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Recent Decisions

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RECENT DECISIONS

Mutual Funds — Capital Gains Distributions Treated as Principal Under the Uniform Principal and Income Act. — Alice Brock, the testatrix, died September 14, 1939. By her will, she created a perpetual trust of her residuary estate. She directed that certain fixed sums, totaling $18,700, be paid annually from the trust income to seven primary beneficiaries; any trust income in excess of this amount be paid annually to two secondary beneficiaries; and any income released from the trust, by the death or deaths of any, and finally all, of the primary and secondary beneficiaries, be paid forever in equal shares to Bryn Mawr College and the Pennsylvania Academy of the Fine Arts. The annual income from this trust presently exceeds $18,700; the excess being paid to the appellant income beneficiary. On September 3, 1964, the trustees purchased seven shares of the capital stock of Philadelphia Fund, Inc. (hereinafter Fund), a mutual fund and regulated investment company. On September 30, 1964, the trustees received from the Fund a distribution of $1.05. The authorizing resolution of the Fund described this distribution as a quarterly distribution of 7 cents per share out of ordinary net income and 8 cents per share payable from realized capital gains. The resolution further provided for payment of such distribution in cash or additional shares of stock, at the option of the receiving stockholders. The trustees elected to receive payment in cash and received 49 cents designated "ordinary net income" and 56 cents designated "realized capital gains." The trustees then filed an account in the Orphans' Court of Delaware County, Pennsylvania, wherein the entire distribution of $1.05 was allotted to income. Bryn Mawr College filed objections to this allocation on the ground that the amount of distribution from "realized capital gains" should be distributed to principal. The Orphans' Court sustained Bryn Mawr's objection. The Supreme Court of Pennsylvania, Judge Roberts dissenting, affirmed and *held:* a distribution made by a mutual fund or regulated investment company,[1] the source of which distribution is "realized capital gains," is properly allocable to principal under section 5(3) rather than section 5(1) of the Pennsylvania Principal and Income Act of 1947.[2] *In re Brock,* 420 Pa. 454, 218 A.2d 281 (1966).

A typical mutual fund is an open-end diversified management investment company.[3] Its business is to select, buy, hold, and sell corporate stocks and other securities.[4] The fund's income is twofold. It derives income from interest and dividends on the securities in its portfolio and gains or profits from advantageous

1 Hereinafter "mutual funds" will mean a regulated investment company under the Investment Company Act of 1940, 54 Stat. 789-847, 15 U.S.C. §§ 80a-1 to -52 (1964).

2 Pa. Stat. Ann. tit. 20, § 3470.5 (1964). The Pennsylvania statute is substantially the same as the Uniform Principal and Income Act § 5 (1931).

3 [The fund is called] "open-end" because the capital of the fund grows with each new share sold and issued, and declines with each share redeemed. "Diversified" because fund investments are not heavily concentrated in individual issues. "Management" because the investments are not fixed, nor are they alterable only under rigidly defined conditions. "Companies" as a generic term to include trusts or other legal forms a fund can assume.

Lobell, *The Mutual Fund: A Structural Analysis,* 47 Va. L. Rev. 181, 182 n.3 (1961).

4 Lovett Estate (No. 2), 78 Pa. D. & C. 21, 24 (Orphans' Ct. 1951).

sales of its securities.[5] This income, after deduction of management fees, is distributed to the stockholders in two distinct dividends — cash and capital gains.[6]

The confusion presently begirding this area of dividend allocation has been caused, to a large extent, by the *unique nature* of a mutual fund. The principal issue is whether a mutual fund is analogous to an ordinary business corporation (a separate entity) or to a common trust fund (a mere conduit). The resolution of this issue is crucial. Under the separate entity theory, sales of securities by a mutual fund are treated as sales from inventory, and thus the gains from such sales are ordinary income to the trust allocable to the life income beneficiary. Under the conduit theory, however, such gains are treated as returns of capital and are thus allocable to principal, in the same manner as if the trustee had invested *directly* rather than through a mutual fund intermediary.[7]

Judge Roberts, in his dissent in *Brock*, argued that the conduit theory was inapplicable and that mutual fund distributions should be governed by the separate entity theory. The basic thesis of the separate entity theory is that the portfolio securities of a mutual fund are inventory or stock in trade.[8] In *Lovett Estate (No. 2)*,[9] the Orphans' Court of Luzerne County, Pennsylvania, stated:

> The portfolio assets of an investment company are not regarded as permanent assets of fixed capital by the managers of the company; the securities held are treated by the managers as funds to be turned over in the normal management of the business. Selling a portfolio asset is but a normal incident of the business. The managers of an investment company must: (1) select, (2) buy, (3) hold, (4) *sell* various issues of securities and stock, depending on market trend, price, indicated earnings, dividend potentials and other factors, in short, they "buy the market." The gain resulting from turning over of any portfolio asset by an investment company is income occurring in the ordinary conduct and course of such business.[10]

The "stock in trade" view is substantiated by the balance sheets of a mutual fund. Mutual funds carry their portfolio assets at market value rather than cost, a practice rarely used in the case of capital assets.[11] This concept of mutual funds as traders in securities, with the portfolio as its stock in trade, has been followed by courts in several jurisdictions.[12]

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5 See Annot., 98 A.L.R.2d 511 (1964).

6 A mutual fund must designate its dividends as either income or capital gains. 54 Stat. 821, 15 U.S.C. § 80a-19 (1964). The fund cannot offset investment losses (capital losses) against investment income. INT. REV. CODE OF 1954, § 852(a)(1).

7 Note, *Trusts — Mutual Funds — Allocation of Capital Gains Distributions,* 18 Sw. L.J. 508, 510 (1964).

8 See BOGERT, TRUSTS AND TRUSTEES § 858 (2d ed. 1962); Young, *A Dissent on Capital Gain Distributions,* 88 TRUSTS & ESTATES 280 (1949).

9 78 Pa. D. & C. 21 (Orphans' Ct. 1951).

10 *Id.* at 24.

11 See Cohan and Dean, *Legal, Tax and Accounting Aspects of Fiduciary Apportionment of Stock Proceeds: The Non-Statutory Pennsylvania Rules,* 106 U. PA. L. REV. 157, 182-83 (1957); Young, *supra* note 8.

12 In Rosenburg v. Lombardi, 222 Md. 346, 160 A.2d 601, 604 (Ct. App. 1960), the court quoted with approval Lovett Estate (No. 2), 78 Pa. D. & C. 21, 24 (Orphans' Ct. 1951): "Selling a portfolio asset is but a normal incident in the business." This view was concurred in by 74 HARV. L. REV. 796 (1961). In *In re* Gardner's Trust, 266 Minn. 127, 144, 123 N.W.2d 69, 80 (1963), the court said, "In other words, the securities held which are bought and sold in the normal course of business of an investment company constitute . . . its stock in trade." Briel v. Moody, 77 N.J. Super. 306, 186 A.2d 314 (Super. Ct. 1962).

The argument in favor of the conduit theory, advanced by the majority in *Brock*, is a persuasive one.[13] The conduit theory focuses on the *substance*, rather than the form, of a mutual fund's activities. This theory views the investor, rather than the mutual fund, as the real party in interest. Such a view is substantiated by the method of evaluating mutual fund shares. The shares are evaluated as if each stockholder owned a pro rata share of the portfolio.[14] Thus, an investment in a mutual fund is, in substance, the same as if the shareholder had invested the amount of his pro rata share in securities directly. The mutual fund is held to be a mere conduit for management purposes.

The argument that a mutual fund is a mere conduit is reinforced by certain provisions of the Internal Revenue Code of 1954.[15] Under the IRC, mutual funds which distribute at least ninety percent of their net investment income (income from interest and dividends) to their shareholders annually are not taxed on such income.[16] Instead, the shareholder receiving the dividend pays the federal income tax on it.[17] Likewise, the IRC provides that distributed capital gains dividends shall be treated by the shareholders as long term capital gains.[18] Thus, for federal tax purposes, the mutual fund is viewed as a mere conduit, the investor being the real party in interest.[19]

The last argument in favor of the conduit theory centers on the unique nature of a mutual fund.[20] A mutual fund is organized in corporate form. A

In Central Hanover Bank & Trust Co. v. Braman, 111 N.J. Eq. 191, 194, 161 Atl. 674, 675 (Ch. 1932), the court held that dividends on the entire stock of the corporation owned by the testator, devised in trust for life tenants' benefit, was income distributable to life tenants. The court stated, "The Alwyn Corporation dealt in securities. Securities were its stock in trade . . . as shoes or hats are the commodities of commercial companies." In *In re* Byrne's Estate, 192 Misc. 451, 452, 81 N.Y.S.2d 23, 24 (Surr. Ct. 1948), the court equated the activity of a mutual fund with that of a corporation engaged in the buying and selling of real estate. When such a corporation distributes the profits from the sale of property it is distributing income and not capital.

13 The conduit theory has received support from a number of commentators. See Lobell, *supra* note 3, at 186-88. Lobell views a mutual fund as a cluster of individual service arrangements, its function being the same as a private investment counsellor — a mere conduit. See generally Ewart, *Principal and Income Problems of Trustees with Mutual Fund Dividends*, 95 TRUSTS & ESTATES 1025 (1956); Putney, *Capital Gain Dividends: Should They be Allocated to Income or Principal*, 95 TRUSTS & ESTATES 22 (1956); Wentworth, *Recent Developments Relating to the Treatment of Investment Company Capital Gains Distributions by Fiduciaries*, 49 MASS. L.Q. 147 (1964); Note, *supra* note 7, at 510-14 (1964).

14 The per share value of the fund is equivalent to the net market value of the fund's portfolio, including both net unrealized capital gains and gains which are realized but undistributed, divided by the total number of shares outstanding. Ignoring nominal management fees, any net capital gain of the fund results in an identical proportionate gain in the value of the mutual fund shares. Likewise, any distribution of realized capital gains necessarily must cause a reduction in per share value which is identical in amount to the per share distribution. Note, *supra* note 7, at 511 (1964).

15 INT. REV. CODE OF 1954, §§ 851-55.

16 *Id.* § 852(a)(1),(b)(2)(D).

17 26 C.F.R. § 1.852-4(a) (1966).

18 INT. REV. CODE OF 1954, § 852(b)(3)(B).

19 In their treatment of mutual fund earnings and gains, both the Investment Company Act and the Internal Revenue Code seek to avoid creating any fundamental difference between the consequences of owning securities outright or through ownership of shares in a mutual fund. Thus the Internal Revenue Code does not recognize the investment company as a separate tax entity with respect to dividends and capital gains so long as they are distributed annually. Instead, the investment company is treated as a conduit, without legal significance as far as the assessment of such taxes is concerned. Wentworth, *supra* note 13, at 151-52.

20 As a business enterprise the typical fund is unique from the moment of its

close analysis of the fund's purpose and activities, however, reveals essential deviations from the ordinary corporate enterprise. As one commentator recently noted:

> The more deeply one analyzes the mutual fund institution, its genesis, the expectations and understandings inherent in it, its ethical and contractual framework, the more one is forced to conclude that many doctrines evolved to fit the usual type of associative enterprise do not fit the fund. . . . In inspecting both judicial and legislative approaches to fund problems, we have seen examples of the *ineptness of various corporate concepts — both of operations and control — applied to the mutual fund.* The danger in that kind of approach is not merely in the harm that it may do, but in the good it does not do. For the fullest potentials for effective and livable regulation can be realized only by accepting, at the very outset, the fact that one is dealing with a set of relationships that do not lose either their personal character or their essentially personal ethical and conceptual framework because they are combined in an associative enterprise form.[21] (Emphasis added.)

A striking example of a mutual fund's uniqueness is that it cannot offset its investment losses against investment income under the IRC.[22] In contrast, an ordinary business corporation will always offset its investment losses against operating income, and only the balance will be treated as net earnings available for distribution.[23] It is submitted that the mutual fund is a unique business entity and should be treated as such. The doctrines evolved to govern the ordinary business corporation do not fit the fund and should not be applied.

Though the problem in *In re Brock* involved the nature of a mutual fund, the court based its decision on an interpretation of section 5 of the Pennsylvania Principal and Income Act.[24] The court sought to determine whether capital gains distributions fall within the provisions of section 5(1) or section 5(3) of this act. Section 5(1) deals with stock dividends, cash dividends, and optional dividends.[25] The court held that the exception clause in the second sentence of

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inception, the circumstances of its formation to some extent foreshadowing its essential character and its difference from other types of companies. Lobell, *supra* note 3, at 184.

21 *Id.* at 216-17.

22 INT. REV. CODE OF 1954, § 852(a)(1),(b)(2)(D). If a mutual fund wishes to avoid paying tax on its investment income, which it must do in order to survive in the competitive field — it must distribute ninety percent of that income without deductions for current net losses on sales of investments.

23 Brief for Appellee, p. 11, *In re* Brock, 420 Pa. 454, 218 A.2d 281 (1966).

24 PA. STAT. ANN. tit. 20, § 3470.5 (1964).

25 Section 5(1) provides:

> *Corporate* distributions made to a trustee in the shares of the distributing *corporation,* however described or designated by the distributing *corporation,* shall be deemed principal but if the number of shares of any class distributed to shareholders of such class is six percent (6%) or less of the number of shares of that class outstanding on the record date for such distribution, the shares so distributed shall be deemed income. *Except as provided above and in other subsections of this section* all dividends payable otherwise than in shares of the distributing *corporation,* including ordinary and extraordinary cash dividends and dividends payable in shares or other securities or obligations of *corporations* other than the distributing *corporation,* shall be deemed income. *Where the trustee shall have the option of receiving a dividend, either in cash or in the shares of the distributing corporation, it shall be considered as a cash dividend and deemed income, irrespective of the choice made by the trustee.* (Emphasis added.) PA. STAT. ANN. tit. 20, § 3470.5(1) (1964).

section 5(1), dealing with cash dividends in general, applies to the third sentence dealing with optional dividends as well. Thus, the court would make the optional dividend provision of 5(1) applicable only if no other subsection provided to the contrary. It is submitted that the third sentence of 5(1) is complete in itself and governs optional dividends exclusively. It was settled law prior to Pennsylvania's enactment of section 5 that optional dividends are to be considered as cash dividends.[26] Thus, in order for the last sentence in section 5(1)[27] to be meaningful, the Pennsylvania legislature must have intended optional dividends to be treated in their own distinct manner, without being governed by the second sentence of 5(1) concerning cash dividends in general. It can be argued that the last sentence of 5(1) was added only to strengthen the previous case law interpretation of optional dividends as cash dividends, and thus the legal implications are to be gleaned from the second sentence of 5(1). This position, however, is untenable in light of the words, "and deemed income." Had the legislature intended the second sentence of section 5(1) to govern optional dividends, the qualifying phrase, "and deemed income," in the last sentence of 5(1) would have been superfluous. The last sentence of 5(1) is clear, precise, and complete; it does not require other subsections for explication.[28]

After superficially disposing of section 5(1), the court in *Brock* held that the second and third sentences of section 5(3)[29] control capital gains distributions of a mutual fund. It is submitted that the court erred in this determination. Section 5(3) applies only to the apportionment of dividends issued by the normal corporate enterprise. It has no application to capital gains distributions of a mutual fund.[30] The phrase, "return of capital," in the second sentence of 5(3),

26 See, *e.g.*, Hyde v. Holmes, 198 Mass. 287, 84 N.E. 318 (1908); Davis v. Jackson, 152 Mass. 58, 25 N.E. 21 (1890); *In re* Hurd's Will, 203 Misc. 966, 120 N.Y.S.2d 103 (1953); RESTATEMENT (SECOND), TRUSTS § 236(c) (1959); BOGERT, *op. cit. supra* note 8, § 846; 3 SCOTT, TRUSTS § 236.4 (2d ed. 1956); Annot., 44 A.L.R.2d 1286 (1955).

27 Where the trustee shall have the option of receiving a dividend, either in cash or in the shares of the distributing corporation, it shall be considered as a *cash dividend* and *deemed income,* irrespective of the choice made by the trustee. (Emphasis added.) See note 25 *supra.*

28 In *In re* Gardner's Trust, 266 Minn. 127, 123, N.W.2d 69 (1963), the decision was based on a provision of a Minnesota statute [MINN. STAT. ANN. § 501.47(4) (Supp. 1965)] which is substantially the same as the last sentence in § 5(1) of the Pennsylvania Principal and Income Act. In Summerfield Estate, 26 Pa. D. & C.2d 526, 529 (Orphans' Ct. 1962), the court stated in dictum: "The provisions of section 5(1) of the [Pennsylvania] Principal and Income Act are clear and unequivocal."

