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GOLDFARB V. VIRGINIA STATE BAR: THE PROFESSIONS ARE SUBJECT TO THE SHERMAN ACT

Richard B. Tyler*

I. INTRODUCTION

"The nature of an occupation, standing alone, does not provide sanctuary from the Sherman Act, . . . nor is the public service aspect of professional practice controlling in determining whether § 1 includes professions. . . ."\(^1\) With these words, the United States Supreme Court established the applicability of the Sherman Act\(^2\) to the "learned professions." The import of the Court's holding has not been lost on the antitrust enforcement agencies. They have recently filed suit or announced investigations of the activities of other professional organizations.\(^3\) Some professionals, on the other hand, have attempted to read the decision

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3. On Sept. 22, 1975, the Justice Department filed suit (Civ. No. 75-4640) in the Federal District Court for the Southern District of New York against the American Society of Anesthesiologists, challenging the Society's promulgation of "relative value guides," which establish monetary values for particular procedures by anesthesiologists and are used by the Society's members to determine fees. Wall Street Journal, Tuesday, Sept. 23, 1975, at 5, col. 2. The next day, the Federal Trade Commission announced that it is investigating restraints on price advertising by the eyeglass industry. Wall Street Journal, Wednesday, Sept. 24, 1975, at 14, col. 2.

More recently, the Federal Trade Commission has begun an investigation of the practice of veterinary medicine, CCH TRADE REG. REP. ¶ 10,167 (1976), and has brought suit against the physician's ethical bans on advertising, American Medical Assn., CCH TRADE REG. REP. ¶ 21,068 (1976). For its part, the Justice Department prevailed at the district court level in its suit challenging the National Society of Professional Engineers' ethical ban on price competition, United States v. National Soc'y of Prof. Engrs., 1975-2 TRADE CAS. ¶ 60,604 (D.D.C. 1975), and is pursuing an investigation into possible agreements in restraint of trade among Texas accountants, Texas State Board of Public Accountancy, Dkt. 75-531, CCH TRADE REG. REP. ¶ 60,021 (1975).
even more narrowly than Chief Justice Burger appears to have written it, in an effort to salvage some practices of professional organizations.4

Despite, or perhaps because of, the Chief Justice's attempt to limit the holding to the facts before the Court, the decision raises more questions than it answers. For example, it is not certain that the decision can be interpreted restrictively. It clearly applies to other professions, as well as to attorneys. The actual scope of the Sherman Act's applicability to other types of professional practices also remains to be delineated in further litigation. Such practices as "advisory" fee schedules, professional licensing restrictions, limits on solicitation and advertising, and boycotts of other, closely related groups will almost certainly be challenged in time, although the present emphasis appears to be on mandatory fee arrangements for professional services. This article will review briefly the holding and logic of Goldfarb, and consider some of its implications for practices common to most professions.

It should be recognized at the outset that there may be other bases on which to challenge particular professional practices, such as infringement of first amendment rights5 or violation of section 1983 of the Civil Rights Act of 1871.6 Such additional theories, however, are beyond the scope of this article.

II. THE GOLDFARB HOLDING7

In 1971 Lewis and Ruth Goldfarb contracted to buy a house in Virginia and contacted an attorney to have the title examined. After he quoted them a fee precisely equal to that suggested in the minimum fee schedule published by the Fairfax County Bar Association, they tried to find an attorney who would examine the title for less. They wrote 36 attorneys, requesting quotations of their fees. Nineteen replied, none indicating that he would charge less than the minimum fee set forth in the schedule; some said that they knew of no attorney who would charge less.

The Fairfax County Bar Association, a voluntary association, had no formal power to enforce the schedule. The Virginia State Bar Association, to which all attorneys practicing in Virginia are required to belong, provided the enforcement. The State Bar is the administrative agency of the Virginia Supreme Court for the regulation of the practice of law in Virginia.8 The State Bar had never taken formal disciplinary action to compel adherence to any fee schedule, but it published reports in 1962 and

7. The statement of facts and procedural history are taken from the Supreme Court opinion, 95 S. Ct. at 2007-09.
1969 condoning fee schedules, and issued two ethical opinions\(^9\) which indicated that fee schedules could not be ignored. The second opinion stated that habitually charging less than the suggested minimum fee schedule adopted by a local bar association raised a presumption of professional misconduct.

The Goldfarbs had the title examined by the attorney they had first contacted and then brought a class action against the State and County Bar Associations, charging that the minimum fee schedule was a contract, combination, or conspiracy in restraint of trade, in violation of Section 1 of the Sherman Act.\(^10\) The district court, trying the issue of liability, held that the minimum fee schedule did violate the Sherman Act and enjoined the use of the schedule, setting the case down for trial to ascertain damages.\(^11\) The United States Court of Appeals for the Fourth Circuit reversed as to liability.\(^12\) Although it agreed that the fee schedule and the enforcement mechanism supporting it substantially restrained competition among attorneys practicing in Fairfax County, it nevertheless exempted the State Bar on the ground that it was immune under the doctrine of "state action" set forth in *Parker v. Brown.*\(^13\) The court held the County Bar immune because it found that the practice of law was not "trade or commerce," a prerequisite to the application of the Sherman Act. The majority opinion also recognized a limited exclusion of "learned professions" from the antitrust laws, based upon the special regulation the states impose on the professions, and the fact that some normal competitive practices might be inconsistent with such regulation. The appellate court concluded that the fee schedule was one area in which the needs of professional regulation conflicted with the requirements of the antitrust laws, and held the practice of law exempt from the Sherman Act. Alternatively, the Fourth Circuit found that the activities of the State and County Bar did not have sufficient impact on interstate commerce to support jurisdiction. The Supreme Court granted certiorari.\(^14\)

The Court said that the issue was "whether the Sherman Act applies to services performed by attorneys in examining titles in connection with financing the purchase of real estate."\(^15\) The Court pursued a four-step analysis: (1) Did the challenged activities amount to price fixing?; (2) If so, were these activities in interstate commerce, or did they affect

\(^9\) Virginia State Bar Committee on Legal Ethics, Opinion No. 98 (June 1, 1960); Virginia State Bar Committee on Legal Ethics, Opinion No. 170 (May 28, 1971).

\(^10\) Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . .


\(^12\) 497 F.2d 1 (4th Cir. 1974).

\(^13\) 317 U.S. 341 (1943).


\(^15\) 95 S. Ct. at 2009.
MISSOURI LAW REVIEW

interstate commerce?; (3) If so, were these activities exempt from the Sherman Act because they involved a “learned profession”?; (4) If not, were the activities exempt as “state action” within the meaning of Parker v. Brown? Writing for a unanimous Court, Chief Justice Burger answered the first two questions affirmatively, the second two negatively, and held that the minimum fee schedule violated Section 1 of the Sherman Act.

III. DISCUSSION OF THE COURT’S OPINION

A. Price-Fixing

In addressing the price-fixing issue, the Court stated that an advisory fee schedule or a mere exchange of price information, without a showing of a restraint of trade, would present a different question. In this case, the district court found there was a “fixed, rigid price floor,” because every lawyer who responded to the Goldfarbs’ inquiry adhered to the fee schedule, and none sought additional information in order to customize his fee. The Court noted that the fee schedule was enforced through the threat of professional discipline, and that the attorneys’ natural desire to observe accepted professional norms was reinforced by each attorney’s knowledge that others would not compete on the basis of price. There was no need to infer an agreement from an exchange of price information—this was an overt agreement with a plain effect on price. The Court emphasized that these activities were particularly damaging to consumers, who could not avoid the system because lenders required title insurance. This dictated a title opinion, which could only be rendered by an attorney licensed to practice in Virginia. All such attorneys—whether or not they were members of the County Bar Association—were subject to the fee schedule. Thus, the challenged activities constituted a “classic illustration of price fixing.”

The Court’s analysis did not add anything new to antitrust law, but it did not really need to mine new veins. Price-fixing is, after all, the most blatant type of case, a per se violation. This aspect of the decision followed United States v. National Association of Real Estate Boards, in which the Court held that a voluntary fee schedule adopted by realtors

16. Id.
17. Mr. Justice Powell took no part in the consideration or decision of the case.
18. 95 S. Ct. at 2010-11.
19. Only 19 lawyers responded. In 1971, there were approximately 382 attorneys admitted to practice in Virginia located in Fairfax County (not including those in the independent cities of Arlington and Alexandria). 4 MARTINDALE-HUBBELL LAW DIRECTORY 661-765 (1971). Thus, fewer than five percent of the members of the Bar responded to the Goldfarbs’ survey and supplied the basis for this conclusion.
20. 95 S. Ct. at 2011.
21. See notes 126-131 and accompanying text infra.
violated Section 3 of the Sherman Act.\textsuperscript{23} Reflecting, perhaps, a realistic appraisal of the implications of \textit{National Association of Real Estate Boards} (as well as Justice Department pressure), approximately 19 state bar associations had abandoned or suspended fee schedules by late 1974; only three indicated then that they still published fee schedules.\textsuperscript{24} However, many local bar associations retained such schedules, even though the state organization had abandoned them. Even the Fairfax County Bar Association kept its schedule in force until confronted with the possibility of defeat in the Supreme Court.

The Court's emphasis on the fee schedule's harm to consumers may be significant. Professor, now Solicitor General, Bork has advanced the thesis that "Congress intended the courts to implement . . . only that value we would today call consumer welfare. . . ."\textsuperscript{25} Several earlier Supreme Court opinions had also emphasized that the purpose of the Sherman Act was to prevent harm to consumers.\textsuperscript{26} The services in \textit{Goldfarb} were indispensable to the particular transaction, and the purchasers could not turn to alternative sources, so that consumer choice was artificially restricted. One of the fundamental tenets of our economic system is that consumer welfare is maximized when basic economic decisions are determined by forces of the marketplace, rather than by a centralized decision-maker—regardless of whether that decision-maker is a government official or a monopolist.\textsuperscript{27} Therefore, the consumer welfare test suggested by Professor Bork has considerable appeal. If that is the touchstone, however, the Court's attempt to restrict its ruling to the precise facts before it is almost certainly doomed to failure, because many other restrictions imposed by professional organizations affect consumer welfare just as adversely as attorneys' fee schedules.\textsuperscript{28}

Similarly, the Court's attempt to distinguish a purely advisory fee schedule seems unlikely to endure. To be sure, in 1958, the American Bar Foundation suggested that a purely voluntary, informational fee schedule might pass muster.\textsuperscript{29} The authors noted factors which would

\textsuperscript{23} 15 U.S.C. § 3 (1970). Section 3 is substantially identical to Section 1, except that Section 3 applies to the District of Columbia and the federal territories. Thus, interstate commerce need not be involved, but the other issues remain the same.


\textsuperscript{25} Bork, \textit{Legislative Intent and the Policy of the Sherman Act}, 9 J. LAW \& ECON. 7 (1967). This argument is based upon the legislative debates preceding enactment of the Sherman Act. Another author traces the inspiration for the Sherman Act to widespread dissatisfaction with the proliferation of commodity trusts during the latter part of the nineteenth century. H. Thorelli, \textit{The Federal Antitrust Policy} 54-163 (1955).

\textsuperscript{26} See, e.g., \textit{Apex Hosiery Co. v. Leader}, 310 U.S. 469 (1940).


\textsuperscript{28} See notes 125-189 and accompanying text infra.

help insulate such a plan, including: that no enforcement be involved; that the schedule be made available to the public as well as the profession; and, that it be presented as a compilation of fees charged in the past, as opposed to a tabulation of fees to expect and charge in the future. Some cases involving trade associations have sustained price-reporting schemes with these attributes. However, it is by no means certain that even such sanitized plans would be sustained. Although the plan is "voluntary," if it results in placing a floor under fees, a violation should still be found, because the harm to consumers would be exactly the same as in *Goldfarb*. Thus, those state bar associations having "non-mandatory" fee schedules should take little comfort from the "narrow" holding in *Goldfarb*. Although it would require a more thorough analysis of effect to establish a violation, one could still be found. Moreover, if most of the attorneys in the state adhered to an "advisory" fee schedule, it would be easy to infer an agreement to adhere to the schedule, as was done in *United States v. Container Corporation*.

The absence of an enforcement mechanism did not save the fee schedule in *National Association of Real Estate Boards*, nor was there any effective enforcement in *United States v. Socony-Vacuum Oil Co.*, which announced the per se rule for price-fixing. The need for finding an enforcement mechanism in the threat of professional discipline is also weakened by the Court's statement in *Goldfarb*:

> Even without that threat [of professional discipline] the [ethical] opinions would have constituted substantial reason to adhere to the schedules because attorneys could be expected to comply in order to assure that they did not discredit themselves by departing from professional norms, and perhaps betraying their professional oaths.

Although the question of betraying professional oaths might not be raised legitimately under a voluntary fee schedule, there is, as the Court noted, a natural human desire to observe accepted norms of behavior. Even if an advisory fee schedule or a report of past charges did not reflect "professional norms," the effect of either probably would be to create a rigid floor under prices. It is possible that the Court would require a sampling of more than five percent of the practitioners

30. *Id.*
33. *But see Jeffers, supra note 4.*
35. 310 U.S. 150 (1940).
36. 95 S. Ct. at 2015.
37. It would be more difficult to predicate a breach of professional ethics on consistent failure to observe a "voluntary" fee schedule.
38. *See note 19 supra.*
in the area to establish the existence of such a rigid floor, or to infer an unlawful agreement, but that relates to the quantum of proof required, not the underlying principle.

In sum, it seems unlikely that any fee schedule, whether mandatory or not, will survive if it has the effect of fixing price; price-fixing is too serious an offense to be avoided so easily. *A fortiori*, *Goldfarb* is a warning to other professions to discard their fee programs.39

### B. Interstate Commerce

The Supreme Court accepted the district court's findings that a significant portion of mortgage funds came from outside Virginia, and that a substantial amount of loans on Virginia real estate were guaranteed by federal agencies headquartered in the District of Columbia.40 Therefore, the very transactions which created the need for the particular legal services involved were frequently interstate transactions, and the necessary connection with interstate commerce was present. It was not necessary to show that potential home buyers had been discouraged by the fee schedules, because once a direct effect is shown, no specific magnitude need be proven.41 Nor was it necessary to show that fees were raised; it sufficed that they were fixed.42

The *Goldfarb* Court appears to have applied a "flow of commerce" theory in resolving this jurisdictional problem.43 The Court did interpret this theory broadly on the facts before it. The facts that much of the mortgage money came from lending institutions in other states and that many mortgages were guaranteed by agencies headquartered outside the state do not seem to compel a finding that the attorneys' services were an integral part of an interstate transaction. This is especially true when it is recalled that the attorneys' services "were carried on wholly within the State of Virginia."44 This approach, of course, may merely be a reflection of the seriousness of the offense.

39. See note 3 supra. In recent years, the Justice Department has secured consent decrees against various professional associations. See, e.g., United States v. Am. Inst. of Certified Public Accountants, Inc., 1972 TRADE CAS. ¶ 74,007 (D.D.C.) (accountants); United States v. Am. Inst. of Architects, 1972 TRADE CAS. ¶ 78,981 (D.D.C.) (architects); United States v. Am. Inst. of Civil Engineers, 1972 TRADE CAS. ¶ 78,950 (S.D. N.Y.) (civil engineers). Shortly before his resignation, former Attorney General Saxbe indicated that the Department's scrutiny of lawyers and realtors was to be extended to doctors, dentists, pharmacists, accountants, engineers, funeral directors, and veterinarians. He stated that professional groups acting under state sanction should not be immune, especially in the present economic climate when "personal services represent one of the most rapidly-rising cost areas for consumers." BUREAU OF NATIONAL AFFAIRS, ANTITRUST & TRADE REGULATION REPORTER, No. 692, p. A-5 (Dec. 10, 1974).

40. 95 S. Ct. at 2011-12.

41. Id. at 2012.

42. Id. See also United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

43. See authorities cited note 47 infra.

44. Goldfarb v. Virginia State Bar, 497 F.2d 1, 16 (4th Cir. 1974).
The use of the restrictive "flow of commerce" theory in Goldfarb reflects the Court's reluctance to rule more broadly than the particular facts required. The Court noted, however, that there might be legal services which affect commerce in other ways, just as there might be services having no nexus with interstate commerce. This language suggests that the Court might, in a proper case, apply the broader "affecting commerce" theory to determine whether a challenged activity falls within the jurisdictional scope of the Sherman Act. The "affecting commerce" theory says that an activity is within the scope of the Commerce Clause if it has a direct and substantial effect on interstate commerce, even though the activity itself is not a part of interstate commerce. This doctrine has been interpreted broadly in Wickard v. Filburn, Burke v. Ford, and Perez v. United States. In Perez, for example, the petitioner was convicted of using extortionate means to collect or attempt to collect extensions of credit in violation of Title II of the Consumer Credit Protection Act—i.e., loan-sharking. He challenged Congress' power to enact this legislation. The Supreme Court, in an 8-1 decision, affirmed the conviction, saying: "extortionate credit transactions, though purely intrastate, may in the judgment of Congress affect interstate commerce. . . ." It has generally been held that, in enacting the Sherman Act, Congress meant to "go to the utmost extent of its Constitutional power. . . ." Given that scope, it is difficult to imagine what professional services may not affect interstate commerce sufficiently to be within congressional jurisdiction.

In a footnote, the Goldfarb Court discussed United States v. Yellow Cab Company. In that case the Court held that taxi trips between

45. 95 S. Ct. at 2012.
46. U.S. CONST. art. I. § 8, cl. 3.
52. 402 U.S. at 157-58. Justice Stewart dissented on the ground that Congress lacked authority to define as a crime and order the prosecution of such a wholly local activity.
53. Id. at 154.
55. 95 S. Ct. at 2011 n.13.
56. 332 U.S. 218 (1947).
57. 95 S. Ct. at 2012.
58. U.S. CONST. art. I, § 8, cl. 3.
50. 402 U.S. at 157-58. Justice Stewart dissented on the ground that Congress lacked authority to define as a crime and order the prosecution of such a wholly local activity.
55. 95 S. Ct. at 2011 n.13.
56. 332 U.S. 218 (1947).
railroad stations used by passengers to change trains during interstate journeys were part of the stream of interstate commerce, but that taxi trips from the travelers' homes or offices to the railroad station, or vice versa, were "too unrelated to interstate commerce to constitute a part thereof within the meaning of the Sherman Act."57 The Goldfarb Court analogized the legal services at issue to the trips between stations in Yellow Cab. This analogy, coupled with the dictum that "there may be legal services that have no nexus with interstate commerce and thus are beyond the reach of the Sherman Act,"58 might suggest that the Court was taking the position that only those aspects of a fee schedule dealing with legal services that affect interstate commerce are subject to the Sherman Act, whereas those aspects of a fee schedule that do not affect interstate commerce would be immune from antitrust scrutiny. This interpretation of Goldfarb would not be justified. First, it is not necessary to show that each particular activity involved in a challenged transaction affects interstate commerce, but only that the class of activities affects interstate commerce.60 As noted above, attorney's services, as a class, would clearly have this requisite effect.60 Moreover, the Court noted in another part of the opinion that the general activities of attorneys undeniably play an important role in commercial intercourse, and that anticompetitive activities of attorneys may exert a restraint on commerce.61 Although this language may be somewhat out of context here, it is equally relevant to the question of jurisdiction. In short, it is nonsensical to sever the elements of a fee schedule, striking down those elements regarding activities that affect interstate commerce, and upholding those that do not.

In sum, there is a constitutional requirement that activities affect interstate commerce to be within the scope of the Sherman Act. If Wickard and Perez are the standards, however, it is difficult to argue that any professional services (with the possible exception of services rendered by ministers) are beyond the jurisdictional scope of the Sherman Act. In the case of the medical profession, for example, medical insurance and payments from Medicare and Medicaid cross state lines, and are similar to the interstate contacts found in Goldfarb. Furthermore, physicians and hospitals purchase supplies in interstate commerce.62 Similar considerations pertain to dentists.63 Although Goldfarb does not speak to the issue,

57. Id. at 230.
58. 95 S. Ct. at 2012.
60. See notes 45-54 and accompanying text supra.
61. 95 S. Ct. at 2014.
63. But see United States Dental Institute v. Am. Ass'n of Orthodontists, 1975 TRADE CAS. ¶ 60,569 (N.D. Ill.) (lower court cases finding such business wholly local).
it would seem that there is little left of those lower court cases, such as *Spears Free Clinic & Hosp. for Poor Children v. Cleere*, which held that the practice of medicine had insufficient effect on interstate commerce for Sherman Act purposes.

C. The "Learned Profession" Exemption

The most important result of *Goldfarb* may be its putting to rest the canard that the professions, as such, are somehow above the antitrust laws. The language quoted at the outset of this article is essentially a reaffirmation of the egalitarian ideas embodied in our fundamental documents. The Court did, however, recognize that there may be special problems associated with regulation of the professions. It remains to be seen how those "special problems" will be reconciled with the public policy favoring free competition.

The language, "Whatever else it may be, the examination of a land title is a service; the exchange of such a service for money is 'commerce' in the most common usage of that term," applies, of course, to everything professionals do for their clients. It is certainly not novel to apply the Sherman Act to the rendition of services. The Court was also correct in noting that there is no support in the legislative history for an exemption for "learned professions." And the Court properly dismissed the language

64. 197 F.2d 125 (10th Cir. 1952).
65. See also United States v. National Soc'y of Professional Engineers, 43 U.S.L.W. 2269 (D.D.C. Dec. 12, 1974), where the court said: "It would be a very dangerous form of elitism, indeed, to dole out exemptions to our antitrust laws merely on the basis of the educational level needed to practice a given profession..."
66. See note 75 and accompanying text infra.
67. 95 S. Ct. at 2013.
69. The legislative debates are, at best, inconclusive. There is but one reference to the professions, in a brief dialogue between Senators Edmunds and Hoar, two of the chief draftsmen of the bill which finally became the Sherman Act. One can only conclude that (1) the Senate was aware of some earlier attempts by local bar associations to set minimum fees, and (2) these Senators expressed no feeling that the professions should be treated any differently from other occupations. See 21 Cong. Rec. 2726 (1890). There is also some intimation that the draftsmen believed that the bill, as originally drawn by the Senate Finance Committee, might include the activities of the Women's Christian Temperance Union. Id. at 2658-60 (speech by Senator Wilson). Senator Sherman apparently thought that the WCTU might be affected, and did not oppose an amendment introduced by Wilson to exempt explicitly organizations promoting enforcement of the state police power. Id. The bill was referred to the Committee on the Judiciary, from whence it emerged with its present wording, absent the Wilson amendment but still containing the language which some had thought might encompass the WCTU. H. THORELLI, THE FEDERAL ANTITRUST POLICY 197-202 (1955); H. TOULMIN, THE ANTI-TRUST LAWS OF THE UNITED STATES 21-23 (1949). THORELLI, at 169-210, contains probably the most complete, accurate, and concise summary of the legislative history of the Sherman Act. See also Coleman, *The Learned Professions*, 33 ANTIMITRUST L.J. 48 (1967).
in the cases relied on by the County Bar as "passing references in cases concerned with other issues,"70 noting that the Court had twice previously reserved the question of the applicability of the Sherman Act to the practice of a learned profession.71 Thus, after *Goldfarb*, the members of the professions are subject to the strictures of the Sherman Act and must depend on judicial consideration for any limitations on the extent to which the principles embodied in that Act should apply to their particular practices.

The Court's emphasis on the commercial impact of lawyers' activities72 may offer some solace to the practitioners of other professions. Physicians and dentists do not have as direct an impact on commercial transactions, but this probably will not exempt them from the Sherman Act. The opinion's concern with harm to consumers73 applies equally to those professions. In the modern world, health is big business in the aggregate,74 and anti-competitive conduct by health professionals clearly has pronounced potential commercial impact.

In footnote seventeen, the Court said:

> The public service aspect, and other features of the professions, may require that a particular practice, which could properly be viewed as a violation of the Sherman Act in another context, be treated differently. . . .75

The Court did not elaborate on this dictum, but it may suggest that most activities of professional groups should be analyzed according to the "rule of reason," even though the conduct complained of might be a per se violation in another context. This requires a balancing of the public interest in professional regulation against the public interest in competition. Considering the strong commitment to competition—rather than combination—as the market regulator, the burden should be on the profession to establish clearly the need for the particular conduct. The profession should be in the best position to establish that fact. Of course, in such a case, the court would have to determine whether the public need for professional regulation could be met by less restrictive means. Where competition is either impossible or undesirable, the usual alternative is some form of regulation by a public body,76 a solution not calculated

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70. 95 S. Ct. at 2012 n.15.
72. 95 S. Ct. at 2014.
73. *Id.* at 2010.
75. 95 S. Ct. at 2013 n.17.
to appeal to most professionals. But if there is a need to reconcile the public service aspect of the professions with the public policy favoring competition embodied in the Sherman Act, such reconciliation should probably be done by the Congress, rather than the courts. As the Goldfarb Court recognized, there is a heavy presumption against implicit exemptions. It seems that there should be at least an equally heavy presumption against applying differing standards to different occupational groups.

Thus, the decision should put to rest the notion that certain occupations enjoy protected status from the Sherman Act. However, the emphasis on commercial impact and the dictum of footnote seventeen will require clarification from future cases. Such clarification may not be long in coming.

D. State Action

Parker v. Brown held that an anticompetitive agricultural marketing program created by state statute did not violate the Sherman Act, because that Act was intended to regulate private practices and not to prohibit a state from imposing a restraint as an act of government. In the Goldfarb context, Virginia, by statute, authorized the state’s highest court to regulate the practice of law, and established the Virginia State Bar as an administrative agency of the court for the purpose of investigating and reporting violations of the rules adopted by the court. The Virginia court adopted ethical codes which dealt in part with fees, but which did not authorize binding price-fixing. Rather, these codes directed lawyers “not to be controlled” by fee schedules. The Supreme Court rejected the claim of state action immunity, stating that the “threshold inquiry” is whether the allegedly anticompetitive activity was required by the state acting as sovereign. That ended the matter, because there was no basis for saying that the state, either by statute or through the Virginia Supreme Court Rules, compelled the adoption of the fee schedules. And, although the State Bar was authorized to issue ethical opinions, there was no showing that the Virginia court approved those opinions. Furthermore,

77. Current manpower legislation being proposed to the Congress includes not only a large bureaucracy but also elaborate systems of loans, fee incentives and disincentives, and a very expensive tax packet to enforce these goals. . . . The federal record in the last 30 years of medical manipulation doesn’t encourage further expansion of the [federal] bureaucracy in this direction.

Dr. Francis D. Moore, Chairman of the Subcommittee on Manpower for the Study on Surgical Services for the United States, speaking to the annual meeting of the American College of Surgeons in San Francisco on October 13, 1975, quoted in The Wall Street Journal, Tuesday, Oct. 14, 1975, at 12, col. 1.


79. See note 3 supra.

80. VA. CODE ANN. § 54.48 (Supp. 1974).

81. Id. at § 54.49.

82. 95 S. Ct. at 2014-16.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
the State Bar, by indicating that deviation from County Bar minimum fees could lead to disciplinary action, voluntarily joined in private anticompetitive activity, and thus was unable to claim insulation from the Sherman Act.

Again, the Supreme Court did not have to carry its reasoning very far on the facts of Goldfarb. It found that the state had not acted, and thus there was no basis for the state action defense.\(^8\) If the anticompetitive activity \(^{were}\) compelled by the state in its sovereign capacity, further exploration of the state action defense would be required.\(^8\) The holding is consistent with those cases which have held that the states have no authority to permit private conduct which violates the antitrust laws,\(^8\) and that the immunity of Parker v. Brown does not extend to private activities permitted, but not required, by law.\(^8\)

The Court also noted:

The fact that the State Bar is a state agency for some limited purposes does not create an anti-trust shield that allows it to foster anti-competitive practices for the benefit of its members.\(^8\)

As its authority the Court cited Gibson v. Berryhill,\(^8\) which enjoined the Alabama Board of Optometry from hearing charges against salaried optometrists on the ground that the Board members stood to benefit financially by excluding optometrists employed by corporations. This may indicate a receptivity to the procedural due process analysis suggested by Professor Verkuil and others.\(^8\) It also appears to call for strict scrutiny of the professions, traditionally self-regulating, because of the regulators' unavoidable pecuniary conflict of interest. In Parker v. Brown the state

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\(^{83}\) "[I]t cannot fairly be said that the State of Virginia through its Supreme Court Rules required the anticompetitive activities of either respondent." 95 S. Ct. at 2015.


The Court's holding on this point may call for a narrow reading of cases like Washington Gas Light Co. v. Virginia Elec. & Power Co., 438 F.2d 248 (4th Cir. 1971), which said that the mere existence of a regulatory body created by statute which \(\textit{could}\) have authorized or directed the challenged conduct will sustain the defense, even absent a showing that the regulatory body had actually considered the conduct.


\(^{87}\) 95 S. Ct. at 2015.


regulatory agency included public officials as well as members of the regulated industry. The significance of the public representation is unclear in the *Parker* opinion, but the fact that the State Bar and the Virginia Supreme Court are composed solely of representatives of the profession should lead the courts to scrutinize the claim of state action more closely.\(^\text{90}\) The same, of course, should apply to any regulatory body which is dominated by persons subject to the regulation. *Parker v. Brown* does not exempt private action masquerading as state action.\(^\text{91}\) The real question is whether the actual decision-makers are public officials or the members of the profession.\(^\text{92}\) Courts will often have to look beyond the state statute or regulation to determine how the "regulatory" program actually operates.\(^\text{93}\)

*Goldfarb* leaves open the question of the effect of a fee schedule established by the legislature,\(^\text{94}\) or set by the state's highest court either pursuant to legislative authorization or to the court's inherent power to regulate the bar. Similar questions are raised by statutes limiting entry into the professions.\(^\text{95}\) Such situations will require the courts to weigh the policies inherent in the state regulation against the federal policy set forth.

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\(^{90}\) The dominance of the regulatory body by the persons regulated is not unique to the professions. A former Director of Policy Planning for the Antitrust Division of the Department of Justice noted in 1970 that 75 percent of the states' occupational licensing boards were composed exclusively of licensed practitioners. Donnem, *Federal Antitrust Law Versus Anticompetitive State Regulation*, 39 ANTITRUST L.J. 950, 955 (1970). Donnem suggested that the danger that the licensing boards' pecuniary interests might lead them to inhibit competition could be reduced by having at least some persons not in the occupation serve on such boards.

If a state did create a public commission to regulate the professions along the lines of public utility commissions, with jurisdiction to police rates and services and control entry and exit, perhaps there would be no need for antitrust scrutiny. See Verkuil, *supra* note 84, at 339 & n.64. But see id. at 340 ff. The danger, of course, is that such a commission might come to be dominated by the profession, much as lay members of a hospital's board of trustees tend to abdicate effective control to the members of the medical profession. See Rayack, *Restrictive Practices of Organized Medicine*, 13 ANTITRUST BULL. 659, 708-09 (1968) (hereinafter cited as Rayack).


94. See, e.g., § 473.153(3), RSMo 1969 (setting minimum attorneys fees, based on a percentage of the value of the estate's personal property, for services rendered the estate at the instance of the executor or administrator). Section 473.153(5), RSMo 1969, provides that no executor or administrator, except one who is himself an attorney, can appear in court except by an attorney; thus, the consumer (estate) has no alternative, just as the Goldfarbs had no alternative but to hire a Virginia attorney. Of course, the statute gives the probate court discretion to allow a fee larger than that prescribed by the statute.

95. E.g., §§ 334.010, .021, RSMo 1969 (requiring licensing of medical professionals).
in the Sherman Act. It frequently may not be possible to achieve a wholly satisfactory reconciliation, in view of the lack of congressional guidance about which of several possible goals is most important in a particular situation. But the Sherman Act embodies a fundamental policy in favor of free competition, and the Congress "exercised all the power it possessed" under the Commerce Clause when it enacted the Sherman Act. On balance, the federal policy in favor of free competition should prevail over conflicting state schemes under the Supremacy Clause.

Thus, despite the attempt in Goldfarb to rule narrowly, it seems likely that even acts directed by the state would fall if they were found to be anticompetitive. The result might turn on whether the violation charged is a per se violation, or requires a "rule of reason" analysis. In the former case, the purpose the conduct was intended to serve would be irrelevant. Under the latter approach, the countervailing policies could be weighed, and the state's regulatory system sustained if it were not found to be too anticompetitive. However, the challenged activity would have to be scrutinized closely to ensure that the members of the profession had not succeeded in advancing their personal economic interests under the guise of state regulatory action. Perhaps the burden of proof should be placed on the profession if it seeks to sustain the regulation. As in many other areas, the result may turn on the nature of the relief sought. A court might be more prone to find a violation in a suit to enjoin enforcement of an offensive regulation than it would be if the action were a criminal prosecution or a private action for treble damages.

E. Dicta

The Goldfarb opinion concluded with a series of dicta in which the Court recognized the states' "compelling interest" in the practice of the professions. Under the states' police powers, they may establish standards for licensing practitioners and regulate their practice. Such standards might include restrictions on some forms of conduct which, although commonplace in the business world, could be demoralizing to a profession. Also, the states have a special interest in regulating

96. See authorities cited note 84 supra, for several suggested modes of analysis.
99. U.S. CONST., art. VI, cl. 2.
101. 95 S. Ct. at 2016.
102. The Court cited United States v. Oregon State Medical Soc'y, 343 U.S. 326 (1952), which involved an alleged concerted refusal of the members of the Society to deal with a private health association, and Semler v. Oregon State Board of Dental Examiners, 294 U.S. 608 (1935), which sustained an Oregon statute authorizing revocation of a dentist's license for engaging in untruthful or misleading advertising. In Medical Society the Court said:
attorneys because of their essential role in the administration of justice.\textsuperscript{103} The Supreme Court said that its holding in \textit{Goldfarb} was not intended to lessen the states' authority to regulate the professions.

These statements present the most troublesome aspects of the case. Unfortunately, a great deal of litigation will probably be required to clarify just what was meant or implied. They may only reflect the Court's wrestling with the concept of federalism and the notion that the states should be free to make their own economic decisions, regardless of whether those decisions coincide with the economic principles held by the federal judiciary.\textsuperscript{104} Also, the dicta may indicate the Court's belief that economic forces alone cannot provide sufficient regulation of the professions.\textsuperscript{105} The latter belief is, of course, one of the usual justifications for imposing public regulation.\textsuperscript{106} One could define the professions as "public callings," and subject them to detailed state regulation.\textsuperscript{107} But, for the reasons already alluded to—the federal policy favoring competition and the Supremacy Clause—even public utility type regulation should not provide an absolute shield against Sherman Act inquiry, where regulation is in fact anticompetitive.

Professor Verkuil has suggested a mode of analysis which a federal court should follow in considering a challenge to such state regulation.\textsuperscript{108} First, the court must decide whether the state agency operated under procedures which granted due process to all interested parties. If due process requirements were not met, the court could pursue the antitrust inquiry, confident that no serious state interest was being infringed. However, if the state agency's procedures fulfilled due process requirements, then the court would have to take up a second question: Does the state have a pervasive regulatory scheme which requires the agency to examine antitrust considerations and to enjoin conduct which is not satisfactory in that light? If the state has such a pervasive scheme, the federal court should abstain until the plaintiff had sought relief from the state agency, unless the action were solely for injunctive relief.\textsuperscript{109} If the state agency ruled against the plaintiff, the court could intervene, but only after

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We might observe in passing, however, that there are ethical considerations where the historic direct relationship between patient and physician is involved which are quite different than the usual considerations prevailing in ordinary commercial matters. This Court has recognized that forms of competition usual in the business world may be demoralizing to the ethical standards of a profession. \textsuperscript{343}U.S. at 336 (citing \textit{S"{e}mler}).
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\begin{itemize}
\item \textsuperscript{103} Attorneys have historically been regarded as officers of the court. \textit{See} note 114 \textit{infra}.
\item \textsuperscript{104} \textit{See} Verkuil, \textit{supra} note 84, at 334.
\item \textsuperscript{105} \textit{Id.} at 336.
\item \textsuperscript{106} \textit{Cf.} C. Kayser & D. Turner, \textit{supra} note 76, at 189-90.
\item \textsuperscript{107} Professor Verkuil suggests this as one test to determine whether the "state action" defense should be sustained. Verkuil, \textit{supra} note 84, at 337.
\item \textsuperscript{108} \textit{Id.} at 349-50.
\item \textsuperscript{109} No abstention would be necessary where the action is only for injunctive relief, because no serious damage is done while the matter is on appeal.
\end{itemize}
considering whether the jurisdiction of the state agency was exclusive—i.e., is the challenged conduct necessary to make the state regulation work? Although this approach contains substantial potential for delay, it does leave room for state experimentation and still preserves a role for the federal judiciary. The point is that even the most elaborate system of state regulation should be open to antitrust scrutiny by federal courts.

The dicta seem to require a balancing of the state's interests in protecting the public health, safety, and other valid objectives by regulating the professions against the policies of the antitrust laws. Such balancing is very difficult for a court. It is basically a legislative task to consider competing policies and select one to be paramount in a particular case. As noted elsewhere, "[T]he federal judiciary has neither guidance from Congress nor any particular expertise to determine which of the several goals [of antitrust policy] is most important in a particular situation." The judiciary is even less equipped to make the determinations which the Goldfarb dicta seem to require.

Unfortunately, the opinion does not elaborate on the nature of the states' "compelling interest" in the practice of the professions, beyond establishing standards for licensing and "regulating the practice." The Court "recognized" that a state might limit a profession's use of the forms of competition usual in the business world, citing United States v. Oregon State Medical Society and Semler v. Oregon State Bd. of Dental Examiners. The citation to Medical Society is of little help, because it is to a dictum; the decision turned on a failure of proof. Semler, dealing with prohibitions against advertising, is more directly in point, although it was not decided on antitrust grounds, but rather on due process and equal protection grounds. Also, it is a pre-1936 case, decided during an era which—and by justices who—held a restricted view of the Sherman Act. It is by no means certain that the case would be decided in precisely the same way today.

The difficulty with this line of argument is that every scheme of regulation is rationalized on the ground of the need to protect the public from the incompetent or fraudulent practitioner. All occupational licensing schemes, for example, are justified—at least in part—in this fashion. In fact, such regulation protects the pecuniary interests of those already in the occupation from competition from newcomers—e.g., by virtue of "grandfather" clauses which exempt those already in the occupation from licensing requirements, and shields them from some of the practices of their more aggressive competitors—e.g., advertising.

111. 343 U.S. 326 (1952).
112. 294 U.S. 608 (1935).
113. "The intent of the tree expert law was primarily to protect the public against tree quacks, slysters and inexperienced persons." Nels J. Johnson, Chairman of the Illinois State Tree Expert Examining Board, testifying before the Illinois legislature, quoted in Moore, The Purpose of Licensing, 4 J. Law & Econ. 93 (1961).
Except for those occupations traditionally regarded as "public callings"—innkeepers, hackmen, wharfmen, etc.—regulation is a relatively recent phenomenon. The modern form of regulation of the legal and medical professions dates from the latter part of the nineteenth century; most other occupations came under regulation even later. This may reflect growing public awareness of incompetence and deceit, but it more likely represents the triumph of the professions' instincts for self-aggrandizement and the growing effectiveness of their political lobbying power. In general, most aspects of regulation are left entirely to the members of the professions; the states as such do not actually regulate them.

If the states do have a strong interest in regulating professional activities, then regulation should be provided by a politically responsible state organ, having procedures that comport with due process and authority to regulate rates and services and to control entry and exit. Such regulation, comparable to that presently imposed on public utilities, would no doubt be anathema to members of the professions. The procedures to be followed should provide for full public, as well as pro-

114. R. Pound, The Lawyer from Antiquity to Modern Times 218-49 (1953) (hereinafter cited as Pound); Stigler, The Theory of Economic Regulation, 2 Bell J. Econ. & Mgt. Sci. 3, 15, table 3 (1971). Perhaps the earliest attempt in Anglo-American law to regulate admission to the bar occurred in 1292, when a royal writ directed the Common Bench to designate a number of better-qualified attorneys and apprentices who alone should appear before the court. 1 Rot. Parl. 84 (1292), cited in T. Plucknett, A Concise History of the Common Law 217-18 (5th ed. 1956). Plucknett does not disclose what prompted the issuance of that royal writ; one cannot help but wonder whether the practitioners then “riding circuit” asked the King to issue it.

115. In America the earliest regulation of the practice of medicine appears to date from about 1760 in New York City, and from 1767 in New York State. See People ex rel. Gray v. Medical Soc'y of Erie County, 24 Barb. 570 (N.Y. Sup. Ct. 1857). Regulation of the medical profession on a broad scale, however, dates from the latter half of the nineteenth century. See Comment, The American Medical Association: Power, Purpose, and Politics in Organized Medicine, 63 Yale L.J. 938 (1954); Stigler, supra note 114; Moore, supra note 113, at 103, table 3; E. Freidson, Profession of Medicine 3-23 (1970) (hereinafter cited as Freidson).

116. Stigler, supra note 114; Moore, supra note 113, at 103, table 3. See also Freidson, supra note 115.

117. Freidson, supra note 115; Stigler, supra note 114; Moore, supra note 113. See also M. Friedman, Capitalism and Freedom 199-40 (1962) (hereinafter cited as Friedman).

118. The efficacy with which the professions regulate themselves has been challenged. For example, a study of the bar of Metropolitan New York estimated that fewer than 2 percent of the violators of the Canons of Ethics were even investigated by the disciplinary agency, and only 0.2 percent were officially sanctioned. J. Carlin, Lawyers' Ethics 170 (1966). An earlier study of the Chicago bar, displayed similar results. J. Carlin, Lawyers on Their Own (1962). Carlin notes that there may be differences in the bars of smaller metropolitan areas, because of the different structure of legal work, less stratification of the profession, etc., all making for a more homogeneous, closer professional community. Id. at 23. However, no definitive studies are available to substantiate or refute this. With respect to the medical profession, see Freidson, supra note 115, at 185-99.

119. C. Kaysen & D. Turner, supra note 76, at 11-18 (1959); Verkuil, supra note 84, at 539, 550 (semble).
professional, input into the decision-making process. Indeed, the regulatory body should be established to insure that policy decisions emanate from public representatives, rather than representatives of the profession. If state regulation does not provide at least this much, and demonstrably satisfy at least one of the goals of antitrust policy, however, then "state action" should not be a bar.

The usual justification for professional self-regulation is that the specialized skills required and special problems presented can only be assessed by persons trained for and working in the professions. This is a fiction. Laymen, in the role of jurors, are asked to evaluate professional practice in malpractice cases, with the aid of expert testimony. There is no reason to believe that a public commission, advised by representatives of the profession, could not do an adequate job. Such a commission might be better able than members of the affected profession to balance the public interest in competence and integrity with the public need for ready availability of the services at reasonable costs. Such a body could determine qualifications for entry and practice and pass on questions of unethical or improper behavior with greater objectivity than members of the profession, whose self-interest may cloud their view. The danger, of course, is that lay members might abdicate their responsibilities, effectively leaving the regulation to the professional "advisers." An analogy might be found in the lay bodies which nominally control hospitals. In practice, the lay governing bodies tend to delegate control over "medical standards" to the physicians already admitted to the staff.

