infra*. I.R.C. § 215(a) allows a husband a deduction for periodic payments to his former wife, provided such payments are included in the wife's gross income. See note 30 *infra*.

2 543 F.2d 593 (7th Cir. 1976).

3 *Id.* at 600.

4 *Id.* at 595. William filed the original claim for divorce. Jean, in turn, filed a counterclaim and the parties proceeded on the latter.

\$1,000,000, of which \$227,752 was attributable to property separately owned by Jean.⁵ The remaining assets were owned by William.⁶

On January 29, 1968 Jean was granted an absolute divorce.⁷ The pertinent findings of fact and conclusions of law were as follows:⁸

1. Alimony was denied.
2. William C. Wright was required to pay the premiums on a \$200,000 term life insurance policy on his life in which Jean Wright was the absolute owner and irrevocable beneficiary.⁹ This obligation was to continue until the earlier of William's sixty-fifth birthday or Jean's death or remarriage.
3. William was directed to pay Jean, in installments, \$228,000 within ten and one-half years dating from October 4, 1967.

In total, the divorce decree awarded Jean assets worth \$459,018. This sum included the present value of the \$228,000 installment payments, separately owned property valued at \$227,752, furnishings valued at \$20,000, two automobiles and a \$41,260 discharge of indebtedness.¹⁰

The divorce decree directed William to pay \$2,000 each month for the first six months, and at least \$1800 per month over a 10½ year period until the \$228,000 was paid.¹¹ Further, it directed him to place in escrow marketable securities sufficient in amount to assure full payment of the principal sum.¹²

In May, 1968, three months after the divorce, the parties executed a mutual release agreeing that the divorce provided for a property settlement "in lieu of alimony."¹³ In calendar years 1968, 1969 and 1970 William paid to Jean as installments on the \$228,000 principal sum, \$22,200, \$21,600, and \$21,600 respectively.¹⁴ In each of those years William also paid \$1505, \$1459 and \$1415 for term insurance premiums as required by the divorce decree.¹⁵

Pursuant to a tax deficiency determination, the Commissioner of Internal Revenue ruled that Jean erroneously excluded the fixed installment payments from her gross income in years 1968, 1969 and 1970. The Commissioner found that the installments were alimony within the meaning of I.R.C. § 71(a) and (c). This determination entitled William to deduct the fixed payments pursuant to I.R.C. § 215(a).¹⁶ The Commissioner, however, disallowed William's deduction of the term insurance premiums on the ground that the premiums were not constructively received by Jean. The Tax Court upheld the Commissioner on both issues.¹⁷

On appeal to the Seventh Circuit, Jean contended that the Tax Court

5 *Id.* at 596.

6 *Id.*

7 *Id.*

8 *Id.*

9 The life insurance policy described in the divorce decree was a ten-year, renewable term policy which, if not converted to whole life, would remain in force until William reached age 65. See William C. Wright, 62 T.C. 377, 385 (1974), *aff'd*, 543 F.2d 593 (7th Cir. 1976).

10 543 F.2d at 598.

11 *Id.* at 596-97.

12 *Id.* at 597.

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.*

17 62 T.C. at 400.

erroneously classified the installment payments as periodic within the meaning of I.R.C. § 71(a).¹⁸ William also appealed, claiming that the insurance premiums he paid, pursuant to the divorce decree, were constructively received by Jean. Therefore, he contended the IRS erred in disallowing his deduction of the premiums in accordance with § 215(a).¹⁹ The Seventh Circuit denied both parties' claims and affirmed the decision of the Tax Court.

The first issue the court of appeals considered was whether William's installment payments were in the nature of a property settlement or alimony. It stated that resolution of the alimony—property settlement controversy depends upon the facts and circumstances of each case:²⁰ labels used in the divorce decree are not conclusive. The court, therefore, attempted to uncover proof of the parties' intent.²¹

Jean cited several factors which, in her view, indicated that the installment payments should be viewed as a property settlement: the payments were secured, and hence not subject to the contingencies of death or remarriage; they were made in exchange for her inchoate rights to her husband's property;²² and, the divorce decree stated that the \$228,000 principal sum was for a "complete division of the estate and to complete the division of property of the parties. . . ."²³

The Seventh Circuit, however, listed several factors which it felt outweighed the indicia supporting the notion of a property settlement. First, the court held that use of the 10½ year installment payment period strongly suggested the intention to classify the payments as periodic within the meaning of I.R.C. § 71(a) and (c):

Had the parties intended these to be installment payments under Section 71(c) (1), rather than periodic payments under section 71(a), they could easily have provided that the principal sum of \$228,000.00 must be paid within ten years.²⁴

18 543 F.2d at 597.

19 *Id.*

20 *Id.* at 598.

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.* I.R.C. § 71(a) in pertinent part provides as follows:

(a) GENERAL RULE—

(1) DECREE OF DIVORCE OR SEPARATE MAINTENANCE—If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

I.R.C. 71(c) provides:

(1) GENERAL RULE.—For purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement shall not be treated as periodic payments.

(2) WHERE PERIOD FOR PAYMENT IS MORE THAN 10 YEARS.—If, by the terms of the decree, instrument, or agreement, the principal sum referred to in paragraph (1) is to be paid or may be paid over a period ending more than 10 years from the date of such decree, instrument, or agreement, then (notwithstanding paragraph (1)) the installment payments shall be treated as periodic payments for the purpose of subsection (a), but (in the case of any one taxable year of the wife) only to the extent of 10 percent of the principal sum. For purposes of the preceding

Second, the court pointed out that, subsequent to the divorce, the parties had executed a mutual release which referred to the installment payments as "a property settlement in lieu of alimony." The Seventh Circuit found this factor to be highly indicative that the parties intended the installment payments to discharge William's legal obligation of marital support. Third, the court noted that a specific provision of the divorce decree dealt with a property settlement and, in fact, awarded Jean her separately owned property. Since Jean's property interests were satisfied via a specific decree provision, the court felt the installments were intended to serve as support. Finally, the court held that inchoate interests in property could support a division of the estate only when "the record *clearly* shows that the parties so intended the payments for this purpose. . . ." ²⁵ No such intent was found.

After denial of Jean's claim, the Seventh Circuit briefly addressed the issue of whether life insurance premiums paid by William were tax deductible, as alimony, within the scope of I.R.C. § 71(a) and § 215(a). ²⁶ The court decided that such payments qualified as alimony in all but one respect: the premium payments were not constructively received by Jean. ²⁷ It based this decision on the theory that premiums on term insurance convey no "ascertainable economic benefit." ²⁸

The Seventh Circuit correctly resolved the issue of property settlement versus alimony. It was, however, mistaken when it held that William's premium payments for term insurance conveyed no economic benefit upon Jean. In short, the Seventh Circuit drew an unwarranted distinction between term and whole life, which ignores the guidelines established by the Commissioner, and which conflicts with judicial authority and similarly related code provisions.

*Periodic Marital Support Payments (Alimony)—Applicable
Statutory and Judicial Concepts*

Alimony is a popular term used to describe periodic amounts paid by a husband to his divorced wife as a result of a divorce decree or a written separation agreement. These amounts are includable in the wife's gross income ²⁹ and are deductible, for federal income tax purposes, by the husband. ³⁰ There are two

sentence, the part of any principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be treated as an installment payment for the taxable year in which it is received.

²⁵ *Id.* (emphasis added).

²⁶ *Id.* at 600.

²⁷ *Id.*

²⁸ *Id.*

²⁹ I.R.C. § 71(a) establishes the basic requirements before divorce payments made by a husband to his former wife will be includable in the latter's gross income. See note 24 and text accompanying note 24 *supra*.

³⁰ In fact, the Internal Revenue Code permits a deduction for such payments only if the amounts paid are includable as income to his former spouse. See I.R.C. § 215(a) which provides as follows:

(a) GENERAL RULE—In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year. No deduction shall be allowed under the preceding sentence with respect to any payment if, by reason of section 71(d) or 682, the amount thereof is not includible in the husband's gross income.

Thus § 71(a) and § 215(a) are complementary in nature in that the latter will only authorize a deduction if the requirements of the former have been met.

basic characteristics of all such payments: (1) alimony is always periodic; and (2) alimony is always taxable to the recipient.

Section 71(a) establishes four requirements before amounts received by a divorced wife will be taxed. The payments must be: (1) incurred by her husband pursuant to a divorce decree or written settlement agreement incident to a divorce; (2) periodic in character; (3) received by the wife either actually or constructively; and (4) in discharge of the husband's obligation of support arising out of the marital or family relationship.³¹ The first requirement is not in controversy in *Wright*. The remaining requirements, however, should be briefly examined.

1. Payments Classified as Periodic

Treasury Regulations and judicial opinions have defined periodic payments as those made for an indefinite time, or payments which are conditional (*e.g.*, on death or remarriage) and, thus, indefinite in amount.³² For example, a divorce decree which requires a husband to make support payments to his divorced wife until either her death or remarriage is periodic because it is payable over an indefinite period of time. Moreover, the total value of the payments cannot be reduced to a definite lump sum. Thus, the above mentioned payments would also be properly classified as periodic because they are, in the aggregate, indefinite in amount. Contrast the above example with a divorce decree which requires a husband to pay his wife \$90,000 in equal monthly installments for nine years from the date of the divorce. The equal monthly payments would not qualify as alimony because fixed sums which, pursuant to a divorce decree, are payable in installments are not treated as periodic payments.³³ The Code, however, provides an exception to this rule in I.R.C. § 71(c)(2). This provision states that principal sums payable in installments will be treated as periodic payments for the purposes of I.R.C. § 71(a) if the principal sum "is to be paid or may be paid over a period ending more than ten years from the date of the decree. . . ."³⁴ Payments, therefore, will be characterized as periodic if they are indefinite in time or amount or if they fall within the exception noted by I.R.C. § 71(c)(2).

2. The Constructive Receipt of Income

The regulations and the courts hold that income can be received either actually or constructively.³⁵ The general rule is that if income is credited to a taxpayer's account or set aside for him, it will be regarded as having been constructively received unless there is a substantial limitation or restriction on

31 See I.R.C. § 71(a), note 24 *supra*.

32 *Van Orman v. Commissioner*, 418 F.2d 170, 172 (7th Cir. 1969); *Fidler v. Commissioner*, 231 F.2d 138 (9th Cir. 1956); *Baker v. Commissioner*, 205 F.2d 369, 370 (2d Cir. 1953); *Treas. Reg. § 1.71-1(d)(3)(i)* (1957).

33 See I.R.C. § 71(c)(1), note 24 *supra*.

34 See I.R.C. § 71(c)(2), note 24 *supra*.

35 *Treas. Reg. § 1.451-2(a)* (1971).

the taxpayer's right to the money (or property).³⁶ Moreover, the concept of constructive receipt is inexorably tied to the concept of the realization of income. Thus, even if a taxpayer does not actually receive income in cash or property, taxable income will be realized (and constructively received) when the economic gain associated with the payment redounds to his benefit.³⁷ Thus, income has been held to be constructively received by a taxpayer when payment was made directly to the taxpayer's creditors,³⁸ when the taxpayer gave away interest coupons to his son before they were due,³⁹ and when the taxpayer's debt was forgiven.⁴⁰

3. Discharge of the Marital Support Obligation

As noted above, periodic payments will not be treated as alimony unless made in discharge of the marital support obligation. The classification of a payment as being in discharge of marital support is difficult and is one of the principal focuses of this comment. The regulations, however, do provide some guidance:

Section 71(a) (1) or (2) does not apply to that part of any periodic payment attributable to that portion of any interest in property [transferred pursuant to a divorce decree or written separation agreement] which interest originally belonged to the wife.⁴¹

It is, therefore, apparent that one of the first steps in classifying a payment as alimony (a discharge of marital support), or as part of a property settlement, is to determine if the divorced wife owns separate property for which an ascertainable interest can be computed.

a. Relinquishment of Inchoate Rights as Evidence of a Property Settlement—The Davis Doctrine and Lack of Mutual Intent

The Regulations do not address the question of whether a wife's inchoate interest in the husband's property is sufficiently ascertainable to serve as consideration for a property settlement. Nonetheless, the Seventh Circuit concluded that in *Wright* the existence of such rights did not evidence a nontaxable division of the estate. As indicated below, this conclusion is supported by the Supreme Court.

In *United States v. Davis*,⁴² a husband, pursuant to a property settlement agreement incident to a divorce decree, transferred one thousand shares of stock to his divorced wife.⁴³ All property transferred was owned by the husband, but,

³⁶ Treas. Reg. § 1.451-2(a) (1971); J. CHOMMIE, FEDERAL INCOME TAXATION § 82 (2d ed. 1973).

³⁷ *Helvering v. Horst*, 311 U.S. 112, 116 (1940); Anita Quinby Stewart, 9 T.C. 195, 198 (1947).

³⁸ *Old Colony Tr. Co. v. Commissioner*, 279 U.S. 716 (1929).

³⁹ *Helvering v. Horst*, 311 U.S. 112 (1940).

⁴⁰ *Wall v. U.S.*, 164 F.2d 462 (4th Cir. 1947).

⁴¹ Treas. Reg. § 1.71-1(c)(4) (1957).

⁴² 370 U.S. 65 (1962).

⁴³ *Id.* at 66.

under local law, was subject to the wife's statutory marital rights.⁴⁴ The husband-taxpayer argued that the stock transfer constituted a nontaxable division of property between two co-owners.⁴⁵ The Supreme Court denied his claim and held that the transfer was a taxable event for income tax purposes:

[T]he inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. . . . In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability of the husband than a property interest of the wife.⁴⁶

In *Wright*, there never was an expression of mutual agreement that Jean's unperfected rights, arising under local law or otherwise, should serve as consideration for the fixed installment payments. In light of *Davis*, and in the absence of a clear showing that the Wrights intended this *quid pro quo*, it is inconceivable that Jean's contention could have been upheld. Thus, the Seventh Circuit refused to acknowledge that, absent mutual intent, relinquishment of Jean's inchoate marital rights could serve as evidence of the property settlement. Jean, however, continued in her attempt to support her cause by contending that the Tax Court's ruling was inconsistent with prior judicial authority within the Seventh Circuit.

b. *Van Orman v. Commissioner and Houston v. Commissioner*—
Distinguishable Precedents

Jean argued that the Tax Court ruling was erroneous in light of *Van Orman v. Commissioner*⁴⁷ and *Houston v. Commissioner*.⁴⁸ A careful examination of each of these cases indicates, however, that *Wright* is clearly distinguishable.

In *Van Orman*, a husband agreed, pursuant to a divorce decree, to provide his divorced wife with a home. Delivery of the house was not contingent upon death, remarriage, or a change in economic status. Unencumbered title was to be conveyed within ten years from the date of the divorce agreement.⁴⁹ The Seventh Circuit held that the husband was not entitled to a deduction for the mortgage payments on the house because "such payments were not 'periodic' and were not in discharge of a continuing obligation to support. . . ."⁵⁰ The court relied on two factors to support this conclusion. First, the house payments (and related incidental expenses) were not indefinite either in time or amount and therefore were not periodic. Even I.R.C. § 71(c)(2) could not salvage a periodic classification because the mortgage installments were payable for a period of ten years or less.⁵¹ Second, in addition to the house purchase clause,

44 *Id.*

45 *Id.* at 69.

46 *Id.* at 70.

47 418 F.2d 170 (7th Cir. 1969).

48 442 F.2d 40 (7th Cir. 1971).

49 418 F.2d at 171.

50 *Id.*

51 *Id.* at 172. See also text accompanying notes 33-34 *supra*.

a specific alimony provision was included in the settlement agreement. Thus, the Seventh Circuit concluded that the parties intended that the house payments were to constitute a nontaxable division of property.⁵²

Since the installments were to continue over a period of 10½ years, the *Wright* payments were properly classified as periodic under I.R.C. § 71(c)(2). Moreover, the divorce decree contained no provision specifically dealing with Jean's support. The only similarity between *Van Orman* and *Wright* is that, in both, the payments were definite in time and amount. This, however, was not sufficient similarity to warrant classifying the *Wright* installments as property settlement payments. In short, a finding of alimony in *Wright* is not inconsistent with the "property settlement" holding in *Van Orman*. This latter case, as in *Houston*, is clearly distinguishable on the facts.

In *Houston*, a husband was directed by the divorce court to transfer \$500,000 in assets to his divorced wife. Included in this amount was a cash payment of \$415,000. One hundred fifteen thousand dollars was payable within one month following the date of the divorce. The remainder was payable in twelve annual installments of \$25,000 commencing approximately one year after the date of the decree.⁵³ The husband-taxpayer attempted to treat the entire \$500,000 transfer as a periodic alimony payment. He argued that all property (including the \$115,000 cash payment) transferred to his wife, within the first year following the divorce, was properly joined with the twelve annual \$25,000 installments and, therefore, the first-year transfer should have been viewed as the first in a series of 13 periodic payments. Consequently, he contended that he should have been allowed a deduction of ten percent of the total value of the transfers within the meaning of I.R.C. § 71(c)(2).⁵⁴

The Seventh Circuit found that the amounts paid during the first year of the divorce were in the nature of a property settlement. The court distinguished the first-year transfers from the latter installments by the type, size and timing of the payments. The assets conveyed shortly after the divorce consisted of \$115,000 in cash, a homestead and miscellaneous personal property. Thus, the court felt the character of the assets conveyed during this period more nearly resembled a nontaxable division of the estate rather than a large support payment:

Where there is a substantial payment, such as this, which comes soon after the entry of the divorce decree, we think it not unreasonable to conclude that a property settlement was intended.⁵⁵

In *Wright*, the fixed installment payments did not resemble the large property and cash transfers which took place during the first year after the *Houston* decree. Instead, the *Wright* installments were analogous to the \$25,000 annual payments, deemed to be periodic under I.R.C. § 71(c)(2), which were to commence one year after the *Houston* divorce was final. Thus, given the char-

⁵² *Id.* at 171.

⁵³ 442 F.2d at 41.

⁵⁴ *Id.*

⁵⁵ *Id.* at 42.

acter and timing of William's payments, the *Wright* decision is consistent with *Houston* and, in fact, is supported by this latter case's rationale.

Van Orman and *Houston*, therefore, are not supportive of Jean's claim that William's installments were part of a nontaxable property settlement. These cases are clearly distinguishable from the facts and circumstances in *Wright*, and the Seventh Circuit correctly classified the fixed installment payments as alimony. Moreover, additional support for this conclusion can be found when *Wright* is analyzed in light of certain factors which traditionally have been indicative of periodic marital support payments.

c. Other Factors Suggesting Alimony

In resolving the controversy over classification of a divorce decree payment as a property settlement or as an alimony award, it is important to determine each party's intent. Given the ambiguity of many divorce instruments, this is not an easy task. However, several factors should be considered in distinguishing support from property settlement:

1. Will payments end upon the wife's death or remarriage? An affirmative answer suggests the payments are probably alimony.⁵⁶

2. Did the wife receive her share of any community, joint, or any other property for which she had an ascertainable interest prior to the divorce? If yes, other payments made are probably alimony.⁵⁷

3. Does the agreement state or imply that payments are to be made in lieu of alimony? An affirmative answer indicates that the parties intended the payments to discharge the husband's support obligation.⁵⁸

4. Were any of the wife's property interests subject to a controversy or dispute in the divorce proceeding? If the property she received was the subject matter of the dispute, the payments, in all likelihood, resemble a property settlement.⁵⁹

5. Were the payments made to the wife, subsequent to the effective date of the divorce, substantially equal to the support payments she received during separation and prior to final disposition of the case? If yes, the payments probably represent alimony.⁶⁰

6. Are payments to continue for a period of longer than ten years? A "yes" answer indicates that the payments were intended to be support within the meaning of I.R.C. § 71(c)(2).⁶¹

7. Were the payments related to the husband's income? If yes, this is indicative of alimony.⁶²

8. Did the wife, in her divorce claim, ask for alimony? An affirmative

56 Robert I. Martin, 41 T.C.M. (P-H) 1273, 1276 (1972); Treas. Reg. § 1.71-(d)(3) (A) (1957); Du Canto, *Determination of Issue of Property Settlement as Opposed to "Periodic Payments" (A/K/A "Alimony")*, 55 CH. B. REC. 130, 138 (1973) [hereinafter cited as Du Canto].

57 41 T.C.M. (P-H) at 1276; Du Canto at 138.

58 Marion R. Hesse, 60 T.C. 685, 693 (1973); 41 T.C.M. (P-H) at 1276.

59 Du Canto at 138.

60 *Id.*

61 See text accompanying note 24 *supra*.

62 41 T.C.M. (P-H) at 1276.

answer suggests the payments were made in discharge of the support obligation.⁶³

9. Were the payments secured? If so, they were probably intended to be in the nature of a property settlement.⁶⁴

It is true that the *Wright* installments were definite in amount and were secured. Taken alone, these factors indicate that the fixed installment payments resembled a settlement of property interests. On the other hand, several characteristics suggest an opposite result. Jean did receive her rightful share of property for which she had an ascertainable interest prior to the divorce. Her original claim did include a request for alimony and eventually she signed a mutual agreement which designated the installment payments as "in lieu of alimony." There was no controversy or dispute during the divorce proceeding regarding Jean's property interests or ownership rights, and the fixed installment payments were to continue over a period of 10½ years. In the aggregate, these factors strongly support the notion that the fixed installments were made in discharge of William's support obligation.

Thus, in *Wright* the "property settlement—alimony" controversy was resolved in an equitable and accurate manner. In so doing, the Seventh Circuit properly concluded that the fixed payments were periodic and taxable to Jean within the meaning of I.R.C. § 71(a).

Term Premiums as Tax Deductible Alimony

In *Wright*, the Seventh Circuit also decided that William could not deduct, as alimony, premiums he paid pursuant to the divorce decree for term insurance on his life. Despite the fact that Jean was the absolute owner of the policy, as well as the irrevocable beneficiary, the court concluded that the premium payments did not satisfy the requirements of I.R.C. § 71(a): they were not constructively received by Jean. In reaching this decision, the Seventh Circuit relied heavily on the reasoning used by the Tax Court which put great weight on the difference between whole life and pure term insurance.⁶⁵ Despite Jean's position

63 Julia Nathan, 19 T.C. 865, 872 (1953).

64 60 T.C. at 693.

65 A term life insurance policy is a contract which provides insurance protection (in the form of a death benefit) for a limited number of years (e.g., to age 65). The face value of the policy will only be paid if the insured dies within the stipulated term and nothing will be paid if the insured dies after the term period has elapsed. Term insurance is relatively inexpensive in part because of its contingent nature and in part because there is not usually a build up of cash surrender value. This latter characteristic gives rise to the reference to term insurance as pure protection. There are many forms of term insurance. A common type involves an increase in annual premiums every one, five or ten years (depending on the specific contract). This premium adjustment is necessary to compensate for higher mortality. See S. HUEBNER & K. BLACK, *LIFE INSURANCE* 55-59 (9th ed. 1976) [hereinafter cited as HUEBNER & BLACK].

Whole life insurance, in contrast to term, is permanent protection with the face amount payable provided the policyowner continues to pay the contract premiums (which are usually payable through insured's age 99). Whole life is typically characterized by its guaranteed level premium and an increasing cash surrender value. The cash value, moreover, is available to the policyowner upon request, via a policy loan. Upon the insured's death, the beneficiary of the policy will receive the face amount which consists of the sum of the cash value and "net amount at risk." This latter term is properly defined as the difference between the face amount and the cash value. Note that if, at the time of the insured's death, a policy loan is outstanding, the amount of the loan will be deducted from the face amount in computing the death benefit. *Id.* at 64-69.

as the absolute owner and irrevocable beneficiary of the term policy, the Tax Court in *Wright* held that the inherently contingent nature of the term insurance contract conveyed no ascertainable and indefeasible property interest to Jean.⁶⁶

The Seventh Circuit's resolution of this issue is difficult to accept for several reasons. First, the facts and circumstances of *Wright* fall within specific guidance provided by the Internal Revenue Service. These guidelines support the notion of deductibility. Second, the weight of judicial authority has long recognized the deductibility of life insurance premiums as alimony when specific requirements have been met. The *Wright* facts appear consistent with these requirements. Third, *Seligmann v. Commissioner*⁶⁷ and *William H. Brodersen, Jr.*,⁶⁸ cases relied on by the Seventh Circuit and the Tax Court as supportive of the *Wright* holding, are erroneous. Fourth, denial of the deduction of the term life premiums is inconsistent with an I.R.S. ruling which permits the taxpayer to deduct premiums for a form of insurance whose benefits are no less "contingent" than the death benefit provided by Jean's policy. Finally, the Seventh Circuit's contention that the economic benefit conveyed by the term premium was "unascertainable" is inconsistent with I.R.C. § 79(a) and Rev. Rul. 64-328, which provide the taxpayer with specific guidance for the calculation of the economic benefit associated with term life insurance premiums.

1. Revenue Ruling 70-218⁶⁹

Revenue Ruling 70-218 deals expressly with whether life insurance premiums paid by a husband, pursuant to a divorce decree, are includable in the gross income of the divorced wife under I.R.C. § 71(a) and, therefore, deductible by the husband in accordance with I.R.C. § 215(a). Under the factual situation outlined by the Commissioner, the husband-insured, pursuant to a divorce decree, absolutely assigned the insurance policy to his former wife. She was the irrevocable beneficiary and her children were contingent beneficiaries. Within a specified number of years, the husband was required to convert the policy to permanent insurance and deliver the new policy to his former wife.⁷⁰ Implicit within the Commissioner's fact pattern is the fact that the original (pre-converted) policy was term insurance which included a convertibility privilege.⁷¹ It must also be noted that, as used, the term "irrevocable beneficiary" has been interpreted by the Service and the courts to mean that full control over the beneficiary designation is vested in the wife.⁷²

66 62 T.C. at 400.

67 207 F.2d 489 (7th Cir. 1953).

68 57 T.C. 412.

69 Rev. Rul. 70-218, 1970-1 C.B. 19.

70 *Id.*

71 Most term insurance contracts include a convertibility provision which gives the owner of the policy the right to convert the term plan to any form of cash value insurance which the insurer is issuing at the time of conversion. The insured's state of health at the time of the conversion is of no consequence. Issuance of the postconverted cash value plan is guaranteed if conversion is affected within the time period indicated in the insurance contract. The owner may exercise the privilege in a manner prescribed by the company. D. GREGG & V. LUCAS, LIFE AND HEALTH INSURANCE HANDBOOK 58, (3d ed. 1973) [hereinafter cited as GREGG & LUCAS].

72 *Stevens v. Commissioner*, 439 F.2d 69, 72-73 (2d Cir. 1971); 62 T.C. at 398; Rev. Rul. 70-218 at 19.

The Commissioner ruled that the life insurance premiums were both includible as gross income to the wife and deductible by the husband pursuant to § 71(a) and § 215(a), respectively.⁷³ Moreover, the Commissioner articulated three conditions which must be met before a husband-insured is entitled to deduct his life insurance premium payments. First, the premiums paid by the husband must be pursuant to a divorce decree or written settlement agreement incident to the divorce. Second, the policy must be absolutely assigned to the wife. Third, the wife must be the irrevocable beneficiary of the policy proceeds. Of course these conditions do not eliminate any of the requirements which must be met before payments are classified as alimony.⁷⁴ Thus, the premiums must qualify as periodic and must be paid in discharge of the husband's support obligation.

The facts in *Wright* reveal that all of the above elements were met. The \$200,000 term policy on the life of William was absolutely assigned to Jean, and she was the irrevocable beneficiary. Moreover, William paid the premiums as directed by the terms of the divorce decree.

Nowhere in the ruling does the Commissioner imply a variance in treatment based on the type of life insurance purchased. Had the Commissioner felt that the type of policy was important, he easily could have provided for this fact. The Seventh Circuit, therefore, should have utilized the guidelines set out in Rev. Rul. 70-218 which, as will be shown below, correctly embodies the weight of judicial authority.

2. Judicial Authority Supporting Deductibility

*Anita Quinby Stewart*⁷⁵ involves factual circumstances similar to those presented in both Rev. Rul. 70-218 and *Wright v. Commissioner*. A husband-insured irrevocably assigned two life insurance policies to his divorced wife pursuant to a written separation agreement incident to a divorce.⁷⁶ The husband was required to pay the premiums for as long as his wife lived and remained unmarried.⁷⁷ She was named the irrevocable beneficiary.⁷⁸ The Tax Court upheld the Commissioner's contention that the premium payments made by the husband were constructively received as income by the wife:

It is difficult to see on what theory it could be successfully contended that the payments of insurance premiums pursuant to the separation agreement did not constitute petitioner's income under section 22(k), Internal Revenue Code. The policies in question were her property and all payments made were at her instigation, for her account, and designed to redound to her benefit. It seems reasonable to say that they were constructively received by her.⁷⁹

73 Rev. Rul. 70-218 at 19.

74 See text accompanying note 24 *supra*.

75 9 T.C. 195 (1947).

76 *Id.* at 196.

77 *Id.* at 197-98.

78 *Id.* at 197.

79 *Id.* at 198.

Similarly, the insurance policy in *Wright* was Jean's property. William's premium payments were for Jean's account and, by virtue of the protection provided, were designed "to rebound" to her benefit. The *Stewart* court did not consider the nature and type of policies in question. Rather, it put great weight on the fact that the wife was the absolute assignee and irrevocable beneficiary. In *Wright*, the Seventh Circuit should have followed the guidance provided by *Stewart* and, likewise, should have treated the premium payments as income to the wife.

*Hyde v. Commissioner*⁸⁰ involved factual circumstances identical to those in *Stewart*. Two questions were considered. First, were the premium payments taxable income to the wife? If so, was the amount taxable equal to the entire premium or merely the increase in cash value?⁸¹ The Second Circuit resolved both issues by holding that the wife received an economic benefit equal in value to the amount of premium.⁸² The court thus acknowledged that the insurance in *Hyde* conferred present benefits other than the cash surrender value.⁸³ Among the benefits mentioned were death protection (if the insured died within the specified time period) and the right to receive any dividends on the policies.⁸⁴ It is clear from a reading of *Hyde* that the policies in controversy were whole life;⁸⁵ thus the Second Circuit did not have to deal with the economic benefit of term premiums. The court, however, in referring to death benefits and dividend rights, correctly noted economic benefits associated with life insurance which go beyond the accumulation of cash surrender value.

In *Wright* the premium payments conferred valuable rights upon Jean. These included death protection until insured reached age sixty-five, the right to automatically convert the term policy to a permanent plan at guaranteed rates, and the right to receive dividends.⁸⁶ In short, *Stewart* and *Hyde* are strong precedents for the proposition that life insurance premiums, regardless of the nature of the policy, can qualify as alimony. Neither case focuses on the type of life insurance in issue and both ground their holding on the fact that the policies, which were required by the divorce decree (or separation agreement), were absolutely owned by the divorced wife. As is indicated by the following cases, this reasoning is consistent with recent judicial pronouncements.

A recent case upholding the treatment of insurance premiums as taxable alimony is *Anita L. Ellis*.⁸⁷ Again the facts were identical to those in *Stewart*. The Tax Court utilized reasoning similar to that appearing in Rev. Rul. 70-218: it required that the divorced wife include the life insurance premiums in her

80 301 F.2d 279 (2d Cir. 1962).

81 *Id.* at 280.

82 *Id.* at 283.

83 *Id.*

84 *Id.*

85 *Id.* at 283. The Second Circuit, throughout the opinion, refers to the cash value associated with the policies in controversy. This fact leads to the reasonable conclusion that the policies in question were whole life.

86 The term policy on William's life was issued by Northwestern Mutual Life Insurance Company. The policyowners of this "mutual" company are in a position analogous to that of a common stockholder in a corporation. Mutual policyholders are entitled to share in the profits of the insurance company, through policy dividends, to the extent their premiums are not needed to pay expenses (including claims). R. RIEGEL & J. MILLER, *INSURANCE PRINCIPLES AND PRACTICES* 43-44, (5th ed. 1966) [hereinafter cited as RIEGEL & MILLER].

87 42 T.C.M. (P-H) 715 (1973).

gross income because the policies were absolutely owned by her (and, therefore, she had the right to name the alternate and contingent beneficiaries); she was the irrevocable beneficiary; and the payments were deemed periodic within the meaning of I.R.C. § 71(a).⁸⁸ Thus, as in *Stewart and Hyde*, the *Ellis* court couched its reasoning in terms of the ownership rights of the wife and the factors which classified the payments as periodic. The Tax Court did not focus on the cash surrender value; nowhere in the opinion does the court attribute any significance to the type of policy under scrutiny. There are two possible reasons for this posture. Either the court did not want to consider an issue that was not presented by the parties (by implication the policy in question was a permanent plan), or they felt the type of policy was not a significant factor.

In *Wright*, Jean was the absolute owner and irrevocable beneficiary of the policy. By virtue of her complete ownership, she also had full power to name alternate and contingent beneficiaries. Additionally, William was required to continue premium payments for an indefinite period of time—until the earlier of Jean's death, remarriage or William's sixty-fifth birthday. The premium payments were, therefore, periodic. In light of *Ellis*, the *Wright* court should have decided that the premiums were taxable to Jean and, in turn, deductible by William.

Stewart, Hyde and Ellis are consistent with Rev. Rul. 70-218. Yet, these cases did not directly consider whether premiums for term insurance can qualify as alimony. The Second Circuit, however, did address this question, and in *Stevens v. Commissioner*,⁸⁹ it held that the nature of the policy is irrelevant. In *Stevens*, the factual situation was similar to that outlined in Rev. Rul. 70-218. In permitting the husband to deduct the life insurance premiums the court stated:

But the Commissioner has recognized that the standard death provision is not the kind of controversy which will forestall the constructive receipt principle. . . . If this analysis were correct, premiums paid on a term insurance policy could never qualify as alimony payments because the protection of term insurance to an irrevocable beneficiary extends only for a specified period rather than over the life of the insured.⁹⁰

The Second Circuit acknowledged that an insurance policy has value beyond payment of the face amount upon the death of the insured. Moreover, this benefit transcends the accumulation of cash value. Death protection is the economic benefit conferred; the *Stevens* court assigned a value to this benefit equal to the premium.

Stevens echoes the position taken by the I.R.S. regarding the constructive receipt, by a divorced wife, of life insurance premium payments. In *Wright*, it is the standard death benefit of a term policy which, in the Seventh Circuit's view, renders the economic benefit "too" contingent to be constructively received. These are not the type of contingencies, however, which are contemplated by either the Service or prevailing case law.⁹¹ As is pointed out by the *Stevens*

88 *Id.* at 718.

89 439 F.2d 69 (2d Cir. 1971).

90 *Id.* at 72.

91 See *Kiesling v. United States*, 349 F.2d 110 (3d Cir. 1965); *Florence H. Griffith*, 35 T.C. 882 (1961); *James Parks Bradley*, 30 T.C. 701 (1958).

court, disqualifying contingencies "include the husband's retention of the power to borrow against the policy, to withdraw its cash surrender value or to substitute himself as beneficiary if the wife predeceases him."⁹²

The *Stevens* holding was sound and should have been followed by the Seventh Circuit in *Wright*. It is important to note that William's obligation to make payments during the term of the life insurance contract was totally within Jean's control. She had an indefeasible right to receive the death protection until the insurance expired as a matter of law. This was because she was both the assignee of the policy and the irrevocable beneficiary. Like *Stevens*, the Seventh Circuit in *Wright* should have found such factors highly significant and likewise should have held that the economic value of the death protection is accurately reflected by the amount of premiums paid. Instead, the Seventh Circuit followed the reasoning of *Seligmann* and *Brodersen*. *Seligmann* is erroneous and *Brodersen* is both distinguishable and inconsistent.

