RECENT CASES

BANKRUPTCY—Employees' Profit Sharing Trust Held Outside Purview of Bankruptcy Act Section 4(a)

The management company for a large number of cemetery corporations created a profit sharing trust fund for the benefit of its employees. The trust agreement provided that title to trust assets would be registered in the name of the trust, but gave to the trustees powers in relation to the assets similar to those which an individual might exercise over his own property.[1] It also purported to limit the trustees' personal liability to willful dereliction and gross negligence,[2] contemplated perpetual existence,[3] and forbade the issuance of transferable shares to the beneficiaries. Employee-beneficiaries were accorded rights limited to electing some of the trustees and designating a recipient for any earned benefit not distributed at the time of the employee's death. The trustees acquired stock of seventeen corporations, voted and encumbered the shares, and had contracted to purchase others. Subsequently, several trustees filed a petition under the federal Bankruptcy Act.[4] The referee entered an order adjudicating the trust bankrupt, but the district court set it aside and dismissed the petition.[5] The court of appeals, affirming, held that a mere private trust fund was not entitled to the benefits of the act. *Associated Cemetery Management, Inc. v. Barnes,* 268 F.2d 97 (8th Cir. 1959).

Determination of who may become a voluntary bankrupt requires correlation of three sections of the Bankruptcy Act. Section 4(a) provides that any person, with certain exceptions, may file a voluntary petition.[6] "Person" is defined to include "corporations" [7] which in turn is used as a word of art pertaining to any body with form of organization or extent of powers sufficiently similar to a corporation to warrant corporate treatment under the act.[8] Judicial gloss of the terms has permitted divers hybrid

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[1] Record, p. 26, Associated Cemetery Management, Inc. v. Barnes, 268 F.2d 97 (8th Cir. 1959).

[2] *Id.* at 29.

[3] *Id.* at 33.

[4] 30 Stat. 544 (1898), as amended, 11 U.S.C. §§ 1-1255 (1958).

[5] *In re* Associated Cemetery Management, Inc., 170 F. Supp. 298 (W.D. Mo. 1958).

[6] 52 Stat. 845 (1938), 11 U.S.C. § 22(a) (1958).

[7] 52 Stat. 841 (1938), 11 U.S.C. § 1(23) (1958).

[8] "'Corporation' shall include all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships and shall include partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint-stock companies, unincorporated companies and associations, and any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument." 52 Stat. 840 (1938), 11 U.S.C. § 1(8) (1958).

associations [9] to be adjudicated bankrupt.[10] However, despite the broad construction given the definition of corporation, the ordinary trust fund has been held not amenable to federal bankruptcy proceedings.[11] In the instant case petitioner attempted to prove that the employees' profit sharing trust in question was not an ordinary trust but rather an entity endowed with enough corporate trappings to be encompassed by the "corporation" terminology elucidated by prior federal bankruptcy cases.

In order to discover whether this profit sharing trust was the type of entity contemplated by the Bankruptcy Act,[12] the court examined the settlement agreement to ascertain the purposes of the trust, the powers and duties of its trustees, and the rights of the beneficiaries. In construing one phrase in the definition of "corporation"—"unincorporated companies and associations" [13]—the court, ignoring the effect of state law,[14] took as its

[9] See *In re* Poland Union, 77 F.2d 855 (2d Cir. 1935), *modified sub nom.* First Nat'l Bank v. Poland Union, 101 F.2d 54 (2d Cir.), *cert. denied,* 309 U.S. 682 (1940) (cooperative store); *In re* Tidewater Coal Exchange, 280 Fed. 638 (2d Cir.), *cert. denied,* 259 U.S. 584 (1922) (informal nonprofit association to expedite wartime coal shipments); *In re* Order of Sparta, 242 Fed. 235 (3d Cir. 1917) (fraternal group providing insurance benefits); *In re* Philadelphia Consistory, 40 F. Supp. 645 (E.D. Pa. 1941), *aff'd per curiam,* 134 F.2d 333 (3d Cir. 1943) (fraternal organization); *In re* Minnesota Ins. Underwriters, 36 F.2d 371 (D. Minn. 1929) (reciprocal insurance exchange); *In re* Carthage Lodge, 230 Fed. 694 (N.D.N.Y. 1916) (fraternal organization); *In re* Associated Trust, 222 Fed. 1012 (D. Mass. 1914) (Massachusetts trust); *In re* Seaboard Fire Underwriters, 137 Fed. 987 (S.D.N.Y. 1905) (Lloyds insurance company). *But see In re* Lloyds of Texas, 43 F.2d 383 (N.D. Tex. 1930) (Lloyds insurance company). See also notes 10, 13 *infra.*

[10] The above cases were all involuntary petitions which were decided on the basis of § 4(b). See note 13 *infra.* In discussing the phrases "any unincorporated company" and "unincorporated companies and associations" contained in § 1(8), the court in Pope & Cottle Co. v. Fairbanks Realty Trust, 124 F.2d 132 (1st Cir. 1941), expressed doubt as to whether there was any substantial difference between the two. *Id.* at 136.

[11] Pope & Cottle Co. v. Fairbanks Realty Trust, *supra* note 10.

[12] Appellant's first contention, instant case at 101, was that the agreement created a Massachusetts Trust and came within the coverage of the words "any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument." See note 8 *supra;* H.R. REP. No. 877, 69th Cong., 1st Sess. 6 (1926). It is usual for these trusts to issue transferable equitable shares, Hecht v. Malley, 265 U.S. 144, 147 (1924), and inasmuch as the trust agreement in question specifically prohibited such issuance, the court concluded that the statutory language was too explicit to allow for this categorization. Instant case at 101-02.

[13] The words "unincorporated company and association" were added to the definition of corporation in 1926. Act of May 27, 1926, ch. 406, 44 Stat. 662. Inasmuch as this term follows the word "include" which has been interpreted as implying flexibility, *In re* Harper, 175 Fed. 412, 423 (N.D.N.Y. 1910), it would seem that the term is merely illustrative of the type of body amenable under § 4(a). Until 1938, § 4(b), on involuntary bankruptcy, contained the provision that "any unincorporated company" might be adjudicated a bankrupt. Act of July 1, 1898, § 4(b), ch. 541, 30 Stat. 547. These words were deleted from § 4(b) when the addition was made to the definition of "corporation." 52 Stat. 845 (1938), 11 U.S.C. § 22(b) (1958).

[14] Several courts have construed the nature of the subject matter of the proceedings in light of state law. See *In re* Carthage Lodge, 230 Fed. 694 (N.D.N.Y. 1916) (fraternal lodge organized under New York law); *In re* Associated Trust, 222 Fed. 1012, 1013 (D. Mass. 1914) (Massachusetts trust). Others discuss state law but seem to decide the nature and attributes of the subject matter on the basis of the words of the Bankruptcy Act and federal precedent alone. See, *e.g., In re* Seaboard Fire Underwriters, 137 Fed. 987 (S.D.N.Y. 1905). In discussing the nature

criteria standards suggested by two federal precedents, *In re Poland Union*[15] and *Pope & Cottle Co. v. Fairbanks Realty Trust*.[16] Both cases found the act's general definitions of "person" and "corporation" controlling: the former opinion maintained that an unincorporated company was a "group of individuals whose object and purpose are either wholly or chiefly of the same kind as the object and purpose of a moneyed business or commercial corporation," [17] and the latter expanded this conceptualism by adding "and conducting their affairs somewhat after the pattern of corporations." [18] *Poland Union* is an example of the type of hybrid association treated by the courts as falling within the act's definition of "corporation" and hence amenable to bankruptcy proceedings: a cooperative store conducting business under articles of association that provided for an organization similar to a corporation in that officers, directors and transferable shares were used. In *Pope & Cottle* two men about to purchase real estate made their mothers beneficiaries of a revocable spendthrift trust. The beneficiaries contributed no capital and the only power accorded them by the trust instrument was that of appointing a replacement at the death or resignation of any trustee. There the court found the arrangement to be an ordinary express trust and, though noting that the phrase "unincorporated companies and associations" does not admit of easy interpretation,[19] concluded that trusts as such were not allowed the benefits of the act inasmuch as the beneficiaries had "not associated themselves together for the conduct of a business with powers similar to those of stockholders in corporations . . . ." [20]

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of a Massachusetts trust before the specific provision concerning these organizations was added to the act, one court stated: "Undoubtedly, such associations . . . are held by the Massachusetts courts to be, for certain narrowly limited purposes, partnerships. But it does not at all follow that under federal law they cannot be properly adjudicated bankrupt as unincorporated companies." Gallagher v. Hannigan, 5 F.2d 171, 174 (1st Cir. 1925).

[15] 77 F.2d 855 (2d Cir. 1935).

[16] 124 F.2d 132 (1st Cir. 1941).

[17] 77 F.2d at 856. This case involved a petition for reorganization under § 77B of the act. Act of June 7, 1934, ch. 424, § 1, 48 Stat. 912. In terms of New York law the Poland Union was held to be a joint-stock company and, for purposes of the act, an unincorporated company.

[18] 124 F.2d at 134. There, an involuntary petition and a petition for reorganization under Chapter X of the Chandler Act, 52 Stat. 885 (1938), as amended, 11 U.S.C. § 526 (1958), were involved and the general definitions were considered at length.

[19] "The phrase [any unincorporated company] has been a puzzling one for the courts. . . . [The] courts have not attempted to give any comprehensive definition of 'unincorporated company' but have been inclined to decide each case on its facts as it arose." 124 F.2d at 134 (Magruder, J.). Compare MACLACHLAN, BANKRUPTCY § 354 (1956): "The assertion in the 1926 Amendment that 'corporation' includes unincorporated associations is paradoxical and correspondingly impractical in conception. This definition has not actually caused the trouble it might be expected to cause. Bankrupts may be corporations, partnerships, or individuals. The definitions in the Bankruptcy Act indicate a preference for administering the associations as corporations, when it is practical and when there is any valid legal reason for doing so."

[20] 124 F.2d at 135.

Courts have tended not to recognize pecuniary organizations—such as those involved in *Poland Union* and *In re Sargent Lumber Co.*[21]—as "unincorporated companies or associations" unless there has been contribution to capital by shareholders or beneficiaries. In the instant case the beneficiaries were not obligated to contribute funds to the trust—this was done by the settlor company. Nor did the beneficiaries purposefully associate themselves in an employees' trust as did the *Poland Union* shareholders in an operating business.[22] And finally, the trustees of the employees' trust were given powers over the trust property as if they, as individuals, owned it; such was not the case in the imitative corporate form contemplated by the articles of association in *Poland Union.* From an economic standpoint an employees' profit sharing trust is somewhat different from the ordinary trust established to benefit infants or the aged.[23] There are more beneficiaries than in the ordinary situation; beneficiaries may change as employees join or leave the settlor company; and the motives for establishment may also differ—an employees' trust may be created to provide fringe benefits rather than because the employees are the natural objects of the settlor's bounty. But these distinctions fail to support a differentiation in bankruptcy treatment between the ordinary trust—as found in *Pope & Cottle*—and the situation described in the instant case.

