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Recent Cases

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RECENT CASES

Antitrust Law—Labor Union Exemption—Agreement Between Union and "Stranger" Building Contractor Obligating Contractor to Subcontract Only with Parties to Union's Collective Bargaining Agreements Is Not Exempt from the Sherman Act

I. Facts and Holding

Plaintiff, a building contractor, sought a judgment declaring its restrictive subcontracting agreement[1] with defendant union violative of the Sherman Act[2] and, therefore, invalid. Defendant, a bargaining agent for plumbers and mechanical tradesmen, neither had nor sought a collective bargaining relationship with plaintiff, who let subcontracts for all of its plumbing and mechanical work on the basis of competitive bids.[3] The litigants' agreement obligated plaintiff to deal only with plumbing and mechanical contracting firms that were parties to defendant's collective bargaining contracts.[4] Plaintiff, calling attention to the "most favored nation" clause[5] of defendant's then current multiemployer bargaining contract, alleged that the agreement served no legitimate union purpose and

1. The contract signed by the litigants will be referred to as the "agreement" to avoid confusion with the defendant's multiemployer or other collective bargaining contracts. The entire text of the agreement is found in the opinion of the Supreme Court. Connell Constr. Co. v. Plumbers Local 100, 95 S. Ct. 1830, 1834 (1975).

2. Plaintiff alleged violations of sections 1 and 2 of the Act. Sherman Anti-Trust Act, §§ 1-2, 15 U.S.C. §§ 1-2 (1970). Plaintiff originally brought suit in a Texas court alleging violations of that state's antitrust and right to work laws and seeking declaratory and injunctive relief. Upon defendant's removal of the case to federal court, plaintiff amended its complaint additionally to claim federal antitrust violations and seek a federal injunction. Connell Constr. Co. v. Plumbers Local 100, 78 L.R.R.M. 3012 (N.D. Tex. 1971) (order).

3. Defendant represents plumbers and mechanical tradesmen in the Dallas, Texas area. Plaintiff, also located in Dallas, is a general contractor who employed no plumbers or mechanical tradesmen at the time the agreement was signed. In the past, plaintiff had subcontracted with both nonunion and union plumbing and mechanical contracting firms.

4. Note 1 *supra*. Plaintiff signed the agreement after initially refusing to do so. Following plaintiff's refusal, defendant peacefully picketed one of plaintiff's construction sites, whereupon some of plaintiff's employees discontinued work. Under protest, plaintiff then signed the agreement. Subsequently, defendant sought to impose similar agreements on other general contractors, some of whom signed while others resisted.

5. Defendant's multiemployer collective bargaining contract was with the Mechanical Contractor's Association of Dallas, a group of about 75 firms. The "most favored nation" clause in this contract obligated the union, upon the granting of a more favorable contract to any other employer, to extend the same terms to the members of the association.

restrained competition. Claiming that the agreement was a lawful means of organizing area subcontractors, defendant disavowed any intent to shelter the parties to its multiemployer collective bargaining contract from competition and counterclaimed for a judgment declaring the agreement both statutorily and nonstatutorily exempt from federal antitrust law. Finding the agreement in accord with the construction industry proviso of section 8(e) of the Labor-Management Reporting and Disclosure Act of 1959[6] (LMRDA), the United States District Court for the Northern District of Texas granted the relief requested by defendant.[7] On different grounds, the United States Court of Appeals for the Fifth Circuit affirmed the district court's order.[8] On writ of certiorari to the Supreme Court of the United States, *held*, reversed in part and remanded.[9] An agreement between a union and a contractor whose employees the union does not seek to organize, which obligates the contractor to subcontract all work of a prescribed nature on any jobsite to firms that are parties to the union's collective bargaining agreements, is not exempt from the Sherman Act. *Connell Construction Co. v. Plumbers Local 100*, 421 U.S. 616 (1975).

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6. Section 8(e) provides in part:

> (e) It shall be an unfair labor practice for any labor organization and any employer to enter into any contract or agreement, express or implied, whereby such employer ceases or refrains or agrees to cease or refrain from handling, using, selling, transporting or otherwise dealing in any of the products of any other employer, or to cease doing business with any other person, and any contract or agreement entered into heretofore or hereafter containing such an agreement shall be to such extent unenforcible and void: *Provided*, that nothing in this subsection shall apply to an agreement between a labor organization and an employer in the construction industry relating to the contracting or subcontracting of work to be done at the site of the construction, alteration, painting, or repair of a building, structure, or other work: . . . .

Labor-Management Reporting and Disclosure Act of 1959, § 8(e), 29 U.S.C. § 158(e) (1970) [hereinafter cited as LMRDA]. Defendant's restrictive subcontracting agreement with plaintiff was drawn carefully to comport with the language of § 8(e). *See* note 1 *supra*.

7. The district court held, as a matter of law, that the agreement was consonant with the construction industry proviso of § 8(e) of the LMRDA and that therefore, being authorized by Congress, the agreement did not violate the Sherman Act. In its order the court did not address the question of nonstatutory antitrust immunity. It did find, however, that under the facts presented the state antitrust laws allegedly violated by the defendant were preempted by federal legislation. Connell Constr. Co. v. Plumbers Local 100, 78 L.R.R.M. 3012 (N.D. Tex. 1971) (order).

8. Essentially, the Fifth Circuit found that no conspiracy violative of the Sherman Act was proved but that a violation of federal labor legislation arguably existed, over which the National Labor Relations Board would have exclusive original jurisdiction. The district court below consequently was held not to have had jurisdiction over the plaintiff's action. Finally, concluding that the state antitrust law in issue was preempted by federal labor legislation, the court affirmed the dismissal. Connell Constr. Co. v. Plumbers Local 100, 483 F.2d 1154 (5th Cir. 1973).

9. The Court affirmed the finding of the lower courts that state antitrust law was preempted. Connell Constr. Co. v. Plumbers Local 100, 421 U.S. 616, 635-37 (1975).

II. LEGAL BACKGROUND

The extent to which labor unions are exempt from federal antitrust law is an issue that has long confronted the Supreme Court and about which the Court and Congress apparently have often disagreed.[10] Stated differently, the question is whether certain union activities are to be dealt with in terms of the national labor policy favoring collective bargaining or the national economic policy favoring free competition.

Subsequent to enactment of the Sherman Anti-Trust Act[11] in 1890, the Supreme Court harbored no doubt that the Act applied to union activities.[12] Prompted by dissatisfaction with this judicial view, Congress passed the Clayton Act[13] in 1914 defining labor unions and the carrying out of their "legitimate objectives" in a manner calculated to exempt them from antitrust sanctions.[14] In the 1921 case of *Duplex Printing Press Co. v. Deering*,[15] however, the Court severely limited the exemptive effect of the Clayton Act by holding that a variety of secondary organizational tactics, including strikes and boycotts, were not legitimate union activities and re-

10. *See* Cox, *Labor and Antitrust Laws—A Preliminary Analysis*, 104 U. PA. L. REV. 252 (1955) [hereinafter cited as Cox]; Meltzer, *Labor Unions, Collective Bargaining and the Antitrust Laws*, 32 U. CHI. L. REV. 659 (1965) [hereinafter cited as Meltzer]; Winter, *Collective Bargaining and Competition: The Application of Antitrust Standards to Union Activities*, 73 YALE L.J. 14 (1963) [hereinafter cited as Winter].

11. Act of July 2, 1890 (Sherman Anti-Trust Act), ch. 647, 26 Stat. 209 (codified as 15 U.S.C. §§ 1-7 (1970)).

12. There is conflicting evidence regarding the intent of Congress to subject unions to the Sherman Act. *See* S. COHEN, LABOR IN THE UNITED STATES 342, 355 n.16 (4th ed. 1975) [hereinafter cited as COHEN]. An amendment to remove unions from the coverage of the Act was defeated in Congress during the legislative debates. Cox, *supra* note 10, at 252, 256. It is noteworthy that of the first six cases initiated by the Justice Department under the Sherman Act, four were against labor unions. A. NEALE, THE ANTITRUST LAWS OF THE U.S.A. 16 n.1 (2d ed. 1974). The Supreme Court first explicitly held unions subject to the Act in Loewe v. Lawlor (The Danbury Hatters Case), 208 U.S. 274 (1908), in which the United Hatters Union was held liable for boycotting an unorganized hat manufacturer and causing approximately $80,000 in lost sales. The case came before the Court again in 1915, when it was held that union members and officers were jointly liable for treble damages and attorney's fees awarded to the manufacturer. Lawlor v. Loewe, 235 U.S. 522 (1915).

13. Antitrust Act, 1914 (Clayton Act), ch. 323, 38 Stat. 730 (codified in scattered sections of 15, 18, 29 U.S.C.) [hereinafter cited as Clayton Act].

14. Sections 6 and 20 of the Clayton Act generally provide that human labor is not a commodity, that the antitrust laws should not be interpreted to restrain the existence of unions or the carrying out of their legitimate activites, and that injunctions should not be issued by the federal courts in certain types of labor disputes. *Id.* §§ 6, 20 (codified as 15 U.S.C. § 17; 29 U.S.C. § 52 (1970)). As early as 1906, the American Federation of Labor had petitioned Congress for such legislation. COHEN, *supra* note 12, at 343.

15. 254 U.S. 443 (1921) (machinists organizations combined to institute a multifaceted secondary boycott against a printing press manufacturer).

mained vulnerable to the Sherman Act.[16] In the Norris-LaGuardia Act[17] and the National Labor Relations Act[18] (NLRA), passed in 1932 and 1935 respectively, Congress renewed its endeavor to protect union efforts to organize labor and improve working conditions. The injunctive power of the federal courts was restricted in labor cases;[19] the jurisdiction of the courts in the enforcement of labor legislation was narrowed through the creation of the National Labor Relations Board;[20] and a variety of organizational tactics were afforded protection and encouragement.[21] A major fault of the new legislation, however, was that it failed to coordinate the intended expansion of union antitrust immunity with either the Clayton Act or a contraction of the potential union liability emanating from the Sherman Act.[22] In the 1939 case of *Apex Hosiery Co. v. Leader*,[23] the Court, while avoiding the statutory integration problem, acknowledged that strikes inevitably restrain the power of employers to compete; it was held, nonetheless, that strikes were not necessarily violative of the Sherman Act.[24] Without finding a statutory exemption, the Court exempted from antitrust liability what, in its view, were legitimate labor activities.[25] The statutory integration problem was confronted and seemingly resolved in 1941 when the Court, in *United States v. Hutcheson*,[26] interpreted the Norris-LaGuardia

16. In so holding, it was apparent that the Court was prepared to apply its own notions of what was or was not a legitimate union activity in interpreting the Clayton Act. Thus, the prerogative of the Court in the area of labor policy continued. *See* Meltzer, *supra* note 10, at 663-65.

17. Act of March 23, 1932 (Norris-LaGuardia Act), ch. 90, 47 Stat. 70 (codified as 29 U.S.C. §§ 101-15 (1970)) [hereinafter cited as Norris-LaGuardia Act].

18. National Labor Relations Act (Wagner Act), ch. 372, 49 Stat. 449 (codified as 29 U.S.C. §§ 151-66 (1970)) [hereinafter cited as NLRA].

19. Norris-LaGuardia Act § 1.

20. NLRA § 3.

21. *Id.* §§ 7-9.

22. *See* Meltzer, *supra* note 10, at 665-66; Winter, *supra* note 10, at 38. Neither the Norris-LaGuardia Act nor the NLRA even mentioned the Sherman Act.

23. 310 U.S. 469 (1940).

24. *Apex*, the first Supreme Court case of the New Deal era involving union liability under the Sherman Act, signalled a definite change in the Court's attitude toward such liability, a judicial deference to the continuing legislative efforts to exempt unions from the Sherman Act, and a shift from the Court to Congress in the initiative regarding national economic policy as it affected labor. *See* UMW v. Pennington, 381 U.S. 676, 697 (1965) (Goldberg, Harlan & Stewart, J.J., dissenting); COHEN, *supra* note 12, at 370.

25. The Court held that workers who, seeking to organize employees, forcibly and illegally seized control over a hosiery manufacturing plant, staged a sit-down strike, and prevented the shipment of finished goods to markets did not *ipso facto* violate antitrust law. The Court, failing to find that the union had an intent to affect competition or market prices or that its actions were actually the cause of such results, found no union liability under the Sherman Act. 310 U.S. at 500-03.

26. 312 U.S. 219 (1941) (union struck and instituted a secondary boycott against em-

and Clayton Acts interdependently.[27] In so doing, the Court held that a labor union acting in its own interest and not in concert with nonlabor entities was exempted legislatively from antitrust liability regardless of any resulting restraint on competition;[28] the congressional intent underlying the Clayton Act, Norris-LaGuardia Act, and NLRA seemingly had been effectuated.[29] Four years later in *Allen Bradley Co. v. Local 3, IBEW*[30] the Court addressed the issue, undecided in *Hutcheson*, of whether a union acting anticompetitively and in concert with nonlabor parties was shielded by the statutory antitrust exemption. Admitting that the union involved had bargained with employers in the interest of its members, the Court nevertheless found that the labor agreements in question were part of a larger plan enabling manufacturers and contractors to create a sheltered geographic market.[31] Characterizing the union activity as "aiding and abetting" violations of the Sherman Act, the Court held that the antitrust exemption recognized in *Hutcheson* was inapplicable and found the union liable.[32] The Court stated, however, that if the union had acted alone it would have been immune from liability.[33]

Federal labor policy took a new turn with the enactment of the Labor Management Relations Act, 1947[34] (LMRA), which reversed the trend of congressional sentiment favoring the secondary organizational activity of unions.[35] In accordance with Congress' intent to limit the vastly increased power of unions,[36] certain types of second-

ployer as a result of jurisdictional dispute with another union).

27. In the majority opinion, Mr. Justice Frankfurter first stated that the existence of a Sherman Act violation must be determined by reading the Sherman, Clayton, and Norris-LaGuardia Acts harmoniously. *Id.* at 229. He asserted that Congress had passed the Norris-LaGuardia Act to clarify the labor policies previously set forth in the Clayton Act but not fully carried out by the courts. *Id.* at 234. He construed the Norris-LaGuardia Act as having ". . . reasserted the original purpose of the Clayton Act by infusing into it the immunized trade union activities as redefined by the later Act." *Id.* at 236. It has been remarked that this statutory construction underlying the holding in *Hutcheson* is not unqualifiedly acceptable. *See* Cox, *supra* note 10, at 265.

28. 312 U.S. at 232.

29. The Court's holding in *Hutcheson* may be seen as marking the beginning of the era, foretold by *Apex*, of congressional prerogatives in the determination of the policy relating to union liability under the Sherman Act. *See* Meltzer, *supra* note 10, at 668-69.

30. 325 U.S. 797 (1945).

31. The union in *Allen Bradley* conspired, in the context of collective bargaining, with contractors and manufacturers who sought to establish a closed market in New York City for electrical components, electrical contracting, and labor. *Id.*

32. *Id.* at 810.

33. *Id.* at 799, 807, 810.

34. Labor Management Relations Act, 1947 (Taft-Hartley Act), ch. 120, 61 Stat. 136 (codified in scattered sections of 18, 29 U.S.C.) [hereinafter cited as LMRA].

35. COHEN, *supra* note 12, at 378-79.

36. *Id.* at 379.

ary activities were denominated "unfair labor practices" and proscribed in section 8 of the LMRA.[37] Both a private action and a National Labor Relations Board enforcement procedure were created to deter unions from engaging in these illegal activities.[38] The Labor-Management Reporting and Disclosure Act of 1959,[39] (LMRDA) placed further legislative control on union secondary activities by closing loopholes that had appeared in section 8 of the LMRA.[40] Viewed together, the LMRA and the LMRDA arguably evidenced a congressional scheme, in the context of labor legislation, to outlaw and to provide new remedies for the use of certain union secondary activities which, although in the nature of antitrust violations, seemed to be shielded by the statutory immunity recognized in *Hutcheson*.[41]

Judicial intervention did not recur significantly until 1965 when a sharply divided Supreme Court simultaneously rendered two important decisions relating to the antitrust exemption.[42] The first case, *UMW v. Pennington*,[43] arose when a union, in return for increased wages, promised one group of employers that it would demand similar wages from other employers regardless of their ability to pay. The alleged intent was to drive small competitors out of business.[44] Conceding that wage bargaining was a legitimate union function, Justice White, speaking for the Court, stated that the clear showing of a union's agreement with some employers to impose wage demands on others would cause a forfeiture of antitrust immunity. Citing *Apex Hosiery* rather than *Hutcheson* or the labor

37. LMRA § 8, *as amended* 29 U.S.C. 158 (1970).

38. LMRA §§ 10, 303, *as amended* 29 U.S.C. 160, 187 (1970).

39. LMRDA, 73 Stat. 519 (codified in scattered sections of 29 U.S.C.).

40. Of particular concern were so-called "hot cargo" contracts whereby an employer voluntarily agreed not to deal with another "unfair" employer. Section 8(b)(4) of the LMRA prohibited union officials from encouraging union members not to work with products made or shipped by an unfair employer, but did not limit "hot cargo" contracts that achieved the same results. Another loophole involved the § 8(b)(4) prohibition against union encouragement of concerted refusals by employees to deal with the goods or services of a neutral employer. The possibility of union pressure being applied to individual employees, that is, encouragement of unconcerted secondary activities, was left open. LAB. REL. REP., LRX 725-27 (1974); COHEN, *supra* note 12, at 388-89.

41. *See* COHEN, *supra* note 12, at 376-84; Meltzer, *supra* note 10, at 702-14.

42. The Justices split into three groups of three, the same in each case. Mr. Justice White, joined by the Chief Justice and Justice Brennan, rendered the opinion of the Court in each case. For a summary of the positions taken by the remaining Justices, see notes 45 and 49 *infra*.

43. 381 U.S. 657 (1965).

