Missouri Law Review

Volume 40
Issue 3 *Summer 1975*

Article 6

Summer 1975

Recent Cases

RECENT CASES

ARBITRATION AND SECURITIES REGULATION — CONFLICT BETWEEN FEDERAL ARBITRATION ACT AND SECURITIES EXCHANGE ACT IN AN INTERNATIONAL TRANSACTION

Scherk v. Alberto-Culver Co.[1]

Alberto-Culver Company, a Delaware corporation, contracted to buy European businesses and trademarks from Fritz Scherk, a German citizen residing in Switzerland. Alleging that the trademarks were encumbered contrary to Scherk's express warranties, Alberto-Culver brought suit in federal district court in Illinois for damages and other relief for fraudulent misrepresentations in violation of the 1934 Securities Exchange Act.[2] Scherk's motion to stay the action pending arbitration in Paris pursuant to prior agreements of the parties[3] and in accordance with the Federal Arbitration Act[4] was denied. Instead, the court granted plaintiff's motion for a preliminary order enjoining Scherk from proceeding with the arbitration.[5] The Court of Appeals for the Seventh Circuit affirmed the district court's decision;[6] the Supreme Court reversed in a five-to-four decision.

The specific problem in *Scherk* was the applicability of the Federal Arbitration Act, allowing the enforcement of arbitration clauses, to claims arising under the Securities Exchange Act of 1934. The lower courts, relying on the Supreme Court's prior decision in *Wilko v. Swan*,[7] held the clause unenforceable against this type of claim. The Supreme Court distinguished the precedent and held the Arbitration Act applicable.

Congress passed the Federal Arbitration Act in 1925, recognizing the advantages of settling disputes quickly and inexpensively,

1. ___ U.S. ___, 94 S. Ct. 2449 (1974).
2. 15 U.S.C. § 78 (1970).
3. Arbitration agreements in contracts for the purchase of each of Sherk's three businesses provided that the parties would submit any claim or controversy arising out of the agreements or their breach exclusively to arbitration by the International Chamber of Commerce, Paris, France; that each party would comply in all respects with any award; and that the laws of the State of Illinois, U.S.A. would apply to and govern the agreements, their interpretation and performance. 94 S. Ct. at 2452 n.1.
4. 9 U.S.C. § 3 (1970).
5. The district court decision is unreported.
6. 484 F.2d 611 (7th Cir. 1973).
7. 346 U.S. 427 (1953).

and thereby reversed a long-standing hostility to arbitration expressed by the federal courts.[8] The Act expressly covers arbitration clauses in any maritime transaction or contract involving interstate or foreign commerce,[9] and thus applied by its terms to the clause in *Scherk*. Under the Act the parties may select both the forum[10] and the rules to be applied.[11] However, courts have held that arbitration is inconsistent with the underlying policies of certain laws and have refused to enforce such clauses against plaintiffs suing under those laws.

The Securities Exchange Act of 1934 makes the use of "any manipulative or deceptive device or contrivance" in connection with the sale of any security illegal,[12] and rule 10b-5 makes the fraudulent sale of any security in interstate commerce unlawful.[13] The Act confers jurisdiction upon the federal courts for alleged violations[14] and directs that any "condition, stipulation, or provision binding any person to waive compliance with any provision of this [Act] or of any rule or regulation thereunder . . . shall be void."[15] In addition, it provides that any contract made in violation of the Act shall also be void.[16] Because Alberto-Culver asserted that Scherk fraudulently induced it to purchase the trademarks, and because enforcement of the arbitration clause would have caused Alberto-Culver to waive

8. 94 S. Ct. at 2453. Regarding judicial hostility to any forum selection by the parties, *see, e.g.*, Carbon Black Export, Inc. v. *The Monrosa*, 254 F.2d 297, 300-01 (5th Cir. 1958), *cert. dismissed*, 359 U.S. 180 (1959).

9. 9 U.S.C. § 2 (1970); "commerce" is defined in 9 U.S.C. § 1 (1970) as "commerce among the several States or with foreign nations . . . ."

10. Parties may choose the arbitrators under 9 U.S.C. § 5 (1970).

11. Arbitrators are bound by the terms of the agreement, and the decision can be set aside for manifest infidelity to their rules. *See* United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593, 597 (1960); Swift Industries, Inc. v. Botany Industries, Inc., 466 F.2d 1125, 1131 (3d Cir. 1972).

12. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1971).

13. 17 C.F.R. § 240.10b-5 (1973) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

14. Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1970).

15. Securities Exchange Act of 1934 § 29(a), 15 U.S.C. § 78cc(a) (1970).

16. Securities Exchange Act of 1934 § 29(b), 15 U.S.C. § 78cc(b) (1970).

its right to resort to federal court under the Act, the district court and the court of appeals agreed that the arbitration stipulation was void and that the federal courts had jurisdiction over the dispute.[17]

In *Wilko v. Swan*,[18] on which both lower courts relied, the Supreme Court found that similar sections in the Securities Act of 1933[19] demonstrated a congressional determination that the special protections against fraud afforded to security investors were more important than prompt and economical solution of controversies through arbitration.[20] Saying that judicial determination of such disputes was necessary in order to preserve the effectiveness of the statutory protections,[21] the Court found the arbitration clause void as a "stipulation" that required Wilko to waive compliance with the "provision" in the Act allowing buyers to sue in any state or federal court.[22]

This conflict between statutory protections was handled differently in *Scherk*. The Court first noted several distinctions between the Securities Act of 1933 and the Securities Exchange Act of 1934, which in themselves were sufficient to render *Wilko* inapposite.[23] The Court, however, based its decision on other grounds. In essence, the special advantages for securities investors in terms of remedies and jurisdiction from which the Court in *Wilko* deduced the primacy of the Securities Act over the Federal Arbitration Act were not present to the same degree in the Securities Exchange Act.[24]

Rather than rule that the *Wilko* reasoning would be inapplicable to all claims under the Securities Exchange Act, however, the

17. 484 F.2d 611, 614-15 (7th Cir. 1973).

18. 346 U.S. 427 (1953).

19. Securities Act of 1933 § 12, 15 U.S.C. § 771 (1970) creates liability of sellers to purchasers for selling securities in interstate commerce where there has been a material falsehood or omission. Jurisdiction is concurrent in state and federal courts, with removal from state courts prohibited. Securities Act of 1933 § 22, 15 U.S.C. § 77v (1971). The Act also provides that:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Securities Act of 1933 § 14, 15 U.S.C. § 77n (1970).

20. 346 U.S. at 438 (1953). Since a plaintiff's advantages under the 1933 Act include an explicit private remedy, multiple jurisdiction, non-removal from state courts, and burden on the seller to show lack of scienter, waiver of these rights would be more detrimental here than under other statutory claims not providing these advantages.

21. *Id.* at 435.

22. *Id.* at 434-35.

23. 94 S. Ct. at 2454.

24. Under the Securities Exchange Act, for example, there is no explicit provision for private remedies, and jurisdiction is exclusively in the federal courts.

Court confined its decision to claims involving international transactions.[25] Noting that the agreement in question was truly international,[26] the Court said that different policies and considerations emanating from this status required enforcement of the arbitration clause. First, having choice of forum and choice of law clauses in international contracts should be encouraged as an "almost indispensable precondition to necessary orderliness and predictability."[27] Refusal to enforce arbitration clauses would result in an unseemly jockeying for favorable forums, with destructive consequences to international commerce.[28] Second, the protections given buyers of securities regarding remedies and jurisdiction by the Acts may be chimerical in foreign transactions, since the opposing party can speedily resort to foreign courts to block suits here until the arbitration is completed.[29] Thus, the basic assumption of the *Wilko* decision could be invalidated in such cases. Third, the Court has held that a forum selection clause should control absent a showing of strong reasons why it should be set aside,[30] and no such reason existed in *Scherk*. Fourth, it would be unfair to let American parties repudiate their solemn promises; upholding such disavowals would be too "parochial."[31] Finally, congressional support for this result could be inferred from the recent adoption of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[32]

The dissent argued that by applying the Securities Exchange

25. 94 S. Ct. at 2457.

26. *Id.* at 2455. Besides the different nationalities and residencies of the parties, the negotiations were conducted in the United States, England, and Germany; the contract was signed in Austria and closed in Switzerland; and the subject matter of the sale were businesses organized in Germany and Liechtenstein with activities in European markets.

27. *Id.*

28. *Id.* at 2456.

29. *Id.*

30. *The Bremen* v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972). Grounds for refusal to enforce the forum clause were limited to showings that enforcement would be unreasonable or unjust, or that the clause was invalid for such things as fraud or overreaching.

31. 94 S. Ct. at 2457. In *The Bremen* v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972), the Court said, "We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."

32. 94 S. Ct. at 2457-58 n.15. The goal of the Convention is to encourage commercial arbitration agreements in international transactions. The Court stated:

> [w]e think that this country's adoption and ratification of the Convention and the passage of Chapter 2 of the United States Arbitration Act provide strongly persuasive evidence of congressional policy consistent with the decision we reach today.

Id.

Act first, the contradiction between the statutes was eliminated.[33] Asserting that the transaction was a sale of securities under the Securities Exchange Act,[34] the dissent contended that any waiver of the provision for remedy in federal courts was void under section 29(a),[35] and without a valid arbitration clause, the Federal Arbitration Act did not apply.[36] It also argued that even if the Federal Arbitration Act were applicable, exceptions recognized by the Convention and the Supreme Court[37] required the Court to refuse to enforce arbitration, because the agreement was void under the Securities Exchange Act and contrary to strong public policy.[38] The dissent reemphasized the importance of the judiciary's role in questions of fraud and statutory interpretation,[39] and asserted that the result was, in effect, to deprive Alberto-Culver of its protection under the Securities Exchange Act.[40] Observing that several prior federal court decisions have held that fraudulent acts of foreign defendants subject them to the American securities laws, even where there was only a minor degree of contact with this country,[41] the dissent averred that nothing justified this diluted version of the laws where the only difference was the existence of an arbitration clause. Finally, the dissent argued that this case could have ominous results on international commerce because it would allow foreigners to profit from fraud by evading American courts. The dissent asserted that only a change in the federal statutes should cause

33. Justice Douglas, former S.E.C. Commissioner, wrote for the dissent.

34. *Id.* at 2458-59. The dissent concluded this from the broad interpretative guidelines in Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) for determining what is a "security." While a sale of the trademarks alone would not have made this a sale of securities, according to the dissent, the sale of businesses whose principal assets were trademarks would.

35. 15 U.S.C. § 78cc(a) (1971).

36. 94 S. Ct. at 2461.

37. *The Bremen* v. Zapata Off-Shore Co., 407 U.S. 1 (1972). *See* note 30 *supra*.

38. 94 S. Ct. at 2461, 2462-63 n.10. Article II, § 3 of the Convention, adopted under 9 U.S.C. § 201 (Supp. 1975), states that a country need not refer parties to arbitration pursuant to their prior agreement if that agreement is "null and void, inoperable or incapable of being performed." In *The Bremen* the Court acknowledged that a choice-of-forum clause should be unenforceable if contrary to a strong public policy of the forum state, 407 U.S. at 15 (1972), and the *Scherk* dissent believed requiring these securities claims to be determined in court was such a policy.

39. 94 S. Ct. at 2463. Included were assertions that arbitrators are not qualified to determine fraudulent misrepresentation, that no explanation or record of the result is required, that effective review of the decision is impossible, that extensive pretrial discovery would be unavailable, and that wide choice of venue would be lost.

40. *Id.*

41. *See* Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363 (1973).

such a diminution in the protection of securities investors.[42]

The majority avoided considering the effect of the Securities Exchange Act on the dispute on the grounds that it was precluded from doing so in an appeal dealing only with a motion to stay court action under 9 U.S.C. § 3.[43] Under that section, a court should order a stay if it is satisfied "that the issue involved . . . is referable to arbitration under such an agreement." The Court had previously held that, although the issue of fraud in the inducement of an arbitration clause would be relevant in a motion to stay court action, the issue of fraud in the inducement of an entire contract is properly referable to arbitration.[44] Since Alberto-Culver had alleged only the latter type of fraud, the majority believed that the question of whether the contract and/or the arbitration clause were void as violations of the Securities Exchange Act should be resolved by the arbitrators themselves.[45]

Whether the Securities Exchange Act should apply to the merits in the subsequent arbitration of the dispute in Paris or in any subsequent court review remains unclear. The majority explicitly stated that it was not deciding its applicability, either generally or particularly.[46] Refusing to agree with the dissent that prior federal court decisions were proper in holding American securities laws generally applicable to foreign parties accused of fraud regarding contracts in which there were no choice-of-forum elements, the majority felt even less reason existed to follow such decisions when forum-selection clauses were included.[47]

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42. 94 S. Ct. at 2464.

43. *Id.* at 2455 n.9.

44. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967). *See* 94 S. Ct. at 2457 n.14.

45. Had the appeal been from a motion to enforce the arbitration in accordance with 9 U.S.C. § 2, which states that arbitration clauses are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract," the dissent would have been on firmer grounds in asserting that the court should have determined whether the clause or the contract would be unenforceable as void under the Securities Exchange Act. 94 S. Ct. at 2460. However, even in enforcement cases the holdings have been to the contrary, *i.e.*, fraud in the inducement of a contract is still a proper issue for arbitration. *See* Erving v. Virginia Squires Basketball Club, 468 F.2d 1064 (2d Cir. 1972); Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co., 408 F.2d 606, 610 (2d Cir. 1969).

46. Regarding general application of the statute, see notes 47-48 *infra*. As to its specific application, the Court denied that it decided or implied any opinion on whether the acquisition constituted a sale of securities under the Act. 94 S. Ct. at 2455 n.8.

47. At 94 S. Ct. at 2455, the Court said:

> In this case . . . in the absence of the arbitration provision considerable uncertainty existed at the time of the agreement, and still exists, concerning the law applicable to the resolution of disputes arising out of the contract.

See note 41 *supra*.

In addition, neither the majority nor the dissent appeared to be entirely convinced that the choice of the parties to have the "laws of the State of Illinois, U.S.A." govern in the arbitration would, by itself, entail the application of the Securities Exchange Act.[48] Thus it appears that the question remains open for resolution by the arbitrators themselves, and their freedom in this matter can only be reinforced by the equivocation in the decision as to the proper rules to be applied. Still, it is probable that the choice of Illinois law would be recognized by the arbitral body,[49] and that "Illinois law" would include the Securities Exchange Act.[50]

Whether the arbitral body ever selects or properly applies the Securities Exchange Act as substantive law may never be known. Court review of arbitration awards through enforcement or vacation proceedings has been strictly limited, both by statute and case law.[51] Arbitrators need not give any explanation of their reasons for an award.[52] Errors in the application of the law are not normally reviewable.[53] Since *Wilko*, courts have believed that limited grounds for nonstatutory review existed where there has been either a "manifest disregard of the law"[54] or an "irrational" award.[55] As yet, however, these terms remain unclear, and their utilization has been

48. At 94 S. Ct. at 2456 n.10, the majority said:

> . . . while the arbitration agreement involved here provided that the controversies arising out of the agreement be resolved under "the laws of the State of Illinois," . . . a determination of the existence and extent of fraud concerning the trademarks would necessarily involve an understanding of foreign law on that subject.

