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FEDERAL REMEDIES FOR RACIAL DISCRIMINATION BY LABOR UNIONS

LEO WEISS*

Calling attention to the discriminatory practices carried on by some unions, the author views the problem from two vantage points: the litigation directed against these unions and the services and benefits conferred upon them under the Railway Labor Act and the National Labor Relations Act. Mr. Weiss finds that although judicial remedies are available to injured employees, federal administrative agencies, particularly the National Labor Relations Board, indirectly "assist" in perpetrating discrimination and thus engage in governmental action forbidden by the fifth amendment when they enforce and protect the exclusive bargaining position of an offending union. The author suggests procedures for the Board which would encourage abandonment of these practices and at the same time protect it from constitutional condemnation.

INTRODUCTION

Labor unions have come a long way in the United States since a Philadelphia judge said: "A combination of workmen to raise their wages may be considered in a two-fold point of view: one is to benefit themselves . . . the other is to injure those who do not join their society. The rule of law condemns both."1 Despite criticism of the activities of some unions, their status as organizations functioning within the law is no longer seriously doubted. In fact, statutes and court decisions have extolled them as useful members of modern society and have provided them with a network of protective devices. As they have

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The views expressed in this article are those of the author and do not necessarily reflect the position of the National Labor Relations Board or any of its members.

grown in membership, wealth, prestige and power, their ability to furnish a wholesome influence on the community has increased. But so also has their ability to do harm. One of the more pernicious practices engaged in by some labor organizations is that of discriminating against workmen because of their race.

Racial discrimination by a union may take many forms. Some unions simply refuse membership to Negroes, while others herd them into segregated locals; some organizations will not allow them either to be hired, advanced to the more desirable jobs, or given the same terms and conditions of employment given to whites, while others will not process their grievances or admit them to apprentice training programs. The consequences are serious, not only to the employees subjected to such disgraceful conduct, but to the community which suffers the ill effects that necessarily result from a lower standard of living for one segment of society. Although the gravity of the problem has been recognized by the federal government, which expends considerable effort in trying to overcome these discriminatory practices, paradoxically, the Government is providing these unions with the same services and benefits it provides to all unions, thereby helping to perpetuate the conditions it seeks to destroy. The guilty unions are being certified as exclusive bargaining agents, protected from attack by other unions or groups of dissident employees, and are having their unfair labor practice complaints treated as though they were advancing the public interest. All this is being done by federal administrative agencies and courts under the National Labor Relations Act and the Railway Labor Act.

This article will consider the possibility that labor unions practicing racial discrimination are not entitled to the federal protection given to other unions under the statutes, and that by continuing to give these unions such protection, the Government violates the due process clause of the fifth amendment. In order to place such a suggestion in proper perspective, however, it will be necessary first to examine judicial reaction to suits against offending unions by the employees injured through these discriminatory practices.

2 Through the President's Committee on Equal Employment Opportunity, the Government is trying to eliminate racial discrimination by employers doing business with the United States and the unions representing their employees. N.Y. Times, July 14, 1961, p. 10, col. 1 (city ed.); N.Y. Times, July 13, 1961, p. 14, col. 1 (city ed.).


I
Judicial View of Union Discrimination

All discussions of this problem must start with the case of Steele v. Louisville & N.R.R.,5 decided in 1944, when the United States Supreme Court held for the first time that there existed governmental protection for racial minorities against discrimination by labor unions. Although the scope of the evil involved in the Steele case was limited, later cases have extended the rule far beyond its original context. They show that the picture is still being painted, its final colors having not yet been placed on the canvas.

In Steele, the Brotherhood of Locomotive Firemen, acting as exclusive bargaining agent under the Railway Labor Act, not only refused to admit Negroes to membership, although they constituted a large proportion of the workers in the craft, but also sought to persuade the railroad to replace these workers with white employees who would be eligible for union membership. Speaking through Chief Justice Stone, the Court ruled that both injunctive relief and damages were available to the Negro firemen for the union’s breach of duty toward them. The Court held that while the Railway Labor Act gave to the union enormous power to make contracts which would bind the employees, it could not and did not authorize the union to run roughshod over the interests of some members of the craft for the benefit of others. If the statute were to give the union such blanket power, it would raise serious questions under the due process clause of the fifth amendment.

But the Court found it unnecessary to pursue the ramifications of this idea because of the way it interpreted the statute:

We think that the Railway Labor Act imposes upon the statutory representative of a craft at least as exacting a duty to protect equally the interests of the members of the craft as the Constitution imposes upon a legislature to give equal protection to the interests of those for whom it legislates. . . . We hold that the language of the Act expresses the aim of Congress to impose on the bargaining representative of a craft or class of employees the duty to exercise fairly the power conferred upon it in behalf of all those for whom it acts, without hostile discrimination against them.6

This concept, that the exclusive bargaining representative under a federal statute owes its constituency the duty of “equal protection,” is the

6 323 U.S. at 202.
keynote of the Steele case and the vehicle by which it has been extended beyond the factual circumstances there involved.

The Chief Justice did take care to point out that it was not interfering with the union's authority to negotiate a contract which treated individual employees of the craft differently, provided those differences were based on relevant considerations such as seniority, skill and type of work performed. But, he said, "discriminations based on race alone are obviously irrelevant and invidious" and could not, therefore, justify variations in treatment.

While no Justice dissented from the result in this case, Mr. Justice Murphy wrote a strongly-worded concurring opinion in which he argued that the case should have been decided on the basis of constitutional rights, rather than statutory interpretation. He concentrated his fire on the presence of racial discrimination, an element of the case almost ignored by Chief Justice Stone, and felt that the Court did not go far enough in merely holding that the Railway Labor Act should not be interpreted as allowing the majority of the craft to deprive the minority of its collective bargaining rights. He viewed "the utter disregard for the dignity and well-being of colored citizens" as a situation demanding "the invocation of constitutional condemnation" and formulated that condemnation by stating that economic discrimination against any race, creed or color should be met with constitutional disapproval whenever it is "applied under authority of law." Thus we see, for the first time, a Justice of the United States Supreme Court declaring that a labor union which owes its status as exclusive bargaining agent to a federal statute violates the Constitution when it discriminates against a minority racial group it is supposed to represent.

Justice Murphy's view of the matter commended itself to the Supreme Court of Kansas when, two years later, it was faced with a similar problem. One of the railroad brotherhoods was the exclusive bargaining agent for a certain craft of employees, including Negro workers who were not eligible to become members of the union. Instead, they were herded into segregated locals where they could neither fix their own dues nor elect delegates to any of the union conventions. Furthermore, they had no voice in selecting the individuals who would negotiate with the railroad and did not participate in formulating collective bargaining.

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7 Id. at 203.
8 Id. at 208.
9 Id. at 208-09.
policy. These matters were handled by the delegates of the nearest white local. The Kansas Supreme Court found this conduct to be a violation of the fifth amendment, rejecting the contention that the union was a "private person" not subject to the provision of the due process clause. It concluded that the brotherhood was "an organization acting as an agency created and functioning under provisions of federal law,"11 and having accepted the protection and privileges which flow to it from the Railway Labor Act, it could not then argue that its policies were not subject to constitutional evaluation by the courts.

Then in 1949 the United States Supreme Court rejected the argument advanced in Graham v. Brotherhood of Locomotive Firemen12 that the Norris-LaGuardia Act13 prevented the federal courts from enjoining racial discrimination by a labor union. A railroad union, as exclusive bargaining agent of both white and Negro employees, negotiated an agreement with a carrier to set up two classifications of workers, one called "promotable," the other "not-promotable." Needless to say, all "not-promotable" employees were Negroes, and as this system was operated all Negroes would soon have been eliminated from employment. The Court was quite positive about one thing. Because the union derived its authority as exclusive bargaining representative from a federal statute, which deprived minority employees of the weapons they would ordinarily use to defend themselves, the beneficiary of that federal grant of power could not abuse its position. Racial minorities in the craft who were subject to discriminatory practices could sue under federal law, and since the Norris-LaGuardia Act was aimed at an entirely different kind of labor problem, the federal courts retained their injunctive powers to protect minorities.

It is interesting to note that while Mr. Justice Jackson spoke of a federal cause of action in this connection, nowhere in his opinion did he indicate the applicable section of the U.S. Code. It should be remembered that Chief Justice Stone in his Steele opinion said that the Railway Labor Act prohibits a union from discriminating unfairly against any of the employees it represents but failed to indicate the prohibiting provision. Actually, of course, no specific provisions can be found in the statutes. Instead, we find among certain judges an underlying feeling that there must be a requirement of fair representa-

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11 Id. at 467, 169 P.2d at 838.
tion and that there must be a cause of action to overcome its violation, regardless of what the statutes say or fail to say. Any other interpretation would mean that Congress had given unlimited power to the union without providing any check for the abuse of that power, and that Congress had authorized the union to mistreat the employees it represents, even helping it to do so by taking from the employees their right to fight back. If the statute specifically authorized the union to discriminate against racial minorities, it would clearly be unconstitutional. Surely Congress could not accomplish the same result by giving the union a free hand.

The willingness of the Justices to extend the Steele doctrine was made clear in Brotherhood of R.R. Trainmen v. Howard, which came before the Court three years after Graham. The Supreme Court reached the same result despite the fact that the Negro employees discriminated against were neither members of the discriminating union, employed in the same craft, nor represented by the defendant union in collective bargaining. The railroad involved in this case had two groups of employees, one white and one Negro, both doing identical work. The whites were called "trainmen" and the Negroes "train porters," with each group having its own union. The problem arose when, after resisting for some twenty years the efforts of the white union to eliminate Negroes from employment, the carrier finally succumbed to a new contract which switched the work from the "train porters" to the "trainmen." It notified the Negro employees that their work had been reassigned and that their services were no longer required.

Mr. Justice Black, speaking for the majority, recognized the factual distinction between Howard and the earlier cases, where the offending unions had been the exclusive bargaining agent for the employees against whom they had discriminated, but he called this an "unsound" basis upon which to decide them differently. Instead, he broadened the union's responsibility by saying that "bargaining agents who enjoy the advantages of the Railway Labor Act's provisions must execute their trust without lawless invasions of the rights of other workers." Once again the Court seemed to be going outside the actual terminology of the statute, calling upon a sense of fairness as an additional requirement engrafted upon the explicit provisions of the law.

Not all members of the Court, however, felt that this was the proper

14 343 U.S. 768 (1952).
15 Id. at 774.
approach. Chief Justice Vinson and Justices Minton and Reed joined in a dissent which accepted the result of the Steele case—that a union which is the exclusive bargaining agent for a group of workers under a federal statute has a duty to represent fairly all the employees in the group—but denied that the union owed the same obligation to workers it did not represent. Instead, the dissenters looked upon the union’s dealings with such workers as those of a private association, not subject to a requirement to refrain from racial discrimination.

From the viewpoint of statutory interpretation, the dissenting opinion would seem to be fully justified. By contrast, Mr. Justice Black’s opinion surprisingly states: “The Federal Act thus prohibits bargaining agents it authorizes from using their position and power to destroy colored workers’ jobs in order to bestow them on white workers. And courts can protect those threatened by such an unlawful use of power granted by a federal act.” The statement is surprising not because of the result it seeks to support, but because no express provision in the act buttresses this view. Mr. Justice Black meant either that he could not conceive of Congress passing a statute which did not provide such protection, or that this type of protection against racial hostility must be deemed to underlie all federal legislation.

Not long after the Howard case, the Third Circuit decided Williams v. Yellow Cab Co., which indicated that that circuit did not subscribe to Mr. Justice Black’s theory. Negro cab drivers sought an injunction and damages against their employer and the Teamsters Union for entering into a discriminatory contract whereby they were to be restricted to certain parts of the City of Pittsburgh and in general given undesirable assignments. The Negro drivers were not only in the bargaining unit, they were actually dues-paying members of the Teamsters Union.

The opinion cited the Steele case for the proposition that a union acting under a federal statute has the duty of fairly representing the employees in the unit. After doing so, however, the court denied that the union was acting under a federal law, even though it was functioning under a National Labor Relations Board certification, because the Negroes had voluntarily joined the union, not under compulsion of the act. The court pointed out that the union’s authority to act as bargaining agent predated the federal statutes and was dependent on voluntary membership. These factors led the court to hold that no federal statute

16 Id. at 775.
17 Id. at 774.
18 200 F.2d 302 (3d Cir. 1952).
was involved and consequently no controversy cognizable in a federal court. Because of the lack of diversity of citizenship, the court was unable to find any basis for federal jurisdiction and dismissed the suit.

Evidently, the court was here looking only at the union-shop provisions of the federal statutes.\textsuperscript{19} It seemed to be saying that the only obligation of fairness imposed upon a union arises from the requirement of union membership exercised upon an unwilling employee by virtue of a union-shop contract authorized by federal law. However, the presence of such a duty may be accounted for by the protection which the federal government grants the union as exclusive bargaining agent of the employees. The specific elements of such protection will be explored later, but it is enough to overcome the court's view of the matter to say at this point that the status of an exclusive bargaining agent may call forth a whole host of statutory safeguards.

Nor did the Court accord proper recognition to the various statements previously quoted from the opinions of Chief Justice Stone and Justices Jackson and Black in the Steele, Graham and Howard cases. It ignored completely the implications of those decisions that there is an underlying federal policy to thwart racial discrimination by labor unions. If the Supreme Court had taken the same view as did the Third Circuit, all three cases would have been dismissed, since none depended on the presence of compulsion to join the union; on the contrary, the unions would not even admit the complaining Negro employees to membership. In spite of the criticisms which can be leveled at the Williams decision, the Supreme Court denied certiorari.\textsuperscript{20}

The temptation to interpret such a denial as an authoritative ruling on the merits is always very great, despite all Supreme Court warnings to the contrary. It is not surprising then that when a similar case arose in the Fifth Circuit, Syres v. Oil Workers Union,\textsuperscript{21} the district court and the court of appeals relied on the Williams case as authority for their decisions. There, two locals belonging to the same international union, one white and the other Negro, agreed to bargain with their employer through a single negotiating committee. That committee executed a contract containing segregated lines of seniority, thereby preventing advancement of Negro employees to the more desirable jobs which traditionally had been held by white employees. In affirming

\textsuperscript{20} 346 U.S. 840 (1953).
\textsuperscript{21} 223 F.2d 739 (5th Cir.), rev'd, 350 U.S. 892 (1955).
the district court’s dismissal of the Negro employees’ petition for injunctive relief, the Fifth Circuit found that no federal statute or constitutional provision was involved upon which to predicate jurisdiction over the suit. Analyzing the action as merely one for a breach of the agreement between the two locals, the court, Judge Rives dissenting, indicated that the complainants might be entitled to reformation of the collective bargaining agreement, but in the absence of diversity of citizenship, that question could only be litigated in the state courts.

Judge Rives’ dissenting opinion explained why the federal government cannot allow such racial discrimination to go unredressed. He admitted that private parties, such as unions and employers, may discriminate to their hearts’ content without interference by the federal government. Yet he recognized that if their contract results from the provisions of federal law, or if that law compels observance of the contract or the federal government is called upon to enforce that agreement, a new ingredient is added which prohibits discrimination based on race or color.

Pointing out that considerable action on the part of the federal government is involved whenever a contract is sought to be imposed on the Negro employees, Judge Rives rejected the argument that the discrimination in the type of case presented arises from the acts of private parties alone. He noted that the appropriate bargaining unit is determined by the National Labor Relations Board, which then holds an election among the employees and certifies the winning union as the exclusive bargaining representative under the Taft-Hartley Act. The employer and the union then have the duty to bargain with each other, and the Board has sanctions available to compel such bargaining. Employees who strike during the protected period of the contract lose their employee status. Thus, should Negroes want to fight back against the discriminatory contract, the act deprives them of many of their most effective weapons. Under these circumstances, Judge Rives concluded that the situation can hardly be described as one in which the federal government has taken no part, saying that since section 9(a) of the act gives to the majority representative the exclusive right to act as bargaining agent for all employees in the unit, it imposes on that agent the duty not to abuse its status by unconstitutional dis-

22 It is interesting to note that the international union intervened as amicus curiae in favor of the Negro employees in opposition to its own white local. Id. at 741-42.
23 Id. at 745.
crimination, and a violation of that obligation by the union gives the federal courts jurisdiction to protect the Negro employees.25

Up to this point (it was now 1955), while it was well-established that the Railway Labor Act carried built-in safeguards against racial discrimination by unions which functioned under that statute, it seemed that, due to the Williams and Syres decisions, the unions which operated under the National Labor Relations Act did not have the same obligations toward the employees covered by that statute.26 Such divergent interpretations of the two acts were not warranted by their language and could not long continue. On petition to the United States Supreme Court, certiorari was granted in Syres, and the judgment of the circuit court reversed, without oral argument, in a one-sentence per curiam opinion which cited the Steele and Howard cases as authority.27 It was now the law that racial discrimination by unions against employees would be treated the same way whether arising under the Railway Labor Act or under the National Labor Relations Act.28

Two years later the Supreme Court in Conley v. Gibson29 took the union’s obligation one step further by ruling that discrimination was prohibited not only in the execution of the collective bargaining agreement, but also in the handling of grievances under the contract. The union had refused to oppose the employer’s removal of Negro employees and their replacement by whites, and had failed to take up the discharged employees’ complaints through the grievance machinery. The Supreme Court held that these allegations of union inactivity stated a good cause of action, reversing the dismissal of the suit by the court of appeals and the district court.

25 This is essentially Chief Justice Stone’s view of the obligation imposed on unions by the Railway Labor Act and of how that obligation may be enforced. Steele v. Louisville & N.R.R., 323 U.S. 192 (1944).

26 It should be remembered that the Railway Labor Act covers employees in the railroad and airline industries only, constituting a much smaller proportion of employees engaged in interstate commerce than is covered by the National Labor Relations Act, which is more generally applicable. The number of unions covered is also much smaller.


28 When this case was subsequently tried under the new theory, a verdict for the defendant was upheld by the court of appeals on the ground that the plaintiffs had failed to prove any actual damage to themselves as individuals. Judge Rives wrote the opinion of the court. Syres v. Oil Workers Union, 257 F.2d 479 (5th Cir. 1958), cert. denied, 358 U.S. 929 (1959).

The following year another facet of the problem came before the Sixth Circuit in *Oliphant v. Brotherhood of Locomotive Firemen,*\(^{20}\) the last case to be considered in our chronological analysis. This time the Negro employees who charged discrimination sought an order requiring their admission to membership in the union which was recognized as their bargaining agent under the Railway Labor Act. They alleged that it negotiated contractual provisions which, because of their race, resulted in a loss of income to them. The district court in fact had found discrimination in both the union’s representation and the conditions of employment.\(^{31}\) It even agreed that if such discriminatory practices had been due to federal action, they would have been unconstitutional. But it dismissed the case, holding that the certification of the union as exclusive bargaining representative by an agency of the United States Government was not sufficient to make the union’s subsequent conduct the equivalent of federal action.

Accepting this view, the court of appeals affirmed the dismissal of the complaint, adding its own stricture that “the Brotherhood is a private association, whose membership policies are its own affair, and this is not an appropriate case for interposition of judicial control.”\(^{32}\) Certiorari was denied by the Supreme Court, which, as though fearful of being misinterpreted, added the unusual statement that the denial was “in view of the abstract context in which the questions sought to be raised are presented by this record.”\(^{33}\) Without trying to clarify the meaning of that Supreme Court statement, it should be pointed out that in none of the previously decided cases had the Court been asked to compel a union to accept applicants for membership.\(^{34}\)

The restricted view of federal action expressed by the lower courts in the *Oliphant* case has not been entirely accepted.\(^{35}\) There is strong support for the view that union discrimination is forbidden not only under the statutes, but under the fifth amendment to the federal constitution. Mr. Justice Murphy in *Steele* and Judge Rives in *Syres* both based their opinions on this concept.\(^{36}\) Be that as it may, in view of

\(^{20}\) 262 F.2d 359 (6th Cir. 1958).


\(^{32}\) 262 F.2d at 363.


\(^{34}\) This problem is treated in Blumrosen, Legal Protection Against Exclusion From Union Activities, 22 Ohio St. L.J. 21 (1961).

\(^{35}\) For a detailed analysis of this case, see Wellington, The Constitution, the Labor Union, and “Governmental Action,” 70 Yale L.J. 345 (1961).

\(^{36}\) Persuasive analogy for this constitutional argument may also be found in the
the decisions we have been examining, there can be little dispute that racial minorities may use the federal courts for redress of discriminatory practices imposed upon them by labor unions acting under the Railway Labor Act or the National Labor Relations Act.\textsuperscript{37} The question which has never been authoritatively settled is whether the speedier, more efficient and often more effective administrative remedies are available as well.

II

The Role of the NLRB in Preventing Discrimination

Congress has not expressly provided administrative remedies and has not specifically charged any agency with the protection of racial minorities against discrimination by a labor union.\textsuperscript{38} Yet the failure of Congress expressly to create such causes of action for enforcement by the federal courts has not stood in the way of the Supreme Court’s granting judicial protection. The Court has developed the doctrine that when a union is clothed by Congress with substantial authority over the welfare of employees, it must exercise that authority without discrimination. This is the common thread that runs through the entire Steele line of cases. It was present in the Steele and Graham cases where the union was the exclusive bargaining representative of all the employees in the craft, including the Negroes whose jobs it sought to destroy. It was also present in the Howard and Syres cases where the union did not represent the complaining employees at all.

It is clear from these cases that a union cannot have it both ways. It cannot accept the preferred status given it by federal law and at the same time engage in a racially discriminatory course of conduct. If it does so, an injured employee may resort to the federal courts for help. No logical reason appears why such union misconduct should be remediable only in the courts; on the contrary, it is arguable that a federal agency, such as the NLRB, lends itself to the effectuation of

\textsuperscript{37} A general review of the cases on racial discrimination by labor unions may be found in Employment Discrimination, 5 Race Rel. L. Rep. 569, 578 (1960).

\textsuperscript{38} See note 2 supra.
illegal racial discrimination when it furnishes services and protection to a discriminating union.

The conceptual difficulty to an approach which suggests that the NLRB “assists” in perpetuating discrimination has been due to the well-accepted doctrine that the fifth amendment applies only to action of the United States Government, that the fourteenth amendment applies only to action of state governments, and that neither amendment inhibits any conduct by private persons.\(^{39}\) The NLRB, of course, never encourages or enforces racial discrimination. The discriminatory acts complained of are those of labor unions, not of the Board.\(^{40}\) For this reason, even those who recognize that the Board is prohibited from directly engaging in racial discrimination often see the problem as that of a private association—the union—which is not governed by the Constitution. In other words, because there is no direct action by a government agency, there can be no violation of the Bill of Rights.

However, in other racial cases the Supreme Court, when faced with the question of whether there has been action by a government agency, has not taken such a mechanistic approach. Instead, it has sought to find the practical effect of the alleged governmental action. This attitude is illustrated in *Shelley v. Kraemer*,\(^{41}\) where an effort was made to uphold state court enforcement of a racial covenant contained in a deed of real property. This discrimination, so the argument ran, was originated by private parties who were constitutionally free to do this, and no state action was involved; state court enforcement of the restriction did not create an unlawful discrimination but merely enforced an agreement into which the parties had lawfully entered.

The Supreme Court disagreed, ruling that the act of a court was as much state action as the act of a legislature. Just as the legislative branch could not impose a racially discriminatory system for occupancy of real property,\(^ {42}\) so the judicial branch could not do so even while enforcing the contracts of private parties. The Court held that court enforcement of the restriction violated the equal protection clause of the fourteenth amendment. It was not the existence of the covenant

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41 334 U.S. 1 (1948).
42 Buchanan v. Warley, 245 U.S. 60 (1917).
which was invalid, but the participation of the state, through its courts, which rendered the scheme unconstitutional.

In a companion case, *Hurd v. Hodge*,\(^43\) the Court struck down enforcement of a similar covenant by the courts of the District of Columbia on the theory that federal courts cannot take action which, if taken by a state court, would violate the fourteenth amendment. This was held to be a matter of public policy.

It does not seem rash to argue that these two cases may well stand for the proposition that no agency of the United States Government can constitutionally participate in the enforcement of a racially discriminatory scheme or plan, even though privately originated. Nor is this a new concept. It was voiced in a concurring opinion by Judge Pope in *NLRB v. Pacific American Shipowners Ass'n*:

I think the last chapter on this question has not been written. When Shelley v. Kraemer . . . held that the Fourteenth Amendment prohibited state courts from enforcing restrictive covenants based on race or color, the Court in *Hurd* v. Hodge . . . declared such covenants equally unenforcible in the federal courts . . . . A union which practices racial discrimination as a practical matter carries its policy into its collective bargaining agreements. It is a nice question whether the Labor Board may recognize or enforce such an agreement any more than a federal court may lend its aid to a racial restrictive covenant.\(^44\)

If Congress is forbidden to legislate and the courts are forbidden to enforce, then surely an administrative agency cannot protect such a project.

It thus appears that the Supreme Court has asked two questions when faced with an allegation that a private party has unlawfully engaged in racial discrimination. In the *Steele* case and its successors, the Court asked whether the Government has delegated to that private party enormous powers to affect the welfare of other persons. In the *Shelley* and *Hurd* cases, the question was whether participation of a government

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\(^{43}\) 334 U.S. 24 (1948).

\(^{44}\) 218 F.2d 913, 917 n.3 (9th Cir.), cert. denied, 349 U.S. 930 (1955). The case involved an attack by a ship stewards' union on a Board certification of an over-all seamen's bargaining unit (including stewards) on the ground that the Seafarers Union, which would undoubtedly win the election in the larger unit, engaged in discriminatory practices against Negroes, and that for the protection of the Negro employees a separate stewards' unit should be found appropriate. The union's motion for an order to show cause was denied per curiam. Judge Pope, in his concurring opinion, pointed out that the NLRB has exclusive jurisdiction to determine the appropriate bargaining unit and that the Seafarers Union had given the Board assurances that the discriminatory practices would stop. Under these circumstances, he felt that the court should not interfere.
agency was necessary to make the discriminatory scheme effective. If the answer to either of these questions is "yes," then the actions of the discriminating private party will be subjected to judicial scrutiny.

The National Labor Relations Act will now be analyzed from this point of view, to determine whether it does give a union such authority over employees and whether the operations of the NLRB are vital to the effectuation of any discriminatory scheme. While no examination will be made of the Railway Labor Act, the two statutes are so similar in this respect that the conclusions reached here would generally be the same under both of them.

There are two types of administrative proceedings contemplated by the National Labor Relations Act. One is the unfair labor practice complaint with its accompanying remedial orders; the other is the designation of the majority union as exclusive bargaining representative of a group of employees. Section 8 of the act contains general antidiscrimination provisions which are as applicable to discrimination for racial reasons as for any other. Thus, if an employee is unfairly denied membership in a union and his lack of membership results in loss of employment, lower wages, earlier layoff, reduced seniority or inability to obtain a job, both the union and the employer have committed unfair labor practices, and the full panoply of NLRB weapons is available to such an employee. This will include reinstatement with back pay and compensation for any financial loss suffered as result of the discrimination.

But the Board is empowered only to protect an employee's job. It cannot compel his acceptance into union membership. Aside from the historical reluctance of government agencies, including courts, to require any private association to admit an applicant to membership, the act contains a specific provision that would seem to prevent the Board from taking such a step. Section 8(b)(1)(A) provides:

It shall be an unfair labor practice for a labor organization . . . (1) to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 7:

Provided, That this paragraph shall not impair the right of a labor organization


46 The general subject of the union's duty to represent employees fairly and without discrimination for reasons other than race has been extensively commented upon. See Aaron, Some Aspects of the Union's Duty of Fair Representation, 22 Ohio St. L.J. 39 (1961); Cox, The Duty of Fair Representation, 2 Vill. L. Rev. 151 (1957); Wellington, Union Democracy and Fair Representation, 67 Yale L.J. 1327 (1958).
to prescribe its own rules with respect to the acquisition or retention of membership.\footnote{47}

The words "this paragraph" limit the proviso to unfair practice cases governed by section 8 and are not applicable to representation proceedings governed by the terms of section 9.\footnote{48} In effect, the unfair practice sections provide remedies for those employees who have been prevented from joining the union, protecting their jobs from being used as instruments of discrimination because of their lack of union membership.

If the Negro employees are permitted to join the union, they may still face unequal treatment in the form of separate seniority lists which prevent them from advancing to the more desirable jobs; union refusal to process their grievances or to allow them entry into apprentice training programs; or the payment of discriminatory wage rates for identical work, based not on lack of union membership, but on the provisions of the collective bargaining agreement. It would seem that such discrimination is not prohibited by section 8 of the act and is not an unfair labor practice.

However, when a union files a petition with the NLRB, claiming to be the majority representative of employees in an appropriate bargaining unit, and asks for certification as their exclusive bargaining agent, the Board immediately becomes involved in the activities of that union. An NLRB employee is assigned to investigate the claim to determine whether the union has enough interest among the employees to warrant a Board hearing. A showing of such interest leads to a hearing to determine whether there are adequate grounds for conducting an election, and when those grounds are established, the Board conducts an election at its own expense and certifies the result. If the union wins the election, it is certified as the exclusive bargaining agent, and the Board will not conduct another election among the same employees for a period of one year.\footnote{49} In addition, if the union and the employer sign a contract, the Board will not hold an election in that unit for an additional period of as much as two years.\footnote{50} In other words, there may be a period of almost three years during which the union is protected from divestiture of its exclusive bargaining status.

During this period both union and employer are required by law to

\footnote{50} Pacific Coast Ass'n of Pulp & Paper Mfrs., 121 N.L.R.B. 990 (1958).
bargain collectively with each other. The employer is prohibited from bargaining with any other union, or with any individual employee, or with small groups of employees. He is prohibited from interfering with the union’s relations with the employees and from coercing or restraining the employees in their dealings with the union. He cannot discriminate against union members, nor can he encourage any other union which he may prefer to come in and campaign among the employees. Severe limitations are placed on his control over the terms and conditions of employment, and often he cannot change them without consulting the union.

On the other hand, the employee is prohibited from concluding an individual bargain with his employer which violates the collective agreement, even though this may be an advantage to the employee involved. If there is a union-shop contract, he is compelled to pay dues to the union, even though he may not want to do so. If he refuses, the employer may be compelled to discharge him. Furthermore, the employees cannot decide to go out on strike without complying with the procedural requirements of the act, nor can they decide during the certification year or the contract term that they want to be represented by a different union.

This elaborate scheme of protection and its vigorous enforcement by the NLRB is not limited to unions which have been certified as victors in a Board-conducted election. Any union which can demonstrate its majority standing by any reasonable method is immediately sheltered by this protective system. It is as much a violation for an employer to refuse to bargain with a union that clearly represents a majority of his employees as to refuse to bargain with one which holds an NLRB certification.

What, then, are the answers to the Supreme Court’s two questions when they are asked concerning the National Labor Relations Act? Has Congress clothed the exclusive bargaining representative with such tremendous power over the employees’ welfare as to impose the

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concurrent obligation to exercise that power without discrimination? Actually the Court answered that question by implication when it cited Steele and Howard in reversing the court of appeals in the Syres case. In making the union the exclusive spokesman for the employees, in compelling union membership where there is a valid union security agreement, in protecting the union against raids for a considerable period of time, and in abolishing individual bargaining, Congress has indeed clothed the union with enormous powers over the welfare of the employees.

Does the NLRB's function in collective bargaining contribute to the effectuation of the discriminatory scheme so as to violate the due process clause of the fifth amendment? The Board provides the election and certification machinery which results in designation of the union as the exclusive bargaining representative. Its processes, facilities and authority are available against raiding unions and employers who refuse to recognize or bargain with the exclusive bargaining agent. Where there is a valid union security agreement, the Board will protect the union against defections by dissatisfied employees, and the union may call upon the NLRB, the court of appeals and, on occasion, the Supreme Court of the United States to vindicate its rights. Under these circumstances, it must be concluded that government agencies, the Board and the courts, thus unconstitutionally participate in the enforcement of the discriminatory scheme.

That racial discrimination by a labor union enjoying the benefits of a federal statute involves serious constitutional issues can no longer be doubted. An employee who is injured by such discrimination has, by virtue of the Steele case and its successors, a cause of action in the federal courts for a declaratory judgment, damages and an injunction. Furthermore, the Shelley and Hurd cases would seem to deny a union access to the courts for enforcement of a racially discriminatory scheme. Both of these theories are applicable to the regulation and protection of unions by the NLRB under the National Labor Relations Act. Upon such analysis it becomes clear that the NLRB is without power to certify a labor union which engages in racial discrimination or to provide such a union with the protections normally furnished to exclusive bargaining representatives under the National Labor Relations Act. In other

58 Civil rights experts do not believe that the Board's refusal to certify or its withdrawal of a certification would be an effective remedy against a discriminating union. See Greenberg, Race Relations and American Law 182 (1959); U.S. Commission on Civil Rights, bk. 3, Employment Report 145-46 (1961).
words, the NLRB cannot do anything which will further the exercise of power by a discriminating union.

The Board has recognized for years that it has both the responsibility and the power to protect employees against some forms of racial discrimination by the union which is their exclusive bargaining agent.59 It has rejected a union's request to exclude Negroes from the bargaining unit because of their race.60 Before the Taft-Hartley Act outlawed discrimination by a union, the Board questioned whether a closed-shop agreement could be given effect when coupled with denial of union membership on racial grounds.61 It announced its willingness to withhold or withdraw a certification if the union discriminated against employees in the unit,62 and it found that a certified local union which had set up a separate local for Negro employees abused its exclusive bargaining status by compelling membership and dues payments on behalf of the uncertified Negro local.63 There is evidence that these steps have contributed somewhat to the amelioration of racially discriminatory conditions, but they have been of only limited value.64 The Board has not yet given full-scale consideration to the constitutional issues involved.

What can the NLRB do to effectuate the policy we have been discussing? The answer to that question depends on a clear understanding that Congress cannot clothe a discriminating union with extensive authority over the employees it represents, and that no government agency can lend its aid to enforcement of a discriminatory system of operations. If these two ideas are grasped, the answer is fairly simple.

When the Taft-Hartley Act was passed in 1947, it contained requirements that unions file certain reports of their activities and that union officers file non-Communist affidavits.65 Failure to comply with these filing requirements deprived a union of the services which the Board might render.66 When a noncomplying union filed a representation

64 Greenberg, op. cit. supra note 58, at 183, points out that fear of NLRB action where two unions competed for a majority of the employees in the unit has sometimes caused abandonment of a racially discriminatory policy.
65 Act of June 23, 1947, ch. 120, §§ 9(f)-(h), 61 Stat. 145. These provisions were repealed by the Labor Management Reporting and Disclosure Act § 201(d), 73 Stat. 525 (1959).
petition, the Board would refuse to make an investigation, thereby making it impossible to hold an election and precluding certification of that union as exclusive bargaining agent for the unit which it sought. If an employer or a complying union filed a petition, the noncomplying union could be placed on the ballot, but it could not be certified if it won. Moreover, the Board would not issue an unfair labor practice complaint at the behest of a noncomplying union but would, of course, prosecute such a union for violation of the act. This meant the noncomplying union could not obtain redress for misconduct directed against it by employers or other unions but was subject to charges under the act for its own misconduct.

These sanctions, which were authorized by statute, were found to be very effective in inducing unions to comply with the filing requirements. They would be equally effective in the field of racial discrimination. Whenever a union involved in an NLRB proceeding was charged with racial discrimination, the Board would determine whether or not the charge was true. All interested parties would be allowed to participate in the hearing, present evidence and make their arguments. This would be done at the usual hearings held in NLRB matters—representation cases before a hearing officer, and unfair practice proceedings before a trial examiner. Upon a finding that the union was discriminating, the Board would thereafter refuse to entertain an election petition from such union, refuse to certify it as exclusive bargaining agent of any bargaining unit, and refuse to issue a complaint upon its charges of unfair labor practices being committed against it. While its collective bargaining agreements would no longer be a bar to an election petition by a raiding union, it would remain subject to unfair labor practice charges. To clear itself, the union would have to show, to the Board’s satisfaction, that it had abandoned the discriminatory practices.

To aid in enforcement of these rules, the Board might require that each petitioning union accompany its petition with a statement that it was not engaging in such discriminatory practices. Such a statement could also be required from every union filing unfair labor practice charges against an employer or another union.

There is no question that such an approach would impose upon the NLRB a substantial quantity of additional work. Nor is there any question that the penalties suggested are severe and would impose substantial hardships on unions which are guilty of racial discrimination. But there is also no question that such a program would provide unions
with considerable encouragement to abandon the racially discriminatory practices in which some of them are now engaged.67

CONCLUSION

Ample reason exists to believe that the Supreme Court will look very carefully at an argument that the fifth amendment is violated by a federal statute which provides valuable benefits to a labor union, takes from the employees the means to defend themselves, and then allows the union to run roughshod over the employees' rights in violation of every pronouncement of public policy made by the Court for the past twenty years.68 Undoubtedly, the NLRB would be faced with the troublesome problems of evidence, enforcement and public relations. But the Board cut its eyeteeth on such problems and has proved to be one of the most effective government agencies in finding solutions to them. The Supreme Court itself has shown an understanding of the difficulties in treating race-relations cases; yet it has not allowed these barriers to stand in the way of effectuating the appropriate constitutional mandates. It will surely expect the same understanding and firmness from the NLRB.

67 The United States Department of Labor has revoked federal certification of an apprentice training program operated by a St. Louis local of the Plumbers and Pipe-fitters Union because of the local's refusal to cooperate in the training of two Negro apprentices. Assistant Secretary of Labor Jerry R. Holleman, who is also executive vice chairman of the President's Committee on Equal Employment Opportunity, has stated that the Labor Department would withdraw certifications in any other such cases which are brought to its attention. N.Y. Times, Feb. 16, 1962, p. 1, col. 2 (city ed.).

68 Racial discrimination has not fared well in the Supreme Court during recent years. E.g., Bailey v. Patterson, 369 U.S. 31 (1962) (state statute requiring segregated travel facilities); Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961) (restaurant operated as part of a public facility); Boynton v. Virginia, 364 U.S. 454 (1960) (restaurant operated as part of a public facility); Brown v. Board of Educ., 347 U.S. 483 (1954) (public school); Takahashi v. Fish & Game Comm'n, 334 U.S. 410 (1948) (fishing license); Oyama v. California, 332 U.S. 633 (1948) (ownership and occupancy of land); Morgan v. Virginia, 328 U.S. 373 (1946) (interstate travel); Mitchell v. United States, 313 U.S. 80 (1941) (interstate travel). The Court now insists that racial discrimination cannot be defended as an expression of public policy. It seems unlikely, therefore, that the Court would allow a union to object to the proposals made herein on the basis of the public policy which encourages collective bargaining and peaceful settlement of labor disputes.
THE NEW COMMERCIAL CODE OF JAPAN:
SYMBOL OF GRADUAL PROGRESS
TOWARD DEMOCRATIC GOALS

Lester N. Salwin*

Tracing the movement toward corporate law reform and the evolution of a large, meaningful individual shareholder class in Japan, the author contrasts the modernized Commercial Code with its earlier unprogressive corporate provisions. Mr. Salwin suggests that the recent moderate recommendations of the committee appointed to study its revision is an indication of the lasting quality of the reformed Code, but cautions that permanence will depend upon a continuing gradual movement toward democratization of Japanese society in general.

INTRODUCTION

The Law for Partial Amendment of the Japanese Commercial Code, approved by the Diet on May 2, 1950, and promulgated as Law No. 167 of 1950,¹ represented a thoroughgoing revision designed to modernize and remove from the corporation laws of Japan certain longstanding inequities and abuses of corporate management.² The new companies

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The article represents the personal views and responsibilities of the author and does not reflect the official policy of any department or agency of the Government.

¹ Law No. 167, May 10, 1950 (date cited is date of promulgation). Japanese laws, imperial ordinances and cabinet orders are published daily by the Government Printing Agency in the Official Gazette (Tokyo). An English edition of the Gazette was printed from April 1, 1946, through April 28, 1952, during the Occupation. Virtually all of the 1950 amendments were made in Book II of the Commercial Code, which embraces articles 52 through 500 dealing with companies (kaisha). The Commercial Code of Japan (Ministry of Justice transl. 1959) [hereinafter cited as Code]. Of the 449 articles comprising Book II, 203 were directly affected by repeal, amendment or other modifications. Books I, III, and IV, which make up the remainder of the Code, were not affected by the amendments except for minor revisions of articles 17, 18 and 22 in Book I.

² Three classes of commercial companies may be established under the Japanese Commercial Code: kabushiki kaisha, gomei kaisha and goshi kaisha. Code art. 53. Kabushiki kaisha are ordinary joint stock companies; gomei kaisha, ordinary unlimited partnerships; and goshi kaisha, limited partnerships. A fourth type, yugen kaisha, is cognizable under the Private Limited Companies Act of 1938. Law No. 74, April 4, 1938, amended by Law No. 151, July 12, 1948, Law No. 137, May 31, 1949, Law No. 214, June 8, 1951. Yugen kaisha is a close-type joint stock company limited to fifty share-
New Commercial Code of Japan

law went into effect on July 1, 1951, after some last minute changes were made on procedural points.\(^3\) The Commercial Code had been in force since 1899\(^4\) and, except for occasional amendments, had not been substantially improved or developed into a progressive corporation statute.\(^5\)

Various abuses existing under the old Code at the time of the Allied Occupation came to the attention of the Supreme Commander for the Allied Powers (SCAP) in the course of the program, based on United States and Far Eastern Commission policies, which was designed to facilitate foreign investment on a fair, nondiscriminatory basis, to bring about widespread distribution of corporate shares in the hands of the holders and restricted against transfer of their shares without approval of a majority entitled to three-fourths of the votes. In keeping with the Code amendments relating to the other three classes of commercial companies, the Private Limited Companies Act was also amended in 1951 to incorporate the same general type of reforms as to yugen kaisha. Law No. 214, June 8, 1951. However, restrictions on transferability of shares to an outsider were retained by recognizing in existing shareholders a preemptive right to purchase at a price not less favorable than that offered by an outsider. Article 19 of the act still requires advance notice to the company and the extension to existing shareholders of an opportunity, for a specified period, to acquire the shares in question. A fifth type of hybrid corporate organization, kabushiki goshi kaisha, consisting of an ordinary partnership combined with a joint stock company, formerly existed under the Commercial Code but was abolished in 1950.

\(^3\) The effective date specified in Law No. 167 of 1950 was reaffirmed in the Enforcement Law subsequently approved by the Diet. Law No. 210, June 8, 1951.

\(^4\) Law No. 48, March 9, 1899.


Compilations of Japanese commercial laws customarily include, in addition to the Commercial Code itself, the separate statutes on yugen kaisha, the special close-type corporation limited to fifty shareholders, Law No. 74, April 4, 1938, amended by Law No. 151, July 12, 1948, Law No. 137, May 31, 1949, Law No. 214, June 8, 1951, bills of exchange and promissory notes, Law No. 20, April 14, 1932, amended by Law No. 195, Dec. 17, 1947, and checks, Law No. 57, July 29, 1933, amended by Law No. 195, Dec. 17, 1947.
Japanese public at large (especially former Zaibatsu-owned securities transferred to the Holding Company Liquidation Commission, a specially created agency of the Japanese Government), and to promote economic democratization objectives in consonance with free competitive enterprise principles. SCAP found that the Commercial Code, based on continental origins but characterized by purely Japanese adaptations, resulted in a number of undesirable practices. As a general rule, corporate management was considered neither responsive nor responsible to the shareholders (kabu nushi). Code provisions embraced a system of protected corporate management antithetical to the shareholders in general and to minority shareholders in particular. The underlying theory was that the original promoters (hokki nin) and management group represented a set of interests distinct from that of the shareholders.

The proposition that individual investors were the true equity owners and the officers fiduciary agents found little expression in the law. The ordinary shareholder had no right of access to corporate books and records for the purpose of intelligently informing himself of suspected mismanagement. He was effectually cut off from any real opportunity of knowing the affairs of his company, especially pertinent details of any outstanding transaction, such as a capital increase, merger, transfer or mortgage of assets, stock acquisition and officers' self-dealing. He was limited to, and had to content himself with, the minutes of general meetings and the stock registry, or routine financial statements and business reports exhibited to the auditor (kansa-yaku) at stated intervals prior to general meetings (so kai). In actual practice, however, such documents were couched in general terms and were far from being informative. Furthermore, although the auditor was a corporate officer

6 The Commission was established by Imperial Ordinance No. 233, April 20, 1946, pursuant to Supreme Commander for the Allied Powers, Holding Company Liquidation Commission, SCAPIN-859, April 4, 1946.


theoretically empowered to review the activities of directors on behalf of the shareholders, his interests had become indistinguishable from those of the directors.

Restrictions on transferability of shares, imposed by the articles (tei kan) in favor of the original promoters or directors, not only impeded free negotiability, but were susceptible of indirect discrimination against foreign participation. Various types of restrictions against the ordinary shareholder-investor rendered him helpless against perpetuation of control in the hands of the original promoters. For example, no provision was made for cumulative voting or other methods to make minority representation on the directorate possible. Alterations of the articles of incorporation, as well as amalgamations or mergers, could be authorized by a majority vote. The dissenting shareholder objecting to a merger had no right to demand the purchase of his interest.

Considerable vagueness and ambiguity surrounded equality of preemptive and subscription rights. Certain subscribers (kabu o hiki uke nin) were given specially preferred terms and conditions to the disadvantage and inequity of other subscribers and shareholders generally. A uniform or fixed maturity date was not required and frequently not specified, permitting certain subscribers to keep alive their rights by payment of a nominal monthly interest charge.

No matter how clear or serious the wrongdoing committed by management, available procedure was so cumbersome as to make legal attack virtually impossible. Self-dealing on the part of directors (torishimari-yaku) could be affirmatively approved by majority shareholders at a general meeting, or excused by failure to take action within two months after the auditor had obtained knowledge of the transaction, or by lapse of one year from the occurrence thereof. A director could carry on business with the company on his own behalf or that of a third person with the consent of the auditor. Shareholders representing a majority in number and in amount of total capital outstanding could, by resolution, remit the liability of recreant directors or auditors for wrongdoing

9 Pre-1950 Code arts. 188, para. 2, 204, 225.
10 Pre-1950 Code art. 343. A majority vote of the shareholders present was sufficient if it represented a majority in number of total shareholders and amount of capital outstanding. Ibid.
11 Pre-1950 Code arts. 175, 348.
12 Pre-1950 Code arts. 348, 350.
13 Pre-1950 Code arts. 176, 177, 179, 348, 354, 356.
14 Pre-1950 Code art. 264.
15 Pre-1950 Code art. 265.
and other reprehensible conduct, such as neglect of duty or acts "in contravention of any law or ordinance or the Articles of Incorporation . . . ."\textsuperscript{16}

A minority stockholder first had to bring his complaint to the attention of the auditor, and if that official refused to honor the demand, the shareholder was relegated to calling a special shareholders' meeting, which he could undertake if supported by those holding ten per cent of the outstanding capital (\textit{shihon}).\textsuperscript{17} Minority shareholders owning less than ten per cent had to await the next annual or semi-annual meeting. Suits against directors could then be accomplished only by resolution adopted at a general shareholders' meeting, or by service of a demand on the directors or auditor within three months of the rejection of such a resolution by shareholders holding ten per cent of the capital stock.\textsuperscript{18}

Upon the failure of the directors or auditor or majority shareholders convened in a general meeting to authorize suit on behalf of the company, ten per cent minority shareholders could (1) compel suit upon furnishing "adequate security" as demanded by the auditor or directors,\textsuperscript{19} (2) demand the convening of a general meeting to remove a director, accompanied by a court petition to suspend the exercise of his duties,\textsuperscript{20} or (3) apply for court appointment of an inspector (\textit{kensa yaku}) to investigate and report on the state of corporate affairs.\textsuperscript{21} Furthermore, "any person interested," upon furnishing security as demanded by the company, could sue to have it dissolved because of gross mismanagement.\textsuperscript{22} However, the grounds for seeking dissolution or the appointment of court inspectors were vague and uncertain, such as whether acts of the directors were "dishonest," contrary to "public policy or good morals," or involved any grave fact in contravention of laws or ordinances or the articles of incorporation.\textsuperscript{23}

The main responsibilities of officers, intrinsic to the management of a company in a faithful and efficient manner, were nowhere clearly defined. The Code did not manifest a strong obligation to conform corporate operations to those authorized by the charter. Rather, it enumerated in

\textsuperscript{16} Pre-1950 Code arts. 245, 266. Compare Pre-1950 Code art. 196 under which a resolution adopted by the same majority vote could waive the promoters' liability for wrongful acts in connection with the establishment of the company.

\textsuperscript{17} Pre-1950 Code art. 237, para. 1.

\textsuperscript{18} Pre-1950 Code art. 268.

\textsuperscript{19} Pre-1950 Code arts. 197, 268, 279.

\textsuperscript{20} Pre-1950 Code art. 272.

\textsuperscript{21} Pre-1950 Code art. 294, para. 1.

\textsuperscript{22} Pre-1950 Code arts. 58-59.

