NOTES

NEW CIVIL LIABILITIES UNDER SECURITIES AND EXCHANGE ACT RULES

Most courts have held that a director, although a fiduciary of the corporation, owes no fiduciary duty to its shareholders personally, and may deal with them at arm's length in the purchase of their shares.[1] Only in a minority of jurisdictions is a duty of disclosure and fair dealing placed upon directors in such transactions.[2] Federal securities legislation has contributed to the extension and enforcement of fiduciary duties in several ways,[3] but until recently insiders buying unlisted securities were able to use their inside information to the detriment of the shareholders from whom they purchased, so long as their conduct did not involve a breach of the limited fiduciary obligations imposed by state courts.

In an attempt to cope with this and other deceptive practices, the Securities and Exchange Commission, in 1942, adopted Rule X-10B-5,[4] under Section 10(b)[5] of the Securities and Exchange Act of 1934. This section prohibits "manipulative or deceptive" devices employed in connection with the purchase and sale of securities and in contravention of the rules and regulations of the SEC. Rule X-10B-5, defining such manipulative or deceptive devices, makes it unlawful:

> .... for any person directly or indirectly
> (1) to employ any device, scheme, or artifice to defraud
> (2) to make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

[1] Berle and Means, The Modern Corporation and Private Property 224, 225 (1932); Ballantine, Corporations 212 (1946).

[2] Ballantine, Corporations 213 (1946).

[3] Section 16(b) of the Securities and Exchange Act of 1934 provides that a director's profits from the purchase and resale within six months of his corporation's listed shares may be captured by the corporation. 48 Stat. 896 (1934), 15 U.S.C.A. § 78p (1941). See Smolowe v. Delendo Corp., 136 F. 2d 231 (C.C.A. 2d, 1943), cert. den. 320 U.S. 751 (1943). Withholding of material facts in the sale—but not the purchase—of both listed and unlisted securities has been made unlawful by Section 17(a) of the Securities Act of 1933. 48 Stat. 84 (1934), 15 U.S.C.A. § 77q (1941). And manipulative practices by brokers and dealers are prohibited by Section 15(c) 1 of the Securities and Exchange Act of 1934. 48 Stat. 895 (1934), amended 49 Stat. 1377 (1936), 15 U.S.C.A. § 78o (1941).

[4] General Rules and Regulations under the Securities and Exchange Act of 1934 (1946).

[5] 48 Stat. 891 (1934), 15 U.S.C.A. § 78j (1941).

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person

in connection with the purchase or sale of any security.

Violations of this rule have constituted the basis of a number of injunctive actions by the SEC, most of which have terminated in consent decrees.[6] Moreover, a new and more effective remedy will become available to shareholders injured by insiders who violate the rule if four recent federal district court decisions are upheld. It was decided in each of the cases that a violation of Rule X-10B-5 creates a civil cause of action in the injured shareholder against the violator.

In the principal case, *Kardon v. National Gypsum Company*,[7] the plaintiffs alleged that the defendant directors induced them to sell their shares to the directors without disclosing that negotiations were pending with the National Gypsum Company for the sale of some of the corporate assets and for contracts governing future business relations between them. It was also alleged that the National Gypsum Company was a party to this scheme, and that since the mails and other instruments of interstate commerce were used, this conduct was a violation of Section 10(b) of the Securities and Exchange Act of 1934 and of Rule X-10B-5. The plaintiffs sought damages for the injury resulting from the statutory violation, or, alternatively, an accounting under Section 29(b) of the act.[8] The court, denying a motion to dismiss for lack of jurisdiction over the defendants, who were served with process in New York and Michigan respectively, held that a private cause of action for damages exists as a result of the violation of Section 10(b). Consequently it held that the jurisdiction of the court was properly invoked under Section 27 of the act,[9] which authorizes service of process anywhere in the United States in suits "to enforce any liability or duty created by this title or rules and regulations thereunder."