29 Section 5(3) provides:

> Where the assets of a *corporation* are liquidated, wholly or partially, amounts paid upon *corporate* shares as cash dividends, declared before such liquidation began, or as arrears of cumulative preferred, or guaranteed dividends shall be deemed income, all other amounts paid, upon *corporate* shares on disbursement of the *corporate* assets to the stockholders shall be deemed principal. *All disbursements of corporate assets to the stockholders, whenever made, which are designated by the corporation as a return of capital or division of corporate property, shall be deemed principal. Any profit or loss resulting from the sale or liquidation of corporate shares shall enure to or fall upon principal.* (Emphasis added.) PA. STAT. ANN. tit. 20, § 3470.5(3) (1964).

30 *In re* Gardner's Trust, 266 Minn. 127, 123 N.W.2d 69 (1963), involved a statute containing sections [MINN. STAT. ANN. §§ 501.47(3), (4) (Supp. 1965)] identical with the second sentence of § 5(3) and the third sentence of § 5(1) respectively. The Minnesota court did not deem § 501.47(3) worthy of discussion but instead held that § 501.47(4) was controlling.

means a return of capital invested.[31] That is clearly not the situation in *In re Brock,* as the trustee did not receive a return of his initial capital investment. The final provision of 5(3) refers to the sale or liquidation of treasury shares, that is, shares of a corporation's own stock held by that corporation. This sentence provides that those dividends which represent gains from the sale or liquidation of the corporation's own stock (treasury shares) are to be deemed principal. It is submitted that the court in *Brock* ignored the statute's intended scope and applied the final provision out of context to mutual funds. Mutual fund distributions which represent gains from the sale of stock and securities held by the fund are not analogous to those corporate dividends which represent gains from the sale of treasury stock.

The policy considerations which the court discusses in *In re Brock* are of the utmost significance in the determination of dividend allocation. The Internal Revenue Service has ruled that when capital gains distributions of a mutual fund are allocable to the income life tenant, a remainder to charity will not qualify for a charitable deduction under the federal estate tax law.[32] In the Greater Philadelphia area alone, at least fifty-nine estates, involving taxes in excess of $3,600,000, are affected by this ruling.[33] This tremendous impact on charitable trusts almost compels the conclusion that capital gains distributions of a mutual fund be allocated to principal.[34] Another policy argument in favor of allocation to principal is that both capital gains and capital losses should inure to the same beneficiary. As the Massachusetts Supreme Court recently noted:

> It is argued that if capital gain distributions . . . [are] paid to the income beneficiary, the trust principal will inevitably suffer in years of losses, which must be expected even in an era generally inflationary, so that, in effect, the investment company shares may become a wasting investment.[35]

Allocating capital gains distributions to the income life tenant will result in

31 *E.g.,* such as distributions received on corporate reorganization, on proceeds of the forced sale of a capital asset, or as the result of a true stock split. See Steel Estate, 32 Pa. D. & C.2d 553 (Orphans' Ct. 1964). In *Steel,* the court held that the distribution by DuPont of its stockholdings in General Motors, pursuant to a court divestiture order, constituted a partial liquidation of the assets of DuPont within the meaning of the second sentence of § 5(3).

32 Rev. Rul. 60-385, 1960-2 Cum. Bull. 77. The court in *In re Brock* noted that under this ruling:

> [W]here a will creates a trust with income payable to someone for life and the principal thereafter to a charity and the trustee is empowered to invest in mutual or regulated investment company funds, the remainder to charity will not qualify for the charitable deduction under federal estate tax law if, *under the applicable state law,* any capital-gains distribution on the shares of the mutual fund or regulated investment company would be allocated to income and distributed to the income beneficiaries. *In re* Brock, 420 Pa. 454, 218 A.2d 281, 282, n.4 (1966).

33 *Ibid.*

34 The Introductory Statement to N.J. REV. STAT. § 3A:14A-5, p. 13 (Supp. 1965) states:

> The change in Section 5 of the [Principal and Income] Act [classifying capital gains distributions of a mutual fund as principal] is proposed as a result of Briel v. Moody . . . . Under this decision where property is transferred or bequeathed in trust to one for life and on his death to charity, then if the trust may be invested in shares of an investment trust, no charitable deduction is allowed under the income, estate and gift tax laws. Rev. Rul. 60-385.

35 Tait v. Peck, 346 Mass. 521, 194 N.E.2d 707, 712 (1963). See Shattuck, *Capital Gain Distributions: Principal or Income?* 88 TRUSTS & ESTATES 160 (1949). *Contra,* Young, *supra* note 8.

the anomalous situation that losses resulting from the sale of securities would be borne by the remainderman, while the profits of such sales would go to the life tenant.[36] Since remaindermen have to bear any net capital loss which might occur,[37] it is reasonable to hold that they should be entitled to any net capital gain.

It is submitted that the court in *In re Brock* could have reached the same desirable result that it did, without violating the provisions of section 5 of the Pennsylvania Principal and Income Act. This result could have been achieved by a fuller utilization of the conduit theory. The mutual fund is a unique entity.[38] The "many doctrines evolved to fit the usual type of associative enterprise do not fit the fund."[39] The conduit theory recognizes this uniqueness and properly classifies the mutual fund as a mere conduit for management purposes. The mutual fund is not analogous to an ordinary business corporation and the doctrines evolved to govern the normal business corporation should not be superimposed upon a mutual fund. Since section 5 deals only with the dividend allocations of an ordinary business corporation,[40] the Pennsylvania Supreme Court could have held that due to the unique nature of a mutual fund, section 5 did not apply at all. The court then would have been free of statutory restrictions and able to adopt completely the approach of the conduit theory under which capital gains distributions are classified as principal.

The conduit theory and section 5 cannot logically coexist. The conduit theory asserts that a mutual fund is not an ordinary business corporation, whereas section 5 is applicable only to ordinary business corporations. It is submitted that the court in *In re Brock* should have clarified this area of law by holding that the conduit theory is applicable, but that section 5 is not.[41] Though the Pennsylvania Supreme Court may have erroneously interpreted section 5 of the Pennsylvania Principal and Income Act, the real impact of *In re Brock* is the court's acceptance of the conduit theory.

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36 *In re* Brock, 420 Pa. 454, 218 A.2d 281, 290 (1966).

37 As the portfolio assets decrease in value, the market value of the mutual fund shares decreases proportionally.

38 See note 20 *supra*.

39 Lobell, *supra* note 3, at 216. See text accompanying notes 21-22 *supra*.

40 See notes 25, 29 *supra*.

41 This view is expressed in the REVISED UNIFORM PRINCIPAL AND INCOME ACT § 6. The REVISED UNIFORM PRINCIPAL AND INCOME ACT § 6(c) gives mutual fund distributions their own separate classification consonant with the conduit theory. Maryland, MD. ANN. CODE art. 75B, § 6(c) (1965), and New Jersey, N.J. REV. STAT. § 3A:14A-5(d) (Supp. 1965), also have passed legislation granting mutual fund distributions their own separate classification consistent with the conduit theory, but distinct from such sections as 5(1) and 5(3) of the Pennsylvania Principal and Income Act. The trend is definitely toward the view that sections such as 5(1) and 5(3) do not apply, but rather that mutual funds should have their own classification. States that have enacted such legislation are: Connecticut, CONN. GEN. STAT. ANN. § 45-113(1) (Supp. 1965); Florida, FLA. STAT. ANN. § 690.06 (Supp. 1965); Idaho, IDAHO CODE ANN. § 68-1006(c) (Supp. 1965); Kansas, KAN. GEN. STAT. ANN. § 58-905(c) (Supp. 1965); Louisiana, LA. REV. STAT. § 9:2149C (1965); Maine, ME. REV. STAT. ANN. tit. 18, § 4054 (1964); Maryland, MD. ANN. CODE art. 75B, § 6(c) (1965); Michigan, MICH. STAT. ANN. § 26.79(6)(c) (Supp. 1965); New Jersey, N.J. REV. STAT. § 3A:14A-5(d) (Supp. 1965); North Carolina, N.C. GEN. STAT. § 37-5(e) (Supp. 1965); South Carolina, S.C. CODE ANN. § 67-509(c) (Supp. 1965); Tennessee, TENN. CODE ANN. § 35-706(1) (Supp. 1966); Wisconsin, WIS. STAT. ANN. § 231.40(5)(a) (Supp. 1966); Wyoming, WYO. STAT. ANN. § 34-379(c) (Supp. 1965).

SECURED TRANSACTIONS — BANKRUPTCY — HOLDER OF A PERFECTED SECURITY INTEREST UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE DENIED RIGHT TO RECLAIM COLLATERAL FROM BANKRUPT DEBTOR IN CHAPTER X REORGANIZATION PROCEEDINGS.—During the summer and fall of 1964, Yale Express System, Inc., (hereinafter Yale) purchased from Fruehauf Corporation a total of fifty trailers and sixty-two truck bodies. Fruehauf sold these items on credit, relying on Yale's apparent financial stability as published in a recent Dun & Bradstreet Report. In February 1965, however, Fruehauf learned that the financial report upon which it had relied was inaccurate. Instead of having a million dollars profit for 1963, Yale had actually sustained a net loss. Fruehauf thereupon entered into a security agreement with Yale waiving its asserted right to reclaim the trailers and truck bodies[1] as consideration for Yale's executing, in Fruehauf's favor, a security interest in the form of a chattel mortgage. Fruehauf contended that this security interest, duly executed and filed in accordance with the applicable provisions of the New York Uniform Commercial Code[2] (hereinafter the Code) constituted a valid purchase money security interest.[3] One of the terms of this agreement provided that Fruehauf, the secured party, could elect to repossess the collateral if a petition for reorganization should be filed by or against Yale. When Yale filed such a petition for reorganization under Chapter X of the Federal Bankruptcy Act,[4] Fruehauf made a formal demand upon Yale's trustee in bankruptcy for immediate repossession of the goods described in the security agreement. Upon the trustee's refusal, Fruehauf brought a petition for reclamation in the reorganization court. The United States District Court for the Southern District of New York denied Fruehauf's petition and *held*: the trucks and trailers purchased by Yale, the debtor, were "property of the debtor" not subject to reclamation by the manufacturer which held a perfected security interest under the Code. *In re Yale Express Sys., Inc.*, 250 F. Supp. 249 (S.D.N.Y. 1966).[5]

Chapter X of the Federal Bankruptcy Act deals with corporate reorganizations. The basic purpose of this chapter is to seek the rehabilitation, rather than forced liquidation, of debtors.[6] Its basic philosophy can be found in two sections

1 At this point the asserted right to reclaim did not arise from any security agreement. Fruehauf contended that it could reclaim the trucks and trailers on the ground that it had the right to rescind the transactions because of Yale's material misrepresentation of its financial condition. Memorandum of Law of Petitioner Fruehauf, p. 7, *In re* Yale Express Sys., Inc., 250 F. Supp. 249, on file with the *Notre Dame Lawyer.*

2 N.Y. UNIFORM COMMERCIAL CODE §§ 9-302 and 9-304 [Hereinafter cited as UCC].

3 UCC § 9-107 defines a "purchase money security interest" as follows:

> A security interest is a "purchase money security interest" to the extent that it is
> (a) taken or retained by the seller of the collateral to secure all or part of its price; or
> (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Article 9 of the UCC does not recognize the traditional distinctions between security agreements. Instead, it covers all traditional types of security agreements with the one term "security interest." A purchase money security interest under the Code is simply a special type of security interest. UCC § 9-312 (3)-(4) gives a purchase money security interest priority over a security interest in after-acquired property.

4 52 Stat. 883 (1938), 11 U.S.C. §§ 501-676 (1964).

5 An appeal to the United States Court of Appeals for the Second Circuit is now pending. Letter from Attorneys for Petitioner, July 7, 1966, on file with the *Notre Dame Lawyer.*

6 In Case v. Los Angeles Lumber Co., 308 U.S. 106, 124 (1939), the Court said: "One

dealing with the power of reorganization courts over a debtor's property. Section 116(4)[7] of the act gives reorganization courts power to enjoin any further proceedings against a debtor to enforce a lien until issuance of the court's final decree approving a petition for reorganization. Section 148[8] makes an approval of a petition for reorganization an automatic stay of any prior bankruptcy proceedings, equity receiverships, mortgage foreclosures, or other proceedings to enforce a lien against the debtor's property. Thus, the purpose of Chapter X is to temporarily insulate the debtor from other proceedings. A debtor is given additional time to regroup his assets, obtain other capital, and prepare a reorganization plan, with the hope that by operating under the new plan the debtor may once again conduct a profitable business.[9]

In a secured transaction, the secured creditor acquires a property right in the collateral. In the event of bankruptcy proceedings, he is placed in a class above general creditors. During regular liquidation bankruptcy proceedings (those under neither Chapter X nor Chapter XI), the secured creditor is entitled to payment from liquidation of the collateral.[10] During Chapter X reorganization proceedings, however, a secured creditor is not entitled to reclaim his property merely by showing that he is a secured creditor. The general rule governing petitions for reclamation in Chapter X reorganization proceedings was set forth in *In re Lake's Laundry, Inc.*[11] In that case, the Second Circuit held that reclamation will be granted against a debtor if the petitioner is able

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of the purposes of § 77B [the forerunner of Chapter X of the Bankruptcy Act] was to avoid the consequences to debtors and creditors of foreclosures, liquidations, and forced sales with their drastic deflationary effects." For a similar philosophy of the purpose of Chapter X, see *In re* Embassy Co., 58 F. Supp. 1004 (E.D. Mo. 1945); *In re* 325 East 72d St., 53 F. Supp. 997 (S.D.N.Y. 1944); *In re* Warren Bros., 43 F. Supp. 173 (D. Mass. 1942). For a discussion of § 77B, its faults and subsequent refinements into Chapter X, see 6 COLLIER, BANKRUPTCY ¶ 0.05 (14th ed. 1965).

7 Section 116 of the Bankruptcy Act, 52 Stat. 884-85 (1938), 11 U.S.C. § 516(4) (1964), provides:

> Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court— . . . .
>
> (4) in addition to the relief provided by section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

8 Section 148 of the Bankruptcy Act provides:

> Until otherwise ordered by the judge, an order approving a petition shall operate as a stay of a prior pending bankruptcy, mortgage foreclosure, or equity receivership proceeding, and of any act or other proceeding to enforce a lien against the debtor's property.

52 Stat. 888 (1938), 11 U.S.C. § 548 (1964).

9 The difference between a Chapter X reorganization and a Chapter XI arrangement is the comprehensiveness of the plan. Chapter X encompasses a more thorough plan of reorganization and protects widely scattered creditors and stockholders. SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965); General Stores Corp. v. Shlensky, 350 U.S. 462 (1956); SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940); SEC v. Crumpton Builders, Inc., 337 F.2d 907 (5th Cir. 1964).

10 Bankruptcy Act § 57(h), 52 Stat. 866 (1938), 11 U.S.C. § 93(h) (1964). See Goggin v. California Labor Div., 336 U.S. 118 (1949) (holder of a statutory lien held to outrank unsecured creditor).

11 79 F.2d 326 (2d Cir.), *cert. denied,* 296 U.S. 622 (1935). The doctrine of *Lake's Laundry* has been followed in a number of subsequent cases. *E.g., In re* White Plains Ice Serv., Inc., 109 F.2d 913 (2d Cir. 1940); *In re* Newjer Contracting Co., 154 F. Supp. 567 (D.N.J. 1957); *In re* Sun Cab Co., 67 F. Supp. 137 (D.D.C. 1946).

to show that the property he seeks to reclaim belongs to him.[12] Thus, the issue is whether a petitioner has title to, or merely a lien on or interest in, the property sought to be reclaimed.

In determining this crucial issue, reorganization courts must look to the appropriate state law governing secured transactions. State laws generally give conditional vendors title to collateral. Likewise, state laws generally provide that a chattel mortgagee has only a lien on property. In the usual reorganization proceeding, therefore, a conditional vendor is granted reclamation, whereas a chattel mortgagee is not.[13] Thus, in order to be successful in its petition for reclamation, Fruehauf had to prove that the goods sought to be reclaimed were its property and not that of the debtor, Yale.

