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LEGISLATION AND ADMINISTRATION

A NEW ANTITOXIN TO ADVERTISING ARTIFICE — TELEVISION ADVERTISING AND THE FEDERAL TRADE COMMISSION.

I. Introduction

If you had watched television to any extent during the Fall of 1959, your program may have been interrupted by the burning question: "Who's the man behind the sandpaper mask?"

While these words struck the viewer's ears, the screen beamed the picture of a professional football player whose face was hidden by what appeared to be a sheet of sandpaper. The athlete then pulled the mask away and reached to his face to run his hand across a heavy growth of whiskers. Taking this as his cue to answer the opening question, the unseen announcer declared: "It's triple-threat man, Frank Gifford — backfield sensation of the New York Giants . . . a man with a problem just like yours . . . a beard as tough as sandpaper . . . a beard that needs . . . PALM-OLIVE RAPID SHAVE . . . super-moisturized for the fastest, smoothest shaves possible."

Following this revelation, the commercial proceeded with a demonstration: "To prove RAPID SHAVE'S super-moisturizing power, we put it right from the can onto this tough, dry sandpaper." A close-up shot was focused on an anonymous hand holding a razor that cut a smooth diagonal path through the lather and purported sandpaper. "It was apply . . . soak . . . and off in a stroke." The remaining portion of this 60-second commercial was consumed by the split screen technique, redemonstrating the sandpaper experiment as the football player made a similar razor stroke across his cheek. "In this sandpaper test . . . or on your sandpaper beard, you just apply RAPID SHAVE . . . then take your razor and shave clean with a fast, smooth stroke." The commercial fell from sight with the closing refrain: "RAPID SHAVE outshaves them all. Use RAPID SHAVE in the morning."

This seemingly harmless 60-second selling package was determined to be unfair and deceptive advertising, under section 5 of the Federal Trade Commission Act.¹ It was found that a plexiglas mock-up had been used instead of sandpaper and further that Rapid Shave will not shave actual sandpaper in the manner depicted. On December 29, 1961, the Commission issued the following order to the Colgate-Palmolive Company and its advertising agency, Ted Bates & Company:

Final Order

IT IS ORDERED that respondents Colgate-Palmolive Company, a corporation, and its officers, and Ted Bates & Company Inc., a corporation, and its officers, and the agents, representatives, and employes of respondents, directly or through any corporate or other device, in the advertising, offering for sale, sale, or distribution of shaving cream or any other product, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

Representing, directly or by implication, in describing, explaining or purporting to prove the quality or merits of any product, that pictures, depictions, or demonstrations, either alone or accompanied by oral or written statements, are genuine or accurate representations, depictions, or demonstrations of, or prove the quality or merits of, any product, when such pictures, depictions, or demonstrations are not in fact genuine or accurate representations, depictions or demonstrations of, or do not prove the quality or merits of, any such product.

AND FURTHER, in the advertising, offering for sale, sale, or distribution of "Palmolive Rapid Shave," or any other shaving cream, in commerce, as "commerce" is defined in the Federal Trade Commission Act, from:

Misrepresenting, in any manner, directly or by implication, the quality or merits of any such product.

¹ Section 5, 38 Stat. 719 (1914), as amended by 52 Stat. 115 (1938), 15 U.S.C. § 45 (a) (1) (1958): "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful."

IT IS FURTHER ORDERED that respondents, Colgate-Palmolive Company and Ted Bates & Company, Inc., shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist.²

The above hard-hitting order is typical of the recent position which the FTC has taken toward questionable television advertising. Typical of the furor of the admen who must labor under the new standards that the FTC is developing is the following comment: "With this precedent upheld by the courts, *creative* advertising, *imaginative* advertising, *mind-stimulating* advertising, is gone for good."³

The role which the FTC wishes to play in the advertising field has been indicated by its new director, Mr. Paul Rand Dixon. Answering Senator Norris Cotton's questions before the Committee on Interstate and Foreign Commerce concerning his nomination to the chairmanship, he said that, with respect to advertising, the Federal Trade Commission has its fullest responsibility. False advertising both hurts the consumer and is a means to control the market:

A false advertisement is an excellent tool of monopoly, you see, just like price discrimination. If I tell a lie about my product, I take advantage of you, my competitor, who tells the truth. If I continue, this may acquire a monopoly in the market, a substantial share of the market.

Not only does it have that effect on competition, but it influences the public who may believe it and buy, and it not be true. This is one area that the FTC must be vigilant and do everything that it can, using all of its imagination and all of its tools to wipe this out. And it must be done in accordance with the law, and not in accordance with somebody's social idea, if I understand your question, what some man may desire should be the law or socially desirable.⁴

This is Chairman Dixon's policy. This article is to be concerned with the particularization of that policy in the area of television advertising.

Combining the twin assets of audio and visual representation, television advertising creates new problems of deception and misrepresentation which the FTC must meet and for which it must fashion rules. Of particular interest is the practice of attempting to prove some superiority or desirable quality of a product by means of a demonstration or test pictured on the television screen. The Commission has attacked some of these demonstrations on two points: "(1) charging that the superiority claimed does not exist, and (2) charging that the demonstration does not prove what it purports to prove."⁵ The objective here is to examine these problem areas and to determine how the FTC is meeting them.

II. Section 5 of the Federal Trade Commission Act as Applied to False and Deceptive Advertising

Section 5 (a) (1) of the Act declares: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful."⁶ This general language is the source to which the FTC must look for its power to proceed against questionable television commercials, as well as all false and deceptive advertising.

Perhaps it would be beneficial to pause for a moment in order to pick up the threads of case development under this section. Although the authority was given to the FTC in 1915, it was not until 1922 that it became clear that this power over

² Colgate-Palmolive Company and Ted Bates & Company, Inc., No. 7736, FTC Final Order, Dec. 29, 1961. (Emphasis added.)

³ "Couchman: Mask Was a Metaphor," *Printers' Ink*, Feb. 2, 1962, p. 57, col. 2.

⁴ *Hearings Before the Committee on Interstate and Foreign Commerce, U. S. Senate on Nominations*, 87th Cong., 1st Sess. 40-41 (1961).

⁵ 2 TRADE REG. REP. ¶ 7805 (1961).

⁶ Section 5, 38 Stat. 719 (1914), as amended by 52 Stat. 115 (1938), 15 U.S.C. § 45 (a) (1) (1958). The 1914 version read simply: "That unfair methods of competition in commerce are hereby declared unlawful."

unfair trade practices included the right to control advertising. In that year, an order forbidding misbranding was sustained by the Supreme Court in the *FTC v. Winsted Hosiery Co.* case.⁷ This opened the door for what has come to be a most important phase of the Commission's work.

However, the path was not yet entirely cleared for effective FTC coverage. In 1931, Mr. Justice Sutherland, speaking for the Court, ruled that deceptive advertisement of an obesity cure could not be deemed an unfair method of competition, where there was no evidence of injury to honest competitors.⁸ "Under that ruling a company with monopoly was immune from attack and the Commission could take no action in any industry in which misrepresentation was rife and there were no honest advertisers."⁹ It was not until the enactment of the Wheeler-Lea Amendment¹⁰ some seven years later that this limitation was overcome. "To make the consumer of equal concern under the law with the man who is engaged in commerce,"¹¹ the new language, "and unfair or deceptive acts or practices in commerce," was added. Of course, the ingredient of interstate commerce must be present to establish jurisdiction of the federal agency.

Another obstacle in the FTC's path was introduced by the Supreme Court's decision in *FTC v. Gratz*.¹² There, Mr. Justice McReynolds asserted: "The words 'unfair method of competition' are not defined by the statute, and their exact meaning is in dispute. It is for the courts, not the commission, ultimately to determine as a matter of law what they include."¹³ But the Court withdrew from this position in two 1934 decisions,¹⁴ delivered by Justices Cardozo and Stone respectively. One of the clearer statements of this 1934 stand by the Court, which is the present attitude, was offered by Chief Judge Duffy of the Seventh Circuit: "The meaning of advertisements or other representations to the public, and their tendency or capacity to mislead or deceive, are questions of fact to be determined by the Commission and should be upheld by a reviewing court unless arbitrary or clearly wrong."¹⁵

What are the general factors which determine whether an advertisement is unfair? Several have been developed through FTC case law. The doctrine of *caveat emptor* was buried in 1937. "The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced."¹⁶ Nor does the fact that the misrepresentation has become widespread or commonplace necessarily prevent a finding of unfair trade practice.¹⁷

It is the entirety of the representation that must be considered. "Advertisements which are capable of two meanings, one of which is false, are misleading."¹⁸ Further, knowledge of the deception on the part of the advertiser is not essential, for its effect on the public and competition is the same regardless.¹⁹

The above factors are concerned with *false* representation; there remains to be considered the principles determinative of *misleading* representations. Here, it is

7 258 U.S. 483 (1922).

8 *FTC v. Raladam Co.*, 283 U.S. 643 (1931).

9 HANDLER, *TRADE REGULATIONS* 1010 (3d ed. 1960).

10 52 Stat. 111 (1938).

11 83 CONG. REC. 397 (1938). (Remarks of Mr. Reece of Tennessee before the House of Representatives.)

12 253 U.S. 421 (1920).

13 *Id.* at 427.

14 *FTC v. Algoma Lumber Co.*, 291 U.S. 67 (1934); *FTC v. R. F. Keppel & Bros. Inc.*, 291 U.S. 305 (1934).

15 *Kalwajtys v. FTC*, 237 F.2d 654, 656 (7th Cir. 1956), *cert. denied* 352 U.S. 1025 (1957).

16 *FTC v. Standard Education Society*, 302 U.S. 112, 116 (1937).

17 *FTC v. Winsted Co.*, 258 U.S. 483, 493 (1922).

18 *Rhodes Pharmacal Co. v. FTC*, 208 F.2d 382, 387 (7th Cir. 1953).

19 *Gimbel Bros. Inc. v. FTC*, 116 F.2d 578, 579 (2d Cir. 1941).

found that actual deception is not essential;²⁰ the capacity or tendency to deceive,²¹ the "fair probability"²² is sufficient. Nor can literal truth be offered as a defense. "A statement may be deceptive even if the constituent words may be literally or technically construed so as to not constitute a misrepresentation. . . . The buying public does not weigh each word in an advertisement or a representation."²³ Moreover, section 5 does not require an intent to deceive.²⁴

Questions of "puffing" have always been a burden to the courts; each case must be judged according to its own peculiar fact situation. Generally, however, for the purposes of the FTC, puffing means "an expression of opinion not made as a representation of fact. . . . While a seller has some latitude in 'puffing' his goods, he is not authorized to misrepresent them or to assign them benefits or virtues they do not possess."²⁵

It may be surprising to note that, in the case of *Ford Motor Co. v. FTC*, it was held that there was no need to demonstrate that damage to a purchaser or competitor had resulted from the offense under complaint: "The Federal Trade Commission Act was intended to afford a preventative remedy, not a compensatory one. . . ."²⁶ In fact, discontinuance of the unfair trade practice normally will not nullify the Commission's cease and desist order, since there is no assurance of permanent discontinuance.²⁷

These are the most salient generalizations which the FTC has developed in its assault against false and misleading advertising; it is by no means exhaustive. There is yet to determine the standard against which questionable advertising is measured. District Judge Lindley, with a lyrical allusion, finds:

The law is not made for experts but to protect the public, — that vast multitude which includes the ignorant, the unthinking and the credulous, who, in making purchases, do not stop to analyze but too often are governed by appearances and general impressions. . . . If the Commission, having discretion to deal with these matters, thinks it best to insist on a form of advertising clear enough so that in the words of the prophet Isaiah, "way-faring men, though fools, shall not err therein," it is not for the courts to revise its judgment. Advertisements are intended not "to be carefully dissected with a dictionary at hand, but rather to produce an impression upon" prospective purchasers.²⁸

"How alien to the colorful conditions of the market place is the legalistic and artificial concept of the 'reasonable man'!"²⁹ Perhaps, it is only the fool who believes everything he reads, but this, the FTC feels, is sufficient justification for it to assert its power. Professor Milton Handler of Columbia University points up the perplexing problem facing the agency quite well: "The skillful advertiser can mislead the consumer without misstating a single fact. The shrewd use of exaggeration, innuendo, ambiguity and half truth is more efficacious from the advertiser's standpoint

20 *FTC v. Balme*, 23 F.2d 615, 621 (2d Cir. 1928), cert. denied 277 U.S. 596 (1928).

21 *Charles of the Ritz Distributors Corp. v. FTC*, 143 F.2d 676, 680 (2d Cir. 1944).

