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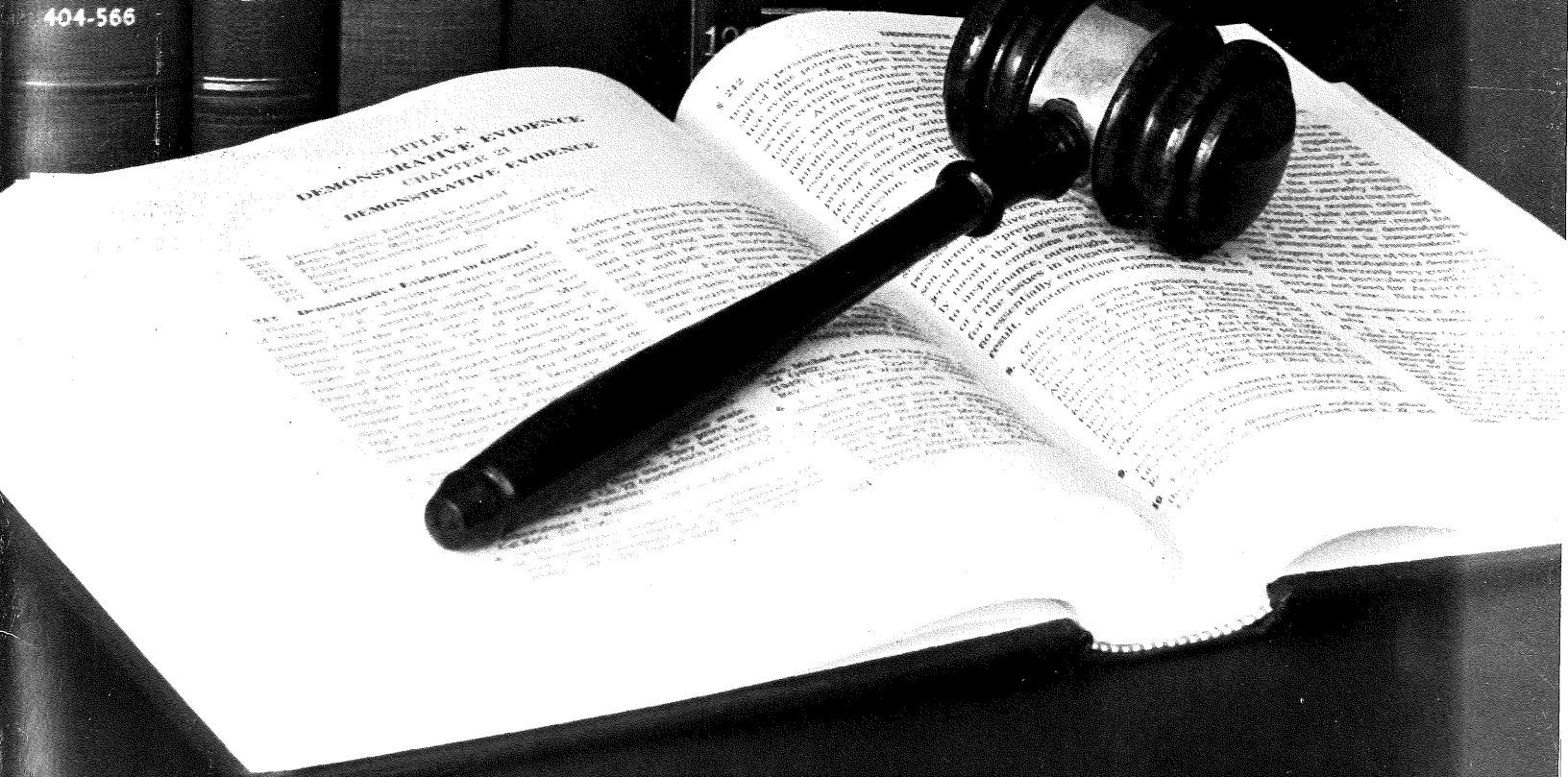
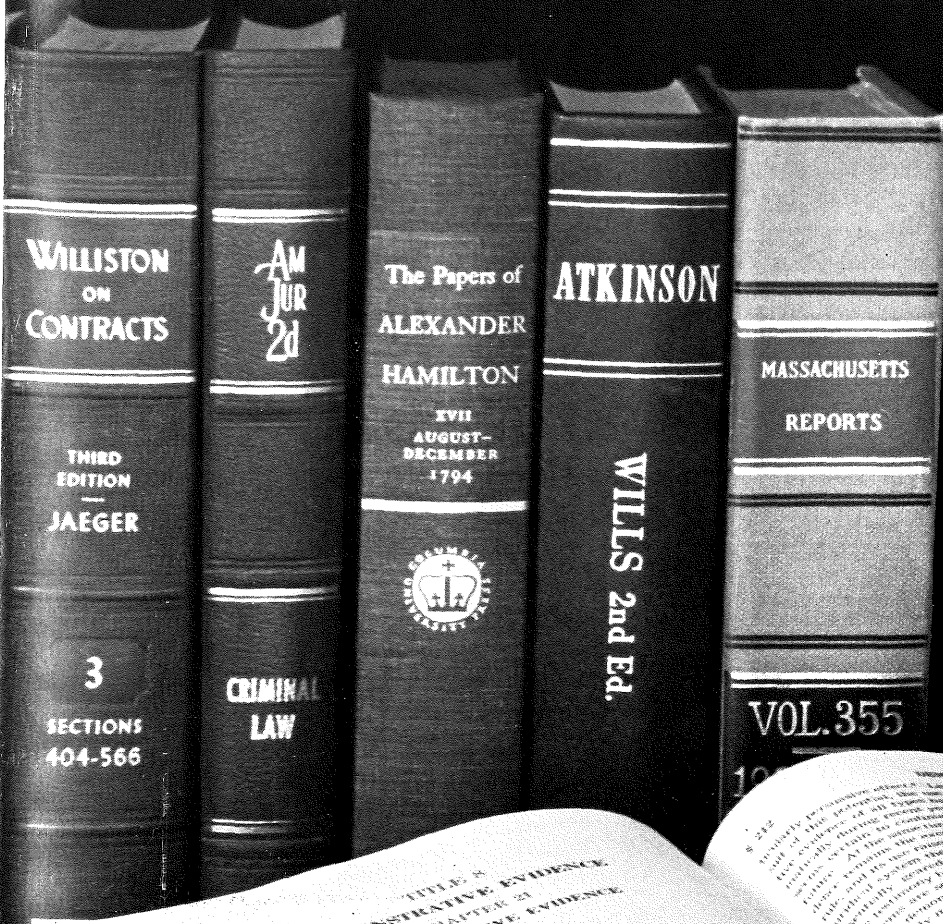
the Advocate

Volume 9 No. 1, Fall 1977

The Suffolk University Law School Journal

Applying the Minimum Contacts Test to Jurisdiction

An Argument for Loss- of-Bargain damages in Churning Cases



Congratulations!

TO CRAIG M. BROWN, JOSEPH B. COLLINS and
PAUL E. MORTON, the Moot Court Team of Suffolk
University Law School.

The brief prepared by the Moot Court Team
was judged to be *the best brief* submitted in the
Region I Division of the National Moot Court
Competition. Thirteen law schools participated
in the Regional Competition.

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young men. They are indeed a credit to Suffolk
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Volume 9 No. 1, Fall 1977

The Suffolk University Law School Journal

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The ADVOCATE is a publication of Suffolk University Law School. Our current circulation of 8,500 is centered in the New England area. The ADVOCATE is published three times a year: orientation, fall and spring issues. The orientation issue is distributed to law students only.

The objectives of The ADVOCATE are to publicize the activities and outstanding achievements of the Law School and to present articles by students, faculty and guest writers on timely subjects pertaining to the law.

All articles and editorials reflect the personal views of the authors and are not necessarily the views of the administration or faculty of Suffolk University Law School.

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Sovereign Immunity is Dead

Mr. Sarapas has been an attorney in Worcester since passing the Bar in 1948. He graduated from Boston University Law School cum laude in 1948 at the age of 21.

In addition to serving as chairman of the Governor's Advisory Council to the Legal Services Corp., Mr. Sarapas is a member of the Worcester Human Rights Council, the American Bar Association, the Massachusetts Bar Association, and the Worcester Bar Association.

Mr. Sarapas successfully argued the case of Whitney v. City of Worcester before the Supreme Judicial Court. It is discussed in the following article.

The Doctrine of Sovereign Immunity, as we have known it for many years, died with the decision in *Whitney v. The City of Worcester*.¹ To fully understand the implications of the case, it is necessary to begin with a case decided four years ago: *Morash & Sons, Inc. v. Commonwealth*.²

The Morash Case:

In the *Morash* case, individuals owning land adjacent to land on which the Department of Public Works stored road salt, sought to enjoin the use of the Commonwealth's property and to recover damages for the resulting pollution. The court created an additional exception to the sovereign immunity doctrine, holding that the Commonwealth is not immune from liability for the creation or maintenance of a private nuisance which causes injury to the real property of another. The court could have stopped there, but instead, went on to declare that the immunity doctrine is logically indefensible and that further discussion was warranted.

The Supreme Judicial Court pointed out that the immunity doctrine has served to prevent recovery in a large and varied line of cases.³ Some exceptions to the doctrine had been established by statute. Beyond that, most exceptions to the doctrine were judge-made, and "grounded in factors that have no necessary relationship to accepted tort principles, equitable principles, or principles of sound policy."⁴

They conclude by saying "(t)he Judge-made exceptions reflect a partial and piecemeal adjustment by the Courts of a doctrine that, if applied in all cases indiscriminately, would bring about some unjust results. We have shown that the exceptions, born of expediency, are not based upon sound legal principles or sound public policy. There are persuasive reasons why the Governmental Immunity Doctrine applicable to the Commonwealth and its subdivisions should be abolished."⁵

The Court noted "that there are also good and controlling reasons why at this time, this Court should not abrogate the

doctrine. *Preferably, the change should be accomplished by legislation,*" (emphasis supplied).⁶ They also felt "that the Legislature should be afforded an opportunity to do this by a comprehensive statute. If immunity is abrogated by the Court, limits and exceptions must be established in good order thereafter by an attenuated case by case process."⁷

The Court refrained from abolishing the doctrine of sovereign immunity at that time, "not merely because we have accepted the doctrine for many years, but also because the comprehensive approach available to the Legislature is the preferable course."⁸

Having made this statement, the Court waited. It waited for four years, until *Whitney*.

The Whitney Case

Kris Whitney and his father, Glen A. Whitney, brought an action to recover for personal injury and consequential damages caused by the alleged negligence of the defendants, the city of Worcester, the members of the city school committee, the city superintendent of schools, the principal and assistant principal of the Downing Street School in Worcester, two elementary teachers at the school and the school custodian.

The complaint alleged that Kris, was six years of age on June 18, 1974, and a pupil in the Worcester Public Schools, attending Downing Street School. He was totally blind in his left eye and had only limited vision in his right eye due to congenital glaucoma. According to the plaintiffs' substitute complaint, on the evening of June 17, 1974, the day before the alleged accident, Kris Whitney experienced hemorrhaging within his right eye, and that this condition continued to be present on the day of the accident, June 18, 1974.

On June 18, 1974, as Kris Whitney was proceeding inside the school building to the school yard, he was struck on the head by a door causing him to be rendered totally blind in the right eye. The action was dismissed as to all defendants but the school custodian, who

filed an answer to the merits. The plaintiffs appealed from the final judgments of dismissal.

Ramifications of the Case

The Court had previously voiced its conclusion that "the Governmental Immun-

ity Doctrine and convoluted scheme of rules and exceptions which have developed over the years are unjust and indefensible."⁹ On those previous occasions, however, "comprehensive legislative action was preferable to judicial abrogation."¹⁰ They cited the *Morash* case as well

as others. They went on to indicate that "four (4) years had passed since *Morash* in which the legislature has apparently been unable to formulate a workable solution."¹¹ However, after waiting four years, to wait another two years, or less if the Legislature acted before the end of



the session, would not be unreasonable under the circumstances.

“Accordingly, we state our intention to abrogate the Doctrine of Municipal Immunity in the first appropriate case decided by this Court after the conclusion of the next (1978) session of the Legislature, provided that the Legislature at that time has not itself acted definitively as to the Doctrine. Thereafter, when appropriate cases concerning State and County Immunity are presented, it is our intention to take similar action to abrogate immunity.”¹²

In *Whitney*, the Court did not completely eliminate the doctrine of sovereign immunity. For example, the actions of the School Committee, the Superintendent of Schools, and the Principal, fell “outside the scope of liability, for the alleged conduct is *discretionary* rather than ministerial” (emphasis supplied).¹³ The Court found that “the alleged negligence in ordering Kris to attend this particular school cannot be separated from the policy making and planning functions of school administration, and no liability thereby attaches.”¹⁴ It would be “inappropriate for Courts to examine the soundness of such decision making in an action for damages.”¹⁵

As to those defendants, the doctrine of sovereign immunity still applied. Presumably it would also apply to others in similar circumstances. However, as to the other defendants — namely, the City of Worcester, the assistant principal, and one elementary teacher at the school — the doctrine is, for practical purposes, abandoned.

Reasoning of the Court

The Court, having waited four years, took the action it did in an effort to get the Legislature to act. As will be seen, its effort may or may not be successful.

While the Court felt that “the four years which have elapsed since *Morash* have provided ample opportunity for Legislative action,”¹⁶ they nevertheless would continue to forebear on the grounds that “Legislative action on the subject of Sovereign Immunity is almost sure to follow any action on our part.”¹⁷

The Court reviewed the history of the doctrine of sovereign immunity in those states where it had been judicially abrogated. In just about every jurisdiction where this had happened, the “judicial action has been followed by legislative action which modified and in some cases completely nullified, the action of the judiciary.”¹⁸

Municipal Liability

Under the existing law a municipality “is not liable for negligent or otherwise tortious acts in the conduct of its schools.”¹⁹ Although the doctrine has been somewhat buffeted, “[O]ne basic principle of immunity emerges: ‘The underlying test is whether the act is for the common good of all without the element of special corporate benefit or pecuniary profit. If it is, there is no liability; if it is not, there may be liability.’”²⁰

The Court concludes that they would abandon the “misfeasance — nonfeasance distinction as a relevant factor. Personal immunity of the public officer, indeed that of public servants, would be determined by the discretionary-ministerial criteria discussed, supra, continued assurance that public officers will perform their duties effectively, free of inordinate fear of personal liability, may be achieved by the municipalities providing indemnity for employees, by insurance or otherwise, under statutes. . . .”²¹

Application of the Principles

Although the conduct of “[T]he teachers ‘order’ to Kris to proceed to recess in the course of normal school routine without supervision is directly analogous to the order of the teacher in *Desmarais vs.*



Wachusett Regional School District, 360 Mass. 591 (1971), to his students to perform chemical experiments without enforcing the wearing of safety glasses,"²² that failure would not render the teacher "immune" even though "there was no misfeasance". The Court found the same thing insofar as the teacher and the assistant principal ordering Kris to remain in the classroom.

The actions of the School Committee and of the Superintendent of Schools and the School Principal, however, are policy-making functions as opposed to the function of carrying the policy out. Therefore, the Court felt that those defendants should not be liable.

What Will the Legislature Do

It is abundantly clear from the case that the Court would much prefer to have the Legislature act. Whether or not the Legislature will act remains to be seen. The principal mover of corrective legislation in the Senate appears to be Senator Robert E. McCarthy, of the Bristol, Plymouth and Norfolk District. He introduced Sen-

Although Senator McCarthy does not feel that this Section is necessarily desirable, it was inserted as a compromise measure. Assuming that the Legislative Act passes at all, it remains to be seen whether the Supreme Judicial Court will allow recoveries of more than \$100,000.

Where the Bill Stands Now

Although the Bill has passed the Senate, it has not as yet passed the House. As of the date of this writing, it is with the House Ways and Means Committee. In talking with one employee of the Committee, it was pointed out that the Committee is very busy; that the Court did give the Legislature until 1978; and that the Committee was quite concerned with the cost to the Commonwealth and its subdivisions of this legislation. It was also pointed out that the Selectmen of the State have asked for a delay at least until the 1978 Session. Finally, it was pointed out that if the House Ways and Means Committee failed to act during 1977, then the Bill would die in the Senate as well and would have to be revived in 1978.



ate No. 1927, superseding Senate 675, Senate 1894 and House 6476 by its passage in the Senate in October.

The Bill²³ basically follows the guidelines as set forth by the Supreme Judicial Court, except that it sets a basic limit of \$100,000.00 for the amount that can be recovered from a municipality. The Supreme Judicial Court, however, did not necessarily set any limit to the recovery.

Footnotes

1. *Whitney v. City of Worcester*, No. W-562, (Mass. S.J.C. 1977).
2. 363 Mass. 612 (1973).
3. *Id.* at 620.
4. *Id.* at 621.
5. *Id.* at 623.
6. *Id.* at 624.
7. *Id.* at 623.
8. *Id.* at 624.
9. *Whitney v. City of Worcester*, No. W-562, slip op. at 2. (Mass. S.J.C. 1977).

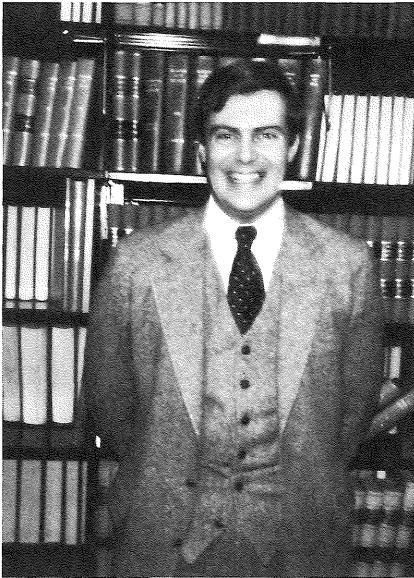


10. *Id.*
11. *Id.*
12. *Id.* at 3.
13. *Id.* at 21.
14. *Id.*
15. *Id.* at 22.
16. *Id.* at 3.
17. *Id.*
18. *Id.* at 4.
19. *Id.* at 7.
20. *Id.* (quoting *Bolster v. Lawrence*, 225 Mass. 337, 390 (1917)).
21. *Id.* at 18 (quoting G.L. Chapt. 40, §5 or G.L. Chapter 4), §§ 100A, C, and D).
22. *Id.* at 20.
23. Mass. Senate Bill No. 1927 reads in pertinent part:

Section 1B. A district may sue and be sued by its name to the same extent and upon the same conditions as a city or town. Districts shall have power and authority to assess member cities and towns for the purpose of paying a proper charge to effect insurance for payment of damages incurred pursuant to chapter two hundred and fifty-eight, or for the purpose of paying a proper charge for payment of damages incurred pursuant to such chapter, and shall have power and authority to defend their interests in civil actions brought pursuant to said chapter.

Applying The Minimum Contacts Test for Jurisdiction

by John F. Klipfel



Mr. Klipfel is a third year day student.

Jurisdiction over the parties in a law suit was originally tied to the parties' physical presence within the forum state.¹ Increased mobility and expanding commercial interdependence among the states increased the desirability of extending jurisdiction beyond state lines.² The now typical "long arm" statute³ permits jurisdiction whenever a court finds "minimum contacts" between the forum and the defendant such that "traditional notions of fair play and substantial justice" are not offended by the court's taking jurisdiction.⁴ Recently the United States Court of Appeals for the First Circuit in *Vencedor Mfg. Co. v. Gougler Industries (Vencedor)*,⁵ extended the "minimum contacts" approach, upholding jurisdiction over a nonresident defendant who had not initiated sales within the forum territory.