At 94 S. Ct. at 2463 n.11, the dissent stated, "Even if the arbitration court should read this clause [selecting the laws of Illinois] to require application of Rule 10b-5 standards . . . ."

49. *See* note 11 *supra*.

50. Federal law would apply to this case in Illinois since foreign commerce is involved.

51. Under 9 U.S.C. § 10 (1970), review may only be based on assertions of corruption, fraud, or undue means in procuring the award; partiality, corruption, misbehavior, or misconduct on the part of the arbitrators; or the arbitrators having exceeded their powers or imperfectly executed them. *See* Wilko v. Swan, 346 U.S. 427, 435-37 (1953); 6 C.J.S. *Arbitration and Award* § 103 (1937).

52. United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593, 598 (1960); Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214-15 (2d Cir. 1972). *See also* I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 429 (2d Cir. 1974).

53. Office of Supply, Gov't of Korea v. New York Navigation Co., 469 F.2d 377, 379 (2d Cir. 1972); Saxis Steamship Co. v. Multifacs Int'l Traders, Inc., 375 F.2d 577, 582 (2d Cir. 1967).

54. Wilko v. Swan, 346 U.S. 427, 436 (1953); *see* Comment, *Commercial Arbitration Under the Federal Act: Expanding the Scope of Judicial Review*, 35 U. PITT. L. REV. 799, 810-12 (1974).

55. Swift Industries, Inc. v. Botany Industries, Inc., 466 F.2d 1125, 1131 (3d Cir. 1972); United Mine Workers of America v. Pennweir Construction Co., 379 F.Supp. 827, 828 (W.D. Pa. 1974).

severly restricted. Additionally, while the Convention on the Recognition and Enforcement of Foreign Arbitral Awards,[56] states that enforcement of an award may be refused on the grounds that it is "contrary to public policy," the public policy defense has also been narrowly construed.[57] Thus, although the majority in *Scherk* implied that the type of fraud alleged by Alberto-Culver could serve as the basis for a challenge to an enforcement proceeding,[58] it is improbable that the opportunity would ever arise because of the flexibility of the arbitration process. Evidently the Court still recognizes that by completely opening up the arbitration process to judicial review, it would simply be creating another form of lower court, destroying the *raison d'etre* of arbitration in the process.[59] Thus the dissent would appear to be correct in asserting that enforcement of arbitration would, in all likelihood, diminish the protection of securities investors.

The *Scherk* decision will have varying effects. In the area of securities regulation, its principal, if not exclusive, impact should be upon international transactions, but the full extent of such impact has not been defined. Domestic American securities transactions should be unaffected by *Scherk*, with the *Wilko* directives remaining in force.[60] *Scherk*'s importance to the Federal Arbitration Act is primarily negative; the Court refused to create yet another exception to the clear language of the Act on the validity and enforceability of arbitration clauses. However, the decision may have some liberalizing impact on judicial review of arbitral awards. In view of the Court's suggestion that a determination on the issue of fraud may be reviewable, perhaps now courts may be able to look not only for "manifest disregard of the law," but also for improper interpretation or application of the law.[61] Finally, the case reem-

56. Art. V, § 2(b) adopted under 9 U.S.C. § 201 (Supp. 1975).

57. Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie de Papier, 508 F.2d 969, 974 (2d Cir. 1974).

58. 94 S. Ct. at 2457 n.14. The Court stated:

> Although we do not decide the question, presumably the type of fraud alleged here could be raised, under Art. V of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards . . . in challenging the enforcement of whatever arbitral award is produced through arbitration [as contrary to the public policy of that country].

59. United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593, 598-99 (1960).

60. The Court specifically rejected the proposal of the dissenting judge in the court of appeals to limit *Wilko* to transactions in which there is a disparity of bargaining power. 94 S. Ct. at 2454 n.6.

61. *See* note 58 *supra*.

phasized the importance of foreign relations and conflicts of law factors to the Court. The decision to practice a policy of restraint where foreign parties are involved has become a significant trend in the American position on jurisdiction in transnational situations.[62] The price of increasing "the orderliness and predictability essential to any international business transaction"[63] will probably be less protection for American investors against fraud in foreign commerce.

In *Scherk* the Court could have considered and advanced the law of arbitration and securities protection to a considerable degree. It chose, however, to confine the decision to narrow grounds and to leave the particularly troublesome problems of arbitration review and securities regulation in international transactions to later cases.

JOHN S. PLETZ

62. *See, e.g., The Bremen* v. Zapata Off-Shore Co., 407 U.S. 1 (1972).
63. 94 S. Ct. at 2455.

CONSTITUTIONAL LAW — ELEVENTH AMENDMENT—SUITS AGAINST THE STATE

Edelman v. Jordan[1]

John Jordan filed a class action in the United States District Court for the Northern District of Illinois seeking injunctive and declaratory relief against two former directors of the Illinois Department of Public Aid, the Director of the Cook County Department of Public Aid, and the Comptroller of Cook County. These Illinois officials, who administered the state and federally-funded programs of Aid to the Aged, Blind and Disabled (AABD),[2] allegedly conducted the programs in a manner inconsistent with various federal regulations and the fourteenth amendment to the United States Constitution. Jordan contended that the directors, by administering the program according to state regulations,[3] did not process and approve AABD grants within the federal time limits.[4] The district court issued a permanent injunction, requiring compliance with the federal time limits and also ordered the state to remit AABD benefits wrongfully withheld to all persons found eligible. The Court of Appeals for the Seventh Circuit affirmed,[5] rejecting the state's contention that the eleventh amendment barred the awarding of retroactive benefits.[6] The United States Supreme Court, in a 5-4 decision, affirmed that portion of the holding requiring prospective compliance with the federal time limits, but held that the eleventh amendment precludes retroactive award of public assistance benefits.[7]

The eleventh amendment[8] was enacted in response to the Supreme Court's decision in *Chisholm v. Georgia*.[9] In *Chisholm*, the Court held that a state could be sued in federal court by a citizen

1. ___ U.S. ___, 94 S. Ct. 1347 (1974).
2. 42 U.S.C. §§ 1381-85 (1970). The AABD program was replaced effective January 1, 1974. *See* 42 U.S.C. §§ 1381-85 (Supp. 1973).
3. The Illinois regulations are found in the ILLINOIS CATEGORICAL ASSISTANCE MANUAL OF THE ILLINOIS DEPARTMENT OF PUBLIC AID §§ 4004.1, 8255, 8255.1.
4. 45 C.F.R. § 206.10(a)(3) (1973).
5. Jordan v. Weaver, 472 F.2d 985 (7th Cir. 1973).
6. *Id.* at 995.
7. 94 S. Ct. at 1356-57.
8. The eleventh amendment, as ratified in 1798, provides:
> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

U.S. CONST. amend. XI.
9. 1 U.S. (2 Dall.) 419 (1793).

of another state in assumpsit. This decision ran counter to the position taken by many advocates of the federal government at the time of the Constitution's adoption[10] that the federal judiciary could not summon a state as defendant and adjudicate its rights and liabilities without its consent. Consequently, at the first meeting of Congress thereafter, the eleventh amendment was proposed and in due course adopted. Although the amendment does not expressly bar suits against a state by its own citizens, the eleventh amendment has been construed to bar suits in federal court against an unconsenting state by its own citizens.[11] Furthermore, even though the state is not a named party, a suit may nevertheless be barred by the eleventh amendment if the state is the real party in interest.[12]

This constitutional immunity was the general rule for suits against a state until the landmark decision of *Ex parte Young*.[13] In *Young*, a state attorney general was enjoined from enforcing a statute which the Court held unconstitutional. The Court reasoned that the use of the state's name to enforce an unconstitutional law was an act without authority and, therefore, the official seeking to enforce the void statute did not represent the state in its sovereign capacity. The attorney general was "stripped of his official or representative character" and "subjected in his person to the consequences of his individual conduct."[14] Accordingly, the action was not a "suit against a state" and the Court refused to extend the eleventh amendment's immunity to the state official.

In *Rothstein v. Wyman*,[15] the Court of Appeals for the Second Circuit held that a retrospective award of public assistance benefits was in fact a suit against the state because it would require a pay-

10. *See* Madison, in 3 ELLIOT'S DEBATES ON THE FEDERAL CONSTITUTION 533 (1788); THE FEDERALIST No. 81 (A. Hamilton).

11. Great Northern Life Ins. Co. v. Read, 322 U.S. 47 (1944); Duhne v. New Jersey, 251 U.S. 311 (1920); Hans v. Louisiana, 134 U.S. 1 (1890). *But see* Justice Brennan's dissent in Edelman v. Jordan, 94 S. Ct. at 1367, where he argued that the eleventh amendment did not apply because its language could not be judicially altered. *See also* McCartney v. West Virginia, 156 F.2d 739 (4th Cir. 1946). See Note, *Private Suits Against States in the Federal Courts*, 33 CHI. L. REV. 331, 334-35 (1966), for the proposition that *Hans v. Louisiana* was not decided on grounds creating a constitutional immunity, but was actually based on common law sovereign immunity.

12. Ford Motor Co. v. Dep't of Treasury, 323 U.S. 459 (1945).

> [W]hen the action is in essence one for the recovery of money from the state, the state is the real, substantial party in interest and is entitled to invoke its sovereign immunity from suit even though individual officials are nominal defendants.

Id. at 464.

13. 209 U.S. 123 (1908).

14. *Id.* at 159.

15. 467 F.2d 226 (2d Cir. 1972), *cert. denied*, 411 U.S. 921 (1973).

ment of funds out of the state treasury.[16] However, the Court of Appeals for the Seventh Circuit, in its consideration of *Jordan*,[17] found that the retroactive award of public assistance benefits did not amount to a suit against the state, but was a logical extension of *Ex parte Young*.[18]

The Supreme Court in *Jordan* accepted the theory that, even where an individual is the named defendant, retrospective relief that requires payment of funds from the state treasury is a suit against the state which is barred by the eleventh amendment.[19] The Court noted that the funds to satisfy the retrospective award in *Jordan* would inevitably come from the general revenues of Illinois.[20] Therefore, the award resembled a monetary award against the state itself, which is barred by the eleventh amendment.[21] Apparently, the Court considered the crucial fact to be that the retrospective award would not be paid personally by the state official.[22] In affirming the prospective injunctive relief in *Jordan*, on the other hand, the Court applied the reasoning used in *Ex parte Young*, saying that the officer was stripped of his official character and as an individual could be compelled to bring his conduct in conformity with federal

16. *Id.* at 241.

17. 472 F.2d 985 (7th Cir. 1973).

18. *Id.* at 991. *Accord*, Silvey v. Roberts, 363 F. Supp. 1006 (M.D. Fla. 1973), holding that retroactive benefits should be available to the class of plaintiffs when the state's policy is clearly inconsistent with federal regulations. *But see* Like v. Carter, 486 F.2d 552 (8th Cir. 1973); Dawkins v. Craig, 483 F.2d 1191 (4th Cir. 1973); Frye v. Lukehard, 364 F. Supp. 1379 (W.D. Va. 1973), where the courts denied retroactive public benefits awards on grounds that the states were immune under the eleventh amendment. The court of appeals in *Jordan* noted four summary affirmances by the Supreme Court allowing retroactive relief, where the Court did not address itself to the eleventh amendment question. 472 F.2d at 989. *See* Sterrett v. Mothers' & Children's Rights Org., 409 U.S. 809 (1972); State Dep't of Health & Rehabilitative Services v. Zarate, 407 U.S. 918 (1972); Wyman v. Bowens, 397 U.S. 49 (1969); Shapiro v. Thompson, 394 U.S. 618 (1969). A summary affirmance is a decision on the merits having precedential value. *See* Jordan v. Weaver, 472 F.2d 985 (7th Cir. 1973), *rev'd on other grounds*, Edelman v. Jordan, 94 S.Ct. 1347 (1974), and cases cited therein.

19. 94 S. Ct. at 1358. *See also* Rothstein v. Wyman, 467 F.2d 226 (2d Cir. 1972), *cert. denied*, 411 U.S. 921 (1973).

20. Justice Rehnquist, for the majority, quoted from Judge McGowan's opinion in Rothstein v. Wyman, 467 F.2d 226, 236-37 (2d Cir. 1972):

> It is not pretended that these payments are to come from the personal resources of appellants. Appellees expressly contemplate that they will, rather, involve substantial expenditures from the public funds of the state . . . .

94 S. Ct. at 1356.

21. Kennecott Copper Corp. v. State Tax Comm'n, 327 U.S. 573 (1946); Ford Motor Co. v. Dep't of Treasury, 323 U.S. 459 (1945); Great Northern Life Ins. Co. v. Read, 322 U.S. 47 (1944).

22. 94 S. Ct. at 1356.

requirements.[23]

The Court emphasized the fact that the AABD program is designed to satisfy bare minimal needs of participants during a certain time period. The Court followed Judge McGowan's position as stated in *Rothstein*: "As time goes by . . . retroactive payments become compensatory rather than remedial; the coincidence between previously ascertained and existing needs becomes less clear."[24] The Court implied that the needs of an applicant during the time funds were wrongfully withheld must necessarily have been satisfied elsewhere if the applicant has survived through the period. Consequently, the applicant has no further need for the state's support during that time period. Because the need no longer exists, the benefits become similar to damages which must be paid by the state.[25] The Court viewed the retroactive award as a type of compensatory damages against the state, rather than a method of returning welfare recipients to the status quo.[26] The eleventh amendment grants the states immunity from federal court suits for compensatory damages.

Jordan does not, however, preclude the possibility of retroactive relief in all cases. The Court merely limited the potential scope of *Ex parte Young*.[27] The Court indicated that two additional, highly restrictive exceptions to eleventh amendment immunity exist and would be available in awarding retroactive relief. The first exception deals with congressional approval of a program that involves state participation; it is dependent on Congress' intention to abrogate the state's immunity, and the state's constructive consent to this abrogation of immunity by participating in the federal program.[28] The

23. But the relief awarded in Ex parte Young was prospective only; the Attorney General of Minnesota was enjoined to conform his future conduct of that office to the requirement of the Fourteenth Amendment. Such relief is analogous to that awarded by the District Court in the prospective portion of its order under review in this case.

Id.

24. Rothstein v. Wyman, 467 F.2d 226, 235 (2d Cir. 1972), *cert. denied*, 411 U.S. 921 (1973).

25. However, Justice Douglas, in dissent, contended that most welfare decisions by federal courts have a financial impact on the states. According to Douglas, because the Illinois official must nevertheless spend state funds to bring his conduct in line with the federal regulations, the prospective/retroactive distinction is irrelevant and the eleventh amendment is no bar. 94 S. Ct. at 1364-65.