\textsuperscript{23} Pre-1950 Code arts. 58, para. 2, 294, para. 1.
a general, imprecise fashion the principle that officers were governed by the law pertaining to "mandates" and could be sued or subjected to court-appointed inspectors on the grounds previously described, that is, for neglect of duty, self-dealing (i.e., without the consent of majority shareholders or the auditor), conspicuously unfair conduct or grave facts in contravention of law or the articles.

Notwithstanding wrongful or unauthorized conduct and the fact that minority shareholders could establish a well-founded case, courts were vested with broad discretion, couched in vague, general terms, to dismiss shareholders’ or creditors’ actions, including suits to dissolve a company on account of mismanagement or applications to appoint a court inspector to investigate or set aside invalid consolidations, capital increases or decreases, or resolutions (including those effecting wrongful removal of a director). Actually, minority stockholder suits against directors were virtually nonexistent. Consequently, there is a paucity of judicial precedents illustrating such remedial action under the provisions of the old Code.

Furthermore, instead of a flexible authorized-unissued capital stock system, SCAP authorities found a rigid stock issuance procedure which required all of the authorized capital to be offered forthwith and subscribed for at the same time, without any power in management to time capital increases by installment issues at necessary intervals. The partially-paid stock system which had been in effect since 1899 had been abolished in 1948. It was also found that the registration require-

25 Pre-1950 Code arts. 58, 294. Dissolution actions could be filed by "any person interested" only after furnishing "adequate security upon demand" at the request of the company. Pre-1950 Code arts. 58-59.
26 Pre-1950 Code arts. 104, 107, 415. Shareholders, directors, auditors, partners, liquidators, bankruptcy administrators and creditors could bring an action to set aside an invalid consolidation. Ibid.
27 Pre-1950 Code arts. 371-72, 380. Any shareholder, director or auditor could bring an action to set aside an invalid capital increase; they, as well as creditors, could also sue to cancel an invalid capital decrease. If a shareholder sued, he had to furnish adequate security as demanded by the company. Pre-1950 Code arts. 249, 372.
28 Pre-1950 Code arts. 247, 249. A shareholder as well as any director or auditor could institute suit to set aside an invalid resolution, but he had to furnish adequate security as demanded by the company. Ibid.
29 Pre-1950 Code art. 257.
31 Pre-1950 Code arts. 192, 199, 356.
32 Law No. 148, July 12, 1948.
ments applicable to foreign companies (gaikoku kaisha) were somewhat ambiguous and the registrant’s standing, as far as equality under the laws was concerned, not firmly stated but subject to considerable interpretation.\(^{33}\)

I

**BACKGROUND TO CODE REFORM**

In order to understand why the rigid Commercial Code was maintained virtually intact for fifty years until enactment and enforcement of the new law in 1950-1951, it is important to bear in mind its Germanic origin and history. A brief survey of the adoption of a Commercial Code in Japan for the first time in 1890 and the series of postponements which put off its effective date until 1898 throws considerable light on the difficulties encountered in sponsoring modern American-type amendments in 1950. The fact that the curriculum of Japanese law schools was concentrated primarily on continental law, and that Japanese lawyers and judges had been nurtured in continental jurisprudence during the fifty years preceding 1950, also contributed to the complex background out of which the new law gradually evolved.

Between 1881 and 1884, Hermann Roesler of Hanover, Germany, came to Japan as Legal Advisor to the Ministry of Justice and drafted the first Commercial Code, which was promulgated as Law No. 32 of 1890.\(^{34}\) Although based primarily upon the German Commercial Code of 1861, this first Code has been characterized as a blend of German and French law, with some adaptations taken from English law.\(^{35}\) Its arrangement into separate books followed the pattern of the French Commercial Code of 1807.

Considerable opposition to the provisions derived from French sources occasioned postponement of the effective date until June 1898.\(^{36}\) After being in effect for eleven months, it was replaced in 1899 by a new Code drafted by the Law Investigation Committee (Horitsu Torishirabe Iinkai) of the Japanese Government. In this Code the French provisions were deleted and the 1861 German Code was rigidly followed, despite the fact that a new German Commercial Code was promulgated in 1897. The Japanese revisers caused the law to be more German than even the Ger-

\(^{33}\) Pre-1950 Code arts. 479-85.
\(^{34}\) Law No. 32, March 27, 1890.
\(^{35}\) I The Commercial Code of Japan Annotated, op. cit. supra note 30, at xxxi.

\(^{36}\) Those parts of the 1890 Commercial Code dealing with companies, bills and bankruptcy were, however, made effective on July 1, 1893.
man draftsmen originally had made it. The 1899 law was subsequently amended but was not liberalized or improved upon in any material respect. Thus the 1950 amendments had to deal with a statute, which despite intervening legislation, was virtually the same as the original 1899 law.

The careful and time-consuming approach which marked the drafting of the new companies’ law of 1950 deliberately took into account the fact that the Japanese Code had been based on continental origins. Since SCAP personnel attending the discussions with the Japanese Government included, at times, two American lawyers who formerly had been attorneys in Austria and Germany, the 1950 draftsmen were acutely aware of the significance to be attached to the continental roots of the Japanese Code. Although some material differences were found to exist between the German and American corporation laws, these were not always irreconcilable, and on many points there were more similarities than differences. In addition, the Japanese Code, including implementing corporate practices in current use, bore the mark of purely Japanese adaptations. It had taken on characteristic Japanese features unrecognizable as emanating from the German prototype. Finally, openminded discussion of the respective merits of the American, Japanese and continental legal provisions established that it was sound to add to Japanese law points of proved validity which happened to be found in American statutes. Since the so-called continental origins of the Commercial Code already had been affected by Japanese adaptation and practices over a long period of years, it was considered unrealistic to assume that their original purity still existed sufficiently to justify the view that improvement from Anglo-American experience represented something improper or irreverent.

Over thirty years ago, Dr. Kenzo Takayanagi pointed out the incongruity of blind attachment to continental origins:

Complaints are also expressed, especially by important business concerns, that while the Commercial Code is predominantly German, their actual business usages influenced by their close contact with their Anglo-American compeers, are largely Anglo-American; that because of the divergence between business usages and the Code provisions many difficulties are experienced in ascertaining the exact legal status of their business usages; and that unexpected results often ensue when commercial disputes are determined by courts of law in accordance with the Commercial Code.\(^1\)

During 1949, 1950 and 1951, Dr. Takayanagi served as chairman of the Commercial Code Subcommittee of the Legislative Council attached to

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\(^1\) The Commercial Code of Japan Annotated, op. cit. supra note 30, at xl.
the Office of the Attorney General,\textsuperscript{38} and his authoritative views on the shortcomings of the Commercial Code as it existed in 1931 are so apposite that they are deserving of full quotation:

And it is now clear that the Commercial Code stands in need of amendment in many respects. . . . The actual operation of the company law, especially, has shown that it has given rise to abuses which cannot be eliminated except by radical changes . . . .

The movement for amendment of [the] company law is, however, focused principally upon the provisions relating to kabushiki-kaisha (joint stock company). There is need to eliminate opportunities of fraud in connection with the promotion of companies and to remove the possibilities for dishonesty in the conduct of business. It has become apparent that [the] development of business enterprises and the adequate protection of shareholders and creditors are difficult of realization under the Code in its present form. A clearer definition of the liability of promoters is needed . . . transfer of shares by endorsement must be allowed . . . the issue of deferred shares must be allowed; provisions relating to the convening of, and the exercise of the right to vote, at a general meeting of shareholders should be modified; the liability of directors and auditors should be made more stringent; provisions relating to accounts and the valuation of property should be amplified; more adequate provisions relating to public notices . . . should be made, and more adequate protection should be given to debenture holders . . . .

. . . .

Thus it is evident that it will not be very long before the Commercial Code will undergo a process of thorough amendment.\textsuperscript{39}

The thorough amendment forecast by Dr. Takayanagi, however, remained substantially unfilled, despite a series of subsequent amendments between 1932 and 1948. The picture portrayed by him in 1931 remained, strangely enough, descriptive of the need for revision still found to exist twenty years later. An advisory group of American business and professional men, known as the Deconcentration Review Board, was attached to SCAP to review actions taken under the Deconcentration Law enacted in December 1947. On August 28, 1948, it recommended, with SCAP approval, the enactment of a modern corporation law to facilitate the successful accomplishment of over-all economic objectives.

The Japanese Government undertook to carry out the recommendation by assigning a team of experts from the Office of the Attorney General to draft the necessary amendatory legislation. This group functioned

\textsuperscript{38} These discussions were conducted with the Office of the Attorney General. Following the Treaty of Peace effected on April 28, 1952, this Office was renamed the Ministry of Justice, the designation by which it was known for many years prior to the Pacific War. Law No. 268, July 31, 1952.

\textsuperscript{39} 1 The Commercial Code of Japan Annotated, op. cit. supra note 30, at xl-xliii.
under the supervision of the Director of the Research and Opinion Bureau and the Legislative Assistant to the Attorney General. Their views, embodied in various drafts, were coordinated and discussed with SCAP representatives acting in a consultative capacity. Day-to-day conferences extended over a period of more than a year. Drafts developed by representatives of the Office of the Attorney General were reviewed by the Commercial Code Subcommittee of the Legislative Council. The latter was composed of some thirty or forty prominent attorneys, judges and law professors, as well as representatives of trade associations and other legal, economic and financial circles.

An agenda of five main points formed the basis of discussion with the draftsmen assigned by the Office of the Attorney General: (1) stockholders' right of access to corporate books and records, (2) free transferability of shares, (3) cumulative voting, (4) clarification of preemptive rights, and (5) stockholders' rights of action against recreant directors, along with detailed specification of the latters' responsibilities. Two additional points were soon added: registration requirements applicable to foreign companies and a clear guaranty of their equal and nondiscriminatory standing as compared with domestic concerns, and the inauguration of a system of no-par stock and authorized-unissued capital. As a helpful guide, the Japanese representatives were furnished with citations to the Illinois Business Corporation Act of 1947 on each of the foregoing subjects. Correspondingly, the Japanese supplied complete references to existing Code provisions relating to the same points. Thereafter, resort frequently was made to applicable sections of American corporation laws of a number of commercial and industrial states, such as New York, Massachusetts, Ohio, Michigan and California.

After numerous conferences, an Attorney General's draft was formulated under date of July 18, 1949, and submitted to the advisory Commercial Code Subcommittee. Its views on fifty-four items, many consisting of suggested modifications, were embodied in two reports dated October 29 and December 14, 1949. A number of its recommendations were adopted in the revised Attorney General's draft bill presented to the Diet on February 24, 1950, and the bill was immediately referred to the Judicial Affairs Committee of each house. Representative viewpoints were expressed at public hearings by spokesmen of both the legal fraternity and leading industrial, commercial and financial circles. Further modifications of the bill were made in the reports of both Diet committees, a number of which were embraced in the law as finally enacted on May 2, 1950.
In this process of legislative draftsmanship and passage, the new Commercial Code underwent at least three major compromises. First, the suggestions and advice of SCAP personnel as to the best and most progressive provisions to be adopted were reexamined and modified by the drafting group itself. Second, the Commercial Code Subcommittee of the Legislative Council was responsible for further changes, especially with regard to stockholders' right of access to books and cumulative voting. Third, the Judicial Affairs Committees of the Diet made additional revisions encompassing more moderate provisions on various points.

II

POSTWAR PROGRESS TOWARD WIDESPREAD OWNERSHIP OF CORPORATE SHARES

The adoption of a progressive corporation statute for Japan presupposed that the attainment of a large individual stock investor class in Japan represented a practicable objective capable of realization at a reasonably early date. Thus a brief reference to Japan's economic history and postwar business trends is indispensable to an understanding of the corporate reforms achieved.

Characteristic methods of large-scale corporate financing in prewar Japan differed markedly from those employed in the United States. They contributed towards the maintenance of a relatively small investor class and an economic attitude which regarded a rigid, unchanging, somewhat antiquated Commercial Code as something desirable. In the United States it has been standard practice to encourage the general public to participate as shareholders in the financing of industrial expansion through increases in capitalization, underwritten and tendered for sale on the market, with a corresponding decreasing reliance on bank loans for that purpose.

On the other hand, the industrialization of Japan during the Meiji era (1868 to 1911) was based, by and large, on a different form of corporate financing, namely, bank loans, and not merely from a bank, but one constituting a unit in the same combine or chain of capital with the operating concern itself. This was characteristic especially of Zaibatsu family enterprises. Family members invested their personal fortunes primarily in the top holding company, or honsha, which held a controlling interest in hundreds of manufacturing plants, mines and service organizations, such as insurance, warehousing, express, shipping, trading, banking and trust companies. The ten largest Zaibatsu families and their top holding
companies owned 164 million shares with a face value of 7.9 billion yen, representing effectual control in some five to six thousand leading operating companies. This embraced effective hegemony over perhaps 50% of Japan's total productive capacity.

The various operating units in Japan obtained required capital from the combine bank, and investment by individual stockholders representing the public at large was kept at a minimum. Instead of the Japanese public investing directly in Zaibatsu and other large enterprises, its savings were deposited in the Zaibatsu banks or in government postal savings accounts. The Deposit Bureau of the Ministry of Finance at times made the funds accumulated in such accounts available to the Zaibatsu banks for ordinary commercial use. The savings of the Japanese public thus found their way into Zaibatsu financial institutions, which used them to finance constituent manufacturing or service organizations of their combine. The chain of capital represented by the combine thus became a closed and self-sufficient economic realm.

This characteristic Japanese phenomenon of family enterprises linked together in the same combine chain of capital, headed by a top holding company, carried over certain unprogressive aspects derived from feudal times. Its main evil was its basic premise which discouraged maximum participation by the Japanese public at large in widespread ownership of the larger enterprises, relegating it to the unenviable position of those undeserving of any vitally significant role in economic affairs.

Since the end of the war, however, the situation has been drastically altered as a result of widespread stock disposals under SCAP economic democratization measures and public absorption of exceedingly large capital increases incident to corporate expansion following the outbreak of the Korean War in 1950. It is estimated that the total number of individual shareholders in Japan at the present time is at least six times greater than in prewar days. In certain close companies, shareholders increased twenty to forty times, including tens of thousands of employees and local residents. More than ten million individuals now own stock, the vast majority consisting of persons who never owned any corporate securities before the war. The general situation was graphically described by a Japanese securities company executive at the close of the SCAP-sponsored stock disposal program:

In postwar days, financial institutions still continue to be the largest holders of governmental and corporate bonds, but a great change has come over the holding

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40 See Nippon Times (Tokyo), April 2, 1952, p. 6, cols. 2-4.
of stocks. Under U.S. sponsorship, Japanese laws and regulations have been democratized. The Zaibatsu has been broken up. Excessive concentrations of economic power have been eliminated. Monopolies have been outlawed. Making investments is now up to the general public. To aid this, the public has become the function and role of the investment trust.  

Over a period of about four years ending in mid-1951, agencies of the Japanese Government actively administered this stock disposal program affecting almost one-half, in total amount, of all corporate shares outstanding in Japan at the close of hostilities in September 1945. This was done pursuant to SCAP directives and supervision. Four hundred twenty-seven million shares, representing approximately one-half of the 1945 total, estimated at 936 million shares, were taken over by and made subject to disposal under the jurisdiction of the Holding Company Liquidation Commission, Closed Institutions Liquidating Commission, Fair Trade Commission and the Ministry of Finance.

Fifty-seven members of ten Zaibatsu families (Mitsui, Iwasaki, Sumitomo, Nakajima, Yasuda, Nomura, Asano, Okura, Furukawa and Ai-kawa) and eighty-three of their designated holding companies transferred title to 164 million shares having a face value of 7.9 billion yen to the Holding Company Liquidation Commission under Imperial Ordinance No. 233 of 1946.  Another 158 million shares were directly taken over by the Closed Institutions Liquidating Commission from several thousand overseas companies, control associations, banks and other closed institutions, or by the Ministry of Finance from taxpayers as payments in kind on capital levy and other taxes. In addition, the Holding Company Liquidation Commission assumed jurisdiction under Imperial Ordinance No. 567 of 1946 to compel the disposal of another 36 million shares by 1,203 "restricted concerns" comprising the first-line subsidiaries of the eighty-three designated holding companies. Pursuant to the Anti-Monopoly Law and implementing regulations, the Fair Trade Commission exercised jurisdiction over the residue of 3,651 other holding companies, operating concerns and financial institutions owning stock, supervising their disposal of 69 million shares representing holdings in companies other than wholly owned subsidiaries. The 427 million shares thus dis- 

42 Nippon Times (Tokyo), April 2, 1952, p. 6, col. 4, quoting Mr. Makio Isono, a director of the Nomura Securities Co.
43 Imperial Ordinance No. 233, April 20, 1946.
44 Imperial Ordinance No. 567, Nov. 25, 1946.
persed represented effective hegemony over 60% to 70%, if not more, of the total productive capacity of Japan.

As a result of increased sales to employees, local residents, securities underwriters and the general public, coincident with the postwar economic recovery of Japan, more than 60%, or roughly 256 million of the 427 million government owned or regulated shares, had been sold and transferred to more than 500,000 new individual purchasers by September 1950. Approximately 85% had been sold by July 1951, when the program, for all practical purposes, came to a close.

In addition to the stock disposal program covering existing shares, over 5 billion newly issued shares were placed on the market and absorbed by the Japanese investing public during the 1945-1951 period of SCAP operations, especially during the latter part of that period. They represented more than 250 billion yen (roughly equivalent to $700 million) of paid-up capitalization of new enterprises and capital increases of several thousand existing firms undergoing financial reorganization. According to one observer, total paid-up corporate capitalization rose from 40.6 billion yen in 1945 to 330 billion yen ($917 million) in 1952. Heavy capital increases of rehabilitated industries and the offerings of new enterprises, totalling more than 300 billion yen between 1949 and 1952, occurred coincident with the institution of economic recovery measures in 1949 and the onset of Korean War procurements in 1950.

After taking into account the 1945-1952 capital increases, certain observers fix the total shares outstanding in 1952 at the close of SCAP

<table>
<thead>
<tr>
<th>Capital Increases (billions of yen)</th>
<th>New Enterprises (billions of yen)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949</td>
<td>71.48</td>
<td>10.25</td>
</tr>
<tr>
<td>1950</td>
<td>33.70</td>
<td>16.53</td>
</tr>
<tr>
<td>1951</td>
<td>67.93</td>
<td>12.32</td>
</tr>
<tr>
<td>1952</td>
<td>117.98</td>
<td>15.88</td>
</tr>
</tbody>
</table>

47 Ibid.; Nippon Times (Tokyo), Feb. 18, 1952, p. 4, cols. 2-3; see Nippon Times (Tokyo), March 3, 1952, p. 4, cols. 1-5. The Civil Affairs Bureau (Minjikyoku) of the Ministry of Justice collates and maintains corporate statistics based on those used by the Bank of Japan and the National Tax Administration Agency.
48 Japanese Ministry of Finance, Monthly Financial Statistics (Zaisei Kinyū Tōkei Geppō), March 1957, p. 61, table 37 (statistics from the Japanese Ministry of Finance are based primarily on those companies whose shares are listed by the Japanese stock exchanges).
operations at 6.3 billion,\textsuperscript{49} representing a total paid-up capitalization of 330 billion yen.\textsuperscript{50} Statistics of the Japanese Ministry of Finance indicate that 5.36 billion shares outstanding in 1952 were attributable to the 770 largest companies either listed on securities exchanges or having total paid-up capitalization exceeding 30 million yen.\textsuperscript{51} In contrast to the prewar situation, the Japanese Ministry of Finance estimated that in March of 1951, 61.3\% of all corporate shares were owned by individuals and other noncorporate investors, 12.6\% by banks and other financial institutions, 11.9\% by securities dealers, 11.0\% by nonfinancial companies, and 3.14\% by government agencies and public corporations.\textsuperscript{52}

Total shares outstanding of these larger companies increased from 443,636,000 to 27,552,000,000 shares between March 1946 and March 1960.\textsuperscript{53} The total number of individual shareholders increased from 492,755,200 to 7,137,556,000 during this period.\textsuperscript{54}

\textsuperscript{49} Nippon Times (Tokyo), March 3, 1952, p. 4, cols. 1-5; Nippon Times (Tokyo), Feb. 18, 1952, p. 4, cols. 2-4. Only 66 million shares, or 1.6\% of the national total of 6.3 billion shares outstanding in the first half of 1952, were owned by foreign individuals or firms. The foreign-owned shares represented a face value investment of 5.4 billion yen, or $15 million at the current rate of exchange; 63 million of these shares were bought to participate in management, 4 million shares for general dividend-earning purposes. The latter 4 million shares amounted to considerably less than the 5 million share daily turnover on the Tokyo Securities Exchange. Ibid. "[I]t is wrong, totally wrong to fear that Japanese stock-shares stand in any danger whatsoever of becoming dominated by foreign capital purchases or investments." Nippon Times (Tokyo), March 3, 1952, p. 4, col. 1, quoting Mr. Yasuji Abe, a director of the Yamaichi Securities Company.

\textsuperscript{50} Annual capital increases have been listed by the Japanese Ministry of Finance as follows:

\begin{tabular}{|c|c|c|}
\hline
& Capital Increases & New Enterprises & Total \\
(billions of yen) & (billions of yen) & \\
\hline
1953 & 179.25 & 16.77 & 196.02 \\
1954 & 140.64 & 7.52 & 148.16 \\n1955 & 93.78 & 9.74 & 103.52 \\
1956 & 296.55 & 16.89 & 313.44 \\
1957 & 228.63 & 24.01 & 252.64 \\
1958 & 149.05 & 90.64 & 239.69 \\
1959 & 356.38 & 31.80 & 388.18 \\
1960 & 508.09 & 36.37 & 544.46 \\
1961 (1st half) & 349.92 & 22.57 & 372.49 \\
\hline
\end{tabular}


\textsuperscript{52} Ibid.

1,673,000 to 10,477,000 during the same period.\(^5\) The number of non-financial company shareholders likewise increased from 20,736 to 82,670.\(^5\) The latest available breakdown (for fiscal year 1959) as compiled by the Japanese Ministry of Finance indicates the following: 47.8% owned by individual shareholders, 29.3% by financial institutions, 3.7% by securities dealers, 17.3% by nonfinancial companies, 0.22% by government agencies and public corporations, and 1.2% by foreign com-

\[
\begin{array}{cccc}
\text{Fiscal Year*} & \text{Total Shareholders} & \text{Individual Shareholders} & \text{Percentage of Total Shares Owned by Individual Shareholders} \\
1945 & 1,712,650 & 1,673,828 (97.7%) & 53.0 \\
1949 & 4,288,543 & 4,190,523 (97.7) & 69.1 \\
1950 & 4,641,527 & 4,512,671 (97.2) & 61.3 \\
1951 & 5,363,651 & 5,214,703 (97.2) & 56.9 \\
1952 & 7,031,910 & 6,840,662 (97.3) & 55.8 \\
1953 & 7,623,336 & 7,437,887 (97.6) & 53.8 \\
1954 & 8,310,204 & 8,122,723 (97.8) & 54.0 \\
1955 & 8,606,889 & 8,417,432 (97.8) & 53.2 \\
1956 & 8,650,771 & 8,459,203 (97.8) & 49.9 \\
1957 & 9,279,839 & 9,091,232 (97.9) & 50.1 \\
1958 & 9,887,087 & 9,706,839 (98.2) & 49.0 \\
1959 & 10,666,260 & 10,477,027 (98.2) & 47.8 \\
\end{array}
\]

* Ends on March 31 of the year succeeding that indicated.

Investment trusts, which did not exist in 1945 but began operations in 1951, accounted for 7.5% of all shareholdings in March 1960.\textsuperscript{57}

Seven investment trusts were established during 1951-1952 by seven securities companies (Nomura, Yamaichi, Nikko, Daiwa, Osaka Shoji, Osakaya, and Oi) following the enactment of enabling investment-trust legislation in 1951.\textsuperscript{58} The aggregate trust funds offered and/or established during the first nine months of operation totalled 16.45 billion yen, equivalent to roughly $46 million.\textsuperscript{59} Small individual investors constituted the overwhelming majority of subscribers. For example, the fifth trust fund established by Nomura Securities Company on December 17, 1951, covering 1 billion yen, had 10,864 subscribers, 10,689 of whom were individuals whose average investment was equivalent to $191 and accounted for 73.4\% of the principal amount.\textsuperscript{60} By 1958 investment trusts had increased their holdings to 1.48 billion corporate shares, or 6.5\% of the national total of all shares then outstanding.\textsuperscript{61}

The Anti-Monopoly Law enacted in April 1947\textsuperscript{62} prohibited companies from owning any corporate shares, except in wholly owned subsidiaries. Those companies not otherwise required by special SCAP directives to turn over their shares for disposition by the Holding Company Liquidation Commission and other agencies were obliged to report their shareholdings and to dispose of them under the supervision of the Fair Trade Commission. The Anti-Monopoly Law was amended in 1949, however, to permit intercorporate stock ownership in noncompetitive enterprises,\textsuperscript{63} thus opening the door to the acquisition of shares by companies for investment and other purposes.

By April 1, 1950, only 1,828 nonfinancial companies (\textit{i.e.}, other than banks, trust and insurance companies, securities dealers and underwriters) out of more than 200,000 corporate enterprises reported to the Commission that they had purchased or then owned corporate shares and that their holdings came to 156 million shares. This was indeed small compared with the estimated 1950 national total of more than 3

\textsuperscript{57}Ibid.
\textsuperscript{58}Law No. 198, June 4, 1951.
\textsuperscript{59}Nippon Times (Tokyo), April 2, 1952, p. 6, col. 3.
\textsuperscript{60}Id. at col. 4.
\textsuperscript{62}Law No. 54, April 14, 1947.
\textsuperscript{63}Law No. 214, June 18, 1949, amended by Law No. 259, Sept. 1, 1953.
billion shares outstanding. As of August 15, 1952, over 2,200 nonfinancial companies reported corporate holdings totalling 630 million shares.64

According to the Japanese Ministry of Finance, the shareholdings of nonfinancial companies, which amounted to 24.6% of all shares outstanding in 1945, declined to 11.7% in 195265 and thereafter increased at a moderate rate to reach 17.3% by March 1960.66 It is anticipated that increasing foreign trade and general rehabilitation and expansion of the Japanese economy, along with a gradual amelioration of the present shortage of capital accumulation, will witness a general rise in intercorporate shareholdings. There is no indication at present, however, of any serious danger that corporate securities will again be concentrated in the hands of a relatively few Zaibatsu family members, holding companies and giant enterprises, as in prewar days.

The undercapitalization of Japanese firms and characteristic dependence on "borrowed capital," accentuated at the close of hostilities in 1945 by wartime depletion of reserves and shortage of capital accumulation, were often exhibited in corporate balance sheets showing a ten to fifteenfold spread between "owned capital" and total assets. According to the Ministry of Finance, in the prosperous prewar years from 1932 to 1936, 59% of corporate capital consisted of "owned capital," including reserves amounting to 13%, and 41% of external obligations, including 33% of "borrowed capital" and 8% of "business liabilities." At the end of 1950, "owned capital" had declined to 22%, including reserves of only 1%, and external obligations had risen to 78%, including 31% of "borrowed capital" and 47% of "business liabilities."67

Events in recent years indicate movement in the direction of a more promising future. Despite large capital borrowings necessary to finance

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65 Ibid.
67 Outlook of the Japanese Economy, Sept. 1951, p. 13, table 17. Statistics published by the Economic Stabilization Board of the Japanese Government give the following percentage breakdown of corporate industrial funds prior to the Pacific War and during the postwar years:

<table>
<thead>
<tr>
<th>Year/Financial Year</th>
<th>&quot;Owned Capital&quot;</th>
<th>&quot;External Debts&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>1934-1936 (yearly average)</td>
<td>47.1%</td>
<td>52.9%</td>
</tr>
<tr>
<td>1937-1941 (yearly average)</td>
<td>28.7</td>
<td>71.3</td>
</tr>
<tr>
<td>1949 (fiscal year)</td>
<td>9.2</td>
<td>90.8</td>
</tr>
<tr>
<td>1950 (fiscal year)</td>
<td>15.3</td>
<td>84.7</td>
</tr>
</tbody>
</table>

Industrial Funds & Capital Increase, 19 Oriental Economist 124 (Tokyo 1952).
industrial expansion after the outbreak of Korean hostilities in June 1950, the sizeable capital stock increases occurring between 1949 and 1952 have more than kept pace in the face of deficiencies of capital accumulation in the hands of the general public and have caused the ratio of "owned capital" to rise steadily. And although the relative position of "owned capital" to "borrowed capital" has vastly improved since 1947, when it dropped to a low of 9% compared to 91% for "borrowed capital," its gradual recovery to 35%, 39%, 37%, 33% and 33%, respectively, during the years between 1953 and 1958 has not as yet approached the prewar level of 66% reached in 1936.

One significant exception in Japan to the traditional overreliance on bank loans for industrial construction has been afforded by the cotton textile industry. The so-called "Big Ten" textile companies (Toyo, Dainippon, Kanegafuchi, Kureha, Kurashiki, Nisshin, Fuji, Daiwa, Shikishima and Nitto), which account for the bulk of Japan's fabric output, have generally employed the modern method of obtaining primary capital requirements through the public offering of new shares. It is readily understandable why they should be more amenable to modern practices. They are engaged in world trade, their officials and other personnel frequently travel or receive university educations abroad, and they often maintain direct sales branches or agencies in other countries. It is noteworthy that after an initial period, corporate growth in this industry was

<table>
<thead>
<tr>
<th>Capital Composition</th>
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<tbody>
<tr>
<td>&quot;Owned Capital&quot;</td>
</tr>
<tr>
<td>&quot;Borrowed Capital&quot;</td>
</tr>
<tr>
<td>----------------------</td>
</tr>
<tr>
<td>Second half, 1949</td>
</tr>
<tr>
<td>Second half, 1951</td>
</tr>
</tbody>
</table>

Funds by Capital Increase, 19 Oriental Economist 636 (Tokyo 1952).


70 Japanese Economic Planning Board, op. cit. supra note 69.
relatively free of Zaibatsu capital, influence or control. As a result, the companies were quicker to adjust to modern conditions and to adopt progressive trade methods. The successful operation of these textile companies, whose output accounted for 56% of total Japanese exports during the 1934-1936 period and roughly one-third of all Japanese exports during 1954-1958,\textsuperscript{72} shows that their industrial leaders have not been hampered but quickened in viewpoint and competitive strength by inviting in the general public as their shareholders.

III

1950 Code Reforms

The main characteristic of the old Code was that the organization and management of companies were looked upon primarily as matters of private concern to the promoters and directors. Various types of restrictions could be and were imposed to insure perpetuation of control in the hands of the original circle of organizers. Very little opportunity existed for minority shareholders generally to learn the actual condition of affairs of their company.

These undesirable corporate practices interfered with the attainment of long-range economic democratization objectives. It was imperative that reform measures based on widespread ownership of securities in the hands of the public at large, encompassing a new class of investors in Japan, be fortified and supplemented by legal protection commensurate with legitimate investors’ interests in corporate management. A healthy sense of individual ownership, as well as a lively interest and participation in corporate affairs, could not be expected to take root unless such protections were afforded.

The 1950 companies law was designed to build up the position of the shareholders by granting them fair and natural rights of ownership, on the one hand, while fixing specifically the responsibilities of the directors, on the other. The underlying theory now was to regard directors as trustees for the shareholders, representing equity holders in the company, with strict accountability for their acts and dutybound to stay within the limits of prescribed authority and to disclose and report on important transactions, without taint of self-dealing or the possibility of wrongdoing being waived by majority shareholders. The purpose was to raise the general standards of corporate management; the hope was that eventually management of its own accord would elevate these standards so as

to make a technical resort to shareholders' rights in the courts under the new Code unnecessary.

Read in the light of the background data indicating the postwar economic democratization programs and objectives, out of which demands arose for corporate reform, the following summary of the new Code provisions should provide interested practitioners with a basic working guide to the 1950 amendments enacted and now incorporated into the Commercial Code of Japan.

1. Shareholders' Rights

Access to Corporate Books and Records. The new Code confers on shareholders owning ten per cent of total shares outstanding the right to examine and make extracts from corporate books, records and documents of account; it provides that the "demand . . . shall be made in writing with reasons."73 New article 293-5 requires the directors to prepare a detailed operations report ("detailed statement") within four months of the closing date fixed for the settlement of accounts. It must "state the operation of the company and the status of its property in reasonable detail, specifying the increase or decrease of the stated capital and the reserve fund," as well as "all transactions with the directors, auditors and shareholders, security created, the loans of money made if the company is non-financial, the acquisition of shares of any company, and the disposition of any fixed assets." Any shareholder may inspect or copy the statement at the main or branch offices or obtain an abstract thereof upon payment of the necessary costs.

Since the right of direct access to corporate books is available only upon request of ten per cent shareholders, it is important to minority shareholders that the company make full disclosure of major transactions in its detailed report. It may be their only available method of obtaining information as to the actual circumstances underlying these transactions. Such information is indispensable to the exercise of other

73 Code art. 293-6. Code art. 293-7 requires the directors to honor such demand unless "reasonable grounds" exist for their believing that (1) the inspection is sought to harass the management or injure the common interests of the shareholders, or is for a purpose other than to inform shareholders as to corporate affairs in connection with the protection or exercise of their statutory rights; (2) the demandants include a business competitor or a stockholder, director or member of such competitor, or a stockholder holding shares in the company on behalf of a competitor; (3) the demandants intend to offer the information received to others at a profit, or within two years have "offered for profit to others" information obtained from the company or any other company; or (4) the demandants have fixed an unreasonable time for the examination.
basic rights, for without proper knowledge shareholders will lack the means of uncovering and maintaining actions against directors’ wrongdoing or understanding and voting intelligently on issues presented at general meetings. The attitude of corporate management toward this new article and the type of reports issued under its provision deserve the most careful scrutiny. The spirit in which lawyers and management receive the amended Code may be fairly judged by their attitude toward reports assembled pursuant to its mandate. If couched in a vague, summary, noninformative style, similar to annual business reports in previous years, the purpose of the law may be subverted and the underlying practice may amount to an actionable violation.

The basic theory behind article 293-5 was that while desirable in principle, stockholders’ access to books is, from the company’s standpoint, inconvenient and incapable of complete realization. Detailed informational reports available to interested stockholders can and should serve as a reasonable and adequate substitute. It was because of this fact that the provision for direct access by any shareholder, orginally contained in the Attorney General’s draft bill of July 18, 1949, was dropped and replaced by the requirement for detailed operations reports designed to serve the same general purpose. Such reports, therefore, should furnish basically the same information that direct access would reveal in regard to transactions outside the normal course of business.

Along with direct access by ten per cent shareholders and detailed operations reports, the 1950 amendments added a new provision permitting inspectors to be appointed at a general shareholders’ meeting, convened on the demand of three per cent shareholders, “to investigate the affairs of the company and the state of its property.”

**Preemptive Rights.** The new Code inaugurated for the first time, as

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74 Code art. 237, para. 3. Article 281, carried over from the old Code, requires the directors to submit to the auditor, for his examination at least two weeks before shareholders’ meetings, an inventory, balance sheet, profit and loss statement and business report. Pre-1950 Code art. 238 authorizes an inspector to be appointed at the shareholders’ meeting “to examine the documents submitted by the directors and the written report of the Auditors.” Pre-1950 Code art. 263 was amended to include examination by any shareholder or creditor of the minutes of “board of directors” meetings. They may also inspect and make extracts from the articles, the minutes of shareholders’ meetings and the registry books. Article 452 was revised to authorize courts, on the application of three per cent instead of ten per cent shareholders, to order an “inspection of the affairs of the company” whenever deemed necessary in view of its financial condition and the state of its property.
an integral part of the Japanese corporate system, a clear and firm concept of preemptive rights. Article 280-4 declares that the term “preemptive rights” shall mean the right of each shareholder holding voting shares to acquire new shares in the same proportion as he then owns. Existing Code provisions were revised\(^7\) to bring them into line with other new articles\(^8\) on the subject. After being in effect for four years, however, the new system was largely nullified by the enactment of legislation in 1955,\(^7\) leaving the matter to each company’s discretion as reflected in its articles of incorporation or as determined by its board of directors. The outlook for large-scale expansion and acceptance of the preemptive-right system in Japan, therefore, does not appear to be a promising one at the present time.

**Capital Stock.** Until recent years virtually all shares of capital stock were issued at a par value of 50 yen, the minimum prescribed by the Code.\(^7\) The new Commercial Code increases minimum par value to 500 yen\(^7\) (approximately $1.39 according to the present rate of exchange) and requires that the issue price for shares having par value shall not be less than their face value.\(^8\) Companies may also issue shares “having par value or shares without par value, or both of them.”\(^8\) The old Code did not recognize and made no provision for no-par shares; references were only to shares having par value.\(^8\) Further, the new Code vests in the board of directors authority to stagger distribution of new shares representing authorized capital unissued at the time of incorporation or an increase in capitalization authorized by amendment of the articles.\(^9\) The authorized-unissued stock system thus inaugurated permits companies to meet current needs for additional capital by a series of subsequent issues. Prior to 1950 capital stock representing all of the authorized

\(^7\) Code arts. 166, para. 1, 175, para. 2, 188, para. 2, 222, para. 3, 225, para. 2, 347.

\(^8\) Code arts. 280-3 to -6.

\(^7\) Law No. 28, June 30, 1955.

\(^7\) Pre-1950 Code art. 202. It also permitted a minimum par value as low as 20 yen per share “when the whole amount of shares is to be paid up at one time.”

\(^9\) Code art. 202, para. 2.

\(^8\) Code art. 202, para. 3.

\(^8\) Code art. 199. No-par shares are specifically referred to in Code arts. 166, para. 1, 175, paras. 2, 3, 280-2, para. 1, and 280-6, which deal with the articles of incorporation, subscription applications and the power of the board of directors to fix terms and conditions governing issuance of new shares.

\(^9\) Pre-1950 Code arts. 166, 175, 188, 199.

\(^9\) Code arts. 166, para. 1, 177, para. 1, 184, para. 1, 188, 280-2 to -3.

\(^8\) Pre-1950 Code arts. 192, 356.
capital had to be issued at one time\textsuperscript{84} and be fully paid for if issued after July 12, 1948,\textsuperscript{85} without any power in the board of directors to time or to stagger the issuance of new shares.

Article 280-3 of the new Code provides that "the price and other terms and conditions of the issuance of shares distributed at any one issuance shall be uniform," except for shares acquired pursuant to preemptive rights granted upon more favorable terms than those available to the general public. The Code also requires that the subscriber of new shares "shall pay the full amount of the issue-price . . . on or before the date set for the payment thereon."\textsuperscript{86}

The existing provisions dealing with the special terms and conditions applicable to different classes of shares were carried over substantially intact into the new law.\textsuperscript{87} As to shares carrying the right of convertibility into another class, the new Code incorporated detailed provisions governing the application form, demand for conversion, registration of the alteration and related procedural matters.\textsuperscript{88} Former provisions authorizing the articles of incorporation to prohibit or restrict the transfer of any shares were eliminated to insure free negotiability. Revised article 204 declares: "The transfer of a share shall not be prohibited or restricted even by the provisions of the articles of incorporation."\textsuperscript{89}

The amended Code authorizes the company to provide for transfer agents and registrars in its articles.\textsuperscript{90} The directors may now keep the

\textsuperscript{84} Pre-1950 Code arts. 170-71, 177. Issuance of new shares after incorporation was possible only through the adoption of a resolution amending the articles by a majority vote representing one-half the number of shareholders and amount of shares outstanding. Prior to 1948, partially paid shares subject to calls for additional payment provided corporate management with a flexible mechanism for the acquisition of new capital requirements. Legislation enacted in 1948 abolished the partially-paid stock system and allowed a two-year period to complete payments on outstanding shares. Law No. 148, July 12, 1948.

\textsuperscript{85} Code art. 280-7. Articles 175, 177, 348 and 350 of the old Code, governing subscription applications for shares issued at incorporation, resolutions increasing capital, and applications for new shares, did not require the terms and conditions to be uniform.

\textsuperscript{86} Code art. 222.

\textsuperscript{87} Code arts. 222-2 to -7.

\textsuperscript{88} Code art. 204, which constitutes one of the basic reforms of the new Code, now applies to all companies in Japan except newspaper publishing concerns. Just prior to the scheduled enforcement date of the new law, the Diet, on June 2, 1951, enacted special legislation authorizing newspaper companies, by appropriate provision in their articles and share certificates, to "restrict the transfer of shares to a person who is related with the enterprise . . . and who is approved by the board of directors thereof, notwithstanding the provisions of Article 204 of the Commercial Code (Law No. 48 of 1899)." Law No. 212, June 8, 1951.

\textsuperscript{89} Code art. 206, paras. 2-3. The old Code did not make any explicit provision for the
registry books or duplicates thereof at the place of business of the transfer agent.\(^91\) When the transfer agent records the name and address of the transferee in the duplicate register of shareholders, "the entry of a change of holders in the register of shareholders . . . is deemed to have been made."\(^92\) Detailed rules are set out governing the issuance of stock dividends approved by a two-thirds majority vote at a general shareholders' meeting,\(^93\) and the board of directors is given general authority to order a splitting of shares.\(^94\) Stock dividends and splitting of shares were not mentioned or regulated under the old Code.

**Voting.** Under the new Code shareholders may exercise cumulative voting rights at elections for directors, unless the articles of incorporation otherwise provide. Notwithstanding the articles, however, service of a demand therefor by holders of one-fourth of the shares outstanding is effective to permit cumulative voting at the next election.\(^95\) In addition, the Code provides for proxies which are now limited in duration to one general meeting.\(^96\)

Article 241 provides that "each shareholder shall have one vote for each share." The former provision\(^97\) permitting the articles to limit the voting rights of holders of eleven or more shares, or to prohibit voting by new shareholders registered less than six months, was repealed. In addition, the new Code eliminated the former authority to create nonvoting classes of shares not to exceed one-fourth of total capital.\(^98\) Voting rights may still be withheld from preferred shareholders but only during the period that required dividend payments are not in arrears.\(^99\)

**Shareholders' Objections to Merger.** Any shareholder objecting to a proposed merger now may require the company to "buy out" his interest by paying him the fair value of his shares.\(^100\) No such right existed under the old Code.

appointment of a transfer agent or registrar, and it was questionable whether authority existed for the directors to maintain duplicate registry books at the place of business of such an agent or registrar.

\(^91\) Code art. 263.
\(^92\) Code art. 206, para. 2.
\(^93\) Code art. 293-2.
\(^94\) Code art. 293-4.
\(^95\) Code arts. 256-3 to -4.
\(^96\) Code art. 239, para. 4.
\(^97\) Pre-1950 Code art. 241, para. 1.
\(^98\) Pre-1950 Code art. 242.
\(^99\) Code art. 242, para. 1.
\(^100\) Code arts. 245-2 to -4, 408-2.
Shareholders' Meetings. Adoption of resolutions at the constituent general meeting now requires approval by a two-thirds majority vote of those present "who have . . . not less than one-half of the total number of shares . . . ."101 However, resolutions at general meetings may be adopted by a majority vote of those present who hold more than one-half of total shares outstanding, unless otherwise provided for by the articles.102 As to general meetings held for the election of directors, the articles of incorporation may not specify a quorum consisting of shareholders owning less than one-third of all shares.103

The new Code requires that resolutions to amend the articles of incorporation be approved by a two-thirds majority vote of the shareholders present, representing more than one-half of the total number of issued shares outstanding.104 The same voting requirement exists for a transfer, lease or entrustment of management of the business of the company, or the taking over of the business of another company.105

Revised article 245 omits former item 4 which permitted the liability of a director or auditor to be waived by a resolution approved by a majority in number of total shareholders and amount of capital outstanding. Revised article 266, paragraph 4, now provides that the liability of a director for misconduct cannot be released "except by the unanimous consent of all the shareholders." The same rule applies to auditor misconduct106 and to the liability of promoters, directors and auditors in connection with the establishment of the company.107

101 Code art. 180, para. 2. The old Code authorized resolutions to be approved at the constituent general meeting by a simple majority vote of those present "who shall constitute in number not less than one-half of the persons who have subscribed for shares and who shall represent not less than one-half of the capital." Pre-1950 Code art. 180.

102 Code art. 239, para. 1. The old Code did not stipulate any quorum for general shareholders' meetings, and resolutions at such meetings could be adopted by majority vote of those present unless the articles of incorporation provided otherwise. Pre-1950 Code art. 239.

103 Code art. 256-2.

104 Code art. 343. Under the old Code, a majority vote of those present representing "one-half of the total number of shareholders and at least one-half of the capital" was necessary to amend the articles, to approve a transfer, lease or entrustment of the management of the company, to acquire another company's business, to remit the liability of promoters, directors or auditors to the company for damage in connection with its formation, and to release director or auditor liability for neglect of duty. Pre-1950 Code arts. 343, 245, 196, 266, 280.

105 Code art. 245.

106 Code art. 280.

107 Code art. 196.
The new Code eliminated former provisions whereby provisional resolutions to amend the articles of incorporation could be adopted by simple majority vote of those present at a general shareholders’ meeting\textsuperscript{108} and then finalized by a like vote at a second general meeting convened within one month, without regard, at either meeting, for the regular quorum requirement for amendment of the articles.\textsuperscript{109}

2. Shareholders’ Remedies

\textit{Standards Governing Responsibilities of Directors and Officers}. Two principal means by which management was made more responsible to the shareholders were the limitations placed upon the auditor system and the introduction of the concept of a board of directors. While the office of auditor was retained in the new law, many of his theoretical functions and certain of his powers were abolished.\textsuperscript{110} The new Code provisions introduced the concept of a board of directors, and references to “board of directors” were inserted at appropriate places throughout the Code. For example, article 265 requires formal “approval of the board of directors” before any director may receive loans or become a party to business transactions with the company. While retaining the existing provision that the “law of mandates” shall apply to corporate directors, it also obliges them to observe the limits of authority prescribed by the articles and to refrain from ultra vires acts.\textsuperscript{111} Moreover, the unanimous consent of all shareholders is now required to release a director from his joint and several liability for wrongful acts on his part or those of other directors acquiesced in by him.\textsuperscript{112} And unless a director expressly dissents from action permitted by a board-approved resolution, he is “deemed to have done such act.”\textsuperscript{113}

\textsuperscript{108} Pre-1950 Code art. 343, para. 2.

\textsuperscript{109} Pre-1950 Code art. 343, para. 3.

\textsuperscript{110} Pre-1950 Code arts. 247, 258, 265, 380-81, 415 were revised to eliminate former functions of the auditor. Existing provisions authorizing him to inspect corporate books and records, examine into the state of corporate affairs, and to render his opinion on financial statements and reports submitted by the directors at a shareholders’ meeting were continued without substantial change. Code arts. 274-75.

\textsuperscript{111} Code arts. 58, para. 1, 254-2, 266, para. 1, 272.

\textsuperscript{112} Code art. 266, para. 4. The only exception is that the statutory liability for extending loans to a director or for permitting him to transact business with the company may be released by “a majority of two-thirds of the total number of the issued shares,” provided that full disclosure of all material facts is made at a general shareholders’ meeting. Code art. 266, para. 5.

\textsuperscript{113} Code art. 266, paras. 2-3.
Action for Damages. The new Code provides that any shareholder who has held his stock for six months may now demand that a damage suit be brought to enforce the liability of directors. If the company fails to do so within thirty days, he may institute a representative suit on behalf of the company in which it and other shareholders may formally intervene, and if successful, attorneys' fees may be recovered as a part of the judgment. If an emergency threatens irreparable damage to the company, the thirty-day waiting period may be dispensed with and the action begun immediately. Instead of mandatory posting of security, as under the old Code, the court may now demand security only if the defendant “renders credible” the fact that suit was initiated in bad faith. In the event that the shareholder loses his suit, he is liable in damages to the company only if he acted with wrongful intent.

If an action is brought against directors and an adverse or inadequate judgment is rendered by collusion “for the purpose of prejudicing the right of the company,” other shareholders or the company may petition for a reopening of the case. Abolished were provisions reserving the right of action to shareholders owning one-tenth of total capital, making it mandatory to furnish security in all cases as requested by the auditor, and subjecting shareholders acting in good faith to liability in damages to the company in case the action failed.

