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Case Notes

CASE NOTES

Antitrust—Bar-Association Minimum Fee Schedules Held Exempt from the Sherman Act.—The plaintiff brought an antitrust class action under the Sherman Act[1] seeking treble damages[2] and injunctive relief,[3] alleging that the maintenance of minimum fee schedules by the Virginia State Bar (State Bar) and the Fairfax County Bar Association (Fairfax Bar) had artificially inflated the cost of legal services to title examinations. The district court held for the plaintiff against Fairfax Bar, enjoining the use of its minimum fee schedule,[4] but refused to find liability on the part of the State Bar, asserting that its limited involvement in the minimum fee structure was within the bounds of its state authorized power to regulate the legal profession, and that it was, therefore, exempt from liability under the Sherman Act.[5] The court of appeals upheld the lower court's ruling which exonerated the State Bar, but reversed as to Fairfax Bar, holding the latter exempt from the Sherman Act under two theories: first, that it was within the "learned profession" exemption; and second, that the practice of law did not involve interstate commerce. *Goldfarb v. Virginia State Bar*, 497 F.2d 1 (4th Cir.), *petition for cert. filed*, 43 U.S.L.W. 3087 (U.S. Aug. 13, 1974) (No. 74-70).

Minimum fee schedules have been held to be a form of horizontal price-fixing,[6] itself an unreasonable restraint of trade per se.[7] Thus, once a determination has

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1. Section 1 of the Sherman Act, 15 U.S.C. § 1 (1970) provides in part:

"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 . . . ."

2. Section 4 of the Clayton Act, 15 U.S.C. § 15 (1970) provides in part:

"Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained . . . ."

3. Section 16 of the Clayton Act, 15 U.S.C. § 26 (1970) provides for "injunctive relief . . . against threatened loss or damage by a violation of the antitrust laws . . . ."

4. Goldfarb v. Virginia State Bar, 355 F. Supp. 491 (E.D. Va. 1973), aff'd in part & rev'd in part, 497 F.2d 1 (4th Cir.), petition for cert. filed, 43 U.S.L.W. 3087 (U.S. Aug. 13, 1974) (No. 74-70). The request for damages was severed from the issue of liability. Id. at 496. The lower court decision is analyzed in Comment, Minimum Fee Schedules: An Antitrust Problem, 48 Tul. L. Rev. 628 (1974).

5. 355 F. Supp. at 496.

6. United States v. National Ass'n of Real Estate Bds., 339 U.S. 485, 489 (1950).

7. Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 221-23 (1940); United States v. Trenton Potteries Co., 273 U.S. 392, 397-98 (1927). In a per se situation, the rule of reason discussed in Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918) does not apply. See Northern Pac. Ry. v. United States, 356 U.S. 1, 8 (1958). The fact that there is no penalty for violation of fee schedules is irrelevant. See United States v. National Ass'n of Real Estate Bds., 339 U.S. 485, 489 (1950); Lehrman v. Gulf Oil Corp., 464 F.2d 26, 44 (5th Cir.), cert. denied, 409 U.S. 1077 (1972).

been made that the minimum fee schedules of the various bar associations constitute a per se restraint of trade, the legal profession is in violation of the Sherman Act unless exempt. Such exemption arguably can exist under the following theories: first, that the practice of law is a purely local activity, not involved in interstate commerce;[8] second, that the promulgation and maintenance of such schedules constitute a legitimate restraint on trade imposed by the state;[9] or third, that the legal profession is neither trade nor commerce, but rather a "learned profession."[10] If any of these theories apply, the minimum fee schedules are outside the purview of the Sherman Act.

The first of these, the intrastate commerce exemption, is based on the fact that the Sherman Act applies only to interstate restraints of trade or commerce.[11] Judicial construction of the commerce clause compels an expansive view of federal jurisdiction under the Sherman Act.

> We have been shown not one piece of reliable evidence that the Congress of 1890 intended to freeze the proscription of the Sherman Act within the mold of then current judicial decisions defining the commerce power. On the contrary, all the acceptable evidence points the other way.[12]

Two distinct categories of activity have been held to involve interstate commerce: those directly in the flow of interstate commerce;[13] and those which are intrastate in nature but which nevertheless substantially affect interstate commerce.[14] The second test has caused the courts difficulty, the elusive question being whether a given situation has a substantial effect. The test of substantiality is not onerous.[15] Further, it is enough that a particular course of conduct merely threatens to affect commerce in a substantial manner.[16] With regard to the Sher-

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8. See note 11 infra and accompanying text.

9. See notes 20-21 infra and accompanying text.

10. See notes 38-39 infra and accompanying text.

11. See generally United States v. Frankfort Distilleries, Inc., 324 U.S. 293, 298 (1945).

12. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 557-58 (1944) (insurance held to affect commerce "among the states").

13. Burke v. Ford, 389 U.S. 320, 321 (1967) (per curiam). See also Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 227-35 (1948); Sun Valley Disposal Co. v. Silver State Disposal Co., 420 F.2d 341, 343 (9th Cir. 1969); Las Vegas Merchant Plumbers Ass'n v. United States, 210 F.2d 732, 739 (9th Cir.), cert. denied, 348 U.S. 817 (1954).

14. See sources cited in note 13 supra.

15. "The effect on interstate commerce need not have been gargantuan nor precisely mathematicized. It is sufficient if it is more than merely inconsequential." Woods Exploration & Prod. Co. v. Aluminum Co. of America, 438 F.2d 1286, 1303 (5th Cir. 1971), cert. denied, 404 U.S. 1047 (1972). See generally Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 234 (1948); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224-25 n.59 (1940); Las Vegas Merchant Plumbers Ass'n v. United States, 210 F.2d 732, 739-40 n.3 (9th Cir.), cert. denied, 348 U.S. 817 (1954).

16. Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 234 (1948).

man Act, a restraint may relate only to the local aspect of the total process and still be subject to its provisions.

Restraints, to be effective, do not have to be applied all along the line of movement of interstate commerce. The source of the restraint may be intrastate, as the making of a contract or combination usually is; the application of the restraint may be intrastate, as it often is; but neither matters if the necessary effect is to stifle or restrain commerce among the states. If it is interstate commerce that feels the pinch, it does not matter how local the operation which applies the squeeze.[17]

Of course, federal power over commerce does not extend to activities so exclusively local that the relationship to any aspect of interstate commerce is clearly tangential.[18] However, it is difficult to predict exactly where this line will be drawn.[19]

A combination in restraint of trade, which involves interstate commerce, does not necessarily violate the Sherman Act. In *Parker v. Brown*,[20] the Supreme Court ruled that the Sherman Act did not govern actions undertaken by state officials at the direction of the state's legislature.[21] At issue in *Parker* was an act authorizing programs to restrict competition and maintain prices of agricultural products in order "to 'conserve the agricultural wealth of the State' and to 'prevent economic waste in the marketing of agricultural products' "[22] grown within

17. United States v. Women's Sportswear Mfrs. Ass'n, 336 U.S. 460, 464 (1949).

18. Rosemound Sand & Gravel Co. v. Lambert Sand & Gravel Co., 469 F.2d 416 (5th Cir. 1972) (dismissal for lack of jurisdiction under the antitrust laws where none of defendant's products were shipped in interstate commerce or shown to substantially affect interstate commerce); Marston v. Ann Arbor Property Managers Ass'n, 422 F.2d 836 (6th Cir.) (per curiam), cert. denied, 399 U.S. 929 (1970) (dismissed for failure to allege substantial adverse impact on interstate commerce on the part of an agreement to fix prices for the rental of local real estate); Sun Valley Disposal Co. v. Silver State Disposal Co., 420 F.2d 341 (9th Cir. 1969) (exclusive franchise for garbage disposal did not affect interstate commerce merely because containers were leased from out-of-state company); Lieberthal v. North Country Lanes, Inc., 332 F.2d 269 (2d Cir. 1964) (interstate purchase of supplies to equip bowling alley conducting a local business did not make activity interstate); Savon Gas Stations Number Six, Inc. v. Shell Oil Co., 309 F.2d 306 (4th Cir. 1962), cert. denied, 372 U.S. 911 (1963) (restrictive covenants in shopping center lease giving a gasoline company exclusive rights to operate a service station does not involve interstate commerce); Page v. Work, 290 F.2d 323, 329-30 (9th Cir.), cert. denied, 368 U.S. 875 (1961) (purchase of newsprint and other supplies does not affect interstate commerce where there is no showing of any effect on interstate commerce).

19. "[C]ommerce among the States is not a technical legal conception, but a practical one, drawn from the course of business." Swift & Co. v. United States, 196 U.S. 375, 398 (1905). See also NLRB v. Jones & Laughlin Steel Co., 301 U.S. 1 (1937). However, questions involving commerce still trouble the courts, and their conclusions are often unpredictable. Cf. Kosydar v. National Cash Register Co., 94 S. Ct. 2108 (1974), rev'g 35 Ohio St. 2d 166, 298 N.E.2d 559 (1973) (state court held state could not tax goods because they were in the flow of foreign commerce).

20. 317 U.S. 341 (1943).

21. Id. at 351-52.

22. Id. at 346.

the state. A state-created commission was empowered to ensure that the program was carried out fairly.[23] The actual determination of a reasonable price for the individual commodity was left to the discretion of the state's supervisory commission.[24] Its composition was likewise fixed by the legislature to ensure fairness in the implementation and operation of the Act.[25]

In fashioning this exemption the Court stressed that the state legislature provided the impetus for such regulation and created the machinery for carrying it out.[26] Thus, it was not a situation in which individuals were given a grant of immunity for past or future disregard of antitrust provisions.[27]

The Supreme Court has not had occasion since *Parker* to apply the doctrine to a similar set of facts. The Fourth Circuit, however, has had several opportunities to construe and apply this principle.

In the first of these cases, *Asheville Tobacco Board of Trade, Inc. v. FTC*,[28] the court refused to extend the state immunity principle to local tobacco boards of trade. The court pointed to the fact that such boards had been functioning in their present capacity long before action was taken by the state legislature. The lack of state initiative, combined with the absence of any active state supervision of the boards made application of the *Parker* exemption inappropriate.[29]

In *Allstate Insurance Co. v. Lanier*,[30] a state law forbade insurance companies from offering rates lower than those established by a state-created rating bureau. The bureau was constituted from the ranks of the insurance companies, and was subject to regulation by the State Commissioner of Insurance. This restraint was held permissible under *Parker*.[31]

More recently, the Fourth Circuit in *Washington Gas Light Co. v. Virginia Electric & Power Co.*,[32] held that the promotional practices pursued by the

23. Id.

24. Id. at 355. This the commission accomplished by holding in a "surplus pool" sufficient raisins to support prices in the manner desired. Id. at 348.

25. Id. at 346.

26. Id. at 352. Under the plan, a commission including the Director of Agriculture, ex-officio, and eight appointees of the Governor (confirmed by the State Senate) administered the marketing plan. Id. at 346.

27. Id. at 351.

28. 263 F.2d 502 (4th Cir. 1959).

29. Id. at 509-10. "It [the state] may even permit persons subject to such control to participate in the regulation, provided their activities are adequately supervised by independent state officials." Id. at 509. While the court was not considering the Sherman Act, it nevertheless appears that the Parker rationale was controlling. See discussion in Goldfarb v. Virginia State Bar, 497 F.2d 1, 7 n.15 (4th Cir.), petition for cert. filed, 43 U.S.L.W. 3087 (US. Aug. 13, 1974) (No. 74-70).

30. 361 F.2d 870 (4th Cir.), cert. denied, 385 U.S. 930 (1966).

31. Id. at 871. "[T]he rating bureau was established and administered under the active supervision of the State . . . ." Id.

32. 438 F.2d 248 (4th Cir. 1971). An even more recent decision of the Fourth Circuit construing the Parker exemption is Business Aides, Inc. v. Chesapeake & Potomac Tel. Co., 480 F.2d 754 (4th Cir. 1973) (no antitrust violation for compliance with state-authorized regulation).

defendant electric company, intended to restrict competition with the plaintiff gas company, were not subject to antitrust sanctions since the state was charged with the regulation of public utilities and had created a commission to oversee their activities.[33] Plaintiff argued that there could be no exemption in the absence of affirmative action by an independent supervisory body. The court replied:

> The argument is not without merit but the conclusion is not inevitable unless one equates administrative silence with abandonment of administrative duty. It is just as sensible to infer that silence means consent, i.e., approval.[34]

This would appear to be the furthest any court has been willing to go to find a state exemption.[35] Presented with a set of facts almost identical to those of *Washington Gas Light*, the Fifth Circuit took note of that decision but stated that it chose not to extend the rationale adopted there.[36] Likewise, the First Circuit made the following observation:

> The [*Parker*] Court's emphasis on the extent of the state's involvement precludes the facile conclusion that action by any public official automatically confers exemption. . . . Our reading of *Parker* convinces us that valid government action confers antitrust immunity only when government determines that competition is not the *summum bonum* in a particular field and deliberately attempts to provide an alternate form of public regulation.[37]

The third possible basis for excluding the legal profession from the sanctions of the Sherman Act is under the so-called "learned profession" exemption. The two principal cases generally cited as authority for this proposition are *Federal Baseball Club, Inc. v. National League of Professional Baseball Clubs*,[38] and *FTC v. Raladam Co.*[39] In the former, the profession of baseball was held immune from antitrust restrictions on the grounds that interstate commerce was not involved.[40] The Court, however, stated in dictum that "personal effort, not related to production, is not a subject of commerce."[41] In *Raladam*, where the professional exemption issue also was unrelated to the actual decision, the Court observed in dictum that "medical practitioners . . . are not in competition with respondent. They follow a profession and not a trade . . . ."[42]

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33. 438 F.2d at 252.

34. Id.

35. Norman's on the Waterfront, Inc. v. Wheatley, 444 F.2d 1011, 1018 (3d Cir. 1971).

36. Gas Light Co. v. Georgia Power Co., 440 F.2d 1135, 1140 (5th Cir. 1971), cert. denied, 404 U.S. 1062 (1972).

37. George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc., 424 F.2d 25, 30 (1st Cir.), cert. denied, 400 U.S. 850 (1970).

38. 259 U.S. 200 (1922).

39. 283 U.S. 643 (1931).

40. 259 U.S. at 209.

41. Id. (dictum).

42. 283 U.S. at 653 (dictum).

The Supreme Court at least has indicated that the professional exemption is not absolute.[43] Thus, in *United States v. National Association of Real Estate Boards*,[44] the Court rejected the contention that the professional services of brokers were not embraced by the term "trade." In holding a fee schedule which was part of a code of ethics to be violative of the antitrust laws, the Court stated:

> The competitive standards which the Act sought to preserve in the field of trade and commerce seem as relevant to the brokerage business as to other branches of commercial activity.[45]

Concerning the first of these three possible bases for exemption—lack of effect on interstate commerce—the district court in *Goldfarb* found substantial involvement with commerce, including, *inter alia*, that a significant portion of home financing comes from outside the state; that lenders require title examination and title insurance; that many of the purchasers commute to work through the channels of commerce; and that many mortgages are guaranteed by federal agencies.[46] Consequently, the lower court concluded that "commerce is sufficiently affected to sustain jurisdiction under the Sherman Act."[47]

43. United States v. National Ass'n of Real Estate Bds., 339 U.S. 485, 491-92 (1950). ("We do not intimate an opinion on the correctness of the application of the term [trade] to the professions."). American Medical Ass'n v. United States, 317 U.S. 519, 528 (1943) ("[W]hether a physician's practice . . . constitutes trade under § 3 of the Sherman Act . . . we need not consider or decide . . . ."). It should be observed that the concept of trade in section 3 of the Sherman Act is identical to that defined in section 1. The former section merely gives the Act jurisdiction over the District of Columbia and United States possessions and territories, which are not embraced by Congress' constitutional authorization over commerce among the states. See 15 U.S.C. §§ 1, 3 (1970). Furthermore, American Medical Ass'n v. United States suggested that professional status is "immaterial" when a criminal conspiracy to violate the antitrust laws is involved. 317 U.S. at 528.

44. 339 U.S. 485 (1950).

45. Id. at 492. In his dissent, Justice Jackson noted:

"I am not persuaded that fixing uniform fees for the broker's labor is more offensive to the antitrust laws than fixing uniform fees for the labor of a lawyer, a doctor, a carpenter, or a plumber." Id. at 496 (Jackson, J., dissenting).

