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RECENT CASES

Bankruptcy—Transfers—Drawee Bank Not Liable for Payment of Depositor's Check After His Voluntary Petition in Bankruptcy Where Notice Is Not Given to Bank

After its depositor had filed a voluntary petition in bankruptcy, but before it had received notice of the bankruptcy, defendant bank paid five checks which had been drawn by the depositor before the filing of the petition. The trustee in bankruptcy applied to the referee[1] for a turnover order[2] requiring the bank to pay to the trustee the amount of the checks, and in the alternative asking the same relief from the payee of the checks. The trustee alleged that since a voluntary petition is tantamount to an automatic adjudication,[3] the payment of the checks constituted a transfer in behalf of the bankrupt after the date of bankruptcy in violation of section 70(d)(5) of the Bankruptcy Act.[4] The referee's determination that the bank and the payee were jointly liable to the trustee was affirmed by the district court and the court of appeals.[5] On appeal to the Supreme Court of the United States, *held,* reversed. Where a bank has neither knowledge nor notice of bankruptcy proceedings, the bank is not liable under section 70(d)(5) of the Bankruptcy Act for the amount of

1. Referees are officers of the court, appointed by judges of the bankruptcy court. The determinations of the referee are subject to review by the judge, but absent obvious abuse the referee's decisions are usually allowed to stand. After his appointment, the referee calls a meeting of the creditors of the bankrupt at which a trustee is elected, or—if the creditors fail to elect a trustee—appointed by the referee. The trustee's duties are to "collect and reduce to money the property of the estates for which [he is trustee], under the direction of the court, and close up the estates as expeditiously as is compatible with the best interest of the parties in interest." 11 U.S.C. § 75(a)(1) (1964). *See generally,* 8 W. COLLIER, BANKRUPTCY, ¶ 5.01-04 (14th ed. 1966) (hereinafter cited as COLLIER).

2. A turnover order in this situation is reimbursement. If the transfer were to be held invalid, the bank would owe the trustee the amount of the checks, as title to the money vested in the trustee when the petition was filed. 11 U.S.C. § 110(a) (1964). The power to reclaim a bankrupt's assets which have been invalidly transferred is granted under 11 U.S.C. § 110(e)(1),(2) (1964). A turnover order may apply to any type of property in the bankrupt's estate and will require the property to be turned over to the trustee. 2 COLLIER, ¶ 23.10.

3. The filing of a voluntary petition operates as automatic adjudication of bankruptcy. *See* 11 U.S.C. § 41(f) (1964).

4. 11 U.S.C. § 110(d)(5) (1964). The section provides that "[except for certain real property transactions dealt with in another section of the act and the provisions of this section] no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee."

5. Bank of Marin v. England, 352 F.2d 186 (9th Cir. 1965). *See* 52 VA. L. REV. 528 (1966); 65 MICH. L. REV. 195 (1966).

a bankrupt depositor's funds transferred after the filing of a voluntary petition in bankruptcy. *Bank of Marin v. England*, 385 U.S. 99 (1966).

The Bankruptcy Act[6] was enacted to provide for the prompt and equitable[7] distribution of the assets of a bankrupt's estate. Originally the Act vested title to all the bankrupt's property in the trustee in bankruptcy[8] at the time of adjudication;[9] however, to prevent depletion of the estate in the period between the filing of the petition and adjudication the courts held that the title of the trustee related back to the time the petition was filed.[10] This interpretation resulted in inequities to persons who dealt with the bankrupt prior to adjudication without notice of the filing of the petition and led to inconsistent decisions by the courts.[11] Provisions in the Chandler Act of 1938[12] remedied these inconsistencies. While section 70(a) of the Act[13] adopts the relation-back doctrine and provides that title vests in the trustee upon the filing of the petition, section 70(d) protects certain enumerated transfers[14] of property by parties acting in good faith[15] between filing and adjudication. However, with the exception of

6. 11 U.S.C. § 1 (1964). The Constitution provides: "Congress shall have power to establish . . . uniform laws on the subject of bankruptcies throughout the United States." U.S. CONST. art. I, § 8. For a thorough discussion of the history of the Bankruptcy Act, see H. REMINGTON, BANKRUPTCY, §§ 1-15 (5th ed. 1950).

7. Equitable powers are conferred on the bankruptcy court by statute. These powers will govern where the Bankruptcy Act is silent, but are to be exercised within the limits laid down by the act. 11 U.S.C. § 11(a) (1964). *See* SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940); Pepper v. Litton, 308 U.S. 295 (1939). Examples of the use of the equitable powers include: Local Loan Co. v. Hunt, 292 U.S. 234 (1934) (creditors enjoined from prosecuting claims in state court); Dearborn Elec. Light & Power Co. v. Jones, 299 F. 432 (1924) (execution of deed compelled); Cross v. Georgia Iron & Coal Co., 250 F. 438 (1918) (bankrupt's estate protected from fraudulent assessment). *See also* 1 COLLIER ¶ 2.09 at 171.

8. 11 U.S.C. § 110(a) (1964).

9. The Bankruptcy Act, ch. 541, § 70(a), 30 Stat. 565 (1898).

10. 4 COLLIER ¶ 70.66; 65 MICH. L. REV. 195, 198 (1966).

11. Cunningham v. Merchants' Nat'l Bank, 4 F.2d 25 (1st Cir. 1925); Citizens' Union Nat'l Bank v. Johnson, 286 F. 527 (6th Cir. 1923); *In re* Zotti, 186 F. 84 (2d Cir. 1911).

12. 52 Stat. 881 (1938). This act was a general revision of the original Bankruptcy Act of 1898.

13. 11 U.S.C. § 110(a) (1964).

14. Persons transfering property of the bankrupt for a "present fair equivalent value" after filing and either before adjudication or before a receiver takes possession of the property of the bankrupt are protected. 11 U.S.C. § 110(d)(1) (1964). Those holding property of the bankrupt or indebted to the bankrupt are protected if they pay such indebtedness or transfer the property in good faith to the bankrupt or to his order. 11 U.S.C. § 110(d) (1964).

15. 11 U.S.C. § 110(d)(3) (1964). This clause states that one will not be deemed to act in good faith if he has actual knowledge of the pending bankruptcy, unless "he has reasonable cause to believe that the petition in bankruptcy is not well founded." As is pointed out in 4 COLLIER ¶ 70.68, at 1508: "This provision clearly takes away the protection of § 70(d) from those who know of the bankruptcy petition, and except possibly as to the relief granted the rare individual who can prove his 'reasonable cause to believe that the petition in bankruptcy is not well founded,' the statutory requirement does not differ essentially from the case law prior to 1938."

certain real property transactions,[16] transfers of property *after* adjudication are not protected.[17] Thus, since section 70(d) applies only to transfers after filing and before adjudication, it affords no protection for innocent parties dealing with the property of a bankrupt who has filed a voluntary petition, as the filing of such a petition operates as automatic adjudication.[18] After adjudication, all persons are considered to have knowledge of the proceeding, since adjudication is said to be notice to the world to refrain from dealing with the bankrupt's estate.[19] However, many debtors, such as banks and other holders of the bankrupt's assets, will generally receive *actual* notice of the proceeds after adjudication through the trustee's efforts to gather the assets of the bankrupt. Thus, whether an innocent bank or other party in interest will avoid an apparently invalid transfer after the filing of a voluntary petition will ultimately depend on the diligence of the trustee.[20] Since creditors are a major concern of the Bankruptcy Act, mandatory notice requirements are provided for them on such occasions as the first meeting of creditors after adjudication and the sale of the bankrupt's property.[21] However, there has been no case in which the trustee has been denied recovery of property transferred after adjudication because of his failure to give timely notice to a debtor or other holder of the bankrupt's assets.[22] In *Mullane v. Central Hanover Bank & Trust Co.*,[23] the Supreme Court held that due process requires that in order to bind *any* person who has a substantial property interest in a proceeding an effort must be made to give him reasonable notice. The Court further stated that reasonable notice may have to be personal notice, regardless of the form of the proceedings.[24] The Supreme Court has

16. *See* 11 U.S.C. § 44(g) (1964).

17. Section 70(d) of the Bankruptcy Act excludes transactions after adjudication or after the appointment of a receiver. In Lake v. New York Life Ins. Co., 218 F.2d 394 (4th Cir. 1955) the insurance company was forced to pay to the trustee the cash surrender value of policies which the insurance company held as security for loans made in good faith to the bankrupt after the receiver had taken possession of the bankrupt's property. The court held the loans were not a protected transaction under 70(d).