Contacts which unduly burden a defendant-seller and which are not initiated by the defendant offend substantial justice, however, and should not support a finding of jurisdiction. This article will demonstrate the importance of both the initiation and commercial interest factors in measuring the taking of jurisdiction against the "minimum contacts" standard described by *International Shoe v. State of Washington (International Shoe)*.⁶

Due Process Requires Minimum Contacts

In *International Shoe* the Supreme Court upheld jurisdiction over a non resident manufacturer pursuant to a state long-arm statute. The State of Washington sought to collect unemployment taxes based on commissions of about \$31,000 paid by a shoe manufacturing firm to its salesmen operating in Washington. The company was incorporated in Delaware with its principal place of business in St. Louis, Missouri. It had no offices in Washington, although salesmen sometimes rented display rooms in the state. The salesmen solicited orders but had no authority to enter into binding contracts. All orders were initiated in Washington, but were approved and shipped from St. Louis.

The holding of *International Shoe* was extended by *McGee v. International Life Insurance Company (McGee)*,⁷ upholding jurisdiction over a nonresident insurance company on the basis of a single contract of insurance assumed by the company. The insurance company's letter of solicitation, the insurance contract and the beneficiary's status as a resident of the forum state constituted substantial contacts with the forum state despite the absence of any indication in the record that the insurance company had ever solicited business or maintained offices within the forum state.⁸

The Supreme Court subsequently restrained the expansion of in personam jurisdiction over nonresident defendants in *Hanson v. Denkla (Hanson)*.⁹ The Court stated categorically that not all restrictions on personal jurisdiction had collapsed.¹⁰ The settlor of a Delaware trust had moved to Florida where she corresponded with the Delaware trustee and performed various administrative acts. The Court denied personal jurisdiction over the nonresident trustee because the necessary "minimum contacts" were lacking.¹¹ The defendant trustee had not submitted to Florida jurisdiction since the record indicated that the trustee conducted no other business in Florida. Unlike *International Shoe*, where the defendant had initiated the contact by sending salesmen into the forum, or *McGee*, where the defendant insurance company had sent a letter to the insured asking him to reinsure with them, the trustee's obligation in *Hanson* was created in Delaware and merely continued when the settlor of the trust moved to Florida. The settlor had initiated the contacts with the forum state, not the defendant.

These cases considered only whether "minimum contacts" existed between the defendant and the forum. The Court did not concern itself with the national interests in interstate commerce. Ignoring that interest may have grave consequences not only for interstate sellers, but also for the citizens of the forum. *Vencedor* was an opportunity to consider commercial interests as well as the identity of the initiator of the contact with the forum, but



the First Circuit failed to make the analysis.

Vencedor — Missed the Opportunity

Vencedor's corporate predecessor had purchased an extruder from Chamber Brothers Company in 1964 and Chambers Brothers had continued to supply spare parts. In 1967, the defendant Ohio corporation purchased the inventory and patterns of Chambers Brothers and began doing business with Vencedor. In the six year period from 1967 to 1973, Gougler did about \$90,000 worth of business with Puerto Rican firms, including sales to Vencedor, which comprised less than .5 percent of Gougler's total sales volume. Gougler sent no salesmen, maintained no offices and sent no technicians to Puerto Rico. A representative of the firm on one occasion did pay courtesy calls on some Puerto Rican firms, but he was in the Commonwealth on vacation at the time. Gougler's Puerto Rican customers ordered their spare parts from catalogues or manuals supplied with the extruders.

In 1969 Vencedor ordered an extruder from Gougler at a cost of more than \$27,000. As with all past sales, the payment term was net cash 30 days, shipped

f.o.b. Ohio, a standard business practice of Gougler, Vencedor filed a shipper's export declaration with the United States Department of Commerce specifying Puerto Rico as the destination.¹² Vencedor's complaint alleged that a sales order was made for nickel alloy replacement augers, but Gougler supplied chrome alloy augers without informing Vencedor of the substitution. The chrome augers failed, causing substantial damage.

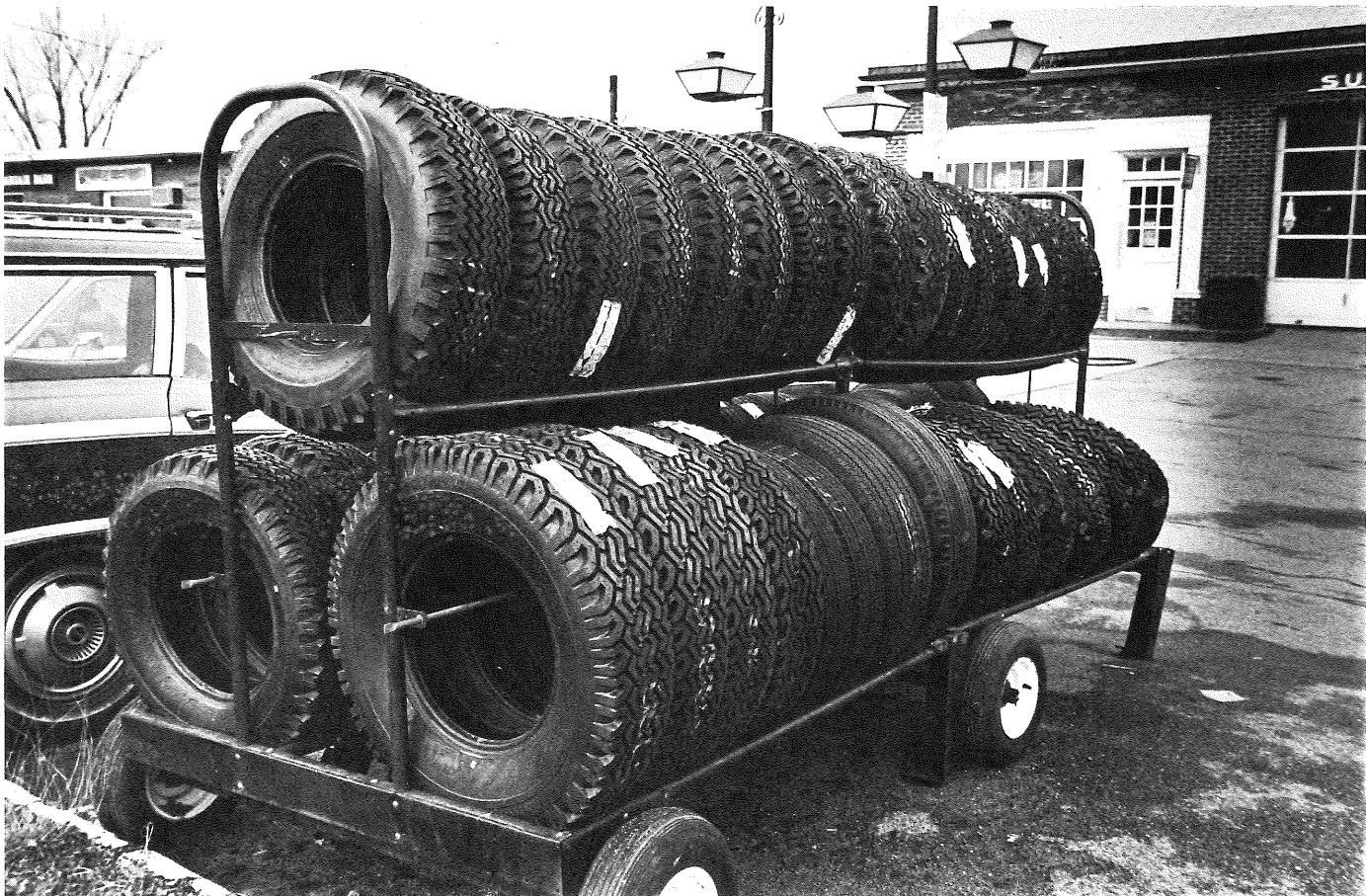
A federal court faced with a challenge to personal jurisdiction over a nonresident defendant must ask: (1) is there statutory authority for the exercise of jurisdiction under the laws of the forum state,¹³ and (2) does the state statute conferring jurisdiction meet the federal Constitutional standard of due process.¹⁴ Because the Puerto Rican "long arm"¹⁵ statute has been construed to allow jurisdiction consistent with due process,¹⁶ the two questions merge into one question and due process delineates the limits of jurisdiction conferred by the statute.

In *Vencedor*, the circuit court focused on the payment term of the contract, net cash 30 days, but refused to give any weight to the agency implications of the shipping term, f.o.b. Ohio,¹⁷ or to the

place of contracting,¹⁸ contrary to sound logic and the holdings of the other courts.¹⁹ To find the place of contracting and the agency term²⁰ of the contract irrelevant to the question of jurisdiction, but to rely on the place of performance to support jurisdiction is not consistent with the "minimum contacts" test of *International Shoe*. It eliminates consideration of the identity of the initiator of the contact with the forum and consideration of whether the defendant "submitted to" and "purposefully availed itself of" jurisdiction in the forum.

The *Vencedor* Court distinguished *Hanson* from *McGee* on two grounds,²¹ (1) the insurance contract in *McGee* was formed in the forum state when the insured dropped his acceptance into the mailbox, and (2) the insurance company in *McGee* solicited business in the forum state by sending a letter to the California insured offering to reinsure him. The First Circuit found jurisdiction without analyzing whether Gougler "submitted to" and "purposefully availed itself of" jurisdiction in the forum as required by *Hanson*.²²

Gougler received the order from Vencedor by mail and placed the product in the hands of the common carrier who,



under the terms of the contract, was acting as Vencedor's agent in Ohio. The ordering of replacement parts for the extruder was simply incidental to the contract of sale and made necessary by the continued use of the extruder, just as the duties of the settlor in *Hanson* were merely incidental acts necessary to the perpetuation of the trust.

The circuit court interpreted Gougler's sending catalogues and manuals with its extruders as unambiguous examples of solicitation,²³ evincing a purposeful conduct of business activities in the forum.²⁴ These catalogues and manuals, however, are incidental to the original sale of the extruder. The manuals were used to order replacement parts for custom made extruders when no other method for obtaining replacement parts was available to *Vencedor*. These catalogues and manuals were shipped with the extruders rather than separately and constantly over extended periods of time as would be the case with commercial advertising. The catalogues and manuals were a necessary and incidental consequence of the original sale within the meaning of *Hanson* and not an effort to solicit business on Gougler's part.

In conferring jurisdiction, the First Circuit weighted heavily Gougler's knowledge that its product was bound for Puerto Rico pursuant to the United States Department of Commerce shipper's export declaration.²⁵ A seller's knowledge of the destination of its merchandise has been a key concern of many courts both when the product was shipped directly into the forum state²⁶ and when it was sold outside the forum state but the defendant knew or had reason to know that the product would be resold in the forum state.²⁷ The serious consequences of relying on the seller's knowledge of the ultimate destination of his product are depicted by Judge Sobeloff in *Erlanger Mills Inc. v. Cohes Fibre Mills Inc.*²⁸

Judge Sobeloff's Hypothetical

Judge Sobeloff was concerned that a California service station owner might be required to defend a products liability suit in Pennsylvania after selling a defective tire to a tourist with Pennsylvania registration plates. The service station owner would know the ultimate destination of his merchandise because simple observation of the license plates²⁹ would lead to the obvious inference that this tourist would eventually use the product in Pennsylvania. This knowledge alone, however, seems insufficient to force the

service station owner to defend an action in Pennsylvania.³⁰

Judge Sobeloff put forward his hypothetical two years before the Supreme Court handed down *Hanson*. In the recent case of *Shaffer v. Heitner*³¹ the Court distinguished *McGee* from *Hanson* solely on the basis of the defendant's purposefully availing itself of conducting business activities in the forum. The defendant in *McGee* had sent a letter of solicitation into California. This element of solicitation in the forum was not present in *Hanson* and it is not present in Judge Sobeloff's hypothetical. *Hanson* would preclude jurisdiction over the California service station owner as violative of due process, but not over the producer of goods regularly shipped to another state.³²

If the service station owner sells the tire with a guarantee backed by the service station owner himself or with a catalogue detailing other parts and services available from the station, then the situation becomes analogous to *Vencedor*. It is not clear, however, that jurisdiction should attach merely because of the guarantee. The initiator of the contact is not changed. Only the presence of a paper guarantee or catalogue has been changed.

Although courts have held that a defendant should not be subjected to jurisdiction by surprise,³³ a general products distribution³⁴ or placing a product into the flow of interstate commerce has been held sufficient³⁵ grounds for jurisdiction because the defendant knows or expects the product to be used in the forum state. Gougler, however, was not involved in a general products distribution in Puerto Rico. The record shows that it sold only three extruders in six years, and then only after being approached by the Puerto Rican buyers by mail.

These facts are arguably closer to the service station hypothetical than to the highly regulated insurance industry. *McGee* spoke of a "contract which had substantial connection with the state,"³⁶ citing cases involving automobiles³⁷ and corporate securities,³⁸ which are also highly regulated industries. That the defendant's contact with the forum state involves a highly regulated industry, the quality and nature of which reflects an intense state interest, should allow for a lower "minimum contacts" standard for jurisdiction. Ordinary commercial transactions should require a higher demonstration of contacts because the state interests are not as strong. There is a

national interest in the free flow of goods and services among the states of the United States which demands a high state interest before it is overridden.

Public Policy Considerations

Judge Sobeloff's hypothetical raises another disturbing problem in terms of economic reality and public policy. If the service station owner knew that he was subject to jurisdiction and could be forced to defend the action in Pennsylvania, he might refuse to sell tires to tourists driving automobiles with out-of-state registration plates or charge an appropriately higher price to cover the costs of the risk of being sued in a remote jurisdiction. This is the probable consequence of upholding jurisdiction in a distant forum where the dollar volume of sales does not justify exposure to the potential costs of future litigation.³⁹ Similarly, had International Life known before hand that by assuming the obligations of its Arizona predecessor for the single California policy-holder it was subjecting itself to personal jurisdiction in California, it would not have assumed these obligations on the same terms, if it assumed them at all. Under the facts of *McGee*, International Life assumed the policy under the original terms.

Finding an in-state insurance company might not appear to be a terrible burden, but if the former policy holder in *McGee* was an elderly person or a young person in ill health, this person might have to pay exorbitant rates. The ramifications of taking jurisdiction go beyond the individual tourists. Puerto Rico is not a large industrial center and the dollar volume of purchases by its industries is small. If suppliers are subject to in personam jurisdiction for a sales volume of a mere one half of one percent of total sales, then these companies may well refuse to sell to Puerto Rican industries. The volume of sales does not warrant the risk of expending large litigation costs defending a law suit in a distant and inconvenient forum so the companies will either raise their rates proportionately to cover this added risk or just curtail sales. Either alternative causes hardship to the other residents of the forum.

First Amendment Protects Publishers

Courts have held that because of the First Amendment guarantees, jurisdiction over a nonresident newspaper in a libel action can only be sustained where the total circulation volume is large in relation to the

possible recovery.⁴⁰ To allow in personam jurisdiction otherwise would be to deny the citizens their First Amendment right to read these publications. Publishers would tend to curtail circulation in areas⁴¹ where potential profits did not outweigh potential costs. While a newspaper may be immune from in personam jurisdiction because of the First Amendment rights implicated in its business, those rights are impinged by the economics of business common to all industries. A manufacturer will simply decline to sell his product or raise his rates appropriately if the costs, including insurance covering the risk and costs of litigation exceed the expected profits.

Commerce Clause Protects Majority

Other Constitutional provisions militate against extending in personam jurisdiction over nonresident defendants when the defendant did not initiate the contact with the forum and when the cost of defending suits in the forum would cause business to avoid the forum. The Commerce Clause gives Congress the power "to regulate Commerce . . . among the states," and that power via the Supremacy Clause, could limit the power of state legislatures to enact jurisdictional statutes.⁴² Granting jurisdiction on minimal contacts inhibits interstate commerce. Businesses will distribute their products only where the potential profits outweigh the potential costs of doing business, including the defense of suits. To be unconstitutional, however, the state acts must not only inhibit interstate commerce, but they must do so unreasonably.⁴³ It can be argued that providing purchasers with convenient forums to sue promotes interstate commerce and any inhibition of commerce among the states is reasonable in light of this factor.

In providing a forum for suits against nonresident businesses causing damage to citizens of the forum, the state legislature is protecting the damaged citizen, his creditors and his family. The state has a valid interest in assuring that its citizens do not become impoverished, possibly requiring public assistance, through the tortious acts of nonresidents. The interest, however, is as well served by allowing such suits only when the domicile of the nonresident business will not allow the injured citizen to retain counsel and sue in the forums of that state. When the citizen initiated the contact which resulted in injury, such an alternative is even more desirable, and possibly



required under the "minimum contacts" test of *International Shoe*.⁴⁴ Moreover, providing for jurisdiction on minimal contacts, impinges the interests of other citizens of the state in obtaining the goods or services supplied by the nonresident business. When the injured citizen may sue in the state where the nonresident is domiciled, his interests do not outweigh the interests of his fellow citizens and a jurisdictional statute which permits jurisdiction over the nonresident is unreasonable. The creation of such "long arm" jurisdictional statutes triggered by minimal contacts unreasonably

inhibits interstate commerce and hence violates the Commerce Clause.

Footnotes

1. *Pennoyer v. Neff*, 95 U.S. 714, 722 (1877).
2. *International Shoe v. State of Washington*, 326 U.S. 310 (1945).
3. Cal. Civ. Proc. Code § 410.10 (West) which provides that: "A court of this state may exercise jurisdiction on any basis not inconsistent with the Constitution of this state or of the United States."
4. 310 U.S. at 316.
5. No. 76-1459 (1st Cir. June 20, 1977).
6. 310 U.S. at 316. This case has been criticized because of the Court's failure to adequately define the "minimum contacts" test which makes

it difficult to specify exactly which factors a court will consider important when granting jurisdiction. *Developments in the Law—State Court Jurisdiction*, 73 HARV. L. REV. 909, 925 (1960).

