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Case Comments

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CASE COMMENTS

SECURITIES REGULATION — CORPORATE INSIDER LIABILITY — DIRECTORS ARE ACCOUNTABLE AT COMMON LAW TO UNHARMED CORPORATION FOR PROFITS REALIZED THROUGH USE OF INSIDE INFORMATION. — Management Assistance, Inc. [MAI] is a New York corporation which purchases used IBM computers and leases them to other companies. Under the terms of the standard lease, MAI is responsible for maintaining the machines; but, since it was unable to do so at the time of the lawsuit, it engaged International Business Machines [IBM] to perform this duty. In August, 1966, IBM sharply increased its rates for the maintenance service; and, as a result, MAI's net earnings declined from \$262,253 in July to \$66,233 in August — a drop of about seventy-five percent. Defendants Oreamuno and Gonzalez, directors of MAI, learned of this disappointing news solely by virtue of their position. Acting on this inside information, they sold a total of 56,500 shares of MAI stock at the then current price of \$28 per share. After the information of MAI's poor August earnings became available to the public, the value of MAI's stock fell to \$11 per share. Thus, by selling before the news was let out, the defendants realized profits of \$960,500. Plaintiff, who did not purchase any of this stock, brought a shareholder's derivative action seeking to make defendants account to MAI for the profits. Special Term granted the defendants' motion to dismiss the complaint for failure to state a cause of action. Appellate Division, with one dissent, modified Special Term's order by reinstating the complaint as to the defendants.¹ On appeal, the New York Court of Appeals affirmed Appellate Division's order and *held*: officers and directors who use material inside information for their own personal benefit are accountable to their corporation for gains from transactions in the company's stock. *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

The *Diamond* decision graphically illustrates the precarious position of a corporate insider who uses confidential information to speculate in his company's stock. This comment is an attempt to examine why his position has become even less stable as a result of that decision.

It is beyond question that directors owe a fiduciary duty of loyalty to their companies, a duty demanding utmost good faith in all matters related to their position.² They must place the performance of their corporate duties above their personal concerns, and all their acts must be for the benefit of the corporation and not for themselves.³ Because of the nature of their office, however, directors are confronted with many opportunities to profit from their position by taking advantage of the trust and confidence placed in them. Often such opportunities come in the form of important advance information concerning the company's affairs. "Extremely valuable tidbits of corporate information offer compelling

1 *Diamond v. Oreamuno*, 29 App. Div. 2d 285, 287 N.Y.S.2d 300 (1st Dep't 1968), *aff'd*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

2 3 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 850 (perm. ed. rev. repl. 1965). *See generally* *Pepper v. Litton*, 308 U.S. 295 (1939).

3 3 W. FLETCHER, *supra* note 2, § 850.

temptations to misuse by those who have access to them."⁴ One of the most common temptations has been in the securities field, where insiders, armed with secret knowledge which, when disclosed, will favorably affect the value of their company's stock, have been able to make quick market killings by purchasing before the news is made public, then selling after disclosure. Or the pattern may be reversed, as where the insider, having undisclosed knowledge of disappointing information that will cause a sharp drop in the stock's value, sells out before the news is announced and thereby avoids a heavy loss.

Prior to 1934 this method of insider speculation was an established practice, enabling insiders to siphon off large profits, often at the expense of their corporations.⁵ The outside investor, deprived of access to privileged information, thus took greater risks than the insider. To make matters even more inequitable, the common-law measures available to prevent this unscrupulous fleecing of ignorant investors were next to worthless — the burdens of proof necessary to establish deceit or misrepresentation were exactingly heavy,⁶ while the remedies for nondisclosure were even less effective. The plaintiff had no right to disclosure unless the defendant had a duty to disclose. According to most courts, few people were held to have this duty;⁷ the exempted included corporate officers and directors in their private dealings with holders of their corporation's stock.⁸ The woeful inadequacy of the common-law remedies and the widespread abuses in the securities markets at a time of national economic crisis necessitated the passage of federal securities acts designed to "produce fair and honest markets, and to restore investor confidence by requiring high standards of conduct in securities transactions."⁹

The Securities Exchange Act of 1934 had as its guiding light the overriding public interest in freeing the securities markets from all artificial influences so that they might reflect true values, and also to curb abuses by insiders who normally have access to confidential information not available to small stockholders and the general public. . . . The Act was broadly designed to stabilize the national economy against the shocks produced by a faulty investment system which had not adjusted itself to modern conditions. At the heart of the problem was the development of large corporations whose management was not as responsive to the ethical and legal sanctions present in earlier years when the companies were smaller, more localized and less widely owned.¹⁰ (Footnotes omitted.)

More specifically, through section 16(b) of the Securities Exchange Act of 1934,¹¹ Congress attempted to iron out the inequities prevalent in insider

4 Rubin & Feldman, *Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders*, 95 U. PA. L. REV. 468, 469 (1947).

5 *Id.* at 468.

6 See Comment, *The Prospects For Rule X-10b-5: An Emerging Remedy For Defrauded Investors*, 59 YALE L.J. 1120, 1123-26 (1950).

7 *Id.* at 1125. See generally H. BALLANTINE CORPORATIONS § 80, at 211-15 (rev. ed. 1946); Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53, 54-63 (1960); Yourd, *Trading in Securities by Directors, Officers and Shareholders: Section 16 of the Securities Exchange Act*, 38 MICH. L. REV. 133, 139-43 (1939).

8 *E.g.*, Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659 (1933).

9 Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146, 1174-75 (1965).

10 Rubin & Feldman, *supra* note 4, at 469-70.

11 Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1964).

trading by cutting out its primary goal—short-term profits.¹² The section makes insiders' profits recoverable by the corporation when those profits result from any purchase and resale of the corporation's shares within a six-month period.

It [section 16(b)] was designed to prevent not only the personal use of advance corporate information by insiders but also to discourage them from perverting corporate financial policies, such as the timing of dividends, for their own speculative gains. The widespread practice of "sure thing" speculation by corporate control groups and managers was to be terminated.¹³

In a nutshell, section 16(b) is "simply an application of the old principle of law that, if you are an agent and you profit by inside information concerning the affairs of your principal, your profits go to your principal."¹⁴

Section 16(b) imposes a "crushing" liability on insiders, since all profits made from short-swing speculation of six months or less are recoverable by the corporation regardless of the period the insider intended to hold the stock when he bought it.¹⁵ Several limitations upon the scope of the section, however, have prevented it from properly performing its intended role as a watchdog provision to keep fiduciaries in line.¹⁶ The mechanistic six-month trading period has proven especially debilitating, since the section will not cover the insider who, in bad faith, uses confidential information in purchasing shares of his corporation but sells no shares during the six-month period. For this reason, section 16(b) is not to be considered a substitute for a common-law fiduciary duty to the corporation when an insider uses corporate information for his own profit.¹⁷

Because of the inherent statutory limitations crimping the efficacy of section 16(b), it has been left to another section of the 1934 Act and a rule promulgated by the Securities and Exchange Commission thereunder to pick up the fallen standard in the campaign against the unfair use of inside information. Section 10(b)¹⁸ and rule 10b-5¹⁹ "have been fashioned by the federal courts into a flex-

12 See Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading*, 54 CORNELL L. REV. 45 (1968); Rubin & Feldman, *supra* note 4; Yourd, *supra* note 7.

13 Conant, *supra* note 7, at 66-67.

14 *Hearings on H.R. 7852 and H.R. 8720 Before House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 133 (1934) (testimony of Mr. Corcoran).

15 *E.g.*, *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); 2 L. LOSS, *SECURITIES REGULATION* 1040 (2d ed. 1961) [hereinafter cited as Loss]. For reasons why section 16(b) ought to be given a subjective application, see Lowenfels, *supra* note 12.

16 Essentially, these limitations are: a six-month trading requirement; a short statute of limitations; a requirement that the security involved be a registered equity security; a limitation upon the class of defendants to officers, directors and more than ten per cent shareholders; a derivative casting of the private remedy which requires that the recovery go to the corporation; and a specific grant of exemptive power to the Securities and Exchange Commission. Lowenfels, *supra* note 12, at 61.

17 Conant, *supra* note 7, at 69. H. BALLANTINE, *CORPORATIONS* § 80, at 217 (rev. ed. 1946). For a thorough comparison of section 16(b) and the common law, see Yourd, *supra* note 7, at 143-52.

18 Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1964) reads:

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

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any securities not so registered, any manipulative or deceptive device or contrivance in contravention of such rules

ible, pragmatic and very potent bar to the speculative abuse of confidential information by corporate insiders.²⁰ Originally promulgated to fill a gap in the existing securities law, so that defrauded sellers as well as purchasers could sue under federal law,²¹ rule 10b-5 has gained notoriety as a general antifraud provision offering relief in a wide and continually expanding variety of cases.²² Essentially, it is designed to prevent "any possible impropriety in connection with the sale or purchase of securities in interstate commerce . . ."²³ It specifically encompasses material omissions in its proscriptions.²⁴ The effect of rule 10b-5 has been to put insiders under an affirmative duty of disclosure:

The SEC and some federal courts have interpreted the anti-fraud provisions of section 10(b) of the Securities Exchange Act and SEC rule X-10b-5 to create a federal cause of action in selling shareholders against corporate insiders who purchase their shares without disclosing special facts they have learned by virtue of their inside position. One must conclude that both state and federal courts have established a trend toward extending the fiduciary duties of disclosure on corporate insiders to individual stockholders from whom they buy shares.²⁵

Though the rule itself does not provide for a private right of action, the courts have consistently held that one is implied,²⁶ and it is the judicial expansion of the private actions being allowed under the rule that has generated the largest amount of controversy.²⁷ The courts initially required privity of contract between buyer and seller before a private 10b-5 action could be instituted.²⁸ In the matrix of a modern securities exchange, however, where the defendant's misrepresentations reach the public at large and it is understood that the parties are anonymous, the privity requirement has been largely dispensed with.²⁹

and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

19 17 C.F.R. § 240.10b-5 (1968). Rule 10b-5 provides:

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

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

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

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

20 Lowenfels, *supra* note 12, at 61-62.

21 A. BROMBERG, *SECURITIES LAW: FRAUD-SEC RULE 10b-5*, § 2.2, at 19-20 (1969) [hereinafter cited as BROMBERG]; Ellis v. Carter, 291 F.2d 270, 273 (9th Cir. 1961).

22 *E.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

23 Comment, *Civil Liability Under Section 10(b) and Rule 10b-5: A Suggestion for Replacing the Doctrine of Privity*, 74 YALE L.J. 658, 660 (1965).

24 See note 19 *supra*.

25 Conant, *supra* note 7, at 75.

26 Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947); 3 Loss 1757-97; Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10b-5*, 20 U. MIAMI L. REV. 81 (1965); Comment, *supra* note 6; Comment, *supra* note 23.

27 See Ruder, *Civil Liability Under 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. REV. 627 (1963). *But see* Joseph, *Civil Liability Under Rule 10b-5: A Reply*, 59 Nw. U.L. REV. 171 (1964).

28 Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701, 706 (S.D.N.Y. 1951), *aff'd*, 198 F.2d 883 (2d Cir. 1952).

29 *E.g.*, Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962); Texas Continental Life Ins. Co. v.

Rule 10b-5's usefulness stems, in part, from its relative freedom from the web of limitations that have circumscribed section 16(b).³⁰ This freedom enables the rule to afford a much wider basis for possible liability than previously had been possible. Another reason for the rule's utility is that recovery under the rule goes to the bilked party, not to the corporation. Finally, the rule's requirements for establishing fraud are much less stringent than the common-law requirements for establishing deceit or misrepresentation.³¹

Despite the comparative accessibility of the rule, still certain prerequisites must be met before a private action will be allowed.³² The traditional requirements (absent privity, which is no longer necessary) have been: (1) plaintiff's injury must have resulted from his purchase or sale of securities;³³ (2) plaintiff must prove some form of reliance on defendant's misrepresentations;³⁴ (3) plaintiff must have suffered injury caused by the defendant's misconduct;³⁵ and (4) plaintiff must prove some form of deception by the defendant over and above mere breach of fiduciary duty, as the latter is regulated by state, not federal, law.³⁶

Although the defrauded stock purchasers in *Diamond* clearly had causes of action under rule 10b-5, since the defendants failed to inform them of MAI's sharp decline in net earnings, it is equally clear that the plaintiff had no such statutory recourse, as neither he nor MAI were purchasers of the securities in question. Furthermore, the defendants had held their shares longer than six months, so their actions fell outside the scope of section 16(b). Thus, the New York Court of Appeals could not look to the federal securities laws to compel the defendants to account to MAI.

Faced with this statutory impotence, the court either had to allow the defendants to keep their profits or posit liability on some other basis. Both Appellate Division and the Court of Appeals found the needed premises for liability in basic agency and fiduciary trust principles distilled from state common law. Appellate Division found that the defendants were guilty of using a corporate asset, inside information, for their own use and consequently held that the gains

Bankers Bond Co., 187 F. Supp. 14 (W.D. Ky. 1960). See generally BROMBERG § 8.5, at 205-08.1; 3 Loss 1767-71; Klein, *supra* note 26, at 104-8; Comment, *supra* note 23, at 661-67.

30 Rule 10b-5 has none of the inherent limitations that circumscribe the application of section 16(b). There is neither a six-month trading requirement nor a short statute of limitations. Rule 10b-5 applies to any person, insider or outsider, as well as to any security, equity or debt, whether or not traded on a national securities exchange, in the over-the-counter markets, or privately held. Moreover, a private action initiated under rule 10b-5 may be direct, derivative, or a combination of both. Lowenfels, *supra* note 12, at 62.

31 3 Loss 1764-65; BROMBERG § 2.7(1), at 55-56.

32 3 Loss 1763-67.

33 *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). The second circuit held that section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs . . ." and that rule 10b-5 extended protection only to the defrauded purchaser or seller. *Id.* at 464.

34 *List v. Fashion Park, Inc.*, 340 F.2d 457, 462-63 (2d Cir. 1965).

35 These requirements "are so obvious that everyone has accepted their presence as elements of a 10b-5 suit." Comment, *supra* note 23, at 661. For a study of the "causation" element, see Note, *Insiders' Liability Under Rule 10b-5 for the Illegal Purchase of Actively Traded Securities*, 78 YALE L.J. 864, 869-75 (1969).

36 *O'Neill v. Maytag*, 339 F.2d 764, 768 (2d Cir. 1964). This requirement probably applies only in derivative suits or in suits where the corporation itself is the plaintiff.

resulting from such use should inure to the corporation.³⁷ While the Court of Appeals, in its opinion, did not emphasize that inside information is a corporate asset, it did rely on virtually the same authorities for holding the defendants accountable to the corporation.

At New York common law some harm to the corporation or seizure of corporate opportunity had been a prerequisite of accountability.³⁸ In the instant case, however, neither the Appellate Division nor the Court of Appeals was influenced by defendants' contention that since MAI was in no way harmed,³⁹ a derivative suit was not the proper action. As Chief Judge Fuld said in the Court of Appeals:

It is true that the complaint before us does not contain any allegation of damages to the corporation but this has never been considered to be an essential requirement for a cause of action founded on a breach of fiduciary duty. [Citations omitted.] This is because the function of such an action, unlike an ordinary tort or contract case, is not merely to compensate the plaintiff for wrongs committed by the defendant but, as this court declared many years ago (*Dutton v. Willner*, 52 N.Y. 312, 319, *supra*), "to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates."⁴⁰

Unable to find New York precedent for divesting defendants of their profits in the absence of injury, the court turned to a 1949 Delaware Chancery decision, *Brophy v. Cities Service Co.*⁴¹ In that case the defendant, a confidential secretary

³⁷ *Diamond v. Oreamuno*, 29 App. Div. 2d 285, 288, 287 N.Y.S.2d 300, 303-4 (1st Dep't 1968), *aff'd*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). For a discussion of inside information as a corporate asset, see Conant, *supra* note 7, at 63-66.

³⁸ See 37 *FORD. L. REV.* 477, 478-79 (1969); 18 *BUFF. L. REV.* 193, 197 (1968-69). *But cf.* Brudney, *Insider Securities Dealings During Corporate Crises*, 61 *MICH. L. REV.* 1, 25-28 (1962) for cases in other jurisdictions in which accountability has been imposed even though no harm was done to the corporation — the rationale being the removal of all temptations to misuse the corporate office. Also, in the "corporate opportunity" cases liability for profits has been found in the absence of harm to the corporation, e.g., *Guth v. Loft, Inc.*, which said:

The rule . . . does not rest upon the narrow grounds of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purposes of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation. *Guth v. Loft, Inc.*, 23 *Del. Ch.* 255, —, 5 *A.2d* 503, 510 (*Sup. Ct.* 1939).

³⁹ Even though the complaint did not allege any harm to MAI as a result of defendants' actions, neither court was so sure that in fact this was the case. Judge Botein in the lower court said that

[t]he prestige and good will of a corporation, so vital to its prosperity, may be undermined by the revelation that its chief officers had been making personal profits out of corporate events which they had not disclosed to the community of stockholders. *Diamond v. Oreamuno*, 29 App. Div. 2d 285, 287, 287 N.Y.S.2d 300, 303 (1st Dep't 1968), *aff'd*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). Chief Judge Fuld in the Court of Appeals mentioned the possibility of an inference of damage to the enterprise, based on a tarnishing of its reputation and an undermining of the public regard for its securities. *Diamond v. Oreamuno*, 24 N.Y.2d 494, 499, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 81-82 (1969). See also Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 *VA. L. REV.* 1425, 1452-53 (1967) where it is argued that insider trading per se involves a conflict of interest between the insider and his company.

⁴⁰ *Diamond v. Oreamuno*, 24 N.Y.2d 494, 498, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 81 (1969).

⁴¹ 31 *Del. Ch.* 241, 70 *A.2d* 5 (*Ch.* 1949).

to one of the company's directors, found out through his office that the company was about to purchase a large block of its own shares on the market in order to retire them. Acting on this inside knowledge, he bought outstanding shares of the stock before the company entered the market. After the company's purchases had boosted the value of the shares, he then sold them at a profit. The chancellor ruled that the defendant had to turn over his profits to the company, even though he was not one of its officers and had not competed against it, since he had used information secured in the performance of his corporate duties for his own personal profit. The court said that lack of harm to the company was irrelevant: "[p]ublic policy will not permit an employee occupying a position of trust and confidence toward his employer to abuse that relation to his own profit, regardless of whether his employer suffers a loss."⁴²

Brophy has been characterized as "imposing a common law liability paralleling Section 16(b)."⁴³ *Diamond* has done the same thing. Indeed, both the cases and the statute seem to predicate liability on the foundation that confidential information belongs to the company, not to employees. The following comment was made specifically in connection with section 16(b), but it is equally applicable to the *Brophy* and *Diamond* holdings:

It [section 16(b)] appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is made liable to the corporation for the profits he realizes. Unlike the "corporate opportunity" cases, however, the action may be brought even though the insider has not competed with his corporation in the use of the information.⁴⁴

Brophy's major contribution to the *Diamond* court was its availability as judicial authority for holding an insider accountable to his corporation for profits even though no damage was done. But the case was also used to demonstrate that a derivative action for an accounting can be an effective common-law method for dealing with insider abuses beyond the scope of section 16(b).⁴⁵ In *Brophy*, since the defendant was not an officer of the company, section 16(b) had no application, just as it had none in *Diamond* because the stock sales were not short-swing.

Even though section 16(b) did not govern *Diamond*, the Court of Appeals still managed to put the section to good use by arguing that the facts in *Diamond* "constituted the same sort of 'abuse of a fiduciary relationship' as is condemned by the Federal law."⁴⁶ Hence, the court did not hesitate to impose the same remedy under New York state law as is provided by the federal statute, namely, a derivative action to recover all profits resulting from the transaction.

A final source of liability, used by both the Appellate Division and the Court of Appeals, was section 388, comment *c*, of the Restatement (Second) of Agency:

⁴² *Id.* at 246, 70 A.2d at 8.

⁴³ Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385, 409 (1953).

⁴⁴ *Id.* at 408.

⁴⁵ *Diamond v. Oreamuno*, 24 N.Y.2d 494, 501, 248 N.E.2d 910, 913-14, 301 N.Y.S.2d 78, 83 (1969).

⁴⁶ *Id.*, 248 N.E.2d at 914, 301 N.Y.S.2d at 84.

An agent who acquires confidential information in the course of his employment or in violation of his duties has a duty . . . to account for any profits made by the use of such information, although this does not harm the principal. . . . So, if he [a corporate officer] has "inside" information that the corporation is about to purchase or sell securities, or to declare or to pass a dividend, profits made by him in stock transactions undertaken because of his knowledge are held in constructive trust for the principal.⁴⁷

As one commentator has already pointed out, however, the cases annotated to this section all involve either a conflict of interest, an appropriation of corporate opportunity, or some other form of injury to the principal.⁴⁸ It would seem, therefore, that courts have been generally unwilling to milk a wrongdoer in the absence of some harm to his principal. But with *Brophy*, and especially *Diamond*, this wall of judicial recalcitrance appears to be crumbling.

With this small legal arsenal composed of a handful of agency and fiduciary trust principles, the *Diamond* court "overrules what has apparently been accepted law in the lower courts of New York for some time."⁴⁹ Finding these tools sufficient to impose liability, the court devoted the remainder of the opinion to a dismissal of two unusual defenses set up by the defendants.

Defendants first argued that since their actions admittedly contravened the policy of the Securities Exchange Act, the federal remedies that Congress had designed to protect against such abuses were exclusive. Therefore, to allow a derivative action to be maintained under state common law would "interfere with the Federal scheme."⁵⁰ The court dismissed this contention by noting that

[t]he primary source of law in this area ever remains that of the State which created the corporation. Indeed, Congress expressly provided against any implication that it intended to pre-empt the field by declaring, in section 28(a) of the Securities Exchange Act of 1934 (48 U.S. Code 903), that "[t]he rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."⁵¹

Second, the defendants argued that if they were forced to account to MAI under state law, they could be faced with double liability in the event of a successful suit by the defrauded purchasers under rule 10b-5. The Appellate Division saw "no need" to discuss the matter, since no purchaser had yet come forward. The Court of Appeals echoed the same sentiment while emphasizing the need for an effective common-law remedy in view of the "rather limited" remedies offered by the federal statutes:

47 RESTATEMENT (SECOND) OF AGENCY § 388, comment *c* at 204-5 (1958).

48 37 FORD. L. REV. 477, 480 (1969).

49 18 BUFF. L. REV. 193, 198 (1968-69), citing *Leffert v. Marcus*, 12 Misc. 2d 1097, 174 N.Y.S. 546 (Sup. Ct. 1958), *rev'd on other grounds*, 7 App. Div. 2d 989, 183 N.Y.S.2d 886 (1st Dep't 1958), in which insiders used corporate information to issue false public statements to inflate the market price of the corporate stock for their own personal profit. The court held that although there may be liability to the purchasers of the stock, there could be no second liability to the corporation, which was not injured. *Accord*, *Newman v. Baldwin*, 13 Misc. 2d 898, 179 N.Y.S.2d 19 (Sup. Ct. 1958).

50 *Diamond v. Oreamuno*, 24 N.Y.2d 494, 502, 248 N.E.2d 910, 914, 301 N.Y.S.2d 78, 84 (1969).

51 *Id.* at 503-4, 248 N.E.2d at 915, 301 N.Y.S.2d at 85.

[T]he defendants' assertion that such a party may come forward at some future date is not a basis for permitting them to retain for their own benefit the fruits of their allegedly wrongful acts. For all that appears, the present derivative action is the only effective remedy now available against the abuse by these defendants of their privileged positions.⁵²

Though the law is by no means settled, it appears that there is no absolute rule precluding double liability.⁵³ By specifically preserving existing legal and equitable remedies, section 28(a) of the Securities Exchange Act makes it clear that the Act does not preclude a shareholder suit in cases where shareholders would have a right of action at common law. Thus common-law counts can be entered alongside counts alleging a statutory violation. But the question remains, and *Diamond* has not helped to answer it, will the insider be liable for his profits to the corporation (suing under the *Diamond* theory or under section 16(b)) if the defrauded party has already recovered those profits in a prior action under common law or rule 10b-5? Alternatively, will the insider be liable to the fraud victims if the corporation has already bled him of his profits? After preserving all existing rights and remedies, section 28(a) provides that

no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.⁵⁴

Professor Loss treats this section as simply precluding a double recovery by the same plaintiff (under rule 10b-5 and common-law deceit, for example), but he does not mention it as affecting the possibility of a defendant's liability to two different parties for the same offense.⁵⁵ Another writer, Kenneth Yourd, views section 28(a) as no bar to a corporate derivative action under the statute after a common-law recovery of the profits by a victimized plaintiff, because "the individual security holder plaintiff is not a person permitted to maintain a suit in his own right under section 16(b) and the action therein provided for recovery of profits is not a suit for 'damages.'"⁵⁶

Moreover, there does not seem to be any difficulty in allowing a corporate recovery under section 16(b) for short-swing profits and recovery to a defrauded purchaser or seller under rule 10b-5.⁵⁷ In this situation the insider has "simply run afoul of two distinct sections of the Exchange Act."⁵⁸ Thus, "[t]here is little reason for allowing him to escape one liability simply because he has managed to incur another."⁵⁹ If there is no conflict in allowing double recovery under two different provisions of the Act, then it would seem that there should be no conflict

52 *Id.* at 504, 248 N.E.2d at 916, 301 N.Y.S.2d at 86.

53 3 Loss 1474.

54 Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a) (1964).

55 3 Loss 1474 n.105.

56 Yourd, *supra* note 7, at 149 n.56. *But cf.* Cook & Feldman, *supra* note 43, at 409 n.99.

57 *See Pappas v. Moss*, 257 F. Supp. 345 (D.N.J. 1966), *rev'd on other grounds*, 393 F.2d 865 (3d Cir. 1968), where a derivative action under rule 10b-5 was brought against directors who had purchased some of the company's shares for themselves. Both the rule and section 16(b) were applied to the same transactions without mention of any possible conflict.