18. "The filing of a voluntary petition . . . shall operate as an adjudication with the same force and effect as a decree of adjudication." 11 U.S.C. § 41(f) (1964). This was an amendment passed in 1959. Prior to that time, transfers after adjudication had been held invalid where the filing of the voluntary petition and adjudication took place on the same day. *See* Ripp v. Fleming, 242 F.2d 849 (7th Cir. 1957).

19. 4 COLLIER ¶ 70.68, at 1505.

20. In the instant case, the trustee waited six days before notifying the bank.

21. 11 U.S.C. § 94 (1964).

22. 65 MICH. L. REV. 195, 197 (1966).

23. 339 U.S. 306 (1950). The case involved notice to non-resident beneficiaries of a settlement of a trust set up under the New York Banking Law.

24. Since bankruptcy proeeedings are considered actions in rem, it had been generally held that personal notice might not be necessary. *See* Hanover Nat'l Bank v. Moyses,

not previously decided whether the due process requirements of reasonable notice must be met for debtors and other holders of assets after the filing of a voluntary petition. However, in *Rosenthal v. Guaranty Bank & Trust Co.*,[25] a federal district court relieved an innocent bank of liability to the trustee for the post-adjudication payment of a bankrupt depositor's check, relying upon a policy favoring negotiability and upon the lack of actual knowledge of the proceedings on the part of the bank.

In the instant case, the Court initially noted that the trustee was subject to the same claims and defenses which could be asserted against the bankrupt. The Court further noted that the duty to pay the checks, which arose from the contract between the bank and the depositor, constituted a valid defense against the trustee unless the bank had received notice of the bankruptcy proceedings prior to the payment. Relying on *Mullane*, the Court held that the filing of a voluntary petition was insufficient notice to the bank,[26] and that thus the contract between the bank and the drawer remained in effect. In answering the trustee's contention that the transfer of the funds was invalid under section 70(d)(5) of the Bankruptcy Act, the Court applied the "overriding consideration" of equitable principles governing the exercise of bankruptcy jurisdiction to hold that it would be inequitable to impose liability on the bank. The Court did not hold that the bank's payment of the checks was proper under section 70(d)(5) but rather that equity demanded that the trustee recover from the party who benefited from the transaction, *i.e.*, the payee of the check. In a dissenting opinion, Mr. Justice Harlan, although noting the obvious inequities to the bank, urged that the plain terms of the statute rendered the bank liable. He contended that any protection afforded by section 70(d) was intended for cases involving involuntary, not voluntary petitions, since one of the main purposes of the section was to encourage business dealings with a solvent debtor against whom an unwarranted petition may have been filed.[27]

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186 U.S. 181, 192 (1902) where the Court stated that creditors are entitled to reasonable notice, and held publication to be reasonable in that case.

25. 139 F. Supp. 730 (W.D. La. 1956). The checks were cashed after the approval of a petition for reorganization under Chapter 10 of the Bankruptcy Act. 11 U.S.C. §§ 501-676 (1964). Approval, which is also an automatic adjudication of bankruptcy, occurred the same day the petition was filed. The court's decision is criticized in 70 HARV. L. REV. 548 (1957).

26. The bank obviously has a substantial interest in the proceedings. Without notice it may have to pay the check twice—once to the payee and once to the trustee.

27. He stated that if Congress had intended to protect those who transferred property after the filing of a voluntary petition, the statute would have so provided. Mr. Justice Harlan concluded that the Court, in not holding the bank liable, was simply "measuring the statute by . . . its own conscience" and diluting the effects of the 1938 amendments to the Bankruptcy Act. 385 U.S. at 110. Mr. Justice Fortas

While the instant Court relied partly on equitable considerations in holding the bank not liable, the impact of the decision on future bankruptcy cases will undoubtedly come from its application of the constitutional doctrine of *Mullane*. There appears to be little doubt that the transfer by the bank was invalid within the literal meaning of section 70(d)(5) of the Bankruptcy Act. Moreover, to relieve the bank of liability would seem contrary to a basic policy of the act of allowing the trustee to control all property after adjudication for equitable distribution to creditors. However, there are other policy considerations which properly prevailed in this situation. The risk of double liability to the bank as a debtor of the bankrupt gives the bank a substantive interest in the proceedings, which entitles it to reasonable notice.[28] To consider the automatic adjudication notice to the world and thus hold the bank liable would seem contrary to other provisions of the Act which have tended to limit the effect of this legal fiction.[29] The *Mullane* case was concerned with preventing the use of patent legal fictions to deprive a person of substantial property interest without notice and opportunity to be heard. The application of its doctrine to the instant case is appropriate. The Court's decision has thus substantially increased the duties of the trustee with regard to notifying interested parties of the adjudication of bankruptcy. This will be particularly helpful to banks, whose rapid transactions in commercial paper warrant some type of notice before liability can be imposed, and the application of *Mullane* to this situation will undoubtedly make the officers of the bankruptcy court more conscious of notice requirements in all steps of the bankruptcy proceedings.

dissented on the point of mootness raised in the oral argument. The payee of the checks paid the joint judgment and only the bank appealed. The majority held that because the payee had filed a demand for contribution from the bank, the question was not moot, as the bank was still subject to suit as a result of the original judgment. Mr. Justice Fortas argued that because the trustee had already been paid, he lacked a substantial stake in the outcome of the litigation, and that the appeal therefore did not present an adversary proceeding.

28. With regard to the invalidity of the transfer, the question should be who, as between the trustee and the payee of the check, should be entitled to the funds which were on deposit in the bank. As stated by the majority, the payee is a creditor of the bankrupt, and allowing the trustee to recover from him does not deprive him of the right to participate in the distribution of the bankrupt's assets.

29. 52 VA. L. REV., *supra* note 5, at 536 n.29. The provision with regard to the transferability of real property after adjudication before such fact is recorded is in keeping with the protection afforded bona fide purchasers by the recording acts, and is contrary to the idea of constructive notice. 11 U.S.C. § 44(g) (1964). Furthermore, personal property can be transferred between filing and adjudication by those acting in good faith and for "present fair equivalent value." Also, a debtor of the bankrupt can discharge a debt in good faith prior to adjudication. 11 U.S.C. § 110(d) (1964). While all of these provisions are concerned with transfers before adjudication in the case of an involuntary petition, the policy underlying them appears to be applicable to a transfer after adjudication and before reasonable notice when filing and adjudication occur simultaneously.

Constitutional Law–States Must Apply Federal Harmless-Error Standard to Federal Constitutional Error

During the California state court proceeding in which defendants were tried and convicted, the prosecutor commented upon the defendants' failure to testify and the trial judge charged the jury that defendants' silence could be used as the basis for adverse inferences.[1] On appeal[2] the California Supreme Court held that, although these comments at trial had denied defendants their constitutional rights, such error did not constitute a "miscarriage of justice" and was therefore harmless and not cause for reversal.[3] On certiorari[4] to the United States Supreme Court, *held*, reversed. Whether a conviction for crime should be sustained when a state has failed to accord federal constitutional rights is a federal question, and before such error can be held harmless, the beneficiary of the error must prove beyond a reasonable doubt that it did not contribute to the verdict obtained. *Chapman v. California*, 386 U.S. 18 (1967).

It is firmly established[5] that the Supreme Court has appellate jurisdiction to review state court decisions only when the state court has decided a federal question which is necessary to the judgment rendered. If an independent and adequate state ground is dispositive of the judgment, the Court has no power to review further. Nevertheless, a recent case, *Henry v. Mississippi*,[6] illustrates the importance of distinguishing between state substantive and procedural grounds of decision. There the Mississippi Supreme Court held that petitioner had waived his right to assert a claim of violation of his federal

1. The charge instructed the jury that in those matters within the knowledge of the defendant on which he is silent the inferences unfavorable to a defendant are the more probable. People v. Teale, 63 Cal. 2d 178, 196, 404 P.2d 209, 220, 45 Cal. Rptr. 729, 740 (1965).

2. Subsequent to the instant trial but before defendants' appeal to the California Supreme Court, the United States Supreme Court, in a separate case, held this state provision (CAL. CONST. art. I, § 13, which allowed comment upon an accused's failure to testify) to be unconstitutional on the ground that it violated a person's fifth amendment right against self-incrimination. Griffin v. California, 380 U.S. 609 (1965).

3. "No judgment shall be set aside, or new trial granted, in any case . . . unless, after an examination of the entire cause, including the evidence, the court shall be of the opinion that the error complained of has resulted in a miscarriage of justice." CAL. CONST. art. VI § 4½.

4. The Court granted certiorari limited to these questions: "Where there is a violation of the rule of Griffin v. California . . . (1) can the error be held to be harmless and (2) if so, was the error harmless in this case?" Chapman v. California, 383 U.S. 956, 956-57 (1966).