44. Under the agreement, union members would benefit from higher wages while the large coal producers would benefit through lessened competition—small producers, unable to bear the burden of high labor costs would be forced to discontinue operations. *Id.* at 659-61.

statutes, he declared that federal labor policy did not condone such agreements and implied that no anticompetitive intent need be shown in order to deny immunity.[45] The second case, *Local 189, Meat Cutters v. Jewel Tea Co.*,[46] involved a multiemployer collective bargaining agreement that imposed specific limitations on the operating hours of employers. An employer bound by the agreement claimed that it had restricted competition by preventing business operations in which the union did not participate and had no legitimate interest.[47] Justice White, writing again for the Court[48] and finding no conspiracy between the union and the contracting employers, limited the issue to whether the union's interest was "intimately related" to the attainment of satisfactory working hours for its members. Finding such a relationship, he held, again without reference to federal labor legislation, that federal labor policy immunized the union from antitrust liability.[49] The *Pennington* and *Jewel Tea* cases, though arguably inconsistent in their results, ap-

45. The decision was reversed and remanded, despite the apparent finding of liability, because of an error in the instructions to the jury during the trial. Justices Douglas, Black, and Clark, in a concurring opinion, construed the opinion of the Court as a reaffirmance of *Allen Bradley*. Emphasizing deference to federal legislation in the labor field, the Justices nevertheless stated that the alleged activity of the UMW, if proved, would be a *prima facie* violation of the Sherman Act for which immunity would not be appropriate. *Id.* at 672-75. Justices Goldberg, Harlan and Stewart, dissenting from the opinion of the Court but concurring in the result, stated that the Court was determining social and economic policy contrary to the will of Congress. Finding that wages were, by statute, a mandatory subject for collective bargaining, the dissenters reasoned that under *Hutcheson* neither the bargaining itself nor the contract before the Court could be the subject of an antitrust action. They stated that judicial determinations of the motives underlying a union's outwardly legitimate bargaining activities were both futile and dangerous. *Id.* at 698-735.

46. 381 U.S. 676 (1965).

47. The contract prevented employers from selling fresh meat between the hours of 6 p.m. and 9 a.m. on weekdays or at any time on Sundays. Similar provisions had been inserted in the union's contracts since 1920, prior to which time butchers had been required to work over eighty hours per week. Jewel Tea Company's complaint arose from the fact that the contract prevented it from operating self-service meat counters in its grocery stores. *Id.* at 694-96.

48. *See* note 42 *supra*.

49. The opinion in which Justices Goldberg, Harlan, and Stewart dissented from the Court's opinion in *Pennington*, but concurred in the result, also served as their concurring opinion in *Jewel Tea*. Like *Pennington*, *Jewel Tea* was viewed as a case involving a statutorily-mandated subject for collective bargaining—working hours. The concurring Justices therefore reasoned that there was no antitrust liability under the theory that the union's actions had been legislatively legitimized. The concurring Justices further stated that the Court should not look beyond the statutory justification for the union's activity, there being no judicial aptitude or criteria for analyzing the social or economic appropriateness of that activity. 381 U.S. at 696-735. Justices Douglas, Black, and Clark dissented in *Jewel Tea*, arguing that the collective bargaining contract itself was evidence of a conspiracy to restrain competition. They contended that the Court was confusing working hours with marketing hours and that the union's members had no direct or immediate interest in the latter. *Id.* 735-38.

peared to signal the Supreme Court's resurrection, over the vigorous protest of some of its members, of the pre-*Hutcheson* nonstatutory antitrust exemption based on judicial conceptions of economically acceptable union activity.

III. The Instant Opinion

In the instant case, the Supreme Court initially acknowledged that the Clayton and Norris-LaGuardia Acts exempted labor unions and some of their activities from the proscriptions of federal antitrust law.[50] Citing Mr. Justice White's opinions in *Pennington* and *Jewel Tea*,[51] the Court further noted that the need for reconciling the congressional policies favoring collective bargaining and competitive markets was the source of a nonstatutory antitrust exemption which recognizes that legitimate union-employer agreements inevitably effect restraints on business markets.[52] Relying on *Allen Bradley*, however, the Court observed that neither of these exemptions protected anticompetitive dealings between unions and nonlabor entities that do not employ the union's members.[53]

Addressing defendant's claim of nonstatutory immunity, the Court examined the actual and potential effects of defendant's agreement with plaintiff and found them to be highly anticompetitive.[54] Acknowledging that defendant's ultimate motive of organizing as many subcontractors as possible was legal in itself, the Court emphasized that defendant did not represent or seek to represent any of plaintiff's employees.[55] The Court then reasoned that, since the agreement was both unrelated to the federal policy favoring collective bargaining and inimical to the federal policy favoring competitive markets, the protection afforded by the nonstatutory antitrust exemption was inappropriate.

The Court next considered defendant's claim of statutory immunity under the construction industry proviso of section 8(e) of the LMRDA.[56] The Court admitted that the restrictive subcontracting

50. Connell Constr. Co. v. Plumbers Local 100, 421 U.S. 616, 621-22 (1975). *See* note 27 *supra* and accompanying text.

51. *See* notes 42, 45 & 49 *supra* and accompanying text.

52. 421 U.S. at 622-23. *See* notes 23-25 *supra* and accompanying text.

53. *See* note 30 *supra* and accompanying text.

54. The Court found that the agreement, in light of the "most favored nation" clause in defendant's multiemployer collective bargaining contract, served to exclude nonunion subcontractors from the Dallas market, assured that subcontractors unaffiliated with the Mechanical Contractors Association of Dallas would not outcompete members of that association, and gave the defendant control over access to the market for subcontracted labor in the plumbing and mechanical trades. 421 U.S. 623-25.

55. *See* noto 3 *supra* and accompanying text.

56. *See* note 6 *supra*.

agreement comported with the statutory language but questioned whether it nonetheless violated the intent of Congress. Supplementing an analysis of legislative intent with case authority, the Court construed the proviso to except agreements pertaining to secondary activities on a single construction site from categorization as unfair labor practices.[57] The Court, noting that the agreement in question obligated plaintiff to restrict its subcontracting on all its jobsites, asserted that the reading of the proviso urged by defendant would provide unions with precisely the sort of unlimited economic weapon that Congress sought to outlaw in section 8 of the LMRDA.[58] Finding no clear evidence of a congressional intent to preserve the legality of such a coercive organizational tactic, the Court rejected defendant's claim of statutory antitrust immunity.

Turning to defendant's final argument that the LMRDA provided the exclusive remedy for violations of its unfair labor practices provisions,[59] the Court held that, despite defendant's apparent violation of section 8(e), the remedy provided by labor statutes was irrelevant in determining whether antitrust sanctions were applicable.[60] The Court thus concluded that under the facts presented the defendant was neither nonstatutorily nor statutorily immunized from federal antitrust liability[61] and that its restrictive subcontracting agreement with plaintiff was a proper basis for a suit under the Sherman Act.[62]

IV. COMMENT

The immediate import of the instant decision is its reassertion of the applicability of federal antitrust law to certain types of union secondary activities. By holding that section 8(e) of the LMRA does not necessarily insulate unions from antitrust liability and that the private action provided by the LMRA for violations of section 8(e) is not exclusive, the Court made clear its view that federal labor

57. 421 U.S. at 626-34.

58. *See* notes 35, 37 & 40 *supra* and accompanying text.

59. *See* note 38 *supra* and accompanying text.

60. 421 U.S. at 635.

61. The Court affirmed the finding of the lower courts that the violations of state antitrust law alleged by plaintiff were preempted on the theory that federal lahor and antitrust statutes operated in the field and, therefore, conflict between federal and state policies could not be permitted. 421 U.S. at 635-37.

62. Justices Stewart, Douglas, Brennan, and Marshall dissented from the opinion of the Court, arguing tbat the majority's analysis of the legislative intent underlying section 8(e) of the LMRDA was incorrect and that the exclusive remedy in the instant case was provided by 29 U.S.C. 187 (§ 303 of the LMRA). The dissent concluded by stating that the majority was imposing liability contrary to the clear intent of Congress and was threatening to destroy the balance hetween employer and employee power provided by federal labor legislation.

legislation has not wholly displaced the Sherman Act when unions are involved.[63] To have held otherwise, however, would have been to violate the established judicial principle permitting a finding of statutory repeal by implication under only the clearest of circumstances.[64] Whether Congress intended section 8 of the LMRA to supplant the Sherman Act is debatable given the legislative history cited by the Court.[65] Nevertheless, the instant holding, that a Sherman action exists for what was apparently an unfair labor practices violation, appears to render both section 8(e) and the private action created for its enforcement somewhat superfluous. The same may be true for section 8 generally. The reason is that the instant holding probably will encourage potential plaintiffs in unfair labor practices suits to bring actions under the Sherman Act instead, in the hope of recovering treble damages and attorney's fees.[66] When such an action is brought, the Court appears willing to thoroughly scrutinize the language of the applicable labor statute and its underlying purposes, the collective bargaining relationships between union and nonlabor entities, and the market effects of secondary organizational tactics in determining whether a union is entitled to statutory antitrust immunity. Thus, the instant decision should discourage unions from participating in questionable secondary practices having markedly anticompetitive effects for which statutory antitrust immunity may provide no shelter.

In addition to raising the issue of whether Congress has in fact achieved a satisfactory legislative accommodation of federal labor and antitrust policy, the instant case poses the question whether it is prudent to leave the task of defining legitimate union activity in light of the Sherman Act[67] to the judiciary. As shown by the instant decision, the answer to both of these questions must be in the negative. The LMRA and the LMRDA, though obviously representing a congressional intent to limit the economic power of unions,[68] contain the same fundamental flaw that was present in the NLRA and the Norris-LaGuardia Act.[69] They do not integrate the definitions of

63. *See* notes 58 & 60 *supra* and accompanying text.

64. *See, e.g.*, Universal Interpretive Shuttle Corp. v. Metropolitan Area Transit Comm'n, 393 U.S. 186, 193 (1968).

65. The dissent's citations to the legislative debates in support of its position seem equally as persuasive as those of the Court. *See* 421 U.S. 616, 640-54. *See* note 62 *supra*.

66. For an early case under the Sherman Act holding that union members were jointly liable for treble damages and attorney's fees see Loewe v. Lawlor, 235 U.S. 522 (1915), cited in note 12 *supra*.

67. *See* notes 35-37 *supra* and accompanying text.

68. *See* note 22 *supra* and accompanying text.

69. *See* note 27 *supra*.

proper and improper union activity with a corresponding limitation on the scope of union liability under antitrust law. The Supreme Court's 1941 *Hutcheson* opinion, founded upon a strained interdependent interpretation of the Norris-LaGuardia and Clayton Acts, doubtless has become obsolete with the passage of the LMRA and LMRDA and therefore contributes little in resolving conflicts between antitrust and unfair labor practices liability.

The instant decision demonstrates the inability of the Court, on its own or with the meager guidance provided by Congress, to discern a clear standard by which to measure the propriety of union organizational activity in light of current federal labor and antitrust law. Faced with a fact pattern that did not embody an apparent anticompetitive intent, a classic conspiracy between labor and nonlabor entities, or activity clearly unrelated to the legitimate union interest in achieving better wages and working conditions, the Court was forced to abandon the "clear showing" test of *Pennington*,[70] the "intimately related" test of *Jewel Tea*[71] and, perhaps, even the *Allen Bradley* doctrine.[72] Instead, the Court applied a balancing standard the precise nature of which remains unarticulated. The instant opinion therefore provides little guidance for unions or the federal judiciary and leaves the function of the unfair labor practices provisions of the LMRA as amended by the LMRDA somewhat in doubt. The competing values involved in the instant case are exceedingly complex. If a satisfactory accommodation of the two seemingly irreconcilable national policies favoring labor organization and competitive markets is to be made, however, the Supreme Court's opinion in the instant case is an indication that the solution inevitably will have to come from Congress.

LAURENCE M. HAMRIC

70. *See* notes 42-45 *supra* and accompanying text.
71. *See* notes 42, 46 & 49 *supra* and accompanying text.
72. *See* notes 31-34 *supra* and accompanying text; *see* note 45 *supra*.

Constitutional Law — Interstate Commerce — Extortion — Federal Criminal Jurisdiction Under Hobbs Act Satisfied by Showing Potential Effect On Commerce

I. Facts and Holding

Defendant, a city alderman,[1] was indicted under the Hobbs Act[2] for obstructing, delaying, and affecting interstate commerce by extorting payments from a property owner in exchange for support of a zoning ordinance amendment that permitted construction of an animal hospital.[3] Despite enactment of the requisite zoning modifications,[4] the animal hospital was never built.[5] Although no proof was adduced that the alleged extortion had any actual effect on interstate commerce, testimony established that the proposed construction would have required the use of out-of-state building materials.[6] The federal government contended that any potential ob-

1. The defendant was Casimir Staszcuk, an elected alderman from the 13th ward of Chicago.

2. 18 U.S.C. § 1951 (1970). Defendant Staszcuk might have been prosecuted under state law. 38 Ill. Ann. Stats. § 33-3 (Supp. 1975) provides in pertinent part:

> A public officer or employee commits misconduct when, in his official capacity, he commits any of the following acts . . .
>
> (d) Solicits or knowingly accepts for the performance of any act a fee or reward which he knows is not authorized by law.

3. In September 1970 William Harris reached an agreement with a veterinarian to build an animal hospital on Harris' property in the 13th ward of Chicago. Such a use of the land was proscribed by existing zoning ordinances. In an effort to procure an amendment to the zoning laws, which would permit him to build the animal hospital, Harris paid $5,500 to Al C. Allen, known in Chicago as "the zoning man." Allen discussed the matter with Alderman Staszcuk, and on September 15, 1970, an amendatory ordinance was introduced in the City Council. On December 8, 1970, the zoning man paid the alderman $3,000 to refrain from opposing the amendment. United States v. Staszcuk, 517 F.2d 53, 56 (7th Cir.), *cert. denied*, 44 U.S.L.W. 3188 (U.S. Oct. 7, 1975).

The evidence indicated that Staszcuk accepted two other payments of $3,000 from Allen in return for support of similar zoning amendments relating to two other pieces of property in the 13th ward. Staszcuk ultimately was indicted for four counts of mail fraud, two counts of filing false income tax returns, and three counts of Hobbs Act violations. Prior to the instant appeal, defendant was convicted on four of the counts. At issue in the instant case is Count III of the indictment for violation of the Hobbs Act by means of extortion. *Id.* at 55-56; United States v. Staszcuk, 502 F.2d 875 (7th Cir. 1974) (panel decision).

4. Following a public hearing on December 8, 1970, the Council zoning committee deferred action on the matter. On January 27, 1971, the ordinance was approved by the committee and adopted by the City Council. Harris was then free to construct the animal hospital. 517 F.2d 53, 56 (7th Cir. 1975).

5. In March 1971 Harris received bids on the animal hospital from three contractors. For unexplained reasons, the veterinarian backed out of the deal and the hospital was never built. Instead, Harris erected buildings that were proper under the previous zoning ordinance. *Id.*

6. Testimony was taken from only one of the three bidders. He testified that in his

struction, delay, or effect on commerce invokes federal criminal jurisdiction under the Hobbs Act, provided that at the time of the offense there was a reasonable probability that the extortion would have affected interstate commerce.[7] Defendant argued that when a threatened effect on commerce fails to materialize there is an insufficient nexus with interstate commerce to satisfy Hobbs Act jurisdictional requirements. Adopting the liberal standard of federal criminal jurisdiction advanced by the Government, the District Court found defendant guilty of extortion affecting commerce in violation of the Hobbs Act.[8] A panel of the Seventh Circuit Court of Appeals reversed, holding that when a potential effect on commerce fails to materialize federal Hobbs Act jurisdiction is forfeited.[9] On rehearing before the Seventh Circuit Court of Appeals sitting *en banc, held*, reversed. Absent an actual effect on commerce, federal jurisdiction under the Hobbs Act is satisfied by showing that at the time of the offense there was a realistic probability that the robbery or extortion would have affected interstate commerce. *United States v. Staszcuk*, 517 F.2d 53 (7th Cir.), *cert. denied*, 44 U.S.L.W. 3188 (U.S. Oct. 7, 1975).

II. Legal Background

The Constitution granted Congress the power to regulate commerce among the several states[10] to secure freedom of trade and to insure the free flow of goods.[11] Expansive judicial interpretation of

opinion the proposed construction would have involved cast iron plumbing fixtures, plate glass, electrical fixtures, and a furnace manufactured outside of Illinois. The evidence showed that the witness' company had been involved in the construction of four comparable animal hospitals in the past five years, and that he was unaware of any Illinois source for the materials. *Id.* at n.5.

7. The Government argued that the extortion elimimated defendant's possible opposition to the removal of a restriction that prevented Harris from building the hospital; if Harris had not changed his plans, the construction of the hospital would have involved the use of out-of-state materials. *Id.* at 56.

8. The District Court's opinion is not reported.

9. 502 F.2d 875 (7th Cir. 1974).

10. "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and witb the Indian Tribes . . ." U.S. Const. art. I, § 8.

11. Justice Rutledge described the central purpose of the commerce clause as follows:

> It was . . . to secure freedom of trade, to break down the barriers to its free fiow, tbat the Annapolis Convention was called, only to adjourn with a view to Philadelphia. Thus the generating source of the Constitution lay in the rising volume of restraints upon commerce which the Confederation could not check. These were the proximate cause of our national existence down to today. . . . No prohibition of trade barriers as among the states could have been effective of its own force or by trade agreements. It had become apparent that such treaties were too difficult to negotiate and the process of securing them was too complex for this method to give tbe needed relief. Power adequate to make and enforce the prohibition was required. Hence, the necessity for creating an

the commerce clause has established that Congress has plenary power[12] to regulate all aspects of the economy affecting interstate commerce.[13] Federal regulation of purely intrastate economic activity has been permitted when the activity directly affects interstate commerce or contributes to a class of activities affecting commerce.[14] In contrast to the wide latitude of congressional power in the economic realm, federal commerce power in the criminal domain has not received corresponding expansive treatment from the judiciary.[15] Although the courts frequently have sustained federal criminal statutes proscribing the misuse of the channels of interstate commerce and protecting the instrumentalities of commerce,[16] the judiciary traditionally has disapproved legislation punishing local criminal conduct that incidentally affects interstate commerce absent exceptional circumstances.[17] This judicial reluctance to ex-

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entirely new scheme of government.