The Supreme Court appears to distinguish between commercial and non-commercial aspects of the professions. The Court seems to be willing to condone the incidental infringement of free enterprise where it involves the professional organizations' right to pass judgment on qualifications and conduct of their members. See Marjorie Webster Junior College v. Middle States Ass'n of Colleges and Secondary Schools, Inc., 432 F.2d 650, 654-55 (D.C. Cir.), cert. denied, 400 U.S. 965 (1970) (refusal to grant accreditation held not in restraint of trade). But where strictly commercial aspects of the profession are involved, the professional status of the particular organization will not be recognized as a defense. See American Medical Ass'n v. United States, 317 U.S. 519 (1943); Northern Cal. Pharmaceutical Ass'n v. United States, 306 F.2d 379, 385 (9th Cir.), cert. denied, 371 U.S. 862 (1962) (price fixing); United States v. Utah Pharmaceutical Ass'n, 201 F. Supp. 29 (D. Utah), aff'd per curiam, 371 U.S. 24 (1962) (price fixing). See generally Comment, Minimum Fee Schedules as Price Fixing: A Per Se Violation of The Sherman Act, 22 Am. U.L. Rev. 439, 452-53 (1973).

46. 355 F. Supp. at 494.

47. Id.

The court of appeals disagreed with this finding of fact, asserting that any effect of the minimum fee schedule on interstate commerce was either indirect or insubstantial.[48] The fact that many persons commuted to out-of-state jobs was deemed irrelevant to the issue of substantial effect.[49] With respect to the title examination required by lenders, the court found that this act was wholly intrastate, notwithstanding the interstate flow of the mortgage funds.[50]

Arguably, the *Goldfarb* court erred in its narrow conception of the commerce power. The reluctance of the court to rely on this ground alone may belie some doubt on their part. As the district court[51] and the dissenting opinion in the court of appeals found,[52] the minimum fee schedule has a substantial effect on interstate commerce. The court of appeal's conclusion that "[t]he fact that a service is occasionally utilized to facilitate interstate activities does not subject the one providing that service to the proscriptions of the Sherman Act,"[53] seems inaccurate when all the evidence is considered. As the dissent points out, "the Supreme Court has consistently approved congressional regulation of local activities that have a potential for affecting interstate commerce."[54] Of course, even a slight retreat from the broad scope recently given to the commerce clause could justify the majority's reasoning and render moot the other questions regarding possible exemptions.[55]

If this holding were valid, it would, as the dissenting opinion points out,[56] foreclose the need for further discussion since the Sherman Act would be rendered inapplicable. However, the majority reached this holding only after discussing the other bases of exemption.[57]

As to the second contention—that the minimum fee schedules formed part of a system of state regulation and therefore were exempt under *Parker*—the court of appeals stressed three criteria essential for the state regulation exemption. These were public benefit, legislative authorization, and state supervision.[58] A public benefit was found since fee schedules uphold high ethical standards.[59] A state law authorized the Virginia Supreme Court to regulate the practice of law and establish a state bar for this purpose. Since the Virginia court was authorized to set ethical standards and had indicated that minimum fee schedules form a part of such standards, the *Goldfarb* court reasoned that the setting of

48. 497 F.2d at 16-17.
49. Id.
50. Id. at 17.
51. 355 F. Supp. at 494.
52. 497 F.2d at 21 (Craven, J., concurring and dissenting).
53. Id. at 17.
54. Id. at 22 (Craven, J., concurring and dissenting).
55. See note 57 supra and accompanying text.
56. 497 F.2d at 21 (Craven, J., concurring and dissenting).
57. Id. at 16-19.
58. Id. at 6.
59. Id. at 9-10. The court cited Lathrop v. Donohue, 367 U.S. 820 (1961) for this proposition. 497 F.2d at 10 n.29. However, Lathrop dealt with compulsory bar association dues, and does not appear to support the Goldfarb assertion that minimum fees benefit the public.

minimum fee schedules by the Virginia court's administrative arm, the State Bar, was well within the scope of the regulatory powers duly delegated by the legislature.[60] Finally, the court found that the silence of the Virginia Supreme Court on the issue of minimum fees signified tacit approval similar[61] to that found in *Washington Gas Light Co. v. Virginia Electric & Power Co.*[62]

It is submitted that the application of *Parker* to *Goldfarb* constitutes a considerable dilution of *Parker*. First, the court's general designation of the first requisite as "public benefit" states the situation in *Parker* in an overbroad fashion which does not fully comprehend the exacting nature of the policy underlying the original exemption granted in *Parker*.[63] That case involved more than the casual assumption that a policy of state-imposed restraints on competition would benefit the public. Rather it involved a studied determination that in a particular instance the ordinary laws of supply and demand achieved results which were undesirable. To the extent that the preservation of the state's agricultural resources insured that there would be an adequate supply of products for the consumer it could be said to have benefited the public. *Goldfarb* ignores the caveat of *Parker* that it must be demonstrably proved that the situation justifies institution of state-imposed restraints.[64]

As to the presence of the second requirement of state legislative authorization, the state legislature authorized the state court to regulate (and the state bar to administer) the profession. But the stretching of that initial grant of authority over regulation to embrace the power to fix minimum prices may present some question as to whether this exceeds the scope of the original authorization.[65] The argument that since fees relate to the question of ethics, there is an implied power to fix minimum fees in the interest of ethics, runs counter to the Supreme Court's repeated admonition that in the field of antitrust laws exemptions are not to be lightly implied.[66]

Perhaps most fatal to the application of the *Parker* doctrine is the absence of

60. 497 F.2d at 11-12. Va. Code Ann. § 54-48 (1972) gives the state court of appeals the power to regulate the practice of law, formulate a code of ethics for attorneys and judges, and establish measures for disciplinary action. Id. § 54-49 authorizes the state court to regulate the Virginia State Bar, which was to act as the administrative agency of the court.

61. "Finally, the Virginia court's inaction with regard to specifically approving or disapproving the schedules in question should not be construed as a failure to adequately supervise." 497 F.2d at 11.

62. 438 F.2d 248, 252 (4th Cir. 1971); see notes 32-34 and accompanying text.

63. See notes 20-27 supra and accompanying text. See also Simmons & Fornacier, State Regulation as an Antitrust Defense: An Analysis of the Parker v. Brown Doctrine, 43 U. Cin. L. Rev. 61 (1974).

64. Parker v. Brown, 317 U.S. 341, 350-52 (1943). See text accompanying notes 22, 37 supra.

65. 497 F.2d at 20-21 (Craven, J., concurring and dissenting). Judge Craven noted that the question of the authority of the State Bar to promulgate minimum fee schedules "can best be left to the Supreme Court of Virginia." Id.

66. United States v. First City Nat'l Bank, 386 U.S. 361, 368 (1967); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 350 (1963).

the active and independent supervision by the state.[67] Inherent in the concept of state-regulation which abridges the normal laws of the marketplace is the principle that there be vigilant independent supervision to prevent the occurrence of the type of abuse the antitrust laws were intended to eliminate, specifically the arbitrary manipulation of prices to the advantage of those having a pecuniary interest in increased prices. *Parker* did not authorize the growers and producers to get together to arrange prices among their fellows,[68] nor did *Allstate* authorize insurance rates absent state approval.[69] The courts in applying the *Parker* doctrine, where those subject to state-sponsored restraints have been allowed to participate in the process, have been consistent in their insistence on independent approval by the state.[70] The only way to maintain that there is active supervision of the minimum fee schedule set by the Bar via a questionable assumption analogous to that articulated by the Fourth Circuit in *Washington Gas Light*:[71] that the Virginia State court's silence meets the requirement of supervision.[72] This equation it is submitted, cannot be made without drastically changing the concept of the words "active" and "independent" as they were used in *Parker*. Such an inference disregards the elaborate safeguards in *Parker* which were carefully applied to the plan to ensure objectivity and fairness in its operation. Yet even conceding the validity of *Washington Gas Light's* holding that lack of action constitutes approval by a supervisory body, there is no equivalent set of circumstances in *Goldfarb* on which to base such an inference. There is nothing to suggest that the Virginia Supreme Court, the supposedly active and independent supervisor, was aware of even the existence of Fairfax County's minimum fee schedule, let alone the rates for the individual services specified.[73]

While the district court entertained reservations both as to the legitimacy[74]

67. See note 58 supra and accompanying text.

68. 317 U.S. at 346.

69. 361 F.2d at 871.

70. George R. Whitten Jr., Inc. v. Paddock Pool Builders Inc., 424 F.2d 25, 30 (1st Cir.), cert. denied, 400 U.S. 850 (1970); Asheville Tobacco Bd. of Trade v. FTC, 263 F.2d 502, 509 (4th Cir. 1959).

71. Washington Gas Light Co. v. Virginia Elec. & Power Co., 438 F.2d 248 (4th Cir. 1971), discussed at text accompanying note 34 supra.

72. 438 F.2d at 252.

73. "Whatever that [Virginia Supreme] court may think of the power claimed for it to equate price fixing with legal ethics, I think it will be surprised to learn that it is engaged in active supervision of the State Bar's implementation of minimum fee schedules in Virginia. I find nothing in the record to suggest that the Virginia court even knew that Fairfax County Bar Association had a minimum fee schedule, or that it approved it either directly or indirectly through the State Bar." 497 F.2d at 21 (Craven, J., concurring and dissenting) (emphasis omitted).

74. Reasons generally advanced by the proponents of minimum fee schedules include the following: (1) to ensure a respectable standard of living for lawyers; (2) to deter "shopping" for legal services; (3) to aid the public in determining what is considered a reasonable fee; (4) to assist the judiciary in the same regard; (5) to aid new lawyers in determining a reasonable value for their services; and (6) to provide for differences in competency among attorneys by fixing a fee for reasonable competency in the performance of

and applicability of the "learned profession" exemption,[75] the court of appeals obviously was not disturbed by the lower court's doubts. Cognizant of the fact that more recent decisions of the Supreme Court had refrained from expressing an opinion on the validity of a special category exempting the professions, the court nevertheless felt that the principle continued to have viability.[76] In so doing, they relied principally on *Federal Baseball*,[77] *Raladam*,[78] and *Atlantic Cleaners and Dyers, Inc. v. United States*.[79] *Atlantic* in turn relied upon a pre-Sherman Act case, *The* [*Schooner*] *Nymph*,[80] in which Justice Story in defining the term "trade" excluded the liberal arts and "the learned professions."[81]

Although it is true that "forms of competition usual in the business world may be demoralizing to the ethical standards of a profession,"[82] it is presumptuous

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designated services. Arnould & Corley, Fee Schedules Should Be Abolished, 57 A.B.A.J. 655, 656 (1971). Thirty-four states had such schedules at the time of this survey. Id. The policy aspects of minimum fee schedules have been discussed widely. See, e.g., Miller & Weil, Let's Improve, Not Kill, Fee Schedules, 58 A.B.A.J. 31 (1972); Morgan, Where Do We Go from Here with Fee Schedules, 59 A.B.A.J. 1403 (1973); Comment, Minimum Fee Schedules as Price Fixing: A Per Se Violation of the Sherman Act, 22 Am. U.L. Rev. 439 (1973); Note, A Critical Analysis of Bar Association Minimum Fee Schedules, 85 Harv. L. Rev. 971 (1972); Note, The Antitrust Division v. The Professions—"No Bidding" Clauses and Fee Schedules, 48 Notre Dame Law. 966 (1973). However, such arguments appear irrelevant.

"[T]here is no defense to price-fixing on the ground that it is reasonable or that it is being done by professionals. Appellants' 'professional' status per se will not protect them if the activity in which they are shown to have engaged is clearly proscribed by the statute." Northern Cal. Pharmaceutical Ass'n v. United States, 306 F.2d 379, 385 (9th Cir.), cert. denied, 371 U.S. 862 (1962).

75. "The Court has some question whether the adoption of a minimum fee schedule is itself 'professional.' It seems to the Court that there is a basic inconsistency between the lofty position that professional services, not commodities, are here involved and the position that a minimum fee schedule is proper. The former properly contemplates differences in abilities, worth and energies expended of those rendering the services. Such differences are made as meaningless by a minimum fee schedule as they would be by a maximum fee schedule. Although there is as yet no evidence of this here, the minimum fee schedule does permit the charging, by an attorney, of more than the services are worth. Certainly fee setting is the least 'learned' part of the profession." 355 F. Supp. at 495.

76. 497 F.2d at 13-14. The most recent Supreme Court comments on the learned profession exemption have been dicta in conspiracy cases. See United States v. National Ass'n of Real Estate Bds., 339 U.S. 485, 491-92 (1950) and American Medical Ass'n v. United States, 317 U.S. 519, 528 (1943). While the learned profession exemption appears inapplicable in antitrust suits involving criminal conspiracies, see note 43 supra, nevertheless, they may arguably fare better in a civil suit for damages.

77. 259 U.S. 200 (1922); see note 41 supra and accompanying text.

78. 283 U.S. 643 (1931); see note 42 supra and accompanying text.

79. 286 U.S. 427 (1932). There the Court, in determining whether dry cleaning was a "trade," discussed the meaning of this term. Id. at 431-37.

80. 18 F. Cas. 506 (No. 10,387) (S.D.N.Y. 1834).

81. Id. at 507.

82. United States v. Oregon Medical Soc'y, 343 U.S. 326, 336 (1952), cited at 497 F.2d at 14.

to conclude that the Court is necessarily saying that the concept of competitive pricing is *incompatible* with those ethical standards. In support of its application of the learned profession exemption the majority notes that "the proscriptions of the Sherman Act were 'tailored . . . for the business world,' not for the noncommercial aspects of the liberal arts and the learned professions."[83] Query whether minimum fees constitute a "noncommercial aspect of the . . . learned professions."[84]

Thomas P. Milton, Jr.

Criminal Law—Conspiracy—Defendant Cannot Be Convicted of Conspiracy to Assault Federal Officer without Knowledge of His Victims Federal Identity.—Hall, a federal narcotics undercover agent working through an informer, negotiated the purchase of a half-kilo of heroin from an unlawful supplier, Feola. Another undercover agent, Hall and the informer met Feola and his companions, Farr, Alsondo and Rosa, in an apartment in Manhattan to complete the transaction. Farr and his accomplices had substituted sugar for the heroin and planned to rob the buyers if they discovered the switch before paying the agreed amount. When the informer announced his desire to inspect the merchandise at the meeting, defendants realized that discovery of the substitution was imminent. Alsondo drew a gun and a struggle ensued as defendants attempted to flee, but the agents finally subdued the group. Alsondo,[1] Rosa, Feola, and Farr[2] were tried and convicted on charges of assaulting a federal officer under 18 U.S.C. § 111[3] and of conspiring to commit that offense under 18 U.S.C. § 371.[4]

83. 497 F.2d at 14 n.41, quoting Marjorie Webster Junior College, Inc. v. Middle States Ass'n of Colleges and Secondary Schools, Inc., 432 F.2d 650, 654 (D.C. Cir.), cert. denied, 400 U.S. 965 (1970) (footnotes omitted). The court has, in addition, omitted the next sentence of Webster: "In these contexts, an incidental restraint of trade, absent an intent or purpose to affect the commercial aspects of the profession, is not sufficient to warrant application of the antitrust laws." 432 F.2d at 654.

84. See note 45 supra. The courts have been presented with another opportunity to answer this and other issues raised in Goldfarb. United States v. Oregon State Bar, Civil No. 74-362 (D. Ore., filed May 9, 1974). It is interesting to note that the Government began this action the day following the Goldfarb decision.

1 Alsondo was also convicted for unlawfully carrying a firearm during the commission of a felony, violating 18 U.S.C. § 924(c)(2) (1970). United States v. Alsondo, 486 F.2d 1339, modified on rehearing, 486 F.2d 1346 (2d Cir. 1973), cert. granted sub nom. United States v. Feola, 94 S. Ct. 1932 (1974).

2. On a separate appeal, Farr's conviction on the assault was affirmed but the conviction on the conspiracy was reversed and the charges dismissed. United States v. Farr, 487 F.2d 1023 (2d Cir. 1973), petition for cert. filed, 42 U.S.L.W. 3379 (U.S. Dec. 19, 1973) (No. 73-953). Farr is challenging the validity of the nonscienter rule in the federal assault conviction

3. 18 U.S.C. § 111 (1970) [hereinafter cited as section 111] provides in pertinent part: "Whoever forcibly assaults, resists, opposes, impedes, intimidates, or interferes with any person . . . while engaged in or on account of the performance of his official duties, shall be fined not more than $5,000 or imprisoned not more than three years, or both."