5. *See* 28 U.S.C. § 1257 (1967) (sets forth the criteria under which the Supreme Court has appellate review of state court decisions); Murdock v. City of Memphis, 87 U.S. (20 Wall.) 590 (1874) (Act of 1867 does not enlarge Court's federal question jurisdiction as set forth in Judiciary Act of 1789).

6. 379 U.S. 443 (1965).

constitutional rights by failing to adhere to the local trial procedure of objecting contemporaneously to the introduction of illegal evidence. On certiorari, the Supreme Court cited *Murdock* and recognized that it had no power to revise judgments based on questions of state substantive law which are constitutionally valid. The Court reasoned that in such cases the state ground of disposition is to be deemed "adequate" and any federal question present in the record becomes moot, since a resolution of the federal question would not be necessary to the decision. A decision by the Court on the federal question would be, in effect, an advisory opinion, which the Court lacks jurisdiction to render. However, if a state procedural rule should bar implementation of a federal right, then "the question of when and how defaults in compliance with state procedural rules can preclude . . . consideration of a federal question is itself a federal question."[7] After finding this federal question jurisdiction the Court then determines whether enforcement of the local procedural rule serves a legitimate state interest, and if it does not the rule is deemed an "inadequate" state ground and cannot bar review. Exhibiting restraint in applying the "adequacy" test to state procedure, the Court in *Spencer v. Texas*[8] determined that the admission into evidence of a defendant's prior convictions was a legitimate means of enforcing a state habitual offender statute.[9] Moreover, the Court held that the possibility of some prejudice to the accused did not render the procedure unconstitutional.[10] Harmless-error statutes,[11] which enable a court to sustain a

7. *Id.* at 447; *see* Herb v. Pitcairn, 324 U.S. 117, 125-26 (1945). *See generally* R. ROBERTSON & F. KIRKHAM, JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES 89, 163 (2d ed. R. Wolfson & P. Kurland 1951); *Federal Judicial Power—A Study of Limitations*, 2 RACE REL. L. REP. 1215, 1222-28 (1957) (discusses doctrine of equitable abstention).

8. 385 U.S. 554 (1967).

9. The majority argued that neither precedent nor specific provisions of the Constitution establish the Court as a "rule-making organ for the promulgation of state rules of criminal procedure." *Id.* at 564. Four dissenting justices found no legitimate state interest to balance against the possible prejudicing of the accused. They countered with the view that the criteria for decision in procedural due process cases need not be drawn from a specific constitutional provision. Rather, they can be drawn from the "traditional jurisprudential attitudes of our legal system." *Id.* at 570. The majority cited Mr. Justice Cardozo to support its conclusion: a state rule of law "does not run foul of the Fourteenth Amendment because another method may seem to our thinking to be fairer or wiser or to give a surer promise of protection to the prisoner at bar." Snyder v. Massachusetts, 291 U.S. 97, 105 (1934).

10. The Court has consistently followed a policy of ensuring, when possible, adequate opportunity for federal judicial review of constitutional rights. In Fay v. Noia, 372 U.S. 391 (1963), the Court held that the adequate state ground rule does not apply to federal habeas corpus jurisdiction, since the rule is a function of the limitations on appellate review. Thus, a federal court has the power to grant habeas corpus relief to a petitioner whose federal claims are barred from review in the Supreme Court "because of a procedural default furnishing an adequate and independent ground of state decision." *Id.* at 434.

11. These statutes represent legislative and judicial reaction to the stringent rule

judgment in the face of admitted trial error, have long been in widespread use in state[12] and federal[13] courts. The majority of these statutes contain broad standards of harmlessness, which emphasize a "miscarriage of justice" and "the substantial rights of the parties."[14] Generally these statutes also place the burden of proof of "harmfulness" on the excepting party, requiring him to show how the error has prejudicially affected the result of his case.[15] In *Fahy v. Connecticut*[16] the Supreme Court reversed a state court decision which had held that the admission of unconstitutionally-obtained evidence was harmless error.[17] Applying its own standard of harmlessness, the Court held that the admission of the evidence was prejudicial and harmful since there was a "reasonable possibility that the evidence complained of might have contributed to the conviction."[18] The Court refused, however, to go beyond the facts of the case and establish a federal standard of harmlessness for state courts to use when reviewing denials of federal constitutional guarantees.[19]

In the instant case, the Court reasoned that the issue of whether a state conviction should be sustained in the face of an admitted failure to accord federal constitutional rights was a federal question. Noting the usefulness of harmless-error statutes, the Court concluded that there might indeed be harmless constitutional error in the setting of a particular case, and thus refused to sustain petitioners' contention that all federal constitutional errors are grounds for automatic reversal.[20] The Court then proceeded to define the standard to be

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at early common law that technical errors alone required automatic reversal of a conviction. "The general object [of the statutes] was simple: To substitute judgment for automatic application of rules. . . ." Kotteakos v. United States, 328 U.S. 750, 759-60 (1946).

12. *See* 1 J. WIGMORE, EVIDENCE § 21 (3d ed. 1940).

13. 28 U.S.C. § 2111 (1964) provides: "On the hearing of any appeal or writ of certiorari in any case, the court shall give judgment . . . without regard to errors or defects which do not affect the substantial rights of the parties." FED. R. CRIM. P. 52(a) provides: "Any error, defect, irregularity or variance which does not affect substantial rights should be disregarded." *See also* FED. R. CIV. P. 61.

14. *See* 1 J. WIGMORE, *supra* note 12.

15. *Id.* at 373 n.12.

16. 375 U.S. 85 (1963).

17. The state court had utilized a state statutory harmless-error provision and had found that the error had not materially injured the appellant. Fahy v. Connecticut, 149 Conn. 577, 183 A.2d 256 (1962).

18. 375 U.S. 85, 86-87 (1963).

19. Four justices, dissenting, argued that the only question which merited the Court's consideration was whether the fourteenth amendment prevented a state from applying its own harmless-error rule in such a situation.

20. The Court recognized that certain of its own decisions had indicated that some constitutional rights are so fundamental to a fair trial that they could never qualify as harmless. 386 U.S. at 23; *see* Gideon v. Wainwright, 372 U.S. 335 (1963) (right to counsel); Payne v. Arkansas, 356 U.S. 560 (1958) (coerced confession); Tumey v. Ohio, 273 U.S. 510 (1927) (impartial judge).

applied by the states[21] in determining the "harmlessness" of federal constitutional error and held that the beneficiary of the error must "prove beyond a reasonable doubt that the error complained of did not contribute to the verdict obtained."[22] In conclusion, the Court held that because of the prosecutor's repeated references to petitioners' failure to testify the state could not possibly meet its burden of proof under the standard, and accordingly reversed the convictions.[23] Mr. Justice Stewart, concurring, contended that the Court had consistently rejected the notion that a harmless-error rule could be applied to constitutional violations. However, he stated that although judicial economy may conceivably require such a rule to be utilized in cases involving appropriate violations, the rule certainly should not be applied indiscriminately to all constitutional violations. But, he concluded that automatic reversal was appropriate in the instant case, since the Court is not equipped to assume the burdensome task of reviewing individual cases which contain such unconstitutional comment to determine whether it contributed to the verdict obtained. In the dissent Mr. Justice Harlan argued that the federal question should be the constitutionality of the state harmless-error rule itself. He concluded that a state rule, if constitutional, would constitute an independent and adequate state ground of judgment and therefore bar further federal review.[24] Individual case applications of constitutional state rules would still be subject to review by the Court on an ad hoc basis to determine "adequacy."

The instant Court has established a standard of harmless error for state courts to apply to all violations of federal constitutional guarantees. However, the question might well be asked whether such a standard is necessary. Certainly nothing in the nature of the federal system would justify a presumption that the states will use their judicial offices in derogation of federal rights. Yet the Court has assumed the burden of supervising the state disposition of such rights. The Court reasons that it "cannot leave to the States the formulation of the authoritative laws, rules, and remedies designed to protect people from infractions by the States of federally guaranteed rights."[25] However, it is questionable whether precedent or statutes defining the

21. State courts are still free to utilize state harmless-error rules where the error concerns only application of state procedure or state law. 386 U.S. at 21.

22. 386 U.S. at 24.

23. "Such a machine-gun repetition of a denial of constitutional rights, all designed and calculated to make petitioners' version of the evidence worthless, can no more be considered harmless than the introduction against a defendant of a coerced confession." 386 U.S. at 26. The Court appended to the opinion the petitioners' compilation of the prosecutor's comments.

24. "The Court has no power, however, to declare which of many admittedly constitutional alternatives a State may choose." 386 U.S. at 48.

25. 386 U.S. at 21.