120. Professor Verkuil expresses the hope that public interest law firms and group legal services "may consciously represent the interests of consumers of legal services and thus serve as the equivalent of public representatives and intervenors." Verkuil, supra note 84, at 355 (citations omitted). It is submitted that such representation is unlikely to be adequate, even though the legal profession is not monolithic. See Carlin's studies, supra note 118. This is because those working in such firms are still members of the profession and conditioned by law teachers to respond much the same as other members of the profession. Of course, the other professions have no such internal subgroup comparable to the public interest law firms to provide public input; presumably, opportunity would have to be provided for input from the public at large. Should the legal profession be treated any differently?

121. At least three goals have been ascribed to federal antitrust policies: (1) preservation of competition, in order to maintain allocative efficiency; (2) preservation of competition to protect consumers by insuring adequate quality at a fair price; (3) preserving small competitors, for noneconomic reasons as well as to approximate the "perfect market." Comment, Parker v. Brown: A Preemption Analysis, 84 YALE L.J. 1164, 1170 (1975). See generally Bork, Bowman, Blake & Jones, Goals of Antitrust—A Dialogue on Policy, 65 COLUM. L. REV. 363 (1965).

122. Verkuil, supra note 84, at 337, 339.


124. Rayack, supra note 90, at 708-09; AMER. COLL. OF SURGEONS & AMER. SURGICAL ASS'N, SURGERY IN THE UNITED STATES: A SUMMARY REPORT OF THE STUDY ON SURGICAL SERVICES FOR THE UNITED STATES 187 (1975) (semble) (hereinafter "Summary Report").
were found to occur in a commission established to regulate a profession, then the existence of the commission should not insulate the scheme from antitrust scrutiny.

Many (and perhaps most) observers will welcome the Court's attempt to rule narrowly on each case according to its facts. This is, after all, the evolutionary method by which our Anglo-American legal system has developed. To be sure, it is cumbersome and slow, but it may well yield better results than broad judicial pronouncements which must later be retracted or modified. Still, it seems doubtful that the Court's endeavor in Goldfarb to preserve a zone within which the states can experiment in regulating the professions without federal interference can stand for long, unless the states impose affirmative regulation of the professions similar to that now imposed on public utilities.

IV. THE IMPLICATIONS OF GOLDFARB

Read most narrowly, Goldfarb deals only with the legal profession. However, nothing in the opinion suggests that the Court intended to limit its rationale to the legal profession. Some of the language of the opinion strongly implies that other professions are equally subject to the Sherman Act.125 Thus, it is important to assess the potential impact of Goldfarb on some practices common to most professions.

In order to make such an assessment, one should recall some general principles of antitrust law. In 1911 the Supreme Court announced that the Sherman Act did not condemn all restraints of trade, but only those which were unreasonable.126 The "rule of reason" doctrine requires a plaintiff or prosecutor to demonstrate not only that the alleged act was perpetrated, but also that the act was unreasonable or contrary to the public interest. This requires the court to make an extended inquiry into the circumstances surrounding the performance of the act, its purposes, and its effect on competition. Frequently, a court must undertake an extensive foray into economic theory to determine whether particular acts or conditions are "reasonable" or in the public interest.

Some practices, however, have been declared to be inherently hostile to competition. These acts, denominated per se offenses, are considered to be so anticompetitive as to warrant their condemnation without extended inquiry into their effects in particular cases or the circumstances

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125. See, e.g., note 1 and accompanying text supra, and the opening sentence of the concluding section of the Goldfarb opinion: "We recognize that the States have a compelling interest in the practice of the professions . . . ." 95 S. Ct. at 2016. The cases cited in that concluding section were United States v. Oregon State Medical Soc'y, 343 U.S. 326 (1952), and Semler v. Oregon State Bd. of Dental Examiners, 294 U.S. 608 (1935), further suggesting extension of the principles of Goldfarb to other professions.
126. Standard Oil Co. v. United States, 221 U.S. 1 (1911).
which gave rise to them. The per se offenses include horizontal price-fixing, territorial allocations, concerted refusals to deal, and agreements tying the sale of one product to the purchase of another.\textsuperscript{127}

One must also recall that the law does not condemn all combinations of competitors. Trade associations, for example, are condoned unless they indulge in prohibited anticompetitive activities, such as price-fixing.\textsuperscript{128} Such associations' activities are viewed in \textit{toto}, and if no anticompetitive results or purposes are found, the association is not disturbed. A similar approach to professional organizations would permit legitimate activities designed to enhance the caliber of the profession, but would condemn anticompetitive behavior.

The professions, however one defines them, do differ from ordinary commercial combinations. All the recognized professions involve special skills, usually acquired through prolonged training. It is often said that a professional's work is so specialized that the uninitiated cannot readily evaluate his performance or determine the desirable qualifications for membership. Also, the functions performed by professionals are usually considered very important to society.\textsuperscript{129} For these reasons, and because of the inherent conflicts of interest present when professionals are allowed to regulate themselves, all the activities of professional associations should be subject to searching scrutiny. Some activities, such as "ethical" bans on price competition, fall within traditional per se categories and should not require elaborate inquiry. Most professional activities, however, will require a rule of reason analysis, balancing the special circumstances of the professions against the policy favoring competition. In making these analyses, however, it is important to distinguish between the technical side of the profession's work (as to which the members of the profession can claim some expertise) and the manner in which this expertise is made available. Professionals are not necessarily better qualified than laymen to pass judgment on the latter aspect.\textsuperscript{130} The analysis will vary, depending upon which aspect of the profession is under examination, but even the technical aspect of professional conduct should not be immune from antitrust scrutiny, at least in the absence of a congressional declaration to that effect.\textsuperscript{131}

\textsuperscript{127} United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940). See C. Kayser & D. Turner, \textit{supra} note 76, at 142-44, for a discussion of appropriate criteria for application of per se rules.


\textsuperscript{130} Freidson, \textit{supra} note 115, at 24, 337 ff.

\textsuperscript{131} Id. at 335-82. In the remainder of this article, it is assumed that the required effect on interstate commerce can be established to reach the activities discussed. See notes 40-64 and accompanying text \textit{supra}.
A. Admission to Practice

The question of restrictions on admission to professional practice is probably the most difficult one which may confront the courts.\textsuperscript{132} Paraphrasing Professor Friedman, licensure is the key to the professions' control over their areas of responsibility.\textsuperscript{133} Most jurisdictions restrict admission to practice the professions, ostensibly to protect the public from the incompetent and unethical. Most have delegated the task of promulgating standards for licensure to the professions themselves.\textsuperscript{134} Thus, the professions' power to control the details of their work is political in nature, involving the aid of the state in establishing and maintaining their preeminence in their respective fields.\textsuperscript{135} Nonetheless, such restrictions have by now become so ingrained that the Goldfarb Court acknowledged them in dicta and appeared to condone them.\textsuperscript{136} It is submitted that this apparent acceptance of restrictions is ill-advised. Because of their potential anticompetitive effects, limitations on entry into the professions should be scrutinized closely.

Such restrictions, of course, constitute barriers to entry and enhance the return to those already practicing in the field at the expense of the public.\textsuperscript{137} If the number of persons admitted to a profession is artificially restricted to a number less than that which would result from the operation of ordinary market forces, those already in the profession would be able to use the forces of supply and demand to garner higher fees than they would receive in a fully competitive situation. This in turn leads to a misallocation of resources, because more is expended for the services rendered than would otherwise be spent. Also, the cost of professional services may be increased to the point that a significant segment of the public is "priced out" of the market. This apparently has happened with the legal profession, particularly regarding middle-income persons who cannot qualify for free legal assistance under some federal program.\textsuperscript{138}

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\textsuperscript{132} Thus far the federal antitrust authorities have not indicated any intentions to challenge professional organizations in that area. \\
\textsuperscript{133} \textsc{Friedman, supra} note 117, at 150. Professor Friedman was speaking of the medical profession and referring to control over the number of physicians. The statement appears equally applicable to other professions. \textit{See also} R. \textsc{Posner}, \textsc{Economic Analysis of Law} 346-48 (1972) (hereinafter cited as \textsc{Posner}); \textsc{Freidson, supra} note 115, at 23 ff. \\
\textsuperscript{134} \textsc{Friedman, supra} note 117, at 137-60, esp. 139-40; \textsc{Posner, supra} note 133, at 346-48; W. \textsc{Gellhorn}, \textsc{Individual Freedom and Governmental Restraints} 106 ff (1956). \\
\textsuperscript{135} \textsc{Freidson, supra} note 115, at 23 ff. Professor Freidson was speaking only of the medical profession, but his analysis need not be limited to that profession. To be sure, the legal profession's power evolved from the lawyers' control over access to the courts which apparently originated with a royal writ in 1292. \textit{See also} POUND, \textit{supra} note 114, at 221-350, discussing the decline and resurrection of the American bar during the nineteenth century. \\
\textsuperscript{136} \textit{See} notes 101-24 and accompanying text \textit{supra}. \\
\textsuperscript{137} \textit{See} J. \textsc{Bain}, \textit{Barriers to New Competition} (1956). \\
\textsuperscript{138} \textit{See}, e.g., \textsc{Symposium—Prepaid Legal Services, 27 Baylor L. Rev. 403-68} (1975).
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Artificial barriers to entry are viewed with suspicion, if not antipathy, in other areas of antitrust law, and they should fare no better simply because the barriers have been raised by a profession. An additional problem with restrictions on admission to practice stems from the definition of what constitutes the "practice" of a given profession. In most cases—at least in both medicine and law—this has led to defining as the "practice" a number of services that could be performed adequately by less highly trained persons, presumably at a lower cost. This in turn resulted in the professions' extending their control over related, subordinate occupations. Neither result is necessarily in the public interest; on the contrary, both tend to enhance the amounts expended on those activities defined as "professional."

The professions' claim that only one trained for a profession can adequately evaluate the competence needed for admission to its practice has been disputed. Logically, even a prolonged period of training and a rigorous examination does not insure that the would-be practitioner is either ethical or capable of judging competence. And, although such requirements may insure some minimal level of competence at the date of admission, they do nothing to insure maintenance of an adequate level of competence. Finally, as Professor Freidson notes (speaking of the medical profession), neither the expertise nor the expert has been examined with sufficient care to allow an intelligent formulation of the proper role of the expert in a free society. Expertise is increasingly susceptible to use as a mask for privilege and power, rather than as a mode of advancing the public interest.

The "unprofessional" solicitation of business and the performance of unnecessary services are other concerns of those who fear abolition of re-

139. Alcoa's erection of artificial barriers to entry in the domestic aluminum market was a major factor in Judge Learned Hand's finding that Alcoa had illegally monopolized the relevant market. United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945). See also United States v. United Shoe Machinery Corp., 110 F. Supp. 295 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954), in which Judge Wyzanski emphasized the barriers to entry created by United Shoe's "lease only" policy.

140. FRIEDMAN, supra note 117, at 150-57; POSNER, supra note 133, at 346-47.

141. FRIEDMAN, supra note 117, at 150; FRIEDSON, supra note 115, at 47-70. The legal profession is now confronting the problem of the paralegal assistant and his place in the profession. See Wall Street Journal, Friday, Nov. 14, 1975, p. 38, col. 1. The legal profession has also engaged in running disputes with realtors and title companies concerning the status of drafting real estate documents as unauthorized practice of law, State Bar of Arizona v. Arizona Land Title & Trust Co., 90 Ariz. 76, 366 P.2d 1 (1961), and with accountants and various other groups whose activities occasionally intrude on what the lawyers consider to be their "turf." This is reminiscent of the disputes between doctors (M.D.) and chiropractors, osteopaths, and others. Cf. FREIDSON, supra note 115, at 29-30; Rayack, supra note 90, at 716-17.

142. FRIEDMAN, supra note 117, at 147-48, 150-60; POSNER, supra note 133, at 347-48; FRIEDSON, supra note 115, at 337-40.

143. FRIEDSON, supra note 115, at 397.
Restrictions on entry into the professions.\textsuperscript{144} Even if there is a danger of unethical behavior which is somehow avoided by restricting entry, such problems can be better handled through disciplinary actions. The weakness in the "unnecessary services" argument is that the professions, especially medicine and law, perform essentially consultation functions. Professionals do not go into the street, lasso clients, and force services upon them; instead, they depend on the clients to come to them if they think they have a problem.\textsuperscript{145} It may be true that an underworked surgeon, for example, may decide to operate when other treatment would be preferable. Nevertheless, some client must bring the problem to him in the first instance. Although "elective" or "cosmetic" surgery may not be necessary to maintain life or health, presumably the patient considers it important enough to undergo it. As long as he does not prevent a sick person from obtaining treatment or otherwise endanger the patient, there is no reason why a doctor should deny him help.\textsuperscript{146} As Professor Friedson points out,\textsuperscript{147} where the terms of work make diagnosing and treating illness more profitable, more illness will be found. Similar comments can be made about other professions. If there are abuses of this type, disciplinary remedies are or should be made available.

Friedman characterizes licensure as the American Medical Association's means of dominating the medical practice and opines that the results have been progressively less adequate medical treatment for the public and a stifling of innovation in the methods of delivering health care.\textsuperscript{148}

\textsuperscript{144} \textit{Friedman}, supra note 117, at 152, points out that this is objectionable on both ethical and factual grounds: the argument that the professions must limit entry so that their members will earn an adequate income and therefore not have to resort to unethical practice amounts to saying that the professions must be paid to be ethical. If that is so, Friedman notes, it is doubtful that the price would have any limit.

A similar argument—that an excessive number of people trained in surgery leads to unnecessary operations—is advanced by the American College of Surgeons and the American Surgical Association to justify their proposal for a drastic cut in surgical residencies. Presently 2500-3000 new surgeons per year are trained. These organizations have called for a reduction of about one-third in the number of residencies (to a level sufficient to produce 1600-2000 surgeons per year) and the restriction of hospital surgical privileges to "board certified" or "board qualified" surgeons (those who have completed an extended residency in surgery and become, or are ready to become, "diplomates" of an appropriate specialty board). At present, the grant of surgical privileges is not restricted to board certified or qualified surgeons, but is available (in the discretion of the particular hospital) to any licensed M.D. or D.O.

\textsuperscript{145} \textit{SOSSUS}, supra note 124, at 81-90.

It is true that Carlin's studies of the metropolitan Chicago and New York bars indicate that those lawyers at the lowest level of the profession, where competition is most fierce, are most likely to violate ethical proscriptions. Carlin, supra note 118.

\textsuperscript{146} \textit{SOSSUS}, supra note 124, at 89-90, discussing "unnecessary operations."

\textsuperscript{147} \textit{Friedson}, supra note 115, at 359.

\textsuperscript{148} \textit{Friedson}, supra note 117, at 150-60, emphasizing the AMA's opposition to group health and prepaid health plans. See also Comment, \textit{The American Medical Association: Power, Purpose and Politics in Organized Medicine}, 63 \textit{Yale L.J.}
Although the medical profession has received more hostile publicity, logic does not require limiting such criticism to that profession.\textsuperscript{149} Licensing contributes strongly to the structures of the professions, which influence their work.\textsuperscript{150} Perhaps some relaxation of the barriers to entry into the professions, and a resulting whiff of competition, would profoundly revolutionize the methods of providing services to the benefit of the public.

The courts need not be concerned that the restrictions on entry to the professions are hallowed by the passage of time. It is true that the legal profession has exercised considerable control over access to the courts for centuries,\textsuperscript{161} but its influence has not been consistent.\textsuperscript{152} In fact, as of 1886, only 50 percent of the states licensed attorneys.\textsuperscript{183} Regarding other professions, 50 percent of the states did not license dentists until 1887, nor physicians until 1894.\textsuperscript{154} Thus, no long-established tradition of professional autonomy existed at the time the Sherman Act was adopted. There is scant reference to the professions in the legislative history of the Act, but one debate between Senators Edmunds and Hoar (two of the principal draftsmen), does suggest that those gentlemen thought that associations of professionals would not be treated any differently from other occupations, at least with respect to price-fixing.\textsuperscript{155} The relevance of legislative history may be questioned, because conceptions of the role of competition do change with time, but the fact remains that Congress did not exempt professional licensing. In the absence of any such declaration, courts should be loath to find any implied exemption.

Professional licensing is probably the most appealing case for the "state action" exemption.\textsuperscript{156} However, this should not automatically exempt licensing from coverage by the Sherman Act. Rather, courts should feel free to make a detailed examination of the effect of the restriction and condemn it if it is anticompetitive.

The issues involved in professional licensing do not lend themselves to per se treatment, notwithstanding the serious anticompetitive effects

\begin{thebibliography}{99}
   \item 938 (1954); Comment, Medical Societies and Medical Service Plans, 22 U. CHI. L. Rev. 694 (1955).
   \item 149. See, e.g., Carlin's studies, cited in note 118 supra.
   \item 150. FREIDSON, supra note 115; see also Carlin's studies, supra note 118.
   \item 151. See note 114 supra.
   \item 152. See POUND, supra note 114.
   \item 153. Moore, The Purpose of Licensing, 4 J. LAW & ECON. 93, 102 (1961); see also Stigler, The Theory of Economic Regulation, 2 BELL J. ECON. & MGT. SCI. 3 (1971).
   \item 154. Moore, supra note 153, at 108, table 3.
   \item 155. See note 69 supra.
   \item 156. See notes 80-100 and accompanying text supra.
\end{thebibliography}
of barriers to entry. In analyzing such a case, the courts should consider, among other things, the following: the purpose of the licensing requirement; the adequacy of the regulation (whether it is comprehensive regulation of conditions of entry and exit, rates, etc., or merely a barrier to entry to protect the economic interests of members of the profession); the nature of the regulatory body (whether it includes adequate representation of the public interest or is solely controlled by members of the profession); and the effect of the restriction (whether it promotes the public interest or only that of the profession). This inquiry requires a legislative determination, rather than a judicial one. Only that branch can adequately consider the conflicting interests involved and arrive at an acceptable solution. Congress has chosen to do so in other areas, and should act here also, if it believes an exemption to be necessary. Unless and until Congress does act, however, the courts should not hesitate to confront the difficult questions presented. Considering the complexities involved, perhaps the courts should adopt a presumption against such barriers to entry and place the burden of justifying an exemption on the professions.

B. Admission to Professional Education

Closely related problems are presented by restrictions on admission to professional education. If specialized training is a precondition to licensure, and such training must be conducted in institutions accredited by the profession, membership in the profession can be effectively restricted by limiting the enrollment of the training institutions. Of course, the justification again is the need to insure the adequacy of the technical training of the new entrants to protect the public welfare. Indeed, several commentators have noted that this, rather than licensure itself, is the point at which the American Medical Association exercised its influence to restrict the number of physicians.\textsuperscript{157} The legal profession, if it has tried this method at all, has been markedly less successful, because law schools presently are turning out about twice the number of graduates as the

\textsuperscript{157} Rayack, supra note 90, at 671-76; FRIEDMAN, supra note 117, at 150-55; Comment, \textit{The American Medical Association: Power, Purpose and Politics in Organized Medicine}, 63 \textit{YALE L.J.} 998, 971-72 (1954). In fairness, it should be noted that the number of approved medical schools has expanded from 79 schools with a total enrollment of 26,186 and 6,185 new graduates in 1950-51, to 112 schools with a total enrollment of 47,546 and 10,391 new graduates in 1972-73. \textit{AMERICAN MEDICAL ASS’N, SOCIOECONOMIC ISSUES OF HEALTH} 186, table 64 (1974). However, there are many more applicants for medical training than can be accommodated. In 1972-73, 36,135 applied for admission to medical school; 13,352 new entrants were accepted. \textit{COORDINATED COUNCIL ON MEDICAL EDUCATION, PHYSICIAN MANPOWER AND DISTRIBUTION: THE ROLE OF THE FOREIGN MEDICAL GRADUATE} 25, table 6 (1975) (this is a preliminary report, subject to approval by the five parent bodies of the CCME). At least partly as a result of the limitation on American medical graduates, 7,419, or 44.5 percent of the 16,689 total licensees representing additions to the medical profession in 1973 were graduates of foreign medical schools. \textit{Id.} at 21, table 2.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
number of legal openings.158 The American Bar Association apparently has not attempted to limit the number of accredited law schools. Nonetheless, many would-be lawyers are turned away, largely because of funding limitations imposed on law schools.159

Before one runs to the barricades to demand abolition of restrictions on professional education, one should consider other factors. For example, how much of society's resources should be expended in training professionals? The question is in terms of society's resources, because few if any professional schools are wholly self-sustaining. In 1972 it cost society from $16,300 to $26,400 per student per year to train medical students, without considering the costs of internship and residency training.160 By comparison, legal training is a bargain, costing only about $1,300 per student per year.161 Other professionals presumably fall somewhere between these two extremes. Such comparisons are admittedly inexact because of differences in the type and amount of training involved, but obviously society expends a great deal more in training a physician than an attorney or others who do not require graduate or professional training. Clearly, a judgment as to the numbers of each profession society needs, and is willing to pay for, is required. Again, such a judgment is properly a legislative responsibility.

Certainly, there is a public interest in maintaining adequate standards in professional training. The defect in the present system is that the task of determining and applying the standards is left to members of the affected professions, whose economic self-interest may influence their performance. That could be remedied by placing the responsibility for accreditation and admission standards for professional training institutions in an administrative body, constituted so that responsibility for policy formulation falls on persons not in the profession. Of course, such a body could draw on the expertise of the profession through an advisory body. Care would be required to insure that the professionals' role was advisory only.162 Ideally, the establishment of such a system should be part of a

158. Although the Department of Labor projects annual requirements of 16,500 law school graduates for the period 1972-1985, U.S. DEPT. OF LABOR, BUREAU OF LABOR STATISTICS, OCCUPATIONAL MANPOWER & TRAINING NEEDS, Bull. No. 1824, p. 38 (1974), 43,798 persons took a bar examination in 1974. Of these, 35,396 were taking a bar examination for the first time.44 THE BAR EXAMINER 115, 117 (1975). The number actually entering practice is unknown, because some persons pursue a career in business or politics after admission to the bar.

159. See note 144 supra. Many law schools have been forced to limit the size of entering classes because of constraints on physical plant and numbers of authorized faculty positions. As a result, the ratio of applicants to admittees seems to run about 7 or 8 to 1.


162. Cf. Rayack, supra note 90, at 717-18; Freidson, supra note 115, at 363-68.
carefully considered, comprehensive, and legislatively formulated national policy for the professions.

One should bear in mind, however, that any attempt to impose such regulation on the numbers of persons to be trained for each of the professions carries the danger of centralized direction as to career choice and location for practice. At present, such decisions are left to the individual, who presumably reaches them on the basis of economic and personal factors. This arrangement has resulted in a tolerably adequate coverage of the professions. If it is determined to limit the number of training spaces for any of the professions, there is a danger that certain areas of the country, or certain specialized skills, may lack even minimally adequate coverage. There would then be strong pressure to alleviate such an imbalance by some form of governmental action: perhaps initially by persuasion—e.g., offering economic inducements such as forgiveness of student loans, assistance in establishing a practice, etc., but ultimately by fiat if necessary. This begins to sound rather Orwellian.

The fact remains that, in the absence of any coherent national policy, such decisions are in effect being made today by essentially private organizations—the societies which accredit professional schools and the school administrations which are forced to limit enrollments due to budgetary considerations. The situation thus cries for legislative determinations of the extent of public support such training should receive and of the extent to which the strictures of the Sherman Act should apply to admission to professional training. In the event that Congress does not act, a court will be confronted with precisely the same issues as those presented by professional licensure. Limitations on professional training in some areas constitute insurmountable barriers to entry. There is less justification for restrictions at this level than at the level of licensure. Therefore, any involvement by professionals in imposing such restrictions (as by unduly stringent accrediting standards, pressure on professional schools to limit enrollment, etc.) would appear to constitute a combination or conspiracy in restraint of trade. One must concede, however, that it will be more difficult to establish involvement of the professional associations in this area than in others.

C. Professional Discipline

Determining when a person, once admitted to a profession, should be expelled for incompetence or breach of ethical standards is closely related to the two areas just discussed and is equally problematic. It would

163. See SOSSUS, supra note 124, at 82:
. . . [A] free system of career choice and location for practice has resulted in a remarkably widespread distribution of surgeons in the United States. While there are some regional inequities, and one might consider some of the specialties overpopulated, the overall distribution of surgeons would be very difficult to improve by forcible constraint, obligatory service, or penalties for failure to follow legal directions.
do no good to invalidate the licensing restrictions if the profession could reconstruct them through the device of bringing disciplinary proceedings against the nonconformist. Also, the same conflict of interest considerations are present. Other professionals might initiate disciplinary proceedings against aggressive competitors, as in *Semler v. Oregon State Bd. of Dental Examiners*.164

Today, professional discipline seems to be more discussed than affected. The legal profession has been criticized for formally disciplining very few violators. It has been noted that the public visibility of the offense is the principal factor in determining the severity of the official sanction imposed. A person operating in the fringe area of the profession is far more likely to be disciplined, and to be disciplined more severely, than is the member of a profession's elite group. These observations suggest that the function of formal controls has been to forestall public criticism of the profession.166 It has also been said that the medical profession's hypothesized profession-wide sense of responsibility is manifested almost entirely in its standards for training and admission. Even in well-organized work settings in which there is ample opportunity for observation and regulation, there is little effort to exclude an offender from practice. Instead, the characteristic mechanism of control is the personal boycott, in which a physician stops referring his patients to the offender and refrains from consulting him. This results in a lack of any effective internal regulation.166

The professions are also criticized for an apparent reluctance to initiate or testify in malpractice actions.167 These symptoms may merely reflect the "There, but for the grace of God, go I" syndrome, or they may reflect a natural hesitance to second-guess the judgment of a colleague who may have made difficult decisions under pressure with less complete information than hindsight provides. Nevertheless, the public needs protection from the incompetent and unethical practitioner. Problems arise when the procedures adopted for that purpose are shrouded in secrecy, when the standards followed are not clearly articulated, and when the decisions are arrived at through procedures neither comporting with traditional notions of due process nor guaranteeing even-handed application to all practitioners. Leaving responsibility for such matters entirely with the profession means that either the discipline will not be administered—as is the case at present—or that it may be administered in accordance with the prejudices and predilections of the profession: the iconoclast is expelled, but the pillar of the profession gets a slap on the wrist.

Again, the ideal solution might be to establish a board independent of the profession, or at least having strong public representation. Until

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164. See notes 176-178 and accompanying text *infra.*
166. FREIDSON, supra note 115, at 161, 190-99.
such a board is created, courts must evaluate each challenge on its particular facts, striking down those practices which appear to be motivated by anticompetitive considerations.

D. Specialization

Admittedly, specialization can enhance the efficient and productive use of resources. It can also be anticompetitive, and therefore more costly to society, to the extent that others are prevented from practicing in the area of the specialty.\footnote{168}

The medical profession has developed specialization to a greater degree than other professions. Certification as a specialist is controlled by the members of the specialty. Certificates are granted on the basis of completing a prescribed course of residency at a teaching hospital and passing an examination administered by the certifying agency.\footnote{169} Neither state licensing laws nor the ethics of the profession, however, preclude any licensed doctor from holding himself out as pursuing a particular specialty.\footnote{170} Although some hospitals might restrict certain privileges to persons having board certification.\footnote{171} Also, one who holds himself out as a surgeon and who is sued in a malpractice action will be held, by most courts, to the standard of care of board-certified practitioners of that specialty.\footnote{172} Thus, there are powerful incentives for one to restrict his activities to fields in which he has been certified.

The legal profession is just coming to grips with the question of recognizing specialties, although a certain amount of de facto specializa-

\footnote{168. See, e.g., Mindes, Lawyer Specialty Certification: The Monopoly Game, 61 A.B.A.J. 42 (1975); Rayack, supra note 90, at 708-16.}

\footnote{169. Telephone conversation with Dr. Jack M. Colwill, Associate Dean of the Medical School at the University of Missouri-Columbia, May 5, 1975; memorandum of call in writer's files.}

\footnote{170. Id. There are presently 94,000 physicians active in surgical work. Of these, 52,000 are either board certified or board qualified (having completed a residency and undergone board examination), and 12,000 are residents in surgery. The remaining 30,000 active in surgery are neither board certified nor qualified. SOSSUS, supra note 124, at 27, table 4.

171. Indeed, the SOSSUS report, having concluded that a pool of 50,000 to 60,000 board certified surgeons plus about 10,000-12,000 interns and residents would be sufficient for surgical care in the United States for the next 40-50 years, SOSSUS, supra note 124, at 22, recommends restricting the grant of hospital surgical privileges to board-certified or board-qualified surgeons, with, of course, a "grandfather" clause for those "older persons who have demonstrated long service in their communities as effective surgical specialists." Id. at 83. The grant of hospital privileges is apparently a local decision, at least initially. Freidson, supra note 115, at 138; Rayack, supra note 90, at 701. However, because the same committee that accredits medical schools also accredits hospitals, and hospitals must be accredited in order to get the interns they need for their house staffs, the profession can exert considerable pressure on the hospitals, and might use that pressure for anticompetitive purposes. Rayack, supra note 90, at 663-65.

tion has existed for some time—especially in areas such as tax, securities, and antitrust. Much of the current furor seems to revolve around the degree to which one can advertise his specialty, which is a part of the advertising problem, to be discussed below. However, many proponents of legal specialization have couched their arguments in terms that raise the specter of exclusivity.\textsuperscript{173}

If specialization in any profession has the effect of exclusivity, the public interest in ready availability of services at reasonable prices will suffer. Paraphrasing an example given by Professor Friedman,\textsuperscript{174} it would be comparable to saying that, if a Cadillac is the best car produced in the United States, then no other cars should be manufactured; all should be compelled to buy Cadillacs. There ought to be room for one to employ a Ford lawyer, if he so chooses. Again, ideally, the standards for specialization and the limitations imposed on the remainder of the profession should be scrutinized closely for anticompetitive effect by some group outside the profession, and any attempt to make the specialities exclusive should be suspect.

E. Advertising

The professions' ethical restrictions on advertising have been successfully challenged on grounds other than their anticompetitive impact.\textsuperscript{175} Currently, the Justice Department is bringing the first suit challenging such proscriptions on antitrust grounds.\textsuperscript{176} The action is against the American Pharmaceutical Association and the Michigan State Pharmaceutical Association, charging them with conspiring to restrain competition by adopting codes of ethics barring their members from advertising retail prescription drug prices. The Federal Trade Commission has proposed regulations which would invalidate state and local laws barring advertising of prescription drug prices, but these regulations are not expected to become effective until sometime in 1976.\textsuperscript{177} The FTC is also investigating state laws and professional codes prohibiting price advertising for eyeglasses and contact lenses.\textsuperscript{178}

The stage is thus being set for a reconsideration of the question presented in \textit{Semler v. Oregon State Board of Dental Examiners},\textsuperscript{179} which was cited with approval by the \textit{Goldfarb} Court.\textsuperscript{180} The plaintiff in \textit{Semler} had been a licensed dentist for seventeen years and had built up a large practice by extensive advertising in newspapers and periodicals and with neon signs and billboards. He displayed teeth and bridgework in his advertisements. He also employed solicitors: He advertised free examina-
tions, quoted prices for various types of work, and guaranteed his work. Plaintiff sought to enjoin enforcement of an Oregon statute, which authorized revocation of a dentist's license for advertising of this sort, on the basis that it violated the due process and equal protection clauses of the fourteenth amendment, and the impairment of contracts clause of Article I, Section 10, of the Constitution. The Supreme Court sustained the law on the ground that the states have the power to regulate such professions in order to insure competence, to prevent the public from being misled by deceptive advertising, and to keep the profession from being "demoralized" by forcing its members into an "unseemly rivalry which would enlarge the opportunities of the least scrupulous."

One must offset against the need for protecting the public from deceptive advertising and the profession from "demoralization" the public interest in free and open price competition. In most areas of the economy, this is believed to be the optimum system of regulation. It is not precisely clear why it should not also be optimum in the professional areas. Additionally, the public has an interest in being able to learn easily which practitioners concentrate in particular fields, and to compare prices for the same services without the need to telephone or visit several practitioners. Perhaps most persons are more concerned about the qualifications of the professional who takes care of them than they are about his charges, but those for whom price is a factor should be able to make such comparisons without artificial hindrances.

The problem of deceptive or misleading advertising is by no means unique to the professions. The Federal Trade Commission is already active in requiring substantiation of advertising claims in normal commercial matters. There is no reason why the FTC, or some other body, could not assume such responsibilities for the professions as well. Furthermore, the public is probably a good deal more sophisticated today than it was in 1936. The consumer is no more likely to be taken in by the outlandish blandishments of the least scrupulous professional than he is by those of the television hawker of used cars.

In short, restrictions on advertising are similar to fee schedules in that they tend to reduce price competition—here by making it more difficult for the consumer to make comparisons. As such, they should be equally vulnerable to antitrust challenge. It appears that further clarification of this problem will not be long in coming.

F. Multistate Practice

All occupations requiring a license to practice have limitations on multistate practice. A typical statute provides:

181. 294 U.S. at 612.
182. The American Bar Association has recently amended the Code of Professional Responsibility by expanding the scope of permissible advertising. Wall Street Journal, Wednesday, February 18, 1976, p. 6, col. 3.
It shall be unlawful for any person not now a registered physician within the meaning of the law to practice medicine or surgery... in this state. . . . The terms "physician" [and] "surgeon" . . . should be construed to mean physicians and surgeons licensed under this chapter. . . .

This has the effect of creating a barrier against out-of-state practitioners. To its credit, the medical profession appears to be quite flexible in this area. As of September 1, 1974, only the Virgin Islands had no reciprocal arrangement for "endorsing" certificates granted in other jurisdictions. Most states have such reciprocal arrangements with virtually all other states, although in some states such arrangements are subject to the discretion of the Medical Licensing Board.\(^\text{185}\)

The legal profession ameliorates this problem through the device of admission \textit{pro hac vice}, admitting a "foreign" attorney for a particular matter upon the motion of, and often in association with, a local attorney. Such admissions are, however, discretionary with the court. There is no guarantee that I can be defended by an out-of-state lawyer if I should be charged with murder in Missouri. There may have been a need for such restrictions in the legal profession in former years, when the states had differing procedural rules and widely divergent case law in some areas. However, the growth of uniform laws, the adoption of court rules patterned on the federal rules, and particularly the improvement in research aids undermine any justification for limitations on multistate practice. There is no justification for territorial limitations in the other professions. Disease does not recognize state boundaries, nor do methods of treatment, nor do ideas. Thus, those who would sustain such restrictions in the face of antitrust attack should be compelled to bear a heavy burden of proof.

**V. Conclusion**

The Goldfarb decision is welcome because it finally puts to rest the notion that the professions are somehow above and beyond the Sherman Act. Unfortunately, in its understandable attempt to rule narrowly, the Supreme Court has left a number of ambiguities which future litigation must clarify. This writer believes these ambiguities should be resolved in favor of the broadest possible interpretation of the Sherman Act, because that appears most likely to promote the public interest in the long run. Thus, the Commerce Clause should be read expansively to permit the Sherman Act to reach any professional activities having any effect on interstate commerce. \textit{Parker v. Brown}, on the other hand, should be read narrowly. Restrictions on professionals should be condoned as "state action" only where the state regulation is pervasive, and only then if the regulatory body is controlled by public representatives, not the profession.

\(^{184}\) §§ 334.010, .021, RSMo 1969.
\(^{185}\) COUNCIL ON MEDICAL EDUCATION OF THE AMERICAN MEDICAL ASS'N, MEDICAL LICENSURE STATISTICS FOR 1973 38-39, App. Table 2 (Sept. 1, 1974).
Many activities of professionals and professional associations besides fee schedules should be subjected to antitrust scrutiny. In evaluating such practices, the federal courts should, in the absence of congressional action, apply the same standards that are applied to other occupations.

One can legitimately question the appropriateness of using antitrust principles to regulate professions. These principles were developed in other contexts, probably without considering the impact which they may have in the peculiar circumstances of professional activities. Certainly, application of rules developed in commercial contexts to professional activities may have unforeseen and unintended results, some of which may not be socially desirable. The current wave of suits against professional organizations may be a resurgence of the nineteenth century populist, egalitarian effort to deprofessionalize the professions and open them to all. Conceding the validity of these concerns, the fact remains that the question whether the antitrust laws ought to apply to the professions is one for Congress. The Supreme Court has held—correctly, I think—that the Sherman Act applies to the professions. If the circumstances of the professions warrant different treatment, only Congress is in a position to make the necessary policy judgments. Congress has shown no hesitation about exempting other types of activities when it believed it desirable. Unless and until Congress acts, the federal courts have no choice but to evaluate professional practices according to developed Sherman Act doctrine.

There is a need for a national policy on the professions and their roles in society. Such a policy should emanate from Congress, but Congress will need a great deal of input from professionals, academics, and lay representatives. In particular, there is a need for further studies similar to those done of the legal profession by Carlin, and of the medical profession by Freidson and others. We need to know more about the internal

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186. In a slightly different context, Professor Handler has pointed out that the net result of every consent decree enjoining real estate boards from publishing suggested rate schedules has been an increase, rather than a decrease, in real estate commissions. Handler, Antitrust—Myth and Reality in an Inflationary Era, 50 N.Y.U.L. Rev. 211, 230 (1975). Therefore, it is not certain that application of antitrust principles to the professions will improve the quality or quantity of services rendered the public.

187. Pound, supra note 114, at XXVII, 221-49, points out that the low point of the legal profession (pre-Watergate) was from 1836 to 1870. Many states enacted legislation eliminating or greatly reducing the requirements of formal training for admission to the bar. Pound ascribes the reemergence of professionalism in part to the development of bar associations, beginning about 1870.


189. See also C. GILB, HIDDEN HIERARCHIES: THE PROFESSIONS AND GOVERNMENT (1966), for an analysis of the effect the professions' political lobbying has exerted on their status.
and external relationships of the professions in order to formulate a coherent policy and establish fair and enforceable standards. Much has been written by sociologists and others, but too little of this is known within the professions.

It may seem anachronistic to suggest expansion of regulation into professional fields at a time when there is considerable public interest in "deregulation." It is true that regulation has a distressing tendency to become pervasive and extend far beyond its original boundaries. In addition, the track record of government intrusions into commercial fields has not been overwhelmingly successful. Although there is already extensive regulation of the professions, it is done by private organizations which work more for the benefit of the profession than the public. If there are to be restrictions on the professions, it would be far better to have them imposed by a politically responsible body in which the decision-making power is vested in public members, rather than in professional "experts."

Rather than develop such an elaborate administrative machinery, it might be preferable to rely on a vigorous, literal application of the Sherman Act to professional practices. The bodies charged with enforcing the antitrust laws, the Justice Department and the Federal Trade Commission, are already acquiring expertise in reviewing professional activities and challenging those activities thought to be most serious. Such an approach places the greatest responsibility on the free market system, allowing the government to challenge deviations from that system. But, if this is to work, given the limitations on budget and manpower of the enforcement agencies, the professions will have to cooperate by taking a long, introspective look at themselves and discarding those aspects of professional practice which may be anticompetitive. In the meantime, courts should feel free to condemn ruthlessly anticompetitive practices.
Comments

COVENANTS NOT TO COMPETE—ENFORCEABILITY UNDER MISSOURI LAW

I. INTRODUCTION

Our economic system, much like our legal system, is a synthesis of concepts that have proven their worth over many centuries. The heart of a capitalistic system is competition. We depend on it to regulate supply and demand which in turn sets prices and determines the optimum division of labor. However, the common law quickly discovered that there were certain types of "unfair competition" that could not be tolerated if the economic system was to function properly. As a result, certain practices were declared by the courts to be illegal per se.\(^1\) In many other situations, the courts have left it to a party to protect himself by means of a restrictive covenant.\(^2\) This comment will discuss the enforceability of such covenants and in particular those made ancillary to the sale of a business or to an employment contract. Emphasis will be placed on the Missouri law in this area and the factors which should be considered in drafting such a covenant.

II. HISTORICAL DEVELOPMENT

The covenant not to compete has not always enjoyed the respectability, or at least tolerance, that it is accorded today. In the *Dyer's Case*\(^3\) a dyer of cloth agreed that he would not practice his craft in a certain town for six months. The medieval judge called on to enforce the contract was astounded, declared it void, and stated: "By God, if the plaintiff were here he should go to prison until he paid a fine to the king."\(^4\) The necessity of a long apprenticeship, the difficulty of travel, and the scarcity of skilled workmen made enforcement of such contracts unthinkable.\(^5\)

Over the centuries, the common law recognized a growing need for such covenants. The early cases applied mechanical tests for determining

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1. Trade secrets, for example, have been protected against appropriation by former employees even in the absence of a prohibitory covenant. Likewise, courts will enjoin the use of customer lists of a former employer. *See* 2 R. Callman, Unfair Competition, Trademarks and Monopolies §§ 52.1, 51.2 (c), 54.2 (c) (2) (3d ed. 1968).

2. Thau-Nolde, Inc. v. Krause Dental Supply and Gold Co., Inc., 518 S.W.2d 5 (Mo. 1974), indicated the possibly disastrous consequences of failing to provide the protection afforded by covenants not to compete.


4. Id.

5. See Arthur Murray Dance Studios v. Witter, 62 Abs. 17, 23, 105 N.E.2d 685, 691 (C.P. Ohio 1952), for a discussion of the factors existing at that time which made the covenant unreasonable.
the validity of "contracts in restraint of trade." Mitchell v. Reynolds was the first case to impose reasonableness as the standard for determining the validity of covenants not to compete and to place upon the draftsman of the covenant the burden of showing that the restraint was reasonable. However, Mitchell did not completely abandon the older mechanical tests and stated that a covenant containing a general restraint—i.e., one unlimited as to time and/or space, was void regardless of the circumstances.

Even prior to Mitchell, the cases treated covenants protecting an employer from unfair competition by a former employee differently from those which attempt to protect the purchaser of a going business. One issue debated today is whether there really is a valid distinction justifying separate treatment. It appears that the "snow-balling weight of authority" does recognize a difference, and as a result courts are prone to look with less indulgence on covenants ancillary to a contract of employment than on those accompanying the sale of a business. This judicial discrimination takes one of two forms. First, a court may require more justification for the former type of covenant before finding it to be reasonable. Alternatively, the court may declare the restraint to be reasonable, but require greater proof of irreparable harm before granting an injunction. Missouri courts have used both methods to show what appears to be a greater dislike for covenants ancillary to employment contracts.

However, in Haysler v. Butterfield a Missouri appellate court seemed to favor abandonment of the distinction, stating: "[T]he ultimate question should be the same in both cases—what is necessary for the protection of the promisee's rights and is not injurious to the public."