3. *Seligmann* and *Brodersen*

In *Seligmann*, a husband-insured, pursuant to a divorce decree, absolutely assigned life insurance policies to an irrevocable trust set up for the benefit of his wife and children. He retained none of the incidents of ownership. In accordance with the trust agreement, the wife would receive the death proceeds if she did not remarry and if she outlived her husband.⁹³ In turn, the husband agreed to pay the insurance premiums until the earlier of his death or the date of the last to die of his wife and children.⁹⁴ The Seventh Circuit held that the wife did not receive any of the premium payments. Any benefit accruing to the wife was considered too contingent and, therefore, not constructively received.⁹⁵ The contingencies of death and remarriage created, in the court's view, an insurance benefit too uncertain to be capable of ascertainment. The Seventh Circuit failed to recognize, however, that the contingencies which were written into the *Seligmann* divorce decree were precisely the characteristics needed to qualify the premium payments as indefinite in amount and, therefore, periodic. The holding in *Seligmann* seems to suggest that with respect to life insurance, those contingencies which would qualify premiums paid as periodic, would, at the same time render the payments incapable of conveying an economic benefit. In light of *Stewart*, *Ellis*, *Hyde*, *Stevens* and Rev. Rul. 70-218, such reasoning is unwarranted.

Unlike *Seligmann*, *William Brodersen, Jr.* dealt specifically with the includability of term insurance premiums for income tax purposes. Pursuant to a divorce decree, a husband agreed to pay alimony to his wife. To secure these payments he purchased a decreasing term insurance policy on his life and named his divorced wife the absolute owner and irrevocable beneficiary.⁹⁶ The Tax Court decided that the husband was not entitled to deduct the term premiums because the payments were not constructively received by the wife.⁹⁷ The Tax

92 439 F.2d at 73; see Rev. Rul. 70-218, 1970-1 C.B. 19.

93 207 F.2d at 491.

94 *Id.*

95 *Id.* at 494.

96 57 T.C. at 414.

97 *Id.* at 419.

Court relied on two legal theories. First, the deduction was disallowed because the policy was purchased as security to insure the continuation of alimony payments. Second, it held that even if the insurance had not been purchased for security purposes, no economic benefit was conveyed because the policy in question was pure term insurance.⁹⁸

The weight of judicial authority supports the theory that premiums on life insurance purchased, pursuant to a divorce decree, to secure a divorced wife's alimony payments are not income to the wife and not deductible to the husband.⁹⁹ To the extent that the Tax Court in *Brodersen* relied on this "security for alimony" theory, the holding is warranted. Of course, the facts in *Brodersen* are distinguishable from those in *Wright*. The *Brodersen* policy was purchased to assure the payment of alimony for a fixed period. By contrast, in *Wright*, Jean would receive the face amount of the policy in addition to the fixed installment payment if William died within the contract period. The *Wright* policy was not purchased for security purposes. The fixed installment payments were secured by escrowed marketable securities rather than life insurance.

The Tax Court in *Brodersen* does not base its holding solely on the "security for alimony" theory. Instead, denial of William's deduction in *Brodersen* is also grounded on the notion that premiums paid by the husband for pure term insurance did not convey an ascertainable economic benefit to the wife and were, therefore, not constructively received by her. The Tax Court distinguished both *Stewart* and *Stevens* because in those cases the policies in issue were whole life rather than term:¹⁰⁰

As owner of a whole life policy the wife is entitled to surrender it for cash value, borrow on it, etc., thereby obtaining an additional economic benefit, over and above any agreed-upon alimony payments. With a term policy, however, there is only a contingent right to obtain a fixed amount of cash at the death of the insured which at best affords the wife peace of mind in knowing his payments are secured.¹⁰¹

In distinguishing the two forms of insurance, the Tax Court focused on the cash surrender value associated with whole life. Mathematically, a portion of each whole life premium can be allocated to cash surrender value with the remaining portion allocated to the amount of "pure protection" provided by the insurance company (equal to the face amount minus the cash value).¹⁰² If, *arguendo*, the cash value is truly the policy characteristic which supports deductibility of the premiums, it would logically seem to follow that only that portion of the premium which adds to the cash surrender value should be classified as alimony. Yet the Tax Court in *Brodersen* would seemingly permit a deduction of the *entire* whole life premium. Ironically, the *Brodersen* court would, therefore, be allowing a deduction for a portion of the premium attributable to decreasing term coverage.¹⁰³

⁹⁸ *Id.* at 417.

⁹⁹ *Baker v. Commissioner*, 205 F.2d 369 (2d Cir. 1953); *Blumenthal v. Commissioner*, 183 F.2d 15 (3d Cir. 1950).

¹⁰⁰ 57 T.C. at 417.

¹⁰¹ *Id.* at 417.

¹⁰² See text accompanying notes 104-107 *infra*.

¹⁰³ Decreasing term is a form of term insurance whereby the face amount of the policy

The typical whole life (or straight life) policy requires a level annual premium payable for the life of the insured.¹⁰⁴ In the early policy years the annual premiums exceed the cost of protection based on assumed mortality and interest rates.¹⁰⁵ This accumulated excess, adjusted for expenses and certain contingencies, is known as the cash value. The cash value serves two purposes. First, it constitutes a savings element available to the owner of the policy on demand. Second, when the insured dies, the cash value is part of the face amount paid to the beneficiary. As the cash surrender value increases, because of premium payments and interest, the amount of pure protection supplied by the insurance company (known also as the net amount at risk) decreases.¹⁰⁶ Whole life insurance has, therefore, appropriately been labeled as a "combination of decreasing term insurance [the pure protection element] and an increasing savings or investment element."¹⁰⁷

It should not be understood, however, that the Tax Court in *Brodersen* would have been correct had it suggested that only the "cash value share" of the whole life premium could qualify as alimony. A denial, in whole or in part, of the deduction for life insurance premiums when the requirements of Rev. Rul. 70-218 have been met, is never appropriate. The *Brodersen* court's refusal to classify, under any circumstances, term insurance premiums as alimony is clearly erroneous. Yet, by implicitly agreeing to the allowability of deducting whole life premiums, the *Brodersen* court manifested a misunderstanding of the nature of permanent insurance contracts (whole life). Moreover, in light of the "pure protection element" existing in such policies, acquiescence to the deductibility of the entire premium is also contradictory to the *Brodersen* position on term insurance.

In short, *Seligmann* and *Brodersen* are clearly erroneous in light of Rev. Rul. 70-218, *Stewart*, *Hyde*, *Ellis* and *Stevens* and should not have been followed by the Seventh Circuit in *Wright*. Moreover, by accepting the nondeductible posture articulated by the *Seligmann* and *Brodersen* decisions, the Seventh Circuit ignored an Internal Revenue Service pronouncement which authorizes a taxpayer to deduct, as alimony, premiums on a type of insurance whose benefits are as contingent as those received by Jean Wright.

4. Rev. Rul. 62-39¹⁰⁸

Revenue Ruling 62-39 presents the Commissioner's position regarding the tax deductibility as alimony of mortgage, interest, taxes and insurance payments made by a husband, pursuant to a divorce decree, on property held as tenants in common with his divorced wife. According to this ruling, one-half of such

decreases by a fixed amount each year. These policies are typically issued over terms extending anywhere from 5 to 35 years. HUEBNER & BLACK at 59.

104 GREGG & LUCAS at 67.

105 *Id.* at 69.

106 *Id.* Mortality rates increase each year and at an increasing rate. This tends to increase the cost of pure insurance coverage. Yet, this is more than offset by the yearly addition to the cash surrender value. *Id.*

107 *Id.* at 70.

108 Rev. Rul. 62-39, 1962-1 C.B. 18.

payments are includable as income to the wife under I.R.C. § 71 and, therefore, deductible by the husband in accordance with I.R.C. § 215(a).¹⁰⁹ Nowhere in the ruling does the Commissioner indicate the type of insurance involved; however, it is reasonable to conclude that it is either a fire and casualty policy or decreasing term insurance to assure payment of the mortgage in the event of the husband's premature death. If it is the latter, Rev. Rul. 62-39 constitutes an I.R.S. pronouncement that term insurance premiums can qualify as deductible alimony. On the other hand, if fire and casualty coverage is the "insurance" addressed by the Commissioner, Rev. Rul. 62-39, in effect, permits a taxpayer to deduct, as alimony, premiums for insurance in which the economic benefit is as uncertain and contingent as it is in term insurance.¹¹⁰ The risk insured against in a typical homeowner's policy is the sudden and unexpected loss or damage to the house due to fire or other covered casualties. The indemnified risk under a typical term life policy is the death of the insured within a specified time period. In both forms of insurance the amount of money necessary to insure against the risks can be reduced to near mathematical certainty; the economic benefit received is protection; and the contingent nature of the contract is reflected in the amount of the premium owed. By analogy, the *Wright* holding is inconsistent with the Commissioner's position with respect to the "insurance" mentioned in Rev. Rul. 62-39. If the cost to protect against the risk of a house burning down can be alimony, so should the cost of providing for the "human life value" lost if a former husband dies prior to age sixty-five.¹¹¹

In the *Wright* holding the Seventh Circuit also asserted that the economic benefit associated with term insurance premiums is unascertainable. Such reasoning is inconsistent with a specific code section and revenue ruling requiring that the term premium benefit be included as income and, moreover, providing the rate information necessary to compute such a benefit.

5. I.R.C. § 79(a) and Split Dollar Life Insurance

Internal Revenue Code § 79(a) provides that an employee must include in his gross income the cost of group-term life insurance provided by his employer. Taxable income will be realized, however, only to the extent that the premiums exceed the sum of: (a) the cost attributable to the first \$50,000 of insurance; and, (b) any contributions toward such insurance made by the employee.¹¹² The Internal Revenue Service, through Treasury Regulations, provides the taxpayer with the information needed to compute the economic benefit associated with the group-term coverage. Table I of the Regulations sets forth the cost of \$1,000 of group-term life insurance for one month computed on the basis of five-year age brackets.¹¹³ The rates appearing in this table are very similar

109 *Id.*

110 In fact, it is more likely that a person will die prior to age 65 than it is for his house to burn down. GREGG & LUCAS at 130.

111 See also Illene Isaacson, 58 T.C. 659 (1972) which allowed a husband to deduct, as alimony, the cost of providing hospital and surgical coverage for his former wife and their children. For an excellent discussion of life insurance as it relates to human life values, see HUEBNER & BLACK at 10-28.

112 I.R.C. § 79(a)(1)-(2).

113 Treas. Reg. § 1.79-3(d)(2) (1966).

to the premiums charged by private companies for similar coverage. It is fair to say, therefore, that after taking into consideration the statutory exclusions, the economic benefit associated with group-term coverage is approximately equal to the premium charged for the insurance.

Section 79(a) applies only to group-term coverage of which several characteristics are noteworthy. As the name implies, the policies are pure term: they contain no cash surrender value. Furthermore the employee-insured is the absolute owner of the policy. Thus, group-term contemplates a premium payor who retains none of the incidents of ownership.

Section 79(a) is statutory proof that term insurance premiums do convey an economic benefit. That benefit is equal to the amount of premiums paid.

Another area in which the I.R.S. has specifically required an individual to report, as economic benefit, premiums paid for pure protection is in so-called split dollar life insurance plans. Such plans are described as follows:

Split-Dollar insurance is a form of insurance co-ownership and is used primarily as a means for one party to help another carry the life insurance protection he needs. The policy must be of a permanent insurance type because the 'split' generally divides the cash value from the pure protection element. Usually one party pays a portion of each premium equal to the annual increase in cash value, and the other party, usually the insured, pays the balance. At the death of the insured, the noninsured party receives a portion of the proceeds equal to the cash value, and the balance of the proceeds is payable to the insured's designated beneficiary. The result is that the insured obtains insurance protection at very little cost to himself, the principal premium share being borne by the party helping him.¹¹⁴

Since split-dollar arrangements are normally used in a business context, the "party helping" the insured is usually the employer.¹¹⁵ At one time the Internal Revenue Service considered this "employer help" an interest-free loan (to the extent of the cash value). This posture has changed, however, and since 1964 the Service has viewed split-dollar plans as a means for "providing an *economic benefit* for employees."¹¹⁶ Revenue Ruling 64-328 requires the employee to include, as income, the value of the economic benefit received less the portion of total premium contributed by the employee. The value of the economic benefit equals the cost for the pure protection in the policy (face amount minus cash surrender value) at rates specified by the Commissioner.¹¹⁷

In light of I.R.C. § 79(a) and Rev. Rul. 64-328, it is clear that the economic benefit associated with the cost of pure protection (term insurance) can be ascertained. The term insurance policy in *Wright* was also pure protection. The benefit provided was total indemnification for William's human life value if death occurred prior to age sixty-five. The ascertainable value of this death benefit is precisely equal to the premium paid. This is the same approach taken by Congress in I.R.C. § 79(a) and by the I.R.S. in Rev. Rul. 64-328. It also should have been the approach taken by the Seventh Circuit in *Wright*.

114 GREGG & LUCAS at 676.

115 *Id.*

116 Rev. Rul. 64-328, 1964-2 C.B. 11; GREGG & LUCAS at 685.

117 *Id.* at 686. These rates, called "P.S.-58 rates," are roughly equal to the cost of one-year term insurance. *Id.* at 685.

Conclusion

Wright v. Commissioner considered two issues. The first dealt with whether certain fixed installment payments made by William Wright were in the nature of a property settlement or, instead, were taxable alimony. After carefully examining all of the facts and circumstances, the Seventh Circuit correctly concluded that the payments were periodic alimony and, therefore, taxable to Jean and deductible by William. While several factors indicated a property settlement, there were others which, in the final analysis, swung the balance in favor of a marital support classification. Thus, the *Wright* court put great weight in the 10½ year payment period, a divorce decree which granted Jean separate property for which she had an ascertainable interest, and a mutually executed agreement declaring the installments to be "in lieu of alimony." Moreover, when the facts and circumstances in *Wright* are analyzed in light of relevant factors outlined above, there is little doubt that the Seventh Circuit resolved the property settlement-alimony controversy in an equitable fashion.

The second issue dealt with whether premiums paid on term life insurance should have been taxable to Jean under I.R.C. § 71(a) and, therefore, deductible by William pursuant to § 215(a). The Seventh Circuit concluded that all but one of the requirements for inclusion as income had been met. The court held that the premiums paid by William for term insurance conferred no ascertainable economic benefit, and were not constructively received by Jean. This holding is erroneous and contrary to the weight of judicial authority as indicated by *Stewart, Ellis, Hyde and Stevens*. The court should have utilized the guidelines established by the Commissioner in Rev. Rul. 70-218 which predicated deductibility of the premiums on: (1) a divorce decree or written separation agreement incident to the divorce; (2) an absolute assignment of the policy to the wife; and, (3) proof that the wife is the irrevocable beneficiary. In *Wright*, each of these requirements was met.

The crux of the Seventh Circuit's holding on this issue was that the economic benefit attributable to the term premium payment was incapable of ascertainment and, therefore, could not be constructively received. This is incorrect and in direct contradiction with the I.R.S. posture regarding group term and split-dollar life insurance. For each of these insurance programs, the I.R.S. specifically attributes an economic benefit equal to the cost of the pure term coverage provided. Thus, I.R.C. § 79(a) requires an employee who receives group-term life insurance from his employer to include the cost of the coverage (less the statutory exclusions) as taxable income. Likewise, if an employer enters into a split-dollar insurance program with an employee, the employee must also include the cost of the economic benefit provided as income. In short, Congress and the I.R.S. have long recognized that the economic benefit associated with pure term insurance is capable of measurement and is, in fact, equal to the premiums necessary to provide such coverage. In *Wright* the Seventh Circuit should have acknowledged this posture and declared that Jean received taxable income equal to the cost of the death protection provided.

Santo Bisignano, Jr.

HOBBS ACT—THE INTERACTION OF THE CONSPIRACY DOCTRINE WITH
OFFICIAL RIGHT EXTORTION UNDER THE HOBBS ACT—AN IMAGINATIVE
PROSECUTORIAL WEAPON

*United States v. Meyers**

Introduction

The Hobbs Act¹ makes robbery, extortion and conspiracy to commit robbery or extortion, federal crimes when interstate commerce is affected. Local political corruption has come within the ambit of the Act by virtue of the Act's twofold definition of extortion. 18 U.S.C. § 1951(b)(2) states: "The term 'extortion' means the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or *under color of official right*."² Within the past few years, federal prosecutors have utilized the concept of "official right" extortion to successfully prosecute public officials who have violated their positions of public trust for personal gain.³ The common thread in each of these prosecutions is that the defendant was a public official when the illegal act was committed. *United States v. Meyers*,⁴ however, indicates a more expansive use of the Hobbs Act: private citizens, who are only nominated for office but never elected, may be subject to federal prosecution for misusing their potential official power.

In *Meyers*, the Seventh Circuit reached three conclusions. First, it reaffirmed the notion that conspiracy can be a continuing crime which does not end until the goal for which it was formed is achieved.⁵ Second, the court held that a mere candidate for public office could conspire to commit official right extortion. Third, the Seventh Circuit decided that it was irrelevant to the issue of guilt or innocence that the conspirators could not have committed the substantive crime at the inception of the conspiratorial agreement.

* 529 F.2d 1033 (7th Cir. 1976).

1 18 U.S.C. § 1951 (1970). The relevant portions of the statute are set forth below:

(a) Whoever in any way or degree obstructs, delays or affects commerce or the movement of any article or commodity in commerce, by robbery or extortion or attempts or conspires so to do, or commits or threatens physical violence to any person or property in furtherance of a plan or purpose to do anything in violation of this section shall be fined not more than \$10,000 or imprisoned not more than twenty years, or both.

(b) As used in this section—

(1) The term "robbery" means the lawful taking or obtaining of personal property from the person or in the presence of another, against his will, by means of actual or threatened force or violence, or fear of injury, immediate or future, to his person or property, or property in his custody or possession, or the person or property of a relative or member of his family or of anyone in his company at the time of the taking or obtaining.

(2) The term "extortion" means the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under color of official right.

2 *Id.* § 1951(b)(2) (emphasis added).

3 See *United States v. Mazzei*, 521 F.2d 639 (3d Cir. 1975); *United States v. Kuta*, 518 F.2d 947 (7th Cir. 1975); *United States v. Staszczuk*, 517 F.2d 53 (7th Cir. 1975); *United States v. Braasch*, 505 F.2d 139 (7th Cir. 1974).

4 529 F.2d 1033 (7th Cir. 1976).

5 See text accompanying note 14 *infra*.

Meyers is the first case in which the official right language of the Hobbs Act has been used to prosecute public officials for a conspiracy to commit extortion which commenced prior to their election and while they were still private citizens. In so doing, it broadens the traditional ambit of the Act and adds another weapon to the prosecutorial arsenal used to attack political corruption.

Charles Meyers and Jack Scoville were indicted for conspiracy to commit extortion under color of official right in violation of the Hobbs Act. Defendants moved to dismiss the indictment for failure to state a cause of action. The district court granted their motion. On appeal, the following facts were stipulated:⁶

1. In October, 1972, Charles Meyers and Jack Scoville were candidates for the position of Trustee of the East Side Levee and Sanitary District, East St. Louis, Illinois. They were both elected the following November. Neither defendant had been a public official prior to December 6, 1972, when they took office.

2. The conspiracy was allegedly formed in October, 1972, as a result of a meeting between defendants and the alleged victims.

3. Any money paid to defendants was allegedly paid during October, 1972, prior to their election, and was retained through May, 1973.

As indicated in the indictment, one of the official responsibilities of a Trustee is to award contracts to suppliers and contractors who do business within the district.⁷ In doing so, Trustees must exercise unbiased and independent judgment. The indictment alleged that each defendant conspired to obtain in excess of \$6,000 in return for his promise, if elected, to suspend his independent judgment in awarding contracts. The Government contended that this conspiracy was in violation of the Hobbs Act. In dismissing the indictment, the district court reasoned that since both the agreement to pay money and the actual payment occurred while defendants were still private citizens, there could be no Hobbs Act violation.

The Seventh Circuit concluded that the district court erroneously couched the issue in terms of the substantive crime of extortion rather than the separate crime of conspiracy.⁸ The appellate court stated the main issue as follows:

[W]hether, within the meaning of the Hobbs Act, it is a crime for candidates for political office to conspire to affect commerce by extortion induced under color of official right during a time frame beginning before the election but not ending until after the candidates have obtained public office.⁹

In dealing with this issue, the Seventh Circuit decided three important sub-issues. First, the court held that the phrase "under color of official right,"¹⁰ specifically modifies only the phrase "obtaining of property from another." Since it does not modify the word "conspires," an individual need not be a public

6 529 F.2d at 1035.

7 *Id.* at 1034.

8 *Id.* at 1035.

9 *Id.*

10 See 18 U.S.C. § 1951(b)(2) (1970) and note 1, *supra*.

official in order to conspire to commit official right extortion. Second, the court held that even if the Hobbs Act were restricted to conspiracies taking place while the co-conspirators were public officials, the alleged activities of the defendants were well within the reach of that statute.¹¹ The Seventh Circuit pointed out that the lower court overlooked the "continuity of the crime of conspiracy."¹² The stipulated facts suggested that the alleged conspiracy continued for several months after the defendants became public officials and, therefore, by that time their conspiracy clearly was proscribed by the Act. Finally, the court dealt with the question of whether impossibility is a defense to a conspiracy prosecution: namely, whether an individual can be convicted of conspiring to commit a crime if it is impossible for him to commit the substantive offense. The court concluded that impossibility is *not* a defense to such a charge. Consequently, the Seventh Circuit resolved the main issue by holding that the Hobbs Act does reach conspiracies to commit official right extortion which are formed while the co-conspirators are private citizens and which continue after they are elected to and assume public office.¹³

The Issues

The court's reasoning has broad implications for the prosecution of future political corruption. By holding that one need not be a public official in order to conspire to commit official right extortion, and that impossibility is not a defense, unscrupulous candidates, who threaten to misuse their future official position unless money is paid prior to their election, will be subject to Hobbs Act prosecution.

Although several alternative issues were raised by the parties to *Meyers*, the Seventh Circuit apparently resolved the question before it on the conspiracy-continuity theory. In declaring the controlling legal theory the court stated:

More important, however, is the consideration of the Government's contention that even if the phrase "under color of official right" in § 1951(b)(2) were held to modify the word "conspires" in § 1951(a), the alleged conspiracy existed even after *Meyers* and *Scoville* took office.¹⁴

This statement suggests, then, the strong reliance on the notion of conspiratorial continuity in deciding the case. Thus, the alternative issues addressed by the court, statutory construction and impossibility, might be viewed as dictum. After consideration of the soundness of the conspiracy-continuity theory, it will be shown that the court correctly decided the issues relating to statutory construction and impossibility, thereby allowing other federal courts to utilize the *Meyers* reasoning in convicting political candidates.

The Conspiracy-Continuity Theory

The district court failed to recognize that conspiracy is a continuing crime

11 529 F.2d at 1036.

12 *Id.*

13 *Id.* at 1038.

14 *Id.* at 1036.

which does not end until the object for which it was formed is achieved.¹⁵ In *Meyers*, the object of the conspiracy was the suspension of defendants' independent judgment as public officials. The fact that the conspiracy was formed prior to actually taking office was, in the court's view, not controlling. The court pointed out that, on the facts stipulated, the trier of fact could properly conclude that the conspiracy continued for several months after defendants had taken office.¹⁶ This reasoning is sound and supported by judicial authority.

A leading case upholding the conspiracy-continuity theory is *Grunewald v. United States*.¹⁷ Defendants were indicted and convicted of conspiracy to defraud the United States by preventing the criminal prosecution of certain taxpayers for fraudulent tax evasion. On appeal to the Supreme Court, the defendants sought to bar the indictment because the three-year statute of limitations had elapsed. The Government argued that the facts indicated a subsidiary conspiracy to conceal the illegal activity and that certain overt acts of this subsidiary conspiracy occurred within the period of limitations.¹⁸ The Supreme Court rejected this contention and decided that the outcome of the case would depend on what the state alleged and proved to be the central objective of the conspiracy.¹⁹ Sustaining the idea that conspiracy can be a continuing crime, the Court stated:

If, therefore, the jury could have found that the aim of the conspiratorial agreement was to protect the taxpayers from tax prosecutions, and that overt acts occurring in the indictment were in furtherance of that aim, we would affirm.²⁰

Thus, the Court suggested that once the main objective of a conspiracy is determined, the overt acts in furtherance of this objective will keep the conspiracy alive. *McDonald v. United States*²¹ is also illustrative of the conspiracy-continuity theory. There the defendant, McDonald, was convicted of conspiring to kidnap a person in violation of a federal statute.²² McDonald did not know of the kidnap plot nor was he in any way involved in carrying it out. In fact, his involvement occurred nearly four months after the ransom had been paid and the victim released. He merely changed the "marked" ransom money into unmarked bills. Nevertheless, the court upheld the conspiracy charge finding that the object of the conspiracy was to obtain money which could be used without the possibility of tracing. Since the defendant's involvement occurred before that goal had been achieved, he was deemed to be part of the conspiracy from the beginning. In explaining this view, the court provided the following guidelines to determine when the object has been reached and the conspiracy ended:

15 *Grunewald v. United States*, 353 U.S. 391 (1957).

16 529 F.2d at 1036.

17 353 U.S. 391 (1957).

18 *Id.* at 397.

19 *Id.* at 411.

20 *Id.*

21 89 F.2d 128 (8th Cir. 1937).

22 Act of June 22, 1932, ch. 271, 47 Stat. 326 (1932) (current version at 18 U.S.C. § 1201 (1970)).

Whenever the unlawful object of the conspiracy has reached that stage of consummation, whereat the several conspirators having taken in spendable form their several agreed parts of the spoils, may go their several ways, without the necessity of further acts or consultation about the conspiracy, with each other or among themselves, the conspiracy has ended.²³

This standard is useful in analyzing the facts of the *Meyers* case. It suggests that one must view the conspiracy and all of its intended activity as a whole. Although the extortionate money was allegedly paid before Meyers and Scoville were officials, the scheme was predicated on the suspension of independent judgment as soon as they took office. Further acts were, therefore, required beyond the mere acceptance of the money, before the conspiracy could be deemed to have ended.

It is apparent that the conspiracy-continuity theory is sufficient by itself to decide this case; the conspiracy having been deemed to continue beyond the time defendants took office, applicability of the Hobbs Act is unquestionable. The *Meyers* court, however, chose unnecessarily to delve into the issues of statutory construction and the defense of impossibility. By doing so, they significantly broadened the reach of the Hobbs Act in prosecuting illegal political activities.

Extortion Under Color of Official Right

Early in the opinion, the Seventh Circuit considered whether the phrase "under color of official right," located at the end of subparagraph (b) (2) of the Act, should be interpreted as modifying the verb "conspires" located in paragraph (a). Had the court decided that the "official right" phrase does modify the word "conspires," it would have been clear that only a public official could commit such a conspiracy, and the impact of the statute with respect to the prosecution of private citizens running for political office, would be largely lost.

The court, however, quickly dispensed with this issue and held that "under color of official right" *does not* modify the verb "conspires." It relied on "established canons of statutory construction."²⁴ As is pointed out by a well-known authority on statutory interpretation, "the words are to be applied to the subjects to which they appear by context most properly to relate to and to which they are most applicable."²⁵ The court pointed out that the phrase "obtaining of property from another" appears in the same subparagraph and precedes the phrase "under color of official right." Read in context, these two phrases relate to each other, with the latter modifying the former. Nowhere in this subparagraph does the word "conspires" appear. Without any evidence of congressional intent, to say that the "official right" phrase modifies a verb in a preceding paragraph is stretching the established rules of construction.

Indeed, the legislative histories of the Hobbs Act and its predecessor, the

²³ 89 F.2d at 134.

²⁴ 529 F.2d at 1036.

²⁵ 2A J. SUTHERLAND, STATUTORY CONSTRUCTION, § 47.26, p. 136 (4th ed., C. SANDS, 1973).

Anti-Labor Racketeering Act of 1934,²⁶ support the interpretation that any individual can conspire to commit "official right" extortion. The Racketeering Act, amended in 1947 by the Hobbs Act, was enacted to protect interstate commerce from racketeers who utilized violence, extortion or coercion to effect their illicit objectives.²⁷ In 1942 the Supreme Court decided *United States v. Local 807*,²⁸ which immunized from the strictures of the 1934 Act labor union members who threatened force or violence to obtain money or property from employers.²⁹ In addition to being a legislative response to this decision, and thereby eliminating this unwarranted exception, the purpose of the Hobbs Act is to protect interstate commerce from robbery and extortion by "whoever might commit such offenses."³⁰ Thus, there remains very little difference between the purpose and effect of the original legislation and its amended version. Both acts proscribe robbery;³¹ both proscribe "official right" and "force or fear" extortion;³² and both make illegal, conspiracies to commit these crimes.³³ The interpretation that the *Meyers* court gave to the Hobbs Act comports with the historical purposes of both statutes. Conspiracy to obtain money through extortion, even if the agreement focuses on the conspirator's future official position, is among the types of activities sought to be proscribed by these statutes. Official racketeering is no less of a danger to commerce than racketeering resulting from the efforts of organized crime. Congress is silent on the meaning they ascribe to the word "conspiracy" however, it is unlikely that they would have limited application of the crime to the "force or fear" definition of extortion.

There is, yet, another reason why the Hobbs Act should be interpreted as including private citizens in its proscription against conspiracy to commit "official right" extortion. As mentioned earlier, the legislative history of the Hobbs Act is silent regarding the meaning of the word "conspires." This being the case, the accepted posture is to presume that Congress intended to use the word according to its well-accepted judicial meaning: a person can properly be convicted of conspiracy to commit a crime although personally incapable of committing the substantive offense. Illustrative of this judicial meaning is *United States v. Rabinowich*³⁴ in which defendant was convicted of conspiring to violate 29(b)(1) of the Bankruptcy Act³⁵ despite the fact that under the

26 Anti Labor Racketeering Act, ch. 569, 48 Stat. 979 (1934) (current version at 18 U.S.C. § 1951 (1970)).

27 H.R. REP. NO. 1833, 73d Cong., 2d Sess 2 (1934).

28 315 U.S. 521 (1942).

29 *Id.* at 527.

30 CONG. REC. 11905 (1945) (remarks of Representative Robson).

31 Compare Anti Labor Racketeering Act § 2(a), ch. 569, § 2(a), 48 Stat. 979 (1934) (current version at 18 U.S.C. § 1951 (1970)) with Hobbs Act, 18 U.S.C. § 1951(b)(1) (1970).

32 Compare Anti Labor Racketeering Act § 2(b), ch. 569, § 2(b), 48 Stat. 979 (1934) (current version at 18 U.S.C. § 1951 (1970)) with Hobbs Act, 18 U.S.C. § 1951(b)(2) (1970).

33 Compare Anti Labor Racketeering Act § 2(d), ch. 569, § 2(d), 48 Stat. 979 (1934) (current version at 18 U.S.C. § 1951 (1970)) with Hobbs Act, 18 U.S.C. § 1951(a) (1970).

34 238 U.S. 79 (1915).

35 Bankruptcy Act § 29(b)(1), ch. 541, § 29(b)(1), 30 Stat. 544 (1898) (current version at 11 U.S.C. § (1970)).

pertinent language he was legally incapable of committing the substantive offense.³⁶ Nonetheless, the Court upheld the conviction holding the notion of impossibility uncontrolling.

Paragraph (a) of the Hobbs Act specifically prohibits a conspiracy to commit extortion which in any way or degree has an effect on interstate commerce. The legislature did not indicate any special conditions under which such conspiracies were to occur. Thus, one is left with the settled interpretation of the nature and scope of this admittedly amorphous crime. If an individual, as the weight of authority suggests, can be convicted of conspiring to commit a crime which it is impossible for him to personally commit, there is no reason to believe that under paragraph (a) of the Act a private individual cannot also conspire to obtain property from another, "with his consent, induced . . . under color of official right." When the district court dismissed the case holding that a mere candidate could not commit the substantive crime of "official right" extortion, it failed, as the Seventh Circuit indicated, to consider the nature and scope of conspiracy.

Impossibility as a Defense

The *Meyers* court also dealt with what it perceived to be defendants' implicit allegation³⁷ that impossibility is a defense to a conspiracy prosecution: "[T]he impossibility that the defendants' conduct would result in consummation of the contemplated crime is not persuasive or controlling."³⁸ The authority cited for this proposition was *Beddow v. United States*.³⁹ In that case, defendant was convicted of conspiracy to defraud the United States by both forgery and the false uttering of Government securities. Despite the fact that the securities could not have been cashed because they were not properly witnessed, the conviction was upheld. The defense of impossibility was rejected. The court stated that the success or failure of the criminal conspiracy was not relevant to the question of defendant's guilt or innocence.⁴⁰ *Israel v. United States*⁴¹ also rejects impossibility as a defense to a conspiracy prosecution. The Sixth Circuit upheld defendant's conviction of conspiracy to conceal property from a trustee despite the fact that defendants, who were neither bankrupts nor discharges in bank-

36 *Id.* The relevant language of 29(b)(1) is as follows:
Sec. 29 Offenses.

(a)

(b) A person shall be punished, by imprisonment for a period not to exceed two years, upon conviction of the offense of having knowingly and fraudulently (1) concealed while a bankrupt, or after his discharge, from his trustee any property belonging to his estate in bankruptcy. . . .

37 529 F.2d at 1037. In their opening Reply Memorandum defendants said they were not raising impossibility of fact or law as a defense; however, a supplement to the memo contained language which led the Court to perceive the defense as implicit. In their Supplemental Reply Memo defendants asked: "Why was it *impossible* for the defendants to conspire 'to obtain property under color'? Because the Government stipulation clearly states that the property be obtained prior to the defendants' election, and, in fact, the 'property' was 'obtained' prior to their election."

38 *Id.*

39 70 F.2d 674 (8th Cir. 1934).

40 *Id.* at 676.

41 3 F.2d 743 (6th Cir. 1925).

ruptcy, could not have legally been convicted of the substantive offense.⁴²

In short, the court in *Meyers* correctly concluded that impossibility is not a defense to a conspiracy prosecution. Thus, the fact that a private citizen cannot obtain property by extortion induced under color of official right has no bearing on the propriety of convicting him of conspiracy to commit such an offense.

Prior Judicial Authority

The decision reached in *Meyers* results naturally from several years of judicial interpretation of the Act. Federal prosecutors, within and without the Seventh Circuit, have often utilized the official right definition of extortion to attack political corruption. A major focus of these decisions has been to define the types of official conduct proscribed by the Act. A summary of the important cases expanding the statutory language helps to explain the Seventh Circuit's current interpretation.

In *United States v. Hyde*,⁴³ the defendant, Attorney General of Alabama, obtained money from life insurance companies and securities dealers by threatening to prevent these organizations from doing business in the state.⁴⁴ On appeal from a Hobbs Act conviction, the defendant argued he was guilty of nothing beyond classic bribery.⁴⁵ He contended that the official right definition of extortion does not encompass threats by a public official to enforce valid rules. The Fifth Circuit denied the defendant's claim and stated: "It is the wrongful use of an otherwise valid power that converts dutiful action into extortion. If the purpose and effect are to intimidate others, forcing them to pay, the action constitutes extortion."⁴⁶

The language of the Act was broadened beyond *Hyde* in *United States v. Braasch*.⁴⁷ There, the defendant, a Chicago police captain, obtained money from tavern owners in return for protection from the enforcement of regulatory laws.⁴⁸ He was convicted of conspiracy to commit extortion under color of official right. Captain Braasch, on appeal to the Seventh Circuit, argued that the police activity under scrutiny amounted to no more than bribery and was, therefore, not covered by the Act.⁴⁹ In upholding the conviction, the Seventh Circuit stated:

It matters not whether the public official induces the payments to perform his duties or not to perform his duties, or even, as here, to perform or not to perform acts unrelated to his duties which can only be undertaken because of his official position. So long as the motivation for the payment focuses on the recipient's office, the conduct falls within the ambit of 18 U.S.C. § 1951.⁵⁰

⁴² Bankruptcy Act § 29(b)(1), ch. 541, § 29(b)(1), 30 Stat. 544 (1898) (current version at 11 U.S.C. § 21 (1970)).