114 Code art. 267, para. 1.
115 Code art. 267, para. 2, 268, para. 2, 268-2, para. 1. Under the old Code, an action-to recover damages for “neglect of duties” could be brought pursuant to a resolution of a general shareholders' meeting, or upon demand of ten per cent stockholders where a proposal to that effect has been rejected at a general meeting. “Neglect of duties” was nowhere explicitly defined. The demand of the ten per cent shareholders had to be lodged with the auditor within three months of the general meeting, and it was then obligatory for the company to initiate suit within one month. Pre-1950 Code arts. 267, para. 1, 268, paras. 1-2.
116 Code art. 267, para. 3.
117 Code art. 267, paras. 4, 5. The requirement for posting of security was added by Law No. 209, June 8, 1951.
118 Code art. 268-2, para. 2.
119 Code art. 268-3, para. 1. The new remedial provisions authorizing shareholders' suits against directors, Code arts. 267 to 268-3, and the new rule requiring unanimous consent of all of the shareholders to release the liability of a director, Code art. 266, para. 4, were made applicable to promoters and auditors. Code art. 196, 280. However, the new right to injunctive relief against directors, Code art. 272, was not carried over to promoters and auditors.
120 Pre-1950 Code art. 268. Minority shareholders were at the mercy of majority shareholders; for example, a director could, to the detriment of the company, engage in the same line of business as the company pursuant to a bare majority vote of a general meeting, or be a party to personal business transactions with it where assented
**Injunctive Relief.** Today, any shareholder of six-months duration may ask for injunctive relief on behalf of the company to stop threatened irreparable damage due to acts of the directors in contravention of law or the articles of incorporation.\(^{121}\) This remedial provision does not mention the posting of security or any liability to the company in case the application proves abortive. Before 1950, the nearest approach to such relief was the right of ten per cent shareholders to convene an extraordinary meeting to remove a director, coupled with an application to the court “to suspend the exercise of the duties of said director” pending the outcome of such meeting.\(^{122}\) The court could not, however, effect removal from the office; that could only be done by resolution of a general shareholders’ meeting.\(^{123}\)

**Removal of Directors.** Directors may now be removed by resolution of a general shareholders’ meeting approved by a two-thirds vote of those present, representing more than one-half of total shares outstanding,\(^{124}\) instead of a bare majority vote of those present as under the old Code. This is one instance where the new law is more lenient in favor of directors than the old Code. Special meetings to remove a director may be convened on the demand of shareholders owning three per cent of total shares,\(^{125}\) instead of ten per cent as was formerly the case. The same number may now institute removal proceedings if a general meeting has rejected a resolution, “notwithstanding that there have been dishonest acts or any grave fact constituting the contravention of any law or ordinance or the articles of incorporation in connection with the performance of his duties . . . .”\(^{126}\)

to by the auditor. Any liability for wrongdoing and resultant damage to the company could be unqualifiedly released by a resolution approved by a majority of shareholders and amount of shares outstanding, even if the latter were beneficiaries of the acts in question. Majority shareholders could effectively thwart and circumvent the efforts of even an organized minority representing the required one-tenth of outstanding capital. By a majority vote at a general meeting, they could authorize the company to sue recreant directors, and by resolution adopted by majority vote at a subsequent meeting, the action could be “withdrawn, compromised or the demand relinquished.” This would make it infeasible for the ten per cent shareholders to demand that the company sue, since rejection at a general meeting of a proposal to that effect was a condition precedent to such demand, and the basis for suit would no longer exist after the claim had been extinguished by majority shareholders. Pre-1950 Code arts. 193, 245, para. 1, 264-67, 280.

\(^{121}\) Code art. 272.
\(^{122}\) Pre-1950 Code arts. 237, 272.
\(^{123}\) Pre-1950 Code art. 257.
\(^{124}\) Code art. 257, paras. 1-2.
\(^{125}\) Code art. 237.
\(^{126}\) Code art. 257, para. 3.
Court-Appointed Inspectors. The provision enabling ten per cent stockholders to apply for court-appointed inspectors "to investigate the affairs of the company and the state of its property" in case of suspected dishonesty, serious wrongdoing or grave violation of law or of the articles of incorporation was carried over without change into the new Code, except for the deletion of the former requirement that such shareholders must have owned their shares for three months. Auditors were also deprived of their former authority to make such applications.

The old Code was further modified in that required shareholder participation was reduced from ten to three per cent in the following situations: (1) in applications for court appointment of inspectors where there was suspicion or danger of insolvency ("in view of the state of the company's property"); (2) in applications for the commencement of adjustment proceedings where the condition of the company is such that "there is a danger of its becoming insolvent"; and (3) in applications to the court in adjustment proceedings for the removal of directors acting as liquidators. In addition, auditors were shorn of their authority to make applications in the latter instance, and courts were deprived of their blanket authority to dismiss an application for the commencement of adjustment proceedings which it deemed "an abusive exercise of a right or with any improper objective . . . ."  

Wrongful or Unauthorized Corporate Acts. Repeated ultra vires acts are now recognized under the new Code as grounds for court dissolution of the company on application of the Minister of Justice, any shareholder, creditor or other interested party. Instead of the former mandatory requirement that the interested-party complainant post security as demanded by the company, the court may now order the furnishing of security only if the company "render[s] credible" the fact that the action was brought in bad faith. It appears somewhat anomalous that while the requirement as to depositing security was retained in modified form,
the old Code provision subjecting applicants who acted with wrongful intent or gross negligence to liability in damages to the company was repealed.\textsuperscript{134}

Furthermore, ten per cent shareholders may now apply to the court for dissolution in case of deadlocked management or gross mismanagement threatening irreparable damage or endangering the existence of the company.\textsuperscript{135} The applicants are made liable in damages where they act in bad faith or with gross negligence, but the posting of security and the broad discretion in the courts to dismiss well-founded actions, similar to that formerly exercised under old articles 107 and 251, was not mentioned in the new provisions.\textsuperscript{136}

No change was made in the right of shareholders or directors to bring suit for unauthorized corporate activity, such as an invalid resolution, consolidation or capital change.\textsuperscript{137} But the previous authority of the auditor to instigate suit for invalid corporate activity has been abolished. Another basic reform under the new Code was the elimination of the trial court's former broad discretion to dismiss such actions.\textsuperscript{138} The new Code, however, retains various provisions calling for liability in damages to the company where an unsuccessful plaintiff acted in bad faith or with gross negligence in bringing action. It also retains provisions calling for the posting of security in suits for invalid consolidation\textsuperscript{139} and resolutions,\textsuperscript{140} the requirement for security having been abolished by Law 167, May 10, 1950, but reinstated in modified form by Law 209, June 8, 1951. Another innovation introduced by the new Code allows any shareholder to obtain injunctive relief where the issuance of new shares is effected in an improper manner or at an unfair price so that shareholders are thereby threatened with "pecuniary disadvantage."\textsuperscript{141}

3. Foreign Companies

The registration requirements applicable to foreign companies were clarified by the 1950 amendments, and an explicit guaranty was added to assure legal equality with domestic companies. The old law, leaving open

\textsuperscript{134} Pre-1950 Code art. 60.
\textsuperscript{135} Code art. 406-2(1).
\textsuperscript{136} Code art. 406-2.
\textsuperscript{137} Pre-1950 Code arts. 104, 371 (now arts. 280-15 to -16), 380, 415.
\textsuperscript{138} Pre-1950 Code arts. 107, 251, para. 1, 371, 380, para. 3, 416, para. 1.
\textsuperscript{139} Code art. 416, para. 1.
\textsuperscript{140} Code art. 249, 280, para. 3, 280-16.
\textsuperscript{141} Code art. 280-10.
the question as to what type of commercial transactions in Japan required a foreign company to have a registered branch office there, merely declared that when a foreign company established a branch office in Japan, it had to file registrations comparable to those of a domestic company and designate a local representative.\textsuperscript{142} The new amendments clearly state that a foreign company must establish and register an "office of business" and appoint a representative when it "intends to engage in commercial transactions as a continuing business in Japan . . ."\textsuperscript{143} Under the former Code, third parties could deny the existence of a foreign company in Japan if it had established but failed to register its branch office.\textsuperscript{144} The new law prohibits foreign companies from engaging in commercial transactions "as a continuing business in Japan" until it has registered an "office of business."\textsuperscript{145} It also subjects the individual handling its affairs to joint and several liability with the company for acts performed.\textsuperscript{146}

Pertinent Commercial Code provisions governing domestic companies were made applicable to the issue, transfer or pledge of share or debenture certificates in Japan by a foreign company.\textsuperscript{147} The existing provisions authorizing a court to order the closure and liquidation of branch offices in Japan on application of the Minister of Justice, a shareholder or other interested party were carried over substantially unchanged.\textsuperscript{148} For some reason, the court's ex officio power to order closure was deleted, but its authority to appoint a receiver on its own initiative to preserve the assets prior or subsequent to an order of closure remains unimpaired.\textsuperscript{149} The grounds for closure include, as heretofore, the creation of an "office of business" for an illegal object, failure to commence business for a period of one year, and abuse of authority conferred by law or repeated violation of the criminal laws despite written notice and warning from the Minister of Justice.\textsuperscript{150}

Among the most significant changes wrought by the new Code was a provision guaranteeing and recognizing, as a matter of general principle, that foreign companies were entitled to legal equality with domestic en-

\textsuperscript{142} Pre-1950 Code art. 479.
\textsuperscript{143} Code art. 479, para. 1.
\textsuperscript{144} Pre-1950 Code art. 481.
\textsuperscript{145} Code art. 481.
\textsuperscript{146} Ibid.
\textsuperscript{147} Code art. 483.
\textsuperscript{148} Code arts. 58, para. 1, 484, para. 1.
\textsuperscript{149} Code art. 484, para. 2.
\textsuperscript{150} Code art. 484, para. 1.
enterprises. According to the new law, a foreign company is "deemed . . . formed in Japan either of the same nature or of the kind which it most closely resembles, insofar as the application of other laws is concerned . . . ."\textsuperscript{151}

**Conclusion**

A Law Advisory Council (Hosei Shininkai), appointed by the Minister of Justice to review and make recommendations with regard to the Commercial Code, Civil Code and other laws, submitted its report on February 2, 1962, after nearly four years of study.\textsuperscript{152} The Commercial Code Subcommittee, made up of six or seven government officials and professors, was headed by a professor of law from Tokyo University. Recommendations were made on twenty-four points directly or indirectly related to various provisions of the companies law. They dealt for the most part with the regulation of mundane fiscal matters, coupled with several suggestions of relatively minor yet significant import on purely legal subjects. None touched on or affected any of the basic Code reforms.

The Advisory Council offered moderate, progressive suggestions for improvement with regard to a number of essentially noncontroversial matters. For example, it was recommended that the establishment, relocation or closure of branch offices need not entail amendment of the articles of incorporation; that the procedures for public registration of the names of managing directors and auditors should be simplified; and that the stock issuance date as to subscribers of new shares shall be deemed effective as of the day immediately following date of payment. Two recommendations were not only in line with the 1950 reforms, but provided, in effect, for the further implementation of Code reforms designed to protect individual shareholders' interest in case of proposed mergers. One would require that balance sheets be prepared and made available for examination and copying by shareholders and creditors at least two weeks before the board meeting convened to approve the merger. The other would require that the period in which objections may be raised to such merger or a capital reduction shall not be less than thirty days.

These recommendations of the Advisory Council were incorporated

\textsuperscript{151} Code art. 485-2. The general equality of treatment guaranteed by this article was qualified by the following closing words: "this shall not apply in cases where it is otherwise provided for in laws."

into a bill drafted by the Ministry of Justice and introduced into the Diet during March 1962. The current thinking of responsible Japanese financial leaders with respect to these proposed amendments is well illustrated in the views expressed by Mr. Gengo Suzuki, Executive Director of the International Monetary Fund:

Legislation recently introduced to amend a part of the Commercial Code does not affect any of the basic principles of the Code reforms enacted in 1950. As in the case of other laws which underwent large-scale changes during the Occupation period, experience during the intervening years has demonstrated a need for some refinement and technical modification in order to meet the changing times. The Commercial Code was no exception in this respect. After a thoroughgoing study by the Law Advisory Council, legislation was introduced in March 1962 to amend a part of the Code on a number of points dealing for the most part with financial accounting matters. The nature of these proposed amendments indicates that there was no change in the basic principles of postwar Code reforms. Even though there may be occasion for change in the future, it will be in response to some developing need, dictated by the changing situation, in order to make the Code applicable to current economic circumstances. Basic Code provisions do not constitute a controversial matter at the present time, and it is unlikely that they would be the subject of controversy or drastic revision in the foreseeable future. There has been general acceptance of the fundamental principles underlying present Code provisions as an integral part of the permanent legislation of Japan.\(^\text{153}\)

It is anticipated that legislative action requested will be enacted before the end of the year.

The Code reforms approved by the Diet in May 1950, immediately prior to the onset of the Korean War, represented what may fairly be described as the last major reform accomplished before the effective date of the Treaty of Peace with Japan, April 28, 1952. Discussions during the negotiating and drafting stage occupied a period of twenty months. The reforms eventually enacted were the result of gradual progress toward mutual understanding based on a full and frank exchange of views. There was no Far East Commission policy decision or formal SCAP directive specifically requiring the Japanese Government to adopt Commercial Code reforms. Success was largely due to the development on the part of the Japanese representatives of a viewpoint favorable to giving the matter a fair trial. Helpful also was the desire not to be

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\(^{153}\) Letter from Gengo Suzuki to Lester N. Salwin, April 12, 1962. Mr. Suzuki, who is an alumnus of the University of Wisconsin, served as Financial Commissioner of Japan, Ministry of Finance, 1951-1957, and as Minister (Financial) at the Japanese Embassy, Washington, 1957-1960. He became Executive Director of the International Monetary Fund and the International Bank for Reconstruction and Development in December 1960 and has represented Japan, Thailand, Burma and Ceylon in that capacity since that time.
identified with the past but to acquire the reputation and good will associated with adherence to internationally accepted standards. The realization became apparent that this too would provide a much needed basis for facilitating the introduction of foreign investment.

The outlook for the future as far as the Code reforms are concerned cannot be predicted apart from or with any greater degree of assurance than the all-embracing, postwar national movement itself toward gradual democratization of virtually every aspect of Japanese society. Only one thing appears certain, viz., that the process must necessarily be gradual and that the ultimate product will represent a Japanese adaptation or version of the democratic system. This will characterize the inevitable order of events despite the fact that it may strike an American observer as painfully slow and the changes effected as extremely modest. But unhurried, gradual progress affords the only assurance that reforms adopted will win general acceptance and have lasting effect in Japan. The Code reforms will endure as long as it is felt that they satisfy a genuine need and that no one is particularly harmed, i.e., the interests of no significant group or segment of the economy are adversely affected by observing the statutory provisions. The fact that the Code reforms, with the sole exception of preemptive rights, have been maintained intact and the Law Advisory Council after four years of study supports their further implementation augurs well for the future.
COMMENTS

CONVERSION OF FOREIGN MONEY OBLIGATIONS MATURING DURING WAR

SHERMAN L. COHN*

Reviewing the approaches taken by United States and foreign courts to the problem of applying appropriate exchange rates where a "force majeure" prevents payment of a foreign currency obligation payable in the forum country and an exchange-rate fluctuation follows, the author suggests using the first rate after resumption of commercial intercourse, a rule originally proposed as a matter of equity. Although an admitted departure from the rule ordinarily applied in the absence of a "force majeure" situation, the breach-date rule, Mr. Cohn feels his suggestion not only meets the requirements of commerce and is consistent with existing monetary theory, but favors those hurt most by exchange-rate fluctuation—the debtor in the country of depreciated currency.

INTRODUCTION

The law is but an attempt to bring order to society. To do this it must find ways of compromising adverse interests. As these interests arise in nonlegal fields, the lawyer must occupy himself with those other branches arbitrarily designated in the social continuum. And, unfortunate though it may be for the tranquility of lawyers and judges, these nonlegal fields refuse to remain static so that the jurist can spin a theory in the abstract that will hold true forevermore, leaving to himself only the mechanical task of fitting the legal theory to the facts at hand. Rather, the jurist is faced with the never-ending process of building and rebuilding order in relationships constantly in flux, referring always to some intangible and immutable concept of justice and equity.

On November 26, 1958, the United States Court of Appeals for the District of Columbia Circuit handed down an opinion in International Silk Guild, Inc. v. Rogers on a little discussed aspect of a problem in flux that has ancient roots—the value of money. The lack of discussion may be attributed to the fact that the particular problem has arisen on

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2 The specific problem has received only passing mention in Mann, Legal Aspects of Money 413 (2d ed. 1953), and in Nussbaum, Money in the Law, National and International 336-37 (rev. ed. 1950).
so few occasions. Yet its solution in the District of Columbia case has reputedly affected the disposition of several millions of dollars in dispute. Questions raised by that case may best be considered after a discussion of the factual context out of which the problem arose. *International Silk Guild* involved a course of conduct going back to 1936, whereby exporters of silk in Japan, acting through their trade associations and the Central Raw Silk Association of Japan, incurred a quasi-contractual obligation to pay to the International Silk Guild of New York the amount of five yen per picul\(^4\) of silk exported from Japan. Payments of the obligation were interrupted, however, by government-imposed exchange restrictions and then stopped altogether in 1941 by the beginning of World War II. The court found that the quasi-contractual obligations existed in whoever possessed the funds in question, at least among those privy to the arrangement. This obligation, the court held, became fixed at the time that the assets of the possessor of the funds were vested in the United States Alien Property Custodian.\(^5\) The action before the court involved Asahi Silk Company, Ltd., whose assets in the United States were vested on October 31, 1942, on which date Asahi possessed 80,327.09 yen of the funds in question. Therefore, the situation involved an obligation on the part of a Japanese firm to pay an American firm some eighty thousand yen at a time when no commercial intercourse was permitted between nationals of those countries because of the war.

Under section 20 of the Monetary Coinage Act of 1792,\(^6\) American courts are permitted to render judgments only in dollars and not in terms of foreign currency.\(^7\) Therefore, the court was faced with the necessity

\(^3\) This case was reputedly a pilot action to determine legal questions that will control subsequent litigation. A second case involving these issues is now pending in the same court. Aratani v. Kennedy, No. 16,808, D.C. Cir., Jan. 8, 1962.

\(^4\) A picul is a bale of 132.3 pounds.


\(^7\) Bronson v. Rodes, 74 U.S. (7 Wall.) 229, 254 (1868); Shaw, Savill, Abion & Co. v. The Fredericksburg, 189 F.2d 952, 954 (2d Cir. 1951); Frontera Transp. Co. v. Abaunza, 271 Fed. 199, 202 (5th Cir. 1921); Pennsylvania R.R. v. Cameron, 280 Pa. 458, 463, 124 Atl. 638, 639 (1924); see Eder, Legal Theories of Money, 20 Cornell L.Q. 52, 63 (1934). England apparently has the same rule. Wolff, Private International Law 460-61 (2d ed. 1950). But it should be noted that many foreign countries allow judgments to be rendered in currencies foreign to their own. Professor Mann says that at least Austria, Egypt, Germany, Italy, Norway, Poland and Switzerland are in this category. Mann, op. cit. supra note 2, at 307. Of course, the American and English rule would not apply where
of converting the foreign-currency debt into a dollar debt. Ordinarily there would be no difficulty, for exchange rates are generally stable. But in time of exchange-rate instability there is an obvious problem. In the International Silk Guild case, the yen, under the last exchange rate before World War II, was worth 23.436 cents, while the postwar rate was 361.55 yen to the dollar. Applying the prewar rate the Guild would be entitled to some $20,000; under the postwar rate, however, it would be entitled to only $222.16. The question presents itself as to which, if either, of these two exchange rates should be applied.

I

Applicable Monetary Theory

Since the basis of the present problem is money, an understanding of the legal characteristics of money is needed before a solution can be found. Blackstone defined money as "the medium of commerce" made current by "the king's perrogative . . . . [It is] an universal medium, or common standard, by comparison with which the value of all merchandise may be ascertained; or it is a sign which represents the respective values of all commodities." This definition has been modified but little to the present day. Professor Mann defines money in the following terms: "[T]n law, the quality of being money is to be attributed to all chattels which, issued by the authority of the law and denominated with reference

the action is brought in the nature of detinue for the recovery of specific pieces of foreign currency treated as chattels.

8 The exchange rate at a given time is a question of fact to be determined by the trier of fact, while the time chosen for the determination of the exchange rate is a question of law. Reissner v. Rogers, 107 U.S. App. D.C. 260, 266, 276 F.2d 506, 512 (1960), cert. denied, 364 U.S. 816 (1961); Farmer v. Orme, 131 Cal. App. 628, 21 P.2d 977 (Dist. Ct. App. 1933); Comstock v. Smith, 20 Mich. 338 (1870); Nussbaum, op. cit. supra note 2, at 366.

9 Since the subject matter of this article does not encompass the American rules on exchange-rate problems in general, they will be discussed only as they relate to the topic at hand. Discussion of these rules appears in several sources, where their rationale, merits and demerits are quite fully developed. See Cheshire, Private International Law 250-56 (5th ed. 1957); Mann, op. cit. supra note 2, at 271 passim; Nussbaum, op. cit. supra note 2, at 341 passim; 3 Rabel, Conflict of Laws 18 passim (1950); Wolff, op. cit. supra note 7, at 450; Dach, Conversion of Foreign Money, 3 Am. J. Comp. L. 155, 160, 179-85 (1954); Evan, Rationale of Valuation of Foreign Money Obligations, 54 Mich. L. Rev. 307 (1956); Evan, The I.L.A Draft Convention on Payment of Foreign Money Obligation, 85 Journal du Droit International 406 (1958); Oliphant, The Theory of Money in the Law of Commercial Instruments, 29 Yale L.J. 606, 619-24 (1920).

10 1 Blackstone, Commentaries *276.
to a unit of account, are meant to serve as universal means of exchange."\(^1\)

A distinction must be drawn between "money" on one hand and "commodity" on the other. A commodity has its own intrinsic value in terms of its own utility and no more, whereas money has value not according to its own intrinsic utility but as a medium of exchange, i.e., the utility that it can purchase. The most vivid example of the difference is paper money. The intrinsic value of the paper that we call the five dollar bill is very little, and minus its official insignia it would bring practically nothing on the commercial market. However, once these official insignia are applied, the same piece of paper acquires a value out of all proportion to its intrinsic worth. Thus the commodity has become money.

Not so very long ago the worth of money was measured by its intrinsic value.\(^2\) The value of a pound or a dollar of gold depended first on the amount of gold contained within the pound or the dollar, and second on the supply or demand of gold that existed.\(^3\) This "intrinsic" theory has now been replaced by one of "nominalism." Certain commodities have been made legal tender in each country for certain amounts, and they must be accepted for those amounts no matter what their intrinsic value may be. Thus a paper dollar in the United States is worth the same as a silver dollar, though their intrinsic values are certainly much different.

Still another distinction must be recognized. Economic theory has abandoned the intrinsic-value concept of money and employs a functional concept. Economists speak of the value of money in accordance with its purchasing power.\(^4\) Under the nominalistic legal theory, however, the value of money is independent of its purchasing power. In the words of Mr. Justice Holmes, "obviously, in fact a dollar or a mark may have different values at different times but to the law that establishes it it is

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11 Mann, op. cit. supra note 2, at 7.

12 See 1 Blackstone, Commentaries *276. Blackstone had a metallistic concept of money. "As the quantity of precious metals increases . . . this universal medium, or common sign, will sink in value, and gross less precious . . . The consequence is, that more money must be given now for the same commodity . . ." Id. at *276-77. Though Blackstone's observations were correct for his time, his metallistic concept is not valid today.

13 For a discussion of early standards of monetary valuation, see Burns, Money and Monetary Policies in Early Times 315 passim (1937).

14 See Chandler, The Economics of Money and Banking 32 passim (1953); Hawtrey, Currency and Credit 30 passim (1950); Keynes, A Treatise on Money 23 passim (1935). See generally Angell, The Story of Money (1929); Steiner, Money and Banking (1933).
always the same."\textsuperscript{15} Thus if \(A\) borrows one hundred dollars from \(B\) for ninety days, he is not obligated by the law to pay back one hundred and three dollars in principal if, due to inflation, the value of the dollar has fallen three per cent in the meantime. Rather, barring any contract stipulation to the contrary,\textsuperscript{16} the repayment of one hundred dollars, plus whatever interest is required, satisfies the contract obligation. The nominalistic theory goes so far as to insist that a "dollar is a dollar" even though the legal tender recognized by the government may have changed between the date of contracting and the date of performance. This concept is well summarized in a passage by Mr. Justice Strong:

The expectation of the creditor and the anticipation of the debtor may have been that the contract would be discharged by the payment of coined metals, but neither the expectation of one party to the contract respecting its fruits, nor the anticipation of the other constitutes its obligation. There is a well-recognized distinction between the expectation of the parties to a contract and the duty imposed by it. Were it not so the expectation of results would be always equivalent to a binding engagement that they should follow. But the obligation of a contract to pay money is to pay that which the law shall recognize as money when the payment is to be made. . . . Every contract for the payment of money, simply, is necessarily subject to the constitutional power of the government over the currency, whatever that power may be, and the obligation of the parties is therefore assumed with reference to that power.\textsuperscript{17}

A nominalistic theory of money is appropriate to a commercial concept of a contract as a vehicle to minimize risk. A buyer enters into a contract of purchase to be sure that he gets the goods he needs on a certain day at a certain price. The seller, on the other hand, enters into such a contract to be sure that he has a buyer for those goods on that day at that price. The buyer in this relationship assumes the risk that before the performance date deflation may raise the value of his dollar in relation to the goods for which he has contracted. The seller assumes the risk that inflation may lower the value of the dollar that he will receive. The fixing of these elements of risk is necessary to the flow of commerce, for it is only by such devices that adequate long-range plans can be made. Nevertheless, it must be recognized that contracts involving

\textsuperscript{15} Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517, 519 (1926).

\textsuperscript{16} See, e.g., Gregory v. Morris, 96 U.S. 619 (1877); Bronson v. Rodes, 74 U.S. (7 Wall.) 229 (1868).

\textsuperscript{17} Legal Tender Cases, 79 U.S. (12 Wall.) 457, 548 (1870); see Ling Su Fan v. United States, 218 U.S. 302 (1910); Woodruff v. Mississippi, 162 U.S. 291, 302 (1896); Effinger v. Kenney, 115 U.S. 566, 575 (1885); Juilliard v. Greenman, 110 U.S. 421, 449 (1884); Faw v. Marsteller, 6 U.S. (2 Cranch) 10 (1804).
payment of money in futuro involve what Chief Justice Hughes once called "a congenital infirmity."

Determination of risk by the contracting parties in such manner still leaves open the question of the risk of currency fluctuation after payment is due. It can validly be argued that though the seller or creditor has agreed to undertake the risk of currency fluctuation between the contract date and the date at which payment is due, he has not undertaken such a risk for the period after payment is due. This argument can be pursued, also quite validly, to the conclusion that the defaulting debtor should recompense the creditor for all losses incurred by his breach, including those caused by currency fluctuation. American courts, however, have refused to recognize such fluctuations as a valid basis of damage and have allowed recovery of only the nominal sum of the debt—plus interest. All of this fits quite logically into the nominalistic theory.

Monetary nominalism forms the basis of the American treatment of exchange-rate problems. Though American courts naturally treat the currency of the United States as money, they treat foreign money as a commodity; a loan of foreign money is "as if one should borrow his neighbor's cow." The consequence of this is that when a debtor defaults on a foreign-currency obligation, the courts assess damages in the same mode as they would if the debtor had failed to return a cow.

20 Interest should not be considered a means of compensation for undertaking the risk of post-due-date currency fluctuations. It is only supposed to serve as a rental charge on the use of money or, conversely, as compensation for the deprivation of the use of money. This conclusion is forced by the fact that the interest rate allowed by courts is as a practical matter no higher than the return the creditor could have expected from a prudent investment. See Deputy v. du Pont, 308 U.S. 488, 498 (1940); Miller v. Robertson, 266 U.S. 243, 257 (1924); Swartzbaugh Mfg. Co. v. United States, 289 F.2d 81, 85 (6th Cir. 1961).
22 McAdoo v. Southern Pac. Co., 10 F. Supp. 953, 955 (N.D. Cal. 1935), rev'd on other grounds, 82 F.2d 121 (9th Cir. 1936). This same description had been used by the House of Lords. S.S. Celio v. S.S. Volturino, [1921] 2 A.C. 544, 563.
that he had borrowed. In the latter situation the court would not render a judgment for a cow of the same age, weight, beauty and what-have-you as the cow which the debtor failed to produce on the due date. Rather, the court would assess in dollars the value of the damage that the creditor had suffered from the debtor's default. So it is with foreign money obligations. If A has defaulted on an obligation to pay B one hundred French francs on January 1, 1962, a court would not order A to pay B that amount of francs plus interest but would convert the one hundred francs into dollars as of the exchange rate existing on the due date, plus interest on the dollar obligation.\footnote{This, the "New York" rule, applies the exchange rate inflexibly as of the date of breach. Sokoloff v. National City Bank, 250 N.Y. 69, 82, 164 N.E. 745, 750 (1928); Gross v. Mendel, 225 N.Y. 633, 121 N.E. 871 (1918); Hoppe v. Russo-Asiatic Bank, 200 App. Div. 460, 465, 193 N.Y.S. 250, 255 (1922), aff'd, 235 N.Y. 37, 138 N.E. 497 (1923). It has been followed in California. Compania Engrav Comercial E. Industrial S.A. v. Schenley Distillers Corp., 181 F.2d 876 (9th Cir. 1950). But cf. note 28 infra.}

This theory, however, cannot be applied in the same manner in all cases, for it runs into conflict with a fundamental tenet of jurisprudence: a plaintiff should recover the same judgment regardless of the court in which he brings his action, \textit{i.e.}, no plaintiff should benefit from forum shopping.\footnote{See Cole v. Cunningham, 133 U.S. 107 (1890).} The problem in treating foreign currency as a commodity in all cases is that, assuming as the courts have\footnote{See cases cited note 21 supra.} that the foreign currency would be treated as money in the country in which it was legal tender, any action brought in that country to recover the same debt would result in a foreign-currency judgment. If the value of the foreign currency had increased or decreased in relation to the dollar since the debt was due, the plaintiff would get more or less by suing in a foreign country. For example, assume that a debt of one hundred English pounds is due A from B on January 1, 1962, and that B defaults. Assume that as of the
breach-date the English pound is valued at four American dollars. Assume further that between the due date of the debt and the date on which judgment is given \( A \), the pound is devalued so that it is worth only three American dollars. If \( A \) brings his suit in the United States he would receive $400, the equivalent of 133\( \frac{1}{3} \) English pounds; if he brings it in England, he would receive one hundred English pounds, the equivalent of $300. The difference lies in the fact that the American court, treating the pounds as a commodity, assesses the damages as of the date of the breach, \( i.e. \), the American court converts the pounds to dollars as of that date. The English courts, however, on the nominalistic theory, would treat the pound as money and award only the nominal amount of the debt no matter how much the value of the pound may have fallen because of the devaluation. The respective recoveries would be in inverse proportion if the American dollar had been devalued in terms of the English pound.

The American courts solved this problem by holding that whenever, under the terms of the contract or by operation of law,\(^{26} \) the foreign-currency debt is to be paid in the United States and is subject to American law under the court's conflict-of-laws principles, the foreign currency would be treated as a commodity and the exchange rate on the date of the breach would be applied.\(^{27} \) However, when the foreign-currency debt is to be paid in the home country of the currency and is subject to its law, it will be treated as money.\(^{28} \) The latter rule is based

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\(^{26} \) By operation of United States law, the place of payment, if the contract is silent on the subject, is deemed to be the place where the creditor resides. See Hicks v. Guinness, 269 U.S. 71, 80 (1925); Mann, op. cit. supra note 2, at 174. This is true also in Great Britain, Switzerland, Holland, Italy, Greece and Hungary. In France, Belgium and Germany, however, the law presumes, again in the absence of contract stipulation, that the place of payment is where the debtor resides. Ibid. Where the currencies of two countries bear the same name, unless there are indications that the parties intended otherwise, the currency of the place of payment is generally the money of payment. Liebeskind v. Mexican Light & Power Co., 116 F.2d 971 (2d Cir. 1941); see Wolff, op. cit. supra note 7, at 460-61.


on the assumption that the nominalistic theory prevails in the foreign country and that any exchange, value or purchasing-power fluctuations will be ignored.

This concept is clearly spelled out by Mr. Justice Holmes in *Deutsche Bank Filiale Nurnberg v. Humphrey*.29 That case involved an action by an American citizen against a German bank for damages incurred due to the failure of the bank to pay a sum of German marks to the American, which the latter had deposited with the bank and had demanded on June 12, 1915. The value of the German mark fell greatly between 1915 and the time the action was brought after World War I. The Court held that since the breach had occurred in Germany under German law, the judgment-date rule should apply. Mr. Justice Holmes, spelling out the theory under which the Court arrived at its conclusion, stated:

> We may assume that when the Bank failed to pay on demand its liability was fixed at a certain number of marks both by the terms of the contract and by German law—but we also assume that it was fixed in marks only, not at the extrinsic value that those marks then had in commodities or in the currency of another country.

Here we are lending our Courts to enforce an obligation (as we should put it, to pay damages) arising from German law alone and ought to enforce no greater obligation than exists by that law at the moment when suit is brought.30

These rules have been criticized by the writers in the field,31 but the fact is that they remain the law. Accepting the underlying assumption that all countries adhere to a nominalistic doctrine, they appear to be valid.32 They are discussed here merely as a means of understanding a

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29 272 U.S. 517 (1926).
30 Id. at 519. It is of interest that in 1920 Judge Augustus Hand, sitting on the District Court for the Southern District of New York, applied the dual rules adopted later by the Supreme Court in Zimmermann v. Sutherland, 274 U.S. 253 (1927); Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517 (1926); and Hicks v. Guinness, 269 U.S. 71 (1925). The Verdi, 268 Fed. 908 (1920). He applied the breach-date rule to a debt payable in sterling in New York at the equivalent rate in dollars. In The Hurona, 268 Fed. 910 (1920), he applied a judgment-date rule to a debt payable in francs at Marseilles.
31 E.g., Mann, op. cit. supra note 2, at 276-77.
32 This assumption, though, is erroneous. Professor Mann states that after World War I
specific problem—the treatment to be given a foreign-country debt when the debtor is unable to render payment or the creditor is unable to receive payment because of conditions beyond the control of either party.

II

Force Majeure Effect on Conversion Rules

Though exchange-rate problems are of ancient origin, there are few reported cases dealing with the question under consideration. These cases have presented four solutions to our problem, two framed by courts of this country.

The United States Court of Appeals for the Second Circuit in *Pape v. Home Ins. Co.* faced the problem of deciding what exchange rate to apply to a debt measured in Spanish pesetas that matured during a period in which the Spanish Civil War caused a temporary interruption of commercial intercourse. The court held that the last-proved exchange rate of a little more than two weeks previous to the maturity of the debt would be presumed to have continued until proved otherwise. This same result was reached by the Supreme Court of Austria in 1916 and by a New York Supreme Court six years later. In both cases the time between the last quotation and the date the obligation matured was relatively short.

Germany allowed creditors relief from being paid currency vastly depreciated by the inflation, and that both Austria and Germany have allowed damages for inflation after the due date of the debt. He points out that these things have never been done in Great Britain or the United States, but that we have never been faced with the inflationary conditions existing in many countries after World War I. Mann, op. cit. supra note 2, at 84-87.

34 139 F.2d 231 (2d Cir. 1943).
35 Id. at 236.
37 Melzer v. Zimmerman, 118 Misc. 407, 194 N.Y. Supp. 222 (Sup. Ct. 1922), aff'd mem., 205 App. Div. 886, 198 N.Y. Supp. 932 (1923). Compare Birge-Forbes Co. v. Heye, 251 U.S. 317, 325 (1920). There an obligation in German marks became fixed before war prohibited intercourse. At that time the par value of the German mark was 23.8 cents, but by the time of the trial its actual value had fallen to 18½ cents. There was no evidence of the commercial exchange rate at the time the obligation arose. The Fifth Circuit held that it would presume that the par value, the only thing in evidence before it, was its actual value, 248 Fed. 636, 640 (1918), and the Supreme Court affirmed. The Fifth Circuit here applied a strict theory of nominalism, treating the marks as a commodity and figuring the obligation in dollars as of the time it arose.
A second approach was used by the Supreme Court of Palestine in Bank Mizrahi, Ltd. v. Chief Execution Officer. The bank had received a judgment on a debt due in French francs. The trial court, acting as Chief Execution Officer, converted the francs into Palestinian currency according to the rate established by the High Commissioner under the Trading with the Enemy Ordinance for ascertaining the value in Palestinian currency, payable to the Custodian of Enemy Property, for debts due enemy aliens in foreign currency.

The third method of solving the problem, an indirect exchange-rate principle, has three adherents in judicial reports. In Pollard v. Herries the English Court of Common Pleas applied such a principle on a debt due in French livres Tournois in 1799, when there was no exchange rate between France and England because of war. The court calculated the French currency in terms of Hamburgh marks and then converted the latter into English pounds. This method was later followed by the Anglo-German Mixed Arbitral Tribunal in cases decided in 1925 and 1927.

The final approach was developed by the United States Supreme Court in Sutherland v. Mayer and followed by the Court of Appeals for the District of Columbia Circuit in the International Silk Guild case. Sutherland involved an action by an American for an accounting of a partnership in which he and several residents of Germany had been members before World War I, and which was automatically dissolved with the declaration of war. The question concerned the evaluation in dollars of partnership assets in Germany and England. To apply the rate existing at the time of dissolution would have resulted in the German partners bearing the whole loss caused by depreciation. The Court held that the first available rate of exchange after the war should be applied, saying that the resultant loss to the American claimant was "an ineluctable consequence of the war."

The courts that have met this problem have one element in common. No matter how their solutions have differed, each has sought to find the answer most equitable to the interests involved. It should be clear that

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42 271 U.S. 272 (1926).
43 Id. at 295.
44 Id. at 292.
there exists no easy mechanistic answer that will provide a fair solution in all situations. Yet a study of the reasoning of the courts in the light of the conditions prevailing at the time of each case should provide guideposts which future jurists can use.

First of all, it must be realized that the existence of a certain exchange rate is, at least in the United States, a question of fact.\textsuperscript{46} Therefore, much will depend on the record made in each individual case. For example, in both \textit{Pape} and \textit{Birge-Forbes Co. v. Heye},\textsuperscript{46} the exchange rate applied by the courts proved to have existed closest to the date on which the debt arose. The court specifically stated in each case that it was presuming, in absence of evidence to the contrary, that these rates continued until the critical dates, or at least that they represented an approximation of true value. The inference is present that if evidence had been introduced to the effect that these rates did not represent true value on the critical dates, the courts might have reached different results.\textsuperscript{47}

Each of the four methods employed by the courts in solving the problem here under discussion has elements to commend it. The method used by the Palestinian court in \textit{Bank Mizrahi} has the advantage of simplicity and ease in that the difficult problem of balancing the equities is shunted to the executive branch of government. It may be especially attractive to a creditor where a governmental custodian of alien property is standing in the shoes of a foreign debtor whose property has been vested in him,\textsuperscript{48} for the custodian would be forced to pay debts at the same rate at which he collects them. But this method could not be applied equitably in an action by the creditor against the foreign debtor himself, for, all theory aside, the debtor could not have paid at the time that rate existed.

The British court, applying an indirect method of exchange conversion in the \textit{Pollard} case, based its action on the fact that it was possible in 1799 to deal in foreign exchange through a circuitous route when direct intercourse was interrupted by war. As this avenue was open to the

\textsuperscript{46} See note 8 supra.

\textsuperscript{46} 248 Fed. 636 (5th Cir. 1918), aff'd, 251 U.S. 317 (1920). See discussion in note 37 supra.

\textsuperscript{47} 139 F.2d at 236; 248 Fed. at 640. See Judgment of March 29, 1924, Corte di Cassazione del Aegno, [1924] 49 Il Foro Italiano 587 (Italy), where this approach was taken.

\textsuperscript{48} See, e.g., the situation in \textit{International Silk Guild}. If this method had been employed in that case, the Guild would have recovered dollars at the prewar rate of exchange, for the Custodian had established that rate for the payment of debts vested in him payable in yen. See General Order No. 30, Office of Alien Property Custodian, 9 Fed. Reg. 2771 (1944).
debtor to satisfy his debt when due, it should have been employed by him; mere inconvenience does not excuse a debtor from rendering a payment due. As abstract justice this view is commendable. However, such a circuitous approach is quite unrealistic in an age of total war. No court should presume, in absence of proof to the contrary, that a Japanese debtor, for example, could have paid an American creditor in 1942 by sending yen through Switzerland to the United States, having it exchanged into dollars along the way.\(^49\)

The principal advantage in the approach used by the courts in \textit{Pape} and \textit{Melzer v. Zimmerman},\(^50\) and by the Austrian court in 1916\(^51\) is a simplification of work for the court; it provides a presumption and puts the burden on the attorneys to prove that the last existing exchange rate does not apply as of the critical date, and that it did not represent true values as of that date.\(^52\) As in the solution of the Palestine court, this approach completely ignores the fact that the innocent debtor just could not make payment on the day on which the debt became due.

The last method, the one utilized in the \textit{Sutherland} and \textit{International Silk Guild} cases is, in this author’s view, the most equitable approach to balancing the adverse interests of debtor and creditor consistent with basic monetary theory. The Supreme Court recognized in \textit{Sutherland} that, from the moment at which the obligation arose,\(^58\) the German debtors had no opportunity to render payment, for no commercial intercourse or traffic between citizens of the two enemy countries, direct or indirect, was permissible:

\(^49\) This method was urged to the court by the International Silk Guild, 104 U.S. App. D.C. at 336 n.9, 262 F.2d at 225 n.9, but was rejected. The Anglo-German Mixed Arbitral Tribunal used this approach to the problem. Strauss v. German Government, 6 Recueil des Decisions Tribunaux Arbitraux Mixtes 17 (1927); Catty v. German Government, 4 Recueil des Decisions Tribunaux Arbitraux Mixtes 261 (1925). Unfortunately, the Tribunal did not report its reasoning in making the disposition. This is to be regretted since, in the author’s view, the possibility of a debtor using an indirect exchange rate was as unrealistic during World War I as it is today.


\(^52\) Compare Judgment of March 29, 1924, Corte di Cassazione del Aegno, [1924] 49 Il Foro Italiano 587 (Italy).

\(^53\) The obligation arose out of the automatic dissolution of the partnership upon the beginning of the war. See Griswold v. Waddington, 16 Johns. Rep. 438, 492 (N.Y. 1819); Small’s Adm’r v. Lumpkin’s Ex’x, 69 Va. (28 Gratt.) 832 (1877); Fenwick, International Law 608-09 (3d ed. 1948); Phillipson, The Effect of War on Contracts and on Trading Associations in Territories of Belligerents 98-99 (1909); Wilson, International Law 276 (1939).
In whatever aspect the case is viewed or upon whatever basis the liability of the German partners be made to rest, the loss, in the final analysis, was an ineluctable consequence of the war. Is it to be borne by them alone or to be shared equally by all the partners as a common misfortune beyond the power of any of them to turn aside? That question justly cannot be solved by a strict enforcement of the ordinary rule as in ordinary cases, for here we are dealing with extraordinary and anomalous conditions, as a result of which money values were swept away by immense causes as much beyond the sway of the German partners as of Mayer. Blame for such a situation rests upon neither; and equality is equity.

The equitable solution reached by the application of the rule in Sutherland on its facts is obvious. The questions remain whether it fits into the rules for exchange-rate conversion discussed above, and whether it would lead to equitable results if applied in cases other than a partnership accounting.

To recapitulate the basic theory: if the obligation be to pay American dollars, there is no need to apply any conversion rules; under nominalism, the theory fundamental to the legal status of money in the United States, it is immaterial that the debtor's assets, be they in currency or not, have depreciated. Second, if there be a foreign-currency obligation and that obligation is both subject to American law and payable in the United States, it is to be converted to dollars as of the date it arose, the so-called breach date. If, on the other hand, the foreign currency debt is subject to foreign law and payable in a foreign country, it is to be converted to dollars as of the date of the judgment.

The initial proposition in Sutherland, as distinguished from Deutsche Bank Filiale Nurnberg v. Humphrey, is the fact that the obligation was subject to American law and payable in the United States. Ignoring for the moment the fact that the obligation in Sutherland arose at a point when commercial intercourse between the parties was barred, we find

54 See Hicks v. Guinness, 269 U.S. 71 (1925). The ordinary rule here would be a conversion as of the breach date. [Author's footnote.]

55 271 U.S. at 292-93. The view that the ordinary solutions to exchange-rate conversion problems should not necessarily apply to situations in which a "force majeure" prevents payment was incorporated into article 4 of the proposed revised draft convention on Payment of Foreign Money Liabilities adopted by the International Law Association at its 1956 conference. The draft convention is published in 85 Journal du Droit International 611 (1958). See the critical analysis of the draft by Charles Evan, id. at 406, and the discussion of the "force majeure" provision, id. at 436-38.

56 272 U.S. 517 (1926). The distinction between Deutsche Bank and Sutherland was drawn by a Court composed of the same nine Justices.

57 Id. at 520.
the same situation as existed in *Hicks v. Guinness*—a foreign-currency obligation subject to American law and payable in the United States. Therefore, the breach-date-conversion rule of *Hicks* is applicable. However, said the Supreme Court in *Sutherland*, to apply the strict breach-date rule in a partnership situation, where the obligor-partners would innocently suffer the entire loss, is inequitable. Therefore, the conversion date should be moved to the first opportunity that the debtors had to satisfy their obligation, *i.e.*, the first rate after the resumption of commercial intercourse should be applied.

The large question arising here is whether this rule should be applied to comparable situations not involving a partnership relation, *e.g.*, a simple contract debt or the quasi-contract obligation existing in *International Silk*. Though the relationship of partners is more one of trust than is the relationship existing in the other two situations, the fiduciary capacity of a given creditor or debtor affects the equities of the *force majeure* situation little. Further, this appears to be the best balancing of the interests from a commercial viewpoint; that is, one of the prime aims of commercial relations is to fix risk. The rule of *Sutherland* does just that. To understand this, assume a contract case reversing the positions of the parties in *Sutherland*. Assume that the obligation of an American debtor to a German creditor, payable in marks in the United States, matured during World War I. Under the principle of *Hicks* conversion would be made and risk fixed as of the breach date; under the *Sutherland* rule this would be set as of the resumption of commercial intercourse. Here the debtor may act in the best of faith by depositing the foreign currency needed to pay the debt where the interest rate, if any, could never keep up with the currency fluctuation that will result from the war. He has acted in utmost good faith, protecting his creditor as best he can, and should not be penalized therefor.

However, *Sutherland* should be limited to situations in which the breach-date rule would ordinarily be employed. It is not applicable, as such, to situations in which a judgment-day rule should be used. In those cases no change from normal rules is required.

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58 269 U.S. 71 (1925).
59 The law of negotiable instruments seeks to satisfy this aim of commerce. See Miller v. Race, 1 Burr. 452, 454-55, 97 Eng. Rep. 398, 400 (K.B. 1758).
60 As mentioned above, the court applied the *Sutherland* rule in *International Silk Guild*. Judge Fahy's opinion contains a passage which, on its face, raises the question whether *International Silk Guild* was a situation for the application of *Sutherland*:

Since the obligation was to pay the Guild in dollars in the United States, which was the method of making remittances employed under the previous arrangements be-
The law as it now stands, at least in federal jurisdictions, is not a perfect solution; it is certainly not so plainly right as to be dictated by some concept of natural law. Unfortunately, until a more perfect solution is found, exchange-rate fluctuations will cause some interest to be hurt in every case. Yet this solution is a balancing of the interests in such a manner as to be lenient toward those persons who are hurt most in currency fluctuations: the debtor in the country of depreciated currency. But no matter who is helped or hurt, it is a rule that is both equitable and in conformity with commercial needs and with the ruling monetary theory of nominalism.

The amount of the judgment now to be entered in dollars is to be ascertained as of the date of the breach of the obligation. Hicks v. Guinness, 269 U.S. 71 . . . .


Under all the rules and theory, if the obligation was to pay in dollars, there should be no need to convert. As pointed out above, it should be immaterial whether the value of a dollar-currency debtor's assets rose or fell between the date of breach and that of payment. By applying Hicks v. Guinness to this situation, the court would in effect be reducing a $20,000 debt to $222.16, because the assets into which the debtor put the $20,000 between maturity and the end of the war depreciated. This, it is submitted, would overrule the Legal Tender Cases, 79 U.S. (12 Wall.) 457 (1870), and the whole line of cases, cited in note 17 supra, culminating in the remark of Mr. Justice Holmes that "obviously, in effect a dollar or a mark may have different values at different times but to the law that establishes it it is always the same." Deutsche Bank Filiale Nurnberg v. Humphrey, 272 U.S. 517, 519 (1926).

Upon analysis, however, it will be seen that the court was correct in applying Sutherland. In the quoted passage Judge Fahy was talking about the original contract debt between the Japanese Central Raw Silk Association and the International Silk Guild. But it was not on this contract debt that Asahi Silk Company's obligation was held to exist. Rather, its obligation was quasi-contractual, arising out of the Central Raw Silk Association's dispersal to it of its share of the funds not sent to the International Silk Guild. And as this dispersal was in yen, Asahi Silk's obligation was in yen.
ON JUDGING THE CONNALLY AMENDMENT

John H. Crabb*

In analyzing the legal impact of the Connally amendment, the author emphasizes that it has thus far been invoked only as a preliminary objection, rather than as a peremptory challenge, to the jurisdiction of the International Court of Justice, thus leaving the Court the power to decide, on the basis of good faith and reasonableness, whether or not the "determination" by the state that the subject matter of the suit is domestic is a true "determination" within the meaning of that state's acceptance of the Court's jurisdiction. Viewed in the light of this less restrictive limitation, its rather infrequent use, and the practical difficulties in securing any acceptance of compulsory international court jurisdiction, Professor Crabb suggests that some reservation clause, such as the Connally amendment, is presently defensible.