8. Id. at 349. The covenantee was forced to assume the burden to prevent what the court termed the "mischief" caused by such restraints, namely, possible loss of the employee's means of earning a livelihood, loss to society of the services of a useful member, and possible monopolization.
10. See Blake, supra note 6, at 630-32. But see Long v. Towl, 42 Mo. 545 (1868), and Mitchell v. Branham, 104 Mo. App. 480, 79 S.W. 739 (St. L. Ct. App. 1904), in which general restraints were stated to be ipso facto void.
11. Blake, supra note 6, at 637-38.
14. In Renwood Food Products, Inc. v. Schaefer, 249 Mo. App. 939, 223 S.W.2d 144 (St. L. Ct. App. 1949), the court stated that a covenant would not be enforced merely because of competition by the former employee, but also required a knowledge of trade secrets or an influence over customers of the employer. In Jaccard Jewelry Co. v. O'Brien, 70 Mo. App. 432 (St. L. Ct. App. 1897), it was held that a court of equity would not enjoin a breach of a contract for personal services unless the services rendered were unique, individual, and peculiar.
The essence of the distinction between covenants in employment contracts and those accompanying the sale of a business is the effect of the restraint on the covenantor. In the former there is seldom equal bargaining power between the employee and the employer. As a practical matter, the prospective employee is forced to sign what is placed before him and receives no extra compensation for executing his covenant not to compete. In many cases employees have been required to sign such agreements as a condition of their continued employment. Because the employee is in no position adequately to protect his future, the courts have done so by requiring the employer to assure the court that enforcement of the covenant will not result in an undue hardship on the employee. Such concern is not as necessary for the seller of a business. He is in a much better position to bargain than an employee and often a significant portion of the price he receives is attributable to his agreement not to compete. Thus a distinction does exist between the two types of covenants which may justify different treatment in certain circumstances.

III. REASONABILITY AS A STANDARD

As a result of the decision in Mitchel v. Reynolds, the "rule of reason" was forever imprinted upon covenants not to compete. Reasonableness, like beauty, is in the eye of the beholder. Courts have given the term various definitions. In Presbury v. Fisher the Missouri Supreme Court was first asked to decide whether a covenant against competition was void as an unreasonable restraint of trade. The court cited only Mitchel and upheld the covenant, stating:

The liberality of our laws, in suffering every man to engage in any trade or occupation he may think best, without any previous apprenticeship, has blunted our perception of the utility of the principle which avoids contracts made in restraint of trade.

In taking this laissez-faire attitude, the court seemed to approve the use of broad covenants not to compete. This is evidenced by the fact that another case on the subject was not brought before the court for fifteen years. In Long v. Towl the Missouri Supreme Court gave its first interpretation of the rule of reason, indicating a partial retreat from its position in Presbury:

17. See pt. V of this comment, infra.
18. See, e.g., R. E. Harrington, Inc. v. Frick, 428 S.W.2d 945 (St. L. Mo. App. 1968); City Ice and Fuel Co. v. Snell, 57 S.W.2d 440 (St. L. Mo. App. 1933).
20. 18 Mo. 50 (1853).
21. Id. at 51-52.
22. The court in Presbury went on to state:
If there is an opening for any trade or business, how little is the community affected by the agreement of one that another should not engage in it, when it is free for all others.
Id. at 52.
23. 42 Mo. 545 (1868).
The prohibition should not extend any further than will fully protec
t the party for whose benefit the contract is made in his occupa-
tion or business. If the prohibition extends beyond this, it is an un-
reasonable restraint of trade, and will render the contract void.24

The early Missouri cases which followed, although attempting to
apply the rule of reason, established rather mechanical tests. One of
these tests was the general restraint-partial restraint distinction. It was
assumed that a restraint limited as to time and place was reasonable and
valid and one that was not so limited was void.25 Although some Mis-
souri courts quickly questioned the validity of this absolute rule,26 many
found it a convenient method to reach what was often a reasonable re-
sult.

In 1932 the Restatement of Contracts27 attempted to define the types
of contracts that were reasonable and those that were not. The draftsmen
explicitly rejected the general restraint-partial restraint test28 and let the
reasonableness of the particular restraint turn on the facts of each case.

The difficulty inherent in all attempts to define reasonableness stems
from the concept itself. Reasonableness is not a rule that can be applied
mechanically, but is instead a judicial balancing of conflicting interests.29
Although Missouri courts seem reluctant to abandon certain of the ob-
jective tests,30 a better approach would be to weigh the interests of the
covenantor, the covenantee, and the public, and to determine in light of
this evaluation whether the restraint in question is reasonable. The next
three parts of this comment examine these interests and attempt to ex-
plain their significance.

IV. REASONABleness AS TO THE COVENANTEE

The first interest to be considered in determining reasonableness is
the interest of the draftsman of the restraint. The buyer of an established
business generally acquires the goodwill31 associated with it. This goodwill
is often due in large part to the efforts expended and relationships created
by the individual selling the business. As such, it is susceptible to de-
struction should the seller enter into competition with the buyer. Similarly,
the established business is continually striving to increase its goodwill,
largely through the efforts of employees hired to service old customers

24. Id. at 549.
25. Id. See also Mitchel v. Branham, 104 Mo. App. 486, 79 S.W. 739 (St. L.
 Ct. App. 1904); Mallinckrodt Chemical Works v. Nemnich, 83 Mo. App. 6 (St. L.
 Mo. App. 1899).
26. Peltz v. Eichele, 62 Mo. 171 (1876) (indefinite place); Gill v. Ferris, 82
 Mo. 156 (1884) (indefinite time).
27. RESTATEMENT OF CONTRACTS §§ 514-516 (1932).
28. Id. at § 515, comment c.
29. See Arthur Murray Dance Studios v. Witter, 62 Abs. 17, 105 N.E.2d 685,
 (C.P. Ohio 1952).
30. See, e.g., American Pamcor, Inc. v. Kline, 488 S.W.2d 287 (St. L. Mo.
31. See Whittle v. Davie, 116 Va. 575, 82 S.E. 724 (1914), for a definition of
goodwill.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6

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and secure new ones. Thus competition by a former employee can also deprive the employer of his investment in goodwill. Because of the delicate nature of goodwill, the owner of a business is allowed to contract to protect it much the same as he would contract to insure his plant and equipment. However, just as one seeking insurance must have an "insurable interest" in an asset, one seeking to protect goodwill may not contract for protection beyond its limits. Because the threat of unfair competition is usually limited to a given area for a given period, the factors of time and space are important.

A. Spatial Limitations

As a general rule, a spatial limitation may not exceed the area in which the covenantee has a business interest. Most modern businesses compete within a relatively small area, usually limited to the boundaries of a particular city. It is conceivable that as cities grow ever larger, a covenant restricting competition within a city may be beyond the needs of the covenantee; however, in the past Missouri courts have regarded such restrictions favorably. As businesses grew to encompass larger areas, the territorial extent of a "reasonable covenant" likewise grew. Many covenants have been drawn to prohibit competition within the city limits plus a radius of X miles from the city to protect against suburban competition. Such restraints are also considered reasonable if the draftsman can show that his protectable interest extends to the additional area.

Companies operating in rural areas and those doing business in large metropolitan districts often find it impractical to use municipal

32. Trade secrets are similar to goodwill in that they are essential to achieving and maintaining a firm's competitive advantage over its rivals.
35. "It must appear that such a contract imposes no restraint upon one party that is not beneficial to the other." Long v. Towl, 42 Mo. 545, 549 (1868).
36. Renwood Food Products, Inc. v. Schaefer, 240 Mo. App. 939, 223 S.W.2d 144 (St. L. Ct. App. 1949), held that a covenant would not be enforced merely because of competition by a former employee, but required a showing of factors making such competition unfair.
37. For example, the buyer of a grocery store on the south end of Kansas City would have trouble showing the danger of the seller opening a store in North Kansas City.
38. Gill v. Ferris, 82 Mo. 156 (1884) (Mexico, Missouri); Peltz v. Eichele, 62 Mo. 171 (1876) (St. Louis, Missouri); Mitchel v. Branham, 104 Mo. App. 480, 79 S.W. 739 (St. L. Ct. App. 1904) (Portageville, Missouri).
40. In Thompson v. Allain, 377 S.W.2d 465 (K.C. Mo. App. 1964), the restrictive covenant excluded an optometrist from practicing his profession within 50 miles of St. Joseph, Missouri. The defendant opened an office in North Kansas City, a distance of about forty miles. The court said that miles meant air miles and found the restraint reasonable after finding that defendant had treated 99 of his former patients from plaintiff's clinic in the thirty days before the injunction was granted.
boundaries as spatial restraints.\textsuperscript{41} The convenient alternative is to restrict competition in a given county or counties.\textsuperscript{42} Missouri courts have allowed the use of county boundaries if the draftsman can show that his business extends into any portion of the county.\textsuperscript{43} It appears likely that in some cases the goodwill of a business may extend to a minor portion of a neighboring county. To restrict competition in the total area of that county would be of no benefit to that business and thus seems unreasonable. However, because the Missouri courts have upheld such restrictions in the past,\textsuperscript{44} this alternative may offer the greatest amount of territorial protection for the smaller business.

Because the reasonableness of a spatial restraint is a function of the interests of the business sought to be protected,\textsuperscript{45} a relatively large business is entitled to a relatively large territorial restraint. In addition to the size of a business, specialization may be considered in determining the extent to which a business requires protection.\textsuperscript{46} In Harrington, Inc. \textit{v. Frick}\textsuperscript{47} an unemployment compensation consulting firm required its employees to sign a covenant restricting post-employment competition within any state in which it was engaged in business at the time of the termination of employment. The trial court enjoined two former employees from engaging in any similar business in Ohio, Missouri, and Texas. The employees appealed, claiming that the restrictive covenant was geographically broader than was necessary to protect the employer's legitimate interests. The appellate court held the restrictive covenant "fair to all concerned," considering that the plaintiff, a specialized corporation with a limited clientele, had over 1,900 customers in the three-state area.\textsuperscript{48}

\textit{Harrington} is consistent with the general rule that a large territorial restraint will be upheld if it can be shown that the draftsman's vulnerable interests are coextensive with the forbidden area. Applying this rule, courts have found a worldwide restraint to be reasonable,\textsuperscript{49} and have upheld restrictive covenants covering the entire United States.\textsuperscript{50} However,

\begin{itemize}
\item \textsuperscript{41} For example, the metropolitan area of St. Louis contains over 100 municipalities in Missouri alone.
\item \textsuperscript{42} See Haysler \textit{v. Butterfield}, 240 Mo. App. 733, 218 S.W.2d 129 (K.C. Ct. App. 1944) (county boundaries used to prohibit competition within a metropolitan area); Gordon \textit{v. Mansfield}, 84 Mo. App. 367 (K.C. Mo. App. 1900) (use of a county restriction in a rural setting).
\item \textsuperscript{43} Athletic Tea Co. \textit{v. Cole}, 16 S.W.2d 735 (St. L. Mo. App. 1929).
\item \textsuperscript{44} See cases cited note 42 \textit{supra}.
\item \textsuperscript{45} See text accompanying note 35 \textit{supra}.
\item \textsuperscript{46} House of Tools \& Engineering \textit{v. Price}, 504 S.W.2d 157 (Mo. App., D. St. L. 1973).
\item \textsuperscript{47} 428 S.W.2d 945 (St. L. Mo. App. 1968).
\item \textsuperscript{48} Id. at 950.
\item \textsuperscript{49} See Nordenfelt \textit{v. Maxim Nordenfelt Guns \& Ammunition Co.}, [1894] A.C. 535, aff'g [1893] 1 Ch. 680 (C.A. 1892), in which the court held that a covenant ancillary to the sale of a world-wide munitions firm which precluded the seller from competing in a similar business anywhere in the world was reasonable under the circumstances.
\item \textsuperscript{50} See, e.g., Goodrich \textit{v. Wohlgemuth}, 117 Ohio App. 493, 192 N.E.2d 99 (1963).
\end{itemize}
at least one Missouri case\textsuperscript{51} indicates that by seeking to overprotect his interests the greedy draftsman may lose his protection entirely.

One method of limiting a post-employment restraint so as to be reasonable without having to establish a territorial restraint is to draft a covenant restricting former employees from soliciting clients of their former employer.\textsuperscript{52} Such a restraint appears to be treated as reasonable \textit{per se}, because the goodwill of an employer clearly extends to his current stock of customers,\textsuperscript{53} and the employee is not forbidden from opening a competing business, even "at plaintiff's doorstep."\textsuperscript{54}

Notwithstanding the well-settled case law requiring a spatial limitation to make a covenant reasonable, covenants are often still drafted without such a limit.\textsuperscript{55} Such an omission will result in the invalidation of the covenant.\textsuperscript{56} It is also important to define clearly the extent of the territorial restraint. If an ambiguity exists, the court will construe it against the draftsman and invalidate what may be the most important part of the restraint.\textsuperscript{57} The careful draftsman will make sure that his covenant contains a clear and unequivocal spatial limit. He must also be sure that he is able to show the necessity of the restraint.

B. Time Limitations

The general rules that apply to spatial limitations also apply to time limitations in covenants not to compete. The time restraint may not exceed that period during which the covenantee's goodwill is subject to appropriation by the covenantor.\textsuperscript{58} The reasonableness of a time limitation depends upon the length of this "vulnerable period." The distinction between time and space limits lies in the difficulty of ascertaining objectively the period during which a former employee or owner retains substantial influence over his former customers. As a result, courts seem to be more lenient when considering a time restraint.

\textsuperscript{51} Mallinckrodt Chemical Words v. Nemnich, 83 Mo. App. 6 (St. L. Ct. App. 1899), aff'd, 169 Mo. 388 (1902).
\textsuperscript{52} See Mills v. Murray, 472 S.W.2d 6 (K.C. Mo. App. 1971);
It is universally recognized that an employer has a proprietary right in his stock of customers and their good will and, if otherwise reasonable, the courts will protect this asset against appropriation by an employee by the enforcement of such a restrictive covenant not to compete.
\textit{Id.} at 12.
\textsuperscript{53} See Mills v. Murray, 472 S.W.2d 6 (K.C. Mo. App. 1971).
\textsuperscript{54} \textit{Id.} at 12.
\textsuperscript{55} Prentice v. Rowe, 324 S.W.2d 457 (Spr. Mo. App. 1959).
\textsuperscript{56} [W]e cannot find that the restraint imposed by the first restrictive covenant, wholly unlimited as to area, was reasonable and no greater than fairly required for the protection of [the covenantees] who here seek its shelter.
\textit{Id.} at 461.
\textsuperscript{57} See Athletic Tea Co. v. Cole, 16 S.W.2d 735 (St. L. Mo. App. 1929), in which the court refused to enforce a covenant restricting competition from "Imperial, Mo. and surrounding territory" and limited it to the city of Imperial only.
\textsuperscript{58} See note 35 and accompanying text \textit{supra}.
Missouri courts, although allegedly following a general rule, distinguish between covenants not to compete ancillary to the sale of a business and those ancillary to an employment contract. When dealing with the former, courts are likely to enforce vague, open-ended covenants, and may even imply a time limit where none exists. On the other hand, the latter must have a definite and reasonable duration.

The same result would usually be reached by following the general rule that the scope of a covenant may not exceed the covenantee's business interest. Several cases indicate that it is not unlikely that an individual who had sold an existing business or professional practice could return many years later and establish a competing business, based heavily on residual goodwill. The restraint needed in post-employment situations is usually more limited, because the goodwill retained by an ex-employee is usually more intangible.

Several recent cases involving employee covenants have found a three year time limitation reasonable. Because the three year period is evidently "safe," there is no apparent need to resort to a shorter period. However, a wise employer-covenantee should be prepared to substantiate his need for any post-employment covenant with a term exceeding three years.

V. REASONABLENESS AS TO THE COVENANTOR

The Restatement of Contracts states that a covenant in restraint of trade is unreasonable if it "imposes undue hardship upon the person re-

59. The general doctrine is that agreements in restriction of trade will be upheld when the restriction does not go beyond some particular locality, is founded on a sufficient consideration, and is limited as to time, place and person.


60. Gill v. Ferris, 82 Mo. 156 (1884).


63. Long v. Towl, 42 Mo. 545 (1868). See text accompanying note 23 supra.

64. Gill v. Ferris, 82 Mo. 156 (1884); Gordon v. Mansfield, 84 Mo. App. 367 (K.C. Ct. App. 1900) (doctor returned seven years after selling his practice only to be enjoined by an indignant court).

65. Thau-Nolde, Inc. v. Krause Dental Supply and Gold Co., Inc., 518 S.W.2d 5 (Mo. 1974), is a sad example where even a one-year covenant might have protected a plaintiff who lost most of its employees and customers to a business established by a former employee.


67. This is especially true because Missouri courts have held, in both sale and employment situations, that a court of equity has the power to limit an injunction "to such duration as is necessary to give an employer fair protection of his interest." State ex rel. Schoenbacher v. Kelly, 498 S.W.2d 388, 393 (St. L. Mo. App. 1966).
Covenants Not to Compete

Missouri courts have recognized the existence of such a factor, but have rarely used it to invalidate restrictive covenants. This reluctance may result from a judicial recognition of the mobility of the American people and the assumed availability of comparable employment in another field. In *Haysler v. Butterfield* the court applied this reasoning to the facts before it and stated:

In enforcing the contract no particular hardship will be worked as to the defendants, for they can be employed in any business except that of employment agency and, in that business, anywhere except within the area generally known as “Greater Kansas City.”

Applying such a rationale, it would be hard to envision a situation in which “undue hardship” existed. However, in *Willman v. Beheler* the Missouri Supreme Court, although finding a restrictive covenant reasonable and awarding monetary damages for its breach, denied an injunction, arguably because of “undue hardship.” *Willman* involved a medical partnership agreement whereby the junior partner agreed not to practice medicine in St. Joseph for five years after leaving the partnership. Upon being dismissed, the junior partner continued to practice in St. Joseph for almost five years. The court stated that it would be inequitable to enforce the contract because during the existence of the partnership defendant had become an “established and recognized medical practitioner and surgeon.” It appears that the court believed that the hardship imposed outweighed the covenantee’s need for protection. The same reasoning seems applicable to many potential covenantors who have become expert in a specialized field and would have difficulty finding other employment.

VI. Reasonableness as to the Public

The interests of the public weigh both in favor of and against the validity of covenants not to compete. Freedom to contract in this area is essential in our economy, because without its assurance a prospective buyer might be driven from the “going-business” market and a prospective employer from the labor market. On the other hand, the public policy against attempts to restrain competition has been clearly shown by the great amount of legislation in this area.

68. Restatement of Contracts § 515 (b) (1982).
69. Prentice v. Rowe, 324 S.W.2d 457 (Spr. Mo. App. 1959).
72. Id. at 739, 218 S.W.2d at 131.
73. 499 S.W.2d 770 (Mo. 1973).
74. Id. at 778.

A lawyer shall not be a party to or participate in a partnership or employment agreement with another lawyer that restricts the right of a
The result of the balancing of these conflicting policies is that a restraint on competition will be tolerated only if it is necessary to protect a legitimate business interest. Further public interests can enter into this process, however, resulting in an otherwise reasonable covenant becoming unreasonable and unenforceable. For instance, it has been stated that if a contract tends to create a monopoly or deprive the public of an unusual talent or productive ability, it will not be upheld. Nevertheless, Missouri courts have been reluctant to use such policy arguments to strike down covenants not to compete. Presbury v. Fisher\(^7\) indicates the weakness of such an argument in Missouri:

"[T]here is no practical man who would not smile at the concept that the public welfare would sustain an injury by enforcing an obligation like that involved in the present case."\(^8\)

It is worthy of note that Presbury involved a covenant executed by the seller of a counterfeit detector. Such an enterprise, due to its specialization, seems particularly susceptible to monopolization. Later cases citing Presbury also involved areas where the possibility of monopolization, or at least public injury, was present.\(^9\)

In a relatively recent case\(^8\) the breaching party to a covenant not to compete argued that such covenants violate section 416.040, RSMo 1969, which declares that all contracts that tend to restrain trade are against public policy and void. Although several states have statutes declaring void certain types of covenants not to compete, the Missouri statute has been interpreted only to prevent such things as price-fixing and unlawful combinations, many of which also are forbidden by the Sherman Act.\(^8\)

Thus, in the absence of expanded legislation, the task of protecting the lawyer to practice law after the termination of a relationship created by the agreement, except as a condition to payment of retirement benefits.

Although not expressly stated, the Code of Professional Responsibility also appears to prohibit the use of covenants not to compete ancillary to the sale of a law business. Cf. Ethical Consideration 4-6, which states that a lawyer should not attempt to sell a law practice as a going business, and Disciplinary Rule 3-102, which prohibits dividing legal fees with a non-lawyer (which, in effect, is what the seller/covenantor would become). Cf. also American Bar Association Comm. on Professional Ethics, Formal Opinion No. 266 (1945) ("The goodwill of the practice of a lawyer is not . . . an asset, which either he or his estate can sell.").

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\(^7\) See, e.g., Gordon v. Mansfield, 84 Mo. App. 367 (K.C. Ct. App. 1900), in which the court enjoined a physician who sold his practice from reentering practice in the county as long as the purchaser remained there. The judge made a comment that many rural residents would challenge today: "It is a social condition, of which we may take notice, that physicians are quite a numerous class of the population of the state. . . ." Id. at 377.

\(^8\) State ex rel. Schoenbacher v. Kelly, 408 S.W.2d 383 (St. L. Mo. App. 1966). But see Reddi-Wip, Inc. v. Lemay, 354 S.W.2d 913 (St. L. Mo. App. 1963), where the court indicated that the statute in question might apply to covenants not to compete.

public from unreasonable covenants remains one for the Missouri courts, a task that in the past has perhaps been taken too lightly.

VII. Remedies for Breach of a Covenant

If the draftsman of a covenant not to compete can convince the court that the covenant is reasonable based on the criteria described above, the court should grant a remedy if it is breached. However, the remedy the court chooses will often have as much bearing on the effectiveness of a given covenant as the language of the covenant itself. When a covenant is breached, the covenantee has two possible remedies. He can, as in any action on a contract, sue for the monetary damages arising from the breach. Although a court will often award money damages even though they only approximate the actual damages in many cases the intangible nature of goodwill prevents the ascertainment of present and future damages. As a result, the preferred remedy, and at times the only effective remedy, is to enjoin the covenantor from further breaches.

Missouri courts faced with the demand for injunctive relief have given varying amounts of consideration to the appropriateness of this type of equitable remedy. In Mills v. Murray a Missouri appellate court held:

The injunctive remedy is peculiarly appropriate to prevent the violation of reasonable non-competition covenants, particularly where, as here, the full damage to be suffered by the breach could be estimated only uncertainly.

This liberal attitude toward injunctive relief was followed in House of Tools v. Price, where the court reversed the lower court's denial of relief and issued a permanent injunction after finding only that the covenant was reasonable and that it had been breached. In State ex rel. Schoenbacher v. Kelly the court discussed the affect of recent legislation on the equity jurisdiction of Missouri courts and concluded that a circuit judge had the power to issue and enforce an ex parte restraining order prohibiting violation of a covenant not to compete. In that case the court noted that equity has granted injunctions forbidding competitive em-

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82. See Willman v. Beheler, 499 S.W.2d 770 (Mo. 1973): “Equity will not suffer a wrong to be without a remedy, and seeks to do justice and avoid injustice.” Id. at 778.
83. In Mills v. Murray, 472 S.W.2d 6 (K.C. Mo. App. 1971), the court stated: In such a case, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show the extent of the damages as a matter of just and reasonable inference, although the result be only approximate. Id. at 17.
84. 472 S.W.2d 6 (K.C. Mo. App. 1971).
85. Id. at 18.
86. 504 S.W.2d 157 (Mo. App., D. St. L. 1974).
87. 408 S.W.2d 383 (St. L. Mo. App. 1966).
ployment following the breach of an exclusive services contract even in the absence of a post-termination covenant.88

The recent case of Willman v. Beheler89 indicates that the remedy of injunction will not always be available to enforce a covenant not to compete. In that case, the covenant prohibited competition by an ex-partner for five years after the termination of the partnership. However, litigation to determine the validity of the covenant consumed four years, during which the ex-partner continued to practice medicine within the proscribed territory. The Missouri Supreme Court reversed the trial court's grant of a five-year injunction. The court stated that a court of equity is reluctant to grant a mere money judgment, but went on to hold:

The only feasible way in which Article XXII [the covenant not to compete] may be enforced in favor of the covenantee and at the same time protect the covenantor against an unjust penalty is to remand the cause for a hearing on the question of Willman's financial loss arising out of competition with Beheler.90

Thus Willman stands as a warning to the injured covenantee to seek injunctive relief immediately by means of a restraining order or a temporary injunction, to avoid risking the loss of any equitable remedy. In order to claim the alternative relief, money damages, the court in Willman stated that the injured party must be prepared to show that his losses were sustained as a natural, direct, and immediate result of the covenantor's breach. In order to meet this difficult and conceivably impossible burden the prudent draftsman would do well to consider the inclusion of a liquidated damages clause. Such a clause was apparently approved in dictum in State ex rel. Schoenbacher v. Kelly.91 The result would be a covenant which provides the court with two viable alternatives on which to compensate adequately an injured covenantee.92

88. The leading case on injunctive relief under these circumstances is Lumley v. Wagner, 1 De G., M. & G. 604, 42 Eng. Rep. 687 (Ch. 1852). Many jurisdictions grant injunctions to restrain violation by an employee of expressed or implied negative covenants in personal service contracts if the employee is a person of "exceptional and unique knowledge, skill and ability in performing the service called for in the contract." Dallas Cowboys Football Club, Inc. v. Harris, 348 S.W.2d 37, 42 (Tex. Civ. App. 1961). On the other hand, under Roscoe Pound's "separate significance of the negative" theory, injunctive relief should be denied unless "breach of the negative involves a damage by itself apart from and above the breach of the affirmative." Pound, Progress of the Law-Equity, 33 Harv. L. Rev. 420, 440 (1920).
89. 499 S.W.2d 770 (Mo. 1973).
90. Id. at 778-79.
91. 408 S.W.2d 383 (St. L. Mo. App. 1966). Possible damages may be substantial, as in Thau-Nolde, Inc. v. Krause Dental Supply and Gold Co., Inc., 518 S.W.2d 5 (Mo. 1974), where plaintiff claimed damages of over $117,000 as a result of competition by former employees.
92. Including a liquidated damages clause in a covenant not to compete has one potential danger. The breaching party could allege that the liquidated damages clause provides an adequate legal remedy and thus injunctive relief should be precluded. However, the general rule is that the mere existence of a liquidated damages clause does not preclude injunctive relief. Rubenstein v. Rubenstein, 23
Missouri courts have applied a variety of tests for determining the validity of covenants not to compete. The result has often been to confuse the attorney called upon to draft such a covenant as to what must or must not be included therein. Although the balancing of a myriad of factors is involved, the courts should find such a covenant valid and enforceable only if it is found to be reasonable as to the covenantee, the covenantor, and the public. The resulting flexibility will become even more important in the future as the courts will be forced, in the absence of adequate statutory regulation, to deal with new attempts to limit competition contractually. By concentrating on the general concept of reasonableness, Missouri courts can avoid the temptation to rely on mechanical rules and place more emphasis on the equities involved in the given case.

HAROLD WILLIAM HINDERER III

LOCAL GOVERNMENT—COUNTY HOME RULE
AND THE 1970 MISSOURI CONSTITUTIONAL AMENDMENT

I. INTRODUCTION

Missouri is credited with giving municipal home rule its start in 1875, and is one of at least seventeen states that authorizes all or some counties to adopt a home rule charter. These states have done so in an attempt to create governmental authority which can “span the metropolitan area from city to suburb and unify the resources of the area with metropolitan wide responsibility.” Problems of pollution, traffic control, sewage and waste disposal, water and utility supply, health care, and welfare financing require effective uniform county solution, without the delay of obtaining approval from the state legislature. This feature is thought to be embodied in county home rule. Home rule under a charter government can serve as:

[B]oth a political symbol and a legal concept. As a political symbol it serves as a rallying point for those who support local autonomy without undue interference by the state government. As a legal concept its basic function is to distribute power between the state and local governments.

N.Y.2d 293, 296 N.Y.S.2d 354, 244 N.E.2d 49 (1968). To be completely safe, however, the draftsman should include a clause saying that the liquidated damages provision is not intended to be in lieu of equitable relief.

1. Mo. Const. art. IX, § 16 (1875).
3. Id.
The Missouri constitution requires counties to be grouped into four classes and the legislature has done so, basing the classification on assessed valuation. The constitution provides that the organization and powers of each class of county shall be defined by uniform general laws, but it further provides that counties with a population of 85,000 or more may frame and adopt a home rule charter form of government.

The primary goal of county home rule is to give counties a certain level of local autonomy by enabling them to act without prior authorization from the state legislature. Prior to 1970, the charter county's source of power was embodied in article VI, section 18 (c) of the Missouri constitution:

The charter may provide for the vesting and exercise of legislative power pertaining to public health, police and traffic, building construction, and planning and zoning, in the part of the county outside incorporated cities; and it may provide, or authorize its governing body to provide, the terms upon which the county shall perform any of the services and functions of any municipality, or political subdivision in the county, except school districts, when accepted by vote of a majority of the qualified electors voting thereon in the municipality or subdivision, which acceptance may be revoked by like vote.

This section was amended in 1970 and now reads as follows:

The charter may provide for the vesting and exercise of legislative power pertaining to any and all services and functions of any municipality or political subdivision, except school districts, in the part of the county outside incorporated cities; and it may provide, or authorize its governing body to provide, the terms upon which the county may contract with any municipality or political subdivision in the county and perform any of the services and functions of any such municipality or political subdivision.

The charter may provide for the vesting and exercise of legislative power pertaining to any and all services and functions of any municipality or political subdivision, except school districts, throughout the entire county within as well as outside incorporated municipalities; any such charter provision shall set forth the limits within which the municipalities may exercise the same power collaterally and coextensively. When such a proposition is submitted to the voters of the County the ballot shall contain a clear definition of the power, function or service to be performed and the method by which it will be financed.

This amendment has ostensibly given charter counties more and broader powers in dealing with county problems and providing county services.

St. Louis County adopted the charter form of government in 1950,
COUNTY HOME RULE

and Jackson County did likewise in 1970. Five other Missouri counties now have sufficient population to qualify for charters and two more seem on the verge of qualification. There has also been a recent movement for a constitutional amendment lowering the population requirement to 80,000. Because of this increase in the number of counties eligible for charter rule, section 18(c) of the Missouri constitution should become increasingly important. This comment will attempt to analyze problem areas solved and possibly created by the 1970 constitutional amendment to section 18(c).

For the purpose of analysis, charter counties should be compared with statutory counties.

II. THE STATUTORY COUNTY

A. Organization And Magnitude of Power

The organization of the government of all Missouri counties, except for the two charter counties, is a creature of state statute. The county court is the basis of county government, performing both legislative and executive or administrative functions. One important administrative function is the review of the budget of each county department. Although it is called a court and its officials are called judges, the county court performs no judicial function. The court is composed of three or fewer judges who are elected officials. Other major elected administrative officials in statutory county government are the clerk, collector of revenue, assessor, treasurer, prosecuting attorney, sheriff, coroner, recorder of deeds, surveyor, and highway engineer.

Statutory counties may exercise only those powers granted to them by the state. This principle has become known as Dillon's Rule, which was expressed in Lancaster v. County of Atchison. Dillon's Rule states that the only powers which counties may exercise are: (1) those granted in express words; (2) those necessarily or fairly implied in or incident


10. Buchanan County (86,915), Clay County (123,702), Greene County (152,929), Jefferson County (105,764), and St. Charles County (92,986) all qualify for charters. Boone County (80,911) and Jasper County (79,852) almost meet the population requirement. 1973-1974 OFFICIAL MANUAL, STATE OF MISSOURI at 1164.

The University of Missouri-Columbia, Governmental Affairs Newsletter, Vol. VII, Issue 3, at 2 (1972), indicates that Jefferson County voters narrowly rejected a charter proposal, Buchanan County was in the drafting process and readying for a vote, and Greene County was circulating petitions for a charter commission. St. Charles County voters defeated a charter proposal on May 6, 1975. St. Louis Globe Democrat, May 7, 1975, at 12B, col. 2.

11. Senate Joint Resolution No. 17 was introduced in the 78th General Assembly by Senators Marshall and Wiggins, calling for a constitutional amendment lowering the population requirement to 80,000. Amendments were also proposed to sections 18(b) and 18(f) of article VI. See pt. IV, § E of this comment, infra.

12. § 49.010, RSMo 1969.


14. 352 Mo. 1099, 180 S.W.2d 706 (1944).
to the powers expressly granted; or (3) those essential to the declared objects and purposes of the county—i.e., powers that are indispensable and not merely convenient. If there is reasonable doubt about a county having a particular power, the courts resolve the doubt against the county. Because of the rule, the county must look to the state legislature for its power, and the power must be clearly stated or implied beyond reasonable doubt.

The legislature has distributed these powers among the four classes of counties, with some statutes pertaining to one or more counties and some pertaining to all. The index to *Vernon's Annotated Missouri Statutes* indicates some twenty pages devoted to indexing legislation for the City of St. Louis and St. Louis County. Although St. Louis County has had a home rule charter since 1950, much of the state legislation has been passed at the county's request, apparently as a precautionary measure. This indicates at least some amount of uncertainty as to what powers charter counties may exercise independent of authorizing legislation.

The restrictive nature of a statutory county's power has been at least partially responsible for the formation of many special districts in Missouri. As of 1968, Missouri was eleventh in the nation in number of local government units. Missouri contained 2,918 units, consisting of school districts, townships, counties, municipalities, and 734 special districts. Forming a special district is often the only feasible method of obtaining a desired service, although such a district may also be formed in order to avoid the constitutional limitation an debt or to finance a project of countywide interest. Whatever the reason for formation, special districts are very cumbersome and often stand in the way of more comprehensive treatment of a problem.

B. The Case Law

The fact that statutory counties, under Dillon's Rule, possess no powers except those conferred by statute has resulted in a less than voluminous amount of case law concerning the exercise of powers by statutory counties. Although the cases which have been decided seem quite reasonable, the question remains as to why there have been so few decisions. There are at least two possible reasons for this. It could

15. *Missouri Has Too Many Local Governments*, 24 J. Mo. B. 499 (1968). Missouri had 57% of all road districts in the United States. A charter county, St. Louis County, had 153 units of government, with 32 special districts. *Id.* at 499, 500.


17. The Jackson County Sports Complex Authority was created by special legislation. See § 64.930, RSMo 1969; Freilich, Robards & Wilson, supra note 9.

18. Counties were found not to possess the powers contested in County of Platte v. James, 489 S.W.2d 216 (Mo. 1973) (county had no power to impose zoning restrictions on incorporated area, even though the government of the corporate area was not functional and had not been for some time); Fulton Nat'l Bank v. Callaway Memorial Hosp., 465 S.W.2d 549 (Mo. 1971) (county hospital had no authority to endorse notes with recourse, and therefore was not liable when notes were not subsequently paid); State ex rel. Crites v. West, 509 S.W.2d
mean that the counties have enough powers under the statutes to deal with their problems. It seems more probable, however, that reported decisions are few because county officials are very reluctant to act unless clearly authorized by statute. One of the principal reasons for adopting a home rule charter is to avoid the necessity of relying wholly upon legislative authorization for power.

III. THE CHARTER COUNTY

A. Case Law Under the Prior Section 18(c)

Grants of power to charter counties have seemingly been restricted in much the same manner that powers of statutory counties have been restricted by Dillon's Rule. This restriction has been in the form of judicial decision. In State ex rel. Town of Olivette v. American Telephone and Telegraph Co., it was stated that the county charter embodies the powers charter counties may exercise, and acts beyond the powers granted or necessarily implied in the charter are void. In Schmoll v. Housing Authority of St. Louis County, the Missouri Supreme Court described St. Louis County's charter as its "fundamental organic law" and said that a charter county must look to its charter for its powers.

Language in both the Jackson County and St. Louis County charters attempts to escape this restrictive interpretation of charter power by asserting that "all powers possible for a county to have under the constitution and laws of Missouri . . . " reside in charter counties, and that powers under the charter shall be liberally construed in favor of the county. To date, no decision by Missouri courts has indicated whether such language is effective in avoiding the restrictive interpretation of charter power. There is, however, dictum in Readey v. St. Louis County Water Co. indicating that the Missouri Supreme Court was ready to

482 (Mo. App., D. Spr. 1974) (power to dissolve a special fire protection district was not necessary to or implied from express powers given by statute).

Implied powers to carry out the contested function were found in Everett v. County of Clinton, 282 S.W.2d 30 (Mo. 1955) (power of county to operate a rock quarry was implied from the power to own real estate, construct and improve roads, and condemn rock quarries for public purposes); State ex rel. Wahl v. Speer, 284 Mo. 45, 223 S.W. 655 (En Banc 1920) (statute empowering county to incur debt to "build" a courthouse, implied spending the borrowed money for expansion of the old courthouse site); Blades v. Hawkins, 133 Mo. App. 328, 112 S.W. 979 (St. L. Ct. App. 1908), aff'd per curiam, 240 Mo. 187, 144 S.W. 1198 (1912) (power of county court to hire an accountant to examine county records was implied from express power making county court the fiscal agent of the county); Sheidley v. Lynch, 95 Mo. 487, 8 S.W. 434 (1888) (power of county to erect a courthouse at county seat implied the power to purchase the necessary land).

19. 280 S.W.2d 134 (St. L. Mo. App. 1955).
20. 321 S.W.2d 494 (Mo. 1959).
23. 352 S.W.2d 622 (Mo. 1961).
accept such language in a similar but earlier charter provision.\textsuperscript{24} If such language is deemed insufficient to avoid the restrictive judicial interpretation of charter power, a county must comply with this interpretation. This would mean that a charter county would have to amend its charter each time it wished to exercise authority not expressly or necessarily implied in its charter. This would be a troublesome procedure because each charter amendment necessitates a countywide vote.\textsuperscript{25}

It should be pointed out that statutes pertaining to a particular class of counties continue to apply to a charter county unless conflicting charter county enactments should prevail. This principle is illustrated by the \textit{Readey} case, where the St. Louis County Water Company, pursuant to an ordinance of the county council, added fluoride ions to water supplied to municipalities within the county. The Missouri Supreme Court found the county had the power to do so, but the power was not derived from article VI, section 18(c) of the constitution, because the pre-1970 version of that section did not permit counties to legislate in incorporated areas. Instead, the decision was based on a statute that authorized first class counties to enact ordinances which enhance the public health.\textsuperscript{26}

Apportionment of powers between charter counties and the state may best be analyzed in terms of: (1) the scope of a home rule county's power in the absence of express constitutional or statutory prohibition or authorization and (2) whether state or county enactments prevail when there is a conflict between them.\textsuperscript{27} A careful distinction should be made between the two situations. "It is one thing to argue that there should be no limit on . . . power in the absence of an express prohibition; it is quite another thing to argue that . . . enactments should prevail over conflicting statutes."\textsuperscript{28} The power of a charter county to act in the absence of express prohibition is still somewhat open to question because most cases have arisen in the context of a conflict between state and county enactments. When such a conflict arises, the test now used by Missouri courts was stated in \textit{State ex rel. St. Louis County v. Campbell}:\textsuperscript{29} "When a conflict occurs, the resolution thereof, as a general principle, depends

\textsuperscript{24} Article I, section 2 of the St. Louis County Charter as it then appeared stated: "The County shall have all the powers now or hereafter vested by the Constitution and laws of Missouri. . . ." The Missouri Supreme Court apparently accepted this provision by stating: It appears, therefore, that by virtue of the constitutional, statutory, and charter provisions last above set forth, the county council was and is authorized to enact ordinances tending to enhance the health of all the residents of St. Louis County.

\textsuperscript{25} S.W.2d at 625.

\textsuperscript{26} § 192.300, RSMo 1959.

\textsuperscript{27} This analysis was used for home rule municipalities in \textit{Westbrook}, supra note 4, at 46.

\textsuperscript{28} \textit{Id.} at 47.

