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Legislation and Administration: Constitutional Law -- Statutory Presumptions -- Legislature's Power to Make the Fact that a Defendant was Armed with a Pistol, Which He Had No License to Carry, Prima Facie Evidence of Intent to Commit Crime Upheld

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LEGISLATION AND ADMINISTRATION

CONSTITUTIONAL LAW — STATUTORY PRESUMPTIONS — LEGISLATURE'S POWER TO MAKE THE FACT THAT A DEFENDANT WAS ARMED WITH PISTOL, WHICH HE HAD NO LICENSE TO CARRY, PRIMA FACIE EVIDENCE OF INTENT TO COMMIT CRIME UPHELD. — Harold Thomas was charged with murder in the second degree and assault in the first degree. At the trial evidence was admitted, over objection, that Thomas was carrying a pistol at the time of the commission of the crimes for which he had no license. The court instructed the jury that the fact that the defendant was armed with a pistol which he had no license to carry was prima facie evidence of his intention to commit the offenses charged.[1] The defendant was convicted on both counts and he appealed on the ground that the instruction of the court concerning the carrying of an unlicensed pistol was based on an unconstitutional statute. *Held*: there is a rational connection between carrying pistols without a license and intending crimes of violence, and the statute in question was constitutional. *State v. Thomas*, 364 P.2d 930 (Wash. 1961).

The power of the legislature to enact statutes embodying presumptions or providing that proof of one fact shall be prima facie evidence of another has been widely recognized.[2] But the courts are aware that a more or less mechanistic method of invoking statutory presumptions can be a danger to the liberty of the individual. For this reason a number of tests have been developed by the judiciary to aid it in deciding whether a legislature has stayed within constitutional limits. One of these is the widely-accepted "rational connection" approach which was formulated by the Supreme Court in *Mobile, J. & R.C.R.R. Co. v. Turnipseed*,[3] wherein it was stated:

> That a legislative presumption of one fact from evidence of another may not constitute a denial of due process of law or a denial of the equal protection of the law *it is only essential that there shall be some rational connection between the fact proved and the ultimate fact presumed*, and that the inference of one fact from proof of another shall not be so unreasonable as to be a purely arbitrary mandate.[4]

The wisdom of the legislature is accorded a wide range of discretion by this test. Since the inference of one fact from another is based on the observation of their relationship in human experience, it is thought that the legislature is better able to make this judgment than are the courts.[5]

As more cases involving statutory changes of evidentiary rules reached the Supreme Court, an expansion of the "rational connection" test took place. The argument has been raised that, in spite of the absence of a rational connection, the statutory presumption might be upheld on the basis of a "manifest disparity in convenience of proof and opportunity for knowledge."[6] However, in *Tot v. United States*,[7] the Supreme Court said:

> The Government seems to argue that there are two alternative tests of the validity of a presumption created by statute. The first is that there be a rational connection between the facts proved and the fact presumed; the second that of comparative convenience of producing evidence of the ultimate fact. We are of opinion that these are not independent tests but that the first is controlling and the second but a corollary. Under our decisions, a statutory presumption cannot be sustained if there be no rational connec-

1 This was drawn from WASH. REV. CODE § 9.41.030 (1956), providing: "In the trial of a person for committing or attempting to commit a crime of violence, the fact that he was armed with a pistol and had no license to carry the same shall be prima facie evidence of his intention to commit said crime of violence."

2 Mobile, J. & R.C.R.R. Co. v. Turnipseed, 219 U.S. 35 (1910); People v. Cannon, 139 N.Y. 32, 34 N.E. 759 (1893).

3 219 U.S. 35 (1910).

4 *Id.* at 43. (Emphasis supplied.)

5 56 HARV. L. REV. 1324, 1325 (1943).

6 Morrison v. California, 291 U.S. 82 (1934).

7 Tot v. United States, 319 U.S. 463 (1943).

> tion between the fact proved and the ultimate fact presumed, if the inference of the one from proof of the other is arbitrary because of lack of connection between the two in common experience.[8]

It seems clear, then, from what the Supreme Court has stated, that the true test which a legislative presumption must undergo is the "rational connection" formula.

Even before the decisions just discussed were handed down, the Court of Appeals of New York had expressed its views on the matter in *People v. Cannon.*[9] After acknowledging the general power of the legislature to enact that, even in criminal prosecutions, when certain facts have been proved they shall be prima facie evidence of the existence of the main fact in question, the court said:

> The limitations are that the fact upon which the presumption is to rest must have some fair relation to, or natural connection with, the main fact. . . . A provision of this kind does not take away or impair the right of trial by jury. It does not in reality change the burden of proof. The people must at all times sustain the burden of proving the guilt of the accused beyond a reasonable doubt.[10]

It should be carefully noted that the effect of the presumption on the jury's determination is permissive and not mandatory.

Only one jurisdiction, Indiana, dissents from the views of the decisions just reviewed. In *Powers v. State,*[11] which involved a statute very similar to the one in question in *State v. Thomas*[12] the court said:

> Facts which are universally recognized as indicating guilt . . . are prima facie evidence of guilt without any legislative enactment, and, if the Legislature is confined to designating such facts as prima facie evidence and the designation of facts which might be consistent with innocence is beyond their power, enactments on the subject are of no force or effect in either event.[13]

In addition, the reasoning of the *Cannon*[14] case, as to the effect of the legislative presumption on the jury's freedom of determination, is completely rejected in the *Powers* decision.[15] In view of that language and the statements in *Dedrick v. State,*[16] it is doubtful that Indiana recognizes the power of the legislature to act in this area in spite of the declarations of other courts that the power always exists, subject to limitations of reasonableness and fairness.[17] The *Powers* decision, which is referred to by the court in the *Thomas* case, indicated that the Indiana courts would disagree that the statute under consideration in *Thomas* is valid under the "rational connection" test.[18] However that may be, the real difference between the Washington and Indiana courts appears to reside in the general approach which these courts take in this matter. The court in *Powers* went further than applying the "rational connection" test and required that the proven fact from which the prima facie evidence of criminal intent is inferred be sufficient of itself to sustain a conviction without legislative support.[19] It is submitted that this attitude renders legislative acts in this area wholly ineffective.

The decisions of the Supreme Court of Washington have been consistent with the approach of the decisions of the United States Supreme Court and the New York court reviewed above. In *State v. Fitzpatrick,*[20] involving a statute which declared that the possession of burglary tools is prima facie evidence of an intent

8 *Id.* at 467-68.
9 139 N.Y. 32, 34 N.E. 759 (1893).
10 *Id.* at 762.
11 Powers v. State, 204 Ind. 472, 184 N.E. 549 (1933).
12 State v. Thomas, 364 P.2d 930 (Wash. 1961).
13 Powers v. State, *supra* note 11, at 552.
14 People v. Cannon, 139 N.Y. 32, 34 N.E. 759 (1893).
15 Powers v. State, *supra* note 11, at 553.
16 "Under our Constitution neither the Legislature by enactment nor the court by instruction may determine what is prima facie evidence of an ultimate fact." 210 Ind. 259, 2 N.E.2d 409, 418 (1936).
17 Tot v. United States, *supra* note 7; People v. Cannon, *supra* note 14.
18 Powers v. State, 204 Ind. 472, 184 N.E. 549, 552 (1933).
19 *Id.* at 552-553.
20 141 Wash. 638, 251 Pac. 875 (1927).

to use them, the court deemed itself unable to say that there was "no rational connection between the possession of false keys and picklocks and the presumed intent to use them in the commission of a crime."[21] In taking that position, the court cited as authority the cases of *Yee Hem v. United States*[22] and *Mobile J. & R.C.R.R. Co. v. Turnipseed.*[23]

The most extensive analysis of Washington's position as to the effect of statutory presumptions in criminal proceedings is contained in *State* v. *Rouw.*[24] There the court had before it a statute which declared that the illegal possession of liquor, with certain exceptions for the clergy, constituted prima facie evidence that the liquor was held for the purpose of unlawful sale or disposition. The court approved the instruction given by the trial judge which embodied the substance of the statute just paraphrased. In construing the effect of the prima facie case on the burden of proof, the court said:

> Assume that the prosecution introduces evidence from which the jury may find beyond a reasonable doubt that the accused had in his possession intoxicating liquor. . . .
>
> Assuming next that the accused introduces no evidence whatever, there still remains a question of fact to be determined by the jury. * * * The presumption of innocence is still operating, and the jury must consider the admitted or proven facts establishing possession, the presumption which under the law follows therefrom, and the presumption that the accused is innocent.[25]

These statements make it adequately clear that statutory presumptions in criminal trials in the Washington courts are not intended, either directly or indirectly, to reduce the substantial rights of its citizens who are accused of crimes which involve legislative rules of evidence. In fact, it is to be wondered whether they have any effect other than procedural.

A very recent pronouncement of the Washington court, *State v. Person,*[26] largely reiterated what the court said in *Rouw,* again negativing the charge leveled by some that statutory presumptions shift the burden of proof or compel the accused to give evidence against himself.

The court in *State v. Thomas*[27] traveled along a well-used path to its decision. At the outset, it recognized the power of the state legislature to declare that proof of one fact shall be prima facie evidence of another. It then stated the test which the statute must pass in order to be consistent with due process. The test used was a formulation of the Minnesota court in *State v. Kelly*[28] which is in substantial conformity with the "rational connection" approach in *Turnipseed,*[29] *Tot,*[30] *Cannon,*[31] and *Fitzpatrick.*[32] Next, the court applied the test to the statute before it[33] and found that there was a rational connection between carrying pistols without a license to do so and intending crimes of violence. Finally, the court examined the significance which the trial court attached to the statutory presumption and, finding error here in the instruction, set aside the conviction and remanded for new trial. On retrial, the trial court would be required to explain the phrase, prima facie evidence, in such manner as to make it clear to the jury that it need give only such weight to the prima facie evidence of intent as it seems to the jury to merit.

It is believed that, in light of the decisions discussed above, the correctness

21 *Id.* at 876.
22 268 U.S. 178 (1925).
23 219 U.S. 35 (1910).
24 156 Wash. 198, 286 Pac. 81 (1930).
25 *Id.* at 84.
26 56 Wash.2d 283, 352 P.2d 189 (1960).
27 364 P.2d 930 (Wash. 1961).
28 218 Minn. 247, 15 N.W. 2d 554 (1944).
29 219 U.S. 35 (1910).
30 319 U.S. 463 (1943).
31 139 N.Y. 32, 34 N.E. 759 (1893).
32 141 Wash. 638, 251 Pac. 875 (1927).
33 WASH. REV. CODE § 9.41.030 (1956).

of the present case, insofar as it acknowledged the power of the legislature to act in this area and adopted the rational connection test, must be conceded. As is the case in most instances which require the application of broad principles to a particular situation, the real core of this case is finding justification for a decision that the statutory presumption in this case met the standard of validity. The court was satisfied that because of the ease with which a license to carry a pistol for a lawful reason may be obtained, the failure to obtain such a license permits the inference that such a failure connotes an unlawful purpose. But that is all the court need find, that is, that whatever the precise motive and grounds of the legislature were in enacting the statute, as long as the court can find that there is *some* basis in reason for concluding the relationship probably exists in human experience, then the court should not superimpose its judgment on that of the legislature. It seems fairly obvious that the Washington tribunal in this instance found that if a person risks the chance of prosecution for carrying an unlicensed pistol, human experience has shown that he probably does so with an intent to commit a crime of violence.

Furthermore, the court very carefully pointed out the language of the statute before it. There are at least three elements of fact which must be shown by the prosecution before the establishment of the prima facie case as to intent exists: 1.) the accused must have been involved in a crime of violence or an attempt to commit same; 2.) he must have been armed with a pistol at that time; and 3.) he must not have had a license to carry the pistol. Conceding the proof of those elements, it follows, by the construction of the Washington court,[34] that the intent to commit is deemed to be reasonably inferred. Under such close analysis, it can be observed that this statute does not jeopardize the rights of the citizen who is arrested for carrying an unlicensed pistol while simply walking along the street. Arming oneself with a pistol without a license to do so is only one factor in the application of the statute. It must be coupled with the commission or attempted commission of a crime of violence. In other words, there must be an overt act in furtherance of the commission or attempt to commit the crime. Under that circumstance, it is posited that the great majority of cases will present facts, over and above the statutory presumption, from which the jury can find the requisite intent. Because of this, any possible danger in this type of statute is modified to a very considerable extent.

The jury is entitled to consider this prima facie evidence "for what it may be worth."[35] There is no compulsion on the jury to find the existence of the requisite intent beyond a reasonable doubt and it need give the inference "only such weight on the issue of intent as it seems to merit."[36]

If examined in a vacuum, the decision in the *Thomas* case would seem to go quite far in acceding to the will of the legislature. But if the decision is examined in light of the previous pronouncements of the court as to the effect of the statute and others like it, it is believed that because of the total lack of conclusiveness on the decision of the jury of these statutes, in conjunction with clear instructions by the trial courts to this effect, the possibilities of danger to liberty are strictly limited.

It should be remembered that the basic fact from which the prima facie evidence of intent is deemed to arise by reasonable inference, arming oneself with a pistol without a license to do so, is not an innocent act. In and of itself it is a violation of statute.[37] This lack of innocence sharply increases the probability

34 State v. Rouw, 156 Wash. 198, 286 Pac. 81 (1930).
35 State v. Thomas, *supra* note 27, at 932.
36 *Id.* at 933.
37 WASH. REV. CODE § 9.41.050 (1956), provides: "No person shall carry a pistol in any vehicle or conceal on or about his person, except in his place of abode or fixed place of business, without a license therefor as hereinafter provided."

that the criminal intent existed in the mind of the accused. Such preponderance of probability is the basis for every genuine presumption.[38]

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HOUSING — STATE LEGISLATIVE PROHIBITION OF DISCRIMINATION IN PRIVATE HOUSING — DEMISE OF LEGISLATION DEPENDENT UPON GOVERNMENT LOAN INSURANCE. — Statutes barring discrimination in the sale or rental of private housing which is publicly assisted in that it is or was financed with the aid of federal or state government loan insurance or guarantee[1] or that a commitment for such government assistance has been issued for it have been enacted in the past few years in six states: California,[2] Massachusetts,[3] New Jersey,[4] New York,[5] Oregon,[6] and Washington.[7] Such statutes are able to affect a large portion of the housing market by virtue of the large number of housing units constructed or acquired with the aid of the Federal Housing Administration mortgage insurance and Veterans Administration loan guarantee programs.[8] The first state to enact such legislation was New York in 1955,[9] and the last was California in 1959.[10] The New York[11] and New Jersey[12] statutes were upheld in court tests. Yet the trend appears to be away from such legislation and toward legislation which prohibits discrimination in private housing regardless of any public assistance but which applies only to housing of a commercial nature, *i.e.*, (1) one and two family dwellings which are located on contiguous lots owned or controlled by the same developer and (2) multiple dwellings. Since 1959, Massachusetts, New Jersey, New York and Oregon have amended their housing discrimination statutes to this effect.[13] The older provisions relating to publicly-assisted housing remain in force, with the exception of Oregon, but they exist in the shadow of the more inclusive amendments. And in California, during the 1961 legislative session, efforts were made to amend that state's housing discrimination statute to apply to private housing regardless of public assistance.[14] Since 1959, five other states have adopted legislation barring discrimination in the sale or rental of commercial private housing regardless of public assistance without having taken the intermediate step of barring

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38 Greer v. United States, 245 U.S. 559, 561 (1918).

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1 Throughout this article, the term "publicly-assisted" will be used to refer only to this type of government assistance, and the term "publicly-assisted housing" will be used exclusively to refer to private housing given this type of assistance.

2 CAL. HEALTH & SAFETY CODE §§ 35700-41 (Supp. 1961).

3 Mass. Acts & Resolves 1959, ch. 239, § 2, at 159 (now MASS. ANN. LAWS ch. 151B, § 4(6) (Supp. 1961)).

4 Laws of New Jersey 1957, ch. 66, §§ 1-2, at 128 (now amended and supplemented by N.J. STAT. ANN. §§ 18:25-4, 18:25-5(1) to (n), 18:25-9.1, 18:25-12(g) to (i) (*1961* NEW JERSEY SESSION LAW SERVICE, at 379)).

5 Laws of N.Y. 1955, ch. 341, at 980, and Laws of N.Y., 1956, ch. 563 §§ 1-2, at 1293 (now N.Y. EXECUTIVE LAW §§ 290-96).

6 Oregon Laws, ch. 725, §§ 2-4 (1957) (now ORE. REV. STAT. §§ 659.031, 659.033 1959)).

7 WASH. REV. CODE §§ 49.60.010, .030, .040, .217 (1959).

8 For example, out of a total of 1,343,000 housing units built in multi-family structures during the 11-year period from 1947 through 1957, 709,000 or nearly 53 percent, were started with FHA assistance. REPORT OF THE U.S. COMMISSION ON CIVIL RIGHTS 462 (1959). And less than two percent of the total number of new homes insured by the FHA from 1946 to 1959 were available to members of minority groups. *Id.* at 463.

9 Laws of N.Y., 1955, ch. 341, at 980.

10 California Statutes, 1959, ch. 1681, § 1, at 4074.

11 New York State Comm'n Against Discrimination v. Pelham Hall Apartments, Inc., 10 Misc. 2d 334, 170 N.Y.S.2d 750 (Sup. Ct. 1958).

