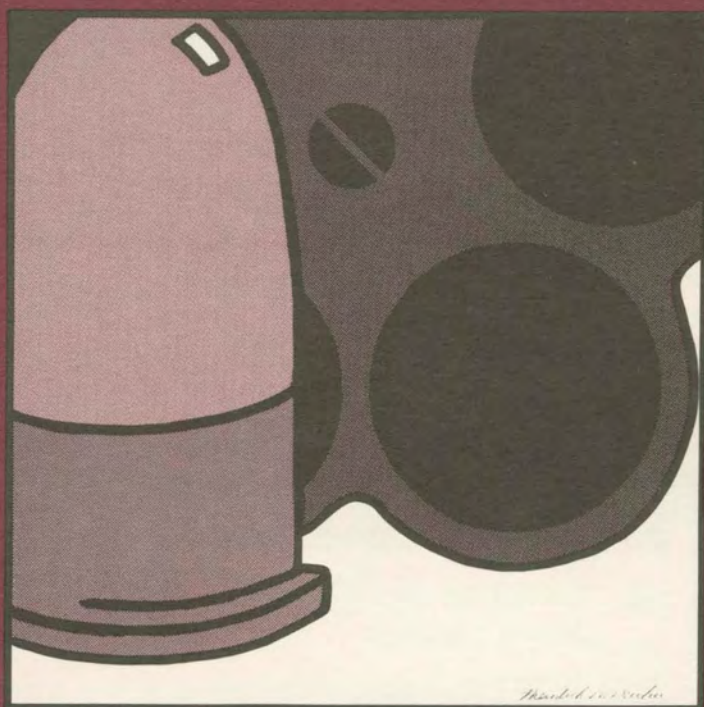


Duke Law Magazine

SUMMER, 1985



An Armed Citizenry?

Duke Law Magazine

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Editors' Column

This issue features articles on corporate law—a field for which the Law School is already well known—and the Private Adjudication Center—a concept which promises to enhance Duke's reputation. Duke's full-time corporate law faculty includes Professors Deborah DeMott and James Cox, both of whom teach the introductory course in Business Associations and offer seminars on specific corporate law topics. Our corporations section, which begins with Ms. DeMott's article comparing takeover provisions in British and American law, then focuses on two of these seminars. Mr. Cox has summarized some of the findings made by participants in two seminars on Corporate Governance.

The section also includes papers written by two students in Ms. DeMott's seminar on mergers and acquisitions. The seminar on "Corporations: Advanced Problems" this year concentrated on issues raised by

merger and acquisition activity, including hostile tender offers and buyouts. The seminar readings emphasized the most recent materials available in this fast-developing field and focused on current transaction structures and techniques. Each student made a presentation in class based on the assigned readings for that session and wrote a paper. Students were encouraged to focus their papers on particular transactions and to develop a rich narrative of relevant events; indeed most student authors obtained primary materials and a few interviewed participants in the transactions they studied. Both Ms. Odell and Ms. Woodbridge received the J.D. degree in May.

As for the Private Adjudication Center, the report on page 27 should be of particular interest to all of those concerned with alternatives to conventional litigation. In further elaboration of the impact of ventures such as the PAC on the curriculum, we will

soon feature articles on the school's expanding clinical program and its joint degree programs. We also hope to have at least one report on the school's growing ties with the People's Republic of China. We would certainly appreciate a submission from anyone who travels on this summer's alumni trip to China. And, as always, we invite manuscripts on any topic which would be of general interest to our readers.

Months after the publication of the last issue, we discovered that some copies of the *Magazine* had been incorrectly bound by the printer. We offer our apologies to those of you who received misbound issues and would like to ask all of you to call or write if such problems surface in future issues. Only if we know how widespread the problem is can we get the printer to reprint the issue or credit our bill for the misprints.

On the Cover

The cover reproduces a poster which was commissioned for the Gun Control Conference held last fall at the Law School. (A report on that conference appears on page 55.) The artist, Meredith Durham, is the wife of J. Porter Durham, a 1985 graduate, who served as one of our reporters during his last two years at the school. Porter's remarks on attorney competence, originally presented to the North Carolina Bar Association, are included in the *About the School* section.

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CORPORATE CONTROVERSIES

A Comment on Mandatory Buy Outs

*Deborah A. DeMott**

One of the traditional goals of tender offer regulation is the protection of target company stockholders against actions that bidders and target management would otherwise be free to take in a wholly unregulated environment. Despite Congress's enactment of the Williams Act in 1968, target stockholders in the United States are not, of course, fully protected against all risks that may be created in the tender offer setting. In particular, bidders are free to make partial offers—to offer to buy some but not all of the target's stock—and to make two tier offers—to pay cash to those who tender earlier and relegate the others to a subsequent merger with less desirable consideration. These possibilities for the bidder create the risk of unequal treatment for shareholders of potential targets.

Reducing this risk appeals to some proponents of reforming tender offer regulation as it now stands in the United States. A mechanism to achieve this end is a buy out requirement, that is a requirement that after acquiring some stated percentage of a company's stock, the acquiring persons must offer to buy out all remaining stockholders at a specified price. Although such a requirement would create a drastic shift in the burdens imposed on tender offer contestants in the United States, its impact can be gauged somewhat by examining the comparable rule in effect in Britain under the aegis of The City Code on Take-Overs and Mergers.

First, however, a word about the institutional context of British takeover regulation is important. By and large such regulation proceeds in a wholly extra-legal fashion and functions independently of the British legal system.

Target stockholders in the United States are not...protected against...risks that may be created in the tender offer setting.

The code of regulations governing such transactions in Great Britain is a product of a body called the Panel on Take-Overs and Mergers which is composed of representatives of the Bank of England and the British financial communities, including The Stock Exchange. The Panel was founded in 1968 in response to perceived abuses of various sorts both by management and by takeover entrepreneurs in a range of transactions; it has



Deborah DeMott

promulgated and enforces a body of rules, the City Code on Takeovers and Mergers, which apply in essence to all tender offers and other large acquisitions of shares in which the targets are public companies. Even though the Code itself applies to all public companies, not just those companies listed on the London Stock Exchange, the exchange itself and these companies to which the Code's rules apply are much smaller in many cases than companies subject to the Williams Act in the United States. Thus, the corporate constituency for this kind of regulation in Britain includes many more smallish companies than would be the case in the United States.

The takeover code is enforced primarily through peer pressure. In addition, the Panel has the ability to censure persons who violate the Code and indeed to declare that persons are unfit to be associated with companies or British financial institutions. As a result, brokerage houses (who are members of the stock exchange and thus parties to the agreement embodied in the City Code) would not extend their facilities in such an instance, and that in practical effect would deny the sanctioned violator of the Code access to the network necessary to communicate and facilitate a tender offer. There are, however, no truly legal sanctions for violations of the Code in Britain.

The general perception in the United Kingdom is that the Panel has been quite successful in most

instances in obtaining compliance with its rules, principally as a result of the small and interconnected nature of the relevant financial communities. The one exception, irrelevant to the present topic but nonetheless noteworthy, in which the Panel's efforts were not suc-

Inevitably some kinds of transactions would be inhibited.

cessful was insider trading. At one point the Panel was the only entity in Great Britain concerned with prohibiting insider trading in stocks in connection with takeovers and was not successful in inhibiting it. Among other reasons, the Panel lacked resources sufficient to the expensive and time-consuming task of establishing that improper trading based on non-public information had occurred. As a result, in 1980 Parliament acted to criminalize insider trading.

Three other basic points should be kept in mind. First, patterns of shareholding in Britain differ somewhat from those in the United States. As a general proposition share ownership in Britain is more concentrated, with financial institutions owning a significantly higher proportion of shares. Second, even though the City Code is in essence an instance of financial industry self-regulation, it is a fairly complicated document in itself. The Code's 1981 edition, for example, is a stout little volume of 81 pages plus pocket parts; half of it is the rules themselves, the other half the Panel's attempts to interpret the rules. Inevitably, then, this discussion oversimplifies in some respects the Code in its sundry detail. Third, the rules in the City Code are applicable when a takeover or tender offer is made or if a certain percentage of shares is acquired regardless of the means of the acquisition. Thus, if a certain percentage of shares is acquired through private transactions or stock market transactions, consequences may flow under the City Code; as a result, the important definitional questions we ask in the United States concerning the nature of a tender offer and thus whether the Williams Act applies to any particular transaction have considerably less

Opinion differs over the ultimate desirability of partial acquisitions.

import in Great Britain due to the way the Code is structured.

The City Code imposes a general buy out requirement that is applicable when 30% of the shares of a company are acquired whether through a private transaction or market transactions or through a tender offer. The acquiring person or group of persons must offer to

buy out for cash the remaining shares at the highest price paid for any shares acquired during the preceding twelve months. To state only the obvious, this is a rule with many significant effects. Perhaps not surprisingly, it appears to have greatly enhanced the popularity of 29.9% blocs. One reads accounts in the British financial press of transactions in which persons indeed acquire 29.99% and then stop.

Another more significant effect created by this kind of buy out obligation stems from the fact that the acquiring party must have access to sufficient capital to buy out the remainder of the shares once the 30% threshold is passed. As a result, it is more expensive to acquire control than would otherwise be the case because the person or group acquiring 30% must have access to sufficient credit or have sufficient capital to be able to offer to buy out the remaining shares. Indeed, the Take-Over Panel has had some problems with acquiring persons who ran out of money either to commence the mandatory buy out offer or to complete it once they began the offer.

In general the City Code's buy out requirement probably inhibits some kinds of transactions; opinions

The legal background that led to the adoption of the Draconian buy out requirement in Britain is different from the legal context in the United States.

obviously would differ upon whether most or all of those transactions are on balance more beneficial than they are harmful. Clearly it has an inhibiting effect on someone acquiring a sizable portion of shares and using that as a basis for exercising control over a company because the acquiring person may either lack the resources to offer to buy 100% or may be unwilling to commit so much of its capital to one enterprise. As there has been no empirical examination of the effects of this rule in Britain, one cannot say with any assurance whether the lot of shareholders and companies generally in Britain is better with the rule than without it.

To be sure, the British rule also assumes that shareholders receive equal treatment or as equal treatment as this kind of structural rule can obtain for them, and that the control premium is effectively shared with all the stockholders. It also effectively prohibits the two-tiered structure for tender offers that has been popular in the United States in recent years, that is a cash tender offer followed by a merger transaction for non-cash consideration. All stockholders under the British rule receive not just an opportunity to sell at the same price but in addition the opportunity to receive the price in the same form of consideration. Another interesting effect of the buy out rule is that the price that the

noncontrolling stockholders receive is determined not by a court but by the previous transactions of the acquiring party. To determine what price must be paid to the noncontrolling stockholders to treat them equally one simply looks at the acquiring person's transactions in the past 12 months and then offers that price to the remaining stockholders, thereby eliminating the need for appraisal or some kind of external or judicial setting of a fair price.

There are a number of questions raised by the experience with the British rule that should be considered in connection with proposals that the United States adopt any comparable rule. One interesting difference between those proposals and the British rule is that for the buy out obligation under these current proposals the triggering percentage would be set at a much lower threshold, as low as 5% in one proposal. What does the experience with mandatory buy outs under the British rule suggest about the desirability or the feasibility of that kind of requirement? First of all, inevitably some kinds of transactions would be inhibited. Venturing into the takeover market at all would

Conditioning the ability to own 5.1% of a company's stock on a person's willingness to buy the whole company limits shareholders' ability to dissent.

become much more of an all-or-nothing proposition than it is at present. The possibility of testing the waters by acquiring a fairly significant toehold in a company as the Williams Act now permits would no longer be feasible and a much stronger financial commitment on the part of the person making the acquisition would be requisite.

Assessing the desirability of these consequences is complicated by the fact that opinion differs over the ultimate desirability of partial acquisitions. Some practitioners think that they are beneficial, and that the mere possibility of a partial acquisition is beneficial, because in some situations stockholders are benefited by some shift in control, even when it occurs through a partial acquisition and the company continues to have some noncontrolling minority stockholders. Other people think that the position of the noncontrolling stockholder in this situation is inherently unfair or inherently risky. It is of some significance that in addition to imposing the mandatory buy out requirement, the City Code itself contains complex regulations concerning partial acquisitions.

If part of any intuitive appeal of the mandatory buy out is that it results in equal treatment of stockholders,

noncontrolling stockholders as well as controlling stockholders, it is relevant to consider as well the current position of minority stockholders in the United States in contrast to their British counterparts. Prior to the adoption of the buy out requirement in the City Code, noncontrolling stockholders in Britain were from the legal standpoint in a significantly weaker position than noncontrolling stockholders in the United States. Among other differences, the net effect of the Companies Acts in Britain—the equivalent of our state corporation statutes—is to give stockholders no appraisal rights in merger transactions, for example. Further, for a variety of reasons, litigation against company managements by disgruntled noncontrolling stockholders is not as significant a possibility in Britain as it is in the United States. Although the statutory and judicial posture toward such litigation has mellowed somewhat in recent years, the structure of the British bar, among other factors, limits its occurrence. Thus, the legal background that led to the adoption of the Draconian buy out requirement in Britain is different from the legal context in the United States, a factor that is important in evaluating the appeal of this kind of rule. Finally, one might wonder about the impact a buy out requirement would have on stock prices or overall shareholder wealth. Again, no empirical study has been done to examine the British experience. The most recent study done in this country on the effect of adoptions of charter amendments that have anti-takeover effects (including "fair price" buy out requirements) found that they slightly lowered the stock prices of companies adopting them. The effects of a uniform buy out requirement may be quite different, of course. Certainly a significant effect on shareholder wealth seems likely to ensue if the buy out requirement were to be triggered by the acquisition of a fairly low percentage like 5%. Indeed, the consequences of such a requirement would transcend the takeover context. To condition the ability to own 5.1% of a company's stock on a person's willingness to buy the whole company limits shareholders' ability to dissent by cutting off significant partial investments and the constraints imposed on management discretion by the presence of sizable minority stockholders. Further, like the British rule, some of the U.S. proposals provide that persons acting in concert to acquire stock become jointly and severally liable to make the mandatory buy out offer. This aspect of the buy out obligation also seems likely to stifle significant stockholder dissent.

**Professor of Law, Duke University. This article is based on a presentation to the section on Business Associations at the Association of American Law Schools meeting on January 4, 1985. It draws heavily on the author's previous article, Current Issues in Tender Offer Regulation: Lessons from the British, 58 N.Y.U. L. Rev. 945 (1983).*

Corporate Governance Seminar

James D. Cox*

Since its inception, the American Law Institute's Corporate Governance Project has been the center of controversy from both the so-called corporate establishment and academics. The introduction of the reporters' first proposals in *Principles of Corporate Governance and Structure: Restatement and Recommendations* at the ALI's 1982 meeting met a firestorm of opposition. Only an agreement with the project's adversaries shortly before the meeting prevented a wholesale truncation of its major provisions. The substance of that agreement was that the proposals would be aired for comment, but no votes of any kind would be taken. In return, the reporters agreed to take the comments as strong instructions to moderate their proposals. Since that meeting, the proposals have undergone many changes. Today they remain in flux and a few have been approved by the ALI's membership.

It was at the 1982 meeting that I began to envision the Corporate Governance Seminar, which has been offered at the law school during the spring term the last two years. The seminar's focus is the junction of the reporters' first highly reform oriented draft and the protests at that meeting. Students enrolled in the seminar commence research on their topic in the fall term; in the spring term each student drafts a paper on his topic and serves as a discussion leader for one class hour.

The following commentary is distilled from weaknesses in the ALI project perceived by students who have participated in the seminar. Unfortunately space limits prevent me from reviewing other topics treated in the seminar, such as insider trading, control person transactions, sanctioning the corporation, and derivative suit procedures.

BOARD COMPOSITION

The most controversial feature of the Corporate Governance Project is the composition, structure, and duties of the board of directors for a large public corporation. The proposals define such a corporation as one whose assets are at least \$100 million and which have 2000 or more holders of its equity securities. The proposals to the ALI reflect the belief of the Project's Chief Reporter, Professor Melvin Eisenberg, that directors, because of the limited time they can devote to their secondary jobs as directors, are poorly suited to manage the corporation's business; they can, however, serve as monitors over the officers who do manage the corporation's business. Nevertheless, the monitoring function requires at least a critical mass of the directors to be independent of any social, familial, and financial ties to managers. The ALI, however, deals only with the familial and finance ties of directors in its definition of

"independence."

Mark Mirkin '84 reviewed the rapid changes in the American boardroom over the past two decades. One study in the late 1960s found that among Fortune 500 corporations a statistical dependence exists between a specific academic background and an individual's chances of becoming a director of a Fortune 500 company: a graduate of Harvard, Yale, or Princeton had one chance in 49 of becoming a director; graduates of other Ivy League schools together with those of twelve other high prestige schools had one chance in 456; graduates of ten prominent state colleges one chance in 818; and graduates of other smaller state colleges one chance in 18,750. Also suggestive of the small world of boardrooms is that most directors today are white, male,

The most controversial feature of the Corporate Governance Project is the composition, structure, and duties of the board of directors for a large public corporation.

Republican, Protestant, and between the ages of 55-65; most also serve either as the chief executive officer of a publicly traded company or as a close advisor to CEOs. With a call for accountability and the expanding perception that too many directors were financially dependent upon the officers they were called upon to monitor, there has been an important shift toward the outside board. Gone are the days when a single person would sit on the board of 35 corporations, as did Sidney J. Weinberg, a partner of Goldman Sachs & Co., prior to his death in 1969. A recent study found that no individual sat on more than eleven boards and only seventeen people served on eight or more boards. C. Forbes Sargent III '85 examined current practices in recruiting and staffing the boards of large corporations. While inside directors comprise only 25 percent of all directors, there is concern in some quarters over the fact that more than 80 percent of the independent directors are themselves either officers (nearly all are the chief executive officer of their own corporations) or financial or legal advisors to officers. Finally, even though there has been a fourfold increase in the past two decades in women and minority directors, they still represent less than six percent of the directors of publicly traded firms. A further interesting development is that since

1979 the percentage of corporations reporting that they initially selected candidates for the board through a nominating committee increased from 31 to 63.9 percent.

Against this demographic background, the proposals to the ALI appear fairly benign. In their earliest form, the proposals required that a majority of the directors of a large public corporation must not be financially dependent on the corporation or its senior officers and that their selection should begin with a nominating

The ALI, however, deals only with the familial and finance ties of directors in its definition of "independence."

committee. As approved at its 1985 meeting, the ALI retreats from its mandatory approach and merely provides that the independent majority is only a recommended practice. The proposals, however, still retain the suggestion that the nominating committee not include any of the corporation's officers and that a majority of the directors should not have a "significant financial relationship" with either the corporation or its the corporation or its senior officers.

Both Mirkin and Sargent questioned the impact of the changes, if any, introduced by the proposals to the ALI. Sargent observes: "In light of the prevailing trend in corporations today towards increasing the percentage of outside directors on boards, the proposal is thus more a restatement of present practices than a suggestion of model practices." On the question of nominating committees, he reasoned "that if one is to have a board comprised of a majority of persons who are truly outsiders (i.e., not beholden to the CEO), one must begin with a nominating committee that is totally objective, free from the CEO's influence. Since the nomination of directors is a relatively non-technical job, and one which would not require intricate knowledge of the inner workings of the corporation," it is reasonable to require a committee comprised solely of outside directors.

The former CEO of International Telephone and Telegraph, Harold Geneen, has called for a totally independent board, one that would even exclude the CEO. Several seminar papers offered a board structure stationed between the proposals of the ALI and Mr. Geneen. Mark Costly '85 and Diana Ingallinera '84 both foresee the need to enhance the outside director's digestion of information pertinent to monitoring the managers' performance and to considering matters requiring their approval. Moreover, the seminar members raised the need for the board to have a chairman who was independent of the firm's officers, preferably one selected by the other outside directors. The important task of the chairman is to establish (with consultations with the CEO) the meeting's agenda and to preside over all

meetings. Also recommended is the employment of a limited professional staff to collect, format, and distribute information reasonably in advance of the meeting. To be sure, many commentators fear that arming outside directors with a professional staff would introduce a "fifth column" to the managerial corps and would ultimately foster friction and destructive competition within the firm. The seminar students' proposals attempt to reduce these results by limiting the staff's function to requesting and distributing information, not investigating the corporation's staff. Finally, these restructuring proposals would be limited to the very largest public corporations so that the additional costs would not be material.

CASE STUDIES IN GOVERNANCE

Ellen Hausler '84, Mike Hemmerich '85, Dave Lockwood '84, and Rebecca Orlich '85 each investigated a series of instances in which a board found itself in a crisis pitting it against its CEO. Researchers were encouraged to locate and analyze instances with parallel problems but different results, attempting to explain the extent to which different board structures may have contributed to the differing results as well as any other important variables. The two most publicized incidents so investigated involve the embezzlements carried out by David Begelman at Columbia Pictures and the illegal political contributions acquiesced in by Gulf Oil Corporation's executives.

The Columbia Pictures saga opens in February 1977 with actor Cliff Robertson receiving an IRS Form 1099 reporting \$10,000 income from Columbia. He had not worked for Columbia in two years. Robertson, with the assistance of the Beverly Hills Bunco Squad, traced the embezzlement to David Begelman, then president of Columbia Studios. The Columbia directors responded by ordering an investigation, which revealed that Begelman had not only embezzled \$10,000 by forging the actor's name but also had committed one other

More than 80 percent of the independent directors are themselves either officers... or financial or legal advisors to officers.

embezzlement. Later it was discovered that while the first investigation was ongoing Begelman had engaged in yet a third embezzlement (raising the total thefts to over \$70,000). Also it soon became clear to the board that Begelman lied repeatedly to the attorneys carrying out the board's investigation. There then ensued a three-month battle pitting Columbia's CEO, Alan Hirschfield, against nearly all the other board members. Hirschfield strongly recommended firing Begelman, a recommendation which he first made when the board learned of the embezzlement and which he repeated at the nearly

dozen board meetings over the next three months. Hirschfield was joined by the only other officer on the board, Leo Jaffe, who uttered perhaps the wisest counsel of all the Columbia directors: "There are certain things you can forgive a man for doing as a human being, but that have no place in a publicly owned corporation." The board ignored Jaffe's sage wisdom and ultimately, tiring of Hirschfield's moralizing, opted to sack Hirschfield. Begelman received a lucrative new contract.

The ALI retreats from its mandatory approach and merely provides that the independent majority is only a recommended practice.

That the board's conduct of the Begelman affair was watched closely by the market is reflected in the movements of Columbia's common stock when compared with Standard & Poors 500 Industrials Index. The market reaction was significant and positive upon announcement that Begelman had been removed (the removal was, however, only temporary) and strongly negative upon announcement that he was reinstated.

Begelman's support on the board came from outside directors—the group that the ALI seeks to install to monitor management. Indeed, all of Begelman's supporters would fit cleanly within the ALI's definition of directors who have no "significant financial relationship" to the corporation or officers. The unusual role assumed by Columbia's outside directors was due to the fact that two of its largest stockholders were directors who wished to manage the corporation for reasons involving ego and power, rather than to maximize the shareholders' wealth. (It is, of course, less likely that egos and the quest for power would be so dominant a trait for the largest shareholder if Columbia produced ballbearings rather than movies.) The other outside directors were close associates and personal friends of these two men and, therefore, followed their lead in opposing Hirschfield's call to sack Begelman.

The Columbia Pictures episode exposes the naive inadequacy of the ALI proposals that significant financial relationships with management alone will inhibit objectivity and the assertion of an independent voice. What greatly enabled the pro-Begelman forces to prevail was the lack of publicity given the misconduct during the period that the board was debating Begelman's fate. Cliff Robertson went public with the full story only after learning of Begelman's reinstatement and after Hirschfield had been fatally wounded in the battles over the issue. The force of both publicity and directors free of a private agenda is illustrated by the response of Gulf Oil Corporation's board to its managers' illegal campaign contributions.

In the summer of 1973, stories of improper payments by large American corporations began to emerge from the Watergate Special Prosecutor's Office. The Nixon Campaign officials were forced to release a list, waggishly referred to as "Rose Mary's Baby," disclosing a \$100,000 contribution from Gulf Oil. This set in motion an investigation headed by Gulf's own outside counsel which after a six-month investigation issued a report documenting that unlawful contributions of approximately \$4.8 million had been made since 1960. The report did not implicate any senior Gulf executive. As a result of its own investigation, the SEC filed suit in March 1975, attacking Gulf's "slush fund" and alleging Gulf's personnel had since 1960 made illegal and questionable payments from the fund in excess of \$10 million. The suit prompted the board to authorize a second investigation to be conducted by outside directors led by John McCloy, the ex-head of Chase Manhattan Bank. The McCloy Report, issued in December 1975, chronicled an elaborate scheme designed to funnel large amounts of money to domestic and foreign political figures. It delicately suggested that such a scheme could only have occurred if Gulf's CEO, Robert Dorsey, "shut his eyes to what was going on around him." Indeed, even some stockholders questioned where the board had been during such a pervasive scheme. At the annual stockholders' meeting, one attendee suggested the directors were mushroom directors: "A mushroom director," he explained, "is one who is kept in the dark and has a lot of manure dumped on him."

Because corporate bribery was a national disgrace, being very much before the public when the McCloy Report was issued, and also because of the involvement of the SEC and the truly independent McCloy committee, a good deal of publicity was given to the matter in advance of the two-day meeting in which the Gulf board deliberated its response to the McCloy Report. Another important variable was that the largest single block of Gulf stock was held by the Mellon family who,

"There are certain things you can forgive a man for doing as a human being, but that have no place in a publicly owned corporation."

as patrons of Pittsburgh, suffered great public embarrassment by the revelation "their" corporation was sharing the headlines with the likes of Robert Vesco. As a result, the five Mellon directors, joined by Sister Jane Scully (who had been appointed by Dorsey under pressure from feminist stockholders), narrowly outvoted Dorsey and three other outside directors in ousting Dorsey and other senior officers.

The fact that the Gulf board, largely on the insistence

of "outsiders," was able to act decisively in removing errant senior management tends, upon first impression, to validate one major assumption of the ALI project: that in large publicly held corporations the independent directors are the bedrock for assuring faithful stewardship of the firm. However, the ALI provisions do little to assure this result. The three outside directors who joined Dorsey in opposing the managers' ouster would be deemed independent of management under the current definitions proposed to the ALI. A review of these three directors' backgrounds reveals personal friendships with Dorsey predating their election to the board. Even absent such personal relationships with management, there remain subtle ties—cultural, social, and educational—which serve as intangible bonds that can inhibit objectivity. Among the group of directors who opposed Dorsey, Sister Jane appeared to be the only one guided predominantly by a concern for shareholder welfare. The Mellon-connected directors, though as instrumental as Sister Jane in forcing management's ouster, appeared much more concerned about their personal reputations and the reputation of the Mellon family in Pittsburgh than about the shareholders as a class. While the Gulf case underscores the importance of publicity in stimulating boardrooms to action, both cases implicate the importance of individual character as an indispensable element in discharging the monitoring function. On this point, the proposals to the ALI have no prescription.

STANDARD OF CARE

Perhaps the sharpest attack against the ALI, examined by Mary Cusano '84, has come from the Business Roundtable, an organization comprised of 200 major corporations, most of which are Fortune 500 companies—with nearly all of the top 100 on that list. In combination, the membership accounts for one-half the current gross national product. A major source of concern to the Business Roundtable is the level of care required of

"A mushroom director is one who is kept in the dark and has a lot of manure dumped on him."

outside directors in fulfilling the monitoring mission of the ALI. Richard Smith '84 examined the positions of both the Business Roundtable, which asserts the proposals introduce a major change in directors' obligations, and the proposals' reporter, who asserts they represent codification of current caselaw requirements.

The proposals specify that the duty of care "encompasses the obligation of a director or officer to make *reasonable inquiry* when acting upon corporate transactions or otherwise performing his function." The Business Roundtable contends that under current law a

corporate director has an obligation of reasonable investigation if, and only if, the particular facts and circumstances are such as to put him on notice that inquiry is required. In short, the current law is said to embody a "notice-inquiry" standard. The leading Delaware case, *Grabam v. Allis-Chalmers Manufacturing Co.*, 41 Del. Ch. 78, 188 A.2d 125 (1963), excused directors from liability for antitrust judgments scored against the corporation arising from the price fixing activities of sub-

Even absent... personal relationships with management, there remain subtle ties—cultural, social, and educational—which serve as intangible bonds that can inhibit objectivity.

ordinates: "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists." *Id.* at 130. It may well be true that the public may expect more of directors of large corporations today than when *Grabam* was decided. Moreover, it may be that the concept of monitoring is more firmly accepted as the role of directors than when *Grabam* was decided. Each are important variables in leading to a movement away from the sweeping language used by the Delaware Chancellor. But as Smith's analysis of the cases reveals, that change has not appeared in the cases.

The language chosen by the ALI to express the directors' duty of care poses much less of a problem when the question is whether the directors have engaged in misfeasance rather than nonfeasance. The questions raised in misfeasance cases are factually laden ones in which the words chosen to express the applicable standard play much less of a determining role than where the question is whether the directors had a duty to investigate. Linda Crouch '85 examined the modern duty of care cases against the language and extensive commentary of the proposals to the ALI. She concludes that no case she examined would be decided differently if the court adhered to the ALI's positions and commentary. In this respect, the proposals conform, but appear not to reform.