The court in the instant case failed to speak directly to whether the trust was a "body" endowed with "any of the powers and privileges of private corporations not possessed by individuals and partnerships" [24]—characteristics of a "corporation" as defined by the statute. This phrase contains two requisites: a body, and corporate powers and privileges conferred thereupon. Institutionally, the trust designates a relationship among individuals as individuals,[25] and neither this relationship nor the trust corpus amounts to a legal entity.[26] And even if an entity were found, it

[21] 287 Fed. 154 (E.D. Ark. 1923). There, an organization of shareholders who contributed to a capital fund and elected trustees who were granted "'all the powers incident to such officers in the case of a corporation'" was adjudicated a voluntary bankrupt.

[22] *Cf. In re* Bloom, 10 F. Supp. 806 (N.D. Ill. 1935) (father conveyed real estate subject to mortgage to trustee for the use of son, trustee held to be a person and not a corporation for purposes of composition under § 74).

[23] See generally Note, *Protection of Beneficiaries Under Employee Benefit Plans*, 58 COLUM. L. REV. 78 (1958).

[24] See note 8 *supra.* In a leading case, *In re* Carthage Lodge, 230 Fed. 694 (N.D.N.Y. 1916), a fraternal organization chartered under the laws of New York was held to possess the attributes of a corporation in that the "trustees" could hold and sue for the recovery of land in their names at the direction of the members, issue bonds to finance the purchase of land, and manage the affairs of the lodge. A more recent case, *In re* Philadelphia Consistory, 40 F. Supp. 645 (E.D. Pa. 1941), held another lodge amenable after the opinion reiterated the allegations of the petitioner that it had a common name, a constitution and by-laws, elected governing trustees, could own property, could sue and be sued, and acted by its trustees.

[25] 1 RESTATEMENT (SECOND), TRUSTS § 2 (1959). *But cf.* Greenough v. Tax Assessor, 331 U.S. 486, 493-94 (1947).

[26] BOGERT, TRUSTS & TRUSTEES § 712, at 450 (2d ed. 1960).

must meet the second statutory requirement of corporate powers and privileges. To ascertain this, the court might have compared the powers purportedly granted by the trust agreement against those inherent in individuals; in other words, did the trust possess any corporate incidents which it, or its trustees as individuals in a fiduciary capacity, could not otherwise attain? The opinion did note that the trustees could, among other broad powers, invest trust funds in securities as well as vote and encumber them. Petitioners relied heavily upon this ability to invest; [27] and to prove that the trust was a "body" they emphasized the agreement's stipulation that the trust would be a "legal entity" [28] and also that the trustees would not be liable to third parties except for gross negligence.[29] It is difficult, however, to envision the creation of such privileges and immunities without compliance with some authorizing statute.[30] Neither the investment of trust funds in securities nor the subsequent use of those securities as collateral for a loan lies beyond the powers of trustees as individuals when, as in the instant case, the powers are expressly provided for by the settlor.[31] Therefore, in the context of the act, this power is not one not possessed by individuals. And while the Rule Against Perpetuities does not, by local statute,[32] apply to an employees' trust fund, it cannot be said that the corporate attribute of indefinite existence will create an entity where one does not already exist.[33]

Disallowance of adjudicating the trust as an entity does not disserve the purposes of the Bankruptcy Act by allowing favoritism toward particular creditors or denying relief to the honest debtor who wishes to return to the business world discharged from debt.[34] Indeed, there is no business

[27] See Brief for Appellant, p. 17.

[28] *Id.* at 16.

[29] *Id.* at 19.

[30] *Cf.* Pope & Cottle Co. v. Fairbanks Realty Trust, 124 F.2d 132, 135 (1st Cir. 1941): "It is hardly necessary to point out that the Fairbanks Realty Trust is not a body 'having any of the powers and privileges of private corporations not possessed by individuals or partnerships.' It is not organized under any law giving special privileges."

[31] BOGERT, *op. cit. supra* note 26, § 711.

[32] MO. ANN. STAT. § 456.060 (1956).

[33] The court in the instant case concluded that the trust was not a "person," without extended discussion of that word. Courts usually do not focus on this particular term—perhaps because of its imprecision or because judges believe it is merely a shorthand method of referring to the definition of "corporation"—but rather decide doubtful cases on the definition of "corporation"; it has, however, been specifically held that for purposes of the act the *trustee* of an express trust is a "person" as contemplated by the act, and not a "corporation." *In re* Bloom, 10 F. Supp. 806 (N.D. Ill. 1935). Of the four classes of "persons," two (officers and women) are human beings, another (corporation) is usually considered a juristic person, and the fourth (partnerships) is an entity or juristic person by force of the statute itself. 1 COLLIER, BANKRUPTCY § 5.03 (14th ed. 1956). Therefore, inasmuch as neither common law nor another section of the act considers the trust relationship as forming a juristic person or legal entity, it would seem excluded under the definition of "person" in the light of the illustrations provided in § 1(8). See note 8 *supra*.

[34] See 1 REMINGTON, BANKRUPTCY § 17 (5th ed. 1950).

to which the profit sharing trust may reasonably be expected to return;[35] and, assuming that the trustee or trustees can be subjected to bankruptcy proceedings as a "person," [36] the possibility remains that creditors may yet obtain payment out of the trust corpus. Trust law gives to the trustee a right of reimbursement from the fund where he has personally satisfied a liability on an intra vires contract,[37] and he may properly use trust funds to exonerate this liability.[38] As for pursuing this right into bankruptcy proceedings, the act provides that the trustee in bankruptcy is vested with the bankrupt's title in certain property including rights of action.[39] It is

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[35] *Cf.* MacLachlan, Bankruptcy § 354 (1956).

[36] The problem of liquidating a trust without the machinery of the act is not dealt with at length by the text writers and there is a paucity of cases on the point, perhaps because trustees are held to high standards of investment and administration with the result that trust insolvency is an infrequent occurrence. The § 4 prohibition on bankruptcy proceedings for banking corporations also contributes to the lack of cases under the act, inasmuch as banks and trust companies probably have title to a large number of trust funds. Regarding liquidation of trusts, Glenn states without citation of authority that "the trust of the sort that was known to our grandfathers does not require liquidation by the use of bankruptcy or general assignment. This method of ownership being a creation of the equitable process solely, not only is its liquidation for a court of equity, but the jurisdiction is ample for that purpose." Glenn, Liquidation § 72 (1935). "[L]iquidation of a trust estate, in whatever form we may find it, is essentially the business of courts of equity." *Id.* at § 148. The same section also states that the appointment of a receiver in equity is not necessary. However, bankruptcy jurisdiction in a state court rather than in the district court would pose problems concerning, *e.g.*, the power of a receiver, if one were appointed, to sue in foreign jurisdictions, O'Connell v. Smith, 131 S.W.2d 730 (Mo. Ct. App. 1939); provision for ratable apportionment among creditors to avoid "the race to the courthouse door," *ibid.*; the effectiveness of a discharge against nonresident creditors, 5 Remington, Bankruptcy § 2112 (5th ed. 1950); the status of a receiver in relation to the trust property, Union Nat'l Bank v. Kansas City Bank, 136 U.S. 223, 236 (1890). Courts of equity will, in some jurisdictions, allow a creditor to be subrogated to the trustee's right to indemnification where the trustee is insolvent. For an extended discussion of whether and by what legal theories a creditor can reach trust funds, see Bogert, *op. cit. supra* note 26, § 716; 3 Scott, Trusts §§ 266-71A (2d ed. 1956). Several situations can be envisioned where the position of the creditors, trustee and trust estate would vary depending on the state of the accounts between trustee and corpus, the financial state of both the trustee and the estate, and on whether subrogation is allowed. For instance, where the trustee is solvent, an action at law by each creditor would suffice; however, where the corpus is insolvent, the trustee would probably not be able to recover the deficiency from the beneficiary, Bogert, *op. cit. supra* note 26, § 718. And where the trustee is insolvent and the corpus solvent, equity may allow the creditors' claims to be subrogated. If subrogation is not allowed it is doubtful that the creditors could sustain a suit against the beneficiary. *Ibid.*

[37] Bogert, *op. cit. supra* note 26, §§ 716, 718; 3 Scott, Trusts § 244 (2d ed. 1956).

[38] Bogert, *op. cit. supra* note 26, § 718; 3 Scott, Trusts §§ 244, 246 (2d ed. 1956); Restatement (Second), Trusts §§ 244, 246 (1959).

[39] "The trustee of the estate of the bankrupt . . . shall in turn be vested by operation of law with the title of the bankrupt . . . to all of the following kinds of property wherever located . . . (5) property, *including rights of action*, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered . . . (6) rights of action arising upon contracts . . . ." 52 Stat. 879 (1938), as amended, 11 U.S.C. § 110(a) (1958). (Emphasis added.) One court has characterized the phrase "rights of action" as a "formal demand made by another in the assertion of a legal or equitable right and instituted upon in a proper tribunal." Chandler v. Nathans, 6 F.2d 725, 729 (3d Cir. 1925). A rule has been stated that title to property impressed with a trust does not vest in

likely that by this means the trustee in bankruptcy would be subrogated to whatever indemnification rights the bankrupt might possess [40] and that he would be vested with title thereto.[41]

CONSTITUTIONAL LAW—FEDERAL COMMUNICATIONS ACT SECTION 605 HELD NOT TO PRE-EMPT STATE STATUTES PUNISHING WIRETAPPING

Defendant, in association with a private investigator and several telephone company employees, maintained wiretapping plants which supplied defendant's "clients" with information concerning their competitors or

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the bankrupt's trustee where the beneficiary can trace the trust assets. 4 COLLIER, BANKRUPTCY § 70.25 (14th ed. 1956); GLENN, LIQUIDATION § 72 (1935); 3 REMINGTON, BANKRUPTCY § 1212 (5th ed. 1950). The *Restatement* states the rule that "under the National Bankruptcy Act if a trustee becomes bankrupt his trustee in bankruptcy is not a bona fide purchaser of the trust property." 2 RESTATEMENT (SECOND), TRUSTS § 307 (1959). It should be noted that this rule speaks to the trustee in bankruptcy not being vested with title to the trust *res*. Contrast this with the assumption that title to a *claim* against the *res* will pass to the trustee. Furthermore, the *Restatement* rule is based on cases involving constructive trusts and those where contracts were made without direct benefit to the trust estate. No case closely resembling the instant fact situation has been found. For an example of the constructive trust cases, see *In re* States Motors, Inc., 168 F. Supp. 82 (E.D. Mich. 1958) (bankrupt employer's certified check for withholding tax held trust fund under federal statute and therefore unavailable to creditors). A type of transaction which is perhaps closer to the situation under discussion is *In re* Steele-Smith Dry Goods Co., 298 Fed. 812 (N.D. Ala. 1924), where a department store which later became bankrupt leased space and retained lessee's receipts for periodic distribution. It was held that lessee could trace funds despite the fact that bankrupt supplied heat, light, etc., and utility companies may have been among the creditors. In view of the cases on which it relies, the *Restatement* rule may be too broadly stated.