12 Levitt & Sons, Inc. v. Division Against Discrimination, 31 N.J. 514, 158 A.2d 177 (1960), *appeal dismissed for want of a substantial federal queston,* 363 U.S. 418 (1960).

13 See notes 3-6, *supra.*

14 N.Y. Times, Sept. 24, 1961, § 8, p. 1, col. 8.

discrimination in private housing financed with the aid of government loan insurance or guarantee.[15]

More recently, in *O'Meara v. Washington State Bd. Against Discrimination*,[16] the Washington Supreme Court may well have delivered the *coup de grace* to housing discrimination legislation based on government loan insurance or guarantee, by holding unconstitutional the Washington statute of that type. The Washington statute,[17] amended to cover publicly-assisted housing in 1957,[18] was more or less typical, except that it covered all publicly-assisted housing accommodations, including noncommercial housing — even owner-occupied, one-family houses. It provided that housing would be deemed to be publicly-assisted only as long as the insured or guaranteed loan remained outstanding.[19] Typically, it provided for an administrative board with power to receive, investigate, and hold hearings on complaints of unfair housing practices.[20] If it found a person to have engaged in an unfair practice, the board was to issue an order requiring him to cease and de-

15 COLO. REV. STAT. §§ 69-7-1 to -7 (Supp. 1960); CONN. GEN. STAT. ANN. § 53-35 (*Connecticut Legislative Service*, 1961, at 650); MINN. STAT. 363.01-.09, .12-.13 (effective as relates to housing Dec. 31, 1962) (MINNESOTA SESSION LAW SERVICE, *1961*, at 510); PA. STAT. ANN. tit. 43, §§ 951-62, as amended by Laws 1961, Act No. 19 (*Purdon's Pennsylvania Legislative Service*, 1961, at 42); a New Hampshire law of 1961, effective Aug. 29, 1961, bars discrimination in the rental of an apartment in a building containing more than one dwelling unit. Violations are punished by fine of from $10 to $100. No enforcement agency was created, so the injured party must himself bring a court action in order to enforce the law. N.Y. Times, Sept. 24, 1961, § 8, p. 1, col. 8.

16 30 U.S.L. WEEK 291 (Washington Sup. Ct., Sept. 29, 1961).

17 WASH. REV. CODE ch. 49.60 (1959). The relevant sections are as follows:

> § 49.60.030. The right to be free from discrimination because of race, creed, color, or national origin is recognized as and declared to be a civil right. This right shall include, but not be limited to:
>
> * * *
>
> (3) The right to secure publicly assisted housing without discrimination.
>
> § 49.60.040. As used in this chapter:
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> * * *
>
> "Publicly-assisted housing" includes any building, structure or portion thereof which is used or occupied or is intended to be used or occupied as the home, residence or sleeping place of one or more persons, and the acquisition, construction, rehabilitation, repair or maintenance of which is financed in whole or in part by a loan, whether or not secured by a mortgage, the repayment of which is guaranteed or insured by the federal government or any agency thereof, or the state or any of its political subdivisions, or any agency thereof, provided that such a housing accommodation shall be deemed to be publicly-assisted only during the life of such loan and such guarantee or insurance, or if a commitment, issued by a government agency, is outstanding that the acquisition of such housing accommodations may be financed in whole or in part by a loan, whether or not secured by a mortgage, the repayment of which is guaranteed or insured by the federal government or any agency thereof, or the state or any of its political subdivisions, or any agency thereof;
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> "Owner" includes the owner, lessee, sublessee, assignee, agent, creditor, lender or other person having the right to ownership or possession of housing, or to have housing pledged as security for a debt.
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> § 49.60.217. It shall be an unfair practice:
>
> (1) For the owner of publicly-assisted housing to refuse to sell, rent, or lease to any person or persons such housing because of the race, creed, color, or national origin of such person or persons;
>
> (2) For the owner of any publicly-assisted housing to segregate, separate or discriminate against any person or persons because of the race, creed, color, or national origin of such person or persons, in the terms, conditions, or privileges of any such housing or in the furnishing of facilities or services in connection therewith;
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> * * *

18 Wash. Sess. Laws 1957, ch. 37, at 107.

19 WASH. REV. CODE § 49.60.040 (1959).

20 WASH. REV. CODE §§ 49.60.050, 49.60.120 (1959).

sist from such practice and to take such affirmative action as would effectuate the purposes of the statute.[21]

The O'Mearas owned a single family home in Seattle which had been constructed over 20 years ago without government financing assistance, but which the O'Mearas had financed, when they bought it in 1955, through a private loan insured by the FHA. The loan was still outstanding when the O'Mearas placed the house on the market in 1959. Jones, a Negro, attempted to purchase the house and was refused. He filed a complaint with the State Board Against Discrimination, charging that the O'Mearas had refused him because of his color. After a hearing at which the O'Mearas were found to have committed an unfair practice under the 1957 amendment, a tribunal of the Board ordered them either to accept Jones' offer to buy the house or to make him a counter-offer.[22] The O'Mearas appealed the order to the Superior Court, which set it aside on the ground that the O'Mearas' efforts to sell their house did not constitute "state action."[23] The Board appealed, and the Washington Supreme Court now has held that the 1957 amendment barring discrimination in publicly-assisted housing was unconstitutionally discriminatory under both the United States and Washington Constitutions.

The Superior Court opinion in *O'Meara* was based on the idea that, "the state here, in order to prevail, must demonstrate that the complainant Jones lies within the ambit of the equal protection clause of the 14th Amendment... [which] proscribes only *state* action."[24] The court concluded that it is "palpable sophistry to argue that Commander O'Meara, in endeavoring to sell his home, is acting by, for, or as the state."[25] The court thus ignored an express statutory declaration that the Washington law against discrimination was an exercise of the police power of the state.[26] State laws against discrimination need not meet the standard set by the Superior Court — that they may proscribe only such discriminatory action as is state action. Such a standard would require that state laws against discrimination be merely an affirmation of the pre-existing command of the fourteenth amendment's equal protection clause.[27] In fact, the amendment is a negative test under which state laws which *establish* discrimination must be struck down,[28] while the test of state laws *against* discrimination is whether they are within the police power of the state. The Washington lower court never reached this latter question, though it discussed it inconclusively.[29]

At least one writer has urged, after considering the lower court's *O'Meara* opinion, that state laws prohibiting discrimination in publicly-assisted housing should indeed be based on the civil rights guarded by the fourteenth amendment, rather than on the police power of the state, in order to avoid what he termed problems of arbitrary classification between housing owners who had benefited from government loan insurance and those who had not.[30] But if an anti-discrimination statute were based on the fourteenth amendment's prohibition of discriminatory state action, its validity would be subject to a case by case determination according to the amount of state action evidenced by the facts of each case, with the neces-

21 WASH. REV. CODE § 49.60.250 (1959).

22 Robert L. Jones, 4 RACE REL. L. REP. 485 (1959) (Wash. State Bd. Against Discrimination, 1959).

23 O'Meara v. Washington State Bd. Against Discrimination, 4 RACE REL. L. REP. 682 (1959) (Wash. Super. Ct. 1959).

24 4 RACE REL. L. REP. 682, 686 (1959).

25 *Id.* at 687.

26 WASH. REV. CODE § 49.60.010 (1959).

27 "[N]or shall any State . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. xiv, § 1.

28 Civil Rights Cases, 109 U.S. 3 (1883) (dictum).

29 For criticism of this aspect of the court's decision, see: Saks & Rabkin, *Racial and Religious Discrimination in Housing,* 45 IOWA L. REV. 488, 519-20 (1960); Forster & Rabkin, *The Constitutionality of Laws Against Discrimination in Publicly Assisted Housing,* 6 N.Y.L.F. 38, 51-52 (1960).

30 Lehman, *Must I Sell My House to a Negro?,* 42 CHICAGO BAR RECORD 283 (1961).

sary amount being measured by the already tangled skein of "state action" precedents. A California lower court has held, in a case decided before California legislatively barred discrimination in publicly-assisted housing, that a real estate developer who was selling homes on which he had accepted FHA and VA commitments to insure loans to be made to their future purchasers could not discriminate in selling them.[31] The basis of the decision was that the nondiscriminatory requirements applicable to the federal government[32] must also be imposed upon private persons who control access to the benefits provided by the government, since their action thus constitutes government action. This decision conceivably opens the door to suits against FHA-VA-aided builders in any state, whether or not state anti-discrimination legislation exists, especially in the case of large-scale developers whose relationship with the FHA is admittedly close. But in two earlier cases with somewhat similar facts, one decided by the Court of Appeals of New York,[33] the other by a federal district court,[34] the results reached were diametrically opposed to that of the California case. At any rate, although persons discriminated against by an FHA builder might be able to secure relief without the assistance of an anti-discrimination statute, by means of the rationale of the California case, it is more logical, and certainly it is preferable from the standpoint of achieving certainty, to attack the problem legislatively rather than to judicially expand the already tortured concept of state (federal) action.

The Washington Supreme Court split five to four in affirming the lower court's decision in *O'Meara*. An opinion written by Judge Foster and concurred in by two judges stated that the reasoning of the lower court was adopted as the opinion of the Supreme Court. But remarkably enough neither this opinion, nor the concurring opinion of two other judges, nor the dissenting opinions, adverted to or commented upon the lower court's erroneous premise regarding the requirement of state action. Instead, the Foster opinion quoted that portion of the lower court opinion which was devoted to the conclusion that the law prohibiting discrimination in publicly-assisted housing created an unconstitutionally arbitrary classification. Although this appears to have been merely a supplementary basis for the lower court's decision, it is the sole basis of the Foster opinion. The gist of the argument, based upon a dictum of Justice Holmes,[35] is that the law applies to housing owners who have an outstanding loan guaranteed by a government agency and does not apply to those owners who do not, while "there is no reason to suppose that persons with FHA mortgages on their homes are more likely to discriminate against minority groups than those who have conventional mortgages or no mortgages. . . . "[36] On the other hand, the dissenters pointed out that when a legislature chooses to correct a given evil, it may proceed step by step and need not try to correct all of the evil at once, but may classify objects of legislation by degrees of evil. They then stated that a reasonable ground for distinction did exist in the *O'Meara* case since discrimination is particularly odious, "in the case of a sale by one to whom the public (including those discriminated against) has lent its aid in acquiring his ownership."[37] Similar contentions of arbitrary classification were raised in the two earlier cases upholding statutes barring discrimination in publicly-assisted commercial housing. In answer, one court pointed out that the legislature

31 Ming v. Horgan, 3 Race Rel. L. Rep. 693 (1958) (Cal. Super Ct. 1958).
32 See Hurd v. Hodge, 334 U.S. 24 (1948).
33 Dorsey v. Stuyvesant Town Corp., 299 N.Y. 512, 87 N.E.2d 541 (1949), *cert. denied*, 339 U.S. 981 (1950).
34 Johnson v. Levitt & Sons, Inc., 131 F. Supp. 114 (E.D. Pa. 1955).
35 "[I]f the class discriminated against is or reasonably might be considered to define those from whom the evil mainly is to be feared, it properly may be picked out." Patsone v. Pennsylvania, 232 U.S. 138, 144 (1914).
36 O'Meara v. Washington State Bd. Against Discrimination, 365 P.2d 1, 5 (Wash. 1961).
37 O'Meara v. Washington State Bd. Against Discrimination, 365 P.2d 1, 10 (Wash. 1961) (dissenting opinion). For a discussion of this and other bases for the distinction, including the argument that discrimination could be more easily controlled in publicly-

could reasonably have chosen to achieve its objective of opening housing up to minority groups through a measure affecting only the one kind of private housing most easily financed and in which existing patterns would be least disturbed.[38] The other court declared that in eliminating discrimination in affairs closely connected with the personal lives of the citizens, it was not only reasonable but necessary in the interest of the public welfare that the legislature proceed step by step.[39] The latter argument has been somewhat weakened by the subsequent enactment of legislation barring discrimination in private housing by several states which had not previously taken the step of barring discrimination in publicly-assisted housing.[40] A further classification problem, which apparently was not raised in *O'Meara* or the two earlier cases, exists in the distinction made between housing on which a government insured or guaranteed loan is still outstanding and housing which was constructed or acquired with the aid of such a loan which has since been fully repaid.

In any case, the *O'Meara* court, perhaps somewhat influenced by the fact that it applied to owner-occupied single-family homes, has declared the Washington publicly-assisted housing statute to be unconstitutional. This leaves California as the sole remaining state whose statutory bar against discrimination in private housing is dependent upon the existence of government loan insurance or guarantee. Whether or not one agrees with the decision in the *O'Meara* case, the decision, added to the trend noted above toward extending housing discrimination statutes to commercial private housing regardless of public assistance, seems to have marked the end of the brief period of prominence enjoyed by legislation prohibiting discrimination in publicly-assisted housing.

Moreover, in its recently issued second report the United States Commission on Civil Rights recommended that the President should issue an executive order banning discrimination by builders, brokers and banks participating in FHA-VA programs.[41] It had been reported even before the Commission report appeared that such an executive order would probably be issued.[42] If such a step is taken, legislation prohibiting discrimination in publicly-assisted housing would become somewhat unnecessary. The present policy of the FHA is to withhold its benefits from a discriminatory builder only when state authorities have found him to have violated a state anti-discrimination law and he has refused to amend his discriminatory practices. The FHA has not yet been occasioned to implement this policy, though, because the requisite combination of facts has not yet occurred.[43]

Although a lower court has summarily upheld the pioneering New York City ordinance,[44] the constitutionality of state laws which prohibit discrimination in commercial private housing regardless of public assistance remains to be judicially tested. Nine states now have some form of fair housing law, as these statutes are

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assisted housing (although this would seem to be true only where the operation of the anti-discrimination law was limited to commercial housing), see: Forster & Rabkin, *The Constitutionality of Laws Against Discrimination in Publicly Assisted Housing*, 6 N.Y.L.F. 38, 56-57 (1960); Saks & Rabkin, *Racial and Religious Discrimination in Housing*, 45 IOWA L. REV. 488, 521 (1960).

38 Levitt & Sons, Inc. v. Division Against Discrimination, 31 N.J. 514, 158 A.2d 177 (1960), *appeal dismissed for want of a substantial federal question*, 363 U.S. 418 (1960).

39 New York State Comm'n Against Discrimination v. Pelham Hall Apartments, Inc., 10 Misc. 2d 334, 170 N.Y.S.2d 750 (Sup. Ct. 1958).

40 See note 15 *supra*.

41 N.Y. Times, Oct. 6, 1961, p. 1, col. 4. The Commission further recommended that the President or Congress should require nondiscrimination by federally regulated, aided or supervised banks and savings and loans associations. But the Commission's recommendations would not prevent individual homeowners from discriminating in the sale of their homes. *Ibid.*

42 N.Y. Times, Sept. 28, 1961, p. 1, col. 2.

43 *Id.*, Oct. 8, 1961, p. 55, col. 1.

44 Martin v. New York, 22 Misc. 2d 389, 201 N.Y.S.2d 211 (Sup. Ct. 1960).

called.[45] A discussion of the constitutionality of such statutes is beyond the scope of this comment, but it appears that they are a proper exercise of the police power of the states.[46] In a separate dissenting opinion filed in the *O'Meara* case, Judge Hill wrote as follows on this point:

> * * * A great public need exists to end this housing discrimination. I am convinced that the police power, the least limitable of the powers of government, already so extensively used to subordinate the rights of property ownership and of contract where they conflict with the public interest, [citing zoning ordinances as an example] can be properly exercised to meet that need. I do not think its exercise requires the crutch of publicly-assisted housing. The prohibition should be directed against discrimination, and not against discrimination by some particular group based on their method of financing.[47]

The classification made by most fair housing statutes between commercial and noncommercial housing[48] certainly seems valid. One reason is that state legislatures may reasonably decide to proceed step by step in correcting an evil.[49] Secondly, an anti-discrimination statute clearly can be more feasibly enforced against apartment owners and developers than against individual homeowners. Most important, such classification may achieve the desired end, *i.e.*, adequate housing opportunity for minority groups, while avoiding the regulation of individual homeowners in the sale of their own homes — regulation which could increase opposition to the enactment of fair housing laws, increase racial tensions by its enforcement, and perhaps provoke judicial diligence in finding reasons for holding fair housing laws unconstitutional.

Paul J. Driscoll

MUTUAL FUNDS — VIOLATION OF INVESTMENT COMPANY ACT BY DIRECTORS — RIGHT OF ACTION BY SHAREHOLDERS HELD TO EXIST BY IMPLICATION. — A question bearing heavily on the extent to which investment companies and their management are to be regulated has been posed by a pair of antithetical decisions of United States Circuit Courts.[1] Summarized, the question is: Has directors' liability to registered investment companies which they serve been created by implication in the Investment Company Act of 1940?[2]

The problem is raised primarily because there are relatively few express pro-

45 COLO. REV. STAT. §§ 69-7-1 to -7 (Supp. 1960); CONN. GEN. STAT. ANN § 53-35 (*Connecticut Legislative Service,* 1961, at 650); MASS. ANN. LAWS ch. 151B,, § 4(6) (Supp. 1961); MINN. STAT. §§ 363.01-.09, .12-.13 (*Minnesota Session Law Service 1961,* at 510); New Hampshire, see note 15 *supra;* N.J. STAT. ANN. §§ 18:25-4, 18:25-5(1)-(n), 18:25-9.1, 18:25-12(g)-(i) (*1961 New Jersey Session Law Service,* at 379); N.Y. EXECUTIVE LAW §§ 290-96; ORE. REV. STAT. §§ 659.031, 659.033 (1959); PA. STAT. ANN. tit. 43, §§ 951-62, as amended by Laws 1961, Act. No. 19 (*Purdon's Pennsylvania Legislative Service,* 1961, at 42).