One important variable, however, is the introduction of ceilings on damage recoveries based on no more than a breach of care by directors. The maximum amount recoverable from any director is the direct compensation he received during the year in which the violation occurred. This feature of the proposals has been seen by the Business Roundtable as cause for stimulating more care-based suits and judgments. Their reasoning is based on an article written earlier by the

ALI reporter, Professor John Coffee of Columbia, who reasoned that courts are hesitant to impose meaningful duties of care for fear that a momentary lapse will expose the directors to disproportionately large liability. Hence, the Business Roundtable concludes that interjection of a ceiling will lead to a greater willingness on the courts' part to find breaches. This in turn will lead to settlements and judgments and ultimately to a greater willingness of the plaintiff's bar to undertake care-based litigation because the ceiling has enhanced the chances of recovering something. On the other hand, this writer has recently argued that the ceiling is an important factor in the ALI's attempt to reduce the importance and impact of the duty of care by making it easier for such suits to be dismissed based on a special litigation committee's judgment that the suit's potential benefits (which are limited by the ceiling on damages) are less than its direct and indirect costs.

A special and important question within the duty of care arises when the alleged misfeasance involves the intentional violation of a criminal statute. The membership of the ALI has tentatively approved Section 2.01, which establishes that while the goal of the corporation is to maximize the wealth of its shareholders, the corporation has the same obligations as a natural person to stay within the bounds of the law. The question therefore arises whether this qualification amplifies in any way the directors' and officers' duty of care? Wilson Schooley '84 examined this question, reporting that under the current caselaw directors who knowingly violate a criminal statute are not protected by their rational motives to further the corporation's interests. However, directors will not be liable if their criminal violation produced a net benefit to the corporation. Hence, at least in the derivative suit context, in which the narrow question is not the governmental interest sought to be served by the criminal statute, but whether the corporation should recover for a harm committed against it by its fiduciary, it may well be true that "crime

A major source of concern to the Business Roundtable is the level of care required of outside directors in fulfilling the monitoring mission of the ALI.

pays." Schooley reminds us that it is the state which charters the corporation and it is the state which also will condition its charter in part on compliance with requirements such as those found in section 2.01:

Indeed, given the acknowledgment of profit as the ultimate aim of that government and inexorable product of its machine, there is an especial need there to reemphasize that although the elected representatives of the people may to a limited extent employ business judg-

ment and cost benefit analysis in determining what conduct will be deemed 'wrongful,' the resulting rule represents the will of society and the application of cost benefit assessments to any given instance of such conduct is no longer appropriate.

To this concern, the earliest pronouncement of the ALI provided that within the directors' duty of care was the obligation to undertake reasonable efforts to assure the corporation complied with its duty under section

Courts are hesitant to impose meaningful duties of care for fear that a momentary lapse will expose the directors to disproportionately large liability.

2.01, i.e., that it stay within the bounds of the law. Moreover, in Tentative Draft 1, the proposals would allow a corporate recovery even though the criminal violation overall produced a net benefit to the corporation if the court believed the defense that "crime paid" would "frustrate authoritatively established public policy." Finally, a knowing violation of a criminal statute not only removed the director from the protection of a ceiling on his liability, but also was a basis for the court assigning minimum damages to that defendant which included the costs of *all* attorneys fees. To these changes, Schooley observes:

The danger is that too many and too long unchallenged expectations canonize their premises and create a theology. Like Luther, the ALI has nailed their ninety-five theses to the corporate door, not as a panacea or even a program of revolution, but as a challenge to a corruption of basic precepts and proposal for reform.

The reform sought to be introduced in this area of the duty of care was, however, soon recanted. The most recent draft approved by the ALI no longer refers to the directors' duty to assure the corporation complies with section 2.01. While the ceiling and floor provisions on damages remain unchanged in their application to knowing criminal violations, the court can ignore the gains of that violation only if the violated statute is for the especial benefit of the shareholders. In all other cases the court can consider the gains of that violation in deciding whether the derivative suit serves the corporate interest.

The discussion of care-based derivative actions against corporate fiduciaries raises the question of the appropriate mission of the derivative suit. Michael Bartok '84 examined closely the sometimes conflicting goals of compensation and deterrence in derivative suits against managers, before concluding that deterrence should assume a more important role than it

currently plays in guiding substantive and procedural rulings before the courts. He takes exception to three points raised against deterrence by Professor Coffee, the reporter for those portions of the ALI project devoted to derivative suit procedures. First, the reporter reasons that because equity will not impose punitive damages, the derivative suit cannot always impose an adequate sanction. Finding circularity in this because law reform invites changes that can alter underlying assumptions, Bartok challenges Coffee to more aggressively consider the minimum damage provisions as meaningful sanctions which can assure deterrence. To accept the reporter's view is to reason that because we now have a compensatorily oriented action it must always be such. Second, the reporter acknowledges the potential chilling effect that deterrent sanctions may have on important entrepreneurial risk taking and service by outside directors. Like a rain, deterrence may fall on the good and bad alike. Bartok reasons that the question is one of judgment in articulating standards and sanctions which achieve the right balance between encouraging socially useful activities and discouraging misbehavior. Arming courts with discretion over the imposition of ceiling limits on liability has been argued by this writer as one means toward such a balance. Finally, there is a concern that attributing predominantly a deterrent function to derivative suits would permit suits to continue when their overall costs to the corporation exceed their expected recovery. To this, the ALI commentary provides the best answer.

Shareholders are recognized as having a generic interest as a class in an effective system of corporate accountability. Because over the long run the shareholder invests in a portfolio of corporations, rather than a single security, the shareholder may benefit from enforcement costs in a single case even though these costs exceed the ultimate recovery to the individual corporation.

Here again the element of judicial discretion is called for in deciding whether the suit implicates a type of wrongdoing such that the suit's continuance is likely to affect behavior across corporate America. It therefore becomes a difficult and presently highly impressionistic empirical question. For example, many of us believe we would be better off if suits were continued against corporate officials who approved poorly controlled secret "slush funds," acquiesced in a "greenmail"

The ceiling is an important factor in the ALI's attempt to reduce the importance and impact of the duty of care.

request, or administered to a suitor a "poison pill." Each of these modern day abuses of power has been so well protected by the fact that the derivative suit serves only

a compensatory mission. Perhaps their frequency and our malaise as savaged investors would decline if courts acknowledge the broader interest served by a suit challenging the practice in a single corporation.

THE MARKET FOR CORPORATE LAWS

While the ALI does not make law, it certainly has had a distinct impact in influencing those who do. The minority caselaw embraced in earlier restatement topics has frequently become the majority rule. Thus, many have viewed the ALI Corporate Governance Project as portending a form of National Corporation Law. Its proposals, whether mandatory or precatory, will guide courts and legislatures in their future decisions and

The question is one of judgment in articulating standards and sanctions which achieve the right balance between encouraging socially useful activities and discouraging misbehavior.

enactments. This raises the most fundamental question of whether uniformity or diversity in corporate norms is optimal. Kevin Dwyer '85 examined the commentaries on this subject, finding that like Gaul, they are divisible into three parts.

The "Race to the Bottom" school chastises Delaware for devaluing the currency of corporate legal standards and advocates minimum federally imposed standards for chartering the largest public corporations. This school is best represented by the late Professor William Cary of Columbia. To its extreme right is the so-called "Climb-to-the-Top" school whose views are expressed by Professor Daniel Fischel of Chicago and Ralph Winter, now a Court of Appeals Judge for the Second Circuit and formerly a professor of law at Yale. They believe that diversity in law is optimal because managers will select a corporate domicile whose corporate law will best accommodate the interests and managerial style of its officers and directors who are motivated to maximize shareholder wealth. If management chooses poorly, the corporation's shares will be discounted in the marketplace. This, it is reasoned, will over time lead to the managers' displacement. Between these two schools is that advanced by Professors Baysinger and Butler, called the "Freedom of Choice" school. It resembles the "Climb to the Top" view, but its emphasis is much more on the shareholders shifting their investments from corporate domicile to domicile, rather than the "Climb to the Top" emphasis on the corporation shifting across domiciles. Under the "Freedom" view, jurisdictional variety is beneficial because it permits shareholders to tailor the statute under which their

corporation is to be governed to their own needs.

Dwyer reviews the empirical and oftentimes anecdotal evidence each school advances in support of its position. The "Race to the Bottom" theorists were found to offer only vague illustrations and empty polemics in support of their view. The critique of the "Climb to the Top" cannot so easily be summarized:

The seduction of this argument—and the Chicago School of economics upon which it so heavily relies, in general—is its crystalline simplicity: simple conclusions following from simple premises. But here, that simplicity appears to conceal a flaw. The problem is that the thesis [that] managers will act to maximize share values [or] otherwise they will be displaced by a takeover cannot account for the proliferation of antitakeover statutes; as Winter himself notes, "the competition between states for charters may provide inadequate protection in the case of takeover statutes." The effect of takeover statutes is to make takeovers more difficult. But, the fear of managerial displacement through takeovers was one finger—perhaps the thumb—of the unseen hand which merged shareholder and managerial interests. To the extent that corporations succeed in incorporating—or worse, reincorporating—in states that offer management significant protection from such displacement, the strength of the congruence between shareholder and management interests weakens, and the maximization of shareholder wealth suffers.

HIGH HOPES, MODEST BEGINNINGS, THEN CONFORMITY

The ALI Corporate Governance Project had its seeds in the corporate scandals of the early 1970s involving bribery, environmental laws, and financial defalcations. In reaction numbers of proposals and criticisms of prevailing modes of corporate governance were put forth. Messrs. Dirk Dunfee '84 and Alan Cregg '85 contrasted these various prescriptions made by the corporation's critics in the early 1970s with the proposals of the ALI reporters. On each count, the ALI, even in its most reform oriented earlier drafts, takes only a half step toward addressing the problems seen by the reviewed commentators. For example, Cregg observes that section 2.01's injunction that the corporation must stay within the boundaries of the law and that directors also have the discretion to consider moral and ethical principles when making their decisions would be excepted to by Professor Chris Stone, who wrote the leading corporate critique, *Where the Law Ends*. Stone is "adamant about the duty of the board and the corporation to operate with a sense of social responsibility. Even Professor Cary would agree that an improved

social conscience on the part of the board would be a positive addition." Indeed, Dunfee found that most commentators concerned with socializing the corporation have looked further into the organization than its board of directors in recommending organizational changes.

Stone seeks to make corporations responsible citizens. Stone wants corporations to consider social values when they make decisions. This is not limited to the board; Stone gives the impression that it is as important for a shop foreman to make moral decisions, as far as he is able, as it is for the board to make moral decisions. The key to corporate responsibility is to encourage individuals within the corporation to exercise their own senses of responsibility. Stone does this by providing for the safe passage of information within the corporation and by populating the board of directors with persons who broaden the field of values the corporation is to consider. Stone's proposal, in the end, demonstrates

Most commentators concerned with socializing the corporation have looked further into the organization than its board of directors in recommending organizational changes.

great faith in human nature; it encourages individuals to use, in the corporation, the tools they already have developed for use outside the corporation. The ALI's implicit belief is that a corporation will have discharged its social responsibility if it simply follows the law and if it governs itself with a certain degree of honesty and professionalism.

Whatever one's view of the necessity for reforming the structure within which corporate decisions occur, there is little doubt that the ALI's Corporate Governance Project, the Business Roundtable notwithstanding, started out as a compromise on reform and has lost ground steadily ever since. It nevertheless has been a fertile area for discourse over what is, what ought to be, and how it could have been.

**Professor Cox came to the Law School in the spring of 1979, was formerly on the faculty at Hastings, and taught at Stanford. For three years he served on the Committee on Corporations, State Bar of California.*

The Tender Offer for Shell Oil Company: Shareholder Expectations and Fairness in Going Private Transactions

Mary Louise Woodbridge

For over sixty years, Royal Dutch Petroleum Company ("Royal Dutch") and The "Shell" Trading and Transport Company, p.l.c. ("Shell Transport") have controlled a majority of the stock of Shell Oil Company ("Shell Oil"), the seventh largest integrated oil company in the United States. Three years ago, the two parent companies, who together control a network of subsidiaries and affiliates known as the Royal Dutch/Shell Group of companies, reached the internal decision to buy out, in one form or another, all of the minority shareholders of their partial subsidiary.¹ As of this writing, it appears that Royal Dutch/Shell will obtain its goal by means of a cash tender offer followed by a short form merger on the same terms.

Last year, in *Joseph v. Shell Oil Co.*, 482 A.2d 335 (Del. Ch. 1984), Vice-Chancellor Harnett called the transaction before his court a "most unusual tender offer." The transaction is not unusual in the sense of structural complexity; its distinction is rather in the goals of the offeror and the expectations of the shareholders, which present policy concerns different from those upon which the customary legal analysis of tender offers in this country is based.

A. BACKGROUND

Royal Dutch, a Netherlands company, and Shell Transport, a United Kingdom company, are large, publicly-owned holding companies, whose



Mary Louise Woodbridge

shares are traded on the New York Stock Exchange and other markets in the United States and Europe. Shell Petroleum N.V., a Netherlands company ("Shell Petroleum"), is one of two principal holding companies within the Royal Dutch/Shell Group. Sixty percent of its shares are owned by Royal Dutch and forty percent of its shares are owned by Shell Transport. At the time of the announcement of the tender offer, Shell Petroleum owned 69.4 percent of the common stock of Shell Oil.

This chain of ownership gave Royal Dutch and Shell Transport, through Shell Petroleum, the power under Delaware law to elect or remove any or all of the directors of Shell Oil. Shell Petroleum has, however, for many years given the management of Shell Oil its proxy for the

election of directors. This has resulted in the operation of Shell Oil as an autonomous business entity, whose management is functionally independent of Royal Dutch and Shell Transport and the management of other Royal Dutch/Shell Group companies. Nominations for directors of Shell Oil are made by a committee composed of the President of Shell Oil and two of its independent directors. Of the eleven directors of Shell Oil, six are independent in that they are not employed by any affiliate of the Royal Dutch/Shell Group. Of the five "inside" directors, three are the three most senior executive officers of Shell Oil, and the remaining two, Sir Peter Baxendell and Mr. L. C. van Wachem, are the chairman and chief executive officers of Shell Transport and Royal Dutch, respectively.

B. DESCRIPTION OF THE TRANSACTION

As early as 1982, Shell Petroleum considered acquiring additional holdings in Shell Oil. In the first half of that year, Morgan Stanley & Co., the prominent investment bank, was retained to give advice regarding this business option. In late 1983, Morgan Stanley was again retained to advise Shell Petroleum with respect to the possible acquisition by Shell Petroleum of all of the outstanding minority shares of Shell Oil, either by the merger of Shell Oil into a subsidiary of Shell Petroleum or otherwise. Early in 1984, Shell Petroleum organized

SPNV Holdings, Inc. ("SPNV"), a Delaware corporation, to facilitate implementation of such a merger.

As part of its engagement, Morgan Stanley compiled and provided to SPNV and Shell Petroleum a selection of statistical information and analyses derived exclusively from public sources. On January 22, 1984, Morgan Stanley delivered to SPNV its written opinion, based on the public information contained in the earlier compilation, that a price of \$53 per share "would be fair, from a financial point of view to [Shell Oil's] shareholders (other than [Shell Petroleum])." A subsequent opinion, making reference to an announcement of a discovery of oil reserves in a holding of one of Shell Oil's subsidiaries, raised the fair financial price to minority shareholders to \$55 per share. On January 23, the day before Shell Petroleum's intentions were made public, shares of Shell Oil closed at \$44 per share on the New York Stock Exchange Composite Tape. The average closing price reported for the previous 30 trading days had been \$40 per share. Thus the revised price suggested by Morgan Stanley reflected a premium in the range of 25% to 37.5% over market price.

A cash merger proposal was first communicated to the management of Shell Oil on January 24, 1984, at a meeting called by Sir Peter Baxendell and L.C. van Wachem with John F. Bookout, President and Chief Executive Officer of the company. Simultaneously, the terms of the proposed merger were announced to the public. Two days later, Baxendell described the merger proposal to the full board of directors of Shell Oil. The board responded with the correct corporate practice, immediately appointing a committee, comprised of all of the company's independent directors, to consider the proposal. The committee itself promptly retained its own prominent financial advisors, the firm of Goldman, Sachs & Co., as well as legal counsel, personnel consultants, and petroleum engineers.

Although SPNV had initially conditioned its merger proposal upon Shell Oil's acceptance within 30 days,

SPNV extended Shell Oil's time to respond when it became clear that the committee would not be in a position to meet the original deadline. On March 29, Goldman Sachs reported to the committee its recommendation that the merger price set out in SPNV's proposal was wholly inadequate and stated its opinion that a more appropriate range would be from \$80 to \$85 per share. Based upon this advice, the committee and the whole board of Shell Oil, speaking through its independent directors, voted to reject the proposal of SPNV and indicated that it would not consider recommending to the shareholders a cash-out merger valued at less than \$75 per share. SPNV was unwilling to negotiate the price of the merger under those circumstances, but rather announced that same day its intention to commence a tender offer for all of Shell Oil's outstanding shares for the cash price of \$55 per share.

On March 31, 1984, Shell Oil provided SPNV with a copy of the draft proxy statement that Shell Oil had intended to issue concerning the merger proposal. This statement contained material non-public information regarding Shell Oil's operating plans and the value of certain of its assets, including appraisals of probable petroleum reserves. The draft proxy statement was also given to Morgan Stanley on that day. Prior to that time, Morgan Stanley had had access only to public information regarding Shell Oil, and its valuation of Shell Oil's assets had included specific appraisals only of proven petroleum reserves; probable reserves were considered in setting a value on the company as a whole, but were not specifically appraised. Morgan Stanley reviewed the information contained in the draft proxy statement and confirmed orally on April 2, and in writing on April 3, that it still considered \$55 per share to be a fair price. Subsequently, and based upon both the information contained in the draft proxy statement and Morgan Stanley's updated opinion, as well as other factors, the board of directors of Shell Petroleum determined that \$55 per share was still a

"fair price" but determined nevertheless to raise the tender offer to \$58 per share "to encourage widespread acceptance of the offer."

C. MARKET RESPONSE TO THE MERGER PROPOSAL AND TENDER OFFER

The market price of stock in Shell Oil Company reacted strongly to the announcement of the merger proposal. In the two months subsequent to the announcement of the merger proposal on January 24, 1984, the stock traded primarily at or above the cash merger price of \$55 per share. This is a powerful example of the upward pressure that risk arbitrage can put on the price of a takeover target's stock. Shell Oil's stock reached a high of \$61 per share in the first quarter of 1984, more than 10 percent over the premium price offered by Shell Petroleum and SPNV. Fifty-five dollars per share thus became the base price for Shell Oil stock while the arbitrageurs sought to accumulate large holdings of the stock, on the chance that Shell Oil, through its special committee, would be able to negotiate a higher price for the merger, confident that the initial merger proposal, while not guaranteed, would provide a floor on any possible losses.

The announcement of the tender offer put downward pressure on the Shell Oil stock. At that point, it must have become clear to players of the market that Shell Petroleum did not intend to negotiate with Shell Oil or its public shareholders over the price of Shell Oil. Contrary to their experience in other tender offer battles, investors realized that Shell Petroleum's seventy percent ownership of Shell Oil made the prospect of a competing bid at a higher price close to impossible. Shell Oil stock traded between \$55-1/2 and \$57-5/8 per share during the first four days of trading after the announcement of the tender offer price of \$55 per share. After the offer was raised to \$58 per share, the stock traded in the slightly higher range of \$56 to \$58-5/8 per share through the remainder of the second quarter.

D. LITIGATION

On January 26 and 27, 1984, within three days of the public announcement of the merger proposal, six class action suits were filed in the Court of Chancery for the State of Delaware objecting to the proposed merger and alleging various breaches of state fiduciary duty and violations of the federal securities laws. These actions were consolidated by the court and arguments were heard on plaintiffs' motion for a preliminary injunction against consummation of the cash merger and other relief. Amended complaints were filed after the commencement of the tender offer. On May 8, 1984, Vice-Chancellor Harnett delivered an opinion granting in part the plaintiffs' application for preliminary relief. The court's order to that effect was entered on May 11.

The allegations of the plaintiffs' amended complaint may be divided into four categories. First, the plaintiffs alleged that the attempt by Shell Petroleum, as majority shareholder of Shell Oil, to cash out the minority shareholders was fraudulent and coercive and therefore a breach of the majority's duty of "fair dealing" to the minority under Delaware law. Second, the plaintiffs alleged that the tender offer price was not a "fair price" under any circumstances. Third, the plaintiffs alleged that the majority had violated state and federal law by failing to disclose various material items of fact with respect to the value of Shell Oil in general and the valuation of the company given by Morgan Stanley in particular. Fourth, the plaintiffs alleged that the timing of the majority in announcing the merger proposal, tender offer, and increased tender offer price was a manipulative scheme or device in violation of state and federal provisions designed to prevent fraud in the purchase and sale of securities and the making of tender offers.

The defendants denied that the tender offer was coercive or manipulative, denied that there was any lack of disclosure, and asserted that \$58 per share was more than a fair price. In addition, the defendants argued that neither state nor federal

law imposed a duty upon them to offer a fair price to the stockholders for their stock, but rather that it was for each stockholder to determine whether or not she was willing to tender her shares at the price offered.

Vice-Chancellor Harnett's opinion on the motion did not address each of these issues, but rather concentrated on the question of disclosure. The Vice-Chancellor did, however, reach two holdings that are of particular interest to the student of tender offers and "going private" transactions. I shall discuss each of these holdings before proceeding to the question of disclosure.

First, the Vice-Chancellor stated that "[i]t is elementary that defendants, because they stand on both sides of the transaction, are under a fiduciary duty to the minority stockholders of Shell."

While it is of course true that a majority shareholder under Delaware law owes a duty of fair dealing to the minority, it is not clear that the defendants, other than L. C. van Wachem and Sir Peter Baxendell, "stand on both sides of the transaction." As to the two defendants who serve on the boards of both Shell Petroleum and Shell Oil, the directors of course have a fiduciary duty to the corporations they serve as well as to all of the shareholders thereof, but this fiduciary duty arises directly from their positions as directors, and not because they may stand on two sides of a transaction. Delaware law provides that transactions between corporations with interlocking directorates will not be void solely for this reason if there is full disclosure and ratification by the disinterested directors.² Thus, if the merger proposal had been approved by the committee of independent directors, it would have been valid under Delaware law. However, even this analysis is beside the point, because the tender offer was not a transaction between Shell Petroleum and Shell Oil, but rather a transaction between Shell Petroleum and the public shareholders of Shell Oil. Once again, it is indisputably true that Shell Petroleum owes these stockholders certain duties, but these duties arise under the Williams Act

and other statutory provisions, and not because of some common law prohibition of self-dealing. This is not a self-dealing transaction and it was inappropriate for the court to refer to it as such without explaining its statement.

Notwithstanding the presence of van Wachem and Baxendell on the board of directors of Shell Oil, that board is and proved itself to be independent of Shell Petroleum and the Royal Dutch/Shell Group. Although no figures are available regarding the possible ownership by any of the directors of Shell Oil Company (other than Baxendell and van Wachem) of shares of stock in Royal Dutch or Shell Transport, it is clear that neither the directors nor management of Shell Oil control Royal Dutch or Shell Transport. Thus, it should be clear that the transactions considered here cannot be called a "management buy out." The element of self-dealing that characterizes management buy outs and requires close scrutiny of such transactions is not present in the tender offer by SPNV for Shell Oil stock and the merger intended to follow.

The second questionable holding of the Court of Chancery was Vice-Chancellor Harnett's assertion that there are "exceptions" to the general rule that a tender offeror has no legal duty to offer a "fair price" to holders of the targeted stock. As the Vice-Chancellor noted, the rationale for this rule has been that "a stockholder is under no compulsion to accept a tender offer and can determine for himself if the offer is fair to him." The Williams Act thus provides that the shareholder have the information and the time she requires to make a meaningful decision on the fairness of the offer but does not require that the terms of the offer meet any standard of fairness other than the procedural requirements of the Act. Vice-Chancellor Harnett found an exception to this general rule, however, "when the maker of a tender offer, who has a fiduciary duty to the offeree, structures the offer in such a way as to result in an unfair price being offered and the disclosures are unlikely to call the unwary stock-

holder's attention to the unfairness." It is difficult to evaluate this holding in the context of the rest of the opinion. Vice-Chancellor Hartnett does not so much as hint as to how the Royal Dutch/Shell Group interests might have "structure[d] the offer" unfairly. The rest of the opinion is devoted to exposing failures of disclosure and fashioning a remedy. The court stated, however, that the failure of SPNV and Shell Petroleum to furnish Morgan Stanley with non-public information as to the value of Shell Oil's assets "would appear to be a breach of fiduciary duty aside from any issue of failure to make full disclosure." There is no direct support for this statement in the relevant case law, and the Court of Chancery did not offer any argument in favor of changing existing law; the statement nevertheless stands as a stumbling block for future makers of tender offers.

Having highlighted the questionable aspects of the Court of Chancery's opinion in *Joseph v. Shell*, we may now turn to the failures of full disclosure cited by the court. Vice-Chancellor Hartnett agreed with the plaintiffs that there were four material omissions in SPNV's published offering materials which, in the aggregate, resulted in the failure of SPNV to meet its duty under Delaware law. First, the court held that SPNV did not sufficiently highlight the fact that, prior to its original fairness opinion of January 22, 1984, Morgan Stanley was not provided with and did not have an opportunity to evaluate any non-public information relating to the value of Shell Oil's probable oil reserves. Second, the court held that SPNV should have specifically disclosed that the management of Shell Oil estimated the company's total value in an auction of bidders for the company as a going concern to equal \$91 per share, and that management had reported that estimate to the committee of independent directors who considered and rejected Shell Petroleum's initial merger proposal. Third, the court held that SPNV should have disclosed to the holders of Shell Oil stock the estimates prepared by Shell Oil's

management of the size and value of the Beaufort Sea discovery and the effect of that discovery on the company's probable oil reserves. Fourth, the court held that SPNV should have disclosed that in the two months prior to the delivery of their original fairness opinion, Morgan Stanley devoted only eight business days of scrutiny to the matters referred to therein.

In fashioning a remedy for these lapses, the Court of Chancery was careful not to overreach. Although the plaintiffs had demanded that the court permanently enjoin the "freeze-out" of the minority stockholders of Shell Oil, the Vice-Chancellor recognized that there were many such stockholders for whom the "freeze-out" was a windfall. The appropriate remedy was thus to order that the omitted disclosures be made and that stockholders who had tendered be given an opportunity to rescind the sale to SPNV and withdraw their shares if, after digesting the information newly disclosed, they desired to do so. In theory, this was the perfect remedy: the purpose of disclosure is to enable stockholders to make a meaningful decision regarding their investment; a failure to disclose material information injures those stockholders who might have reached a different decision had they had such information in the first place; thus, a remedy that permits such stockholders to re-think their decision on the basis of the information they should have had in the first place, but still leaves this decision in the hands of each stockholder, should be tailor-made to fit the breach. However, it may be assumed that most of the stockholders who tendered and sold their shares in April or May had already spent or invested the money received on the sale by the end of June when the rescission offer was made. The offer to rescind was left open for twenty-one days; stockholders who needed to liquidate other investments were effectively given three additional business days to transmit the proceeds of such liquidation to the tender depository from their bank or brokerage company. In that time, most stockholders had to make two investment decisions: first,

whether or not to sell the investment into which they had put the money they received on the sale of their Shell Oil stock to SPNV; second, whether or not to buy that Shell Oil stock back from SPNV for the price of \$58 per share. Courts and lawyers use the word "rescission" to describe the reversal of a sale, but for investors, that transaction is indistinguishable (without respect to tax consequences) from a purchase. Yet the price for this purchase, at \$58 per share, was \$2 per share above the current market price for Shell Oil stock. Granted, if sufficient numbers of investors rescinded to prevent SPNV from executing a short-form merger under Delaware law, the market price might very well have risen in expectation of a better tender offer or merger proposal from SPNV. It is, however, not surprising that under these conditions, only 300,000 of the 78,000,000 shares validly tendered were the subject of an election to rescind.

The lack of response to the rescission offer is illustrative of the dichotomy faced by Vice-Chancellor Hartnett in *Joseph*. On the one hand, it is very clear that the Vice-Chancellor thought that \$58 per share was too low a price for Shell Oil Company. On the other hand, Vice-Chancellor Hartnett knew that there was a very good chance that this was the best price that any minority stockholder was likely to be offered for her shares in the foreseeable future. Shell Petroleum owns 70 percent of Shell Oil and has no intention of selling its controlling interest in the company. Thus, there is no hope that any other person or entity could compete with the former's tender offer by making a higher bid for the minority's stock. The only return that any minority shareholder of Shell Oil can expect from her investment is a proportionate share in the company's earnings, realized through dividends and capital gains over the long term. The liquidation or "break-up" value of Shell Oil's assets is thus of only theoretical importance. The minority shareholder of Shell Oil cannot even realistically hope that another oil company would seek to purchase Shell Oil for its assets, as other oil

companies have been purchased. The Royal Dutch/Shell Group is the second largest oil company in the world; it is inconceivable that it would be profitable for any company in the industry to challenge it for Shell Oil. The result of these circumstances is that the "control premium" for Shell Oil, that is, the amount by which the value of the company as a whole exceeds the sum obtained by multiplying the market price of its stock times the number of shares of stock outstanding, inures almost entirely to the majority shareholder, Shell Petroleum.

Vice-Chancellor Hartnett was clearly uncomfortable with this circumstance. The Vice-Chancellor's finding that the acquisition of Shell Oil by SPNV was a self-dealing transaction, and his suggestion that SPNV structured this transaction "in such a way as to result in an unfair price being offered" to the minority shareholders of Shell Oil, are expressions of his wish that SPNV and Shell Petroleum share the benefit of their implicit "control premium" with the minority shareholders. Hartnett's closing paragraph underscored this wish.