26. The Court rejected the respondent's contention that upholding the district court's award was permissible as a form of "equitable restitution." 94 S. Ct. at 1357.

27. 209 U.S. 123 (1908).

28. *See* Parden v. Terminal R.R., 377 U.S. 184 (1964); Petty v. Tennessee-Missouri Bridge Comm'n, 359 U.S. 275 (1959).

Court clearly indicated that this possibility is still available, but rejected such an argument on the facts of *Jordan*.[29] The second exception is the situation where a state waives its constitutional immunity. However, waiver will be found only where there is express language or such overwhelming implication that there is no other reasonable conclusion.[30]

The impact of *Edelman v. Jordan* will be felt widely throughout three interested sectors: the federal government and agencies, state government and agencies, and welfare recipients. As was noted in *Rothstein*, court-ordered retroactive relief serves three congressional interests: (1) deterring willful state violations of federal requirements; (2) insuring proper use of federal funds; and (3) promoting the federal policy of satisfying the ascertained needs of impoverished individuals.[31] *Jordan*'s denial of retrospective awards will undermine the first two interests and possibly the third. The only federal remedy available to deter willful state violations after *Jordan* is to cut off federal funds, a drastic sanction which the Department of Health, Education, and Welfare is reluctant to use.[32] If the states are not held responsible for funds which are wrongfully withheld, they can defy federal regulations with no sanction other than an order that future conduct be in accordance with federal regulations. Furthermore, a determination of wrongdoing may not be made until sometime after suit has been filed, allowing violations to continue for months or even years.[33] If the federal government cannot deter willful violations of its regulations, there is little or no power to guarantee proper use of federal funds. Whether the third congressional interest is undermined depends on whether Congress views the unsatisfied needs of impoverished individuals during the period the funds were wrongfully withheld as no longer ascertain-

29. 94 S. Ct. at 1360. Justice Marshal, in dissent, contended that Congress intended to provide public aid recipients with a cause of action and that Illinois' agreement to participate was also an agreement to submit to suit in federal court. Congressional intent was arguably demonstrated by congressional adoption of the AABD program and HEW regulations which require the states to make corrective payments after successful "fair hearings" and provide for federal matching funds to satisfy federal court orders of retroactive payments. 94 S. Ct. at 1368-69. *See also* 42 U.S.C. § 1983 (1970). For relevant HEW regulations, see 45 C.F.R. § 205.10(b)(2)-(3) (1973).

30. 94 S. Ct. at 1361. *See also* Great Northern Life Ins. Co. v. Read, 322 U.S. 47 (1944); Murray v. Wilson Distilling Co., 213 U.S. 151 (1909).

31. Rothstein v. Wyman, 467 F.2d 226, 235 (2d Cir. 1972).

32. 94 S. Ct. at 1370.

33. In *Edelman v. Jordan*, Illinois operated the program under time limits which were known to be inconsistent with federal time limits from July 1, 1968 to April 16, 1971. 94 S. Ct. at 1350.

able and thus not due the applicant.[34] The result is that the individual welfare recipient has no remedy for wrongfully withheld payments under *Jordan*, despite the fact that *Goldberg v. Kelly*[35] indicates that public assistance benefits are a right which requires due process protection before termination. A private individual seeking benefits due him is left to the caprice of the state agency and officials who administer the program.

In conclusion, although recent decisions had indicated that eleventh amendment immunity would not be applied as broadly as in the past,[36] *Jordan* appears to limit this trend of allowing suits against states in federal court. States now have the assurance that they will not be subject to suits for retroactive relief in federal court. Furthermore, the Court has given added weight to the proposition that modern writers recognize as the only valid grounds for sovereign immunity and the eleventh amendment—noninterference with state government operation.[37] In particular, the Court appears to be concerned about causing the fiscal bankruptcy of the states.

Jordan appears to indicate an easy solution to the eleventh amendment problem by the characterization of relief sought as "prospective" rather than "retroactive." Yet this distinction cannot reconcile the two conflicting policies which are deeply imbedded in the judicial system and at the root of the eleventh amendment problem. One is the practice of providing a federal forum for the vindication of federal rights; the other is the policy of shielding the sovereign from suit. In its effort to protect state treasuries, the Court has blocked the use of the federal government's most effective monitoring device[38] over state administration of federal funds in federal-state "matching funds" programs.[39] A state may willfully fail to comply with federal guidelines without risk of retrospective consequences. *Jordan* deprives individuals of benefits to which they are

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

35. 397 U.S. 254 (1970).

36. Maryland v. Wirtz, 392 U.S. 183 (1968); Parden v. Terminal R.R., 377 U.S. 184 (1964); Petty v. Tennessee-Missouri Bridge Comm'n, 359 U.S. 275 (1959).

37. *See, e.g.*, K. DAVIS, ADMINISTRATIVE LAW § 27.02 (3d ed. 1972).

38. Congress can retain some measure of control over its spending policies by requiring waiver of immunity with respect to particular programs. However, Congress has done so infrequently in the past.

39. As of 1971, there were over 500 separate programs which annually distributed more than $30 billion in the form of categorical grants which feature federal "matching funds" administered by the state. OFFICE OF ECONOMIC OPPORTUNITY, CATALOGUE OF FEDERAL ASSISTANCE PROGRAMS (1967). *See* Advisory Comm'n on Intergovernmental Relations, *Revenue Sharing — An Idea Whose Time Has Come* 7 (1970).

entitled and opens federal "matching funds" programs to potential abuses.

JOHN G. YOUNG, JR.

CRIMINAL LAW—JUVENILE CONFESSIONS—REQUIREMENTS FOR ADMISSION IN MISSOURI

State v. Wright[1]

The defendant, Roy Lee Wright, age 15, was arrested in connection with a robbery and homicide. He was subsequently taken to the juvenile court building where he was turned over to the custody of the juvenile court.[2] The juvenile authorities allowed the police to interrogate the defendant at the juvenile center in the presence of a juvenile officer and defendant's mother. Prior to the questioning, the defendant was informed of his constitutional rights and asked, after each part of the *Miranda* warning, if he understood. He said that he understood, that he did not want an attorney, and that he would make a statement. He then admitted his participation in the planning and commission of the robbery.[3]

The juvenile court, after determining that Wright was not a proper subject to be dealt with under the Juvenile Code, certified him for trial as an adult.[4] He was charged with first degree murder. At trial, the court found that the defendant had knowingly and intelligently waived his right to remain silent. The confession was admitted into evidence. Defendant was convicted of murder in the first degree.[5]

On appeal, the Missouri Supreme Court affirmed, holding that defendant's confession was properly admitted into evidence.[6] The

1. 515 S.W.2d 421 (Mo. En Banc 1974).

2. *Id.* at 423.

Wright was not taken to the juvenile court immediately after his arrest because he told the police he was 17. When Mrs. Wright, the defendant's mother, was telephoned, she informed the police that he was 15 or 16. He was then immediately delivered to the custody of the juvenile court.

3. 515 S.W.2d at 423.

4. Section 221.071, RSMo 1969, provides:

> In the discretion of the judge of the juvenile court, when any petition under sections 211.011 to 211.431 alleges that a child of the age of fourteen years or older has committed an offense which would be a felony if committed by an adult, or that the child has violated a state or municipal traffic law or ordinance or that a minor between the ages of seventeen and twenty-one years over whom the juvenile court has jurisdiction has violated any state law or municipal ordinance, the petition may be dismissed and such child or minor may be prosecuted under the general law, whenever the judge after receiving the report of the investigation required by sections 211.011 to 211.431 and hearing evidence finds that such child or minor is not a proper subject to be dealt with under the provisions of sections 211.011 to 211.431.

The defendant had allegedly been involved with the juvenile court on 42 previous occasions.

5. 515 S.W.2d at 422.

6. Prior to being informed of his fifth and sixth amendment rights, the defendant had answered one question posed by the police about a shotgun used in the robbery. Defendant

court rejected defendant's assertion that section 211.271(3), RSMo 1969,[7] operated as an absolute bar to the admission into evidence of statements made by juveniles while they were in the custody of the juvenile court. The court held that after a juvenile is informed of his fifth and sixth amendment rights and made aware that the questioning authorities are his adversaries and that criminal responsibility may result from any statement he makes, his statements are admissible in evidence against him in a subsequent criminal trial.[8]

The use of a juvenile's statements, made while he is in the custody of the juvenile court, against him in an adult, criminal proceeding is inconsistent with the nature of the juvenile court system. The philosophy underlying the Juvenile Code is that the state assumes the role of *parens patriae* toward the juvenile offender.[9] The juvenile court's task is not to determine guilt or innocence, but to rehabilitate the wayward youth. To this end, he is dealt with in the manner best calculated to achieve the goal of reforming him, rather than punishing him.[10] Consistent with this purpose, juvenile proceedings are deemed civil rather than criminal,[11] juvenile records are

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contended that under Westover v. United States, 384 U.S. 436 (1966), this tainted and made inadmissible his later confession. Although an opinion was written and adopted in Division One of the Missouri Supreme Court reversing the conviction on this ground, the opinion was not adopted after reargument en banc. 515 S.W.2d at 424.

7. Section 211.271(3), RSMo 1969, provides:

> After a child is taken into custody as provided in section 211.131, all admissions, confessions, and statements by the child to the juvenile officer and juvenile court personnel and all evidence given in cases under this chapter, as well as all reports and records of the juvenile court, are not lawful or proper evidence against the child and shall not be used for any purpose whatsoever in any proceeding, civil or criminal, other than proceedings under this chapter.

8. 515 S.W.2d at 430-31.

9. The Juvenile Act is rooted in the concept of *parens patriae*, that the state will supplant the natural parents when they fail in their role. The dominant purpose is clearly stated in § 211.011, RSMo 1969, and carries through the entire act. *In re* F____ C____, 484 S.W.2d 21, 25 (Mo. App., D.K.C. 1972).

10. Section 211.011, RSMo 1969, states:

> 1. The purpose of sections 211.011 to 211.431 is to facilitate the care, protection and discipline of children who come within the jurisdiction of the juvenile court. Sections 211.011 to 211.431 should be liberally construed, therefore, to the end that each child coming within the jurisdiction of the juvenile court shall receive such care, guidance and control, preferably in his own home, as will conduce to the child's welfare and the best interests of the state and that when such child is removed from the control of his parents the court shall secure for him care as nearly as possible equivalent to that which should have been given him by them.

11. The Missouri Juvenile Act is neither criminal nor penal in its nature. State v. Harold, 364 Mo. 1052, 1058, 271 S.W.2d 527, 530 (1954). For a list of jurisdictions holding that juvenile proceedings are not criminal, see Pee v. United States, 274 F.2d 556, 561-62 (D.C. Cir. 1959).

kept confidential,[12] and youthful offenders are encouraged to communicate freely and openly with juvenile officers and other juvenile court personnel.[13]

However, not all juvenile offenders remain in the custody of the juvenile court. In some cases, the juvenile court, having found the defendant to be an improper subject to be dealt with under the Juvenile Code, will certify him for trial as an adult.[14] When certified for trial as an adult, a juvenile who has responded to the juvenile officer's plea for open communication by providing a detailed account of his part in the crime may find, at his criminal trial, that he has provided the state with its best evidence against him. Thus, there is a need to protect the juvenile from having his prior

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Since juvenile proceedings were deemed civil rather than criminal, early cases held that the constitutional rights of an accused did not attach to juvenile defendants. *See, e.g., Ex parte* Naccarat, 328 Mo. 722, 726, 41 S.W.2d 176, 178 (En Banc 1931); State *ex rel.* Matacia v. Buckner, 300 Mo. 359, 363, 254 S.W. 179, 181 (En Banc 1923); Minor Children of F.B. v. Carruthers, 323 S.W.2d 397, 400 (St. L. Mo. App. 1959). This view was rejected by the Supreme Court in *In re* Gault, 387 U.S. 1 (1967), where the due process clause of the fourteenth amendment was held applicable to juvenile proceedings. *See In re* M____ C____, 504 S.W.2d 641 (Mo. App., D. St. L. 1974).

The U.S. Supreme Court has held that juveniles are constitutionally entitled to proof of guilt beyond a reasonable doubt when charged with a violation of the criminal law. *In re* Winship, 397 U.S. 358 (1970). The requirements of Miranda v. Arizona, 384 U.S. 436 (1966), have been held applicable to interrogations of children in juvenile proceedings. *See* Lopez v. United States, 399 F.2d 865 (9th Cir. 1968); State v. Stevens, 467 S.W.2d 10 (Mo. 1971); State v. Sinderson, 455 S.W.2d 486 (Mo. 1970).

A good overview of the juvenile court system in the United States is S. FOX, THE LAW OF JUVENILE COURTS IN A NUTSHELL (1971). For suggestions as to the attorney's role in representing juvenile defendants, see McMillian & McMurtry, *The Role of the Defense Lawyer in the Juvenile Court—Advocate or Social Worker?*, 14 ST. L.U.L.J. 561 (1970); Scheppner, *You Have a Juvenile Matter Today*, 29 J. Mo. B. 386 (1973); Comment, *Representing the Juvenile Defendant in Waiver Proceedings*, 12 ST. L. U.L.J. 424 (1968); Comment, *Representing the Juvenile in the Adjudicatory Hearing*, 12 ST. L. U. L.J. 466 (1968).

For one author's view of the Missouri procedures in light of these developments, see Habiger, *Prosecution of Children in Missouri Poses Constitutional Problems*, 30 J. Mo. B. 11 (1974).

12. Section 211.321(1), RSMo 1969, provides:

> The proceedings of the juvenile court shall be entered in a book kept for that purpose and known as the juvenile records. These records as well as all information obtained and social records prepared in the discharge of official duty for the court shall be open to inspection only by order of the court to persons having a legitimate interest therein.

13. The atmosphere in the juvenile court has been described as: "the nonadversary, nonpunitive atmosphere of the juvenile system . . . ," State v. O'Neill, 216 N.W.2d 822, 829 (Minn. 1974); " . . . the relaxed, friendly, parens patriae relationship which . . . is characteristic of the juvenile court approach . . . ," 515 S.W.2d at 435; "the relaxed, non-adversary atmosphere of the juvenile interrogation . . . ," State v. Arbeiter, 449 S.W.2d 627, 633 (Mo. 1970).

14. *See* § 211.071, RSMo 1969, quoted note 4 *supra*.

communications, made in the relaxed atmosphere of the juvenile court system, used against him in a subsequent, adult prosecution. Section 211.271(3) was enacted in 1957 to provide this needed protection.[15] As enacted, section 211.271(3) provided that "evidence given in cases" under the Juvenile Code is not admissible in a subsequent criminal proceeding.[16] Section 211.271(3) was amended in 1969. It is this amendment which was in issue in *Wright*. However, the interpretation of section 211.271(3) prior to the amendment is important.

