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Case Comments

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FEDERAL PROCEDURE—A SUIT AGAINST A CONTRACTOR AND HIS SUBCONTRACTORS CONSTITUTES "SEPARATE AND INDEPENDENT CLAIMS OR CAUSES OF ACTION" AND MAY BE REMOVED TO A FEDERAL COURT UNDER 28 U.S.C. § 1441(c). Climax Chemical Company engaged C. F. Braun & Company, as prime contractor, to build a salt cake and muriatic acid plant. After the plant had been completed, Climax filed suit in New Mexico state court against Braun and seven others, all subcontractors and suppliers. The damages sought arose from the allegedly negligent and improper performance of the work, "as a result of which the plant proved to be totally inoperable." Specifically, the complaint alleged that Braun had guaranteed the overall operation of the plant and also agreed to design, engineer, and purchase the necessary equipment. Each of the seven other defendants had separately contracted to design, engineer and/or construct different parts of the plant. Climax sought damages from Braun for both out-of-pocket expenses and operating losses with respect to the entire plant, and for various portions of these losses from the seven other defendants. All of the subcontractors and suppliers were alleged to be jointly and severally liable with Braun for damages resulting from defects in the plant equipment that each had contracted to construct and install.

The plaintiff, Climax, was a Delaware corporation, and the principal defendant, Braun, was a California corporation. The complaint alleged that the seven other defendants were all citizens of states other than Delaware and New Mexico, the state in which Climax had its principal place of business.[1] Following removal of the suit to the United States District Court for the District of New Mexico, it appeared that one of the defendants, Thermal Research and Engineering Corporation, was also incorporated in Delaware. Climax then moved to remand the case to the state court because of the lack of complete diversity and the defendants' alleged failure to comply with the statutory requirements regarding a removal bond as required by 28 U.S.C. § 1446(d).[2] The district court decided that the lawsuit was comprised of a number of separate and independent claims or causes of action which, with the exception of the claim against Thermal, satisfied the diversity requirements for original federal jurisdiction. Then, since it viewed the claim against Thermal as a "separate and independent claim or cause of action," the district court decided to retain that claim pursuant to 28 U.S.C. § 1441(c) which provides:

> Whenever a separate and independent claim or cause of action, which would be removable if sued upon alone, is joined with one or more otherwise non-removable claims or causes of action, the entire case may be removed and the district court may determine all issues therein, or, in its discretion, may remand all matters not otherwise within its original jurisdiction.

1 Under 28 U.S.C. § 1332(c) (1964), Climax is a citizen of both states for purposes of diversity jurisdiction:

> For the purposes of this section and section 1441 [removal] of this title, a corporation shall be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business . . . .

2 This article deals only with the former allegation.

Climax then filed an interlocutory appeal under 28 U.S.C. § 1292(b) from the district court's denial of its motion to remand. The Court of Appeals for the Tenth Circuit, one judge dissenting, affirmed and *held:* in an action against a prime contractor for negligently performing its contract to design, engineer, and construct a plant and against each subcontractor for negligently performing its work on the plant, more than one claim or cause of action is alleged and these are "separate and independent" under section 1441(c). *Climax Chemical Company v. C.F. Braun & Company,* 370 F.2d 616 (10th Cir. 1966), *cert. denied,* 386 U.S. 981 (1967).

Section 1441(c) was enacted in 1948 to replace the "separable controversy" test,[3] allowing removal in cases where complete diversity is lacking, with the test of "separate and independent claim or cause of action."[4] Basically, the "separable controversy" test allowed a defendant to remove the *entire* suit to a federal court upon a showing that he was a party to a distinct controversy in the suit, which controversy would have been within the original federal diversity jurisdiction of the court if sued upon alone. This test evolved slowly. The first Judiciary Act[5] contained no provision for removal on the ground of a separable controversy. Thus, the only grounds for removal were complete diversity of the parties or the existence of a federal question. The Act of 1866[6] allowed for removal by an alien or nonresident defendant of the separable controversy only; the rest of the case was left in the state court. A year later, this Act was amended to permit removal of the separable controversy between citizens of different states upon the petition of the nonresident party, whether plaintiff or defendant.[7] This amendment did not change the provision requiring that the remainder of the suit be left in the state court. The rationale behind this provision was to protect the plaintiff's right to proceed with the non-diverse action in his state court.[8] Theoretically, this may have been a worthy ideal to protect; practically, it was not. As the Fifth Circuit noted in 1945: "Much confusion and embarrassment, as well as increase in the cost of litigation, resulted from this procedure in cases where, consistently within the rules of pleading, all of the controversies might conveniently have been disposed of in one suit."[9] The Act of 1875[10] deleted this provision. In 1881, the Supreme Court noted this omission and held that Congress intended that the whole case be removed.[11] The Act of 1887[12] limited the right of removal to nonresident defendants; plaintiffs could no longer remove. The language of the 1887 provision was retained in former section 71 of Title 28 of the United States Code:

3 *See generally* Holmes, *The Separable Controversy — A Federal Removal Concept,* 12 MISS. L.J. 163 (1939).

4 Although this comment is limited to the diversity issue, section 1441(c), unlike all the removal statutes preceding it, may also be used in non-diversity cases. *See* Cohen, *Problems in the Removal of a "Separate and Independent Claim or Cause of Action,"* 46 MINN. L. REV. 1, 25-40 (1961).

5 Judiciary Act of Sept. 24, 1789, ch. 20, § 12, 1 Stat. 79-80.

6 Act of July 27, 1866, ch. 288, § 1, 14 Stat. 306.

7 Act of March 2, 1867, ch. 196, § 1, 14 Stat. 558.

8 Texas Employers Ins. Ass'n v. Felt, 150 F.2d 227, 233 (5th Cir. 1945).

9 *Id.*

10 Act of March 3, 1875, ch. 137, § 2, 18 Stat. 470-71.

11 Barney v. Latham, 103 U.S. 205, 212-13 (1881).

12 Act of March 3, 1887, ch. 373, § 2, 24 Stat. 553, *as amended,* Act of Aug. 13, 1888, ch. 866, § 2, 25 Stat. 434-35.

> And when in any suit mentioned in this section there shall be a controversy which is wholly between citizens of different States, and which can be fully determined as between them, then either one or more of the defendants actually interested in such controversy may remove said suit into the district court of the United States for the proper district.[13]

This separable controversy test was the law from 1887 until the Judicial Code of 1948.

Moore states that the revisers of the Judicial Code had two reasons for eliminating the separable controversy test:

> First, this ground for removal had been added following the Civil War in an effort to protect a non-resident defendant who had been joined with one or more local defendants under the relaxed and expanding state joinder provisions. Second, the confusion surrounding the concept of separability overshadowed whatever present utility it had.[14]

Thus, it seems that the revisers no longer thought that the danger of local prejudice was as acute for a nonresident. Moore continues that some of the revisers were not willing to confine removal to the two general grounds of complete diversity and the existence of a federal question. They desired, however, a substitute more restrictive than the old separable controversy test.[15] Hence, the test of a separate and independent, *i.e.,* completely dissociated,[16] claim or cause of action was embodied in section 1441(c).[17]

Three years later, the Supreme Court in *American Fire & Casualty Company v. Finn*[18] defined for the first and only time "cause of action" as employed by section 1441(c). This definition has probably restricted the use of section 1441(c) in diversity cases even more than the drafters intended. In *Finn,* the Court made it clear that one cause of action may contain many separable controversies. A cause of action is "a single wrongful invasion of a single primary right of the plaintiff . . . whether the acts constituting such invasion were one or many, simple or complex."[19] In other words, if a person suffers one actionable wrong, he has only one cause of action. The fact situation in *Finn* is illustrative

13 Act of March 3, 1911, ch. 231, § 28, 36 Stat. 1094.

Note that some have thought section 1441(c) to be unconstitutional, in that it allows a federal court to determine a suit where complete diversity of citizenship is lacking. The authority cited for this point was Strawbridge v. Curtiss, 7 U.S. (3 Cranch) 267 (1806). For a good discussion of this, see Cohen, *supra* note 4, at 20-25. The Supreme Court has recently settled the question; *Strawbridge* construed only the Judiciary Act of 1789. State Farm Fire & Cas. Co. v. Tashire, 386 U.S. 523, 531 (1967), specifically mentioning section 1441(c) and American Fire and Cas. Co. v. Finn, 341 U.S. 6 (1951).

14 1A J. MOORE, FEDERAL PRACTICE, ¶ O. 162(1), at 622 (2d ed. 1965).

15 *Id.*

16 "The word 'separate' means distinct; apart from; not united or associated. The word 'independent' means not resting on something else for support; self-sustaining; not contingent or conditioned." Snow v. Powell, 189 F.2d 172, 174 (10th Cir. 1951).

17 Subsection (c) permits the removal of a separate cause of action but not of a separable controversy unless it constitutes a separate and independent claim or cause of action within the original jurisdiction of the United States District Courts. In this respect it will somewhat decrease the volume of Federal litigation. Reviser's Note, 28 U.S.C. § 1441 at 5981 (1964).

18 341 U.S. 6 (1951).

19 *Id.* at 13, *quoting from* Baltimore S.S. Co. v. Phillips, 274 U.S. 316, 321 (1927).

By way of historical background, the Supreme Court has adopted Professor Clark's theory that any wrong gives rise to a cause of action no matter what legal theories are

of the Court's distinction between controversy and cause of action. A citizen of Texas brought suit to recover for a fire loss against two out-of-state insurance companies and their Texas agent. The Supreme Court held that the plaintiff had one *cause of action* because of his single loss due to the fire; yet, he had separable *controversies* with each of the defendants. Under the old test, one of the insurance companies could have removed; under the new test, it could not.

The rationale behind section 1441(c) is similar to that behind former section 71, *i.e.*, to avoid splitting the suit[20] and to retain the defendant's right of removal that would have existed but for liberal state joinder rules.[21] But, while the same rationale remains, the Court's broad definition of "cause of action" in *Finn* clearly indicated that the new section was not to be as liberally construed as the old.[22] Recognizing the congressional intent to limit removal in this area,[23] the Court took care not to confuse the two tests: "Although 'controversy' and 'cause of action' are treated as synonymous by the courts in situations where the present considerations are absent, here it is obvious different concepts are involved."[24] This distinction clearly showed what the new test was to be, at least on the theoretical level:[25]

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employed to redress it. *See* Keeffe, *Venue and Removal Jokers in the New Federal Judicial Code,* 38 VA. L. REV. 569, 599-612 (1952). O. L. McCaskill, in opposition to this, maintained that a cause of action is related to the relief sought. The two had a law review debate during the 1920's. *See* Clark, *The Code Cause of Action,* 33 YALE L.J. 817 (1924); McCaskill, *Actions and Causes of Action,* 34 YALE L.J. 614 (1925).

20 *See* J. MOORE, COMMENTARY ON THE U. S. JUDICIAL CODE 252-53 (1949). Note that section 1441 (c) does provide: "[T]he district court may determine all issues therein, or, in its discretion may remand all matters not otherwise within its original jurisdiction." 28 U.S.C. § 1441(c) (1964).

21 Cohen, *supra* note 4, at 19.

22 This statement by Judge Holmes when *Finn* was in the Court of Appeals is illustrative of the initial confusion in this area.

> The difference, if any, between separable controversies under the old statute and separate and independent claims under the new one is in degree, not in kind. It is difficult to distinguish between the two concepts, but it is not necessary to attempt it in a case like this, which would be removable under either statute. American Fire & Cas. Co. v. Finn, 181 F.2d 845, 846 (5th Cir. 1950), *rev'd,* 341 U.S. 6 (1951).

See also Mayflower Indus. v. Thor Corp., 184 F.2d 537 (3d Cir. 1950), where three different interpretations were given to section 1441(c).

23 This finding has been challenged by Keeffe, *supra* note 19, at 603.

> Stop right there. To begin with, we all know that Congressional intent in any legislation is a figment of judicial imagination and that seldom can anyone be sure of the intent of Congress about anything except to adjourn for elections or the grouse or salmon season. In the case of the new Judicial Code, however, the record is clear that Congress thought it was making no change whatever in existing law. It thought so because those asking it to enact the new Judicial Code told it so.

Keeffe supports this contention by citing some of the legislative history of the section. *See, e.g.,* 94 CONG. REC. 7928 (1948), where Senator Donnell made this vague statement:

> It would take considerable time to state all the changes; but I may say that the purpose of this bill is primarily to revise and codify and to enact into positive law, with such corrections as were deemed by the committee to be of substantial and noncontroversial nature.