7. 355 U.S. 220 (1957).
8. 355 U.S. at 223. The premiums were mailed from California and the insured was a resident of California when he died.
9. 357 U.S. 235 (1958).
10. 357 U.S. at 251.
11. 357 U.S. at 253-54 where the Court stated: "The unilateral activity of those who claim some relationship with the nonresident defendant cannot satisfy the requirement of contact with the forum state. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum state thus invoking the benefits and protections of its laws. *International Shoe v. Washington*, 326 U.S. 310, 319. . . . It does not acquire that jurisdiction by being the 'center of gravity' of the controversy, or the most convenient location for litigation. The issue is personal jurisdiction not choice of law. It is resolved in this case by considering the acts of the trustee. As we have indicated they are insufficient to sustain jurisdiction."
12. *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 2 (1st Cir. June 20, 1977).
13. *Hardy v. Pioneer Parachute Co.*, 531 F.2d 193, 195 (4th Cir. 1976), citing *Bouman v. Curt G. Joa, Inc.*, 361 F.2d 706, 711 (4th Cir. 1966).
14. *Id.* at 195, citing *International Shoe v. Washington*, 326 U.S. 310 (1945).
15. P.R. Laws Ann. tit. 32; App. II, R.4.7. This rule provides in relevant part that the Puerto Rican Court shall have personal jurisdiction over a nonresident defendant if the claim arose because the defendant: (1) "Personally or by his agent carried out business transactions with Puerto Rico . . ."
16. See *Arthur H. Thomas Co. v. Tribunal Superior Court*, 98 P.R.R. 864, 870-71 n.5 (Puerto Rican "long arm" permits jurisdiction to the full extent allowed by due process); *Romon Vela, Inc. v. Sagner, Inc.*, 382 F. Supp. 478 (D.P.R. 1974) (Puerto Rican "long arm" permits jurisdiction to the full extent allowed by due process).
17. *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 6 (1st Cir. June 20, 1977).
18. *Id.*
19. See *Consolidated Laboratories, Inc. v. Shander Scientific Co.*, 384 F.2d 797 (7th Cir. 1967) (granting jurisdiction); *E.C.C. Corp. v. Slater Electric Inc.*, 336 F. Supp. 148, 151-52 (E.D.N.Y. 1971) (sending personnel into the state for negotiation purposes can give rise to personal jurisdiction). Compare *Bowman v. Curt G. Joa, Inc.*, 361 F.2d 706, 714 (4th Cir. 1966) (actions arising out of contracts to be executed or performed in this state allow taking in personam jurisdiction) and *Maryland National Bank v. Shaffer Stores Co.*, 240 F. Supp. 777, 783 (D. Md. 1965) (under Maryland "long arm" statute a nonresident's regular place of business and place of contracting must be Maryland) with *Davis v. Triumph Corp.*, 258 F. Supp. 418, 425 (E.D. Ark. 1966) (contracting to supply goods or services in Arkansas and breaching the contract is sufficient).
20. Other courts have found that a shipment contract not only shifts the risk of loss to the buyer but also converts the common carrier into the buyer's agent sufficiently to confer in personam jurisdiction over the buyer. See *Electric Regulator Corp.*

- v. Sterling Extruder Corp.*, 280 F. Supp. 550, 556-58 (D. Conn. 1968) (passage of risk of loss sufficient grounds for jurisdiction); *Colony Press Inc. v. Fleeman*, 17 Ill. App. 3d 14, 19-20, 308 N.E.2d 78, 81-82 (Ill. App. 1974) (taking jurisdiction over the nonresident buyer based on a shipment contract); Uniform Commercial Code § 2-509(1) (risk of loss passes to buyer when goods are duly delivered to the carrier).
21. *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 6-7 (1st Cir. June 20, 1977).
22. See *Shaffer v. Heitner*, No. 75-1812, slip op. at 16 n.20 (Supreme Court of the United States, June 24, 1977) (defendant in *Hanson* had not committed any acts sufficiently connected to the State to justify jurisdiction). The First Circuit in *Vencedor* stated that Gougler could have sued on the contract in Puerto Rico or sued there on a judgment obtained in Ohio on the contract, *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 10 (1st Cir. June 20, 1977). The First Circuit noted that Gougler could have provided in the contract

that disputes would be resolved under Ohio law, citing *National Equipment Rental v. Szukhent*, 375 U.S. 311, 316 (1964). But neither of these First Circuit's views are always true. See *Manhattan Fuel Co. v. New England Petroleum Corporation*, 422 F. Supp. 797, 802 (S.D.N.Y. 1976) (foreign corporation cannot maintain actions simply because it solicited in-state business and delivered pursuant thereto). The First Circuit in *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 10-12 (1st Cir. June 20, 1977), in anticipation of a possible argument by Gougler that their decision relied too heavily on decisions in which the underlying cause of action sounded in tort, disavowed any belief in a dual category approach to jurisdiction. However in an effort to treat equally contract and tort actions the First Circuit strips away the contract attributes of the case instead of ascertaining the true nature and quality of the contacts such as which party initiated the contacts with the forum and where the contract was formed as required by the





- "minimum contacts" test under *International Shoe*, 326 U.S. at 319. There is a split of opinion as to whether the underlying cause of action should make a difference for jurisdictional purposes. See Carrington & Martin, *Substantive Interests and the Jurisdiction of the State Courts*, 66 MICH. L. REV. 227, 232 (1967) (supporting the categorical approach favoring actions which sound in tort); Currie, *The Growth of the Long Arm: Eight Years of Extended Jurisdiction in Illinois*, 1963 U. ILL. L. F. 533, 569-70 (stating that there is no constitutional support for the dual category approach).
23. *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 8 (1st Cir. June 20, 1977).
 24. *Id.* at 9, citing *Hardy v. Pioneer Parachute Co.*, 531 F.2d 193, 195 (4th Cir. 1976) (defendant's contribution to the advertising budget of exclusive distributor and forty-two direct sales to the residents of the forum sufficient to warrant jurisdiction). Compare *R.F.D. Group Limited v. Rubber Fabricator, Inc.*, 323 F. Supp. 521, 525 (attempts by mail, telephone and independent contractors to interest buyers sufficient for jurisdiction) with *Didactic Corp. v. Welch Scientific Co.*, 291 F. Supp. 890, 894-95 (N.D. Ohio 1968) (service on Secretary of State, where firm supplied goods on numerous occasions and whose materials were present and continuously being used, was not violative of due process).
 25. See *Vencedor Mfg. Co. v. Gougler Indus.*, No. 76-1459, slip op. at 10 (1st Cir. June 20, 1977). ("On at least some occasions Gougler had the destination especially impressed upon it by the need for an export declaration").
 26. See *Buckeye Boiler Co. v. Superior Court of Los Angeles County*, 71 Cal.2d 893, 907-08, 80 Cal.Rptr. 113, 120-21, 458 P.2d 57, 64-65 (1969) (knowledge of destination of product as a matter of "commercial reality" is doing business sufficient to confer jurisdiction despite middleman).
 27. Compare *Gray v. American Radiator & Standard Sanitary Corp.*, 22 Ill.2d 432, 442, 176 N.E.2d 761, 766 (1961) (jurisdiction over nonresident who put product into stream of interstate commerce on grounds that a tortious act is committed where the resultant damage occurs) with *O'Brien v. Comstock Foods, Inc.*, 123 Vt. 461, 464-65, 194 A.2d 568, 570-71 (1963) (jurisdiction over nonresident defendant denied on mere showing that the defendant put product into stream of interstate commerce and product ultimately purchased in Vermont).
 28. 239 F.2d 502, 507 (4th Cir. 1956).
 29. This of course is not the only possibility. For example the motorist could be a Pennsylvania resident who has moved to California but has not had time to switch his registration. However, observing the out-of-state registration plate should be sufficient to put the service station owner on notice and he could not claim surprise if the tire fails in Pennsylvania.
 30. Currie, *supra* note 22 at 556-57.
 31. *Shaffer v. Heitner*, slip op. at 27-28.
 32. 357 U.S. at 253.
 33. See *Bullard v. Rhodes Pharmacal Co.*, 263 F. Supp. 79, 83 (D. Mont. 1967) (nonresident defendant corporation should not be subjected to jurisdiction in distant state by accident).
 34. *Id.*
 35. *Everly Aircraft Co. v. Lillian*, 414 F.2d 591, 597 (5th Cir. 1969). There have also been suggestions to the effect that the burden of distant litigation should be placed only on those who obtain significant benefits from frequent interstate transactions, *Vencedor* slip op. at 12, citing *Whittaker Corp. v. United Aircraft*, 482 F.2d 1079 (1st Cir. 1973). This however is no real solution because courts will have to define what are "significant benefits" and what are not. This will require the same type of subjective balancing involved in trying to define the present "minimum contacts" test.
 36. 355 U.S. 220, 223.
 37. *Hess v. Pawloski*, 274 U.S. 352 (1927).
 38. *Henry L. Doherty & Co. v. Goodman*, 294 U.S. 623 (1935).
 39. *Buckley v. New York Post*, 373 F.2d 175, 182 (2d Cir. 1967).
 40. Courts have found that the First Amendment interests demand that newspapers not be subjected to in personam jurisdiction for libel actions where the total circulation volume does not justify it in light of the possible recovery, *New York Times v. Connor*, 365 F.2d 567, 570-72 (5th Cir. 1966); *Buckley v. New York Post*, 373 F.2d 175, 182 (2d Cir. 1967); *Rebozo v. Washington Post Co.*, 515 F.2d 1208, 1214-15 (5th Cir. 1975).
 41. *New York Times v. Connor*, 365 F.2d 567, 570-72 (5th Cir. 1966).
 42. *Burbank v. Lockheed Air Terminal*, 411 U.S. 624 (1973); *Rice v. Sante Fe Elevator*, 331 U.S. 218 (1947).
 43. *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 529-30 (1959).
 44. 357 U.S. 235, 253.

by Joanne Maas

Medicare As A Vehicle for Discrimination



Ms. Maas is a second year day student.

In 1973 a federal statute was passed governing reimbursement of fees to physical, occupational and speech therapists under the Medicare Act.¹ Regulations were issued shortly thereafter prescribing its application only to physical therapists, leaving speech and occupational therapists untouched by the law.

The effect of this legislation, §1395x(v)(5)(A), is to regulate the prices independent physical therapists can charge for treatment of Medicare beneficiaries. Without a compelling state interest, the statute interferes with the independent physical therapist's fundamental rights to contract and to practice a profession. The statute has no rational relation to a legitimate government purpose as it does not achieve its stated goal. In fact, the success of the statute is thwarted by its own terms.

The Medicare Act, administered by the Secretary of Health, Education and Welfare, is intended to protect its beneficiaries from the costs of hospital and related post-hospital services. Beneficiaries receive services from hospitals, extended care facilities and home health agencies. These institutions are designated "providers of services" and are reimbursed by the Secretary or certain private organizations (Blue Cross, Blue Shield, Prudential) acting as fiscal intermediaries. Only providers of services can receive payment under the Act. Independent physical therapists do not qualify as providers of services; therefore, they must contract with a designated institution to provide physical therapy for Medicare beneficiaries. The provider charges the Secretary or Blue Cross for all services performed by its own employees and those independents with whom it has contracted. The provider keeps the reimbursement as to its employees and pays the independent for his or her services. In 1974 there were about 20,000 physical therapists in the country and about 25% had independent practices.²

Congress has enacted section 1395x(v)(5)(A) to regulate fees reimbursed to physical therapists. The section provides that when therapy services are furnished under a contract arrangement

with a provider of services, the amount reimbursed to the provider as the reasonable cost will not exceed an amount equal to the salary a provider would have paid an employed therapist, plus the cost of expenses the Secretary determines to be appropriate in the regulations.

Under the former provision, both the provider and independent were reimbursed their reasonable cost on a per treatment basis. Section 1395 changes the measure of costs from a per treatment rate to an hourly rate.

The billing method differs for providers' employees and independents. According to the regulations, the provider charges the hourly salary rate plus a fringe benefit factor (½ hourly rate) plus a reasonable cost of its entrepreneurial function. This latter function is a catch-all for a providers' general overhead and operating expenses. The provider can tack on an extra amount to cover costs of its institution wholly unrelated to the provision of therapy services.

According to the law, the reasonableness of the amount charged by the provider is subject to review by the Secretary. As a practical matter, most charges are made directly to Blue Cross or Blue Shield which pays whatever the institution charges. The reasonableness of the charge is assumed. Providers thus are free to pass on their operating costs to Medicare billings in uncontrolled amounts. Therefore, in its application, §1395x(v)(5)(A) does not reduce the amount the provider charges for therapy services.

When the independent physical therapist contracts with a provider to treat Medicare beneficiaries, the provider charges the seventy-fifth percentile of the hourly rates in the geographic area plus an expense factor of one-half the hourly rate plus a travel allowance of one-half the hourly rate per day and travel expense of \$1.50 per day. On its face, this regulated amount appears reasonable. In application, however, the rates being reimbursed to independents are inadequate. The established rates do not allow for an independent's office expenses or profit. The amount reimbursed is based

on the hourly salary the provider decides to pay its employed therapists in the area. The independent is not free to charge what he or she considers to be the reasonable value of treatment and the cost of providing it. There is no catch-all "entrepreneurial function" factor available to the independent. Rather, the independent's expenses are based on the hourly rate convenient for the provider as salary.

The stated purpose of section 1395 is to control Medicare costs. In 1975 the constitutionality of section 1395 was challenged before a three-Judge court in *Clemmons v. United States of America*.³ The attempt was unsuccessful because the court failed to understand the serious issues involved and/or was reluctant to question the wisdom of the Legislature.

In *Clemmons*, twelve licensed independent physical therapists sought a declaration that section 1395 is unconstitutional and an injunction against its enforcement and the publishing of the regulations. The plaintiffs claimed section 1395 arbitrarily deprived them of equal treatment under the law. The defendants contended the legislative classification is rationally related to the legitimate governmental purpose of fiscal responsibility. The court granted defendants' motion to dismiss for failure to state a claim.

The plaintiffs argued section 1395 was a price fixing control and, as such, is morally repugnant and constitutionally infirm. They claimed physical therapists are being singled out from other medical service groups as a target for special price fixing restrictions. Plaintiffs asserted that the statute is a haphazard and discriminatory restriction on their income which has no logical justification. They further claimed that, for some unexplained reason, the Department of Health, Education and Welfare wants to put independent physical therapists out of business. Plaintiffs further argued that the statute is not economizing because it will not in fact result in a reduction of costs.

The plaintiffs asserted that the right to practice a profession is fundamental and any impairment of that right requires strict judicial scrutiny. The court in *Clemmons* rejected this argument. Government regulation of professions is reviewed by the rational basis and not the compelling governmental interest test. The rational basis test requires, at a minimum, that a statutory classification bear some rational relation to a legitimate state purpose. The court's rationale was that in the area of

economics and social welfare, if the classification has some reasonable basis it does not violate the Constitution just because it is not made with mathematical nicety or because in practice it results in some inequality.⁴ The problems of government are practical ones and may justify rough accommodations — illogical and unscientific⁵ as they may seem.

The court in *Clemmons* found the governmental purpose of conserving limited resources to attain legislatively determined social and economic goals to be constitutionally permissible. The court found the legislation to be a good faith attempt to limit costs to reasonable fees for physical therapy services. "The Court will not speculate on the possible success or failure of the statute in achieving its goal."⁶

The *Clemmons* court rejected plaintiffs' argument that similar limitations are not imposed on other medical professions. The legislature is not required to solve all problems at once, and it may legislate partial solutions, neglecting other equally important problems. Congress is not constitutionally required to attempt to regulate all Medicare costs in the same manner.

In *Clemmons*, the court finding that the classification had a rational basis was grounded on the assumption that the legislature sincerely believed the measure would reduce costs. The court recognized the inequalities but allowed them to stand because the Legislature meant well. The court confused altruism with efficiency. Proper judicial review demands more than an inquiry into primary legislative intent. In questioning the constitutionality of the statute, the court abandoned concerns for general welfare and equality for fear of speculation, forgetting that analysis and vision require some degree of speculation. The amount of speculation required here is limited. Independent physical therapists are already harmed. The plaintiff B.V. Clemmons was granted standing on the basis of his uncontroverted affidavit stating section 1395(v) (5) (A) would cause him to lose \$10,000 in income. Closer scrutiny of the statute reveals it is inherently self-defeating. It is impossible to reduce costs. Does the court want to make sure Medicare costs will soar before realizing the implications of this statute? Is it necessary to witness the extinction of the independent physical therapist before questioning the constitutionality of section 1395? It is clear the court either failed to

adequately study and understand the nature of section 1395, or it was afraid to challenge the legislature.

The court in *Clemmons* did not accept the legislature's assumption of economy and failed to recognize the true classification created. The majority based its decision on a finding of a reasonable basis for the classification of independent physical therapists being separated from other medical professions. There is a finer classification however. Independent physical therapists are subject to a salary equivalency standard whereas in-house physical therapists have a standard of reasonableness in charging for services. This finer classification is ignored in *Clemmons* and it is upon this classification that section 1395 should be declared unconstitutional.

The classification created infringes upon independent physical therapists' rights to contract and to practice a profession. Recent trends suggest the right to practice one's profession is not among those rights the court has established as fundamental. However, the right of independent physical therapists to charge reasonable fees is arguably a fundamental right.

Although the right to practice a profession is not explicitly guaranteed in the Constitution, like the right to travel or right to privacy it is implicitly guaranteed. The rights to travel and to privacy have been held to be fundamental, deriving from penumbras to the Constitution. The right to practice a profession derives from the concepts of property and liberty in the Fifth Amendment and thus should be considered fundamental.

The Fifth Amendment's due process clause incorporates the concept of equal protection and applies it to federal actions. When a legislative classification works to the disadvantage of a suspect class or interferes with the exercise of a fundamental right of liberty, the Court must determine whether the discrimination was necessary to promote a compelling governmental interest. With economic regulations, almost any legislative measure meets the constitutional test of reasonableness unless it is based upon a classification deemed inherently unreasonable (suspect class). In economic regulation cases, the fundamentality of a right is secondary to the promotion of the general welfare. The police power to regulate for the general welfare is usually held out to be a sufficiently compelling state interest. The police power has been extended so far that there are few eco-

conomic activities beyond the reach of regulatory authority. The justification for the expansion of the police power is to control the formation of monopolies and to encourage free enterprise.

This case can be distinguished from other economic regulation cases which uphold the police power because there is no promotion of general welfare with section 1395. Although the police power is held out to justify the statute, the statute does not and can not achieve its purpose.

The purpose of the law is to control Medicare costs. Section 1395 does not reduce the amounts the provider can charge for in-house therapy services, so the only possible reduction will come from the independent physical therapist. It is ludicrous to look to the independents as they constitute only 25% of all licensed therapists, and therapy services constitute 1% of Medicare costs. Furthermore, independents charge less than providers. A survey of twenty hospitals showed the amounts charged by providers for treatment was higher than the amount charged by the independent for the same treatment.⁷ Hospitals and other providers are notoriously expensive institutions to run and the statute does not prevent them from passing on their expenses to Medicare charges.

The statute will not bring reduced costs. Any amount saved by reimbursing the independents, ¼ of all reimbursements, will be spent in reimbursements to providers who can now charge more and receive ¾ of all reimbursements. Besides bringing no immediate reduction, section 1395 will result in *increased* costs. As independents are reimbursed rates which do not cover their expenses, they will be forced out of business. They will not be able to afford to treat Medicare beneficiaries. A substantial part of most independents' business is providing treatment for elderly Medicare beneficiaries. Independents have little opportunity to adjust the scope of their business to the new law as their patients include the elderly, accident victims and those with generic muscular disorders.

As independents are forced out of business, providers will have to hire more in-house therapists to provide treatment for beneficiaries. A larger cost will come from establishing physical therapy departments. At present, 53% of our nation's hospitals have physical therapy departments. This is hardly enough to fill the need. Providers will have to construct

departments, buy equipment and establish out-patient clinics. The net effect is soaring overhead and increased charges of all its bills. The costs to the Medicare plan will be astronomical.

Prior to the law, in rural areas the independent therapist served a vital role. Hospitals did not have to establish an in-house physical therapy department, they could contract with the independents to provide treatment for Medicare beneficiaries. Now all these rural hospitals will have to spend money to open a therapy department.

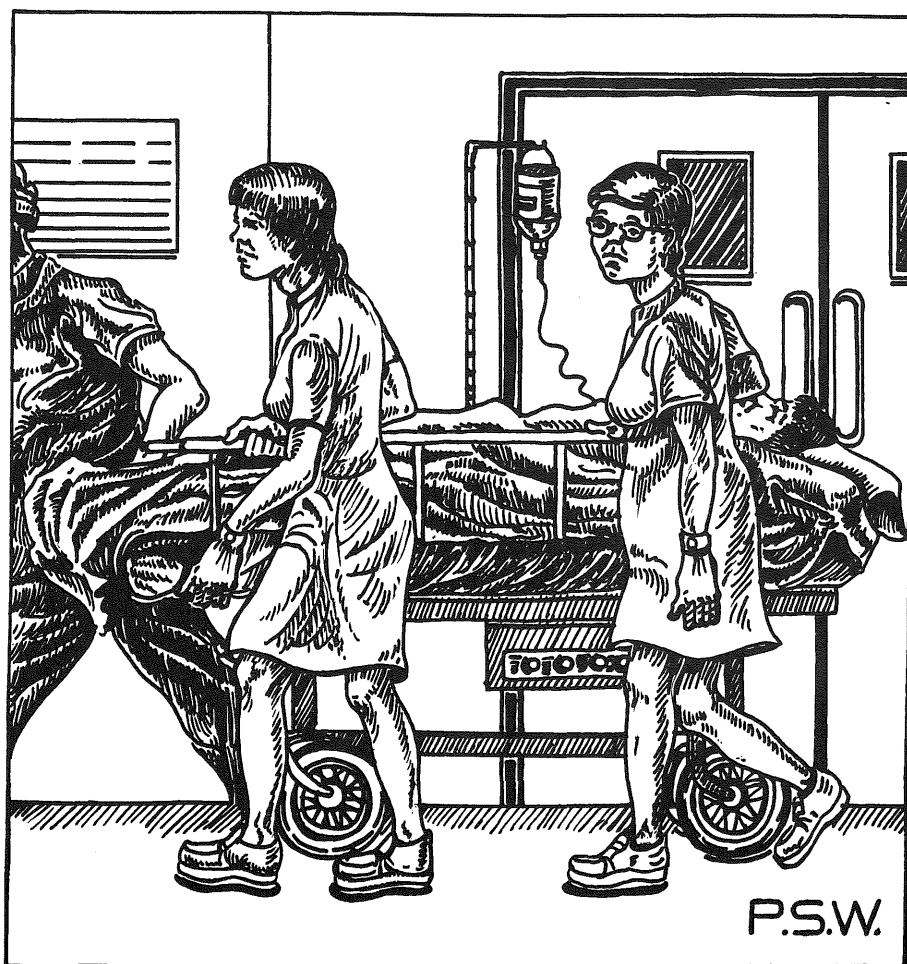
It is clear the legislation will not reduce costs. It will result in all physical therapy services to Medicare beneficiaries being supported through the Medicare Act. As regulations are issued to occupational and speech therapists, these services will likewise become supported and run by the government. The problem is circuitous; the remedy is short-sighted, and the law is inherently self-defeating.