I also note that mere compliance with the mandate of this opinion will not end this matter. The other remedies for the defendants' apparent breach of their fiduciary duties, however, must await another day.

The Vice-Chancellor seems here to be flexing the muscles of the Court of Chancery, warning Shell Petroleum and SPNV that he will not make it easy for SPNV to carry out the purchase of tendered shares and second-step merger at a price of \$58 per share. Vice-Chancellor Hartnett does not want to block the transaction completely, for that would be detrimental to the immediate interests of many of the minority shareholders, who would rather take their money and run than wait around for Shell Petroleum to come up with a better deal. The Vice-Chancellor however does want to put what pressure he can on the purchasers to raise the price of the deal.

One additional issue raised by

the plaintiffs' amended complaint appears to be worthy of some examination, although it is not directly addressed by the Court of Chancery. That is plaintiffs' assertion that defendants timed the release of certain of their announcements regarding the merger proposal and tender offer to coincide with the release by Shell Oil of other favorable news regarding the company, with the express purpose of interfering with the ability of the market to digest that favorable information and translate it into higher prices for Shell Oil stock. The plaintiffs allege that this scheme amounted to a manipulative, deceptive, or fraudulent device intended to induce Shell Oil stockholders to accept a lower premium in return for their shares than they would otherwise have been willing to accept, had the market price been allowed to rise naturally with the favorable economic news.

The plaintiffs' amended complaint offered three examples of this alleged manipulation.³ First, on January 23, 1984, the day before the announcement of the merger proposal, "but before the market could absorb the extremely favorable news," Shell Oil announced the Beaufort Sea discovery. Second, on January 26, 1984, merely two days after the merger announcement, Shell Oil reported a 25 percent increase in fourth quarter earnings for 1983, from \$1.42 to \$1.78 per share. Third, on April 4, 1984, the day that SPNV announced that it would raise the price of its tender offer from \$55 to \$58 per share, Shell Oil realized a net income for February, 1984, that was 58 percent above that of the year before.

This alleged scheme probably underestimates the market, which is sophisticated enough to evaluate such information instantaneously notwithstanding the importance of other information received simultaneously. Moreover, the earnings figures of Shell Oil, while perhaps somewhat better than expected, were certainly anticipated by the market to be favorable. Thus, it is not clear how much of an additional impact such information would have had on the price

of Shell Oil stock had it been allowed to reach the market without the competition of SPNV's takeover announcements. Nevertheless, this may have been what Vice-Chancellor Hartnett was referring to when he implied that the defendants had structured the transaction in such a way as to result in an unfair price.

We shall probably never know. In March of 1985, days before the trial on the merits was scheduled to begin, the plaintiffs' representatives reached an agreement-in-principle as to settlement with the defendants. In return for the plaintiffs' dropping the suit and agreeing to tender their shares, the defendants agreed to pay every stockholder an additional two dollars per share, raising the effective price for the outstanding minority shares by \$188,000,000. The settlement proposal is at this writing before the Court of Chancery, which must approve any settlement under the class action rules of that court. My prediction is that the settlement will be permitted.

E. EMPLOYEE BENEFITS.

A second interesting aspect of the Shell transaction from a legal perspective was the treatment of stock held by the Shell Stock Fund and the Shell Employee Stock Ownership Plan for the benefit of Shell Oil employees. The former fund holds 24.5 million shares and the latter 3.5 million shares of Shell Oil stock, 7.9% and 1.2% of all outstanding shares of stock, respectively. The legal issue results from the fact that the sale of this stock would lead to tax consequences that would reduce the amount of employee retirement benefits available to participants in the funds. In order to compensate these employees for the loss of such benefits, Shell Petroleum, through SPNV, decided to pay to each affected employee a cash amount calculated to make such employee whole, on an after-tax basis. This decision was based on the separate recommendations of the employee benefit consulting firms hired by Shell Oil and its special committee, respectively. Such payment would be made to the employee directly, would be

separate from the payment for shares purchased by SPNV, which would be paid to the stock funds, and would be calculated on a case-by-case basis with respect to the actual benefits lost by each employee. The payments would not give to employee/stockholders a benefit not available to non-employee/stockholders because the net result would be only to put all stockholders on an equal footing. Indeed, it would be logically fair to say that the additional payments to employees were not with respect to the shares tendered at all, but rather with respect only to benefits lost in the corporate reorganization.

Despite these arguments, the Securities and Exchange Commission refused to bless the compensatory payment to employees, forcing SPNV to withdraw the offer to make such payments. Claiming that the Williams Act implicitly requires that a bidder in a tender offer pay to every shareholder the highest consideration paid to any other shareholder, the Commission took the position that special cash payments to employee stockholders violated that unstated but understood "Best Price Rule."

In addition to the arguments laid out above to show that payments to compensate employees for benefits lost on the sale of stock by their retirement plans do not violate but rather support a "Best Price Rule," SPNV raised the alternative argument that no such rule exists. Section 14(d)(6) of the Williams Act states:

Where any person *varies* the terms of a tender offer . . . by *increasing* the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder . . . whether or not [tendered shares are purchased] before the variation of the tender offer. [emphasis added]

This provision prohibits the unfair aspects of a manipulative practice in which the person making a tender offer attempts to segregate his market by initially offering a very low premium and raising it as necessary to persuade additional shareholders to tender. It does not on its face pro-

hibit tender offers whose initial terms offer different prices to shareholders in different circumstances.

The limits of Section 14(d)(6) are highlighted by the Commission's attempt to promulgate a rule to enforce a "Best Price Requirement." Proposed Rule 14e-4(a) was circulated for comments in 1979, but was never adopted. That rule would have expressly required each shareholder responding to a tender offer to receive the highest consideration offered to any such shareholder. The failure of the Commission to adopt the rule implies that no such requirement now exists.

F. EVALUATION

Earlier in this essay I stated that what made this transaction unique was not the utilization of arcane legal maneuvers but rather the goals and expectations of the parties. It is obvious that this tender offer, although unsolicited and opposed, is not a battle for the control of Shell Oil. The Royal Dutch/Shell Group has had the power to control Shell Oil for sixty years, and will continue to have it even if it is prevented from completing this transaction.

What, then, was the motivation for Royal Dutch and Shell Transport to pursue this tender offer and proposed merger? Two answers can be given:

First, and perhaps most important, the merger would relieve Shell Petroleum and Royal Dutch/Shell of its fiduciary duties under American state laws to Shell Oil's minority stockholders. Under Delaware law, a controlling shareholder is a quasi-fiduciary to the minority. The majority shareholder may not usurp opportunities belonging to the corporation, a rule which is very hard to interpret when the shareholder is a major player in the same business as the corporation. In order to find itself a safe harbor, Royal Dutch/Shell has consistently bent over backwards to yield opportunities to its autonomous partial subsidiary, perhaps often to its own detriment.

Second, Shell Petroleum perceived Shell Oil to be a highly worthwhile investment for the immense

amount of cash assets which the former had accumulated. This was true not only because of Shell Oil's extensive oil reserves and industry-low cost per last barrel obtained, but because of Shell's prospects as a going concern for future profits and market share.

Thus, Royal Dutch/Shell's goals in attempting to purchase the outstanding minority interest in Shell Oil were grounded in efficiency and economics, not the prospects of greenmail or glory. In the United Kingdom, any person who acquires greater than 30 percent of a company is required to bid for the remaining shares at the highest price paid for such shares over the previous twelve months; partial tender offers are highly discouraged.⁴ Although one scholar has explained that the British perspective is prompted at least in part by the unfavorable position of the minority shareholder under English company law,⁵ it is also true that some policy values favor the wholly-owned subsidiary over the subsidiary dominated by a single large shareholder, because the latter circumstance results in shareholders facing all of the risks of an equity investment without the benefit of control over the investment that ownership of voting stock would provide.

A second factor in evaluating this transaction is the expectations of the minority shareholders. It is important to realize that most if not all of such shareholders knew when they purchased stock in Shell Oil Company that they would always be the minority voice in a company susceptible of absolute control by the majority shareholder. If they are now forced to sell their shares at a discount from the liquidation value of the company, it cannot be doubted that they purchased their investment at such a discount in the first place. To compensate such shareholders without regard to their conscious acceptance of limited rights and a limited return when they made their investment decision would be to grant such shareholders a windfall at the expense of the innocent majority shareholder.

It is for this reason that the con

cern that I have ascribed to Vice-Chancellor Hartnett over the relatively low premium offered by SPNV in the tender offer is unfounded. Shell Petroleum has indeed kept for itself the value of the "control premium" of Shell Oil, but this premium rightfully belongs to Shell Petroleum. As discussed above in part E, the policy for shareholder equality under the Williams Act is not absolute. Shareholders in public corporations are not co-venturers but investors whose rights are determined primarily by statute and by the terms of their investment contract with the corporate entity.⁶ Thus, shareholders need be treated with absolute equality only in the areas in which they expect to be so treated under statute and the terms of their stock. All common

shares must participate equally in dividends, voting rights, and other direct attributes of shareholder status. They need not be given the right to require an auction of the company merely because they find themselves in a minority position. Such a right, suggested by Commissioner Bevis Longstreth of the SEC,⁷ would give the minority shareholder in this situation a right that he had not bargained for at the expense of the rights of the majority shareholder and the principles of freedom of contract. A far better result would be to permit the so-called "freeze-out" of the minority stockholders of Shell Oil with our blessing, and urge them to put the proceeds of their better-than-market price in the alternative investment of their choice.

1. "Offer to Purchase for Cash Any and All Outstanding Shares of Common Stock of Shell Oil Company at \$58 Net Per Share by SPNV Holdings, Inc., A Wholly Owned Subsidiary of Shell Petroleum N.V.", dated April 4, 1984, (hereinafter, the "Tender Offer") 1. See also "SPNV Holdings, Inc. Supplement Dated June 26, 1984 to Offer to Purchase Shell Oil Company Common Stock Relating to Rescission Rights for Tendered Shares" (hereinafter, the "Rescission Offer").

2. Section 144, Delaware Gen. Corp. Law.

3. Plaintiffs' amended complaint, para. 25, p. 12.

4. Rules 34, 27, "The City Code on Take-overs and Mergers (Council for the Securities Industry 5th Rev. ed. 1981), as discussed in DeMott, "Current Issues in Tender Offer Regulation: Lessons from the British" 58 *NYU L. Rev.* 945, 954 et seq. (1983).

5. *Id.*

6. *Ibid.*

7. Bevis Longstreth, *Speech to Int'l Bar Ass'n, Oct. 6, 1983*, [1983-84 Transfer Volume] Fed. Sec. L. Rep. ¶ 83,436.

The Metromedia Leveraged Buy Out

Davia A. Odell

I. INTRODUCTION

On December 6, 1983, four top executives of Metromedia, Inc., shocked the investment community by announcing a plan to take the company private in a record \$1.5 billion leveraged buy out ("LBO"). The buy out was spectacular not only in magnitude, but also in structure—a deal financed mainly by the subsequent sale of "junk bonds," which lead one authority to call this the "first ever public leveraged buy out."¹ Surprisingly, shareholder litigation arising out of the Metromedia LBO was quickly settled; and it is estimated that John Warner Kluge, the first and only ever chairman and chief executive officer of the company, both pocketed \$115 million in cash and securities and increased his personal equity stake in Metromedia from 26 percent to 75.5 percent.

II. METROMEDIA: 1960 to 1983

In 1959, John W. Kluge purchased a controlling interest in Metropolitan Broadcasting Corp., which owned two television and four radio stations. He became its chairman and chief executive officer, and took the company public the next year. In 1961, Mr. Kluge acquired the Foster & Kleiser outdoor advertising (billboard) firm, and shareholders voted for a change of name to Metromedia to reflect the company's expected expansion into diverse media in major metropolitan markets. In the mid-1970s, as Metromedia acquired more stations in major markets and broadcasters generally became the favorites of Wall Street, the company's price per share rose from \$4.25 in 1974 to a peak of \$560 in 1983. Industry experts generally foresaw Metromedia as the upcoming "Fourth Network," competing with ABC, CBS, and NBC for viewers, producing first-



Davia Odell

run programs, and buying up popular but outdated syndicated shows.

To make the acquisitions that fueled its dramatic rise, Metromedia adopted a policy of extreme leveraging—by October 1983, its debt-to-capital ratio was a colossal 70 percent. Its policy was to purchase small television and radio stations and then sell them as larger stations in major markets became available, pledging the assets of the larger station as collateral against the enabling loan. Its purchases in 1981 and 1982 of Boston and Chicago stations for \$220 million and \$136 million respectively were by far the highest prices ever paid for television stations. [Those purchases were followed by the acquisition of large companies specializing in cellular transmission technology (i.e., radio paging and mobile telephone service)]. Overall, experts estimated that the company paid \$100 million more than the fair-market value of the assets it purchased on this cellular buying spree.

To finance these massive acquisitions, Metromedia engaged in diverse

and creative schemes to raise cash. For instance, the company did not hesitate to take advantage of an August 1981 federal tax law allowing losing companies to sell unusable tax breaks to other companies seeking to reduce their taxes. In 1982, Metromedia paid \$15 million to New York City's Metropolitan Transportation Authority for \$99 million worth of tax breaks on railway cars and buses. The company, later that year, paid \$108 million for tax benefits on \$465 million worth of equipment owned by unidentified companies. Some of the benefits were acquired in sale and leaseback transactions. In November 1983, Metromedia sold some of the real estate on which its broadcast facilities are located to a limited partnership headed by Blythe Eastman Paine Webber for \$125 million. It then leased back the real estate, along with the right to repurchase it at fair market value in 20 years.

In a more highly publicized and more creative transaction, Metromedia raised \$450 million by selling "certain operating assets" of its Foster & Kleiser outdoor advertising division to a limited partnership. Metromedia served as general partner, managed the assets for a fee, and retained the right to repurchase the assets at a later date, probably 1987. The limited partner investors received tax deductions from the depreciation of assets and the interest expense from debt in the partnership. The deal was seen "as a mark of Kluge's financial acumen" and "drew rave reviews on Wall Street."² It apparently was designed to offset the company's \$141 million increase in long-term debt resulting from the company's \$220 million purchase of WCVB-TV, Boston. The leasing deals

and the success of the limited partnership plan seemingly foreshadowed Kluge's LBO the next year; one analyst described the deals as getting "private market value without going private."³ Said another, "These are massive transactions . . . [some] of the biggest deals of their kind ever made."⁴ They resulted in the huge upsurge in Metromedia's stock price, which soared above the \$200 mark for the first time immediately after they were announced.

Nor were the effects of these and other creative financing schemes lost on the company's critics. Foremost among them was Abraham J. Briloff, an accounting professor at the City University of New York, who wrote two articles in *Barron's* magazine criticizing the limited partnership deal and the way Metromedia kept its books.⁵ Briloff argued that, rather than a stroke of brilliance, the limited partnership arrangement cost the company \$42 million in opportunity cost, plus a \$200 million loss of the repurchase of the asset—an annual interest-equivalent cost of 26 percent.⁶ He speculated that only a company which "urgently needed the cash" would "enter into this deal at such a great cost to the corporation."⁷ He continued,

Why didn't the corporation borrow what it realized from the putative sale? The answer appears to be that given its balance sheet [current assets of \$206.7 million and current liabilities of \$408.7 million] it might not have found a willing lender on an agreeable basis.⁸

Further, Briloff deleted certain "extraneous" items from Metromedia's financial report, and the 29 percent increase in 1983 first-half per share operating net income turned into a nine percent decline, or even a 31 percent decline.⁹ In the two days after the second article was published, Metromedia shares fell \$110 apiece, from \$500 to \$390.

Other commentators also criticized Metromedia's allegedly illusory bookkeeping procedures. One called the company's financial statements "impenetrable."¹⁰ Another said they failed candidly to attribute the

increase in earnings per share to stock repurchases. During the time in which Metromedia's stock price was rising above the \$500 mark, Mr. Kluge resisted suggestions for a stock split. He insisted that the stock in general, and the broadcast properties in particular, were vastly undervalued, and the company instead embarked on a major stock repurchase program. The number of outstanding shares declined from 6.7 million in 1976 to 5 million in 1982. Of the latter number, 4 million were held by insiders and institutions; Mr. Kluge himself held between 17 and 25 percent of the company, or 850,000 to one million shares. Moreover, the stock repurchases, by lowering the number of outstanding shares, raised the earnings per share figure, which investors use to judge the value of the company. Considering the stock repurchases, the value of Metromedia had not appreciated nearly as swiftly as had its share price.

In the fall of 1983, Mr. Kluge succumbed to market forces, and Metromedia declared a 10-for-1 stock split. Although it was designed to broaden investor interest, its effect was to encourage institutions to sell off their overloaded positions in the company. By Thanksgiving, Metromedia's stock had declined from a 1983 high of \$57 to \$20, adjusted for the split. It was at this time, commentators say, that Mr. Kluge realized that Metromedia stock had become cheap enough to make possible a LBO.¹¹

III. LBOS: THE STATE OF THE ART IN 1983

Typically, a LBO is the purchase of the stock or assets of a company, or a subsidiary of a company, by an investor group, which almost always includes the management of the organization to be bought. The investors' up-front cash usually amounts to approximately 10 percent of the purchase price. The rest is borrowed, using the company's existing assets as security. As the new, privately-held company repays the loan, all interest is tax-deductible.

LBOs gained popularity in the late 1970s and early 1980s. LBOs, as a percentage of completed divesti-

tures, rose from 6 percent (49 LBOs) in 1977 to 13 percent (113 LBOs) in 1982. The money spent on these transactions increased from \$75 million to \$2 billion during that period. By 1983, more than 50 LBOs per quarter were being recorded. One reason for this dramatic rise in the value of the takeovers was that LBOs originally were used only for takeovers of small, closely held operations. The idea was—and still is—that self-run companies run best; the LBO phenomenon is a reflection of the "decentralization megatrend"¹² and what some experts see as an impending shift in corporate America's focus from acquisition to divestiture.¹³

Another, more pragmatic view attributes the increase in popularity of the LBO to its new-found recognition as a "classic insider's technique for snapping up a company at a cut-rate price" and pocketing millions of dollars within about five years.¹⁴ For instance, Wall Street insiders with designs on managing their own companies watched with envy when their counterparts at Gibson Greeting Cards and Converse acquired those companies in LBOs in early 1982 when their stock prices were at low points and took them public again 18 months later at a huge profit.¹⁵

Financing a LBO takes months to accomplish and is highly complex. Management must recruit at least one lending institution, such as a commercial bank, life insurance company, or venture capital firm, to put up the remaining 90 percent of the capital for the buy out. An institution may demand an equity stake in the resulting venture, particularly if it is a risky proposition. The lenders also closely supervise the resulting company's affairs after the buy out until the debt is completely repaid—a period of five to seven years if the deal is successful. Lenders also often restrict the new company from selling assets, merging, substantially changing its line of business, and/or taking on new debt.

Institutions, however, were not the exclusive lenders by the time the Metromedia LBO took place. Individual investors were participating,

too. For example, in 1983, Rothschild, Inc., to help finance its \$64 million purchase of four television stations from Ziff-Davis Publishing Co., raised \$26 million by syndicating shares in a limited partnership. Institutional pension funds also became interested in LBOs; E. F. Hutton & Co., for one, developed a LBO partnership for individuals. These types of LBOs are in fact extensions of the Metro-media concept of selling assets to limited partnerships while retaining control of the assets. The Metro-media LBO itself utilized this limited partnership avenue to some extent.

IV. SUCCESS PLUS; THE METROMEDIA LBO

On December 5, 1983, Metro-media halted trading in its shares on the New York Stock Exchange pending a self-termed "major news announcement" the next day. Some analysts speculated the company would make public more acquisitions in the cellular radio field.¹⁶ Instead, Metromedia's four top executives announced a complicated plan to take the company private in a \$1.5 billion LBO, the largest ever.

A. The LBO Plan

Metromedia's LBO carried to the extreme the type of leveraging in which the company had always been engaged. Instead of borrowing against the future cash flow of a television station or cellular radio franchise for Metromedia, Mr. Kluge borrowed to buy the whole company for himself and his three right-hand men, using its future cash flow as collateral. The offer gave shareholders \$30 in cash and \$22.50 in principal amount of a new issue of a subordinated, discounted debenture for each share. The debentures were set to mature on July 1, 1998, and begin bearing interest on January 1, 1990, at a rate of 16 percent per year, payable semi-annually. They also had the benefit of an unspecified sinking fund beginning in the tenth year. The debentures were subject to redemption at the company's option, at a price equal to face value plus accrued interest. Thus, for the first five years, when the financial pressures on the new company were expected to be the most

severe, Metromedia did not have to pay anything to the debenture holders. One commentator, calling the structure of the LBO "little short of brilliant," termed the deal a "leveraged leveraged buy out" for just this reason—it deferred payment to shareholders by offering them cash plus debentures with a face value of \$22.50 but an initial value of only \$10 to \$11.¹⁷

The market responded favorably to the proposed LBO; the stock price rose approximately \$10 to \$34 a share the day Metromedia announced the deal. But some shareholders were not satisfied with it. During December 1983, nine class action suits were filed in the Delaware Court of Chancery to enjoin the LBO, alleging the plan was an unfair, fraudulent, and unlawful attempt to acquire Metromedia. The actions were consolidated and captioned *Marilyn Pill and Samuel Pill, et al. v. Metromedia, Inc., et al.*¹⁸ The exact allegations of the lawsuit are unclear; the plaintiffs apparently based it on such figures as the estimated value of the LBO—between \$35 and \$40 per share—in contrast to the value of the company's broadcast properties alone—more than \$40 per share by all accounts. Moreover, the value of Metromedia's television stations was expected to increase vastly when the Federal Communications Commission lifted its rule limiting ownership by a single concern to seven stations. The parties settled the suit on March 22, 1984, when Metromedia agreed to grant shareholders certain warrants and pay them a quarterly dividend of \$.19 per share. Analysts estimated the value of the settlement at approximately \$.69 per share.¹⁹

At the June 20, 1984, annual shareholder meeting, Metromedia's shareholders overwhelmingly approved the management LBO. The executive group justified the buy out as granting shareholders a "substantial premium" above market value, book value, liquidation value, and all purchase prices paid by the company in recent stock repurchases.²⁰ The executives repeated the reason they had given all along for their desire to purchase the company: a need to

operate it "without the constraints of answering to the public and analysts every 90 days."²¹ Put another way, management wanted to free itself from having to maximize reported quarterly earnings, with which it historically had had difficulty, while emphasizing expansion into risky fields and increasing cash flow, which had never been problems for Metromedia.²²

In approving the LBO, Metromedia's shareholders rubber-stamped the recommendation of a Special Committee, which the Board of Directors had appointed on December 6, 1983, to "study, review and evaluate" the LBO proposal.²³ The committee met four times between December 15, 1983, and January 31, 1984, and heard opinions and information from financial advisors Lehman Brothers and Bear, Stearns & Co. Based on such information, all but one member of the committee concluded that management's proposal was "fair, from a financial point of view, to holders of Metromedia common stock."²⁴ Yet, the company's Proxy Statement notes that both the special committee and the board of directors recognized that

consummation of the Merger will deprive current stockholders of Metromedia (other than the members of the Management Group and the Institutional Investor) of an opportunity to participate in the future growth prospects of Metromedia. The Special Committee and Board were also aware that the Management Group has a conflict of interest in connection with the Merger in that, among other things, they will have a substantial equity interest in, and will continue to comprise the Office of the President of, Metromedia after the Merger. In evaluating the fairness of the Merger and its desirability, the Special Committee and Board took into account the fact that the Management Group views Metromedia as an attractive investment opportunity. The Special Committee also considered that Metromedia would have to substantially realize its projections, which are subject to numerous assumptions and uncertainties, to satisfy its obligations to repay the

indebtedness incurred in connection with the Merger and thereby achieve the future values anticipated by the Management Group.²⁵

Noting these concerns, several shareholders tried to speak against the LBO at the annual meeting. However, they were silenced by Mr. Kluge, who adjourned the meeting without taking questions from the audience. Of particular concern to some shareholders was speculation whether Metromedia would be able to redeem the debentures when they come due in 1998.

In October 1984, the new, privately-owned Metromedia registered with the Securities Exchange Commission to raise \$1.3 billion through the sale of four new public debt issues, the largest package ever put on the market by a non-financial corporation. All but \$50 million of the proceeds was used to repay bank loans incurred in the LBO. The creative use of this debt package led experts to term the Metromedia LBO "the first-ever public leveraged buy out."²⁶ The package consisted of four types of "below-investment-grade securities," which investment bankers called "the biggest single offering of 'junk bonds' ever made."²⁷ Standard & Poor's Corp. rated the debt "highly speculative."²⁸ Still, the offering sold out in just two hours, entirely to institutional investors. It consisted of \$960 million of zero-coupon notes; \$225 million of 15-year senior subordinated debentures yielding 15.75 percent; \$335 million of 12-year exchangeable, variable rate debentures with interest payments that rise in 1988 if the cash flow from television and radio stations rises enough; and \$400 million of 18-year adjustable-rate subordinated debentures with an option to switch to a fixed rate if Metromedia so desires.

From management's viewpoint, refinancing with the public debt package enabled it to cut interest costs from more than 14 percent to approximately 10 percent. More importantly, selling its bank debt to the public enabled Metromedia to get out from under the \$100 million net worth minimum specified in its original \$1.3 billion bank loan agree-

ment. In turn, by paying off the bank debt and avoiding the net worth minimum, the company sidestepped having to sell one or more of its seven prized television stations, which it had anticipated doing before Mr. Kluge and his financial advisors conjured up the public debt offering plan. Finally, the zero-coupon notes, while requiring no cash interest payments, actually allow Metromedia to *increase* its interest deduction for tax purposes because interest accrued on the notes is deductible even though it is not paid in cash. For all of these reasons, the new refinancing is perhaps even more advantageous to Mr. Kluge than the original bank loan. Said one commentator: "Metromedia paid the banks \$14.5 million in front-end fees to get a loan that was outstanding for only about six months. But the loan served its purpose—it allowed Kluge to rid himself of those pesky outside shareholders."²⁹

B. The Participants

The participants in the Metromedia LBO reflect the scope, magnitude, and intent of the deal itself. The managers, Mr. Kluge, 70, Robert Bennett, 57, George Duncan, 53, and Stuard Subotnick, 41, put up a lot of experience and a little cash for the buy out. All but Mr. Kluge contributed \$3 million for what potentially could yield \$47 million by the end of 1988. Mr. Kluge, who owned 26 percent of public Metromedia, put up not cash, but 4.5 million of the 7.2 million shares he owned in the company. He sold his remaining 2.7 million shares on the open market for between \$36 and \$37.50 per share, or about \$100 million. *In addition*, Mr. Kluge gained a financial stake of 75.5 percent, including a 93 percent voting stake, in the new, private Metromedia. The other three executives each received two percent of the company.

Behind Mr. Kluge, the second largest holder of Metromedia is the Prudential Insurance Co., whose participation was needed to lure the bank loan. It received a 15.5 percent equity stake in the new company; in turn, it purchased \$125 million worth of 14-year, 10 percent preferred stock,

with warrants to buy common stock at a nominal cost. Prudential, however, has no voting rights in Metromedia; only the four executives have voting power. Further, Metromedia has the right to buy out Prudential regardless of whether it wants to sell.

Boston Ventures Limited Partnership paid \$10 million for the remaining three percent of Metromedia. The group is made up of many prominent and aggressive figures in the media, motion picture, and financial industries. It is run by William F. Thompson, former executive vice president of the First Bank of Boston. The limited partners include Rupert Murdoch's News American Publishing, Inc., \$1.25 million; Warner Communications, Inc., \$1.25 million; television producers Norman Lear and Jerry Perenchio, \$312,500 each; Carl Lindner's American Financial Corp., \$312,500; football team owners Jack Kent Cooke (Washington Redskins) and Eugene V. Klein (San Diego Chargers), \$312,500 each; Denver oilman, real estate developer, and 20th Century Fox owner, Marvin Davis, \$312,500; movie theater and soft drink conglomerate General Cinema Corp., \$312,500; and Manufacturers Hanover's venture capital subsidiary, \$500,000. As with Prudential, Metromedia has the option to buy out any of the Boston Ventures partners at will.

The remaining "participants" in the Metromedia deal were the lawyers—Skadden, Arps, Slate, Meagher & Flom of Metromedia, and Wachtel, Lipton, Rosen & Katz for Mr. Kluge's management acquisition group. Michael Milken, known in Wall Street circles as a financial wizard, handled the public debt financing plan for private Metromedia.

V. METROMEDIA TODAY

Despite initial doomsday predictions from critics that Metromedia might not be able to meet its debt payment schedule and the cellular challenge it set up for itself, the company thus far has been able to do both. According to the most recent figures available, the first nine months of 1984, Metromedia's net

profit figures show a loss of \$4.6 million. But this loss was expected, and in fact was the purported justification for management's LBO. Net revenues were \$272.6 million for the nine-month period, compared to \$343.7 million for all of 1983. Working capital remained about steady—\$47 million for the period versus \$60.4 million for 1983. Leverage was still high, with Metromedia's balance sheet showing \$1.3 billion in debt and negative \$52.9 million of net worth. However, the company's broadcasting assets currently are valued at nearly \$2 billion, approximately 150 percent of total debt. Cash flow from the properties is expected to rise from \$126.7 million in 1983 to more than \$300 million in 1989.

Ironically, Metromedia's affairs have been little reported in the press since the aftermath of the LBO. This may be due to its new status as a private company; it no longer must account to the public for its well being, and hence is of limited interest to readers of financial publications. With respect to Metromedia's futuristic cellular operations, the only operable system today is in Washington/Baltimore. The company hopes to introduce service in Chicago, Philadelphia, Boston, and New York within the next year. Metromedia has a total of 53 cellular mobile system applications approved or pending in 90 markets.