But cf., Reviser's Note, *supra* note 17: "In this respect it [1441(c)] will somewhat decrease the volume of Federal litigation." However, this statement does seem tame in context, and even assuming that Congress read the Reviser's Note, it would not be too evidentiary of a congressional intent to limit removal.

24 American Fire & Cas. Co. v. Finn, 341 U.S. 6, 12 (1951).

25 This must be qualified, since there is still much confusion in applying the *Finn* test to particular facts, as *Climax* and other cases illustrate. Keeffe, *supra* note 19, at 608, foresaw this difficulty because of the broad definition given to a cause of action in *Finn*:

> Considering the previous history of "separable controversy," the broad meaning of "cause of action," and the congressional purpose in the revision resulting in 28 U.S.C. § 1441(c), we conclude that where there is a single wrong to plaintiff, for which relief is sought, arising from an interlocked series of transactions, there is no separate and independent claim or cause of action under § 1441(c).[26]

Clearly, then, section 1441(c) prescribes a more restrictive test than its predecessor. Because of this, the utility of the section has been doubted. Judge Aldrich's majority opinion in *Climax* cited one such criticism from two noted authors. "It is difficult to see how there can ever be a diversity case properly removed under this statute in the light of the construction placed on it in the Finn case."[27] The majority dismissed such criticism of *Finn:*

> We do not take such a morbid view. If the Court was sounding the death knell of section 1441(c) we believe it would have said so. The Court's statement, 341 U.S. at 10, 71 S. Ct. at 538, that one of the purposes of the then recent amendment of the statute was "to limit removal from state courts" was not an announcement that it was to foreclose it.[28]

As *Climax* illustrates, the *Finn* test is often very difficult to apply to a particular set of facts.[29] On the basis of its pleading, which controls the issue

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> Instead, however, section 1441(c) is to be interpreted apparently as embalming Clark's highly theoretical and questionable theory of code pleading. If section 1441(c) does this, then there is no telling when a cause is removable and when it is not.

Cf. Harper v. Sonnabend, 182 F. Supp. 594, 595 (S.D.N.Y. 1960). The district court noted: "[I]t is not an exaggeration to say that at least on the surface the field luxuriates in a riotous uncertainty."

26 American Fire & Cas. Co. v. Finn, 341 U.S. 6, 13-14 (1951).

27 Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 618 (10th Cir. 1966), *cert. denied,* 386 U.S. 981 (1967), *quoting from* 1 W. BARRON AND A. HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE, § 105, at 494 (Wright ed. 1960).

The following rationale of these two writers was not included in the majority's opinion in *Climax*:

> Even the most liberal state statutes and rules on joinder of parties permit such joinder only where there is a common question of law or fact and the various claims arise out of the same transaction or occurrence or series of transactions or occurrences. Such claims, it would seem, involving common questions and coming from the same transaction, will never rise to the dignity of separate and independent claims or causes of action. W. BARRON AND A. HOLTZOFF, *supra* at 494.

Interestingly, in their 1966 supplement, Barron and Holtzoff partially recant:

> The statement in the text of the main volume that even the most liberal state practice permits joinder only where the various claims joined involve common questions and come from the same transaction is theoretically inaccurate. The restrictions of common question and the same transaction apply to the parties to be joined, not to the claims. See vol. 2, § 533.1. Thus it is theoretically possible to state a claim against A and B, arising out of a single transaction, and to join with it an entirely unrelated claim against A. In this situation A would be entitled to remove under 28 U.S.C.A. § 1441(c) as interpreted in the Finn case. *In practice, however, such cases do not arise.* W. BARRON AND A. HOLTZOFF, *supra* at 286 n.73.8 (Supp. 1966). (Emphasis added.)

For a collection of cases held nonremovable since *Finn* until 1966, see 1A J. MOORE, *supra* note 14, at 706 n.7.

28 Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 619 (10th Cir. 1966), *cert. denied,* 386 U.S. 981 (1967).

29 Judge Kerr, dissenting, stated: "Our difference of opinion is in the application of the pertinent test succinctly stated in the *Finn* case. . . ." Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 620 (10th Cir. 1966) (dissenting opinion), *cert. denied,* 386 U.S. 981 (1967).

of "separate and independent claim or cause of action,"[30] Climax had alternative arguments. First, it had alleged only one cause of action because it had suffered only a single wrong. Second, if there were more than one cause of action, they were interdependent rather than "separate and independent." The majority felt that Climax's first contention of a single wrong overstated the rationale of *Finn,* and they distinguished this fact situation from that of *Finn.*

> In *Finn* there was one fire, and one single compensable loss. In the case at bar it is true that it is alleged that plaintiff's plant would not function, but in no real sense was this a single loss. The plant was composed of a number of separate units. Obviously, whether one unit, or several, failed to function, the plant could not operate. The liability of the defendants other than Braun was separate, distinct, and unrelated. With the exception of Braun, no defendant assumed responsibility for other than its own unit, or was liable in any way for the failure of the others. We think it clear that there was more than one primary right, and that more than a single wrong was alleged.[31]

This analysis brought the majority to the issue of whether the causes of action against the defendants other than Thermal, "which would be removable if sued upon alone," were separate and independent from the otherwise nonremovable cause of action against Thermal. The court reasoned that, if Braun were not a defendant, "it is inconceivable that plaintiff could, simply because all the units were to be installed in one plant, say that the separate claims against the several defendants were single and interdependent."[32] Next, the majority considered whether Braun's presence made the different causes of action somehow interrelated. Analyzing the complaint, they found two kinds of claims against Braun: (1) Braun was jointly liable with each of the subcontractors for the defects caused by each of them; (2) Braun was solely liable for all the damages due to the poor engineering and design of the plant. The majority reasoned: "It may be granted that this latter claim is a single cause of action. However, by its very nature it is separate and independent of the causes of action asserted against the other defendants."[33] The court then proceeded to consider the important question of whether the fact that Braun guaranteed the performance of each of the subcontractors and suppliers destroyed the separate and independent nature of the causes of action against them. The court conceded that, if the case had involved merely a complaint asserting joint liability against Braun and Thermal for furnishing defective plant equipment, Braun could not have removed. But, as Judge Aldrich pointed out:

> [T]his case involves a number of additional claims against Braun and the other defendants that are in no way related to the claim against Thermal. The fact that they are related to the same plant is not enough. Cf. Greenshields v. Warren Petroleum Corp., 10 Cir., 1957, 248 F.2d 61, *cert. den.,* 355 U.S. 907 . . . .[34]

30 American Fire & Cas. Co. v. Finn, 341 U.S. 6, 14 (1951).
31 Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 618 (10th Cir. 1966), *cert. denied,* 386 U.S. 981 (1967).
32 *Id.*
33 *Id.* at 619.
34 *Id.*

In concluding, the court again distinguished *Finn* by noting that in *Finn* the Supreme Court had emphasized that " 'the damage comes from a single incident.' "[35] It seemed obvious to the majority in *Climax* that more than one incident had contributed to the total damage, the failure of the plant to operate. Judge Aldrich quoted a portion of Climax's motion to remand: "[A]ll of the defendants are jointly and severally liable with the other defendants or some of them."[36] He found this "both perceptive and accurate. This is not a definition of either a single claim, or a series of interdependent claims."[37] Thus, all the cases relied upon by Climax were dismissed, because "[i]n all of them one wrong was alleged by the plaintiff . . . ."[38]

Judge Kerr, in dissent, found validity in Climax's first contention that only one cause of action was alleged. He began "with the premise that every doubt as to the right of removal under Section 1441(c) should be resolved in favor of remand."[39] He found only one claim or cause of action, because only one primary right existed — Climax's contractual right to have the defendant Braun and its subcontractors and suppliers construct a workable plant. In his mind, the complaint alleged one wrong; namely, the plant

> "when completed would not function or operate and could not be put to its intended use of manufacturing salt cake and muriatic acid." The facts alleged to have constituted the breach of contract give rise to only one, complete, indivisible cause of action.[40]

Placing the complaint within the *Finn* test he found:

> The wrong for which plaintiff seeks relief arises from an interlocked series of transactions which are alleged with some particularity, naming each of the defendants and stating the various fundamental and fatal defects, defaults, and acts of negligence in the work of the defendant and its subcontractors and suppliers that combined to produce an unsatisfactory and inoperable plant. The complaint describes the sundry components which were necessary to fulfill the construction contract and for which the several defendants were responsible. These separate *controversies* do not make separate and independent causes of action.[41] (Emphasis added.)

Judge Kerr supported this reasoning by noting that the complaint alleged one claim against Braun in the aggregate sum of $3,600,000, while it itemized the amounts attributable to the other defendants. Climax did not seek an award from the other defendants in addition to complete relief from Braun. "Plaintiff asks judgment against Braun for $3,600,000 and 'out of that amount' it seeks

35 *Id.*
36 *Id.*
37 *Id.* This statement misses the point. Obviously, Climax was not attempting to define a "single claim." The allegation quoted by the court is not necessarily inconsistent with a "single claim," *i.e.*, one claim or cause of action could contain such alleged liability.
38 *Id.*
39 *Id.* at 620 (dissenting opinion). For policy considerations behind restricting federal jurisdiction, see Young Spring & Wire Corp. v. American Guar. & Liab. Ins. Co., 220 F. Supp. 222, 228 (W.D. Mo. 1963); Frankfurter, *Distribution of Judicial Power Between United States and State Courts,* 13 CORNELL L.Q. 499 (1928).
40 Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 620-21 (10th Cir. 1966) (dissenting opinion), *cert. denied,* 386 U.S. 981 (1967).
41 *Id.* at 621.

joint and several judgments against the other named defendants."[42] Judge Kerr concluded by finding "but one cause of action, claim or actionable wrong, viz., a breach of contract."[43] He detected several *controversies* involving Braun and the other defendants as parties to this breach, but he foresaw only one possible recovery to which any or all of the defendants would have to contribute.

The dissenting opinion certainly seems more in line with the definition of "cause of action" in *Finn*. Climax negotiated one contract with the general contractor Braun. At this time it had a single contractual right, *i.e.*, to receive from Braun a workable salt cake plant. When Braun subcontracted with the other defendants, it assigned these contracts to Climax, but still retained the overall responsibility for the performance of the general contract. Climax's contract rights against the subcontractors and suppliers were only parts of the original contract right against Braun. Thus, there was only one primary right, the correlative duty of which was never properly performed. This gave rise to one wrong resulting in one cause of action which included many different controversies.[44]

Agreeing, for the sake of discussion, with the majority's finding of several claims or causes of action, their further finding that the claim against Thermal is "separate and independent" of the claim against Braun is reasonable. These causes of action are not related and dependent merely because they have been joined in one suit containing a common question of law or fact.[45] The fact that, if Thermal were not found liable, this would not affect the liability of the other defendants, indicates that the cause of action against it is independent of the others.

Regardless of whether the majority's original premise — several causes of action existed — is correct in light of *Finn*,[46] it is important because this fact situation of Owner versus Contractor and Subcontractors is common. When the court in *Climax* stated that the fact that plaintiff's plant would not operate was in no real sense a "single loss,"[47] they seemingly set up a new test for this type of situation. This test may not be in accord with the test of *Finn*, but it is one that will be much easier to apply and one that will allow far more removals under section 1441(c). In this sense, the result in *Climax* is desirable.

Joseph P. Kennedy

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42 *Id.*

43 *Id.*

44 That fact that Climax alleged $1,500,000 as operating losses which resulted from the accumulated defects would seem to strengthen this finding.

45 Whenever, for example, two or more defendants individually act in such a manner that each has invaded a separate right of the plaintiff and thereby caused as many wrongs, the plaintiff has multiple claims against the several defendants individually; and although plaintiff joins defendants in one action, on the basis of a common question of law or fact, the claims are separate and independent within the intendment of § 1441(c). 1A J. MOORE, *supra* note 14, at 708.

46 After dismissing the criticism of *Finn* by W. BARRON AND A. HOLTZOFF, see text accompanying note 29 *supra*, the court stated: "We take *Finn* to mean that there must be substantive separability, and no more." Climax Chem. Co. v. C.F. Braun & Co., 370 F.2d 616, 619 (10th Cir. 1966), *cert. denied*, 386 U.S. 981 (1967). What is meant by this is uncertain. Perhaps the court is hinting that it is expanding the test of *Finn* or creating a new test for this situation.