It was in proving this contention that Fruehauf encountered difficulty. Fruehauf's security agreement with Yale was executed in accordance with the applicable provisions of the New York Uniform Commercial Code. Although it replaces the concept of chattel mortgage with the broader concept of "security interest," the Code still allows parties to use the traditional forms of security agreements.[14] Fruehauf's security agreement was in the form of a chattel mortgage. Therefore, under traditional concepts of chattel mortgage, Fruehauf would not have had title to the collateral and would not have been allowed to reclaim it.

Fruehauf's main argument in seeking reclamation was that Code section 9-202 abolishes the distinction between title and lien. Hence, the fact that title was in Yale, the debtor, should not bar reclamation in a Chapter X proceeding. Section 9-202 of the Code states: "Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor." Fruehauf asserted that since the Code no longer recognizes the distinction between title and lien as material to the rights, obligations, and remedies arising out of secured transactions, the title-lien distinction should not be material in granting or denying petitions for reclamation in Chapter X bankruptcy proceedings. Fruehauf further contended that since it had a valid purchase money security interest under the Code, reclamation should be granted if, under the equitable powers of the court, such a result would serve justice.[15]

The problem which confronted the district court in *Yale Express* involved the interplay of two statutes — the Uniform Commercial Code and the Federal Bankruptcy Act. The fact that the former is codified as state law, while the latter is a federal statute complicated the problem. The Code, being state law,

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12 *In re* Lake's Laundry, Inc., *supra* note 11, at 327-28.

13 *Id.* at 328.

14 UCC § 9-102(2) provides:

> This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security.

The Comment to UCC § 9-101 states:

> Under this Article the traditional distinctions among security devices, based largely on form, are not retained; the Article applies to all transactions intended to create security interests in personal property and fixtures, and the single term "security interest" substitutes for the variety of descriptive terms which has grown up at common law and under a hundred-year accretion of statutes. This does not mean that the old forms may not be used . . . .

15 Reply Memorandum of Law of Petitioner Fruehauf, p. 6.

is not authority for solving problems governed by the Federal Bankruptcy Act. Neither the code drafters nor the state legislatures that adopted the Code can tell bankruptcy courts, which are governed by federal statutes, what to do.

Yale Express raised the interesting question of the Code's application in bankruptcy proceedings. The Code, which has become effective in almost every state, replaces existing state legislation dealing with security devices.[16] Article 9, which deals with secured transactions, departs radically from traditional concepts of title and lien. The Code attempts to base its remedies on the factual circumstances of each transaction rather than on a technical inquiry into whether the secured party has title to, or merely a lien on, the property in question.

A noted commentator in the field of secured transactions has stated that the old title-lien distinction makes little sense when analyzed from the businessman's point of view.[17] A businessman desiring to enter into a secured transaction should not be placed in jeopardy simply because the law governing conditional sales contracts developed differently from the law governing chattel mortgages. Article 9 of the Code is the answer to the businessman's dilemma.[18] This article develops different rules to be applied in different situations. These rules do not depend on formal title-lien distinctions. Rather, the Code looks to the relationship between the parties and the substantive basis of the transaction. In all cases, the interest which the secured creditor obtains under the Code has the same designation — a "security interest."[19]

Code section 9-202, which abolishes the title-lien distinction, is the focal point of the Code's new theory of secured transactions. A comment to section 9-507 makes it clear that the Code drafters hoped this new theory would be adopted by the bankruptcy courts:

> But since this Article adopts neither a "title" nor a "lien" theory of security interests . . . *the granting or denying of, for example, petitions of reclamation in bankruptcy proceedings should not be influenced by speculations as to whether the secured party had "title" to the collateral or "merely a lien."*[20] (Emphasis added.)

The Code, then, adopts a new approach to secured transactions. If bankruptcy courts continue to follow the rule of *Lake's Laundry*, they must look to state law to determine a petitioner's rights. In those jurisdictions which have adopted the Code, Article 9 is the state law governing secured transactions to

16 The Comment to UCC § 9-101 states that Article 9 "supersedes existing legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivable. . . ."

17 SPIVAK, SECURED TRANSACTIONS 6 (Uniform Commercial Code, Practice Handbook 5, 1963).

18 *Id.* at 7.

19 UCC § 1-201(37) defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation. . . . The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9. . . ." For an example of the "substantive basis of the transaction," see Comments to UCC §§ 9-101 and 9-109. For excellent discussions of UCC Article 9, see Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code,* 63 COLUM. L. REV. 1 (1963); Coogan, *The Lazy Lawyer's Guide to Secured Transactions Under the Code,* 60 MICH. L. REV. 685 (1962); and Schwartz, *The Effect of the Uniform Commercial Code on Secured Financing Transactions and Bankruptcy,* 38 ST. JOHN'S L. REV. 50 (1963).

20 UCC § 9-507, comment 1.

which bankruptcy courts must look. As has been noted, Article 9 does away with the traditional analysis of secured transactions in terms of title and lien. All this article gives a secured party is a "security interest." The problem before the court in *Yale Express*, therefore, was to choose between two conflicting sets of laws. The court could have strictly adhered to the pre-Code bankruptcy precedents and have tried to determine, without the aid of current state law, whether the secured party had title to, or a lien on, the collateral; or, it could have adopted the new theory embodied in the Code, ignored the antiquated title-lien distinction, and granted reclamation if such relief would have served justice under the circumstances.

The court in *Yale Express* stated that Fruehauf's reliance on Article 9 of the Code was "misplaced."[21] It held that section 9-202 applied only to "the rights, obligations and remedies *which are provided by the Code itself*, and none of the Code provisions, separately or when read together, give a holder of a chattel mortgage (or purchase money security interest) the right to reclaim collateral from a debtor in Chapter X proceedings."[22] The court felt that the Code should not be allowed to encroach upon settled bankruptcy precedents. Since the security agreement in *Yale Express* was in the *form* of a chattel mortgage which, according to pre-Code state law, gave the mortgagee (or "secured party" using Code terminology) a lien on the collateral, the district court followed *Lake's Laundry* and denied reclamation.

A second reason given by the court in *Yale Express* for denying reclamation was based on Code section 9-503.[23] This section gives secured parties the right to repossession with or without judicial process. Since a Chapter X proceeding is clearly a judicial process, the court reasoned that the right to repossession should be based on Chapter X bankruptcy precedents. The court cited with approval the 1956 Report of the New York Law Revision Commission which stated: "It is incredible that any court would ever construe the default provisions of Code Article 9 as over-riding any provisions of existing assignment or insolvency statutes."[24]

Viewed narrowly, in terms of the Bankruptcy Act, the court's decision in *Yale Express* denying petitioner's claim for reclamation was the only logical holding. The Bankruptcy Act in many sections contains the words "property of the debtor." The act thus implies that if the property is not that of the debtor (*i.e.*, if title is in another person), the provisions of the act will not be applicable. Similarly, the distinction between property held by a debtor as a conditional

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21 250 F. Supp. 249, 253 (S.D.N.Y. 1966).
22 *Ibid.*
23 UCC § 9-503 provides:

> Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable and may dispose of the collateral on the debtor's premises. . . .

24 1956 N.Y. Report of Law Revision Commission, Report Relating to the Uniform Commercial Code, p. 104.

vendee and property mortgaged by him has ancient roots.[25] Hence the time-honored concepts of title and lien are so firmly entrenched in legal thought and the Bankruptcy Act that it is very unlikely a single Code section will easily efface them. While the Code changes existing state law dealing with secured transactions, it does not change federal bankruptcy precedents.

It is submitted that if the district court's decision in *Yale Express* is followed the law governing secured transactions will become static. In jurisdictions where the Code is in effect, bankruptcy courts will not be able to look to Article 9 of the Code to determine whether a secured party has title to, or a lien on, the collateral. Rather, bankruptcy reorganization courts faced with resolving the title-lien dichotomy will have to look at state law as it existed prior to the state's adoption of the Code. The outcome of this procedure will be the crystallization of pre-Code state laws dealing with secured transactions. The high hopes of the Code drafters that the Code would abolish title-lien speculations in reclamation proceedings will thus be frustrated. If bankruptcy courts in the future choose to follow the lead of *Yale Express,* a large uncrossable gap will result in the law. In determining whether a secured party has title to, or a lien on, collateral, bankruptcy courts will have to overlook the state's adoption of the Code and seek their answer in pre-Code state law.

This gap created in the law by *Yale Express* will have some very important ramifications unless the Bankruptcy Act is amended. Every secured transaction is entered into with the possibility of bankruptcy in mind. However, according to the rationale of *Yale Express,* creditors who wish to enter into secured transactions will have to look to two different sets of laws. First, in order to make sure his security interest is properly perfected, a creditor must comply with all the requirements of the Code for a signed writing[26] and proper perfection.[27] Then, a secured creditor who is a seller desiring to protect himself in the event of a Chapter X proceeding, will still have to use the time-honored forms of conditional sales contracts to make certain that he retains title to the goods.[28]

The concept of title is steadily being eroded in the area of commercial law. The Code drastically modifies the importance of title in the law of sales.[29] It makes rights, duties and remedies dependent on the factual situation of each case rather than an artificial inquiry into the location of title. The ordinary businessman should not be expected to have an attorney at his side every time he enters into a secured transaction. In lessening the importance of title, the Code emphasizes the substantive basis of the transaction. This practical approach allows

25 *In re* Lake's Laundry, Inc., 79 F.2d 326, 328 (2d Cir.), *cert. denied,* 296 U.S. 622 (1935).

26 UCC § 9-203.

27 UCC § 9-303.

28 A concomitant problem is that of voidable preferences. For a discussion of Article 9 secured transactions that might constitute voidable preferences, see 3 COLLIER, *op. cit. supra* note 6, ¶ 60.51A (14th ed. 1966).

29 UCC § 2-401 provides in part:

> Each provision of this Article [Article 2, Sales] with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title.

For an excellent comparison of the Uniform Commercial Code and the Uniform Sales Act, see generally Whiteside, *Uniform Commercial Code—Major Changes in Sales Law,* 49 KY. L.J. 165 (1960).

businessmen to conduct secured transactions on the basis of their reasonable expectations. Thus, commercial transactions are not only considerably expedited, but they acquire a needed element of certainty.

Judge Learned Hand, in his dissenting opinion in *Lake's Laundry,* stated: " 'title' is a formal word for a purely conceptual notion; I do not know what it means and I question whether anybody does . . . ."[30] It is submitted that the vast amount of litigation over the location of title graphically illustrates the unsatisfactory nature of such an inquiry. The Code, in doing away with formal conceptions of title, codifies prevailing business practices. If there is to be uniformity in this area of commercial law, it is imperative that other laws dependent on the Code follow its leadership.

If bankruptcy courts refuse to follow the Code, which now represents state law in the area of secured transactions, a large uncrossable gap will develop between the law of secured transactions and the law of bankruptcy. Bankruptcy law depends, in great measure, on the location of title. In adopting the Code, the vast majority of states have given their approval to a law of secured transactions which is not based on the location of title. It is submitted that the Federal Bankruptcy Act should be amended to recognize the new theory embodied in the Code.

William T. Coleman

CRIMINAL PROCEDURE — PROSECUTOR'S FAILURE TO DISCLOSE EVIDENCE EQUALLY AVAILABLE TO THE DEFENSE MAY CONSTITUTE A VIOLATION OF DUE PROCESS. — Milton Levin was indicted on a charge of grand larceny. The indictment charged that Levin had conspired with certain union officials to effect the corrupt acquittal of a union president on trial for perjury. In pursuance of this conspiracy, Levin allegedly received $35,000 to "fix" the necessary parties. The government's case contained several inconsistencies upon which Levin built his defense.[1] Despite these inconsistencies, the jury was allowed to find Levin guilty.[2] Levin unsuccessfully sought collateral relief in a habeas corpus proceeding on the theory of newly discovered evidence which the government possessed during his trial and failed to disclose.[3] The United States

30 *In re* Lake's Laundry, Inc., 79 F.2d 326, 328 (2d Cir.) (dissenting opinion), *cert. denied,* 296 U.S. 622 (1935).

1 One union official, Landriscina, testified that on the morning of February 12, 1959, he gave Levin ten $1,000 bills. Later, Levin requested payment in smaller denominations and was given $20 bills in exchange for the $1,000 bills. The remaining $25,000 was allegedly delivered on the afternoon of February 13. However, two other union officials, Ashby and Olson, recounted the events differently. They testified that Olson had obtained the entire $35,000, in $1,000 bills, on the morning of February 13, and later that day, Ashby exchanged the $1,000 bills for $20 bills. This money was then given to Landriscina to forward to Levin.

Levin also attempted to show that he was in Washington, D.C., only from the evening of February 12, until the early afternoon of the following day. If this were true, he could not have received any money from Landriscina on the morning of February 12.

2 The jury was allowed to find that Landriscina gave Levin $10,000 on the morning of February 13. Levin v. United States, 338 F.2d 265, 269 n.4 (D.C. Cir. 1964) (Bazelon, J., dissenting), *cert. denied,* 379 U.S. 999 (1965).

3 Levin v. Katzenbach, 363 F.2d 287, 288 (D.C. Cir. 1966). This newly discovered evidence consisted of a check drawn by the bank where the union officials obtained the money to pay Levin. The check was drawn to replenish the bank's supply of $1,000 bills. Levin argued that a replenishment would have been unnecessary if the $1,000 bills had been exchanged for the $20 bills. There was also a statement of a bank official, interviewed by

Court of Appeals for the District of Columbia, in reversing and remanding Levin's conviction, *held:* the prosecutor's failure to disclose evidence, which, in the context of the case, might have led the jury to entertain a reasonable doubt about defendant's guilt, was a violation of due process, notwithstanding the fact that such evidence was equally available to the defense. *Levin v. Katzenbach,* 363 F.2d 287 (D.C. Cir. 1966).

The duty of a criminal prosecutor discussed in *Levin* traces its genesis to the fountainhead case of *Mooney v. Holohan.*[4] Taken alone, *Mooney* is not a startling case. The principle announced therein is quite fundamental: instigation of perjury by a prosecuting attorney to obtain a conviction is a violation of due process which vitiates the proceedings. On its face, *Mooney* does not appear to be the kind of case that lends itself to judicial extension. However, *Mooney* is precisely that kind of case. From the elemental principle that a fraudulent conviction is invalid, courts have developed a highly sophisticated body of law dealing with problems far removed from the crude situation which confronted the defendant in *Mooney. Mooney's* present-day progeny have undergone such a complete metamorphosis that they resemble their distinguished ancestor only insofar as they employ the same due process grounds for decision. At the same time, the *Mooney* principle has been utilized to solve problems of an essentially different nature.[5]

Mooney first spawned a line of cases which rounded out the notion of fraudulent conviction. These cases paved the way for the extension to come. In *Napue v. Illinois,*[6] the assistant district attorney asked the chief witness if he had been offered any consideration for his testimony. The witness's negative reply was false and went uncorrected. The jury knew from previous testimony that someone had offered the witness consideration; what they did not know was that it was the prosecuting attorney. In this case, a lie bearing only on the witness's credibility was held sufficient to taint the conviction. *Napue* is best explained in terms of the prosecutor's deliberate conduct rather than the testimony's prejudicial effect upon the defendant.[7] Also, the Supreme Court has made it clear that a prosecutor cannot knowingly use perjured testimony even though such testimony goes to the question of punishment rather than guilt.[8]

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the defense, to the effect that he remembered Olson making the withdrawal, but he could not remember Ashby making the exchange. There was no implication that the exchange was not made, only that it was beyond recollection.

4 294 U.S. 103 (1935).

5 The fact that *Mooney* was based upon broad constitutional grounds may go far in explaining this phenomenon. "Due process of law, as a historic and generative principle, precludes defining, and thereby confining these standards of conduct more precisely than to say that convictions cannot be brought about by methods that offend 'a sense of justice.'" Rochin v. California, 342 U.S. 165, 173 (1952).

6 360 U.S. 264 (1959).

7 As was noted in People v. Savvides, 1 N.Y.2d 554, 136 N.E.2d 853, 154 N.Y.S.2d 885 (1956):

> The administration of justice must not only be above reproach, it must also be beyond the suspicion of reproach. . . . It is of no consequence that the falsehood bore upon the witness' credibility rather than directly upon defendant's guilt. A lie is a lie, no matter what its subject, and, if it is in any way relevant to the case, the district attorney has the responsibility and the duty to correct what he knows to be false and elicit the truth. *Id.* at 556-57, 136 N.E.2d at 854, 154 N.Y.S.2d at 887.