46 On this point, see Saks & Rabkin, *Racial and Religious Discrimination in Housing,* 45 IOWA L. REV. 488, 521-22 (1960); 45 VA. L. REV. 428 (1959); Lehman, *Must I Sell My House to a Negro?,* 42 CHICAGO B. RECORD 283, 288 (1961).

47 O'Meara v. Washington State Bd. Against Discrimination, 365 P.2d 1, 13 (Wash. 1961) (dissenting opinion). (Footnote omitted.)

48 The New York statute, for example, applies to dwellings rented to be occupied as the residence of three or more families (not counting the family of the owner if it lives there) living independently of each other, and to any housing accommodation which is among ten or more housing accommodations located on land that is contiguous and which is offered for sale or rent by a person who owns or otherwise controls the sale or rental of such ten or more accommodations. N.Y. EXECUTIVE LAW §§ 292(12), 296(5)(a).

49 Williamson v. Lee Optical of Oklahoma, Inc., 348 U.S. 483 (1955); New York State Comm'n Against Discrimination v. Pelham Hall Apartments, Inc., 10 Misc. 2d 334, 170 N.Y.S.2d 750 (Sup. Ct. 1958).

1 Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961); Brouk v. Managed Funds, 286 F.2d 901 (8th Cir. 1961), *cert. granted,* 366 U.S. 958 (1961). The *Brouk* case was decided on January 13, 1961, and the *Brown* case on September 5, 1961.

2 54 Stat. 789 (1940), 15 U.S.C. §§ 80a(1)-(52) (1958).

visions in the 1940 Act making directors liable to private actions.[3] Aggrieved stockholders apparently feel that the express civil liability provisions of the 1940 Act, (including provisions vesting rights of action in the Securities and Exchange Commission), and its criminal provisions, are inadequate to compensate stockholders and corporations for damages caused by directors in dereliction of duty.[4] As a result, litigants have utilized the common law tort action based upon violation of a statute.[5] The doctrine is enunciated in the Restatement of Torts:

> The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if:
>
> (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and
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> (b) the interest invaded is one which the enactment is intended to protect; and
>
> (c) where the enactment is intended to protect an interest from a particular hazard, the invasion of the interests results from that hazard; and
>
> (d) the violation is a legal cause of the invasion, and the other has not so conducted himself as to disable himself from maintaining an action.[6]

Since the interest invaded must be one which the enactment is intended to protect, a violation results in no civil liability where the enactment is designed exclusively to protect the interests of the state or the public as a whole.[7]

Whether civil liability is implied is a question which is enmeshed with jurisdictional problems in the federal courts. The question does not arise in regard to jurisdiction where jurisdiction in a suit is founded on diversity of citizenship.[8] The problems do arise, however, where jurisdiction is founded on a "federal queston."[9] There the matter in controversy must "arise under the Constitution, laws or treaties of the United States."[10] In order to establish that a right of action arises under a federal statute it must be shown that the plaintiff's interest was one the statute, or a particular provision thereof, was designed to protect. Where the statute explicitly announces this protection, there is less difficulty than where the statute is silent on the matter. In cases where the statute is silent, the district court must decide whether or not the statute was intended to afford the plaintiff's interest protection. If it decides in the affirmative, civil liability arises and the jurisdictional issue is settled.

Bringing this discussion, then, out of the abstract to the specific jurisdictional problem under the Investment Company Act, it may be asked, in the absence of express civil liability provisions of a satisfactory nature, if civil liability may be implied from provisions of the 1940 Act. As noted above, two federal circuit courts recently have spoken on this point, reaching decisions of a contrary nature.

In *Brouk v. Managed Funds*,[11] Judge Woodrough in the Eighth Circuit Court

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3 Section 30 (f) of the Act, 54 Stat. 836 (1940), 15 U.S.C. § 80a-29 (1958), incorporates by reference the civil liability clause of section 16 (b) of the Securities Exchange Act, 48 Stat. 896 (1934), 15 U.S.C. § 78 (p) (1958), relating to recovery of insiders' short-swing trading profits. There is belief that sections 44, 24 (e) (3), 17 (h) and 38 (c) are express civil liability provisions. See 1961 DUKE L.J. 431 and *Brief for the SEC as Amicus Curiae*, pp. 11-12, Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961).

4 Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961); Brouk v. Managed Funds, 286 F.2d 901 (8th Cir. 1961), *cert. granted*, 366 U.S. 958 (1961); Chabot v. National Securities and Research Corp., 290 F.2d 657 (2d Cir. 1961).

5 *Ibid.*

6 RESTATEMENT, TORTS § 286 (1934).

7 LOSS, SECURITIES REGULATION 1044 (1951).

8 28 U.S.C. § 1332 (1958).

9 28 U.S.C. § 1331 (1958).

10 *Ibid.*

11 286 F.2d 901 (8th Cir. 1961), *cert. granted*, 366 U.S. 958 (1961).

of Appeals ordered the dismissal of consolidated actions against investment company directors. According to the court, the Investment Company Act did not expressly or by implication impose any statutory duty upon directors of an investment company, whose violation would give rise to a private cause of action by the company against the directors within the jurisdiction of a federal district court. In *Brown v. Bullock*,[12] however, a case decided just eight months after the *Brouk* case, Judge Friendly of the Second Circuit reached a contrary conclusion in affirming a refusal to dismiss an action by shareholders of a mutual fund against fund directors.[13] The court held that a complaint alleging that directors acted in the interests of a management company in which they were also directors rather than in the interest of the fund stated federal claims under separate provisions of the Investment Company Act making it a crime to convert assets of the company and requiring the annual approval of investment advisory and underwriting contracts.[14]

Brown v. Bullock[15] appears to be the most significant case yet on the subject of implied civil liability under the Investment Company Act, although it may be pointed out that cases in the area have not been too numerous. *Doyle v. Milton*,[16] a 1947 district court case, involved a suit by stockholders to disenfranchise a holding company which, as alleged by the stockholders, was used by directors of the investment company to control the investment company. The stockholders alleged that the device employed by the directors was that of pyramiding, in contravention of section 1 (b) of the Investment Company Act.[17] Section 1 (b) contains no express civil liability provision. The court made these comments:

> The Investment Company Act is a carefully framed statute in which Congress has, with particularity, stated the means and methods, both judicial and administrative, by which its declaration of policy is to be executed. It has not confided in the courts a broad discretion to shape judicially contrived remedies for the mischief it has discovered. Insofar as power is entrusted to the courts under this Act its exercise must, of course, be steered toward the fulfillment of the national policy as declared. The policy itself, however, when declared in a statute as comprehensive and detailed as this Act, does not authorize the courts to fashion sanctions withheld by Congress.
>
> In the case at bar, . . . the court is asked to . . . assume that Congress has inadvertently omitted the power to disenfranchise and that the court should supply the omission. All the internal evidence points inescapably to the conclusion that the omission is deliberate. Were the court to supply it they would engage not only in judicial lawmaking where Congress is silent but in overruling the Congressional mandate.[18]

The defendant's motion to dismiss was granted. Subsequently, in *Breswick &*

12 294 F.2d 415 (2d Cir. 1961).

13 The lower court order was certified by the district court judge, under 28 U.S.C. 1292 (b) (1958), as a case involving "a controlling question of law as to which there is substantial ground for difference of opinion," and hence as a case needing appellate determination. Said the appellate court: "This Court . . . granted leave to appeal . . . believing that determination *in limine* of the issue of Federal jurisdiction, an issue of first impression in this Circuit, . . . was likely to have precedential value for a large number of other suits against directors of registered investment companies now pending in the Southern District. . . ."

14 The approach thus taken has the wholehearted approval of the Securities and Exchange Commission. Brief for the SEC as Amicus Curiae, Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961).

15 294 F.2d 415 (2d Cir. 1961).

16 73 F.Supp. 281 (S.D.N.Y. 1947).

17 Section 1 (b) says in part:

> [I]t hereby is declared that the national public interest and the interest of investors are adversely affected — (4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control. . . . 54 Stat. 789 (1940), 15 U.S.C. 80a-1 (1958).

18 Doyle v. Milton, 73 F.Supp. 281, 284-85 (S.D.N.Y. 1947). According to Judge Herlands' district court opinion in Brown v. Bullock, 194 F.Supp. 207, 228: The conclusion reached in the *Doyle* case [*i.e.*, that the omission of the power to disenfranchise was deliberate] has no bearing on the availability of the conventional remedy of accounting sought herein. . . .

Co. v. United States,[19] stockholders of an investment company sued to enjoin the enforcement of orders of the Interstate Commerce Commission recognizing the company as a carrier subject to the Interstate Commerce Act, rather than as an investment company subject to the provisions of the Investment Company Act. On the matter of the plaintiffs' rights under the Investment Company Act the court said:

> One of the purposes of the Investment Company Act is thus to protect investors in investment companies against the managing of those companies in the interests of persons other than the investors. . . .
> The stockholders here allege that, by obtaining an erroneous ruling from the I.C.C., persons in control of the corporation have succeeded in escaping the provisions of an act passed for the express purpose of protecting stockholders from persons in control. Since the corporation, by hypothesis, is helpless, plaintiffs say that they have standing to sue to prevent the thwarting of the declared will of Congress. We are convinced that a stockholder, who seeks only that which Congress has provided for him as matter of right, need not show money damage to entitle him to sue.[20]

In a 1958 case, *Cogan v. Johnston*,[21] a stockholder brought suit to enjoin an investment company from operating unregistered in violation of the Investment Company Act, to enjoin officers and directors from continuing in those capacities, and to secure the appointment of a receiver or trustee to enable the company to comply with the Act. The complaint alleged that the officers and directors were engaged in a continuing conspiracy to freeze out the company's public stockholders, were causing the company to violate the Act in their own interests and were guilty of gross abuse of trust. The court found that "jurisdiction was properly invoked under Section 44 of the Investment Company Act, which grants to the district court jurisdiction of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, the Act or the rules, regulations or orders thereunder."[22] However, the court denied that jurisdiction could be predicated by the plaintiff on Section 36 of the Act, which authorizes the SEC to seek an injunction against an officer or director of a registered investment company on the basis of gross misconduct or gross abuse of trust. The court said:

> Whatever relief the plaintiff may be entitled to, he may not, as an *individual*, sue under this section on the basis of alleged abuse of trust by an officer or director of an *unregistered* investment company, to enjoin the officer or director from holding his office.[23]

Finally, in *Taussig v. Wellington Fund*,[24] the Delaware District Court entertained a suit for a declaratory judgment on the part of minority stockholders of an investment company who contended that the corporation in which they were investors should be adjudged rightful user of the name "Wellington." They contended that another investment company was employing the same name. The court held:

> Since the common law causes of action accord plaintiffs complete vindication of the derivative rights they assert, orderly judicial process re-

19 134 F.Supp. 132 (S.D.N.Y. 1955), *Rev'd sub. nom.* Allegheny Corp. v. Breswick & Co., 353 U.S. 151 (1956), on other grounds. The court speaks in terms of whether the orders of the ICC should be sustained. There is, however, no indication of disagreement with the district court's contentions on the extent of investor's rights under the Investment Company Act, as the following passage, at 174, would indicate:

> Reliance on the alleged benefits of protection under the Investment Company Act subtly begs the question. . . . The fact that there may be another Act that gives appellees greater protection as investors is immaterial to the appellees right to a hearing in the merger-status order proceeding. The question here is whether the proposed transaction falls within the Interstate Commerce Commission's jurisdiction, not what the consequences will be if it does not.

20 Breswick & Co. v. United States, 134 F.Supp. 132, 138 (S.D.N.Y. 1955).
21 162 F.Supp 907 (S.D.N.Y. 1958).
22 *Id.* at 909.
23 *Ibid.*
24 187 F.Supp. 179 (D. Del. 1960).

> quires that the court abstain from ruling on the substance of the admittedly novel federal claims until a more propitious occasion, where, perhaps, the adjudicating tribunal will be in a better position to enlist the assistance of an administrative agency's expertise, or, at least, until the law in the area has crystallized.[25]

Nevertheless, in dicta the court maintained:

> Violation of a federal statute may accord a private litigant a remedy by implication notwithstanding the absence of specific statutory authority conferring upon the injured the right to redress statutory wrongs, for the common law will supply a remedy where the statute is silent. The intention to create civil liability is presumed unless a contrary legislative intent is to be inferred from the whole purview of the Act.[26]

It was in the context of these cases that *Brouk v. Managed Funds,*[27] and *Brown v. Bullock*[28] were decided.[29] The significant passages of both the *Breswick* case and the *Taussig* case are dicta, and thus are of doubtful precedential value, even though they do indicate a trend of judicial thinking favorable to implied liability. The *Cogan* case implies a cause of action under one provision and denies it under another. The provision relied upon in implying liability is section 44 of the Investment Company Act, which grants district courts jurisdiction in suits to enforce duties and liabilities created by the act. There remains the crucial question as to what duties and liabilities, found in what provisions of the act, are being enforced in *Cogan.* It is begging the question to base implied liability on section 44 without any explanation as to what specific provisions of the act are the source of the duties asserted. The precedential value of *Cogan* is thus subject to considerable doubt, also. Finally, the *Doyle* case must be regarded with a mind to the peculiar remedy sought therein. It does not seem strange that a court would find much greater hesitation in implying a cause of action for disenfranchisement as in implying a cause of action for the ordinary remedy of damages. Had the plaintiffs in *Doyle* sought damages, a decision in their favor would have had more significance than it does as it stands. As a group, the most that can be said for these four cases is that they are some evidence, though slight, of an inclination toward implied liability. That contrary decisions were reached by the *Brouk* and *Brown* courts is an indication that these four cases were somewhat less than controlling in a clear and decisive manner.

The defendants in the *Brouk* action were officers and directors of the mutual fund, the fund's investment adviser, two companies that sold the fund's shares, a stock brokerage firm and former officers and directors of the fund. The plaintiffs alleged that defendants committed, aided, or acquiesced in violations of the Investment Company Act by (a) operating the fund in their own interest rather than that of the fund's security holders;[30] (b) causing the fund to publish and circulate documents containing untrue statements or omitting material facts;[31] (c) causing the fund to deviate from its fundamental investment policy[32] and (d) permitting certain defendants to act as investment advisers without a written contract approved by holders of the fund's outstanding voting securities.[33] The

25 *Id* at 220. The plaintiff relied on provisions of several of the securities acts, including section 34 (d) of the Investment Company Act, which makes it unlawful "for any registered investment company hereafter to adopt as part of the name or title of such company . . . any word or words which the commission finds and by order declares to be deceptive or misleading." 54 Stat. 840 (1940), 15 U.S.C. § 80a-34 (1958).

26 *Id.* at 217.

27 286 F.2d 901 (8th Cir. 1961), *cert. granted,* 366 U.S. 958 (1961).

28 294 F.2d 415 (2d Cir. 1961).

29 After the *Brouk* decision but before the *Brown* decision, Judge Friendly (who wrote the latter decision) was faced with the same type of jurisdiction question as in those cases. The judge delayed a determination pending a decision of the *Brown* case. Chabot v. National Securities and Research Corp., 290 F.2d 657 (2d Cir. 1961).

30 Alleged as a violation of 54 Stat. 789 (1940), 15 U.S.C. § 80a-1 (b) (1958).

31 Alleged as a violation of 54 Stat. 840 (1940), 15 U.S.C. § 80a-33 (1958).

32 Alleged as a violation of 54 Stat. 811 (1940),15 U.S.C. § 80a-13 (1958).

33 Alleged as a violation of 54 Stat. 812 (1940), 15 U.S.C. § 80a-15 (a) (1958).

district court denied a motion to dismiss the action and this appeal was prosecuted by certain of the defendants described as "outside directors," that is, "directors alleged to have had actual or constructive knowledge of the alleged wrongful acts of [other of the directors]."[34]

After a review of the authorities, Judge Woodrough made this statement:

> On consideration of the whole record and citations we conclude the claim stated against these appellants does not support the federal jurisdiction. At common law directors are liable to exercise due care and are not insurers. 13 Am. Jur. Corporation Sec. 990, pp. 943-944. The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.[35]

The district court was reversed with directions to dismiss the complaint as to these "outside directors" for lack of jurisdiction of the subject matter.[36]

Thus, at the time *Brown v. Bullock*[37] was decided in the circuit court, only a handful of decisions on the matter of implied liability under the 1940 Act was available for consideration. Though faced with *Brouk* v. *Managed Funds,*[38] a most recent and persuasive case, Judge Friendly in *Brown* accorded it little weight, saying:

> Appellants have cited to us Brouk v. Managed Funds, Inc., 8 Cir., 1961, 286 F.2d 901, certiorari granted 366 U.S. 958, 81 S.Ct. 1921, appellees seek to distinguish it as holding only that directors of registered investment companies are not liable as insurers. The opinion does contain some language of that sort, 286 F.2d at page 918, but we are by no means certain the decision is adequately distinguished on that ground. So far as it is not, we must respectfully disagree, to the extent indicated herein.[39]

While, as the quote suggests, it is possible to distinguish *Brown* and *Brouk,* it is questionable whether there is valid ground for making the attempt. The directors on whose behalf the complaint in *Brouk* was dismissed were "outside directors." The directors charged as defendants in *Brown* included individuals who allegedly "participated and acquiesced in such transactions with knowledge or notice of their wrongful character."[40] The difference between the conduct of the directors in *Brouk,* who had actual or constructive knowledge of the wrongful acts, and that of the directors in *Brown,* who acquiesced in the wrongful acts, if there is any difference, would not appear to be decisive. The more reasonable approach to the two cases must be to regard them as contrary and to avoid attempts at reconciling them.