Missouri first considered the use of a juvenile's statements in a later criminal proceeding in the *Arbeiter* cases, hereafter referred to as *Arbeiter I, II,* and *III.*[17] *Arbeiter I* dealt with statements obtained from a juvenile by the police before the juvenile was turned over to the juvenile court authorities. The court held the statements inadmissible because the police failed to comply with section 211.061, which required that an arrested juvenile be brought immediately before a juvenile court or juvenile officer.[18] The court held that any and all statements obtained prior to delivering the youth to the juvenile authorities are inadmissible in a later adult criminal prosecution.[19] The court expressly reserved the question of the admissibility of statements obtained from a juvenile by the police after compliance with section 211.061.[20] Thus, the exclusionary rule of *Arbeiter I* applies only where section 211.061 of the Juvenile Code has been violated.

Arbeiter II[21] involved the prosecuting attorney's attempt to gain access to the juvenile court records of the defendant, who was then

15. Section 211.271(3), RSMo 1959, (subsequently amended) provided:

> Evidence given in cases under sections 211.011 to 211.431 is not lawful or proper evidence against the child for any purpose whatever in a civil, criminal or other proceeding except in subsequent cases under sections 211.011 to 211.431.

16. *Id.*

17. These cases dealt with the statements of a fifteen year old boy. State v. Arbeiter, 408 S.W.2d 26 (Mo. 1966) (referred to as *Arbeiter I*); State *ex rel.* Arbeiter v. Reagan, 427 S.W.2d 371 (Mo. En Banc 1968) (referred to as *Arbeiter II*); and State v. Arbeiter, 449 S.W.2d 827 (Mo. 1970) (referred to as *Arbeiter III*).

18. Section 211.061, RSMo 1969, provides:

> 1. When a child is taken into custody with or without a warrant for an offense, the child together with any information concerning him and the personal property found in his possession, shall be taken immediately and directly before the juvenile court or delivered to the juvenile officer or person acting for him.

19. 408 S.W.2d 26, 29-30 (Mo. 1966).

20. *Id.* at 31. *See also* Hamby v. State, 454 S.W.2d 894, 897 (Mo. En Banc 1970), stating that unless the record affirmatively shows compliance with § 211.061, a confession obtained while the juvenile was in custody would be inadmissible.

21. State *ex rel.* Arbeiter v. Reagan, 427 S.W.2d 371 (Mo. En Banc 1968).

facing prosecution as an adult. The court concluded that the prosecutor was entitled to the information in the juvenile court file, even though it had been prepared by juvenile court personnel while they had custody of the defendant.[22] The court did not, however, decide whether these records could be used as evidence in the defendant's adult criminal trial.[23]

This question was squarely presented in *Arbeiter III*,[24] where the defendant appealed his conviction, contending that the information found in his juvenile court file was improperly admitted into evidence at trial. The court held that section 211.271(3)[25] rendered a juvenile's statements to a juvenile officer inadmissible in his criminal trial. The court stated that although the phrase "evidence given in cases"[26] did not expressly refer to statements made to juvenile court personnel, such statements were within the statutory prohibition.[27] The court pointed out that the *parens patriae* concept would be endangered by allowing juvenile court personnel to obtain statements from a juvenile in the friendly, open surroundings of the juvenile interrogation and then admit these statements against the juvenile in subsequent criminal proceedings.[28]

In *State v. Sinderson*,[29] a juvenile in the custody of a juvenile officer made statements to the police which were used against him in a subsequent criminal proceeding. The defendant, relying on *Arbeiter III* and section 211.271(3), contended that these statements were inadmissible.[30] The court rejected this argument and held that statements made to the police by a juvenile in the presence of his mother and the juvenile officer were properly admissible.[31] *Arbeiter III* was distinguished because Sinderson's statements were not made to a juvenile officer in the friendly atmosphere of a juvenile interrogation, without any warning as to the potential consequences of making a statement. Sinderson was given a constitutionally adequate warning of his rights, was advised of the consequences of making a statement, and was aware that the police were operating

22. *Id.* at 378. *See* § 211.321(1), RSMo 1969, quoted note 12 *supra*.
23. 427 S.W.2d at 378.
24. State v. Arbeiter, 449 S.W.2d 627 (Mo. 1970).
25. *See* § 211.271(3), RSMo 1959, quoted note 15 *supra*.
26. *Id.*
27. 449 S.W.2d at 632-33.
28. *Id.* at 633.
29. 455 S.W.2d 486 (Mo. 1970).
30. *Id.* at 492.
31. *Id.*

as his adversaries and not as his friends.[32] Because there was no potential abuse of the *parens patriae* concept under these circumstances, the court concluded that section 211.271(3) did not require the exclusion of the defendant's statements from evidence.[33]

Section 211.271(3), which prohibited the use in later criminal proceedings of "evidence given in cases" under the Juvenile Code, was amended in 1969. The amendment expanded the reference to "evidence given in cases" to prohibit expressly the use of "statements by the child to the juvenile officer and juvenile court personnel . . . as well as all reports and records of the juvenile court" as evidence in a subsequent criminal trial.[34] Known as the "Arbeiter amendment," this legislation apparently answered the question expressly reserved by the court in *Arbeiter II*.[35] The amended statute was passed before the appellate decisions in *Arbeiter III* and *Sinderson*, but was not applicable to either of these cases because the trial convictions were handed down prior to the effective date of the amendment. Since the language of the amended statute was in accord with the result in *Arbeiter III*, the question presented in *Wright* was whether the amendment had changed the result in *Sinderson*, from which *Wright* was factually indistinguishable.

In *Wright*, the court held that amended section 211.271(3) did not prohibit the admission into evidence of a juvenile's statements made to police officers while in the custody of the juvenile court.[36] In interpreting the amended statute in this way, the court relied on the legislative history and the express language of the amendment.[37] The court concluded that the purpose of the amendment was to answer the question reserved in *Arbeiter I* and *II*, that is, whether statements to juvenile court personnel, made by a juvenile in the custody of the juvenile court, are admissible against the juvenile in a subsequent criminal proceeding.[38] The court rejected the argument that the amendment was intended to cover all statements

32. *Id.*

33. *Id.* at 492-93.

34. *Compare* § 211.271(3), RSMo 1969, quoted note 7 *supra*, *with* § 211.271(3), RSMo 1959, quoted note 15 *supra*.

35. During oral argument in *Wright*, counsel admitted that the amendment to § 211.271(3) was referred to as the "Arbeiter amendment." 515 S.W.2d at 428 n.8. Judge Seiler, dissenting, agreed with the majority that the amendment was intended to close a potential "loophole" with respect to statements made to juvenile officers by juveniles in their custody. 515 S.W.2d at 434.

36. 515 S.W.2d at 430-31.

37. *Id.* at 427, 429.

38. *Id.* at 428-29.

made by the juvenile while in the custody of the juvenile authorities.[39] In interpreting the statute strictly, the court pointed out that the Missouri legislature could have prohibited the use of *any statements* made by juveniles under the jurisdiction of the juvenile court, but did not. The court viewed itself as bound by what the legislature said, not what it might have said.[40]

This interpretation of amended section 211.271(3) agrees with the express language of the statute. In addition, the interpretation seems to harmonize with the doctrine of *parens patriae*. As long as the juvenile is aware that he is in an adversary situation, that the people with whom he is dealing are *not* his friends and that any statements he makes may be used against him in a criminal proceeding, there is no danger that he may have been misled by the relaxed atmosphere of the juvenile court process.[41]

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39. *Id.* at 429-30. The court refused to adopt the per se exclusionary rule announced in Harling v. United States, 295 F.2d 161 (D.C. Cir. 1961). This rule would exclude all statements made by a juvenile in the custody of the juvenile court from evidence in all proceedings except those under the Juvenile Code. The *Harling* court emphasized that the juvenile court provides a separate system for dealing with juvenile offenders. In their view, the protection of this separate system requires the exclusion of all such statements from evidence because of the:

> flexible and informal procedures of the Juvenile Court which are essential to its *parens patriae* function. To avoid impairment of this function, the juvenile proceeding must be insulated from the adult proceeding. This requires that admissions by a juvenile in connection with the non-criminal proceeding be excluded from evidence in the criminal proceeding.

295 F.2d at 164. The *Harling* approach was considered and rejected by Missouri in State v. Sinderson, 455 S.W.2d 486, 493 (Mo. 1970). *See also* State v. O'Neill, 216 N.W.2d 822, 829 (Minn. 1974); State v. Stevens, 467 S.W.2d 10, 19 (Mo. 1971); State v. Gullings, 244 Ore. 173, 176, 416 P.2d 311, 313 (1966) (quoted with approval in *Sinderson* and *Wright*); State v. Prater, 77 Wash. 2d 526, 533, 463 P.2d 640, 644 (1970).

40. 515 S.W.2d at 429.

41. *Id.* at 430-31. The police do not occupy a *parens patriae* relationship toward the juevnile offender; they are not concerned with the best interests of the child, but with law enforcement. Thus, they are not a part of the friendly surroundings of the juvenile court. So long as the juvenile offender is aware that he is talking to the police and not to juvenile court personnel, there is no danger that he will be lulled into a false sense of security by the relaxed, informal approach of the juvenile court system.

It is not clear whether merely informing the juvenile that he is talking to the police and not juvenile court personnel is sufficient to make him aware that the questioning authorities are his adversaries rather than his friends. It would seem that to ensure he is fully aware of the consequences of his statements a more detailed warning should be required, for example:

> These gentlemen are police officers and they would like to ask you some questions. You do not have to answer any of their questions and, if you answer any questions, you may refuse to answer any further questions at any time. Any answers you give may not only be used against you in juvenile court, but can also be used against you in a criminal trial if you are certified and tried as an adult.

This would, of course, be a warning in addition to the *Miranda* warning rather than in lieu of it.

However, even though the court's interpretation seems to recognize the intention of the legislature and the philosophy of the juvenile court, it does leave two problems unanswered. First, authorizing the juvenile officer to permit the police to question a juvenile creates a conflict of interest. The juvenile officer is charged with protecting the juvenile's interests. Interrogation by the police is, arguably, not in the best interests of the juvenile defendant. Thus, authorizing the juvenile officer to permit police interrogation may place him in the position of not acting in the juvenile's best interests.[42] In their dissent in *Wright*, Judges Seiler and Bardgett express their fear that this type of police involvement with juvenile court personnel and juvenile offenders will tend to pierce the barrier which has been established between the juvenile court system and the adult criminal process.[43] In their view, the legislature has provided that a juvenile, whether guilty or not, should be treated differently from an adult until the juvenile court determines that he is not amenable to the juvenile process and waives jurisdiction over him. They argue that the juvenile should not be exposed to a police interrogation until he has been released from the custody of the juvenile court.[44] Second, there is serious doubt as to the capacity of a juvenile defendant to effectively, knowingly, and intelligently waive his constitutional rights.[45]

However, until the legislature provides that *all statements* made by a juvenile in the custody of the juvenile court shall be inadmissible in a criminal proceeding, statements made by a juvenile to the police while the juvenile is in the custody of the juvenile

42. State v. Wright, 515 S.W.2d 421, 435 (Mo. En Banc 1974) (dissenting opinion). As a practical matter, the police will be interested in interrogating a juvenile for the purpose of obtaining statements which will be admissible against him in a criminal proceeding in those cases where they suspect the juvenile will be certified for trial as an adult by the juvenile court. Since this is precisely the situation where the juvenile will need the maximum protection of his interests and where the juvenile authorities will have a minimal interest in protecting the defendant, it may well be that the juvenile officer in this type of case would not be an adequate guardian of the juvenile's interests.

43. 515 S.W.2d at 437.

44. *Id.*

45. Ferguson & Douglas, *A Study of Juvenile Waiver*, 7 SAN DIEGO L. REV. 39, 54 (1970). Furthermore, even the presence of the juvenile's parents at the interrogation may not provide adequate protection of the child's rights. *See* S. FOX, THE LAW OF JUVENILE COURTS IN A NUTSHELL 129 (1971). However, case law in Missouri clearly stands for the proposition that a juvenile can waive his rights. The presence or absence of an adult "friend" is apparently one of the factors to be considered under the "totality of the circumstances." *See* State v. Stevens, 467 S.W.2d 10, 18 (Mo. 1971) (waiver by a 14 year-old held effective); State v. Sinderson, 455 S.W.2d 486, 492-93 (Mo. 1970) (waiver by a 14 year-old held effective).

authorities will be admissible in evidence in a subsequent criminal trial if the following requirements are satisfied:

1. Immediately after his arrest, the juvenile must have been taken before the juvenile judge or delivered to the juvenile officer.[46]

2. The statements made by the juvenile were not communications between the child and a juvenile officer or juvenile court personnel.[47]

3. Prior to making the statements, the juvenile was apprised of his fifth and sixth amendment rights,[48] fully advised of the potential consequences of any statements he might make to the police,[49] and made aware that the interrogation was being conducted in an adversary situation.[50]

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46. State v. Arbeiter, 408 S.W.2d 26 (Mo. 1966) and § 211.061, RSMo 1969. The record must affirmatively show compliance with these requirements for any statements made by the juvenile to be admissible. Hamby v. State, 454 S.W.2d 894, 897 (Mo. En Banc 1970).

47. State v. Arbeiter, 449 S.W.2d 627 (Mo. 1970) and § 211.271(3), RSMo 1969. In *Wright*, 515 S.W.2d at 430, the court stated:

> The mere presence of the juvenile officer to warn the youth of his rights and to make sure they were accorded to him, when all the facts and circumstances are considered, did not make the confession to the police officer a statement to the juvenile officer.

This suggests that any active participation in the interrogation by the juvenile officer might "taint" the statements made by the juvenile and bring them within the ambit of § 211.271(3). Apparently, statements made by the child in an honest, but mistaken, belief that he was communicating with juvenile authorities would also be within the coverage of § 211.271(3). Finally, application of the *Hamby* rule, note 46 *supra*, would further safeguard the juvenile's interests.

48. *In re* Gault, 387 U.S. 1 (1967); State v. Stevens, 467 S.W.2d 10 (Mo. 1971); State v. Sinderson, 455 S.W.2d 486 (Mo. 1970). This is also required where the juvenile is communicating with the juvenile authorities, if there is a possibility of commitment to a state institution for juveniles. *In re* M ___ C ___, 504 S.W.2d 641, 647 (Mo. App., D. St. L. 1974).

49. State v. Rone, 515 S.W.2d 438 (Mo. En Banc 1974) (decided concurrently with *Wright*); State v. Wright, 515 S.W.2d 421 (Mo. En Banc 1974); *see* State v. McMillian, 514 S.W.2d 528 (Mo. En Banc 1974) (also decided with *Wright*) (confession of a juvenile held inadmissible because the warning dealt only with what the juvenile court could do with the defendant, not with the possibility that he could be certified for trial and prosecuted as an adult under the criminal law); State v. Ross, 516 S.W.2d 311 (Mo. App., D. St. L. 1974) (conviction reversed because the juvenile defendant was not warned before the interrogation of the possibility that he might be bound over to the circuit court to be tried as an adult).