40 *But cf. In re* Furness, 7 F. Supp. 844 (E.D.N.Y. 1934). Here, the bankrupt was trustee of a testamentary trust and had not received compensation for his services prior to bankruptcy. The court held that, inasmuch as under New York decisions his right to compensation was "inchoate" until a proper accounting was made, "no title vested in this trustee [in bankruptcy] to such future allowance under the provision of [§ 70(a)(5)] however broadly this may be interpreted." The policy behind this inchoate rule is based on the belief that if the right to compensation were complete and assignable before the settling of accounts, "a strong incentive to diligence and zeal is wanting, and the temptation to be content with lax or perfunctory administration of the trust becomes more pursuasive." *In re* Worthington, 141 N.Y. 9, 35 N.E. 929 (1894). The policy behind compensation which determined *Furness* would seem to be lacking in the context of the assignability of the right to *reimbursement*.

41 Cases regarding other property rights and claims which have been deemed to pass to the trustee in bankruptcy under § 70(a)(5) are: Chandler v. Nathans, 6 F.2d 725 (3d Cir. 1925) (claim on the federal government for a tax refund); *In re* Fisher, 103 Fed. 860 (1st Cir. 1900) (license to sell liquor); *In re* Ghazal, 169 Fed. 147 (E.D.N.Y. 1909) (claim to reward); *In re* St. John, 105 Fed. 234 (N.D.N.Y. 1900) (interest in a vested remainder). A suggestion that the courts might be willing to recognize that the trustee in bankruptcy may claim the indemnity rights was made in *In re* Tate-Jones & Co., 85 F. Supp. 971 (E.D. Pa. 1949): "A bankruptcy trustee takes title to all property in which the bankrupt has title, although it be held in trust, but when it appears that a bankrupt is only a trustee and has no beneficial interest in or *claim against the property*, the court should turn it over to its own true owner where possible." *Id.* at 981. (Emphasis added.)

spouses.[1] Defendant was convicted under the New York wiretapping law which punishes not only tapping itself but also the use and possession of wiretap instruments.[2] The New York Court of Appeals affirmed the conviction, holding that the state statute was not superceded by the Federal Communications Act provision prohibiting interception and divulgence of telephonic communications.[3] *People v. Broady*, 5 N.Y.2d 500, 158 N.E. 2d 817, 186 N.Y.S.2d 230, *appeal dismissed, cert. denied*, 361 U.S. 8 (1959).

Though concurrent regulation by federal and state governments is constitutionally permissible,[4] a state statute will be declared inoperative whenever Congress intends that its enactment should "occupy the field." [5] Rarely, however, will the federal statute include an express statement of federal exclusiveness.[6] If the state statute contradicts either the terms or the objectives of the federal program, the former must yield; [7] and judicial application of such tests as "pervasiveness of the federal statute," "dominant federal interest" and "conflict in administration" has resulted in the implication to Congress of pre-emptive intent and consequent supercession of the state statute even where the local enactment is designed to complement federal legislation.[8] The federal statute involved in the instant case, the Federal Communications Act, provides a comprehensive scheme of national communications regulation and section 605 [9] prohibits the interception and divulgence of telephonic communications. Construction of this section

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1 For a detailed narrative of the intriguing factual situation see DASH, KNOWLTON & SCHWARTZ, THE EAVESDROPPERS 80-94 (1959).

2 Conviction was based on N.Y. Laws 1901, ch. 661, § 1 and N.Y. Laws 1911, ch. 316, § 1(6), which were consolidated in 1957 with other provisions into a new heading called "Eavesdropping." See N.Y. PEN. LAWS §§ 738-45.

3 Federal Communications Act § 605, 48 Stat. 1103 (1934), 47 U.S.C. § 605 (1958).

4 *Ex parte* McNiel, 80 U.S. (13 Wall.) 236, 240 (1871). See also Grant, *The Scope and Nature of Concurrent Power*, 34 COLUM. L. REV. 995 (1934).

5 This power of Congress derives from the supremacy clause of the Constitution. U.S. CONST. art. VI. See Charleston & W.C. Ry. v. Varnville Furniture Co., 237 U.S. 597 (1915); *Ex parte* McNeil, *supra* note 4, at 240; *cf.* California v. Zook, 336 U.S. 725 (1949). See also Note, 60 HARV. L. REV. 262 (1946); Note, 86 U. PA. L. REV. 532 (1938).

6 No federal statute has yet expressly excluded the states from legislating in an area, but some have provided that state statutes may remain intact. *E.g.*, 18 U.S.C. § 3231 (1958); 73 Stat. 541 (1959), 29 U.S.C.A. § 164(c)(2) (Supp. 1959).

7 Sinnot v. Davenport, 63 U.S. (22 How.) 227, 243 (1859).

8 See, *e.g.*, Pennsylvania v. Nelson, 350 U.S. 497 (1956); Southern Ry. v. Railroad Comm'n, 236 U.S. 439 (1915); Erie R.R. v. New York, 233 U.S. 671 (1914). See also Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947) (pervasiveness); Hines v. Davidowitz, 312 U.S. 52 (1940) (dominant federal interest); Pennsylvania R.R. v. Public Serv. Comm'n, 250 U.S. 566 (1919) (pervasiveness); New York Cent. R.R. v. Winfield, 244 U.S. 147 (1917) (desirability of uniform treatment); Charleston & W.C. Ry. v. Varnville Furniture Co., 237 U.S. 597 (1915) (desirability of uniform treatment). *But see* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960); California v. Zook, 336 U.S. 725 (1949); New York Cent. R.R. v. Winfield, *supra* at 154 (dissent of Brandeis, J.).

9 48 Stat. 1103 (1934), 47 U.S.C. § 605 (1958).

has occurred most often in cases involving the admissibility of wiretap evidence,[10] and no case has held it to pre-empt state penal statutes condemning similar activity.[11] Neither the terms nor the objectives of the New York statute conflict with those of section 605—enforcement of both statutes will result in protection against unwarranted intrusions on privacy and against damage to the communications system. In fact, the state statute is even more comprehensive than its federal counterpart.[12]

To ascertain whether the supplemental New York legislation was superceded by section 605, the court applied the three tests enunciated in *Pennsylvania v. Nelson,*[13] where the Supreme Court held a state statute punishing subversive activities against the United States to be pre-empted by federal prohibitions. First, was the scheme of section 605 so pervasive as to make reasonable the inference that Congress had left no room for state supplementation?[14] The court found it necessary to distinguish *Benanti v. United States,*[15] which stated with regard to the validity of another New York statute authorizing wiretaps upon ex parte orders that "keeping in mind this comprehensive scheme of interstate regulation and the public policy underlying section 605 as part of that scheme, we find that Congress, setting out a prohibition in plain terms, did not mean to allow state legislation which would contradict that section and that policy."[16] Emphasizing that the *Benanti* holding was based on contradiction and did not go directly to the issue of pervasiveness, the court went on to view section 605 as an entity in itself and concluded that it appeared to lack the broad sweep of the federal statutes held pre-emptive in *Nelson.*[17] Whatever

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10 Admission of wiretap evidence in a criminal proceeding does not violate the constitutional guarantees of the fourth or fifth amendments. Olmstead v. United States, 277 U.S. 438 (1928). But since the enactment of the Federal Communications Act in 1934, the Supreme Court has refused to allow the admission in federal courts of any evidence obtained by violating § 605 of that act. *E.g.,* Nardone v. United States, 308 U.S. 338 (1939). Although § 605 applies to intrastate as well as interstate communications, Weiss v. United States, 308 U.S. 321 (1939), a state court's admission of such illegally obtained evidence does not constitute a violation of due process. Schwartz v. United States, 344 U.S. 199 (1952). *But see* Pugach v. Dollinger, 275 F.2d 503 (2d Cir. 1960). But wiretap evidence procured by state officers, even pursuant to state procedures authorizing wiretaps, is acquired through a violation of § 605 and is therefore inadmissible in federal courts. Benanti v. United States, 355 U.S. 96 (1957).

11 See Benanti v. United States, *supra* note 10.

12 See text accompanying note 2 *supra.* See generally DASH, KNOWLTON & SCHWARTZ, THE EAVESDROPPERS 423-39 (1959). Section 605 prohibits only an interception and divulgence and several courts have required the commission of both acts before finding a violation. United States v. Sullivan, 116 F. Supp. 480 (D.D.C. 1953), *aff'd,* 219 F.2d 760 (D.C. Cir. 1955); United States v. Coplon, 91 F. Supp. 867, 871 (D.D.C. 1950), *rev'd,* 191 F.2d 749 (D.C. Cir. 1951), *cert. denied,* 342 U.S. 926 (1952). *But see* Benanti v. United States, 355 U.S. 96, 100 n.5 (1957) (dictum).

13 350 U.S. 497 (1956).

14 See Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

15 355 U.S. 96 (1957).

16 *Id.* at 105-06.

17 See Pennsylvania v. Nelson, 350 U.S. 497 (1956).

the propriety of the court's result, this dissection of the Federal Communications Act would seem questionable at best, especially in view of the Supreme Court's reconsideration of the matter in *Benanti.* While the Court did, in *Weiss v. United States,*[18] differentiate the thrust of section 605 from the scheme of the rest of the statute for the purpose of applying its sanctions to intrastate communications, *Benanti* more recently recognized that section 605 is an integral part of the act's regulatory program.[19] And by reading the wiretapping section in context with the entire statute, a not unreasonable conclusion could be drawn that the federal act is "pervasive"—a term itself implying little.[20]

The second test concerns "dominant federal interest" and it is apparent that a strong national interest is involved in controlling and safeguarding telephonic communications. Even though it was conceded that the control of telephonic communications falls within the scope of national interest, the court circumnavigated this obstacle by reasoning "that protecting the individual's right of privacy is an area primarily entrusted to the care of the States rather than the Federal Government, falling logically within the ambit of the State's police power." [21] This reasoning, however, assumes its conclusion: that section 605 can be read as continuing the states' responsiblity for the protection of privacy. Several federal courts have construed the section's purpose as protection of the integrity of the communications system [22] while another has viewed it as a safeguard of privacy.[23] But it would seem that acceptance of the one interpretation would not necessarily exclude the other—a possibility overlooked in the instant case. Perhaps more significant is the realization that, in all cases of concurrent exercise of legislative powers, the subject acted upon will be within both the scope of the national interest and the area of legitimate operation of the state's police power.[24] Many state statutes covering matters which appear to lie within the realm of exclusive federal control have been saved from preemption because they were viewed as malicious mischief laws aimed at curbing injury and violence to individuals and property.[25] The run-of-the-mill state wiretap statute could be sustained in this fashion since it prohibits

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18 308 U.S. 321 (1939).

19 355 U.S. at 104-06.

20 See text accompanying notes 31-33 *infra.*

21 Instant case at 513, 158 N.E.2d at 824, 186 N.Y.S.2d at 241.

22 Goldman v. United States, 316 U.S. 129, 133 (1942); Diamond v. United States, 108 F.2d 859, 860 (6th Cir. 1938); United States v. Coplon, 91 F. Supp. 867, 871 (D.D.C. 1950), *rev'd,* 191 F.2d 749 (D.C. Cir. 1951), *cert. denied,* 342 U.S. 926 (1952).