The precise charge in *Brown v. Bullock* was that two of the directors of the investment company, who at the same time were directors of the company's management company, dominated the remainder of the investment company's board so as to cause the investment company to enter into contracts with the management company alloting excessive fees to the management company for its services. It was alleged by the plaintiff stockholders that the fee paid to the management

34 Brouk v. Managed Funds, 286 F.2d 901, 902 (8th Cir. 1961), *cert. granted,* 366 U.S. 958 (1961).

35 *Id.* at 918. The defendants, on appeal, in the *Brouk* case not only relied on this argument — that legislative history shows a complete absence of any legislative intent to create such private actions — but also argued that the void contract theory of liability and the theory of tort liability based on violation of a federal statute have been rejected in situations where director liability to their corporation has been involved. While the *Brouk* court quoted extensively from several cases upholding the latter position, it did not comment on the cases and did not explicitly refer to this line of reasoning in its conclusion.

36 The Securities and Exchange Commission "believes that the *Brouk* case was incorrectly decided and regards that decision as a substantial threat to investment company shareholder protections under the Act." Brief for the SEC as Amicus Curiae, pp. 11-12, Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961).

37 294 F.2d 415 (2d Cir. 1961).

38 286 F.2d 901 (8th Cir. 1961), *cert. granted,* 366 U.S. 958 (1961).

39 Brown v. Bullock, 294 F.2d 415, 421-22 (2d Cir. 1961).

40 *Id.* at 419.

company was greater than that paid by other investment companies to the management company, that in proxy statements the defendants had stated that the arrangement with the management company was the same as those between other investment companies and the management company and that, as a result, the proxy statements were in violation of securities statutes and Securities and Exchange Commission rules promulgated thereunder.

Utilizing the common law tort doctrine of private action based upon violation of a statute, the court held that the complaint was sufficient to state federal claims arising under sections 37[41] and 15 (a) and (b)[42] of the 1940 Act. Section 37 is a criminal provision making it a crime for a party to steal, unlawfully abstract, unlawfully and willfully convert to his own use or to the use of another or to embezzle the moneys, funds, securities, credits, property, or assets of a registered investment company. Sections 15 (a) and (b) make it unlawful to act as investment adviser or as principal underwriter of a registered investment company for more than two years after the execution of a contract to that end, unless continuance of the contract is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding securities of the company.

With respect to section 37, Judge Friendly's discussion is restricted to the issue of whether the defendants committed a violation of the provision. He does not involve himself in a discussion of whether civil liability can be predicated on the provision but merely leaves his affirmation of that fact to implication. With respect to sections 15 (a) and (b), the civil liability issue is dealt with more extensively. After citing a portion of the Act's policy statement that indicates that the Act was intended, among other things, for the protection of investors, the court said:

> When Congress mandated annual approval of investment advisory and underwriting contracts, it must have been concerned with the substance and not simply with the form. It would scarcely seem consistent with the declared Congressional purpose to hold that although a federal court would have jurisdiction of a complaint alleging that the directors' approval had come a few days late, or that notice of the directors' meeting had been defective in some formal respect, the court lacks jurisdiction over a complaint alleging that the directors' approval was given without any real consideration of the merits. It is similarly unreasonable to suppose that Congress would have wished to permit its purpose to protect investors in all investment companies using the mails or the means of interstate commerce to be frustrated if a particular state of incorporation should be satisfied with lower standards of fiduciary responsibility for directors than those prevailing generally. (Footnote omitted.) Indication of Congressional intent to create a body of federal law giving rise to a distinctive federal claim has been found from evidence less compelling than here. Textile Workers of America v. Lincoln Mills, 1957, 353 U.S. 448, 77 S.Ct. 912, 1 L.Ed.2d 972. We think 15 (a) and (b) laid down a requirement of annual approval not merely formal but substantial, the minimum content of which is a matter of federal law; hence a complaint alleging failure to conform to that requirement sets forth a federal claim.[43]

Judge Friendly seems to rely on a "Congress surely must have intended" rationale. What Congress intended, however, is subject to dispute. Those who op-

41 54 Stat. 841 (1940), 15 U.S.C. § 80a-36 (1958).

42 54 Stat. 812(1940), 15 U.S.C. § 80a-15 (a) and (b) (1958).

43 Brown v. Bullock, 294 F.2d 415, 421 (2d Cir. 1961). The 1940 Act includes a section that in large part reiterates the "federal question" provision of 28 U.S.C. § 1331 (1958):

> The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with state and territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or the rules, regulations, or orders thereunder . . . 54 Stat. 844 (1940), 15 U.S.C. § 80a-43 (1958).

pose the implication of civil liability will maintain that Congress, had it desired private actions, would have expressly provided for them. Those who favor the implication of civil liability will argue that Congress, being a fallible body, could not have been expected to anticipate all possible problems. One indication of Congressional intent is the policy provision of the 1940 Act:

> (b) [T]he national public interest and the interest of investors are adversely affected—
>
> (2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, . . . underwriters, . . . or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders. . . .[44]

In concluding its policy statement; Congress said:

> [T]he policy and purposes of this subchapter, . . . in accordance with which the provisions of this subchapter . . . shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.[45]

It is undisputed that the Investment Company Act was passed because of malpractices by investment company officers and directors.[46] In 1937 one authority characterized the investment company field as "a playground for incompetent and unscrupulous managers and promoters."[47] The reason generally cited for this condition is the very nature of the assets of an investment company. Being completely liquid, mobile and readily negotiable, the assets afforded those in control manifold opportunities for exploitation.[48]

It is another matter to say that Congress intended to implement these objectives by writing in provisions it expected would be the subjects of suits implying civil liability. The Securities and Exchange Commission, a body strongly in favor of a *Brown v. Bullock*[49] result, has admitted that the legislative history of the 1940 Act is devoid of any discussion of the implied private cause of action doctrine.[50] Some authorities say that this omission was deliberate — that Congress never intended implied causes of action to arise under the act.[51] Whatever one's view, it cannot be challenged that the Senate and House Reports on the bill are of little assistance in settling this issue.[52]

One factor which can be taken into consideration is the development of the doctrine of implied liability under securities statutes other than the Investment Company Act. While it may be said that cases arising under these statutes have no bearing on problems arising under the Investment Company Act, since each statute must be viewed individually, the statutes do form an overall scheme of securities regulation.[53] There are numerous cases allowing the implication of civil

44 54 Stat. 789 (1940), 15 U.S.C. 80a-1 (1958). This section has been characterized as a "frame of reference" for the problems of interpretation involved in Brown v. Bullock. Brown v. Bullock, 194 F.Supp, 207, 219 (S.D.N.Y. 1961).

45 54 Stat. 789 (1940), 15 U.S.C. 80a-1 (1958). In Brown v. Bullock, 194 F.Supp. 207, 218 (S.D.N.Y. 1961), it was said: "This [section] is more than a mere exordium. It is a directive to the courts."

46 H.R. Rep. No. 2639, 76th Cong., 3rd Sess. 7 (1940).

47 46 YALE L.J. 1214 (1937).

48 86 CONG. REC. 10072 (1940).

49 294 F.2d 415 (2d Cir. 1961).

50 Brief for the SEC as Amicus Curiae, p. 27, Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961).

51 Brouk v. Managed Funds, 284 F.2d 901, 912 (8th Cir. 1961), *cert. granted,* 366 U.S. 958 (1961); Jaretzki, *The Investment Company Act of 1940,* 26 WASH. U.L.Q. 303, 346-47 (1941), where it is said:

> It was not intended that the Act should be a complete cure of all possible evils in the investment company field. It seemed wiser to proceed cautiously and experimentally, attempting to prevent the main abuses which have been known to exist.

52 H.R. Rep. No. 2639, 76th Cong., 3rd Sess. 7 (1940); 86 CONG. REC. 10072 (1940).

53 The Investment Company Act of 1940 is the fifth in a series of six Congressional enact-

liability under, for example, the Securities Exchange Act of 1934.[54] According to one source:

> The most surprising development in the whole area of civil liabilities under the federal (securities) statutes has been the recognition in recent years of what might be termed the implied liabilities. There is good reason to believe that these may turn out to be far more significant than the express liabilities which Congress created.[55]

An extensive review of these cases is unnecessary. Several may be pointed out as illustrative. In *Kardon v. National Gypsum Co.*,[56] a complaint charging a conspiracy between the defendants for the purpose of inducing the plaintiff to sell his stock for less than value was held to state a cause of action by implication under section 10 (b) of the Securities Exchange Act and SEC Rule X-10B-5. The court said there:

> Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. *In other words, in view of the general purpose of the Act, the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.*[57]

In *Remar v. Clayton Securities Corp.*,[58] an investor was held to have a cause of action under section 7 (c) of the 1934 Act[59] against a broker who arranged loans for the plaintiff in an amount greater than that permitted by law.

In *Fratt v. Robinson*[60] a complaint stated a cause of action under section 10 of the 1934 Act that alleged that majority stockholders acquired corporate stock from a minority stockholder through fraudulent representations. The court relied on "the weight of authority"[61] and "the best reasoning."[62]

Finally, a noteworthy case decided in 1956 presents an instance where a court refused to imply civil liability. In *Howard v. Furst*,[63] a stockholders' derivative suit

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ments relating to securities. The first four acts were the Securities Act of 1933, 48 Stat. 74 (1933), 15 U.S.C. §§ 77a-aa (1958), the Securities Exchange Act of 1934, 48 Stat. 881 (1934), 15 U.S.C. §§ 78a-jj (1958), the Public Utility Holding Company Act of 1935, 49 Stat. 803 (1935), 15 U.S.C. §§ 79a-z, (1958), and the Trust Indenture Act of 1939, 53 Stat. 1149 (1939), 15 U.S.C. §§ 77 aaa-bbbb (1958). The sixth act was the Investment Advisers Act of 1940, 54 Stat. 847 (1940), 15 U.S.C. §§ 80b(1)-(21) (1958). Brouk v. Managed Funds, 286 F.2d 901, 905 (8th Cir. 1961), *cert. granted*, 366 U.S. 958 (1961).

54 Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); Osborne v. Mallory, 86 F.Supp. 869 (S.D.N.Y. 1949); Remar v. Clayton Securities Corp., 81 F.Supp. 1014 (D. Mass. 1949); Kardon v. National Gypsum Co., 69 F.Supp. 512 (E.D. Pa. 1946).

55 Loss, Securities Regulation 1043 (1951).

56 69 F.Supp. 512 (E.D. Pa. 1946).

57 *Id.* at 514. A second ground of recovery in *Kardon* was the void contract theory, that is, that where the statute provides that a contract made in violation of the act is void it is reasonable to assume that the legislature intended there be a remedy in respect of the void contract. The *Brouk* court, however, seemed to ignore the common law tort action arising from violation of a statute and to fasten upon the void contract approach. It said:

> We do not express disagreement in any respect with the Kardon decision and others in accord with it. In Kardon the party damaged by a contract obtained in violation of a federal law, which contract the law made void, was allowed to sue in federal court the party who offended and profited. But we do not hold the situation here to be analogous. 286 F.2d 901, 913 (1961), *cert. granted*, 366 U.S. 958 (1961).

58 81 F.Supp. 1014 (D. Mass. 1949).

59 7(c) makes it unlawful for a broker or dealer to extend or maintain credit or to arrange for the maintenance of credit in contravention of the federal reserve rules. 48 Stat. 887 (1934), 15 U.S.C. § 78g (c) (1958).

60 203 F.2d 627 (9th Cir. 1953).

61 *Id.* at 632.

62 *Ibid.*

63 238 F.2d 790 (2d Cir. 1956). In Brown v. Bullock, 194 F.Supp. 207, 232 (S.D.N.Y. 1961), the court distinguished the *Brown* case from *Howard* on the following grounds: (1) The 1934 Act was intended to regulate a commodity whereas the 1940 Act was intended to regulate an industry. (2) The complaint in *Brown* sets forth a substantial federal claim, not

was brought against officers and directors of a corporation alleging implied liability under section 78aa of the 1934 Act.[64] The plaintiffs contended that the defendants sold the corporation's assets for less than value, in breach of fiduciary duties, and that the sale was voted on with the use of misleading proxy statements. The suit was dismissed for lack of jurisdiction over the subject matter. The opinion stated:

> As the case is said to be one "arising under" the laws of the United States, our first inquiry is addressed to appellant's contention that the statutory provisions above quoted create or give rise to a substantive civil right on behalf on Circle, which may be enforced in a derivative action by an individual stockholder. We reject this contention as unsound. We find nothing in the language of 14 (a) or in the legislative history of the Securities Exchange Act of 1934 to warrant an inference that it was the intention of the Congress to create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate.[65]

Generally speaking, as these cases would indicate, there has been a tendency in the courts to imply liability under the other securities statutes. The *Howard* case seems to be the exception rather than the rule and even that case was distinguished by the district court in the *Brown* case.

In view of the grant of certiorari by the Supreme Court in the *Brouk* case, conjecture may be in order as to what view of the foregoing materials the high court will take. As noted above, the legislative history does not clearly reveal the intent of Congress. Cases under the Investment Company Act itself have been neither numerous nor consistent in approach. Of the factors to be weighed, the history of federal decisions on implied liability under the other securities acts seems to wield the greatest influence. The majority of the cases imply liability.

Edmund John Adams

THE INTERSTATE INGREDIENT OF SECTION 304 (a) OF THE FEDERAL FOOD, DRUG AND COSMETIC ACT.

I. *Introduction*

In the science of mathematics, there exists the maxim that the whole is equal to the sum of all of its parts. Recently, the United States Court of Appeals, Second Circuit,[1] adopted this principle to expand the scope of the interstate commerce requisite of section 304 (a) of the Federal Food, Drug and Cosmetic Act. This section concerns the grounds and jurisdiction for seizure under the Act. The pertinent part thereof reads:

> Any article of food, drug, or cosmetic that is adulterated or misbranded when introduced into or while in interstate commerce *or while held for sale (whether or not the first sale) after shipment in interstate commerce,* or which may not, under the provisions of section 404 or 505, be introduced into interstate commerce, shall be liable to be prosecuted against while in interstate commerce, or at any time thereafter, on libel of information and condemned in any district court of the United States within the jurisdiction of which the article is found.[2]

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a claim tacked onto a non-federal claim for purposes of creating a colorable federal question. (3) The *Brown* suit was both representative and derivative, whereas the action in *Howard* was only derivative. The court reasoned on this point that since the right to a fair proxy statement is designed for the protection of stockholders and not for the corporation it is reasonable to deny a derivative suit but not one both representative and derivative.

64 63 Stat. 107 (1949), 15 U.S.C. § 78aa (1958). This provision is quite similar to section 44 of the 1940 Act, which is found at note 44 *supra.*

65 Howard v. Furst, 238 F.2d 790, 793 (2d Cir. 1956).

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1 United States v. 40 Cases, More or Less, of Pinocchio Brand Oil, 289 F.2d 343 (2d Cir. 1961); *cert. denied,* 30 U.S.L. WEEK 3113 (U.S. Oct. 10, 1961).

2 Federal Food, Drug and Cosmetic Law, § 304 (a), 52 Stat. 1044 (1938), as amended by 62 Stat. 582 (1948), 21 U.S.C. § 334 (a) (1958). (Emphasis added to indicate new language of the 1948 amendment.)

In the case before the Second Circuit, there had been interstate and foreign shipments of various vegetable and olive oils to the A. M. S. Packing Company in Ozone Park, New York. At that point, the oils were blended and packaged under the label, "25 per cent pure olive oil." Upon shipments to Syracuse, the oil was seized by the Government and found to contain little or no olive oil. The question before the Court of Appeals was whether section 304 (a) authorized the United States to seize and proceed against misbranded[3] cases of "Pinocchio" blended oils, mixed entirely within the state of New York from components, shipped in interstate commerce under proper labeling. Chief Judge Lumbard, reversing the decision below,[4] answered: "The appellee would have us hold here that the blending of the oils which had been transported in interstate commerce took the final product out from under federal regulation although each of its separate components was being held for sale after shipment in interstate commerce. We do not agree."[5]

This decision represents an ever broadening interpretation of what constitutes interstate commerce,[6] as the Food and Drug Administration seeks to extend the range of the Federal Act.

Federal legislation in this area first came at the urgings of muckraking such as that of Upton Sinclair's *The Jungle* and the militant interest that Dr. Harvey W. Wiley, chief chemist of the United States Department of Agriculture from 1883 to 1912, took in the subject of adulteration of food and drink. The Pure Food and Drug Act went into effect on June 30, 1906, and continued in force with the help of various amendments until June 25, 1938.[7] "[P]rofound changes in methods of manufacturing and selling goods and drugs"[8] necessitated the enactment of an entirely new law. The present Federal Food, Drug and Cosmetic Act took a comprehensive look at the subject and notably expanded coverage to medical devices and cosmetics.[9]

The validity of federal food and drug law rests on the commerce clause of the Constitution, article I, section 8.[10] Congress holds the right not only to regulate interstate commerce, but also possesses full power to keep the channels of such commerce free from the transportation of harmful and illicit articles.[11] Since

3 Section 403 (a), 52 Stat. 1047 (1938), 21 U.S.C. § 343 (a) (1958) states that food shall be deemed misbranded "if its labeling is false or misleading in any particular." For a further discussion of what constitutes misbranding, see 26 NOTRE DAME LAWYER 706 (1951).