W. RUTLEDGE, A DECLARATION OF LEGAL FAITH 25-6 (1947); *see* E. CORWIN, THE TWILIGHT OF THE SUPREME COURT 17 (1934); P. FENN, THE DEVELOPMENT OF THE CONSTITUTION 411 (1948); B. SCHWARTZ, A COMMENTARY ON THE CONSTITUTION OF THE UNITED STATES 229 (1963); Bogen, *The Hunting of the Shark: An Inquiry Into the Limits of Congressional Power Under the Commerce Clause*, 8 WAKE FOREST L. REV. 187 (1972).

12. Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 258 (1964); Hanley v. Kansas City S. Ry., 187 U.S. 617, 619 (1903).

13. NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937); *see* Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 258 (1964); Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Wrightwood Dairy Co., 315 U.S. 110 (1942); United States v. Darby, 312 U.S. 100 (1941). For a historical development of the commerce power see P. BENSON, THE SUPREME COURT AND THE COMMERCE CLAUSE 1937-1970 (1970); Stern, *The Commerce Clause and the National Economy, 1933-1946* (pts. 1 & 2), 59 HARV. L. REV. 645, 883 (1946); Stern, *That Commerce Which Concerns More States Than One*, 47 HARV. L. REV. 1335 (1934); Stern, *The Problems of Yesteryear — Commerce and Due Process*, 4 VAND. L. REV. 446 (1951); Stern, *The Scope of the Phrase Interstate Commerce*, 41 A.B.A.J. 823 (1955). *See also* Bogen, *supra* note 11, at 190.

14. United States v. Darby, 312 U.S. 100, 120-21 (1941); *accord*, Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Wrightwood Dairy Co., 315 U.S. 110 (1942); *see* Stern, 59 HARV. L. REV., *supra* note 13. An individual showing of effect on commerce is unnecessary if Congress determines that in the aggregate the class of activities affects interstate commerce. Katzenbach v. McClung, 379 U.S. 294, 303-04 (1964); *accord*, Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964); *see* Perez v. United States, 402 U.S. 146, 152 (1971). *But see* United States v. Bass, 404 U.S. 336 (1971); Rewis v. United States, 401 U.S. 808 (1971).

15. *See generally* 1972 U. ILL. L. F. 805; 46 TUL. L. REV. 829, 833 (1972).

16. *See* Perez v. United States, 402 U.S. 146, 150 (1971); *see, e.g.*, Brooks v. United States, 267 U.S. 432 (1925) (stolen motor vehicles); Caminetti v. United States, 242 U.S. 470 (1917) (women for immoral purposes); Champion v. Ames (The Lottery Case), 188 U.S. 321 (1903) (sale of lottery tickets). *See also* Perez v. United States, 402 U.S. 146, 150 (1971); Cushman, *The National Police Power Under the Commerce Clause of the Constitution*, 3 MINN. L. REV. 289, 297 (1919); Stern, *The Commerce Clause Revisited — The Federalization of Intrastate Crime*, 15 ARIZ. L. REV. 271, 273 (1973); 32 MICH. L. REV. 378 (1934); 1972 U. ILL. L. F. 805.

17. Hodges v. United States, 203 U.S. 1 (1906); H. HART & A. SACKS, THE LEGAL

tend the reach of federal commerce power to local crime derives from the American system of federalism, which historically has allocated the power to define and punish crimes to the states.[18] Recognizing that federal police resources are limited,[19] that local authorities are better situated to enforce criminal laws, and that duplicitous federal criminal legislation encourages relaxation of essential state law enforcement efforts,[20] the courts steadfastly have resisted alteration of the sensitive federal-state balance of criminal jurisdiction. As a general principle, ambiguities in federal criminal statutes have been construed narrowly.[21] Additionally, the courts have refused to uphold criminal legislation federalizing intrastate crimes unless Congress clearly articulates an intention to change the federal-state balance of power in the criminal domain.[22]

Nevertheless, recent years have witnessed a dramatic increase in federal utilization of the commerce clause power to punish heretofore purely local crimes that incidentally affect interstate commerce.[23] Reasoning that the national government can manage most

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PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW 1241 (tent. ed. 1958); *see* United States v. Bass, 404 U.S. 336, 349 (1971).

18. H. HART & A. SACKS, *supra* note 17; *see* 1972 U. ILL. L. F. 805.

19. Rewis v. United States, 401 U.S. 808, 812 (1971); Bogen, *supra* note 11, at 195.

20. *See* 72 CONG. REC. 6214 (1930) (letter from the Attorney General to the Chairman of the Senate Committee on the Judiciary).

21. Ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity. Rewis v. United States, 401 U.S. 808, 812 (1971); *see* Ladner v. United States, 358 U.S. 169 (1958); Bell v. United States, 349 U.S. 81 (1955); United States v. Five Gambling Devices, 346 U.S. 441 (1953) (plurality opinion).

22. United States v. Bass, 404 U.S. 336, 349 (1971); *see* Rewis v. United States, 401 U.S. 808, 812 (1971); United States v. Five Gambling Devices, 346 U.S. 441 (1953); Apex Hosiery Co. v. Leader, 310 U.S. 469 (1940); Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 539-40 (1947).

In *Bass* the Supreme Court reversed the conviction of a defendant for possessing firearms in violation of section 1202(a) of the Omnibus Crime Control and Safe Streets Act, 18 U.S.C. APP. § 1202(a) (1970), because the Government did not allege or prove that the firearms had been possessed in or used in a manner affecting commerce. Given the "meager legislative history," the failure of Congress to specify clearly its intentions, and the ambiguity of the Act, the Court refused to read the statute in a way that would alter the federal-state balance of criminal jurisdiction. "[T]he legislative history provides scanty basis for concluding that Congress faced these serious questions and meant to affect the federal-state balance in the way now claimed by the Government." 404 U.S. 336, 350 (1971). For commentary on the *Bass* case see 2 MEMPHIS ST. L. REV. 441 (1972).

23. *See* Stern, *supra* note 16; 1972 U. ILL. L. F. 805; *see, e.g.*, Perez v. United States, 402 U.S. 146 (1971). *See also* Hufstedler, *Comity and the Constitution: The Changing Role of the Federal Judiciary*, 47 N.Y.U.L. REV. 841 (1972). In *Perez* the Supreme Court upheld the application of the federal anti-loansharking statute, 18 U.S.C. §§ 891-96 (1970), to a purely intrastate credit transaction without requiring an interstate commerce nexus. Given the congressional finding that the class of activities affected commerce, the Court held that it was unnecessary to demonstrate an actual effect on interstate commerce in the individual case. For commentary on *Perez* see Bogen, *supra* note 11; Levine, *The Proposed New Federal*

effectively problems not indigenous to individual states[24] and that states require federal law enforcement assistance,[25] Congress has federalized intrastate crimes in three situations.[26] First, local crimes have been subjected to federal control in order to protect a particular federal interest or involvement.[27] Second, federal action has been impelled when local officials are unwilling or unable to prosecute criminal activity.[28] Finally, federal criminal power under the commerce clause has been exercised when the aggregate effect of local crimes exerts a nationwide impact on interstate commerce.[29]

One crime traditionally controlled by local authorities that has been subjected to at least partial federal control is extortion.[30] The first congressional attempt to criminalize extortion at the federal level was the Anti-Racketeering Act of 1934,[31] a statute designed to curb the exaction of payments from industry by threat of labor unrest.[32] The Anti-Racketeering Act provided criminal penalties for persons who in any way or degree affected interstate commerce by threat of force, fear, violence, or coercion in order to obtain money or property.[33] The scope of the Act, however, was curtailed sharply

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Criminal Code: A Constitutional and Jurisdictional Analysis, 39 BROOKLYN L. REV. 1 (1972); Stern, *supra* note 16; 49 TEXAS L. REV. 568 (1971); 46 TUL. L. REV. 829 (1972). *See also* 1972 L. & SOC. ORDER 683.

24. Stern, *supra* note 16, at 285.

25. *Id.* at 283.

26. One commentator has argued that the potential costs of federal non-involvement generally are (1) delay, (2) potential weakening of federal rights, (3) erosion of the right to a federal forum, and (4) decreased confidence in the ability of federal courts to execute their primary functions. Hufstedler, *supra* note 23, at 869.

27. *See* 5 LOYOLA (CHICAGO) U.L.J. 513, 534 (1974).

28. H. HART & A. SACKS, *supra* note 17; Stern, *Prosecutions of Local Political Corruption Under the Hobbs Act: The Unnecessary Distinction Between Bribery and Extortion*, 3 SETON HALL L. REV. 1 (1971).

29. *See* Stern, *supra* note 16, at 285.

30. United States v. Laudani, 134 F.2d 847, 850-51 (3d Cir. 1943), *rev'd on other grounds*, 320 U.S. 543 (1944).

31. Act of June 18, 1934, ch. 569, 48 Stat. 979, *as amended* 18 U.S.C. § 1951 (1970).

32. *See* articles cited note 37 *infra*.

33. The Anti-Racketeering Act provided in pertinent part:

> Sec. 2. Any person who, in connection with or in relation to any act in any way or in any degree affecting trade or commerce or any article or commodity moving or about to move in trade or commerce —
>
> (a) Obtains or attempts to obtain, by the use of or attempt to use or threat to use force, violence, or coercion, the payment of money or other valuable considerations, or the purchase or rental of property or protective services, not including, however, the payment of wages by a bona-fide employer to a bona-fide employee; or
>
> (b) Obtains the property of another, with his consent, induced by wrongful use of force or fear, or under color of official right; or
>
> (c) Commits or threatens to commit an act of physical violence or physical injury to a person or property in furtherance of a plan or purpose to violate sections (a) or (b); or
>
> (d) Conspires or acts concertedly with any other person or persons to commit any of the

by the Supreme Court's decision in *United States v. Teamsters Local 807*,[34] which exempted the activities of organized labor from the ambit of the statute.[35] In direct response to the Court's restrictive holding in *Teamsters Local 807*,[36] Congress enacted the Hobbs Act[37] in 1946 as an amendment to the Anti-Racketeering Act.[38] The Hobbs Act punishes any person who "in any way or degree obstructs, delays, or affects commerce," or attempts or conspires to do so,[39] by robbery or extortion.[40] Although the general purpose of the

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foregoing acts; shall upon conviction thereof, be guilty of a felony and shall be punished by imprisonment from one to ten years or by a fine of $10,000, or both.

Sec. 3 . . . (b) The terms "property," "money," or "valuable considerations" used herein shall not be deemed to include wages paid by a bona-fide employer to a bona-fide employee. Act of June 18, 1934, ch. 569, §§ 2, 3(b), 48 Stat. 979, 979-80.

34. 315 U.S. 521 (1942).

35. *See* articles cited note 37 *infra*.

36. "The sole purpose of the bill is is undo the outrageous opinion of the Supreme Court in the Teamsters Union Case . . . ." 91 CONG. REC. 11841 (1945) (remarks of Representative Cox).

37. 18 U.S.C. § 1951 (1970) (originally enacted as Act of July 3, 1946, ch. 537, 60 Stat. 420). For a general history of the Hobbs Act see Brown & Peer, *The Anti-Racketeering Act: Labor and Management Weapon Against Labor Racketeering*, 32 N.Y.U.L. REV. 965, 968-72 (1957); Stern, *supra* note 28, at 1-3; 14 B.C. IND. & COM. L. REV. 1291, 1291-95 (1973); 35 GEO. L.J. 362 (1947); 25 N.C.L. REV. 58 (1946).

38. For an analysis of the difference between the two statutes see 35 GEO. L.J. 362, 364-66 (1947); 5 LOYOLA (CHICAGO) U.L.J. 513, 516 (1974); 101 U. PA. L. REV. 1030, 1033-34 (1953).

39. An attempt or conspiracy to commit robbery or extortion under the Hobbs Act does not require an intent to affect commerce. It is sufficient if the natural effect of the attempt or conspiracy affects commerce. United States v. Battaglia, 394 F.2d 304, 311-12 (7th Cir. 1968), *vacated in part on other grounds sub nom.* Giordano v. United States, 394 U.S. 310 (1969); United States v. Pranno, 385 F.2d 387, 389 (7th Cir. 1967), *cert. denied*, 390 U.S. 944 (1968); United States v. Green, 246 F.2d 155, 159-60 (7th Cir.), *cert. denied*, 355 U.S. 871 (1957).

40. The Hobbs Act, 18 U.S.C. § 1951 (1970), provides:

(a) Whoever in any way or degree obstructs, delays, or affects commerce or the movement of any article or commodity in commerce, by robbery or extortion or attempts or conspires so to do, or commits or threatens physical violence to any person or property in furtherance of a plan or purpose to do anything in violation of this section shall be fined not more than $10,000 or imprisoned not more than twenty years, or both.

(b) As used in this section —

(1) The term "robbery" means the unlawful taking or obtaining of personal property from the person or in the presence of another, against his will, by means of actual or threatened force, or violence, or fear of injury, immediate or future, to his person or property, or property in his custody or possession, or the person or property of a relative or member of his family or of anyone in his company at the time of the taking or obtaining. (2) The term "extortion" means the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under color of official right. (3) The term "commerce" means commerce within the District of Columbia, or any Territory or Possession of the United States; all commerce between any point in a State, Territory, Possession, or the District of Columbia and any point outside thereof; all commerce between points within the same State through any

Act ostensibly was to remove artificial restraints on the free flow of goods,[41] Congress specifically intended to proscribe the levy of "blackmail upon industry" by labor racketeers.[42] Congress determined that the aggregate effect of labor racketeering interfered with a segment of national industry of sufficient importance to merit federal protection, particularly since state officials in the 1930's were unwilling or unable to control these criminal activities.[43] Nevertheless, the Hobbs Act is couched in broad terms and applies not only to labor racketeering, but to all robbery and extortion obstructing, delaying, or affecting interstate commerce.[44] As such, the federal government in recent years has utilized the Act as a major weapon for attacking local political corruption that affects interstate commerce.[45]

The statutory language, legislative history, and judicial interpretation of the Hobbs Act evidence a congressional intent to exercise full commerce clause power to punish robbery and extortion affecting interstate commerce. In the statute itself, Congress defined "commerce" as encompassing "all . . . commerce over which the United States has jurisdiction."[46] Similarly, the legislative history of the Hobbs Act and its predecessor indicates that the statute was designed "to extend Federal jurisdiction over all restraints of any commerce within the scope of the Federal Government's constitutional powers."[47] This expansive interpretation of the scope of

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place outside such state; and all other commerce over which the United States has jurisdiction.

41. 78 CONG. REC. 453 (1934) (memorandum submitted by Walter L. Rice, Special Assistant to the Attorney General); 5 LOYOLA (CHICAGO) U.L.J. 513, 516 (1974).

42. *See* Hearings Before the Subcomm. of the Senate Commerce Comm., 73d Cong., 2d Sess. pt. 1, at 1 (1933). Judge Learned Hand described the purpose of the Hobbs Act as follows:

> For a number of years before 1934 — at least in the City of New York — the levy of blackmail upon industry, especially upon relatively small shops, had become very serious, and the local authorities either would not, or could not, check it. The courts were powerless, because the witnesses were terrorized and could not be protected if they told what they knew; the public felt themselves at the mercy of organized gangs of bandits and became wrought up over the situation. It was, at least primarily, to check such Camorras that Congress passed this measure. United States v. Teamsters Local 807, 118 F.2d 684, 687-88 (2d Cir. 1941), *rev'd*, 315 U.S. 521 (1942).

43. *See* note 42, *supra*; 32 MICH. L. REV. 378, 379 (1934).

44. United States v. Caci, 401 F.2d 664 (2d Cir. 1968), *vacated and remanded on other grounds sub nom.* Giordano v. United States, 394 U.S. 310 (1969); Carbo v. United States, 314 F.2d 718 (9th Cir. 1963), *cert. denied*, 377 U.S. 1010 (1964).

45. *See* Stern, *supra* note 28, at 1; 5 LOYOLA (CHICAGO) U.L.J. 513 (1974); *see, e.g.*, United States v. Addonizio, 451 F.2d 49 (3d Cir. 1971), *cert. denied*, 405 U.S. 936 (1972).

46. 18 U.S.C. § 1951(b)(3) (1970). The definition of commerce in the Anti-Racketeering Act encompassed "all other trade or commerce over which the United States has constitutional jurisdiction." Act of June 18, 1934, ch. 569, § 1, 48 Stat. 979.

47. SEN. REP. No. 532, 73d Cong., 2d Sess. 1 (1934); *see* 78 CONG. REC. 453 (1934)

Hobbs Act jurisdiction was adopted by the Supreme Court in *Stirone v. United States*,[48] in which the Court held that the broad language of the Hobbs Act manifests "a purpose to use all the constitutional power Congress has to punish interference with interstate commerce by extortion . . . ."[49] In light of the language of the statute, its legislative history, and the *Stirone* decision, the courts consistently have held that a *de minimis* effect on commerce satisfies the federal jurisdictional requirements of the Hobbs Act.[50] Additionally, language in several federal circuit court cases suggested that a potential impact on interstate commerce is sufficient to invoke Hobbs Act jurisdiction. In *Hulahan v. United States*[51] a union representative, threatening labor unrest, successfully extorted payments from construction companies involved in interstate commerce. The Eighth Circuit stated: "We have no doubt that Congress has the power to deal with extortion or attempted extortion actually or potentially affecting interstate commerce . . . ."[52] The Seventh Circuit espoused a similar rule in *United States v. Pranno*,[53] which involved a conspiracy by city officials to extort money from a property owner and a building contractor by threatening to withhold a building permit. Since the extortion money was paid, the interstate movement of building materials remained uninterrupted. Nevertheless, the court discerned a sufficient commerce nexus, explaining that it was only necessary to prove that commerce would have been delayed had the threat been carried out. The Seventh Circuit observed that "[t]he statute seems to be read as not only prohibiting the obstruction of commerce by extortion, but also prohibiting extortion by any threat, the carrying out of which would obstruct commerce."[54] In *United States v. Augello*[55] defendant successfully extorted payments from a restaurant owner who purchased out-of-state meat products, in return for protection against interference

(memorandum submitted by Walter L. Rice, Special Assistant to the Attorney General).