Given the justification for the police power as a compelling state interest it is ludicrous to uphold section 1395. Its

effect will be to discourage free enterprise and create a monopolist situation. All providers of services will be under single governmental control. Independents are prevented from practicing. While it is Constitutional to invoke the police power for the general welfare as a check against expanding industries, if the police power goes unchecked it can become dictatorial and basic Constitutional rights can be circumvented.

There is no compelling state interest to justify the interference with the independent's right to charge reasonable fees, a right which is indeed fundamental. Many rights guaranteed by the Constitution may be viewed as fundamental.

The Fifth Amendment's due process clause declares no person shall be deprived of life, liberty or property without due process of law. The right of a person to practice a profession is protected as a liberty interest. The right to charge reasonable fees for services rendered is a property interest. These rights are guaranteed by the Constitution and certainly should be defended as funda-



mental. In this situation, their fundamental character becomes even more important because the only justification for its infringement, the police power, infringes those same rights without compelling need.

Where a statute establishes a classification which is inherently unreasonable or suspect, no state interest is compelling, and the statute may be declared unconstitutional. Classifications based on wealth are suspect. Section 1395 creates such a classification. As independents stop contracting with providers, they will have to rely exclusively on their private business. Patients who used to be paid for by Medicare have to pay the independents fees from their personal savings or go to a nearby provider for continued treatment. Most beneficiaries could not afford the fees. If there is no provider with a physical therapy department nearby, these people will have to forego treatment or suffer the inconvenience of travel to the nearest provider, if travel is even possible. They are forced into this position because they cannot afford to pay the independent's fees and keep him in business. Section 1395 creates this class of Medicare beneficiaries which is affected on the basis of wealth. As such, it is inherently unreasonable and no state interest is enough to justify it.

The minimum test of the constitutionality of a statute is that it have some rational relationship to a legitimate government purpose. Section 1395 does not even meet the rational basis standard.

In economic regulation cases, courts do not severely question the rational relation, especially when no fundamental right is involved. It is assumed the police power is performing its legitimate function of promoting the general welfare. It has already been demonstrated that section 1395 fails to accomplish its purpose. Exercise of the police power here serves no function. Instead, its application is harmful.

When a regulatory scheme differentiates between people engaged in the same economic activity, the classification is underinclusive — people similarly situated are left untouched. The crucial inquiry is whether the differentiation in treatment is based upon a classification that itself has a rational foundation in fact. Here independents are treated differently from in-house therapists who are essentially left untouched. There is no basis for this underinclusiveness as there is no evidence that the services of inde-

pendents are inferior, more expensive, undesirable or unnecessary. They are equally well trained, and their need is firmly established, especially in rural areas. There is no rational basis upon which Congress has acted to treat independents differently from providers with in-house therapy employees. Section

1395 does not even pass the minimal test for constitutionality.

It is questionable whether the Legislature understood the practical applications of section 1395 when it was passed. If its true motivation was to reduce costs, it could not have foreseen the problems of hospital overhead, the eventual extinc-



tion of the independent physical therapist and the harm resulting to the Medicare beneficiary. On its surface, the law appears reasonable. It looks like the independents were charging outrageous fees before the law and that the legislature would control this. Although neither of these propositions is correct, it seems this is what the Legislature believed.

If Congress actually understood the results of the statute's application, perhaps they intended to put the independent physical therapist out of business. Support of this theory exists in that regulations for the implementation of section 1395 have been issued only as to physical therapists.

Past treatment to physical therapists also indicates deliberate discrimination. A statute that directly excluded a proprietary agency, i.e., an independent therapist, from contracting with a public or non-profit home health agency for the provision of therapy services for Medicare beneficiaries was challenged in 1974.⁸ The provision was found arbitrary and capricious and revoked. The effect of the statute would have been that providers would hire more in-house therapists and independents would lose business. The new statute section 1395 is more confusing, perhaps deliberately so. Instead of a *direct* exclusion of independents rendering it arbitrary, section 1395 can be upheld as a gradual resolution or a rough accommodation to the problem of curtailing Medicare costs. In the practical application of section 1395, independents are excluded from contracting with a public or non-profit home health agency because they cannot afford to do so. The affect of the former arbitrary and capricious provision is the same. Independent physical therapists are discouraged and unable to stay in business and thus encouraged, if not forced, to work for a provider.

This statute could be an attempt to establish the groundwork for drawing in other medical professions. Independent physical therapists are small in number with no wealthy or powerful lobbying group behind them. Query the response to a statute which set a salary equivalency standard for doctors. Would the American Medical Association lie idle and allow such legislation to stand? Hardly. Yet Medicare could control costs much more effectively by starting with doctors as the percentage of reimbursements to doctors is greater than that to therapists. Nothing opens the door to



arbitrary action so effectively as to allow officials to pick and choose only a few to whom they will apply legislation and thus escape the political retribution that might be visited upon them if larger numbers were affected.⁹

By singling out a small group, the independent physical therapist, the government could quietly set a precedent without much response from other professions. With this precedent, the government can now pass legislation to include other professions, i.e., doctors, surgeons, chiropractors, nurses, anaesthesiologists, the whole gamut in the medical field. The end result would be government price control of the amount any independent medical professional could charge a Medicare beneficiary.

If this is the underlying intent of Congress, it is not justified by the goal of reducing Medicare costs. As independents receive lower reimbursements, they will be forced out of business. Providers will have to hire more therapists, expand their facilities, acquire new equipment and thus increase their overhead. Charges to all its patients, including those for treatment of beneficiaries, will increase. The Department of Health, Education and Welfare will bear the burden of higher costs. Ultimately the burden rests with the taxpayers in the form of increased taxes.

Congress could not have possibly understood the financial ramifications of the statute if their intent is to expand its scope. All indications point to the fact that this is a bad law. It discriminates against independent physical therapists. It eliminates the availability of services for some Medicare beneficiaries. It sets a

precedent with dangerous overtones and far-reaching implications. It does not reduce costs or promote general welfare. The statute is senseless and injurious and should be repealed.

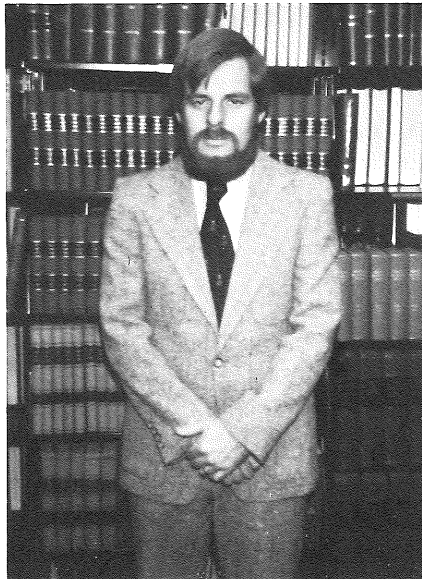
Footnotes

1. Public Law No. 92-603 § 251 (c), 42 U.S.C. § 1395x (v) (5) (A), which reads:
(5) (A) *Where physical therapy services, occupational therapy services, speech therapy services, or other therapy services or services of other health-related personnel (other than physicians) are furnished under an arrangement with a provider of services or other organization, specified in the first sentence of subsection (p) of this section the amount included in any payment to such provider or other organization under this subchapter as the reasonable cost of such services (as furnished under such arrangements) shall not exceed an amount equal to the salary which would reasonably have been paid for such services (together with any additional costs that would have been incurred by the provider or other organization) to the person performing them if they had been performed in an employment relationship with such provider or other organization (rather than under such arrangement) plus the cost of such other expenses (including a reasonable allowance for traveltime and other reasonable types of expense related to any differences in acceptable methods of organization for the provision of such therapy) incurred by such person, as the Secretary may in regulations determine to be appropriate.*
2. *Clemmons v. United States*, No. 73-530 (S.D. Ohio, Mar. 1976).
3. *Id.*
4. *Lindsay v. Natural Carbonic Gas Co.*, 220 U.S. 61 (1911).
5. *Metropolitan Theatre Co. v. City of Chicago*, 228 U.S. 61, 69-70 (1913).
6. *Clemmons v. United States*, No. 73-530, slip. op. at 9 (S.D. Ohio, Mar. 1976).
7. *Id.*, Plaintiff's Brief.
8. *American Physical Therapy Association v. Weinberger*, No. 74-897 (S.D. Ohio, July 2, 1974).
9. *Railway Express Agency v. N. Y.*, 336 U.S. 106 (1949).

This is to acknowledge the assistance of Virginia Mills, a student of physical therapy.

Assessing Damages in Churning Cases: An Argument for Loss-of-Bargain Recovery

by Gregg McClelland



Mr. McClelland is a third year night student.

In a private action for securities fraud in which plaintiff's net losses are virtually impossible to ascertain, should the measure of recovery be the amount of defendant's ill-gotten profits, perhaps only a fraction of plaintiff's actual losses, or the amount of plaintiff's losses, perhaps a figure so speculative as to unfairly burden the defendant? The problem arises in a type of securities fraud known as churning,¹ which occurs when a broker² controlling a securities or commodities account engages in excessive transactions meant to generate commissions for the broker rather than to benefit the investor. In the typical churning case, a widow with no investment experience will entrust to a broker the few securities left her by her husband for her support. Knowing that his client is naive, the broker engages in a program of active trading, collecting commissions for every purchase and sale he makes on his client's behalf. The broker's actions may not only cost the widow the commissions, but may depress the value of the account if the original income-producing securities have been exchanged for less valuable, more speculative securities. The problem in assessing damages arises in determining the loss in value attributable to the churning rather than to market fluctuations or nonfraudulent transactions.

Legal Analysis of Churning

Although the facts are rarely clearcut, as in the hypothetical, a court will find that churning has occurred if the broker's control over the account is demonstrated³ either by express contract, or by inference from the investor's lack of sophistication, and if the trading in the account is shown to be excessive. A court is more apt to find excessive trading in an income-generating or growth account, as in the hypothetical, than in a relatively more active trading or commodities account. The investor's stated investment goals will also be considered. Excessive trading is indicated by a high turnover rate, which is the ratio of the dollar amount of total purchases made by the broker to the dollar amount of the inves-

tor's total investment; a pattern of "in and out trading";⁴ or large broker's commissions in comparison to the size of the account. The fact that the account made a profit despite the churning is no defense because the same account, properly handled, probably would have been more profitable.

Churning actions are usually brought under the anti-fraud provisions of the Federal Securities Acts. Churning is covered by section 17(a) of the Securities Act of 1933,⁵ section 10(b) of the Securities Exchange Act of 1934,⁶ and Securities Exchange Commission Rule 10b-5, although it is not mentioned specifically.⁷ The act of churning is described in Securities and Exchange Commission Rule 15c-1-7,⁸ and a churning action may be brought under that Rule or section 15(c) (1) of the 1934 Act⁹ under certain circumstances.¹⁰ Churning actions under state blue sky laws and at common law¹¹ are also possible. Under the Federal Securities Acts, a plaintiff must prove his case by a preponderance of the evidence.¹² The present article is concerned with the standards of proof and damages applicable under the Federal Securities Acts.

Federal courts have applied three measures of computing damages in churning cases.¹³ Under a quasi-contract theory, the broker is required to return the profits of his wrongdoing; principally, the commissions he earned from the victim's account. Out-of-pocket recovery awards the victim the difference between his original investment plus the profits it would have made if left dormant, and the value of his account after churning plus profits actually received. A loss-of-bargain measure would exact from the wrong-doer the profits the account would have made if "properly managed".

Loss of Bargain Recovery

It is widely conceded that Congress' principal purpose in enacting the Federal Securities Acts was to protect the investor from fraud while not allowing him to recover for a bad bargain.¹⁴ Any scheme purporting to protect the investor would best accomplish that end by making the

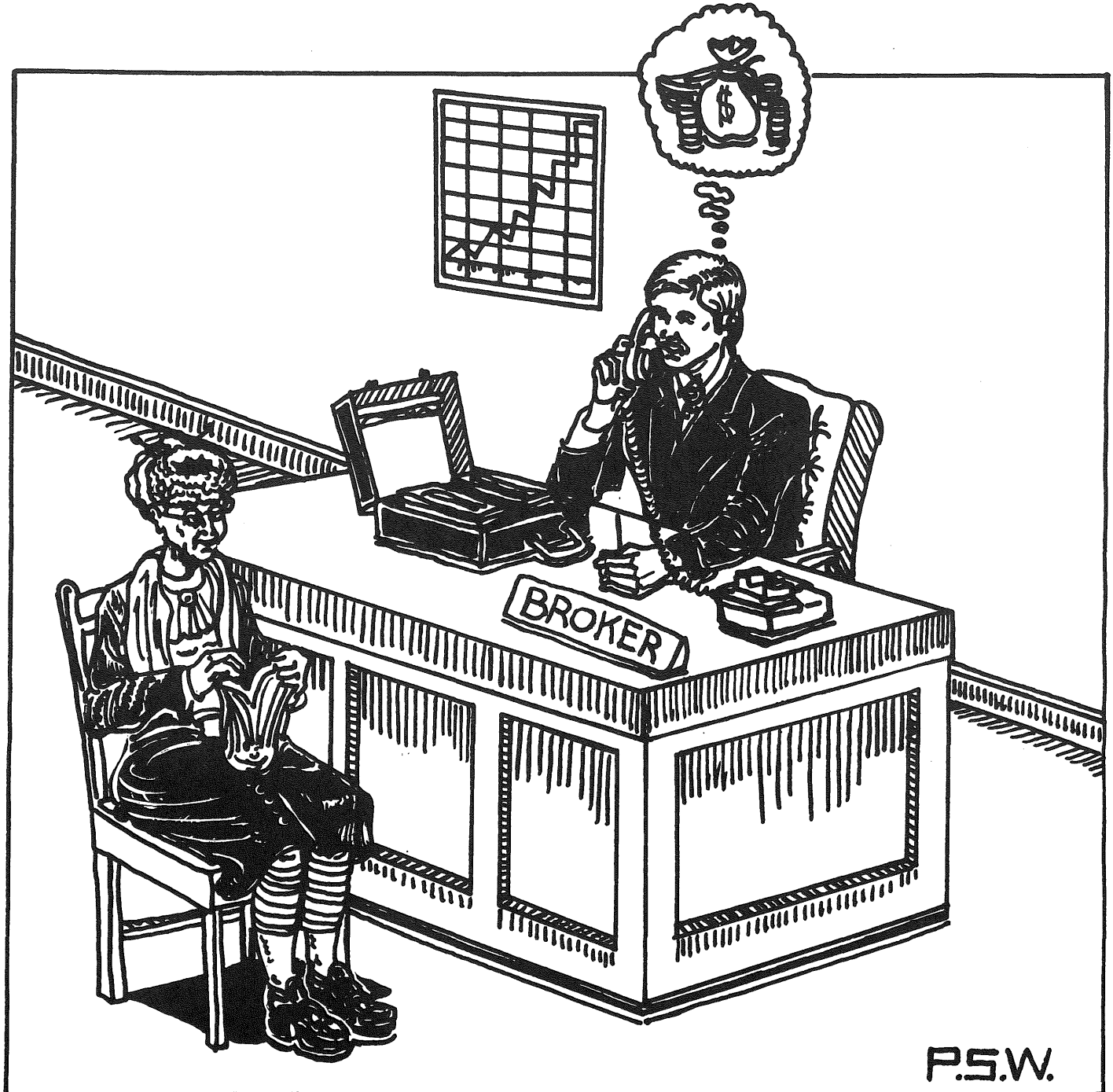
investor whole when he fell victim to fraud, and by deterring brokers from acting fraudulently in the future. Considerations of punishment are secondary in such a scheme, at least insofar as they do not serve the purposes of compensation and deterrence. Loss-of-bargain damages, including the profits of a properly handled account and other losses occasioned by the fraud such as commissions,¹⁵ are more likely to satisfy the compensation-deterrence criteria than damages under other available recovery theories. Loss-of-bargain damages compensate the

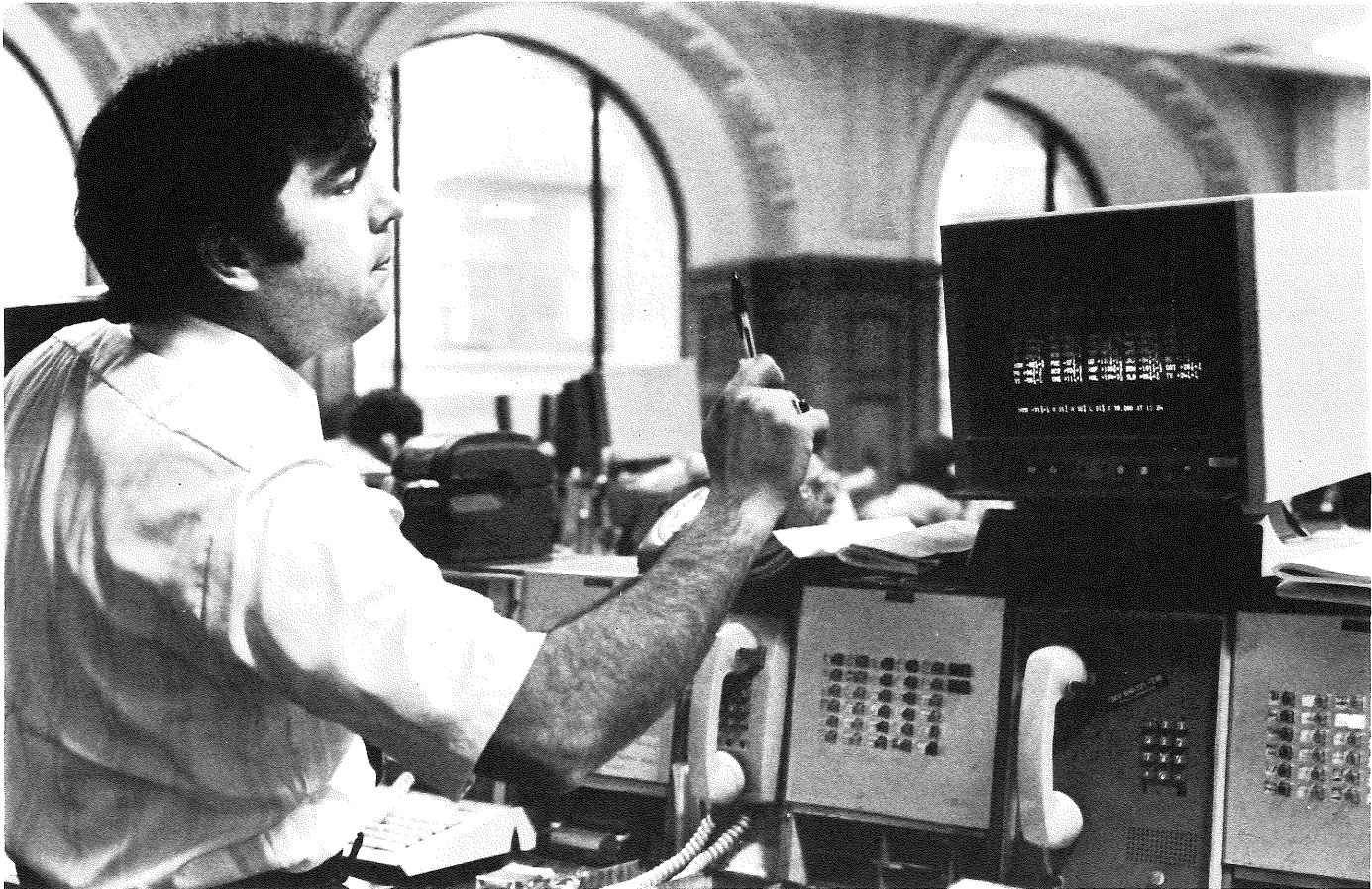
investor for all his losses: loss of equity and lost investment opportunities as well as cash losses proximately caused by the fraud. Such damages provide deterrence by holding the broker liable for a greater dollar amount than would normally be assessed under the quasi-contract and out-of-pocket theories.¹⁶

To avail himself of the loss-of-bargain measure of damages the plaintiff must introduce expert testimony establishing the amount of returns his account would have produced had it been properly managed.¹⁷ The defendant may then attempt

to refute plaintiff's figure with evidence of his own. The basic issue is what constitutes "proper" management of the account in a given case. Proper management is subjective, but it certainly excludes churning or any act a broker undertakes for his own benefit and in disregard of his client's interest.