Court's power of appellate review can justify the Court's adoption of a harmless-error rule to be applied to all violations of federal constitutional guarantees. The instant Court, contrary to its approach in *Henry,* did not first seek an adequate state ground of decision by utilizing the basic distinction between state procedural and substantive grounds. As the dissent implied, the distinction should have been made, since in this distinction lies the jurisdictional basis for Supreme Court review of state court adjudications of federal constitutional issues. Had it made the distinction before applying its own standard of "harmlessness," the Court could have legitimately disposed of the California rule by declaring it either unconstitutional or, if constitutional, "inadequate" as a non-federal ground of decision. But having sidestepped the distinction, the Court merely concluded that the state's application of a local harmless-error rule to a federal constitutional error was itself a federal question which demanded formulation and future application of a national standard. The dissent's reasoning would seem to be the better approach. Since there was no evidence here that California, or any other state, had defeated or diluted the application of federal constitutional guarantees through the use of local harmless-error rules, it would seem to have been unnecessary for the Court to fashion a new standard to impose on all state proceedings. Had the Court allowed the state courts to continue applying local standards to federal constitutional rights, it would still have retained the power to determine the constitutionality of a state rule and then assess its "adequacy" as an independent state ground of decision. However, now that the states must apply the federal standard in such situations, the Court has insured further uniformity in the adjudication of federally-guaranteed rights.

Juvenile Courts—Juveniles in Delinquency Proceedings Accorded Same Rights as Adults in Criminal Trials

Petitioner Gault, a minor of fifteen, was placed in the custody of a detention home[1] after being apprehended for allegedly having made a lewd telephone call. Gault's parents were not given formal notice of their son's apprehension or of the informal delinquency hearing

1. At the time of his apprehension, Gault was on probation following a prior juvenile court proceeding. *In re* Gault, 387 U.S. 1 (1967).

which was to be held the following day.[2] During this hearing[3] petitioner made an inculpatory statement. At neither this hearing nor the formal hearing held a few days later were the complainant or defense counsel present.[4] At the conclusion of the formal hearing, Gault was adjudged "delinquent" and committed to the State Industrial School for the remainder of his minority.[5] Since the state provided no appeal from a juvenile court proceeding, Gault petitioned for a writ of habeas corpus, claiming that sections 8-201 through 8-239 of the Arizona Juvenile Code were unconstitutional because they allowed the use of unsworn testimony, failed to provide for proper notice of the hearing and charges to the child and parents, and did not accord the child the rights to counsel, confrontation, and silence.[6] The lower court dismissed the petition, and the Arizona Supreme Court affirmed on the ground that a lesser standard of due process was demanded for delinquency proceedings than for adult criminal trials.[7] On appeal to the United States Supreme Court, *held*, reversed. The due process clause of the fourteenth amendment requires that notice of hearing and charges, the right of confrontation, the right to counsel and the privilege against self-incrimination be provided in juvenile court proceedings in which a juvenile is threatened with a deprivation of his liberty resulting from a determination of delinquency. *In re Gault*, 387 U.S. 1 (1967).

Delinquency[8] proceedings are considered civil rather than criminal

2. The Gaults learned of their son's arrest through neighbors. In addition, they received only informal notice of the two hearings. *Id.*

3. The detention officer filed a petition with the juvenile court on the date of this hearing which the Gaults never saw, and which gave no grounds for detention other than that the petitioner was a juvenile in need of custody as a delinquent. *Id.* at 5.

4. Although Mrs. Gault requested that the complainant come forward, the judge stated that this was unnecessary. *Id.* at 7.

5. Under ARIZ. REV. STAT. § 8-201 (6)(a),(b) a "delinquent child" is one "who has violated a law of the state or an ordinance or regulation of a political subdivision thereof" or who is "incorrigible." Petitioner's delinquent conduct consisted of a violation of ARIZ. REV. STAT. § 13-377 which provides that a person who "in the presence or hearing of any woman or child . . . uses vulgar, abusive or obscene language, is guilty of a misdemeanor." The adult penalty for this offense is a fine of $5 to $50 or not more than two months imprisonment in the county jail; had Gault been 18, he would have been subject to the adult penalty.

6. Gault also challenged the statute's failure to require a written record of the hearing and to provide for appellate review, but the Supreme Court did not rule on these issues.

7. *In re* Gault, 99 Ariz. 181, 407 P.2d 760 (1965).

8. The definitional aspect of the word "delinquent" under statutes similar to Arizona's has led to divergent interpretations. For example, in State v. Breon, 244 Iowa 49, 55 N.W.2d 565 (1952), the Iowa Supreme Court held that a youth who had attempted a rape was not delinquent, for to be so classified, one must habitually violate the law. On the other hand, in New York, a minor arrested for driving without a license was adjudged delinquent for breaking a state law. *In re* Jacobsen, 283 App. Div. 719, 127 N.Y.S.2d 356 (1954).

in nature. In such cases, the state acts as *parens patriae*,[9] not to determine the guilt or innocence of the juvenile,[10] but rather "what had best be done in his interest and in the interest of the state to save him from a downward career."[11] This philosophy has created an informal courtroom atmosphere in which the restrictive elements of a criminal trial are not present. The denial of the procedural rights accorded to adults has been defended on several grounds. First, a juvenile is not accused of a specific crime and is not placed on trial; therefore, the rights of an accused simply do not arise.[12] Secondly, since protection from the stigma of a criminal trial is sought,[13] a flexible system in which the judge can act to correct the child's condition is considered preferable to an adversary system which would result not only in punishment, but also in publication of the child's conduct. Finally, some authorities feel that formal proceedings which induce fear in the youth, are unsuitable for reform.[14] Strict adherence to the parens patriae doctrine, however, places the juvenile in a procedural limbo; if the court determines that he is "delinquent," he is subject to a confinement often comparable to or greater than the criminal penalties to which adults are subjected;[15] yet he is denied the defenses available to an adult. Realizing this gap between theory and practice, several courts in recent years have attempted to bring the juvenile and criminal systems closer together through the application of certain constitutional safeguards to delinquency proceedings.[16] In *Haley v. Ohio*,[17] the United States Supreme Court held that merely

9. The classic case setting forth the parens patriae philosophy is Cinque v. Boyd, 99 Conn. 70, 121 A. 678 (1923).

10. The contrast between the parens patriae philosophy and the reality of juvenile court procedure is shown in Harris v. Souder, 233 Ind. 287, 289, 119 N.E.2d 8, 10 (1954) where a juvenile was found "guilty as charged" of "contributing to the delinquency of a minor," but the Indiana Supreme Court found no such juvenile offense.

11. Mack, *The Juvenile Court*, 23 HARV. L. REV. 104, 119-20 (1909).

12. *E.g.*, United States *ex rel.* Yonick v. Briggs, 266 F. 434 (W.D. Pa. 1920); *In re* Hans, 174 Neb. 612, 119 N.W.2d 72 (1963) (denial of trial by jury); *In re* Holmes, 379 Pa. 599, 109 A.2d 523, *cert. denied*, 348 U.S. 973 (1954) (denial of privilege against self-incrimination); State v. Christensen, 119 Utah 361, 227 P.2d 760 (1951) (no error to use unsworn testimony).

13. Those jurisdictions holding that proceedings in a juvenile court are not criminal prosecutions are listed in Pee v. United States, 274 F.2d 556, 561-62 (D.C. Cir. 1959).

14. Note, *Juvenile Delinquents: The Police, State Courts, and Individualized Justice*, 79 HARV. L. REV. 775, 791 (1966).

15. *See* note 5 *supra.*

16. *E.g.*, Trimble v. Stone, 187 F. Supp. 483 (D.D.C. 1960) (right to bail); *In re* Poff, 135 F. Supp. 224 (D.D.C. 1955) (right to counsel); *In re* Gregory W. and Gerald S., 19 N.Y.2d 55, 224 N.E.2d 102, 277 N.Y.S.2d 675 (1966) (privilege against self-incrimination); *In re* Mantell, 157 Neb. 900, 62 N.W.2d 308 (1954) (right of confrontation); Hampton v. State, 167 Ala. 73, 52 So. 659 (1910) (privilege against self-incrimination); Garza v. State, 172 Tex. Crim. 468, 369 S.W.2d 36 (1963) (freedom from double jeopardy).