48. 361 U.S. 212 (1960).

49. *Id.* at 215.

50. United States v. Crowley, 504 F.2d 992 (7th Cir. 1974); United States v. Shackleford, 494 F.2d 67 (9th Cir.), *cert. denied*, 417 U.S. 934 (1974); United States v. Gill, 490 F.2d 233 (7th Cir. 1973); United States v. DeMet, 486 F.2d 816 (7th Cir. 1973), *cert. denied*, 416 U.S. 969 (1974); United States v. Tropiano, 418 F.2d 1069 (2d Cir. 1969), *cert. denied*, 397 U.S. 1021 (1970). The effect on commerce need not be direct or substantial. United States v. Hyde, 448 F.2d 815 (5th Cir. 1971), *cert. denied*, 404 U.S. 1058 (1972); United States v. Malinsky, 19 F.R.D. 426 (S.D.N.Y. 1956).

51. 214 F.2d 441 (8th Cir.), *cert. denied*, 348 U.S. 856 (1954).

52. *Id.* at 445.

53. 385 F.2d 387 (7th Cir. 1967), *cert. denied*, 390 U.S. 944 (1968).

54. *Id.* at 389.

55. 451 F.2d 1167 (2d Cir. 1971), *cert. denied*, 405 U.S. 1070 (1972).

with his business. "Given the sweeping power of Congress under the commerce clause, particularly evident in the Hobbs Act," noted the Second Circuit, "it is enough that the extortion 'in any way or degree' affects commerce, though its effect be merely potential or subtle."[56] Despite the suggestion in *Hulahan*, *Pranno*, and *Augello* that a potential effect on commerce satisfies federal Hobbs Act jurisdiction, there was an actual effect on commerce in each case. In *Hulahan* and *Augello* the extortionate transactions actually affected commerce by diminishing the resources of companies engaged in or dependent upon interstate commerce; in *Pranno* some building material had already been brought into the state. Since the "potential effect" language in these cases was unnecessary to the holdings, the instant case afforded the first clear opportunity to consider the extension of federal criminal jurisdiction under the Hobbs Act to robbery and extortion having only a potential or threatened effect on interstate commerce.

III. The Instant Opinion

The instant court[57] initially discerned that the general purpose of the Hobbs Act — to secure freedom of trade — unambiguously parallels the central purpose of the commerce clause.[58] Given this coextensive purpose, the court reasoned that Congress was free to exercise power under the Hobbs Act commensurate with the extensive power granted by its constitutional predicate. Noting that the language of the Hobbs Act, its legislative history, and its interpretation by the Supreme Court in *Stirone* all confirm an intent by Congress to exercise its full powers under the commerce clause, the court concluded that the statute must receive an expansive construction. Characterizing extortion by public officials as a species of "blackmail upon industry," the court ascertained that Congress intended the Hobbs Act to apply to local political corruption.[59] The court explained that federal control over this type of local political corruption is justified by the harmful nationwide consequences of

56. *Id.* at 1169.

57. The majority opinion was written by Judge Stevens. He was joined by Chief Judge Fairchild, Judge Cummings, Judge Tone, and Judge Bauer. Judge Sprecher dissented for the reasons set forth in his panel opinion. 502 F.2d 875 (7th Cir. 1974). Judge Swygert concurred with Judge Sprecher's dissent and also dissented on a voir dire issue. Judge Pell also filed a dissenting opinion.

58. *See* notes 11 & 41 *supra* and accompanying text.

59. "[W]e have no doubt that the extortion revealed by this record is a species of the 'blackmail upon industry' that Congress mustered its full power to eradicate. The muscle of the faithless public servant is just as intolerable as the muscle of the Camorras described by Judge Hand." 517 F.2d at 59.

the class of transactions to which defendant's extortion contributes. Reasoning that an effective prohibition of "blackmail upon industry" must be broad enough to encompass those cases in which the illegal payments are actually made and the threatened effect on commerce fails to materialize, the court inferred that Congress intended the Hobbs Act to apply whenever there is a potential impact on interstate commerce.[60] Thus the court discerned that *Hulahan*, *Pranno*, and *Augello* correctly interpreted the congressional purpose.[61] Holding that federal criminal jurisdiction under the Hobbs Act is satisfied by demonstrating that at the time of the offense there was a realistic probability that the extortionate transaction would have affected interstate commerce, the court concluded that the evidence in the instant case supported a finding that the proposed construction would have affected commerce.[62]

The dissenting opinion[63] observed that the plain meaning of the statutory language does not comport with the majority's construction of the Hobbs Act.[64] The ordinary meanings of the jurisdictional words — "obstruct," "delay," and "affect" — import the concept of accomplishment, explained the dissent. Disagreeing with the majority's interpretation of the legislative history of the Act, the

60. "An effective prohibition against blackmail must be broad enough to include the case in which the tribute is paid as well as the one in which a victim is harmed for refusing to submit. Since the payment would normally enable the business to continue without interruption, the inference is inescapable that Congress was as much concerned with the threatened impact of the prohibited conduct as with its actual effect." *Id.* at 57.

61. The court also cited a similar case, United States v. Tropiano, 418 F.2d 1069 (2d Cir. 1969), *cert. denied*, 397 U.S. 1021 (1970). Another case relied upon by the court was United States v. Hyde, 448 F.2d 815 (5th Cir. 1971), *cert. denied*, 404 U.S. 1058 (1972), which observed that there is no requirement that "the company be engaged in an interstate transaction at the moment of the extortion to support federal jurisdiction." *Id.* at 836.

62. "The jury could reasonably infer that . . . there was then a likelihood that the movement across state lines of a furnace, plate glass, and plumbing and electrical fixtures would be affected." 517 F.2d at 60.

Furthermore, the court argued that federal jurisdiction should not be defeated by the fortuitous circumstance that, after the crime had been committed, a change of plans occurred and the animal hospital was never built. *Id.* "Nor would appellant have been any less culpable," the majority maintained, "if for some unanticipated reason the [zoning amendment] had not in fact passed. . . . Conversely if on December 8, 1970, no effect on interstate commerce had been foreseeable, a subsequent decision creating an interstate nexus would not retroactively convert a possible state offense into a federal crime." *Id.* at 60 n.19.

63. The dissent was written by Judge Pell. Judge Sprecher filed a dissent which incorporated his panel opinion for the majority. Sprecher was unable to discern any precedent in *Pranno* and other cases, since in each instance there was an actual effect on commerce. Sprecher concluded that "when the effect never materializes — despite the failure or success of the extortion — the commerce element of the Hobbs Act is not established." 502 F.2d at 879.

64. Judge Pell cited Burns v. Alcala, 420 U.S. 575 (1975), for the principle that "words used in a statute are to be given their ordinary meaning in the absence of persuasive reasons to the contrary." *Id.* at 580-81.

dissent maintained that Congress in fact was more interested in controlling local crime than in removing restraints on the free flow of goods. Furthermore, the broad language of the Hobbs Act did not signify to the dissent a congressional intent to extend the exercise of legislative power to local conduct having no actual effect on interstate commerce.[65] Recognizing that other federal statutes in which Congress intended to exercise its full commerce powers also contain "affecting commerce" jurisdictional requirements, the dissent noted that none of these statutes had received a corresponding expansive statutory construction.[66] The dissent distinguished *Hulahan*, *Pranno*, and *Augello* as cases in which "potential effect" language was unnecessary to the decisions.[67] Thus, perceiving no basis for inferring a congressional intent to make the operation of the Hobbs Act independent of any actual effect on interstate commerce, the dissent concluded that the majority holding represented a substantially incorrect extension of federal jurisdiction into essentially localized crime.

IV. COMMENT

As a case of first impression, the instant decision represents the first significant expression of judicial willingness to sustain federal criminal jurisdiction under the Hobbs Act in the absence of an actual effect on interstate commerce. By holding that a potential effect on commerce satisfies the jurisdictional nexus requirement of the Act, the decision dramatically augments the power of the federal government to punish the traditionally local crimes of robbery and extortion, subject only to two restrictions. Hobbs Act jurisdiction may be invoked when the Government proves that at the time of the offense there was a realistic probability of a *de minimis* effect on commerce and that federal concern is justified by the harmful nationwide consequences of the class of activities to which the robbery or extortion belongs. In light of the highly integrated modern American economy, however, it is difficult to envision any robbery or extortion that does not have a realistic probability of affecting commerce to some degree or any such class of criminal activity that

65. Although the dissent failed to reach the question of whether Congress has the power to reach potential effects on commerce, the dissent did indicate that it was not at all clear that Congress possesses the requisite power to extend the exercise of legislative power to local activities that have no effect whatsoever on interstate commerce. 517 F.2d at 63.

66. *See, e.g.*, National Labor Relations Act, 29 U.S.C. § 160(a) (1970), and its interpretation in NLRB v. Suburban Lumber Co., 121 F.2d 829 (3d Cir.), *cert. denied*, 314 U.S. 693 (1941), and NLRB v. Fainblatt, 306 U.S. 601 (1939).

67. *See* text following note 56 *supra*.

does not substantially injure interstate business.[68] Given these nonrigorous limitations, it is apparent that the federal government now retains ample power to reach virtually all robbery and extortion, however attenuated the actual connection with interstate commerce may be. More specifically, the instant decision provides federal authorities with a highly potent weapon for attacking local political corruption. If more active prosecution of robbery and extortion does result, the decision may well encourage relaxation of essential state law enforcement efforts in the robbery-extortion area. As such, the case may alter significantly the delicate federal-state balance of criminal jurisdiction.

It remains to be seen, however, whether the judiciary in future robbery and extortion cases will embrace the instant court's expansion of federal Hobbs Act jurisdiction. Because of analytical flaws in the Seventh Circuit's reasoning, courts may be disinclined to follow the decision. One major weakness in the court's analysis was its underlying assumption that Congress is empowered under the commerce clause to reach purely local activities that probably would have affected commerce; such a proposition remains unsupported by precedent. Furthermore, a significant omission in the opinion was the court's failure to draw the traditional distinction between federal commerce power in the economic and criminal realms.[69] While the court correctly discerned that Congress intended to exercise its plenary constitutional power in the Hobbs Act, it failed to recognize that full commerce power in a criminal context historically has never been commensurate with the wider scope of commerce power in the economic realm. As such, the court's conclusion that the Hobbs Act warrants expansive statutory construction is seriously impaired. As the dissent pointed out, judicial interpretation of analogous federal statutes with "affecting commerce" jurisdictional requirements does not comport with the majority's construction of the Act. Despite the court's contention that Congress intended to eradicate local political corruption as a species of "blackmail upon industry," the legislative history of the statute gives no indication that elimination of local political corruption was specifically contemplated by the drafters of either the Hobbs Act or the Anti-Racketeering Act.[70] Furthermore, although Congress ascertained that the aggregate effect of labor racketeering compelled fed-

68. *See* Perez v. United States, 402 U.S. 146, 157-58 (1971) (Stewart, J., dissenting) ("interstate business suffers from almost all criminal activity"); 1972 L. & Soc. Order 683, 684; 49 Texas L. Rev. 1106, 1107 (1971).

69. *See* notes 15-17 *supra* and accompanying text.

70. *See* notes 41-43 *supra* and accompanying text.

eral action, there was no showing that local political corruption exerted a nationwide effect on commerce of similar dimensions. It is apparent, as the dissent perceived, that Congress was not as interested in securing freedom of trade under the Hobbs Act as it was in proscribing crimes that local authorities were incapable of controlling.[71] The instant court, however, failed to demonstrate that state officials were either unwilling or unable to prosecute the defendant for extortion.[72] In addition, the majority's inference that Congress intended the Hobbs Act to apply to potential effects on commerce conflicts with the plain meaning of the statutory language; the concept of "degree," as well as the ordinary meanings of "obstruct," "delay," and "affect," implies that some effect or impact on commerce, however insubstantial, is required. By broadly interpreting the jurisdictional limits of the statute, the instant court ignored the basic tenet of construction that ambiguities in criminal laws are construed narrowly. Despite judicial admonition to the contrary, the court extended the reach of federal criminal power under the Hobbs Act in the absence of a clearly articulated expression of congressional intent to that effect; as such, the decision is subject to attack for statutory misconstruction. The decision is further weakened by the court's disregard for the underlying policy implications of its holding. The court failed to consider the extent to which local authorities are better situated to control essentially local crimes, limited federal resources may be drained by federal enforcement efforts, state authorities may relax prosecution of robbery and extortion, and the existing federal-state balance of criminal jurisdiction may be altered. Finally, the instant decision was impaired by the failure to specify adequate guidelines for implementing the "realistic probability" test.

By extending federal jurisdiction to encompass all robbery and extortion potentially affecting interstate commerce, the instant decision not only reflects, but substantially contributes to, the increasing federalization of intrastate crime under the commerce clause. In light of the decision's broad rationale, the case may portend virtually unlimited expansion of federal jurisdiction into the field of crime control. At the very least, the decision constitutes authority for extending the jurisdictional range of other "affecting commerce" statutes to encompass all conduct potentially affecting commerce. It is difficult to conceive of any criminal activity, no matter how localized, that remains beyond the scope of the instant rationale.

71. *See* notes 43 & 69 *supra* and accompanying text.

72. *See* note 2 *supra* for the text of an Illinois criminal statute under which defendant might have been prosecuted.

Additionally, the court's failure to distinguish between economic and criminal commerce cases may presage expansion of federal power in the criminal domain to the full extent of the commerce clause power. In any event, further alteration of the delicate federal-state balance of criminal jurisdiction should emanate not from the judiciary, as in the instant case, but from the legislature. In considering federal criminal statutes designed to punish traditionally local criminal conduct, however, future courts must evaluate carefully whether the congressional purpose for such legislation is actually to regulate commerce, or merely to reach local crime.

WILLIAM G. SCOTT

Constitutional Law—Search and Seizure—Search and Seizure of Business Records by IRS Does Not Violate Fifth Amendment Privilege Against Self-Incrimination or Fourth Amendment Right of Privacy

I. FACTS AND HOLDING

Defendants,[1] agents of the Internal Revenue Service (IRS), searched[2] the office of plaintiff,[3] a dentist operating as a sole practitioner, under authority of a valid search warrant[4] and seized business records[5] for use against plaintiff as evidence in a contemplated

1. Defendants were three special agents of the Internal Revenue Service Intelligence Division, joined with a United States Attorney and the government of the United States.

2. The search in dispute, conducted by six to eight IRS agents, began at approximately 8 a.m. on a business day and lasted approximately seven hours.

3. Plaintiff's wife, who worked as his secretary-receptionist, joined as co-plaintiff.

4. The search warrant was issued on the basis of defendant Wilson's affidavit setting forth his belief that the items to be seized would support charges of tax evasion and filing a false tax return. Attached to the application for a warrant were affidavits by former employees of plaintiff that alleged existence of certain records, especially a so-called "cheat book," which supposedly would document plaintiff's failure to report income in his tax return. The instant court quoted from the warrant:

> . . . there is now being concealed certain property, namely fiscal records relating to the income and expenses of Dr. Wendall L. Shaffer from his dental practice and other sources from January 1, 1966 to December 31, 1970, including, but not limited to, dental patient cards, cash receipt books, cash disbursement books, expense records, business ledgers, log books, bank ledger sheets and statements, deposit tickets, cancelled checks, purchase invoices, copies of receipts covering payments of bills . . . , an approximately 5-½" by 7"—paper pad—allegedly known as a "cheat book," . . . [and diverse other records of financial transactions].

No. 74-1641 at 8-9 (bracketed material quoted only in dissenting opinion, No. 74-1641 at 1).

5. The seizure of some 18 cartons of financial and business records indicating income

criminal action for tax evasion.[6] Plaintiff filed an action[7] for return of the seized records and suppression of any evidence obtained,[8] for damages,[9] and for injunctive relief.[10] Plaintiff maintained that seizure of the records constituted a compulsory production of private papers in violation of the fifth amendment privilege against self-incrimination[11] and that the search and seizure were unreasonable under the fourth amendment.[12] Defendants contended that the records seized were neither evidence produced under compulsion nor private papers entitled to fifth amendment protection and that the search warrant was issued and executed properly. The trial court accepted defendants' arguments and granted a motion for summary judgment. On appeal, the Tenth Circuit Court of Appeals *held*, affirmed. The seizure, pursuant to a valid search warrant, of business records of a sole proprietor, which could not be produced compulsorily by summons or subpoena, does not violate either the individual's privilege against self-incrimination or his fourth amendment right of privacy. *Shaffer v. Wilson*, No. 74-167 (10th Cir., May 23, 1975).

II. Legal Background

The fifth amendment privilege against self-incrimination and the fourth amendment guarantee of freedom from unreasonable searches and seizures have been characterized by the Supreme Court as seeking to protect the overlapping values represented in

and expenses and, according to plaintiff, nonfinancial personal and clinical records, resulted from the search.

6. Plaintiff was suspected of violation of 26 U.S.C. § 7201 (tax evasion) and 26 U.S.C. § 7206(1) (filing a false or fraudulent tax statement).

7. Plaintiff filed the action on May 24, 1973, approximately 19 months after the search.

8. Rule 41(e) of the Federal Rules of Criminal Procedure provides in relevant part:

> (e) Motion for Return of Property. A person aggrieved by an unlawful search and seizure may move the district court for the district in which the property was seized for the return of the property on the ground that he is entitled to lawful possession of the property which was allegedly seized.