58 Comment, *supra* note 6, at 1141.

59 *Id.*

in allowing a double recovery in an analogous common-law situation such as *Brophy* or *Diamond*. In each of those cases the insider has incurred two separate liabilities: one to the corporation and one to the defrauded party. Thus, double liability would be possible in the event of a derivative action for an accounting followed by a tort action in deceit or misrepresentation.⁶⁰ Similarly, the derivative action at common law would not preclude double liability based on a violation of the Act or rule 10b-5.

The problems, however, do not stem from the double liability concept itself so much as from the dilemma of how to allocate damages under two separate causes of action.⁶¹ Should the insider be forced to pay twice for the same offense, or should one recovery be set off against recovery in a subsequent suit? As the measure of damages is based upon the amount of the insider's "profits," it seems logical to say that since one recovery would destroy or at least reduce these profits, the insider ought be immune from any further action.⁶² It is, on the other hand, equally persuasive to argue that there is no reason to read the word "profits" to mean net profits after deduction of losses sustained in an earlier lawsuit.⁶³ Also, a disgorgement of the total amount of the insider's profits through the restitutionary remedy of an accounting is possible not only under common law, but also under rule 10b-5.⁶⁴ If a setoff is allowed, there might be a race between the corporation and the victimized party to be first to recover the defendant's booty, since the first recovery could strip the insider of all his profits, leaving nothing at all for a subsequent plaintiff. If the wrongdoer has already been milked of his profits by the corporation, will he be forced to disgorge again out of his own pocket to the party who has actually been injured? Or, even more anomalous, if he paid the injured party first would he still be forced to pay his corporation which sustained no loss? Though provisions of the Exchange Act are said to be remedial rather than penal,⁶⁵ the nature of the restitutionary remedies applied under rule 10b-5 shows clearly that in some cases the courts are unperturbed if the defendant ends up paying out more than the plaintiff actually lost:⁶⁶

60 Cf. 63 HARV. L. REV. 1446, 1448 (1950).

61 For a discussion of the difficulty of computing damages in *Diamond*, see 37 FORD. L. REV. 477, 481 (1969).

62 Brudney, *supra* note 38, at 35 n.107; Cook & Feldman, *supra* note 43, at 409 n.99; cf. *Newman v. Baldwin*, 13 Misc. 2d 898, 901, 179 N.Y.S.2d 19, 22-23 (Sup. Ct. 1958), where the court dismissed a derivative action for an accounting against insiders who had profited by selling stock after spreading false reports. Among its reasons the court noted that "[i]f the corporation were permitted to sue for defendants' profits, defendants would still be liable to purchasers who relied on the misrepresentations, thus exposing them to double liability for the same acts." Presumably a payment of profits to the corporation would be credited to the insider and would act as a defense to a later action by the defrauded party. 2 LOSS 1124 n.333. See also R. STEVENS, CORPORATIONS 701-2 (2d ed. 1949), where the suggestion is made that a court ought stay a section 16(b) action pending any sellers' actions based on deceit, so that the recovery would diminish the insiders' profits and thereby constitute a *pro tanto* defense to the corporate action.

63 Cf. 3 LOSS 1473-74; Comment, *supra* note 6, at 1142. But cf. Brudney, *supra* note 38, at 35, who says that the corporation to which the insider has turned over his profit can be required to pay the defrauded victim's claim to that extent.

64 Comment, *Measurement of Damages in Private Actions Under Rule 10b-5*, 1968 WASH. U.L.Q. 165, 170; Comment, *Private Remedies Available Under Rule 10b-5*, 20 SW. L.J. 620, 627 (1966).

65 *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 769-70 (D.N.J. 1955).

66 See, e.g., *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), cert. denied, 382 U.S. 879

[C]ourts have been more interested in depriving defendants of ill-gotten gains than in compensating sellers for credible losses. The only consistent pattern emerging from the case law is that regardless of circumstances, the insider will be deprived of an amount equal to or exceeding any "profit" he might have made.⁶⁷

Thus, the courts may not be too timid about making an insider compensate a defrauded investor even if the insider has already been squeezed dry by his corporation in an earlier suit, especially if his transgressions have been in bad faith. It is less likely, however, that the courts will allow an uninjured corporation to recover after the victim's claim has been satisfied, since the insider has already been deprived of his profits by a plaintiff who was actually harmed.⁶⁸ On the other hand, "if the [corporate] recovery under section 16(b) is considered as in the nature of a penalty, there is no reason for refusing the second recovery on the ground of prior satisfaction."⁶⁹ In short, thanks to *Diamond's* timidity, nothing is certain.

Counsel for defendants-appellants in *Diamond* have succinctly brought to light the many loose ends left dangling by the court's failure to come to grips with this issue of double liability and its consequences:⁷⁰

The court below did not state that the derivative complaint would be dismissed if a suit by the purchasers was instituted. There is no indication if there is to be a race between the public investor and a stockholder on behalf of the corporation as to which shall first recover the alleged profit or if the insider is to be penalized by being required to pay twice. Is the corporate right of action to be independent of a settlement or discontinuance of the action by the purchaser?⁷¹

Such is the confused state of this area of the law in the wake of *Diamond v. Oreamuno*. Though an opportunity was present, the court gave no indication of how it felt the problem should be handled when it eventually did arise, but merely swept it under the judicial rug for a future court to deal with. Since the situation will probably present itself in the future, *Diamond* quite clearly passed the buck.

As previously noted, the plaintiff in *Diamond* had no cause of action under rule 10b-5 because the Court of Appeals was cognizant of the *Birnbaum v. Newport Steel Co.* requirement that only a purchaser or seller of securities may

(1965), where it was said, "it is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." *Id.* at 786.

67 Note, *Insiders' Liability Under Rule 10b-5 for the Illegal Purchase of Actively Traded Securities*, 78 YALE L.J. 864, 878 (1969).

68 To the extent that accountability for profits is required even though the corporation is not injured, it is difficult to see why, if the insider has no profits because he has compensated his victimized seller, the corporation should nevertheless recover the quondam profits. Brudney, *supra* note 38, at 35 n.107; cf. Cook & Feldman, *supra* note 43, at 409 n.99. To the extent that the corporation is considered injured (see note 39, *supra*) this rationale breaks down.

69 Yourd, *supra* note 7, at 149 n.56.

70 "In the absence of any such appearance by adverse claimants, we need not now decide whether the corporation's recovery would be affected by any amounts which might have to be refunded by defendants to the injured purchasers." *Diamond v. Oreamuno*, 24 N.Y.2d 494, 504 n.1, 248 N.E.2d 910, 916 n.1, 301 N.Y.S.2d 78, 86 n.1 (1969).

71 Brief for Defendants-Appellants at 22, *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 310 N.Y.S.2d 78 (1969). See 6 Loss 3646 for additional queries.

proceed under the rule.⁷² In *Birnbaum*, the Second Circuit stressed that section 10(b) did not encompass "fraudulent mismanagement of corporate affairs"⁷³ and "had no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers."⁷⁴ The court evidently felt that section 16(b) was sufficient statutory protection against breaches of fiduciary duties by insiders, and consequently held that section 10(b) and rule 10b-5 extended protection only to the defrauded purchaser or seller.⁷⁵

There is evidence, however, that this requirement is being whittled away.⁷⁶ In fact, one writer, Lewis Lowenfels, feels that "the demise of the *Birnbaum* doctrine" is even now at hand.⁷⁷ The trend started with three Second Circuit opinions that portended the possible fall of the purchaser-seller requirement,⁷⁸ and has continued with later decisions that Mr. Lowenfels believes may "nail the lid on the *Birnbaum* coffin."⁷⁹ In *Mutual Shares Corp. v. Genesco, Inc.*,⁸⁰ the Second Circuit, though denying money damages because no harm was proven, permitted injunctive relief under section 16(b) and rule 10b-5 to prevent controlling outsiders from depressing the price of Mutual's stock by manipulation, even though the complaining shareholders had purchased their shares prior to the manipulation and had not yet sold them.

[T]he claim for damages on this theory founders both on proof of loss and the causal connection with the alleged violation of the Rule; on the other hand, the claim for injunctive relief largely avoids these issues, may cure harm suffered by continuing shareholders, and would afford complete relief against the Rule 10b-5 violations for the future.⁸¹

Another case, *Entel v. Allen*,⁸² apparently has gone even further, not only holding that a plaintiff under rule 10b-5 need not be a purchaser or seller, but also casting some doubt on the "deception" requirement imposed by *O'Neill v. Maytag*.⁸³ Furthermore, though the Second Circuit recently declined to overrule *Birnbaum* specifically,⁸⁴ in a later case a different panel of that court reached a

72 See note 33 *supra*.

73 *Birnbaum v. Newport Steel Co.*, 193 F.2d 461, 464 (2d Cir. 1952).

74 *Id.* at 463.

75 *Id.* at 464.

76 BROMBERG § 8.8, at 222.1.

77 Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968).

78 See *Vine v. Beneficial Fin. Co., Inc.*, 374 F.2d 627 (2d Cir. 1967) (purchaser-seller requirement relaxed through court's finding that a "constructive sale" took place as a result of a merger, even though there was no actual sale); *A. T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967) (court held that rule 10b-5 prohibited all fraudulent schemes in connection with the purchase or sale of securities, not just those usually associated with their purchase or sale); *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840 (2d Cir. 1967) (court assumed without deciding that plaintiff who was neither a purchaser nor seller had standing under rule 10b-5).

79 Lowenfels, *supra* note 77, at 274.

80 384 F.2d 540 (2d Cir. 1967).

81 *Id.* at 547.

82 270 F. Supp. 60 (S.D.N.Y. 1967).

83 339 F.2d 764 (2d Cir. 1964). For a discussion of the possible effects of *Entel* on *O'Neill*, see 42 N.Y.U.L. Rev. 978 (1967).

84 See *Iroquois Industries, Inc. v. Syracuse China Corp.*, No. 32984, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,526 (2d Cir. Nov. 3, 1969), where the court reaffirmed the purchaser-seller requirement in affirming the dismissal of an action brought by a tender offeror who alleged that the target corporation submitted deceptive information to its shareholders, thereby preventing the offeror from purchasing any of its shares. In a strict application of the

decision that seems to buttress strongly the proposition that the purchaser-seller rule is on the downslide. In *Crane Co. v. Westinghouse Air Brake Co.*,⁸⁵ the court held that when two major companies in the same industry vie for control of another company, antitrust laws will make the losing party an "involuntary seller" by forcing it to dispose of its shares in the target corporation controlled by the successful party. The case therefore falls within the rationale of *Vine v. Beneficial Finance Co., Inc.*,⁸⁶ and the losing party has standing under the *Birnbaum* doctrine. Some may feel that this dilution of the elements necessary for a private suit under the rule will lead to an unwarranted federal invasion into an area normally regulated by state law, namely, corporate mismanagement.⁸⁷ Others, however, claim that "[s]uch a development not only will be consistent with the legislative pattern, but also will help to effectuate the central purpose underlying securities regulations — the protection of the investing public."⁸⁸

Though *Mutual Shares* allowed injunctive relief under rule 10b-5, it dismissed a claim for damages on the ground that plaintiff had not shown proof of loss. Presumably, then, damages would have been awarded if loss had been proven, even though plaintiff was not a buyer or seller of securities. Such a hypothesis is especially significant when viewed from the standpoint of derivative actions under rule 10b-5.⁸⁹ In the past, such suits have been a haven for many a defrauded plaintiff who did not fulfill the *Birnbaum* requirement, since he could bring a 10b-5 suit in the name of his corporation, which often was a buyer or seller of securities.⁹⁰ Now, however, with the demise of this prerequisite, it may be possible for a derivative action against insiders to be brought under rule 10b-5 on behalf of a corporation never involved in the illegal purchase or sale of securities. This would mean that a situation such as *Diamond* may eventually permit a derivative suit under the federal rule with its many important procedural advantages.⁹¹

Birnbaum rule, the court held that the plaintiff had no standing under rule 10b-5 because he was neither a purchaser nor a seller of securities.

The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, the protection of defrauded purchasers and sellers. It is not the province of the courts to extend Section 10(b) to apply to transactions not intended to be covered by Congress. *Id.*

85 Nos. 32569-72 (2d Cir., Dec. 10, 1969).

86 374 F.2d 627 (2d Cir. 1967).

87 See note 96 *infra*, and accompanying text.

88 Lowenfels, *supra* note 77, at 277.

89 See generally Lowenfels, *Rule 10b-5 and the Stockholder's Derivative Action*, 18 VAND. L. REV. 893 (1965); Note, *Securities Regulation: Shareholder Derivative Actions Against Insiders Under Rule 10b-5*, 1966 DUKE L.J. 166.

90 For a collection of cases that have sustained a stockholder's 10b-5 derivative suit, see Lowenfels, *supra* note 89 at 896-97.

91 Few of these advantages exist for the private plaintiff pursuant to section 10(b) and rule 10b-5 because the states do not impose the same restrictions upon direct action which they impose upon a derivative private action. First, instead of grappling with the infinitely complex problems of effecting jurisdiction and obtaining a suitable venue for trial under state law, the stockholder suing derivatively pursuant to section 10(b) and rule 10b-5 is able to utilize the nationwide jurisdictional and venue provisions of section 27 of the act. Second, instead of being required to post security for expenses, to obtain prior stockholder authorization for suit or being hamstrung by a short statute of limitations under state law, the stockholder suing derivatively pursuant to the above section and rule is able to circumvent each of these problems. Third, instead of being compelled to choose between a derivative suit pursuant to state law and a derivative suit pursuant to federal law, the stockholder who bases his derivative action on federal rights may join his state cause of action to the

Two other elements, however, are still lacking in a *Diamond* situation for a derivative action under the rule: (1) deception beyond mere breach of fiduciary duty (*O'Neill*), and (2) proof of loss or harm before damages will be given (*Mutual Shares*). But *Entel* has already put a crack in the foundation of the deception standard, and if that holding is broadly construed, "deception" may be the next barrier to fall by the wayside.⁹² If, however, the courts are reluctant to dispose of this element completely, then perhaps, as one article has suggested, the nature of "deception" may shift to include misuse of undisclosed inside information pertaining to value.⁹³ Arguably, this was the "type" of deception that Congress intended to deal with in enacting section 10(b), rather than the deception present in *O'Neill* where there was no misuse of inside information.⁹⁴ If this interpretation becomes accepted, a *Diamond* situation obviously would have no trouble meeting the deception prerequisite.

As for the harm requirement, the derivative actions brought thus far under rule 10b-5 have all alleged some harm to the corporation because the corporation itself was the defrauded purchaser or seller of securities.⁹⁵ But with the broadened vistas of relief being opened under the rule, perhaps this element also will be weeded out as courts continue to give full sway to rule 10b-5 as a prophylactic device aimed at preventing any form of fraud in securities dealings. "[T]he substantive development of principles based on rule 10b-5 in this derivative area may well be extended beyond what is at present foreseeable."⁹⁶ Possibly the courts in deciding a 10b-5 case will be influenced by the common-law cases that suggest that the insider ought to be held accountable for his profits from those securities transactions that subject him to the *temptation* to mismanage or to betray his corporation, even though he is not shown to have injured it.⁹⁷ Or the courts may one day hold that insider trading on privileged information does, per se, constitute a form of injury to the corporation.⁹⁸ As Bromberg says, "[T]he incidence of injury can be as elusive as the distinction between fiduciary breach and fraud."⁹⁹

Nevertheless, compelling reasons militate against the possibility of such a

federal claim and maintain both in a federal court under the doctrine of pendent jurisdiction. The emergence of this stockholder's derivative action . . . conflicts directly with strong state policies in favor of discouraging derivative plaintiffs. *Id.* at 894-95.

92 Most broadly construed, *Entel* would overrule both *Birnbaum* and *O'Neill* completely. Both the purchaser-seller and deception requirements would be eliminated. In their place might well emerge a federal common law of corporations using section 10(b) as its foundation. This step could be rationalized on the ground that any fraudulent mismanagement constitutes a practice "in connection with the purchase or sale" of securities since someone who purchased or sold some of the corporation's stock at some time would be adversely affected. This construction would involve not only a complete elimination of the purchaser-seller and deception requirements, but would require a reading of rule 10b-5 that would reduce the phrase "in connection with the purchase or sale of any security" to a jurisdictional ground devoid of substantial significance. 42 N.Y.U.L. REV. 978, 982 (1967).

93 Note, *Shareholders' Derivative Suit to Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5*, 114 U. PA. L. REV. 578, 587 (1966).

94 *Id.* at 584.

95 Lowenfels, *supra* note 89, at 896.

96 *Id.* at 897.

97 See Brudney, *supra* note 38, at 27-28.

98 Schotland, *supra* note 39 at 1452-53.

99 BROMBERG § 4.7(2), at 88.

far-reaching expansion. First, a derivative action for insider's profits has already been allowed under state law; why should the federal courts feel any compulsion to inject a further degree of implied civil liability into a federal statute that probably wasn't geared to allowing any civil liability in the first place?¹⁰⁰ Second, corporate mismanagement has always been regulated by fiduciary principles under state law. Courts, therefore, may hesitate to add any more fuel to the charge that rule 10b-5 already amounts to a "federal corporation law" that has usurped areas commonly thought to be the exclusive domain of the states.¹⁰¹ There is a potential overlap between federal law governing securities transactions and state law governing the conduct of corporate affairs, since cases arise that would fit either a 10b-5 suit or a suit based on state law for breach of fiduciary duty to the corporation.¹⁰² The regulatory scheme of the federal securities legislation, however, "was not meant to reach conduct involving the breach of intracorporate responsibilities and duties."¹⁰³ (This was the rationale behind *O'Neill's* requirement of deception beyond breach of fiduciary duty.) Rather, federal law was obviously designed to regulate securities transactions, and "if it extends to suits of corporate mismanagement, it is only because a transaction in securities is somehow involved."¹⁰⁴ Any further expansion of insider liability for trading on inside information ought to be left to Congress to be dealt with on a uniform plane, not to the courts deciding piecemeal on a case-by-case basis. "If the domain of the states is to be invaded, the authorization for this move should come from the representatives of the states."¹⁰⁵ Third, if the purchaser-seller, deception, and loss-caused-by-the-defendant requirements all are dispensed with, there would be no meaningful connection between the plaintiff's complaint and the alleged violation. Hence, virtually every stock transaction by an insider would raise the possibility of a lawsuit, since the only allegations necessary would be that an insider bought or sold stock and that he had inside information. "One can readily imagine the variety of tactics which insiders would be forced to consider when contemplating a purchase or sale and when considering how to defend the action."¹⁰⁶ Fourth, the spectre of double liability, this time under a single section of the federal statute, returns to haunt us: one liability to the corporation under a 10b-5 derivative action; the other liability to the defrauded purchaser or seller of stock suing under rule 10b-5 in his own behalf. How this would be resolved it is impossible to predict. It seems likely, however, that both actions would be allowed, much as if the double liability occurred under section 16(b) and rule 10b-5, or under state common law and the rule. The allocation of damages between the corporation and the victimized plaintiff would again be most troublesome.

Whatever the future course of the courts with regard to *Diamond* and

100 Ruder, *supra* note 27; Comment, *supra* note 23, at 660-61. *But see* Fleischer, *supra* note 9, at 1172-79.

101 Note, *supra* note 93, at 579. For a suggestion that would alleviate the conflict by using state law as the basis for determining whether the misconduct falls under the federal rule, see *id.* at 585-87.

102 *E.g.*, *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261 (S.D.N.Y. 1963).

103 Comment, *supra* note 23, at 681. *See* 16 KAN. L. REV. 260, 264 (1968).

104 Comment, *supra* note 23, at 681.

105 42 N.Y.U.L. REV. 978, 982-83 (1967).

106 Comment, *supra* note 23, at 678.

rule 10b-5, the significance of the decision as it now stands must not be underestimated. In its insistence on strict observance by insiders of their fiduciary duties to their corporations, the court has handed down a landmark decision for the protection of shareholders against unscrupulous management. But at the same time, a virtual straitjacket has been placed on the insider who in good faith may wish to trade in his company's shares. In its failure to resolve the question of double liability, the court has buried its head in the sand in hopes that the problem will disappear; but this will not happen until some other court, having inherited *Diamond's* legacy, finally settles the issue. Meanwhile, the scope of insiders' liability for using inside information remains uncertain.¹⁰⁷ In its sanction of derivative suits by "private attorney generals" to enforce directors' duties to their corporations, the court may have instigated the initiation of a rash of such suits by the "legion of volunteers who may now scour the public lists of insider trades for possible claims of misuse of inside information."¹⁰⁸ Finally, in its use of a state common-law remedy to fill gaps in the federal securities statutes, the court has completed the circle that has been developing in judicial and legislative efforts to ensure fair dealing in stock transactions: section 16(b) was enacted to "plug the hole" in the existing common-law remedies that allowed fiduciaries to profit from their position by using corporate information;¹⁰⁹ section 10(b) and rule 10b-5 were enacted to circumvent the many limitations that emasculated section 16(b); and now with *Diamond* a state common-law remedy based on a derivative action to force insiders to account for guilty profits has been used when both section 16(b) and rule 10b-5 have been inapplicable due to inherent or judicially imposed limitations.

Patric J. Doherty

CONSTITUTIONAL LAW — ABORTION — 1850 CALIFORNIA STATUTE PROHIBITING ALL ABORTIONS NOT "NECESSARY TO PRESERVE [THE MOTHER'S] LIFE" IS UNCONSTITUTIONALLY VAGUE AND AN IMPROPER INFRINGEMENT ON WOMEN'S CONSTITUTIONAL RIGHTS. — In 1966 Leon Phillip Belous, an obstetrician licensed as a physician in California since 1931, was contacted by a young unmarried couple for the purpose of procuring an abortion. After a conference with the couple, Belous directed them to Karl Lairtus, an experienced abortionist. Lairtus was licensed to practice medicine in Mexico but not in California. He performed the abortion in an apartment in Los Angeles for the

107 With *Diamond*, lawyers may find that they can be on the receiving end of a double recovery. For example, a plaintiff may bring a derivative action against an insider under state law for breach of fiduciary duty, then later bring a 10b-5 action for fraud to remedy his own loss. If both actions are successful, and if damages are assessed against the defendant for each claim, a lawyer who tried both suits would take a percentage of both awards. A single fact situation thus yields a double recovery and a double fee.

The impact of this particular stimulus to litigation is somewhat more attenuated than may first appear. If the private suit is brought first, then the "reasonable attorney's fee" allowed by the court in the derivative action may not approach the amount that would be allowed had the private suit not been brought. If the derivative suit is prosecuted first, a full attorney's fee may be allowed by the court, but the amount charged to the client in a subsequent private suit would be limited by principles of professional ethics.

108 Brief for Defendants-Appellants at 21, *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

109 Conant, *supra* note 7, at 67.

sum of five hundred dollars. Subsequent to the abortion, Lairtus was arrested, and notebooks containing the names of several physicians, including Belous's, were found. The police interpreted these notebooks to be a list of the doctors who referred women to Lairtus. On the basis of this information Belous was arrested. He was charged with abortion and conspiracy to commit abortion in violation of sections 274 and 182, respectively, of the California penal code.

Dr. Belous based his defense upon the contention that under the circumstances an abortion was necessary to preserve the woman's life. He contended that the young couple's threats and the woman's emotional state had led him to believe that she would either attempt an abortion on herself or seek one in Mexico. Either of these methods, Belous believed, would seriously endanger the woman's life. A jury found Dr. Belous guilty as charged, and he was fined five thousand dollars.

On appeal Belous attacked the constitutionality of section 274. That section, substantially unchanged since its enactment in 1850,¹ provided:

Every person who provides, supplies, or administers to any woman, or procures any woman to take any medicine, drug, or substance, or uses or employs any instrument or other means whatever, with intent thereby to procure the miscarriage of such woman, *unless the same is necessary to preserve her life*, is punishable by imprisonment in the state prison not less than two nor more than five years.² (Emphasis added.)

In a four to three decision,³ the Supreme Court of California reversed the judgment of the trial court and *held*: the uncertainty of the term "necessary to preserve" in section 274 of the California penal code renders the statute void for vagueness; and the statute is an unconstitutional infringement of the woman's

1 Section 274 as originally enacted in 1850 provides:

[E]very person who shall administer or cause to be administered or taken, any medicinal substances, or shall use or cause to be used, any instruments whatever, with the intention to procure the miscarriage of any woman then being with child, and shall be thereof duly convicted, shall be punished by imprisonment in the state prison for a term not less than two years, nor more than five years; *provided*, that no physician shall be affected by the last clause of this section, who, in the discharge of his professional duties, deems it necessary to produce the miscarriage of any woman in order to save her life. Ch. 99, § 45, [1850] Cal. Stats. 233.

In 1967, section 274 was amended and the Therapeutic Abortion Act was added to the Health and Safety Code. As amended, section 274 read:

Every person who provides, supplies, or administers to any woman, or procures any woman to take any medicine, drug, or substance, or uses or employs any instrument or other means whatever, with intent thereby to procure the miscarriage of such woman, * * * except as provided in the Therapeutic Abortion Act, Chapter 11 (commencing with Section 25950) of Division 20 of the Health and Safety Code, is punishable by imprisonment in the state prison not less than two nor more than five years. CAL. PENAL CODE § 274 (West Supp. 1968).

The California Therapeutic Abortion Act of 1967 authorizes abortions if the following conditions are met: the abortion takes place in an accredited hospital; the abortion is approved in advance by a committee of the medical staff of the hospital; and the committee finds that there is substantial risk that a continuation of the pregnancy would gravely impair the mother's physical or mental health, or that the pregnancy resulted from rape or incest. CAL. HEALTH & SAFETY CODE § 25951 (West Supp. 1967).

