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PRIVATE ENFORCEMENT OF FEDERAL ANTI-POLLUTION LAWS THROUGH CITIZEN SUITS: A MODEL

DAVID ALLAN FELLER*

I. INTRODUCTION

At the time of their enactment, the Clean Water Act (CWA)[1] and the Clean Air Act (CAA)[2] were envisioned as statutory schemes permitting federal agencies and corps of local private attorneys general to work together to conserve and enhance the country's air and water resources through administrative actions and private citizen suits.[3] Citizen suit enforcement has not reached its potential to compel compliance with anti-pollution laws. Many complex factors such as financing, sophisticated technology, standing, and discovery present formidable barriers to potential plaintiffs. The need to distribute enforcement responsibilities between the public and private sectors, however, remains undiminished. It is essential, therefore, that citizen suits assume a vital role in the protection of the nation's air and water resources.

As the concept of citizen suits evolved in the 1970's, private enforcement became the principal means for inducing the Environmental Protection Agency to take regulatory or prosecutorial action under anti-pollution laws.[4] The incidence of reported private suits brought directly against polluters was relatively small in both number and effect; fewer than twenty-five suits were reported between 1970 and 1978 under the CWA and CAA.[5] Despite the plan by Congress to create a broad-based enforcement scheme,[6] the private sector never has emerged as an effective auxiliary to EPA's enforcement efforts.

The potential for private enforcement contributions expands and contracts with shifting political fortunes. For example, under the present federal

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1. 33 U.S.C. §§ 1251-1376 (1976 & Supp. V 1981).

2. 42 U.S.C. §§ 7601-7642 (1976 & Supp. V 1981).

3. 33 U.S.C. § 1365(a) (1976 & Supp. V 1981) (CWA's grant of authority to bring citizen suits). *See also* 42 U.S.C. § 7604 (Supp. V 1981) (similar enforcement mechanism in the CAA). For case law application of citizen suits under the CWA, see City of Evansville v. Kentucky Liquid Recycling, Inc., 604 F.2d 1008, 1014-17 (7th Cir. 1979).

4. *See* Natural Resources Defense Council, Inc. v. Train, 510 F.2d 692 (D.C. Cir. 1975) (suit to compel EPA promulgation of effluent limitation guidelines under the CWA).

5. Figure based on applicable statutes analyzed through LEXIS research system.

6. *See* S. REP. NO. 414, 92d Cong., 2d Sess. 79, *reprinted in* 1972 U.S. CODE CONG. & AD. NEWS 3668. "The Committee has established a provision in the bill that would provide citizen participation in the enforcement of control requirements and regulations. . . ." *Id.* at 3745. *See also* Senate Debate on S. 4358, Sept. 21, 1970, *reprinted in* ENVIRONMENTAL POLICY DIVISION OF CONGRESSIONAL RESEARCH SERVICE, *A Legislative History of The Clean Air Amendments of 1970*, Vol. I (1974). "[C]itizens can be a useful instrument for detecting violations and bringing them to the attention of the enforcement agencies and courts alike." *Id.* at 280 n.35.

administration, EPA's enforcement programs have been substantially restructured because of agency budget reductions. Whereas the total EPA budget for fiscal year 1981 was approximately $1.4 billion, the 1982 budget was only $1.16 billion.[7] During debate over the 1983 fiscal year budget, then EPA Director Anne Burford projected further reductions in agency spending to approximately $975 million.[8] It is estimated that these cuts have reduced the actual spending power of the EPA by sixty percent in 1983, taking into account present rates of inflation.[9] The effects of this budget shrinkage are currently being felt. Agency staff has decreased from 10,381 employees to 8,340 for fiscal year 1983, and EPA staff enforcement attorneys have been cut from 200 to just 30.[10]

Budgetary pressure is not the only cause of the EPA's reduced enforcement of water and air quality laws; policy changes also influence enforcement activity. For example, Congress has directed the EPA to focus its attentions on the implementation of the Toxic Substances Control Act (TSCA)[11] and the Resource Conservation and Recovery Act (RCRA),[12] which will demand a substantial part of the EPA's enforcement capabilities for the next three years.[13] The EPA has modified its enforcement policies in other areas. The agency will no longer pursue cases solely for civil money penalties.[14] Thus, although polluters substantially violate a federal pollution standard or emissions permit, the EPA will not bring actions against them unless injunctive relief or cleanup steps are appropriate remedies.[15] The result of these budgetary pressures and policy modifications is a reduced number of referral cases to the Department of Justice for enforcement proceedings. Approximately 100 cases were transferred to the Department of Justice for prosecution in the first eighteen months of the Reagan Administration.[16]

Vigorous enforcement of anti-pollution laws in the future will depend upon the initiative of private attorneys general. The purpose of this article is to reexamine the concept of the citizen suit and evaluate its use as an enforcement tool. This process will involve three steps: 1) consideration of the present law governing private suits against polluters; 2) discussion of the practical difficulties facing the development of a widespread private movement to enforce anti-pollution laws in the United States; and 3) examination of one source of potential citizen enforcement litigation in CWA violations.

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7. *EPA Hard Hit By Budget Cuts*, SCI. MAG., Oct. 16, 1981, at 306.

8. *The 'Ice Queen' at EPA*, NEWSWEEK, Oct. 19, 1981, at 67-68.

9. *Pollution Is Our Most Important Product*, NATION, Nov. 7, 1981, at 473-75.

10. *E.P.A. Is Prodded Into Toxic Waste Rules*, 68 A.B.A. J. 250, 250 (1982).

11. 15 U.S.C. §§ 2601-2629 (1976 & Supp. V 1981).

12. 42 U.S.C. §§ 6901-6987 (1976 & Supp. V 1981).

13. Interview with James Heenahan, Enforcement Attorney, EPA Region III, in Philadelphia (Mar. 19, 1982) [hereinafter cited as Heenahan Interview]; *see also* SCI. MAG., *supra* note 7, at 306.

14. LEGAL TIMES OF WASHINGTON, Nov. 30, 1981, at 1, col. 2.

15. *Id.*

16. This figure is approximated from information derived from NEWSWEEK, *supra* note 8, at 67, and Washington Post, June 23, 1982, at A25, col. 3. As those articles reported, approximately 69 cases were referred to the Department of Justice from January 1981 through March 1982; 31 cases were referred from March to June 1982.

II. PROCEDURAL STRUCTURE OF CITIZEN SUITS

The CAA established the statutory model for citizen suit provisions in subsequent anti-pollution and substantive environmental protection statutes.[17] These clauses provide liberal access to the courts and administrative agency resources. Generally, any person may bring a suit based on a violation of a federal pollution law, regulation, or permit issued under that law.[18] By not requiring plaintiffs to allege an injury in fact to obtain standing, Congress hoped to recruit citizens to serve as private attorneys general to facilitate enforcement of statutes in the face of official inaction.[19] An exception to this general standing rule was created in the CWA, which defines a citizen as a "person or persons *having an interest* which is or may be adversely affected."[20] Thus, standing to sue under the CWA is available to those persons who qualify as plaintiffs under the standing criteria established in *Sierra Club v. Morton*.[21] Given the broad interpretation of *Sierra Club* applied in recent citizen suits decisions,[22] this stricter standard for standing probably is not a significant impediment to private suits.

Jurisdiction over citizen suits is vested exclusively in the federal courts.[23] Parties are thereby spared the need to establish diversity of parties or a minimum claim for damages as required under 28 U.S.C. § 1292 or other jurisdictional statutes.[24] Of course, jurisdiction over citizen actions may be acquired through other laws such as the Administrative Procedure Act,[25] but, in general, violations of anti-pollution laws fall under the jurisdiction of the federal courts without resort to other statutes.

Notice requirements form the only limitation on the jurisdiction of the courts to entertain citizen suits. Under each statute allowing private enforcement actions, private plaintiffs must notify interested parties, the government of the state where the alleged violation occurred, and the EPA administrator of the contemplated action sixty days in advance of the suit's

17. 42 U.S.C. § 7604 (1976 & Supp. V 1981). *See also* 15 U.S.C. § 2619 (1976 & Supp. V 1981) (Toxic Substances Control Act); 16 U.S.C. § 1540(g)(1) (1976 & Supp. V 1981) (Endangered Species Act); 33 U.S.C. § 1515 (1976) (Deep Water Port Act); 42 U.S.C. § 4911 (1976) (Noise Control Act); 42 U.S.C. § 6305 (1976 & Supp. V 1981) (Energy Conservation Act).

18. *See, e.g.*, Metropolitan Washington Coalition for Clean Air v. District of Columbia, 511 F.2d 809, 814 (D.C. Cir. 1975) (general standing requirements relaxed for citizen suits).

19. *Id.*

20. 33 U.S.C. § 1365(g) (1976 & Supp. V 1981) (emphasis added).

21. 405 U.S. 727 (1972) (plaintiff required to allege facts showing he is adversely affected). *See* Natural Resources Defense Council, Inc. v. Train, 510 F.2d 692, 701 nn.47-8 (D.C. Cir. 1975); Loveladies Property Owners Ass'n v. Raab, 430 F. Supp. 276, 280 (D. N.J. 1975) (application of the *Sierra Club v. Morton* standing rule).

22. *See* O'Leary v. Moyer's Landfill, Inc., 523 F. Supp. 642 (E.D. Pa. 1981); Pymatuning Water Shed Citizens for a Hygienic Environment v. Eaton, 506 F. Supp. 902 (W.D. Pa. 1980) (suit to halt sewage discharges from municipal treatment plant).

23. *See, e.g.*, 42 U.S.C. § 7604(a) (1976 & Supp. V 1981) (CAA's liberal grant of federal jurisdiction). *See also* 33 U.S.C. § 1365(a) (1976 & Supp. V 1981). The CWA states that "district courts shall have jurisdiction, without regard to the amount in controversy or the citizenship of the parties, to enforce such an effluent standard of limitation." *Id.*

24. 33 U.S.C. § 1356(a) (1976 & Supp. V 1981); 42 U.S.C. § 7604(a) (1976 & Supp. V 1981).

25. 5 U.S.C. §§ 701-706 (1976 & Supp. V 1981). *See* NRDC v. Callaway, 524 F.2d 79, 83 (2d Cir. 1975).

commencement in federal district court.[26] Notice provides the agency with an opportunity to seek abatement of the violation through administrative means.[27] In *NRDC v. Train*,[28] Judge Leaventhal agreed that the notice section of the CWA's citizen suit provision was designed to give the EPA an opportunity to act on the alleged violation, and the court should therefore "stay its hand" when the administrator might be able to act informally and obviate the need for litigation.[29]

The EPA has authority to influence the polluter in various ways. For example, under the CAA, the EPA administrator is empowered on the basis of information available to him, to give a violator thirty days to comply with the applicable standard.[30] If compliance is not achieved, the EPA may institute a civil suit or issue an administrative order to bring the pollution source into compliance.[31] The threat of such administrative action or the administrative order itself may alleviate the pollution problem without further action.

Several exceptions to the sixty-day notice requirement are found in pollution legislation and case law. Where targets of enforcement are dischargers of hazardous substances, citizens may commence suit immediately; no deferral period is imposed where there is threat of public injury.[32] Another exception to the notice requirement has been noted by at least two courts.

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26. *See, e.g.*, 33 U.S.C. § 1365(b) (1976 & Supp. V 1981) (CWA's notice requirements for citizen suits). Susquehanna Valley Alliance v. Three Mile Island Nuclear Reactor, 619 F.2d 231, 243-44 (3d Cir. 1980) (60 day notice provisions were constructively satisfied).

27. *See, e.g.*, 42 U.S.C. § 7604(c) (1976 & Supp. V 1981). *See also* S. REP. NO. 1196, 91st Cong., 2d Sess. 35-6 (1970). The purpose of notifying the EPA of a potential suit against polluting parties was described by the Senate Committee which drafted the citizen suit clauses: "Government initiative in seeking enforcement under the Clean Air Act has been restrained. Authorizing citizens to bring suits for violations of standards should motivate governmental agencies charged with the responsibility to bring enforcement and abatement proceedings." *Id.*

28. 510 F.2d 692 (D.C. Cir. 1975) (a suit by private parties to compel the EPA to publish effluent regulations as required under the law). Subsequent cases involving private actions against polluters have upheld the notice requirement. Plaintiffs in Pymatuning Water Shed Citizens v. Eaton, 506 F. Supp. 902 (W.D. Pa. 1980), were allowed to maintain an action against the local municipal water treatment facilities which had failed to comply with their permit, only after a showing that plaintiffs had given 60 days notice of the action to the EPA and the Pennsylvania State Department of Environmental Resources. *Id.* at 907-08. Similarly, in Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n, 453 U.S. 1 (1981) the Supreme Court affirmed the denial of jurisdiction to fishing groups seeking damages and other remedies from local municipalities for alleged dumping of waste materials in violation of CWA. *Id.* at 22. The plaintiffs had failed to notify government agencies of the prospective suit, ignoring the 60 day prior notice requirement. *Id.* at 14. The Court emphasized that plaintiffs invoking the citizen suit provisions "first must comply with specified procedures." *Id.*

See also Massachusetts v. United States Veterans Admin., 541 F.2d 119, 121-22 (1st Cir. 1976) (complaint for alleged CWA violations dismissed for failure to provide actual or constructive notice); City of Highland Park v. Train, 519 F.2d 681, 690 (7th Cir. 1975) (action brought pursuant to CAA failed to satisfy 60 day notice requirement).

After plaintiffs in Metropolitan Washington Coalition for Clean Air v. District of Columbia, 511 F.2d 809 (D.C. Cir. 1975) failed to provide 60 days notice of the suit, they filed an identical claim 60 days after the first unnoticed complaint in order to meet the requirements of the CAA. *Id.* at 814.

29. *Metropolitan Washington Coalition for Clean Air*, 511 F.2d at 814.

30. 42 U.S.C. § 7413(a)(1) (Supp. V 1981).

31. *Id.*

32. *See, e.g.*, Clean Water Act, 33 U.S.C. § 1365(b) (1976 & Supp. V 1980) (allowing immediate actions for violations involving toxic materials).

Where administrative action would be inadequate to provide relief from the violation alleged[33] or where the agency refuses to take any action against the polluter,[34] constructive notice of the suit will satisfy the statute. In effect, constructive notice allows plaintiffs to commence their suit prior to the passage of the sixty-day notice period.[35]

In addition to encouraging the EPA to take administrative action where it would be beneficial to the public interest, notice of a citizen enforcement suit allows the agency to intervene in the proceeding.[36] The EPA has the statutory authority to intervene in any citizen action as a matter of right.[37] Agency intervention may have useful consequences for the plaintiffs' case. Parties violating emissions standards or discharging beyond their permitted levels are more inclined to cooperate with the EPA than with private plaintiffs during discovery proceedings or settlement negotiations. Another advantage of agency intervention is citizen access to EPA's extensive system of information on all permittees and discharging entities in the region.[38]

The EPA is under no obligation, however, to intervene in suits against polluters initiated by citizens.[39] In fact, since it is the EPA's failure to obtain compliance with the relevant pollution standard which initially creates the need for citizen action, the agency may be reluctant to participate. Thus, despite notification of the suit, EPA may decide to entrust the private attorney general with responsibility for the enforcement action.

As stated in the amendments to the CAA, any person may commence a civil action on his own behalf against any person "alleged to be in violation of (A) an emission standard or limitation under this chapter or, (B) an order issued by the Administrator or State with respect to such a standard or limitation . . . ."[40] Similar language is contained in other anti-pollution and environmental protection laws.[41] The courts consistently require that plaintiffs show a violation of a clear cut standard issued under the pertinent anti-pollution law. For example, the defendants in *O'Leary v. Moyer's Landfill, Inc.*,[42] were accused of recirculating hazardous leachate materials into their

33. *See* Massachusetts v. United States Veterans Admin., 541 F.2d 119, 121 (1st Cir. 1976) (citing CWA's legislative history).

34. National Resources Defense Council, Inc. v. Callaway, 524 F.2d 79, 83 (2d Cir. 1975) (citing Conservation Soc'y of S. Vt., Inc. v. Secretary of Transp., 508 F.2d 927 (2d Cir. 1974).

35. *See generally supra* notes 33-34.

36. *See, e.g.*, 42 U.S.C. § 7604(c) (1976 & Supp. V 1981).

37. *See, e.g.*, 33 U.S.C. § 1365(c) (1976 & Supp. V 1981); 42 U.S.C. § 7604(c) (1976 & Supp. V 1981).

38. Interview with Thomas Voltaggio, Division Chief, EPA Region III Compliance Division, in Philadelphia (Mar. 19, 1982) [hereinafter cited as Voltaggio Interview]. *See* Friends of the Earth v. Carey, 535 F.2d 165 (2d Cir. 1976). In this case the Second Circuit declared that "the EPA's participation in a citizen enforcement suit is welcomed by the court, since the EPA, as the agency vested by Congress with important overall responsibilities related to the matter under consideration, possesses expertise which should enable it to make a major contribution." *Id.* at 173.

39. Friends of the Earth v. Casey, 535 F.2d 165, 173 (2d Cir. 1976); Metropolitan Washington Coalition for Clean Air v. District of Columbia, 511 F.2d 809, 814-15 (D.C. Cir. 1975).

40. 42 U.S.C. § 7604(a) (1976 & Supp. V 1981).

41. *See, e.g.*, 42 U.S.C. § 4911(a) (1976 & Supp. V 1981) (Noise Control Act); 42 U.S.C. § 6972(a) (1976 & Supp. V 1981) (RCRA).

42. 523 F. Supp. 642 (E.D. Pa. 1981).

privately operated landfill, allowing some 100,000 to 200,000 gallons of the waste liquid to seep from the landfill into a nearby river every month. The landfill's state operating permit, issued pursuant to the CWA, proscribed the treatment of leachate near the fill, requiring instead that landfill operators transport the material to the municipal sewage treatment facility.[43] The finding of a clear violation of the defendant's permit sustained an order for the repair and cleanup of the landfill site.[44]

A comparable suit against the North and South Shenango, Pennsylvania, municipal water treatment plant resulted in a court order to the defendants to rectify their plumbing problems. The treatment system had emitted sewage into the local river on numerous occasions.[45] The court found a clear violation of the plant's permit. Defendants' assertion that the underground sewage transport system was poorly constructed and negligently installed provided no defense to the permit violation.[46] Because the CWA required the treatment plant to utilize the "Best Practical Technology" (BPT) to meet its permit discharge requirements, the court's order mandated that a plan, to install the technology or repair the system, be submitted to the court within ninety days of the order.[47]

The Seventh Circuit Court of Appeals further clarified the types of violations that are actionable under citizen suit provisions in *City of Evansville v. Kentucky Liquid Recycling, Inc.*[48] Plaintiffs brought suit claiming that defendants had discharged toxic chemicals into the sewage treatment system, thereby contaminating the Ohio River and the local water supply.[49] In addition to problems of insufficient notice and standing, which were addressed by the court, the Seventh Circuit found that plaintiffs had failed to raise a proper claim under the Act. Because plaintiffs had sought compensatory damages for past acts violating CWA guidelines,[50] the court held that the statute authorizing civil action against a party "alleged *to be* in violation" of effluent standards was not applicable.[51] To the extent that plaintiffs alleged only past violations, the court lacked jurisdiction to hear the claim.

The *Evansville* plaintiffs failed to seek remedies satisfying the statute. Had they sought an injunction on the grounds that the defendants' past acts indicated a pattern of behavior that was likely to lead to future violations, the court may have granted relief. The parties in *O'Leary v. Moyer's Landfill, Inc.*,[52] on the other hand, succeeded under similar facts, by showing that defendants' discharges in excess of the permitted levels had occurred on a regular basis in the past, and that defendants had taken no more than stopgap measures to remedy the violations.[53] By showing that the violations

43. *Id.* at 651-53.
44. *Id.* at 659.
45. *Pymatuning Water Shed*, 506 F. Supp. 902 (W.D. Pa. 1980).
46. *Id.* at 909.
47. *Id.*
48. 604 F.2d 1008 (7th Cir. 1979) (citizens suit brought under the CWA).
49. *Id.* at 1010.
50. *Id.* at 1014.
51. *Id.*
52. 523 F. Supp. 642 (E.D. Pa. 1981).
53. *Id.* at 652-53.

were likely to continue, plaintiffs provided the court with an adequate basis to grant injunctive relief.[54]

III. REMEDIES AVAILABLE IN CITIZEN SUITS

Private enforcement actions provide a number of remedial options for pollution law violations. Injunctive relief is a common remedy awarded to successful plaintiffs in citizen enforcement actions. Private suits may enforce anti-pollution laws by obtaining court-ordered compliance with the applicable standard or limitation. This compliance order may take the form of prohibitory or mandatory injunctive relief.[55] Secondly, where appropriate remedies are not readily identifiable, the court may rely on its equitable authority to require a polluter to submit a plan describing the steps he will take to attain compliance with the standard violated.[56] This was the course taken by the court in *Pymatuning Water Shed*.[57] The technological problems involved in repairing defendant's water treatment facility plumbing were not sufficiently understood by the court that immediate compliance could be demanded; but the court did require, in cooperation with the state and the EPA, preparation of a plan for compliance within a reasonable time.[58]

A third remedial category is civil penalty. Requests for civil penalties are not often granted, though they are appropriately requested under the CWA.[59] In many cases, courts consider that the penalty money would be more wisely invested in the effort to attain compliance rather than in punitive sanctions.[60] The judiciary may be reluctant to allow private citizens to bring cases seeking quasi-criminal sanctions in the form of civil fines for pollution violations. Although Congress sought to create private attorneys general under anti-pollution laws, the spirit of citizen enforcement actions casts plaintiffs in the role of protectors of their immediate environment, rather than in the role of society's corporate watchdogs.[61] Pursuit of penalties against violators is more appropriate as an agency function.[62]

Another reason for judicial unwillingness to award civil penalties is the statutory reservation to plaintiffs of private common law causes of action.[63]

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54. *Id.* at 659.

55. *See, e.g.*, 33 U.S.C. § 1365(a) (1976 & Supp. V 1981). *See also* National Resources Defense Council, Inc. v. Train, 510 F.2d 692 (D.C. Cir. 1975) (establishing timetable for defendants to comply with CAA).

56. *Pymatuning Water Shed*, 506 F. Supp. 902 (W.D. Pa. 1980); *see supra* text accompanying notes 45-47.

57. 506 F. Supp. 902 (W.D. Pa. 1980).

58. *Id.* at 909.

59. 33 U.S.C. § 1365(a) (1976 & Supp. V 1981).

60. *See O'Leary*, 523 F. Supp. at 659.

61. Voltaggio Interview, *supra* note 38.

62. *Id.*

63. Citizen suit provisions in CWA and CAA create no implied private cause of action as has been held to exist in other federal statutes. *See generally* Cort v. Ash, 422 U.S. 66 (1975). Implied actions were discussed by the Court in Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n, 453 U.S. 1 (1982). The structure of the CWR and its "legislative history both lead us to conclude that Congress intended that private remedies in addition to those expressly provided should not be implied. Where, as here, Congress has made clear that implied private actions are not contemplated, the courts are not authorized to ignore this legislative judgment." *Id.* at 18. Citizen suit clauses, however, do specifically reserve for plaintiffs any

Thus, citizens may pursue damages emanating from the violation in a separate action. The availability to plaintiffs of these civil remedies may affect the inclination of courts to impose penalties on polluters.

IV. ATTORNEYS FEES

Although plaintiffs rarely recover damages under citizen suit enabling clauses, private attorneys general are eligible for attorneys fees. All citizen suit clauses in anti-pollution laws provide for the award of attorneys fees to "any party, whenever the court determines that such an award is appropriate."[64] Recent judicial discussion of attorneys fees clauses has affirmed the viability of fee awards before the courts.

In *Sierra Club v. Gorsuch*,[65] the Court of Appeals for the District of Columbia awarded attorneys fees to the Sierra Club and co-plaintiff Environmental Defense Fund (EDF), despite the fact that plaintiffs did not substantially prevail in their suit challenging regulations controlling sulfur dioxide and particulate emissions, promulgated by the EPA under the CAA.[66] In its two-pronged analysis the court first considered whether the questions raised by plaintiffs in the course of the suit were significant. Second, the court evaluated whether the plaintiffs substantially assisted the court in its consideration of the important questions raised.[67] The controversy before the court also presented the first major judicial review of the rulemaking procedures adopted in the 1977 amendments to the CAA.[68]

At trial, plaintiffs had alerted the court to several crucial issues regarding EPA's rulemaking procedure for the challenged rule.[69] In addition, counsel for the EDF and the Sierra Club compiled extensive legislative history and factual background for the specific amendments under review, not only enriching the court's understanding of the issues but also saving the court time in its deliberations.[70] The award of fees was justified by the court on the grounds that the plaintiffs did substantially contribute to the goals of the Act:

> the issues they addressed were important, complex and novel; their assistance in the resolution of the issues was substantial and not duplicative of the efforts of other parties; and the caliber of their written and oral presentations was exemplary. While the occasions upon which non-prevailing parties will meet such criteria may be exceptional [cite omitted], *Sierra Club* is such an occasion.[71]

Contrary to the general rule that parties bear their own litigation ex-

other common law actions they might have. *See, e.g.*, 33 U.S.C. § 1365(e) (1976 & Supp. V 1981).

64. *See, e.g.*, 33 U.S.C. § 1365(d) (1976 & Supp. V 1981); 42 U.S.C. § 7604(d) (1976 & Supp. V 1981).

65. 672 F.2d 33 (D.C. Cir. 1982), *cert. granted*, 103 S. Ct. 254 (1982).

66. 672 F.2d at 34.

67. *Id.* at 39-42.

68. *Id.* at 40.

69. *Id.* at 40-41.

70. *Id.* at 41.

71. *Id.* at 39.

penses regardless of the suit's outcome,[72] the decision in *Sierra Club v. Gorsuch* is the latest in a line of cases that have established the principles of fee awards to parties who seek to enforce federal anti-pollution laws through private suits.[73] Because courts have recognized that awards of attorneys fees provide a major incentive for parties to undertake public interest litigation, it is not surprising that Congress voted to codify this socially utilitarian practice into environmental statutes.

The rationale for attorneys fees awards in citizen suits is not the reimbursement of the party "wronged" in the litigation.[74] Theoretically, whether a party prevails in a suit brought to enforce anti-pollution laws is inconsequential in determining the award of fees:

> [T]he purposes of the authority to award fees are not only to discourage frivolous litigation, but also to encourage litigation which will assure *proper implementation and administration of the act* or otherwise serve the public interest. The committee did not intend that the court's discretion to award fees under this provision should be restricted to cases in which the party seeking fees was the "prevailing party." In fact, such amendment was expressly rejected by the committee, largely on the grounds set forth in *NRDC v. EPA*.[75]

The phrase "proper implementation and administration of the act"[76] has been interpreted narrowly by the courts.[77] Only cases brought under the jurisdiction of the citizen suit clause itself may qualify for fee awards; suits brought to remedy actions illegal under the act, but nonetheless not included in those violations of effluent or emission standards or limitations, are subject to the historical prohibition against fee awards.[78] Thus, where suits are properly commenced to enforce emission standards or similar anti-pollution limitations under the laws which provide for citizen action, prevailing plaintiffs are entitled to receive fee awards from defendant polluters. Courts award fees or request parties to negotiate a proper fee settlement consistent with the terms of the act and subject to the approval of the court.[79]

In *Alabama Power Co. v. Gorsuch*,[80] a companion case to *Sierra Club*, the court addressed, among other issues, whether environmental groups, which had intervened on behalf of the EPA, were entitled to an award of attorneys fees under the CAA.[81] EPA opposed the award of attorneys fees, asserting

72. *See generally* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975).

73. *See, e.g.*, Natural Resources Defense Council, Inc. v. EPA, 484 F.2d 1331 (1st Cir. 1973); Palila v. Hawaii Dep't of Natural Resources, 512 F. Supp. 1006 (D. Haw. 1981); Save Our Sound Fisheries Ass'n v. Callaway, 429 F. Supp. 1136 (D. R.I. 1977); Citizens Ass'n v. Washington, 383 F. Supp. 136 (D. D.C. 1974), *rev'd on other grounds*, 535 F.2d 1318 (D.C. Cir. 1976).

74. *See* S. REP. NO. 414, 92d Cong., 2d Sess. 79, *reprinted in* 1972 U.S. CODE CONG. & AD. NEWS 3668, 3747.

75. H. REP. NO. 294, 95th Cong. 1st Sess. 337, *reprinted in* 1977 U.S. CODE CONG. & AD. NEWS 1077, 1416 (emphasis added).

76. *Id.*

77. Save Our Sound Fisheries Ass'n v. Callaway, 429 F. Supp. 1136 (D. R.I. 1977).

78. *Id.* at 1141.

79. *See, e.g.*, *Pymatuning Water Shed*, 506 F. Supp. at 909; *Sierra Club*, 672 F.2d at 42.

80. 672 F.2d 1 (D.C. Cir. 1982).

81. *Id.* at 4.

that the intervenors had duplicated the EPA's efforts. The court held that the Sierra Club and the Environmental Defense Fund in their role as intervenors had "not demonstrated with any sort of particularity that their intervention added in any essential way to EPA's stance on the issues involved,"[82] and therefore, the court denied that portion of the award for attorneys fees associated with the environmental groups' intervention.

The calculation of attorneys fees has been standardized under most federal attorney fee shifting schemes.[83] To encourage competent attorneys to undertake public interest representation, the court must compensate attorneys sufficiently for the work they perform.[84] The measurement for computation of fees is a "reasonable hourly rate" multiplied by the number of hours expended on the law suit.[85] On its face this formula appears simple, but complications have surfaced in its application by the courts. Many courts have been unwilling to accept the actual number of hours spent on a case as the basis for calculating reasonable fees. The court in *Copeland v. Marshall*,[86] asserted that "no compensation is due for nonproductive time."[87] Thus, where multiple attorneys are assigned to duties that the court finds could have been handled by a single attorney, under *Copeland* the court would deny fees for those hours billed by the extra lawyers. Only the hours necessary for the task, in the court's estimation, would be compensable.

The hourly rate should be the prevailing rate in the community for similar work performed.[88] That rate is a product of the level of skill required by the suit, the importance or risk posed by the litigation, and the attorney's reputation and ability.[89] Although the hourly rate emerging from this calculus has consistently approached fair market value for the services of the attorneys in the case,[90] some courts tend to discount fee rates to public interest attorneys.[91] These courts opine that attorneys who litigate public interest claims should not expect remuneration, but rather serve *pro bono* under their

82. *Id.* The court did, however, grant these environmental groups' attorneys fees in their role as petitioners and in the situation where the court specifically requested one of the intervenors to address an issue. *Id.*

83. *See generally* Environmental Defense Fund v. EPA, 672 F.2d 42 (D.C. Cir. 1982); Lindy Bros. Builders, Inc. v. American Radiation and Standard Sanitary Corp., 487 F.2d 161 (3d Cir. 1973). These cases measure attorneys' fees by market value. *Cf.* Keith v. Volpe, 501 F. Supp. 403 (C.D. Cal. 1980). The court calculated fees to prevailing plaintiffs based on market value, but added a 3.5 multiplier to compensate counsel for their meritorious services in a complex environmental case. *Id.* at 574-77.

84. Copeland v. Marshall, 641 F.2d 880, 889 (D.C. Cir. 1980) (award of attorneys' fees in a Title VII action). In Environmental Defense Fund v. EPA, 672 F.2d 42 (D.C. Cir. 1982), the Court of Appeals adopted the *Copeland* fee calculus in the environmental context.

85. *Copeland*, 641 F.2d at 891.

86. 641 F.2d 880.

87. *Id.* at 891.

88. *See* Environmental Defense Fund v. EPA, 672 F.2d at 50-61 (extensive discussion of fee awards calculation).

89. *Id.* at 52 (citing Lindy Bros. Builders, Inc. v. American Radiation and Standard Sanitary Corp., 487 F.2d 161, 168 (3d Cir. 1973)).

90. *See* Environmental Defense Fund v. EPA, 672 F.2d at 58 n.11; Keith v. Volpe, 501 F. Supp. at 412-13.

91. *See* Berger, *Court Awarded Attorneys Fees: What is Reasonable?*, 126 U. PA. L. REV. 281, 310-11 (1977).

professional obligation to perform community service.[92] Nevertheless, many courts utilize the formula set out in *Copeland*, instructing parties to develop a fee settlement based on those criteria.[93]

Fee awards are also available to the alleged violators in environmental citizen suits where frivolous or bad faith claims are shown. Although actual awards of such fees have not been reported in any case, potential plaintiffs should be aware that fee awards are available to defendants under the standard "American Rule," which allows a court to make an award of fees to parties victimized by bad faith or frivolous claims.[94]

It is noteworthy that while the prevailing standards for attorney fee awards are fairly liberal toward plaintiffs, the Supreme Court recently granted certiorari in *Sierra Club v. Gorsuch*.[95] The Court's pending scrutiny of *Sierra Club*'s "award where appropriate" analysis has raised speculation that attorneys fees may not be as broadly accepted by the Court on review.[96]

The development of the law governing citizen suits to enforce anti-pollution laws has resulted in a favorable climate for litigation. Jurisdiction and standing limitations present no major restrictions on citizen suits,[97] providing plaintiffs meet rudimentary notice requirements. The major procedural impediment has been plaintiffs' strategic error in seeking personal damages instead of remedies to abate defendants' prohibited activity.[98] It is clear that causes of action created by environmental laws are for the public benefit; therefore, the selection of remedies should be tailored to that end in order to state a proper cause of action.

Recent court decisions regarding awards of attorneys fees encourage plaintiffs in citizen enforcement suits. The District of Columbia Circuit's adoption of the "substantial contribution" theory of awarding fees to public interest litigants,[99] would seem to indicate that prevailing plaintiffs, in particular, have a strong claim to fees because their suits generally will advance the purposes of the statute at issue. In addition, the language of *Sierra Club v. Gorsuch* suggests that in cases focusing on national policy issues, non-prevailing plaintiffs stand a better chance of obtaining some fees from successful defendants than do those plaintiffs in smaller, locally oriented cases.[100]

92. *Id.* at 311. *See, e.g.*, Gilpin v. Kansas State High School Activities Ass'n, 377 F. Supp. 1233, 1253 (D. Kan. 1974).

93. *See, e.g.*, Environmental Defense Fund v. EPA, 672 F.2d at 50-61.

94. For an overview of the development of attorney fee awards in American law and the introduction of statutorily authorized awards, see Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975).

95. 672 F.2d at 33.

96. The Department of Justice argued in its petition for certiorari in *Sierra Club v. Gorsuch* that awards of attorneys fees to losing plaintiffs in suits against the government impose a major burden on government efforts, by encouraging "unproductive, expensive and time consuming litigation." Note, *Awards of Attorneys' Fees to Unsuccessful Environmental Litigants*, 96 HARV. L. REV. 677, 687 n.56 (1983) (quoting Petition for Certiorari at 8, Sierra Club v. Gorsuch, 672 F.2d 33 (D.C. Cir.), *cert. granted*, 103 S. Ct. 254 (1982).

97. The CWA contains a stricter standing requirement. *See supra* text accompanying notes 20-25.

98. *See supra* notes 48-54 and accompanying text.

99. *See supra* text accompanying notes 64-80.

100. Sierra Club v. Gorsuch, 672 F.2d at 39-40.

Because the basic legal landscape appears amenable to private enforcement of federal anti-pollution laws, the paucity of such actions must result from non-procedural factors.

V. THE SCARCITY OF CITIZEN SUITS

Examination of available case law suggests a number of reasons why citizen suits to enforce anti-pollution laws have been relatively scarce. Many violations are not readily apparent to the inhabitant of an area affected by illegal air and water pollution; violations do not often announce themselves in easily perceived forms. While some cases arise where citizens observe a visible change in the color or odor of a river, see a shift in the color or quality of industrial smokestack exhaust, or experience personal injury from contaminated drinking water or failing crops, most violations are not so evident. Nevertheless, inconspicuous deviations from emissions and discharge standards may have significant impacts on water and air quality.

A second reason for the rare use of private enforcement is the highly complex, scientific nature of many environmental regulations.[101] Average citizens may not have the ability or willingness to engage in the educational process required to understand and effectively enforce environmental quality standards.

Even where lack of knowledge is no barrier to a citizen suit, economic disincentives may stifle the prospective plaintiffs' initiative. Actual costs of a suit vary with the facts of the case; however, in the simplest case, filing of charges and motions with the court, discovery efforts, and the assembly of expert witnesses requires some financial resources "up front." The expectation that plaintiffs may be reimbursed by the court through an award of fees does not remove the immediate burden of such expenses.[102]

Other financial disincentives discourage citizen suits. Several citizens' suits to date have been brought in pursuit of compensation for personal injuries received allegedly from the illegal pollution caused by the defendant;[103] but, since private enforcement precludes recovery of damages, plaintiffs are deprived of a powerful, personal motive to sue. In addition, citizens must consider the economic risk of liability for defendants' attorneys fees. Though these awards are rare, the fear of having to pay one's adversary's legal costs may dissuade citizens from bringing suit.

Situations conducive to private enforcement action usually involve obvious regulatory violations resulting in public harm, such as a river foaming due to toxic discharges of a tanning company or the silting of a local creek by a coal mining operation. But such patent violations are also likely to be the subject of EPA or state enforcement actions. It is, therefore, arguable that a portion of citizen enforcement activity in the last decade has been preempted by some form of agency action.

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101. *See* 40 C.F.R. §§ 129-36 (1982) (examples of the complex nature of chemical regulations).

102. Heenahan Interview, *supra* note 13.

103. *See generally* City of Evansville v. Kentucky Liquid Recycling, Inc., 604 F.2d 1008 (7th Cir. 1979); Yates v. Coal Creek Co., 485 F. Supp. 995 (D. W.Va. 1980).

Agency action taken in the sixty-day notice period may also limit the number of citizen suits that actually reach the litigation stage. Because an agency letter or conference with the polluter often achieves corrective action,[104] citizen suits perform their intended role: to awaken government enforcement machinery.[105] Nevertheless, at the point where a citizen gives notice to the EPA of his intended suit, he may have expended considerable energy and resources. EPA action during the deferral stage renders those efforts non-compensable because fees are available only to litigants. Thus, citizens may be discouraged from bringing suits if they anticipate being preempted by agency action.

No one of these problems facing citizen plaintiffs may be cited as the primary cause for the scarcity of private enforcement actions. In combination, however, they present major barriers to the participation of private parties in the implementation of water and air quality statutes.

The remaining section of this paper proposes a model for citizen enforcement suits, focusing on the CWA as a potential arena for increased citizen suit participation.

VI. A Model for Private Attorneys General Actions

One of the major impediments to citizen participation in the enforcement of anti-pollution standards has been the difficulty, both perceived and real, of collecting sufficient factual evidence on which to base citizen enforcement suits.[106] Several factors contribute to this problem including the complexity of pollution standards, the specialized technology often required to discover violations of regulations, and the cost of acquiring data. During the initial years of anti-pollution legislation, citizens were on their own to collect necessary information; but as state and federal administration of those laws developed, a number of agencies have created substantial resource systems from which private citizens can draw information to support their enforcement efforts.[107]

The machinery created for the administration of anti-pollution laws is illustrative of the government resources presently available to citizens. The EPA is divided into geographic regions, each administered by an office containing an enforcement division and a compliance division.[108] These regional offices are responsible for: 1) the collection of compliance data from all parties governed by federal pollution laws and regulations; 2) the coordination of the enforcement efforts of the state environmental programs with the region; and 3) the screening and development of desirable enforcement actions, which are forwarded to the EPA headquarters in Washington, D.C. for approval and reference to the Department of Justice.[109]

104. Voltaggio Interview, *supra* note 38.
105. *Id.*
106. *Id.*
107. *Id.*
108. Interview with Anne Pyzick, Report Manager, EPA Region III NPDES Compliance Division, in Philadelphia (Mar. 19, 1982) [hereinafter cited as Pyzick Interview].
109. Voltaggio Interview, *supra* note 38.

Each region has developed its own reporting and compliance evaluation system,[110] tailored to the needs of the federal jurisdiction in the area and the memoranda of agreement signed with the delegated states in the region. Delegated states have elected to accept primary responsibility for enforcement of water quality standards subject to EPA review.[111] These states issue permits to parties who are subject to emission and discharge regulations, collect monthly discharge reports from permittees, and seek compliance with limitations or standards through administrative or civil actions.[112] Delegated states must report to the EPA regional administration any compliance information as specified in the memorandum of agreement for that state. By contrast, in non-delegated states the EPA compiles all compliance information and carries out enforcement actions.[113]

EPA Region III offers a good example of a reporting system under the CWA. The principal reporting document is the National Pollutant Discharge Elimination System (NPDES) permit, which describes the specific limitations under which the permittee must operate.[114] In order to ascertain whether those limitations are being complied with, the NPDES permit typically requires the permittee to file a monthly discharge monitoring report (DMR).[115] The DMR requires three categories of information.

1) Permitted Discharge Levels. Each permittee is permitted to discharge amounts of various effluent matter, measured both by total volume of discharge and by the concentration of effluent in the water receiving the discharge. The limitations circumscribe safe levels of discharge of chemical compounds, total suspended solid materials, and other water quality measures such as water acid content, biochemical oxygen, and water color. The DMR also locates the permittee and the specific body of water receiving discharges.

2) Method of Discharge Analysis. As specified in the NPDES permit, effluent discharges are measured by the permittee utilizing various testing methods. Sampling is done one of two ways: "composite sample," a combination of individual samples taken at regular intervals proportional to the discharge flow rate, or in volumes proportional to the total flow; or a "grab sample," an individual sample taken to spot check the water quality and content. By multiplying the proportional content of the sample by the total flow, which is also a regulated quantity, a permittee computes total output levels of the effluents. Most effluent discharges are regulated by average as well as by minimum/maximum output level.

3) Actual Discharge Levels. These are the actual figures which describe the permittee's discharge activity for the reported month, the results of the permittee's mandatory sampling under the NPDES permit.[116]

110. Pyzick Interview, *supra* note 108.

111. *See, e.g.*, 33 U.S.C. §§ 1316-19 (1976 & Supp. V 1981).

112. Pyzick Interview, *supra* note 108.

113. *Id.*; *see supra* text accompanying notes 109-10.

114. 40 C.F.R. § 122.18 (1982) established reporting requirements under the CWA.

115. 40 C.F.R. § 122.7(j) (1982).