22 *Herzfeld v. FTC*, 140 F.2d 207, 208 (2d Cir. 1944).

23 *Kalwajts v. FTC*, 237 F.2d 654, 656 (7th Cir. 1956).

24 *FTC v. Balme*, 23 F.2d 615, 621 (2d Cir. 1928).

25 *Gulf Oil Corp. v. FTC*, 150 F.2d 106, 109 (5th Cir. 1945).

26 120 F.2d 175, 182 (6th Cir. 1941), cert. denied 314 U.S. 668 (1941).

27 *FTC v. Goodyear Tire & Rubber Company*, 304 U.S. 257, 260 (1938); *National Silver Co. v. FTC*, 88 F.2d 425, 428 (2d Cir. 1937). The Commission itself has articulated this principle very well; in *Argus Cameras, Inc.*, 51 F.T.C. 405, 409 (1954) it stated:

Dismissal of a complaint in cases of this general character is not the usual procedure. It should not be done unless there is a clear showing of unusual circumstances which in the interest of justice require it. Those circumstances exist in this case. Respondent has shown its good faith by both word and deed. That fact has an important bearing on the likelihood of the practices complained of being resumed in the future.

Respondent had voluntarily discontinued the practices involved and had been cooperative at all times.

28 *Aronberg v. FTC*, 132 F.2d 165, 167 (7th Cir. 1943).

29 *HANDLER, TRADE REGULATIONS* 981 (3d ed. 1960).

than factual assertions. Facts are dull and dangerous; exaggerations are vivid, attractive and privileged."³⁰

III. Zeroing in on Television Advertising

1. Television, a Unique Advertising Medium

Televised advertisement is unique. It is a breed of its own. Television itself has inherited all the advantages of radio and perfected its own dominant characteristic of visual representation. Combining sight, sound, and motion, its advertising approximates face-to-face selling. It reaches the home, which permits effective selling to both the individual and the family group. Moreover, television seizes attention, enabling the advertiser to exploit the viewer's addiction by repeating its message again and again.³¹

Here is another point, concerning advertising in general, that is made by Rosser Reeves, the chairman of the board at Ted Bates & Company. He offers an advertising principle and then elaborates:

The consumer tends to remember just one thing from an advertisement — one strong claim, or one strong concept.

The advertisement may have said five, ten, or fifteen things, but the consumer will tend to pick out just one, or else, in a fumbling, confused way, he tries to fuse them together into a concept of his own.

Reality campaigns, those that climb the ladder of penetration with the most speed, do not put the consumer in this predicament. Instead, they gather their energies together into a tight coil. They present him with one moving claim or concept which he can easily remember.³²

Think of this principle in terms of the unique advantages which television possesses as an advertising medium. To appreciate its force, consider how effectively television's hammer helped forge these strong claims or concepts: The Marlboro Man and Tattoo; "Where there's life, there's Bud"; "See the U.S.A. in your Chevrolet"; "Have a real Cigarette, have a Camel"; Brylcreem's "A little dab will do ya, use two only if you dare"; Hallmark's "When you care enough to send the very best."³³

This is the communication system which the Federal Trade Commission has recently joined its relative, the Federal Communications Commission, in scrutinizing.

2. Recent FTC Activity Against Deceptive Television Commercials

Prior to November of 1959, the FTC investigated a television commercial only when the script indicated possible violation of section 5 of the Act or when a complaint was received from a competitor of the commercial's advertiser. This activity was frequently haphazard and often without effect. However, in 1959, the Federal Communications Commission's investigation of the "TV quiz show scandal" spurred complaints concerning video representations occurring between the programs. FTC's Chairman, Earl W. Kintner, reported that the public had complained that too many commercials "exaggerate, irritate and nauseate."³⁴ On November 2, 1959, Mr. Kintner launched a major drive against spurious commercials: "Instead of the present system of selective monitoring of TV 'commercials,' all national television networks are to be monitored throughout the time they are on the air. Any advertising of doubtful integrity will be investigated on a priority basis, with the scope of the investigation to reach all those responsible for the deception."³⁵ Special scrutiny was given to the pre-Christmas period of November 15 to December 15 of that year. Further, it was revealed by the Commission Chairman that there were 53 investi-

30 Handler, *The Control of False Advertising Under the Wheeler-Lea Act*, 6 LAW & CONTEMP. PROB. 91, 99-100. (1939).

31 SEEHAFFER & LAEMMAR, SUCCESSFUL TELEVISION AND RADIO ADVERTISING 15, 18 (1959).

32 REEVES, REALITY IN ADVERTISING 34-35 (1961).

33 This idea was borrowed from Reeves, *supra* note 32 at 36.

34 Mr. Kintner's statement as it appeared in FTC News Summary, No. 59, Nov. 4, 1959.

35 *Ibid.*

gations under way at that time, and that since July, 1958, 18 complaints and 11 orders had been issued. At the same time, the broadcasting industry was asked to recognize its responsibility to guard against bad taste in advertising.

Activity since November, 1959, has indeed been intensive, but the FTC's sluggishness has made case law conspicuously absent. Attention must be focused on the Commission's complaints and orders in order to attempt an understanding of the agency's position on false and misleading television commercials.

These complaints and orders fall roughly into two categories of wrongs.³⁶ The first includes demonstrations which purport to prove something which they do not prove. The other includes television representations prohibited chiefly because of the false implications and inferences created in the viewer's mind.

On December 11, 1959, a complaint was issued against Brown & Williamson Tobacco Corporation and its advertising agency, Ted Bates & Company, charging the pictorial demonstrations of Life cigarette's "millecel super-filter's" ability to absorb tar or nicotine did not prove what it purported to prove. The demonstrations consisted of the pouring of liquid into two tubes, one of which contained Life's filter and the other contained another cigarette's filter. The announcer wondering which is best, exclaimed: "Look! The other filter fails . . . lets drops through. LIFE'S filter absorbs them. Compare! See proof how LIFE gives least tar and nicotine." The complaint alleged there was no correlation between the liquid used and cigarette tar and nicotine. The case terminated in a consent decree: respondents, though not admitting they had violated the law, agreed to discontinue the demonstrations.³⁷

"Super-Strength Alcoa Wrap" aluminum foil lost some of its virility when the FTC went after a comparative test with "ordinary wrap" early in 1960. The commercial showed two hams side by side. The one held by "ordinary wrap" was dried out and its foil was tattered, while the other ham, dressed in "Super-Strength," was fresh looking and the foil was in fine condition. The complaint alleged that the "ordinary wrap" had been deliberately torn and severely wrinkled, and that the ham protected by the worn wrap had been aged longer than the ham covered by Alcoa's product. The companies involved consented to cease and desist from purporting to demonstrate Alcoa wrap's properties in preserving food or its strength and durability, when such proof was not actually shown.³⁸

Perhaps, the reader recalls viewing then-heavyweight boxing champion, Ingemar Johansson, and announcer, Bud Palmer, perform the "boxing glove test" with a Schick safety razor. First, an "old style round head" razor was run across the skin of a glove worn by Johansson, cutting the surface. Palmer declared: "Look! If that can happen to this glove, think what could happen to your face." Johansson replied, "No thanks!" But picking up the Schick razor, Palmer continued, "SCHICK shields blade corners," and after running it across the glove without a scratch, he found "no danger of nicks or scrapes." The Commission's complaint alleged: "The said demonstration and the statements and representations used in connection therewith are false, misleading and deceptive. In truth and in fact, said demonstration is not a valid portrayal of any danger in actual use of competitive so-called round head razors since said demonstration does not duplicate, in any manner, the conditions of actual use."³⁹ An order to cease and desist was subsequently issued⁴⁰ and consented to on August 9, 1960.

36 The delineation of these two categories is suggested by 2 TRADE REG. REP. ¶¶ 7805.77 and 7805.84 (1961).

37 Brown & Williamson Tobacco Corp. and Ted Bates & Co., Inc., No. 7688, FTC Consent Order, March 21, 1960.

38 Aluminum Co. of America, Wear-Ever Aluminum, Inc. and Ketchum, MacLeod & Grove Co., Inc., No. 7735, FTC Consent Order, March 20, 1961.

39 Eversharp, Inc., No. 7811, FTC Complaint, para. 7, March 10, 1960.

40 Eversharp, Inc., No. 7811, FTC Consent Order, Sept. 30, 1960.

Concerning another complaint issued early in 1960,⁴¹ Lever Brothers Company and Foote, Cone and Belding advertising agency denied the charge of using deceptive television commercials for Pepsodent toothpaste. A lab technician informed the television audience: "This is a cigarette smoking machine. It deposits yellow smoke stain on the enamel like the hard surface of your teeth." The video portion then showed him brushing Pepsodent across the stain, rinsing it with water, and indicating the clear area. "See? The smoke stain is gone where we used PEPSODENT. Yes, PEPSODENT removes even yellow smoke stain, perhaps the hardest of all stains to remove. In fact, PEPSODENT cleans your teeth more effectively." The FTC charged that the demonstration purports to prove that Pepsodent toothpaste is effective in removing tobacco stains from the teeth of all smokers. Respondents, denying that any such connotation may be drawn from the commercial, asked for dismissal. In February, 1962, Examiner Hinkes ruled in an initial decision that these commercials were not deceptive and issued an order which would dismiss the complaint. He first distinguished the *Rapid Shave* case (discussed below) on the ground that there was no concealment of the nature of the test here; all parts of the demonstration were found to be accurately represented. He then asserted that these commercials could not be construed to represent that Pepsodent toothpaste will remove accumulated stain from the teeth of habitual smokers. "At most, these are demonstrations of Pepsodent toothpaste's ability to clean recently deposited smoke stains from clean surfaces. The surface of the glass plate used in the commercial, although different in many respects from the surface of a living tooth, is sufficiently like a living tooth surface to render the demonstration valid in all material respects."⁴²

The second area of categorization concerns those representations giving rise to deceptive implications. During the pre-1959 era, the Commission handed down two noteworthy decisions indicating its line of attack. In *Lanolin Plus Inc.*,⁴³ it knocked down a hair shampoo commercial for its use of scare tactics and disparagement of competitors' products. The television sequence showed a model, applying a competitive product and becoming frightened at the announcer's remarks: "Stop! Don't burn your hair . . . with harsh, detergent shampoos." And in the case of *American Chicle Co.*,⁴⁴ it was determined that the manufacturers of Roloids shall cease and desist from any advertisement that represents: "By the use of a white coat or any other object, device, or words indicative of the medical profession, that doctors or the medical profession recommend Roloids, unless the representation is limited to numbers of doctors not greater than has been ascertained to be the fact."⁴⁵ In other words, a man wearing a white coat in the context of a commercial that implied he was a member of the medical profession had to be just that. *Printers' Ink*, an advertising trade magazine, speculated that "advertisers may be able to get around the ban by using lab technicians."⁴⁶

On October 30, 1959 the FTC issued charges against Libbey-Owens-Ford Glass Company and General Motors Company for inaccurately comparing the optical distortion of automobile safety sheet glass to that of safety plate glass:

The pictures and depictions, displayed in the aforesaid representations, are not accurate demonstrations of perceptible disparity, between the optical distortion of automobile safety plate glass and automobile safety sheet glass, under ordinary conditions of use, because the photographic techniques and devices, used in making such pictures, were designed to exaggerate the distortion inherent in automobile safety sheet glass and minimize the distortion inherent in automobile safety plate glass. As for example, in one sequence

⁴¹ Lever Bros. Co. and Foote, Cone and Belding, No. 7747, FTC Complaint, Jan. 13, 1960.

⁴² Lever Bros. Co., No. 7747, FTC Initial Decision, as quoted in FTC News Summary, No. 13, Feb. 26, 1962.

⁴³ *Lanolin Plus, Inc.*, 54 F.T.C. 446 (1957).

⁴⁴ 54 F.T.C. 1625 (1958).

⁴⁵ *Id.* at 1627.

⁴⁶ *Printers' Ink*, June 27, 1958, p. 13, col. 2.

of pictures, represented as showing the disparity between the optical distortion of safety sheet glass and safety plate glass, different camera lenses were used, resulting in an inaccurate demonstration of such comparative distortion and in another sequence of pictures, the picture, purportedly taken through an automobile safety plate glass window, was actually taken through an open window, i.e. with the automobile window rolled down.⁴⁷

This case still awaits determination by the Commission.