23 United States v. Hill, 149 F. Supp. 83, 85 (S.D.N.Y. 1957).

24 See note 31 *infra.*

25 For example, the National Labor Relations Act, 61 Stat. 140, 141 (1947), 29 U.S.C. §§ 157, 158 (1958), has been held to pre-empt general state regulation of picketing but not to such an extent that a state will be precluded from protecting against violence. See UAW v. Wisconsin Employment Relations Bd., 351 U.S. 266 (1956).

wiretapping only to the extent that damage to property results.[26] But New York can not benefit from this argument because its statute has been interpreted as designed primarily to protect the privacy of telephonic communications.[27]

Application of the third test—"conflict of administration"—may be somewhat more helpful in determining what Congress intended in that it does involve practical considerations. In the instant case the court reasoned that the state's legislation protecting its citizens from wiretapping would not interfere with any federal program [28] inasmuch as, unlike the extensive federal activity against subversion in the *Nelson* situation, there was no appreciable federal program based on section 605 and federal prosecutions under that section were sparse.[29] But even if federal enforcement were extensive, it would not preclude sustaining the state statute. There are many areas in which federal and local authorities cooperate even though each acts in its own right.[30] Only where conflict will inevitably arise from any concurrent enforcement is an inference of congressional pre-emptive intent justified.

It is doubtful that an accurate determination of what Congress intended can be made merely by applying standards such as "dominant federal interest," "pervasiveness" and the like. It is a heavy task to displace a state enactment by implication or reflection from a federal statute, and it is no wonder that even the Supreme Court has been uncertain in applying its "tests." [31] By not expressly stating an intention to exclude state action,

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[26] For a summary of state wiretap statutes see Note, 67 YALE L.J. 932 (1958). See also Rosenzweig, *The Law of Wire Tapping*, 33 CORNELL L.Q. 73 (1947).

[27] People v. Applebaum, 277 App. Div. 43, 97 N.Y.S.2d 807, *aff'd*, 301 N.Y. 738, 95 N.E.2d 410 (1950). This interpretation was accepted in the instant case.

[28] Instant case at 513, 158 N.E.2d at 824-25, 186 N.Y.S.2d at 241.

[29] There appear to have been only three convictions under § 605 since its enactment in 1934. See Massicot v. United States, 254 F.2d 58 (5th Cir.), *cert. denied*, 358 U.S. 816 (1958); United States v. Gris, 247 F.2d 860 (2d Cir. 1957); United States v. Gruber, 39 F. Supp. 291 (S.D.N.Y.), *aff'd*, 123 F.2d 307 (2d Cir. 1941).

[30] A conspicuous example of federal-state cooperation is in the area of criminal investigation and detection, but there are many others. See Andrews, *New Mechanics of Federal-State Cooperation*, 7 FED. B.J. 42 (1945); Anslinger, *Cooperation in Narcotic-Law Enforcement*, 12 FOOD DRUG COSM. L.J. 88 (1957); Koenig, *Federal and State Cooperation Under the Constitution*, 36 MICH. L. REV. 752 (1938). The regulation of misbranded and adulterated food products is another such field. See Corn Prods. Ref. Co. v. Eddy, 249 U.S. 427 (1919); Savage v. Jones, 225 U.S. 501 (1912). *But cf.* Cloverleaf Butter Co. v. Patterson, 315 U.S. 148 (1942).

[31] The Court seems to have applied its tests either separately or in concert without assigning any relative weight to them. For example, a state safety measure regulating train length was held invalid as unduly burdening interstate commerce, Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945), but a state ban on overly wide and heavy interstate trucks was sustained on the theory that the regulation of highways is a concern more local in nature than that of railroads. See South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938); *cf.* Southern Ry. v. King, 217 U.S. 524 (1910). Though Congress has excluded misbranded and adulterated articles from interstate commerce, the states may require, as local health measures, the disclosure of contents, Savage v. Jones, *supra* note 30, and specific labels, Corn Prods. Ref. Co. v. Eddy, *supra* note 30; Armour & Co. v. North Dakota, 240 U.S.

Congress has made necessary judicial decision of social, economic, and political questions which Congress neglected or avoided. Dissatisfaction with and distrust of any type of universal test for ascertaining unexpressed congressional intent has found expression on the present Court; Mr. Justice Frankfurter has stated: "Proper accommodation is dependent on an empiric process, on case-to-case determinations. Abstract propositions and unquestioned generalities do not furnish answers." [32] And even *Nelson*, after analyzing and applying the three tests, moved on to consider other factors and indicated that the possibility of double prosecution militated toward a conclusion of pre-emption.[33]

The court in the instant case apparently considered the Supreme Court's three tests as the exclusive criteria of pre-emption—that a negative answer to each would necessarily presage a finding of no pre-emptive intent on the part of Congress. But these tests, as we have seen, actually add little to meaningful deliberation and other considerations should and must be examined to arrive at a sound conclusion. A state court may begin with a presumption of the validity of the state statute [34] since the effect of a decision of invalidity merely removes state sanctions without the congressional reappraisal often engendered by a Supreme Court holding.[35] The likelihood of double prosecution should also be considered; [36] it seems that

510 (1916). And while it would appear that a "dominant federal interest" is involved equally when there is interference with wartime enlistment and when there are subversive activities against the national government, a state is not precluded from acting in the former instance, Gilbert v. Minnesota, 254 U.S. 325 (1920), but is pre-empted in the latter, Pennsylvania v. Nelson, 350 U.S. 497 (1956). Conflict of administration is another area of uncertainty. Where actual conflict exists the state statute has been declared invalid, Hines v. Davidowitz, 312 U.S. 52 (1941). But where conflict is merely possible, the local enactments have been allowed to stand. Parker v. Brown, 317 U.S. 341 (1943); H. P. Welch Co. v. New Hampshire, 306 U.S. 79 (1939); Northwestern Bell Tel. Co. v. Nebraska State Ry. Comm'n, 297 U.S. 471 (1936). In Pennsylvania v. Nelson, *supra*, the Court felt that the mere possibility of conflict was sufficient to satisfy the test. *But cf.* California v. Zook, 336 U.S. 725 (1949), where the Court found no clear manifestation of congressional intent to pre-empt and thus avoided the application of any of its tests.

32 UMW v. Arkansas Oak Flooring Co., 351 U.S. 62, 76 (1956) (dissenting opinion). See also Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

33 Pennsylvania v. Nelson, 350 U.S. 497, 509-10 (1956).

34 See, *e.g.*, Harlem Check Cashing Corp. v. Bell, 296 N.Y. 15, 17-18, 68 N.E.2d 854, 855 (1946) (per curiam). *But cf.* Pennsylvania v. Nelson, *supra* note 33, at 504.

35 In response to the Supreme Court's decisions in Guss v. Utah Labor Relations Bd., 353 U.S. 1 (1957), and San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959), Congress included in the Labor-Management Reporting and Disclosure Act of 1959, 73 Stat. 541 (1959), 29 U.S.C.A. § 164(c)(1) (Supp. 1959), a provision designed to eliminate the no-man's land created by those decisions. See 108 U. PA. L. REV. 587 (1960).

36 See, *e.g.*, Pennsylvania v. Nelson, 350 U.S. 497, 509-10 (1956); California v. Zook, 336 U.S. 725, 737-38 (1949). See also Grant, *Successive Prosecutions by State and Nation: Common Law and British Empire Comparison*, 4 U.C.L.A.L. REV. 1 (1956); Note, *Pre-Emption By Federal Criminal Statutes*, 55 COLUM. L. REV. 83 (1955). The penalty for violating § 605 is a fine of not more than $10,000 or imprisonment for not more than 1 year, or both, for the first offense. A second or subsequent offense may include imprisonment for up to 2 years. Federal Communications Act § 501, 68 Stat. 30 (1954), 47 U.S.C. § 501 (1958).

nothing would stand in the way of a subsequent federal prosecution under section 605.[37] Possible injustice to the defendant must be weighed against the desirability of saving the state statute if the language of pre-emptive intent—did Congress intend to define the outermost limits of penalty—is to be given meaningful content.[38] Though troublesome, the same problems were handled in *California v. Zook*,[39] where a sharply divided Court sustained a state prosecution for the very act which was subject also to federal sanctions. And in the instant case, the rare enforcement of section 605 [40]—which renders the possibility of double prosecution little more than academic—should militate toward sustaining the more comprehensive state wiretap act.

The malicious mischief-type wiretap laws of many states [41] render prosecution on the state level inconsistent and inadequate: [42] the wiretapper's modern techniques will seldom cause damage to the line.[43] And even under New York's comprehensive scheme of direct prohibitions there have been few prosecutions.[44] While these factors may point to the desirability of a more extensive and better enforced federal regulation of wiretapping,[45] they are hardly reasons for finding pre-emption in the absence of some clear manifestation [46] of congressional intent to "occupy the field."

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[37] See Abbate v. United States, 359 U.S. 187 (1959); Bartkus v. Illinois, 359 U.S. 121 (1959); United States v. Lanza, 260 U.S. 377 (1922). See also Grant, *The Lanza Rule Of Successive Prosecutions*, 32 COLUM. L. REV. 1309 (1932); Comment, 10 HASTINGS L.J. 188 (1958); Note, 53 NW. U.L. REV. 521 (1958); 34 TUL. L. REV. 197 (1959).

[38] *Cf.* Jerome v. United States, 318 U.S. 101 (1943); Erie R.R. v. New York, 233 U.S. 671 (1914).

[39] 336 U.S. 725 (1949).

[40] See note 29 *supra* and accompanying text.

[41] See note 26 *supra* and accompanying text.

[42] Compare State v. Behringer, 19 Ariz. 502, 172 Pac. 660 (1918); People v. Dement, 48 Cal. 2d 600, 311 P.2d 505 (1957); People v. Lawrence, 149 Cal. App. 2d 435, 308 P.2d 821 (1957); People v. Miller, 146 Cal. App. 2d 444, 304 P.2d 208 (1956); Williams v. State, 109 So. 2d 379 (Fla. Dist. Ct. App. 1959); Robert v. State, 220 Md. 159, 151 A.2d 737 (1959); State v. Giardina, 27 N.J. 313, 142 A.2d 609 (1958); Morse v. Forbes, 24 N.J. 341, 132 A.2d 1 (1957); Commonwealth v. Smith, 391 Pa. 607, 140 A.2d 347 (1958).

[43] Brown & Peer, *The Wiretapping Entanglement: How To Strengthen Law Enforcement and Preserve Privacy*, 44 CORNELL L.Q. 175, 176 (1959).

[44] Before the instant case there was only one conviction for wiretapping in New York and that occurred more than thirty years ago. People v. Senes, 242 N.Y. 556, 152 N.E. 524 (1926).