Loss-of-bargain recovery is often attacked as being too speculative. The thrust of this argument is that the concept of proper management is so subjective that it gives free rein to the plaintiff in claiming damages. However, as noted





above, defendant may attack plaintiff's version of the damages. Further, loss-of-bargain is attractive from an equitable point of view. The Second Circuit stated in the context of section 16(b) of the 1934 Act:

*when damages are at some unascertainable amount below an upper limit and when the uncertainty arises from the defendant's wrong, the upper limit will be taken as the proper amount.*¹⁸

Such a doctrine should be applicable in the churning context insofar as it gives the plaintiff the benefit of the doubt in fixing damages.

To date no court has applied the loss-of-bargain theory of recovery in a churning case. There are cases in which the quasi-contract and out-of-pocket theories have been applied, however, and an examination of those cases will serve to point out their weaknesses in comparison with loss-of-bargain.

Quasi-Contract Recovery

In the first churning case in which damages were assessed, *Newkirk v. Hayden, Stone & Co.*,¹⁹ the federal district court settled on a quasi-contract measure, awarding plaintiff the amount of commissions

paid. The court reasoned that only that amount of damage had been proximately caused by the defendant.

Newkirk was followed in *Hecht v. Harris, Upham & Co.*²⁰ when that federal district court found that plaintiff, a widow, had entrusted her securities account to a broker who had not only traded heavily in the securities themselves, but had exchanged some of the securities for commodities futures. The court found that plaintiff had knowledge of both the heavy trading activity and the venture into the volatile commodities market. Because she was sophisticated enough to understand the risk involved and the commissions charged, the plaintiff was estopped from asserting that those transactions were unsuitable for her investment purposes. The court found, however, that the plaintiff did not have the expertise to know that the volume of transactions was excessive, and she was not precluded from recovering for the losses directly attributable to the churning. These losses, according to the federal district court, included not only the commissions paid, but also the losses incurred in the commodities account and the loss of dividend income due to the

transfer of securities into non-dividend-paying commodities. The court reasoned that the commodities account was a mere "device for churning the securities account"²¹, therefore, the losses it incurred were directly attributable to the churning and recoverable.

The Ninth Circuit affirmed the award of commissions, but reversed the inclusion of the commodities losses in the damages. The court ruled that these losses were not directly traceable to the churning, but instead were due to the switch to commodities, which the lower court had estopped the plaintiff from asserting.

Courts applying the quasi-contract theory are concerned with including in damages only those losses "proximately caused" by churning. Typically this means only commissions, although the federal district court in *Hecht* attempted to extend the reach of proximate causation. In churning cases, indirect losses such as loss of value in the investor's account and loss of dividends, may be greater than the dollar value of the commissions. Further, it is doubtful that this measure of recovery deters potential wrongdoers. The prospect of being

forced to relinquish only commissions received if found liable may not outweigh the attractiveness of the potential gains from the fraud in a broker's mind.²² A broker is more likely to be deterred from churning an account if he knows he will be held responsible for all losses that would not have occurred in that account had it been properly managed, as under the loss-of-bargain theory.

The quasi-contractual theory was also applied in *Stevens v. Abbott, Proctor & Paine*.²³ There, a woman with no investment experience turned her portfolio over to a broker who engaged in active trading. The federal district court found churning, and assessed damages including all commissions and concessions, capital gains taxes paid by plaintiff on the account, and transfer taxes charged by the stock exchange. The court felt constrained to include in the damages only those costs directly attributable to the churning and capable of reasonably accurate estimation, and the burden of proving damages by a preponderance of the evidence rested on the plaintiff. However, defendant had the burden of showing which part of the capital gains tax did not result from the fraud, since the defendant's action had occasioned the losses.²⁴ The court also discussed and rejected the other two measures of recovery. Regarding loss-of-bargain recovery, the court observed that "even 'properly managed accounts' are subject to losses"²⁵ and that such a measure of damages would impose upon the broker a presumption that "... he is endowed with unparagoned powers of prediction."²⁶ An award of such "speculative" damages would constitute an imposition of punitive damages. Out-of-pocket recovery was dismissed as being based on the erroneous assumption that all the transactions had been improper. A net profit in the churned account is no defense to a churning action, but under the out-of-pocket theory there could be no recovery when such a profit occurred since the account would show no decrease in value. Everyone entering the stock market is aware of the risk of loss, regardless of the nature of their account. Only damages demonstrably due to the fraud were fairly assessable.

In rejecting loss-of-bargain damages on the ground that "even 'properly managed accounts' are subject to losses," the *Stevens* court overlooked the fact that losses in properly managed accounts are by definition not due to broker fraud.

Concededly, an investor must always accept the risk of loss due to market factors and sometimes the risk of loss due to broker error, but he should not have to assume the risk of fraud. Further, although the plaintiff in a churning case does bear the burden of proving his case by a preponderance of the evidence under the Federal Securities Acts, establishing the existence of churning, which is an intentional act undertaken for the broker's benefit and in disregard of the investor's interest, raises the probability that the account did not fare as well as it would have had it been managed in the investor's interest. Given that probability, it is not harsh to hold the broker to a "proper management" standard. Finally, loss-of-bargain damages cannot be equated with punitive damages, since the

main purpose of loss-of-bargain damages is to compensate the victim rather than to punish the wrongdoer.

Out-of-Pocket Recovery

The only churning cases in which the out-of-pocket measure was applied were *Twomey v. Mitchum, Jones & Templeton, Inc.*²⁷ and *Pierce v. Richard Ellis & Co.*,²⁸ both decided in state courts. In the latter case, the New York court made the broker replace the investor's original investment plus interest, rejecting the broker's contention that he should be liable under a common-law quasi-contract theory.

In *Twomey*, the California appeals court upheld the trial court's out-of-pocket award. The defendant had controlled plaintiff's account from January 1961 to



July 1964, during which time the account decreased in value. The trial court added the value of the account at the beginning of this period to the amount of profits the account would have made had it remained dormant during the period. From this, the court subtracted the sum of the value of the account at the close of the period, and the profits the account actually made while defendant controlled it to determine the damages. The court did not include defendant's commissions in the award. To defendant's objection that the method of computing damages was speculative, the court answered that the evidence showed the original account would have appreciated in value given the market activity during the period in question, if it had been properly managed. In the absence of evidence to the contrary, the court said, it was inferable that the losses plaintiff sustained were due to defendant's negligence and breach of fiduciary duty. Absent contrary evidence, the total losses minus the profits actually made were an accurate measure of losses flowing from defendant's wrongdoing. A simple award of commissions would have no relationship to actual losses suffered.

The *Twomey* court placed the burden on defendant to *disprove* any part of the damages not attributable to his wrongdoing. However, if the account returned to the plaintiff had been worth more than the account she originally turned over to the defendant, she could show no damages despite the fact that defendant's handling of the account might have prevented it from garnering even greater profits. The court acknowledged that "The most rational approach in a case of this nature may well be a comparison of the actual experience with a theoretical properly managed account,"²⁹ hinting at a loss-of-bargain measure, but it declined to use such an approach since there was no evidence in the record on which to base it.

Out-of-pocket recovery suffers from the speculativeness for which the loss-of-bargain measure is criticized, while not assuring adequate compensation to the investor for his losses. The investor recoups his original investment *in toto*, and this is better than quasi-contractual recovery, but he loses the profits and dividends he would have received from the same account managed competently and in his interest. From the standpoint of deterrence, the effectiveness of out-of-pocket damages varies with the amount

of recovery. If in a given case the original investment is significantly depleted by the churning, the plaintiff's recovery will be great, and the risks attending apprehension may outweigh the potential rewards of the wrongdoing in the eyes of future wrongdoers. However, if the broker can make the account show a profit despite the churning, no damages will be assessed although the churning may have decreased the earning potential of the account. Brokers will be more likely to commit fraud if they feel they can create a small net profit in the accounts they churn and thereby escape liability. Under the loss-of-bargain theory, damages would be awarded in both cases, making fraud less attractive to brokers.

Punitive Damages

The purposes of awarding punitive damages are to punish the wrongdoer and to deter future wrongdoing.³⁰ As pointed out above, the philosophy pervading the Federal Securities Acts emphasizes protection of the investor from fraud rather than punishment of the wrongdoer. There is a split of authority on the question whether punitive damages are expressly excluded under the Federal Securities Acts.³¹ Deterrence plays an important part in protecting the investor, but punitive damages are not necessary to provide deterrence in churning cases if loss-of-bargain recovery is available. Loss-of-bargain recovery provides deterrence while setting damages at a level that has some relation to the actual loss suffered, while the theory behind punitive damages is that deterrence increases proportionately with the increase in dam-

ages. Loss-of-bargain provides flexibility, in that the defendant may dispute plaintiff's *ad damnum*, whereas punitive damages are usually imposed after hearings on damages and without input from the defendant.

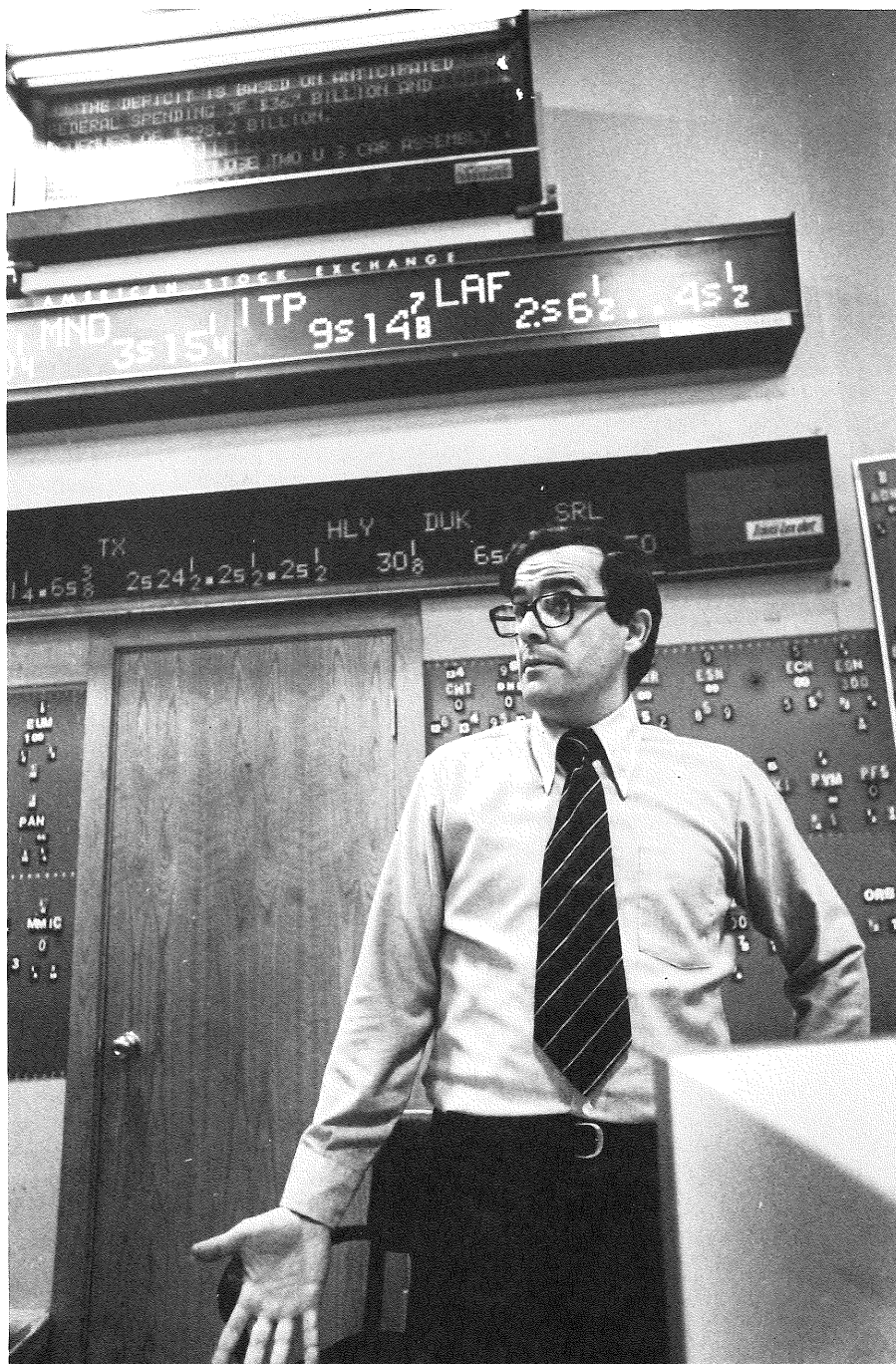
Conclusion

Of the available theories of recovery, loss-of-bargain recovery most nearly fulfills the congressional purpose in enacting the Federal Securities Acts, which is to protect the investor. The loss-of-bargain measure accomplishes this in churning cases by compensating the investor for all the losses caused by the broker's fraud, and by providing more effective deterrence than the other theories of recovery.

Footnotes

1. Note, *Churning by Securities Dealers*, 80 Harv. L. Rev. 869 (1967); *Private Actions for "Churning,"* 40 Mo. L. Rev. 281 (1975).
2. "Broker" in this article will be used to designate the person controlling a given securities account: the defendant in churning situations. Such a person may be a broker-dealer, dealer, or investment advisor in a given situation. "Broker" will be used for simplicity's sake. Although this article does not deal with agency questions in churning cases, "broker" may also refer to an investment firm if the firm's liability is coextensive with that of the employee-broker.
3. See 80 Harv. L. Rev. at 871-878 (elements of the offense of churning).
4. "A pattern of trading . . . [consisting] of the sale of all or part of the customer's portfolio, with the money immediately reinvested in other securities, followed in a short period of time by the sale of the newly-acquired securities." 80 Harv. L. Rev. at 876.
5. 15 U.S.C. § 77q(a) (1970).
6. 15 U.S.C. § 78j(b) (1970).
7. The wording of section 10(b) of the 1934 Act is representative: "It shall be unlawful for any per-





son, directly or indirectly, by 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 or regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Since most churning cases which have reached the stage of damage computation were brought under these provisions and Rule 10(b)-5, this article deals primarily with actions of this type. Note, however, that one of the cases discussed herein sounded in common law fraud. *Infra* note 28 and accompanying text. For the dif-

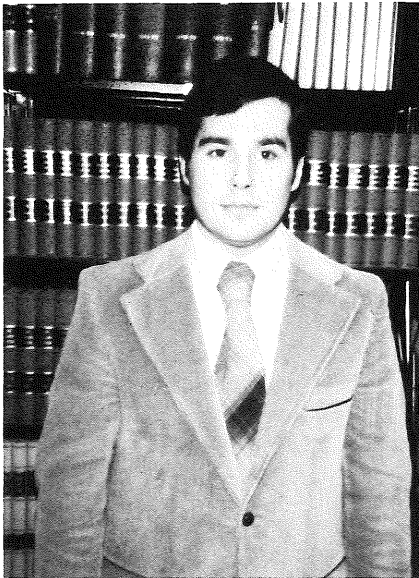
- ferences between actions brought under sections 17(a) and 10(b), and those brought on other grounds, *see* notes 10 and 11 *infra*.
8. "The term 'manipulative, deceptive or other fraudulent device or contrivance,' as used in section 15(c) of the act, is hereby defined to include any act of any broker or dealer designed to effect with or for any customer's account in respect to which such broker or dealer or his agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of such account." 17 C.F.R. § 240.15c 1-7.
 9. 15 U.S.C. § 780(c) (1) (1970).
 10. The circumstances under which such an action may be brought: (1) when the transaction is in over-the-counter securities (not registered on any

exchange), and (2) when the action is brought within one year after the discovery of the churning or within three years after the churning occurs, pursuant to section 29(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78cc(b) (1970).

11. Churning actions at common law differ from those brought under the Federal Securities Acts in that: (1) the former require a more stringent "clear and convincing" standard of proof of the plaintiff, and (2) punitive damages may be awarded in common law actions, but they may be precluded under federal law. 40 Mo. L. Rev. at 292-295. *See* note 32, *infra* (sources discussing basis of preclusion of punitive damages under Federal Securities Acts).
12. 40 Mo. L. Rev. at 291.
13. *See* 80 Harv. L. Rev. at 883-885 and 40 Mo. L. Rev. at 297-302 (brief discussions of the various measures of recovery).
14. 1 L. LOSS, SECURITIES REGULATION 121-128 (2d ed. 1961).
15. Since loss-of-bargain damages include all losses other than those which would have occurred in a properly handled account, commissions and all losses attributable to the improper handling of the account are included in a loss-of-bargain measure.
16. *See infra* comparison of deterrence provided by loss-of-bargain with quasi-contract and out-of-pocket.
17. 40 Mo. L. Rev. at 294-295.
18. *Gratz v. Cloughton*, 187 F.2d 46, 51-52 (2d Cir. 1951), *cert. denied*, 341 U.S. 920, *cited in* 6 L. LOSS 3679 (2d ed. Supp. 1969). *Also see* *Fey v. Walston*, 493 F.2d 1036, 1055 (1974) ("when precise damages measurements are precluded by wrongful acts, the wrongdoer cannot insist on exact measurement. . .").
19. FED. SEC. L. REP. (CCH) ¶ 91,621 (S.D. Cal. 1965).
20. 283 F. Supp. 417 (N.D. Cal. 1968), *modified*, 430 F.2d 1202 (9th Cir. 1970).
21. 283 F. Supp. 417, 440 (1968).
22. *See* *Pierce v. Richard Ellis & Co.*, 62 Misc. 2d 771, 774, 310 N.Y.S.2d 266, 269 (Civ. Ct. N.Y. 1970) ("To only require restoration of commissions would encourage this conduct as low risk larceny.")
23. 288 F. Supp. 836 (E.D. Va. 1968).
24. *Id.* at 850.
25. *Id.* at 849.
26. *Id.*
27. 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968).
28. 62 Misc. 2d 771, 310 N.Y.S.2d 266 (Civ. Ct. N.Y. 1970).
29. 262 Cal. App. 2d 690, 732, 69 Cal. Rptr. 222, 250-251 (1968).
30. RESTATEMENT OF TORTS § 908, comment (a) at 554 (1939).
31. *See* 4 A. BROMBERG, SECURITIES LAW: FRAUD SEC RULE 10b-5 at 229 (1977) (punitive damages precluded under Federal Securities Acts); 80 Harv. L. Rev. at 885 (favoring punitive damages).

by John T. Wallace

The Demise of Work Preservation Clauses



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The utilization of technological advances has had a dramatic impact upon the American construction worker. Above all, the increased use of prefabricated material threatens to deprive building trade unions of work traditionally done by their members at the jobsite.¹ In short, prefabricated material will reduce these trade union members to the status of installers and thereby severely limit their income potential. In response to this threat, unions have incorporated into their collective bargaining agreements clauses designed to retain to the bargaining unit work that was traditionally done by it. Clauses of this type are known as work preservation clauses.