Between December, 1959, and February, 1960, a 60-second commercial interestingly compared Rise shaving cream with "brand X." The televised sequence first pictured an actor shaving with what was claimed to be ordinary shaving cream lather. It disappeared quickly, drying out on his face shortly after application. Naturally, this caused the actor to wince while attempting to shave. But in fact, the competing substance was composed of 90 percent H₂O and 10 percent "ultra-wet 60L," a foaming agent, placed in a can under pressure. "This mixture resembling shaving cream did not contain any soaps or fatty acid salts usually found in shaving cream lathers."⁴⁸ (These ingredients prevent the substance from breaking down.) In the next sequence, the actor is shown shaving comfortably with Rise, which "keeps your whiskers wet and soft all through your shave — gives you closer, more comfortable shaves." Examiner Poindexter rejected respondents' contention that they used the simulated shaving lather in the filmed commercials because of technical photographic problems. His opinion offers a glimpse at the FTC's policy toward mock-ups, those models or product look-alikes which are employed as stand-ins for the actual product for one reason or another:

Reasonable latitude is and should be granted to advertisers and advertising agencies in the use of "make-up" where necessary to meet the technical requirements of photography. However, this is not a license to misrepresent the truth as to a material fact. It is undisputed that respondents used "Rise" shaving lather in the television commercials complained about. If respondents could successfully photograph "Rise" shaving lather, they could also successfully photograph a competing or competing shaving lathers. Representatives of respondents testified that their reason for using the specially prepared substance which resembled shaving cream but contained ingredients which caused it to disappear and dry up considerably faster than ordinary shaving cream was to dramatize the difference between "Rise" and "ordinary" lathers. Even so, it was not necessary to prepare and use a phony substance resembling shaving cream and represent this to the public as a competing shaving cream, inferior to "Rise."⁴⁹

The initial decision was issued during August of 1961 with leave to appeal, stay, or docket for review. The case is still pending. However, it is interesting to compare Examiner Poindexter's view of mock-ups with that of Commissioner Elman in the *Rapid Shave* case, considered below.

A third shaving cream case involved Mennen's Sof Stroke. This resulted in a consent settlement in May, 1961.⁵⁰ The inevitable attention-getting question was asked: "Mister, do you wet your face before shaving?" Simultaneously, a skindiver with an appropriately heavy beard leaped into the waters of Silver Springs, Florida. Under water, he first demonstrated how competing aerosol shaving creams quickly dissipated in his hand, while Sof Stroke held up, allowing him to lather his beard. The FTC alleged that the Mennen product was actually a mixture of toothpaste and shaving cream and that the diver cupped his hand to a lesser degree in discharging the competing brand. Perhaps the Commission should have allowed Rapid Shave, Rise, and Sof Stroke to continue their demonstrations against each other; even more interesting tests and claims may have resulted as the competition thickened.

47 Libbey-Owens-Ford Glass Co. and General Motors Co., No. 7643, FTC Complaint, para. 7 (1), Oct. 30, 1959.

48 Carter Products, Inc. and Sullivan, Stauffer, Colwell & Bayles, Inc., No. 7943, FTC Initial Decision, p. 4, Aug. 30, 1961.

49 *Id.*, pp. 5-6.

50 The Mennen Company, No. 8146, FTC Consent Order, May 4, 1961.

A final order of the FTC pierced Colgate-Palmolive's "protective shield" on March 9, 1961. Colgate's dental cream with "Gardol" had been depicted as placing an invisible shield of protection around teeth similar to the invisible shield behind which the announcer stood as it deflected balls and coconuts propelled in his direction. Commissioner Kern declared:

The hearing examiner found that the representation alleged in the complaint was conveyed by means of "visual innuendo." However, we do not find it necessary to rely on an innuendo to establish the existence of the alleged representation in this case. The audio portion of the commercial specifically claims that Colgate's with Gardol forms an invisible protective shield around the teeth and states that this protection is the same as that afforded the announcer by the invisible shield in the commercial. The picture accompanying this statement plainly shows that the announcer was completely protected. The fact that the shield is not visible in the commercial is obviously respondent's method of indicating the *manner* in which Colgate's with Gardol works, which is not at issue in this proceeding.⁵¹

Most recently the Commission has issued complaints on the "fastest relief of pain" claims which have been placed on television by leading analgesic firms. Specifically, there are these advertising claims: Anacin with its combination of ingredients "for fast . . . fast . . . fast relief";⁵² "Bayer is ready to go to work *instantly*, for the fastest pain relief you can get";⁵³ "Bufferin works twice as fast as aspirin for millions, thanks to its exclusive *Speed* Ingredient *Di-Alminate*."⁵⁴ The FTC contends that, in reality, there is no significant difference in the rate of speed with which these preparations relieve pain. It is saying, "Prove it!"

This scattered survey attempts to focus on the direction in which the FTC is moving concerning television advertisements. But there is little, if any, authoritative precedent established, for a great many of the cases examined were either settled by consent agreement or are still pending. Yet, they do indicate the types of television commercial practices which the Commission believes to be unfair. It seems fairly clear that demonstrations which purport to prove something which they do not prove are unfair trade practices. There is no difficulty in accepting the proposition that false claims are unfair. However, it is uphill work to discern clear guidelines in the area of "deceptive implication."

For the moment, let us accept the conclusions that *Printers' Ink* made from a discussion between the Association of National Advertisers and then-FTC Chairman Kintner during November, 1959. *Printers' Ink*, at that time, observed that there are three categories of device or prop employment in television advertising:

Theatrical or technical devices to make a product seem to perform on the TV screen as it actually would if viewed through the naked eye under normal conditions of advertising.

Contrived effects to present the product as attractively as possible such as some "cosmetic glorification."

Devices employed in a way to imply properties or performance characteristics for the product which it does not possess and which are of sufficient importance to be likely to affect the decision to purchase.⁵⁵

It concluded that only the third category would be suspect.

There remains to consider one important case before the Commission.

51 Colgate-Palmolive Company, No. 7660, Opinion of the Commission, pp. 2-3, July 14, 1960.

52 American Home Products Corp., No. 8318, FTC Complaint, March 14, 1961.

53 Sterling Drug, Inc., No. 8321, FTC Complaint, March 14, 1961.

54 Bristol-Myers Co., No. 8319, FTC Complaint, March 14, 1961, as amended July 25, 1961. One other drug company was involved in these series of complaints, but it did not use any of the questioned advertisements over television: Plough, Inc., No. 8320, FTC Complaint, March 14, 1961.

55 *Printers' Ink*, Nov. 27, 1959, p. 16, col. 2.

IV. *The Rapid Shave Case*⁵⁶

No doubt the best insight into the FTC's position on this problem to date lies in the *Rapid Shave* case. In a unanimous opinion of the five Commissioners, the agency sharpened its attack against television commercials. There are two points of primary interest which this decision calls to attention. First, Commissioner Philip Elman gives a great deal of consideration to the use of mock-ups and television's so-called technical difficulties. Second, the order itself is notable for its toughness and broad scope.

1. *The Use of the Mock-up*

The reader will recall that instead of sandpaper a simulated plexiglas sheet was used for Colgate's Rapid Shave test. The sandpaper appearance was effected by spreading a coat of jelly-like substance onto the sheet and then sprinkling this with sand. Examiner William Pack, dismissing the FTC's complaint in the initial decision, excused the use of the mock-up:

There appear to be several reasons why it was not feasible to use sandpaper. One reason doubtless was that the length of the commercials — 60-seconds — was not adequate for sandpaper to be soaked to the point where it could be shaved cleanly. Aside from this, however, there were technical difficulties peculiar to television. When placed under a television camera, sandpaper appears to be nothing more than plain, colored paper; the texture or grain of the sandpaper is not shown. Thus it is necessary to improvise — use a mock-up — if what is seen by the television audience is to have the appearance of sandpaper.⁵⁷

The examiner makes a good point. But the point of difficulty here is the meaning of the word, "soak," as used in the audio portion of the commercial: "It was apply . . . soak . . . and off in a stroke." By expert testimony the FTC established that the grade sandpaper most closely resembling the mock-up was "extra coarse." Moreover, this type of sandpaper cannot successfully be shaved immediately after application of Rapid Shave, despite its "super-moisturizing power," nor can it be cleanly shaved after an hour's soaking. However, Commission's Exhibit No. 11 gave evidence that "fine" grade sandpaper could be shaved clean after an hour of saturation. Arguing that "literalness cannot be demanded in television commercials because of the very nature of the medium," respondent Bates submitted that "proper use of formula 'Apply . . . soak . . . and off in a stroke' results in the same cleanly shaved swath on sandpaper as on the mock-up."⁵⁸ In fact, after appropriate soaking time any grade of sandpaper can be shaved with a single stroke. Both respondents point to the definition of the word, "soak," as meaning "to wet thoroughly; to saturate, to drench." They further argue that a 60-second commercial necessitates compression of words and images. By considering the audio portion in conjunction with the video, it is submitted that the word, "soak," naturally conveys to the listener a passing of time. This argument did not move the Commission. Noting that the formula was spoken at a normal rate of speed with no "fade" or "dissolve," or other visual indication of time between "apply," "soak," and "off in a stroke," Commissioner Elman reported:

The Commission observed these commercials with an educated eye, forewarned that, from respondents' standpoint, "soak" was a key word in the announcer's spiel. Even so, the word failed to convey to us the impression that respondents' counsel urged for it. How much less a flag of caution must it have been to the uninitiated, gazing at their sets perhaps casually or distracted by other household activities. In these television commercials the pictorial demonstration was the thing, and the net effect of the spoken commentary was to accentuate rather than detract from it.⁵⁹

⁵⁶ Colgate-Palmolive Company and Ted Bates & Company, Inc., No. 7736, Opinion of the Commission, Dec. 29, 1961.

⁵⁷ Rapid Shave case, Initial Decision, p. 4, May 29, 1961.

⁵⁸ Brief for Respondent Bates, p. 11.

⁵⁹ Opinion of the Commission, *supra* note 56, at 8-9.

In the initial decision, the examiner, asking whether there was any material misrepresentation of the product, found in the negative:

The shaving cream does possess at least adequate moistening or wetting properties, and sandpaper can be shaved through use of the product, provided adequate time for soaking is allowed.

Essentially, what is presented here would appear to be little or nothing more than a case of harmless exaggeration or puffing. Obviously, the sandpaper sequences were employed simply for the purpose of emphasizing and dramatizing the recognized moistening or wetting properties of the cream. It is difficult to believe that anyone could have been misled as to the properties or qualities of the product.⁶⁰

Commissioner Elman flatly rejects this position. Relying on the comment of *Gulf Oil Corp. v. FTC*,⁶¹ that, although there is some latitude in puffing, the seller cannot assign his product benefits it does not possess, he declared: "[Respondents] represent, unqualifiedly, that 'Rapid Shave' will dramatically facilitate the shaving of sandpaper and that they were demonstrating this fact before a television audience to prove it. Both of these were factual representations; neither is true."⁶²

Mr. Albert Couchman, who heads up the Couchman Advertising Agency of Dallas, Texas, proposes an interesting argument. He contends that the mask was a metaphor.

No one at Ted Bates, no one at Colgate, ever had the slightest thought of selling Rapid-Shave for the purpose of scraping off sandpaper. The sandpaper — or whatever sanded surface was used — was clearly, plainly, remote from the purpose of the product.

No viewer could possibly gain the impression from that commercial that Rapid-Shave was for any other purpose than to help get a tough beard off a man's face. How many generations of rugged males have stroked a bristled chin and said, "Rough as sandpaper!" How many generations of wives and sweethearts have said the same thing — silently or aloud — in the self-same words?

What the sandpaper gimmick in the commercial did — and the only thing it did — was to dramatize this metaphor; to bring to life this simple, common pictorial phrase.

Who was deceived?

Who could possibly have gained any impression from the commercial, except that Rapid-Shave makes it easy to shave the beard which is "as rough as sandpaper?"⁶³

Counsel for the FTC counters in its appeal brief:

The wetting or moistening properties of a shaving cream is of utmost importance to the users thereof because these are the properties of a shaving cream that soften the whiskers, enabling one to shave with ease and comfort. Being aware of this, respondents herein have sought, by means of television commercials, to demonstrate to the viewing and purchasing public, this quality of Rapid-Shave. First they liken a heavy beard to sandpaper by saying that the beards of certain individuals are "as tough as sandpaper" and that they need "Palmolive Rapid Shave . . . super-moisturized for the fastest smoothest shaves possible." Apparently feeling the mere assertion of the quality of the product was not sufficiently convincing, respondents proceed to attempt to demonstrate this quality, to prove it by means of visual demonstrations. By these demonstrations they convey the impression that Rapid Shave has such excellent wetting or moistening properties that one can shave a very coarse "tough" piece of sandpaper as easily and as quickly as he can shave his face.⁶⁴

The point is that this was *deception*. The fact that no one will buy Rapid Shave to scrape sandpaper is beside the point. In this regard, the Commission's opinion finds support in the holding of *L. & C. Mayers Co. v. FTC*, that "It is not necessary that the product so misrepresented be inferior or harmful to the public; it is sufficient that the sale of the product be other than as represented."⁶⁵ The difference

60 Initial Decision, *supra* note 57, at 3-4.

61 150 F.2d 175, 182 (9th Cir. 1945).