116. All information regarding DMRs was gathered through Freedom of Information Act requests. *See also* Pyzick Interview, *supra* note 108; interview with John Hundertmark, Engineer,

Immediately available to the public once filed with the regional office, DMRs are not difficult to interpret. Substantial violations by the permittee may be identified by comparing the discharge level reported with the permitted level of effluent output. The gravity of a violation, however, may be burdensome to estimate because a number of considerations qualify the importance of effluent discharges. For example, in some parts of the country it is more difficult for permittees to meet permit standards during the winter months than from June to October, owing to decreased water levels in most inland tributaries; effluent concentrations necessarily increase during such times, although the actual amounts discharged remain static.[117] Many NPDES permits take these seasonal changes into account, dictating relaxed effluent limits during periods of low water flow.[118]

The Code of Federal Regulations requires that each regional office produce a quarterly noncompliance report (QNCR) which catalogues all instances of NPDES violations by major effluent sources in the region.[119] Among the violations recorded in the QNCR are failures to submit DMRs, submission of inadequate DMRs, failures of municipal entities to meet secondary treatment construction schedules, and deviations beyond effluent discharge limitations.[120] The regulations, however, do not require the publication of all discharge violations, only those violations that the permittee has not remedied within forty five days from the DMR reporting date.[121] Under most NPDES permits, the reporting date is twenty eight days after the end of each month.[122] Permittees, therefore, have approximately ten weeks to correct discharge violations before risking publication. Some permittees try to avoid publication of violations in the QNCR by a series of excess discharges followed by corrective action within the forty-five day period. To prevent these cyclical violations, the regulations also require the publication of those violations which establish a pattern of noncompliance over the most recent four-month reporting period.[123]

The availability of NPDES reports to private citizens is key to the effi-

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Region III NPDES Permit Division in Philadelphia (Mar. 19, 1982) [hereinafter cited as Hundertmark Interview].

117. Heenahan Interview, *supra* note 13. For an example of seasonal effects on effluent concentrations in tributaries receiving discharges, see Discharge Monitoring Reports of the Hershey Chocolate Co., NPDES Permit No. Pa. 0008087 (Mar. 1982) (on file at the Denver Law Journal) (low seasonal flow creating temperature differentials of 10 degrees in excess of permitted levels).

118. *See, e.g.*, NPDES Permit of the City of St. Albans, NPDES Permit No. WV. 0023175, EPA, Region III, Philadelphia, Pa. (variance of organic nitrogen and ammonia nitrogen levels from June to October and November to May).

119. 40 C.F.R. § 122.18 (1982). EPA compiles a similar report on violations by non-major permittees which is published annually. 40 C.F.R. § 122.18(c) (1982).

120. *See, e.g.*, EPA Region III Quarterly Non-Compliance Report for Period Ending September 1981, EPA Region III, Philadelphia, Pa. (Dec. 1981) (on file at the Denver Law Journal).

121. 40 C.F.R. § 122.18(a)(2)(A) (1982). In addition to using DMRs and QNCRs to determine NPDES permit violators, citizens can retrieve discharge information from the EPA by filing a Freedom of Information Act request.

122. Pyzick Interview, *supra* note 108. *See also* NPDES Permit of Met Fin Co., NPDES Permit No. WV 0004596, EPA, Region III, Philadelphia, Pa. (on file at the Denver Law Journal).

123. 40 C.F.R. § 122.18(a)(2)(B) (1982).

cient use of citizen suits to enforce water pollution laws. First, the reports readily identify the sources of pollution, their locations, and the public waters affected by the effluent discharges.[124] Second, the DMRs filed by permittees clearly describe specific discharge activities.[125] If a permittee is exceeding his effluent limitations, one need only look to the results of the permittee's monitoring tests to verify the violations. The DMRs provide the EPA and private attorneys general with a *prima facie* case of illegal water pollution activity against the NPDES violator.[126] In addition, the quarterly and annual noncompliance reports indicate which violations have been targeted for compliance by informal or judicial administrative efforts.

Although the average QNCR in Region III contains more than 1500 discharge and reporting violations,[127] not all of the listed CWA violations are appropriate for citizen enforcement suits. Where agency enforcement action has commenced, private efforts would be duplicative. Moreover, many violations identified in the QNCR may not warrant the investment of litigation resources; citizen suits for small, inconsistent violations lack cost effectiveness. Thus, the dilemmas facing potential plaintiffs are numerous. If citizens are to accept increased responsibility for the enforcement of the CWA and other anti-pollution statutes in response to flagging EPA activities, a coherent litigation strategy must be developed.

Because relatively few citizen enforcement suits have been brought directly against polluters, successful litigation strategies have not been developed. One alternative is to examine the EPA's exercise of prosecutorial discretion in its case selection process. At a minimum, regional staff attorneys consider four factors to decide whether a violator should be prosecuted: degree of excursion from stipulated discharge limits, time over which the violations occurred, corrective action taken to bring the effluent source into compliance with the permit, and future corrective measures planned.[128]

When evaluating degree of excursion from stipulated discharges, it is difficult to determine when effluent discharges constitute a significant enough excursion to support enforcement. Obviously, the limitations of the permit delineate acceptable emission levels within the regulation. Small deviations from the limitations may or may not have a major impact on the affected tributary. In addition, testing methods may provide ambivalent data on discharges, such as a permittee who reports being within his permitted maximum daily discharge, but far exceeds the allowable monthly discharge standard. In such cases the agency often has been unwilling to institute an administrative action;[129] however, the violation could support a private enforcement proceeding notwithstanding EPA's exercise of prosecutorial discretion.

The duration of a violative practice may raise the significance of an excursion to an actionable level. For example, a poultry processing plant

124. *See supra* text accompanying note 116.
125. *Id.*
126. Heenahan Interview, *supra* note 13; Voltaggio Interview, *supra* note 38.
127. Hundertmark Interview, *supra* note 116.
128. Heenahan Interview, *supra* note 13.
129. *Id.*

exceeding its Biological Oxygen Demand (BOD)[130] daily maximum limitation for eighteen consecutive months indicates disregard for the statutory requirements imposed by the CWA. The permittee may claim that his excursions are relatively small; but, if he fails to comply over a period of months, the permittee is a good candidate for enforcement proceedings. In contrast, many instances of noncompliance found in the QNCR are short term excursions[131] caused by temporary equipment failures or seasonal variations, after which the permittee returns to compliant discharge levels.[132] Because the statute does not provide citizens with a cause of action for past violations, one-time or infrequent violators technically would not be valid subjects for citizen actions.[133] Where it appears, however, that structural or technical infirmities of a permittee's pollution control system create the expectation of future violations, equitable remedies allow suit for injunctive relief. Expectations of continued excessive discharges must be measured by a consistent pattern of past violations, over a minimum period of three or four months.[134] Examination of violators' DMRs would supply data to determine the duration of violations.[135]

Citizens should avoid bringing suits against polluters who are in the process of correcting problems in their discharge treatment equipment. This suggestion does not indicate that violators are able to avoid enforcement by promising corrective action when threatened with a suit, but rather that those permittees making good faith efforts to comply with their permits are not cost-effective subjects for citizen actions.

Since 1977, permittees under the CWA have been required to use the Best Practical Technology (BPT) in their efforts to reduce effluent discharges to acceptable levels.[136] Insuring that such technology is continually effective presents a problem in a number of industries; constant repair and modification is necessary to meet permitted discharge levels. During these repair periods, permittees report violations over which they exercise little control.[137]

Some violations exceed permit limitations but, nevertheless, are difficult to enforce for policy or economic considerations. For example, a small company, which has conscientiously attempted to meet its NPDES discharge standards, spends perhaps $2-3 million installing the Best Practical Technology but discovers that the technology fails to perform as needed. The company remains in violation of its permit. Because of its substantial expenditure on treatment equipment, the company rejects plans for corrective action in the immediate future. This situation, considered in light of

130. The BOD level is a quantification of the amount of oxygen necessary to maintain the ecological balance of the subject tributary. *See* O'Leary v. Moyer's Landfill, Inc., 523 F. Supp. at 653 n.22.

131. *See supra* text accompanying notes 119-22.

132. Dates on which a permittee returns to compliance prior to publication also appear in the QNCR. 40 C.F.R. § 122.18(a)(1)(iv) (1982).

133. *See supra* text accompanying notes 48-54.

134. Heenahan Interview, *supra* note 13.

135. *See supra* text accompanying notes 115-17.

136. *See, e.g.*, *Pymatuning Water Shed*, 506 F. Supp. at 909.

137. *See* NPDES Permit for the City of St. Albans and Pursuant Correspondence, *supra* note 118.

EPA's case selection criteria,[138] presents a potential cause of action. The likelihood that a court would grant any significant relief to claimants, however, is negligible. The company has, in fact, met its statutory burden of fitting BPT equipment. Although the system failed to achieve acceptable performance levels, the courts may deem equipment failure more a misfortune of the marketplace than a situation of the company's inattention to NPDES standards.[139] Consequently, private enforcement resources would not be wisely spent bringing suit against the company unless the alleged discharges had an environmental impact that overshadowed the benefits of continued plant operation. In enacting the CWA, Congress theoretically balanced these factors and decided that environmental protection was the predominant consideration; however, practical aspects of the laws' application will probably lead courts to deny any major form of relief where no immediate threat to public health exists.

Generally, municipal treatment facilities are good subjects for citizen enforcement actions. The crunch in local public funds of the mid-1970's caused many jurisdictions to become lax in the operation and maintenance of their treatment facilities. Many localities have been unable to construct water treatment facilities without the assistance of federal grant monies available through the CWA.[140] Because of these difficulties the EPA has been reluctant to initiate enforcement proceedings against jurisdictions that have not acquired federal grants. Although fiscal incapacity to attain compliance with NPDES standards is not a defense to a charge of failing to install BPT treatment facilities, the factor effectively reduces the court's options to construct an appropriate remedy. For this reason, EPA suits have focused on municipal violators that have the fiscal capacity to properly comply with effluent guidelines, or have rejected available funds.[141]

A private enforcement group created with the intent to implement a plan of action could be organized efficiently on a regional basis. First, regional enforcement groups could confront environmental problems where they frequently occur: at the interstate level. Local enforcement efforts aimed at large local pollution sources may be sufficient to halt various immediate point sources from further violations of the law, but fail to cleanup the entire stream where discharges were attributable to out-of-state points of emission. A regional structure also would effectively coordinate with EPA regional reporting and administrative systems. Where federal or state authorities in a region are active in cleaning up a particular water body, private resources could be channeled to complement enforcement efforts.

VII. CONCLUSIONS

To predict the success of large-scale efforts to enforce anti-pollution laws through a scheme of citizen suits would be highly speculative. The history of citizen suits brought directly against polluters provides little indication of

138. *See supra* text accompanying note 129.
139. Heenahan Interview, *supra* note 13.
140. 33 U.S.C. § 1256 (1976 & Supp. V 1981).
141. Hundertmark Interview, *supra* note 116.

how a continuous, organized program of litigation would fare as a public interest enterprise. The stage is set for a systematic attempt to privately enforce environmental statutes. The evolution of federal administrative machinery in support of those laws has created a store of discovery materials on which citizens may draw to identify and assemble cases. This is the cornerstone of any future private enforcement venture. The EPA reporting machinery facilitates selection of violations and significantly reduces the costs of discovery. The judiciary seems favorably disposed to the award of attorneys fees to plaintiffs bringing effective or useful citizen suits. Though it is impossible to state with any certainty that courts will allow all plaintiffs the full value of the fees and costs incurred in litigation, it is clear that courts are currently more willing to make such awards than at any time in the past. As a result, the financial deterrents are less threatening than in previous years.

These favorable mechanical factors create the opportunity for an effectively organized and conducted private enforcement group to operate. As federal enforcement efforts are directed away from the CAA and CWA, and the degradation of the environment becomes an expanding threat, the use of citizen suits to enforce anti-pollution laws becomes correspondingly more attractive and feasible.

INTERNAL REVENUE SERVICE INVESTIGATIONS OF UNIDENTIFIED PERSONS

JEROLD A. FRIEDLAND*

I. INTRODUCTION

In 1976, legislation was enacted that substantially restricted the Internal Revenue Service's (IRS) power to issue John Doe summonses to investigate unidentified persons.[1] Congress action reflected its concern about the use of these summonses to conduct "fishing expeditions" through the records of banks and other third parties in the hope of uncovering useful information about someone.[2] The new law seeks to protect the privacy of such records by permitting a John Doe summons to issue only *after* the IRS has satisfied a district court, in an *ex parte* hearing, that there is a reasonable basis for believing that ascertainable persons may have violated the tax laws.

The new legislation and IRS interpretation of the statute have raised a number of questions concerning the scope of the IRS authority to conduct investigations or research projects not focused upon any particular taxpayer or tax liability. One issue involves IRS attempts to circumvent the John Doe summons requirements by requesting information about unidentified persons while auditing an identified taxpayer. An administrative summons is issued for documents relevant to the audited person's tax liability.[3] The IRS does not follow the John Doe summons requirements even though the records concern unidentified persons. The courts have disagreed about whether administrative summonses with a dual purpose of investigating both the audited person and an unidentified person are enforceable. Several courts have ruled administrative summonses with a dual purpose are enforceable[4] while one court has required the IRS to follow the John Doe summons requirements any time information is requested about unascertained persons.[5]

The IRS has also sought to avoid the John Doe summons procedures by

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1. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1205, 90 Stat. 1520, 1701 (codified at I.R.C. § 7609(f) (1976)).

2. H.R. REP. NO. 658, 94th Cong., 1st Sess. 311 (1975) *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 2897, 3207 [hereinafter cited as H.R. REP. 658]; S. REP. NO. 938, 94th Cong., 2d Sess. 373 *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3802 [hereinafter cited as S. REP. 938].

3. The general administrative summons is issued pursuant to I.R.C. § 7602 (1976). *See infra* note 14 and accompanying text.

4. United States v. First Nat'l Bank, 635 F.2d 391 (5th Cir. 1981); United States v. Flagg, 634 F.2d 1087 (8th Cir.), *cert. denied*, 451 U.S. 909 (1980); United States v. Barter Sys., Inc., 82-2 U.S. Tax Cas. (CCH) ¶ 9698 (8th Cir. 1982); United States v. Constantinides, 80-2 U.S. Tax Cas. (CCH) ¶ 9830 (D.C. Md. 1980). *See infra* notes 64-66 and 73-86 and accompanying text.

5. United States v. Gottlieb, 82-1 U.S. Tax Cas. (CCH) ¶ 9257 (M.D. Fla. 1982). *See infra* notes 67-69 and accompanying text.

relying upon a statutory right to inspect records that taxpayers and other third parties are required to maintain.[6] The IRS has asserted that the inspection authority is implicit in the statutes that mandate recordkeeping.[7] Such warrantless inspections, however, may raise serious constitutional issues in light of Supreme Court decisions involving administrative searches.[8]

Another controversy focuses on the reasonable basis standard for issuing and enforcing a John Doe summons. The courts have disagreed as to what the IRS must show to establish a reasonable basis for its belief that the taxpayer has not complied with the tax laws. Some courts have concluded this belief may be based upon IRS audit experience and statistical analyses,[9] while one court has required evidence about the specific unidentified person or transaction.[10] Courts have also disagreed about whether the *ex parte* judicial determination authorizing issuance of a John Doe summons may be challenged in a subsequent adversarial enforcement proceeding.[11]

A final area of concern is the possible "chilling effect" an IRS summmons may have upon the exercise of first amendment freedoms. It has been asserted that a summons for documents identifying members of controversial groups has an impermissible impact upon the members' freedom of association.[12] Similarly, summonses for records of religious organizations have been challenged as infringing upon the members' right to exercise their religious beliefs.[13] The courts in each of these cases have attempted to create standards that will protect the interests of both the IRS and the taxpayers.

II. BACKGROUND

A. *Administrative Summonses in General*

The basic investigatory tool of the IRS is the administrative summons authorized by I.R.C. Section 7602.[14] The statute grants the IRS broad pow-

6. This claim is based upon I.R.C. § 6001 (Supp. V 1981) and the regulations promulgated thereunder.

7. United States v. Mobil Corp., 543 F. Supp. 507 (N.D. Tex. 1981); United States v. Ohio Bell Tel. Co., 475 F. Supp. 697 (N.D. Ohio 1978). *See infra* notes 87-108 and accompanying text.

8. Marshall v. Barlow's, 436 U.S. 307 (1978); Camara v. Municipal Court, 387 U.S. 523 (1967); See v. Seattle, 387 U.S. 541 (1967). *See also* United States v. Mobil Corp., 543 F. Supp. 507, 517-19 (N.D. Tex. 1981). *See infra* notes 109-19 and accompanying text.

9. United States v. Pittsburgh Trade Exch., Inc., 644 F.2d 302 (3d Cir. 1981); United States v. Island Trade Exch., Inc., 535 F. Supp. 993 (E.D.N.Y. 1982). *See infra* notes 120-28 and accompanying text.

10. United States v. Brigham Young Univ., 679 F.2d 1345 (10th Cir. 1982). *See infra* notes 129-44 and accompanying text.

11. United States v. Brigham Young Univ., 679 F.2d 1345 (10th Cir. 1982), *cert. granted*, 103 S. Ct. 713 (1983); United States v. Pittsburgh Trade Exch., Inc., 644 F.2d 302 (3d Cir. 1981); *In re* John Does, Dairy Cattle Prog., 541 F. Supp. 213 (N.D.N.Y. 1982); United States v. Island Trade Exch., Inc., 535 F. Supp. 993 (E.D.N.Y. 1982). *See infra* notes 146-69 and accompanying text.

12. United States v. Citizens State Bank, 612 F.2d 1091 (8th Cir. 1980). *See infra* notes 170-78.

13. United States v. Grayson County State Bank, 656 F.2d 1070 (5th Cir. 1981), *cert. denied*, 455 U.S. 1920 (1982); United States v. Holmes, 614 F.2d 985 (5th Cir. 1980). *See infra* notes 179-86.

14. I.R.C. § 7602 (1976) provides:
Examination of books and witness

ers to require persons to produce information relevant to the determination or collection of federal taxes. In *United States v. Powell*[15] the Supreme Court analogized the IRS summons to a grand jury subpoena,[16] and held that the government need make no showing of probable cause to obtain enforcement of a summons.[17] A subpoena may be issued, therefore, based on suspicion that the laws have been violated, or merely to ascertain that the law *is* being obeyed.[18]

Although issued by an IRS agent, an administrative summons is enforced only through an order of a federal district court.[19] This enforcement proceeding provides for an impartial judicial officer to determine whether the summons meets all statutory and constitutional requirements. In *Powell*, the Supreme Court held that a summons will be enforced if: 1) the investigation has a legitimate purpose, 2) the information sought is relevant to the purpose, 3) the IRS does not already possess the information, and 4) the summons procedural requirements have been followed.[20]

The *Powell* decision maintained that a taxpayer may challenge a summons on "any appropriate ground."[21] Prior to the Tax Reform Act of 1976,[22] however, taxpayers had little opportunity to challenge a summons served on a third party seeking information about their affairs. In many instances, the third parties (such as banks and credit-card issuers) voluntarily complied with the summons, thereby eliminating the judicial enforcement proceeding.[23] The IRS was not required to notify taxpayers that informa-

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For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

15. 379 U.S. 48 (1964).

16. *Id.* at 57.

17. *Id.*

18. *Id.* at 57-58.

19. I.R.C. § 7402(b) (1976) provides:

To Enforce Summons—

If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

20. 379 U.S. at 57-58.

21. *Id.* at 58 (citing Reisman v. Caplin, 375 U.S. 440, 449 (1964)).

22. Pub. L. No. 94-455, 90 Stat. 1699 (codified in scattered sections of 26 U.S.C.).

23. *See generally* Kenderdine, *The Internal Revenue Service Summons to Produce Documents: Powers, Procedures, and Taxpayer Defenses*, 64 MINN. L. REV. 73 (1977); Note, *Taxation: IRS Use of John Doe Administrative Summonses*, 30 OKLA. L. REV. 465 (1977); Comment, *Government Access to Bank*

tion concerning their affairs was being requested from a third party. Even if the taxpayer was aware of the summons, he could not be assured that the third party would assert any defenses in his absence. Moreover, if the summoned third party refused to comply, the taxpayer had no absolute right to intervene in the enforcement proceeding to present his case.[24]

Congress provided a partial remedy in 1976 by creating special procedures for the issuance of third-party summonses. Section 7609(a)(1) requires the IRS to notify a taxpayer whenever a summons concerning his affairs is served upon a statutorily defined third-party recordkeeper.[25] If the taxpayer challenges the summons, the IRS must seek an enforcement order in the district court.[26] The taxpayer now has an absolute right to intervene in the enforcement proceeding and he may raise any appropriate defense.[27]

B. *The John Doe Summons*

Obviously, if the taxpayer's identity is not known, the rights to notice of the summons and to intervene in the enforcement proceeding provide no practical protection. In these situations I.R.C. section 7609(f) provides judicial supervision for IRS use of the John Doe summons by requiring a district court proceeding *before* the summons is issued.[28] In that proceeding, the IRS must establish that: 1) the summons relates to an investigation of particular

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Records in the Aftermath of United States v. Miller *and the Tax Reform Act of 1976*, 14 HOUS. L. REV. 636 (1977).

24. Donaldson v. United States, 400 U.S. 517, 527-30 (1971) (taxpayer may not intervene in third-party summons enforcement proceeding merely because his tax liability is the subject of the summons).

25. I.R.C. § 7609(a)(3) (West Supp. 1983).

Third-party recordkeeper defined.

For purposes of this subsection, the term "third-party recordkeeper" means—

(A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501(c)(14)(A));

(B) any consumer reporting agency (as defined under section 603(d) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f)));

(C) any person extending credit through the use of credit cards or similar devices;

(D) any broker (as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)));

(E) any attorney;

(F) any accountant; and

(G) any barter exchange (as defined in section 6045(c)(3)).

26. The Tax Equity and Fiscal Responsibility Act of 1982 (Act), Pub. L. No. 97-248, 96 Stat. 324 (codified in scattered sections of 26 U.S.C.), made some changes in this area. Prior to this Act, a taxpayer could stay compliance of the summons by notifying the third party. The new statute requires the taxpayer to file a petition to quash the summons in the appropriate district court within 20 days after receiving notice of the summons. Tax Equity and Fiscal Responsibility Act of 1982, § 331(a), (b) (codified at I.R.C. § 7609(b)(2), (d) (West Supp. 1983).

27. I.R.C. § 7609(b)(1) (West Supp. 1983).

28. I.R.C. § 7609(f) (West Supp. 1983).

Additional requirement in the case of a John Doe summons.—

Any summons described in subsection (c) which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that—

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or

persons; 2) there is a reasonable basis for believing the person being investigated has not complied with the tax laws; and 3) the information sought is not readily available from other sources.[29]

The John Doe summons requirements provide greater taxpayer protection than the general administrative summons requirements. One major difference is the John Doe summons requirement that the IRS must establish a reasonable basis for believing that the unidentified taxpayer has not complied with the tax laws.[30] This limitation on the traditionally broad investigatory power of the IRS questions the validity of the Supreme Court's analogy in *Powell* between an IRS summons and a grand jury subpoena.[31] A second important difference is that the restrictions of section 7609(f) apply to the issuance of *all* John Doe summonses, whereas the notice requirements of section 7609(a) are only applicable when a summons is served on a third-party recordkeeper.[32]

The legislative history of the Tax Reform Act of 1976[33] suggests section 7609(f) was enacted in response to a congressional belief that the IRS might abuse the summons power in the case of unidentified taxpayers.[34] The legislation appears to have been prompted by the Supreme Court's holding in *United States v. Bisceglia*.[35] Several commentators suggested *Bisceglia* allowed the IRS to use a John Doe summons as a "license to fish" through third-party records.[36] Although the committee reports do not indicate an intent to overrule any particular decision, it is clear Congress was not satisfied that the privacy interests of taxpayers were properly safeguarded.[37]

In *Bisceglia*, the IRS was attempting to learn the identity of a person who had deposited $20,000 in "paper thin, severely disintegrated" $100 bills

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class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

29. *Id.*

30. I.R.C. § 7609(f)(2).

31. 379 U.S. at 57. *See supra* notes 15-18 and accompanying text.

32. *See supra* note 25 and accompanying text.

33. Pub. L. No. 94-455, 90 Stat. 1699 (1976).

34. The House Ways and Means Committee explained its rationale for changing the law relating to administrative summonses as follows:

> The Service has instituted an administrative policy designed to establish certain safeguards in this area. Under this policy, IRS representatives are instructed to obtain information from taxpayers and third parties on a voluntary basis where possible. Where a third party summons is served, advanced supervisory approval is required. In the case of a John Doe summons, the advance supervisory approval must be obtained on a high level basis. The committee believes, however, that these administrative changes, while commendable, do not fully provide all of the safeguards which might be desirable in terms of protecting the right of privacy.

H.R. REP. 658, *supra* note 2, at 307; S. REP. 938, *supra* note 2, at 368.

35. 420 U.S. 141 (1975).

36. *See* Note, *The IRS Gets Its Fishing License*—United States v. Bisceglia, 11 GONZ. L. REV. 251 (1976) [hereinafter cited as *IRS Gets Fishing License*]; Note, *Federal Tax Procedure—An Extension of the Summons Authority of the Internal Revenue Service*, 21 LOY. L. REV. 1026 (1975) [hereinafter cited as *Extension of Summons*]; Note, *IRS Subpoena Power to Investigate Unknown Taxpayers*, 50 N.Y.U. L. REV. 177 (1976) [hereinafter cited as *IRS Subpoena Power*].

37. H.R. REP. 658, *supra* note 2, at 307; S. REP. 938, *supra* note 2, at 373.

at a bank.[38] An IRS agent, suspecting unpaid taxes, issued a John Doe summons to the bank requesting all its records for the time period during which the deposits were made. The bank refused to comply and the IRS obtained an enforcement order from the district court.[39] The Sixth Circuit reversed, holding that the section 7602 summons power requires the IRS to identify the person it wishes to investigate.[40]

Chief Justice Burger, writing for the majority, disagreed with this conclusion, emphasizing the practical necessities of the tax collection business. "[I]t would be naive," the Chief Justice maintained, "to ignore the reality that some persons attempt to outwit the system, and tax evaders are not readily identifiable."[41] The opinion suggests that the IRS summons power must be viewed against such a realistic background.

The Court stressed that sections 7601 and 7602 authorize the IRS to investigate *all* persons who may be liable for *any* tax and to summon *any* persons with respect to *any* tax liability.[42] To read these statutes in a restrictive fashion would ignore the fact the IRS "has a legitimate interest in large or unusual financial transactions, especially those involving cash."[43] It would be impractical to investigate such transactions if the IRS was required to ascertain the identities of the persons involved. Such a requirement would frustrate the broad power of inquiry authorized by Congress in section 7601.[44]

Chief Justice Burger's opinion rejected the contention that the Court was permitting the IRS to carry on "fishing expeditions into the private affairs of bank depositors."[45] Because the IRS must enforce a summons through the courts,[46] taxpayers will be protected from improper searches. The Court did not, however, address the practical question of who would challenge a John Doe summons, given that the summoned third party has little at stake.

A second decision, *United States v. Humble Oil & Refining Co.*,[47] apparently convinced Congress that the IRS might engage in "fishing expeditions." The issue in *Humble Oil* was the enforceability of a John Doe summons issued in connection with an IRS research project concerning the extent of tax avoidance among mineral property lessors. The summons requested the names of all mineral lessors who held leases that were surrendered by Humble Oil without production.[48] The Fifth Circuit refused to enforce the summons and held the section 7602 summons authority extended only to investigations of specific individuals. The summons power could not be used

38. 420 U.S. at 142-43.
39. United States v. Bisceglia, 72-1 U.S. Tax Cas. (CCH) ¶ 9474 (D.C. Ky. 1972).
40. Bisceglia v. United States, 486 F.2d 706, 710 (6th Cir. 1973).
41. 420 U.S. at 145.
42. *Id.* at 149.
43. *Id.*
44. *Id.* at 150.
45. *Id.*
46. *Id.* at 151.
47. 488 F.2d 953 (5th Cir. 1974), *vacated and remanded*, 421 U.S. 943, *aff'd per curiam*, 518 F.2d 747 (5th Cir. 1975).
48. 488 F.2d at 954.

to conduct general research projects.[49]

The Supreme Court vacated the Fifth Circuit's decision and remanded the case for reconsideration in light of the holding in *Bisceglia*.[50] On remand, the Fifth Circuit again concluded the summons was unenforceable.[51] The court distinguished *Bisceglia* as involving an ongoing particularized investigation which presented facts indicating tax evasion.[52] In contrast, *Humble Oil* involved a research project that might reveal liability for unpaid taxes only as a result of an IRS fishing expedition.[53]

Justices Blackmun and Powell in their concurring opinion in *Bisceglia* observed that a John Doe summons may be used to learn the identity of a particular person whose transactions "strongly suggest liability for unpaid taxes."[54] The Fifth Circuit's holding in *Humble Oil* is in agreement with this interpretation.[55] If this more limited view of the summons power had been generally accepted, it is doubtful Congress would have enacted section 7609(f). The legislative history of section 7609 indicated, however, that Congress feared *Bisceglia* allowed the IRS to roam at will through third-party records in order to discover liability for unpaid taxes.[56]

III. WHEN MUST THE JOHN DOE SUMMONS BE USED

A. *The Dual Purpose Summons*

Many of the questions about John Doe summonses have arisen in connection with the burgeoning phenomenon of barter exchanges. These entities operate as clearinghouses for exchanges of goods and services between exchange members. Each member is credited with units in proportion to the dollar value of the goods and services he provides. These units are then traded for goods and services contributed by other exchange members.[57]

With few exceptions,[58] an exchange of property is a taxable event which is to be reported as income by each party to the exchange. The amount of reportable income equals the difference between the value of the property received and the adjusted basis of the property contributed. In the barter exchange context, the IRS views the taxable event as occurring when the member's account is credited with units having an ascertainable market value.[59] IRS experience indicated exchange members frequently failed to report income from barter exchange transactions.[60]

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49. 488 F.2d at 962-63.
50. 421 U.S. 943 (1975).
51. 518 F.2d at 748-49.
52. *Id.*
53. *Id.*
54. 420 U.S. at 151 (Blackmun, J., concurring).
55. 518 F.2d at 748-49.
56. H.R. REP. 658, *supra* note 2, at 307; S. REP. 938, *supra* note 2, at 373. *See generally IRS Gets Fishing License*, *supra* note 36; *Extension of Summons*, *supra* note 36; *IRS Subpoena Power*, *supra* note 36.
57. United States v. Barter Sys., Inc., 82-1 U.S. Tax Cas. (CCH) ¶ 9127 (D. Neb. 1981).
58. Nonrecognition or deferral of gain realized from a property exchange is provided for certain exchanges of "like-kind" property by I.R.C. § 1031 (1976).
59. Rev. Rul. 80-52, 1980-1 C.B. 100.
60. Congress responded to the increasing use of barter exchanges as tax avoidance devices in the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324

The IRS sought to discourage the use of barter exchanges as a tax avoidance device by selecting a high proportion of exchange members for audit.[61] To identify exchange members, the IRS summoned membership lists in the course of exchange audits. These summonses have been resisted on the grounds that the IRS is seeking information about unidentified taxpayers without following the John Doe summons requirements[62] or that the information is for a general research project and therefore contrary to the *Humble Oil* ban on general research summonses.[63]

In *United States v. Constantinides*,[64] a district court enforced a summons for a barter exchange's membership list even though the IRS clearly intended to use the information in connection with a research project. The summons was enforced because the information requested was relevant to a determination of the exchange's tax liability.[65] The summons was not invalid merely because it might also be useful for an IRS research project.[66]

Not all courts agree with the *Constantinides* rationale. In *United States v. Gottlieb*,[67] the court held the IRS must follow John Doe summons procedures whenever they request information about unidentified taxpayers from a third party.[68] The court reasoned that if the IRS could obtain information about unidentified taxpayers while auditing a third party, they would never have to use the John Doe summons procedures.[69]

A Nebraska district court, in *United States v. Barter Systems, Inc.*,[70] followed a rationale similar to *Gottlieb* in concluding that section 7609(f) was intended to make a firm distinction between investigations of identified and unidentified persons. The opinion indicates section 7609(f) was intended by Congress to be a limitation on the broad investigative powers of the IRS.[71] Therefore, a summons issued in the course of an audit must comply with the special John Doe provisions if the IRS intends to use the information for the primary purpose of investigating unknown persons.[72]

The Eighth Circuit reversed, maintaining that the lower court had construed the scope of the IRS summons power too narrowly.[73] The court indicated the IRS summons authority should be upheld unless it was expressly

(codified in scattered sections of 26 U.S.C.). This Act amended I.R.C. § 6045 (West Supp. 1983), making barter exchanges subject to transaction reporting requirements. The Act also amended I.R.C. § 7609(a) (West Supp. 1983) to classify a barter exchange as a third-party recordkeeper.

61. United States v. Constantinides, 80-2 U.S. Tax Cas. (CCH) ¶ 9830 at 85,733 (D. Md. 1980).

62. *See supra* notes 28-29 and accompanying text.

63. *See supra* notes 47-53 and accompanying text.

64. 80-2 U.S. Tax Cas. (CCH) ¶ 9830 (D. Md. 1980).

65. *Id.* at 85,734.

66. *Id.* at 85,735.

67. 82-1 U.S. Tax Cas. (CCH) ¶ 9257 (M.D. Fla. 1982).

68. *Id.* at 83,561.

69. *Id. Contra* United States v. Barter Sys., Inc., 82-2 U.S. Tax Cas. (CCH) ¶ 9707 (E.D. Mich. 1982).

70. 82-1 U.S. Tax Cas. (CCH) ¶ 9127 (D.C. Neb. 1981), *rev'd*, 82-2 U.S. Tax Cas. (CCH) ¶ 9698 (8th Cir. 1982).

71. 82-1 U.S. Tax Cas. (CCH) at 83,094.

72. *Id.*

73. United States v. Barter Sys., Inc., 82-2 U.S. Tax Cas. (CCH) ¶ 9698 at 85,519-20 (8th Cir. 1982).

prohibited by statute or was contrary to substantial policy interests. The court concluded that section 7609(f) is not a limit on IRS use of a general summons during an investigation of a named taxpayer even though the summons requires disclosure of information relating to unidentified taxpayers whom the IRS might also wish to audit.[74]

The IRS experience in enforcing summonses issued in connection with its Taxpayer Compliance Measurement Program (TCMP) also sheds light on the dual purpose summons issue.[75] The TCMP is a research project designed to evaluate overall compliance with tax reporting requirements.[76] Several thousand taxpayers are selected randomly by computer for intensive audits. The ultimate purpose of the TCMP is to increase the IRS efficiency by concentrating enforcement efforts on specific problem areas.[77]

In *United States v. Flagg*,[78] the IRS sought enforcement of a summons served on a taxpayer selected under the TCMP. Although the district court refused to enforce the summons,[79] the Eighth Circuit reversed, maintaining the IRS summons power must be construed broadly to effectuate congressional intent that the IRS insure compliance with the tax laws.[80] The court concluded that *Humble Oil* did not establish that tax records might never be examined for research purposes; *Humble Oil* only held that a summons must be issued pursuant to a "particularized investigation of an individual taxpayer."[81] The TCMP satisfies this requirement because the summonses are issued to determine a particular individual's tax liability.

Interestingly, the Fifth Circuit concurred in this interpretation of *Humble Oil* in *United States v. First National Bank of Dallas*,[82] which involved the enforcement of a third-party summons issued to a bank, requesting records pertaining to a taxpayer undergoing a TCMP audit.[83] Relying on *Humble Oil*, the district court refused to enforce the summons.[84] On appeal, the Fifth Circuit reversed and explained that *Humble Oil* did not hold that a summons could not be enforced if issued primarily for research purposes. A summons may be used to obtain information for research purposes if the summons is issued to determine the tax liability of a specific taxpayer.[85] Thus, the Fifth Circuit stated that the rationale of *Humble Oil* is limited to cases where a summons is issued *solely* to obtain research data.[86]

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74. *Id.* at 85,519.

75. *See generally* Note, *Enforcing Internal Revenue Service Summonses Under the Taxpayer Measurement Compliance Program: The Need for Statutory Reform*, 10 HOFSTRA L. REV. 861 (1982).

76. [3 Audit] INTERNAL REV. MAN. (CCH) § 4861.1(2) (Aug. 27, 1980).

77. United States v. Flagg, 634 F.2d 1087 (8th Cir.), *cert. denied*, 451 U.S. 909 (1980).

78. *Id.*

79. 45 A.F.T.R. 2d (P-H) 80-618, 80-621 (S.D. Iowa 1979).

80. 634 F.2d at 1091.

81. *Id.* at 1092. *See supra* notes 47-53 and accompanying text.

82. 635 F.2d 391 (5th Cir.), *cert. denied*, 452 U.S. 916 (1981).

83. 635 F.2d at 392.

84. 468 F. Supp. 415 (N. D. Tex. 1979). *See supra* notes 47-53 and accompanying text.

85. 635 F.2d at 395.

86. It should be noted that these TCMP cases are not controlling on the issue of whether a dual purpose summons may be used to obtain information about unidentified persons. The TCMP cases are concerned solely with whether the summons was issued for a proper purpose. Issuance of a John Doe summons also requires a determination of whether § 7609(f) restrictions

B. *The Right to "Inspect" Records*

The IRS has attempted to avoid statutory and judicial restrictions on its use of administrative summonses to conduct general research by asserting a statutory right to inspect documents that taxpayers and third parties are required to maintain.[87] The IRS claims such records may be inspected without issuing a summons. Two courts disagree as to whether there is an absolute inspection right. One court, in *United States v. Mobil Corp.*,[88] held that section 6001 did not imply authority to inspect.[89] Another court, in *United States v. Ohio Bell Tel. Co.*,[90] ruled that statutory authority to require records implies an authority to inspect the records.[91]

1. *United States v. Mobil Corp.*[92]

In *United States v. Mobil Corp.*,[93] the IRS requested a permanent injunction to compel production of records which Mobil kept pursuant to section 6001. The information sought concerned the number of personal exemptions claimed by Mobil's employees on their tax withholding forms and reflected the government's concern over the increasing use of unwarranted exemption claims to reduce the amount of tax withheld from wages. The IRS claimed that its right to inspect these records was implied from both the language of section 6001,[94] and its implementing regulations.[95]

Mobil refused the request, contending that the section 6001 recordkeeping provisions should not be utilized to compel a production of records that could not be obtained by a summons.[96] Mobil suspected that the IRS was requesting the information in connection with a general research project, in which case *Humble Oil* indicated that a summons would not be enforceable.

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apply. *See* United States v. Barter Sys., Inc., 82-2 U.S. Tax Cas. (CCH) ¶ 9698 at 85,518 n.10 (E.D. Mich. 1982).

87. The basis for the claim of a statutory right to inspect is found in I.R.C. § 6001 (Supp. V 1981) which provides:

Notice or regulations requiring records, statements and special returns

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title. The only records which an employer shall be required to keep under this section in connection with charged tips shall be charge receipts, records necessary to comply with section 6053(c), and copies of statements furnished by employees under section 6053(a).

88. 543 F. Supp. 507 (D.C. Tex. 1981).

89. *Id.*

90. 475 F. Supp. 697 (N.D. Ohio 1978).

91. *Id.* at 700.

92. 543 F. Supp. 507 (N.D. Tex. 1981).

93. *Id.* An earlier reported decision in this case by the same court considered Mobil's motion for discovery. 499 F. Supp. 479 (N.D. Tex. 1980).

94. The IRS asserted its right to inspect was inherent in the language of section 6001 that requires "maintenance" of records for tax liability.

95. 543 F. Supp. at 509. In Treas. Reg. § 31.6001-1(e)(1) (1960) the Secretary declared "[a]ll records required by the regulations in this part shall be kept, by the person required to keep them, at one or more convenient and safe locations accessible to internal revenue officers, and shall at all times be available for inspection by such officers."

96. 543 F. Supp. at 508.

Also, if no specific employees were under investigation, the IRS would have to comply with the John Doe summons procedures.[97]

Mobil sought to discover the purpose for the IRS inspection by serving a subpoena *duces tecum* and requesting documents that would reveal the identities of any employees under investigation by the IRS. On an IRS motion to quash the subpoena, Mobil argued that any inspection right conferred by section 6001 is analogous to the summons power granted by section 7602. Thus, it should enjoy all the statutory and procedural rights that would be available in a summons enforcement proceeding.

The district court quashed the subpoena, holding that whatever result would obtain in a summons enforcement proceeding is not dispositive with respect to the scope of discovery under section 6001.[98] A preliminary inquiry into the IRS purpose for an inspection is unnecessary with respect to section 6001 because the inspection causes only a limited disruption and intrusion into the privacy of the inspected party. Conversely, section 7602 provides a far greater reach with respect to the parties, subject matter, and type of testimony that may be summoned. It is this "sweeping and intrusive" nature of the summons power that necessitates the judicial restrictions set forth in *Powell* as well as the requirement that the summons be issued only with respect to specific and well-defined investigations. The court concluded in the discovery order that the government may demand an inspection of records even though its purpose is to avoid statutory and judicial restrictions on the issuance of a summons.

Judge Higginbotham clearly had second thoughts about this discovery order. In granting Mobil's motion for summary judgment, the court held that the IRS derives no inspection authority from section 6001. In order to compel an inspection, the IRS must issue a summons pursuant to section 7602.[99] The court did not find an implied right to inspect because to construe section 6001 otherwise would raise serious constitutional questions.[100] To avoid these constitutional difficulties, the court indicated the IRS was obligated to construe section 6001 narrowly.[101]

2. *United States v. Ohio Bell Telephone Co.*[102]

In contrast to the *Mobil* case, *United States v. Ohio Bell Telephone Co.* provides judicial support for the IRS interpretation of its inspection authority. *Ohio Bell* concerned an IRS investigation into the validity of excise tax exemptions claimed by Ohio Bell customers.[103] Although the tax is paid by the customer, it is collected and paid to the IRS by the telephone company.

97. *See supra* notes 29-32 and accompanying text.

98. 499 F. Supp. at 484.

99. 543 F. Supp. at 519. *See supra* note 14 and accompanying text.

100. *Id.* at 511-16.

101. This construction process begins with an exhaustive analysis of the relevant legislative history, which, the court concludes, presents no clear picture of congressional intent. Without such guidance, the rules of construction mandate that the statute be construed in a manner that avoids constitutional difficulties.

102. 475 F. Supp. 697 (N.D. Ohio 1978).

103. *Id.* at 699.

Certain organizations[104] could obtain exemptions from the tax by submitting an exemption certificate and supporting documents to the telephone company.[105] The regulations require these certificates to be made available for inspection.[106]

In the course of its investigation of Ohio Bell subscribers, the IRS requested access to the exemption certificates and documents. Ohio Bell refused to comply with the request. In an action instituted by the IRS to compel production of the documents, Ohio Bell maintained that the IRS must first issue a summons and comply with the John Doe notice provisions.[107] The court rejected this contention and found that section 6001 authority to require recordkeeping implied a grant of authority to inspect the records without issuing a summons.[108]

3. The Fourth Amendment Issue

The constitutional problem perceived by the *Mobil* court stems from the Supreme Court's decision in *Marshall v. Barlow's, Inc.*[109] In *Barlow's* the Court declared the Occupational Safety and Health Act of 1970 (OSHA)[110] unconstitutional to the extent it authorized the Secretary of Labor to conduct nonconsensual, warrantless, administrative inspections of business work areas. As in *Mobil*, the inspection in *Barlow's* was not initiated in response to a specific complaint, but was the result of OSHA's routine compliance selection process.

The Court held that a warrant, or its equivalent, must be obtained before nonconsensual searches are conducted. This procedure insures that "the inspection is reasonable under the Constitution, is authorized by statute, and is pursuant to an administrative plan containing specific neutral criteria."[111] The warrant requirement also serves to advise the owner of the

104. I.R.C. § 4253 (1976).

105. 26 C.F.R. § 49.4253-11 (1982).

106. 26 C.F.R. § 148.1-4(g) (1982).