47 *Id.* at 618.

CRIMINAL PROCEDURE — "BEYOND A REASONABLE DOUBT" STANDARD NOT APPLICABLE IN JUDGE'S PRELIMINARY DETERMINATION OF THE VOLUNTARINESS OF A CONFESSION — On April 18, 1946, Nathaniel Clifton, appellant, was convicted of robbery in the District of Columbia and sentenced for a term of two to six years in prison.[1] He chose not to appeal this conviction and served his sentence. In 1964 Clifton was convicted of grand larceny in New York state and was sentenced under a New York multiple offender statute[2] for a ten to fifteen year prison term as a third felony offender.[3] In order to avoid the bite of this statute, Clifton sought to set aside his 1946 conviction. Accordingly, he filed a motion for a writ in the nature of coram nobis[4] in the United States District Court for the District of Columbia. His motion was denied. If he had been successful, he would have been entitled to be resentenced as a second felony offender. Clifton alleged that this resentencing could have resulted "in a reduction by almost one-half of his

1 Clifton v. United States, 239 F. Supp. 49 (D.D.C. 1965), *aff'd*, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

2 N.Y. PEN. LAW § 1941 (McKinney Supp. 1966) provides in part:

> 1 [A] person, who, after having been once or twice convicted within this state, of a felony . . . or, under the laws of any other state . . . of a crime which, if committed within this state, would be a felony, commits any felony, within this state, is punishable upon conviction of such second or third offense, as follows:
>
> If the second or third felony is such that, upon a first conviction, the offender would be punishable by imprisonment for any term less than his natural life, then such person must be sentenced to imprisonment for an indeterminate term, the minimum of which shall be not less than one-half of the longest term prescribed upon a first conviction, and the maximum of which shall be not longer than twice such longest term.

3 Brief for Appellee at 2, Clifton v. United States, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

4 The Government assumed that the use of a writ in the nature of coram nobis was the proper vehicle for attacking the 1946 conviction:

> The assumption is not untroublesome. At common law the writ of *coram nobis* had an extremely narrow function. The writ lay to assert some previously unknown *fact* going to the right of the court to proceed and affecting the power of the court to attain a valid result in the proceedings. . . . The writ was not available where (as in the instant case) the facts relied upon were disclosed on the face of the record or where (as here) the error alleged was one of *law*. See generally, *Morgan v. United States*, 346 U.S. 502 (1954). . . .
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> Nevertheless, the Supreme Court termed the writ which it reviewed in *Morgan* not a writ of *coram nobis*, but a writ *in the nature of coram nobis* and indicated some difference. See 346 U.S. at 505, 506, 508, 509. . . . Brief for Appellee at 6 n.11, Clifton v. United States, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

The use of the writ in the nature of coram nobis was necessitated by the fact that 28 U.S.C. § 2255 only allows an appeal from a conviction presently being served. That section states in part:

> A prisoner in custody under sentence of a court established by Act of Congress claiming the right to be released upon the ground that the sentence was imposed in violation of the Constitution or laws of the United States, or that the court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack, may move the court which imposed the sentence to vacate, set aside or correct the sentence. 28 U.S.C. § 2255 (1964).

The writ of coram nobis has been abolished in Federal civil proceedings by FED. R. CIV. P. 60(b):

> Writs of coram nobis, coram vobis . . . are abolished, and the procedure for obtaining any relief from a judgment shall be by motion as prescribed in these rules or by an independent action.

See generally Smith, *Title 28, Section 2255 of the United States Code — Motion to Vacate, Set Aside or Correct Sentence: Effective or Ineffective Aid to a Federal Prisoner?*, 40 NOTRE DAME LAWYER 171, 178-80 (1965); Comment, *Availability of the Remedy Coram Nobis in New York*, 22 ALBANY L. REV. 125 (1958); Comment, *The Relation Between Habeas Corpus and Coram Nobis in New York*, 34 CORNELL L.Q. 596 (1949).

present sentence."[5] The district court's denial of his motion meant that if Clifton were subsequently convicted of a felony in New York, he could receive a sentence of life imprisonment.[6]

On February 17, 1965, after the Supreme Court had decided the landmark case of *Jackson v. Denno*,[7] Clifton filed an identical motion to vacate his 1946 conviction in the same district court. This motion was premised on the argument that in 1946 the trial court had not complied with the Supreme Court's holding in *Jackson* that a trial court must have a preliminary hearing on the voluntariness of a confession that is "fully adequate to insure a reliable and clear-cut determination of the voluntariness of the confession, including the resolution of disputed facts upon which the voluntariness issue may depend."[8] The district judge, relying on his own detailed personal longhand notes of the 1946 trial, concluded that he had in fact conducted an independent hearing on the issue of the voluntariness of Clifton's confession, and denied the appellant's motion.[9] On appeal, the United States Court of Appeals for the District of Columbia affirmed the denial of the motion and *held:* a confession should not be admitted in evidence unless the trial judge makes a preliminary determination and an express finding that on all the evidence he is satisfied that the confession was voluntarily made, but the trial judge need not be convinced beyond a reasonable doubt that the confession was voluntary if the question of voluntariness is also left to the jury. *Clifton v. United States*, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

Courts have always rejected a nonvoluntary confession.[10] However, the procedures used to determine voluntariness[11] have varied. Before *Jackson*, there were three[12] procedures by which the voluntariness of a confession might be determined: (1) the Orthodox or Wigmore rule, in which the trial judge made a preliminary determination of the voluntariness of the confession, and the jury could consider only its weight and credibility;[13] (2) the Massachusetts or

5 Brief for Appellant at 20, Clifton v. United States, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

6 N.Y. PEN. LAW § 1942 (McKinney 1944).

7 378 U.S. 368 (1964).

8 *Id.* at 391.

9 Clifton v. United States, 239 F. Supp. 49, 51 (D.D.C. 1965), *aff'd*, 371 F.2d 354, (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

10 *See, e.g.*, Bram v. United States, 168 U.S. 532, 542 (1897); King v. Warickshall, 168 Eng. Rep. 234, 235 (1783). *See generally* Rogge, *Proof by Confession*, 12 VILL. L. REV. 1 (1966).

11 An accepted definition of voluntariness is:

> If an individual's "will was overborne" or if his confession was not "the product of a rational intellect and a free will," his confession is inadmissible because coerced. These standards are applicable whether a confession is the product of physical intimidation or psychological pressure and, of course, are equally applicable to a drug-induced statement. Townsend v. Sain, 372 U.S. 293, 307 (1963) (footnotes omitted).

To this definition has been added this supplement by one writer: "Additionally, a confession or admission including exculpatory statements, may not be considered voluntary if obtained in violation of the procedural safeguards set forth in *Miranda* [Miranda v. Arizona, 384 U.S. 436 (1966)] . . . ." W. RINGEL, ARRESTS, SEARCHES, CONFESSIONS 66 (1966).

12 Professor Meltzer has identified four rules rather than three, but his fourth rule is one in which the trial court judge has discretion to follow the Orthodox or the Massachusetts rule. Meltzer, *Involuntary Confessions: The Allocation of Responsibility Between Judge and Jury*, 21 U. CHI. L. REV. 317, 320 (1954).

13 *E.g.*, McHenry v. United States, 308 F.2d 700, 704 (10 Cir. 1962), *cert. denied*, 374 U.S. 833 (1963). For a complete list of cases adhering to the Orthodox or Wigmore rule, see

Humane rule, in which the trial judge made a preliminary determination of the voluntariness of the confession, but if the judge found it voluntary, the jury also had to pass upon its voluntariness before using it as weight against the accused;[14] and (3) the New York rule in which the trial judge, if he found that there was a factual question as to the voluntariness of the confession, sent this issue, along with the issue of the defendant's guilt or innocence, to the jury which then brought back a general verdict only.[15]

Then, in 1964, the Supreme Court in *Jackson* rejected the New York rule in favor of the Orthodox rule and, in the course of its opinion, apparently approved the Massachusetts procedure.[16] After the *Jackson* decision, those jurisdictions which had formerly used the New York rule were forced to choose a procedure for the future. State courts that switched to the Massachusetts procedure emphasized the role of the jury.

> The Massachusetts rule, however, appeals to us as the better rule because by allowing the jury also to pass on the issue of voluntariness *it preserves to the defendant his right to a jury trial on this critical issue.*[17] (Emphasis added.)

On the other hand, those state jurisdictions that switched to the Orthodox procedure indicated a fear of a jury "second-guessing" the trial judge.

Jackson v. Denno, 378 U.S. 368, 411-414, 421 (1964) (appendices A and B to opinion of Black, J., dissenting in part and concurring in part). At least one state, Kentucky, has made the Orthodox rule statutory:

> The trial judge shall determine the competency and admissibility of any alleged confession under the provisions of this section from evidence heard by him, independent of and without the hearing of the jury trying the case. KY. REV. STAT. ANN. § 422.110(2) (1963).

14 *E.g.*, Commonwealth v. Preece, 140 Mass. 276, 5 N.E. 494, 495 (1885), in which the court stated:

> The rule is well established that, to be admissible, a confession must be the free and voluntary confession of the defendant. If it is induced by any promises or threats of one in authority over the defendant, it is incompetent. When a confession is offered in evidence, the question whether it is voluntary is to be decided primarily by the presiding justice. If he is satisfied that it is voluntary, it is admissible; otherwise it should be excluded. When there is conflicting testimony, the humane practice in this commonwealth is for the judge, if he decides that it is admissible, to instruct the jury that they may consider all the evidence, and that they should exclude the confession, if, upon the whole evidence in the case, they are satisfied that it was not the voluntary act of the defendant. . . .

For a complete list of cases adhering to the Massachusetts or Humane rule, see Jackson v. Denno, 378 U.S. 368, 417-20, 422-23 (1964) (appendices A and B to opinion of Black, J., dissenting in part and concurring in part).

15 *E.g.*, Stein v. New York, 346 U.S. 156, 172 (1953), in which the court stated:

> The procedure adopted by New York for excluding coerced confessions relies heavily on the jury. It requires a preliminary hearing as to admissibility, but does not permit the judge to make a final determination that a confession is admissible. He may —indeed, must—exclude any confession if he is convinced that it was *not* freely made or that a verdict that it was so made would be against the weight of the evidence. . . . If the voluntariness issue presents a fair question of fact, he must receive the confession and leave to the jury, under proper instructions, the ultimate determination of its voluntary character and also its truthfulness. . . .

For a complete list of cases adhering to the New York rule, see Jackson v. Denno, 378 U.S. 368, 414-17, 421-22 (1964) (appendices A and B to opinion of Black, J., dissenting in part and concurring in part). The New York rule and *Stein* were expressly overturned by Jackson v. Denno. *Id.* at 391.

16 Jackson v. Denno, 378 U.S. 368, 378 n.8 (1964).

17 State v. Brewton, 238 Ore. 590, 395 P.2d 874, 879 (1964). *See* People v. Huntley, 15 N.Y.2d 72, 78, 204 N.E.2d 179, 183, 255 N.Y.S.2d 838, 843 (1965).

> We think the latter rule [Massachusetts rule] contains a contradiction in terms. If we arrogate to the trial judge the right to adjudicate voluntariness, even though that question involves issues of fact, we find no basis in logic in submitting the same question over again to the jury to *second-guess* him. We believe their determination should be limited to truthfulness, *i.e.*, weight and credibility.[18] (Emphasis added.)

On the authority of *Jackson*, many federal courts reversed and remanded convictions handed down under the New York rule, but naturally declined to adopt a specific procedure for their jurisdiction.[19] Of course, jurisdictions with approved procedures stayed in accord with and cited *Jackson*.[20]

The district court that convicted Clifton in 1946 had followed the Massachusetts procedure in determining the voluntariness of his confession. As stated by Judge Burger, the author of *Clifton*, the issue on appeal was whether that preliminary determination in 1946 violated the rule set out in *Jackson* in that the trial judge did not find Clifton's confession voluntary "beyond a reasonable doubt."[21]

Unfortunately, this question of the standard of proof required in the judge's preliminary determination of the voluntariness of a confession was not settled in *Jackson*.[22] However, as both the majority opinion and Judge Leventhal's concurring opinion point out, the question was not entirely novel. The

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18 People v. Walker, 374 Mich. 331, 132 N.W.2d 87, 91 (1965). *See* State v. Holland, — Iowa —, 138 N.W.2d 86, 91 (1965); People v. Jury, 3 Mich. App. 427, 142 N.W.2d 910 (1966); State v. Keiser, 274 Minn. 265, 143 N.W.2d 75, 78 (1966); State *ex rel.* Goodchild v. Burke, 27 Wis. 2d 244, 133 N.W.2d 753, 763 (1965), *cert. denied,* 384 U.S. 1017-18 (1966).