62 Opinion of the Commission, *supra* note 56, at 16-17.

63 *Printers' Ink*, Feb. 2, 1962, p. 56, col. 1.

64 Brief for Appellant, p. 4.

65 97 F.2d 365, 367 (2d Cir. 1938).

between telling and not telling the truth could, in this instance at least, have been the difference between an effective and ineffective 'sell.'⁶⁶

Depart for the moment from the specific holding of the case and look at the broad import that lies within the opinion. Elman did more here than merely decide the Rapid Shave question. Speaking for the Commission, he attempted to disclose the present approach of the FTC toward all types of television commercial practices which it deems deceptive.

The Commissioner meets the problem of advertising artifice in television head-on. He asserts:

As to the asserted technical limitations of the medium, the Commission is inclined to be somewhat skeptical. We doubt that the skills and resources available in television photography, in an industry which has made such striking technological advances in recent years, are as inadequate as they have been portrayed to us by the counsel for respondents. However, assuming it to be the fact that there are indeed such limitations in television photography, the Commission can appreciate that these "technical" difficulties could give rise to problems for sponsors and agencies in determining how most effectively to use television in advertising their products. The limitations of the medium may present a challenge to the creative ingenuity and resourcefulness of copywriters; but surely they could not constitute lawful justification for resort to falsehoods and deception of the public. The argument to the contrary would seem to be based on the wholly untenable assumption that the primary or dominant function of television is to sell goods, and that the Commission should not make any ruling which would impair the ability of sponsors and agencies to use television with maximum effectiveness as a sales or advertising medium.

Stripped of polite verbiage, the argument boils down to this: Where truth and television salesmanship collide, the former must give way to the latter. This is obviously an indefensible proposition. The notion that a sponsor may take liberties with the truth in its television advertising, while advertisers using other media must continue to be truthful, is patent nonsense. The statutory requirements of truth in advertising apply to television no less than to other media of communication. Adherence to the truth should be no more of an impediment to effective advertising in television than in any other medium.⁶⁷

The above, taken together with the finding that, even if the commercial did truthfully describe Rapid Shave's effectiveness, it would still be deceptive "in the manner in which they deliberately misinform the viewer that what he sees being shown is genuine 'tough, dry sandpaper,' rather than a plexiglas mock-up,"⁶⁸ indicates that the FTC will allow no product make-up. This seems to include product glamorization as well as devices reproducing a product in true-to-life fashion. The word, "seems," is used advisedly here, for the opinion is not explicit in this matter. No doubt, if the advertiser adequately forewarns the television viewer that he is not seeing the actual product or its actual performance and sufficiently dispels any false implication that may arise therefrom, his commercial will escape FTC complaint. But, in meeting this demand, the advertiser would sacrifice whatever is to be gained by the use of the device.

Evidently, this has proved to be good administration, inasmuch as television advertisers appear to be dropping the use of artificial stand-ins. As *Advertising Age*, a trade journal, points out: "Film experts said that since the start of the crackdown on questionable tv production devices, producers have discovered, that most products can be photographed properly for tv in their natural state. Some exceptions: Whipped cream, which simply doesn't stay firm or fluffy long enough to take a pretty picture, and gelatin that has to be made double strength for the cameras."⁶⁹ But is this good law? Commissioner Elman responds:

Respondents would have us hold that a television demonstration purport-

66 Opinion of the Commission, *supra* note 56, at 13.

67 *Id.* at 14.

68 *Id.* at 10.

69 *Advertising Age*, Jan. 8, 1962, p. 12, col. 1.

ing to prove the qualities claimed for a product, where the public is told it is seeing one thing when it is actually seeing something different, is nonetheless lawful and not deceptive if in fact the product involved has the qualities claimed for it. This would flout the principle implicit in the multitude of cases which hold that one may not advertise so-called "phony" or dishonest testimonials; or imply an erroneous source or origin for a product; or fail to disclose that a product, although as good as a new one, has, in fact, been reprocessed; or deceive the public into believing that one is in a certain line of business when this is not so. The vice assailed in these cases is the use of a falsification of fact, extrinsic to the objective value of the product, to sell that product, whether or not it may deserve to be bought on its own merits.⁷⁰

Advertising Age further informs the reader that precautions have already been taken. Cakes are no longer made artificially fluffier for television shootings. Before-after demonstrations of detergents which formerly required one day of filming, using two identical articles of clothing, now take an extra day of shooting time so that the clothes can be sent to the laundry. "Such restrictions cost admen more without giving the viewer anything extra."⁷¹

The Commission answers this objection by distinguishing between papier-mâché sets for acting and simulated props for selling:

The set designer is not attempting, through his depiction of the saloon, to sell us a saloon, nor is the actor, sipping at his drink, peddling bourbon. There is a world of difference between a casual display of steaming "coffee" that is really heated red wine (again, because of television's "technical difficulties"), and a commercial showing a closeup of what is actually red wine to the accompaniment of a claim that the high quality of the sponsor's coffee is proved by its rich, dark appearance — which the viewer can verify for himself simply by looking at the "coffee" on the screen. Similarly, an announcer may wear a blue shirt that photographs white; but he may not advertise a soap or detergent's "whitening" qualities by pointing to the "whiteness" of his blue shirt. The difference in all these cases is the time-honored distinction between a misstatement of truth that is material to the inducement of a sale and one that is not.⁷²

If, for example, a cup of red wine may be photographed in place of coffee, where there is no claim to the quality of such coffee by reference to the deep, rich color of the wine, then perhaps, product glorification is not frowned upon by the FTC after all. The opinion is far from clear on this point.

"Slice of life" commercials, *Advertising Age* indicates, should become more prevalent as a result of the agency's restrictive overtures. An example of this technique is showing a pretty, well-coiffured girl simply enjoying herself in pleasant surroundings, with intermittent closeups of her hair style, instead of picturing the girl receiving a permanent or making comparisons with other permanents. Certainly this is more relaxing to the viewer, but one film producer warned of the danger: "Let's just hope they don't go too far with this realism stuff. Next thing you know, models will be out, and we'll have to show the Girl Next Door as ugly as she really is."⁷³

2. *Scope of the Final Order*

Before examining this area, consider briefly Bates' contention that it is merely an agent. "So far as the record is concerned, Bates does not represent Colgate alone; it has other clients as well for whom it performs advertising services; it does not appear that Bates and Colgate are controlled by the same stockholders, or that Bates has any control over the policies and sales activities of Colgate."⁷⁴ The Commission found this a "curious contention. Bates not only carried these commercials to the television networks, it originated the idea for the 'sandpaper tests' in the

70 Opinion of the Commission, *supra* note 56, at 11-12. (Authorities omitted.)

71 *Advertising Age*, Jan. 8, 1962, p. 12, col. 2.

72 Opinion of the Commission, *supra* note 56, at 15.

73 As quoted in *Advertising Age*, Jan. 8, 1962, p. 12, col. 2.

74 Brief for Respondent Bates, p. 18.

first place."⁷⁵ When an agency proposes a campaign, it cannot side-step a subsequent unfavorable reaction by the FTC.

Turning to the order itself, it can immediately be seen that the "for any other product" phrase therein has a broad effect. Any future misrepresentation, directly or by implication, in the description, explanation, or demonstration purporting to prove the quality or merits of any product, can be considered a violation of the order. Such an offense by either respondent company will be summarily handled by a contempt proceeding that carries punishment up to \$5,000 for every day of violation.⁷⁶

Several admen have attacked this order; an editorial comment by *Advertising Age* typifies some of the argument: "If this type of broad order were accepted legally, it can well be seen that a mere handful of similar orders, addressed to a mere handful of advertisers and their agencies, might easily result in placing the whole business in continuing danger of violating old cease and desist orders, as well as the normal danger of having a new one issued in a specific case."⁷⁷ But there is an underlying misunderstanding of the law here. This comment pushes the device of a broad order to an impossible extreme.

First, the Supreme Court has said: "[T]he Commission is not limited to prohibiting the illegal practice in the precise form in which it is found to have existed in the past. If the Commission is to attain the objectives Congress envisioned, it cannot be required to confine its roadblock to the narrow land the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be bypassed with impunity."⁷⁸ On the other hand, "Like injunctions of equity courts, administrative orders must be reasonably related to the findings upon which they rest and must avoid undue breadth."⁷⁹

Following the latter directive, the Commission offers justification for the broad scope of the order:

This case did not come to us vacuum-packed. The violations of law found here cannot be treated as isolated, discrete phenomena. As has already been noted, the problem of deceptive television advertising, although recent in origin, is making its appearance on the Commission's docket with increasing frequency. Although most of the cases have ended in orders based on consent agreements reciting, as is customary, that respondents in no way admit illegality, they nonetheless indicate the prevalence and growing seriousness of the problem. It is a problem with which both respondents have had prior experience.⁸⁰

In fact, the Commission saw fit to limit the scope of the order. Concerning the second paragraph of the order, counsel supporting the complaint wanted, in addition to a ban against false and deceptive depictions and demonstrations as outlined in the first paragraph, a prohibition against *misrepresenting in any manner* the quality or merits of *any product*. This would include misbranding, false claims, or any other type of misrepresentation that can be made, besides spurious demonstrations already condemned, for any product which Colgate may manufacture, sell and advertise on the market and/or the advertising design and promotion of which may be in the Bates account. Commissioner Elman said that "so broad and indefinite a command would be most difficult to obey."⁸¹ He, therefore, narrowed the second paragraph to prohibit the misrepresentation in any manner the quality or merits of Rapid Shave, "or any other shaving cream."

Probably, the best criticism of the order is that of Gilbert Weil, general counsel of the Association of National Advertisers. He pointed out: "To labor under such

75 Opinion of the Commission, *supra* note 56, at 19.

76 Section 14 (a), 52 Stat. 115 (1938), 15 U.S.C. § 54 (a) (1958).

77 *Advertising Age*, Jan. 15, 1962, p. 20, cols. 1 and 2.

78 *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952).

79 DAVIS, 1 ADMINISTRATIVE LAW TREATISE § 8.19 (1958).

80 Opinion of the Commission, *supra* note 56, at 22-23.

81 *Id.* at 24.

an order — which carries up to \$5,000 a day in penalties — is a very burdensome situation. Agencies will almost have to live at their peril. The guidelines are far from clear, and you don't know if you are violating the law or not."⁸² But one must realize that the Commission is operating in a new field of advertising, where abuse can have far-reaching consequences. Despite the lack of clear guidelines, the FTC is obliged to act. The Rapid Shave case appears destined to be the first to go to the United States courts concerning deceptive television advertising;⁸³ it will be interesting to observe whether the courts sharpen the guidelines.

Digressing for a moment, it is noted that a bill has been introduced and referred to the House Committee on Interstate and Foreign Commerce by Messrs. Steed and Patman, which calls for an amendment to the cease and desist power of the Federal Trade Commission. It would amend the Act to provide for the issuance of temporary cease and desist orders to prevent certain acts and practices pending the completion of the Commission's proceedings.⁸⁴

V. Conclusion

*The advertising business urgently needs a new stance. The tide is running against it, and we find our leaders taking the indefensible position that puffery is harmless and deceptive "metaphors" are essential. Could it be that this position encourages the FTC to use a heavy hand and to be intentionally fuzzy over what is spurious?*⁸⁵

In a recent study made for Television Advertising Representatives by Pulse, Inc., there were some noteworthy findings reported. "The women who spend the most money for food and household products also devote the most time to television. The more lavish housewives watch tv approximately 4 3/4 hours daily against three hours for the light spenders and four hours for the average spenders."⁸⁶ Evaluate such statistics as you wish; but the fact remains that television advertising carries powerful influence. With its ability to emphasize and re-emphasize its point both to the audio and visual senses, television's 60-second messages should be viewed with microscopic care to sift out any tendency to deceive. If for no other reason, so that "fools shall not err therein."