I

The Connally amendment has been a lively source of controversy since its birth in 1946. Most writings on the subject have appeared either in the period immediately following its adoption or in recent years when suggestions were being pressed for its repeal. Despite the considerable volume of writing on this topic, it remains an unresolved issue. Presumably, it will continue to remain unresolved until such time as definite action or decision results from an assertion by a state of a right of peremptory challenge to the Court's jurisdiction in a case of patently international character. Unless and until this happens, a broad field for speculative writing remains open, and it is proposed here to indulge in just such an activity.

As a matter of terminology, it may be suggested that the nomenclature "Connally amendment," while having the virtue of brevity and convenience, has the vice of being somewhat parochial and unscientific. Though the Connally amendment may have originated this specific problem of the compulsory jurisdiction of the International Court of Justice, actually it reflects a general principle and is not peculiar to the United States. Essentially, the same reservation has been made by several other states in accepting the compulsory jurisdiction of the Court. And while the

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1 For example, in the case brought by France against Norway, it seems rather unnatural to speak in terms of the "Connally amendment" when one of the parties utilized a reservation similar to that amendment to assert a right to make its own determination of domestic jurisdiction. Norwegian Loans Case, [1957] I.C.J. Rep. 9. The other states
term "peremptory reservation of domestic jurisdiction" has been mooted, the use of the adjective "peremptory" contains controversial value judgments with which this article proposes to take issue. A more neutral (and cumbersome) designation might be something like "reservation of advance determination of domestic jurisdiction." However, rather than burden the discussion with such unwieldy terminology, the phrase "Connally amendment" or "Connally reservation" will be retained here, with apologies for its inadequacies and anomalies when applied to non-United States cases.

The issue of the Connally amendment has been raised in two cases before the International Court of Justice. In the Norwegian Loans Case, France, who had accepted the compulsory jurisdiction of the Court but with a Connally reservation, brought suit against Norway, whose acceptance of compulsory jurisdiction contained no such reservation. Norway made preliminary objections to the Court's jurisdiction on the grounds that the matter was by nature domestic to Norway, and that by invoking the reciprocity of the French reservation, Norway had determined the matter to be domestic to her. The Court expressly declared it lacked jurisdiction because of Norway's assertion that it had determined the matter to be domestic and said that this certain ground of lack of jurisdiction made it unnecessary for the Court to examine whether the case was in fact domestic.

Although this decision may seem to go a long way toward establishing the peremptory or arbitrary character of the Connally amendment, whereby the Court's jurisdiction is precluded ipso facto by the defendant's statement that it finds the matter to be domestic to itself, the case actually cuts both ways in this respect. For one thing, there is the fact that Norway did not rely solely on her right to declare the matter domestic so as to defeat the Court's jurisdiction, but also advanced separate

now having the reservation are the United States, Mexico, Liberia, Pakistan, Sudan and South Africa. Similar reservations also had been made by France, Great Britain and India, but these states have dropped them by now. See Ober, The Connally Reservation and National Security, 47 A.B.A.J. 63 (1961).


3 Judge Lauterpacht, in his separate opinion in the Norwegian Loans Case, [1957] I.C.J. Rep. 9, 34, uses the phrase "automatic reservation." Despite some attractiveness of this phrase, the word "automatic" is also objectionable in about the same way as "peremptory."


5 Id. at 27.
reasons why the matter was domestic as a matter of law. If by invoking this reservation Norway considered that its own determination of domestic jurisdiction was an "arbitrary," "peremptory," or "automatic" exclusion of the Court's jurisdiction, there would have been no need, even out of considerations of abundance of caution, to plead additional arguments as to why the matter was domestic. This interpretation is buttressed by the opinion of dissenting Judge Basdevant. In addition, there were reasonable grounds in this case upon which Norway could base tenable arguments as to the domestic nature of the controversy. Thus the case does not stand very sturdily for the proposition that the Connally amendment gives the state invoking it an arbitrary and unqualified power to divest the Court of jurisdiction, regardless of matters of good faith or whether any reasonable bases for a determination of domestic jurisdiction exist.

The other case involving the Connally amendment is the Interhandel Case, which has been so protracted as to seem to qualify as international justice's version of Dickens' famed Jarndyce case. In the Interhandel Case, brought by Switzerland against the United States, the United States invoked the Connally amendment as one of four preliminary objections to the Court's jurisdiction. Among these, the United States argued that the affair was, as a matter of the Court's own jurisprudence, a domestic one, and not merely that the United States had so determined. Here again, as in the case of Norway, a litigant armed with the Connally reservation felt constrained not to rely upon it alone, but rather to submit alternative grounds of objection as well. The United States, then, apparently does not consider its use of the Connally amendment as an ultimate and absolute weapon beyond the scrutiny of the Court. Moreover, the circumstances of the Interhandel Case were such that reasonable arguments as to its domestic nature could be made. Though both parties urged the Court to make a ruling on the Connally amendment, it felt that the status of the case was such that it could not properly do so and declined jurisdiction on other grounds.

There has been a wide variation of intellectual quality and approach in both the attacks on the amendment and the defenses raised in its behalf.

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6 Id. at 25.
7 Id. at 71.
9 Id. at 11.
10 Ibid.
11 Id. at 15-19.
Some of the defenses are based on sentiments seeming to stem from attitudes of isolationism, chauvinism and xenophobia. Their central theme is a distrust of the Court, in that it may lack the integrity to limit itself to matters of international jurisdiction. In addition, the method of selecting the members of the Court has been suggested as opening the door to judgments by scurrilous and unprincipled judicial nominees from the Iron Curtain bloc, and the Connally amendment is advanced as a salutary shield against such outrages. These superficial defenses of the amendment scarcely recommend it to those more thoughtfully concerned with juristic matters. Indeed, if it has no better justifications than that, it would scarcely be worth defending from a standpoint of legal theory and should be considered purely a matter of political discretion. Thus its efficacy would have to be argued solely on that basis.

However, there have been profound and analytical defenses of the Connally amendment from a standpoint of legal analysis, including some well-reasoned doubts as to whether the Court is in fact the most appropriate entity in which to repose the power that a repeal of the amendment would entail. And the amendment has been intelligently defended as being fully in accord with principles of international law as they now stand; whether that law should or will change is a separate inquiry which should not be the basis for attacking the present validity of the amendment.

Similarly, a number of attacks on the amendment partake of the same characteristics as those written in its defense. Many articles assume that the motivation and support for it derive solely from the more superficial attitudes of some of the amendment's supporters. Complaint is also made, on a rather sentimental basis, that the Connally amendment makes us look foolish, offends world opinion, and detracts from our posture of world leadership. Moreover, an attack on the purity of the Court or the United Nations may be held up uncritically as a piece of unrelieved barbarism. Such reactions of horror deserve no more respectful attention than the tub-thumping type of support the amendment has received. However, here, as among the writings in its defense, there

12 A collection of such sentiments is presented with disapproval in Briggs, Confidence, Apprehension and the International Court of Justice, 1960 Proceedings, Am. Soc'y of Int'l L. 25.
exists a substantial bibliography of analytical and well-reasoned dis-passionate attacks on the amendment.15

Although contemporary writings against the amendment are numerous, it may be that it has gained rather than lost in reputation and respectability over the last decade and a half. The early spearhead of opposition after its adoption by the Senate in 1946 was the American Bar Association. At its February 1947 meeting, the Association’s House of Delegates adopted by a large majority the Teasdale resolution expressly condemning the Connally amendment.16 Further vigorous institutional opposition has been indicated by the appearance in New York City of the Committee for Effective Use of the International Court.

Yet not all the reaction contemporary to its adoption was unfavorable.17 The basic resolution accepting the compulsory jurisdiction of the Court, to which the Connally amendment was appended, had been offered by Senator Morse.18 Although he opposed the amendment, he did not at first consider that it substantially destroyed his resolution and manifested no great distress at its inclusion.19 In the years that have passed since that time, there has been some indication of a softening of this opposition, and commentary favorable to it has been published under the American Bar Association auspices.20 In the 1960 meeting of the Association, the question was raised as to whether the condemnation of the amendment in the Teasdale resolution of 1946 should be withdrawn. Although this move was defeated, it was by the narrow and much reduced margin of 114 to 107.21

The purpose of this discussion is not so much to argue for the re-


tention of the amendment as it is to explore its real legal impact and, in the light of this analysis, to point out the defensibility of its present use. It has become somewhat fashionable to deride the amendment as a wholly disreputable thing, and as an accused it may stand in need of a fairer hearing than it is getting. As to whether the accused ultimately should be convicted is not a prime concern of this discussion.

II

The amendment has been denounced frequently as being an unwholesome bit of self-judging, making a mockery out of the concept of compulsory jurisdiction. More concretely, it has been argued that the amendment is invalid as being in conflict with article 36(6) of the Statute of the Court, which provides: "In the event of a dispute as to whether the Court has jurisdiction, the matter shall be settled by the decision of the Court." If the Connally amendment means that the determination of law as to whether the state, armed with this amendment, is subject to the Court's jurisdiction in a given case is to be made in the chancellories of the state involved, rather than in the judicial chambers of the Court, the amendment is certainly in conflict with this paragraph of the Statute of the Court.

However, this is not what happens. When a government decides to classify a matter as domestic and invokes its reservation, that is not the end of the matter. If it were, that state could probably ignore any subsequent judicial proceedings in the case and simply do nothing at all. No doubt, as a matter of practicality and minimal diplomatic courtesy, the state would at least send a note to the president or registrar of the Court advising of the determination made. But the matter would lie entirely outside the Court. Instead, the amendment has been invoked in the form of a preliminary objection to the jurisdiction of the Court and presented to the Court for its determination the same as any other preliminary objection designed to cause or persuade the Court to find that it is without jurisdiction. This is the way the matter was handled in the Norwegian Loans Case and the Interhandel Case, the only two occasions it has been raised before the Court. The procedure qua

22 See Preuss, Questions Resulting from the Connally Amendment, 32 A.B.A.J. 660 (1946).
23 Stat. Int'l Ct. Just. art. 36, para. 2; see Interhandel Case, [1959] I.C.J. Rep. 6, 55-59 (Spender, J., separate opinion); id. at 101-04 (Lauterpacht, J., dissenting); id. at 76-78 (Klaestad, J., dissenting); id. at 32 (Carry, J., dissenting); id. at 93-94 (Armand-Ugon, J., dissenting). See also Larson, supra note 15.
procedure followed by Norway and the United States occasioned no comment or surprise and certainly appears to be the normal and expectable way for states to invoke their reservations. The Court, then, becomes the agency to decide whether the litigant state has determined the matter to be domestic, and hence whether, by terms of the acceptance of compulsory jurisdiction by that state (or, by reciprocity, of its opponent state), the Court has jurisdiction. Thus, at least from a standpoint of formal and technical judicial procedures, no self-judging of jurisdiction by the litigant state is or could be involved.

Nevertheless, it may readily be argued that this hardly leaves the Court with any real competence, and that these technicalities of procedure do not affect the substance of the power to make the determination as to domesticity, which is the point of real concern. Such a technical position is merely an empty verbalism, since this effect of the Connally amendment would reduce the Court’s function to the purely ministerial one of registering the fact that the litigant state has determined the matter to be domestic.24 Yet the fact that the Court technically does decide whether a state employing the amendment has determined the matter to be domestic may not be such a superficial point as it first appears. This opens the door to the Court’s interpreting the meaning of the amendment, as well as deciding whether the state’s action has amounted to a determination that the matter is domestic. Certainly the Court in the Norwegian Loans Case and the Interhandel Case, together with the separate and dissenting opinions, spoke on the meaning and validity of the reservations before it. That being so, the Court should be able to decide what constitutes a “determination” by the state that the matter is domestic.

The Court, in interpreting this aspect of the state’s acceptance of compulsory jurisdiction, would, among other things, have recourse to the norm of *pacta sunt servanda*. This issue can be as readily present in interpreting this kind of an obligation as it could be in any other international treaty. The state accepting the Court’s compulsory jurisdiction must be held to honor the obligation it has thereby assumed.

24 Norwegian Loans Case, [1957] I.C.J. Rep. 9, 47. Judge Lauterpacht, in his separate opinion, states:

In the first instance, it has been said that if the Court declines jurisdiction by reference to the “automatic reservation” it is actually, in full conformity with Article 36(5), making a decision on the question of its jurisdiction. This argument is of a verbal character. For in that case it is not the Court which makes the actual decision on the question of its jurisdiction. The decision is made by the defendant Government of Norway. The Court merely registers it.

Ibid.
This involves interpreting the acceptance and the nature and extent of the obligation it involves. If the acceptance includes a Connally amendment, then that too must be interpreted along with the rest of the acceptance in the light of all relevant principles of law, including *pacta sunt servanda*.

Such interpretation necessarily must conclude that the amendment involves a reasonable determination in good faith by the state that the matter is of a domestic nature. The proposition that international obligations are to be given reasonable interpretations and that the states undertaking them must be presumed to have done so in good faith undoubtedly requires little documentation. It follows then that the Connally amendment would not permit a state to make a "determination" that a matter was domestic if it could not reasonably be said to be domestic or if the state did not really think it was so. To do so would violate the requirements of reasonableness or good faith or both. If these requirements were not met by the state, there would be no "determination," within the meaning of the acceptance with its amendment, that the state found the matter to be domestic. The Court, then, would function as something more than a mere registrar of the fact that the state made such a determination; it would also decide the issue whether the state so "determined" within the meaning of that state's

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25 For a recent survey of this doctrine, see Wehberg, Pacta Sunt Servanda, 53 Am. J. Int'l L. 775 (1959).
26 Some of these rules of interpretation have been well expressed in Oppenheim's International Law:

(1) All treaties must be interpreted according to their reasonable, in contradistinction to their literal, sense.

(3) It is taken for granted that the contracting parties intend something reasonable and something not inconsistent with generally recognized principles of International Law, nor with previous treaty obligations towards third States. If, therefore, the meaning of a provision is ambiguous, the reasonable meaning is to be preferred to the unreasonable, the more reasonable to the less reasonable, the consistent meaning to the meaning inconsistent with generally recognized principles of International Law and with previous treaty obligations towards third States.

(4) The whole of the treaty must be taken into consideration, if the meaning of any one of its provisions is doubtful; and not only the wording of the treaty, but also its purpose, the motives which led to its conclusion, and the conditions prevailing at the time.

(12) It is to be taken for granted that the parties intend the provisions of a treaty to have a certain effect, and not to be meaningless. Therefore, an interpretation is not admissible which would make a provision meaningless, or ineffective . . . .

(13) All treaties must be interpreted so as to exclude fraud, and so as to make their operation consistent with good faith.

acceptance of compulsory jurisdiction with its Connally amendment included.

The conclusion so often put forward, that the amendment gives the state an absolute power and discretion to declare a matter domestic and by such declaration alone to defeat the Court’s jurisdiction, reveals other repugnancies under close analysis. If this were to give the state the right and power to classify any matter it chooses as domestic for this purpose, regardless of how much violence such classification might do to reason and logic, it becomes senseless to tie such power to the question of classifying disputes at all. If the purpose of the amendment is simply to allow the state to withdraw a given case out of its acceptance of compulsory jurisdiction any time it chooses to do so, regardless of the type of case it may actually be, this could be accomplished much more simply and directly by a type of categorical reservation. For example, such a reservation might be worded: "Provided, that this declaration (of acceptance of compulsory jurisdiction) shall not apply to any dispute which this government decides to withdraw from the jurisdiction of the Court."

It makes no more sense to append such a categorical power by indirection, if not subterfuge, to the question of domestic concern than it would, for example, to the question of whether or not the dispute involved interpretation of a treaty. Thus the same effect could be achieved had the amendment been appended to a hypothetical reservation in a state's acceptance of compulsory jurisdiction as follows: "Provided, that this declaration shall not apply to any dispute with regard to matters that do not involve the interpretation of a treaty as determined by this government." According to the same line of reasoning that has been applied to interpreting the Connally amendment, the state in our hypothetical case could always excuse itself from the Court’s jurisdiction by declaring that a dispute did not involve the interpretation of a treaty. This would be so even though the aggrieved state was alleging violation of a specific treaty and requesting the Court to interpret it.

It is probably true that it is a more debatable and nebulous thing to classify a dispute as domestic than it is to find whether a dispute involves interpretation of a treaty. But this only suggests that the former was chosen to which to affix the Connally amendment rather than

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some other item equally available, because it would give wider scope to the subterfuge and make its detection more difficult. In any case, to say the Connally amendment gives the state the absolute power alleged, without regard to any aspect of reality of the domesticity of the dispute, is to render it a nonsensical thing. International obligations are not unnecessarily given such interpretations.

It is also obvious, as critics of the amendment stoutly maintain, that such an interpretation vitiates the entire acceptance of compulsory jurisdiction and renders it illusory. Such an interpretation violates the principle that states, upon undertaking an obligation, intend that it shall have some effect and not be meaningless. Also involved is a suggestion that by their basic acceptance of compulsory jurisdiction, the Connally amendment states are seeking to practice something in the nature of a fraud on other states by leading them to rely on being able to sue in the International Court of Justice. Again, needless interpretations imputing fraud are to be avoided.

How then is the Court to interpret a Connally amendment when faced squarely by a preliminary objection based thereon? It seems settled that the Court is still entitled to take jurisdiction of the case, at least for the purpose of looking at the acceptance of compulsory jurisdiction together with any reservations on which the preliminary objection is based. Most critically for our purposes, this means the Court must decide whether the objecting state has "determined" that the matter is domestic. The mere fact that the state says it has and thereby puts forth its preliminary objection is not conclusive, or else there would be nothing for the Court's deliberation and decision. Should the Court find that the state did not believe what it was saying, or that it was repugnant to reason to classify the matter as domestic, then the Court could find that there had been no such "determination," that the reservation would not be applicable, and that the obligation to submit to compulsory jurisdiction would attach. Conversely, if the Court were to find that the state honestly believed that the matter was domestic and that there was some reasonable ground for such a classification, it would find there had been a determination within the meaning of the amendment and decline jurisdiction. And since the Court would be determining in a substantial way the question of its own jurisdiction and not merely registering a veto, no violence would be done to article 36(6) of the Statute of the Court.

This still leaves the amendment with considerable effect in narrowing the scope whereby the Court is to determine its jurisdiction. Apart
from the amendment, the Court would determine whether, as a matter of law, the dispute was domestic, without regard to the opinions of the litigating states, other than listening to such arguments as they chose to present. The borderline for decision no longer would be whether the dispute was domestic as a matter of law, but whether it had been determined to be so reasonably and in good faith by the defendant state. This shift in the line for decision is substantial. It is also a different thing from the self-judging of jurisdiction theory and falls far short of complete destruction of the power of the Court to determine its own jurisdiction.

The opinion of the Court in the *Norwegian Loans Case* is not a rejection of the foregoing line of argument.28 True, the Court declined jurisdiction because it found that Norway had invoked, by reciprocity, France’s version of the Connally reservation. But it had no occasion to consider the question of reasonableness or good faith on the part of the Norwegian Government in doing so. The observations of France, in opposing Norway’s preliminary exceptions, were not directed toward such a question. Rather, the discussion of France related principally to the questions of whether this was an international dispute and whether various earlier treaties bound Norway to submit to the Court’s jurisdiction in this particular matter.29 France argued that Norway erred as a matter of law in thinking that the matter was domestic but did not seek to impugn the reasonableness or good faith of Norway’s position. Nor were the facts of this case such as to make it blatantly unreasonable for Norway to classify it as a domestic matter.30 Thus that case cannot stand as authority for the proposition that the issues of reasonableness and good faith are irrelevant to the lawful implementation of the Connally amendment because such issues were not presented to the Court.

The possibility of the Connally amendment still leaving the Court with the function of deciding the reasonableness and good faith of its invocation has occurred to Judge Lauterpacht. He considered but rejected this interpretation of the amendment in his dissenting opinion in the *Interhandel Case*,31 basing his conclusion largely on what he considered the intent of the United States in appending the amendment to

29 Id. at 24-25.
30 The dissenting opinion of Judge Basdevant stated that Norway never considered itself to have the right to make an arbitrary determination of the character of the dispute without regard to reasonableness. Id. at 73.
its acceptance of compulsory jurisdiction. In search of the intent of the United States, he reviewed the history of the American policy relative to the prospective submission of disputes to international adjudication, found it to be quite restrictive as to the jurisdiction of international tribunals, and hence determined that the United States intended that an interpretation of maximum restrictiveness should be placed on the amendment. Yet this is a general approach not engaging satisfactorily with some of the specifics of the Connally amendment problem from which the historical instances cited can be readily distinguished.

Judge Lauterpacht feels that the Court should not arrogate to itself the function of passing on the reasonableness or good faith of the United States when, as he sees it, the United States has expressly denied to the Court the authority to do so. He supports this thesis by alluding to the difficulties inherent in arriving at a classification of "domestic" or "international" as a matter of law.\textsuperscript{32} If this classification problem is fraught with such difficulties, to be resolved in most cases only after careful scrutiny of facts and refinements of dogma, then it would be rare that the Court could ever find such depravity in a state's determination as to amount to "no determination" that the matter was domestic.\textsuperscript{33} As the Judge expressed it:

The decisive difficulty is that in view of the comprehensiveness of the notion of domestic jurisdiction—coupled in the case of the United States with a uniform insistence on the right of unilateral determination—that right assumes in effect the complexion of an absolute right not subject to review by the Court.\textsuperscript{34}

Although these difficulties are readily apparent, they would seem to go not to establishing the Connally amendment as conferring a conceptually absolute right in the state to determine jurisdiction, but rather to the difficulties and awkwardness to be encountered judicially in applying the amendment. It might also be a valid basis for criticizing the wisdom of the particular form of the amendment, or for exposing it to well-founded attacks that it is vague, perhaps to the point of invalidity, and that

\textsuperscript{32} The uncertainty shrouding the distinction between domestic and international matters has been discussed from the opposite point of view, out of fear that an absence of the Connally amendment would give the Court nearly carte blanche to invade the domestic jurisdiction of the United States. Schweppe, supra note 13, at 733-34.

\textsuperscript{33} Judge Lauterpacht does admit, at least for purposes of discussion, the possibility of distinguishing between wrong determinations and unreasonably and abusively wrong determinations. His language at this particular point is rather obscure and confusing in both the English and French versions, but the foregoing appears to be what he had in mind. See [1959] I.C.J. Rep. at 112.

\textsuperscript{34} Id. at 113-14.
some specifications should be given in it as a guide to what it means by “domestic.” But such difficulties scarcely warrant, as a solution, the conclusion that the amendment is to be interpreted as conferring an absolute or peremptory power on the state regarding the determination. This would involve one in the absurdities and contradictions discussed above.

III

On a more political basis, the Connally amendment has been attacked as tending to inhibit the development of international law and to retard the arrival of that millenium when the “rule of law” will be in the ascendency throughout the world. It is generally agreed that since no state is under any obligation to submit to compulsory jurisdiction at all, it lawfully may limit its acceptance of such jurisdiction in any way it chooses. This is according to general principles of law and the express provisions of article 36 of the Statute of the Court.

But the complaint is to the effect that an unconditional acceptance of compulsory jurisdiction would show a fine example to the world of an abnegation of nationalistic parochialism. Such complaints draw some nourishment from the proposition that one of the sources of international law is the practice of states. If the international community as a whole generally indulges in a given practice over a substantial period of time, it will become solidified into a rule of law. Thus if the bulk of states were to submit themselves to the compulsory jurisdiction of the Court, this could evolve into a rule of law whereby the Court would have jurisdiction over all states in all cases that the Court determines are not primarily domestic affairs. It is argued that it would be salutary for the United States to take the lead toward such a wholesome development of the law, rather than impede it through the limitations imposed by the Connally amendment on the Court’s assuming of jurisdiction.35

35 This is a generally recurring theme in most of the attacks on the Connally amendment. Articles emphasizing this point are Briggs, Towards the Rule of Law? 51 Am. J. Intl L. 517, 529 (1957); Sohn, International Tribunals: Past, Present and Future, 46 A.B.A.J. 23, 25 (1960); Tondel, The Connally Reservation Should Be Repealed, 46 A.B.A.J. 726 (1960). A celebrated publicist for “rule of law” is Justice William O. Douglas. See Douglas, The Rule of Law in World Affairs (1961), published by the Center for the Study of Democratic Institutions, an activity of the Fund for the Republic, Inc. It may be noted in passing, without an attempt to explore the point, that the “rule of law” people seem to assume that “law” is something which is necessarily court-made or court-enforced; there may be those who would argue that courts are involved only with a
A pertinent inquiry here would be into the apparent effect on the development of law of the actual practice of the United States while the Connally amendment has been in effect. This should further illuminate its significance. The United States has been named party defendant three times to date before the International Court of Justice. Only in the Interhandel Case did the United States have recourse to the Connally amendment. As earlier discussion indicated, the United States did not act as though it relied on the amendment giving it an absolute right to deprive the Court of jurisdiction under all circumstances, but felt constrained to make three additional preliminary objections. When sued by France in 1950, the United States expressly declined to raise any question as to jurisdiction, even though it stated that it disagreed with the points argued by France regarding compulsory jurisdiction.\(^{38}\) In 1953 the United States was named defendant, along with France and the United Kingdom, in a suit brought by Italy regarding the right to certain gold that had been removed from Rome.\(^{37}\) The United States manifested no disposition to balk the jurisdiction of the Court, though in that instance there had been, in addition, a special acceptance of the Court’s jurisdiction. Thus the record to date indicates that the United States has not considered the Connally amendment as conferring an absolute immunity from the Court’s jurisdiction. Such administrative or executive action and policy bear authoritatively on interpreting the amendment. They have scarcely been damaging to the Court’s competence or prestige, or inhibiting of the development of beneficial rules of international law.

On the other hand, the United States has appeared before the Court as party plaintiff in five cases, all of them involving aerial incidents with Russia or one of her satellite states.\(^{38}\) In none of these cases did the defendant state utilize the reciprocity aspect of the Connally amend-
ment to seek to declare the matter to be of domestic concern and thus defeat the jurisdiction of the Court. In each case the Court found a want of jurisdiction simply because the defendant state had never filed any general acceptance of compulsory jurisdiction of the Court and had not submitted specially to the Court’s jurisdiction for purposes of the particular case. The United States was aware, of course, that these defendants had not filed an acceptance of compulsory jurisdiction under article 36(2), but invited them to accept jurisdiction specially under article 36(1) of the Statute of the Court. If it puts a state in an unfavorable light to seem reluctant to submit to the Court’s jurisdiction (and this is one of the hypotheses underlying many attacks on the amendment), supposedly these defendant states would have sought to throw on the United States the responsibility for depriving the Court of jurisdiction. They could have done just that had the Connally amendment rendered nugatory the acceptance by the United States of the Court’s compulsory jurisdiction. They could have scored a propaganda success by declining to accept the Court’s jurisdiction on the theory that they were dealing with a state that callously manipulated this jurisdiction to suit its fancy by inviting others to submit themselves as defendants while always reserving to itself the power to avoid such jurisdiction. Instead, they sought to justify their refusal to submit to the Court by arguing the merits of the case, amazingly saying in effect that the Court could not properly take jurisdiction because, if the case were to be heard, the defendant would surely win.

Thus, although the natural and unavoidable theoretical tendency of the amendment is to derogate from the competence of the Court, while not destroying it, the practice of the United States has done nothing to justify the exaggerated fears of some critics of the amendment; indeed, properly viewed, it should have offered them solace and comfort. Moreover, it is not to be forgotten that the acceptance of the concept of compulsory jurisdiction represents a big advance so far as the amenability of international disputes to judicial process is concerned. In any event, it is clearly a piece of self-abnegation far in advance of the standards practiced by the Iron Curtain countries, which have not accepted compulsory jurisdiction in any form. Criticisms of the United

39 Stat. Int’l Ct. Just. art. 36, para. 1: “The jurisdiction of the Court comprises all cases which the parties refer to it and all matters specially provided for in the Charter of the United Nations or in treaties and conventions in force.”

States for according the Court less than its maximum jurisdiction are bound to seem rather hollow in view of the blatant and overt attitudes of these other states in rejecting entirely the concept of compulsory jurisdiction.  

Moreover, from a standpoint of practical politics, one may speculate that the amendment may be beneficial to the development and encouragement of the Court’s competence. Senator Connally, the author of the amendment, was scarcely an isolationist, but he was an adroit politician. As a matter of expediency, some such reservation as this may have been indispensable to securing the necessary legislative approval of any acceptance of compulsory jurisdiction. Beyond considerations of legislative tactics, there is the matter of general popular acceptance of the Court. In the absence of the amendment, should the Court make a popularly unpalatable finding that it had jurisdiction in a case that the United States viewed as domestic, there might be an unfortunate revulsion against the whole concept of allowing the Court to handle cases involving the United States. This should not be deemed to imply a sort of blackmail to foist the amendment on a reluctant world opinion, because it is not being suggested that this is the way things should happen; it is but an attempt to analyze the way even well-intentioned people may react to situations they cannot be relied upon fully to comprehend.

Related to this dispute over the restrictions of the Connally amendment is the broader question of the justiciability of all international disputes. This is not so much an identifiable jurisdictional limit, such as the limitation of the Court to international matters, but the conceptual one as to whether a matter, even though wholly international in nature, is susceptible of judicial treatment. The question of what is justiciable is an inherently difficult one at best, but with regard to disputes between states the problem has special difficulties.

Such problems relate to the notion of the “sovereignty” of each state,

41 An example of taking an unanalytical view of the Connally amendment and then castigating the United States for having adopted it, without reference to the utterly flagrant attitude of Russia and company, is furnished by the Indian Ambassador to the United States in an address to the 1960 meeting of the American Society of International Law. See Chagla, Rule of Law and the International Court of Justice, 1960 Proceedings, Am. Soc’y of Int’l L. 237.

42 See Wilcox, supra note 17, at 714.

which hypothesizes no authority superior to it. The voluntary abdication or delegation of any of this sovereignty necessarily involves questions of policy and prudence as to how far doing so will redound to the best interests of the state. In addition to matters of policy, it may be questioned how far a state may lawfully divest itself of its ultimate authority by assigning to some other institution the function of making decisions vital to its fundamental interests or security or independence. It seems well-settled that a state cannot be held bound to an obligation when the implementation of it would destroy or gravely endanger it. Therefore, if an international dispute brought before the Court were to be of such a nature that one party to it would be unable to abide by a result unfavorable to it, then such a matter would not be properly justiciable. This would not be so because one of the parties is unwilling to honor its obligations under international law, but rather because international law itself does not require the state to abdicate to such an extent its function of making basic decisions, and may even forbid it to do so.

If some workable definition of "justiciability" could be devised, many vexatious juristic problems of the international community could be laid to rest. If the competence of the Court could be described so as to include the outer limits of justiciability consonant with generally accepted norms of international law, the prestige and utility of the Court should be greatly enhanced. While such considerations do not bear directly on the Connally amendment, the latter may be a reflection, even if technically inappropriate, of a feeling that there are some inherent proper limitations on the scope of the International Court of Justice that somehow need more specific formulation than the Statute of the Court now provides.

44 See Hall, International Law 415 (8th ed. 1924).
46 It is to be hoped that some more optimistic definition might evolve than the discouraging one that justiciable international disputes are those of minor importance, as discussed in Lauterpacht, The Function of Law in the International Community 19 (1933).
47 For discussion and extended bibliography of this point, see Stone, Legal Controls of International Conflict 146 (1954).
NOTES

CORPORATE CRIMINAL LIABILITY FOR ACTS IN VIOLATION OF COMPANY POLICY

With the rise of the corporation as the predominant organization in the business world, and with the increase in business crimes, many of the traditional concepts of criminal justice seemingly have become outmoded and no longer reflective of society’s attitude toward criminal conduct. The hitherto controlling concepts of mens rea and punishment only of the guilty appear to have little applicability where the crime is committed by an abstract business entity which can act only through its agents. Since the whole notion of a corporate intent is at best a fiction, the application of vicarious criminal liability, to some extent, became a necessity when society was confronted with an illegal act committed by a corporate officer in pursuance of his corporate duties. It became inevitable that the state should resort to imposing punishment upon the corporation itself, and thus indirectly upon the stockholders, whenever those controlling corporate action used their authority for illegal ends. To do this the courts initially found a corporate intent, in an analogous sense, by imputing to the corporation the intent of its officers and directors—the source of all corporate action.

Moreover, in view of the increasing complexity of the corporate structure and the growth of decentralization of many large corporations, the scope of this vicarious liability was of necessity extended to embrace not only the acts of the officers and directors, but also the acts of all those performing managerial and decision-making functions. The culmination of this trend was achieved when the courts eventually declared what is now regarded by many as established law, namely, that the corporation will be held liable for the crimes of all its agents within

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1 See Sutherland, White Collar Crime (1949).

2 Even the most adamant advocates of corporate responsibility for criminal acts of the agent concede that it is the innocent shareholders who generally must bear the burden of any penal sanctions imposed upon the corporation. See Edgerton, Corporate Criminal Responsibility, 36 Yale L.J. 827, 837 (1927).

3 It soon became impossible to draw a line between corporate responsibility for the acts of officers and the acts of other agents since, as a necessary consequence of decentralization in many large corporations, a large part of the decision-making function, traditionally entrusted to the corporate officers, was delegated to those who were not part of the executive hierarchy. See Gordon, Business Leadership in the Large Corporation 114 (1961).
the scope of their authority. In their departure from the common law
case of criminal responsibility, the courts have thus gone beyond the
stage of holding the corporation vicariously liable for the criminal acts
of its management, and have imposed upon the corporation a vicarious
liability twice removed\(^4\) by imputing to it the crime of any ministerial
agent who might happen to carry out the general policies enunciated by
management in a manner which is both illegal and contrary to company
policy.

It will be the purpose of this note to reexamine the necessity for such
departure from these traditional concepts of criminal responsibility,
especially in those situations where the crime with which the corpora-
tion is charged is a codified common law offense and where the corpora-
tion, in good faith, has taken all reasonable precautions to prevent the
commission of such crimes.\(^5\) Implicit in any suggestion that such a
necessity should be shown is the belief that the common law require-
ments of *mens rea* has become so ingrained in the general fibre of our
jurisprudence that it should be departed from only where such a course
is necessary to protect the greater public interest.\(^6\) Moreover, even
should some necessity be shown, this belief also suggests that the degree
of any departure should be strictly limited to that extent necessary to
adequately protect society's interest.

The landmark case for the present doctrine of corporate criminal
liability is the Supreme Court decision in *New York Cent. & H.R.R.R. v. United States*, which broadly declared that "the act of the agent,

\(^4\) This concept was first advanced in Mueller, Mens Rea and the Corporation, 19
U. Pitt. L. Rev. 21, 42 (1957).

\(^5\) The validity of a corporate defense based on good-faith precautions was most recently
raised in the electrical price-fixing cases, when Ralph Cordiner, then Chairman of the
Board of General Electric, reportedly suggested to his attorneys a defense based on GE's
Directive Policy 20.5 calling for full compliance with the antitrust legislation on the
part of all its employees. Attorneys for GE thought this defense to be tenuous at best.
They reported:

The trend of the law appears to be that a business corporation will be held crimi-
ally liable for the acts of an employee so long as these acts are reasonably related to
the area of general responsibility entrusted to him notwithstanding the fact that
such acts are committed in violation of instructions issued by the company in good
faith . . . .

be noted, however, that in view of the likelihood of involvement of high corporate officials
in antitrust violations, the problems of proving this defense, if available, would be much
greater in Sherman or Clayton Act prosecutions than in other criminal proceedings against
the corporation.

\(^6\) For a good discussion of mens rea and its part in the history of criminal theory, see
Hall, General Principles of Criminal Law 70-104 (2d ed. 1960).
while exercising the authority delegated to him . . . may be controlled, in the interest of public policy, by imputing his act to his employer and imposing penalties upon the corporation for which he is acting . . . .”

With this language the Court seemingly extended the scope of the corporation’s liability for the crimes of its agent to equal the scope of its civil liability for the agent’s torts. However, the breadth of this holding is greatly contracted when examined in the light of the facts of that case. The crime for which the corporation was convicted was the violation of the Elkins Act, which makes it a misdemeanor for any carrier to knowingly pay or receive a rebate, and which specifically provides that the act of the agent within the scope of his employment “shall in every case be also deemed to be the act, omission, or failure of such carrier as well as that of the person.”

Viewed in the context of this provision, New York Central appears only to be the logical application of a clear congressional purpose to dispense in that one instance with the necessity of proving a corporate intent, in addition to that of the agent.

In spite of this apparent explanation of the holding in New York Central, its broad language quickly took root in both federal and state courts until eventually one court was able to declare: “Of course, it is familiar law that a substantive offense committed by a corporate employee in the scope of his employment will be imputed to the corporation . . . .” For purposes of determining the corporation’s criminal liability, the courts came to regard the act of the employee, no matter what position he held in the corporate hierarchy, as the act of

7 212 U.S. 481, 494 (1909).
9 United States v. Dotterweich, 320 U.S. 277, 281-82 (1943), states that the Elkins Act provision making the acts of the agent those of the corporation was superfluous to the New York Central decision, but Armour Packing Co. v. United States, 209 U.S. 56, 85-86 (1908), suggests that this was because the Elkins Act violation was in the nature of a public welfare offense imposing strict liability. See C.I.T. Corp. v. United States, 150 F.2d 85 (9th Cir. 1945).
10 See, e.g., Old Monastery Co. v. United States, 147 F.2d 905 (4th Cir. 1945); Egan v. United States, 137 F.2d 369 (8th Cir.), cert. denied, 320 U.S. 788 (1943); United States v. New York Great A. & P. Tea Co., 67 F. Supp. 626 (E.D. Ill. 1946), aff’d, 173 F.2d 79 (7th Cir. 1949); United States v. Wilson, 59 F.2d 97 (W.D. Wash. 1932).
the corporation itself. To find the corporation guilty, it was only necessary to establish that the agent was acting within the area entrusted to him and that he violated the law. Even where the offense charged was a statutory one requiring a knowing and willful violation, it was necessary to prove only that the crime had been committed knowingly and willfully by the agent. In 1947 the Supreme Court itself recognized this interpretation when it viewed a Norris-LaGuardia Act provision limiting the employer’s liability to acts authorized by its officers as an exception to the general doctrine of corporate responsibility for the acts of all agents within their scope of employment.

In opposition to this line of cases, there stands only a handful of decisions in which the courts have manifested a reluctance to depart from the traditional doctrine of criminal responsibility requiring “the guilty mind” and imposing punishment only upon those who participated in the doing of the evil act. The clearest expression of this reluctance was given by the New York Court of Appeals in People v. Canadian Fur Trappers Corp., where, in reversing the conviction of the defendant corporation for grand larceny, it stated:

The mere knowledge and intent of the agent or the servant to steal would not be sufficient in and of itself to make the corporation guilty. While a corporation may be guilty of larceny, may be guilty of the intent to steal, the evidence must go further than in the cases involving solely the violation of prohibitive statutes. The intent must be the intent of the corporation and not merely that of the agent.

The court then proceeded to state that with the exception of a violation of prohibitive statutes, the so-called “police regulations,” the corporation can be found guilty only where a “corporate intent” can be found in the authorization or acquiescence of officers or directors. A later New

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14 United States v. Steiner, 231 F.2d 149 (2d Cir. 1956); see, e.g., United States v. Van Riper, 154 F.2d 492 (3d Cir. 1946); Zito v. United States, 64 F.2d 772 (7th Cir. 1933).
18 248 N.Y. 159, 163, 161 N.E. 455, 456 (1928). (Emphasis added.)
19 Id. at 163-64, 161 N.E. at 456.
York court modified this decision to a certain extent by extending the corporation’s criminal liability to include those cases where the corporation benefited from the crime of its agents, or where its officers had knowledge of such illegal acts or were chargeable with negligence in not obtaining such knowledge. However, the court clearly pointed out that “something more than the mere fact of employment or agency must be shown.”

In spite of New York Central, a few federal courts early adopted a position substantially similar to that expressed by the New York courts. But these cases, paying deference to the requirement of criminal intent in the case of corporations, are few and far between when compared to those decisions which impute to the corporation the illegal acts of all agents committed within their scope of employment. The broad language of the courts indicates that the requirement of corporate criminal intent has been all but dispensed with by the application of the tort principle of respondeat superior. However, as previously intimated, this evolution has not been the result of a general rejection of the common law principles of criminality as much as it has been the result of practical policy considerations requiring a different attitude toward the corporation-agent relationship than is manifested toward the relationship between the individual principal and his agent.

Unfortunately, the policies that have dictated the courts’ extension of the scope of the corporation’s criminal liability are seldom clearly enunciated in their decisions. All too often the courts have simply declared it well established that the criminal acts of the agent in the

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21 Id. at 584, 72 N.Y.S.2d at 750.
23 It is worth noting that in many of these cases the corporation, due to the involvement of corporate management, would probably have been held liable without resort to broad language imputing to the corporation criminal acts of all agents within the scope of their employment. See, e.g., United States v. George F. Fish, Inc., 154 F.2d 798 (2d Cir.), cert. denied, 328 U.S. 869 (1946); United States v. Van Riper, 154 F.2d 492 (3d Cir. 1946); Mininsohn v. United States, 101 F.2d 477 (3d Cir. 1939); United States v. Wilson, 59 F.2d 97 (W.D. Wash. 1932); State v. Graziani, 60 N.J. Super. 1, 158 A.2d 375 (App. Div. 1959).
scope of his employment are imputable to the corporation.25 Nevertheless, a close examination of the cases discloses several underlying considerations motivating the courts in this direction.

The most basic reason derives from the fact that the corporation can act only through its agents. If it is to be held responsible at all for crimes committed in the course of its business, it must be on the basis of vicarious liability, and courts find it difficult to draw a logical line of vicarious responsibility between the acts of officers and the acts of inferior agents.26 This is a shorthand method of stating that if the courts were to draw a distinction between the corporation’s officers and its ordinary agents, imputing the criminal intent of only the former to the corporation, the corporation could then completely immunize itself from penal punishment for its crimes by simply delegating the officer’s responsibility for those acts which might be performed in an illegal manner to agents below the officer level.27 Accordingly, to prevent any such evasion the courts have declared that it is “the function delegated to the corporate officer or agent which determines his power to engage the corporation in a criminal transaction,” not his official position in the corporate hierarchy.28

Closely allied to this rationale is the concomitant policy that a corporation should not be allowed to benefit from the illegal acts of its agents committed within the scope of their corporate functions merely

25 E.g., United States v. Milton Marks Corp., 240 F.2d 838, 839 (3d Cir. 1957); C.I.T. Corp. v. United States, 150 F.2d 85, 90 (9th Cir. 1945); Egan v. United States, 137 F.2d 369, 379 (8th Cir.), cert. denied, 320 U.S. 788 (1943); Mininsohn v. United States, 101 F.2d 477, 478 (3d Cir. 1939).


27 For a poignant statement to this effect, see United States v. Van Riper, supra note 26, at 493, in which the court declared that “otherwise a corporation would escape criminal liability by the simple expedient of the persons responsible for its corporate existence and management failing to perform the functions imposed upon them by corporation law.” For a concrete example of extensive corporate delegation of executive authority, see General Electric Share Owners Quarterly, Jan. 25, 1961, p. 2, which states that the corporation has decentralized into more than one hundred profit-seeking departments, each under separate managers having extensive authority to function without first “checking back” with headquarters. . . . [and] responsible for such operations as establishing production schedules, setting inventory levels, determining the flow of cash, keeping organization structure sound, arriving at acceptable prices with customers, and maintaining favorable relations with employees.

28 C.I.T. Corp. v. United States, 150 F.2d 85, 89 (9th Cir. 1945).
because the acts were neither authorized nor acquiesced in by corporate management.29 Where the corporation’s assets have been increased by the illegal acts of an inferior agent, it is indeed easy to justify the imposition of a fine reducing those assets and the corresponding value of the shareholder’s equity,30 especially if one accepts the view that the effect upon the corporation of a criminal conviction is no greater than the effect of a judgment rendered against it in a civil suit.31 However, it must be noted that the majority of the courts that have discussed this issue have pointed out that the reception of benefits by the corporation is not a *sine qua non* to its responsibility for its agent’s crimes.32

The third predominant consideration underlying the present doctrine of corporate criminal responsibility is the strong feeling that punishing the individual wrongdoer without punishing the corporation does not provide an adequate deterrent to the possible commission of like crimes in the future.33 This view receives added support from those sociological studies which suggest that the real cause of the so-called “white-collar crime” lies more in the management’s mode of doing business than in the criminal tendencies of the individual employee.34 Such a position

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30 Consider also that the resultant economic loss, ordinarily borne by the shareholders, can in some instances be passed on to the consumer by means of price increases. See Mueller, supra note 4, at 42.

31 See Edgerton, supra note 2, at 839. This theory seems to lose much of its cogency when one considers that a criminal sanction imports conduct which will incur a formal and solemn pronouncement of moral condemnation and is likely to result in the destruction of the corporate image in the eyes of the public. See Hart, The Aims of the Criminal Law, 23 Law & Contemp. Prob. 401, 405 (1958); Note, supra note 24, at 286.

32 “We do not accept benefit as a touchstone of corporate criminal liability; benefit, at best, is an evidential, not an operative, fact.” Old Monastery Co. v. United States, 147 F.2d 905, 908 (4th Cir. 1945); see, e.g., United States v. United States Cartridge Co., 198 F.2d 456 (8th Cir. 1952); C.I.T. Corp. v. United States, 150 F.2d 85 (9th Cir. 1945); State v. Western Union Tel. Co., 13 N.J. Super. 172, 80 A.2d 342 (Crim. Div. 1951).

33 See Sutherland, op. cit. supra note 1, at 52-54; Edgerton, supra note 2, at 833. But see Mueller, supra note 4, at 44, wherein it is suggested that even corporate criminal sanctions may not be an effective deterrent where they are imposed solely on the basis of vicarious liability without regard to actual culpability.

34 Sutherland, op. cit. supra note 1, at 217-33. In a great number of cases the individual employee who commits the crime is torn between conscience and the pressures
also seems to take cognizance of the practical difficulties in identifying the individual officers or agents who actually committed the crime, even where it is apparent that the offense was committed by some agent of the corporation in pursuance of his corporate duties.\textsuperscript{85}

In view of these reasons, it is neither surprising nor objectionable that the courts have refused to limit the criminal liability of the corporation only to those crimes which involve the participation or acquiescence of officers or directors. However, the question still remains whether these reasons also justify a criminal conviction of the corporation for the crimes of inferior agents where the corporation itself has obviously made a good faith and diligent effort to enforce adherence to the law among its employees.

This question first came clearly into focus in 1946 when the Sixth Circuit handed down its decision in \textit{Holland Furnace Co. v. United States}.\textsuperscript{36} In that case the corporation was indicted for knowingly violating a War Production Board regulation\textsuperscript{37} by fraudulently selling a customer a new furnace on the misrepresentation that the customer’s old furnace was damaged beyond repair. The facts showed that the defendant’s salesman fraudulently obtained the customer’s signature to a certificate stating that his furnace was irreparably damaged, which certificate was required by the War Production Board before any sale of a new furnace could be made. However, in making the sale the defendant corporation had no knowledge of its salesman’s deceit and acted in complete reliance on the truth of the certificate. Moreover, the

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\item inherent in profit-motivated industries, and if he must breach the law to meet the demands of his superiors, he finds “balm for his conscience in additional comforts and the security of his place in the corporate set-up.” N.Y. Times, Feb. 7, 1961, p. 26, col. 3 (pre-sentence statement by Chief Judge Ganey of the United States District Court for the Eastern District of Pennsylvania in the electrical price-fixing case).
\item “[I]t can be argued that responsibility in the modern corporation is diffused among so many executives that it is difficult, if not impossible, to fix personal responsibility for the corporation’s crime.” Kramer, Criminal Prosecutions for Violations of the Sherman Act: In Search of a Policy, 48 Georgetown L.J. 530, 540 (1960). This problem is well illustrated by the number of cases in which the corporation was convicted, although all individual defendants were acquitted. E.g., Magnolia Motor & Logging Co. v. United States, 264 F.2d 950 (9th Cir.), cert. denied, 361 U.S. 815 (1959); Southern Advance Bag & Paper Co. v. United States, 133 F.2d 449 (5th Cir. 1943); American Medical Ass’n v. United States, 76 U.S. App. D.C. 70, 130 F.2d 233 (1942), aff’d, 317 U.S. 519 (1943); United States v. General Motors Corp., 121 F.2d 376 (7th Cir.), cert. denied, 314 U.S. 618 (1941). See generally Gordon, Business Leadership in the Large Corporation (1945).
\item 158 F.2d 2 (6th Cir. 1946).
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corporation showed that it had taken extensive precautions to insure that its employees strictly adhered to the Board's regulations. These measures included the corporation's issuance of daily bulletins, informing its employees of the pertinent provisions of the regulations, and scheduling daily meetings at which these provisions were discussed. The corporation also issued a directive stating that any employee found violating these provisions would be subject to summary dismissal.