50. State v. Rone, 515 S.W.2d 438 (Mo. En Banc 1974); State v. Wright, 515 S.W.2d 421 (Mo. En Banc 1974); State v. Sinderson, 455 S.W.2d 486 (Mo. 1970).

DUE PROCESS—THE REQUIREMENT OF NOTICE IN PROBATE PROCEEDINGS

Haas v. Haas[1]

On May 1, 1970 a writing purporting to be the last will and testament of Ervin Frank Haas was admitted to probate, and letters testamentary were issued. The first publication of notice to creditors was on May 6, 1970, and proof of publication of notice was filed May 27, 1970. A stamped, unmailed post card in the form of notice of issuance of letters testamentary addressed to Ervin A. Haas, "address unknown," was in the probate file. On October 5, 1971, Ervin A. Haas, testator's son and recipient of one dollar under the will, filed a petition to contest the will. Petitioner alleged that a coexecutor of the estate knew that petitioner was incarcerated in the federal penitentiary in Leavenworth, Kansas, but that petitioner had not been given personal notice of the probate proceedings; thus he alleged that he had not been given notice reasonably calculated to apprise him of the pending proceedings and that such failure amounted to a denial of due process. The trial court dismissed the petition with prejudice because it was filed more than six months after the first publication of notice of the issuance of letters testamentary.[2] On appeal, the Missouri Supreme Court affirmed.

Appellant's major contention on appeal was that, absent a requirement of due diligence on the part of an applicant for letters testamentary to ascertain the whereabouts of heirs, devisees, or legatees, the quality of notice required by sections 473.017[3] and 473.033,[4] RSMo 1969, does not satisfy due process requirements.

1. 504 S.W.2d 44 (Mo. 1973).

2. Section 473.083(5), RSMo 1969, provided, "[i]f no person appears within the time aforesaid [six months], then probate or rejection of the will is binding . . . ." This statute has since been amended; however, a similar provision may be found in section 473.083(1), RSMo 1973 Supp.

3. Section 473.017.1, RSMo 1973 Supp., provides in part:

> An application for letters testamentary or of administration shall be verified by applicant and shall state:
>
> . . . .
>
> (2) The names, relationship to decedent, and residence addresses of the surviving spouse and heirs, devisees and legatees of the decedent . . . and if applicant has reason to believe that there are any heirs or devisees who are of unsound mind or that there are other heirs or devisees but their names and addresses are unknown to him, he shall so state . . . .

4. Section 473.033, RSMo 1973 Supp., provides in part:

> The clerk, as soon as letters testamentary or of administration are issued, shall cause to be published in some newspaper a notice of the appointment . . . . The notice shall be published once a week for four consecutive weeks. The clerk shall

The principal authority relied upon by the appellant was *Mullane v. Central Hanover Bank & Trust Co.*,[5] in which the United States Supreme Court held that notice by publication of a binding judicial settlement of common trust fund accounts violated due process as to those persons known to the trustee to be beneficiaries of the trust. The Court established a due process standard of notice, saying:

> An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is *notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.*[6]

Appellant contended that this standard applies to probate proceedings, and that the indifferent effort of the coexecutor to inform the probate court of appellant's whereabouts did not meet this standard.

The majority opinion of the Missouri Supreme Court characterized appellant's contentions regarding notice as irrelevant, and did not discuss two crucial issues: (1) whether section 473.017, RSMo 1969, requires personal representatives to exercise due diligence in locating and notifying interested parties; and (2) if so, whether failure to comply with that standard of notice is a jurisdictional defect robbing the probate decree of its validity, or, in the alternative, whether it tolls the special statute of limitations governing will contests. Instead, the court rested its affirmance on the ground that section 473.083, RSMo 1969, confers jurisdiction upon the circuit court to hear will contests only for a six month period following the date of probate or of first publication of notice of the issuance of letters testamentary, whichever is later. Since appellant's petition was not filed within this six month period, the court held that his action was barred.[7]

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send a copy of the notice by ordinary mail to each heir and devisee whose name and address are shown by the application for letters or other records of the court . . . .

5. 339 U.S. 306 (1950). The trustee of a common trust fund petitioned a New York surrogate court for a judicial settlement of its accounts. Such settlement was to be binding and conclusive as to matters set forth therein and upon every person having any interest in the common fund or in any participating trust. The trustee, complying with the minimum statutory requirements, gave notice of the petition by publication in a local newspaper. The notice contained only the company's name, address, the name and date of establishment of the common fund, and a list of all participating estates, funds, or trusts.

6. *Id.* at 314 (1950) (emphasis added).

7. The court cited several cases in support of its decision, but although all of the cited cases were decided on the ground that the statutory period within which to contest the will

In a concurring opinion, Judge Seiler took a broader view, saying that if appellant's contention was correct, the probate court had no jurisdiction to open the estate, and the statute of limitations would never have begun to run against him. Judge Seiler then addressed the due process argument in a manner sympathetic to appellant, but voted to affirm the lower court's dismissal, preferring to await legislative action or a definitive treatment of probate proceedings by the United States Supreme Court.[8]

The issue of the applicability of the *Mullane* standard of notice to probate proceedings has occasioned much litigation and scholarly commentary in recent years.[9] Advocates of applying the *Mullane* standard of notice to probate proceedings stress the similarities between trust settlements, as in *Mullane*, and administration of decedents' estates. Both situations have in rem and in personam characteristics.[10] Neither trust settlements nor probate in common form have any supplemental notice. Possession of estate assets by the decedent's personal representative may be adverse to persons interested in those assets, just as possession by the trustees in *Mullane* could have been adverse to the interests of the trust beneficiaries. Property was not taken directly from the *Mullane* trust beneficiar-

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had expired, none dealt specifically with the issue of notice. In all of the cases the contestants had actual knowledge of the proceedings and could have contested within the allowed period. Black v. City Nat'l Bank & Trust Co., 321 S.W.2d 477 (Mo.), *cert. denied*, 360 U.S. 920 (1959), involved a prisoner whose initial petition to contest a will was timely filed, but in the wrong court. The court held that the status of a prisoner was not an exception listed in section 468.600, RSMo 1949 [now section 473.083, RSMo 1973 Supp.]. The issue of notice was neither raised by the parties nor addressed by the court. State *ex rel.* Bier v. Bigger, 352 Mo. 502, 178 S.W.2d 347 (En Banc 1944), dealt with a subsequent will found several years after probate of the first will. The central issue was fraud, not lack of notice due to fraud. Miller v. Munzer, 251 S.W.2d 966 (St. L. Mo. App. 1952), concerned an amendment to a petition filed after the expiration of the statutory time limitation, but the initial petition was timely filed.

8. 504 S.W.2d 44, 47-48 (Mo. 1973).

9. *See generally* Hayward, *The Effect of Mullane v. Central Hanover Bank and Trust Co. Upon Publication of Notice in Iowa*, 36 IOWA L. REV. 47, 57 (1950); Carson, *Probate Proceedings—Administration of Decedents' Estates—The Mullane Case and Due Process of Law*, 50 MICH. L. REV. 124 (1952); Manlin and Martens, *Informal Proceedings Under the Uniform Probate Code: Notice and Due Process*, 3 PROSPECTUS 39, 50-55 (1969); Fraser, *Jurisdiction by Necessity—An Analysis of the Mullane Case*, 100 U. PA. L. REV. 305, 316 (1951); Note, *Requirements of Notice in In Rem Proceedings*, 70 HARV. L. REV. 1257, 1270 (1957); Note, *Validity of Probate Notice Statutes in Ohio*, 27 U. CIN. L. REV. 76, 84 (1958).

10. *See In re* Shew's Estate, 48 Wash.2d 732, 734, 296 P.2d 667, 669 (1956). The Washington Supreme Court refused to apply the *Mullane* standard of notice to probate proceedings because it characterized *Mullane* as an in personam case, whereas probate was in rem. The decision is criticized in 32 WASH. L. REV. 165 (1957), and is highly suspect in view of the fact that the Supreme Court in *Mullane* explicitly stated that its decision was not based on an in rem-in personam distinction. 339 U.S. 306, 312 (1950).

ies, and property is not taken directly from those interested in estates. These similarities between probate and trust proceedings, plus the recent Supreme Court decision in *Robinson v. Hanrahan*,[11] where the *Mullane* standard of notice was utilized and expanded, indicate that the Supreme Court probably would have applied *Mullane* to the circumstances presented in *Haas*. In addition, many state courts have recognized that fourteenth amendment standards of due process are at least relevant in determining proper notice of probate proceedings.[12] Names and addresses of persons known to be entitled to notice must be included in the petition for probate under many state statutes.[13] Four states have statutes explicitly requiring the executor to make a diligent effort to ascertain interested persons in order to make personal service upon them.[14] A majority of states require some form of notice, although not necessarily notice complying with the *Mullane* standard.[15]

Opponents of extending the *Mullane* standard of notice to probate proceedings rely upon five traditional, non-policy arguments.[16] First, there is some indication in the majority opinion in *Mullane* that its holding is to be limited to the facts of the case.[17] This

11. 409 U.S. 38 (1972). The Court held, through the application of the *Mullane* standard of notice, that where the state of Illinois knew that the appellant was not at the address to which notice was mailed, the automobile forfeiture proceeding was invalid. Notice mailed to appellant's home address while he was being held in the Cook County jail was not, *under the circumstances*, reasonably calculated to apprise him of the pending forfeiture.

12. *See* State v. Haddock, 140 So. 2d 631 (Fla. Dist. Ct. App. 1962) (failure to comply with the statutory requirement to give notice to known persons *not* cured by publication); Vogel v. Katz, 64 Ill. App. 2d 126, 212 N.E.2d 295 (1965) (petitioner for probate of will required to make reasonable inquiry to ascertain the information required by notice statute); Estate of Barnes, 212 Kan. 502, 512 P.2d 387 (1973) (statute contemplates giving notice to those known or capable of being known through the exercise of reasonable diligence); Daft v. John & Elizabeth Whiteley Foundation, 363 Mich. 6, 108 N.W.2d 893 (1961) (reasonable diligence exercised in locating heirs at law held a matter of satisfaction of the probate judge). *But see In re* Pierce's Estate, 245 Iowa 22, 60 N.W.2d 894 (1953) (notice by publication only held *not* to violate due process); Davidek v. Wyoming Inv. Co., 77 Wyo. 141, 308 P.2d 941 (1957) (publication held notice to the whole world).

13. *See, e.g.*, FLA. STAT. ANN. § 732.28 (Supp. 1974); ILL. REV. STAT. ch. 3, § 63 (Supp. 1974); MD. ANN. CODE ch. 11, § 7-104 (1974); § 473.017, RSMo 1969; N. D. CENT. CODE § 30-05-07 (1960); WYO. STAT. ANN. § 2-63 (1959).

14. IDAHO CODE § 15-3-301 (Supp. 1973); KAN. STAT. ANN. § 59-2220 (Supp. 1973); MICH. COMP. LAWS § 701.32 (Supp. 1956); WIS. STAT. ANN. § 879.01 (1971).

15. *See* cases cited note 12 *supra*; Note, *Notice—Probate Procedure—1967 Draft of the Uniform Probate Code*, 53 IOWA L. REV. 508 (1967).

16. *See* references note 9 *supra*.

17. The Court stated:

> Personal service has not in all circumstances been regarded as indispensable to the process due to residents, and it has more often been held unnecessary as to nonresidents. We disturb none of the established rules on these subjects.

argument, somewhat forceful in 1950, has lost most of its impact. *Mullane* has been cited by the Supreme Court as authority for holding invalid notice requirements in proceedings for bankruptcy,[18] condemnation,[19] and enforcement of tax liens.[20] There has been no indication from the Supreme Court that the *Mullane* rationale is to be limited to trust situations.[21]

The second argument against applying the *Mullane* standard of notice to probate proceedings is that the Supreme Court is not willing to override established rules and time-honored procedures with fourteenth amendment due process requirements.[22] This contention is highly suspect in view of the recent Supreme Court decisions in *Fuentes v. Shevin*[23] and *Sniadach v. Family Fin. Corp.*[24] Established practices are now being reexamined by the Court in light of modern concepts of due process.

The third argument is based on the 70-year-old Supreme Court decision in *Farrell v. O'Brien.*[25] In *Farrell*, the Court held that probate in common form, followed by a one year period during which the will might be contested, is a procedure adequate under the fourteenth amendment. In probate in common form,[26] no notice is

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339 U.S. at 314.

The Supreme Court of Washington refused to apply the *Mullane* standard of notice to probate proceedings saying *Mullane* applies only to a trust situation. New York Mdse. Co. v. Stout, 43 Wash. 2d 825, 828, 264 P.2d 863, 864 (1953).

18. City of New York v. New York, N.H. & H.R.R., 344 U.S. 293 (1953).

19. Schroeder v. City of New York, 371 U.S. 208 (1962); Walker v. City of Hutchinson, 352 U.S. 112 (1956).

20. Covey v. Town of Somers, 351 U.S. 141 (1956).

21. The *Mullane* standard of notice has been applied in numerous situations. *See, e.g.*, Robinson v. Hanrahan, 409 U.S. 38, 40 (1972) (automobile forfeiture proceeding); Groppi v. Leslie, 404 U.S. 496, 502 (1971) (contempt resolution by legislature); Bell v. Burson, 402 U.S. 535, 541 (1971) (revocation of driving license); Boddie v. Connecticut, 401 U.S. 371, 378, 380 (1971) (divorce).

22. In Jackman v. Rosenbaum Co., 260 U.S. 22 (1922), the Court said:

> If a thing has been practised for two hundred years by common consent, it will need a strong case for the Fourteenth Amendment to affect it . . . .

Id. at 31.

23. 407 U.S. 67 (1972). The Court held Florida and Pennsylvania replevin statutes invalid under the fourteenth amendment on the basis of deprivation of property without due process of law notwithstanding the fact that the statutes are descendants of common law replevin actions with a six century history. The *Mullane* standard of notice was cited with approval.

24. 395 U.S. 337 (1969). A Wisconsin prejudgment garnishment of wages statute was held to violate due process even though the Court had previously upheld the constitutionality of similar garnishment procedures in Ownbey v. Morgan, 256 U.S. 94 (1921), and McKay v. McInnes, 279 U.S. 820 (1929).

25. 199 U.S. 89 (1905).