Norman E. Matteoni

CORPORATIONS — IN SUPREME COURT'S FIRST INTERPRETATION OF SECTION 16 (b) OF SECURITIES EXCHANGE ACT, PARTNERSHIP ENGAGED IN SECURITIES TRADING DID NOT BECOME A "DIRECTOR" OF CORPORATION BY FACT THAT PARTNER THEREIN WAS CORPORATE DIRECTOR. — The petitioner Blau, a stockholder in Tidewater Associated Oil Company, brought an action in a United States district court on behalf of the company under section 16(b) of the Securities Exchange Act of 1934,¹ to recover, with interest, "short-swing" profits, alleged to have been realized by respondents, Lehman Brothers, in Tidewater securities dealings, and Joseph A. Thomas, a partner of Lehman Brothers, as well as a director of Tidewater. Lehman Brothers is a partnership which deals in investment banking, the brokering of securities, and in securities trading for its own account. Thomas was both partner and director

⁸² As quoted in *Advertising Age*, Jan. 15, 1962, p. 1, col. 5. This argument resembles Mr. Justice Jackson's dissent in *Ruberoid*, 343 U.S. 470, 480 (1952), calling for a "set of yardsticks."

⁸³ Letters from both Mathias F. Correa of Cahill, Gordon, Reindel & Ohl, representing Colgate, and A. Michael Frothingham, senior vice president and secretary for Ted Bates & Company, to the NOTRE DAME LAWYER, Feb. 20, 1962, on file in the Notre Dame Law Library, stated each company intends to petition for review in a United States Court of Appeals before March 5, 1962, the expiration date.

⁸⁴ H.R. 8830 and H.R. 8831, 107 CONG. REC. 15487 (1961).

⁸⁵ *Printers' Ink*, Feb. 2, 1962, p. 57, col. 2. (Emphasis added.)

⁸⁶ *Advertising Age*, Jan. 8, 1962, p. 12, col. 5.

at the time that Lehman Brothers made a large profit through the purchase and sale of stock in Tidewater within a six-month period. *Held*: Neither the partnership, nor the partner Thomas was liable for the total amounts of profits "realized" on the purchase and sale of Tidewater stock within a six-month period. The Supreme Court, in its first interpretation of Section 16(b), held that an investment banking firm may not be judicially regarded as "standing in the shoes of" one of its partners who is on the board of directors of a company, the stock of which is traded in by his investment banking firm. The partner-director, Thomas, was directed to return his proportionate share of the profits earned by Lehman Brothers to the corporation, despite the fact that he had disclaimed any part in the transaction, waived his interest in all potential profits, and gave notice of the activities to the Securities and Exchange Commission. *Blau v. Lehman*, 82 S.Ct. 451 (1962).

The precise issue before the court in *Blau* was whether the provision in section 16(b) of the Securities Exchange Act of 1934, which permits recovery by or on behalf of a corporation of short-swing profits made by an insider, should include profits made by an investment banking firm through its trading in securities issued by a corporation, one of whose directors is also a partner in the investment banking firm.

Section 16(b) of the Securities Exchange Act of 1934² provides, in part:

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter. . . .

In enacting section 16(b), Congress recognized that all transactions by "insiders"³ in their corporation's stock involved a great risk of unfairness,⁴ but allowed such insiders to purchase the stock as a permanent investment so that they could associate themselves with the fortunes of their corporation. What is precluded by section 16(b) is trading in the securities within a six-month period by insiders, the purpose of the section being to minimize the temptation of corporate insiders to profit from advance and confidential information.

In viewing the legislative history of section 16(b), it is to be noted that great difficulty was foreseen in determining the actual use of insider information.⁵ As a result of such problems, a "rule of thumb" was designed legislatively, to recover profits made on the use of inside information. An arbitrary six-month holding time was required by law. Thus, no direct proof of the use of information by insiders was necessary. Profits are recoverable from any purchase and sale or sale and purchase of corporate securities by insiders within six months.

Thomas G. Corcoran, one of the draftsmen of section 16(b) explained the operation of the section during the hearings, when he declared its purpose to be: to prevent directors recovering the benefit of short-term speculative savings on the securities of their own companies, because of inside information. The profit on such transaction under the bill would go to the corporation. You

² *Ibid.*

³ Under § 16, an "insider" is an officer, director, or ten per cent stockholder. See Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385, 397-405.

⁴ 73 HARV. L. REV. 1635 (1960).

⁵ Meeker & Cooney, *The Problem of Definition in Determining Insider Liabilities Under Section 16(b)*, 45 VA. L. REV. 949, 951 (1959).

hold the director, irrespective of any intention or expectation to sell the security within six months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short-swing.⁶

In *Smolowe v. Delendo Corp.*,⁷ liability was imposed by showing that the insider merely had access to information which could lead to abuse because of the insider's relation to the corporation. It was not necessary to prove an actual unfair use of inside information. The holding is supported by *Gratz v. Claughton*⁸ and *Ellerin v. Massachusetts Mut. Life Ins. Co.*⁹

As a result of the legislation, a conclusive presumption was established that an officer, director, or ten per cent stockholder of a listed company has received and used inside information when he purchases and sells or sells and purchases, securities within a six-month period.

There were many corrupt practices which section 16(b) was intended to correct in toto.¹⁰ There were instances where insiders, with advance knowledge of information which would effect a rise in the market price of the stock of their companies, bought stock at the then current market prices and sold it when publication of the information created the rise. Likewise, information would become available to insiders that indicated a depression in the market price of their corporation's stock. Consequently, they would sell at the then current price and repurchase when the stock dipped, upon release of the information to the investing public.

While the legislation was designed to correct corrupt practices on behalf of insiders, it had another important purpose — instilling investor confidence in the stock markets. It was recognized that such confidence could be achieved only when the investors realized that corporate fiduciaries were going to be held to a high degree of responsibility.

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.¹¹

As a result of section 16(b) and its strict enforcement by the courts, much of the incentive for insiders to utilize information secured as a result of their relation to the company to their own advantage has been curtailed.

While section 16(b) carries no criminal liabilities, it does have rather strong remedial consequences.¹² The penalty to the insider is the disgorging of all profits which he makes in violation of the section.¹³ The extent of the fiduciary's liability is determined by the "lowest price in, highest price out" rule, as set out in the *Smolowe* case.¹⁴ The exact procedure is to match, within any six-month period, the lowest priced shares against the highest priced shares, and so on, until all purchases and sales are paired off and to deem the differences to be the profits. The

6 Hearings on Stock Exchange Practices, Senate Committee on Banking & Currency, 73d Cong., 1st Sess., pt. 15, at 6557 (1934).

7 136 F.2d 231 (2d Cir. 1943) cert. denied, 320 U.S. 751 (1943).

8 187 F.2d 46 (2d Cir. 1951), cert. denied, 341 U.S. 920 (1951).

9 167 F. Supp. 71 (S.D.N.Y. 1958), aff'd., 270 F.2d 259 (2d Cir. 1959).

10 Meeker & Cooney, *supra* note 5, at 952.

11 H. Rep. No. 1383 73d Cong., 2d Sess. 13-14 (1934); S. Rep. No. 1455, 73d Cong., 2d Sess. 55-68 (1934).

12 Meeker & Cooney, *supra* note 5, at 957.

13 48 Stat. 896 (1934), 15 U.S.C. § 78p (b) (1958).

14 136 F.2d 231, 239 (2d Cir. 1943), cert. denied, 320 U.S. 751 (1943).

courts have followed the rule set out in *Smolowe* quite strictly. It was there observed that:

[T]he statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, . . . and the faithful performance of his duty.¹⁵

It is of course apparent then that even if good faith motives did exist, and a purchase and sale or sale and purchase was rendered absolutely necessary, the penalty would be only applicable to profits, with the original investment being kept intact.

While section 16(b) serves to restrain officers, directors, and principal stockholders from directing inside information to their own benefit, as well as to instill confidence in the investing public, it also affords protection to bona fide insider investments by virtue of the fact that insiders may make permanent investments in their corporations with impunity, as long as the six-month rule is respected.

Section 16(b) explicitly mentions that officers, directors, and principal stockholders are covered. The 1934 Act itself gives a clear definition of the term "director."¹⁶ He is defined as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated." The Commission under its rule-making power has defined the term in Rule X-3B-2 as follows:¹⁷ "The term 'officer' means a president, vice president, treasurer, secretary, comptroller and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers."

The difficulty in *Blau* arose from the fact that Lehman Brothers was not itself the director, nor an officer, nor the principal stockholder of Tidewater, as determined by the Supreme Court. One of its partners was a director of the company. Attempts were made by petitioner and the Securities and Exchange Commission to prove that, in effect, the partnership was the director and, consequently, could be made to disgorge all profits made on the purchase and sale of Tidewater stock. In a dissent from the Court of Appeals' holding in this case, Judge Clark contended that each partner retains an individual interest in the entire partnership profit and that, consequently, each partner may be said to "realize" the entire profit.¹⁸ The Supreme Court held otherwise.¹⁹ It is suggested that the Supreme Court decision gives only token effect to section 16(b) because it affords investment banking firms the opportunity to use information gained from partners sitting as directors in corporations in whose stock the investment firms trade, contrary to the spirit of that section. In other words, information may readily be exchanged among the partners of the investment banking firm who have been on the boards of different corporations in such a manner as to make it virtually incapable of detection — it is the potentiality of the situation which presents the danger and it is this potentiality which should be avoided. According to *Blau*, the partnership would suffer the loss only of the particular director's share, each loss being small in relation to the probable large profits "realized" from still other short-swing dealings. It appears that the result reached in *Blau* would have a tendency to stimulate insider dealing by investment banking firms.

The Supreme Court affirmed the lower court's finding that "there was no evidence that the firm of Lehman Brothers deputed Thomas to represent its interests as director on the board of Tide water' and that there had been no actual use of inside information, Lehman Brothers having bought its Tide water stock 'solely on the basis of public announcement and without consulting Thomas.'"²⁰ The

15 *Id.* at 239.

16 48 Stat. 883 (1934), 15 U.S.C. § 78c (a) (7) (1958).

17 Securities and Exchange Commission Rules, Rule X-3B-2, 17 CFR 240.3b-2 (1949).

18 286 F.2d 786, 794 (2d Cir. 1960).

19 *Blau v. Lehman*, 82 Sup. Ct. 451 (1962).

20 *Id.* at 453.

reasoning of the majority was based on the holding in *Rattner v. Lehman*,²¹ a case involving substantially similar facts. The majority in *Blau* stated that:

The law is now well settled that the mere fact that a partner in Lehman Brothers was a director of Tide water, at the time the Lehman Brothers had the short swing transaction in the stock of Tide water, is not sufficient to make the partnership liable for the profits thereon, and that Thomas could not be held liable for the profits realized by the other partners from the firm's short swing transactions. . . .²²

Section 3(a)(9) of the Securities Exchange Act of 1934²³ defines the term "person" to include a "partnership." Consequently, a partnership *may be* subject to the regulation of section 16(b). It would seem that the recovery of insider profits directed against stockholders holding a ten per cent interest in a corporation should be, and could be under the statute, equally applicable to partnership holdings. While the Securities and Exchange Commission argued that a partnership and its members are inseparable, the Court held otherwise. There is merit in the contention that the corporation has the benefit of the expertise of the investment banking firm through the partner-director, Thomas, and therefore it could be said that the partnership is the director for purposes of section 16(b). By his very presence, Thomas sits as a partner-director. It would seem difficult to keep separate these distinct relationships when he is dealing with either the partnership or the corporation. Again, the exchange of information between corporation and partnership could be easily effectuated through the person of Thomas who is, at the same time, a partner of Lehman Brothers and a director of Tidewater.

The concurring opinion in *Rattner* by Judge Learned Hand indicates that partnership liability is possible in a section 16(b) case. Judge Hand was bothered by the possibility of the situation where a partner is deputized by his partnership to serve on a corporate board of directors. He stated: "[B]ut I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally 'directors'; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person."²⁴ In the instant case, the Supreme Court found no reason to overturn the district court's finding that in fact Thomas was not deputed to represent Lehman Brothers. A formal deputization is necessary and yet it is to be noted that the sanction of section 16(b) is admittedly designed as a rule of thumb to make unnecessary the proof of the existence of inside information in particular cases. It is feasible to apply the same principle to a partnership situation without specific proof that the partner was installed to aid the partnership or that he transmitted inside information to his associates. The mere fact of his functioning as both partner and director should be sufficient to require the disgorging of profits.

The Supreme Court stated that the fact that the Securities Exchange Act of 1934 treated a partnership as a person is no ground for saying that Congress wanted a partnership to be subject to all the responsibilities and financial burdens of its members in carrying on their other individual business activities.²⁵ It is difficult to perceive how a dichotomy can exist between the partner's two personalities, business and personal, in a section 16(b) situation, where there is such a direct relationship between his duties as director and his responsibilities as partner. On the one hand, he is committed to the best interests of the corporation and, on the other, he is expected to work for the advancement of the partnership. It seems highly unlikely that a partner-director would not pass on information which would be of great benefit to the partnership. It would be extremely difficult to prove such transmittal,

21 193 F.2d 564 (2d Cir. 1952).