The other three cases also involved private actions for violation of Rule X-10B-5. In the first case, the court, relying on the decision in the *Kardon* case, also denied a motion to dismiss for lack of jurisdiction and upheld civil liability for violation of the rule.[10] An oral decision in the second case—a shareholder

[6] Tenth Annual Report of the Securities and Exchange Commission 82 (1945); see Purcell, Foster, and Hill, Enforcing the Accountability of Corporate Management and Related Activities of the Securities and Exchange Commission, 32 Va. L. Rev. 497, 551–54 (1946).

[7] 69 F. Supp. 512 (Pa., 1946).

[8] 48 Stat. 903 (1934), amended 52 Stat. 1076 (1938), 15 U.S.C.A. §78cc (1941).

[9] 48 Stat. 902 (1934), amended 49 Stat. 921 (1936), 15 U.S.C.A. § 78aa (1941).

[10] The court's decision took the form of a letter to counsel. Fifth-Third Union Trust Co. v. Block, Civil Action No. 1507 (S.D. Ohio, 1946). The plaintiff had alleged that the defendants—directors and officers of the corporation of which the plaintiff's mentally incompetent ward was a shareholder—induced the ward to believe that the shares were worth far less than their actual value, purchased his shares through a broker without disclosing their identity, and resold them a week later for seven times as much as they paid for them. Relying on the decision in the Kardon case, the court denied a motion to dismiss for lack of jurisdiction and thus upheld a private cause of action for damages for breach of Section 10(b) of the Securities and Exchange Act of 1934.

derivative suit—denied a similar motion to dismiss,[11] and in the third case the court not only upheld the liability of directors for a breach of the fiduciary standards of Rule X-10B-5 but also extended liability to the brokers involved.[12] Although the complaint in each of the cases spells out what amounts to a common law action for fraud and deceit, the comparative ease of proving a material non-disclosure, the uncertainty of relief in the state courts, and the broad federal jurisdiction over multiple out-of-state defendants, make the federal statutory cause of action much more attractive. But whether a federal court can assume jurisdiction depends in turn upon whether a private cause of action exists for a violation of the federal statute.

The court in the *Kardon* case stated that a private cause of action for violation of the rule was created in two ways: first, through the common law rule of civil liability for violation of a statutory duty designed to protect the class of persons to which the plaintiff belongs; second, under Section 29(b) of the Securities and Exchange Act,[13] which provides that contracts in violation of any section of the act shall be void.

In upholding common law liability for breach of a statutory duty, the court, applying conventional tort doctrines, declared that "the disregard of the command of a statute is a wrongful act and a tort,"[14] and quoted from the *Restatement of Torts*[15] in support of the doctrine that one who violates a statutory duty and thereby brings about the harm which the statute was designed to prevent becomes liable to a member of the class of persons whom the statute was intended to protect.[16] Statutory liability of this nature has most often been invoked in personal injury cases, and it is usually said that violation of a statutory duty is negligence per se.[17] But holding that the violation of a statute is negligence per se is equivalent to creating a direct civil liability based solely upon the violation of the statute.[18] Moreover, there are a number of cases in which liability of this nature has been imposed for injuries to property rights rather than to personal rights.[19] Indeed, in several cases where an action based upon negligence would have been unsuccessful it has been held that the viola-

[11] Slavin v. Germantown Fire Insurance Co., Civil Action No. 6564 (E.D. Pa., 1946).

[12] Fry v. Schumaker, C.C.H. Sec. Act. Serv. ¶90366 (1947).

[13] 48 Stat. 903 (1934), amended 52 Stat. 1076 (1938), 15 U.S.C.A. § 78cc (1941).

[14] Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (Pa., 1946).

[15] 2 Rest., Torts § 286 (1934).

[16] Prosser, Torts § 39 (1941); Harper, Torts § 78 (1933).

[17] Ibid.; see also Lowndes, Civil Liability Created by Criminal Legislation, 16 Minn. L. Rev. 361 (1932); The Effect of Penal Statutes on Civil Liability, 32 Col. L. Rev. 712 (1932).

[18] Lowndes, op. cit. supra note 17.