17. 332 U.S. 596 (1948); *accord*, Gallegos v. Colorado, 370 U.S. 49 (1962).

informing a juvenile of his right to silence was not sufficient to meet the requirements of due process; he must also be fully apprised of his right to counsel. The Court reasoned that the age and inexperience of youths confronting police interrogators militated against their comprehension and exercise of the right to silence. One court has demanded that when juveniles are being interrogated, a stenographer be present at all times so that the "voluntariness" of their confessions be, if not assured, at least readily ascertainable on review.[18] Another court provided that the minor be charged with a specific act, not merely "delinquency" and that the truth of the charge be determined in an adversary proceeding.[19] The right to counsel at delinquency proceedings[20] and at preliminary hearings to decide whether jurisdiction will be waived by the juvenile court in favor of criminal court[21] has been extended. In a recent decision, *Kent v. United States*,[22] the Supreme Court interpreted the District of Columbia Juvenile Code to entitle a juvenile to a hearing on the question of waiver, access to any probation office files on the youth,[23] and a statement of reasons for the court's disposition of the case. Although the *Kent* decision was largely limited to its facts, the Court questioned "the justifiability of affording a juvenile less protection than is accorded to adults . . . particularly where . . . there is an absence of any indication that the denial of rights available to adults was offset, mitigated or explained by the action of the [g]overnment, as *parens patriae*."[24]

In the instant case the Court stated that written notice of the specific charges or factual allegations to be considered at the hearing must be given at the earliest possible time to the minor and his parents. Failure to give notice in an effort to shield the child from public knowledge of his conduct was denounced as a violation of due process. As in many juvenile cases, the initial hearing was on the merits and the child's freedom was at stake; notice was demanded so that his freedom could be defended. The Court found it necessary for the child and his parents to be informed of the right to counsel and, in the case of indigents, the right to appointed counsel. The Court noted that in Arizona the probation officer is the arresting officer who testifies against the youth, and therefore, in no sense

18. *In re* State *ex rel.* Carlo, 48 N.J. 224, 225 A.2d 110 (1966).
19. *In re* Coyle, 122 Ind. App. 217, 101 N.E.2d 192 (1951).
20. Shioutakon v. District of Columbia, 236 F.2d 666 (D.C. Cir. 1956).
21. Black v. United States, 355 F.2d 104 (D.C. Cir. 1965). A decision to waive jurisdiction is a determination that the youth in questiou will not benefit from the parens patriae system.
22. 383 U.S. 541 (1966), *noted in* 19 VAND. L. REV. 1385 (1966).
23. Such files are used by the judge at the hearing in considering the extent of corrective action necessary, *e.g.*, whether to place the child on probation or to commit him to an institution.
24. 383 U.S. at 551.

acts as his "defender" or fulfills the role of attorney in guiding the youth. Reasoning that it would be inequitable if hardened criminals could avail themselves of the privilege against self-incrimination but children could not, the Court held that the privilege is an essential requirement of due process in dealing with juveniles. Furthermore, the Court stated that the civil nature of the proceedings did not interfere with exercise of the privilege which may be claimed in any proceeding. The Court also refused to allow commitment of a juvenile as the result of a proceeding in which unsworn testimony was used and the right to confront witnesses was unavailable unless a valid confession[25] had been obtained. In stating these procedural rights, the Court looked to the failure of the parens patriae system in preventing recidivism,[26] the unreliability of confessions made by juveniles without the aid of counsel,[27] and the general inability of the adolescent to comprehend his rights and the consequences of his actions when confronted by the state in its role as parent. The Court concluded that if a child is to suffer deprivation of his liberty as a consequence of a court's analysis of his conduct, he must be provided with procedural tools with which to defend himself.

Struck by the paradox of a system which protects the rights of adults but not of children, the Court has attempted to preserve the flexibility of the juvenile court system while laying down certain safeguards which must be provided in delinquency proceedings in order to satisfy the requirements of due process. Many will no doubt view this decision as inevitable in light of the last decade of decisions extending the same rights to adults.[28] In this sense the instant decision is merely a downward chronological extension of established rights. However, the introduction of the adversary system into the framework of the juvenile court poses the question of whether the parens patriae framework will be engulfed by this new element.

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25. A valid confession would generally require the presence and assistance of counsel. If, for a permissible reason, counsel is not present, a valid confession would be one which has not been coerced, nor one which is the product of fright, despair, or "adolescent fantasy." 387 U.S. at 55.

26. The Court relied extensively on S. WHEELER & L. COTTRELL, JUVENILE DELINQUENCY—ITS PREVENTION AND CONTROL (1965) to indicate the distrust felt by juveniles who had been urged to confess and then punished by the state-parent. This often resulted in subsequent difficulties in rehabilitation.

27. In addition to the use made by the Court of the REPORT OF THE PRESIDENT'S COMMISSION ON LAW ENFORCEMENT AND THE ADMINISTRATION OF JUSTICE (1967) in its general assessment of the juvenile court system, the Court noted the Report's demand that counsel be appointed in all juvenile cases "without requiring any affirmative choice by child or parent." at 86-87.

28. *E.g.*, Cole v. Arkansas, 333 U.S. 196 (1948) (right to notice); Gideon v. Wainwright, 372 U.S. 335 (1963) (indigent's right to counsel); Malloy v. Hogan, 378 U.S. 1 (1964) (privilege against self-incrimination); Miranda v. Arizona, 384 U.S. 436 (1966) (right to counsel and to remain silent at critical stages of proceedings).

Criticism of the decision will come from those who fear that the beneficial aspects of the parens patriae philosophy will be lost and the child once again placed in the position he held at the turn of the century[29]—subject to the more brutal aspects of adult proceedings and punishment.[30] However, this criticism does not take into account the tremendous changes in adult criminal procedure which have taken place since the first separation of juvenile from adult proceedings. Nor does it consider that a determination of delinquency is often the same as conviction for a crime, under a more euphemistic name.[31] Finally, this criticism fails to realize that the instant decision was made with the interests of the child in mind. The *Gault* case shows an awareness of the gulf between the philosophy and the reality occasioned by the efforts of the state to provide for its children.[32] As stated in dicta in *Kent*: "[t]he admonition to function in a 'parental' relationship is not an invitation to procedural arbitrariness."[33] Just as a child is protected from an abusive parent by the law, the Court has placed restrictions on the treatment a child may receive at the hands of his "state-parent." Confronted with this demand to provide juveniles adult procedural safeguards if they are to be punished by confinement as adults, the state legislatures should take this opportunity to re-evaluate the effectiveness of their systems in providing the more desirable aspects of the parens patriae doctrine.

29. Illinois was the first to establish a separate system for dealing with juveniles in 1899.

30. 387 U.S. at 78 (dissenting opinion).

31. Paulsen, *Fairness to the Juvenile Offender*, 41 MINN. L. REV. 547, 550-51 (1957).

32. For an analysis of all aspects of juvenile courts, including arguments to limit further their jurisdiction, see Lemert, *Juvenile Justice—Quest and Reality*, 4 TRANSACTION 30 (1967).

33. Kent v. United States, 383 U.S. at 555.

Taxation—Federal Income Taxation—Section 267 of the IRC Applies to Involuntary Sale

In 1960 the Internal Revenue Service seized petitioner's shares in a closely-held family corporation for the purpose of satisfying a federal tax liability.[1] The IRS sold the stock at public auction to petitioner's wife, the only bidder, for $25,000. Petitioner's basis for the stock had been $135,000. In their joint income tax return for 1960 petitioner and his wife claimed a capital loss on the sale, and in their returns for 1961 and 1962 claimed capital loss carryovers based on the sale.[2] The Commissioner disallowed the carryovers[3] on the ground that a deduction for the loss on the 1960 sale of stock was an exchange between related parties and prohibited by section 267[4] of the Internal Revenue Code. On petition to the Tax Court, *held*, affirmed. Deduction by a stockholder of a loss arising from an involuntary sale of corporate stock to a member of his family is prohibited by section 267(a)(1) of the IRC. *James H. Merritt, Sr.*, 47 T.C. 519 (1967).

Prior to 1934 taxpayers were free to create tax losses by sales or exchanges between related parties and then to take a tax deduction for the "loss" sustained. In an attempt to limit this previously unqualified right, Congress enacted section 24(a)(6) of the Revenue Act of 1934[5] (hereinafter referred to as section 267) which provided that "no deduction shall be allowed . . . in respect of losses from sales or exchanges of property between . . . members of a family . . . ."[6] The scope of this provision was delineated in *McWilliams v. Commissioner*,[7] where the Supreme Court held that deduction for losses arising

1. Action was taken pursuant to INT. REV. CODE OF 1954, §§ 6331, 6335, 6338, and 6339, to collect taxes owing by petitioner for the years 1944-46. The total indebtedness was $191,812.98 plus interest.

2. *See* INT. REV. CODE OF 1954, § 1212, pertaining to capital loss carryovers.

3. Although the court does not discuss the matter, the deduction taken in 1960 was obviously not challenged because of the 3 year statute of limitations. Thus, only the 1961 and 1962 carryovers could be reached.