107. 475 F. Supp. at 699. *See supra* notes 29-32 and accompanying text.

108. *Id.* at 700. The *Mobil* court rejected this rationale because it found no language in § 6001 to support the conclusion that the statute grants "implicit authority" to inspect records. The requirement that records be available for inspection does not necessarily allow them to be inspected without the protections provided by summons enforcement procedures. Thus, the IRS regulations go beyond the authority granted by the statute. *See* 543 F. Supp. at 511.

109. 436 U.S. 307 (1978). The constitutional questions raised by warrantless administrative searches of business and residential areas have been discussed in a number of excellent articles. *See generally* McManis & McManis, *Structuring Administrative Inspections: Is There Any Warrant For A Search Warrant?*, 26 AM. U.L. REV. 942 (1977); Note, *Administrative Searches and the Implied Consent Doctrine: Beyond the Fourth Amendment*, 43 BROOKLYN L. REV. 91 (1976); Note, Camara, *See and Their Progeny: Another Look at Administrative Inspections Under the Fourth Amendment*, 15 COLUM. J. L. & SOC. PROBS. 61 (1979); Note, *Rationalzing Administrative Searches*, 77 MICH. L. REV. 1291 (1979); *Administrative Search Warrants*, 58 MINN. L. REV. 155 (1967).

110. Pub. L. No. 91-596, 84 Stat. 1590 (codified at 29 U.S.C. §§ 651-678 (1976 and Supp. V 1981). The statute provides that an employer must "make, keep and preserve, and make available" to the Secretary of Labor or the Secretary of Health, Education and Welfare such records as the Secretary of Labor may prescribe by regulation. 29 U.S.C. § 657(c)(1) (1976).

The regulations issued pursuant to this authority authorize inspectors to "review records required by the Act . . . and other records which are directly related to the purpose of the inspection." 29 C.F.R. § 1903.3 (1982).

111. 436 U.S. at 323. In discussing the Secretary's contention that requiring warrants seriously burdens the enforcement process, the Court noted that warrants for administrative

premises of the "scope and objects of the search, beyond which limits the inspector is not expected to proceed."[112]

In *Mobil*, the court indicated that the undefined scope of the warrantless inspection authority claimed by the IRS created constitutional problems similar to those presented in *Barlow's*.[113] The court noted that the IRS interpretation of section 6001 would allow it to "unilaterally determine the scope of its inspection rights."[114] The court interpreted *Barlow's* as rejecting such broad administrative latitude and requiring judicial supervision over agency record inspections.[115]

The court's conclusion in *Mobil* that this judicial supervision necessitates the issuance of a summons is, however, questionable. The *Barlow's* requirement of review by a neutral officer is satisfied by a "warrant or its equivalent."[116] The Fifth Circuit's decision in *United States v. Mississippi Power & Light Co.*[117] suggests the IRS procedures for enforcing record inspections may provide a warrant equivalent. The court in *Mississippi Power* ruled that Department of Labor procedures providing resort to a federal court prior to the inspection are the type of warrant equivalent contemplated by the Court in *Barlow's*.[118]

The court interpreted the *Barlow's* warrant equivalent standard as mandating judicial review of an inspection request *before* an inspection.[119] Under this view, requiring the IRS to obtain an injunction to enforce its inspection right provides adequate constitutional protection because a court will determine the reasonableness of the search before it is conducted.[120]

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searches do not require probable cause in the criminal law sense, but instead require only that reasonable legislative and administrative standards be followed in selecting an establishment for inspection. This category of "administrative" probable cause was created by the Court in the companion cases of Camara v. Municipal Court, 387 U.S. 523 (1967) and See v. City of Seattle, 387 U.S. 541 (1967). The less demanding standard recognized that effective regulatory programs often require the deterrent effect of unannounced, random inspections. An administrative warrant only requires a showing that "a valid public interest justifies the intrusion." *Camara*, 387 U.S. at 539.

In later cases, the Court held that a warrant need not be obtained in all circumstances. In Colonnade Catering Corp. v. United States, 397 U.S. 72 (1970) and United States v. Biswell, 406 U.S. 311 (1972), the Court concluded that valid warrantless searches could be conducted with respect to industries that historically have been pervasively regulated and which require frequent, unannounced inspections for effective law enforcement. Thus, persons in industries such as those involving firearms or liquor are deemed to have impliedly consented to the inspections. *Biswell*, 406 U.S. at 316; *Colonnade*, 397 U.S. at 74-77. The *Barlow's* decision indicates this "implied consent" doctrine will not be extended to permit warrantless inspections merely because an industry engages in interstate commerce or is subject to governmental regulation.

112. 436 U.S. at 323.

113. 543 F. Supp. at 518-19.

114. *Id.*

115. *Id.*

116. 436 U.S. at 325.

117. 638 F.2d 899 (5th Cir.), *cert. denied*, 454 U.S. 892 (1981).

118. 638 F.2d at 907.

119. *Id.*

120. The inquiry into the reasonableness of a particular search is held to require consideration of three elements. *Id.* at 907. The first is whether there is statutory authority for the proposed search. The second is whether the scope of the search is properly limited. The third element requires an examination of whether the standards used by the agency in choosing to initiate a particular search satisfy the fourth amendment standards of reasonableness. The decision must be based upon evidence of an existing violation, upon reasonable legislative or admin-

IV. ISSUING AND ENFORCING JOHN DOE SUMMONSES

A. *Reasonable Basis*

IRS reluctance to use section 7609(f) procedures reflects its uncertainty about its ability to demonstrate a reasonable basis for believing someone has not complied with the tax laws.[121] In most instances where John Doe summonses have been sought, the IRS has asserted two bases for meeting this statutory requirement. The first is that the transaction involved is inherently suspicious as susceptible to tax cheating.[122] The second is that examinations of taxpayers in similar situations indicate a high degree of improper reporting.[123]

Most courts have agreed that either of these circumstances alone can provide the reasonable basis required for issuing a John Doe summons. For example, in *United States v. Pittsburgh Trade Exchange, Inc.*,[124] the Third Circuit upheld a summons demanding production of a barter exchange's membership list and bartering transaction records.[125] The holding was supported principally by a revenue agent's testimony that barter transactions "are inherently susceptible to tax error."[126] Similarly, the Sixth Circuit held that the fact members of barter exchanges "historically, exhibited numerous errors in the reporting of non-cash transactions" constituted a reasonable basis for investigating members of a particular exchange.[127] In *United States v. Island Trade Exchange, Inc.*,[128] the court allowed issuance of a John Doe summons because the IRS met the rational basis standard by establishing that the "unique and nontraditional features of bartering transactions cause taxpayers to omit or improperly report income."[129]

Evaluation of whether the IRS belief in a particular case is reasonable is quite subjective as was illustrated in *United States v. Brigham Young University*.[130] In that case, the IRS asserted a reasonable basis derived from its audit experience with 162 returns of property donors to the university.[131] Every one of the returns revealed substantial overvaluations of the contributed property. Because the vast majority of these overvaluations involved contributions of art objects or silver mining claims arranged by particular dealers or appraisers, Brigham Young University (BYU) offered to identify the donors of such property. The IRS refused this offer and obtained an *ex*

istrative standards, or, the search must be made "pursuant to an administrative plan containing specific neutral criteria." *Id.* at 907 (quoting *Barlow's*, 436 U.S. at 323).

121. I.R.C. § 7609(f)(2) (West Supp. 1983). *See supra* note 13.

122. United States v. Pittsburgh Trade Exch., Inc., 644 F.2d 302 (3d Cir. 1981); United States v. Island Trade Exch., Inc., 535 F. Supp. 993 (E.D.N.Y. 1982).

123. United States v. Brigham Young Univ., 679 F.2d 1345 (10th Cir. 1982), *cert granted*, 103 S. Ct. 713 (1983); United States v. Pittsburgh Trade Exch., Inc., 644 F.2d 302 (3d Cir. 1981); United States v. Maxwell, 81-1 U.S. Tax Cas. (CCH) ¶ 9378 (D. Nev. 1981).

124. 644 F.2d 302 (3d Cir. 1981).

125. *Id.* at 308.

126. *Id.* at 306.

127. *In re* John Does, 671 F.2d 977, 980 (6th Cir. 1982).

128. 535 F. Supp. 993 (E.D.N.Y. 1982).

129. *Id.* at 997.

130. 679 F.2d 1345 (10th Cir. 1982), *rev'g*, 485 F. Supp. 534 (D. Utah 1980), *cert. granted*, 103 S. Ct. 713 (1983).

131. 485 F. Supp. at 536.

parte order allowing it to serve a John Doe summons for the names of *all* persons who donated property.[132]

In the subsequent enforcement proceeding, the court refused to enforce the summons. The fact that many BYU donors overvalued their gifts did not provide a reasonable basis for believing other donors had overvalued their gifts.[133] The court was not persuaded by the IRS statistical argument that the large number of improper deductions discovered made it likely that other donors had also overstated the value of their contributions.[134]

On appeal, the Tenth Circuit rejected the district court's interpretation of the reasonable basis standard.[135] The court compared this case to the cases of *Columbus Trade Exchange*[136] and *Pittsburgh Trade Exchange*,[137] where the IRS statistical experience had been with members of *other* barter exchanges. Supported by these cases in two other circuits, the court concluded that the fact each of the 162 donors examined had overvalued their gifts made it reasonable to believe at least some of the remaining 150 donors had overvalued their gifts.[138]

One issue not explored in *Brigham Young University* is the validity of the statistical evidence upon which the IRS established its reasonable basis. It must be noted that all the determinations about the overvalued contributions were made by the IRS.[139] It is possible that a number of the findings were incorrect and certainly all were subject to challenge in the administrative appeals process or in the courts.

This statistical question was raised in *United States v. Maxwell*,[140] where the IRS sought enforcement of a John Doe summons demanding the membership list of a Nevada barter exchange. To establish a reasonable basis for the summons, the IRS presented the results of two annual surveys of the audits of members of a large Los Angeles barter exchange.[141] The 1976 survey indicated fifty-nine percent of the active members failed to report any income from their barter transactions, while the 1977 survey showed seventy-two percent failed to report. The IRS also asserted that statements made by the exchange's proprietor, to the effect that he knew members were not reporting income, established a second reasonable basis for the summons.[142]

The court straddled the issue, somewhat, in holding that the IRS surveys "may not . . . standing alone" be sufficient to establish a reasonable basis.[143] The court noted "[t]he survey was not an independent study by unbiased researchers," and observed that "the results of any study are only

132. *Id.* at 535.
133. *Id.* at 538.
134. *Id.*
135. 679 F.2d at 1349.
136. 671 F.2d 977 (6th Cir. 1982).
137. 644 F.2d 302 (3d Cir. 1981).
138. 679 F.2d at 1350.
139. 485 F. Supp. at 536.
140. 81-1 U.S. Tax Cas. (CCH) ¶ 9378 (D. Nev. 1981).
141. *Id.* at 87,026-27.
142. *Id.* at 87,025-26.
143. *Id.* at 87,029.

as reliable as the methodology employed."[144] The summons was, however, enforceable because the survey results together with the proprietor's statements established the requisite reasonable basis.[145]

B. *Challenging the John Doe Summons*

A fundamental question about section 7609(f)[146] is whether it created new substantive limitations on the IRS summons power or whether it merely provided additional procedural requirements. Congress directed the district courts to authorize the service of a John Doe summons in an *ex parte* proceeding based "solely upon the [IRS] petition and supporting affidavits."[147] This language has been interpreted to allow the summoned party to challenge the enforcement of a summons by attacking the sufficiency of the IRS showing with respect to issuance of the summons.[148] The effect of this interpretation is to make a sharp distinction between the enforcement standards for John Doe and other administrative summonses. Some courts, however, have maintained that Congress did not intend to create such a distinction, precluding later challenges to the *ex parte* findings.[149]

The disagreement on this issue results from different analyses of the Supreme Court's opinion in *Powell*.[150] If *Powell* is interpreted as being primarily concerned about IRS abuse of its summons powers, then the grounds for challenging enforcement of a summons should be quite broad. In contrast, if *Powell* is viewed as rejecting any probable cause requirement for enforcement of an IRS summons, a taxpayer may not challenge the *ex parte* reasonable basis findings in a subsequent proceeding to enforce the summons. Using this more restrictive interpretation, section 7609(f) only provides a new *procedure* to restrain IRS use of John Doe summonses; under this approach no new substantive ground for challenging a summons has been created.

The practical effect of allowing a summoned party to challenge the issuance of a John Doe summons at an enforcement proceeding is to convert the *ex parte* inquiry into an adversarial contest. In *Brigham Young University*,[151] the Tenth Circuit indicated the Supreme Court mandated such a contest.[152] The court quoted *Reisman v. Caplin*[153] as authority for its contention that a summons enforcement proceeding is an adversarial determination of the issues wherein a "witness may challenge the summons on any appropriate

144. *Id.* at 87,028.

145. *Id.* at 87,029.

146. *See supra* note 25.

147. I.R.C. § 7609(h)(2) (West Supp. 1983).

148. United States v. Brigham Young Univ., 679 F.2d 1345 (10th Cir. 1982), *cert. granted*, 103 S. Ct. 713 (1983); United States v. Island Trade Exch., Inc., 655 F. Supp. 993 (E.D.N.Y. 1982).

149. Agricultural Asset Management Co. v. United States, 688 F.2d 144 (2d Cir. 1982); United States v. Pittsburgh Trade Exch., Inc., 644 F.2d 302 (3d Cir. 1981); *In re* John Does, 541 F. Supp. 213 (N.D.N.Y. 1982).

150. *See supra* notes 15-21 and accompanying text.

151. 679 F.2d 1345 (10th Cir. 1982).

152. *Id.* at 1348.

153. 375 U.S. 440 (1964).

ground."[154] *Powell* is cited as authorizing the courts to "inquire into the underlying reasons" for an IRS investigation.[155] A similar rationale was adopted by one New York district court in *United States v. Island Trade Exchange, Inc.*[156] The court in *Island Trade Exchange* viewed section 7609(f) as encompassed by the requirements in *Powell* that a summons meet all the administrative provisions of the Code.[157]

In re John Does[158] heard by a second New York district court, rejected the view that the *ex parte* findings could be challenged in the summons enforcement proceedings.[159] The court noted that permitting a redetermination of the *ex parte* hearing issues would render the *ex parte* proceeding unnecessary and would interfere with IRS investigatory powers.[160]

The Second Circuit resolved this difference of opinion by holding that the section 7609(f) criteria are not appropriate grounds for challenging enforcement of a summons.[161] An analysis of the statute's legislative history persuaded the court that Congress did not intend for questions about the issuance of summonses to become entangled in adversarial proceedings.[162] To hold otherwise "would make the ex parte proceeding superfluous," a result Congress can hardly have intended.[163]

In *Pittsburgh Trade Exchange*,[164] the Third Circuit also stated that the section 7609(f) criteria cannot serve as an additional substantive basis for challenging summons enforcement.[165] The court's opinion, however, was based on a different and more questionable analysis of the statute's legislative history. This opinion noted that a major portion of section 7609 is concerned with providing notice to taxpayers when summonses regarding their affairs are served upon third parties. From this, the court concluded the thrust of section 7609(f) is to provide procedural safeguards for unidentified taxpayers who cannot be notified.[166] Because the *ex parte* proceeding is essentially a substitute for notice, the criteria used in the *ex parte* proceeding were not intended to create substantive defenses to summons enforcement.[167]

While the court's conclusion may be valid, the legislative history does not support the view that section 7609(f) is primarily concerned with the problem of notice.[168] The placement of this subsection among the general

154. 679 F.2d at 1348 (quoting *Reisman*, 375 U.S. at 449).
155. 679 F.2d at 1348 (quoting *Powell*, 379 U.S. at 58).
156. 535 F. Supp. 993 (E.D.N.Y. 1982).
157. *Id.* at 996.
158. 541 F. Supp. 213 (N.D.N.Y. 1982).
159. *Id.* at 218.
160. *Id.* at 218-19. This reasoning echos that of *Powell*. The Court rejected the probable cause requirement for IRS summonses "because it might seriously hamper the Commissioner in carrying out investigations he thinks warranted, forcing him to litigate and prosecute appeals on the very subject which he desires to investigate. . . ." 379 U.S. at 54.
161. Agricultural Asset Management Co. v. United States, 688 F.2d 144 (2d Cir. 1982).
162. *Id.* at 149.
163. *Id.*
164. 644 F.2d 302 (3d Cir. 1981).
165. *Id.* at 306.
166. *Id.*
167. *Id.*
168. H.R. REP. 658, *supra* note 2, at 307; S. REP. 938, *supra* note 2, at 368.

third-party recordkeeping provisions appears to be more a matter of convenience than affinity. The Committee Reports clearly indicate that section 7609(f) is directed at curbing potential IRS abuse of John Doe summonses.[169]

It is equally clear Congress did not intend to establish a new basis for resisting enforcement of summonses. Congress understood the importance of the John Doe summons as an investigatory tool and did not intend John Doe summons provisions to impose an excessive burden on the IRS.[170] By mandating an *ex parte* proceeding, Congress apparently recognized that permitting an adversarial contest on the reasonable basis question would inhibit the use of John Doe summonses.

V. THE FIRST AMENDMENT ISSUES

The possibility that the government may learn the names of members of controversial political, religious, or similar organizations inhibits participation by some people who might otherwise join or support these groups. In light of this reality, the courts have recognized that the constitutional right to freedom of association depends in great measure upon an ancillary right to privacy in one's associations.[171] Thus, an investigation that would infringe upon associational privacy is permissible only where the government can demonstrate a substantial relationship between the information requested and a compelling state interest.[172]

An illustration of how this constitutional protection may limit the IRS summons power is presented in *United States v. Citizens State Bank*,[173] where an organization of tax protestors, the United States Taxpayers Union (USTU), sought to prevent the IRS from summoning bank records that could reveal the identities of its members and contributors.[174] The summons was issued to a bank during an investigation of a USTU officer who had not filed an income tax return for ten years. The IRS requested all bank records for the officer's personal account and for a USTU account controlled by the officer. The bank did not comply with the summons. In an IRS action to enforce the summons, the officer and the USTU intervened alleging that release of the records would identify members and contributors of the organization. The intervenors claimed that giving the IRS access to USTU records would discourage persons from joining or contributing to the organization out of

169. *Id.*

170. H.R. REP. 658, *supra* note 2, at 306; S. REP. 938, *supra* note 2, at 373.

171. Gibson v. Florida Legislative Investigation Comm., 372 U.S. 539 (1963) (committee request for NAACP membership lists in connection with investigation of Communist Party denied because state did not demonstrate a substantial relation between the information sought and a subject of overriding and compelling state interest); NAACP v. Alabama, 357 U.S. 449 (1958) (state request for NAACP membership lists denied because state could not justify the infringement on right of freedom of association); Pollard v. Roberts, 283 F. Supp. 248 (E.D. Ark.), *aff'd per curiam*, 393 U.S. 14 (1968) (no compelling government interest shown for subpoena requiring production of records identifying contributors to Republican Party). *But see* Laird v. Tatum, 408 U.S. 1 (1972) (Army Intelligence system for surveillance of lawful political activity did not, by itself, have a chilling effect upon constitutional freedoms).

172. Gibson v. Florida Legislative Investigation Comm., 372 U.S. 539, 546 (1963).

173. 612 F.2d 1091 (8th Cir. 1980).

174. *Id.* at 1093.

fear of IRS retaliation.[175] To support this contention, the USTU sought to introduce evidence on the adverse effects such an IRS summons would have on its activities. The district court, however, deemed this evidence irrelevant and enforced the summons.[176]

The Eighth Circuit Court of Appeals reversed, holding that a *prima facie* showing of a first amendment infringement required the IRS to establish an appropriate need for the material.[177] The IRS must demonstrate that there is a rational connection between disclosure of the information and a legitimate and compelling government interest.[178] On remand the district court was ordered to determine whether disclosure of the bank records would adversely affect USTU's freedom of association and, if so, whether the government had a compelling need for the information. The court emphasized, however, that its decision would "only rarely serve to limit the reach of an IRS summons."[179]

Just how rare is illustrated by the Fifth Circuit's decision in *United States v. Holmes*,[180] involving a summons issued during an investigation into the exempt status of a church. Although the court found the summons too broad to meet the restrictive statutory standard of I.R.C. section 7605(c), which permitted examination of church records only to the extent necessary,[181] the likelihood of a subsequent narrower summons impelled the court to consider the constitutional issue.[182] The church asserted that any summons for documents relating to its internal affairs would infringe upon its members' free exercise of religion.[183] The court held, however, that although the summons might create an incidental burden upon religious activities, this burden was balanced by the government's substantial interest in its fiscal integrity.[184]

In the later case of *United States v. Grayson County State Bank*,[185] the same court indicated that religious free exercise cases are distinguishable from the essentially political situation presented in *Citizens State Bank*. The court con-

175. *Id.*
176. *Id.* at 1094.
177. *Id.*
178. *Id.* (quoting Pollard v. Roberts, 283 F. Supp. at 248).
179. *Id.*
180. 614 F.2d 985 (5th Cir. 1980) (*per curiam*).
181. I.R.C. § 7605(c) (1976) *Restriction on Examination of Churches*—
No examination of the books of account of a church or convention or association of churches shall be made to determine whether such organization may be engaged in the carrying on of an unrelated trade or business or may be otherwise engaged in activities which may be subject to tax under part III of subchapter F of chapter 1 of this title (sec. 511 and following, relating to taxation of business income of exempt organizations) unless the Secretary (such officer being no lower than a principal internal revenue officer for an internal revenue region) believes that such organization may be so engaged and so notifies the organization in advance of the examination. No examination of the religious activities of such an organization shall be made except to the extent necessary to determine whether such organization is a church or a convention or association of churches, and no examination of the books of account of such an organization shall be made other than to the extent necessary to determine the amount of tax imposed by this title.
182. 614 F.2d at 88-89.
183. *Id.*
184. *Id.* at 990.
185. 656 F.2d 1070 (5th Cir. 1981), *cert. denied*, 455 U.S. 920 (1982).

cluded that allowing the IRS access to church records did not restrict religious freedom.[186] The court did not, however, discuss the potential chilling effect an examination of church financial records would have on church members and contributors.[187]

VI. CONCLUSION

The controversies surrounding the John Doe summons legislation indicate that the statute has not protected taxpayer privacy interests, but rather has created a tactic for delaying and hindering IRS investigations. This is the result of a congressional failure to recognize the wisdom of the Supreme Court's longstanding view that the IRS power to summon documents cannot be narrowly construed if the tax laws are to be effectively administered.[188]

Section 7609(f) was enacted because Congress believed that the *Bisceglia*[189] decision authorized IRS fishing expeditions and because it approved of the holding in *Humble Oil*.[190] Yet the rationale in *Bisceglia*, is the better reasoned view. The IRS can protect government revenues only by having access to records of financial transactions. In most cases, access to records will not violate legitimate privacy expectations because the records have been voluntarily thrust into the stream of commerce.

For similar reasons, the IRS should be permitted to collect information concerning potential tax evasion. This does not suggest the IRS should be free to roam through records without purpose, but the IRS should be allowed to accumulate information about specific types of transactions. Limited access to records required to be maintained would protect the IRS interest in tax compliance. Given the judicial role in the injunction process, the recordkeeper's fourth amendment rights would also be protected.

The issue of IRS summons infringements on first amendment rights has not been fully developed. As the courts hear more of these cases, the scope of IRS authority to summon records of churches and political organizations will be defined.

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186. 656 F.2d at 1074. In quoting from *Holmes*, the court noted that even if there is an incidental burden on the free exercise of religion, the burden is justified if a compelling government interest outweighs the degree of impairment. *Id.*

187. The position of the Eighth Circuit on the issue of IRS summonses and religious free exercise is not clear. In United States v. Life Science Church, 636 F.2d 221 (8th Cir. 1980) (*per curiam*) the court remanded the case to the district court for a determination of whether a summons for church records was too broad under § 7605(c). The court *also* ordered a determination of the constitutional issues raised by *Citizens State Bank* and *Holmes*. The court did note, however, that the IRS summons probably was an infringement on the first amendment rights of the Life Science Church. 636 F.2d at 224.

The Ninth Circuit, in United States v. Trader's State Bank, 83-1 U.S. Tax Cas. (CCH) ¶ 9131 (9th Cir. 1983) (*per curiam*), refused to enforce an IRS summons for a church's bank records. Citing *Citizens State Bank*, the court found the IRS had shown no rational connection between the documents sought and a legitimate governmental end.

188. *See supra* note 159 and accompanying text.

189. *See supra* notes 35-46 and accompanying text.

190. *See supra* notes 47-56 and accompanying text.

ANTITRUST'S PER SE RULE: REPORTS OF ITS DEATH ARE GREATLY EXAGGERATED

SETH E. LIPNER*

In the five years between 1975 and 1980, the Supreme Court, led by "the new antitrust majority,"[1] appeared to undo thirty years of antitrust precedent. A series of cases under section 1 of the Sherman Act[2] discarded the much criticized *per se* rule in favor of the rule of reason. Due in large part to a change in membership on the Court,[3] the transition has had resounding effects.

In *Arizona v. Maricopa County Medical Society*,[4] however, the Supreme Court may have reversed this trend. In a four-three opinion, the Court declared that competing physicians who had agreed to use a maximum fee schedule had violated the Sherman Act *per se*.[5] Less than ten years ago the decision would not have been considered controversial or even noteworthy; today it is both.

This article will examine the current state of the law under section 1 of the Sherman Act. Part I traces, in detail, the series of events which brought about increased reliance on the rule of reason, reviewing in particular the Burger Court's price-fixing cases. Part II reports the *Maricopa County* decision. Finally, Part III analyzes the Supreme Court's decision in *Maricopa County* and attempts to assess the status of antitrust law under section 1 of the Sherman Act.

I. THE BURGER COURT AND THE *PER SE* RULE

Success or failure in an antitrust case frequently depends upon whether the court applies the *per se* rule of illegality. This rule states that if a practice falls into a forbidden category,[6] it will be condemned without inquiry into

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1. United States v. Marine Bancorporation, 418 U.S. 602, 643 (1974) (White, J., dissenting).

2. Sherman Anti-Trust Act, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7 (1976)).

3. The resignation of Justices Douglas and Black during the 1970's had a major impact upon antitrust law. For many years, these two jurists greatly influenced the development of antitrust law. A perusal of a standard law school antitrust casebook reveals a total of 20 cases in which one of them authored the majority opinion. *See* M. HANDLER, H. BLAKE, R. PITOFSKY & H. GOLDSCHMID, CASES AND MATERIALS ON TRADE REGULATION (1975).

4. 457 U.S. 332 (1982).

5. *Id.* at 344-45.

6. Over the years the forbidden categories have been expanded to include: price fixing, division of markets by competitors, group boycotts, tie-ins, and certain exchanges of price information. Vertical division of markets by manufacturers, placed into the *per se* category in United

its justifications or procompetitive benefits.[7] Since the inception of our antitrust laws, price fixing has been held to be one of the forbidden practices.[8] Thus, characterization of a practice as price fixing inevitably leads to *per se* treatment. During the Warren Court era, the *per se* rule was used with remarkable frequency;[9] its complement, the rule of reason,[10] which calls for a full-scale economic analysis of the impact of the restraint,[11] was never invoked by the Warren Court to decide a price-fixing case.[12]

In a series of cases beginning in 1975, the Supreme Court, under the influence of its new members, resurrected the rule of reason. The Burger Court quickly expanded the breadth of the rule of reason and brought its previously undefined contours into sharper focus. Increased reliance on the rule of reason was necessarily accompanied by a decreased role for the *per se*

States v. Arnold Schwinn & Co., 388 U.S. 365 (1967), was withdrawn from that category in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). *See infra* text accompanying notes 31-42. *See also* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST §§ 63-77 (1977); Redlich, *The Burger Court and the* Per Se *Rule*, 44 ALB. L. REV. 1 (1979).

7. *See* National Soc'y of Prof. Eng'rs, 435 U.S. 679, 692 (1978); Northern Pac. R.R. v. United States, 356 U.S. 1, 5 (1958).

8. *See* United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897); United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898), *modified*, 175 U.S. 211 (1899). *See also* Albrecht v. Herald Co., 390 U.S. 145 (1968); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Trenton Potteries Co., 273 U.S. 392 (1927); Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911); L. SULLIVAN, *supra* note 6, at § 167; Bork, *The Rule of Reason and the* Per Se *Concept: Price Fixing and Market Divisions*, 74 YALE L.J. 775 (1965); Redlich, *supra* note 6.

9. *See, e.g.*, United States v. Topco Assocs., 405 U.S. 596 (1972) (*per se* rule applied to division of markets by competitors); Albrecht v. Herald Co., 390 U.S. 145 (1968) (maximum price fixing); United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967) (division of markets by manufacturers); United States v. General Motors Corp., 384 U.S. 127 (1966) (refusal to deal by manufacturer induced by competitor); Simpson v. Union Oil Co., 377 U.S. 13 (1964) (price fixing by manufacturer); Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959) (concerted refusal to deal induced by competitors). *But see* United States v. Container Corp., 393 U.S. 333, 338 (1969) (Fortas, J., concurring) (stating that a *per se* rule was not being applied; the majority opinion, authored by Justice Douglas, is unclear as to the standard utilized.).

10. The rule of reason dates back to Chief Justice Edward White's opinion in Standard Oil Co. v. United States, 221 U.S. 1 (1911). The application of the rule was expounded upon by Justice Brandeis in Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918). The rule of reason has lain largely dormant since that time, although it has made occasional appearances. *See* White Motor Co. v. United States, 372 U.S. 253 (1963); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933).

11. *See* Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918), where Justice Brandeis stated:

> The . . . test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id. at 238. *See also* National Soc'y of Prof. Eng'rs v. United States, 435 U.S. 679, 687-99 (1978) (Justice Stevens, for the majority, stating that inquiry under the rule is directed at forming a judgment about the impact of a restraint upon competition); *cf. id.* at 700 (Blackmun, J., concurring) (questioning the narrowness of the majority's approach to the rule, at least as applied to professional organizations).

12. *But see* United States v. Container Corp., 393 U.S. 333, 338 (1969) (Fortas, J., concurring).

rule. While some of this decrease has been substantive and substantial, other aspects of it have been more symbolic. For instance, in the first case, *Goldfarb v. Virginia State Bar*,[13] the Court held that dissemination and enforcement of a minimum fee schedule for attorneys constituted "a classic illustration of price-fixing."[14] But despite this finding, the Court never expressly declared the practice "*per se*" unlawful.[15]

The State and County Bar Associations in Virginia had distributed a "suggested" minimum fee schedule to all the state's attorneys.[16] When Mr. and Mrs. Goldfarb sought an attorney for a title search, they could not find one who would charge less than the suggested fee.[17] Compliance with the schedule had been secured by the State Bar Association's publication of ethical opinions indicating that failure to adhere to the fee schedule was "misconduct."[18]

Chief Justice Burger, speaking for a unanimous Court, distinguished several cases which had not involved the *per se* rule,[19] demonstrating, for instance, that the schedule was more than merely advisory.[20] The opinion thus suggests that an advisory schedule,[21] or perhaps one involving past transactions,[22] might have been lawful.[23] Since the Bar Association en-

13. 421 U.S. 773 (1975).

14. *Id.* at 783.

15. The words "*per se*" are never used. Instead, Chief Justice Burger noted that the practice was unusually damaging, an irrelevancy under the *per se* rule. *id.* at 782. *See supra* text accompanying note 7. *See also* Arizona v. Maricopa County Medical Soc'y, 643 F.2d 553, 564 (9th Cir. 1980) (Larson, J., dissenting), *rev'd* 457 U.S. 332 (1982) (stating that nevertheless a *per se* rule was applied in *Goldfarb*).

16. 421 U.S. at 776-78.

17. *Id.* at 775-76. The Goldfarbs contacted over 36 attorneys; of those who replied, none would charge less than the suggested minimum fee, and several stated that they knew of none who would. *Id.* at 776.

18. *Id.* at 776-78, 783. The Court stated: "[The associations created] a pricing system that consumers could not realistically escape." *Id.* at 783. Membership in the State Bar Association was required in order to practice law in Virginia. *Id.* at 776. The ethical opinions stated, *inter alia*, that "evidence that an attorney *habitually* charges less than the suggested minimum fee schedule adopted by his local Bar Association, raises a presumption that such lawyer is guilty of misconduct. . . ." *Id.* at 777-78.

19. *Id.* at 781. For example, the Court cited American Column & Lumber Co. v. United States, 257 U.S. 377 (1921), which had involved a purely advisory fee schedule.

20. 421 U.S. at 781-83.

21. Advisory schedules have historically been treated as information exchanges, rather than outright price fixing. An exchange might facilitate price fixing, as in American Column & Lumber Co. v. United States, 257 U.S. 377 (1921), or it may be a legitimate effort by businessmen to improve market information. United States v. United States Gypsum Co., 438 U.S. 422 (1978). The crucial distinction between price fixing (*per se*) and information exchanges (rule of reason) is that the former includes an agreement lacking in the latter, to adhere to a price or follow a particular policy. *See also* United States v. Container Corp., 393 U.S. 333 (1969); L. SULLIVAN, *supra* note 6 at § 73; Redlich, *supra* note 6 at 24-26.

22. *See* Cement Mfrs. Protective Ass'n v. United States, 268 U.S. 588 (1925); Maple Flooring Mfrs. Ass'n v. United States, 268 U.S. 563 (1925).

23. Thus, for example, the American Society of Anesthesiologists was able to escape condemnation when their members agreed to adopt, publish and disseminate a relative value guide for professional service. *See* United States v. American Soc'y of Anesthesiologists, 473 F. Supp. 147 (S.D.N.Y. 1979). The schedule in that case, however, was also insulated because it contained no suggestion of any monetary values, just suggested formulas for the computation of professional time for various medical procedures. *Id.* at 153. *Cf.* Plymouth Dealers Ass'n v. United States, 279 F.2d 128 (9th Cir. 1960) (agreement among competitors to begin negotiations from agreed list prices held unlawful *per se* as price fixing).

forced the schedule through the prospect of professional discipline, the effect was to produce adherence to the fee schedule, and thus the Bar Associations were guilty of price fixing.[24]

The opinion also rejected any notion that a learned profession was exempt from Sherman Act proscriptions.[25] The practice of law, stated the Court, is "trade or commerce" which falls within the ambit of the Sherman Act.[26] The Court did indicate, however, that the public service aspects of a profession might, in some cases, warrant treatment different from that governing other businesses.[27] It was left unclear exactly what that different treatment might be.

In retrospect, it is significant that early *per se* price-fixing cases, such as *United States v. Trans-Missouri Freight Association*[28] and *United States v. Socony-Vacuum Oil Co.*,[29] were not cited to support the Court's decision. In addition, the Chief Justice cited no Warren Court majority opinion on the price-fixing question.[30] The *Goldfarb* opinion foreshadowed the coming change in court philosophy.

Two years later, in *Continental T.V., Inc. v. GTE Sylvania Inc.*,[31] the Burger Court made what is to date its greatest assault on the *per se* rule. Sylvania, a subsidiary of the giant, General Telephone and Electronics, was accused of a *per se* violation of section 1 by enforcing franchise agreements which limited its distributors to the sale of Sylvania products from specified locations only.[32] A similar nonprice restraint, allocation of exclusive territo-

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24. 421 U.S. at 781-83.

25. *Id.* at 786-88. The County Association advanced several reasons for its contention, including the existence of state licensing regulations and that the goal of professional services is not profit but provision of necessary services. The defendant thus argued it was totally exempt from the Sherman Act. *Id.* at 787.

26. *Id.* As the Court stated: "[T]o read into [the Act] so wide an exemption as that urged on us would be at odds with [congressional] purpose." *Id.* The Court also rejected the argument that since the Bar Association was established by act of the Virginia legislature, the Association's practice was immunized as state action under Parker v. Brown, 317 U.S. 341 (1943). It could not be argued, said the Court, that the price schedule was mandated by the legislature and thus immunized. 421 U.S. at 790-92.

27. *Id.* at 788 n.17. The Court stated:

> The fact that a restraint operates upon a profession as distinguished from a business is, of course, relevant in determining whether that particular restraint violates the Sherman Act. It would be unrealistic to view the practice of professions as interchangeable with other business activities, and automatically to apply to the professions antitrust concepts which originated in other areas. The public service aspect, and other features of the professions, may require that a particular practice, which could properly be viewed as a violation of the Sherman Act in another context, be treated differently. We intimate no view on any other situation than the one with which we are confronted today.

Id.

28. 166 U.S. 290 (1897).

29. 310 U.S. 150 (1940).

30. The opinion does cite the concurring opinion in United States v. Container Corp., 393 U.S. 333, 337-39 (1969), in which Justice Fortas states that his understanding of Justice Douglas' majority opinion is that the case was to be analyzed under the rule of reason. *See* 421 U.S. at 782. Justice Douglas' opinion in *Container*, silent on that question, is notably terse and indicates, at least to some, a *per se* analysis. For an in depth analysis of the question see Kefauver, *The Legality of Dissemination of Market Data by Trade Associations: What Does* Container *Hold?*, 57 CORNELL L. REV. 777 (1972).

31. 433 U.S. 36 (1977).

32. *Id.* at 40. Sylvania had extracted from dealers "location clauses" requiring the distrib-

ries to distributors, was held by the Warren Court to be *per se* unlawful only ten years earlier in the case of *United States v. Schwinn*.[33] In *Sylvania*, the Burger Court overruled *Schwinn*,[34] refused to apply the *per se* rule, and instead applied the rule of reason.[35] Justice Powell, writing for a divided Court, reasoned that the restraint was not necessarily pernicious and without redeeming effect. Therefore, he stated, a *per se* rule could not be applied. Rather, a full-scale inquiry into the effect of the restraint was required.[36]

Over a dissent by Justice Brennan,[37] Justice Powell thus cast into chaos

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utors to resell only at designated locations. Continental T.V., a San Francisco distributor who had so agreed, opened a new outlet in Sacramento. Under pressure from its Sacramento distributor, Sylvania reduced Continental's line of credit. In response Continental withheld payments owed to Sylvania's finance company. When the finance company sued Continental for these payments, Continental cross-claimed against Sylvania, asserting the § 1 violation. The trial court, Justice Clark (retired) sitting by designation, held the practice to be a *per se* violation. On appeal, the Court of Appeals affirmed, 1974-1 Trade Cas. (CCH) ¶ 75,072 (9th Cir. 1974), but on rehearing *en banc*, the court reversed, 537 F.2d 980 (9th Cir. 1976), over two vigorous dissents, *id.* at 1004, 1018.

33. 388 U.S. 365 (1967). The *Schwinn* case came to the Supreme Court only four years after the Court had decided White Motor Co. v. United States, 372 U.S. 253 (1963). In *White Motor* the Court held that the judiciary's unfamiliarity with vertical territorial restraints required remand for the study of their effects. *Id.* at 263-64. In *Schwinn*, the Court changed its approach and held that Schwinn's allocation of exclusive territories to its independent distributors was a *per se* violation of § 1. 388 U.S. at 379. The *Schwinn* decision was subjected to severe criticism from some scholars. *See, e.g.*, McClaren, *Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers and Handling of Competitive Products*, 13 ANTITRUST BULL. 161 (1968); Orrick, *Marketing Restrictions Imposed to Protect the Integrity of Franchise Distribution Systems*, 36 A.B.A. ANTITRUST L.J. 63 (1967); Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975). *But see* Redlich, *supra* note 6.

34. 433 U.S. at 58. The Court could not find a "principled basis for distinguishing" the *Schwinn* restraints from those present in *Sylvania*. *Id.* at 46.

35. *Id.* at 57-59.

36. *Id.* at 49, 54-59. Relying primarily on the writings of antitrust scholars and economists, the Court noted that competition among different brands, interbrand competition, is enhanced by vertical restraints such as the location restrictions in *Sylvania* or the exclusive territories in *Schwinn*. Each "exclusive" dealer has the incentive to furnish local advertising and other point-of-sale services, such as showrooms and repair and maintenance shops. Without the restraint, firms which also sell the manufacturer's product in the territory would take a "free ride" on the other distributor's advertising or services, thereby discouraging the provision of these services. Elimination of the free rider effect through allocation of territories thus improves a manufacturer's ability to compete with other brands. The Court therefore would not condemn the practice *per se*. *Id.*

As the Court recognized, vertical restraints, while protecting interbrand competition, also reduce intrabrand competition by limiting the number of sellers of a particular product in any given market. *Id.* at 54. A court's job is to balance the procompetitive interbrand effects of the vertical restraint against the concomitant reduction in intrabrand competition. The Court intimated no view on how this balancing would be done. The Court's willingness to so balance, however, is significant in light of its refusal to engage in a similar balancing in United States v. Topco Assocs., 405 U.S. 596 (1972). In that case, Justice Marshall, writing for the majority, stated that the Court's "inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector is one important reason we have formulated *per se* rules." *Id.* at 609-10. In *Topco*, the Court, over the dissent of Chief Justice Burger, *id.* at 613, held an agreement among competitors to divide territories was illegal *per se*.

37. 433 U.S. at 71. Joined by Justice Marshall, Justice Brennan would have applied the *per se* rule of *Schwinn*. Justice White, in a separate concurrence, would have distinguished *Schwinn* from *Sylvania* and applied the rule of reason in *Sylvania*. He argued there was no need to overrule *Schwinn* since, in his view, the restrictions in *Sylvania* had "less potential for restraint of intrabrand competition and more potential for stimulating interbrand competition" than the exclusive territories restrictions in *Schwinn*. *Id.* at 59 (White, J., concurring).

the entire body of law under section 1.[38] The little used[39] and poorly understood rule of reason[40] was brought to the forefront of antitrust analysis. But perhaps more significant was the suggestion that *per se* treatment was always inappropriate if the restraint had any "redeeming virtue."[41] Courts and commentators began to wonder what the effect of this new test of *per se* illegality was on other classes of trade restraints.[42]

Only a year later, the Court, by expounding on the factors that define the rule of reason, set out to remedy some of the problems it had created. In *National Society of Professional Engineers v. United States*,[43] the Court considered the legality of a professional society's ethical canon prohibiting competitive bidding on engineering projects.[44] The defendant in the case was a nationwide association of engineers, organized to deal with the nontechnical, business aspects of engineering.[45] The Society's code of ethics provided that members could not submit competitive bids. The question of fees was not even to be discussed until the prospective client had selected an engineer for his project.[46] In 1972, the government charged that this ethical canon had the effect of suppressing price competition, and was therefore unlawful *per se*.[47] The Society argued that the canon promoted the interests of safety and quality by ensuring against inferior engineering work, which might flow from the desire and ability to cut prices.[48] In essence, the Society asserted that the Canon was reasonable and thus insulated from section 1 condemnation, because competition among engineers was contrary to the public interest.[49]

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38. *See* Posner, *The Rule of Reason and the Economic Approaches: Reflections on the* Sylvania *Decision*, 45 U. CHI. L. REV. 1 (1977); Redlich, *supra* note 6.

39. *See supra* text accompanying note 12.

40. Professor Posner, upon whose writings the Court partially relied, *see* 433 U.S. at 55-56, has written:

> The content of the Rule of Reason is largely unknown; in practice, it is little more than a euphemism for nonliability. Before *Schwinn*, restrictions on distribution were tested under the Rule of Reason, meaning: they were lawful. The Court in *Sylvania* may not have intended by its invocation of the Rule of Reason to bless all restrictions in distribution, but it was deceived if it thought it was subjecting those restrictions to scrutiny under a well-understood legal standard.