2 Ch. 528, § 1, [1935] Cal. Stats. 1605.

3 Justice Peters wrote the majority opinion with which Chief Justice Traynor and Justices Tobriner and Pierce concurred. Judge Pierce of the California Court of Appeals, Third District, was assigned by the Chairman of the Judicial Council to fill the seat of Justice Mosk for this case. Dissenting opinions were written by Justices Sullivan and Burke. Justice McComb concurred in both dissents.

constitutional right to choose whether to bear children. *People v. Belous*, — Cal. 2d —, 458 P.2d 194, 80 Cal. Rptr. 354 (1969).

Reasonable certainty in legislation is now generally held to be an essential element of due process of law.⁴ The potential danger of convicting a man of violating a law which he could not understand demands an even more exacting standard of certainty in criminal than in noncriminal statutes.⁵ The application of this standard to criminal statutes was recognized by the Supreme Court in *United States v. Harriss*:⁶

The constitutional requirement of definiteness is violated by a criminal statute that fails to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden by the statute. The underlying principle is that no man shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed.⁷

This standard of certainty and definiteness, however, does not demand absolute precision. A statute is not unconstitutionally vague simply because it is difficult to determine whether a particular marginal case falls within the statute's language.⁸ A statute is sufficiently definite if the general class of offenses to which it is directed falls plainly within its terms; if the statute can reasonably be construed so that this general class of offenses is constitutionally definite, the court has a duty to give the statute that construction.⁹ The Supreme Court has noted that impossible standards are not required by the Constitution; all that is required is that the warning as to the proscribed conduct given by the statutory language be sufficiently definite when measured by common understanding and practices.¹⁰

The majority in *Belous*, instead of focusing its attention on the general class of offenses prohibited or the sufficiency of the warning given by section 274, chose to concentrate on three words of the statute: "necessary to preserve." Finding no standard definition for the phrase taken as a whole,¹¹ the majority turned to the dictionary to define the words separately. From this search, no "fixed meaning" for the word "necessary" emerged, and the definition of the word "preserve" was found to be "even less enlightening."¹² Unable to find a clear meaning from the dictionary, the majority next considered a possible meaning that it felt had been suggested by the respondent's assertion: "'If medical science feels the abortion should be performed as it is necessary to preserve her life, then it may be performed; that is, unless it is performed the patient will die.'"¹³ From this declaration, Justice Peters, writing for the majority, felt that the respondent was suggesting an interpretation of the phrase

4 *E.g.*, *Bouie v. City of Columbia*, 378 U.S. 347, 351 (1964); *Lanzetta v. New Jersey*, 306 U.S. 451, 453 (1939); *Connally v. General Constr. Co.*, 269 U.S. 385, 391 (1926).

5 *Winters v. New York*, 333 U.S. 507, 515 (1948).

6 347 U.S. 612 (1954).

7 *Id.* at 617.

8 *United States v. National Dairy Corp.*, 372 U.S. 29, 32 (1963).

9 *United States v. Harriss*, 347 U.S. 612, 618 (1954).

10 *United States v. Petrillo*, 332 U.S. 1, 7-8 (1947).

11 *People v. Belous*, — Cal. 2d —, —, 458 P.2d 194, 198, 80 Cal. Rptr. 354, 358 (1969).

12 *Id.*

13 *Id.*

that would require certain and immediate death.¹⁴ Justice Peters rejected this interpretation of the statute by citing to earlier California cases decided under section 274. For example, in *People v. Ballard*¹⁵ a California court of appeal had said:

Surely, the abortion statute (Penal Code, § 274) does not mean by the words "unless the same is necessary to preserve her life" that the peril to life be imminent. It ought to be enough that the dangerous condition "be potentially present, even though its full development might be delayed to a greater or less extent. Nor was it essential that the doctor should believe that the death of the patient would be otherwise *certain* in order to justify him in affording present relief."¹⁶ (Citations omitted.)

"[T]o uphold a criminal statute against a charge of vagueness by adopting a construction of the statute rejected by the courts of this state . . ." would be an anomaly, according to Justice Peters, "unless there was a clear showing of a strong public policy or legislative intent requiring adoption of the rejected construction."¹⁷ Since no such showing had been made, respondent's interpretation fell. Other possible interpretations of the phrase were rather perfunctorily rejected by the majority in dicta.¹⁸ Thus, unable to find a clear meaning of "necessary to preserve" from the dictionary or from suggested interpretations, the majority concluded that the phrase was not susceptible to a construction that was sufficiently certain to satisfy the requirements of due process.¹⁹

What the majority had achieved by its analysis was aptly stated by Justice Sullivan in his dissenting opinion: "[T]he majority, by engaging in a process of elaborate and lavish analysis, transform that which is simple and lucid into something complex and arcane."²⁰ For over one hundred years men of ordinary intelligence in California have apparently understood what conduct the statute forbids. Indeed, the Supreme Court of California has seemingly had no trouble applying section 274 in numerous cases.²¹ In one of these cases, although not discussing the phrase declared vague in *Belous*, the court upheld section 274 against a void-for-vagueness argument.²² Even more ironic, New Jersey has recently upheld its antiabortion statute against a vagueness attack by limiting "justifiable" abortions to those necessary to preserve the mother's life. The New Jersey statute provided that abortions were illegal "without lawful justification."²³ Interpreting this statute, the Supreme Court of New Jersey, in *State v. Moretti*,²⁴

14 *Id.*

15 167 Cal. App. 2d 803, 335 P.2d 204 (Dist. Ct. App. 1959).

16 *Id.* at 814, 335 P.2d at 212.

17 *People v. Belous*, — Cal. 2d —, —, 458 P.2d 194, 199, 80 Cal. Rptr. 354, 359 (1969).

18 *Id.* at —, 458 P.2d at 204-05, 80 Cal. Rptr. at 364-65.

19 *Id.* at —, 458 P.2d at 197, 80 Cal. Rptr. at 357.

20 *Id.* at —, 458 P.2d at 211, 80 Cal. Rptr. at 371 (Sullivan, dissenting).

21 *People v. Davis*, 43 Cal. 2d 661, 276 P.2d 801 (1954); *People v. Gallardo*, 41 Cal. 2d 57, 257 P.2d 29 (1953); *People v. Buffum*, 40 Cal. 2d 709, 256 P.2d 317 (1953); *People v. Wilson*, 25 Cal. 2d 341, 153 P.2d 720 (1944); *People v. Long*, 15 Cal. 2d 590, 103 P.2d 969 (1940); *People v. Rankin*, 10 Cal. 2d 198, 74 P.2d 71 (1937); *People v. Coltrin*, 5 Cal. 2d 649, 55 P.2d 1161 (1936); *People v. Shafer*, 198 Cal. 717, 247 P. 576 (1926); *People v. Morani*, 196 Cal. 154, 236 P. 135 (1925); *People v. Richardson*, 161 Cal. 552, 120 P. 20 (1911); *People v. Balkwell*, 143 Cal. 259, 76 P. 1017 (1904).

22 *People v. Rankin*, 10 Cal. 2d 198, 202, 74 P.2d 71, 73 (1937).

23 N.J. STAT. ANN. § 2A:87-1 (1969).

24 52 N.J. 182, 244 A.2d 499 (1968).

stated: "Clearly, a construction of the statute which confined the meaning of the phrase 'lawful justification' to the preservation of the mother's life would avoid any constitutional attack based on vagueness."²⁵

Antiabortion statutes similar to the one in controversy in *Belous* are currently in force in twenty-six states.²⁶ Judicial interpretations of these statutes and of section 274 would appear to show that "necessary to preserve" is sufficiently definite so that the general class of offenses to which section 274 is directed falls plainly within its terms. As Justice Burke pointed out in his dissenting opinion in *Belous*,²⁷ the proper interpretation of "necessary to preserve life" was stated by the Supreme Court of Washington in *State v. Powers*:²⁸

If the appellant, in performing the operation, did something which was recognized and approved by those reasonably skilled in his profession . . . then it cannot be said that the operation was not necessary to preserve the life of the patient.²⁹

Powers's interpretation of "necessary to preserve" was quoted with approval by the California court in *People v. Ballard*,³⁰ the case cited by the majority in *Belous* for rejecting an interpretation that would require imminent death.³¹ A more recent California decision reversed the conviction of a doctor, found guilty of two counts of illegal abortion, because the prosecution failed to show that the abortion "was not reasonably necessary to save the life of such woman."³² The prosecution did not meet its burden of proof, partly, because it failed to show "that the doctor did not proceed in accordance with professional [*sic*] recognized and approved methods."³³ It is significant that the interpretation offered by *Powers* was not specifically considered by the *Belous* majority when discussing possible meanings of section 274.

As previously stated, a statute will be upheld against a void-for-vagueness argument if the warning as to the proscribed conduct is sufficiently definite when measured by common understanding and practices.³⁴ The judicial history and interpretations of section 274 and similar statutes reveal that

25 *Id.* at 191, 244 A.2d at 504.

26 ALASKA STAT. § 11.15.060 (1962); ARIZ. REV. STAT. ANN. § 13-211 (1956); FLA. STAT. ANN. § 782.10 (1965); HAWAII REV. STAT. § 768-7 (1968); IDAHO CODE ANN. § 18-601 (1948); ILL. REV. STAT. ch. 38, § 23-1 (1967); IND. ANN. STAT. § 10-105 (1956); IOWA CODE ANN. § 701.1 (1950); KY. REV. STAT. ANN. § 436.020 (1969); ME. REV. STAT. ANN. tit. 17, § 51 (1964); MICH. STAT. ANN. § 28.204 (1962); MONT. REV. CODES ANN. § 94-401 (1969); NEB. REV. STAT. § 28-404, -405 (1964); N.H. REV. STAT. ANN. § 585:13 (1955); N.Y. PENAL LAW § 125.05 (McKinney 1967); N.D. CENT. CODE § 12-25-01 (1960); OHIO REV. CODE ANN. § 2901.16 (Page 1954); OKLA. STAT. ANN. tit. 21, § 861 (Supp. 1969); R.I. GEN. LAWS ANN. § 11-3-1 (1956); S.D. COMP. LAWS ANN. §§ 22-16-18, 22-17-1 (1967); TENN. CODE ANN. § 39-301 (1955); TEXAS PEN. CODE ANN. art. 1196 (1961); UTAH CODE ANN. § 76-2-1 (1953); VT. STAT. ANN. tit. 13, § 101 (1958); WIS. STAT. ANN. § 940.04 (1958); WYO. STAT. ANN. § 6-77 (1957).

27 *People v. Belous*, — Cal. 2d —, —, 458 P.2d 194, 208, 80 Cal. Rptr., 354, 368 (1969) (Burke, dissenting).

28 155 Wash. 63, 283 P. 439 (1929).

29 *Id.* at 67, 283 P. at 440.

30 167 Cal. App. 2d 803, 814-15, 335 P.2d 204, 212 (Dist. Ct. App. 1959).

31 See text accompanying notes 15 & 16, *supra*.

32 *People v. Ballard*, 218 Cal. App. 2d 295, 307, 32 Cal. Rptr. 233, 241 (Dist. Ct. App. 1963).

33 *Id.*

34 See text accompanying note 10, *supra*.

The phrase in question, when applied according to the standard heretofore stated (namely, whether persons reasonably skilled in their profession practicing in the same community recognized and approved the act as being required to save the patient from dying) *clearly gives such warning*.³⁵ (Emphasis added.)

Even though the void-for-vagueness basis of the *Belous* decision may be tenuous, the majority seemed to offer an alternative ground — the statute's unconstitutional infringement of the rights of women. Although the court speaks of "vagueness" and "infringement" in the same breath, placing primary emphasis on the "vagueness" basis,³⁶ it appears as though the decision is based on the two grounds separately.

The technique of camouflaging a second ground for a decision by focusing on the uncertainty of the statute is not novel. As one commentator has said, "in the great majority of instances the concept of vagueness is an available instrument in the service of other more determinative judicially felt needs and pressures."³⁷ In other words, the void-for-vagueness argument is used in many cases to create an "insulating buffer-zone of added protection at the peripheries of several of the Bill of Rights freedoms."³⁸ *Belous* was one of those cases in which the "buffer zone" theory applied. It was obviously less difficult for the court to declare section 274 unconstitutionally vague than it would have been for them to unequivocally state that family planning, even if achieved through abortion, is a constitutionally protected right. Such a statement, considering the present moral and sociological issues surrounding the question of abortion,³⁹ would be disquieting. Aware of these social pressures, the majority utilized the "buffer zone" theory to hide what apparently is another ground for the decision — the woman's individual right to choose to bear (or not to bear) children.

The majority considers the right to choose whether to bear children to follow from the general right to privacy. Although the right to privacy is not expressly mentioned in the Constitution, it is considered to be implicit in many of the Constitution's provisions and in the philosophical background from which the Constitution was drawn.⁴⁰ The Supreme Court has long recognized the right as the most sacred and most carefully guarded right conferred on the in-

35 *People v. Belous*, — Cal. 2d —, —, 458 P.2d 194, 209, 80 Cal. Rptr. 354, 369 (1969) (Burke, dissenting).

36 Before giving the reasons for its conclusion, the majority stated:

We have concluded that the term "necessary to preserve" in section 274 of the Penal Code is not susceptible of a construction that does not violate legislative intent and that is sufficiently certain to satisfy due process requirements without improperly infringing on fundamental constitutional rights. *People v. Belous*, —, Cal. 2d —, —, 458 P.2d 194, 197, 80 Cal. Rptr. 354, 357 (1969).

37 Note, *The Void-For-Vagueness Doctrine in the Supreme Court*, 109 U. PA. L. REV. 67, 75 (1960).

38 *Id.*

39 This comment deals with the constitutionality of antiabortion statutes, and consequently concentrates on the legal issues of abortion. For discussions of the moral and sociological issues surrounding the practice of abortion, see C. DALY, *MORALS, LAW AND LIFE* (1961); D. LOWE, *ABORTION AND THE LAW* (1966); N. ST. JOHN-STEVAS, *THE RIGHT TO LIFE* (1964); DRINAN, *The Morality of Abortion Laws*, 14 CATH. LAW. 190 (1968); Jacobovits, *Jewish Views on Abortion*, in *ABORTION AND THE LAW* 124 (D. Smith ed. 1967); *Church-State: A Legal Survey—1966-68*, 43 NOTRE DAME LAWYER 684, 695-707 (1968).

40 Griswold, *The Right to be Let Alone*, 55 NW. U. L. REV. 216, 216 (1960).

dividual.⁴¹ Expounding on the constitutional basis for the right, Mr. Justice Brandeis, in his dissent in *Olmstead v. United States*,⁴² stated:

The makers of our Constitution undertook to secure conditions favorable to the pursuit of happiness. . . . They sought to protect Americans in their beliefs, their thoughts, their emotions and their sensations. They conferred, as against the Government, the right to be let alone — the most comprehensive of rights and the right most valued by civilized men.⁴³

This comprehensive right was recently extended, in *Griswold v. Connecticut*,⁴⁴ to matters relating to sex, family, and marriage. In that case, the state law prohibiting the use of contraceptive devices was declared an unconstitutional infringement of married couples' right to privacy as guaranteed by the due process clause of the fourteenth amendment. The Court found this right to marital solitude to lie within the zone of privacy created by the first, third, fourth, fifth, and ninth amendments.⁴⁵

Although the Supreme Court has recognized the right of privacy, it has also warned that the state may infringe on these personal liberties when they conflict with a compelling state interest.⁴⁶ But, just as the right to privacy is not unlimited, so too the right of the state to assert its compelling interest is not unlimited. When asserting its interest the state may not "broadly stifle fundamental personal liberties when the end can be more narrowly achieved."⁴⁷

With this background the court in *Belous* confronted two issues. Did section 274 infringe upon a personal right to privacy? If so, was this infringement justified by a compelling state interest? In answering the first issue in the affirmative, the court found section 274 violated the woman's rights,⁴⁸ particularly, her right to choose whether to bear children.⁴⁹ The majority felt that this right emanated from the more general right to privacy in matters related to sex, family, and marriage,⁵⁰ as established by *Griswold* and other Supreme Court decisions.⁵¹ In showing that there was no law to the contrary, the majority thought it notable that none of the parties filing briefs in the case disputed the existence of this fundamental right.⁵²

Having found that section 274 did infringe upon fundamental rights, the majority turned to the second issue. Was there a compelling state interest that might be asserted to justify such an infringement? Justice Peters considered two possible state interests. The first was the state interest in the woman's health.

41 See *Union Pac. Ry. v. Botsford*, 141 U.S. 250, 251 (1891).

42 277 U.S. 438 (1928).

43 *Id.* at 478.

44 381 U.S. 479 (1965).

45 *Id.* at 484.

46 *E.g.*, *Sherbert v. Verner*, 374 U.S. 398, 406 (1963).

47 *Shelton v. Tucker*, 364 U.S. 479, 488 (1960).

48 Although Justice Peters concentrates on section 274's effect on the woman's right to choose whether to bear children, he indicated the woman's right to life could also be infringed by the statute "because childbirth involves risks of death." *People v. Belous*, —, Cal. 2d —, —, 458 P.2d 194, 199, 80 Cal. Rptr. 354, 359 (1969).

49 *Id.*

50 *Id.*

51 The *Belous* majority lists other Supreme Court cases which it feels acknowledges this aspect of the right to privacy. *Id.* at —, 458 P.2d at 199-200, 80 Cal. Rptr. at 359-60.

52 *Id.* at —, 458 P.2d at 200, 80 Cal. Rptr. at 360.

According to Justice Peters, this interest may have justified a direct interference with the woman's constitutional rights in 1850 when considered in the light of the then existing medical and surgical sciences.⁵³ But, when considered in the light of modern medical and surgical practices, which indicate that a hospital therapeutic abortion during the first trimester of pregnancy is now safer for a woman than is giving birth,⁵⁴ this state interest in the woman's health can no longer take precedence over her constitutional rights.⁵⁵

The second possible state concern pondered was the interest in the protection of the embryo or fetus. The respondent had maintained that several statutes and court rules showed that the embryo or fetus is equivalent to the born child and is, therefore, entitled to the same protection by the state.⁵⁶ The majority rejected this contention because "all of the statutes and rules relied upon required a live birth or reflect the interests of the parents."⁵⁷ Also influential in rejecting the contention was the recognition that the intentional destruction of the embryo or fetus is never treated as murder, and rarely treated as manslaughter, whereas the intentional destruction of the born child is always one of these two offenses.⁵⁸ There being no compelling state interest to justify the infringement of the woman's rights, section 274 fell as unconstitutional.

As previously noted, the majority's rationale for holding section 274 void for vagueness was somewhat tenuous. However, the reasoning behind the alternative basis for declaring the statute unconstitutional — unreasonable infringement upon a constitutional right — appears legally sound in light of the growing recognition of the right to privacy in sex, marriage, and family matters, and the absence of a recognized state interest in protecting the fetus or embryo as a human being. The majority avoided the issue of whether the state has or should have a *moral* interest in protecting the unborn. Instead, it searched for *legal* recognition of that interest and found that none had been made either judicially or legislatively.⁵⁹ Until such recognition is made, the finding reached in *Belous* must be upheld. The court's rationale for finding an unconstitutional infringement of the woman's rights would apply equally well to any antiabortion statute. Therefore, section 274, even if not vague, was correctly declared unconstitutional.

The effect which *Belous* has on antiabortion laws in California and in other states may be greater than one might anticipate. In California, section 274 had been amended, after *Belous's* arrest, by the Therapeutic Abortion Act of 1967.⁶⁰ Since the majority did not reach a conclusion on the constitutionality of the new act, it might appear that the decision does not affect the current

53 *Id.*

54 *Id.* at —, 458 P.2d at 200-01, 80 Cal. Rptr. at 360-61. For facts on which this conclusion is based, see Brief for Medical School Deans and Others as Amici Curiae in Support of Appellant, Appendix A, *People v. Belous*, — Cal. 2d —, 458 P.2d 194, 80 Cal. Rptr. 354 (1969).

55 *Id.* at —, 458 P.2d at 202, 80 Cal. Rptr. at 362.

56 *Id.*

57 *Id.*

58 *Id.* at —, 458 P.2d at 203, 80 Cal. Rptr. at 363.

59 The *Belous* majority searched to no avail the California statutes and judicial decisions for a recognition of an interest in the protection of the embryo or fetus. *People v. Belous*, — Cal. 2d —, — n.12, 458 P.2d 194, 202-3 n.12, 80 Cal. Rptr. 354, 362-63 n.12 (1969).

60 CAL. HEALTH & SAFETY CODE §§ 25950-54 (West Supp. 1969).

status of the law in California.⁶¹ Nevertheless, the same reasoning used to strike down section 274 as an unconstitutional infringement of the woman's rights may be used to invalidate the Therapeutic Abortion Act. Surely the rights affected by the new act are the same as those affected by section 274. And the legally nonhuman status of the unborn is certainly not changed under the new act. To the contrary, because of the broader circumstances under which abortion is justified in the new law,⁶² it would appear that the *Belous* court's finding that there has been no legislative or judicial recognition of the embryo or fetus's right to life is buttressed. For example, under the 1967 act a pregnancy resulting from a willing act of incest may be terminated by abortion,⁶³ but one resulting from the typical marital act may not be so terminated. Certainly a statute providing some embryos with the state's protection and denying it to others does not recognize a right to life in that embryo. Rather, it provides added indicia that the state has failed to legislatively recognize that the embryo or fetus is the equivalent of the born child and, therefore, entitled to protection. Considered in this light, the California Therapeutic Act of 1967 is just as unreasonable an infringement as was section 274.

The antiabortion statutes of many other jurisdictions are susceptible to the same constitutional arguments raised in *Belous*. Even if these statutes withstand the "vagueness" attack, they must still confront the "infringement" argument. In order to uphold these statutes against this second argument, judicial or legislative recognition of the embryo or fetus as the equivalent of a human being must be shown. This recognition may exist expressly or impliedly within the antiabortion statute itself. At the present, only Wisconsin has an antiabortion statute that expressly makes such recognition.⁶⁴ That state's statute provides, "In this section 'unborn child' means a human being from the time of conception until it is born alive."⁶⁵ In a few other states⁶⁶ the antiabortion laws contain the following (or similar) language when describing when an abortion may be legally performed: "unless the same is necessary to preserve her [the mother's] life or that of her unborn child."⁶⁷ (Emphasis added.) Although this additional qualification "probably has no functional effect other than to make it clear that induced labor is not a violation of the criminal law,"⁶⁸ it might be argued in these jurisdictions that the legislature, by including the additional language, was implying a protectible state interest in the unborn's right to life — an interest that might be asserted to justify an infringement of the mother's rights.

61 The *Belous* court was urged to consider the constitutionality of the new act, but since the act was adopted after the abortion in question, the majority did not reach the issue of its validity. *People v. Belous*, — Cal. 2d —, — n.15, 458 P.2d 194, 206 n.15, 80 Cal. Rptr. 354, 366 n.15 (1969).

62 See note 1 *supra*.

63 CAL. HEALTH & SAFETY CODE § 25951(c)(2) (West Supp. 1969).

64 WIS. STAT. ANN. § 940.04 (1958).

65 *Id.* § 940.04(6).

66 CONN. GEN. STAT. ANN. § 53-29 (1958); MINN. STAT. ANN. § 617.18 (1964); MO. ANN. STAT. § 559.100 (1949); NEV. REV. STAT. § 201.120 (1967); S.C. CODE ANN. § 16-82 (1962); VA. CODE ANN. § 18.1-62 (1960); WASH. REV. CODE ANN. § 9.02.010 (1961); W. VA. CODE ANN. § 61-2-8 (1966).

67 *E.g.*, CONN. GEN. STAT. ANN. § 53-29 (1958).

68 George, *Current Abortion Laws: Proposals and Movements for Reform*, in ABORTION AND THE LAW 1, 9 (D. Smith ed. 1967).

But there remain many jurisdictions whose antiabortion statutes contain language similar to section 274⁶⁹ and do not expressly or impliedly recognize the unborn's right to life. In these jurisdictions, other statutes and case law must be scoured to find a recognition of this right to life. If none is found and if the deciding court chooses not to make the initial recognition, these statutes would readily fall under the *Belous* court's reasoning. Also vulnerable to constitutional attack are those antiabortion statutes that allow abortion for limited reasons in addition to saving the mother's life. Such statutes are presently in existence in twelve jurisdictions including California.⁷⁰ The same reasons given above for striking down the California Therapeutic Abortion Act of 1967 — the recognized rights of privacy of the women, the nonhuman status of the unborn, and the unequal protection of the law given some embryos and fetuses under these statutes — could be used to assail these other liberal antiabortion laws as well.

Developments since the *Belous* decision have indicated that the above discussion on the vulnerability of other jurisdictions' antiabortion laws is not mere speculation. The United States District Court for the District of Columbia recently struck down that jurisdiction's antiabortion law in *United States v. Vuitch*.⁷¹ The sixty-eight-year-old statute that was declared unconstitutional had permitted abortions only when "necessary for the preservation of the mother's life or health" ⁷² In his memorandum opinion Judge Gerhard A. Gessell, like the *Belous* majority, placed primary emphasis on the vagueness of the statute. He held, citing *Belous*, that the statute failed to give that "certainty which due process of law considers essential in a criminal statute."⁷³ Judge Gessell added, however, that the ambiguities of the statute were "particularly subject to criticism for the statute unquestionably impinges to an appreciable extent on significant constitutional rights of individuals."⁷⁴ (Emphasis added.) The degree to which the woman's right to privacy might now extend was noted by Judge Gessell when he stated:

69 See note 26 *supra*.

70 ALA. CODE tit. 14, § 9 (1958) (life or health of mother); ARK. STAT. ANN. § 41-304 (Supp. 1969) (life or health of mother; physical or mental defect of unborn child; pregnancy resulting from rape or incest); CAL. HEALTH & SAFETY CODE §§ 25950-54 (West Supp. 1969); COLO. REV. STAT. ANN. §§ 40-2-50, 40-2-51 (Supp. 1967) (life, physical or mental health of mother; physical deformity or mental retardation of the unborn child; pregnancy resulting from rape or incest); DEL. CODE ANN. tit. 24, § 1790 (1970) (life, physical or mental health of mother; physical deformity or mental retardation of unborn child; pregnancy resulting from rape or incest); GA. CODE ANN. §§ 26-1201, -1202 (1969) (life or health of mother; mental or physical defect of fetus; pregnancy resulting from rape); KAN. STAT. ANN. § 21-34-07 (Supp. 1969) (physical or mental health of mother; physical or mental defect of unborn child; pregnancy resulting from rape, incest or other felonious intercourse); MD. ANN. CODE art. 43, § 149 E (Supp. 1969) (physical or mental health of mother; physical deformity or mental retardation of unborn child; pregnancy resulting from rape); MISS. CODE ANN. § 2223 (Supp. 1968) (life of mother; pregnancy resulting from rape); N.M. STAT. ANN. §§ 40A-5-1, 40A-5-3 (Supp. 1969) (life, mental or physical health of mother; physical or mental defect of unborn child; pregnancy resulting from rape or incest); N.C. GEN. STAT. § 14-45.1 (Supp. 1969) (life or health of mother; physical or mental defect of unborn child; pregnancy resulting from rape or incest); ch. 684, [1969] ORE. LAWS 1782 (physical or mental health of mother; physical or mental defect of unborn child; pregnancy resulting from felonious intercourse).