9. Plaintiff's claim for monetary damages in the amount of $12,000 from each of the named defendants was based on the judicially created cause of action against federal agents under Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388 (1971).

10. Plaintiff sought invocation of the court's equity powers to enjoin use of any evidence gathered in the allegedly illegal search in any criminal proceeding against him, as well as the suppression relief statutorily available under Rule 41(e).

11. "No person . . . shall be compelled in any criminal case to be a witness against himself . . . ." U.S. Const. amend. V.

12. "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized." U.S. Const. amend. IV.

the "historic interests of 'self-protection.' "[13] In *Boyd v. United States*,[14] the Supreme Court first recognized that the two amendments "run almost into each other"[15] when there is any "forcible and compulsory extortion of a man's own testimony or of his private papers to be used as evidence to convict him of a crime . . . ."[16] The *Boyd* decision invalidated on fourth and fifth amendment grounds a revenue statute[17] providing that failure of an individual to produce records for government inspection would be deemed an admission of the allegations contained in the production order application. Because the individual's only alternative to producing the documents was an implicit admission of guilt, the Court found that the statute compelled an individual to produce evidence against himself in violation of the fifth amendment. The *Boyd* Court, in reaching its decision, enunciated the "intimate relation" rationale, finding that the fifth amendment privilege against self-incrimination places limits on the items of evidence subject to compulsory production under the fourth amendment. The greater importance of *Boyd* to later cases, however, is its extension of the "intimate relation" rationale to searches and seizures. The Court stated in dictum[18] that "a search and seizure, or, what is equivalent thereto, a compulsory production of a man's private papers, to be used in evidence against him . . . is . . . an '*unreasonable* search and seizure' within the meaning of the Fourth Amendment . . . ."[19] Thirty-five years later,

13. Camara v. Municipal Court, 387 U.S. 523, 530 (1967).

14. 116 U.S. 616 (1886).

15. 116 U.S. at 630. The *Boyd* Court elaborated on the relationship between the amendments:

> For the "unreasonable searches and seizures" condemned in the Fourth Amendment are almost always made for the purpose of compelling a man to give evidence against himself, which in criminal cases is condemned in the Fifth Amendment; and compelling a man "in a criminal case to be a witness against himself," which is condemned in the Fifth Amendment, throws light on the question as to what is an "unreasonable search and seizure" within the meaning of the Fourth Amendment. And we have been unable to perceive that the seizure of a man's private books and papers to be used in evidence against him is substantially different from compelling him to be a witness against himself.

Id. at 633.

16. *Id.* at 630.

17. Act of June 22, 1974, ch. 391, § 5, 18 Stat. 186.

18. The governmental action challenged in *Boyd* was a court order to produce an invoice allegedly establishing a violation of an import-duty statute; however, the Court broadened the impact of its holding to include searches and seizures by stating in dictum that production pursuant to a search warrant amounted to compulsory production equivalent to that compelled by a court order. *See* note 15 *supra*.

19. 116 U.S. 616, 622. The *Boyd* Court supported its "intimate relation" rationale by referring to Lord Camden's opinion in Entick v. Carrington, 19 How. St. Tr. 1029 (1765), which struck down a search for evidence of seditious libel with the observation "that search for evidence is disallowed" because it obligates a man to accuse himself. Entick v. Carrington,

in *Gouled v. United States*,[20] the Court reiterated the *Boyd* proposition that certain items of evidence could never be the object of a reasonable search and seizure. In *Gouled*, the Court established the "mere evidence rule," holding that the taking under an apparently valid warrant[21] of items of mere evidentiary value in which the government could assert no superior property right constituted an unreasonable search and seizure.[22] After many years of decreasing application,[23] the Court in *Warden v. Hayden*[24] rejected the "mere evidence rule" as a means of determining whether evidence is subject to reasonable search and seizure. The *Hayden* Court held that the test for invocation of fourth amendment protections is the ex-

quoted in 116 U.S. at 629. One commentator has pointed out that the search in *Entick* was disallowed because of its general or exploratory nature (a concern later embodied in the fourth amendment particularity requirement) rather than because of the incriminatory nature of the records seized and was therefore inapplicable to the *Boyd* facts. Note, *Evidentiary Searches: The Rule and the Reason*, 54 GEO. L.J. 593, 599 n.34 (1966).

20. 255 U.S. 298 (1921).

21. Two searches had taken place in the *Gouled* case, one warrantless and one under a warrant that met fourth amendment requirements of issuance upon a showing of probable cause and a particular description of the items to be seized. Only that portion of the *Gouled* decision concerning the latter search is of significance to this discussion.

22. In establishing the "mere evidence" rule, the *Gouled* Court listed those circumstances which would justify the government's assertion of a superior property right to items of evidence when it observed that warrants:

> may not be used as a means of gaining access to a man's house or office and papers solely for the purpose of making search to secure evidence to be used against him in a criminal or penal proceeding, but . . . that they may be resorted to only when a primary right to such search and seizure may be found in the interest which the public or the complainant may have in the property to be seized, or in the right to the possession of it, or when a valid exercise of the police power renders possession of the property by the accused unlawful and provides that it may be taken.

255 U.S. at 309. The lower court in the instant case catalogued the classes of evidence seizable under this rationale as developed by subsequent case law:

> Evidence to which the government may assert a superior property right, and which is therefore subject to search and seizure includes the following: stolen goods and contraband; records to be kept, and items fairly characterized as instrumentalities of crime . . . .

Shaffer v. Wilson, 383 F. Supp. 554, 559 (D. Colo. 1974) (citations omitted).

23. The primary exception to the mere evidence rule appeared when the Supreme Court approved the seizure and introduction of its evidence of items of purely evidential value in Schmerber v. California, 384 U.S. 757 (1966). In *Schmerber*, the Court held that the taking of a blood sample from a drunk-driving suspect over his objections was a compulsory taking of "real or physical," rather than "testimonial or communicative," evidence as prohibited by the fifth amendment. The Court further found that such taking was not so unreasonable an intrusion into the suspect's privacy that it constituted a fourth amendment violation. Recognizing that "[t]he values protected by the Fourth Amendment . . . substantially overlap those the Fifth Amendments helps to protect" so that the "intimate relation" rationale would seem to apply, the Court nonetheless explicitly dismissed *Boyd* and *Gouled* as establishing limitations on the kinds of property that may be seized under warrant and therefore of no help in this case. 384 U.S. at 767-68.

24. 387 U.S. 294 (1967).

tent to which an individual's privacy is compromised by seizure of evidence, rather than the existence of superior property rights or characterization of the property as mere evidence. Under *Hayden*, the reasonableness standard of the fourth amendment is satisfied, and thus the evidence may be seized under warrant, when there is a reasonable nexus between the item to be seized and the alleged criminal behavior.[25] The Court in *Hayden* explicitly limited the scope of its decision to the fourth amendment protection of privacy question, however, and cautioned that the opinion left undecided the "intimate relation" question of "whether there are items of evidential value whose very nature precludes them from being the object of a reasonable search and seizure."[26]

The Second Circuit Court of Appeals became the first court to address the question left open in the *Hayden* caveat with its decision in *United States v. Bennett*.[27] The court held that the fourth amendment does not protect against searches for and seizures of items whose compulsory production would be prohibited by the fifth amendment. The application of fourth and fifth amendment protections involve different considerations; the fourth is concerned with securing individual privacy by restricting the limit of searches to a reasonable scope, whereas invocation of fifth amendment protection requires a preliminary determination of the testimonial character of the item or information to be seized.[28] The Sixth Circuit subse-

25. The required nexus will automatically exist when the item to be seized is an instrumentality, contraband, or fruit of a crime, whereas a proposed seizure of "mere evidence" requires a demonstration of sufficient connection between the crime itself and the object to be seized to satisfy probable cause. The Supreme Court's repudiation of the mere evidence rule has since assumed statutory dimension in 18 U.S.C. § 3103(a) and Federal Rule of Criminal Procedure 41(b).

26. 387 U.S. at 302-03. This caveat was stated in *Hayden* because the Court found that as the clothing seized was not of a testimonial nature and there was no compulsion on the suspect to bear witness against himself the fifth amendment problems did not arise.

27. 409 F.2d 888 (2d Cir.), *cert. denied*, 396 U.S. 852 (1969) & 402 U.S. 984 (1971).

28. The *Bennett* court maintained, on the basis of *Hayden*, that the "intimate relation" dictum of *Boyd* had been largely repudiated and found that the fourth amendment's purpose is not to protect evidence whose compulsory seizure would violate the fifth amendment. 409 F.2d at 896-97. Citing the opinion of Judge Learned Hand in United States v. Poller, 43 F.2d 911, 914 (2d Cir. 1930), the *Bennett* court stated that the evil to be guarded against in search and seizure cases is the unlimited search. The court emphasized that the letter seized in *Bennett* and introduced as evidence of conspiracy to violate narcotics laws (21 U.S.C. § 173-74 (1970)) was seized incident to a valid arrest and involved "no 'rummaging'" through defendant's apartment. 409 F.2d at 897. Thus, the *Bennett* court has been interpreted as holding that "no item is inherently unseizable, pursuant to a valid warrant or incident to a lawful arrest, unless its seizure compromises the defendant's Fourth Amendment rights." Shaffer v. Wilson, 383 F. Supp. 554, 560 (D. Colo. 1974). *See also* United States v. Scharfman, 448 F.2d 1352 (2d Cir. 1971), which follows *Bennett* on the fourth (a search must be more than a "mere roving commission") and fifth amendment grounds.

quently adopted the *Bennett* rationale by ruling in *United States v. Blank*[29] that the seizure of business records[30] pursuant to a valid warrant does not violate the author's privilege against self-incrimination. Finding that production of evidence under a valid warrant is not a form of compulsion in the fifth amendment sense,[31] and that business records of which others have knowledge are not testimonial or communicative of privately held thoughts, the *Blank* court ruled that the author must rely on his right to privacy[32] for protection against governmental intrusion. The Seventh Circuit, however, reached an opposite result in *Hill v. Philpott*,[33] holding that if the introduction of the evidence seized would be prohibited by the fifth amendment privilege against self-incrimination, a search for and seizure of that evidence would be unreasonable under the fourth amendment through the "intimate relation" rationale. Emphasizing that a search warrant is a form of compulsion for fifth amendment purposes,[34] the *Hill* court stated that when the records seized[35] are testimonial in nature,[36] the privilege against self-incrimination attaches and the seizure, although pursuant to a search warrant, is unconstitutional under both amendments.[37] The

29. 459 F.2d 383 (6th Cir.), *cert. denied*, 409 U.S. 887 (1972).

30. The records seized under warrant in *Blank* were betting sheets from an alleged horse-book gambling business.

31. The court accepted Wigmore's distinction between subpoenas and search warrants for compulsion purposes, and quoted *Hayden* and *Schmerber* to support that view.

32. In so holding, the *Blank* court expressed the view that only those items intimately connected with fourth amendment privacy rights could fall within the *Hayden* caveat classification, being by nature precluded from reasonable searches and seizures. Following the reasoning of *Bennett*, the *Blank* court found that the fourth amendment protections of probable cause, particularity, and a neutral magistrate sufficiently preserve privacy from unreasonable intrusion. The *Blank* court further suggested, however, that the right to privacy extends beyond the fourth amendment to the broader rights described in fifth amendment terms in *Hayden* and *Schmerber*, and in fourteenth amendment terms in Griswold v. Connecticut, 381 U.S. 479 (1965). 459 F.2d at 386.

33. 445 F.2d 144 (7th Cir.), *cert. denied*, 404 U.S. 991 (1971).

34. The *Hill* court reasoned that *Gouled* established that a search warrant is as much a form of compulsion as a court order. (*See* Boyd v. United States, note, 15 *supra* and accompanying text.) The court maintained that to dismiss the compulsory qualities of a warrant "ignores the realities of trial." 445 F.2d at 149. *See* 46 TUL. L. REV. 545, 549-50 (1972); *see also* 54 GEO L.J., *supra* note 18, at 598 n.29.

35. The facts of *Hill* closely parallel those of the instant case. In *Hill*, special agents of the IRS Intelligence Division were granted search warrants on the basis of affidavits by former employees of plaintiff which alleged existence of files evidencing tax evasion. The subsequent search of plaintiff physician's home and office resulted in seizure of more than thirty cartons of papers.

36. According to *Hill*, the first step in evaluating the constitutionality of a seizure of private records is determining whether introduction of the evidence would violate the fifth amendment by inquiring whether the evidence "relates to some communicative act or writing." 445 F.2d at 148.

37. The majority in *Hill* rejected the government's position that "once the validity of a

dissenting opinion reasoned that the doctor's business records seized in *Hill* were not of "a class of papers so intimately confidential and so much a part of personhood"[38] to deserve protection from seizure on self-incrimination grounds and, alternatively, such records constituted "instrumentalities" of a crime which have never been protected by the fourth amendment. The Ninth Circuit, presented with a factual situation almost identical to *Hill* and the instant case, recently held in *VonderAhe v. Howland*[39] that the search and seizure in question violated the fourth amendment due to overbreadth,[40] but because no criminal prosecution was initiated, the petitioner's fifth amendment self-incrimination claim must fail. One judge, concurring in part and citing *Boyd*, reasoned that use of a search warrant, coupled with the fact that the petitioner alone had made entries in the records seized, constituted a compulsory taking of personal thoughts in violation of the fifth amendment.[41] The separate opinion also noted that such a search and seizure violated petitioner's interest in a personal inner sanctum that is protected under the fifth amendment[42] from government intrusion. Thus, presented

search is established under the Fourth Amendment—and by that fact alone—the Fifth Amendment is not and cannot be violated." *Id.* at 146.

38. *Id.* at 150.

39. 508 F.2d 364 (9th Cir. 1974) (dentist's records seized by IRS).

40. The *VonderAhe* court found that while there was probable cause for issuance of the warrant in question, the agents were guilty of exceeding the limits of the general warrant by seizing *all* the plaintiff's records and private papers.

41. The *VonderAhe* court employed slightly different reasoning than *Hill* in assessing the compulsion factor inherent in a search warrant. The former court reasoned that the "imminence of such force" resulting from refusal to submit to a warrant administration constituted sufficient compulsion for fifth amendment purposes. 508 F.2d at 373. In asserting the testimonial nature of the seized records, the *VonderAhe* court further found that the search in that case went beyond a search for "real or physical" evidence to a quest for writings that would bespeak the author's guilt. *Id.* at 377.

42. The concurrence relied on Couch v. United States, 409 U.S. 322 (1973), and cases cited therein as authority for the existence of a right to a "sanctum of individual feeling and thought" which the government cannot invade to extract self-condemnation. 508 F.2d at 377. The dissents by Justices Douglas and Marshall in *Couch* agreed that the fourth and fifth amendments together delineate a sphere of privacy to be protected absolutely from governmental intrusion. Marshall suggested criteria for determining whether the evidence sought lies within an individual's sphere of privacy, including consideration of the nature of the items to he seized and the steps taken by the author to insure privacy of the items. Marshall further rejected the alternative view to the intimate relation rationale, which maintains:

> unless a Fifth Amendment privilege is involved, the Fourth Amendment authorizes intrusion where it is not unreasonable. However, this Court has held that increasingly severe standards of probable cause are necessary to justify increasingly intensive searches. *Cf.* Camara v. Municipal Court, 387 U.S. 523 (1967). The precise elements required of a Fifth Amendment violation need not coincide exactly with the elements of an invasion of privacy that should be considered unreasonable, and I see no reason to confine the sphere of privacy free from intrusion to just what the Fifth Amendment protects.

409 U.S. at 349-50, n.6 (other citations omitted).

with nearly identical fact situations in the context of a question left open by the Supreme Court, the circuit courts have employed various reasoning processes and have arrived at antithetical results in deciding whether the fifth amendment places any restrictions on the kinds of evidence that reasonably may be seized under the fourth amendment.

III. The Instant Opinion

In determining whether the challenged search violated plaintiff's fifth amendment privilege against self-incrimination, the instant court first confronted the split of authority among other circuits presented by the *Bennett, Blank, Hill,* and *VonderAhe* decisions. The instant court chose not to follow the factually similar[43] *Hill* and *VonderAhe* decisions that found violations of the self-incrimination privilege and adopted the view that seizure pursuant to a valid search warrant does not involve compulsion in the fifth amendment sense.[44] The court further asserted that the fifth amendment was not violated by the search in question because the records seized were business records of which others must have had knowledge, implying that such records could not be considered communicative of privately held thoughts. The court, reasoning from a policy viewpoint, stated that to disallow information properly obtained in a nonaccusatorial setting pursuant to a valid search and seizure would diminish the value of the search warrant as "one of the most effective tools in the enforcement of the criminal justice system."[45] Having found no fifth amendment objections to the seizure in question, the court cited *Bennett*[46] in rejecting the "intimate relation" rationale that the fourth amendment protects against searches and seizures of items whose compulsory production would be forbidden by the fifth amendment. The court concluded that the lack of compulsion incident to a search warrant and the fact that the items

43. According to the district court's opinion in the instant case, the government admitted in its pleadings that *Hill* and *VonderAhe* were "factually indistinguishable" from the instant case. 383 F. Supp. at 561.

44. The Tenth Circuit avoided premising its noncompulsion contention on Wigmore's authority but relied on the following cases from other circuits finding lack of coercion attendant to searches under warrant: United States v. Murray, 492 F.2d 178 (9th Cir. 1973), *cert. denied*, 419 U.S. 854 (1974); Taylor v. Minnesota, 466 F.2d 1119 (8th Cir. 1972), *cert. denied*, 410 U.S. 956 (1973); United States v. Blank, 459 F.2d 383 (6th Cir.), *cert. denied*, 409 U.S. 887 (1972).