19 Burns v. Beto, 371 F.2d 598, 604 (5th Cir. 1966); Hutcherson v. United States, 351 F.2d 748, 753 (D.C. Cir. 1965); Curtis v. United States, 349 F.2d 718, 719 (D.C. Cir. 1965); Luck v. United States, 348 F.2d 763, 766 (D.C. Cir. 1965); Trotter v. Stephens, 241 F. Supp. 33, 48 (E.D. Ark. 1965). By statute, Arkansas switched from the New York rule to the Orthodox rule:

> Issues of fact shall be tried by a jury, provided that the determination of fact concerning the admissibility of a confession shall be made by the court when the issue is raised by the defendant; that the trial court shall hear the evidence concerning the admissibility and the voluntariness of the confession out of the presence of the jury and it shall be the court's duty before admitting said confession into evidence to determine by a preponderance of the evidence that the same has been made voluntarily. ARK. STAT. ANN. § 43-2105 (Supp. 1965).

20 *E.g.*, People v. Sanchez, 56 Cal. Rptr. 648, 423 P.2d 800, 808 (1967); Rollins v. State, 179 So. 2d 377, 380 (Fla. Dist. Ct. App. 1965), *appeal dismissed,* 188 So. 2d 805 (Fla. 1966); State v. Washington, 399 S.W.2d 109, 114 (Mo. 1966); State v. Jackson, 43 N.J. 148, 203 A.2d 1, 11 (1964); *cert. denied,* 379 U.S. 982 (1965); McCoy v. Commonwealth, 206 Va. 470, 144 S.E.2d 303, 309 (1965).

21 Clifton v. United States, 371 F.2d 354, 357 (D.C. Cir. 1966), *cert. denied,* 386 U.S. 995 (1967).

22 In *Jackson*, Mr. Justice Black noted:

> Another disadvantage to the defendant under the Court's new rule is the failure to say anything about the burden of proving voluntariness. The New York rule does now and apparently always has put on the State the burden of convincing the jury beyond a reasonable doubt that a confession is voluntary. . . . The Court has not said that its new constitutional rule, which requires the judge to decide voluntariness, also imposes on the State the burden of proving this fact beyond a reasonable doubt. Does the Court's new rule allow the judge to decide voluntariness merely on a preponderance of the evidence? If so, this is a distinct disadvantage to the defendant. In fashioning its new constitutional rule, the Court should not leave this important question in doubt. Jackson v. Denno, 378 U.S. 368, 404-05 (1964) (Black, J., dissenting in part and concurring in part).

See Note, *The Role of a Trial Jury in Determining the Voluntariness of a Confession,* 63 MICH. L. REV. 381, 385-86 (1964).

Fourth Circuit, also a Massachusetts procedure circuit, had ruled in *United States v. Inman*[23] that the judge must be convinced beyond a reasonable doubt that a confession is voluntary.[24] In accordance with the "two-bite"[25] theory, the Fourth Circuit also stated that "the jury must be satisfied beyond a reasonable doubt" that it is voluntary.[26] State courts also have considered this issue and have arrived at various results. These jurisdictions have concluded that the state has the burden of proof to show by a "preponderance of the evidence,"[27] or by "credible evidence,"[28] or "beyond a reasonable doubt"[29] that the confession was voluntarily made. Still other decisions have held that the trial judge must be "satisfied,"[30] or have a "prima facie showing,"[31] or make a finding with "unmistakable clarity"[32] that the confession was voluntarily made.

In *Clifton*,[33] appellant relied on *Inman* and, in interpreting *Jackson*, argued:

> The repeated emphasis by the majority that the issue be "reliably" determined in order to avoid absolutely the possibility of convicting a defendant on the basis of an involuntary confession requires the conclusion that the *Court intended the voluntariness issue to be resolved "beyond any reasonable doubt."*[34] (Citation omitted.) (Emphasis added.)

The Government rejected this plea and took the position that in the 1946 trial the judge had

> conducted an independent hearing on voluntariness out of the presence

23 352 F.2d 954 (4th Cir. 1965).

24 *Id.* at 956 (dictum). However, the case was reversed because the trial court failed to leave the ultimate decision of voluntariness to the jury as required by the Massachusetts procedure which is followed in the Fourth Circuit. *Id.* at 955.

25 One author explains this term as follows:

> Under this rule [The Massachusetts rule], the judge makes an "independent determination" of admissibility pretrial or during trial in the absence of the jury. If the determination is "inadmissible" the trial proceeds without the confession. If his determination is "admissible," he submits to the jury the identical issue of admissibility without disclosing his finding. The Massachusetts rule is therefore a "two-bite" rule. N. SOBEL, THE NEW CONFESSIONS STANDARDS "MIRANDA v. ARIZONA" 118 (1966).

26 United States v. Inman, 352 F.2d 954, 956 (4th Cir. 1965).

27 People v. Sammons, 17 Ill. 2d 316, 319, 161 N.E.2d 322, 324 (1959).

28 McCoy v. Commonwealth, 206 Va. 470, 144 S.E.2d 303, 307 (1965).

29 State v. Ragsdale, 249 La. 420, 187 So. 2d 427, 430 (1966), *cert. denied*, 385 U.S. 1029 (1967); State v. Stewart, 238 La. 1036, 117 So. 2d 583, 586 (1960).

30 Lopez v. State, 384 S.W.2d 345, 348 (Tex. Crim. App. 1964).

31 Duncan v. State, 278 Ala. 145, 176 So. 2d 840, 857 (1965) (dictum).

32 Evans v. United States, 375 F.2d 355, 360 (8th Cir. 1967). For the requirements of this case, see text accompanying note 58 *infra*.

33 The district court rejected the argument that *Jackson v. Denno* ought to be retroactive. On appeal, the Government conceded that it was retroactive. Brief for Appellee at 8-10, Clifton v. United States, 371 F.2d 354 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967). Hence, the majority opinion in *Clifton* did not consider retroactivity to be an issue, but the concurring opinion stated that *Jackson* should not be retroactive in cases in which there was some "judicial screening of the issue prior to its presentation to the jury." Clifton v. United States, 371 F.2d 354, 363-64 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967). See Linkletter v. Walker, 381 U.S. 618, 628-29 n.13 (1965); Commonwealth v. Rundle, 416 Pa. 321, 206 A.2d 283 (1965). In *Rundle, supra* at 286, the court stated that "[t]he most persuasive authority for the proposition that the principle of Jackson v. Denno is to be applied to convictions finalized prior to the date of that decision is Jackson itself." *Contra*, United States *ex rel* Conroy v. Pate, 240 F. Supp. 237 (N.D. Ill. 1965) (dictum).

34 Brief for Appellant at 24-25, Clifton v. United States, 371 F.2d 354 (D.C. Cir. 1966) *cert. denied*, 386 U.S. 995 (1967).

> of the jury before deciding to submit that issue to the jury, and that this procedure, generally conforming to the so-called Massachusetts procedure approved in *Jackson*, fully satisfied the requirements of *Jackson*.[35]

The majority opinion in *Clifton* began with a restatement of the requirements of *Jackson*, *i.e.*, the procedures used must be "fully adequate to insure a reliable and clear-cut determination of the voluntariness of the confession."[36] They then applied the facts of Clifton's 1946 trial to this proposition and found that the *Jackson* requirements had been met. In deciding that *Jackson* did not necessitate the use of the "beyond a reasonable doubt" standard in a Massachusetts procedure jurisdiction, the majority gave confessions no unique character and concluded that the admission of a confession is merely a ruling on admissibility of evidence.

> The determination of whether a confession is voluntary is, in substance, a ruling on its admissibility as evidence. . . .
>
> It is one thing to call for this high standard of proof [beyond a reasonable doubt] from the ultimate fact finders and quite another to ask that this issue be resolved preliminarily by the judge beyond a reasonable doubt contrary to all the law governing admissibility of evidence.[37]

The majority was troubled by the Fourth Circuit's application of the "beyond a reasonable doubt" standard, but finally reasoned that the "beyond a reasonable doubt" test would fail to maintain "the role of lay jurors in their historically high place,"[38] and would, instead, limit jurors "to resolving only those fact issues which can be 'safely' entrusted to their collective judgment."[39] The majority felt that a standard in which the judge is "satisfied" is a sufficient safeguard to the rights of the accused, especially in view of other recent Supreme Court holdings.

> For a generation judicial trends have been to exclude from the jury all evidence thought to have been unfairly or improperly secured, and more recent holdings place stringent limits on the use of any utterance by an accused. In the future trial judges will be evaluating only those utterances of an accused which have already passed through the whole gamut of screening processes outlined in *McNabb*,[40] *Mallory*,[41] *Escobedo*,[42] *Mas-*

35 Clifton v. United States, 371 F.2d 354, 356 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

36 *Id.* at 357, *quoting from* Jackson v. Denno, 378 U.S. 368, 391 (1964).

37 *Id.* at 357-58.

38 *Id.* at 360.

39 *Id.*

40 In McNabb v. United States, 318 U.S. 332, 341-42 (1943) the Court declared:

> [W]e are constrained to hold that the evidence elicited from the petitioners in the circumstances disclosed here must be excluded. For in their treatment of the petitioners the arresting officers assumed functions which Congress has explicitly denied them. . . . Congress has explicitly commanded that "It shall be the duty of the marshal, his deputy, or other officer, who may arrest a person charged with any crime or offense, to take the defendant before the nearest United States commissioner or the nearest judicial officer having jurisdiction under existing laws for a hearing, commitment, or taking bail for trial. . . ." 18 U.S.C. § 595.

41 In Mallory v. United States, 354 U.S. 449, 455 (1957) the Court held:

> The duty enjoined upon arresting officers [by FED. R. CRIM. P. 5(a)] to arraign "without unnecessary delay" indicates that the command does not call for mechanical or automatic obedience. . . . But the delay must not be of a nature to give opportunity for the extraction of a confession.

> *siah*,[43] and *Miranda*.[44] The prospects now are that trial judges, otherwise much overburdened, will not be overworked in passing on the voluntariness of the few confessions which will survive the application of these cases.[45] (Footnotes added.)

The concurring opinion, written by Judge Leventhal, rejected the majority's view that a ruling on the voluntariness of a confession is merely a ruling on the admissibility of evidence: "We are not dealing with an ordinary ruling on evidence. The exclusion of confessions not shown to be voluntary inheres in the constitutional privilege against self-incrimination. . . ."[46] He noted that the determination of the voluntariness of a confession

> has the deepest roots in our Constitution and system of jurisprudence. And it relates to a matter which is usually the key item in the proof of guilt, and certainly one of overpowering weight with the jury. The very introduction of an involuntary confession is a denial of constitutional rights so prejudicial as to vitiate the conviction irrespective of the quantum of other untainted evidence demonstrating the guilt of the accused.[47] (Footnotes omitted.)

In support of this proposition, Judge Leventhal stressed that the great need for reliability dictates that this preliminary determination "must be made by the court."[48] He reasoned that this was *not* a derogation of the jury, but a

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> The circumstances of this case preclude a holding that arraignment was "without unnecessary delay." . . .
>
> We cannot sanction this extended delay, resulting in confession, without subordinating the general rule of prompt arraignment to the discretion of arresting officers in finding exceptional circumstances for its disregard.

See FED. R. CRIM. P. 5(a); Dession, *The New Federal Rules of Criminal Procedure: I*, 55 YALE L.J. 694, 706-13 (1946).

42 In Escobedo v. Illinois, 378 U.S. 478, 490-91 (1964) the Court held

> that where, as here, the investigation is no longer a general inquiry into an unsolved crime but has begun to focus on a particular suspect, the suspect has been taken into police custody, the police carry out a process of interrogations that lends itself to eliciting incriminating statements, the suspect has requested and been denied an opportunity to consult with his lawyer, and the police have not effectively warned him of his absolute constitutional right to remain silent, the accused has been denied "the Assistance of Counsel" in violation of the Sixth Amendment to the Constitution as "made obligatory upon the States by the Fourteenth Amendment," . . . and that no statement elicited by the police during the interrogation may be used against him at a criminal trial.