71 305 F. Supp. 1032 (D.D.C. 1969).

72 D.C. CODE ENCYCL. ANN. § 22-201 (1967).

73 305 F. Supp. at 1034.

74 *Id.*

There has been . . . an increasing indication in decisions of the Supreme Court of the United States that as a secular matter a woman's liberty and right of privacy extends to family, marriage and sex matters and may well include the right to remove an unwanted child at least in early stages of pregnancy.⁷⁵

In his ruling Judge Gessell threw out the illegal abortion charges against a physician but refused to dismiss the indictment against a nurse's aide on the ground that Congress had "constitutionally required that abortions be undertaken only under the direction of a competent physician."⁷⁶

The constitutionality of the antiabortion statute of at least one other jurisdiction will be decided in the near future. A recent newspaper report indicated that three suits attacking the constitutionality of New York's antiabortion statute have been consolidated for argument before a three-judge federal district court.⁷⁷ The New York law allows abortions only when necessary to save the mother's life.⁷⁸ The report also indicated that the American Civil Liberties Union plans to challenge the constitutionality of the antiabortion statutes of Indiana, New Jersey, South Carolina, and South Dakota.⁷⁹

The ultimate goal of those leading the current attack on the constitutionality of antiabortion laws appears to be abortion on request by a licensed physician.⁸⁰ As a result of the *Belous* and *Vuitch* decisions, the achievement of this goal has been promoted. Since there are inescapable and, seemingly, unresolvable moral issues involved in declaring the embryo or fetus a human being, it is doubtful that there will be any mass legal recognition of the unborn's right to life. Without such recognition, any statute that denies a woman an abortion by a licensed physician for any reason, at least during the early stages of pregnancy, would, under the reasoning of *Belous* and *Vuitch*, be placing the interests of a legally nonhuman entity above the constitutional rights of the woman. This would, of course, be imposing unconstitutional limitations on the woman's rights. What remains of an antiabortion statute after blue-penciling these unconstitutional limitations was illustrated in *Vuitch* — abortion on request if performed by a licensed physician. Such is the probable fate of all current antiabortion legislation.

Nelson J. Vogel, Jr.

75 *Id.* at 1035.

76 *Id.*

77 N.Y. Times, Nov. 12, 1969, at 30, col. 1 (city ed.).

78 N.Y. PENAL LAW § 125.05 (McKinney 1967).

79 N.Y. Times, Nov. 12, 1969, at 30, col. 1 (city ed.).

80 Many who are disenchanted with present antiabortion statutes have publicly declared their support for some form of abortion on request. For example, 280 psychiatrists who form the Group for the Advancement of Psychiatry recently asserted that "[a] woman should have the right to abort or not, just as she has a right to marry or not." This group urged that abortion, when performed by a licensed physician, be removed from the domain of criminal law. South Bend Tribune, Oct. 12, 1969, at 22, col. 1. At the opening of the annual meeting of the American College of Surgeons, speeches were presented suggesting that the decision whether to bear a child ought to be left to the mother and the physician. Chicago Sun-Times, Oct. 7, 1969, at 18, col. 3. The leader of a radical feminist group called the Feminists has emphatically come out in favor of abortion on request. Ti-Grace Atkinson, a plaintiff in the pending New York suits, has stated: "Any reason a woman gives for an abortion that is sufficient reason for her should be sufficient for the law." N.Y. Times, Nov. 12, 1969, at 30, col. 1 (city ed.).

SECURITIES REGULATION — SECURITIES EXCHANGE ACT OF 1934 — A CORPORATION IS AN INSIDER FOR THE PURPOSE OF SECTION 16(b) WHEN IT DEPUTIZES ITS PRESIDENT TO REPRESENT ITS INTERESTS ON THE ISSUER'S BOARD OF DIRECTORS — AN INSIDER IS LIABLE UNDER SECTION 16(b) FOR PURCHASES AND SALES OF SECURITIES WITHIN A SIX MONTH PERIOD EVEN THOUGH HE HAS CEASED TO HOLD HIS INSIDE POSITION WHEN THE FINAL TRANSACTION WAS CONSUMMATED. — On December 14, 1962, defendant Martin Marietta Corporation commenced purchasing stock in defendant Sperry Rand Corporation and continued making purchases throughout a period extending to July 25, 1963. On March 27, 1963, Sperry's board of directors resolved that George M. Bunker, Martin's president and chief executive officer, be invited to membership on the Sperry board. At the April twenty-fifth meeting of the Martin board of directors, Bunker informed the directors of Sperry's invitation and asked permission to serve. It was the consensus of the board that he accept the offer. On April 29, 1963, Bunker was elected a director of Sperry and he retained the directorship until his resignation on August 1, 1963. During the period from August 29, 1963 through September 6, 1963, Martin disposed of its Sperry stock. Sperry shareholder Judith S. Feder subsequently brought suit pursuant to section 16(b)¹ of the Securities Exchange Act of 1934 to recover for Sperry the profits Martin realized by selling the 101,300 shares of Sperry stock acquired by Martin between April 29, 1963, and August 1, 1963, all of which were sold within six months of their purchase by Martin. Plaintiff alleged that Bunker was deputized by or represented Martin when he served as a member of the Sperry board of directors and that during Bunker's membership Martin was a "director" of Sperry within the meaning of section 16(b).

The case was tried in the United States District Court for the Southern District of New York before Judge Cooper. Finding no deputization, Judge Cooper dismissed the action. On appeal, the United States Court of Appeals for the Second Circuit unanimously reversed the judgment and *held*: (1) the determination of the district court that Martin's executive officer was not deputized to represent Martin's interests on the board of directors of Sperry Rand was clearly erroneous, and (2) section 16(b) liability attaches to a sale of stock by a former director of the issuer if the stock had been purchased by him while he was a director and the sale was made within six months after purchase.

1 Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1964). Section 16(b) in relevant part provides:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Feder v. Martin Marietta Corporation, 406 F.2d 260 (2d Cir. 1969), cert. denied, 38 U.S.L.W. 3267 (U.S. Jan. 20, 1970) (No. 125).

The Securities Exchange Act of 1934 is designed to regulate and control the national securities exchanges and their brokers and dealers. The Act's purpose is "to protect the investing public by maintaining fair and open markets for the buying and selling of securities."² Section 16(b) was enacted, in the words of its preamble, "for the purpose of preventing the unfair use of information"³ by corporate insiders for their own profit. Among the inequitable transactions that prompted the enactment of section 16(b) were those in which insiders, having advance knowledge of information that would affect the market price of stock of their company, purchased (or sold) stock at the then current market prices and sold (or purchased) it when publication of the information had caused the anticipated change to occur. Occasionally the desire to obtain such profits had even led insiders to manipulate the market price of the corporation's stock by pursuing financial policies calculated to produce sudden fluctuations in market prices.⁴

In order to curb such abuses, and in recognition of the difficulty of proving that the insider had acted on the basis of inside information,⁵ the draftsmen of the Act adopted a method of purging all profits realized by corporate insiders through short-term speculation, without regard for the insider's intent and without proof of actual use of inside information. Congress did recognize, however, the desirability of corporate officials investing in their own corporations.⁶ Con-

² Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385 (1953).

³ Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1934).

⁴ Blau v. Lamb, 363 F.2d 507, 514-15 (2d Cir. 1966). The common-law remedy for breach of fiduciary duty on the part of the corporate insider was inadequate to protect the shareholder involved in the transaction. The majority of courts had held that corporate officials owe fiduciary duties only to their corporations and not to the individual shareholders. Yourd, *Trading in Securities by Directors, Officers, and Stockholders: Section 16 of the Securities Exchange Act*, 38 MICH. L. REV. 133, 139-43 (1939). It is generally held that the duty owed to the corporation is not violated by trading on the open market on the basis of inside information. See N. LATTIN, *THE LAW OF CORPORATIONS* 261-73 (1959). *But cf.* Blau v. Lehman, 368 U.S. 403, 416-20 (1962). (Douglas, J., dissenting). There is a growing line of cases, however, treating directors as ordinary agents and, therefore, under a fiduciary duty not to use confidential information for their own profits. *E.g.*, *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). The effect of section 16(b) is to create a conclusive presumption that this duty was breached whenever both a purchase and sale are made within six months by such a corporate official.

Professor Manne argues that not every shareholder who enters into a transaction with a corporate official armed with inside information is actually hurt by the transaction. He contends that only the short-term speculator would be injured by insider trading since the long-term investor's decision to hold or sell his securities is a function of time and would be unaffected by short-term price fluctuations. H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 94-110 (1966). This hypothesis is suspect, however, since Professor Manne fails to verify it with statistical evidence; moreover, there is evidence to the contrary, i.e., all transactions are affected by price fluctuations. See Schotland, *Unsafe at any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1447 (1967). Furthermore, there is no reason per se why short-term speculators should be discouraged since their discouragement would reduce, in the long run, the amount of capital available for the stock market and the liquidity of the market itself.

⁵ *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239-40 (2d Cir. 1943).

⁶ One of the past vices in the business world was the formation of companies with little capital and with their managing personnel and promoters having no financial stake in the success or failure of the company. Many of these businesses folded shortly after incorporation. To remedy this situation, statutes were passed requiring that directors own a certain number of shares in the company before assuming their positions. As early as 1845, for example, Parliament passed an act providing that: "no person shall be capable of being a director unless

sequently, a line was drawn at six months for the purpose of separating short-swing speculation from long-term investment in the company's future. Thus, 16(b) provides that all profits realized by a corporate insider from a purchase and sale, or sale and purchase, of any security of the issuing corporation within a period of less than six months shall be recoverable by the issuer.

The judicial history of section 16(b), especially in the Second Circuit, has been marked by what might be termed a teleological approach. The courts have characterized the section as broadly remedial⁷ and have consequently interpreted it in the light of its legislative purpose, even departing when necessary from the literal statutory language.⁸ Until the present case, the scope of section 16(b) has never been extended to persons other than directors, officers, and ten percent shareholders,⁹ yet this is what has been done in *Feder* through the creation of what the Second Circuit frankly admitted to be a legal fiction.¹⁰

The basis for this legal fiction, through which a corporation or partnership can be held a constructive director of another corporation for the purpose of section 16(b) liability, may be found in the Act itself. Section 3(a)(7)¹¹ provides that: "director means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated." Section 3(a)(9)¹² defines "person" to mean "an individual, a corporation, [or] a partnership" Consequently, a partnership or a corporation can be a director of another corporation for the purposes of section 16(b) if it has actually performed the functions of a director through a deputy.

The seeds for the theory employed for the first time in *Feder* were planted by Judge Learned Hand in his concurring opinion in *Rattner v. Lehman*.¹³ In *Rattner*, the United States Court of Appeals for the Second Circuit faced the issue of whether a partnership is liable under section 16(b) for profits realized through a short-swing purchase and sale of securities merely because a partner of that firm is a director of the issuing corporation. A majority of the court held that section 16(b) liability does not automatically attach in such a situation. The court reasoned that the elimination of a provision in an earlier draft of the Act manifested a Congressional intention to limit liability to members of the three statutory categories.¹⁴ Since the partner-director had already returned to the

he be a shareholder, nor unless he be possessed of the prescribed number, if any, of shares." Companies Clauses Consolidation Act of 1845, 7 & 8 Vict. c.16, § 85.

7 [W]e construe this statute to be remedial, not penal, and hence subject to that interpretation most consistent with the legislative purpose as that can be discerned from the statute itself and by resort to its history if that be needed. *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959); *accord*, *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir. 1943).

8 See note 53 *infra* and accompanying text.

9 The Supreme Court has expressly rejected the idea that section 16(b) liability could be extended beyond the three statutory categories, observing that the "broadening of the categories of persons on whom these liabilities are imposed by the language of § 16(b) was considered and rejected by Congress when it passed the Act." *Blau v. Lehman*, 368 U.S. 403, 411-12 (1962). The theory of deputation overcomes this hurdle by placing the corporation or partnership into one of the three statutory categories.

10 *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 262 (2d Cir. 1969).

11 Securities Exchange Act of 1934 § 3(a)(7), 15 U.S.C. § 78c(a)(7) (1964).

12 *Id.* § 3(a)(9), 15 U.S.C. § 78c(a)(9) (1964).

13 193 F.2d 564 (2d Cir. 1952).

14 The provision deleted from the first draft read in part:

It shall be unlawful for any director . . . To disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not neces-

issuing corporations his proportionate share of the profits realized by the partnership, no additional liability was incurred. In his concurring opinion, Judge Learned Hand agreed that the partnership should not be automatically liable but opened the doors for the *Feder* decision when he added:

I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally "directors"; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person.¹⁵

The Supreme Court accepted this dictum in *Blau v. Lehman*,¹⁶ a case with nearly the same fact situation as *Rattner*. The plaintiff there alleged — following the language used by Judge Hand — that a partnership, which had realized a profit on a short-swing transaction, had deputized one of its partners to represent its interests on the issuer's board of directors. Although the Court affirmed the lower court's determination that the director was not in fact deputized, the theory was given new life when the Court stated:

No doubt Lehman Brothers, though a partnership, could for the purposes of § 16 be a "director" of Tide Water and function through a deputy Lehman Brothers would be a "director" of Tide Water, if as petitioner's complaint charged Lehman actually functioned as a director through Thomas, who had been deputized by Lehman to perform a director's duties not for himself but for Lehman.¹⁷

The first attempt to apply the deputization theory to a corporation in order to impose section 16(b) liability was made in *Marquette Cement Manufacturing Co. v. Andreas*.¹⁸ In *Marquette*, a shareholder in a family corporation was also the director on the board of the issuing corporation, and both the director and his family corporation made a purchase and sale of stock in the issuing corporation within a six-month period. The plaintiff-issuing corporation alleged

sary or proper to be disclosed as a part of his corporate duties. Any profit made by any person, to whom such unlawful disclosure should have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer H.R. 7852, 73d Cong., 2d Sess. § 15(b) (1934); S. 2693, 73d Cong. 2d Sess.

§ 15(b) (1934).

Although the Supreme Court in *Blau v. Lehman* has endorsed the argument used in the *Rattner* decision, and although it now seems firmly established that a partnership will not be held liable (absent a showing of deputization) for profits realized while one of the partners was an insider, it is not at all clear that this was the intention of Congress in eliminating the provision. The alternative to the *Rattner* court's theory is that section 15(b) of the earlier draft was altered in order to remove the requirement of proving an unfair use of inside information. The Second Circuit in *Smolowe* seems to have adopted this appraisal when it stated that the provision was removed "presumably because the burden of proof made enforcement unfeasible." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 236 (2d Cir. 1943). If the *Smolowe* court's analysis is correct, such an argument would augment the plaintiff's contention in *Rattner* that 16(b) liability ought extend automatically to partnerships in order to prevent the possibility of a "tippee" acting on inside information. If the earlier draft had read "to whom such disclosure had been made or *might have been made*," the *Blau-Rattner* interpretation would clearly be correct.

15 *Rattner v. Lehman*, 193 F.2d 564, 567 (2d Cir. 1952) (L. Hand, J., concurring).

16 368 U.S. 403 (1962).

17 *Id.* at 409-10.

18 239 F. Supp. 962 (S.D.N.Y. 1965).

that this director was a deputy of his family corporation and that all profits realized by the family corporation ought therefore inure to the issuing corporation. The court recognized the availability of the deputization theory to impose section 16(b) liability on a corporation; but the court eschewed the imposition of liability, holding that when a stockholder in a family corporation has engaged in a short-swing transaction from which the family corporation has also benefited, actual deputization has not been established.¹⁹

The *Marquette* court also stated that deputization is a question of fact to be determined on a case-by-case basis.²⁰ For this reason, reviewing courts have been hesitant to reverse a trial court's determination of no deputization. The conclusion in *Feder* that Bunker was — contrary to the district court's finding — a deputy of Martin demands a close analysis of the facts of that case.

The district court in *Feder* based its conclusion that Martin had not deputized Bunker on the following findings of fact:²¹

- 1) Bunker had been initially invited by Sperry to join its board two and one-half months before Martin began its accumulation of Sperry stock.²²
- 2) Bunker's fine business reputation and engineering expertise was the prime motive for Sperry's interest in Bunker.²³
- 3) No other Martin man was ever mentioned for the position in the event Bunker absolutely declined.²⁴
- 4) Sperry, not Martin, took the initiative in encouraging Bunker to become a Sperry director.²⁵
- 5) Bunker had rejected Sperry's initial invitation before Martin had acquired any of its Sperry stock and had also rejected a subsequent offer made after Martin had accumulated well over four hundred thousand shares of Sperry stock.²⁶

The district court found this evidence insufficient to support a claim of deputization. In reaching this conclusion, the district court followed *Blau* and *Marquette*²⁷ and held that the plaintiff must prove that the insider (Bunker) was formally deputized by the purchasing corporation (Martin). In the alternative, the plaintiff would be required to show by circumstantial evidence that the insider in fact represented the purchasing corporation on the board of the issuing corpo-

19 *Id.* at 967.

20 *Id.*

21 The sequence of ordering these facts has been chosen for classification purposes. Items 1-3 relate to the attitude of Sperry Rand towards the function of Bunker on the Sperry board; items 4 and 5 concern Martin's attitude to Bunker's role.

22 *Feder v. Martin Marietta Corp.*, 286 F. Supp. 937, 943 (S.D.N.Y. 1968).

23 *Id.*

24 *Id.* at 944.

25 *Id.*

26 *Id.* at 943. The court also found that no member of Martin's board ever gave Bunker the impression that he was to represent Martin's interests on the Sperry board; that Bunker's acceptance of Sperry's offer was motivated by his own personal interests and his belief that future benefits would inure to Martin as a result of his direct experience with the operational problems of a firm involved in the computer business, a field into which Martin had planned to expand; that decision to purchase and sell Sperry stock originated with Martin's financial vice-president, even though Bunker could veto such transactions; and that Bunker never disclosed any inside information to Martin personnel. Since these findings, or their significance, were disputed by the court of appeals, they will be discussed later.

27 *Blau v. Lehman*, 286 F.2d 786, 789 (2d Cir. 1960); *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962, 967 (S.D.N.Y. 1965).

ration (Sperry).²⁸ The court also stressed that the invitation to Bunker to join the Sperry board was tendered on Sperry's initiative and that the lower courts in both *Rattner* and *Blau* gave considerable weight to this factor.²⁹

Upon reviewing the district court's fact findings, the court of appeals found "additional, more germane, uncontradicted evidence" which left the "definite and firm conviction that a mistake was committed."³⁰ The court therefore reversed the lower court's decision as "clearly erroneous."³¹ An understanding of the importance of this decision necessitates a lengthy consideration of the "more germane" facts relied upon by the *Feder* court and the extent to which a new criterion has emerged for evaluating evidence of deputization.

"First and foremost"³² of the facts emphasized by the *Feder* court was Bunker's position of control over the total operations of Martin, "including personal approval of all the firm's financial investments, and, in particular, all of Martin's purchases of Sperry stock."³³ The court noted that Bunker's control over Martin's investments, coupled with his position on the Sperry board, placed him in a position where he could easily use inside information without disclosing it to any other Martin personnel.³⁴ Although the court stopped short of holding that Bunker's power of approval would alone be sufficient to constitute deputization,³⁵ it did intimate that this was the key element in its findings.³⁶

The court then went on to outline additional evidence to support its conclusion that Bunker represented Martin on the Sperry board. First, Bunker's letter of resignation to General Douglas MacArthur, the chairman of the Sperry board, stated: "When I became a member of the Board in April, it appeared

28 *Feder v. Martin, Marietta Corp.*, 286 F. Supp. 937, 945 (S.D.N.Y. 1968). It is not necessary to prove that the insider was deputized for the purpose of relating inside information to the deputizing corporation. Proof of the disclosure of inside information, as the lower court noted, is only one factor to be considered in determining whether an insider has been deputized. *Id.* at 945-46. The court seemed to indicate that under Hand's view in *Rattner*, "deputized to represent its interests" means that the insider receives information from the deputizing entity on how to vote, etc., rather than that the insider sits on the board of the issuing corporation for the purpose of disclosing inside information to the deputizing corporation. If the latter were the case, a rule 10b-5 action might be appropriate. *But see* note 49 *infra*.

29 *Feder v. Martin, Marietta Corp.*, 286 F. Supp. 937, 944 (S.D.N.Y. 1968).

30 *Feder v. Martin, Marietta Corp.*, 406 F.2d 260, 263-64 (2d Cir. 1969).

31 *Id.* at 263.

32 *Id.* at 264.

33 *Id.*

34 *Id.* This conclusion made insignificant the district court's findings that Bunker never disclosed inside information relevant to investment decisions. *Id.* Furthermore, such findings, according to the court of appeals, were not totally supportable in light of the following facts: 1) Bunker testified that three Sperry officials had furnished him with information relating to the short-range outlook of Sperry; 2) Bunker discussed Sperry's affairs with two officials of Martin; and 3) an unsigned document, describing the Sperry short-term outlook, was found in the Martin files.

As the district court recognized, use of inside information is not relevant in determining liability under 16(b) but is relevant in determining whether an alleged deputy was, in fact, deputized by the purchasing entity. Nevertheless, it is doubtful that the Second Circuit attached any weight to the foregoing evidence of disclosure since similar evidence, namely, that the alleged deputy had told the purchasing partnership that the issuing corporation was "under good management" and that it was an "attractive investment," was presented in *Blau* and the court there failed to attach any significance to such evidence. *Blau v. Lehman*, 362 U.S. 403, 406 (1962).

35 *Feder v. Martin, Marietta Corp.*, 406 F.2d 260, 265 (2d Cir. 1969).

36 See note 44 *infra* and accompanying text. The court's finding that there was no significant difference between Martin's deputies on the boards of other corporations and Bunker's position on the Sperry board is another ramification of Bunker's peculiar position with Martin Marietta. *See Feder v. Martin, Marietta Corp.*, 406 F.2d 260, 266 (2d Cir. 1969).

to your associates that the Martin Marietta ownership of a substantial number of shares of Sperry Rand should have representation on your Board."³⁷ The court drew from this statement the inference that "Bunker served on the Sperry Board as a representative of Martin Marietta so as to protect Martin's investment in Sperry."³⁸ The court's reasoning on this point is not very persuasive, however, since the inference from this letter of some common agreement between Martin and Sperry that Bunker represent Martin's interest on the Sperry board can be rebutted by the fact that the initial offer was made to Bunker prior to Martin's purchases of Sperry stock.³⁹ Furthermore, the only two witnesses in the case, Norman B. Frost (the Sperry director who extended the offer to Bunker on behalf of Martin) and Bunker himself, testified that with the exception of General MacArthur, no other Sperry director considered Bunker to be sitting on the board to represent Martin.⁴⁰

The Second Circuit also found relevant the fact that Martin's board of directors gave formal approval to Bunker's directorship on the Sperry board prior to Bunker's acceptance of the position.⁴¹ This approval was the only act relied upon by the appellate court which pointed to some affirmative conduct by Martin in seeking to have Bunker represent its interests. Yet the persuasiveness of the court's argument on this point is lessened by the fact that Martin's policy required that its directors receive permission to serve on other corporations "because of the time element."⁴² There is no evidence that this approval would not have been given before Martin had acquired its large Sperry holdings. Furthermore, even if the Martin board's conduct "supports an inference that it deputized Bunker to represent its interests in Sperry's Board," the evidence adduced by the *Feder* court was surely insufficient to overcome a finding of fact by the district court.

Thus, Bunker's position of control over the financial investments of Martin was crucial to the *Feder* holding. The fact that power of approval over the purchaser's financial investments and knowledge on the part of the alleged deputy of the transactions in question were the only facts militating towards deputization not present in the *Rattner* and *Blau* cases lends additional support to this conclusion.⁴³ Furthermore, the *Feder* court intimated that in future decisions such control alone may be sufficient to constitute deputization.⁴⁴

37 *Id.* at 265.

38 *Id.*

39 This does not negate the possibility of a subsequent deputization but does nullify the inference from the letter that Sperry wanted Bunker on the board to represent Martin, unless Sperry anticipated a merger or other reorganization with Martin when the initial offer was made. It is possible, of course, that Sperry might later have suggested to Bunker that he represent the recently acquired Martin shareholding, but the letter is not indicative of Bunker's reasons for accepting the directorship.

40 *Feder v. Martin Marietta Corp.*, 286 F. Supp. 937, 947 (S.D.N.Y. 1968).

41 *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 265 (2d Cir. 1969).

42 *Feder v. Martin Marietta Corp.*, 286 F. Supp. 937, 944 (S.D.N.Y. 1968).