8 Alcorta v. Texas, 355 U.S. 28 (1957).

In *Pyle v. Kansas*,[9] the inevitable question was raised. The defendant in *Pyle* alleged that the state knowingly used perjured testimony and deliberately suppressed favorable evidence. Suppression was clearly presented as a ground for decision. However, since *Pyle* was amenable to proper disposition without passing on suppression, the Supreme Court left the question for future determination. In *United States ex rel. Montgomery v. Ragen*,[10] a federal district court, faced with the issue of whether suppression taints a conviction, answered in the affirmative. In this case, the prosecutor deliberately suppressed conclusive medical testimony, equally available to the defense, that the complainant had not been raped. The court termed the prosecutor's conduct "shocking" and granted relief in spite of a lack of due diligence by defendant's counsel.[11]

The rationale behind these cases rounds out the principle first enunciated in *Mooney* that the prosecutor's undesirable, even outrageous, conduct is a fraud which constitutes a stinging indictment against the state in its administration of criminal justice. Such conduct violates the fundamental precepts of our legal order and is therefore intolerable. When faced with such objectionable conduct on the part of prosecutors, courts are apparently oblivious to other considerations, viz., the prejudicial effect of the evidence and its availability to the criminal accused. The reason for the rule in these fraud cases is that "mere admonitions are insufficient to prevent repetition of the abuse."[12]

That line of cases based upon the instigation of, knowing use of, or failure to correct perjury had nearly run full course[13] when courts turned to the alternative ground of suppression, suggested in *Pyle*, to fashion a significant and still-developing body of law. In *United States ex rel. Almeida v. Baldi*,[14] the petitioner was convicted of murder. In this case, the prosecutor failed to reveal laboratory evidence which would have established defendant did not fire the murder weapon. Under the indictment, the defendant's having fired the murder weapon would have made no difference as to guilt, but this information would have been considerably important in fashioning punishment. *Baldi*, which was decided on the authority of *Mooney* and *Pyle*, was grounded on the fraud rationale. Obviously the fraud found in *Baldi* was of a different variety than that present in either *Mooney* or *Pyle*.

Two years later, in *United States ex rel. Thompson v. Dye*,[15] a defendant was convicted of first degree murder. The defense was his testimony, corroborated by some witnesses and discredited by others, that he was drunk and drugged and thus unable to formulate the necessary intent to commit first degree murder. The prosecutor, after examining a witness who testified as to defendant's sobriety, told the jury he could call other arresting officers who would give similar testi-

9 317 U.S. 213 (1942).

10 86 F. Supp. 382 (N.D. Ill. 1949).

11 *Id.* at 387. *Ragen* is not as clear a holding as could be desired. The prosecutor also perjured himself and intimidated defendant's trial counsel. However, these matters were not dwelt upon to any appreciable extent in the opinion. The court was concerned primarily with the suppression issue.

12 Kyle v. United States, 297 F.2d 507, 514 (2d Cir. 1961).

13 The case of misrepresentation logically belongs to this line. See text accompanying note 15 *infra*.

14 195 F.2d 815 (3d Cir. 1952), *cert. denied*, 345 U.S. 904 (1953).

15 221 F.2d 763 (3d Cir.), *cert. denied*, 350 U.S. 875 (1955).

mony. In so doing, he failed to communicate to either defense counsel or the court that at least one officer would testify that Thompson was under the influence of alcohol at the time of his arrest. In *Dye,* the prosecutor not only failed to disclose significant exculpatory evidence which he deemed irrelevant, but he also made a misleading affirmative statement as to the nature of the available but unused testimony. Regardless of the prosecutor's motives in withholding such significant testimony, his misrepresentation was found to be highly misleading and prejudicial. Since there was no finding of fraud on the prosecutor's part, the decision could not have rested squarely on the fraud rationale. Nonetheless, the Third Circuit granted relief. It can thus be seen that a misrepresentation that conceals the existence of significant exculpatory evidence, even absent fraudulent intent, can be violative of due process, damaging enough to outweigh considerations of diligence on the part of defense counsel.[16]

In *United States ex rel. Meers v. Wilkens,*[17] the prosecutor withheld the fact that there were two eyewitnesses who would state, positively, that the accused was not involved in the alleged crime. Although the court admitted that the availability of witnesses to the defense, through its own investigations, is a relevant consideration, availability was not determinative in this case since defense counsel had only one week to prepare his case. The court, in *Wilkens,* understood it as settled law that a characterization of the prosecutor's conduct was not a necessary precondition to granting relief.[18] In *Barbee v. Warden,*[19] the defendant was convicted of assault with intent to kill. Three witnesses identified the accused and tentatively identified, as the assault weapon, a pistol, which was not entered into evidence. Unknown to the prosecutor,[20] there was a ballistics report showing that the pistol was not wanted for any known crime. The court found a violation of due process in *Barbee,* but the exact reason is not clear.

Present in all these cases is the dilution of the fraud rationale to the point of nonexistence. Stress is now laid upon the prejudice generated to the defendant's disadvantage. Courts make extensive inquiries to determine if the suppressed evidence would have helped the defendant. *Smallwood v. Warden*[21] is typical of this approach. There the court stated, "motive is immaterial if the evidence was vital, i.e. was likely to have affected the result of the trial."[22] *Brady v. Maryland*[23] provides final confirmation. The Supreme Court stated:

> We now hold that the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evi-

16 It has been suggested that *Baldi* and *Dye* may be regarded as anomalous due to their highly compelling fact situations. Note, *The Duty of the Prosecutor to Disclose Exculpatory Evidence,* 60 COLUM. L. REV. 858, 860 (1960).
17 326 F.2d 135 (2d Cir. 1964).
18 "Formulation of the duty in terms of wilful or wrongful conduct would seem only to confuse here, and is not necessary under the governing law as we understand it." *Id.* at 139.
19 331 F.2d 842 (4th Cir. 1964).
20 "Indeed, there is nothing to indicate that this official had been told by the police of the existence of the reports." *Id.* at 844.
21 205 F. Supp. 325 (D. Md. 1962).
22 *Id.* at 329.
23 373 U.S. 83 (1963).

dence is material either to guilt or to punishment, *irrespective of the good faith or bad faith of the prosecution.*[24] (Emphasis added.)

Through the years, courts have continued to base their decisions in these cases on broad constitutional grounds — violation of due process. Exactly what is it that gives prejudice its peculiar flavor and constitutional dimension? It has been suggested that, in varying degrees, the criminal defendant's inadequate facilities to obtain facts necessary for a fair trial is the element which gives prejudice its constitutional dimension.[25] As one court recently stated:

> The average accused usually does not have the manpower or resources available to the state in its investigation of crime. Nor does he have access to all the evidence . . . . I do not think it imposes too onerous a burden on the state to require it to disclose the existence of a witness . . . of . . . significance . . . .[26]

The problem posed by *Levin,* then, directly considered, is one of criminal discovery, which has been dealt with by expanding the prosecutor's duty of disclosure.[27] It is important to note, however, that the prosecutor's duty of disclosure and criminal discovery are not equally efficacious means for achieving the same end — at least in the federal system. Judicial expansion of the prosecutor's duty of disclosure has been employed as a backhanded technique for extending criminal discovery. *Levin* is perhaps the best illustration of this phenomenon, for it is doubtful that a criminal discovery theory would have called for the same result.[28]

An analysis of *Mooney's* progeny brings to light a complex of three factors which intermingle with frivolous delight. Where the prosecutor's conduct is virtually fraudulent, courts are oblivious to other considerations. The resulting prejudice might be the subject of expatiation in order to dramatize the horror

24 *Id.* at 87.

25 Note, *The Prosecutor's Constitutional Duty To Reveal Evidence to the Defendant,* 74 YALE L.J. 136, 142-43 (1964).

26 Application of Kapatos, 208 F. Supp. 883, 888 (S.D.N.Y. 1962).

27 "I . . . would not cast in constitutional form a broad rule of criminal discovery." Brady v. Maryland, 373 U.S. 83, 92 (1963) (dissent); Traynor, *Ground Lost and Found in Criminal Discovery,* 39 N.Y.U.L. REV. 228, 242 (1964).

28 On the facts of *Levin,* FED. R. CRIM. P. 17(c) would be controlling. See generally Orfield, *Discovery and Inspection in Federal Criminal Procedure,* 59 W. VA. L. REV. 312 (1957). In essence, Rule 17(c) is a codification of the federal courts' power to issue *subpoenas duces tecum.* Bowman Dairy Co. v. United States, 341 U.S. 214 (1951), interpreted Rule 17(e) to permit discovery only if it would facilitate a good faith effort to gather evidence. Discovery is usually barred when an item is not "directly admissible at the instance of the moving party . . . ." Traynor, *supra* note 27, at 235. To make the picture bleak beyond hope, there is authority to the effect that Rule 17(c) is not directed at discovery, but rather at expediting complicated trials. United States v. Carter, 15 F.R.D. 367 (D.D.C. 1954). The only other source of criminal discovery which could be operative in *Levin,* the inherent power of the federal courts to grant discovery rights, also presents a dim picture. "It is not without significance that since the *Jencks* case [Jencks v. United States, 353 U.S. 657 (1957)] the federal courts have been reluctant to exercise their inherent powers to permit discovery." Traynor, *supra* note 27, at 240. Now "the federal courts allow discovery only in isolated cases, and even then only when the moving party is able to particularize a need or interest." Traynor, *supra* note 27, at 230. Interestingly enough, Levin's attorney did make a pretrial motion to inspect the checks, records, and correspondence in the government's possession. The motion was denied, and this denial was not attacked on direct appeal. Brief for Appellee, p. 15, n. 22.

of the fraud.[29] Otherwise, it is not conspicuous in granting relief.[30] Defense counsel's ineffective assistance is no bar to relief.[31] Absent fraudulent conduct by the prosecutor, prejudice and availability of the evidence to the accused are the key considerations. If prejudice is shown and the defense has been diligent, relief is granted. Thus, convictions have been overturned where the prosecutor made misleading statements before the court,[32] where the defense did not have adequate time to prepare for trial,[33] and where the information was in the state's control.[34] In a case where nondisclosed evidence, if known to the accused, would have been of great significance, regardless of defense counsel's lack of diligence, the prosecutor's failure to inform defense counsel of this evidence amounted to a denial of due process.[35] However, when the prosecutor's conduct is above reproach and the nondisclosed evidence is equally available to the defense, relief is usually denied.[36] *Levin* appears to be the first case granting relief where the prosecutor's conduct was so unquestionable, the defense counsel's lack of diligence so extreme, and the evidence's prejudicial effect so dubious. In short, *Levin* is unprecedented.

Levin treated three issues: the standard the evidence must meet, the type of the conduct the prosecuting attorney must display, and the degree of diligence the defense counsel must show. On the standard of evidence issue, *Kyle v. United States*[37] held that the required showing of prejudice varies inversely to the degree to which the conduct of the trial has violated fundamental notions of fairness.[38] Absent unfair conduct, it would have to be shown that the evidence would probably produce a different verdict.[39] Instead of attempting to deal with *Kyle,* Chief Judge Bazelon, in *Levin,* discussed a standard laid down by the Supreme Court in *Griffin v. United States.*[40] Bazelon concluded that "evidence which . . . might have led the jury to entertain a reasonable doubt . . ."[41] would entitle petitioner to relief. Why this standard, which bears no apparent relation to the standards laid down in *Kyle* or *Griffin,* was chosen is not revealed.

On the issue of the prosecutor's conduct, *Levin* held that the prosecutor's failure to disclose evidence which might have led the jury to entertain a reasonable

29 Napue v. Illinois, 360 U.S. 264 (1959).
30 People v. Savvides, 1 N.Y.2d 554, 136 N.E.2d 853, 154 N.Y.S.2d 885 (1956).
31 In United States *ex rel.* Montgomery v. Ragen, 86 F. Supp. 382 (N.D. Ill. 1949), defendant's attorney was submissive to threats of intimidation and refused to call in any witnesses to testify on defendant's behalf.
32 United States *ex rel.* Thompson v. Dye, 221 F.2d 763 (3d Cir. 1955).
33 United States *ex rel.* Meers v. Wilkens, 326 F.2d 135 (2d Cir. 1964).
34 Barbee v. Warden, 331 F.2d 842 (4th Cir. 1964).
35 Ashley v. Texas, 319 F.2d 80 (5th Cir.), *cert. denied,* 375 U.S. 931 (1963). *Contra,* State v. Giles, 239 Md. 458, 212 A.2d 101 (1965), *cert. granted,* 383 U.S. 941 (1966).
36 *E.g.,* United States v. Soblen, 301 F.2d 236 (2d Cir.), *cert. denied,* 370 U.S. 944 (1962); Jordan v. Bondy, 114 F.2d 599 (D.C. Cir. 1940).
37 297 F.2d 507 (2d Cir. 1961).
38 *Id.* at 514.
39 *Ibid.* See generally Note, *supra* note 16, at 865; Note, *supra* note 24, at 138-42.
40 336 U.S. 704 (1949). The lower court was to grant relief if it were "too dogmatic, on the basis of mere speculation, for any court to conclude that the jury would not have attached *significance* to the evidence favorable to the defendant had the evidence been before it." (Emphasis added.) Griffin v. United States, *supra* at 709.
41 Levin v. Katzenbach, 363 F.2d 287, 291 (D.C. Cir. 1966).

doubt about appellant's guilt is to be "classified as negligence."[42] Chief Judge Bazelon employed a definition of negligence which stressed the *result* of the prosecutor's failure to disclose. The standard and accepted definition of negligence,[43] however, characterizes the *act* and not its result. What was done in *Levin*, in a rather subtle fashion, was to eliminate the requirement of showing negligence on the prosecutor's part. It is submitted that if words are to have any precision, they cannot be stuffed with new and unrelated meanings. A word "is the skin of a living thought."[44] It is not a fit subject for legal taxidermy.

Levin is cryptic on the issue of defense counsel's diligence. Noting that ordinarily a lack of due diligence will bar relief when a motion is based solely upon discovery of evidence, the court stated that Levin's claim for relief was based upon a breach of the prosecutor's duty of disclosure, which challenged the validity of the proceedings, and therefore the diligence of defense counsel was not a proper consideration in determining the fairness of those proceedings.[45] By way of qualification, *Levin* stated that if "appellant's counsel actually knew the facts withheld, appellant [could not] . . . seek relief on the basis of the government's failure to disclose these . . . facts."[46] By way of amelioration, the court added that the government was under no duty to search for evidence favorable to the accused, nor "disclose all its evidence, however insignificant, to the defense."[47]

Judge Burger's dissent in *Levin* concentrated primarily on the issue of diligence. Judge Burger was at pains to demonstrate that diligence was determinative in assaying the validity of the proceedings in question. He discussed the advantages already enjoyed by criminal defendants[48] and proffered several arguments of consequence in criticism of the majority opinion. Burger surmised that the majority holding would encourage slovenly preparation, put another crack in the concept of judicial finality, and place upon the prosecution the impossible

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42 *Ibid.*

43 PROSSER, TORTS 148 (3d ed. 1964).

44 Towne v. Eisner, 245 U.S. 418, 425 (1918) (Holmes, J.).

45 Ordinarily, a finding of lack of due diligence will defeat a motion for a new trial based only upon the significance of newly discovered evidence. But appellant's claim for relief based upon a breach of the prosecutor's duty of disclosure challenges the fairness, and therefore the validity, of the proceedings, and relief, either on a motion for a new trial or for habeas corpus, may not depend on whether more able, diligent or fortunate counsel might possibly have come upon the evidence on his own. A criminal trial is not a game of wits between opposing counsel, the cleverer party, or the one with the greater resources, to be the "winner." Levin v. Katzenbach, 363 F.2d 287, 291 (D.C. Cir. 1966).

46 *Ibid.*, n. 11.

47 *Id.* at 291.

48 As was stated in United States v. Garsson, 291 Fed. 646, 649 (S.D.N.Y. 1923) (L. Hand, J.):

> Under our criminal procedure the accused has every advantage. While the prosecution is held rigidly to the charge, he need not disclose the barest outline of his defense. He is immune from question or comment on his silence; he cannot be convicted where there is the least fair doubt in the minds of any of the twelve. Why in addition he should in advance have the whole evidence against him to pick over at his leisure, and make his defense, fairly or foully, I have never been able to see.