4. 18 U.S.C. § 371 (1970) [hereinafter cited as section 371] provides in pertinent part:

Although it affirmed—either initially or on rehearing—the convictions of all four individuals on the substantive assault offense,[5] the court of appeals reversed the convictions on the conspiracy charge, holding that the government's failure to prove defendants' knowledge of the official identity of their victims necessitated the dismissal of that charge.[6] *United States v. Alsondo*, 486 F.2d 1339, *modified on rehearing*, 486 F.2d 1346 (2d Cir. 1973), *cert. granted sub nom. United States v. Feola*, 94 S. Ct. 1932 (1974).

The *Alsondo* decision raises the problem of reconciling the scienter requirements of the federal conspiracy and assault statutes.

Scienter refers to "defendant's . . . previous knowledge . . . of facts which it was his duty to guard against . . . ."[7] Lower court cases have held uniformly that defendants prosecuted under the federal assault statute need not have knowledge that their victims were federal officers, acting in an official capacity, in order to be found guilty of violating the statute. Thus, scienter is not an element of the offense.[8]

This lack of a scienter requirement suggests that the federal statute is analytically indistinguishable from any state assault statute.[9] Most states have codified the common law offense of assault which required merely intent to injure.[10] The identity of the victim was not and still remains unimportant to the offense of simple assault. Since state statutes apparently provide ample op-

"If two or more persons conspire either to commit any offense against the United States, or to defraud the United States . . . and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both."

5. United States v. Alsondo, 486 F.2d 1339, modified on rehearing, 486 F.2d 1346 (2d Cir. 1973), cert. granted sub nom. United States v. Feola, 94 S. Ct. 1932 (1974).

6. Id. at 1344.

7. Black's Law Dictionary 1512 (rev. 4th ed. 1968); see Morissette v. United States, 342 U.S. 246, 252 (1952) (guilty knowledge); United States v. Dotterweich, 320 U.S. 277, 281 (1943) (awareness of some wrongdoing); United States v. Balint, 258 U.S. 250, 251 (1922) (knowledge); People v. Gould, 237 Mich. 156, 163-64, 211 N.W. 346, 348-49 (1926) (design, understanding, knowledge, guilty knowledge); Horton v. Tyree, 104 W. Va. 238, 242, 139 S.E. 737, 738 (1927) (actual knowledge, indifference to truth or falsity).

8. United States v. Fernandez, 497 F.2d 730, 736 (9th Cir. 1974) (undercover narcotics agent); United States v. Langone, 445 F.2d 636, 637 (1st Cir.), cert. denied, 404 U.S. 915 (1971) (undercover narcotics agent); United States v. Goodwin, 440 F.2d 1152, 1155-56 (3d Cir. 1971) (F.B.I. agents); United States v. Linn, 438 F.2d 456, 459 (10th Cir. 1971) (postal employee); United States v. Leach, 429 F.2d 956, 963 (8th Cir. 1970), cert. denied, 402 U.S. 986 (1971) (narcotics agent); United States v. Ulan, 421 F.2d 787, 789 (2d Cir. 1970) (federal deputy marshal); United States v. Kartman, 417 F.2d 893, 894 (9th Cir. 1969) (federal deputy marshal); United States v. Wallace, 368 F.2d 537, 539 (4th Cir. 1966), cert. denied, 386 U.S. 976 (1967) (revenue agent).

9. E.g., N.Y. Penal Law § 120.00(1) (McKinney 1967) sets forth the scienter requirement for assault in the third degree: "With intent to cause physical injury to another person, he causes such injury to such person . . . ." Other states have similar provisions. See, e.g., Cal. Penal Code § 240 (West 1970); Colo. Rev. Stat. Ann. § 40-2-33 (1963); Ill. Ann. Stat. ch. 38, § 12-1 (Smith-Hurd 1972); Ohio Rev. Code Ann. § 2901.25 (Page 1954); Pa. Stat. Ann. tit. 18, § 2701 (1973); Tex. Penal Code art. 22.01 (1974).

10. W. LaFave & A. Scott, Jr., Criminal Law 603 (1972).

portunity for prosecution of criminals who commit assaults,[11] the federal government's motive in creating a separate assault statute is not readily apparent. One must look to the reasons advanced for its enactment.

In a letter to the Senate Committee on the Judiciary in 1934,[12] Attorney General Homer Cummings recommended that such legislation be enacted so that the federal government would not have to rely on state prosecution of criminal acts against federal personnel acting in their official capacity.[13] He hoped that such legislation would further the purposes of the federal government through effective protection of its law-enforcement officials.[14]

The committee's reluctance "to withdraw exclusive jurisdiction from the State courts"[15] over assaults suggests congressional desire to limit the conduct proscribed in the statute to the knowing assault on a federal officer.[16]

Other history on this particular legislation is sparse. However, the Supreme Court considered the purpose of the enactment in *Ladner v. United States*.[17] Ladner wounded two federal officers with a single shot from his weapon. He was convicted on two assault counts and sentenced to two consecutive ten year prison terms. Ladner contended that he was guilty of only one assault under the terms of the statute. The Supreme Court agreed with his argument and reversed his conviction.[18] Reviewing the meager legislative history of the statute, the Court felt its main aim was "to prevent hindrance to the execution of official duty, and thus to assure the carrying out of federal purposes and interests . . . ."[19] The protection of the persons of federal officers was a subordinate considera-

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11. See note 9 supra.

12. Ladner v. United States, 358 U.S. 169, 174-75 n.3 (1958) (construing 18 U.S.C. § 254 (1940), as amended, 18 U.S.C. § 111 (1970)).

13. Id. at 174-75 n.3. "[R]esort must usually be had to the local police court, which affords but little relief to us, under the circumstances, in our effort to further the legitimate purposes of the Federal Government." Id.

14. Id.

15. 78 Cong. Rec. 8127 (1934) (remarks of Mr. Sumners). The legislative history of this assault statute is meager, principally comprising Attorney General Cummings' letter to the Senate Committee on the Judiciary. Ladner v. United States, 358 U.S. 169, 174 (1958). However, it was evident that "[u]ndue expansion of federal criminal jurisdiction was unacceptable to the Congress that adopted the statute that now is section 111." United States v. Fernandez, 497 F.2d 730, 746 (9th Cir. 1974) (Hufstedler, J., concurring).

16. "Congress was seeking to avoid creation of a federal crime that was wholly duplicative of a state crime." United States v. Fernandez, 497 F.2d 730, 746 (9th Cir. 1974) (Hufstedler, J., concurring). Since the aim of the statute is to further the purposes of the federal government, knowledge that one is encountering a federal officer seems essential to the offense. Id.

17. 358 U.S. 169 (1958).

18. Id. at 179. "[T]he single discharge of the shotgun would constitute an 'assault' without regard to the number of federal officers affected . . . ." Id. at 177.

19. Id. at 176. "Support for this meaning may be found in the fact that . . . it [is] unlawful not only to assault federal officers engaged on official duty but also forcibly to resist, oppose, impede, intimidate or interfere with such officers." Id.

tion.[20] For this reason, the act of hindering the federal officers as they carry out their official duties would be the sole criminal act.[21] The form of the hindrance and the number of federal personnel involved would be insignificant.[22]

Although the Court did not discuss the scienter requirement of the statute, knowledge of the federal identity of one's victim seems essential if the true purpose of the statute is to be served. Only one who has knowledge of the fact that he is interfering with a federal officer's performance of his duties will be deterred by the *federal* statute.[23]

Subsequent decisions in lower federal courts appear to have deviated from the *Ladner* interpretation of the statute's purpose. These cases indicate that the basic purpose of the statute is to provide a convenient federal forum when the offenses within the statute are committed against a federal officer.[24] The defendant's lack of knowledge of the federal identity of his victim is irrelevant to such a construction of the statute. A federal prosecution requires only that the defendant have the general intent to assault someone and that his victim prove to be a federal officer.[25]

This interpretation seems to expand the scope of the statute and to enlarge federal jurisdiction over assault.[26] For example, in *United States v. Langone*,[27] a federal narcotics undercover agent, on his way to meet an informer, parked his automobile in front of defendant's funeral home. Defendant, unaware of the identity of the agent or of the nature of his activities, objected to the agent's leaving his vehicle in that place, became violent and shoved the agent against

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20. Id.

21. Id. The court did not believe that Congress intended a person who prevented federal officers from entering a building "might commit as many crimes as there are officers denied entry." Id.

22. Id. at 177.

23. United States v. Fernandez, 497 F.2d 730, 744-45 (9th Cir. 1974) (Hufstedler, J., concurring).

24. "Congress merely sought to provide a federal forum for the trial of cases involving various offenses against federal officers in the performance of official duties." United States v. Lombardozzi, 335 F.2d 414, 416 (2d Cir.), cert. denied, 379 U.S. 914 (1964) (assault on a federal agent conducting surveillance of a funeral); accord, United States v. Goodwin, 440 F.2d 1152, 1155 (3d Cir. 1971) (assault on two F.B.I. agents); United States v. Kartman, 417 F.2d 893, 895 (9th Cir. 1969) (assault on a federal deputy marshal).

25. See note 8 supra.

26. See notes 12-16 supra and accompanying text. The courts, as a result, are affirming convictions on substantive counts even when defendants are unaware of the federal identity of their victims and have no intent to thwart the federal government. E.g., United States v. Fernandez, 497 F.2d 730 (9th Cir. 1974) (defendants unaware that assault victim was a federal undercover agent; conviction affirmed); United States v. Alsondo, 486 F.2d 1339, modified on rehearing, 486 F.2d 1346 (2d Cir. 1973), cert. granted sub nom. United States v. Feola, 94 S. Ct. 1932 (1974) (same); United States v. Maynard, 452 F.2d 1087 (1st Cir. 1971) (per curiam) (same); United States v. Langone, 445 F.2d 636 (1st Cir.), cert. denied, 404 U.S. 915 (1971) (same).

27. 445 F.2d 636 (1st Cir.), cert. denied, 404 U.S. 915 (1971).

the car.[28] Defendant was convicted of assaulting a federal officer who was engaged in official activities.[29] The court rejected defendant's argument that the government was required to prove defendant knew the victim was a federal officer, declaring that such a requirement would weaken the effectiveness of the statute.[30] Similar reasoning is found in a recent decision, *United States v. Fernandez*,[31] where the Ninth Circuit recognized that defendants who attacked a federal narcotics undercover agent, believing him to be a drug pusher, quite possibly never would have assaulted him if they had known his federal identity.[32] However, the court affirmed their convictions[33] because it felt only Congress had the power to change the elements of the statute to include scienter.[34]

Judge Hufstedler, concurring in *Fernandez*, re-examined the legislative intent behind the statute. She felt that the main purpose of the statute is the "facilitation of certain federal officials' law enforcement efforts,"[35] rather than the protection of individuals.[36] She also noted the similarity between the intent of the federal statute and that of certain state statutes which punish the knowing assault on state law enforcement officers.[37] These state statutes require more than the simple intent to injure; to be convicted, a defendant must know that his victim is a law enforcement officer.[38] Such "aggravated assault"[39] would be more analogous to the conduct proscribed in the federal statute than would

28. Id. at 636.

29. Id.

30. Id. at 637. "Burdening the government with an obligation to prove knowledge could seriously impede [the protection of federal officers.]" Id.

31. 497 F.2d 730 (9th Cir. 1974).

32. Id. at 735, 738.

33. Id. at 740.

34. Id. at 738.

35. Id. at 743 (Hufstedler, J., concurring). "The basic purpose of section 111 is preventing obstruction of justice." Id. "[T]he knowledge requirement is well suited to the purpose of an obstruction of justice law." Id. at 744.

36. "[I]f an obstruction of justice statute protects persons, it does so only as a means of protecting those individuals' functions." Id. at 743.

37. Id. at 745. These statutes include, e.g., Cal. Penal Code § 241 (West Supp. 1974); Colo. Rev. Stat. Ann. § 40-7-54 (Supp. 1967); Ill. Ann. Stat. ch. 38, § 12-2(b) (Smith-Hurd Supp. 1972); N.Y. Penal Law § 120.05(3) (McKinney 1967); Ohio Rev. Code Ann. § 2901.252 (Page Temp. Supp. 1972); Pa. Stat. Ann. tit. 18, § 2702(3) (1973); Tex. Penal Code art. 22.02(a)(2) (1974).

38. In re Cline, 255 Cal. App. 2d 115, 123, 63 Cal. Rptr. 233, 239 (3d Dist. 1967), cert. denied, 392 U.S. 938 (1968) (assault with a deadly weapon on a police officer); People v. Prante, 177 Colo. 243, 248, 493 P.2d 1083, 1085 (1972) (en banc) (assault on a police officer); People v. Litch, 4 Ill. App. 3d 788, 791, 281 N.E.2d 745, 747 (2d Dist. 1972) (assault on a police officer in a stationhouse); People v. Wheeler, 59 Misc. 2d 825, 826-27, 300 N.Y.S.2d 362, 364 (Chemung County Ct. 1969), aff'd mem., 36 App. Div. 2d 549, 317 N.Y.S.2d 111 (3d Dep't 1971) (assault on a police officer); Ford v. State, 158 Tex. Crim. 26, 252 S.W.2d 948 (Tex. Ct. Crim. App. 1952).

39. 497 F.2d at 745 (Hufstedler, J., concurring).

"simple assault."[40] Nevertheless, the federal courts generally have not applied a scienter requirement.[41]

The problem of scienter in federal assault cases[42] must be contrasted with the federal courts' treatment of scienter for conviction of *conspiracy* to commit a federal offense. In *United States v. Mack*,[43] where the substantive offense of keeping and failing to register an alien prostitute did not require defendant's knowledge of alienage,[44] the court affirmed a conspiracy conviction.[45] Speaking through Judge Learned Hand, the court reasoned that the proof established that "the parties had in contemplation all the elements of the crime they are charged with conspiracy to commit."[46] Defendant in *Mack* acted at his peril and was "chargeable . . . with knowledge that the proscribed conduct [was] . . . unlawful."[47] In this case, the federal element of alienage seems to be merely a basis for jurisdiction over defendant.

However, in *United States v. Crimmins*,[48] where the substantive offense of causing stolen bonds to be transported in interstate commerce did not require defendant's knowledge that the bonds would cross state lines, the court, speaking through Judge Hand, reversed a conspiracy conviction[49] since "the conspiracy simply did not include that element of the crime."[50] Since interstate transportation seems to be an essential part of the agreement, knowledge of interstate transportation must be established independently of the act of transporting the bonds. Although these two cases suggested a dual approach to the scienter element in federal conspiracies, most subsequent cases adopted the *Crimmins* rationale that knowledge of the federal element must be part of the conspirators agreement.[51]

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40. Id. On the basis of this analogy, Judge Hufstedler concluded that "[a] statute proscribing assaults on peace officers should be interpreted as requiring proof of knowledge of the status of the victim." Id.

41. See note 8 supra.

42. See notes 8-41 supra and accompanying text.

43. 112 F.2d 290 (2d Cir. 1940).

44. Id. at 292. "[A] person entertaining an alien prostitute is liable regardless of his knowledge that she is an alien." Id. (citation omitted).

45. Id. at 293.

46. Id. at 292. Accord, Wilkerson v. United States, 41 F.2d 654 (7th Cir. 1930), cert. denied, 282 U.S. 894 (1931) (conspiracy to violate National Motor Vehicle Theft Act). The substantive statute did not require that defendant have knowledge that the stolen property was part of interstate commerce, so the court did not feel it was necessary to prove such knowledge for conspiracy to violate the statute. Id. at 656.

47. 112 F.2d at 292.

48. 123 F.2d 271 (2d Cir. 1941).

49. Id. at 274.

50. Id. at 273. Since defendant was unaware that the bonds had crossed state lines and since the agreement did not include an intended violation of federal law, his conviction was reversed. Id.