43 In Massiah v. United States, 377 U.S. 201, 206 (1964) the Court held

> that the petitioner was denied the basic protections of that guarantee [sixth amendment] when there was used against him at his trial evidence of his own incriminating words, which federal agents had deliberately elicited from him after he had been indicted and in the absence of his counsel.

44 In Miranda v. Arizona, 384 U.S. 436, 444 (1966) the Court held:

> As for the procedural safeguards to be employed, . . . the following measures are required. Prior to any questioning, the person must be warned that he has a right to remain silent, that any statement he does make may be used as evidence against him, and that he has a right to the presence of an attorney, either retained or appointed. The defendant may waive effectuation of these rights, provided the waiver is made voluntarily, knowingly and intelligently.

To see this case incorporated into the required hearing of *Jackson*, see text accompanying notes 56-58 *infra*.

45 Clifton v. United States, 371 F.2d 354, 360 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 995 (1967).

46 *Id.* at 361 (concurring opinion).

47 *Id.* at 362.

48 *Id.*

recognition of "the prejudice inhering in the admixture of a determination of voluntariness together with the jury's inescapable consideration of reliability of the confession, and indeed ultimate guilt or innocence."[49] Indeed, to Judge Leventhal, a standard of "beyond a reasonable doubt" was a *logical conclusion* of *Jackson:*

> It is true that in Jackson v. Denno the Supreme Court did not expressly address itself to the question before us. But to me a reasonable doubt standard for the judge's determination of voluntariness ensues from the Court's reasoning as surely as Euclid's corollaries unfolded from his theorems. The decisive ruling in Jackson v. Denno is that it is the determination of voluntariness by the judge which is crucial to our constitutional liberties. *Any redetermination by the jury may be "ultimate" in time but not in constitutional significance.*[50] (Emphasis added.)

In addition, Judge Leventhal noted that practical considerations favored the use of the "beyond a reasonable doubt" standard by the trial judge. Evidence, capable of raising a reasonable doubt such as "the testimony of a defendant who dare not risk presentation of prior convictions to the jury,"[51] often will be available only to the trial judge. As the final point in his rationale, the concurring judge charged that the majority had no "post-*Jackson* ruling discarding the reasonable doubt standard for the trial judge which they can champion as authoritative."[52] And, even assuming that the "beyond a reasonable doubt" standard is not constitutionally required in a Massachusetts procedure jurisdiction, Judge Leventhal countered: "[T]he reasonable doubt standard for the judge should be enunciated in the exercise of our responsibility to exercise supervisory powers over the administration of justice in the District of Columbia."[53] In conclusion, Judge Leventhal agreed entirely with the Fourth Circuit decision in *Inman*, but he would apply the "beyond a reasonable doubt" standard only to those cases tried subsequent to *Jackson.*

> In my view the overall interest of justice is achieved by ruling that this aspect of *Jackson v. Denno* — that the judge must be convinced of voluntariness beyond a reasonable doubt even where the issue is also submitted to the jury — is requisite for subsequent trials, but need not be accorded retrospective application.[54]

The rationale of the concurring opinion is especially appealing in the light of the already famous decision of the Supreme Court in *Miranda v. Arizona.*[55] After *Miranda,* the requirements of *Jackson* are still imposed upon the court, but a new definition of voluntariness has been necessitated. One author has stated: "We need not spend any time with definitions of voluntariness.

49 *Id.*
50 *Id.* at 362-63.
51 *Id.* at 363.
52 *Id.*
53 *Id.*
54 *Id.* at 364.
55 384 U.S. 436 (1966). For the holding of this case, see note 44 *supra.*

Miranda makes such definitions obsolete. . . . Hereafter the sole tests to be used in determining 'admissibility' will be 'custody', 'warnings' and 'waiver'."[56]

This same commentator observed that

> the term "admissibility" meant "voluntariness" for *Jackson v. Denno* was decided while only the traditional rule was in effect. For cases tried after *Escobedo* and *Miranda* "admissibility" means not "voluntariness" but *Escobedo* standards of "accusatory stage", "warnings" and "waiver" and *Miranda* standards of "custody", "warning" and "waiver".[57]

It appears unmistakable that *Miranda* standards must be incorporated into this procedure and ruled upon in the trial judge's preliminary determination. Indeed, the Eighth Circuit — although it did not require the reasonable doubt standard — did incorporate the *Miranda* standards into the required procedure of *Jackson*.

> In summary, the district court was required to make a finding on the record with "unmistakable clarity" that (1) the *Miranda* warnings were given; (2) the defendant knowingly and intelligently waived his privilege against self-incrimination; (3) the defendant voluntarily, knowingly and intelligently waived his right to have retained or appointed counsel present at the interrogation; (4) the confession or statement was freely and voluntarily made.[58]

This new dimension and meaning given by *Miranda* to the trial judge's preliminary determination of voluntariness necessitates even more the use of the "beyond a reasonable doubt" standard. As the concurring opinion pointed out, when the trial judge makes his determination he has *all* the facts before him; not just those that are successfully entered into evidence.[59] In addition, he will have a more acute knowledge of the requirements and meaning of *Miranda* than the ordinary juryman.

In *Clifton*, both the majority[60] and concurring opinion[61] agreed that nothing less than the "beyond a reasonable doubt" standard would suffice in an Orthodox procedure jurisdiction.[62] In refusing to apply this same standard to a Massachusetts procedure jurisdiction, the majority apparently overlooked the fact that, in a Massachusetts procedure jurisdiction, the jury may still bring back a general verdict with no explicit determination of the voluntariness of the confession. Such a procedure would have the same defect as led to the downfall of the New York rule, *i.e.*, the jury could be influenced by the veracity of the confession without being convinced beyond a reasonable doubt that it was

56 N. SOBEL, *supra* note 25, at 30.
57 *Id.* at 117.
58 Evans v. United States, 375 F.2d 355, 360 (8th Cir. 1967). For the holding of *Miranda*, see note 44 *supra*.
59 Clifton v. United States, 371 F.2d 354, 363 (D.C. Cir. 1966) (concurring opinion), *cert. denied*, 386 U.S. 995 (1967).
60 *Id.* at 357 n.7.
61 *Id.* at 362 (concurring opinion).
62 The issue may still be alive in at least one Orthodox jurisdiction since the Illinois Supreme Court's decision in People v. Golson, 32 Ill. 2d 398, 207 N.E.2d 68 (1965), *cert. denied*, 384 U.S. 1023 (1966). This was an Orthodox jurisdiction, yet the court was "not required to be convinced of its [the confession] voluntary character beyond a reasonable doubt." *Id.* at 70.

voluntary.[63] Hence, in such a jurisdiction, if the judge is not required to apply the reasonable doubt test, the practical effect may be that no one will. Uniform application of the "beyond a reasonable doubt" standard to a trial judge's preliminary determination of voluntariness would avoid such a failing in those jurisdictions that still employ the Massachusetts rule.

Merle F. Wilberding

SECURITIES REGULATION — SECURITIES EXCHANGE ACT OF 1934 — SAVINGS AND LOAN ASSOCIATIONS — A WITHDRAWABLE CAPITAL ACCOUNT IN A STATE-CHARTERED SAVINGS AND LOAN ASSOCIATION IS NOT A "SECURITY" WITHIN THE MEANING OF THE ACT. — In 1958, City Savings, an Illinois-chartered savings and loan association, was unable to meet all of its cash commitments, and under the then-existing provisions of the Illinois Savings and Loan Act, it limited the amount of cash a depositor could withdraw.[1] Thereafter, the association was prohibited from accepting new deposits.[2] In July of 1959, the Act was amended to allow such an association to accept new deposits, but limitations on withdrawals of these deposits were forbidden.[3] Plaintiffs, having been induced by solicitations sent through the mail, had opened accounts with City Savings at various dates subsequent to July 1959. These solicitations, or advertisements, offered television sets and other expensive premiums to individuals who opened up new accounts of a stated amount or who added a specified sum to their existing accounts.[4] These allurements also spoke of the financial strength of City Savings and the benefits to be derived from investing in it.[5] However, such inducements failed to mention that: (1) City Savings was unable to obtain federal insurance of its shareholder accounts; (2) when City Savings did apply for such insurance its application was denied because of its unsound financial management; (3) one of its principal officers and directors was C. Oran Mensik, a man who had been involved in the Orville Hodge scandal, and who had been indicted for mail fraud in connection with another savings and loan association; and (4) City Savings was operating on a restricted withdrawal basis with regard to its pre-1959 accounts.[6]

On June 26, 1964, Joseph E. Knight, Director of Financial Institutions for the State of Illinois, assumed control of City Savings pursuant to section 7-8 of the Illinois Savings and Loan Act.[7] Two days later, the shareholders approved

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63 One suggested method of combating the defect of the jury bringing back only a general verdict in the Massachusetts jurisdictions is the use of special interrogatories. M. LADD, CASES AND MATERIALS ON EVIDENCE 504 (2d ed. 1955); Rames, *Wyoming Procedures Re Admissibility of Confessions,* 19 WYO. L.J. 203, 212 (1965).

1 Law of July 5, 1955, art. 4 § 4-13(b), [1955] Ill. Laws 869-70, *as amended,* ILL. ANN. STAT. ch. 32, § 773(b) (Smith-Hurd Supp. 1966).

2 Tcherepnin v. Knight, 371 F.2d 374, 375 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

3 Law of July 9, 1959, sec. 1, § 4-13(h), [1959] Ill. Laws 717 (repealed 1965).

4 Brief for Appellee at 7, Tcherepnin v. Knight, 371 F.2d 374 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

5 *Id.*

6 *Id.* at 7-9.

7 Law of July 24, 1959, sec. 1, § 7-8, [1959] Ill. Laws 2396, *as amended,* ILL. ANN. STAT. ch. 32, § 848 (Smith-Hurd Supp. 1966).

a plan of voluntary liquidation. On July 24, 1964, plaintiffs, invoking jurisdiction under section 27 of the Securities Exchange Act of 1934[8] [hereinafter SEA or the Act], filed suit in federal district court. Plaintiffs contended that by opening withdrawable capital accounts they had thereby purchased "securities" of City Savings. They further contended that they had relied on false and misleading solicitations mailed to them by City Savings in violation of section 10(b) of the SEA[9] and the regulations promulgated thereunder.[10] If successful in this contention, their purchases would be void under section 29(b) of the Act,[11] and they would be entitled to rescind the transaction and to recover the full amount of their investment plus interest. The Securities Exchange Commission filed an amicus curiae brief in support of plaintiffs' position. Defendants moved to dismiss the complaint for lack of jurisdiction on the ground that such accounts are not "securities." The district court denied the defendants' motion to dismiss, but certified the question for an immediate interlocutory appeal under 18 U.S.C. § 1292(b). The United States Court of Appeals for the Seventh Circuit granted defendants' petition for leave to file the appeal and succinctly stated the sole issue presented: "[I]s a withdrawable capital account in an Illinois-chartered savings and loan association a 'security' within the meaning of that term as it is used in the Securities Exchange Act of 1934?"[12] That court, Justice Cummings dissenting, in reversing and remanding *held:* such an account is not a security within the meaning of the SEA. *Tcherepnin v. Knight,* 371 F.2d 374 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

The structure of a savings and loan association is relatively uncomplicated.[13] The United States Savings and Loan League characterizes such an institution as:

> A financial intermediary which accepts savings from the public and invests those savings mainly in mortgage loans. Always a corporation, it may be

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8 15 U.S.C. § 78aa (1964).

9 15 U.S.C. § 78j(b) (1964) provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

10 SEC Reg. 10b-5, 17 C.F.R. § 240.10b-5 (1967) states:

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

11 15 U.S.C. § 78cc(b) (1964).

12 Tcherepnin v. Knight, 371 F.2d 374, 376 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

13 For a good analysis of the savings and loan business, see L. KENDALL, THE SAVINGS AND LOAN BUSINESS (1962).

> either a mutual or a capital stock institution and may be either state-chartered or federally chartered.[14]

Furthermore, "savings and loan associations can be classified as insured or uninsured and as federally chartered or state-chartered. The state-chartered associations, in addition, either are mutually owned or have some form of permanent stock ownership. All federals are mutuals."[15] By a mutual association it is meant that the depositors themselves own the association; that is, each depositor is allotted a certain number of "shares," depending upon the size of his account.[16] Thus, when a depositor has an account in a mutual association he is a holder of a share of that association. City Savings fell into the classification of an uninsured, mutual, state-chartered association.