\textsuperscript{29} 498 S.W.2d 833 (Mo. App., D. St. L. 1973).
on whether the functions are 'private, local corporate functions' or 'governmental.'\textsuperscript{30} For example, in \textit{Casper v. Hetlage}\textsuperscript{31} it was stated that zoning of a charter county was not a governmental matter over which the state retained control.\textsuperscript{32}

A governmental interest was found to exist in \textit{State ex rel. Cole v. Matthews},\textsuperscript{33} where it was determined that St. Louis County could not purchase voting machines from the lowest bidder. The State Board of Election Commissioners preferred another type of machine. Elections were found to be governmental in nature, and the State Board prevailed. A recent opinion of the Office of the St. Louis County Counselor concluded that the county could not require an affidavit of value to be filed with each deed recorded by the Recorder of Deeds because it was thought to be preempted by the uniform statewide system of recording which was governmental in nature.\textsuperscript{34}

In \textit{St. Louis County v. City of Manchester}\textsuperscript{35} a charter county's right to plan and zone was determined to be local in nature and was given precedence over a city's statutory power to acquire sewage disposal facilities outside city limits. This decision is often cited for the proposition that when county planning and zoning efforts conflict with other statutes, charter counties will prevail whereas statutory counties will not. This is a result of comparing \textit{City of Manchester} with \textit{State ex rel. Askew v. Koppe},\textsuperscript{36} where residents of a statutory county sought to prevent the City of Raytown from acquiring sewage facilities outside the city limits pursuant to statute. In \textit{Koppe} the city's statutory power prevailed. The opinion

\textsuperscript{30} Id. at 836.
\textsuperscript{31} 359 S.W.2d 781 (Mo. 1962).
\textsuperscript{32} In \textit{Casper} St. Louis County, being a charter county, could vest the management of the county business in some other agency than a county court. County courts, which a statutory county must utilize, must unanimously vote to rezone, pursuant to section 64.140, RSMo 1959. St. Louis County did not require a unanimous vote of its council, and in \textit{Casper} it was held that such power to rezone was local in nature and was not subject to the legislative power of the state. \textit{Id.} at 790. See also \textit{State ex rel. Noland v. St. Louis County}, 478 S.W.2d 363 (Mo. 1972) (charter county had powers pertaining to planning and zoning outside incorporated areas under old section 18(c)); Dahman v. City of Ballwin, 483 S.W.2d 605 (Mo. App., D. St. L. 1972) (charter county's zoning power is in the public interest to promote public health and welfare).
\textsuperscript{33} 274 S.W.2d 286 (Mo. En Banc 1954).
\textsuperscript{34} St. Louis Co. Counselor Op. No. DL68-59 (July 18, 1975). The affidavit was sought to aid the County Assessor in updating countywide property values. The opinion was based primarily on Chapter 59, RSMo 1969, which pertains to Recorders of Deeds, and Chapter 442, RSMo, which pertains to the conveyance of real estate. The opinion concluded these statutes indicated "statewide" concern. It is questionable, however, whether this is really a case where the action sought by the county conflicts with and is preempted by existing statutes. In \textit{Blades v. Hawkins}, 135 Mo. App. 828, 112 S.W. 979 (St. L. Ct. App. 1908), \textit{aff'd per curiam}, 240 Mo. 187, 144 S.W. 1198 (1912), the power of a \textit{statutory} county to hire an accountant to examine county records was implied from the express power making the county court the fiscal agent of the county.
\textsuperscript{35} 360 S.W.2d 638 (Mo. En Banc 1962). The City of Manchester sought to condemn land for such facilities pursuant to sections 71.680, 79.380, RSMo 1959.
\textsuperscript{36} 330 S.W.2d 882 (Mo. 1960).
in *City of Manchester* distinguished *Kopp*, however, because in the latter case private landowners were contesting the City of Raytown's action. No controversy between Jackson County and the City of Raytown existed.\(^\text{37}\)

In *Appelbaum v. St. Louis County*\(^\text{38}\) the county was found to have the power to acquire land for the purpose of constructing an incinerator. The land sought by the county was inside an incorporated municipality and use of the land for incinerator purposes conflicted with the municipality's zoning restrictions. With partial reliance on statutes pertaining to first class counties,\(^\text{39}\) the Missouri Supreme Court stated:

> The County Council has acted pursuant to these [statutory and charter] authorities, and its power with respect to enactment of ordinances which tend to enhance public health is not limited to the power conferred by Article VI, Section 18(c) of the Missouri Constitution. . . . \(^\text{40}\)

Although the Missouri decisions do not clearly define the powers charter counties may exercise in the absence of express statutory or constitutional prohibition or authorization, a recent opinion by the Missouri Supreme Court could be construed as defining such powers. In *Flower Valley Shopping Center, Inc. v. St. Louis County*\(^\text{41}\) a county ordinance required shopping centers which were located in unincorporated areas and which had parking areas in excess of 200,000 square feet to provide outside security protection for shoppers. The licensed watchmen were to be employed by the shopping centers, and they were to have full power of arrest and the use of weapons. The watchmen were to be under the direction and supervision of the Superintendent of Police of St. Louis County. The ordinance was challenged on constitutional grounds. The Missouri Supreme Court, while finding the ordinance constitutional, concluded that St. Louis County lacked the authority to enact the ordinance because police protection was a matter of statewide concern. The court did not indicate whether the ordinance was preempted by existing statutes or constitutional provisions requiring police protection to be provided by the county, or whether they viewed the ordinance as an attempt to legislate in the absence of any applicable statutory or constitutional authorization. *Flower Valley* indicated that it makes no difference whether the charter county's ordinance conflicts and is therefore preempted by an existing state statute, or whether the ordinance is an attempt to legislate in the absence of any statutory authorization—in either case the test is whether the activity is of statewide or local concern. In speaking of article VI, section 18(b) of the constitution, the court stated:

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37. 360 S.W.2d 638, 641 (Mo. En Banc 1962).
38. 451 S.W.2d 107 (Mo. 1970).
39. Section 49.303, RSMo 1969, and section 64.320, RSMo 1969, authorize first class counties to acquire land by eminent domain for the protection of public health, and to construct and operate incinerators and land fills.
41. 528 S.W.2d 749 (Mo. En Banc 1975).
In our opinion, the question whether owners of private property may be compelled to provide police protection for shoppers is also one of state-wide concern and may not be addressed by counties without constitutional or statutory authority more explicit than is found in Art. VI, § 18(b).42

The court made no mention of section 18(c), which designates powers that charter counties may exercise. The fact that only unincorporated areas of the county were affected by the ordinance seems to indicate that St. Louis County contemplated section 18(c) when it enacted the ordinance, because "police and traffic" was one of four express areas in which counties could legislate for unincorporated areas under the earlier section 18(c). The court reasoned that allowing such action by a county could result in the apportionment of police and fire services to potentially troublesome areas, with the resulting cost being assessed to the private landowners in those areas. This policy reasoning is understandable, but the decision completely avoids the issue of whether a charter county has the authority to take such action under section 18(c).

B. The Impact of the 1970 Amendment

The 1970 amendment to section 18(c)43 consists of two paragraphs, the first of which expands the legislative power that charter counties may exercise outside incorporated areas of the county. Originally authorized to legislate "pertaining to public health, police and traffic, building construction, and planning and zoning, in the part of the county outside incorporated cities. . . ."44 charter counties are no longer limited to the four listed categories but may now legislate pertaining to "any and all services and functions of any municipality or political subdivision, except school districts, in the part of the county outside incorporated cities. . . ."45

The second paragraph of the 1970 amendment allows charter counties to exercise power pertaining to "all services and functions of any municipality or subdivision, except school districts, throughout the entire county within as well as outside incorporated municipalities . . ."46 This paragraph had no earlier counterpart. The prerequisites to the exercise of such countywide power are probably the most important feature of the 1970 amendment to section 18(c).

One article suggests that countywide action cannot be taken by legislative enactment of the county because such measures must be submitted to the county voters.47 The second paragraph of section 18(c), with reference to the exercise of countywide legislative power, reads in pertinent part:

42. Id. at 754.
43. The amendment is set out at pt. I of this comment, supra.
44. Mo. Const. art. VI, § 18(c).
45. Mo. Const. art. VI, § 18(c) 1970 amend.
46. Id. (emphasis added).
47. Freilich, Robards & Wilson, supra note 9, at 332.
The charter may provide for the vesting and exercise of legisla-
tive power . . . any such charter provision shall set forth the limits
within which the municipalities may exercise the same power. . . .
When such a proposition is submitted to the voters of the
County . . . (emphasis added).

The initial part of the paragraph indicates such action might be taken
by the exercise of legislative power by the county, but the latter part of
the paragraph contemplates a countywide vote. Reading the paragraph
as a whole, it rather clearly indicates that a charter amendment is necessary
for any countywide measure.

St. Louis County officials also believe that countywide measures re-
quire a charter amendment. St. Louis County has made the only attempt
thus far to utilize the 1970 amendment. In 1971, ordinances calling for
charter amendments were passed by the county legislative body. The three
proposed charter amendments were all defeated at the November 2, 1971
election. The first amendment called for 24-hour police protection for all of
St. Louis County, the second for the adoption of a countywide minimum
housing code, and the third for the adoption of a countywide building
code. The charters of both St. Louis County and Jackson County were
written prior to the 1970 constitutional amendment, and both charters
attempt to include all powers subsequently given charter counties by
statute or in the constitution. St. Louis County, however, required a
countywide vote and did not attempt to rely on such language in its charter.

Neither Jackson County nor St. Louis County have current plans to

48. The charter amendments, if adopted, would have consisted of the fol-
lowing:
1) Said charter as amended would require each city, county, town or village
police department in St. Louis County to provide patrol services and preliminary
investigative services at all times, and create a Police Standards Commission to
determine compliance with this requirement and further authorize the County
Council, after hearing, to direct the County Police Department to perform such
services where the responsible police department had failed to comply with this
requirement, the cost of such additional services to be paid by St. Louis County,
to be reimbursed by any municipality receiving such services;
2) Said charter as amended would authorize the County Council to enact
and provide for the enforcement of uniform building construction codes through-
out St. Louis County at the County's expense and to provide the terms on which
any municipality or fire district may enforce any such code at its own expense,
and would authorize any political subdivision to enact different provisions after
public hearing, and would also provide for enlarging the existing Building Com-
misson and the creation of the City Selection Committee and a Fire Safety Ad-
visory Board;
3) Said charter as amended would authorize the County Council to enact and
provide for the enforcement of a uniform housing code throughout St. Louis
County at the County's expense and to provide the terms on which any municipali-
ity may adopt and enforce such a code at its own expense, would provide for a
distribution of part of the County's expenditures to such municipalities, and
would also provide for the creation of a Housing Code Commission and a City
Selection Committee.

49. See note 21 and accompanying text supra.
propose any charter amendments, indicating that no judicial decision under the 1970 amendment will be immediately forthcoming. The construction and interpretation of the 1970 amendment to section 18(c) must await judicial determination, but certain issues concerning the amendment that seem likely to arise in the future will be discussed in this comment.

IV. THE 1970 AMENDMENT: ISSUES AND CONSTRUCTION

A. The County's Basic Authority Redefined?

The cases decided prior to the 1970 amendment limited a charter county's power to legislate to matters of local concern, as opposed to matters of governmental or statewide concern. The earlier section 18(c) specified four areas in which counties had legislative power: public health, police and traffic, building construction, and planning and zoning. The 1970 amendment speaks of "any and all services and functions of any municipality or political subdivision." It can be argued this changes the test for when and on what matters a county may act. The term "services" may indicate only those services which were formerly provided by a municipality, or "functions" may expand the authority to other areas. "Functions" seems to be a much broader term than "services" and may include implementing or regulating local policy rather than merely the performance of services. It is possible, however, that "services and functions" was intended to include only services otherwise awkward or impossible to fit under public health, police and traffic, building construction, and planning and zoning—the enumerated categories of the earlier section 18(c). Nevertheless, "services and functions" seem to indicate that something more was intended under section 18(c), as amended, than under the prior section.

The second paragraph of the 1970 amendment empowers charter counties to legislate countywide when approved by county vote. The last part of that paragraph states that "the ballot shall contain a clear definition of the power, function or service to be performed. . . ." Here "power" is added to "function or service." "Power" did not appear in paragraph one or in the first part of paragraph two. Such a term, when coupled with function and service, seems to indicate that the amendment changes a charter county's basic authority. Because "power" was not used in paragraph one, it could be argued that charter counties have less au-

50. Telephone interview with the Office of County Counsel of both Jackson and St. Louis Counties, July, 1975.
51. Casper v. Hetlage, 359 S.W.2d 781 (Mo. 1962); State ex rel. St. Louis County v. Campbell, 498 S.W.2d 833 (Mo. App., D. St. L. 1973).
52. In State ex rel. Cole v. Matthews, 274 S.W.2d 286 (Mo. En Banc 1954) a charter county was held not to have the power to purchase voting machines from the lowest bidder, as elections were said to be governmental in nature. If the case had arisen under the 1970 amendment to section 18(c), the result might have been different.
53. The amendment is set out at pt. I of this comment, supra.
authority when legislating for unincorporated areas. It remains an open question whether a charter county's basic authority has been altered to exceed the power of providing constitutionally required services and determining the manner in which they are to be provided. Section 18(c), as amended, provides an argument that a charter county's authority has been redefined.

B. Instrument of Grant or Limitation?

By definition, an instrument of grant gives charter counties only those powers which are specified or necessarily implied in their charters. An instrument of limitation, on the other hand, gives charter counties all powers not prohibited by the constitution or by the charter. It is clear from the language of section 18(c), as amended, that county charters are instruments of grant.

Language in Jackson County's charter states:

The county shall have all powers possible for a county to have under the constitution and laws of Missouri, as fully and completely as though they were specifically enumerated in this charter . . . and all powers not expressly prohibited by the constitution, or by this charter.54

Whether this language will be successful in creating an instrument of limitation has not been answered by the courts. If the courts view such language as being ineffective in creating an instrument of limitation, county legislation that was otherwise local in nature could be invalidated if power to enact such legislation was not provided for in the county charter.55

An argument against allowing such expansive language to create an instrument of limitation is that section 18(c) is concerned with the difficult subject of intergovernmental relations. Such matters should be defined as clearly as possible in the charter. An instrument of limitation would give a county all powers not expressly prohibited in the charter. This would arguably result in less clarity, because there would be powers existing outside the instrument.

C. Constitutional Conflicts

If a state statute provides the terms under which a charter county can provide countywide services, the question arises whether the statute is unconstitutional because of a conflict with sections 18(b) and 18(c) of the Missouri constitution. Section 18(b) says in pertinent part:

The charter shall provide for . . . the form of the county government, the number, kinds, manner of selection, terms of office and salaries of the county officers, and for the exercise of all powers and duties of counties and the county officers . . .

It can be argued that a statute allowing a charter county to provide

54. See note 21 and accompanying text supra.
55. Freilich, Robards & Wilson, supra note 9, at 338.
COUNTY HOME RULE

Countywide services would be unconstitutional, because charter counties retain freedom to choose the manner in which to perform the services required by the constitution. A state statute may require the result, but where it also prescribes the manner in which the result shall be obtained, a constitutional question is presented. For example, assume that a state statute required all charter counties to provide a countywide system of mosquito control, and that the system be implemented by a Mosquito Control Supervisor who must not be a part of any other department or agency of county government. It could be argued that the statute would be unconstitutional because it dictates the manner in which the service is to be provided.

Where provisions of a county charter conflict with provisions of a charter of a city within the charter county, the question arises as to which governmental entity should prevail. For example, if a charter county enacted a uniform countywide building code and a charter city within the county persisted in utilizing a less stringent code, a constitutional conflict would be presented. The Missouri constitution provides for both charter counties and charter cities. In *St. Louis County v. City of Manchester* the city sought to acquire land outside the city limits for purposes of sewage disposal. The action was pursuant to statute, but was contrary to the planning and zoning provisions of St. Louis County. St. Louis County prevailed in that case, but the decision does not answer the question posed because Manchester was not a charter city. In fact, the Missouri Supreme Court declined to determine whether the county or the city "occupies a superior position in the governmental hierarchy." It would seem that in keeping with the spirit of the 1970 constitutional amendment to section 18(c), the charter county should prevail. Section 18(c) requires a countywide vote. A charter city should not be able to act contrary to the county charter when the county acts pursuant to a majority vote of the residents of the county, which includes the voters of the charter city. A contrary argument is based on the doctrine that when there is conflict between two entities of government, the smallest local unit of self government should prevail.

D. Problems of Interpretation

The last sentence of the second paragraph of amended section 18(c) states that when countywide action is submitted to a vote, the ballot shall contain "a clear definition of the power, function or service to be performed and the method by which it will be financed." It could be argued that the language having to do with the method of financing limits...
countywide action to powers, functions, and services which incur debt and eliminates those powers, functions, and services of a regulatory nature which are enforced or carried out by an existing county office. Additional expense would undoubtedly be incurred for these regulatory functions, but the expense may be absorbed by the county operating budget and not require additional revenue measures. It seems doubtful that such a construction was intended because this would force the charter county to incur additional debt each time it attempts to implement countywide measures, and incurring such debt should not be encouraged. Moreover, because incurring additional debt usually has little voter appeal, many countywide measures would be doomed to failure in a countywide election.

The word "clear" appearing in the last sentence of the second paragraph of section 18(c) may present a point of challenge to future charter amendments. A "clear" definition of the power, function, or service to be performed and the method by which it will be financed would be difficult to present in some cases. It seems doubtful that courts would give a broad scope of review to a challenge that the ballot did not contain a "clear" definition of the proposal. The acceptance of such an argument would allow belated attacks on countywide legislation by parties who, if genuinely interested or affected, could have asked for clarification prior to submission to county vote. Another argument for a narrow scope of judicial review was stated in Windle v. Lambert:61 "The general rule is that courts will not inquire into the motives of Legislatures where they possess the power to act and it has been exercised as prescribed by law . . . ."62 By analogy, if a charter county legislature has complied with the state constitution and its own charter in enacting legislation, its enactments should be subject to the same rule.

The second paragraph of amended section 18(c), having to do with countywide services and functions, states that any such charter provision "shall set forth the limits within which the municipalities may exercise the same power collaterally and coextensively." There are at least three ways this language could be construed. First of all, the phrase may imply that the right to exercise the same power collaterally and coextensively always resides in the city, and that this residual role may prevent the county from completely taking over a service or function. Second, it may mean that the city's collateral and coextensive power, if it exists at all in a particular case, is to be limited by the charter amendment. Finally, this particular phrase omits "political subdivision," which was used earlier in the paragraph in conjunction with "municipality." This may indicate that if the county wants to contract with any political subdivision other than a city—e.g., a special road district, the charter does not have to set forth the limits for collateral and coextensive exercise of the same power by the political subdivision.

61. 400 S.W.2d 89 (Mo. 1966).
62. Id. at 93.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
The question whether a county can perform a countywide service without all cities in the county having the same power may arise under section 18(c). The second paragraph of section 18(c) refers to the “exercise of legislative power pertaining to any and all services and functions of any municipality or subdivision . . . throughout the entire county. . . .” Because of the language of amended section 18(c) refers to any municipality, it suggests that it is not necessary for all cities to have the power.

Article VI, section 16 of the Missouri constitution provides:

Any municipality or political subdivision of this state may contract and cooperate with other municipalities or political subdivisions thereof . . . for the planning, development, construction, acquisition or operation of any public improvement or facility, or for a common service, in the manner provided by law.

Section 70.220, RSMo 1969, was enacted to implement article VI, section 16 of the Missouri constitution. This statute requires that the subject or purpose of any contract or cooperative action be within the scope of the power of each municipality or subdivision. Because article VI, section 16 implies that each municipality or subdivision shall have coextensive power, it is questionable that this conflicts with section 18(c) as amended, which allows counties to legislate countywide when approved by county vote. Section 16, by the use of the language “may contract,” speaks in terms of voluntary action or cooperation. In contrast, section 18(c) speaks of powers vested in a charter county by reason of its charter, the exercise of these countywide powers, and the implementation of countywide programs. Because of this difference in intent, it is improbable that each municipality and political subdivision in a county must have reciprocal power before a charter county could adopt countywide measures.

E. Proposed Constitutional Amendments

A Senate joint resolution introduced in the last General Assembly called for the submission to Missouri voters of amendments to sections 18(a), 18(b), and 18(f) of article VI of the Missouri constitution. The amendments to section 18(a) and 18(f) would have lowered the population requirement for charter counties from 85,000 to 80,000 inhabitants, and lowered the percentage of county voters required for a petition for a charter commission from 20 to 8 percent of the total vote cast for governor at the last general election. The amendment to section 18(b) would have

63. In School District of Kansas City v. Kansas City, 382 S.W.2d 688 (Mo. En Banc 1964), the Missouri Supreme Court stated:
Section 70.220 follows the language of the constitutional provision, § 16 of Art. 6, but further spells out the requirement implicit in the Constitution that the subject and purposes of the cooperative contract or action shall be within the scope of the powers of the municipality or subdivision.

Id. at 692.


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substituted "not prohibited" for "prescribed" in section 18(b), so that it would have read as follows:

The charter shall provide for its amendment, for the form of the county government, the number, kinds, manner of selection, terms of office and salaries of the county officers, and for the exercise of all powers and duties of counties and county officers [prescribed] not prohibited by the constitution and laws of the state.

The latter proposed amendment was intended to give charter counties greater powers, presumably in areas where there are no conflicting legislative or constitutional provisions. There was some thought that the legislature could act in matters of purely local concern under the prior section 18(b). Where such a conflict occurs, and the matter is actually determined to be local, the charter county should prevail under the constitution as it now reads, provided the county has appropriate authority in its charter. The amendment was opposed by the two charter counties, St. Louis County and Jackson County, because they believed that the present section 18(b) was adequate, and they were content with its provisions. The resolution was passed in the Senate, but was not acted upon by the House. If passed, the proposed section 18(b) would change county charters from instruments of grant to instruments of limitation, by the use of language similar to that found in both the Jackson County and St. Louis County charters. The charter counties apparently believe that the language in their charters is sufficient and wish no further tampering with section 18(b). It appears that there will be no further immediate attempts to amend section 18(b), because the authors of the proposed amendment will probably defer to the judgment of the charter counties. There will, however, be further attempts to amend sections 18(a) and 18(f) in regard to the population requirement for charter counties.

V. Observations and Conclusions

With the addition of Jackson County as a charter county and the possibility of more counties obtaining charters in the near future, the
permissible scope of a charter county's power to legislate under section 18(c) will become increasingly important.

The legality or constitutionality of a particular action is not the only problem charter counties face. Under the 1970 amendment, counties can now legislate countywide if there is a charter amendment approved by county voters. Political considerations, however, may restrict the use of countywide legislation. Rather than viewing charters as county self-government or as home rule, residents of outlying areas of the counties may view them as similar to big city government or as another layer of government being imposed on them. Outlying municipalities often feel disenfranchised by attempts of others to act within their boundaries. At least three reasons were given by incorporated areas within the county for the opposition and ultimate defeat of the three St. Louis County proposals: (1) anticipated higher taxes; (2) county takeover of municipalities; and (3) countywide building and housing codes containing less stringent provisions than the existing municipal codes. Even with the failure of such attempts at countywide measures, such attempts may have value in bringing about the desired result through contract and compromise, at least where incorporated areas fear a different result at a later election.

The desirability and potential success of county home rule may well turn on the geographical make-up of a county. St. Louis County is more or less homogeneous and to a large extent incorporated. This situation lends itself more readily to the concept of home rule. Jackson County, on the other hand, contains two large cities, Kansas City and Independence, with almost one-third of the remaining county being unincorporated. The budget of the City of Kansas City is approximately twice that of Jackson County. In addition to problems of political division, this creates funding problems for Jackson County, because it must come up with an attractive program to persuade the voters to approve countywide action, particularly where the action requires incurring additional debt. Kansas City presently provides services to a large percentage of the county voters, and these voters may be content with such services.

County government may seek to overcome such problems by showing out-county areas the benefits of county home rule. Current plans in Jackson County are to improve out-county relations with programs of bridge and road improvement. There is also some discussion of eventual consolidation of countywide logistical functions.

Though home rule provides counties with powers not found in statutes, what home rule can offer a lightly urbanized county is subject to conjecture at this point. County home rule has met with two recent failures:

71. St. Louis Post-Dispatch, October 28, 1971, at 6W.
72. Telephone interview with Office of County Counsel of Jackson County, July 1975.
73. Id.
74. Id.
in Missouri. Both Jefferson County and St. Charles County have rejected the county charter form of government.75 This is apparently a manifestation of out-county fears that gaining power to act independently of the state legislature in some areas may only result in the transfer of that power to one city or interest group in the county. Such fears will arise at each and every charter election, and, whether unfounded or not, will take some time to allay.

The 1970 constitutional amendment has apparently given charter counties more tools with which to work, but obtaining the approval of a majority of voters for countywide programs may often be difficult because of out-county opposition. Charter government does present many safeguards for out-county areas: the petition requirement to form a charter commission, a countywide vote to adopt a charter, an elected county legislative body, a majority vote of the county council, and a subsequent countywide vote for countywide measures. These safeguards should be sufficient to prevent any abuse of charter power. The 1970 amendment to section 18(c) does not, however, clearly enumerate the powers of charter counties. The uncertainty of what, if any, powers were added by the amendment, the potential constitutional conflicts, and the interpretation problems must be resolved by judicial decision. A liberal judicial interpretation of section 18(c) would seem desirable to enable charter counties to utilize the amendment and to enable them to carry out the purpose behind its adoption.

Rex V. Gump

OCCUPATIONAL LICENSING:
AN ANTITRUST ANALYSIS

I. Introduction

In recent years licensing of persons seeking to engage in various occupations has been an ever-increasing phenomenon.1 Occupational licensing includes licensing of professionals, such as physicians, attorneys, and engineers, as well as nonprofessionals, such as beauticians, barbers, boiler inspectors, and egg graders. It restricts certain occupations to those individuals licensed by a particular state or subdivision of a state.2 Under a typical

75. See note 10 supra.

1. Council of State Governments, Occupations and Professions Licensed by the States, Puerto Rico and the Virgin Islands (1968); B. Shimberg, B. Esser, & D. Kruger, Manpower Administration, U.S. Dep’t of Labor, Occupational Licensing: Practices and Policies 13 (1973) [hereinafter cited as Shimberg]. In 1968 the Council of State Governments listed sixty-seven licensed occupations including abstractor, accountant, attorney, and physician, as well as auctioneer, barber, boiler inspector, cemetery salesman, egg grader, librarian, milk weigher, photographer, used car dealer, horseshoer, feeder pig dealer, tattoo artist, and hunting guide.

licensing scheme, the license may be granted only after satisfying require-
ments of a licensing board, such as passing an examination, and may be subject to denial for other reasons. Those granting the license are usually members of the same occupation as those seeking licensure. Entry of new members into a field, therefore, may be effectively controlled by those already members of a particular occupation by denial of licensure. In the same manner, behavior of those already in the occupation may be controlled by the threat of license suspension or revocation.

Restricting entry into an occupation and controlling behavior of those already in the occupation have strong economic implications. Economic theory has long recognized the effect of such a closed market structure on existing members of the occupation, consumers, and potential entrants into the market. A closed market structure, a cartel, may be defined as:

Monopolistic control of the supply of a product or service for the purpose of enhancing returns to members of the cartel and protecting members of the cartel from price competition that would reduce the return to a competitive level.

The resultant higher profit margin for those already in the market directly correlates with less efficient utilization of resources and less consumer choice. The cost of protection for cartel members is increased price of the product or service to consumers and restricted access of prospective entrants into the market. Imposition of a licensing requirement magnifies the detrimental effects created by preexisting natural barriers, such as large start-up costs, specialized knowledge, and patents. Given these effects, additional entry barriers, such as occupational licensing, should be discouraged unless strong reasons exist for perpetuating them.

Conversely, a competitive economic model insures that resources would be used more efficiently and beneficially for prospective buyers and sellers. In such a competitive system both buyers and sellers have alternatives. "Buyers can choose among alternative sellers, and sellers are free to enter any line of production they believe will be profitable." Sellers have maximum mobility; they can enter and leave various industries at will. Entry

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6. Barton, supra note 4, at 644.
7. It must be remembered that economic models are just models and as such may not accurately describe the complexities of the real world.
8. Barton, supra note 4, at 643.
9. Id. at 644.
10. J. Bain, Barriers to New Competition: Their Character and Consequences in Manufacturing Industries 172-73 (1956); Barton, supra note 4, at 643.
11. J. Bain, supra note 10, at 207.
12. Id.
13. Barton, supra note 4, at 640.
14. Id.
will be determined by the existence or absence of a profit factor. Buyers also have maximum mobility; they are free to choose among all sellers of a particular product or service. Selection by buyers will eliminate those sellers who cannot utilize their resources most efficiently. Theoretically, prices will reflect this competitive situation. If price exceeds cost of a given product or service, profit will exist. Because there are no restrictions on entry into this market, new sellers are free to enter. The presence of new sellers in the market will cause a reduction in price to near cost.  

This competitive market system is the focal point of the Sherman Antitrust Act. In the main, the premises of the Act are coextensive with the theories underlying this system. Many cartels which inhibit attainment of this objective, therefore, have been condemned. Although occupational licensing produces the same economic effect, it has not traditionally been recognized as a barrier to entry of the same posture. It is the purpose of this comment to analyze the Sherman Antitrust Act as a vehicle for eliminating barriers to entry created by occupational licensing.

II. Scope of the Sherman Antitrust Act

The jurisdiction of the Sherman Antitrust Act appears to be coextensive with the commerce clause. The Act provides:

[Section 1] Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations is declared to be illegal. . . .

. . . .

[Section 2] Every person who shall monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor. . . .

15. Id. at 640-41.
The threshold question for analysis is whether occupational licensing is within this jurisdictional purview.\textsuperscript{20}

A. Trade or Commerce

At the inception of Sherman Act litigation, case law focused heavily on whether the activity in issue could properly be classified as constituting "trade or commerce."\textsuperscript{21} Early decisions limited the scope of "trade or commerce" to production, distribution, and exchange of goods and transportation. Manufacture of a product,\textsuperscript{22} personal efforts or services unrelated to production,\textsuperscript{23} and learned professions were not "trade or commerce" within the meaning of the Act.\textsuperscript{24} This narrow construction was short-lived in the commercial context;\textsuperscript{25} subsequent cases developed an expansive view of the "trade or commerce" requirement.\textsuperscript{26} No longer are manufacturing or personal services deemed outside "trade or commerce." Learned professions, such as law, medicine, and engineering, have also been found to be within the ambit of "trade or commerce."\textsuperscript{27}

The scope of activities considered "trade or commerce" has been defined in \textit{United States v. American Medical Association}\textsuperscript{28} as "... all occupations in which men are engaged for a livelihood."\textsuperscript{29} Applying this definition, occupations subject to licensing would seem to fall within the phrase "trade or commerce." Any remaining doubt as to the validity of this conclusion has been erased by the Supreme Court in \textit{Goldfarb v. Virginia State Bar}.\textsuperscript{30}

\textsuperscript{20} Rasmussen v. Am. Dairy Ass'n, 472 F.2d 517 (9th Cir. 1973).

Conduct of the defendant is within the jurisdictional reach of the Sherman Act if Congress can prohibit that conduct under the Commerce Clause. ... Before this general test is particularized, an important distinction should be stressed—the distinction between jurisdictional questions ... and the question of a ... substantive violation of the Sherman Act. ... Id. at 521.

\textsuperscript{21} Federal Baseball Club v. National League, 259 U.S. 200 (1922); United States v. Trans-Mo. Freight Ass'n, 166 U.S. 290 (1897); United States v. E. C. Knight Co., 156 U.S. 1 (1895); see Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899).

\textsuperscript{22} United States v. E. C. Knight Co., 156 U.S. 1 (1895).


\textsuperscript{26} United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 539, 547 (1944); United States v. American Medical Ass'n, 110 F.2d 703, 710 (D.C. Cir. 1940).


\textsuperscript{28} 110 F.2d 703 (D.C. Cir. 1940).

\textsuperscript{29} Id. at 710.
State Bar. In rejecting the "learned professions" exemption to "trade or commerce," the Court said:

[T]he nature of an occupation standing, alone, does not provide sanctuary from the Sherman Act... nor is the public service aspect of professional practice controlling in determining whether Section 1 includes professions. Congress intended to strike as broadly as it could in Section 1 of the Sherman Act... Given this broad statement, any allegation that occupational licensing does not fall within "trade or commerce" would have little merit.

B. Among The Several States

Assuming that occupational licensing is trade or commerce, a second requirement must be met before the Sherman Antitrust Act's jurisdiction attaches: "trade or commerce" must be "among the several states." "Trade or commerce" purely intrastate in character and effect fails to meet this jurisdictional test.

Most early cases turned on a local-interstate distinction in determining whether this jurisdictional requirement had been met. One of the first cases litigated under the Act, United States v. E. C. Knight Co., held that manufacture of goods was local in character and therefore outside the Act's jurisdiction. Such a local analysis greatly limited the scope of the Act.

Modern cases have rejected this local analysis. The distinct trend has been an expansive construction of the commerce clause, resulting in a broader jurisdictional reach for the Sherman Antitrust Act. Two predominate theories have advanced this trend. The first of these, plenary control, emphasizes the use of facilities of interstate movement. The

31. Id. at 2013.
33. United States v. Yellow Cab Co., 332 U.S. 218, 230 (1947). See also Evanston Cab Co. v. Chicago, 325 F.2d 907 (7th Cir. 1963) (local operation of taxicabs did not constitute interstate commerce within the meaning of the Act); John Kalin Funeral Home, Inc. v. Fultz, 315 F. Supp. 435 (W.D. Wash. 1970) (if all mortuary supplies were delivered to and came to rest in plaintiff's establishment and never resold, the Act's jurisdiction did not attach).
34. See, e.g., Industrial Ass'n v. United States, 268 U.S. 64 (1925); Hopkins v. United States, 171 U.S. 578 (1898); United States v. E. C. Knight Co. 156 U.S. 1 (1895).
35. 156 U.S. 1 (1895).
36. Id. at 16.
38. See text accompanying note 18 supra.
39. United States v. Women's Sportswear Mfrs. Ass'n, 336 U.S. 460 (1939); Las Vegas Merchant Plumbers Ass'n v. United States, 210 F.2d 732 (9th Cir. 1954). In Rasmussen v. Am. Dairy Ass'n, 472 F.2d 517 (9th Cir. 1973), the court found a local manufacturer of beverages had a sufficient relationship to the interstate commerce in fluid milk to come within Congress' plenary control over interstate commerce. The opinion, in dictum, indicated barbering may not satisfy the jurisdictional requirements.
second focuses upon the interstate impact of an activity—even one totally local in character. Under the first approach the scope of the commerce clause is based on Congress' plenary control over the instrumentalities of interstate movement. Through the “necessary and proper” clause, this control reaches back to the point of origin and forward to the point at which the modes of interstate movement are no longer involved.

Most likely, occupational licensing under state statutes would be immune from Sherman Act jurisdiction under this rationale. Licensing statutes center primarily on restricting the practice of an occupation within a given state or subdivision and do not involve tangible interstate movement.

The second approach is conceptually broader. This approach finds its genesis in the opinion of Chief Justice Marshall in Gibbons v. Ogden. Marshall defined the scope of the commerce clause as commerce which concerns or affects more than one state. It is unclear, however, what requisite effect must be achieved to meet this constitutional test. The predominate approach previously seemed to have hinged on whether the cumulative impact of the activity actually exerted a substantial economic effect on interstate commerce. If it did, then the activity—whether purely local or not—was within the realm of the commerce clause. However, in Heart of Atlanta Motel, Inc. v. United States and Perez v. United States the Court stated that the scope of the commerce clause included intrastate activity which might have a substantial effect on interstate commerce. These two cases may indicate that potential (as opposed to actual) and substantial interstate effect will be sufficient to bring the activity within the reach of the commerce clause.

Restrictive interpretations of the commerce clause continue to surface, however. A recent Supreme Court case, Goldfarb v. Virginia State Bar.
seemingly resurrects the earlier "actual effect" argument. While finding restraint on the availability of legal services substantially affects interstate commerce, the Court based its analysis on the local-interstate distinction. Citing numerous factors, the Court concluded that "a substantial volume of commerce was involved." Goldfarb indicates that facts showing actual and substantial interstate effect must be alleged to meet the Sherman Antitrust Act's jurisdictional requirements. Thus, the Court may be retreating from the "potential interstate effect" test applied in Heart of Atlanta Motel and Perez.

The impact of this decision on occupational licensing litigation cannot be underestimated. By requiring actual effect, occupational licensing statutes which create a cartel-like impact, but fail actually to affect a substantial volume of commerce, may be immune from antitrust action for failure to satisfy the jurisdictional requirements.

III. THE STATE ACTION EXEMPTION

Even if occupational licensing falls within the jurisdictional requirements of the Sherman Antitrust Act, a major obstacle confronting antitrust litigation is the state action exemption. Licensing is primarily achieved by state statute. In Parker v. Brown the Supreme Court found California's statutory program regulating prices, disposition, and production of raisins ultimately moving in interstate commerce outside the purview of the Act. The rationale of this decision rested on the premise that Section 1 of the Act was directed at private action rather than state action:

We find nothing in the language of the Sherman Act or in its history which suggests its purpose was to restrain a state or its officers or agents from activities directed by its legislature.

Respect for federal-state comity and ultimate preservation of the federal system also influenced the Parker holding. Emphasizing action by independent state officials, sanctioned by legislative mandate, Parker formed the basis for a judicially created state action exemption to the Act. The purpose of this exemption was to exclude state-compelled anti-

51. See text accompanying note 46 supra.
52. 95 S. Ct. at 2011-12.
53. Id. at 2012.
54. See text accompanying note 49 supra.
55. 317 U.S. 341 (1943). Parker involved a suit brought by a California producer and packer of raisins. The suit challenged California's Agricultural Prorate Act. The Act required each raisin producer to deliver over two-thirds of his crop to an agency authorized by law to control marketing and eliminate competition, thus increasing the price of raisins. A three judge federal court enjoined enforcement of the Act finding that it: (1) violated the Sherman Antitrust Act; and (2) constituted an undue burden on commerce. The Supreme Court reversed.
56. Id. at 352.
57. Id. at 350-51.
58. Id. at 351. See also P. Benson, The Supreme Court and the Commerce Clause 243-44 (1970).
competitive goals and means from the scope of the Act. Underpinning this exemption was the perceived congressional directive to prevent only private anticompetitive actions.  

The scope of the state action exemption has been left unclear by subsequent decisions. Attempts at definition generally emerge in one of three patterns. The majority of federal courts have adopted a three-pronged mechanical approach. A substantial minority embrace a more flexible variation of the three-pronged mechanical approach. Finally, a few courts interpret the state action exemption along the lines of a police power rationale.  

Those circuits adopting the three-pronged mechanical test embrace a restrictive view of Parker. Attempts at definition of this test can best be illustrated by Traveiner's Insurance Co. v. Blue Cross of Western Pennsylvania. In that case, the defendants argued that state regulation of the insurance business and state approval to operate as an insurance carrier in Pennsylvania exempted them from an action brought under the Sherman Antitrust Act. Rejecting this contention, the court stated that "regulation and supervision alone do not constitute a delegation of governmental authority." Further case law using this mechanical test has refined the exemption and three essential elements have emerged: (1) a legislatively created entity; (2) furtherance of an express public policy; and (3) express statutory authorization to utilize anticompetitive means to achieve the specific governmental purpose expressed. Absence of one of these elements precludes application of the state action exemption.  

Other circuits have adopted a more flexible approach. These circuits have not required all three elements of the mechanical test to be present before the state action exemption is applied. Rather, emphasis has been...
placed on the existence of statutorily created state machinery and state supervision implementing an important state policy. If these factors are present, the *Parker* state action exemption will apply. This approach differs from the mechanical test in that it does not require an express statutory goal of anticompetitive activity, nor does it necessarily require expressly authorized anticompetitive means to achieve the state policy. The emphasis of this approach focuses upon a statutorily created agency and an overriding public interest. Failure to control affirmatively the activities of such an agency, or expressly to set out approval of anticompetitive goals and means in the enabling statute does not preclude application of the state action exemption.

The third interpretative approach, present in a few cases, rests its analysis primarily upon state regulation falling within the scope of a state's police power. This approach emphasizes a state's compelling interest in protection of public health, safety, and other valid interests. Presence of such an interest, without more, triggers the state action exemption. Absence of express state anticompetitive goals, authorization of anticompetitive means, or lack of state supervision do not in themselves preclude application of the state action exemption.

The continued predominance of the mechanical test was recently thrown into question by the *Goldfarb* decision. The Supreme Court did not expressly adopt the mechanical test enunciated in lower court decisions, nor did it cite to any case law adopting this test in support of its position. Rather, the Court, while recognizing the existence of a state statute and state agency, expressed the prerequisites for the state action exemption as "activity compelled by the state as sovereign." The Court, in dictum, stated:

We recognize that the States have a compelling interest in the practice of professions within their boundaries, and that as part of their power to protect the public health, safety, and other valid

69. *Id.* at 251-52.
70. *Id.* at 252.

The concept of state action is not susceptible to rigid, bright-line rules. Each case must be considered on its own facts in order to determine whether or not the anti-competitive consequence is truly the action of the state.

*Id.* at 1294.
75. The *Goldfarb* opinion did, however, cite *Olsen v. Smith*, discussed note 72 *supra*. *See note 63* and accompanying text *supra*.
interests they have broad power to establish standards for licensing practitioners and regulating the practice of professions.77

The Goldfarb rationale for the state action exemption approximates the third interpretative approach. The opinion may indicate a shift toward a broader exemption coextensive with a state's police power.

Expansion of the state action exemption would have strong repercussions in occupational licensing litigation. Occupational licensing, by its very definition, is statutory. It may very well be argued under the police power test that such licensure is properly deemed a "compelling interest . . . of the state to protect public health, safety, and other valid interests. . . ." If this argument is sustained, occupational licensing would be immune from the remedial efforts of the Sherman Antitrust Act.

Similarly, if the second approach were applied, occupational licensing could properly be found within the state action exemption if a statutorily created licensing agency was deemed to further an important state policy. The exemption would apply regardless of the lack of affirmative control over licensing activities or absence of an express statutory intention to utilize anticompetitive means toward achievement of an anticompetitive goal. Consequently, the cartel-like effect of licensing statutes would be imposed without inquiry into the presence of legislative intention to impose such a result.

Under the three-pronged mechanical test, occupational licensing would not be exempt per se from the thrust of the Act. Although occupational licensing has its genesis in state statutes, this alone would not invoke the state action exemption. Generally, monopolistic public policy is not expressed in the licensing statutes, nor are anticompetitive means authorized to achieve a monopolistic policy. Absence of either of these elements would preclude invocation of the state action exemption and subject occupational licensing to antitrust litigation.79

Such a strict construction of Parker comports with the basic policy underlying the Act.80 Although designed to apply solely to private action,81 the objective of the Act is to promote and protect a competitive economic system and exceptions to its application should be narrowly construed. This goal would not be vitiated by a narrow construction of the Parker exemption. Indeed, the Court in Parker stated that the exemption did not apply to private action masquerading as state action.82 Furthermore, the Parker decision was influenced by the existence of an express federal policy coextensive with state policy.83 California had adopted a state

77. Id. at 2016.
78. Id.
82. Id. at 351.
83. See P. Benson, supra note 58, at 244.
statute similar to the Federal Agricultural Agreement Act. The California statute covered areas of commerce in which Congress had not expressly legislated, but which directly effectuated policies of the federal statute. This consistency of interest, arguably, was the pivotal factor in the Parker decision. Accordingly, this factor should limit the scope of the state action exemption to state programs consistent with an express national policy.\textsuperscript{84}

The narrow three-pronged mechanical test is the most favorable to litigants attacking occupational licensing. Unless an express state policy, expressly authorizing anticompetitive means is sanctioned for use by a legislatively created entity, the state action exemption should not apply and occupational licensing would not be immune from the reach of the Sherman Antitrust Act.

IV. AN UNREASONABLE RESTRAINT OF TRADE

Assuming occupational licensing is not immune from the Sherman Antitrust Act by reason of the state action exemption, liability is not automatic. Liability under the Act is based upon an activity's injury to the public.\textsuperscript{85} A corollary to finding public injury is a finding that the activity in issue is unreasonable under the facts of the particular situation\textsuperscript{86} or because the very nature of the activity is unreasonable per se.\textsuperscript{87}

The reasonableness standard is a judicially created concept.\textsuperscript{88} It finds statutory support, however, in the express statutory policy to promote competition and protect the public from the effects of a noncompetitive market.\textsuperscript{89} It follows that only conduct that offends this statutory policy should be condemned as an unreasonable restraint of trade.\textsuperscript{90}

Determining what constitutes unreasonable activities or practices is

\textsuperscript{84} Cf. Hecht v. Pro-Football, 444 F.2d 931, 937 (D.C. Cir. 1971).
\textsuperscript{85} Rogers v. Douglas Tobacco Board of Trade, Inc., 266 F.2d 636, 644 (5th Cir. 1959).
\textsuperscript{86} Standard Oil Co. v. United States, 221 U.S. 1, 63 (1911); Lynch v. Magnavox Co., 94 F.2d 883, 891 (9th Cir. 1938); Sandidge v. Rogers, 167 F. Supp. 553, 559-60 (S.D. Ind. 1958). See also Feddersen Motors, Inc. v. Ward, 180 F.2d 519 (10th Cir. 1950).
\textsuperscript{87} Certain activities are per se unreasonable—i.e., the activity is so likely to injure the public under any set of circumstances that no inquiry is made into the existing fact situation. Courts have found price fixing, division of markets, group boycotts and tying arrangements to be per se unreasonable. Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958).
\textsuperscript{89} United States v. Union Pac. R.R. Co., 226 U.S. 61 (1912).

To preserve from undue restraint the free action of competition in interstate commerce was the purpose which controlled Congress in enacting this statute [Sherman Antitrust Act], and the courts should construe the law with a view to effecting the object of its enactment.