51. E.g., Ingram v. United States, 360 U.S. 672 (1959) (conspiracy to defeat payment of federal taxes on lottery operations); Pereira v. United States, 347 U.S. 1 (1954) (conspiracy to violate the federal mail fraud statute and the National Stolen Property Act); United

In *United States v. Roselli*,[52] the Ninth Circuit departed from the *Crimmins* rationale and moved toward the *Mack* reasoning. There, defendants appealed their convictions for conspiring to use interstate commerce to facilitate racketeering. The court stated that the gist of section 371 "is an agreement . . . to commit the substantive crime."[53] Use of interstate commerce, the court continued, merely established jurisdiction in federal court for the prosecution of defendants who planned a crime that "is in fact and law a federal offense."[54] Since knowing use of interstate commerce was not an element of the choate crime, it would not be an element of the corresponding conspiracy.[55]

Despite *Roselli*, the Second Circuit has consistently reaffirmed the *Crimmins* rationale.[56] However, the National Commission on the Reform of Federal

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States v. Jacobs, 475 F.2d 270 (2d Cir. 1973), cert. denied, 414 U.S. 821 (1974) (conspiracy to deal in stolen securities moved in interstate commerce); United States v. Vilhotti, 452 F.2d 1186 (2d Cir. 1971), cert. denied, 406 U.S. 947 (1972) (conspiracy to buy, receive, or possess goods stolen from interstate commerce); United States v. Cimini, 427 F.2d 129 (6th Cir.), cert. denied, 400 U.S. 911 (1970) (conspiracy to steal and convert goods moving in interstate commerce); Nassif v. United States, 370 F.2d 147 (8th Cir. 1966) (conspiracy to steal and convert goods moving in interstate commerce). Something more than wrongful intent is necessary for conviction under the general federal conspiracy statute. Knowledge of the federal element involved (interstate commerce, mails, federal officers) establishes "an intent which is distinctly anti-federal." Developments in the Law—Criminal Conspiracy, 72 Harv. L. Rev. 920, 937 (1959).

52. 432 F.2d 879 (9th Cir. 1970), cert. denied, 401 U.S. 924 (1971).

53. Id. at 891. "There is no apparent reason for requiring not only proof of a concert of action that includes all elements of the substantive offense, but also proof of knowledge of the jurisdictional element that is not required for conviction of the substantive offense." Id. at 891-92.

54. Id. at 892.

55. Id. at 891-92. The court further declared that "[defendant's] conviction of conspiracy was proper even if knowledge of the interstate aspects of the illegal scheme is an essential element of the offense." Id. at 892. Other courts have commented favorably on the Roselli rationale. United States v. Polesti, 489 F.2d 822, 824 (7th Cir. 1973) (conspiracy to steal goods from interstate commerce) (collecting cases); United States v. Iannelli, 477 F.2d 999, 1002 (3d Cir. 1973), cert. granted, 94 S. Ct. 2602 (1974) (conspiracy to violate federal gambling laws); United States v. Thompson, 476 F.2d 1196, 1199-1200 (7th Cir.), cert. denied, 414 U.S. 918 (1973) (conspiracy to transport forged checks in interstate commerce) (dictum).

56. United States v. Rizzo, 491 F.2d 1235, 1236 (2d Cir. 1974) (per curiam) (conspiracy to steal goods from interstate commerce); United States v. Cangiano, 491 F.2d 906, 910 (2d Cir.), cert. denied, 94 S. Ct. 3223 (1974) (conspiracy to transport obscene materials in interstate commerce); United States v. Houle, 490 F.2d 167, 171-72 (2d Cir. 1973) (conspiracy to steal goods moving in interstate commerce); United States v. DeMarco, 488 F.2d 828, 832 (2d Cir. 1973) (conspiracy to possess goods stolen from interstate commerce); United States v. Jacobs, 475 F.2d 270, 281-82 (2d Cir.), cert. denied, 414 U.S. 821 (1973) (conspiracy to deal in stolen treasury bills moving in interstate commerce); United States v. Fields, 466 F.2d 119, 120-21 (2d Cir. 1972) (conspiracy to receive and possess goods stolen from interstate commerce); United States v. Vilhotti, 452 F.2d 1186, 1189-90 (2d Cir. 1971), cert. denied, 406 U.S. 947 (1972) (conspiracy to possess goods stolen from interstate commerce).

Criminal Laws has urged adoption of the *Roselli* approach.[57] Knowledge of the federal element would not be an element of the choate offenses or conspiracy.[58] Rather, the federal element would serve only as the basis for federal jurisdiction.[59]

The commission's recommendations were still before Congress when the Second Circuit in *United States v. Alsondo*,[60] faced the problem of reconciling the scienter requisite to conspiracy to assault a federal officer with the absence of such a requirement from the elements of the choate offense.

The court affirmed the assault convictions on the theory that knowledge of the federal identity of the victim is not an element of the substantive offense of assaulting a federal officer while he is engaged in the performance of his duties.[61] In so holding, the court followed without question the generally accepted construction of the assault statute.

The court was more reluctant to follow the *Crimmins* construction of the conspiracy statute.[62] The *Alsondo* court believed that recognition of the federal element as a basis for jurisdiction would eliminate the anomaly between the absence of a knowledge element in the section 111 choate offense and the presence of the element in the corresponding conspiracy under section 371.[63] The court

57. The Act of Nov. 8, 1966, Pub. L. No. 89-801, § 3, 80 Stat. 1516 created this commission to conduct a "full and complete review and study of the statutory and case law of the United States . . . ." Concerning the commission's proposed Federal Criminal Code, Senator McClellan has stated that "its treatment of Federal jurisdiction . . . is the keystone of its suggested reform . . . . The framework underlying the [proposed] Code's treatment of Federal jurisdiction is the following: Federal penal laws are defined with a focus on punishing misconduct within the Federal jurisdiction, rather than, as is often now the case, some interference with a jurisdictional factor itself." 117 Cong. Rec. 6127 (1971) (remarks of Senator McClellan). For a discussion of the proposed Federal Criminal Code and its impact on the federal law of conspiracy, see generally id. at 6120-33 (remarks of Senator McClellan); Johnson, The Unnecessary Crime of Conspiracy, 61 Calif. L. Rev. 1137 (1973); McClellan, Codification, Reform, and Revision: The Challenge of a Modern Federal Criminal Code, 1971 Duke L.J. 663 (1971); Comment, Criminal Conspiracy, 68 Nw. U.L. Rev. 851 (1973).

58. 117 Cong. Rec. 6128 (1971) (remarks of Senator McClellan).

59. Id. at 6131 (remarks of Senator McClellan). "[Jurisdiction would be] no longer a definitional element of the offense, but instead a 'basis' under which the misconduct becomes prosecutable by the Federal sovereign, not unlike the showing of the place where the offense occurred now required to establish state jurisdiction to prosecute." Id.

60. 486 F.2d 1339, modified on rehearing, 486 F.2d 1346 (2d Cir. 1973), cert. granted sub nom. United States v. Feola, 94 S. Ct. 1932 (1974); see notes 1-6 supra and accompanying text.

61. Id. at 1342. Originally, Alsondo's assault conviction was the only one affirmed by the court. However, on rehearing, the court also affirmed the assault convictions of codefendants Feola and Rosa on "general agency principles" inasmuch as "the jury must already have found an agreement . . . to assault a victim . . . ." Id. at 1347. Under this rationale, the court apparently was able to recognize that defendants had agreed to commit a crime, without violating its holding that such a conspiracy could not be punished without defendants' knowledge that their victims were federal officers.

62. Id. at 1343-44; see notes 48-50 supra and accompanying text.

63. 486 F.2d at 1343.

also discussed the proposed legislative changes which would reduce the federal element of section 371 to purely jurisdictional significance.[64]

Alsondo considered distinguishing *Crimmins* on the grounds that the government's interest in protecting its federal agents might be strong enough to eliminate the knowledge requirement in a conspiracy to assault a federal officer.[65] Ultimately, however, the court felt compelled to uphold *Crimmins* at least until legislative changes in the federal penal code superseded it.[66] Since defendants had been unaware that they were conspiring to attack federal officers, the court reversed the conspiracy convictions.[67]

Faced with an opportunity to re-evaluate the scienter requirement in the federal assault and conspiracy statutes, the Second Circuit in *Alsondo* chose to follow the familiar path that had been paved by its predecessors, content to leave the problem of scienter in these offenses to Congress.

It appears that the only bona fide interest which the federal government has in a federal assault or a federal conspiracy statute is the protection of the activities of federal officers. To effectuate this purpose, a scienter requirement is necessary. Since Congress apparently intended nothing more,[68] the courts should be reluctant to expand the scope of federal jurisdiction in this area. Furthermore, in light of the purpose of the federal statutes, there is little logic in requiring scienter in the conspiracy area and not requiring it in the substantive offense. Should it grant certiorari in *United States v. Farr*,[69] the Supreme Court will have an opportunity to decide whether scienter is necessary in the substantive offense. Alternatively, the Court could reject the scienter requirement in the conspiracy situation when it decides *Alsondo*. Hopefully, its decisions will harmonize the scienter requirements of the assault and conspiracy offenses.

Rose Mary Reilly

Securities—Securities Investor Protection Act—Broker's Recovery Depends upon Customer's Conduct.—In February, 1971, petitioner Arenstein ordered petitioner Coggeshall & Hicks, Inc. (Coggeshall), a brokerage house with which Arenstein had extensive dealings, to purchase 2,000 shares of Syntex common stock. Arenstein did not tender payment at that time, and did not have sufficient funds in his special account with Coggeshall to complete the purchase.[1] Coggeshall purchased the shares for $90,933.82. Shortly thereafter, Arenstein ordered Packer, Wilbur & Co. (Packer Wilbur), another brokerage house with which he dealt, to sell 2,000 shares of Syntex stock. When Packer Wilbur had

64. Id.; see notes 57-59 supra and accompanying text.

65. 486 F.2d at 1344.

66. Id. at 1343.

67. Id. at 1344; see note 6 supra.

68. See notes 12-15 supra and accompanying text.

69. 487 F.2d 1023 (2d Cir. 1973), petition for cert. filed, 42 U.S.L.W. 3379 (U.S. Dec. 19, 1973) (No. 73-953); see note 2 supra.

1. At the time of the Second Circuit's decision, Arenstein had not paid for the shares.

negotiated a sale at $94,203.10, Arenstein ordered Coggeshall to transfer the shares to Packer Wilbur against payment, which Coggeshall did. Packer Wilbur, which was experiencing financial difficulties, forwarded two checks to Coggeshall, knowingly drawn against insufficient funds, and completed the sale of the 2,000 shares to a bona fide purchaser,[2] depositing the $94,203.10 in its own account. Packer Wilbur's financial condition subsequently worsened and a trustee was appointed under section 5 of the Securities Investor Protection Act of 1970 (SIPA)[3] to liquidate the brokerage house, satisfy claims of customers who had securities or cash on account, and complete certain of its contractual commitments with other broker-dealers.[4] Coggeshall filed a claim with the trustee for $90,933.82, representing that the non-payment of the Packer Wilbur checks constituted an "open contractual commitment"[5] to be completed by the trustee. Arenstein also filed a claim under section 6 of SIPA,[6] seeking a $50,000 advance on his total claim against Packer Wilbur.[7]

The district court[8] determined that Arenstein had no right to protection under SIPA because he was not an innocent customer,[9] declaring that Arenstein had committed a securities margin rule violation (Regulation T[10]) when he ordered

2. A "bona fide purchaser" of a security (defined in Uniform Commercial Code § 8-302 (1962 version) as "a purchaser for value in good faith and without notice of any adverse claim . . . .") "acquires the security free of any adverse claim." Id. § 8-301(2). "An adverse claim may be either legal or equitable . . . ." Id. § 8-301, Comment 4.

3. Securities Investor Protection Act of 1970 § 5(b)(3), 15 U.S.C. § 78eee(b)(3) (1970).

4. The terms "broker" and "dealer" are defined in the Securities Exchange Act of 1934 §§ 3(a)(4) & (5), 15 U.S.C. §§ 78c(a)(4) & (5) (1970). See generally Douglas & Bates, Stock "Brokers" as Agents and Dealers, 43 Yale L.J. 46 (1933); Note, The Securities Investor Protection Act of 1970: A New Federal Role in Investor Protection, 24 Vand. L. Rev. 586 n.2 (1971) [hereinafter cited as SIPA Federal Role]. There is no doubt that Coggeshall is a broker-dealer within the meaning of the securities acts.

5. Open contractual commitments are "transactions in securities [between broker-dealers] which were made in the ordinary course of . . . business and which were outstanding on the filing date—(1) in which a customer had an interest . . . or (2) in which a customer did not have an interest . . . [but are deemed by the SEC] to be in the public interest [to complete]." Securities Investor Protection Act of 1970 § 6(d), 15 U.S.C. § 78fff(d) (1970). "Filing date" means the day on which SIPC submits its application for trusteeship. Id. § 5(b)(4)(B), 15 U.S.C. § 78eee(b)(4)(B) (1970).

6. Securities Investor Protection Act of 1970 § 6(f), 15 U.S.C. § 78fff(f) (1970).

7. The claims were, to a large extent, duplicative since any sums collected by Coggeshall would have been credited to Arenstein's account. See SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583, at 96,040 n.4 (2d Cir. May 31, 1974).

8. SEC v. Packer, Wilbur & Co., 362 F. Supp. 510 (S.D.N.Y. 1973), aff'd sub nom. SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974).

9. "One who engages in a fraudulent transaction cannot reap the benefits of the Act's intended protection." Id. at 513-14.

10. 12 C.F.R. § 220.4(c) (1974), promulgated under Securities Exchange Act of 1934 § 78(c), 15 U.S.C. § 78g(c) (1970). A customer-investor is prohibited from violating Regulation T by virtue of Regulation X, 12 C.F.R. § 224 (1974). See Comment, Civil Lia-

the purchase without sufficient funds in his special cash account and without intending to pay for the shares before selling. In addition, it indicated that he had violated rule 10b-5[11] by concealing his true intentions while dealing with the two brokerage houses.[12]

The court found that Coggeshall also had violated Regulation T[13] because it had furthered Arenstein's transaction while on constructive notice that he was deficient under the margin requirements. Therefore, the court concluded that Coggeshall could not demand, under SIPA, completion of Packer Wilbur's contractual commitment to render payment.[14]

Arenstein did not appeal the district court's decision. Coggeshall appealed that part of the decision which denied its request for completion of the open commitment. In affirming the lower court, the Second Circuit Court of Appeals adopted the district court's holding that protection under SIPA does not extend to unscrupulous customers.[15] It indicated, however, without so holding, that Coggeshall had not violated Regulation T.[16]

Nonetheless, it denied Coggeshall's claim for two reasons. First, the court stated that since commitments to be completed under SIPA are transactions between brokers *on behalf of customers*,[17] and since Arenstein correctly had been denied recovery in his own right, "it would hardly serve the cause of statutory consistency to allow Coggeshall to recover . . . under another section."[18] Secondly, the court held that the contractual commitment to be completed must be wholly executory at the time of the demand on the SIPC trustee, whereas in this case the contract had been partly executed.[19] *SIPC v. Packer, Wilbur & Co.*, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974).

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bility for Margin Violations—The Effect of Section 7(f) and Regulation X, 43 Fordham L. Rev. 93 (1974).

11. 17 C.F.R. § 240.10b-5 (1974), promulgated under Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970).

12. 362 F. Supp. at 514. If the transaction had gone as planned, Arenstein would have realized a profit of $3,269.28 without any investment of cash. SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583, at 96,040 (2d Cir. May 31, 1974) [hereinafter cited by page as CCH Binder].

13. 362 F. Supp. at 516. See note 10 supra.

14. 362 F. Supp. at 517.

15. CCH Binder at 96,043. To do otherwise "would in effect be giving succor under one section of the Securities Exchange Act to a person who violated another section." Id. Securities Investor Protection Act of 1970 § 2, 15 U.S.C. § 78bbb (1970), provides that SIPA shall be considered an amendment to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78hh (1970). This Casenote will not treat the issue of the right of a customer to recover under SIPA for losses arising out of a transaction in which the customer violated rule 10b-5.

16. CCH Binder at 96,044. Coggeshall was not accused of violating § 10(b) or rule 10b-5.

17. See note 5 supra.

18. CCH Binder at 96,043. Arenstein applied for an advance under § 6(f) of the Securities Investor Protection Act of 1970, 15 U.S.C. § 78fff(f) (1970); Coggeshall's open contractual commitment claim fell within § 6(d), 15 U.S.C. § 78fff(d) (1970).

19. CCH Binder at 96,043-44.

Central to the Second Circuit's rejection of Coggeshall's claim is its finding that the statutory requirement of an underlying "customer interest" in the transaction between broker-dealers was not satisfied since Arenstein was not an innocent customer.[20] In reaching this conclusion, the court briefly discussed the legislative and economic history prior to SIPA to determine the range of problems and the classes of people the statute was intended to affect.