But see People v. Riser, 47 Cal. 2d 566, 305 P.2d 1 (1956). See generally Goldstein, *The State and the Accused: Balance of Advantage in Criminal Procedure*, 69 YALE L.J. 1149 (1960).

burden of determining what a witness has revealed to the other side.[49] This otherwise well-reasoned dissent is marred, however, by a major flaw. Judge Burger believed that the majority's decision will "tend to allow a second trial to any defendant imaginative enough to dream up a new theory of defense as 'newly discovered' because neither party *elected* to use it at trial."[50] (Emphasis added.) To elect, however, one must choose between known alternatives. The majority opinion explicitly holds that such a situation would bar relief.[51]

Levin does not, by its terms, require the prosecutor to make complete disclosure. It is submitted, however, that the rule announced in *Levin* is designed to make complete disclosure a practical necessity. The determination as to whether nondisclosed evidence might have led the jury to entertain a reasonable doubt about defendant's guilt is not to be made until after trial. To forecast beforehand the conduct of the trial to take place and to determine with any degree of precision what effect any given piece of evidence "might have had" on the jury, requires powers which would have stirred the jealousy of the Pythia. A decision by the prosecutor not to disclose a piece of evidence also becomes a precarious affair. The prosecutor is placed under the imminent threat of reversal should his judgment prove erroneous. Prosecutors must, therefore, either take an excessive risk in not disclosing certain matters or else disclose all information in their possession. Wisdom would demand adherence to the latter course. Moreover, this result is reached by expanding the prosecutor's duty of disclosure, which is unconditioned by any request from the defense.[52] This result not only inters the requirement that the defense make a showing of need, but permits what would otherwise be discovery of discovery.

What is most curious about *Levin* is that the reason given by the majority to justify its result is equally applicable to the view urged in the dissent.[53] Chief Judge Bazelon's major premise is inarticulate. It is submitted that the only rationale which can hope to account for the result reached in *Levin* is that expounded by the California Supreme Court in *People v. Riser*.[54]

> Absent some governmental requirement that the information be kept confidential for the purpose of effective law enforcement, the state has no interest in denying the accused access to all evidence that can throw light on issues in the case . . . .[55]

Analytically, the *Riser* rationale has a double aspect. On the one hand, there is the notion that an accused should not be denied access to any relevant information. This notion is characteristic of a view aimed at furthering and

49 Levin v. Katzenbach, 363 F.2d 287, 296 (D.C. Cir. 1966).
50 *Id.* at 292.
51 See note 46 *supra*.
52 This result was not unforeseen. "It will be noticed that the Supreme Court's statement [in Brady v. Maryland, 373 U.S. 83 (1963)] still requires . . . a demand or request for the pertinent item . . . . In all likelihood, the Court will soon begin to erode . . . [this] requirement and dispense with the demand . . . ." Cahn, *Law in the Consumer Perspective,* 112 U. PA. L. REV. 1, 11 (1963).
53 "[P]recisely because a trial is not to be a 'game of wits', the law has always required a showing of due diligence as the precondition to gaining a new trial." Levin v. Katzenbach, 363 F.2d 287, 292 (D.C. Cir. 1966).
54 47 Cal. 2d 566, 305 P.2d 1 (1956).
55 *Id.* at 586, 305 P.2d at 13.

assuring the integrity of the criminal *process*. On the other hand, there is an *outside* policy limitation placed upon the accessibility of evidence which springs from governmental requirements. Because criminal law has more than one aspect, it gives rise to competing values which impinge upon one another and demand recognition. If this recognition is not forthcoming, if one value is allowed to smother the other in the struggle for recognition, criminal law will become an ineffective tool in ordering the relations among men. Unfortunately, *Levin* does not provide that a prosecutor may, upon a proper showing, refuse to disclose relevant information without violating his duty of disclosure.

Even if this defect is ignored, the merits of *Levin* are still open to question. California, which has supplied the rationale which best accounts for the *Levin* result, has not implemented its full logic, but has been considerably more demure.[56] Absent any outside policy limitation that a piece of evidence remain undisclosed, a criminal defendant does not have an unqualified right to its production. Logic, seemingly, must wait upon experience. Apparently, Judge Bazelon recognized that there is something to be said for restraint when he stated "we do not suggest that the government is required to . . . disclose all its evidence . . . ."[57] In view of the result which *Levin* will produce, this qualification is either an oversight or an impious requiem.

The main criticism which *Levin* must bear is that it is grounded on a broad constitutional base — violation of due process. The difference between discovery rights and a constitutional duty of disclosure is fundamental. The prosecutor's duty of disclosure does not create a correlative right in the criminal accused to discovery. Rather, it gives the criminal accused a right to reversal in a habeas corpus proceeding. This constitutional duty of disclosure also precludes the fashioning of any pretrial remedy.[58] Not only does the concept of judicial finality suffer an appreciable loss of meaning, but courts are compelled to engage in a highly speculative inquiry into what the jury might have done. Further, the issues in these cases may easily assume distorted proportions when viewed through the medium of due process. There is also a real temptation to come perilously close to the rule of men and not law.[59] Even a cursory glance at these cases will show that the concept of due process has become an instrument of judicial activism. One might wonder if the problem would not be more appropriately left to the rule-making power exercised under the legislative

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56 "No case has gone so far as to state that the denial of a motion for pretrial inspection in an abuse of discretion without a showing before the trial court as to why the material is needed." Brenard v. Superior Court, 172 Cal. App. 2d 314, 318, 341 P.2d 743, 746 (Dist. Ct. App. 1959). *Accord*, People v. Cooper, 53 Cal. 2d 755, 349 P.2d 964 (1960). See generally Louisell, *Criminal Discovery: Dilemma Real or Apparent?* 49 CALIF. L. REV. 56 (1961).

57 Levin v. Katzenbach, 363 F.2d 287, 291 (D.C. Cir. 1966).

58 "In sum, while the government has an important duty to conduct criminal prosecutions fairly, its obligations must be examined and tested after trial, not before." United States v. Manhattan Brush Co., 38 F.R.D. 4, 7 (S.D.N.Y. 1965).

59 It is clear that theoretically due process is objective in content. "The vague contours of the Due Process Clause do not leave judges at large. We may not draw on our merely personal and private notions and disregard the limits that bind judges in their judicial function." Rochin v. California, 342 U.S. 165, 170 (1952). One may sometimes wonder if such theoretical purity has been carried over into practice. "It has become increasingly apparent in these habeas corpus cases that the judicial concept of due process, like beauty, 'is in the eye of the beholder.' " United States *ex rel.* Butler v. Maroney, 319 F.2d 622, 629 (3d Cir. 1963) (dissent).

eye. Even if the matter is best left solely to judicial cognizance, it is submitted that the present need is not for implementation of an across-the-board disclosure rationale. Rather, there is a need for moderately detailed rules which will work out the limits of discovery rights by taking into view the complexity of the situation and the competing values inherent in the problem. There is a need for a set of rules which will work with a tolerable degree of precision and facility. It is further submitted that the concept of due process is too cumbersome a tool for a work of such delicacy. It follows, then, that if the constitutional duty of disclosure is inadequate to accomplish the task, the problem can no longer be cast in terms of the prosecutor's duty of disclosure, but must be considered, directly, as one of criminal discovery rights.

John A. Burgess

FEDERAL PROCEDURE — SERVICE OF PROCESS ON A NONDOMICILIARY IN A FEDERAL TAX CASE SUSTAINED UNDER A STATE "LONG-ARM" STATUTE THOUGH THE REQUISITE JURISDICTIONAL TRANSACTION OF BUSINESS WAS ESTABLISHED BY LESS THAN A PREPONDERANCE OF THE EVIDENCE. — Isidor Klein, managing director of a Canadian distillery, used his corporate position to force two United States distributing agents to pay "commissions" to friends and relatives who had done essentially nothing to earn them. One of the distributing agents was a New York corporation which made the required "commission" payments through checks drawn on a New York bank. The other was a San Francisco liquor distributor who, as a precondition to a distributorship, signed a contract in New York to share two-thirds of his profits with Klein's brother-in-law, a New York resident. The United States government brought an action to recover $9,862,-053.34 in income taxes, interest, and penalties on the theory that these "commissions" were properly the income of Klein under the attribution of income rules of *Helvering v. Horst.*[1] Under the New York "long-arm" statute,[2] personal service of process was made on Klein's executor, Montreal Trust Co., in Canada. The United States District Court for the Southern District of New York accepted Montreal Trust's contention that the court did not have jurisdiction on the ground that Klein had not "transacted business" in New York within the meaning of the New York statute. The United States Court of Appeals for the Second Circuit in reversing, *held:* the facts as found by the district court demonstrate that New York had sufficient contacts with the transactions which are the subject matter of this case to justify asserting jurisdiction. The Second Circuit remanded the case to the district court for trial on the merits. *United States v. Montreal Trust Co.*, 358 F.2d 239 (2d Cir.), *cert. denied,* 384 U.S. 919 (1966).

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1 311 U.S. 112 (1940).

2 N.Y. CIV. PRAC. LAW & RULES § 302 provides:

> A court may exercise personal jurisdiction over any nondomiciliary, or his executor or administrator, as to a cause of action arising from any of the acts enumerated in this section, in the same manner as if he were a domiciliary of the state, if, in person or through an agent, he:
> 1. transacts any business within the state . . . .

Federal Rules of Civil Procedure 4(e) and 4(f)[3] make the procedure for federal service of process coterminous with the applicable state procedure. These rules allow a party not an inhabitant of a state or found therein to be served with a summons in a federal court in the same manner and under the same circumstances prescribed by the state statute.[4]

Ever since the Supreme Court's landmark decision in *International Shoe Co. v. Washington*,[5] it has been well settled that a state may take in personam jurisdiction over a nondomiciliary, if he has "certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'"[6] The rule announced in *International Shoe*

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3 FED. R. CIV. P. 4(e) provides:

> Whenever a statute of the United States or an order of court thereunder provides for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state in which the district court is held, service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule. Whenever a statute or rule of court of the state in which the district court is held provides (1) for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state, or (2) for service upon or notice to him to appear and respond or defend in an action by reason of the attachment or garnishment or similar seizure of his property located within the state, service may in either case be made under the circumstances and in the manner prescribed in the statute or rule.

FED. R. CIV. P. 4(f) provides:

> All process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held, and, when authorized by a statute of the United States or by these rules, beyond the territorial limits of that state. . . .

4 United States v. First Nat'l City Bank, 379 U.S. 378 (1965). The Supreme Court citation for this proposition was the preliminary opinion by Judge McLean, in United States v. Montreal Trust Co., 35 F.R.D. 216 (S.D.N.Y. 1964), that the amended rules of Federal Civil Procedure would allow personal jurisdiction over Montreal if the requisites of the New York "long-arm" statute were met.

5 326 U.S. 310 (1945).

6 *Id.* at 316. State power to assert personal jurisdiction over nondomiciliaries has been slowly increased by broader interpretations of the due process clause. This extension has been necessitated by vastly increased interstate commerce, travel, and communication. The leading case of Pennoyer v. Neff, 95 U.S. 714 (1877), held that jurisdiction over the person is solely derived from the state's power over such person due to his physical presence within the state. Since all states are of equal dignity, the independence of one implies the exclusion of power from all others. The result was that states could assert personal jurisdiction only upon those persons found within their own borders. Foreign corporations "doing business" within a state's boundaries were still held amenable to service of process on the theory that since a state had power to exclude them from carrying on business within the state, the corporations impliedly consented to *in personam* jurisdiction by doing such business within the state's boundaries. Flexner v. Farson, 248 U.S. 289 (1919), said that the "doing business" test could not be applied to individuals because a state may not exclude nonresident individuals. Thus, the transaction of business by such persons could not be the basis for implying consent to be bound by the process of the state's courts. With the same type of reasoning, a nonresident motor vehicle statute was upheld in Hess v. Pawloski, 274 U.S. 352 (1927). In *Hess*, it was held that since a state had a paramount interest in regulating its highways, it could exclude a nonresident until he appointed an agent to receive process. Thus, the statute saying that use of the highways was implied consent to have a state official act as agent to receive process was held to be constitutional. Some years later, the Supreme Court held that regulation of the securities business was so fit for state control that a law providing for personal service of process upon the agent of a nonresident transacting a securities business was valid. Doherty v. Goodman, 294 U.S. 623 (1935). Finally, in 1945, the Supreme Court, in *International Shoe*, allowed complete personal jurisdiction over nondomiciliaries so long as such persons have sufficient minimum contacts with the forum state that the maintenance of the suit does not offend traditional notions of fair play and substantial justice. The decision was based on the reasoning that a nonresident, having received the benefits of a state's laws, must submit to the obligations under them. McGee v. Interna-

clearly authorizes extraterritorial service of process when a state statute allows such service. This rule, although it creates a new dispensation for states, still leaves it to the states to determine by statute the persons over whom they wish to assert jurisdiction. Thus, *International Shoe* is best viewed as an enabling act, and statutory authority is still necessary. Section 302 of the New York Civil Practice Law and Rules is a "long-arm" statute passed to take advantage of this new jurisdictional enclave created by *International Shoe* and its companion cases.[7]

The issue presented by *Montreal Trust* was whether the activities of Klein amounted to a transaction of business within the meaning of the New York "long-arm" statute. In a sense, however, this is only half the problem. In all such cases where there is an attempt to impose in personam jurisdiction upon a nondomiciliary, validity of service depends on the satisfaction of two criteria. First, the act upon which service is predicated must be one which the state statute contemplates as a basis for such service. Secondly, the nonresident defendant must have such minimum contacts with the state that in personam service made upon him outside the forum state does not violate due process.[8]

The majority in *Montreal Trust* found that Klein's activities, based on the allegations and facts before the district court, were outside his role as a corporate officer and that in securing the payment of "commissions" to friends and relatives he transacted business in New York. This ruling was based upon a finding that the two United States distributors became Klein's personal agents in paying the "commissions" and that through these payments there was the necessary transaction of business within the meaning of the New York statute.

In vigorous disagreement, Judge Timbers took issue with the majority's finding that there was a personal agency present. He concluded that the requirements of section 302 were not met and thus the assertion of jurisdiction under it was unconstitutional as applied to the Montreal Trust Co.[9] Anyone familiar with the record would have to agree that the existence of such a personal agency is at most tenuous under the facts shown.

The court's detailed inquiry into the agency question obscures the real problem in *Montreal Trust*. Considering the weakness of this agency straw, one wonders on what basis jurisdiction was sustained. The problem posed by *Montreal Trust* is germane to many cases where jurisdiction is seriously questioned.

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tional Life Ins. Co., 355 U.S. 220 (1957), further expanded and clarified *International Shoe* by showing that even a single contact with the forum state can be enough to allow it to assert *in personam* jurisdiction. However, Hanson v. Denckla, 357 U.S. 235 (1958), shows that *Pennoyer* is not yet dead. *Hanson* held that for a state to assert personal jurisdiction over a nonresident, he must have purposely availed himself of the privilege of conducting activities within the forum state.

For a detailed discussion of this development of *in personam* jurisdiction over nondomiciliaries in relation to the due process clause see: 2 MOORE, FEDERAL PRACTICE ¶¶ 4.25[3], [4], [5]; ¶¶ 4.41-1[1], [3] (2d ed. 1962). See generally Cleary & Seder, *Extended Jurisdictional Basis for the Illinois Courts,* 50 NW. U.L. REV. 599 (1955); Currie, *The Growth of the Long Arm: Eight Years of Extended Jurisdiction in Illinois,* 1963 U. ILL. L. F. 533; O'Conner & Goff, *Expanded Concepts of State Jurisdiction Over Non-Residents: The Illinois Revised Practice Act,* 31 NOTRE DAME LAWYER 223 (1956).

7 Longines-Wittnauer Watch Co. v. Barnes & Reinecke, Inc., 15 N.Y.2d 443, 209 N.E.2d 68, 261 N.Y.S.2d 8 (1965).

8 2 Moore, *op. cit. supra* note 6, ¶ 4.41-1[3], at 1291.51.