[45] See Brown & Peer, *supra* note 43, at 184-85; Dash, *Fact Finding on Eavesdroppers*, Prac. Law., Dec. 1958, p. 58; Gerhart, *Let's Take the Hypocrisy Out of Wiretapping*, 30 N.Y.S.B. BULL. 268 (1958); Westin, *The Wire-Tapping Problem: An Analysis and a Legislative Proposal*, 52 COLUM. L. REV. 165, 200-08 (1952); Williams, *Wiretapping Should Be Liberalized*, 30 N.Y.S.B. BULL. 261 (1958); 13 VAND. L. REV. 547, 550 n.26 (1960); 67 YALE L.J. 932 (1958).

[46] See California v. Zook, 336 U.S. 725, 733 (1949); Maurer v. Hamilton, 309 U.S. 598, 607 (1940).

CORPORATIONS—ONE OF MANY BENEFICIARIES OF AN ACTIVE TRUST IS NOT A SHAREHOLDER OF THE CORPORATION WHOSE STOCK IS HELD BY THE TRUST FOR PURPOSES OF A STOCKHOLDERS' DERIVATIVE SUIT

A California remainderman beneficiary of two Connecticut testamentary trusts,[1] the *res* of which consisted in part of shares of corporate stock,[2] brought two actions under diversity jurisdiction[3] in the district court of Connecticut. The first action was a class suit on behalf of all the beneficiaries of the trusts against present and former trustees seeking, *inter alia*, removal of the present trustees, an accounting by trustees and others, appointment of a temporary receiver and new trustees, and restoration to the *res* of property wrongfully transferred therefrom.[4] The second, a stockholders' derivative suit against certain defendants including the trustees who were also directors of the corporation whose stock was held by the trust and who, in addition, held stock individually, alleged a conspiracy to defraud the corporation[5] and sought a money judgment of $7,500,000. On consolidated appeals from the district court's orders denying defendants' motions to dismiss, the Second Circuit reversed and dismissed both actions, holding: (1) that under the doctrine of "virtual representation" the class of trust beneficiaries was so small and so readily available for actual joinder that the representative action could not be brought within the numerosity and impracticability provisions of Rule 23(a) of the Federal Rules of Civil Procedure; (2) that, inasmuch as plaintiff individually did not qualify as a "shareholder" within the meaning of Rule 23(b)[6] because he did not hold equitable or legal title to any specific shares of stock held by the trust but merely had—in conjunction with the other beneficiaries—an equitable interest in such shares, he could not main-

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[1] The interest was vested as to the George E. Matthies trust, subject to open, and possibly subject to complete divestment; and was contingent as to the Annie W. Matthies trust. Matthies v. Seymour Mfg. Co., 23 F.R.D. 64, 72-74 (D. Conn. 1958). For the principal dispositive provisions of the two wills, see *id.* at 96-98.

[2] Both trusts held substantial blocks of stock of the defendant Connecticut corporation, which itself owned all the stock of Batiscan Corporation, a subsidiary Delaware corporation dissolved in 1957. The district court's dismissal as to the Seymour Corporation of Delaware (a third corporate defendant that was dissolved in 1950) under the three-year statute of limitations provided in DEL. CODE ANN. tit. 8, § 278 (1953), was not contested on appeal.

[3] In the trust action all defendants were Connecticut residents except one, who was a New York resident. In the stockholders' action all the defendants were residents of Connecticut, New York, or Delaware. Of the George E. Matthies trust beneficiaries, only the plaintiff and his daughter lived elsewhere than Connecticut. Under the Annie W. Matthies trust, in addition to plaintiff and his daughter, some of the next of kin of Annie who had contingent remainders were not Connecticut residents.

[4] Matthies v. Seymour Mfg. Co., 23 F.R.D. 64, 69 (D. Conn. 1958).

[5] Petition for Certiorari, pp. 5-6.

[6] FED. R. CIV. P. 23(b) in the relevant part provides: "In an action brought to enforce a secondary right on the part of . . . shareholders in an association . . . because the association refuses to enforce rights which may properly be asserted by it, the complaint . . . shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. . . ."

tain the stockholders' derivative suit without joining the other beneficiaries; and (3) that "the [therefore necessary] joinder of any other beneficiary as a party plaintiff . . . [would] destroy the requisite diversity of citizenship." [7] *Matthies v. Seymour Mfg. Co.*, 270 F.2d 365 (2d Cir. 1959), *cert. denied*, 361 U.S. 962 (1960).[8]

The Second Circuit viewed decision on the plaintiff's right to represent the trust in a class action [9] as determinative also of the stockholders' derivative action and failed to analyze the latter as a separate issue. The court seemed to believe that the derivative action was analogous to a trust beneficiary's suit against a third party for a wrong to the trust, and, since all the beneficiaries must be in court in that instance, they should also be joined for the derivative suit. Clearly this is an erroneous line of analysis for the stockholders' action, which is a suit to restore or protect corporate assets and where the trust is merely an incidental beneficiary to the extent that its *res* consists of stock in the corporation which will be directly benefited if the action is successful.

In order that a plaintiff may maintain a shareholders' derivative action, he must be a stockholder when the suit is instituted.[10] What qualifications constitute a "stockholder" for purposes of bringing the suit is an issue frequently considered by federal and state courts, including those state courts which are bound by statutory requirements similar to Rule 23(b).[11] It is clear that the holder of legal title to a share of stock which is registered in his name on the corporate books can maintain a derivative action [12]

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[7] Matthies v. Seymour Mfg. Co., 270 F.2d 365, 368 (2d Cir. 1959), *cert. denied*, 361 U.S. 962 (1960); Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806). See note 3 *supra*. An interesting recent development in the concept of diversity as applied to corporations is Smith v. Sperling, 354 U.S. 91, 94-98 (1957), which relaxed the degree of corporate antagonism to the plaintiff stockholder formerly necessary before the corporation could be aligned as a party defendant, Doctor v. Harrington, 196 U.S. 579 (1905). Thus, the federal courts were made more accessible to plaintiffs in shareholders' derivative actions under diversity jurisdiction. The holding of Matthies v. Seymour Mfg. Co., *supra*, that the plaintiff must join the other beneficiaries, may make the proceedings, whether brought in a federal or a state court, unnecessarily cumbrous. And where the diversity requisite for federal jurisdiction is destroyed, a situation where the beneficiaries are residents of many diverse states would present obvious state procedural difficulties—primarily service on out-of-state residents—that might prevent plaintiff from pursuing his remedy in any forum.

[8] Petition for rehearing and reconsideration en banc was denied in an unreported three-to-two decision, with Chief Judge Clark and Judge Waterman dissenting. Petition for Certiorari, app. C, p. 89a.

[9] For a thorough discussion of this aspect of the case see 69 YALE L.J. 816 (1960).

[10] BALLANTINE, CORPORATIONS 350 (rev. ed. 1946); 13 FLETCHER, PRIVATE CORPORATIONS § 5972 (perm. ed. repl. vol. 1943); 3 MOORE, FEDERAL PRACTICE ¶ 23.17 (2d ed. 1948).

[11] See, *e.g.*, ARIZ. R. CIV. P. 23(b); COLO. R. CIV. P. 23(b); DEL. CODE ANN. tit. 8, § 327 (1953); GA. CODE ANN. § 22-711(6) (1948); KY. REV. STAT. § 271.605 (1959); N.J. STAT. ANN. § 14:3-16 (Supp. 1959); N.M. STAT. ANN. § 21-1-1(23b) (1953); N.Y. GEN. CORP. LAWS § 61; PA. STAT. ANN. tit. 12, § 1321 (1953). *But see, e.g.*, CAL. CORP CODE § 834(a)(1) and WIS. STAT. ANN. § 180.405(1)(a) (1957), which require that a plaintiff in a stockholders' derivative action must have been a shareholder registered as such at the time of the challenged transaction.

[12] Rinn v. Asbestos Mfg. Co., 101 F.2d 344 (7th Cir. 1938); Rosenthal v. Burry Biscuit Corp., 30 Del. Ch. 299, 60 A.2d 106 (1948); News-Journal Corp. v. Gore, 147 Fla. 217, 2 So. 2d 741 (1941); Bacon v. National Bank of Commerce, 259 S.W. 244 (Tex. Civ. App. 1923).

if he meets the prerequisite of ownership contemporaneous with the alleged wrongful transaction.[13] And most recent cases also allow an equitable owner of stock to prosecute a derivative suit.[14] While equitable ownership takes many different forms—for instance, a purchaser of stock in street name,[15] a pledgee of stock as collateral,[16] a residuary legatee under a will,[17] or a beneficiary of a trust that consists of shares of stock [18]—owners of all types have been allowed to maintain a secondary action for the benefit of the corporation. Conceding that the plaintiff in the instant case, unlike a purchaser in street name, did not have equitable title in any specific shares of stock but rather had an equitable interest in shares in which other persons also had an interest, does this difference between title and interest prevent plaintiff from maintaining a 23(b) action? The Second Circuit answered in the affirmative.

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[13] See Hawes v. Oakland, 104 U.S. 450 (1882). The requirement that a shareholder be such at the time of the challenged transaction has a dual purpose. One function, which is common to both federal and state courts, is to preclude commerce in law suits. Dimpfell v. Ohio & Miss. Ry., 110 U.S. 209, 210 (1884); Rosenthal v. Burry Biscuit Corp., 30 Del. Ch. 299, 310-11, 60 A.2d 106, 111 (1948). The other purpose is to prevent the creation of federal jurisdiction by placing shares in the hands of a nonresident and then having him commence the action. Hawes v. Oakland, *supra* at 452-53; Hand v. Kansas City S. Ry., 55 F.2d 712, 714 (S.D.N.Y. 1931). A possible third rationale is the equitable principle that one who was not a shareholder at the time of the alleged wrongful transaction should not be heard to question such transactions. Home Fire Ins. Co. v. Barber, 67 Neb. 644, 657-58, 93 N.W. 1024, 1029 (1903); see 3 MOORE, *op. cit. supra* note 10, ¶ 23.15. But some state courts do not require contemporaneous ownership and allow a subsequent transferee of shares of stock to maintain a derivative action. See, *e.g.*, Parsons v. Joseph, 92 Ala. 403, 8 So. 788 (1890); Winsor v. Bailey, 55 N.H. 218 (1875); Robertson v. Draney, 53 Utah 263, 271-73, 178 Pac. 35, 38-39 (1918).

[14] See cases cited notes 15-18 *infra*. Some older authority is to the contrary. See Whitaker v. Whitaker Iron Co., 238 Fed. 980 (N.D.W. Va. 1916), *aff'd*, 249 Fed. 531 (4th Cir.), *cert. denied*, 248 U.S. 564 (1918); McHenry v. New York, P. & O.R.R., 22 Fed. 130 (C.C.N.D. Ohio 1884); Hodge v. United States Steel Corp., 64 N.J. Eq. 90, 53 Atl. 601 (Ch. 1902), *rev'd on other grounds*, 64 N.J. Eq. 807, 54 Atl. 1 (Ct. Err. & App. 1903).