SIPA was passed in reaction to the "bear market" condition of the securities industry during the late 1960's.[21] As the court of appeals observed in *Packer Wilbur*,

> [t]he near collapse in 1969 of Hayden Stone and the rumors of impending failures of other brokerage houses cast a pall over Wall Street that was reminiscent of its never-to-be-forgotten "Black Tuesday." The industry naturally feared that the breakdown of these houses would be attended by a general decline in public confidence in the securities market. Congress soon became concerned for the state of the market and in particular for the plight of the many small investors who fell victim to the economic demise of their brokers.[22]

SIPA was designed to provide a limited amount of insurance protection to customer-investors in this situation.[23]

The plight of the investor was found to be a result of the manner of operation of the securities industry.[24] Prior to SIPA's enactment broker-dealers had almost unlimited use of customer-investors' cash and securities. They could use the cash to finance the margin purchases of other customer-investors, and even to satisfy general business expenses.[25] When broker-dealers intentionally or negligently failed to comply with anti-hypothecation provisions,[26] customers often found it very difficult to obtain reimbursement upon their broker-dealer's dissolution. In some cases, customers might recover their cash balance or securities from the receiver in bankruptcy—but only after lengthy liquidation proceedings.[27] In other cases, they might never recover, or at best receive a small pro rata distribution, if the broker had wasted or misapplied most of its assets.[28]

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20. See notes 43 and 50 infra and accompanying text.

21. SEC v. F.O. Baroff Co., 497 F.2d 280 (2d Cir. 1974). "The late 1960's saw the collapse of several brokerage establishments, causing serious financial losses to their clients. . . . There was considerable concern that investors, particularly smaller ones, would lose confidence in the stability of broker-dealers, and withdraw from the securities market." Id. at 283.

22. CCH Binder at 96,039.

23. 15 U.S.C. §§ 78fff(c)(2)(A)(ii)-(iii) (1970).

24. See Hearings on S. 2348, S. 3988, and S. 3989 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 17 (1970) [hereinafter cited as Senate Hearings] (statement by SEC Chairman Budge).

25. Id. at 8-9; see 116 Cong. Rec. 39,352 (1970) (remarks of Rep. Broomfield). H.R. Rep. No. 1613, 91st Cong., 2d Sess. 2 (1970) [hereinafter cited as House Report].

26. 17 C.F.R. § 240.8c-1 (1974).

27. House Report 1-3.

28. Id. See 116 Cong. Rec. 39,343 (1970) (remarks of Rep. Latta); id. at 39,346 (remarks of Rep. Staggers); id. at 39,352 (remarks of Rep. Boland). Rule 15c3-3, 17 C.F.R. § 240.15c3-3

Existing legislation and agency rules and regulations did not provide adequate protection against these practices.[29] Trust funds, established voluntarily by several national securities exchanges to aid customers of bankrupt member brokerage houses, proved insufficient.[30] SIPA was a response to the dual needs of protecting the investor and reinforcing public confidence in the market.[31] It established SIPC,[32] an agency with authority to act for the benefit of customer-investors of member broker-dealers[33] in financial difficulty.[34]

After briefly reviewing the conditions which brought the Act into being, the Second Circuit noted in *Packer Wilbur* that "[t]he present case requires us to define some of the bounds of protection afforded by SIPA and, more particularly, to determine who its beneficiaries may be."[35] It held that Coggeshall had the

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(1974), issued by the SEC on Nov. 10, 1972, was intended "to provide regulatory safeguards over customers' funds and securities held by brokers and dealers." SEC Securities Exchange Act Release No. 9922 (Jan. 18, 1973), reprinted in 2 CCH Fed. Sec. L. Rep. ¶ 25,132, at 18,323. The rule requires broker-dealers to maintain "a reserve with respect to customer funds and . . . to promptly obtain and thereafter maintain the physical possession or control of fully paid and excess margin securities of customers." Id. The authority for this rule flows from provisions in SIPA amending § 15(c)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o (1970). See Securities Investor Protection Act of 1970 § 7(d), codified as 15 U.S.C. § 78o(c)(3) (1970).

29. "While the totality of the rules and regulations . . . provide important protections for investors, it is clear that these rules are not sufficient by themselves to prevent the exposure of customers to substantial risk of loss as a result of financial mismanagement by a firm or its employees or insolvency." House Report 3; see 116 Cong. Rec. 39,351 (1970) (remarks of Rep. Broyhill).

30. "Self-help efforts in the industry—such as the New York Stock Exchange Trust Fund—were either severely strained or ineffective." SEC v. F.O. Baroff Co., 497 F.2d 280, 283 (2d Cir. 1974); Senate Hearings 17. See Sowards & Mofsky, The Securities Investor Protection Act of 1970, 26 Bus. Law. 1271, 1276 (1971); Note, The Securities Investor Protection Act of 1970: An Early Assessment, 73 Colum. L. Rev. 802 (1973); SIPA Federal Role, supra note 4, at 595-604 (1971).

31. House Report 3-4.

32. 15 U.S.C. § 78ccc(a) (1970).

33. SIPA provides that "SIPC shall . . . be a membership corporation the members of which shall be . . . all persons registered as brokers or dealers under section 78o(b) of this title, and . . . all persons who are members of a national securities exchange . . . ." 15 U.S.C. § 78ccc(a)(2) (1970). The Act makes limited exceptions to this membership requirement, but these are not relevant here. Id.

34. 15 U.S.C. § 78eee(a)(1) (1970); House Report 1. When notified that a subject broker-dealer is in or is approaching financial difficulty, SIPC may apply to courts of competent jurisdiction for an adjudication that customers of the broker-dealer are in need of the Act's protection. 15 U.S.C. § 78eee(a)(2) (1970). When such a decree is granted, the court must appoint a trustee, id. § 78eee(b)(3), who shall complete all open contractual commitments of the debtor in which a customer had an interest, and who shall direct to customers the appropriate payments, id. §§ 78fff(a), (g), from the single and separate fund, id. § 78fff(c)(2)(B), and from the corporation fund, id. § 78ddd. The trustee shall also manage the liquidation of the broker-dealer's business. Id. § 78fff(a)(4).

35. CCH Binder at 96,039.

responsibility to "demonstrate that its transaction with Packer Wilbur comes within the protection of the Act."[36]

Under SIPA the trustee must give first priority to the completion of open contractual commitments in which a customer has an interest.[37] With a limited exception, all property "received, acquired or held by or for the account of" the debtor broker-dealer, and all property in the "single and separate fund," from which the customers receive their pro rata share of the cash and securities owed them, is available to complete open contractual commitments.[38] The priority given to this function highlights a significant, though admittedly secondary, purpose of SIPA; namely, to prevent the failure of one brokerage firm from creating havoc in the securities industry due to the interrelationship of brokerage houses.[39] It is clear that the primary purpose in completing open contractual commitments is to insure that the customer of the debtor broker-dealer will not suffer undue loss: the customer for whom the commitment is completed may obtain the property involved immediately as part of his specifically identifiable property.[40] *Packer Wilbur* appeared to place exclusive emphasis on this goal.[41] But, by ignoring the other purpose of SIPA, to stabilize the securities market, the court risked weakening that market by effectively causing a brokerage house to face an undeserved financial loss of almost $100,000.[42]

As a basis for its conclusion that the Coggeshall/Packer Wilbur transaction was not an open contractual commitment as envisioned in SIPA, the Second Circuit argued that SIPA does not protect an unscrupulous customer such as Arenstein.[43] This finding appears to be one of first impression.[44] The court based its conclusion on the arguments of the lower court, the purposes of SIPA as indicated in legislative history, specific sections of earlier securities laws and resultant regulations, and cases interpreting those sections and regulations.

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36. Id. at 96,042.

37. 15 U.S.C. § 78fff(d) (1970). For the purposes of this section a customer is any person other than a broker or dealer. A customer has an interest in the transaction if the broker was acting as agent for him, or if a dealer "held a customer's order which was to be executed as part of the transaction." Id. Coggeshall claimed under the latter portion of this section. 362 F. Supp. at 515.

38. 15 U.S.C. § 78fff(d) (1970).

39. Senate Hearings 1 (statement of Senator Williams); see note 60 infra; SEC v. Aberdeen Sec. Co., 480 F.2d 1121, 1125-26 (3d Cir.), cert. denied, 414 U.S. 1111 (1973).

40. 15. U.S.C. § 78fff(d) (1970).

41. "[T]he objective of SIPA was to protect members of the investing public, not brokers. There was no intention to 'bail out' the securities industry." CCH Binder at 96,042 (footnote omitted).

42. See note 69 infra.

43. CCH Binder at 96,042-43. The court does acknowledge that such a finding would not apply to a customer who violated such a regulation through an honest mistake. Id. at 96,043 n.13.

44. "There is no indication in the legislative history that Congress ever adverted to the possibility of a securities law violator reaping the rewards of SIPA. Congressional attention appears to have been preempted by a concern for the misdeeds of the brokerage community." Id. at 96,043 n.11. But see text accompanying note 52 infra.

The district court had questioned whether the overriding goal of SIPA demands that a customer who deliberately violates the margin rules be prohibited from recovering out of SIPC funds.[45] Noting that the recently promulgated Regulation X[46] requires investors as well as broker-dealers to observe loan requirements such as those contained in Regulation T,[47] the district court stated that "[t]o allow Arenstein to recover from SIPC would contradict the *express* intent of Congress."[48] This it refused to do.[49]

The Second Circuit followed the lower court's reasoning, arguing that the open contractual commitment between Coggeshall and Packer Wilbur was one in which the "essential 'customer' interest required by the Act" was absent,[50] saying:

> We cannot believe that Congress intended that an active and sophisticated securities investor such as Arenstein, who deliberately engaged in a margin violation, should enjoy the benefits of SIPA.[51]

Nowhere in the legislative history of the Act,[52] however, is there a single reference to a congressional intent to exclude any customers other than those specifically mentioned in the statute itself. Section 6(f)[53] categorizes certain classes of customers who may not receive the benefits of SIPA; the exclusion extends to any customer of the debtor broker-dealer

> who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor . . . or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor . . . .[54]

A customer who is a broker, dealer or bank is also ineligible unless he can first demonstrate, by appropriate proof,[55] that his claim arose out of a transaction

45. 362 F. Supp. at 514.

46. 12 C.F.R. § 224 (1974); see note 10 supra.

47. 12 C.F.R. § 220.4 (1974); see note 10 supra.

48. 362 F. Supp. at 515 (emphasis added).

49. Id. The court also argued, by analogy to the bankruptcy laws, that its ruling was based on equitable considerations. Id. at 517. This reasoning appears incorrect. See Simonson v. Granquist, 369 U.S. 38 (1962); Keppel v. Tiffin Sav. Bank, 197 U.S. 356 (1905); Tiffany v. National Bank, 85 U.S. (18 Wall.) 409 (1873).

50. CCH Binder at 96,042. See note 5 supra.

51. CCH Binder at 96,043 (footnote omitted).

52. S. Rep. No. 1218, 91st Cong., 2d Sess. (1970); House Report, supra note 25; Senate Hearings, supra note 24; Hearings on H.R. 13308, H.R. 17585, H.R. 18081, H.R. 18109, and H.R. 18458 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess. (1970) [hereinafter cited as House Hearings].

53. 15 U.S.C. § 78fff(f) (1970).

54. Id. § 78fff(f)(1)(C); see House Report 21.

55. "[I]t shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise . . . ." that the transaction was for a customer of the broker, dealer or bank. 15 U.S.C. § 78fff(f)(1)(D).

for his customers.[56] Arenstein, a private investor, could not be excluded from protection under SIPA on the basis of this section. Coggeshall is a brokerage house, and to be entitled to recover under SIPA must demonstrate that its involvement in the transaction was on behalf of its customer, Arenstein. But this requirement is not at issue here, for the record in the case clearly indicates that Coggeshall was acting on Arenstein's behalf and not its own.[57] Therefore, Coggeshall cannot be excluded from SIPA's protection simply on the basis of section 6(f). The question remains, did Arenstein's conduct negate his broker's status? There is nothing in the legislative history or in the Act itself to require an affirmative response.

In some circumstances where Congress has failed to include a specific provision in a securities statute, it was clear that Congress intended the omitted provision be supplied by another part of the act.[58] Arguably, however, this is not the general rule, and does not apply in the instant case.[59] The omission of any reference in SIPA or its legislative history to the status of unscrupulous customers should be taken to mean that Congress intended SIPA only to stabilize the securities market and protect the investor.[60] Fraudulent practices, both by

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56. Id.

57. This is clear from the record. Brief for Appellant at 2, Reply Brief for Appellant at 9-10, SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974). However, the court suggested the possibility that Coggeshall might try to claim protection under SIPA as a customer in its own right. CCH Binder at 96,044 n.16. Apparently, the court believed that Coggeshall might claim customer status in its own right pursuant to 15 U.S.C. § 78fff(f)(1)(D) (1970), if it was purchasing or transferring the stock on Arenstein's behalf. The court itself admits that this provision at best gives only a limited opportunity to broker-dealers to claim under SIPA. CCH Binder at 96,044 n.16.

58. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963) (failure by Congress to insert a particularized anti-fraud provision in the Investment Advisers Act of 1940 overcome by consideration of the history and chronology of the anti-fraud securities legislation prior to 1940; earlier anti-fraud provision deemed to be incorporated in the 1940 Act).

59. See, e.g., Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971) and materials discussed in note 49 supra.

60. "The Securities Act of 1933 requires that investors have adequate information to exercise sound judgment concerning the securities he purchases [sic]. The Securities Exchange Act of 1934 insures that he will not be victimized by fraudulent, manipulative, or deceptive selling schemes, and that the market in which his broker transacts his order will be maintained in a fair and orderly fashion. But neither statute insures that this same investor who exercises sound judgment in his choice of stock, and places his order with a reputable broker, cannot lose his entire investment if that broker subsequently fails because of operational or financial difficulties." Senate Hearings 142 (statement by Senator Muskie). "Stock brokers owe money to one another. The failure of one aggravates the problem and reduces the financial soundness of all other firms to which it is indebted. Since many firms invest their capital in securities, market declines may further aggravate brokers' financial problems and cause stock broker failure to pyramid. This can also force a sale of brokers' securities, intensifying a general decline in securities values. A combination of these events can erode

broker-dealers and customer-investors, are expressly subject to the regulation and penalties set forth in previous securities regulation legislation.[61] Had Congress intended SIPA to add an additional check against fraud, it would clearly and unambiguously have stated that purpose.

On the contrary, Congress appears to have intended to avoid "the lengthy delay which might otherwise result if customers had to wait until the completion of the liquidation proceeding"[62] set in motion by SIPC. A critical section of SIPA provides:

> *In order to provide for prompt payment* and satisfaction of the net equities of customers of debtor, SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for each customer; except that . . . a claim for cash . . . shall not exceed $20,000 . . . .
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> . . . .
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> *It shall be the duty of the trustee to discharge promptly* . . . all obligations of the debtor to each of its customers relating to, or net equities based upon, securities or cash by the delivery of securities or the effecting of payments to such customer . . . .[63]

SIPA appears to enable a customer-investor—innocent or not—to avoid going into debt or filing for bankruptcy simply because of the financial collapse of the brokerage house with which he dealt. There are no express provisions in SIPA for withholding funds from a customer who is otherwise entitled to such funds under SIPA. In contrast, the Federal Deposit Insurance Act,[64] on which the theory of SIPA was based, in principle at least,[65] provides that:

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investor confidence and cause securities values to plummet. One of the features of this insurance program is to guard against such a situation by protecting brokers from each others' failures." Id. at 142-43.

In the House debate on SIPA, several Congressmen noted that the Act does not provide sanctions—criminal or otherwise—against violations of the securities laws. See, e.g., 116 Cong. Rec. 39,353 (1970) (remarks of Rep. Rarick); id. at 39,360 (remarks of Rep. Gross and Rep. Moss). In SIPA "Congress has departed from its traditional policy of preventive protection." SIPA Federal Role, supra note 4, at 612.