9 United States v. Montreal Trust Co., 358 F.2d 239, 242-43 (2d Cir.) (separate opinion), *cert. denied,* 384 U.S. 919 (1966).

Courts often encounter difficulty in trying to differentiate between jurisdictional issues and issues on the merits.

Counsel for the government argued that in a suit for back taxes, the jurisdictional question of a transaction of business is "inextricably related" to the substantive issue of tax liability.[10] In essence, this argument is that since a transaction is necessary to obtain income on which tax might be owing, it is obvious that if there were a tax liability, there would necessarily have to have been a transaction upon which jurisdiction could be based. Thus, a determination of one necessarily involves a determination of the other.

In presenting this argument that the substantive issue and the jurisdictional issue were inextricably related, the government attempted to convince the Second Circuit that the district court had erroneously decided the jurisdictional issue since such a decision necessarily involved a decision on the merits.[11] However, the Second Circuit initially refused to accept this argument for two reasons. First, the government had failed to raise this contention in the district court. In fact, this was a reversal of position for them. Thus, according to the rule that appellate courts will not ordinarily consider points not raised in the district court, this argument could not be determinative.[12] Second, despite the argument that a transaction is necessary to incur tax liability, so that if there is tax owing there had to have been a transaction, the facts in *Montreal Trust* can be distinguished from the landmark cases where jurisdictional and substantive issues were so closely related that a trial of the merits was required.[13]

The Second Circuit has a practice of settling jurisdictional disputes through

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10 Brief for Appellant, p. 9, United States v. Montreal Trust Co., 358 F.2d 239 (2d Cir.), *cert. denied,* 384 U.S. 919 (1966).

> It is clear, therefore, that the court could only have decided that there was no jurisdiction under Section 302 by deciding that the transactions described did not produce income taxable to Klein. Since the issue of the taxability to Klein of the income arising from these transactions is the very issue on the merits, there is no escape from the conclusion that jurisdiction and merits are, in this case, inextricably related. *Ibid.*

11 Reply Brief for Appellant, p. 5.

12 United States v. Montreal Trust Co., 358 F.2d 239, 247 n.4 (2d Cir.) (separate opinion), *cert. denied,* 384 U.S. 919 (1966).

13 In Land v. Dollar, 330 U.S. 731 (1947), the question was whether the United States Maritime Commission wrongfully retained stocks delivered by a corporation or whether the stocks were held by the United States itself. The United States had not consented to suit and was thus immune from district court jurisdiction. The Supreme Court ruled that the case had to be tried on the merits because the only method of determining if there was jurisdiction was to answer the principal question of whether the United States or the Maritime Commission held the stocks. In Smithers v. Smith, 204 U.S. 632 (1907), plaintiff alleged and defendants denied that the defendants jointly took and held his whole lot of land. The district court found that the defendants had not jointly taken the whole lot of land. This finding denied jurisdiction and, in effect, decided the controversy between the parties on the merits, but without the benefit of trial. The Supreme Court reversed saying the merits could not be decided while determining the existence of jurisdiction. The distinguishing element in *Montreal Trust* was that proof of the allegations in the complaint would establish only that Klein owed some taxes and would not, without further proof or assumptions, establish absolute jurisdictional necessity of a transaction of business in New York, though such might logically follow. The point is that it is possible to receive income without ever transacting business, and it is the transaction alone that gives jurisdiction under § 302. In other words, despite the government's argument, there is a necessity of proving that Klein individually transacted business in New York, either personally or through agents. This can be done without showing his tax liability and a determination by the trial judge would not amount to any decision on taxability, or for that matter, whether any transaction created income.

further hearings on the relevant facts in the district court.[14] In *Montreal Trust,* however, there had been a full hearing and determination by the district court that the jurisdictional facts had not been proven. Logically, though, it still followed that if the government could prove the merits of its tax claim, in all probability, the necessary jurisdictional transactions would appear as well. Therefore, according to the majority:

> The District Court, in dealing with this issue at the preliminary hearing, we believe, placed a too heavy burden on the government in requiring it to establish a strong factual basis upon which jurisdiction is predicated in this case. At this early stage of the proceedings, the government should not have been required to submit proof which would, in effect establish the validity of its claim and its right to the relief sought. Rather, to bring § 302 into operation, and thereby invoke the jurisdiction of the District Court, the government was required to establish only *prima facie tax-related transactions* of Klein in New York. We must, therefore, determine whether on the *allegations* and facts before Judge McLean, Klein was transacting sufficient business within New York so as to bring him within reach of the "long-arm" statute and require a trial on the merits.[15] (Emphasis added.)

The effect of this holding is to allow imposition of personal jurisdiction under the New York "long-arm" statute with much less than a preponderance of the evidence being needed to establish the requisite jurisdictional facts. Such a result is in direct conflict with the Supreme Court's holding in *McNutt v. General Motors Acceptance Corp.*[16] In *McNutt,* it was held that:

> In the nature of things, the authorized inquiry is primarily directed to the one who claims that the power of the court should be exerted in his behalf. As he is seeking relief . . . it follows that he must carry *throughout* the litigation the burden of showing that he is properly in court. The authority which the statute [28 U.S.C. § 80, now 28 U.S.C. §§ 1359, 1447, 1919 (1964)] vests in the court to enforce the limitations of its jurisdiction precludes the idea that jurisdiction may be maintained by mere averment or that the party asserting jurisdiction may be relieved of his burden by any formal procedure. If his allegations of jurisdictional facts are challenged by his adversary in any appropriate manner, he must support them by competent proof. And where they are not so challenged the court may still insist that the jurisdictional facts be established or the case be dismissed, and for that purpose the court may demand that the party alleging jurisdiction justify his allegations by a preponderance of evidence.[17]

The majority made a feeble effort to stay within the *McNutt* rule by stating in a footnote:

> Our conclusion that the government established at least threshold jurisdiction at the preliminary hearing does not relieve it at the trial of the case-

14 Agrashell, Inc. v. Bernard Sirotta Co., 344 F.2d 583 (2d Cir. 1965); Gelfand v. Tanner Motor Tours, Ltd., 339 F.2d 317 (2d Cir. 1964); Arrowsmith v. United Press Int'l, 320 F.2d 219 (2d Cir. 1963).

15 United States v. Montreal Trust Co., 358 F.2d 239, 242-43 (2d Cir.), *cert. denied,* 384 U.S. 919 (1966).

16 298 U.S. 178 (1936).

17 *Id.* at 189.

in-chief from proving the facts upon which jurisdiction is based by a preponderance of the evidence.[18]

It is submitted that establishment of "threshold jurisdiction" through the presentation of the so-called "prima facie tax-related transactions" satisfies neither the language nor the purpose of *McNutt*. Despite the Second Circuit's subtle sidestep of requiring a preponderance of evidence in the trial on the merits, it remains obvious that Montreal challenged jurisdiction in an appropriate manner.[19] Nevertheless, the case was allowed to go to trial without jurisdiction being established by a preponderance of the evidence. This result is in direct conflict with *McNutt* and a long series of companion cases which have held that *whenever* the defendant questions jurisdiction in an appropriate manner, plaintiff has the burden of establishing the requisite jurisdictional facts by a preponderance of the evidence.[20]

The Second Circuit in *Montreal Trust* fell for the government's contention that if they are permitted to prove tax liability, jurisdictional transactions are bound to appear. The court accepted the allegation that Klein obtained constructive income by having the "commissions" paid. On this basis, the payments were viewed as "prima facie tax-related transactions" by assumed agents capable of satisfying the requirements of the New York "long-arm" statute.

The effect of the *Montreal Trust* decision is to create a hiatus between the procedural method of asserting in personam jurisdiction in the state and that in the federal courts — at least in relation to federal tax claims. In New York and Illinois,[21] and indeed in the Second Circuit itself, it has long been the practice when there has been an initial motion questioning validity of service to determine jurisdictional issues under the "long-arm" statutes prior to a trial on the merits.[22] In making this determination, at least one court has required that the person invoking the jurisdiction of the court under a "long-arm" statute has the burden of proving the essential jurisdictional facts.[23]

Now, in the Second Circuit, the establishment of "prima facie tax-related

18 United States v. Montreal Trust Co., 358 F.2d 239, 242 n.4 (2d Cir.), *cert. denied*, 384 U.S. 919 (1966).

19 By motion to set aside the service and to dismiss the action. United States v. Montreal Trust Co., 235 F. Supp. 345, 346 (S.D.N.Y. 1964).

20 KVOS, Inc. v. Associated Press, 299 U.S. 269 (1936); Arnold v. Troccoli, 344 F.2d 842 (2d Cir. 1965); Anderson v. Stoffle, 339 F.2d 214 (5th Cir. 1964); Yoder v. Assiniboine and Sioux Tribes of Fort Peck Indian Reservation, 339 F.2d 360 (9th Cir. 1964); Industrial Electronics Corp. v. Cline, 330 F.2d 480 (3d Cir. 1964); Birmingham Post Co. v. Brown, 217 F.2d 127 (5th Cir. 1954); Town of Lantana v. Hopper, 102 F.2d 118 (5th Cir. 1939); Magnaflux Corp. v. Foerster, 223 F. Supp. 552 (N.D. Ill. 1963) (based on the Illinois "long-arm" statute); Shaffer v. Coty, 183 F. Supp. 662 (S.D. Cal. 1960); Murarka v. Bachrack Bros., Inc., 108 F. Supp. 597 (S.D.N.Y. 1952).

21 The Illinois "long-arm" statute, ILL. ANN. STAT. ch. 110, § 17 (Smith-Hurd 1956), is very similar to New York's. In fact, § 302 was modeled after the Illinois act. Longines-Wittnauer Watch Co. v. Barnes Reinecke, Inc., 15 N.Y.2d 443, 209 N.E.2d 68, 261 N.Y.S.2d 8 (1965).

22 Agrashell, Inc. v. Bernard Sirotta Co., 344 F.2d 583 (2d Cir. 1965); Gelfand v. Tanner Motor Tours, Ltd., 339 F.2d 317 (2d Cir. 1964); Arrowsmith v. United Press Int'l, 320 F. 2d 219 (2d Cir. 1963); Magnaflux Corp. v. Foerster, 223 F. Supp. 552 (N.D. Ill. 1963); Nelson v. Miller, 11 Ill.2d 378, 143 N.E.2d 673 (1957); Kramer v. Vogl, 17 N.Y.2d 27, 215 N.E.2d 159, 267 N.Y.S.2d 900 (1966); Longines-Wittnauer Watch Co. v. Barnes Reinecke, Inc., 15 N.Y.2d 443, 209 N.E.2d 68, 261 N.Y.S.2d 8 (1965).

23 Magnaflux Corp. v. Foerster, 223 F. Supp. 552 (N.D. Ill. 1963). A reading of the cases cited at note 22 *supra* suggests that this is the general rule.

transactions" based on the allegations and facts of a particular case will be enough to invoke New York's "long-arm" statute and force a defendant into a trial on the merits. Such a ruling forces a nondomiciliary to make a costly defense in a foreign jurisdiction even though the plaintiff has been unable to prove by a preponderance of the evidence that such a court has jurisdiction. According to Judge Timbers, when the facts are as sketchy as they were in *Montreal Trust,* section 302 is rendered unconstitutional as applied. Timbers felt that requiring a trial on the merits under such circumstances violates the traditional notions of fair play and substantial justice required by *International Shoe.* As he so aptly stated:

> I regret that my colleagues on the majority . . . by today's decision are departing from the historic role of our Court in not furnishing the sound guidance, based on the unmistakably clear state substantive law here controlling, so sorely needed in defining the proper scope of constitutional assertion of personal jurisdiction over a non-domiciliary in a federal tax case. The issue is one of first impression. It is vital to the sound administration of the revenue laws of the United States. And its radiations, for good or bad, will surely permeate interpretations by other courts of state long arm statutes throughout the land. I wish I could believe its radiations were good.[24]

It would be difficult to disagree. The "long-arm" statutes evidently make hard cases when applied in the tax field. Here the application may have also made bad law.

John E. Amerman

PROBATE JURISDICTION IN WRONGFUL DEATH ACTION — SETTLEMENT OBTAINED BY STATUTORY TRUSTEE'S FRAUD IS NOT RES JUDICATA AS TO PARTY WHOSE CLAIM WAS NOT PRESENTED. — On April 12, 1956, Willard Milliman left his wife, Clarabelle, and their six children at home in New York and departed for work. His family never saw or heard from him again. That summer Willard turned up in Arizona. Without ever obtaining a divorce from Clarabelle, Milliman remarried in Arizona. When this marriage ended in divorce, Milliman traveled to New Mexico where he met and married Lucy Mae Horn in 1960. At the time of this marriage, Lucy Mae was the mother of an illegitimate child. Milliman and Lucy Mae subsequently had a child of their own. As of March 1, 1961, Willard Milliman was the legal husband of Clarabelle, in New York, and was living as husband to Lucy Mae and father to her two children. The next day Willard was killed in an automobile accident on an Arizona highway. Lucy Mae petitioned the probate court for letters of administration. Upon her appointment as administratrix, she petitioned for authorization to compromise and settle the wrongful death claim arising out of Willard's death. At the time of this petition, Lucy Mae knew about Willard's legal wife in New York but told neither the court nor the insurance company. The compromise petition was approved, and in compliance with the court's

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24 United States v. Montreal Trust Co., 358 F.2d 239, 259 (2d Cir.) (separate opinion), *cert. denied,* 384 U.S. 919 (1966).

order, the Farmers Insurance Company paid Lucy Mae $50,000, "individually and as administratrix." Lucy Mae appropriated $33,333.33 of this sum to herself; the remainder was placed in a trust fund for the two minor children. After Lucy Mae had squandered the entire amount, Clarabelle arrived from New York and sought to revoke Lucy's letters of administration. An administrator *de bonus non,* appointed on behalf of Clarabelle, petitioned the probate court to set aside its order approving the compromise and settlement of the wrongful death claim. When the trial court did so, Farmers Insurance (the real party in interest) took an appeal to the Arizona Court of Appeals which affirmed the lower court's decision.[1] This opinion was modified on rehearing.[2] An appeal from these decisions was taken by the Farmers Insurance Group. In a unanimous opinion, the Arizona Supreme Court affirmed and *held:* a settlement of a wrongful death claim made on petition of a person in her individual capacity and as administratrix, who fraudulently concealed from the court a legal survivor, is not res judicata as to the legal widow and surviving children when the petition was acted on by the probate court without notice to the legal widow and children. *In re Milliman,* 415 P.2d 877 (Ariz. 1966).

The two critical questions that the court faced in *Milliman* concerned the probate court's jurisdiction over settlement of a wrongful death claim and the authority of a personal representative to compromise a claim where there are survivors.

The Arizona Supreme Court in *Milliman* distinguished between two types of wrongful death legislation.[3] Under one type of statute, the cause of action vests in the estate of the deceased. The statute in force in Arizona prior to 1956 was of this type.[4] The other type wrongful death act vests the cause of action in the individual beneficiaries named in the statute. *Milliman* was decided under the Arizona Wrongful Death Act, as enacted in 1956. Under this statute, the cause of action arises on behalf of the individual beneficiaries named in the statute[5] and not on behalf of the estate, as was the case under the former act.

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1 *In re* Milliman, 2 Ariz. App. 155, 406 P.2d 873 (1965).

2 *In re* Milliman, 2 Ariz. App. 338, 409 P.2d 54 (1965), *aff'd,* 415 P.2d 877 (1966).

3 Care must be taken to distinguish wrongful death acts from survival statutes. Survival statutes continue a cause of action which arose before the decedent's death. Such statutes traditionally vest the cause in the estate of the deceased. Wrongful death acts, on the other hand, are derived from Lord Campbell's Act, 1846, 9 & 10 Vict. c. 93, and create a *new* cause of action in favor of those named in the particular statute. The act may create the cause in favor of the estate, but it need not. For a good discussion of those designated to sue on a wrongful death claim, see SPEISER, RECOVERY FOR WRONGFUL DEATH § 11:17 (1966).

4 Arizona Wrongful Death Statute (April 19, 1901) (repealed), ARIZ. REV. STAT. § 2765 (1901), provided:

> Every such action shall be brought by and in the name of personal representative of such deceased person; and, *provided,* that the father, or in the case of his death or desertion of his family, the mother, may maintain the action for the death of a child, and the guardian for the death of his ward; and the amount recovered in every such action shall be distributed to the parties and in the proportions provided by law in relation to the distribution of personal estate left by persons dying intestate.