[15] *E.g.*, Murdock v. Follansbee Steel Corp., 213 F.2d 570 (3d Cir. 1954); HFG Co. v. Pioneer Publishing Co., 162 F.2d 536 (7th Cir. 1947); Steinberg v. Hardy, 90 F. Supp. 167 (D. Conn. 1950); Rosenthal v. Burry Biscuit Corp., 30 Del. Ch. 299, 60 A.2d 106 (1948).

[16] *E.g.*, Arcola Sugar Mills Co. v. Burnham, 67 F.2d 981 (5th Cir.), *cert. denied*, 292 U.S. 630 (1933); Gorman-Wright Co. v. Wright, 134 Fed. 363 (4th Cir. 1904); Green v. Hedenberg, 159 Ill. 489, 42 N.E. 851 (1896); Campbell v. American Zylonite Co., 122 N.Y. 455, 25 N.E. 853 (1890).

[17] Hurt v. Cotton States Fertilizer Co., 145 F.2d 293 (5th Cir. 1944), *cert. denied*, 324 U.S. 844 (1945). See also Law v. Alexander Smith & Sons Co., 271 App. Div. 705, 68 N.Y.S.2d 143 (1947), *reversing* 189 Misc. 200, 66 N.Y.S.2d 187 (Sup. Ct. 1946) (widow elected her statutory share).

[18] *E.g.*, Santarelli v. Katz, 270 F.2d 762 (7th Cir. 1959); Felsenheld v. Bloch Bros. Tobacco Co., 119 W. Va. 167, 192 S.E. 545 (1937); Hall v. M. B. O'Reilly Realty & Inv. Co., 306 Mo. 182, 267 S.W. 407 (1924); Great W. Ry. v. Rushout, 5 Deg. & Sm. 290, 64 Eng. Rep. 1121 (Ch. 1852). *Contra*, Pflug v. Dietz, 260 App. Div. 503, 22 N.Y.S.2d 968 (1940), 54 HARV. L. REV. 1063 (1941). See Willcox v. Harriman Sec. Corp., 10 F. Supp. 532 (S.D.N.Y. 1933), where, after plaintiffs had been induced by fraud to transfer legal title in shares of stock to another, the court impressed a constructive trust on shares in the hands of the fraudulent transferee and ordered a transfer back to the original owner who was deemed to have held equitable title throughout the transactions.

It is not clear whether the requirements of Rule 23(b) are procedural or substantive.[19] If they are substantive, *Erie R.R. v. Tompkins*[20] is applicable and the law of the state where the court is sitting is determinative;[21] if procedural, then 23(b)—and the federal courts' construction of it—is controlling. Recognizing this unsettled problem, the court in the instant case surveyed both state and federal decisions and held that, whether federal or state law governs, plaintiff cannot maintain the derivative action. But in *Hurt v. Cotton States Fertilizer Co.*[22] the Fifth Circuit allowed one of six legatees under a will disposing of corporate stocks to complain of a wrong to the corporation when the executor had declined to do so—notwithstanding that the estate had not been settled and that the executor retained power to sell the stocks for payment of debts of the estate. The court stated:

> "Since equity regards substance rather than form, the equitable title, in the absence of intervening rights of third parties, is superior to the naked legal title. In equity, therefore, the owner of the equitable title to shares of stock is a stockholder in a fuller sense than is the owner of the naked legal title. Assuredly it is not the purpose of . . . [Rule 23(b)] to afford the holder of the naked legal title to shares of stock a right of action and to deny the holder of a higher right, the equitable title, such a privilege. The protection of the law would hardly be denied to the owner of the substance, meanwhile being accorded to the holder of the shadow. We do not believe that it was the purpose of . . . [Rule 23(b)] to deny the process of the Court to the owner of an equitable right, title, or interest in stock, regardless of whether that right be vested or contingent. . . . We conclude, therefore, that an owner of the equitable title, or *an equitable interest in the title,* to shares of stock is not prevented . . . from maintaining a suit which seeks to protect stock in which he has such an ownership or interest from impairment or loss."[23]

The same view was impliedly adopted by the Seventh Circuit in *Santarelli v. Katz*,[24] where the court reached the merits in a stockholders' derivative suit brought by one of two sisters who were beneficiaries of an inter vivos trust consisting of shares of stock. Although the Seventh Circuit's opinion did not specifically address itself to the question of whether the suit could be maintained on the basis of the plaintiff's mere equitable interest, implicit

[19] See Advisory Committee on Rules for Civil Procedure, Second Preliminary Draft of Proposed Amendments 29-30 (1945). The Advisory Committee concluded that the wisest course would be to await a judicial decision in a litigated case.

[20] 304 U.S. 64 (1938).

[21] "[T]hat law will normally refer to the law of the state of incorporation." 3 Moore, *op. cit. supra* note 10, ¶ 23.17 n.6.

[22] 145 F.2d 293 (5th Cir. 1944), *cert. denied*, 324 U.S. 844 (1945).

[23] *Id.* at 295. (Emphasis added.) The court drew the same conclusion regarding the Georgia rule, Ga. Code Ann. § 22-711(6) (1948).

[24] 270 F.2d 762 (7th Cir. 1959). It should be noted that there is a distinction between *Santarelli* and *Hurt* on the one hand and the instant case on the other, in

in the disposition of the case on the merits is that one trust beneficiary may bring a derivative suit without joining other beneficiaries.[25] And state cases are not generally helpful in providing a clear-cut answer[26] to the precise question involved in the instant case—whether one of several beneficiaries of a trust whose *res* consists in part of shares of stock should be able to maintain a shareholders' derivative action.

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the immediacy of the plaintiff's interest. Santarelli was a life beneficiary at the time of the challenged transaction and, when she instituted suit, the trust had terminated by its own terms and she had an immediate right to her share of the *res*. Hurt was one of six residuary legatees at the time of the alleged wrongdoing and actually held legal title to the stock when he brought suit. Matthies, on the other hand, had a vested remainder interest in the trust *res*. But the court did not distinguish the instant case on these lines, nor have other courts drawn such a distinction in determining the right to maintain a shareholders' derivative action. FED. R. CIV. P. 23(b) requires plaintiff to be "a shareholder at the time of the transaction of which he complains," and as of that time the plaintiffs in all three cases had only equitable interests in the stock.

25 The district court had specifically addressed itself to the issue of maintenance of the suit under Rule 23(b) by one of the two beneficiaries. Appendix to Brief for Plaintiff-Appellant, p. 305, Santarelli v. Katz, 270 F.2d 762 (7th Cir. 1959). And the implied holding of the circuit court is strengthened by virtue of the fact that concurrently with the federal action, the other sister, an Illinois resident, was maintaining a substantially similar suit on the same facts in the state courts of Illinois. In the latter proceedings, brought under ILL. ANN. STAT. ch. 32, § 157.86(a)(3) (Smith-Hurd 1954), the remedies sought by the plaintiff (whose equitable interest had ripened into legal title after the occurrence of the wrongs on which both actions were based) were an accounting and dissolution of the corporation. See Letter from Russell J. Topper, Attorney for Plaintiff, to *University of Pennsylvania Law Review*, June 16, 1960, on file in Biddle Law Library, University of Pennsylvania. Inasmuch as the ultimate relief sought in both cases was identical in that the corporation would have recovered the losses suffered by it as a result of the fraudulent actions of the directors, and different only in the incident of dissolution, any consideration that the plaintiff had no other adequate remedy against the directors must be eliminated from the circuit court's reasoning. Thus, allowing the one beneficiary to maintain the suit without joining the other must be premised solely on Rule 23(b).

26 Guidelines which might have been provided by state cases remain ambiguous, either because one of the crucial issues—necessary joinder—is seldom reached or because of conflicts within the jurisdiction. A recent lower court decision in Delaware, the state of incorporation of two of the defendant corporations, allowed beneficiaries to maintain a secondary action for the benefit of the corporation. Brown v. Dolese, 154 A.2d 233 (Del. Ch. 1959). In that case, however, all beneficiaries of the trust joined as plaintiffs, thereby obviating a determination of whether a single beneficiary would have been qualified to maintain the suit. *Id.* at 235. Though not speaking to a necessary joinder problem, a recent decision in Connecticut, Brecker v. Nielsen, 21 Conn. Supp. 33, 143 A.2d 463 (Super. Ct. 1958), relevant here inasmuch as the Seymour Manufacturing Company was incorporated in that state, reflected the protective concern of courts of equity for trust beneficiaries, even though a writ of mandamus to require inspection of the corporate books was denied. There, no allegations of waste, extravagance or mismanagement were made against the officers and directors of the corporation involved; the court does indicate in dictum, however, that had there been an allegation of fraudulent conspiracy (as there was in *Matthies*) a court of equity would have sustained the efforts of the trust beneficiaries to obtain information concerning the affairs of the corporation. *Id.* at 465. Conflict exists in New York, which is an important center of commercial litigation, and two inconsistent lines of cases have evolved. *Compare* Baum v. Sporborg, 146 App. Div. 537, 131 N.Y. Supp. 267 (1911); Singer v. State Laundry, Inc., 188 Misc. 583, 68 N.Y.S.2d 808 (Sup. Ct. 1947); *and* Braman v. Westaway, 60 N.Y.S.2d 190 (1945), *modified*, 59 N.Y.S.2d 509 (Sup. Ct. 1946); *with* Faiello v. Li Castri, 2 App. Div. 2d 749, 153 N.Y.S.2d 247 (1956) (mem.); Steuer v. Hector's Tavern, Inc., 1 App. Div. 2d 1003, 151 N.Y.S.2d 830 (1956) (mem.); Pflug v. Dietz, 260 App. Div. 503, 22 N.Y.S.2d 968 (1940) (per curiam); *and* Miller v. Miller, 256 App. Div. 846, 9 N.Y.S.2d 448 (mem.), *aff'd*, 280 N.Y. 716, 21 N.E.2d 212 (1939). The first group of cases seems to support the position of the plaintiff in *Matthies* while the second argues against it.

Normally, actions by trust beneficiaries seeking relief for wrongs to the trust are against the trustee.[27] However, in exceptional circumstances —for instance, where, as in the instant case, the trustees are also directors of the corporation whose stock was held by the trust—the beneficiaries, if properly joined or represented, are permitted to bypass their primary recourse and maintain an action directly against the offending third party.[28] But here the plaintiff was not attempting to assert, as the representative of the trust, the trust's derivative claim in regard to a wrong to the corporation; rather he was suing as a stockholder for the benefit of the corporation. And that action is a device unique to the corporate area embodying specific policies of shareholder supervision[29] and incorporating its own rules to protect other parties in interest.[30] Therefore, it appears that the court's requirement of joinder to protect the other beneficiaries[31] is irrelevant to the shareholders' derivative action.