61. 3 J. Sutherland, Statutes and Statutory Construction § 70.04 (4th ed. 1974): "The general purpose of the statutes controlling the sale of securities is to prevent fraudulent sales of worthless securities to the purchasing public." Id. Customers and investors, as well as brokers, are subject to the anti-fraud statutes. A.T. Brod & Co. v. Perlow, 375 F.2d 393, 396 (2d Cir. 1967). The anti-fraud securities acts are the following: Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1970); Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78hh (1970); Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 to 79z-6 (1970); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1970); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1970); Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (1970).

62. 116 Cong. Rec. 39,353 (1970) (remarks of Rep. Anderson); id. at 39,344 (remarks of Rep. Latta); see House Report 22; SIPA Federal Role 612.

63. 15 U.S.C. §§ 78fff(f), (g) (1970) (emphasis added).

64. 12 U.S.C. §§ 1811-31 (1970).

65. House Report 2; Senate Hearings 2 (statement of Senator Williams); id. at 142 (statement of Senator Muskie); 116 Cong. Rec. 39,347 (1970) (remarks of Rep. Springer).

The Corporation may withhold payment of such portion of the insured deposit of any depositor in a closed bank as may be required to provide for the payment of any liability of such depositor . . . to the closed bank or its receiver . . . pending the determination and payment of such liability by such depositor or any other person liable therefor.[66]

Absent an express provision in SIPA permitting or requiring the trustee to withhold funds until the customer's liabilities are determined, it is difficult to justify a judicial decision mandating such a withholding.

The difficulty with the court's decision is further evidenced by the abundance of remedies available in the anti-fraud securities legislation noted above.[67] All of those acts give the SEC broad discretionary power to investigate suspected violations of any act, rule or regulation. Its powers include the right to request injunctions and the right to report violations to the Attorney General for criminal prosecution.[68]

Because of the multiplicity of explicit remedies and penalities in these acts, the absence of such provisions in SIPA becomes all the more significant. The Second Circuit refused to enforce SIPA in a situation in which SIPA itself does not forbid enforcement. In so doing the court implicitly imposed a penalty on Coggeshall and an undeserved benefit on Packer Wilbur's other customers.[69]

It should be noted, however, that there are significant differences between FDIC and SIPC. For example, before joining FDIC, banks must submit to a rigorous examination; for all practical purposes, membership in SIPC is automatic for all broker-dealers and members of national stock exchanges. 15 U.S.C. § 78ccc(a)(2) (1970). Also, the securities industry exercises a greater amount of self-regulation than permitted in the banking industry. See generally Senate Hearings 212-13, 252-55; House Hearings 221, 367, 375-76; 116 Cong. Rec. 39,348 (1970) (remarks of Rep. Celler); SIPA Federal Role 607.

66. 12 U.S.C. § 1822(d) (1970).

67. See note 61 supra and accompanying text.

68. 15 U.S.C. §§ 77t(a), (b), 78u(e), 79r(a), (f), 80a-41(e), 80b-9(e) (1970). See also id. §§ 77v(b), 77x, 77uuu(a), (b), 77yyy, 78u(a), (b), 78ff(a), 79r(d), 79z-3, 80a-41(a), (c), 80a-48, 80b-9(a), (c), 80b-17 (1970); Douglas & Bates, The Federal Securities Act of 1933, 43 Yale L.J. 171, 173-78, 181-82 (1933); Herlands, Criminal Law Aspects of the Securities Exchange Act of 1934, 21 Va. L. Rev. 139 (1934); Kline, Enforcement Work of the Securities and Exchange Commission, 4 Fed. B. Ass'n J. 117 (1940); Note, Commingled Civil and Criminal Proceedings: A Peek at Constitutional Limitations and a Poke at the SEC, 34 Geo. Wash. L. Rev. 527 (1966); Note, Penal and Injunctive Provisions of the Securities Act, 23 Wash. U.L.Q. 251 (1938).

69. The practical results of the decisions by the district court and the Second Circuit are as follows: (1) Arenstein, who did not put up any money at any time during the transaction, has no right to the 2,000 shares of stock, has no right to the $90,933.82 which he claimed from Packer Wilbur, and owes $90,933.82 to Coggeshall. If he is forced to pay this sum in a civil action he will receive no stock in return, since the stocks for which he would be paying had been sold by the subsequently liquidated Packer Wilbur to a good faith purchaser. Arenstein's only possible recourse would be to sue the liquidated Packer Wilbur for the price of the stock which the latter sold. Any such suit would be stayed until the completion of the liquidation proceedings. 15 U.S.C. § 78eee(b)(2) (1970). (2) Coggeshall has no right to either the stock or the money, and is in fact out $90,933.82. Its only possible

The court suggested several other remedies for Coggeshall,[70] indicating that at least one of the proposed alternatives would eventually enable the brokerage house to recoup its loss. Despite these suggestions, however, the goal of SIPA to maintain a balanced market during the crisis period of a broker-dealer failure remained unfulfilled.

To strengthen its position that the unscrupulous Arenstein was not a customer as defined by SIPA, the Second Circuit cited *A.T. Brod & Co. v. Perlow*.[71] This case held that the Exchange Act and rule 10b-5 were intended to prevent fraud from all sources. Both investor and broker-dealer are bound, "in the public interest," to avoid "manipulative and deceptive" practices.[72] The *Packer Wilbur* court observed that Arenstein's fraudulent conduct placed him "squarely within the proscription" of rule 10b-5.[73] However, the court immediately moved beyond its characterization of Arenstein as a deliberate violator to a conclusion that "[p]roviding assistance under SIPA to such an individual would be a gratuitous, indeed counter-productive, gesture."[74] In so doing it failed to make an important distinction between the instant case and *Perlow*. The latter involved a civil suit[75] to recover damages resulting from the fraud of a customer.

remedies are to sue Arenstein in a civil suit (a prolonged procedure) or to submit a claim as a customer in its own right against the single and separate fund of the trustee of Packer Wilbur (a tenuous procedure, since the 1970 Act is not primarily geared to benefit broker-dealers as customers in their own right. See Senate Hearings 253). CCH Binder at 96,044; 15 U.S.C. §§ 78fff(c)(2)(A)&(B) (1970). (3) Packer Wilbur, whose conduct in sending two bad checks to Coggeshall caused the immediate problem and whose poor management caused it to encounter the financial difficulty which led to its liquidation, has $94,203.10 from the sale of 2,000 shares of stock which it received from Coggeshall. This "windfall" will be disbursed "pro rata" from the single and separate fund to Packer Wilbur's other customers, who are the ultimate, though undeserving, beneficiaries of the decision in the instant case. 15 U.S.C. § 78fff(c)(2)(B) (1970).

70. See note 57 supra. Even if Arenstein were to bring an action against the trustee, the latter might assert advantageously a defense under § 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(b) (1970), which states in pertinent part: "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract . . . the performance of which involves the violation of . . . any provision of this chapter or any rule or regulation thereunder, shall be void . . . as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract . . . ." This section has been interpreted to give an innocent party the right to rescind or affirm such a contract. Goldman v. Bank of Commonwealth, 332 F. Supp. 699 (E.D. Mich. 1971), aff'd, 467 F.2d 439 (6th Cir. 1972). If the trustee were successful in such a defense, Arenstein would be relegated to the position of an unsecured general creditor.

71. 375 F.2d 393 (2d Cir. 1967).

72. Id. at 396.

73. CCH Binder at 96,043.

74. Id.

75. Although not expressly provided in the statute or the agency promulgations, the courts have construed an implied private cause of action for violations of the securities laws. E.g., J.I. Case Co. v. Borak, 377 U.S. 426 (1964); Deckert v. Independence Shares Corp., 311 U.S. 282 (1940); Junger v. Hertz, Neumark & Warner, 426 F.2d 805 (2d Cir.), cert.

The only statutes with which the court had to deal were the securities laws which had been enacted to prevent fraud.[76] The *Perlow* court implicitly acknowledged this, citing the Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.*:[77]

> Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation "enacted for the purpose of avoiding frauds," not technically and restrictively, but flexibly to effectuate its remedial purposes.[78]

Packer Wilbur, on the other hand, involved a proceeding established by a securities law enacted for the purpose of providing reimbursement for investors so as to "restore confidence in and strengthen the operation of the securities market."[79] The *Packer Wilbur* court apparently did not observe that the standard of flexibility lauded by the Supreme Court was intended to be limited, and was in fact so limited by the court in *Perlow*, to anti-fraud securities legislation.[80] There is no indication in SIPA or its legislative history that Congress intended the courts to interpret the Act as broadly or as flexibly as they interpret the regulatory securities acts. Moreover, Coggeshall, under the facts, was blameless.

In another part of the *Perlow* opinion the court noted, "the practices allegedly employed by the Perlows will, if allowed to continue, exacerbate the very evils that the securities laws were designed to prevent."[81] For this reason, *inter alia*, the *Perlow* court held that rule 10b-5 prohibited conduct such as the Perlows were engaged in.[82] On the other hand, SIPA was enacted principally as an

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denied, 400 U.S. 880 (1970); Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), cert. denied, 389 U.S. 970 (1967); Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951). Brokers may also sue in a private action against violating investors. A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

76. See note 61 supra.

77. 375 U.S. 180 (1963). In this case, one of the respondents, an investment advisory company which published monthly reports to subscribers regarding stocks for purchase and investment, was found to have established a pattern of purchasing stock shortly before recommending it in their report. When the stock's value rose within a few days of the recommendation (probably due to heavy buying stimulated by the recommendation), respondent immediately sold for a profit. Despite the absence of any evidence that respondent intended to injure anyone, or that anyone was in fact injured, the Court held such conduct to constitute fraud under Investment Advisers Act of 1940 § 206, 15 U.S.C. § 80b-6 (1970). 375 U.S. at 195.

78. 375 U.S. at 195 (footnote omitted).

79. CCH Binder at 96,043.

80. See text accompanying note 78 supra.

81. 375 F.2d at 397.

82. Id. Plaintiff had alleged that the Perlows had ordered the purchase of stock intending not to pay if, on the day set for payment, the value of the stock had decreased. Id. at 395. In fact, the Perlows did not make payment. Noting the potentially manipulative effect on the securities market—by generating an artificial demand for that stock—the court held the complaint to state a cause of action under section 10(b) and rule 10b-5. Id. at 397; see 1967 Duke L.J. 894. In Packer Wilbur, however, there was no allegation that Arenstein

insurance law; it was not designed to prevent the fraudulent activity in which Arenstein was involved. SIPA does not empower the trustee to prevent fraud by such customers, and in fact limits the trustee to specific statutory functions.[83]

In *Packer Wilbur* the court distinguished another recent Second Circuit case, *Pearlstein v. Scudder & German*,[84] which allowed "an investor who benefits from a margin violation to sue his broker for [the broker's] part in that same violation."[85] The *Pearlstein* court explained its decision:

> In our view the danger of permitting a windfall to an unscrupulous investor is outweighed by the salutary policing effect which the threat of private suits for compensatory damages can have upon brokers and dealers above and beyond the threats of governmental action by the Securities and Exchange Commission.[86]

The *Packer Wilbur* court argued that no such rationale exists for justifying a payment from a fund established to strengthen the securities market to one "whose fraudulent activities have tended to weaken the market."[87] The court appears correct in distinguishing *Pearlstein*, since it is not nearly on point. *Pearlstein* involved the intricate and perplexing issue of an implied right of private civil action under the securities acts,[88] while the instant case involved statutory interpretation and the relation of SIPA to other securities acts.

The court stated a second reason why Coggeshall could not require completion of the open contractual commitment under section 6(d). Such commitments, the court found, must be wholly executory, for Congress intended their completion to result merely in a net flow[89] of cash or securities from or to the debtor broker-dealer. Only totally unexecuted contracts would result in such a net flow; to complete partially executed contracts, the court believed, would open the debtor to unlimited obligations and grant an extraordinary preference to certain parties. The court argued: "There is nothing to indicate that the framers of the legislation intended to bestow on certain customers of a brokerage house such an extraordinary preference. On the contrary, the legislative history reveals a clear intent to restrict the outflow from the estate."[90]

However, the Second Circuit appears to have erroneously interpreted the

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intended to pay only if the stock increased in value, but not to pay at all if it declined. CCH Binder at 96,040.

83. 15 U.S.C. § 78fff(b) (1970). See also SEC v. Alan F. Hughes, Inc., 481 F.2d 401 (2d Cir.), cert. denied, 414 U.S. 1092 (1973), wherein the court appeared to limit the power of the trustee strictly to the statutory grant.

84. 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971), noted in 39 Fordham L. Rev. 782 (1971).

85. CCH Binder at 96,043.

86. 429 F.2d at 1141 (footnote omitted).

87. CCH Binder at 96,043.

88. See note 75 supra. It also preceded enactment of Regulation X. See Comment, supra note 10.

89. "Net flow", as used by the court, appears to mean generally the benefit of the bargain; i.e., the difference in price of the shares on the purchase day and the date of filing by the SIPC.

90. CCH Binder at 96,044 (referring to House Hearings, supra note 52, at 227).

intent of section 6(d). There is no language in the legislation or its history[91] to indicate that an open contractual commitment must be totally unperformed by either party. Furthermore, the court's argument regarding net outflow will, upon analysis, lead to a conclusion opposite from its own. A net flow in the transaction between Coggeshall and Packer Wilbur can be achieved only by completion of the transaction. Packer Wilbur received shares worth $90,933.82 from Coggeshall. From a bona fide purchaser Packer Wilbur received $94,203.10 in cash, $90,933.82 of which it owed to Coggeshall. In arguing that such payment by the trustee would, under SIPA, be an unconscionable outflow,[92] the court appeared to be untroubled by the fact that the trustee's refusal to pay the sum was an equally unjustified inflow to Packer Wilbur.

A careful study of the statutory language indicates that Coggeshall clearly was in that class of persons entitled to the completion of their transactions.[93] The Coggeshall/Packer Wilbur transaction satisfied all six elements required by section 6(d): The transaction was a contractual commitment, a bilateral agreement between the two parties. It was a transaction in securities, and was made in the ordinary course of Packer Wilbur's business. Significantly, the obligation was outstanding on the filing date.[94] Arenstein, the customer, had an interest in the transaction,[95] and the SEC had issued no rule or regulation determining that completion of such commitments was not in the public interest.[96]

The Second Circuit's decision in *Packer Wilbur* might be seen as a natural and logical extension of equitable principles.[97] It is tenable to argue that an intentional violator of the securities laws who put no fund into the entire transaction should be denied relief in the courts, as well as excluded from a quasi-public fund. Since he comes into court with unclean hands, the court will leave him to his self-made dilemma.[98] While such argument *might be*

91. See note 52 supra.

92. See text accompanying note 97 supra.

93. 15 U.S.C. § 78fff(d) (1970).

94. The checks issued by Packer Wilbur were negotiable instruments. Uniform Commercial Code § 3-802 (1962 version) states: "Unless otherwise agreed where an instrument is taken for an underlying obligation . . . the obligation is suspended pro tanto . . . if it is payable on demand until its presentment. If the instrument is dishonored action may be maintained either on the instrument or the obligation . . . ." When Coggeshall presented the checks for payment and they were dishonored, Packer Wilbur's previously suspended obligation was revived, and remained outstanding on the day the SIPC trustee was appointed.

95. See notes 50 to 88 and accompanying text for a discussion of the validity of Arenstein's interest and his status as customer.

96. In 1973 the SEC announced a rule which limits the net cash flow in the completion of open contractual commitments to $20,000. SEC Securities Investor Protection Act of 1970 Release No. 5 (July 25, 1973). See SIPC v. Packer, Wilbur & Co., CCH Binder at 96,044 n.15.

97. See note 49 supra and accompanying text.

98. See CCH Binder at 96,041; see also Brief for Appellant, Brief for Respondent (Joint Appendix) at 18, SIPC v. Packer, Wilbur & Co., [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. May 31, 1974).

valid against Arenstein, however, it lacks merit when applied to Coggeshall, who acted in good faith and in compliance with the margin rules.[99] In the instant case it was Coggeshall, not Arenstein, who sought the funds from SIPC.