Many market-watchers speculate that Mr. Kluge intends to make himself a billionaire by the end of the decade by waiting for broadcast and cellular properties to appreciate substantially and then taking Metromedia public again.³⁰ The Federal Communications Commission's April 1, 1985, rule raising the limit on individual ownership of broadcast properties to 12, as well as the increasing popularity of mobile telephones certainly are initial steps toward that end—both will increase the value of the company's assets.

These factors, combined with Metromedia's postponement of interest payments via the public debt financing, would seem to make ultimate success more likely for Mr. Kluge and Metromedia.

VI. CONCLUSION

The Metromedia LBO perhaps best illustrates why this type of acquisition has become so popular with confident managers. The company's principal executive, Mr. Kluge, both netted \$10 million in cash on the deal and tripled his equity stake in the company. He also convinced his partners to grant him 93 percent voting power. Mr. Kluge makes his own decisions and most of Metromedia's profits will inure to him.

However a chairman of lesser repute or one with a less valuable company to leverage might not have been able to make the Metromedia LBO work. It was successful because banks and other backers had confidence in Mr. Kluge's management abilities and in Metromedia's properties. From the participants' standpoint, a LBO suited the company perfectly—the stock price and current earnings were low, but future cash flow was promising. The participants invested in the future—this is the essence of leveraging. From a policy perspective, going private probably will enhance Metromedia's efficiency; the LBO freed the company to engage in risky, futuristic pursuit that it might have otherwise ignored. Yet, given an admittedly promising future, one cannot help but wonder whether the \$10 premium Metromedia paid its shareholders reflected its true value. Because the shareholder suit was so quickly settled, this is something we will never know.

[*Editor's Note.* According to the report in the *Wall Street Journal* on May 7, 1985, Kluge received "top dollar" in an agreement to sell seven television stations to Twentieth Century Fox Film Corp. owners Rupert

Murdoch and Marvin Davis for a total of about \$2 billion, including the assumption of \$1.3 billion of Metromedia Inc. debt. The deal is expected to close in early 1986, and is estimated to be bringing Kluge "a windfall of \$400 million or more." *WSJ*, May 6, 1985, at 3, col. 1.]

1. *Wall Street Journal*, Nov. 30, 1984, at 48, col. 2.

2. "Wunderstock: Metromedia Soars Past \$200," *Broadcasting*, April 26, 1982, at 89.

3. *Id.*

4. *Id.*

5. Briloff, "No Sale," *Barron's*, Nov. 22, 1982, at 84; Briloff, "More on Metromedia: Abe Briloff Still Doesn't Like Its Accounting," *Barron's*, Aug. 8, 1983, at 32.

6. "More on Metromedia," *supra* note 5, at 33.

7. *Id.*

8. *Id.* at 34.

9. *Id.* at 32.

10. Sloan, "The Magician," *Forbes*, Apr. 23, 1984, at 32.

11. *WSJ*, Apr. 25, 1984, at 33, col. 4.

12. "L.B.O.s: A New Capital Market (And How to Cope with It)," *Mergers and Acquisitions*, Fall 1983, at 21.

13. "Why Leveraged Buyouts Are Getting So Hot," *Business Week*, June 27, 1983, at 86.

14. *Id.*

15. "L.B.O.s: A New Capital Market," *supra* note 34, at 21-22.

16. *WSJ*, Dec. 6, 1983, at 12, col. 3.

17. "The Magician," *supra* note 10, at 32-34.

18. Civil Action Nos. 7378, 7379, 7380, 7381, 7382, 7384, 7385 and 7404. See *Metromedia, Inc. Proxy Statement and Prospectus*, May 21, 1984, at 8; *WSJ*, Dec. 14, 1983, at 16, col. 2.

19. *WSJ*, Apr. 30, 1984, at 10, col. 3.

20. See *Proxy Statement and Prospectus, supra* note 18, at 18.

21. "Buyout May Trigger Big Metromedia Shift," *Advertising Age*, Dec. 12, 1983, at 3 (statement of Robert M. Bennett).

22. See "The Magician," *supra* note 10, at 32; *WSJ*, Apr. 25, 1984, at 33, col. 4.

23. The Special Committee was composed of Thomas T. Goldsmith, Jr., Jane Pickens Hoving, Warren H. Lasher, and John P. Lomenzo. None was affiliated with Metromedia or acquired an equity interest in the company after the LBO. *Proxy Statement and Prospectus, supra* note 18, at 16.

24. *Id.* at 17.

25. *Id.* at 19.

26. *WSJ*, Nov. 30, 1984, at 48, col. 2.

27. *Id.*

28. "Metromedia's Blockbuster Bid to Stretch Out Its Debt," *Business Week*, Nov. 26, 1984, at 61.

29. Sloan, "Metromedia Revisited," *Forbes*, Dec. 17, 1984, at 32.

30. *Id.* at 33.

FOCUS ON DECISIONMAKING

Duke's Private Adjudication Center

In his annual report on the state of the judiciary, delivered at the January 1982 mid-year meeting of the American Bar Association, Chief Justice Burger addressed the serious problems of increased cost, delay, and personal stress which the explosion in civil litigation was causing for the American judicial system. The Chief Justice noted:

The obligation of our profession is, or has long been thought to be, to serve as healers of human conflicts. To fulfill our traditional obligation means that we should provide mechanisms that can produce an acceptable result in the shortest possible time, with the least possible expense and with a minimum of stress on the participants. That is what justice is all about.

The law is a tool, not an end in itself. Like any tool, our judicial mechanisms, procedures, or rules can become obsolete. Just as the carpenter's handsaw was replaced by the power saw, and his hammer was replaced by the stapler, we should be alert to the need for better tools to serve the ends of justice.

Many thoughtful people, within and outside our profession, question whether that is being done today. They ask whether our profession is fulfilling its historical and traditional obligation of being healers of human conflicts and whether we are alert in searching for better tools. Although it may be too much to say that we lawyers are becoming part of the problem instead of the means to a solution, I confess there is more to support our critics than I would have thought 15 or 20 years ago.

Burger advocated expanded use of arbitration "not as the answer or cure-all for . . . mushrooming caseloads . . . but as one example of a 'better way to do it' . . . an alternative that will complement the judicial system."

Among the most exciting, fastest growing and innovative attempts at expanded use of arbitration to resolve civil disputes is that being undertaken by the Private Adjudication Center, Inc., of the Duke University School of Law.

The concept of the Center evolved from discussions at the Law School regarding the School's public responsibility and its program of clinical instruction. Among those participating in early planning were Dean Carington, Allen Foster (a Senior Lecturer teaching Commercial Arbitration at the School), and Professor Richard Maxwell. The Center was planned to provide a more expeditious and cost effective means of resolving parties' disputes and also the "enforcement of, rather than the structured compromising of, legal rights." (Progress Report at 1). This goal developed, at least in part, from a sense that prior efforts at alternate dispute resolution too often stressed "baby-splitting" (an award half-way

between what plaintiff and defendant each seek) when parties to a legal dispute want vindication of their legal rights.

In addition to offering parties a forum for expeditious dispute resolution consistent with controlling law, the Center would "provide instruction to students at the Duke University School of Law, and to a wider audience, in the arts of settlement and private adjudication" and would spearhead research "into the most effective procedures for resolving [legal] disputes." (Quinquennial Report).

Prior efforts at alternate dispute resolution too often stressed "baby-splitting."

In June 1983, the Duke Law School faculty approved the Private Adjudication Center in principle; approval by the Duke Board of Trustees followed and the Center was established in December 1983, as a nonprofit corporation affiliated with Duke Law School.

Among those who have accepted leadership roles in the Center are the following: Richard C. Maxwell, Chairman of the Center Board of Directors—Maxwell is Chadwick Professor of Law at Duke, former dean of UCLA Law School, an expert on real estate finance and oil and gas law, and an experienced arbitrator; L. Richardson Preyer, President of the Center—Preyer has served as a judge in North Carolina state courts, as U.S. District Judge in the Middle District of North Carolina, and a five-term Congressman; Benjamin R. Foster, Vice-President and Executive Director—Foster, for fifteen years senior vice president and chief financial officer for a Boston hi-tech firm (where he continues as a director), has long been interested in alternative resolution of commercial disputes, and came to Duke Law School to pursue this interest; Carmon Stuart, Vice-President for Adjudication Services—Stuart, a Duke alumnus, retired in 1983 from a distinguished career as Clerk of Court for the Middle District of North Carolina; C. Allen Foster, Vice-President for Education Services—Foster is a member of a Greensboro law firm, an experienced arbitrator, as well as an adjunct Senior Lecturer; and Thomas D. Rowe, Jr., Vice-President for Research and Reporter to the Center Rules Committee (responsible for drafting and revision of Center Rules of Procedure)—Rowe is Professor of Law at Duke and has

served as Associate Dean for Research. Professor Melvin G. Shimm also serves as Corporate Secretary-Treasurer.

As the Center was in its formative stages, Joann Snider, a federal court reporter in the Middle District of North Carolina, familiar with the effort to establish the Private Adjudication Center, put Allen Foster in touch with Carmon Stuart. Stuart took a great interest in the Center and approached the federal judges in the Middle District regarding the possibility of establishing a special extrajudicial procedure, generally known as court annexed arbitration, in the district.

Court annexed arbitration is not true arbitration because it is mandatory (not voluntary) and is advisory. It entails judicial assignment of civil suits for damages below a certain dollar amount to a mandatory hearing before an arbitrator or arbitrators. Hearings are generally scheduled to take place within six months of registration of the case for arbitration, and the time limit is strictly adhered to. Discovery takes place during the period between registration and hearing. Pre-hearing briefs are permitted. Court annexed arbitrators decide cases according to controlling law. Arbitrators' opinions are non-binding, i.e., parties are entitled (on request) to trial de novo, thus preserving the right to a jury trial. It is the non-binding nature of the mandated court annexed arbitration programs which presumably makes them constitutional. In *Kimbrough v. Holiday Inn*, 478 F Supp. 566 (E.D. Pa. 1979), the Eastern District of Pennsylvania held its court annexed arbitration program was not violative of the seventh amendment right to jury trial nor of fourteenth amendment equal protection and due process.

The purpose of court annexed arbitration is to simulate the result the parties might expect in court, in order to encourage parties to accept the results as final and thus reduce the incidence of trial among these cases. Also, given the strict time limits of the program, court annexed arbitration hopes to expedite resolution of disputes, thus reducing costs to litigants and to the judicial system.

The narrow time limits and strict hearing deadline operate to force parties to develop their arguments and

use in nine states, the District of Columbia, and two U.S. District Courts (the Eastern District of Pennsylvania and the Northern District of California). (It should be noted that the District of Connecticut terminated its court annexed arbitration program.) A program in Philadelphia County courts has been in existence since the 1950's. Research indicates that court annexed arbitration

Early settlement should reduce the cost of dispute resolution.

programs are achieving some of the hoped for results. A Federal Judicial Center study of court annexed arbitration in the Eastern District of Pennsylvania and the Northern District of California found that incidence of trial among cases assigned to judicial arbitration was reduced by approximately fifty percent. In the Eastern District of Pennsylvania, during the programs' first five years under two percent of the several thousand cases referred to court annexed arbitration required trial de novo versus eight percent for cases outside the program. Median time for cases to reach an arbitration hearing was under six months versus thirteen months for other civil cases to reach trial.

Based on the experience of other courts with court annexed arbitration, the judges in the Middle District of North Carolina were quite interested in the program. With the encouragement of the judges, Stuart and Rowe drafted proposed rules for a court annexed arbitration program in the Middle District and circulated the rules to members of the local bar for their input. The District Court enacted the rules in October 1984.

As in other jurisdictions employing court annexed arbitration, in the Middle District, most tort and contract cases in which the monetary relief sought is no greater than a certain dollar amount (\$150,000 in the Middle District) will be referred to arbitration unless exempted by the court. Damages sought are *presumed* to be no greater than \$150,000 unless counsel files a certificate based on reasonable inquiry that relief at issue is greater than \$150,000 (the burden is thus on counsel to take steps to keep the case out of arbitration). In addition to exemption by certificate of counsel, the court may exempt cases even where relief sought does not exceed \$150,000, where legal issues are unusually complex or novel, where legal issues predominate over questions of fact, or where the action includes a material claim for equitable relief. As discussed below, the court may also exempt cases from arbitration at random to create a control group for research purposes.

Those who wish to serve as arbitrators file application with the PAC. The court has responsibility for approving applicants who wish to be arbitrators. To qualify, each applicant must have been an attorney for eight years, must be a member of the bar of the U.S. Court for the Middle District or a member of the faculty

Court annexed arbitration is... mandatory... and advisory.

evidence at a much earlier point than occurs in conventional litigation (with crowded dockets and frequent continuances). Court annexed arbitration should thereby accelerate the settlement process. In the same way as cases settled "on the courthouse steps" (on the eve of trial), parties will, it is hoped, settle prior to or shortly after the arbitration hearing. As with parties' acceptance of the arbitrators' decision as final, early settlement should reduce the cost of dispute resolution.

As of spring 1983, court annexed arbitration was in



Left to right: L. Richardson Preyer, President of the Center; Judge Raymond J. Broderick, U. S. District Court for the Eastern District of Pennsylvania; Judge Hiram H. Ward, U. S. District Court for the Middle District of North Carolina.

of an accredited North Carolina law school, and must be found by the Chief Judge to be competent to perform the duties of an arbitrator. At hearings, the Federal Rules of Evidence do not apply (except for testimonial privileges); an arbitrator can thus hear a case in any manner which will expeditiously elicit evidence. No official record (i.e., transcript) of an arbitration hearing is made, unless the parties obtain and pay for a reporter.

It should be noted that the court at all times retains jurisdiction over cases in arbitration and failure of a party to proceed with the arbitration in good faith can result in severe sanctions.

An arbitrator must issue an award within fifteen days of the close of the hearing. Copies of the award are sent to the parties with another copy to the clerk to be kept under seal for thirty days. Unless, after thirty days, the parties have filed a stipulation for dismissal (because of settlement) or a party has demanded trial de novo, the award is unsealed and incorporated within a judgment by the court. The judgment has the same effect as a consent judgment and is thus final and non-appealable. If trial de novo is demanded, the award remains sealed until judgment or dismissal of the case. Evidence that the arbitration has taken place is not admissible at trial de novo (though testimony recorded at the hearing is admissible for the same purposes as a deposition).

As a mild disincentive to a party seeking trial de novo, if a party requests trial de novo and does not receive an award which, exclusive of costs and interest, is greater than the arbitration award the court will tax arbitrators' fees to the party.

In a number of important respects, the Middle District's court annexed arbitration rules differ from and

are intended to improve on rules utilized by several other courts. The \$150,000 cap on cases eligible for court annexed arbitration is \$50,000 higher than the limit utilized by any other court annexed program. Arbitration hearings are to be conducted by a single arbitrator rather than a panel. Presumably this will increase the overall quality of arbitrators available since, for each case, a court will only have to select one qualified arbitrator rather than attempt to find three. (Correspondingly, the single arbitrator receives a higher wage of \$400 per day.) If, after the arbitrator files the sealed award, a party requests trial de novo, the rules require that the arbitrator meet with the parties to discuss frankly the strengths and weaknesses of each side's case and that, thereafter, the parties must, within thirty days after request for trial de novo, inform the court by letter of the prospects for settlement.

Perhaps most significantly, the rules establish the PAC as co-administrator of the court annexed arbitration program in the Middle District. The PAC is the only institution of its type in the United States to have a role in the administration of a court annexed arbitration program.

A major reason the Middle District asked the Center to help coordinate the program was to tap the research capabilities of a major university in evaluating the success of the program. Prior research into court annexed arbitration has, as noted, indicated that court annexed arbitration results in speedier case resolution and a fifty percent reduction of incidence of trial in those cases assigned to arbitration. However, the value of prior research into court annexed arbitration is limited by the fact that the statistics upon which the research is

based are primarily caseload statistics (e.g., how many cases went to trial de novo). In particular, research has established little in two areas: first, although the time-compressed proceedings and reduced incidence of trial should yield dollar savings to courts and litigants, the extent of these savings is unknown; second, satisfaction of litigants and counsel with the program (the perception of it as "fair" or "effective") has not been measured.

With the PAC involved in the Middle District court annexed arbitration program from its inception, and with the PAC as co-administrator, the program has been structured and will be administered (and statistics gathered) with the research effort firmly in mind.

The program should thus yield more valuable data and more conclusive results as to just how good court annexed arbitration can be. In an effort to make the program which the research measures as "good" as possible, the program structure has been designed to eliminate some of the problems which, at one time or another, have beset other court annexed arbitration programs. Use of one arbitrator (rather than a panel) will, it is hoped, increase arbitrator quality. The post-hearing conference (with possible effects on settlement) should increase litigant and counsel satisfaction with the process (and reduce costs to the system). Regarding administration: the Center, with alternative dispute resolution its specialty and entire reason for being, should be able to monitor closely the progress of each case in the court annexed arbitration program to make sure time limits are being strictly observed, presumably increasing benefits of the program to the court system and litigants. (In court annexed arbitration programs administered by courts alone, it has sometimes been the case that the courts, flooded with so

many cases exempt from arbitration, have difficulty overseeing cases in arbitration to ascertain that time limits were met.)

Perhaps most important from a research standpoint, however, is Middle District rule 611 (developed with the PAC) which authorizes a randomly selected (control) group of cases which the clerk will exempt from arbitration. The MDNC is the only existing program to have such a control group and together with the facts discussed above, this control group should make possible conclusive research into the benefits of court annexed arbitration. Rule 611 embodies the district's and PAC's commitment to effective research in the program. The rule expressly notes that the court annexed arbitration rules are experimental and mandates evaluation of the program's affect on the court, the bar, and litigants. The Chief Judge has, under the rule, appointed a research committee of at least three members of the bar and two PAC representatives (with the clerk and chief judge serving ex officio). Thirty months after the program begins, the committee must file a report on the program with recommendations and, six months thereafter, the court must determine whether to continue, modify, or terminate the program.

E. Allan Lind, Jr., recently Associate Professor of Psychology at the University of Illinois, now on the staff at Rand Corporation's Institute of Civil Justice and an experienced social science researcher and co-author of the Federal Judicial Center's study of court annexed arbitration, is developing a preliminary research plan for the Middle District court annexed arbitration program. The research committee has been appointed.

The court annexed arbitration rules, adopted by the Middle District last year, took effect at the beginning of



Left to right: Thornton H. Brooks, Attorney; C. Allen Foster, Vice-President for Educational Services; Carmon J. Stuart, Vice-President for Adjudication Services.

January 1985. Selection of the first cases also took place in January. It is estimated that 150-300 cases will be assigned to the program this year.

Response from members of the bar in the Middle District has been extremely supportive. The court has certified fifty-five attorneys as arbitrators. Among the arbitrators are many of the most prominent members of the bar in the Middle District, including name partners in some of the largest law firms in the state, deans of law schools, a former federal judge, and several former superior court judges. The arbitrators are some of the most accomplished trial practitioners in the state; many of the arbitrators have extensive arbitration experience, as well.

In March of this year, the Private Adjudication Center and the Middle District held two programs of instructions for the arbitrators (half the arbitrators attended one, half the other). The purpose of the programs was to emphasize to the arbitrators the underlying philosophy of the court annexed arbitration program; in particular, that the arbitrators were to adjudicate legal rights. At the first seminar, held on March 15, 1985, in Durham, one of the speakers was Judge Kendall Sharp of Orlando, Florida, who discussed court annexed arbitration in Florida and conducted a demonstration of court annexed arbitration. In the second seminar, held March 29, in Greensboro, two of the speakers were Raymond Broderick, judge in the Eastern District of Pennsylvania, and Michael Kunz, clerk of court of the Eastern District of Pennsylvania, who discussed arbitration in their district (Broderick, too, conducted a demonstration arbitration).

Early experience with the program has been encouraging. One litigant delayed filing suit until January, so that his case would be assigned to court annexed arbitration. In order to take part in the program, counsel in another case refrained from filing a certificate seeking exemption from arbitration despite the fact the amount in dispute was approximately \$800,000. (The award can be for more than \$150,000.)

The burden is... on counsel to take steps to keep the case out of arbitration.

The first arbitration hearing in the program was scheduled for May 9, 1985, in a case concerning a life insurance company which had refused to pay a claim. Discovery in preparation for the hearing produced information upon which the case was settled about two days before the hearing was scheduled. This saved counsel and the parties the time and expense of preparing for a trial.

In addition to co-administering court annexed arbitration in the Middle District of North Carolina, the PAC has developed several procedures for adjudicating private cases (as with traditional arbitration, most private

cases adjudicated by the PAC will, it is thought, be commercial disputes). The PAC has structured its private arbitration programs so that they offer disputants the major benefits of traditional arbitration (in particular, informal presentation of evidence and privacy) without many of the perceived problems of conventional arbitration.

Failure of a party to proceed with the arbitration in good faith can result in severe sanctions.

There are a number of problems thought by many to exist with traditional arbitration. First, costs to parties are thought to be quite high. Second, the arbitration procedures can be long and subject to delay (similar to that in litigation). Under the Federal Arbitration Act, one ground for vacating an arbitrator's award is failure by the arbitrator to hear material evidence, so arbitrators tend to give the parties all the time they want. Also, under conventional arbitration, arbitrator approval is not necessary to continue a hearing to a later time so there are frequent continuances. Third, quality of arbitrators is seen as uneven. Some arbitrators have little expertise in the subject matter (often complex) of the dispute they are arbitrating. Finally, arbitrator's awards are often perceived as "baby-splitting" rather than an application of the law to the facts. This could occur either because, as noted, some arbitrators do not have sufficient expertise in the subject matter to apply the law to the facts or simply because the arbitrator is not required or expected to render an award faithful to the law. Additionally, arbitrators do not want to be reputed to favor either plaintiffs or defendants.

In contrast, PAC costs to parties are structured to be reasonable; the arbitration procedures are designed to yield expedited adjudication. As in court annexed arbitration in the Middle District, time limits are strictly enforced; in no PAC private arbitration procedure is longer than six months allowed to elapse between registration and hearing. No continuance of a hearing is allowed without the arbitrator's permission and the rules expressly state that the arbitrator need not hear cumulative evidence. PAC arbitrators (or "private judges" as they are called) are highly qualified and experienced arbitrators. The PAC list of private judges is fairly short and when the parties choose an arbitrator they know he will be a good one. (Unless parties agree otherwise, an arbitration is heard by a single arbitrator rather than a panel; as with court annexed arbitration, it is hoped this will lead to high quality decisions. As Allen Foster notes, it is better to have one arbitrator paid "a living wage" who, as a result, will give full attention to his duties, than to have three arbitrators, paid only a small honorarium, who might not give their full attention to their

duties.) Finally, in keeping with PAC philosophy, private arbitration will be geared to enforcement of legal rights. In the PAC rules for binding arbitration, it is expressly stated that questions of law will, where the parties have not agreed otherwise, be decided in accordance with North Carolina law (and applicable state and federal arbitration statutes).

Response from members of the bar... has been extremely supportive.

The PAC offers three types of private adjudication. Voluntary binding adjudication is offered. In addition, the PAC has a procedure by which parties receive a non-binding advisory opinion. The Center hopes parties to a dispute will use this procedure prior to going to court or to AAA arbitration (where the parties' contract calls for AAA arbitration). The hope is that parties will accept the advisory opinion as final, or at least that the non-binding procedure, which forces parties to develop arguments and perform discovery will ultimately lead to a quicker, more satisfactory (to the parties) resolution in other forums than would have occurred without the advisory opinion. Finally, the PAC offers an expedited procedure for those cases in which parties can narrow the difference in amount claimed to no greater than \$40,000 (e.g., plaintiff claims \$60,000 from defendant and defendant admits owing \$30,000). Under this procedure (a variant of one used by Judge Long in the North Carolina state court), a hearing takes place approximately three months after registration, only limited discovery is allowed, briefs can be no longer than ten pages, the Center selects the arbitrator (from a list of seven experienced arbitrators), and parties can represent themselves or, with approval of the Center and the arbitrator, be represented by a third-year law student.

Early experience with the program has been encouraging.

In order to generate a caseload for its private arbitration program, Bo Foster is encouraging companies to include in their contracts a provision calling for binding PAC arbitration of disputes (companies will, it is hoped, include a PAC arbitration clause in lieu of a clause calling for arbitration by another organization). To date, more than one hundred companies—primarily in North Carolina, but also out of state—have included the PAC clause in contracts. Informational presentations led by Bo Foster and others should increase the number of such provisions. In addition, the exposure which court annexed arbitration provides for the PAC should,

it is felt, lead to additional submission to the PAC of private cases for arbitration.

While contractual provisions and "spin off" from the court annexed program will take some time to generate a caseload, Toyota Motor Sales, U.S.A., Inc. has recently asked the PAC to administer all disputes which occur between its dealers over allocation of automobiles. More than 100 disputes have been registered thus far and an additional fifty per month are anticipated.

As numbers of private arbitration cases increase, the PAC will engage in research to evaluate the effectiveness of its private arbitration procedures (just as research into court annexed arbitration is now under way).

Under the supervision of C. Allen Foster, the PAC Vice-President for Educational Services, the PAC is engaging in a number of educational activities. As noted above, training of arbitrators has begun. In addition, the PAC makes presentations to bar groups and companies on the benefits of private adjudication. In June, for example, a PAC representative will speak at a meeting of the Consulting Engineers of North Carolina. The Center has also begun work on private adjudication publica-

The Center hopes, eventually, to be a major forum for adjudication of large, complex disputes.

tions. The Center's first publication, *The Law and Practice of Commercial Arbitration in North Carolina*, by C. Allen Foster, is now at the printer. In the near term, the Center hopes to publish companion handbooks on the law and practice of commercial arbitration in neighboring states.

Education of Duke Law students in private adjudication skills is to take place in a number of different contexts. Students will serve as law clerks to arbitrators in court annexed and private arbitrations, and assist in research for publications. In addition, Foster feels that parties to disputes under a certain dollar amount (e.g., \$25,000) may wish to have law students represent them in private arbitration. Student representation in these disputes would enable parties to enforce legal rights not otherwise enforceable, while at the same time providing students with experience in private adjudication.

After a start-up period of approximately two years, the Center is expected to be self-sustaining. Income sources will include service fees from private arbitrations, publication income and workshop fees for arbitrators, practicing attorneys, and possibly potential litigants. In addition, the Center has received a \$30,000 challenge grant from the National Institute for Dispute Resolution to perform research on the court annexed arbitration program. Research grants from other sources are anticipated in the future.

There are a variety of long term plans under consid-

eration by the PAC. While the Center's primary goal is adjudication, some within the Center seek development of greater mediation capabilities—so that once disputants have decided they would like to settle, the Center can facilitate settlement. Expansion of the court annexed program to other federal districts in North Carolina is also a possibility. In addition, Carmon Stuart has been working with North Carolina bar committees as they study the possibility of bringing an arbitration program to North Carolina state courts.

The Center hopes to expand its private arbitration program in several ways. First, the Center would like to increase the number of out-of-state private judges so that arbitration hearings may occur more easily in other parts of the country. Second, the Center hopes to take a leading role in adjudication of health care disputes (between hospital and patient; hospital and employee; patient and doctor, etc.) as well as in adjudication of disputes between state government and government employees. Third, the Center hopes, eventually, to be a major forum for adjudication of large, complex disputes similar to the asbestosis claims now in the courts. In

addition, given Duke Law School's special relationship to legal education in the People's Republic of China, the Center envisions serving as a forum for resolution of commercial disputes which may arise as foreign investment in China increases.

It is also hoped that numbers of arbitrations can be held in Duke Law School's courtroom facilities (at present Duke's courtrooms are used only for mock trials).

Through its many innovative activities in the months since its founding, Duke Law School's Private Adjudication Center has successfully begun to pursue its three objectives: dispute resolution faithful to controlling law, education in private adjudication, and research to determine which private adjudication procedures are most effective. With the strength of a national law school behind it and the cooperation and encouragement of courts, members of the bar, and corporations (here in North Carolina and throughout the country) the Center's success in meeting these important objectives will, it is hoped, continue and increase in the years ahead.

The Logical Force of Arguments by Analogy in Common Law Reasoning

*Martin P. Golding**

According to standard doctrine, arguments may be divided into two classes: deductive and non-deductive. A deductive argument purports that its premises are sufficient to establish the truth of its conclusion, and this will be the case if all the premises are true and the argument is formally valid. Judges, of course, give formally valid deductive arguments in justifying decisions on questions of law, but they also give arguments that in terms of logical structure have the form of non-deductive arguments, e.g., arguments by analogy. It is traditionally held that it is a feature of non-deductive arguments that their form is not sufficient to establish the truth of their conclusions even if all their premises are true: such arguments at best show only that the conclusions are more likely to be true than false. This, however, does not seem to be an adequate characterization of judicial arguments by analogy; for in supplying such an argument a judge presumes to have established the correctness, rather than the mere likelihood, of his conclusion of law on the basis of premises that he uses. This paper deals with the problem of whether this presumption is well founded. Let us begin with an example.

In *Adams v. New Jersey Steamboat Co.*, 151 N.Y. 163, 45 N.E. 369 (1896), it was held that when money for travelling expenses, carried by a passenger on a steamboat, was stolen from his stateroom at night, without negligence on his part, the carrier was liable therefor, without proof of negligence. Judge O'Brien argued by analogy from the liability of innkeepers. In his opinion he called a steamboat a "floating inn."