Posner, *supra* note 38, at 14.

41. 433 U.S. at 58 (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958)).

42. *See, e.g.*, Posner, *supra* note 38, at 6-12; Redlich, *supra* note 6, at 56 n.397; *see also* Bohling, *A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis and Sylvania*, 64 IOWA L. REV. 461, 519-24 (1979); Robinson, *Antitrust Development*, 80 COLUM. L.J. 1, 14 (1980); Note, Sylvania *and Beyond: An Expanding Rule of Reason for Distributional Restraints*, 4 J. CORP. LAW 169, 185-89 (1978).

43. 435 U.S. 679 (1978).

44. *Id.* at 683-84.

45. *Id.* at 682. The Society's membership of 69,000 represents less than one quarter of the nation's licensed professional engineers. *See id.* at 681-82.

46. The Society's Code of Ethics prohibited members from soliciting or submitting competitive bids for engineering projects. A member was not permitted to give any estimate on fees, either verbal or written, prior to selection of a project's engineer. In fact, a prospective engineer was required to withdraw his name from consideration if a prospective client persisted in requesting a fee proposal. The Society thus sought to preserve the traditional method of selection, based upon quality and reputation rather than price. *Id.* at 683-84.

47. *Id.* at 684. The complaint prayed for an injunction against the practice.

48. *Id.* at 684-85.

49. *Id.*

Justice Stevens, writing for the majority,[50] rejected the Society's assertions[51] and in so doing set forth his understanding of the rule of reason. Reviewing its history,[52] he stated that inquiry under the rule is limited to balancing anticompetitive and procompetitive effects.[53] Justice Stevens then compared the "two complementary categories of antitrust analysis,"[54] the rule of reason and the *per se* rule. He stated that under both categories the judicial inquiry is directed at forming "a judgment about the competitive significance of the restraint."[55] But, the Court is not to judge the wisdom of the congressional policy in favor of economic competition.[56] The legislative mandate in favor of free and unfettered competition cannot be questioned by the courts.

In order to demonstrate that the Society's "public interest" argument was fatally flawed, Justice Stevens concentrated not on the price-fixing characterization,[57] which had dominated Warren Court antitrust analysis,[58] but rather on the restraint's impact upon competition. In fact, he hedges when he states that the engineers' restraint is "not price fixing as such,"[59] even though the Society's practice clearly had an effect upon price.[60] The Warren Court would have condemned it on that basis alone.

In a detailed discussion, which would only have been necessary under the rule of reason, Justice Stevens concluded that the restraint had an anticompetitive character, requiring no elaborate industry analysis.[61] The Court's language, however, indicates reliance on the *per se* rule. The Court asserted, for example, that allegations of better quality,[62] or even improved health and safety[63] are not "reason[s], cognizable under the Sherman Act, for doing away with competition."[64] But, by leaving unclear which rule he was actually applying, Justice Stevens came close to obliterating the differ-

50. Justice Blackmun, joined by Justice Rehnquist, concurred separately in the Court's opinion. *Id.* at 699. Chief Justice Burger dissented in part, asserting tersely that the first amendment guaranteed the right of the Society to state in its canon that competitive bidding is unethical. *Id.* at 701.

51. *Id.* at 692-96.

52. *Id.* at 687-92.

53. *Id.* at 691-92. *But see supra* note 11.

54. *Id.* at 692. *See* L. SULLIVAN, *supra* note 6, at § 72.

55. 435 U.S. at 692.

56. *Id.*

57. *See* cases cited *supra* note 8.

58. *See* L. SULLIVAN, *supra* note 6, at § 74; cases cited *supra* note 9.

59. 435 U.S. at 692.

60. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940).

61. 435 U.S. at 692.

62. *Id.* at 693-96.

63. *Id.* at 696 n.22.

64. *Id.* at 696. *See also* Mardirosian v. American Inst. of Architects, 474 F. Supp. 628 (D. D.C. 1979) where the court held a similar restraint among architects unlawful under the rule of reason. The court facially distinguished the engineers case by pointing out that the architects had not banned *all* price discussions between potential client and potential architect. Rather, in *Mardirosian* one architect could discuss price with a client, but a second architect could not seek to match or underbid the first. *Id.* at 645-48. If one notes that the practices of both the engineers and the architects affected price, the distinction offered by the court highlights no real difference. Although the engineers' restraint is probably more injurious, both are now clearly illegal.

ence between the *per se* rule and the rule of reason.[65]

In its next term, the Supreme Court was faced with a different and difficult price-fixing case. The Columbia Broadcasting System (CBS) television network attacked the blanket licensure practices of two copyright performing rights societies, Broadcast Music, Inc. (BMI) and American Society of Composers, Authors and Publishers (ASCAP).[66] These societies are granted nonexclusive[67] performance rights by individual copyright owners; the societies, in turn, sell a "blanket license," permitting licensees to use any composition in the licensor's repertoire.[68] The price charged for this license is based not upon frequency or amount of use, but rather upon the licensee's gross revenues.[69] The societies then distribute the royalties to copyright owners. A necessary result of this scheme is that the society must choose a price for its license, and CBS challenged that practice of price setting as violating section 1 of the Sherman Act.[70]

The blanket license has been in use for several decades and, although it has often been challenged[71] under the antitrust laws, it has never been proscribed.[72] Nevertheless, the Supreme Court in *BMI v. CBS*[73] was faced with a court of appeals opinion which, for the first time in the license's history, decreed the practice illegal *per se*.[74]

The Supreme Court reversed the court of appeals.[75] Justice White, writing for a unanimous Court,[76] refused to apply the *per se* rule.[77] He

65. *See supra* text accompanying note 55.

66. Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979). BMI is a nonprofit corporation owned by members of the broadcasting industry and represents approximately 30,000 authors, composers, and publishers. ASCAP was organized in 1914 and represents some 22,000 composers and publishers. *Id.* at 4-5.

67. The nonexclusivity of the license is an important aspect of its legality. *Id.* at 28-30 (Stevens, J., dissenting). Prior to 1950, members granted ASCAP exclusive rights to license their works. In 1950, the government challenged a 1941 consent decree, resulting in, *inter alia*, the nonexclusivity of the license granted by ASCAP. *See* United States v. ASCAP, 1950-51 Trade Cas. (CCH) ¶ 62,595 (S.D.N.Y. 1950). BMI is in a similar situation. 441 U.S. at 12 n.20.

68. The societies also sell a per-program license. According to the most recent challenge to the blanket license, the per-program license was, at least regarding television stations, an unattractive alternative to the blanket license because 1) its base percentage rate is several times higher than the blanket license, and 2) its reporting provisions are unusually onerous. *See* Buffalo Broadcasting Co. v. ASCAP, 1982-2 Trade Cas. (CCH) ¶ 64,898, at 72,533 (S.D.N.Y. 1982).

69. 441 U.S. at 31 (Stevens, J., dissenting). This fee, based upon a user's ability to pay, is, as Justice Stevens points out in a dissenting opinion, nothing more than an effective price discrimination. The blanket license requires a user to purchase a license which is far broader than his actual needs. The price he pays is unrelated to either the quantity or the quality of the music used. *Id.* at 30-31. For a detailed economic analysis, see Cirace, CBS v. ASCAP: *An Economic Analysis of A Political Problem*, 47 FORDHAM L. REV. 277 (1978).

70. 441 U.S. at 6, 8-9.

71. The license continues to be the subject of antitrust litigation. Subsequent to *CBS v. BMI* the license was challenged and found to violate the rule of reason in Buffalo Broadcasting Co. v. ASCAP, 1982-2 Trade Cas. (CCH) ¶ 64,898 (S.D.N.Y. 1982).

72. *See* Cirace, *supra* note 69. The *CBS* case, and the history of ASCAP and BMI in the courts, is the subject of two excellent notes: Note, CBS v. ASCAP: *Blanket Licensing and the Unresolved Conflict Between Copyright and Antitrust Law*, 13 CONN. L. REV. 465 (1981); Note, *Blanket Licensing: The Clash Between Copyright Protection and the Sherman Act*, 55 NOTRE DAME LAW. 729 (1980).

73. 441 U.S. 1 (1979).

74. CBS v. ASCAP, 562 F.2d 130 (2d Cir. 1978), *rev'd*, 441 U.S. 1 (1979).

75. 441 U.S. at 7.

76. Justice Stevens, in a dissenting opinion, stated that while the practice should be evalu-

would not characterize the practice in question as price-fixing,[78] stating that the Court had some doubt whether the practice was a threat to free market pricing.[79] "The blanket license cannot be wholly equated with a simple horizontal arrangement among competitors."[80] Factors such as lowered transaction costs through reduction of the number of individual sales, and easier monitoring and enforcement against unauthorized copyright use made the blanket license a necessary and useful part of commerce.[81]

The license was viewed as being unlike anything the individual copyright owners could sell.[82] The setting of a price was a necessary consequence of creation of this new product.[83] Analogous to a joint venture, the legality of the blanket license must be judged under the rule of reason rather than under the *per se* rule.[84] The Court thus remanded the case[85] for evaluation of its legality under that rule.[86] Justice Stevens, in a dissenting opinion,[87] would have avoided the remand; he found sufficient evidence in the record to declare that the practice violates the rule of reason.[88]

With its decision in *BMI*, the Court concluded four years of restructuring antitrust law under section 1 of the Sherman Act. The new members of the Court had had the opportunity to set forth their views of antitrust law. Lower courts and commentators were predictably split on the effect and wisdom of the Court's decisions.[89] Yet, even as *BMI* was being decided, the

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ated under the rule of reason, there was sufficient evidence then before the Court to ban the blanket license. *Id.* at 25 (Stevens, J., dissenting).

77. *Id.* at 24-25.

78. *Id.* at 23.

79. *Id.*

80. *Id.* at 23.

81. *Id.* at 20-21. *But see* Buffalo Broadcasting Co. v. ASCAP, 1982-2 Trade Cas. (CCH) ¶ 64,898 (S.D.N.Y. 1982).

82. 441 U.S. at 21-23.

83. *Id.* at 21.

84. *Id.* at 23. *See also infra* text accompanying notes 170-71.

85. 441 U.S. at 25.

86. On remand to the Second Circuit, Judge Newman held that the blanket license, at least as regards CBS, is not an antitrust violation. *See* CBS v. ASCAP, 620 F.2d 930 (2d Cir. 1980).

87. 441 U.S. at 25 (Stevens, J., dissenting).

88. *Id.* at 34-38. In Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980) (per curiam), the Supreme Court ruled that an agreement among competitors fixing credit terms affected price and thus was a *per se* violation of § 1. Credit terms, held the Court, are an inseparable part of price, and any attempt to tamper with price has always been unlawful *per se*. *Id.* at 648. "The fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful *per se*." *Id.* at 649. The Court's decision was not surprising. In United States Steel Corp. v. Fortner Enters., 429 U.S. 610 (1977), the Court, including the dissenters, agreed that in the normal case, credit terms are intimately associated with price. For an extended discussion, see Favretto, *The* Per Se *Rule: Alive and Well and Living in* Catalano, 6 U. DAYTON L. REV. 11 (1981).

89. *Compare* Bohling, *A Simplified Rule of Reason for Vertical Restraints: Integrating Social Goals, Economic Analysis and* Sylvania, 64 IOWA L. REV. 461 (1979); Posner, *supra* note 38 *with* Redlich, *supra* note 7; Sullivan, *Economics and More Humanistic Disciplines: What Are The Sources of Wisdom for Antitrust?* 125 U. PA. L. REV. 1214 (1977). *See* Arizona v. Maricopa County Medical Soc'y, 643 F.2d 553 (9th Cir. 1980), *rev'd*, 457 U.S. 332 (1982) (discussed *infra* note 100); Mardirosian v. American Inst. of Architects, 474 F. Supp. 628, 636-40 (D. D.C. 1979) (discussed *supra* note 64); *see also, e.g.*, Hydrolevel Corp. v. American Soc'y of Mechanical Eng'rs, 635 F.2d 118, 126-27 (2d Cir. 1980); Paralegal Inst., Inc. v. American Bar Ass'n, 475 F. Supp. 1123 (E.D.N.Y. 1979);

District Court of Arizona had issued an opinion[90] which was clearly influenced by the Burger Court's trend. Two years later, the Supreme Court would be confronted with that very case, and would be presented with the opportunity to extend its four previous opinions to a logical conclusion.

II. *ARIZONA V. MARICOPA COUNTY MEDICAL SOCIETY*

In 1978, the State of Arizona charged that a nonprofit county medical society, composed of competing doctors, had violated the Sherman Act by establishing maximum fee schedules for use by its members.[91] Insurance companies gained Society approval by agreeing to pay member doctors the scheduled amount, and doctors in turn agreed to accept this payment in full satisfaction for their services.[92] The doctors were permitted to charge insured patients less than but no more than the scheduled amount; they could charge uninsured patients more than the scheduled amount.[93] Insured patients were also free to visit nonmember doctors, but then they were not guaranteed full insurance coverage.[94]

The state charged that the fee schedules had the effect of enhancing prices,[95] primarily through periodic upward revisions of the fees.[96] The Society, on the other hand, argued that the schedules were an effective cost containment device and assured patients full coverage.[97] The state moved for partial summary judgment on the issue of liability, alleging that the agreement was a *per se* violation of section 1.[98] The district court, influenced by the Supreme Court's recent decisions, denied the motion[99] and ordered a

Veizaga v. National Bd. of Respiratory Therapy, 1977-1 Trade Cas. (CCH) ¶ 61,274 (N.D. Ill. 1977).

90. Arizona v. Maricopa County Medical Soc'y, 1979-1 Trade Cas. (CCH) ¶ 62,694 (D. Ariz. 1979), *aff'd*, 643 F.2d 553 (9th Cir. 1980), *rev'd* 457 U.S. 332 (1982).

91. Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 337 (1982). Actually two such societies were charged; one in Maricopa County, the other in Pima County. The complaint also charged a violation of the state antitrust law, a law which is read in conformity with the federal statute. *Id.* at 336 n.1.

92. *Id.* at 341.

93. *Id.*

94. *Id.*

95. Unlike the advisory relative value guide involved in United States v. American Soc'y of Anesthesiologists, 473 F. Supp. 147 (S.D.N.Y. 1979), the doctors in the Maricopa County Society: 1) agreed to abide by the plan, and 2) established a monetary conversion factor in addition to the relative value guide. 457 U.S. at 340-41. For a discussion of how antitrust has been applied to the health care field, see Borsody, *The Antitrust Laws and the Health Industry*, 12 AKRON L. REV. 417 (1979); Grad, *The Antitrust Laws and Professional Discipline in Medicine*, 1978 DUKE L.J. 443; Havighurst, *Professional Restraints on Innovation in Health Care Financing*, 1978 DUKE L.J. 303; Kallstrom, *Health Care Cost Control by Third Party Payors: Fee Schedules and the Sherman Act*, 1978 DUKE L.J. 645; Leibenluft & Pollard, *Antitrust Scrutiny of the Health Professions: Developing a Framework for Assessing Private Restraints*, 34 VAND. L. REV. 927 (1981); Rosoff, *Antitrust Laws and the Health Care Industry: New Warriors into an Old Battle*, 23 ST. LOUIS U.L.J. 446 (1979); Comment, *The Professions and Noncommercial Purposes: Applicability of* Per Se *Rules Under the Sherman Act*, 11 U. MICH. J.L. REF. 387 (1978).

96. 457 U.S. at 341-42. But the questions of upward revision are irrelevant to the question under § 1: whether the Sherman Act prohibits establishment of a maximum fee schedule in this case. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224 n.59 (1940).

97. 457 U.S. at 342, 351.

98. *Id.* at 336-37.

99. 1979-1 Trade Cas. (CCH) ¶ 62,694, at 77,897 (D. Ariz. 1979). The district judge offered three justifications for his result: 1) the Court's trend as embodied in *Engineers* and *Sylva-*

trial under the rule of reason. On interlocutory appeal, the court of appeals issued three separate opinions,[100] each judge expressing a different view. Nevertheless the court upheld the denial of the motion, applying the rule of reason.[101]

Before the Supreme Court, the Society conceded the established principle that price-fixing agreements are illegal *per se*, but argued that the rule did not apply to them because the agreements at issue: 1) fixed maximum, not minimum prices; 2) were among members of a profession; 3) were in an industry with which the judiciary had little antitrust experience; and 4) had redeeming competitive effects.[102]

Justice Stevens took pains to review the Court's price-fixing cases, emphasizing that both minimum and maximum price-fixing arrangements have always been *per se* unlawful.[103] Justice Stevens then quickly dismissed the doctors' contention that the professional character of their business justified different treatment. The agreements involved, said the Court, "are not premised on public service or ethical norms. . . . [T]he claim that the price restraint will make it easier for customers to pay does not distinguish the medical profession from any other provider of goods or services."[104] The Court similarly rejected the argument that the *per se* rule should not apply because the judiciary has little antitrust experience with the health care industry.[105] The Sherman Act, said the Court, "establishes one uniform rule applicable to all industries alike."[106]

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nia, 2) that the professional character of the restraint dictated rule of reason treatment; and, 3) that the Supreme Court cases involving maximum price fixing did not expressly call for *per se* treatment. *Id.* at 77,895-97.

100. Arizona v. Maricopa County Medical Soc'y, 643 F.2d 553 (9th Cir. 1980), *rev'd*, 457 U.S. 332 (1982). The majority opinion was authored by Circuit Judge Sneed. It expressed uncertainty regarding the state of antitrust law as applied to the health care field. 643 F.2d at 556. Admitting that even doctors can be motivated by economic considerations, the court refused to characterize the restraint as price fixing, since the doctors apparently lacked monopoly power and thus could not effectively raise prices. *Id.* at 557. The court also concluded that *Socony-Vacuum* was inapposite in light of the Supreme Court's decision in *BMI*. *Id.* at 557-58. Judge Kennedy filed a separate concurring opinion, asking for additional evidence before making the price-fixing determination. *Id.* at 560 (Kennedy, J., concurring). In dissent, Judge Larson stated that in spite of the uncertainty created by *Goldfarb* and *Engineers*, "the Supreme Court would be willing to apply *per se* rules to professional price tampering. . . ." *Id.* at 564 (Larson, J., dissenting). He also admonished the other members of his bench that if a cautious approach was proper as the majority asserted, then caution counseled application of the long established *per se* rule rather than embarkation upon a theory based on "erroneous legal premises and abused . . . discretion." *Id.* at 569.

101. *Id.* at 560.

102. 457 U.S. at 342.

103. Justice Stevens traced the history of the *per se* rule and rule of reason, beginning with the Court's decisions in United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898) and Standard Oil Co. v. United States, 221 U.S. 1 (1911). He then turned to the strict rule against price fixing, noting Justice Stone's words to that effect in United States v. Trenton Potteries Co., 273 U.S. 392, 398 (1927), and the harsh treatment of the defendants applied by Justice Douglas in the seminal case, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940). Justice Stevens then quoted at length from two prior maximum price-fixing cases in the Supreme Court, Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951) and Albrecht v. Herald Co., 390 U.S. 145 (1968). 457 U.S. at 342-48. Thus, with sweeping language, Justice Stevens foreclosed the notion that a price restraint can be anything other than *per se* unlawful.

104. 457 U.S. at 349.

105. *Id.* at 349-51.

106. *Id.* (quoting United States v. Socony-Vacuum, 310 U.S. 150, 222 (1940)).

The defendant's principal argument was that *per se* treatment was inappropriate because of the presence of significant procompetitive effects. These effects included full insurance coverage, a choice of doctors, and lower premiums.[107] The Court rejected the argument as demonstrating "a misunderstanding of the *per se* concept."[108] The rule that price fixing is illegal *per se* precludes any argument that an individual price-fixing scheme might have a beneficial effect.[109] Such a claim, the Court stated, is so unlikely to prove significant in a particular case that the general rule warrants application in all price-fixing cases.[110]

Justice Stevens then noted that the goal of lower fees, allegedly flowing from transaction cost savings,[111] could be achieved without price fixing among doctors.[112] The opinion alludes to state regulation or doctor-insurer agreements as alternative means of accomplishing this end.[113] There was thus no factual basis in the record for defendant's contention that doctors alone must set the price schedule.[114]

The dissenters argued that the doctors' agreements should be judged under what was a rule of reason approach, citing the *BMI* case.[115] The majority distinguished the *BMI* decision, as involving price fixing in the "literal sense" only.[116] The salient feature of the blanket license in *BMI* was that it had characteristics quite different from anything the individual copyright owners could sell. The establishment of performance rights societies permitted the free flow of performance rights licensure; without them, efficient selling and monitoring would be impossible. The "price fixing" involved in that case was nothing more than a producer's decision as to what price he would charge for this new product, the blanket license.[117]

Justice Stevens contrasted the doctors' maximum fee schedule with price setting in partnerships and other joint arrangements where collective pricing decisions are necessary.[118] He found the doctors' fee schedule analogous neither to a partnership's price setting nor to the blanket license in *BMI*.[119] No new and distinct product was offered. Rather, the only effect was to permit the sale of medical services at predetermined prices, avoiding

107. 457 U.S. at 351.
108. *Id.*
109. *Id.*
110. *Id.* As Justice Black said in Northern Pac. R.R. v. United States, 356 U.S. 1, 5 (1958):
> This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

111. 457 U.S. at 352.
112. *Id.* at 352-54.
113. *Id.* (citing, *e.g.*, Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979)). *See also* Kartell v. Blue Shield, Inc., 592 F.2d 1191 (1st Cir. 1979); Medical Arts Pharmacy, Inc. v. Blue Cross & Blue Shield, Inc., 518 F. Supp. 1100 (D. Conn. 1981).
114. 457 U.S. at 352-53 n.26.
115. *Id.* at 357-67. (Powell, J., dissenting).
116. 457 U.S. at 355-56.
117. *Id.* at 355-56 & nn. 31-32.
118. *Id.* at 356-57.
119. *Id.*

the interplay of free market forces.[120] Such arrangements among independent competing entrepreneurs, declared the Court, remain illegal *per se*.[121]

Joined by the Chief Justice and Justice Rehnquist, Justice Powell dissented on the question of whether to apply the *per se* rule.[122] The dissenters would have avoided the price-fixing characterization in two ways. They found no showing in the record that the plan was plainly anticompetitive,[123] and they would have held that the facts of *Maricopa County* fell within *BMI*.[124] Regarding the first, Justice Powell did not expressly find that competitive efficiencies were present, but instead he bemoaned the lack of a detailed record.[125] He noted that the plan "seems to be in the public interest,"[126] although he could point to no specific procompetitive benefit.[127] According to the dissent, if significant procompetitive effects could be found, *per se* treatment would be inappropriate.[128]

Turning to their second argument, the dissenters would hold that the agreement in *Maricopa County* had enough in common with the blanket license in *BMI* to justify rule of reason treatment.[129] Justice Powell asserted that the plan has characteristics different from the usual horizontal arrangement,[130] similar to the combination in *BMI*. Several similarities between *BMI* and *Maricopa County* were said to be of significance: each involved competitors in cooperative pricing, each addressed the need for better service to consumers, and each created a new product through otherwise unattainable efficiencies.[131]

The plaintiff State of Arizona, wrote Justice Powell, had not yet discharged its burden of proving the plainly anticompetitive character of the restraint.[132] In basing its *per se* condemnation of this novel plan upon a limited record, the majority had lost sight of the central "consumer welfare" purpose of the Sherman Act.[133] Unlike Justice Stevens, Justice Powell

120. *Id.* at 356.

121. *Id.* at 356-57.

122. 457 U.S. at 357 (Powell, J., dissenting). Justices Blackmun and O'Connor took no part in the consideration of the case.

123. *Id.* at 359-64.

124. *Id.* at 364-66.

125. *Id.* at 358, 361, 367.

126. *Id.* at 357.

127. Justice Powell noted that the Society's plan "forecloses *no* competition," *id.* at 360, since consumers and doctors are free to participate or withdraw. Even if that is so, the fact that no injury results from the restraint cannot be equated with a *procompetitive* benefit. Second, the dissent asserts that the insurers adequately represent consumer interests, quality service at lower prices. *Id.* at 360-61. But, as the majority properly notes, the plan allegedly reduces transaction costs, *not medical costs*. *Id.* at 352 n.25. Thus, the plan does not promote that which consumers desire: lower medical cost and quality of care. *See infra* text accompanying note 156.

128. 457 U.S. at 352 (Powell, J., dissenting). *See infra* text accompanying notes 151-62, 175-78.

129. 457 U.S. at 361-64 (Powell, J., dissenting).

130. *Id.* at 360.

131. *Id.* at 364-65. Justice Powell argued that the Societies had created a different product in that they "set up an innovative means to deliver a basic service—insured medical care from a wide range of physicians of one's choice—in a more economical manner." *Id.* at 365 n.12. *See infra* text accompanying notes 167-74.

132. *Id.* at 366.

133. *Id.* at 367.

would have remanded the case for trial under the rule of reason.

III. THE REVITALIZATION OF THE *PER SE* RULE

The Court's decision in *Maricopa County* is a stunning reaffirmation of the *per se* rule against price fixing. After several years of movement away from the use of *per se* rules, the Court has for the present halted this trend.[134] While *Maricopa County* is certain to engender some confusion, it must nevertheless be lauded as a significant step toward reestablishment of a predictable and functional rule of law.

Maricopa County, though, is not particularly noteworthy in its assertion that professions must not be treated differently from other businesses in the legality of their pricing practices. The Court thus continues to clarify its statement in *Goldfarb*, left open in *Engineers*,[135] that the public service aspects of professions might require varied rules. *Goldfarb* had made clear that professions are not exempt from the Sherman Act's proscriptions;[136] *Maricopa County* confirms the thrust of *Engineers*: professions will be treated no differently from other providers of goods and services, at least regarding agreements affecting price.

In fact, *Engineers* had decreed that even if a professional agreement improves the quality of service, it remains unlawful if there is an affect upon price.[137] The doctors in *Maricopa County* did not even assert that their agreement improved the quality of medical service offered. They alleged, rather, that the agreement made payment easier for customers.[138] The latter, said Justice Stevens, is a concern endemic to all industries, and it alone will not distinguish the doctors' restraint from agreements among nonprofessionals.[139]

Justice Stevens also reaffirmed the long-standing principle that the *per se* rule applies to all industries alike. The doctors had argued that *per se* treatment was inappropriate because the judiciary had little antitrust experience in the health care field.[140] The Court has, in the past, spoken of not applying a *per se* rule in areas in which it was unfamiliar.[141] These statements, however, referred to unfamiliar restraints rather than industries.[142] Price fixing, the restraint involved in *Maricopa County*, has always been illegal.[143] Agreements establishing price ceilings have twice been condemned by the Supreme Court.[144] The fact that courts might lack experience in the

134. The existence of such a trend cannot be doubted. *See, e.g.*, *supra* notes 99-100.

135. *See* National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 696 (1978).

136. 421 U.S. at 787-88. *See supra* text accompanying notes 13-27.

137. 435 U.S. at 696 n.22.

138. 457 U.S. at 348-49.

139. *Id.* at 349.

140. *Id.* at 350-51.

141. *See, e.g.*, United States v. Topco Assocs., 405 U.S. 596, 607-08 (1972); White Motor Co. v. United States, 372 U.S. 253, 261-63 (1963).

142. *See* White Motor Co. v. United States, 372 U.S. 253 (1963). Justice Stevens refers to the distinction in *Maricopa County*, 457 U.S. at 349 n.19.

143. *See supra* note 8 and accompanying text.

144. *See* Albrecht v. Herald Co., 390 U.S. 145 (1968); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951). These cases arguably involved "vertical" restraints, agree-

health care field does not warrant a different rule of law. In fact, the uniformity of the *per se* rule is one of its primary virtues.[145]

The two most important aspects of the Court's opinion are: 1) the role of the price-fixing characterization in section 1 analysis[146] and 2) the narrowing of *BMI*. Regarding the first, Justice Stevens' opinion is founded upon his description of the agreement as one fixing prices.[147] Once this characterization is made, *per se* treatment necessarily follows; questions of procompetitive benefits become wholly irrelevant.

In its first four cases, the Burger Court apparently retreated from the characterization approach. *Engineers* bypassed the characterization issue, and *BMI* questioned its utility[148] in the copyright field. *Maricopa County* reverses this trend. While the dissent calls for more detailed rules,[149] the majority applies the traditional rule that an agreement which affects price is to be placed in the forbidden category.[150] Characterization's role has, with the *Maricopa County* decision, been restored after a short hiatus.

The dissenters would have avoided the price-fixing label.[151] Relying on occasional Court language to the effect that agreements in the *per se* category had no purpose except stifling competition,[152] Justice Powell would have allowed the alleged procompetitive virtue to remove the practice from the *per se* category.[153] Once removed, trial under the rule of reason must follow. The dissent, however, seems to have taken that language out of context; language referring to "no purpose except stifling of competition," or "lack of any redeeming virtue" was not intended as a talisman.[154] It is noteworthy

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ments between firms at different levels of the distribution system. The agreement in *Maricopa County* was among entrepreneurs at the same level of competition, and is known as a "horizontal" arrangement. But Justice Stevens wrote that: 1) the earlier cases did have horizontal aspects as well as vertical, and 2) in general, horizontal restraints are less defensible than vertical restraints. 457 U.S. at 348 n.18. *But see* Blair and Kaserman, *The* Albrecht *Rule and Consumer Welfare: An Economic Analysis*, 33 U. FLA. L. REV. 461 (1981); Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886 (1981).

145. 457 U.S. at 349-51, 353-54. Even Professor Bork, whose writings have greatly influenced the Burger Court, wrote: "The benefits of a broad *per se* category in ease of enforcement and predictability are so great that its legitimate availability constitutes one of the main tradition's chief assets." Bork, *supra* note 8, at 837. *See also* Redlich, *supra* note 6, at 54-58. Sullivan, *supra* note 89. *But see* Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

146. *See supra* note 8. The characterization approach is well developed and explained in L. SULLIVAN, *supra* note 6, at § 74.

147. *See* 457 U.S. at 348-54.

148. *See supra* text accompanying notes 77-79.

149. 457 U.S. at 366 (Powell, J., dissenting). But the characterization approach to price fixing is not as unclear as the dissent believes. *See* L. SULLIVAN, *supra* note 6, at §§ 74-78, 81, 86-92; Redlich, *supra* note 6, at 14 n.91.

150. *See supra* text accompanying note 103.

151. *See supra* text accompanying notes 122-28.

152. United States v. Topco Assocs., 405 U.S. 596, 608 (1972) (quoting White Motor Co. v. United States, 372 U.S. 253, 263 (1963)). *See also* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49, 50 (1977); Northern Pac. Ry. v. United States, 356 U.S. 1, 5, *quoted* in *Sylvania*, 433 U.S. at 50.

153. 457 U.S. at 361-64.

154. *See, e.g.*, Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). To confirm that language such as this is not to be taken literally, one need only look to the remainder of the paragraph in which it is contained. Justice Black therein states that regarding restraints in the *per se* categories, a general reasonableness inquiry is "so often fruitless" as to be judicially un-

that Justice Stevens avoided reference to this "standard".

Assuming *arguendo* the dissent's view of the significance of a benefit, Justice Stevens demonstrated that the procompetitive benefit was not even present.[155] He noted that in Maricopa County, Arizona about seventy percent of the doctors offered the benefits of the Society's plan, and that a patient therefore had a seven in ten chance of choosing a doctor who offered full insurance coverage. In other markets that do not have the plan, however, presumably at least seventy percent of the doctors also offer "usual, customary, and reasonable" rates, that typical insurers will reimburse. A prospective patient in those counties, therefore, also has a seven in ten chance of full coverage.[156] A patient is no better off in Maricopa County than is a patient elsewhere. The alleged benefit to the patient, guaranteed coverage with freedom of choice of doctor, simply is not effected as a result of the doctors' agreement.

Further, the allegation of lower insurance cost, perhaps the most significant potential procompetitive benefit, was rejected as a valid defense.[157] Such "lower cost" defenses historically have been invalid in price-fixing cases.[158] There is, however, an important distinction between the defendant's argument and previous "lower cost" defenses. The doctors did not allege that the agreement reduced medical costs, but rather that a prearrangement on fees makes medical insurance less expensive by improving the accuracy of the insurer's risk calculation.[159] But, says the Court, even if some prearrangement is desirable, it is not necessary for the doctors to set the maximum price.[160] State regulation or insurer-doctor arrangements are possible alternatives.[161] "[I]n any event," wrote Justice Stevens, "there is no reason to believe that any savings that might accrue from this arrangement would be sufficiently great to affect the competitiveness of these kinds of insurance plans."[162]

The dissenters take a different view of the significance of potentially lower insurance rates. Justice Powell analogized the case to *BMI*, noting that the agreements in both *BMI* and *Maricopa County* were intended to pro-

economical. *Id.* By inference then, a reasonableness inquiry in a *per se* case would often, *but not always*, result in condemnation. If the "no purpose except stifling of competition" language is read outside its context, the *per se* rule and its attributes would be forever lost. Indeed as the Court stated in United States v. Topco Assocs., 405 U.S. 596, 609 (1972): "Whether or not we would decide this [*per se*] case the same way under the rule of reason . . . is irrelevant to the issue before us." *See also* Arizona v. Maricopa County Medical Soc'y, 457 U.S. at 332, 343-44 (1982); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 50 n.16 (1977).

155. 457 U.S. at 351-52.

156. *Id.* Justice Stevens indicated this presumption was in accord with the Society's figures. *Id.* at 352 n.24. Discussions between this author and members of the medical and insurance fields confirm the validity of those figures.

157. *See supra* text accompanying notes 107-13.

158. *See, e.g.*, Catalano, Inc. v. Target Sales, Inc., 446 U.S. 663, 647 (1980); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Trenton Potteries Co., 273 U.S. 392, 397-98 (1927); United States v. Trans-Missouri Freight Ass'n., 166 U.S. 290, 340-41 (1897).

159. 457 U.S. at 352 n.25.

160. *Id.* 352-53.

161. *Id.* The fact that the doctors can best compute medical fees does not insulate them from *per se* treatment. *See* 457 U.S. at 353.

162. *Id.* at 353-54.

vide "better service" to the consumer through the creation of a new and more efficient product.[163] Justice Powell's approach is clearly not as refined as that of Justice Stevens, who distinguished between improved care and a patient's ability to pay,[164] finding that an allegation of the former was not present.[165] Justice Powell simply refers to "better service."[166]

Cheaper full insurance coverage is the "new product" created by the doctors, according to Justice Powell.[167] He would thus hold that, as in *BMI*, the doctors' agreements are price fixing only in the "literal sense."[168] Yet the crucial distinction, according to the majority, lay in the fact that the doctors had created no new product;[169] they sold only medical services. It was the price for these services that the doctors tried to affect through agreement. In *BMI*, by contrast, the societies were created to sell what was, in fact, a new product, the blanket license.

Justice Stevens also analogized the *BMI* blanket license to a joint venture or partnership which involved the creation of a new entity.[170] This new entity would naturally have to price its product. For instance, doctors with different specialties might combine to form a new business entity which offered a wider range of health care services. In such an arrangement, each doctor would give up his identity as an independent competitor in order to become a member of the group, much as a composer delegates his price setting power to the performing rights societies.[171] Price setting by such an entity is a necessary part of our economic system.

The agreement in *Maricopa County*, however, was "fundamentally different."[172] It involved no new product and no new entity.[173] Each doctor maintained his individual identity as a competitor. The Court has declared repeatedly that any agreement among individual competitors that establishes a fee schedule of any kind is unlawful *per se*.[174] At least four Justices are unwilling to change this rule.

Having found that the doctors' agreements were illegal *per se*, the Court saw no need to analyze in depth the restraint's anticompetitive nature. The entire history of the Sherman Act is replete with judicial statements that, in price-fixing cases, no such inquiry is required.[175] The maximum price wrinkle is not unfamiliar to the courts, and it is easily seen how the doctors' conspiratorial price ceiling tends to become a uniform price.[176] Each doctor,

163. *Id.* at 364-65 (Powell, J., dissenting).
164. *See supra* text accompanying notes 104, 138-39.
165. 457 U.S. at 349.
166. *Id.* 364-65 (Powell, J., dissenting).
167. *Id.* 365 n.12.
168. *Id.* at 361-64.
169. 457 U.S. at 356-57.
170. *Id.*
171. *Id.* at 2480.
172. *Id.* at 2479.
173. "Neither the foundations nor the doctors sell insurance, and they derive no profits from the sale of health insurance policies. The members of the foundations [the doctors] sell medical services." *Id.*
174. *See* cases cited *supra* note 8.
175. *See, e.g.*, United States v. Socony-Vacuum Oil Co., 340 U.S. 150 (1940).
176. 457 U.S. at 348. *See* Albrecht v. Herald Co., 390 U.S. 145, 152-53 (1968) (Harlan, J.,

confident of the prospect of full payment from an insurer, has little or no incentive to lower prices to insured patients. The patient makes the choice of doctor without considering the price; he need only be concerned with whether the doctor is a Society member. Price competition among Society members is thus eliminated; the pricing decision is removed from the marketplace and placed in the Society's smokefilled rooms.[177] The Sherman Act, from its inception, has proscribed any such removal. Justice Stevens thus stated that the doctors' agreements "fit squarely into the horizontal price fixing mold."[178]

The dissent, on the other hand, would not condemn the doctors' plan on the limited record before the Court. The case reached the Court on motion for partial summary judgment, the State of Arizona demanding *per se* treatment. Justice Powell indicated that he would not characterize the agreement as a *per se* violation without additional information.[179] But such an approach in every case would undermine the utility of the *per se* rule whose purpose, at least in part,[180] is to enhance judicial economy.[181]

In conclusion, Justice Stevens praises in general terms the benefits of the

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dissenting); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211, 213 (1951). *See also* L. SULLIVAN, *supra* note 6, at § 78.

177. Antiseptic-smelling corridors? In addition, the restraint reduces the incentive to innovate. 457 U.S. at 348.

178. 457 U.S. at 357 (Powell, J., dissenting).

179. *Id.*

180. There are those who believe that the antitrust laws in general, and the *per se* rule in particular, have social as well as economic goals. Foremost among these social goals is the protection of small businesses and independent decisionmaking. *See, e.g.*, United States v. Aluminum Co., 148 F.2d 416 (2d Cir. 1945) where Judge Hand stated:

> It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes.

Id. at 427. Judge Hand added that "[t]hroughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other." *Id.* at 429.

> In Standard Oil Co. v. United States, 337 U.S. 293 (1949), Justice Douglas stated:
> But beyond all that there is the effect on the community when independents are swallowed up by the trusts and entrepreneurs become employees of absentee owners. Then there is a serious loss in citizenship. Local leadership is diluted. . . . These are the prices which the nation pays for the almost ceaseless growth in bigness on the part of industry.

Id. at 318-19 (Douglas, J., dissenting).

Justice Black, adding strength to this view, used it as the basis of his decision in Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951), stating:

> The Court of Appeals erred in holding that an agreement among competitors to fix maximum resale prices of their products does not violate the Sherman Act. *For such agreements, no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.*

Id. at 213 (emphasis added). *See also* United States v. Von's Grocery Co., 384 U.S. 270, 274-78 (1966); Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1957).

> Commentators have also expressed this view. Blake and Jones have stated:
> Another political objective of antitrust is the enlargement of individual liberty. . . . [I]t *was* the purpose of the antitrust laws to expand the range of consumer choice and entrepreneurial opportunity by encouraging the formation of markets of numerous buyers and sellers, assuring ease of entry to such markets, and protecting participants—particularly small businessmen—against exclusionary practices.

per se rule,[182] concluding with the almost proverbial suggestion that the doctors take their case to Congress.[183] The Court's commendation of the *per se* rule in *Maricopa County* is particularly interesting; mention of the virtues of the *per se* rule is notably absent from *Goldfarb*[184] and *Engineers*,[185] and is contained in a mere footnote in *Sylvania*.[186] At least four members of the Court now clearly approve of a broad *per se* rule against price fixing.

The apparent difference of opinion which has arisen between Justices Stevens and Powell is worthy of continued observation. The battle will undoubtedly continue for the last word in shaping the nature and policy of the Sherman Act. But the Supreme Court, which in recent years has concentrated on the rule of reason, has once again demonstrated its preference for the *per se* rule. While the future remains uncertain, the *per se* rule has returned to improve predictability and reaffirm the roles of Congress and the judiciary in formulating antitrust law.

CONCLUSION

With the Court's decision in *Maricopa County*, the *per se* rule, at least for now, retains its vitality in antitrust analysis. The four-three decision, however, leaves open the possibility that the Court will again shift its approach.[187] Justice Stevens, joining the remaining Warren Court members,[188] has reaffirmed a wise rule and its traditions. If a restraint is characterized as price fixing, it will be condemned *per se*; there is no need for elaborate inquiry into alleged procompetitive benefits or redeeming virtues.

Blake & Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377, 383-84 (1965). *See also* Redlich, *supra* note 6; Sullivan, *supra* note 89.

Similar concerns motivated other antitrust legislation. See the statements by Representative Celler, 95 CONG. REC. 11,486 (1949), and Senator Kefauver, 96 CONG. REC. 16,450 (1950), regarding the need for stronger measures against economic concentration.

181. 457 U.S. at 343-44 & n.14.

182. *Id.* at 355-57.

183. *Id. See also* Borsody, *supra* note 95; Kallstrom, *supra* note 95; Rosoff, *supra* note 95.

184. Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975).

185. National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679 (1978).

186. Continental T.V., Inc., v. GTE Sylvania Inc., 433 U.S. at 50 n.16 (1977).

187. Justice Blackmun took no part in the *Maricopa County* decision. It is not clear which side of the argument he would favor. In United States v. Topco Assocs., 405 U.S. 596 (1972), Justice Blackmun concurred separately in Justice Marshall's majority opinion, stating that the *per se* rule "appears to be so firmly established by the Court that, at this late date, I could not oppose it." *Id.* at 613 (Blackmun, J., concurring). But in *Sylvania*, Justice Blackmun agreed with the majority, and thus supported the Court when it overruled *Schwinn*'s *per se* approach in favor of the rule of reason. *See supra* text accompanying notes 31-32. Justice Stewart, the "perennial antitrust dissenter," has been replaced by Justice O'Connor, whose views in the area of antitrust are, as yet, unknown. Redlich, *supra* note 6, at 46.

188. Justices White, Marshall, and Brennan made up the remainder of the four-judge majority in *Maricopa County*. It is noteworthy that it was Justice Stevens, in *Engineers*, 435 U.S. 679, 681 (1978), who first elevated the phrase "rule of reason" to "Rule of Reason." In *Maricopa County*, Justice Stevens has reduced the phrase to lower case designation. 457 U.S. at 342.