While in theory, these work preservation clauses seem to be a rational and practical solution to technological advances; in reality, they tend to do little more than polarize the competing demands of the parties involved. Owners and manufacturers are opposed to union demands for traditional work preservation. Owners have a natural desire to specify prefabricated material because of the substantial savings in labor that are realized by its utilization. The warranty provisions accompanying prefabricated units may make it additionally advantageous. Manufacturers, however, tend to be reluctant to have their products completed at the jobsite by employees other than their own because of potential warranty liability. Completion of the product outside the factory also may create labor problems with the manufacturers' own employees because it would take work away from them.

Caught between these competing demands is the contractor (usually a subcontractor) with whom the union has a valid collective bargaining agreement containing a work preservation clause. The specification of prefabricated material presents the contractor with a dilemma. The trouble free choice for the contractor is not to bid the job; however, by abstaining, he runs the risk of not being able to meet his fixed expenses and potentially of being forced out of business. Alternatively, the contractor could bid the job; and if his bid is accepted, the

contractor could run the risk of being struck by his employees in an effort to enforce the collective bargaining agreement. The latter course of action would expose the contractor to liability for missed deadlines if not for a total breach of contract.

These competing interests and equities have caused the National Labor Relations Board and the courts to attempt to fashion remedies which are reasonable and justified within the context of the American economy and existing Congressional mandates.

Historically, work preservation clauses have been considered a type of "hot cargo" clause² and as such, violative of sec. 8(e) of the National Labor Relations Act.³ This section provides in part:

It shall be an unfair labor practice for any labor organization and any employer to enter into any contract or agreement, express or implied, whereby such employer ceases or refrains . . . from handling, using, selling, transporting, or otherwise dealing in any of the products of any other employer . . .

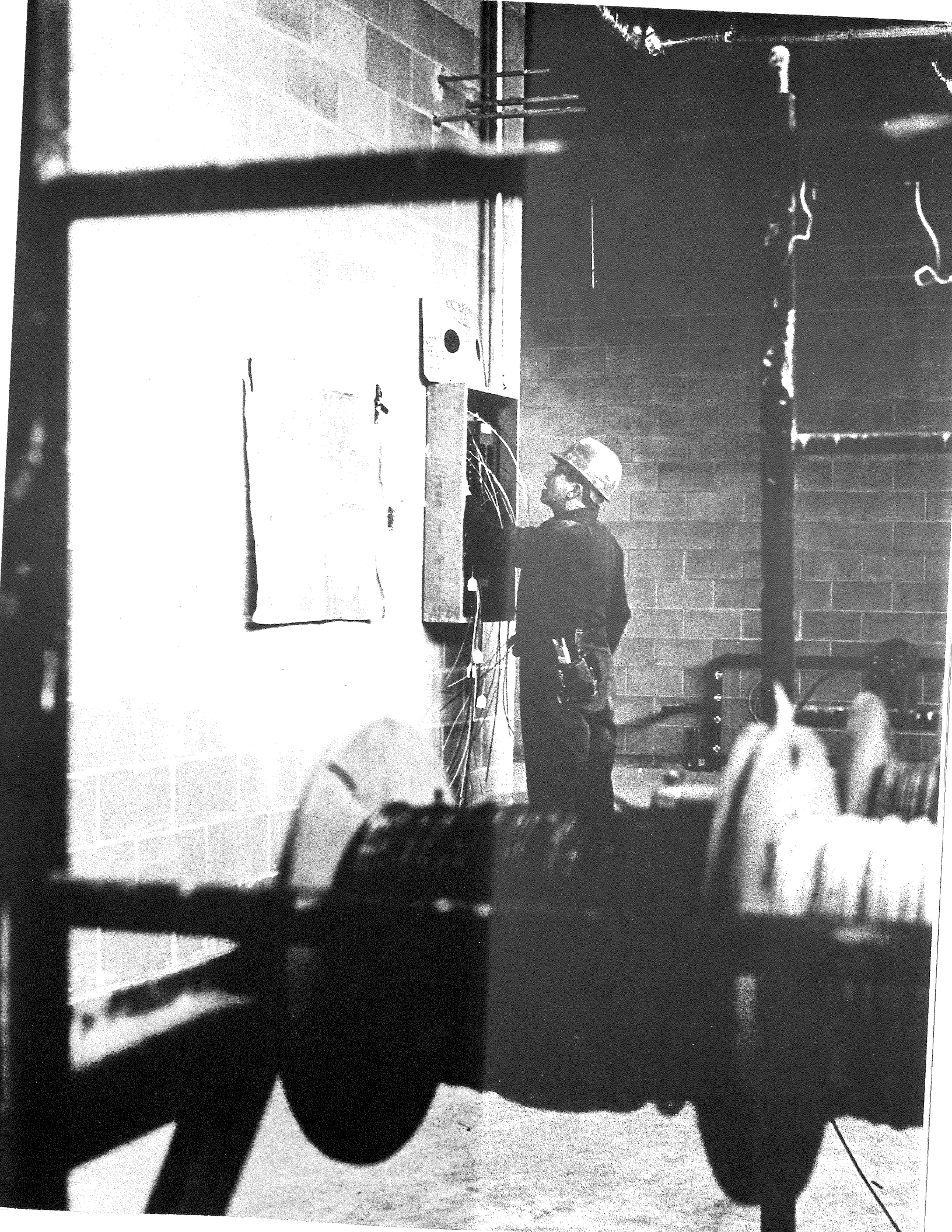
In addition, conduct used to enforce these clauses is technically violative of sec. 8(b) (4) (B) of the Act. This section closely paralleling the language of sec. 8(e) states that a union commits an unfair labor practice by:

Forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor or manufacturer, or to cease doing business with any other person . . .

A cursory reading of these sections leads one to believe that taken together sections 8(e) and 8(b) (4) (B) of the Act outlaw all work preservation agreements. This is not the case.

The Landrum-Griffin Act which added sec. 8(e) to the National Labor Relations Act, also added a proviso clause excluding from the sweeping scope of 8(e) the garment and construction industries.

Ostensibly, this enactment was a response to the Supreme Court's decision in *Local 1976, United Brotherhood of Carpenters v. Labor Board (Sand Door)*.⁴ This case involved a collective bargaining agree-



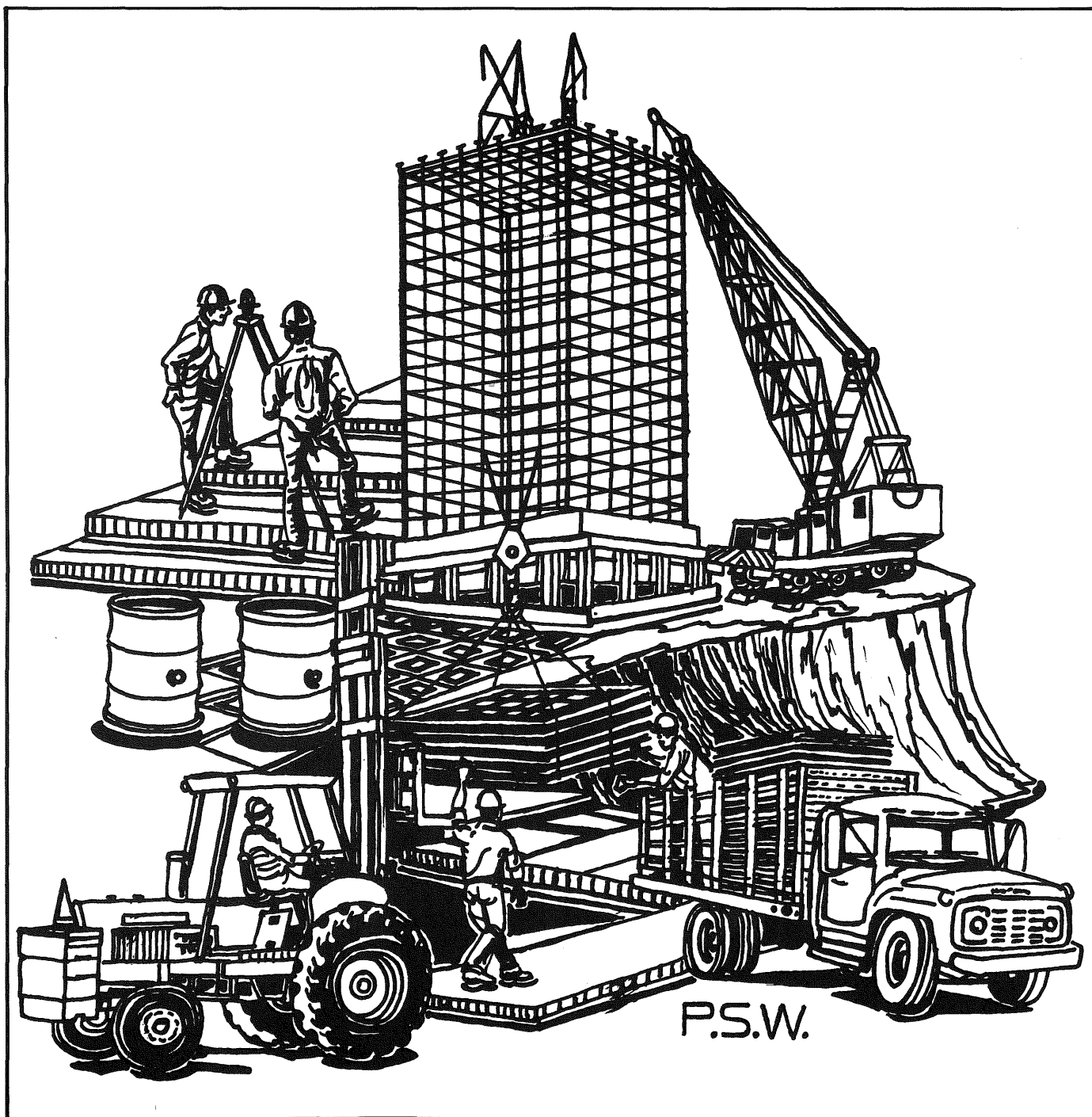
ment with a valid "hot cargo" clause: "Workmen shall not be required to handle non-union material."⁵ Non-union doors arrived at the jobsite and the union members refused to work with the doors. The Board found that the Union committed an unfair labor practice by encouraging the union workers to strike or otherwise refuse to handle the doors.⁶ The union steadfastly insisted on the validity of its agreement with the employer, and the case reached the Supreme Court.

Prior to *Sand Door*, it was felt that the

existence of a valid collective bargaining agreement constituted a defense to an unfair labor practice charge under sec. 8(b) (4) (A). The underlying rationale was that because the agreement was a voluntary contractual arrangement, the provisions of the National Labor Relations Act would not apply. The Court in *Sand Door*, contrary to this then prevailing notion, held that a valid collective bargaining agreement was not a defense to an unfair labor practice charge. The Congressional response to the Court's decision was to

close the loophole in the Act by enacting sec. 8(e) thus eliminating all "hot cargo" clauses save for the above noted exceptions.

The net effect of the Landrum-Griffin Act was to create the nether world distinction between primary and secondary activity. Work preservation clauses in the construction industry do not run afoul of sec. 8(e) because work preservation is considered to be primary activity. Any concerted activity to protect the integrity of the work preservation clause escapes



an unfair labor practice charge as long as such activity is directed against the primary employer. Not all activity against the primary employer, however, is sanctioned by sec. 8(b) (4) (B). The activity loses immunity from an unfair labor practice characterization if the object of the activity is to influence someone other than the primary employer. In such a case, the activity is considered secondary and violative of the Act.

It should be noted that even though a collective bargaining agreement includes a work preservation clause not violative of sec. 8(e), this will not necessarily preclude a finding of secondary activity on the part of the union.

Determination of what conduct used to enforce a work preservation clause is primary and what type of conduct is secondary is essential to resolving the tension which exists between sections 8(e) and 8(b) (4) (B). In attempting to elucidate this primary versus secondary activity distinction, the National Labor Relations Board has relied upon the "right to control" test as an integral part of its analysis. Under this test, if the primary employer does not have the power to assign the disputed work, an inference arises that the activity engaged in by the union must be tactically calculated to influence someone other than the primary employer.⁷ The struck primary employer, therefore, becomes a neutral party in the dispute and can avail himself of sec. 8(b) (4) (B) by charging the union with an unfair labor practice. While the inference of secondary intent greatly aids the analysis of union activity, it is not the sole determinative factor of the Board's inquiry and may be rebutted. A showing of collusion between the contractor and a third party to circumvent the work preservation clause, or a showing of the right of the struck employer to control the work in question would rebut the inference of violative secondary activity. In these cases, activity designed to enforce the agreement is primary in every sense of the word.

Criticism of the "right to control" test as being a simplistic, mechanistic approach to the problem of primary versus secondary conduct is erroneously based on a belief that the control issue is dispositive of the dispute being considered. Indeed, the Board has countered such criticism by stating that

... the Board has always proceeded with an analysis of (1) whether under all the surrounding circumstances the union's

objective was work preservation and then (2) whether the pressures exerted were directed at the right person, i.e., at the primary in the dispute. . . . In following this approach, however, our analysis has not nor will it ever be a mechanical one, and, in determining, under all the surrounding circumstances, whether the union's objective is truly work preservation, we have studied and shall continue to study not only the situation the pressured employer finds himself in but also how he came to be in that situation.⁸

This approach taken by the NLRB had been uniformly upheld by Courts of Appeals prior to the 1967 decision of *National Woodwork Manufacturers Association v. NLRB (National Woodwork)*.⁹ Subsequent to this decision, four of the six circuits to consider the question of work preservation rejected the Board's "right to control" test in favor of the "totality of the circumstances" standard thought to have been espoused in *National Woodwork*.¹⁰

In applying this test, the courts focused upon the neutrality of the employer and bolstered their analysis with an appeal to basic equity. Thus under this approach the operative legal effect of the Board's "right to control" test was viewed as:

... to allow an employer to bind his own hands and thereby immunize himself from union pressure occasioned by his employees' loss of work. In one act the employer helps to create a labor conflict and simultaneously wash his hands of it.¹¹

The courts seem to feel that there is something inherently unfair in allowing an employer who, in their opinion has voluntarily entered into a collective bargaining agreement containing a work preservation clause, to avoid possible labor problems on the one hand and then to deliberately provoke the union into a job action by accepting work that it has contracted not to handle. The contractor then seeks to extricate himself from this situation by claiming that he does not have the power to control the work which his men are doing; and, therefore, the union is committing an unfair labor practice.

Under the analysis of the "totality of the circumstances" test, a great deal of emphasis is placed upon the existence of a work preservation clause. The courts reasoned that when an employer enters into such an agreement with his employees, he forfeits his neutral status and should suffer the consequences of his actions without the protection of sec. 8(b)

(4) (B). It is felt that since the employer entered into the contract with the union, he is the one who should extricate himself from the situation either by refusing material that he has agreed not to handle or by negotiating a wage settlement that will compensate the employees for the lost time.¹² "You agreed to the clause, you solve the problem" summarizes the approach of these courts.

One cannot help but question the application of the "totality of the circumstances" test in lieu of the Board's "right to control" test for a number of reasons. Potentially, it appears from a reading of the cases that the "totality of the circumstances" test is wider in scope than the "right to control" test. In practice, however, this does not appear to be true. The courts' inquiry into the conflicting claims of the parties seems to stop with a finding of a valid work preservation clause. The conclusion reached being that if the clause is valid under sec. 8(e), it will make all action taken to enforce it protected primary activity. This is illustrated in Justice Brennan's dissent in *NLRB v. Enterprise Association of Steamfitters*:¹³

Pressure undertaken in order to preserve work traditionally performed by unit members aims at benefits for those members, and centers on a conflict between the employees and their employer, which, although it has secondary effects on the other employers as does the use of almost any economic weapon in a labor dispute, can only be regarded as primary. Thus if a contract clause is intended to preserve work, its objective and the objective of pressure to enforce it is primary and therefore legitimate.¹⁴

Under this test there is also curiously little inquiry into the extrinsic circumstances surrounding a labor dispute such as: the competitive nature of the industry, the extent of union organization in a given locality, or the fact that an employer is mandated to bargain over work preservation.¹⁵

Such a narrow view of the law as sanctioned by the "totality of circumstances" test gave rise to the contorted analysis exemplified in dicta in *Associated General Contractors of California v. NLRB*¹⁶ which suggested that activity intended to enforce a work preservation clause may have a secondary object if the product is new to the market.

In this case, a new type of scrub sink was to be installed at a hospital construction site. The sink was essentially a pre-



fabricated unit; and, as such, the union claimed that to install it would violate the terms of the collective bargaining agreement in that all material was to be assembled at the jobsite. In holding this conduct to be prohibited secondary activity, the Court of Appeals never reached the issue of whether the object of the strike was the primary employer and, as such, primary activity; or whether it was aimed at another party and, hence, secondary activity. Instead, the court reasoned that because the product was new, the object of the activity was secondary because in essence the union sought to acquire the work and not to preserve it. This court's failure to reach the issue of primary versus secondary activity did nothing to help clear the murky world of work preservation clauses.

The most glaring defect of the "totality of circumstances" test is, however, the obvious misreading of *National Woodwork*. Instead of reading the decision for its single purpose, "... a delineation of that degree of proof which establishes a permissible primary boycott but falls short of evidencing the interdicted secondary boycott,"¹⁷ a number of circuits read *National Woodwork* as overruling the "right to control" test in favor of the "totality of circumstances" standard. In reality, a careful reading of *National Woodwork* would indicate that the issue of the "right to control" analysis was never before the Court.¹⁸

In attempting to resolve the conflict between the circuits, the Supreme Court granted certiorari to a Court of Appeals

case, *Enterprise Association of Steamfitters v. NLRB*.¹⁹ In this case, the Court of Appeals refused to enforce the Board's cease and desist order issued pursuant to a finding of an unfair labor practice.