[19] Abounader v. Strohmeyer & Arpe Co., 243 N.Y. 458, 154 N.E. 309 (1926); P. G. Farm v. Newton By-Products Mfg. Co., 248 N.Y. 293, 162 N.E. 84 (1928); Tarrance v. Chapman, 196 Ala. 88, 71 So. 707 (1916); Mazzetti v. Armour & Co., 75 Wash. 622, 135 Pac. 633 (1913); cf. Steckler v. Pennroad Corp., 136 F. 2d 197 (C.C.A. 3d, 1943).

tion of a statute in itself constitutes a basis for civil liability.[20] In the *Kardon* case the conduct complained of was in violation of Section 10(b) of the statute and the shareholder plaintiff was a member of the class (investors) which Section 10(b) of the statute is designed to protect. Unless a contrary intention of Congress is manifest, it would appear that the alleged breach created in the injured party a private cause of action.

Such a contrary intention has been found in the fact that Congress expressly created civil liability for violations of three other sections of the act. It has been argued that if Congress had also intended that civil liability should be a consequence of a violation of this section it would have so provided.[21] The court in the *Kardon* case, in rejecting the applicability of the maxim, *expressio unius est exclusio alterius*, which epitomizes such an argument, asserted that in view of the general purpose of the act, the mere omission of an express provision for civil liability is not sufficient to negative a liability which normally, by virtue of the basic principles of tort law, results from the doing of the prohibited act. This assertion is supported by a number of cases which have severely limited the applicability of the maxim.[22] Moreover, the view that Congress did not intend to deny a private right of action for a violation of Section 10(b) when it expressly provided for a civil cause of action in other sections is substantiated by an examination of Sections 9(e),[23] 16(b)[24] and 18(a)[25]—the three sections which expressly provide for private causes of action. These sections deal with special matters; they provide for less restricted recovery than would be possible at common law; they prescribe special rules as to the burden of proof and a shorter statute of limitations.[26] When these provisions are viewed in the light of the broad purposes of the statute and the large area in which it was intended that protection

[20] In Texas & Pacific Ry. Co. v. Rigsby, 241 U.S. 33, 39 (1916), the Supreme Court said: "A disregard of the command of a statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover damages from the party in default is implied. . . . ." See also Narramore v. Cleveland, C., C. & St. L. Ry. Co., 96 Fed. 298 (C.C.A. 6th, 1899); Zaskowski v. American Steel & Wire Co., 258 Fed. 9 (C.C.A. 6th, 1918); Donaldson v. Tuscon Gas, Electric Light & Power Co., 14 F. Supp. 246 (Ariz., 1935); Armour v. Wanamaker, 202 Fed. 423 (C.C.A. 3d, 1913); Annis v. Britton, 232 Mich. 291, 205 N.W. 128 (1925); Meshbesher v. Channellene Oil & Mfg. Co., 107 Minn. 104, 119 N.W. 428 (1909); Ives v. Welden, 114 Iowa 476, 87 N.W. 408 (1901).

[21] SEC Action against Fraudulent Purchasers of Securities, 59 Harv. L. Rev. 769, 779 (1946); see SEC v. Long Island Lighting Co., 148 F. 2d 252 (C.C.A. 2d, 1945).

[22] United States v. Barnes, 222 U.S. 513 (1912); Springer v. Government of the Philippine Islands, 277 U.S. 189 (1928); Neuberger v. Com'r of Int. Rev., 311 U.S. 83 (1940); SEC v. Joiner Leasing Corp., 320 U.S. 344 (1943); Bland v. Com'r of Int. Rev., 102 F. 2d 157 (C.C.A. 7th, 1939), cert. den. 308 U.S. 563 (1939); New York v. Davis, 7 F. 2d 566, 575 (C.C.A. 2d, 1925); Collins v. Russell, 114 F. 2d 334, 337 (C.C.A. 8th, 1940).

[23] 48 Stat. 890 (1934), 15 U.S.C.A. § 78i (1941).