26. In early English law there were two forms of probate. In common form probate the

required primarily because it is believed that interested parties will receive actual knowledge of the death anyway. Times and circumstances have changed since the 1905 approval of this no-notice procedure.[27] The Court recently stated that "[t]he fact that a procedure would pass muster under a feudal regime does not mean it gives necessary protection to all property in its modern forms."[28]

Another argument advanced for not applying the *Mullane* standard to probate proceedings is that persons interested in a decedent's estate do not possess a property interest which is entitled to due process protection.[29] The contention is that the right to succeed to a decedent's property is not a constitutionally guaranteed right; therefore, the state may adopt any statutory scheme upon which receipt of estate property may be conditioned regardless of the type of notice required. Recent Supreme Court decisions have established that the requirements of due process do apply to the termination of statutory entitlements regardless of how the entitlement is denominated.[30] Moreover, the Supreme Court has referred to

executor or other person desiring to establish the will produced it and proved its execution by his own oath or such other witnesses as might be required, without giving notice to any other person interested in establishing or defeating the instrument. Probate in solemn form required that interested persons be given notice and an opportunity to be heard. In solemn form probate there could be no reexamination except on appeal, but the common form might be called into question at any time within thirty years and probate in solemn form was then required. The Missouri Probate Code (ch. 473, RSMo 1969) has virtually duplicated the English practice by providing for what is essentially common form probate with a possibility of a will contest, equivalent to solemn form probate, in the circuit court thereafter. However, one major difference remains. The English common form probate could be contested for thirty years, whereas in Missouri the probate becomes binding after six months, if not contested within that time. § 473.083, RSMo 1969. For a general discussion of probate in common form, see 2 J. WOERNER, THE AMERICAN LAW OF ADMINISTRATION § 215 (3d ed. 1923); Fratcher, *Missouri and the Uniform Probate Code*, 26 J. Mo. B. 349 (1970); Levy, *Probate in Common Form in the United States: The Problem of Notice in Probate Proceedings*, 1952 WIS. L. REV. 420.

27. No longer is the family the close knit unit characteristic of medieval England or rural America of the 19th century. Family members are now often dispersed throughout the country and beyond. The sheer size of this country, combined with the present mobility of its people, negate the assumption that news of a testator's death will be made known to all interested persons.

28. Sniadach v. Family Fin. Corp., 395 U.S. 337, 340 (1969). The Missouri Supreme Court has also looked with disfavor upon *ex parte* proceedings affecting property rights. *See, e.g.*, B-W Acceptance Corp. v. Alexander, 494 S.W.2d 75 (Mo. En Banc 1973) (where mortgagee had obtained prejudgment possession in replevin, notice of its intent to exercise claimed resale rights prior to judgment must be given the mortgagor fifteen days prior to the sale); State *ex rel.* Williams v. Berrey, 492 S.W.2d 731 (Mo. En Banc 1973) (deprivation of property without prior notice, prior opportunity to be heard, or establishment of validity of underlying claim held a violation of due process clause of the fourteenth amendment).

29. *See In re* Pierce's Estate, 245 Iowa 22, 27, 60 N.W.2d 894, 898 (1953).

30. Bell v. Burson, 402 U.S. 535, 539 (1971) (statutory right to driver's license); Goldberg v. Kelly, 397 U.S. 254 (1970) (welfare rights).

"legally protected interests," instead of "property interests," when describing interests protected by due process.[31]

Finally, opponents of applying the *Mullane* standard of notice to probate proceedings also point to the fact that *Mullane* dealt with a final order and contend that its principles should not be invoked in cases dealing with future or conjectural interests. The probate order is depicted as not being final, because there remains a period in which to contest the proceedings.[32] However, the *Haas* case clearly exhibits that an opportunity to contest is of value if, and only if, the contestant knows of the initial proceeding, and such knowledge is received before the statute of limitations runs. The Supreme Court has recognized that the right to be heard has little value unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest.[33] In *Schroeder v. City of New York*,[34] the Supreme Court disregarded the existence of a three year statute of limitations for filing claims against the city and held that published and posted notice of a condemnation proceeding was inadequate.

In addition to the above arguments, several policy arguments have been advanced against applying the *Mullane* standard of notice to probate proceedings. Opponents of applying the *Mullane* standard allege that such application would place an undue burden on both personal representatives and probate courts. This contention ignores the fact that the *Mullane* standard is essentially one of reasonableness in the circumstances. The *Mullane* decision does not require personal notice in all circumstances and acknowledges that notice by publication, however imperfect it may be, satisfies due process requirements as to persons whose names or addresses cannot with due diligence be ascertained.[35] Persons known to the personal

31. Schroeder v. City of New York, 371 U.S. 208, 212 (1962).

32. *See* Farrell v. O'Brien, 199 U.S. 89 (1905); *In re* Pierce's Estate, 245 Iowa 22, 60 N.W.2d 894 (1953). The Iowa Supreme Court in *Pierce* viewed this as a vital distinction between the *Mullane* situation and probate proceedings.

33. Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950); *cf.* Sniadach v. Family Fin. Corp., 395 U.S. 337, 339 (1969).

34. 371 U.S. 208 (1962).

35. 339 U.S. 306, 317 (1950). At face value, the notice requirements of the Missouri Probate Code would seem to comply with standards set by the *Mullane* decision. Section 473.017, RSMo 1973 Supp., requires the administrator or executor to list the names and residence addresses of the surviving spouse, heirs, devisees, and legatees. The clerk of the probate court must then publish notice of the appointment of the executor or administrator and "send a copy of the notice by ordinary mail to each heir and devisee *whose name and address are shown by the application for letters or other records of the court.*" § 473.033, RSMo 1973 Supp. (emphasis added). Presumably, a judicially imposed duty of due diligence

representative, or capable of discovery in the exercise of due diligence, are entitled to notice reasonably calculated to apprise them of the pendency of the proceedings, that is, personal notice. Notice by ordinary mail fully complies with due process requirements.[36] Such a requirement is not unduly burdensome to personal representatives.

With respect to the burden on probate courts, a due diligence standard would require no more than an inquiry by the probate judge into the efforts made by the personal representative to ascertain the names and addresses of interested parties. If no effort, or an insufficient effort, had been made, the court could require additional specified measures. If the court is satisfied with the representative's efforts, the proceeding could continue and notice by publication to undiscovered interested persons would satisfy due process requirements.[37]

An additional policy argument against applying the *Mullane* standard of notice to probate proceedings is that this would open all probate proceedings to collateral attack by undiscovered or omitted interested parties, thereby frustrating the state's interest in quick and conclusive settlement of decedents' estates. Concededly, the state has a valid and substantial interest in closing estates. However, this interest is not significantly greater than its interest in settling trust accounts, and the latter was held insufficient to justify notice requiring less than due diligence in *Mullane*. Moreover, the interests of a beneficiary of an estate closely parallel the interests

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on the executor or administrator could have satisfied the *Mullane* requirements. Judge Seiler in his concurring opinion chose to defer this decision to the legislature.

36. Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 319 (1950).

37. There may be a problem in determining what means and degree of proof will be required of an administrator or executor to satisfy the due diligence requirement. The usual family records and affidavits of relatives and close friends of the deceased would be available to the representative as a source for identifying all interested persons, but a large degree of discretion must be exercised by the probate judge in determining when the statutory duty has been met in a particular case. A related problem involves the method for preserving evidence of due diligence on the record in case of appeal or collateral attack in a will contest. The Supreme Court of Michigan, in Daft v. John & Elizabeth Whiteley Foundation, 363 Mich. 6, 108 N.W.2d 893 (1961), held the representative must be able to meet a timely challenge as to diligence exercised, but that absent a statutory requirement, he need not meet it in advance by affidavits.

It is in the interest of the personal representative to preserve on the record as much proof of due diligence as is possible, regardless of whether or not the *Mullane* standard of notice is made a procedural requirement. The general rule acknowledged in most jurisdictions is that a personal representative is subject to personal libility for negligence or fraud in failing to locate and notify the decedent's heirs, legatees, and devisees. *See* Annot., 10 A.L.R.3d 547 (1966).

of a beneficiary of a trust, and are deserving of comparable due process protection.

The most substantial problem in allowing collateral attacks on probate decrees on the ground that either the notice defect was jurisdictional or because the notice defect tolled the statute of limitation is that this could injure creditors and purchasers at probate sales, who acted in reliance on the validity of the probate decree. This third party reliance problem was not present in *Mullane*, and arguably tips the scales against applying the *Mullane* standard of notice to probate proceedings. However, this problem is not insoluble. All notice defects need not be jurisdictional, but, rather, may be held to toll the special statute of limitations applicable to will contests.[38] An analogy may be drawn to Missouri's statutory scheme for the administration of the estates of absent persons.[39] Section 473.710, RSMo 1969, provides for the revocation of letters of administration upon satisfactory proof that the absent person is alive, at which time all powers of the administrator cease. All receipts and disbursements of assets and other acts of the administrator remain as valid as if the letters were unrevoked, but title to any property received by the widow, next of kin, or heir is revoked, and the property may be recovered from such parties. A similar provision could be adopted for the ordinary probate scheme, allowing collateral attack on a final decree of distribution upon a showing that the personal representative negligently or intentionally failed to supply the probate court with the names and addresses of interested parties and that the omitted party could have successfully contested the will presented for probate. All prior actions of the personal representative pertaining to the collection of receipts and payment of creditors, including the sale of assets to pay the debts of the decedent, would remain valid and binding. Only the final distribution to heirs, devisees, and legatees would be invalidated.[40] These indi-

38. Original § 473.013 in the 1955 Probate Code was amended by the legislature in 1957 by inserting the words "notice by publication" in the last sentence to make clear that the initial publication of notice of letters is the only jurisdictional notice required. Welch, *Probate Code Amended by Senate Bill No. 1*, 13 J. Mo. B. 148 (1957). Clapper v. Chandler, 406 S.W.2d 114 (Spr. Mo. App. 1966), however, has cast considerable doubt on whether the law in this area has actually been changed. The court in *Clapper* held that the probate court acquired no more jurisdiction initially over an intestate's realty than it did under the prior statutes and that compliance with the supplemental notice provisions of § 473.493, RSMo 1959, was still a condition precedent to the exercise of the probate court's jurisdiction to order a sale of the intestate's realty. This decision is soundly criticized in Basye, *Are Probate Courts in Missouri Undergoing Retrogression?*, 32 Mo. L. Rev. 175 (1967).

39. §§ 473.697-.720, RSMo 1969.

40. Such a statute would be an incentive for heirs, devisees, and legatees to notify the

viduals, who received property without giving valuable consideration, would be required to return to the estate the assets they received or the proceeds from the sale of the assets, and the contesting party would be allowed to prove the proper distribution.

The practical effect of the *Haas* decision is to allow a personal representative, negligently or intentionally, to omit the name or address of an interested party from his application for letters testamentary, thus depriving the omitted party of any meaningful opportunity to contest the testamentary disposition. Such a result is not dictated by overriding policy considerations. Moreover, Missouri courts have traditionally put a premium on notice to interested parties.[41] Noncompliance with notice requirements[42] has been deemed a jurisdictional defect[43] rendering the probate court's order void and tolling the special statute of limitations applicable to will contests.[44] In view of this tradition, the majority opinion in *Haas* must be viewed as a significant retreat from earlier cases emphasizing the importance of notice to interested parties.

In light of the *Haas* court's failure to respond to the dictates of *Mullane*, legislative action appears to be the only available remedy.

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personal representatives of the existence and addresses of other interested parties.

41. In Clapper v. Chandler, 406 S.W.2d 114 (Spr. Mo. App. 1966), a probate court's order for the sale of realty to pay claims was held invalid due to the lack of compliance by the court with supplemental notice requirements to parties already within the proceeding. The complaining heir was already a party to the proceeding, had actual knowledge of the sale, and actively participated in the sale itself; but strict adherence to formalities was still required. Query why the courts in Missouri should be more concerned with supplemental notice to a party who already knows of the proceeding and is actively participating, as in *Clapper*, than with giving initial notice to an interested person who does not know of the proceeding but will be bound by its decree, as in *Haas*?

42. Query whether the executor in *Haas* failed to comply with the statutory notice requirements, since in his petition for letters he listed appellant's "address unknown. Last known confined to Federal prison[?]" 504 S.W.2d at 45. An Illinois appellate court in Vogel v. Katz, 64 Ill. App. 2d 126, 212 N.E.2d 295 (1965), held that listing an address as "New York City," without making the effort of looking in a phone book for a more precise address, did not meet statutory requirements of listing "known" interested parties. The Missouri Supreme Court did not reach this issue in *Haas*.

43. *In re* Jackson's Will, 291 S.W.2d 214, 225 (Spr. Mo. App. 1956) (reasonable notice to persons whose interests were involved in a contemplated order required as a prerequisite to lawful exercise of court's power); *accord*, Wolff v. Rager, 326 Mo. 222, 30 S.W.2d 1005 (1930); Clapper v. Chandler, 406 S.W.2d 114 (Spr. Mo. App. 1966).

44. Munday v. Leeper, 120 Mo. 417, 25 S.W. 381 (1894); Clark v. Collins, 31 Mo. 260 (1860); Bryan v. Mundy, 17 Mo. 556 (1853); Hawkins v. Ridenhour, 13 Mo. 125 (1850); Wiggins v. Lovering, 9 Mo. 157 (1845). These cases dealt with situations where the executor failed to comply with the statutory requirement of notice by publication. In *Haas* the court did not meet the issue of whether the executor satisfied the required statutory notice, much less the issue of whether the statutory notice provisions themselves meet the demands of due process.

The problem of notice to heirs of the admission of a will to probate is not the only due process problem under the Missouri Probate Code.[45] The Code makes no provision for notice to devisees under a will which is known to exist but which has, in effect, been denied probate by the admission of a different will to probate or the issuance of letters of administration on a theory of intestacy. The rationale of *Mullane* should also extend to such devisees.

Compliance with due process could be achieved without massive revision of the Missouri Probate Code. Section 473.017, RSMo 1969, should be amended to require every application for letters testamentary or of administration to state that the applicant has made a diligent search for all wills, all heirs of the decedent, the addresses of all heirs discovered in such search, and to list the names and addresses of beneficiaries named in known wills not offered for probate. Because section 473.013, RSMo 1969, already provides that only the original notice by publication is jurisdictional, the probate court would have jurisdiction to proceed once it is satisfied with the sufficiency of notice. In order to insure the marketability of titles derived from a decedent, the enactment of a recording statute requiring the probate judge to file an affidavit of his finding of due diligence might be considered. Adoption of the previously suggested provision limiting collateral attacks to the decree of final distribution and allowing only the recovery of proceeds if the previously distributed assets have been sold to bona fide purchasers for value would adequately protect creditors and purchasers at probate sales. Section 473.617, RSMo 1969, should be amended to make the final decree of distribution subject to attack on proof of the proper scheme of distribution and that the probate procedure was invalid because an interested person was denied constitutionally sufficient notice. Finally, section 473.083, RSMo 1969, should be amended to furnish remedies for an heir or devisee who failed to commence timely proceedings for the probate or contest of a will because he was denied constitutionally sufficient notice, provided he can establish that such proceedings would have been successful. A provision tolling the special six month statute of limitations should be added to allow omitted parties a reasonable time after learning of the probate proceedings to challenge the distribution. These remedies could also include liability in damages of an applicant for letters who failed to make a diligent search for wills, heirs,

45. Chapter 473, RSMo 1969.

or the addresses of heirs. They could include the imposition of a constructive trust upon the property of the estate received by the distributee, or its proceeds, if: (1) the distributee accepted distribution under such circumstances that he should be charged with knowledge that an heir was not given notice by mail because of failure of the distributee to reveal to the applicant for letters the existence of a will or the existence, interest, or address of the heir; (2) the applicant failed to make the diligent search required of him; or (3) anyone deliberately suppressed a will or concealed the existence or address of the heir.