THE COMMODITY FUTURES TRADING COMMISSION AND SUITABILITY: NOW YOU SEE IT, NOW YOU DON'T

M. VAN SMITH*

I. INTRODUCTION

In September 1977, the Commodity Futures Trading Commission (CFTC or Commission) proposed customer protection rules, one of which would have required commodity futures brokers to determine whether commodity futures trading was suitable for customers.[1] When the Commission adopted the proposed customer protection rules, however, it did not adopt the suitability rule.[2] The CFTC announced its action as being for the protection of customers.[3] Yet, despite what the CFTC announced, the thesis of

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1. (a) [No broker may], directly or indirectly make any recommendation to any customer concerning the purchase, sale or continued holding of any commodity interest, or may effect, directly or indirectly, any transaction in a commodity interest for a customer pursuant to discretionary power . . . unless [the broker]:

(1) Within a reasonable period of time before the recommendation or transaction,

(i) Obtained from the customer the essential facts about the customer's financial condition and trading objectives, and

(ii) Verified with the customer the accuracy of that information if previously obtained and

(2) At the time of the recommendation or transaction, had reason to believe that the recommendation or transaction was suitable for the customer in light of

(i) The information obtained from the customer and otherwise known about the customer . . . and

(ii) The risk of loss involved therein.

(b) For purposes of this section, the term "recommendation" means any advice, suggestion or other statement that is intended, or can reasonably be expected, to influence a customer to purchase, sell or hold a commodity interest, but does not include any statement that merely describes in an objective fashion the commodity interest, the manner in which it is traded or the services of [the broker].

(c) This section does not apply to recommendations furnished solely through—

(1) Uniform publications distributed to subscribers thereto,

(2) Books,

(3) Television or radio communications, or

(4) Seminar or lecture presentations.

Protection of Commodity Customers: Standards of Conduct for Commodity Trading Professionals, 42 Fed. Reg. 44,750 *reprinted in* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,474, at 21,940 (Sept. 6, 1977).

2. Adoption of Customer Protection Rules, 43 Fed. Reg. 31,886, *reprinted in* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,642, at 22,623 (July 24, 1978) (codified at 17 C.F.R. § 1.33) [hereinafter cited as Customer Protection Rules].

3. On October 1, 1978, William T. Bagley, Chairman of the CFTC, announced the commission's action.

Starting as a brand new regulatory Commission three and one-half years ago, we have now virtually completed a new book of rules for commodity traders and the public. These much-needed customer protections are another step toward assuring a smooth-working marketplace that has greater safeguards for the participants.

The phenomenal growth of futures trading in recent years, with new contracts in both the traditional commodities and the attractive new financial instrument futures,

this article is that the Commission declined to adopt a suitability rule so that brokers would not have a duty to determine whether commodity futures trading is suitable rather than to protect customers. This article reviews the history of the suitability concept, discusses the ways suitability duty can be enforced by the common law, and concludes that the efforts of the CFTC to obstruct the development of a suitability duty will ultimately fail.

II. THE CONCEPT OF SUITABILITY

A. *General Principles*

In investing, one person's meat is another person's poison. A suitable investment for a young widow with children who has recently received $150,000 in life insurance proceeds on which she must rely for support differs from what is suitable for a doctor who makes $150,000 a year. "Suitability" is the label given to the concept to express the appropriateness of an investment or speculation in the light of the finances and objectives of customers.[4]

The concept of suitability was endemic to the brokerage community long before it was adopted as a legal concept. The essence of the brokerage suitability concept is investments that conform to the needs and goals of the particular investor.[5] A well-known writer on investing, Roger Babson, stated, "[t]he proper investment procedure for an individual depends largely on his personal circumstances. He must reckon not only the amount of his capital and his financial position but his family responsibilities, his tempera-

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has brought thousands of new investors into the market and swelled the ranks of the professionals who serve them, he said.

Because of this, the Commission has answered the need for shoring up the framework in which the industry operates.

These customer protection rules come as a follow-up to steps taken earlier to effect improvements in the in-house operations of exchanges, brokerage houses and other commodity firms, through such things as strengthened registration, reporting and minimum financial requirements, and through exchange rule enforcement reviews.

Under the rules that go into effect October 1 [1978], customers are going to get from futures commission merchants risk disclosure statements prepared by the CFTC, which the customer must acknowledge before opening an account.

CFTC Release No. 432-78 (Oct. 1, 1978).

4. *See generally* Roach, *The Suitability Obligations of Brokers: Present Law and the Proposed Federal Securities Code*, 29 HASTINGS L.J. 1067 (1978) (survey of the development of suitability for all forms of investment).

5. *See* INVESTMENT AND INVESTORS 49 (P. Rossi ed., 21st ed. 1936). This book sets forth an elaborate scheme for classifying individuals with respect to their suitability for different kinds of investments:

GROUP I.—Investors who rely entirely for their maintenance upon the income produced by their investments.

(a) Rich people who have more than sufficient income.

(b) Well-to-do people who need not strain their investments.

(c) People moderately well off who must make a large income.

(d) People who are compelled to make their investments produce the largest possible income.

GROUP II.—Investors who live partly on their present efforts and partly on the income produced by their investments.

(a) People with ample means.

(b) People with insufficient income from earnings but ample income from investments.

(c) People with insufficient income from earnings and a small capital.

ment, and the goal for which he is striving."[6]

Professor Paul Fenlon, of the University of Texas Business School, analyzed the profiles of various investors to determine the suitability of invest-

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GROUP III.—Investors who live entirely on the results of their present efforts.

(a) People with surplus earnings, which they apply towards increasing their capital, the income from which is already sufficient to provide for their wants.

(b) People with surplus earnings, which they apply towards the building up of a capital, the income from their present capital being still insufficient to keep them.

(c) People with a moderate surplus and a very moderate capital, or no capital at all.

Differences in investment policy for these classes are set forth:

CLASS 1.—The provision of a definite capital sum for educational or other purposes within a short term of years.

CLASS 2.—A policy suitable for investors who are not dependent on the income from their capital, and who, for various reasons, anticipate the necessity of realizing substantial sums from time to time at very short notice.

CLASS 3.—A policy suitable for investors who have sufficient income for their present needs but who wish to accumulate as much capital as possible against the time when they retire.

CLASS 4.—A policy suitable for those who do not anticipate the necessity to realize capital but who want to benefit as much as possible from their capital immediately and who, therefore, desire as large an income as possible without taking unreasonable risks.

6. R. BABSON, INVESTMENT FUNDAMENTALS 261 (3d ed. 1935). Babson classified investors as very conservative investors, conservative investors, average investors, businessmen, and speculators. *Id.* He outlined the suitability of investments for each class of investor as follows:

BABSON WORKING PLAN FOR YOUR MONEY

Specimen Schedule of Distribution

Very Conservative Investor	Conservative Investor	Average Investor	Business Man	Speculator
One with small resources, or a fiduciary investor, a trustee, a bank, and also the investor who desires very conservative issues.	One with limited resources, or a bank, a trustee, and the investor who wants conservative securities.	One who gives a reasonable degree of attention to investments and has ordinary resources.	The investor who has a fairly substantial income from business and is in a position to assume some risk.	One who devotes his time largely to stocks with the idea that appreciation in value is of primary importance.
He buys bonds only (Part II).	His bond holdings predominate but he buys a few stocks, mostly from the gradual growth standpoint (Part III).	He divides his resources equally between bonds and stocks. He, too, buys some gradual growth stocks but concentrates more on Part I, using the major stock movements which conform to the business areas.	A backlog of bonds is essential for him but more risk may be assumed and perhaps 70% of his funds be placed in stocks.	The backlog of bonds may be cut down but should never be omitted. Stocks bought for appreciation are, however, his mainstay.

In no instance is margin trading advised. Buy bonds and stocks outright and put them in your own box. *Id.* at 267.

ment decisions for them.[7] There was no discussion, however, concerning any legal duty that customers be advised of what is suitable.

B. *Early Suitability Rules*

The first suitability rule was promulgated in 1939 as article III, section 2 of the National Association of Securities Dealer's Rules of Fair Practice.[8] This rule was probably only intended to state a rule of ethics.[9] If the first suitability rules were rules of ethics which were not intended to give rise to legal liability, they became rules to which legal liability attached when the Securities and Exchange Commission (SEC) used suitability rules to hold brokers liable in disciplinary proceedings.[10] The process of suitability rules evolving into rules of legal liability continued as brokers were found liable in fraud for advising customers to make unsuitable investments.[11] Since 1939, the suitability concept has become recognized by lawyers as one of the major philosophical themes of the securities laws.[12]

Despite this development in the field of securities, there has not been a comparable recognition of the suitability concept for commodity futures. This is not because suitability is irrelevant to commodity futures. In 1933, Telford Taylor, an official of the Roosevelt administration, called for protection of inexperienced customers involved in speculative investments. Not only did he see a need for customer protection, but he also saw the need for broker regulation.[13] In 1937, Harold Irwin, an economist with the Commodity Exchange Commission and one of the leading students of commodity futures trading, expressed similar thoughts.[14]

Despite the relevancy of suitability rules for commodity futures, however, the philosophy of the Commodity Exchange Act[15] was not conducive

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7. P. FENLON, INVESTMENT DECISIONS: A CASE BOOK (1972).

8. In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

[1976] NASD MANUAL (CCH) ¶ 2152, at 2051.

9. *See* O'Boyle, *Suitability*, in CONFERENCE ON SECURITIES REGULATION 94 (R. Mundheim ed. 1964). Philip A. Loomis, Jr., General Counsel of the SEC, stated: "[t]he concept of suitability originated with the NASD as an ethical principle." *Id.* at 103.

10. *See, e.g.*, *Gerald M. Greenberg*, 40 S.E.C. 133 (1960); *R.H. Johnson & Co.*, 33 S.E.C. 180 (1952).

11. *See, e.g.*, Twomey v. Mitchum Jones & Templeton, 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968).

12. *See* Lipton, *The Customer Suitability Doctrine*, in PLI FOURTH ANNUAL INSTITUTE ON SECURITIES REGULATION 273 (R. Mundheim, A. Fleischer, Jr., & J. Schepper eds. 1973) (prepared statement of M. Lipton).

13. *See* Taylor, *Trading in Commodity Futures: A New Standard of Legality?*, 43 YALE L.J. 63, 103-04 (1933). Taylor commented:

> [s]teps must be taken for the protection of the gullible and the inexperienced. The past eighty years have amply demonstrated that the general public is easily enticed into the field of speculation. Men need some organized restraint upon their tendency to gamble as much as upon their inclination to drink. And brokers stand in need of regulation of their dealings with the public as much as do the merchants of securities. Both are fields in which the parties cannot safely be left on to the law of offer and acceptance and their own consciences.

14. *See* Irwin, *Legal Status of Trading in Futures*, 32 ILL. L. REV. 155, 169 (1937).

15. 7 U.S.C. § 5 (1976).

to the development of suitability rules. The basic purpose of the Commodity Exchange Act was not to protect public traders, but to protect commodity futures markets from manipulation.[16] The protection of the public which traded commodity futures was incidental to this purpose. In contrast, the basic purpose of federal securities legislation was and is to protect the public investor.[17]

III. THE HISTORY OF SUITABILITY IN COMMODITIES FUTURES TRADING

A. *Suitability to Avoid Illegality*

The practice of complying with what amounted to a suitability duty dissipated the impetus for suitability rules in the area of commodity futures. Even though a suitability duty was not stated in a rule, suitability was an innominate presence. One way the suitability concept manifested itself was in the control the courts had through the rule requiring an intent to deliver. The general rule is that transactions are illegal if the parties do not intend to deliver, but rather to settle on price differences.[18] The custom in commodity futures contracts is to settle on price differences,[19] and as a consequence, a pall of illegality has hung over commodity futures transactions.[20] This anomaly persisted until the state laws which conflicted with the federal regulations were finally preempted in 1974.[21]

Brokerage firms had to be selective with whom they did business. They dared not do business with a person for whom commodity futures were unsuitable for fear that a customer would challenge the legality of the transaction.[22] In *Ohlendorf v. Bennett*,[23] for example, an action was brought by the

16. The purpose of the Act was stated:
> Transactions in commodity involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest . . . the transactions and prices of commodity on such boards of trade are susceptible to speculation, manipulation, and control and sudden or unreasonable fluctuations in the prices thereof frequently occur as a result of such speculation, manipulation, or control which are detrimental to the producer or the consumer and the person handling commodity and products and by-products there in interstate commerce, and such fluctuations in prices are an obstruction to and a burden upon interstate commerce in commodity and the products and by-products thereof and under regulation imperative for the protections of such commerce and the national public interest therein.

Id.

17. S. REP. NO. 41, 73d Cong., 1st Sess. 6 (1933); H.R. REP. NO. 85, 73d Cong., 1st Sess. 2 (1933).

18. *See* 6A A. CORBIN, CONTRACTS 662 (1962); Taylor, *supra* note 13, at 63.

19. *See* REPORT OF THE GRAIN FUTURES ADMINISTRATION 46 (1924); Note, *Legislation Affecting Commodity and Stock Exchanges*, 45 HARV. L. REV. 912, 913-14, nn. 8-9 (1932).

20. *See* T. HIERONYMUS, ECONOMICS OF FUTURES TRADING FOR COMMERCIAL AND PERSONAL PROFIT 57 (1971); Smith, *Preventing the Manipulation of Commodity Futures Markets: To Deliver or Not To Deliver?*, 32 HASTINGS L.J. 1569, 1575 (1981).

21. *See* Smith, *The Commodity Futures Trading Commission and The Return of The Bucketeers: A Lesson In Regulatory Failure*, 57 N.D.L. REV. 7, 15 (1981).

22. *See, e.g.*, Dickson v. Uhlmann Grain Co., 288 U.S. 188 (1933); Irvin v. Williar, 110 U.S. 499 (1884); Roundtree v. Smith, 108 U.S. 269 (1883); Lyons Milling Co. v. Coffee & Carkener, 46 F.2d 241 (10th Cir. 1931); Riordon v. McCabe, 341 Ill. 506, 173 N.E. 660 (1930); Irwin, *Legal Status of Trading in Futures*, 32 ILL. L. REV. 155, 165-69 (1937).

23. 241 Ill. App. 537 (1926).

receiver of a bank to recover money which a cashier wrongfully withdrew and paid to brokers for his losses in grain futures trading. The cashier was a young man with limited business experience, supporting a family, and had never made more than $125 a month. The value of the cashier's property did not exceed $10,000.[24] The cashier testified he could not have delivered or taken delivery. The evidence showed the trading was illegal gambling.[25]

Although the name of the game was illegality, the result was to vitiate transactions which today would be labeled unsuitable. Consequently, even though there was no suitability rule for commodity futures, brokers had to comply with what amounted to a suitability duty to avoid the defense of illegality. If they did not comply and an account went into a deficit, the practice was to write these deficits off as uncollectable.[26]

B. *The Effect of Increased Trading*

In the mid-1960's, there was a great increase in the public participation in commodity futures markets.[27] This increasing involvement brought a concomitant need to protect the public. In 1970, Alex Caldwell, Administrator of the Commodity Exchange Authority, expressed his views about what the agency was doing toward developing antifraud rules which would require, among other things, that the commodity broker make a suitability inquiry.[28] In a letter written to this writer in September of 1970, Mr. Caldwell stated:

> You will be interested in knowing that some time ago we requested the Department's General Counsel to determine the extent of the Secretary's rule making authority in this entire area. We have asked that proposed legislation be drafted if it is necessary to extend to commodity customers the same type of safeguards now available to security customers. This study currently is underway.
>
> Insofar as exchange suitability rules are concerned, over 18 months ago we requested all contract markets to adopt regulations designed to give added protection to customers whose accounts are handled on a controlled or discretionary basis. Among such regulations was one which would have required brokerage firms to learn the essential facts relating to each customer, including his financial resources and trading objectives. Another would have required each controlled or discretionary account to be given diligent supervision to see that the trading in the account is consistent with the customer's trading objectives and his financial resources. While the Chicago Mercantile Exchange recently adopted new regulations somewhat along the lines we proposed, no other contract market has taken action. It is for this reason that we requested the Department's General Counsel to conduct its current review of this

24. *Id.* at 550.
25. *Id.* at 551.
26. *See* Taylor, *supra* note 13, at 63.
27. *See* Bagley, *A New Body of Law In An Era of Industry Growth*, 27 EMORY L.J. 849 (1978).
28. Letter from Alex Caldwell Administrator, Commodity Exchange Authority, to M. Van Smith (Sept. 17, 1970) (discussing agency development of antifraud rules) (available at the Denver Law Journal Office).

area.[29]

The provision of the Chicago Mercantile Exchange to which Mr. Caldwell referred was Rule 942, subsection E,[30] which required supervision of the discretionary accounts by the clearing members, "to see that trading in such an account is not overly excessive in an amount or frequency in relation to the equity in the account."[31]

Regulation 1992 of the Chicago Board of Trade[32] set forth regulations for discretionary accounts and provided that "[e]ach account with respect to which employee has discretionary authority must be given continuous supervisions by the employer, . . . to see that trading in such account is not excessive in size or frequency in relation to financial resources in the account."[33]

The only exchange which had a suitability rule for nondiscretionary accounts was the New York Mercantile Exchange. Rule 48.01 of the New York Mercantile Exchange[34] required every brokerage firm to use due diligence in learning the facts relative to every customer and the nature of that customer's account. Brokerage firms were also required to keep informed of the character and volume of trading in every account opened.[35] Although the rule did not explicitly state that the brokerage firm had a duty to determine whether commodity futures trading was suitable for a prospective customer, this duty was implicit in requiring brokerage firms to inquire into the facts relative to every customer, and into the nature of the customer's account.

In 1973, Mr. Caldwell testified before a congressional committee conducting hearings on legislation to amend the Commodity Exchange Act.[36] He spoke of the need to establish suitability rules. "We would like to have a standard rule under which the members of all exchanges would be required to delve into the needs of a particular customer to trade in the market, his financial ability to do so—and other matters."[37]

C. *Protection of the Public*

The protection of the public involved in futures trading became one of the main purposes of the Commodity Futures Trading Commission Act of 1974.[38] In accordance with this purpose, the CFTC established the Advisory Committee on Commodity Futures Trading Professionals to study and recommend standards for the regulation of professionals.[39]

The committee recommended that brokers be required to have a rea-

29. *Id.*
30. Chicago Mercantile Exchange Rule 942(E) (1970).
31. *Id.*
32. Chicago Bd. of Trade Reg. 1992 (1970).
33. *Id.*
34. New York Mercantile Exchange Guide § 48.01.
35. *Id.*
36. 7 U.S.C. § 5 (1976).
37. *Hearings before the Subcomm. on Special Small Business Problems of the Permanent Select House Comm. on Small Business*, 93d Cong., 1st Sess. 375 (1973) (Statement of Alex Caldwell).
38. H.R. 13,113, 93d Cong., 2d Sess. § 1 (1974); *see* Leist v. Simplot, [1980-1982 Transfer Binder] COMM. FUT. L. REP. ¶ 21,051, at 24,180 (2d Cir. July 8, 1980).
39. 40 Fed. Reg. 32,866 (1975).

sonable ground for believing that each recommendation they make is suitable in light of customers' financial condition, objectives, and other factors.[40] In discussing suitability, the committee noted that a suitability duty is of particular importance in commodities trading because of the wide variety of trading programs that are available to customers.[41] As part of a suitability duty, the committee recommended that brokers should "obtain from each customer complete information as to his income, net worth, number of dependents, etc."[42] The duty to know customers "must be a continuing one. A customer's financial situation and capacity for risk taking may change from what it was when he opened the account."[43] In the view of the committee, brokers, "should know their customers not only for the purpose of making suitable recommendations but also to avoid situations in which a defaulting customer might jeopardize the entire firm and other customers."[44] In order not to jeopardize their firm, brokers should determine if and to what extent their customers are trading with other firms.

The CFTC proposed suitability regulations in September 1977[45] which followed the recommendations of the Advisory Committee.[46] The proposed rule prohibited commodity professionals from recommending trades, or trading pursuant to discretionary authority, unless the trading professional has 1) obtained from a customer the essential facts about a customer's financial condition and trading objectives, and 2) has reason to believe that the position would be suitable for the customer based on information known to the professional.[47] The CFTC explained that, "[t]he suitability of a position would depend on whether the risk of loss involved was (a) one that the customer could safely assume in light of his financial condition and (b) consistent with the customer's trading objectives."[48] In its comment on the proposed suitability rule, the CFTC stated that the suitability determination consisted of two different judgments:

> (1) Whether commodity trading in general is suitable for the customer in view of his trading objective and financial condition and, (2) if so, whether the particular position that is the subject of the recommendation in discretionary trade is suitable. The latter requirement reflects the fact that the risk of loss can vary widely depending on the size of the trade, the volatility and market liquidity of the commodity involved, and the amount of margin required.[49]

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40. *Report of the Commodity Futures Trading Comm'n Advisory Comm. on Commodity Futures Trading Professionals*, COMM. FUT. L. REP. (CCH) Report No. 29, Part II at ii (Aug. 20, 1976).

41. *Id.* at 11.

42. *Id.*

43. *Id.* at 10.

44. *Id.* at 11.

45. Proposed Rulemaking of the CFTC, 42 Fed. Reg. 44,742 (1977), *reprinted in* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH), ¶ 20,474 (Sept. 6, 1977) [hereinafter cited as Proposed Rulemaking].

46. *Id.*

47. *Id.* at 44,743; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 21,928.

48. *Id.*

49. *Id.* at 44,744; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 21,929. The CFTC gave the following example:

Thus, in recommending to a customer the purchase of 10 future contracts of a particu-

The CFTC adopted the proposed customer protection rules in July 1978.[50] When the CFTC adopted these customer protection rules, however, it declined to adopt a suitability rule.[51]

IV. THE RATIONALE FOR REJECTION OF THE RULE

The CFTC stated two reasons for not adopting a suitability rule. The first reason was the inability of the CFTC "to formulate meaningful standards of universal application."[52] The second reason was that a rule would merely codify principles implicit in the antifraud provisions of the Act, and the benefits to be gained by codification were outweighed by the risk of unintentionally narrowing the scope of the provisions.[53] These reasons were a pretense.

A. *The Universal Standard*

Suitability is based on the notion that risks should be judged according to the finances, needs, and objectives of customers as individuals. Customers cannot be treated as individuals if suitability is to be determined by a "universal" standard. When the CFTC proposed the suitability rule, it requested comment on the "appropriateness of specific suitability standards, such as a requirement that commodity customers have a minimum net worth (e.g., $50,000), annual gross income (e.g., $25,000), account equity (e.g., $10,000) or some combination of those factors."[54] What the CFTC specifically had in mind was never discussed, but it probably contemplated net worth and income criteria similar to those that have been adopted by states for tax shelter investments.[55]

The appeal of these criteria to brokers is that they require no judgment to apply. If the criteria of suitability are a net worth of $50,000 and income of $25,000 per year, the decision about suitability has been made; all a broker need do is assure himself that a customer indeed has a net worth of $50,000 and income of $25,000.

Although objective criteria require no thought to administer, they are, by definition, somewhat arbitrary.[56] The efficacy of objective criteria de-

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lar commodity the professional would be required to have a reasonable basis for believing that the risk of loss from an adverse price movement could be absorbed by the customer without undue hardship. If the professional thought the risk of buying 10 contracts was too great, the proper recommendation might be to purchase fewer contracts.

50. Customer Protection Rules, *supra* note 2, at 31,886; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 22,623.

51. *Id.* at 31,889; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 22,625.

52. *Id.*

53. *Id.*

54. 42 Fed. Reg. 44,744, *reprinted in* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,474, at 21,930 (Sept. 6, 1977).

55. *See* Murdock, *Tax Sheltered Securities: Is There a Broker-Dealer in the Woodwork?*, 25 HASTINGS L.J. 518 (1974).

56. In a curious twist, one writer argues that arbitrary standards are necessary to avoid brokers being intimidated into not advising customers in their best interest for fear a trade may later be found to be unsuitable. *See* Hudson, *Customer Protection in the Commodity Futures Market*, 58 B.U.L. REV. 1, 16-17 (1978).

pends on how relevant they are to the investment. In the case of tax shelter investments, a requirement that an investor be in a fifty percent tax bracket is relevant. A substantial part of the return of any tax shelter is the tax benefits to be derived, benefits which obviously cannot be realized by persons who do not have a high enough income tax bracket to make use of tax write-offs. These tax write-offs compensate for the generally higher than normal risk of tax shelter ventures. Consequently, even though a criterion based on a tax bracket is an objective criterion, it makes sense because tax benefits are essential to the suitability of tax shelter investments.

This is not necessarily true for other speculative ventures. Persons of modest income may be able to afford to speculate if they do not have family obligations or financial obligations.[57] Persons of modest finances often can evaluate the risk of speculative ventures as well as those who are well-off. Furthermore, there is the problem of deciding what is speculative, a decision which the public resents being made for them by government.

Because of the leverage possible in speculating on margin, commodity futures trading offers the opportunity to make significant amounts of money with relatively little capital. This opportunity may be an illusion, but it is cherished nonetheless. A suitability rule which would bar persons from trading who do not meet a prescribed net worth or income requirement would arouse too much customer resentment to win compliance. And then there would be no assurance that commodity futures trading would be suitable for the person who met financial requirements.[58]

In its commentary that accompanied the proposed customer protection rules, the CFTC expressed skepticism about an objective standard of suitability.[59] The CFTC has done nothing to formulate a universal standard since it declined to adopt a suitability rule. One must doubt how seriously the CFTC believes in a universal standard.

B. *Suitability as Implicit in Antifraud Provisions*

The second reason asserted by the CFTC for not adopting a suitability rule was that a suitability rule would merely codify principles implicit in the antifraud provision of the Act and there would be too much risk of narrowing the duty by incorporating it in a rule.[60] The CFTC, however, never explained how a suitability duty would have been narrowed by being stated in the general rule proposed by the CFTC. The narrowing rationale was actually relied on as a reason for not adopting the churning and due diligence rules the CFTC had proposed as part of its customer protection

57. *See, e.g.*, Tucker v. Economic Systems, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. ¶ 20,480 (CCH) (CFTC Aug. 25, 1977) (suitability determined in view of client's resources, responsibilities, and objectives).

58. Bernard Kummerli, a compulsive speculator, lost $20 million and brought down the United California Bank of Basel, Switzerland, by speculating in cocoa futures. *See* Smith, *Are You Suitable For Trading?*, COMMODITIES 32 (Oct. 1977).

59. Proposed Rulemaking, *supra* note 45, at 44,744; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 21,929.

60. Customer Protection Rules, *supra* note 2, at 31,889; [1977-1980 Transfer Binder] COMM. FUT. L. REP. at 22,625.

rules.[61] This rationale was applied as an afterthought to justify the CFTC's rejection of a suitability rule.[62]

Under the theory that a suitability duty was implicit in the antifraud provisions of the law, administrative law judges of the CFTC have said that firms who sell unsuitable commodity futures to customers can be held liable for fraud.[63] The CFTC, however, has hinted that it may reject the notion that suitability is implicit in the antifraud provisions of the Act. In two cases in which the CFTC reviewed reparation awards in which administrative law judges had reasoned that suitability was implicit in the antifraud provisions of the Commodity Exchange Act, the CFTC stated, in footnotes to its decisions, that it refused to adopt the administrative law judges' reasoning,[64] although the CFTC affirmed the awards. The significance of this dicta is difficult to predict. The CFTC did not state why it did not agree with the statements of the administrative law judges or what its own views on suitability were.

Commentators anxious to be rid of suitability, however, have had no trouble in attaching significance to the footnoted statements. Referring to the *Avis v. Shearson Hayden Stone, Inc.*[65] footnote, it was recently stated that, "the CFTC has unequivocally determined that there is no customer suitability standard implicit to any of the provisions of the Commodity Exchange Act."[66]

Yet, to exorcise suitability from the antifraud provisions of the Commodity Exchange Act, it will take more than merely stating that suitability is not present. The antifraud provisions of the Act were adopted in 1936 to incorporate the duties of agency in the broker-customer relationship.[67] The antifraud provisions, therefore, incorporate the duties arising out of agency. Suitability is a material fact which a broker, as an agent, has a duty to disclose.[68]

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61. *Id.*

62. "The Commission is not adopting the proposed suitability rule (proposed Sec. 166.2), . . . but may adopt such a rule at a later time if meaningful standards can be developed." *Id.*

63. *See, e.g.*, Jensen v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,062 (CFTC July 28, 1980) (futures commission merchant who trades with a client whom he had reason to believe cannot assume the risks raises a presumption of fraud); Avis v. Shearson Hayden Stone, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,738 (CFTC Jan. 11, 1979) (failure to disclose material facts is a breach of fiduciary duty); Hauser v. Rosenthal & Co. [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,731 (CFTC Jan. 4, 1979) (futures commission merchants must meet the high ethical standards applied to the securities industry); Dwyer v. Murlas Brothers Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,520 (CFTC Nov. 21, 1977) (breach of fiduciary duty in commodity futures exchange constituted fraud).

64. Avis v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,379, at 25,830 n.4 (CFTC Apr. 13, 1982); Jensen v. Shearson Hayden Stone, Inc., [1981-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,324 at 25,582, n.1 (CFTC Oct. 9, 1981).

65. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) at 25,830, n.4.

66. *See* Miller & Zarfes, *No Customer Suitability Rule But AP's Recklessness Brings Recovery*, COMMODITIES LAW LETTER 4 (May 1982).

67. *See* J. BAER & O. SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 261 (1949) (setting forth digest of Act written in 1936 by N.M. Mehl, Administrator of the Commodity Exchange Authority, the agency which regulated futures markets until 1975).

68. *See infra* notes 69-71; Smith, *Breaking the Chains That Bind: Arbitration Agreements Versus*

C. *A Conflict of Interest*

The CFTC's somewhat jumbled rationale for refusing to adopt a suitability rule invites interpolation as to other possible factors affecting the Commission's decision. One explanation is the way the United States brokerage business has become high volume retailing, as seen by the "Madison Avenue" advertising of some brokerage firms.[69] Brokers are salesmen who are paid for what they sell, not on how much their customers make. Because of their high fixed overhead, brokers must sell in volume. Commissions on commodity futures transactions are charged only when a trade is closed out. The commission per contract is low, varying from .2% to .6% of the value of a contract.[70] For these reasons brokers are under relentless pressure to induce their customers to trade in and out of markets with heavy positions.

To sell in volume, a broker cannot be overly concerned with suitability. If it comes down to a choice between selling and deciding that commodity futures trading is unsuitable, brokers opt to sell. Brokers see the problem not as a matter of choice, but as a matter of business survival.

If suitability rules are incompatible with volume merchandizing, should futures brokers have to comply with suitability rules? The ever-present conflict of interest inherent in high volume retailing was considered by attorney Thomas O'Boyle, at a Securities Conference at Duke University in 1964. O'Boyle commented that stressing an image of professionalism the regulatory authorities may do a disservice to the public if that status of professionalism does not in fact exist.[71]

If brokers sold tangible products, one might be able to take O'Boyle's suggestion seriously. But brokers sell intangible merchandise. Customers cannot see, feel, or test what a broker sells. Moreover, by the time customers have the experience to evaluate commodity futures trading, they may have already lost their investment.

Regardless of whether it is wise or unwise to do so, customers rely on their brokers' advice, and most brokers expect to advise their customers. As long as this is a legitimate expectation, advice must be honest. To accomplish the goal of giving honest advice, the advisor must subordinate his interest to that of the person being advised.[72] This is true of any professional

Forum Rights Under the Commodity Futures Trading Commission Act of 1974, 16 SAN DIEGO L. REV. 749, 759 n.44 (1979).

69. In contrast to American brokers, the London Stock Exchange forbids advertising by member firms, advertising being considered inimical to the mutual relationship of trust between broker and customer. *See* Cohen & Rabin, *Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication in Their Development*, 29 LAW & CONTEMP. PROB. 691, n.88 (1964).

70. *See* B. GOULD, DOW-JONES-IRWIN GUIDE TO COMMODITIES TRADING 64 (1973).

71. *See* O'Boyle, *supra* note 9, at 100.

72. *See* H. BINES, THE LAW OF INVESTMENT MANAGEMENT ¶ 4.01[2][a], 4-12 (1978). William O. Douglas observed this in 1936 in a speech to a school maintained by the New York Stock Exchange for employees of brokerage firms:

> He who holds himself as rendering this investment counsel and this service to customers should be held to high fiduciary standards of conduct. If he who gives this advice and encourages and stimulates his customer's purchases and sales has a self-interest in the transaction over and above his salary or regular compensation, his customer is apt to receive not unbiased and disinterested advice but advice discolored by the self-interest which such purchases and sales will serve. The presence of this self-interest

advice, whether it be by a lawyer, doctor, or commodity futures broker.

To avoid the duty required by suitability rules, brokers would have to abstain from giving advice.[73] There are a few brokers who do not advise, acting solely as order takers; however, this is atypical. Most brokers want to sell, and to sell, they think they must advise.

Because customers rely on brokers for advice, the written disclosure statement which the CFTC adopted as a palliative for not adopting a suitability rule was a sham.[74] Written disclosure statements are no match for aggressive selling.[75] In a speech on December 7, 1979, before the American Bar Association National Institute on Commodities Regulation, James Stone, then chairman of the CFTC, warned that a disclosure statement could be easily undermined by salestalk. He called for integrity throughout the sales process in order to adequately serve customers' needs.[76]

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will deprive the customers of the benefit of disinterested and impartial advice, the very thing which presumably the customer thinks he is getting.

See W. DOUGLAS, DEMOCRACY AND FINANCE 114-15 (J. Allen ed. 1940).

73. *See* Carras v. Burns, 516 F.2d 251, 257 (4th Cir. 1975).

74. *See* 17 C.F.R. § 1.55 (1982) which provides:

This statement is furnished to you because rule 1.55 of the Commodity Futures Trading Commission requires it.

The risk of loss in trading commodity futures contracts can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. In considering whether to trade, you should be aware of the following:

(1) You may sustain a total loss of the initial margin funds and any additional funds that you deposit with your broker to establish or maintain a position in the commodity futures market. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the required funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account.

(2) Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market makes a "limit move."

(3) Placing contingent orders, such as "stop-loss" or "stop-limit" order, will not necessarily limit your losses to the intended amounts, since market conditions may make it impossible to execute such orders.

(4) A "spread" position may not be less risky than a simple "long" or "short" position.

(5) The high degree of leverage that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

The brief statement cannot, of course, disclose all the risks and other significant aspects of the commodity markets. You should therefore carefully study futures trading before you trade.

75. *See, e.g.*, Akmajian v. International Commodity Options, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,584 (CFTC March 29, 1978) (claimant was granted reparation due to insufficiency of disclosure statement). Walker v. Rosenthal & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,627 (CFTC June 19, 1978) (verbal misrepresentations took precedence over written disclosure statements).

76. Speech by James M. Stone, Commodity Futures Trading Commission Chairman to the National Institute on Commodities Regulation (Dec. 7, 1979) (on file with M. Van Smith).

Understanding is not assured by a simple disclosure rule. The Commission has such a rule—and I support it as far as it goes. It does not, however, go very far. A disclosure boilerplate is easily undermined by fast talk. Disclosure to a woefully unsophisticated account prospect is often worth nothing at all. I recall from my previous job with a shudder hearing that Massachusetts health insurance disclosure forms on pregnancy coverage were returned with signature by scores of elderly women in nursing homes. A disclosure form by itself can serve the unscrupulous huckster at least as well

It is evident from the euphemistic tenor of the CFTC's risk disclosure statement[77] that it was intended to disclose as little as possible. If brokers really wanted to disclose the risks of trading, they would acknowledge that the prices of commodity futures are unpredictable and warn that any statements to the contrary are generally not to be believed.[78] Brokers would also need to disclose the conflict of interest between their interest in commissions and a customer's interest in profits[79] and the fact that generally brokers are the ones most likely to profit.[80] The CFTC's risk disclosure statement is of the genre of prospectus described as "a literary art form calculated to communicate as little of the essential information as possible while exuding an air of total candor."[81] The danger with the disclosure approach is that it encourages the attitude that once brokers have made a token warning, customers are fair game for the hard sell.

V. ALTERNATIVE REMEDIES

Although a suitability duty is essential to countervail the conflict of interest inherent in the dealings between customers and brokers, it is unlikely that the CFTC will promulgate a suitability rule for commodity futures until Congress threatens to legislate.[82] Until there is a suitability rule, customers will have to rely on the common law to vindicate their rights.

A. *Common Law Duties*

Under common law, brokers have a fiduciary duty to disclose to customers material facts of transactions concerning those customers.[83] If the unsuitability of commodity futures trading is a material fact, then the nondisclosure of that fact is a false representation.[84] Furthermore, because brokers must act as fiduciaries, they can be held liable in constructive fraud without an intent to deceive.[85] Thus, under common law, brokers must ad-

as it serves the public. Assurance of adequate customer understanding requires integrity throughout the entire sales process.

77. *See* 17 C.F.R. § 1.55 (1982).

78. A warning similar to this has been proposed for securities by one writer. *See* Note, *Broker Investment Recommendations and the Efficient Capital Market Hypothesis: A Proposed Cautionary Legend*, 29 STAN. L. REV. 1077 (1977).

79. This kind of conflict would have to be disclosed prominently in a securities prospectus. *See, e.g.*, Gould v. American Hawaiian Steamship Co., 331 F. Supp. 981 (D. Del. 1971), *modified*, 351 F. Supp. 853 (D. Del. 1972); *In re* Managed Funds, Inc., 39 S.E.C. 313, 319 (1959).

80. *See* T. HIERONYMUS, *supra* note 20, at 253. "On being asked to whom the speculating public's money goes, the commission house people are hard pressed for an answer. The most usual explanation is that a good share falls through the slot in the table. That is, into the paying of commissions, but this is only part of the story." *Id.* at 250.

81. Feit v. Leasco Data Processing Equip. Corp., FED. SEC. L. REP. (CCH) ¶ 93,163, at 91,185 (E.D.N.Y. 1971).

82. The CFTC only banned the sale of commodity options to the general public when Congress started hearings to legislate such a ban. *See* Smith, *supra* note 21, at 32.

83. *See* Cecka v. Beckman & Co., 28 Cal. App. 3d 5, 104 Cal. Rptr. 374 (1972); Bond & Share Trading Corp. v. Insuransharer Corp., 40 F. Supp. 326 (E.D.N.Y. 1941).

84. *See, e.g.*, Twomey v. Mitchum, Jones & Templeton, Inc. 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968). (failure to inform customer that excessive trading unsuitable held a fraud).

85. *See, e.g.*, CAL. CIV. CODE, § 1573 (Deering 1971); Vai v. Bank of America, 56 Cal. 2d 329, 342, 364 P.2d 247, 256, 15 Cal. Rptr. 71, 80 (1961); County of Santa Cruz v. McLeod, 189 Cal. App. 2d 222, 234-35, 11 Cal. Rptr. 249, 253-54 (1961).

vise their customers in accordance with a suitability duty to avoid defrauding their customers. Common law can be used to enforce a suitability duty by applying conventional legal principles.[86]

One difficulty customers will have in resorting to common law remedies is that there is no common law duty to inquire of a prospective customer whether commodity futures trading is suitable for that customer.[87] Thus, unscrupulous brokers can avoid disclosing that commodity futures trading is unsuitable by remaining ignorant of the finances and needs of prospective customers. This could be countervailed by a law which recognizes that when one advises another, it is implicit that the advice is suitable for the person being advised.[88]

B. *Duty Arising From Custom*

Customers may also be able to hold brokers liable for losses from unsuitable commodity futures trading under a breach of duty arising out of custom. Custom is a practice that is so well accepted in a community that it has the force of law.[89] It is the practice of ethical commodity futures brokerage firms to have procedures to determine whether commodity futures trading is suitable for their customers. These procedures generally involve some inquiry to determine whether customers can afford the risk of commodity futures trading, whether they understand those risks, and whether they have previously traded. A few firms will inquire into family obligations to determine whether the money a customer will use to trade is "risk capital"—money that would not affect the standard of living if lost. The wire houses often have a "dollar line," a procedure that allows a customer to trade a percentage of his capital over and above his home and automobile. Although the procedures used by brokerage firms to determine suitability would vary, the ethical firms have some way to determine whether commodity futures trading is suitable for their customers. And because of the prevalence of this practice, one can contend that it is the custom of commodity futures firms to undertake a suitability duty.

Assuming it is the custom for ethical commodity futures brokerage firms to follow procedures consonant with a suitability duty, this custom gives rise to a legal duty under which a brokerage firm must operate when it accepts the business of a customer.[90] Furthermore, the agreements that customers

86. *See* H. BINES, *supra* note 72, at ¶ 4.01[2][a], 4-13; Twomey v. Mitchum, Jones & Templeton, 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968).

87. Sherry v. Diercks, 29 Wash. App. 433, 628 P.2d 1336 (1981).

88. *See, e.g.*, Feeney v. SEC, 564 F.2d 260 (8th Cir. 1977), *cert. denied*, 435 U.S. 969 (1978); University Hill Found. v. Goldman Sachs & Co., 422 F. Supp. 879, 898 (S.D.N.Y. 1976); Best Securities, Inc., 39 S.E.C. 931 (1960).

89. 5 S. WILLISTON, CONTRACTS 10 (1961).

90. In Bibb v. Allen, 149 U.S. 481, 489-90 (1893), the Court stated: "Where a principal sends an order to a broker engaged in an established market or trade, for a deal in that trade, he confers authority upon the broker to deal according to any well-established usage in such market or trade. . . ." Similarily, in an article co-authored by William O. Douglas, Bates & Douglas, *Secondary Distribution of Securities—Problems Suggested by* Kinney v. Glenny, 41 YALE L.J. 949 (1932), it was stated:

> It would seem that the placing of an order to buy or sell by the customer and an indication to the customer by the broker of his willingness to undertake to execute the

sign when they open accounts generally provide that transactions will be governed by the rules, regulations, customs, and usages of the markets where transactions are executed. These agreements give rise to a suitability duty by contract. Brokerage firms can undertake contractual duties that are not imposed by general law. For example, in *Iowa Grain v. Farmers Grain and Feed Co.*,[91] a brokerage firm was held liable for losses incurred because it failed to comply with the duty it had undertaken in the customer's agreement to comply with exchange margin rules. The court held the brokerage firm liable for breach of a contractual duty despite the cases holding that brokerage firms are not liable, absent a specific contractual provision, for violation of exchange margin rules.[92] The reasoning of the cases holding brokers liable for violating exchange rules that a brokerage firm has agreed to follow in its customer's contract would also apply to holding brokers liable for violating customs that a brokerage firm has agreed to follow in its customer's contract.[93]

Brokerage firms can argue that the practice of firms making a suitability inquiry is not a custom, but merely a house rule for the protection of firms. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Goldman*,[94] a customer attempted to avoid liability for a deficit in his account on the ground that commodity futures trading was unsuitable. The court decided that there was no evidence of a suitability violation.[95] The court observed, moreover, that absent fraud, there was no authority which recognized a private cause of action for an alleged violation of house rules.[96] The customer did not contend that the firm had a suitability duty by custom or that the house rule in this case manifested a duty which the firm had undertaken by custom. Probably the customer was unaware of the prevalence of the suitability inquiry in commodity futures or the significance of custom. Because the issue of whether the brokerage firm had a suitability duty as imposed by custom was never raised, the court could not decide this issue. Nevertheless, the case suggests the line of defense that brokerage firms can take against the contention that there is a legal duty imposed by custom to inquire into the suitability of commodities trading.

As noted previously, the courts have yet to decide the question of whether there is a custom of commodity futures brokerage firms undertaking a suitability duty. Nevertheless, when this issue is finally considered, the following factors should demonstrate the existence of this custom: 1) the

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order give rise to a bilateral contract. The mutual promises are all implied in fact being based on the common undertaking of the parties, the way in which such business is normally conducted, and the custom and usage of particular markets or exchanges.