Plaintiff meets head-on the issue of ability to maintain a shareholders' derivative action by arguing that the determinative standard should be "the relationship of the individual to the *res*, not labels of uncertain meaning such as 'title' or 'interest.'"[32] On this basis, plaintiff continues, his remainder interest of more than $1,000,000, comprised largely of stock in the defendant corporation, should enable him to maintain the 23(b) action. But this suggested criterion presents problems in drawing lines that would perhaps be more difficult than the conceptual title-and-interest test espoused by the Second Circuit. Apparently even plaintiff would not argue that any beneficiary of a trust, no matter how small or contingent his interest in the *res*, should be permitted to maintain a derivative action. Presumably, a person with a minute interest would be required to join other beneficiaries so that their combined interests, if not then constituting equitable title, would yet bear a "sufficient" relationship to the *res*. What percentage or dollar value should be considered sufficient? Were sufficiency to be defined in terms of a fixed percentage or valuation—a standard similar to the substantial interest in the corporation now required by security-for-expenses statutes—legislative action would probably be required. But

[27] 4 BOGERT, TRUSTS AND TRUSTEES § 870, at 457-59, 460-61 (1948).

[28] *Id.* at 459-64. See also Brown v. Dolese, 154 A.2d 233, 239 (Del. Ch. 1959) (dictum).

[29] This aspect of shareholder supervision—implemented through the device of the derivative suit—has become increasingly important in view of the current business trend toward dilution of corporate ownership and the concomitant increasing independence of corporate directors. See Note, 36 B.U.L. REV. 78 (1956); Note, 99 U. PA. L. REV. 999 (1951).

[30] Such as FED. R. CIV. P. 23(c), which requires court approval for the settlement or voluntary dismissal of shareholders' derivative actions, or the various state security-for-expenses statutes which require, upon motion by the corporation, that a plaintiff with less than a specified minimum percentage or dollar value holding of corporate stock post a bond sufficient to defray expenses for which the corporation might be liable. See CAL. CORP. CODE § 834(b); N.J. STAT. ANN. § 14:3-15 (Supp. 1959); N.Y. GEN. CORP. LAWS § 61-b; PA. STAT. ANN. tit. 12, § 1322 (1953); WIS. STAT. ANN. § 182.013(3) (1957). Note that Connecticut has no such security-for-expenses statute.

[31] See text accompanying note 9 *supra*.

[32] Petition for Certiorari, p. 21.

absent such action, a logical criterion to govern actions against corporations by the owners of *equitable* interests in its shares could be judicially developed by analogy to holdings which permit the *legal* owner of a single share to maintain a shareholders' derivative suit.[33] While some courts consider the smallness of plaintiff's stockholdings as a circumstance relevant to the equities and good faith of the action,[34] the right of action nevertheless remains. Therefore, it is suggested that a workable criterion determining who qualifies as a "shareholder"—one which would recognize the vital nature of this remedial device yet not involve the courts in an essentially legislative decision—would be a standard that allows one who has an equitable interest in stock equivalent to the present fair market value or book value of at least one share of stock [35] to maintain a shareholders' derivative action. Such a test would provide a standard which is both objective and at the same time more equitable than the title-interest line of analysis employed by the Second Circuit.

RESTRAINT OF TRADE—SALES TO WHOLESALERS CONDITIONED ON THEIR REFUSAL TO SELL TO PRICE-CUTTING RETAILERS WHO ARE INFORMED OF SUCH POLICY CONSTITUTES A COMBINATION AND CONSPIRACY

The United States sought to restrain violations of sections 1 and 3 of the Sherman Antitrust Act,[1] alleging that defendant drug manufacturer had combined and conspired with certain distributors to maintain retail prices on its products. Defendant sold a variety of pharmaceutical products nationally through wholesalers and directly to some retailers and had a schedule of suggested minimum resale prices for each type of customer.

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[33] See, *e.g.*, General Inv. Co. v. Lake Shore & Mich. So. Ry., 250 Fed. 160 (6th Cir. 1918), *aff'd*, 269 Fed. 235 (6th Cir. 1920), *modified, aff'd*, 260 U.S. 261 (1922) (5 shares out of 499,961 shares outstanding); Wagner Elec. Corp. v. Hydraulic Brake Co., 269 Mich. 560, 257 N.W. 884 (1934) (50 out of over 53,000 shares); Levine v. Behn, 169 Misc. 601, 8 N.Y.S.2d 58 (Sup. Ct. 1938), *rev'd on other grounds*, 282 N.Y. 120, 25 N.E.2d 871 (1940) (one plaintiff owned one share of stock and the other owned 24 of 6,200,000 shares outstanding). See generally FLETCHER, *op. cit. supra* note 10, § 5885.

[34] See, *e.g.*, Ashwander v. TVA, 297 U.S. 288, 318-23 (1936); Clarke v. Gold Dust Corp., 106 F.2d 598, 604 (3d Cir. 1939), *cert. denied*, 309 U.S. 671 (1940); Isaac v. Milton Mfg. Co., 33 F. Supp. 732, 737 (M.D. Pa. 1940); Aldrich v. Union Bag & Paper Co., 81 N.J. Eq. 244, 245, 87 Atl. 65 (Ch. 1913).

[35] Or who has an interest monetarily equivalent to whatever requirements are placed on equitable or legal title holders in the jurisdiction in question.

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[1] 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1, 3, 4 (1958). Section 1 provides that "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . . Every person who shall make any contract or engage in any combination or conspiracy declared . . . to be illegal shall be deemed guilty of a misdemeanor. . . ." Section 3 uses similar language but deals with the District of Columbia. Section 4 provides that "the several district courts of the United States are invested with jurisdiction to prevent and restrain violations of . . . this title; and it shall be the duty of the several United States attorneys . . . to institute proceedings in equity to prevent and restrain such violations. . . ."

In an effort to gain compliance with its retail price schedules, the defendant informed wholesalers that it would refuse to sell to them not only if they cut their own prices but also if they sold to retailers who undercut suggested prices. The defendant also informed retailers of this expanded enforcement program, its former policy of dealing with only those customers who abided by their respective schedules having proved ineffective in achieving uniform adherence to retail price lists. Retailers who refused any assurance of compliance were cut off, wholesalers being instructed not to sell to them. The new method also proved ineffective to stop price cutting, and a compromise was reached whereby the defendant restored sales upon a retailer's ceasing to advertise Parke, Davis products at lower-than-list prices. After the Government completed presentation of this evidence at the trial, the district court [2] ruled that no showing of any violation of the Sherman Antitrust Act had been made inasmuch as there was no agreement with co-conspirators—the defendant manufacturer's actions being merely unilateral. No allegation or finding that defendant was a violator of the monopoly provisions of the act having been made,[3] the court further reasoned that there was no coerced combination inasmuch as the retailers were free either to do without the goods or to sell them in accordance with the manufacturer's policies. On direct appeal [4] the Supreme Court reversed, holding that sales to wholesalers conditioned on their refusal to sell to price-cutting retailers who are informed of the policy and who subsequently compromise with defendant in order to have discontinued sales reinstituted fall within the act's proscriptions. Should the defendant not refute the facts, the Government would be entitled to an injunction. *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960).[5]

Price-maintenance agreements were first held to be contracts or combinations in restraint of trade under section 1 in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[6] which established that a seller, having once sold his product, cannot fix the price for subsequent resale. There the contracts were written, and the case, therefore, did not involve questions of implied contracts, coercion or selective selling—problems which remained to be solved in future litigation. In a context of procedural limitations necessitated by a faulty indictment, *United States v. Colgate & Co.*[7] held that a

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[2] United States v. Parke, Davis & Co., 164 F. Supp. 827 (D.D.C. 1958).

[3] Sherman Antitrust Act § 2, 26 Stat. 209 (1890), 15 U.S.C. § 2 (1958). In a monopoly context the alleged actions of the defendant would have had different implications, and the holding of the district court is clearly not one involving a monopolistic manufacturer. However, a violation of § 1 a fortiori becomes an "attempt to monopolize" under § 2 in the case of a monopolistic manufacturer.

[4] See Expediting Act § 2, 32 Stat. 823 (1903), as amended, 15 U.S.C. § 29 (1958).

[5] Mr. Justice Brennan delivered the opinion of the Court, which contained an elaborate history of what constituted a violation of § 1. Mr. Justice Stewart concurred in the result, although impliedly finding the majority's elaborate distinctions not meaningful or necessary, as he considered defendant's action a combination to maintain retail prices and thus a clear violation. Mr. Justice Harlan, joined by Justices Frankfurter and Whittaker, dissented, finding the distinctions untenable and declining to come to the majority result without overruling precedents.

[6] 220 U.S. 373 (1911).

[7] 250 U.S. 300 (1919). The decision turned on an indictment which was held not to charge a violation of § 1 of the Sherman Antitrust Act inasmuch as it *alleged*

manufacturer, not having a monopoly,[8] may sell or not sell to customers according to pre-announced policies—including price maintenance.[9] But the realm of legality demonstrated by *Colgate*—in contrast to the prohibitions of section 1—was quickly narrowed. In *United States v. A. Schrader's Son, Inc.*,[10] the Court found that as soon as a manufacturer forces another party to acquiesce to a plan of price maintenance, there is an implied agreement violative of the act.[11] Soon thereafter, *FTC v. Beech-Nut Packing Co.*[12] arose on facts quite similar to those of *Colgate*, and the Court held them to constitute an "unfair method of competition." [13] More recently the case of *United States v. Bausch & Lomb Optical Co.*[14] demonstrated that conduct beyond a mere refusal to sell may violate the Sherman Antitrust Act by coercing a combination with wholesalers who cooperate either overtly or by acquiescence in the seller's plan. *Colgate* thus stands as an extremely narrow exception to the basic proposition that price maintenance is a violation of the act.[15]

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no contract, combination, or conspiracy. *Id.* at 302. However, the factual context of the case came far closer to, if not within, the prohibition of the act. Therefore, confusion was unavoidably created as to whether the factual context would be tolerated under a well-drawn indictment. See *id.* at 305.

[8] See note 3 *supra.*

[9] "In the absence of any purpose to create or maintain a monopoly, the [Sherman] act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell." 250 U.S. at 307.

[10] 252 U.S. 85 (1920).

[11] *Id.* at 99-100. Defendant by use of its advantageous position in the market sold only upon acceptance of what was a uniform contract with all buyers. The district court's confusion demonstrates the problem caused by *Colgate's* procedural context. *Id.* at 98. *Cf.* Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208 (1921). The lower court concluded that there were no written or oral contracts and directed a verdict for the defendant. On appeal it was held that an implied contract violates § 1 and that this might be found from the course of dealings. *Id.* at 210.

[12] 257 U.S. 441 (1922).

[13] Federal Trade Commission Act § 5, 38 Stat. 719 (1914), as amended, 15 U.S.C. § 45 (1958). This case did not arise under the Sherman Antitrust Act, yet the standard of "unfair competition" used by the Court in this case is that of § 1 of the act. However, there is some doubt as to whether the basis of the holding is suppression of competitive freedom or implied contracts. *Id.* at 455. The distinction is important where there is fair trade legalization of contracts so that the contractual illegality is excepted from the act; but where there are coercive methods, the fair trade laws are incapable of exculpating any resulting combination.

[14] 321 U.S. 707 (1944). The system of distribution here was designed to limit sales unless the retailers abided by defendant's policy.