[24] 48 Stat. 896 (1934), 15 U.S.C.A. § 78p (1941).

[25] 48 Stat. 897 (1934), 15 U.S.C.A. § 78r (1941).

[26] See dissenting opinion of Judge Clark in Baird v. Franklin, 141 F. 2d 238, 245 (C.C.A. 2d, 1944).

be made "reasonably complete and effective,"[27] it becomes clear that reference to special civil actions in some sections was not intended to exclude a private cause of action in others. Added support for this view is to be found in Section 28(a) of the act, which says, "The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity. . . . ."[28]

Direct authority for upholding civil liability for a breach of a duty created by a section of the Securities and Exchange Act may be found in *Baird v. Franklin*,[29] a case in which investors brought an action against the New York Stock Exchange, claiming that a failure of the Exchange to enforce its rules constituted a violation of Section 6(b) of the Securities and Exchange Act.[30] The entire court agreed that a private cause of action could be maintained for the violation of Section 6(b) of the act, although the majority found that the plaintiffs had failed to sustain the burden of proving damages.[31] As in the *Kardon* case, the jurisdiction of the court was upheld under Section 27 of the act.[32]

Apart from the common law remedy for the breach of a statutory duty, the court in the *Kardon* case found another remedy, for the alleged violation of Section 10(b), under Section 29(b) of the Securities and Exchange Act,[33] which provides that contracts in violation of any provision of the act shall be void. The court ruled that "a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect to it,"[34] and pointed out that the 1938 amendment to this section clearly indicates that Congress intended the original statute to be interpreted as providing for suits by private parties.[35]

In 1938 Section 29(b) was amended[36] by adding a proviso prescribing the same statute of limitation for an action brought under Section 29(b) for violation of Section 15[37] as for an action brought directly under Section 9(e),[38] which

[27] See statement of the necessity for regulation in Section 2 of the Securities and Exchange Act of 1934. 48 Stat. 881 (1934), 15 U.S.C.A. § 78b (1941).

[28] 48 Stat. 903 (1934), 15 U.S.C.A. § 78bb (1941).

[29] 141 F. 2d 238 (C.C.A. 2d, 1944).

[30] 48 Stat. 886 (1934), 15 U.S.C.A. § 78f (1941).

[31] Baird v. Franklin, 141 F. 2d 238, 239 (C.C.A. 2d, 1944).

[32] 48 Stat. 902 (1934), amended 49 Stat. 921 (1936), 15 U.S.C.A. § 78aa (1941). The Supreme Court in Deckert v. Independent Shares Corp., 311 U.S. 282 (1940), upheld the jurisdiction of the district court under the almost identical provisions of Section 22 of the Securities Act of 1933. The question of jurisdiction in that case also depended only upon whether there was a violation of a duty created by any section of the act.

[33] 48 Stat. 903 (1934), amended 52 Stat. 1076 (1938), 15 U.S.C.A. § 78cc (1941).

[34] Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (Pa., 1946).

[35] The court relied on Geismer v. Bond and Goodwin, 40 F. Supp. 876, 878 (N.Y., 1941); see Oppenheimer v. F. J. Young & Co., 144 F. 2d 387 (C.C.A. 2d, 1944).

[36] 52 Stat. 1076 (1938).

[37] 48 Stat. 895 (1934), amended 49 Stat. 1377 (1936), 15 U.S.C.A. § 78o (1941).

[38] 48 Stat. 890 (1934), 15 U.S.C.A. § 78i (1941).

also makes unlawful certain manipulative practices of brokers and dealers. The amendment thus confirms the view that the original Section 29(b) provided for a cause of action for violations of other sections of the act where a contract was involved. This interpretation was upheld by the Second Circuit Court of Appeals in *Goldstein v. Groesbeck*,[39] a case arising under the Public Utilities Holding Company Act. The court, after declaring the contract void under Section 26(b),[40] held that the plaintiff was entitled to a remedy in damages, saying, " .... § 26 is incomplete if not ineffective, unless it is considered to authorize recovery..... A useful analogy in favor of this interpretation may be found in § 29 of the Securities and Exchange Act of 1934 which is virtually identical with § 26 of the Utility Act, for it is now clear from the 1938 amendment to § 29 that Congress intended a right of recovery thereunder."[41]