Id. at 965.

91. 293 N.W.2d 22 (Iowa 1980). *See also* First Mid America, Inc. v. Palmer, 197 Neb. 224, 248 N.W.2d 30 (1976) (broker agreed to follow exchange rules); S. WILLISTON, *supra* note 75, § 651 at 32, 34.

92. *See, e.g.*, John S. Morris & Co. v. Mezvinsky, 24 A.D.2d 950, 265 N.Y.S.2d 588 (1965); Dupont v. Neiman, 156 Cal. App. 2d 313, 319 P.2d 60 (1957).

93. *See* S. WILLISTON, *supra* note 89, at 36.

94. 593 F.2d 129 (8th Cir. 1979).

95. *Id.* at 133.

96. *Id.* at 134.

practice of writing off deficits because of the pall of illegality which hung over commodity futures,[97] 2) the exchange rules,[98] 3) the prevalence of brokerage firm procedures to determine suitability,[99] and 4) the general assumption that it is wrong for persons for whom commodity futures trading is unsuitable to trade.[100] Even the CFTC's risk disclosure statement is some indication of the existence of this custom. Finally, the most compelling argument should be that ethically commodity futures brokers, who hold themselves out to their customers as professionals, and who benefit from the trust they instill in their customers, should uphold a duty commensurate with this trust.

C. *Judicially Imposed Suitability*

Although the judicial system can fashion a suitability duty from the common law, it is not well suited to this task. The randomness of cases and the limitation of cases to their facts make the formation of policy through case-by-case adjudication a slow process.[101] Courts are adversarial rather than inquisitorial tribunals, depending on litigants to develop the facts on which decisions are based. The courts do not have the expertise that is available to administrative agencies, which can bring their expertise and investigative capability to bear on a problem.

VI. CONCLUSIONS

Ironically, the brokerage community may have the most to lose under the CFTC's obstructionist policy. Brokers, as well as customers, will lose the protection a suitability rule could provide. Brokers are confronted with an uncertain potential liability for losses of customers for whom commodity futures trading is unsuitable. This uncertainty is a two-edged sword. While brokerage firms may escape liability to some customers, they will be exposed to potential liability for damages—especially punitive damages—from others. The CFTC could ameliorate this potential liability by promulgating a rule which would define the contours of brokers' suitability duty. If brokers complied with such a rule, this compliance could be urged as a defense

97. *See* Taylor, *supra* note 13, at 63; Irwin, *supra* note 14, at 155.

98. *See* Chicago Mercantile Exchange Rule, *supra* note 30, and accompanying text.

99. *See Hearings Before Comm. on Agriculture and Forestry*, 93d Cong. 2d Sess. 514 (1973) (statement of Paul H. Franklin, Vice President and Director of Commodities Division for Merrill Lynch).

100. In the congressional hearings in 1973 which preceded the adoption of the Commodity Futures Trading Commission Act of 1974, Michael Weinberg, Jr., Chairman of the Chicago Mercantile Exchange, alluded to the importance of screening customers with respect to the issue of the suitability of commodity futures trading:

> We have advertised—and told our member firms—that only persons with excess risk capital, above their living and savings needs, should be in any market. We have held seminars, talked at colleges, produced millions of brochures, and gone on radio and TV—all over the country—passing the word that the commodity world is one of excitement, *but it should be approached only by persons with the temperament, knowledge and support to properly use it.*

Small Business Problems Involved In The Marketing of Grain and Other Commodities: *Hearings Before Subcomm. on Special Small Business Problems*, 93d Cong., 1st Sess. 246 (1973) (statement by Michael Weinberg, Chairman, Chicago Mercantile Exchange) (emphasis added).

101. *See* Cohen & Rabin, *supra* note 69, at 692.

to liability. Furthermore, by knowing what is expected of them, brokers could adopt procedures to guard themselves from potential liability.

Brokers would benefit from a suitability duty promulgated by the CFTC rather than one hammered out by litigants in the courts. If a suitability duty is a corollary to honest advice, the CFTC's refusal to adopt a suitability duty could be perceived as deference to the brokerage community. This could persuade the courts that there is a need to overcome the CFTC's unjust protection of brokers at the customers' expense. The reaction may be a suitability duty of draconian harshness.[102]

Consider what has happened to the medical profession. For years, doctors were able to suppress patients being able to recover malpractice claims by refusing to testify against fellow doctors.[103] The courts countered this conspiracy of silence with the doctrine of *res ipsa loquitur*, "the happening of an unusual occurrence which creates an inference of negligence on the part of the doctor."[104] Out of necessity, the courts became so receptive to this doctrine that doctors were put in the position of having to prove their absence of malpractice.[105] How different it would have been if the medical profession had faced up to its responsibilities instead of making aggrieved patients and the courts do it for them.

The rejection by the CFTC of a suitability rule and the efforts by this agency to undermine any suitability duty which brokers have under the Commodity Exchange Act once again demonstrate that the public would have been far better off had there never been a CFTC.[106] The CFTC wants to appear to be carrying out its mandate, while serving the interests of the brokerage community. Hence the analogy to the pea and shell game—"now you see it, now you don't."

102. *See* H. BINES, *supra* note 72, at ¶ 4.01[2][b], 4-17 n.54. "In its present stage of development, the suitability doctrine leaves unresolved many questions which could lead to harsh results if there were an absolute rule that violation of suitability standards would lead to civil liability." *Id.*

103. *See* Ames, *Modern Techniques in the Preparation and Trial of a Malpractice Suit*, in PROFESSIONAL NEGLIGENCE 129-30 (T. Roady & W. Andersen eds. 1960).

104. *See* McCoid, *The Care Required of Medical Practitioners*, in PROFESSIONAL NEGLIGENCE 85 (T. Roady & W. Andersen eds. 1960).

105. *Id.* at 91.

106. *See, e.g.*, Smith, *The Commodity Futures Trading Commission and the Return of the Bucketeers: A Lesson In Regulatory Failure*, 57 N.D.L. REV. 7, 41 (1981). For another example, the CFTC has recently proposed rules to promote binding arbitration to the exclusion of its own jurisdiction and thereby foster the interest of brokerage firms in having disputes with their customers arbitrated by their fellow brokers. *See* COMM. FUT. L. REP. (CCH) ¶ 21,608, at 26,332 (Oct. 28, 1982). *See* Smith, *Breaking the Chains That Bind: Arbitration Agreements Versus Forum Rights Under the Commodity Futures Trading Commission Act of 1974*, 16 SAN DIEGO L. REV. 749, 770 (1979) (predicting the CFTC proposal of such binding arbitration).

SPORHASE V. NEBRASKA EX REL. DOUGLAS: A CALL FOR GROUND WATER LEGISLATION

I. INTRODUCTION

In *Sporhase v. Nebraska ex rel. Douglas*,[1] the Supreme Court fulfilled commentators' prophecies[2] by holding that state water anti-export statutes are contrary to the commerce clause of the federal Constitution.[3] This decision brings water regulations within the scope of the Court's previous pronouncements on state statutes regulating interstate commerce in animal, vegetable, and mineral resources.[4]

This comment will outline the development of the commerce power as it relates to state export/import restrictions, and examine the Court's rationale in *Sporhase* in the context of commerce clause precedent. The Court's characterization of water will be analyzed, and probable effects of this holding on future interstate water allocation plans will be projected. This comment takes the position that some state regulation of ground water export is possible after *Sporhase*.

II. FACTS OF *SPORHASE V. NEBRASKA EX REL. DOUGLAS*

Joy Sporhase and Delmer Moss, both Colorado residents, owned contiguous tracts of farmland in Colorado and Nebraska. The crops on these two tracts were irrigated with ground water[5] pumped from a well located on the Nebraska tract.[6] These facts in and of themselves did not spark a controversy worthy of Supreme Court attention; however, the additional element of a Nebraska statute[7] conditioning water export provoked inquiry into con-

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1. 102 S. Ct. 3456 (1982).

2. Several commentators have suggested water anti-export statutes may present constitutional problems. *E.g.*, F. Trelease, Federal-State Relations in Water Law 60-61 (Nat'l Water Comm'n Legal Study No. 5, 1971); Comment, *"It's Our Water!"—Can Wyoming Constitutionally Prohibit the Exportation of State Waters?*, 10 LAND & WATER L. REV. 119, 120 (1975). *See* Hellerstein, Hughes v. Oklahoma: *The Court, the Commerce Clause, and State Control of Natural Resources*, 1979 SUP. CT. REV. 51, 91-92.

3. U.S. CONST. art. I, § 8, cl. 3.

4. *See* Hughes v. Oklahoma, 441 U.S. 322 (1979) (state cannot restrict interstate sale of naturally seined minnows); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (intrastate fruit packaging requirements invalid); West v. Kansas Natural Gas Co., 221 U.S. 229 (1911) (natural gas anti-export statute invalid).

5. The term ground water has many definitions; throughout this comment it will be used as defined by the Nebraska Legislature. "Ground water shall mean that water which occurs or moves, seeps, filters, or percolates through ground under the surface of the land." NEB. REV. STAT. § 46-657(2) (1978). For a more thorough and scientific definition of ground water, see generally D. TODD, GROUND WATER HYDROLOGY (1963).

6. Sporhase v. Nebraska *ex rel.* Douglas, 102 S. Ct. 3456, 3458 (1982).

7. The relevant Nebraska statute provides in part:

> Any person . . . intending to withdraw ground water from any well . . . in the State of Nebraska and transport it for use in an adjoining state shall apply to the Department of Water Resources for a permit to do so. If the Director of Water Resources finds that the withdrawal of ground water requested is reasonable, is not contrary to the conservation and use of ground water, and is not otherwise detrimental to the public welfare, he shall grant the permit if the state in which the water is to be

stitutional issues under the commerce clause.

Sporhase and Moss did not apply for a permit to the Nebraska Department of Water Resources, as required by the statute, before exporting ground water from their Nebraska well for use on their land in Colorado. This violation prompted Nebraska to seek permanently to enjoin further water exports by the landowners. Ruling that the export was not in compliance with the statute, the trial court granted the injunction[8] and rejected Sporhase's claims that the statute was contrary to the commerce, due process, and equal protection clauses of the Constitution.[9] The Nebraska Supreme Court affirmed, holding that because ground water was not an article of commerce under Nebraska law, it could not be subject to commerce clause considerations. The court also rejected Sporhase's due process and equal protection claims.[10]

The constitutional challenge was, however, ultimately successful. In a seven-to-two decision, the United States Supreme Court reversed the Nebraska decision.[11] The majority concluded that the state statute could not be upheld based on the negative power of the commerce clause.[12]

III. BACKGROUND

A. *Judicial Interpretation of the Commerce Clause*

The commerce clause of the federal Constitution provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[13] On its face, this constitutional provision does not demand exclusive congressional control of commerce. The debates of the Constitutional Convention likewise do not reflect an intent that states be powerless to institute regulatory legislation.[14]

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used grants reciprocal rights to withdraw and transport ground water from that state for use in the State of Nebraska.

NEB. REV. STAT. § 46-613.01 (1978).

8. Nebraska was readily able to determine that the Sporhase export did not meet the statutory criteria. Colorado has an absolute embargo on ground water export (COLO. REV. STAT. § 37-90-136 (1973)); therefore, the Nebraska reciprocity requirement could not be met.

It is also important to note that Sporhase was using water from his Nebraska well because he had been denied a permit for a Colorado well. Colorado denied the permit application because of excessive demands on ground water in the area. Brief of the National Agricultural Lands Center and Kansas City Southern Industries as *Amicus Curiae* at 11-12, Sporhase v. Nebraska *ex rel.* Douglas, 102 S. Ct. 3456 (1982).

9. Jurisdictional Statement of Appellants at 4, Sporhase v. Nebraska *ex rel.* Douglas, 102 S. Ct. 3456 (1982).

10. Nebraska *ex rel.* Douglas v. Sporhase, 208 Neb. 703, 305 N.W.2d 614 (1981), *rev'd*, 102 S. Ct. 3456 (1982).

11. 102 S. Ct. at 3467. Justice Stevens wrote the majority opinion, joined by Chief Justice Burger and Justices Brennan, White, Marshall, Blackmun, and Powell. Justice Rehnquist filed a dissenting opinion in which Justice O'Connor joined.

12. *Id.* at 3463-67. The Court, by virtue of its commerce clause holding, did not reach the questions of due process and equal protection. Although due process and equal protection considerations are relevant, they are beyond the scope of both the decision and this comment.

13. U.S. CONST. art. I, § 8, cls. 1 and 3.

14. *E.g.*, Phillips, *The Growth and Development of the Federal Commerce Power*, 11 TEMP. L.Q. 517, 521 (1937); *see generally* Abel, *The Commerce Clause in the Constitutional Convention and in Contemporary Comment*, 25 MINN. L. REV. 432 (1941).

The scope of state regulatory power, however, may be clarified by examining Supreme Court commerce clause decisions.

The Supreme Court first interpreted the commerce clause in *Gibbons v. Ogden*.[15] This case involved a New York statute prohibiting steamships, not licensed by the state from navigating in New York waters. The sole question to be decided was whether a state could regulate commerce in contravention of a federal statute. In finding the New York law repugnant to the Constitution, the Court reasoned that supremacy of congressional action demands that a state law yield when it is in conflict with a valid act of Congress.[16]

Gibbons dealt with the positive commerce power—the situation where Congress has acted by legislating on a subject. The negative implications of the commerce clause, where congressional power is dormant, present more difficult questions regarding state regulatory power.

Willson v. Black Bird Creek Marsh Co.[17] marked the beginning of Supreme Court pronouncements on the dormant commerce power. In *Willson*, the Delaware Legislature authorized construction of a dam across navigable water in the absence of congressional action forbidding such construction. The Delaware Act clearly did not violate the positive force of the commerce clause; moreover, the Court found no reason to consider it repugnant to the dormant commerce power.[18] In upholding the Act, the Court nevertheless indicated there might be a limit to a state's commerce power even when Congress had not acted.[19]

The case most often credited[20] with delineating the negative implications of the commerce clause is *Cooley v. Board of Wardens*.[21] A Pennsylvania pilot regulation, which did not conflict with any federal regulation, was upheld in *Cooley*. The Court reasoned that although state regulation of commerce was not expressly excluded by the commerce clause, it would not be allowed where the subject was national in nature and required uniform treatment.[22] Finding that regulation of ship pilots was not a subject of national concern, the Court allowed the Pennsylvania law to stand.[23]

The first case to use the negative implication of the commerce clause to invalidate a state regulation was *Wabash, St. Louis, & Pacific Railway Co. v. Illinois*.[24] The issue in *Wabash* was whether Illinois could regulate interstate railroad rates by requiring lower rates for short distance intrastate hauls than for long distance interstate hauls.[25] The Court found interstate rate

15. 22 U.S. (9 Wheat.) 1 (1824).

16. *Id.* at 210. For a more comprehensive discussion of this case, see P. BENSON, THE SUPREME COURT AND THE COMMERCE CLAUSE, 1937-1970, at 9-25 (1970).

17. 27 U.S. (2 Pet.) 245 (1829).

18. *Id.* at 252. Construction of the dam was calculated to enhance property values and protect the public health. *Id.* at 250.

19. *Id.* at 252.

20. *See, e.g.*, B. GAVIT, THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION 7 n.13 (1932); Phillips, *supra* note 14, at 522.

21. 53 U.S. (12 How.) 299 (1851).

22. *Id.* at 319.

23. *Id.* at 318-21. For a later case further developing the extent of the state power to regulate commerce, see Gilman v. Philadelphia, 70 U.S. (3 Wall.) 713 (1865).

24. 118 U.S. 557 (1886).

25. *Id.* at 561.

regulation to be a subject of national concern that could only be addressed by Congress.[26] Following *Wabash* a line of cases invalidated state commerce regulation in areas where no federal legislation existed.[27]

Decisions based on the negative power of the commerce clause present a problem because they do not follow a clearly predictable pattern.[28] In 1946, Justice Rutledge aptly described the nature and scope of the negative function of the commerce clause:

> It is not the simple, clean-cutting tool supposed. Nor is its swath always correlative with that cut by the affirmative edge, as seems to be assumed. For clearly as the commerce clause has worked affirmatively on the whole, its implied negative operation on state power has been uneven, at times highly variable. . . . [T]he business of negative implication is slippery.[29]

The varying results in dormant commerce clause cases may be attributed to the Court's use of several different standards. Over the years, the Court has tested indirect versus direct burdens on commerce,[30] balanced state police power needs against the need for free commerce among the states,[31] evaluated the reasonableness of restrictions,[32] and determined whether nondiscriminatory alternatives were available.[33] The variety of analyses makes early decisions less useful precedent than more recent commerce clause pronouncements.

The modern test for determining the validity of a state statute affecting interstate commerce was enunciated in *Pike v. Bruce Church, Inc.* [34] The plaintiffs in *Pike* challenged the constitutionality of an Arizona statute requiring all Arizona cantaloupes to be packaged in the state prior to export.[35] Writing for a unanimous Court, Justice Stewart stated that unless the burden on commerce was clearly excessive, a statute regulating evenhandedly to further a legitimate local public interest, with only incidental effects on interstate commerce, would be upheld.[36] A close inspection of what has become the

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26. *Id.* at 577.

27. *See generally* B. GAVIT, *supra* note 20, at 250-52 (a collection of pre-1932 cases invalidating state regulation under the dormant commerce clause).

28. An attempt to categorize and reconcile all the dormant commerce clause cases would be an immense, if not impossible, task and is beyond the scope of this paper.

29. Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 418 (1946).

30. *E.g.*, Di Santo v. Pennsylvania, 273 U.S. 34 (1927) (state licensing statute directly interfered with interstate commerce and was therefore invalid).

31. *E.g.*, Southern Pac. Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761 (1945) (safety benefit of train length law did not outweigh federal interest in unburdened interstate commerce).

32. *E.g.*, South Carolina State Highway Dep't v. Barnwell Bros., Inc., 303 U.S. 177 (1938) (regulation of truck weight and size was reasonable based on evidence; therefore, legislature's wisdom was not to be questioned by Court).

33. *E.g.*, Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951) (discriminatory milk regulation invalid since reasonable nondiscriminatory alternatives were available).

34. 397 U.S. 137 (1970).

35. *Id.* at 138.

36. *Id.* at 142. The following explanation by Justice Stewart has become known as the *Pike* test:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course de-

general rule for determining the validity of state commerce regulation, reveals that it is a combination of tests previously used by the Court.

Most of the negative commerce clause decisions since *Pike* have been based on this test. Two cases held the state's interest was sufficient to uphold the regulation.[37] Four cases invalidated state requirements for failing to further legitimate local interests.[38] Two other cases struck down statutes using the *Pike* test in addition to invoking the strict scrutiny test reserved for *prima facie* discriminatory statutes.[39] The only exceptions to analysis under the *Pike* test have been three special cases where the state was a market participant rather than a market regulator.[40] In the absence of a congressional mandate, the state acting as a market participant is not prohibited from favoring its own citizens.[41]

In summary, a state has a residuum of power to regulate matters of local concern that affect interstate commerce. The scope of state regulation allowed depends on the particular state concern and whether the local benefit outweighs the federal interest in unrestricted interstate commerce.

B. *Natural Resource Export/Import Restrictions Under the Dormant Commerce Clause*

In the specific area of natural resource export/import restrictions, most state regulation has been held invalid.[42] Both facially discriminatory export/import restrictions[43] and regulations invalid as applied[44] have been

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pend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id.

37. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981) (state's waste management interest sufficient to support plastic container ban); Baldwin v. Montana Fish & Game Comm'n, 436 U.S. 371 (1978) (state's game preservation interest sufficient to support hunting license fee differential).

38. Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981) (Iowa's truck length statute invalid as a burden on interstate commerce considering the state's questionable safety interest); Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429 (1978) (state's interest in less than 55 foot trucks had only speculative relationship to safety); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (apple grading regulation invalid burden on interstate commerce); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976) (reciprocity barrier to milk imports furthered no legitimate interest).

39. Hughes v. Oklahoma, 441 U.S. 322, 337 (1979) (absolute barrier to minnow export facially discriminatory) (*see infra* notes 47-54 and accompanying text); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (prohibition on imported waste facially discriminatory).

40. White v. Massachusetts Council of Constr. Employers, 103 S. Ct. 1042 (1983) (city could limit employment to city residents for a city funded construction project). Reeves, Inc. v. Stake, 447 U.S. 429 (1980) (state owned cement plant and therefore could sell its product free of commerce clause considerations); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976) (state recycling bounty favoring citizens valid because state entered market as a participant).

41. Reeves, Inc. v. Stake, 447 U.S. 429, 436 (1980) (quoting Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976)).

42. An exception is Hudson County Water Co. v. McCarter, 209 U.S. 349 (1908). The Court in *Hudson* upheld a water anti-export statute, designed to protect the health of the citizens, as a legitimate exercise of state police power. *Id.* at 356-57.

43. Hughes v. Oklahoma, 441 U.S. 322 (1979); City of Altus v. Carr, 385 U.S. 35 (per curiam), *aff'g* 255 F. Supp. 828 (W.D. Tex. 1966); Pennsylvania v. West Virginia, 262 U.S. 553 (1923) (West Virginia not allowed to retain all natural gas for local use); West v. Kansas Natural Gas Co., 221 U.S. 229 (1911) (Oklahoma cannot prevent export of natural gas).

44. City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (waste anti-import statute

struck down. Writers have suggested that state ownership of resources validates otherwise questionable regulation of commerce.[45] While possibly valid at one time, the state ownership theory has been discredited repeatedly.[46]

In *Hughes v. Oklahoma*,[47] a recent example of an absolute restriction on export, Oklahoma attempted to prevent the export of minnows procured from the natural waters of the state.[48] Oklahoma relied on an earlier Supreme Court case, *Geer v. Connecticut*,[49] which had validated a statute prohibiting the export of lawfully killed game birds. The theory in *Geer* was that the birds were owned by the state and the state, therefore, could make any regulations concerning the birds free of negative commerce clause implications.[50] The Court in *Hughes* rejected the outmoded legal fiction of state ownership, overruled *Geer*,[51] and analyzed the minnow export restrictions using the *Pike* criteria.[52] In addition, the Court announced that facially discriminatory legislation would be strictly scrutinized.[53] The Oklahoma regulation was held to be invalid as unjustified discrimination against interstate commerce.[54]

Pike v. Bruce Church, Inc. [55] is an illustration of an export restriction found invalid as applied. Arizona, by requiring all cantaloupes grown in-state to be packaged in Arizona, was enhancing the reputation of local cantaloupe growers and providing jobs for local citizens at the expense of an interstate packaging corporation.[56] Although the state's interest may have been legitimate, the regulation as applied imposed an unjustifiable burden on interstate commerce and therefore was held unconstitutional.[57]

Theoretically, the negative implications of the commerce clause do not preclude state regulation. It is conceivable under *Pike* that a state may restrict the export or import of natural resources so long as the statute is tailored narrowly and designed to effect a legitimate local interest. In practice, however, no case since *Hudson*[58] has upheld a state commerce regulation in

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invalid as simple economic protectionism); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (apple grading regulation invalid since purpose was economic protection); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970); Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1 (1928) (intrastate packaging requirements for shrimp invalid because designed to favor Louisiana manufacturers).

45. *E.g.*, Hellerstein, *supra* note 2, at 71-92.

46. *See generally* Note, *Interstate Transfer of Water: The Western Challenge to the Commerce Clause*, 59 TEX. L. REV. 1249, 1259-67 (1981) (recites general history of the common ownership theory).

47. 441 U.S. 322 (1979).

48. *Id.* at 323. For a thorough discussion of this case, see Hellerstein, *supra* note 2, at 119.

49. 161 U.S. 519 (1896), *overruled*, Hughes v. Oklahoma, 441 U.S. 322 (1979).

50. 161 U.S. at 529-32.

51. 441 U.S. at 322-35.

52. *Id.* at 336-38. The Court found the restriction facially discriminatory. A legitimate local interest existed in conservation and protection of wild animals but could have been fulfilled more effectively by nondiscriminatory alternatives. *Id.*

53. *Id.* at 337. "At a minimum such facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose . . . ." *Id.*

54. *Id.* at 338.

55. 397 U.S. 137 (1970). The Court set forth the modern test of validity under the commerce clause in this case. *See supra* note 36 and accompanying text.

56. 397 U.S. at 142-43.

57. *Id.* at 143-46. *See supra* note 36.

58. 209 U.S. 349 (1908). *See supra* note 42.

natural resources. Although the Court articulated a standard in *Pike* for permissible state regulation, it is possible that state natural resource import/export restrictions will not be tolerated.

C. *Congressional Permission*

State restrictions on commerce may be validated by explicit congressional permission because the Constitution vests the commerce power in Congress.[59] An early illustration of the effect of explicit congressional permission is *Pennsylvania v. Wheeling & Belmont Bridge Co. (II)*.[60] When the case was first before the Court, Pennsylvania asked for an order requiring that a bridge authorized by Virginia be raised because it obstructed free passage of ships on the Ohio River.[61] The Supreme Court agreed that the bridge obstructed commerce and ordered that it be elevated.[62] Congress, however, passed a statute authorizing the bridge in its original position.[63] On a second hearing, the Court held the federal statute valid based on Congress plenary power over commerce.[64]

A more recent example of express authorization of state regulation affecting interstate commerce exists in the insurance industry. Under the McCarran-Ferguson Act,[65] Congress removed all commerce clause limitations on state authority to regulate and tax the insurance industry. Cases interpreting this statute have ruled that express congressional permission of state regulation admits of no exceptions.[66]

Congressional deference is not to be confused with congressional permission. The fallacy of the assumption that congressional deference validates state commerce regulations is apparent in two recent cases. *Lewis v. BT Investment Managers*[67] involved the Bank Holding Company Act,[68] and *New England Power Co. v. New Hampshire*[69] addressed the Federal Power Act.[70] Both cases held that for local legislation to be immune from a commerce clause attack, Congress must expressly state its intention that the local legislation be sustained.[71]

Although there has been no explicit congressional permission for state export/import water regulation, local control is a reasonable possibility.

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59. U.S. CONST. art. I, § 8, cls. 1 and 3.

60. 59 U.S. (18 How.) 421 (1856).

61. Pennsylvania v. Wheeling & Belmont Bridge Co. (I), 54 U.S. (13 How.) 518 (1852).

62. *Id.* at 626-27.

63. Act of Aug. 31, 1852, ch. III, §§ 6-7, 10 Stat. 112.

64. Pennsylvania v. Wheeling & Belmont Bridge Co. (II), 59 U.S. (18 How.) 421, 435-36 (1855).

65. 15 U.S.C. §§ 1011-1015 (1976).

66. Western & S. Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981); Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946).

67. 447 U.S. 27 (1980).

68. 70 Stat. 133 (1956) (codified as amended at 12 U.S.C. §§ 1841-1850 (1976 & Supp. V 1981)).

69. 455 U.S. 331 (1982).

70. 41 Stat. 1063 (1920) (codified as amended at 16 U.S.C. §§ 791-821c (1976 & Supp. V 1981)).

71. *BT Inv. Managers*, 447 U.S. at 49; *New England Power*, 455 U.S. at 331.

Currently, two coal slurry pipeline bills are pending before Congress.[72] If enacted, these bills will enable states to restrict commerce in water used for coal slurry purposes.

IV. *SPORHASE V. NEBRASKA EX REL. DOUGLAS*

The Nebraska Supreme Court reasoned in *Sporhase* that a product must be an article of commerce to be governed by the commerce clause.[73] The court defined an article of commerce as a commodity capable of being reduced to private possession and exchanged for value.[74] Nebraska ground water, according to the court, had never been considered a freely transferable market item and therefore could not be subject to the Constitution's commerce clause restrictions.[75]

In a two-step analysis, the United States Supreme Court reversed the Nebraska court's decision. First, the Court rejected the contention that ground water is not an article of commerce and therefore not subject to the negative impact of the commerce clause.[76] Next, using the *Pike* test, the Court examined the water-export statute for validity under the commerce clause.[77]

The Court ruled that ground water is an article of commerce, but cited no direct precedent. Instead, the Court seemed to reach its conclusion by deductive reasoning. Ground water shortages are a national problem; Congress has power to deal with national problems under the commerce power; therefore, ground water must be an article of commerce.[78] The Court further reasoned that the affirmative commerce power of Congress could never be utilized to correct the problem of ground water overdraft unless such water was considered an article of commerce.[79]

Using the *Pike* test, the Court examined the constitutionality of the Nebraska statute.[80] The Nebraska law[81] required that four conditions be met prior to granting approval to export ground water. The export had to be: reasonable, consistent with conservation, not detrimental to public welfare,

72. Coal Pipeline Act of 1983, H.R. 1010, 98th Cong., 1st Sess. Coal Distribution and Utilization Act of 1983, S. 267, 90th Cong., 1st Sess. The explicit language authorizing state authority, § 206(b) of the Coal Pipeline Act of 1983, H.R. 1010, 98th Cong., 1st Sess., is:

> Pursuant to the commerce clause in article I, section 8, of the United States Constitution, the Congress declares that the establishment and exercise of terms or conditions (including terms or conditions terminating use on permits or authorizations) for the reservation, appropriation, use, or diversion of water for a coal pipeline for which a certification has been made under section 208 shall be determined pursuant to State law notwithstanding any transport, use or disposal of such water in interstate commerce.

Section 5(b) of the Coal Distribution and Utilization Act of 1983, S. 267, 98th Cong., 1st Sess. contains nearly identical provisions.

73. 208 Neb. at 705, 305 N.W.2d at 616.

74. *Id.* at 705, 305 N.W.2d at 616.

75. *Id.* at 705-09, 305 N.W.2d at 616-19.

76. 102 S. Ct. at 3458-63.

77. *Id.* at 3463-65. *See supra* note 36 and accompanying text.

78. 102 S. Ct. at 3462-63.

79. *Id.* at 3463.

80. *Id.* at 3463-65.

81. NEB. REV. STAT. § 46-613.01 (1978). *See supra* note 7.

and to a state granting reciprocal rights to export ground water. Under *Pike*, the Court held the first three requirements were facially valid restrictions on interstate commerce; the state interest in conserving a vital resource is legitimate under the police power.[82] Although the public ownership theory does not prevent the application of commerce clause restrictions, the public ownership nature of western water played a part in the Court's examination of the local interest and in the Court's justification of the first three export restrictions.[83]

The fourth statutory element, reciprocity, was found to be an explicit barrier to interstate commerce[84] and therefore triggered the strict scrutiny test of *Hughes v. Oklahoma*.[85] The Supreme Court found no evidence establishing a close means-end relationship between the reciprocity requirement and conservation of ground water.[86] Nebraska's requirement did not meet the minimum *Pike* standard of effecting a legitimate local public purpose and therefore was held to be an impermissible burden on interstate commerce.[87]

Nebraska asserted that the history of congressional deference to state water law protected its statute from commerce clause restrictions.[88] Specifically, Nebraska referred to thirty-seven federal statutes[89] containing language deferential to state water laws.[90] The Court ruled this language was not evidence Congress intended to remove commerce clause restrictions on state water law, but was only indicative of the specific federal legislation's preemptive power.[91] Moreover, under *New England Power Co. v. New Hampshire*,[92] congressional permission must be expressly stated to protect local legislation from a commerce clause attack. With ground water anti-export statutes there has been no explicit congressional permission to burden interstate commerce.[93]

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82. 102 S. Ct. at 3464-65. *See generally* Brief of the National Agricultural Lands Center and Kansas City Southern Industries as *Amicus Curiae, Sporhase* (in-depth discussion of the vital nature of the ground water resource).

83. 102 S. Ct. at 3463. *See supra* notes 45-46 and accompanying text.

84. 102 S. Ct. at 3465.

85. 441 U.S. 322 (1979). Strict scrutiny is applicable when legislation is facially discriminatory. *See supra* notes 51-54 and accompanying text.

86. 102 S. Ct. at 3465.

87. *Id.*

88. Appellee's Brief at 22-27, *Sporhase*.

89. *See Federal-State Water Rights: Hearings on S. 1275 Before the Subcomm. on Irrigation and Reclamation of the Senate Comm. on Interior and Insular Affairs*, 88th Cong., 2d Sess. 302-10 (1964) (contains abstracts of the relevant sections of the 37 statutes).

90. The Reclamation Act of 1902, § 8, 32 Stat. 388, 390 (codified at 43 U.S.C. § 383 (1976)), is one example of the language referred to by the state. "[N]othing in this Act shall be construed as affecting or intended to affect or in any way interfere with the laws of any State or Territory relating to the control, appropriation, use, or distribution of water used in irrigation."

91. 102 S. Ct. at 3465-66. The Court also may have been influenced by the fact that all 37 statutes involved surface water.

92. 455 U.S. 331 (1982). *See supra* notes 69-71 and accompanying text.

93. Nebraska devoted a considerable portion of its brief to the argument of congressional permission for all state regulations of water allocation. Appellee's Brief at 22-27, *Sporhase*. *Amicus curiae* briefs of New Mexico, California, Colorado, Wyoming, Kansas, South Dakota, Missouri, Nevada, North Dakota, and Utah were in accord. The Court did not find this argument convincing. 102 S. Ct. at 3465-66. This portion of the decision appears to be correct consider-

Justice Rehnquist, in a dissent joined by Justice O'Connor, questioned the basis of the majority decision.[94] The majority tested the statute's validity by considering whether Congress has authority to regulate interstate commerce in ground water.[95] The dissent emphasized that congressional authority and state authority require distinct analyses because the affirmative implications of the commerce clause extend further than the negative implications.[96] The article of commerce analysis, according to Justice Rehnquist, was wholly unnecessary to a decision on the validity of the Nebraska law.[97] Arguably, Congress could regulate ground water overdraft even if ground water was not an article of commerce by showing that overdraft substantially affected interstate commerce.[98]

The dissent's approval of the Nebraska statute was based on the traditional authority of the states in matters of water regulation.[99] Although the dissent criticized the majority's article of commerce analysis, Justice Rehnquist summarized his objections by stating that Nebraska ground water cannot be an article of commerce for purposes of the negative impact of the commerce clause. He reasoned that because Nebraska only recognizes a limited usufructory interest in ground water, there can be no commerce in water.[100] Justice Rehnquist categorized the Nebraska regulation in question as merely another of the many western water use regulations.[101]

V. ANALYSIS

The Supreme Court decision in *Sporhase* is generally consistent with the majority of commerce clause cases.[102] Under strict commerce clause analysis, the *Sporhase* result was predictable.

The Court's reasoning, however, was flawed. As suggested by the dissent, the holding that water is an article of commerce was unnecessary[103] and unfortunate because the transfer of water was not the issue. Sporhase attempted to transfer a water *right*, and that should have been the focus of the analysis.

A water right is a limited property interest defined by state law,[104] which allows the owner to use a certain amount of water in a particular

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ing that deference must be expressly stated to be valid. For an exhaustive treatment of the complex topic of federal-state water relations, see generally F. Trelease, *supra* note 2.

94. 102 S. Ct. at 3467-68 (Rehnquist, J., dissenting).

95. *Id.* at 3467.

96. *Id.*

97. *Id.* at 3467-68.

98. *See* United States v. Darby, 312 U.S. 100, 118 (1941). "The power of Congress over interstate commerce . . . extends to those activities intrastate which so affect interstate commerce . . . as to make regulation of them appropriate means to the attainment of a legitimate end. . . ." *Id.*

99. 102 S. Ct. at 3467-68 (Rehnquist, J., dissenting).

100. *Id.* at 3469.

101. *Id.* at 3468-69.

102. *See supra* note 4, and accompanying text.

103. 102 S. Ct. at 3467-68.

104. States have traditionally been responsible for defining property rights. *See* California Oregon Power Co. v. Beaver Portland Cement Co., 295 U.S. 142 (1935) (affirmation of state's right to choose system for defining property rights).

manner on specified lands. Under Nebraska law, the owner of a water right owns only the right to use a limited quantity of ground water on the land from which it is drawn.[105] There is no property interest that allows him unilaterally to transfer the right.[106]

The Court's focus on water rather than on a water right oversimplified the issue. By referring to water as an article of commerce, the Court implied that specified water molecules could somehow be owned. The concept of water as a tangible item of commerce, similar to other natural resources, is inaccurate.

Natural gas is appropriately considered an article of commerce; it is a commodity that can be wholly owned, transferred, and destroyed.[107] The owner's property interest is not defined in terms of the rights of other owners of natural gas, and the natural gas can be used without redefining the other owners' property interests.[108]

In contrast, water is not owned.[109] The property interest in water is an intangible right, described as an incorporeal hereditament, which is attached to the tangible substance—water.[110] The right is owned, but specific identifiable water is not.[111] Each individual water right is defined in terms of the rights of all other water users in the state system.[112] The interrelated nature of the right prevents an appropriator from unrestricted transfer or change; such actions would affect the rights of all other water right holders.[113] Only by redefining his water right can an appropriator transfer the right or change the place or manner of use of the water. Some states, such as Nebraska, do not recognize the right of a general appropriator to sever water from the land.[114] The distinction between the tangible substance, water,

105. *See generally* Aiken, *Nebraska Ground Water Law and Administration*, 59 NEB. L. REV. 917 (1980) (overview of Nebraska ground water law); Harnsberger, *Nebraska Ground Water Problems*, 42 NEB. L. REV. 721 (1963) (general hydrologic and legal overview of Nebraska's ground water system).

106. *Sporhase*, 208 Neb. at 707, 305 N.W.2d at 617.

107. *See generally* 1 H. WILLIAMS and C. MEYERS, OIL AND GAS LAW § 201, at 17-18 (1981).

108. Another distinction between water and natural gas, which helps explain their different treatment under the law, is that water is a renewable resource and natural gas is not. The specified water molecules are not destroyed by use, but instead become the object of the next appropriator's water right. This physical fact makes it imperative that any definition of a property right in water consider every other appropriator's rights in that same water.

109. For a discussion of the nature of property rights in water see generally S. CIRIACY-WANTRUP, W. HUTCHINS, C. MARTZ, S. SATO, A. STONE, 1 WATERS AND WATER RIGHTS § 53.1, at 344-49 (1967).

110. The tangible/intangible distinction was probably best articulated in Hammond v. Johnson, 94 Utah 35, 40, 75 P.2d 164, 170 (1937). Justice Wolfe, in his dissent, pointed out that a water right does not have all the attributes of real property and therefore cannot automatically be subject to legal doctrines that apply to tangible items capable of being possessed. The majority in *Sporhase* automatically identified water as a commodity without noting its different characteristics.

111. 1 W. HUTCHINS, WATER RIGHTS LAWS IN THE NINETEEN WESTERN STATES 137-38, 442-43 (1971).

112. The appropriative right is measured by beneficial use and absence of harm to other appropriators. *Id.* at 491-516, 569-83; S. CIRIACY-WANTRUP, W. HUTCHINS, C. MARTZ, S. SATO, A. STORE, *supra* note 109, § 51.7 at 296-98.

113. S. CIRIACY-WANTRUP, W. HUTCHINS, C. MARTZ, S. SATO, A. STONE, *supra* note 109, § 53.4 at 357. *See generally* 1 W. HUTCHINS, *supra* note 111, at 623-44.

114. *See Sporhase*, 208 Neb. at 709, 305 N.W.2d at 617-18.

and the intangible property interest in water must be made to appreciate the consequences of *Sporhase*.

Each state plays an important role in defining, administering, and protecting its system of water rights. By interstate compacts[115] and by equitable apportionment decrees[116] a state is allocated an equitable share of water which it must further allocate by a system of rights to users in the state. Had the Court identified the interest being transferred as a water right rather than water, a more convincing connection between the reciprocity requirement and the state's interest in conservation might have been found. The reciprocity requirement could be a legitimate means of ensuring that a state receives its equitable share of the limited interstate water allocation. The burden on interstate commerce would not be excessive because each state would retain its equitable, allocated share of water; individuals would not be allowed to reapportion and thereby redefine the right to use this valuable, life giving resource.

Although the dissent appeared to appreciate the meaning of a water right and the theory of equitable apportionment, Justice Rehnquist did not link the two ideas to justify the reciprocity requirement. Recognition of the two theories led Justice Rehnquist to conclude that a state may regulate a natural resource so as to protect it from the negative impact of the commerce clause.[117] This assertion is not valid under prior commerce clause decisions.[118] Justice Rehnquist would have had more success upholding the Nebraska statute by arguing within the confines of the accepted *Pike* analysis.[119]

The premise that water itself was the commodity being transferred, and that water is an article of commerce, triggered a commerce clause analysis of the Nebraska statute. The statute, however, would not necessarily have been invalid under the *Pike* test if the connection between a reciprocity requirement and the true nature of the interest being transferred had been considered.

VI. CONCLUSION

The *Sporhase* decision leaves questions unanswered and emphasizes the need for a federal ground water policy. The extent to which state water policies will be affected is unclear, and whether Congress will define bounds for permissible state regulation remains to be seen.

115. For an in-depth discussion of interstate water compacts, see generally J. Muys, Interstate Water Compacts (Nat'l Water Comm'n Legal Study No. 14, 1971).

116. Equitable apportionment is the basis for allocating interstate benefits among affected states. *See generally* Kansas v. Colorado, 206 U.S. 46 (1907). Although no court has considered apportionment of an interstate ground water aquifer, it is reasonable to assume that such an allocation would follow the equitable apportionment doctrine of *Kansas v. Colorado*.

117. 102 S. Ct. at 3468 (Rehnquist, J., dissenting).

118. The accepted *Pike* analysis does not provide for absolute state authority over natural resources unless its criteria are met. *See supra* notes 34-36 and accompanying text.

119. *See supra* note 36 and accompanying text. This assertion assumes *Pike* is the standard for measuring state export/import restrictions. If in practice courts will not tolerate state restrictions on import or export of natural resources, the state interest in a system of water right allocation and conservation is irrelevant.

Congressional response, however, is imperative. States must have specific information regarding their regulatory power so that the long-range planning necessary to effective water allocation procedures can be implemented.[120] Theoretically, if narrowly drawn and sufficiently supported, state anti-export statutes could be valid after *Sporhase*.[121] The opinion, however, does not indicate how narrowly regulations must be drawn nor how much evidence must be presented to ensure that such regulations will be upheld.[122] The complex and vital nature of state water resource policies requires extensive planning; case-by-case legal determinations will not suffice. Congress must either expressly recognize state authority or formulate a federally administered conservation program.

In the proposed Coal Pipeline Act of 1983[123] or the Coal Distribution and Utilization Act of 1983,[124] Congress may affirm exclusive state authority over the control of water for slurry export purposes. These bills would not totally resolve the issue of state versus federal control of ground water, and, rather than permitting state control of water only in the context of coal slurry uses, it would clearly be preferable for Congress to formulate a comprehensive ground water policy.

Whether state control is affirmed or a federal plan established, it is critical that a policy be formulated. Ground water is vital to social and economic development and without predictable conservation guidelines this slowly renewable resource will be lost.

Jolene M. Crane

120. Fourteen states have statutes regulating water export, *see* Brief of National Agricultural Lands Center and Kansas City Southern Industries as *Amicus Curiae* at 16, *Sporhase*.

121. Overcoming commerce clause objections, however, will not necessarily ensure a statute's validity. Due process and equal protection issues may also have to be addressed.