\textit{Id.} at 87.
\textit{Id.}
a difficult task. Courts must analyze all economic factors peculiar to the particular trade or industry and their effect on the competitive market. Pertinent factors considered in making this determination traditionally include: (1) the intensity and dimension of the relevant market; (2) the history of the restraint; (3) the nature of the restraint and its effect, actual or probable; and (4) the evil believed to exist, the reason for adopting the particular remedy, and the purpose or end sought to be attained.

Examination of occupational licensing statutes in terms of all the above factors is a prerequisite to finding a licensing scheme an unreasonable restraint of trade. Each licensing scheme would have to be examined in light of its particular factual context. The last two of the above factors particularly lend themselves to a general analysis.

The nature of the restraint imposed by occupational licensing is a barrier to entry. Empirical evidence supports the conclusion that most occupational licensing statutes have an inhibiting effect on free competition thereby causing public injury. A case study reported by the Federal Trade Commission is illustrative. The study compared television repair rates in two states, one utilizing a licensure system and the other a certification system. The licensing state had repair bills twenty percent higher than those in the nonlicensed system. This study strongly suggests that the effect of such licensing statutes, by limiting the number of sellers of a product or service, is to force prices to a high, noncompetitive level.

The last factor encompasses a balancing test. Proponents of occupational licensing argue that public health and welfare would be endangered in the absence of regulatory statutes. Therefore, they contend, occupational licensing statutes protect the innocent public against the abuses of charlatans and insure that only competent persons are allowed to engage in the occupation. This argument might have significant merit in a situation where an unwary consumer who is victimized by an incompetent practitioner would suffer irremediable harm, such as medicine, law, and other professions, but it loses its potency in the nonprofessional area.

A pivotal argument in support of finding occupational licensing an unreasonable restraint of trade in nonprofessional fields is the availability

91. Chicago Board of Trade v. United States, 246 U.S. 231 (1918).
92. Id. at 238.
93. The legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.
96. See W. GELLHORN, supra note 2, at 109.
of alternative methods which advance the same interests that licensing purports to further. By either registration or certification the public interest can be protected without the resultant public injury imposed by a licensing scheme.

Registration is the least restrictive alternative. By requiring all individuals who wish to practice a given trade to register with the state, consumers may choose among all available sellers. Any seller who does not sufficiently produce will eventually be cast aside in favor of sellers whose products or services measure up to consumer standards.

Certification is a second available alternative. Under a certification scheme a governmental agency may certify an individual as qualified to practice a particular trade, but may not prevent noncertified persons from selling the same product or service. Consumers are thus given the choice of selecting among all available sellers. Simultaneously, certification assures that those certified are competent.

Perhaps the most persuasive factor courts should consider in determining the reasonableness of occupational licensing statutes is the policy underlying the Sherman Antitrust Act itself. This policy was most aptly stated in Northern Pacific Railway Company v. United States:

It [the Sherman Antitrust Act] rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.

Occupational licensing statutes inherently conflict with this policy by creating barriers to entry. To find a licensing statute reasonable, courts must analyze the factors previously listed. Only if the competitive policy of the Act is outweighed by competing public interests should occupational licensing be deemed reasonable.

V. Conclusion

Occupational licensing statutes present an analytical dilemma. Most certainly, many statutes blatantly offend the competitive economic policy the Sherman Antitrust Act seeks to advance. However, these statutes may be immune from the thrust of the antitrust remedies because of lack of jurisdiction under the commerce clause or the state action exemption. Any litigant seeking to subject occupational licensing to antitrust analysis will be faced with these problems.

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97. See M. Friedman, supra note 2, at 148-49; Barron, supra note 4, at 660-65.
98. See Barron, supra note 4, at 662, 664.
99. See M. Friedman, supra note 2, at 149; Barron, supra note 4, at 663.
100. 356 U.S. 1 (1958).
101. Id. at 4.
The major problem facing courts in occupational licensing litigation will be the determination of which statutes should be preserved. Not every occupational licensing scheme should fall under the Act. In many professions it may be persuasively argued that licensing is the only adequate safeguard preventing irreparable public injury. This argument is particularly strong in the legal and health professions. In both, the consumer may not have sufficient knowledge or expertise to choose a qualified practitioner. A wrong choice could be an irreversible decision jeopardizing life or property. In such situations public policy must be counterbalanced against economic ideals. Where the reasonableness of the restraint of trade outweighs the competitive philosophy of the Sherman Antitrust Act, the competitive ideal must give way to prevent public injury.

KATHLEEN SOWLE STOLAR
Recent Cases

AFFIRMATIVE DEFENSES AND THE FIFTH AMENDMENT—BOTH SWORD AND SHIELD IN MISSOURI

State ex rel. Pulliam v. Swink

Defendant was involved in an automobile collision in which the driver of the other vehicle was killed. The wife of the deceased filed suit for the wrongful death of her husband. Defendant's answer generally denied the plaintiff's allegations and asserted contributory negligence as a defense. Both parties appeared at the appointed time for the taking of depositions. The plaintiff's deposition was taken first and she answered all questions. The defendant was then sworn and plaintiff's counsel began to take his deposition. The defendant gave only his name and address and thereafter refused to answer any questions on the ground that to do so might incriminate him. At trial, the plaintiff moved to strike the defendant's answer pursuant to section 491.180, RSMo 1969, which provides:

If a party, on being duly summoned, refuse [sic] to attend and testify, either in court or before any person authorized to take his deposition, besides being punished himself as for a contempt, his petition, answer or reply may be rejected, or a motion, if made by himself, overruled, or, if made by the adverse party, sustained.

The trial judge indicated his intention to sustain the plaintiff's motion. The defendant sought and obtained a preliminary writ of prohibition from the Missouri Court of Appeals, St. Louis District. The writ was transferred to the Supreme Court of Missouri where it was made permanent. The court held that where a defendant seeks no affirmative relief and makes a good faith assertion of his constitutional privilege to remain silent at the first opportunity, a trial court would exceed its jurisdiction if it entered an order striking the defendant's answer.

Although in both the United States and the Missouri constitutions the privilege against self-incrimination is phrased in terms of criminal proceedings, the privilege is available to witnesses in both criminal and civil actions. Generally speaking, a penalty may not be imposed against a party who makes a valid assertion of this privilege. However, a majority of

1. 514 S.W.2d 559 (Mo. En Banc 1974).
2. For a general discussion as to the scope and problems of the privilege, see 8 J. Wigmore, Evidence §§ 2254-66 (McNaughton rev. 1961); see also State ex rel. North v. Kirtley, 327 S.W.2d 166 (Mo. En Banc 1959); Morgan, The Privilege Against Self-Incrimination, 34 Minn. L. Rev. 1 (1949).
3. Spevack v. Klein, 385 U.S. 511 (1967); Garrity v. New Jersey, 385 U.S. 493 (1967); Malloy v. Hogan, 378 U.S. 1 (1964). In none of these cases was the party seeking any affirmative relief or asserting any affirmative defenses.
jурисдикции⁴ have refused to allow either a plaintiff⁵ or defendant⁶ to obtain affirmative relief while refusing to testify on matters which, if known, might bar the granting of such relief. The rationale behind this approach is that the fifth amendment was not intended to be "both a sword and a shield."

Under this reasoning, the privilege against self-incrimination is analogous to the doctor-patient privilege. A patient has the right to prevent his physician from testifying;⁸ however, this privilege is waived if the patient files a suit for personal injuries because such a suit places the patient's physical condition in issue.⁹ Similarly, if a party's cause of action is based on facts peculiarly within his knowledge, that party waives the privilege against self-incrimination as to these facts when he seeks such affirmative relief.¹⁰ The Pulliam⁴ court endorsed this reasoning, saying: "It is not unfair to preclude one who invokes the assistance of the courts from recovery when he refuses to produce evidence peculiarly within his knowledge pertinent to his right to recover."¹¹ The question to be pursued by this note is whether asserting an affirmative defense constitutes "invoking the assistance of the courts."

Some courts have refused to allow the assertion of an affirmative defense by a defendant who invokes the fifth amendment in connection with the proceedings. In Rubenstein v. Kleven¹² an unmarried woman brought an action against a married man for breach of a contract under which the plaintiff was to render companionship and other services to the defendant. The defendant's answer asserted the illegality of the alleged contract as a defense. At deposition, the defendant asserted the privilege against self-incrimination in response to certain questions to which an affirmative answer might have indicated adultery. The United States District Court of Massachusetts held that the defendant could not assert the affirmative defense of illegality, based on a criminal act involving himself, while claiming the privilege against self-incrimination. The court said further

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8. § 491.060, RSMo 1969.
11. 514 S.W.2d at 561.
that the defendant could not use "the testimony of any witness" or establish that the acts occurred "simply by inference" while claiming the privilege against self-incrimination.\(^{13}\)

The United States Court of Appeals for the Eighth Circuit recently upheld the dismissal with prejudice of a defendant's affirmative defenses and counterclaims where the defendant had refused to answer interrogatories on the ground that to do so might incriminate him.\(^{14}\) The decision was based on a finding of bad faith on the part of the defendant, but the following language indicates the court's position in relation to the invocation of the fifth amendment by a party asserting an affirmative defense:

("T]he right to assert the privilege does not, a priori, free the claimant of the responsibility to respond in pre-trial discovery when information sought bears upon the claimant's own counterclaim and affirmative defenses.\(^{15}\)

In Pulliam the Missouri Supreme Court discussed and expressly affirmed\(^ {16}\) Franklin v. Franklin.\(^ {17}\) Franklin was a divorce case in which the plaintiff wife, relying on the fifth amendment, refused to answer written interrogatories regarding the status of her previous marriage. This refusal was held to justify striking her pleadings. The court recognized her right to assert the privilege, but said she may not by virtue of that privilege obtain affirmative relief.\(^ {18}\)

The Pulliam court also expressly affirmed\(^ {19}\) Geldback Transport, Inc. v. Delay.\(^ {20}\) Geldback was a replevin action against two defendants wherein one defendant cross-claimed alleging that he was entitled to possession of the chattel in question. His co-defendant sought by interrogatories to discover how and from whom this right to possession was obtained. Following the cross-claimant's refusal to answer on the ground that to do so might incriminate him, the trial court dismissed the cross-claim. The appellate court affirmed the dismissal on the basis that a party should not be allowed to seek affirmative relief without disclosing the basis of his claim.\(^ {21}\)

\(^{13}\) Id. at 48.

\(^{14}\) General Dynamics Corp. v. Selb Manufacturing Co., 481 F.2d 1204 (8th Cir. 1973). The dismissal was based on FED. R. Civ. P. 37(b)(2), which provides: \([T]he court in which the action is pending may make such orders in regard to a failure to obey an order to provide discovery as are just, and among others the following: \)

\(^{15}\) C. An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party.

\(^{16}\) 481 F.2d at 1213 (emphasis added).

\(^{17}\) 514 S.W.2d at 561.

\(^{18}\) 283 S.W.2d 483 (Mo. En Banc 1955).

\(^{19}\) Id. at 485.

\(^{20}\) 514 S.W.2d at 561.

\(^{21}\) 443 S.W.2d 120 (Mo. 1969).
The affirmation of Franklin and Geldback by the Pulliam court maintained the long-standing position of the Missouri Supreme Court that if the privilege against self-incrimination is asserted by a party seeking affirmative relief, the trial court may strike that party's pleadings. The application of this statutory sanction is generally held to be within the discretion of the trial court, to be reversed only in cases of clear abuse. Such a striking is not a violation of due process. The importance of Pulliam is that implicit in the court's decision is the concept that a party is not "invoking the assistance of the courts" when he asserts an affirmative defense. Pulliam stands for the proposition that a party in Missouri can both plead an affirmative defense and invoke the fifth amendment during all phases of the proceeding. As pointed out by the dissenting opinion of Judge Finch, the majority's refusal to equate an affirmative defense with affirmative relief is open to criticism.

The defendant in Pulliam not only denied his own negligence, but also asserted that the plaintiff's deceased was negligent. Contributory negligence is an affirmative defense with the burden of proof on the defendant. The existence of contributory negligence on the part of the plaintiff is a complete bar to his recovery. Assuming that the defendant in Pulliam was in fact negligent, there arose in the plaintiff a right of action, such right being the personal property of the plaintiff. Assume also that, in the absence of contributory negligence, a jury would award damages of $50,000, thereby assigning a dollar value to his "property." If the defendant is successful in establishing a defense of contributory negligence, the plaintiff will be unable to collect any of this claim. As a practical matter, the defendant is seeking affirmative relief from the court in the full amount of plaintiff's claim. If the defendant was seeking a set-off of all or part of plaintiff's claim via a counterclaim, and at the same time asserting a privilege against self-incrimination as to some element of his counterclaim, the court would deny him this affirmative relief. Yet, the court in Pulliam said that absent some bad faith or waiver on the part of the defendant, a trial court would exceed its jurisdiction by striking the affirmative defense of contributory negli-

22. Franklin v. Franklin, 283 S.W.2d 483 (Mo. En Banc 1955).
23. § 491.180, RSMo 1969.
24. Graveman v. Huncker, 139 S.W.2d 494 (Mo. 1940); Frankel v. Hudson, 271 Mo. 495, 196 S.W. 1121 (1917); State v. Buckstead, 399 S.W.2d 622 (K.C. Mo. App. 1966); State v. Reagan, 382 S.W.2d 425 (St. L. Mo. App. 1964); Kaiser v. Gardiner, 211 S.W. 883 (St. L. Mo. App. 1919); Dustin v. Farrelly, 81 Mo. App. 380 (1899).
25. Miles v. Armour, 239 Mo. 438, 144 S.W. 424 (1912).
26. 514 S.W.2d at 562.
27. Fed. R. Civ. P. 8 (c); Mo. Sup. Ct. R. 55.10.
30. See generally C.J.S. Property § 9 at 175; Clark v. Baker, 186 Ga. 65, 196 S.E. 750 (1938); Cincinnati v. Hafer, 49 Ohio St. 60, 30 N.E. 197 (1892).
gence, even though the defendant, by virtue of the fifth amendment, conceals facts essential to that defense. To deny affirmative relief in one situation and grant what amounts to affirmative relief in the other is arguably inconsistent.

If the defendant in a civil suit is allowed to assert both his privilege against self-incrimination and an affirmative defense, he has a decided advantage. The party bringing the action must submit to being fully deposed, but will be effectively denied the right to take the defendant’s deposition, and will thereby be deprived of a prime opportunity to obtain admissions and impeachable statements. Furthermore, the plaintiff must face the perils of cross-examination at trial, while the defendant sits comfortably behind the fifth amendment.

The Pulliam court acknowledged that "... in some situations the ruling ... will present hardships to other litigants." Such hardships would be greatly reduced if the court would apply consistent reasoning and bar affirmative defenses as well as direct affirmative relief when a party utilizes the fifth amendment shield.

JOEL WILSON

BANKRUPTCY—
LOSS OF EXEMPTIONS IN BANKRUPTCY—
THE SECTION 6 PROVISO

In re Myers¹

Ten days before filing a voluntary petition in bankruptcy, the bankrupt conveyed title to residential property, which she had held as sole owner, to her husband and herself as tenants by the entirety. The trustee in bankruptcy filed a petition to take possession and control of the property on the ground that the conveyance was fraudulent under section 67d of the Bankruptcy Act.² After a hearing, the referee found that the transfer was made without fair consideration, at a time when the bankrupt was insolvent, and with actual intent to defraud creditors, in violation of sections 67d(2)(a) and 67d(2)(d) of the Bankruptcy Act.³ He ordered the

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3. Sections 67d (2)(a) and (2)(d) provide that:
Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this Act by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or ... (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors.

32. 514 S.W.2d at 561.
conveyance set aside and possession of the premises given up for sale by the trustee. The bankrupt objected to the referee's order alleging that it made no provision for her homestead exemption as provided by section 513.475, RSMo 1969. The referee rejected this claim on the ground that the proviso to section 6 of the Bankruptcy Act specifically provides that the bankrupt cannot claim an exemption in property recovered by the trustee. Pursuant to section 39c of the Bankruptcy Act, bankrupt sought review of the referee's order disallowing the homestead exemption. On review, the district court upheld the referee's order.

Section 6 of the Bankruptcy Act provides:

This title shall not affect allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the petition in the State wherein they have had their domicile.

It is well-established that this language "makes the state laws . . . the measure of the right to exemptions" allowed a bankrupt. This means that the variety of exemptions allowed by state law are to be recognized in bankruptcy, as well as the construction state courts have given the exemption laws. State law, however, is not always the only consideration, because "even if the state law permits the exemption, it also must be one allowable under federal law." The federal law which must be considered in bankruptcy is, of course, the Bankruptcy Act itself.

In 1938 Congress amended the Bankruptcy Act by passing the Chandler Act. This Act added the following proviso to section 6:

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4. Section 513.475, RSMo 1969, provides:
The homestead of every housekeeper or head of a family, consisting of a dwelling house and appurtenances, and the land used in connection therewith, not exceeding the amount in value herein limited, which is or shall be used by such housekeeper or head of a family as such homestead, shall, together with the rents, issues and products thereof, be exempt from attachment and execution, except as herein provided; such homestead in the country shall not include more than one hundred and sixty acres of land, or exceed the total value of fifteen hundred dollars; and in cities having a population of forty thousand or more, such homestead shall not include more than eighteen square rods of ground, or exceed the total value of three thousand dollars; and in cities having a population of ten thousand and less than forty thousand, such homestead shall not include more than thirty square rods of ground, or exceed the total value of fifteen hundred dollars; and in cities and incorporated townships and villages having a population of less than ten thousand, such homestead shall not include more than five acres of ground, or exceed the total value of fifteen hundred dollars.

7. 383 F. Supp. at 262.
Provided, however, that no such allowance shall be made out of the property which a bankrupt transferred or concealed and which is recovered or the transfer of which is avoided under this Act for the benefit of the estate, except that, where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess.\textsuperscript{13}

Prior to the adoption of this proviso there was a split of authority as to whether a bankrupt could claim exemptions in property that had been recovered by the trustee in bankruptcy following the bankrupt's fraudulent conveyance of the property.\textsuperscript{14} "Most of the decisions had reference to the applicable state law, since the Bankruptcy Act had no express provisions on the subject."\textsuperscript{15} Where such claims were made, the decisions allowing the exemptions rested on one of two bases. First, to the extent of the exemption, the conveyance was considered not to have harmed creditors.\textsuperscript{10} Second, the statutory provision for the homestead exemption was deemed to be for the benefit of the bankrupt's family as well as the bankrupt; thus, to deny the exemption would be to give "creditors a profit out of the attempted fraud, at the expense of the family..."\textsuperscript{17} Some decisions denying the exemptions rested upon the ground that the bankrupt forfeited his exemption by his fraudulent conduct.\textsuperscript{18} Others held that when the conveyance was set aside as fraudulent, title did not again vest in the bankrupt; thus, the bankrupt owned no property out of which an exemption could be claimed at the time the petition in bankruptcy was filed.\textsuperscript{19}

Congress enacted the proviso to section 6 in an effort to resolve this conflict.\textsuperscript{20} Judges,\textsuperscript{21} commentators,\textsuperscript{22} and treatises\textsuperscript{23} all seem to agree that

\begin{itemize}
  \item \textsuperscript{13} 11 U.S.C. § 24 (1970).
  \item \textsuperscript{14} I.A. Collier on Bankruptcy §§ 6.11[4], 856-57 (14th ed. 1975); 161 A.L.R. 1009, 1018-1019 (1946).
  \item \textsuperscript{15} I.A. Collier on Bankruptcy §§ 6.11[4], 856-57 (14th ed. 1975).
  \item \textsuperscript{16} See, e.g., In re Thompson, 140 F. 257 (D.C. Wash. 1905). This is the view taken by Missouri courts. See cases cited note 36 infra.
  \item \textsuperscript{17} See, e.g., Cox v. Wilder, 6 Fed. Cas. 684 (No. 3,308) (C.C. Mo. 1872).
  \item \textsuperscript{18} See, e.g., In re Hupp, 43 F.2d 159 (S.D. Cal. 1930); In re Coddington, 126 F. 891 (M.D. Pa. 1904).
  \item \textsuperscript{19} See, e.g., In re Heeg, 22 Am. Bankr. R. 120 (D.C. Ref. Wisc. 1932).
  \item \textsuperscript{20} In the proviso added to [section 6] no allowance shall be made for exemptions out of property which is recovered after a preference or fraudulent transfer. The decisions are conflicting and it is considered that the law should be made clear that a bankrupt should not profit at the expense of the creditors from the efforts of the trustee in undoing the bankrupt's own acts.
  \item \textsuperscript{21} H.R. Rep. No. 1409, 75th Cong., 1st Sess. 9 (1937).
  \item \textsuperscript{22} See, e.g., In re Grisanti, 58 F. Supp. 646 (W.D. Ky. 1945):

  [I]t was the intention of Congress in enacting this proviso in the 1938 Act to clear up this conflict by making the matter uniform throughout the country and not to permit an allowance to be made out of property which is recovered after a preference or fraudulent transfer.

  \item \textsuperscript{23} It would seem that a bankrupt may not claim a homestead in property fraudulently conveyed, transferred by way of preference, or concealed from the trustee and creditors in the bankruptcy proceedings.
\end{itemize}
this proviso effectively eliminates a bankrupt’s right to claim exemptions in property once it has been recovered by the trustee after having been fraudulently conveyed by the bankrupt. In *Myers* the referee found the conveyance of the bankrupt's homestead to be fraudulent. The bankrupt did not seek review of this finding. The referee set aside the conveyance and correctly denied the bankrupt's claim to a homestead exemption under the proviso to section 6.

Section 70c of the Bankruptcy Act allows the trustee to assume the position of a creditor who possesses a lien on the property of the bankrupt. Thus, where state law dictates that an exemption cannot be claimed against a creditor who has levied on property of the debtor, it also cannot be claimed against the trustee, who represents all creditors in a bankruptcy proceeding. Bankrupts have lost their homestead exemption, for example, by failing to perfect the exemption with a filing required under local law declaring their residence a homestead. Such a result would not occur where no filing is required to perfect a homestead or other exemption.

In Missouri, the homestead exemption is automatically perfected against all causes of action which mature after the filing of the deed vesting title in the debtor. To establish a homestead in Missouri the debtor is merely required to own and occupy the residence as a homestead. Failure to continue to meet the requirements of ownership and occupancy may be deemed a waiver or abandonment of the homestead exemption. What constitutes an abandonment depends upon the facts of each case.

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23. Under the terms of the Act of 1938, the conflict has been stilled. It is clear, therefore, that wherever the trustee recovers property transferred or concealed by the bankrupt, or where any transfer can be avoided under the terms of the Act, the bankrupt will not be allowed to amend his schedules and claim exemptions out of that particular property, save in the situation within the “except” clause.

IA *COLLIER ON BANKRUPTCY* ¶ 6.11[4], 857 (14th ed. 1975).

24. The referee’s finding that the conveyance was fraudulent and may be set aside in toto, even though a portion of the property may have been exempt, was undoubtedly correct under sections 67d(2)(a) and 67d(2)(d) of the Bankruptcy Act. See Haskins, *Homestead Exemptions*, 63 Harv. L. Rev. 1289, 1318 (1950):

[I]f both the homestead and nonexempt property are fraudulently conveyed in one parcel, or if an excessive homestead or one reachable by some creditors is fraudulently conveyed, the trustee may set aside the transfer and the bankrupt can not claim a homestead exemption. (Emphasis added).

See also 4 *COLLIER ON BANKRUPTCY* ¶ 67.30, 490 (14th ed. 1975).


27. See 1A *COLLIER ON BANKRUPTCY* ¶ 6.15, 877 (14th ed. 1975).


29. Dent v. Dent, 350 Mo. 560, 568, 166 S.W.2d 582, 586 (1942); Palmer v. Omer, 316 Mo. 1188, 1194, 295 S.W. 123, 125 (1927).


example, although a lease of property which was a homestead may constitute abandonment, it has been held that temporarily renting the homestead does not. A valid conveyance by a debtor of his homestead clearly constitutes an abandonment of the claim to the exemption.

A conveyance which consists only of exempt property cannot be set aside in a Missouri state court as a fraud against creditors, even though made without consideration and with intent to defraud creditors. This is because creditors could not have reached the property even if the conveyance had not been made. Where a transfer is made of property which includes exempt homestead property, but is in excess of the exemption allowed with respect to acreage or value, the conveyance may be set aside as fraudulent. The debtor, however, may still claim his homestead exemption out of the property conveyed on the theory that, to the extent of the exemption, the conveyance was not fraudulent. Simply stated, the law of Missouri is that the conveyance of a homestead is fraudulent only to the extent that the value of the property conveyed exceeds the exemptions which could have been claimed therein had it not been conveyed. Therefore, such a conveyance does not destroy the exemption.

Were state law the only factor to be considered, then, the bankrupt in Myers would not have lost her homestead exemption by her conveyance of the homestead property, even though the property conveyed may have been in excess of the exemption and in fraud of her creditors. Where exemptions are claimed in a bankruptcy proceeding, however, state law is preempted by the Bankruptcy Act. "Once bankruptcy has intervened, the time manner and conditions under which such exemption may be claimed as against the trustee are matters of federal law, and are determined by the Bankruptcy Act." In Myers the proviso to section 6 preempted Missouri law to deny the bankrupt her exemption.

34. This proposition is accepted by both state courts and bankruptcy courts. See Phillips v. C. Palomo & Sons, 270 F.2d 791 (5th Cir. 1959); Kilgo v. United Distributors, 223 F.2d 167 (5th Cir. 1955); Beall v. Pinckney, 150 F.2d 467 (5th Cir. 1945); Bostian v. Jones, 244 S.W.2d 1 (Mo. 1951); Moberly v. Watson, 340 Mo. 820, 102 S.W.2d 886 (1937); May v. Gibler, 319 Mo. 672, 4 S.W.2d 769 (1928); Armor v. Lewis, 252 Mo. 568, 161 S.W. 251 (1913); Seilert v. McAnally, 223 Mo. 505, 122 S.W. 1064 (1909); Reed Bros. v. Nicholson, 189 Mo. 396, 88 S.W. 71 (1905); Stam v. Smith, 183 Mo. 464, 81 S.W. 1217 (1904); Spratt v. Easley, 169 Mo. 357, 69 S.W. 13 (1902); Rose v. Smith, 167 Mo. 81, 66 S.W. 940 (1901); Bartels v. Kinninger, 144 Mo. 370, 46 S.W. 163 (1898); Hart v. Leete, 104 Mo. 815, 15 S.W. 976 (1891); Davis v. Land, 88 Mo. 436 (1885); State v. Diveling, 66 Mo. 375 (1877).
35. See statute quoted note 4 supra.
36. See Bank of New Cambria v. Briggs, 361 Mo. 723, 236 S.W.2d 289 (1951), where, in a suit by a levying judgment creditor, it was held that a conveyance of homestead property by an insolvent debtor was fraudulent only to the extent that the property's value exceeded the exemption. See also Moberly v. Watson, 340 Mo. 820, 102 S.W.2d 886 (1937); May v. Gibler, 319 Mo. 672, 4 S.W.2d 769 (1928); Reed Bros. v. Nicholson, 189 Mo. 396, 88 S.W. 71 (1905).
The Missouri practitioner should be mindful of the differences between ordinary debtor-creditor cases and those involving bankruptcy. Where the debtor seeks an exemption in property, the fraudulent conveyance of which has been set aside by a levying creditor, the debtor will generally be allowed the exemption. Where bankruptcy is involved, however, the proviso to section 6 will apply and the exemption will be denied. The only exceptions to the application of the proviso appear to be where the trustee has set aside a general assignment for the benefit of the bankrupt's creditors and where the transfer that was set aside was made by way of security within the "except" clause to the proviso.

Counsel for an insolvent client should advise against conveying or concealing property out of which exemptions may be claimed, in order to avoid the proviso's application. If a fraudulent conveyance of homestead property has already been made, as was the case in Myers, the debtor should attempt to have the conveyance rescinded prior to any action by the trustee to recover the property. If this is done, it may be argued that the proviso applies only if there has been a recovery of property under the Bankruptcy Act, and that a voluntary recovery by the bankrupt is not such a recovery.

Bruce H. Beckett

Gardner denied a claimed exemption out of property recovered by the trustee under the proviso to section 6 of the Bankruptcy Act, holding that setting aside a fraudulent conveyance did not re vest title in the bankrupt so as to allow him to claim an exemption out of the property so recovered, and that even if title did return to the bankrupt, the proviso would bar an amendment of his schedules of property and exemptions claimed. For other cases concerning the application of the proviso, see In re Smith, 366 F. Supp. 1213 (D.C. Idaho 1973) (the proviso has no application where the conveyance of bankrupt's homestead was by deed of trust for security purposes); In re Sherk, 108 F. Supp. 138 (N.D. Ohio 1952) (where trustee recovered money settlements from transferees of the bankrupt in lieu of setting aside the transfers as fraudulent, the bankrupt was denied an exemption out of those settlements); In re Grisanti, 58 F. Supp. 646 (W.D. Ky. 1945) (where a creditor was denied status as a secured creditor because the encumbrance given him by the bankrupt was fraudulent, the bankrupt's claimed homestead exemption in the encumbered property was denied); In re Rogers, 45 F. Supp. 297 (E.D.N.Y. 1942) (bankrupt could not claim exemptions out of the cash surrender value of a life insurance policy he owned which he had attempted to conceal from the trustee in bankruptcy).


39. 1A Collier on Bankruptcy ¶ 6.11[4], 857 (14th ed. 1975).
BANKS AND BANKING--
BANK CHARTERS IN MISSOURI--
A NEW APPROACH?

Central Bank of Clayton v. State Banking Board of Missouri

In October 1971, five officers of the Bank of St. Louis filed articles of agreement for the incorporation of a new bank with the Missouri Commissioner of Finance. The bank was to be called the Central Bank of Clayton. In accordance with section 362.030, RSMo 1969, the Commissioner ordered an investigation to determine if the incorporators had complied with statutory requirements. After a two month investigation, the Commissioner issued a charter for the proposed bank, finding that "all the requirements of sections 362.020; 362.025; and 362.030 RSMo have been met." The Commissioner's decision was made without a contested hearing, although he did receive and include in the record letters of protest from existing Clayton banks.

An appeal to the State Banking Board was certified by the protesting Clayton banks, alleging that the convenience and needs of the community did not justify the granting of a new bank charter. The Board held a hearing on the appeal at which evidence relating to the "convenience and needs of the community to be served" by the new bank was taken. Three expert witnesses testified and two others submitted reports. The Board also received the report of the Commissioner's investigation. The Board revoked the charter, finding that the evidence did not sup-

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1. 509 S.W.2d 175 (Mo. App., D. St. L. 1974).
2. The chartering procedure in Missouri is set out in sections 362.015-040, RSMo 1969, and consists of five or more people filing articles of agreement to incorporate with the Commissioner of Finance. The Commissioner then conducts an investigation to determine if the statutory requirements of section 362.030 have been met. No hearing is required. If the Commissioner is satisfied that the requirements have been met, the charter is issued and recorded in the county or city in which the corporation is located.
3. This section provides in part:
   1. When any bank or trust company has filed . . . its articles of agreement, paid all incorporation and other fees in full, as required by law, and provided the cash required by law, the commissioner . . . shall cause an examination to be made to ascertain whether the requisite capital of the bank or trust company has been subscribed in good faith and paid in actual cash and is ready for use in the transaction of business of the proposed bank or trust company, and whether the character, responsibility and general fitness of the persons named in the articles of agreement are such as to command confidence and warrant belief that the business of the proposed corporation will be conducted honestly and efficiently . . . and if the convenience and needs of the community to be served justify and warrant the opening of the bank or trust company therein, and if the probable volume of business in such locality is sufficient to insure and maintain the solvency of the new bank or trust company and the solvency of the then existing banks and trust companies in the locality, without endangering the safety of any bank. . . .
port a finding that the convenience and needs of the community would be served by granting the charter. The Board found that the applicant had failed to show a "public need" for the new bank or any complaints about, or inadequacy of, present banking services.

The Circuit Court of St. Louis County affirmed and held that this finding was supported by competent and substantial evidence on the record as a whole. Central Bank and the Commissioner appealed to the Missouri Court of Appeals for the St. Louis District. The court reversed the circuit court and the Banking Board as to the finding that "the convenience and needs of the community to be served" had not been met and reinstated the Commissioner's order.4

Banking has been a heavily regulated industry for many years. Bank regulation began a quarter of a century before insurance regulation and more than forty years before public utility regulation,5 but the regulation in the early stages was not as pervasive as today. The bank chartering process was originally the province of the legislature and all charters had to be approved by that body. A 1915 statute, which established requirements for opening branch banking offices, contained the first real statutory criteria for establishing banks or offices.6 In the same year, the State Banking Department was created and given some of the powers it has today. Before that year the chartering of state banks was increasing and the only ground upon which the state could decline to charter a bank when five incorporators filed an application was the dishonesty of the persons applying.7 Attempts to limit the granting of charters were generally unsuccessful during this period and some commentators have attributed that to a distrust by Missourians of any limitation which might permit a concentration of the money power in a few hands.8 In 1927 the chartering statute was amended, giving the Commissioner the authority to make an investigation to determine "if the probable volume of business in such location is sufficient to insure and maintain the solvency of the then existing bank or banks in such location, without endangering the safety of any bank in such locality as a place of deposit of public or private moneys. . . ."9

The key statutory requirement for chartering was added to section 362.030 by the Banking Act of 1941.10 The amendment required an examination into "the convenience and needs of the community." Almost all states have enacted similar provisions requiring proof of "public necessity.”

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4. 509 S.W.2d at 194.
7. See Mo. Laws 1915, at 129, § 59; State ex rel. Jones v. Cook, 174 Mo. 100, 73 S.W. 489 (1903).
8. F. Helm, Banking Developments in Missouri 15 (1939).
The major goal and perhaps the entire justification for the rigid and pervasive regulation of banking is a sound and healthy banking system. This goal requires maximum profits, which are a function of the amount of business transacted. Generally, the greater the number of banking units in a given area, the less business each competitor will attract. Therefore, unbridled competition is in some ways incompatible with a healthy banking system. Yet to the extent that competition is curbed by legislation, the consumer is forced to pay more for the services he receives. Normally, questions of entry and expansion are solely the choices of private entrepreneurs. However, in the banking industry, the final decision in this area has been assigned to regulatory agencies. Regulators are required to encourage competition while attempting to maintain a healthy and solvent banking system. This delicate balancing problem is the main issue confronted by the court in Central Bank.

Cases interpreting statutes such as that in Missouri can be broadly divided into three categories of chartering policies. Although all the

12. Generally “efficiency” is associated with competition. Under conditions of “perfect” competition profits are maximized at prices and levels of output which bring about an optimum allocation of resources. . . . Consequently, so the argument runs, the more “competitive” an industry, the more “efficient” it is.
13. Other considerations, however, make it difficult to choose between the objectives of “efficiency” and “soundness.” For example, competition forces “inefficient” firms to leave the market because they cannot charge prices high enough to cover the costs. Under monopolistic conditions, high cost firms are afforded a certain degree of immunity from the forces of competition, which permits them to operate inefficiently and still survive. Thus a monopolistic industry is more compatible with the goal of maintaining a “failure-proof” banking system, while competition is more compatible with the goal of “efficiency.”

Edwards, The Banking Competition Controversy, 3 NAT. BANK. REV. 1, 2 (1965).

14. See Marshfield Community Bank v. State Banking Bd., 496 S.W.2d 17 (Mo. App., D. Spr. 1973). The court stated:

To that extent, then, public policy which encourages free competition runs counter to the public interest which requires its regulation in these cases, and some adjustments of priorities, some balancing of equities, must consequently be made. The question is: Where shall the line be drawn to avoid undue repression on the one hand and prevent unfair advantage on the other?

Id. at 29.


16. We must consider what value of (sic) Constitution and laws placed on competition, under what circumstances and for what reasons can competition be stifled by regulation for the public good, and what type of evidence will justify interference with competition by regulation for a good reason.

509 S.W.2d at 181.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
statutes are similar, the difference in interpretation based upon the presumed intent of the legislature has led to wide variances in each of entry and expansion.

The first policy is an outgrowth of the bank failures of the 1930's. Few states escaped massive assaults on their banking laws after the experiences of that era. The result was a framework of laws that placed a premium on solvency and, more importantly, upon protecting the weaker banking units from excessive competition from stronger, and frequently larger, banks. The few states which continue to follow this theory recognize that the protection of existing units and their profits is the primary and overriding goal of regulation. The method used to achieve this goal is a chartering requirement of "absolute need." No new bank can be chartered without a showing that the existing banks can continue to thrive and that the proposed new bank can become solvent and prosper without drawing business from existing banks. This was the rule in many states until the advent of deposit insurance, increased supervision and regulation, and the passage of time helped to restore public confidence and faith in banking institutions.

The second policy is a result of this increased confidence in banking and the recognition that competition is necessary to achieve the most advantageous prices for consumers. Although recognizing that safety and solvency are important ingredients of the statutory scheme of banking regulation, this theory balances that goal against the increased efficiency to be gained by allowing additional competitive units in an area. This intermediate approach has been favored by many courts.

The third policy falls somewhat short of the complete freedom of entry which appeared in the late 1830's as a result of the "free banking"

18. See generally F. HELMS, BANKING DEVELOPMENTS IN MISSOURI (1939); Townsend, History of Missouri Banking Legislation, 18 V.A.M.S. 321, 360-67 (1949).
An unnecessary bank in a community is not a thing of passive uselessness only, and so merely of no benefit. It is an active disturber of the financial peace, to the detriment of the public welfare, and it is not very material whether we say that public harm will be prevented or that public good will be promoted by its suppression.
Id. at 609, 118 P. at 85.
20. Davis, supra note 5, at 640.
acts. The emphasis in this theory is on encouraging competition if at all feasible, and protection of existing banks is determinative only upon a clear showing that insolvency would actually result from chartering the proposed bank.

Prior Missouri cases dealing with bank chartering have relied heavily on the findings of the Banking Board. The two major cases viewed the role of the courts, as merely determining whether competent and substantial evidence on the record supports the Board's findings. In *Suburban Bank of Kansas City v. Jackson County State Bank* the proposed bank was only the second bank to enter a growing and prosperous area. Under even the most restrictive chartering test the applicant would succeed on these facts and the court in *Suburban Bank* affirmed the issuance of the charter, pointing out that the solvency of the existing banks would not be affected and that both banks could prosper in the community. Competent and substantial evidence on the whole record was again the test in *Marshfield Community Bank v. State Banking Board*. The court affirmed the Board's decision denying the charter. However, the court examined the evidence in somewhat greater detail than in *Suburban Bank of Kansas City*, and pointed out the need for balancing the competing considerations of bank safety and industry competition. The evidence showed that the applicant would probably be insolvent within two years, but the opinion indicated that the court's primary concern was with insuring bank safety instead of promoting competition.

Section 362.030(1), RSMo 1969, requires the Commissioner to consider several factors before issuing a certificate of incorporation to a proposed bank. Two of these factors are the most important. First, the Commissioner must determine that the "probable volume of business . . . is sufficient
to insure and maintain the solvency of the new bank or trust company and the solvency of the then existing banks and trust companies in the locality. . . .” Second, the Commissioner must determine that “. . . the convenience and needs of the community to be served justify and warrant the opening of the bank or trust company. . . .”

The application of these two statutory determinates to the chartering process requires a consideration of three somewhat competing factors. Two of these are related to the test of probable volume of business, and the other is related to the convenience and needs of the community. The probable volume of business factor first anticipates proof that the new bank can look forward to solvency in the proposed location. This requires an examination of its prospects for profitable operation in the chosen locale. Almost all courts profess to be interested in the solvency of the new bank and entry is therefore permitted only when the bank can show that it can develop sufficient business to cover costs plus a certain level of profitability.

The second statutory consideration illustrates a competing interest in the probable volume test which must be considered. The Commissioner must consider whether the new bank will endanger the safety of existing banks in the locality. In those states that adopt the third approach of allowing freer entry, this consideration is relegated to a position of lesser importance. If the other requirements are met, the only protection afforded existing institutions is upon a showing that the chartering of the applicant bank will result in actual insolvency of existing banks.

With this in mind, the third consideration relating to “convenience and needs” is more easily placed in focus. This is determined first from the consumer’s viewpoint, and in the freer entry states is limited to this perspective. Any review of the new bank’s effect on competitors, except as those effects impact upon consumers, moves the inquiry from that of a freer entry approach back to the balancing approach.

An examination of the factors which the court in Central Bank found to be relevant in reaching its decision reflects a policy of allowing somewhat freer bank entry. In finding that the protection of the statutory criteria for chartering extended to depositors and customers but not to competing banks, the court said: “The [convenience and needs consideration] does not contemplate preventing new banks from entering a market because existing banks are rendering adequate services.”

Focusing on the new bank itself is the first step. One of the leading indicators of convenience and needs among banking experts is the prospect of the new bank’s profitable operation. In fact, the court in Suburban Bank of Kansas City v. Jackson County State Bank indicated that substantial deposits and business projections should be enough in itself to meet the test. Accordingly, the court in Central Bank said that the amount of future de-

27. 509 S.W.2d at 184.
posits of the proposed bank may be considered, but the factual basis for these projections should be closely scrutinized. The court also suggested that the new bank's impact on the economy of the community to be served is relevant and can be determined by: (1) the number of lending alternatives available to small business and consumer borrowers; (2) the actual competition among existing units in the area; and (3) whether credit is readily available within reasonable bounds to all sectors of the local economy. However, the court rejected the opponent's evidence on this point which showed that deposits in existing banks were growing faster than the normal indicators of need for banking facilities. However, the court rejected the opponent's evidence on this point which showed that population and household growth rates were declining and retail sales were dropping while deposit growth was climbing at an annual rate of 13.6 percent.

The court did not require the proponents to show a "need" for the bank in the community or produce evidence of complaints about existing banks. This is consistent with the approach to entry taken by the court. However, if produced, evidence of this sort would certainly be considered relevant.

On the other hand, the court found that much of the opponent's evidence was irrelevant to the statutory considerations: (1) evidence that the new bank would affect the growth rate of existing banks; (2) evidence that the new bank would draw deposits from the area already served by existing units; (3) evidence that the area banks may increase their promotional activity because of the new entry; and (4) evidence that the proposed bank would add little or nothing to the driving convenience of the people in the community. This is also consistent with the court's approach to chartering, because these factors focus on the effect of the entry on the profits of existing units. As mentioned earlier,

29. 509 S.W.2d at 187.
30. *See* 509 S.W.2d at 187. Actual competition among existing units can be a nebulous concept. It may be measured in terms of indicators such as interest rates paid on deposits held by the bank, or the interest rate which the bank charges its customers for various loans. Some experts have concluded that the concentration of banks within a given market area is a good statistical indicator of competition. Edwards, *supra* note 12, at 25, 32. Nonetheless, measuring competition in the banking industry is not readily accomplished, and this factor may be more easily stated by the courts than proven by a litigant.