43 In *Blau*, the defendant partnership completed both transactions without consulting the partner-director and the partner-director did not learn of these transactions until after they were completed. The *Rattner* case was decided on the assumption that the purchases and sales were made without the knowledge of the partner-director.

44 It appears to us that a person in Bunker's unique position could act as a deputy for Martin Marietta even in the absence of factors indicating an intention or belief on the part of both companies that he was so acting. *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 265 (2d Cir. 1969).

In thus emphasizing Bunker's position of control as the primary evidence of deputization, the court was no doubt prompted by a consideration of the possibility of abuse⁴⁵ in situations where the insider has the final word on all stock transactions carried out by the purchasing corporation. Bunker, for example, could have easily gained knowledge of some matter likely to affect the price of Sperry stock and could have used that information for Martin's benefit without communicating it to any other Martin personnel. It should be noted, however, that the possibility-of-abuse test, though an accepted method for determining whether a particular transaction (e.g., a stock conversion or a stock option plan) is a "purchase" or "sale" under section 16(b), had never before been employed to determine whether a person is a section 16(b) director. Indeed, this test was rejected in *Blau* and *Rattner*, where the courts were seeking some affirmative conduct on the part of the purchasing entity to make the insider its representative on the board of the issuing corporation.⁴⁶ The *Feder* approach also conflicts with the holding of the *Marquette* decision that control over the purchasing corporation — though one factor to be considered in determining whether a director was actually deputized — is, by itself, insufficient to prove a deputization.⁴⁷

Although the Second Circuit thus seems prepared to attach 16(b) liability to any short-swing transaction where an insider of the issuing corporation has power of approval over the stock transactions of the purchasing corporation, it is not clear that future courts will continue to use the possibility-of-abuse test to extend 16(b) liability beyond that situation.⁴⁸ Future courts may instead limit the possibility-of-abuse test to the facts present in *Feder*, i.e., to cases where the insider has power of approval over the stock transaction of the purchasing corporation. The power-of-approval situation would then represent an exception to the general requirement⁴⁹ that the plaintiff must prove that the insider sat on the

45 The possibility-of-abuse test has been applied by a number of courts in determining the scope of section 16(b). The test is essentially this: in deciding whether a transaction is proscribed by section 16(b), the court should initially inquire whether "the transaction in question held out at least the possibility of abuse;" if a possibility of abuse does exist, then "[s]ection 16(b)'s regulatory mechanism requires that the section be applied without further inquiry." *Blau v. Lamb*, 363 F.2d 507, 519 (2d Cir. 1966). See also *Smolowe v. Delendo Corp.*, 136 F.2d 231, 240 (2d Cir. 1943); *Adler v. Klawans*, 267 F.2d 840, 845 (2d Cir. 1959); *Blau v. Oppenheim*, 250 F. Supp. 881, 884 (S.D.N.Y. 1966).

46 Doubtless the firm was pleased to have Thomas succeed Hertz as a director However, there is no evidence of any deputizing or other affirmative action by the firm to cause Thomas to be made a director to protect the interests of the firm or to become its representative. *Blau v. Lehman*, 286 F.2d 786, 789 (2d Cir. 1960). See also *Rattner v. Lehman*, 193 F.2d 564, 566-67 (2d Cir. 1952).

The Supreme Court's dictum in *Blau* that "inferences could perhaps have been drawn from the evidence to support petitioner's charges" permits two interpretations: 1) affirmative conduct on the part of the deputizing entity is not required but the question of deputization is to be settled on a case-by-case basis and the determination of the lower court will not normally be upset; or 2) there was evidence of affirmative conduct present in *Blau*, namely that the retiring director, another Lehman partner, had recommended Thomas to the president of the issuing corporation as his successor on the board, but that the inference from this evidence need not necessarily be drawn.

47 *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962, 967 (S.D.N.Y. 1965).

48 It might be argued that courts ought to extend section 16(b) liability to any corporation that makes a short-swing transaction when a member of its board is sitting on the board of the issuing corporation since it is possible that the insider could tip information to the "stockholder" corporation. The difficulty with making such an extension, however, is that in doing so a court would be in direct conflict with the Supreme Court's holding in *Blau*.

49 The reason for the general requirement is that 16(b) is primarily an antimanipulation

issuer's board to represent the purchasing entity. The rationale for such an exception is that if the insider can veto the stock transaction made by the purchasing corporation and he is present when the transactions in question are made, he is in effect the purchasing corporation's alter ego and the two should be treated as one for purposes of 16(b) liability.⁵⁰

The second issue presented to the *Feder* court was whether section 16(b) liability could attach to an insider's short-swing profits realized after the insider — here, the corporation's deputy — had ceased to be a member of the issuer's board of directors. In reaching its conclusion that an insider could be liable under these circumstances, the *Feder* court relied heavily on its earlier decision, *Adler v. Klawans*.⁵¹ In *Adler*, the court was faced with the correlative question of whether an insider is liable under section 16(b) for short-swing transactions even though the insider did not become a director until after the date of purchase. A literal reading of the statute makes it plain that Congress intended the provision to reach a "purchase and sale" or "sale and purchase" within a six-month period by one who was a director, officer or beneficial owner *at some time*, but it is not clear whether the insider must hold his position at both ends of the transaction. To resolve this ambiguity, the *Adler* court felt that it must consider both the intent and purpose of the statute and the results that would flow from each of the two contended interpretations.⁵² The court concluded that, given the purpose of discouraging a widespread abuse of fiduciary obligations, section 16(b) ought to be given a broad interpretation.⁵³ The court therefore extended the section's proscription to cover the case before it.

The *Feder* court applied this same teleological approach to the situation where the director retires before the sale is made. The reasoning behind its decision would seem to be correct: the insider could have gained access to im-

device for its purchase and sale requirements and its six months limitation are aimed at the prevention of insider manipulation of corporate policy to affect the market price of shares, e.g., by declaring a dividend when the earnings and profits are insufficient. If 16(b) is such a device, the deputation doctrine ought to be invoked only where the deputy receives instructions from the purchasing corporation on how to vote or otherwise influence policy, and liability for "tipping" ought to be limited to a 10b-5 action.

The difficulty with a 10b-5 action is that the plaintiff would be required to prove that the transaction was based on inside information, and the plaintiff must be a purchaser or seller of securities. Since section 16(b) establishes a conclusive presumption that inside information is used when a purchase and sale have been made by an insider within a six-month period, and since a section 16(b) action is maintainable by the issuer or a shareholder of the issuer, plaintiffs would prefer to use section 16(b) to prevent "potential tipping" of inside information by insiders to other corporations and partnerships in which the insider has an interest. In the narrow facts of *Feder*, this is what the plaintiff in effect accomplished.

50 An alternative approach to this analysis might be that since Bunker had sufficient power to buy and sell millions of dollars of stock owned by Martin, he possessed the power to designate himself as Martin's representative on the Sperry board. Plaintiff's Reply Memorandum at 4, *Feder v. Martin Marietta Corp.*, 286 F. Supp. 937 (S.D.N.Y. 1968). Although there is no indication in the court's opinion that it considered this approach, there would seem to be little difference in result whether this theory or a court-imposed constructive deputation theory is employed.

51 267 F.2d 840 (2d Cir. 1959).

52 *Id.* at 844.

53 The judicial tendency has been to give a broad interpretation to the requirements of the section respecting the dates of the transaction. *E.g.*, *Stella v. Graham-Paige Motors Corp.*, 352 U.S. 831 (1956) (ten percent beneficial owner held liable under section 16(b) although he became a ten percent owner at the moment the purchase and sale of the stock occurred); *Perfect Photo, Inc. v. Grabb*, 205 F. Supp. 569 (E.D. Pa. 1962) (officers and directors held liable under section 16(b) although the stock was not registered on a national securities exchange at the date of purchase).

portant information, purchased stock on that basis, resigned his position, and then sold the stock — all within six months. A contrary holding would seem to create a large loophole in the law. A literal reading of the statute also supports this result, since section 16(b), while expressly excluding from liability any transaction “where such *beneficial owner* was not such both at the time of the purchase and sale, or sale and purchase,”⁵⁴ has no similar provision for directors or officers. Under the canon of construction *expressio unius est exclusio alterius*, the presence of this clause in the portion of the provision governing the class of beneficial owners manifests a legislative intent that no such requirement apply to the other two categories.

Defendant Martin then contended that an insider is not required under section 16(a)⁵⁵ to report changes in ownership after it ceased to be an insider, and that according to rule X-16A-10⁵⁶ of the Securities and Exchange Commission, it would therefore be exempt from section 16(b) liability.⁵⁷ In response to this contention, the court first considered whether rule X-16A-10 was a valid administrative rule. The court observed that although Congress had vested the Commission with the power to promulgate rules and regulations exempting transactions from the coverage of section 16(b), this power could only be exercised to exempt transactions “not comprehended within the purpose” of that section. The court held that since it is possible for a sale made by a former director to have been unfairly motivated by information gained while on the board, such a transaction must be comprehended within the purpose of section 16(b). To the extent that rule X-16A-10 exempts such a transaction, it was declared invalid.⁵⁸

There is much judicial authority for the view that an administrative agency lacks the authority to promulgate a regulation that is inconsistent with the express purpose of the authorizing statute.⁵⁹ It is not clear, however, that rule X-16A-10

54 Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1964). Section 16(b) is set out at note 1 *supra*.

55 Securities Exchange Act of 1934, ch. 404, § 16(a), 48 Stat. 896 (1934). Section 16(a) of the Act provided, in 1963:

Every person who is . . . a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such . . . director, or officer, a statement with the Exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such beneficial ownership during such month, shall file with the Exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

56 17 C.F.R. § 240.16a-10 (1969). The rule provides:

Any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, in so far as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b).

57 *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 267-68 (2d Cir. 1969). This argument was not touched by the holding in *Adler* since section 16(a) expressly imposes its reporting requirements on every person “who is a director” or who “becomes such . . . director.”

58 *Id.* at 268.

59 In a case where the court was required to construe the validity of rule X-16B-3 of the Securities and Exchange Commission, it was said:

[W]e express doubt as to the power of the Commission to promulgate Rule X-16B-3 inasmuch as the Rule’s broad language may permit acts by insiders sought to be prevented by the Securities Exchange Act. Nor do we regard the promulgation of the Rule as a matter solely within the expertise of the SEC and therefore beyond

is an incorrect interpretation of section 16,⁶⁰ since subsection (b) applies to "such beneficial owner, director, or officer," and, when read literally, this language probably only refers to such beneficial owner, director, or officer as described in subsection (a). If this interpretation is correct, it would follow that if a person has no duty to report pursuant to subsection (a), he would not be liable under subsection (b).

The *Feder* court, recognizing this possibility and assuming, *arguendo*, that rule X-16A-10 was valid and that section 16(b) should be read in light of section 16(a), considered whether a former director is required to report under section 16(a). Rather than construing section 16(a) itself, the court pointed out that "SEC Form 4 . . . which governs the reporting provisions of § 16(a) seems to extend the reporting requirement to ex-directors so as to include the calendar month during which their directorships terminate."⁶¹ The court then reasoned that since Form 4 is arbitrarily inadequate in that it extends section 16(b) coverage only to the calendar month in which the resignation occurred, a less arbitrarily defined reporting requirement—presumably one that would extend section 16(a) to any former director for a period of six months from the date of his resignation — would be but a logical extension of section 16(a) coverage.⁶²

The reasoning employed by the court on this point is tortuous at best. First of all, as an administrative regulation Form 4 would not govern a statutory provision, but rather vice versa. Also, if section 16(a) limits liability to present directors, the argument used by the court in dealing with rule X-16A-10 would be applicable: Form 4 would be valid only to the extent that it conformed with the statute. To predicate liability on the fact that an administrative regulation extended the statutory liability — but not far enough — seems difficult to justify. What the court did, in essence, was attempt to determine what Congress would have provided had it envisioned the situation of the ex-director. Although this result may have been more easily reached had the court held that section 16(a)'s reporting requirements are ambiguous as regards ex-directors and then interpreted the section in light of the legislative purpose,⁶³ the decision itself appears to be correct and necessary. As pointed out above, the abuses that Congress wished to discourage through section 16(b) may be present whether

the scope of judicial review. Rather, the question is one of interpreting the Securities Exchange Act in order to ascertain whether the Rule was a proper exercise of the authority delegated to the Commission under that Act. *Greene v. Dietz*, 247 F.2d 689, 692-93 (2d Cir. 1957). See also *Perlman v. Timberlake*, 172 F. Supp. 246, 254-55 (S.D.N.Y. 1959).

⁶⁰ This argument is supported by dicta in *Pappas v. Moss*, 257 F. Supp. 345, 366 (D.N.J. 1966), and *Heli-Coil Corp. v. Webster*, 222 F. Supp. 831, 836 (D.N.J. 1963), *aff'd as modified*, 352 F.2d 156, 160 (3d Cir. 1964).

⁶¹ *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 268 (2d Cir. 1969). Form 4, in relevant part, reads as follows:

Statements on this form are required to be filed by each of the following persons:

(a) Every person who at any time during any calendar month was . . . (ii) a director or officer of the company which is the issuer of such securities, and who during such month had any change in his beneficial ownership of any class of equity securities of such company . . . SEC Form 4, 2 CCH FED. SEC. L. REP. ¶ 33,721 (1966).

⁶² *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 268-69 (2d Cir. 1969).

⁶³ The SEC has recently amended the reporting requirements under rule 16a-1 so that one or more Form 4 reports are required after the director or officer ceases to hold his position only if (and so long as) transactions occur within six months of other transactions occurring before he ceased to hold such position. See Sec. Exch. Act Rel. No. 86471 (Sept. 18, 1969) [Current Volume] CCH FED. SEC. L. REP. ¶ 77,740 at 83,691.

or not the insider held his position at both ends of the transaction, and this result is attainable by a literal reading of the statute.⁶⁴

The *Feder* decision unquestionably represents a dramatic breakthrough in the realm of securities regulation.⁶⁵ Like other recent securities law bombshells, *Escott v. BarChris Construction Corp.*⁶⁶ and *SEC v. Texas Gulf Sulphur Co.*⁶⁷ to name two, its effect has likely been to promote a healthy measure of soul-searching (if not outright panic) on the part of those managing many of our nation's corporations.

By unleashing the highly conceptual and hitherto basically dormant monster named "deputization," the *Feder* court has placed yet another weapon in the arsenal of shareholders having a mind to litigate. Because of the Second Circuit's disinclination to provide a set of standards governing the use of the deputization device, just how potent and versatile a weapon the theory will be in future suits brought under section 16(b) and other securities law provisions remains to be seen. In the meantime, the haunting spectre of deputization can be expected to have an appreciable *in terrorem* effect on the creation and exploitation of corporate interlocks.

James A. Hardgrove

CONSTITUTIONAL LAW — CRIMINAL LAW — SIXTH AMENDMENT RIGHT TO COUNSEL MUST BE HONORED IN ALL STATE OR LOCAL CRIMINAL ACTIONS THAT MAY LEAD TO LOSS OF LIBERTY. — On November 19, 1967, the Miami police arrested Betty James for stealing dresses valued at thirty-five dollars. In addition to being charged with petty larceny, she was charged with resisting arrest and with three separate counts of assault and battery upon an officer; each offense carried a maximum sentence of sixty days and a \$500 fine. She remained in jail until her trial in the City of Miami Municipal Court two days later. Also on November 19, Raymond Miller was arrested and charged with petty larceny and resisting arrest. He was likewise held in jail until the trial, when he was tried simultaneously with Miss James. Without being advised of their right to counsel, both defendants entered pleas of not guilty. Both were convicted and given maximum sentences on each charge. Miss James received a sentence of 300 days and a fine of \$2,500, or, in lieu thereof, an additional 300 days.

⁶⁴ See note 54 *supra* and accompanying text.

⁶⁵ This case has already been the subject of much discussion on Wall Street. The *Wall Street Journal*, for example, reports: "Most major companies have directors who are executives of other corporations. In theory, at least, the employers of these directors now must be more careful in stock-market dealings." The *Wall Street Journal*, Feb. 24, 1969, at 1, col. 6. An example of the possible effect of the *Feder* decision on corporations is given by the Martin Marietta situation itself. The 1969 edition of *Poor's* lists George M. Bunker as a director of Martin and the following corporations and associations: Bulova Watch Company, Nuclear Corporation of America, Florida Capital Corporation, American Security and Trust Company, the Washington Senators, and Bunker-Ramo Corporation. STANDARD & POOR'S CORP., POOR'S REGISTER OF CORPORATIONS, DIRECTORS AND EXECUTIVES 2173 (1969). According to the *Feder* holding, Martin Marietta would be in effect precluded from entering into a short-term purchase and sale of securities of any of these corporations, at least if Bunker were present when these transactions would be made.

⁶⁶ 283 F. Supp. 643 (S.D.N.Y. 1968).

⁶⁷ 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

Miller received a sentence of 120 days and a fine of \$1,000, or, in lieu thereof, an additional 120 days. Later the fines were suspended.

Appellants initiated their quest for freedom by bringing a class action for an injunction to restrain the Miami judges and city prosecuting attorney from trying any plaintiff without first providing appointed counsel, unless an express and knowledgeable waiver had been given. As there was a suitable remedy at law, the federal district court disallowed the class action request for equitable relief and treated it as a petition for habeas corpus. The district court denied the writ, holding that persons are not entitled to court-appointed counsel when charged with petty offenses¹ as defined in the United States Code.² The United States Court of Appeals for the Fifth Circuit, relying on the sixth amendment, reversed the district court and *held*: counsel must be provided in any state or local criminal action that could result in the loss of liberty. *James v. Headley*, 410 F.2d 325 (5th Cir. 1969).

Although the right to counsel in all criminal prosecutions was not recognized under the common law of England, it was considered a necessity in the American colonies.³ By 1868 Judge Cooley could say, "With us it is a universal principle of constitutional law, that the prisoner shall be allowed a defence by counsel."⁴

In 1932, seven young Negroes challenged their country to meet this high standard. Accused of raping two white girls while in an open gondola car on a freight train near Scottsboro, Alabama, the defendants were brought to trial amidst an outpouring of public hostility so great as to require military protection.⁵ Although counsel was provided, it was ineffectual, and the defendants were convicted. The decision was upheld by the Alabama Supreme Court,⁶ but Chief Justice Anderson, in an angry dissent, argued that "the record indicates that the appearance [of counsel] was rather pro forma than zealous and active . . ."⁷ Agreeing with the Alabama chief justice, the United States Supreme Court reversed the conviction. In his opinion in the case, *Powell v. Alabama*, Mr. Justice Sutherland eloquently examined the plight of the layman in the labyrinth of law:

The right to be heard would be, in many cases, of little avail if it did not comprehend the right to be heard by counsel. Even the intelligent and educated layman has small and sometimes no skill in the science of law. If charged with crime, he is incapable, generally, of determining for himself whether the indictment is good or bad. He is unfamiliar with the rules of evidence. Left without the aid of counsel he may be put on trial without a proper charge, and convicted upon incompetent evidence, or evidence irrelevant to the issue or otherwise inadmissible. He lacks both the skill and knowledge adequately to prepare

1 *James v. Headley*, 281 F. Supp. 588, 590 (S.D.Fla. 1968), *rev'd*, 410 F.2d 325 (5th Cir. 1969).

2 Any misdemeanor, the penalty for which does not exceed imprisonment for a period of six months or a fine of not more than \$500, or both, is a petty offense. 18 U.S.C. §1(3) (1964).

3 *Powell v. Alabama*, 287 U.S. 45, 64-65 (1932); F. HELLER, *THE SIXTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES* 109 (1951).

4 T. COOLEY, *A TREATISE ON THE CONSTITUTIONAL LIMITATIONS* 334 (1868).

5 *Powell v. Alabama*, 287 U.S. 45, 51 (1932).

6 *Powell v. State*, 224 Ala. 540, 141 So. 201, *rev'd*, 287 U.S. 45 (1932).

7 *Id.* at 555, 141 So. at 214 (dissenting opinion).

his defense, even though he have a perfect one. He requires the guiding hand of counsel at every step in the proceedings against him. Without it, though he be not guilty, he faces the danger of conviction because he does not know how to establish his innocence. If that be true of men of intelligence, how much more true is it of the ignorant and illiterate, or those of feeble intellect.⁸

For all of the eloquence of *Powell*, the decision was so tightly bound up in its fact pattern⁹ that it did not prove as useful as many civil libertarians had hoped.

In 1938 the Supreme Court, in *Johnson v. Zerbst*,¹⁰ again had occasion to discuss the right to counsel. Johnson and Birdwell, two Marines on leave, had been arrested in Charleston, South Carolina, for passing and possessing counterfeit federal reserve notes. At the arraignment, both men pleaded guilty; and, although neither had a lawyer, they told the judge that they were ready for trial. They were tried, convicted, and sentenced to the Atlanta penitentiary — all without the assistance of counsel. When the district court and the circuit court of appeals denied a petition for habeas corpus, the Supreme Court granted certiorari.

As in *Powell*, the Court was most eloquent; this time, however, the gains were more than rhetorical, as the Court examined the sixth amendment guarantees and found them to be “essential barriers against arbitrary or unjust deprivation of human rights. The Sixth Amendment stands as a constant admonition that if the constitutional safeguards it provides be lost, justice will not ‘still be done.’”¹¹ (Footnote omitted.) After quoting heavily from Sutherland’s opinion in *Powell*, the Court laid down its absolute rule: “The Sixth Amendment withholds from federal courts, in all criminal proceedings, the power and authority to deprive an accused of his life or liberty unless he has or waives the assistance of counsel.”¹² (Footnote omitted.)

8 *Powell v. Alabama*, 287 U.S. 45, 68-69 (1932).

9 Whether this would be so in other criminal prosecutions, or under other circumstances, we need not determine. All that it is necessary now to decide, as we do decide, is that in a capital case, where the defendant is unable to employ counsel, and is incapable adequately of making his own defense because of ignorance, feeble mindedness, illiteracy, or the like, it is the duty of the court, whether requested or not, to assign counsel for him as a necessary requisite of due process of law
Id. at 71.

10 304 U.S. 458 (1938).

11 *Id.* at 462.

12 *Id.* at 463. Although the Court speaks of depriving the “accused of his life or liberty,” this has not been interpreted as a restriction on the right to counsel in the federal courts; “[t]he constitutional mandate of the sixth amendment is without doubt applicable to petty offenses.” 2 U.S. CODE CONG. & AD. NEWS 3002 (1964). In discussing its interpretation of the sixth amendment, the Supreme Court, in *Betts v. Brady*, said that in *Johnson* “[w]e have construed the provision to require appointment of counsel in all cases where a defendant is unable to procure the services of an attorney, and where the right has not been intentionally and competently waived.” 316 U.S. 455, 464-65 (1942). (Emphasis added.) In 1947, the Court again pointed to the “absolute rule . . . which the Sixth Amendment contains,” noting that “[b]y virtue of that provision, counsel must be furnished to an indigent defendant prosecuted in a federal court in every case, whatever the circumstances.” *Foster v. Illinois*, 332 U.S. 134, 136-37 (1947). (Emphasis added.) The following term, in *Bute v. Illinois*, the Court approvingly cited rule 44 of the Federal Rules of Criminal Procedure and the accompanying notes of the advisory committee:

“RULE 44. ASSIGNMENT OF COUNSEL. If the defendant appears in court without counsel, the court shall advise him of his right to counsel and assign counsel to represent him at every stage of the proceeding unless he elects to proceed without counsel or is able to obtain counsel. [Citation omitted.]

While the sixth amendment's absolute command was now followed literally in the federal courts,¹³ the Supreme Court, in *Betts v. Brady*,¹⁴ held that the complete guarantee was not applicable in state courts.¹⁵ *Betts* had been indicted for robbery and brought to trial, when he requested the court to appoint counsel for him. The request was denied, and *Betts* was convicted and sentenced to eight years in prison. *Betts* petitioned the Supreme Court for review, but the Court, deciding that due process was "a concept less rigid and more fluid than those envisaged in other specific and particular provisions of the Bill of Rights,"¹⁶ held that unless there was "a denial of fundamental fairness, shocking to the universal sense of justice," the fourteenth amendment would not cause the right to attach.¹⁷

In 1961, the Supreme Court decided that a capital case in a state court was so serious that they would depart from *Betts* and "not stop to determine whether prejudice resulted."¹⁸ The following year, tired of dealing with the antiquated *Betts* rule, Mr. Justice Black, in a concurring opinion in *Carnley v. Cochran*,¹⁹ urged outright abandonment of the "special circumstances" rule. He reasoned that since "the Fourteenth Amendment protects life, liberty, and property . . . defendants prosecuted for crime are entitled to counsel whether it is their life, their liberty, or their property which is at stake . . ."²⁰

By 1963 Black had won a majority of the Court over to his position; in *Gideon v. Wainwright*,²¹ the anachronistic test of *Betts v. Brady* was rejected.²² Reminiscent of *Powell v. Alabama*, the *Gideon* opinion contains sweeping universals:

[A]ny person haled into court, who is too poor to hire a lawyer, cannot be assured a fair trial unless counsel is provided for him. . . . The right of one charged with crime to counsel may not be deemed fundamental and essential to fair trials in some countries, but it is in ours.²³

As in *Powell*, however, results did not measure up to expectations. Since *Gideon* was based on a felony conviction, many state courts refused to apply it to misdemeanors or petty offenses.²⁴ Although presented with numerous opportunities

This rule is a restatement of existing law in regard to the defendant's constitutional right of counsel as defined in recent judicial decisions. [Citations omitted.]²⁵
333 U.S. 640, 662 n.18 (1948).

13 See, e.g., *Foster v. Illinois*, 332 U.S. 134, 136-37 (1947).

14 316 U.S. 455 (1942).

15 *Id.* at 471.

16 *Id.* at 462.

17 *Id.*

18 *Hamilton v. Alabama*, 368 U.S. 52, 55 (1961); accord, *Walton v. Arkansas*, 371 U.S. 28 (1962).

19 369 U.S. 506 (1962).

20 *Id.* at 519-20.