It was on this showing of good faith and diligence and on a provision in the regulation allegedly violated, stating that "anyone who reasonably relies on the truth of a [consumer's] certificate, is not to be held responsible, should it turn out to be false," that the corporation predicated its defense. The court of appeals sustained this defense in reversing the lower court conviction. In so holding, it stated that it was "sound doctrine, applicable to a corporation, as well as to an individual" to say the defendant can "rebut the presumption of prima facie agency arising from evidence against him by showing that an unlawful sale . . . was, in fact, made without his authority and against his direction" provided that these directions were "in good faith and not merely formal and colorable . . . ." It pointed out that even though the state does not have the burden of proving a criminal intent on the part of the corporation, it is still competent for the corporation to introduce evidence showing that the unlawful acts of the agent were in direct violation of the corporation's instructions.

One year before the Holland decision, however, the Ninth Circuit in C.I.T. Corp. v. United States rejected the defendant corporation's defense that the crime with which it was charged was committed by its agent without the knowledge of the corporate officers and in violation of the corporation's good-faith instructions. The court thereupon affirmed the corporation's conviction for conspiring to violate section 512(e) of the National Housing Act by procuring and filing false credit statements to obtain government insurance on corporate loans, despite the fact that an FHA regulation allowed an insured institution acting

39 158 F.2d at 8.
40 Ibid.
41 150 F.2d 85 (9th Cir. 1945).
42 Ch. 13, 52 Stat. 25 (1938).
43 38 501.6(c), 7 Fed. Reg. 4248 (1942), provided:

An insured institution acting in good faith may, in the absence of information to the contrary, rely upon all statements of fact made by the borrower which are called for by the borrower's Credit Statement-Application, in determining the credit risk
in good faith to rely upon the truth of the credit statement signed by the borrower. The court stated that this provision did not relieve the corporation of responsibility for its agent's crime, since the agent had not acted in good faith, and that his bad faith was imputable to the corporation.\footnote{44}{150 F.2d at 89-90.}

However, in \textit{C.I.T.} the corporate agent who procured the false credit statement was an area manager who had been delegated the full responsibility for passing upon the credibility of all credit statement-applications filed in his area, a duty which was imposed directly upon the corporation by the FHA regulations. It was on the basis of this factual difference between \textit{C.I.T.} and \textit{Holland} that the \textit{Holland} court distinguished the latter case. However, by way of dicta, the \textit{C.I.T.} court clearly pointed out that its decision would have been the same no matter how low in the corporate hierarchy the individual guilty agent stood.\footnote{45}{Id. at 90.}

The decisions subsequent to \textit{Holland} seem to have adopted \textit{C.I.T.}'s dicta, ignoring the distinction drawn by \textit{Holland}. In \textit{United States v. General Motors Corp.},\footnote{46}{226 F.2d 745 (3d Cir. 1955).} the Third Circuit specifically approved lower court instructions that company directives to obey the statutory provisions allegedly violated were immaterial to the defendant's responsibility for its employees' crimes. However, the effect of this holding upon \textit{Holland} seems inconsequential in view of the fact that in \textit{General Motors} the offense charged was a violation of the Elkins Act for which corporate intent is not an essential element.\footnote{47}{See note 9 supra.}

A more substantial shadow had been previously cast upon \textit{Holland} by the Third Circuit when it handed down its decision in \textit{United States v. Armour & Co.}.\footnote{48}{168 F.2d 342 (3d Cir. 1948).} There it upheld the corporation's conviction for violating the Emergency Price Control Act\footnote{49}{Ch. 26, 56 Stat. 23 (1942).} in spite of the fact that the company had taken elaborate good-faith precautions to enforce adherence to the act's provisions among its employees. The court stated that the duty to abide by the price control regulations was a "non-delegable" one and that the corporation must stand or fall with those

\footnote{44}{The Georgetown Law Journal [Vol. 50: p. 547}

and eligibility of the transaction. The Commissioner does not place upon the insured institution the burden of verifying the truth of any such statements.
whom it selects to act in its behalf.\textsuperscript{50} It went on to declare that \textit{Holland} must be limited to the facts of that case.\textsuperscript{51} Subsequently, in a prosecution under section 1 of the Sherman Act,\textsuperscript{52} the Sixth Circuit itself, relying heavily upon \textit{Armour}, rejected the corporation's defense that the anti-trust violations of a general manager were without corporation authority and in contravention of express company orders to the contrary.\textsuperscript{53}

The \textit{Armour} view was reiterated by a district court in \textit{United States v. Thompson-Powell Drilling Co.},\textsuperscript{54} which stated that either \textit{Holland} must be limited to its facts or it must be recognized as being completely out of step with precedent. Although neither court expressly declared just what facts \textit{Holland} must be limited to, the implication is clear that they considered \textit{Holland} inapplicable unless there was both a good-faith and diligent effort on the part of the corporation to adhere to the law \textit{and} an express statutory or regulatory provision specifically making a diligent effort a defense to any criminal action brought thereunder.

A review of the cases thus suggests that even outside of the strict public welfare offenses, as long as the crime is one created by statute and unknown at common law, then the crime of the agent, if it be within the scope of his employment, will be imputed to his corporate employer regardless of the corporation's good-faith efforts and instructions, unless the statute expressly states otherwise.\textsuperscript{55} This is so even though the statute requires a knowing and willful violation\textsuperscript{56} and provides generally that the good faith of the defendant is a defense to a criminal prosecution.\textsuperscript{57}

In these cases, such a conclusion, inflexible as it may seem, appears to be required by the fact that to do otherwise would often completely frustrate the intent of the legislature. As some courts have pointed

\textsuperscript{50} 168 F.2d at 343-44. This language was first used by Judge Cardozo in affirming the conviction of a corporation for violating the state child labor law, traditionally a public welfare offense. People ex rel. Price v. Sheffield Farms-Slawson-Decker Co., 225 N.Y. 25, 121 N.E. 474 (1918).
\textsuperscript{51} 168 F.2d at 344 n.2.
\textsuperscript{53} Continental Baking Co. v. United States, 281 F.2d 137, 149-50 (6th Cir. 1960).
\textsuperscript{54} 196 F. Supp. 571 (N.D. Tex. 1961).
\textsuperscript{55} See St. Johnsbury Trucking Co. v. United States, 220 F.2d 393, 397 (1st Cir. 1955) (concurring opinion).
out in sustaining corporate convictions under the Emergency Price Control Act, where the crime proscribed by statute will almost invariably be performed by employees far removed from the official level, rather than by corporate chiefs, to allow the corporation to disown or repudiate the acts of these employees contrary to company instructions would be to "attribute...manifest impotency to the legislative branch of the government."\(^{58}\)

So also in the case of the Sherman and Clayton Act violations, the public interest, as expressed by Congress and the judiciary, may well be so great as to justify placing upon the corporation an absolute duty to enforce adherence to those laws among its employees. As one court pointed out: "Upon their [the antitrust laws] vigorous and constant enforcement depends the economic, political and social well-being of our nation."\(^{59}\) This was reiterated by the court in the recent electrical price-fixing cases, where in its pre-sentence statement the court declared: "This is a shocking indictment of a vast section of our economy, for what is really at stake here is the survival of a kind of economy under which America has grown to greatness, the free enterprise system."\(^{60}\)

Indeed, if a determination is made that the social and economic well-being of the country requires that this burden of strict liability for such statutory violations on the part of any agent be placed upon the corporation, then in the light of what has been said, such a result would seem to offend neither logic nor precedent. For the purpose of liability in such a case would not really be to punish a criminal offender, but to spur a transgressing corporation on to extraordinary efforts to enforce adherence among its employees to an express congressional declaration of what is in the public interest.

However, where the offense charged is a codified common law offense involving some degree of moral turpitude, this summary denial of the corporation's defense—that it made a good-faith effort to enforce the law—bears closer scrutiny. The types of offenses here involved are generally the common law felonies, conspiracy and the crime of fraud as codified specifically to protect the federal and state governments in their commercial dealings with the business community.\(^{61}\) It would appear

\(^{58}\) Id. at 306, 54 N.E.2d at 220.


\(^{60}\) N.Y. Times, Feb. 7, 1961, p. 26, col. 3.

\(^{61}\) See, e.g., United States v. Milton Marks Corp., 240 F.2d 838 (3d Cir. 1957) (fraud);
that the validity of treating these offenses in the same manner as the purely statutory offenses simply because all are crimes against the state should be questioned, unless the same policy considerations which support the judicial view toward the corporation’s liability for strict statutory offenses apply with equal force to these codified common law crimes. Yet even without such a showing, the courts have displayed a tendency in cases involving offenses of this nature to summarily declare: “As a matter of law, proof of such misconduct by the general foreman . . . would sustain a charge of corporate criminality.”

Although the contention that the mere corporate nature of the defendant should not call for a complete departure from the mens rea requirement has, at first glance, been ignored by the courts in their attempt to define the scope of corporate criminal liability, some suggestions of it can be found in a few state and federal court decisions.


A distinction must be drawn between the conspiracy prohibited by the Sherman and Clayton Acts and the general crime of conspiracy known at common law. To prove common law conspiracy, unless the act conspired to is malum in se, it is generally necessary to prove a knowledge on the part of the defendants that the acts contemplated violated the law. Thus to convict an individual of conspiring to commit an offense which is merely malum prohibitum, it is necessary to prove that he had knowledge of the fact that the acts contemplated were prohibited by statute. However, under the Sherman and Clayton Acts, the individual can be convicted of conspiracy if it can be shown that he had knowledge of the fact that his act formed part of a total plan which was in fact illegal, irrespective of whether or not he knew it to be such. See Whiting, Antitrust and the Corporate Executive, 47 U. Va. L. Rev. 929, 933-34 (1961); Developments in the Law—Criminal Conspiracy, 72 Harv. L. Rev. 920, 936-1000 (1959). This might be explained by the fact that restraint of trade, as a substantive crime, had its roots in the common law and might be regarded as malum in se. However, a better explanation for this distinction between Sherman Act conspiracy and common law conspiracy would seem to be the great extent to which the public interest is at stake in the antitrust cases, and the great practical problems that would have to be met were the Government forced to prove in all such cases that the defendant had knowledge of the illegality of the contemplated acts. See Rahl, Conspiracy and the Anti-Trust Laws, 44 Ill. L. Rev. 743 (1950).


63 This contention has long been advanced by legal writers. See Canfield, Corporate Responsibility for Crime, 14 Colum. L. Rev. 469, 480-81 (1914); Francis, Criminal Responsibility of the Corporation, 18 Ill. L. Rev. 305, 310 (1924); Lee, supra note 24; Mueller, Mens Rea and the Corporation, 19 U. Pitt. L. Rev. 21, 46-47 (1957); Note, supra note 24.
dealing with common law crimes. As mentioned previously, the New York Court of Appeals refused to find the corporation guilty of larceny unless it could be shown that the intent was "the intent of the corporation, and not merely that of the agent."

A more recent indication that perhaps a different attitude should be manifested toward the common law type of offense was seen in United States v. Thompson-Powell Drilling Co. The court, after holding the corporation strictly liable for its employee's willful violation of the Connally Hot Oil Act, went on to hold that the same liability might not attach where the charge was conspiracy to violate that act. It declared that "it remains to be decided whether the fact that the corporate employee may have acted in concert with other individuals in the commission of the substantive offense will similarly by imputation implicate the corporation in the conspiracy." Emphasizing that the crime of conspiracy requires the knowledge and consent of the accused, it concluded: "It may be that the assent of some agent in supervisory or executive authority would be necessary to commit a corporation to a conspiracy." Accordingly, the court acquitted the corporation as to the conspiracy count on the grounds that the Government failed to present


69 Ibid.
sufficient authority to support its claim that the act of any agent can involve the corporate employer in the crime of conspiracy.

Although the Thompson-Powell court failed to give any substantial reason for its distinction between the corporation's liability for the substantive offense of knowingly and willfully violating the act's provisions and its liability for the offense of conspiracy, one possible explanation is that the court may have recognized the difference between those crimes that are purely creatures of statute and those that have ancient roots in the common law. In the case of the former, the courts have tended to regard the very commission of the act, intentional or unintentional, as generally resulting in a direct harm to the general public which Congress explicitly intended to prevent—\textsuperscript{70} a characteristic which these offenses share with the public welfare offense. The primary purpose of the punitive provisions of such statutes is to deter the physical act proscribed, which purpose, in view of the immensity and complexity of the modern corporate structure, can be achieved only by the imposition of penal sanctions upon the transgressing corporations, regardless of the subjective guilt of the corporate management.\textsuperscript{71} In the case of the offense of conspiracy, however, the harm to society lies not in the mere objective act of cooperation of corporate bodies, but in the subjective illegal purpose behind such cooperation,\textsuperscript{72} regardless of whether the end sought is achieved. Thus intent in the form of a purpose to achieve an illegal end by concerted action is here an essential element, and it can be argued that the acts of ministerial agents seem insufficient to bring the intent home to the corporation itself.

So also in the case of fraud, the objective act of filing false credit statements with the FHA, for example, prescinded from any "corporate intent" to defraud the Government, harms society only insofar as it might impose a monetary loss upon the Government in its proprietary capacity. On the other hand, the harm posed by the \textit{conscious} filing of such a claim is twofold: first, the above-mentioned threat of a pecuniary loss to the state; secondly, the external manifestation of a willful rejection of society's values, which, if allowed, would pose a serious

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\textsuperscript{71} Compare Edgerton, Corporate Criminal Responsibility, 36 Yale L.J. 827 (1927), with Mueller, Mens Rea and the Corporation, 19 U. Pitt. L. Rev. 21 (1957).

\textsuperscript{72} See Goldstein, Conspiracy to Defraud the United States, 68 Yale L.J. 405, 413-14 (1959); note 61 supra.
threat to their continued existence. This requires not only the objective doing of the act itself, but also a subjective criminal intent. In fact, whether it is a common law or a purely statutory offense, where the harm done is the result of a fusion of an objective and subjective wrong, it can never really be corrected. It can only be deterred; and this deterrence can only be achieved by the imposition of penal sanctions.

However, where the act charged is the innocent filing of a false claim, the wrong consists only in the objective harm of pecuniary loss, and this can be remedied adequately by compensation, which can be accurately ascertained and easily awarded in noncriminal proceedings. This type of objective harm is to be contrasted with an innocent violation of the Emergency Price Control Act, where the harm, though solely objective, lies not only in the monetary overcharge to the individual, but also in a noncompensable upsetting of the general balance and price structure of the wartime economy. There deterrence of the objective act itself is the primary purpose of the statute, and punishment of the well-meaning but transgressing corporation can be justified. In light of this difference, it would seem that as to the common law type offense of defrauding the state, the institution of anything more than a civil proceeding, even against a corporation, would require proof not only of the objective doing of the act itself, but also of the subjective element of criminal intent in the corporate management.

Nor is this changed by the fact that the crime proscribing the act has been codified. Codification alone in no way lessens the necessity for proving a criminal intent unless, in incorporating the offense into statute, the legislature clearly expressed some purpose which would be frustrated by relieving the corporation of criminal liability when no intent or culpable negligence could be traced to corporate management. Such a purpose is usually found in pure statutory offenses, the very commission of which inflicts harm upon the general economy; but no similar purpose is readily apparent in statutes proscribing the crimes of fraud and conspiracy. Until such a legislative purpose can be found, there seems to be no valid reason for dispensing completely with the necessity of proving a “corporate intent” as the basis for the imposition of any penal sanction.

However, if we were to admit the validity of this thesis, the question still remains to what extent and in what manner are we to limit the corporation's liability for the common law offenses of its agents without exposing the public to a greater danger of corporate criminality. The general policy considerations discussed previously have shown that
it would be infeasible to limit the corporation’s liability to only those crimes in which its officers or directors have participated or expressly or impliedly authorized. Moreover, the Thompson-Powell court’s suggestion that a line might be drawn between the acts of agents in supervisory or executive authority and those of inferior position leaves unanswered the question of just which agents are to be designated supervisory and which nonsupervisory. The third alternative would be to apply the holding of the Holland case to these common law offenses by allowing the corporation to rebut a presumption of responsibility for all such crimes of those in its employ by showing that the corporation in good faith did everything within its power to prevent the commission of the offense.73

The use of such a presumption to resolve the conflict between the public interest and the desire to punish only those who are in some manner culpable can be found in the analogous area of the publisher’s criminal liability for libelous statements published by his employees without his knowledge. In the libel cases, just as in corporate criminal cases, the courts were forced to depart from the traditional criminal procedures to protect the public from the publication of defamatory communications. To achieve this end the courts not only imposed a duty upon the publisher to prevent the publication of all libelous matter, but also held that the publisher would be criminally liable unless he could prove that “the unlawful publication was made under such circumstances as to negative any presumption of privity, or connivance, or want of ordinary precaution . . . to prevent it.”74

Prior to Holland, this same approach was used in the area of the corporation crime by the court in John Gund Brewing Co. v. United States, where it stated: “We are of the opinion that while, in the absence

73 This alternative is in substance the position taken by the Model Penal Code, which provides:

In any prosecution of a corporation or an unincorporated association for the commission of an offense . . . other than an offense for which absolute liability has been imposed, it shall be a defense if the defendant proves by a preponderance of the evidence that the high managerial agent having supervisory responsibility over the subject matter of the offense employed due diligence to prevent its commission. This paragraph shall not apply if is inconsistent with the legislative purpose in defining the particular offense.

§ 2.07(4) (Tent. Draft No. 5, 1956). (Emphasis added.) Mueller, supra note 71, at 43, takes issue with this last sentence on the grounds that “what it grants with one hand, it takes away in part with the other.”

74 Commonwealth v. Morgan, 107 Mass. 199, 204 (1871); accord, People v. Fuller, 238 Ill. 116, 135, 87 N.E. 336, 342 (1909); State v. Mason, 26 Ore. 272, 281, 38 Pac. 130, 132 (1894); Perkins, Criminal Law 364 (1957).
of any *explanatory evidence* on the part of the defendant, the principal will be liable in a case of this nature where it is unnecessary to establish an unlawful intent on the part of the defendant for the acts of his agent... The court then added that the company could rebut this presumption of responsibility by showing that it had no knowledge of the crime, had issued instructions against the illegal conduct, and had taken precautions against its commission. In this manner, courts can relieve the prosecution of the burden of identifying the locus of criminality within the corporate structure and place the burden upon the corporation to prove not only that none of the management participated in or had knowledge of the act, but also that management had called forth its best efforts to prevent its commission.

The state can thus impose upon the corporation the positive duty of policing itself at the risk of incurring heavy penalties for any breach. Any attempted evasion of this duty by means of an unwarranted delegation or decentralization not only will be abortive, since the state can rely upon a presumption of responsibility, but also it will actually work to the detriment of the corporation, since it will increase the already substantial difficulties of showing good faith and the taking of all due precautions. On the other hand, where the corporation has acted in good faith and taken all reasonable steps to prevent the commission of the crime, an acquittal on these grounds should give it greater incentive to continue its efforts of self-inspection and law enforcement.

Moreover, it is difficult to see how this procedure would run afoul of the policy considerations previously advanced. Any attempted evasion by means of delegation or decentralization can be thwarted by use of this presumption as effectively as it can by an across-the-board application of *respondeat superior*. As for the policy against allowing the corporation to benefit from the illegal acts of its agents, this too would seem to be preserved by the *Gund-Holland* decisions. For in a case where a production foreman, without the knowledge and contrary to the instructions of his superiors, knowingly delivers defective merchandise under a government contract, an action for breach of contract would effectively prevent the innocent corporation from benefiting from its employee’s illegal acts. If the corporation had not acted with due diligence and good faith and had implicitly condoned or negligently allowed such deceit, then not only should it not profit from the crime, but it should be punished criminally. However, in the converse situation, the imposition of punitive sanctions seems an unnecessary anomaly in criminal law.

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75 204 Fed. 17, 23 (8th Cir.), modified, 206 Fed. 386 (1913). (Emphasis added.)
It equally appears that the objective of providing an adequate deterrent to the future commission of these common law codified offenses could be achieved by this presumption. The measures taken by the corporation itself, which would have to be shown to negative this presumption, would seemingly prevent recidivism among the corporation’s employees to the fullest extent that this is realistically possible.\textsuperscript{76}

In effect, resort to a punitive sanction would be necessary only where the corporation had failed in fulfilling its duty of self-deterrence, in which event, it would be at least culpably negligent, justifying the imposition of a heavier fine and thus a more effective deterrent.

It is submitted, therefore, that there are justifiable doubts that public policy necessitates any across-the-board imposition of vicarious liability upon the corporation for the criminal acts of all its agents. If this be so, then a reexamination of the corporation’s criminal liability in the area of the common law crimes, codified or uncodified, seems more than appropriate before the courts finalize their trend toward a complete departure from the traditional concepts of criminal justice. The belief that only those who are in some degree culpable should be criminally punished, though not the sole determinant for the imposition of penal sanctions, is nevertheless an important one which should be weighed along with all the other considerations of public policy in arriving at any definition of the scope of corporate criminality. Such a time-honored principle should be deviated from only to that extent clearly demanded by a carefully considered determination of what is necessary to adequately protect the general welfare.

\textbf{James V. Dolan}

\textbf{Richard S. Rebeck}

\textsuperscript{76} For a practical suggestion as to what a corporation might do to effectively promote adherence to the law among its employees, see Whiting, Antitrust and the Corporate Executive II, 48 U. Va. L. Rev. 1-18 (1962). Although, as the title indicates, these suggestions are specifically concerned with the antitrust violations, they would seem to have equal application to any codified offense.

This article also points out that corporate executives are becoming increasingly aware of the necessity for instituting effective self-policing measures. This same awareness had been previously expressed by Mr. Cordiner of General Electric when he stated:

I believe any organization, whether it be a corporation, a union, a professional association or whatever, must policy [sic] itself. If it does not—if it leaves entirely to others the unpleasant job of enforcing its ethical standards, then I believe the validity of the standards and the integrity and independence of the organization inevitably suffer.

INDEMNIFICATION OF THE CORPORATE OFFICIAL
FOR FINES AND EXPENSES RESULTING FROM
CRIMINAL ANTITRUST LITIGATION

The attention of industry and the public has recently been focused upon the far-reaching effects of the antitrust laws. During the last decade the Justice Department brought to bear the full force of these laws when it indicted 431 corporate officials for alleged violations of the Sherman or Clayton Acts.\(^1\) Fines running as high as $75,000 were levied on those found guilty.\(^2\) A high point in the crescendo of antitrust prosecution was reached when forty-four electrical corporation officials were found guilty of conspiring to restrain trade and fines totaling more than $100,000, as well as jail sentences, were imposed.\(^3\) As yet no corporate official charged in the recent prosecutions has sought indemnification from his corporate employer for the litigation expenses and fines incurred. At least no such request for indemnification\(^4\) has been the subject of litigation.\(^5\) However, the magnitude of the expenses and fines involved and the history of similar proceedings indicate that it is likely that such requests will find their way into court. In anticipation of this likelihood, inquiry into the law which will be applied in evaluating these requests for indemnification appears timely.

It is immediately clear that the law in this area is unsettled and deficient in precedent.\(^6\) The majority of claims for indemnification arise

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1. See Whiting, Antitrust and the Corporate Executive, 47 Va. L. Rev. 929, 938 (1961). Mr. Whiting gives the following breakdown as to position of the defendant in the corporation: presidents, 170; vice presidents, 106; division or department managers, 45; secretaries and/or treasurers, 30; other “managers,” 23.

2. United States v. Safeway Stores, Inc., 20 F.R.D. 451 (N.D. Tex. 1957). The former president of Safeway Stores pleaded nolo contendere and was fined $35,000 on each count of a two-count indictment charging conspiracy and attempt to monopolize the retail grocery business, and $5,000 on a third count charging a violation of section 3 of the Robinson-Patman Act, by selling goods at prices lower than exacted elsewhere.


4. Indemnification, as used in this note, refers to reimbursement by the corporation of expenses and fines incurred by an officer or director in defense of actions brought against him personally for acts performed in his corporate capacity.

5. One action has been brought by a shareholder to prevent Safeway Stores from paying the fines of its officials. Koster v. Warren, 297 F.2d 418 (9th Cir. 1961).

6. The few cases decided which deal with indemnification in antitrust suits have been stockholders’ derivative actions. Koster v. Warren, supra note 5, at 423; Schwarz v. General Aniline & Film Corp., 305 N.Y. 395, 113 N.E.2d 533 (1953), reversing 279 App. Div. 996, 112 N.Y.S.2d 146 (1952), affirming 198 Misc. 1046, 102 N.Y.S.2d 325 (Sup. Ct.
out of derivative suits by a shareholder against a director or officer of the corporation. In such cases it has generally been held that the defendant director or officer who is unsuccessful in defending the action brought against him by the stockholder is not entitled to indemnification. This is manifestly just, for the decision of the court in favor of the plaintiff shareholder is an adjudication that the defendant director or officer has been guilty of negligence or misconduct in the performance of his duties to the corporation. It is unreasonable to expect a corporation to reimburse a director or officer for the expenses he has incurred in an adjudication which establishes that he has broken faith with the corporation. Thus the success of the defendant in the derivative action giving rise to the expenses for which indemnification is sought is a prerequisite for indemnification from the corporation.

Other cases dealing with the problem of indemnifying the directors or officers of a corporation impose a further limitation and base the award or refusal of indemnification upon the benefit bestowed upon the corporation by the successful litigation giving rise to the request. If the litigation is viewed as directly beneficial to the corporation, the director or officer will be reimbursed. The amount and type of benefit


7 E.g., Wickersham v. Crittenden, 106 Cal. 329, 39 Pac. 603 (1895); McConnell v. Combination Mining & Milling Co., 31 Mont. 563, 79 Pac. 248 (1905); Hollander v. Breeze Corp., 131 N.J. Eq. 585, 26 A.2d 507 (Ch. 1941), aff'd per curiam, 131 N.J. Eq. 613, 26 A.2d 522 (Ct. Err. & App. 1942); Apfel v. Auditore, 223 App. Div. 457, 228 N.Y. Supp. 489 (1928), aff'd mem., 250 N.Y. 600, 166 N.E. 339 (1929); Washington, Litigation Expenses of Corporate Directors in Stockholders' Suits, 40 Colum. L. Rev. 431, 433 (1940). It has been suggested that a possible exception to this rule exists where his defense, even though unsuccessful, substantially benefited the corporation and at the same time the defendant director had acted in good faith and not for his personal benefit. Bishop, Current Status of Corporate Directors' Right to Indemnification, 69 Harv. L. Rev. 1057, 1060, 1067 (1956). Contra, Hornstein, The Counsel Fee in Stockholder's Derivative Suits, 39 Colum. L. Rev. 784, 816 (1939).

8 See Bishop, supra note 7, at 1060.


which must be rendered in order to justify awarding of indemnification varies with the court.\textsuperscript{11}

Some courts have noted that public policy favors indemnification of corporate directors who incur legal expenses in the successful defense of derivative suits;\textsuperscript{12} others have recognized that the corporation has the power to indemnify its "vindicated" corporate officials but require a charter provision, by-law, shareholder action or express contract before indemnification is allowed.\textsuperscript{13} The numerous studies made in this area of indemnification for expenses incurred by a director in the defense of a derivative suit clearly indicate that the law is unsettled and courts often apply varying and contradicting tests.\textsuperscript{14}

\textsuperscript{11} See cases cited note 10 supra.

\textsuperscript{12} Three of these public policy considerations are: (1) to encourage innocent directors to resist unjust charges and provide them with an opportunity to hire competent counsel, (2) to "induce responsible business men to accept the post of directors," and (3) "to discourage in large measure stockholders' litigation of the strike variety . . . ." In re E. C. Warner Co., 232 Minn. 207, 214, 45 N.W.2d 388, 393 (1950); accord, Solimine v. Hollander, 129 N.J. Eq. 264, 19 A.2d 344 (Ch. 1941); Figge v. Bergenthal, 130 Wis. 594, 109 N.W. 581 (1906). See generally Washington, Litigation Expenses of Corporate Directors in Stockholders' Suits, 40 Colum. L. Rev. 431 (1940); 26 Minn. L. Rev. 119 (1941).


\textsuperscript{14} See Henn, Corporations §§ 382-83 (1961); Bishop, Current Status of Corporate Directors' Right to Indemnification, 69 Harv. L. Rev. 1057 (1956); Carson, Further Phases of Derivative Actions Against Directors, 29 Cornell L.Q. 431 (1944); Hornstein, Directors' Expenses in Stockholders' Suits, 43 Colum. L. Rev. 301 (1943); Hornstein, The Counsel Fee in Stockholder's Derivative Suits, 39 Colum. L. Rev. 784 (1939); Washington, supra note 12. The failure of the courts to enunciate unambiguous principles of law in this area has been due partly to their inability to determine clearly the relationship which exists between the corporation and the directors seeking indemnification. Some courts cast the position of director as "sui generis." New York Dock Co. v. McCollom, supra note 13, at 109, 16 N.Y.S.2d at 847. For a discussion of this characterization, see Note, Position of Corporate Director as \textit{Sui Generis}, 35 Minn. L. Rev. 564 (1951). Other courts view the directors' position not as sui generis, but regard directors
Dissatisfaction with the inconsistent common law decisions in this area has led many jurisdictions to provide for indemnification by statute.\(^{15}\) The reaction of the New York legislature to the deficiency of the law in this area can be seen in the laws passed immediately following a decision denying indemnification upon most uncertain grounds.\(^{16}\) This is typical of the growing recognition of the need for more definite standards with which to solve the problem.

Even though many jurisdictions have enacted indemnification statutes, they have not proved to be a panacea. Most of the statutes grant to corporations the \textit{power} to indemnify corporate officials.\(^{17}\) Other statutes give to the corporate officials the \textit{right} to receive indemnification,\(^{18}\) and a few have both features.\(^{19}\) North Carolina expressly abrogates any rights which may have existed outside the statute, while others do not.\(^{20}\)

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\(^{17}\) Colorado, Connecticut, Delaware, District of Columbia, Indiana, Iowa, Maine, Maryland, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Rhode Island, Texas, Virginia.

\(^{18}\) E.g., California, Missouri, Montana, North Carolina.

\(^{19}\) E.g., New York, North Carolina, Wisconsin.

\(^{20}\) Alaska, Colorado, Connecticut, Delaware, District of Columbia, Indiana, Iowa, Maine,
Although the statutes are generally agreed that the benefit test should not be determinative,21 and that a defendant who has been adjudged negligent or guilty of misconduct is not entitled to indemnification,22 they are varied in their scope and context and are not readily adaptable to determining the question of indemnification in antitrust cases.23

Moreover, the common law decisions dealing with indemnification of directors or officers for expenses incurred in the defense of a derivative suit are at best only analogous to the questions presented by indemnification in criminal antitrust actions. One basic difference is apparent; in the derivative action the director or officer is brought to task for allegedly violating his fiduciary duty to the corporation; in an antitrust action, as in any action by a third party or "outsider" against a corporate official, the defendant is charged with violating a duty either to the individual plaintiff, in the case of a tort, or to society, in the case of a crime. In the shareholder suit an adjudication of guilt is an indication that the director or officer has not fulfilled his duty to the corporation, and he is therefore not entitled to indemnification. In the third party suit, however, an entirely different standard of conduct is applied to the director or officer. It is not a question of whether he has been faithful in executing his duties as a fiduciary to the corporation, but rather it is his relation to a third party or society, as an agent of the corporation, that is in issue. It is therefore entirely conceivable that a director or officer can be in violation of a criminal statute in the furtherance of corporate activity and yet still be fulfilling his obligations to the corporation in all good faith. In short, the determination that his conduct is tortious or criminal is no adjudication per se as to his relation to the corporation. Despite these disparities, the statutory and case law which has developed to deal with the problem of indemnification in derivative actions will

Maryland, Michigan, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, Texas, Virginia, Wisconsin.


22 E.g., Delaware, Kentucky, Maine, Missouri, Montana, New Jersey, New York, Rhode Island, Wisconsin.

23 The indemnification statutes, with the exception of those in Indiana, Iowa and Nebraska, are generally inapplicable in regard to expenses incurred through criminal antitrust prosecutions. See Schwarz v. General Aniline & Film Corp., 305 N.Y. 395, 113 N.E.2d 533 (1953). Therefore, this note will concern itself solely with the common law theories upon which the corporate official may seek indemnification.
be called upon to aid in answering the question of indemnification in antitrust actions.24

Only a few cases have been decided upon the question of indemnification in antitrust actions. In *Simon v. Socony-Vacuum Oil Co.*25 a New York court held, in the absence of statute, that a corporation had the power to indemnify corporate officials for expenses incurred by reason of antitrust proceedings against them. Several directors pleaded not guilty to the charges and were convicted after a trial, while two pleaded nolo contendere. The corporation paid all fines and expenses resulting from the litigation. When shareholders instituted a derivative suit to force the directors to return those amounts, the court stated that the corporate interest was so bound up in the defense of those directors who went to trial that the corporation was defending a threat to itself and hence the payments were justified. The power to indemnify the directors who pleaded nolo contendere was upheld on the ground that valuable consideration moved from the directors to the corporation as a result of that plea. The court also took note of the good faith of the directors and of the fact that they were not aware of their violations of the antitrust laws. A recent case from the Ninth Circuit, *Koster v. Warren,*26 followed the rationale of *Simon* that a valuable consideration passes to the corporation upon the official’s plea of nolo contendere and therefore the corporation is not wasting its assets when it pays the official’s fine.

The only case on antitrust indemnification as a matter of right is *Schwarz v. General Aniline & Film Corp.*27 This case was decided under a New York statute granting to a corporate director or officer the right to be indemnified for expenses incurred in the defense of an action against him.28 The court interpreted this statute as not encompassing the right to indemnification in a criminal action.

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24 It should be emphasized that the common law approach has been more concerned with the right of corporate personnel to indemnification than with the power of the corporation to indemnify the corporate official. E.g., *Mooney v. Willys-Overland Motors, Inc.,* 204 F.2d 888, 899 (3d Cir. 1953) (dictum); *In re E. C. Warner Co.,* 232 Minn. 207, 45 N.W.2d 388 (1950); *Sollimine v. Hollander,* 129 N.J. Eq. 264, 19 A.2d 344 (Ch. 1941). Compare New York Dock Co. v. McColloM, 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. 1939) (neither duty nor power to indemnify unless defense benefited corporation).


26 297 F.2d 418 (9th Cir. 1961).


The Simon and Koster cases upheld the power of the corporation to indemnify the director-officer; however, the Schwarz case is more nearly illustrative of the problem. As noted, the court reasoned that the indemnification statute envisioned civil rather than criminal actions against the corporate official and therefore denied recovery. The question which is unanswered by the case is whether there was any common law theory upon which the director or officer could have sought indemnification from his corporation.  

The corporate official is an agent of the corporation, and under

29 See Bishop, supra note 14, at 1075. "Nowhere either in the opinions of the lower courts or in those of the majority or dissent in the court of appeals is there any suggestion that the plaintiff might have had a common-law remedy which was neither dependent upon nor limited by article 6-A." Cf. Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 896 (3d Cir. 1953).


The other obligation the director or officer has is that of a fiduciary or quasi-fiduciary responsibility to the corporation and its shareholders. This is the internal relationship as opposed to the earlier defined external relationship, i.e., of a general agent. However, this appears to be "one of the most confused and entangled subjects in corporation law." Geller v. Transamerica Corp., 53 F. Supp. 625, 629 (D. Del. 1943). The general rule is that the officer's relationship to the corporation is that of a fiduciary. SEC v. Chenery Corp., 332 U.S. 194, 208, rehearing denied, 332 U.S. 783 (1947); Pepper v. Litton, 308 U.S. 295 (1939); In re Norcor Mfg. Co., 109 F.2d 407 (7th Cir.), cert. denied, 310 U.S. 625 (1940); Rinn v. Asbestos Mfg. Co., 101 F.2d 344 (7th Cir. 1938); Carpenter v. Danforth, 52 Barb. 581 (N.Y. 1868); Litwin v. Allen, 25 N.Y.S.2d 667 (Sup. Ct. 1940); 19 C.J.S. Corporations § 761 (1940). It should be noted that for the purposes of this article, the converse of this fiduciary relationship is what is important, i.e., the right
accepted agency law the agent is entitled to indemnification for losses sustained as a direct consequence of the execution of the agency.\(^\text{31}\) Two early cases recognized that agency law provided a right to indemnification when a corporate official sustained losses in regard to criminal prosecutions arising as a consequence of performing his authorized duties for the corporation.\(^\text{32}\) The particular losses in both cases involved expenses incurred by the official in the successful defense of criminal actions brought by the United States.

The official in *Du Puy v. Crucible Steel Co. of America* was acquitted of charges of fraudulently filling out the corporation’s income tax statement but was denied indemnification because his loss was not “the direct and natural consequence of the execution of the agency.”\(^\text{33}\) The court reasoned that while the officer was authorized to make out the tax returns, the prosecution flowed from the *manner* in which the return was filled out. It is apparent from the opinion that the court was not convinced of the officer’s innocence, at least as to negligence, and his failure to plead that there was no mistake in the return or that the indictment resulted from an honest mistake was noted as a significant

of the director or officer to receive indemnification from the corporation when the officer in acting for the corporation is subjected either to a criminal or civil action, or both.

For a discussion of the corporate official’s liability as a fiduciary in regard to antitrust violations, see Blake, *The Shareholders’ Role in Antitrust Enforcement*, 110 U. Pa. L. Rev. 143 (1961).

\(^\text{31}\) In the absence of terms to the contrary in the agreement of employment, the principal has a duty to indemnify the agent where the agent

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(b) suffers a loss which, because of their relation, it is fair that the principal should bear.

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Unless otherwise agreed, a principal is subject to a duty to exonerate an agent who is not barred by the illegality of his conduct to indemnify him for:

\(\ldots\)

(d) expenses of defending actions by third persons brought because of the agent’s authorized conduct, such actions being unfounded but not brought in bad faith \(\ldots\).


\(^\text{32}\) *Du Puy v. Crucible Steel Co. of America*, 288 Fed. 583 (W.D. Pa. 1923); *Hoch v. Duluth Brewing & Malting Co.*, 173 Minn. 374, 217 N.W. 503 (1928). A recent case dealt with the question of whether a corporation could deduct as a business expense amounts paid to a corporate official as indemnification for legal expenses incurred by the official in defense of an action arising from corporate business. In finding the payment a valid business expense, the court recognized the duty of the principal to indemnify the agent for losses sustained in the performance of his agency. *Standard Galvanizing Co. v. Commissioner*, 202 F.2d 736, 738-39 (7th Cir. 1953).

\(^\text{33}\) 228 Fed. 583, 586-87 (W.D. Pa. 1923).
omission. The reasoning of the court, that a corporate official may recover indemnification from his corporation for losses sustained as a direct and natural consequence of the execution of his agency unless barred by misconduct or negligence, is in complete agreement with the *Restatement of Agency.*

In *Hoch v. Duluth Brewing & Malting Co.*, an official was indicted for an alleged invasion of United States land patents. When he sought indemnification from the corporation for the expenses incurred in the successful defense of the action, the court enunciated the principle of agency law upon which the right to indemnification was based but denied recovery because the loss was not a natural consequence of the official's duties as agent for the corporation. The loss, the court stated, was caused by "independent and unexpected wrongful acts of third persons for which the principal is in nowise responsible."

This statement, in the context used, has doubtful application and would appear to deny indemnification for expenses incurred in any criminal proceeding. Moreover, even if the statement was accurate when used, it has no validity today. With the advent of federal statutes regulating many aspects of interstate business, and more specifically the antitrust legislation, the threat of criminal prosecution of a corporate official is no longer "unexpected"; it is a "normal hazard of corporate operation, a risk of doing business to be borne by the company, which in all probability, profited from his activities." In the criminal prosecution for antitrust violations, the corporation could contend that the agent was not authorized to precipitate an antitrust prosecution and that therefore his loss was not sustained while performing an authorized duty. It is clear, however, that the legal expenses incurred by the official in

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34 Restatement (Second), Agency § 439(d) (1958).
35 173 Minn. 374, 217 N.W. 503 (1928).
36 Id. at 377, 217 N.W. at 504, quoting Mechem, Outlines of Agency § 422 (3d ed. 1923).
37 There is authority which would question the accuracy of the statement as applied to the facts in the *Hoch* case. In *D'Arcy v. Lyle*, 5 Binn. 441 (Pa. 1813), the agent sought indemnification from his principal for losses sustained when the agent, while transacting business for his principal, was sued in "St. Domingo" for a matter arising out of that business. The despotic government then in power forced the agent to confess judgment under threat of trial by combat to the death. The majority of the court held immaterial the fact that the loss was occasioned by a wrongful act of a third person, i.e., the government of "Hayti." The loss "was a consequence flowing from the agency, and which could not have existed but for the agency." Id. at 448.
38 Schwarz v. General Aniline & Film Corp., 305 N.Y. 395, 409, 113 N.E.2d 533, 540 (1953) (Fuld, J., dissenting); see Blake, supra note 30, at 169.
defending his actions are direct consequences of the execution of his agency. Appreciating the pervasion of antitrust proscriptions, it is readily conceivable that an official conducting normal business activities well within his authority will be indicted for a violation.

At least to this point the legal principles stated in the *Du Puy* and *Hoch* cases would be available to the corporation official who has sustained a loss as a consequence of defending an antitrust prosecution. The case for indemnification becomes most compelling where the official has been found not guilty on the merits. In this situation the corporate official is supported in his action for indemnification not only by the law of agency, but by several of the legal theories which have been put forward to support indemnification for expenses incurred in the director's successful defense of a derivative suit. Since the criminal antitrust prosecution against a corporate official is a formidable threat to the corporate image, the successful defense of this prosecution is a benefit to the corporation. Indeed, it has been stated that where an

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39 Judge Learned Hand noted in 1918 that the “law has always tended towards larger and larger liability” in this area. United States v. Nearing, 252 Fed. 223, 231 (S.D.N.Y. 1918). In Continental Baking Co. v. United States, 281 F.2d 137 (6th Cir. 1960), the court analyzed this expanding liability and found that the cases which held a corporation responsible for an officer’s actions—even exceeding the expressed corporate authority—all had a “common denominator”: 1) the officer or agent of the corporation had broad express authority; 2) the officer had committed a criminal act relating to corporate business; and 3) as long as the criminal act was related to the performance of the duties which the officer had broad authority to perform, the corporation was deemed to have authorized the act. The court noted that the various theories and the use of terms such as “apparent” and “implied” authority were merely a resort to “legal labeling” rather than a basis for liability. It concluded that a corporation which employs a man in a position with broad authority, commensurate with the responsibility, cannot say the man was only authorized to act legally.

Among the earlier cases holding a corporation liable for an officer’s criminal acts, proceeding under various theories, are: Clews v. Jamieson, 182 U.S. 461 (1901); St. Johnsbury Trucking Co. v. United States, 220 F.2d 393 (1st Cir. 1955); United States v. Armour & Co., 168 F.2d 342 (3d Cir. 1948); Old Monastery Co. v. United States, 147 F.2d 905 (4th Cir.), cert. denied, 326 U.S. 734 (1945); Egan v. United States, 137 F.2d 369 (8th Cir.), cert. denied, 320 U.S. 788 (1943). See also New York Cent. & H.R.R.R. v. United States, 212 U.S. 481 (1909); United States v. United States Cartridge Co., 198 F.2d 456 (8th Cir. 1952).

40 See Blake, supra note 30, at 169.

41 See notes 7 (successful defense), 9 (defense benefited corporation), and 12 (public policy requires indemnification) supra.


43 The benefit requirement as expressed in New York Dock Co. v. McCollom, 173
official who is motivated solely by the corporation's best interests is indicted for antitrust violations and later acquitted, his only fault is that "he was an official of a corporation whom the government chose to indict for a violation of the antitrust laws." And possibly of paramount importance, public policy is satisfied by indemnifying the corporate official who has successfully defended a criminal action.

The application of the same agency principles would clearly deny indemnification in the situation where the corporate official has been found guilty of the antitrust violation. The agent's right to indemnification is based on an implied contract in which the principal agrees to compensate the agent for expenditures and losses suffered from authorized conduct. Where the authorized conduct constitutes a violation of the law, the subject matter of the implied contract is tainted by illegality and there can be no recovery.

The result of a contrary holding is obvious. To indemnify the convicted official is to encourage the disregard of antitrust laws, for he then will have no fear of personal financial sanction as a result of conduct which is not carefully self-scrutinized to comply with such laws. Public

Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. 1939), was that the unsuccessful defense of the action would be a threat to the corporate interest. Even following this strict benefit requirement, indemnification should be available in the official's successful defense of the criminal antitrust prosecution.


Where the defense of the action is successful, with the exception of discouraging strike suits, the public policy considerations favoring indemnification are the same irrespective of whether the expenses resulted from a derivative suit or a criminal prosecution. See id. at 409, 113 N.E.2d at 540; cases cited note 9 supra.

Irrespective of an express agreement "there was at least an implied agreement on the part of the [corporation] . . . to save its agent from financial loss resulting from his doing what the [corporation] . . . had instructed him to do and what the [corporation] . . . knew he was doing." Standard Galvanizing Co. v. Commissioner, 202 F.2d 736, 739 (7th Cir. 1953).

"Generally, payment made to indemnify another springs from contract, express or implied. . . . [A]n agreement to pay the penalty which might be imposed upon one found guilty of violating the law would be tainted with illegality and unenforceable." Sachs v. Commissioner, 277 F.2d 879, 883 (8th Cir.), cert. denied, 364 U.S. 833 (1960); accord, Mills Novelty Co. v. Dupouy, 203 Fed. 254 (7th Cir. 1913). In Dupouy plaintiff sued to recover for fines imposed on him by the Venezuelan Government for violations of law incurred while transacting business on behalf of the defendant. The court held that an agent's claim against his principal for reimbursement or compensation for losses sustained through the performance of a contract which is tainted by violation of law is not allowed on public policy grounds. Id. at 259.
policy would demand this result in order to prevent circumvention of the manifest purpose of the legislation. The indictments and convictions arising out of the aforementioned electrical companies conspiracy is indicative of the widespread violations of the antitrust laws. These indictments also indicate an awareness that the relatively innocuous criminal sanctions available against the corporations are insufficient to stop the violations, and only by bringing the full impact of the violation home to the responsible individuals will price-fixing activities be curtailed. Finally, it is clear that the indemnification of the official’s expenses by the corporation ultimately will be passed on to the consumer for whose benefit the prosecution was sought in the first instance.

It has been argued that since the antitrust laws are couched in broad language, bounds of permissible corporate activity are not always clearly discernible. By utilizing aggressive market policies in the

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49 It is clear that civil penalties alone, entered against either the corporation or the individual offender, whether or not corporate indemnification is allowed, are insufficient to deter intended violations of the antitrust laws. Kramer, Criminal Prosecutions for Violations of the Sherman Act: In Search of a Policy, 48 Georgetown L.J. 530, 532 (1960). Compilation of necessary documentary evidence in a civil proceeding is also a problem. Cummings, A General Survey and Critique, in Antitrust Administration and Enforcement and the Attorney General’s Committee Report: A Brief Symposium, 50 Nw. U.L. Rev. 307 (1955). Violations of the Sherman Act are often brought in multiple counts, with a possible maximum fine of $50,000 per count. Id. at 309-10. However, much lower fines are generally assessed by the courts. Kramer, supra at 532 n.9. Furthermore, until recently little use has been made of the Sherman Act in criminal prosecutions against individual corporate defendants. Id. at 530 n.2. At least one commentator has deprecated the use of criminal sanctions in antitrust prosecutions because of the individual’s constitutional protections. McAllister, The Trial of a Big Case on the Criminal Side, 1 Antitrust Bull. 345 (1955).

50 The first and second sections of the Sherman Antitrust Act, 26 Stat. 209 (1890), 15 U.S.C. §§ 1, 2 (1958), are illustrative. Section 1 provides: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade . . . among the several States . . . is declared to be illegal.” Section 2 is equally pervasive: “Every person who shall monopolize, or attempt to monopolize . . . or conspire . . . to monopolize any part of the trade . . . among the several States . . . shall be deemed guilty of a misdemeanor.”

51 An example is the complex problem presented when the legality of price leadership, a loose form of price fixing, is under consideration. Hansen, The Current Federal Policy on Antitrust Matters, 4 Antitrust Bull. 541, 543 (1959). Statutory differences in the various antitrust acts also create difficulty, since certain activity, such as conscious parallelism, would seem to be legally permissible in view of the requirements of sections 1 and 2 of the Sherman Act, but may contravene section 5 of the Federal Trade
“gray areas” of antitrust law, corporate executives risk antitrust prosecution. A judicial determination of corporate civil liability could render the corporate entity subject to a fine, thereby permitting charges of official misconduct to be leveled against responsible corporate officials. As a necessary corollary, the official would then be precluded from corporate indemnification protections afforded under existing case law. Thus infringements of sales and pricing strategy would occur in areas of mere legal uncertainty, as opposed to positive illegality. In this instance, the responsible business executive might well adopt a conservative marketing approach, thereby sacrificing immediate corporate gains for long-term individual and corporate security from antitrust prosecution.