The principle upon which innkeepers are charged by the common law as insurer of the money or personal effects of their guests originated in public policy. It was deemed to be a sound and necessary rule that this class of persons should be subjected to a high degree of responsibility in cases where an extraordinary confidence is necessarily reposed in them, and where great temptation to fraud and danger of plunder exists by reason of the peculiar relations of the parties. . . . The relations that exist between a steamboat company and its passengers, who have procured staterooms for their comfort during the journey, differ in no essential respect from those that exist between the innkeeper and his guests. The passenger procures and pays for his room for the same reasons that a guest at an inn does. There



Martin Golding

are the same opportunities for fraud and plunder on the part of the carrier that was originally supposed to furnish a temptation to the landlord to violate his duty to the guest. A steamer carrying passengers upon the water, and furnishing them with rooms and entertainment is, for all practical purposes, a floating inn, and hence the duties which the proprietors owe to their charge ought to be the same. No good reason is apparent for relaxing the rigid rule of the common law which applies as between innkeeper and guest since the same considerations of public policy apply to both relations. . . . The two relations, if not identical, bear such close analogy to each other that the same rule of responsibility should govern. We are of the opinion, therefore, that the defendant was properly held liable in this case for the money stolen from the plaintiff, without any proof of negligence.

In basic outline Judge O'Brien's argument fits the following pattern:

- (i) x has characteristics F, G, \dots
- (ii) y has characteristics F, G, \dots
- (iii) x also has characteristic H .
- (iv) F, G, \dots are H -relevant characteristics
- (v) Therefore, y has characteristic H .

A possible brief formulation of Judge O'Brien's argument is this: (i) A hotel guest procures a room for per-

- sonal use, and his money and personal effects are highly subject to fraud and plunder from the proprietor.
- (ii) A steamboat passenger procures a room for personal use, and his money and personal effects are highly subject to fraud and plunder from the proprietor.
- (iii) A hotel guest's proprietor has a stringent responsibility, such that the proprietor is liable, without proof of negligence, if money is stolen from the guest's room.
- (iv) Procuring a room for personal use and having one's

- (iii) x also has characteristic H.
- (iv) F, G, \dots are H-relevant characteristics
- (v) Therefore, unless there are countervailing considerations, y has characteristic H.

A legal argument is supposed to provide a court with a reason for doing something.

money and personal effects highly subject to fraud and plunder from one's proprietor are reasons for the proprietor's having such a stringent responsibility.

(v) Therefore, a steamboat passenger's proprietor is liable, without proof of negligence, if money is stolen from the passenger's room. Premise (iv) states that the two mentioned characteristics are, as it were, "H-relevant," that is, grounds for imposing this degree of liability on certain proprietors (innkeepers and steamboat companies).

It is a feature of non-deductive arguments that their form is not sufficient to establish the truth of their conclusions even if all their premises are true. Such arguments at best only show that the conclusions are more likely to be true than false. But would this be an appropriate characterization of Judge O'Brien's argument? Although his argument has the form of a non-deductive argument, doesn't he presume to have established the truth (or correctness), rather than the mere likelihood, of his conclusion of law on the basis of the premises he uses? Apparently he does presume this. Also, I think other judges usually make this presumption when they employ arguments by analogy. The problem, then, is whether this presumption is well-founded. Let us proceed step-by-step.

It should be noticed, first, that legal arguments are normative arguments in that they purport to establish how a case or class of cases *ought* to be treated. Furthermore, these arguments are a species of practical reasoning. A legal argument is supposed to provide a court with a reason for doing something, namely, rendering a specific judgment. Now it is a characteristic of this context of practical normative reasoning that when a judge has a good reason for accepting a certain normative conclusion, he is *committed* to accepting and acting on the conclusion, unless there is another good reason for not doing so. This is a feature of practical rationality.

Let us now revise the form of arguments by analogy. Consider the following:

- (i) x has characteristics F, G, \dots
- (ii) y has characteristics F, G, \dots

This revision has a *weaker* conclusion than the previously given form. The weakness of the conclusion is brought out by the qualifying phrase, "unless there are countervailing considerations." In a non-normative analogical argument of this form, which has descriptive premises and a descriptive conclusion, it would still be said that the premises do not logically entail the conclusion (the premises could be true while the conclusion is false), though whether this is the case may depend on how (iv) is interpreted and on what the qualifying phrase would mean in this context. But in a legal analogical argument, which is normative and practical, it is plausible to hold that the conclusion (v) is, in a sense, "entailed" by the premises: that is, that the truth (or correctness) of the premises commits a judge to accepting the conclusion.

It certainly seems to be the case that if there is a good reason for accepting a particular normative conclusion and no reason at all for not accepting it, then the conclusion ought to be accepted too. And we can go farther: if there is a good reason for the conclusion and no good reason for not accepting it—which is how we shall interpret the qualifying phrase—then the conclusion ought to be accepted. So, if a judge were to accept the premises of an analogical argument and were to draw the qualified conclusion (v), it is not difficult to see why he might think that his result is conclusively established. Let us look at the situation in a bit more detail.

Suppose a judge gives an argument by analogy of precedent, by which I mean to include analogical arguments that use well-entrenched rules of the common (case) law.¹ In such an argument, for which the letters in the above form would be substituted by appropriate terms, premises (i) and (ii) ordinarily will be descriptive statements and their truth would be certified by appeal to the facts. Premise (iii), however, will be a normative statement, and its truth or correctness gener-

Truth or correctness is one of the important criteria for something to be a good reason.

ally will be established by an appeal to a prior decision or trend of decisions. Thus, in the *Steamboat* case, Judge O'Brien's premise (iii) was the proposition about the stringent responsibility of innkeepers, which he took to be a settled rule of the common law, repeatedly affirmed in prior cases. Premise (iv) also will be a normative statement, and its truth or correctness might be established by an appeal to the precedent that is

appealed to in reference to premise (iii).

Two other aspects of premise (iv) should be noted. First, a judge who gives an argument by analogy of precedent surely will want his premises to add up to a good reason for accepting his conclusion, and truth or correctness is one of the important criteria for something to be a good reason. But, clearly, the truth or correctness of the premises is insufficient in this kind of argument for them to add up to a good reason; they must also be *relevant* to the conclusion. The relevance of premises (i), (ii), and (iii) is established through the relevance-premise, namely, premise (iv). The truth (or correctness) and relevance of the premises seem jointly sufficient to constitute the premises as a good reason for accepting the qualified conclusion (v).

Second, given the significance of premise (iv), it could be said that premise (iv) is "doing all the work," as it were. There is some truth to this remark, though premises (i), (ii), and (iii) are certainly indispensable to the argument. And there is a further important point. As stated earlier, in an argument by analogy of precedent a judge might establish his appropriate premise (iv) by reference to the prior case(s) on which he is relying with respect to premise (iii). But he might also try to establish premise (iv) independently, especially if he thinks there is a better rationale for it than the one in the prior case(s). In either event, however, the truth or correctness of premise (iv) will rest, in a more fundamental way, on underlying considerations of policy or principle. When a judge is extending a precedent to cover a new kind of case, as Judge O'Brien did in the *Steamboat* case, he should be understood as implicitly, if not explicitly, endorsing some underlying consideration of policy or principle, and perhaps the one of his precedential case(s).

It is not difficult to see why a judge can be justified in drawing the weakened conclusion (v) from the premises (assuming them all to be true) in an argument by analogy of precedent. But, of course, he will want to draw a stronger conclusion, that is, an unqualified conclusion, which is the decision on the question of law. One possibility is to regard the judge as, in effect, subjoining an additional argument, using (v) as a premise:

(v) Unless there are countervailing considerations, *y* has characteristic H.

(vi) *There are no countervailing considerations.*

(vii) Therefore, *y* has characteristic H. Given the truth (or

correctness) of premise (vi), the judge's unqualified conclusion follows. Judges sometimes do explicitly affirm a premise like (vi). It will be recalled that Judge O'Brien saw "no good reason" for not applying the innkeeper rule to steamboat proprietors.

Although a judge, in a given case, may believe premise (vi) to be true (or correct), he may not be able to claim to *know* it to be true (or correct). Premise (vi) might be disputed, and another judge sitting on the case may believe it to be false (or incorrect). So though conclusion (vii) is compelling for one judge, it need not be for another. It still can be said, however, that a judge who accepts premises (i)-(vi) is rationally committed to accepting conclusion (vii).

Though a certain conclusion is compelling for one judge, it need not be for another.

If this statement is right, we can understand why judges presume that the conclusions of legal arguments by analogy are not merely established as more likely to be true or correct than false or incorrect. The explanation of this presumption depends, as we have seen, on the fact that these arguments are normative and a species of practical argument. There thus appears to be at least one kind of good legal non-deductive argument which can conclusively establish its conclusion as true (or correct). One could, of course, treat such an argument as an enthymeme and turn it into a formally valid argument by supplying a missing premise (P): *If* (i), (ii), (iii), (iv), (v), (vi), *then* (vii). But there is no reason to regard (P) as true, unless we also agree that this kind of non-deductive argument can conclusively establish its conclusion.

**Professor of Philosophy and Law. Golding presented this paper last December at an international congress on "Reason and Law" in Bologna, Italy.*

1. Arguments by analogy of statute and the use of analogical arguments in criminal law raise problems that cannot be considered here.

Judge Parker and the Public Service State

Peter G. Fish

On November 1, 1984, Peter G. Fish, Duke University Professor of Political Science and Law, attended the annual meeting of the Southern Political Science Association in Savannah, Georgia, where he presented a paper entitled "Judge John J. Parker of the United States Court of Appeals: Judicial Apostle of New South Progressivism, 1925-30." The following material is excerpted from that paper:

TO THE SUPREME COURT

Before a gathering of the White House press corps at a four o'clock news conference on Friday, March 21, 1930, President Herbert Hoover announced his nomination of John J. Parker, Judge of the Court of Appeals for the Fourth Circuit, for Associate Justice of the United States Supreme Court. Although utterly lacking in national visibility, the 44 year-old North Carolinian brought impressive credentials: a distinguished undergraduate academic career at the University of North Carolina from 1903-07, a year of legal education there, a flourishing general law practice largely in his hometown of Monroe and then in the bustling commercial center of Charlotte, and Supreme Court litigation experience as counsel for country banks in their battle with the Federal Reserve Bank of Richmond. Above all, he possessed close ties to the "business respectable" faction of the state Republican party. His contributions to it as a member of John Motley Morehead's dominant bloc included vigorous but fruitless campaigns as G.O.P. candidate for Congress in 1910, attorney general in 1916, and governor in 1920. Following Morehead's death in December, 1923, Parker became national committeeman. His yeoman services to the party combined with advocacy skills attained as a courtroom lawyer led to appointment as Special Assistant to the Attorney General of the United States in 1923-24 during which time he unsuccessfully prosecuted alleged war profiteers. At the unusually young age of 40, he had been appointed to the three-member regional appellate bench by Hoover's predecessor, Calvin Coolidge, on October 3, 1925.

[Judge Parker quickly assumed a leadership role on the Court of Appeals, leading his proponents to praise the nomination of this "apt representative of the 'New South.'" His critics, however, denounced him as "uncivilized," a racist, a "sworn enemy of labor" and representative of big business interests, and an extreme conservative. These diametrically opposed views of



Peter Fish

Parker's fitness for the High Court bench led to prolonged debate in the Senate over his nomination.]

In the six-week battle over Parker's confirmation, his record as a jurist on the United States Court of Appeals compiled over approximately four years received little consideration. Only his single decision affirming a lower court injunction against the United Mine Worker's unionization campaign in the southern bituminous coalfields drew attention. For black antagonists, his previous political record, not his subsequent judicial performance, disqualified him. These antagonists prevailed on May 7, 1930, when the Senate, on a 41-39 vote refused to advise and consent to President Hoover's second Supreme Court nomination.

Hindsight would suggest that the Senate had erred. But vision improved only after it became apparent that the judicial record of substitute nominee Owen Joseph Roberts would fall well short of meeting hopes

held for him by Parker's opponents. But, in fact, the North Carolinian's record made reasonably clear at the moment of nomination both his judicial philosophy and its antecedents.

THE PUBLIC SERVICE STATE

A. *Institutional reform impulses*

However much preference might be accorded the value of private property, realization of the New South demanded active modern government, government free of the debilitating influence of populism yet capable of modifying tendencies toward economic *laissez-fairism*. Parker stood on the platform of progressivism in advocating efficacious means for attaining a prosperous and free society. In his 1920 gubernatorial race, he identified himself as "a progressive," while berating Democratic opponent Cameron Morrison as "a hopeless standpatter." Manifestations of progressivism surfaced in proposals for imposing on government institutions Frederick W. Taylor's business-based prescriptions for efficiency, centralization, coordination, rationalization, and integration. Inefficient state government could be traced to a fragmented organization which, in turn, gave rise to political irresponsibility.

The solution, as Parker saw it, lay in a strong and unified executive department. Paramount was establishment of an executive budget system analogous to that soon to be adopted by the federal government in the Budget and Accounting Act of 1921. Imperative too was a shift in the source of state revenues from real property taxes "paid by the small farmer, the home owner, and the tenant," to a progressive income tax "which will recognize that we are no longer a purely agricultural state, but have become a manufacturing and commercial state as well." Modern state government required an executive veto and a council of state appointed by the governor in lieu of the existing one whose members were separately elected.

Once on the bench, Parker's reformist impulses became muted, although they grew pronounced in the 1930's when he achieved national fame as an advocate of administrative and procedural reforms in federal and state court systems. Glimpses of his affinity for efficient, simple and judge-controlled case processing surfaced in appeals presenting esoteric procedural technicalities.

On the bench, Parker's reformist impulses became muted.

When counsel for the Great American Insurance Company complacently introduced no testimony and serenely awaited a favorable judgment on grounds that the insured had erroneously sought a remedy at law rather than one in equity, Parker fairly bristled. Hailing from a code pleading state where distinctions between law and equity had been abolished, he demanded to

know whether appellant's counsel anticipated a favorable outcome "merely because the case was heard on the law side . . ."? Such a holding would, he warned, "hark back to the outworn technicalities of a day that is dead. . . ."¹ Worse still, it would prove conducive to inefficient administration and consequently to burdensome costs imposed on the plaintiff-insured. Nothing required him to find prejudicial error and order a new trial "where all of the evidence in the lower court is before us, where it appears that the case was fully developed, and where the relief obtained at law is exactly what . . . should have been awarded in equity. . . ."

Reliance on technicalities associated with criminal procedure likewise received a chilly reception. He applied the due process "fair trial" standard in gauging criminal procedures. But it was enough that indictments contained sufficient information "to fairly and reasonably inform the defendants of the character of the offense charged. . . ."² Mere failure of indictment language "to allege that the automobile was in fact stolen when it is alleged that the defendants on receiving it knew it to have been stolen can be nothing more than a defect of form which could not possibly tend to their prejudice . . .," he remarked in *Wendell v. United States*.³ No explanation of a preference for substance over form in criminal cases appeared in his published opinions. But privately, he exclaimed that "it would be a reproach to the administration of justice to allow defendants to escape conviction on such a technicality."

B. *Unshackling reserved "police powers"*

The public service state envisioned by Parker clearly emerged in numerous 1920 campaign addresses. In common with other Southern progressives, his program for affirmative state activity contained a noticeable rural tilt, intended to meet a perennial agricultural problem distinguished by a "exodus of the farm population from the countryside." Preservation of rural and small-town Carolina, together with that society's vital moral values demanded expanded governmental services and transfer of their administration from the counties to Raleigh. Farmers would directly benefit from centralized state-sponsored cooperative marketing and from what he called "a liberal system of rural credits."

The paucity of two hallmarks of twentieth century civilization constituted a major impetus for the rural exodus, Parker believed. In advocating good roads and good schools, he reportedly "went as far, if not farther, than any other candidate." The motoring buff and member of the state's Good Roads Association decried North Carolina's highway construction efforts and called for a program financed by borrowing, the interest and principal to be met by automobile and gasoline taxes. North Carolina schools were as poor as its roads, especially in rural districts. "We must create a state system of public schools," he urged, "a system in which the state collects the school money and distributes it so as to give the children in every county an equal opportunity for education." Higher teachers' salaries, free books, voca-

tional education, and even improved mental health facilities all became possible with a unified and efficient government pursuing priorities vital to a modern state.

No predisposition to second-guess or to nullify governmental acts marked Parker's jurisprudence from 1925 to early 1930. On the contrary, his decisions suggest a solicitude for often hard-pressed state and municipal governments sometimes impaled on unforeseen consequences of their modernization efforts. Even in mundane contract actions, a recognition of an interrelationship between law and politics surfaced. The novice

His decisions suggest a solicitude for often hard-pressed state and municipal governments.

jurist reacted heatedly when a breaching contractor sued Marion County, West Virginia, for payments due, allowed the case to languish on the docket for four years, suddenly brought it to trial in the midst of confusion caused by a transfer of county political control, and won by default.⁴ Privately he castigated the plaintiffs for securing a court-ordered award "by means of conduct which renders it unconscionable that the judgment be allowed to stand. . . ." It would fall even if only private parties were involved. "But certainly," he continued, "where defendant is a county and where it appears. . . . that there had been a complete change of the county officials, this court ought not allow a judgment to stand unless it appears that the county was fairly notified that the case was set for trial."

Political turmoil similarly gripped a North Carolina county government which had contracted for construction of an inaccessible highway bridge. An anti-bridge faction subsequently gained control of the Board of Commissioners and cancelled the contract, whereupon the contractor blithely completed the project. His suit for payment received a favorable answer from three dissident members of the Board, none of whom had sat for ten months and one of whom had actually resigned. Yet, acting in the Board's name, they admitted full liability. Parker reversed.⁵ The contractor, he said in his case memorandum, "had no right to increase the damages by proceeding with the erection of the bridge in the midst of the wilderness, which is perfectly useless to the county or to anybody else."

Business regulations under reserved state police powers were deemed by Parker as conducive to economic progress, not as threats to economic enterprise. An order by the city fathers of Lincolnton, North Carolina, directing a railroad to replace wooden bridges, formerly specified by ordinance, with more fire resistant concrete structures met with his approval.⁶ The railroad's fusillade of objections founded on the Constitution's obligation of contract and commerce clauses

as well as on the fourteenth amendment left him unmoved. Perhaps more impressed with the relationship of the new bridge ordinance to the "City Beautiful" movement than to fire safety considerations, Parker reflected on the march of municipal progress occurring since enactment of the wooden bridge ordinance in 1901. From that date, he mused in his case memorandum, "the town of Lincolnton has grown to be much larger than formerly, the business section has spread out beyond the bridges, streets have been paved with concrete, and the old bridges constitute a fire menace and are altogether unsightly and out of keeping with the streets and other improvements within the town. . . ." Lincolnton was not unique. "Progress and development" had visited other municipalities since the turn of the century and required "many things . . . for the public safety which were not necessary then." After all, "the main street of the city is paved with concrete and asphalt, and a steel or wooden bridge would be absolutely out of keeping with the remainder of the street. . . ." With such aesthetic considerations looming so large in the mind of the "Good Roads" booster, Parker proclaimed privately that "it is nothing but right and proper, in my judgment, that the railroad company should be required to construct a viaduct in keeping with the remainder of the street."

His published opinion in the *Lincolnton Case* manifested virtual disappearance of "City Beautiful" allusions. Parker quietly dismissed the commerce clause argument as "so frivolous as not to merit discussion," while he quashed the often potent substantive due process argument.

No facts are alleged upon which the conclusion can legitimately be based that the extension of the fire limits was not justified by the growth and development of the town, or that the replacing of wooden by concrete bridges was not required for the safety of the public, or that the building of concrete bridges would entail any undue hardship or unreasonable expense. . . .⁷

He acted... "with the feeling that we ought not interfere with the state's collection of its tax if it is possible to avoid doing so."

The obligation of contract issue likewise received short shrift from Parker who believed that the railroad enjoyed at most a municipally-granted license, not a vested right in its property. But his formal opinion focused on subordination of such rights to the state police powers. Certainly, Lincolnton had never "intended to surrender for an indefinite future the right to provide for the safety of the public using its streets, or the right to control, in the interest of fire prevention, the struc-

tures to be erected in or near the center of its business section. . . . And, if the town had attempted by contract to part with such rights, the contract would have been void, because contrary to public policy."

Two years before, Parker had similarly eschewed foisting a contract clause restraint on Lynchburg, Virginia, which in 1908 had granted the Lynchburg Traction and Light Company a trolley franchise. Its terms stipulated a five-cent fare within city limits. Beyond those limits, a six-cent fare had been authorized by the Virginia Corporation Commission. The two decades since issuance of the franchise brought growth to Lynchburg and its annexation of unincorporated areas in the six-cent fare district. When in 1925 the city ordered a fare reduction to five cents within the annexed areas, the Company sought an injunction on grounds that the city had violated an obligation of contract.⁸ Parker, however, could find no contract between the city and trolley company mandating a six-cent fare. That higher fare had been granted by the state agency under its police powers, not by the city.

Parker also exercised self-restraint in other state regulatory cases, concurring in a decision upholding the power of Virginia's Commissioner of Fisheries to exclude oyster harvesters from navigable waters of the state allocated to oyster raisers.⁹ Similar restraint marked his treatment of Virginia's efforts to combat cedar rust, a fungus disease in which the fungus winters on cedar tree hosts before disseminating spores that subsequently infect apple tree hosts. Thereafter the cedars are reinfected and the cycle continues. Prior to development of antibiotics, the sole method of controlling the disease required elimination of one of the two varieties of host trees. To protect its economically valuable apple crop, Virginia enacted the "Cedar Rust" law establishing procedures for destruction of cedar tree hosts. Enforcement of the law by the state entomologist threatened Kelleher, owner of a 2,200 acre Shenandoah Valley estate, with loss of cedar trees which shaded his cattle and beautified his mansion. He sought to enjoin execution of the Commonwealth's regulatory statute by raising questions of constitutional and statutory interpretation.

To Kelleher's argument that Virginia's law had taken his property without due process of law contrary to the fourteenth amendment, Parker responded,

[W]e have no doubt that the enactment of the statute was a valid exercise of the police power of the state. . . . [I]t does not authorize the taking of one man's property for another man's benefit, but it is a reasonable regulation of the use of property in furtherance of the public welfare. It authorizes the destruction of trees, which are shown to be of but comparatively little value, only where they constitute a menace to a great industry of the state.¹⁰

To be sure, gentleman farmer Kelleher enjoyed a property right in his attractive cedar trees, but the due process clause did not bar Virginia from saying "that in the enjoyment of property the owner shall not use it in

such a way as to endanger the rights and property of others."

Having disposed of the substantive due process issue, Parker turned to the more difficult task of construing the statute. Sections one and two of the Cedar Rust Act of 1914 were shrouded in a degree of ambiguity sufficient to permit federal court nullification by statutory construction. Section one declared cedar trees within one mile of an apple orchard a public nuisance *per se* and authorized the state entomologist to order their destruction. Section two authorized him to investigate "host" cedar trees upon the request of ten freeholders and, if deemed a threat to apple trees within a two-mile radius, order their destruction. Kelleher's cedars lay within two miles but not within one of an apple orchard. He contended that the two-mile radius in the 1914 Act was a clerical error which if corrected would read "one mile." Not so, replied Parker:

For us to assume that the Virginia legislature intended to change the radius of the second section also, would be to indulge in a mere guess unsupported by the language or the history of the act, and completely at variance with the plain meaning of the language used.¹¹

Eminently "more reasonable," he thought, "as well as more respectful to the lawmaking body of the state, [was] to assume that, if it had intended to amend the second section at the time it amended the first section it would have done so."

Caution characterized Parker's response to public utilities regulation.

Three-judge court colleague Henry Clay McDowell of Virginia's Western District maintained that the 1920 amendment had left in force a one-mile radius rule in those counties adopting the 1914 Act, a condition precedent to the law's effective operation. That the amending legislation of 1920 had established a two-mile radius, thereby destroying Kelleher's vested right "to possess and enjoy cedar trees more than one mile and within two miles of an orchard . . ." rendered it suspect. And, the failure to mention the local option provision meant to him that the one-mile radius had not been suspended by the 1920 Act and remained the law of those counties which had adopted it between 1914 and 1920, unless, of course, they consented to the amendment. McDowell would dissent on this basis. To his argument Parker remonstrated:

When the Legislature amended the statute, it changed that [1914] law. It did not leave the old law in existence unaffected by the amendment, as it might have done, and pass a new law for such counties and districts as might thereafter adopt it. It amended the only law which was in existence on the subject; and as that had become by adoption the law of certain districts, it thereby amended the law of those districts.¹²

That it had made the 1914 Act operative only on county consent did not impair its law-making power to amend that law at a later time without such local approval.

How could it be otherwise, he asked McDowell? Must the court hold that because a legislature in granting a city charter subject to adoption by referendum or vote by governmental bodies could amend that charter not by general legislation but only by a similar consensual mode of amendment? Such a restrictive view of legislative power would, he warned McDowell, "lead to endless difficulty for the courts. . . ." Furthermore, to maintain, as did the district judge, that the Act of 1914 remained in its unamended pristine form in those counties which had adopted it "would be judicial legislation and judicial legislation of the most indefensible sort; for we would be holding the unamended statute to be effective after it had been expressly amended by the Legislature." More cautious phraseology on the same point marked his opinion in the published case. But obviously his caution extended beyond form; it pervaded the substance of his judicial philosophy. States and their sub-divisions were not to be shackled by federal judges except in the clearest of cases.

The property rights of the Suncrest Lumber Company were, like those of estate owner Kelleher, also subordinated to state police powers, in this instance to that of condemnation.¹³ The Delaware corporation owned vast stands of valuable virgin spruce, hemlock, chestnut, and yellow poplar timber in western North Carolina. At least 26,000 acres of its holdings fell within the boundaries of the projected Great Smoky Mountains National Park. Since the mid-1920's, North Carolinians had been promoting a park in that area to serve multiple purposes: recreation, tourism, forest, and water preservation. But unlike parks developed on the public domains in the West, eastern parks such as that in the Great Smokies had to be carved out of the private domain. To this end Congress in 1926 authorized creation of the Park and empowered the United States Government to accept at zero cost park lands in fee simple. Aided by a \$2,000,000 bond issue and by millions more donated by John D. Rockefeller, Jr., the North Carolina Park Commission moved to condemn and purchase its 225,000 acre share of the new Park. Lumber companies responded by accelerating their timber cutting operations. To prevent denuding of lands within the projected Park's boundaries, the Commission enjoined timber cutting pending condemnation proceedings, at which point the Suncrest Lumber Company sought a federal injunction against further state interference with use of their mountain properties.

Before a three-judge district court, which included Parker, the Commission fought and won its first serious legal battle. Answering the plaintiff's argument that North Carolina could not empower a state judge to enjoin its frantic timber cutting without violating the due process clause of the fourteenth Amendment, Parker declared in *Suncrest Lumber Co. v. North Carolina Park Commission*:

It would seem self-evident that, if the State has a right to take property for a public use, it has the right while engaged in the act of taking to prevent it from being so mutilated as to destroy the use which it has for the public.¹⁴

This power was especially necessary where, as in the case at hand, the extent of the condemned lands were large, the surveying process slow, and the administrative and adjudicatory processes time-consuming. That the Commission should be subjected to a temporary

Fourteenth amendment substantive due process jurisprudence hardly affected Parker's decisions.

restraining order appalled Parker. Such a course, he objected, would delay:

acquisition of lands for the Great Smoky Mountains Park, a great public enterprise which should be of inestimable value to that section of the country as a help toward flood control and as providing a beautiful recreation park for the benefit of the people.

Restraining the Commission would emphatically not serve the purpose of equity; it would not preserve the *status quo*. Instead, such judicial intervention "would result in depreciating the value of the property for the purpose of which it is desired by the public."

Suncrest Lumber immediately carried Parker's decision to the United States Supreme Court, arguing their case for a restraining order pending appeal before Chief Justice Taft, Circuit Justice for the Fourth Circuit. With the lower court's decree and opinion in hand, Lycurgus R. Varser, attorney for North Carolina, felt confident that Parker's "admirable opinion [would be] ample to convince . . . him that the restraining order . . . ought not to be issued." The hearing in fact went well for the State. "The Chief Justice complimented your opinion—*properly*," the Lumberton lawyer and namesake of the Ninth Century B.C. Spartan lawgiver reported to the Tar Heel jurist who had in his *Suncrest* opinion subordinated private property rights to the public interest. The Taft Court agreed with his judgment and dismissed the company's appeal.¹⁵

C. Nurturing state taxing power

State taxing power provides an essential support for the public service state. Parker looked benignly on its exercise. A graduated excise tax levied by South Carolina on local retailers of tobacco products was effected by stamps affixed to the individual items which had been shipped in interstate commerce and which were ready either for transit out of state or for local sale even if remaining in their original package. Alleging the unconstitutionality of the tax, Charleston tobacco dealers sought to enjoin collection by South Carolina's

Tax Commission. Parker, in authoring the three-judge district court's opinion, did not write on a clean state.

Early in the life of the Taft Court, a tangled mass of precedents on state taxing powers had been sorted out largely . . . through the intra-Court lobbying efforts of Justice Brandeis. Brandeis stressed that the key test of constitutionality related to whether or not the state tax fell as a direct burden on goods in their original package but "at rest" following their interstate movement. Also considered was whether or not the tax was nondiscriminatory as between goods shipped in intrastate and those shipped in interstate commerce. These Brandeisian principles filtered into Justice Mahlon Pitney's opinion in *Texas Co. v. Brown*,¹⁶ and into Chief Justice Taft's burial in *Sonneborn Bros. v. Cureton*,¹⁷ of the "original package" doctrine applicable to goods which moved only in interstate commerce.