The SEA defines the term "security" in section 3(a)(10):

> The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[17]

While, as will be shown, a persuasive argument can be made in favor of classifying withdrawable capital accounts as "investment contracts," a majority of the court in *Tcherepnin* felt that such instruments could only be covered by the statutory phrase "any instrument commonly known as a security."[18]

There was apparently no discussion of savings and loan associations in the congressional hearings on the SEA.[19] The Senate report that accompanied the bill merely noted that the definition of a security was "substantially the same

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14 UNITED STATES SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK 1966, at 140 (1966).

15 UNITED STATES SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK 1967, at 53 (1967).

16 The Illinois Savings and Loan Act, § 3-2(d)(2), ILL. ANN. STAT. ch. 32, § 742(d)(2) (Smith-Hurd Supp. 1966) provides:

> Each person holding one or more withdrawable share accounts shall have the vote of one share for each one hundred dollars of the aggregate withdrawal value of such accounts, and shall have the vote of one share for any fraction of one hundred dollars.

See Marshall Sav. and Loan Ass'n v. Henson, 78 Ill. App. 2d 14, 26-27, 222 N.E.2d 255, 261 (1966), where the court stated: "It is undisputed that the Illinois Savings and Loan Act gives the depositors the status of shareholders by conferring one vote for each $100 on deposit and that under this formula the depositors own the majority of the voting rights."

17 15 U.S.C. § 78c(a)(10) (1964).

18 Tcherepnin v. Knight, 371 F.2d 374, 376 (7th Cir.), *cert. granted*, 87 S. Ct. 2076 (1967).

19 *Id.* at 380 (dissenting opinion).

as . . . in the Securities Act of 1933."[20] Because of this close similarity,[21] the legislative history and judicial construction of the Securities Act of 1933[22] are pertinent to the question of whether Congress meant to include withdrawable capital accounts within the scope of the SEA.

When Congress enacted the Securities Act of 1933, it expressly exempted the *securities* of savings and loan associations from the registration provisions of the Act. Section 3(a)(5) of the Act provides:

> Except as hereinafter expressly provided, the provisions of this title shall *not apply* to any of the following classes of *securities:*
>
> . . . .
>
> (5) Any *security issued by a building and loan association,* homestead association, savings and loan association, or similar institution, substantially all the business of which is confined to the making of loans to members. . . .[23] (Emphasis added.)

Representatives of the savings and loan industry desired this exemption because of technical difficulties and prohibitive costs.[24] One of the principal drafters of the Securities Act of 1933, James N. Landis, indicated that the securities of savings and loan associations "were made exempt for obvious political reasons."[25] It should be pointed out, however, that, while exempted from the registration provisions of the Securities Act of 1933, savings and loan associations were made subject to the antifraud provisions of the Act by section 17(c).[26]

In 1933, although Congress exempted any *securities* issued by a savings and loan association from the registration provisions, it left unclear whether this meant the permanent reserve stock issued by some state associations or the withdrawable capital accounts issued by mutual associations. Since at the time of the passage of the Securities Act of 1933 the vast majority of associations were of the mutual rather than the stock type, it seems probable that Congress was referring to the former type of institution. Moreover, there is a similar type of exemption in the Securities Acts Amendments of 1964.[27] These amendments enlarged the Securities Exchange Act of 1934 by adding registration

20 S. REP. No. 792, 73d Cong., 2d Sess. 14 (1934).

21 The definition of a security in the Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1964), *formerly* 48 Stat. 74 (1933) reads:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

22 15 U.S.C. §§ 77a—77bbbb (1964).

23 48 Stat. 75 (1933), 15 U.S.C. § 77c(a)(5) (1964). *See also* H. R. REP. No. 85, 73d Cong., 1st Sess. 15 (1933) where the House Committee on Interstate and Foreign Commerce, reporting on exempted securities under the Securities Act of 1933, wrote: "Paragraph (5) exempts the *securities* of building and loan associations and similar institutions . . . ." (Emphasis added.)

24 Brief for SEC as Amicus Curiae at 9-10, Tcherepnin v. Knight, 371 F.2d 374 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

25 Landis, *The Legislative History of the Securities Act of 1933,* 28 GEO. WASH. L. REV. 29, 39 (1959).

26 15 U.S.C. § 77q(c) (1964).

27 78 Stat. 565-580 (1964) (codified in scattered sections of 15 U.S.C.).

provisions for securities traded in the over-the-counter market.[28] However, the "securities" of savings and loan associations were made exempt from these new registration provisions by paragraph (2) of section 12(g) which reads:

> The provisions of this subsection shall not apply in respect of—
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> . . . .
>
> (C) any security, other than permanent stock, guaranty stock, permanent reserve stock, or any similar certificate evidencing nonwithdrawable capital, issued by a savings and loan association, building and loan association . . . .[29]

The Senate Report on the bill proposing the 1964 amendments, in discussing this subsection, noted that "[t]here is normally no trading interest in the remaining categories of *securities* exempted from the registration provisions."[30] (Emphasis added.)

Both the plaintiff-appellees and the SEC argued that the exemption of the "securities" of savings and loan associations from the registration provisions of the Securities Act of 1933, and again from the registration provisions of the Securities Acts Amendments of 1964, indicated that Congress meant to include such interests within the definition of a "security." Any other interpretation, they contended, would leave such exemptions meaningless.[31]

However, a majority of the court in *Tcherepnin* rejected this line of reasoning by analogizing the exemption provided savings and loan associations with that provided for insurance policies.[32] Section 3(a)(8) of the Securities Act of 1933[33] exempts insurance policies from the registration provisions and therefore, by negative implication, it would seem that they would be included under the definition of a "security." Nevertheless, the House Report on the bill noted:

> Paragraph (8) makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. . . . The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from

28 H. R. REP. No. 1418, 88th Cong., 2d Sess. 15 (1964).
29 78 Stat. 567 (1964), 15 U.S.C. § 78l(g)(2) (1964).
30 S. REP. No. 379, 88th Cong., 1st Sess. 61 (1963).
31 At least one state court has adopted this position. The Wisconsin Supreme Court in First Nat'l Sav. Foundation v. Samp, 274 Wis. 118, 80 N.W.2d 249, 259 (1956), after noting that the Wisconsin Securities Law, WIS. STAT. ANN. § 189.06(8), exempts the securities of savings and loan associations, held that savings accounts were "securities."

> We need not determine the exact legal nature of these savings accounts, for clearly they are "any interest, share or participation in any profits, earnings . . . [or] property," and probably are either "stock" or "membership[s] in a corporation without capital stock." Hence they are "securities." Recognition of this fact may be found in the provision of sec. 189.06, that "the following securities may be sold without registration . . . (8) . . . any security issued by a savings and loan association chartered and supervised by the federal government or any agency thereof."

There is a similar exemption of the securities of savings and loan associations in the Illinois Security Law § 3(D), Law of July 13, 1953, § 3(D), [1953] Ill. Laws 1333, *as amended*, ILL. ANN. STAT. ch. 121½, § 137.3(D) (Smith-Hurd Supp. 1966).
32 Tcherepnin v. Knight, 371 F.2d 374, 378-379 (7th Cir.), *cert. granted*, 87 S. Ct. 2076 (1967).
33 15 U.S.C. § 77c(a)(8) (1964).

> the provisions of the act, but the specific exemption is included to make misinterpretation impossible.[34]

Judge Cummings, in dissent, dismissed this analogy as irrelevant by stating that insurance policies "possess none of the attributes of securities."[35]

The two leading Supreme Court decisions construing the definition of a security in the Securities Act of 1933 are *SEC v. C. M. Joiner Leasing Corporation*[36] and *SEC v. W. J. Howey Company.*[37] In *Joiner,* the defendant engaged in the sale of oil and gas leases to small investors, coupled with a promise to dig a test well. While both the district court and the Fifth Circuit had declared that such instruments were not securities, the Supreme Court reversed. The Court wrote:

> In the Securities Act the term "security" was defined to include by name or description many documents in which there is a common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well-settled meaning. Others are of a more variable character and were necessarily designated by more descriptive terms, such as . . . "investment contract," and "in general any interest or instrument commonly known as a security." We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. Instruments may be included within any of these definitions . . . if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached . . . .[38]

The Court went on to state that the test of whether or not an instrument is a security ". . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect."[39]

In *Howey,* one of the defendants was a Florida corporation which sold interests in citrus groves together with an optional service contract whereby the codefendant corporation would cultivate the groves and distribute the proceeds. The SEC sought an injunction to restrain both defendants from using the mails

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34 H. R. REP. No. 85, 73d Cong., 1st Sess. 15 (1933). *See also* 1 L. LOSS, SECURITIES REGULATION 497 (2d ed. 1961), where the author notes:

> This is a perfect example of how it sometimes does not pay to be too cautious. Without this exemption, and without any specific reference to insurance policies in the definition of a "security," . . . it is hardly conceivable that Congress would have subjected insurance policies to federal control *sub silentio,* even control which was merely of the disclosure variety. As it is, § 3(a)(8) seems on its face to create a negative implication that insurance policies *are* securities, which may be exempt from the registration requirements but are subject to the antifraud provisions. Nevertheless, the Commission has taken the position that insurance or endowment policies or annuity contracts issued by regularly constituted insurance companies were not intended to be securities, and that in effect § 3(a)(8) is supererogation. (Footnotes omitted.)

35 Tcherepnin v. Knight, 371 F.2d 374, 380 (7th Cir.) (dissenting opinion), *cert. granted,* 87 S. Ct. 2076 (1967).

36 320 U.S. 344 (1943).

37 328 U.S. 293 (1946).

38 SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

39 *Id.* at 352-53.

and interstate commerce for the offer and sale of unregistered securities. Again, both the district court and the Fifth Circuit held that the arrangement did not constitute a sale of "securities" and the Supreme Court reversed. In delivering the opinion of the Court, Justice Murphy wrote: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[40]

It would appear that, using the tests enunciated by *Joiner* and *Howey,* withdrawable capital accounts would classify as securities. When an individual places his money in a savings and loan association, he expects to receive dividends from the management of his money by the officers of the association.[41] Clearly, this seems to be "an investment of money in a common enterprise with profits to come solely from the efforts of others."[42] The *Tcherepnin* majority felt, however, that such accounts were not encompassed by the *Joiner-Howey* test[43] because "[a]n 'investor' in a savings and loan association lends his money to be withdrawable at will and to earn interest. The relationship with the enterprise is much more that of debtor-creditor than investment."[44] This reasoning runs counter to the Illinois Savings and Loan Act which specifically provides: "The holder of withdrawable capital for which application for withdrawal has been made, does not become a creditor by reason of such application."[45] Furthermore, not all share accounts are withdrawable at will. Under certain circumstances, an association is allowed to limit the amount of cash that a depositor can withdraw.[46] In fact, the court itself noted that City Savings was operating on a restricted withdrawal basis with regard to its pre-1959 accounts.[47]

Previous to *Tcherepnin* there had been no judicial determination as to whether or not savings accounts were securities,[48] but an analogous situation was presented in *Los Angeles Trust Deed & Mortgage Exchange v. SEC.*[49] In that case, the defendants were engaged in the sale of notes secured by second trust deeds or mortgages on specified real estate. The individual investors relied

40 SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).

41 L. KENDALL, *supra* note 13 at 10, notes that most savings and loan associations ". . . are mutual associations . . . owned by the savers. As such, they accept savings accounts from individuals and other sources, and invest these funds principally in monthly-payment, amortized loans for the construction, purchase, or repair and modernization of homes."

42 SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).

43 For a compilation of cases illustrating a more liberal interpretation of the term "security" and application of the *Joiner-Howey* test, see 1 CCH FED. SEC. L. REP., ¶ 1071 at 2062-69-4 (1966). *See also* 1 L. LOSS, *supra* note 36, at 488, where the author comments:

> Nor is the *Howey* formula limited by any means to the production of Vitamin C. A great many other schemes — many of them of the Alice in Wonderland variety — have been brought under both federal and state umbrellas by the *Joiner-Howey* process of looking through form to substance.

44 Tcherepnin v. Knight, 371 F.2d 374, 377 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

45 ILL. ANN. STAT. ch. 32, § 773(f) (Smith-Hurd Supp. 1966).

46 Law of July 5, 1955, art. 4 § 4-13(b), [1955] Ill. Laws 869-70, *as amended,* ILL. ANN. STAT. ch. 32, § 773(b) (Smith-Hurd Supp. 1966). *See* Aetna Cas. and Sur. Co. v. Porter, 296 F.2d 389, 392 (D.C. Cir. 1961), *rev'd on other grounds,* 370 U.S. 159 (1962), where the court remarked: ". . . federal savings and loan associations are not obligated to permit withdrawals on demand, but only to honor withdrawal requests within thirty days."