⁴³ 448 F.2d 815 (5th Cir. 1971).

⁴⁴ *Id.* at 820.

⁴⁵ *Id.* at 822.

⁴⁶ *Id.* at 833; see also *United States v. Sopher*, 362 F.2d 523 (7th Cir.), *cert. denied*, 385 U.S. 928 (1966).

⁴⁷ 505 F.2d 139 (7th Cir. 1974).

⁴⁸ *Id.* at 142.

⁴⁹ *Id.* at 151.

⁵⁰ *Id.* (emphasis added).

Thus, the *Braasch* standard proscribes, as extortionate, the receipt of money or property induced by the official's misuse of his official power. This standard has subsequently been reaffirmed in other Seventh Circuit opinions.⁵¹

A further expansion of the official right language addressed the issue of whether the Act encompasses the misuse of de facto official power. The Third Circuit provided the answer in *United States v. Mazzei*.⁵² Defendant, a state legislator, promised the corporate victim that certain state agencies would agree to rent office space from the corporation. In return the defendant received a substantial sum of money.⁵³ Mazzei contended that the Hobbs Act did not reach his activity since he had no statutory authority over the leasing policies of the agencies. Nonetheless, the Third Circuit upheld the Hobbs Act conviction, finding that the statutory language contemplates a misuse of both de jure and de facto power.⁵⁴ The court articulated the standard by holding that the defendant "[E]xploited a reasonable belief that the state system so operated that the power in fact of defendant's office included the effective authority to determine recipients of the state lease here involved."⁵⁵

The cumulative effect of such cases as *Hyde*, *Braasch* and *Mazzei* is an almost unlimited applicability of the Hobbs Act to instances of local political corruption. Any public official can commit extortion induced under color of official right regardless of whether or not the individual has actual power to carry out the promises which are the subject of the extortionate activity. The Seventh Circuit has continued this expansive interpretation of the Hobbs Act's statutory language, with *Meyers* reflecting a predictable willingness to apply the notion of extortion under color of official right in an imaginative manner. *Meyers* deals specifically with private citizens who eventually ascend to a position of public trust. Since their illegal conspiracy, formed prior to their election, extended into the terms of office, the court had little difficulty in applying the statute. However, if the past affords a basis for prediction, there is no reason to believe that, under similar circumstances, failure of election would bar a conviction.

Conclusion

United States v. Meyers seems to be limited to the notion that a conspiracy does not end until its ultimate goal has been achieved. By stressing the importance of the conspiracy-continuity theory, the Court suggested this to be the foundation of the case. Whether or not other jurisdictions will likewise restrict this decision will depend, in large part, on the accuracy with which the court resolved the issues of statutory interpretation and the defense of impossibility in conspiracy prosecutions. As noted earlier, the court's resolution of these issues was sound and supported by judicial authority.

The canons of statutory construction, the legislative histories of both the Anti-Racketeering Act of 1934 and the Hobbs Act, and the well-accepted

51 See *United States v. Staszczuk*, 517 F.2d 53 (7th Cir. 1975) and *United States v. Kuta*, 518 F.2d 947 (7th Cir. 1975).

52 521 F.2d 639 (3d Cir. 1975).

53 *Id.* at 641.

54 *Id.* at 643.

55 *Id.*

judicial meaning of the crime of conspiracy support the contention that the Hobbs Act proscribes a conspiracy to commit extortion induced under color of official right regardless of whether the conspirator is a public official. If the conspiratorial scheme, even if effectuated by a mere candidate, focuses on a future (extortionate) misuse of that candidate's public office, there is a Hobbs Act violation provided the jurisdictional element of interstate commerce is present. Indeed the weight of authority supports the court's conclusion that impossibility is not a defense to a conspiracy prosecution.⁵⁶

The importance of the *Meyers* decision is that a federal prosecutor may now be able to police the political arena for improprieties which, in the past, have been largely subject to local jurisdiction. Consider a hypothetical case in which a private citizen running for mayor promises, in violation of his future public trust, that as soon as he is elected he will grant political favors to businessmen, provided they make "contributions" directly to him or his political party. The businessmen, unsure of the outcome of the election, play it safe and agree to the extortionate scheme. Assuming the requisite plurality for a conspiracy prosecution and the necessary effect on interstate commerce, a federal prosecutor may utilize *Meyers* in two ways to reach this illegal activity. First, if the candidate is elected and the conspiracy continues, the "continuity" theory can be applied to prosecute the mayor. Second, and more important, is the basis for prosecution if the candidate loses the election. The *Meyers* interpretation of the Hobbs Act language, combined with the irrelevance of the impossibility defense, indicates that this citizen can be successfully prosecuted for conspiring to commit extortion induced under color of official right, even though at the inception of the conspiracy it was legally impossible for him to commit the substantive crime.

It is impossible to predict how much the "conspiracy-impossibility" dichotomy will be used by federal authorities to prosecute political candidates. To the extent it is used, a new dimension will be added to the already versatile Hobbs Act.

Santo Bisignano, Jr.

⁵⁶ See text accompanying notes 37-42 *supra*.

LABOR LAW—UNFAIR LABOR PRACTICES—UNIONS REQUIRED TO ARBITRATE BEFORE ENGAGING IN SYMPATHY STRIKE

*NLRB v. Keller-Crescent Company**

Negotiations broke down during the summer of 1972 between the Keller-Crescent Company (Company) and Local 117 of the Evansville Printing and Pressmen and Assistants Union, AFL-CIO (Pressmen). The Pressmen called a strike and established a picket line. During the strike, twelve members of the Evansville Typographical Union No. 35 (Local 35), a union which represents a different unit of employees of the Company, refused to cross the Pressmen's picket line. Local 35 is a subordinate union of the International Typographical Union (ITU) and the Pressmen are a division of the AFL-CIO.¹

When the Company learned that Local 35 was contemplating honoring the Pressmen's picket lines, it informed Local 35 that, in its opinion, §§ 12 and 13 of the collective-bargaining agreement between the Company and Local 35 prohibited that action. Section 12, a limited sympathy strike clause, provided that Local 35 members would not be required to cross a picket line established by any other subordinate union of the ITU.² Section 13, a broad mandatory arbitration agreement, prohibited strikes or lockouts unless the other party refused to comply with the grievance procedure.³ After the Pressmen's strike ended, the twelve sympathy strikes returned to work and were subjected to disciplinary suspensions by the Company for violation of the contract's no-strike

* 538 F.2d 1291 (7th Cir. 1976).

1 *Id.*

2 Section 12 reads as follows:

No employee covered by this contract shall be required to cross a picket line established because of a strike by, or lockout of, any other subordinate Union of the International Typographical Union, when such strike is authorized by, or such lockout is recognized by the ITU.

3 Section 13 reads as follows:

A Joint Standing Committee of two representatives each of the Employer and the Union shall be selected. It is agreed that if neither of the Union representatives is an employee of the commercial branch of the printing trade, that one member shall be selected by the Union from the employees of the above-mentioned commercial branch of the trade, such member to attend all meetings of the Joint Standing Committee, but not to have power to vote on decisions. To this committee shall be referred all disputes which may arise as to the application of and construction to be placed upon any provision of this agreement, or alleged violation thereof, which cannot be settled otherwise. . . . The decision of the committee shall be final and binding upon both parties. Provided that the General Laws of the International Typographical Union shall not be subject to arbitration.

It is agreed that the conditions prevailing prior to any dispute shall be maintained until the Joint Standing Committee has rendered a decision as provided above except in discharge cases.

There shall be no strikes or lockouts during the term of this agreement unless either party refuses to comply with the grievance procedure as outlined hereinabove.

It is agreed that the procedures for settlement of any disputes or grievance arising under this contract are as defined herein and that the only recourse each party may have against the other for any damages alleged to be due for any breach of this contract shall be the Joint Standing Committee.

* * *

Under no circumstances shall the arbitrator have the power or right to add to, subtract from, change or modify any provision of this contract. The arbitrator is authorized only to interpret the specific provision(s) of the contract, and to apply them to the specific facts of the grievances which are being arbitrated.

clause. An unfair labor practices charge was filed against the Company with the NLRB.

After a fact-finding investigation,⁴ the administrative law judge found that the no-strike clause of the contract⁵ was inapplicable because waiver of the right to strike⁶ extended to matters only within the scope of the arbitration grievance procedure. Since the issue of the strike was the Pressmen's contract, which was not arbitrable under Local 35's contract, it did not fall within the no-strike ban of § 13. It was not a "dispute or grievance arising under this contract. . . ."⁷

The administrative law judge ruled, however, that the employees had breached the no-strike clause because of the limited sympathy strike clause of § 12. He concluded that the parties intended to encompass within § 12 a prohibition on the honoring of any picket line other than those of subordinate unions of the ITU. Although § 12 contained no express waiver of the right to honor another union's picket line, such waiver could be implied from the language of the section considered together with extrinsic evidence as to the parties' intent. The administrative law judge felt that the union's attempt to broaden its long-standing picket-line clause to cover all picket lines at the plant revealed its belief that the contract, as it existed, would not protect sympathy picketing. Accordingly, the administrative law judge recommended that the complaint be dismissed.

A majority of the NLRB agreed with the administrative law judge that a sympathy strike did not fall within the no-strike ban of § 13. The majority, however, did not find that Local 35 had, even impliedly, waived its statutory right to honor the Pressmen's picket line. The NLRB referred to a line of cases requiring that the waiver of a collective bargaining right must be in "clear

4 See 29 U.S.C. § 160(b) (1970). This section empowers the NLRB to issue an unfair labor practice complaint whenever it is alleged that someone is engaging in such practices. The NLRB cannot initiate an unfair labor practice proceeding without the impetus of an outside complaint. The filing of the charge initiates an investigation of the alleged statutory violation and a trial examiner is appointed. 29 C.F.R. §§ 101.2, 101.10(a) (1976). His duty is to inquire fully into the facts as to whether the respondent has engaged in or is engaging in an unfair labor practice affecting commerce as is set forth in the complaint. 29 C.F.R. § 101.35 (1976). The trial examiner's decision is filed with the NLRB which then enters an order transferring the case to it. The parties are notified and have twenty days to file exceptions to the trial examiner's decision. 29 C.F.R. §§ 102.45(a), 102.46(a) (1976). 29 U.S.C. § 106(c) (1970) provides that if no exceptions are filed within twenty days after service on the parties of the trial examiner's report and recommended order, or within such further period as the NLRB may authorize, the recommended order becomes the NLRB order and is effective as therein prescribed. If any party files exceptions to the trial examiner's decision, the NLRB may decide the matter upon the record or after oral argument, or may reopen the record and receive further evidence before an NLRB member or agency, or may close the case on compliance with the trial examiner's recommendations, or make other disposition of the case. 29 C.F.R. § 102.48(b) (1976). The trial examiner's recommendations may be accepted or rejected by the NLRB. See *NLRB v. Oregon Worsteds Co.*, 94 F.2d 671 (9th Cir. 1938). 29 U.S.C. § 160(k) (1976) directs the NLRB to hear and determine the dispute, and to issue an order requiring the offending party to cease and desist if it finds a violation. 29 U.S.C. § 160(c) (1976). The NLRB has no power to enforce its own orders, but is empowered to petition any court of appeals for the district wherein the unfair labor practice took place or wherein the person bound by NLRB order resides or transacts business. See *In re Labor Board*, 304 U.S. 486 (1937). The court has jurisdiction of the proceeding and of the question determined therein, and has power to issue such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, or setting aside the NLRB order in whole or in part 29 U.S.C. § 160(e) (1970).

5 See § 13, *supra* note 2.

6 See § 12, *supra* note 1.

7 See § 13, *supra* note 2.

and unmistakable language."⁸ Since it was not so expressed in the contract, the NLRB found that this right had not been waived; the employees remained protected in their expressions of sympathy for the other union's causes. The Board ruled, therefore, that the Company had engaged in unfair labor practices in violations of § 8(a)(1), (3) of the National Labor Relations Act.⁹ The Company was ordered to cease and desist from these unfair labor practices and to make whole the twelve employees for any loss of wages they had suffered. The NLRB, then, petitioned the court of appeals to enforce its order.¹⁰ The Seventh Circuit denied this application for enforcement, concluding that Local 35 members were contractually bound to arbitrate the dispute over the construction of the sympathy strike clause once disagreement over whether or not it ruled out the possibility of sympathy strikes for non-related unions emerged. This decision can only be understood against the background of developing case law in the area of mandatory arbitration and no-strike clauses.

Historical Background of Mandatory Arbitration and No-Strike Clauses

1. Taft-Hartley Act

In response to the oft-expressed concern that there exists an inherent judicial bias favoring management in labor disputes,¹¹ Congress divested federal courts of jurisdiction to issue restraining orders or injunctions in labor disputes.¹² With the growth and increasing strength of unions, however, the need to empower the judiciary to aid in arbitration proceedings became apparent. Thus Congress granted to the federal courts in the Labor Management Relations Act (Taft-Hartley Act),¹³ jurisdiction to issue restraining orders and injunctions in certain limited cases. Subsequently, this was construed as a congressional mandate favoring arbitration. Indeed, the Supreme Court in *Textile Workers' Union v. Lincoln Mills*¹⁴ held that the Taft-Hartley Act conferred upon the courts the power to force compliance with arbitration procedures to which both parties had agreed.

8 Gary Hobart Water Corp. v. NLRB, 511 F.2d 284, 287 (7th Cir.), cert. denied, 423 U.S. 925 (1975), quoting NLRB v. Wisconsin Aluminum Foundry Co., 440 F.2d 393, 399 (7th Cir. 1971). That case in turn takes the phrase from a line of Sixth Circuit cases, including Beacon Journal Publishing Co. v. NLRB, 401 F.2d 366, 367 (6th Cir. 1968).

9 29 U.S.C. § 158(a)(1), (3) (1970). The only dissenting member of the Board had not inquired as to the applicability of § 13 to the strike as had the administrative law judge and the majority. Rather, he recommended that the order of dismissal be adopted. This decision was based on his conclusion that the strike was a violation of § 12 of the agreement because its language inescapably implied that the Local 35 members were prohibited from honoring any picket lines other than those specifically excepted in that clause. Moreover, he thought it was clear, in light of the collateral evidence, that the union had understood the clause to preclude such sympathy strikes. Accordingly, he found that § 12 of the agreement had waived the employees' statutory right to lend support to the striking Pressmen by refusing to work. 538 F.2d at 1294-95.

10 See 29 U.S.C. § 160(e) (1970). See also note 3 *supra* for a brief summary of procedure and authority for unfair labor practices complaints.

11 See generally F. FRANKFURTER & N. GREENE, *THE LABOR INJUNCTION* (1930).

12 29 U.S.C. § 164 (1970).

13 29 U.S.C. § 141 *et seq.* (1970).

14 353 U.S. 448 (1957).

2. *Boys Market* Injunction

In 1970, the Supreme Court held in *Boys Markets, Inc. v. Retail Clerks Local 770*,¹⁵ that the federal policy to encourage arbitration mandated that a narrow exception be carved out of the anti-injunction clause of the Norris-LaGuardia Act. Here the union was using a strike to strengthen its demands and was short-circuiting the mandatory arbitration procedure to which it had agreed. The Ninth Circuit denied the injunctive relief that the Company had requested because it considered itself bound by the earlier Supreme Court decision in *Sinclair Refining Co. v. Atkinson*.¹⁶ *Sinclair Refining* had held that § 4 of the Norris-LaGuardia Act¹⁷ barred a federal district court from enjoining a strike in breach of a no-strike clause in a collective-bargaining agreement, even though the agreement contained binding arbitration provisions enforceable under § 301(a) of the Labor Management Relations Act.¹⁸ Upon examining *Boys Market*, however, the Supreme Court reversed its holding in *Sinclair Refining*. Instead, it held that in those particular circumstances—where the grievance was subject to arbitration under the collective-bargaining agreement, the Company was willing to arbitrate, and the violations of the no-strike clause were causing irreparable injury—the Norris-LaGuardia Act considered in conjunction with § 301(a) of the Taft-Hartley Act does not bar the granting of injunctive relief.¹⁹ Three criteria were established which had to be met in order to justify the issuance of the injunction. First, the parties had to have agreed to a procedure for the adjustment of the dispute. Second, the strike sought to be enjoined must be over a grievance which both parties are contractually bound to arbitrate. Finally, the injunction must be called for by the regular principles of equity.²⁰

3. *Boys Market* and Sympathy Strikes

One of the most controversial uses of the *Boys Market* injunction was in sympathy strike cases. Since the strike of a union in a sympathetic work stoppage is not over a grievance the union is bound to honor, but rather over the grievance of some other group, the criteria for the issuance of the injunction would not appear to be met. As the Sixth Circuit said in a recent case, “there is a clear difference between a labor dispute which results from a work-stoppage and work-stoppage which is the result of a labor dispute. . . .”²¹ Whether this distinction was significant enough to take a case out of the narrow exception laid down by the court in *Boys Market* was the question considered by the lower courts.

A split of authority developed among the circuits on the application of the

15 398 U.S. 235 (1970).

16 370 U.S. 195 (1962).

17 29 U.S.C. § 104 (1970).

18 29 U.S.C. § 185(a) (1970).

19 370 U.S. at 254-55.

20 398 U.S. at 254. See Comment, *The New Federal Law of Labor Injunctions*, 79 YALE L.J. 1593 (1970).

21 *Plain Dealer Publishing Co. v. Cleveland Typographical Union* 53, 520 F.2d 1220, 1225 (6th Cir. 1975), cert. denied, 96 S. Ct. 3221 (1976).

Boys Market exception in sympathy strike cases. Injunctions have been granted in the Third, Fourth, and Eighth Circuits,²² but denied in the Second, Fifth, and Sixth.²³ The Seventh Circuit had adopted an intermediate position of a case-by-case analysis of the specific language of the individual contracts.²⁴ This growing conflict among the circuits prompted the Supreme Court to grant certiorari in *Buffalo Forge Co. v. United Steelworkers of America*.²⁵

The Court in *Buffalo Forge* discussed its rationale for the *Boys Market* holding; namely, the need for a judicial method of implementing the congressional mandate for private grievance and arbitration procedures whenever possible.²⁶ The agreement of management to arbitrate would be meaningless without the commensurate obligation of the union not to strike over an arbitrable issue. In fact, this interdependence is considered to be so essential that an obligation not to strike over an arbitrable dispute is implied even when no express no-strike clause exists.²⁷ In the absence of an explicit expression negating any implied no-strike obligation, the agreement to arbitrate and the duty not to strike should be construed as having coterminous application. It would be necessary, therefore, to have a clause in the collective-bargaining agreement which specifically and expressly negated the no-strike implication of a broad mandatory arbitration provision.

Even in light of this strong preference for resort to the private dispute settlement, however, the *Buffalo Forge* Court found that *Boys Market* was not controlling in the sympathy strike situation because:

[t]he strike at issue was a sympathy strike in support of sister unions negotiating with the employer; neither its causes nor the issue underlying it were subject to the settlement procedures provided by the contract between the employer and respondents [the union].²⁸

The strike in no way deprived the employer of its bargained right to strike. There was no direct connection between mandatory arbitration and obligation not to engage in sympathy strikes as there was between mandatory arbitration and the obligation not to strike over an arbitrable dispute. The Company may

²² *Valmack Indus. v. Food Handlers Local 425*, 519 F.2d 263 (8th Cir. 1975), *vacated and remanded*, 96 S. Ct. 3215 (1976); *Associated Gen. Contractors v. International Union of Operating Engineers*, 519 F.2d 269 (8th Cir. 1975); *Armco Steel Corp. v. UMW*, 505 F.2d 1129 (4th Cir. 1974), *cert. denied*, 423 U.S. 877 (1975); *Island Creek Coal Co. v. UMW*, 507 F.2d 650 (3d Cir.), *cert. denied*, 423 U.S. 877 (1974); *Wilmington Shipping Co. v. International Longshoremen's Ass'n*, 86 L.R.R.M. 2846 (4th Cir.), *cert. denied*, 419 U.S. 1022 (1974); *Pilot Freight Carriers, Inc. v. International Bhd. of Teamsters*, 497 F.2d 311 (4th Cir.), *cert. denied*, 419 U.S. 869 (1974); *NAPA Pittsburgh, Inc. v. Automotive Chauffeurs, Local 926*, 502 F.2d 321 (3d Cir.) (en banc), *cert. denied*, 419 U.S. 1049 (1974); *Monongahela Power Co. v. Local 2332, IBEW*, 484 F.2d 1209 (4th Cir. 1973).

²³ *520 F.2d 1220* (6th Cir. 1975), *cert. denied*, 96 S. Ct. 3221 (1976); *Buffalo Forge Co. v. Steelworkers*, 517 F.2d 1207 (2d Cir.), *cert. granted*, 423 U.S. 911 (1975); *Amstar Corp. v. Amalgamated Meat Cutters*, 468 F.2d 1372 (5th Cir. 1972).

²⁴ *Hyster Co. v. Independent Towing Ass'n*, 519 F.2d 89 (7th Cir. 1975), *cert. denied*, 96 S. Ct. 3220 (1976); *Gary Hobart Water Corp. v. NLRB*, 511 F.2d 284 (7th Cir.), *cert. denied*, 423 U.S. 925 (1975).

²⁵ 96 S. Ct. 3141 (1976).

²⁶ *Id.* at 3147.

²⁷ *Gateway Coal Co. v. UMW*, 414 U.S. 368 (1974); *Teamsters Local v. Lucas Flour Co.*, 369 U.S. 95 (1962).

²⁸ 96 S. Ct. 3141, 3147 (1976).

allege that the union violated the no-strike clause by participating in the sympathy strike, but this is not sufficient to call forth an injunction. The federal courts were granted the power to issue injunctions to enforce arbitration, not to halt specific violations of collective-bargaining agreements. Accordingly, the Supreme Court settled the conflict among the circuits by ruling that *Boys Market* injunctions could not issue in sympathy strike situations.

Nevertheless, the Supreme Court recognized that although no injunction could issue because the situation did not warrant the application of the narrow *Boys Market* exception:

[w]hether the sympathy strike the Union called violated the no-strike clause, and the appropriate remedies if it did, are subject to the agreed upon dispute settlement procedures of the contract . . . are ultimately issues for the arbitrator. The employer thus was entitled to invoke the arbitral process to determine the legality of the sympathy strike and to obtain a court order requiring the Union to arbitrate if the Union refused to do so. Furthermore, were the issue arbitrated and the strike found illegal, the relevant federal statutes as construed in our cases would permit an injunction to enforce the arbitrable decision.²⁹

Thus, even though a sympathy strike may be determined ultimately to have been in violation of the collective-bargaining agreement, the employer may not obtain an injunction under *Buffalo Forge*. The legality of disciplinary action taken after the strike is a separate issue from the issuance of the injunction.

Distinction Between Unfair Labor Practice Proceedings and Injunctions

The Seventh Circuit had previously considered the arbitrability issue as the same whether it arose under unfair labor practice proceedings or under applications for *Boys Market* injunctions.³⁰ In view of the distinction made by the Supreme Court in *Buffalo Forge*,³¹ this combining of enforcement cases and injunction petitions is no longer legitimate. As in *Buffalo Forge*, the arbitration provision in *Keller-Crescent* may be broad enough to reach disputes over the meaning of the no-strike clause itself. Whether it does encompass that clause is the first place where the Company and the Board disagree.³²

1. *Keller-Crescent*

The Board determined in *Keller-Crescent* that sympathetic activity involved no issue that could be reached by resorting to the arbitration procedure. Local 35 was not striking over an issue that had arisen out of its contract; the strike was in sympathy for a dispute between the Company and the Pressmen. Obvious-

²⁹ *Id.* at 3146.

³⁰ 519 F.2d 89 (7th Cir. 1975), *cert. denied*, 96 S. Ct. 3220 (1976).

³¹ 96 S. Ct. at 3147.

³² Because the NLRB initiated the action in petitioning the court to enforce its order, it is its contentions rather than those directly of the union which are at stake here. *See* note 3 *supra* for more complete outline of procedure.

ly, that conflict could not be resolved in any arbitration proceeding between Local 35 and the Company. Since there would be no purpose, then, in the arbitration process, it would follow that sympathetic activity would not fall within the penumbra of the prohibition of the no-strike clause. The Board cited the Seventh Circuit's decisions in the *Hyster Co. v. Independent Towing Ass'n*³³ and *Gary Hobart Water Corp. v. NLRB*³⁴ cases as authority for its assertions that a dispute over the meaning and applications of the picket-line clause is not arbitrable. Both of those cases involved the question of the arbitrability of a sympathy strike. The *Gary Hobart* case, like the *Keller-Crescent* case, arose in the context of an unfair labor practice charge. The Seventh Circuit unequivocally stated:

[t]he refusal to dishonor another local union's picket line or engaging in a sympathy strike in connection with another local's strike are not disputes or controversies arising under or in connection with the first local union's agreement and are therefore neither arbitrable nor subject to the no-strike provision[s] [of the bargaining agreement].³⁵

Further, the Board argued that § 12 does not waive the employees' right to engage in sympathy strikes which honor picket lines established by groups other than subordinates of their own International. The enumeration and specific reservation of certain statutory rights should not imply a waiver of ones not mentioned.³⁶ A collective-bargaining agreement is not an ordinary contract to which the principles of law governing ordinary contracts apply.³⁷ Rather, it is a generalized code which has been adopted by the parties to cover the whole employment relationship and to comply with the strong statutory protections of rights that Congress has provided.³⁸

The Company maintained that the very fact that there was a question over the interpretation of the picket-line clause should draw the controversy within the parameters of the mandatory arbitration procedure and, therefore, within the no-strike prohibition. The union insisted that since the strike had nothing to do with its own contract with the Company, mandatory arbitration was inapplicable. Conversely, the Company pointed out that there was a dispute over the interpretation of a clause of the contract³⁹ and that the strike would be illegal if the arbitrator ruled in favor of the Company on that issue. The question, therefore, should be submitted to the arbitration procedure in order to

33 519 F.2d 89 (7th Cir. 1975), *cert. denied*, 96 S. Ct. 3220 (1976).

34 511 F.2d 284 (7th Cir.), *cert. denied*, 423 U.S. 925 (1975).

35 *Id.* at 288.

36 530 F.2d 1291, 1297 (1976).

37 Transportation-Communication Employees Union v. Union Pac. R.R. Co., 385 U.S. 157, *rehearing denied*, 385 U.S. 1032 (1966); *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964).

38 "An employee's claim does not necessarily fail where he cannot point to a specific contract provision on which the claim is founded, because there are too many problems, and too many unforeseeable contingencies to make the words of the contract the exclusive source of rights and duties." *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 577 (1960), citing to *Cox, Reflections Upon Labor Arbitration*, 72 HARV. L. REV. 1482 (1959).

39 Whether or not the picket-line clause permitted that particular sympathy strike.

comply with the agreement and, in accordance with the purpose of the contract, to avoid pressure tactics.

Moreover, the Company urged the Seventh Circuit to accept its view that because § 12 enumerated what picket lines could be honored, it necessarily precluded the possibility that any others could be accorded the same respect. The court found the latter contention to be persuasive, but chose to base its decision on prior authority within its own circuit and on a much broader basis.

2. Consideration of the Specific Contract Language

After briefly outlining the arguments of the opposing parties, the Seventh Circuit in *Keller-Crescent* analyzed the particular language of the agreement.⁴⁰ By doing so, it distinguished its own precedents of *Gary Hobart* and *Hyster*. Citing a long line of cases favoring arbitration and the peaceful resolution of labor disputes,⁴¹ the court recognized the presumption of arbitrability which only disappears if it "may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute."⁴² Section 13 of the agreement makes the construction of any provision of the agreement subject to the arbitration procedure. Clearly, the limited picket-line clause of § 12 is a provision of the agreement. Accordingly, then, in order for the court to have found that the sympathy strike did not fall within the no-strike ban of § 13, it must have been able to state with positive assurance that § 13 could in no way be interpreted to cover the dispute over § 12. This it was not prepared to do; the court determined that the evidence available simply did not meet such a high burden. In fact, the only support the Seventh Circuit found for the contention that the sympathy strike issue was not arbitrable was the suggestion by the Board that the *Gary Hobart* and *Hyster* cases controlled. Those cases contained very specific language to the effect that a sympathy strike could not be an arbitrable issue because it was not a dispute or controversy arising under the collective-bargaining agreement.⁴³

3. Distinguishing *Gary Hobart* and *Hyster* precedents

On the basis of *Buffalo Forge*, the Seventh Circuit felt justified in distinguishing at least the *Hyster* case because it involved a petition for a *Boys Market* injunction rather than an attempt to enforce or review an unfair labor practices charge.⁴⁴ More important, however, the Seventh Circuit emphasized that all cases are limited by their facts, and application of a case as precedent is limited to the degree of similarity of the facts of the two cases. The court found that the factual circumstances of the *Gary Hobart* and *Hyster* cases differed in several

40 As was its established practice in considering the question of arbitrability in sympathy strike cases. 530 F.2d 1291, 1295-96 (1976).

41 *Western Publishing Co., Inc. v. Local 254, Graphic Arts I.U.*, 522 F.2d 530 (7th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3428 (U.S. Jan. 27, 1976); *Steelworkers v. American Mfg. Co.*, 363 U.S. 564 (1960); *Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

42 414 U.S. 368, 377-78 (1974).

43 See note 34 *supra* and accompanying text.

44 96 S. Ct. 3141, 3146 (1976).

important aspects from the *Keller-Crescent* case. The most crucial difference was the addition of the picket-line clause to the collective-bargaining agreement in *Keller-Crescent*. This inclusion of specific language dealing directly with the issue of sympathy strikes almost inevitably made the issue arbitrable when coupled with the very broad arbitration clause also involved in *Keller-Crescent*. The court concluded, therefore, that the dispute over the interpretation of § 12 was arbitrable. According to the court, allowing the language of *Gary Hobart* and *Hyster* to control would encourage employees to strike over the interpretation of picket-line clauses, rather than utilize the agreed upon arbitration process. This would be violative of public policy and the congressional mandate.

Impact of Keller-Crescent

The Seventh Circuit in this case has used its usual case-by-case analysis of specific language to decide a controversy arising over the arbitrability of a sympathy strike. The court maintains that its decisions on the arbitrability of sympathy strikes are consistent;⁴⁵ the decisions show differing results because determinations were based on the language of the individual agreements, and the provisions of the agreements were different enough to warrant the seemingly contrary findings of the cases.⁴⁶ This case-by-case method allows for flexibility and permits the court to balance the competing demands of existing case law in its own circuit with new input from the Supreme Court.⁴⁷ Moreover, it makes the ultimate disposition of a case turn on particular clauses of the specific collective-bargaining agreement. The focal point of the court's scrutiny in the *Keller-Crescent* case was the inclusion of the picket-line clause of § 12 in the agreement. Without that, the case would have been indistinguishable from the *Gary Hobart* case which involved otherwise similar language in treating grievance procedures and no-strike clauses. In order to avoid the strong precedent of non-arbitrability of that case, the Seventh Circuit had to distinguish it on the basis of the picket-line clause.

The strong presumption of arbitrability which they rely so heavily upon, however, is not an end in itself. This presumption has been developed merely as an aid to facilitate the congressional preference for private settlement of disputes. By labelling the sympathy strike question arbitrable, the court is, in theory, preventing the union from using force to argue its position, thus promoting the settlement of the suit by arbitration. Unfortunately, that end is not achieved. Clearly, the heart of the dispute and, thus, the cause of the strike, was the question of whether § 12 was to be read as excluding all sympathy strikes, except those of subordinate unions, or whether it was a mere specification of one of many situations when a sympathy strike would be permitted.

The Union was not striking for recognition of its right to honor picket lines of other unions. Indeed, even the employer's recognition of that right would not have ended the strike. The Local 35 sympathizers returned to work only

45 538 F.2d 1291, 1295-96 (1976).

46 519 F.2d 89; 511 F.2d 284; *Inland Steel Co. v. Local 1545, UMW*, 505 F.2d 293 (7th Cir. 1974).

47 See note 26 *supra*.

when the Pressmen removed their pickets. They did not stay out until the Company agreed to recognize the right to engage in sympathy strikes. Obviously, here the purpose of the work stoppage by Local 35 was not to force a settlement before arbitration could take place. On the other hand, if Local 35 had declared that it would not return to work until the pickets were removed, and the Company acquiesced in their interpretation of § 12, a different situation would have existed. The strike would have been over an arbitrable grievance, and the union would have been required to submit to arbitration before engaging in any such work stoppage.⁴⁸ The Seventh Circuit's fear is unwarranted; allowing the *Gary Hobart* decision to control this case would not encourage employees to strike over the interpretation of picket-line clause rather than arbitrate.

This difference in characterizing the catalysts of the two different types of strikes, however, is not necessarily a practical difference. Even though the origin of the strike was not § 12, that clause became an arbitrable issue once the strike had commenced. Since there is a strong presumption of arbitrability, § 12 could only be interpreted to be nonarbitrable if there were virtually no way in which it could be read as the Company contended. The Seventh Circuit determined that this high burden was not met. With this in mind, it is difficult to imagine how it ever could be met. Nonetheless, the waiver of a collective-bargaining right must be in "clear and unmistakable language."⁴⁹ Such a waiver, therefore, could not be inferred by omission. The Company's contention, that the union waived its rights to engage in non-subordinate union sympathy strikes, collapses in the face of this mandate for specific waiver language.

There is also a practical problem which should be noted. The Company contended that as soon as there was a dispute over whether or not the sympathy strike in question fell within the exception to the no-strike clause embodied in § 12, an arbitrable dispute came into existence and the union was required to submit to arbitration before striking. The Seventh Circuit's adoption of this reasoning could mean that whenever a union includes a provision specifically reserving their sympathy strike rights, there exists a potential dispute as to its meaning. The Company, then, could at least delay every sympathy strike by questioning whether it fell within the clause. Ironically, under the *Keller-Crescent* decision and the *Gary Hobart* ruling, it would seem preferable for a union wanting to preserve its sympathy strike rights not to treat them at all in the collective-bargaining agreement. The Seventh Circuit's finding of arbitrability assumed that § 12 could be interpreted as a waiver of some sympathy strike rights. This is completely unwarranted in light of the clear and unmistakable language requirement for such a waiver. In so ruling, the Seventh Circuit made it difficult for a union to explicitly protect its sympathy strike rights in a collective-bargaining agreement without giving the Company the potential of delaying each strike by invoking the arbitration process to determine its legality.

Kathryn Kelly

48 522 F.2d 530.

49 414 U.S. 368, 377-78 (1974).

LABOR LAW—OCCUPATIONAL SAFETY AND HEALTH ACT—INSPECTIONS—INSPECTOR'S SUBSTANTIAL COMPLIANCE SATISFIES MANDATORY WALKAROUND RIGHT PROVISION

*Chicago Bridge & Iron Co. v. OSHA Review Commission**

The provisions of the Occupational Safety and Health Act (OSHA)¹ are designed to increase employee protection on worksites. Indeed, the general purpose of the Act is "to assure so far as possible every working man and woman in the Nation safe and healthful working conditions and to preserve our human resources. . . ."² Toward this goal, OSHA requires government inspections of worksites.³ During reasonable times, an inspector may enter a worksite to inspect and investigate the place of employment.⁴ Moreover, a walkaround right provision exists requiring the presence of employer and employee representatives on such inspections.⁵ This requirement provides a direct aid to inspectors in satisfying the statutory mandate. This requirement also serves to provide representation for the interests of both parties: employer and employee.⁶ However, the size and manner of selection of the constituency of this combined inspection party can lead to conflicting results between the general purpose of the Act and the specific purpose of the walkaround right provision.