However, these objections become transparent when an analysis of current antitrust law is made. The bounds of corporate criminal behavior have been drawn with reasonable certainty. Relative uniformity is noticeable in both the attitude of the courts and the Justice Department in regard to price-fixing violations, currently in the main arena


52 See Hollander v. Breeze Corps., 131 N.J. Eq. 585, 26 A.2d 507 (Ch. 1941), aff’d per curiam, 131 N.J. Eq. 613, 26 A.2d 522 (Ct. Err. & App. 1942).

53 In some instances, price fixing may be legal, i.e., where general market prices and trade volume remain unaffected. Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); Cement Mfrs. Protective Ass’n v. United States, 268 U.S. 588 (1925); Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918); cf. Sugar Institute v. United States, 297 U.S. 553 (1936). But in general, collusive price fixing, whether horizontal, United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Trenton Potteries Co., 273 U.S. 392 (1927), or vertical, United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); United States v. Univis Lens Co., 316 U.S. 241 (1942); Dr. Miles Medical Co. v. John D. Park & Sons, 220 U.S. 373 (1911), has been declared illegal by courts.

54 A generally uniform policy in regard to corporate price-fixing practices has been discernible in recent years. It is clear that deliberate efforts to monopolize distribution channels and overwhelm free and open competition will continue to be prosecuted. Rahl, Antitrust Policy in Distribution, in Report of the Attorney General’s Committee on Antitrust Law—A Symposium, 104 U. Pa. L. Rev. 145, 185 (1955). In past years the policy has been established that criminal action will be instigated when price fixing is involved. Segal & Mullinix, Administration and Enforcement, in Report of the Attorney General’s Committee on Antitrust Law—A Symposium, 104 U. Pa. L. Rev. 285, 290 (1955). Of course a reasonable belief must be present that an antitrust violation has been committed, and proof of the conspiracy will be required at the forthcoming trial. An undesirable economic effect is not a prerequisite to commencement of action under section 1 of the
of antitrust activity. Although judicial reasoning has varied, it is clear that collusive price fixing has long been looked upon with judicial abhorrence. Furthermore, the Justice Department views collusive price fixing as intrinsically unreasonable, and vigorous prosecution inevitably follows discovery of these practices. Although considerations of corporate good faith would not seem to enter into a determination of which violations to prosecute, it is clear that questions of morality and intent will continue to pervade departmental policy in this area.

Sherman Act, since the collusive price-fixing agreement is assumed as a matter of law to have a deleterious effect on competition. Hansen, supra note 51, at 543.

Courts have vacillated between a "rule of reason" and an "illegal per se" approach. See generally Morris, Is Price-Fixing Per Se Reasonable? A Discussion, 47 Ky. L.J. 63 (1958), for an exhaustive review of recent case law. An excellent discussion of earlier precedent is found in Jaffe & Tobriner, The Legality of Price-Fixing Agreements, 45 Harv. L. Rev. 1164 (1932).

Early judicial treatment of corporate price-fixing activities is readily available, since the antitrust acts did not expressly outlaw this practice. See, e.g., Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899); Anderson v. United States, 171 U.S. 604 (1898); Hopkins v. United States, 171 U.S. 578 (1898); 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).


A literal reading of the Sherman Act would seem to negate corporate contentions that intent should play a part in the outcome of an antitrust prosecution. At least one attorney in the Justice Department has developed a test of reasonableness that does not depend on mens rea. Steinberg, A New Look at the Antitrust Laws, 43 Ky. L.J. 357, 368 (1955). Further substantiation of the view that price-fixing prosecutions should not be concerned with corporate good faith or a corresponding ignorance of the law can be gained by an analogy to merger problems under section 7 of the Clayton Act, 38 Stat. 731 (1914), 15 U.S.C. § 12 (1958), where the primary considerations in determining whether to issue a complaint in a given case depend not on mens rea, but rather on whether new points of law are presented, relative economic importance, and whether a determination in this particular instance will help clarify existing law. Hansen, supra note 51, at 560. The business judgment defense would also be of no avail, since a reasonable exercise of the business judgment by an independent majority of the board of directors would not be involved. Blake, supra note 30, at 176.

Judge Wyzanski favors the literal interpretation of the act. United States v. United Shoe Mach. Corp., 110 F. Supp. 295, 345 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954). Partial substantiation for this position may be found in Report of the Attorney General's National Committee To Study the Antitrust Laws 349 (1955), which recommended that civil proceedings be filed in all cases except "where the law is clear and the facts reveal a flagrant offense and plain intent unreasonably to restrain trade." Furthermore, if corporate mens rea is to be a factor in the decision to bring the suit, it is
It is probable that future prosecutions will be restricted to intentional price fixers, not on the grounds that the law is still unsettled as to the prerequisites of a price-fixing violation, but on more practical limitations of time and money.61

Nor should the position of the convicted corporate official be strengthened by an allegation of good faith,62 absence of negligence63 or express contract granting indemnification as a matter of right.64 Many corporations have included indemnification provisions in charter, by-laws or contract of employment.65 These provisions, while normally broad enough to encompass legal expenses and fines incurred in antitrust proceedings,66 are merely restating the implied contract which exists at common law and are subject to the same restrictions.67

The cases involving indemnification of a director in his fiduciary capacity for expenses incurred in the defense of a derivative suit again give support to the conclusion.68 It is immediately apparent that the official’s unsuccessful defense of the criminal prosecution has resulted

the smaller companies, rather than the larger, that have to resort to the more obvious methods of combination and conspiracy, and they would necessarily bear the brunt of antitrust prosecution. Kramer, supra note 49, at 541.

61 At least one commentator has argued that future prosecutions be restricted to “hard core” violations. Weston, Antitrust and Economic Structure, supra note 51, at 413.

62 The official’s right to indemnification is generally predicated on contract, express or implied. Sachs v. Commissioner, 277 F.2d 879, 883 (8th Cir.), cert. denied, 364 U.S. 833 (1960). In affirming a district court’s refusal to enforce a contract to purchase malt during prohibition, Judge Clark of the Third Circuit stated: “As the interest of the state and not the quality of the act is important, questions of mala in se and mala prohibita, moral turpitude, etc., are irrelevant and have been so declared by the great weight of authority.” Fitzsimons v. Eagle Brewing Co., 107 F.2d 712, 713, affirming 27 F. Supp. 29 (E.D. Pa. 1939). But see Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 205, 38 N.Y.S.2d 270, 274 (Sup. Ct. 1942), aff’d mem., 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

63 See note 62 supra.

64 See Bishop, Current Status of Corporate Directors’ Right to Indemnification, 69 Harv. L. Rev. 1057, 1077 (1956).

65 See O’Neal, Molding the Corporate Form to Particular Business Situations: Optional Charter Clauses, 10 Vand. L. Rev. 1, 26 (1956). See also Jervis, Corporate Agreements to Pay Directors’ Expenses in Stockholders’ Suits, 40 Colum. L. Rev. 1192, 1194 (1940).


68 See cases cited note 7 supra.
in a detriment to the corporation. That the conviction is detrimental to the corporation is true not only because the corporate image is tarnished, but also because corporate assets are subjected to potential liability for civil damages arising out of these actions.\(^6^9\)

As seen in the discussion to this point, the question of whether indemnification should be permitted can be answered with some finality where the corporate official is found guilty of the violation charged or, in the converse situation, where he is exonerated by acquittal. Unfortunately, the plea of *nolo contendere*, in which the question of indemnification is not as susceptible of a clear and definitive answer, is more prevalent in the antitrust actions than in either of the aforementioned situations.

In the general area of criminal law, the *nolo contendere* plea means that the accused does not contest the charges leveled against him and resembles a demurrer in that it admits for the purposes of the case all facts well pleaded.\(^7^0\) In the case in which it is pleaded, the *nolo contendere* plea has the same result as an admission of guilt but cannot be used in evidence in another case.\(^7^1\) This latter feature explains the popularity of the plea in antitrust actions.\(^7^2\) Section 5 of the Clayton Act provides that the judgment or decree against a defendant in the criminal action is *prima facie* evidence against "such defendant" in subsequent suit by a third person,\(^7^3\) but the conviction of the corporate

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\(^6^9\) See generally Blake, supra note 30. The article discusses the feasibility of a shareholder's derivative suit against a director who caused the corporation to violate the antitrust law on the theory that the violation may constitute a breach of the director's fiduciary duty to the corporation.


\(^7^1\) Mickler v. Fahs, 243 F.2d 515, 517 (5th Cir. 1957); United States v. Standard Ultramarine & Color Co., 137 F. Supp. 167, 170 (S.D.N.Y. 1955). However, there is a limitation on the use of the plea of nolo by the corporate official and/or the corporation, in that the acceptance of a plea of nolo is not a matter of right but is entirely within the discretion of the court. See Hudson v. United States, 272 U.S. 451 (1926). Furthermore, once the plea is accepted, the court in its discretion may permit the plea to be withdrawn and replaced by another form of pleading. See United States v. Norris, 281 U.S. 619 (1930).


\(^7^3\) A final judgment or decree rendered in any criminal prosecution or in any suit or proceeding in equity brought by or on behalf of the United States under the antitrust laws . . . that a defendant has violated said laws shall be prima facie evidence against such defendant in any suit . . . brought by any other party against such defendant under said laws as to all matters . . . which said judgment . . . would be an estoppel as between the parties thereto: *Provided*, This section shall not apply to consent judgments or decrees entered before any testimony has been taken.

official apparently is not a judgment or decree against the corporation and hence may not be used as prima facie evidence against it.\textsuperscript{74} However, the fact that a court would be reluctant to entertain a \textit{nolo contendere} plea from one defendant, \textit{i.e.}, the corporation, and a plea of not guilty from a codefendant, \textit{i.e.}, the official, is indicative of the corporation’s interest in obtaining the cooperation of its official in the defense of the action.\textsuperscript{75}

The significance of this fact has moved two courts, by express language, to hold that a corporation could pay the fines and legal expenses of its officials because valuable consideration passed to the corporation as a result of the \textit{nolo contendere} plea.\textsuperscript{76} While it could be argued that a corporation’s \textit{power} to indemnify is broader than the official’s \textit{right} to indemnity,\textsuperscript{77} the argument loses some validity when the nature of the transaction is scrutinized. The corporation may not waste its assets,\textsuperscript{78} and therefore it may not pay the fines or legal fees as a gratuity.\textsuperscript{79} Hence, the corporation does not have the \textit{power} to pay these items unless it has received something in return,\textsuperscript{80} or unless its agent has


\textsuperscript{74} See generally Timberlake, The Use of Government Judgments or Decrees in Subsequent Treble Damage Actions Under the Antitrust Law, 36 N.Y.U.L. Rev. 991 (1961). The evidentiary value or the corporate official’s plea in a subsequent action against the corporation is a matter of conjecture.

\textsuperscript{75} See Koster v. Warren, 297 F.2d 418, 423 (9th Cir. 1961).


\textsuperscript{77} See Bishop, supra note 64, at 1062. In discussing the \textit{power} of the corporation to indemnify, which is broader than the \textit{right} of the director to demand indemnification, Bishop alludes to situations in which public policy favors indemnification. It is submitted that in the area of antitrust actions, where public policy favors or discourages indemnification depending on the existence of the violation, the \textit{power} and \textit{right} are nearly coextensive. The public policy limitation on the \textit{power} is recognized in Mooney v. Willys-Overland Motors, Inc., 204 F.2d 888, 896 (3d Cir. 1953).

\textsuperscript{78} See, e.g., Seitz v. Union Brass & Metal Mfg. Co., 152 Minn. 460, 189 N.W. 586 (1922); Lillard v. Oil, Paint & Drug Co., 70 N.J. Eq. 197, 56 Atl. 254 (Ch. 1903); Fletcher, Private Corporations \textit{§} 2507 (perm. ed. rev. repl. 1950).


\textsuperscript{80} "All indemnity agreements are based on a \textit{quid pro quo} for services rendered." Id. at 361.
sustained this loss in the performance of a service for the corporation and is guilty of no misconduct or negligence. If either of these circumstances exists, it would seem that the agent has a right under an implied contract to recover for these items. It is submitted, therefore, that in *Simon v. Socony-Vacuum Oil Co.* and *Koster v. Warren*, where the corporation's power to pay the official's fines and expenses was upheld against a shareholder's derivative suit, the same rationale would support an action by the official to demand indemnification. This is particularly true of the situation in *Koster*, in which the officials apparently changed their pleas from not guilty to *nolo contendere* at the request of the corporation. Although the court denied that it was permitting indemnification, it was recognizing an implied contract—the promise of the corporation to pay the expenses if the officials will plead *nolo contendere*.

The *nolo contendere* plea creates a unique situation in that some of the arguments for and against indemnification are equally applicable. In *Simon* and *Koster* the courts recognized that the aforementioned benefit inured to the corporation as a consequence of the *nolo contendere* plea. But the benefit would be greater if the official were found not guilty or had not precipitated the indictment in the first place. A threat to the corporation is ameliorated, but not removed. There is some dispute as to whether the official who pleads *nolo contendere* is guilty of misconduct or negligence which would preclude indemnification. It is true that an innocent person may have reasons for not contesting a criminal prosecution, but as an official of a corporation who would probably be indemnified for his expenses upon establishment of his innocence, the use of the *nolo* plea leads to only one conclusion—the prosecution in all probability would lead to conviction. Surprisingly, the propriety of the corporation paying the fines of its agents arising

82 Standard Galvanizing Co. v. Commissioner, 202 F.2d 736, 738-39 (7th Cir. 1953).
84 297 F.2d 418 (9th Cir. 1961).
85 Id. at 423.
86 Schwarz v. General Aniline & Film Corp., 198 Misc. 1046, 1047, 102 N.Y.S.2d 325, 326 (Sup. Ct. 1951), rev'd mem., 279 App. Div. 996, 112 N.Y. 146 (1952), rev'd, 305 N.Y. 395, 113 N.E.2d 533 (1953). Both lower courts held that the conviction of Schwarz following a plea of *nolo contendere* was an adjudication of "misconduct in the performance of his duties."
out of an antitrust violation has gained only passing comment in one decision. Judge Merrill in *Koster* noted that an agreement between the corporation and its official which would permit the official to violate the antitrust law with impunity—freed from pecuniary loss—would likely be void, but stated that in the case at bar

the corporation was simply attempting to extricate itself from a troublesome situation which presented itself after the fact of the alleged violation. The payment of the fines was not made pursuant to any agreement of indemnity, but was to compensate Warren and Cliff for foregoing rights which if exercised could operate to the detriment of the corporation.\(^{87}\)

The court was alluding to the defendants' right to plead not guilty, and the foregoing of this right at the request of the corporation was the consideration which the corporation received in return for its payment of the fines. The distinction drawn by the court—that an agreement consummated before the violation might be void, but that payment of the fines after the violation in order to extricate the corporation from the troublesome possibility of criminal or civil action was a valid business expense—is tenuous. Inevitably the corporate official will be placed in a bargaining position following his indictment under the antitrust laws. As illustrated by *Koster*, the corporation's flexibility of defense may be restricted by the official's plea, and consequently the official can extract indemnification for his expenses in return for his plea of *nolo contendere*. The relative certainty of the case reaching this posture would, for practical reasons, make immaterial the time when the indemnification agreement is consummated. The effect is that the official has good reason to believe that if he violates the antitrust law he will not have to pay the fine from his personal assets.\(^{88}\)

There is no dispute but that the corporation received its *quid pro quo*; the gravamen, however, is whether the court is condoning a practice which tends to weaken the enforcement of antitrust laws.\(^{89}\)

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87 297 F.2d at 423.

88 A recent tax case underscores this argument. The case held that a payment made under an agreement between a corporation and one of its officials to pay a fine imposed on the official for fraudulently filling out the corporation's income tax statement is not deductible as a valid business expense. Sachs v. Commissioner, 277 F.2d 879, 883 (8th Cir.), cert. denied, 364 U.S. 833 (1960). The court further reasoned that the payment of the fine must be construed as a constructive receipt of dividends by the official because an agreement to pay the fine, although entered into after the conviction, would be "tainted with illegality and unenforceable." Ibid.

89 A court's role in preventing conduct which indirectly frustrates a statute protecting the public interest can be seen from the Supreme Court's holding in *Tank Truck*
edge that the courts will not prevent indemnification for fines and legal expenses incurred by the official will of necessity, either by tacit or express understanding between the official and the corporation, promulgate the philosophy which seems prevalent among the higher echelons of industry that antitrust laws must be violated on occasion in the interest of profitable operation. Conversely, if the courts recognize the underlying purpose of the antitrust prosecution of the corporate official and deny the corporation the power to pay his fines and expenses incurred in any criminal action which does not result in complete exoneration, the conclusion is inescapable that regardless of the corporation’s position, individual officials will be reluctant to engage in suspect activities. Since the wisdom of antitrust legislation is not germane to this problem, the courts must prevent not only blatant violations of the law, but also subtle erosion of congressional intent.

THE EXCLUSIONARY RULE AND THE QUESTION OF STANDING

INTRODUCTION

For some forty-eight years the courts in the federal system have felt that the best method of effectuating the rights guaranteed by the fourth amendment would be to exclude, in criminal prosecutions, all evidence obtained by unreasonable searches and seizures. This sanction against

Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958). The corporation sought to deduct for tax purposes amounts reimbursing its truck drivers for fines imposed upon them for violating state maximum weight laws. The Court held that these reimbursements were not deductible as an ordinary and necessary business expense, stating that “a finding of ‘necessary’ cannot be made . . . if allowance of the deduction would frustrate sharply defined national or state policies prescribing particular types of conduct, evidenced by some governmental declaration thereof.” Id. at 33-34; accord, Hoover Motor Express Co. v. United States, 356 U.S. 38 (1958). “Even assuming . . . all due care and no willful intent . . . allowance of the deduction . . . would severely and directly frustrate state policy.” Id. at 40; cf. Fox Midwest Theatres, Inc. v. Means, 221 F.2d 173 (8th Cir. 1955). “Any contractual provision which could be argued to absolve one party from liability for future violations of the antitrust statutes against another would to that extent be void as against public policy.” Id. at 180. Similar language is found in Westmoreland Asbestos Co. v. Johns-Manville Corp., 39 F. Supp. 117, 119 (S.D.N.Y. 1941).


1 Weeks v. United States, 232 U.S. 383, 393 (1914).
unlawful police action is embodied in Rule 41(e) of the Federal Rules of Criminal Procedure. However, it was not entirely clear as to who could raise the objection and suppress evidence obtained by unconstitutional means. Then in 1960 the United States Supreme Court in \textit{Jones v. United States} for the first time faced the problem of "standing" and enunciated a broad interpretation of the exclusionary rule as codified in Rule 41(e).

Prior to the Supreme Court decision, a defendant, in order to attain standing to object, generally had to allege (1) a right to possession of the premises searched or (2) a possessory interest in the property seized. Behind this requirement is the pervading notion that the right must be personal to the defendant, and this has consistently been announced as the foundation of the defendant's status when moving to suppress evidence. The spirit of the requirement was strained in some instances before \textit{Jones}, but the broad scope of that decision, abolishing many of the requisites demanded by the lower federal courts, may lead the way toward an ultimate rejection of this limitation.

The main thrust of this note will be directed at an analysis of the \textit{Jones} decision, its effect upon the lower federal courts' established prerequisites for standing under Rule 41(e), and an attempt at charting the present and future course of the Supreme Court in this area. In this regard, California law will be considered and compared to federal theory, especially with regard to the personal limitation placed on the right to suppress.

\section{I}

\textbf{Rule 41(e) Before the Jones Decision}

Prior to 1914 the Supreme Court of the United States and the judicial bodies of the states were of the opinion that it was not proper for a court to take notice of the manner in which evidence presented to them was obtained when it was material to the issues in question and properly offered. In its decision in \textit{Weeks v. United States}, however, the Court altered its course and required the return of incriminating papers to the defendant when it was determined that a United States marshal seized them without a search warrant. In adopting a rule which would exclude evidence obtained in violation of the fourth amendment, the Court felt that a contrary decision would "manifest neglect if not an open defiance of the prohibitions of the Constitution." Whether or not the \textit{Weeks}

\begin{itemize}
  \item \textsuperscript{2} 362 U.S. 257 (1960).
  \item \textsuperscript{3} 232 U.S. 383 (1914).
  \item \textsuperscript{4} Id. at 394.
\end{itemize}
decision was a prudent one, considering other sanctions which might have been employed, has been the subject of considerable controversy.\textsuperscript{5} A discussion of the merits and drawbacks of the exclusionary rule itself, however, would appear to be merely academic in light of the Court's subsequent decisions, culminating in the imposition of this rule upon the states.\textsuperscript{6}

1. Personal Limitation

The more interesting and complicated aspect of the rule is presented in the problem of who may raise the objection in a federal court concerning evidence presented in a criminal case which has been obtained by unconstitutional means. May the objection be made only by the defendant when it was his home which was searched or when it was his property which was seized, or may the defendant object when he will be adversely affected by the presentation of evidence obtained in violation of anyone's constitutional rights?

The Federal Rules of Criminal Procedure were adopted in 1940, and Rule 41(e) allows a "person aggrieved" by an unlawful search and seizure to move for the suppression for use as evidence of any property obtained by those means.\textsuperscript{7} Since the rule was a statement of the existing law and practice, one must look to case law prior to 1940, in addition to the subsequent interpretations of the rule, to determine who may qualify as a "person aggrieved."

The fundamental concept present in the decisions of the lower federal courts,\textsuperscript{8} and reflected in the decisions of the Supreme Court,\textsuperscript{9} is that the

\textsuperscript{5} See 8 Wigmore, Evidence § 2184a (McNaughton rev. 1961).


\textsuperscript{7} A person aggrieved by an unlawful search and seizure may move the district court for the district in which the property was seized for the return of the property and to suppress for the use as evidence anything so obtained on the ground that (1) the property was illegally seized without warrant, or (2) the warrant is insufficient on its face, or (3) the property seized is not that described in the warrant, or (4) there was not probable cause for believing the existence of the grounds on which the warrant was issued, or (5) the warrant was illegally executed. The judge shall receive evidence on any issue of fact necessary to the decision of the motion. If the motion is granted the property shall be restored unless otherwise subject to lawful detention and it shall not be admissible in evidence at any hearing or trial. The motion to suppress may also be made in the district where the trial is to be had. The motion shall be made before trial or hearing unless opportunity therefor did not exist or the defendant was not aware of the grounds for the motion, but the court in its discretion may entertain the motion at the trial or hearing.

\textsuperscript{8} E.g., In re Nassetta, 125 F.2d 924 (2d Cir. 1942); Gowling v. United States, 64 F.2d 796, 799 (6th Cir. 1933); Nunes v. United States, 23 F.2d 905, 907 (1st Cir. 1928).

\textsuperscript{9} E.g., Jones v. United States, 362 U.S. 257, 261 (1960); Goldstein v. United States, 316 U.S. 114, 121 (1942).
defendant’s personal rights must have been violated before he is “agrieved.” It was felt that without some interest in the premises or the property a defendant could not be heard to complain of a search and seizure which violated another’s rights. This limitation on the application of the exclusionary rule has drawn severe criticism as being an unwarranted emphasis on the joinder of the fifth amendment, which is personal, to the fourth, which is basically a broad grant of immunity.¹⁰ A number of seemingly inequitable decisions have arisen because of the personal limitation of the rule,¹¹ but it has been said that the most serious objection stems from the fact that the limitation appears to strike at the fundamental reason for the exclusionary rule itself, viz., the prevention of unlawful police activity.¹² To secure a conviction of one conspirator, the prosecution may elect not to prosecute a co-conspirator who had been the victim of an unreasonable search and seizure. Even in the case of a single defendant, the police may be free to “rummage, everywhere for evidence . . . except among his belongings or in his house.”¹³ Whether this fear is well grounded, however, requires a consideration of two important Supreme Court decisions rendered prior to the Jones case.

Taking them in reverse chronological order, the second of these, United States v. Jeffers,¹⁴ involved the unlawful entry of two police officers into a hotel room occupied by an aunt of the defendant. A quantity of narcotics was discovered, and upon arrest the defendant claimed ownership of the narcotics. The Government argued that the search did not invade defendant’s privacy and that he lacked standing to suppress the evidence. The Court rejected this approach, saying that the elements of search and seizure could not be “untied” but are bound together by one purpose—“to locate and seize the narcotics” of the defendant.¹⁵ In addition, the Court held that the defendant could claim ownership of the narcotics for purposes of the exclusionary rule,¹⁶ notwithstanding the fact that the narcotics were contraband and could not be returned to him.

¹⁰ Comment, 58 Yale L.J. 144, 156 (1948).
¹¹ See United States v. DeVasto, 52 F.2d 26 (2d Cir.), cert. denied, 284 U.S. 678 (1931) (available to corporation rather than stockholders); A. Guckenheimer & Bros. v. United States, 3 F.2d 786 (3d Cir.), cert. denied, 268 U.S. 688 (1925) (not available to officers of corporation); Lusco v. United States, 287 Fed. 69 (2d Cir. 1923) (not available to codefendant).
¹² Comment, supra note 10, at 158.
¹³ Ibid.
¹⁵ Id. at 52.
¹⁶ Id. at 54.
Although the defendant might technically qualify as a "person aggrieved" because he claimed ownership, the fact that the case involved the premises of one other than defendant, concerned property which was not in the possession of the defendant, and was property in which there could be no legal property interest, could have been and was interpreted as an implied rejection of the personal limitation of the exclusionary rule. This interpretation, though premature, was not totally without merit, for the Supreme Court had, three years earlier, rendered a decision which appeared to narrow the limitation placed on a defendant's use of the exclusionary rule.

That decision, *McDonald v. United States*, appears to mark the first time the federal courts allowed a third party to question the use of illegally obtained evidence. Prior to 1948, the year *McDonald* was decided, the federal courts had ruled that a defendant could not complain of the introduction of evidence obtained from the unreasonable search of a codefendant's premises or person. The facts of the *McDonald* case indicate that the police, without a warrant, broke into defendant McDonald's home and discovered an illegal gambling operation. McDonald's motion to suppress certain evidence was erroneously denied at trial, and the Supreme Court corrected this error. In addition, the Court held that the conviction of McDonald's codefendant should also be reversed because in the joint trial the evidence was used against him as well.

The breadth of the decision can be appreciated when one considers that the Court assumed that the codefendant "had no right of privacy that was broken," but felt that the denial of McDonald's motion was prejudicial to the codefendant. No consideration was given to the plight of the codefendant where the victim of the search does not appeal, is acquitted or is not indicted. These possible situations might also be decided under the *McDonald* rationale, but further discussion of this problem area will be deferred until the implications of the *Jones* case are considered later in this note.

2. Allegations Required

In order for the defendant to establish himself as a "person aggrieved," the lower federal courts, prior to *Jones*, consistently required that he

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17 28 Wash. L. Rev. 56 (1953).
18 335 U.S. 451 (1948).
19 E.g., Winslett v. United States, 43 F.2d 358 (10th Cir. 1930); Brooks v. United States, 8 F.2d 593 (9th Cir. 1925); Lusco v. United States, 287 Fed. 69 (2d Cir. 1923); United States v. Wexler, 4 F.2d 391 (S.D.N.Y. 1925).
20 335 U.S. at 456.
prove a proprietary or possessory interest in the premises searched or the property seized. With no guidelines established by the Supreme Court, the case law appears to have been arbitrary and based to some extent on antiquated property law concepts where a defendant asserted an interest in the premises searched. When an owner leased certain land, the lessee could suppress at his trial, but the lessor was prevented from doing so if he were tried. Guests dwelling on the premises did not have standing, nor did a casual or temporary visitor. And even though employees had certain physical custody and control of the premises, this was found not to be a substantial interest. Strangely, however, where there was exclusive right to the use of a desk, there arose the requisite standing, even though the desk was the property of the Government and a superior consented to the search. Trespassers were not accorded standing, but tenants at sufferance were entitled to constitutional protection. This brief sketch of the quantum of interest necessary in the premises searched in order to gain “standing” vividly points up the need for uniformity later established in this area by the Supreme Court.

As an alternative to a property or possessor interest in the premises, the federal courts required that the defendant have an interest in the property seized. Where the property seized consisted merely of documents or records, an allegation of possession presented little difficulty. Where possession of certain other items, such as narcotics and other contraband, is in itself a crime, the problem became more acute. Recognizing the difficulty faced by the defendant, the courts were nevertheless adamant in their demand that a defendant choose either to admit possession or waive the unlawful search and seizure. In the words of Judge Learned Hand:

21 E.g., United States v. Pepe, 247 F.2d 838, 841 (2d Cir. 1957); United States v. Pisano, 193 F.2d 361, 365 (7th Cir. 1951); Gowling v. United States, 64 F.2d 796, 799 (6th Cir. 1933).
22 With the exception of the aspects of standing considered in McDonald and Jeffers, the Supreme Court, before Jones, had never passed on the standing requirements established by the lower federal courts. See Goldstein v. United States, 316 U.S. 114, 121 (1942).
23 Schnitzer v. United States, 77 F.2d 233 (8th Cir. 1935); United States v. Muscarelle, 63 F.2d 806 (2d Cir.), cert. denied, 290 U.S. 642 (1933).
25 In re Nassetta, 125 F.2d 924 (2d Cir. 1942).
26 Kelley v. United States, 61 F.2d 843 (8th Cir. 1932); Connolly v. Medalie, 58 F.2d 629 (2d Cir. 1932).
28 Klee v. United States, 53 F.2d 58 (9th Cir. 1931).
29 See, e.g., cases cited note 8 supra.
Men may wince at admitting that they were the owners, or in possession, of contraband property; may wish at once to secure the remedies of a possessor, and avoid the perils of the part; but equivocation will not serve. If they come as victims, they must take on that role, with enough detail to cast them without question. The petitioners shrank from that predicament; but they were obliged to choose one horn of the dilemma.\textsuperscript{30}

Either "horn" chosen by a defendant, however, would appear to require him to waive involuntarily a constitutional right. By asserting ownership and preserving his standing, the defendant seemingly waived his privilege against self-incrimination.\textsuperscript{31} If he denied ownership or possession, thereby losing his status as a "victim," he then apparently waived his right to challenge a violation of the fourth amendment in order to preserve his fifth amendment privilege. This "dilemma" has been felt to be unconstitutional.\textsuperscript{32} Inherent in an argument which views this involuntary waiver in that light is the concept that the exclusionary rule is an integral part of the fourth amendment and not merely a means of protecting the rights guaranteed by that amendment.

Although the \textit{Weeks} rule has been in existence for forty-eight years, this concept has not as yet been accepted by a majority of the creators of the rule, the Justices of the United States Supreme Court.\textsuperscript{33} Whether the exclusionary rule is part of the fourth amendment is, however, a controversy beyond the scope of this note, but it remains obvious that the alternative choices given to the defendant by the lower federal courts,

\textsuperscript{30} Connolly v. Medalie, 58 F.2d 629, 630 (2d Cir. 1932).

\textsuperscript{31} The cases are not entirely clear as to whether this admission against interest could be used at trial irrespective of the final determination made in the motion to suppress. Where the motion was overruled on the ground that the search was legal, the defendant's testimony in support of his motion was held admissible. Fowler v. United States, 239 F.2d 93 (10th Cir. 1956); Kaiser v. United States, 60 F.2d 410 (8th Cir.), cert. denied, 287 U.S. 654 (1932); Heller v. United States, 57 F.2d 627 (7th Cir.), cert. denied, 286 U.S. 567 (1932). Where the motion was sustained, however, it was held that the admissions were not usable at trial. Safarik v. United States, 62 F.2d 892 (8th Cir. 1933). As late as 1958 the District of Columbia, the site of the \textit{Jones} case, had not passed on the question. Christensen v. United States, 104 U.S. App. D.C. 35, 40 n.9, 259 F.2d 192, 197 n.9 (1958) (dissenting opinion). The attitude of the courts in the District, however, seems to indicate that the admission might be offered in either situation. See Wilkins v. United States, 103 U.S. App. D.C. 322, 258 F.2d 416, cert. denied, 357 U.S. 942 (1958). In any event, it is clear that whether the admission made by the defendant is usable in just one or in both situations, he is forced to gamble.


\textsuperscript{33} Compare majority, concurring and dissenting opinions in Mapp v. Ohio, 367 U.S. 643 (1961).
whether unconstitutional or not, were an almost insurmountable pro-
cedural difficulty.

II

Jones v. United States

With the law in this posture, the Supreme Court in 1960 attempted
to clarify and render uniform the requirements of standing under Rule
41(e). In Jones v. United States\(^{34}\) the Court tackled the alternative
grounds upon which a defendant could qualify as a “person aggrieved”
by an unlawful search and seizure—interest in the premises or an interest
in the property seized. Jones was faced with a two-count narcotics
indictment. He was arrested in the apartment of a friend by federal
narcotics officers who were executing a search warrant. The narcotics
which formed the basis of the prosecution were found in a bird’s nest out-
side the window of the apartment. Prior to the trial the defendant moved
to suppress the evidence obtained in the search on the ground that the
warrant had been issued without a showing of probable cause. The Gov-
ernment opposed the motion, arguing that the defendant lacked standing
because of his failure to allege either ownership in the goods seized or an
interest in the premises greater than that of an “invitee” or “guest.”
The defendant’s motion was denied, the court ruling in accordance with
the Government’s suggestion.

In an unanimous reversal of the lower court’s decision on the question
of standing,\(^{35}\) the Supreme Court first attacked the “dilemma” confront-
ing the defendant and found it not “inescapable.” Recognizing that the
Government was permitted to occupy contradictory positions, \(i.e.,\) the
conviction was based on possession but the evidence was admitted on the
ground that the defendant did not have possession, the Court felt that
this practice was “not consonant with the amenities, to put it mildly, of
the administration of justice.”\(^{36}\) The Court then concluded that a de-
fendant had standing where (1) possession is the basis of a possible con-
viction or (2) the indictment charged possession. In the former case,
the Court cautioned the Government that it would not be allowed to
prevent a defendant from asserting his status as a victim by drawing an
indictment in general terms but prosecuting for possession.\(^{37}\) In counter-

\(^{34}\) 362 U.S. 257 (1960).

\(^{35}\) Mr. Justice Douglas concurred in the decision as to standing but dissented on the
grounds that the warrant had been issued without probable cause. Id. at 273.

\(^{36}\) Id. at 263.

\(^{37}\) Id. at 264-65.
ing the Government’s argument that Rule 41(e) requires the defendant to object before trial rather than during the presentation of the Government’s case, it was stated that if necessary the district courts should exercise the discretion granted them under 41(e) to hear the motion to suppress during trial.\textsuperscript{38}

It should be noted that at no time in its rejection of the “dilemma” established by the lower federal courts did the Supreme Court consider the matter a constitutional issue. The problem was treated as procedural, and the Court merely found that the inconsistency practiced by the Government was not “consonant . . . with the administration of justice.”

The Court had little difficulty in clarifying the alternate ground available under Rule 41(e), viz., an interest in the premises searched. The Government had contended that presence in the apartment with the mere permission of the owner was too “tenuous” an interest to support a motion to suppress, relying on the fine distinction which had developed in the federal system since the inception of the exclusionary rule. Finding that an extensive property interest is not required and that the requisite interest was satisfied in the factual situation presented to it, the Court concluded by saying:

No just interest of the Government in the effective and rigorous enforcement of the criminal law will be hampered by recognizing that \textit{anyone legitimately on premises} where a search occurs may challenge its legality by way of a motion to suppress when its fruits are proposed to be used against him.\textsuperscript{39}

In short, the Court’s broad language allowing “anyone legitimately on the premises” to raise the objection wipes away all of the many property interest distinctions which were the product of the federal court decisions save one—the trespasser still cannot acquire standing. Whether or not the Court is correct in finding that its decision will not hamper law enforcement can only be a matter of conjecture at the present time, and a detailed study of the effect of \textit{Jones} may prove beneficial at a later date when a representative number of cases can be studied. It is to belabor the obvious to state that law officers will view the decision as a serious and unwarranted limitation on aggressive police activity. In this regard it might be valuable to treat, at this juncture, the broad interpretation applied to the exclusionary rule by the courts of the State of California.

\textsuperscript{38} Id. at 265 n.1.

\textsuperscript{39} Id. at 267. (Emphasis added.)
III

California and the Exclusionary Rule

The year 1955 and the decision of People v. Cahan\textsuperscript{40} marked California's adoption of the exclusionary mechanism to secure against unreasonable searches and seizures.\textsuperscript{41} After considering in detail the disadvantages of the other available remedies, an example of which would be a civil suit against the offending police officers, the California Supreme Court was of the opinion that the only effective means of securing constitutional guarantees would be to render illegally obtained evidence inadmissible. The primary objective voiced by the court in accepting the exclusionary rule was to discourage illegal police activity. Syllogistic reasoning was applied: the goal of the police is to secure criminal convictions; convictions will not be obtained when evidence is gathered by illegal means; therefore, the police will be impelled to obey the law.\textsuperscript{42}

The core of the California rule, then, is that it strikes at police activity, and this appears to be the dominant theory rather than the concept that an individual's privacy should remain untrammeled. The court felt that a continued adherence to its past practice would amount to "lending its aid" to the success of a "lawless venture."

The Cahan case reviewed in detail the attitudes expressed in the cases and by the commentators as to the merits and weaknesses of the rule itself. In this review the court expressed an awareness of the criticisms of the federal exclusionary rule and its procedures as arbitrary and as introducing "needless confusion" into criminal prosecutions. In an attempt to avoid all pitfalls, the court declared that it was developing a rule of evidence and would not be bound by decisions which had applied the federal exclusionary rule.\textsuperscript{43} To eliminate the feared "confusion," the Cahan case indicated that "workable rules" would be developed governing searches and seizures.

Later that same year the California Supreme Court enunciated one of its major "rules" in its decision of People v. Martin.\textsuperscript{44} Although the decision failed to determine that an illegal search and seizure had taken place in the factual situation presented, the court granted standing to

\textsuperscript{40} 44 Cal. 2d 434, 282 P.2d 905 (1955).
\textsuperscript{41} The language of the California constitution is almost identical to that of the fourth amendment. Cal. Const. art. I, § 19.
\textsuperscript{42} 44 Cal. 2d at 448, 282 P.2d at 913.
\textsuperscript{43} Id. at 450-51, 282 P.2d at 914-15.
\textsuperscript{44} 45 Cal. 2d 755, 290 P.2d 855 (1955).
object to the admission of evidence to one who, under federal concepts, could not have been the victim of illegal police investigation. By again adverting to the basis for its adoption of the exclusionary rule, that is, to discourage illegal law enforcement, the court reasoned that the rule was applicable "whenever evidence is obtained in violation of constitutional guarantees . . . whether or not it was obtained in violation of the particular defendant's constitutional rights."\(^{46}\)

Ironically, the California court rejected the personal limitation placed on the federal exclusionary rule by using federal precedent. Initial reliance was placed on the Supreme Court decision in *Walder v. United States*\(^{46}\) because it was felt that the case "clearly" recognized that the aim of the federal rule was to deter lawless enforcement of the law. This interpretation would place the federal concept squarely within the theory of the California rule. Whether this analysis is justified is open to question, but language in other Supreme Court opinions might lead one to suspect that an accurate determination cannot be made as to whether greater stress is placed on the deterrent quality of the federal rule or upon the theory that individual privacy should be protected.\(^{47}\)

In any event, after adopting the above-mentioned premise, the court proceeded to discuss the Supreme Court decision in *McDonald*, which had reversed the conviction of a defendant for the erroneous denial of a codefendant's motion to suppress.\(^{48}\) With compelling logic the court stated:

> There is no basis for concluding . . . that a defendant whose rights have not been violated should have standing to challenge a pretrial ruling against his codefendant, if he has no standing to challenge the legality of the original seizure. In either situation his right to object to the use of the evidence must rest, not on a violation of his own constitutional rights, but on the ground that the government must not be allowed to profit by its own wrong . . . .\(^{49}\)

It has been said that this broader prohibition and stricter view was mandated by the reason for which the rule was adopted—to deter overzealous enforcement of the law.\(^{50}\)

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\(^{45}\) Id. at 761, 290 P.2d at 857. (Emphasis added.)


\(^{48}\) 335 U.S. 451 (1948).

\(^{49}\) 45 Cal. 2d at 761, 290 P.2d at 857.

\(^{50}\) Ibid.
The California rejection of the personal limitation placed upon the rule by federal courts has drawn criticism because it appears unduly to burden police officers by making it possible for one to escape legal penalties through a mere failure to comply with the strict letter of the law in the execution of a warrant. Under the federal system this fear might be justified, but the California judiciary, in developing “workable rules” with regard to search and seizure, has provided law enforcement agencies with a number of avenues of approach in obtaining evidence, which compensate for the strict interpretation of the exclusionary rule. It does not appear that the “rules” have unduly hampered the California police, and a brief sketch of examples of the wide latitude granted California law enforcement personnel may suffice to indicate that the elimination of the personal limitation is not oppressive.

The mere presence of suspicious circumstances would appear to be sufficient in California to justify aggressive police investigation and arrest without a warrant. In People v. Martin inference was added to inference and resulted in “reasonable cause” where police discovered two men sitting in a parked car in what was termed a “lover’s lane.” When the police attempted to investigate, the car drove off. After overtaking the vehicle and ordering the defendants to remove their hands from the seat, the police noted that a small bag had been uncovered, which, when emptied, was found to contain marijuana. From this set of circumstances the Supreme Court of California concluded that the search of the automobile without a warrant was lawful, the arrest was justified and the evidence was admissible. In reaching this conclusion the court reasoned that when the police saw the bag, they “had reasonable cause to believe that . . . possession of it prompted the flight and that it contained contraband.”

A similar situation was presented in People v. Blodgett. Police ordered defendants out of a cab which was illegally parked in front of a hotel in the early morning hours. Here again the court considered this action not unreasonable; a subsequent search of the cab, which resulted in the discovery of marijuana, was also considered reasonable because one of the officers had noted “the furtive action” of one of

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53 46 Cal. 2d 106, 293 P.2d 52 (1956).
54 Id. at 108, 293 P.2d at 53.
55 46 Cal. 2d 114, 293 P.2d 57 (1956).
the defendants in withdrawing his hand from the seat. It must be noted, however, that a dissent was recorded in each of these decisions\(^{56}\) which found it difficult to discover in the California penal statutes a prohibition against conversing in an automobile during the nighttime and getting into a taxicab in the early morning hours.

In addition to being able to search when suspicious circumstances are present, California police appear to have wide latitude in conducting a search as an incident to a lawful arrest. Where an arrest was made outside of an apartment in which defendants were conducting bookmaking operations, it was held that the arresting officers could then return to the apartment and conduct a search, utilizing a key obtained in a search of one of the defendant's person at the time of the arrest.\(^{57}\) By merely paying lip-service to the "immediate possession and control" test, the California court was able to summarily reject as "without merit" the defendants' objection that the searched premises were located more than a half block from the place where they were apprehended and were not in the immediate vicinity of the arrest.\(^{58}\) A like result obtained when a car, located some sixty feet away from the point of arrest, was searched after a key had been discovered in a search of the defendant's person.\(^{59}\)

It appears, therefore, that a defendant has little trouble, procedurally, in acquiring standing under the California exclusionary rule\(^{60}\) but may find considerable difficulty in excluding anything. The situations discussed above and other broad grants of power to the police\(^{61}\) seem to indicate that the "workable rules" developed by the judiciary favor law enforcement officers. In a discussion of the \textit{Cahan} exclusionary rule it has been suggested that "enlightened" law enforcement can avoid the very spirit of the rule; police may question suspects instead of arresting them, and suspicious actions would then give rise to "reasonable cause" to search.\(^{62}\) Whether such compensating factors do in fact soften the effect of the exclusionary rule on police work, and whether the California method of balancing the rights of the individual against the interest of law enforce-

\(^{56}\) Id. at 118, 293 P.2d at 59 (1956); 46 Cal. 2d at 108, 293 P.2d at 53 (1956).
\(^{58}\) Id. at 162, 320 P.2d at 531.
\(^{60}\) Note, supra note 52, at 535-36.
\(^{62}\) Note, supra note 52, at 537-38.
ment places both in proper perspective, are difficult questions which require a detailed analysis of California procedures. Such an analysis is outside the scope of a note limited essentially to a consideration of standing in the federal system. The purpose of a summary of California law in this area has been to use it as a basis of comparison and to borrow some of its rationale to assist in an appraisal of the implications raised by the Jones decision in the federal sphere.

IV

The Federal Viewpoint After Jones

The obvious results of the Jones decision can be stated briefly. The Government can no longer impale a defendant upon the “horns of a dilemma” by effectively removing the remedy of Rule 41(e) while securing a conviction for possession of items which cannot lawfully be possessed. Where the indictment charges possession or where proof of possession is at the crux of the Government’s case at trial, the defendant has standing to object. In addition, the Supreme Court has removed the arbitrary property interest requirements with regard to the premises searched when the defendant chooses to base his attempt to suppress on the alternate ground available.63

Less obvious, however, is the effect of the Jones rationale upon the lower federal courts when those courts are confronted with cases of search and seizure which do not involve contraband. The question as to what allegations are to be required when incriminating papers, documents or tools of a crime are the focal point of a motion to suppress was not before the Jones Court, and therefore no definite statement was made

63 Although it does not relate directly to the question of standing, an interesting problem relative to contraband, especially narcotics, is the question of abandonment, i.e., a situation arising when the defendant discards items of contraband upon being questioned or pursued by the police without a warrant. See, e.g., Rios v. United States, 364 U.S. 253 (1960); Trujillo v. United States, 294 F.2d 583 (10th Cir. 1961); Haerr v. United States, 240 F.2d 533 (5th Cir. 1957); Ellison v. United States, 93 U.S. App. D.C. 1, 206 F.2d 476 (1953). The Supreme Court decision in Hester v. United States, 265 U.S. 57 (1924), proves to be a stumbling block for the defense in this area. There the Court found no illegal search and seizure where the defendant “abandoned” illegal liquor while being pursued across an open field by police, acting without a warrant. The peril involved in discarding contraband property, however, may be lessened by the decision in Work v. United States, 100 U.S. App. D.C. 237, 243 F.2d 660 (1957). There the court, after examining the motives of the defendant, found no abandonment in placing narcotics in a trash can after police had entered defendant’s residence without a warrant. See also United States v. Merritt, 293 F.2d 742 (3d Cir. 1961).
in this regard which would bind the courts to any clear course. From what has already been said about the state of the law prior to Jones, however, it appears safe to predict that the requirement of an allegation of possession will persist, although no reported decision as yet has so held. But the difficulties inherent in the noncontraband cases cannot easily be overlooked.

Although the mere possession of medical equipment or signed documents is not in itself criminal, the requirement that a defendant admit possession of such items before getting the protection of Rule 41(e) would undoubtedly result in a conviction when an indictment charges abortion or forgery. Such a result would perpetuate, as a quotable piece of case literature, Judge Hand’s famous statement concerning the “dilemma” facing a defendant who is the victim of an unreasonable search and seizure. Whether that result can be justified in light of Jones is debatable. On the one hand, it can be argued that since the Court remained silent as to situations not involving contraband, it accepted the standards established by the lower federal courts in this area. On the other hand, however, a consideration of the decision itself and its theory would appear to lead to the conclusion that Jones is broad enough to shelter the defendant who avoids dealing in contraband items.

In conferring standing automatically in a Jones-type case, the Supreme Court has taken an extreme position; it has facilitated the defendant’s use of the exclusionary mechanism in cases where suppression of the items seized will, in the majority of cases, result in no trial. It would not then be illogical to conclude that the Court would be equally sympathetic to a defendant’s “dilemma” when noncontraband items have been seized, especially when, in that type of case, other evidence generally will be available to the Government to establish guilt. The theory of the Jones decision aims at avoiding an infringement of the defendant’s right against self-incrimination. A forced waiver of the fifth amendment guarantee can easily be seen when one is required to claim articles which aid in his conviction and which have been obtained by violation of the Constitution. It is beyond question that medical equipment, signed documents and crowbars are relevant evidence in abortion, forgery and burglary prosecutions, but relevancy is an argument precluded by the exclusionary rule itself. It is suggested, therefore, that the “dilemma” posed by the noncontraband situation, in the words of Jones, is also “not consonant with the amenities . . . of the administration of justice.”

In addition to the problem area just considered, the preliminary or introductory language used by the Court raises questions requiring more
than passing reference. Before attacking the then prevailing standing requirements imposed by the lower federal court, the Jones opinion acknowledged the personal limitation of the exclusionary rule by saying:

In order to qualify as a "person aggrieved by an unlawful search and seizure" one must have been a victim of a search or seizure, one against whom the search was directed, as distinguished from one who claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else.64

The Court thus appears to have, in one breath, preserved the personal limitation and, without citing the case, recognized the existence of the exception inherent in its decision of McDonald v. United States.65

No attempt was made in Jones to distinguish the decisions previously rendered in McDonald or United States v. Jeffers.66 A consideration of the results of all three cases, however, would lead one to surmise that the Court is drifting away from the restriction placed on the use of the exclusionary procedure. In McDonald the Court permitted a defendant, on the grounds of prejudice, to benefit from the erroneous denial of a codefendant's motion to suppress; Jeffers granted the defendant a remedy when property was taken from the room of a third person because he claimed ownership of the property—property which could have no legal owner; Jones secured the utilization of Rule 41(e) whenever possession is in question and expanded the definition of that rule to include numerous persons not previously considered "aggrieved."