Despite the court's persuasiveness, then, the decision in *Packer Wilbur* fails for one principal reason: the result is precisely what Congress, in enacting SIPA, appeared most anxious to avoid; namely, that when a broker-dealer collapses financially, customers and other broker-dealers are severely handicapped and often face the risk of their own financial ruin. SIPA was a narrowly constructed response designed to prevent this type of chain reaction bankruptcy. It attempts to provide a speedy method of liquidating the debtor broker-dealer with a minimum of disruption or uncertainty for customers and other broker-dealers.[100] If the court had permitted the completion of the open contractual commitment, Coggeshall, who by the court's own reasoning acted in good faith throughout the transaction,[101] would have received the money it expended while acting on Arenstein's behalf.[102] Although this result would have released Arenstein from his debt to Coggeshall,[103] he would still be liable for his fraudulent conduct and his violation of the margin rules.[104] He would remain responsible for his actions, and at the same time the principal goal of SIPA would be furthered. The court ignored that principal purpose and based its decision on a broader, less specific purpose of the Act to maintain an honest and reputable securities industry.[105] The result is that the latter, less fundamental purpose is permitted to supercede the primary purpose of SIPA.[106]

Joseph B. Valentine

Welfare Rights—Aid For Dependent Children—State Can Reduce Benefits on the Basis of the Mother's Living Arrangements.—Plaintiff Hurley, a woman with three dependent children, had been receiving $150 per month under the Aid For Dependent Children program,[1] until an unrelated male friend moved in with her. The man was under no duty to support either Mrs. Hurley or her children, and in fact did not contribute to their support. Nevertheless, Mrs. Hurley's shelter allowance was reduced by $35 per month for the four months that her friend remained in her home. On Hurley's motion for summary judgment, the district court voided the relevant state welfare regulation on supremacy clause grounds.[2]

99. See note 101 infra.
100. 15 U.S.C. §§ 78fff(d), (f), (g) (1970).
101. CCH Binder at 96,041-42.
102. See notes 5 and 69 supra and accompanying text.
103. SIPC v. Packer, Wilbur & Co., CCH Binder at 96,040 n.4.
104. See notes 10, 11 & 74 supra and accompanying text.
105. 116 Cong. Rec. 39350 (1970) (remarks of Rep. Keith).
106. See Moscarelli v. Stamm, 288 F. Supp. 453, 459 (E.D.N.Y. 1968).

1. 42 U.S.C. §§ 601 et seq. (1970).
2. Hurley v. Van Lare, 365 F. Supp. 186 (S.D.N.Y 1973), rev'd and remanded sub nom.

Plaintiff Taylor lived with her dependent daughter and disabled sister. The Taylors' rent was $180 per month, toward which the disabled sister had no duty to contribute and in fact did not contribute. While the disabled sister was receiving home relief, the family received the maximum shelter allowance. But when the sister became ineligible for home relief, the shelter payments were reduced to $110 per month. As a result, plaintiff Taylor could not meet her rent payments and received an eviction notice. The district court voided the state regulation requiring the shelter payment reductions.[3]

Mrs. Otey lived with her thirteen year old son. When her twenty-three year old son, who was unemployed and ineligible for assistance, moved in, the family's grant was reduced from $145 per month to $96.65. Again the district court voided the relevant state regulation.[4]

On consolidated appeals, the Second Circuit reversed the district courts and sustained against supremacy clause attack the regulations that required the reductions in the plaintiffs' benefits. *Taylor v. Lavine*, 497 F.2d 1208 (2d Cir. 1974).

The primary purpose of the Aid For Dependent Children program is to aid needy dependent children within the home.[5] It was established in 1935[6] in response to the depression concern that each family be supported by a "breadwinner."[7] The initial question, of course, is who is a needy dependent child. The simple statutory answer is that a needy child is anyone who has been deprived of parental support by reason of death, continued absence or disability of a parent.[8] But the real answer is far from simple, being determined—and complicated—by the "cooperative federalism"[9] under which the Aid For Dependent Children program operates.

Taylor v. Lavine, 497 F.2d 1208 (2d Cir. 1974). Hurley challenged 18 N.Y.C.R.R. § 352.31(a)(3)(iv) (1973) which provides that "[w]hen the man [living with a female applicant or recipient to whom he is not married] is unwilling to assume responsibility for the woman or her children, and there are no children of which he is the acknowledged or adjudicated father, he shall be treated as a lodger in accordance with section 352.30(d)." Hurley also challenged id. § 352.30(d) (1973) which provides in part: "A non-legally responsible relative or unrelated person in the household, who is not applying for nor receiving public assistance shall not be included in the budget and shall be deemed to be a lodger. . . . In the event a lodger does not contribute at least $15 per month, the family's shelter allowance . . . shall be a pro rata share of the regular shelter allowance."

3. Taylor v. Lavine, No. 73-699 (E.D.N.Y. Oct. 23, 1973), rev'd, 497 F.2d 1208 (2d Cir. 1974).

4. Id.

5. King v. Smith, 392 U.S. 309, 325 (1968); Doe v. Gillman, 479 F.2d 646, 648 (8th Cir. 1973), cert. denied, 94 S. Ct. 3073 (1974); Rosen v. Hursh, 464 F.2d 731 (8th Cir. 1972); Mothers & Childrens Rights Org. v. Stanton, 371 F. Supp. 298, 303 (N.D. Ind. 1973); Jenkins v. Georges, 312 F. Supp. 289, 292 (W.D. Pa. 1969).

6. Act of Aug. 14, 1935, ch. 531, Title IV, § 401, 49 Stat. 627 (codified at 42 U.S.C. § 601 (1970)).

7. King v. Smith, 392 U.S. 309, 327-30 (1968); see Lurie, Major Changes in the Structure of the AFDC Program Since 1935, 59 Cornell L. Rev. 825, 826-27 (1974).

8. 42 U.S.C. § 606(a) (1970).

9. "The AFDC program is based on a scheme of cooperative federalism. . . . States are

King v. Smith[10] held that while states have wide discretion in determining eligibility requirements measuring need, they are not permitted to impose additional eligibility requirements unrelated to need.[11] In *King*, Alabama sought to circumvent the federal definition of a needy child as one deprived of parental support, by redefining "parent" to include a man who has frequent sexual encounters with the needy child's mother.[12] Thus, in every case where an AFDC mother had a male companion Alabama concluded that a parent was present, and therefore, the child, by definition, was not needy.[13] Alabama asserted two state interests in defense of its plan: it sought to deter immorality and illegitimacy, and to prevent unmarried cohabiting couples from obtaining benefits unavailable to married couples.[14] As to the first interest, the United States Supreme Court held that, though immorality and illegitimacy are valid state concerns,[15] a state

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not required to participate in the program, but those which desire to take advantage of the substantial federal funds available . . . are required to submit an AFDC plan . . . . The plan must conform with several requirements of the Social Security Act and with rules and regulations promulgated by HEW." King v. Smith, 392 U.S. 309, 316-17 (1968).

10. 392 U.S. 309 (1968).

11. The Court construed 42 U.S.C. § 602(a)(10) (1970) which provides: "[A]id to families with dependent children shall be furnished with reasonable promptness to all eligible individuals . . . ." 392 U.S. at 316-27; see Comment, AFDC Eligibility Requirements Unrelated to Need: The Impact of King v. Smith, 118 U. Pa. L. Rev. 1219, 1228-29 (1970). For a discussion of the distinction between eligibility requirements based on need and eligibility requirements unrelated to need see id. at 1241. The courts have made this distinction consistently. Carleson v. Remillard, 406 U.S. 598 (1972) (states may not restrict federal definition of dependent child to exclude children whose fathers are continually absent in Vietnam); Townsend v. Swank, 404 U.S. 282 (1971) (state effort to exclude college students from eligibility invalidated); Doe v. Gillman, 479 F.2d 646 (8th Cir. 1973), cert. denied, 94 S. Ct. 3073 (1974) (voiding Iowa statute requiring mother to cooperate with state in legal actions against those responsible for child's support); Doe v. Ellis, 350 F. Supp. 375 (D.S.C. 1972) (state cannot deny benefits to mothers who refuse to identify putative fathers of their illegitimate children); Saddler v. Winstead, 332 F. Supp. 130 (N.D. Miss. 1971) (invalidating state regulation requiring that custodian of child must give name and address of parents who deserted the child and otherwise assist state in locating parents); X v. McCorkle, 333 F. Supp. 1109 (D.N.J. 1970), modified on other grounds sub nom. Engleman v. Amos, 404 U.S. 23 (1971) (per curiam) (struck down state attempt to eliminate income tax exemptions from determination of available adjusted income for AFDC eligibility purposes); Doe v. Shapiro, 302 F. Supp. 761 (D. Conn. 1969), appeal dismissed for failure to docket, 396 U.S. 488 (1970) (termination of benefits unless mother reveals name of father of illegitimate children; held invalid). But cf. Jefferson v. Hackney, 406 U.S. 535, 544-45 (1972) (§ 602(a)(10) concerned only with time element and elimination of waiting lists); Dandridge v. Williams, 397 U.S. 471, 481 n.12 (1970) (dictum) (suggestion that § 602(a)(10) may have been intended only as a ban on waiting lines).

12. 392 U.S. at 313-14.

13. Id. at 314, 317-18.

14. Id. at 318.

15. "We . . . emphasize that no legitimate interest of the State of Alabama is defeated by the decision we announce today. The State's interest in discouraging illicit sexual behavior and illegitimacy may be protected by other means . . . including state participation in AFDC

may not deal with them by depriving children of AFDC benefits to which they would otherwise be entitled.[16]

For the same reason, the Court rejected Alabama's second interest of preventing cohabitors from obtaining benefits foreclosed to married couples.[17] The Court reasoned that an unmarried male companion, unlike a parent, is not obligated to support his mistress or her child.[18] The Court declared that Congress intended the term "parent" to encompass persons under a legal duty to support the child.[19] A "substitute father," the Court concluded, is under no such duty.[20]

Following the *King* decision, HEW promulgated the "man-in-the-house" regulation to deter further state efforts to reduce AFDC benefits in disregard of the actual resources and actual need of families. The HEW regulation provided that the presence in the home of a "substitute parent" or other nonlegally obligated individual does not permit a presumption that income is available to a child.[21] The HEW regulation supplemented existing regulations declaring that only income actually available to the recipient could be included in the computation of AFDC benefits.[22]

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rehabilitative programs. Its interest in economically allocating its limited AFDC resources may be protected by its undisputed power to set the level of benefits and the standard of need, and by its taking into account in determining whether a child is needy all actual and regular contributions to his support." Id. at 333-34.

16. The Court was at pains to emphasize that Alabama's regulation contravened the basic purpose of the program it sought to supplement. "[I]t is simply inconceivable . . . that Alabama is free to discourage immorality and illegitimacy by the device of absolute disqualification of needy children. . . . [T]he method it has chosen plainly conflicts with the Act." Id. at 326-27 (footnote omitted); see Comment, AFDC Eligibility Requirements Unrelated to Need: The Impact of King v. Smith, 118 U. Pa. L. Rev. 1219, 1226-27 (1970).

17. 392 U.S. at 329.

18. An exhaustive analysis of legislative history convinced the Court in King that Congress intended "parent" to mean only those persons legally obligated to support the child. Id. at 327-33.

19. Id. at 329.

20. Id.

21. "[T]he determination whether a child has been deprived of parental support or care by reason of the death, continued absence from the home, or physical or mental incapacity of a parent . . . will be made only in relation to the child's natural or adoptive parent, or in relation to the child's stepparent who is ceremonially married to the child's natural or adoptive parent and is legally obligated to support the child under State law of general applicability . . . . Under this requirement, the inclusion in the family, or the presence in the home, of a 'substitute parent' or 'man-in-the-house' or any individual other than one described in this paragraph is not an acceptable basis for a finding of ineligibility or for assuming availability of income by the State. In establishing financial eligibility and the amount of the assistance payment, only such net income as is actually available for current use on a regular basis will be considered, and the income only of the parent . . . will be considered available for children in the household in the absence of proof of actual contributions." 45 C.F.R. § 233.90(a) (1973) (formerly 45 C.F.R. § 203.1 (1971)).

22. "[O]nly such net income as is actually available for current use on a regular basis will be considered . . . and (d) income and resources will be reasonably evaluated." Id. §§ 233.20(a)(3)(ii)(c)-(d) (1973).

The HEW regulations were sustained in *Lewis v. Martin*.[23] The United States Supreme Court, relying on *King* and the federal "man-in-the-house" regulation,[24] invalidated a California statute and regulations conclusively presuming that the income of a nonadoptive stepfather or a man assuming the role of spouse was available to the children.[25] Moreover, as other cases have recognized, such a conclusive presumption of support undermines the objectives of the AFDC program.[26] If relatives who cannot afford to care for a child have their benefits reduced on the assumption that additional income is available, they may be less inclined to shelter the child.[27] State legislatures do not view AFDC from the perspective of the Supreme Court, however, for they focus upon a wholly different administrative problem: how to police a system that lends itself to dishonesty.[28] To curtail dishonesty, many states legislate presumptions. Such presumptions rarely are sustained by the courts.[29]

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23. 397 U.S. 552, 554 (1970).

24. "Our decision in King v. Smith held only that a legal obligation to support was a necessary condition for qualification as a 'parent'; it did not also suggest that it would always be a sufficient condition. We find nothing in [the man-in-the-house] regulation to suggest inconsistency with the Act's basic purpose of providing aid to 'needy' children, except where there is a 'breadwinner' in the house who can be expected to provide such aid himself . . . . In the absence of proof of actual contribution, California may not consider the child's 'resources' to include either the income of a nonadopting stepfather who is not legally obligated to support the child . . . or the income of a [man assuming the role of a spouse]—whatever the nature of his obligation to support." Id. at 559-60 (italics deleted).

25. Id. at 560.

26. "The AFDC provisions . . . envision aid to strengthen the entire family unit, including the dependent child's parent, so as to encourage the care of the child within his own home. See 42 U.S.C. § 601. A procedure which directly or indirectly lessens the benefits flowing to the dependent child should not be approved." Doe v. Gillman, 479 F.2d 646, 648 (8th Cir. 1973), cert. denied, 94 S. Ct. 3073 (1974).

27. "The purpose of . . . AFDC is to encourage '[t]he care of dependent children in their own homes or in the homes of relatives . . . .' 42 U.S.C. § 601. By reducing payments to children living with non-legally responsible adults, the Pennsylvania regulations have the effect of discouraging such adults from caring for dependent children; they make it more difficult for the 'substitute parent' to maintain the child's family unit." Jenkins v. Georges, 312 F. Supp. 289, 292 (W.D. Pa. 1969).

28. See generally Lurie, Major Changes in the Structure of the AFDC Program Since 1935, 59 Cornell L. Rev. 825, 855-57 (1974); Note, AFDC Income Attribution: The Man-in-the-House And Welfare Grant Reductions, 83 Harv. L. Rev. 1370, 1372-76 (1970); Comment, AFDC Eligibility Requirements Unrelated to Need: The Impact of King v. Smith, 118 U. Pa. L. Rev. 1219, 1242-50 (1970).

29. Shea v. Vialpando, 94 S. Ct. 1746 (1974) (standardized maximum deduction for employment expenses invalid if no provision for proving actual expenses above the standard deduction); Rodriguez v. Vowell, 472 F.2d 622 (5th Cir.), cert. denied, 412 U.S. 944 (1973) (invalid to conclusively presume child's income used only for himself); Reyna v. Vowell, 470 F.2d 494 (5th Cir. 1972) (invalid to presume that income of child is available to family); Rosen v. Hursh, 464 F.2d 731 (8th Cir. 1972) (invalid to presume that stepfather's income is contributed to child's support); Mothers & Childrens Rights Org. v. Stanton, 371 F. Supp. 298 (N.D. Ind. 1973) (unlawful to conclusively presume that AFDC recipient receives

In *Owens v. Parham*,[30] a three judge district court struck down a presumption nearly identical[31] to that involved in *Taylor*. Georgia's method of computing shelter allowances under the Aid to the Aged, Blind and Disabled program (AABD)[32] was based on the number of persons in the household. As the number of persons in the house increased, the allowance decreased. Since, as applied, there was no opportunity for the AABD recipient to rebut the presumption[33] that each member of the household sustained his pro rata share of housing expense, the court ruled that this method of computation denied the recipient due process of law.[34]

Owens was followed in *Hausman v. Department of Institutions and Agencies*.[35] In *Hausman*, the New Jersey Supreme Court invalidated a state regulation requiring a per capita reduction in the AFDC recipient's level of need when ineligible individuals reside in the household.[36]

pro rata contribution from non-recipient living with him); Owens v. Parham, 350 F. Supp. 598 (N.D. Ga. 1972) (irrebuttable presumption that non-eligible persons living with recipients contribute pro rata share of expenses and that recipients' need can be reduced accordingly held invalid); Boucher v. Minter, 349 F. Supp. 1240 (D. Mass. 1972) (conclusive presumption that stepfather supports stepchildren invalidated); Gaither v. Sterrett, 346 F. Supp. 1095 (N.D. Ind.), aff'd mem., 409 U.S. 1070 (1972) (state attempt to hold stepfathers liable for stepchildren's support invalidated as not a law of general applicability); Gilliard v. Craig, 331 F. Supp. 587 (W.D.N.C. 1971), aff'd mem., 409 U.S. 807 (1972) (assets of individual are not to be presumed available to whole family); Doe v. Schmidt, 330 F. Supp. 159 (E.D. Wis. 1971) (invalid to conclusively presume presence of spouse unless divorce proceedings filed); Jenkins v. Georges, 312 F. Supp. 289 (W.D. Pa. 1969) (invalid to conclusively presume contribution by non-legally responsible adult living with AFDC family); Hausman v. Department of Insts. & Agcys., 64 N.J. 202, 314 A.2d 362, cert. denied, 94 S. Ct. 3083 (1974) (per capita reduction in recipient's level of need when ineligible individuals reside in household violates due process if it cannot be rebutted); Battle v. Lavine, 44 App. Div. 2d 307, 354 N.Y.S.2d 680 (2d Dep't 1974), appeal docketed, No. —, Ct. App. July 2, 1974 (invalid to presume that AFDC recipient's level of need is no greater than a pro rata share of the expenses of the non-AFDC family with whom he resides); Uhrovick v. Lavine, 43 App. Div. 2d 481, 352 N.Y.S.2d 529 (3d Dep't 1974) (invalid to presume that stepfather's income is contributed to child's support); Slochowsky v. Lavine, 73 Misc. 2d 563, 342 N.Y.S.2d 525 (Sup. Ct. 1973) (same).