22 82 S.Ct. 451, 453 (1962).

23 48 Stat. 883 (1934), 15 U.S.C. § 78c (a) (9) (1958).

24 193 F.2d 564, 567 (2d Cir. 1952) (concurring opinion).

25 82 S.Ct. 451, 455 (1962).

but, by considering the partnership as the "director," such proof would be unnecessary, since this matter would be guided by the "rule of thumb" in section 16(b).

The Supreme Court was unwilling to broaden the categories of persons on whom liability was imposed by the language of section 16(b). Much reliance was placed on the drafts of the section considered and rejected by Congress when it passed the Act. It was pointed out that those drafts that eventually became section 16(b), in addition to making it unlawful for any director, officer, or ten per cent stockholder to disclose any confidential information regarding registered securities, also made "all profits received by anyone, 'insider' or not, 'to whom such unlawful disclosure had been made' recoverable by the company."²⁶ This, coupled with the *Rattner* decision and Congressional silence since that decision, was enough, the Court felt, to preclude it from extending the coverage of section 16(b).²⁷ The silence of Congress should be no part of the basis for a decision in *Blau*, although support for a similar interpretation may be found in the case of *Toolson v. New York Yankees*.²⁸ The dissent in *Blau* adequately points out that the general rule is as it was expressed in *Girouard v. United States*,²⁹ where the Court declared that: "It is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law."

The respondent, Thomas, as a fiduciary, is to be held to a very high degree of responsibility and, in his capacity as a director, is held to a high degree of accounting. Any conflict of interest which would prevent a director from exercising his best judgment in the interests of his corporation should be carefully guarded against. It has been said that "the level of conduct for fiduciaries [must be] kept at a level higher than that trodden by the crowd."³⁰ In *Magruder v. Drury*,³¹ it was noted that restrictions on a trustee's dealing with the trust apply with equal force to a firm of which he is a member. Where nonfiduciaries knowingly associated with a trustee in purchasing property of the trust, the Supreme Court, in *Jackson v. Smith*,³² held that the trustee and his associates were jointly and severally liable for all profits realized by the joint venture.

Fiduciary responsibility was again accentuated in *Mosser v. Darrow*,³³ where employees of a trustee of an estate in reorganization under the Bankruptcy Act profited from trading in the securities of the debtor. The Supreme Court held that the trustee was liable for the profits. It was reasoned that, since equity would have denied him the profits, the close relationship of his employees was enough to justify the finding of liability of the trustee for all profits made by the employees. It is suggested that it is possible to draw an analogy between *Mosser* and *Blau* and, on that basis, find that the partner-director could be liable for all profits made by the partnership.

These strict prohibitions would serve little purpose if the trustee were free to authorize others to do what he is forbidden. While there is no charge of it here, it is obvious that this would open up opportunities for devious dealings in the name of others that the trustee could not conduct in his own. The motives of man are too complex for equity to separate in the case of its trustees the motive of acquiring efficient help from motives of favoring help, for any reason at all or from anticipation of counterfavors later to come. We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for the benefit of others as they would have been on behalf of the trustee himself.³⁴

The respondent, Thomas, was found to have "realized" a profit, thus incurring liability under 16(b). Thomas had waived all interest in the profit. Never-

26 82 S.Ct. 451, 456 (1962).

27 *Ibid.*

28 346 U.S. 356 (1953).

29 328 U.S. 61, 69 (1946).

30 *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

31 235 U.S. 106 (1914).

32 254 U.S. 586 (1921).

33 341 U.S. 267 (1951).

34 *Id.* at 271-72.

theless, it was held that this constituted, in effect, an assignment of his profits to the remaining partners. The case of *Helvering v. Horst*³⁵ supports this aspect of the decision. It was there held that "the power to dispose of income is the equivalent of ownership of it." The waiver by Thomas was the disposition, according to *Blau*.

Analogous to section 16(b) in the Securities Exchange Act of 1934 is section 249 of Chapter X of the Bankruptcy Act,³⁶ in that a "rule of thumb" is similarly provided. Just like section 16(b), section 249 was designed to prevent possible conflicts of interest in trading of securities, by making use of insider information. Like section 16(b), proof of actual injury or use of inside information is unnecessary. It is suggested that a partnership or a partner could be found liable for all profits in a situation such as that encountered in *Blau* by analogizing to this section of the Bankruptcy Act. At various times the courts have extended section 249 to apply to others than those persons acting in a representative or fiduciary capacity. For instance, compensation has been denied to an attorney when his firm, partner, or wife has traded in securities of the debtor. In *In re Los Angeles Lumber Products Co.*,³⁷ where it had been contended that section 249 did not bar compensation to the firm or innocent partners thereof because of trading by one partner in the bonds of the debtor, it was stated that:

The court feels that in a situation such as this, each member of a law firm should share the responsibility for the individual acts of another partner or other partners. To construe section 249 otherwise would largely destroy its effectiveness. The relationship between partners is too close to make it possible to insure that compensation allowed to an innocent partner may not ultimately benefit a guilty partner, directly or indirectly. If section 249 were to be construed as suggested, it might be possible to work out evasions of its provisions whereby one partner traded and another did legal work.³⁸

Certainly the analogy between section 249 of the Bankruptcy Act and section 16(b) of the Securities Exchange Act of 1934 can be readily appreciated. Thus, the partnership, or Thomas himself, could be made liable for all of the profits "realized" in the *Blau* situation.

It is evident that support could have been found for making the Lehman Brothers' partnership liable for the profits which they made on Tidewater stock. It seems that the Court vitiated the spirit of section 16 in order to avoid extending the coverage of that section.

It would seem to be necessary that Congress take action to remedy the situation imposed upon the investing public by *Blau v. Lehman*. If investor respect is to be maintained in the stock market at a time when congressional authorizations are being given for investigations of the stock exchanges, it is necessary that section 16 of the Securities Exchange Act be amended and enlarged, with but one thought in mind, that of maintaining a high level of responsibility for fiduciaries and eliminating even the slightest possibility of profits being realized as a result of inside information. At the present time, coverage in section 16 extends to officers, directors, and principal stockholders. Legislation should be enacted which would encompass investment banking firms. Since the insider could benefit by his family's utilization of his inside information, they too should be included. Employees of the insider, as has been shown, can readily take advantage of the employer's inside information. They too should be brought within the reaches of section 16. This would be in accord with the spirit of section 16, which is aimed at fair dealing in corporate securities and which recognizes that fiduciaries must be held to a high degree of honesty and fair dealing, so as to avoid the conflict of interests which so easily arise from personal considerations as opposed to corporate interests.

Robert W. Cox

35 311 U.S. 112 (1940).

36 52 Stat. 901 (1938), 11 U.S.C. 649 (1958).

37 37 F. Supp. 708 (S.D. Cal. 1941).

38 *Id.* at 711.

PROFESSIONAL CORPORATION LEGISLATION — DISTINCT APPROVAL BY THE JUDICIARY, UNDER ITS INHERENT POWERS OVER ATTORNEYS, ALSO NECESSARY FOR PROFESSIONAL CORPORATIONS TO BE ADMITTED TO THE BAR — Since 1954, there has been an ever-increasing demand by professional persons for tax equity in regard to deferred tax treatment of retirement funds. In 1961, this demand was met to some extent when the legislatures of fourteen states enacted professional corporation statutes,¹ and when Colorado adopted a rule of court which permits lawyers to organize professional corporations pursuant to its general corporation laws.² Of these fourteen states, ten have either expressly provided for, or have enacted laws broad enough to allow, the formation of professional associations or corporations by lawyers.³

The purpose of this article is to consider two major questions raised by these professional corporation laws: First, whether professional corporation statutes are of any practical significance in the absence of a change in the judicial attitude of a state toward the practice of law by a corporation, and the second question, to be summarily discussed, whether a professional corporation or association, with such characteristics necessary to have approval of the state courts, can qualify as a corporation under the Treasury Regulations.

There are many helpful treatises⁴ which discuss the historical background and practical consideration which must be made in order to meet the requirements of the Treasury Regulations.⁵ Since this article is in no way intended to be exhaustive of these considerations, only a brief survey of the tax advantages which motivated the professional association and corporation laws will be necessary.

The Internal Revenue Code of 1954 contains special provisions for tax-deferred treatment of qualified pension, profit-sharing, and stock bonus plans.⁶ A plan which qualifies under these provisions is afforded two major advantages: First, contributions by the employer to the fund are not treated as current income to the employee until he actually receives the income from the fund or obtains an unqualified right to withdraw the income from it.⁷ This allows an employee to postpone the inclusion of this additional compensation until later in life, when it is very likely that he will be in a lower tax bracket. Along this line the Code also provides for capital gains treatment if a lump sum distribution is made to the employee in one year, rather than a distribution of the fund over a period of years.⁸ Second, the employer is allowed to deduct from current income contributions which he makes to the retirement fund.⁹ Certain limitations based upon the annual income of the employee are placed upon the amount which an employer can deduct from current income.¹⁰ However, generally, these limitations are not of such a nature as to affect the desirability of such retirement plans.

An additional tax advantage can be gained by organizing and operating the

1 Ala. Prof. Ass'n. Act 1961, No. 865; Ark. Med. Corp. Act 1961, No. 179; Conn. Public Act No. 158, 1961; Fla. Prof. Ser. Corp. Act 1961, Ch. 61-64; Ga. Prof. Ass'n. Act 1961, No. 285; Ill. Prof. Ass'n. Act 1961, S.B. No. 804; Minn. Prof. Corp. Act 1961, Ch. 1; Ohio Prof. Ass'n. 1961, S.B. No. 550; Okla. Prof. Corp. Act 1961, S.B. No. 399; Pa. Prof. Ass'n. Act 1961, S.B. No. 525; S.D. Med. Corp. Act 1961, Ch. 29; Tenn. Prof. Ass'n. Act 1961, Ch. 181; Tex. 1961, Ch. 158; Wis. Ser. Corp. Law 1961, Ch. 350.

2 Colo. R. Civ. P. Rule 231, Ch. 19 (1961).

3 Alabama, Connecticut, Florida, Georgia, Illinois, Ohio, Oklahoma, Pennsylvania, Texas, and Wisconsin, *supra* note 1.

4 A.B.A. Foundation Research Memo. No. 28 (1961); Jones, *The Professional Corporation*, 27 *FORDHAM L. REV.* 353 (1958); Jones, *Should Lawyers Incorporate?*, 11 *HASTINGS L.J.* 150 (1959); *Professional Corporation Laws Explained*, CCH 1962 *CUR. LAW H.B. ED.*; *Professional Association and Qualified Pension Plans*, 37 *IND. L.J.* 124 (1961).

5 *Treas. Reg.* §§ 301.7701-1—2 (1960).

6 *INT. REV. CODE OF 1954*, §§ 401-04.

7 *INT. REV. CODE OF 1954*, § 402.

8 *INT. REV. CODE OF 1954*, § 403.

9 *INT. REV. CODE OF 1954*, § 404.

10 *Ibid.*

corporation so that it will qualify as a small business corporation.¹¹ Such a corporation may then elect not to be taxed and thereby avoid double taxation of its income. In such a case, the income of the electing corporation will be taxed on a pro rata basis among the stockholders of the corporation.¹²

The advantages which can be gained by the organization of a professional corporation are obvious. Since a stockholder can also be an employee of a corporation, a professional person can participate in the ownership of the entity which employs him and, as a stockholder, he can exert strong influence over the establishment of a pension fund of which he will be a beneficiary. The contributions to the fund will decrease the distributable annual income of the corporation and thereby reduce the current annual income of the employee-stockholder. Thus, during his peak earning years, the professional person can defer the imposition of an income tax on a portion of his income to a time in the future when it is likely that this income will be taxed at a much lower rate. However, an employer-employee relationship must be present before such a plan will be given favorable tax treatment.¹³ Since this requirement naturally excludes self-employed professional men and also members of partnerships, a hybrid form of doing business had to be created.

THE CANONS OF ETHICS v. THE TREASURY REGULATIONS

In 1954, the Court of Appeals of the 9th Circuit decided the now famous *Kintner* case.¹⁴ The court affirmed a decision of the district court which held that money paid into a pension fund by a group of doctors who had formed a professional association was not personal income, and was entitled to deferred tax treatment. This decision has had a profound impact. In 1960, the Internal Revenue Service promulgated what is now popularly known as the "Kintner Regulations."¹⁵ These regulations establish the characteristics which a professional association must possess in order to be categorized as a corporation and thereby be entitled to receive deferred tax treatment for its retirement funds.