In *Chicago Bridge & Iron*, the Seventh Circuit applied a substantial compliance standard to the walkaround right provision of OSHA. Unfortunately, a non-discriminatory application of such a standard could diminish rather than enlarge employee protection. This comment will analyze the effect this substantial compliance standard has upon the walkaround right provision, the inspection section, and the general purpose of the Act.

Chicago Bridge & Iron Company was one of many prime contractors involved in the construction of a nuclear power plant at Zion, Illinois. Pursuant to the walkaround right provision, an inspector sought to organize a group representing employees and employers to accompany him on his inspection of the worksite. For this purpose, the inspector contacted the project manager of the worksite. The resulting inspection party was comprised only of representatives of employees and employers from the two largest contractors at the site; consequently, Chicago Bridge & Iron was not represented in the party.

As a result of this inspection, twenty-three employers were issued citations for violations of OSHA.⁷ In particular, eight violations were found against

* 535 F.2d 371 (7th Cir. 1976).

1 29 U.S.C. § 651, *et seq.* (1970).

2 *Id.* § 651(b).

3 *Id.* § 657.

4 *Id.* § 657(a).

5 The contested walkaround right provision is stated in the following language:

Subject to regulations issued by the Secretary, a representative of the employer and a representative authorized by his employees shall be given an opportunity to accompany the Secretary or his authorized representative during the physical inspection of any workplace . . . for the purpose of aiding such inspection.

Id. § 657(e).

6 *See* note 14, *infra*.

7 For the issuance of citations, *see* 29 U.S.C. § 658.

Chicago Bridge & Iron.⁸ Instead of correcting the violations,⁹ Chicago Bridge & Iron chose to contest the citations before an administrative law judge appointed by the Occupational Safety and Health Review Commission.¹⁰ Chicago Bridge & Iron premised its argument on the fact that neither it nor its employees were given an opportunity to accompany the inspector as required by OSHA.

Though a formal offer to accompany the inspector was not given to Chicago Bridge & Iron, the inspector had informed a representative of the company that an inspection was to be undertaken. Moreover, after the inspection had commenced, the project manager also informed Chicago Bridge & Iron of the inspection and of the constituency of the inspection party. Despite this informal notification, the administrative law judge vacated the citations because the inspector had failed specifically to extend the walkaround right to Chicago Bridge & Iron. On review, the Occupational Safety and Health Review Commission reversed this holding.¹¹ Consequently, Chicago Bridge & Iron petitioned the Seventh Circuit for review of the Commission's order.¹²

On appeal, the Seventh Circuit considered whether an inspector's failure to extend formally the walkaround right to a company is grounds for voiding citations issued to the company resulting from that inspection. In reaching its decision, the Seventh Circuit examined the contested walkaround right provision, focusing on the type of reading to be given that provision: mandatory or directory. In addition, the court examined the sufficiency of the inspector's attempt to effectuate the provision balanced against the general purpose of the Act. The court accepted the inspector's performance and concluded that when an inspector has substantially complied with the mandatory walkaround right provision, then in the absence of a demonstration of prejudice from the inspection, citations issued to the company as a result of the inspection are valid.

The Walkaround Right, § 657(e)

To permit employee involvement in worksite inspections, groups representing the unions pushed for inclusion of the walkaround right in OSHA. Groups representing the employers sought to maintain control over production. Accordingly, the Act provides that a representative of both groups "shall be given an opportunity to accompany the Secretary or his authorized representative during the physical inspection of the workplace."¹³ Thus, representation of both em-

8 OSHA distinguishes between a serious violation and a non-serious violation. A serious violation is defined in the following manner:

A serious violation shall be deemed to exist in a place of employment if there is a substantial probability that death or serious physical harm could result from a condition which exists, or from one or more practices, means, methods, operations, or processes which have been adopted or are in use, in such place of employment unless the employer did not, and could not with the exercise of reasonable diligence, know of the presence of the violation.

Id. § 666(j). A non-serious violation is a violation which "is specifically determined not to be of a serious nature. . . ." *Id.* § 666(c).

9 The option to contest a citation is available to an employer. *Id.* § 659(a).

10 For the hearing procedure, *see id.* § 661(i).

11 The Commission is authorized to review the decisions of administrative law judges. *Id.*

12 For the procedures governing judicial review, *see id.* § 660.

13 *Id.* § 657(e) (emphasis added).

ployees and employers on the inspection party is, clearly, the product of compromise.¹⁴ Furthermore, it was believed that employee participation would serve as an invaluable aid to the inspector on his inspection of the workplace.¹⁵

Although the Seventh Circuit concluded that the term "shall," within the walkaround right provision, is to be given a mandatory reading,¹⁶ it allowed substantial compliance, rather than strict compliance, to satisfy this requirement.¹⁷ In reaching its decision, the court relied heavily upon the Fifth Circuit's decision in *Accu-Namics, Inc. v. OSHA Review Commission*.¹⁸ In *Accu-Namics*, a citation for a serious violation issued to an employer was upheld, despite the inspector's failure to follow the letter of the law: (1) the inspector failed to give employee and employer representatives an opportunity to exercise their walk-around rights; and, (2) the inspector failed to identify himself immediately upon his arrival at the worksite. A citation was issued as a result of the cave-in of a trench, twenty-four feet deep, in which four employees, laying pipe, were killed.

The Fifth Circuit ruled that the inspector's failure to give the opportunity to exercise the walkaround right and to identify himself on arrival were procedural or technical violations. If such violations did not prejudice the employer, the court reasoned that these procedural deficiencies could not be used to render void the citation. According to this court, such a conclusion was necessary to avoid frustrating the general purpose of the Act: "to assure so far as possible every working man and woman in the Nation safe and healthful working conditions and to preserve our human resources. . . ."¹⁹

Fully in accord with this reasoning in *Accu-Namics*, the Seventh Circuit *Chicago Bridge & Iron* determined that the OSHA inspector need only substantially comply with the mandatory procedure for the walkaround right, provided the employer is not prejudiced thereby; hence, a substantial compliance standard was imposed.²⁰ This unusual conclusion is primarily explained by the practical justification provided by the court for its decision, which seems to create a division between the letter and the application of the law. The mandatory reading of the walkaround right provision is severed from the practical

14 In the words of one senator:

This section reflects a fair and practical resolution of the conflicting viewpoint of employers who fear that an unlimited right of employees to accompany inspectors would lead to disruption of production operations and, the viewpoint of employees who urgently believe they need their representatives to participate and assist in the inspection which is so important to their continued protection in their job.

116 CONG. REC. 37340 (1970) (remarks of Senator Williams).

15 The importance of employee involvement is brought out by the senator later in his speech:

Certainly no one knows better than the workingman what the conditions are, where the failures are, and particularly, where there are safety hazards. The opportunity to have the workingman himself and a representative of other workingmen accompanying inspectors is manifestly wise and fair, and in arriving at the objectives of the legislation, I think it is one of the key provisions of the bill presented to the Senate in committee.

116 CONG. REC. 37340 (1970) (remarks of Senator Williams).

16 535 F.2d at 375.

17 *Id.*

18 *Id.* at 376. 515 F.2d 828 (5th Cir. 1975).

19 29 U.S.C. § 651(b) (1970).

20 535 F.2d at 377.

effect of that section. If "the employer is unable to demonstrate that prejudice resulted from his non-participating in the inspection,"²¹ then there is no practical basis to render void citations issued during the inspection. Consequently, in the Seventh Circuit's interpretation, the primary concern for adequate safety conditions overrides the procedural conditions of statutory compliance. Upon a closer analysis of the court's opinion, however, this departure from the mandatory letter of the law is not justified by this practical consideration in all cases.

Substantial Compliance Standard

No actual notice of the walkaround right was given to Chicago Bridge & Iron. Before the inspection, an inspector informed a representative of Chicago Bridge & Iron that an inspection was to be undertaken, and the inspector gave the representative an informational pamphlet explaining OSHA. Later, a project manager also informed Chicago Bridge & Iron of the inspection and of the constituency of the inspection party. In the absence of a formal offer to have its representative accompany the inspector, Chicago Bridge & Iron made no request to accompany the inspector. The Seventh Circuit found this to be sufficient compliance with the mandatory requirements of the statute to support the issuance of citations.²²

Increased safety at a place of employment is the general purpose of OSHA. To satisfy that purpose, the Seventh Circuit adopted the substantial compliance standard for the walkaround right provision, provided the employer was not thereby prejudiced. To avoid prejudice, however, the court could have adopted a varying standard: strict compliance at small worksites and substantial compliance at large worksites. Instead, the Seventh Circuit validated a substantial compliance standard regardless of the size of the worksite.²³

In grounding its argument on the general purpose of the Act, the court failed to emphasize the importance of the specific purpose of the walkaround right: to aid the inspection at worksites of varying sizes. If the walkaround right is strictly exercised, this purpose is presumed to be achieved. In turn, achievement of this purpose is supposed to further the general purpose of the Act. An inspection party adequately represented by all employer and employee groups is presumed to lead to a more careful inspection, and thus greater safety. Consequently, it is necessary to attempt to balance both the specific purpose of this provision and the general purpose of the Act.

Although the walkaround right is supposed to further both its own specific purpose as well as the general purpose of the Act, it will not always have such

²¹ *Id.*

²² 535 F.2d at 377-78.

²³ The court refused to expressly limit the substantial compliance standard to large worksites. Though it did emphasize the need for this standard at large worksites, it left open the possibility of applying the standard to smaller worksites: "This result [the abandonment of the strict compliance standard], we believe, is compelled particularly in the circumstance of large on-site inspections involving multiple contractors." *Id.* at 376-77. The express holding, likewise, fails to limit the standard. *Id.* at 377. By relying on this overbroad holding in *Chicago Bridge & Iron*, the Ninth Circuit, in *Hartwell Excavating Co. v. Dunlop*, 537 F.2d 1071 (9th Cir. 1976), applied the substantial compliance standard to a worksite exceedingly smaller than the one in *Chicago Bridge & Iron*. For an argument against this misapplication, see text accompanying note 28, *infra*.

consistent and beneficial results. Under varying factual circumstances, the practical effects of the walkaround right, and imposition of the strict compliance standard to that right, may or may not further either the specific purpose of that provision or the general purpose of the Act. Specifically, though strict compliance to the walkaround right provision may not further these purposes at the larger worksites, it may further the purposes at smaller worksites. The Secretary of Labor argued that strict enforcement of the walkaround right at a huge worksite (as in Chicago Bridge & Iron) would result in an inspection party of an unmanageable size. The size of the party would hinder, rather than aid, the inspection;²⁴ the quality of the inspection would be poorer, resulting in less safety assurance. The Secretary, therefore, argued for judicial adoption of the substantial compliance standard. But strict compliance at a small worksite would not result in a large unmanageable inspection party, thus each employer and its employees could be represented on the party. Greater aid could be afforded the inspector, a more careful inspection and greater safety resulting.

These different practical effects arising at worksites of varying sizes were overlooked in the Seventh Circuit's summary treatment of the specific purpose of the walkaround right provision. Indeed, the court admits that the primary source of support for its application of the substantial compliance standard, *Accu-Namics*, was able to apply the standard "in spite of the statutory language."²⁵

Instead of an approach grounded squarely upon the specific purpose of the walkaround right provision, the Seventh Circuit chose to base its reasoning upon the broad general purpose of the Act. In effect, the court created its broad substantial compliance rule despite the express language of the walkaround right provision. In so doing, the court overlooked the practical effects of its interpretation which might run counter to the specific purpose of the provision as well as the general purpose of the Act.

*A Question of Balance: Practical Effect of the Walkaround
Right upon the Specific Purpose of the Right*

Since the practical effect of an inflexible walkaround right may not be consistent with the specific purpose of that provision, a varying standard, depending upon the size of the worksite involved, should be applied. Specifically, at the small worksite, strict compliance to the walkaround right provision furthers the specific purpose of that provision and the general purpose of the Act. Since each company and its employees are most familiar with their own work, their representatives, by exercising their walkaround rights, can join with the inspector to arrive at on-the-spot resolutions.²⁶ The more careful inspection which results better ensures safety. Obviously, the general purpose of the Act is also furthered by such a strict observance of the walkaround right.

If strict compliance to the provision is replaced by substantial compliance at small worksites, the walkaround right is curtailed. Employees and employers

²⁴ This reasoning forms part of the Secretary's policy argument. 535 F.2d at 374.

²⁵ *Id.* at 376.

²⁶ This reasoning forms a part of the policy argument of *Chicago Bridge & Iron. Id.* at 374.

are thereby denied the opportunity to exercise their rights fully. By omitting a company and its employees from the inspection, their insight into their own work is lost. A less careful inspection, and, thus, less safety results. No practical limitation, such as an inspection party of a large unmanageable size, can be found to justify such an omission. The express purpose of the walkaround right provision, as well as the general purpose of the Act is frustrated: neither the employees nor the employer receives the desired benefits under the provision or Act.

By contrast, at the large worksite the same argument does not necessarily apply. Here, inspection parties of an unmanageable size would result from strict compliance with the walkaround right provision. Clearly, such inspection parties would hinder rather than aid the inspection resulting, perhaps, in a less safe worksite.

The Seventh Circuit, however, fails to discuss the beneficial effects strict compliance would have for workplaces of smaller size. After analyzing the detrimental effect strict compliance would have at a large worksite, the court announces a broad substantial compliance standard, without expressly limiting its application, and without working out the practical application of the strict compliance approach to the walkaround right at large workplaces.²⁷ This summary treatment of the practical application of both the strict and the substantial compliance standards to all worksite sizes is an error. In cases involving worksites of various sizes, the practical effect of the walkaround right may or may not aid the inspection. The practical effect of the right at worksites of varying sizes should have been examined by the court. Such an examination could have led the court to limit the application of the rule it sets forth.

The Walkaround Right and Recent Case Law

Due to the Seventh Circuit's failure to expressly limit application of the substantial compliance standard to large places of employment, the Ninth Circuit overlooked the effects that differing sizes of workplaces would have upon the walkaround right provision. Though the facts in *Hartwell Excavating Co. v. Dunlop*²⁸ made it possible for the Ninth Circuit to use this distinction between large and small workplaces, *Chicago Bridge & Iron* made it easier for the Ninth Circuit to disregard the effects of this worksite size distinction and to incorporate the substantial compliance standard.

Unlike the *Chicago Bridge & Iron* worksite (covering twenty-six acres and over fifty subcontractors), Hartwell Excavating Company was digging a 750-foot trench which ran under a highway and extended on both sides of the road. As inspectors were searching for the foreman in charge at the workplace, they noted several violations of OSHA: inadequate shoring in the trench and insufficient distance between excavated material and the trench.

Hartwell contended that the lapse in time between the inspectors' initiation of the inspection and their presentation of credentials to the superintendent provided the basis for a violation of the walkaround right provision.²⁹ The alleged

²⁷ For the court's failure to work out a practical application of the standard at large workplaces, see *id.* at 377. The failure to expressly limit the standard is discussed in note 23, *supra*.

²⁸ 537 F.2d 1071 (9th Cir. 1976).

²⁹ *Id.* at 1072.

violations against Hartwell were found without the presence of any representative of Hartwell in the inspection party. Indeed the party consisted of only the two inspectors. Hartwell claimed that it was prejudiced by the inspectors' failure to strictly follow the statute.³⁰ The testimony of Hartwell's superintendent conflicted with the testimony of the inspectors concerning the depth of the trench and the composition of the soil. Strict compliance to the walkaround right provision would have secured the superintendent's presence on the inspection party and could have possibly resulted in an on-the-spot resolution of the conflicting views.

The practical justification based upon a large worksite was not present. With only one contractor, an inspection party of unmanageable size could not result. Moreover, Hartwell's superintendent could have aided the inspectors by correcting their possibly mistaken opinion at the worksite, rather than before an administrative law judge or court.

Hartwell's walkaround right was not respected; the inspectors were not given aid. The citations issued did not necessarily result in greater safety. Safety at such a small worksite could have been better assured by having the representatives of Hartwell and its employees—the ones whose safety is at stake—as part of the inspection party. The relatively small effort needed to organize such a party, and the avoidance of unwarranted citations, further compel strict compliance to the walkaround right at small worksites. Undue reliance upon the Seventh Circuit's overbroad substantial compliance holding leads to ineffective administration of the walkaround right provision.

Conclusion

The relation between the practical effect of the walkaround right and its expressed purpose—to aid the inspection—should be examined more thoroughly before a court announces a broad substantial compliance rule, as the Seventh Circuit did in *Chicago Bridge & Iron*. Though the greater part of the court's practical argument was based on its assumption that a large worksite is involved, no such express limitation can be found in the opinion. The danger of applying this standard to smaller worksites, as illustrated in *Hartwell Excavating Co.*, is thereby increased.

There are large differences in the practical problems in inspecting a worksite as large as the Commonwealth Edison worksite in *Chicago Bridge & Iron*, and one as small as the worksite in *Hartwell Excavating Co.* While a huge worksite may require a limitation on the strict exercise of the walkaround right in order to prevent interruptions and distractions to the inspector, in a small worksite the walkaround right could be exercised by all representatives of employees and employers, resulting in greater aid to the inspector and greater safety. Without a more careful examination, a broad substantial compliance holding impinges too greatly upon both the aid afforded the inspector and the walkaround right.

James M. Varga

30 *Id.* at 1073.

McFADDEN ACT—TITLE 12 U.S.C. § 36 (f)—
APPLICABILITY OF “BRANCH” BANK CONCEPT TO CUSTOMER-BANK
COMMUNICATIONS TERMINALS

Illinois ex rel. Lignoul v. Continental Illinois National Bank & Trust Co.
and
*Illinois ex rel. Lignoul v. First National Bank**

Introduction

Introduced in 1927, the McFadden Act, Title 12 U.S.C. § 36 (f), remains the key legislation on branch banking in the United States today. This 1927 Act was passed as a response to rapidly-growing congressional concern over the competitive imbalance between state and national banks. With the sudden outbreak of branching within the state banking system,¹ the Act was directed specifically toward alleviating this competitive tension. This goal was to be accomplished by providing national banks with the same branching privileges allowed banks of the state system in which they were located. Thus, national banks were to look to individual state law for branching guidelines.² Under the McFadden Act, “branching” occurs whenever “deposits are received, or checks paid, or money lent”³ by a bank at a location that can be construed as an “additional office.”⁴

Since enactment of this legislation, major controversy has arisen over the scope of “branch” banking, and, consequently, over the extent to which national banks must defer to state law.⁵ Current interest in the Act, however, is due primarily to the introduction of computerized banking terminals. This new addition to banking, the customer-bank communication terminal (CBCT),⁶ was originally visualized as a computer rather than the typical brick-and-mortar structure generally contemplated by the statute. Understandably, such a technological development could not have been foreseen during the 1920’s and, consequently, no specific provision in the McFadden Act encompasses these modern

* 536 F.2d 176 (7th Cir. 1976).

1 Between 1920 and 1923, several states had allowed their chartered banks to branch, thus facing the national banking system with an emergency affecting its very existence, and ultimately, the existence of the Federal Reserve System. 65 CONG. REC. 11296-97 (1924).

2 In effect, Congress had placed on state legislatures the responsibility of deciding whether branching was sound public policy for their respective states. Each state would have to weigh for itself the benefits of convenience derived from branching against a potential threat of monopolization.

3 Title 12, U.S.C. § 36(f) defines the term “branch” to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any state or territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent. 12 U.S.C. § 36(f) (1970).

4 *First Nat’l Bank v. Dickinson*, 396 U.S. 122 (1969).

5 The specific issue over the extent to which national banks must defer to state law was dealt with in *First Nat’l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252 (1966), discussed in text and notes at notes 40-43, *infra*.

6 The customer-bank communication terminal, or CBCT, is an electronic device which is remote from the main bank or from one of its branches. By means of tape which is periodically processed at the main bank, the CBCT records any information that is not transmitted instantaneously to the control computer. Once a transaction has been completed, it will be verified in one of two ways: if the CBCT is connected by wire to the bank’s central computer, the verification is said to be “on-line”; if the CBCT is self-contained, the communication verifying the transaction is “off-line.”

facilities employed by banks.⁷

The question of "branch" status for the CBCT was considered recently by the United States District Court for the Northern District of Illinois. In two consolidated cases, *Illinois ex rel. Lignoul v. Continental Illinois National Bank & Trust Co.*, and *Illinois ex rel. Lignoul v. First National Bank*,⁸ the Illinois Commissioner of Banks & Trust Companies sought an injunction against two national banks that were utilizing CBCTs in the Chicago area. These computer terminals were capable of performing functions normally transacted at any bank on a normal banking day: 1) the depositing of checks or currency in the appropriate account; 2) the transfer of funds between savings and checking accounts; 3) the withdrawal of cash; and 4) the payment of installment loans due the bank. For each of the foregoing functions, the procedure utilized in operating the terminal was essentially the same.⁹

The two defendant banks originally intended to operate these terminals and to open several more in new locations. This decision was prompted by a 1974 interpretive ruling issued by the United States Comptroller of the Currency¹⁰ who had stated that CBCTs were not "branch" banks, hence their use by national banks was not confined by state law. On cross motions for summary judgment, however, the district court found for the plaintiff, thereby restricting the defendants' use of the CBCTs. For purposes of making deposits and trans-

7 Congress intentionally defined the term "branch" broadly enough so as to include facilities, such as teller windows. However, there was no immediate need before Congress at that time to further define the limits of "branching." It could not have foreseen the technological developments that would, in fact, occur fifty years later.

8 409 F. Supp. 1176 (N.D. Ill. 1975).

9 Once the customer inserts his magnetically-encoded card into the CBCT and thereby activates the terminal, the CBCT will scan the card's magnetic tape. If the card has been damaged, it will be returned to the customer; if it has expired, it will be "captured" (i.e., retained) by the machine. Provided the card is neither damaged nor has expired, the CBCT will instruct the customer to insert his "message" through the computer. The customer begins informing the machine by entering his Personal Identification Number (PIN). He has 90 seconds in which to enter this item. The "message" will also contain the customer's electronic fund transfer system (EFTS) access number, and the transaction which he has entered. After entering his PIN on the keyboard, he will select the type and amount of the desired transaction. If the machine is capable of dispensing the requested amount, and the customer sees that it is stated correctly in the window, he then presses the "enter" key. If the amount in the window is incorrect, the customer may "clear" the machine and begin his transaction again. See 409 F. Supp. at 1179.

Accordingly, the CBCT sends the message over the telephone wires to the bank's main computer which in turn checks the customer's Master Record to assure that this matches the access number sent by the CBCT. The main computer contains several files that are storage medium for data called a "disc." These include customer authorization files kept on an indexed according to the EFTS access number, transaction log and history files, and an index of the PINs in a scrambled pattern so that unauthorized discovery of them is prevented. Provided the PIN entered by the customer is correct, the main computer will ascertain the credit status of the customer, verify the validity of the card, and proceed to authorize the transaction. Having established that the necessary amount requested does exist, the main computer will check the "capture code" to determine whether the card has been revoked or suspended. If the card clears this process, the CBCT will receive an authorization reply from the main computer. The CBCT will now respond to the authorization, dependent upon the type of transaction requested by the customer. In the case of a deposit, the customer will insert his envelope into the machine where a receipt number will be stamped on it. When the receipt is dispensed, the CBCT transmits a Completion Status Message (CSM) to the main computer. The other transactions proceed in a similar fashion.

10 On December 11, 1974, the Comptroller of the Currency of the United States construed Title 12 of the National Bank Act as permitting national banks to establish CBCTs apart from their main offices and branches. The ruling stated that CBCTs are not "branches" within the meaning of 12 U.S.C. § 36(f).
12 C.F.R. § 7.7491 (1976).

ferring funds, including both check cashing and money lending, the district court concluded that the CBCTs being operated by the two national banks were branch banks, and thus subject to state proscriptions under the McFadden Act.¹¹

Conversely, for purposes of withdrawing cash and paying installment loans due the bank, the CBCTs were not branches, and therefore could perform these two operations¹² despite state branching restrictions. According to the district court's interpretation of the statutorily-defined term "branch," branching occurs whenever deposits are made, checks are cashed, or money is lent. Based on this premise, these last two functions were analyzed by the lower court. Since neither the cash withdrawal nor the installment loan payment constituted deposit-making, check-cashing, or money-lending, both activities were declared non-branch functions and were allowed to continue.¹³

The two national banks in Chicago appealed the adverse portions of the district court's decision. On appeal,¹⁴ the Seventh Circuit affirmed the lower court's ruling to the extent that the CBCTs made deposits, cashed checks, and lent money. These three functions constituted the tripartite criterion within the McFadden Act. The Seventh Circuit upheld the decision, then, to the extent that the district court had made a determination clearly within the confines of the statute and the two national banks were enjoined from further use of the terminals for these three functions. Relying upon the same premise as did the district court, however, the Seventh Circuit found that the cash withdrawal and the installment loan payment were equally branch functions.¹⁵

In determining the scope of the term "branch" with respect to these two CBCT functions, the court was faced with two options. It could find that these two activities were contained within the express statutory formulation of deposit-making, check-cashing, and money-lending, as hybrids of those functions. Alternatively, the court could have held that, although not included within those three terms, the CBCT functions were, nonetheless, proscribed by the McFadden Act. Rather than expand the explicit terms of the legislation, the Seventh Circuit chose the first alternative, thereby attempting to decide the issue consistently with the criteria promulgated by the McFadden Act.

The Seventh Circuit, only the second circuit to deal with this issue,¹⁶ refused to distinguish the cash withdrawal and the installment loan payment from those functions proscribed by McFadden. Although these two functions can be technically distinguished from the three proscribed functions enumerated in the statute, and in fact were so distinguished by the lower court, the Seventh

11 Pursuant to the relevant portion of Illinois law, branch banking is prohibited by state banks. Therefore, the two national banks in *Lignoul* could no longer operate the CBCTs insofar as these terminals performed "branch" operations under the McFadden Act. See ILL. REV. STAT. ch. 16½, § 106 (1972).

12 409 F. Supp. at 1181.

13 *Id.*

14 536 F.2d 176 (7th Cir. 1976). On Monday, October 4, 1976, the two defendant banks in the Seventh Circuit were denied certiorari by the United States Supreme Court. *Continental Illinois Nat'l Bank & Trust v. Lignoul and First Nat'l Bank v. Lignoul*, 45 USLW 3238 (U.S. Oct. 1976).

15 *Id.* at 178.

16 The first circuit to deal with the branching issue presented by the CBCT was the Court of Appeals for the District of Columbia in *Independent Bankers Ass'n of America v. Smith*, 534 F.2d 921 (D.C. Cir. 1976) [hereinafter cited as *IBAA*]. See discussion note 108, *infra*.

Circuit found their essential character to be indistinguishable. The court noted that holding otherwise would exalt technicality over substantive analysis¹⁷ in dealing with the CBCT. The customer-bank communication terminals, therefore, were branch banks for every function which they performed.

Interface: The Federal Definition Within State Branching Law

Although state law determines how, where, and when a national bank can branch, federal law determines what constitutes a branch.¹⁸ In *First National Bank v. Dickinson*,¹⁹ the United States Supreme Court rejected the idea that state definitions of "branch" banking must control the content of the federal definition:

In § 36 (c) Congress entrusted to the states the regulation of branching as Congress then conceived it. But to allow the states to define the content of the term "branch" would make them the sole judges of their own powers. Congress did not intend such an improbable result, as appears from the inclusion in § 36 (c) of a general definition of "branch."²⁰

The relevant portion of that section reads as follows:

A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) within the limits of the city, town, or village in which said association is situated, if such establishment and operation are at the time expressly authorized by the law of the state in question; and (2) at any point within the state in which said association is situated, if such establishment and operation are at the time authorized to state banks by the statute law of the state in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the state on state banks . . .²¹

The specific issue concerning the CBCT is whether such a facility fits within the federal definition of a "branch" bank. If the 1927 Act is interpreted restrictively as to national banks, then, to a large degree, the ability of the national system to expand will be severely limited by the extent to which state banks may similarly expand under state law. Due to the current status of state law,²² the inclusion of the CBCT within the term "branch" would inhibit virtually all development of these terminals within the national banking system. By contrast, if the CBCT is viewed as a "non-branch" facility of the national banking system, federal authorities will have the ultimate power to regulate the national banks'

17 The Court of Appeals takes this warning from the *Dickinson* decision in the Supreme Court, 396 U.S. 122 (1969), discussed in text and notes at notes 44-53, *infra*.

18 *Independent Bankers Ass'n v. Board of Governors of Federal Reserve System*, 516 F.2d 1206 (D.C. Cir. 1975).

19 396 U.S. 122 (1969).

20 *Id.* at 133. *See also* 39 Fed. Reg. 44416, 44417 (1974).

21 12 U.S.C. § 36(c) (1970).

22 Currently, twelve states prohibit branch banking entirely, twenty-one allow it but with geographical limitations, and eighteen permit statewide branching. *See* the discussion in text and notes at notes 74-76, *infra*.

usage of the computer terminals. Thus, the state banking system would be forced to adapt or become competitively inferior to the national banks.

Competitive Equality and the Meaning of Branching: Three Views

1. The Notion of "Competitive Equality"

The National Bank Act of 1864,²³ the predecessor of the 1927 Act, made no reference to branch banks. In 1923, however, the Attorney General responded²⁴ to the disadvantageous competitive position of national banks after several state institutions had been allowed to branch. The Attorney General ruled that it was within the powers of national banks to establish "teller windows," remote from the main offices of the bank, for the purpose of offering routine paying and receiving services.²⁵ Shortly thereafter, the United States Supreme Court overturned this ruling in *First National Bank v. Missouri ex rel. Barrett*,²⁶ concluding that the national banks had no implied power to branch, but were restricted by statute to one office or banking house. In answer to the Attorney General's position that the power to establish teller windows had become "necessary" because the states had begun to allow branch banking, the Court replied that the remedy existed in the hands of Congress only.²⁷

Consequently, Congress attempted to effectively exercise its authority by formulating the necessary remedy. A House Report on the McFadden Act in 1926 expressed the congressional concern over the survival of the national banking system and the Federal Reserve System. In the face of an expanding state banking system, Congress indicated that "if state banks continue to engage in unlimited branch banking it will mean the eventual destruction of the national banking system. . . ."²⁸ Representative McFadden warned that the trend toward conversion of national banks into state chartered institutions would cause mutation of the national monetary policy:²⁹

The present situation is intolerable to the national banking system. The bill proposes the only practicable solution by stopping the further extension of state-wide branch banking in the Federal Reserve System by state member banks and by permitting national banks to have branches in those cities where state banks are allowed to have them under state laws.³⁰

Those opposing branch banking argued that the McFadden bill contravened public policy by placing the entire credit of the nation in the hands of relatively few financial institutions.³¹ In other words, the allowance of extensive branch-

23 Act of June 3, 1864, ch. 106, 13 Stat. 101 (1864).

24 34 OP. ATT'Y. GEN. 1 (1923).

25 The basis of the Attorney General's Opinion was the National Bank Act of 1864 which permitted national banks to exercise those "incidental powers" necessary to carry on their business.

26 263 U.S. 640 (1924).

27 *Id.* at 659.

28 H.R. Doc. No. 90, 68th Cong., 1st Sess., 6 (1924).

29 See 65 CONG. REC. 11296 (1924).

30 See H.R. Doc. No. 2, 69th Cong., 1st Sess. (1926).

31 66 CONG. REC. 1575, 1624 (1925).

ing would discourage the creation of new banks and encourage the opening of new branches by already-established banks. To counter such arguments, the proponents of the McFadden Act emphasized that the power to branch was limited under the bill. They pointed to the provision which stipulated that state banks were confined to citywide branching if they were members of the Federal Reserve System.³² Acknowledging that statewide branching might lead to monopoly,³³ the proponents found citywide branching defensible on the basis of a service proposition.³⁴ Since the overpopulation of large metropolitan areas had made convenient banking facilities a necessity,³⁵ the McFadden Act would allow national banks to join with state institutions in meeting the needs of modern industry and commerce. Then, "competitive equality" will have been established³⁶ between national and state banking institutions.

2. Overstressing the Notion of "Competitive Equality"

The case law interpretation of the McFadden Act has been inconsistent with the historical evidence surrounding the enactment of this statute.³⁷ Judicial decisions have yielded a restrictive reading of the Act as it applies to national banks. Consistently, courts have adopted the notion of "competitive equality" between state and national banks as the essence of the 1927 Act. Admittedly, the McFadden legislation attempts to utilize state law in order to provide certain guidelines for implementing federal policy, and in this way addresses itself to the competitive tensions inherent in a dual banking structure. However, the original tensions which gave rise to the Act were due to the rapid growth of state banks relative to the growth of the national banking system.

Clearly, "competitive equality" was the congressional goal sought to be achieved by passage of the McFadden Act. Equally clear, however, is that the means employed by the statute to attain such competitive balance was to afford national banks an opportunity to expand. The relevant problem existing in the 1920s was the sudden outbreak of statewide branching. The solution to that problem was to equalize the competitive scale which weighs the state bank against the national bank. In other words, the purpose of the Act was simply to allow the national banking system to meet, head-on, the branching challenge presented by state banks. In retrospect, then, the notion of "competitive equality" was intro-

32 Act of Feb. 25, 1927, ch. 191, § 9, 44 Stat. 1229, amending § 9 of the Federal Reserve Act.

33 According to Representative McFadden, statewide branching was an unsound and "un-American" form of banking. 65 CONG. REC. 11297 (1924).

34 66 CONG. REC. 1645, 1767 (1925).

35 66 CONG. REC. 1775 (1925).

36 Clearly, the proponents of the bill were arguing that by the adoption of the McFadden Act, Congress would attain the essential goal of competitive equality. This would, then, eliminate the problem posed by the state banking institutions. Therefore, whether the notion of "competitive equality" was intended by these drafters to be carried forward into the modern problem of the CBCT is doubtful. See 68 CONG. REC. 5815 (1927).

37 To illustrate, compare the six consolidated cases which were decided by various federal district courts in 1975: *Colorado ex rel. Bloom v. First Nat'l Bank*, 394 F. Supp. 979 (D. Colo. 1975); *Illinois ex rel. Lignoul v. Continental Illinois Nat'l Bank & Trust Co. and Illinois ex rel. Lignoul v. First Nat'l Bank*, 409 F. Supp. 1167 (N.D. Ill. 1975); *IBAA v. Smith*, 402 F. Supp. 207 (D.D.C. 1975); *Missouri ex rel. Kostman v. First Nat'l Bank*, 405 F. Supp. 733 (E.D. Mo. 1975); *Oklahoma ex rel. State Banking Bd. v. Utica Nat'l Bank & Trust Co.*, 409 F. Supp. 71 (N.D. Okla. 1975).

duced to foster a remedy to a specific problem. It was not meant to be given the far-reaching impact which case law subsequently attributed to it. Judicially interpreted, the competitive equality doctrine became a statement of both the underlying purpose and the test to be used in construing whether a banking facility was a "branch" under the McFadden Act.³⁸ Recognition of the doctrine's original purpose as a solution to a particular antiquated problem became lost.