30. 350 F. Supp. 598 (N.D. Ga. 1972).

31. But see the Taylor court's attempt to distinguish these presumptions at text accompanying notes 55 & 56 infra.

32. 42 U.S.C. § 1382 (1970).

33. The presumption actually was invalid on the facts of the case. Plaintiff was disabled and lived with two sons, aged 19 and 20, who were unemployed and in school. Neither son was eligible for AFDC or AABD benefits, and neither contributed to plaintiff's housing expense. Plaintiff's aid was reduced from $91 to $69 monthly when the basis of computation shifted from the number of eligible individuals in the household to the number of inhabitants in the household. 350 F. Supp. at 601.

34. The court held that the statute presented a valid rebuttable presumption on its face, but as plaintiff had no opportunity for rebuttal, it was unconstitutional as applied. Id. at 604-05.

35. 64 N.J. 202, 314 A.2d 362, cert. denied, 94 S. Ct. 3083 (1974).

36. The presumption was irrebuttable in its operation. Plaintiff was receiving $214 per

The real thesis behind lowered benefits when the household comprises eligibles and non-eligibles, as the [State] concedes . . . is in effect an irrebuttable presumption that the non-eligibles are paying their share of the total household expenses (as distinguished from contributing to the recipients' share). . . . The United States Supreme Court has long since held, in King . . . and Lewis . . . that a state may not . . . conclusively presume that a "man in the house" or other non-eligible member of the household is bearing his share of the household expenses or contributing to the living costs of the welfare recipients so as to permit the reduction of benefits to them.[37]

Battle v. Lavine[38] invalidated a New York regulation[39] which conclusively presumed that when a recipient lives with non-legally responsible relatives or friends, the recipient's housing cost is no greater than a pro rata share of the total cost of housing to the family or friends with whom he is living.[40] The majority in *Battle* evaluated the New York regulation in light of the federal "man-in-the-house" regulation[41] which makes it invalid to presume that an ineligible person living with a family eligible for assistance contributes to the family's support. The issue in *Battle*, however, was not whether a man was living with the recipient and contributing to her support, but whether the recipient was living with friends and thus was not liable for full rent expense. By invalidating this regulation, the *Battle* court impliedly held that a conclusive presumption of level of need is no more valid than a conclusive presumption of support.[42]

Furthermore, in invalidating the presumption of need, the *Battle* court also rejected the state interests put forth in support of the presumption. The court cited the soon to be reversed *Hurley v. Van Lare*[43] for the proposition that there is no valid state interest in preventing assistance from inuring to ineligible persons living with eligible recipients.[44] The *Hurley* court had reasoned that

Despite the defendants' professed concern that ineligibles not receive a rental stipend,

month for herself and her child. When her male companion moved in, her allowance was decreased to $188, despite the fact that he did not contribute to her support. Id. at 205-06, 314 A.2d at 364.

37. Id. at 208, 314 A.2d at 365-66; accord, Mothers & Childrens Rights Org. v. Stanton, 371 F. Supp. 298 (N.D. Ind. 1973) (rejected claim that states have absolute discretion in determining standard of need).

38. 44 App. Div. 2d 307, 354 N.Y.S.2d 680 (2d Dep't 1974), appeal docketed, No. —, Ct. App., July 2, 1974.

39. 18 N.Y.C.R.R. § 352.3(c)(1973) which provides: "For children or adults in receipt of public assistance residing with a self-maintaining non-legally responsible relative or friend . . . the allowance for rent . . . shall be computed on a prorated basis . . . ."

40. 44 App. Div. 2d at 309, 345 N.Y.S.2d at 682.

41. See note 21 supra.

42. 44 App. Div. 2d at 310, 354 N.Y.S.2d at 683. The concurring opinion did not reach the constitutional question, but argued that the regulation was inapplicable to plaintiff's case and that it was furthermore unreasonable to terminate her assistance because of the landlord's failure to cooperate. Id. at 310-11, 354 N.Y.S.2d at 684-85 (Christ, J., concurring in part).

43. 365 F. Supp. 186 (S.D.N.Y. 1973), consolidated and rev'd on appeal, sub nom. Taylor v. Lavine, 497 F.2d 1208 (2d Cir. 1974).

44. 44 App. Div. 2d at 310, 354 N.Y.S.2d at 683.

the inevitable result of these regulations is to reduce, perhaps drastically, the stipend for those who are eligible.[45]

Hurley invalidated the New York regulations in question because it concluded that

a *pro rata* reduction does indeed assume that the male lodger will pay his own way, whether or not he actually does. That is precisely the assumption found impermissible in *King* and *Lewis*.[46]

The Second Circuit in *Taylor v. Lavine*[47] reversed *Hurley* and held that New York could reduce shelter allowances when lodgers resided with the welfare recipients. The court distinguished *King*. In *King*, the state's definition of "parent" resulted in rendering ineligible for benefits an otherwise eligible child.[48] The *Taylor* court reasoned that New York's "lodger" regulations[49] do not render a child ineligible but

merely [determine] the *level of payment* to the eligible family on the basis of the presence or absence of a lodger in the recipient household. This method of computing shelter allowance is permitted under the *King v. Smith* rationale if it *is not designed to vindicate a moral interest unrelated to the need of the family*, and if it realistically determines the level of need.[50]

There is little basis for the court's first premise that this method of computation is permitted under *King* so long as the underlying purpose is not moralistic. It is true that the Alabama regulations invalidated by *King* were designed to "vindicate a moral interest."[51] However, the *King* Court did not hold the state interest in deterring immorality and illegitimacy invalid in itself. Rather, it held that the state's valid interest may not take precedence over the federal government's goal as incorporated in AFDC.[52] While the invalidity of a state purpose per se may result in condemnation of its regulation, a valid purpose will not save the regulation if its effect is to defeat or deter the federal interest fixed by AFDC.[53]

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45. 365 F. Supp. at 195.

46 Id.

47. 497 F.2d 1208 (2d Cir. 1974).

48. Id. at 1214.

49. 18 N.Y.C.R.R. §§ 352.30(d), 352.31(a)(3)(iv) (1973). See note 2 supra for text of regulations.

50. 497 F.2d at 1214-15 (emphasis added). The court was correct in distinguishing New York's "lodger" from Alabama's "substitute parent," in that New York's lodger regulation merely reduces benefits, whereas Alabama's substitute parent regulation terminated them. However this distinction is doubtful in light of the "man-in-the-house" regulation (see note 21 supra), which the court failed to confront directly. See text accompanying note 42 supra.

51. See text accompanying note 14 supra.

52. "We . . . emphasize that no legitimate interest of the State of Alabama is defeated . . . . The State's interest in discouraging illicit sexual behavior and illegitimacy may be protected by other means . . . ." 392 U.S. at 333-34.

53. Id. at 316-27.

The *Taylor* court's second premise, that this method of computation realistically determines—by fair inference—level of need, also is questionable. The court concluded that New York's regulations were distinguishable from those invalidated by *Lewis* and its progeny[54] because New York relied on a "fair inference" rather than a conclusive presumption.[55] In addition, the court continued, New York's fair inference was not related to possible additional income contributed by the AFDC lodger, but was reasonably related to the family's need for space.[56]

The court posited that if an AFDC recipient living with non-AFDC relatives or friends would only be entitled to his pro rata share of the total rent regardless of his actual contribution thereto, then, likewise, the AFDC family should only be entitled to its pro rata share of the total expenses when a non-recipient lives with them.[57] However, the former situation was presented in *Battle v. Lavine*,[58] and there the New York Appellate Division reached the contrary conclusion.[59]

The crux of the *Taylor* court's decision is found in its reasoning that "economies of scale" justify reducing shelter payments when a lodger moves in.

> [P]er-individual housing costs decrease as the number of individuals living together increases. . . . Thus, the New York scheme does not attribute a false duty of support or a false source of income, but rather accounts for the *actual cost* of housing to an AFDC-recipient family.[60]

It is true that if the rent remains constant while the number of individuals increases the per capita cost of rent is less. However, per capita rental cost is irrelevant unless the lodger actually pays his per capita share. Thus the "economies of scale" formula is valid only if the lodger in fact contributes—or is presumed to contribute. When the lodger does not contribute, the formula depends upon this presumption for its relevance, but there is adequate authority which would reject conclusive presumptions as unconstitutional.[61]

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54. Lewis v. Martin, 397 U.S. 552 (1970). See also notes 23-25 supra and accompanying text.

55. 497 F.2d at 1215. See text accompanying note 46 supra.

56. Id. at 1215.

57. Id.

58. 44 App. Div. 2d 307, 354 N.Y.S.2d 680 (2d Dep't, 1974) appeal docketed, No. —, Ct. App. July 2, 1974.

59. Id. at 310, 354 N.Y.S.2d at 683. See notes 38-42 supra and accompanying text.

60. 497 F.2d at 1215-16 (emphasis added).

61. "When the economies of scale theory is applied to a mixed household [eligible persons and ineligible persons], one consideration . . . becomes relevant which is not relevant in considering a household composed solely of AFDC recipients. The nonrecipient is presumed to contribute one equal share of the the household expenses." Mothers & Childrens Rights Org. v. Stanton, 371 F. Supp. 298, 302 (N.D. Ind. 1973) (state regulation irrebuttably presuming support violative of supremacy clause); accord, Owens v. Parham, 350 F. Supp. 598, 605 (N.D. Ga. 1972) (pro rata deduction in AABD benefits invalid as applied); Hausman v. Department of Insts. & Agcys., 64 N.J. 202, 314 A.2d 362 (1974), cert. denied, 94 S. Ct. 3083 (1974) (automatic pro rata reduction in level of need invalidated). For a criticism

Dissenting in *Taylor*, Judge Oakes reasoned that *King* was controlling.

The first challenged regulation . . . is New York's administrative soft shoe around *King v. Smith*. . . . New York defines a man who lives with a woman to whom he is not married and for whom he does not assume financial responsibility as a "lodger." In *King*, Alabama had defined a man who engaged in the same conduct a "parent." . . . [B]y New York's cleverness in changing a "parent" to a "lodger," it has managed, with the aid of today's decision, to accomplish what a number of other states have not—the reduction in the AFDC child's benefits on the basis of the mother's living arrangements.[62]

The majority's sole basis for distinguishing *Lewis* was that New York's fair inference is not a conclusive presumption.[63] Judge Oakes took issue with the majority's conclusion.

Labeling the New York regulation a "fair inference" does not change its conclusive nature where a showing contrary to the inference will not affect the shelter allowance reduction; here the only fact considered by the State in the fair hearing is the presence or absence of a lodger, not the amount of space in the apartment. If the regulation provided only for a rebuttable presumption, whether of payments by the lodger or of excess space, there might well be a different question.[64]

This led him to conclude that the inference was invalid not only because it was conclusive, but also because it was neither factually valid nor material. The presence of a lodger in the household, he continued, does not necessarily indicate that the family had more space than it needed.[65] Even if this inference were factually valid, Judge Oakes concluded, this could not have been the basis for the regulation because benefits are restored as soon as the lodger moves out.[66]

Judge Oakes found little justification in the argument that "economies of scale" justify reductions in shelter payments as lodgers move in.

It is nonsense . . . to say that the cost of housing to the recipient family decreases when there is a *non-paying* lodger. Moreover, an economy of scale does not reduce the *total* cost of anything. . . . An economy of scale would operate only if the lodger were presumed to pay his pro rata share. But such a presumption would be clearly unlawful, as the majority concedes. . . .[67]

The dissent focused on the problems of the family, rather than the lodger. It pointed out that the ineligible lodger does not obtain any AFDC benefits; thus a reduction in the AFDC grant takes nothing away from the lodger.[68] Instead, Judge Oakes maintained, these regulations penalize the family by depriving

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of irrebuttable presumptions, see Note, The Irrebuttable Presumption Doctrine in the Supreme Court, 87 Harv. L. Rev. 1534 (1974).

62. 497 F.2d at 1217 (Oakes, J., dissenting).
63. Id. at 1215; see notes 54-56 supra and accompanying text.
64. 497 F.2d at 1219 (Oakes, J., dissenting).
65. Id.
66. Id. at 1219 n.8.
67. Id. at 1222.
68. Id. at 1220-21.

them of benefits to which they would otherwise be entitled.[69] The state's remedy against "free riding," he argued, would be to proceed against the lodger, not the family.[70]

Lastly, the dissent found that the AFDC goal of strengthening the family[71] was contravened by New York. Judge Oakes noted that these regulations make it unprofitable for a welfare family to stay together unless they are all on public assistance.[72]

Therefore, he concluded that these regulations violate the federal statute and federal regulations because they deny the child his needs for reasons "which are irrelevant to the welfare of the child,"[73] and which bear no relation to the purpose of the statute.[74]

The dissent is persuasive. The cases—until *Taylor*—had made it clear that it is irrelevant to inquire whether New York's purpose is to prevent non-eligible persons from indirectly benefitting under AFDC, or to prevent eligible recipients from receiving duplicative assistance, or to discourage cohabitation or illegitimacy. Prior courts would have inquired only whether these regulations deny needy and dependent children benefits to which they would otherwise be entitled, for reasons unrelated to need.

Taylor's "fair inference" is a semantic circumvention of *King* and *Lewis*. That the Second Circuit in reality has sanctioned a conclusive presumption is made clear by the district court opinion on remand,[75] which held that the regulations are violative of due process because "[t]here can be no hearing to decide whether in any particular case the presumptions are contrary to the facts."[76] It remains to be seen whether the Supreme Court will sanction what under *Lewis* clearly seems violative of the supremacy clause.

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69. "[W]hat the State is doing is not keeping welfare funds from the ineligible by this regulation. Rather it seeks to punish the welfare family for using its own resources in a manner of which the Commissioner disapproves in advance in every case. Whether the Commissioner is attempting to enforce 'middle class morality' . . . or just trying to save money any way he can, the federal statute and regulations, and the unanimous case law forbid the State from enforcing its predilections which are irrelevant to the welfare of the child by depriving the eligible child of its needs." Id. at 1221 (emphasis omitted) (footnotes omitted).

70. Id. at 1222.

71. Rodriguez v. Vowell, 472 F.2d 622 (5th Cir.), cert. denied, 412 U.S. 944 (1973). See notes 5, 26-27 supra.

72. 497 F.2d at 1218-19 (Oakes, J., dissenting).

73. Id. at 1221 (emphasis omitted).

74. Id. at 1222-23.

75 Hurley v. Van Laye, Nos. 73-3423, 72-699 (S.D. & E.D.N.Y. Aug. 5, 1974) (three judge court, with Judge Hays, who wrote the Second Circuit opinion in Taylor, vigorously dissenting).

76. Id. at 7.