These regulations motivated the demand for legislation which would allow professional persons to form organizations which could qualify for deferred tax treatment of retirement funds under the provisions of the 1954 Code. A professional corporation statute must be drafted with precision to serve the purpose for which it was intended. It must be broad enough to allow the corporation or association to be classified as a corporation by the Internal Revenue Service and it must limit the corporate characteristics of the organization to those which will not be offensive to the ethical standards established by the Canons of Professional Ethics.

The fact that a state statute classifies a certain type of organization as a corporation is no guarantee that it will be treated as a corporation for federal income tax purposes.¹⁶ An organization will be treated as an "association" for federal tax purposes if its characteristics are such that the organization more nearly resembles a corporation than a partnership or trust.¹⁷

The Internal Revenue Service promulgated a Treasury Regulation¹⁸ in which it established the major corporate characteristics which will be taken into account when it determines whether a particular organization will be classified as a corporation. Of these, there are four essential characteristics which will be determinative of this question: continuity of life, transferability of interests, centralization of management, and limited liability.¹⁹

11 INT. REV. CODE of 1954, §§ 1371-77, added by sub. ch. S (1958).

12 INT. REV. CODE of 1954, §§ 1373, 1374, and 1375, added by sub. ch. S (1958).

13 *Supra* note 6.

14 *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

15 *Treas. Reg.* §§ 301.7701-2 (1960).

16 *See* *Treas. Reg.* § 301.7701-1 (c) (1960).

17 *Ibid.*

18 *Treas. Reg.* § 301.7701-2 (a) (1) (1960).

19 *Ibid.*

Continuity of life. The element of continuity of life exists if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization.²⁰ Continuity of life has been provided for, in some form, by all the states which have enacted laws which allow the organization of professional associations or corporations for the practice of law.²¹ Some states have enacted statutes which contain express provisions for continuity of life of the association.²² Others have incorporated by reference the general corporation laws of the state, and thereby provide for the continuity of life of the association.²³ There are no serious problems necessarily presented by the fact that the form of organization used to practice law continues as an entity uninterrupted by the death, incompetency, or bankruptcy of its members.²⁴ Necessarily interwoven with continuity of life is transferability of interests, which is more likely to present difficulties in reconciling the Canons and the Regulations. It is obvious that the element of continuity cannot exist in the absence of this other element.

Transferability of interests. Under the Treasury Regulations, the characteristic of free transferability of interests is present if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a non-member.²⁵ It would not be consistent with the present ethical restraints imposed on the members of the legal profession by the Canons of Ethics to allow a lawyer to transfer his permanent beneficial and voting interests in a professional association or corporation to a non-lawyer.²⁶ Herein lies the difficulty.

The reasons for prohibiting a non-lawyer from ownership of a beneficial and voting interest in an organization formed to practice law are simple. As the owner of a beneficial and voting interest, the lay person would be entitled to a division of the profits of the corporation. Canon 34 prohibits the division of fees with anyone but another lawyer based upon a division of services or responsibility. The lay person could place himself in a position where he might influence or even control the lawyer's decision as to which clients the lawyer would represent. Canon 31 provides that a lawyer must himself decide what employment he will accept as counsel. As a part of making corporate decisions, the fear is that the non-lawyer might elicit confidences made by clients to lawyers employed by the corporation. Canon 37 prohibits a lawyer from disclosing the confidences of his clients. In addition, the ownership of beneficial and voting interests by non-lawyers would result in violation of Canons 33, 35 and 47. Canon 33 prohibits the formation of a partnership for the practice of law between lawyers and non-lawyers. This prohibition would likewise apply to the practice of law in the corporate form.²⁷ Canon 35 prohibits the intervention of a lay intermediary between the lawyer and his client, and Canon 47 prohibits a lawyer from aiding the unauthorized practice of law by any lay agency, personal or corporate.

The A.B.A. Committee on Professional Ethics and Grievances has concluded that an organization of lawyers for the practice of law which contemplated transferable shares was unethical even though other lawyer-members had a first option to purchase a member's share.²⁸ In 1961, the A.B.A. Committee stated that, "To

20 Treas. Reg. § 301.7702 (b) (1960).

21 Ala. Prof. Ass'n. Act 1961, No. 865; Conn. Public Act No. 158, 1961; Fla. Prof. Ser. Corp. Act 1961, Ch. 61-64; Ga. Prof. Ass'n. Act 1961, No. 285; Ill. Prof. Ass'n. Act 1961, S.B. No. 804; Ohio Prof. Ass'n. Act 1961, S.B. No. 550; Okla. Prof. Corp. Act 1961, S.B. No. 399; Pa. Prof. Ass'n. Act 1961, S.B. No. 525; Tex. 1961, Ch. 158; Wis. Ser. Corp. Law 1961, Ch. 350.

22 Alabama, Connecticut, and Georgia, *supra* note 21.

23 Colorado, Florida, Ohio, Oklahoma, and Wisconsin, *supra* note 21.

24 A.B.A. Committee on Professional Ethics and Grievances, Opinion No. 303 (1961).

25 Treas. Reg. § 301.7701-2 (e) (1) (1960).

26 A.B.A. Opinion 303, *supra* note 24.

27 *Ibid.*

28 A.B.A. Committee on Professional Ethics and Grievances, Opinion No. 283 (1950).

avoid a violation of the Canons there must be a requirement that a member's transferable interest not fall into the hands of a layman on a permanent beneficial and voting basis.²⁹ The Committee discussed the effect of death, incompetency, etc., of a shareholder and reached the conclusion that limited transferability in these cases would not be unethical so long as the lawyer's interests would be transferred to a lawyer or lawyers within a limited time.³⁰ It is clear that free transferability of interests is not possible for an association or corporation organized for the practice of law. A professional corporation statute should require immediate purchase by the other shareholders or redemption by the corporation of the stock of a shareholder in the event an attorney voluntarily leaves the organization or dies or is disqualified. All of the states which have enacted professional corporation statutes require all of the members of the corporation to be licensed members of the profession for which the corporation was formed. However, provisions requiring the redemption of shares in the event of the death or disqualification of a shareholder have not been uniformly enacted.³¹ In these states it would appear that an organization formed by a group of lawyers pursuant to these statutes would meet with judicial disapproval because of the failure of such provisions to satisfy the Canons of Ethics. Therefore, it would be advisable for the organizers of a professional corporation to include a provision in the corporation's charter requiring redemption of the stock of a member who voluntarily leaves the corporation or becomes disqualified or dies.

Limited transferability of interests could prevent an organization from being classified as a corporation for tax purposes. The Treasury Regulations go only this far:

If each member of an organization can transfer his interest to a person who is *not* a member of the organization only after having offered such interest to the other members at its fair market value, it will be recognized that a modified form of free transferability of interests exists. In determining the classification of an organization, the presence of this modified corporate characteristic will be accorded less significance than if such characteristic were present in an unmodified form.³²

A modified form of free transferability of interests does not seem to encompass a requirement that the stock of a member of a professional association must be redeemed by the corporation or purchased by a person who is qualified to become a member of that corporation. Therefore, it seems that any legislation which does conform to the Canons of Ethics or any form of organization wherein safeguards have been provided which would satisfy the Canons, would not be reconcilable with the concept of a modified form of free transferability of interests as provided by the Treasury Regulations.

Centralized management. The A.B.A. Committee on Ethics and Grievances considered the question of centralized management and reached the conclusion that centralized management, by lawyers exclusively, of a legal corporation "does not in and of itself present any ethical difficulties."³³ The committee considered the element of centralized management in regard to Canons 31, 33, 35, and 47. In each case, it reached the conclusion that, if the group making the decision consists solely of lawyers, no violation of the Canons of Ethics will be involved. The Committee pointed out that, "When the centralized management must be in lawyers, the intervention is basically no different than that which takes place in a law partnership where some of the partners have managing responsibilities and where a procedure exists for clearing advice to clients with senior partners."³⁴

Restricting the management of a professional association or corporation to

29 A.B.A. Opinion 303, *supra* note 24.

30 *Ibid.*

31 A.B.A. Foundation Research Memo. Series No. 28, p. 50 (1961).

32 Treas. Reg. § 301.7701-2 (e) (2) (1960). (Emphasis added.)

33 A.B.A. Opinion 303, *supra* note 24.

34 *Ibid.*

lawyers does not seem to conflict with the characteristic of centralized management as defined by the Internal Revenue Service, which has said that: "An organization has centralized management if any person (or any group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed."³⁵

Centralization of management has been expressly provided for in the professional corporation statutes of Alabama, Connecticut, Georgia, and Illinois.³⁶ Pennsylvania has provided for a board of governors to manage the affairs of the association.³⁷ The professional corporation laws of Colorado, Florida, Ohio, Oklahoma, Tennessee, and Wisconsin³⁸ do not specifically provide for centralized management. However, they do incorporate by reference their general corporation laws and therefore the characteristic of centralized management appears to have been provided for.

Limited liability. The Treasury Regulations provide that an organization has limited liability if, under local law, no member is personally liable for the *debts of or claims against* the organization.³⁹ The A.B.A. Committee on Ethics and Grievances has stated that there may be limited liability without violating any of the Canons of Ethics if certain safeguards are observed. First, the lawyer rendering the legal services to the client must be personally responsible *to the client* and, secondly, restrictions on liability as to other members of the organization must be made clear to the client.⁴⁰ These minimum safeguards requiring this very limited form of personal liability of a lawyer employed by a professional corporation would not conflict with the tax concept of limited liability.

The corporate characteristic of limited liability has been modified by the professional corporation statutes in most of the states which allow lawyers to incorporate by providing that a client may look to the individual attorney rendering legal services to him for, *e.g.*, negligent practice, but that the attorneys are not liable for the general liabilities of the corporation. In such cases, a professional corporation readily complies with the Committee's minimum requirements of personal liability.⁴¹ Several states have provided that all shareholders, directors, associates, etc., of a professional corporation will be held jointly and severally liable for all acts, errors, and omissions of the corporate employees.⁴² Whether the absence of limited liability in these states would prevent a professional corporation from being classified as a corporation for tax purposes is an open question.⁴³ By virtue of the language of the Treasury Regulations, it seems that the likelihood is that such classification would be prevented.

From this discussion of the Treasury Regulations, it would seem that the restrictions imposed by the Canon of Ethics would prevent a professional association or corporation from being classified as a corporation for tax purposes. It is apparent, on the other hand, that the Internal Revenue Service is favorably disposed toward providing tax relief to professional people employing this corporate device. This is strongly manifested by the promulgation of the "Kintner Regulations," which in turn are a reflection of substantial approval by the Service of the basic philosophy of the *Kintner* decision. However, these regulations were issued prior to any state professional corporation legislation. Thus, the Service obviously

35 Treas. Reg. § 301.7701-2 (c) (1) (1960).

36 Ala. Prof. Ass'n. Act 1961, No. 865, § 7; Conn. Public Act No. 158, 1961, § 44(1); Ga. Prof. Ass'n. Act 1961, No. 285, § 8; Ill. Prof. Ass'n. Act 1961, S.B. No. 804, § 8.

37 Pa. Prof. Ass'n. Act 1961, S.B. No. 525, § 6.

38 *Supra* note 1.

39 Treas. Reg. § 301.7701-2 (d) (1) (1960).

40 A.B.A. Opinion 303, *supra* note 24.

41 *Ibid.*

42 Pa. Prof. Ass'n. Act 1961, S.B. No. 525, § 17; Wis. Ser. Corp. Law 1961, Ch. 350, § 8. This is provided by court rule in Colorado. Colo. R. Civ. P. Rule 231, Ch. 19 (1961).

43 *Supra* note 39.

could not envision the precise form in which the concept of "professional corporation" would be molded by the various state legislative and judicial branches. This has resulted in deficiencies in these regulations, assuming agreement with the proposition that the Internal Revenue Service has intended to make it possible for professional groups to take advantage of deferred tax provisions. It therefore seems that further amendment of the regulations is necessary. However, no determination has thus far been made of the question whether the present promulgations are adequate and it is not absolutely clear that they would not be. At the very least, there need be no hesitation in stating that matters are most unsettled at present.

CATS, OLIVES AND PROFESSIONAL CORPORATIONS.

Despite the uncertainties apparent from an analysis of the Treasury Regulations, by the end of 1961, it appeared that wide acceptance of professional corporations was assured. The probable hope is that steps will be taken by the Internal Revenue Service which will guarantee recognition of associations and corporations formed under the new state laws. Of the twenty-one professional corporation statutes which were proposed in 1961, only six were not passed.⁴⁴ Eleven states had given a green light to lawyers to form professional corporations,⁴⁵ and, most significantly, it appeared that a change of judicial attitude was taking place in regard to organization of professional corporations by lawyers. Reconciliation of this statutory concept of professional corporations for the practice of law with the judiciary's distinct authority over the legal profession is necessary. Ultimately, it will be the reaction of the courts which will determine how meaningful this legislation is apt to be.