5 ARIZ. REV. STAT. § 12-612(A) (1956) provides:

> An action for wrongful death shall be brought by and in the name of the surviving husband or wife or personal representative of the deceased person for and on behalf of the surviving husband or wife, children or parents, or if none of these survive, on behalf of the decedent's estate.

Since the wrongful death claim in *Milliman* was not an asset of the decedent's estate, the probate court had no jurisdiction to grant a court order approving the settlement.[6] Thus, the order in *Milliman* was issued without jurisdiction and was void from the beginning. Such an order could not be res judicata in regard to undisclosed legal survivors.

Letters of administration, however, *do* authorize the holder to act as personal representative of the deceased. Since Lucy Mae had such letters, she was entitled to bring an action for wrongful death.[7] However, as the Arizona Supreme Court pointed out, the personal representative acts in this capacity only as a statutory trustee for the benefit of the named beneficiaries.[8] Such a trustee cannot settle a claim on behalf of the beneficiaries unless he obtains their consent; or unless the settlement money is paid to those found by the probate court to be heirs entitled to such money under the same proceeding as provided for in the distribution of the estate. By this reasoning, Lucy Mae could not have acted as trustee for the absent beneficiaries. Consequently, when Lucy Mae settled with the insurance company, "individually and as administratrix," she was compromising the claim in her individual capacity only. In so doing, Lucy Mae could not affect the rights of Milliman's legal wife and children. According to this line of reasoning, the insurance company merely paid $50,000 to the wrong individual, and their mistake did not alter their liability toward the rightful beneficiaries.[9]

The question on appeal in *Milliman* involved the validity of the court order approving the wrongful death compromise. The opinion, however, went beyond this narrow point to discuss the validity of the compromise itself. By interpreting the Arizona Wrongful Death Act as creating the cause of action in the beneficiaries and not in the estate,[10] the court placed the order approving the settlement outside the probate court's jurisdiction.[11] A judgment entered without jurisdiction is void,[12] and it is within the court's inherent power to purge its records of void judgments regardless of the statute of limitations applicable to collateral attacks.[13]

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6 ARIZ. REV. STAT. § 14-474(B) (1956) provides: A compromise of a claim by or against the estate may be authorized when it appears just *and for the best interests of the estate.* (Emphasis added.)

7 ARIZ. REV. STAT. § 12-612(D) (1956):

> The term "personal representative" as used in this section shall include any person to whom letters testamentary or of administration are granted by competent authority under the laws of this or any other state. The action for wrongful death may be maintained by any such personal representative without issuance of further letters, or other requirement or authorization of law.

8 *In re* Milliman, 415 P.2d 877, 885 (Ariz. 1966).

9 *Id.* at 887.

10 *Id.* at 884.

11 The Arizona Supreme Court agreed with the appellate court's excellent analysis of the effects of the amendments to the wrongful-death statute. The appellate court had stated:

> If, as seems to be very clear, a probate proceedings [sic] is one in rem, what is the thing over which the court has jurisdiction? We believe it to be no more than the "estate" of the deceased, and . . . [it] may include less depending upon one's definition of a decedent's "estate." *In re* Milliman, 2 Ariz. App. 155, 406 P.2d

873, 878 (1965). *Accord, In re* Riccomi's Estate, 185 Cal. 458, 197 Pac. 97 (1921); Wright v. Royse, 43 Ill. App. 2d 267, 193 N.E.2d 340 (1963). See Tidball, *Probate Jurisdiction in Wrongful Death Actions,* 2 WYO. L. J. 109 (1948).

12 Rico Consol. Mining Co. v. Rico Exploration Co., 23 Ariz. 389, 204 Pac. 138 (1922).

13 Preston v. Denkins, 94 Ariz. 214, 382 P.2d 686 (1963).

The court's invalidation of the order approving the settlement, however, although it answered the narrow question raised on appeal, did not settle the real issue of whether or not the settlement itself was res judicata as to the rightful beneficiaries. In trying to invalidate the settlement itself, the court's reasoning was a bit more tenuous.

The court in *Milliman* acknowledged that although the administrator cannot maintain a wrongful death action on behalf of the estate, he is empowered by the statute to bring the action as personal representative.[14] As personal representative, the administrator is statutory trustee for the named beneficiaries.[15] In *Milliman,* the order which made Lucy Mae administratrix was never challenged. Since her power as trustee stemmed from the letters of administration, which she received from the probate court,[16] her standing as trustee had nothing to do with her marital status or lack of it. Although the order approving the settlement may have been void for want of jurisdiction, granting letters of administration is expressly within the probate court's jurisdiction.[17] Thus, the precise problem in *Milliman* becomes one of defining the power of a statutory trustee to settle disputed claims on behalf of statutory beneficiaries. The best-reasoned law on fiduciaries is that a statutory trustee can settle such claims[18] without court approval,[19] and even without the consent, and contrary to the wishes of, the lawful beneficiaries.[20]

In *American Car & Foundry Co. v. Anderson,*[21] the United States Court of Appeals for the Eighth Circuit dealt with a Missouri Wrongful Death Statute, which, like the Arizona act, creates a cause of action in favor of the statutory beneficiaries rather than the estate. The Eighth Circuit, in discussing the power of the administrator to settle, stated:

> It is quite uniformly held that the administrator or other persons authorized to bring suit for damages for the death of another may compromise the claim . . . *and that such compromises may be made, not only*

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14 *In re* Milliman, 415 P.2d 877, 884 (1966). See text accompanying note 7 *supra.*

15 The California Supreme Court, in Ruiz v. Santa Barbara Gas & Elec. Co., 164 Cal. 188, 128 Pac. 330 (1912), in speaking about the California Wrongful Death Act, stated:

> It is settled by the decisions that an action of the character authorized by section 377 of the Code of Civil Procedure is one solely for the benefit of the heirs, by which they may be compensated for the pecuniary injury suffered by them by reason of the loss of their relative, that the money recovered in such an action does not belong to the estate but to the heirs only, and that an administrator has the right to bring the action only because the statute authorizes him to do so, and that he is simply made a statutory trustee to recover damages for the benefit of the heirs.

Ruiz v. Santa Barbara Gas & Elec. Co., *supra* at 191-92, 128 Pac. at 332. *Accord,* Bright's Estate v. Western Air Lines, 104 Cal. App. 2d 827, 232 P.2d 523 (1951). See also SPEISER, *op. cit. supra* note 3, at § 11:20 (1966); Tidball, *supra* note 11, at 110.

16 ARIZ. REV. STAT. § 12-612(D) (1956). See text accompanying note 7 *supra.*

17 ARIZ. REV. STAT. § 14-301(A) (1956). See also Tidball, *supra* note 11, at 109.

18 *E.g.,* Pittsburg, C.C. & St. L. Ry. v. Gipe, 160 Ind. 360, 65 N.E. 1034 (1903); Bell v. Hankins, 249 N.C. 199, 105 S.E.2d 642 (1958).

19 Pittsburg, C.C. & St. L. Ry. v. Gipe, *supra* note 18; Montgomery v. Mutual Life Ins. Co., 71 So. 162 (Miss. 1916).

20 Mann v. Minnesota Elec. Light & Power Co., 43 F.2d 36 (10th Cir. 1930); American Car & Foundry Co. v. Anderson, 211 Fed. 301 (8th Cir. 1914); Manns v. A. E. Sanford Co., 82 N.J.L. 124, 81 Atl. 491 (1911). *Accord,* Shaffer, *Fiduciary Power To Compromise Claims,* 41 N.Y.U.L. REV. 528, 534 (1966). *But see* SPEISER, *op. cit. supra* note 3, at § 11:23 (1966).

21 211 Fed. 301 (8th Cir. 1914).

> *where the beneficiaries do not consent, but where they affirmatively object.*[22] (Emphasis added.)

A settlement made by a legally appointed statutory trustee exhausts the cause of action unless the third party settlor acts fraudulently.[23] Fraud on the part of the third party settlor will void the settlement regardless of the statutory trustee's power to compromise the claim. However, fraud by the *trustee,* acting alone, should not prejudice the rights of a third party, good faith settlor, after the money has been paid.[24]

It is the duty of the trustee, at his peril, to distribute the trust to the proper beneficiaries.[25] If the trustee fails in this duty through fraud or neglect, he and his bondsman should be held accountable to those damaged by such default.[26] It is submitted that insurance companies, who settle in good faith, should not have to pay a justly compromised claim a second time. Parties whose real interests are involved should be entitled to the benefits of res judicata.[27] Res judicata is primarily a rule of public policy and is only secondarily for the benefit of the litigants.[28] Wrongful death acts of the type involved in *Milliman* anticipate but one cause of action.[29] When the insurance company settled in good faith with the court-appointed trustee, all claims of the beneficiaries arising out of the accident should have been extinguished.

When Lucy settled "individually and as administratrix," she was acting in a dual capacity. As an individual, she might have a claim to the proceeds. As an administratrix, she was empowered by statute to bring the action and act as statutory trustee for the beneficiaries, whoever they might be. Surely, the fact that Lucy Mae had no valid claim to the money as an individual should not invalidate a settlement made by her as trustee.[30] As trustee, she held the money for the legal beneficiaries. The fact that the probate bond might be insufficient to secure the trust, or that an action against the fraudulent trustee might prove worthless, should not deprive a third party, settling in good faith, of the benefits of res judicata.

As a result of the Arizona Supreme Court's decision in *Milliman,* Arizona insurance companies desiring to compromise wrongful death claims are in a precarious position. According to the Arizona court, insurance companies can protect themselves in one of two ways. They can either seek diligently to ascertain the rightful party with whom to settle where a wrongful death statute (as opposed to a survival statute) is involved;[31] or, they can settle with the heirs found

22 *Id.* at 308.

23 Reed v. Blevins, 222 Ark. 202, 258 S.W.2d 564 (1953), *cert. denied,* 347 U.S. 937 (1954); Spencer v. Bradley, 351 S.W.2d 202 (Mo. 1961); Wilson-Harris v. Southwest Tel. Co., 141 P.2d 986 (Okla. 1943), noted in 92 U. Pa. L. Rev. 323 (1944).

24 See Carr v. Illinois Cent. R.R., 180 Ala. 159, 60 So. 277 (1912).

25 Tidball, *supra* note 11, at 113.

26 *Id.* at 109.

27 Restatement, Judgments § 85, comment *a* (1942).

28 Scott, *Collateral Estoppel by Judgment,* 56 Harv. L. Rev. 1 (1942).

29 Reed v. Blevins, 222 Ark. 202, 258 S.W.2d 564 (1953), *cert. denied,* 347 U.S. 937 (1954); Wilson-Harrison v. Southwest Tel. Co., 141 P.2d 986 (Okla. 1943).

30 Williams v. Louisville & N.R.R., 246 F. Supp. 758 (E.D. Tenn. 1965): *Contra,* Ellenberg v. Arthur, 178 S.C. 490, 183 S.E. 306 (1936).

31 Actions under the survival statutes would theoretically still be actions vesting in the estate of the deceased and under probate court jurisdiction as to settlements. See text ac-

by the probate court, under the same proceeding as provided in the distribution of the estate.[32]

The trouble with the first alternative is that it does not really protect insurance companies. There is no foolproof investigative technique for uncovering beneficiaries. By following the second suggested alternative, insurance companies will either have to wait until heirship proceedings are commenced in probate court or press for such proceedings themselves. They must either assume the burden of being the moving party or sit idly by until the proceeding runs its normal course. Even if they do get a determination of legal heirs from the probate court, they still may not be safe. The probate court's determination of the heirs may be subject to collateral attack, either because the statutory notice requirements were not met,[33] or because the constitutional safeguards of due process were not observed.[34] It would seem that a wrongful death settlement based on such a probate determination would be open to the same attack as the determination itself.

The effect of the *Milliman* decision in other states with similar wrongful death acts[35] will depend on whether these states accept the *Milliman* rule concerning the statutory trustee's power to settle in the face of the trustee's own fraud. In Arizona, where the problem is more immediate, insurance companies will have to send detectives into the hills to find all lawful beneficiaries, if they want to *finally* settle a wrongful death claim. They will also have to scatter a few in the probate courts.

Thomas M. Ward

FEDERAL PROCEDURE — SERVICE OF PROCESS IN FEDERAL GARNISHMENT PROCEEDINGS MUST COMPLY WITH FEDERAL RULE 4(c) AND NOT STATE RULES. —On July 3, 1962, Theodore Tanos, a use plaintiff, obtained a money judgment in the United States District Court for the District of Puerto Rico. When this judgment became final, Tanos instituted a garnishment action in the United States District Court for the Southern District of Florida, naming St. Paul Mercury Insurance Company (hereinafter St. Paul) as garnishee. The clerk of this court drew up a writ of garnishment expressly directed "TO THE UNITED STATES MARSHAL, AND OR THE SHERIFFS AND CONSTABLES OF THE STATE OF FLORIDA." Thereafter, the writ was served, in

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companying note 6 *supra*. See also Hamill, *Death by Wrongful Act—"Survival" and "Death" Statutes*, 5 MICH. S.B.J. 189 (1926).

32 *In re* Milliman, 415 P.2d 877, 886 (1966).

33 ARIZ. REV. STAT. § 14-413 (1956). For a good discussion of probate notice requirements, see Stevens v. Torregano, 192 Cal. App. 2d 105, 13 Cal. Rptr. 604 (1961).

34 An heir who is not notified of probate proceedings may have been deprived of due process, even if the statutory notice requirements of the forum state were fulfilled. Due process requirements regarding notice do not depend upon a distinction between actions in rem and those in personam. Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950).

35 In order to fall under *Milliman*, the state's wrongful death act must vest the cause of action in the beneficiaries named in the statute rather than in the decedent's estate. For a list of the persons designated by statute to bring a wrongful death action, in the several states, see SPEISER, *op. cit. supra* note 3, at § 11:17.

accordance with Florida law,[1] upon the State Insurance Commissioner. This official accepted service on behalf of the garnishee and immediately sent a copy of the writ by registered mail to the insurance company's president, together with a statement that the writ had been served upon him by the sheriff. St. Paul filed a motion to quash service of the writ because it had not been served by a United States marshal pursuant to Federal Rule of Civil Procedure 4(c).[2] After the federal district court sustained its request, St. Paul received permission from a state court to deposit in that court's registry the full amount due on the superseded judgment. When a second writ of garnishment was drawn by the clerk of the federal district court and served by a United States marshal, St. Paul met this new challenge with a motion for summary judgment, arguing that it was no longer indebted to the judgment debtor. The district court granted defendant's motion for summary judgment. Though a strong dissent was filed, the United States Court of Appeals for the Fifth Circuit affirmed the district court and *held:* service of process in a federal district court garnishment proceeding in order to be valid must comply with federal and not state rules. *United States ex rel. Tanos v. St. Paul Mercury Ins. Co.*, 361 F.2d 838 (5th Cir. 1966), *petition for cert. filed*, 35 U.S.L. WEEK 3141 (U.S. Oct. 18, 1966) (No. 652).

It is quite obvious that had this case been filed in a Florida state court and process served by a county sheriff, as done above, the service would have been proper.[3] However, by its decision in *Tanos*, the Fifth Circuit rejected this state procedure for service of process and required that, if no person is specially appointed by the court, all process in a federal garnishment proceeding must be served by a United States marshal.