4. INT. REV. CODE OF 1954, § 267, *formerly* INT. REV. CODE OF 1939, § 24. The pertinent parts of this section are as follows:

"(a) Deduction Disallowed.—No deduction shall be allowed—(1) Losses.—In respect of losses from sales or exchanges of property . . . directly or indirectly, between persons specified within any one of the paragraphs of subsection (b).

"(b) Relationships—The persons referred to in section (a) are: (1) Members of a family . . . ; (2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual . . . ."

5. 48 Stat. 691 (1934).

6. *Id.*

7. 331 U.S. 694 (1947). In order to establish tax losses, a husband who managed the separate estate of his wife, as well as his own, ordered his broker to sell certain stock for the account of one of the two and to buy the same number of shares of the same stock for the other, at as nearly the same price as possible. The exchange was made on the open market and the buying spouse received stock certificates different from those the other had sold. The Court held that deductions in their

from the sale of stock on the open market followed by a purchase on the open market of the same number of like shares by a related party was prohibited by section 267. In denying the deduction, the Court declared "that the purpose of section 267 was to put an end to the right of taxpayers to choose . . . their own time for realizing tax losses on investments which, for most practical purposes, are continued uninterrupted."[8] The *McWilliams* decision, however, involved only a voluntary sale of stock,[9] and a conflict has since developed as to whether section 267 should also apply to involuntary sales. In *Helvering v. Hammell*[10] the Supreme Court, considering the character of a loss sustained from the involuntary sale of a capital asset, held that no distinction was intended between losses from involuntary sales and losses from voluntary sales of capital assets. The Court found no basis for such a distinction either in the language of the Revenue Act of 1934 itself or in its purpose and legislative history.[11] Applying this approach to sales of ordinary property, the Tax Court in *Zacek v. Commissioner*[12] held that both voluntary and involuntary sales of property to members of the taxpayer's family were contemplated by section 267 (a)(1).[13] The court stated that since the sale of the property was between members of a family it must be disallowed under the broad language of the statute, regardless of the resulting hardship. Two courts of appeal, however, have rejected this interpretation.[14] In *McCarty v. Cripe*,[15] the Seventh Circuit determined that the purpose of section 267 was to put an end to the right of taxpayers to choose their own time for realizing losses, and that the section therefore does not apply to an involuntary sale or

separate income tax returns for losses on such sales were forbidden by § 267 as losses from "sales or exchanges of property directly or indirectly . . . between members of a family."

8. *Id.* at 700.

9. *See* Commissioner v. Ickelheimer, 132 F.2d 660 (2d Cir. 1943), where the court in a much criticized opinion held that § 267 would not apply when the sale takes place on the open market. 55 HARV. L. REV. 872 (1942). *But see* Commissioner v. Kohn, 158 F.2d 32 (4th Cir. 1946), which held that when there is a clear purpose to avoid taxes and to control the realization of a loss, § 267 will apply even if the sale takes place on the open market through a broker or some other third party.

10. 311 U.S. 504 (1941). The taxpayer sustained a loss upon the foreclosure sale of his interest in real estate which he acquired for profit.

11. *Id.* at 510. The Court also pointed to the canon of statutory construction that courts are not free to reject the literal or usual meaning of the words of a statute unless an absurd result would be reached.

12. 8 T.C. 1056 (1947). The transaction involved an involuntary foreclosure sale of mortgaged property to members of the mortgagor's family.

13. *Cf.* Norton v. United States, 144 F. Supp. 425 (W.D. La. 1956). Sales of stock by the taxpayer and subsequent purchase of the same shares for his mother were made at the direction of their mutual agent. The losses sustained by the taxpayer were disallowed under § 267.

14. The court placed particular emphasis on the words of the statute, "in any case." 8 T.C. at 1057.

15. 201 F.2d 679, 682 (7th Cir. 1953). The taxpayer's farm was sold for taxes and

transfer over which the taxpayer has no control. The same principle was endorsed by the Fourth Circuit in *McNeill v. Commissioner.*[16] The courts in both cases relied upon the *McWilliams* interpretation of the purpose of section 267,[17] and emphasized that the taxpayers should not be allowed to "choose their own time for realizing tax losses . . . ."[18]

In disallowing the deduction in the instant case the court interpreted *McWilliams* as dictating an absolute prohibition of the allowance of a deduction for a loss resulting from a sale between related parties. The court pointed to the declaration in *McWilliams* that the purpose of section 267 was to terminate the practice of taxpayers choosing their own time for the realization of a tax loss on investments which, in effect, were uninterrupted. Particular emphasis was placed on the Supreme Court's statement that this purpose was to be effectuated "independent of the manner in which an intragroup transfer was accomplished . . . ."[19] While recognizing that the timing of a transaction was necessary in the taking of any loss, the court determined that this timing is of no consequence in the situation which Congress intended to eliminate when it enacted section 267, that situation being the deduction of a loss resulting from a sale directly or indirectly between members of a family. Thus the court concluded that the operation of section 267 does not depend upon the good faith of the parties involved or upon the voluntariness of the sale; the statute simply requires that the loss result from a sale directly or indirectly between related parties.[20] Judge Dawson, in a dissenting opinion, examined the legislative history of the statute, which he felt the majority erroneously ignored. He determined that, since the statutory purpose was to close a loophole which allowed taxpayers to avoid taxes by choosing the time when their losses would be realized, section 267 was not meant to apply to situations such as that found in the instant case where the taxpayer had no power to determine the time of the sale or transfer.

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was purchased by a trustee with money furnished by the taxpayer. The trustee shortly thereafter conveyed the farm to a corporation in which the taxpayer owned more than 50% of the stock, and the taxpayer was credited by the corporation for the amount of the loan.

16. 251 F.2d 863 (4th Cir.), *cert. denied,* 358 U.S. 825 (1958). The taxpayer, a lawyer, entered into an unsuccessful real estate venture. The land was seized to satisfy taxes. Both the government and the taxpayer tried unsuccessfully to sell the land. Finally, after 6 years, the government offered to sell the land at a price considerably lower than the basis of the taxpayer. The property was subsequently sold to a corporation in which all the stock was held by the taxpayer and members of his family.

17. *See* note 7 *supra* and accompanying text.

18. *See* note 7 *supra* and accompanying text.

19. 331 U.S. at 699.

20. The concurring opinion of Judge Raum supports the majority by citing legislative

The divergence between the two views over the proper interpretation to be given *McWilliams* is one of emphasis. Both sides cite the same passage from *McWilliams* in support of their conclusions regarding the scope of section 267 but place emphasis on different clauses. The *McCarty-McNeill* view places emphasis upon the fact that taxpayers are allowed to "choose . . . their own time for realizing tax losses . . . ."[21] The other view, consistently advanced by the Tax Court, emphasizes that section 267 was directed at a type of transaction where the "investments . . . for most practical purposes, are continued uninterrupted."[22] Proponents of the first view cite several excerpts from the legislative history of the act in support of the argument that the statutory purpose is the "closing up of a loophole" which the taxpayers had prior to the enactment of the Revenue Act of 1934. The nature of this loophole, however, is never precisely explained. Upon close examination of the history, it can be seen that the evil sought to be remedied was not allowing taxpayers to choose their own time for realizing a loss,[23] but was instead the allowance of a loss deduction when the taxpayer retained control over the property and in effect suffered no real economic loss. If related parties are viewed as an economic unit, it can be seen that in fact no economic loss occurs.[24] The statute [section 267] is clear and certain. It deals with "sales or exchanges of property . . . , directly or indirectly," between related parties. An involuntary sale, by the designation of all proponents of the *McCarty-McNeill* view, is in fact a sale. There is no ambiguity, and the courts should be slow to reject the literal or

history of the section which indicates that involuntary sales as well as voluntary ones were meant to be encompassed by the act.

21. 331 U.S. at 700.

22. *Id.*

23. According to INT. REV. CODE OF 1954, § 165, the taxpayer is allowed to take a deduction for any loss realized, even when the realization resulted from an exercise of choice by the taxpayer, provided that the property is free and clear of its former owner. "There shall be allowed as a deduction *any* loss sustained during the taxable year and not compensated for by insurance or otherwise." (Emphasis added).