Utilizing competitive equality as the underlying purpose of this banking law, the courts have consistently placed severe restriction upon the growth of the national banking system. This restrictive interpretation is the result reached by several federal district courts³⁹ and now the Seventh Circuit Court of Appeals.

a. *Competitive Equality Is Congress' "Underlying Purpose"*

In *First National Bank v. Walker Bank & Trust Co.*,⁴⁰ the Supreme Court recognized that "competitive equality" was the underlying purpose of the McFadden Act:

It appears clear from this resume of the legislative history of § 36(c) (1) (2) that Congress intended to place national and state banks on a basis of "competitive equality" insofar as branch banking was concerned⁴¹

Under this theory, the question of branch banking is left to the states:⁴² thus, state and national banks can compete equally on a state-created level. The goal is to insure that neither system has branching privileges unavailable to the other. The burden of interpretation, however, falls on the United States Comptroller of the Currency.⁴³ He is required to determine both whether branching under the law of a particular state is permitted, and whether the actual expansion contemplated by a national bank is in fact branching.

b. *Departure of "Competitive Equality" from the Brick-and-Mortar "Branch"*

The Supreme Court continued to support the *Walker Bank* rationale in *First National Bank v. Dickinson*.⁴⁴ In *Dickinson*, the Comptroller had issued interpretive rulings⁴⁵ authorizing national banks to operate mobile messenger services and off-premises deposit machines, without regard to state branch banking restrictions. Thus, relying upon the Comptroller's ruling, the First National Bank acted as an agent for customers during the transfer of funds. This transaction was considered not to constitute branch banking so long as the bank's contracts of

³⁸ *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252 (1966). See discussion in text and notes at notes 40-43, *infra*.

³⁹ See note 37, *supra*. Of the six consolidated cases cited, all except the *Oklahoma* decision restricted the national banking system's use of the CBCT to some degree.

⁴⁰ 385 U.S. 252.

⁴¹ *Id.* at 261.

⁴² *Id.* at 258.

⁴³ It is to be noted, however, that the Comptroller is not bound by state judicial interpretations. *Howell v. Citizens First Nat'l Bank*, 385 F.2d 528 (3d Cir. 1967).

⁴⁴ 396 U.S. 122 (1969).

⁴⁵ 12 C.F.R. § 7.7490 (1976). (Mobile messenger service) and 12 C.F.R. § 7.7491 (1976) (deposit machines). The original rule was promulgated in 1966.

deposit stipulated that no money was actually deposited until brought to the tellers at the main bank.⁴⁶

The Supreme Court refused to uphold the process, concluding that the term "branch bank" includes "any" place for receiving deposits from the bank's premises.⁴⁷ Recognizing the desirability of fostering a policy of competitive equality,⁴⁸ the Court determined that this policy is so firmly embedded in the banking statutes that a national bank could only establish a "branch" under the same conditions which permit state banks to do so.⁴⁹ Since the relevant state statute prohibited branching privileges to the state banks, the Court concluded that the congressional policy of competitive equality foreclosed the Comptroller from modifying that standard.⁵⁰ When cash was being delivered and checks were being received, then, a branch bank was in operation "for all purposes contemplated by Congress."⁵¹

Thus, the *Dickinson* Court settled the legal status of delivery services as potential branch banks. The Supreme Court's central concern was that certain aspects of a banking transaction would yield a competitive advantage to one banking system over the other.⁵² In construing the McFadden Act, the Court believed that it was compelled to view the place of delivery of a customer's cash or checks accompanied by a deposit slip as an "additional office, or . . . branch place of business . . . at which deposits are received."⁵³

3. Application of the Legislative History

Thus, by logical expansion, the *Dickinson* decision amounted to a determination that a CBCCT constitutes branch banking, at least with regard to deposit-making.⁵⁴ It illustrates that the operation of such a system would permit an unacceptable competitive advantage to the national banking system over the state counterpart.

Disregard for the genuine legislative history found in both *Walker Bank* and *Dickinson* has led to judicial confrontation with the Comptroller's ruling in *Lignoul*.⁵⁵ Whereas *Walker Bank* and *Dickinson* viewed competitive equality as the underlying purpose of the McFadden Act, the Comptroller refused to inject this same policy into the branch banking issue. The Comptroller's decision to

46 This contractual agreement between the bank and the customer is referred to as a Comprehensive Dual Control Contract. Under the agreement, all monies, transported solely in padlocked money bags furnished by the bank, could be opened only under the dual control of two of the bank's tellers. See 396 U.S. at 127 n.3.

47 *Id.* at 135.

48 The Fifth Circuit in *Dickinson* had held that the mobile messenger service and the deposit receptacle were "branches." Citing *Walker Bank*, the circuit court warned of the danger in overlooking Section 36(f) since the McFadden Act was their guiding force in upholding the doctrine of competitive equality. *First Nat'l Bank v. Dickinson*, 400 F.2d 548 (5th Cir. 1968).

49 385 U.S. 252.

50 396 U.S. at 138.

51 *Id.* at 137.

52 *Id.*

53 *Id.*

54 In addressing the "branch" question with regard to both the mobile messenger service and the deposit receptacle, the *Dickinson* Court was faced only with the issue of deposit-making. Therefore, as far as *Dickinson* is concerned, the issue of fund transferrals is left unresolved.

55 409 F. Supp. 1167.

encourage national banks to exercise incidental powers⁵⁶ represented a challenge to the case law interpretation of the McFadden Act. Ultimately, the courts would charge the Comptroller with placing the state banks in a position of competitive disadvantage.⁵⁷

In 1974, with the advent of the CBCT, the United States Comptroller of the Currency, James E. Smith, issued an interpretive ruling⁵⁸ holding that CBCTs could be operated by national banks without regard to state restrictions on branch banking.⁵⁹ The ruling stated that CBCTs were not "branches" within the meaning of the McFadden Act because those transactions usually associated with a banking facility could not be consummated at such a terminal. The national banks, therefore, would be permitted to install and operate CBCTs regardless of whether these computerized terminals were permitted under the laws regulating state-chartered banks.⁶⁰

The Comptroller strengthened his position by stating that when Congress passed the McFadden Act, it was understood that a branch would be a large and separate banking facility.⁶¹ He analogized the CBCT to a mailbox through which customers would be able to communicate with banks to accomplish routine transactions.⁶² Accordingly, since banking transactions by mail do not constitute "branch" banking, then, by analogy, the transacting of the same functions at a

56 The question of implied powers is a long-standing one. There had been a long sequence of opposition to the exercise of federal power in the banking field. President Jefferson was opposed to the creation of the first Bank of the United States during his 1801-1809 terms of office. Thereafter, President Jackson vetoed the Act of Congress which extended the charter of the second Bank of the United States. The charter was resolved in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). There, Chief Justice Marshall held that the national bank could be chartered under the implied powers of Congress.

57 Those courts charging the Comptroller with throwing the scale of competitive balance would be those that disagree with his ruling, and therefore hold that the CBCT is a branch. With the exception of the *Oklahoma* decision, then, the five other federal district court decisions have challenged the Comptroller's ruling to varying degrees.

58 The Comptroller's ruling reads in part: Part 7 of 12 C.F.R. Chapter 1 is amended by revising § 7.7491 in the following manner:

§ 7.7491 Customer-Bank Communication Terminals

A national bank may receive and act upon communications from its customers transmitted through electronic devices or machines requesting the withdrawal of funds either from the customer's deposit account or from a previously authorized line of credit, or instructing the bank to receive funds or to transfer funds for the customer's benefit. The device or machine may be established and operated by the bank, by the customer, or by a third party. In accordance with the customer's request or instruction and subject to verification by the bank, cash or checks may be received and cash may be dispensed at the location of the device or machine. The device or machine may not be staffed by a bank employee, except that the bank for a reasonable period of time may provide an employee to instruct and assist customers in the operation of the device or machine. Any transactions initiated by such a device or machine shall be subject to verification by the bank either by direct wire transmission or otherwise. A bank may provide insurance protection under its bonding program for transactions involving such a device or machine. 40 Fed. Reg. 21700, 21703-04 (1974).

59 See discussion in text and notes at note 10, *supra*.

60 39 Fed. Reg. 44416, 44418 (1974).

61 See note 7, *supra*.

62 The Comptroller also characterized the CBCTs to certain routine activities which were approved as non-branching in Supreme Court decisions antedating the McFadden Act. In *First Nat'l Bank v. Missouri*, 263 U.S. 640 (1923), the Supreme Court endorsed a 1911 opinion of Attorney General Wickersham, which held that there is a difference between the mere appointment of agents to receive and collect money, and the establishment of branch banks at which a general banking business is transacted.

CBCT is similarly a "non-branch" operation.⁶³

Furthermore, the Comptroller's ruling served as a response to regulations of the Federal Home Loan Bank Board⁶⁴ and the National Credit Union.⁶⁵ These regulations permit the establishment of service units by federally chartered savings and loan associations and by credit unions respectively. If the remote services for these institutions were allowed to operate while the CBCT was unplugged because of its "branch" characterization, the national banking institution would become vulnerable to competitive attacks by those savings and loan/credit organizations. This result would yield a lack of competitive equality within the very federal financial system itself.

In 1975, one of six consolidated federal district court decisions sustained the Comptroller's position. In *Oklahoma ex rel. State Banking Board v. Utica National Bank & Trust Co.*,⁶⁶ computer bank terminals were being operated by Utica National Bank at a shopping center. The Utica customer was able to initiate a deposit or a withdrawal, provided he had a prearranged line of credit, funded by a disbursement of funds pursuant to the credit line.⁶⁷ Such transactions were initiated by the Utica customer at the store where the CBCT was located, but were consummated in the Utica computer on the bank's premises.

The *Oklahoma* court made three determinations: First, a deposit is not received until the items tendered for deposit have been verified, credited to the depositor's account, and made available for both customer and bank use. Second, a plastic card⁶⁸ and a personal identification number are not "checks" within the statutory definition under the Uniform Commercial Code,⁶⁹ nor are they

63 The 1974 ruling also made a distinction between a manned CBCT and an unmanned terminal. See 39 Fed. Reg. 44416, 44418 (1974). With regard to the manned line, the Comptroller stated that the operator is an employee of a third party, such as a supermarket, who is financially involved in the transaction. A bank customer presents the necessary information to the operator so that the desired transaction may be implemented. Accordingly, the transaction instructions are communicated electronically to the bank which consummates the desired transaction.

With respect to the unmanned terminal, a transaction is not consummated until the bank is actually notified of the customer's instructions and the amount of funds necessary to carry out the instructions is received and verified. This notification, receipt, and verification all take place at the bank after collection of the funds from the CBCT. Thus, the bank cannot give credit for these funds prior to the receipt and verification, just as it would not be allowed to give credit for items sent to the bank by mail which have not yet been received. These funds do not become deposits for any purpose until received and accepted at the chartered banking premises.

Furthermore, the Comptroller argued that even if the CBCT was a branch bank, it did not receive deposits, pay checks, or make loans within the meaning of 12 U.S.C. § 36(f) (1970). See 39 Fed. Reg. 44416, 44419 (1974). A deposit at an unmanned terminal is not made until cash or checks are received and verified at the bank, cash withdrawals are not made pursuant to writing a check but upon the presentation of a card, and cash withdrawals on the basis of a credit card are not loans because they are effectuated pursuant to a previously approved line of credit and are subject to verification. At the manned terminal, he continued, the transfers between the customer and store accounts are consummated at the bank with cash withdrawals actually coming from the store, not from the bank. 12 C.F.R. § 7.7491 (1976).

64 39 Fed. Reg. 23991 (1974).

65 39 Fed. Reg. 30107 (1974).

66 409 F. Supp. 71 (N.D. Okla. 1975).

67 Thus, the customer did not necessarily need funds in his checking account to make a withdrawal.

68 In the present case, a "Uticaid" was the device needed in order to activate the terminal.

69 See U.C.C. § 3-104.

written instruments within the contemplation of the McFadden Act.⁷⁰ Third, making a loan requires the exercise of the personal judgment of a bank officer based upon a credit evaluation. The loan is not, therefore, made at the communication terminal since, although the proceeds are there advanced, the decision of the bank officer is not made there.⁷¹

Further, the court stated that if other federal financial institutions in Oklahoma were allowed to use computerized terminals,⁷² then the national banks herein could not be denied such use. The denial would work "unfair treatment, inequality, and an undue hardship on the banks."⁷³ Therefore, the court concluded that the use of the CBCT facilities did not constitute branch banking under the McFadden Act.

Thus, the emphasis of case law on competitive equality conflicts with the Comptroller's ruling. If the CBCT is a "branch" within the meaning of the McFadden Act, state restrictions on the use of the CBCT could inhibit the growth of the national banking system. Currently, twelve states prohibit branch banking entirely,⁷⁴ twenty-one allow it but with geographical limitations,⁷⁵ and eighteen permit statewide branching.⁷⁶ Thus, the Comptroller is required to comply with the particular state's branching conditions via the *Walker Bank* rationale.⁷⁷ On the other hand, if the CBCT is not a "branch," then states will be faced with the grave task of deciding whether to revamp their traditional banking structure or be competitively overridden by the national banking system.

70 "The term 'branch' . . . shall be held to include any branch bank . . . at which . . . checks are paid. . . ." 12 U.S.C. § 36(f) (1970).

71 409 F. Supp. at 91-92.

72 The Federal Home Loan Bank Board has permitted federally chartered savings and loan associations to establish remote service units (RSUs). 39 Fed. Reg. 23991 (1974). Similarly, the National Credit Union Administration has permitted federally chartered credit unions to establish remote terminals. 39 Fed. Reg. 30107 (1974).

73 In making this point, the Court utilized the "form over substance" rationale of the *Dickinson* Court. 409 F. Supp. at 95, n.5.

74 See COLO. REV. STAT. § 14-3-1 (Supp. 1973); FLA. STAT. ANN. § 659.06 (West Supp. 1974); ILL. REV. STAT. ch. 16½, § 106 (1973); KAN. STAT. § 9-1111 (Supp. 1974); MINN. STAT. ANN. § 48.34 (1970); MO. ANN. STAT. § 362.105 (Vernon 1968); MONT. REV. CODES ANN. § 5-1028 (1968); NEB. REV. STAT. § 8-157 (Supp. 1974); OKLA. STAT. ANN. tit. 6, § 2061 (West 1966); TEX. REV. CIV. STAT. ANN. art. 342-903 (Vernon 1973); W. VA. CODE § 31-A-8-(1972); Wyoming—no statutory provision.

75 See ALA. CODE tit. 5 § 125 (1) (1960); ARK. STATS. ANN. § 67-340 (Supp. 1973); GA. CODE ANN. § 13-203.1 (Supp. 1974); HAWAII REV. STAT., § 403-53 (1968); IND. CODE ANN. § 28-1-17-1 (Burns 1973); IOWA CODE ANN. § 524.1201 (West Supp. 1974); KY. REV. STAT. ANN. § 287.180 (Baldwin 1972); LA. REV. STAT. ANN. § 6:54 (West 1951); MASS. ANN. LAWS ch. 172 A, § 12 (Michie Law Co-op Supp. 1974); MICH. COMP. LAWS ANN. § 487.471 (Supp. 1974); MISS. CODE ANN. § 81-7-1 (1972); N.H. REV. STAT. ANN. § 384-B:2 (1968); N.M. Stat. Ann. § 48-2-17 (1966); N.Y. BANKING LAW § 105 (McKinney 1974); N.D. CENT. CODE § 6-03-14 (Supp. 1973); OHIO REV. CODE ANN. § 1111.02-03 (Page Supp. 1973); PA. STAT. ANN. tit. 7, § 904 (Purdon Supp. 1974); TENN. CODE ANN. § 45-443 (Supp. 1974); UTAH CODE ANN. § 7-3-6 (1971); VA. CODE § 6.1-39 (Supp. 1974); WIS. STAT. ANN. § 221.04 (1974).

76 ALASKA STAT. § 06.05.415 (1962); ARIZ. REV. STAT. § 6-190 (1974); CAL. FIN. CODE § 500 (West 1968); CONN. GEN. STAT. ANN. § 36-59 (West Supp. 1975); DEL. CODE ANN. tit. 5, § 770 (Supp. 1970); D.C. Code Encl. Ann. § 26-103(b) (West 1967); IDAHO CODE § 26-1001 (1968); ME. REV. STAT. ANN. tit. 9 § 442 (1964); MD. ANN. CODE art. 11, § 65 (1968); NEV. REV. STAT. § 660.015 (1973); N.J. REV. STAT. ANN. § 17:9A-19 (West Supp. 1974); N.C. GEN. STAT. § 53-62 (Supp. 1974); ORE. REV. STAT. § 714.030-170 (1973); R.I. GEN. LAWS ANN. § 19-1-13 (1968); S.C. CODE § 8-57 (1962); S.D. COMPILED LAWS ANN. § 51-20-1 (Supp. 1974); VT. STAT. ANN. tit. 8, § 651 (1971); WASH. REV. CODE ANN. 30.40.020 (Supp. 1974).

77 In *Walker Bank*, Justice Clark noted that the "intent of Congress was to leave the question of the desirability of branch banking up to the states." 385 U.S. at 258.

The Seventh Circuit: The Persistence of "Competitive Equality"

The *Dickinson* decision raises the disparity between the Comptroller's ruling and the case law interpretation of the McFadden Act. In some instances, federal courts⁷⁸ have allowed this disparity to permeate the judicial shield of "competitive equality." In 1975, two federal district courts⁷⁹ held that the CBCT did not constitute a branch bank, while four other district courts reached the opposite conclusion.⁸⁰ These six cases preceded the decision of the Seventh Circuit in *Lignoul*.

1. *Lignoul*: An "Indicia of Branchness" in the CBCT

The Seventh Circuit drew upon two district court decisions to conclude that all functions carried on through the CBCT constitute branch banking. The district court in *Lignoul* held that the CBCT was a "branch" only with regard to making deposits, cashing checks, and lending money; however, with respect to the withdrawal of cash and the payment of installment loans, the CBCT was not to be considered a branch. The CBCT, therefore, could remain intact to perform these latter two functions.⁸¹

Regarding the making of deposits, the district court disagreed with the Comptroller's analogy between banking transactions by mail and by CBCT.⁸²

⁷⁸ See note 39, *supra*.

⁷⁹ See *Oklahoma ex rel. State Banking Board v. Utica Nat'l Bank & Trust Co.*, discussed in text and notes at notes 66-73, *supra*. See also *Colorado ex rel. Bloom v. First Nat'l Bank*, 394 F. Supp. 979 (D. Colo. 1975).

In *Colorado*, the court utilized the competitive equality doctrine with an application of state law, which prohibited branch banking entirely. First, the court considered the making of a deposit and concluded that for this function, the machine was a branch bank; the reason behind this decision was that the bank in question already had a detached facility, and the CBCT in question was beyond any geographical limitation as well. Second, however, the court stated that the CBCT was not a branch for the purpose of cashing checks. The CBCT was not a place at which this transaction takes place because a check, being a written order, is not the equivalent of the depression of keys on a computer (Docutel) terminal. Finally, the court said that the CBCT did not lend money either, because the customer's utilization of the bank card to withdraw cash is merely a drawing against a prearranged line of credit; and to conclude that this operation constitutes branch banking "would therefore require the conclusion that any such use of bank credit cards is also branch banking." 394 F. Supp. at 984. Nevertheless, on appeal in the Tenth Circuit, the *Colorado* District Court's decision with respect to the latter two functions was reversed. The circuit court, therefore, held that for the purposes of cashing checks and lending money as well as receiving deposits, the Fort Collins facility was a "branch" bank in violation of 12 U.S.C. § 36(f) (1970). To the extent that such use was permitted by the Comptroller's ruling, that ruling was invalid. 540 F.2d 497 (10th Cir. 1976).

⁸⁰ See 409 F. Supp. 1167.

The other two district court decisions which found that the CBCT was a branch bank were *IBAA v. Smith*, 402 F. Supp. 207, discussed in text and notes at notes 102-106, *infra*, and *Missouri ex rel. Kostman v. First Nat'l Bank*, 405 F. Supp. 733 (E.D. Mo. 1975).

In *Missouri*, the court utilized the underlying rationale of the McFadden Act rather than the specific categorizations of branch functions set out in section 36(f). Involved were two module machines consisting of a telephone hot-line which was connected directly to the bank. These machines were able to procure cash, deposit and transfer funds, and make installment loan payments due the bank.

The court, in a brief opinion, ruled that the two off-premises CBCTs in question would have to cease operation because they were in violation of the national and state banking laws. As the court saw it, Congress intended the national banks to have no more branching rights than were enjoyed by state banks. 405 F. Supp. at 735. Upon appeal by the national bank, the Eighth Circuit affirmed. 538 F.2d 219 (8th Cir. 1976).

⁸¹ 409 F. Supp. at 1181.

⁸² The Comptroller also characterized the CBCTs as routine activities. 39 Fed. Reg. 44416, 44418 (1974). See note 62, *supra*.

The district court pointed out that, in a mail transaction, no bank place of business is involved; rather, the customer mails his requested transfer from some indeterminate location. On the other hand, the CBCT is clearly a "place" within the language of *Dickinson*,⁸³ and thus transfers have been consummated by the customer on the bank's premises, that is, at its branch. Accordingly, such a transfer at a CBCT would be violative of the Illinois state banking law.⁸⁴

Having determined that deposit-making at a CBCT was a branch bank function, the district court delineated the installment loan payment. This analysis led to the lower court's conclusion that the installment loan payment, unlike the deposit, did not constitute "branch" banking:

Payments on installment loans or credit card accounts, however, do not constitute deposits inasmuch as they are payments on existing loan obligations or credit card account balances and not the deposit of funds in an account which is subject to future withdrawals by the customer.⁸⁵

With respect to the functions of check-cashing and money-lending, the district court accepted prevailing judicial precedent:

Since under *Plant City /Dickinson/*, the bank's maintenance of a place, off-premises, where either /deposits are made/, checks are cashed, or money is lent, amounts to branch banking, CBCTs must be so characterized.⁸⁶

The CBCT was a branch, then, when it cashed checks and lent money as well as when it made deposits. This conclusion enabled the district court to illustrate how the withdrawal of cash could be neither characterized as check-cashing nor money-lending, and therefore, not a "branch" function.

First, the cash withdrawal was not a form of check-cashing because no check is written in the cash withdrawal transaction.⁸⁷ Citing Illinois law,^{88, 89} the district court pointed out that negotiability is the "essential characteristic"⁹⁰ of the instrument because it contains an unconditional promise to pay money to a third party. When, however, a card is inserted into a CBCT to secure a sum of money, there is neither transferability nor third party designation involved.

Second, the cash withdrawal was not a form of money-lending since the use

83 The *Dickinson* Court argued that the implications from section 36(f) are that the term "branch bank" at the very least "includes any place for receiving deposits, or paying checks or lending money apart from the chartered premises." 396 U.S. at 135.

84 The relevant portion of the Illinois Statute provides as follows: No bank shall establish or maintain more than one banking house or receive deposits or pay checks at any other place than such banking house, and no bank shall establish or maintain in this or in any other state of the United States any branch bank, nor shall it establish or maintain in this state any branch office or additional office or agency for the purpose of conducting any of its business.

ILL. REV. STAT., ch. 16½, § 106 (1972).

85 409 F. Supp. at 1177.

86 *Id.*

87 *Id.*

88 ILL. REV. STAT. ch. 26 § 3-104(2) (1963).

89 The relevant portion of the Illinois Statute and of § 3-104 of the U.C.C. provides:

- (1) Any writing to be a negotiable instrument within this Article must
 - (a) be signed by the maker or drawer; and
 - (b) contain an unconditional promise or order to pay a sum certain in money.
- (2) A writing which complies with the requirements of this section is
 - (b) a "check" if it is a draft on a bank and payable on demand.

90 409 F. Supp. at 1177.

of a credit card to obtain goods and services from a merchant is distinguishable from the use of such a card to obtain cash on two grounds.⁹¹ First, whereas the CBCT is a bank "place"⁹² to obtain cash, there is no analogous place established by the bank for obtaining goods and services. Second, the issuance of credit cards with respect to cash advances is an agreement to make small cash disbursements at some future time rather than actual loans themselves; the agreement does not transfer funds or commence the running of interest, and therefore, is not a loan.

The district court did not pierce the substantive problem posed by the computerized terminals. It overlooked the infeasibility of permitting the use of the CBCT for some functions while prohibiting its use for others. The court left unresolved the real problem, namely whether the functions of cash withdrawal and installment loan payment are within the proscriptions of the McFadden Act.⁹³ To conclude that they are not, as the district court did, creates a judicial revision of the McFadden Act.

The Seventh Circuit reversed the district court with respect to its decision on the cash withdrawal and the loan payment. According to the court, these were branch bank functions as were deposit-making, check-cashing, and money-lending.

The Seventh Circuit distinguished the district court's conclusion with regard to cash withdrawals and installment loan payments, based upon provisions of the Uniform Commercial Code⁹⁴ and Illinois law.⁹⁵ In the case of both the cash withdrawal and the installment loan, the state statute was found to be relevant. That particular state law declares a check to be a negotiable instrument drawn on a bank and payable on demand, with negotiability being its essential characteristic. The instrument is signed by the maker and contains either an order (in the case of a cash withdrawal), or a promise (in the case of an installment loan payment), to pay a sum certain in money. Based upon this law, the district court had pursued a technical distinction by concluding that a card inserted into a CBCT to secure money was not the cashing of a check.⁹⁶ The Seventh Circuit disagreed, stating that the check is merely the means used by a bank to make payment to its customer. By analogy, the credit card is an order on the bank, and serves the same purpose as the check:

Any order/or promise/to pay which is properly executed by a customer, whether it be check, card, or electronic device, must be recognized as a routine banking function. . . . The relationship between the bank and its customer is the same.⁹⁷

91 *Id.* at 1178.

92 *See* 396 U.S. at 135.

93 "The public should be permitted . . . to enjoy the benefits of modern technology . . . Unfortunately, the language of the McFadden Act establishes a relatively simplistic test as to what constitutes a branch bank. It was enacted in 1927 at a time when banks performed far fewer functions and services than they do today. The three services, the performance of any one of which constitutes a branch, represent a fraction of the myriad of activities carried on daily by even the smallest national banks." 409 F. Supp. at 1181.

94 *See* note 88, *supra*.

95 *See* note 89, *supra*.

96 409 F. Supp. at 1177.

97 536 F.2d at 177.

Furthermore, although the Uniform Commercial Code defines a check as a negotiable instrument, it also provides that the term "check" may refer to non-negotiable instruments as well as negotiable ones.⁹⁸ For example, a transfer of funds by cable is clearly recognized as a check despite the non-negotiability of the cable.⁹⁹ Thus, even in the absence of negotiability, the credit card used for the purpose of withdrawing cash is a check. According to the Seventh Circuit, the essential factor is the foundation of the relationship between the bank and its customer: the former agrees to pay money to the latter's order.¹⁰⁰ That order may be implemented by computer record since computer impulses have been upheld as sufficient writing under the order test.¹⁰¹

The Seventh Circuit thus ruled that the cash withdrawal and the installment loan payment were "branch" functions of the CBCT. The question left open by the acceptance of this rationale is twofold: 1) are cash withdrawals and installment loan payments separate and distinct from deposit-making, check-cashing, and money-lending? If so, the Seventh Circuit oversteps its judicial powers by, in effect, re-writing the "branch" criteria set out in *McFadden*; or, 2) are cash withdrawals and installment loan payments merely hybrids of either deposit-making, check-cashing, or money-lending? If they are the latter, then they fit within the express proscriptions of the 1927 *McFadden* statute.

2. *IBAA v. Smith*: The CBCT Is a Branch "For All Functions"

Pursuant to a second district court decision, the Seventh Circuit was able to place the cash withdrawal and the installment loan payment more specifically within the confines of the *McFadden* Act. Citing *Independent Bankers Association of America v. Smith*,¹⁰² the court refused to distinguish the cash withdrawal and the installment loan payment from the functions proscribed in the *McFadden* Act.¹⁰³ In *IBAA*, the focus centered more upon the validity of the Comptroller's ruling¹⁰⁴ than upon the "branch" status of CBCT functions. Nevertheless, the court in *IBAA* discussed the various branching functions in light of the *Dickinson* ruling:

It has been stipulated that a CBCT permits an existing bank customer to initiate transactions resulting in a cash withdrawal from his account, a crediting of funds to his account, a transfer between his checking account and savings account, and payment transfers. . . . The Court is therefore

98 U.C.C. § 3-104(3).

99 *Lourie v. Chase Nat'l Bank*, 42 N.Y.S.2d 205 (Sup. Ct. N.Y. Co. 1943).

100 J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 17-1 (1972).

101 *See United States v. DeGeorgia*, 420 F.2d 889 (9th Cir. 1969). The Court stated that the mere fact that business records were maintained in a computer rather than in the company books was immaterial in determining the admissibility of the records into evidence. *See also* 28 U.S.C. § 1732 (1970).

102 402 F. Supp. 207.

103 536 F.2d at 178.

104 In reinforcing the importance of competitive balance between state and national banks, the *IBAA* District Court rendered the Comptroller's ruling null and void. By stressing the argument made in *Dickinson*, the *IBAA* deliberators were convinced that the Comptroller's ruling was clearly without merit. In due course, therefore, the court ruled that any further utilization of the ruling would serve only to dismiss stability within the national banking system. 402 F. Supp. at 209.

compelled to conclude that since a CBCT transacts business which is carried on at the main office, it is a branch under the McFadden Act.¹⁰⁵

The *IBAA* court reasoned that the definition of "branch" set forth in the McFadden Act did not have to be a model of precision¹⁰⁶ in order for it to be determined that a CBCT does, in fact, perform the above-quoted functions. This reasoning facilitated its conclusion that all functions of the CBCT—including the cash withdrawal and the installment loan payment—are branch bank functions.

The Seventh Circuit drew upon the district court decisions in both *IBAA* and *Lignoul* to conclude:

We see no need for an elaborate opinion in this case. Judge Will^[107] has ably covered the off-premises functions performed by the CBCT as to deposits, cashing of checks, and the loaning of money; Judge Wilkie^[108] in the *IBAA v. Smith* case has thoroughly canvassed the functions of the withdrawing of cash and the payment of installments on loans.¹⁰⁹

The Seventh Circuit has thus made it clear that in order to adhere to the *Dickinson* decision, technical distinctions between branch and non-branch functions must be avoided.

Nevertheless, inconsistency remains between the historical evidence underlying the McFadden Act and the case law interpretation of what the McFadden drafters had intended. In light of the legislative history, the McFadden Act should be interpreted so that bank customers may enjoy the benefits of computerized banking while the national banking system is allowed to expand. In light of the judicial understanding of the 1927 Act, however, public policy has become secondary to the competitive balance between state and national banks, with emphasis placed upon state control over branch banking.

Conclusion

The review of modern case law indicates the inadequacy of the 50-year-old McFadden Act in its application to the CBCT dilemma. The federal courts have not given proper weight to the historical evidence surrounding the birth of the federal statute, and have placed undue emphasis upon the concept of "competitive equality." Upon closer scrutiny, it is evident that a restriction upon the growth of the national banking system was not the essential idea behind en-

105 396 U.S. at 135.

106 *Id.*

107 Judge Will delivered the opinion for the District Court in *Lignoul*, 409 F. Supp. 1167.

108 Judge Wilkie delivered the *IBAA* Opinion for the Circuit Court of Appeals in the District of Columbia. While the Seventh Circuit cites the D.C. Circuit Court, it draws its conclusion based upon the substantive analysis in the *IBAA* District Court, 402 F. Supp. 207 (D.D.C. 1975).

Upon the U.S. Comptroller's appeal from the district court to the circuit court in *IBAA*, the lower court's decision, which had nullified the Comptroller's ruling, was affirmed. The circuit court reasoned that the legislative history of the McFadden Act and the Supreme Court's decision in *Dickinson* together yield an indication that Congress intended to include under section 36(f) at least the routine and traditional bank services which are usually found at a bank's main office. 534 F.2d at 943.

109 536 F.2d at 177.

actment of the statute. Intricate distinctions over branch bank functions can thus properly be avoided.

Proponents of the case law view will conceivably opt for an amendment to the McFadden Act, in order to relieve the federal courts of the burden of adapting old statutory law to a modern practical framework. Such an amendment should seek to facilitate customer convenience; to anticipate its own impact upon systems of monetary policy, both domestically and internationally; to give proper weight to the United States Comptroller's decisions. Since the Comptroller is both interpreter and enforcer of the National Bank Act, Title 12, U.S.C. § 1 *et seq.* (1970), his rulings should be judicially challenged only when they are proven to be unreasonable constructions of federal statutes.

The problem with such an amendment, however, is that it would reinforce the "competitive equality" interpretation the courts have given to the Act. To couple the governing force of state branching laws over the national banks with this restrictive analysis of federal law, computerized banking would be destined to extinction. Notwithstanding the *Walker Bank* decision, there is no substance to the argument that Congress has regarded equality between the federal and state banking systems as the essence of the McFadden Act. The federal banking statutes do not mandate absolute equality; national banks have been allowed both express¹¹⁰ and implied¹¹¹ powers that are clearly not possessed by competing state banks.¹¹²

In either case, whether the McFadden Act can be successfully amended or not, it is inevitable that the opportunity offered by the CBCT cannot be overlooked. It provides financial institutions with a means of developing more efficient methods of fund transfer, and should therefore be offered for utilization to both state and national banking institutions. To implement the proper use of the CBCT, perhaps the "state v. national" criteria could be discarded to introduce a more practicable test: one that considers whether the use of the CBCT will lead to a concentration of capital in the hands of a few wealthy banks—not necessarily national banks—to result in competitive disadvantage to the smaller banking institutions. Then it would seem more hopeful that the convenience to customers and the genius behind the CBCT could both be fully utilized without the destruction of either state or national banking systems.

Edward Charles DeVivo

110 *See Missouri ex rel. Burnes Nat'l Bank v. Duncan*, 265 U.S. 17 (1924).

111 *Franklin Square Nat'l Bank v. New York*, 347 U.S. 373 (1954).

112 One example is *Commissioner v. Morris Trust*, 367 F.2d 794 (4th Cir. 1966).

TRUTH-IN-LENDING ACT—FIRST IMPOSITION ON OPEN-END CREDIT PLANS OF FINANCE CHARGES INCONSISTENT WITH PRIOR DISCLOSURES BEGINS THE ONE-YEAR LIMITATIONS PERIOD

*Goldman v. First National Bank**

The disclosure provisions of the Truth-in-Lending Act¹ represent Congress' attempt to insure the dissemination of credit information to consumers who would otherwise be unaware of the credit costs. Although Congress has established an enforcement scheme under this Act which encourages private suits, the aggrieved consumer must pursue his cause of action within a one-year limitations period. In typical consumer open-end credit plans, this limitations period has often prevented valid grievances from being remedied. In *Goldman v. First National Bank*,² the Seventh Circuit attempted to alleviate this harsh effect.

Plaintiff, Steven Goldman, applied to the defendant First National Bank of Chicago for a Bank Americard early in April 1970. In compliance with Truth-in-Lending Act provisions relating to open-end credit plans,³ and § 226.7 of Regulation Z promulgated by the Federal Reserve Board,⁴ the defendant sent plaintiff a "Disclosure Statement in Compliance with the Federal Truth-in-Lending Act." This statement explained the amount and method of computing the finance charge on credit purchases and cash borrowings.⁵ With respect to credit purchases, it provided for a twenty-five-day "free-ride" period from date of billing.⁶ During this period, the consumer could remit the balance and avoid incurring any finance charge.

The plaintiff's application was approved in April 1970, and the card was first used on July 1, 1970. The first billing statement he received reiterated that a 1.5% finance charge would be imposed on the outstanding balance if this balance were not paid within twenty-five days from the billing date.⁷ Plaintiff used his card a number of times from September 1970 to January 1971, and avoided any finance charge by paying the outstanding balance due on each billing statement within the twenty-five-day free-ride period. He delayed, however, in sending payment of the balance due February 8, 1971, and his payment was not received until March 9, 1971. Consequently, a finance charge for the entire period,

* 532 F.2d 10 (7th Cir.), *cert. denied*, 45 U.S.L.W. 3238 (U.S. Oct. 4, 1976).