31. This apparent inconsistency was explained by the facts that the opponents of the charter failed to consider the growth of the community as an office and commercial services area and that the opponents' daytime employment figures were substantially lower than those furnished by the commercial reporting agencies. 509 S.W.2d at 189.
32. Requiring evidence of this nature indicates a restricted entry approach. Evidence that there is an "absolute need" for another bank or that there are numerous complaints with existing facilities is difficult to adduce. Reliance on this evidence usually serves to protect existing units and prevent new units from entering. *See* Moran v. Nelson, 322 Mich. 230, 235, 33 N.W.2d 772, 777 (1948); Suburban Bank of Kansas City v. Jackson County State Bank, 330 S.W.2d 183 (K.C. Mo. App. 1959); Application of Howard Sav. Inst. of Newark v. Howell, 32 N.J. 29, 159 A.2d 115 (1960).
consideration of the effect on the profits of existing units is irrelevant unless the evidence tends to prove that actual insolvency will result. Even the rejection of evidence as to driving convenience can be justified on the facts of this case, although this factor is consumer-oriented and therefore normally relevant. The court also discussed evidence that entry of the new bank would diminish the ability of the largest area bank to compete with the metropolitan banks. The court rejected this evidence as unsubstantiated. Such evidence should probably be deemed irrelevant, because it focused on the protection of existing banks.

The courts of other states have considered several factors in addition to those reviewed by the court in Central Bank. These include: (1) adequacy of services now provided compared to the needs of residents and the new services to be offered by the applicant bank; (2) ability of existing banks to handle potential growth; (3) number of persons in the area desiring to use the proposed bank and the amount of business they would generate; (4) population growth; (5) character of the community and surrounding area; (6) the wealth and earning capacity of the residents; and (7) the concentration of business establishments. These factors are not inclusive, and keeping in mind the policy that the chartering statute seeks to further, the relevancy

33. The analysis of driving convenience is based on the assumption that the volume of business a new bank attracts will vary proportionately with the amount of driving time customers must expend to reach the new bank. The evidence in this case tended to show that the area within a five minute radius of the new bank was also within a five minute radius of at least three other banks. Accordingly, the fact that the new bank would add little or nothing to the driving convenience of the community would not be very probative. However, where the closest bank in the community is thirty minutes from some residents and a proposed bank would be considerably more convenient in terms of driving time, such evidence should be allowed as relevant and probative of the “convenience and needs of the community.”

34. The opinion indicated that the court considered at least seven other factors which are presumably relevant: (1) the growth of the area to be served; (2) the date the last bank was chartered in the area; (3) the business and commercial growth in the community; (4) the estimated buying power of area residents; (5) the number of existing banks in the area; and (7) the proposed location of the new bank.

35. Jackson v. Valley Nat'l Bank, 277 Minn. 293, 295, 152 N.W.2d 472, 474 (1967). This evidence would be relevant to the community need for the bank, a criterion which the court in Central Bank said was not required to be shown, but could nonetheless be relevant. See note 32 supra.

36. 277 Minn. at 293, 152 N.W.2d at 472. This factor pertains to the probability that the new bank will operate profitably.

37. Id.

38. See Application of Burrill, 262 Minn. 270, 114 N.W.2d 688 (1962), where the court suggested that public demand might be inferred from a tremendous expansion in the population and economy.


40. Id.

41. Id.
of others can be readily ascertained. Questions remain, but Central Bank seems to mark a definite choice by the Missouri courts of a freer approach to the chartering process. This is certainly the trend in many other states, and according to some economists, long overdue.\textsuperscript{42}

In spite of the trend toward encouraging competition in the field of banking, a word of caution is appropriate. It is not clear whether the decrease in the number of bank failures since the 1930's is attributable to increased state regulation of entry or to federal legislation such as that which established deposit insurance and increased the effectiveness of the Federal Reserve System. But the failure of a bank, whether insured or not, has so great an effect on the economy of the whole community\textsuperscript{43} that the important consideration is to avoid the catastrophic structure which results from excessive chartering and over-banking.

The consumer-oriented approach in Central Bank is commendable and possibly the most popular in the short run. However, the banking structure as a whole must be considered and concern for solvency should override considerations of immediate advantages from increased competition. Competition in the banking industry is subtle yet effective even with a smaller number of units.

The impact of Central Bank remains to be seen. At least on the surface the case moves Missouri closer to a freer chartering approach. The rejection of evidence that the new bank would draw deposits from existing banks and slow their growth rate reflects a greater concern for competition and increased efficiency, with a subsequent disregard of the historical concern for existing banks. Although the conservative approach of the past is being reexamined in Missouri, the banking industry is still based upon the concepts of capital investment and allocation of resources which are factors for entry in any industry. As such, entry decisions carry sanctions of their own which will help to discourage imprudent entry attempts and help maintain a stable system.\textsuperscript{44}

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\textsuperscript{43} Berle, \textit{Banking Under the Anti-trust Laws}, 49 \textit{Colum. L. Rev.} 589 (1949). A bank failure is a community disaster, however, wherever, and whenever it occurs. While competition may be desirable up to a point in deposit banking, there is a clear bottom limit to its desirability. . . .

The economic and social premises of the Sherman Act in respect of other businesses are not fully accepted by the Congress, the States, or the public as the only considerations applicable to deposit banking. \textit{Id.} at 592. See generally Jacobs, \textit{The Framework of Commercial Bank Regulation: An Appraisal}, 1 \textit{Nat. Bank. Rev.} 343 (1964).

RECENT CASES

COMMERCIAL LAW—CONVERSION LIABILITY OF COLLECTING BANK TO PAYEE OF A NEGOTIABLE INSTRUMENT AND THE DEFENSE OF UNIFORM COMMERCIAL CODE SECTION 3-419(3)

Cooper v. Union Bank

Bernice Ruff had financial difficulties as a result of gambling debts. In 1963 she retained the services of an attorney, Joseph Stell, to represent her in litigation brought by her creditors. Not long thereafter Mr. Stell employed Miss Ruff as his secretary and bookkeeper. Between December 14, 1965, and February 20, 1967, Miss Ruff took 29 checks intended for her employer and forged the necessary endorsements. She cashed some of the checks and deposited the others in her own account. She withdrew all funds prior to the discovery of the forgeries. Stell and his partners brought an action for conversion against the collecting and the payor banks. The California Court of Appeals affirmed a judgment for defendants, concluding that Uniform Commercial Code section 3-419(3) provides a complete defense for both collecting and payor banks so long as they act reasonably and in good faith. The Supreme Court of California affirmed the nonliability of the payor banks and

2. Miss Ruff pleaded guilty to two counts of forgery.
3. A drawee/payor bank is the bank upon which the check is written. A collecting bank is any bank that handles the instrument prior to its receipt by the payor bank. Uniform Commercial Code § 4-105.
5. Uniform Commercial Code § 3-419(3) provides:
Subject to the provisions of this Act concerning restrictive indorsements a representative, including a depositary or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.
The word “Code” is substituted for the word “Act” in the California statute.
7. The court disagreed with the lower court on the applicability of the defense of section 3-419(3) to payor banks. The supreme court found that the payor banks were not liable because the suit against the collecting banks operated as a ratification of the payment by the payor banks. In the three instances where there was no ratification the payor bank was allowed to utilize the defense of section 3-406, which provides:
Any person who by his negligence substantially contributes . . . to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority . . . against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee’s or payor’s business (emphasis added).
the collecting banks for all instruments received after April 1, 1966; however, the court reversed the lower courts and held the collecting banks liable for checks handled before that date. The reversal rested upon an interpretation of Uniform Comercial Code section 3-419(3).

Two reasons were given for holding that section 3-419(3) does not limit the liability of collecting and depositary banks. First, the banks had the proceeds. Under bank collection theory, when the payor bank transmits funds to the collecting bank in return for the forged instrument, it is transmitting its own funds. A suit for conversion against the collecting bank ratifies this transfer, so that the collecting bank holds the proceeds in a constructive trust for the payee. Because the payee has not ratified the transfer of funds to the forger, the money given to the forger is the bank's. The second reason for avoiding the defense was that the legislature did not intend to change pre-Code law holding collecting and depositary banks liable to the payee.

Prior to the enactment of the Uniform Commercial Code, a majority of jurisdictions, including California and Missouri, held a collecting bank liable to the payee if the bank took a check upon an unauthorized endorsement. Sometimes this liability was for conversion, sometimes assumpsit. A recent case said collecting banks are liable, but the theory behind the liability is unimportant.

The Uniform Commercial Code followed pre-Code law in holding a collecting and depositary bank liable to the payee for conversion if it pays a check which has not been validly endorsed. However, section 3-419(3)

8. The court relied on section 3-404 and the accompanying official comments. Section 3-404(1). Any unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it . . . . (emphasis added). Comment 4. The words "or is precluded from denying it" are . . . to recognize the negligence which precludes a denial of the signature. This is a novel use of this section, and is discussed in 5 Rutgers Camden L.J. 319, 333-35 (1974). But cf. Federal Deposit Ins. Corp. v. Marine Bank, 431 F.2d 341, 344 (5th Cir. 1970) (applying Florida law) (defense of contributory negligence is not available in an action for conversion).


Although subsection (1)(c) says "forged indorsements," courts have interpreted this to include unauthorized indorsements. R. Anderson, 2 Anderson on the Uniform Commercial Code 1034 (2d ed. 1971). An unauthorized signature includes a forgery. Uniform Commercial Code § 1-201 (43).
seemingly limits this liability\textsuperscript{14} to the remaining funds if the bank acts in good faith and in accordance with reasonable commercial standards.\textsuperscript{15} The prevailing rule prior to \textit{Cooper} was that a collecting bank's liability to the true owner\textsuperscript{16} was reduced by whatever amounts were paid out.\textsuperscript{17} However, only one reported case\textsuperscript{18} has used section 3-419 (3) to deny relief to a payee. One well-known work attributes this paucity to deliberate manipulation by the courts.\textsuperscript{19} The most common method is to find that the bank did not act in a reasonable commercial manner,\textsuperscript{20} although sometimes courts simply ignore the section.\textsuperscript{21} One court found that the bank was not a representative\textsuperscript{22} in the ordinary check handling situation. The state of the law prior to \textit{Cooper} was that a collecting bank's liability could be limited if the requirements of section 3-419 (3) were met—but the courts rarely found that they were.

The defendant collecting and depositary banks in \textit{Cooper} asserted nonliability to the payee under section 3-419 (3)—i.e., no proceeds remaining in their hands. The lower courts sustained this defense, but the California Supreme Court, after redefining proceeds,\textsuperscript{23} found that they retained the proceeds and thus were liable to the plaintiff. \textit{Cooper} is a reversal of prior understanding, but not case law,\textsuperscript{24} of the meaning of “pro-

\begin{itemize}
\item \textsuperscript{14} A collecting bank may be liable to other banks under sections 3-417 and 4-207 even if no proceeds remain; but the payee cannot recover directly against the collecting bank under these warranty sections. See text accompanying notes 53-61 \emph{infra}.
\item \textsuperscript{15} Forman v. First Nat. Bank, 320 N.Y.S.2d 648 (Sup. Ct. 1971) (dictum).
\item \textsuperscript{16} Section 3-419 speaks of the “true owner” of an instrument, rather than the payee, but for the purposes of this note, the terms are assumed to be synonymous.
\item \textsuperscript{17} “To the extent it pays cash over the counter to the thief it has no proceeds.” J. \textsc{White} \& R. \textsc{Summers}, \textsc{Uniform Commercial Code} 502 (1972) (hereinafter cited as \textsc{White} \& \textsc{Summers}).
\item \textsuperscript{18} Hence, a collecting bank which has remitted the proceeds of a check which has a forged indorsement would not be liable to the owner. . . .” Murray, \textit{Negotiable Instruments}, 20 \textit{U. Miami L.R.} 225, 237 (1965).
\item \textsuperscript{19} Messeroff v. Kantor, 261 So. 2d 553 (Fla. App. 1972).
\item \textsuperscript{20} So much for the work of the Code draftsmen. Thereafter, the courts have taken up section 3-419 (3), and what they have done to it shouldn't happen to a dog. The courts have ingeniously evaded the restrictions in 3-419 (3) . . .
\end{itemize}

\textsc{White} \& \textsc{Summers}, \textit{supra} note 17, at 504.


22. \textsc{Ervin} v. \textit{Dauphin Deposit Trust Co.}, 38 Pa. D. & C.2d 473, 84 Dauph. 280 (C.P. 1965). \textit{Cooper} also came to this conclusion.

23. \textsc{The Cooper} definition of proceeds is criticized in Note, \textit{74 Colum. L. Rev.} 104 (1974); \textit{Note, 5 Rutgers-Camden L.J.} 319 (1974).

24. \textsc{The only other case that has discussed the nature of “proceeds”,} \textsc{Ervin} v. \textit{Dauphin Deposit Trust Co.}, 38 Pa. D. & C.2d 473, 84 Dauph. 280 (C.P. 1965), came to the same conclusion as \textit{Cooper}, namely, when a depositary bank releases

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ceeds” as used in section 3-419 (3). The effect of its definition of “proceeds” is that no matter how much the depositary bank gives to the forger, the bank will still have all of the proceeds remaining in its hands.

The Coopera court began its analysis by asking two questions: “first, did [the depositary banks] receive any proceeds and second, have they parted with any proceeds they may have received?”25 In answer to the first, the suit brought by the payee against the depositary bank ratified the collection of the proceeds from the payor bank; therefore, the defendant collecting banks did receive the proceeds. This answer is not controversial and is well-supported in case law. But the answer to the second question, the finding that the bank retained the proceeds even after releasing to the forger amounts equal to the proceeds, was not so obvious.

In support of its holding that the depositary bank gave its own funds to the forger while retaining the proceeds, Cooper makes several points. There is the general point that ratification of the collection is not a ratification of delivery to the wrong person. And in the case of an instrument cashed over the counter,26 the bank must be giving its own money because it has not yet collected the proceeds. As for an instrument deposited, the court relies on the doctrine of constructive trusts. The court said that agency ceases after the collection process is completed and the bank becomes a debtor to the true owner. The money collected is mingled with the bank’s funds and thus the money received by the forger is the bank’s money, while the bank holds the proceeds of the collected instrument in a constructive trust for the true owner.27

The court’s reasoning is open to criticism in several respects. First, the court assumes that “proceeds” is a word of art, with a highly technical meaning. The absence of any Code definition28 would seem to negate this inference and suggest an ordinary meaning for the word. An ordinary understanding would be that once the depositary bank gives value for the instrument and is in turn given value for the instrument by the payor bank, it has parted with the proceeds. Second, even assuming that “proceeds” has a technical meaning in the bank collection situation,

funds to a forger, it is giving away its own money, while the proceeds collected from the payor bank are held for the true owner. See also United States v. Collins, 464 F.2d 1163 (9th Cir. 1972) (no conversion since the bank paid its own money on a draft with a forged indorsement).

25. 9 Cal. 3d at 376, 507 P.2d at 609, 107 Cal. Rptr. at 5.

26. Some commentators have suggested that a bank is not a representative when it cashes a check (and therefore purchases the instrument with its own funds), but is when it accepts it for deposit. Farnsworth and Leary, UCC Brief No. 10: Forgery and Alteration of Checks, 14 PRAC. LAW. 75, 79 (March, 1968). Ervin rejected such a distinction. 38 D. & C.2d at 478, 84 Dauph. at 283, as did Cooper. 9 Cal. 3d at 380, 507 P.2d at 616, 107 Cal. Rptr. at 8. This rejection is criticized in Note, 74 COLUM. L. REV. 104 (1974).

27. 9 Cal. 3d at 379, 507 P.2d at 615, 107 Cal. Rptr. at 7.

28. “Proceeds” are not defined in Articles 3 or 4. The definition given in section 9-306 (1) does not apply.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
the court's definition is questionable statutory construction because it is apparently irreconcilable with the language of section 3-419 (3). That subsection says liability for conversion is limited to the amount of proceeds remaining in the bank's hands; a clear implication that it is possible for no proceeds to remain in the bank's hands. Yet, under the Cooper definition, it is practically impossible for the depositary bank not to have the proceeds remaining in its hands. A final criticism of the court's "proceeds" argument is the lack of authority for its application of the constructive trust theory to the Code and to the forged endorsement situation.

On balance, whether Cooper's definition of proceeds is correct is a close question. On the one hand, it is supported by the only other court to face the issue and by the many pre-Code cases saying the proceeds are held in trust for the true owner. On the other hand, the Cooper definition makes section 3-419 (3) a nullity, which violates one of the first principles of statutory construction, namely, that a statute should be construed so as to give meaning to every part. The answer would seem to lie with the intent of the drafters and the legislators.

The California Supreme Court found no intent on the part of either draftsmen or the legislature to change the pre-Code law that collecting and depositary banks are liable to the true owner for conversion if they take an instrument with a forged endorsement. The court placed significance on the fact that section 3-419 (3) uses the ambiguous word "proceeds" instead of expressly absolving collecting and depositary banks if they gave "value" for the instrument. The court went on to say that neither the draftsmen nor the legislature had any reason for making direct suits against the collecting and depositary banks more difficult, because these banks will ultimately be liable anyway, and that requiring uneconomical circuity of action violates the purposes of the Code and creates "a significant potential for injustice." Furthermore, the court pointed

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29. The only time the bank will not have the full proceeds is when cash on hand goes below the face amount of the instrument.
30. The court relied on 5 R. Scott, Scott on Trusts § 540 (3d ed. 1967) and Jennings v. United States Fidelity and Guar. Co., 294 U.S. 216 (1935). An examination of Scott reveals that the treatise is concerned with the claims of depositors, creditors, etc., against a bank that has failed, not instruments collected upon a forged indorsement. Likewise, Jennings involved a bank failure and not a forged indorsement situation.
32. Some pre-Code Missouri cases used the word "proceeds" in a similar way as used in Cooper. See Strong v. Missouri-Lincoln Trust Co., 263 S.W. 1038 (Mo. App. 1924); Aetna Cas. & Surety Co. v. Lindell Tract Co., 348 S.W.2d 558 (St. L. Mo. App. 1961); Chemical Workers Basic Union v. Arnold Sav. Bank, 411 S.W.2d 159 (Mo. En Banc 1966). See also United States Fidelity & Guar. Co. v. Fidelity Nat. Bank & Trust Co., 232 Mo. App. 412, 109 S.W.2d 47 (K.C. Ct. App. 1937).
33. This is criticized in Note, 23 Cath. U.L. Rev. 163 (1973).
34. Uniform Commercial Code §§ 4-207, 3-417.
35. 9 Cal. 3d at 382, 506 P.2d at 617, 107 Cal. Rptr. at 9.
out that the comments to section 3-419 (3) do not indicate any change in the law.\textsuperscript{36} And finally, the court found that section 3-419 (3) was not meant to apply to the ordinary bank collection transaction,\textsuperscript{37} because all of the illustrations and cases cited in the comments deal with the situation where an innocent broker sells stolen securities for his principal.

Criticism of the \textit{Cooper} divination of legislative intent can focus on two areas; the weakness of the evidence supporting the “no-change” contention, and other evidence strongly suggesting that a change was meant.

To begin with, the court said the Code should and could have said “for value” instead of the ambiguous word “proceeds” if collecting and depositary banks are to be exonerated when they release funds to the forger. This assumes that “proceeds” is an ambiguous term. Prior to \textit{Cooper}, however, there was no difficulty in understanding what “proceeds” meant. Even if “proceeds” is an ambiguous term, no special significance should be placed on bad draftsmanship.

The court also said there is no reason why the Code should present impediments to direct suit by the payee against collecting and depositary banks; therefore, there are no impediments. This argument overlooks the background against which the Code was drafted. Although most states allowed a payee to sue any bank which handled the instrument, a substantial number of states did not allow the payee to sue the drawee bank\textsuperscript{38} and a few other states did not allow him to recover from collecting banks.\textsuperscript{39} The Code does not explain why it was drafted in this way, but possibly there was a compromise on the issue. The draftsmen might have been influenced by the civil law.\textsuperscript{40} At a more basic level, the interests of the banks might have influenced the draftsmen.\textsuperscript{41} The point is, there might have been many reasons why the Code modified the pre-Code rule.

Evidence of the function of section 3-419 (3) as a defense is found in Official Comment 6,\textsuperscript{42} which explicitly forsees that a collecting bank will

\begin{itemize}
  \item \textsuperscript{36} The court characterizes Official Comment 5 as saying that section 3-419 (3) is a codification of prior case law and California Comment 5 as saying the section is consistent with prior California law.
  \item \textsuperscript{38} California Code Comment 3 to § 3-419.
  \item \textsuperscript{39} Soderlin v. Marquette Nat. Bank, 214 Minn. 408, 8 N.W.2d 331 (1943).
  \item \textsuperscript{40} For a comparison of Anglo-American and Continental law, see Kessler, \textit{Forged Indorsements}, 47 Yale L.J. 863 (1938).
  \item \textsuperscript{41} Beutel, \textit{The Proposed Uniform [?] Commercial Code Should Not Be Adopted}, 61 Yale L.J. 534 (1954); \textit{Allocation of Losses from Check Forgeries Under the Law of Negotiable Instruments and the Uniform Commercial Code}, 62 Yale L.J. 417, 469 (1953); \textit{White & Summers, supra note 17}, at 505 n.18.
  \item \textsuperscript{42} Official Comment 6 reads:
    Thus a collecting bank might be liable to a drawee bank which had been subject to liability under this section, even though the collecting bank might not be liable directly to the owner of the instrument.
\end{itemize}
not always be liable to the payee, even though it will be liable to the drawee bank. This comment seems inconsistent with the Cooper definition of proceeds under which the collecting bank will always be liable to the true owner.

The court saw another indication that no change was intended in California Code Comment 5, which says section 3-419 (3) is consistent with prior California law. But a reading of the full text of the comment erodes the comment’s credibility, because it incorrectly summarizes the Code and prior California law as allowing good faith as a complete defense to conversion. The court went on to find support in Official Comment 545 by characterizing it as saying that section 3-419 (3) is “merely a codification of prior decisions,” and since the prior decisions referred to are cases of an investment broker selling stolen securities, section 3-419 (3) does not refer to the bank collection situation. But the comment does not say the section is a codification of prior case law. Rather, it says subsection (3) adopts the rule of decisions which limit a good faith representative’s liability to the proceeds remaining in his hands. If the “decisions” referred to are investment broker cases which held an agent not liable after he turned the proceeds over to his principal, then it may be significant that the comment says “adopt the rule,” rather than “adopt the decisions.” Apparently, the draftsmen intended to extend the rule to the bank collection situation, because section 3-419 (3) defines a representative as including depositary and collecting banks. An even more compelling argument that Cooper is wrong in limiting section 3-419 (3) to the investment broker situation is that investment securities and the liability of brokers thereon are covered by Article 8 of the Code and not Article 3.

The intent of the draftsmen to provide a defense to collecting and

43. California Code Comment 5 reads:
   Subdivision (3) is new statutory law. Its basic premise that a person dealing in good faith with the property of another is not liable for conversion is consistent with prior California law on the tort of conversion.

44. The Missouri Code Comment reads: “Subsection (3) is new and is self-explanatory.”

45. For example, Cooper held the collecting banks liable for conversion, even though the lower court “concluded that all defendants . . . had acted in good faith. . . .” 9 Cal. 3d at 375-76, 507 P.2d at 613, 107 Cal. Rptr. at 5.

46. Official Comment 5 reads:
   Subsection (3), which is new, is intended to adopt the rule of decisions which has held that a representative, such as a broker or depositary bank, who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument or otherwise, except that he may be compelled to turn over to the true owner the instrument itself or any proceeds of the instrument remaining in his hands. . . .

47. For a technical definition, see section 8-102.

48. UNIFORM COMMERCIAL CODE § 8-318 provides in part:
   An agent . . . who in good faith . . . has received securities and sold, pledged, or delivered them according to the instructions of his principal is not liable for conversion . . . although the principal has no right to dispose of them.

49. UNIFORM COMMERCIAL CODE § 8-102 (b) provides in part: “A writing which
depositary banks is clear. Official Comment 5\(^5\) says section 3-419(3) adopts the rule of those cases which limit a representative's liability. Official Comment 6\(^6\) foresees that collecting banks will not be liable to the payee in some situations, even though the drawee bank will be. The very inclusion of the subdivision in the section on conversion and forged indorsements raises the natural inference that the limitation of liability applies to collecting and depositary banks which handle instruments containing a forged indorsement.

Once it becomes evident that the draftsmen intended section 3-419(3) as a limitation on conversion liability, the proper definition of "proceeds" is obvious—the amount forwarded from the payor bank in exchange for the instrument less the amounts paid out to the forger. The *Cooper* definition cannot withstand close scrutiny, because it violates the intent of the draftsmen and the purpose of subdivision (3).

The bases for the *Cooper* interpretation of section 3-419(3) are unsound. The court did not, however, decide the case solely on the basis of statutory construction; it made a policy choice in favor of payees and against collecting banks.\(^5\) As a matter of policy, the court may well have been right. No commentator or court has praised the process whereby the payee sues the drawer,\(^5\) who sues the drawee bank,\(^5\) who sues the intermediary bank who sues the depositary bank,\(^5\) whereas several have condemned it.\(^5\) Defenders of this circuitous method say it is necessary because the defenses which may not be available in a direct suit by the payee against the depositary bank are available in the longer route.\(^5\) The weakness of this argument is that most of the defenses spoken of are either

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50. See note 45 supra.
51. See note 42 supra.
52. Apparently the interpretation of the Code as given in *Cooper* was entirely the court's own and was made without benefit of arguments and briefs of the opposing counsels. See *Rutgers Camden L. J.* 319, 321 n.15 (1974).
53. *Uniform Commercial Code* § 3-804. The payee can also sue the drawee. *Uniform Commercial Code* § 3-419(1).
54. See *Uniform Commercial Code* § 4-401.
55. See *Uniform Commercial Code* §§ 4-207, 3-417, describing the warranty of good title.
available only when the drawer is the plaintiff or are as readily available as a defense by collecting and depositary banks as by any other defendant. As a practical matter, the drawee banks might be located all across the nation and the expense of bringing suit in a distant forum might be so great, that the payee would have to bear the loss. The court felt this to be unjust, and more than one commentator has agreed that the better rule would be to allow direct suit.

The Cooper definition of proceeds may be correct under bank collection theory, but it is obvious that the draftsmen of section 3-419 (3) had a broader definition in mind. The draftsmen intended to limit the conversion liability of collecting and depositary banks, a goal that cannot be achieved under Cooper. On the other hand, the Code is so complex that the court may have been correct in asserting that the legislature neither knew nor intended such a result. And as a matter of fairness and economy, the Cooper solution is superior to the Code.

Other courts will have to face this same problem and should consider two other relevant factors: uniformity and the true rule. Uniformity is the reason for the existence of the Uniform Commercial Code. Although it would be desirable for all courts to interpret the Code correctly, this will not happen; California is a precedent setter. Perhaps it would be better if all jurisdictions uniformly interpreted section 3-419 (3) incorrectly than to have a "majority rule" and a "minority rule." A second factor to consider is what could be called a "true rule." Although courts have said collecting and depositary banks can limit their conversion liability, the courts almost never allow them to do so. Perhaps it would be better to emasculate section 3-419 (3) openly than to do so by setting an impossible standard of reasonableness for banks. These two factors, plus sympathy for the payee, would lead a court to adopt the Cooper definition of proceeds.

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The banks prefer the circuitous route because it increases the likelihood of someone else shouldering the loss. On occasion the collecting bank will escape liability because the payor bank asserts a successful defense against the drawer under section 4-406. Other times the collecting bank will be able to defend successfully against the payor bank under sections 4-207 (4) and 4-406 (5). And often the payor bank will be in such a distant forum that the payee cannot afford to sue.

58. UNIFORM COMMERCIAL CODE § 4-406.
59. See, e.g., UNIFORM COMMERCIAL CODE § 1-201 (43) (an unauthorized indorsement means one without actual, implied, or apparent authority); § 3-404 (an unauthorized signature can be ratified).
60. WHITE & SUMMERS, supra note 17, at 503. For example in Cooper the collecting banks were in as good a position as anyone to show that the payee had been negligent, and were able to do so successfully.
CONSTITUTIONAL LAW—LEGISLATIVE
INVESTIGATIONS—THE SPEECH OR DEBATE
CLAUSE: CONGRESSIONAL SUBPOENAS ISSUED TO
THIRD PARTIES—NO RIGHT TO QUESTION THEIR
CONSTITUTIONALITY ON FIRST
AMENDMENT GROUNDS

Eastland v. United States Servicemen's Fund

In January 1970 the United States Senate passed a resolution authorizing the Senate Subcommittee on Internal Security to make a study of the administration, operation, and enforcement of the Internal Security Act of 1950. Pursuant to its mandate the subcommittee began an inquiry into various activities of the United States Servicemen's Fund (U.S.S.F.) to determine whether it was potentially harmful to armed service morale. The subcommittee issued a subpoena duces tecum to a New York bank where the organization had an account, ordering the bank to produce all records involving the account. The U.S.S.F. brought an action to enjoin implementation of the subpoena. Because of an earlier decision that jurisdiction and venue lies only in the District of Columbia in actions against congressional committees, suit was filed in Washington, D.C. As a result, the New York bank was not subject to proper service. The only parties before the court were Chairman Eastland, Senate members, and the Chief Counsel of the subcommittee.

The U.S.S.F. alleged that enforcement of the subpoena should be enjoined because: (1) the authorizing resolution and subcommittee action implementing it were not within a "legitimate legislative sphere" and thus the legislators were not immune under the speech or debate clause of the Constitution; and (2) even if the immunity applied, answering the subpoena duces tecum would constitute a violation of its first amendment rights. The U.S.S.F. further claimed that issuing the subpoena to a third party deprived it of the ability to refuse to answer. Such refusal might have led the Congress to institute a contempt action, in which the U.S.S.F. could have raised the first amendment issue.

1. 95 S. Ct. 1813 (1975).
3. The U.S.S.F. is a nonprofit membership corporation supported by contributions. It established coffeehouses near domestic military installations and aided in the publication of an underground paper which communicated its philosophy to armed service personnel concerning United States involvement in Southeast Asia.
5. U.S. Const. art. I, § 6, cl. 1. The language in question states that "for any Speech or Debate in either House, they [members of Congress] shall not be questioned in any other place."
6. 2 U.S.C. § 192 (1970), provides for punishment of any person who was summoned as a witness to give testimony or to produce papers upon matters under proper inquiry and wilfully makes default or refuses to answer questions upon appearance.
After a hearing on the merits, the district court denied the permanent injunction. The Court of Appeals for the District of Columbia reversed. The Supreme Court reversed, dismissing the complaint. The Court found that issuance of the subpoena was within a "legitimate legislative sphere" and hence the committee was absolutely immune from being questioned. Because the privilege is absolute, first amendment rights play no part in a case where a private citizen attempts to interfere with an ongoing congressional activity.

The speech or debate clause of the Constitution provides legislators and their aides with immunity from judicial review if their actions are within a "legitimate legislative sphere." The purpose of the clause is to provide legislators with immunity for any speech or debate in either House and to protect legislators from being questioned in any other place. The clause enables legislators to function independently, free from "intimidation by the executive and accountability before a possibly hostile judiciary," and reinforces the separation of powers embodied in the Constitution. However, it is not the purpose of the clause to protect all conduct in which a legislator engages. Although the immunity is broad, it is not unlimited. The term "legitimate legislative sphere" has been adopted to define the limits of the immunity. In order for a congressmen's activities to be immune from judicial review, they must be within this sphere. In *Gravel v. United States* the Supreme Court defined "legitimate legislative sphere" as:

>[That range of activity which is] an integral part of the deliberative and communicative processes by which Members participate in committee and House proceedings with respect to . . . proposed legislation or . . . other matters which the Constitution places within the jurisdiction of either House.

In *United States v. Brewster* the Court referred to the sphere as including "acts that occur in the regular course of the legislative process." Unusual or irregular acts would not be immune from judicial questioning. Both congressional investigations and the issuance of subpoenas have been found to be acts that occur in the regular course of the legislative process.

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11. *Id.* at 625.
13. *Id.* at 525.
Watkins v. United States further developed the "legitimate legislative sphere" concept. The Court stated that to be within the protection of the speech or debate clause a congressional investigation "must be related to, and in furtherance of, a legitimate legislative task." A legitimate task is the enactment of valid legislation and appropriations in reference to it. The subject must be one on which legislation or appropriations could be made. It is only then that the investigation is an integral part of the legislative process. A second requirement of Watkins is that the committee be instructed as to what it is to do with the power delegated to it. These instructions can be transmitted through the authorizing resolution, the Chairman's statement, or the nature of the proceedings themselves. Through some means the committee's jurisdiction and purpose must be spelled out so that their actions conform with the will of the parent body. A third requirement is that there exist a nexus between the subject matter of inquiry and the individual under investigation—i.e., a demonstrable relationship between the individual's activities and the legitimate legislative task. If these requirements are met, congressional activities are within the "legitimate legislative sphere." The ensuing immunity under the speech or debate clause extends to legislative aides and employees. However, they are immune only insofar as their conduct would be protected if performed by the legislator himself.

The Court in Eastland devoted considerable time to the conclusive finding that an investigation and issuance of a subpoena are "an integral part of the deliberative and communicative process. . . ." In contrast, the Court gave only cursory treatment to the requirements set down for congressional investigations in Watkins. In two paragraphs the Court determined that all requirements were met. The majority opinion states that the inquiry was related to a legitimate task because the subject was a proper one for legislation, the authorizing resolution was unambiguous, and there was a prima facie case showing the need for investigation of the U.S.S.F. Irrespective of the wisdom of such brevity, the Court was probably correct in finding that the requirements of Watkins were met.

The U.S.S.F. alleged that the production of its bank accounts, including the names of contributors, was unconstitutional because such pro-
duction would force public disclosure of beliefs and associations of private citizens and deter them in their exercise of first amendment rights. It asked the Court to protect these rights by adopting some exception to the immunity of legislators and their aides acting within a "legitimate legislative sphere."

In the past, three exceptions to the broad immunity given Congress by the speech or debate clause have been discussed or applied by the Court. The first applies when the "aggrieved" party is a defendant in a criminal contempt proceeding. In such cases an individual's constitutional rights may be asserted as a defense. The Court justified this "exception" on the grounds that an interference with congressional action has already occurred when the case reaches the judiciary. In addition, in a contempt proceeding Congress is seeking the aid of the courts to enforce its actions; thus, Congress has waived its immunity. This exception did not extend to Eastland where the U.S.S.F. sought the aid of the federal courts.

In Gravel v. United States and Powell v. McCormack the Court discussed a second theory limiting the immunity of the speech or debate clause. Under this theory, whereas legislators issuing an unconstitutional order are immune from judicial interference, those parties executing that order may be subject to the power of the courts if their acts are "non-essential" to legislating. If the decision is illegal, and the act "non-essential," the aggrieved individual may seek redress from the employee or aide who executed the decision. Acts which have been determined "non-essential" to legislating include the private publication of papers, the barring of a legislator from the floor of Congress, and the imprisonment of one who refused to honor a congressional inquiry. Thus the key term is "non-essential," but no clear definition of the phrase can be found in Gravel or in other cases discussing this exception. In all of these situations, however, a planned or completed legislative act was to some extent frustrated. Thus it seems safe to conclude that an act may have a sub-

25. An organization is allowed to sue in behalf of its members so that their rights may be protected. See N.A.A.C.P. v. Alabama, 357 U.S. 449, 458-59 (1958).
27. See note 6 and accompanying text supra.
34. Kilbourn v. Thompson, 103 U.S. 168 (1880). Judicial proceedings were not involved in this case. Here the House itself ordered and caused the imprisonment of Kilbourn. By allowing an action to lie against the sergeant at arms, the Court had determined the execution of an act involved in enforcing a congressional subpoena to be "non-essential."
The majority of the Court in Eastland discussed the idea of allowing an action to lie against those individuals who executed the subpoena, but rejected it. The Court declared summarily that although some acts of employees are not "essential to legislating," "quite the contrary is the case with a routine subpoena intended to gather information." Unfortunately, the Court did not find it necessary to define the term "non-essential" nor distinguish other cases which allowed an action against those executing congressional decisions. The concurring opinion would have applied the Gravel exception if the individual who executed the subpoena had been before the Court.

A third theory, suggested in Kilbourn v. Thompson and the court of appeals' decision in Eastland, is that in "extraordinary situations" direct action may be allowed against the legislators. Although Kilbourn first suggested this exception, it offered little description as to what constitutes such a situation. It briefly referred to legislative actions with criminal purposes.

The court of appeals' opinion in Eastland expanded this concept to include "unique circumstances . . . which . . . demonstrate that such Member's presence in the litigation is unavoidable if a valid order is to be entered by the court to vindicate rights which would otherwise go unredressed." Eastland presented such circumstances. The U.S.S.F. could not force the subcommittee affirmatively to use the courts. In addition, the only parties before the Court were those who caused the subpoena to be issued, whose actions were within a "legitimate legislative sphere," and were immune. Therefore, absent direct action against the legislators, the U.S.S.F. had no remedy.

The Supreme Court rejected the concept that direct action could be allowed in extraordinary situations. The Court accepted the absolute nature of the immunity conferred by the speech or debate clause. Realizing the potential for abuse by unconstitutional acts within a "legitimate legislative sphere," the Court bowed to "the conscious choice of the Framers [of the Constitution] buttressed and justified by history." The Court thus found no applicable limitation of congressional immunity. The Court deemed it of the utmost importance that legislative proceedings not be delayed by judicial questioning. The subcommittee's inquiry in this case was frustrated for five years by the actions of the

36. 95 S. Ct. at 1824.
37. Id. at 1828.
38. 103 U.S. 168 (1880).
40. Id. at 1270.
41. 95 S.Ct. at 1823.

http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
RECENT CASES

U.S.S.F. The Court reacted against that delay. The decision shuts the door completely to individuals who allege that their constitutional rights were violated by an affirmative action of Congress. No leeway is given to accommodate a case where the legislative interest is insignificant, whereas the individual’s interest is great. The Court will, however, continue to declare congressional activities unconstitutional and provide remedies when an individual asserts constitutional rights in a criminal contempt proceeding.

In light of the Court’s determination that judicial review of legislators’ activities is limited in this context to finding that the activities are or are not within a “legitimate legislative sphere,” a more probing look into the satisfaction of Watkins’ requirements seems fitting. The cursory examination undertaken by the Court in Eastland belittles the impact that judicial review can and should have on congressional investigations through a determination that the activities are within a “legitimate legislative sphere.” Ideally, the legislature should realize that its actions are examined extensively to insure compliance with the Constitution.

If the purpose of the speech or debate clause is to insure the integrity of the legislative branch by preventing intimidation by other branches and to free the legislative process from delays initiated by citizens, the majority opinion best accomplished it. The Gravel exception, by disallowing the execution of legislative decisions, plays as much havoc with the integrity of the legislature as direct judicial invalidation of congressional action. However, previous cases have accepted such interference in order to protect an individual’s constitutional rights. If the purpose of the clause is to “assure the independence of the legislators and their freedom from vexatious and distracting litigation,” the court of appeals’ decision also accomplished that purpose by providing some protection to both the citizens and the legislators.

The anomalous result of the Supreme Court’s decision in Eastland is that whether an individual can protect his constitutional rights when threatened by a congressional subpoena within a “legitimate legislative sphere” depends upon such factors as: whether the subpoena is directed to the individual or his bank; whether the individual’s bank can be served

43. 95 S. Ct. at 1825.
44. Id. at 1824 n.16.
45. Id. at 1820, 1827.
48. 95 S. Ct. at 1828.
whether the individuals who executed the subpoena are included in the suit; and which branch of government is abridging the individual's rights. It now appears that an individual's constitutional rights rest on precarious grounds. It is not apparent that the Constitution demands this result. The Court has avoided creating needless friction with legislators, but unfortunately the citizen has gotten the rub.

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**CRIMINAL LAW—WITNESSES—SCOPE OF CROSS-EXAMINATION OF THE DEFENDANT**

*State v. Booth*

Defendant Booth was charged with second degree murder. At trial, defendant testified about the events leading to the killing and admitted the act, claiming self-defense. He concluded his testimony on direct examination by stating that he got into his car and left the scene. Over defendant's objection, the prosecutor was allowed to ask defendant what he had done with the alleged murder weapon after he left the scene. Defendant was convicted and appealed to the Missouri Court of Appeals for the St. Louis District. The court found that the trial court erred in allowing the prosecutor to ask defendant about his disposition of the murder weapon, because the subject was not referred to either directly or indirectly in the direct examination and was thus beyond the proper scope of cross-examination. The court held, however, that this was not reversible error, because defendant failed to preserve the issue for review.

At common law the defendant in a criminal case was incompetent to

49. The U.S.S.F., if able to obtain jurisdiction over the New York bank, might obtain relief. Because the bank is involved in executing the legislative decision but is under no immunity, the court could issue an injunction against it. The U.S.S.F. could bring an action in New York against the bank under 42 U.S.C. § 1983. But under *FED. R. CIV. P. 19* it would have to be determined if Congress is an indispensable party. Assuming the court would proceed without the committee, it is questionable that the court would render a decision which would leave the bank with two conflicting orders to obey. This alternative open to the U.S.S.F. is unlikely to prove helpful.

A second source of relief would be for the bank to refuse to comply with the subpoena and thus be held in contempt. Standing problems may be presented if the bank attempts to assert the organization's defenses. See California Banker's Assoc. v. Shultz, 94 S. Ct. 1494, 1512 (1974); Note, 88 HARV. L. REV. 423 (1974).

1. 515 S.W.2d 586 (Mo. App., D. St. L. 1974).
3. Defendant did not set out the answer he was required to give or state how he was prejudiced in either his points relied on or his motion for new trial. 515 S.W.2d at 590. See *Mo. R. CRIM. P. 27.20*. The case was reversed for failure to instruct on self-defense. The court decided the cross-examination question because it might reoccur at retrial. 515 S.W.2d at 589.
testify. Missouri first removed this incompetency by statute in 1877.\(^4\) The Missouri Supreme Court soon held that a defendant who chose to take the stand under the statute could be cross-examined on any relevant matter.\(^5\) In response, the legislature enacted a statute limiting this wide scope of cross-examination.\(^6\) A defendant or his spouse who chose to take the stand under the new statute would only be "liable to cross-examination, as to any matter referred to in his examination in chief."\(^7\) What is a "matter referred to" has since been the source of considerable litigation, but is still difficult to determine.\(^8\) The difficulty only arises when a criminal defendant or his spouse takes the stand. In 1905 the legislature codified the common law allowing wide-open cross-examination of all other witnesses. That provision is now section 491.070, RSMo 1969.