24. Aside from the disallowance of the loss deduction, § 267 does not change the position of the economic unit to a great extent. Acording to § 267(d) if a taxpayer acquires property by purchase or exchange from a transferor who sustained a loss on the transaction not allowable as a deduction by reason of § 267(a)(1), then any gain realized by the taxpayer on a sale or other disposition of the property is recognized only to the extent that the gain exceeds the amount of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. For example, if petitioner's wife had disposed of the property previously owned by petitioner, her basis *in effect* would have been his old basis of $135,000 rather than the cost of the property to her ($25,000), and she would have been taxed only on that amount which exceeded $135,000. However, it should be noted that § 267(d) applies only to the nonrecognition of gain and does not technically affect basis. Thus, in the above illustration if petitioner's wife had disposed of the property for an amount less than $25,000, a loss deduction could have been taken only on the remainder of $25,000 minus the sale price. Treas. Reg. § 1.267(d)-1 (1958).

usual meaning of the words of a statute.[25] Furthermore, it is not important how the transaction takes place. So long as the taxpayer taking the loss maintains an economic interest in the property after the transaction is completed, no genuine loss is deemed to have taken place, and a deduction is precluded by section 267.

Torts—Right of Privacy—Rule of *New York Times v. Sullivan* Extended to Actions for Invasion of Privacy

In February, 1955, the defendant publisher of *Life Magazine* published an article entitled "True Crime Inspires Tense Play"[1] concerning a play based on the novel *The Desperate Hours*, by Joseph Hayes. The article sensationally portrayed the novel and the play as accurate versions of plaintiffs' ordeal while held hostages of two escaped convicts.[2] The plaintiffs brought an action under the New York right of privacy statute[3] alleging that the novel and play contained significant factual differences from their experience. The defendants contended that the article dealt with legitimate news of value and concern to the public and was published in good faith without malice. The trial court entered judgment for the plaintiffs for $50,000 compensatory and $25,000 punitive damages. The Supreme Court, Appellate Division, ordered a new trial as to damages only, sustaining the plaintiffs' verdict on the ground that the article was not dissemination of news,[4] and the New York Court of Appeals affirmed.[5] On

25. *See* Helvering v. Hammell, *supra* note 10.

1. LIFE, Feb. 28, 1955, at 75.

2. The article contained photographs of scenes from the play taken on location at the Hills' former residence. The text of the article which identified the plaintiffs by name was: "Three years ago Americans all over the country read about the desperate ordeal of the James Hill family, who were held prisoners in their home outside Philadelphia by three escaped couvicts. Later, they read about it in Joseph Hayes' novel, *The Desperate Hours*, inspired by the family's experience. Now they can see the story re-enacted in Hayes' Broadway play based on the book, and next year will see it in his movie. . . ."

3. N.Y. CIV. RIGHTS LAW §§ 50-51 (McKinney 1948). Section 50 is a penal provision, making violation of the statute a misdemeanor, but it was not applied in this case. Section 51 provides: "Any person whose name, portrait or picture is used within this state for advertising purposes or for the purposes of trade without the written consent first obtained . . . may . . . sue and recover damages. . . ." The section further provides for punitive damages in the event of a knowing violation by the defendant.

4. 18 App. Div. 2d 485, 240 N.Y.S.2d 286 (1st Dep't 1963).

5. 15 N.Y.2d 986, 207 N.E.2d 604, 260 N.Y.S.2d 7 (1965).

appeal to the United States Supreme Court, *held,* reversed. Liability for invasion of the right of privacy by a published article containing false statements must be predicated on a showing of the publisher's knowledge of the falsity of the statements or his reckless disregard for the truth. *Time, Inc. v. Hill,* 385 U.S. 374 (1967).

Responding to the advocacy of Warren and Brandeis, New York was the first state to recognize a right of privacy.[6] The New York statute, enacted in 1903, is limited in scope, permitting recovery only for the unauthorized use of a person's name or picture for purposes of advertising or trade usage.[7] While "advertising" has presented few problems to New York courts,[8] determining when publicity by mass media is a trade usage rather than a communication of news has presented much greater difficulty. New York has refused to adopt the view that presentations by communications media, operated for profit, are always trade usages,[9] a conclusion which would place the use of any person's name within the statute. The courts have recognized as an exception to the statute a privilege to publish names and pictures in connection with the dissemination of news, educational and informational material which is within the public interest.[10] The courts have noted that a public figure,[11] whether he be such by choice or involuntarily, "is subject to the often searching beam of publicity

6. Warren & Brandeis, *The Right to Privacy,* 4 HARV. L. REV. 193 (1890). Following that article, several New York courts permitted recovery on the basis of such a right. *See, e.g.,* Marks v. Jaffa, 6 Misc. 290, 26 N.Y.S. 908 (Super. Ct. N.Y.C. 1893). But this trend was halted in Roberson v. Rochester Folding Box Co., 171 N.Y. 538, 64 N.E. 442 (1902) where the New York Court of Appeals rejected the existence of the right of privacy, causing a storm of professional and popular disapproval which led to the enactment of New York's right of privacy statute. *See* 15 HARV. L. REV. 227 (1901); 2 COLUM. L. REV. 486 (1902).

7. "The statute, while accepting and incorporating into the law the principle of privacy, is not as broad in its embrace as the champions of privacy or pioneers in that field would make it. . . . The statute was born of an advertising case and its application is still confined to a commercial use or exploitation of a person's name or picture." Sutton v. Hearst Corp., 277 App. Div. 155, 162, 98 N.Y.S.2d 233, 239 (1st Dep't 1950).

8. However, the meaning of advertising can present some difficulty. *Compare* Booth v. Curtis Publishing Co., 11 N.Y.2d 907, 182 N.E.2d 812, 228 N.Y.S.2d 468 (1962) (mem.), *with* Myers v. U.S. Camera Publishing Corp., 9 Misc. 2d 765, 167 N.Y.S.2d 771 (N.Y. City Ct. 1957).

9. Silver, *Privacy and the First Amendment,* 34 FORDHAM L. REV. 553, 555 (1966).

10. *See* Sidis v. F-R Publishing Corp., 34 F. Supp. 19 (S.D.N.Y. 1938), *aff'd,* 113 F.2d 806 (2d Cir.), *cert. denied,* 311 U.S. 711 (1940), holding the statute was not violated by publication in defendant *New Yorker* magazine of a story of the career of a once-famous child prodigy. *See also* Molony v. Boy Comics Publishers, Inc., 277 App. Div. 166, 98 N.Y.S.2d 119 (1st Dep't 1950).

11. A public figure has been defined as "a person who, by his accomplishments, fame, or mode of living, or by adopting a profession or calling . . . gives the public a legitimate interest in his doings, his affairs, and his character. . . ." Cason v. Bashkin, 159 Fla. 31, 36, 30 So. 2d 635, 638 (1947), or as "anyone who has arrived at a position where public attention is focused upon him as a person." W. PROSSER, TORTS 845 (3d ed. 1964).

and that, in balance with the legitimate public interest, the law affords his privacy little protection."[12] Once a person has become a part of the "news,"[13] even unwillingly, it is probable that he will remain in this category the rest of his life,[14] for "once an event is determined to be news the individuals involved are inevitably subject to coverage."[15] The rationale for this rule is that a legitimate function of the press is to educate and remind the public of past history.[16] The performance of this function, however, is generally limited to substantially truthful presentations.[17] In New York, actions for invasion of privacy have been sustained when a public figure demonstrates that his character has been fictionalized.[18] In addition to the invasion of privacy action, decisions have established that a public figure can maintain a libel action against the publisher of a false or fictitious statement concerning him.[19] However, in *New York Times Co. v. Sullivan*,[20] the Supreme Court modified this rule by holding that a public official may not constitutionally recover damages for false and defamatory statements about his public conduct unless he shows that the statements were motivated by actual malice

12. Spahn v. Julian Messner, Inc., 18 N.Y.2d 324, 326, 221 N.E.2d 543, 545, 274 N.Y.S.2d 877, 879 (1966), where baseball pitcher Warren Spahn was awarded damages for a substantially fictitious biography published by defendant. For earlier cases holding no right of privaey for a public figure, *see* Koussevitzky v. Allen, Towne & Heath, Inc., 188 Misc. 479, 68 N.Y.S.2d 779 (Sup. Ct.), *aff'd*, 272 App. Div. 759, 69 NY.S.2d 432 (1st Dep't 1947); S. HOFSTADTER & G. HOROWITZ, THE RIGHT OF PRIVACY § 6.5 (1964).

13. "News" has been variously defined in the cases. A New York court has held "a report of recent occurrences . . . is generally understood by the term 'news.'" Jenkins v. News Syndicate Co., 128 Misc. 284, 285, 219 N.Y.S. 196, 198 (Sup. Ct. 1926). It is said to have "that indefinable quality of interest, which attracts public attention." Associated Press v. International News Serv., 245 F. 244, 248 (2d Cir. 1917), *aff'd*, 248 U.S. 215 (1918). "The emphasis . . . is on what *is* of interest to the public rather than on what *ought* to be of interest." Franklin, *A Constitutional Problem in Privacy Protection: Legal Inhibitions on Reporting of Fact*, 16 STAN. L. REV. 107, 115 (1963).