1 15 U.S.C. §§ 1601-13, 1631-44, 1661-65 (1970). The Act became effective July 1, 1969.

2 532 F.2d 10 (7th Cir.), *cert. denied*, 45 U.S.L.W. 3238 (U.S. Oct. 4, 1976).

3 15 U.S.C. § 1637 (1970).

4 The specific provisions relating to required disclosures involved in open-end consumer plans are set out at 15 U.S.C. § 1637 (1970), and require, *inter alia*, that the creditor disclose the conditions under which a finance charge may be imposed.

In § 1604, Congress empowered the Federal Reserve Board to prescribe "such regulations to carry out the purposes" of the Act. Section 226.7(a) of Regulation Z sets forth the disclosures which must be made before the first transaction is made on the account, including the method used to compute the finance charge. 12 C.F.R. §§ 226.1-226.14 (1976).

5 532 F.2d at 13. This statement informed Goldman that the finance charge was computed on the basis of 1.5% on the cash balance outstanding on the billing date.

6 *Id.* Under many open-end credit plans, the consumer has the opportunity to pay off the outstanding balance within a certain time after the billing date and avoid any finance charge of his credit transaction. This time has been termed the "free-ride period." See Garwood, *Truth-in-Lending After Two Years*, 89 BANKING L.J. 3 (1972).

7 Specific disclosures are also required on each periodic billing statement. 12 C.F.R. § 226.7(b) (1976).

January to February 1971, was assessed on the following month's statement.⁸

Goldman brought a class action under the Truth-in-Lending Act sixteen months after the account was first opened.⁹ The suit alleged that the defendant bank had failed to accurately disclose the computation method involved in the imposition of the finance charge, thereby violating § 1637(a) and § 1640(a) of the Truth-in-Lending Act.¹⁰

The district court granted defendant bank's motion for summary judgment on the basis that the plaintiff had failed to bring the action within the one-year statute of limitations.¹¹ Goldman had argued that the disclosure violation continued until the creditor complied with the Truth-in-Lending Act's disclosure requirements. The creditor's compliance marked the beginning of the one-year limitations period. Alternatively, plaintiff contended that this period should be measured from the date a finance charge inconsistent with the disclosure is first imposed.

The trial court, however, determined that the Truth-in-Lending Act and Regulation Z simply required that credit disclosures for open-end accounts be made when the account was first opened. Since disclosure of the cost of credit was made at that time, there was no violation of the Act.¹² Thus the consumer's right of action expired one year after the opening of the account.¹³

On appeal, the Seventh Circuit reversed and remanded.¹⁴ Unlike the

8 532 F.2d at 13.

9 *Id.* 15 U.S.C. § 1637(a) (1970) which corresponds to 12 C.F.R. § 226.7(a) requires disclosure concerning finance charges in connection with open-end accounts before the account is opened. 15 U.S.C. § 1640(a) (1970) is the civil liability section for failure to comply with disclosure requirements. It imposes liability on "any creditor who fails in connection with any consumer credit transaction to disclose to any person any information . . ." required to be disclosed.

10 *Goldman v. First Nat'l Bank*, 392 F. Supp. 214 (N.D. Ill. 1972).

11 *Id.* at 218.

12 *Id.*

13 In a separate opinion, the trial court denied plaintiff's motion for a determination of class. It ruled that the class represented by the plaintiff did not meet the tests of Fed. R. Civ. P. 23. The court stated that while the proposed class met the common questions of fact and law test under Fed. R. Civ. P. 23 (a), the plaintiff failed to show the risk of varying adjudications respecting the class members, and thus did not meet the tests of Fed. R. Civ. P. 23(a)(1) (A).

The major reason for the court's denial of class status was its fear of the possibility of a crushing damage award disproportionate to the actual injury inflicted due to the minimum recovery provision of the Act. As originally enacted, § 1640(a)(1) of the Act permitted a minimum recovery of \$100.00. If each member of a class were to recover these minimum damages alone, the total amount of damages for which an individual creditor could be liable would be devastating. *Goldman v. First Nat'l Bank*, 56 F.R.D. 587 (N.D. Ill. 1972). For a discussion of recent amendments to § 1640(a), see text accompanying note 14 *infra*.

14 532 F.2d at 22. In addition to reversing the lower court on the statute of limitations issue, the Seventh Circuit ruled that the proposed class did meet the tests of Fed. R. Civ. P. 23 and therefore the motion for determination of class was improperly denied. In reaching this decision, the Seventh Circuit emphasized not only the recent amendments to the Truth-in-Lending Act limiting recovery in class actions, but also the actual superiority of such actions for Truth-in-Lending suits. The court felt that, in cases in which widespread noncompliance with the Act was found, such class actions had the advantage of preventing violators from limiting recovery to only a few plaintiffs. *Id.* at 16.

As noted by the Seventh Circuit, Congress clearly indicated its intent to include class actions within the Act by amending 15 U.S.C. § 1640(a) in 1974. 15 U.S.C.A. § 1640(a) (1970) (amended 1974). Before this amendment, a number of courts had ruled that the incentive given to the individual consumer to enforce the Act in the form of minimum recovery of damages plus attorney's fees indicated that the class action was inconsistent with the aims of the Act. See *Ratner v. Chemical Bank New York Trust Co.*, 54 F.R.D. 412 (S.D. N.Y. 1971). Now, "Congress has recognized that class actions are a proper vehicle for enforcing a remedial statute such as the Truth-in-Lending Act." Eovaldi v.

district court, the Seventh Circuit accepted plaintiff's contention that the statute of limitations should run from time a finance charge inconsistent with previous disclosures is first imposed.¹⁵ In light of the Act's focus on the significance of the finance charge, and its stated purpose to promote the informed use of credit, the court ruled that the imposition of the finance charge constituted the last significant event to be used in measuring the limitations period.¹⁶

Truth-in-Lending Act: Legislative Intent

Growing concern at the rapid increase in the level of consumer credit¹⁷ without a corresponding rise in consumer awareness of the costs of such credit, prompted Congress to enact the Consumer Credit Protection Act, or "Truth-in-Lending."¹⁸ The stated purpose of the Act is to "assure a meaningful disclosure of credit so that the consumer will be able to compare . . . the various credit terms available to him and avoid the uninformed use of credit."¹⁹ Congress believed that if the consumer were provided with the information necessary to make an intelligent choice among lenders, his purchasing power in the credit marketplace would increase.²⁰ The basic thrust of the Act is the disclosure, rather than the regulation, of the terms and conditions under which credit may be extended.²¹

To implement this purpose, Congress required that certain disclosures be

First Nat'l Bank, (N.D. Ill. 1976), 5 CONS. CRED. GUIDE (CCH) ¶ 98,419. Nevertheless, determination of class will still depend on the proposed class meeting the dual requirements of Fed. R. Civ. P. 23(a) and (b).

However, Congress has placed a ceiling on the statutory recovery. It has limited the maximum recovery in any class action brought under this section to "such amount as the court may allow. . . ." but the total recovery in such action "shall not be more than the lesser of \$100,000.00 or one percentum of the net worth of the creditor." Minimum individual statutory recovery of \$100.00 was eliminated in class actions. In 1975, Congress again increased the maximum recovery to \$500,000.00.

As a result of these developments, much of the controversy regarding the appropriateness of class actions under Truth-in-Lending has been eliminated. The class action issue raised in the case presently under consideration is largely outside the scope of this comment. Instead, primary attention will be given to the Seventh Circuit's analysis of the statute of limitations question.

15 532 F.2d at 21. Justice Stevens dissented as to the court's ruling on the statute of limitations issue. He agreed that a different limitation provision might have been more appropriately enacted for open-end credit accounts. Nevertheless, he emphasized that the Act imposed the same limitations period on actions involving both open- and closed-end credit. He concluded that if, as in the instant case, a defendant's violation had occurred more than one year before the action commenced, the statutory remedy would be barred. *Id.* at 22.

16 On October 4, 1976, the Supreme Court denied the defendant bank's petition for a writ of certiorari. 45 U.S.L.W. 3238 (U.S. Oct. 4, 1976).

17 In H. REP. NO. 1040, the Joint Committee on Banking and Currency cited a Federal Reserve Board report that in 1967 revolving credit had reached \$5.3 billion. American families were paying \$13 billion a year in interest and service charges for consumer credit. H. REP. NO. 1040, 90th Cong., 2d Sess., reprinted in [1968] U.S. CODE CONG. & ADMIN. NEWS 1971.

18 See note 3 *supra*.

19 15 U.S.C. § 1601 (1970).

20 See the remarks made by Senator William Proxmire, reporting to the Senate on Truth-in-Lending. 113 CONG. REC. 2042 (1967).

The Act apparently achieving the desired effect of increasing consumer awareness of the cost of credit. In its Annual Report to Congress on Truth-in-Lending in 1971, the Federal Reserve Board noted an 18% increase in the number of persons aware of the interest levels on personal loans. See Garwood, *supra* note 6.

21 113 CONG. REC. 2050 (1967).

made in both open-end and closed-end credit transactions,²² and empowered the Federal Reserve Board to implement the Act by promulgating regulations. Regulation Z of the Federal Reserve Board is designed to guide credit institutions in the nature, timing and form of disclosures.²³ In addition, Congress gave federal courts jurisdiction over causes of action for violations of the Act and provided a statutory scheme for the recovery of damages. The consumer, however, who initiates an action against an offending creditor in the federal courts must bring that action "within one year from the date of occurrence of the violation."²⁴

Judicial Interpretations of the Liability Provisions of the Truth-in-Lending Act

In asserting its authority over civil actions involving violations of the Act,²⁵ the federal judiciary has been faced with the task of interpreting two crucial, interrelated questions: (1) what constitutes a "consumer transaction" requiring disclosures under the Act²⁶ and (2) if a credit arrangement involves a series of significant transactions, at what point must a creditor make the necessary disclosures to avoid a violation of the Act?²⁷ Resolution of this second question is crucial for those plaintiffs faced with the one-year statute of limitations.²⁸

Closed-end Credit

Courts have addressed these two problems most frequently when closed-end credit is involved. Under such a credit arrangement, disclosures must be made "before credit is extended."²⁹ If there is a failure to disclose, a cause of action accrues and the statute of limitations commences to run from that date. The

22 The term open-end credit is defined as

consumer credit extended on an account pursuant to a plan under which (1) the creditor may permit the customer to make purchases or obtain loans directly from the creditor, or indirectly by use of a credit card, check or other device. . . ; (2) the customer has the privilege of paying the balance in full or in installments; (3) a finance charge may be computed by the creditor from time to time on the outstanding unpaid balance.

24 12 C.F.R. § 226.2(a) (1976). Closed-end credit is all other consumer credit.

23 Regulation Z, 12 C.F.R. § 226.1-14 (1976), sets forth in great detail a creditor's disclosure requirements for both open- and closed-end credit transactions. The information to be disclosed includes the amount in dollars of all finance charges directly or indirectly imposed upon the extension of credit under § 226.4 and various specific disclosures where open-end credit plans are involved (e.g., conditions for the imposition of finance charges, the existence of any free-ride period, etc.) under § 226.7. As required by § 226.6, all such information must be presented clearly, conspicuously and in a sequence meaningful to the consumer.

24 15 U.S.C. § 1640(a), (e) (1970).

25 *Ratner v. Chemical Bank New York Trust Co.*, 309 F. Supp. 983 (S.D. N.Y. 1970), noted in 42 *FORDHAM L. REV.* 664, 667 (1974). This decision concerns the jurisdictional issue and is one of three separate decisions in the *Ratner* case. See note 14 *supra*.

26 15 U.S.C. § 1640(a) (1970).

27 For example, most mortgage agreements, while often considered a unit, actually involve both a commitment to extend credit and the execution of an instrument of indebtedness at the closing. *Postow v. Oriental Bldg. Ass'n*, 390 F. Supp. 1130 (D.D.C. 1975).

28 15 U.S.C. § 1640(e) (1970) states that "any action under this section may be brought . . . within one year from the date of the occurrence of the violation."

29 This requirement is set out in 15 U.S.C. §§ 1638(b), 1639(b) which generally cover the form and timing of disclosures where closed-end credit plans for sale of goods or services or consumer loans are involved.

point at which credit is "extended" was first identified by the Sixth Circuit in *Wachtel v. West*.³⁰ There, the plaintiff had argued that the defendant's failure to disclose information required by § 1635 of the Act³¹ constituted a continuing violation until disclosure actually occurred. The Sixth Circuit rejected this, pointing out that Regulation Z expressly requires disclosure only when the credit transaction occurs. Disclosure must take place either when the contractual relationship between the creditor and consumer is created or, at the latest, upon performance of the contract.³²

The Sixth Circuit envisioned the violation of the disclosure requirements as occurring at a specific time.³³ In identifying this point, the *Wachtel* court partly adopted the Federal Reserve Board's focus on the execution of the credit contract,³⁴ but broadened it to include also the performance of the contract. It therefore expanded the creditor's duty to disclose to encompass the latest transaction in which disclosure of credit information would continue to be relevant to the consumer. This transaction would, then, mark the beginning of the limitations period. Other circuits have essentially adopted the *Wachtel* approach by measuring the one-year limitations period from a specific event in the consumer/creditor relationship.³⁵

In *Stevens v. Rock Springs National Bank*,³⁶ the Tenth Circuit limited the application of the *Wachtel* principle by adopting a stricter view of the Act: violations occur, at the latest, when the credit contract is formally executed.³⁷ Despite this difference, both *Wachtel* and *Stevens* measure the limitations period from the date of a specific credit transaction and disregard the date the consumer first became aware of any failure to disclose. Various other decisions have

30 476 F.2d 1062 (6th Cir. 1973). Plaintiffs brought suit in the federal court under § 1640 of the Act alleging the defendants' failure to disclose financing terms involved in plaintiffs' obtaining a second mortgage on their home. The suit was brought almost 1½ years after the mortgage was signed. On appeal, the appellate court affirmed the lower court's dismissal of the suit based on the expiration of the statute of limitations. 15 U.S.C. § 1640(e) (1970).

31 15 U.S.C. § 1635 (1970) sets out requirements for disclosures in residential real estate financing arrangements. It provides, among other remedies, for rescission of the mortgage contract (other than a first mortgage) when the creditor can acquire a security interest on the consumer's home.

32 Section 226.8 of Regulation Z requires that all disclosures connected with closed-end plans must occur "before the transaction is consummated." The Federal Reserve Board has defined "consummation" as the time the lender issues its permanent loan commitment to the purchasing customer and the purchaser accepts such commitment. Federal Reserve Board Letter No. 93, Aug. 27, 1969, reprinted in CLONTZ, TRUTH-IN-LENDING MANUAL at A-31 (rev. ed. Supp. 1972). (These letters represent the official interpretation by the F.R.B. of the Act's provisions and are given almost as much precedential weight by the courts as the Regulation.)

33 476 F.2d 1062, at 1065.

34 *Id.*

35 Only the Fifth, Seventh and Tenth Circuits appear to have addressed issues similar to those raised in *Wachtel*. See note 30 *supra*. A line of decisions from the Tenth Circuit most strongly affirms the *Wachtel* principle that violations of the Act occur at a specific time. See generally *Redhouse v. Quality Ford Sales, Inc.*, 511 F.2d 230 (10th Cir. 1975); *Littlefield v. Walt Flanagan & Co.*, 498 F.2d 113 (10th Cir. 1974); *Stevens v. Rock Springs Nat'l Bank*, 497 F.2d 307 (10th Cir. 1974). See also *Thomas v. Myers-Dickson Furniture Co.*, 479 F.2d 740 (5th Cir. 1973).

36 497 F.2d 307 (10th Cir. 1974). Plaintiffs brought a class action alleging failure to disclose where the purchase of mobile homes under a closed-end plan involved two transactions — the signing of the purchase agreement and the execution of the promissory note. The court held that the execution of the note was the consummated transaction envisioned by the Act, and the statute of limitations ran from this date.

37 *Id.* at 309-10.

also focused on a specific event which automatically operates as the consummation of the transaction for purposes of liability under the Act.³⁸ Thus, as interpreted by the federal courts, the extension of credit under a close-end plan contractually binds the consumer and occurs at an identifiable time. Disclosure must be made before this time so that the consumer can make an informed decision whether or not to become bound. This transaction is the latest significant event at which a disclosure violation can occur, and provides the date from which the one-year statute of limitations will run.

Open-end Credit

Open-end credit has presented greater conceptual difficulties in the judicial determination of when a disclosure is required for statute of limitations purposes. Open-end credit plans possess a distinctly different character from the closed-end plans. The Act recognizes these differences and defines an open-end credit plan as:

[A] plan prescribing the terms of credit transactions which may be made thereunder from time to time and under the terms of which a finance charge may be computed on the outstanding unpaid balance from time to time.³⁹

The credit relationship is composed of a series of transactions in which credit is extended. With each billing the consumer has the option to pay back this extension, by paying the outstanding balance, or to carry the balance to the following statement date and incur a finance charge.⁴⁰

Despite the nature of the open-end credit plan as a continuing relationship between the creditor and the consumer, both the Act and Regulation Z require that disclosures be made to the consumer at specific stages; when the account is first opened, and with each periodic billing statement. Regulation Z simply expands the Act's language concerning disclosures when the account is first opened and mandates disclosure before the first transaction is made.⁴¹ Nonetheless, for the purposes of § 1640(a) liability, both the Act and the Regulation are unclear as to whether the opening of the account and the billing statements are to be regarded as one or as separate transactions. Moreover, they are silent concerning the point during these transactions at which the violation giving rise to

38 See generally *Stavrides v. Mellon Nat'l Bank & Trust Co.*, 353 F. Supp. 1072 (W.D. Pa. 1973) (closing on a mortgage loan); *Bissette v. Colonial Mortgage Corp.*, 340 F. Supp. 1191 (D.D.C. 1972) (commitment agreement to make a loan); *Kristiansen v. John Mullins & Sons, Inc.*, 59 F.R.D. 99 (E.D. N.Y. 1973) (the execution date of the installment contract).

39 15 U.S.C. § 1602(i) (1970). See note 22 *supra*.

40 *Thomas v. Myers-Dickson Furniture Mart*, 479 F.2d 740, 747 (5th Cir. 1973). See note 49 *infra*.

41 The text of the Act is set out at 15 U.S.C. § 1637(a),(b) (1970). The text of the Regulation may be found at 12 C.F.R. § 226.7(a),(b) (1976). See text accompanying note 9 *supra*.

The Federal Reserve Board has also informally issued an opinion in its Annual Report to Congress on Truth-in-Lending that open-end credit plans should be regarded as constitution "one transaction" from its opening to all subsequent extensions of credit for purposes of liability under § 1640(a). This interpretation conceives the failure to disclose as constructively occurring when the account is opened, regardless of when the actual failure takes place. Under this theory, the statute of limitations could have already expired before the violation of the Act occurs. See *Thomas v. Myer-Dickson Furniture Mart*, 479 F.2d at 747.

a cause of action occurs. However, since the Act requires disclosure when the account is opened, and when periodic statements are sent to the customer, it seems to envision significant, identifiable events in the open-end credit context as determining when a cause of action accrues. Apparently, the statute of limitations would run from the date these transactions occur, as in the close-end credit context.

*Measuring the Limitations Period under the Act:
The Continuing Violation Theory*

The precise question of when the statute of limitations begins to run in connection with a disclosure violation under an open-end credit plan has not been directly addressed by any federal district or appellate court. Several have considered the question under a closed-end plan. The major controversy has centered around the "continuing violation theory." According to this theory, the creditor is obliged to make disclosures when the credit transaction is consummated.⁴² This disclosure obligation will continue during the existence of the credit relationship. Violations of the disclosure provisions thus continue until they are remedied. Under this theory, the statute of limitations runs either from the date of compliance or from the date of discovery of the non-compliance.

In *Wachtel*, the Sixth Circuit rejected this theory on the grounds that the Act's purpose is to require the lender to disclose credit information to the consumer before he becomes contractually bound. The Act emphasizes the finality of the credit contract regarding a consumer's right to invoke the penalties provided by requiring disclosure before the credit is extended.⁴³ The duty to disclose arises once; the violation occurs only when this duty is not fulfilled and does not continue thereafter.

In contrast to the *Wachtel* court's complete rejection of the continuing violation theory in Truth-in-Lending actions, the New York district court in *Kristiansen v. John Mullins & Sons, Inc.*,⁴⁴ at least recognized that this theory was valid for statute of limitations purposes in certain types of wrongs.⁴⁵ Yet it ultimately rejected this theory in connection with violations of the Act on the grounds that:

There is nothing in either the letter or the spirit of the Act which imposes upon the creditor a continuing duty during the entire term of the contract to disclose what he has failed to disclose the first time the contract was executed.⁴⁶

⁴² See note 24 *supra*.

⁴³ 476 F.2d 1062 at 1065.

⁴⁴ 59 F.R.D. 99 (E.D. N.Y. 1973). This case involved a class action brought by plaintiff against defendant store for failure to disclose information required by 12 C.F.R. § 226.8 in connection with closed-end installment sales contracts.

⁴⁵ See *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968) (Sherman Anti-Trust Act violations); *Katz v. NLRB*, 196 F.2d 411 (9th Cir. 1952) (violation of the National Labor Relations Act).

⁴⁶ 59 F.R.D. at 107. The plaintiff had argued that the failure to disclose was a continuing violation, since during the period of non-disclosure or at the longest, for the life of the contract, the creditor continues to receive unlawful benefits and inflicts harm on the consumer. The court rejected this notion on the grounds that the harm envisioned by the plaintiff was mere speculation and based only on the possibility that the plaintiff might have ended the contract had she discovered the non-disclosure.

The District of Columbia Federal District Court in *Postow v. Oriental Building Association*⁴⁷ also applied a continuing violation theory to a failure to disclose under the Act. *Postow* isolated several factors, found in other substantive classes of wrongs held to be continuing violations, which it considered relevant in Truth-in-Lending actions. In particular, the district court emphasized that the misdeed must have constituted an ongoing, improper relationship which caused a continuing invasion of the other party's rights.⁴⁸ The court narrowly applied the continuing theory, however, by ruling that the creditor's duty to disclose continued only from the date the contract to make a loan was executed to the date of its performance. The period during which the violation was deemed to have continued was thus carefully confined within the parameters of these two transactions.

The factors used in the *Postow* decision to determine whether an obligation to disclose is continuing could also be applied appropriately to the open-ended credit plan. The consumer/creditor relationship under such plans is a dynamic one, formed by a series of credit extensions over a period of time. Any failure to disclose the costs of such credit would result in a continuing invasion of the consumer's rights. The Fifth Circuit in *Thomas v. Myer-Dickson Furniture Mart*⁴⁹ recognized this ongoing nature of open-end credit plans. The court pointed out that one of the primary characteristics of open-end plans is the receipt of monthly billing statements which offer a continual option to a consumer to carry over the outstanding balance to the next month and incur a new credit obligation. Each statement constitutes, in the court's view, a separate consumer transaction giving rise to potential liability under § 1640(a).⁵⁰ The opening and use of the account are not to be considered one transaction: instead, they are a series of separate consumer transactions for which credit disclosures are required.

Moreover, in its discussion, the Fifth Circuit indirectly addressed the problem of establishing when liability for non-disclosure arises under the Act. Despite its recognition of the ongoing nature of open-end credit plans, the court determined that the issuance or receipt of a non-conforming periodic billing statement is the significant event marking liability.⁵¹ Presumably, the violation occurs at this point and the statute of limitations begins to run on the ensuing cause of action.

Thus the line of cases considering the statutory one-year limitation on Truth-

47 390 F. Supp. 1130 (D.D.C. 1975). This was an action for disclosure violations under the Act involving a closed-end mortgage loan agreement in two segments: a commitment to finance and a closing. Disclosure was presented to plaintiffs only one hour before the final closing.

48 *Id.* at 1139.

49 479 F.2d 740 (5th Cir. 1973). Plaintiff brought suit for defendants' failure to disclose on her billing statements for her open-end account the effect of credit life insurance upon the finance charge, in violation of 15 U.S.C. § 1605(a) (1970).

50 *Id.* at 747. 15 U.S.C. § 1640(a) (1970) provides in part that "any creditor who fails in connection with any consumer credit transaction to disclose to any person any information required under this part to be disclosed is liable to that person. . . ."

In 1974, Congress completely reworded § 1640(a) liability provision and deleted any reference to "consumer transaction." It substituted a provision placing liability on any creditor who fails to comply with any requirement imposed under the Act. 15 U.S.C.A. § 1640(a) (1)(A) - (B) (1974), amending 15 U.S.C. § 1640(a) (1) (1970).

51 *Thomas v. Myer-Dickson Furniture*, 479 F.2d 740. In so concluding, the Fifth Circuit noted and then rejected the Federal Reserve Board's unofficial view of the "one transaction" character of such accounts. See text accompanying note 39 *supra*.

in-Lending actions in both the open-end and closed-end contexts focuses on specific events in the consumer/creditor relationship. The consensus is that the violation occurs and the statute begins to run from the date of one specific event, whether this event be the moment the credit contract is performed or the billing statement is received.

The Goldman Court's Analysis

The Seventh Circuit's ruling in *Goldman* represents the most lenient approach yet taken by any court faced with the problem of the possible expiration of the statute of limitations. In reversing the lower court, this appellate court focused on three elements; the stated purpose of the Act, the specialized nature of open-end credit plans, and the finance charge.

Initially, the analysis by the Seventh Circuit is similar to that found in the other federal court decisions discussed above. All evidence a desire to carry out the spirit of the Act and to adequately protect the unwary consumer. In *Goldman*, the Seventh Circuit emphasized that the main intent of the Act is to punish the failure to disclose credit terms to the consumer. As the court notes, the general concern is for the "meaningful disclosure of credit terms."⁵² This concern provides the background for the court's focus on the special conceptual problems presented by the open-end account.

According to *Goldman*, the salient characteristic of an open-end credit account is the lack of a ceiling on the aggregate amount of credit extendable during the use of the account.⁵³ The Seventh Circuit's emphasis on the amount of total credit extendable is necessary because such emphasis supports the central role the imposition of a finance charge plays in the court's subsequent discussion. The lifetime cost (in terms of the total finance charge) of credit extensions to a consumer could be very high. Awareness of how a finance charge is calculated might provide enough incentive for the consumer to pay any outstanding balance within the free-ride period. The court, therefore, is properly concerned that all information about finance charges be disclosed to aid meaningful consumer credit choices.

Despite the Seventh Circuit's sensitivity to the special Truth-in-Lending problems presented by open-end credit, the court tacitly accepted the *Wachtel* interpretation for statute of limitations purposes. Likewise, the *Goldman* court concluded that the Act conceives of a specific time in the course of the credit relationship when a disclosure violation occurs. Like most courts which have considered the question, the *Goldman* court rejects the continuing violation theory for failure to disclose. When open-end credit accounts are involved, the court recognizes that the Act fails to indicate clearly the specific

52 532 F.2d 10, 18. This language would also apparently include situations, like that in the instant case, where the disclosure is incomplete or misleading.

53 *Id.* Open-end credit accounts may impose ceilings on the outstanding debt carried by a customer at any one time. But if this debt is cleared by payment, the customer is free to transact more credit extensions. Thus the gross total of all these transactions may well exceed the actual debt ceiling.

The Seventh Circuit's analysis distinguishes the *Goldman* approach to open-end credit plans from the approach in *Myer-Dickson Furniture Mart*, which characterized such plans as a constant series of transactions governed by umbrella credit terms. See *Thomas v. Myer-Dickson Furniture Mart*, 479 F.2d at 747.

time violations occur.⁵⁴ This omission suggests that different rules may apply to open-end accounts. Nevertheless, the Seventh Circuit found that a joint reading of the disclosure provisions of the Act and of Regulation Z pertaining to open-end accounts revealed a congressional intent to require a specific time for disclosure of credit information in these accounts.⁵⁵ The court refused, therefore, to impose a continuing obligation of the creditor to make disclosures, finding such intent lacking in either the language or the history of the Act.

Nevertheless, because of the peculiar nature of a free-ride, open-end credit plan, the *Goldman* opinion proceeded beyond the "specific time for disclosures" analysis. It agreed with the plaintiff that, until a finance charge is imposed, a debtor continues to be unaware of any inaccurate disclosure concerning these charges. When free-ride periods are built into open-end accounts, discovery of inaccuracies by the consumer who takes advantage of the free credit ride can be indefinitely postponed.

The court then attempted to distinguish "no disclosure" from "inaccurate disclosure."⁵⁶ In the former situation the violation is apparent to the consumer, while in the latter the consumer has no opportunity to test the accuracy of a disclosure until a finance charge is imposed. While the court's distinction may be correct, it nevertheless is irrelevant. For purposes of determining liability under the Act, inaccurate disclosure would seem the equivalent of no disclosure at all. In both situations, the consumer cannot make an informed choice since all the facts and hidden costs are not known. Furthermore, the difference becomes immaterial once the court adopts the specific event analysis to determine when liability arises. Violations of the Act, whether due to no disclosure or inaccurate disclosure, occur at one specific time. Moreover, the fact that Congress has not treated inaccurate disclosures as separate categories for liability further minimizes the relevance of the *Goldman* court's distinction.

The Seventh Circuit was obliged to draw heavily on legislative intent to reach a determination that the cause of action accrued when the finance charge was imposed and that the one-year statute commenced on that date. It correctly regarded the finance charge as the central consideration in the legislative history of the Act and, thus, as the major trigger of civil liability.⁵⁷ Since the finance charge's disclosure is essential to the informed use of credit, the court's concern is understandable. Conceivably, the full impact of an inaccurate finance charge might not be felt by a consumer who had taken advantage of the free-ride period until after the statute of limitations had run.

The Act's provisions do not expressly cover this problem. To fill this very crucial gap, the court made the first imposition of a finance charge which is inconsistent with the disclosure the event which marks the beginning of the one-year limitations period. This approach implements the Act's purpose by insuring that

54 See note 33 *supra*.

55 532 F.2d at 20.

56 *Id.*

57 "The basic disclosure concept contained in the proposed legislation is to require lenders and merchants to provide consumers with a statement of the 'finance charge' imposed by the creditor in connection with a particular credit transaction." *Report to the Senate on H.R. 11601, Truth-in-Lending*, 90th Cong., 2d Sess., reprinted in [1968] U.S. CODE, CONG. & ADMIN. NEWS 1971.

the consumer is fully informed about the cost of his credit, and reflects the general trend of judicial concern for the consumer.⁵⁸ *Goldman* attempted to lessen the ambiguity of the Act by construing its provisions liberally, thus enabling an aggrieved consumer to take advantage of the remedy provided for him.⁵⁹

Conclusion

In its opinion, the Seventh Circuit has not departed radically from the considerations at work in previous decisions. It, too, focused on a specific event in the credit relationship—the first imposition of a finance charge. If this charge is inconsistent with previous disclosures, a cause of action accrues to the consumer. The statute of limitations then runs from the date of this event. The fact that the consumer's actual discovery of the inaccuracies in disclosure may also occur at the same time is immaterial.⁶⁰ This analysis is conceptually consistent with earlier decisions which determined that a cause of action arises at a specific point in a consumer/creditor relationship.

Nevertheless, this decision will expose creditors who offer "free-ride" credit plans to a greater number of potentially successful suits. Formerly, these suits were limited by a strict judicial construction of the Act's statute of limitations. The *Goldman* decision permits the suspension of this statute until a finance charge inconsistent with the disclosure is first imposed. Due to the effect of the free-ride period, this event could occur many months after the opening or first use of the open-end account.

This result is fully consistent with the "let the creditor beware" philosophy underlying the Act. Furthermore, the decision limits its impact by making the time the finance charge is first imposed, rather than its discovery, the material event commencing the limitations period. The creditor need only show that the finance charge was first imposed one year before the action was filed in order to defeat the plaintiff consumer's claim.

58 In general, the federal courts that have considered Truth-in-Lending actions reveal a strong awareness of Congress' intent to protect the credit consumer. Although often restricted by rather narrow interpretations of the Act's provisions, all have evidenced a desire to implement the Act by careful scrutiny of the credit transaction under attack by an aggrieved consumer-plaintiff. See generally *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356 (1973); *Eby v. Reb Realty, Inc.*, 495 F.2d 646 (9th Cir. 1974); *Allen v. Beneficial Finance Co.*, 393 F. Supp. 1382 (N.D. Ind. 1975); *Ratner v. Chemical Bank New York Trust Co.*, 329 F. Supp. 270 (S.D. N.Y. 1971).

59 From this decision, it is clear that the Seventh Circuit concurred with the United States Supreme Court's analysis of the philosophy behind the Act:

The Truth-in-Lending Act reflects a change in Congressional policy from a philosophy of "Let the buyer beware," to one of "Let the seller disclose." By erecting a barrier between the seller and the prospective purchaser in the form of hard facts, Congress expressly sought to . . . "avoid the uninformed use of credit."

Mourning v. Family Publications Service, Inc., 411 U.S. at 377.

60 Despite a superficial similarity, the Seventh Circuit has not adopted the view expressed in the dissent to the *Wachtel* decision. In his dissent, Judge Young argued that the majority limited the effectiveness of the Act when it ruled that the limitations period began to run when the mortgage contract was signed. Even though the Act allows the mortgagor to rescind the contract once the disclosure violation is discovered, his right to recover damages as well may already have been lost due to the expiration of the statute of limitations. Analogizing to the approach taken in fraud actions, Judge Young contended that the purposes of the Act would be better served if the Act's limitation provision were interpreted as beginning either when the failure to disclose was first discovered or when the disclosure was made. The consumer's actual knowledge thus becomes the event triggering the statute of limitations. *Wachtel v. West*, 476 F.2d at 1066-67 (Young, J., dissenting).

By taking into account the special character of an open-end credit plan, the Seventh Circuit has attempted to remedy a situation not envisioned by the framers of the Act. In view of the confusion surrounding open-end credit plans, and the risk of inconsistent judicial attempts to resolve ambiguity in the Act concerning them, Congress should define when the cause of action accrues. Unless it does so, the Act's short statute of limitations will deprive unwary consumers of the remedies given to them against creditors. Without this necessary clarification, Congress' intent to encourage private enforcement of the Act through consumer suits is severely thwarted.

Mary E. Schaffner

TRUTH IN LENDING ACT—MEANINGFUL SEQUENCE REQUIREMENT
NECESSITATES LOGICAL SEQUENTIAL ORDERING OF ARITHMETICAL TERMS—
CO-OBLIGOR ALLOWED TO RECOVER CIVIL PENALTY DESPITE POSSIBILITY
OF MULTIPLE PENALTIES

*Allen v. Beneficial Finance Co., Inc.**

The Truth in Lending Act has been the subject of extensive litigation since its enactment in 1968.¹ Nevertheless, two particular issues raised under this Act have received only limited attention in the federal courts. These issues pertain to the meaningful sequence requirement of Regulation Z, and to the question of multiple recoveries by co-obligors arising from one consumer loan. Both these subjects were recently addressed by the Seventh Circuit in *Allen v. Beneficial Finance Co., Inc.*² In resolving the first issue, the court joined with an earlier decision by the Fifth Circuit, concluding that a disclosure statement in a consumer loan must group arithmetical terms in a logically sequential order. Furthermore, the statement must group related terms, whether descriptive or arithmetical, in relative proximity to each other. Secondly, the Seventh Circuit held that a co-obligor, although not receiving a disclosure statement, is nevertheless entitled to a separate recovery of the statutory penalty, even when the other obligor is not a party to the action.