The rule has not imposed strict limits on the cross-examiner.\(^9\) The supreme court has continually said that the state is not confined to a mere categorical review of the direct testimony,\(^10\) that the cross-examination may cover any matter "within the fair purview"\(^11\) of the direct,\(^12\) and that a defendant who refers to a subject in a general way may be examined in detail on it.\(^13\)

In fact, a general denial alone may subject the defendant to a wider scope of questioning than detailed alibi or self-defense testimony. In *State v. Scown*\(^14\) the defendant denied performing an abortion on the night in question. The trial court allowed the prosecutor to ask a wide range of questions, most of which asked for explanations of the state's evidence regarding defendant's connection with the premises where the crime allegedly occurred. The supreme court found that the defendant's statement on direct amounted to a denial, not just of the crime, but of the state's evidence as well, and approved cross-examination on those matters.\(^15\) In

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5. State v. Clinton, 67 Mo. 380 (1878).
6. § 1918, RSMo 1879. The statute is unchanged in its present form, § 546.260, RSMo 1969.
8. State v. McClinton, 418 S.W.2d 55, 59 (Mo. En Banc 1967); State v. Williams, 519 S.W.2d 576, 578 (Mo. App., D. St. L. 1975).
9. See, e.g., State v. Miller, 190 Mo. 449, 89 S.W. 377 (1905), where a defendant accused of establishing a lottery denied employment by the Mexican Lottery Company, he could be cross-examined with questions designed to show he had some connection with the organization. The court said the statute does not allow a defendant to take the stand, negate the state's evidence by answering a few carefully chosen questions, and then avoid cross-examination on the issues thus raised.
10. State v. Dalton, 433 S.W.2d 562 (Mo. 1968).
11. This refers to what actually was asked on direct, and not what could have been asked.
14. Id.
15. But see State v. Kelley, 284 S.W. 801 (Mo. 1926), which held that defendant's general denial of robbery on direct was not a sufficiently broad refer-
State v. Whiteaker\textsuperscript{16} the defendant claimed amnesia for the period during which the crime occurred. The court found no error in allowing the prosecutor to ask the defendant if he could have killed his wife.\textsuperscript{17} Whiteaker is an indication that the more general the direct testimony is, the wider the allowable scope of cross-examination may become.

The limited cross-examination statute provides that the defendant "may be contradicted and impeached as any other witness."\textsuperscript{18} Thus, although the prosecutor\textsuperscript{19} cannot attempt to elicit answers covering factual areas not related to the direct examination, he can ask questions designed to test the defendant's memory or the accuracy of his testimony.\textsuperscript{20} For example, in State v. Phillips\textsuperscript{21} the defendant testified on direct that he was drunk and sleeping in a truck during the commission of the alleged burglary. The court held that he could be asked on cross-examination if he drove the truck away. Even though outside the scope of direct, the question was proper as bearing on the credibility of defendant's claim of drunkenness. Similarly, a defendant may be cross-examined about a previous confession, even though he did not refer to it on direct examination.\textsuperscript{22} If the defendant asserts an alibi on direct examination, the prosecution can test his memory by asking him where he was on the same date of a prior month or year.\textsuperscript{23} Thus, questions clearly designed to discredit the defendant's testimony need not be limited to the scope of direct. However, as the emphasis of the cross-examination shifts toward the addition of new evidence to the state's case, a closer relationship to the direct examination is required.

A survey of the cases prior to Booth indicates that few questions are outside the proper scope of cross-examination and even fewer constitute reversible error. Those rare cases often involve clear violations of the statute. An example is State v. Black,\textsuperscript{24} where the defendant was accused of manslaughter, allegedly effectuated by beating his daughter. His wife\textsuperscript{25} testified about defendant's treatment of their children on direct. It was held reversible error to allow the prosecutor to ask the wife if the defendant also beat her.\textsuperscript{26}

\begin{itemize}
  \item \textsuperscript{16} 499 S.W.2d 412 (Mo. 1973), cert. denied, 415 U.S. 949 (1974).
  \item \textsuperscript{17} Id. at 419.
  \item \textsuperscript{18} § 546.260, RSMo 1969.
  \item \textsuperscript{19} The statute also applies to questions by the court. State v. McClinton, 418 S.W.2d 55 (Mo. En Banc 1967); State v. Grant, 394 S.W.2d 285 (Mo. 1965).
  \item \textsuperscript{20} State v. Brown, 312 S.W.2d 818 (Mo. 1958).
  \item \textsuperscript{21} 490 S.W.2d 836 (Mo. 1972).
  \item \textsuperscript{22} State v. Kaufman, 254 S.W.2d 640 (Mo. 1953).
  \item \textsuperscript{23} State v. Abbott, 245 S.W.2d 876 (Mo. 1952); State v. Davit, 343 Mo. 1151, 125 S.W.2d 47 (1938).
  \item \textsuperscript{24} 360 Mo. 261, 227 S.W.2d 1006 (1950).
  \item \textsuperscript{25} Section 546.260 applies to both defendant and his spouse.
  \item \textsuperscript{26} 360 Mo. at 270, 227 S.W.2d at 1011.
\end{itemize}
More common are situations such as the one in *State v. Northington.* On direct, defendant testified that he had six rounds in his revolver before the encounter and that he shot in self-defense. The court found it within the proper scope of cross-examination to ask when he loaded his revolver and where the gun was the afternoon before the shooting. The decision may have been influenced by the fact that the defendant's answer to the question, which showed that he was a county constable authorized to carry the weapon, was favorable rather than harmful to him.

An attempt to summarize the cases and state a general rule delineating the allowable scope of cross-examination would be fruitless. Many decisions have been expressly limited to their facts and courts have often disclaimed an ability to add definitiveness to the statute.

Once a question has been found to be outside the proper scope of cross-examination, the court must determine whether its admission was prejudicial. The supreme court has stated two apparently conflicting views on this subject. In *State v. McClinton* the court said that such cross-examination is “generally held to . . . constitute reversible error.” The authorities cited were *State v. Santino,* which said prejudice would be presumed absent clear evidence to the contrary, and *State v. Pierson,* which dealt with errors prejudicial under any test. A year later, the court again cited *Pierson,* this time for the proposition that cross-examination beyond the scope of direct was not grounds for reversal unless “material or prejudicial to the accused’s substantial rights.” Thus asking the defendant if he had been drinking prior to the crime was held not prejudicial, because the question was immaterial.

The trend of the cases seems to follow the latter rule by implication, but the status of the law is far from clear.

The handling of the question of prejudice in *Booth* is of little help in settling the law in this area. The court avoided a discussion of the issue by pointing to the defendant’s failure to show how he was prejudiced. Clearly this was not an application of the rule that prejudice will be presumed. Yet the court, in finding the questions beyond the proper

27. 268 S.W. 57 (Mo. 1924).
28. The courts have not adequately defined what the phrase “referred to” in the statute means.
30. *Id.*
31. *Id.* at 59.
32. 186 S.W. 976 (Mo. 1916).
33. 331 Mo. 636, 56 S.W.2d 120 (1932).
34. Among other things, the prosecutor asked defendant if he was willing to go into the entire transaction or if there were some matters he would rather not discuss. *Id.* at 645, 56 S.W.2d at 123.
35. *State v. Moser,* 423 S.W.2d 804 (Mo. 1968). The *Pierson* court had required that the question be “on a material point or . . . prejudicial to the substantial rights of the defendant.” 331 Mo. at 645, 56 S.W.2d at 123.
36. *State v. Moser,* 423 S.W.2d 804, 807 (Mo. 1968).
37. *See note 3 supra.*
38. *See text accompanying note 32 supra.*
The statute provides little protection to the defendant, even when the trial court sustains his objection to cross-examination on matters not referred to on direct. When the defendant takes the stand, he waives his constitutional protection against self-incrimination and has only the statute to shield him. Although there is some suggestion that the outer limits of cross-examination of a criminal defendant may be constitutionally imposed, no case law requires the statutory rule. The United States Supreme Court has even found a waiver of the right against self-incrimination by a defendant who voluntarily took the stand in a civil denaturalization proceeding. In addition, although the statute may protect the defendant from the prosecutor's questions, it does not limit what the prosecutor may say in closing argument. Once the accused decides to testify, the prosecutor, in closing argument, may "make any legitimate comment upon his testimony" including the defendant's failure to explain the state's evidence against him. Thus, the jury is permitted to draw inferences which would be improper if the defendant chose not to testify at all.

A clear ruling is needed to specify when allowing cross-examination to exceed the proper scope will be reversible error. A presumption of prejudice is not warranted because the questions will not always be prejudicial, as cases like State v. Northington show. The requirement that the question be on a material point is equally hard to support. A question that exceeds the scope of direct is no less prejudicial because it is also immaterial; in fact, it may be more prejudicial for that reason. A more defensible position would be to require the appellant to demonstrate a clear likelihood of prejudice from the question. Deciding whether a question is prejudicial or merely harmless error should be no more difficult in these cases than it is for other instances of inadmissible evidence.

There appears to be no strong reason for limiting cross-examination of criminal defendants. In those jurisdictions that limit all cross-examination, the primary justification for the rule is that it requires the parties

39. See text accompanying notes 30-31 supra.
40. The same court recently said that such questions were not reversible error unless "prejudicial to the substantial rights of the accused," citing Moser. State v. Rice, 519 S.W.2d 573, 575 (Mo. App., D. St. L. 1975).
41. State v. Scown, 312 S.W.2d 782, 786 (Mo. 1958).
43. Raffel v. United States, 271 U.S. 494 (1926), held that defendant's "waiver is not partial; having once cast aside the cloak of immunity, he may not resume it at will, whenever cross-examination may be inconvenient or embarrassing." Id. at 497.
47. § 546.270, RSMo 1969.
48. 268 S.W. 57 (Mo. 1924). See text accompanying note 28 supra.
to present their facts in order.\textsuperscript{49} That reasoning has little application to
the Missouri statute because the prosecutor must present his case before
the defendant takes the stand. The statute does not place strict limits on
the prosecutor, who can ask questions relating to impeachment and can
comment in closing argument on the defendant's limited testimony even
if defense counsel's questions have been carefully designed to restrict the
cross-examination.\textsuperscript{50}

The effect of the statute is to allow a defendant to make only a par-
tial waiver of his right against self-incrimination, thus affording him
greater protection than the Constitution requires. This additional pro-
tection may be important in at least two situations. First, a defendant
being tried for two or more unrelated crimes may wish to testify as to
one, but not the other. Second, where a defendant asserts an alibi at trial
after remaining silent during arrest and detention, he can avoid ques-
tions like "Why didn't you tell this story to the police?" and thus prevent
the jury from drawing improper inferences from his earlier exercise of
fifth amendment rights. However, these minimal benefits are outweighed
by the uncertainty surrounding the interpretation of the rule. The cases
are so numerous, diverse, and contradictory that there is authority to sup-
port either side of most arguments regarding the proper scope of cross-
examination. In addition, there is no clear rule delineating which improper
questions constitute reversible error. The majority of cases holding a
question or questions improper find that the questions did not con-
stitute reversible error, an indication that the defendant seldom gains any
protection from the statute. In short, the protections afforded a defend-
ant by the statute in its present form do not seem worth the problems
it causes. The two specific advantages mentioned above could be provided
by statute without otherwise restricting cross-examination.\textsuperscript{51}

H. MARTIN JAYNE

\textsuperscript{49} C. McCormick, Evidence § 26 (2d ed. 1972).
\textsuperscript{50} See text accompanying notes 18-23, 45-47 \textit{supra}.
\textsuperscript{51} See \textit{Prop. Fed. R. of Evid.}, Rule 611, Advisory Comms. note, subdivi-
dision \textit{(b)} (1971), recommending unrestricted cross-examination.
INVESTMENT TAX CREDIT – SECTION 38 PROPERTY – BUILDINGS

Arne Thirup

The investment tax credit, designed to stimulate modernization and expansion of the nation’s productive facilities, is a major business tax incentive. Currently, the credit is ten percent of the qualified investment in new and used section 38 property. Limitations, carryover, and recapture rules are found with the basic provisions in sections 38 and 46 through 50 of the Internal Revenue Code (hereinafter referred to as the Code).

Section 38 property is generally defined in section 48(a)(1) of the Code and may be summarized to include depreciable property with an estimated useful life of three years or more which is:

1. Tangible personal property.
2. Other tangible property (excluding buildings and structural components thereof) if—
   A. used as an integral part of certain qualifying activities, or
   B. a storage or research facility used in connection with the same qualifying activities.
3. Elevators and escalators.

The balance of section 48 contains exceptions and qualifications to the above general definition. Distinguishing between buildings, which do not

1. 508 F.2d 915 (9th Cir. 1974), rev’d, 59 T.C. 122 (1972).
4. Int. Rev. Code of 1954, § 48(a)(1) provides:
   in general.—Except as provided in this subsection, the term “section 38 property” means—
   (A) tangible personal property or
   (B) other tangible property (not including a building and its structural components) but only if such property—
   (i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or
   (ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or
   (iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or
   (C) elevators and escalators, but only if—
   (i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or
   (ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date.

   Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

5. See, e.g., Int. Rev. Code of 1954, §§ 48(a)(3) (exclusion of property used to furnish permanent lodging), 48(a)(6) (certain livestock previously excluded now eligible for investment credit).
qualify for the investment credit, and other structures, which may qualify, has proven to be one of the most troublesome problems encountered in applying the investment credit.

In *Arne Thirup* the taxpayers claimed an investment credit for investments made in a greenhouse used in their business of growing and selling cut flowers. The greenhouse was a completely enclosed structure, 200 feet wide by 400 feet long. It was constructed of a wooden frame with fiberglass panels for a roof and walls. There was no floor; the flowers grew directly from the enclosed soil. The greenhouse was designed to supply a controlled environment and had built-in automatic temperature, humidity, watering, liquid fertilizing, and carbon dioxide systems. The fiberglass wall and roof panels were of a special type designed to diffuse the sunlight for better growing conditions. Also, windows in the roof opened and closed automatically to coordinate the external and internal temperature and humidity. Within the greenhouse, the taxpayers' employees performed such tasks as turning and fertilizing the soil, planting, pulling weeds, spraying chemicals, pruning, and harvesting. On occasion, some of the employees ate lunch and took work breaks inside the greenhouse, although no formal facilities were provided for this. It was estimated that approximately one-half of the total work hours were spent inside the greenhouse.

The Commissioner, conceding that the greenhouse was "other tangible property . . . used as an integral part of production" within section 48 (a)(1)(B)(i) of the Code, contended that the greenhouse was a building and therefore ineligible for the investment credit. The United States Court of Appeals for the Ninth Circuit reversed the Tax Court and found the greenhouse to be section 38 property eligible for the investment credit.

The "appearance test" (because it looks like a building, it must *ipso facto* be a building) was rejected by the court of appeals in *Thirup*. This test is derived from legislative history and finds additional support in the Treasury Regulations, which provide: "The term 'building' generally means any structure or edifice enclosing a space within its walls, including research or storage facilities, that is used in connection with any of the activities mentioned above. It is possible that a non-building structure could qualify as tangible personal property and not be subject to the question whether it is other tangible property used in a prescribed activity. See note 38 and accompanying text *infra.*"
and usually covered by a roof. . .”

It is clear, however, that courts have generally concluded that certain structures, although resembling a building in appearance, are not to be considered such for purposes of defining section 38 property.13 This is particularly true where the issue is whether the structure is a building or a storage facility, as opposed to a building versus a non-storage facility.14 Illustrative is Robert E. Catron,15 where the Tax Court analyzed the apparent contradiction between the broad definition of “building” in the Regulations and the eligibility of storage facilities as provided in section 48. It noted that a storage facility would not qualify if it were also a building and that it was difficult to imagine a storage facility that would not fit within the Regulations’ definition of a building. The court refused to attribute to Congress such a “nugatory provision” and rejected the appearance test.16 Similarly, the Commissioner has, when presented with the building versus storage facility issue, frequently refused to apply the appearance test.17 The Thirup decision is significant because it is one of the first decisions rejecting the appearance test where the question is whether a structure is a building or a non-storage facility.18

A different test more frequently applied by the courts is a “function” or “use” test. Like the appearance test, the function test is derived from legislative history19 and finds additional support in the Regulations.20 This test limits the broad scope of the appearance test and states that a building is generally a structure with walls and a roof which also provides “. . . for example, . . . shelter or housing, or . . . working, office, parking, display, or sales space.”21 The function test was first developed in storage facility cases22 and has only recently been applied in non-
Standards for applying the function test were initially announced in Revenue Ruling 66-89 (5) and provide that a structure is not a "building" if: (1) the structure cannot be reasonably adapted to other uses, and (2) the structure provides only storage space, but not work space.24

The inquiry whether the structure is reasonably adaptable to alternative uses focuses on the economic and physical practicability of conversion. The cost of converting the structure to an alternative use is a factor only recently mentioned in the cases and, standing alone, may not be very persuasive.25 A showing by the taxpayer that the structure was specially designed to accomplish a particular qualifying activity alone may be enough to satisfy this standard.26 Where, however, the structure has not been used exclusively for that activity or is available for multiple uses, then, notwithstanding a showing of special design, the structure may not qualify as section 38 property.27 In Central Citrus Company28 "sweet rooms" were used solely for storing fruit in a controlled atmosphere. Because of the special design and equipment systems involved, the Tax Court held that these structures were not reasonably adaptable to alternative uses. In Palmer Olson29 quonset-type structures were specially designed for grain storage. One of the structures had been used by the taxpayer as a machine shed and the others were used for grain storage only about ninety percent of the year. The Tax Court concluded that these structures were available and adaptable for alternative uses and consequently not eligible section 38 property.

The work aspect of the function test states that a structure may qualify as a storage facility if the only human activity performed therein is activity incidental to the storage function, and if the structure does not provide general work space.30 In applying the work aspect portion of the

23. See Arne Thirup, 508 F.2d 915 (9th Cir. 1974), rev'd 59 T.C. 122 (1972); Melvin Satrum, 62 T.C. 413 (1974).
25. See Brown & Williamson Tobacco Corp. v. United States, 491 F.2d 1258 (6th Cir. 1974); Melvin Satrum, 62 T.C. 413 (1974); Arne Thirup, 59 T.C. 122 (1972), rev'd, 508 F.2d 915 (9th Cir. 1974).

To qualify for the investment credit, a storage facility must be used for the
function test, the Tax Court has been inclined to characterize as a “building” structures in which a “substantial number of [people are] frequently and regularly occupied.” Thirup, however, joins the other appellate court decisions on this issue and makes it clear that it is the nature of the work activity, rather than the amount of work, that is determinative. The policy in tolerating work activity incidental to the storage function—e.g., moving a product in and out of the storage facility, is consistent with section 48, for to do otherwise would disqualify most storage facilities.

Thirup extended the function test to non-storage facilities and may have confused the otherwise consistent development of a building’s definition. The function test, based on sound policy, was developed to distinguish between a building and a storage facility. Application of this test in non-storage facility cases seems unwarranted in light of clear legislative history contemplating a broad definition of “building.” This is not to say that the ultimate decision in Thirup was erroneous, only that the rationale was faulty.

The Regulations provide two express exceptions to the definition of a building, either of which was potentially applicable in Thirup. The term “building” does not include a structure which is essentially an item of machinery or equipment. Brick kilns and refrigerator-freezer structures would be included under this exception.

32. 508 F.2d 915 (9th Cir. 1974), rev’g 59 T.C. 122 (1972). The Thirup court stated:

We find the distinction based on the amount of human activity unpersuasive. The proper inquiry, which goes to the nature of the employee activity inside the structure, is “whether the structures provide working space for the employees that is more than merely incidental to the principal function or use of the structure.” Id. at 919. (emphasis in original—citations omitted). See also Brown-Forman Distillers Corp. v. United States, 499 F.2d 1263 (Ct. Cl. 1974); Brown & Williamson Tobacco Corp. v. United States, 491 F.2d 1258 (6th Cir. 1974).
33. See Robert E. Catron, 50 T.C. 806 (1968) (citing Rev. Rul. 68-133 where the Commissioner held moving potatoes in and out of storage did not disqualify the storage facility).
34. See also Melvin Satrum, 62 T.C. 413 (1974) (applying the function test to an egg producing facility).
38. Rev. Rul. 489, 1971-2 Cum. Bull. 64. If an item of property is within this exception, it might properly be characterized as tangible personal property, and as such it would qualify as section 38 property without regard to a qualifying activity. Compare Int. Rev. Code of 1954, § 48(a)(1)(A) with Int. Rev. Code of 1954, § 48(a)(1)(B)(i), (ii), (iii). See also note 6 supra. However, the Regulations provide that tangible personal property does not include “inherently permanent” structures. See Treas. Reg. § 1.48-1(c) (1972). The appropriate definitional subpart
RECENT CASES

The second exception is for "special purpose structures." The Regulations state that if the structure houses equipment used as an integral part of a qualifying activity and if the use of the structure is so closely related to the use of that equipment that the structure can be expected to be replaced contemporaneously with the equipment, then the structure is excepted from the definition of a building and is eligible for the investment credit.\(^8\) Factors enumerated in the Regulations indicating that a structure is within this exception are: (1) that the structure is specially designed to provide for the stress and other demands of the equipment housed therein, and (2) that the structure could not be economically used for other purposes.\(^40\)

There is little case law elaborating either exception.\(^41\) One interesting example of a "special purpose structure" is a 1966 Revenue Ruling where the Commissioner ruled that a unitary hog raising facility did not qualify for the investment credit.\(^42\) An elliptical steel structure housed automated systems for the farrowing, feeding, and raising of hogs. The equipment housed within the structure included automatic feeders, waterers, and heat system, special airflow units, slatted flooring for sewage disposal, space heaters for farrowing, and movable pens and partitions. The Commissioner ruled that special design alone was not controlling to except the structure from classification as a building.

However, in 1971, while considering statutory language to limit storage facilities to those storing fungible goods in bulk, the Senate Finance Committee Report clarified the fact that the term building is not intended to include "special purpose structures." The Report used as an example of such a structure a unitary system for raising hogs and specifically concluded that such a structure would be eligible for the investment credit.\(^43\) Considering the external shell of the structure as merely a way of tying together the equipment systems, the Senate report stated: "There is no other practical use for the structure and it can . . . be expected to be used only so long as the equipment it houses is used."\(^44\)


44. *Id.*

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Similarly, the greenhouse in *Thirup* could have been analogized to the hog raising facility in the Senate report. The greenhouse contained environmental control systems used as an integral part of a qualifying activity and was so closely related to the use of that equipment that it might be expected to be used only so long as that equipment was used. No doubt the greenhouse was specially designed to accommodate the equipment systems and further factual inquiry would probably have led to the conclusion that it had no economically practical alternative use.

In summary, it is essential to keep in mind that there are several separate and distinct approaches available to avoid the "building" label: (1) the two exceptions to the Regulation's definition of a building—classification as machinery or equipment, and "special purpose structures;" and (2) the statutory exclusion for storage facilities. In certain respects, the standards for applying these different approaches are similar. For example, the factual considerations under the Regulation's exception for "special purpose structures" closely approximate those of the alternative use aspect of the function test used in storage facility cases. Confusion may easily result from this similarity unless careful examination is made of the context in which such phrases as "special design" and "alternative use" are employed. Additionally, in attempting to avoid the "building" label, a critical distinction must be observed. The work aspect of the function test is a relevant consideration only in storage facility cases and should not be a factor in a non-storage facility case, as it was in *Thirup*. The legislative intent will be more accurately carried out if this distinction is noted and respected.

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45. A literal reading of section 48(a)(1)(B) indicates that only those storage facilities which are not also buildings are eligible section 38 property. However, as noted, the courts have contracted the otherwise broad definition of "building" where it conflicts with the statutory provision making certain storage facilities eligible for the investment credit. See text accompanying note 16 supra.


47. A word of caution is appropriate. The scope of this note is confined to particular aspects of the definition of the term "building" as that term is used in defining section 38 property. The complex definitional scheme of section 38 property is thoroughly integrated, with individual definitional subparts interdependent upon others. As a consequence, expansion of an individual definitional subpart will result in contraction of others. Before relying on a particular aspect of this scheme, careful examination of the whole is necessary.
JOINT AND MUTUAL WILLS--
EFFECT OF CONTRACT NOT TO REVOKE

Owens v. Savage

Samuel F. and Ida Alice Jones, husband and wife, executed their joint and mutual last will and testament on March 23, 1959 and a codicil thereto in 1964. These instruments contained an agreement not to revoke the testamentary dispositions. Ida Alice Jones died on June 6, 1968. On January 11, 1969 Samuel executed an instrument declaring it to be his last will and testament and therein expressly revoked all former wills. In this instrument Samuel made several small specific bequests, and devised and bequeathed all of his remaining property according to a dispositive scheme different from that contained in the joint and mutual will. Samuel died on May 15, 1971 and probate proceedings were initiated. Subsequent to these proceedings, the legatees and devisees of the joint and mutual will filed suit in the circuit court for declaratory judgment and equitable relief, naming as defendants Samuel's personal representative, legatees, and devisees. Plaintiffs based their claim upon the existence of a binding contractual obligation between Samuel and Ida.

The trial court found that there was an agreement between Samuel and Ida to make a joint and mutual will and that the agreed testamentary distribution constituted an irrevocable contract. Based upon these findings, the trial court declared that the 1959 joint and mutual will could not be revoked by the surviving testator and ordered it admitted to probate. On appeal, the Kansas City District of the Missouri Court of Appeals affirmed as to the existence of a binding and enforceable contract inuring to the benefit of the plaintiffs and granted relief in the nature of specific performance, but ordered stricken that portion of the decree admitting the 1959 will to probate.

The contract involved in Owens is one of several types which may become involved with testamentary dispositions. Contracts to make a will, contracts not to make a will, contracts to revoke a will, and contracts not to revoke a will, each with variations, appear frequently in reported cases. Many questions relating to contractual obligations and their effect on testamentary disposition have been definitively answered, but the effect of a contract not to revoke testamentary dispositions contained in a joint and mutual will has remained confused. In part this confusion may be attributable to the hesitancy with which courts recognized the validity of

1. 518 S.W.2d 192 (Mo. App., D.K.C. 1974).
2. Id. at 199-201.
3. As used herein the term "joint will" means one where the same instrument is made the will of two or more persons and is jointly signed by them. The term "mutual will" means the separate wills of two persons which are reciprocal in their provisions. See Curry v. Cotton, 356 Ill. 538, 543, 191 N.E. 307, 309 (1934); American Trust and Safe Deposit Co. v. Eckhardt, 331 Ill. 261, 264, 162 N.E. 843, 845 (1928). See generally Eagleton, Joint and Mutual Wills: Mutual Promises to Devise as a Means of Conveyancing, 15 CORNELL L.Q. 358 (1930); Partridge, The Revocability of Mutual or Reciprocal Wills, 77 U. PA. L. REV. 357 (1929).
a testamentary instrument purporting to be the will of two or more persons. The more persuasive reason for the confusion is that a testamentary instrument executed pursuant to, or embodying, a contract not to revoke gives rise to a conflict of legal concepts. The conceptual nature of wills is that they are ambulatory until the death of the testator. An equally strong hallmark of contract law is that enforceable rights are created at the making of a contract. It is in dealing with the "hybrid" relationship, resulting from combining the elements of contracts and wills, that confusion was created and remains.

Contractual and testamentary principles are brought sharply into conflict when a joint and mutual will embodying a contract not to revoke is unilaterally revoked by the surviving testator. In dealing with this conflict some courts have given preference to the contractual principles by holding a contract not to revoke is not only enforceable, but operates to deprive the will of its ambulatory nature. The will is thus deemed irrevocable after the death of one of the testators and an attempted revocation by the surviving testator is without effect. Cases so holding often

Missouri courts, while not totally consistent in the use of terms, seem to have settled upon the use of the term "joint and mutual" to denote a single document containing testamentary dispositions of two testators, with the dispositions being reciprocal in nature. This terminology may not be semantically pure, but in light of its use in Owens and other cases it will be used in this note.

4. See, e.g., Darlington v. Pulteney, 1 Cowp. 260, 98 Eng. Rep. 1075 (K.B. 1775) (Lord Mansfield stated "there cannot be a joint will"); Hobson v. Blackburn, 1 Add. 274, 162 Eng. Rep. 96 (Ecli. 1822) (mutual or "conjoint" will is an instrument "unknown to the testamentary law of this country"). For American cases refusing to probate joint wills, see Shackleford v. Edwards, 278 S.W.2d 775 (Mo. 1955); Clayton v. Liverman, 2 N.C. 558 (1837); Walker v. Walker, 14 Ohio St. 157 (1862). See also B. SPARKS, CONTRACTS TO MAKE WILLS 3 (1956) [hereinafter cited as SPARKS].


7. The contract involved may arise in several ways. A minority of jurisdictions adhere to the view that the mere execution of a joint will with reciprocal provisions gives rise to a contract not to revoke. See, e.g., Frazier v. Patterson, 243 Ill. 80, 84-86, 90 N.E. 216, 218 (1909); cf. Tutunjian v. Vetzigian, 299 N.Y. 315, 87 N.E.2d 275 (1949). Missouri joins the majority holding that mere execution of such a will does not per se create such a contract. See, e.g., Plemmons v. Pembroton, 346 Mo. 45, 139 S.W.2d 910 (1940), citing the "general rule" of Clements v. Jones, 166 Ga. 738, 742, 144 S.E. 519, 522 (1928); Wanger v. Marr, 257 Mo. 482, 165 S.W. 1027 (1914). In jurisdictions following the majority view a contract not to revoke may be oral, contained within the testamentary instrument, or set forth in a separate document. See Comment, Contracts to Make Joint or Mutual Wills, 55 MARQ. L. REV. 103, 108-33 (1972).

As to revocation of a contract not to revoke prior to the death of either of the contracting parties, the weight of authority reaches the conclusion that the contract is irrevocable except by mutual consent of both parties to the contract. See SPARKS, supra note 4, at 111. See generally, Note, Contracts Not to Revoke Joint or Mutual Wills, 15 WM. & MARY L. REV. 144 (1973).

8. See, e.g., Frazier v. Patterson, 243 Ill. 80, 84-86, 90 N.E. 216, 218 (1909); Stewart v. Shelton, 356 Mo. 258, 201 S.W.2d 395 (1947). See also SPARKS, supra note 4, at 111-15.
RECENT CASES

appear to treat the rights under the will and the preexisting contract rights as being identical. This deprivation of the ambulatory qualities of a will has been widely criticized as violating basic testamentary law.9

The better reasoned view would seem to be that, notwithstanding a contract not to revoke, the survivor may subsequently revoke the will thereby rendering it ineligible for probate as his last will and testament.10 By adhering to this approach, a court is not put in the undesirable position of probating an instrument it knows the testator did not intend as his last will and testament. This approach also avoids what the Owens court referred to as "[a] miscegenation of the law of contracts and law of wills . . . when courts state wills are irrevocable."11

The Missouri courts' position with respect to the effect of a contract not to revoke testamentary dispositions contained in a joint and mutual will has not been clear or consistent. Through loose and sometimes contradictory language, two lines of cases emerge. Some cases, failing to delineate between contractual and testamentary principles, have held a later revoking will "void"12 or the joint and mutual will "irrevocable."13 The second line of cases, which Owens joins, holds that, notwithstanding a contract not to revoke, the joint and mutual will retains its ambulatory nature and is denied probate as the last will and testament.14

Cases upholding the revocable nature of joint and mutual wills, even in the presence of a contract not to revoke, do not necessarily deny relief to the devisees and legatees of the revoked will. These cases grant relief relying upon the third party beneficiary doctrine of contract law rather than the probate of a revoked will, and indicate that the aggrieved contract beneficiary may have a remedy at law or in equity.15

While cases and commentators indicate the availability of either legal or equitable relief, the vast majority of the cases involve equitable relief. The preponderance of equitable proceedings is partially explainable because of the operation of the Statute of Frauds16 and the equitable doc-

9. See generally T. Atkinson, Atkinson on Wills 224 (2d ed. 1953); Sparks, supra note 4, at 111; Eagleton, Joint and Mutual Wills: Mutual Promises to Devise as a Means of Conveyancing, 15 Cornell L.Q. 358, 367 (1930).
11. 518 S.W.2d at 200.
12. Ragsdale v. Achuff, 324 Mo. 1159, 1175, 27 S.W.2d 6, 13 (1930).
13. See, e.g., Wimp v. Collett, 414 S.W.2d 65, 75 (Mo. 1967); Stewart v. Shelton, 356 Mo. 258, 201 S.W.2d 395, 399 (1947).
16. § 432.010, RSMo 1969.

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129
trine of part performance. A large number of the reported decisions involve either oral agreements or vague agreements contained within the testamentary instrument. As a result, in an action at law the plaintiff faces the risk of the Statute of Frauds acting to make the agreement unenforceable. This risk is largely negated at equity through the doctrine of part performance. Additionally, due to the nature of the property involved, the plaintiff often finds it difficult to ascertain damages and prefers to receive title to the property as opposed to the monetary equivalent. One advantage an action at law may have over the equitable remedy is a lesser degree of proof required with respect to the existence of a contract.

17. See, e.g., Wimp v. Collett, 414 S.W.2d 65 (Mo. 1967); Plemmons v. Pemberton, 336 Mo. 45, 139 S.W.2d 910 (1940), Section 2-107 of the Uniform Probate Code lessens some problems in this area by providing three exclusive methods of establishing a contract not to revoke a will, all of which require a signed writing. The Uniform Probate Code section, now in force in a number of states, has been recommended for enactment by the Board of Governors of the Missouri Bar and has been introduced in the 1976 Missouri General Assembly.

18. The Missouri Statute of Frauds, which is based on section 4 of the English Statute of Frauds of 1676, 29 Car. 2, c. 3, requires a signed writing to support an action "upon any contract made for the sale of lands, tenements, hereditaments, or an interest in or concerning them..." § 432.010, RSMo 1969. It has been held applicable to contracts relating to a devise of land or of land and chattels. See, e.g., Shaw v. Hamilton, 346 Mo. 366, 141 S.W.2d 817 (1940); Buxton v. Huff, 254 S.W. 79 (Mo. 1923); Ver Standig v. St. Louis Union Trust Co., 228 Mo. App. 1242, 62 S.W.2d 1094 (St. L. Ct. App. 1933). The Statute of Frauds has been held inapplicable to a contract relating to a bequest of chattels only. See generally Schnebly, Contracts to Make Testamentary Dispositions as Affected by the Statute of Frauds, 24 Mich. L. Rev. 749 (1926). Some states have express provisions relating to contracts to devise or bequeath or to refrain from doing so. Mass. Gen. Laws. Ann. ch. 259 § 5A (1965); N.Y. Gen. Oblig. Law § 5-701 (McKinney Supp. 1975); Ohio Rev. Code Ann. § 2107.04 (1968).

19. See generally J. Calamari, Contracts § 296 (1970). For a discussion of the history and basis of the doctrine of part performance, see Moreland, Statute of Frauds and Part Performance, 78 U. Pa. L. Rev. 51 (1929). As to what sort of part performance takes an oral contract to devise or not to revoke a will out of the Statute of Frauds, see Mills v. Bergbauer, 452 S.W.2d 237 (Mo. 1970) (son's moving back to farm upon father's oral promise to devise held sufficient); Shaw v. Hamilton, 346 Mo. 366, 141 S.W.2d 817 (1940) (husband's execution of will to heirs of wife insufficient where there was an alleged oral contract between husband and wife to make wills in favor of heirs of other); Ver Standig v. St. Louis Union Trust Co., 344 Mo. 880, 129 S.W.2d 905 (1939) (alleged oral contract to devise for services rendered, evidence of services rendered held sufficient performance for enforcement of contract); Clark v. Cordry, 69 Mo. App. 6 (K. C. Ct. App. 1897) (oral agreement whereby plaintiff agreed to board and lodge defendant's deceased in return for promise to bequeath $2000, held sufficient performance to render the Statute of Frauds inapplicable).


21. Day v. Blackbird, 331 S.W.2d 658 (Mo. 1960), was a suit in equity seeking specific performance of an alleged contract to make a will. The Missouri Supreme Court held that proof of the existence of such a contract must be beyond a reasonable doubt. Within two weeks of the above decision the St. Louis Court of Appeals decided Reighley v. Fabricius' Estate, 332 S.W.2d 76 (St. L. Mo. App. 1960), an action at law for breach of contract to bequeath a definite sum. The court required the proof of the contract to be only by a preponderance of the
Statutes regulating the time within which claims must be filed against decedents' estates may also frustrate the plaintiff's action at law for damages. It would appear that the type of remedy pursued by the plaintiff can be determinative of the applicability of a nonclaim statute.\(^2\) If the beneficiary of a contract not to revoke is seeking damages at law, then the nonclaim statute applies.\(^2\) However, if the remedy sought is specific performance, then the plaintiff is not making a claim against the estate so as to be within the scope of the nonclaim statute; he is claiming title to the property, and in fact, the property he is claiming is itself subject to claims against the estate.\(^2\)

If the decedent's dispositive scheme, either that contained in a later revoking will or provided by the intestate succession laws, is inconsistent with the terms of the contract, specific performance of the contract may be granted.\(^2\) It is the contract that creates the right upon which the contract beneficiary's action is based; the revoked joint and mutual will is relevant only in establishing the terms of the contract.\(^2\) In an action for specific performance the contract beneficiary should name as defendants the surviving testator's personal representative, legatees and devisees, or distributees and heirs-at-law.\(^2\) A decree of specific performance does not affect the administration of the estate as to the payment of claims and expenses;\(^2\) it merely acts at the time of distribution to transfer title to the contract beneficiary.\(^2\)

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22. SPARKS, supra note 4, at 184. The Missouri nonclaim statute provides that a claim is lost if the claim or notice of action is not filed in the probate court within six months after first publication. § 473.360, RSMo 1969.

23. Abrams v. Schlar, 27 Ill. App. 2d 237, 169 N.E.2d 583 (1960) (plaintiff beneficiaries of promise to leave them share of decedent's estate had remedy at law in the nature of a claim against the estate and should have filed claim in the probate court within the time set out in the nonclaim statute); contra, O'Connor v. Immele, 77 N.D. 346, 43 N.W.2d 649 (1950) (claim of a beneficiary under a revoked will is not a claim against the estate).

24. The decree in Owens supports this view. 518 S.W.2d at 201. In Mills v. Bergbauer, 452 S.W.2d 237 (Mo. 1970), the Missouri Supreme Court held that the title decreed to be in the beneficiary of a contract to devise shall be subject to claims properly allowed by the probate court and costs incurred in the administration of the estate.

25. See, e.g., Wimp v. Collett, 414 S.W.2d 65 (Mo. 1967); Bennington v. McClintick, 253 S.W.2d 132 (Mo. 1952); Plemmons v. Pemberton, 346 Mo. 45, 139 S.W.2d 910 (En Banc 1940). See generally SPARKS, supra note 4, at 22-38.

26. The most vigorously litigated aspect of such contracts has been the proof requirements to establish the existence, rather than the validity, of the contract. The proof requirements and cases are considered in Wimp v. Collett, 414 S.W.2d 65, 76 (Mo. 1967). See also note 21 supra; Eagleton, Joint and Mutual Wills: Mutual Promises to Devise as a Means of Conveyancing, 15 Cornell L.Q. 358, 367 (1930).


28. See note 24 and accompanying text supra. See also SPARKS, supra note 4, at 152.

29. See Adams v. Moberg, 356 Mo. 1175, 205 S.W.2d 553 (1947) (detailing the proper form of decree to transfer legal title to the beneficiaries).
Relief predicated upon specific performance has not been the exclusive equitable remedy relied upon by Missouri plaintiffs. There is authority to support granting injunctive relief to prevent a surviving testator from disposing of his property in violation of the contractual rights of the contract beneficiaries. Pleas invoking the declaratory judgment act have also been recognized. In Stewart v. Shelton the beneficiaries of a joint and mutual will executed by husband and wife sought to set aside deeds executed by the wife after the husband's death. The court held that a "justiciable controversy" within the declaratory judgment statute was presented. It would seem that under proper circumstances equity can also entertain an action for an accounting and can award damages.

The court in Owens held that the joint and mutual will and the codicil thereto constituted a binding and enforceable contract inuring to the benefit of the plaintiffs. Relief was afforded through a decree in the nature of specific performance. The defendants were ordered to "convey, transfer, and deliver" the plaintiffs' shares under the contract as set forth in the joint and mutual will "subject only to the payment of debts, claims, taxes, and costs of administration according to law." In the final analysis the plaintiffs received what they would have received but for Samuel's revocation of the joint and mutual will and codicil.

Much of the confusion with respect to joint and mutual wills executed pursuant to or embodying a contract not to revoke stems from a failure to distinguish the testamentary aspects of the instrument from the contractual aspects. Upholding the ambulatory nature of wills while decreeing the contract specifically enforceable retains intact fundamental concepts in both fields of law while affording relief to the injured parties.

Although the wise practitioner may continue to avoid drafting joint and mutual wills, the Owens holding has removed some of the confusion and added a much-needed degree of certainty as to the effect of a contract not to revoke testamentary dispositions.

JOHN M. MOWER

31. 356 Mo. 258, 201 S.W.2d 395 (1947).
33. In situations where specific performance would be impossible equity may award monetary damages. This follows from the fact that once equity has taken jurisdiction, full relief will be granted. Elliott v. Richter, 496 S.W.2d 860 (Mo. 1973).
34. 518 S.W.2d at 201.
35. See generally Peterson & Eckhardt, Legal Forms, 7 Mo. Practice Series, 476 (1960); Fingar, Joint, Mutual and Reciprocal Wills, 94 TRUSTS AND ESTATES 782, 786 (1955); Sparks, Contracts To Devise or Bequeath As An Estate Planning Device, 20 Mo. L. REV. 1, 5 (1958).
TAX AND INSURANCE ESCROW ACCOUNTS IN MORTGAGES—THE ATTACK PRESSES ON

Buchanan v. Brentwood Federal Savings and Loan Ass'n1

Several lending institutions in and around Pittsburg, Pennsylvania, financed the residential borrowing of various homeowners who had executed mortgages and accompanying personal bonds as security for the loans. Along with the normal principal and interest payments, the mortgagees required one-twelfth of the amount of the annual property taxes and casualty insurance premiums to be deposited monthly with the mortgagees in escrow accounts.2 The lending institutions paid these assessments from the accumulated funds as they became due. The institutions commingled the mortgage escrow funds with general funds and invested them for their own profit, but did not pay the depositors for the use of the funds.3 Twenty-nine individuals brought a class action against these institutions to recover the profits derived from the investment of such funds by the institutions.4 The trial court sustained the defendants' joint demurrer and dismissed the complaints for failure to state a cause of action. On appeal, the Supreme Court of Pennsylvania held that the mortgagors' allegations of misuse of the escrow funds by the mortgagees stated a cause of action for breach of an express trust, imposition of a constructive trust, and breach of an implied contract,5 and remanded for a trial on the merits.

The most common6 method of challenging the legality of non-interest


2. The origin of these payments dates back to the 1930's when the financial situation of thousands of people made this type of account the easiest and most convenient method of paying the taxes and insurance on their mortgaged property. At the same time these payments protected the lending institutions against tax liens which would take priority over the mortgages. See, e.g., CONSUMER REP., March 1973, at 202; Hearings on H.R. 13337 Before a Subcomm. on Housing of the House Committee of Banking and Currency, 92d Cong., 2d Sess. 322-25 (1972); 4 AMERICAN LAW OF PROPERTY § 16.1061 (A. J. Casner ed. 1952). See also Comment, Payment of Interest on Mortgage Escrow Accounts: Judicial and Legislative Developments, 23 Syracuse L. Rev. 845 (1972).