The majority in *Tanos* relied on two Tenth Circuit decisions for support: *Rumsey v. George E. Failing Co.*[4] and *Mid-Continent Cas. Co. v. Everett.*[5] The *Rumsey* case involved a proceeding in garnishment upon a federal court money judgment. A summons had been duly issued and served upon the garnishee, Rumsey. This summons required the garnishee to answer whether he was indebted to the judgment debtor, and whether he had in his possession or under his control any property belonging to the debtor. Rumsey, as garnishee, properly filed his sworn answer claiming that he was not indebted in any manner and that he did not have in his possession any such property. The judgment creditor filed notice to take issue with Rumsey's answer. This answer was served by mail in accordance with Federal Rule of Civil Procedure 5(b). Kansas law, however, required service in such a case to be personal. The Tenth Circuit noted that although Federal Rule of Civil Procedure 69(a) requires that state practice and procedure control in supplementary proceedings, any statute of the United States governs to the extent that it is applicable.[6] The court held that

1 FLA. STAT. ANN. § 624.0221 (1960).
2 FED. R. CIV. P. 4(c) provides: "Service of all process shall be made by a United States marshal, by his deputy, or by some person specially appointed by the court for that purpose . . . ."
3 FLA. R. CIV. P. 1.3(c) (1956).
4 333 F.2d 960 (10th Cir. 1964).
5 340 F.2d 65 (10th Cir. 1965).
6 FED. R. CIV. P. 69(a) provides in part:

> The procedure on execution, in proceedings supplementary to and in aid of a

service under the federal rule was proper, since the general provisions of state law did not specifically deal with practice and procedure in supplementary proceedings.[7] The court in *Rumsey* also noted that although the federal rules are not statutes, they have the force and effect of statutes.[8]

In the *Mid-Continent* case, the Tenth Circuit again observed that, although Kansas law required personal service upon the garnishee of election to take issue with an answer, in federal garnishment proceedings, mailing a copy of election to the garnishee's attorneys constitutes sufficient service. As authority for this proposition, the court cited with approval its prior decision in *Rumsey*.[9]

It is clear that "no authority exists for the service of process in a manner other than that set forth in the Federal Rules of Civil Procedure."[10] Furthermore, since the federal rules have statutory effect, it was the duty of the court clerk to follow such rules in issuing process.[11] However, though it is the clerk's obligation to pursue his duties in accordance with the federal rules, "responsibility for the service of process is upon the plaintiff . . . and he may not 'pass the buck' to the Clerk . . . . "[12] Applying this reasoning to *Tanos*, it follows that ultimate responsibility for proper service of process rested on the plaintiff. Therefore, even though the clerk in *Tanos* expressly directed the writ to a United States marshal, and/or the sheriffs of Florida, the plaintiff could not complain of the clerk's error.

A number of cases in both state and federal courts emphasize the necessity of following the explicit procedure for service of process set forth in that jurisdiction's rules or statutes. In *Mendoza v. Acme Transfer & Storage Co.*[13] the garnishee was served by a person other than a sheriff, contrary to state law. The New Mexico Supreme Court held that the writ had to be delivered by the sheriff. Since the plaintiff failed to comply with this procedure, service was void, and the lower court was precluded from acquiring jurisdiction over the

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> judgment, and in proceedings on and in aid of execution shall be in accordance with the practice and procedure of the state in which the district court is held, existing at the time the remedy is sought, except that any statute of the United States governs to the extent that it is applicable.

7 Rumsey v. George E. Failing Co., 333 F.2d 960, 962 (10th Cir. 1964).

8 *Ibid. Accord,* Sibbach v. Wilson & Co., 312 U.S. 1 (1941); John R. Alley & Co. v. Federal Nat'l Bank, 124 F.2d 995 (10th Cir. 1942). Professor Moore also points out this statutory effect of the federal rules. "Rule 69 . . . states 'that any statute of the United States governs to the extent that it is applicable.' A Federal Rule, which has statutory effect, will also govern." 7 Moore, Federal Practice, ¶ 69.04[2] (2d ed. 1966).

9 Mid-Continent Cas. Co. v. Everett, 340 F.2d 65, 69 (10th Cir. 1965).

10 Oster v. Dominion of Canada, 144 F. Supp 746, 748 (N.D.N.Y.), *aff'd sub nom.,* Clay v. Dominion of Canada, 238 F.2d 400 (2d Cir. 1956), *cert. denied,* 353 U.S. 936 (1957).

11 After stating the first qualification to Federal Rule 64 that "any existing statute of the United States governs to the extent to which it is applicable," the Sixth Circuit in Brown v. Beckham, 137 F.2d 644, 646 (6th Cir.), *cert. denied,* 320 U.S. 803 (1943), commented:

> We think this undoubtedly means that if there is any existing applicable federal statute that modifies the manner provided by the state in making the remedy of attachment available, the Clerk of the District Court, whose duty it is to issue all process from that court, is bound thereby.

12 Huffmaster v. United States, 186 F. Supp. 120, 122 (N.D. Cal. 1960). *Cf.* Messenger v. United States, 231 F.2d 328 (2d Cir. 1956).

13 66 N.M. 32, 340 P.2d 1080 (1959). *Cf.* Williams v. Smith, 169 Ga. 136, 149 S.E. 908 (1929); Thompson v. Central Metal & Supply Co., 158 Md. 186, 148 Atl. 231 (1930); Carroll County Bank v. Goodall, 41 N.H. 81 (1860); Edwards v. Case, 78 Or. 220, 152 Pac. 880 (1915). Annot., 75 A.L.R.2d 1437 (1961).

garnishee. The Michigan Supreme Court, in *Webster v. Bennett*,[14] likewise held that only a sheriff or his deputy could properly serve a writ of garnishment.

The United States Supreme Court, prior to the adoption of the federal rules, rendered an opinion in a related area which lends some support to the holding in *Tanos, Yazoo & M.V.R.R. v. City of Clarksdale*[15] involved a federal court supplementary proceeding in an execution sale by a United States marshal of defendant city's stock. In reference to the proper procedure to be followed in the federal system, the Supreme Court stated:

> These qualifying words [in REV. STAT. §§ 914, 916 (1875)] recognize the necessity for some play in adapting the state procedure to the practice of the federal courts. Certain things must be changed. The officer issuing the writ of execution must be the United States clerk, the officer executing it *must be the marshal, and not the sheriff* . . . .[16] (Emphasis added.)

It should be noted, however, that since *Yazoo* was decided before the adoption of the federal rules it cannot be considered binding authority in a case such as *Tanos*. Nevertheless, Federal Rule 4(c) explicitly states that process must be served by a United States marshal or one specially appointed by the federal court. Therefore, since the process serving sheriff in *Tanos* was neither a federal marshal nor one specially appointed by the court, service of process was invalid.

In his dissent in *Tanos*, Judge Brown argued that it is a mere technicality to distinguish between a United States marshal and a Florida county sheriff for purposes of service of process in a federal court garnishment proceeding.[17] Judge Brown attempted to distinguish the authority cited by the majority as well as to offer an explanation as to why process could validly be served by the sheriff.

Judge Brown accepted the holdings of the two cases relied on by the majority. However, he qualified the holdings in these cases as applied to the situation in *Tanos*. After first pointing out that the problem in *Rumsey* and *Mid-Continent* arose because the garnishee followed the federal rather than the Kansas rule on service of process, he went on to say:

> Although the Court used some language to the effect that the Federal Rules are controlling, the sole issue it had to decide was *whether Kansas law was controlling*. It held *only* that delivering the answer to the Garnishor pursuant to Rule 5(b) was *permissible*. *It did not hold that following the Kansas procedure would be impermissible*.[18] (Emphasis added.)

Rumsey and *Mid-Continent*, therefore, merely stand for the proposition that

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14 247 Mich. 616, 226 N.W. 684 (1929).
15 257 U.S. 10 (1921).
16 *Id.* at 24.
17 Judge Brown stated:

> I cannot believe that in the 20th Century in an atmosphere which aims the Rules at attaining substantial justice . . . it matters whether the person, delivering the paper to the responsible well-run office of a high state official whose function is then to buy and lick a United States postage stamp, wears a blue suit rather than an open-range hat, displays the badge of a marshal rather than the badge of a sheriff. United States *ex rel.* Tanos v. St. Paul Mercury Ins. Co., 361 F.2d 838, 848-49 (5th Cir. 1966) (dissenting opinion).

18 *Id.* at 844.

in a federal court proceeding, if you have acted in accordance with the federal rules, you have performed properly. Brown believed that these cases did not answer the question presented in *Tanos,* viz., whether following state procedure in a federal court proceeding may be valid.

In his dissent, Judge Brown cited *Ospina v. Vanelli,*[19] which is nearly on all fours with the relevant facts in *Tanos.* The plaintiff in *Ospina* prepared a garnishment summons, and service was made by someone other than the United States marshal. As in *Tanos,* the defendants claimed that under the federal rules the marshal must serve process in order for service to be valid. The district court, noting that Minnesota law allows service by any person not a party, rejected the defendants' contention and held the service valid. Although this case was clearly relevant, the majority's opinion in *Tanos* made no mention of it whatsoever. Perhaps this omission can be attributed to the fact that *Ospina* is a district court opinion. Professor Moore notes that district court opinions may have "little or no precedential value" in this area because of the wide variations in the nature and detail of the individual state statutes authorizing provisional remedies.[20] However, due to the close factual resemblance between *Ospina* and *Tanos,* the majority, even though they might decline to follow its holding, should have at least acknowledged *Ospina* and given reasons for their refusal to follow it.

Judge Brown placed strong emphasis in his dissent on the idea that a mere technicality, such as requiring process to be served by a United States marshal rather than an equally trustworthy Florida sheriff, should not traverse justice. Brown termed this requirement a "new, fresh victory for meaningless formalism."[21] His basic argument was that mere technicalities are not proper grounds for objection. However, it is evident that the majority would never concede that service by a Florida county sheriff, instead of a United States marshal, is an inconsequential deviation.

Brown further contended that Federal Rule 4(c) was inapplicable in the present case. This raises a most important question. In essence, Brown's argument was that under Rule 69 state law controls the procedure to be followed in such a case as *Tanos,* except to the extent that Rule 4(c) is applicable.[22] Rule 4(e) allows the use of state service of process procedures on "a party not an inhabitant of or found within the state."[23] Brown noted an apparent conflict between Rules 4(c) and 4(e). While Rule 4(e) controls the manner of service, 4(c) prescribes who shall make the service. Brown believed that the reach of Rule 4(c) was limited under 4(e) to statutes requiring personal service only.

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19 34 F.R.D. 151 (D. Minn. 1964).

20 7 MOORE, *op. cit. supra* note 8, ¶ 64.07[2], at 1522 (2d ed. 1966).

21 United States *ex rel.* Tanos v. St. Paul Mercury Ins. Co., 361 F.2d 838, 849 (5th Cir. 1966) (dissenting opinion). Brown cited his dissenting remarks in O'Neal v. United States, 264 F.2d 809, 814 (5th Cir. 1959), where he called such requirements "a harking back to the formalistic rigorism of an earlier and outmoded time."

22 United States *ex rel.* Tanos v. St. Paul Mercury Ins. Co., *supra* note 21, at 845 (dissenting opinion).

23 FED. R. CIV. P. 4(e). Brown claims it was undisputed that St. Paul was a nonresident of Florida, and thus Rule 4(e) applied. However, he notes that whether Rule 4(d)(7) or Rule 4(e) applied made no difference, since the Florida statute required the same procedure, substituted service on the state insurance commissioner, whether the insurer was domestic, foreign, or alien. United States *ex rel.* Tanos v. St. Paul Mercury Ins. Co., *supra* note 22, at 845 n.15.

In other words, Brown argued that the provisions of 4(c) are binding only when the manner of service called for by the appropriate statute must be personal. He concluded that since the Florida statute involved substituted service of process,[24] Rule 4(c) was inapplicable, and therefore the means of service under Florida law could validly be followed.

As authority for this argument, Brown relied on Professor Moore's treatise on the federal rules.[25] Moore supports the proposition that there is an implied exception to Rule 4(c) derived from the 1963 amendments to Rule 4. Under these amendments, both the manner of service, by explicit language, and the means of service, by implication, could be governed by state law.[26] Moore realizes that, ideally, Rule 4(c) should also have been amended in 1963 to conform to his views. In support of his argument, he relies on the Advisory Committee's Notes to the 1963 amendments which appear to substantiate his position.

> But it seems that the Advisory Committee did not deem such an amendment to Rule 4(c) necessary, and in its 1963 Note took the position that Rule 4(c) is not a limitation upon service under federal statutes or state statutes or rules, as provided in subdivision (e).[27]

Moore concludes that whenever a federal statute, or state statute or rule, calls for "a mode of service of original process other than by personal delivery to the party, the mode envisioned by the federal or state provision may be followed."[28]

Moore's analysis, however, is open to question. Moore states that Rule 4(c) does not limit Rule 4(e). However, the Advisory Committee has only stated that Rule 4(c) does not limit Rule 4(d)(7).

> It has also been held that the clause of paragraph (7) [Rule 4(d)(7)] which permits service "in the manner prescribed by the law of the state," . . . is not limited by subdivision (c) requiring that service of all process be made by certain designated persons.[29]

Moore evidently extended the Advisory Committee's statement on Rule 4(d)(7) to apply to Rule 4(e). It is submitted that such a reading is not warranted by the Committee's Notes.

However, the Advisory Committee's meaning is also far from clear. The above quote read in context gives the impression that if you can serve process under Rule 4(d)(7), then either federal or state means of service is permissible. This conclusion is strengthened by the Committee's citation to *Farr & Co. v. Cia. Intercontinental De Navegacion*,[30] which wholly supports such a proposition. However, the Committee also cites *Sappia v. Lauro Lines*,[31] which holds a con-

24 FLA. STAT. ANN. §§ 624.0221-.0222 (1960).
25 United States *ex rel.* Tanos v. St. Paul Mercury Ins. Co., 361 F.2d 838, 845 n.16 (5th Cir. 1966) (dissenting opinion).
26 2 MOORE, *op. cit. supra* note 8, ¶ 4.08, at 1007 (2d ed. 1965).
27 *Id.* at 1011.
28 *Ibid.*
29 1963 Amendments to the Federal Rules of Civil Procedure, Advisory Committee Notes 156 (July 1, 1966). Perhaps this is the reason why Brown noted that under the Florida statute substituted service was required for all insurance companies, and therefore it made no difference whether Rule 4(d)(7) or Rule 4(e) applied. See note 23 *supra.*
30 243 F.2d 342 (2d Cir. 1957).
31 130 F. Supp. 810 (S.D.N.Y. 1955).

trary view. Further confusion arises when the Advisory Committee goes on to note that "the salutary results of these cases are intended to be preserved."[32] The precise meaning of this statement is unclear. A lawyer can only rely on what he reads. From the Advisory Committee's Note, an attorney could reasonably conclude that service by a Florida sheriff in a Florida federal district court is proper procedure.

Likewise the rule itself is ambiguous and calls for corrective measures. Literally interpreted, the word "manner," as used in Rule 4, would encompass the entire method of service propounded by state law, including state means of service. The mandatory use of Rule 4(c) would thus be extremely limited. However, "manner" has been construed so as not to include the means of service.[33] It is submitted that the present ambiguity should be eliminated either by a clarification in the Advisory Committee's Note or by an amendment of the Rule.

The question remains: to what extent is Rule 4(c) binding on litigants in the federal courts? The preliminary draft of the original Federal Rules of Civil Procedure would have allowed service of a summons or subpoena by a marshal; his deputy; or any other person, not a party, who is of sound mind and at least twenty-one years old.[34] This draft was rejected, however, and the rule was amended to require service by a United States marshal, his deputy, or some person specially appointed by the court.[35] This means prescribed closely followed that previously laid down in former Federal Equity Rule 15.[36] Thus, early legislative history supports the idea of mandatory federal service of process. However, the present state of the law concerning who may serve process in a federal court proceeding is at best ambiguous. Certainty clearly demands explanation and clarification from the rulemakers.

Though considerations such as needless formality and plaintiff's responsibility for service lurked in the background in *Tanos,* the real import of this case lies in its revelation of the striking ambiguity in Rule 4. Are federal means of service to be extended to coincide with state means of service? Does Rule 4(c) apply to 4(d)(7), 4(e), neither, or both? For a proper answer, lawyers must await a clarification from the Advisory Committee. Until then, attorneys practicing in federal courts will be well advised to serve process in accordance with Rule 4(c).

Theodore A. Sinars

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32 Advisory Committee Notes, *op. cit. supra* note 29, at 156.

33 1 Barron & Holtzoff, Federal Practice and Procedure, ch. 6, § 175, at 657 (Rules ed. 1960); 2 Moore, *op. cit. supra,* ¶ 4.08 at 1007 (2d ed. 1965).

34 Advisory Committee on Rules for Civil Procedure, Preliminary Draft, Rule 5(b) (May 1936).

35 Report of the Advisory Committee on Rules for Civil Procedure, Proposed Rule 4(c) (April 1937). For comment on the proposed rules see Hammond, *Some Changes in the Preliminary Draft of the Proposed Federal Rules of Civil Procedure,* 23 A.B.A.J. 629 (1937).

36 1 Edmunds, Federal Rules of Civil Procedure, Rule 4 §§ 74, 76 (1938).