The inconsistency present in a consideration of the personal limitation and these opinions, commented on by the California Supreme Court,67 bears brief repetition. It would appear to be illogical to grant a defendant the right to challenge an erroneous denial of a codefendant's pretrial motion, and at the same time refuse to grant standing where no pretrial motion is made, where the codefendant is acquitted or fails to appeal, or where the unlawful search violates the rights of an individual not on trial. If "prejudice" is present in the first situation, it is also present in the other possibilities posed. To grant standing indirectly to one not affected by unlawful police action, solely in the case where a codefendant avails himself of the remedy of appeal, is to draw an arbitrary line between those "aggrieved" and/or "prejudiced" and those not so prejudiced that they warrant judicial attention, even though they are indirectly the victims of an unlawful search and seizure.

64 362 U.S. at 261 (1960).
65 335 U.S. 451 (1948).
Although this observation has been made before by those analyzing Jeffer and McDonald at the time those decisions were rendered, the spirit of the Jones decision seems to indicate an ever expanding definition of the term “person aggrieved” and may lead to a complete rejection of the personal limitation in the federal system. If this decision were eventually made, law enforcement officials undoubtedly would contend that this expanded version of the exclusionary rule would fetter efficient police machinery and might demand more liberal policies, similar to those of California, with regard to searches and arrests with or without warrants. Judging by the current temper of the Court, the latter demand would probably fall on deaf ears, and police activity would undoubtedly be forced to work within the more stringent existing framework.

In order to test accurately the application of the more rigid federal standards with regard to arrests, and in order to counterbalance, for reasons of fairness and justice, this expanding interpretation of the rights of a defendant, it may prove beneficial to allow the Government to appeal from a district court decision sustaining a motion to suppress. Presently the right of prosecution appeal is severely limited in the federal system, and certain limitations undoubtedly are correct for historical as well as constitutional reasons. The Government has recently been granted the right by Congress to appeal from unfavorable rulings on motions to suppress in narcotics cases. A congressional committee has also recommended that the right to appeal on motions to suppress be extended to all criminal cases. The reasons given in support of this proposed modification take into account the fact that an erroneous decision at the trial level generally will eliminate an otherwise solid government case. In addition, the right to appeal on the question of suppression might render uniform the federal concept of what actually does constitute an unreasonable search and seizure and probable cause. Without government appeal these questions cannot be answered at the appellate level with any frequency.

Although these contentions may appear to be reasonable, the decision granting this right will have to be made by Congress. In a broad holding, the Supreme Court very recently blocked any nonstatutory avenue of

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68 97 U. Pa. L. Rev. 728 (1949); 28 Wash. L. Rev. 56 (1953).
appeal which had been available to either the defendant or the Government with regard to trial court decisions on motions to suppress.\textsuperscript{78} The Court, in resolving a conflict within the circuits, held that orders granting or denying pre-indictment motions to suppress were interlocutory and not appealable, whether the motion was made in the district where the trial is to be held or the district where the seizure was made. Recognizing the exception carved out by Congress in favor of the Government in narcotics cases, the Court commented that the "allowance of any further right must be sought from Congress and not this Court."\textsuperscript{74}

Commentators on the Jones decision appear to be unanimously in favor of its rejection of the old-line concepts with regard to standing.\textsuperscript{76} Those comparing the new federal theory and the broad California rule are split as to whether the Supreme Court should take the next step and grant standing to anyone adversely affected by illegally obtained evidence. Disagreement is generally based on the age-old legal problem of where the point of proper balance can be found when the conflicting interest of the police and the individual are compared.\textsuperscript{76} An interesting issue raised, however, is that after Jones the defendant rather than the Government is now permitted to take inconsistent positions—he may move to suppress the seized articles on the basis of possession and deny the possession at trial. The conclusion that this objection does not approach serious proportions has merit when, as has been pointed out, the inconsistency is the result of the consideration given to the protection of individual constitutional rights.\textsuperscript{77} With the exception of the comments mentioned above, the commentators do little more than reiterate in a noncommittal manner the language of the Jones decision and its obvious implications. No attempt has been made to fit the rationale of the case into any evolving pattern with respect to the exclusionary rule.

The lower federal court decisions after Jones have applied the directives enunciated by the Court where possession is in issue\textsuperscript{78} and where the

\textsuperscript{78} DiBella v. United States, 369 U.S. 121 (1962).

\textsuperscript{74} Id. at 130.


\textsuperscript{77} 14 Vand. L. Rev. 418, 421 (1960).

\textsuperscript{78} E.g., Polk v. United States, 291 F.2d 230 (9th Cir. 1961); Contreras v. United States, 291 F.2d 63 (9th Cir. 1961); Plazola v. United States, 291 F.2d 56 (9th Cir. 1961); Bourg v. United States, 286 F.2d 124 (5th Cir. 1960); United States v. Festa, 192 F. Supp. 160 (D. Mass. 1960).
defendant is legitimately on the premises.\textsuperscript{79} Two decisions rendered by courts of appeals in different circuits are worthy of comment, however, in that they may have broad implications. In the first, \textit{Hair v. United States},\textsuperscript{80} defendant Hair was successful in convincing the United States Court of Appeals for the District of Columbia Circuit that certain evidence used against him had been obtained illegally because the application for the warrant was based on a police officer's visual observation of the goods in defendant's room after the officer had illegally broken into his dwelling. The court also held, consistent with the \textit{McDonald} case, that the evidence was inadmissible against Hair's codefendant. While commenting that the codefendant had no interest in the property seized or the premises invaded and that "ordinarily one . . . must establish that he was a victim of the alleged invasion of privacy,"\textsuperscript{81} the court recognized the \textit{McDonald} case as another ground for exclusion. In the second of these recent decisions,\textsuperscript{82} the Ninth Circuit reversed the conviction of a codefendant who alone appealed from a narcotics conviction. Since he was charged with possession of narcotics seized from both his car and that of the codefendant, the court, solely on the authority of \textit{Jones}, held that he had standing to move to suppress both quantities of narcotics.\textsuperscript{83}

The recent decisions noted above may or may not have significance within the pattern of Supreme Court decisions which may be a trend away from the personal limitation of the federal exclusionary rule. But it does seem clear that there is a disturbing inconsistency in saying, on the one hand, that the right to object to illegally obtained evidence is a personal right and, on the other hand, that one has standing, at least in contraband cases, whenever the indictment or the case at trial charges possession. Under existing law the status gained in the latter situation may not be sufficient to secure the final remedy if the rights of one not a codefendant were violated. But where the victim is a codefendant and "prejudice" is shown, the Court has said that the remedy will obtain. The next step, the elimination of the codefendant-prejudice concept, would seem to be near.\textsuperscript{84}

\textsuperscript{79} United States v. Pisano, 191 F. Supp. 861 (S.D.N.Y.), aff'd, 193 F.2d 361 (7th Cir. 1961).


\textsuperscript{81} Id. at 156, 289 F.2d at 897.

\textsuperscript{82} Plazola v. United States, 291 F.2d 56 (9th Cir. 1961).

\textsuperscript{83} Id. at 63.

\textsuperscript{84} Whether \textit{Jones} and the changing federal picture with regard to standing has significance in the state courts after Mapp v. Ohio, 367 U.S. 643 (1961), is a matter of conjecture.
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CONCLUSION

This summary of the case law, both old and new, under Rule 41(e) of the Federal Rules of Criminal Procedure has been made in an attempt to gauge the temper of the federal courts with regard to the question of standing. 82 The impression gathered is that the momentum of the Supreme Court in this area is carrying it toward the acceptance of a broad definition of the term "person aggrieved." Whether this observation is an accurate appraisal of the law or whether the inconsistencies present have real value and will persist is a matter which will only be resolved by the Court itself. Recent decisions indicate that the Court is of the impression that the exclusionary rule is the best and only method to prevent abuse of the fourth amendment. The next logical step would be to indicate clearly who may utilize the rule.

JEROME C. GORSKI

Prior to Mapp, most of the state jurisdictions accepting the exclusionary remedy followed federal precedent as to the mechanics involved in acquiring standing. E.g., Mitchell v. State, 233 Ind. 16, 115 N.E.2d 595 (1953), cert. denied, 347 U.S. 975 (1954); Vogler v. Commonwealth, 255 Ky. 511, 75 S.W.2d 11 (1934); Frank v. State, 189 Md. 591, 56 A.2d 810 (1948). See generally Annot., 50 A.L.R.2d 531, 577-82 (1956) and cases cited therein. Clearly, after Mapp some procedure will have to be adopted by those states which had rejected the federal rule. The dissenters in that case appear to express some fear that the imposition of the exclusionary rule on the states may carry with it the procedural aspects of the federal rule. The majority opinion of Mr. Justice Clark, however, states that no fixed formula can be created to guide states in the formulation of a method to exclude unconstitutionally seized evidence, and that reasonableness is to be determined by the trial court. 367 U.S. at 653. In light of the serious impact of the Mapp decision on the conduct of affairs within the states, it can be anticipated that a good deal of apprehension will exist as to the question of whether the state or the Supreme Court will be the final arbiter on the issue of reasonableness.


82 The second aspect of Rule 41(e)—the timeliness of the motion—has not been considered in detail in this note. It was felt that the more problematic area was that of standing.
RECENT DECISIONS


The United States sought to restrain the defendants, state, county, and city officials in Mississippi, from prosecuting John Hardy, the leader of a Negro voting registration school, who had been arrested for disturbing the peace. The complaint, filed in the United States District Court for the Southern District of Mississippi two days before the scheduled date of Hardy’s trial, maintained that the prosecution, regardless of its outcome, was designed to and would intimidate other Negro citizens in the exercise of their right to vote in violation of section 131 of the Civil Rights Act of 1957. The Government, contending that this intimidation would cause irreparable injury to the United States’ interest in having all qualified citizens exercise their franchise, requested a temporary restraining order prior to a hearing on its petition for an injunction. The district court refused to issue the order or to sign a certificate allowing the plaintiff to seek appeal of an interlocutory order. The United States Court of Appeals for the Fifth Circuit reversed after basing its jurisdiction on the fact that because Hardy’s trial would be completed before the hearing on the injunction could be held, the district court’s denial of the temporary restraining order was in effect a final decision dismissing the Government’s claim for failure to state a cause of action. Held, a petition under the Civil Rights Act for an injunction against a state criminal prosecution requires a fair hearing on the merits, and where to deny a temporary restraining order would render such a hearing moot, the order must be granted.2

The ambit of federal power to enjoin state proceedings is defined in and limited by section 2283 of the Judicial Code3 which prohibits interference by federal courts, except where an injunction has been specifically authorized by Congress, or where it is necessary to aid the court’s jurisdiction or to protect or effectuate its judgments. Buttressing this federal-state jurisdictional balance is a self-imposed, deeply ingrained principle of comity which has been responsible for the traditional reluctance of federal courts to enjoin state criminal proceedings.4 A rigorous standard was imposed to implement this principle in the leading case of Douglas v. City of Jeannette, where the Supreme

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Court, in refusing to grant the petition of private parties to enjoin threatened state criminal prosecutions under an unconstitutional city ordinance, stated that federal courts "should conform to this policy [of nonintervention] by refusing to interfere with or embarrass threatened proceedings in state court save in those exceptional cases which call for the interposition of a court of equity to prevent irreparable injury which is both clear and imminent."\(^8\) Clear and imminent danger, sufficient to create an exception to the comity principle, has been found where there was no opportunity to test the constitutional issue in state proceedings\(^6\) or where state courts were unable to afford adequate protection.\(^7\) However, where adequate state remedies are available, federal courts have declined to interfere with threatened prosecutions.\(^8\)

An important exception to this deep-rooted policy of nonintervention and to the sweep of section 2283 was announced in *Leiter Minerals v. United States*.\(^9\) There the Supreme Court held the Judicial Code's ban to be inapplicable when the United States in its sovereign capacity sought to enjoin a civil suit brought in a state court. At the time of the instant suit, however, it was still an open question whether the *Leiter Minerals* rule also applied when the United States seeks to enjoin a state criminal prosecution.

The *Wood* court immediately dispensed with the Judicial Code's prohibition by relying upon the sweeping language of the Supreme Court in *Leiter Minerals* that the frustration of "superior federal interests" that would result from the application of this prohibition to suits brought by the United States "would be so great that we cannot reasonably impute such a purpose to Congress from the general language of § 2283 alone."\(^10\) Since the Supreme Court failed to state any exceptions to this broad principle, the *Wood* court declared that it was immaterial that *Leiter Minerals* involved civil rather than criminal proceedings. In response to the defendants' added contention that no "superior federal interest" was involved in the instant case, the court cited *United States v. Raines*, where the Supreme Court held that "there is the highest public interest in the due observance of all the constitutional guarantees."\(^11\) By thus reading *Leiter Minerals* and *Raines* together, the *Wood* court concluded that the statutory

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\(^5\) 319 U.S. 157, 163 (1943).


\(^7\) See AFL v. Watson, 327 U.S. 582 (1946) (threatened state prosecution of all labor organizations with closed-shop agreements); Denton v. City of Carrollton, 235 F.2d 481 (5th Cir. 1956) (prosecution under confiscatory tax ordinance).

\(^8\) E.g., Steffanelli v. Minard, 342 U.S. 117 (1951); Beal v. Missouri Pac. R.R., 312 U.S. 45 (1941); Palomar Holding Co. v. County of San Mateo, 283 F.2d 390 (9th Cir. 1960); Williams v. Dalton, 231 F.2d 646 (6th Cir. 1956); Reid v. City of Norfolk, 179 F. Supp. 768 (E.D. Va. 1960).


\(^10\) Id. at 226.

provisions of section 2283 barred neither the granting of the temporary restraining order nor a possible injunction against the state's prosecution of Hardy.

However, the greater barrier was presented by the rigorous standard imposed upon the comity principle in Douglas, limiting permissible federal court interference in state criminal prosecutions to those cases where the interference is necessary to prevent "irreparable injury which is both clear and imminent." To justify its action the Wood court relied upon its interpretation of the jurisdictional section of the Civil Rights Act of 1957. In substance this section provides that when the Attorney General brings an action to enjoin conduct which would deprive a citizen of his right to vote, then the federal district courts shall have jurisdiction over such proceedings "and shall exercise the same without regard to whether the party aggrieved shall have exhausted any administrative or other remedies that may be provided by law." The court held this to be a "mandatory jurisdictional statute," demanding, at the very least, that the Government be given a fair hearing on the merits of its petition for an injunction even where the injunction is sought against a state criminal proceeding. In other words, the court declared that as long as the Attorney General presents a prima facie claim under the act, he is entitled to a fair hearing on the merits of his petition, and if to deny his application for a temporary restraining order prior to the hearing would render moot any determination on the merits, then the temporary restraining order must be granted. Thus the court concluded that in such a situation the district court lacks all power of discretion normally vested in the trial court to determine whether or not a restraining order is justified. However, in doing so the majority was careful to point out that this legislative mandate did not determine whether or not the final relief sought would ultimately be granted.

To arrive at this interpretation, the Wood court liberally construed the jurisdictional section of the act in the light of the broad language found in its legislative history. To support its conclusion that the injunctions authorized by the act included injunctions against state criminal prosecutions, the court relied heavily upon the remarks of Senator Johnston, who, in opposition to the act, stated that it was a "complete flouting of state law, complete ouster of state jurisdiction, even where it may have attached in a criminal case." To support its holding that the jurisdictional section of the act was intended as a legislative mandate to give the Government's petition for an injunction a full hearing on the merits regardless of all principles of comity, the court construed the words "and shall exercise jurisdiction" to mean "they shall exercise equitable

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13 Ibid.
14 295 F.2d at 783.
15 Ibid.
16 Ibid.
Quoting Senator Case of South Dakota, the court declared that the act was a mandate to the district court to "'consider an injunction regardless of the fact that there might be a simpler and better way to achieve the relief desired.'"19

Despite this rather exhaustive reference to the act's legislative history, a close analysis discloses that what support it gives to this court's interpretation is neither persuasive nor unequivocal. The majority report gives no indication that the jurisdictional section contemplated stripping the district court of its discretionary power to determine whether, on the basis of comity, a temporary restraining order against state court proceedings should be granted.20 Certainly it shows no expressed intent on the part of Congress to dispense with the time-honored principle against enjoining state criminal prosecutions. Rather, it indicates that the language of the jurisdictional section was intended to alter the existing law that required a party to exhaust state administrative remedies before seeking relief in a federal court.21 This is amply borne out by the remarks of Senator Case, whose only objection to the bill was that it "would destroy the right of a court to exercise its function or to grant an injunction" without regard to whether or not the applicant had exhausted the administrative procedures provided by state law.22

Some justification for this court's interpretation can be found in the report's general statements of purpose, where it points out that the states' authority over voting rights is limited by the fourteenth and the fifteenth amendments and Congress' power to enforce them by appropriate legislation.23 Furthermore, the report declares that if our democratic system of government is to be maintained, Congress must exercise this power and protect the right to vote against any and all unlawful interference. "That the proposal of this section does that very thing is clear."24

Moreover, if it could be shown that the statements of Senator Johnston and others in opposition to the bill were accurate appraisals of the act's true effect, there would be even more substantial ground for concluding, as the court did, that Congress intended the petition for an injunction to be heard without the traditional deference to state court proceedings. However, past experience has shown that in the eyes of an opponent any undesired piece of legislation takes on exaggerated proportions; and the fact that the opposition's appraisals are in no way supported by the majority report suggests that they are statements of apprehension rather than detached evaluations of the true scope of the act.

18 295 F.2d at 783.
19 Id. at 783, quoting from 103 Cong. Rec. 13451 (1957).
21 Id. at 10-11.
22 103 Cong. Rec. 13451 (1957).
24 Ibid.
In spite of the seemingly tenuous grounds for this broad interpretation, more questionable yet is the court's subsequent dicta that the Douglas doctrine has no applicability whatsoever to cases involving the constitutional protection of civil rights.\textsuperscript{25} Although this view had been previously advanced by the Fifth Circuit in the case of Morrison v. Davis,\textsuperscript{26} it has been rejected by the only other court to rule directly on the question.\textsuperscript{27} However, by reading Morrison and Leiter Minerals together, the court found support for its contention that where the United States brings an action under the Civil Rights Act, "the normal equitable doctrines of comity between the court systems, doctrines which are the basis of the Douglas v. City of Jeannette rationale, have little or no bearing."\textsuperscript{28} In so stating, the court patently presumes that in bringing this action under the act the United States is seeking to prevent an irreparable injury to a national interest.\textsuperscript{29}

The court also relied upon the Civil Rights Act itself by reasoning that Congress did not create a special cause of action for injunctive relief to protect the right to vote only to have this relief frustrated by the judicial ban against enjoining state criminal proceedings.\textsuperscript{30} As we have seen, this reasoning can be accorded a certain validity. However, the majority report on the bill gives no express indication that Congress contemplated authorizing injunctions against state criminal prosecutions, much less that it intended to create an exception to the Douglas rule in cases involving the protection of civil rights.

It is submitted, therefore, that the soundest basis for the instant decision lies not in the court's interpretation of the Civil Rights Act, but in its finding that the Government had shown that to allow Hardy's prosecution to take place on schedule would intimidate eligible Negroes in the exercise of their right to vote. On these grounds one can have little objection to the court's decision that it was not within the district court judge's discretion to deny the Government's request for a temporary restraining order, for such a denial could well cause irreparable injury to federal interests, while a grant of the temporary stay would impose little or no burden upon the state.

By ignoring this approach and preferring to base its decision upon an in-

\textsuperscript{25} 295 F.2d at 784.


\textsuperscript{27} Reid v. City of Norfolk, 179 F. Supp. 768, 772 (E.D. Va. 1960) (three-judge court); cf. Williams v. Dalton, 231 F.2d 646, 648 (6th Cir. 1956), where, prior to the 1957 amendments to the Civil Rights Act, the court, citing Douglas, declared: "It is well settled, however, that accepted principles governing equitable and declaratory relief are no less applicable where such relief is sought under the Civil Rights Act."

\textsuperscript{28} 295 F.2d at 783.

\textsuperscript{29} Ibid.

\textsuperscript{30} Id. at 784.
interpretation of the Civil Rights Act, the wisdom of the court's decision becomes suspect. The court's reasoning leaves the reader in doubt as to whether under any circumstances it would be within the discretionary power of the lower court to deny such an order when the Government seeks an injunction under the act. Clearly, circumstances could exist when, although a valid claim under the act was alleged, the equities would not be in the Government's favor and a temporary stay of the state court proceeding should, in justice and according to the rules of comity, be denied.

A second and more serious objection to the broad language of the instant decision is that it raises a question as to whether a district court, after a full hearing, could deny a permanent injunction for reasons of comity, even though a valid claim under the act has been proved. Dicta suggests a negative answer.31 Such a conclusion would completely ignore the traditional lines of demarcation between federal and state authority.

While the jurisdictional limitations that are brushed aside by the Wood court are not constitutional ones, the rule of comity that supports such a division is a sound one with deep historical roots. A decision to do away with this principle in the area of civil rights is one that should be expressly made by Congress, not by court reliance on broad and equivocal statements of congressional purpose. In apparently basing its decision upon such broad grounds, rather than the facts before the court, the Wood case has not only needlessly deviated from a policy of deference to state criminal proceedings, but has also provided dangerous precedent for greater deviation in all future cases where the action can be brought within the extensive arms of the present Civil Rights Act.

D. MICHAEL HARVEY

CRIMINAL LAW—EVIDENCE OBTAINED UNDER A SEARCH WARRANT WHERE AN ENTRAPMENT PROVIDED THE PROBABLE CAUSE WOULD BE ADMISSIBLE TO SUPPORT COUNTS OTHER THAN THOSE TO WHICH ENTRAPMENT IS A DEFENSE. Fletcher v. United States, 295 F.2d 179 (D.C. Cir. 1961).

Appellant was indicted, tried before a court sitting without a jury, and convicted of violation of the federal narcotics laws.1 The first three counts of the indictment were based upon a sale of narcotics made by the appellant to a special employee of the Metropolitan Police Department of the District of Columbia. The narcotics were immediately handed over to one Hutcheson, a member of the narcotics squad, who had stationed himself within sight but not within hearing distance of the transaction. This sale supplied the probable cause

31 Ibid.

which enabled the police to obtain a warrant for appellant's arrest and the search of his home, where narcotics, needles and syringes were found. Counts 4 and 5 of the indictment were based upon the possession of these items. The special agent did not testify at the trial, and the Government relied upon the testimony of Hutcheson. The issue of entrapment was raised through a suggestion of counsel, but no evidence was offered on behalf of the appellant. The trial court found no evidence of an entrapment and denied the appellant's motion based on that ground to suppress the evidence seized under the arrest and search warrant. On appeal, the conviction on all five counts was affirmed. Held, the mere statement of counsel suggesting entrapment was not sufficient to cast doubt on the plain evidence that the appellant was engaged in the traffic of narcotics and ready, willing and able to make delivery; and even if there had been an entrapment, the suppression of evidence seized under a search warrant where an entrapment provided the probable cause would be an unwarranted extension of the suppression of evidence doctrine.2

The defense of entrapment appears to be purely an American doctrine.3 Except where the entrapped person was no more than a passive tool, or where the criminality of the act was destroyed by consent because the person affected by the wrong was also the inducer, the defense of entrapment was a stranger to the common law.4 The doctrine was discussed in several early federal cases5 but was not successfully pleaded until 1915;6 following the passage of federal narcotics and liquor laws and the correlative establishment of special enforcement bodies, it became a frequently asserted defense during the next two decades.7 These cases recognized that where the criminal design originates in the mind of the defendant, the fact that the government officers used decoys, artifice and stratagem to furnish the accused an opportunity to commit the crime cannot be asserted as a defense.8 But where the design originates in the mind of the police, and they in turn induce a person otherwise indisposed toward the act to commit crime in order that he may be prosecuted, the defense of

4 Wharton, Note, 10 Fed. 97, 99 (1881).
8 E.g., Price v. United States, 156 F.2d 135 (7th Cir. 1932); Butts v. United States, 273 Fed. 35 (8th Cir. 1921); Voves v. United States, 249 Fed. 191 (7th Cir. 1918); Yick v. United States, 240 Fed. 60 (9th Cir. 1917).
entrapment is available. The doctrine was generally based upon a sound public policy which recognized that the first duty of police officers is to prevent crime, not incite it for the sole purpose of prosecution and punishment, and that the courts should not lend aid or encouragement to officers who have so acted.

It was not until 1932, in Sorrells v. United States, that the Supreme Court was directly confronted with the doctrine. The majority spoke with approval of the basis upon which the circuit courts had placed the doctrine, but departed from their rationale by finding entrapment an implied exception to the statute creating the offense. Thus entrapment was made an issue for the jury to determine under its general verdict. If the jury found that the criminal design originated in the mind of the police, the statute simply did not apply and the accused was not guilty. The predisposition and conduct of the accused, rather than the conduct of the police, were made the deciding factors, and by raising the defense the accused waived any right to complain of disadvantages suffered from "an appropriate and searching inquiry into his own conduct and predisposition as bearing upon that issue."

Mr. Justice Roberts, writing also for Justices Brandeis and Stone, forcefully rejected the concept of an implied condition or exception to the statute as a strained and unwarranted construction which amounted to judicial amendment. Entrapment, they reasoned, does not contradict the obvious fact of the accused's violation; rather, the doctrine rests upon a fundamental rule of public policy which withholds the court's imprimatur from a scheme for the actual creation of a crime by those whose duty it is to deter its commission. This is basically an exclusionary rule which has no bearing upon the question of guilt, but simply disallows prosecution in cases where police conduct "falls below standards, to which common feelings respond, for the proper use of governmental power." To the minority the issue of entrapment is to be determined by the court, and this shift of emphasis from the accused to the actions of the police makes inquiry into the accused's past actions irrelevant.

9 Butts v. United States, supra note 8, at 38.
10 Ibid.
11 Lucadamo v. United States, 280 Fed. 653 (2d Cir. 1922).
12 287 U.S. 435 (1932).
13 The Court had, however, mentioned the doctrine in Grimm v. United States, 156 U.S. 604 (1895), but summarily rejected its application to the facts of that case; and it had been discussed by Mr. Justice Brandeis, dissenting in Casey v. United States, 276 U.S. 413, 423 (1928).
14 287 U.S. at 452.
15 Id. at 451.
16 Id. at 456.
17 Id. at 454, 457.
19 287 U.S. at 457.
20 Id. at 458-59.
The Sorrells decision was much criticized, and the lower federal courts generally ignored the theory of that case, content to rest their decisions upon whether evidence of entrapment was before them. The doctrine was, however, reaffirmed in Sherman v. United States with the Court splitting along the same lines.

The issues facing the court in the instant case were whether the case presented by the defendant was sufficient to raise the issue of entrapment, and if the defendant was entrapped, whether the evidence seized as a product of the entrapment was admissible to prove the separate counts of the indictment. The majority opinion reasoned that as a matter of law the record did not show that an otherwise unwilling person had been induced to commit a criminal act. The defendant had offered no evidence, and the court rightly held that a mere self-serving statement suggesting entrapment is not sufficient to raise the defense. Since there was no entrapment, the sale of narcotics observed by the police officer constituted probable cause for the issuance of a search warrant, and the evidence thus obtained was admissible. But the court went further and stated that even if there had been an entrapment, exclusion of this evidence would have constituted an unwarranted extension of the suppression of evidence doctrine. If the evidence had been offered to rebut the defense of entrapment, the court's holding could be justified by that portion of the Sorrells doctrine by which the accused, as the price paid for raising the defense, waives objection to inquiry into his conduct and predisposition. But Sorrells carefully limits such an inquiry to evidence "pertinent to the controlling question whether the defendant is a person otherwise innocent whom the government is seeking to punish for an alleged offense which is the product of the creative activity of its own officers." Here the evidence was admitted to prove all counts of the indictment and over the objection that it was the product of illegal activities of the police. The court's statement then has the effect of denying any affinity between entrapment and the legal questions concerning the admissibility of evidence.

The dissent, concluding that the issue of entrapment had been properly raised and that the Government had not carried its burden as to the appellant's predisposition, found entrapment as a matter of law. The holding of the majority on the admissibility of the evidence was also challenged. Entrapment, the

21 Donnelly, Judicial Control of Informants, Spies, Stool Pigeons and Agent Provocateurs, 60 Yale L.J. 1091, 1098-1115 (1951); Mikell, supra note 3, at 246.
22 E.g., United States v. Sherman, 200 F.2d 880, 882 (2d Cir. 1952); United States v. Chiarella, 184 F.2d 903, 908 (2d Cir. 1950); Malatkoński v. United States, 179 F.2d 905, 918 (1st Cir. 1950).
24 For a penetrating analysis of these two theories, see Model Penal Code § 2.10, comment (Tent. Draft No. 9, 1959).
25 287 U.S. at 451; see Wigmore, Using Evidence Obtained by Illegal Search and Seizure, 8 A.B.A.J. 479 (1922).
dissent reasoned, is not a legal way of acquiring evidence and renders the warrant obtained on this basis invalid, the search and seizure under the warrant unreasonable, and the evidence seized inadmissible. While the admissibility of evidence at common law was not affected by the illegality of the means through which it had been obtained,26 in Weeks v. United States27 it was held that no evidence would be admissible in a federal criminal proceeding which had been procured by federal officials in violation of the constitutional guarantees against unreasonable search and seizure and of due process of law. This doctrine was extended in Silverthorne Lumber Co. v. United States,28 which not only affirmed the exclusion of such evidence from use before the court, but denied its use for any purpose. The Supreme Court has not expanded the Silverthorne doctrine to the question of probable cause, but the rule has been interpreted by circuit courts as holding that evidence so obtained cannot support a search warrant.29

In Fraternal Order of Eagles v. United States30 it was held that illegal activities observed after gaining entry through fraudulent misrepresentations could not provide the probable cause necessary to procure a search warrant, and that the fruits of such a warrant were inadmissible. The court in that case recognized that “unlawful and unconstitutional practices get their first footing by silent approaches and slight deviations, under extenuating circumstances, from legal modes of procedure,”31 and based its holding upon the principle that the constitutional guarantee of the fourth amendment must not be so narrowly construed that overzealous government officials are allowed to do indirectly and by subterfuge what they may not do directly.32 If fraudulent misrepresentations on the part of the police can so contaminate observations of illegal acts which are completely disassociated from either the fraud or the entry, so that these observations cannot constitute probable cause, it is difficult to see how a valid warrant can be based upon probable cause manufactured by the police.

The dissent in the instant case recognizes that the defense of entrapment is directly related to the question of admissibility of evidence, particularly where, as here, the evidence is used not to show a predisposition on the part of the accused, but to support a count in the indictment separate from the one in which the defense was raised. Entrapment, if established, can mean only that the criminal design originated with the police and that the accused, a person otherwise unwilling and undisposed toward crime, was induced to commit the act for which he is being prosecuted. It is one thing to say that evidence ob-

26 Olmstead v. United States, 277 U.S. 438, 467 (1928).
27 232 U.S. 383 (1914).
28 251 U.S. 385, 392 (1920).
29 McGinnis v. United States, 227 F.2d 598, 603 (1st Cir. 1955); Fraternal Order of Eagles v. United States, 57 F.2d 93 (3d Cir. 1932).
30 57 F.2d 93 (3d Cir. 1932).
31 Id. at 94.
32 Ibid.
tained under a warrant supported by an entrapment is admissible to show the willingness and predisposition of the accused to commit the act induced. But to hold that such a warrant can be used to procure evidence to support a conviction on a separate count ignores the basis of the defense of entrapment and unduly restricts rather than expands the federal exclusionary rule.

The instant case is illustrative of the confusion which surrounds the federal entrapment rule. By emphasizing the state of the defendant's mind over the conduct of the police, and by rationalizing the doctrine by implying a condition to penal statutes rather than placing it upon its ultimate foundation, i.e., the policy of the courts not to condone such action on the Government's part, the rule invites judicial pronouncements such as that of this majority which would allow the Government to accomplish by indirectness what the doctrine forbids it to do directly.

ALLEN D. BRUFSKY


U. S. Tire Engineers, Inc., a wholesale and retail establishment, required certain electrical work at its premises and hired Plauche Electric, Inc., who at that time was engaged in a dispute with respondent union. Respondent began to picket the entrance of U. S. Tire, despite the fact that Plauche maintained an office in the area to which his employees reported briefly at the beginning and end of each day. Although the signs displayed clearly disclosed the dispute to be solely with Plauche, there was no picketing of Plauche's office. The trial examiner, relying on Washington Coca Cola Bottling Works, Inc.1 and Moore Dry Dock Co.,2 found that respondent had violated section 8(b)(4)(i)(B) of the Labor Management Relations Act3 (1) by picketing at the premises of the secondary employer, U. S. Tire, when the dispute could have been publicized at the primary employer's place of business, and (2) by picketing the secondary employer while the employees had left for a lunch and coffee break. The union filed exceptions and the trial examiner's findings were reviewed by the National Labor Relations Board. Held, (1) common situs picketing is not per se unlawful when the primary employer maintains a regular place of business in the locality which can be picketed; (2) common situs picketing while the employees are taking

2 Sailors' Union, 92 N.L.R.B. 547 (1950).
time off for a lunch or coffee break is not in itself unlawful, since the standards of *Moore Dry Dock* are not to be applied on an indiscriminate per se basis.  

Section 8(b)(4), the secondary-boycott provision, was originally enacted in 1947 to protect neutral employers from the pressures of labor disputes. It brands as an unfair labor practice the attempt of a union to induce or encourage neutral (secondary) employers to terminate their business with the (primary) employer involved in the dispute. Since the object of nearly all union picketing is to influence secondary employers and all other neutral parties to withhold their business from the primary employer, it is a finding of specific intent, rather than a mere determination of the union’s objective or motive, which is required; whether the secondary employer is induced as intended is immaterial. Proof of this intent will be assumed, however, where the natural foreseeable consequences of the conduct warrants its inference.

As aids in distinguishing between legitimate primary and proscribed secondary activity, the Board has attempted to devise reasonable criteria "to protect, on the one hand, traditional primary strike activity, and to prevent the unnecessary involvement of neutral employers in those strikes." In *Moore Dry Dock* the Board promulgated four conditions, making lawful common situs picketing contingent upon the union’s restricting its use to (a) times when the situs of dispute is located at the common situs, (b) times when the primary employer is engaged in his normal business at the situs, (c) places reasonably close to the location of the situs, and (d) a manner which clearly discloses that the dispute is with the primary employer. Later, in *Washington Coca Cola*, the Board added a fifth condition: picketing at the premises of a secondary employer was not lawful when the primary

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6 Local 657, Int’l Bhd. of Teamsters, 115 N.L.R.B. 981, 984-85 (1956) (Southwestern Motor Transp., Inc.).


10 Chauffeurs Union, 128 N.L.R.B. 522, 531 (1960) (McJunkin Corp.) (Fanning, separate opinion), modified and enforced, 294 F.2d 261 (D.C. Cir. 1961).

11 92 N.L.R.B. at 549.
employer maintained a permanent place of business within the locality which could be picketed. It was reasoned that from the existence of such a place of business the Board could conclude only that the common situs picketing was directed toward the proscribed objective of inducing the secondary employer to sever his relationship with the primary employer.12

The Washington Coca Cola decision purported to be based on the entire record,13 and its affirmation by the United States Court of Appeals for the District of Columbia Circuit14 was based primarily on this assumption, rather than lending approval to a rigid rule of per se illegality.15 In succeeding decisions,16 however, the Board clearly enunciated this condition as a per se doctrine, modifying it in Pittsburgh Plate Glass Co.17 only to the extent that the union must be able effectively to pressure the primary employer at his regular place of business before picketing of the common situs would be held unlawful in itself.18 The subsequent condemnation of this doctrine by the circuit courts19 led the Board to reconsider its position in the instant case.

In overruling Washington Coca Cola, the Board was confronted with a reevaluation of the validity of that decision's conclusive inference—that picketing of the common situs while the primary employer maintained a permanent place of business which could be picketed was secondary and therefore proscribed. In a deeper context the instant case presented the question of whether the Board would continue to found its decisions on inferences drawn from predetermined formulas of unfair labor activity.

The Board based its decision on criticism by the federal courts of the Washington Coca Cola doctrine and on recent Supreme Court disapproval of another per se doctrine.20 These two sources of authority present an interesting contrast, for while the other per se doctrines attacked to date have been

12 107 N.L.R.B. at 302-03; accord, Local 657, Int'l Bhd. of Teamsters, 115 N.L.R.B. 981, 983 (1956) (Southwestern Motor Transp., Inc.).
13 107 N.L.R.B. at 302-03.
18 "Effective picketing" was determined principally by the number of times per day the employees reported to the primary premises and the distance from there to the common situs. Ibid.
19 NLRB v. Local 294, Int'l Bhd. of Teamsters, 284 F.2d 887, 890-91 (2d Cir. 1960); Retail Fruit & Vegetable Clerks Union v. NLRB, 249 F.2d 591, 600 (9th Cir. 1957); Sales Drivers v. NLRB, 97 U.S. App. D.C. 173, 176, 229 F.2d 514, 517 (1955), cert. denied, 351 U.S. 972 (1956). But see NLRB v. Truck Drivers, 228 F.2d 791 (5th Cir. 1956).
overturned almost exclusively on the ground that legislative history revealed the questioned activity to be impliedly if not expressly permitted, the validity of Washington Coca Cola is based on the reasonableness of inferring the proscribed intent when the union is able to pressure the primary employer at his own premises but instead chooses to picket a common situs. The Board’s position on this issue had previously been stated as follows:

This conclusion rests on the sound premise that a union which can direct its inducement to the primary employer’s employees at the primary employer’s premises, does not seek to accomplish any more with respect to the same employees by directing the same inducements to those same employees at the premises of some other employer. Consequently, the only reasonable inference in such a situation is that inducements which are ostensibly directed at the primary employer’s employees are in fact directed at the employees of the secondary employers.

Although the power of the Board to infer “such conclusions as reasonably may be based upon the facts proven” is clear, in the instant case the Board appears to be abandoning an inference never completely shown to be unreasonable. The courts that have rejected the Washington Coca Cola doctrine generally have relied on the conclusion that rigid rules of legality are not deducible from the statute, or else merely state that all factors must be considered. Only the Second Circuit has directly attacked its reasonableness, and even that court admits that the inference might justifiably be drawn if the Board’s experience enabled it to say that picketing not meeting the “fifth condition” was almost uniformly directed toward the proscribed objective.


22 Legislative history affords no insight into the effect which the availability of the primary premises has on common situs picketing. The Conference Report on the Labor Management Relations Act discloses only that secondary boycotts “were made unfair labor practices if the purpose was to force an employer or other person to cease using, selling, handling, transporting, or otherwise dealing in the products of another, or to cease doing business with any other person.” H.R. Rep. No. 510, 80th Cong., 1st Sess. 43 (1947).

23 Local 657, Int’l Bhd. of Teamsters, 115 N.L.R.B. 981, 984 (1956) (Southwestern Motor Transp., Inc.).

24 Republic Aviation Corp. v. NLRB, 324 U.S. 793, 800 (1945).


27 NLRB v. Local 294, Int’l Bhd. of Teamsters, 284 F.2d 887, 891 n.3 (2d Cir. 1960).
Whether the "fifth condition" was based on experience as to the ultimate fact inferred is not certain. At the very least it was based on sound reasoning and not on the Board's erroneous interpretation in Washington Coca Cola of prior judicial construction, as the Second Circuit claims. The inference on which this condition was based seems no less reasonable than the inferences of unlawful intent which those courts rejecting Washington Coca Cola would advance where picketing at the common situs follows a secondary employer's noncompliance with a union appeal to terminate business with the primary employer, or where the secondary employees strike subsequent to common situs picketing.

The suspicion with which Washington Coca Cola has been regarded appears to stem from the Board's initial use of that doctrine to select arbitrarily the primary premises as the situs of dispute without advancing any reason for the selection. The subsequent clarification in Pittsburgh Plate, requiring the unavailability of the primary premises for effective picketing, has done little to allay criticism, probably because of the paucity of cases in which the primary premises have been found to be "unavailable." However, there can be no question that Pittsburgh Plate has been the rule applied; hence it is difficult to interpret the Board's statement in the instant case that the "legislative history plainly leaves us as free to return to Pittsburgh Plate as to follow Washington Coca Cola." The majority of the Board, much to the concern of its dissenting members, made no attempt to determine whether effective picketing could have been conducted at the primary premises. The decision can only be explained by the statement that Plauche's office "was not the sole permissible situs for the publication of the dispute . . . ." Determining whether the picketing could be conducted effectively at Plauche's office, therefore, becomes unnecessary, since it is possible to have more than one "permissible situs," and the premises of U. S. Tire had already qualified. Such reasoning, even where each situs must permit the nonstriking primary employees to be notified of the controversy, constitutes a dangerous relaxation of the leg-

28 Ibid.
30 NLRB v. Local 294, Int'l Bhd. of Teamsters, 284 F.2d 887, 890 (2d Cir. 1960) (dictum).
33 135 N.L.R.B. No. 41, at 6. (Emphasis added.)
34 Id. at 6.
islative intent. Application would give official sanction to the secondary activity of truck drivers, construction crews, electricians and the many other tradesmen whose work is not confined to the premises of their immediate employer, irrespective of the time actually spent at those premises. In such a situation compliance with the conditions of *Moore Dry Dock* would validate any picketing conducted, for the proscribed intent would be quite difficult to prove.

The reasoning behind *Washington Coca-Cola* and *Pittsburgh Plate* remains as sound as any put forth. Both statutory objectives—the protection of primary strike activity and the unnecessary involvement of neutral employers in labor disputes—can be achieved only by precluding common situs picketing when the primary premises can be effectively picketed. The majority in the instant case made no attempt to refute this reasoning. Indeed, it is difficult to determine whether the Board has (1) reevaluated its prior inference as an unreasonable one; (2) recognized that even if reasonable the inference could no longer be drawn where federal courts would refuse to enforce it; or (3) merely displayed a pro-labor orientation. All that the opinion does make clear is that future common situs picketing must still accord with the *Moore Dry Dock* standards, and, as illustrated by the Board's handling of lunch and coffee breaks, even those standards "are not to be applied on an indiscriminate 'per se' basis, but are to be regarded merely as aids in determining the underlying question of statutory violation."

The instant opinion forces the conclusion that as to all complaints of unfair labor practices, the Board will no longer continue to draw conclusive inferences of illegality from one or two specific factors "in lieu of analysis of the particular facts in each case," and that it will permit common situs picketing to be conducted under the sanctity of the law regardless of whether the dispute can be publicized effectively at the primary premises. It is submitted that such a policy, as applied to common situs picketing, intensifies the burden of proving specific intent to such a degree as to infringe upon the rights secured to secondary employers by the authors of the statute.

ALAN D. GROSS


Following a report of the Antitrust Subcommittee of the House of Representatives, plaintiff Civil Aeronautics Board issued an all-inclusive order

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35 Id. at 7.
36 Id. at 5.

instituting a general inspection of the activities of the defendant Air Transport Association. Claiming an attorney-client privilege, the defendant withheld a number of documents, and these were subpoenaed by the plaintiff. Upon noncompliance, and after proceedings before the agency, the CAB filed a complaint in the United States District Court for the District of Columbia, seeking an order to enforce its subpoena or, in the alternative, enforcement of the Board's original order. The court denied the plaintiff's motion for summary judgment, based principally on a contention that the attorney-client privilege did not apply to agency investigations in view of the broad grant of investigatory power in sections 204, 407, and 415 of the Federal Aviation Act, and granted the cross-motion of Air Transport Association and intervenors for a partial summary judgment. _Held_, investigations conducted by federal administrative agencies pursuant to statutory authority are subject to the attorney-client privilege.5

It is undisputed that a legitimate end of congressional authority is regulation in the public interest through legislation, and that an investigatory power is necessary to achieve that end.6 However, the scope of the legislative power of inquiry has long been an area of recurring controversy,7 since a basic resolution of public and private interests must necessarily be accomplished. This determination of the rights of the individual to be free from interference, as evidenced by constitutional and evidentiary privileges of silence vis-à-vis the public interest in full disclosure, remained unsolved by broad grants of congressional authority to administrative agencies. Judicial determination of policy questions often gave way to questions of statutory construction of delegated powers, or were at least discussed in such terms.8 An early emphasis on individual rights prompted narrow judicial construction of grants of such power9 and led to broad grants of legislative authority by Congress to public bodies.10

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7 See generally 1 Davis, Administrative Law § 3.01 (1958).
8 Ibid.
The increasing stature of the administrative agency soon promoted a change in the approach to the question of construction. In a series of significant decisions, agency investigations were permitted without a showing of probable cause\(^\text{11}\) or probable jurisdiction;\(^\text{12}\) prerequisites to legitimate use of the investigative power were eventually reduced to a lawfully authorized purpose and relevance of the material sought to that purpose.\(^\text{13}\) It became common in defining the limits of investigative power to analogize that procedure to the broad grand jury powers of inquiry.\(^\text{14}\) Finally, the decision in *United States v. Morton Salt Co.*\(^\text{15}\) rendered ancient history earlier judicial distaste for agency "fishing expeditions";\(^\text{16}\) "official curiosity" was now considered a sufficient reason for use of investigative power.\(^\text{17}\)

Constitutional objections to compulsory agency production orders are generally present whenever broad investigative statutes have been interpreted by the Supreme Court. In *FTC v. American Tobacco Co.*\(^\text{18}\) the Court anchored its holding on the "spirit" of the fourth amendment as expressed in *Hale v. Henkel.*\(^\text{19}\) A definitive review of the protection afforded by the fourth amendment against the subpoena of corporate records was made in *Oklahoma Press Pub. Co. v. Walling,*\(^\text{20}\) the Court concluding that "the Fourth, if applicable, at the most guards against abuse only by way of too much indefiniteness or breadth in the things required to be 'particularly described.'"\(^\text{21}\) Administrative subpoenas of records or reports are now inhibited by the fourth amendment only by considerations of breadth and relevancy, almost a due process test.

Use has also been made of the fifth amendment privilege in corporate attempts to withstand compulsory agency production orders. Although the courts have interpreted "due process" as applicable to corporations,\(^\text{22}\) protection has not been extended under the aegis of the self-incrimination clause.\(^\text{23}\)

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14 See Genecov v. Federal Petroleum Bd., 146 F.2d 596 (5th Cir. 1944); Boehm v. United States, 123 F.2d 791 (8th Cir. 1941).
17 338 U.S. at 652.
18 264 U.S. 298 (1924).
19 201 U.S. 53 (1906).
20 327 U.S. 186 (1946).
21 Id. at 208.
Furthermore, the privilege against self-incrimination does not apply to corporate records required to be kept, and immunity statutes often compel testimony and production in circumstances where the privilege would otherwise apply, generally reducing the defense to a makeweight factor of relative unimportance.

Questions of evidentiary privilege in the face of agency powers under many statutes create a judicial dilemma, since the broad language of many provisions makes it difficult to determine the framers' intent. However, it is clear that the technical rules of evidence are not to be applied indiscriminately to agency activities; also evident is the fact that certain procedural safeguards must be met, since agency investigations may lead to adjudications in which the substantive rights of the parties will be determined. As a result, a broader problem presents itself. A recognition of the attorney-client privilege in the administrative investigation may permit the frustration of the function of many federal agencies. Conversely, a determination that the attorney-client privilege is not applicable in an agency investigation would mean invasion of the heretofore revered attorney-client relationship. This would require rejection of weighty, historical policy values.

In ruling on plaintiff's motion for summary judgment in the instant case, Judge Holtzoff was presented squarely with this deep issue, framed by the parties in terms of statutory construction of the congressional grant of investigative power to the CAB. Both parties in the instant case utilized United States v. Louisville & N.R.R. in an attempt to clarify the broad investigative provisions of the Federal Aviation Act. In Louisville the United States Supreme Court ruled that the inspection provisions of section 20 of the Commerce Act as then written, providing for inspection of "accounts, records

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24 Shapiro v. United States, 335 U.S. 1 (1948).
25 Id. at 6 n.4.
28 Section 902(f) of the Federal Aviation Act seems designed to safeguard the contents of documents produced under the investigative authority of the CAB. 72 Stat. 785, 49 U.S.C. § 1472(f) (1958). However, public disclosure is still possible if directed by the Board or the courts, since this determination is wholly dependent on the judgment of the Board or the administrator. § 1104, 72 Stat. 797, 49 U.S.C. § 1504 (1958).
29 The rationale of the privilege, the necessity of providing subjectivity for the client's freedom from apprehension in consulting his legal advisor, is discussed in 8 Wigmore, Evidence § 2291 (McNaughton rev. 1961).
31 236 U.S. 318 (1915).
and memoranda," did not imply a Commission right to review the business correspondence of the defendant railroad. In this decision the Supreme Court did not directly decide whether Congress had intended by this grant of authority to include confidential correspondence between the railroad and counsel, but the clear implication of the decision was that the privilege remained inviolate. However, the CAB contended that a study of the legislative history of the amendments to the act, enacted subsequent to Louisville, indicated a congressional intent to overcome the attorney-client privilege and extend the investigative powers of the Interstate Commerce Commission. These contentions were relevant in the instant case in that inspection provisions of the Interstate Commerce Act served as the model for the inspection provisions of the Federal Aviation Act, the terms of the two differing only in minor respects.