47 Tcherepnin v. Knight, 371 F.2d 374, 375 (7th Cir.), *cert. granted,* 87 S. Ct. 2076 (1967).

48 *Id.* at 379.

49 285 F.2d 162 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961).

on the skill and knowledge of the defendants' officers to check the worth of the trust deeds and to collect and service the purchased notes.[50] Many of the investors never saw the trust deed or mortgage, but were assured that their money would earn a ten percent return.[51] The Ninth Circuit, after discussing both *Joiner* and *Howey,* affirmed the district court's decision that such arrangements involved the sale of securities within the meaning of the SEA.[52] In stressing the fact that the investors embarked in a common enterprise and relied on the efforts of the defendants to realize a return on their investment, the court declared: "Thus Howey adds the test of *common enterprise* to the Joiner test of *results dependent on the efforts of one other than the purchaser.*"[53] As Judge Cummings pointed out, under this rationale it would seem that accounts in savings and loan associations, where the funds are commingled in one pool and then invested in mortgage loans, would ". . . clearly represent an 'investment contract' within the security definition in the 1934 Act."[54]

The trend of judicial interpretation, at least until the decision in *Tcherepnin,* has been to enlarge the concept of a security.[55] In 1959, the Supreme Court decided the celebrated case of *SEC v. Variable Annuity Life Insurance Company of America* [VALIC].[56] Once more the Supreme Court overruled the decisions of both lower courts to hold that a variable annuity contract[57] is a "security" within the meaning of the Securities Act of 1933. In other cases interpreting both the Securities Act of 1933 and the SEA, the courts have consistently held that the acts should not be narrowly construed[58] and that substance rather than form will be analyzed to ascertain whether or not a particular instrument is a security.[59]

The decision in *Tcherepnin* is far-reaching. By holding that withdrawable capital accounts are not securities within the meaning of the SEA, the Seventh Circuit forced the plaintiffs to accept the same fate as the general creditors of City Savings and, thereby, pocket a diminished dollar return. The scope of the question extends far beyond the hundred-plus individuals represented by the plaintiffs in *Tcherepnin.* As of December 31, 1966, there were 4,162 state-chartered savings and loan associations in the United States[60] of which 1,703

50 *Id.* at 168.
51 *Id.* at 168 & n.3.
52 *Id.* at 172.
53 *Id.* at 168.
54 Tcherepnin v. Knight, 371 F.2d 374, 382 (7th Cir.) (dissenting opinion), *cert. granted,* 87 S. Ct. 2076 (1967).
55 *See* Pasquesi, *The Expanding "Securities" Concept,* 49 ILL. B.J. 728 (1961); Shipley, *The SEC's Expanding Definition of a Security,* 37 N.Y.S.B.J. 521 (1965).
56 359 U.S. 65 (1959).
57 Unlike the fixed annuity, the return to an investor holding a variable annuity fluctuates depending upon the success of the investment company and there is no guarantee of a fixed income.
58 *See, e.g.,* SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 350-54 (1943); Llanos v. United States, 206 F.2d 852, 854 (9th Cir. 1953); SEC v. Crude Oil Corp. of America, 93 F.2d 844, 846-47 (7th Cir. 1937).
59 *See, e.g.,* Penfield Co. v. SEC, 143 F.2d 746, 750 (9th Cir.), *cert. denied,* 323 U.S. 768 (1944); SEC v. Universal Serv. Ass'n, 106 F.2d 232, 237 (7th Cir. 1939), *cert. denied,* 308 U.S. 622 (1940); SEC v. Tung Corp. of America, 32 F. Supp. 371, 374 (N.D. Ill. 1940); SEC v. Wickham, 12 F. Supp. 245, 247 (D. Minn. 1935).
60 UNITED STATES SAVINGS AND LOAN LEAGUE, *supra* note 15, at 51 (Table 38).

were uninsured.[61] These uninsured institutions held $4.401 billion in total assets[62] and symbolized the savings of a large number of people.

The majority's holding is surprising, not only in that it fails to follow the trend of the *Joiner, Howey,* and *VALIC* decisions, but it reaches a result at odds with the basic policy considerations involved. As Judge Cummings aptly noted, "[t]he typical savings and loan account-holder is a small investor, as unwary and in need of protection as a typical, unsophisticated holder of corporate stock."[63] Furthermore,

> [t]he investors in City Savings were less able to protect themselves than the purchasers of orange groves in *Howey.* These plaintiffs had to rely completely on City Savings' management to choose suitable properties on which to make mortgage loans. . . . The members of City Savings were widely scattered. Many of them probably invested in City Savings on the ground that their money would be safer than in stocks. They doubtless expected insurance through the Federal Savings and Loan Insurance Corporation or other sources. Through SEC regulation helpful information would be available to these investors.[64]

It is unfortunate that the majority in *Tcherepnin* chose to place these investors outside the protective shield of the antifraud provisions of the SEA, ". . . for compliance with rules and regulations under Section 10(b) of the 1934 Act . . . would not involve any excessive burden on these associations, nor is there any undue intrusion on State regulation."[65] Hopefully, the Supreme Court will follow Judge Cummings' rationale and grant the holders of withdrawable capital accounts the protection they require.

Robert W. Neirynck

FEDERAL PROCEDURE — THE EXTENT OF A LIVESTOCK BROKER'S LIABILITY FOR CONVERSION OF CATTLE IN WHICH THE FEDERAL GOVERNMENT HAS A SECURITY INTEREST IS DETERMINED BY FEDERAL LAW. — Upon obtaining an operating loan under the Bankhead-Jones Farm Tenant Act,[1] Charles E. Carson executed a promissory note payable to the United States in the amount of 18,000 dollars. The note was secured by a duly recorded mortgage on Carson's livestock and other chattels located in Mississippi. Contrary to an agreement not to sell or encumber the mortgaged property without government consent, Carson delivered some of the mortgaged cattle to W. R. Ellis, a Tennessee livestock broker. Ellis then sold the cattle for approximately 1875 dollars and transferred to Carson the proceeds of the sale, keeping approximately 235 dollars in commissions. After Carson was declared bankrupt, the Government

61 *Id.*
62 *Id.* at 52 (Table 39).
63 Tcherepnin v. Knight, 371 F.2d 374, 384 (7th Cir.) (dissenting opinion), *cert. granted,* 87 S. Ct. 2076 (1967).
64 *Id.* at 384-85 (dissenting opinion).
65 *Id.* at 384 (dissenting opinion).

1 Consolidated Farmers Home Administration Act of 1961 § 311-16, 7 U.S.C. § 1941-46 (1964).

filed a complaint in the United States District Court for the Western District of Tennessee against both Carson and Ellis, alleging that they had converted property in which the Government had a security interest. The district court held that state law should determine the extent of Ellis' liability. Since Tennessee law limits recovery in this type of situation to the amount retained by the livestock merchant at the time demand is made, judgment was entered against Ellis for the 235 dollars. The Government, contending that federal law should have been applied, appealed, and the United States Court of Appeals for the Sixth Circuit in reversing and remanding, *held:* the extent of liability for the conversion of property in which the Government has obtained a security interest, as the result of an operating loan made under the Bankhead-Jones Farm Tenant Act,[2] is to be determined by federal law; and the correct measure of damages under federal law is the fair market value of the property. *United States v. Carson*, 372 F.2d 429 (6th Cir. 1967).

With its decision in *Carson,* the Sixth Circuit became involved in a dispute that has produced a split among the circuits on the question of the liability of a commission merchant who sells livestock in which the Government has acquired a security interest by way of an agricultural loan. In a fact situation similar to that involved in *Carson,* the Ninth Circuit held in *United States v. Matthews*[3] that federal law should determine an auctioneer's liability for selling cattle on which the federal government held a lien as security for a loan extended by the Farmer's Home Administration.[4] In *United States v. Sommerville,*[5] the Third Circuit adopted a view similar to the *Matthews* court by holding that federal law determines an auctioneer's liability and that, under federal law, such liability remains even though the auctioneer sells without knowledge of the recorded security agreement.[6] In *United States v. Kramel,*[7] the Eighth Circuit adopted the opposite view by applying Missouri law to dismiss an action against commission dealers for conversion of a cow included in a chattel mortgage held by the Farmer's Home Administration. And the Fourth Circuit, in *United States v. Union Livestock Sales Company,*[8] also applied state law "under precisely similar circumstances"[9] as existed in *Kramel.*[10] The *Carson* court, taking notice of this divergence in opinion, stressed the importance of the issues involved:

2 *Id.*
3 244 F.2d 626 (9th Cir. 1957). It should be noted that both litigants in *Matthews* agreed that federal law was applicable.
4 *Id.* at 628.
5 324 F.2d 712 (3d Cir. 1963), *cert. denied,* 376 U.S. 909 (1964).
6 *Id.* at 717-18.
7 234 F.2d 577 (8th Cir. 1956).
8 298 F.2d 755 (4th Cir. 1962).
9 *Id.* at 757.
10 Various district courts have also participated in the divergence of views. United States v. Sig Ellingson & Co., 164 F. Supp. 7 (D. Mont. 1958) expressly followed *Matthews* in applying federal law in assessing the liability of a Montana livestock commission auctioneer who sold cattle subject to a chattel mortgage in favor of the Government; United States v. Ferguson, 158 F. Supp. 814 (E.D. Ark. 1958) expressly followed *Kramel* in applying the law of Arkansas to determine the liability of commission merchants for the conversion of cows in which the Government held a security interest; United States v. Covington Independent Tobacco Warehouse Co., 152 F. Supp. 612 (E.D. Ky. 1957) assumed without discussion that state law controlled a commission mechant's liability for the conversion of tobacco in which the United States had a security interest pursuant to an FHA loan.

"Far more is involved here than a few head of cattle. This case raises serious issues both of federalism and of the separation of powers of the branches of the federal government."[11]

In deciding that federal law should govern, *Carson* relied heavily on the landmark case of *Clearfield Trust Company v. United States.*[12] In this case, the Supreme Court held that the United States, as drawee of a government check, could avail itself of its right under federal law to enforce Clearfield's guaranty of prior endorsements. In addition to furnishing the basic rationale for the court's decision in *Carson,* the holding in *Clearfield* allowed the court to distinguish the rule set out in *Erie Railroad Company v. Tompkins.*[13] As Judge McCree, the author of the opinion, pointed out:

> *Erie,* which curtailed the power of the federal courts to enunciate federal common law when federal jurisdiction was founded solely on diversity of citizenship, was concerned with the unconstitutionality of federal judicial lawmaking in areas beyond the reach of Congressional legislation. 304 U.S. at 72, 58 S. Ct. 817. *Clearfield* and the cases cited therein emphasize that the federal courts should determine the governing rule or law "according to their own standards" in areas where constitutionally valid federal legislative programs have been commenced. Where a decision is likely to have a substantial effect on the implementation of a federal program, then a federal court should declare a rule consistent with the program's demands.[14]

However, the *Carson* court noted that the application of the *Clearfield* doctrine does not automatically prescribe the application of uniform federal law, since as "[t]he Court noted in *Clearfield:* 'In our choice of the applicable federal rule we have occasionally selected state law.' "[15] But "[i]n the instant situation, however, formulation of a uniform federal rule, rather than adoption of the laws of the several states as the federal rule, is the more appropriate alternative."[16]

The previously mentioned conflicting circuit court decisions stressed various factors in deciding whether to apply state or federal law. The court in *Kramel* placed considerable weight on the element of the legislative intent behind the federal statute authorizing the loan. The Eighth Circuit concluded that one reason for the application of state, rather than federal, law is the apparent lack of congressional intent to the contrary:

> This legislation was general in its intention to make or to insure loans in all States. Congress must have known that State laws affecting or protecting titles and their attributes — such as possession for example — are not identical in all of the states. Yet this legislation omitted any reference to this inevitable situation. From this omission we must conclude that here Congress did not deem that the complete uniformity now urged by the Government was necessary to effectuate the purposes it intended to accomplish by the Act.[17]

11 United States v. Carson, 372 F.2d 429, 431 (6th Cir. 1967).
12 318 U.S. 363 (1943).
13 304 U.S. 64 (1938).
14 United States v. Carson, 372 F.2d 429, 432 (6th Cir. 1967).
15 *Id.*
16 *Id.*
17 United States v. Kramel, 234 F.2d 577, 581 (8th Cir. 1956).