In denying injunctive relief to the Charleston tobacco dealers, Parker relied on the pair of Taft Court opinions in *Sonneborn Bros.* and *Texas Co.* He observed in *Dosher v. Query*:

[J]ust as the commerce clause will not protect property from taxation after its interstate journey has ended and it has come to rest and become part of the general mass of property within the state, neither will that clause protect from taxation property that is still at rest and a part of such general mass of property, even though it be intended for export or shipment in interstate commerce, if the movement in foreign or interstate commerce be not actually commenced. . . . And this is true, notwithstanding the goods have been transported in interstate commerce to the place where they are sought to be taxed, and are intended for shipment to other states, if they have reached the destination of their first journey and are being held by their owner for disposition in the ordinary course of business, and the stoppage be not a mere temporary delay in transportation.¹⁸

Conceivably, the tax statute might be unconstitutional, but if so, it was because of a conflict with the constitution of South Carolina. And, that was pre-eminently a question to be answered in the first instance by the Palmetto State's Supreme Court.

Less successful was Parker's attempt to free South Carolina's taxing power from injunctive shackles in *Southern Railway Co. v. Query*.¹⁹ Claiming that state assessments had taxed income derived from interstate commerce and therefore had unconstitutionally burdened such commerce, the railroad sought and won, much to Parker's chagrin, an injunction against collection of the disputed taxes. On first impression, he doubted any need for imposing equitable restraints on South Carolina because, as he informed one of the resident trial judges on the three-judge district court, "the remedy at law is plain, adequate and complete." After all, the statute which created the state's Tax Commission had provided that by paying under protest, the taxpayer could sue the Commission for recovery of taxes paid, and the Supreme Court of South Carolina had held that such recovery could include interest as well as principal, a holding which the Fourth Circuit judge gratuitously

pronounced as "in accordance with natural justice." Colleague Ernest F. Cochran of the Eastern District of South Carolina, author of the published opinion, took a very different view.

Cochran maintained that in fact the aggrieved taxpayer enjoyed access only to an equitable remedy in federal court. Contrary to Parker's contention, the district judge invoked *Smith v. Reeves*,²⁰ a decision of the United States Supreme Court which had held that an action at law to recover tax overpayments was a suit against the state tax commission. It was therefore a judgment to be paid directly out of the state treasury and constituted a suit against the state barred by the eleventh amendment—unless the State had consented to be sued. South Carolina had explicitly consented to be sued, but only in its Court of Common Pleas. A perplexed Cochran laid out the legal dilemma in a long letter to Parker. He explained:

If we say that the suit is not one against the State, then we are deciding directly contrary to *Smith v. Reeves*. If we say that the State has no right to restrict it to the Common Pleas and that therefore a party may sue in the Federal Court, we are directly in conflict with those decisions which say that the State has such a right. If we say that [the statutory consent to suit] in Common Pleas, intended that it might also be brought in another court, then it seems to me we do violence to the English language; for it certainly was the intention of the framers of the Act to restrict the suit to the Common Pleas. If we say that the suit provided for, while it must be brought in the Common Pleas and cannot be brought in the Federal Court, is adequate, then we are in conflict with those decisions which establish with equal firmness the principle that the suit must be available in the Federal Court.

Cochran concluded "that the only way to give effect to these established principles is to hold that in this case the State has consented to be sued in the Common Pleas; that such remedy is not available in the Federal Court, and therefore the remedy at law is inadequate, and the interlocutory injunction should issue."

A dismayed Parker admitted the correctness of Cochran's assessment. "At least, I am not able logically

He believed that unleashing of the individual's energies offered a sure route to realization of the good society.

to combat the conclusion," he wrote. "Nevertheless, I have a feeling that it is wrong, without being able to give any very good reason for the feeling." And, reiterating his Senior Circuit Judge, Edmund Waddill, Jr., the Tar Heel jurist guessed he would "have to go along with you, unless I can discover some good ground for holding the contrary." When further research failed to yield an alternative course of jurisprudence, Parker concurred in Cochran's opinion enjoining the tax com-

mission. He acted reluctantly and "with the feeling that we ought not interfere with the state's collection of its tax if it is possible to avoid doing so. . . ."

With the authorities against him, he felt confident that Cochran's "fine piece of work will put the matter squarely up to the Supreme Court, and if that Court thinks that an injunction should not be granted in such cases as this, it will have to modify some of its previous decisions."

Broad construction of national commerce power... marked his record.

D. Restraining State Power

Not all state regulatory actions received Fourth Circuit approval. Caution characterized Parker's response to public utilities regulation. Railroads and electric power companies provided vital elements of the region's economic infrastructure. They were themselves harbingers of progress; their franchises were "valuable not only to the [utility] but to the community which it serves."²¹ Mullins, South Carolina, therefore could not acquire by prescription a portion of the Atlantic Coast Line's right of way. Nor could the South Carolina Railroad Commission require the Southern Railway to switch cars from a tiny local feeder line onto the regional carrier's tracks.²² The state agency's order conflicted with national commerce power and took "property without due process of law . . . because [it] required the Southern Railway, without compensation, to open up terminal facilities to competitors."

Fourteenth amendment substantive due process jurisprudence hardly affected Parker's decisions, however much it marked those of the Supreme Court during Taft's chief justiceship. That public power-limiting doctrine did figure in the unpublished three-judge district court opinion delivered by Parker in *Bluefield Water Works Improvement Co. v. Public Service Commission*.²³ The Supreme Court had previously overturned both the Commission and West Virginia's high court in a case involving the same parties. Associate Justice Pierce Butler, writing for the Court, held that reproduction cost, not the original cost of the Company's water works, was the proper rate base. That the agency had "wholly disregarded" the former base notwithstanding the post-war inflationary surge in construction costs led him to . . . conclude "that a rate of return of 6 percent upon the value of the property is substantially too low to constitute just compensation for the use of the property. . . ." The unmistakable tenor of Butler's message in the *Bluefield Water Works* litigation doubtlessly encouraged close scrutiny of the Commission's subsequent findings. These, Parker deemed in error. They underrated interest paid by the utility on new construction as well as the Company's "going

value," and the seven and one-half percent on capital he deemed inadequate.

"Taking all these things into consideration," the circuit judge opined "that the complainants have made a showing, probably, for, and that they are entitled to, the preliminary injunction [for] which they pray." But he granted the injunction with strings attached. The Commission was restrained from enforcing its order or from interfering with the plaintiffs in putting into effect the schedule of rates in accordance with this order. . . ." The temporary injunction also limited the Company from fixing rates which exceeded by more than ten percent those previously approved by the Commission, and required that strict accounting be made of the rate increase, and that a \$25,000 bond be posted from which refunds to ratepayers might be distributed should facts found on a final hearing warrant. The Court subsequently dismissed the suit following agreement by the Commission and the Company on "the fair value for rate making purposes . . . of the plant and property," on "a fair return . . . of eight . . . percent," and on a new rate schedule.

CONCLUSION

Whatever Parker's public image molded in the weeks following nomination to the Supreme Court, his judicial record remains as clear today as it was from March to May 1930. No clairvoyance is required now, nor was it needed then to classify Parker's jurisprudence articulated as a member of the United States Court of Appeals for the Fourth Circuit from late 1925 to March 1930. Combined with the public record made as a politician, attorney, and civic leader prior to ascending the appellate bench, his status as a New South progressive is evident. He articulated typical themes of progressivism in his speeches, decrying turmoil and moral erosion and questing for order and opportunity in society. Uplifting of citizens to new heights required social regulation—control of liquor, suffrage for women, disfranchisement of blacks. Yet in speaking to these impassioned issues of public policy as a jurist, Parker treated them not as a zealot, but with the caution

Reliance on technicalities associated with criminal procedure... received a chilly reception.

and study befitting a federal judge.

In common with progressives generally, he sought no radical transformation of society. The linchpin of society was the individual and, in the tradition of the previous century, he believed that unleashing of the individual's energies offered a sure route to realization of the good society. Essential to that end was protection of private property, especially that created by enterprising individuals. This theme coursed most promi-

nently through his opinions relating to patents, federal taxation of business corporations, and in his single Sherman Anti-Trust Act case between private business-firm litigants.

Tempering an affinity for property rights was a recognition of the necessity for the "public service" state as an instrument for promoting New South economic growth. Parker's embrace of "business progressivism" became manifest in this context. An enthusiasm for reform of governmental structure surfaced in judicial opinions giving short shrift to archaic and complex legal procedures. No "judicial legislator," his *Cedar Rust* and *Suncrest Lumber* opinions made clear a concern for unshackling the reserved police powers of the several states and, in his vindication of state taxing power, the ability to raise revenues necessary for development of public services. Restraints on state powers might be required, especially by the imperatives of the Taft Court's jurisprudence. But as suggested in the *Bluefield Water Works* case, he sought a middle ground in simultaneously restraining both the state agency and the private enterprise.

As with exercises of state power, so with those of the national government, the North Carolina jurist proved no "man against the state." His decisions in major civil and criminal litigation favored the federal government as against the interests of private businesses, even innocent enterprises. Broad construction of national commerce power was manifested in his controversial labor injunction opinion, *United Mine Workers of America v. Red Jacket Consolidated Coal and Co.*, involving application of the Sherman Anti-Trust Act to unionization campaigns.²⁵ Parker's judicial record likewise reveals a propensity for defending the essential tenet of the New South creed: regional economic growth. His record suggests an abiding concern for providing federal judicial protection to the region's economic infrastructure, to its public utilities and rail carriers as well as to its shippers, entrepreneurs, and consuming members of the public. His search for the point at which interstate freight rates applied reflect this concern. So too did constraints placed on the Interstate Commerce Commission in his *Lake Cargo* decision, a decision which encouraged public policy favorable to a labor-intensive industry of the New South in its intersectional com-

petition for markets.²⁶ *Red Jacket* also manifested a similar interest on Parker's part. But that case forced a balancing of deeply felt sympathy for laboring men and women, a sympathy articulated in his gubernatorial campaign addresses and in other judicial decisions involving members of the working class. Yet, his moderate treatment of the scope of the injunction affirmed against John L. Lewis and his United Mine Workers of America went largely unnoticed in the passionate debates on confirmation. And, in the boiling cauldron of Supreme Court confirmation politics a jurist bearing New South progressive credentials became a veritable political ogre to critical elements of Franklin Roosevelt's future constituency.

1. *Great Am. Ins. Co. v. Johnson*, 25 F.2d 847, 849 (4th Cir.), *reh'g. denied*, 27 F.2d 71 (1928), *cert. denied*, 278 U.S. 629 (1928).

2. *Belvin v. United States*, 12 F.2d 548, 550 (4th Cir.), *cert. denied*, 273 U.S. 706 (1926).

3. 34 F.2d 92, 94 (4th Cir.), *cert. denied*, 280 U.S. 589 (1929).

4. *Marion County Court v. Ridge*, 13 F.2d 969 (4th Cir. 1926).

5. *Rockingham County v. Luten Bridge Co.*, 35 F.2d 301, 304-07 (4th Cir. 1929).

6. *Carolina & Northwestern Ry. v. Town of Lincolnton*, 33 F.2d 719, 721 (4th Cir. 1929).

7. *Id.*

8. *Lynchburg Traction & Light Co. v. City of Lynchburg*, 16 F.2d 763 (4th Cir. 1927).

9. *Gloucester Seafood Workers' Ass'n v. Houston*, 35 F.2d 193 (4th Cir. 1929).

10. *Kelleber v. French*, 22 F.2d 341, 343 (W.D. Va. 1927).

11. *Id.* at 345.

12. *Id.* at 346.

13. *Suncrest Lumber Co. v. North Carolina Park Comm'n*, 30 F.2d 121, 123 (W.D.N.C. 1929).

14. *Id.* at 127.

15. *Suncrest Lumber Co. v. North Carolina Park Comm'n*, 280 U.S. 615 (1929). Prolonged and tedious negotiations resulted in state payment to the company of \$600,000 for lands taken, but the company underwent liquidation in 1933.

16. 258 U.S. 466 (1922).

17. 262 U.S. 506 (1923).

18. 21 F.2d 521, 526 (E.D.S.C. 1927).

19. 21 F.2d 333 (E.D.S.C. 1927).

20. 178 U.S. 436 (1900).

21. *Williams v. Atlantic Coast Line Ry.*, 17 F.2d 17 (4th Cir. 1927).

22. *Southern Ry. Co. v. Shealy*, 18 F.2d 784 (E.D.S.C. 1927).

23. Unpublished transcript, S.D.W.Va., May 2, 1927.

24. *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1923).

25. 18 F.2d 839 (4th Cir. 1927).

26. *Anchor Coal Co. v. United States*, 25 F.2d 462 (S.D.W.Va. 1928).

ABOUT THE SCHOOL

Moral Values in Legal Education

*Richard C. Maxwell**

The American Bar Association Model Rules of Professional Conduct, adopted in 1983, provide that a lawyer acting as advisor to a client may properly "refer to relevant moral and ethical considerations in giving advice." Further, a lawyer may terminate the representation of a client if "the client insists on a repugnant or imprudent objective." If moral values are to guide professional action, it is fair to ask to what extent moral education is a part of the law school experience.

Law schools teach law; that is, they teach a body of principles, rules, and decisions. They also teach a way of working with these formulations in their application to that level of reality which stands as facts in the classroom. Lawyers must try to predict what will happen to their clients if a particular course of action is taken. They must also try to achieve a beneficial result if their clients have already taken ill-advised actions. To relate these objectives to moral considerations suggests that the lawyer's evaluation of the client's situation can be gauged by some accepted moral standard.

If that standard can be found in religion, the source and authority of the values applied are comfortably explicable in traditional terms. If, however, the reference is to a moral order not founded on generally accepted divine revelation, actions taken in its name must be defended pragmatically or by reference to the human reasoning process. Personal moral standards applied in a legal context are bound to be affected by the moral underpinnings of the legal system.

American law no longer operates, even verbally, as though it rested on supernatural foundations. Legislatures and judges declare law in the American system and when the legislatures declare it, the courts interpret



Richard Maxwell

it and sometimes, using the Constitution, our closest equivalent to publicly accepted holy writ, pronounce its nullity.

The work of judges and legislators is frequently subjected to critical analysis. Sometimes this process focuses on the technical nuances of how the job has been performed but frequently the criticism seems to measure the results against some system of values, assuming standards that go beyond a personal morality. The idea that such standards are being utilized is strengthened by the fact that law exists to govern relation-

Law exists to govern relationships between human beings and not the actions of individuals in a vacuum.

ships between human beings and not the actions of individuals in a vacuum.

If the moral content of law is not

referred for authority and substance to a formal religious matrix, from what source is this element of the system derived? Lawyers, in common with other human beings, bring to any decision or assertion of opinion a melange of beliefs, traditions, and intuitions as to what is good, bad, useful, and destructive. Sometimes these elements have been carefully nurtured in the formal study of religion, philosophy, history, or economics. The study of law itself can also supply a source of guidance for decisions on moral matters.

The law consists of a myriad of determinations and judgments on human relationships. In law school, many of these determinations are studied and weighed against each other, and against the beliefs, traditions, and intuitions which faculty and students bring into the classroom. In this sense, a great deal of law school time is spent in moral education. Meaning is given, in relation to particular facts, to such words as justice, fairness, and responsibility. Yet, questions of ends and values are a part of legal education only within a rather narrow professional framework.

Law students, in common with other human beings, have a taste for certainty, but legal education does little to satisfy it. The process subjects assertions of certitude in the governance of human affairs to severe tests. This aspect of the educational experience extends to moral values. It becomes obvious that human reason is a limited tool for resolving in a satisfying way differences in the beliefs to which people adhere. It is possible that students are left with the idea that it is not productive to spend too much time in thinking about the ageless questions of good and evil.

In many professional situations the values involved are seen to be

given—they are the values of the client. Law is viewed as a means for achieving goals which the client wishes to achieve. A faith emerges, but it is a faith in process: that the application of reason within a procedural structure governed by the general values of the Constitution will produce good long term results for society or, at least, an acceptable resolution of a current problem.

The idea of improving the human condition in the long run or of decently resolving a dispute between individuals in the short run includes value judgments as to what is improvement and what is decency. Many law students bring with them to law school strongly held views of how the world should work. As their perception as to how the world does work diverges from this model, their expectations of attaining a professional role that will fulfill their high ideals and values may moderate.

It is in the examination of the

Law students... have a taste for certainty, but legal education does little to satisfy it.

demands of the professional role that the law school has found its most important mechanism for the direct discussion of moral issues. As noted at the outset of this discussion, the Rules of Professional Conduct make direct reference to moral standards, providing for "optional withdrawal" from representation of a client who wishes to take an advantage of another that the lawyer finds "repugnant." This advantage is by hypothesis legal, since an illegal course of conduct, under the Rules, calls for "mandatory withdrawal" from representation of the client who insists upon it. Where the results the client seeks are merely "repugnant," the lawyer's course of action is a matter of individual preference. If one lawyer withdraws, the client is free to seek another who will exercise his individual moral preferences differently.

What does this mean for the professional education of lawyers? The tradition of loyalty and commitment to the client will often mean that the lawyer will choose to give candid moral advice to the client but will then follow the client's wishes and do for the client's cause, if that is the client's wish, that which is lawful even though unfair or unjust. At the action stage of the lawyer/client relationship, the value system of the

At the action stage of the lawyer/client relationship, the value system of the lawyer becomes irrelevant.

lawyer becomes irrelevant. It is to be hoped, however, that some experience in examining troubled situations in terms of moral values will increase a student's skill in dealing with such problems and lend force to the use of "relevant moral and ethical considerations in giving advice." At least, a student so exposed will enter practice sensitized to the difficulty of asserting non-obligatory moral principles when acting in a professional role which places a very high value on loyalty to the client.

**Richard C. Maxwell is the Harry R. Chadwick, Sr., Professor in the School of Law. This essay appeared in Duke University Letters (Sept. 5, 1984).*

Thoughts on Attorney Competence

*J. Porter Durham**

Lord Coke captured the essence of the problem which those concerned about young lawyer competence clearly see:

No man can be a complete lawyer by universality of knowledge without experience in particular cases, by bare experiences without universality of knowledge; he must be both speculative and active, for the science of laws, I assure you, must joyn hands with experience.¹

Each day, the law student encounters the handiwork of incomplete lawyers and the criticisms of a lawyer-weary society. Often, the cases studied exhibit poor legal skills which leave one party without adequate representation and at the mercy of an unsavory opponent with a weaker case. Although such study is the prevalent method of "learning the law," many students believe the experience one-dimensional, lacking in practical content. After three years of casebook learning and a few selected encounters with limited clinical programs, the graduate is expected to pass the bar and begin practice, completely prepared and fully "competent."

During the past fifteen years it has been argued that the novitiate, as well as the profession as a whole, lacks some yet defined quality or status. Some in the profession believe that there is an absence of skill at bar—an inability to *do* whatever it is that lawyers are supposed to do. Howard H. Kestin, chief administrative law judge and director of the New Jersey Office of Administrative Law, has said flatly:

Law practice is both a science and an art. Law school graduates have firm foundations in the science of law, but they know little of the art of



J. Porter Durham

practice—the application of the science—perhaps less than their entering counterparts in other professions.²

Others suggest that there are problems with the lawyer's attitude and personal skills. As Professors Shaffer and Redmount have stated:

Lawyers prefer an impersonal coolness. They avoid strictly human encounters. They seize . . . opportunities to put distance between themselves and people who need them. Problems are seen as opportunities for investigation, defense, abstract persuasion, and argument, rather than as opportunities for involvement. Even when the problem calls for moralism . . . the moralism selected is the lawyer's moralism: lawyers are uninterested in the moral impulses of their clients.

[Lawyers] tend to deal with human feelings by ignoring them when possible, and battering them away when they will not be ignored. They prefer faith in words to faith in people.³

Still others contend that the American lawyer has lost his social and public character. In the Preface to Joel Seligman's *The High Citadel*, Ralph Nader challenges lawyers and law schools to remember the unique public character of their mission, as summarized by A.Z. Reid years earlier:

Practicing lawyers do not merely render to the community a social service, which the community is interested in having them render well. They are part of the governing mechanism of the state. [L]awyers were instituted, as a body of public servants, essential for the maintenance of private rights.⁴

The criticism and the not so subtle reminders of our professional mission from within the profession have been matched in intensity by those outside of it. The public has little or no faith in the legal system, or in the lawyer's ability to handle problems and to address the major issues of the day with skill or intelligence. Ann Strick, in her book *Injustice For All*, broadly attacked the adversarial nature of the legal system and stated that it subverts justice and victimizes the victim.⁵ Morris Harrel, ABA President from 1982 to 1983, argued that the public's lack of trust in the profession had become so intense that the ABA should commit whatever resources necessary to enhance the public's understanding of the profession and to deliver the "highest quality of justice" possible.⁶

Historically, the lawyer has suffered great slings and arrows. Students are told routinely that this criticism is attributable to the fact that lawyers are often litigious adversaries who find themselves embroiled in knotty problems which are unpleasant and highly personal. Law-

yers are the "champions" of unpopular causes which are perceived as inherently evil or "lawless." However, this familiar litany has not satisfied those who continue to challenge the lawyer's character and his competence and to question his role in society.

Each day, the law student encounters the handiwork of incomplete lawyers and the criticisms of a lawyer-weary society.

In response to the criticism, and out of an awareness of some of these problems, many members of the profession and interested scholars have spoken out and offered criticisms of their own. Derek Bok has suggested that the law and the legal system have become too obscure, too expensive, and too burdensome. He contends that the law schools are only havens for good minds unable to find other direction, and that often, the talent is wasted there.⁷ President Giamatti of Yale has suggested that undergraduate schools should teach general and pre-law courses to better inform the public and better prepare the interested student.⁸ Justice Sandra Day O'Connor has been highly critical of law schools "preoccupied with legalisms" and neglectful of the teaching of practical skills and, perhaps more importantly, ethical responsibility.⁹ The American Bar Association has cited with approval the efforts of New Jersey and New Hampshire to strengthen the bar by requiring "transition education" between law school and law practice. However, at the same time it is admitted that the number of these programs is small and that, overall, the competence problem is "so real, in fact, that it qualifies as a crisis in our profession."¹⁰

In an effort to address the "competence problem" in North Carolina, the state bar association studied the feasibility of creating practical skills

courses, local bar support groups, and programs to strengthen trial advocacy skills. Those efforts were considered positive post-law school steps toward acquainting the law school graduate with the practical aspects of his profession, thereby enhancing his professional competence. It was believed that another possible benefit, increased "social" competence, would accrue as well. Perhaps this heightened sensitivity to social needs and a greater sense of professional commitment would restore to the profession some of the élan that it has lost.

However, these worthy efforts will be of little or no value if law school graduates who come to the bar are already "professional misfits" with little practical training, social insight, or personal integrity. Thus, the various state bars should focus their attention not on "gap bridging" or transitional education, but on the law schools themselves. What happens

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within a law school's walls is critical, because it is the seed bed of the profession.

PRACTICAL TRAINING

The desire to enhance the new lawyer's practical skills begs a broader question about the nature and form of legal education. Law schools currently rely, in large part, on a standard curriculum, taught using the casebook method and the Socratic dialogue. Some believe, however, that law students should participate in a very different kind of educational experience before they ever reach the local bar.¹¹ Stanford Professor Lawrence M. Friedman has argued that legal education should consist of one-half clinical training and one-half intellectual training—

essentially toughening the mind while honing the skills.¹² This course of study, known as "Curriculum B," was tested at Stanford University and has, according to Professor Paul Brest, produced lawyers who are more skeptical, more sensitive, and more reflective, as well as more technically able.¹³ Duke Law School recently expanded its curricular and extra-curricular programs to include a unique commercial practice course which pits one student team against another in simulated commercial litigation. The problems are created and the progress of the actions are supervised by several attorneys across the country. Duke's new Private Adjudication Center will provide needed negotiations experience to balance the emphasis on oral advocacy skills. These programs are, in effect, like those recommended in the Cramton Report, which argued strenuously for instruction in basic skills all lawyers need: effective writing, persuasive speech, proper negotiation techniques, and personal counseling.¹⁴

By and large, however, the profession remains wedded to the conventional methods of instruction. New topics of some significance are often forced into the casebook mold whether they fit or not. One important example should be related.

In the aftermath of the Watergate scandal, the so-called "lawyers' scandal," the study of legal ethics, using the ABA Code of Professional Responsibility, became a part of the

By and large... the profession remains wedded to the conventional methods of instruction.

law school curriculum. Unfortunately, rather than teaching this course with very practical hypothetical situations as models over a semester, schools often wedge it into a one-week session, using a casebook. Students go through the motions of "learning about" ethics, quickly complete the

requirements, and lose, or never discover, the real significance of the subject matter. If anything, their cynicism about "legal ethics" grows.

SOCIAL COMPETENCE

In 1617, Lord Bacon implored the justices of the Star Chamber to "[d]o good to the people, love them,

New topics... are often forced into the casebook mold whether they fit or not.

and give them justice, [b]ut let it be as the Psalm saith, 'look for nothing in return, neither praise, nor profit.'¹⁵ He was telling them to be mindful of the public welfare and of their responsibility as professionals to society generally, without thought of personal gain. He was describing what can be called social competence—the ability to deal with other lawyers, other troubled people, or complex moral or ethical dilemmas with sensitivity, patience, and conscience. This type of "competence" is a vital complement to practical competence and its renewal may well be the only way that the profession can rescue itself from low public esteem.

Law students are usually bright, competitive people. They often bring to school great notions of peace and justice and certain skills which they hope will be refined to serve positive ends and to help them become "good lawyers."¹⁷ It is this combination of highly talented and highly motivated people which creates, in the law school, a fertile environment for discourse on sensitive and controversial topics (within the context of the law). These same people, once graduated, take up the practice of law, or engage in other fields where their knowledge may be applied.

However, the practicing attorney is a reflection, not only of the skill and ideas he brought to the law school or of the training he received there, but also of the conditions

under which he was trained. Often, the progressive dialogues can become skewed, and the learning process cut off for many students by school reward systems which reinforce certain narrowly defined skills or attributes while ignoring others. Students, in their drive to "succeed" in law school and win the honors that will assure easy job placement, distort healthy competition and further charge an already intense environment. As pressures mount, getting on the law review or making the moot court team may become more important than the learning and talent such activities seek to distinguish. Some choose to pursue these goals at any cost, with certain ends justifying any means. In this climate, it becomes easier to forget or to ignore the most important and most basic of the lawyer's professional values: honor, duty to client, and community responsibility. The conscience and character of the law student are often battered or broken by the law school process. Seldom recognized and never rewarded, they languish. The notions of peace and justice are buried by piles of cases and statutes, seldom to be heard from again. It has been argued that the debilitation of law students is not a function of the law school environment but of the inadequacy of the students themselves. A study conducted by Dean Paul D. Carrington while at the University of Michigan Law School¹⁸ indicated that one

Students go through the motions of "learning about" ethics... and lose, or never discover, the real significance of the subject.

in seven Michigan law students "dropped out" emotionally and intellectually without formally withdrawing from school. Carrington categorizes these people as either alienated or dissatisfied and suggests that the result of such poor attitudes is lower

student and faculty morale. He argues that one way to avoid this problem is to identify, by profile, the people likely to become "turned-off," "teed-off," or "overly lonely," and reject them before they enter the school.

Yet, Professor Shaffer, in the Preface to Swygert and Battey's *Maximizing the Law School Experience*,

The conscience and character of the law student are often battered or broken by the law school process.

presents a pessimistic view of the law school's interaction with and development of personal character and conscience:

It is not true that the American lawyer-heroes found their moral substance in the profession. They found their moral substance . . . in their families, their church, and their community. [L]awyers of character, lawyers worthy of moral leadership America thrusts on them, were good lawyers because they were good people to begin with. They had the goodness before they became lawyers. The moral challenge in their learning the law was to hold on [to their integrity].¹⁸

CONCLUSION

Students are told throughout their first year of law school that the experience will shape them professionally. If this is the case, perhaps the mold should be reexamined. The public's perception of lawyers as fee-chasing cutthroats, bent on winning at any cost may be accurate—and may be a direct result of a climate which is character-debilitating rather than character enhancing. The current environment at many of the country's best schools stifles the very ethical and human sensitivities without which even the most technically proficient graduates cannot practice effectively. Moreover, without these sensitivities, the lawyer cannot ade-

quately face the challenges which society places before him, or confront the problems which he, as a lawyer, cannot ignore.

In order to achieve the goals of greater practical and social competence, the members of the legal profession must insist that law schools accept not only good *students* but good *people* as well; that they teach basic skills *with* basic theory; and that they frame the competitive spirit with conscience. Only if the legal profession reassesses some of its most basic assumptions about the form and nature of legal education and the current role of lawyers in society will it overcome the view of some within the profession and many outside of it that:

[T]he things we admire in men, kindness and generosity, openness, honesty, understanding, and feeling are the concomitants of failure in our system. And those traits we detest, sharpness, greed, acquisitiveness, meanness, egotism, and self-interest are the traits of success.¹⁹

*J. Porter Durham, a 1985 J.D. graduate and former President of the Duke Bar Association, presented the substance of this paper in a statement to the Committee on the Competence of New Admittees of the North Carolina Bar Association, on March 30, 1984.