21 372 U.S. 335 (1963).

22 *Id.* at 345.

23 *Id.* at 344.

24 State courts follow a wide variety of procedures. Ohio and Florida refuse to appoint counsel for misdemeanors. *City of Toledo v. Frazier*, 10 Ohio App. 2d 51, 226 N.E.2d 777 (1967); *Fish v. State*, 159 So. 2d 866 (Fla. 1964). At the other end of the spectrum, California and Washington provide counsel in all cases while Minnesota and Oregon afford counsel in cases that may lead to imprisonment. *In re Newbern*, 53 Cal.2d 786, 3 Cal. Rptr. 364, 350 P.2d 116 (1960); *City of Tacoma v. Heater*, 67 Wash. 2d 733, 409 P.2d 867 (1966); *State v. Borst*, 278 Minn. 388, 154 N.W.2d 888 (1967); *Application of Stevenson*,

to clarify the scope of *Gideon*, the Court has repeatedly refused to do so.²⁵ Six years later, *Gideon* remains an enigma.²⁶

With its decision in *James v. Headley*, the United States Court of Appeals for the Fifth Circuit has jumped headlong into the maelstrom. In examining the court's opinion, the reader is enticed by an alluring thought: here, at last, the promise of strict adherence to the absolute command of the sixth amendment expressed earlier in *Gideon* and by Mr. Justice Black in *Carnley* will be brought to fruition. The court boldly stakes out the boundaries within which the right to counsel must be honored:

The Sixth Amendment establishes the right to counsel in "all criminal prosecutions." There is, therefore, no constitutional distinction between felonies and misdemeanors, between gross and petty offenses, between the loss of liberty for 181 days and the loss of liberty for 180 or fewer days.²⁷ (Footnote omitted.)

Judge Wisdom, however, immediately sets about qualifying the right that he had described as constitutionally absolute only a moment before. Terrified by visions of overburdened city and state judicial systems and a shortage of lawyers, but still admitting that "the Constitution does not in terms allow exceptions,"²⁸ he restricts the court's holding to those cases involving loss of liberty.²⁹ In transforming the absolute command to honor the right to counsel into a qualified right to counsel in all cases that "may result in the loss of liberty for any period of time,"³⁰ Judge Wisdom finds support in the American Bar Association Project on Minimum Standards for Criminal Justice. The project urged that "[c]ounsel should be provided in all criminal proceedings for offenses punishable by loss of liberty, except those types of offenses for which punishment is not likely to be imposed, regardless of their denomination as felonies, misdemeanors or otherwise."³¹

While, admittedly, requiring appointment of counsel for those faced with the loss of liberty is an improvement over not requiring it,³² one must seriously doubt whether this is enough. Even Judge Wisdom is apparently not completely satisfied by his new limit, as he specifies additional situations where counsel "should" be provided (when circumstances such as moral turpitude or social

Ore. ———, 458 P.2d 414 (1969). Representative of the middle ground, where counsel is appointed or not depending on the circumstances of the case, are Wisconsin and North Carolina. *State ex rel. Plutshack v. State Dept. of Health & Social Serv.*, 37 Wis. 2d 713, 155 N.W. 2d 549 (1968); *State v. Morris*, 275 N.C. 50, 165 S.E.2d 245 (1969).

²⁵ See *Winters v. Beck*, 385 U.S. 907 (1966); *DeJoseph v. Connecticut*, 385 U.S. 982 (1966).

²⁶ While the states have gone their separate ways in determining the meaning of *Gideon*, the Supreme Court gave an indication of the interpretation it intended in its disposition of *Patterson v. Warden*, 372 U.S. 776 (1963), *rev'g Patterson v. State*, 227 Md. 194, 175 A.2d 746 (1961), which arose in the same term as *Gideon*. In a case involving a denial of the right to counsel for a misdemeanor, the Court, in a memorandum opinion, vacated the judgment and remanded for further proceedings in light of *Gideon*.

²⁷ *James v. Headley*, 410 F.2d 325, 333 (1969).

²⁸ *Id.* at 334.

²⁹ *Id.*

³⁰ *Id.*

³¹ ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, STANDARDS RELATING TO PROVIDING DEFENSE SERVICES 37-38 (1967).

³² The new rule will provide some relief. Florida, for example, will be forced to overrule *Fish v. State*, 159 So. 2d 866 (Fla. 1964).

stigma are present),³³ or where it would be "appropriate" for the court to appoint counsel (when circumstances obtain such as the "revocation of a license [that] may deprive the licensee of his livelihood" or the involvement of a slow-witted defendant in a complex case).³⁴ This emphasis on the circumstances of the individual case, if not identical to that of *Betts v. Brady*, at least bears a striking resemblance to that repudiated case. In *Betts*, the Court stated that a denial of counsel

may, in certain circumstances, or in connection with other elements, operate, in a given case, to deprive a litigant of due process of law in violation of the Fourteenth. . . . Asserted denial [of due process] is to be tested by an appraisal of the totality of facts in a given case. That which may, in one setting, constitute a denial of fundamental fairness, shocking to the universal sense of justice, may, in other circumstances, and in the light of other considerations, fall short of such denial.³⁵ (Footnotes omitted.)

In *Gideon*, the Supreme Court used unequivocal language when it declared that "*Betts* was 'an anachronism when handed down' and . . . should now be overruled."³⁶ It is hardly appropriate that the unfortunate *Betts* doctrine be resurrected six years later to plague the courts once more.

The court's new distinction is disturbing in that it not only fails to recognize two traditional ends of criminal justice, but also creates two new problems. The court's rule is lacking in that it fails to recognize that "[t]he importance of counsel also proceeds from values transcending the interests of any individual defendant."³⁷ The American Bar Association project noted that if the people "are to develop respect for [the court's] processes it must treat them fairly; and providing counsel to those unable to retain their own is essential to the development of that respect."³⁸ Since it is at the petty offense level that the largest number of people confronts the administration of criminal justice,³⁹ it is at this level that a court must be at its best.

The notion that the judicial process must earn the respect of the people by providing equal justice under law is by no means new. The Supreme Court of Wisconsin early went on record as urging that unless a lawyer was provided, it would be "a little like mockery to secure to a pauper these solemn constitutional guaranties for a fair and full trial . . ." ⁴⁰ The court believed that it would "be a reproach upon the administration of justice, if a person, thus upon trial, could not have the assistance of legal counsel because he was too poor to secure it."⁴¹ Even earlier, the Supreme Court of Indiana said that it was uncivilized for a community to allow a citizen to be brought to trial without the assistance of counsel; it declared that "[n]o Court could be respected, or respect itself, to sit and hear such a trial."⁴²

33 *James v. Headley*, 410 F.2d 325, 334 (1969).

34 *Id.* at 335.

35 *Betts v. Brady*, 316 U.S. 455, 462 (1942).

36 *Gideon v. Wainwright*, 372 U.S. 335, 345 (1963).

37 PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE, TASK FORCE REPORT: THE COURTS 52 (1967).

38 ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, *supra* note 31, at 39.

39 *Id.*

40 *Carpenter v. Dane County*, 9 Wis. 274, 276 (1859).

41 *Id.* at 275.

42 *Webb v. Baird*, 6 Ind. 13, 18 (1854).

Closely related to the role of the courts in developing respect for the law is the role that they must play in "prevent[ing] recidivism and revers[ing] the tendency of petty criminality to lead to aggravated forms of antisocial conduct."⁴³ This must be accomplished by creating the impression that the courts are more interested in securing justice than in securing convictions. It cannot be seriously suggested that the practice in many local courts of an abbreviated trial followed by the imposition of a monetary fine is designed to attain this end. "Providing counsel at the lower levels may counter to some degree the pressure to mass-produce justice and in this and other ways serve the ends of rehabilitation."⁴⁴

In applying a "loss of liberty" rule as advocated in *James v. Headley*, a court would immediately run into serious practical problems since many state statutes and local ordinances require indigent defendants to serve prison sentences if they are unable to pay the assessed fine.⁴⁵ The difficulties arising from this practice are illustrated by the construction of a commonplace hypothetical case. B, an indigent Negro, is arrested for parading without a permit and fined fifty dollars. The hypothetical ordinance involved does not itself provide for a jail sentence. Unable to pay the fine, B is sent to jail for twenty days under a hypothetical ordinance which reads:

Any person convicted of violating any provision of this Code upon whom a fine shall be imposed and who shall not be able to pay such fine, shall be made to work out such fine at the rate of two dollars and fifty cents per day.⁴⁶

B has now been deprived of his liberty without the assistance of counsel. This will compel one of three equally undesirable results:

- (1) B loses his liberty while deprived of the right to counsel in disregard of the constitutional protection established in *James*;
- (2) B is released without paying the fine or serving the jail sentence — even if he is guilty, he is not subject to any punishment;⁴⁷ or
- (3) the earlier judgment is vacated, and B is given a new trial at which he is awarded counsel, thus doubling the load on the local court system.

The refusal to appoint counsel in all petty offense cases would also promote difficulties such as that which faced the Supreme Court of Arizona in *State v. Reagan*,⁴⁸ where the court dealt with the Arizona recidivist statute.⁴⁹ Defendant Reagan was found guilty of stealing a fifth of Cutty Sark Scotch whiskey. Because of a prior conviction for petty theft, the charge carried the enhanced punishment of a felony. Since the earlier conviction had been obtained in the

⁴³ ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, *supra* note 31, at 39.

⁴⁴ *Id.*

⁴⁵ *E.g.*, ARK. STAT. ANN. § 19-2416 (1956); CONN. GEN. STAT. ANN. § 18-50 (Supp. 1969); IOWA CODE ANN. § 789.17 (1950). The constitutionality of this practice is at issue in a case presently pending before the Supreme Court. *Morris v. Schoonfield*, 301 F. Supp. 158 (D. Md. 1969), *prob. juris. noted*, 38 U.S.L.W. 3334 (U.S. Mar. 3, 1970) (No. 782).

⁴⁶ This ordinance is similar to the Miami law involved in *James v. Headley*.

⁴⁷ This anomalous result is reached in Colorado; see COL. REV. STAT. ANN. § 39-10-9 (1963).

⁴⁸ 103 Ariz. 287, 440 P.2d 907 (1968).

⁴⁹ ARIZ. REV. STAT. § 13-1649 (1956).

absence of counsel,⁵⁰ it could not be used in enforcing the recidivist statute, thus frustrating the legislature's intent. The court reasoned that

when an allegation of prior conviction of petty theft is used to enhance punishment it effectively becomes a "serious offense" which requires that the record of that prior conviction show that defendant was represented by counsel, or advised of his rights to counsel and waived his right to counsel, before it can be used in the subsequent prosecution.⁵¹

There are, thus, practical as well as constitutional objections to the *James* court's attempt to use the fourteenth amendment to apply only a part of the sixth amendment right to counsel to the states. As the court was, at minimum, aware of the constitutional problems involved, what then prompted it to shrink from applying an absolute rule? While other considerations may have affected the decision, the only reason presented in the opinion is that "city and state systems of justice could be so overburdened as to break down. There are simply not enough lawyers to go around."⁵²

The ghost that the court conjures up, upon closer examination, turns out to be only a mist. The court points to no evidence that the burden on courts would be intolerable; indeed, it cannot, for there is no such proof. The same cries of doom greeted the Supreme Court's decisions in *Johnson* and *Gideon*, but still our judicial system survives. Even should such a rule impose strains upon the system, "the burdens counsel may impose upon the system are burdens that too long have been avoided and must be borne if there is to be an effective adversary system."⁵³ There are many factors, on the other hand, that indicate that the system would not be outrageously overtaxed as the court in *James* foresees. The facts and legal issues involved in petty offenses are usually relatively simple and uninvolved.⁵⁴ It is more likely in such a case that there will be no jury trial,⁵⁵ even if the right would exist in a particular case.⁵⁶ There would be fewer court appearances and smaller legal fees in petty offense cases.⁵⁷ Since most of the data available for time-cost computations is based on serious crimes, it is singularly unsuited to the present discussion. In 1965, however, the American Bar Foundation issued a national report on the defense of the poor, which stated:

The very limited information available does indicate that a considerably larger proportion of felony than of misdemeanor defendants are indigent. For example, in San Francisco, where the public defender handles misdemeanors as well as felonies, 35,450 misdemeanor charges were filed in

⁵⁰ Arizona provides appointed counsel only for "serious offenses"; see *State v. Anderson*, 96 Ariz. 123, 392 P.2d 784 (1964).

⁵¹ *State v. Reagan*, 103 Ariz. 287, 289, 440 P.2d 907, 909 (1968).

⁵² *James v. Headley*, 410 F.2d 325, 334 (1969).

⁵³ PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND ADMINISTRATION OF CRIMINAL JUSTICE, *THE CHALLENGE OF CRIME IN A FREE SOCIETY* 150 (1967).

⁵⁴ 1 L. SILVERSTEIN, *DEFENSE OF THE POOR IN CRIMINAL CASES IN AMERICAN STATE COURTS*, NATIONAL REPORT OF THE AMERICAN BAR FOUNDATION 125 (1965).

⁵⁵ *Id.*

⁵⁶ Unlike other sixth amendment rights, the right to trial by jury has been held not to apply to petty offenses. For cases involving jury trial, see *Bloom v. Illinois*, 391 U.S. 194, 210 (1968); *Duncan v. Louisiana*, 391 U.S. 145, 160 (1968); *Cheff v. Schnackenberg*, 384 U.S. 373, 379 (1966). For cases involving other sixth amendment rights, see, e.g., *Klopfer v. North Carolina*, 386 U.S. 213 (1967); *In re Oliver*, 333 U.S. 257 (1948).

⁵⁷ 1 L. SILVERSTEIN, *supra* note 54, at 125.

1961-1962 in the Municipal Court, not counting motor vehicle charges. Of these the public defender took care of 7747, or 22%, which is well below the comparable figure for felonies. For motor vehicle charges 125,488 were filed, of which the defender handled 2521, or 2%. Data published by the National Legal Aid and Defender Association indicate similar or lower percentages of indigent misdemeanor defendants in Los Angeles, Long Beach, Cincinnati, and Columbus.⁵⁸

In the national report, it was also shown that the states or local governments could further reduce the cost of supplying counsel by selecting the system best suited to their needs.⁵⁹ Contrary to popular expectation, the report found that it was not always advantageous to have a larger population. "[A]s population increases, the cost of operating an assigned counsel system increases at a greater rate. . . . For [public] defender counties, by contrast, as population increases, the per capita cost of operating the system goes down."⁶⁰ There is always the possibility that the cost would be high as the court fears. Even if established, however, this would still not be enough to remove the constitutional mandate.

In *Gideon*, it was held that, because of its fundamental nature, the portion of the sixth amendment dealing with the right to counsel was incorporated into the due process clause of the fourteenth amendment.⁶¹ The Court did not, merely by going through the fourteenth amendment, water down the guarantees provided; indeed, by its very terms, the fourteenth amendment protects not only life and liberty, but also property. Neither did it give any indication that it meant other than what it said, i.e., that the sixth amendment, in giving the right to counsel in "all criminal prosecutions," applies to the states as well as to the federal government.⁶²

The Supreme Court has given state and local governments six years in which to conform to the standards expressed in *Gideon* — six years that should have been spent in building up more efficient courts and in establishing practical systems of assigned counsel or public defenders, so that the fears of Judge Wisdom could not materialize. Instead, these six years have been squandered as the courts pursued policies of vacillation and evasion. The delay cannot be ignored merely because the offense involved has been designated as petty; petty does

58 *Id.* at 124-25.

59 *Id.* at 63. See also PRESIDENT'S COMM'N ON LAW ENFORCEMENT AND ADMINISTRATION OF CRIMINAL JUSTICE, *supra* note 53, at 150.

60 1 L. SILVERSTEIN, *supra* note 54, at 63-65. For a discussion of a recent cost study in Oregon, see Application of Stevenson, — Ore. —, —, 458 P.2d 414, 418 (1969).

61 *Gideon v. Wainwright*, 372 U.S. 335, 342 (1963).

62 *Id.* In *Malloy v. Hogan* the Court said:

We have held that . . . the right to counsel guaranteed by the Sixth Amendment, *Gideon v. Wainwright*, *supra*, [is] to be enforced against the States under the Fourteenth Amendment according to the same standards that protect those personal rights against federal encroachment. . . . The Court thus has rejected the notion that the Fourteenth Amendment applies to the States only a "watered-down, subjective version of the individual guarantees of the Bill of Rights." [Citation omitted.] *Malloy v.*

Hogan, 378 U.S. 1, 10-11 (1964).

In *Benton v. Maryland*, the Court reiterated its position, saying:

Our recent cases have thoroughly rejected the *Palko* notion that basic constitutional rights can be denied by the States as long as the totality of the circumstances does not disclose a denial of "fundamental fairness." Once it is decided that a particular Bill of Rights guarantee is "fundamental to the American scheme of justice," the same constitutional standards apply against both the State and Federal Governments." [Citation omitted.] *Benton v. Maryland*, 395 U.S. 784, 795 (1969).

not mean unimportant. Nearly thirty years after the Supreme Court stated that "[t]he right to have the assistance of counsel is too fundamental and absolute to allow courts to indulge in nice calculations as to the amount of prejudice arising from its denial,"⁶³ the courts are still indulging in those "nice calculations."

In 1963, when Congress was considering the bill that was to become the Criminal Justice Act of 1964,⁶⁴ the late Robert Kennedy, then United States attorney general, sent a letter to the president in which he pleaded for passage of the bill:

The inscription which graces the Attorney General's rotunda in the Department of Justice declares that "The United States wins its point whenever justice is done its citizens in the courts." Clearly justice is not done when poverty prevents a person from securing effective legal representation for his defense against a criminal prosecution which places his personal liberty, or even his life, in jeopardy.⁶⁵

Under such a definition, state and local governments that secure convictions by depriving defendants of counsel have not been winning their point.

Gerald Grieman

COURTS — FEDERAL ANTI-INJUNCTION STATUTE, 28 U.S.C. § 2283, GIVES WAY TO COMPELLING INTERESTS OF FIRST AMENDMENT RIGHTS. — In 1967, the district attorney of Orleans Parish, Louisiana, was conducting an investigation of an alleged plot to assassinate the late President John F. Kennedy. During late spring, Walter Sheridan, a television reporter for the National Broadcasting Company, and Richard Townley, a reporter for the New Orleans affiliate of NBC, station WDSU-TV, prepared an hour-long documentary report on District Attorney Garrison's investigation. The program, televised nationally on June 19, was highly critical of Garrison's tactics.¹ On July 7, the district attorney filed a bill of information against Sheridan, charging him with the public bribery of Perry Russo, a witness in the Kennedy probe; Garrison also filed three informations against Townley, charging him with bribing Russo and two other witnesses.²

On July 18, Sheridan appeared at the office of the clerk of the criminal district court and was there served with a subpoena commanding his appearance before the Orleans Parish Grand Jury the next morning. Sheridan made efforts to quash the subpoena, including an unsuccessful appeal to the Louisiana Supreme Court. On August 9, at 4:00 p.m., Sheridan's attorney was served with an instantan subpoena naming Sheridan. The attorney immediately in-

63 *Glasser v. United States*, 315 U.S. 60, 76 (1942).

64 Criminal Justice Act of 1964, 18 U.S.C. §3006A (1964).

65 2 U.S. CODE CONG. & AD. NEWS 2996 (1964).

1 Brief for Appellants at 2-3, *Sheridan v. Garrison*, 415 F.2d 699 (5th Cir. 1969), *cert. denied*, 90 S. Ct. 685 (1970).

2 *Sheridan v. Garrison*, 273 F. Supp. 673, 676 (E.D. La. 1967), *rev'd*, 415 F.2d 699 (1969), *cert. denied*, 90 S. Ct. 685 (1970).

formed the grand jury foreman and the presiding judge that Sheridan was in Chicago and that it would be physically impossible for him to appear that day. The attorney did say that Sheridan would be able to appear the next morning. At 5:15 p.m., the grand jury foreman advised Sheridan's attorney that Sheridan would have to appear on August 15 to show good cause why he should not be held in contempt for failing to respond to the instanter subpoena.³

The following morning, Sheridan and Townley filed a complaint with the United States district court seeking injunctive relief against the foreman and defendant Garrison, under section 1983 of Title 42, United States Code.⁴

Following the pretrial conference, Sheridan filed a motion for summary judgment, with supporting affidavits, on the injunction against the grand jury foreman. The court granted this motion.⁵ Garrison also filed a motion for summary judgment, seeking dismissal of the complaint; he filed no affidavits in support of this motion. Appellants, however, filed numerous affidavits against Garrison's motion, including several that provided substantial support for appellants' contentions that the criminal prosecution was brought merely to harass.⁶ The court heard oral arguments and granted Garrison's motion for summary judgment based on the conclusion that section 2283,⁷ the anti-injunction statute, precluded the issuance of an injunction in this case.⁸

The United States Court of Appeals for the Fifth Circuit reversed, remanded, and *held*: based on the narrow facts where a state proceeding had begun only by the filing of an indictment, and on a proper evidentiary showing that no effective alternative is available to protect first amendment rights, the anti-injunction statute, 28 U.S.C. § 2283, is not a bar to the grant of injunctive relief. *Sheridan v. Garrison*, 415 F.2d 699 (5th Cir. 1969), *cert. denied*, 90 S. Ct. 685 (1970).

In reaching this decision, the *Sheridan* court was afforded the opportunity to help clarify an area of federal law that is in great confusion. The effect of the decision is to extend the scope of federal court activity into an area previously thought to be immune from federal court interference.

Early in our history, Congress placed rather strict limitations on federal court intervention in state court proceedings. The original act, in 1793,⁹ forbade stays by federal courts of state court proceedings.¹⁰ This restriction remained in its original form until the 1874 revision of the United States Statutes, when

³ Brief for Appellants at 3-4, *Sheridan v. Garrison*, 415 F.2d 699 (5th Cir. 1969), *cert. denied*, 90 S. Ct. 685 (1970).

⁴ Section 1983 provides:

Every person who, under color of any statute, ordinance, regulation, custom or usage of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceedings for redress.

Civil Rights Act of 1871, § 1979, 42 U.S.C. § 1983 (1964).

⁵ This issue has since dropped out of the case.

⁶ Brief for Appellant at 6-7, *Sheridan v. Garrison*, 411 F.2d 699 (5th Cir. 1969).

⁷ 28 U.S.C. § 2283 (1964). This section is set out in the text accompanying note 23.

⁸ *Sheridan v. Garrison*, 273 F. Supp. 673, 692-93 (E.D.La. 1966), *rev'd*, 415 F.2d 699 (5th Cir. 1969), *cert. denied*, 90 S. Ct. 685 (1970).

⁹ Act of March 2, 1793, ch. 22 § 5, 1 Stat. 333, 334.

¹⁰ For background materials see Warren, *Federal and State Court Interference*, 43 HARV. L. REV. 345 (1930).

a legislative exception was added for proceedings under the bankruptcy laws.¹¹ Although the legislature has grafted other exceptions onto this statute,¹² the basic format remained relatively unchanged, even with the Judicial Code of 1911, and the codification thereof as 28 U.S.C. § 379 in 1940.¹³

The courts have, however, been somewhat hesitant about establishing judge-made exceptions to the prohibition of interference in state court proceedings. There were, nonetheless, several exceptions that had been established in earlier federal court cases. These included the *res* exception, the relitigation exception, the ancillary exception, the fraudulent judgment exception, and the pseudo exception based on the rationale of *Ex parte Young*.¹⁴ While most of these were established in lower courts, they had a definite impact on the Supreme Court's decision in the now-famous *Toucey v. New York Life Insurance Co.*¹⁵ In *Toucey* the Court was faced with the question whether the federal courts had the power to enjoin state court relitigation (already begun) of an *in personam* issue that had been finally adjudicated by a prior federal court decree. Prior Supreme Court decisions had established that where one court takes possession of a *res*, be the court federal or state, this would withdraw the property "from the reach of the other."¹⁶ As to whether the federal court could enforce the *res judicata* effect of its judgment by enjoining further proceedings in the state courts, Mr. Justice Frankfurter, speaking for the Court, noted:

The fact that one exception [the *res* exception] has found its way into § 265 [now § 2283] is no justification for making another The rule of the *res* cases was unequivocally on the books when Congress reenacted the original § 5

In striking contrast are the "relitigation cases." Loose language and a sporadic, ill-considered decision cannot be held to have imbedded in our law a doctrine which so patently violates the expressed prohibition of Congress.¹⁷

While *Toucey* spoke only to the relitigation exception, it was quite apparent to the courts that the effect was to prohibit all attempts by federal courts to enjoin state court proceedings, except in accord with specifically recognized exceptions.¹⁸

Two years later, in *Douglas v. City of Jeanette*,¹⁹ the Court further clarified its attitude toward federal interference with state court proceedings when it commented:

Congress, by its legislation, has adopted the policy, with certain well defined statutory exceptions, of leaving generally to the state court the trial of criminal cases arising under state laws, subject to review by this Court of any

11 Rev. Stat., ch. 12, § 720 (2d ed. 1874).

12 For a discussion of the statutory exceptions, see Note, 74 HARV. L. REV. 726, 737-40 (1961); 1a J. MOORE, FEDERAL PRACTICE ¶ 0.209-213, at 2401-18 (2d ed. 1965).

13 See 1a J. MOORE, *supra* note 12, ¶ 0.208[1], at 2302.

14 209 U.S. 123 (1908). For a full discussion of the exceptions and their general impact, see Comment, 35 CALIF. L. REV. 545 (1947).

15 314 U.S. 118 (1941).

16 *Id.* at 135.

17 *Id.* at 139.