On April 2, 1974, plaintiff and her ex-husband renegotiated an outstanding consumer loan with defendant, Beneficial Finance Company of Gary, Inc. (Beneficial). As a result of the renegotiation, plaintiff's ex-husband received an additional \$453.09, thereby obligating both plaintiff and her former husband to repayments totaling \$2404. However, only plaintiff's ex-husband received a statement of disclosure detailing the transaction. On January 3, 1975, plaintiff filed a complaint claiming that defendant failed to comply with the statutory provisions requiring disclosure of pertinent credit information. Specifically, the allegation charged that the information provided by Beneficial was not supplied in a meaningful sequence as required under Regulation Z, § 226.6(a).³ Both parties made motions for summary judgment;⁴ the trial court granted plaintiff's motion, and awarded plaintiff the statutory penalty of \$1,000 plus attorney's fees.⁵

The district court premised liability on defendant's failure to disclose information as required under the civil liability section, § 1640. The court found that the lack of a meaningful sequence in the disclosure statement effectively masked any information contained therein.⁶

Although it affirmed the decision of the district court, the Court of Appeals

* 531 F.2d 797 (7th Cir.), cert. denied, 97 S. Ct. 237 (1976).

1 The Truth in Lending Act, Pub. L. No. 90-321, § 102, 82 Stat. 146, 15 U.S.C. § 1601 (1970) (prior to 1974 amendment). The Truth in Lending Act is Title I of the Consumer Credit Protection Act.

2 531 F.2d 797 (7th Cir. 1976).

3 12 C.F.R. § 226.6(a) (1976).

4 The ex-husband, who received the statement, was not a party in this lawsuit.

5 393 F. Supp. 1382, 1385 (N.D. Ind. 1975).

6 *Id.*

for the Seventh Circuit premised its finding of liability on different grounds. As previously indicated, the two principal issues before the Seventh Circuit were: (1) whether the disclosure statement of the defendant met the meaningful sequence requirement of Regulation Z; and (2) whether a co-borrower who did not receive the statement of disclosure could recover for a violation in that statement.⁷

On appeal, defendant attempted to respond to both issues. Beneficial initially noted that the meaningful sequence provision of Regulation Z is satisfied by a logical ordering of the terms of the credit agreement. Defendant further argued that the subtractional ordering of terms appearing in its statement to plaintiff sufficiently complied with that logical order requirement.⁸ In response to the standing issue, Beneficial contended that the statute implicitly precludes recovery by a co-borrower since it requires the statement of disclosure to be delivered to only one borrower in a multiple obligor situation. This explicit limitation on the rights of co-borrowers to receive multiple statements was interpreted by Beneficial to encompass a limitation on the rights of those borrowers to maintain separate actions. Pursuant to this position, Beneficial contended that plaintiff should not be allowed to recover for the violation since she was not the party who received defendant's statement.

Neither contention persuaded the appellate court. The Seventh Circuit first ruled that Beneficial's statement failed to meet the disclosure requirements of Regulation Z because the statement failed to group items in a logically sequential order. The court further found liability because the statement failed to group related items together. The subtractional order provided in the disclosure statement was found by the court to be inadequate, as a matter of law.⁹ Moreover, although the creditor was obligated to furnish only one statement, the court found such a requirement does not limit the right of other obligors to recover if insufficient disclosures appear in the statement furnished. In order to properly analyze the decision of the Seventh Circuit in *Allen*, it is necessary to understand the purpose underlying the Truth in Lending Act.

The Rationale of the Truth in Lending Act

Enacted in 1968, the Truth in Lending Act¹⁰ was designed to provide the consumer with sufficient information to allow a comparison of the cost of dif-

7 Two other issues were raised by the appellant. In the first, the appellant claimed the trial court erred in granting the plaintiff's motion for summary judgment without allowing oral argument or submission of briefs in opposition to the motion. In the second, the appellant challenged the constitutionality of the meaningful sequence requirement. Both questions were quickly disposed of by reviewing the rules of civil procedure for the Northern District of Indiana. 531 F.2d at 799-800, 805.

8 Alternatively, the defendant blamed any deviations from a meaningful sequence on the practical necessities of a national computer system which compiled the statement. The Seventh Circuit summarily dismissed this contention on the grounds that creditor convenience is no defense. *Id.* at 804.

9 *Id.*

10 15 U.S.C. § 1601 (1970). For analyses of the assumptions underlying the Truth in Lending Act, see Kropke, *Consumer Credit Regulation*, 68 COLUM. L. REV. 445 (1968); Boyd, *The Federal Consumer Credit Protection Act—A Consumer's Perspective*, 45 NOTRE DAME LAW. 171 (1970).

ferent types of consumer credit.¹¹ It was intended that such information enables the consumer to make an intelligent decision regarding his use of credit. It was further expected that these disclosures would promote "consumer shopping" among credit providers, ultimately resulting in lower credit costs through enhanced competition. However, the Act does not attempt to regulate the substantive terms and conditions of consumer credit, nor does it attempt to place a ceiling on the cost of that credit. Rather, it is simply designed to better inform the public of the terms of credit, whatever those terms might be, by requiring disclosure in a uniform manner.

To implement this purpose, the Act requires creditors to disclose certain terms and conditions of the credit agreement before completing the transaction. In particular, it directs all affected creditors to disclose the finance charge and annual percentage rate of extended credit.¹² The Act further requires that all disclosures be made clearly and conspicuously, and in accordance with regulations promulgated by the Federal Reserve Board to carry out the purpose of the Act.¹³ Although other disclosure requirements do exist, their applicability to a given situation depends on the nature of the transaction involved.

Creditor noncompliance with the provisions of the Act gives rise to a private damage action on behalf of the borrower.¹⁴ A borrower may recover an amount equal to twice the finance charge of the loan, subject to a minimum of \$100 and a maximum of \$1000. In addition, an aggrieved debtor is allowed to recover any actual damages and reasonable attorney's fees. This civil penalty provision was inserted by Congress to foster private enforcement, in an effort to aid governmental agencies in the monumental task of policing the consumer credit industry.

Courts have generally construed the Act liberally, so that it may accomplish its broad remedial purpose. The only Supreme Court decision, to date, arising under the Truth in Lending Act, *Mourning v. Family Publications Service, Inc.*,¹⁵ noted the basic effect of the Act: "The Truth in Lending Act reflects a transition in congressional policy from a philosophy of 'Let the buyer beware' to one of 'Let the seller disclose.'"¹⁶ Most courts in dealing with the Truth in Lending Act have expressly adopted this approach. Characteristic of this approach is a statement by the Fifth Circuit in *Thomas v. Myers-Dickson Furni-*

11 H.R. REP. No. 1040, 90th Cong., 1st Sess. (1967) '(to accompany H. R. 11601), reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1970-71.

12 15 U.S.C. §§ 1636-38 (1970). There are a number of exceptions to this rule. A creditor need not disclose the finance charge in dollars for a long-term mortgage on a residence. Also, the annual percentage rate need not be stated if the finance charge does not exceed \$5 and is applicable to an amount financed not exceeding \$75, nor if it does not exceed \$7.50 and is applicable to an amount financed exceeding \$75. 15 U.S.C. § 1638. The Act divides consumer credit into three categories: (1) "open-end credit" extended under a plan where the creditor permits a line of credit on a revolving basis, such as bank credit cards; (2) "closed-end sales" such as installment contracts; and (3) "closed-end loans" extended by banks or consumer finance companies. The loan in *Allen* falls into category (3), and this discussion is aimed principally at this category.

13 15 U.S.C.A. § 1631(a) (as amended, Supp. 1976). The Act also authorizes the Federal Reserve Board to formulate regulations to carry out the purposes of the Act in general. 15 U.S.C. § 1604 (1970).

14 15 U.S.C.A. § 1640 (as amended, Supp. 1976).

15 411 U.S. 356 (1973).

16 *Id.* at 377.

ture Company.¹⁷ Noting that the Act has formulated a system of private attorney generals to assist in enforcing the legislation, the court pledged its support to that system:

The regulatory scheme forcefully expounds an emerging ethic of "*caveat vendor*," and we will not strain to avoid giving effect to the Federal Consumer Credit Protection Act.¹⁸

The Meaningful Sequence Requirement

The Truth in Lending Act is a broad system regulating a complex area of the economy. Due to this complexity, and the knowledge that many schemes could be devised to circumvent a rigid set of congressional rules formulated in a statute which might not be amended for many years, Congress granted authority to the Federal Reserve Board to promulgate regulations enforcing the Act. Pursuant to this grant of authority, the Federal Reserve Board has issued numerous regulations which are collectively known as Regulation Z.¹⁹ Regulation Z serves to clarify the broad congressional directives found in the statute and attempts to adapt the law to changing economic conditions.

The Act also directs the Federal Reserve Board to adopt regulations which will define in greater detail the statutorily imposed "clear and conspicuous" disclosure requirements.²⁰ In response to this directive, the Board added a meaningful sequence requirement to the general disclosure section of Regulation Z.²¹ As used in the regulations, the Seventh Circuit has interpreted the meaningful sequence requirement to mean that "disclosure statements must use clear language arranged in an order which provides ease of comprehension."²²

The staff of the Federal Reserve Board has issued two Public Position Letters outlining its interpretation of meaningful sequence. The first, Public Position Letter No. 545,²³ did not define the requirements; rather the staff provided an example of what it believed to be a violation of meaningful sequence. In their view, it would be a violation "to scatter the disclosures of the various elements of the finance charge throughout the contract or agreement."²⁴ Additionally, this letter attempted to clarify the question of who bears the burden of proving whether the statement is in meaningful sequence. Although the creditor may meet the requirements of meaningful sequence in a "multitude of ways," Regulation Z does not prescribe how this may be accomplished. Consequently, the Federal Reserve Board's staff has indicated that, in their opinion, the burden is on the creditor to prove that his method adequately satisfies the meaningful disclosure requirement.²⁵

17 479 F.2d 740 (5th Cir. 1973).

18 *Id.* at 748 (emphasis in original).

19 12 C.F.R. § 226 (1976).

20 15 U.S.C.A. § 1631(a) (as amended, Supp. 1976).

21 12 C.F.R. § 226.6(a) (1976).

22 531 F.2d at 801.

23 [1969-1973 Transfer Binder] CON. CRED. GUIDE ¶ 30,759. For the full text of the letter, see R. GLONTZ, JR., TRUTH-IN-LENDING MANUAL at D-202 (4th ed. 1976).

24 *Id.*

25 *Id.*

The second letter, Public Position Letter No. 780,²⁶ defined meaningful sequence in terms of grouping items bearing an arithmetical relationship to each other:

A meaningful sequence would call for those items which are arithmetically related to appear within a reasonable proximity to each other, not mixed with items which are irrelevant to a progression of arithmetical computations or thought.²⁷

In these two letters the agency charged with overseeing the administration of the Act has examined meaningful sequence from both a negative and a positive standpoint. Both letters concentrate on the grouping of related terms; the second letter expressly forbids the mixing of items not relevant to a mathematical progression. Yet neither explicitly requires a sequential ordering of terms within the grouping of relevant items.

Few cases have discussed the requirements of meaningful sequence. The first case to do so in more than a cursory fashion was *Garza v. Chicago Health Clubs, Inc.*²⁸ The district court in *Garza* was faced with deciding the relative positions of default terms in a required disclosure statement. In holding that such terms must be placed "adjacent to or near other disclosures concerned with default,"²⁹ the court interpreted meaningful sequence to mean that "those disclosures which are logically related must be grouped together rather than scattered through the contract."³⁰ Thus, the court adopted the view, expressed in Public Position Letter No. 545, that the requirement applies to the grouping of all related terms. Since the terms in question were descriptive, the subject of arithmetical order was not reached.

A somewhat contrary view of the disclosure requirements was taken by another district court in *Barksdale v. Peoples Financial Corp.*³¹ There it was held that the meaningful sequence requirement addressed only those items having an "arithmetic relationship and interdependence requiring presentation in a logical progression of arithmetic computations or thought."³² Therefore, it did not require that the disclosure of the consequences of default be in relative proximity to, nor in any particular sequence with, the schedule of due dates, since those items were informative in nature and had no arithmetical interdependence.

The only court of appeals to discuss meaningful sequence in any depth, prior to the Seventh Circuit in *Allen*, was the Fifth Circuit in *Bussey v. Georgia Bank-america*.³³ In addressing the format of the periodic statement of a credit card issuer, the court found the disclosure to be adequate. Without any discussion of the history of meaningful sequence, the court held that the information satisfied the requirement since it was "logically itemized in arithmetical order."³⁴ The

26 [1976] 5 CONS. CRED. GUIDE (CCH) ¶ 31,102.

27 *Id.* at 66,490.

28 347 F. Supp. 955 (N.D. Ill. 1972).

29 *Id.* at 960.

30 *Id.* at 961.

31 393 F. Supp. 112 (N.D. Ga. 1975).

32 *Id.* at 116 (emphasis in original).

33 516 F.2d 452 (5th Cir. 1975).

34 *Id.* at 457.

copy of the statement reproduced in the opinion shows that the arithmetical information was in two sets of horizontal figures with no clear indication that the two were linked. In addition, a number of items interrupted the horizontal flow. Nevertheless, the court affirmed the findings of the special master that the statement provided meaningful disclosure. Significantly, the Fifth Circuit utilized an arithmetical sequence test, becoming one of the first courts to do so.

In *Allen*, the Seventh Circuit found that the statement provided by Beneficial was in violation of the sequence requirement.³⁵ It elicited two elements of meaningful sequence from prior authorities. The first was that disclosures which are logically related should be grouped together;³⁶ second, the terms within these groupings must be arranged in a "logically sequential order emphasizing the most important terms."³⁷

The Court initially found that the disclosure statement did not group together terms which were logically related. For example, the elements of the amount financed were scattered across the top half of the statement. This was aggravated by the proximate grouping of certain other terms which were not logically related. Additionally, the Seventh Circuit noted that the statement failed to describe the security interest in one continuous narration.³⁸ The description of security consisted of a check-box system and an explanation of the mechanics of that system.³⁹ It began in the upper right hand quarter of the statement. Inside a portioned-off rectangle were a set of boxes alongside the names of various types of assets. The appropriate box was to be checked to designate which type of asset was to be provided as collateral for the loan. The explanation of the box system was directly below the rectangle, but the description of the last item to be checked, the real estate mortgage, appeared in the middle of the page, starting at the left margin. The only indication given the reader that the latter explanation belonged to the box system was a heading entitled "Security (cont.)."

The Seventh Circuit next found that the form violated the second requirement of meaningful sequence as well: the statement did not contain a satisfactory ordering of the arithmetical terms within each group.⁴⁰ This was evidenced by the statement's treatment of the amount financed. The principal elements of this item were found in the middle of both columns among minor terms. The

35 531 F.2d at 802. The district court cited ten instances in which the statement violated meaningful sequence. 393 F. Supp. at 1384-85.

36 531 F.2d at 801.

37 *Id.*

38 *Id.* at 803. It is interesting that the court draws the reader's attention to the description of security on the form and merely states that the description does not provide an understandable statement. The Seventh Circuit, in *Tinsman v. Moline Beneficial Co.*, 531 F.2d 815 (7th Cir. 1976), found a similar description to be a violation of the Truth in Lending Act. Since Illinois law prohibited a security interest from arising unless the debtor acquires rights in them 10 days after the secured party gives value, the statement purporting to create a security interest in all consumer goods thereafter acquired is an inaccurate description of Illinois law. Indiana law is identical to Illinois law on this point. Compare ILL. REV. STAT. ch. 26, § 9-204(2) (1973) with IND. CODE § 26-1-9-204(4)(b) (1971). Hence, in *Allen*, Beneficial's statement of security is in and of itself a violation of the Truth in Lending Act. This, indeed, is perhaps the best evidence of the completely confusing nature of the statement that the Seventh Circuit highlighted the discontinuity in disclosure, yet failed to note its substantive inaccuracy.

39 See appendix for a facsimile of the disclosure statement.

40 531 F.2d at 803.

court concluded that there was a need for arithmetical progression, as shown by the confusion which resulted from this intermingling. This was underscored by the addition error of five cents which the Seventh Circuit adroitly pointed out.⁴¹

The court continued by examining the defendant's arguments relating to the sufficiency of the subtractational format employed in the statement.⁴² The court correctly noted that there were basic flaws in the defendant's presentation of the subtractational method. However, the Seventh Circuit did not base its decision on these errors; rather, the court attacked the method itself, finding the subtractational format inadequate as a matter of law.⁴³ It reasoned that the order of disclosure must correspond to the sequence in which a borrower visualizes a loan, so that the borrower can easily understand the terms of the contract.

There is little doubt as to the correctness of the Seventh Circuit's decision holding Beneficial's statement violative of the meaningful sequence requirement. The statement provided was confusing and failed to disclose in an understandable manner the essence of the transaction. However, the court's rationale was unnecessarily broad.

The particular question confronting the court concerned the logical order of the defendant's statement. In agreeing with the lower court's conclusion, the Seventh Circuit needed only to affirm that court's finding that the statement contained so many deviations from logical order that it effectively masked meaningful disclosure. However, the court continued its analysis and determined that even if the information in the statement had been displayed in the correct form, it would nevertheless have been inadequate because the subtractational method of presenting that information was itself insufficient under the law. Such a method fails to follow the conceptual framework in which people visualize a loan.⁴⁴ According to the court, the majority of people tend initially to focus on

41 *Id.*

42 By subtractational order, the defendant meant that the statement began with the amount of total payments, from which were subtracted the various charges, leaving the amount actually received by the borrower. For example:

Total of Monthly Payments

Less: Finance Charge

Insurance Costs

Amount Financed

Less: Refinancing of Prior Loan

Amount Received by the Borrower.

Id. at 804.

43 *Id.* The court summarily dismissed the defendant's contention that any defects in the form should be ignored because they resulted from the national computer system which the defendant employed. The Seventh Circuit reasoned that creditor convenience is not a defense, since the Act was passed to aid the borrower by requiring the lender to supply adequate information. The lender may not avoid the burden of designing forms which the borrower can understand by maintaining that its own computer prohibits this. The court further indicated its belief that the computer is capable of producing a printed form in a more comprehensible format through more intelligent programming, in any event if such programming is not possible, the necessary data can be transferred by hand to another, more intelligible, document.

The conclusion of this decision clearly places the Seventh Circuit in accord with those courts, principally the *Garza* court, that have interpreted meaningful sequence to require a grouping of related terms. As evidenced by its finding that the failure to disclose the terms of the security interest in a more comprehensible format violated the meaningful sequence requirement, the court rejected the *Barksdale* decision which limited that requirement to arithmetical terms.

44 *Id.*

the principal element of a loan. Progressing from there, the cognitive process looks to the interest figure and arrives at the total amount to be repaid.

Notwithstanding the court's rationale, there appears to be no valid reason for not upholding the subtractational order, if it is correctly displayed. Regulation Z requires "meaningful sequence"; there is no requirement that a specific format be followed. Furthermore, although the conceptual framework described by the court is, theoretically, the manner in which most people visualize a loan; it is not necessarily the only way people view the transaction. One of the reasons why Congress requires that monthly payments, as well as the finance charge, be stated in dollar amounts, is that many people, particularly those at the lower-income levels, do not make credit decisions based on interest rates. Rather, they decide whether to borrow primarily on the basis of repayment amounts, considering both total payments and monthly payments.⁴⁵ Under this approach, a consumer compares his available income with the prospective payment. Thus for those people who use such a budgeting process, the subtractational order would not only be adequate, but preferable.

The congressional intent to organize a flexible system of disclosure requirements so that the regulations could be adapted to varying circumstances was one of the primary reasons for giving the Federal Reserve Board the power to promulgate rules.⁴⁶ Since people analyze loans in different ways, prohibiting the subtractational method is contrary to the congressional intent to organize such a flexible system. Allowing the subtractational method, when properly implemented and in logical sequence, would permit the creditor to disclose in an order which reflects the manner in which many people actually visualize a loan. The regulation does not purport to require a particular meaningful sequence; once it has been demonstrated that the order is meaningful to a sizeable segment of the population it should be left to the legislature, or its agencies, to determine if that order will suffice. Nevertheless, the Seventh Circuit concluded as a matter of law, without discussion of empirical evidence, and in direct conflict with the congressional intent and the testimony before the legislative committees regarding the consumer's use of the data, that the subtractational method was inadequate. Additionally, it unreservedly accepted the views expressed in the Public Position Letters of the Federal Reserve Board's staff. Specifically, this endorsement included the imposition on the creditor of the burden of proving that his statement adheres to the meaningful sequence requirement. Finally, *Allen* reinforces prior authorities by demanding a logically sequential order with the most important terms emphasized.

Allen clearly follows the recent trend of courts in giving effect to the Truth in Lending Act's broad remedial purpose by requiring the creditor to comply with ever increasing regulations. This trend has several important implications. First, the imposition of stricter and more numerous requirements should produce more comparable statements from the various creditors. This greater uniformity of disclosure, which is the primary goal of the Act, is presumed to start a chain

⁴⁵ See NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 172, 174-75, 182-83 (1973).

⁴⁶ H.R. REP. NO. 1040, 90th Cong., 1st Sess. (1967) (to accompany H. R. 11601), reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1986-87.

reaction: uniformity will promote consumer shopping; shopping will encourage competition; competition will lower the cost of credit. Additionally, the short-term cost of disclosure will be increased by the imposition of stricter disclosure requirements and by the authorization of recovery even when there is no actual damage. The increased costs resulting from these additional sanctions will naturally be passed on to all consumers in the form of higher interest rates.

Furthermore, despite *Allen's* compatibility with the purposes of the Truth in Lending Act, it leaves the creditor in an uncertain position. Although told that the subtractive method of presenting information will not suffice, the creditor has not been provided with a precise indication of how to comply with the regulation. In refuting the order used by Beneficial, the court has suggested a possible format: principal plus interest equalling total payments. The question remains, however, whether this is adequate, or commercially practicable, for the infinite number of differing transactions which must comply with the statute.

Coupled with this uncertainty, the credit industry is also affected by the burden which is imposed on the creditor to prove that his statement is in compliance with the law. For all practical purposes, the creditor now must prove that his statement satisfies the disclosure requirements. Naturally, the ultimate result of these burdens will be increased costs to the consumer. Deciding whether to impose these requirements involves a balancing of the costs, both short-term and long-term, with the expected benefits to the public. This balancing, however, should be resolved by the legislature. Its decision, as reflected in the Truth in Lending Act, is to increase the requirements in the expectation that costs will decrease over the long run. Since Congress and the Federal Reserve Board have left the particular issues involved in *Allen* unresolved, the Seventh Circuit has attempted to decide the questions in a manner consistent with that general legislative decision.

Separate Recovery by a Co-obligor

The purpose of the Truth in Lending Act is to require lenders to disclose to borrowers information relevant to the financial decision involved. The Act thus requires each creditor to disclose this information "to each person to whom consumer credit is extended."⁴⁷ When there is more than one obligor, creditor need not furnish a "statement of information required under this part . . . to more than one of them."⁴⁸ Regulation Z adds a condition that the one to whom the statement is given be "other than an endorser, comaker, guarantor, or a similar party."⁴⁹

The Truth in Lending Act is designed by Congress to enhance disclosure by private enforcement of the law. This is necessitated by the vast number of loans extended each year.⁵⁰ While primary enforcement of the Act is delegated to administrative agencies, the size of the task prompted Congress to reinforce

47 15 U.S.C.A. § 1631(a) (as amended, Supp. 1976).

48 15 U.S.C.A. § 1631(b) (as amended, Supp. 1976).

49 12 C.F.R. § 226.6(e) (1976).

50 See H.R. REP. No. 1040, 90th Cong., 1st Sess. (1967) (to accompany H.R. 11601), reprinted in [1968] U.S. Code Cong. & Ad. News 1962, 1966-69.

such a procedure with a system of private enforcement.⁵¹ Thus a section providing for recovery of a civil penalty by the aggrieved debtor was included.

Allen serves to emphasize the problem which confronts a court in attempting to balance the various considerations necessarily involved under the Act. On the one side, the interest in inducing private litigation to enforce the law is furthered by permitting multiple recoveries. Contrastingly, since a party is allowed to recover the statutory penalty without suffering any actual damages, the interest in avoiding windfall profits requires that only a single penalty be recovered. Also, allowing multiple recoveries may result in excessively punitive penalties when only a single violation occurs.

The ambiguity of the statutory language has resulted in a division of the courts on this point. The problem has arisen because of divergent interpretations of the general disclosure section:

§ 1631. Disclosure requirements—Clear and conspicuous disclosure to person extended consumer credit

(a) Each creditor shall disclose clearly and conspicuously, in accordance with the regulations of the Board, to each person to whom consumer credit is extended, the information required under this part or part D of this subchapter.

Statement of information where more than one obligor

(b) If there is more than one obligor, a creditor need not furnish a statement of information required under this part or part D of this subchapter to more than one of them.⁵²

In *St. Marie v. Southland Mobile Homes, Inc.*,⁵³ a district court equated "statement of information" with the requirement to disclose. Accordingly, the court concluded that since subparagraph (b) requires only one statement to co-obligors, the creditor had failed to disclose only to that obligor to whom the statement was given.⁵⁴ Hence, the creditor was only liable to that obligor. However, the court emphasized that the two plaintiffs were husband and wife.⁵⁵ It theorized that they received the disclosures as a family unit, rather than as two separate debtors. It specifically left open the question of whether two unrelated co-obligors would be allowed separate recoveries.

In *Burrell v. City Dodge, Inc.*,⁵⁶ another district court denied separate recoveries after reviewing the legislative history of the Act. *Burrell* began by noting that the Act limited liability to \$1000 or twice the finance charge "in connection with any consumer credit transaction." It interpreted this phrase as showing that the emphasis "is on the transactional liability of the creditor, not on recovery by the consumer."⁵⁷ Furthermore, the court noted that it would

51 *Id.* at 1975-76.

52 15 U.S.C.A. § 1631 (as amended, Supp. 1976).

53 376 F. Supp. 996 (E.D. La. 1974).

54 *Id.* at 996-97.

55 *Id.* at 997.

56 [1976] 5 CONS. CRED. GUIDE (CCH) ¶ 98,764 (N.D. Ga. 1974).

57 *Id.* at 88,390.

have been relatively easy for Congress to express an intent to allow separate recoveries. Thus, faced with this statutory limitation allegedly allowing no exception, the court concluded that Congress intended only a single recovery.

After analyzing the legislative history, the court reasoned that Congress intended to penalize the errant creditor, but limited that penalty to one for each transaction. Since Congress was not attempting to compensate the consumer for loss, the measure of the penalty should be in terms of the creditor. It also pointed out that nothing in the Act prohibited the additional recovery of actual damages.⁵⁸

The court then countered the argument premised on an interpretation of the penalty as liquidated damages. Even if the penalty were designed to measure the loss, the number of obligors involved would have no bearing on the amount of damages, since the loss that the penalty presumably liquidates would be the difference between the cost of the credit actually extended and the cost of alternative credit. However, the court stated, the lost opportunity has the same value regardless of the number of co-obligors. Thus the liability of the creditor should be limited to one joint recovery by the co-obligors. Since potential liabilities would be enormous, the court would not extend the penalties beyond those explicitly provided for in the Act without a clear mandate. Most courts which have denied separate recoveries have relied upon *Burrell*; however, its precedential value has been undermined by the 1974 amendments to the Act.

After the decision in *Burrell*, Congress amended § 1640, the civil liability section. The phrase "in connection with any consumer credit transaction," upon which the *Burrell* court built its argument, was replaced by "with respect to any person."⁵⁹ This amendment is significant because it manifests the intent of Congress to determine liability based upon the persons borrowing rather than upon the "transactional liability of the creditor."

Consequently several courts before *Allen* have allowed separate recoveries for co-obligors. These courts have read the language of the civil liability section as clearly imposing liability on "any creditor . . . to any person," and providing no limitation on such liability. For example, in *Rivers v. Southern Discount Company Atlanta II*,⁶⁰ the district court reasoned that although the creditor is only required to furnish the statement to one borrower, it is assumed by all parties that all the borrowers will be able to view that statement. If that copy is incorrect, then each borrower has received inadequate disclosure. The court further noted that since two signatures were required by the lender, the spirit of the Act requires sufficient disclosure to both. Clearly the result of any inaccuracy in even the single statement would be the deception of each borrower and, consequently, the suffering of damages by each.

The Seventh Circuit in *Allen* adopts this same approach. First, the court states that Congress did not intend to limit the general disclosure requirements

⁵⁸ After the *Burrell* decision, Congress amended § 1640 and specifically added actual damages to the list of recoverable damages. 15 U.S.C.A. § 1640(a)(1) (as amended, Supp. 1976).

⁵⁹ Compare 15 U.S.C. § 1640 (1970) with 15 U.S.C.A. § 1640 (as amended, Supp. 1976).

⁶⁰ [1976] 5 CONS. CRED. GUIDE (CCH) ¶ 98,796 (N.D. Ga. 1973).

of subparagraph (a) by only requiring one statement.⁶¹ Rather, the disclosure would be made to all, even though there was only one statement. As the *Rivers* court noted, there was no evidence that not all the borrowers were to view the one statement furnished.

The Seventh Circuit was most persuaded by the variations in the language employed in the section.⁶² Subparagraph (a) requires a creditor to "disclose" to each borrower;⁶³ subparagraph (b), on the other hand, requires a creditor to provide only one "statement of information."⁶⁴ The court points out the meaningful difference in this language:

Congress did not say disclosure need only be given to one of multiple obligors. Nor did it say that recovery may only be had by one. It said a "statement of information" need only be furnished to one of multiple obligors.⁶⁵

The court further concluded that since the description of subparagraph (b) is discussed only in the committee report, under a section entitled "Methods of Disclosure," Congress merely meant this section to facilitate compliance by reducing paperwork.⁶⁶ In fact, the legislative history of the Act expressly describes the purpose of the subparagraph as being "to reduce needless paperwork. . . ."⁶⁷ Thus the court correctly found no attempt to reduce disclosure requirements.

Moreover, the court indicated that even if disclosure need be made to only one borrower, recovery by other obligors is not thereby foreclosed. "Congress could have expected all obligors to be protected by proper disclosure to only one in that the one who received disclosure would certainly take the best credit terms available."⁶⁸ Improper disclosure to one would therefore harm all the obligors.

This view is seemingly undermined by a portion of the House Report on the Act. In a general description of the penalty provisions of the Act, the legislative history describes the effect of the penalty:

61 531 F.2d at 805. A further consideration which has swayed these courts is the system of private attorneys general envisioned by the Act. The legislature created a private cause of action for violation of the disclosure requirements to provide an incentive to consumers to report infractions. This consumer action would then greatly assist the governmental agencies in enforcing the Act.

62 *Id.* at 806.

63 15 U.S.C.A. § 1631(a) (as amended, Supp. 1976).

64 15 U.S.C.A. § 1631(b) (as amended, Supp. 1976).

65 531 F.2d at 806.

66 *Id.*

67 H.R. REP. NO. 1040, 90th Cong., 1st Sess. (1967) (to accompany H.R. 11601), reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1984.

68 531 F.2d at 805. The Seventh Circuit, in a later case, *Mirabal v. General Motors Acceptance Corp.* Nos. 75-1048, 75-1049, 75-1050, slip op. (7th Cir. March 26, 1976), quoted extensively from *Allen*. The court also gives further arguments in the form of "practical considerations." *Id.* slip op. at 17. First, the creditor is gaining additional security by requiring two signatures. The court sees it as appropriate to proportion punishment for failure to disclose to the security obtained. Second, administrative problems would arise where only one obligor sued. For instance, the statute does not discuss who could sue, and how much one would be entitled to recover. From this the court concludes Congress did not anticipate the problem—presumably because it expected separate recoveries.

Any creditor failing to disclose required information would be subject to a civil suit with a penalty equal to twice the finance charge, with a minimum penalty of \$100 and a maximum penalty not to exceed \$1,000 on any individual credit transaction.⁶⁹

While this language could be interpreted as limiting liability under the Act to \$1000 on any loan, it seems as if the Seventh Circuit was correct, in a later case, in disregarding it in considering multiple recoveries.⁷⁰ There are four reasons for this conclusion. First, the language appears in a general description of the Act and is not specifically aimed at the question of multiple recovery. Second, a situation in which two (or more) persons co-sign can be interpreted as two individual credit transactions. The creditor is doing business with two individuals; conversely, both borrowers are liable to the creditor. Third, in the same paragraph the House Report implies that Congress intends to allow any party to the transaction a separate recovery.⁷¹ In the sentence following the discussion of the \$1000 limitation, the Report states the exemption of credit advertising from the application of civil penalties. It then describes the purpose of the exemption:

This exemption has been written into the bill by your Committee to avoid the possibility that anyone, not a party to an actual transaction, seeing an advertisement not complying with the disclosure requirements of the bill would attempt to seek civil penalties.⁷²

This indicates an intent to use status as a party to the transaction as a major test for recovery under the Act, thus implicitly allowing recovery by all parties to a transaction which violates the disclosure requirements. Additionally, the exemption of credit advertising implies that Congress foresaw multiple recoveries; because Congress did not exempt recoveries under co-obligor situations, one can infer that Congress condoned such recovery. Four, Congress amended the civil liability provision, § 1640, changing "with any consumer credit transaction" to "with respect to any person," thus arguably indicating an intent to clarify liability. Instead of using the transaction as the yardstick, the new law expressly looks to those persons to whom disclosure is required. This reorientation strongly implies a congressional intent to allow recovery by all persons actually involved in the transaction.

Allen, as the first court of appeals decision to expressly address the question of separate recoveries by co-obligors, should add substantial weight to the deci-

69 H.R. REP. No. 1040, 90th Cong., 1st Sess. (1967) (to accompany H.R. 11601), reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1976.

70 *Allen* did not cite the legislative history involved. However, *Mirabal* did cite it.

71 H.R. REP. No. 1040, 90th Cong., 1st Sess. (1967) (to accompany H.R. 11601), reprinted in [1968] U.S. CODE CONG. & AD. NEWS 1962, 1976.

72 *Id.*

sions of those district courts which have reached a similar conclusion.⁷³ The possible damage to all obligors who co-sign entitles them to individual recovery; since they expose themselves to liability under the loan, and possible loss from inadequate disclosure of credit terms, they should each be afforded full protection. Moreover, since the civil liability provision is designed to promote compliance with the Act, separate recoveries will certainly further that purpose by increasing the incentive to comply with the law. Thus, the decision to allow separate recoveries promotes the accomplishment of the purposes for which the statute was enacted.

Conclusion

There can be little doubt that the decision by the Seventh Circuit in *Allen*, holding the disclosure statement of Beneficial violative of the meaningful sequence requirement of Regulation Z, is correct. The statement fails to convey the terms in an understandable order. However, the court's statement that the subtractational order of presentation was inadequate as a matter of law is suspect. There is no basis for requiring one specific order; in fact, such a holding contradicts the congressional attempt to construct a flexible disclosure system. The ruling adds to the difficulty creditors encounter in striving to design adequate statements for varying, complex transactions. It also decreases the incentive for innovation in designing forms to convey the information in a more comprehensible fashion. However, this ruling results in at least one benefit to the creditor: the uncertainty surrounding adequacy of disclosure is decreased by the total prohibition of the subtractational method.

The ruling to allow a co-obligor to recover, absent the presence of the other obligor, is not so easily evaluated. Faced with conflicting legislative history and statutory provisions, the federal courts have divided on the question. Considering the overall purpose of the Act, including its attempt to motivate private parties to assist the government in enforcing the law, the Seventh Circuit selected the better reasoned approach in allowing a separate recovery.

Realistically, Congress never foresaw the precise problem raised by *Allen*. Although the practice of requiring co-signatures on a loan is fairly commonplace, especially when the borrower is married, there is no statutory language or legislative history which expressly addresses this issue. *Allen* attempts to resolve this problem in the manner which most closely adheres to the overall purpose of the Act.