[15] See Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953). This case demonstrates the limited area in which *Colgate* operates, especially in a monopoly context. *Id.* at 626. See also A. C. Becken Co. v. Gemex Corp., 272 F.2d 1 (7th Cir. 1959) (refusal to sell for failure to maintain resale price and some coercion in this respect causes violation of § 1 by implied contract with those to whom sales continue). See generally Comment, *Refusal to Sell: A Means of Achieving Resale Price Maintenance in Non-Fair-Trade States*, 36 TEX. L. REV. 799 (1958); Comment, *Resale Price Maintenance and the Anti-Trust Laws*, 18 U. CHI. L. REV. 369 (1951); Comment, *Refusals to Sell and Public Control of Competition*, 58 YALE L.J. 1121 (1949). Compare HEATHCOTE-WILLIAMS, ROBERTS & BERSTEIN, RESTRICTIVE TRADE PRACTICES AND MONOPOLIES (1956). Note especially the discussion in an English context of problems similar to *Colgate*. *Id.* at 82-89.

A second exception to the declared illegality of resale price maintenance is that granted by legislation to fair trade laws.[16] The federal government has never enacted a positive fair trade law in the sense of categorically permitting resale price maintenance; it has, however, enabled states to act by allowing their fair trade statutes an exemption from the antitrust laws.[17] The basic provision of the federal exemption is that vertical price maintenance agreements on identifiable products, when such agreements conform to state laws, do not violate section 1 of the Sherman Antitrust Act. There is an incidental horizontal aspect to these contracts in that a nonsigner with notice may be bound by the agreement;[18] thus, insofar as the wholesaler or retailer is the party who in fact seeks the institution of the agreement, he is clearly restraining competition among his competitors. Forty-six states availed themselves of the federal sanction by enacting fair trade laws; sixteen, however, have either judicially or legislatively invalidated them subsequent to enactment.[19] · At the current time, there is before Congress a true federal fair trade act, the Harris bill,[20] which is sponsored by the National Association of Retail Druggists.

In fair trade jurisdictions the price-fixing statutes may mitigate the effect of any limitations placed on the *Colgate* doctrine inasmuch as the contractual arrangements permitted under these laws—enforceable resale price maintenance and nonsigner clause horizontal restraints on competi-

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[16] See ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 149-55 (1955); De Bevoise, *Problems of Pricing*, in AN ANTITRUST HANDBOOK (1958); Herman, *Fair Trade: Origins, Purposes, and Competitive Effects*, 27 GEO. WASH. L. REV. 621 (1959); MacLachlan, *A New Approach to Resale Price Maintenance*, 11 VAND. L. REV. 145 (1957); Fulda, *Resale Price Maintenance*, 21 U. CHI. L. REV. 175 (1954); Schactman, *Resale Price Maintenance and The Fair Trade Laws*, 11 U. PITT. L. REV. 562 (1950); Williams, *Resale Price Maintenance and Minimum Price Legislation*, in 1950 INSTITUTE ON ANTITRUST LAWS AND PRICE REGULATIONS 141; *A Symposium on the Fair Trade Laws*, 27 FORDHAM L. REV. 68 (1958); Note, 3 SYRACUSE L. REV. 144 (1951); Note, *The Enforcement of Resale Price Maintenance*, 69 YALE L.J. 168 (1959); 50 COLUM. L. REV. 1144 (1950). See generally KRONSTEIN, MILLER & SCHWARTZ, MODERN AMERICAN ANTITRUST LAW (1958); FTC REP. ON RESALE PRICE MAINTENANCE (1945).

[17] Miller-Tydings Fair Trade Act, 50 Stat. 693 (1937), as amended, 15 U.S.C. § 1 (1958); McGuire Bill, 66 Stat. 632 (1952), 15 U.S.C. § 45(3) (1952).

[18] This is true only of the McGuire Bill. Specific provisions legalizing nonsigner clauses were necessitated by the Supreme Court's holding that nonsigners could not be compelled, under the Miller-Tydings Fair Trade Act, to maintain prices. Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951). See Pepsodent Co. v. Krauss Co., 56 F. Supp. 922 (E.D. La. 1944), for legislative history of the Miller-Tydings Fair Trade Act and its interaction with state laws.

[19] H.R. REP. No. 467, 86th Cong., 1st Sess. 2, 3 n.1, 6-7 (1959). See Herman, *supra* note 16; Schactman, *supra* note 16, at 570-76 for a useful tabulation of various state statutes.

[20] H.R. 1253, 86th Cong., 1st Sess. (1959). The bill would permit manufacturers of identified merchandise to establish and control resale prices of goods in interstate commerce merely by notifying distributors of the manufacturer's price schedule. The bill is comprehensive in scope, encompassing the entire United States including the District of Columbia. See also H.R. REP. No. 467, *supra* note 19. Note especially the minority views of Mr. Dingell wherein the present defendant is specifically considered. However, the legislation will not be acted upon by Congress this session. See Time, May 2, 1960, p. 85.

tion—are clearly more effective instruments for price maintenance[21] than the unilateral refusal to sell.[22] On the other hand, outside fair trade jurisdictions, *Colgate's* importance as the sole exception to the general section 1 proscription of price maintenance is obvious. It is in these areas that the instant case has a profound and direct effect.[23] It would now seem that the definition of unilateral action has been factually narrowed so that conditioning sales on refusals to sell at lower levels of distribution constitutes an "arrangement,"[24] and therefore goes beyond merely exercising the right to select one's own customers. The right to refuse to sell is, for the Court, a "countervailing consideration"[25] to the sweeping prohibitions against price maintenance which cannot prevail where the seller involves others in enforcing his policy of refusing sales to price-cutters. In addition, a vacillation between refusals to sell and reinstituted sales upon a compromise condition negotiated in discussions with the buyer now renders probable a finding of combination.[26] Communication would seem best restricted to form letters, avoiding personal contact and its implications of coercion and compromise. The instant case points up the anomaly resulting from an attempt to reconcile *Beech-Nut's* condemning and *Colgate's* condoning the same conduct. The refusal to sell has become a narrow doctrine fraught with danger of violating the Sherman Antitrust Act: the *Colgate* doctrine is apparently effective only when the methods used are ineffective.[27] The logical conclusion of the Court's reasoning in the instant case was in fact reached earlier by the Seventh Circuit in *A. C. Becken Co. v. Gemex Corp.*,[28] where a properly unilateral refusal to sell to those not assenting to conditions was sufficient to ground a finding of illegal combination between the defendant and those to whom it continued to sell.

If the instant case represents not merely a factual narrowing of what constitutes unilateral action but rather is a declaration that even unilateral action may result in a coerced combination,[29] the decision is relevant within

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21 "On the other hand, the Department of Justice and the Federal Trade Commission in numerous past official policy procurements [*sic*] have registered adamant opposition to 'Fair Trade' as incompatible with the Nation's antitrust policy of fostering free competition." ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 153 (1955).

22 For a criticism of the logic of the *Colgate* exception to proscription of price maintenance, see Comment, 36 TEXAS L. REV. 799 (1958).

23 See authorities cited note 19 *supra* for the geographic scope of the opinion.

24 Instant case at 45.

25 Instant case at 44.

26 Instant case at 35-36, 46-47. These discussions with retailers on their advertising of cutrate prices and the resultant change in policy give an impression of an agreed upon compromise in violation of the act.

27 Compare George W. Warner & Co. v. Black & Decker Mfg. Co., 28 U.S.L. WEEK 2569 (2d Cir. May 3, 1960): "The Colgate principles have not been completely destroyed. The Supreme Court has left a narrow channel through which a manufacturer may pass even though the facts would have to be of such Doric simplicity as to be somewhat rare in this day of complex business enterprise."

28 272 F.2d 1 (7th Cir. 1959).

29 The instant case is not clear whether the violation is coercive or contractual in that the opinion reads "the program upon which Parke Davis embarked to promote

fair trade jurisdictions as well as in nonfair trade states.[30] Such conduct, coercive in nature, would not become legal by virtue of the contract exception to the antitrust laws contained in fair trade statutes[31]—especially if the fair trade exemption is strictly construed as applying only to contract enforcement.[32] While the majority opinion may be read as holding Parke, Davis' conduct illegally contractual, Mr. Justice Stewart, concurring, seems to view it as unilaterally coercive inasmuch as he sees a clear violation of the Sherman Antitrust Act without analyzing what constitutes the required combination or conspiracy.[33] The ambivalence of the majority opinion is clearly pointed out by the dissent, which questions the continuing vitality of *Colgate* and asks whether the need for "countervailing considerations" to offset Parke, Davis' conduct does not make legality turn on social policy rather than on the absence of the concert of action required by sections 1 and 3. The dissenters contend that the Court has relegated *Colgate* to a meaningless exception to an overall proscription of price maintenance.[34] But a narrow reading of the decision does not abandon the *Colgate* doctrine, although the newly limited right to refuse to sell will little avail most companies so large that their doings are of interest to the Attorney General. And a conclusion that conduct previously condoned under *Colgate* remains unilateral and nevertheless illegally coercive would not only abandon that saving doctrine but also encroach upon fair trade rights to price maintenance. Furthermore, the fair trade exemption from the antitrust laws is legislative and not properly subject to such judicial limitations as may be imposed on the judicially created *Colgate* rule. Whatever the wisdom of the fair trade exemption,[35] it is entitled to the same reasoned construction given other congressional enactments and should not be rendered ineffective by holding illegal all unilateral enforcement except court contract actions. The legislative pattern thus dictates reading the instant case as only a factual narrowing of what action is unilateral.

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general compliance with its suggested resale prices plainly exceeded the limitations of the *Colgate* doctrine and under *Beech-Nut* and *Baush & Lomb effected arrangements* which violated the Sherman Act." Instant case at 45. (Emphasis added.)

30 Wall Street J., March 1, 1960, p. 2, col. 3.

31 See, *e.g.*, United States v. Frankfort Distilleries, Inc., 324 U.S. 293 (1945) (coercion into fair trade illegal).

32 "The department [of justice] has further stated it to be its belief that if its Antitrust Division had sufficient men and money to examine every resale price maintenance contract written under State and Federal legislation, and to proceed in every case in which the arrangement goes beyond the authorizations of the Tydings-Miller [*sic*] Amendment, there would be practically no resale price maintenance contracts, and that, in the absence of such wholesale law enforcement, the system of resale price legislation fosters restraints of trade such as Congress never intended to sanction." FTC, *op. cit. supra* note 16, at LXI. "Exact compliance with the Miller-Tydings provision is necessary to avoid violation of the federal anti-trust acts." Williams, *supra* note 16, at 156. *But cf.* Adams-Mitchell Co. v. Cambridge Distrib. Co., 189 F.2d 913 (2d Cir. 1951) (broad interpretation of the Miller-Tydings exception to § 1).

33 Even though the district court found the conduct unilateral, Mr. Justice Stewart finds "no occasion to question, even by innuendo, the continuing vitality of the *Colgate* decision." Instant case at 49 (concurring opinion). See note 5 *supra*.

34 Instant case at 57 (dissenting opinion). See note 5 *supra*.

35 For a discussion of the conflict between antitrust philosophy and allowance of price maintenance, see 50 Colum. L. Rev. 1144 (1950). See also note 21 *supra*.