This remedial legislation would afford greater protection to beneficiaries of decedents' estates and also insulate Missouri probate practice from constitutional infirmity in the event that the United States Supreme Court applies the *Mullane* standard of notice to probate proceedings.

GARY R. CUNNINGHAM

TAXATION—SECTION 337 TREATMENT OF INVOLUNTARY CONVERSION BY FIRE—SALE OR EXCHANGE OCCURS ON DATE OF CASUALTY

Central Tablet Manufacturing Co. v. United States[1]

On September 10, 1965, during a strike which had reduced production to about five percent of normal volume, an accidental fire destroyed a substantial portion of the plant and manufacturing equipment of Central Tablet Manufacturing Company. Central Tablet was an Ohio corporation engaged in the manufacture and sale of writing tablets, school supplies, and related items. The equipment and facilities were never repaired and Central Tablet never again opened for business.

The corporation carried fire and extended coverage insurance on the building, machinery, and inventory, as well as business interruption insurance. Negotiations began with the insurance company one month later, after the "not unusual" rejection of the initial proofs of claim was made by the insurance company. Although the insurance company's liability was never seriously disputed, there existed several areas of disagreement.[2] At a special shareholders' meeting eight months after the date of the fire, the decision to dissolve the corporation was made and a plan of dissolution and complete liquidation was adopted. One month later, payment was received on the building claim. The taypayer's personal property claim was settled in August, and payment on that claim was received in November, 11 and 13 months after the fire, respectively. The corporate assets remaining after distribution to the shareholders was placed in trust for the shareholders on May 3, 1967, and on the same day the corporation filed a certificate of dissolution with the Ohio Secretary of State. These last steps were accomplished within 12 months of the adoption of the plan of complete liquidation, although it was 21 months after the date of the casualty. The remaining insurance claim for business interruption was settled in August, 1967, and payment was received in September of that year. Therefore, the final insurance payment was not received until almost two years after the casualty had occurred.[3]

The taxpayer realized a gain from the fire insurance proceeds which it treated as non-taxable, relying upon section 337 of the 1954

1. ___ U.S. ___, 94 S. Ct. 2516 (1974).
2. 94 S. Ct. at 2518.
3. 94 S. Ct. at 2519.

Internal Revenue Code.[4] The Internal Revenue Service asserted a deficiency for the capital gain equal to the excess of the fire insurance proceeds over adjusted basis. The taxpayer paid the deficiency and brought an action to recover the amount paid.

The district court[5] relied heavily on the decision of the Court of Appeals for the Eighth Circuit in *United States v. Morton*.[6] In adhering to the holding in *Morton*, the court found that the purpose of section 337 was to avoid double taxation and that the section included within its coverage plans of complete liquidation adopted *after* involuntary conversion. The district court rejected the government's attempt to distinguish the cash basis taxpayer in *Morton* from the accrual basis taxpayer in *Central Tablet*. The court found that even under the accrual basis system of accounting, income is not received, and therefore not taxable, until the amount is susceptible of calculation. The court held that the income to the taxpayer in *Central Tablet* was not determinable until some time after the fire, and consequently no gain resulted until after the plan had been adopted.[7]

On appeal, the United States Court of Appeals for the Sixth Circuit reversed.[8] The court expressly declined to follow the decision in *Morton*, finding instead that section 337 was intended to apply only when the corporation was firmly committed to liquidation prior to the casualty or sale. The court recognized that involuntary conversions are entitled to nonrecognition under section 337, but held that the taxpayer's failure to adopt the plan of complete liquidation prior to the casualty was fatal to its case since the date of the fire is the date of the conversion for purposes of section 337. The Supreme Court granted certiorari to resolve the apparent conflict between the Eighth Circuit and the Sixth Circuit.[9]

The Supreme Court found that the only point in issue was

4. INT. REV. CODE OF 1954, § 337(a):
General rule—If—
(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and
(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.
5. 339 F. Supp. 1134 (S.D. Ohio 1972).
6. 387 F.2d 441 (8th Cir. 1968).
7. 339 F. Supp. 1134, 1139 (S.D. Ohio 1972).
8. 481 F.2d 954 (6th Cir. 1973).
9. *Cert. granted*, 414 U.S. 1111 (1973).

whether section 337 can be applied when the involuntary conversion occurs prior to the date of the adoption of a plan of complete liquidation. To determine this it was necessary to ascertain at what point the "sale or exchange" takes place in the involuntary conversion process for purposes of section 337. The Court found that the sale or exchange took place at the time of the casualty and not at some later time in the process. Since the plan did not precede the sale or exchange, section 337 was unavailable to allow the corporation to escape tax on the gain.[10]

The enactment of section 337 was primarily a result of the tax problems which arose when a corporation undertook to sell its assets and liquidate. Under the general tax principles then governing, a corporation selling low basis assets for cash realized a corporate gain equal to the amount by which the selling price exceeded the corporation's basis in the assets. The corporation, after paying the tax on this gain, would then distribute the remaining cash in liquidation and each shareholder would receive cash in exchange for the surrender of his stock in the corporation. Each shareholder would therefore realize a taxable gain to the extent that the cash received in liquidation exceeded his basis in the stock. Thus, in the overall process, two taxable gains resulted: first at the corporate level and then at the shareholder level.

On the other hand, if the corporation first liquidated by transferring the assets to the shareholders in exchange for the cancellation of all their stock, the shareholders would have a gain equal to the amount by which the fair market value of the assets received exceeded their basis in the stock. However, pursuant to section 334(a), the shareholders take a basis in the assets equal to fair market value. If these assets are then immediately sold by the shareholders to a buyer for an amount equal to fair market value, no gain is realized since the basis in the assets equals the selling price. Thus, when the sequence is a liquidation followed by a sale, only one taxable gain occurs; but if the sequence is a sale followed by liquidation, two taxable gains occur. It is hardly surprising to find that, when such substantial tax consequences depended on such inconsequential factual differences, inequities resulted. Two leading Supreme Court cases signaled the problem.

In *Commissioner v. Court Holding Co.*,[11] the Court held that the tax consequences which arise from gains upon sale of property

10. 94 S. Ct. at 2524.
11. 324 U.S. 331 (1945).

are not to be determined solely by the means used by the taxpayer to transfer legal title.[12] The taxpayer in that case was a closely held corporation in which the sole asset was an apartment house. The stock was held by two persons, husband and wife. Negotiations were commenced between the corporation and a buyer for the sale of the apartment house. The terms of the sale had been substantially agreed upon when the parties met to reduce the agreement to writing. At this meeting the officers of the corporation were informed of the tax consequences of the proposed sale and it was called off. The next day a liquidating dividend was declared by the corporation, and the assets were transferred to the husband and wife. They subsequently completed the sale to the original buyer under substantially the same terms, except that the names of the shareholders were substituted for that of the corporation as seller. Justice Black, writing for the majority, adopted the Tax Court's findings of facts and agreed that the sale had been made by the corporation, rather than the shareholders. Therefore, the corporation was first taxed on the capital gain realized in the sale of the asset, and the shareholders were then taxed on the amount they had received in the surrender of their stock above its adjusted basis.

Five years later, in a case involving similar facts, the Court reached the opposite result. Justice Black again wrote the opinion of the majority in *United States v. Cumberland Public Service Co.*[13] *Cumberland* involved a closely held utility company whose shareholders had voted to go out of business. The buyer refused the corporation's original offer to sell all the company's stock. Thereafter, the corporation refused the buyer's counteroffer to purchase only the transmission lines of the company, and the negotiations were called off. Hoping to save the corporation from a large capital gains tax, the shareholders had the assets transferred to themselves in partial liquidation, and they in turn sold the transmission lines to the original buyer. The corporation then sold its remaining assets and went out of business. A large gain was realized on the sale of the transmission lines, and the Commissioner charged that gain to the corporation. The Court relied on the finding of the Court of Claims that the sale had been made by the shareholders in their personal capacity *after* the liquidation, and therefore, held that the corporation had realized no taxable gain from the sale. The transfer of the assets to the shareholders resulted in a taxable gain to the

12. *Id.* at 334.
13. 338 U.S. 451 (1950).

shareholders equal to the excess of fair market value of the assets over the basis of the stock in the hands of the shareholders. As a result, the shareholders' basis in the assets transferred by the corporation was equal to the fair market value of those assets. The amount realized on the subsequent sale of the transmission lines by the shareholders at fair market value equaled the basis of those assets in the hands of the shareholders and, therefore, no capital gain was realized.

Although the practical difference seemed to be whether the tax advice came early or late, the distinction between the *Court Holding Co.* and the *Cumberland* decisions was a source of much confusion to taxpayers.[14] In order to simplify steps necessary to avoid the double taxation of a liquidating corporation, Congress enacted section 337 of the 1954 Internal Revenue Code. Section 337 allows the taxpayer nonrecognition of both capital gains *and* losses which occur from the sale of the corporation's assets if the sale occurs on or after the date of adoption of a plan of complete liquidation and the assets are distributed in complete liquidation within the twelve month period following the date of the adoption of the plan. The section removes the formalistic necessity of transferring the assets to the shareholders who then make the sale. Under section 337, a corporation may simply adopt a plan of complete liquidation and then sell its property. The subsequent transfer of the proceeds from the sale in exchange for the shareholders' stock will be the only transaction which produces recognized tax consequences. Although the most publicized purpose of this section was to avoid the formalistic distinctions which had developed from the *Court Holding Co. - Cumberland* decisions,[15] it seems reasonable to assume that the tacit implication of the enactment was that the double tax situations should be avoided by corporations selling assets in the course of liquidation. The Senate and House versions of the original bill differed in some respects, the most significant being a definition of "plan" which appeared in the House version but not in the Senate's.[16] However, both houses made it clear that determining tax

14. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 11.63, at 11-57 (3d ed. 1971).

15. H.R. REP. No. 1337, 83d Cong., 2d Sess. 38(B)(3) (1954) states in part:

> . . . In order to eliminate questions resulting only from formalities, your committee has provided that if a corporation in process of liquidation sells assets there will be no tax at the corporate level . . . .

16. *Compare* S. REP. No. 1622, 83d Cong., 2d Sess. 48-49, 258-59 (1954), which had no definition section, *with* H.R. REP. No. 1337, 83d Cong., 2d Sess. A113 (1954), which included the following language:

consequences on the subtle distinctions outlined in *Court Holding Co.* and *Cumberland* was undesirable. Section 337 was aimed at remedying the uncertainty and complexity in the area of corporate liquidation[17] caused by taxpayers' attempts to avoid double taxation.[18]

Even after the enactment of section 337 as part of the 1954 Code, the section's applicability to involuntary conversions was unclear. In 1956, the Internal Revenue Service issued a ruling that fire insurance proceeds did not constitute a "sale or exchange" for purposes of section 337 nonrecognition.[19] The ruling relied on the Supreme Court decision in *Helvering v. William Flaccus Oak Leather Co.*,[20] which held that nothing in the language of the Internal Revenue Code of 1939 expressed an intention by Congress to classify the proceeds from fire insurance for loss of property as a sale or exchange of a capital asset. The lower courts refused to follow the ruling,[21] and in 1964, the original ruling was rescinded and a new ruling announced which recognized involuntary conversion by reason of fire as a sale or exchange for purposes of section 337.[22]

When the involuntary conversion was brought about by condemnation, the Service was somewhat more consistent. It had less

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Subsection (c) defines the plan which is required in a partial or complete liquidation. Present law does not define a plan of liquidation either in connection with section 112(b)(6) or (7) or 115(c). Under subsection (c), a distribution shall be considered made pursuant to a plan, if it is made subsequent to and in accordance with a resolution by the shareholders or the board of directors providing for the termination of the business (or one of the businesses in a partial liquidation) and the transfer of a part or all of the assets in redemption of the stock. Subsection (c) further provides that any anticipatory specification of the time required to complete the distribution in partial or complete liquidation is irrelevant.

17. *See* S. REP. No. 1622, 83d Cong., 2d Sess. 49 (1954); H.R. REP. No. 1337, 83d Cong., 2d Sess. A106 (1954).

18. *See* Rev. Rul. 387, 1956-2 CUM. BULL. 189 (involving an involuntary bankruptcy proceeding in which the receiver applied for treatment under section 337):

> Congress intended through section 337 of the 1954 Code to eliminate the double tax on gains realized from sales of corporate assets during a period of liquidation, but did not intend to eliminate entirely the tax on such gains. Where the shareholders are to receive nothing in the liquidation in payment for their stock, there is no possibility of a tax to both the corporation and the shareholders on the gains resulting from the sale.

19. Rev. Rul. 372, 1956-2 CUM. BULL. 187.

20. 313 U.S. 247 (1941). The result in this case was reversed by the enactment of the Revenue Act of 1942, ch. 619, § 151(b), 56 Stat. 846 (now INT. REV. CODE OF 1954, § 1231).

21. *See* Kent Mfg. Corp. v. Commissioner, 288 F.2d 812 (4th Cir. 1961); Towanda Textiles, Inc. v. United States, 180 F. Supp. 373 (Ct. Cl. 1960). These cases relied on the statutory change after *Flaccus*. *See* note 20 *supra*.