45. Shaffer v. Wilson, No. 74-1671 at 7 (10th Cir., May 23, 1975).

46. The court also pointed out that United States v. Scharfman, 448 F.2d 1352 (2d Cir. 1971), *cert. denied*, 405 U.S. 919 (1972), reiterated the *Bennett* rule that there is no violation of one's fifth amendment privilege against self-incrimination by reason of the proper execution of a valid search and seizure.

seized were business records of which others must have had knowledge combined to defeat the plaintiff's fifth amendment claims. Further, the court found that without a fifth amendment basis the "intimate relation" rationale could not operate to establish a violation of the fourth amendment through the fifth.

The court next considered the plaintiff's fourth amendment claims that the warrant was invalid for overbreadth and that the execution by the IRS agents was defective because they seized personal records not authorized by the warrant. Addressing the overbreadth issue, the court found that the warrant contained a description of items to be seized sufficient to meet the particularity requirement of the fourth amendment. The court also found sufficient probable cause because the warrant was issued "largely upon" the supporting affidavits of three of plaintiff's former employees.[47]

In finding sufficient probable cause, the court emphasized that the records seized possessed the requisite nexus under *Hayden*.[48] The court additionally concluded that since the records seized were business rather than private records, "not so much a part of personhood that they ought to enjoy a superlative privacy,"[49] the formal warrant requirements provided sufficient protection of plaintiff's privacy interests under the fourth amendment. Ruling that the instant seizure was not in violation of the fifth amendment privilege against self-incrimination and that the search warrant was properly issued and executed, the court found the search and seizure of plaintiff's business records to be constitutionally permissible.

Writing in dissent, Judge Seth initially argued that searches and seizures of business records for evidence of tax evasion are unreasonable because they amount to a general search in violation of the fourth amendment.[50] Noting the shift in the Supreme Court's

47. *See* note 4 *supra*.

48. *See* note 25 *supra* and accompanying text. The instant court failed to make clear whether the requisite nexus was established on a demonstration of probable cause or whether the records were found to satisfy the nexus requirement because of their characterization as instrumentalities, a rationale suggested by the instant court's citation to *Bennett* (letter could be seized to determine whether it was an instrumentality for effecting a conspiracy) and *Scharfman* ("it is entirely reasonable to assume that the materials were used as instrumentalities in connection with the crime of disposing of stolen fur garments"). No. 74-1671 at 5.

49. Quoting Judge Fairchild's dissent in Hill v. Philpott, 445 F.2d 144, 150 (7th Cir.), *cert. denied*, 406 U.S. 991 (1971).

50. A search under these circumstances has to be unreasonable. For all practical purposes the scope of both the search and of the seizure had to be determined on the ground by the agents making the search to try to meet the nexus standard and to attempt to make a case. This situation cannot be in conformity with the fourth amendment. This is more than a defect or complaint as to the wording of the warrant; it is a basic fault in the post-*Warden* method. It is not a search for evidence, but a search for a case.

concern from protection of a category of papers to protection of an individual's privacy, the dissent reasoned that the nexus requirement and the *Hayden* caveat were directed toward protection of the privacy interest. The dissent stated that, since searches for evidence of tax evasion are of a general nature, necessitating rummaging through *all* the taxpayer's records, the requirement of showing a nexus between the particular item to be seized and the alleged criminal activity prior to obtaining a warrant could not be met. The judge further observed that on the authority of such general warrants the IRS field agents are free to determine during the course of the search which items possessed the requisite nexus to justify their seizure, thus emphasizing that the lack of nexus prior to the search helped create an unjustifiably broad execution. The dissent argued that plaintiff's fourth amendment right to privacy protecting personal papers is a right to be free from searches of those papers, not merely a guarantee that before trial personal papers will be separated from seized items that will be offered as evidence. Accordingly, the dissent labelled in-the-field probable cause determinations unreasonable.[51] Having found that both the issuance and the execution of the warrant in the instant case violated the fourth amendment requirements of particularity and probable cause, the dissent further asserted that such a search could be unreasonable even assuming its conduct under a valid warrant. The dissent maintained that a search under warrant of private records[52] constituted a compulsory production of self-incriminatory evidence in violation of the fifth amendment,[53] and therefore was unreasonable under the fourth amendment through the "intimate relation" rationale. Contending that the majority's rejection of the "intimate relation" rationale amounted to a denial of any connection between the two

No. 74-1671 at 6.

51. [W]e cannot help but wonder where the "privacy" is after such a process . . . . There must be a "privacy" which surrounds the search itself. The Fourth Amendment contemplates some protection from a *search* as an important right. This is just as much a matter of privacy as the document-sorting procedure seeks to protect and perhaps more important . . . . It is the search—the entry which is the invasion of personal rights. The forcible entry by strangers is what impinges on: "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures."

Id. at 8-9 of dissent.

52. The dissent rejected the majority's contention that the records seized were not private by asserting that the right of privacy from governmental intrusion which attaches to records is not eliminated by the mere fact that employees participated in recording those papers. *Id.* at 9 of dissent.

53. Judge Seth criticized the majority's noncompulsion position, characterizing the distinction between production by subpoena and production by warrant as a "typical distinction without a difference." *Id.* at 11.

amendments, the dissent claimed that the amendments' joint concern with the right of privacy indicates an interconnection so intimate that fourth amendment searches must be limited to those items whose production could be compelled under the fifth amendment.

IV. COMMENT

The instant decision, relying on one side of conflicting precedent from other circuits, does little to reconcile the divergent answers to the issue raised by the *Hayden* caveat: what limits, if any, on searches and seizures should be developed to replace the discredited categorizations of the mere evidence rule. The *Bennett* decision, considering whether an item that possessed the requisite characteristics for protection under the privilege against self-incrimination consequently was proscribed as an object of a reasonable search and seizure, began a series of opinions obscuring the focus of this issue by failing to recognize that the amendments jointly protect overlapping substantive values through procedurally distinct mechanisms. In the instant case the dissent comes closest to recognizing the dual nature of the relationship between the amendments by looking beyond the question of whether an item's seizure meets the procedural prerequisites for protection under the fourth or fifth amendment and, instead, concentrating on the broader concern shared by the amendments—protection of an individual's privacy from governmental intrusion. Although the amendments' procedural prerequisites provide tools for examining the constitutional permissibility of a given seizure or compelled production, reliance on such tools as the threshold criteria for determination of a privacy-invasion claim exalts the mechanisms over the substantive right of privacy those mechanisms were designed to protect.[54] The better approach is to recognize that the amendments jointly create a right in the individ-

54. The constitutional stature of a right of privacy has found acceptance by the Supreme Court, beginning with the landmark case of Griswold v. Connecticut, 381 U.S. 479 (1965). The Court further has explicitly based fourth and fifth amendment decisions striking down compelled testimony and unreasonable searches on concern for protection of the right of privacy. *See, e.g.*, Camara v. Municipal Court, 387 U.S. 573 (1967); Miranda v. Arizona, 384 U.S. 436 (1966). As recently as 1974, the Supreme Court has emphasized:

> . . . the protection of an individual's right to a "private enclave where he may lead a private life."
>
> We have recognized that the Fifth Amendment "respects a private inner sanctum of individual feeling and thought"—an inner sanctum which necessarily includes an individual's papers and effects to the extent that the privilege bars their compulsory production and authentication—and "proscribes state intrusion to extract self-condemnation."

Bellis v. United States, 417 U.S. 85, 91 (1974) (citations omitted).

ual to be free from governmental intrusion. In cases concerning searches for and seizures of business records, this right protects certain items within a zone of personal privacy.[55]

Determining the validity of a search and seizure on the basis of a zone of privacy analysis is preferable for several reasons. First, the analysis is consistent with the *Boyd* and *Gouled* precedent as it establishes limits on searches conducted under a valid warrant after the fourth and fifth amendment requirements have been met, and further suggests a conceptual approach for determining those limits. Secondly, a zone of privacy analysis more accurately emphasizes the indication in *Boyd, Gouled,* and *Hayden* that there are limits on searches created by the intimate relationship of the fourth and fifth amendments. Such an approach achieves that emphasis while avoiding hypertechnical discussions concerning formal prerequisites for protection under the separate amendments (probable cause, particularity, compulsion, communicative evidence) that previously have obstructed judicial analysis. Thirdly, employing a zone of privacy approach abrogates the need to develop artificial constructs of such formal requirements as "compulsion" which have become technical impediments to the exercise of the privacy right. Finally, the establishment of a zone of privacy protected from governmental intrusion should end the practice of seizing immune personal items, sorting through those items, and subsequently returning them without introduction into evidence after privacy already has been destroyed by the search itself. Although the zone of privacy concept, best oriented to the common concern of the fourth and fifth amendments, should be used as the new limit on allowable searches and seizures, the obvious problem is delimiting the proper boundaries of that zone. A rational definition of the zone and the items protected thereby is no more difficult to construct,[56] however, than are the present efforts that attempt to manipulate divergent procedural requirements. Additionally, a zone of privacy analysis is more logi-

55. In their dissenting opinions in Couch v. United States, 409 U.S. 322 (1973), Justices Douglas and Marshall reiterate their analysis that the relationship between the fourth and fifth amendments creates a zone or sphere of privacy that those amendments jointly protect from governmental intrusion. 409 U.S. at 338, 344. One commentator suggests that the majority decision accepts that same theory when it points out the interdependence of the two amendments. Comment, *The Search and Seizure of Private Papers: Fourth and Fifth Amendment Considerations,* 6 LOYOLA L.A.L. REV. 274, 293 (1973).

56. In this context, the concurring opinion of Justice Harlan in Katz v. United States, 389 U.S. 347, 360 (1967), proposing a two-tiered test to determine the applicability of fourth amendment privacy protection, and the dissenting opinion of Justice Marshall in Couch v. United States, 409 U.S. 322, 344 (1973), suggesting criteria for determining if an item is to be considered within an individual's sphere of privacy for fourth and fifth amendment purposes, are instructive as to implementation of the "intimate relation" privacy protection.

cally connected with the proscriptions developed in *Boyd* and *Gouled*.

Because it is questionable whether records of transactions that would be used to establish tax evasion could be considered private documents, or even within a protected zone, the status of private business records vis-a-vis valid search warrants accentuates the need for a definitive statement by the Supreme Court. The dissent suggests two ways in which the issue could be resolved to effect greater protection for business records. The first method is adoption of the zone of privacy rationale and delineation of guidelines for determining the extent of that zone. A second approach is to seek protection of records at the threshold level of warrant issuance, rather than to attempt to restrict the limits of the search permissible under a valid warrant by relying on a zone of privacy. To prevent a general search and seizure of *all* the accused's records, the instant dissent recommends that IRS searches be placed in a category of their own, requiring a different probable cause showing prior to issuance of a warrant.[57] Since IRS searches by nature tend to require exploration of all the records of a suspect, the post-*Hayden* practice of sorting the documents after seizure comes too late to protect the privacy interests. A stronger showing of the reasons for the search, coupled with a detailed listing of records to be searched as well as those to be seized, would be the only effective check on the discretion of a field agent and a better assurance of privacy for records unrelated to the evidence sought. Additionally, requiring a stricter probable cause burden when papers are sought provides the court with an alternative to placing papers of all degrees of privacy expectation into a protected zone; a sliding scale of probable cause also will protect legitimate government discovery interests. The instant decision simply adds to the division among the circuits without resolving the question of what limits should be applied to searches under warrant. The dissenting opinion, however, suggests an approach that may provide a workable alternative to the present analysis and insure the continued protection of privacy—the primary concern of the fourth and fifth amendments.

MITCHELL M. PURVIS

57. No. 74-1671 at 7. Such a "sliding scale" of probable cause has been suggested by the Supreme Court in Camara v. Municipal Court, 387 U.S. 523 (1967) and adopted by lower courts. *See* Stanford Daily v. Zurcher, 353 F. Supp. 124 (N.D. Cal. 1972).

Labor Law—Bankruptcy—Collective Bargaining Agreement May Be Rejected in Chapter XI Proceeding if Debtor-in-Possession Can Show Agreement to Be Onerous and Burdensome

I. Facts and Holding

REA Express, Inc., a debtor-in-possession under Chapter XI of the Bankruptcy Act,[1] moved for an order[2] permitting rejection of its collective bargaining agreements with two unions,[3] contending that the agreements were voidable under section 313(1) of the Bankruptcy Act[4] as onerous and burdensome executory contracts. The unions argued that the Railway Labor Act [RLA] prohibits such rejection of collective bargaining agreements except in the manner prescribed in that Act,[5] and asserted that the debtor-in-possession

1. REA Express, Inc. [hereinafter REA] and several affiliated companies filed petitions under Chapter XI, § 322 of the Bankruptcy Act, 11 U.S.C. § 205 *et seq.* (1970), on February 18, 1975. REA was authorized under § 343 of the Bankruptcy Act, 11 U.S.C. § 743 (1970), to operate its business under court supervision as a debtor-in-possession.

2. REA moved pursuant to § 313(1), 11 U.S.C. § 713(1) (1970), and Rule 11-53 of the Bankruptcy Rules, for an order permitting rejection of the agreements. While accepting the evidence of REA's precarious financial situation, the bankruptcy judge denied authority to reject the agreement, holding that a bankruptcy court is without authority to permit the rejection of a collective bargaining agreement. The judge determined that "this is not the kind of Chapter XI." Brotherhood of Railway Clerks v. REA Express, Inc., 523 F.2d 164 at 167 (2d Cir. 1975). Pursuant to 11 U.S.C. § 67(c) (1970), REA appealed this decision to the United States District Court for the Southern District of New York, which reversed.

3. REA is a party to separate collective bargaining agreements with the Brotherhood of Railway, Airline, and Steamship Clerks (BRAC) and the International Association of Machinists and Aerospace Workers (IAM). These agreements, which are subject to the provisions of the Railway Labor Act, 45 U.S.C. § 151 *et seq.* (1970) [hereinafter RLA], substantially affect REA's right to close or consolidate facilities and transfer or lay off workers, and require supplementary unemployment benefits to workers who have been laid off. In bankruptcy court, REA presented evidence that it had incurred substantial liabilities as debtor-in-possession, had an outstanding payroll liability of over $4 million, and was unable to meet either its current expenses or the full wage scales mandated by the collective bargaining agreements. It further contended that the bargaining agreements would prevent implementation of a reorganization plan that would enable the company to survive.

4. Section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1) (1970), provides:

> Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties conferred and imposed upon it by this chapter—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate . . . .

5. Section 2 of the RLA, 45 U.S.C. § 152(7) (1970), provides, in pertinent part, that "no carrier, its officers, or agents shall change the rates of pay, rules, or working conditions of its employees, as a class" without undergoing the protracted procedures prescribed by § 6 of the RLA, 45 U.S.C. § 156 (1970). The unions emphasized that a "carrier" as defined in § 1 of the RLA, includes "any receiver, trustee, or other individual or body . . . when in possession of the business of any such 'carrier' . . . ." 45 U.S.C. § 151 (1970). The unions contended

was obligated as a successor-employer to assume the existing labor contracts. Finding the agreements burdensome and concluding that there was no limitation on the type of executory contracts that a debtor-in-possession could reject under section 313(1),[6] the United States District Court for the Southern District of New York rendered judgment for REA Express. On appeal to the United States Court of Appeals for the Second Circuit, *held*, remanded.[7] Although a debtor-in-possession is obligated as a successor-employer to negotiate with its employees' bargaining representative, it may under section 313(1) reject its predecessor's onerous and burdensome collective bargaining agreement when it has neither expressly assumed the agreement nor conformed to its terms without disaffirmance. *Brotherhood of Railway Clerks v. REA Express, Inc.*, 523 F.2d 164 (2d Cir. 1975).

II. LEGAL BACKGROUND

Federal bankruptcy law authorizes the court under section 313(1) to relieve a debtor-in-possession from the burdens of an executory contract entered into by its predecessor. Ordinarily, the section 313(1) power is exercised when rejection of an executory contract will benefit the estate and preserve solvency.[8] When the executory contract to be rejected is a collective bargaining agreement, however, there is a strong conflict between the Bankruptcy Act policy giving the debtor a new start and the labor laws policy encouraging enforcement of collective bargaining agreements. Because section 313(1) fails to describe the circumstances warranting rejection of an executory contract and makes no distinction among classes of executory contracts that may be rejected, the determination of whether collective bargaining agreements are voidable under section 313(1) becomes a task of judicial interpretation.

The initial decision addressing the issue was *In re Klaber Bros., Inc.*,[9] in which a federal district court held that collective bargaining

that the debtor-in-possession, as a carrier, was obligated to utilize the statutory notice, conference, and mediation procedures required by the Act before it made any change in its collective hargaining agreements.

6. *See* Countryman, *Executory Contracts in Bankruptcy, Part II*, 58 MINN. L. REV. 479, 494 (1974); Comment, *Collective Bargaining and Bankruptcy*, 42 S. CAL. L. REV. 477 (1969).

7. The court remanded the case for a determination whether the bargaining agreements in question were sufficiently onerous and burdensome to warrant rejection. The court found that the record failed to indicate clearly: (1) the extent to which each agreement would preclude continued operation of REA; (2) the extent to which the district court balanced the competing interests of the debtor-in-possession and the employees who would be affected by such a rejection. REA subsequently was adjudicated bankrupt November 6, 1975.

8. 8 COLLIER ON BANKRUPTCY ¶ 3.15[8] (14th ed. rev. 1975).