Thus the precedents seem to support the decision in the *Kardon* case granting a remedy for an injury sustained as a result of conduct in violation of Section 10(b) of the Securities and Exchange Act, both under the common law rule creating civil liability for breach of a statutory duty and under Section 29(b) of the act.[42]

[39] 142 F. 2d 422 (C.C.A. 2d, 1944), cert. den. 323 U.S. 737 (1944).

[40] 49 Stat. 836 (1935), 15 U.S.C.A. § 79z (1941).

[41] Goldstein v. Groesbeck, 142 F. 2d 422, 426–27 (C.C.A. 2d, 1944).

[42] The recent opinion of the Delaware district court in Downing v. Howard, 68 F. Supp. 6 (Del., 1946), however, contains statements which conflict with those of the Kardon case. The court distinguished Goldstein v. Groesbeck and dismissed the complaint of a plaintiff in a derivative suit who sought an accounting under Section 26 of the Holding Company Act, or, alternatively, damages for violation of Section 4 of that act. It was alleged that the corporation suffered damages to an amount in excess of $100,000,000 because of depreciation in the value of the securities held by the corporation resulting from manipulations by the directors during a period in which it failed to register under the Public Utility Holding Company Act. The court, sustaining a motion to dismiss, held that since no cause of action was stated under the act, federal jurisdiction could not be invoked. The court argued, first, that the damages could not be said to be a result of a failure to register, because the conduct of the directors would have been legal if the corporation had registered; second, that because there were no illegal contracts involved, the plaintiff could not maintain an action under Section 29(b) of the act; third, that since there was no express provision in Section 4 of the act for civil liability, whereas civil liability was expressly provided in other sections, the plaintiff could not recover in a private cause of action; and fourth, that Section 4 is regulatory and only penal liabilities ensue from a violation of that section.

The decision hinged on the issue of damages. If the alleged damages were not the result of the statutory violation then neither of the alternative claims stated a valid cause of action. On the other hand the facts of the case do not completely reject the possibility that the securities would not have declined in value if the corporation had registered and had become subject to the regulation of the SEC. Had the plaintiffs alleged specific acts of the directors which damaged the corporation and which would have been subject to the regulation of the SEC if the corporation had registered, it is possible that their complaint might have been sustained. Although the corporation may not have entered into any contracts in violation of Section 4 (a) (2), as the corporation did in the Goldstein case, its holding and voting of securities in subsidiaries was in violation of Section 4 (a) (6). If the plaintiffs could have shown that this conduct would have been prevented by regulation of the SEC, they would have been entitled to relief under the common law rule creating civil liability for the breach of a statutory duty. Although the expressions in the opinion in respect to the maxim *expressio unius est*

The cases suggest that the remedies of shareholders may be extended in other similar transactions which involve violations of the rules and regulations of the Securities and Exchange Commission. One such extension of civil liability under Rule X-10B-5 is the application of the rule to transactions between directors and the corporation rather than between directors and shareholders.[43] Although a director already owes a duty of fair dealing and disclosure to the corporation, a federal statutory remedy for shareholders might prove more effective than an attempt to enforce that duty in the state courts, especially since the SEC as a potential *amicus curiae* can command much greater legal resources than the average shareholder. Thus a shareholder's derivative suit might be entertained under Rule X-10B-5 against a director or a promoter who obtained shares from the corporation for an inadequate consideration and without disclosure.