122. An appeal from the trial court of a commerce clause case involving a New Mexico anti-export statute may provide additional guidance for permissible state regulation. City of El Paso v. Reynolds, 563 F. Supp. 379 (1983) (although New Mexico had a legitimate interest in its attempts to conserve ground water, the interest was not sufficient to support a total ban on interstate ground water transportation).

123. H.R. 1010, 98th Cong., 1st Sess. (1983).

124. S. 267, 98th Cong., 1st Sess. (1983).

ANTITRUST LAW IN COLORADO: BACK ON TRACK

INTRODUCTION

To many lay persons, the term "antitrust" conjures up thoughts of huge corporations and elite corporate lawyers. To many lawyers, antitrust remains a distant and esoteric area of the law.[1] While both of these viewpoints are justified to a certain extent, they are also restrictively narrow, for antitrust law is indeed a broader and more pervasive subject. Most businessmen will, at some time, encounter an antitrust problem.[2] In fact, most of the people who violate the antitrust laws are small businessmen or local field executives of larger corporations.[3] The subject case, *People v. North Avenue Furniture and Appliance, Inc.*,[4] exemplifies this wider notion of antitrust law.

North Avenue is a price-fixing case involving small businessmen in Grand Junction, Colorado. The decision appears destined to assume an important bench-mark status in Colorado's antitrust law for three reasons. First, *North Avenue* is the Colorado Supreme Court's initial construction of the state's modern antitrust statute.[5] Second, state antitrust enforcement has increased dramatically in recent years, both in Colorado and across the nation.[6] *North Avenue*, as the sole source of state judicial precedent, will naturally be a guiding force for this increased antitrust activity in Colorado. Finally, although the holding in *North Avenue* is necessarily narrow, the *reasoning* employed to reach that holding appears to be broadly applicable to future cases construing Colorado's antitrust statute.

This comment begins with a historical overview of Colorado's scant and unsettled[7] antitrust law. This background helps prepare for a discussion of the *North Avenue* decision and an analysis of its major issues. The comment concludes by outlining some of the possible ramifications of this important case.

I. BACKGROUND OF ANTITRUST LAW IN COLORADO

Colorado originally recognized a cause of action under the common law doctrine of "restraint of trade."[8] The legislature enacted this doctrine into the first antitrust statute in 1913.[9] After some brisk application in the early

1. Ducker, *Antitrust and the Lay Lawyer*, 44 DEN. L.J. 558, 558 (1967).
2. *Id.*
3. *Price Fixing: Crackdown Underway*, BUS. WEEK, June 2, 1975, at 34, Col. 1.
4. 645 P.2d 1291 (Colo. 1982).
5. *Id.* at 1294. *See* COLO. REV. STAT. §§ 6-4-101 to -108 (1973 & Supp. 1982).
6. Burke & Walters, *Antitrust Enforcement in Colorado: New Directions, New Concerns*, 6 COLO. LAW. 1, 1 (1977). *See generally* Rahl, *State Antitrust Symposium*, 4 J. CORP. L. 475 (1979).
7. Note, *Colorado Antitrust Law: Untied and Drifting*, 48 U. COLO. L. REV. 215, 215, 231 (1977).
8. *See* Denver Jobbers Ass'n v. People *ex rel.* Dickson, 21 Colo. App. 326, 122 P. 404 (1912). For general background information on Colorado antitrust law, see generally *North Avenue*, 645 P.2d at 1294; Burke & Walters, *supra* note 6, at 6-7; Ducker, *supra* note 1, at 560-62; Note, *supra* note 7, at 215.
9. 1913 Colo. Sess. Laws, ch. 161, § 1.

1920's,[10] the statute was declared unconstitutionally vague by the United States Supreme Court in 1927.[11] This ruling resulted in a thirty-year hiatus in the state's antitrust law,[12] which lasted until the present statute's enactment in 1957.[13]

When drafting the state's modern antitrust statute,[14] the Colorado legislature used Wisconsin's antitrust statute[15] as a prototype. Wisconsin had based its statute on applicable sections of the federal antitrust statutes,[16] namely the Sherman Act of 1890[17] and the Clayton Act of 1914.[18]

Although case law construing the federal antitrust statutes abounds,[19] the modern Colorado antitrust statute did not receive a substantive judicial interpretation until 1975, eighteen years after its enactment.[20] This interpretation came from a federal court in the case of *Q-T Markets, Inc. v. Fleming Companies, Inc.*[21] Although *Q-T Markets* did not address the same antitrust issues as *North Avenue*,[22] the method of analysis employed by the *Q-T Markets* court became extremely significant in deciding *North Avenue* and, therefore merits a brief discussion.

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10. *See* People v. Apostolos, 73 Colo. 71, 213 P. 331 (1923) (1913 antitrust statute applied to shoe industry); Johnson v. People, 72 Colo. 218, 210 P. 843 (1922) (statute applied to price fixing in electrical contracting business); Campbell v. People, 72 Colo. 213, 210 P. 841 (1922) (statute applied to restraint of plumbing and gas fitting business).

11. Cline v. Frink Dairy Co., 274 U.S. 445 (1927).

12. Note, *supra* note 7, at 215.

13. Colorado Antitrust Act, 1957 Colo. Sess. Laws 369 (originally codified as amended at COLO. REV. STAT. §§ 55-4-1 to -9 (1958)). The antitrust statute is currently codified at COLO. REV. STAT. §§ 6-4-101 to -108 (1973 & Supp. 1982) (Restraint of Trade and Commerce). Colorado has promulgated other statutes designed to prevent anti-competitive practices: COLO. REV. STAT. §§ 6-1-101 to -114 (1973 & Supp. 1982) (Consumer Protection Act) and COLO. REV. STAT. §§ 6-2-101 to -117 (1973 & Supp. 1982) (Unfair Practices Act). Two other provisions were repealed in 1975: COLO. REV. STAT. §§ 6-3-101 to -106 (1973) (Fair Trade Act) and COLO. REV. STAT. §§ 6-5-101 to -114 (1973) (Unfair Cigarette Sales Act).

14. The *North Avenue* court cited the affidavit of David J. Clark, the drafter of the antitrust bill, which states in pertinent part:

> I decided that the antitrust statute enacted in Wisconsin . . . provided the best model. I then drafted the bill which was subsequently enacted as Senate Bill No. 200 using the Wisconsin statute as a model. . . . In drafting this legislation it was my intent to follow the substantive provisions of the Wisconsin statute so that any court decision interpreting the Wisconsin statute could be cited by Colorado courts.

People v. North Ave. Furniture & Appliance, Inc., 645 P.2d at 1294, n.4.

15. WIS. STAT. § 133.01 (1939) (current version at WIS. STAT. § 133.03 (1980)).

16. *See* Pulp Wood Co. v. Green Bay Paper & Fiber Co., 157 Wis. 604, 147 N.W. 1058 (1914), *cert. denied*, 249 U.S. 610 (1919) (Wisconsin Supreme Court held that its antitrust statute was to mean the same thing as the federal statute).

17. 15 U.S.C. §§ 1-7 (1976 & Supp. V 1981).

18. 15 U.S.C. §§ 12-27, 44 (1976 & Supp. V 1981).

19. Note, *supra* note 7, at 225-26.

20. *Id.* at 215. *North Avenue* is the only decision by the Colorado Supreme Court construing the state's antitrust statute, and only three cases even mentioning the Colorado antitrust statute have ever reached the Colorado Court of Appeals. None of the three cases was decided on a substantive application of the antitrust statute. *See* National Cigarette Serv. Co. v. Farr, 42 Colo. App. 356, 594 P.2d 603 (1979); Beneficial Fin. Co. v. Sullivan, 534 P.2d 1226 (Colo. App. 1975) (not selected for official publication); People *ex rel.* Kinsey v. Sumner, 34 Colo. App. 61, 525 P.2d 512 (1974). *See also* Appellant's Opening Brief at 7, North Ave. Furniture & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

21. 394 F. Supp. 1102 (D. Colo. 1975).

22. *Q-T Markets* dealt with the application of the restraint of trade provision of the Colorado Antitrust Act to tying agreements and exclusive dealing contracts.

A. *The* Q-T Markets *Case*

The plaintiff in *Q-T Markets* asserted both federal and state antitrust claims against the defendant.[23] The federal claims alleged an illegal tying arrangement,[24] in violation of section 1 of the Sherman Act,[25] and an exclusive dealing contract,[26] in violation of section 3 of the Clayton Act.[27] More importantly for present purposes, the plaintiff also alleged a violation of Colorado's Antitrust Act.[28] The federal court entertained the state claim under the doctrine of pendent jurisdiction,[29] whereby the federal court construes state law in accordance with available state interpretations.[30] Because no Colorado case law construing the antitrust statute existed, the federal court interpreted the state statute as a matter of first impression.[31]

In its interpretation of section 6-4-101,[32] the federal court seized upon slight differences[33] in language between the Colorado statute and the Sherman Act. The court concluded that "[b]ecause of those differences it would be unwarranted to assume that the Colorado legislature intended to adopt the case law interpreting the Federal statutes."[34] The court therefore strictly construed the Colorado statute in accordance with the literal meaning of the language used by the legislature.[35] The court's holding has had an ironic result: while Colorado's Little Sherman Act was drafted so as to track the federal Sherman Act,[36] the effect of *Q-T Markets* was to disregard the entire body of federal case law construing the Sherman Act. The *Q-T Markets* decision made Colorado a minority of one[37] by construing its antitrust law independently of federal law. Courts and commentators have, without exception, questioned or criticized this holding, arguing instead that federal precedent should furnish a guide to interpreting Colorado's antitrust stat-

23. 394 F. Supp. at 1105.

24. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958) where an illegal tying arrangement was defined as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."

25. 394 F. Supp. at 1107.

26. *See* 3 J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION § 11.03 (1982), defining an exclusive dealing contract as one where "the buyer is precluded from purchasing a particular commodity from anyone but the seller; in other words, the sales are conditioned on the agreement that no competing lines will be carried."

27. 394 F. Supp. at 1109.

28. *Id.* at 1105.

29. *See* Chatanooga Foundry & Pipe Works v. Atlanta, 203 U.S. 390 (1906). *See also* Romero v. International Terminal Operating Co., 358 U.S. 354 (1959).

30. United Mine Workers v. Gibbs, 383 U.S. 715 (1966).

31. 394 F. Supp. at 1106.

32. COLO. REV. STAT. § 6-4-101 (1973 & Supp. 1982).

33. The court found the significant difference between the two statutes to be that section 1 of the Sherman Act makes illegal "every contract, combination in the form of a trust *or otherwise*, or conspiracy, in restraint of trade . . ." 15 U.S.C. § 1 (1976 and Supp. V 1981) (emphasis added). The Colorado statute omits the words "or otherwise." 394 F. Supp. at 1106.

34. 394 F. Supp. at 1106.

35. *Id.*

36. 645 P.2d at 1294.

37. *But cf.* Note, *State Anti-Merger Policy: Divesting the Federal Government of Exclusive Regulation*, 12 LOY. U. CHI. L.J. 531, 564 n.189 (1981) (speculating that Louisiana may also construe its antitrust statute independently of federal precedent).

ute.[38] *Q-T Markets*, however, remained the only reported construction of the statute until 1982 when *People v. North Avenue Furniture and Appliance, Inc.*, provided an opportunity to challenge the *Q-T Markets* decision.

II. *PEOPLE V. NORTH AVENUE FURNITURE*

A. *Facts*

Adam Smith once said that "[p]eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices."[39] While that statement may be somewhat conclusory, it nonetheless applies to the circumstances of *People v. North Avenue Furniture*.

In Grand Junction, Colorado, the locus of the instant controversy, the larger retail carpet stores subcontract their installation work to independent carpet installers. As part of the total purchase price, retailers quote carpet installation rates to their customers from a published price list.[40] In early 1980, the defendants, who were all either sellers or installers of carpeting, met to discuss the possibility of increasing the established price for carpet installation. The defendants reached an initial agreement on a fixed price increase for installation services.[41] The increase was then proposed for approval to twenty-five other independent carpet installers in the area, who later became unindicted co-conspirators.[42] This group also approved the increase, and the installers and retailers agreed to abide by the newly established prices effective March 1, 1980.

The Attorney General's office received an anonymous complaint regarding the price-fixing arrangement and initiated a grand jury investigation.[43] This resulted in the return of an indictment charging price-fixing violations under the Colorado Antitrust Act in May of 1980.[44]

The district court dismissed the indictments in November of 1980 after finding the defendant's activity was protected by the statutory labor exemption to the antitrust statute.[45] Disagreeing with the lower court's construction of the labor exemption, the Attorney General filed a notice of appeal to

38. *North Avenue*, 645 P.2d at 1293, n.3 ("We therefore reject the contrary assumption implicit in *Q-T Markets*."); Kelly v. Blue Cross, 1979-1 Trade Cases (CCH), ¶ 62,646 at 77,651 (Mich. Cir. Ct. 1979) ("The Court is not persuaded by Defendant's [citation of the *Q-T Markets* case]."); Burke & Walters, *supra* note 6, at 7 ("Whether or not the Colorado courts will follow this . . . [*Q-T Markets*] analysis remains to be seen. Some hint of rejection can be found . . . ."); Note, *supra* note 7, at 229-30 ("The *Q-T Markets* opinion abrogates the pervasive intent of state legislatures to look to federal law and landmark cases in construing their own laws.").

39. A. SMITH, THE WEALTH OF NATIONS 128 (1st Modern Library ed. 1937), quoted by Ducker, *supra* note 1, at 577.

40. 645 P.2d at 1292.

41. *Id.*

42. Appellant's Opening Brief at 5, People v. North Ave. Furniture, 645 P.2d 1291 (Colo. 1982) [hereinafter cited as Appellant's Opening Brief].

43. 645 P.2d at 1293.

44. *Id.*

45. *Id.* *See* COLO. REV. STAT. § 6-4-103(2) (1973), which states that "[t]he labor of a human being is not a commodity or article of commerce."

the Colorado Supreme Court.[46]

B. *The Issues and Decisions*

In *North Avenue* the Colorado Supreme Court confronted the state antitrust statute on first impression.[47] The principal issue of the case concerned the construction of the statutory labor exemption.[48] Before considering whether the case qualified for the exemption, however, the court had to decide whether Colorado's antitrust statute even applied to *North Avenue*.[49]

1. The "Trade or Commerce" Issue

The illegal restraint of trade provision of the Colorado Antitrust Act provides in part that "[e]very contract or combination in the nature of a trust or conspiracy in restraint of *trade or commerce* is declared illegal . . . ."[50] The preliminary issue, then, was whether carpet installation, generally considered a service, was also "trade or commerce" within the scope of the antitrust statute.[51] If carpet installation was *not* a trade under the purview of section 6-4-101, then the antitrust statute would not apply, and construction of the labor exemption issue would have been unnecessary.

2. The Decision

The court held that carpet installation was "trade or commerce" within the meaning of the Colorado Antitrust Act.[52] The court noted that the distinction between carpet installation as an exchange of services for money, as opposed to an exchange of commodities for money, was without antitrust significance.[53]

In reaching their conclusion, the Colorado court chose to follow the multitude of federal cases that broadly apply the Sherman Act.[54] The court

46. The notice of appeal to the supreme court from the district court was filed pursuant to COLO. REV. STAT. § 16-12-102 (1973 & Supp. 1982) and COLO. APP. R. 4(b).

47. 645 P.2d at 1294.

48. *Id.* at 1297.

49. *Id.* at 1296.

50. COLO. REV. STAT. § 6-4-101 (1973 & Supp. 1982) (emphasis added). This section provides in full that:

> Every contract or combination in the nature of a trust or conspiracy in restraint of trade or commerce is declared illegal. Every combination, conspiracy, trust, pool, agreement, or contract intended to restrain or prevent competition in the supply or price of any article or commodity constituting a subject of trade or commerce in this state, or every combination, conspiracy, trust, pool, agreement or contract which controls in any manner the price of any such article or commodity, fixes the price thereof, or limits or fixes the amount or quantity thereof to be manufactured, produced, or sold in this state, or monopolizes or attempts to monopolize any part of the trade or commerce in this state, is declared an illegal restraint of trade.

Id. The penalties for violating the Colorado antitrust statute are found in COLO. REV. STAT. § 6-4-107 (1973 & Supp. 1982).

51. 645 P.2d at 1296.

52. *Id.*

53. *Id.*

54. For other examples of labor and service industries within the scope of the Sherman Act, *see, e.g.*, National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679 (1978) (engineering services); Gordon v. New York Stock Exch., 422 U.S. 659 (1975) (stock brokerage services); Connell Constr. Co., Inc. v. Plumbers and Steamfitters Local Union No. 100, 421 U.S. 616

was persuaded by legislative history which showed that in enacting section 1 of the Sherman Act,[55] "Congress intended to strike as broadly as it could."[56] Recognizing that Colorado's section 6-4-101 was modeled on section 1 of the Sherman Act,[57] the court looked to several United States Supreme Court constructions of the Sherman Act for guidance in construing the Colorado Act.[58]

The court first looked to the Supreme Court decision in *Atlantic Cleaners & Dyers v. United States*,[59] where "trade" under the Sherman Act was interpreted as the equivalent of "occupation, employment, or business whether manual or mercantile."[60] Thus, laundering clothes, although a service, nonetheless constituted a "trade" under the Sherman Act.[61] The court also discussed *Goldfarb v. Virginia State Bar Ass'n*,[62] where the Supreme Court held that real estate title examination conducted by attorneys was "trade or commerce."[63] The Court tersely stated that land title examination is a service and that exchanging such a service for money is "commerce" in the most ordinary use of that term.[64]

On the strength of federal interpretations of "trade or commerce" under the Sherman Act, the Colorado Supreme Court held carpet installation to be within the corresponding provision of the Colorado act.[65] This holding appears to indicate that Colorado will follow the federal lead by reading wide coverage into Colorado's Little Sherman Act.

3. The Labor Exemption Issue

Having found that carpet installation services were "trade or commerce" within the scope of the antitrust act, the court turned to the pivotal issue of the case: construction of the labor exemption.

The labor exemption states that "[t]he labor of a human being is not a commodity or article of commerce."[66] The defendants argued that because their agreement to increase carpet installation charges "dealt solely with the

(1975) (construction services); United Mine Workers v. Pennington, 381 U.S. 657 (1965) (coal mining); Associated Press v. United States, 326 U.S. 1 (1945) (furnishing news).

55. 15 U.S.C. § 1 (1976 & Supp. V 1981).

56. Goldfarb v. Virginia State Bar Ass'n, 421 U.S. 773, 787 (1975).

57. 645 P.2d at 1294 n.4. *See supra* note 14.

58. *Id.* at 1295.

59. 286 U.S. 427 (1931).

60. *Id.* at 436.

61. The court's citation to *Atlantic Cleaners & Dyers* is problematic, however, because that case relates only to section 3 of the Sherman Act. Section 3 deals *exclusively* with people engaged in trade or commerce in the District of Columbia, and therefore, by definition, ought to be inapplicable to other jurisdictions (15 U.S.C. § 3 (1976 & Supp. V 1981)).

62. 421 U.S. 773 (1975).

63. *Id.* at 787.

64. *Id.* Perhaps the best test used to determine Sherman Act (and Little Sherman Act) applicability is the one articulated by Sullivan: "If there is a dollar to be made, it's trade or commerce." L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 709 (1977).

65. 645 P.2d at 1296. After finding applicability of the antitrust statute to the carpet installation business, the court swiftly moved to a construction of the labor exemption. The court, however, never stated whether the defendants' activity actually constituted a price fixing violation; instead, it tacitly assumed the requisite illegality and proceeded to construe the exemption. In the court's defense, it should be noted that neither party discussed price fixing in their briefs.

66. COLO. REV. STAT. § 6-4-103 (1973).

price of human labor," their actions were immune from antitrust prosecution under the Colorado labor exemption.[67] The Attorney General argued that Colorado should narrowly interpret its labor exemption and thereby limit its application to bona fide labor union activities relating to the terms and conditions of employment.[68]

4. The Decision

The Colorado Supreme Court rejected the defendant's broad interpretation and held that in order for the labor exemption to apply, the defendants' agreement would have to arise from an employer-employee relationship concerning wages, hours of work and other conditions of employment.[69]

In arriving at this conclusion, the court had to juggle several entangled concepts that were not susceptible of a pigeonhole analysis. It is therefore understandable why the court experienced difficulty in articulating their rationale. The holding itself and the reasoning used, however, appear to be entirely proper, with the net effect being that *North Avenue* interprets Colorado's labor exemption in harmony with both the history and the case law constructions of the federal labor exemption. The following sections explore the court's treatment of the labor exemption issue.

C. *Analysis*

1. History of the Federal Labor Exemption

A necessary dimension of the court's analysis was its discussion of the Clayton Act labor exemption.[70] The purpose of antitrust law has been to promote free competition and prevent restraints of trade.[71] The goal of federal labor law, however, has been to enhance workers' rights by encouraging voluntary economic agreements between employers and employees.[72] The aims of labor law thus clash with those of antitrust law where employer-employee agreements have the effect of inhibiting competition and restraining trade.[73]

The tension between antitrust law and labor law climaxed in 1908 when the Supreme Court decided the so-called *Danbury Hatters* case,[74] where a union-organized boycott of the plaintiff's nonunion-made hats was found

67. 645 P.2d at 1293.

68. *Id.*

69. *Id.* at 1299.

70. 15 U.S.C. § 17 (1976 & Supp. V 1981).

71. 645 P.2d at 1295. *See* 21 CONG. REC. 2457 (1890) (Comments of Senator Sherman). *See also* United States v. Hutcheson, 312 U.S. 219 (1941); Standard Oil Co. v. Tennessee, 217 U.S. 413 (1910).

72. 645 P.2d at 1295. *See* Connell Constr. Co. v. Plumbers Local 100, 421 U.S. 616 (1975). *See also* Casey & Cozzillo, *Labor-Antitrust: The Problems of* Connell *and a Remedy that Follows Naturally*, 1980 DUKE L.J. 235, 235.

73. 645 P.2d at 1295. *See* Casey & Cozzillo, *supra* note 72, at 235-36; Winter, *Collective Bargaining and Competition: The Application of Antitrust Standards to Union Activities*, 73 YALE L.J. 14, 16-17 (1963).

74. Lowe v. Lawlor, 208 U.S. 274 (1908).

to violate the Sherman Act.[75] This decision prompted the labor unions to seek specific statutory immunity for legitimate union activities violative of the Sherman Act. Congress responded by passing section 6 of the Clayton Act[76]—the labor exemption. In providing this exemption, Congress sought to accommodate the important national policies of both antitrust enforcement and legitimate labor union activities.[77]

2. Federal Construction of the Labor Exemption

A long line of federal cases has perpetuated the historical purpose of the Clayton Act exemption, and these cases firmly support the *North Avenue* court's interpretation of the Colorado provision. Unlike the broad applicability of section 1 of the Sherman Act, the courts narrowly construe *all* antitrust statutory exemptions in order to effectuate the legislative intent of promoting competition.[78] The section 6 labor exemption of the Clayton Act is no exception to this general rule, and its scope has been severely limited by the judiciary.

In *Columbia River Packers Association, Inc. v. Hinton*,[79] the Supreme Court held that the labor exemption did not apply to agreements between independent businessmen, but rather, only to employer-employee relationships.[80] Similarly, in *Allen Bradley Co. v. Local Union No. 3, Int'l Bhd. of Elec. Workers*,[81] the Supreme Court held the labor exemption was available only to legitimate unilateral union activity.[82] *Los Angeles Meat and Provision Drivers Union v. United States*[83] continued the well-defined trend by stating that the labor exemption's purpose is to ensure that legitimate union activities are not stifled by the antitrust laws.[84]

In light of this federal precedent, the Colorado Supreme Court formulated the following test for application of the labor exemption: where an agreement "arises from lawful associational activities of employees concern-

75. *Id.* at 301.

76. 15 U.S.C. § 17 (1976 & Supp. V 1981).

77. People v. North Ave. Furniture, 645 P.2d at 1295.

78. Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 231 (1979).

79. 315 U.S. 143 (1943).

80. *Id.* at 145-47. The Supreme Court's conclusion is particularly applicable to *North Avenue*:

> The controversy here is altogether between fish sellers and fish buyers. The sellers are not employees of the petitioners or of any other employer nor do they seek to be. On the contrary, their desire is to continue to operate as independent businessmen, free from such controls as an employer might exercise. That some of the fishermen have a small number of employees of their own, who are also members of the Union, does not alter the situation. For the dispute here, relating solely to the sale of fish, does not place in controversy the wages or hours or other terms and conditions of employment of these employees.

Id. at 147.

81. 325 U.S 797 (1945).

82. *Id.* at 808-11.

83. 371 U.S. 94 (1962).

84. *Id.* at 103. In H.A. Artists & Associates, Inc. v. Actor's Equity Ass'n, 451 U.S. 704 (1981), the Supreme Court found that the federal labor exemption applied only to *bona fide* labor activity and not to independent contractors or entrepreneurs. *See also* Home Box Office, Inc. v. Directors Guild of Am., Inc., 531 F. Supp. 578, 588 (S.D.N.Y. 1982); Cesnik v. Chrysler Corp., 490 F. Supp. 859, 865 (M.D. Tenn. 1980).

ing the terms or conditions of their employment," the exemption is available.[85] Applying this test to the facts of *North Avenue*, the court found that the defendant carpet retailers and installers bore no employment relationship with each other. The primary purpose of their agreement was to fix the prices for carpet installation and thereby restrain competition in the Grand Junction market.[86] The court therefore ruled that the labor exemption was not available to the *North Avenue* defendants.[87] The court concluded by stating that businessmen cannot organize into a union and, on that basis, hope to escape from antitrust prosecution.[88]

3. Disposing of *Q-T Markets*

If federal law controlled the *North Avenue* case, the analysis would end here. Even the defendants agreed that under *federal* law, their pricing agreement did not result from a *union* activity, much less stem from a *bona fide* employer-employee relationship.[89] Federal law, however, did not control the instant case,[90] and the issue thus became, to what extent should the federal constructions apply to the Colorado statute?

Relying on the rationale of *Q-T Markets*,[91] defendants contended that minor differences between the labor exemptions in the Colorado antitrust statute and the Clayton Act indicated a legislative intent to depart from federal precedent.[92] This argument was not frivolous as it was founded on the logic of the only prior case which construed Colorado's modern antitrust

85. 645 P.2d at 1299.
86. *Id.*
87. *Id.*
88. *Id.* at n.9.
89. *Id.* at 1297.
90. *Id.* at 1295-96.
91. *See supra* text accompanying notes 23-38.
92. Since their interpretations are critical to the outcome of the case, the two statutes are juxtaposed below. The italicized portions show the Colorado statute places the human labor sentence in a *second* section, at the *end* of the statute. The federal provision on the other hand, has only *one* section, with the human labor sentence appearing at the *beginning*.

In defense of the alleged price fixing, the defendants invoked Colorado's labor exemption, COLO. REV. STAT. § 6-4-103 (1973):

> (1) Nothing in this article shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations instituted for the purpose of mutual help, or engaged in making collective sales or marketing for its members or shareholders of farm, orchard, or dairy products produced by its members or shareholders, and not having capital stock or conducted for profit or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade under this article.
>
> (2) *The labor of a human being is not a commodity or article of commerce.*

(emphasis added).

The People offered, by way of comparison, the Clayton Act labor exemption, which served as the model for section 6-4-103:

> *The labor of a human being is not a commodity or article of commerce.* Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purpose of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

15 U.S.C. § 17 (1976 & Supp. V 1981) (emphasis added).

statute.[93]

The court, however, viewed any reliance on *Q-T Markets* as tenuous and declined the invitation to deviate from the clear federal case law of *Columbia River Packers* and its progeny.[94] The court rejected the assumption implicit in *Q-T Markets* that the Colorado antitrust statute was intended to mean something distinct from federal antitrust statutes.[95] Instead, the court reached the conclusion that the federal constructions were entitled to considerable weight.[96]

4. Justification for Applying Federal Precedent to the State Statute

Having dispensed with the *Q-T Markets* cases, the *North Avenue* court then had to justify why it could apply federal precedent, by analogy, to the state statute. The court accomplished this by resorting to the doctrine of *in pari materia*.

Under this doctrine of statutory construction, the court interprets the meaning of a statute by looking to constructions of statutes with similar language and purpose.[97] In this case, the court noted that both federal and state antitrust laws were devoted to the dual purpose of protecting the public against restraints of trade while preserving the rights of workers to bargain collectively with employers over the terms and conditions of employment.[98] The court stated that the role of state antitrust laws was to address conditions beyond the reach of federal laws.[99] The court concluded that given the substantial similarity in text and purpose of federal and state antitrust laws, the federal decisions construing the Sherman and Clayton Acts, although not necessarily controlling, were entitled to careful scrutiny in determining the scope of the state antitrust statute.[100]

In justifying its adoption of federal precedent as a guide to interpreting the Colorado Act, the court appears to rely solely on the doctrine of *in pari materia*. Interestingly, the court ignored the Attorney General's argument,[101] which reached the same conclusion by means of the "borrowing doctrine." Under this doctrine, the construction of statutes borrowed from other jurisdictions is controlled by the lending jurisdiction's interpretation of

93. It is interesting to note that the defendant did not contest the application of federal precedent in interpreting COLO. REV. STAT. § 6-4-101 (1973), which differs slightly from section 1 of the Sherman Act.

94. 645 P.2d at 1299.

95. *Id.* at 1293 n.3.

96. *Id.* at 1296.

97. 2A C. SANDS, STATUTES AND STATUTORY CONSTRUCTION 51.01 (4th ed. 1973). An illustrative case is State v. Duluth Bd. of Trade, 107 Minn. 506, 121 N.W. 395 (1909):

> The Minnesota anti-trust law is framed along the lines of the federal statute, although it is more diffuse. It may fairly be assumed, however, that the general purpose of all statutes of this kind is the same, and we may therefore properly look to the decisions made under federal and state statutes of a similar character for the principle by which to construe our own statute.

Id. at 107 Minn. at 510, 121 N.W. at 399.

98. 645 P.2d at 1295.

99. *Id.*

100. *Id.* at 1296.

101. Appellant's Opening Brief, *supra* note 42, at 9.

its statute at the time of the borrowing.[102] The advantage of employing this doctrine is that it has solid support in Colorado case law.[103]

The court did note that in enacting the Colorado antitrust statute in 1957, the legislature "borrowed" Wisconsin's antitrust statute as a model.[104] The court cited an affidavit from the draftsman of the Colorado statute, which stated that it was the legislator's intent that any cases interpreting Wisconsin's statute could be used as precedent to interpret Colorado's statute.[105] Significantly, at the time Colorado borrowed Wisconsin's antitrust statute, Wisconsin interpreted it in harmony with federal precedent.[106] Thus, by looking to Wisconsin case law, the *North Avenue* court could have "borrowed" that state's policy of accepting federal constructions of the Sherman Act as a guide to interpreting its own statute. The court could have supported this conclusion by citing its own line of decisions concerning the borrowing doctrine.[107]

Thus, the court could have solidly and artfully justified its application of federal constructions to the Colorado Act. The court, however, declined to take this approach in favor of the more direct comparison of the Colorado statute to the federal antitrust laws.

5. The Language Differences in the Federal and State Exemption

The final issue that the court had to address was the defendants' argument concerning the organizational differences in the federal and state exemption provisions.[108] The defendant seized upon two differences, namely, the bifurcation and the reverse order of the human labor sentence.

The court easily disposed of the bifurcation issue. The original enactment of the labor exemption came in a single section entitled "organizations exempt."[109] In the 1973 version of the statutes, that section was editorially divided into two parts by the statutory revisor, with the human labor sentence appearing separately.[110] There were no intervening amendments authorized by the legislature. The change was only cosmetic, with no apparent explanation. Because editorial changes by the statute revisor cannot alter the substantive meaning,[111] the court stated that it would attach no significance to the revisor's bifurcation.[112]

The court never actually addressed the defendants' argument about the

102. *Vandermee*, 164 Colo. 117, 121, 433 P.2d 335, 337 (1967).
103. *See, e.g.*, Vandermee v. District Court, 164 Colo. 117, 433 P.2d 335 (1967).
104. 645 P.2d at 1294.
105. *Id.* at 1294 n.4.
106. *See, e.g.*, Pulp Wood Co. v. Green Bay Paper & Fiber Co., 157 Wis. 604, 147 N.W. 1058 (1914).
107. *See* Vandermee v. District Court, 164 Colo. 117, 433 P.2d 335 (1967).
108. 645 P.2d at 1298.
109. COLO. REV. STAT. § 55-4-3 (1963).
110. COLO. REV. STAT. § 6-4-103(2) (1973).
111. COLO. REV. STAT. § 2-5-103(2) (1973 & Supp. 1982). *See also* COLO. REV. STAT. § 2-3-703 (1973 & Supp. 1982).
112. 645 P.2d at 1298. The human labor sentence once again appears as a part of a single section. An editor's note attributes the change to the *North Avenue* case. *See* COLO. REV. STAT. § 6-4-103 (Supp. 1982).

reverse order of the human labor sentence. After noting the history behind the sentence, the court only stated that the sentence, in and of itself, does not affect the rest of the exemption and "has no independent legal significance."[113] A plain meaning analysis of the federal and state exemptions would probably have been sufficient justification of the court's quick dismissal of any significance to the reverse order.

III. THE RAMIFICATIONS OF *NORTH AVENUE*

The numerous federal interpretations have molded the labor exemption into a mature and well-defined legal concept. The *North Avenue* holding, which accords with the federal case law, therefore cannot be claimed as a milestone in the development of antitrust law. Instead, *North Avenue* is best viewed in a broad sense. This generic approach suggests several likely ramifications of the case and permits a richer appreciation of the importance of *North Avenue* to Colorado antitrust law.

A. *A Death-Knell to* Q-T Markets

The court's rejection of *Q-T Markets* will probably be viewed as a death-knell to that anomalous case. The severe criticism received by *Q-T Markets*, together with the *North Avenue* decision, firmly establishes that *Q-T Markets* was wrongly decided. The only technicality remaining in the *Q-T Markets* saga is its inevitable overruling by a federal court.

The court's treatment of the *Q-T Markets* case, however, seems mildly troubling. Although the *Q-T Markets* decision was heavily criticized,[114] it was the only judicial interpretation of Colorado's antitrust statute. As such, the case merited a direct, frontal attack if it were to be disregarded. Instead, the *North Avenue* court's rejection of *Q-T Markets* was relegated to mere footnote status.[115] The unfortunate, though by no means fatal, result was to dilute an otherwise forceful ruling indicating that Colorado intends to interpret its statute by carefully considering federal precedent.

B. *The Use of Federal Precedent in State Antitrust Law*

By ruling that federal precedent furnished a guide to the interpretation of the antitrust act,[116] the court has breathed new life into Colorado antitrust enforcement. This ruling adds stability and predictability to antitrust law in Colorado because businesses, as well as other public and private litigants, can now confidently rely on the wealth of federal antitrust precedent to guide their activities and shape their strategies.

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113. 645 P.2d at 1299.

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

115. 645 P.2d at 1293 n.3.

116. The court stops short of holding federal precedent "controlling" on the Colorado interpretation, thus preserving the court's room to maneuver in future cases. This loophole was probably intended to avoid exactly the kind of dilemma that led to the *Q-T Markets* aberration. It has been speculated that the reason behind the *Q-T Markets* ruling with respect to the Colorado statute was the federal district court's disagreement with the course federal antitrust law was taking. *See* Note, *supra* note 7, at 225.

C. *Some Final Thoughts on* North Avenue

The analysis of *North Avenue* and the implications suggested above seem to assume that there is a significant amount of antitrust activity in Colorado. It has also been noted, however, that only two cases, *Q-T Markets* and *North Avenue*, have construed Colorado's antitrust statute since its enactment over twenty-five years ago. The pragmatic question, then, becomes: does the *North Avenue* case really matter? The answer, unreservedly, is yes.

The student or practitioner of Colorado antitrust law should not be deceived by the paucity of *reported* antitrust cases. Because antitrust litigation is expensive, there is a strong incentive for litigants to settle.[117] One commentator claims that over eighty per cent of all antitrust cases reach settlement through consent decrees.[118] The popularity of settlements helps explain why so few cases reach the Colorado appellate courts and are reported.

The best evidence of the antitrust statute's present vitality in Colorado is the amount of antitrust enforcement conducted by the office of the Attorney General. The office did not have an antitrust section until 1975,[119] which may well account for the relative dormancy of antitrust law in Colorado prior to that time. Since the antitrust section has been added, however, antitrust activity in the state has increased dramatically.[120] Most of this antitrust enforcement activity has been initiated by the Attorney General. *North Avenue* constitutes judicial approval of the Attorney General's activities and should be the encouragement needed to stimulate an aggressive enforcement policy in Colorado.

Private antitrust actions may also increase as a result of *North Avenue*. The use of federal precedent adds one of the incentives needed for litigants to choose a state forum, namely, predictability in the law. A serious deterrent, however, to choosing a state forum remains due to the mysterious absence from the Colorado statute of a treble damage penalty.[121] The Colorado Legislature should view *North Avenue* as an invitation to enact such a remedy.

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117. Note, *supra* note 7, at 218.

118. L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 758 n.8 (1977). *See also* Burke & Walters, *supra* note 6, at 2.

119. Burke & Walters, *supra* note 6, at 1.

120. Burke & Walters, *supra* note 6, at 1. There are several reasons for this increase in state antitrust enforcement in Colorado and across the nation. An exhaustive discussion of these reasons, however, is both beyond the scope of this comment and has been well documented in other writings. *See generally* Dibble & Jardine, *The Utah Antitrust Act of 1979: Getting into the State Antitrust Business*, 57 UTAH L. REV. 73 (1980); Rahl, *State Antitrust Symposium*, 4 J. CORP. L. 475 (1979); Sieker, *The Role of States in Antitrust Law Enforcement—Some Views and Observations*, 39 TEX. L. REV. 873 (1961); Note, *The Present Revival and Future Course of State Antitrust Enforcement*, 38 N.Y.U.L. REV. 575 (1963).

121. The absence of a treble damages penalty was explained in part by the affidavit of David J. Clark, cited by the *North Avenue* court. "I did make certain changes regarding penalties to be applied, such as elimination of the provision for treble damages in civil cases, because I thought the new statute should be 'on the books' for awhile before private actions for treble damages could be instituted. 645 P.2d at 1294, n.4. This does not explain, however, why the legislature has failed to enact a treble damages penalty since the enactment of the law eighteen years ago.

Finally, state antitrust enforcement is important to Colorado because some industries may be wholly intrastate and thus not within the federal jurisdiction. In what is perhaps the major downfall of the *North Avenue* opinion, the court made only a fleeting reference to this issue when it stated that the purpose of state antitrust law is protection of the public against restraints of trade "beyond the reach of federal law."[122] The court leaves to the reader the troubling task of deciding what constitutes an activity "beyond the reach of federal law."

Presumably, the answer is those activities that are entirely intrastate. The authorities, however, are in conflict on the viability of the interstate/intrastate distinction. Some argue that almost all actions will result in interstate commerce.[123] Other writers maintain that industries do exist which are completely intrastate, such as dry cleaning, dairy farming, and restaurants.[124] In light of the tremendous docket problems facing the federal courts today, it is not inconceivable that the federal courts will be less inclined to find the degree of interstate activity required to invoke federal jurisdiction. This increased burden on state courts would make state antitrust laws even more important.

CONCLUSION

North Avenue represents the Colorado Supreme Court's first construction of the state's modern antitrust statute. The case clearly indicates that interpretations of federal antitrust statutes will be given considerable weight when construing Colorado's antitrust statute. The concepts delineated above are compelling reasons for an aggressive state antitrust enforcement policy, and they show that any reliance on the scarcity of reported antitrust cases as an indication of the degree of antitrust activity in Colorado is a trap for the unwary. As a result, *North Avenue* is not an example of much ado about nothing, but rather, *North Avenue* should be viewed as an important case which will significantly guide antitrust enforcement in Colorado.

North Avenue has put antitrust law in Colorado back on track. However, *North Avenue* is but a single step. To continue the advances begun by *North Avenue*, the judiciary must further define the parameters of the Colorado antitrust statute, the Attorney General must maintain its aggressive enforcement philosophy, and the legislature must provide litigants with an appropriate remedy.

Mark Lillie

122. 645 P.2d at 1295.
123. Ducker, *supra* note 1, at 560 n.7.
124. Note, *supra* note 7, at 232-33.

THE UNWED FATHER'S PARENTAL RIGHTS AND OBLIGATIONS AFTER *S.P.B.*: A RETREAT IN CONSTITUTIONAL PROTECTION

INTRODUCTION

A child, S.P.B., was born during the summer of 1979. The father, P.D.G., admitted paternity, but denied any obligation to support the child. The father and the child's mother, C.F.B., were both college students at the time of the birth. They never married and were not living together at the time of trial. The father claimed that when the mother told him she was pregnant, he indicated his desire that the pregnancy be terminated and offered to pay for an abortion. The father asserted that this discussion took place within the first trimester of pregnancy. The mother did not consent to an abortion, gave birth to S.P.B., and subsequently filed a lawsuit against the father for child support. The mother has had custody of the child since birth.[1]

At trial the father argued that due process requires that he have an opportunity to rebut the irrebuttable presumption of section 19-6-116 of the Colorado Uniform Parentage Act (UPA),[2] which states that a father should share in the support of his child. The father also contended that he was denied equal protection as a result of the state's use of a gender-based classification. The state, on behalf of the minor child S.P.B., argued in favor of the El Paso County District Court's award of both child support and half the birth expense.

The Colorado Supreme Court affirmed the father's child support obligation, finding the father's due process and equal protection arguments to be without merit.[3] In so deciding, the Colorado Supreme Court rejected the father's argument that the nexus, or rational relationship, between sexual intercourse and birth is broken. Instead the court relied on *Roe v. Wade*[4] and subsequent cases[5] which hold that the father's desire that the fetus be

1. *In re* S.P.B., 651 P.2d 1213, 1214 (Colo. 1982); Brief for Respondent-Appellant, *In re* S.P.B., 651 P.2d 1213 (Colo. 1982) [hereinafter cited as Brief for Respondent-Appellant].

2. COLO. REV. STAT. §§ 19-6-101 to -129 (1978 & Supp. 1982).

3. This case was transferred by the court of appeals to the Colorado Supreme Court under COLO. REV. STAT. § 13-4-110(1)(a)(1973) because of the constitutional question involved.

4. 410 U.S. 113 (1973) (holding state criminal abortion statutes unconstitutional). In *Roe* the Court did not base its reasoning on the permissibility of the gender-based classification, but rather on the woman's fundamental right to privacy. The Court held that the decision whether to bear a child or have an abortion lies solely with the mother and her physician.

5. *See generally* Maher v. Roe, 432 U.S. 464 (1977); Planned Parenthood v. Danforth, 428 U.S. 52 (1976). The *Maher* Court stated that the constitutional freedom recognized in *Roe v. Wade* and its progeny did not prevent Connecticut from making a value judgment favoring childbirth over abortion. Consequently, the Court upheld a welfare regulation under which Medicaid recipients received payments for childbirth expenses but not for medical services related to abortions.