9. 173 F. Supp. 83 (S.D.N.Y. 1959).

agreements subject to the National Labor Relations Act[10] [NLRA] are within the class of executory contracts which may be rejected in Chapter XI proceedings. Balancing the disadvantages to the debtor of keeping the contract in force against the potential liabilities created by its rejection, the *Klaber* court determined that rejection of an executory contract should be authorized when rejection will benefit the estate.[11] Subsequently, in *In re Overseas Nat'l Airways, Inc.*,[12] a district court held that collective bargaining agreements subject to the RLA are never within the class of executory contracts that may be rejected in Chapter XI proceedings. The court distinguished *Klaber*, which permitted the rejection of an NLRA agreement, noting that the airline employees affected were covered by section 2 of the RLA. That section expressly forbids a carrier from unilaterally altering the existing rates of pay, rules, or working conditions of its employees without undergoing the protracted procedures prescribed in section 6 of the RLA.[13] The court acknowledged that agreements covered by the NLRA were voidable under section 313(1), but stressed that rejection or modification of RLA contracts could be effected only through the specified statutory procedures. The Supreme Court apparently strengthened the position of the *Overseas* court by its decision in *Detroit & T.S.L.R.R. v. United Transp. Union*,[14] holding that the purpose of section 2 of the RLA is to give legal and binding effect to collective bargaining agreements and to require that they be changed only in accordance with statutory procedures.

Subsequently, in *Shopmen Local 455 v. Kevin Steel Prods., Inc.*,[15] the Second Circuit became the first federal court of appeals

10. National Labor Relations Act of 1935, 29 U.S.C. § 151 *et seq.* (1970).

11. 173 F. Supp. at 85. *See* Carpenters Local 2746 v. Turney Wood Prods., Inc., 289 F. Supp. 143 (W.D. Ark. 1968) (NLRA bargaining agreement held voidable in straight bankruptcy proceeding).

12. 238 F. Supp. 359 (E.D.N.Y. 1965).

13. The procedures embodied in § 6 require 30 days written notice of intended changes in terms of employment and submission of disputes to the National Mediation Board, should either party so request. Section 6 also specifies that the carrier may not alter rates of pay, rules, or working conditions, pending exhaustion of these procedures. The purpose of § 6 is to stabilize labor relations by extending agreements for a limited period regardless of the parties' intentions. Manning v. American Airlines, Inc., 329 F.2d 32 (2d Cir.), *cert. denied*, 379 U.S. 817 (1964).

14. 396 U.S. 142, 156 (1969).

15. 519 F.2d 698 (2d Cir. 1975). Kevin Steel Products, Inc., a debtor-in-possession under Chapter XI, appealed the ruling of the United States District Court for the Southern District of New York, which held that the power of a bankruptcy court to relieve a debtor from the burdens of executory contracts does not apply to collective bargaining agreements. Shopmen Local 455 v. Kevin Steel Prods., Inc., 381 F. Supp. 336 (S.D.N.Y. 1974). Kevin Steel sought to disaffirm its collective bargaining agreements, governed by the NLRA, with the Iron

to confirm the power of a bankruptcy court under section 313(1) to reject "onerous and burdensome" collective bargaining agreements subject to the NLRA.[16] The court suggested, however, that the standard for determining the voidability of a bargaining agreement should not be based (as the *Klaber* court proposed) solely on a determination that such rejection will improve the financial status of the debtor.[17] Rather, the court emphasized that a bankruptcy court should permit rejection only after balancing the benefits and burdens of rejection to both the debtor and its employees.[18] The court then rejected the unions' contention that collective bargaining agreements were excluded from the class of executory contracts voidable under the Bankruptcy Act, reasoning that had Congress desired such an exclusion, it would have so provided.[19] Finally, the court suggested in dictum that even when a court authorizes the rejection of a bargaining agreement, the 1972 Supreme Court decision in *NLRB v. Burns Int'l Security Servs., Inc.*[20] may require the debtor-in-possession to bargain with the incumbent employees' designated representative.[21] *Burns* held that a successor-employer will

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Workers. There was no effort to reject additional contracts with other unions representing the company's outside iron workers and truck drivers.

16. The case was remanded, however, to determine whether the agreement in question was sufficiently onerous to warrant rejection.

17. 519 F.2d at 707.

18. *Id.*, *citing In re* Overseas Nat'l Airways, Inc., 238 F. Supp. 359, 361 (E.D.N.Y. 1965); *cf.* Comment, *Collective Bargaining and Bankruptcy*, 42 S. CAL. L. REV. 477, 481 (1969). *See also In re* Mamie Conti Gowns, 12 F. Supp. 478 (S.D.N.Y. 1935).

19. The court found the absence of such exclusionary language particularly significant in light of § 77(n) of the Bankruptcy Act, 11 U.S.C. § 205(n) (1970), which specifically prohibits bankruptcy courts from interfering with collective bargaining agreements affecting "railroad employees." Section 77(n) provides in part:

> No judge or trustee acting under this [Act] shall change the wages or working conditions of railroad employees except in the manner prescribed in [the RLA] . . . .

The court also rejected the claim of the unions and the NLRB that § 8(d) of the NLRA, 29 U.S.C. § 158(d) (1970), prohibits rejection of a collective bargaining agreement. Although § 8(d) expressly imposes upon a "party" certain notice and mediation procedures before a labor contract may be terminated or modified, the *Kevin Steel* court found that a debtor-in-possession is not a "party" under § 8(d) to any labor agreement with the union and thus will not be subject to the § 8(d) termination restrictions unless and until it assumes the old agreement or enters into a new one.

20. 406 U.S. 272 (1972).

21. Although Burns Security Services was not bound by the substantive provisions of the predecessor's collective bargaining agreement, the Court suggested in dictum that when the successor-employer is a party in a reorgnization proceeding, the party may be held to have assumed the predecessor's agreement. In support of its proposition, the Court cited *Oilfield Maintenance Co.*, 142 N.L.R.B. 1384 (1963), in which the respondent construction company was held to be the "alter ego" of its predecessor and was thus required to maintain the predecessor's contracts because: (1) both companies were owned and controlled by the same persons; (2) the business of the predecessor was carried on without a break by the successor; (3) both companies employed the same supervisory personnel; (4) nearly all of the predeces-

be bound by its predecessor's duty to bargain collectively when the appropriate bargaining unit is identical both before and after the change in employers and when the successor has hired a substantial percentage of its predecessor's employees.[22] Since the court in *Kevin Steel* merely suggested, without elaboration, that the obligations of a debtor-in-possession are "analogous" to those of a successor-employer under *Burns*, the decision left unclear the extent to which a debtor-in-possession may free itself from its predecessor's duty to bargain. Moreover, although *Kevin Steel* established the voidability of collective bargaining agreements subject to the NLRA, the law regarding agreements under the RLA was less clear because of the earlier decisions in *Overseas Nat'l Airways* and *United Transportation*.

III. THE INSTANT OPINION

Recognizing at the outset that federal labor policy strongly favors the specific performance of collective bargaining agreements, the instant court nevertheless held that in the absence of a clear congressional mandate to the contrary,[23] federal labor law must yield to the bankruptcy court's power to relieve debtors of onerous and burdensome executory contracts. The court reasoned that neither the RLA nor the Bankruptcy Act contained language excluding collective bargaining agreements from the operation of section 313(1). Had Congress desired such an exclusion, the court observed, it would have so provided.

The court next dismissed the unions' contention that the plain language of the RLA prohibits rejection of a collective bargaining agreement except in the manner prescribed by that Act. Although noting that the RLA expressly obligates an employer to undergo

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sor's employees accepted employment with the new company. It is unclear whether this rationale would be applicable to debtors-in-possession under Chapter XI.

22. 406 U.S. 272 (1972). The successor-employer may also assume an obligation to bargain when it: (1) fails to hire a majority of the predecessor's work force for anti-union reasons; or (2) plans to retain all of the predecessor's employees. In the first case in which it considered the obligations of successor-employers, *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964), the Supreme Court held that in some circumstances a successor-employer may be bound by the duty to arbitrate imposed by its predecessor's collective bargaining agreement. *Id.* at 550-51. Nash, *Successorship in Light of Burns*, 7 GA. L. REV. 664, 671 (1973); *see* Note, *The Bargaining Obligations of Successor Employers*, 88 HARV. L. REV. 759 (1975).

23. The instant court cited § 77(n) of the Bankruptcy Act, *supra* note 19, as an example of the ability of Congress to exclude certain executory contracts from the operation of the Bankruptcy Act. *See In re* Overseas Nat'l Airways, Inc., 238 F. Supp. 359 (E.D.N.Y. 1965) (applying § 77(n) to a collective bargaining agreement between an airline and its stewardesses). *See also* NLRA § 15, 29 U.S.C. § 165 (1970) (overriding Bankruptcy Act § 272, 11 U.S.C. § 672 (1970)).

protracted procedures[24] before implementing changes in a collective bargaining agreement, the instant court determined that the debtor-in-possession is a new "juridical entity"[25] which is not bound to follow the procedures of section 6 of the RLA unless it assumes the agreement either expressly or by conforming to its terms without disaffirmance.[26] Accordingly, the court held that section 6 neither binds REA as a debtor-in-possession, nor prevents the bankruptcy court from rejecting the collective bargaining agreement under section 313(1). The court then established a new test for determining the voidability of RLA agreements under section 313(1). In view of the "serious effects" that rejection of a bargaining agreement has on the debtor's employees, the court held that rejection "should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs."[27] The case was remanded for a determination, under this test, of whether the agreement was sufficiently onerous and burdensome to warrant rejection.

Finally, the court stressed that the Bankruptcy Act does not authorize a debtor-in-possession to ignore its obligations under the labor laws. Recalling *Burns*,[28] the instant court noted that even where the debtor-in-possession is permitted to reject the burdensone collective bargaining agreement of its predecessor, it may nevertheless be obligated under *Burns* to bargain collectively with the representative of the employees it hires.[29] Under the facts presented in the instant case, the court held that REA, as a successor-employer, was obligated to negotiate with its employees' bargaining representative.

IV. COMMENT

In holding that the Bankruptcy Act overrides provisions of the RLA expressly requiring the exhaustion of statutory procedures before changing terms of employment, the instant decision, in conjunction with the decision in *Kevin Steel*, firmly establishes the

24. *See* note 13 *supra*.

25. 523 F.2d 164 at 170; *see In re* Capital Serv., Inc., 136 F. Supp. 430, 434 (S.D. Cal. 1955).

26. *See generally In re* Public Ledger, 161 F.2d 762 (3d Cir. 1947) (by retaining the predecessor's employees without changing their terms of employment, the bankruptcy trustees assumed the collective bargaining agreement and could not subsequently reject it); Burke v. Morphy, 109 F.2d 572 (2d Cir.), *cert. denied*, 310 U.S. 635 (1940) (receiver implicitly adopted debtor's labor contract).

27. 523 F.2d 164 at 172.

28. *See* notes 20-22 *supra* and accompanying text.

29. *See* Chicago & N.W.R.R. v. United Transp. Union, 402 U.S. 570, 574-76 (1971).

power of a bankruptcy court to void burdensome collective bargaining agreements in Chapter XI proceedings. The extent to which the Bankruptcy Act actually displaces federal labor law, however, remains unclear. Although the instant court argued that the RLA must yield to the broader powers of the Bankruptcy Act, the decision nevertheless appears to implement indirectly the RLA termination policies by requiring that the debtor-in-possession under a collective bargaining agreement meet a more substantial burden of proof for voiding an executory contract under section 313(1) than the burden imposed upon parties to non-labor contracts. Whereas a debtor-in-possession seeking to reject a non-labor executory contract need prove only that rejection will benefit the estate and preserve solvency,[30] a debtor-in-possession petitioning for rejection of a collective bargaining agreement further must establish that unless the agreement is rejected, the business will collapse and the employees will no longer have jobs. The court thus appears to be adopting an interpretation of section 313(1) that would allow the rejection of an RLA agreement only when the retention of the contract would prevent survival of the carrier.

Requiring this heavier burden in establishing the onerousness of a collective bargaining agreement appears to be desirable for several reasons. First, a stricter standard will give the fullest effect to the intention of Congress in federal labor legislation to avoid disruption of commerce by requiring the parties to exhaust statutory procedures before initiating unilateral actions. Secondly, the test proposed by the instant court more effectively will protect employee expectations by insuring that the bargaining agreements will be rejected in only the most extraordinary circumstances. Thus, under this test, it will be less likely that employees will lose benefits secured through collective action. Finally, allowing the debtor-in-possession to reject an otherwise disabling collective bargaining agreement will help enable the business to survive, keeping at least some of the employees at work and providing creditors greater assurance that the debtor's obligations will be honored.

Although the test developed in the instant opinion may implement indirectly the policies of the RLA, it nevertheless conflicts with both the express provisions of the RLA and with the Supreme Court interpretation of that act in *United Transportation*.[31] It therefore is incumbent upon Congress to provide some guidance in either the RLA or the Bankruptcy Act concerning resolution of the conflict

30. *See* 8 COLLIER ON BANKRUPTCY ¶ 3.15[8] (14th ed. rev. 1975).
31. 396 U.S. 142, 156 (1969).

between these two bodies of law. Secondly, the instant decision does not make clear under which circumstances and at what point in time a debtor-in-possession's duty to bargain with the union arises. Under *Burns*, a successor-employer assumes an obligation to bargain with the representative of his predecessor's employees if the employees constitute a majority of its work force in an appropriate bargaining unit. The instant court appears to have adopted the *Burns* standard in holding, without explanation, that REA "as a new employer" is obligated to bargain collectively with its employees.[32] In merely requiring the debtor-in-possession to bargain with the incumbent employees, however, the instant decision fails to reach an adequate compromise between the competing interests of employers and employees in Chapter XI bankruptcy proceedings. The court recognized that alternatives exclusively favoring either labor or management interests were not acceptable. Imposing the predecessor's burdensome contractual obligations on the debtor-in-possession, for example, could restrict management prerogative and thwart efforts to save a failing business from bankruptcy. On the other hand, failure to bind the debtor-in-possession to the collective bargaining obligation of its predecessor could deprive employees of benefits gained through collective action. The instant court attempted to resolve the tension between these interests by permitting rejection of the entire agreement only after a substantial showing that continued operations would lead to collapse of the business. The court then would require a debtor-in-possession to bargain with the incumbent employees. A better approach would be to permit rejection of only those portions of the collective bargaining agreement that the court finds onerous and burdensome, while leaving in force the remaining portions of the agreement upon which the employees have relied. Such an analysis would afford employees greater protection than merely imposing an obligation to bargain, while simultaneously allowing the debtor-in-possession to renegotiate the burdensome provisions of the old agreement.

GEORGE M. KRYDER, III

32. 523 F.2d 164 at 171.

Securities Regulation—Securities Fraud—Federal Subject Matter Jurisdiction—Extraterritorial Application of Federal Securities Acts Depends Upon the Nationality and Residence of the Purchaser and the Extent of Activity in the United States.

I. FACTS AND HOLDING

Plaintiff, a resident United States citizen, brought a class action[1] on behalf of all American and foreign subscribers to the international securities offering of I.O.S., Ltd.,[2] contending that the corporation,[3] its international accounting firm,[4] and its international underwriters were subject to the anti-fraud provisions of the Securities Act of 1933[5] and the Securities Exchange Act of 1934.[6] Plaintiff

1. The complaint was brought as a class action under FED. R. CIV. P. 23(b)(3). The court estimated the class of purchasers to be 50,000, preponderantly citizens and residents of Canada, Australia, England, France, Germany, Switzerland, and many other countries in Europe, Asia, Africa, and South America. The American purchasers, including the plaintiff, were estimated at 386, most of whom lived abroad.

2. I.O.S., Ltd., an international sales and financial service organization principally engaged in the sale and management of mutual funds and complementary financial activities, is organized under the laws of Canada, with its main business office in Geneva, Switzerland, and currently is being liquidated under Canadian law. The instant offering consisted of three separate distributions of I.O.S. common stock. The primary distribution of 5,600,000 shares, underwritten by six of the defendants, was sold to foreign investors outside of the United States. The secondary offering of 1,450,000 shares was underwritten by another defendant, a Canadian investment house, and distributed in Canada, solely to Canadian purchasers. A third offering of 3,950,000 shares, underwritten by a Bahamian subsidiary of I.O.S., was offered to employees, clients, and associates of I.O.S. The American investors involved purchased in this last offering, even though none of the stock was listed or offered on American exchanges. Plaintiff purchased 600 shares. All offerings involved substantially the same prospectus, and offered the shares at the same price, $10 per share. The offerings were successful in the limited sense of being fully subscribed, but after stabilizing briefly at $14, the price per share drifted downward, and, in April of 1970, collapsed through the $10 level; three weeks later the shares were virtually unsaleable.

3. Plaintiff joined both I.O.S., Ltd. and its organizer, Bernard Cornfeld.

4. One international accounting firm, having its principal office in the United States, prepared the balance sheets and income statements that were included in all three prospectuses.

5. Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a) (1970), provides in pertinent part:

> 77v. Jurisdiction of offenses and suits.—(a) The district courts of the United States, . . . shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulaions promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter.

6. Section 27 of the Securities Exchange Act [hereinafter cited as the 1934 Act], 15 U.S.C. § 78aa (1970), provides in pertinent part:

> 78aa. Jurisdiction of offenses and suits.—The district courts of the United States, . . .

cited extensive activities within the United States,[7] sales of securities to Americans,[8] and adverse general effects on domestic securities markets[9] as bases for federal subject matter jurisdiction. Defendants argued, however, that the offering was three distinct transactions[10] and, that when considered separately, not one had sufficient nexus with the United States to warrant application of its securities laws.[11] The district court overruled a motion to dismiss for lack of subject matter jurisdiction.[12] On interlocutory appeal to the United States Court of Appeals for the Second Circuit, *held*, affirmed in part, reversed in part, and remanded for further proceedings.[13] When resident American investors subscribe to a foreign offering of securities, the securities laws of the United States are applicable; when American investors, resident abroad, subscribe to a foreign offering, the securities laws apply if, and only if, acts within the

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shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

In addition to his charges under the securities laws, plaintiff alleged common law fraud.

7. The lower court found, in part, that representatives of the defendants had met in New York on numerous occasions to initiate, organize, and structure the offering; that a New York law firm and a New York accounting firm were retained in connection with the offerings; that parts of the prospectus were drafted in New York; that proceeds from the underwriting were deposited in accounts in a New York bank; and that extensive use was made of telephone communication between New York and Switzerland.