4 188 F.Supp. 290 (N.D.N.Y. 1960).

5 United States v. 40 Cases, Etc., *supra* note 1, at 345.

6 Section 201 (b), 52 Stat. 1040 (1938), 21 U.S.C. § 321 (b) (1958) defines interstate commerce as: "(1) commerce between any State or Territory and any place outside thereof, and (2) commerce within the District of Columbia or within any other Territory not organized with a legislative body."

7 ARTHUR, THE LAW OF DRUGS AND DRUGGISTS 286 (4th ed. 1955). For a list of the amendments to the Pure Food and Drug Act of 1906, see TOULMIN, LAW OF FOOD, DRUGS AND COSMETICS § 3 (1942).

8 From Senator Copeland's report to the Senate on March 15, 1934, 78 CONG. REC. 4758 (1934).

9 See TOULMIN, *op. cit. supra* note 5, § 7 for a résumé of the primary differences between the Acts of 1906 and 1938. See generally *Developments in the Law — The Federal Food, Drug and Cosmetic Act,* 67 HARVARD LAW REVIEW 632 (1954).

10 McDermott v. Wisconsin, 228 U.S. 115 (1913); Hipolite Egg Co. v. United States, 220 U.S. 45 (1911).

11 United States v. Cardiff, 95 F.Supp. 206 (E.D. Wash. 1951); United States v. Walsh, 331 U.S. 432, 434 (1947) states:

> The Federal Food, Drug, and Cosmetic Act rests upon the Constitutional power resident in Congress to regulate interstate commerce. To the end that the public health and safety might be advanced, it seeks to keep interstate channels free from deleterious, adulterated and misbranded article of specific types. . . . It is in that interstate context that the various sections of the Act must be viewed.

the purpose of the Act is to protect the public health, the courts have consistently declared that it should be given a liberal construction.[12] The decision of *Kordel v. United States*[13] issues a warning against the creation of loopholes at the expense of public protection.

II. *Predecessors of Section 304 (a): The Miller Amendment*

Section 10[14] of the original act addressed itself to the problem of federal jurisdiction in seizure of adulterated or misbranded food, drug, or liquor. In the early case of *Hipolite Egg Co. v. United States,*[15] it was contended that section 10 of the 1906 Act did not apply to an article of food which had not been shipped for sale, but which had been shipped solely for use as a raw material in the manufacture of some other product. The Supreme Court refused to sustain such a position:

> The object of the law is to keep adulterated articles out of the channels of interstate commerce, or, if they enter such commerce, to condemn them while being transported or *when they have reached their destination, provided they remain unloaded, unsold or in original unbroken packages.* These situations are clearly separate, and we cannot unite or qualify them by the purpose of the owner to be a sale.[16]

Prima facie, one may think that seizure was valid only where the goods had been adulterated before or while in interstate commerce. This simply was not so.[17] The courts appear to have adopted the position that the element of adulteration of goods, remaining in the original unbroken packages was independent of the interstate transportation factor and that interstate shipment was to be proved as a condition precedent.[18] Therefore, the Government maintained the viewpoint that goods which were in an adulterated condition at the time of seizure were subject to libel regardless of whether they were adulterated when transported, as long as they had remained in the original packages.[19]

When the new law was enacted, the section under consideration was com-

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12 United States v. 7 Jugs, 53 F.Supp. 746 (8th Cir. 1944).

13 335 U.S. 345 (1948).

14 Pure Food and Drug Act of 1906, 34 Stat. 771.

15 220 U.S. 45 (1911).

16 *Id.* at 54. (Emphasis added.)

17 See statement of Charles W. Crawford, *Hearing Before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives on H.R. 3128 and H.R. 3147,* 80th Cong., 1st Sess. 2 (147):

> The old law authorized seizure of foods and drugs that became adulterated or misbranded after interstate shipment if they remained unloaded, unsold, or in original unbroken packages. Thousands of shipments of foods and drugs that became filthy, debased, or deteriorated after interstate transportation were seized and condemned under this provision and thereby were prevented from reaching the consuming public. The authority to make seizures in such circumstances was never challenged by court contest.

18 United States v. 300 Cans of Frozen Eggs, 189 Fed. 351, 353 (2d Cir. 1911):

> But the charge was against the goods in the original packages after transportation was over. The applicable words of the Act are "or having been transported remains unloaded, unsold, or in original unbroken packages." The allegations as to the carriage of the goods between Nebraska and New York were for the purpose of showing that they were the subject of interstate commerce.

19 Kleinfield, *Reflections on the Miller Amendment,* 4 Food Drug Cosm. L.Q. 43, 45 (1949).

20 Section 304 (a), 52 Stat. 1044 (1938) read in part:

> Any article of food, drug, device, or cosmetic that is adulterated or misbranded *when introduced into or while in interstate commerce,* or which may not, under the provisions of section 404 or 505, be introduced into interstate commerce, shall be liable to be proceeded against while in interstate commerce, or *at any time thereafter,* on libel of information and condemned in any district court of the United States within the jurisdiction of which the article is found. (Emphasis added.)

pletely revised and the words, "unsold, unloaded or in original unbroken packages," were excluded.[20] The new section 304 (a)[21] contained two phrases worthy of particular note: first, "when introduced into or while in interstate commerce," and second, "while in interstate commerce, or at any time thereafter."[22] These phrases will be examined in inverse order.

It has already been observed that the Act of 1938 expanded the scope of the former law and that it was generally intended to be farther-reaching than its predecessor. The statuory language, "while in interstate commerce, or at any time thereafter" appeared clear. It was believed that these words

> were at least as inclusive as the language of the old law, "having been transported [from one State to another], remains unloaded, unsold or in original unbroken packages." There is nothing in the extensive legislative history of the new act, including hearings, debates and committee reports, or in the records of hearings before Appropriation Committees where this kind of enforcement work was discussed, that reveals anything but approval by the Congress and the regulated industries of the long-standing practice of condemning goods which after interstate shipment became adulterated while unsold or in original unbroken packages.[23]

But when a United States Circuit Court of Appeals declared in *United States v. Phelps-Dodge Mercantile Co.* that "the fact that the food was adulterated while held in original packages did not show that it was adulterated when introduced into or while in interstate commerce,"[24] the seizure of an interstate shipment of goods "at any time thereafter" was no longer possible.

Briefly, the facts in that case were these: food was shipped from Colorado to Arizona and there held in the original packages for more than two years. But the libel action by the government did not state that the food was adulterated "when introduced into or while in interstate commerce"; to the contrary, it stated, in effect, that the food was contaminated with filth while held in the original packages in the appellee's warehouse. The court held that the terms "interstate commerce" and "original packages" were not synonymous. It went on to say that this "original package" provision of section 10 of the Wiley Food and Drug Act could not be read into section 304 (a) of the 1938 Act, for that section had long since been repealed and the new law made no mention of such words. By his narrow construction of section 304 (a), Circuit Judge Mathews boldly terminated the Government's exercise of an authority which had existed (or had been thought to exist) for 40 years,[25] *viz.*, to seize food and drug products that became adulterated or misbranded while held for sale after interstate transportation.

It is interesting to note the decision in *United States v. Olsen*[26] which Judge Mathews handed down eight months subsequent to his *Phelps-Dodge* opinion. He there held that where a therapeutic device was misbranded, although not inherently dangerous, when introduced into and while in interstate commerce, the Government was within its rights to seize and condemn it, despite the fact that it was no longer in interstate commerce. In fact, the device was in the hands of an individual purchaser who was satisfied with it.

Charles Wesley Dunn theorized from the *Olsen* and *United States v. Sullivan*[27] decisions (the latter of which is considered below) and "the broad concept of 'interstate commerce' in other Federal laws and cases, that the Commerce Clause does more or less sanction the incidental application of this Act to a food or drug

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21 *Ibid.*

22 See Kleinfield, *The Seizure Section of the Federal Food, Drug, and Cosmetic Act,* 2 FOOD DRUG COSM. L.Q. 21 (1947).

23 *Hearing on H.R. 3128 and H.R. 3147, supra* note 17, at 3.

24 157 F.2d 453 (9th Cir. 1946); *cert. denied,* 330 U.S. 818 (1946).

25 *Hearing on H.R. 3128 and H.R. 3147, supra* note 17, at 2. See also 94 CONG. REC. 134 (1948).

26 161 F.2d 669 (9th Cir. 1947); *cert. denied,* 332 U.S. 768 (1947).

27 United States v. Sullivan, 332 U.S. 689 (1948).

(etc.) which becomes adulterated or misbranded while it is held for intrastate sale after its interstate shipment."[28]

Had the *Phelps-Dodge* fact situation been delayed in presentation to Judge Mathews another year or more, one may speculate that legal reasoning might have spun its fine theories in extending the scope of section 304 (a) to allow an opposite result. Yet, as they stand, there is no inconsistency between the two opinions of Judge Mathews. In the *Phelps-Dodge* case, the point of his concern was that there was neither proof nor allegation that the adulteration had occurred in interstate commerce, while in the *Olsen* case, misbranding was shown to have taken place prior to the interstate shipment. It, therefore, followed, by giving effect to the words of the statute, that this device could be seized "at any time thereafter." What the judge balked at in the *Phelps-Dodge* decision is a situation that appeared to be strictly an intrastate matter with no established key in law to permit federal entrance.[29] The Ninth Circuit Court of Appeals had done nothing more than carefully scrutinize the meaning of section 304 (a).

III. *The Miller Amendment of 1948*

The Food and Drug Administration's reaction to the *Phelps-Dodge* loophole was immediate, the final result of which was an amendment to the Federal Food, Drug and Cosmetic Act.[30] In recommending the amendment, it was noted that the *Phelps-Dodge* decision revealed

> a serious defect in the present law. Approximately 20 per cent of the seizures of adulterated and misbranded foods instituted during recent years have involved adulteration clearly resulting from unsanitary conditions and other causes during storage after interstate shipment. Many other cases were such that it would have been impossible to prove that contamination or deterioration occurred before transportation ended. Even where that fact could have been established through investigations, the time required to make them frequently would have been such that unfit material would have reached the consuming public.[31]

Further, this same report comments upon a serious enforcement problem in the 1938 law:

> Many articles which actually were offensive at the time they were introduced into interstate commerce will escape seizure because of the impossibility of obtaining proof prior to distribution to customers to show that the condition did not develop after interstate transportation. Scientific methods have not advanced to the point where they will show infallibly when a particular product became debased. . . .
>
> The practical reasons for the assertion by Congress of its power to the extent recommended by the committee become apparent in viewing the problems of enforcement. More than 25 billions of dollars' worth of these commodities annually flows through the channels of interstate commerce. The Food and Drug Administration has approximately 200 food and drug inspectors on its rolls. The opportunity for inspection while the goods are in transit is quite inadequate. It is inevitable — at least in the absence of an increase in inspection personnel beyond anything that might be considered practicable — that the bulk of Federal inspection activities takes place after merchandise has been transported in interstate commerce and while it is stored pending further processing or disposition to consumers.[32]

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28 Dunn, *House of Representatives Bill 4071,* 2 FOOD DRUG COSM. L.Q. 284, 290 (1947). Weight is lent to his argument by the fact that the Supreme Court in the *Sullivan* case, *supra* note 27, at 698, cites the *Olsen* decision to support the validity of the Act's criminal section 301 (k).

29 157 F.2d 453, 456 (9th Cir. 1946):

> Whether Congress could have provided in § 304 (a) of the Federal Food, Drug and Cosmetic Act . . . for the condemnation of any article of food that is adulterated while held in original packages after being transported in interstate commerce need not be considered, since Congress did not, in fact, so provide.

30 62 Stat. 582 (1948).

31 Senate Report No. 1221, U.S. CODE CONG. SERVICE, 80th Cong., 2d Sess., p. 2120 (1948).

32 *Id.* at 2121.

The amendment sought to clarify the phrase, "when introduced into or while in interstate commerce," by inserting immediately after those words the following: "or while held for sale (whether or not the first sale) after shipment in interstate commerce." These added words, minus the parenthetical phrase, are identical to those appearing in the 1938 criminal section 301 (k)[33] of the Act. Moreover, the Miller Amendment effects changes in this latter section[34] to make it coextensive with the new language of section 304 (a), by including acts which result in adulteration as well as misbranding. Further, it adds the parenthetical phrase, "(whether or not the first sale)," making express what had previously been left to implication.[35]

The Miller Amendment was approved and signed into law by the President on June 24, 1948.[36] Earlier that same year, the *Sullivan*[37] case was decided under the yet-to-be amended section 301 (k). In that criminal proceeding, a retail druggist in Columbus, Georgia had purchased sulfathiozole tablets from a distributor in Atlanta, Georgia who had in turn received them from Chicago, Illinois. It was suspected that he had been selling this drug without a prescription to men stationed at nearby Fort Benning for treatment of venereal disease. Investigators moved in and on two separate occasions found that the druggist removed tablets from their properly labeled bulk container in which they had been transported in interstate commerce and in which they were than being held for resale. He then placed them in a pill box, labeled simply "sulfathiozole" and not containing the statutory required directions for use or warnings of danger, and sold them locally to customers. The Court held that Sullivan's conduct fell within the language of section 301 (k) and that a literal interpretation of this section was consistent with the general purpose of the Federal Food, Drug and Cosmetic Act. "Its purpose was to safeguard the consumer by applying the Act to articles from the moment of their delivery to the ultimate consumer."[38] In the concluding paragraph of the majority opinion, Justice Black quickly disposed of the constitutional objection to the above interpretation by relying primarily on *McDermott v. Wisconsin*,[39] a 1913 decision which upheld the constitutional power of Congress to regulate the branding of articles that have completed their interstate journey and are being held for local sale. He then offered a brief barrage of recent cases as auxillary support.[40]

Since the Miller Amendment made sections 304 (a) and 301 (k) coextensive, the *Sullivan* opinion is often[41] cited in support of section 304 (a)'s constitutional validity.

IV. *The Expanding Interpretation of Section 304 (a) of the Miller Amendment*

Although the Miller Amendment was precipitated by the *Phelps-Dodge* decision, it went much further than merely filling this breach in the administration of

33 Section 301 (k), 52 Stat. 1042 (1938).

34 Section 301 (k) as amended, 62 Stat. 582 (1948), 21 U.S.C. § 331 (k) (1958) prohibits:

> The adulteration, mutilation, destruction, obliteration, or removal of the whole or any part of the labeling of, or the doing of any other act with respect to, a food, drug, device or cosmetic, if such act is done while such article is held for sale (*whether or not the first sale*) after shipment in interstate commerce and results in such article being *adulterated or* misbranded. (Emphasis added to indicate the amended portions.)

35 Senate Report No. 1221, U.S. CODE CONG. SERVICE, *supra* note 31, p. 2121.

36 94 CONG. REC. 9366 (1948).

37 United States v. Sullivan, 332 U.S. 689 (1948). See Recent Decision, 23 NOTRE DAME LAWYER 392 (1948).

38 United States v. Sullivan, *supra* note 37, at 696.

39 228 U.S. 115 (1913).

40 United States v. Walsh, 331 U.S. 432 (1947); Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Wrightwood Dairy Co., 315 U.S. 110 (1942); United States v. Darby, 312 U.S. 100 (1941); United States v. Olsen, 161 F.2d 669 (9th Cir. 1947).

41 *E.g.*, United States v. 4 Devices, Labeled in Part "Color-Therm," 176 F.2d 652 (10th Cir. 1949).

the Act. It is to be observed that a proscribed article remains under the ambit of the 1948 section 304 (a), despite the number of sales that occur in intrastate commerce. As long as the interstate origin of the article can be traced in its travels of sale and resale within a state, it appears that the Government may extend its reach over that article.

The tremendous authority intended to be granted to the Food and Drug Administration is made evident by the following inquiry during a hearing before a subcommittee of the House Committee on Interstate and Foreign Commerce:

> Mr. Hale. Under this language as drawn there is no limitation at all as to Federal jurisdiction until the goods reach the ultimate purchaser, is there?
>
> Mr. Crawford. That is right, and that was on the assumption that the happening of evil things to these goods which originate in interstate commerce reacts unfavorably upon the interstate demand for those goods.[42]

Mr. Crawford, later in this same interrogation, added:

> Congress unquestionably has the authority to maintain these goods in a state of lily-white purity up to the time the interstate vehicle stops rolling; but if that is all the authority Congress has it may be futile to exercise that authority because it cannot protect the consequences of the regulation by preventing the evil things happening to the goods after the interstate journey has ended. It seems to us to be a kind of negation of the beneficent effect of that authority while interstate transportation is in course, to say that nothing could be done to carry out the purpose of Congress and to bring it to fruition, the purpose being the protection of the ultimate consumer of goods from interstate sources.[43]

Before examining the case history subsequent to the Miller Amendment, a moment should be taken to pick up an early thread in the pattern of expanding interpretation. In October of 1948, the Supreme Court declared that the separate shipment of machines and leaflets did not prevent the machines, when the leaflets, containing false and misleading statements, were attached thereto, from being subject to condemnation under the 1938 version of section 304 (a).[44] This reversed the decision of the court below.[45] It appears that the Court, well aware of the scope of the 1948-designed section 304 (a), offered a liberal interpretation of the former language to maintain consistency.