18 See generally, Comment, 35 CALIF. L. REV. 545 (1947).

19 319 U.S. 157 (1943).

federal questions involved. Hence, the courts of equity in the exercise of their discretionary powers, should conform to this policy by refusing to interfere with or embarrass threatened proceedings in state courts save those exceptional cases which call for the interposition of a court of equity to prevent irreparable injury which is clear and imminent²⁰

The Court then found that the facts failed to meet the test of "irreparable injury which is clear and imminent," and dismissed for want of equity.²¹

In 1948, Congress reacted to the *Toucey* limitation (that the Court viewed further judicial exceptions to section 265 as inappropriate) through additions to the anti-injunction section of the Code.²² The new statute, section 2283, provides:

A Court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.²³

The Revisor's Note indicates that the purpose of the revision was to clearly indicate that a federal court does have the power to enjoin cases under the relitigation doctrine, contrary to *Toucey's* holding, to "protect or effectuate its judgments."²⁴

The Court was soon to interpret the new statute. In *Amalgamated Clothing Workers v. Richman Brothers Co.*,²⁵ the Court faced the question of whether the Taft-Hartley Act was an express exception to section 2283. In the opinion by Mr. Justice Frankfurter, who also wrote the opinion for *Toucey*, the Court, in discussing the argument that the field was preempted by Congress, said:

No such exception has been established by judicial decision under the former § 265. In any event, Congress left no justification for its recognition now. This is not a statute conveying a broad general policy for appropriate *ad hoc* application. Legislative policy is here expressed in a clear-cut prohibition qualified only by *specially defined exceptions*.²⁶ (Footnote omitted, emphasis added.)

This language in *Amalgamated Clothing* would appear to be quite firm, and the Court could reasonably have been interpreted as saying that unless Congress specifically carved out an exception to section 2283, the federal courts have no business attempting to interfere with proceedings in a state court. The following year, however, the strictness of this language was to be tempered.

In *Leiter Minerals, Inc. v. United States*,²⁷ the petitioner had filed a mineral lease suit in state court, based on a state statute, whereupon the United States

²⁰ *Id.* at 163.

²¹ *Id.* at 165.

²² Act of March 3, 1911, ch. 231, § 265, 36 Stat. 1162. This section provided:

The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy.

²³ 28 U.S.C. § 2283 (1964).

²⁴ *See*, 1a J. MOORE, *supra* note 12, ¶ 0.208 [3.-1], at 2311-12.

²⁵ 348 U.S. 511 (1955).

²⁶ *Id.* at 515-16.

²⁷ 352 U.S. 220 (1956).

filed suit in the district court to quiet title and also prayed for injunctive relief against the state court action. In the opinion of the Court, also written by Mr. Justice Frankfurter, the issue was whether section 2283 constituted a bar to injunctive relief where the United States sought the injunction. The Court, speaking of the policy underlying the statute, noted:

The statute is designed to prevent conflict between federal and state courts. This policy is much more compelling when it is the litigation of private parties which threatens to draw the two judicial systems into conflict than when it is the United States which seeks a stay to prevent irreparable injury to a national interest. . . . It is always difficult to feel confident about construing an *ambiguous statute* when the aids to construction are so meager, but the interpretation excluding the United States from coverage of the statute seems to us preferable in the context of healthy federal-state relations.²⁸ (Footnote omitted, emphasis added.)

From a comparison of the *Amalgamated Clothing* and *Leiter Minerals* decisions, both authored by Mr. Justice Frankfurter, it would appear that the absolute prohibition developed in the former case was definitely abridged by the latter. Further, it would appear that the *Leiter Minerals* holding has injected ambiguity into a statute that otherwise might seem rather clear on its face. The holding was, however, carefully limited and did not establish any *carte blanche* for renewed attempts to establish judicial exceptions to section 2283. Rather, what *Leiter Minerals* did was face a unique situation where the presence of the United States compelled a judicial interpretation of the underlying intent of Congress; and the holding made no basic change in the rule established in *Amalgamated Clothing*.

It appeared as though a definite policy was established as to additional judicial exceptions to section 2283. The advent of the civil rights movements of the sixties, however, resurrected the question of whether section 2283 constituted an absolute bar to injunctive relief. In *Dombrowski v. Pfister*²⁹ a civil rights group sought a federal injunction to stay threatened criminal proceedings in the Louisiana state courts, arguing alternatively that the statute in question was unconstitutionally broad and that, even if constitutional, that statute was invoked in bad faith for the purpose of harassing plaintiffs.³⁰

The *Dombrowski* decision avoids section 2283 altogether. In a footnote, the Court commented: "This statute and its predecessors do not preclude injunctions against the *institution* of state court proceedings, but only bar stays of suits already instituted."³¹ Because the injunction was sought before state proceedings were instituted, section 2283 would not apply by its clear language. The Court, in facing the problem of enjoining the state proceeding, recognized a broader federal policy that "federal interference with a State's good-faith administration of its criminal laws is peculiarly inconsistent with our federal framework."³² The Court also noted that, while section 2283 was not a

28 *Id.* at 225-26.

29 380 U.S. 479 (1965).

30 *Id.* at 482.

31 *Id.* at 484, n.2.

32 *Id.* at 484.

bar in this case, the use of equity power would be appropriate only where a clear showing of irreparable injury was made.³³

The next case to reach the Supreme Court with implications in this area was *Cameron v. Johnson*.³⁴ There, the appellants contended that section 1983 constituted an express exception to section 2283, and thus they sought an injunction to prevent prosecution for violating an antipicketing statute, asserting that the statute was applied in a discriminatory manner. The *Cameron* case involved two trips to the Court. In the first,³⁵ the Court, in a brief *per curiam* decision, remanded the case for consideration in light of *Dombrowski*, with instructions to the district court to determine whether section 2283 constituted a bar to injunctive relief under section 1983. If there was no bar, then the court was to consider the case on its merits. The district court found that the antipicketing statute was not void on its face.³⁶ It also determined that, in light of *Dombrowski*, appellants failed to show sufficient irreparable injury to justify federal injunctive relief. When the Supreme Court again heard the case, it agreed with the district court that the appellants failed to meet the irreparable injury test³⁷ and added that "[w]e find it unnecessary to resolve either question [of whether section 1983 was an exception or whether section 2283 prohibited an injunction against state action already commenced] and intimate no view whatever upon the correctness of the holding of the District Court."³⁸

This casual treatment of whether there might be, in fact, an exception to section 2283 without specific statutory authority would again point out that the absolute prohibition in *Amalgamated Clothing*, that only "specially defined exceptions" should be recognized, might not be as absolute as first appears.

Thus, up until the hearing of *Sheridan*, the Supreme Court had not established clear guidelines for the district courts. The policy of noninterference had been codified by Congress in section 265 and its successor, section 2283. This statute had existed in our laws, in one form or another, since 1793. The decision in *Toucey* had apparently expressed an attitude that the Court was against judicial exceptions to this enactment. The decision in *Amalgamated Clothing* even more clearly seems to hold that there should be recognition of an exception only where such appears to be the clear intent of the legislature. However, the decision in *Leiter Minerals* does establish that an exception could exist, without specific legislative expression, in the unusual cases where the United States is a party. The *Leiter Minerals* category involves a compelling national interest. *Leiter Minerals* did expressly recognize, however, that the anti-injunction statute was to be given effect where only private rights were being litigated. Then in

33 *Id.* at 485-86.

34 390 U.S. 611 (1968).

35 381 U.S. 741 (1965).

36 390 U.S. at 615.

37 *Id.* at 617-20.

38 *Id.* at 613-14, n.3. In *Zwickler v. Koota*, 389 U.S. 241 (1967), the Court, under facts where appellant sought both injunctive relief and a declaratory judgment that the statute in question was unconstitutional, ruled that a "federal district court has the duty to decide the appropriateness and the merits of the declaratory request [as to the constitutionality of the statute] irrespective of its conclusion as to the propriety of the injunction." *Id.* at 254. On remand, the *Cameron* court, using this criterion, found that the statute was constitutional and that the facts in the case would not warrant injunctive relief, even if section 1983 were an express exception to section 2283.

Cameron, the Supreme Court seems to further muddle the waters when they noted that they did not then decide the question of whether section 2283 constituted a bar to an injunction against a state court proceeding already commenced. In the face of what appeared to be rather clear language in *Amalgamated Clothing*, the language in *Cameron* would certainly leave open the question of whether the *Leiter Minerals* rationale might be extended to other unusual fact situations.

With the law in this parlous state, the Fifth Circuit decided *Machesky v. Bizzel*.³⁹ There, suit was filed against appellants in the state court to enjoin picketing and boycotting activities intended to eliminate discrimination and segregation in Greenwood, Mississippi. The supporting picketing was very intensive. The state court enjoined the group from picketing and other related activities, whereupon appellants filed a suit in federal court to obtain an order vacating the state court injunction. The prayer was denied.⁴⁰ On appeal, Judge Bell, speaking for the court, said that it was unnecessary, in the context of first amendment rights only, to resolve the question of whether section 1983 constituted an express exception to section 2283.⁴¹

Our decision is grounded on the premise that § 2283 is non-jurisdictional in that it is no more than a statutory enactment of the principle of comity for application in the relationships between federal and state courts. As such, it gives way in those extraordinary cases where the federal injunction is necessary to vindicate clear First Amendment rights. The question on this premise becomes whether appellants alleged such a case.⁴²

Judge Bell then discussed the criteria for making out the extraordinary case that would justify departure from the strictness of section 2283.

[A] federal court must yield to the important institutional interests in comity where only private rights are involved. Where, however, the institutional interests in comity collides [*sic*] with the paramount . . . interests protected by the First Amendment, comity must yield.⁴³

In *Sheridan*, Judge Thornberry was faced with two interrelated problems. First, he had the same basic issue as *Machesky*, that is, whether section 2283 is an absolute bar to relief when there is an existing state proceeding. Second, he

39 414 F.2d 283 (5th Cir. 1969).

40 *Id.* at 286.

41 On this question see generally Note, 21 *RUTGERS L. REV.* 92 (1966) (supporting section 1983 as an exception to section 2283); Note, 74 *HARV. L. REV.* 726, 738 (1961) (arguing that section 1983 should not constitute an exception).

42 414 F.2d at 287. In support of his decision, Judge Bell quoted from part of the dictum in *Baines v. City of Danville*, 337 F.2d 579 (4th Cir. 1964), where the court recognized that "it [§ 2283] is as least as broad as the judicially developed principle of comity which forbids federal interference with state court proceedings . . ." The *Baines* court further noted:

Since the statute was fathered by principles of comity, it has been held that the statute should be read in light of those principles and, though absolute in its terms, it is *inapplicable in extraordinary cases* in which an injunction against state court proceedings is the only means of avoiding grave and irreparable injury. 337 F.2d at 593 (footnote omitted, emphasis added).

The omitted footnote was to the earlier Supreme Court decision in *Smith v. Apple*, 264 U.S. 274 (1924), where the Supreme Court said that section 265 [now section 2283] was not a jurisdictional statute.

43 414 F.2d at 291.

faced the problem of granting such relief in a pending *criminal* prosecution, rather than a civil suit as in *Machesky*. In settling the first issue, the *Sheridan* court relies almost exclusively on the decision in *Machesky* to establish its premise that section 2283 does not constitute an absolute bar to injunctive relief. To settle the question of whether injunctive relief would be available where a state *criminal* prosecution had already begun, the court noted that federal courts have always been reluctant to intervene in state criminal prosecutions;⁴⁴ still, relief was available in *Dombrowski*, based on the requirement of a clear showing of irreparable injury (though *Dombrowski* did not confront section 2283). Further, the *Sheridan* court notes, the availability of relief "under *Dombrowski* cannot reasonably be interpreted as applying only to those rare and fortuitous cases" where the accused is notified of the probability of criminal prosecution.⁴⁵

The central portion of the *Sheridan* decision may give the casual observer some difficulty, for after expressly stating that the decision will not reach the question of whether section 1983 constitutes an express exception to section 2283,⁴⁶ the court repeatedly refers to the section 1983 provision. The apparent purpose was to show that the Congressional intent in enacting section 1983 was to provide a remedy where state officials had abused their power or had not provided the individual with adequate protection. The Supreme Court, in *Monroe v. Pape*,⁴⁷ noted that "the legislation was passed to afford a federal right in federal courts because, by reason of prejudice, passion, neglect, intolerance or otherwise," the rights of the citizens of a state might not be adequately protected.⁴⁸ Because of the controversy surrounding the issue whether section 1983 is an express exception to section 2283,⁴⁹ the references to section 1983 only serve to illustrate the overall policy that the courts ought attempt to implement.

If *Dombrowski* were relied on to provide the absolute basis for federal injunctive relief, the facts of that case would limit such relief to those fortuitous circumstances where the victim happened to discover that the state was about to institute criminal proceedings against him. *Dombrowski* may, however, serve as a guide to the type of conduct necessary to establish the exceptional circumstance where the federal courts might be justified in intervening in state court proceedings. According to the *Sheridan* court, one of the fundamental criteria relied on in *Dombrowski*, in addition to the well-known test of irreparable injury, was that such relief might be available where "state officials are using or threatening to use prosecutions, *regardless of their outcome*, as instrumentalities for the *suppression of speech*."⁵⁰ (Emphasis added.)

After establishing the underlying policy considerations behind section 1983 and the nature of the conduct that might warrant federal interference in state proceedings, the *Sheridan* court found an injunction justified by two Supreme Court decisions. First, it relied on the holding in *Leiter Minerals*, that section

44 Cf. *Stefanelli v. Minard*, 342 U.S. 117 (1951).

45 415 F.2d at 705.

46 *Id.* at 703.

47 365 U.S. 167 (1961).

48 *Id.* at 180.

49 See text accompanying notes 58 & 59, *infra*.

50 *Sheridan v. Garrison*, 415 F.2d 699, 706 (5th Cir. 1969), *cert. denied*, 90 S. Ct. 685 (1970).

2283 would give way where there was a compelling national interest. This is fundamental to the *Sheridan* exception. *Leiter Minerals*, by creating an exception, established that the words of section 2283 are not absolute. This was accomplished in the face of the absolute nature of the Court's language in *Amalgamated Clothing*. Because of the compelling national interest raised when the United States was a party, *Leiter Minerals* held that it could not "reasonably impute such a purpose [that is, of frustrating superior federal interests] to Congress from the general language of 28 U.S.C. § 2283 alone."⁵¹

The second reference was to the recent Supreme Court decision in *Red Lion Broadcasting Co. v. FCC*.⁵² There the Court, while not involved with section 2283, clearly indicated that a paramount national interest lies in the protection of free speech.

From these two cases, *Sheridan* concludes that where bad faith prosecution suppresses first amendment freedoms, and where there is no adequate remedy under state law, sufficient irreparable injury has been made out in an area of grave national interest to justify relief through a federal injunction.⁵³ Judge Thornberry notes that there is a clear basis for an exception in first amendment cases, relying on "the nature of comity, the remedy provided by § 1983, and the cases that establish overriding policy for vindicating first amendment rights immediately,"⁵⁴ where the probability of irreparable injury is great.⁵⁵

In formulating his opinion, Judge Thornberry carefully discussed the probable impact of too general a decision and set clear limits on the availability of injunctive relief when a state prosecution has already begun.

Indeed we are concerned, as was the district court, lest "every state defendant might have a go at the game" and win delays and exposition of the state's case merely by alleging that the prosecution is being brought in bad faith and that his first amendment rights are being chilled. . . . In the case before us, however, we do not find that a reluctance to "open the floodgates" of litigation would justify judgment without a hearing of appellants' case. In the first place, as we have already held, the appellants' pleadings, if fully proved, would state a cause of action under *Dombrowski*. In the second place, the cases themselves demonstrate that the courts have been able to distinguish, with surprising clarity for so difficult an area of law, those cases in which the *Dombrowski* requirements are pleaded in sufficient terms or are not supported by the facts.⁵⁶

As to the scope of the decision, he said:

Thus we emphasize that our decision is in the context of first amendment rights only. Furthermore, we limit our decision in two other ways. First, we consider only the case before us, that is the case in which a criminal prosecution has "begun" only in the technical sense with the filing of an information or indictment, and not the case in which trial proceedings are under way. Second, we consider only the case in which it appears that,

51 352 U.S. at 226.

52 395 U.S. 367 (1969).

53 415 F.2d at 707.

54 *Id.*

55 *Id.*

56 *Id.* at 710.

if first amendment rights are in jeopardy, no other equally effective protection can be had for them than resort to the federal injunction.⁵⁷

The *Sheridan* decision has not shed any new light on the interesting controversy whether section 1983 is an express exception to section 2283, and indeed the question may never be completely answered. The controversy among the various circuits is quite apparent. The Fourth Circuit currently in the majority is strongly on the side that holds that section 1983 does not constitute an express exception, as illustrated in *Baines v. City of Danville*.⁵⁸ The Third Circuit, however, in *Cooper v. Hutchinson*,⁵⁹ has noted in dictum and without discussing its rationale, that section 1983 does constitute an express exception to section 2283.

It may be argued that the *Sheridan* facts were particularly appropriate for a determination of whether section 1983 constitutes an express exception to section 2283. Those who urge that it should be an exception argue that to hold otherwise would be to deny any remedy, under a statute purporting to establish one, to the affected individual.⁶⁰ They also note that section 1983 was enacted to deal with "discriminatory enforcement of the laws by the state courts in the Reconstruction period [and] are applicable to the conditions of today."⁶¹ Those who argue against the existence of an exception point to the fact that allowing a general exception to section 2283 would lead to frequent interruptions of state court proceedings. Therefore, they assert, "if Congress meant to allow federal injunctions in such cases, it would seem desirable to require it to express its meaning more clearly than it has in the Civil Rights Acts."⁶² Even more explicit argument against an exception can be found in *Baines v. City of Danville*.⁶³ There, the court noted that the Civil Rights Act "creates a federal cause of action, but with no suggestion, explicit or implicit, that appropriate relief shall include an injunction which another Act of Congress forbids."⁶⁴

Further, the main argument of those supporting a section 1983 exception is that, as already noted, to hold otherwise would deprive citizens of an effective remedy under that portion of a statute which creates a federal cause of action. To this, one can reply that for those rights with a compelling national interest at their core — those that cry out for immediate attention — there exists a right under *Sheridan*. The fact that the original statute was enacted to prevent "discriminatory enforcement of the laws"⁶⁵ does not militate against the view that it is not an express exception. In discussing the purpose of the act, the Supreme Court, in *Monroe*,⁶⁶ noted:

57 *Id.* at 708.

58 337 F.2d 579 (4th Cir. 1964).

59 184 F.2d 119, 124 (3d Cir. 1950).

60 Note, 21 RUTGERS L. REV. 91, 124 (1966).

61 *Id.* at 111. For a general discussion of the history, see *id.* at 109-13. See also *Monroe v. Pape*, 365 U.S. 167 (1961).

62 Note, 74 HARV. L. REV. 726, 738 (1961).

63 337 F.2d 579, 586-94 (4th Cir. 1964).

64 *Id.* at 589.

65 Note, 21 RUTGERS L. REV. 92, 111 (1966).

66 *Monroe v. Pape*, 365 U.S. 167 (1961).

The debates are replete with references to the lawless conditions existing in the South in 1871. There was available to Congress during these debates a report, nearly 600 pages in length, dealing with the activities of the Klan and the inability of the state governments to deal with it. This report was drawn on by many speakers. It was not the unavailability of state remedies but the failure of certain States to enforce the laws with an equal hand that furnished the powerful momentum behind this "force bill."⁶⁷

It is abundantly clear that one reason the legislation was passed was to afford a federal right in federal courts because, by reason of prejudice . . . state laws *might not be enforced* and the claims of citizens to the enjoyment of rights, privileges, and immunities guaranteed by the Fourteenth Amendment might be denied by the state agencies.⁶⁸ (Emphasis added.)

The Court further quotes from a statement by Mr. Kerr of Indiana:

"This section gives to any person who may have been injured in any of his rights, privileges, or immunities of person or property, a *civil action for damages* against the wrongdoer in the Federal courts."⁶⁹ (Emphasis added.)

The view in *Baines* would seem to be the more reasonable approach to the question of whether section 1983 constitutes an express exception to the anti-injunction statute. Those statutes that are considered by the Court to be an express exception to section 2283⁷⁰ contain either an express grant of such power or by their very nature inherently imply that an injunction ought issue.⁷¹ Two general arguments seem to support the rationale that section 1983 is not an exception. First, as a practical matter, if section 1983 did constitute an express exception it would encompass all constitutionally protected rights, permitting persons in state courts to obtain delays wholly inconsistent with the nature of the right to be protected.⁷² This would flood the federal courts with spurious attempts to stop legitimate prosecutions and literally make them a clearing house for state cases, in effect destroying that which section 2283 seeks to maintain — a separate system without interference from federal courts.

Second, as discussed in *Monroe*, legislative history certainly does not indicate that Congress intended a clear exception to this policy. The nature of this policy of noninterference, as expressed in *Toucey*, is that the federal courts ought not interfere in state actions unless absolutely necessary. This was reiterated in *Dombrowski* and *Amalgamated Clothing*. It would seem clear that, in the exercise of its equity jurisdiction, a federal court ought strictly respect the requirements of section 2283 unless there is a clear-cut statutory exception or a compelling national interest which would make application of the statute inconsistent with the overall intent of Congress.

The *Sheridan* decision may raise the question of whether the issue will ever be fully determined. It has, apparently, established a broader ground on which

67 *Id.* at 174-75.

68 *Id.* at 180.

69 *Id.* at 178.

70 For a list of these statutes and a discussion of their specific provisions see Note, 74 HARV. L. REV. 726, 737-40 (1961).

71 *Baines v. City of Danville*, 337 F.2d 579, 589 (4th Cir. 1964). This case contains a discussion of the implied exception arising out of the Removal Acts.

72 See *Stefanelli v. Minard*, 342 U.S. 117, 122-24 (1951).

relief in meritorious situations may be made available. Instead of focusing on the controversy raised by section 1983, it strikes instead at the jugular, directly at section 2283, saying that because of the compelling federal interest in the protection of freedom of speech (to paraphrase *Leiter Minerals*) it would not be reasonable to impute the frustration of first amendment rights to Congress from the general language of section 2283 alone.⁷³ Rather, the *Sheridan* decision would make the right to relief turn more closely on the underlying intent of the original drafters of section 1983. In *Monroe*, the Court noted that the statute was meant to serve three very important purposes:

1. To override specific state laws.
2. To provide a remedy where state law was inadequate.
3. To make a federal remedy available where a state remedy was not available in fact or in practice.⁷⁴

The availability of this relief, without resolving the issue of whether section 1983 constitutes an express exception to section 2283, was carefully limited in *Sheridan* without destroying the effect of prior decisions such as *Amalgamated Clothing*.

There should be little doubt as to the validity of the extension of the right to relief in those first amendment cases where prosecution has "begun." Why should a litigant's rights in federal court depend on the happenstance that he received word of an imminent state prosecution? The right of citizens to seek federal assistance, if placed on such a tenuous basis, would be almost non-existent. It can be argued equally effectively, however, that the accused ought not be permitted to wait an unreasonable time before seeking federal assistance. The time permitted in each situation ought, necessarily, have to depend on the facts and circumstances attendant upon the case.

The elements of the *Sheridan* decision seem to give citizens the needed protection. The federal government cannot stand to protect the citizen from every inconvenience or slight deprivation of right; however, when the deprivation is of a right fundamental to the very democracy itself, the Court has clearly indicated that federal relief ought be available.⁷⁵

Moreover, this form of relief ought be available in both criminal and civil cases. In *Machesky*, the injunction sought was against a group of merchants and bankers.⁷⁶ The local police and elected officials do not have a monopoly on the use of the state courts to deprive individuals of their constitutionally protected rights. Of course, the use by the state of the state courts to intimidate select citizens is not new; and in particular, the district attorney for Orleans Parish is not unfamiliar with the effective range of tactics to suppress free speech.⁷⁷

Sheridan raises a valid issue and it sets meaningful and clear-cut limitations around the breadth of the exception it creates. To make the exception general would invite unwarranted interference in state court proceedings. Rather, under the *Dombrowski* standard for intervention in state proceedings, the *Sheridan*

⁷³ See text accompanying note 51, *supra*.

⁷⁴ *Monroe v. Pape*, 365 U.S. 167, 173-74 (1961).

⁷⁵ See *New York Times v. Sullivan*, 376 U.S. 254, 269-70 (1964).

⁷⁶ 414 F.2d at 284.

⁷⁷ *Dombrowski v. Pfister*, 380 U.S. 479, 481 (1965); *Garrison v. Louisiana*, 379 U.S. 64 (1964); *Shaw v. Garrison*, 283 F. Supp. 937 (E.D.La.), *aff'd*, 393 U.S. 220 (1968).

decision allows the courts to adequately protect those individual rights which, because of a more compelling public nature and because of their association with the very fundamental underpinnings of our democracy, call for immediate vindication whenever a clear showing of irreparable injury is made. The safeguards established by *Sheridan* serve to protect first amendment rights and afford the accused a forum for relief *if* he makes out the necessary grounds for intervention.

The decision does not provide easy rules for the courts and practicing attorneys to follow. Rather, it sets out a right to relief in those few meritorious situations where injunctive relief is demanded by the very principles on which our form of government is founded and which sustain its existence. There is no easy answer; this is the price we must pay if we are to maintain the underlying philosophy behind section 2283.