The court in *Carson* placed considerably less emphasis on legislative intent, and in fact, the court's only statement on the subject was an admission that a congressional desire for uniformity cannot be inferred from the Bankhead-Jones Farm Tenant Act itself.

> Congress, of course, is the primary source of federal law, and the federal courts must adhere to the intent of Congress whenever this intent is discernible. When Congressional intent is not expressed or otherwise ascertainable, however, the courts may, within reasonable bounds, utilize the techniques of the common law to reach the appropriate rules for disposition of the controversies before them.[18]

Failing to find legislative intent, the *Carson* court faced a basic policy question. This involved a weighing of the need to apply uniform federal law against countervailing state interests. The court in *Union Livestock* saw no need for the application of federal law in this area.

> We find no need for uniformity in these transactions throughout the United States. On the contrary, it seems to us that the interest of the Government and of the borrower will be properly protected if the local rules governing dealings in the transfer of property, which have been built up by the experience in like transactions and are familiar alike to the courts and the citizens of the several localities, are given application. Moreover, the general purpose of the statute to give aid and assistance to the farming community will be promoted if the loans are made in accordance with local practice.[19]

This statement is in contrast to that of the court in *Sommerville:*

> [T]he power of the United States to protect its purse is operative. Potential financial injury to the United States is apparent. The duty to mold a federal rule is clear. . . .
>
> . . . The interest of the United States in the administration of the loan program would be undermined and its power to protect its purse limited if disparate laws of individual states were applied to substantially identical loan transactions.[20]

Carson adopted a view similar to that enunciated in *Sommerville.* The court stated:

> The Bankhead-Jones Farm Tenant Act established an extensive federal lending program to help assure the efficient and productive use of our agricultural resources. The act requires that the loans made by the government be adequately secured. 7 U.S.C. § 1946. A uniform federal rule governing the liability of livestock brokers dealing tortiously with mortgaged property will help prevent the security interests of the United States from being unjustifiably defeated. See United States v. Sommerville, supra.[21]

18 United States v. Carson, 372 F.2d 429, 432 (6th Cir. 1967).
19 United States v. Union Livestock Sales Co., 298 F.2d 755, 759 (4th Cir. 1962).
20 United States v. Sommerville, 324 F.2d 712, 716 (3d Cir. 1963), *cert. denied,* 376 U.S. 909 (1964).
21 United States v. Carson, 372 F.2d 429, 432-33 (6th Cir. 1967).

In *Carson*, the Sixth Circuit also relied heavily on its own decision in *United States v. Helz*[22] to justify the application of uniform federal law. *Helz* involved an unsecured loan made under the National Housing Act;[23] the court held, despite Michigan law to the contrary, that the United States could sue the wife of a man discharged in bankruptcy for the balance due on a Federal Housing Administration note executed by both husband and wife.[24] The court in *Carson* found support in the following language:

> In cases affecting government money and the credit of the government, the authorities set up the principle that federal law should apply. . . . Local rules limiting the effectiveness of the remedies available to the United States for breach of a federal duty cannot be adopted.[25] (Footnotes omitted.)

The *Carson* court was compelled to resolve one problem not encountered by the courts in *Matthews, Sommerville,* or *Union Livestock.* In 1966, the Supreme Court decided the case of *United States v. Yazell.*[26] The holding in *Yazell* indicates that even if the pecuniary interests of the federal government under a broad lending program are involved, there may be factors dictating the adoption of state law.[27] A Small Business Administration disaster loan had been made to Mr. and Mrs. Yazell; the Government urged that Mrs. Yazell should be precluded from relying on the Texas law of coverture to protect her separate property from the Government's efforts to obtain repayment of the loan. However, the Supreme Court rejected the Government's contention and held that state law applied. The Court reasoned:

> None of the cases in which this Court has devised and applied a federal principle of law superseding state law involved an issue arising from an individually negotiated contract. None of these cases permitted federal imposition and enforcement of liability on a person who, according to state law, was not competent to contract. None of these cases overrode state law in the peculiarly state province of family or family-property arrangements.[28]

The determinative factors in *Yazell* should be noted: (1) the loan contract was individually negotiated; and (2) a familial relationship was involved. Absent such factors, there is no indication that the Court would have reached the same decision. Thus, the Sixth Circuit capably distinguished *Carson* from *Yazell*:

> In the present case, there is no evidence that the FHA-Carson agreement was the type of "custom-made, hand-tailored, specifically negotiated transaction" (382 U.S. at 348, 86 S. Ct. at 504) which the Supreme Court determined the SBA-Yazell loan to have been, and on which the Court relied heavily in its decision. . . . Even if the FHA-Carson agreement had been as carefully negotiated as the SBA-Yazell agreement, the dispute in-

22 314 F.2d 301 (6th Cir. 1963).
23 12 U.S.C. § 1702-06d (1958).
24 United States v. Helz, 314 F.2d 301, 303 (6th Cir. 1963).
25 *Id.*
26 382 U.S. 341 (1966).
27 United States v. Carson, 372 F.2d 429, 433 (6th Cir. 1967).
28 United States v. Yazell, 382 U.S. 341, 353 (1966). Interestingly, the Court found it unnecessary to decide whether state law applied by reason of adoption of federal law or *ex proprio vigore.*

> volved here is not with the borrower, Carson, but with Ellis, who was not a party to any negotiations with the government. . . .
>
> There is another important difference between the instant case and *Yazell*. This case does not involve the "peculiarly local" (382 U.S. at 353, 86 S. Ct. 500) matter of family property rights and liabilities involved there.[29]

The logic and rationale behind the decision in *Carson* seem sound. Conceding that Congress did not expressly provide for the application of uniform federal law, it does not follow that congressional intent was lacking. As the Fifth Circuit stated in *Fahs v. Martin:*[30]

> [I]n areas where Congress has legislated extensively so as to establish a general policy, that *policy* may furnish the answer to a particular question, even though the federal statutes do not expressly answer it, and though a state statute expressly enacts a contrary rule.[31]

It is certain that the eventual repayment of loans is an integral and essential part of the agricultural credit program. Permitting a state law to interfere with and hinder the program is unjustifiable when the elements present in *Yazell* are not involved. Moreover, the Secretary of Agriculture is specifically authorized to make loans upon such security as he "may prescribe,"[32] and it would greatly frustrate that authorization if local laws could be used to defeat the Government's security interests.

There is almost universal agreement among the states that a livestock broker in a situation similar to that in *Carson* would be liable for conversion. The court in *Union Livestock* noted:

> The almost universally accepted rule is that an agent, factor, commission merchant or auctioneer who receives property from his principal and sells it and pays the proceeds of the sale to him is guilty of conversion if the principal has no title to the property, even though the agent acts without knowledge of the defect in the title.[33]

It is also well settled that the measure of damages, in an action for the conversion of personal property, is the market value of the property at the time of the conversion.[34] Thus, it is quite possible that Congress, under the assumption that the Government would have a cause of action for the market value of the converted property in which it held a security interest, thought it unnecessary to enunciate a uniform federal rule.[35] The court in *Union Livestock* felt that the interests of the Government would be properly protected by the application of

29 United States v. Carson, 372 F.2d 429, 433-34 (6th Cir. 1967).
30 224 F.2d 387 (5th Cir. 1955).
31 *Id.* at 392.
32 7 U.S.C. § 1946 (1964).
33 United States v. Union Livestock Sales Co., 298 F.2d 755, 760 (4th Cir. 1962). *See* Annot., 96 A.L.R. 2d (1964).
34 2 A. SEDGWICK, DAMAGES § 493, at 950 (9th ed. 1920); 4 J. SUTHERLAND, DAMAGES § 1109, at 4209 (4th ed. 1916). Of course, Tennessee law, giving rise to the dispute in *Carson*, varies from the general rule.
35 S. REP. No. 566, 87th Cong., 1st Sess. 69-71 (1961), involving the pertinent sections of the Agricultural Act of 1961, reveals no indication of congressional intent on the precise issue under consideration.

state law, but as *Carson* illustrates, in some jurisdictions the security interests of the Government would be defeated by following state law.

In addition, the general policy of giving aid and assistance to the farming community is not disrupted by the application of federal law. Assistance is given in the form of loans, and the application of federal law to determine the extent of the liability of an auctioneer or commission merchant does not hamper the original lending process in any way.[36]

The court in *Union Livestock* concluded that the loans should be *made* in accordance with local practice. However, the real issue in both *Union Livestock* and *Carson* involves the *enforcement* of a security interest that has already been validly created under state law. This distinction between the creation and enforcement of a security interest was enunciated by the Ninth Circuit in *Bumb v. United States*.[37] The court in *Bumb* held that the Small Business Administration, as an intended mortgagee of personal property located in California, was not exempt from state law concerning recording requirements in a bulk sales transaction. The court noted that local requirements must predominate when the creation of a security interest is at issue, for such requirements "are designed to protect local creditors against undisclosed action by their local debtors which impair the value of their claims."[38] However, the decision in *Bumb* is not inconsistent with the holding in *Carson*, and the court in *Bumb* noted that the pertinent state law

36 Indeed, numerous cases involving federal loan statutes have held that the rights of the parties are to be determined under federal law. *See, e.g.*, Clark Inv. Co. v. United States, 364 F.2d 7 (9th Cir. 1966) (a person choosing to redeem property foreclosed by the Federal Housing Administration was not entitled to a deduction of rents from the redemption price as would be allowed by Idaho law); United States v. Sylacauga Properties, Inc., 323 F.2d 487 (5th Cir. 1963) (in determining when to foreclose on an FHA mortgage after default, discretion lay with the Federal Housing Commissioner and was not regulated by local law); United States v. View Crest Garden Apts., Inc., 268 F.2d 380 (9th Cir.) *cert. denied,* 361 U.S. 884 (1959) (in an action by the Government to foreclose an FHA mortgage and for the appointment of a receiver, federal law is applicable); United States v. McCabe Co., 261 F.2d 539 (8th Cir. 1959) (the cause of action accruing to the United States against an insolvent grain warehouseman for its conversion of grain covered by warehouse receipts owned by the Commodity Credit Corporation could not be taken away by state legislation assertedly giving the sole cause of action against the warehouseman to the state public service commission); McKnight v. United States, 259 F.2d 540 (9th Cir. 1958) (federal law applies in a suit brought by the United States against a veteran to recover the amount which the Government had been required to pay as guarantor on a loan obtained by the veteran pursuant to the Serviceman's Readjustment Act of 1944); United States v. Fleming, 69 F. Supp. 252 (N.D. Iowa 1946) (federal law applies when a mortgagor sells corn subject to a lien held by the Commodity Credit Corporation pursuant to a corn loan).

37 276 F.2d 729 (9th Cir. 1960).

38 *Id.* at 738. An additional rationale for the distinction between the creation and enforcement of a security interest is furnished by the following statement:

> Thus state recording acts interfere with no federal policy as there is no federal recording system for the type of mortgages here involved. It is commercially convenient to adopt existing state systems as it saves the expense of setting a whole new federal recording system and it enables persons checking ownership interests in property to refer to one set of record books rather than two. . . .
>
> A different set of factors come into play when the planning stage and the working stages of the agreement have been terminated. After a default the sole situation presented is one of remedies. Commercial convenience in utilizing local forms and recording devices familiar to the community is no longer a significant factor. Now the federal policy to protect the treasury and to promote the security of federal investment . . . becomes predominant. Local rules limiting the effectiveness of the remedies available to the United States for breach of a federal duty can not be adopted. United States v. View Crest Garden Apts., Inc., 268 F.2d 380, 383 (9th Cir.), *cert. denied,* 361 U.S. 884 (1959).

> regulates only the manner of acquisition of a valid security interest, and does not purport to regulate the remedy of the mortgagee after default by the mortgagor in foreclosing the validly created security interest and liquidating the loan which the chattel mortgage was given to secure.[39]

Hence, far from conflicting, *Yazell, Bumb,* and *Carson,* taken together, stand for the principle that once a security interest has been validly created according to the requirements of state law, the federal government's ability to enforce that interest should be determined by federal law, unless an individually negotiated contract or a familial relationship is involved. Uniform application of such a principle could alleviate much of the confusion and conflict now troubling those federal courts faced with controversies similar to that in *Carson.*

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39 Bumb v. United States, 276 F.2d 729, 737 (9th Cir. 1960).