The Supreme Court in *Danforth* struck down a Missouri statute requiring prior written consent of the spouse of a woman seeking an abortion during the first twelve weeks of pregnancy

aborted or carried to term is irrelevant and neither state legislatures nor the courts, on behalf of the father, may interfere with the mother's decision whether to give birth.

Before *Roe*, simple reproductive biology and the illegality and unavailability of abortion were thought to produce the required nexus between sexual intercourse and birth.[6] In the years since that decision, however, some legal scholars have argued that the woman's essentially unilateral decision to bear or to abort serves as an intervening factor and replaces the act of intercourse as the proximate cause of birth.[7] The *S.P.B.* court gave no credence to that argument, and reaffirmed the United States Supreme Court's recognition of the legally mandated equality between illegitimate and legitimate children.[8] At the same time, however, it would appear that the court's holding may infringe on the constitutional protection afforded the father through a serious procedural flaw that denies his due process of law.[9]

This comment traces the evolution of illegitimacy and child support, the apparent conclusion of a trend by the Colorado Supreme Court to recognize unwed fathers' rights, and the current status of gender-based classifications in Colorado. In addition, the comment discusses the rationale behind the *S.P.B.* court's decision and the potential social ramifications of this opinion, which strikes a precarious balance between the competing interests of the state and the individual.

I. BACKGROUND

A. *Illegitimacy and Child Support*

1. Development at Common Law

Illegitimacy, a social problem for the last two centuries, often has been viewed as an index of the moral state of the community.[10] At common law the parents of an illegitimate child had no duty to support him, since he was considered "filius nullius," a child of no one.[11] Various arguments have been advanced in support of this proposition. It has been said that the unwed father could not be made to support his illegitimate child because of the uncertainty of the child's paternity.[12] It also has been argued that the policy of discrimination between illegitimate and legitimate children encourages

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unless the abortion was certified to be necessary to preserve the life of the mother. The Court said that the state cannot " 'delegate to a spouse a veto power which the state itself is absolutely and totally prohibited from exercising during the first trimester of pregnancy.' " 428 U.S. at 69 (citation omitted).

6. Brief for Respondent-Appellant, *supra* note 1, at 3.

7. Swan, *Abortion on Maternal Demand: Paternal Support Liability Implications*, 9 VAL. U.L. REV. 243 (1975).

8. *See* Gomez v. Perez, 409 U.S. 535 (1973). The terms "illegitimate" and "legitimate" should be avoided, because of the stigma associated with bastardy. *See infra* note 31 and accompanying text.

9. *See infra* note 123 and accompanying text.

10. P. LASLETT, BASTARDY AND ITS COMPARATIVE HISTORY 1 (1980).

11. H. KRAUSE, CHILD SUPPORT IN AMERICA 3 (1981).

12. *See* Comment, *Domestic Relations-Illegitimates-Father's Duty to Support*, 28 N.C.L. REV. 119, 122 (1949).

marriage, and serves as a deterrent to illicit cohabitation.[13] Most twentieth century commentators find this argument uncivilized because it seeks to punish innocent children on the unreasonable hope that their suffering will promote marriage.[14]

By 1576, enforcement of the English Poor Law[15] provided a quasi-criminal procedure for obtaining support from the natural father of an illegitimate child. The Poor Law was designed to relieve the state of the burden of supporting such children, who were thought of as sin turned into flesh.[16]

Although many years ago the common law ceased legitimacy-based discrimination in mother-child relationships,[17] as recently as 1953 the New Jersey Supreme Court strained to find a paternal child support obligation in the common law.[18] Failing in this attempt, the court found it necessary to fashion this obligation from equitable principles, natural law and reference to the laws of "civilized European countries."[19]

Recently, the trend has been to impose an equal support obligation on mothers and fathers, either by statute or by judicial decisions. Courts sometimes base this obligation on state equal rights amendments or on the equal protection clause of the United States Constitution.[20]

2. United States Supreme Court Decisions

More than a dozen Supreme Court cases since 1968, decided on the basis of the equal protection clause, have mandated full equality for the illegitimate child.[21] As a result, many state statutes discriminating against illegitimate children have been held unconstitutional.[22]

Citing the fourteenth amendment, the Court has demanded equal legal treatment of legitimate and illegitimate children over a broad range of substantive areas.[23] Even so, in 1976 the Court refused to declare illegitimacy

13. *Id.*

14. *Id.*

15. An Act for Setting the Poor on Work, 1576, 18 Eliz. 1, c.3 § 7, *cited in* H. KRAUSE, CHILD SUPPORT IN AMERICA 3 (1981).

16. FATHERS, HUSBANDS AND LOVERS 6 (S. Katz & M. Inker eds. 1979).

17. Dalton v. State, 6 Blackf. 357 (Ind. 1842), *cited in* J. O'DONNELL & D. JONES, THE LAW OF MARRIAGE AND MARRIAGE ALTERNATIVES 97 n.29 (1982).

18. Greenspan v. Slate, 12 N.J. 426, 97 A.2d 390 (1953).

19. *Id.*

20. "[N]or shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.

21. *See, e.g.*, Gomez v. Perez, 409 U.S. 535 (1973) (illegitimates are not to be denied their right to support from their natural father); Weber v. Aetna Casualty & Sur. Co., 406 U.S. 164 (1972) (illegitimates should share equally with other children who recover workmen's compensation benefits for the death of a parent); Glona v. American Guar. & Liab. Ins. Co., 391 U.S. 73 (1968) (statutes granting causes of action for wrongful death cannot deny a right to recovery to the parent of an illegitimate child); Levy v. Louisiana, 391 U.S. 68 (1968) (a state may not create a right of action in children for the wrongful death of a parent which excludes illegitimate children).

22. *See generally* H. KRAUSE, CHILD SUPPORT IN AMERICA (1971) (discussing child support laws which were written when illegitimate paternity had only limited legal consequences).

23. The equal protection and due process afforded an illegitimate child have been the focus of the United States Supreme Court in a number of cases. *See* cases cited *supra* note 21.

per se sufficiently suspect to compel strict judicial scrutiny.[24] Recent United States Supreme Court cases dealing with illegitimacy, which have applied varying levels of scrutiny, illustrate the Court's difficulty in arriving at a consistent method of analysis.[25]

Justice Powell, principal architect of the Burger Court's position on illegitimacy under the equal protection clause,[26] stated that "imposing disabilities on the illegitimate child is contrary to the basic concept of our system that legal burdens should bear some relationship to individual responsibility or wrongdoing."[27]

In *Gomez v. Perez*[28] the Court found no constitutional justification for denying support to a child simply because the parents were not married. This decision illustrates the Court's progression toward broadening the rights of illegitimate children.

3. Development of Colorado Law

Colorado's UPA[29] provides the statutory framework for child support. The roots of this part of the UPA can be found in a Texas law review article written by Harry Krause in 1966, which was considered revolutionary at the time it was written.[30] In effect since July 1977, the Colorado UPA allows the parent-child relationship to be established or acknowledged, regardless of the parents' marital status. The act attempts to abolish the stigma attached to bastardy by avoiding the labels of "illegitimacy" and "legitimacy."[31]

Parental child support for illegitimate children, as provided for by the Colorado UPA, is not new to Colorado. As early as 1918, in *Wamsley v. People*,[32] a father was convicted under Colorado's nonsupport statute of 1911 for failure to support his illegitimate child. Over fifty years later in *Munn v. Munn*,[33] the court held that the father's support obligation to his illegitimate child could not differ substantially from that owed to his legitimate child. Colorado Supreme Court Chief Justice Pringle, in his 1972 dissent in *In Re L.B.*, wrote: "We have, it seems to me, now passed the time when we distin-

24. The Supreme Court traditionally gave only minimal scrutiny to gender-based classifications. Goesaert v. Cleary, 335 U.S. 464 (1948) (statute upheld which permitted only the wife or daughter of a male owner of a liquor establishment to bartend). *Goesaert* was later overruled by Craig v. Boren, 429 U.S. 190 (1976) (finding gender-based classification in drinking age law to be unconstitutional).

25. *See, e.g.*, Parham v. Hughes, 441 U.S. 347 (1979) (applying a rational relationship test); Trimble v. Gordon, 430 U.S. 762 (1977) (applying intermediate-level scrutiny).

26. He wrote not only the majority opinion in Weber v. Aetna Casualty & Sur. Co., 406 U.S. 164 (1972), but also three other majority opinions, two concurring opinions and one plurality opinion.

27. Weber v. Aetna Cas. & Sur. Co., 406 U.S. at 175-76.

28. 409 U.S. 535 (1973).

29. COLO. REV. STAT. §§ 19-6-101 to -129 (1978 & Supp. 1982).

30. Krause, *Bringing the Bastard into the Great Society: A Proposed Uniform Act on Legitimacy*, 44 TEX. L. REV. 829 (1966).

31. H. KRAUSE, ILLEGITIMACY: LAW AND SOCIAL POLICY 22 (1971) (noting the danger that a legislature, overconcerned with nomenclature, may think it has solved an unpleasant problem by outlawing an unpleasant word).

32. 64 Colo. 521, 173 P. 425 (1918).

33. 168 Colo. 76, 450 P.2d 68 (1969).

guish between so-called 'illegitimate' children and 'legitimate' children."[34]

B. *Parental Rights of Unwed Fathers*

1. The United States Supreme Court and Gender-Based Classifications

Because the father owed no legal duty to his illegitimate child at common law, it naturally followed that he should have no rights concerning the child. Responding to the need to reduce welfare rolls, the laws eventually changed and support duties were imposed upon the father.[35] Unlike most obligations, this duty came with no rights as courts have often failed to recognize the unwed father's right to visitation and custody.[36]

During the last ten years, the judicial trend has been to broaden the parental rights of unwed fathers and more closely scrutinize some of the disabilities under which unwed fathers traditionally have been placed with respect to their children.[37] Some of this expansion of rights has been based on procedural due process requirements, as illustrated in *Stanley v. Illinois*.[38] In *Stanley*, the Court held that the Illinois statute in question created an unconstitutional irrebuttable presumption that all unmarried fathers are unsuitable parents.[39] The Court recognized the due process right of a biological father to maintain a parental relationship with his children, unless he is found to be unfit.[40]

Many of the United States Supreme Court decisions broadening the rights of unwed fathers, like those broadening the rights of illegitimate children, have been based on the fourteenth amendment.[41] These cases are best understood by reviewing the Court's complicated equal protection approach to gender-based classifications.[42] Until 1971, the United States Supreme Court employed a two-tier test to judge the validity of a statute under constitutional attack based on the equal protection clause of the fourteenth amendment. Under the minimal scrutiny required by the traditional "lower tier," most statutes were upheld since they were only required to show a "rational relationship" to a legitimate state end.[43] The "upper tier test," requiring a "compelling state interest," was applied to statutes restricting fundamental rights and creating suspect classes such as race.[44]

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34. 179 Colo. 11, 19, 498 P.2d 1157, 1161-62 (1972).

35. *See* H. KRAUSE, *supra* note 22.

36. *See generally* W. WADLINGTON & M. PAULSEN, DOMESTIC RELATIONS § 8 (3d ed. 1978) (discussing the lack of attendant rights of unwed fathers).

37. Comment, *Equal Protection and the Putative Father: An Analysis of* Parham v. Hughes *and* Caban v. Mohammed, 34 Sw. L.J. 717 (1980).

38. 405 U.S. 645 (1972).

39. *Id.* at 656-57.

40. *Id.* at 649.

41. *See supra* note 21.

42. Discrimination against the unwed father involves three separate judicial classifications: gender, marital status, and illegitimacy. *See* Note, R. McG. & C.W. v. J.W. & W.W.: *The Putative Father's Right to Standing to Rebut the Marital Presumption of Paternity*, 76 NW. U.L. REV. 669, 674 (1981).

43. *See, e.g.*, McGowan v. Maryland, 366 U.S. 420 (1961). For a more recent decision based on the rational basis test, see City of New Orleans v. Dukes, 427 U.S. 297 (1976).

44. *See, e.g.*, Graham v. Richardson, 403 U.S. 365 (1971) (alienage); Harper v. Virginia Bd.

The Court's dislike for the two-tier test surfaced in 1971 when it developed an intermediate level of scrutiny in *Reed v. Reed*.[45] Writing for a unanimous Court, Chief Justice Burger applied a "heightened scrutiny" test to invalidate a statute which favored men over women as administrators of decedents' estates. The new test required that a classification have "a fair and substantial relation to the object of the legislation."[46] In *Frontiero v. Richardson*,[47] decided two years later, four justices supported the elevation of gender to the level of a suspect class, but the idea did not receive majority support.

In *Craig v. Boren*[48] the Court clarified its equal protection test for gender discrimination cases by taking an activist stand and invalidating a statute that discriminated against males. The Court stated that: "classifications by gender must serve important governmental objectives and must be substantially related to achievement of those objectives."[49]

In *Caban v. Mohammed*[50] the Court applied its intermediate scrutiny test to the rights of unwed fathers and invalidated a New York statute allowing unmarried mothers, but not unmarried fathers, to prevent the adoption of their children by withholding consent. The Court held that the statute was violative of equal protection because it created a gender-based distinction between unwed parents bearing no substantial relationship to the state's asserted interests.[51] The Court refused to accept the state's argument that maternal and paternal relations are fundamentally different.

The Court's five-four split in *Caban* vividly illustrates the difficulty of defining unwed fathers' rights in the equal protection context. This lack of agreement indicates a judicial reluctance to further broaden rights in this area. Consequently, it would appear that *Caban* represents the current culmination in the development of the unwed father's rights.

2. Colorado Supreme Court

In 1981 the Colorado Supreme Court in *R. McG. v. J.W.*[52] seriously weakened a longstanding legal presumption that the husband of the mother

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of Elections, 383 U.S. 663 (1966) (right to vote); Griswold v. Connecticut, 381 U.S. 479 (1965) (right to privacy); Loving v. Virginia, 388 U.S. 1 (1962) (race).

45. 404 U.S. 71 (1971).

46. *Id.* at 76.

47. 411 U.S. 677, 685-86 n.17 (1973). The plurality enunciated three criteria which characterize a suspect class: 1) the class suffers from an immutable characteristic determined solely by accident of birth and bearing no relation to the ability to contribute in society; 2) the class suffers historic vilification; and 3) the class lacks effective political power and redress.

48. 429 U.S. 190 (1976) (invalidating a statute prohibiting beer sales to males under 21 and females under 18).

49. *Id.* at 197. The Court in Parham v. Hughes, 441 U.S. 347 (1979) showed its hesitancy to implement the intermediate scrutiny test laid out in *Craig*. In *Parham* the plurality actively avoided characterizing the statute as gender-based. Instead, they justified their decision on comparatively trivial differences in circumstance.

50. 441 U.S. 380 (1979). *Caban* was the first unwed father case to directly face the equal protection issues.

51. *Id.* at 393-94.

52. 615 P.2d 666 (Colo. 1980). For an indepth analysis of this case, see *Bastardizing the Legitimate Child: The Colorado Supreme Court Invalidates the Uniform Parentage Act Presumption of Legitimacy in* R. McG. v. J.W., 59 DEN. L.J. 157 (1981).

of a child born during marriage is the father of that child.[53] The court held that R. McG., the alleged biological father, must be given standing to rebut such a presumption and an opportunity to establish the existence of a parent-child relationship with C.W., his alleged minor child,[54] even though the child's mother was married to another at the time of conception and had remained married at the time of trial.

The Colorado court relied on Supreme Court precedents, including *Stanley* and *Caban*, in finding this gender-based distinction unconstitutional.[55] The court held that the UPA statute[56] violated equal protection by granting biological mothers judicial access while denying putative biological fathers standing. Such a distinction, the court said, was not substantially related to an important governmental interest.[57]

Although the intermediate level of scrutiny does not require a statute to fit the state's interest exactly, the court noted that the statute must, at least, substantially mesh with the classification's purpose;[58] such was not the case in *R. McG.*[59] The court further held that the denial of standing to R. McG. violated the equal rights amendment of the Colorado Constitution, which forbids the denial of equal rights on the basis of sex.[60]

The justices in *R. McG.* also found fatal flaws under procedural due process analysis. They stated that although the drafters of the UPA claimed that the act created presumptions rebuttable by clear and convincing evidence,[61] the UPA was actually irrebuttable because it denied an unwed father standing to rebut.[62] The court eyed the presumption with apprehension in light of the recent judicial trend away from irrebuttable presumptions, noting the similarity between the statutory framework of the UPA and the presumption held violative in *Stanley*.[63] Several commentators believe this controversial decision will have far-reaching effects especially in this time of rapidly changing reproductive techniques.[64]

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53. Historically, this presumption, *pater est quem nuptiae demonstrat*, could be conquered only by strong proof of the husband's absence or impotency. In England the rule was that any children born to a man's wife were irrebuttably presumed to be his issue, if the husband was anywhere within the "four seas." Note, *supra* note 42, at 669. *See*, 2 F. POLLOCK & F. MAITLAND, THE HISTORY OF ENGLISH LAW 398-99 (2d ed. 1903), *cited in* Note, *supra* note 42, at 699.

54. Test results showed a 98.89% probability that R. McG. was the child's father. 615 P.2d at 668.

55. 615 P.2d at 671.

56. COLO. REV. STAT. §§ 19-6-105 to -107 (1978).

57. 615 P.2d at 670.

58. *Id.* at 671.

59. *Id.*

60. *Id.* at 670. "Equality of rights under the law shall not be denied or abridged by the state of Colorado or any of its political subdivisions on account of sex." COLO. CONST. art. II, § 29.

61. COLO. REV. STAT. § 19-6-105(2) (1978).

62. 615 P.2d at 671.

63. The *Stanley* Court said that procedure by presumption was permissible, but "when . . . [that] procedure forecloses the determinative issues . . . [and] explicitly disdains present realities in deference to past formalities, it needlessly risks running roughshod over the important interests of both parents and child." 405 U.S. at 657.

64. *See* Note, *supra* note 42, at 705-66. *See also* Wadlington, *Artificial Insemination: The Dan-*

II. *IN RE S.P.B.*

Judicially mandated, *In re S.P.B.* leaves no doubt that the constitutional principles articulated ten years ago by the United States Supreme Court in a series of highly controversial decisions[65] are still arousing debate in Colorado. Through its affirmation of the district court opinion, the Colorado Supreme Court gave no credence to either the equal protection or due process arguments advanced by the unwed father.

The court held that the father, P.D.G., could not escape his obligation to provide child support. This decision was perhaps made inevitable in light of the constitutional mandate set forth a decade ago in *Gomez*,[66] which required equal support for illegitimate and legitimate children.

Although controversy over the continuing enforcement of child support duties against unwed fathers[67] undoubtedly will continue, in this era in which the courts have, in essence, said that women have a choice not to be burdened with unwanted children but that men have no choice;[68] the court's finding of a paternal support obligation in *S.P.B.* is not surprising. Moreover, this decision furthers the state's objective of protecting the best interests of the child.

A. *The Father's Position*

Although the father admitted paternity, he advanced several arguments in denial of a child support obligation. He argued that the UPA, through its statutory imposition of the duty of child support upon both parents without granting the father the right to decide whether to terminate the pregnancy, violates the father's right to equal protection of the laws under both the United States Constitution[69] and the state constitution.[70]

The father also claimed that the UPA creates an irrebuttable presumption that a father must share in child support. According to the father, this presumption is no longer valid because the availability of legal abortions breaks the required nexus between intercourse and birth. He contended that he should at least be given an opportunity to demonstrate that this nexus had been broken.[71]

The father reasoned that the wide-spread availability of legalized abortions, together with the mother's unilateral decision to have the child against his wishes, served as an "intervening factor" breaking the nexus between the

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ger of a Poorly Kept Secret, 64 NW. U.L. REV. 777 (1970) (discussing the current judicial dilemma concerning artificial insemination).

65. *See supra* notes 4-5.

66. 409 U.S. 535 (1973).

67. *See* Comment, *Child Support: Implications of Abortion on the Relative Parental Duties*, 28 U. FLA. L. REV. 988 (1976).

68. Swan, *Paternal Child-Support Tort Parallels for the Abortion on Maternal Demand Era: The Work of Regan, Levy, and Duncan*, 3 GLENDALE L. REV. 249, 250 (1978-79).

69. *See supra* note 20.

70. "No person shall be deprived of life, liberty or property, without due process of law." COLO. CONST. art. II, § 25. This clause has been interpreted to include equal protection of laws. *See* Vanderhoof v. People, 152 Colo. 147, 380 P.2d 903 (1963).

71. Brief for Respondent-Appellant, *supra* note 1, at 1.

act of intercourse and the birth.[72] Specifically, the father advanced his belief that the sex-based distinction found in the UPA was unconstitutional under the Supreme Court's intermediate scrutiny test.[73]

In addition, the father argued that *Roe*, in making alternatives to birth available, removed the inevitability of an implied contract between the parties in which they agree that the father will meet his support obligation if conception occurs.[74] At most, the father contended, the parties impliedly contract to share the expense of the immediate consequences of their act—the expense of the pregnancy or the abortion. The father noted that if a court were to find that the parties did enter into an implied contract to support the child, this would result in paternal rights to the fetus, a right the Supreme Court has emphatically denied.[75]

The father also contended that *Roe* destroys any tort basis for imposing support liability on the biological father.[76] Under the tort theory, the "negligence" of the father arises in the performance of an act that potentially requires parental liability. This liability is not imposed, however, unless the act is the proximate cause of the injury. The mother's unilateral decision to bear a child or to abort acts as an intervening force and removes the act of intercourse as the proximate cause of birth.[77]

Additionally, the father proposed that the mother indemnify him for his child support expenses since she had the last clear chance to avoid birth, and her inaction was more responsible for the damages (birth) than his action. The father maintained that every plaintiff in Colorado has a duty to mitigate the damages sustained. The mother failed in this duty, and as a result the father's liability should be limited to the cost of an abortion or childbirth and should not extend to the aggravated damage of child support.[78]

Finally, the father argued that traditional concepts of American law require that obligations imposed upon an individual be offset by the enjoyment of corresponding rights. According to the father, these rights were foreclosed and the fair consequence would be placing the burden of financial responsibility on the mother for her unilateral decision.[79] The father likened his role to that of an artificial insemination donor. Under Colorado law, these fathers are non-liable, even though they are aware that their donation will possibly result in child support needs.[80]

B. *The State's Position*

The state reasoned that the father's duty to the child is no greater than the obligation imposed on the mother, and that such a duty is mandated on

72. *Id.* at 3.
73. *See supra* note 42.
74. Brief for Respondent-Appellant, *supra* note 1, at 4-5.
75. *Id.* at 5-6. Planned Parenthood v. Danforth, 428 U.S. 52, 69 (1976).
76. Brief for Respondent-Appellant, *supra* note 1, at 6-7.
77. *Id.* at 6.
78. *Id.* at 6-8.
79. *Id.* at 10.
80. *Id.* at 9. COLO. REV. STAT. § 19-6-106 (1978).

equal protection grounds by *Gomez*.[81] The state claimed that the best interests of the child are served by the statutory provisions of the UPA,[82] which presume a shared parental support obligation; moreover, it was asserted that the child's equal protection rights would be violated unless the father's duty to support was affirmed. The state strengthened this argument by comparing the total innocence of the child with the father's relative lack of innocence.[83]

The state reiterated the United States Supreme Court's position that the right to privacy requires freedom from governmental intrusion into areas as intimate as the decision to bear or abort a child.[84] Noting that it was the father's conscious decision to engage in sexual intercourse with the possible consequence of conception, the state asserted that the father's desire to preclude this natural result could not be forced upon the mother or enforced by the state as this would constitute impermissible governmental intrusion.[85]

The state also observed that other jurisdictions have ruled against unwed fathers making similar arguments.[86] With facts precisely on point to *S.P.B.*, the Alabama Supreme Court in *Harris v. State*,[87] rejected the father's offer to pay for an abortion as a legitimate escape from his child support obligation. The Alabama justices rejected the father's argument that because he was denied any decision as to the birth of the child, he should be released from any child maintenance obligation. Furthermore, the court held that the state's paternity statutes did not deny the father equal protection of the laws.[88]

The Maryland Court of Appeals in *Dorsey v. English*[89] found no merit to a father's theory that the nexus between intercourse and birth is broken by the woman's right to abortion. The court discounted the father's claim that his role in the birth of the child had become so attenuated that his circumstance was dissimilar from the mother, and that the Maryland statute treated him unequally.[90]

C. *The Colorado Supreme Court's Holding*

The court's holding was significantly influenced by Colorado's interest in promoting the welfare of its children.[91] The court validated the statutory presumption requiring parents who have participated in an act resulting in conception to be jointly responsible for their actions and this presumption

81. Brief for Petitioner-Appellee at 6, *In re* S.P.B. 651 P.2d 1213 (Colo. 1982) [hereinafter cited as Brief for Petitioner-Appellee]; Gomez v. Perez, 409 U.S. at 538.

82. COLO. REV. STAT. § 19-6-102 (1978).

83. Brief for Petitioner-Appellee, *supra* note 81, at 7.

84. *See* Roe v. Wade, 410 U.S. 113, 153 (1973).

85. Brief for Petitioner-Appellee, *supra* note 81, at 8-9.

86. *Id.* at 9.

87. 356 So. 2d 623 (Ala. 1978).

88. *Id.* at 624.

89. 283 Md. 522, 390 A.2d 1133 (1978).

90. A case with similar facts in the Texas Civil Appeals Court arrived at the same conclusion. D.W.L. v. M.J.B.C., 601 S.W.2d 475 (Tex. Civ. App. 1980).

91. 651 P.2d at 1217.

was found to reflect the "well-considered judgment" of the legislature.[92] The court emphasized, however, that the state has little room for error on its constitutional catwalk toward protecting the best interests of the child, due to the proscription from interference with the woman's "fundamental right" to make decisions regarding her pregnancy.[93]

Although the justices recognized the existence of a sex-based classification they, nonetheless, upheld the statute by finding that the father's right to be free from these classifications is outweighed by the state's substantial, competing interest. Additionally, the court, applying heightened judicial scrutiny, found that an important governmental objective is served by the classification and that it is substantially related to the achievement of that objective.[94]

Recognizing the disfavor with which irrebuttable presumptions have been viewed in light of the due process clause,[95] the court applied the *Vlandis v. Kline* two-pronged test.[96] The *S.P.B.* court found the father incapable of meeting the second prong of the test, which requires a challenger to demonstrate that the state has reasonable alternative means of making its determination without applying an irrebuttable presumption. Therefore, the court never reached the first prong of the test,[97] which provides that a statutory presumption can be invalidated only when it is not necessarily or universally true.

The father's request for a case-by-case determination[98] of the existence of the nexus was swiftly rejected on the basis of three critical interests served by the presumption. The court found that the presumption of a shared parental support obligation protects the interests of the child, the interests of the state in preventing children from becoming its wards, and the parents' privacy interests.[99]

III. ANALYSIS

Almost one-third of the births in this country are the result of non-legalized relationships.[100] The rights of these children have evolved over centuries to a current judicial policy,[101] which requires that such children receive care, maintenance, and education equivalent to children born of a legalized

92. *Id.*

93. *Id.* at 1216. *See* Eisenstadt v. Baird, 405 U.S. 438, 453 (1972) (decision whether to bear a child is fundamental); Cleveland Bd. of Educ. v. LaFleur, 414 U.S. 632 (1974).

94. 651 P.2d at 1215.

95. The Supreme Court emasculated irrebuttable presumptions in a series of decisions stretching from the early 1940's to the late 1960's. *See, e.g.*, Shapiro v. Thompson, 394 U.S. 618, 631 (1969) (presumption that new residents exploited welfare system condemned); Carrington v. Rash, 380 U.S. 89, 96 (1965) (presumption denying voting by military struck down); Skinner v. Oklahoma, 316 U.S. 535 (1942) (injustice of automatic sterilization). *See also* L. TRIBE, AMERICAN CONSTITUTIONAL LAW 1092-93 (1978).

96. 412 U.S. 441, 452 (1973).

97. 651 P.2d at 1217.

98. Vlandis v. Kline, 412 U.S. 441, 452 (1973).

99. 651 P.2d at 1217.

100. FATHERS, HUSBANDS AND LOVERS 95 (S. Katz & M. Inker eds. 1979).

101. *See supra* text accompanying notes 11-20.

relationship.[102]

In an effort to prevent the state from suffering economically for the so-called "sins of the fathers," several states have enacted parental support statutes.[103] Although such statutes are fair in some respects, they are contrary to basic American judicial traditions in their imposition of obligations without the granting of concurring rights.[104] This analysis will discuss the unwed father's support obligation, the underlying social policies, and the court's procedure in implementing this obligation.

A. *The Question of the Nexus*

Although paternal support statutes have been in effect for many years, few scholars questioned their constitutionality until *Roe*. Under *Roe*, the decision whether to abort rests solely with the mother and her physician,[105] allowing the mother to make a unilateral decision completely unaffected by the desires or direction of the father. The mother's unilateral decision-making capability raises questions concerning the proximate cause of birth. Is conception still the cause, as was the accepted view when abortions were illegal and unavailable, or does the woman's decision regarding the pregnancy intervene as the cause of birth and place responsibility for the support of the child solely upon her?

If the mother's decision is considered the proximate cause of birth, then the father's rights under the equal protection clause are violated when he is forced to support the child, because the mother's action breaks the required nexus between intercourse and birth. One scholar, examining this nexus, strongly argued that it is broken under the rationale in *Roe* and that all paternal support statutes are invalid, because their underlying premise has been removed.[106] This argument is supported by reference to such cases as *Doe v. Doe*[107] and *Jones v. Smith*.[108]

Indeed, it seems illogical that the same act that cannot commit the female partner to motherhood can commit the male partner to fatherhood and twenty-one years of child support. Because the Supreme Court has declared that a woman's right to privacy guarantees that she should not be burdened with unwanted children,[109] proponents of the broken nexus theory believe it

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102. *See generally* H. KRAUSE, CHILD SUPPORT IN AMERICA (1981).

103. Nine states including Colorado have adopted legislation conforming to the Uniform Parentage Act. CAL. CIV. CODE §§ 7000-7021 (West Supp. 1983); COLO. REV. STAT. §§ 19-6-101 to -129 (1978 & Supp. 1982); HAWAII REV. STAT. §§ 584-1 to -26 (1976 Supp. 1982); MINN. STAT. ANN. §§ 257.51 to -.74 (West Supp. 1982); MONT. CODE ANN. §§ 40-6-101 to -135 (1981); NEV. REV. STAT. §§ 126.011- to -.391 (1981); N.D. CENT. CODE §§ 14-17-01 to -26 (1981); WASH. REV. CODE ANN. §§ 26.26.010 to .905 (Supp. 1980); WYO. STAT. §§ 14-2-101 to -120 (1977).

104. The unwed natural father is only now gaining rights with respect to his child. *See supra* text accompanying notes 37-41.

105. 410 U.S. at 163.

106. *See supra* note 7.

107. 365 Mass. 556, 314 N.E.2d 128 (1974) (a husband has no constitutional or statutory right to determine whether or not his child should be aborted).

108. 278 So. 2d 339 (Fla. App. 1973), *cert. denied*, 415 U.S. 958 (1974) (a potential putative father does not have the right to restrain the natural mother from terminating her pregnancy).

109. Roe v. Wade, 410 U.S. 113, 153 (1973).

is inequitable for the father to be so burdened.[110]

Directly countering this argument is the view currently expressed by the majority of commentators, who suggest that the nexus is not broken under the *Roe* rationale.[111] Under this theory, the mother's decision to bear the child, even in light of the abortion option, is insufficient to shift the burden of support solely to her. The foundation for this theory is based on the argument that the father, as a person of ordinary intelligence and prudence, can foresee conception and the subsequent birth of the child as a possible consequence of intercourse. Two commentators, Levy and Duncan,[112] disagree that the proximate cause of birth should be imputed to the mother alone, because such a theory is based on the untenable implication that the mother's unilateral decision not to abort could have caused the birth independently of the original act of intercourse.

Moreover, if the mother has a duty to avoid the natural consequences of intercourse, an implied contract to abort would result. This type of contract, as well as any other contract for sexual relations, is in violation of public policy,[113] and damages for its breach will not be imposed.[114] Consequently, the father's act of intercourse places him in the position of one jointly responsible for the pregnancy. A chain of causation is created between his actions and the birth; the mother's unilateral action or inaction serves as a weak link, though insufficiently weak to break the causal chain.

With the causal connection even feebly intact, any challenge to the validity of paternal support statutes using the broken nexus approach will fail. Several theories remain, however, to challenge the support obligation imposed on the unwed father.

B. *An Obligation Without Rights?*

One theory, an equal protection argument distinct from the broken nexus rationale, was advanced in *S.P.B.* and dismissed by the Colorado court. The father argued that his right to equal protection was violated by the statutory imposition of a child support obligation on both parents,[115] without giving him a role in the decision of whether to terminate the pregnancy.[116] Under the so called "abortion cases,"[117] however, equal protection arguments are subservient to the fundamental privacy rights recognized as an implicit liberty guarantee in the fourteenth amendment.[118] The court

110. *See, e.g.*, *supra* note 7.

111. Levy & Duncan, *The Impact of* Roe v. Wade *on Paternal Support Statutes: A Constitutional Analysis*, 10 FAM. L.Q. 179, 193 (1976).

112. *Id.*

113. Early Colorado law suggests that a contract for sexual relations is void. *See* Baker v. Couch, 74 Colo. 380, 221 P. 1089 (1923).

114. *Cf.* J. SONENBLICK, LEGALITY OF LOVE 154 (1981) (no damages will be imposed for breach of an agreement not to bear children).

115. 651 P.2d at 1215.

116. *Id.* at 1214.

117. *See supra* notes 4 and 5.

118. *See, e.g.*, Carey v. Population Serv. Int'l, 431 U.S. 678 (1977) (invalidating a law which prohibited distribution of nonprescription contraceptives to adults except by licensed pharmacists and to persons under sixteen who do not have the approval of a licensed physician); Eisenstadt v. Baird, 405 U.S. 438 (1972) (decision to bear children is a privacy right belonging to a

in *S.P.B.*, therefore, properly dismissed this argument.

The statutory imposition of the duty of child support upon both parents will inevitably pass the intermediate standard of review employed by the Supreme Court in cases of gender classifications.[119] The classification present in the parental support statutes serves the important governmental objectives of ensuring the woman's right to privacy and the best interest of the child, and is substantially related to achievement of those objectives.

The statute also passes the standard of review mandated at the state level, since the Colorado Equal Rights Amendment[120] exempts from scrutiny a narrow class of cases in which the classification of the sexes is based on physiological differences.[121] Undoubtedly, this exemption includes the capability of women to carry and bear children.[122] Even the most skeptical critics of the imposition of child support obligations on the unwed father have been forced to agree that the sexes are not similarly situated with respect to childbirth. Consequently, the inevitable conclusion surfaces: absolute equal treatment is not mandated by the constitution. The only requirement is that the classification meet the intermediate scrutiny standard.

C. *The Irrebuttable Presumption*

The court, zealous in pursuing its goal to protect the best interests of the child, also found the father's procedural due process argument to be without merit.[123] The *S.P.B.* court held that the father's suggestion of a case-by-case determination of the existence of a child support obligation, rather than utilization of the irrebuttable presumption, failed to meet the second prong of the *Vlandis* test,[124] because such an *ad hoc* determination is an unreasonable alternative for the state.[125]

The court reasoned that a case-by-case determination would constitute "unconscionable governmental interference with privacy rights which the Supreme Court has deemed inviolate."[126] This privacy argument is inadequate for several reasons.

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single person as well as a married person); Griswold v. Connecticut, 381 U.S. 479 (1965) (invalidating a law which made it a crime to use contraceptives).

119. *See supra* notes 45-47 and accompanying text.

120. COLO. CONST. art. II, § 29.

121. G. DOUTHWAITE, UNMARRIED COUPLES AND THE LAW 302 (1979).

122. People v. Green, 183 Colo. 25, 514 P.2d 769 (1973). As a consequence of such exemption, a Colorado rape statute, COLO. REV. STAT. § 40-3-401 (1963), punishing only male offenders was found constitutional in *People v. Salinas*, 191 Colo. 171, 551 P.2d 703 (1976). The *Salinas* court stated that the Equal Rights Amendment "does not prohibit differential treatment among the sexes when, as here, that treatment is reasonably and genuinely based on physical characteristics unique to just one sex. . . . In such a case, the sexes are not similarly situated and thus, equal treatment is not required." *Id.* at 174, 551 P.2d at 706. Note, however, that COLO. REV. STAT. § 18-3-401 (1973) now punishes both male and female offenders.

123. 651 P.2d at 1214.

124. Under *Vlandis* an irrebuttable statutory presumption can be invalidated only when a two-pronged test is met: when the presumption is not necessarily or universally true, and when the state has reasonable alternative means of making the crucial determination. 412 U.S. at 452.

125. 651 P.2d at 1217.

126. *Id.*

In most previous cases involving the penumbra-based constitutional right to privacy, a statute was found invalid when individuals challenged that statute because they believed it violated their privacy.[127] In these cases the challenged statutes were found invalid because they created unwarranted intrusions into intimate and private spheres. Although the father in *S.P.B.* was willing to waive his right to privacy, the court would not allow the mother's right to privacy, inseparable from the father's under these circumstances, to be violated. The result is an interesting and questionable twist in judicial interpretation of who can assert a privacy interest and when it can be asserted.

The court cloaked itself with a privacy rationale and did not articulate the true reasons behind the denial of the case-by-case method: public policy considerations and administrative convenience.[128] Apparently uncomfortable with basing their decision explicitly upon these reasons, the court resorted to a "parade of horribles" argument which climaxed when the court said it should not be burdened with a judicial inquiry into "any of a multitude of legal theories which ingenious litigants and their lawyers might advance."[129] The court stated that such an inquiry would represent an unconscionable governmental interference with privacy rights.[130] Although it may legitimately be argued that such a procedure would be a difficult task, case-by-case determination is a traditional role of the courts and administrative convenience alone is not a valid reason to uphold an irrebuttable presumption.[131]

The irony behind the court's use of privacy to prevent rebuttal of the presumption becomes clear when one realizes that one year earlier, in *R. McG. v. J. W.*,[132] the Colorado Supreme Court explicitly rejected a very powerful privacy argument advanced by a woman and her husband. Indeed, *R. McG.* paves the way for a serious intrusion into the private, intimate sphere of marriage.

The court in *R. McG.* allowed an alleged biological father to rebut a long standing legal presumption.[133] The unwed father in *S.P.B.*, however, was not allowed to rebut the presumption of the father's duty to share in child support. Such a difference is difficult to reconcile. Undoubtedly, the court noted that *R. McG.* dealt with the denial of the parent-child relationship, while in *S.P.B.* only a monetary property interest was at issue.[134]

Putting all other theories aside, the unwed father should prevail in his

127. *See supra* note 118.

128. Dorsey v. English, 283 Md. 522, 526, 390 A.2d 1133, 1138 (1978). The court in *Dorsey* listed the simplification of procedures as one reason for upholding a similar statute.

129. 651 P.2d at 1217.

130. *Id.*

131. The *Stanley* Court said that although "efficacious procedures to achieve legitimate state ends [are] a proper state interest . . . the Constitution recognizes higher values than speed and efficiency. . . . Procedure by presumption is always cheaper and easier than individualized determination." 405 U.S. at 656-57.

132. 615 P.2d 666. The mother and her husband argued that their constitutional right to privacy was violated by the court's grant of standing to the putative father, R. McG. *Id.* at 672.

133. *See supra* note 53.

134. *See* Swan, *supra* note 7, at 257.

effort to submit evidence to rebut the presumption simply because such a presumption is contrary to due process, which requires an opportunity to be heard in protection of a property interest.[135] In order to determine whether or not the unwed father should be provided an opportunity to rebut the presumption of the shared parental obligation of child support, due process demands that the competing private and state interests be weighed.[136] In *S.P.B.* the unwed father's property interest, the cost of twenty-one years of child support plus half the expense of birth, should be weighed against the state's legitimate interests, which are the best interests of the child and the state's economic interest in preventing the child from becoming its ward.[137]

As noted by Justice Marshall: "Where the private interests affected are very important, and the governmental interest can be promoted without much difficulty by a well-designed hearing procedure," the Constitution "requires the government to act on an individualized basis, with general propositions serving only as rebuttable presumptions or other burden-shifting devices."[138] Because the father has a constitutionally cognizable property interest, such a weighing process leads to the logical conclusion that he be given an opportunity to be heard.

Although it may be argued that unwed fathers will seldom be successful in rebutting the presumption of their child support duties and that Colorado need not undergo the administrative inconvenience of such inquiry, the due process clause was designed to protect such fragile individual rights from the often overbearing governmental concern for efficiency.[139] In light of these due process considerations, unwed fathers should be allowed to submit evidence to rebut the presumption of responsibility for child support.

IV. CONCLUSION

The Colorado Supreme Court's decision in *S.P.B.* reaffirms the slow and sometimes painful evolution of the legal status of illegitimate children from second-class citizens to equal participants in society. The decision recognizes the unwed mother's constitutional right to privacy, and right to unilaterally choose to abort or bear a child while not foregoing the possibility of child support from the father. The court in *S.P.B.* affirms the interest of the state minimizing its welfare roles while ensuring adequate support of its children. The decision, however, fails to recognize the unwed father's constitutional right to procedural due process by upholding an irrebuttable presumption of mutual, parental child support obligations.

135. Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123 (1951) (due process consists of those procedural safeguards designed to accord to the individual the right to be heard before being condemned to suffer grievous loss of any kind).

136. Board of Regents v. Roth, 408 U.S. 564, 570 (1972).

137. *See* Mathews v. Eldridge, 424 U.S. 319, 335 (1976) (discussing constitutional adequacy of state's procedures). In *S.P.B.*, the risk of erroneous deprivation of the father's interest was high while the value of a hearing, as an additional procedural safeguard, was not unduly burdensome.

138. United States Dep't of Agriculture v. Murry, 413 U.S. 508, 518 (1973) (Marshall, J., concurring).

139. Stanley v. Illinois, 405 U.S. at 656.

While the court's dismissal of the father's equal protection claim is justified, dismissal of his due process argument is flawed. Through this denial of due process, the court strikes a needlessly dangerous balance between competing state and private interests. This problem could have been avoided effectively by permitting the father to rebut the presumption of his child support obligation and by requiring the court to reach the merits of his case. Procedure by presumption is seldom justified,[140] and it is not justified here. Although case-by-case determination may present complications for the court, such complications are surmountable.[141]

S.P.B. not only represents the end of the trend in Colorado toward broadening the rights of an unwed father, it represents a judicial step backward in the area of an unwed father's rights to procedural due process.

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140. L. TRIBE, AMERICAN CONSTITUTIONAL LAW 1092 (1978).

141. The Supreme Court has found that interests similar to the one at stake in *S.P.B.* were important enough to trigger the admission of rebuttal evidence. Cleveland School Bd. v. LaFleur, 414 U.S. 632 (1974) (fitness of pregnant teachers); United States Dep't of Agriculture v. Murry, 413 U.S. 508 (1973) (food stamps); Vlandis v. Kline, 412 U.S. 441 (1973) (reduced college tuition); Stanley v. Illinois, 405 U.S. 645 (1972) (unwed father's competency to raise his children); Bell v. Burson, 402 U.S. 535 (1971) (suspension of a driver's license).