Harry L. Henning

CONSTITUTIONAL LAW — CIVIL RIGHTS — A PRIVATE CONSPIRACY TO DEPRIVE CITIZENS OF EQUAL PROTECTION OF THE LAWS, THEIR PRIVILEGES AND IMMUNITIES UNDER THE LAWS, AND RIGHTS OF A CITIZEN OF THE UNITED STATES IS NOT ACTIONABLE UNDER 42 U.S.C. § 1985 (3).—Lavon and James Breckenridge, white citizens of Mississippi, mistakenly believed that R. G. Grady, black citizen of Tennessee, was a worker for the civil rights of Negroes. Thus, they allegedly drove their truck into the path of Grady's automobile and blocked its passage over the public road in Kemper County, Mississippi. After forcing the occupants out of the car, the Breckenridges proceeded to club Grady while holding the others at gunpoint. After repeated threats to kill or injure the other occupants, the Breckenridges also attacked them with clubs. One of the victims was Eugene Griffin. Griffin and the other victims brought a civil action for damages in the United States District Court for the Southern District of Mississippi under section 1985(3), which provides:

If two or more persons in any State or Territory conspire or go in disguise on the highway or on the premises of another, for the purpose of depriving, either directly or indirectly, any person or class of persons of the equal protection of the laws, or of equal privileges and immunities under the laws . . . whereby another is injured in his person or property, or deprived of having and exercising any right or privilege of a citizen of the United States, the party so injured or deprived may have an action for the recovery of damages, occasioned by such injury or deprivation, against any one or more of the conspirators.¹

The complaint alleged a conspiracy between defendants Lavon and James Breckenridge to deprive the plaintiffs, black citizens of Mississippi and Tennessee, of their rights, privileges, and immunities as citizens of the United States, including their right to be secure in their persons, their right to petition their government for redress of grievances, and "their right to travel the public

¹ 42 U.S.C. § 1985(3) (1964), formerly ch. 22, § 2, 17 Stat. 13 (1871).

highways without restraint in the same terms as white citizens in Kemper County, Mississippi." Plaintiffs sought both compensatory and punitive damages. The district court dismissed the complaint, reasoning that it alleged no more than an invasion of private rights by private individuals, whereas section 1985(3) was limited to conspiracies performed under color of law — state action.

Plaintiffs appealed to the United States Court of Appeals for the Fifth Circuit, which affirmed and *held*: an action under section 1985(3) against private conspirators who, in a racially motivated assault, deprived black citizens of their rights, privileges, and immunities as citizens of the United States fails to state a cause of action because the conspirators did not act under color of law. *Griffin v. Breckenridge*, 410 F.2d 817 (5th Cir. 1969).

Section 1985(3), popularly known as the Ku Klux Klan Act, was enacted during Reconstruction to enforce the rights of freed slaves. The state action limitation on various civil rights acts² of this era has a long and complicated history beginning with the 1876 case of *United States v. Cruikshank*.³ This case involved an action under what is now 18 U.S.C. § 242 (a criminal counterpart of section 1985(3) for interference with Negroes' rights to assemble freely, to bear arms, and to equal protection of the laws. The Supreme Court decided that:

The fourteenth amendment prohibits a State from denying to any person within its jurisdiction the equal protection of the laws; but this provision does not . . . add anything to the rights which one citizen has under the Constitution against another. The equality of the rights of citizens is a principle of republicanism. Every republican government is in duty bound to protect all its citizens in the enjoyment of this principle, if within its power. That duty was originally assumed by the States; and it still remains there. The only obligation resting upon the United States is to see that the States do not deny the right.⁴

The *Civil Rights Cases*⁵ enunciated the doctrine more fully. These cases dealt with various denials to Negroes of public accommodations enumerated in the Civil Rights Act of 1875. In his majority opinion, Mr. Justice Bradley further cemented the doctrine of state action by stating that "[i]ndividual invasion of individual rights is not the subject matter of the Amendment."⁶ Justice

2 42 U.S.C. § 1982 (1964), formerly ch. 31, § 1, 14 Stat. 27 (1866); 42 U.S.C. § 1983 (1964), formerly ch. 22, § 1, 17 Stat. 13 (1871); 42 U.S.C. § 1984 (1964); 42 U.S.C. § 1985 (1964), formerly ch. 22, § 2, 17 Stat. 13 (1871).

3 92 U.S. 542 (1876).

4 *Id.* at 554-55. U.S. CONST. amend. XIV provides:

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State where they reside. No state shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 5. The Congress shall have the power to enforce, by appropriate legislation, the provisions of this article.

5 109 U.S. 3 (1883).

6 *Id.* at 11.

Bradley also developed the "corrective legislation" interpretation of the fourteenth amendment's section five:

[T]he last section of the amendment invests Congress with the power to enforce it by appropriate legislation. To enforce what? To enforce the prohibition. To adopt appropriate legislation for correcting the effects of such prohibited State laws and State acts, and thus to render them effectually null, void, and innocuous.⁷

In his dissent, Justice Harlan asserted that "[i]t is . . . a grave misconception to suppose that the fifth section of the amendment has reference exclusively to express prohibition upon State laws or State action."⁸

In the same year, the original criminal counterpart of section 1985(3) was declared unconstitutional in *United States v. Harris*.⁹ State prisoners, in the custody of a county deputy, were beaten and intimidated as the result of a private conspiracy. The conspirators were prosecuted under federal law¹⁰ for denying the prisoners equal protection of state laws. The Supreme Court reasoned that section five did not authorize Congress to enact enforcement legislation to prosecute private crimes.¹¹ Thus section 5519, the federal law invoked, was declared unconstitutional. The statute now in force covers the same class of conspiracies, but does not use the offensive language applying to states. The wording of this statute, 18 U.S.C. § 241, is very similar to that of section 1985(3).¹²

The state action requirement has continued to develop through the case law. A recent statement of its longevity is found in *Huey v. Barloga*:¹³

This distinction between purely private discrimination and discrimination pursuant to "state action" has persisted for over eighty years. Only discrimination which falls within the latter category warrants Fourteenth Amendment protection and falls within the ambit of the Civil Rights Act.¹⁴

One judicial inroad on the state action requirement as it relates to federal enforcement legislation against conspiracies involves an attack on the "corrective legislation" interpretation of section five of the fourteenth amendment. The leading case in this attack, *United States v. Guest*,¹⁵ involved a criminal prosecution under section 241, referred to above. Six private individuals were convicted of conspiring to deprive black citizens of their rights to equal enjoyment

7 *Id.*

8 *Id.* at 46.

9 106 U.S. 629, 640 (1883).

10 70 Rev. Stat. 1070, § 5519 (1873), formerly ch. 22, § 2, 17 Stat. 13-14 (1871).

11 *United States v. Harris*, 106 U.S. 629, 640 (1883).

12 18 U.S.C. § 241 (1968) provides in part:

If two or more persons conspire to injure, oppress, threaten, or intimidate any citizen in the free exercise or enjoyment of any right or privilege secured to him by the Constitution or laws of the United States, or because of his having exercised the same; or

If two or more persons go in disguise on the highway, or on the premises of another, with intent to prevent or hinder his free exercise or enjoyment of any right or privilege so secured —

They shall be fined

13 277 F. Supp. 864 (N.D. Ill. 1967).

14 *Id.* at 869.

15 383 U.S. 745 (1966).

of public accommodations, streets, and highways and their right to travel between states freely. The conspiracy was carried out by shooting, killing, and false reports of criminal activities on the part of the black citizens. There was no allegation of state action, but the majority found that the false reports of criminal activities constituted at least indirect state action,¹⁶ thereby upholding the convictions. The case is especially significant because, in two separate opinions, six of the justices concluded that section five empowers Congress to enact legislation against purely private conspiracies.¹⁷ This is clearly an abrogation of the "corrective legislation" theory of congressional power under section five. In his separate opinion, Mr. Justice Brennan stated:

I am of the opinion that a conspiracy to interfere with the right to equal utilization of state facilities . . . is a conspiracy to interfere with a "right . . . secured . . . by the Constitution" within the meaning of § 241 — without regard to whether state officers participated in the alleged conspiracy. . . .¹⁸

I acknowledge that some of the decisions of this Court, most notably an aspect of the Civil Rights Cases, 109 U.S. 3, 11 have declared that Congress' power under § 5 is confined to the adoption of "appropriate legislation for correcting the effects of . . . prohibited State laws and State acts, and thus to render them effectually null, void, and innocuous." I do not accept — and a majority of the Court today rejects — this interpretation of § 5.¹⁹

This opinion was joined by Chief Justice Warren and Mr. Justice Douglas.

In his separate opinion, Mr. Justice Clark specifically agreed with Justice Brennan, stating: "[T]here now can be no doubt that the specific language of § 5 empowers the Congress to enact laws punishing all conspiracies — with or without state action — that interfere with Fourteenth Amendment rights."²⁰ This opinion was joined by Justices Black and Fortas. Due to the strong dicta in these separate opinions, the commentators read in *Guest* the eventual demise of the state action requirement.²¹

The subsequent cases, however, have retained the state action requirement based on Mr. Justice Stewart's majority opinion in *Guest*;²² and the issue in *Griffin* was decided on the basis of these subsequent cases. The Fifth Circuit disposed of the *Guest* separate opinions by saying that "[s]uch an important and significant extension of the Fourteenth Amendment, though intimated in several recent Supreme Court decisions, must still await a specific and authori-

16 *Id.* at 756.

17 *Id.* at 761, 774 (concurring opinions of Brennan & Clark, JJ.)

18 *Id.* at 777.

19 *Id.* at 782-83.

20 *Id.* at 762.

21 *E.g.*, Avins, *The Civil Rights Act of 1875 and The Civil Rights Cases Revisited: State Action, The Fourteenth Amendment and Housing*, 14 U.C.L.A. L. REV. 5 (1966); Silard, *A Constitutional Forecast: Demise of the "State Action" Limit on the Equal Protection Guarantee*, 66 COLUM. L. REV. 855 (1966); Note, *Constitutional Law — Civil Rights — Congressional Power Under Section 5 of the Fourteenth Amendment May Extend to Punishment of Private Conspiracies to Interfere with the Equal Enjoyment of State-Owned Public Facilities*, 45 TEXAS L. REV. 168 (1966); Comment, *Civil Rights — Federal Criminal Code Protects Rights Secured by Fourteenth Amendment*, 20 VAND. L. REV. 170 (1966).

22 *United States v. Price*, 383 U.S. 787 (1966); *Jones v. Alfred H. Mayer Co.*, 379 F.2d 33 (8th Cir. 1967), *rev'd on other grounds*, 392 U.S. 409 (1968); *Wilkins v. United States*, 376 F.2d 552 (5th Cir.), *cert. denied*, 389 U.S. 964 (1967); *United States v. Lester*, 363 F.2d 68 (6th Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).

tative pronouncement by that Court."²³ (Footnote omitted.) Essentially, the Fifth Circuit is asking the Supreme Court to consider *Griffin* in light of the separate opinions in *Guest*.

Another judicial inroad on the state action requirement as it relates to federal enforcement legislation against conspiracies involves fundamental rights of national citizenship. Certain rights, protected against private acts, are inherent in and arise solely from national citizenship. There is considerable confusion and debate about the constitutional source of such rights.²⁴ The privileges and immunities clause of the fourteenth amendment was hinted to be the source of a very limited number of national citizenship rights in the *Slaughter-House Case*,²⁵ but most ordinary rights of American citizens, such as the right to pursue a course of employment, derive from state citizenship.²⁶ The right of access to the country's navigable waters, however, is peculiar to national citizenship.²⁷ The *Slaughter-House* theory seems to be that such a right derives from the privileges and immunities clause,²⁸ and its enforcement is thus limited to legislation correcting state action.

Certain other fundamental rights, however, have their source not in the privileges and immunities clause, but in other constitutional provisions or in the very nature of our federal government. The right to vote in a federal election is such a right, derived from article I, section 2 of the Constitution.²⁹ The right to petition the federal government for redress of grievances is inherent in our republican form of government.³⁰ The right to travel freely among the states was recognized as fundamental by the majority in *Guest*. "In this connection, it is important to reiterate that the right to travel freely from State to State finds constitutional protection that is quite independent of the Fourteenth Amendment."³¹ Legislation enforcing those fundamental rights of national citizenship that do not derive from the privileges and immunities clause is not burdened with the state action requirement. Therefore, the criminal counterpart to section 1985(3) has been applied in a number of cases of private criminal conspiracies to violate such fundamental rights. Conspiracies to interfere with voting in federal elections or petitioning the federal government for redress of grievances are two examples.³²

There have only been a few rights recognized as fundamental to national citizenship in cases brought under section 1985(3). *Paynes v. Lee*³³ recognized voting rights as fundamental.³⁴ Although in a subsequent case it found state

23 *Griffin v. Breckenridge*, 410 F.2d 817, 821 (9th Cir. 1969).

24 Feurestein, *Civil Rights Crimes and the Federal Power to Punish Private Individuals for Interference with Federally Secured Rights*, 19 VAND. L. REV. 641, 652 (1966).

25 83 U.S. (16 Wall.) 36 (1873).

26 *Id.* at 76.

27 *Id.* at 79-80.

28 *Id.* at 80.

29 *Ex parte Yarborough*, 110 U.S. 651, 663-64 (1884).

30 *United States v. Cruikshank*, 92 U.S. 542, 552 (1876).

31 *United States v. Guest*, 383 U.S. 745, 759 n.17 (1966); *accord*, *Shapiro v. Thompson*, 394 U.S. 618, 630 n.8 (1969).

32 Other examples are: the right to inform federal officers of violations of federal law, *Motes v. United States*, 178 U.S. 458 (1900); the right to protection from attack while in the custody of a federal marshal, *Logan v. United States*, 144 U.S. 263 (1892); the right to enjoy the privileges of the homestead laws, *United States v. Waddell*, 112 U.S. 76 (1884).

33 377 F.2d 61 (5th Cir. 1967).

34 *Id.* at 64.

action in a suit by black citizens against compulsory segregation in railroad waiting rooms, the same court said that section 1985(3) "applies to private persons who, in concert with others, deprive a citizen of certain rights and privileges judicially confined to those inhering in Federal citizenship."³⁵ The question arises whether section 1985(3) can also enforce those fundamental rights enumerated in the section 241 cases, i.e., those rights peculiar to national citizenship that do not derive from the privileges and immunities clause.

The question reached the Supreme Court in *Collins v. Hardyman*³⁶ in 1951. In *Collins*, a political meeting was broken up by a private conspiracy to deprive the participants in the meeting of their right to petition the government for redress of grievances. An action was brought against the conspirators under section 1985(3). It was contended that the portion of section 1985(3) dealing with rights of national citizenship is severable from the rest of the statute, which speaks in terms of equal protection and privileges and immunities.³⁷ This contention was an attempt to avoid the constitutional issue of *Harris*.³⁸ If section 1985(3) were read as indivisible and applicable by its terms to private conspiracies, then either it would have to be declared unconstitutional or the "corrective legislation" interpretation of the fourteenth amendment's section five would have to be abrogated. The Court did not agree that the national rights portion of section 1985(3) was severable from the rest of the statute.³⁹ The Court avoided the constitutional issue by deciding that the language of section 1985(3) itself limits the section's application to conspiracies under color of law: "We think that Congress has not, in the narrow class of conspiracies defined by this statute, included the conspiracy charged here. We therefore reach no constitutional questions."⁴⁰

Since the majority did not agree that the national rights portion of section 1985(3) was severable, it did not actually decide whether the fundamental right in question could give rise to an action under the statute. Restricting the statute on its face to conspiracies under color of law precluded recovery. In their dissent, Justices Burton, Black, and Douglas reached the opposite conclusion:

Congress certainly has the power to create a federal cause of action in favor of persons injured by private individuals through the abridgement of federally created constitutional rights. It seems to me that Congress has done just this in R.S. 1980(3) [section 1985(3)].⁴¹

The plaintiffs in *Griffin* contended that the Breckenridge conspiracy deprived them of certain fundamental rights of national citizenship, including the right to petition their government for redress of grievances. The Fifth Circuit reluctantly followed the *Collins* doctrine that section 1985(3) does not afford such relief absent state action:

We have serious doubts as to its continued vitality, but we, as an inferior court, cannot expand the statutory girth of § 1985(3) when we are "...

35 *Baldwin v. Morgan*, 251 F.2d 780, 790 (5th Cir. 1958).

36 341 U.S. 651 (1951).

37 See text accompanying note 1 *supra*.

38 *Collins v. Hardyman*, 341 U.S. 651, 659 (1951).

39 *Id.*

40 *Id.* at 662.

41 *Id.* at 664.

faced with a limiting Supreme Court decision which, so far as we are told directly, remains good law."⁴² (Footnote omitted.)

In *Griffin* the Fifth Circuit is actually asking to be overruled:

[I]t would not surprise us if *Collins v. Hardyman* were disapproved and if § 1985(3) were held to embrace private conspiracies to interfere with rights of national citizenship. . . . For many years § 241 has been applied to private conspiracies against rights of national citizenship, and why § 1985(3) should be given a narrower compass when its constitutionality would be no further impaired or its language further abused has mystified the commentators.⁴³ (Footnotes omitted.)

Thus, on the issue of fundamental rights of national citizenship, the Fifth Circuit has asked the Supreme Court to consider *Griffin* in light of the dissent in *Collins* — that the language of section 1985(3) does not restrict it to state action.

On this issue, the legislative history of the statute indicates an intent to reach private as well as public conspiracies.⁴⁴ Nowhere in the wording of section 1985(3) does the language "under color of law" appear. This is significant because that language does appear in section 1983,⁴⁵ a similar statute directed toward individuals rather than conspiracies. The sponsors of the Ku Klux Klan Act and other civil rights acts were the same men who sponsored the fourteenth amendment itself. Although their statements in the Reconstruction debates are often couched in terms of fourteenth amendment powers, those statements are important in analyzing section 1985(3) on the issue of national rights.

Congressman Pool, sponsor of the criminal counterpart to section 1985(3), stated in 1870:

That the United States Government has the right to go into the States and enforce the fourteenth and fifteenth amendments is, in my judgment perfectly clear, by appropriate legislation that shall bear upon individuals. . . . If there is to be appropriate legislation at all, it must be that which applies to individuals.⁴⁶

During the 1871 House debates on the Ku Klux Klan Act itself, Congressman Bingham commented that "[t]hese last amendments—thirteen, fourteen, and fifteen — do, in my judgment, vest in Congress a power to protect the rights of citizens against States, and individuals in States, never before granted."⁴⁷ Later in the same debate, Congressman Lowe argued that section five of the fourteenth amendment was intended "to enable Congress, by Federal legislation and by the proper power of the Government, to secure to citizens the actual

⁴² *Griffin v. Breckenridge*, 410 F.2d 817, 823-24 (5th Cir. 1969).

⁴³ *Id.* at 825-26.

⁴⁴ See generally H. FLACK, *THE ADOPTION OF THE FOURTEENTH AMENDMENT* 210-77 (1908).

⁴⁵ 42 U.S.C. § 1983 (1964), formerly ch. 22, § 1, 17 Stat. 13 (1871), is couched in the following terms:

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 . . . (Emphasis added.)

⁴⁶ VIRGINIA COMMISSION ON CONSTITUTIONAL GOVERNMENT, *THE RECONSTRUCTION AMENDMENTS' DEBATES* 448 (A. Avins ed. 1967).

⁴⁷ *Id.* at 509.

enjoyment of the rights and privileges guaranteed [*sic*]."⁴⁸ Specifically referring to the fourteenth amendment, Congressman Moore stated:

The Government can act only upon individuals. . . .

Whatever conspiracy may be formed having for its purpose to create a terror which shall deter any class of people from the exercise of those rights, it is a direct infringement of this amendment which may be punished by the laws of the United States.⁴⁹

Although contrary opinion was voiced in the debates, the general intent is typified by the above statements. This demonstration of legislative intent is important in interpreting section 1985(3) on the issue of fundamental national rights and also in analyzing the earlier discussion of abrogating the state action requirement of enforcement legislation under section five of the fourteenth amendment.

The intent of these legislators did not go completely unnoticed by the courts. In *United States v. Williams*, decided during the same term as *Collins*, Mr. Justice Frankfurter noted of section 241:

Men who "go in disguise upon the public highway, or upon the premises of another" are not likely to be acting in official capacities. The history of the times — the lawless activities of private bands, of which the Klan was the most conspicuous — explains why Congress dealt with both State disregard of the new constitutional prohibitions and private lawlessness. The sponsor of § 6 [section 241] in the Senate made explicit that the purpose of his amendment was to control private conduct.⁵⁰

In *United States v. Mosley*,⁵¹ a case involving suppression of black voters and false election returns, Mr. Justice Holmes stated that "[t]he source of this section [241] in the doings of the Ku Klux and the like is obvious and acts of violence obviously were in the mind of Congress. Naturally Congress put forth all its powers."⁵²

Given their identical legislative history, there is no reason why the above comments should not apply to section 1985(3) as well as section 241. In fact, the dissent in *Collins* comes to this conclusion:

That Amendment [fourteenth] prohibits the respective states from making laws abridging the privileges or immunities of citizens of the United States or denying to any person within the jurisdiction of the state the equal protection of the laws. Cases holding that those clauses are directed only at state action are not authority for the contention that Congress may not pass laws supporting rights which exist apart from the Fourteenth Amendment.⁵³

In essence, recovery under the fundamental national rights theory in cases like *Griffin* is precluded only by the *Collins* majority's reading of state action into the language of section 1985(3).

48 *Id.* at 516.

49 *Id.* at 524-25.

50 *United States v. Williams*, 341 U.S. 70, 76 (1951).

51 238 U.S. 383 (1915).

52 *Id.* at 387.

53 *Collins v. Hardyman*, 341 U.S. 651, 664 (1951).

The *Griffin* case has left the Supreme Court a number of choices in resolving the question whether section 1985(3) can reach private conspiracies that violate either rights of national citizenship or rights protected by the fourteenth amendment. The Court can affirm *Collins* on the issue of national rights. This would involve affirming that the national rights portion of section 1985(3) is not severable from the rest of the statute, which, since it speaks in terms of equal protection and privileges and immunities, is restricted to conspiracies under color of law.

The Court could, on the other hand, decide that the national rights portion is severable and applies to private conspiracies against fundamental national rights, thereby overruling *Collins*. This seems to be the approach favored by the Fifth Circuit in *Griffin*. Both of the above choices avoid the constitutional problems raised by the following alternative.

Should the Court follow *Collins* in holding that section 1985(3) is not severable and yet overrule *Collins* by holding that section 1985(3) is not restricted to state action by its own terms, a constitutional dilemma would arise. Either section 1985(3) would have to be declared unconstitutional on the basis of *Harris*, or the "corrective legislation" interpretation of section five of the fourteenth amendment would have to be abrogated. The latter alternative finds support in the separate opinions of *Guest* and involves fourteenth amendment rights, a significantly more far-reaching category of rights than fundamental rights of national citizenship.

The necessary legal framework is present for any of these choices. The selection process will constitute an interesting challenge for the Court. Since the decision must rest heavily on policy considerations, former Solicitor General Archibald Cox's comments merit consideration:

In deciding whether Congress has power to punish private violence aimed at preventing the enjoyment of constitutional rights, the most compelling short-run factor at a time when we are seeking to accomplish a revolution in race relations within the framework of the law, in the face of bitter and occasionally lawless opposition, is the need for federal power to secure the safety of those who exercise their constitutional rights, not as a substitute for local law enforcement but as visible proof that if local officials are inadequate, slothful, or conniving, still an impartial rule of law will be preserved.⁵⁴

This statement is a compelling argument for federal enforcement statutes unhindered by the state action requirement. Even the majority in *Collins* did not completely close the door on action against private conspiracies under section 1985(3):

We do not say that no conspiracy by private individuals could be of such magnitude and effect as to work a deprivation of equal protection of the laws, or of equal privileges and immunities under laws. Indeed, the post-Civil War Ku Klux Klan, against which the Act was fashioned, may have, or may reasonably have been thought to have, done so.⁵⁵

⁵⁴ Cox, *Foreword: Constitutional Adjudication and the Promotion of Human Rights, The Supreme Court, 1965 Term*, 80 HARV. L. REV. 91, 114 (1966).

⁵⁵ *Collins v. Hardyman*, 341 U.S. 651, 662 (1951).

The Court seemed to have in mind the breadth of the effects of such conspiracies. Is it really possible to say that today's conspiracies are any less effective than those of the last century?

Returning for a moment to the Reconstruction debates, this emotional statement merits consideration:

While murder is stalking abroad in disguise, while whippings and lynchings and banishment have been visited upon unoffending American citizens, the local administrations have been found inadequate or unwilling to apply the proper corrective. Combinations, darker than the night that hides them, conspiracies, wicked as the worst of felons could devise, have gone unwhipped of justice. Immunity is given to crime, and the records of the public tribunals are searched in vain for any evidence of effective redress. If there is no remedy for this, if the rights of citizenship may be denied without redress, if the Constitution may not be enforced, if life and liberty may not be effectively protected, then, indeed, is our civil Government a failure, and instead of enjoying liberty regulated by law, its subjects may live only by the sufferance of lawless and exasperated conspirators.⁵⁶

Is it not a sufficient indication of the effectiveness of today's conspiracies that the words above apply equally as well now as then?

From this point of view, the least desirable choice for the Supreme Court to make in *Griffin* is a complete reaffirmation of *Collins*. That *Collins* is unsatisfactory is attested to by the *Griffin* case itself. It would also be undesirable for the Court to follow *Collins* on the issue of the severability of the national rights portion of section 1985(3) and then declare the statute unconstitutional on the basis of *Harris*.

Following the recommendations of the Fifth Circuit to overrule *Collins*, declaring section 1985(3) applicable to private conspiracies against fundamental rights of national citizenship, would achieve a desirable result. This category of rights is very narrow, however, and such a decision might have the undesirable side effect of freezing that category altogether.

The most desirable choice is the abrogation of the "corrective legislation" interpretation of section five of the fourteenth amendment. Following *Collins* on the severability of section 1985(3), but not restricting the statute to state action by its language, the Court could adopt the separate opinions in *Guest* rather than declare section 1985(3) unconstitutional. The abrogation of the "corrective legislation" interpretation of section five would allow direct federal legislation to enforce fourteenth amendment rights. Particularly, it would allow actions for damages against conspirators under section 1985(3).

Whether this alternative will prevail is at least problematical. It is predicated upon the reasoning of the six justices who joined in the *Guest* separate opinions. Three of those justices are no longer sitting.⁵⁷ Whether their successors will see the problem in the same light remains to be seen.

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⁵⁶ VIRGINIA COMMISSION, *supra* note 46, at 516.

⁵⁷ Clark, Fortas, and Warren.