This same question, under the new section, was given further study in *United States v. 4 Devices, Labeled in Part "Color-Therm"*[46] and *Lee v. United States.*[47] In the former case, one Lee was a district salesman in Oklahoma of therapeutic devices, which had been shipped to him from a Dr. Gerkey of Mission, Kansas. The device itself was a wooden cabinet, with various tubes on the top and electrical connections needed to operate it. When a person, seeking relief through the machine, properly positioned his bare feet on the cabinet tubes and elevated his head to the right level, he could see neon lights flashing in pinball machine-like fashion, as he massaged with the applicator. Copies of instructions concerning the device were typed in Oklahoma from a master circular furnished to Lee by the Kansas doctor. These papers contained false and misleading statements as to the efficacy of the device. Consequently, it was here that the Government had to find a nexus to establish misbranding of the machine. Section 201 (m) of the statute stated clearly: "The term 'labeling' means all labels and other written, printed, or graphic matter (1) upon any article or any of its containers or wrappers, or (2) accompanying such article."[48] But the instructions neither accompanied the devices in interstate commerce from Kansas nor were they affixed to the devices while in

42 *Hearing on H.R. 3128 and H.R. 3147, supra* note 17, at 19.
43 *Ibid.*
44 United States v. Urbeteit, 335 U.S. 355 (1948).
45 Urbeteit v. United States, 164 F.2d 245 (5th Cir. 1947).
46 176 F.2d 652 (10th Cir. 1949).
47 187 F.2d 1005 (10th Cir. 1951).
48 Section 201 (m), 52 Stat. 1041 (1938), 21 U.S.C. § 321 (m) (1958).

Lee's possession. The evidence simply showed that when Lee made a sale, he would fold a copy of the instructions under the tubes before delivery to the customer. Nevertheless, the court found that "textual" rather than physical attachment was significant; it was sufficient that the instructions supplemented or explained the devices. With little ado it was then declared: "The devices were misbranded while held for sale after shipment in interstate commerce."[49] The same court further expanded its view in the *Lee* case (after *Color-Therm* was remanded and the district court sustained a motion by the United States for summary judgment, this appeal was prosecuted) by finding that the article "is subject to seizure at any time, the fact that at the time of seizure the false label is not upon the device or does not accompany the device does not purge the device of its prior false labeling or render it immune from seizure and condemnation."[50]

The case of *United States v. Allbrook Freezing & Cold Storage*,[51] decided in 1952, bears a strong similarity to the *Pinocchio* case. Here, though, the articles in question, raw strawberries, were alleged to be adulterated before interstate shipment and later processed and packaged in this condition. But, the point to grasp is that the court refused to recognize that processing and packaging of the strawberries created a new product "which cannot be seized unless and until it moves in interstate commerce in its changed form. If this were a sound view, and adulterated constituents of processed products could be seized only when in their unprocessed form, the enforcement of the act would be easily defeated."[52] Seizure was not premature; it was enough that the ingredients of raw strawberries were adulterated while in interstate commerce.

The devastation of the 1951 Missouri flood produced an interesting food and drug case,[53] the concern of which was the meaning of "while held for sale." Claimant to the insuing libel action was the owner of a large quantity of distilled spirits which was stored and held for sale in the Last Chance Tavern and Shawnee Club. At the advance of the rising waters, the tavern and club were closed; and while closed they were engulfed by the deluge, which covered the stored bottles with filth and mutilated their labels. Several days after the waters had subsided, claimant washed the bottles and removed them to two residences in Kansas City, Missouri, where they were later seized. The issue presented was whether the intoxicating beverages were adulterated and misbranded by the flood waters while "held for sale" and therefore subject to forfeiture under section 304 (a), inasmuch as the imminence of the flood forced a closing of the tavern and club. The district court found that there was no contention by the claimant that he intended to cease business or abandon the goods in question. Therefore,

> the only conclusion to be reached is that from the time the floodwaters descended until the liquor was removed from the above premises they became and were adulterated and misbranded within the meaning of the Federal Food, Drug and Cosmetic Act . . . , while being "held for sale." The removal of such liquor from the premises where it was so held, after its adulteration and misbranding, did not withdraw such liquor from the ambit of the Act.[54]

It is not the holding for sale after adulteration but the adulteration or misbranding of the article "while held for sale (whether or not the first sale)" after interstate transportation that subjects the goods to immediate forfeiture.

A few years later a United States district court in Pennsylvania[55] concerned itself with this same problem of when an article is held for sale, and it cited *United*

49 United States v. Color-Therm, 176 F.2d 652, 654 (10th Cir. 1949).
50 Lee v. United States, 187 F.2d 1005, 1007 (10th Cir. 1951).
51 194 F.2d 937 (5th Cir. 1952).
52 *Id.* at 939.
53 United States v. 1,800.2625 Wine Gallons of Distilled Spirits, 121 F.Supp. 735 (W.D. Mo. 1954).
54 *Id.* at 738.
55 United States v. 10 Cartons, Labeled in Part "Hoxsey," 152 F.Supp. 360 (W.D. Pa. 1957).

States v. 1,800.2625 Wine Gallons[56] as controlling. The Food and Drug Agency had charged that the pills dispensed by the Hoxsey Cancer Clinic in Portage, Pennsylvania were misbranded by leaflets and printed matter which explained the drug's usefulness. The medications, located in the drug and sterilization rooms, were seized while in their original containers from which they were eventually to be transferred to small envelopes for distribution to patients. At the same time, the literature in question, found in the entrance hall of the clinic, was seized. The court determined that where printed or graphic matter is used in the distribution or sale of the drug to explain its use and effectiveness, it may be considered labeling within the Act, even though there is a separation between the article and the printing.[57] But the claimants urged that the drugs were not intended for sale in the statutory sense, but for prescription by physicians in pursuit of a local practice of medicine. The argument was lost upon the court:

> It may be that physicians are not understood as holding for sale the drugs which they may administer or prescribe in connection with their treatment of patients. But potentiality of harm to the public from misbranded drugs is not less because the intervening agency of distribution may be a physician rather than a layman. The terms "while held for sale" have been given an expansive rather than a technical construction. . . . It is not the holding for sale in a technical sense which gives rise to the federal jurisdiction in cases arising under § 304 (a) but the fact that the channels of commerce have been used.[58]

The above selection of cases manifests a persistent forward push by the Food and Drug Administration. The Act has been extended to an ever greater control of goods which have been shipped in interstate commerce, but which at the time of the government's seizure have ended their trans-states travel. However, there are limits to how far the Government may reach into a state in order to keep its finger on the articles which have their origin from without that state. This line was sharply drawn in the *Phelps-Dodge* decision under the 1939 version of section 304 (a). The same reluctance was demonstrated under the amended section in *United States v. An Article or Device Consisting of 31 Units (Gonsertron)*,[59] a 1959 case over which Chief Judge Levin presided. The federal district court, in an almost matter-of-fact opinion, refused to allow libel against a device,[60] constructed entirely within the state of Michigan, partly from nine components which were received from various other states, where the device was neither sold nor held for sale outside the state. These components were ordinary electrical fixtures "in

56 121 F.Supp. 735 (W.D. Mo. 1954).

57 United States v. Urbeteit, 335 U.S. 355 (1948) was cited in support of this position.

58 United States v. 10 Cartons, Labeled in Part "Hoxsey," 152 F.Supp. 360, 364-365 (W.D. Pa. 1957).

59 180 F.Supp. 52 (E.D. Mich. 1959).

60 Section 201 (h), 52 Stat. 1041 (1938), 21 U.S.C. § 321 (h) (1958) states:

> The term "device" (except when used in paragraph (n) of this section and in sections 301 (i), 403 (f), 502 (c), and 602 (c) of this title) means instruments, apparatus, and contrivances, including their components, parts, and accessories, intended (1) for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or other animals; or (2) to affect the structure or any function of the body of man or other animals.

Compare the above to the parts (2) and (3) of the definition of "drug" which is the subject matter of the case immediately following *Gonsertron* in the text. Section 201 (g), 52 Stat. 1041 (1938), 21 U.S.C. § 321 (g) (1958) states:

> The term "drug" means (1) articles recognized in the official United States Pharmacopœia, official Homœopathic Pharmacopœia of the United States, or official National Formulary, or any supplement to any of them; and (2) articles intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or other animals; and (3) articles (other than food) intended to affect the structure or any function of the body of man or other animals; and (4) articles intended for uses as a component of any article specified in clause (1), (2), or (3) of this paragraph; but does not include devices or their components, parts, or accessories.

common use in industry. None of them were made to the specifications of the manufacturer of the device."[61]

However, in March, 1961, the *United States v. An Article of Drug Consisting of 39 Cases (Korleen)*[62] case arose on this same point before the same judicial representative of the United States. Here, the Government alleged a misbranding of drug tablets under section 304 (a). Judge Levin held that tablets which were composed of drugs shipped in interstate commerce were subject to the Act, although they were manufactured in Michigan for distribution there. In contrast to *Gonsertron,* "in the case at bar, the 'drugs' comprising the Korleen Tablets are the very heart of the manufactured and tableted 'drug' and were proclaimed as such to the public."[63] The advertisements laid stress on the alleged therapeutic value of the active ingredients of Korleen Tablets. Further, the court declared:

> It would be a strained interpretation to say that each "drug" component falls within the jurisdiction of the Act, being shipped in interstate commerce, but, when compounded together to form another "drug," the finished product is not being held for sale after shipment in interstate commerce.[64]

It appears that the Food and Drug Administration has carefully chosen fact situations from which its attorneys can fashion fuller federal control of food, drugs and cosmetics, under the banner of protecting the public health and purse. One of the latest of these chosen cases has yet to be examined.

V. *United States v. 40 Cases, More or Less, of Pinocchio Brand Oil*[65]

It will be recalled that here the government brought a libel action against a food[66] product, known as "Pinocchio" oil, which had been manufactured and misbranded in New York State from components received by interstate shipment. Although the blended oil product was not held for sale outside of New York, the Food and Drug Administration pressed its case on the ground that all of the components had been shipped in interstate commerce and that the sum of these separate components was misbranded after their shipment and while held for sale in their blended form.

When a federal district court ruled that this constituted "a new product or complete article of intrastate manufacture"[67] which was beyond the reach of section 304 (a), the Government quickly sought an appeal. The *Wall Street Journal* noted that the administration feared this decision, "if upheld, would significantly curb [its] power to seize misbranded foods."[68] The news article further stated:

> Agency lawyers regard the new ruling as a "test case" of the agency's jurisdiction over the misbranding of similar foods. This type of violation makes up 3% to 5% of the agency's 100 to 150 monthly enforcement cases. If the District Court is upheld, an agency spokesman said a "significant number" of cases will be removed from the agency's reach. The Supreme Court never has interpreted the scope of the agency's power under the 1948 amendment.[69]

On appeal before the Second Circuit, appellee, A. M. S. Packing Company, contended that "the libel alleges that Pinocchio the product manufactured in New York was misbranded and adulterated; not the original oils (ingredients) received from out of state."[70] In addition it was stated that the product was first created

61 United States v. Gonsertron, 180 F.Supp. 52, 53 (E.D. Mich. 1959).
62 192 F.Supp. 51 (E.D. Mich. 1961).
63 *Id.* at 52.
64 *Ibid.*
65 289 F.2d 343 (2d Cir. 1961); *cert. denied,* 30 U.S.L. Week 3113 (U.S. Oct. 10, 1961).
66 Section 201 (f), 52 Stat. 1040 (1938), 21 U.S.C. § 321 (f) (1958) states: "The term 'food' means (1) articles used for food or drink for man or other animals, (2) chewing gum, and (3) articles used for components of any such article."
67 188 F.Supp. 290, 291 (N.D. N.Y. 1960).
68 The Wall Street Journal, Nov. 25, 1960, p. 3, col. 4.
69 *Ibid.*
70 Brief for Appellee, p. 8.

in New York and never left that jurisdiction.[71] Appellant attacked both this contention and the holding below that Pinocchio was a "new product":

> The article is "new" only in the sense that the interstate components have been blended together, a mixture almost wholly vegetable oil substituted for a blend containing a substantial amount of olive oil, and a false label affixed. The very same interstate oils are in the cans, and the Government is attempting to bring to bear the Congressional protection against their sale to the consumer in their now adulterated and misbranded form.[72]

The agency attorneys argued further:

> As in *Sullivan,* articles were shipped legally in interstate commerce; mixed together so as to alter their form as in *Allbrook;* and, subsequently, misbranded as in *Color-Therm* and *Lee.* In addition, in this case, the articles were also adulterated. The important fact on which federal jurisdiction rests is that the components of the misbranded and adulterated oil had once moved interstate. A. M. S. as the consignee received the advantages of federal regulation which assured it honest labeling and unadulterated components. It now would deny the same protection to the ultimate consumer on the technicality that the honestly labeled oils it received have been mixed together.[73]

The force of these arguments obviously left their mark on the mind of the court. It declared that the completed mixture which was being held for sale as "oil" was "the very same type of food which had traveled across the state line."[74] Judge Lumbard easily distinguished the *Gonsertron* case with the aid of the *Korleen* limitation. Yet he reasoned with strain that it was the end result of the labor expended in assembling the component parts which was misrepresented. However, in the case before him, the "misbranding related directly to the percentage content of the olive oil shipped in intersate commerce."[75] It is in this no doubt subtle distinction that the essence of the opinion lies. This is a point which will again be examined in appraising the scope of the decision.

A. M. S. Packing Company petitioned the Supreme Court for certiorari. This was denied in October, 1961.[76] The petition, however, offered the Government an opportunity to sharpen its argument. In its brief in opposition to certiorari, the policy issue is brought into clear focus:

> If the petitioners are right in their contention that misbranding or adulteration of food "while held for sale * * * after shipment in interstate commerce" can be removed from the reach of the Act by any change, however slight, in the form of the product, there would be a significant loophole for evasion. For example, many misbranders and adulterators of food and drugs that move in interstate commerce could get around the Act simply by "decentralizing" certain phases of their operations. A nationwide operator who, before the 1948 amendment, could get away with mixing or processing his product at one central location and then shipping it interstate for misbranding or adulteration in the state of sale, could now escape the effect of the amendment by varying his operation solely to the extent of doing the mixing or processing at the same place he does the misbranding or adulteration. And if the simple mixing involved in the instant case is a sufficient "change in form" to achieve this result, presumably almost anything, such as addition of a coloring agent, would do. It is not reasonable to suppose that Congress intended to permit such artificial distinctions to defeat its purpose.[77]

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71 *Id.* pp. 4-5:

> Pinocchio was created in this state and moved solely intrastate. The wrong, if any, occurred in connection with such newly manufactured article by reason of acts committed *wholly* within the State of New York, and hence this transaction falls within the orbit of intrastate — not interstate commerce, and the libel was wrongfully filed.

72 Brief for Appellant, pp. 7-8.

73 *Id.* p. 13.

74 United States v. Pinocchio, 289 F.2d 343, 345 (2d Cir. 1961).

75 *Id.,* at 346.

76 30 U.S.L. WEEK 3113 (U.S. Oct. 10, 1961).

77 Brief for the United States in Opposition to Petition for a Writ of Certiorari, pp. 9-10.

VI. *The Law of Gonsertron, Korleen and Pinocchio*

The *Pinocchio* case and its two immediate predecessors, *Gonsertron* and *Korleen,* represent the law of what constitutes the necessary interstate ingredient for the Federal Food and Drug Law to attach to an article which has received a new form after it has come to rest within a state. The *Gonsertron* decision makes it difficult to harmonize the three cases. Both the court of *Korleen* and that of *Pinocchio* recognize this dissonance, in drawing distinctions to the *Gonsertron* fact situation.[78] These have been examined. Yet, some difficulty with these distinctions may still persist.

One is inclined to wonder why the Government ever initiated the *Gonsertron* case. The libel was tersely dismissed in the United States District Court of Michigan's Eastern Division; there was no appeal. Mr. William W. Goodrich, Assistant General Counsel of the Department of Health, Education and Welfare, Food and Drug Division, answers: "The case came to us because this worthless device was being used locally in the treatment of serious diseases and could not be controlled by the state medical authorities. We thought we had a good case. We recommended an appeal. The Solicitor General declined."[79]

Probably, the most lucid distinction between the *Pinocchio* and *Gonsertron* decisions was set forth in the Government's brief in opposition to petition for certiorari:

> Petitioners' reliance upon [*Gonsertron*] is misplaced. There the components that had been shipped interstate were ordinary electrical fixtures, shipped with no intention that they be used in assembling a therapeutic device. They were purchased on the open market by the claimant, who originated the idea that the assembled machine had a therapeutic and diagnostic merit. Thus, unlike the situation here where all the component oils had been received in interstate commerce, no "device" — defined by the Act as an article intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease (21 U.S.C. 321 (h)) — had moved interstate.[80]

This, Mr. Goodrich indicates in his letter, was the point the Solicitor General's office stressed in declining appeal to the district court's determination in *Gonsertron.* "They considered the record inadequate to show that the components met the statutory definition of 'device' when they were in interstate commerce or at any time prior to their purchase on the open market in Michigan and their assembly into a therapeutic device."[81] However, in *Korleen* and *Pinocchio,* it is to be noted that the drug components and oils which went into their respective blends were *already drug and food when they were transported in interstate commerce.*

No distinction among the cases can be based on the number or percentage of ingredients received from out of state as the criterion for determining whether the completed article of food, drug or device was sold or held for sale after shipment in interstate commerce. One will recall that only some of the components which made up the *Gonsertron* device were of foreign origin, whereas in *Korleen* and *Pinocchio* all the ingredients of the articles involved came from without the state.