14. In Sidis v. F-R Publishing Corp., *supra* note 10, the court held that a 27-year period of obscurity had not dimmed the public interest in a once famous person.

15. Franklin, *supra* note 13, at 115. The decisions indicate that "once a man has become a public figure, or news, he remains a matter of legitimate recall to the public mind to the end of his days." Prosser, *Privacy*, 48 CALIF. L. REV. 383, 418 (1960).

16. Prosser, *supra* note 15 at 418.

17. "The factual reporting of newsworthy persons and events is in the public interest and is protected. The fictitious is not." Spahn v. Julian Messner, Inc., *supra* note 12, at 326, 221 N.E.2d at 545, 274 N.Y.S.2d at 879. "A substantial number of cases have indicated . . . that a cause of action does arise when the story is dressed up in a sensational fashion and is 'fictionalized'—in other words, when a false impression is created regarding the plaintiff." Wade, *Defamation and the Right of Privacy*, 15 VAND. L. REV. 1093, 1102 (1962).

18. Spahn v. Julian Messner, Inc., *supra* note 12. *See also* Silver, *supra* note 9, at 555.

19. *See* W. PROSSER, TORTS 848-49 (3d ed. 1964).

20. 376 U.S. 254 (1964).

or made with reckless disregard for their truth.[21] The Court held that state tort law is "state action" within the fourteenth amendment, and that where such law unduly interferes with freedom of speech or of the press under the first amendment, it cannot be enforced.[22] *Sullivan* was a landmark decision in the law of libel, setting forth, for the first time, "the extent to which the constitutional protections for speech and press limit a State's power to award damages in a libel action brought by a public official against critics of his official conduct."[23]

In the instant case, the Supreme Court accepted the lower court's finding that the plaintiff was a public figure substantially without a right of privacy as far as his hostage experience was concerned, and it concluded that the article in *Life*, linking the opening of a new play to an actual incident, was a matter of public interest. Rejecting the New York rule permitting recovery when there is proof of substantial and material fictionalization,[24] the Court reasoned that requiring verification of all news articles would present the grave hazard of discouraging the press from exercising its constitutional right. The Court held that constitutional protections of speech and press preclude the application of the New York statute to false reports of matters of public interest, in the absence of a showing that the defendant published the article with knowledge of its falsity or with reckless disregard for the truth.[25] Mr. Justice Harlan, concurring in part and dissenting in part, objected to the Court's extension of the *New York Times v. Sullivan* rule, on the grounds that a private individual like the plaintiff lacks the same opportunity to defend himself publicly against false statements that would be available to a public official and should therefore be granted greater protection. Stating that there is a much greater state interest in protecting persons like Hill than in protecting public officials, he concluded that the press should not be insulated from sanction by the

21. This decision resolved the dispute as to whether the press should have such a qualified privilege. *See* 1 F. HARPER & F. JAMES, TORTS § 5.26 at 449-50 (1956); W. PROSSER, TORTS 814 (3d ed. 1964); Hallen, *Fair Comment*, 8 TEXAS L. REV. 41, 62-70 (1929); Noel, *Defamation of Public Officers and Candidates*, 49 COLUM. L. REV. 875, 896-97 (1949).

22. Silver, *supra* note 9, at 553.

23. 376 U.S. at 256.

24. *See* note 18 *supra*.

25. Justices Black and Douglas, concurring, found that the first and fourteenth amendments provide a much wider freedom of the press than that expressed by the majority. They found that the rule of *New York Times* is too narrow to provide adequate protection for this freedom, and concluded that no law should be permitted which abridges the freedom of speech or freedom of the press in any way.

Mr. Justice Douglas also found that state action abridging freedom of the press is barred by the first and fourteenth amendments, and concluded that the majority holding did not provide sufficient protection for the freedom. He concluded that even a knowingly fictionalized account of an event is in the public domain and cannot constitutionally be prohibited by a state right of privacy statute.

first amendment when it creates a severe risk of irremediable harm to individuals involuntarily exposed to it and powerless to protect themselves. Chief Justice Warren and Justices Fortas and Clark, dissenting, based their opinion on the view that since privacy has become a basic right, the state legislatures may enforce it by appropriate legislation. The justices first established that the first amendment does not bar effective protection of the right of privacy and then maintained that the majority opinion would greatly weaken this protection by immunizing the press in areas far beyond the needs of legitimate news, comment on public persons and events, and the free discussion of public ideas.

In limiting a state's right to award damages for invasion of privacy, the Supreme Court in the instant case adopted substantially the same test as that employed in the *New York Times* decision. The applicability of that test to an action by a private individual for invasion of privacy can be determined by examining the reasoning of the Court in *New York Times*. The rationale of that decision was based on the proposition that the first amendment was intended to protect and promote uninhibited debate on public issues.[26] The focus of the Court on an interest in "public discussion"[27] and "free political discussion to the end that government may be responsive to the will of the people"[28] indicates that its concern was not freedom of the press in the abstract, but was constructive political and social change through uninhibited debate. Such an end is clearly not served through protecting misstatement by the press concerning private individuals who have been involuntarily and only temporarily thrust into the public spotlight. Thus, the aims which guided the Court's decision in *New York Times* are not applicable to the instant case. Nonetheless, the majority holding is substantially in accord with earlier decisions of the New York courts, which adhered to a narrower interpretation of the right of privacy than have most states.[29] After the development of the privilege to comment on newsworthy persons and events in New York, which is violated only by substantial fictionalization, the lower court decision in the instant case[30] was viewed as a change in the law.[31] The reversal by the Supreme Court brings

26. 376 U.S. at 269. The court considered the case "against the background of a profound national commitment to the principle that debate on *public issues* should be uninhibited, robust, and wide-open . . . ." 376 U.S. at 270 (emphasis added).

27. *Id.* at 270.

28. *Id.* at 269.

29. *See* S. HOFSTADTER & G. HOROWITZ, *supra* note 12, at § 12.4. Other states which have adopted statutes of a similar limited nature are Oklahoma, Utah, and Virginia. W. PROSSER, TORTS 832 (3d ed. 1964).

30. Hill v. Hayes, 18 App. Div. 2d 485, 240 N.Y.S.2d 286 (1st Dep't 1963), *aff'd*, 15 N.Y.2d 986, 207 N.E.2d 604, 260 N.Y.S.2d 7 (1965) (mem.).

31. Silver, *supra* note 9 at 556-57, states that the instant case in the lower court

the case more in line with the authority and the net effect of the holding on New York law is only a change in the test for recovery from "substantial fictionalization" to knowledge of the falsity of the statements or reckless disregard for the truth by the publisher. The effect on other jurisdictions will be far more severe. As the dissent points out,[32] at least 35 states now recognize the right of privacy either by decision or by statute.[33] In effect, the Supreme Court has erased whatever standard these courts had established for determining when an individual's privacy has been invaded by a publication of false statements and has superimposed the test of this case. It has done this by applying the first amendment guarantee of freedom of the press through the fourteenth amendment. But "[t]he first amendment cannot be viewed as an absolute command. Its content involves a constant balancing of competing interests."[34] In almost every jurisdiction, the right of privacy has become a basic individual right, and the interest of preserving this right must be balanced with the interest of preserving an unintimidated free press. The conflict of these interests does not seem to be as severe as the majority makes it. Generally, the rule has been that true statements may be published about newsworthy events or private persons. Such a rule offers a sound balance, preserving the right of the press to report legitimate news and protecting the individual against false statements which he might well not be able to adequately rebut publicly. The burden of making the press check the accuracy of the facts about private individuals in the news to avoid substantial misstatement does not seem overly severe. In the instant case, the Court has granted to the press an immunity which is not necessary and which materially restricts the individual's right of privacy.

changed the standard and imposed a novel test of newsworthiness in the light of the leading decision of Sidis v. F-R Publishing Corp., *supra* note 10.

32. 385 U.S. at 413.

33. The only states specifically rejecting a right of privacy are Nebraska, in Brunson v. Ranks Army Stores, 161 Neb. 519, 73 N.W.2d 803 (1955); Rhode Island, in Henry v. Cherry & Webb, 30 R.I. 13, 73 A. 97 (1909); Texas, *e.g.*, McCullagh v. Houston Chronicle Publishing Co., 211 F.2d 4 (5th Cir.), *cert. denied*, 348 U.S. 827 (1954); and Wisconsin, *e.g.*, Yoeckel v. Samonig, 272 Wis. 430, 75 N.W.2d 925 (1956). *See* W. PROSSER, TORTS 831-32 (3d ed. 1964).

34. Pedrick, *Freedom of the Press and the Law of Libel: The Modern Revised Translation*, 49 CORNELL L.Q. 581, 595 (1964).