22. Rev. Rul. 100, 1964-1 CUM. BULL. 130 (citing *Kent* and *Towanda* as the basis for the new ruling).

difficulty finding a sale or exchange present in a condemnation proceeding, which involves an actual passing of title. In condemnation cases, the courts and the Commissioner have been in agreement that, for purposes of section 337, the sale or exchange occurs when title passes as determined by the applicable local law.[23] Therefore, if a plan of liquidation is adopted prior to title passing, the benefits of section 337 are available to the condemnee. This policy necessarily results in divergent treatment of condemnation proceeds under section 337 in different jurisdictions. The taxpayer has more time to adopt a plan in states such as Missouri, where title passes only after the award is made and payment is received in the registry of the court or by the condemnee.[24] A taxpayer may be penalized in states where title passes upon the mere filing by the condemnor of a declaration of taking.[25] Therefore, the process of corporate liquidation in cases of involuntary conversion by condemnation is dependent upon the local law, specifically upon what point title to the property in question passes to the condemnor. But as the courts have recognized, it is impossible to draw a perfect analogy between the condemnation cases and those involving involuntary conversion by fire, since in the latter instances, title to the property is never relinquished. It thus becomes more difficult to determine at what point the sale or exchange takes place.[26]

Mere difficulty or imprecision in determining the date of a necessary occurrence, however, has not always deterred the courts or the Internal Revenue Service from allowing a taxpayer the benefit of protective provisions of the Code. The courts have on occasion liberally construed some parts of section 337 in order to reach "just" results. In finding the date of adoption of a plan of liquidation, broad construction is evident. The Treasury Regulations accompanying section 337 have allowed plans adopted on the same day as the sale to be considered as within the scope of the statute.[27] Fur-

23. *See* Likins-Foster Honolulu Corp. v. Commissioner, 417 F.2d 285 (10th Cir. 1969), *cert. denied*, 397 U.S. 987 (1970); Covered Wagon, Inc. v. Commissioner, 369 F.2d 629 (8th Cir. 1966); Dwight v. United States, 328 F.2d 973 (2d Cir. 1964); Driscoll Bros. v. United States, 221 F. Supp. 603 (2d Cir. 1963); Rev. Rul. 108, 1959-1 CUM. BULL. 72.

24. *See* Feinberg v. Commissioner, 377 F.2d 21 (8th Cir. 1967); Pettit v. County Comm'r, 123 Md. 128, 90 A. 993 (1914); St. Louis Housing Auth. v. Barnes, 375 S.W.2d 144 (Mo. 1964); Heidisch v. Globe & Republic Ins. Co., 368 Pa. 602, 84 A.2d 566 (1951). *See generally* 26 AM. JUR. 2d *Eminent Domain* § 131 (1966).

25. *See* Wendall v. Commissioner, 326 F.2d 600 (2d Cir. 1964); Place Realty Corp., 21 T.C.M. 754 (1962). *See also* Federal Declaration of Taking Act, 40 U.S.C. §§ 258(a) *et. seq.* (1970).

26. *See, e.g.*, United States v. Morton, 387 F.2d 441, 446 (8th Cir. 1968).

27. Treas. Reg. § 1.337-1 (1954), *as amended* T.D. 6806, 30 Fed. Reg. 2850 (1965).

thermore, the position taken in the regulations is that the date of adoption of the plan of liquidation is to be ascertained by a determination of all the facts and circumstances, and gathered from the intent of the parties.[28] The Regulations distinguish between executory contracts and executed contracts of sale. "Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional."[29] This flexible policy has allowed some courts to find the adoption of a plan of liquidation without formal proof of shareholder approval.[30] Although it has led to a few arguably inconsistent results,[31] this approach does appear reasonable. For purposes of section 337, the important aspect to be considered should be the intent to liquidate at the time of the sale, coupled with an actual cessation of operations and a liquidating distribution.[32]

The Supreme Court, however, did not choose to support the policy of liberal determination of dates when the conversion is a result of actual destruction of the property. It instead placed some emphasis in *Central Tablet* on the fact that taxpayers who incur a gain as a result of a casualty can seek relief under section 1033(a)(3) of the 1954 Code which allows nonrecognition of gains from casualty insurance proceeds when used to acquire replacement property sim-

28. Treas. Reg. § 1.337-2 (1954). "The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances . . . ." *Id.* In theory, of course, this stance can work both in favor of and against taxpayers. *See* cases cited note 31 *infra*.

29. Treas. Reg. § 1.337-2 (1954).

30. *See, e.g.*, Benoit v. Commissioner, 238 F.2d 485, 492 (1st Cir. 1956); Richard H. Survaunt, 5 T.C. 665, 672, *aff'd*, 162 F.2d 753 (8th Cir. 1947); Walter S. Heller, 2 T.C. 371, 382 (1943), *aff'd*, 147 F.2d 376 (9th Cir.), *cert. denied*, 325 U.S. 868 (1945); Holmby Corp., 28 B.T.A. 1092 (1933), *aff'd*, 83 F.2d 548 (9th Cir. 1936). See Pustilnik, *Liquidation of Closely-Held Corporations Under Section 337*, 16 TAX L. REV. 255, 260 (1961), noting two lines of authority to support the proposition: (1) liquidation is a question of fact, regardless of whether a formal plan of dissolution has been adopted; and (2) reorganization has occurred even in absence of a formal shareholder resolution. *See also* Bennion, *Sale of Corporate Assets Under Section 337*, 1958 SO. CALIF. TAX INST. 253, 259.

31. *Compare* City Bank, 38 T.C. 713 (1962) (shareholder approval); and Virginia Ice & Freezing Corp., 30 T.C. 1251 (1958) (shareholder approval); *with* Alameda Realty, 42 T.C. 273 (1964); Republic Nat'l Bank v. United States, 64-1 U.S.T.C. 9157 (N.D. Tex. 1963); Henry H. Adams, 38 T.C. 549 (1962); *and* Mountain Water Co., 35 T.C. 418 (1960).

32. *See* Mountain Water Co., 35 T.C. 418 (1960), in which the court said:

> If all the facts and circumstances indicate that the assets were in fact sold as a part of a plan to liquidate the company and the corporation in fact goes out of business and distributes its assets in complete liquidation within the 12-month period, it would seem the purpose has been accomplished . . . .

Id. at 426.

ilar or related in use.[33] Once the property has been replaced under section 1033, if liquidation is desired the taxpayer can always adopt a plan and proceed under section 337, and thereby avoid a double tax on the gain from the transaction. Unfortunately, this procedure is not always available or desirable considering the restrictions inherent in section 1033.[34] Many times reinvestment is simply not feasible, particularly where a substantial portion of the assets of the corporation was destroyed in the fire. In a period of inflation the insurance proceeds may not even begin to cover the skyrocketing costs of rebuilding on the same scale as the old operation. Even if replacement were feasible, this long-hand method of reaching the result of a true section 337 liquidation seems unnecessary.[35]

The thrust of the opposition to the decision reached in *Central Tablet* is that one who *chooses* to liquidate should not be favored over one who is *forced* into liquidation by involuntary conversion. The courts and the Internal Revenue Service have been lenient toward corporations which have attempted to utilize section 337 in the course of voluntary liquidation, even finding the adoption of a plan of liquidation where none was formally adopted.[36] Corporations pursuing voluntary liquidations have a better opportunity to ascertain the nature of gains or losses from the sale or exchange of their assets before they are locked into section 337 nonrecognition.[37] The extent of the flexibility under section 337 afforded corporations which choose to liquidate is evident from the result reached in many of the so-called "straddle cases." The procedure in such cases involves a sale by a corporation of assets which it expects will produce a loss, followed by adoption of a plan of complete liquidation and a sale of the remaining assets which it expects to result in a capital gain. By a literal interpretation of section 337, the loss realized before the adoption of the plan of liquidation is recognized while the capital gain realized after the plan was adopted will not be recognized. The loss from the pre-liquidation sales can then be applied to offset the taxable capital gains incurred while the corporation was in business. The Internal Revenue Service will typically accept the

33. 94 S. Ct. at 2525-26.

34. *See* INT. REV. CODE OF 1954, § 1033 (requirement that replacement property be similar or related in use).

35. *See* United States v. Morton, 387 F.2d 441, 444 (8th Cir. 1968); Towanda Textiles, Inc. v. United States, 180 F. Supp. 373, 376 (Ct. Cl. 1960); Kovey, *When will Section 337 Shield Fire Loss Proceeds? A Current Look at a Burning Issue*, 39 J. TAX. 258, 260 (1973).

36. *See* cases cited note 31 *supra*; Granite Trust Co. v. United States, 238 F.2d 670, 674 (1st Cir. 1956).

37. *See, e.g.*, Treas. Reg. § 1.337-2 (1954).

taxpayer's reported dates for the respective sales and adoption of the plan of liquidation if the taxpayer is prepared to either sell substantially all of its assets before the plan so that losses will offset gains outside of section 337, or sell substantially all of its assets after the plan.[38] Otherwise, the Service will require proof that the earlier sale was not in contemplation of liquidation and not connected with the later sale of gain-producing assets.[39] Attempts by the Service to pierce through the straddle device by arguing that an "informal plan" of liquidation was adopted before the initial loss sale, have been largely unsuccessful in the courts, in situations where the taxpayers followed the necessary formalities. The courts have paid particular attention to the formal adoption of a plan by shareholder resolution.[40] Careful *advance planning* has been the key to taxpayer success in most of those cases.

The Internal Revenue Service[41] and some courts[42] have found that Congress intended that there should be only one tax upon the liquidation and sale of assets of a corporation. If that were the intent embodied in section 337, the important factor in applying it to an involuntary conversion should be whether the assets involuntarily converted actually cause the complete liquidation of the corporation. Broad interpretation of the statute in dealing with involuntary conversions would reach the most equitable result.[43] However, the court in *Central Tablet* refused to acknowledge a congressional intent to prevent double taxation when the sale is caused by involuntary conversion, even though the corporation subsequently liquidates. Consequently, taxpayer corporations are forced to deal with the strict, literal reading given section 337 by the court in *Central Tablet* and accept the date of the casualty as the date of the sale or exchange. As Justice White pointed out in his dissent, those corporations which are closely held may be able to move quickly enough

38. B. BITTKER & J. EUSTICE, *supra* note 14, at ¶ 11.64.

39. *See* Rev. Rul. 140, 1957-1 CUM. BULL. 118.

40. *See* Jason L. Honigman, 55 T.C. 1067 (1971); City Bank, 38 T.C. 713 (1962); Mountain Water Co., 35 T.C. 418 (1960); Virginia Ice & Freezing Corp., 30 T.C. 1251 (1958). *But see* Henry H. Adams, 38 T.C. 549 (1962) (loss sale; date of deed controls, held within section 337 when dated same day as adoption of plan).

41. *See* Rev. Rul. 387, 1956-2 CUM. BULL. 189, which was a ruling on a bankruptcy application under section 337. The Internal Revenue Service stated: "Congress intended through section 337 of the 1954 Code to eliminate the double tax on gains realized from sales of corporate assets during periods of liquidation . . . ."

42. *See, e.g.*, Mountain Water Co., 35 T.C. 418, 426 (1960).

43. *See* United States v. Morton, 387 F.2d 441 (8th Cir. 1968); Towanda Textiles, Inc. v. United States, 180 F. Supp. 373 (Ct. Cl. 1960).

to adopt a plan to complete liquidation on the same day as the fire.[44] The problem with this approach is that section 337 applies with equal vigor to gains and *losses* which accrue and, conceivably, quick adoption of the plan could result in undesired nonrecognition of a loss to the taxpayer, with no opportunity to use the "straddle" scheme and save section 337 treatment for the gains.

There is some authority to support the proposition that a contingent plan of liquidation, approved in advance by the shareholders, would be accepted by the courts.[45] A plan which becomes effective only upon the destruction or condemnation of substantially all the assets of the corporation is a possible hedge against being forced into liquidation at a disadvantage. If such a contingent plan is put into effect, the corporation must then complete the distribution of assets within the twelve-month period from the date of adoption of the plan.[46] It must not forget that section 337 treats both gains and losses accruing on or after adoption of the plan as nonrecognizable. However, the corporation with a contingent liquidation plan can avoid the nonrecognition of a loss if it is also willing to forego nonrecognition of gains by prolonging the distribution of the assets to shareholders beyond the statutory twelve-month period. This removes the corporation from the treatment of section 337. If the corporation decides not to liquidate after the casualty, the contingent plan could simply be rescinded by corporate action.

The denial of section 337 to taxpayers who are forced by involuntary conversion to liquidate may create more problems for taxpayers. Certainly, the date on which a sale or exchange occurs in an involuntary conversion by fire is resolved by the decision in *Central Tablet*. The flexibility shown by the courts in finding the date of adoption of the liquidation plan suggests a possible avenue of litigation for those taxpayers intending to liquidate who discover too late that a casualty loss can create unforeseen and undesirable tax consequences. However, in the last analysis the remedy rests with Congress. Specific legislation is needed to equalize the tax consequences

44. Central Tablet Mfg. Co. v. United States, 94 S. Ct. 2516, 2531-32 (1974) (dissenting opinion).

45. *See* Henry H. Adams, 38 T.C. 549 (1962) (sale contract tied to date of plan of liquidation); *cf.* Mountain Water Co., 35 T.C. 418 (1960) (plan held adopted from intent of directors). *But see* Whitson v. Rockwood, 190 F. Supp. 478 (D.N.D. 1961) (danger in making liquidation plan contingent upon *prior* sale of assets).

46. In this respect, it should be noted that Central Tablet would not have benefited even if it had previously drawn such a contingent plan, since the distribution was not completed within 12 months of the fire.

of involuntary and voluntary liquidation.[47] Until Congress acts it is obvious that section 337 of the 1954 Internal Revenue Code remains an area where careful advance corporate planning is essential.[48]

KIM R. MOORE

47. *See Hearings Before the House Committee on Ways and Means on Advisory Group Recommendations on Subchapters C, J, and K of the Internal Revenue Code*, 86th Cong., 1st Sess. 532 (1959). It is important to note that in spite of the recognition by the committee of the need for explicit changes in § 337 to include provisions for involuntary conversion, no congressional action has been taken.

48. *See* B. BITTKER & J. EUSTICE, *supra* note 14, at ¶ 11.64, discussing the need of a "plan" and potential abuses of the statute. "One can only speculate about the number of fraudulently predated documents that are employed in this area, where the stakes are high and the taxpayer is likely to feel that his failure to adopt a plan in advance was an inconsequential detail." *Id.* at 11.62.

U S POSTAL SERVICE

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(Act of August 12, 1970 Section 3685, Title 39, United States Code

1 TITLE OF PUBLICATION	2. DATE OF FILING
Missouri Law Review	9/26/75
3 FREQUENCY OF ISSUE	3A. ANNUAL SUBSCRIPTION PRICE
Quarterly	$ 8.50

4 LOCATION OF KNOWN OFFICE OF PUBLICATION *(Street, city, county, state and ZIP code) (Not printers)*

114 Tate Hall, School of Law, University of Missouri, Columbia, MO 65201

5 LOCATION OF THE HEADQUARTERS OR GENERAL BUSINESS OFFICES OF THE PUBLISHERS *(Not printers)*

114 Tate Hall, School of Law, University of Missouri, Columbia, MO 65201

6 NAMES AND ADDRESSES OF PUBLISHER, EDITOR, AND MANAGING EDITOR

PUBLISHER *(Name and address)*

The Curators of the University of Missouri, Columbia, Missouri 65201

EDITOR *(Name and address)*

R.J. Robertson, Jr., 3 Tate Hall, School of Law, U. of MO., Columbia, MO 65201

MANAGING EDITOR *(Name and address)*

Mike Gill, 3 Tate Hall, School of Law, Univ. of MO., Columbia, MO 65201

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