8. Although most of the American purchasers, estimated at 386, lived abroad, sales aggregating 41,936 shares were made to 22 American residents, all having relationships with I.O.S. or its affiliates as employees, lawyers, directors, or consultants.

9. An affidavit by Morris Mendelson, Associate Professor of Finance at the Wharton School of the University of Pennsylvania, stated that the collapse of the I.O.S. offering (1) deteriorated investor confidence in American underwriters, at home and abroad, (2) contributed to a steep decline in the purchase of United States securities by foreigners and the large redemption of mutual fund shares, and (3) contributed to the breakdown of the American securities markets' offshore investing industry. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987-88 (2d Cir. 1975).

10. *See* note 2 *supra.*

11. Defendants pointed out that: (1) while the primary offering may have involved certain activity in the United States, it sold no stock to American investors; (2) the second offering involved neither United States activities nor sales to American investors; and (3) while the third offering included sales to Americans, it involved no activities in the United States.

12. The district court also found no *in personam* jurisdiction over one of the defendants, the Canadian underwriters of the secondary offering. The district court attached a Rule 54(b) certificate to the dismissal for lack of *in personam* jurisdiction, and certified its holding on subject matter jurisdiction for interlocutory appeal under 28 U.S.C. § 1292(b) (1970).

13. As to the district court's holding of no *in personam* jurisdiction over one of the defendants, the Court of Appeals affirmed. Furthermore, the court refused to recognize pendent jurisdiction over the foreign members of the class on the hasis of the common law fraud charge. Considering the size of the class and the potential confusion in applying both statutory and common law provisions, the court held it would be a hreach of discretion to retain the foreign plaintiffs in the class.

United States significantly contributed to the alleged fraud; and, when foreign investors subscribe to a foreign offering, the securities laws apply if, and only if, acts within the United States directly caused the alleged fraud. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied sub nom., Bersch v. Arthur Andersen & Co.*, Civil No. 75-596 (U.S. Dec. 8, 1975).

II. LEGAL BACKGROUND

Section 22(a) of the Securities Act of 1933[14] and section 27 of the Securities Exchange Act of 1934[15] grant federal courts broad subject matter jurisdiction to hear suits for violation of the acts' anti-fraud provisions. Neither act, however, defines the proper application of the anti-fraud provisions to the transnational purchase and sale of securities.[16] Further, although the Securities Exchange Commission has exempted certain foreign offerings from the registration provisions of the acts,[17] it has not promulgated a rule governing the extraterritorial scope of the anti-fraud provisions. Rather, the proper scope of subject matter jurisdiction in international securities transactions has been left to judicial determination. *Kook v. Crang*,[18] the first case to consider the issue, sought guidance in section 30(b) of the 1934 Act, which excludes from the provisions of the Act any person who "transacts a business in securities without the jurisdiction of the United States."[19] Construing that provision,

14. *See* note 5 *supra*.

15. *See* note 6 *supra*.

16. Section 10(b), the anti-fraud provision of the 1934 Act, 15 U.S.C. 78(j)(b) (1970), does provide its own jurisdictional standards:

> 78j. Manipulative and deceptive devices. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—. . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

The instant decision deals, however, with the issue of whether the securities acts are at all applicable—a threshhold consideration before the more precise requirements of section 10(b) can even be reached.

17. SEC Securities Act Releases Nos. 33-4708, 34-7366 (July 9, 1964). *But see* SEC Rule 17a-7, 17 C.F.R. § 240.17a-7 (1975)(registration requirements applied to foreign brokers selling securities in the United States via the mails).

18. 182 F. Supp. 388 (S.D.N.Y. 1960).

19. Section 30(b) of the 1934 Act, 15 U.S.C. § 78dd(b) (1970), provides in pertinent part:

> 78dd. Foreign securities exchanges.
>
> (b) The provisions of this chapter . . . shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

the court determined that the Act was not intended to apply extraterritorially—at least not without substantial conduct occurring within the United States. Nevertheless, fearing ease of avoidance of the securities laws, courts in recent cases have adopted a more restrictive interpretation of the section 30(b) exclusion. In *Schoenbaum v. Firstbrook*,[20] the Second Circuit focused on the "*business* in securities" requirement, holding the section 30(b) exclusion to be inapplicable to an isolated sale of securities. The Ninth Circuit was even more restrictive in *SEC v. United Financial Group, Inc.*,[21] construing "without the jurisdiction of the United States" as referring not to territorial limits, but to the sphere of legitimate American interests. Having thus limited the ability of section 30(b) to remove international securities transactions from the reach of American securities laws, the courts moved to determine subject matter jurisdiction in light of foreign relations policy[22] and the investor protection purposes underlying the securities acts.[23] One line of cases has followed the objective territorial approach enunciated by Justice Holmes in *Strassheim v. Daily*,[24] that a state has the

20. 405 F.2d 200 (2d Cir.), *rev'd on the merits*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied sub nom.*, Manley v. Schoenbaum, 395 U.S. 906 (1969). There is, however, a dispute among commentators as to the proper interpretation of *Schoenbaum*. *Compare* Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1390-91 (1973)(section 30(b) was inapplicable in *Schoenbaum* because the transaction was an isolated sale—not a *business* in securities) *with* Note, *The International Character of Securities Credit: A Regulatory Problem*, 2 LAW & POL. INT'L BUS. 147, 159-60 (1970)(*Schoenbaum* departed from the territorial interpretation of "within the jurisdiction of the United States"). It also is interesting to note, that the lower court in the instant action adopted the latter interpretation of *Schoenbaum* when faced with the section 30(b) defense raised by one of the defendants. Bersch v. Drexel Firestone, Inc., 389 F. Supp. 446, 458-59 (S.D.N.Y. 1974).

21. 474 F.2d 354 (9th Cir. 1973).

22. *See, e.g.*, Investment Properties Int'l, Ltd. v. I.O.S., Ltd., [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,011 at 90,735 (S.D.N.Y.), *aff'd mem.* (2d Cir. 1971) (unreported):

> If there is no such domestic impact from a substantially foreign transaction, United States courts bave no reason to become involved, and compelling reason *not* to become involved, in the burdens of enforcement and the delicate problems of foreign relations and international economic policy that extraterritorial application may entail.

(Emphasis in original).

23. *See, e.g.*, H.R. REP. No. 85, 73d Cong., 1st Sess., May 4, 1933.

24. 221 U.S. 280 (1911)(the case dealt with tbe extradition to Michigan of an Illinois citizen who was charged with bribery of a Michigan public officer and with obtaining money from the State of Michigan under false pretenses). Justice Holmes stated:

> Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if he had been present at the effect, if the State should succeed in getting him within its power.

Id. at 285.

In *United States v. Aluminum Co. of America*, 148 F.2d 416, 443 (2d Cir. 1945), Judge Learned Hand relied upon the *Strassheim* doctrine to extend the provisions of the Sherman Act to encompass international activities.

power to exert jurisdiction over conduct that occurs outside its territory but that causes a substantial effect within its territory.[25] Under this principle, the Second Circuit readily found subject matter jurisdiction in *Schoenbaum*[26] on the strength of the fact that the securities at issue were listed on a domestic exchange, and that the activities had an adverse effect on the American securities market. Subsequent cases[27] de-emphasized the importance of a domestic exchange listing, but in *Leasco Data Processing Equipment Corp. v. Maxwell*,[28] the Second Circuit held that adverse market effects alone would not invoke subject matter jurisdiction. Rather, the *Leasco* court adopted a subjective territorial approach requiring a combination of adverse effects and significant activity within the United States to justify application of American securities laws to international securities transactions.[29] Subsequently, *Travis v. Anthes Imperial Ltd.*[30] established the *de minimis* amount of activity within the United States upon which subject matter jurisdiction might be based. Both *Leasco* and *Travis*, however, emphasized that the adverse effect involved fell upon resident American investors. Indeed, even though the actual purchaser defrauded in *Leasco* was a Netherlands Antilles corporation, the court, in finding jurisdiction, perceived the real party affected to be its American parent corporation. The court suggested that a contrary result would have obtained had all parties been foreign.[31] Nevertheless, in *IIT v. Ven-*

25. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 18(b)(ii) (1965) [hereinafter cited as RESTATEMENT (2d)] ably expresses the principle:

> § 18. Jurisdiction to Prescribe with Respect to Effect within Territory.
>
> A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if . . . (b) . . . (ii) the effect within the territory is substantial . . . .

26. 405 F.2d 200, 206 (2d Cir. 1968).

27. *E.g.*, Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973), *rev'g and remanding* 331 F. Supp. 797 (E.D. Mo. 1971); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972).

28. 468 F.2d 1326 (2d Cir. 1972).

29. RESTATEMENT (2d) § 17(a), expresses the principle:

> § 17. Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest within Territory. A state has jurisdiction to prescribe a rule of law (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory. . . .

30. 474 F.2d 515 (8th Cir. 1973), *rev'g and remanding* 331 F. Supp. 797 (E.D. Mo. 1971)(extensive use of United States mails and other facilities of interstate commerce held sufficient to justify application of American securities laws).

31. The court stated:

> The case is quite different from another hypothetical . . . where a German and a Japanese businessman met in New York for convenience, and the latter fraudulently induced the former to make purchases of Japanese securities on the Tokyo Exchange.

468 F.2d at 1338.

cap, Ltd.,[32] involving the purchase of foreign securities by an international investment trust, the Second Circuit upheld subject matter jurisdiction over substantially foreign parties when a fraudulent investment scheme was perpetrated from the United States. Moreover, stressing that the fraud was practiced upon the international trust itself, and not upon the individual investors, the court refused to recognize as significant the adverse consequences to the small number of American shareholders involved.[33] It was, then, the foreign investor that *IIT* sought to protect.[34] Yet, the court failed to define adequately what, if any, limits governed the availability of American securities laws to foreign investors defrauded in international transactions.

III. The Instant Opinion

The instant court recognized at the outset that the proper extraterritorial application of the securities laws was not to be found in the language of the acts.[35] Neither did the court consider the SEC's disclaimer of the applicability of registration requirements to be controlling.[36] Rather, the court looked to case law[37] and foreign relations policy[38] in determining subject matter jurisdiction. The court analyzed, one at a time, the jurisdictional bases relied upon by the lower court.[39] Considering first the defendants' activities within the United States, the court noted its holding in *IIT v. Vencap, Ltd.*, that the United States was not to be a breeding ground for fraud.[40] The court nonetheless concluded that jurisdiction would not attach on the basis of activities that were merely preparatory and insignificant in the overall scheme.[41] The court next addressed the general adverse effects on the American securities market which

32. IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975)(decided the same day as *Bersch*).

33. Approximately 300 American investors, owning about .5% of IIT, were involved. *Id.* at 1016.

34. The court stated:

> We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.

Id. at 1017.

35. *See* notes 5, 6, 16 *supra* and accompanying text.

36. *See* note 17 *supra*.

37. The court noted, however, that the two major cases in the area, Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), and Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972), were not controlling.

38. *See* Investment Properties Int'l, Ltd. v. I.O.S., Ltd., [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011 (S.D.N.Y.), *aff'd mem.* (2d Cir. 1971).

39. *See* notes 1, 2, 7-9 *supra* and accompanying text.

40. 519 F.2d 1001, 1017 (2d Cir. 1975).

41. *See* note 7 *supra*.

flowed from the alleged fraud.[42] The court acknowledged the precedent of *Strassheim v. Daily*,[43] but reasoned that the only adverse effects sufficient to invoke subject matter jurisdiction were losses to American purchasers of securities—purchasers in whom the United States has an interest—not mere adverse effects to the general economic interests of this country. Thus the court distinguished, on the basis of nationality and residence, three groups of purchasers in the instant class.[44] Addressing the sales of foreign securities to Americans resident in the United States, the court found subject matter jurisdiction solely on the basis of the adverse effects to those investors.[45] Secondly, construing the sales to Americans resident abroad, the court stated that mere participation by such Americans will not of itself invoke subject matter jurisdiction. When such sales were viewed in conjunction with the preparatory acts occurring in this country,[46] however, the court held the United States' interest sufficient to justify application of the securities laws. Finally, as to the foreigners purchasing outside the United States, the court held that mere preparatory acts within its boundaries did not give the United States a sufficient interest to subject such sales to its securities laws. Subject matter jurisdiction would arise in this last situation only when acts performed in the United States directly caused the alleged fraud.

IV. COMMENT

Articulating a definitive standard for extraterritorial application of the anti-fraud provisions of the American securities laws, the instant decision resolves much of the confusion incident to the transnational purchase and sale of securities. The Second Circuit establishes an inverse relation between the purchaser's nexus with the United States and the extent of activity occurring within this country—the two traditional bases of subject matter jurisdiction—and forges new law at both ends of the spectrum. Essentially, the court recognizes that, the greater the purchaser's nexus with the United States, the lesser the activity within the United States that must be shown to invoke subject matter jurisdiction. Conversely, as the purchaser's nexus with this country weakens, the extent of activity within the United States must be considerably greater to

42. *See* note 9 *supra*.
43. 221 U.S. 280 (1911).
44. *See* note 1 *supra*.
45. The losses sustained from the purchase of the I.O.S. securities were the adverse effects recognized by the court.
46. *See* note 7 *supra*.

bring the action within the United States' securities laws.

Decided the same day as *IIT v. Vencap, Ltd.*,[47] the instant decision is of major import first for its limiting effect on the application of the securities acts to substantially foreign investors. *IIT* involved a blatantly fraudulent scheme perpetrated from the United States and, to discourage such activities, the court felt compelled to allow foreign purchasers relief under the provisions of the American securities laws. Yet, basing jurisdiction on domestic activities alone, the Second Circuit feared establishing too liberal a precedent for foreign access to the securities acts. Thus *Bersch* presents the vehicle to limit unequivocally foreign access to situations in which the fraud actually emanates from the United States. Further, from a policy standpoint, declining subject matter jurisdiction when contacts with the United States are minimal appears to be a sound decision. Extraterritorial application of the securities laws raises serious questions of the binding effect of American judgments on foreign parties,[48] and portends an adverse effect on already crowded federal dockets.[49] As *Bersch* suggests, extraterritorial application of the securities laws to transactions between foreign parties should be but an extreme alternative.

Yet of potentially greater significance is the effect of the *Bersch* decision on American purchasers of foreign securities. Citing injury to American investors as the only type of consequence in the United States that will justify subject matter jurisdiction, the *Bersch* court expressly defines what *Schoenbaum*[50] and *Leasco*[51] only hinted at in their "domestic exchange listing" and "real party affected" requirements. Unlike *Schoenbaum* and *Leasco*, in which the standard of subject matter jurisdiction was inescapably tied to the factual setting involved, the *Bersch* decision speaks in terms beyond the instant facts and establishes a rule of broad application. Moreover, when resident American investors are involved, the *Bersch* court seems to go well beyond the bounds of prior decisions. *Leasco*, although recognizing a substantial detrimental effect to American shareholders of the corporation involved, expressly required signifi-

47. 519 F.2d 1001 (2d Cir. 1975); *see* notes 32-34 *supra* and accompanying text.

48. The record before the court contained uncontradicted affidavits that England, the Federal Republic of Germany, Switzerland, Italy, and France would not recognize an American judgment in favor of the defendant as a bar to an action by their own citizens, even assuming that the citizens had in fact received notice that they would be bound unless they affirmatively opted out of the plaintiff class.

49. Indeed, a class action may stand on special ground because of, as Judge Friendly notes in *IIT*, "the likelihood that a very small tail may be wagging an elephant." IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 n.31 (2d Cir. 1975).

50. 405 F.2d 200 (2d Cir. 1968); *see* text accompanying notes 26 and 27 *supra*.

51. 468 F.2d 1326 (2d Cir. 1972); *see also* notes 28 and 29 *supra* and accompanying text.

cant conduct within the United States to justify subject matter jurisdiction.[52] Even *Travis*, which liberalized the measure of domestic conduct necessary to support jurisdiction, was loath to disregard the requirement entirely.[53] Nevertheless, construing similiar adverse effects on resident American investors, the court in *Bersch* holds that such adverse consequences alone are sufficient to support jurisdiction. The court's conclusion appears reasonable when one considers that the primary purpose of the securities acts was to protect the domestic investor,[54] but the precedential value of *Bersch* is unclear. Courts generally have proved reluctant to extend jurisdiction beyond its fundamentally territorial nature,[55] and with regard to this one aspect—sales to resident American investors—the *Bersch* decision appears to go further than necessary. Indeed, a critical examination of the facts could discern activities within the United States with respect to all three offerings[56] and, although Judge Friendly's new standard is clear, the question remains whether future courts will follow an overly broad, even though explicit, holding. Nevertheless, balancing the intent of the securities acts with the delicate nature of foreign relations policy, the result in *Bersch* appears sound. And, although it does not completely resolve the vagueness in the area,[57] the Second Circuit's definitive statement of the law in each of three major classes of foreign securities transactions is a commendable effort.

RICHARD MICHAEL PITT

52. 468 F.2d 1326 (2d Cir. 1972).

53. 474 F.2d 515 (8th Cir. 1973); *see* text accompanying note 30 *supra*.

54. *See* note 23 *supra*.

55. *See* note 22 *supra*.

56. *See* notes 7, 11 *supra*.

57. The *Bersch* court avoids addressing the applicability of the section 30(b) foreign seller exclusion, raised by one defendant, dismissing the complaint against that defendant for lack of *in personam* jurisdiction. Such avoidance is unfortunate, however, in light of the fact that the lower court rejected the section 30(b) defense, citing *Schoenbaum* for the proposition that "without the *jurisdiction* of the United States" does not refer to territorial boundaries—rather to the sphere of American interests. *See* note 20 *supra*. *Schoenbaum* does not appear to espouse such a view and, if section 30(b) is not a dead letter, it is odd that *Bersch* declines the opportunity to establish the proper scope of the exclusion.