3. The most recent estimate of annual lost interest income to consumers amounts to over $235,000,000. Total escrow account collections themselves amount to $9.4 billion annually. United States General Accounting Office (GAO), Study of the Feasibility of Escrow Accounts on Residential Mortgages Becoming Interest Bearing 7 (1973).

4. Consumer protection groups have become very involved in this area of home financing. Wall Street Journal, July 21, 1972, at 12, col. 3.


bearing escrow accounts is the breach of trust theory. The first appellate consideration of this theory was in Sears v. First Federal Savings and Loan Ass’n. The plaintiffs contended that their monthly prepayments were deposits to be used for a specific purpose and were therefore sufficient to establish a trust relationship. The court disagreed, perhaps confusing the requirements of a deposit for a specific purpose with those of a special deposit. The court held that the monthly payments gave rise only to a debtor-creditor relationship, not a trust. It is to be noted that the Sears decision was based on the court’s interpretation of the specific mortgage instrument in issue. A major portion of the court’s opinion centered on the instrument’s express language relating to the monthly prepayments. The form used contained three possible wordings, of which one was to be selected at the option of the lending institution. The language actually chosen was in contrast to specific trust language contained in another of the available options. Further construction of the agreement’s language led the court to regard the deposits as being pledged against the main indebtedness; that is, the escrow funds were construed merely to represent payments on a debt owed to the institution. The exact language of the contract, as alleged in the complaint, proved to be a bar to the plaintiffs’ recovery.

Carpenter v. Suffolk Franklin Savings Bank went a step further than Sears by “recognizing the special purpose nature of these prepayments [tax-escrow funds] and the resulting trust relationship.” Carpenter was the first appellate decision to hold that the mortgagor’s trust theory stated a cause of action. Unlike Sears, the Carpenter decision was not per curiam, 487 F.2d 953 (3d Cir. 1973) (antitrust, truth in lending, usury, unjust enrichment, breach of fiduciary duty).

7. The payments are considered as creating a trust relationship between mortgagor and mortgagee under this theory. Ulbricht, Impound Accounts and After, 28 Bus. Law. 203 (1972).
9. Specific property deposited with a bank and earmarked for exact return is a special deposit. The relationship created is one of bailor-bailee. A deposit for a special purpose requires only that the designated purpose of the deposit be strictly adhered to by the bank and a trust is thereby created. Annot., 31 A.L.R. 2d 472 (1924); cf. 5 A. Scott, THE LAW OF TRUSTS § 550 (3d ed. 1967). The Sears court believed that the payments must be segregated and earmarked before a trust could arise. However, these are not requirements for a special purpose deposit. See Comment, The Attack Upon the Tax and Insurance Escrow Accounts in Mortgages, 47 Temp. L.Q. 352, 353-58 (1974).
10. The options in regard to the escrow payments were that they: (1) be held in trust by it without earnings for the payment of such items; (2) be carried in a borrower’s tax and insurance account and withdrawn by the lender to pay such item; or (3) be credited to the unpaid balance of said indebtedness as received.
12. Comment, supra note 9, at 359.
13. Only a New York Small Claims Court has gone farther. It allowed a mortgagor to recover profits derived from the investment of the escrow funds on a breach of fiduciary duty theory. Tierney v. Whitesone Sav. & Loan Assn, 353 N.Y.S.2d 104, 75 Misc. 2d 284 (Small Claims Ct. 1974).
based on an interpretation of the specific language of the mortgage and loan agreements in question. The language of these instruments was not specifically set forth in the pleadings and therefore was not before the court. The allegations pertinent to the decision set forth only that the mortgagors made monthly payments into escrow in order to pay their property taxes, that the bank commingled the funds with its own resources, invested the funds for a profit, and refused to render these earnings to the mortgagors.

To support its holding, the Carpenter court relied on two lines of trust theory: the so-called "ABC" case and two special deposit cases. The former analysis is based on the decision of In Re Interborough Consolidated Corp. In that case the United States Court of Appeals for the Second Circuit said that when A gave money to B to be delivered to C, a trust arose in favor of C. Under the facts of Carpenter, A is the mortgagor and B the lending institution which pays the taxes to the city, C. If the bank refused to remit the mortgagor's tax payments to the city, the "ABC" theory would allow the city to sue the bank for a breach of trust. However, the primary function of this theory is to protect creditors from middlemen, not to allow mortgagors to recover the profits derived from a mortgagee's wrongful use of escrow funds.

The second theory involves the creation of a trust relationship through the existence of special deposits. This relationship arises when money is deposited with a bank to be held by it separate from its own assets. But the bankruptcy cases relied on in Carpenter in support of this theory are of doubtful precedential value. The imposition of a trust to preserve a special depositor's rights against unsecured creditors in a bankruptcy case does not, a priori, support the finding of a trust where mortgagors are seeking an accounting of profits from mortgagees.

Surprisingly, the Carpenter court did not indicate the specific form of trust that may have been created. This is in contrast to the distinction between express and implied trusts made by the Sears court. There it was held that no express trust could arise, because of the nature of the express language of the agreements. The Sears court proclaimed:

Although the term "implied trust" has been used to designate an express trust arising from the construction of language in a document, it seems to us that it is preferable to define the trust which would arise in such situations as an express trust.
Because the complaint before the *Carpenter* court did not assert the express language of the agreement, the trust in issue should have been considered an implied trust.

It has been suggested that a resulting trust most properly conforms to the facts of *Carpenter.* This is a logical position, even though none of the three traditional classes of resulting trusts is precisely applicable. In contrast to an express trust, which is created by the settlor's external expression of intention, a resulting trust exists if the circumstances show an absence of intention on the part of a transferor to give the beneficial interest in property to one who has received legal title. In the tax escrow account area, it can be argued that the mortgagor did not intend to allow the lending institutions the beneficial use of his money. Therefore, any profits derived from the use thereof should result back to the mortgagor. The intent of the escrow payments is to protect the mortgagor's security interest, not to increase his income.

The *Carpenter* court noted that the intention of the parties determines the existence of a trust. However, *Carpenter* did not consider the merits of a constructive trust theory. Unlike an express trust or resulting trust, a constructive trust is remedial in nature. A creature of equity, a constructive trust does not arise by virtue of agreement or intention.

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23. A resulting trust theory may provide a tactical advantage to the class action lawsuit which typifies tax escrow account litigation. As the circumstances surrounding the payments are instrumental in the determination of the mortgagor's intention and therefore the applicability of a resulting trust, the similarity of circumstances arising from the dealings of one lending institution facilitates the class treatment. A constructive trust theory has similar advantages. As an advocate of the resulting trust theory, one has several possible contentions. He can point to the limited purpose of the escrow payments and to other factors leading to a strong inference that the mortgagor intended to keep the beneficial interest in his tax payments. "The mortgagor could require the bank to rebut this inference by showing, perhaps, that it was the bank's policy and practice to raise this matter routinely with prospective mortgagors. If the bank cannot demonstrate that its usual practice was to inform borrowers that they would not receive any interest or earnings from the bank's investment of their tax escrow payments, it will be difficult for the bank to argue effectively against the finding of a resulting trust." Without such disclosure it will be difficult to prove that the mortgagors desired to give away any beneficial interest in their payments to the mortgagee. Comment, *supra* note 1, at 528-29.

24. Traditionally, resulting trusts have been found where an express trust fails, where an express trust is fully performed and there remains a surplus in the trust estate, and where property is purchased with funds supplied by A, but legal title is transferred to B. See *Restatement (Second) of Trusts* §§ 411, 430, 440 (1959). The last kind of resulting trust is commonly called a "purchase money resulting trust." See G. & G. Bogert, *The Law of Trusts and Trustees* § 454 (3d ed. 1964). It has been suggested that the only traditional resulting trust similar to that which may exist in *Carpenter* is the purchase money resulting trust. See Comment, *supra* note 1, at 525-29.

25. 5 A. Scott, *supra* note 20, § 404.1.
27. 89 C.J.S. *Trusts* § 139 (1955).
28. See *Restatement (Second) of Trusts* ch. 12, at 326 (1959) (introductory note to topic 1).
Buchanan marks the most significant advancement of the trust theory by an appellate court. Only the Buchanan court treated the constructive trust theory as stating a cause of action. Not really a legal trust at all, a constructive trust is an equitable remedy imposed to prevent the unjust enrichment of one party at the expense of another.29

In seeking the imposition of a constructive trust, the plaintiffs in Buchanan contended that a confidential relationship arose between themselves and the mortgagees as a result of the relative position of the parties to the mortgage transaction.30 As the primary basis for their cause of action, the plaintiffs asserted that the mortgagees' retention of the escrow fund profits had breached this confidential relationship. The court stated that proof of the existence of a confidential relationship is sufficient justification for imposing a constructive trust, unless the party with the dominant position can prove "by clear and satisfactory evidence" that the contract was not tainted by his superior bargaining position.31

A second theory offered by the plaintiffs in support of the imposition of a constructive trust was based on the alleged existence of an agency relationship between the mortgagors and mortgagees. If an agent makes an unauthorized use of his principal's money for his own advantage, a court may appropriately decree the equitable remedy of a constructive trust.32 The court agreed with this reasoning, stating that the plaintiffs could prevail on this theory if it could be proven on remand that the mortgage agreement contemplated such an agency relationship.33

Unjust enrichment was the third theory proposed by the plaintiffs as a basis for declaring the mortgagees constructive trustees of the earned profits. In reply to this proposal, the court stated that the fundamental question was whether "the conscience of equity" would conclude that the mortgagees would be unjustly enriched should they be allowed to keep the profits from the escrow funds.34 In general, equity will impose a constructive trust when property has been acquired in such circumstances that the one who holds the legal right to the property ought not in equity and good conscience retain the beneficial interest therein.35 It is well-settled that this remedy will be imposed whenever justice or the need for fair dealing warrant it.36

The dissent in Buchanan believed that the complaint did state a cause of action on the constructive trust theory, but also said that the complaint

30. A fiduciary or confidential relationship may arise from the relative standing of the parties to a transaction. Triesler v. Helmbacher, 350 Mo. 807, 817, 168 S.W.2d 1030, 1036 (1943).
33. 457 Pa. at ——, 320 A.2d at 128.
34. Id.
36. Id.
itself violated a Pennsylvania rule of civil procedure requiring a complaint to state specifically whether any claim set forth therein is based upon a writing. This objection underscores an advantage of a constructive trust theory. The mortgage agreement itself can destroy the express trust theory because the language of the agreement can be drafted to negate expressly any intention to create a trust. A constructive trust is not based upon the intent of the parties and no amount of careful draftsmanship can circumvent this theory.

Missouri courts have set forth standards for the imposition of a constructive trust applicable to mortgage escrow account litigation. It has been held that a confidential or fiduciary relationship exists whenever confidence is reposed by one party and the other exerts a resulting influence or superiority on the reposing party. The origin of this confidence and its resulting influence are immaterial. However, there must be evidence of some inequality, dependence, or weakness coexisting with the granting of this confidence before a constructive trust will be imposed. It is of no consequence that the constructive trustee acted in good faith or without actual intent to defraud.

The Buchanan rationale illustrates the inherent flexibility of established trust and constructive trust doctrines. Before relying on the Buchanan case, however, a thorough examination of the mortgage agreements in question is necessary, because mortgagors filing similar actions should expect close judicial scrutiny of these agreements. Further decisions in this area are likely to be on a case by case basis.

The most satisfactory remedy to the problem of tax and insurance escrow accounts lies in recourse to the legislatures. A recent New York statute requires the payment of interest at a rate to be established periodically by a Banking Board, but in no event less than two percent per annum. Additionally, the legislation prohibits the imposition of service charges on escrow accounts. The latter provision is a substantial victory for the potential mortgagor entering the housing market, because the increased costs of “administration” of the system may well have been passed on to him in its absence. This “passing on” result is inherent in a Massachusetts law, which requires a mortgagee to pay interest in a manner determined by the mortgagee. The net effect of this latter provision may be to require future borrowers to pay for the administrative costs incident to the maintenance of an escrow account, a service that has traditionally been provided free of charge. Nevertheless, resolution of the consumer’s

37. 457 Pa. at ----, 320 A.2d at 128.
38. Trieseler v. Helmbacher, 350 Mo. 807, 168 S.W.2d 1030 (1943).
39. Id. at 817, 168 S.W.2d at 1036.
40. Cohn v. Jefferson Savings and Loan Ass'n, 349 S.W.2d 854, 859 (Mo. 1961); Gates Hotel Co. v. C.R.H. Davis Real Estate Co., 331 Mo. 94, 52 S.W.2d 1011 (1932).
41. Swon v. Huddleston, 282 S.W.2d 18 (Mo. 1955).
42. N.Y. BANKING LAW § 119 (McKinney 1974).
43. MASS. LAWS ANN. ch. 183, § 61 (Supp. 1974).
dissatisfaction with the present escrow account system can be achieved through the elimination of such hidden charges coupled with legislative requirements that mortgagors be credited in some manner with the profits derived from the investment of their escrowed funds.

Michael E. Kaemmerer

TAXATION—ACCUMULATED EARNINGS TAX NOT APPLICABLE TO A PUBLICLY HELD CORPORATION

Golconda Mining Corp. v. Commissioner

Section 531 of the Internal Revenue Code of 1954 imposes a tax on earnings which a corporation unreasonably accumulates instead of distributing as dividends. The purpose of the tax is to discourage the use of a corporation as a tax shelter for individual shareholders—e.g., where it would be advantageous for the shareholder to have earnings disbursed at a later date when tax conditions are more favorable to him. The purpose of the tax is to deter tax avoidance by the shareholders of a corporation, rather than any avoidance by the corporation itself. The more independent management is from one or a few of the shareholders, the less likely it is that the corporation will retain its earnings for the tax benefit of individual shareholders. Thus, the likelihood of the accumulated earnings tax being imposed is greatest where a single group of shareholders has effective control over corporate dividend policy. On the other hand, a corporation with a large number of shareholders and independent management would have little reason to fear imposition of the tax.

The Commissioner has generally assessed the tax only against closely held corporations, although there is no specific statutory provision making a distinction between closely held and publicly held corporations.

1. 507 F.2d 594 (9th Cir. 1974), rev'd 58 T.C. 139 (1972).
2. "In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income . . . an accumulated earnings tax . . . ." Int. Rev. Code of 1954, § 531.
3. For an interesting side effect, see Barker, The Accumulated Earnings Tax as a Deterrent to Business Diversification of Close Corporations, 16 Kan. L. Rev. 98, 103 (1967), where it is pointed out that small closely held corporations are deterred from retaining funds in preparation for expansion into a different area of business due to fear of the accumulated earnings tax and a statutory presumption that these funds are being accumulated for the purposes of avoiding income tax.
5. Robson, Corporate Liquidity, Reserves, and the Accumulated Earnings Tax, 51 N. Car. L. Rev. 81, 82, n.6 (1972).
6. Int. Rev. Code of 1954, § 532(a) provides:
   General Rule—The accumulated earnings tax imposed by Section
Stockholder pressure in a publicly held corporation, including potential shareholder derivative actions, is usually an even greater incentive for management to declare dividends than the tax imposed by section 531. On at least one occasion, however, the government has attempted to impose the tax on a corporation with relatively broad ownership. The application of the tax to a corporation with a large number of shareholders is an issue which has troubled the business world and which had not been confronted under the 1954 Code prior to Golconda.

Golconda Mining Corporation was a publicly held Idaho corporation. During the years in issue, it had from 1,500 to 2,900 shareholders and the management group owned or controlled no more than 12 to 17 percent of its stock. Golconda was assessed with the accumulated earnings tax for the years 1962 through 1966. The Tax Court found that for the years 1962 through 1965 Golconda did not accumulate its earnings beyond the reasonable needs of its business. For the year 1966, however, Golconda failed to establish by a preponderance of the evidence that its accumulation was not for avoidance of income tax. The Tax Court held, therefore, that Golconda was subject to the accumulated earnings tax.

The threshold question that the Tax Court faced in Golconda was whether the accumulated earnings tax could be assessed against a publicly held corporation. The Tax Court looked at the manner in which the company was managed to negate public ownership. Then, in reliance on the Trico Products cases, decided under the 1939 Code, the Tax Court held that the tax was applicable. The Court of Appeals for the Ninth Circuit reversed, holding that the accumulated earnings tax does not apply to publicly held corporations. Subsequently, the Internal Revenue Service

531 shall apply to every corporation . . . formed or availed of for the purpose of avoiding the income tax with respect to its shareholders . . . by permitting earnings and profits to accumulate instead of being divided or distributed (emphasis added).


11. Id. at 157.

12. Id.

13. See note 21 and accompanying text, infra.


16. 507 F.2d at 597.
RECENT CASES

isued a non-acquiescence bulletin stating that it does not accept the court of appeals' decision in Golconda.17

The decision of the court of appeals in Golconda makes the determination whether a corporation is publicly held a critical issue in cases involving the imposition of the accumulated earnings tax. Corporations with a large number of shareholders, such as Golconda, undoubtedly need to know if they will be considered publicly held and thereby avoid the application of the accumulated earnings tax.18 Unfortunately, the court of appeals' decision in Golconda does not specify what factors a court should consider in making the determination whether a corporation is publicly held for purposes of the accumulated earnings tax. The case is subject to three different interpretations19 with respect to how this determination is to be made.

First, Golconda could be narrowly read on its facts as simply saying that a corporation like Golconda is a publicly held corporation, and therefore the tax is not applicable. Under this view, the predominant guideline in the field would be a series of cases which arose in the 1940's involving the Trico Products Corporation.20 Until Golconda, these cases had been the only instances of application of the tax to a publicly held corporation (approximately 2,200 stockholders). Under this approach, corporations with a large number of shareholders may be found to be not publicly held, and thus subject to the accumulated earnings tax. In Golconda, the Tax Court looked at the manner in which the company had been managed to override the fact that the corporation was owned by many shareholders.21 Notwithstanding reversal of the Tax Court on appeal, it is arguable that, under a narrow reading of the court of appeals' opinion in Golconda, courts will still examine the manner in which a corporation is managed to decide the threshold question whether the corporation is publicly held for purposes of the accumulated earnings tax.22

18. For example, to decide if they can safely retain funds in preparation for expansion into a different area of business. See note 3, supra.
19. A fourth possible interpretation may exist. A specific statutory exception for publicly held corporations was offered by the House of Representatives in the enactment of the 1954 Code. It would have excluded all corporations which could produce records showing that no more than 10 percent of its stock was held by one family. H. R. REP. No. 8300, 83d Cong., 2d Sess. § 532 (1954). This provision was rejected by the Senate because of the difficulty of proof a corporation would have, considering the type of records which would have to be produced. S. REP. No. 1622, 83d Cong., 2d Sess. 69 (1954). It can be argued that this was an implicit adoption of the House standard, but a rejection of the stringent proof requirement.
21. We are mindful, however, that the imposition of this tax upon a publicly held company should only occur where the fact of public ownership is neutralized by the manner in which the company has been managed.
22. Cf. BITTKER & EUSTICE, supra note 4, ¶ 8.02, at 8-5, 8-6, where it is stated...
The second possible approach is to limit Trico to its facts and treat Golconda as setting forth the general rule that almost all widely held corporations will be found to be publicly held and thereby avoid imposition of the accumulated earnings tax. This interpretation is supported by several factors. First, Trico dealt with an unusual set of facts. A group of 21 shareholders held between 62 and 68 percent of the company’s total shares, either directly or indirectly through ownership of 85 percent of a holding company which in turn owned 55 percent of Trico’s stock. Three-quarters of Trico’s shareholders were substantially benefited by its accumulation of earnings and over $3,000,000 in personal income taxes were avoided.23 Second, although the court of appeals in Golconda recognized Trico without overruling it, it specifically pointed out that Trico should not be relied upon because of its unusual facts.24 Third, nearly 30 years passed between Trico and Golconda without any other cases allowing the accumulated earnings tax to be assessed against a publicly held corporation. Under this second interpretation, courts would not examine the manner in which a corporation is managed to negate the fact that the corporation is owned by many shareholders. Obviously, such an approach would be advantageous to the corporation involved.

The final interpretation is based on the legislative history of section 531. In enacting the 1954 Code the Senate rejected a proposed House exclusion for publicly held corporations, but it did recognize that “as a practical matter, the provision has been applied only in cases where 50 percent or more of the stock of a corporation is held by a limited group.”25 The court of appeals pointed out that this recognition takes on special meaning when coupled with the rule that treasury interpretations long continued without substantial change, applying to substantially reenacted statutes, are deemed to have received congressional approval and to have the effect of law.26 Under this rationale, the standard would appear to be absolute; however, a counterargument rests on Senate recognition that the tax was theoretically applicable to publicly held, as well as closely held, corporations.27 The Tax Court in Golconda had relied on this “theoretically applicable” language to conclude “as a matter of law that the ac-
cumulated earnings tax can apply to publicly held corporations.”\textsuperscript{28} The holding of the court of appeals in ‘\textit{Golconda}’ has two significant features. First, there is an implicit rejection of any argument based on the “theoretically applicable” language found in the Senate report.\textsuperscript{29} Second, it most likely draws the line between closely held and publicly held corporations at a limited group holding 50 percent or more of the stock.\textsuperscript{30}

Regardless of what test is ultimately adhered to by the courts, the impact of \textit{Golconda} will be primarily one of relief to publicly held corporations after two and one-half years of confusion following the Tax Court’s decision. It also represents a retreat from the ever-increasing intrusion of revenue agents and federal judges into the policy-making role of corporate management.\textsuperscript{31} \textit{Golconda} gives superficial relief to publicly held corporations by holding the tax not applicable in this case, but its overall effect is to shift the emphasis to the criteria to be established in determining whether a corporation is publicly held. No matter what standard is adopted, it would seem that in the extreme case, such as that of a publicly held corporation deliberately availing itself to upper-bracket shareholders with an announced policy of accumulating investment income, the court will find a way to impose the tax of section 531.\textsuperscript{32}

R. Michael Baron

\textbf{WILLS – THE PRETERMITTED HEIR IN MISSOURI}

\textit{Vogel v. Mercantile Trust Company National Association}\textsuperscript{1}

The will of a testatrix who died in 1921 devised the residue of her estate to a trustee to pay income to her only child for life, and then to distribute the trust property to the named only child of the life beneficiary. Two more children were born to the life beneficiary after the death of the testatrix. The life beneficiary died in 1970. His two younger children sued the trustee and their older sibling seeking intestate shares in the estate of the testatrix under the pretermitted heir statute in force in 1921.\textsuperscript{2} The trial court sustained defendant’s motion for summary

\textsuperscript{28} 58 T.C. at 158.
\textsuperscript{29} Although the court recognized that this was the basis of the Tax Court decision, it did not expressly reject this rationale. 507 F.2d at 595-96.
\textsuperscript{30} \textit{Id.} at 597.
\textsuperscript{31} \textit{See} Simons, \textit{The Gathering Storm of Section 531 of Our Tax Law}, \textit{44 Taxes} 528, 529 (1966).
\textsuperscript{32} Bittker & Eustice, \textit{supra} note 4, \textit{\$} 8.08, at 8-30. \textit{See} Whitmore, \textit{supra} note 7, at 239.

1. 511 S.W.2d 784 (Mo. 1974).
2. Section 514, RSMo 1919, provided:
   \textit{If any person make his last will, and die, leaving a child or children, or descendants of such child or children in case of their death, not named or provided for in such will, although born after the making of such
judgment on the ground that testatrix's only child, the father of the plaintiffs, was named and provided for in the will. Thus, had testatrix died intestate, plaintiffs would still have received nothing because their father, who was then living, would have been the sole heir.\(^3\)

The Missouri Supreme Court unanimously affirmed the judgment,\(^4\) stating that the statutory provisions for a child or children and for descendants of such child or children in case of their death were made in the alternative, and the word "their" necessarily referred back to "child or children."\(^5\) Thus, the provision for "descendants" did not become operational unless a child or children did not survive the testator. The plaintiffs tried to distinguish their case by the fact that their father only received the income for life and thus could not leave anything to his children, and by the fact that the fee estate did not vest in possession until his death. The court found no merit in this argument, saying "[w]e cannot see that this makes any difference."\(^6\) The court cited Lawnich v. Schultz\(^7\) for the proposition that any provision at all for the surviving child is sufficient to satisfy the requirements of the statute. A contrary holding would have meant that any descendant of a testator not provided for or expressly excluded by a will, even one born years after the testator's death, could demand the intestate share to which he would have been entitled had his parent not survived the testator.

The idea behind pretermitted heir statutes, that of preventing unintentional disinheritation, has a long history. Under Roman law, a person's children were entitled to a certain portion of their parents' estate called a legitime. In order to defeat the rights of children in his estate a testator was required to declare his intention expressly and name or designate clearly the one to be disinherited.\(^8\) The law would not permit the intention to disinherit to be inferred from silence. A child left out could bring an action called querela inofficiosi testamenti, claiming...
unjust disinheritance, to have the will set aside.\textsuperscript{9} Under modern civil law a system of forced heirs still restrains one's freedom of testation.\textsuperscript{10} Certain heirs, generally the testator's parents and descendants, cannot be deprived of their allotted share of the testator's estate, except for certain defined reasons which must be set out expressly in the will, along with the name of the party to be disinherit.\textsuperscript{11}

In early England a similar system of forced shares was enforced by the ecclesiastical courts with regard to personal property.\textsuperscript{12} This practice began to die out in the fourteenth century,\textsuperscript{13} but lasted until 1703 in York and 1724 in London, having been expressly preserved by the Statute of Distribution.\textsuperscript{14} Before the Statute of Wills in 1540\textsuperscript{15} no testamentary transfers of real property were allowed. After 1540 a tenant in fee simple could devise two-thirds of his land held by military tenure, and all land held by socage tenure. In 1660, when military tenure was converted into socage tenure, a testator had complete freedom of testation as to his real property.\textsuperscript{16} Thus from the time of the Restoration, English law allowed a testator to cut off his heirs at law from succession to land by will for any reason or no reason at all.

Soon afterwards, however, the English courts established the doctrine of revocation of a will by implication of law from change of circumstance.\textsuperscript{17} The earliest known case to enunciate this doctrine was Overbury v. Overbury in 1682,\textsuperscript{18} where it was held that the birth of a child revoked a previously executed will bequeathing personal property. In this case it was expressly stated that the doctrine was based on the

\textsuperscript{9} Justinian's Institutes, Lib. 2, Tit. 18; 2 W. Blackstone, Commentaries *503. Cicero tells of a case where a father willed his estate to a stranger upon the mistaken belief that his son was dead. Upon petition the son was reinstated to his inheritance. Cicero, De Orat. Lib. 1, c. 38.


\textsuperscript{11} Id. at art. 1617-21. The application of the civil law rule of forced heirs concerning disinheritance of descendants is illustrated by Walet v. Darby, 167 La. 1095, 120 So. 869 (1929).

\textsuperscript{12} H. Swinburn on Testaments and Wills, pt. 3, § 16. See also W. D. Mac Donald, Fraud on the Widow's Share (1960).

\textsuperscript{13} 2 W. Blackstone, Commentaries *493; Fratcher, Toward Uniform Succession Legislation, 41 N.Y.U.L. Rev. 1037, 1051 (1966).

\textsuperscript{14} Statute of Distribution, 22 & 23 Car. 2, c. 10, § 4 (1670); W. Blackstone, supra note 13, at *519.

\textsuperscript{15} 32 Hen. 8, c. 1 (1540). However, a tenant in fee simple could accomplish the same result by means of a feoffment to the use of the feoffor or to such uses as he might by will appoint or some similar use of the use device. See Fratcher, Uses of Uses, 34 Mo. L. Rev. 39, 52 (1969).

\textsuperscript{16} W. Blackstone, supra note 13, at *12; Fratcher, supra note 15.

\textsuperscript{17} See generally Graunke and Beuscher, The Doctrine of Implied Revocation of Wills by Reason of Change in Domestic Relations of the Testator, 5 Wis. L. Rev. 386, 387-94 (1930).

\textsuperscript{18} 2 Show. 242, 89 Eng. Rep. 915 (1682). "[I]f a man make his will and dispose of his personal estate amongst his relations and afterwards has children and dies... this is a revocation of his will." Graunke and Beuscher, supra note 17, at 389. See Note, Wills—Revocation by Judicial Legislation, 17 Mich. L. Rev. 351, 335 (1918).
In civil law, the doctrine of *querela inofficiosum testamentum* was clarified to require both the birth of issue and marriage subsequent to the will in question, extending to devises of land and making posthumous children possible heirs. Two theories were given for revocation in these cases: (1) to give effect to the assumed intent of the testator to revoke his will on such a drastic change in circumstances, and (2) as a tacit condition annexed to the will itself, at the time it was made, that the testator did not intend that it should take effect if there should be a total change in the situation of his family.

This is as far as the English doctrine progressed in the courts, and the common law rule remained that birth of issue alone did not revoke the will of a man made subsequent to his marriage. The reason given for this rule was that after marriage a man is presumed to contemplate the birth of issue and to take this into account when making his will. The Wills Act of 1837 did away with the doctrine of revocation on marriage and birth of issue and provided for revocation of a will by implication of law only upon a subsequent marriage. This remained the state of the law in England until passage of the Inheritance (Family Provision) Act in 1938.

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19. See notes 9-10 and accompanying text *supra*.
26. Easterlin v. Easterlin, 62 Fla. 468, 56 So. 688 (1911); W. PAGE, THE LAW OF WILLS § 514, at 943 (3d ed. 1941). The common law rule was enacted in Missouri by Section 7, at 1079, RSMo 1845 (superseded and repealed in 1955 by Section 474.240 RSMo 1969).
27. W. PAGE, note 26 *supra*.
28. 1 Vict., c. 26, § 19 (1837), provides: “No will shall be revoked by any presumption of an intention on the ground of an alteration in circumstances.”
29. Id. at § 18. See Note, 17 MICH. L. REV. 331, 332 (1919).
30. 1 & 2 Geo. 6, c. 45, §1, provides in part: Whereas, after the commencement of this Act, a person dies domiciled in England leaving—
a) a wife or husband;
b) a daughter who has not been married, or who is, by reason of some mental or physical disability, incapable of maintaining herself;
c) an infant son; or
d) a son who is, by reason of some mental or physical disability, incapable of maintaining himself; and leaving a will, then, if the court . . . is of the opinion that the will does not make reasonable provision for the maintenance . . . , the court may order that such reasonable provision as the court thinks fit shall . . . be made out of the testator's net estate for the maintenance of that dependent . . . .

The Intestates Estates Act, 15 & 16 Geo. 6 & I Eliz. 2, c. 64, § 7 (1952), extended the
http://scholarship.law.missouri.edu/mlr/vol41/iss1/6
In this country the common law rule that the birth of issue alone would not revoke a previous will was not well received because it frequently resulted in disinheriting after-born children whom the testator probably never meant to disinherit. Early in the history of the American colonies statutes were enacted to mitigate the consequences of the common law rule, the earliest being enacted in Massachusetts in 1700. These statutes generally provided that if the testator did not mention or provide for his children in his will, he was considered to die intestate as to those not mentioned. The origin of these statutes is unclear, because there was no English precedent for them. It may be that they were derived from the Roman law idea of inofficiosum testamentum, but they may have developed on their own from the same sense of parental obligation which inspired the Roman law. Unlike the civil law system of forced heirs, the American pretermitted heir statutes are based upon a presumption that the omission of the child is unintentional and that the actual intention of the testator is not to disinherit his issue.

The first Missouri pretermitted heir statute was enacted by the legislature of the Territory of Louisiana on July 4, 1807. It was reenacted with no significant changes in language, by the legislature of the Territory of Missouri in 1815 and again by the General Assembly of the provision to intestates' estates. See Crane, Family Provision On Death in English Law, 35 N.Y.U.L. Rev. 984 (1960).

32. Acts and Resolves of the Province of Massachusetts Bay, Ch. 4, at 430 (1700), provides in part:
That any child or children not having a legacy given them in the will of their father or mother, every such child shall have a proportion of the estate of their parents given and set out unto them as the law directs for the distribution of the estates of intestates.
33. See Dainow, Inheritance by Pretermitted Children, 32 Ill. L. Rev. 1 (1937); Mathews, Pretermitted Heirs: An Analysis of Statutes, 29 Colum. L. Rev. 748 (1929); Touster, Testamentary Freedom and Social Control—After-born Children, 6 Buffalo L. Rev. 251 (1957). Dainow conjectures that the common law revocation upon marriage and birth of issue was changed by substituting the word “or” for “and” making it marriage or birth of issue. The next step was separation of birth of issue from marriage. Ga. Code § 113-408 (1933) is given as an example of the intermediate form. Dainow, supra, at 2.
34. McCourtney v. Mathes, 47 Mo. 533, 535 (1870); Guitar v. Gordon, 17 Mo. 408, 411 (1854); Block v. Block, 3 Mo. 594 (1834); Dainow, supra note 33, at 3; Mathews, supra note 32, at 749; Note, The Establishment of the Rights of Pretermitted Children Born Prior to the Execution of a Will, 16 Iowa L. Rev. 244 (1930). For a summary of American pretermitted heir statutes as of 1960, see Rees, American Wills Statutes, 46 Va. L. Rev. 856, 892-98 (1960).
35. Act of July 4, 1807, 1 Terr. Laws, p. 132, § 22, provides in part:
Where any person shall make his or her last will and testament and omits to mention the name of any child or children or afterwards shall marry or have a child or children not provided for in any such will, and die leaving a widow and child, or either widow or child, although such child be born after the death of its father, every such person, so far as shall regard the widow or such child or children, shall be deemed to die intestate. . . .
State of Missouri in 1821. The origin of this statute is also unclear, but the French civil law influence might have provided part of the inspiration. Perhaps this explains why this early statute applied whenever a pretermitted heir was not "provided for," which implied the receipt of some beneficial interest, whereas later statutes have required that the heir be "not mentioned." The pretermitted heir statute in force until 1955 was enacted in 1825 with substantially different wording but with the same meaning as the 1821 statute. After Block v. Block in 1834, in which it was questioned whether an express disinheritance was a "providing for" with the meaning of the statute, the General Assembly at its October term that same year amended the statute to read "not named or provided for" to make it clear that the child need not receive any positive benefit.

The Missouri courts have given their statute a different interpretation from that of many other states, notably the "Massachusetts type" statute. As early as 1857 the Missouri Supreme Court said in Bradley v. Bradley that the Missouri statute, unlike the Massachusetts statute, does not take into account mistake or intentional omission; thus, if a child is not mentioned, the statute automatically operates. In this respect the Missouri statute operates mechanically—i.e., if children are not sufficiently mentioned in the will the statute applies no matter what other evidence shows that the testator in fact intended to disinherit the omitted child. The severity of this rule was somewhat eased in later cases by the holding that the child need not be mentioned by name and that any reference which indicates that the omitted party was in the mind of the testator is sufficient to satisfy the statute. The net effect

40. Id. This was the first recorded case to interpret this statute.
42. The "Massachusetts type" statute is similar to Missouri's except that it contains the qualifying phrase "unless they have been provided for by the testator in his life time or unless it appears that the omission was intentional and not occasioned by accident or mistake." Mass. Gen. Laws Ann. c. 191, § 20 (1958), as amended, (Supp. 1969). See 26 A. C. J. S. Descent & Distribution, § 45 at 590 (1956).
43. 24 Mo. 311 (1857).
44. Williamson v. Roberts, 187 S.W. 19 (Mo. 1916); Bradley v. Bradley, 24 Mo. 311, 312 (1857).
45. Goff v. Goff, 352 Mo. 809, 179 S.W.2d 707 (1944); Thomas v. Black, 113 Mo. 66, 20 S.W. 657 (1892); Bradley v. Bradley, 24 Mo. 311 (1857).
46. Zillig v. Patzer, 365 Mo. 787, 287 S.W.2d 771 (1956) ("Between all of you" held sufficient naming of children); Miller v. Aven, 327 Mo. 20, 34 S.W.2d 116 (En Banc 1930) (55 to daughter who predeceased testatrix sufficient to prevent pretermision of her children); Ernshaw v. Smith, 2 S.W.2d 803 (Mo. 1928) (contingent remainder to grandchildren who survive life tenant sufficient providing for all grandchildren); Fitzsimmons v. Quinn, 282 S.W. 37 (Mo. 1926) (appointment as executor sufficient for son); Woods v. Drake, 155 Mo. 393, 37 S.W. 109 (1896) (naming four grandchildren satisfies statute as to their mother);
is that under a Massachusetts-type statute extrinsic evidence is admitted to show an intention to disinherit,\textsuperscript{47} whereas in Missouri any evidence offered to rebut the presumption of inadvertent omission must appear within the four corners of the will.\textsuperscript{48} Because of this, the Missouri statute has in many instances operated to defeat the true intention of the testator, in that the presumption that an omission of a child or descendant is unintentional may often be unsound. Thus, despite the assertions of the courts to the contrary,\textsuperscript{49} it is a kind of ritual formalism that governs whether the testator's omitted heir can take, not the testator's true intention.

In 1955, as part of a major revision of Missouri's probate code, the previous pretermitted heir statute was repealed and replaced by section 474.240, RSMo 1969.\textsuperscript{50} Although no reported decisions have yet interpreted this statute, it would appear to make three substantial changes in prior Missouri law as to pretermitted children. First, it expressly applies only to children born or adopted after the making of the testator's last will, while the previous statute applied to children born both prior to and after the testator's death.

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\textsuperscript{47} White v. White, 322 Mass. 30, 76 N.E.2d 15 (1947); Buckley v. Gerard, 123 Mass. 8 (1877); Wilson v. Fosket, 6 Met. (Mass.) 400 (1843); W. \textsc{Page}, \textit{The Law of Wills} § 550 at 992 (3d ed. 1941); \textit{King, Statutory Status of Pretermitted Heirs}, 13 \textit{Boston U. L. Rev.} 672 (1933); Annot., 94 A.L.R. 26, 209 (1935).

\textsuperscript{48} Goff v. Goff, 352 Mo. 809, 179 S.W.2d 707 (1944); Conrad v. Conrad, 280 S.W. 707 (Mo. 1926); Pounds v. Dale, 48 Mo. 270 (1871); Batley v. Batley, 239 Mo. App. 664, 198 S.W.2d 64 (K.C. Ct. App. 1946); W. \textsc{Page}, \textit{note 47 supra}, § 550 at 990; Annot., 94 A.L.R. 26, 211 (1935).

\textsuperscript{49} Guitar v. Gordon, 17 Mo. 408 (1853); Block v. Block, 3 Mo. 594 (1834). In \textit{Block} the court said: "The true intent of the testator is to govern all things and where it is clear it must prevail." \textit{Id.} at 596.

\textsuperscript{50} Section 474.240, RSMo 1969, corresponds to section 41 of The Model Probate Code and provides:

1. When a testator fails in his will to mention or provide for any of his children born or adopted after the making of his last will, such child, whether born before or after the testator's death, shall receive a share in the estate of the testator equal in value to that which he would have received if the testator had died intestate, unless it appears from the will that such omission was intentional, or unless when the will was executed the testator had one or more children known to him to be living and devised substantially all his estate to his surviving spouse.

2. If, at the time of the making of his will, the testator believes that any of his children are dead, and fails to provide for such child in his will, the child shall receive a share in the estate of the testator equal in value to that which he would have received if the testator had died intestate, unless it appears from the will or from other evidence that the testator would not have devised anything to such child had he known that the child was alive.
to and after the making of the will.\textsuperscript{51} This change recognizes the fact that it is highly unlikely that a parent would inadvertently omit a child who was alive when the will was made. Section 474.240(2) makes an exception where the testator believed, at the time of the execution of the will, that a child born prior to the will was dead, unless it appears that the omitted child would have taken nothing anyway. Second, the statute is inapplicable to after-born children if the testator had one or more children living at the time the will was executed and devised substantially all of his estate to his spouse.\textsuperscript{52} Third, and most significant with respect to the question raised in \textit{Vogel}, no provision is made for omitted grandchildren or more remote issue.\textsuperscript{53}

The \textit{Uniform Probate Code} was promulgated for adoption in August 1969 by the National Conference of Commissioners on Uniform State Laws in cooperation with the American Bar Association Section of Real Property, Probate and Trust Law.\textsuperscript{54} In late 1972 the Subcommittee for Revision of Missouri Probate Laws was appointed by the Missouri Bar Committee on Probate and Trusts and in subsequent meetings the Subcommittee decided that instead of seeking enactment of the \textit{Uniform Probate Code} in Missouri, it would use it as a drafting model for a bill amending specific portions of the Missouri Probate Code of 1955.\textsuperscript{55} The Draft of the 1976 amendments to the Missouri Probate Code of 1955, 1 October 1975, which has been approved by the Probate and Trusts Committee and the Board of Governors of The Missouri Bar, would make several changes affecting the status of the pretermitted heir in Missouri. Section 474.010 would be amended to conform to section 2-102 of the \textit{Uniform Probate Code},\textsuperscript{56} which gives the surviving spouse the first $50,000 of the estate plus half of the remainder where there is no issue by another spouse. Thus in most estates there would be no intestate share left about which omitted children could dispute. Amended section 474.060 would conform to section 2-109 of the \textit{Uniform Probate Code},\textsuperscript{57} making illegitimates children of their father as well as of their...
mother for purposes of intestate succession if paternity is established and the father had treated the child as his during his life. This would allow a new group of people to claim an intestate share as a pretermitted heir. Finally, the Draft of 1 October 1975 would substitute section 2-302 of the Uniform Probate Code for present section 474.240. This amendment would deprive children who would otherwise come within the statute of an intestate share if the testator devises substantially all of his estate to their “other parent” rather than his “surviving spouse,” as the 1955 Code reads. Also, a new exception is added to the operation of the statute where the testator has provided for the child outside of the will.

The net effect of the 1955 Code is to make the pretermitted heir statute a vehicle for furthering a testator’s probable intent rather than a trap to thwart the intention of the unwary. An attempt is made to balance the societal values of parental duty and familial obligation which call for the protection of children from disinheritance with the common law idea of freedom of testation. Section 474.240 is an indication that the ideal of freedom of testation is becoming predominant, at least where disinheritance of descendants of the testator is concerned. The amendments proposed by The Missour Bar would seem to be a continuation of this trend.

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58. Id. at § 2-302.
59. On October 18, 1975 the Board of Governors unanimously approved the Draft of 1 October 1975 and recommended it for enactment by the General Assembly.
60. See Fratcher, Protection of the Family Against Disinheritance in American Law, 14 Int’l & Comp. L. Q. 293 (1965); Note, Limitations on Testamentary Power in Missouri: Protection of the Spouse and Children of the Testator, 1954 Wash. U.L.Q. 354. In the latter article the author advocates changing the pretermitted heir statute so as to give a minor child of the testator absolute protection against disinheritance.
61. This is just the opposite trend to that predicted by Dainow, supra note 33, at 11.