Plaintiff further contended that the wide scope of the investigative powers granted to the CAB, coupled with the liberal interpretation to be given remedial legislation, gave it virtually unlimited powers of investigation, restricted only by the onus of relevancy, which was not at issue. However, by way of dicta, section 20 of the Interstate Commerce Act, as amended subsequent to Louisville, has received judicial interpretation negating the contentions of the CAB in the instant case.

Given the public's right to every man's evidence and the fact that this general rule is particularly true in the quasi-legislative atmosphere of administrative action, courts could easily conclude that Congress, in the breadth of the statutes delegating investigative power, codified its attitude toward the rules of evidence in its own investigations. There is little case discussion of the attorney-client privilege before legislatures. Recommendation that privileges

33 236 U.S. at 336.
34 Memorandum for Plaintiff in Support of Motion for Summary Judgment, p. 11.
38 8 Wigmore, Evidence § 2192, at 72-73 (McNaughton rev. 1961).
39 See 1 Wigmore, Evidence § 4k, at 142-45 (3d ed. 1940), for a discussion of congressional attitude on the applicability of the rules of evidence to its proceedings.
of confidential communications be imposed by statute on Congress\(^{41}\) suggests that such privileges are not weighty before Congress, that they are relative, and that the relationships are protected only by a longstanding absence of any abuse by Congress of its investigative power.\(^{42}\) However, an attorney-client privilege which is relative to the facts of each case is no privilege at all, in that client freedom from apprehension in consulting his attorney cannot exist if the client knows that under some circumstances he may not avail himself of his privilege to silence his adviser.\(^{43}\) It has yet to be shown that effective administrative action requires abrogation of the privilege; conversely, the need for the privilege may be found in the fact that administrative investigation may well lead to criminal prosecution in the same manner as a grand jury investigation.\(^{44}\)

These considerations were given effect by the unequivocal acceptance of the attorney-client privilege in the instant case. By recognition rather than extension of its presence in the administrative arena, the court was able to achieve a partial resolution of the public interest-private interest conflict inherent in the agency investigation, without a corresponding interpretation of the scope of the investigative provisions of the Federal Aviation Act. This recognition was accomplished by placing justifiable reliance on the common law background of the privilege and the great weight in legal process given it by history, although the court adopted without discussion the traditional policy interests underlying the privilege. Thus affirmative and unambiguous legislative action will be necessary to abrogate the privilege in this field.

The significance of the instant decision lies in the fact that it is the first direct and explicit recognition of a definite limit on the investigative power of administrative agencies since the concept of that power began to broaden in the 1940's. With the increase of regulation necessary in an industrialized society and the consequent necessity of access to facts on which to base regulation, the interest in nondisclosure of private conduct has become one of little weight.\(^{45}\) The courts have felt that, short of constitutional limitations, any limitation on agency power of inquiry, necessary for the agency to do its job, was unjustified.\(^{46}\) But as indicated earlier, the constitutional limits in themselves are insignificant;\(^{47}\) protection from abuse of power by way of judicial review seems the only solace to the individual.

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\(^{41}\) Comment, Congressional Investigations and the Privileges of Confidential Communications, 45 Calif. L. Rev. 347 (1957).

\(^{42}\) See 1 Wigmore, Evidence § 4k, at 144 (3d ed. 1940).

\(^{43}\) Comment, supra note 41, at 355-57.

\(^{44}\) The privilege limits the inquisitorial powers of the grand jury. Schwimmer v. United States, 232 F.2d 855 (8th Cir.), cert. denied, 352 U.S. 833 (1956).


\(^{47}\) See notes 18-25 supra and accompanying text.
Recognition in this case, not on a constitutional basis, of an interest that is of such weight that a court conceivably could deny an administrative probe and thereby effectively prevent the administrative body from performing its function is unusual in view of recent judicial attitude as found in Morton Salt. However, since the attorney-client relationship was the interest involved, there is no reason to believe that this case represents a reversal of attitude on the part of the judiciary with respect to the necessity and scope of administrative investigation. The case merely represents respect for an interest traditionally recognized by courts. Since the investigative provisions of the Federal Aviation Act closely resemble similar provisions in other federal agencies, a lateral extension of this holding will require little judicial manipulation or imagination.

MICHAEL J. WYNGAARD


Plaintiff was injured when a defective accelerator pedal in the automobile in which he was a guest passenger caused the driver to collide with another automobile. The driver had purchased the car, manufactured by defendant General Motors, from defendant Reedman trading as Reedman Motors. Plaintiff commenced this action against both the dealer and manufacturer, alleging

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48 Judge Holtzoff remarked in his opinion: "The very existence of the right of counsel necessitates the attorney-client privilege in order that a client and his attorney may communicate between themselves freely and confidentially." 11 Ad. L. (2d ser.) (Decisions) at 1121-22. Thus it would seem that he would also rest his decision on a due process right to counsel or a sixth amendment right to counsel; these guarantee assistance of counsel at a criminal prosecution. See Chandler v. Fretag, 348 U.S. 3 (1954). They do not guarantee assistance of counsel at the investigation stages of such proceedings. In re Groban, 352 U.S. 330 (1957). A preliminary inquisition not establishing any right, but constituting only a quasi-administrative remedy whereby information is had that may move the court or agency to other acts, is not a proceeding at which one is entitled to counsel. Anonymous v. Baker, 360 U.S. 287 (1959). The view that a person's right to counsel is rendered ineffective because he must choose between possible self-incrimination or use of the privilege, without aid of counsel, has not been accepted by the Supreme Court. See In re Groban, supra at 332-33. Compare Coplon v. United States, 89 U.S. App. D.C. 103, 191 F.2d 749 (1951), cert. denied, 342 U.S. 926 (1952).

49 Professor Wigmore would recognize the privilege in this type of situation. 8 Wigmore, Evidence § 2300(a) (McNaughton rev. 1961). See also Note, 54 Harv. L. Rev. 1214, 1218-19 (1941).
breach of express and implied warranties of merchantability and fitness for purpose. The defendants moved to dismiss the complaint for lack of privity. Held, a guest passenger injured in a collision proximately caused by the defective construction of the automobile in which he was riding may recover from the dealer or manufacturer on breach of an implied warranty, notwithstanding the absence of privity.1

The responsibility of a manufacturer, distributor or seller of chattels to the purchaser and ultimate consumer is an old problem2 and has been complicated primarily by the admixture of the contract concept of privity and the actions of negligence and breach of warranty, on which purchasers or consumers rely for recovery when chattels prove defective. Since MacPherson v. Buick Motor Co.,3 in which Judge Cardozo laid down so broad an exception to the rule barring recovery without privity that the exception effectively obliterated the rule itself, manufacturers generally have been held liable for the negligent manufacture or assembly of chattels.4 MacPherson received general acceptance throughout the states within a short time after its enunciation.5 The source of the manufacturer's liability, where the consequences of his negligence may be foreseen, "is based upon a breach of duty imposed by law."6

Even without the privity requirement, however, the suit in negligence remained an ineffective remedy due to the difficulty of proof. Injured parties, therefore, have attempted to abolish the privity obstacle in warranty actions,7 arguing that public policy requires that stricter liability be imposed upon manufacturers and sellers than that resting on a showing of negligence, notwithstanding the availability to the plaintiff of the doctrine of res ipsa loquitur.

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2 As Chief Justice Gibson stated well over a century ago:
   On no subject have the decisions been so anomalous, as on warranty of chattels; and an attempt to arrive at a satisfactory conclusion about any principle supposed to be settled by them, would be hopeless, if not absurd. Of such jarring materials have they been compounded, that it is impossible to extract from them any principle of general application, and we are left by them in the predicament of mariners compelled to correct their dead reckoning by observation.


3 217 N.Y. 382, 111 N.E. 1050 (1916).
4 Prosser, Torts 500 (2d ed. 1955).
7 The case most prominently cited as originally espousing the cause of privity in warranty actions is Winterbottom v. Wright, 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842), wherein an injured coach passenger was not allowed to proceed on the theory of breach of warranty on a contract between the carrier and a third party to keep the coach in repair.
Although the once absolute prerequisite of privity in such actions has been significantly modified in recent years, a majority of states still cling to it.\(^8\)

The greatest leniency has been allowed buyers where adulterated food or drink has been the subject matter of a sales contract. The requirement of privity has been circumvented most often in this area,\(^9\) and sales of these commodities, as well as drugs, could be considered as sui generis. Although courts have shown greater reluctance to abandon privity where the product, if defective, is not likely to cause grave personal injuries, recent years have witnessed numerous breaches in the once solid wall labeled "privity" where the subject matter is much less personally oriented than the above-mentioned consumables.\(^10\) Typically, these cases are instances of the purchaser-consumer recovering against a remote manufacturer on breach of an implied warranty, and foreseeability and social expediency, perhaps here more than elsewhere, best justify the strict liability imposed upon the manufacturer. If the manufacturer should properly warrant his product to anyone, certainly the purchaser-consumer, from whom the manufacturer ultimately derives his profits, should be the beneficiary. Although no privity of contract exists, there is a relationship analogous to privity of title which serves as a logical link between plaintiff and warrantor.

The more difficult situation is presented when the plaintiff is not a party to any contract in the distributive chain but is one who utilizes or consumes with the purchaser's consent. Here recovery has been easiest to justify in terms of foreseeability when the plaintiff consumer is a member of the pur-


\(^9\) Prosser indicates that strict liability in food cases, without privity, is the majority rule in states having spoken on the matter. Prosser, The Assault Upon the Citadel, 69 Yale L.J. 1099, 1110 (1960).

chaser's family or household.11 Henningsen v. Bloomfield Motors,12 a recent New Jersey decision renouncing privity in that jurisdiction, presented such a situation. Expressly overruling Tomlinson v. Armour & Co.,13 which held that a warranty, express or implied, is a strict contract right requiring privity, the court ruled that in the interest of justice the implied warranty extends to anyone using or occupying the car with the purchaser's consent. There the wife of the ultimate vendee was allowed recovery on an implied warranty against the manufacturer of a defective automobile which caused her personal injury. The language of Henningsen would extend the benefit of warranties on chattels to those persons who, in the reasonable contemplation of the parties, might become users of the chattel. While this language is broad as an abstract proposition, it is necessarily restricted in application by the close identity of husband-purchaser and wife-consumer. Whether this language will be given full effect in future cases involving plaintiffs having more remote ties with the ultimate vendee is an open question.14 Other jurisdictions have given to the consumer a warranty action where he was neither a member of the purchaser's family or household nor otherwise financially dependent upon him, but these apparently are limited to food and drink cases.15

Jurisdiction in the instant case was founded on diversity, and it was determined that Pennsylvania law should be applied under the Erie doctrine. Plaintiff based his right to recover on section 2-318 of the Uniform Commercial Code,10 adopted by Pennsylvania in 1953, which he interpreted as expressly abolishing the technicalities of privity in warranty actions and extending to him the same warranties received by the purchaser. The court, while appreciating the liberality that this statute has injected into Pennsylvania warranty law, was unwilling to rely on the provision to allow this plaintiff to recover, finding it "too much of a leap" from the "guest in home" provision

14 A later New Jersey case, Pabon v. Hackensack Auto Sales, Inc., 65 N.J. Super. 476, 164 A.2d 773 (App. Div. 1960), relies upon Henningsen in sustaining a cause of action by a minor driver against a dealer and manufacturer for injuries sustained due to a "locked steering wheel" in an auto purchased by plaintiff's adult sister for plaintiff's use. Since a close family connection existed between vendee and consumer, however, Pabon does not extend the privity obliteration effected by Henningsen.
of the Code to the “guest in car” question before the court. Instead, the Uniform Commercial Code comment,\17\ setting forth the intent of the drafters of this section, was deemed by the court to justify going beyond the three privileged categories set out in the section\18\ to glean the rule from developing case law. But it would seem that the court gave the comment a strained construction by concluding that warranties which are available to the purchaser inure to the benefit of persons beyond those categories—family, household, or guest in home—when no resale is effectuated. The comment merely provides that the section is “neutral” and hence does not preclude further judicial inquiry into the privity question when a resale is involved, which was not the case here. It is readily inferable from the language of the comment that the privity requirement between ultimate purchaser and ultimate consumer should be dispensed with only when the plaintiff consumer falls into one of the three categories enumerated in section 2-318.

Once beyond the Uniform Commercial Code, the court turned to case law to support its bypassing of privity both from the manufacturer to the ultimate purchaser and from such purchaser to the instant plaintiff consumer. The case primarily relied on by the court is Mannsz v. MacWhyte Co., where the Third Circuit declared: “We think it is clear that whether the approach to the problem be by way of warranty or under the doctrine of negligence, the requirement of privity between the injured party and the manufacturer of the article which has injured him has been obliterated from the Pennsylvania law.”\19\ The Mannsz court indicated that a co-worker as well as the purchaser of certain steel cables from a party other than the manufacturer could sue the latter on the grounds of breach of express warranty, even though neither was in privity with the manufacturer and the co-worker was not in privity with the ultimate purchaser. The express warranty was founded upon representations by the cable manufacturer as to the strength of his product made in literature intended to reach the general consumer market.

At least as to the actual purchaser in Mannsz there existed early authority for imposing strict liability upon the manufacturer. In 1891 it was held in Conestoga Cigar Co. v. Finke\20\ that an express warranty on a tobacco tag

17 This section expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extends to other persons in the distributive chain.

18 Section 2-318 provides:

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

19 155 F.2d 445, 449-50 (3d Cir. 1946).

20 144 Pa. 159, 22 Atl. 868 (1891).
imured to the benefit of a remote purchaser. It would appear that the Mannsz court also conceived of an express warranty running directly to the co-worker on the theory that the representations in the manufacturer's literature were directed to all the public and not just to those of the public who actually became purchasers.

Application of the Mannsz rule to implied warranties had been accomplished prior to the instant case by a lower state court in Jarnot v. Ford Motor Co.,\textsuperscript{21} also cited for support by the instant case, but Jarnot abandoned privity only between manufacturer and ultimate purchaser. Hence disregard of privity as to implied warranties beyond the purchaser must find its genesis, if anywhere, in Mannsz.

Pritchard v. Liggett & Myers Tobacco Co.,\textsuperscript{22} cited by the Reedman court, appears to be only cumulative authority, since that action was on an express warranty and involved the ultimate purchaser as plaintiff and the manufacturer as defendant. As such, the holding does not go even as far as Mannsz in renouncing privity. Also referred to, but probably of little merit, is the dictum in Magee v. General Motors Corp.\textsuperscript{23} to the effect that that action could have been maintained upon the theory of breach of implied warranty or fitness for purpose and merchantability, whereas liability was actually predicated on negligence.

The instant court rejected the contention of defendants that Loch v. Confair\textsuperscript{24} decided some three years after Mannsz, represented the controlling case law in Pennsylvania and that it impliedly overruled Mannsz. There recovery was denied in a suit against the manufacturer of a bottle of ginger ale which exploded as the plaintiff was selecting it from a shelf in a self-service supermarket. The basis for that decision was that mere possession existing prior to the sale gave rise to no warranty since title had not passed. By appearing to require a contract extending to the consumer level before privity will be disregarded, Loch does indicate pointedly that the obliteration of which Mannsz speaks was not complete and absolute.

The language of Mannsz and Jarnot is broad, but the instant case clearly goes beyond the facts of both in fashioning its result. Although admitting that the cases are "not overwhelmingly compelling on the right of this guest plaintiff to bring his action," the instant court stated that their language was broad enough to cover the situation before it.\textsuperscript{25} Further, it appears to have extended a remedy in warranty for injuries due to a defective chattel to a more remote plaintiff than other jurisdictions have deemed just and

\textsuperscript{23} 117 F. Supp. 101, 102 (W.D. Pa. 1953), vacated on other grounds, 213 F.2d 899 (3d Cir. 1954).
\textsuperscript{24} 361 Pa. 158, 63 A.2d 24 (1949).
\textsuperscript{25} 199 F. Supp. at 123.
The words of the Mannsz case tolling the "obliteration" of privity in Pennsylvania do seem all-encompassing, and the instant court refused to place any express limitation on the Mannsz decision. It appears, however, that a contract extending to the consumer level as well as consensual use on the part of plaintiff consumer, where he is not the owner, are implied limitations, although the express language in Mannsz would probably be sufficiently broad to extend its coverage to any person injured by the defective chattel should future concepts of justice so dictate.26

The instant case moves to the forefront of the surge towards strict product liability by allowing this guest plaintiff to recover against the car manufacturer, ostensibly on the grounds of established case law, but perhaps more realistically in accordance with evolving notions of social justice. It is difficult to find fault with the result reached here when guided by the principle that users reasonably contemplated by parties to the contract should be allowed to sue on a breach of warranty. Although this plaintiff was perhaps contemplated only in a general sense, this would seem to be an insufficient reason for denying him recovery. The increasing scope of a manufacturer's liability is well recognized and continues to increase as the courts redefine the flexible concept of justice to keep pace with changes in the economic and manufacturing growth of the country. The step taken in the instant case in finding a warranty action in a plaintiff who was not related to or dependent upon the vendee could well be considered a fitting object of Dean Prosser's observation that "no breach... in a beleaguered wall is to be ignored."27

HARRY J. STAAS

26 Indeed, it has been suggested that complete outsiders be allowed to recover. This suggestion contemplates recovery for injured bystanders or third persons who happen to be in the path of harm brought about by defective construction or assembly. 2 Harper & James, The Law of Torts 1572 n.6 (1956).
BOOK REVIEWS


It is unfortunate that Professor Konvitz and Mr. Leskes, men eminently qualified to make a full study of the progress of Negroes in the United States during the past century, entitled their book so as to suggest that that is what they have done. The book is not a study of a century of civil rights; rather, it is a much more limited work, embracing a thumbnail history of the Reconstruction, a more detailed history of Reconstruction legislation (particularly the Civil Rights Act of 18751 and the Civil Rights Cases2 of 1883), and a statement and survey of laws in those states that have affirmatively created protections against private discrimination. No attempt is made to chart a path for the future, to analyze critically what mistakes have been made in the past, or to describe in other than legal terms the progress which Negroes in this country have made during the past century. If the book is read in light of its more limited purposes, rather than for the broad implications of its title, there can be no doubt that A Century of Civil Rights is a useful, scholarly and interesting addition to civil rights literature.

The book begins with an historical chapter entitled “Freedmen or Free Men?”3 which proposes that, unlike the institution of slavery in other civilizations, slavery practices in North America in the first half of the nineteenth century were based solely on race. As a result of this equation of slavery with the Negro, it is the thesis of this chapter that a distinction between free men and newly freed Negroes followed, the latter being considered free only in the sense that they were no longer legally pieces of property without human rights, and that this distinction vitally affected the course of our nation’s history. In positing this thesis, which has much validity, the worst side of the South’s development is necessarily emphasized. One of the many general condemnations of the South reads:

Not only did the South avoid the idea of human equality; in order to effect total suppression of this idea, it became necessary, as a means to this accomplishment, to suppress freedom of speech, press, assembly, and petition, freedom of preaching, and academic freedom. The white man himself lost the most essential

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1 Act of March 1, 1875, ch. 114, 18 Stat. 335.
2 109 U.S. 3 (1883).
liberties in the process of denying all liberties to the Negro. There were no operative bills of rights in the South for the masters or, of course, for the slaves, and even the idea of justice was greatly weakened by reversion to self-help and lynch law.

In the South, then, beginning with the 1830s, slavery was not challenged by the great idea of human dignity or "the idea of the essential rights of human beings, arising from their sheer humanity." In this respect the South excluded itself from the mainstream of Western intellectual and spiritual history.4

Elsewhere the assertion is made that southerners in general held a firm conviction that the Negro belonged to another and inferior species; that the Negro was "subhuman not because he was a slave; he was a slave because he was subhuman,"5 citing Lloyd's study of American slavery between 1831 and 1860.6 Professor Konvitz, in a sweeping generalization, refers to this as not only "'the central theme of Southern history,'" but as an unqualified explanation of the Civil War, the Black Codes, Jim Crow laws, the South's opposition to Reconstruction and its political solidarity since then, and "'Southern resentment at 'interference' in their affairs from the 'outside.'"7

It is unnecessary to dispute the thrust of this historical sketch to note its oversimplification of many currents of history and its failure to take into account racial problems and causes of discrimination which exist outside the South and are reflected in the minds of many white people who have not been exposed to the theories or prejudices of the slave system. Yet Professor Konvitz treats this slave system as the sole cause of the vast injustices which the Negro has endured and continues to endure throughout the United States. The authors are not professional historians but legal specialists, and this part of their book is a synopsis and synthesis of the work of others, rather than the product of original research or historical and psychological analysis. It would have been more effective if carefully qualified and set forth with more restraint.8

The next portion of the book deals with federal civil rights legislation. One chapter treats the Civil War amendments and Reconstruction legislation, two are devoted to the Civil Rights Act of 1875 and the Civil

4 Id. at 7.
5 Id. at 11.
7 Konvitz & Leskes 11.
8 The same can be said of parts of the concluding chapter. The South and southerners are making much progress in the fair treatment of Negroes, and despite the greater political power of the Negro in the North, great injustices and inequality of opportunity exist throughout northern cities and states. While the conclusion gives a nod to this, id. at 270, the thrust is to blame all Negro problems on the South.
Rights Cases of 1883, and the last of the four chapters in the section sketches the birth and death of the separate-but-equal doctrine and, very briefly, the beginnings of the sit-in movement in the South.

The chapters dealing with the 1875 statute contain much detailed legal analysis, particularly in the discussion of the majority and dissenting opinions in the Civil Rights Cases. The legislative history of the Civil Rights Act of 1875 is interesting and detailed, and in the chapter\(^9\) setting it forth, Professor Konvitz makes particularly useful reference to some of the statements made on the floor of Congress during the debates on the act. They might be made in a similar debate today without any appearance of anachronism. Then, as now, the argument was that the passage of time, without moral or economic pressures from the outside, would do away with the roots and causes of discrimination and lead to equality of opportunity for all citizens regardless of race.

The emphasis on the 1875 statute and the Civil Rights Cases derives from the central concern of the book with equality in the enjoyment of accommodations in places of public resort, which Professor Konvitz refers to as "basic human rights."\(^10\) Accordingly, the book’s major contribution in the federal field is the analysis of the legal aspects of the sit-in demonstrations.\(^11\) Quoted is a statement made in the spring of 1960 by Governor Leroy Collins of Florida that while it is unfair and morally wrong for a department store which invites trade from all persons to refuse service to Negroes in one part of its store, the department store had a legal right to do this.\(^12\) The thesis of the book is that, on this legal question, Governor Collins was wrong.

The first of the sit-in cases has recently been decided by the Supreme Court.\(^13\) These cases, which came up from Baton Rouge, Louisiana, all involved the kind of accommodation to which Governor Collins referred—public places where the patronage of Negroes as well as whites was solicited in the first instance. They also involved, according to positions taken by counsel for the petitioners and by the United States as amicus curiae, voluntary enforcement by the police of the City of Baton Rouge of a policy of segregation which existed as a public and official matter, wholly apart from the personal wishes of the owners of the places involved. On this view of the cases, the Department of Justice supported

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\(^9\) Id. at 90-101.
\(^10\) Id. at 93.
\(^11\) Id. at 135-52.
\(^12\) Id. at 138.
the position advanced by the petitioners that the convictions on breach of peace charges were unconstitutional.\(^\text{14}\)

The Court in fact decided the cases on an even narrower ground, also advanced by the Government, that there was no evidence in the records to support convictions of the defendants for disturbing the peace.\(^\text{15}\) The Court, Justices Douglas and Harlan concurring on broader, separate grounds, deliberately and obviously refrained from expressing any view on the basic issue of the right of a restaurant owner to invoke the processes of the law to remove Negroes from his premises because of their race.

Since other cases involving these questions are before the Court, and since I appeared on the brief filed by the United States in the first cases, it would be inappropriate to discuss in any detail the legal analysis made by Professor Konvitz on the sit-in question. In brief, however, he contends that state action is involved whenever there is an arrest, that the arrest constitutes governmental aid to private racial discrimination, and that such governmental aid is a violation of the fourteenth amendment under the decision of the Supreme Court in *Shelley v. Kraemer*.\(^\text{16}\) In addition, occasional emphasis is put on an assumed state or municipal policy of racial discrimination which is being implemented by individual proprietors.\(^\text{17}\) It is not clear to me what view would be taken if, for example, a private restaurant owner in the State of Oregon were to refuse service to Negroes as a matter of private prejudice and to invoke the aid of the police to have removed from the restaurant any Negro who refused to leave voluntarily. The case would differ from those where the proprietor seeks the trade of all persons in at least two ways: first, the restaurant would not be a public place inviting the patronage of Negroes generally, as is true of a department store, a drug store or a bus station; and second, no assumption could be made concerning a state or municipal custom of racial discrimination. It seems that Professor Konvitz would not distinguish at all between a lunchroom in a department store and a hot dog stand open to the public generally, except Negroes,\(^\text{18}\) but I cannot tell how he feels, as a legal matter, about the question posed above.

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\(^{14}\) Id. at 162–63.

\(^{15}\) Id. at 163–64.

\(^{16}\) Konvitz & Leskes 142, 144–45, 147–52.

\(^{17}\) "The proprietor does not practice segregation as an isolated private person. He acts in response to and in accordance with the policy of the state or municipality, just as if he were enforcing a state or local law." Id. at 142.

\(^{18}\) Id. at 139.
Apart from the legal analysis, I think that it is appropriate and proper for me to mention two aspects of this problem not fully explored in the book. One is the significant progress which has been made in many cities, not through court action, but through private and public acceptance of the opening of public accommodations to Negroes. The book makes passing reference to these events but that is all. To me they are one of the most heartening of many recent advances in the area of civil rights, and on the whole I think it well that they were taken as a matter of economic pressure and of acceptance of racial advancement and morality, as has been true, for example, in Atlanta and Dallas last year, rather than under the pressure of law.

The other point to which I think more consideration should have been given is the problem of self-help. The legal analysis in the book suggests three courses for the owner of a restaurant: to close the lunch counter, to remove the seats and serve customers standing, or to call the police and have the demonstrators removed. It is only in the last case that the question of state action arises and the constitutional doctrines on which Professor Konvitz relies come into play. He does not say what the legal consequences would be if the proprietor tried to force sit-in demonstrators to leave the establishment without calling in the police, although this is a problem inherent in the situation. I do not suggest that it is an insurmountable one, but I should have liked to see full discussion of it.

It is again a mark of the difference between the scope of the book itself and the scope of its title that the discussion of federal law and federal legislation makes only a cursory analysis of the federal Civil Rights Acts of 1957 and 1960. The text of the statutes is summarized and some of their political history given, but their significance is minimized, and no thorough consideration is given to their potential. It is my own belief that the remedies of these statutes can be made much more effective through imaginative litigation and plain sweat than was believed possible by most people at the time of their passage. While our experience under the statutes is still limited, effective relief has been

19 Id. at 136.
22 Konvitz & Leskes 145.
25 Konvitz & Leskes 72-89.
26 Sixteen cases charging discrimination in the registration processes of particular coun-
obtained where litigation has been pressed and the court has made full exercise of its equitable powers.

This is illustrated in the litigation in Macon County, Alabama, the seat of Tuskegee Institute. While there had been previous private litigation in the county, among other things to defeat an attempt at gerrymandering, injunctive relief was granted on March 17, 1961, in a suit by the Government to protect voting rights. Only nine Negroes had been registered in the county between October 1958 and the date of the injunction; since then almost 1500 have been registered. In early fall the Justice Department filed an application for further relief, which was granted. As an alternative to court appointed federal voting referees under the 1960 act, two new registration officials were appointed by the Governor to serve as registrars in the county starting last October, and the new Board of Registrars speeded up its work. In contrast to an almost complete cessation in the processing of Negro applicants to vote during the preceding years, seventy-seven applications were processed on October 16, sixty-one on November 5, and one hundred and three on November 20. For the first time in the history of the county, Negroes will have substantial representation at the polls during the elections in 1962. For several months there were a substantial number of additional potential voters on a list waiting to be processed. The supplementary court order required that no applicant be deprived of his right to be registered without discrimination for more than five registration days; as a result, the entire waiting list was processed by the end of February.

In other ways the book's discussion of federal law does not appear to consider, or at least fully to consider, the potentials of the exercise of federal executive power. In one portion of the field of public accommodations where the law previously may have been satisfactory but its enforcement certainly was not, I think it quite startling that, except in a few spots which are now being eliminated, the entire rail and bus transportation system in the South has been desegregated since last May. In the less dramatic but certainly crucial area of employment, the President's Committee on Equal Employment Opportunity has

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changed in a short time the patterns of employment in many companies handling government contracts. While these are changes only in pattern and direction at the moment, enforcement procedures are now being devised which will have far greater impact than that which could be achieved by legislation setting up administrative machinery limited to the processing and litigating of complaints, as in the case of the state machinery discussed in the excellent chapters on state regulation. No part of this area of federal law is discussed. The authors cannot, of course, be in any way criticized for not discussing what has taken place since the writing of their book; nevertheless, the potential for executive action which has now been taken was widely recognized in 1960 and before, and I think that it is at least fair to say that subsequent events have been such as to suggest that the authors, if they had had prescience, would have included further analysis of the potential for nonlegislative federal action.

On the whole, I think that the most useful portion of the book is the four chapters dealing with state laws against discrimination. These chapters contain detailed facts as to the content of the statutes and decisions taken under them. The national and international importance of the inability of either the federal or the state government to deal with private discrimination in public accommodations has recently been dramatized by the controversy over the restaurants located along route 40, the principal highway between Washington and New York, along which many African diplomats travel between the United Nations and the seat of our Government. I hope, among other things, that Maryland and other states which have under consideration legislation to deal with such problems will note particularly the discussion of the use of administrative remedies initiated by New Jersey in the elimination of racial discrimination in public accommodations.

Burke Marshall*

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30 Konvitz & Leskes 155-251.

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Anyone who has traveled between Washington and New York recognizes the part that competition plays within and between the regulated industries. Given good weather the traveler can choose among frequent, low-cost, crowded commuter planes, a comfortable "business-man's" flight during the cocktail hour, or a hectic (for the hostess) dinner flight. He is also offered a wide choice in the type and size of plane in which to fly, although jet aircraft are presently banned from Washington National Airport. When the weather is bad, the only time when many travelers will consider any alternative, he is limited to whatever transportation is available on the ground. Here there is wider variety. There was a time when a traveler might choose between the fast Pennsylvania electric trains and the comfortable, slower B. & O. steam-powered service. Now the only choice is between the few modern cars and the many shabby ones on the Pennsylvania line. But the New York bound traveler might also go by air-conditioned bus over the turnpikes, or rent a car for the trip or drive his own.

A fickle public has shifted its patronage from one to the other of these industries over the years and even from one company to another. The railroads once dominated the route to New York. Now, crowded out of the way by automobiles, airplanes and buses, the transportation of persons has become an unwanted, uneconomic liability of the railroads. Speed, comfort, price, and the glamour of newer modes of travel have all played a role in this competitive process. And while the railroads' experience with freight transportation has not been as disastrous, competition from motor carriers has grown more fierce over the years.

Competition between and within these regulated industries has not always taken the form of lower prices, improved service or more modern equipment. Efforts have sometimes been made to induce state and federal governments to intervene in the competitive process in support of one carrier over another, as happened when the legislators of Pennsylvania were persuaded by the railroads to enact legislation which would hamstring the motor carriers.¹

The very regulatory process itself has become grist for the mills of competition. Many of the troublesome delays, vacillations and incon-

sistencies found in regulatory actions find their genesis in the vigorous activities of competitors which spill over into the regulatory proceedings.

In this fourth volume in the Trade Regulation Series, edited by S. Chesterfield Oppenheim, Professor Carl H. Fulda of The Ohio State University has undertaken to examine the accommodation of the philosophy of competition with the philosophy of the regulatory statutes, insofar as they apply to certain of the transportation industries engaged in interstate and foreign commerce under the jurisdiction of the Interstate Commerce Commission, the Civil Aeronautics Board and the Federal Maritime Board, in an effort to evolve a substantive philosophy as to the respective functions of competition and regulation. A simple listing of the industries covered in this volume indicates the magnitude and challenge of the task which the author has undertaken: railroads, motor carriers, water carriers, commercial aviation, freight forwarders and international shipping.

Professor Fulda has focused his analysis of applicable legislative history, rules, regulations and decisions of the regulatory agencies, and the decisions of courts arising therefrom, on three aspects which have competitive overtones: freedom of entry, mergers, and agreements between competitors as to rates and other cooperative arrangements. The regulatory statutes with which he is concerned date from different periods of our history, were designed to meet particular problems and complaints, and were moulded with a view to the nature of the industry concerned. While attempts have been made to bring these statutes up to date from time to time, the lag between economic developments and remedial legislation is the true source of some of the allegedly defective administration of the regulatory statutes.

Professor Fulda begins with a discussion of the acts under which the ICC, the CAB and the FMB regulate the transportation industries with which this book is concerned. Then he discusses briefly the nature of competition between the different modes of transportation, particularly the railroads, motor carriers and water carriers regulated by the ICC. Next he analyzes competition and regulation between and among railroads, motor carriers, water carriers, commercial aviation lines and freight forwarders. In the course of this discussion Professor Fulda

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2 Now the Federal Maritime Commission.
3 Professor Fulda proposes to take up in a later volume the industries which are regulated by the Federal Communications Commission and the Federal Power Commission. This later study will include natural gas pipelines under the jurisdiction of the FPC and other pipelines under the jurisdiction of the Interstate Commerce Commission.
points out, where appropriate, the legislative history requisite to a correct understanding of the statute in question. As a useful addendum he has carefully accumulated at the end of several of the chapters brief references to agency decisions affecting competition.

Rate agreements among competing carriers have experienced heavy weather before the Supreme Court. By its decisions in United States v. Trans-Missouri Freight Ass'n⁴ and United States v. Joint Traffic Ass'n⁵ agreements between competing railroads to establish "reasonable and just rates, fares, rules and regulations on state and interstate traffic"⁶ were held to violate the Sherman Act. Despite these blows, rate bureaus continued to exist in the rail, motor and water carrier industries, with the blessings of the ICC, until stunned again by the Supreme Court in 1945 upon a finding that "regulated industries are not per se exempt from the Sherman Act"⁷ and that "none of the powers acquired by the [Interstate Commerce] Commission since the enactment of the Sherman Act relates to the regulation of rate-fixing combinations."⁸ Whereupon Congress in 1948 enacted, over President Truman's veto, the so-called Reid-Bullwinkle Act⁹ which authorized the Commission to approve rate agreements among competing carriers and to relieve the parties thereto of liability under the antitrust laws if the Commission finds that this exemption would further the National Transportation Policy. Approval is prohibited where each party to the agreement does not have "the free and unrestrained right to take independent action either before or after any determination arrived at"¹⁰ through a procedure for joint determination. In a careful analysis of this statute and its aftermath, Professor Fulda calls this latter provision "the heart of the act."¹¹

From rate agreements on the domestic scene, Professor Fulda turns to rate agreements in international shipping. Here we have an even more vivid example of the transitory and kaleidoscopic nature of the problem which the author has so well presented in his book.

Most of the steamship lines making scheduled sailings over most of the world's trade routes have organized into formal associations known

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⁴ 166 U.S. 290 (1897).
⁵ 171 U.S. 505 (1898).
⁶ Id. at 506.
⁸ Id. at 457.
¹¹ Fulda, Competition in the Regulated Industries: Transportation 292 (1961) [hereinafter cited as Fulda].
as "steamship conferences." Ships belonging to over one hundred such conferences periodically ply the trade routes to and from the United States.\textsuperscript{12} In 1958 the Supreme Court in \textit{FMB v. Isbrandtsen Co.}\textsuperscript{18} held that the dual-rate contract system designed to provide a rate reduction to shippers consistently using conference lines violated section 14 of the Shipping Act of 1916\textsuperscript{14} if employed as "predatory devices," even though the conference agreement had been approved by the FMB. Congress immediately suspended the full effect of the \textit{Isbrandtsen} decision while it undertook to determine what further legislation was necessary. At the time Professor Fulda's book went to press, the outcome was still uncertain. However, in October 1961 Congress enacted new legislation\textsuperscript{15} authorizing the Board, on application, to permit dual-rate contracts which satisfy certain specific requirements designed to protect shippers and to ensure Board supervision, despite the fact that such contracts have the effect of excluding independent competition.\textsuperscript{16} The supervisory power bestowed on the Board has caused considerable anxiety and indignation among foreign flag lines and maritime countries.

Returning to the problem of competition between modes of transportation, Professor Fulda discusses the duty of the ICC to consider the effect of rates on competition among the modes of transportation which it regulates as a part of its responsibility to carry out the National Transportation Policy. This issue is most clear cut when the survival of one of the competing modes is threatened. Then, Professor Fulda argues, "the needs of shippers and consignees for the 'inherent advantages' of the threatened mode should be decisive."\textsuperscript{17} But to know when rates are destructive one has to know when they are compensatory. What is missing is a predictable basis for competitive ratemaking. The author suggests that any departure from fully distributed costs should be the standard governing suspensions of rate changes in such competitive situations.\textsuperscript{18}

\textsuperscript{13} 356 U.S. 481 (1958).
\textsuperscript{17} Fulda 369.
\textsuperscript{18} Id. at 458.
analysis of the decisions of the ICC in cases involving proposed or actual common ownership and control of more than one mode of transportation. The railroads have long been hampered by statute in their efforts to own and operate motor carriers which would permit them to provide speedier, more efficient, low-cost service. Having joined the ranks of the most vocal proponents of the right to compete, they complain that this discriminatory treatment is now an anachronism, stemming as it does from a time when the railroads had an economic power they do not enjoy today.

Before coming to his conclusions Professor Fulda notes briefly the problem of reconciling the roles played by the courts in the enforcement of the antitrust laws and by the administrative agencies in carrying out the regulatory statutes. This is the battleground of the doctrine of primary jurisdiction. The conflict stems from the fact that the regulatory agency sometimes sanctions what the antitrust laws forbid. As a result, issues often arise which may be cognizable by both court and agency. Whether Congress intended to have the regulatory action supersede the antitrust laws so as to bring about an exemption from them is a substantive question which only the courts can resolve in the last analysis.

Do civil and criminal antitrust proceedings survive agency approval insofar as action giving rise to such proceedings occurred before approval became effective? If they do not, then the court must await an agency decision before deciding the antitrust matter. Professor Fulda appears to favor the rigorist view that "the antitrust laws remain applicable unless and until agency approval is granted; then, and only then, and not one second earlier, does relief from antitrust liability become effective."21

It is questionable, in this reviewer's mind, whether a rigid application of this principle is realistic. To arrange a merger, to initiate an expansion program, rate reduction or improved service may require a great deal of detailed ground work. Preliminary agreements with potential customers, equipment suppliers, sources of capital, engineers and consultants of all sorts may be necessary to permit the applicant to demonstrate to the satisfaction of the regulatory agency that the proposal is viable and in the public interest. Preliminary steps reasonably necessary to the preparation of a proposal for presentation to the regulatory

21 Fulda 444.
agency for its approval should enjoy, I believe, the same exemption that the approved action would enjoy. And even if the agency does not ultimately authorize the project, it may not be prudent to prosecute those who have taken these preliminary steps in anticipation of commission approval. Any other approach to this problem might lead to one of two effects, neither of which is in the public interest. Either it would stifle efforts to put together complicated projects in highly competitive situations where cooperative efforts are required because the entrepreneurs would fear prosecution under the antitrust laws should they be unsuccessful, or the regulatory commission would be subjected to enormous extra-record pressures emanating from those fearful of the results of failure.

Professor Fulda has presented what he accurately calls "an ever changing picture at a particular moment of time."22 During the course of his analysis he pauses from time to time to evaluate what has been done and to give his views as to why and how greater competition might be permitted. His conclusions, because of their modesty in the face of very complex situations, deserve careful consideration.

"Limitations on freedom of entry are necessary as a safeguard against oversupply of transportation facilities."23 However, too severe limitations on entry of new or expansion of existing direct carriage, as in the case of motor carriers, may deny the public the benefit of superior and cheaper service. "[C]ost and quality as distinguished from mediocrity of service should be considered of paramount importance in certification cases."24

Contrasting the actions of the CAB with the ICC, the author observes that the CAB has granted competitive route authorizations, even though minimum standards of adequate service were met by existing carriers. However, he notes, authorized competition does not guarantee actual competition.25

Lawyers specializing in the practice before the ICC, CAB or FMB might wish to add to the list of problems which Professor Fulda discusses. Proponents of competition n'importe quoi will wish he had spent more time analyzing the actual state of competition in each of these industries, the reasons why there is not more, and precisely how competition could be better enforced. But competition is not something that

22 Id. at 459.
23 Id. at 456.
24 Id. at 457.
25 Id. at 458.
readily lends itself to imposition by legislative fiat. Its source is ultimately in the wills and minds of men. At most it can be encouraged and unfettered. For this reason I believe it is too much to say with Professor Fulda that the antitrust laws "ordain that competition shall be the motivating force of business conduct." But certainly those laws were designed to remove certain man-made impediments to competition which are not in the public interest.

The author has compressed within a very small space the results of an enormous amount of patient research and thoughtful study. His book provides a clear, easily readable introduction to the competition-regulation problems of a group of very important regulated industries within which a large amount of competition abounds. Only on the basis of such expositions can legislative and administrative reforms be intelligently discussed and properly evaluated.

JOHN T. MILLER, JR.*


The real contribution of this book is its demonstration that right-to-work laws are germinal and that by an almost ineluctable logic they flower into principles which clash head on with the philosophy supporting the federal labor policy. To this extent right-to-work laws resuscitate old powers of the courts under the common law. Only the federal law can mark out the limits of these powers, and the extent and force of the federal law is still hard to discern.

Though the book is cast in a legal format, with copious citations from cases and briefs and with a great deal of case analysis, yet it is not, nor does it seem meant to be, a book about the law. The cases are too few in any one jurisdiction, too scattered in all, too dependent on courts of first instance, to do more than to adumbrate the possibility of a dynamic antiunion philosophy. Arguments are culled equally from briefs and opinions, from dicta and holdings, to show what right-to-work laws could mean if they were unchecked by federal law. Yet the lawyer may profit in considering how to adjust the conflicting views expressed in state statutes and federal legislation.

Through the book runs a discussion of two opposing viewpoints as to

26 Id. at 3.

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the meaning of right-to-work laws. Those proposing right-to-work laws have generally adopted a "contractual approach"; they have been concerned with prohibiting those labor contracts which condition employment upon membership in a union. Aimed at curbing compulsory unionism, the right-to-work law is generally not a part of broader legislation marking out the rights of unions and union men. Thus, as the author goes on to show, the effort to guarantee complete freedom from compulsory unionism has resulted in efforts and arguments, with varying success, to limit union organizational techniques and representational claims.

On the other hand, those opposing right-to-work laws share an "integral viewpoint." They have insisted that there is a necessary interdependence between unionism, collective bargaining and a union-security contract. This is the view which has led unions to establish job control by a setting up of jurisdictional claims and by an insistence upon a closed or union shop.

A few points might perhaps have been more strongly highlighted. That some balance should be struck between the right to organize and the right not to join a union has been recognized in federal labor policy. Thus the closed shop has been outlawed, and an employee may not be discharged under a union-shop agreement so long as he pays his dues. Hence the right-to-work laws do not differ from the federal law so much in being opposed to "compulsory unionism" as in making this opposition the core of a labor policy. Secondly, many of the arguments favoring right-to-work laws presume that under the federal law an employer must recognize the bargaining representative of a majority of his employees. So it is argued that the union has protection enough for its legitimate interests without having a union shop. Yet it must be borne in mind that the federal protection does not extend to purely intrastate commerce. And whether and to what extent it protects in other cases is a thorny question.

There are two main areas of discussion in the book. The first is mostly background material—an exposition of the historical antecedents of the right-to-work laws\(^1\) and an outline of certain established principles of federal law: free speech and picketing,\(^2\) preemption,\(^3\) and Supreme Court decisions on the constitutionality of the right-to-work

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2 Id. at 50-52, 55-57, 114-16.
3 Id. ch. IX.
laws.\textsuperscript{4} This area is too well known and too briefly treated to be significant, but it serves to place the remaining materials in context for the nonlawyer. One reading the remainder will conclude that right-to-work laws are not concerned only with the abolition of the union shop; the author has persuasively indicated that right-to-work laws can be a military position from which the economic battle can be commanded. However, the implication that the courts apply the law beyond its intended contract situation\textsuperscript{5} is somewhat weakened by the fact that three of the six states discussed have enacted laws clearly prohibiting picketing for a closed-shop demand.\textsuperscript{6} Again, while showing that collective bargaining can be restricted in right-to-work states,\textsuperscript{7} the author seems to assume that collective bargaining is an enforceable legal right in the absence of right-to-work laws. This, however, depends upon the law of the state, and while the common law may be reflected in the right-to-work laws, it seems to put the cart before the horse to blame the right-to-work law for the judicial decisions. Nevertheless, though the book does point out that some courts have construed the statutes narrowly, it seems clear that right-to-work laws can be a point of legal departure for restrictions on picketing, hiring halls and collective bargaining.

The most complicated legal question treated in the book is that of preemption. While admitting that the precise limits of state action have not been defined, this reviewer takes some exceptions to the analysis and conclusions proposed by the author. Relying on a state lower-court decision,\textsuperscript{8} the author concludes\textsuperscript{9} that \textit{Local 429, IBEW v. Farnsworth & Chambers Co.}\textsuperscript{10} is no bar to the "use of the state court injunction to enjoin picketing which might force an employer to violations of the Right-to-Work Law."\textsuperscript{11} The whole history of the preemption doctrine in labor relations seems to indicate that \textit{Farnsworth & Chambers} stands for the proposition that state courts lack the power to enjoin picketing of an interstate employer on the ground that it violates a right-to-work law of the state. This conclusion is fortified by numerous state deci-

\textsuperscript{4} Id. ch. IV.
\textsuperscript{5} Id. ch. V.
\textsuperscript{7} Dempsey ch. VII.
\textsuperscript{8} Pruitt v. Lambert, 41 L.R.R.M. 2369 (Tenn. Ch. 1957).
\textsuperscript{9} Dempsey 118.
\textsuperscript{10} 353 U.S. 969, reversing per curiam 201 Tenn. 329, 299 S.W.2d 8 (1957).
\textsuperscript{11} Dempsey 114.
sions,12 by the adoption of section 8(b)(7) of the National Labor Relations Act13 prohibiting recognitional picketing, and by De Vries v. Baumgartner's Elec. Constr. Co.,14 in which a state court was prohibited from awarding damages resulting from the picketing by a union of an interstate employer for an objective in violation of the state right-to-work law. Hence, as a practical matter, it should be concluded that, as regards union activities in interstate commerce, right-to-work laws are circumstances to be considered by the National Labor Relations Board in unfair-labor-practice proceedings. In such proceedings the protection of workers from compulsory unionism will be balanced against the other stated aims of the federal law. Hence, contrary to what has been experienced in some state courts,16 the NLRB could permit picketing to protest sub-standard wages18 without finding an objective which is violative of the right-to-work laws. Thus the impact of these state laws in the field of interstate commerce will continue to be limited—an opinion which the author shares.17

The paucity of cases found by the author in what appears to be an exhaustive study would indicate that the right-to-work laws have not had a great impact on union activities in intrastate commerce. It would be interesting to know whether this is due to conformity to the law by the unions, to a toleration of union shops and closed shops by management, to a lack of effort to unionize small intrastate businesses, to an inability on the part of small business to fight union demands, or to some other causes.

The book closes with a reference to section 14(c) of the NLRA18 which, in 1959, granted to the states jurisdiction over cases declined by the NLRB. Whether or not this cession of jurisdiction will lead to state inroads on federal policy is not yet clear. Though this jurisdictional grant may modify in part Farnsworth & Chambers, this reviewer be-

15 See Dempsey chs. V, VII.
17 Dempsey 122.
lies, contrary to most comment on the matter, that state law cannot be applied so as to destroy federally guaranteed rights.\textsuperscript{19} If he is in error, the Landrum-Griffin Act\textsuperscript{20} may be the field in which antiunion sentiment will yet flourish.

One severe stricture must be mentioned. The book is filled with misspellings in the body and in quotations, typographical errors and wrong citations. There is an inconsistency of punctuation and of citation form that is disturbing and sometimes misleading. For instance, on page 107: the first word is a typographical error; footnote 8 should refer to the third sentence in the next-to-last paragraph; the same footnote should refer to A.L.R.2d, not A.L.R.; and the case which is footnoted can be found in 202 Tenn. 580, 308 S.W.2d 381 (1957), though no case citation is offered. It would serve no purpose to list the many errors which are found in a casual reading, but the publisher is to be censured for issuing a book in a format so scholarly and yet so filled with errors and inconsistencies.

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