By virtue of apparently immediate response to this legislation by certain factions of the legal profession, three cases have been decided since the fall of 1961. The Florida Supreme Court⁴⁶ approved a petition by the Florida Bar to amend its Integration Rule and the Canons of Ethics so that lawyers could practice law as a corporation pursuant to the Florida Professional Service Corporation Act.⁴⁷ The Colorado Supreme Court⁴⁸ adopted a rule of court which permitted the organization of professional corporations by lawyers. At the same time, however, Ohio refused to give its sanction in an action to require the State Secretary to accept articles of incorporation for a proposed legal corporation.⁴⁹

It is perhaps worthwhile at this point to pause briefly, before looking at what court reaction there has been thus far, to note the traditional ethical objections to the practice of law by a corporation. Prior to the enactment of professional corporation statutes, this practice was uniformly prohibited. There was no judicial dissent from the proposition that a corporation could not lawfully engage in the practice of law.

There are four basic reasons why corporations have been barred from the practice of law in the past: First, the fact a lawyer would not only owe a duty to his client but also to his corporate employer would cause the lawyer to be confronted with the problem of divided loyalty between client and corporation;⁵⁰ second, traditionally, the lawyer-client relationship has been purely personal in nature, and the intervention of a corporation between the lawyer and his client would necessarily weaken this relationship;⁵¹ third, a corporation could not satisfy the requirements

44 California, Indiana, Iowa, New York, North Carolina, and Oregon. See A.B.A. Foundation Research Memo. Series No. 23, p. 3 (1961).

45 *Supra* note 21. Also, Colo. R. Civ. P. Rule 231, Ch. 19 (1961).

46 *In re* The Florida Bar, 133 So.2d 554 (Fla. 1961).

47 Fla. Prof. Ser. Corp. Act 1961, Ch. 61-64.

48 Colo. R. Civ. P. Rule 231, Ch. 19 (1961).

49 *Green v. Brown*, 30 L. WEEK 2415 (Ohio February 14, 1962).

50 *People v. People's Trust Co.*, 180 App. Div. 494, 167 N.Y. Supp. 767, 768 (1917).

51 *People ex rel. Lawyers' Institute of San Diego v. Merchants' Protective Corp.*, 189 Cal. 531, 209 Pac. 363, 366 (1922).

for admission to the bar nor be subjected to punishment for violating the ethics of the legal profession;⁵² and, fourth, there has been a belief that any change in the basic relationship of a lawyer to a client and to the community would be contrary to public policy.⁵³

These fundamental objections to the practice of law by a corporation have been maintained by the members of the bar in the belief that a change in the status quo in this area could not be made without abrogating the basic standards and ideals of the legal profession. However, the reasons for barring corporations from the practice of law do not seem to be of such a nature that the form of organization used to practice law should be solely determinative as to whether it should be barred from the practice of law. The A.B.A. Committee on Ethics and Grievance has indicated that it is the substance of the organization, rather than the form, which should determine whether the practice of law by a professional association would be unethical.⁵⁴ The substance of the new concept of a legal corporation should be such as to render these customary objections inapplicable. The statement that there is no judicial dissent from the proposition that a corporation cannot practice law is no longer true.

Note is to be taken of the manner in which the Florida and Ohio cases arose. The Ohio Supreme Court refused to acknowledge a direct effort under its statute to incorporate without there first being an amendment of its Rules of Practice.⁵⁵ On the other hand, the Florida Bar filed an original petition requesting approval of amendments to Florida's Integration Rule and Code of Ethics.⁵⁶ It is plain from the opinion of the court, though not expressly stated, that this was a necessary initial step before any action was taken under the statute.⁵⁷ Thus, it is clear that a professional corporation statute, at least with respect to attorneys, is not sufficient in itself to allow lawyers to incorporate. Court approval of amendments to its rules of practice is a superimposed condition.

By virtue of the Florida ruling, several significant amendments to the court's rules are in effect. The Integration Rule, under which all persons licensed to practice law in Florida must be members of the Bar of that state and are prohibited from practicing unless they are such in good standing, was amended to allow the admission of professional service corporations to the practice of law, so long as all of a corporation's shareholders, officers, directors, agents, and employees⁵⁸ who are members of the Florida Bar comply with the rules and regulations promulgated by the Supreme Court and by the Bar. The state's Canon 33 was also amended so as to substantially provide the same. An addition to the language of Canon 35 declared that a professional service corporation is not to be deemed a lay agency or such intermediary. A similar addition was made to Canon 47, and Rule 10 of the Rules Governing the Conduct of Attorneys in Florida was amended to include professional service corporations. The foregoing amendments and the addition of a new article to the Integration Rule⁵⁹ appear to adequately dispel the difficulties formerly inherent in Florida's Canons of Ethics.

The Florida Supreme Court warned that these amendments should not be

52 *In re* Co-operative Law Co., 198 N.Y. 479, 92 N.E. 15, 16 (1910).

53 *United States Title Guar. Co. v. Brown*, 86 Misc. 287, 149 N.Y. Supp. 186, 188 (Sup. Ct. 1914), *affd.*, 166 App. Div. 688, 152 N.Y. Supp. 470 (1915), *affd.*, 217 N.Y. 628, 111 N.E. 828 (1916).

54 A.B.A. Committee on Professional Ethics and Grievances, Opinion No. 303 (1961).

55 *Green v. Brown*, *supra* note 49.

56 *In re* The Florida Bar, 133 So.2d 554 (Fla. 1961).

57 *Id.* at 555.

58 Note that the term "employee," as defined in the Florida statute, does not encompass "clerks, secretaries, bookkeepers, technicians and other assistants who are not usually and ordinarily considered by custom and practice to be rendering professional services to the public for which a license or other legal authorization is required." Fla. Prof. Ser. Corp. Act 1961, Ch. 61-64, § 6.

59 *In re* The Florida Bar, 133 So.2d 554, 557-58 (Fla. 1961).

construed as an intention to eliminate any of the other requirements of the Integration Rule and the Canons of Ethics. It went on to state:

On the contrary, because of the privilege that is being made available to the lawyers of this State there will be increased responsibilities commensurate with the privilege. . . . We are pioneering in a new field of professional relationships and responsibilities. In the interest of individual clients, the public and the practitioner, care and caution should guide the footsteps of those who venture into this relatively unexplored area.⁶⁰

In Colorado, judicial assent to the practice of law by a professional corporation is emphasized by the fact that no professional corporation statute was in force when the Colorado Supreme Court⁶¹ adopted a Rule of Court to permit the practice of law by professional service corporations. This unique assent was based upon the court's authority to prescribe rules governing admission and to supervise practice of attorneys in Colorado. There were no constitutional or statutory prohibitions against such corporate form.

The Colorado Rule is similar to the Florida decision. The Colorado Supreme Court amended Canon 33 to include professional service corporations, required that all shareholders must be members of the Colorado bar, and provided that "professional service corporations organized and operated in accordance with the provisions of this Rule shall not be deemed lay agencies within the meaning of the Canons of Professional Ethics." A significant portion of the Colorado Rule requires that "all shareholders agree that they shall be jointly and severally liable for all acts, errors and omissions of the employees of the corporation." An exception to this rule is allowed if the corporation maintains lawyer's professional liability insurance. The amount which must be carried is also established by this Rule.

The Colorado Rule protects the standards and ideals established by the Canons of Ethics. However, again, the joint and several liability provision may present some problems from a tax standpoint. The Treasury Regulations establish limited liability as one of the essential characteristics of a pure corporation. Since the Colorado rule allows an exception to the joint and several liability rule where a professional corporation maintains lawyer's professional liability insurance the tax concept of limited liability can be met. The regulations provide that limited liability is present even though a member of an association makes an agreement with a third person to indemnify him for any liability incurred as a result of his membership in the association.⁶² Therefore, a professional service corporation can, by carrying the required insurance, attain the characteristic of limited liability for tax purposes under this rule of court.

Thus, at least in Florida and Colorado, assuming compliance with the dictates of those states' supreme courts by submitting acceptable articles of incorporation, there exists no bar to permitting a professional corporation to pursue its appropriate endeavors. The rulings of those courts are such as to indicate that a fundamental change may be taking place as to the judiciary's attitude toward the practice of law by a corporation. This new breed of organization, with its peculiar characteristics, should prove acceptable to the judiciary inasmuch as it simply negates so many of the reasons which have formerly been invoked in denying professional people the opportunity to incorporate.

On the other hand, in February of 1962, the traditional attitude of the judiciary toward the practice of law by a corporation may well have been reaffirmed by the Ohio Supreme Court.⁶³ Pursuant to the Ohio Professional Association Act, a relator licensed to practice law in the State of Ohio tendered articles of incorporation, on behalf of himself and several other attorneys, to the Secretary of State. The latter refused to accept them and the relator filed petitions for writs of mandamus to

60 *Id.* at 557.

61 Colo. R. Civ. P. Rule 231, Ch. 19 (1961).

62 Treas. Reg. § 301.7701-2 (d) (1) (1960).

63 *Green v. Brown*, 30 L. WEEK 2415 (Ohio February 14, 1962).

compel the Secretary of State to accept for filing the articles for the formation of a corporation to engage in the practice of law in Ohio. The Ohio Supreme Court, in *Green v. Brown*,⁶⁴ denied the petitions for writs of mandamus and held, that:

The inherent power of this court to prescribe standards for admission to the practice of law has been implemented by the adoption of Rule XIV of its Rule of Practice. By no stretch of the imagination can the words of Rule XIV be expanded to include any other than natural persons. And until such time as this court, through its rules for admission to the practice of law, recognizes the right of a corporate entity to practice law, the Secretary of State is under no clear duty to accept for filing and record articles of incorporation which set forth that a purpose of the corporate entity is to "practice Law."⁶⁵

In the opinion, the Ohio court noted that "several very thorough and helpful briefs" had been filed by various bar associations in Ohio. In the court's comment on these briefs which were apparently quite diverse in approach, there is perhaps an indicative reflection of the attitude of the members of the bar toward their practicing as a corporation. It noted: "From these briefs it is obvious that so far as members of the bar are concerned the idea of the practice of law within the corporate structure is an emotional thing. It is much like cats, olives and Roosevelt; it is either enthusiastically embraced or resolutely rejected." It is, after all, the response of lawyers which will ultimately determine the practical significance of this type of legislation, even assuming it was quite clear that a legal corporation would be encompassed by the terms of the Regulations and also received the blessings of the state courts. While the cry for more equitable tax treatment⁶⁶ has been strong, there may be varying degrees of reluctance in accepting this means of obtaining it. Of course, reluctance at this time may also result from the several unsettled questions in the area of tax impact and judicial acceptance. This manifestation of reluctance, though, will naturally disappear as more ground is broken and some definite answers are provided.

The likely impact of the *Green* decision is not clear. Is it to be construed as a reflection of the Ohio Supreme Court's strong feeling that the traditional approach to the problem should not be modified and that professional corporation legislation is not capable of reconciliation with this approach or is it nothing more than a determination, in effect, that there must first be a proceeding brought before the court similar to that pursued in Florida before a group of lawyers can take steps under the professional corporations statutes? The Court merely stated that its present Rules of Practice are not broad enough to permit admission to the bar of artificial persons, but at least left the door open, presumably, for a proceeding asking the court to amend its Rules. How the court would rule in the event of this is in no way expressly indicated.

It may be conjectured, that, in the instant case, the approach taken was due to the desire of the court to keep tight rein on one of its important functions. On the other hand, the mere fact that no clue is given as to the court's feeling on the propriety of a legal corporation may be evidence of a holdfast attitude. Thus, it is not altogether clear that the Ohio court as well as other states in which the matter is likely to arise, will be able to overcome the customary objections, despite explicit legislative sanction.*

John W. Dell

64 *Ibid.*

65 *Ibid.*

66 It is to be noted that this desire is also reflected in an effort to attain federal legislation. This direct form of tax relief would permit the professional person, as well as all other self-employed persons, to pursue pension plans while remaining a partner or an individual practitioner. H.R. 10, 87th Cong. 1st Sess. (1961).

* Four more states, Arizona, Kentucky, South Carolina, and Virginia, have recently enacted professional corporation legislation. Wall Street Journal, Apr. 4, 1962, p. 1, col. 5 (Midwest ed.)