1. Quotation found at the beginning of Chapter Three, entitled "The Law Schools: Where the Lawyers Come From" in Mayer, *The Lawyers* 71 (1967).
2. "Bridging the Gap Between School and Practice," ABA J., Jan. 1984, at 58; See also Mayer, *The Lawyers* 118 (1967):

At bottom, the problem of the law school is that startlingly little is known systematically about the real world of the lawyer

3. Shaffer & Redmount, *Lawyers, Law Students, and People* 4-5 (1977).
4. Preface to Seligman, *The High Citadel* (1978).
5. Strick, *Injustice for All* (1978).
6. *ABA Annual Report*, 1982-83, at 22.
7. The Bok Report is excerpted in Margolick, "The Trouble with American Law Schools," N.Y. Times, May 22, 1983, 6 (Magazine), at 15.
8. Dr. Giamatti's remarks can be found in the American Bar Endowment Annual Report, 1982-83, ABA J., Feb. 1984, at 88.
9. "O'Connor Stresses Training," The Nashville Banner, September 22, 1982, at C-2.
10. Kestin, "Bridging the Gap," ABA J., Jan. 1984, at 59.
11. For a very complete evaluation of some of the shortcomings of legal education and bar admissions, see *Monograph 3 of the Conference on Legal Education in the 1980s* (American Bar Association 1982).
12. Margolick, *supra* note 7, at 20.
13. *Id.* at 32.
14. Report and Recommendation of the Task Force on Lawyer Competence: The Role of the Law Schools (American Bar Association 1979), named for its chairman, Dean Roger C. Cramton of the Cornell Law School.
15. Heard, *Oddities of the Law*, 1881, p. 110, quoting from Lord Bacon's Speech in the Star Chambers, before the Summer Circuits, 1617. *Letters and Life*, VI, at 211 (Spedding ed.).
16. Shaffer & Redmount, *Lawyers*, at 196. Interestingly, Shaffer found during his study that while law students understood their combative ways, they hoped that law school would channel their aggressions and verbal order in useful skills and habits which would further justice and foster interpersonal relationships. This expectation is apparently not met. In fact, student respondents

suggested that the law school climate was debilitating in terms of their personal skills and human instincts.

17. Carrington & Copley, *The Alienation of Law Students*, 75 Mich. L. Rev. 887 (1977). See also, Carrington, *Correspondence*, 76 Mich. L. Rev. 1036 (1978), for a follow-up report.
18. Shaffer, Preface to Swiggert & Batley, *Maximizing the Law School Experience* (1983).
19. Steinbeck, *Cannery Row* (1971).

“Freedom” & “Coercion”— Virtue Words & Vice Words

Peter Westen

Peter Westen, Professor of Law at the University of Michigan, delivered the address excerpted below as the 1984-85 Currie Lecture at Duke Law School. The text will appear in full in a forthcoming issue of the DUKE LAW JOURNAL. Considerable controversy resulted from publication of The Empty Idea of Equality, 95 HARV. L. REV. 537 (Jan. 1982), an article with a theme similar to this lecture. Interestingly enough, Mr. Westen said he had changed his mind since writing the Equality article. He no longer feels we can segregate the language of law from that of everyday life. He now feels we should “unpack” such concepts to fully realize their hidden prescriptive/descriptive elements.

Three special guests attended the Lecture: Mrs. Brainerd Currie and Mr. & Mrs. John H. Lewis. Mrs. Currie's husband taught Conflict of Laws at Duke Law School; the lecture series is in his memory. Mr. Lewis (J.D. 1967) is the current patron of the lecture. Also in the audience were Professor Dellinger, who clerked with Mr. Westen on the U.S. Supreme Court, and Professor Beale, who had been his student.

I. INTRODUCTION

Much has changed since 1781 when Thomas Jefferson wrote of “freedom” and “coercion,” and even more since Plato discussed these topics two millennia hence. Different ways of life have engendered different societal and personal philosophies, values, and ideals. For instance, the United States' short lifetime has witnessed the abolition of slavery, the demise of monarchies, the prohibition of torture, the banning of child labor, the prevalence of premarital sex, and the creation of no-fault divorce.

Despite the world's vast transformations, we use the same phrases to laud and condemn. Very different conceptions of good and evil are expressed with identical language: “freedom,” “equality,” “justice,” “misery,” “shame,” and “coercion.” A major subset of the recurring terms of moral discourse are “virtue words” and “vice words.”

Virtue words and vice words are both protean and nonlexically normative.

First, like the Greek god Proteus, each has the capacity to retain its own essential identity while simultaneously assuming a variety of distinct and even contradictory forms. Virtue words and vice words possess. . . the quality of being less than fully specified and hence. . . capable of further specification.

Virtue words and vice words convey judgments of right or wrong without being defined as expressing normative values.



Peter Westen

[S]ome concepts in normative discourse, like the concept of “rights” and the concept of “duress,” are normative by definition. They are “value concepts. . .” It is paradoxical to speak negatively of rights or to speak positively of duress, because the relationship between rights and legitimacy, and duress and illegitimacy, is not contingent. It is lexical. . .

One does not misuse language when one condemns

equality or praises inequality, because while statements of equality and inequality tend to be statements of good and bad, and right and wrong, respectively, the relationship between equality and virtue and inequality and vice is not lexical. It is contingent.

Because virtue words and vice words are protean, they are versatile. Deeply-held moral beliefs can be expressed by the same term even though morally inconsistent. Because they are non-lexically normative, they

Very different conceptions of good and evil are expressed with identical language.

persuade without being conclusory. Moral discourse is tilted in the direction the speaker wishes, yet an opponent cannot protest that the issue has simply been defined away. Combined, these two features of virtue words and vice words generate great rhetorical force.

"Freedom," a virtue word prototype, will be analyzed in detail to enhance our understanding of its rhetorical power.

Freedom is protean, because freedom is a single, generic concept that can simultaneously encompass many different and morally contradictory conceptions. . . . Freedom is also non-lexically normative, . . . it tends to be "laudatory" without being defined as [such]. . . . [I]t is generally assumed to be something right and good; yet there is nothing contradictory about "bad" or "undesirable" . . . freedoms.

"Coercion," a vice word prototype, will be "unpacked" in the same manner to reveal its core concepts. Like freedom, coercion is a single concept that is sufficiently open-textured to encompass a range of diverse and mutually inconsistent norms. As well, the word can be used correctly, yet advance normatively inconsistent positions.

[C]oercion" . . . is generally derogatory, but there is nothing contradictory about the notion of justified or legitimate coercion.

Shared notions of good and evil drive virtue words and vice words less than their connotative meaning. Much of their rhetorical force is semantic, not substantive.

II. FREEDOM

[Freedoms] consist of three implicit terms: an agent or class of agents, X, who possess the stated freedom; a constraint or a set of constraints, Y, that inhibits agent X from doing or being something he may wish . . . ; and the goal, Z, that constraint Y inhibits agent X from doing or being if he so chooses. The concept of freedom is a generic relationship among X, Y, and Z. It is the relationship of an agent X, from a constraint Y, to do or be a goal, Z, that he may desire.

Depending upon which of two relations exists between agents X and constraints Y, freedoms are either descriptive or prescriptive. While the distinction between these categories is significant, both types of freedoms are equally genuine. Descriptive relationships are where

X is unconstrained by Y to pursue Z, without regard to whether he also *ought to be* unconstrained. . . .

An example is "The prisoner is free to walk without shackles." From descriptive statements, nothing prescriptive necessarily follows.

The Bill of Rights refers to prescriptive freedoms. These exist where

X stands in a relationship to Y and Z such that he is *and ought to be* unconstrained by Y to pursue Z.

Every statement of freedom, then, expresses either an "is" or an "is and ought to be."

To speak of "freedom," therefore, is either to say something neutral—[which] . . . cannot be inferred to be either good or bad—or to say that something ought to be; but it is never to say that something ought *not* to be. To be sure, one can say that a particular descriptive freedom is undesirable, or that a particular prescriptive freedom is unsound, or that a particular agent ought not to be free from Y to pursue Z. But in order to convey that a particular freedom is unjust or unsound, one must say so *expressly*, because the word freedom . . . does not itself ever say that "X ought *not* to be free from Y to do or be Z."

III. COERCION

Although a person who is coerced is not free, coercion is not merely the converse of freedom. An agent can lose or gain freedom without being coerced. Moreover, unlike freedom, coercion presupposes a human agent (X-1). It is an interpersonal relation where one person affects the behavior of another.

X-1 must knowingly bring a constraint upon X for the purpose or with the expectation of causing X to do or become Z-1 against her will.

[T]he "absence of will" alone does not suffice to render the event "against the will" unless the event is also against [personal] wishes. . . . [Suppose a man] wanted to jump but being too scared to do so on his own, hoped someone would push him, we would *not* say that he entered the water "against his will." . . . [O]ne can constrain X to do Z-1 "against the will" by so structuring the relative consequences of X's doing Z-1 as opposed to not doing Z-1 as to cause X to choose [what] . . . *would not otherwise [be chosen]*.

A constraint is coercive regardless of whether it achieves its purpose. The term "coerce" alone does not imply success, but "coerce into" does.

To say that X-1 "coerced X into" doing something means that X chose to do something . . . that but for the constraint or promise of constraint X-1 brought to bear, X would not have chosen to do.

X must also be aware of the constraint that X-1 is bringing to bear to force the course of action, Z-1. Finally, coercion must render Z-1 more "eligible" (attractive) in X's eyes than it would otherwise be under the circumstances. It must supply the actor with a reason to do X-1's bidding.

Like freedom, all coercion is either prescriptive or descriptive, depending on the relevant baseline. Prescriptive, or normative, coercion leaves X in a worse position relative to a baseline level than she ought to be for refusing to do what X-1 proposes.

Descriptive coercion exists when X is left worse off than she otherwise expects to be, relative to a particular baseline. The combination of prescriptive and descriptive qualities renders "coercion" a vice word. The essential elements of coercion, then, are:

[A] constraint or promise of a constraint, Y, that X-1 knowingly brings to bear on X in order that X choose to do something, Z-1, that X would not otherwise do and that X does not wish to be constrained to do—where X knows that X-1 is bringing or promising to bring Y to bear on him for that purpose, where Y renders X's doing Z-1 more eligible to X than Z-1 would otherwise be, and where Y leaves X worse off either than actually expected otherwise or than he ought to be for refusing to do X-1's bidding.

IV. CONCLUSION

What can we learn from "freedom" and "coercion" about virtue words and vice words? What gives freedom and coercion their protean, open-textured quality? What is it that makes "freedom" sound good and "coercion" sound bad without their being defined as good and bad?

"Freedom" and "coercion" each have three features that explain their being virtue words and vice words. Both consist of certain fixed elements, as well as variables. They are, therefore, sufficiently elastic to encompass morally inconsistent conceptions.

The second significant feature that freedom and coercion both possess is that neither can be reduced solely to prescriptive statements, because both also take descriptive forms. . . . [Finally], just as freedom and coercion cannot be reduced exclusively to prescriptive statements of "ought" or "ought not," they cannot be reduced exclusively to descriptive statements of "is". . . .

Freedom and coercion are useful, because they serve the same purpose in moral discourse that large, all-purpose vessels serve in the field: they can contain and carry a wide diversity of particular contents without altering their nature. . . . The words "freedom" and "liberty" are related, because they both refer to a relationship in which an agent X is unhindered by a constraint Y to do something Z. But liberty is less versatile and, to that extent, less useful than freedom, because liberty is a subset of all freedoms. We use "liberty" to refer to a relationship in which a particular class of agents (i.e., purposeful agents) are unhindered by a particular class of constraints (i.e., human constraints), to pursue their goals. . . .

It is linguistically useful to have special-purpose words like "liberty" that are tailored to a narrow range of tasks; but it is also linguistically useful to have multi-purpose words like "freedom" that can perform many tasks.

The same is true of the relationship between "coercion" and "duress." Coercion and duress are related, because they both involve threats that X-1 brings to bear on X to do something, Z-1, that X would not otherwise choose to do. Coercion is broader and, to that extent, more versatile than duress; because duress is solely a prescriptive concept encompassing constraints to leave X worse off than she ought to be left, while coercion can encompass either prescriptive or descriptive constraints. Again, it is useful to have special-purpose words like duress that take only a prescriptive form. But it is also useful to have multi-purpose words like . . . coercion that can express both descriptive and prescriptive relationships.

Although the capacity of "freedom" and "coercion" to express both descriptive and prescriptive relations is linguistically useful, it is also rhetorically treacherous because it

causes us to unthinkingly blend the two kinds of relationships together. Instead of recognizing that prescriptive freedoms are good because they are defined to be good, and that descriptive freedoms themselves are neither good nor bad, we carelessly come to believe that all freedoms are presumptively good. Instead of remembering that prescriptive coercion is bad because it is defined to be bad, and that descriptive coercion itself is neither good nor bad, we carelessly assume that all coercion is presumptively bad. Rather than demand moral argument in favor of particular freedoms, and moral argument against particular kinds of coercion, we come to believe that freedom is itself something to favor and coercion itself something to oppose. . . .

[T]here is nothing in their being "freedoms" and "coercions" that makes them presumptively good or bad. A person who advocates a particular freedom ought to give reasons for believing that a particular X ought to be unhindered by a particular Y to pursue a particular Z. Calling it "freedom" is either a neutral description or a question-begging conclusion, but it is not a reason for believing X ought to be unrestrained by Y to pursue Z. By the same token, a person who opposes a particular coercion ought to give reasons for believing that a particular proposal leaves X worse off than X ought to be left for refusing to do X-1's bidding. Calling the proposal "coercive" is either a neutral description or a question-begging conclusion, but it is not a reason for believing that X-1 proposes to leave X worse off than X ought to be left. The danger with words like freedom and coercion is that by mixing descriptions with prescriptions, they tend to persuade us not through . . . reasons but through tricks of language. They possess rhetorical force not by facilitating argument, but by bypassing it. They are words that lay claim to virtues they do not deserve, and to vices they do not possess.

A Conference Report

Gun Control

A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed. —U.S. Constitution, amendment II

The meaning of the second amendment to the Constitution and its impact on gun control legislation served as not only the beginning point, but also an underlying theme, of the *Law and Contemporary Problems* Editorial Conference on Gun Control. The conference, which was held at the Law School and the Sheraton University Center on October 19-21, 1984, featured a great deal of spirited discussion in addition to the presentation of materials prepared for a forthcoming *Law and Contemporary Problems* Symposium on the issue. The conference host and moderator, as well as the Special Editor of the Symposium, was Don Kates, a San Francisco attorney known for his activity in the area of gun control.

The controversial nature of gun control was highlighted from the start of the conference, when it became apparent that the participants had diverse views of the meaning of the short, but ambiguous, second amendment. The first topic of discussion, "The Second Amendment," was introduced by Professor Robert Shalhope of the History Department of the University of Oklahoma, who presented a paper entitled "The Armed Citizen in the Early Republic." Professor Shalhope concentrated on explaining the premises underlying the amendment by examining the philosophical framework from which its authors began. He noted that, in the current controversy over private possession and use of firearms, those favoring freedom of individual ownership stress the "right to bear arms" phrase while their opponents emphasize the "well regulated Militia" phrase to support arguments restricting the use of firearms by those not connected with the militia. Professor Shalhope concentrated on the "interrelationship linking arms, the individual, and society" as viewed through the eyes of eighteenth century libertarians. He concluded that the individual right to bear arms was considered essential to prevent individuals from being subjected to the tyranny of governments, while the "well ordered Militia" phrase was directed toward the philosophy of communal responsibility for the safety of the community. According to his reading of the reasons for the amendment, "The Second Amendment included *both* of its provisions because the Founders intended that both of them be taken seriously. They intended to balance as best they could individual rights with communal responsibilities."

Mr. Kates presented a slightly different historical viewpoint while summarizing an article he had written for the *University of Michigan Law Review*, 82 Mich. L. Rev. 204-273 (Nov. 1983). According to Mr. Kates, the view that the second amendment was intended to protect states' rights to arm their militias is based on a twentieth century definition of "militia": the eighteenth century viewpoint was that all citizens should be armed and ready to defend their colony. Mr. Kates stated, however, that even if one accepts the wider, individual rights view of the purpose of the second amendment, gun control is not altogether precluded. He found that the right to bear arms had three purposes in eighteenth century America: individual protection; citizen law enforcement; and military use. Thus, he concluded that any weapon that is not useful for all three purposes can be banned without violating the second amendment (for example, 22 caliber handguns could be banned because they have no military value).

A third historical perspective was introduced by one of the commentators, Mr. David Caplan, a New York City attorney who, in addition to his patent law practice, is a member of the National Board of the National Rifle Association. Mr. Caplan suggested that the second amendment should be analyzed in the context of the eighteenth century common law right to bear arms, which protected all non-threatening private ownership and use of arms. According to him, there was a tremendous communal benefit to allowing citizens to do away with felonious predators. Mr. Caplan also stressed that, insofar as private ownership of firearms presents a potential—albeit slight—threat of armed rebellion, that threat is a guarantee against a takeover of the government by despots.

Finally, a pragmatic view of the constitutional question was offered by Professor William Murphy of the University of North Carolina School of Law. Professor Murphy pointed out that no constitutionally guaranteed rights, except the right to believe, are absolute; all of them are subject to being balanced away by ends vs. means analysis of an infringing law. Professor Murphy also pointed out that, even if one or more of the foregoing historical analyses is correct, the Supreme Court has exhibited a tendency to make selective use of history—sometimes even ignoring it altogether. He also cautioned that any decision made by the Court on gun

control legislation would be based, at least in part, on contemporary policy.

The second topic explored on the first day of the conference was mandatory penalties for gun use. Professor Alan Lizotte of the Rutgers University Department of Sociology discussed research that he had done with Majorie S. Zatz for the Center for the Study of Justice at Arizona State University. Professor Lizotte pointed out that one strategy that has been attempted for controlling the use of guns by criminals is the enactment of laws providing for enhanced sentences for those who commit a crime with a firearm. After reviewing other studies on the efficacy of these laws, he reported on his and Zatz's study, "The Use and Abuse of Sentence Enhancement for Firearms Offenses in California." They studied length of prison sentences given in felony convictions in California over a three-year period. They found that, although criminals who used a gun during the commission of a felony should have received a sentence of at least one year longer than those who committed the same offense without a gun, this was not usually the case. In fact, it was only when they considered those who had been convicted of *five or more* felonies within the three-year period that they found any statistically significant variation in sentences between gun-users and those who committed their crimes without the use of firearms. Thus, they concluded that whether mandatory sentence enhancement affects gun usage by criminals cannot be determined until judges begin enforcing the laws that have been written.

Other participants in the conference included Professor Robert Batey of Stetson University College of Law, who discussed "Strict Construction of Firearms Offenses: The Supreme Court and the Gun Control Act of 1968," concluding that the Court's liberal reading of that act has led to "abusive investigations and dubious prosecutions," which, in turn, have strengthened opposition to "even the mildest forms of gun control." Professor James B. Jacobs, of the New York University School of Law, considered "Exceptions to a General Prohibition on Handgun Possession: Do They Swallow up the Rule?" Professor Jacobs pointed out that even statutes that pur-

Those favoring freedom of individual ownership stress the "right to bear arms" phrase while their opponents emphasize the "well regulated Militia" phrase.

portedly prohibit private ownership and use of handguns, such as the widely publicized Morton Grove, Illinois, law, contain broad exceptions for police officers, private security guards, gun collectors, and so on, thus

leading one to question whether these laws can properly be characterized as "prohibiting" firearms.

Professor Daniel D. Polsby of Northwestern University School of Law offered "Reflections on Violence, Guns and the Defensive Use of Lethal Force." Analyzing the self-defensive use of firearms, in part under "games strategies," Professor Polsby concluded that "some amount of private gun possession" might be helpful in "keeping violence in the world to a minimum." Professor Polsby's use of utilitarian theory was challenged

Whether mandatory sentence enhancement affects gun usage by criminals cannot be determined until judges begin enforcing the laws.

in a thoughtful essay, "Close Encounters of the Lethal Kind: The Use of Deadly Force in Self-Defense," presented by Professor Lance Stell of the Davidson College Department of Philosophy.

Professor Margaret Howard, of the Vanderbilt University School of Law, gave the last presentation on the second day. Her presentation on "Husband-Wife Homicide: An Essay from a Family Law Perspective" provided some intriguing information (for instance, current studies show that in spousal homicide cases, husbands and wives are victims in approximately equal ratios, although more wives are killed in the bedroom while more husbands are killed in the kitchen), but Professor Howard was unable to determine whether gun control legislation would alleviate the problem of spousal homicides.

On the final day of the conference, Professor Gary Kleck of Florida State University's School of Criminology discussed "Policy Lessons from Recent Gun Control Research." After finding that privately owned guns do have defensive value for their owners and do deter criminal behavior to some extent, Professor Kleck concluded that the status quo as to private gun ownership should be maintained for the most part. He would, however, support laws prohibiting the sale of guns to those with a history of violent mental instability or a record of violent criminal offenses. He would also support a registration or licensing system by which civil liability could be imposed on those who transferred guns to someone without a permit.

The final presentation on the agenda, a discussion by Don Kates and Professor Phil Cook of Duke University's Institute of Policy Sciences on "Strict Liability for Gun Manufacturers," was cancelled because the intense discussions on the earlier topics had caused the schedule to go awry.

A Conference Report

Federal Regulation of Work

Federal Regulation of Work from Recruitment to Retirement" was the title given to a conference held at the Law School on November 17-18, 1984. The conference was sponsored by Duke Law School Professors Richard Maxwell, Donald Horowitz, and C. Allen Foster. The articles presented at the conference will form the nucleus of a forthcoming issue of *Law and Contemporary Problems*, for which Professor Horowitz will serve as Special Editor.

The focus of the conference was on federal laws enacted during the 1960's and 1970's that affected the employment relationship. Particular focuses of discussion were laws dealing with employment discrimination, health and safety regulation in the workplace, and retirement programs and policy.

The first morning of the conference dealt with the subject of older workers. Following a welcome by Dean Paul Carrington and a short introduction by Professor Horowitz, Professor Marilyn Yarbrough of the University of Kansas School of Law discussed the Age Discrimination in Employment Act (ADEA) and its impact on displaced homemakers. (Displaced homemakers are women who have been out of the workforce and dependent on their husbands for income, but whose ties to that income have been severed due to divorce, death, or other separation from their husbands.) Professor Yarbrough focused on the possibility of using "disparate impact theory," as well as "disparate treatment theory," to redress employment discrimination against displaced homemakers attempting to return to the work force. Although not all courts accept the applicability of disparate impact theory, which was developed in race discrimination actions under Title VII, to ADEA claims, Professor Yarbrough noted that a case brought under that theory should be easier for a displaced homemaker to prove than would be a case brought under the disparate treatment theory more often used in ADEA cases.

In the second presentation to focus on older workers, Professor Merton Bernstein of Washington University Law School discussed the Employment Retirement Income Security Act (ERISA), and particularly, the failures and shortcomings of private pension plans, which induced the federal government to enact ERISA in 1974. Commentary on the morning's presentations was offered by Allen Foster, Professor Emeritus Arthur Larson, and Theodore Rhodes, of the Washington, D.C., law firm of Steptoe & Johnson.

Health and safety in the workplace was the concern of the afternoon's presentations. Professor W. Kip Viscusi of Duke University's Fuqua School of Business dis-



Donald Horowitz

cussed "The Structure and Enforcement of Job Safety Regulation" under the Occupational Safety and Health Act (OSHA), and Professor Elinor P. Schroeder of the University of Kansas School of Law discussed "Compensation for Occupational Disease." Professor Viscusi was critical of the federal government's handling of safety questions under OSHA and Professor Schroeder echoed his sentiments while discussing proposed federal legislation to compensate workers suffering from asbestos-related illnesses. She noted that "[t]he same kind of delay and industry opposition that has plagued OSHA could easily befall a federal occupational disease compensation system."

The focus during the second day of the conference was on employment discrimination law, particularly Title VII of the Civil Rights Act of 1964. The two presentations reviewing the first twenty years under Title VII were particularly interesting because the speakers presenting the two sides of the issue had often faced each other in the courtroom. Discussing the employer's side of the issue were Thornton H. Brooks and M. Daniel McGinn of the Greensboro, N.C., firm of Brooks, Pierce, McLendon, Humphrey & Leonard. They discussed "Second Generation Problems Facing Employers in Employment Discrimination Cases: Continuing Violations, Pendent State Claims, and Double Attorneys' Fees." Although Messrs. Brooks and McGinn felt that the use of continuing violation theory and the appending of state law claims to Title VII cases greatly expanded the bur-

den on the employer, they appeared even more concerned with the chilling effect on the defense of an action brought about by the employer's prospect of being forced to pay not only its own attorneys' fees, but also those of the plaintiff. They noted that, in several recent cases, employers have been forced to pay plaintiffs' attorneys' fees of \$2,000,000 and more, in addition to backpay awards to the plaintiffs and their own attorneys' fees. They concluded that some system must be devised to handle employment discrimination claims without the tremendous expenses currently involved in litigation.

Presenting the plaintiffs' view of twenty years of Title VII was Julius L. Chambers, now Director of the NAACP Legal Defense Fund, but formerly a direct adversary of Messrs. Brooks and McGinn as a member of the former Charlotte firm of Chambers, Stein, Ferguson & Becton. Although Mr. Chambers agreed that new ways to litigate Title VII cases should be found, his concern was that these new ways must lead to the provision of meaningful relief for victorious plaintiffs. He noted that the

provision of meaningful relief was hindered by the Supreme Court's expansive reading of the "bona fide seniority system" exception to Title VII and by the Reagan administration's opposition to affirmative action. In fact, he concluded, despite twenty years of litigation, Title VII appears not to have accomplished its aims; the continuing earnings and unemployment gap between blacks and whites indicate that much remains to be done.

The final presentation of the conference was an extremely lucid discussion on the statistical proof of employment discrimination through utilization of multiple regression analysis. Barbara A. Norris, a solo practitioner from Albany, California, managed to make multiple regression analysis seem understandable, a truly amazing feat in the eyes of any nonstatistician who has ever attempted to fathom the mysteries of the subject. Commentary on the mornings' presentations was offered by Professor Douglas Laycock of the University of Texas Law School.

A Conference Report

Tax Symposium

The tax legislation enacted during President Reagan's first term and that proposed early in his second term were the topics of discussion at a symposium held at the Law School, January 10-12. Professor Richard Schmalbeck, who organized the symposium in conjunction with *Law and Contemporary Problems*, described the goal of the conference:

We wanted to examine why we have had the explosion of tax legislation in recent years, what that legislation has done to our tax system, and where we might be headed in the future. The papers presented were a mix of comprehensive treatments of these major themes, and more concrete analyses of specific applications.

During the first day of the symposium, participants took a retrospective view of the tax changes which have occurred over the past four years. Session topics included "Movement toward a Consumption Base," presented by Professor Charles O. Galvin of Vanderbilt University Law School; "Reaganomics: The Revolution in American Political Economy," presented by Rutgers University Professor Charles E. Jacob, and "Taxation of Capital Income," presented by Duke Law School Professor Pamela B. Gann.

Professor Galvin began his presentation by describing the accretion system of taxing income. Under a pure accretion system, all assets would be inventoried each year, liabilities would be deducted, and the taxpayer's net worth would be determined at market value. The difference between beginning year and end-year net worth, plus the taxpayer's expenditures for consumption for the period, would reflect the taxpayer's taxable income for the year. Such a pure system would, in Galvin's estimation, "immeasurably simplify the Code and tax each individual on real economic income." It would also mean the elimination of provisions regarding income exclusion; consumption deductions such as personal interest and taxes, medical expenses, and charitable contributions; tax free exchanges; corporate reorganizations; and the capital gain-ordinary income distinction. "Only through such a system could we expect as simple and as equitable a statute as we could hope to devise in a complex economy involving over 200 million people."

Galvin noted, however, that there are significant objections to such a system. These objections are, primarily, that asset valuation each year would be difficult for the taxpayer to determine and the IRS to administer; that taxpayers with substantial asset appreciation could have significant wherewithall problems at tax time; and that the transitional problems of providing everyone with a "fresh start" each year would be troublesome.



Richard Schmalbeck

Under an accretion system, according to Galvin, upper bracket taxpayers would pay more tax, even though rates would remain constant, because net unrealized appreciation, currently excluded accessions to wealth, and large consumption expenditures would fall into the base, making it larger. Galvin speculated that "[t]he overall effect of using the same rates would be to raise somewhat more than twice the revenue as at present, [and] to shift disproportionately more of that additional burden to the upper brackets." Lower and middle income taxpayers would pay more than they do currently to the extent that deductions were disallowed. However, this would be a proportionate increase, with lower income taxpayers relying on the zero bracket amount to cover personal deductions.

Professor Galvin then discussed the consumption system, in which taxpayer savings and investment fall outside of the tax base. The base, under this system, is measured by only that amount which is consumed during the period. For the vast majority of taxpayers in the middle and lower brackets, this system would produce results similar to those of the present system, with the exception that currently deductible personal consumption items would be included in the base, thereby enlarging it. For upper bracket taxpayers, the base would be smaller because capital income would drop out of the system.

In Galvin's opinion, the exclusive use of one of these systems would be preferable to the present system, which is a messy hybrid of the two, designed in random

fashion to promote various social and economic goals. The current system, however, has failed to achieve broadly these goals and has resulted in unfairness throughout and wide-scale evasion. Thus, concludes Galvin, the President's tax reform efforts should focus on moving toward a pure accretion system or a pure consumption system. But, cautions Galvin, neither system would provide adequate revenue to overcome the federal deficit and pay off the national debt, given the present rate structure. He therefore suggests that a broad based value added tax (VAT) system should be layered on top of a new system, with appropriate minimum or vanishing credits to protect lower bracket taxpayers.