Patrick J. Crotty

⁷³ Since the decision in *Allen* two courts have refused to allow separate recoveries under the amended Act. The District Court for the Eastern District of Louisiana, in *Gillard v. Aetna Fin. Co., Inc.*, 414 F. Supp. 737 (E.D. La. 1976), refused to grant separate recoveries, on the grounds that such recoveries had been allowed by other courts only when a right of rescission entitled each obligor to a separate statement. The Fourth Circuit, in *Powers v. Sims & Levin*, 542 F.2d 1216 (4th Cir. 1976), refused to grant a separate recovery, even when the right to rescission required disclosure to each obligor. The court relied entirely on the legislative history of the Act which stated that the maximum penalty on any individual transaction was to be \$1000. Since it saw only one credit transaction, it granted only one recovery. The court noted that the statute read literally does provide that a creditor is liable to any person to whom disclosure of any information is required. However, it decided to forego literal application of the statute in favor of its interpretation of the legislative history.

Appendix*

STATEMENT OF DISCLOSURE AND LOAN REGISTER

As shown hereon, the amount shown below as the Total of Payments, which is the Amount Financed plus the Finance Charge, is payable in successive monthly instalments of principal and charges combined. The Number of instalments and the amounts of the 1st Instalment and the Other instalments are set forth below. The first of said instalments is payable on the 1st Due Date shown below and each subsequent instalment on the same day of each succeeding month thereafter, the final instalment being due and payable on the Final Due Date shown below. The sum of the instalments is shown below as the TOTAL OF PAYMENTS.

LENDER:

Account no. Type Sequential Number
Name & Mailing Address of Borrower(s) Spouse
Residence Address ← if not the same
Date of Loan 1st Due Date Final Due Date 1st Instal. Other Instal. Payable in Monthly Instal.

SECURITY: The security for this loan is checked below:

Security Agreement dated

on [] Furniture Yr. Make
on [] Auto

[] Accommod Maker [] Real Estate Mortgage

INSURANCE IS INCLUDED IF COST OR PREMIUM IS INSERTED TO THE LEFT HEREON.

\$ TOTAL OF PAYMENTS \$ Unpaid Balance—Prior Loan
\$ Precomputed Charges \$ Precomputed Charges
\$ FINANCE CHARGE \$ Time Price Differential
1. AMOUNT FINANCED \$ Other
3. Disability Ins. Cost \$ Disability Ins. Cost
4. Life Ins. Cost \$ Life Ins. Cost
5. Hshld. Conts. Ins. Prem. 2. Net Balance—Prior Loan
6. Dwelling Ins. Prem. Nature of Security
7. Auto. Phys. Dam. Ins. Prem. % ANNUAL PERCENTAGE
8. Filing Fees—UCC Forms RATE
9. Certificate of Title Fees \$ Default Charge

If the box alongside the word "Furniture" is checked, the Security Agreement identified by the date shown hereon covers all of the consumer goods of every kind then owned or thereafter acquired by the Borrowers in replacement thereof and then or thereafter located at the Borrowers' place of residence set forth hereon. Such Security Agreement secures future advances or loans made by Lender to Borrowers, at Lender's option, within eight years of the date of such Security Agreement.

At the direction and request of the Borrowers, on their behalf and for their benefit, the Lender has disbursed, from the Amount Financed, the proceeds of loan for Items 2 through 9 shown to the left hereof and for those items shown below as follows:

10. Closing Costs-Real Estate	\$	_____
11. To:		_____
12. To:	\$	_____
13. To:	\$	_____
14. To:	\$	_____
Cash or Check Delivered to Borrowers	\$	_____
(Line 1 less sum of lines 2 through 14)		

SECURITY (cont.)

If the box opposite the description "Real Estate Mortgage" in said Security section is checked, this loan is secured by a mortgage on real property owned by the Borrowers which is the Borrowers' place of residence shown unless otherwise identified below.

Property Other Than Borrowers' Residence

* Merely a representation of the original agreement.

IV. Legal Profession

ATTORNEYS' FEES AWARDS—FEE-SHIFTING UNDER THE BAD FAITH EXCEPTION—LIMITATIONS ON FEDERAL COURTS' POWERS

*Bond v. Stanton**

In cases of public interest litigation, attorneys' fees often surpass the average client's ability to pay. In appropriate cases, federal courts may provide relief by invoking special judicial powers to allocate attorneys' fees between parties to a suit. The limitations of these powers, however, are not altogether clear.

The Seventh Circuit in *Bond v. Stanton*¹ affirmed the liberal exercise of fee-shifting power by a lower court. This decision evidenced the current trend toward a more generous use of attorneys' fees awards. However, in so deciding, the Seventh Circuit's holding served to further obscure the bounds of federal court's fee-shifting powers.

Bond v. Stanton involved an injunction suit brought under Title 42 U.S.C. § 1983² by Indiana citizens and welfare assistance organizations against state officials to compel state compliance with federal welfare regulations. Plaintiffs initiated the proceeding in the Federal District Court for the Northern District of Indiana. The action sought to enjoin State Commissioner of Welfare, Wayne Stanton, and other state welfare officials in their individual and official capacities, from denying plaintiffs' civil rights by failing to implement Medicaid programs in a timely manner. It was alleged that state officials had failed to meet a July 1, 1973 Medicaid Program deadline requiring full implementation of an early and periodic screening, diagnosis and treatment program (EPSDT) for persons under the age of twenty-one.³

Both parties moved for summary judgment; plaintiffs alleged non-compliance, and defendants, though conceding that full implementation of the specific program had not been effectuated, argued that plaintiffs had received more than an adequate amount to provide for the health care needs of their children.

The district court found that state officials had made ascertainable progress toward implementing a statewide program in only eight pilot counties. Accordingly, the district court granted plaintiffs' motion for summary judgment and ordered state officials to bring the program within substantial compliance of the federal regulations by July 1, 1974.⁴

In addition to requiring injunctive relief, the plaintiffs sought reimbursement of attorneys' fees. Their request was reserved by the district court in its opinion on the merits and was subsequently treated in an unpublished order.⁵ That order provided that an amount of \$2,366 would be assessed against the de-

* 528 F.2d 688 (7th Cir.), cert. granted, 426 U.S. 905 (1976).

1 *Id.*

2 42 U.S.C. § 1983 (1970).

3 Authorization of Appropriations, 42 U.S.C. § 1396(a)(4)(B) (1970), and regulations pursuant thereto, 45 C.F.R. § 249.10(a)(3)(19) (1976).

4 372 F. Supp. 872 (N.D. Ind.), *aff'd*, 504 F.2d 1246 (7th Cir. 1974).

5 *Bond v. Stanton*, No. 75—(N.D. Ind. 1975).

defendants in their official capacities. The district court noted two grounds for the award: the "private attorney general theory" and the "bad faith exception."⁶ The defendants appealed, challenging the constitutionality of this award.

On appeal, apart from the question of whether such an award against state officials violated the eleventh amendment of the United States Constitution,⁷ the Seventh Circuit examined the grounds on which the award for attorneys' fees were made. Citing language from the district court's opinion, the Seventh Circuit noted evidence of bad faith which supported an exercise of fee-shifting powers:

The bad faith which is the basis for the award may be in conduct which necessitates the action or in conduct occurring in the course of action. The defendant state officials, disregarding their clear legal duty, were, in the words of the district court, "more than two years late in even attempting to implement a statewide EPSDT program." It was this conduct which necessitated the present injunctive suit. [Citations omitted] In addition, defendants, after the suit was filed "continually asserted compliance with HEW requirements in the face of documentation to the contrary."⁸

While the court was ultimately forced to dismiss the private attorney general grounds for the award under *Alyeska Pipeline Co. v. Wilderness Society*,⁹ it determined that fee-shifting could be justified solely on the basis of the bad faith exception.

An examination of the application of the bad faith exception in recent years by federal courts indicates a gradual trend toward broadening the exception beyond its original scope. The Seventh Circuit in *Bond* also demonstrated a willingness to expand the scope of the bad faith exception. However, in light of the *Alyeska* decision, which sharply criticized judicial expansion of fee-shifting doctrines, it is questionable whether a continued broadening of the exception is to be permitted.

Alyeska and the Status of the Fee-shifting Doctrines

The Supreme Court decision in *Alyeska Pipeline Co. v. Wilderness Society* made a significant step toward clarifying the availability of attorneys' fees awards to prevailing litigants in federal courts. This ruling effectively halted use of the private attorney general theory grounds for assessing attorneys' fees against the losing party to a lawsuit. The private attorney general approach, which had gained increasing favor among the federal circuit courts prior to *Alyeska*, was a fee-shifting doctrine available to prevailing litigants who were deemed to have

⁶ *Id.*

⁷ The Seventh Circuit held that such fee-shifting against state officials in their official capacities was not violative of the eleventh amendment of the Constitution. The court regarded as controlling a summary affirmance by the Supreme Court in *Sims v. Amos*, 409 U.S. 942 (1972), citing *Hicks v. Miranda*, 422 U.S. 332, 334-45 (1975), for the proposition that even summary decisions of the Supreme Court are to be regarded as binding on the lower federal courts. In so doing, the Seventh Circuit neatly avoided a difficult issue which has split the circuits. The disagreement among the circuits on the question is described but not resolved in the *Alyeska* opinion. See *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y.*, 421 U.S. 240, 269 n.44 (1975).

⁸ 528 F.2d at 690.

⁹ 421 U.S. 240.

furthered the interests of a significant class of persons by bringing litigation which effectuated a strong congressional policy.¹⁰

In curtailing use of the private attorney general theory, the *Alyeska* Court reserved comment on the so-called American rule,¹¹ as applied to public interest litigation, but warned that it was not judicial prerogative to dissipate this fundamental rule. The American rule requires that litigants be responsible for payment of their respective attorneys' fees. Its rationale is to permit parties to seek vindication of their rights in a court of law without being deterred by the possibility of having to bear the financial burden of their opponent's attorneys' fees.¹² The American rule stands in contrast to traditional English procedure in which fees are regularly assessed against the losing party.

While the *Alyeska* Court prohibited further use of the private attorney general theory without express congressional sanction, the decision noted the availability of three traditional exceptions to the American rule: first, when a "common fund" is involved; second, when a litigant's conduct is vexatious, harassing, or in bad faith; and third, when a court order is willfully disobeyed.¹³ Thus after *Alyeska*, failure to justify fee-shifting under one of these authorized exceptions precludes the award of fees to prevailing litigants.

During the life of the private attorney general theory the awarding of attorneys' fees became increasingly common in lower federal courts, especially in public interest litigation.¹⁴ The combination of two factors explained this phenomenon. First, the relatively broad and flexible grounds provided by the private attorney general theory gave courts wide discretion to shift fees. Second, civil rights suits often involve compelling equities when private citizens without large financial resources confront state officers who are backed with unlimited state funds. *Alyeska's* elimination of the private attorney general theory compels federal courts desirous of sustaining equitable awards to justify fee-shifting under one of the remaining exceptions. Since these exceptions have been customarily narrower and more stringent than the private attorney general theory, federal courts undoubtedly feel the parameters within which they can award attorneys' fees greatly restricted.

Significant among the remaining exceptions to the American rule is the so-called bad faith exception. As noted by the *Alyeska* Court, this traditional exception permits the awarding of attorneys' fees against a litigant who has acted in bad faith. In recent civil rights suits the bad faith exception has frequently been relied upon either as an alternative, or as a supplement to the private at-

10 See *Brandenburger v. Thompson*, 494 F.2d 885, 888 (9th Cir. 1974). See also *Newman v. Piggie Park Enterprises, Inc.*, 390 U.S. 400 (1968) (per curiam) (doctrine originally announced).

11 421 U.S. at 257, citing *Fleishmann Distilling Corp. v. Maier Brewery*, 386 U.S. 714, 718 (1966); *Hall v. Cole*, 412 U.S. 1, 4 (1972).

12 With respect to public interest litigation, however, the American Rule tends to have the opposite effect. In that context, the American Rule works to deter lawsuits brought by low income citizens who seek vindication of their federally guaranteed rights. As a result, federal courts have sought to expand the exceptions to the American Rule out of a sense of equity and fairness. One of these ways was by means of the private attorney general theory.

13 See 421 U.S. at 258-59. See generally Note, *Attorneys' Fees and the Eleventh Amendment*, 88 HARV. L. REV. 1875 (1975).

14 See cases cited at 421 U.S. at 270 n.46.

torney general theory as justification for attorneys' fees awards against losing parties.

Generally, the trial court is granted broad discretion in awarding fees on the basis of bad faith. Barring clear failure of the evidence to support the award, the decision usually will not be overturned.¹⁵ Notwithstanding this broad prerogative, however, when a trial court has gone beyond the limits prescribed by the bad faith exception, the award of attorneys' fees will be reversed on review.¹⁶ Despite evidence which failed to satisfy the usual standards of the exception, the Seventh Circuit sanctioned its application in *Bond*. The bad faith exception has two aspects which govern its application; the level of bad faith conduct which triggers the award and the timing of the bad faith in relation to the litigation.

Traditional Requirements of the Bad Faith Exception

1. Appropriateness of the Circumstances

The judiciary's power to shift attorneys' fees under the bad faith exception is thought to be derived from the inherent equity powers of the court.¹⁷ All fee-shifting engaged in by American courts under this authority has been regarded as an exception to the fundamental American rule. Traditionally, judicial exceptions have been kept guardedly narrow in order to preserve the American rule's basic rationale. In general, equitable exceptions to the American rule are limited to extraordinary situations involving "compelling circumstances and overriding considerations of justice."¹⁸

The bad faith exception is one such traditional equitable exception. Customarily, fee-shifting under this exception has been reserved for contumacious conduct of litigants before a court. Its rationale is basically punitive.¹⁹ The purpose, of course, is to deter abuse and misuse of the judicial forum.

The type of conduct which warrants invoking the exception is most commonly expressed by one of two formulas. First the use of the exception is proper when a party has acted in "bad faith, vexatiously, wantonly, or for oppressive reasons."²⁰ Second is a formulation first articulated by the Fourth Circuit in its *Bell-Bradley* line of school desegregation cases. The court there stated that bad faith conduct exemplifies "unreasonable, obdurate obstinacy" or "persistent

15 *Brewer v. School Board*, 456 F.2d 943, 947 (4th Cir. 1972), *cert. denied*, 409 U.S. 892 (1972).

16 *See Satoskar v. Indiana Real Estate Comm'n*, 517 F.2d 696, 698 (7th Cir.), *cert. denied*, 423 U.S. 928 (1975).

17 412 U.S. at 4-7. Also see the full discussion of federal courts' power of equity to award counsel fees in *Guardian Trust Co. v. Kansas City So. Ry. Co.*, 28 F.2d 233, 241-42 (8th Cir. 1928), where authorities are collected and analyzed.

18 456 F.2d at 948. Also espoused by the Supreme Court is the restriction that fee-shifting be reserved for "exceptional cases and for dominating reasons of justice." *Sprague v. Ticonic Nat. Bank*, 307 U.S. 161, 167 (1939). *See generally* 6 MOORE, FEDERAL PRACTICE ¶ 54.77 [2] (2d ed. 1972).

19 412 U.S. at 15; *Incarcerated Men of Allen County v. Fair*, 507 F.2d 281, 284 (6th Cir. 1974). *Accord Heucker v. Milburn*, 538 F.2d 1241, 1245 n.9 (6th Cir. 1976); *Class v. Norton*, 505 F.2d 123, 127 n.1 (2d Cir. 1975).

20 *F.D. Rich Co. v. Industrial Lumber Co.*, 417 U.S. 116, 129 (1973), *citing* *Vaughan v. Atkinson*, 369 U.S. 527 (1962). 6 MOORE, FEDERAL PRACTICE ¶ 54.77 [2] (2d ed. 1972).

defiance of the law."²¹ While reciting these formulas offers some help in determining the level of conduct traditionally required and considered to be exceptional, an examination of actual civil rights cases, in which the bad faith exception has most frequently been invoked, better illustrates the required standard.

The *Bell-Bradley* line of desegregation cases provides numerous examples of bad faith conduct. In *Bell v. School Board*,²² the Fourth Circuit affirmed application of the bad faith exception on the basis of vexatious and obstinate behavior of school officials who were resisting school desegregation. The trial record disclosed:

There was a persistent purpose and plan on the part of the defendants to deny the plaintiffs their constitutional rights . . . [W]e must take into account the long continued pattern of evasion and obstruction which included not only the defendants' unyielding refusal to take any initiative, thus casting a heavy burden on the children and their parents, but their interposing a variety of administrative obstacles to thwart the valid administration wishes of the plaintiffs for a desegregated education. To put it plainly, such tactics would in any other context be instantly recognized as discreditable.²³

Similarly in *Tohen v. Jenkins*,²⁴ another school desegregation case, the Fourth Circuit found that once suit had been filed, defendants continuously blocked all avenues of compromise and fully litigated every detail to the delay and detriment of the plaintiffs.²⁵ Defendants failed on numerous occasions to cooperate with plaintiffs' counsel and the court.²⁶ The court noted two specific instances of unreasonable litigation tactics: an appeal of a consent order entered at the defendant's own suggestion; and insistence on an incorrect procedural position to prolong the trial.²⁷ The *Tohen* court assessed attorneys' fees, classifying this behavior as "obdurate obstinacy."

Voting reapportionment cases involving similarly egregious forms of racial discrimination often provide adequate findings of bad faith. In *Sims v. Amos*,²⁸ a federal district court in Alabama assessed attorneys' fees against Alabama state officials on the basis of the bad faith exception and the private attorney general theory. That suit was the culmination of ten years of repeated court orders and class actions against the state legislature to compel reapportionment.²⁹ In addition to repeated deliberate refusals to obey prior court orders, the state officers were shown to have deliberately presented unacceptable plans to prolong litigation,³⁰ thus causing plaintiffs to incur legal fees in excess of \$14,800.

Examples of bad faith conduct which justify fee-shifting, however, are by no means limited to cases of racial discrimination. In *Stolberg v. Members of the*

21 456 F.2d at 949 (cases in accord therein collected). Noteworthy is that this formula has never been reviewed by the Supreme Court despite its wide and repeated usage.

22 321 F.2d 494 (4th Cir. 1953).

23 *Id.* at 500.

24 517 F.2d 3 (4th Cir. 1975).

25 *Id.* at 6.

26 *Id.*

27 *Id.* at 6-7.

28 340 F. Supp. 691 (M.D. Ala. 1972), *aff'd mem.*, 409 U.S. 942 (1972).

29 336 F. Supp. 924, 930 (M.D. Ala. 1972).

30 340 F. Supp. at 694.

Board of Trustees,³¹ the Second Circuit affirmed an award of attorneys' fees under the bad faith exception. The court noted that the litigation, concerning the unjustified dismissal of a public employee, had been vigorously opposed by the defendants, who prolonged the discovery and trial for two years.³² Moreover, the court found that the defendants had deliberately suppressed the plaintiffs' first and fourteenth amendment rights in clear violation of two Supreme Court rulings.³³

Similarly, in *Gates v. Collier*,³⁴ the Fifth Circuit awarded over \$42,000 in attorneys' fees pursuant to this equitable exception. The inmate-plaintiffs in that case claimed that: (1) operation of Mississippi prisons subjected them to conditions and practices which amounted to cruel and unusual punishment; and (2) regulations on mail were in violation of their first amendment rights under the Constitution. The district court found that in addition to persistent racial discrimination and abuse, defendants continually sought extensions and delays to avoid compliance with a district court order.³⁵ Additionally, defendants repeatedly submitted plans requested by the district court that were inadequate.³⁶ Furthermore, they unyieldingly adhered to a position of denial, compelling the plaintiffs to undergo extensive pre-trial discovery involving interviews of hundreds of witnesses.³⁷

In support of its own affirmance of the application of the bad faith exception, the Seventh Circuit in *Bond* relied on *Doe v. Poelker*.³⁸ In that case, plaintiffs sought to enjoin enforcement policies and procedures of St. Louis city hospitals which effectively barred abortions in contravention of applicable state statutes. The district court found defiance of court orders,³⁹ continual enforcement of hospital procedures designed to circumvent constitutional guarantees,⁴⁰ evasive trial tactics⁴¹ and willful discrimination by the mayor of St. Louis.⁴² On the basis of this wanton and obstinate behavior, the court found it proper to invoke the bad faith exception.⁴³

This group of civil rights cases illustrates the levels of conduct which typically result in application of the bad faith exception: affirmative discriminatory behavior violative of constitutionally guaranteed rights; willful disobedience of

31 474 F.2d 485 (2d Cir. 1973).

32 *Id.* at 491.

33 *Id.*

34 489 F.2d 298 (5th Cir. 1973).

35 *Id.* at 300-01.

36 *Id.*

37 *Id.* See *Class v. Norton*, 505 F.2d 123. That suit involved a contempt proceeding against a Connecticut welfare official to enforce a prior court order requiring compliance with federal AFDC regulations. That court found the refusal to obey a direct court order "obdurate obstinacy" and awarded attorneys' fees.

38 515 F.2d 541 (8th Cir. 1973).

39 *Id.* at 547.

40 *Id.*

41 *Id.* at 548.

42 *Id.*

43 The *Bond* court cited a second case, *Fairley v. Peterson*, 493 F.2d 598 (5th Cir. 1974), which broadly interpreted *Bradley* as holding that the use of the bad faith exception was warranted when defendants violate a clearly established law and compel plaintiffs to expand efforts preparing and/or conducting a trial. In *Fairley*, the court affirmed an award of attorneys' fees on the basis of both the bad faith exception and private attorney general theory, but failed to make clear what precisely was the conduct of the defendants which met the bad faith grounds.

court orders and injunctions; or dilatory trial tactics designed to prolong litigation and increase expenses.

In addition, however, to the two formulations of bad faith conduct presented above, a third formula has appeared in the language of several recent cases including *Bond*.⁴⁴ This third formulation defines bad faith simply as a "violation of a clear legal duty," omitting elements of wantonness or obstinacy. Cited as a source⁴⁵ of this broader formula is *Allen v. NAACP*.⁴⁶ Findings of fact in *Allen* showed that defendant state troopers had failed to abide by a court order requiring them to implement an affirmative information and recruitment program for racial minorities.⁴⁷ The lower court held that failure to abide by the court order compelled the second suit, and, whether out of intentional action or neglect, such conduct was sufficient to support a finding of bad faith. "Violation of a clear legal duty," then, according to *Allen*, is not mere violation of law. Instead, defiance of a specific judicial order to vindicate constitutionally guaranteed rights were the circumstances under which fee-shifting was invoked in *Allen*.

However, the *Allen* court ultimately based its fee award on the private attorney general theory, which had not yet been stricken down by *Alyeska*. This consequently reduced the "violation of clear legal duty" language to mere dictum. Such a result leaves in doubt whether the court actually would have been willing to justify fee-shifting on this purported bad faith conduct alone.⁴⁸

Examination of the factual findings in *Bond* reveals that the level of conduct which warranted invoking the bad faith exception comports much more closely with the *Allen* standard than either the *Moore's* formulation, or the formula illustrated by the *Bell-Bradley* line of decisions. Instead of defiance or obstinacy, the conduct of the *Bond* defendants prior to litigation is more aptly characterized as bureaucratic lethargy in failing to implement welfare programs in a timely manner in compliance with federal standards. The lower court stated:

A careful reading of the original and supplementary materials filed in this case indicated in a clear and convincing fashion, that little, if any headway has been made by the State as far as the implementation of the EPSDT program is concerned. From the information supplied by the Lake County Welfare Department, as well as that supplied by the State, it appears to a certainty that the welfare procedures are nearly the same as they were last year . . . In fact there is no evidence of a comprehensive EPSDT program, nor even any semblance of any screening program, however minimal . . . [O]ver two years have elapsed since the initial part of the EPSDT program was supposed to have been implemented and in full effect by the State of Indiana.⁴⁹

In contrast to the aforementioned cases illustrating the bad faith exception

44 See 522 F.2d at 80; 493 F.2d at 606. Cf. 538 F.2d at 1245 n.9. (also citing the standard formula from *MOORE*).

45 522 F.2d at 80. But see, 493 F.2d at 606. (attributing formula to *Bradley*).

46 340 F. Supp. 703 (M.D. Ala. 1972), *aff'd*, 493 F.2d 614 (5th Cir. 1974).

47 United States v. Frazer, 317 F. Supp. 1079 (M.D. Ala. 1970).

48 Cf. *Sims v. Amos*, 340 F. Supp. 691 (M.D. Ala. 1972) (mention of the case by the *Alyeska* Court suggests, however, that the award made therein may be sustained solely on the basis of the bad faith exception).

49 372 F. Supp. 872, 874-75 (N.D. Ind. 1974).

standard of conduct, *Bond* did not involve willful discriminatory treatment, defiance of prior court orders, or delaying trial tactics. Certainly, the performance of the Indiana welfare officials had been inadequate. However, that element of persistent or defiant misconduct, which at least until *Allen* has characterized judicial use of its inherent powers to shift attorneys' fees, was lacking in *Bond*. The district court did not suggest that state welfare officials had used prolonged discovery, sham defenses, or frivolous interlocutory litigation; nor was it suggested that officials had engaged in a course of conduct calculated to prevent or delay the distribution of welfare benefits. Aside from showing that substantial sums had been collected by the plaintiffs for their children's health care through the normal channels of Medicaid,⁵⁰ the facts demonstrated that some effort was made to initiate at least a partial implementation of EPSDT in pilot Indiana counties by the deadline date.⁵¹

In addition to the failure of the circumstances in *Bond* to rank as "extraordinary," other reasons militate against the applicability of the bad faith exception. First is the fact that the case was disposed of by summary judgment. Thus an attempt to frivolously protract the proceedings was noticeably lacking. Furthermore, a timely implementation of Medicaid programs, especially EPSDT, has rarely been feasible.⁵²

Clearly, then, the Seventh Circuit has, by its sanctioning of the district court's discretion in awarding attorneys' fees on the basis of bad faith, permitted a further broadening of the requirements for the exception. The court has effectively held that non-feasance short of contumacious conduct is sufficient to invoke the bad faith exception. Not only has the Seventh Circuit followed the trend taken by those lower federal courts which, by dictum or otherwise, approve of the "violation of clear legal duty" standard, it has gone further by actually sustaining an award of attorneys' fees based solely on this level of conduct without the further support of supplementary equitable grounds.

2. Timing of the Bad Faith

In addition to the Seventh Circuit's willingness to liberally interpret the level of conduct sufficient to invoke the bad faith exception, the court further indicated a willingness to broadly interpret the exception by relying on bad faith conduct occurring prior to, rather than during the course of, litigation. Traditionally, the exception was designed only to insure that parties to a suit maintain due respect for the judicial forum during litigation.⁵³ Consequently, bad faith conduct giving rise to litigation was more typically regarded as a basis for punitive damages rather than a basis for fee-shifting.

⁵⁰ *Id.*

⁵¹ *Id.* Even the district court conceded the unavoidable problems state welfare officials encounter in trying to comply with federal regulations and commented that "[t]his court can sympathize with the State Welfare Department's difficulties in following the decrees of the Department of Health, Education and Welfare." *Id.*

⁵² See generally *Subcommittee on Oversight and Investigations, House, Interstate and Foreign Commerce Committee: Dept. of Health, Education and Welfare's Administration of Health Programs: Shortchanging Children*, 94th Cong., 2 Sess. (Comm. Print 1976). In fact, HEW itself was over two years tardy in promulgating the details of the EPSDT Program. *Stanton v. Bond*, 504 F.2d 1246, 1248 (7th Cir. 1974).

⁵³ 6 MOORE, FEDERAL PRACTICE ¶ 54.77 [2] (2d ed. 1972). See, e.g., *Universal Oil Co. v. Root Rfg. Co.*, 388 U.S. 575, 580 (1946).

The Seventh Circuit, relying on Supreme Court authority in *Cole v. Hall*,⁵⁴ indicated that it is appropriate to consider pre-litigation bad faith as a basis for fee-shifting.⁵⁵ Numerous other circuit courts, citing *Hall*, have likewise indicated that the language of that case authorizes use of the exception on the basis of pre-litigation bad faith.⁵⁶ However, it is questionable whether the circuit courts are warranted in placing exclusive reliance on *Hall* to justify use of pre-litigation bad faith for fee-shifting. First, mention of the bad faith grounds for awarding fees was made only in passing reference to the respondents' erroneous objection that it had been invoked against them. Since the *Hall* Court premised fee-shifting on the "common benefit" rationale, the bad faith language is dictum to the holding. Furthermore, the language of the Court may be open to more than one interpretation:

Petitioners also contend that the award of attorneys' fees in this case was improper because the District Court, in denying respondent's claim for punitive damages, found that "the defendants, in good faith, believed that they had a right to charge and discipline respondent for his actions." It is clear, however, that "bad faith" may be found, not only in the action that led to the lawsuit, but also in the conduct of the litigation.⁵⁷

Rather than indicating that pre-litigation bad faith is a basis for fee shifting, the *Hall* Court may have been acknowledging a distinction between prior bad faith, which warrants assessment of punitive damages, and bad faith during the course of litigation, which warrants suspension of the American rule. Had the *Hall* Court intended this second interpretation, punitive damages are the appropriate remedy for conduct which occurs prior to, or gives rise to the litigation.⁵⁸ In contrast, fee-shifting under the bad faith exception applies only to conduct which, by complicating and prolonging litigation, results in unreasonably excessive attorneys' fees. Despite these worthwhile distinctions, in *Bond*, fee-shifting was found to be appropriate on the basis of pre-litigation bad faith while punitive damages were denied.⁵⁹

Although regularly permitted under admiralty law,⁶⁰ the Supreme Court

54 412 U.S. 1.

55 The Seventh Circuit also noted conduct during the course of litigation on which it based its decision to affirm fee-shifting: "[D]efendants . . . continually asserted compliance with HEW requirements in the face of documentation to the contrary." 528 F.2d at 690. Maintaining a defense of compliance and acting wantonly or vexatiously is easily distinguished, however. This is hardly the "bad faith" conduct which is required by the exception and must accordingly be discounted.

56 See 538 F.2d at 1245 n.9; 522 F.2d at 80; 505 F.2d at 127.

57 412 U.S. at 15.

58 See *Donhue v. Staunton*, 471 F.2d 475, (7th Cir. 1972), cert. denied, 410 U.S. 955 (1973).

59 The reason given by the district court for refusing to award punitive damages against state officials was that such damages were considered not to be able to serve their proper function of deterrence and punishment when awarded against state officials. This reasoning is especially anomalous since fee-shifting on the basis of bad faith is considered to be premised on a punitive rationale.

60 Pre-litigation bad faith conduct as a basis for fee-shifting has been addressed by the Supreme Court in *Vaughan v. Atkinson*, 369 U.S. 527, 530-31 (1962). There the Court affirmed assessment of attorneys' fees against a delinquent party. *Vaughan*, however, was a case in admiralty, in which attorneys' fees are normally awarded as part of compensable damages upon a finding of bad faith. The *Appollon*, 22 U.S. [9 Wheat.] 362 (1824). *Vaughan* may be easily distinguished from a civil rights case such as *Bond*. Since the bad faith exception was not the theory upon which attorneys' fees were awarded in *Vaughan*, it has little relevance to *Bond*.

has never clearly sanctioned use of pre-litigation bad faith as grounds for fee-shifting in non-admiralty cases. However, the Court illustrated lower courts' use of the bad faith exception by citing three non-admiralty pre-litigation bad faith cases in *F.D. Rich Co. v. Industrial Lumber Co.*⁶¹ a case denying an attorneys' fees award under the Miller Act. Unfortunately, *Rich* was the very case relied upon as authority in *Alyeska* to illustrate the narrow standards required for use of the bad faith exception.⁶² This use of *Rich* creates some doubt about the effect of *Alyeska*, which otherwise criticized judicial erosion of the American rule.

In response to the affirmance of the American rule and the emphasis placed on the narrowness of exceptions to that rule by the *Alyeska* Court, two circuit courts, thus far, have subsequently discounted the apparent ambiguity created by the citation of the *Rich* case, and questioned the appropriateness of pre-litigation bad faith as a basis for fee-shifting under the bad faith exception.

In *Cordeco Development Corp. v. Vasquez*⁶³ the First Circuit refused to award attorneys' fees premised on pre-litigation bad faith in addition to assessing punitive damages. The court termed such an award inappropriate⁶⁴ since awarding attorneys' fees on the basis of wrongful conduct giving rise to litigation clearly surpassed the traditional scope of the exception. Such action, the court concluded, would contradict the *Alyeska* caveat against broadening the equitable exceptions to the American rule.

Similarly, the Third Circuit in *Skehan v. Board of Trustees*⁶⁵ held that attorneys' fees awards against state officials based on pre-litigation bad faith conduct were not permissible. The court discussed the confusion created by the *Alyeska* decision with regard to the timing of the behavior and concluded that foreclosure of broad equitable grounds for awarding fees by *Alyeska* prevented such an award, at least when based only on admiralty authority.

According, then, to the views of the First and Third Circuits, an expansive interpretation of the bad faith exception such as that taken by the Seventh Circuit in *Bond* clashes with the indications of the *Alyeska* decision.⁶⁶ The *Bond* court's accession to use of the exception on the basis of pre-litigation bureaucratic inefficiencies and, then, exclusive reliance on this modified exception to overcome the American rule, indicates that the Seventh Circuit may not have given proper weight to the *Alyeska* decision.

Hope for Clarification

As noted at the outset, the *Alyeska* decision made inroads toward clarifying the availability of fee-shifting in federal courts. There remain, however, ambiguities concerning the scope of the equitable exceptions to the Amer-

61 417 U.S. at 129 n.17.

62 421 U.S. at 259.

63 539 F.2d 256 (1st Cir. 1976).

64 *Id.* at 263.

65 538 F.2d 53 (3d Cir. 1976).

66 Speculation may be made that the expansive approach taken by the Seventh Circuit was a frustrated attempt to permit fee-shifting by forcing it into the mold of the bad faith exception resulting from a deprivation of the private attorney general theory. Regardless of laudable objectives, such would be clearly impermissible.

ican rule, including the bad faith exception. *Bond v. Stanton* exemplifies the increasingly expansive interpretation of the bad faith exception adopted by the circuit courts. Before the exception swallows the rule, one hopes that there will be reevaluation of this trend toward broadening discretionary fee-shifting. Clearly, potential litigants as well as counsel could benefit from more definitive policy on the availability and risks of fee-shifting under the bad faith exception.⁶⁷

Kymson F. DesJardins

67 On October 1, 1976, Congress responded to the suggestion of the Supreme Court in *Alyeska* that the legislature provide statutory authorization for fee-shifting. The Civil Rights Attorney's Fees Awards Act of 1976 accordingly became law on that date, providing:

Sec. 2. That the Revised Statutes section 722 (42 U.S.C. § 1988) is amended by adding the following: "In any action or proceeding to enforce a provision of sections 1977, 1978, 1979, 1980 and 1981 of the Revised Statutes, title IX of Public Law 92-318, or in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code, or title VI of the Civil Rights Act of 1964, the court in its discretion may allow the prevailing attorney's fee as part of the costs."

The Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, § 2, 90 Stat. 2641 (1976). For congressional intention with regard to the meaning of "judicial discretion" see H.R. REP. No. 94-1558, 94th Cong., 2d Sess. 8 (1976).

In accordance with applicable decisions of the Supreme Court, the newly enacted amendment to the Civil Rights Act is considered to apply to all cases pending on the date of enactment. *Bond*, having been granted certiorari is regarded as a pending case. *Bradley v. School Board*, 416 U.S. 696, 711-16 (1974). Review in light of the statute may therefore preclude examination of the bad faith grounds if more general equitable grounds are reinstated by the Supreme Court.

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