The factual situation centered around a subcontractor who had a contract with a general contractor for the heating, ventilation and air conditioning work in the construction of a home for the aged. The specifications provided that the general contractor would purchase climate control units from Slant/Fin with all of the internal piping of these units to be done at the factory. The collective bargaining agreement between the union and the subcontractor, however, provided that all of the internal piping was to be done at the jobsite. When the units arrived, the union steamfitters employed by the subcontractor refused to install the units on the grounds that the factory installed piping violated the collective bargaining agreement. The general contractor then filed a complaint with the NLRB alleging an unfair labor practice under sec. 8(b) (4) (B), specifically charging that the union action was taken to force the subcontractor to cease doing business with the general contractor and to force both contractors to cease dealing with Slant/Fin's products.²⁰

In reversing the Court of Appeals, the Supreme Court attacks the decision and reasoning on two points. The first proposition so attacked is the Court of Appeals' holding that:

An employer who is struck by his own employees for the purpose of requiring him

*to do what he has lawfully contracted to do to benefit those employees can never be considered a neutral bystander in a dispute not his own.*²¹

The Supreme Court finds this proposition untenable under both the Act and the *Sand Door* decision:

*To hold as the Court of Appeals did, that a work stoppage is necessarily primary and not an unfair practice when it aims at enforcing a legal promise in a collective bargaining contract is inconsistent with the statute as construed in Sand Door, a construction that was accepted and that has never been abandoned by Congress.*²²

In dealing with the lower court's rejection of the "right of control" test and its reliance on the "totality of circumstances" standard, the Supreme Court reviews its findings in *National Woodwork*:

*That since Frouge (the general contractor) had the power to settle the dispute by specifying blank doors instead of prefabricated ones, the union did not commit an unfair labor practice by striking to enforce the agreement.*²³

Thereupon, the *Enterprise* Court declares that *National Woodwork*

*... did not announce a new legal standard, but rather simply sustained the Board's findings... without questioning either the legal standard employed... or the Board's resolution of the facts under that standard.*²⁴

In enforcing the Board's order, the Court in *Enterprise* goes further than tacitly approving the "right to control" test. The Court expressly declares that the approach taken by the administrative law judge and adopted by the Board fully complies with the standard of *National Woodwork*.²⁵

In addition, the Court allows that *... the Board may assign the presence or absence of control much more weight than would the Court of Appeals, but this far from demonstrates a departure from... the test recognized in National Woodwork.*²⁶

Such a holding tends to remove from the Courts of Appeals review of this issue, thus emasculating their version of the *National Woodwork* test.

In light of the *Enterprise* revitalization of the "right to control" test, the efficacy of work preservation clauses in a modern context is indeed questionable. Given the *Enterprise* decision and the structure of the construction industry as previously discussed and the trend towards the increased use of prefabricated material, it is inevitable that activity by a union

against a subcontractor to enforce a work preservation clause will be classified as prohibited secondary activity. Such a result, however, is not as inequitable as it may initially seem. The result tends to strike a balance between the labor union and the primary employer. This stand-off accurately reflects the ability of each party to deal with the problem, namely, no ability. A subcontractor cannot get the general contractor to forego the use of prefabricated material, nor can the local union hope to convince a manufacturer to stop producing units that are prefabricated by striking a subcontractor. The parties, thus, are left in a position of equal helplessness. Such an approach fails to violate Congress' intent in enacting the NLRA: "For management and labor to negotiate solutions to these sig-

nificant and difficult problems."²⁷ The solution to this problem is beyond the control of the union and the employer. To negotiate a solution to a problem which for these parties has no solution would indeed be a ludicrous exercise and surely not mandated by Congress.

In fashioning this remedy, the *Enterprise* Court has in effect refused to become an instrument of social change with regard to the question of work preservation. Instead, it has effectively endorsed the best possible test in light of the restrictions imposed by the language of the National Labor Relations Act. By allowing the Board broad latitude in resolving disputes concerning work preservation, the net result is to keep the parties in relative balance until there is a final legislative resolution of this prob-

lem. If no such resolution is forthcoming, hopefully, the test fashioned by the Court and the Board will keep pace with the changing socio-economic climate and continue to strike a balance between the parties rather than becoming an albatross around the neck of labor or management.

In the final analysis, the *Enterprise* decision, in addition to laying to rest the "totality of circumstances" test, without Congressional initiative, signalled the death of work clauses as we know them today. They will die a slow death enjoying some vitality in the increasingly rare situation where the primary employer has the right to assign work, but for the most part these clauses are no longer effective in the modern context.

Footnotes

1. *NLRB v. Enterprise Association of Steamfitters*, 45 U.S.L.W. 4144 (February 22, 1977).
2. *Brinker, Hot Cargo Cases Since 1958*, 22 LABOR LAW JOURNAL 586, 604 (1971).
3. 29 U.S.C. § 158(e).
4. 357 U.S. 93 (1958).
5. 45 U.S.L.W. at 4146.
6. *Id.*
7. *Id.* at 4148.
8. *Id.* at 4148 n.11, quoting the Board's decision in *George Koch Sons Inc.*, 201 NLRB 59, 64 (1973).
9. 386 U.S. 612 (1967).
10. 45 U.S.L.W. at 4149 n.15, quoting *Enterprise Association of Steamfitters v. NLRB*, 521 F.2d 885 (D.C. Cir. 1975), *cert. granted* 424 U.S. 908 (1976); *Local Union 636, United Association of Journeymen v. NLRB* _____ U.S. App. D.C. _____, 430 F.2d 906 (1970); *American Boiler Manufacturers Association v. NLRB*, 404 F.2d 556 (8th Cir. 1968); *NLRB v. Local 164, International Brotherhood of Electrical Workers*, 388 F.2d 105 (3rd Cir. 1968); *Beacon Castle Square Building Corp. v. NLRB*, 406 F.2d 188 (1st Cir. 1969) (dictum).
11. *Enterprise Association of Steamfitters v. NLRB*, 521 F.2d 885, 895 (D.C. Cir. 1975).
12. 45 U.S.L.W. at 4152.
13. 45 U.S.L.W. at 4144.
14. *Id.* at 4152.
15. 386 U.S. at 642.
16. 514 F.2d 433 (9th Cir. 1975).
17. *George Koch Sons Inc. v. NLRB*, 490 F.2d 323, 327 (4th Cir. 1973).
18. 386 U.S. at 617 n.3.
19. U.S.L.W. at 4152.
20. 45 U.S.L.W. at 4144.
21. *Id.* at 4146.
22. *Id.* at 4147.
23. *Id.* at 4148.
24. *Id.*
25. *Id.*
26. *Id.*
27. 386 U.S. at 640.



Rebuttal

Attorney Thomas A. Walsh's article was submitted in response to an article written by Harvey B. Fireman entitled "Obscenity Prosecutions: A Chill on First Amendment Rights" which was published in the Spring, 1977 issue of The Advocate.

After tracing the history of obscenity prosecutions, Mr. Fireman stated the three-prong modern test for obscenity: (a) whether the average person would find that the material appeals to the prurient interest, and (b) whether the material depicts sexual conduct in a patently offensive manner, and (c) whether the work lacks serious literary, artistic, political, or scientific value. Mr. Fireman argued that the test of community standards, applying to the first two tests, was unduly vague and that the community standards test prevents the use of collateral estoppel, forcing the defendant to relitigate the issue of obscenity in each prosecution. These two problems force a publisher to weigh potentially protected speech against the spectre of multiple prosecutions, chilling his First Amendment rights.

Few attorneys outside of the civil libertarian fringe defend pornographers or those involved with pornographers, chiefly because of its very distaste and because of the tie-in of Organized Crime with the pornography and obscenity industries. The poor First Amendment has been much overworked and overtaxed as a defense by the unceasing contentions of defense attorneys that their clients' rights have been violated, even though our United States Supreme Court has repeatedly ruled that obscenity and pornography are not protected forms of free speech.

The article bemoans the "community standards" ruling in the *Miller* case because it "lays a dangerous trap for anyone distributing material that in any way describes or depicts sexual conduct." But the *Miller* case also stated that this description and depiction must be "patently offensive 'hard core' sexual conduct specifically defined by existing state law, as written or construed." The Court continued, "(w)e are satisfied that these specific prerequisites will provide fair notice to a dealer in such materials that his public and commercial activities may bring prosecution." It was Justice Potter Stewart of the United States Supreme Court who observed that "no one had to tell me what obscenity was. I knew it when I saw it." Make no mistake about it, the pornographers know that it is pornography they are spewing out all over our land.

Our obscenity laws have been based on "community standards" since 1957, when the Court ruled in *Roth v. United States* that the test for obscenity was, "whether to the average person, applying contemporary community standards, the dominant theme of the material taken as a whole appeals to the prurient interest." This test became the constitutional test of obscenity. The "community standards" test is nothing new.

The author complains that the standards of City A should not be imposed on Cities B and C. I believe that the standards of Cities B and C should not be imposed on City A. If City A has no right to speak out, then everyone else's stand-

ards are imposed on her. The article implies that there should be a national standard. The *Miller* Court rejected the idea of a national standard saying "[n]othing in the First Amendment requires that a jury must consider hypothetical and unascertainable 'national standards' when attempting to determine whether certain materials are obscene as a matter of fact." Chief Justice Warren, dissenting in *Jacobellis v. Ohio*, stated that "it is my belief that when the Court said in *Roth* that obscenity is to be defined by reference to community standards, it meant community standards — not a national standard, as is sometimes argued. I believe that there is no provable national standard." The *Miller* Court also said that,

"[i]t is neither realistic nor constitutionally sound to read the First Amendment as requiring that the people in Maine or Mississippi accept public depiction of conduct found tolerable in Las Vegas or New York City.

... People in different states vary in their tastes and attitudes and this diversity is not to be strangled by the absolutism of imposed uniformity."

In June of 1974 the United States Supreme Court ruled in *Hamling v. United States* that no precise geographic area was required with reference to the definition of a community. In the same case, the Court implied that mailers of obscene material could be prosecuted at any point of destination of the material. In writing the decision, Justice Rehnquist said

"[t]he *Miller* case standards, including the 'contemporary community standards' formulation, apply to federal legislation. The fact that distributors of allegedly obscene materials may be subjected to varying community standards in the various federal judicial districts into which they transmit the materials does not render a federal statute unconstitutional because of the failure of application of uniform national standards of obscenity. Those same distributors may be subjected to

such varying degrees of criminal liability in prosecutions by the States for violations of state obscenity statutes; we see no constitutional impediment to a similar rule for federal prosecutions."

The citizens of a city or town have the right to determine the character and quality of life they want for their own, providing they do not violate the law.

The article questioned jury selection in obscenity cases. In *Roth*, the Supreme Court observed that "[i]t is common experience that different juries may reach

different results under any criminal statute. That is one of the consequences we accept under our jury system." No constitutional rights are abridged under this system.

It may be truthfully said that no work of any literary merit has ever been permanently suppressed in our nation, even though restraints of one kind or another have been on our statute books since the country's beginnings 200 years ago. After the hue and cry raised by a vociferous minority, the pornographers, that their First Amendment rights are constantly

violated, it is time that the great, great majority of our citizens secure the minimum standards of *public* decency to which they are constitutionally and morally entitled. It is time to call to the attention of the American people that there is no such a thing as absolutism under the First Amendment to our Constitution.





The Broad Reach of The Consumer Protection Act

The Massachusetts Consumer Protection Act, chapter 93A of the General Laws, "is a statute of broad impact which creates new substantive rights and provides for new procedural devices for enforcement of those rights . . ." ¹ This brief will provide an overview of this statute, how it affects consumer litigation, ² the type of transactions it may reach, and an explanation of the demand and settlement procedures of §9. ³

The Scope of 93A:

Section 2 defines the substantive violation of ch. 93A by providing that "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce" are unlawful. This section further provides that decisions of the Federal Trade Commission and the Federal Courts are to be used for guidance. In addition, the state Attorney General has the authority to promulgate rules and regulations interpreting the act.

To bring an action under §9, one must have purchased or leased property or services for personal, family, or household use. ⁴ In only a very few cases have the courts expressly stated that the given acts were not a violation of ch. 93A. ⁵

The rules and regulations of the Attorney General have given an even broader reach to the statute and perhaps spread its protection into areas not contemplated by the Legislature. For example, in *Slaney v. Westwood Auto, Inc.*, ⁶ the court reversed the trial court's ruling that ch. 93A created no new cause of action in a classic case of breach of express and implied warranties under the Uniform Commercial Code. The court relied on Attorney General Regulation VIIIB which reads:

Warranties. It shall be an unfair or deceptive Act or practice to fail to perform or fulfill any promises or obligations arising under a warranty. The utilization of a deceptive warranty is unlawful.

Although it is too early to tell, a broad reading of *Slaney* may have the effect of injecting ch. 93A into all warranty ⁷ and product liability claims. ⁸ This very broad sweep can have serious consequences in an attorney's tactical decisions because of the clout of ch. 93A's settlement procedures.

The Demand and Settlement Procedures of ch. 93A:

Section 9(3) is the heart of ch. 93A and was intended to force most complaints to

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be settled without litigation. ⁹ A defendant who doesn't respond to a demand letter sent pursuant to §9(3) may find himself liable for double or treble damages, ¹⁰ minimum damages, and the plaintiff's attorney's fees. These strictures should make the most recalcitrant defendant respond to a demand letter. If he responds with a reasonable offer of settlement, he can effectively place a ceiling on the plaintiff's recovery, eliminate the possibility of double or treble damages, ¹¹ and limit the amount of attorney's fees.

The demand letter must be the first step in the negotiation procedures of ch. 93A. It must be sent 30 days prior to the filing of suit and contain sufficient facts to give the defendant notice and an opportunity to review the facts and law to see if the requested relief should be granted or denied. ¹² The demand letter, then, an absolute prerequisite to suit starts the settlement process by throwing the ball to the defendant to take action or suffer the penalties. It should be noted, however, that the demand letter is not a commencement of the action, and hence does not toll the statute of limitations. ¹³

If the defendant responds with a reasonable offer of settlement, and the plaintiff accepts, the procedures of §9(3) have served their function. If the tender of settlement is rejected, however, the defendant may file the written tender of settlement and an affidavit concerning its rejection and thereby limit the plaintiff's recovery to the offer of settlement, assuming it has been found to be reasonable. ¹⁴

The defendant bears the burden of proving the reasonableness of the settlement offer, ¹⁵ but what is a reasonable offer? This is a very important determination, and perhaps even more important in a case where there are several counts. The question really is, what type of damages are recoverable under ch. 93A? The court in *Baldassari v. Public Finance Trust* ¹⁶ reluctantly dismissed a case which contained facts characterized by the court as "clear, serious and continuing violations of ch. 93 §49" ¹⁷ because of the failure to plead money or property lost." The alle-

gation of severe emotional distress was found to be an inadequate allegation of damages. This case may be read, and the statute may be interpreted, for the proposition that only monetary damages may be recovered under ch. 93A §9(1). ¹⁸ If this is the case, and there are no contrary indications ¹⁹, then the settlement provisions of ch. 93A will not have as great an influence as if damages were recoverable for pain and suffering.

Finally, in measuring the reasonableness of the tender of settlement, the judge should not treat attorney's fees as part of the injury suffered. ²⁰

Conclusion:

Chapter 93A offers intriguing possibilities in many areas of consumer litigation. While the extent of its impact cannot be known until some questions are answered by the SJC, it is certain to become a large part of consumer law as it develops.

Footnotes

1. *Slaney v. Westwood Auto, Inc.*, _____ Mass. _____, 322 N.E.2d 768, 722 (1975).
2. For an exhaustive treatment of the protection of the businessman provided for in MASS. ANN. LAWS ch. 93A, §11, see Pirozzolo, *Chapter 93A: The Massachusetts Little FTC Act—A Potent Unexplored Remedy in Business Disputes*, 62 MASS. L.Q. 77 (1977).
3. A seminal treatment of this area may be found in Rice, *New Private Remedies for Consumers*, 54 MASS. L.Q. 307 (1969). This article discusses no cases, but its author was one of the principal draftsmen of the act.
4. *United States v. Roche*, 425 F.Supp. 743 (D. Mass. 1977).
5. *Donnelly v. Suffolk University*, _____ Mass. _____, 337 N.E.2d 920 (1975); *Kantervitz v. Academy of Physical and Social Development*, _____ Mass. _____, 346 N.E.2d 910 (1976); *P.M.P. Associates v. Globe Newspaper Co.*, _____ Mass. _____, 321 N.E.2d 915 (1975).
6. _____ Mass. _____, 322 N.E.2d 768 (1975).
7. The Attorney General's Regulations define warranty so as to encompass express and implied warranties.
8. *Cf. Kohl v. Silver Lake Motors, Inc.*, _____ Mass. _____, 343 N.E.2d 375 (1976) where on essentially the same facts, the court found no ch. 93A violation. The court stated, however, that no argument was presented that there was a violation of the Attorney General's Regulation. *Id.* at n.5. The court has stated that it

- will not take judicial notice of the Regulations. *Yoch v. Sullivan*, _____ Mass. _____, 338 N.E.2d 341 (1975).
9. 54 MASS. L.Q. at 309.
 10. In order to recover double or treble damages, there must be a wilful violation of ch. 93A or a bad faith refusal to settle. The present uncertainty of what is or is not a violation of ch. 93A dilutes the effectiveness of this provision. The *Slaney* court seems to indicate that only where the alleged act was clearly declared unlawful by an A.G. Regulation has there been a sufficient showing to recover double or treble damages, _____ Mass. _____, 322 N.E.2d at 722 n.20.
 11. This is true even if the original violation of ch. 93A was wilful. *Entrialgo v. Twin City Dodge, Inc.*, _____ Mass. _____, 333 N.E.2d 202 (1975).
 12. *Baldassari v. Public Finance Trust*, _____ Mass. _____, 337 N.E.2d 701 (1975).
 13. *Id.*
 14. *York v. Sullivan*, _____ Mass. _____, 338 N.E.2d 341 (1975).
 15. _____ Mass. _____, 333 N.E.2d 202 (1975).
 16. *Id.*
 17. MASS. ANN. LAWS ch. 93, §49 pertains to unfair debt collection practices and states that a violation of ch. 93§49 is a violation of ch. 93A.
 18. Equitable relief, including injunctions, is expressly authorized in the statute.
 19. See *Kohl v. Silver Lake Motors*, _____ Mass. _____, 343 N.E. 2d 375, _____ (1976); *York v. Sullivan*, _____ Mass. _____, 338 N.E.2d 341, _____ (1975). *Cf. Nader v. Citroen*, _____ Mass. Adv. Sh. _____ (1977); *Dodd v. Commercial Union Ins. Co.*, _____ Mass. Adv. Sh. _____ (1977).
 20. *Kohl v. Silver Lake Motors*, _____ Mass. _____, 343 N.E.2d 375 (1976).

Carmine Cornelio

The Right to Counsel in the Grand Jury

Massachusetts now permits defense counsel to be present in Grand Jury proceedings.

Governor Michael Dukakis signed into law Senate Bill No. 1482 which amends ch. 277 of the Massachusetts General Laws by adding the following new section 14A:

Any suspect shall be entitled to consult with counsel and to have counsel present at every step of the proceedings including the presentation of evidence, questioning or examination before the Grand Jury.

An advisory opinion is expected from the Supreme Judicial Court sometime in December on the constitutionality of the Bill.

Only seven other states permit counsel's presence before the Grand Jury: Arizona, Kansas, Utah, Virginia, Washington, Michigan and Minnesota. 29 OKLA. L. REV. at 970 (1976). The laws regulating

the attorney's function in this capacity vary widely among these seven states. The Kansas statute, for example, limits the attorney's function to that of giving advice and making objections on his client's behalf. KAN. STAT. ANN. §22-3009 (1974). The Oklahoma statute provides that the Grand Jury must hear the testimony of the accused upon his request. Therefore, it appears that counsel in Oklahoma may conduct a direct examination of his client. 29 OKLA. L. REV. at 973. The impact that the new Massachusetts law will have on the Grand Jury has yet to be determined. One suspects that the lawyer's function in the Grand Jury will hinge upon future court decisions interpreting the legislative meaning of the word "consult".

The Grand Jury is not an adversary proceeding in which guilt or innocence is determined. It is an investigative forum which is "designed to examine the possibility that a crime has been committed and whether a criminal complaint should issue," *United States v. Calandra*, 414 U.S. 338 (1974). It is this rationale that has enabled the prosecution to exclude defense counsel from the Grand Jury for such a long time. However, support for this position has waned in recent years. The trend away from a staunch adversarial posture between prosecution and defense, the increasing skepticism surrounding the effectiveness of the Grand Jury, and the liberalization of criminal discovery procedures indicate that Massachusetts will not be the last state to admit defense counsel into the Grand Jury room.