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78 It is interesting to note that Judge Levin in United States v. Korleen, 192 F.Supp. 51, 52 (E.D. Mich. 1961) distinguished the situation before him from both the district court's decision of *Pinocchio* as well as the *Gonsertron* decision:

> In both cases, the Courts held that an article or device is not subject to the jurisdiction of the Act where only components shipped in interstate commerce were either a minor ingredient of the final product or several commonly used components which lost their identity within the newly manufactured device.

The Korleen case was decided in March, while the appellate court's decision of *Pinocchio* was not issued until April, 1961.

79 Letter of Nov. 29, 1961, from William W. Goodrich, Assistant General Counsel of the Department of Health, Education and Welfare, Food and Drug Division, on file at Notre Dame Law Library.

80 Brief for the United States in Opposition to Petition for a Writ of Certiorari, p. 8.

81 Letter of Nov. 29, 1961, from William W. Goodrich, *supra* note 78.

Particular significance is not attached to this. Neither court in the latter decisions made an argument of it, although each distinguished the case before it from *Gonsertron.*

Perhaps the point to grasp is the degree of change which takes place in the articles from their condition "while in interstate commerce." Must the components remain basically the same, differing only in form; or must the intrastate product be primarily composed of the ingredients which have been shipped interstate? Mr. Goodrich is again informative:

> When you ask how great a change must be made in the component, I must answer that I do not consider that the critical problem, although it was quite significant in the *Pinocchio* and *Korleen* cases. Assume that there was shipped in interstate commerce a food additive which is permitted for use in potato chips at a level of 50 ppm. This tolerance has been established to assure the safe use of the additive. If we found potato chips, prepared locally, with the food additive of interstate distribution present at a level higher than the established tolerance, we would attempt to enforce the tolerance and to condemn the potato chips in the interest of protecting the public health.[82]

What then are the limits of federal jurisdiction? The petition for a writ of certiorari in the *Pinocchio* case points up this problem:

> If the present attempt at power by the Food & Drug is upheld it means that the Act will affect every food product manufactured locally from wholesome ingredients obtained from out of state — even though the manufactured product is sold intrastate — a revolutionary concept in the enforcement of the law and recasting with strange meaning the definition of interstate commerce and the term "while held for sale after shipment in interstate commerce."[83]

The petitioner appears to be indulging in invective. The Supreme Court answered just such a contention in the *Sullivan* decision, when it said:

> The scope of the offense which Congress defined is not to be judicially narrowed as applied to drugs by envisioning extreme possible applications of its different misbranding provisions which relate to food, cosmetics, and the like. There will be opportunity enough to consider such contingencies should they ever arise.[84]

Each case must be judged on its merits. The author does not presume to draw the line. "An accurate, all-inclusive definition of interstate commerce has never been formulated by the courts. . . . [I]ts facets are far too numerous and diverse."[85]

VII. *Conclusion*

The difficulty in interpreting the commerce clause, as the basis for federal jurisdiction, is often one of determining whether local goods or transactions have a sufficient effect on interstate commerce.[86] However, recent interpretation of the Federal Food, Drug and Cosmetic Act's section 304 (a) has given consideration to the other side of the coin. *Gonsertron, Korleen* and *Pinocchio* all face the question of how far into interstate commerce the Food and Drug Administration can reach after interstate transportation has come to a halt. No doubt the best insight to the problem lies in the words of the Assistant General Counsel of the Department of Health, Education and Welfare: "To my mind the problem is whether the misuse or misbranding of the interstate component has some consumer significance in the end product. If it does, we would try to apply the statute to it."[87] The Government will seek to extend its jurisdiction as far as possible. Moreover, the *Gonsertron* limitation cannot be generalized. The same judge who decided that case, narrowly limited it to its facts in the subsequent *Korleen* decision.

82 *Ibid.*
83 Petition for a Writ of Certiorari, pp. 7-8.
84 United States v. Sullivan, 332 U.S. 689, 694 (1948).
85 United States v. Sanders, 99 F.Supp. 113, 115 (W.D. Okl. 1951).
86 *E.g.,* Wickard v. Filburn, 317 U.S. 111 (1942).
87 Letter of Nov. 29, 1961, from William W. Goodrich, *supra* note 78.

The scope of section 304 (a) appears in the words of the Second Circuit Court of Appeals: "Congress surely intended the provisions of the Food, Drug, and Cosmetic Act to apply to foods processed within a state, after shipment in interstate commerce, as was the case here. The statute must be read and applied broadly in order to effectuate its remedial purpose."[88]

*Norman E. Matteoni**

UNEMPLOYMENT COMPENSATION — DEFAMATION — REQUIRED SEPARATION REPORTS AND LIABILITY BASED UPON DEFAMATORY MATTER CONTAINED THEREIN — Every state at present has unemployment compensation or employment security statutes. These statutes provide for periodic payments to unemployed workers based on credits accumulated while gainfully employed. An almost universal requirement demands that upon cessation of employment an employer submit to the state employment security commission reasons for such discontinuance. This requirement serves a twofold purpose: it qualifies or disqualifies an unemployed worker for or from benefits and determines an employer's net cost. Under the acts, employing units are required to contribute to these funds in accordance with their unemployment costs as shown by experience. A unit which has little unemployment, *i.e.*, voluntary dismissals, is entitled to a reduced rate. Under these statutes, an employee who is fired for cause is disqualified from receiving benefits for a certain length of time, *e.g.*, four to nine weeks in Iowa.[1] Thus, in order to keep his rate of contribution at a low level, it is in the interest of an employer to see to it that an employee, who has been fired for cause, does not recover benefits and is not classified as one voluntarily dismissed.

The commissions which have been created to administer the acts provide forms for the employer to indicate whether an employee has been involuntarily discharged. The majority of states require an employer to file a separation report, either soon after the dismissal or after a request by the commissioner, and some states impose harsh penalties for a wilful failure to file. The Arkansas provision for a fine of $20-$200 and/or a sixty day imprisonment is a common sanction aiding enforcement.[2] All states which require reports hold that a failure to file represents an admission of the employee's claim and status.

As stated, the vast majority of the states require a separation report setting forth the reasons for the discharge. The few states which do not require reports do make some provision for an appeal of the commissioner's determination, if an employer is dissatisfied with the result. Thus, by virtue of the charges made at such times, the question of libel may arise in some manner in all of the states.

"Libel consists of the publication of defamatory matter by written or printed words, by its embodiment in physical form, or by any other form of communication which has the potentially harmful characteristic of written or printed words."[3] Formerly, liability was imposed on all libelous, *i.e.*, written, statements. Gradually, however, the tort of defamation encompassed both libel and slander, with the result that libel was "treated like slander, which is to say that except for certain categories of imputation, [*i.e.*, crime, unchastity, lack of business, trade, or professional ability] it is not actionable without proof of special damages."[4] Consequently, by disclosing his reason for a discharge, which often includes a charge of stealing or dishonesty, an employer may well subject himself to a suit for damages.

A party is absolutely privileged to publish defamatory matter in certain in-

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88 United States v. Pinocchio, 289 F.2d 343, 346 (2d Cir. 1961).

* The author wishes to express his appreciation to John B. Buckley, Associate Legal Counsel, Miles Laboratories, Inc., Elkhart, Ind., for his time and assistance in this subject matter.

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1 IOWA CODE ANN. § 96.5(2) (Supp. 1960).
2 ARK. STAT. ANN. § 81-1119(b) (1960).
3 RESTATEMENT, TORTS § 568(1) (1938).
4 PROSSER, TORTS 588 (2d ed. 1955).

stances, *e.g.*, in judicial proceedings.[5] Also, the law recognizes a qualified privilege in areas where "the interest the defendant is seeking to vindicate is regarded as having an intermediate degree of importance, so that the immunity conferred is not absolute, but is conditioned upon publication in a reasonable manner and for a proper purpose."[6] Since an accusation that one is a thief, or is dishonest, is libelous *per se,* a qualified privilege which may be destroyed at the whim of the jury is of little aid and comfort to an employer. The absence of an absolute privilege has a tendency to thwart the full and honest disclosure envisaged in the requirement of separation reports upon termination of employment. Many states have provided for this absolute privilege in their Employment Security legislation.

States Providing an Absolute Privilege

Nineteen states have given recognition to the problem by passing legislation providing employing units with an absolute privilege in their disclosures to the Unemployment Compensation Commission.[7] A typical statute conferring immunity is represented by the Florida provision, which states that:

> All letters, reports, communications, or any other matters, either oral or written, from the employer or the employee to each other or to the commission or any of its agents, representatives or employees which shall have been written, sent, or delivered, or made in connection with the requirements and administration of this chapter, shall be absolutely privileged and shall not be made the subject matter or basis for any suit for slander or libel in any court of the state of Florida.[8]

Three of the jurisdictions, California, New York, and Oregon, do not follow the general form but achieve the same result by holding information required by the Unemployment Compensation Commission to be inadmissible in evidence in any court action or proceeding. For instance, Section 537 of the New York Labor Law provides:

> Information acquired from employers or employees pursuant to this article shall be for the exclusive use and information of the commissioner in the discharge of his duties hereunder and shall not be open to the public nor be used in any court in any action or proceeding pending therein unless the commissioner is a party to such action or proceeding, notwithstanding any other provisions of law.[9]

The question of liability for defamation in required reports under the Unemployment Compensation Act has had an interesting history in New York. Although the Court of Appeals has not yet been presented with an occasion to rule on the question, the cases which have dealt with this issue have concluded that an employer is immune from suit for libel.

In the first New York case on this subject, *Andrews v. Cacchio,*[10] an action for personal injuries, where a defendant sought to subpoena the records of the Division of Employment in order to determine whether the plaintiff had received unemployment insurance benefits and whether the plaintiff had made certain representations in connection with her physical condition during the period when she claimed to have been disabled as a result of the injuries sustained, the court

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5 *Id.* at 607.
6 *Id.* at 614.
7 ALA. CODE tit. 26, § 233 (1958); FLA. STAT. ANN. § 443.16(3) (1952); GA. CODE ANN. § 54-642.1 (1961); KY. REV. STAT. ANN. § 341.190(3) (1955); ME. REV. STAT. ANN. ch. 29, § 29 (1954); MASS. ANN. LAWS ch. 151A, § 46 (1957); MICH. STAT. ANN. § 17.511(b) (1960); MINN. STAT. ANN. § 268.12(12) (1959); MO. ANN. STAT. § 288.250 (1952); N.H. REV. STAT. ANN. § 282:9(m)(2) (Supp. 1959); N.C. GEN. STAT. § 96-4(g)(1) (1958); N.D. CODE ANN. § 52-06-37 (1960); OHIO REV. CODE ANN. § 4141.21 (1954); OKLA. STAT. ANN. tit. 40, § 221(1) (1954); S.C. CODE § 68-27 (1952); S.D. CODE § 17.0814 (Supp. 1960); TENN. CODE ANN. § 50-1339 (Supp. 1961); TEX. REV. CIV. STAT. ANN. art. 5221b-9(h) (Supp. 1960); W.Va. CODE ANN. § 2366(154) (1955).
8 FLA. STAT. ANN. § 443.16(3) (1952).
9 N.Y. LAB. LAWS § 537.
10 264 App. Div. 791, 35 N.Y.S.2d 259 (1942).

reversed the order directing that the records be produced at the trial. It reasoned that the applicable section of the Unemployment Insurance section of the Labor Law prohibited the use of such records.

Simpson v. Oil Transfer Corporation[11] indicates that the same rule applies to proceedings in the federal courts. This was an action for libel removed from the Supreme Court of the State of New York to the United States District Court for the Northern District of New York upon a finding of diversity of citizenship. The commissioner, in order to ascertain whether or not to award unemployment insurance benefits, requested certain information from the applicant's former employer. The latter, under compulsion of the applicable statute and regulations, complied with the request. The plaintiff contended that certain of the statements contained in the defendant's reply were false and malicious. The court, relying on *Andrews v. Cacchio,* dismissed the complaint. It determined that:

> It is apparent that the writings of the defendant referred to in the complaint were pertinent and relevant to a determination by the commissioner of the plaintiff's right to unemployment benefits, and as such, they were privileged under the laws of the State of New York, and may not be used in any court therein. It follows that an action based thereon must be dismissed.[12]

Coyne v. O'Connor[13] involved an employer's letter to the Industrial Commission setting forth the reasons for an employee's discharge, made in connection with an application for unemployment benefits for a discharged employee. The court reasoned that the letter was confidential and privileged and that the plaintiff was not entitled to maintain a suit for libel. It stated:

> No New York case has heretofore considered what effect a statute such as Sec. 537 of the Labor Law should have on the doctrine of absolute privilege. That section does not in terms deal with "privilege" absolute or otherwise, but it does provide for a positive non-disclosure of the communication complained of here, in court or out of court. I deem this to show a legislative intent to remove defendant's letter from the realm of actionable libel. This may be equivalent to saying that it is absolutely privileged. More accurately it could be termed a statutory privilege, since the confidential nature of these records distinguish this case from the common-law variety of absolute privilege which is confined to a public trial in a judicial proceeding, statements made in the legislature, and similar situations.[14]

Also, in *Breuer v. Bo-Craft Enterprises,*[15] an analogous case, the court decided that, in view of the employer's duty to furnish reasons in a separation report in response to an inquiry from the State Department of Labor, Division of Employment, and in view of the statute making such communications confidential, an employer's report could not be used by the employee as a basis for a libel action against the employer. The court concluded:

> It appears to this Court that the Legislature in its wisdom has weighed the benefits to the greater number by providing for confidential communications as against the damage that might be done to an individual by a malicious response to a Department inquiry and had decided in favor of the greater benefits to the greater number. Any other interpretation could well emasculate the Labor Law.[16]

Two recent decisions protecting an employer with a privilege in libel have relied on this line of authority.[17]

11 75 F. Supp. 819 (N.D.N.Y. 1948).
12 *Id.* at 822.
13 204 Misc. 465, 121 N.Y.S.2d 100 (Sup. Ct. 1953).
14 *Id.* at 101-02.
15 8 Misc. 2d 736, 170 N.Y.S.2d 631 (Sup. Ct. 1957).
16 *Id.* at 633.
17 Mandell v. Terminal Beauty Shops, Inc., 23 Misc.2d 205, 201 N.Y.S.2d 233 (Sup. Ct. 1960), held that an employer's letter, stating that the cause of the plaintiff's dismissal was because she was a "trouble maker," was a privileged communication. Graham v. Seaway Radio, Inc., 28 Misc. 2d 706, 216 N.Y.S.2d 52 (Sup. Ct. 1961), decided that an employer's

The California statute also holds required information inadmissible as evidence.[18] There is one case, decided in a lower court, which states that since an employer must advise the state of the facts surrounding the termination of an employee's services, an employer's communication to the state is absolutely privileged.[19]

Oregon's provision is comparable to that of New York and California.[20] There have been no cases reported dealing with absolute privilege in this area. Yet in *Moore v. Sater*,[21] where an attorney accused his neighbors, who protested his appointment as guardian of a client, of libelous remarks made in the pleadings, the Oregon Supreme Court held that the statements, because published in a judicial proceeding, were absolutely privileged. The court discussed this doctrine and adopted what it considered to be the general rule, namely, that "The class of absolutely privileged communications is narrow and is practically limited to legislative and judicial proceedings and other acts of state, including it is said, communications made in the discharge of a duty under express authority by law, by or to heads of executive departments of the state and matters involving military affairs."[22]

In *Garcia v. Hilton Hotels International, Inc.*,[23] a federal district court decided that defamatory matter communicated to the Labor Department under the law in Puerto Rico was absolutely privileged as a communication made before a legislative or judicial proceeding.

Non-Statutory Indication of Absolute Privilege

There are a few states which, while not clothing separation reports with an absolute privilege in their statutes or in their case law, have indicated that an employer will be immune from suit. In *White v. United Mills Co.*,[24] where an employer stated to the Unemployment Compensation Commission the cause of the employee's discharge to be "inefficiency and wilful disobedience in complying with company regulations," a Missouri court decided that reports made to the Commissioner of Labor under the Kansas statute, which classified the reports as confidential, were quasi-judicial in nature and hence were absolutely privileged. Although the Kansas courts have yet to deal with this question, the Commissioner of Labor in Kansas has stated that although "this case was tried in a Missouri court . . . it is printed in the Kansas section of the several services because the alleged libel occurred in Kansas and the court applied the Kansas law rather than the Missouri law."[25]

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statement to the Unemployment Compensation Commission, that former employee was a lazy man and one that would rather receive unemployment benefits than work, was privileged.

18 CAL. UNEMP. INS. CODE § 1094 (1956), which in part provides:

> Except as otherwise specifically provided in this division the information furnished to the director by any employing unit, pursuant to this division, shall be for the exclusive use and information of the director in the discharge of his duties and shall not be open to the public, nor admissible in evidence in any action or special proceeding, other than one arising out of the provisions of this division.