Professor Charles Jacob shifted the day's discussion to an assessment of Reaganomics, which spurred lively conversation and sharp criticism from Duke Political Science Professor James David Barber. Jacob began his presentation by asserting that "the first year of the Reagan Administration produced a set of changes in political-economic relationships so novel as to merit the denomination revolutionary." The evidence of such a revolution, argued Jacob, lay in the specific actions of the Administration: a reduction in personal taxes of thirty percent over three years; accelerated depreciation allowances for business; 49 billion dollars in domestic program spending cuts; and a non-incremental approach to defense spending. Jacob went on to say that these fundamental alterations in American domestic revenue collection and spending policies were the result of the application of specific political resources marshalled by the Administration: to set the policy agenda, to secure adoption by Congress, and to manage the people involved in the process. One of the most significant resources used in the "revolution," according to Jacob, was the presidential leadership exhibited by Ronald Reagan. His ability to adhere uniformly to basic values and political concepts, such as an unfettered economy and the primacy of individualism, and to manage subordinates and public opinion effectively, created an environment and a system ripe for revolutionary changes. So

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effective was the revolution, asserted Jacob, that the Congress passed the Tax Equity and Fiscal Responsibility Act (TEFRA) a year later. Yet, Jacob assessed this move as a "Thermodynamic reaction," rather than a counter-revolution—an event which involved consolidation and fine tuning of the Reagan revolution.

Reacting to the presentation, Professor James David

Barber argued that Reagan's 1981 legislative victories were primarily explained by a conjunction of political circumstances, such as media misinterpretation of the 1980 election, the disarray of the Democrats, and the accident of his near assassination. Such circumstances are unlikely to be repeated. Nor does the evidence support the supposition that American political values have changed or that the Reagan "revolution" represents the death or lapse of top level pragmatism.

The neutral taxation of capital income was the topic of Professor Pamela Gann's presentation. As Gann explained, the first Reagan Administration responded to the poor economic performance of the late 1970's and early 1980's as if income taxation of capital were "the culprit." The Economic Recovery Tax Act (ERTA) lowered the effective tax rates on capital income even though Administration economists and others were unsure to what the nation's sluggish and inflationary economy was to be attributed. Some argued that overtaxation of capital income was resulting from the interaction of an unindexed tax base and high inflation. Others countered that overall effective tax rates had not significantly increased because of inflation and that the economic slowdown was a function of more profound social and economic forces and in only small measure attributable to the federal income tax.

Nevertheless, Gann continued, the Administration proceeded with ERTA, a package of "reforms" which unevenly lowered effective tax rates and left the base unindexed. With the lowering of inflation, the ERTA system created a new imbalance which resulted in "very low positive and even negative effective tax rates for many investments." These misallocation effects have prompted those involved in policy making to urge that capital income should be taxed more neutrally with respect to investment choice.

Gann then argued that a neutral income tax system was achievable even though detractors argued that the creation of a neutral system would require more political will than Congress can muster, and a more precise measure of capital income than has yet been seen. Gann suggested that the major problems with income measurement had been solved in large part and that at no time before had there been a more clear understanding of the workings of a neutral system. In fact, the Treasury Department's 1984 tax reform proposals demonstrate that elements of neutrality can be placed in legislative form and administered if passed. The primary stumbling block, believed Gann, was the mood of Congress. She concluded by asking "where is the political will to achieve the goal of neutrality?"

Interesting presentations were also made by Professor Charles T. Clotfelter of the Duke University Department of Economics as well as Mr. Don S. Samuelson of Samuelson Associates in Chicago. Professor Clotfelter's evaluation of "Charitable Giving and Tax Legislation in the Reagan Era" provided unusual insight into the changing patterns of charitable giving in the United States. His presentation demonstrated that,

although the Reagan philosophy relies heavily on the willingness and ability of the private sector to make a host of charitable contributions to support various social programs, the Reagan tax reform plans have the potential of having a negative impact on charitable giving. In 1983, individual donors contributed 54 billion dollars to nonprofit charitable organizations. Bequests and corporate contributions equalled 7 billion dollars. Current income and estate tax laws permit deductions for chari-

Reagan tax reform plans have the potential of having a negative impact on charitable giving.

table gifts to individuals, while corporations may deduct charitable gifts of up to 10 percent of net income. The traditional view has been that an increase in tax liability causes a decline in contributions, while a tax cut stimulates giving, if charitable giving is considered a normal good and demand for it increases as disposable income increases.

However, Clotfelter asserted that the recent Reagan reforms, while creating a system under which more lower and middle income taxpayers were able to make charitable contributions, caused the cost of charitable giving to corporations and wealthy individuals to rise 60 percent. Thus, between 1981 and 1986, gifts to religious organizations, given primarily by lower and middle income taxpayers, are expected to increase 14 percent in real dollars. In sharp contrast, contributions to cultural organizations, colleges and universities, and other educational institutions are projected to decline between 14 and 17 percent, in real terms, because of the increased cost to upper-income individuals who support such programs and institutions.

Likewise, in the estate tax area, Clotfelter foresees similar increased cost of giving and thus fewer contributed dollars generated than under the prior tax system. Yet, the giving picture is more promising now than if a "flat" tax were introduced. According to Clotfelter, the removal of the charitable deduction, along with all other such deductions, would remove the "subsidy" for giving which taxpayers now enjoy. Without this incentive, it has been estimated that individual charitable contributions would drop by as much as one quarter.

Mr. Samuelson's review of real estate taxation during the Reagan years focused on the use of municipal bonds. He recounted the specific, detailed provisions of municipal bond tax legislation of the Reagan years, noting that, in his opinion, none of the measures would have significant impact on municipal bonds as a whole. However, Samuelson pointed out that changes made in the law with respect to Industrial Development Bonds or "IDB's" would result in fewer issues and different purposes for those issues. Specifically, it was noted that

the elimination of an exemption for certain types of small issue IDB's seemed to suggest that a public purpose test would be imposed at the federal level during the small issue review process. Samuelson argued that the thrust of all such changes was to provide the federal government with more control over the uses of tax-exempt financing and to limit the volume of tax exempt debt by reducing IDB borrowing. The result of increased controls on bonds and reduced availability of inexpensive debt financing, Samuelson asserted, would be increased tax revenue for the government, lower yields on available exempt bonds, and increased ownership of bonds by the wealthy. This effect, in turn, would result in reduced benefits from tax exemption and an increase in the effective progressivity of the tax structure.

The second day of the symposium was devoted primarily to discussion of the Treasury Department's tax reform proposals first announced in December, 1984. Presentations were made by Mr. Willard B. Taylor of the Sullivan and Cromwell law firm in New York City, and Professor C. Gordon Bale of the law faculty at Queen's University in Canada.

Mr. Taylor's paper outlined the recent changes to Subchapter C and the tax policies which lay behind those proposals. Taylor discussed the fact that changes in Subchapter C had been accompanied by a continuing reduction in effective income tax rates. Interestingly, the income tax receipts from corporations in 1950 provided 28.3 percent of the total receipts for that year. By comparison, this figure had declined in 1981 to 11.5 percent, and in 1983, to under 7 percent. Taylor went on to say that many of the changes made to Subchapter C strengthened the system of double taxation of corporate income rather than achieving further integration. Changes which made the most difference included the elimination of non-recognition of income for distribution of property; the expansion of earnings and profits; the extension of the accumulated earnings tax provisions; and the change in the treatment of acquisitions. While not faulting the changes wrought by Subchapter C legislation, Taylor did argue that the piecemeal repeal of the *General Utilities* doctrine was confusing and distorting; that pass-through entities had not been adequately treated; and that recapture provisions were inadequate to meet the demands of the Accelerated Cost Recovery System (ACRS).

Dr. Bale provided conference participants with a Canadian view of the Treasury Department's proposals. Interestingly, the Carter Royal Commission developed many of the same reform proposals nearly two decades ago. As the Canadian government discovered, however, political realities greatly reduced the extent to which the measures could be implemented, even though the tax base would have been broadened and revenues enhanced.

The symposium concluded with a round table discussion of all the proposals at issue. The discussion was conducted by Professor S. Malcolm Gallis of the Duke University Department of Economics.

THE DOCKET

Duke Goes to Phoenix

Duke Law School has traditionally sought to provide a high quality legal education that would prepare its graduates to practice in any area of the United States. At the same time, the school has endeavored to maintain a geographically diverse student body. It is therefore not surprising that quite a few Duke graduates today have successful and rewarding careers not only on the Eastern Seaboard but also in distant cities such as Los Angeles, Houston, and San Francisco.

It is perhaps somewhat more unusual to find Duke graduates practicing law in a city like Phoenix, Arizona, often associated with movie westerns and the law of the six-gun. However, Phoenix has long outgrown its reputation as a rough and ready cowtown and a number of Duke alumni and alumnae are pursuing interesting careers there.

The Phoenix metropolitan area, which includes such suburbs as the posh Scottsdale area and the university town of Tempe, now has a population of about 1.7 million. Phoenix proper has a population of approximately 790,000. The city has grown culturally as well. It has its own symphony orchestra, a metropolitan ballet company, and a number of museums. And, of course, Phoenix is renowned for its fair weather. Although temperatures soar well above the 100 degrees Fahrenheit mark in the summer months, Phoenix residents enjoy winter temperatures in the 60's and 70's and sunshine 60% of the year.

The number of lawyers practicing in Phoenix has quadrupled in the past twenty years. On July 5, 1984, the Arizona State Bar Association estimated that there were about 4,647 lawyers in the Phoenix metropolitan area—3,600 in Phoenix proper. About thirty of those lawyers are Duke Law School graduates. They practice in a variety of areas, ranging from medical malpractice to environ-

mental law.

One Duke graduate is a highly-respected judge on the Arizona Court of Appeals. Judge Thomas Kleinschmidt grew up in Clayton, Missouri. He decided to attend Duke in 1962 when a representative of the school visited his college. When he graduated in 1965, Kleinschmidt felt Duke had provided him with a "strong springboard from which to begin [his] career." Kleinschmidt chose to move to Phoenix after having clerked there for a summer with Jennings, Strauss, Salmon & Trask, the predecessor of Jennings, Strauss & Salmon. After being admitted to the bar in 1966, Kleinschmidt continued to work at Jennings, Strauss and eventually became a partner in the firm.

Anticipating appointment to the bench and anxious to diversify his background, Kleinschmidt left Jennings, Strauss in 1971 to work for the Public Defender's Office under Tom Karas, another Duke alumnus. In 1977, Kleinschmidt was appointed to the Superior Court for Maricopa County. He found trial work "enormously satisfying" and earned a rep-



Roger Ferland

utation as an excellent trial judge.

Five years later, Kleinschmidt was appointed to the Arizona Court of Appeals. He finds the thoughtful analysis required by appellate work as rewarding as trial work. According

to Karas, Kleinschmidt is "an outstanding appellate judge."

Among his recent opinions are *State v. Stewart*, an armed robbery case which concerned the troubling issue of shackling defendants at trial, and *State v. Holstun*, which discussed the issue of whether or not a trial judge should be required to articulate his reasons for accepting a sentence stipulated in a plea bargain when the stipulated sentence is to a term longer than the presumptive term for the reduced charge.

Kleinschmidt enjoys his work immensely, and has a great deal of respect for the legal system in Arizona. "It is largely free of the seamy customs one hears of in some areas. . . . The system has a good clean tradition and works the way it should."

Roger Ferland, unlike Kleinschmidt, is a Phoenix native. He chose to attend Duke because of its reputation. He was unsure of where he wanted to practice after graduating and wanted to leave his options open. Ferland also found Duke's small urban setting appealing. Commenting on the education he received at Duke, Ferland said the school "taught me to think like a competent, ethical attorney."

When Ferland graduated in 1974, he returned to Phoenix to practice. At that time, he became associated with Paul Castro's 1974 campaign for governor of Arizona. He was responsible for drafting the candidate's issues papers. After the campaign, Ferland accepted an appointment as Administrative Counsel for the Arizona Department of Health Services. He assisted in the drafting of the Hospital Certification of Need Laws and Regulations and was involved in a number of administrative decisions made under them. While in that position, Ferland said, "I saw Professor Havighurst's concepts substantially borne out in the real world." He also commented that he had perceived the direct influence of Professor

Arthur Larson's work.

In 1977, Ferland became Senior Counsel to the Environmental Protection Section of the Attorney General's Office. While there, he did environmental work exclusively. He was largely responsible for rewriting all of Arizona's Air Pollution Regulations in 1979. The new regulations were innovative in that they committed to words a complex graph designed by University of Arizona specialists to ensure that, given variations in meteorological conditions and emissions content, there would never be excessive amounts of sulphur dioxide pollution in Arizona's atmosphere.

Three and a half years after the regulations were submitted, they were approved by the Environmental Protection Agency. Shortly thereafter, the Environmental Defense Fund sued the Environmental Protection Agency for its approval of the regulations. In *Kamp v. Hernandez* (Feb. 5, 1985), a Ninth Circuit panel affirmed the EPA's approval of Arizona's "multi-point implementation plan for the control of SO₂ emissions from copper melters." The EDF petitioned for rehearing en banc.

Since 1981, Ferland has been in private practice, doing environmental defense work for the Phoenix firm of Twitty, Sievwright & Mills. Ferland regards his practice as something like preventive medicine. He often requests his clients to read pertinent cases before meeting with him. "It is my firm belief that clients need to be educated about relevant issues of environmental law so that they can make intelligent decisions in their corporate planning."

Ferland recently wrote an article on alternative regulatory approaches that appeared in the 1984 edition of the *Rocky Mountain Mineral Law Institute*. In September, he addressed a group of corporate environmental affairs specialists at a Hazardous Wastes Symposium held in Phoenix. He spoke about the legal issues that arise when a purchaser of real property discovers the purchased land to be contaminated with hazardous wastes.

According to Ferland, "The



From top left, clockwise: Andy Friedman, Al Shrago, Bob Hackett, Bill Kurtz.

essence of environmental law is the resolution of conflict between the equally valid interests of the public in a clean environment and business in survival." Ferland finds the creative challenges involved in resolving that conflict particularly rewarding.

Larry Haddy was born in Iowa and spent most of his life there until he went into the service. In 1968, he was stationed in Fort Huachaca, Arizona, and "fell in love with the state." In 1970, when Haddy was in Vietnam, he was admitted to Duke Law School. "I still remember the day my mud-splattered acceptance letter arrived in camp." Haddy returned to the United States to enter Duke that fall.

Haddy had not forgotten his days in Fort Huachaca and decided to practice in Phoenix because it was the largest city in Arizona. He spent the summer after his second year working as a Superior Court bailiff in Phoenix and, after graduating in 1973, he returned to Phoenix to clerk for the Honorable Walter E. Craig, a federal district court judge. Following his clerkship, Haddy joined the small Phoenix firm of Carson, Messenger, Elliot, Laughlin & Reagan, where he became a litigation partner doing primarily bank and insurance defense work.

In 1981, the opportunity to strike out on his own arose and Haddy left Carson, Messenger. He and two other attorneys, Karasek and Rayes, set up an overhead-sharing arrangement.

They share only common expenses; otherwise, each attorney is responsible for his own risks and reaps the full benefit of his rewards.

Haddy describes his present practice as a "general civil practice." He handles matters ranging from real estate and commercial litigation to personal injury and domestic relations cases. He also does some bankruptcy work. Any criminal cases that come into the office are handled by his associates.

Haddy finds the independence and diversity of his practice satisfying. He also very much enjoys living and working in Phoenix. "It's a vacationland year-round." According to Haddy, the city's warm and relaxed atmosphere is also reflected in the legal sphere. "Problems like late discovery are often handled with a simple phone call; you don't have to file papers with the court."

Three of four Duke graduates who are now members of the Phoenix firm of Evans, Kitchell & Jenckes were also interviewed for this article. They share Haddy's appreciation of Phoenix's lifestyle and legal climate.

Andy Friedman, a native of New Jersey, moved to Phoenix after graduating from Duke in 1978. What initially attracted him to Phoenix was Evans, Kitchell. The firm's atmosphere and litigation practice appealed to him. Today, he is a litigation partner at the firm and handles a variety of civil cases. Friedman finds Phoenix

culturally interesting and enjoys the fact that one can live in very pleasant neighborhoods within five minutes of one's job. He also appreciates the informal manner in which matters like extensions can be handled.

Al Shrago, a member of the class of '77, is a native of North Carolina. He too moved to Phoenix after graduating from Duke primarily because of Evans, Kitchell. He had clerked there after his second year and felt "the firm was the sort of place in which I could practice for the rest of my life." Like Friedman, Shrago is a litigation partner at the firm. Last February the United States Supreme Court heard argument in *Kerr-McGee Corp. v. Navajo Tribe*, a case in which Shrago was lead counsel for the business. The Court decided that Kerr-McGee will have to pay taxes, imposed by the Navajo tribe, on mineral leases on Navajo property.

Phoenix, according to Shrago, is unique among cities of its size. "It's a major metropolitan area with most of the opportunities available elsewhere, professionally and otherwise; yet it offers a more small-town quality of lifestyle." In particular, it is a city that "offers attractive opportunities to lawyers recently graduated from law school."

Bob Hackett graduated some ten years earlier than Shrago and Friedman. Professor Weistart was then a member of the student body. After graduating, Hackett returned to New York to practice. He had spent four years with a Wall Street firm when Evans, Kitchell, as he put it, "made me an offer I couldn't refuse." He is now a partner in the firm's corporate department. Hackett misses neither the practice nor the lifestyle of New York. He finds Phoenix "rich and diverse culturally" and he enjoys the more relaxed atmosphere of the city.

Friedman, Shrago, and Hackett share positive feelings about the quality of the legal education they received at Duke. Duke provided them with the analytical skills that they all agree are the key to good legal craftsmanship, whether in the field of litigation or corporate work. Friedman, in particular, remembers



Norman Herring

Donald Beskind's Trial Practice course. He recalls, "Beskind opened my eyes to the fact that you don't have to be bombastic to be a good trial lawyer. The course was one of the primary motivating factors that led to my choice to go into litigation."

Tom Karas, originally from Chicago, moved to Phoenix after he graduated from Duke in 1959. Since that time, he has devoted his career to criminal law. Karas began his professional life as a Maricopa County Attorney. He then went on to become an Assistant United States Attorney, Chief of the Criminal Division for the District of Arizona.

In 1965, Phoenix became the home of the first Public Defender Pilot Program in the United States. Karas was asked to run the program. Of the nine lawyers Karas hired, five are now judges. Kleinschmidt was one of those five lawyers. Kleinschmidt recalls, "Karas was wonderful to work for. He was fiercely independent, scrupulously honest, diligent, and inventive about probing areas of the law to develop new rights."

Karas remembers how he and Kleinschmidt worked together on cases involving sections of the United States Code that then provided for punishment applicable only to American Indian criminal offenders. *United States v. Cleveland* was the first case in which the court held that such disparate punishment violated the equal protection component of the Fifth Amendment's Due Process

Clause. Six or seven other sections fell in cases following *United States v. Cleveland* and the entire chapter was eventually amended to provide equal punishment for offenders of all races.

In 1971, the Public Defender program became national. Karas remained at the Phoenix office until 1975, when he left to join Lewis & Roca, one of the largest firms in Phoenix. Karas had been a partner at Lewis & Roca for seventeen months when he decided that he needed more independence. He has been a sole practitioner ever since.

Today, Karas is considered one of the foremost criminal defense lawyers in Arizona. He is listed in both *The Best Lawyers in America* and *The Directory of Legal Professions*. About fifty percent of Karas's usual caseload involves charges of white collar crime; the rest are charges such as murder and rape. He is very selective about the cases he takes. They must involve fact situations or legal issues of particular interest to him.

For example, in *State v. Flynn*, Karas successfully defended Flynn, a highly respected physician, president of the Arizona Medical Association, and an Arizona State Senator who was instrumental in the passage of Arizona's Child Abuse Reporting Statute. After the statute was passed, Flynn was indicted for allegedly failing to report a child abuse case. It was the one of the first cases in the United States in which a physician was prosecuted for failure to report child abuse.

Karas has also been active outside his practice. He sat on the American Bar Association Criminal Justice Section for eight years during which he became Vice-Chairman, Chairman-Elect, and finally, Chairman of the Section. Then Dean Kenneth Pye also sat on the Section for several of the years when Karas was there. Karas recalls, "Pye was a real healing presence between the prosecution and defense factions of the Section." When Pye left to become Chancellor at Duke University, he was sorely missed.

It was largely Karas's initiative that led to the use of video-tapes and the institution of a more demonstrative

educational approach at the National College for Criminal Defense in Houston. He chaired two terms of the Board of Regents of the College. Karas now serves on the Board of Governors of the Arizona State Bar.

Karas remembers Duke for its small classes and its rigorous educational program. He attributes a good deal of his success to the training he received at Duke.

Another Duke alumnus who looks back at Duke from the perspective of a number of years of practice is Norman Herring. Herring was a member of the first graduating class of Duke Law School. Born in a silver mining camp in Nevada, Herring and his family moved to Douglas, Arizona, when he was still a small boy. One of his ancestors was a prominent lawyer in Arizona in the Territorial Days. When Herring entered Duke Law School in 1931 as a transfer student from the University of Arizona Law School, he had no intention of practicing anywhere other than Arizona. He is, and always had been, as he puts it, "a desert man."

Herring chose to attend Duke because, "I wanted a first-rate legal education and the broadening experience of living somewhere other than Arizona." According to Herring, his class was hand-picked for its high degree of scholarship and for its geographic diversity. The student-professor ratio was nearly one-to-one in those days. Justin Miller, then Dean of the Law School, held early morning classes over coffee at his

home.

Herring also remembers his sales and contracts professor, Malcolm McDermott. Professor McDermott apparently wore glasses on a string and when making a particularly salient point, would let the glasses fall from his nose and fix the class with a stony gaze. "'Gentlemen,' McDermott would say, 'This is the law.'"

When Herring returned to Arizona in 1933, there were only three or four hundred lawyers in the state. Herring felt that the intense educational experience he had had at Duke made him one of the best-trained lawyers in the state. Duke had also, Herring says, instilled in him a strong sense that "the basic responsibility of a lawyer to society is greater than the lawyer's need for money."

Herring was admitted to the Arizona bar in 1934 and began his career as a general practitioner. He worked in Tucson and Douglas for some years before settling in Phoenix. In 1949, while still in Tucson, he began to specialize in personal injury and worker's compensation litigation. He attended a number of medical seminars for lawyers taught by Professor Hubert Winston Smith. Gradually, Herring found that he had a natural aptitude for medical lore. If he carefully studied anatomy and the relevant literature, he could become an "instant expert" in a particular area of medicine. He was one of the first members of the National Association of Claimants Counsel of

America, the forerunner of the American Trial Lawyers Association.

Since 1959, Herring has been legally blind. He has no central vision and only 2% peripheral vision. Nonetheless, Herring still maintains a vigorous practice. In 1968, he passed the California Bar Exam with one of the highest scores. He is one of the best-known medical malpractice lawyers in Phoenix. Last year, he was the subject of an article on medical malpractice that appeared in the *Phoenix Gazette*, a local newspaper.

As he stated in that article, Herring feels he is "'the place of last resort for people injured by doctors' carelessness.'" However, Herring declines to accept about nine of every ten cases that come to him. He does careful preliminary research of all potential cases and accepts only those in which he feels the plaintiff's legal expenses will be justified by the probable award. Malpractice awards and settlements are not only a means of earning a living to Herring. They also serve to fulfill the ethical duty he feels lawyers owe to society by deterring bad doctors and raising the standard of practice of medicine.

Duke Law School is still probably best-known in the East. However, many Duke graduates have chosen to pursue their careers in the Western states. A number of them are now living in Phoenix, Arizona. They have found the city's climate and lifestyle ideal and its practice of law both broad and challenging.

SPECIALLY NOTED

Obituaries

Charles H. Livengood, Jr.

Charles H. Livengood, Jr., a nationally known labor law expert, died at Duke Hospital on October 10, 1984, after a long illness. He was 73.

Professor Livengood, a Durham native, attended Duke University and graduated in 1931. He later entered Harvard University and earned his law degree in 1934. He was associated with two New York law firms before joining the United States Department of Labor as regional attorney for Kentucky and Tennessee shortly before World War II. During the war, he served as a lieutenant commander in the Navy. He was later cited for meritorious service during the Solomon Islands campaign.

After the war, Professor Livengood returned to Durham, where he briefly entered private practice before joining the Duke Law faculty in 1948. During his years at Duke, he served as University Marshall from 1953 to 1961. He also taught at several other universities, including the University of Sydney, where he was a Fulbright lecturer. He was the author of *Federal Wage and Hour Law*, and a contributor to numerous legal journals.

Professor Francis Paschal, remembering Professor Livengood's years at Duke, noted that Professor Livengood had the reputation of being the finest seminar instructor at the law school, and was regarded highly by his students. Professor Paschal also recalled Professor Livengood's good humor and spirit, often masked by a

certain reserve. Professor John Weistart, a student and colleague of Professor Livengood, noted his clarity and precision in writing.

Professor Livengood held several governmental posts throughout his career. He served as a consultant to the United States Senate subcommittee on labor relations in 1950. Between 1957 and 1960, he was an arbitrator with the Federal Mediation and Conciliation Service, the American Arbitration Association, and the North Carolina Department of Labor. He had been a member of the state



Charles H. Livengood, Jr.

General Statutes Commission since 1966, serving as chairman in 1970, and vice-chairman from 1962 to 1970.

Professor Livengood is survived by his wife, Virginia, and a son, Charles H. Livengood, III.

John S. Bradway

On January 2, 1985, Professor of Law Emeritus John S. Bradway died after a brief illness in Eureka, California. Born in 1890 in Swarthmore, Pennsylvania, Professor Bradway earned his undergraduate degree at Haverford College and his LL.B. from the University of Pennsylvania. He held honorary degrees from Haverford College and California Western University. He was a member of Phi Beta Kappa and Order of the Coif. After service in the Navy during World War I, several years in private practice in Philadelphia, and brief teaching assignments at the University of Pennsylvania and the University of Southern California, Professor Bradway came to Duke in 1931.

During his time at Duke, Professor Bradway focused his research activities on the interrelationship of law and social work, on clinical legal aid instruction, and on domestic relations. He is probably best remembered for his emphasis on clinical training for law students through legal aid programs for the poor. He was the Founder and Director of the Duke Legal Aid Clinic, and authored numerous books on the subject, including *Clinical Instruction for Law Practice*, *Basic Legal Aid Clinic Materials and Exercises*, and *Law and Social Work*. Mr. Matthew S. Rae, Jr., a graduate of the law school, pupil of Professor Bradway, and past Supreme Justice of Phi Alpha Delta Law Fraternity, said of him:

Thousands of underprivileged citizens who never heard of him owe Professor Bradway their thanks for

his pioneering work which resulted in today's national system of legal aid clinics. He indeed left the nation richer than he found it.

From 1922 to 1942, Professor Bradway served as Secretary and President of the National Association of Legal Aid Organizations. In 1948, he chaired the Legal Aid Committee of the American Bar Association. He also served on numerous state commissions and boards, including the North Carolina Probation Commission, and the Commission to Study Domestic Relations Laws. He was president of the North Carolina

Mental Hygiene Society and the State Legislative Council from 1947 to 1949. Professor Bradway retired from Duke in 1959.

After leaving Duke, Professor Bradway taught at California Western University School of Law in San Diego and at Hastings College of Law from 1960 to 1965. He later returned to California Western, where he taught until his final retirement from teaching in 1973, at the age of 83. At the time of his death, Professor Bradway was working on a collection of essays dealing with law and legal education.



John S. Bradway

For Attorneys, CPA's, Trust Officers, CLU's, and Other Estate and Financial Planners

The Duke University School of Law and The Duke University Estate Planning Council will present the Seventh Annual Estate Planning Conference on the campus of Duke University in Durham, North Carolina, October 17-18, 1984. An outstanding and nationally known faculty will present a program of *timely* and *practical* interest to all members of the estate planning team.

Subjects on the program will include: The Treasury View of Tax

Reform; Gifts and Sales of Partial Interests in Property (Life Estates and Remainders); Income Tax Planning; The Role of Charitable Giving in Estate Planning; The Use of Insurance in Estate Planning; Estate Tax Planning; Gift Loans—Proper Subject for a Gift; The New South Executive; The Marital Deduction Revisited; General Administration of Estates; IRD—The Atomic Bomb in the Estate of a Professional Partner; The Year in Review—An Estate Planner's Perspective on Tax

Developments.

The conference is designed for continuing education credit. Participation is limited to 175. Fee \$250. Information write or call:

Roland R. Wilkins, Director
7th Annual Duke University Estate Planning Conference
P.O. Box 3541
Durham, NC 27710
Telephone: (919) 684-4429

Agenda

Law Alumni Weekend, November 1-2, 1985

Friday, November 1, 1985

- 2:00 p.m. Registration Desk Opens—Lobby, Law School
- 3:00 p.m. Law Alumni Council Meeting—Law School
- 6:00 p.m. Cocktails, Lobby, Paul M. Gross Chemical Laboratory
- 7:30 p.m. Dinner on your own

Saturday, November 2, 1985

- 9:00 a.m. Coffee—Danish, Hallway, adjacent to Moot Courtroom
- 9:15 a.m. Professional Program—Moot Courtroom
- 11:00 a.m. Pig Pickin' BBQ Luncheon, Back Lawn, Law School

(If rain, Portico of Gross Chem.)

1:30 p.m. Duke vs. Georgia Tech

REUNION CLASS PARTIES

- 6:30 p.m.* Cocktails, Sheraton University Center (each reunion class will have its own party)
- 8:00 p.m.* Dinner, Sheraton University Center (each reunion class will have its own party)

*Should the University decide to reschedule the afternoon football game to an evening game, the reunion parties will be held earlier (i.e., 4:00 p.m. for cocktails and 5:00 p.m. for dinner).

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