Ronald R. Sussman

Advertising is the Greatest Concern

Forty-two percent of the lawyers responding to a recent American Bar Association poll listed advertising as the single greatest problem facing the profession. Based on a random telephone survey of 602 ABA members in August, the poll showed that most attorneys fear advertising will ultimately lead to "the slick kind of advertising that we associate with consumer products." In addition, 68 per cent of those interviewed said they disagreed with the premise that lawyer advertising will lead to more competitive pricing, resulting in a general fee

decrease. Sixty-six per cent of the respondents also stated that attorneys would not generally pass advertising costs to the consumer in the form of higher fees.

The lawyers' image before the public ranked second in concern with the respondents with 25 per cent, followed by ethics, legal services for the middle class, legal services for the poor, and specialization. Unequal justice ranked as the least important area of concern.

Here is how the poll reflected answers to the question of importance of issues before the legal profession:

Law and Society	71	%
Advertising	42	
Lawyer image before the public	25	
Legal services for middle class	14	
Legal services for the poor	8	
Prepaid legal services	5	
Lawyer-community relations	4	
Practice of Law	33	
Ethics	18	
Fee structures	7	
Malpractice insurance	6	
No-fault insurance	4	
Conditions of the Bar	30	
Specialization	8	
Mandatory continuing education	7	
Self-regulation and policing	6	
Relicensing	4	
Too many lawyers	3	
Raising bar qualifying standards	2	
System of Justice	21	
Clearing court calendars	4	
Streamlining procedures	4	
Criminal justice reform	3	
Federal judiciary	3	
Government encroachment on civil liberties	2	
Simplification of the system	2	
Unequal justice	1	
Other justice system	5	
Not Sure/Don't Know	6	

(Note: Percentage adds to more than 100 and individual mentions to more than subtotals because of multiple responses.)

Harvey Fireman

Age Discrimination and the Equal Protection Standard

The ability to continue to be employed as long as an individual is physically and mentally able to do so was dealt a severe

blow when the U.S. Supreme Court upheld a Massachusetts statute which provided that any officer of the state police shall be retired at age fifty. The case was *Massachusetts Board of Retirement v. Murgia*, 96S. Ct. 2566 (1976).

The petitioner, Robert Murgia, was involuntarily retired as a uniformed police officer pursuant to the statute. The petitioner brought suit to have the statute (M.G.L. c.32 sec.26(3)(a)) declared unconstitutional. A three judge panel of the U.S. District Court for the district of Massachusetts declared the statute unconstitutional and the Commonwealth appealed.

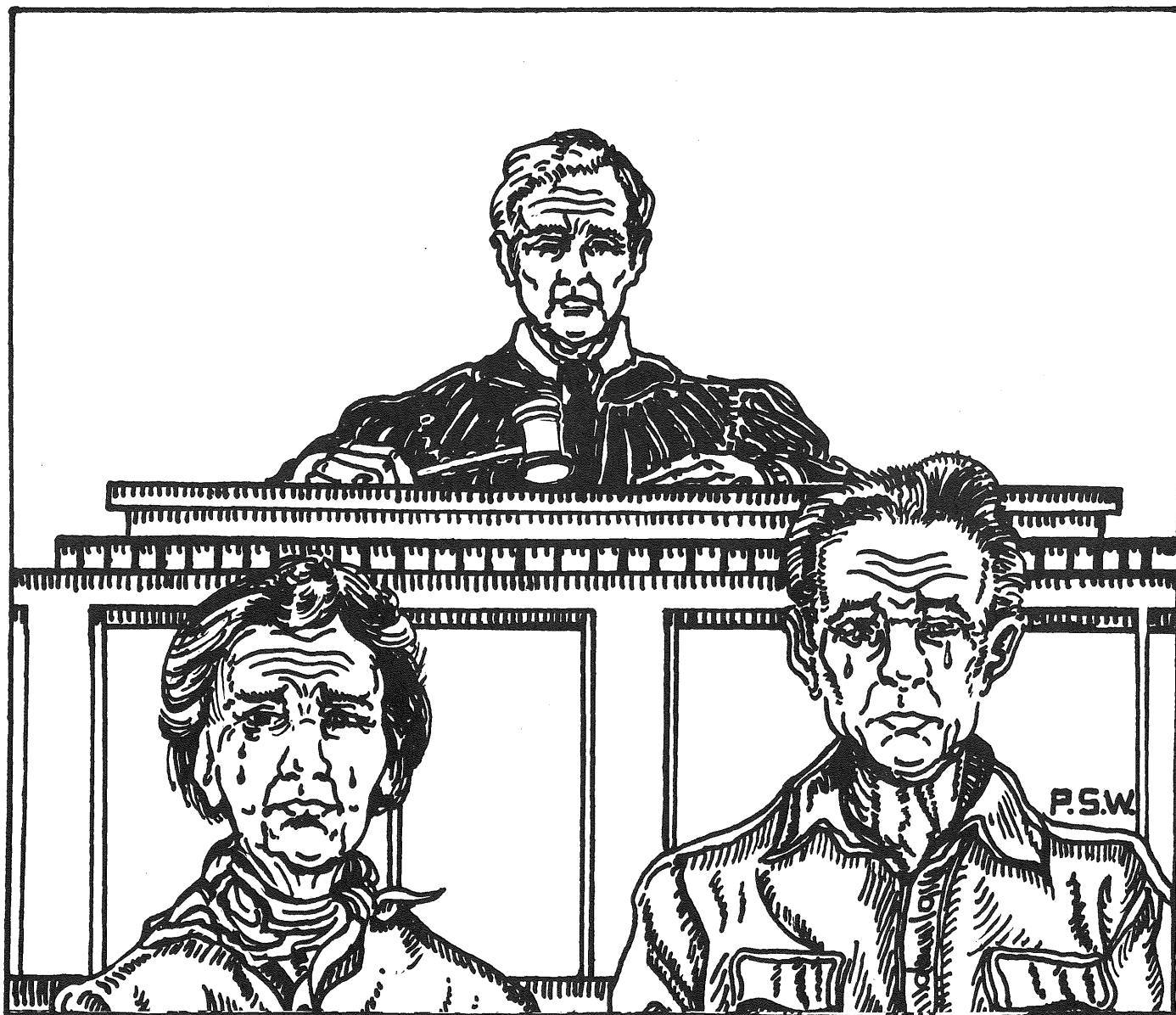
On appeal the U.S. Supreme Court held with Justice Marshall dissenting, that the District Court improperly applied the strict scrutiny standard to the

question. The Court stated that the rationality test, rather than strict scrutiny, was the proper standard in determining whether the statute violated equal protection. The Court further determined that the age classification was rationally related to furthering a legitimate state interest; protecting the public by assuring a physically fit police force.

In essence this case revolved around the Supreme Court's continued support of the "two tiered" system of deciding equal protection cases. In the "two tiered" approach the Court applies a strict standard of review to statutes which involve either "fundamental" rights or "suspect classes"; in all other cases a more relaxed standard is applied. The Court initially inquires into whether the challenged statute infringes on a "fun-

damental" right, such as the right to vote (*Bullock v. Carter*, 405 U.S. 134) (1972); or operates to the disadvantage of a "suspect class", such as race (*Graham v. Richardson*, 403 U.S. 365) (1971). If the statute is found to do either, the Court will find the statute unconstitutional unless it can be justified by a showing of a compelling state interest. This test, as articulated in *Shapiro v. Thompson*, 394 U.S. 618 (1969), is nearly impossible to meet; only once has the Supreme Court found the state's argument of compelling state interest sufficient to justify the infringement of a "fundamental" right or discrimination against a suspect class. *Koramatso v. U.S.*, 319 U.S. 432 (1943).

In *Murgia* the Court first inquired as to whether the strict scrutiny test was the proper test. The Court first stated that the



right to employment in government was not *per se* fundamental, so that strict scrutiny would not be applied on that basis.

The court next examined the age criteria, stating: "While the treatment of the aged in the Nation has not been wholly free of discrimination, such persons, unlike, say, those who have been discriminated against on the basis of race or natural origin, have not experienced a 'history of purposeful unequal treatment' or been subjected to unique disabilities on the basis of stereotyped characteristics not truly indicative of their abilities." *Murgia, supra*, at 2566-67. The Supreme Court determined that the right to be employed is not fundamental and that age is not a suspect class; therefore, the strict scrutiny test was inapplicable.

The Court then determined that the statute should be examined in the light of the rationality test. This test simply requires the challenged statute to bear a rational relationship to a legitimate state objective. In this case the Court held that the compulsory retirement statute furthered a legitimate state purpose; that of providing a physically prepared police force to protect the public.

The Court, while admitting that the age cutoff might force the retirement of some individuals still physically able to do the job, defended the statute as being satisfactory since it is impossible to draw the line perfectly. The Court further stated that simply because the Commonwealth "chooses not to determine fitness more precisely through individualized testing after age fifty is not to say that the objective of assuring physical fitness is not rationally furthered by a maximum age limitation. It is only to say that with regard to the interest of all concerned, the state perhaps has not chosen the best means to accomplish this purpose." *Id.*, at 2568.

The dissent sharply attacks the lip service paid to the right to employment and the treatment of the middle aged and aged because the court failed to strike down the statute. The dissent combined a plea for the invalidation of the compulsory retirement statute and for a more realistic approach to equal protection problems. The dissent recognizes the rigidity of the two tier system and the Court's hesitance to expand its determination of what constitutes "fundamental" rights or "suspect classes". The dissent argues that as the system presently stands, if legislation falls within the first aspect in that it infringes upon funda-

mental rights or discriminates against a suspect class it will be found unconstitutional; while if it fails to fit into the strict scrutiny standard the legislation will always be upheld.

In assaulting the two tier system as being inadequate to protect rights not classified as "fundamental" and classes not presently classified "suspect", the dissent stated that to adhere rigidly to the traditional test was inadequate. The Supreme Court could uphold the constitutionality of the Massachusetts statute only by ignoring the importance of the benefits denied, the character of the class and the asserted state interest.

The dissent analyzed the Massachusetts statute in terms of the three factors stated above. The dissent first noted that fundamental or not, the right of an individual to engage in an occupation has been recognized as falling within the concept of liberty guaranteed by the Fourteenth Amendment, *Murgia, supra*, at 2571. The dissent continued by admitting that even if the right to earn a living does not include the right to work for the government, an argument the appellee did not make, it is settled "that because of the importance of the interest involved, we have always carefully looked at the reasons asserted for depriving a government employee of a job", *Id.*, at 2571.

The dissent next noted that deprivation of government employment works a disadvantage on any individual but particularly the older worker. Forced retirement can seriously injure a person emotionally as well as economically. Whether or not older workers form a suspect class, the dissent argues: "... it cannot be disputed that they constitute a class subject to repeated and arbitrary discrimination in employment." *Id.*, at 2572.

The dissent, while agreeing that the state interest in providing and maintaining a healthy police force was legitimate, attacked the statute and the majority for supporting a system which arbitrarily takes away a person's livelihood simply for attaining a certain age. Without data supporting a theory that people are unfit for the position of police officer upon attaining the age of fifty, the statute is denying people a right to continue to support themselves and to prove themselves capable of continuing their service to their employer by arbitrarily setting a standard without a rational basis for the standard.

The Court could have invalidated the statute by applying the strict scrutiny

test. While the right to earn a living has not been identified as "fundamental", its importance has often been recognized by the Supreme Court so that the recognition of it as Fundamental could have been accomplished.

Similarly the Court could have invalidated the statute by recognizing age as a suspect class. Such a step could be rationalized by the Court upon examining the text of the Discrimination in Employment Act of 1967, which stated that: "The setting of arbitrary age limits regardless of potential for job performance has become a common practice", and that older workers face "grave" problems of high unemployment. 29 U.S.C. 621(a) (2).

It is possible that the Court, if it desired to maintain the two tiered system, could still have struck down the statute under the rationality test in that the statute constituted arbitrary discrimination against police officers over fifty. The statute provided for yearly physicals to determine the physical ability of each officer on an individual basis. Given this factual setting, a statute which automatically retires employees at a specific age, regardless of ability, is arbitrary and irrational.

The problems arising in equal protection cases including this one should be resolved by using a more flexible test. The approach taken by the dissent, where an individual's rights receive the increased protection of the judicial system as the importance of the benefits increases, seems better suited than the present system to protect the rights of those individuals seeking judicial protection as a non-suspect class. Unless the system as it presently exists is corrected or the Court acts on enlarging the scope of fundamental rights and suspect classes, little judicial protection will be available to persons outside the aura of the "fundamental" and "suspect" classifications.

Mark J. Noonan

Suffolk To Gain AALS Accreditation

Suffolk Law School will soon gain admission to the Association of American Law Schools (AALS), an organization which includes only the finest institutions of legal education, according to Associate Dean Herbert Lemelman. Suffolk's application will be on the agenda at the AALS convention in Atlanta in late December. At that time, the full AALS membership will be presented with the recommendations of the Accreditation Committee and the Executive Committee, both of which favor Suffolk's admission. Since it is rare that the advice of these committees is overruled, admission is foreseen.

The effect of AALS accreditation will be to "further enhance the reputation of the school" according to Dean Lemelman, because Association standards are much more restrictive than those of the American Bar Association. AALS accreditation will also eliminate the problems which students have heretofore encountered when attempting to transfer Suffolk course credits to some other law schools. Suffolk's Summer Program will thus be made even more attractive to students studying full time at other law schools.

The Templars Formed for \$100 Donors

The establishment of a donors club called The Templars recognizing alumni and friends whose gifts to the Annual Fund range from \$100 to \$499 has been announced by Ronald A. Wysocki, National Chairman of the Annual Law Fund.

"The Templars should fulfill a need to recognize significant contributions by alumni," said Wysocki. "This club is similar to the Century Club which existed for many years. The name Templars was selected by a group of alumni interested in forming the program. A Templar was a member of the chivalric order at the time of the Crusades and is also a barrister or student of law in England. The title also has reference to the commonly used address of the Law School — 41 Temple Street."

The Annual Fund already has the Advocates Society, the donors club for contributions of \$500 or more.

"The matching gift program becomes much more significant now with the establishment of The Templars," reports

Suffolk Notes

Wysocki. "A minimum gift of \$50 matched by an employer qualifies the graduate for membership."

Suffolk's New Face

The Temple Plaza improvement project, under construction during the summer and autumn, is now near completion. When the work is finished, Temple Street will feature widened brick sidewalks, granite benches, and small trees. Vehicles, although not barred, will be prohibited from parking. The project has cost \$125,000, of which one-fifth was contributed by the University.

Professor John Lynch Retires

After ten years as Suffolk University Professor of Law and Law Librarian, John W. Lynch has retired. Professor Lynch, who served twenty years in the Judge Advocate General's Corps of the U.S. Army, taught courses in Land Use and Professional Responsibility at Suffolk. During his tenure as law librarian the library has expanded three-fold and this fall the LEXIS law computer research system was added.

Mr. Lynch stated that he enjoyed his years at Suffolk. He attributed this feeling to the capable assistance he has received from the library staff and the cooperation which has been extended to him by the trustees, the administration, and his fellow faculty members.

A. David Mazzone Named Federal District Court Judge

President Carter has nominated A. David Mazzone, an Associate Justice of the Superior Court of Massachusetts and a member of the Special Faculty of the Law School, to a Federal Judgeship for the District of Massachusetts. The nomination was recommended by Senator Edward M. Kennedy. Justice Mazzone served as Assistant U.S. Attorney for the District of Massachusetts from 1961 until 1965, at which time he resumed private practice. He has been a judge of the Superior Court since 1975. At Suffolk,

Justice Mazzone currently teaches an Evening Division course in Federal Criminal Practice.

"United States Tax Court in Session"

A visitor to the Donahue Building Tuesday and Wednesday, October 25 and 26, might have been somewhat surprised to see the above notice outside the door of the Tom Clark Moot Courtroom. Chief Judge C. Moxley Featherston presided at the session which was called to order by U.S. Tax Court Clerk Alex Andrews at 10:00 a.m. Tuesday, November 25th. Some thirty-five litigants were present.

Suffolk offered its facility to the Tax Court through the regional office of the Internal Revenue Service when it was learned that a suitable courtroom would not be available in Boston's Customhouse Building due to extensive construction work in progress there.

Alumni Class Notes

In Memoriam

Michael F. Hourihan, JD '25, of Cohasset, MA.

John P. Flavin, JD '32, of Quincy, MA.

Joseph Levine, JD '68, of Hingham, MA.

1959

L. Ross Merrow, JD, has opened a law office in Westboro, MA.

1966

John Biafore, JD, is a partner in the law firm, Goldman, Biafore & Hines in Rhode Island.

1968

Paul A. Tucker, JD, is a Probate Judge for the City of East Providence, Rhode Island.

1969

Fred O'Connell, JD, is an Internal Revenue Service agent assigned to the Cambridge, MA office.

1970

Leighton Detora, JD, is a partner in the law firm of Valsangiacomo, Heilmann and Detora in Barre, Vermont.

Stephen A. Krukjian, JD, is an assistant editor for the *Boston Globe*.

Joseph E. McClanaghan, JD, has opened a law office in New Canaan, Connecticut. **Roland A. Merullo, JD**, is employed as director of the Self-Insurance Industrial Accident Board in Revere, MA.

1971

Paul P. Heffernan, JD, is clerk of the Boston Juvenile Court. **Robert D. Luss, JD**, is the Associate Counsel-Regulatory Affairs at Hooker Chemicals & Plastics Corporation in New York. **Douglas P. Faucette, JD**, is the Associate General Counsel and Director of the Securities Division of the Office of General Counsel, Federal Home Loan Bank Board, Washington, D.C.

1972

Anthony G. Bertino, JD, of North Attleboro, MA is a branch manager for the Charlestown Savings Bank.

1974

Michael Colognesi, JD, is an attorney in Southbridge, MA. **George C. McMahon, JD**, has been appointed assistant U.S. attorney to the New England division of the United States Department of Justice.

1975

Joseph R. DeCiantis, JD, is the legal counsel to the state Department of Employment Security Board of Review in Rhode Island. **John E. Farley, JD**, is an assistant public defender for the State of Rhode Island. **Edward D. Fitzpatrick, JD**, has been named deputy Franklin County State's Attorney in Vermont.

1976

Diane D. Croughan, JD, is the Assistant Counsel for Microwave Associates, Inc. in Burlington, MA. **John J. Gentile, Jr., JD**, has opened a law office in Westerly, Rhode Island. **Charles Ksieniewicz, JD**, is associated in the practice of law with Attorney James P. Rooney in Palmer, MA. **Ritchie Machado, JD**, has a law office in Fall River, MA. **Gary I. Widett, JD**, is a partner in the law firm of Beans, Robert & Widett, Boston, MA. **Paul T. Cronin, JD**, is a partner in the firm of Thomas, Sharp and Cronin, Newton (Auburndale),

MA.

1977

Donald E. Allocock, JD, is a police prosecutor-attorney with the Pawtucket Police Department in Rhode Island. **Frederick S. Ury** is associated with the firm of Sherwood, Garlick & Cowell, Westport, Conn. **Baker A. Smith** is Executive Director of The Center on National Labor Policy, Inc., a non-profit public interest law firm located in Arlington, VA.

New Attorneys

Sincere congratulations to the following Suffolk University Law School Alumni who successfully passed the New Hampshire Bar Examination.

- David L. Broderick, JD '77
- John F. Davis, JD '77
- Paul A. Frick, JD '77
- Paul M. Gagnon, JD '77
- Donald D. Goodnow, JD '77
- Joseph L. Hamilton, JD '77
- Dennis G. Lapointe, JD '77
- Elizabeth A. Marean, JD '77
- Douglas N. Riley, JD '77
- Michael F. Sullivan, JD '74
- Robert P. Sullivan, JD '77
- Coleman J. Walsh, Jr., JD '77

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