19 Huber v. The San Francisco Bank (Super. Ct., San Francisco County, Nov. 4, 1953) 2 CCH UNEMP. INS. REP. *Cal.* ¶ 1670.19 (1961).

20 ORE. REV. STAT. § 657.655(1)(b) (1959), provides that:

> Information secured from employing units, employees or other individuals pursuant to this chapter:
>
> (b) Shall not be used in any court in any action or proceedings pending therein unless the commissioner or the state is a party to such action or proceedings.

21 215 Ore. 417, 335 P.2d 843 (1959).

22 *Id.* at 845.

23 97 F. Supp. 5 (D.P.R. 1951).

24 240 Mo. App. 443, 208 S.W.2d 803 (1948).

25 Letter From Harold L. Smith, Labor Commissioner, Kansas Employment Security Division, to the *Notre Dame Lawyer*, Nov. 29, 1961, on file in the Notre Dame Law Library.

The New Mexico Employment Security Commission has said that their act, which considers separation reports as confidential,[26] renders the reports privileged and that "our courts, state and federal, do not require their production even upon subpoena."[27]

While the above statements, obtained from the commissions, would not be binding upon a court, they do demonstrate the apparent attitude in these two states.

States Providing a Qualified Privilege

Illinois, Maryland, Mississippi, and Nebraska, while recognizing the problem and enacting some type of legislation, have still not protected the employer, since they grant only a qualified privilege which is overcome by proof of the existence of malice or unreasonableness.[28] The Maryland statute provides:

> No report, communication, or any other such matter either oral or written from the employee or employer to each other or to the Executive Director or Board of Appeals or any of their agents, representatives or employees, which shall have been written, sent, delivered or made in connection with the requirements and administration of this article shall be made the subject matter or basis of any suit for slander or libel in any court, *unless such report, communication, or other such matter is false and malicious.*[29]

Since the circumstances surrounding an employee's discharge, if published, are often deemed automatically malicious or libelous *per se*, a qualified privilege affords no protection at all.

The problem is not as severe in Mississippi, where no separation reports are required,[30] as it is in the other three states. No cases have been reported in Nebraska and Maryland. In Illinois, although the courts have stated that a person is not subject to suit for slander or libel for defamatory statements in a paper filed before a board or commission,[31] and have prohibited the disclosure of information obtained from any individual by the Labor Department,[32] there has been no outright recognition of an absolute privilege in the face of the statute.

States Indicating That Reports Are Not Required

Although the legal counsel for the Unemployment Compensation Commissions for the states of Montana and Washington have indicated that separation reports are not required,[33] the problem still exists, since an employer who is dissatisfied with a commissioner's decision must appeal to prevent his account from being charged accordingly.

26 N.M. STAT. ANN. § 59-9-11.11 (Supp. 1961).

27 Letter From A. M. Frazier, Commission Counsel, Employment Security Commission of New Mexico, to the *Notre Dame Lawyer,* Nov. 27, 1961, on file in the Notre Dame Law Library.

28 ILL. ANN. STAT. ch. 48, § 640 (Smith-Hurd Supp. 1960); MD. ANN. CODE art. 95A, § 12(g)(2) (1957); MISS. CODE ANN. § 7412 (Supp. 1960); NEB. REV. STAT. § 48-612 (1943).

29 MD. ANN. CODE art. 95A, § 12(g)(2) (1957). (Emphasis supplied.)

30 Letter From Floyd P. Smith, General Counsel of the Mississippi Employment Security Commission, to the *Notre Dame Lawyer,* Nov. 21, 1961, on file in the Notre Dame Law Library.

31 Parker v. Kirkland, 298 Ill. App. 340, 18 N.E.2d 709 (1939), decided that counsel's defamatory statements, made in a hearing on a capital stock assessment before the Board of Appeals of Cook County, were absolutely privileged, since made in the course of a judicial proceeding.

32 Smith v. Illinois Valley, 20 Ill. App.2d 312, 156 N.E.2d 361 (1959), held that a person's statement, that he was able to work, made to an employee of the Department of Labor, was inadmissible in view of a provision in the Unemployment Compensation Law prohibiting disclosure of information obtained from any individual by the Department of Labor.

33 Letter From Edward C. Schroeter, Attorney for the Montana Unemployment Compensation Commission, to the *Notre Dame Lawyer,* Nov. 21, 1961, on file in the Notre Dame Law Library.

Letter From Paul J. Murphy, Assistant Attorney General for the State of Washington, to the *Notre Dame Lawyer,* Nov. 25, 1961, on file in the Notre Dame Law Library.

STATES NOT GRANTING AN ABSOLUTE PRIVILEGE

State	*Reports Required*	*Penalty for Failure to File*	*Reports Made Confidential*	*Qualified Privilege*	*Indication that Employer Will Be Protected*
Alaska	x	If *wilful,* up to $200 and 60 days.	ALASKA COMP. LAWS ANN. § 51-5-110 (Supp. 1958).		
Arizona	x	$20-200 and/or 90 days.	ARIZ. REV. STAT. ANN. § 23-722 (1956).		
Arkansas	x	If *wilful,* $20-200 and /or 60 days.	ARK. STAT. ANN. § 81-1114(1) (1960).		
Colorado	x	$25 and barred from protesting award of benefits.	COLO. REV. STAT. ANN. § 82-3-7 (1953).		
Connecticut	x	Up to $200 and six months.			
Delaware	x	If *wilful,* $20-200 and /or 60 days.	DEL. CODE ANN. tit. 19, § 3126 (1953).		
District of Columbia	x	Up to $1000 and/or six months.	D.C. CODE ANN. § 46-313(f) (1961).		
Hawaii	x	If *wilful,* $20-200 and /or 60 days.	HAWAII REV. LAWS § 93-94 (1955).		
Idaho	x	If *wilful,* $20-200 and /or 60 days.	IDAHO CODE ANN. § 72-1342 (Supp. 1961).		
Illinois	x	Misdemeanor, $5-200 and/or six months.	ILL. ANN. STAT. ch. 48, § 640 (Smith-Hurd Supp. 1960).	ILL. ANN. STAT. ch. 48, § 640 (Smith-Hurd Supp. 1960).	
Indiana	x	$5.	IND. ANN. STAT. § 52-1544 (1951).		
Iowa	x	If *wilful,* $20-200 and /or 60 days.			
Kansas	x	If *wilful,* $20-200 and /or 60 days.	KAN. GEN. STAT. ANN. § 44-714(f) (Supp. 1959).		Letter From Labor Commissioner.*
Louisiana	x	If *wilful,* $20-200 and /or 60 days.	LA. REV. STAT. § 23:1660 (1950).		
Maryland	x	$2-10.		MD. ANN. CODE art. 95A, § 12(g) (1957).	
Mississippi			MISS. CODE ANN. § 7411 (Supp. 1960).	MISS. CODE ANN. § 7412 (Supp. 1960).	
Montana			MONT. REV. CODES ANN. § 87.124 (1947).		

In *Magelo v. Roundup Coal Mining Co.,*[34] the Montana Supreme Court held that a letter, characterizing the employee as a malingerer and as one who had presented fraudulent claims in the past, written by the employee's manager in connection with the employee's claim for compensation under the Workmen's Compensation Act, was libelous and was not privileged as a publication made in an official proceeding, since the statements made were not relevant and material to the issue before the board.

In Washington, although there is an informal Attorney General's Opinion[35]

34 109 Mont. 293, 96 P.2d 932 (1939).
35 OPS. ATT'Y GEN. (1952), 9 CCH UNEMP. INS. REP. *Wash.* ¶ 1670.03 (1956).

STATES NOT GRANTING AN ABSOLUTE PRIVILEGE (Continued)

State	*Reports Required*	*Penalty for Failure to File*	*Reports Made Confidential*	*Qualified Privilege*	*Indication that Employer Will Be Protected*
Nebraska	x	If *wilful,* $20-200 and/or 60 days.	NEB. REV. STAT. § 48-612 (1943).	NEB. REV. STAT. § 48-612 (1943).	
Nevada	x	$5 plus 1½% interest on wages subject to contribution.	NEV. REV. STAT. § 612.625 (1955).		
New Jersey	x	$5 plus $5 for each additional 5-day period; if *wilful,* $50.			*Fenning v. S.G. Holding Corp.,* 47 N.J. Super. 110, 135 A.2d 346 (1957).
New Mexico	x	If *wilful,* $100 and/or 30 days.	N.M. STAT. ANN. § 59-9-11 (Supp. 1961).		Letter From Employment Security Commission Counsel.**
Pennsylvania	x	If *wilful,* $50-500 or 30 days.			*Wagner v. Bell,* Ct. of Com. Pleas, Oct. 17, 1949.***
Rhode Island	x	If *wilful,* $10-100 and/or 60 days.	R.I. GEN. LAWS ANN. § 28-42-38 (1956).		
Utah	x	If *wilful,* $50-250 and/or 60 days.	UTAH CODE ANN. § 35-4-11(g) (Supp. 1961).		*Mortensen v. Life Insurance Corporation,* 6 Utah 2d 408, 315 P.2d 283 (1957).
Vermont	x	$50 and/or 30 days.			
Virginia	x	If *wilful,* misdemeanor.			
Washington			WASH. REV. CODE § 50.12.070 (1951).		
Wisconsin	x	$5; if *wilful,* $25-100 and/or 30 days.			
Wyoming	x	If *wilful,* misdemeanor, and up to $200 and/or 60 days.	WYO. COMP. STAT. ANN. § 27-34(m) (1957).		

* Letter From Harold L. Smith, Labor Commissioner, Kansas Employment Security Division, to the *Notre Dame Lawyer,* Nov. 29, 1961, on file in the Notre Dame Law Library.

** Letter From A. M. Frazier, Commission Counsel, Employment Security Commission of New Mexico, to the *Notre Dame Lawyer,* Nov. 27, 1961, on file in the Notre Dame Law Library.

*** 8 CCH UNEMP. INS. REP. *Pa.* ¶ 1670.05 (1960).

stating that no action based upon information furnished by the employer to the Unemployment Compensation Commission would lie, the statute dealing with privileged communications grants only a qualified privilege.[36]

Other States — Analogous Situations

Arizona. The only statement made that an employer should not be subject to damages sought in an action for libel or slander in this area was made by the Attorney General in 1953.[37] The Criminal Code grants only a qualified privilege for communications made by one interested party to another similarly interested in the communications.[38] Also, in *Rose v. State,*[39] a libel action which arose out

36 REV. CODE OF WASH. ch. 9.58, § .070 (1956).
37 OPS. ATT'Y GEN. No. 53-57-ESC (1953), 2 CCH UNEMP. INS. REP. *Ariz.* ¶ 1670.03 (1958).
38 ARIZ. REV. STAT. ANN. § 13-355 (1956).
39 54 Ariz. 396, 96 P.2d 285 (1939).

of an affidavit charging a candidate for Governor with having hired people to steal the election, the court refused to extend the doctrine of immunity and found only a qualified privilege, saying:

> A publication is conditionally or qualifiedly privileged where circumstances exist or are reasonably believed by the defendant to exist which cast on him a duty of making a communication to a certain other person to whom he makes such other communication in the performance of such duty or where the person is so situated that it becomes right in the interests of society that he should tell third persons certain facts, which he in *good faith* proceeds to do.[40]

Idaho. One lower court has discussed this problem and has held that as long as the statements made are pertinent to the issue involved, the privilege afforded by the occasion should be an absolute bar to any action for defamation.[41] Investigation reports, which must be submitted to the Commissioner of Insurance, concerning insurance agents are "deemed privileged communications and . . . not . . . admissible in evidence in any court proceeding."[42]

Louisiana. State v. Mills[43] dealt with a criminal prosecution based on information derived from required reports of the Louisiana Unemployment Compensation Act. The court reasoned that since there was no explicit provision of the Act which prohibited the use of the information in court, the recognition of a privilege would be narrowly confined. Although this was not a libel action, it demonstrates that a qualified privilege was the most that could be hoped for.

New Jersey. In *Fenning v. S. G. Holding Corporation,*[44] the court construed a landlord's letter, written to the rent control authority in reply to a tenant's answer, to be libelous *per se* but non-actionable. It reasoned that the realm of absolute privilege extends to quasi-judicial proceedings, *i.e.,* those before boards and commissions.

Pennsylvania. There is a provision which states that in an action for libel a plea of justification shall be accepted as a complete defense when it is proved that the publication is proper for public information and has not been maliciously made (qualified privilege).[45] Yet a lower court, terming proceedings before the Unemployment Compensation Commission as quasi-judicial in character, has held that a report, even though it might be malicious and untrue, will not subject an employer to libel damages for classifying an employee as "mentally sick."[46]

Utah. The Utah Supreme Court in *Mortensen v. Life Insurance Corporation,*[47] although granting damages for libel, because a letter containing defamatory information was not really required by the Insurance Commission, adopted Professor Prosser's approach to the effect that:

> The judicial proceeding to which the immunity attaches has not been defined very exactly. It includes any hearing before a tribunal which performs judicial functions, ex parte or otherwise, and whether the hearing is public or not. It extends to the proceedings of administrative officers, such as boards and commissions, so far as they have powers of discretion in applying the law to the facts which are regarded as judicial or quasi-judicial in character.[48]

40 *Id.* at 288.
41 Moon v. Capital Cleanears (Dist. Ct., 3rd Judicial Dist., Nov. 13, 1939), 3 CCH Unemp. Ins. Rep. *Idaho* ¶ 1670.02 (1958).
42 Idaho Code Ann. § 41-1011(3) (1961).
43 229 La. 758, 86 So.2d 895 (1956).
44 47 N.J. Super. 110, 135 A.2d 346 (1957).
45 Pa. Stat. Ann. tit. 12, § 1582 (1953).
46 Wagner v. Bell (Ct. of Com. Pleas, Oct. 17, 1949), 8 CCH Unemp. Ins. Rep. *Pa.* ¶ 1670.05 (1960).
47 6 Utah 2d 408, 315 P.2d 283 (1957).
48 *Id.* at 284.

Some of the remaining states have enacted statutes providing for immunity in analogous situations. Connecticut holds required factory reports to be inadmissible in evidence.[49] Alaska, Delaware, Iowa, Rhode Island and Wisconsin have clothed the reports made to the Workmen's Compensation Board with an absolute privilege.[50] Indiana and Wyoming have made provisions for the inadmissibility in evidence of required motor vehicle reports.[51]

Conclusion

The fact remains that a large number of states have done nothing to protect an employer from a libel suit in this area. In some states, notably New Jersey[52] and Utah,[53] the courts have taken the initiative and have extended the doctrine of absolute privilege to proceedings before boards and commissions. In the New York cases[54] and in the *United Mills*[55] case, the courts have utilized the confidential nature of the reports to create an immunity from suit. Yet, when eight[56] of the twenty-nine states, which do not grant full protection to the employer in his disclosures to the commissioner, do not even classify the reports as confidential, an employer is placed in a difficult situation; one, it is submitted, that was never intended by the legislatures.

Originally, the tort of defamation was created as a safeguard for one's good name and reputation in the community. The law, however, recognized at the outset that there were certain instances where one should be permitted to publish defamatory matter. Hence, the defense of privilege grew up in response to society's need for information, *e.g.*, the privilege accorded to statements made in judicial proceedings and in the legislatures. In the area with which this article is concerned, the public, through its Unemployment Compensation Boards, in order to make a just determination of benefits, is entitled to know whether an employee has been fired for cause. Since an employer has this information, he, too, should be immune from suit in his disclosures. Since none of this material is published to those outside the commission, what harm does the employee actually suffer? As a matter of fact, there occurs only a "technical" libel for which no redress should be given.

An employer, by stating in a private communication to a governmental commission or board that one of his former employees is "mentally sick" or "dishonest," should not be considered a calumniator, since the public has demanded that reports, including reasons, be filed. The state legislatures should respond with the inclusion of an absolute privilege in their statutes. However, in the absence of legislative activity, the courts should not refuse to protect an employer who is faced with a dilemma, *i.e.*, whether to disclose his information and face a possible defamation suit or whether to refuse to file his report and face a monetary penalty and/or imprisonment. As was said in the *Breuer* case, in granting an absolute privilege, "any other interpretation could well emasculate the Labor Law."[57]

Paul K. Rooney

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49 CONN. GEN. STAT. ANN. § 31-40 (1960).

50 ALASKA COMP. LAWS ANN. § 42-3-67 (Supp. 1959); DEL. CODE ANN. tit. 19, § 2313 (1953); IOWA CODE ANN. § 88.12 (1949); R.I. GEN. LAWS § 28-32-4 (1956); WIS. STAT. ANN. § 102.40 (1957).

51 IND. STAT. ANN. § 47-1920 (1952); WYO. COMP. STAT. ANN. § 31-229 (1959).

52 Fenning v. S. G. Holding Corporation, 47 N.J. Super. 110, 135 A.2d 346 (1957).

53 Mortensen v. Life Insurance Corporation, 6 Utah 2d 408, 315 P.2d 283 (1957).

54 *Supra* notes 10-17.

55 White v. United Mills Co., Inc., 240 Mo. App. 443, 208 S.W.2d 803 (1948).

56 Connecticut, Iowa, Maryland, New Jersey, Pennsylvania, Vermont, Virginia, Wisconsin.

57 Breuer v. Bo-Craft Enterprises, 8 Misc. 2d 736, 170 N.Y.S.2d 631 (Sup. Ct. 1957).