Similarly, a duty of disclosure has already been placed on directors in buying shares *for* the corporation. The leading case of this type under Rule X-10B-5 has been the *Ward La France Truck Corporation* case,[44] in which shares were purchased for the corporation at $3 to $6 per share when secret negotiations were pending to sell the controlling shares for $45 per share and to liquidate at a figure which would give the shareholders $25 per share. The situation was corrected without litigation and the shareholders recompensed after the SEC had stated that the purchase of the securities under these circumstances without disclosure constituted a violation of Rule X-10B-5. The increasing number of transactions in which shares are purchased for the corporation where the insiders have secret information indicating that their value is greater than the market price has led the SEC to report that "the need for more drastic action to prevent violations of this type is becoming increasingly apparent."[45] A shareholder class suit in the federal courts under Rule X-10B-5, possibly with the aid of the SEC in notifying the parties, might prove an effective remedy for shareholders who sell under these circumstances.[46]

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exclusio alterius are dicta, if it had been held that the damages were caused by a violation of the statute the application of the maxim would have been an obstacle to recovery by the plaintiffs. Similarly the contention that Section 4 is a regulatory provision is also dictum, although that contention, too, might become important if the issue of damages had been resolved differently. But a closer examination of the Holding Company Act would reveal that Congress did not intend to deny civil liability for violation of Section 4, either when it expressly provided civil liability for violation of other sections or when it provided other penalties for failure to register under the act.

43 See Slavin v. Germantown Fire Insurance Co., Civil Action No. 6564 (E.D. Pa., 1946).

44 Matter of Purchase and Retirement of Ward La France Truck Corp. Class "A" and Class "B" Stocks, Securities Exchange Act Release No. 3445 (1943).

45 Tenth Annual Report of the Securities and Exchange Commission 82 (1945). See SEC Action against Fraudulent Purchasers of Securities, 59 Harv. L. Rev. 769 (1946).

46 The purchase by a corporation of its own preferred shares when dividends are in arrears is a special case of the type under discussion. Since unpaid cumulative dividends tend to depress the market for preferred shares, the directors of the issuing corporation, allied pri-

Civil liability might also be extended to promotors, brokers, and dealers. The SEC has prosecuted a large number of criminal actions against such insiders for various types of fraudulent schemes.[47] In such situations there usually is a civil remedy available to the defrauded investor in the state courts. The cause of action in the federal courts, however, might prove more effective here for the same reasons which make it more attractive in other actions for violation of a federal statutory fiduciary duty. Thus, relief may be provided for shareholders defrauded by "Ponzi" schemes,[48] bucket shops,[49] false investment advice, market manipulations, and other broker-dealer violations of various provisions of the federal securities acts.[50] In fact each section of the several federal securities acts in which certain conduct is made unlawful, and in which no exclusive remedy is provided, might become the basis of civil actions of the type under discussion, provided the section is designed for the protection of investors.

It is possible, however, that the federal courts may be reluctant to uphold the commission's broad quasi-legislative powers. They may set aside as being beyond the Congressional grant of authority[51] rules which the SEC may promulgate. Further, courts may be reluctant to allow personal recovery of large sums against corporate directors and officers or to impose burdensome or uncertain duties of disclosure upon them. The courts may adopt measures of damages which will tend to discourage such actions.[52] Finally, the general political trend may reduce the effectiveness of government regulation of manipulative prac-

marily with the common stockholders, find corporate purchase of the preferred stock under these circumstances attractive, particularly if the prospects of a more prosperous future suggest that dividends will be available to the common if the preferred arrearages can be eliminated. If there has been an actual misrepresentation or a significant lack of disclosure in the purchase of the corporation's shares, the directors might become liable, under Rule X-10B-5 and the decision in the Kardon case upholding civil liability for its violation, to the shareholders from whom they purchased the shares. See Purchase by a Corporation of Its Own Preferred Shares with Dividends in Arrears, 14 Univ. Chi. L. Rev. 66 (1947).

47 "Most of the cases developed by the Commission involve fraud in the sale of securities. These are prosecuted for the most part under Section 17(a) of the Securities Act of 1933. . . . . In the last few years there has been a distinct increase in prosecutions under the Securities and Exchange Act, particularly Sections 10(b) and 15(c)." Tenth Annual Report of the Securities and Exchange Commission 189–90 (1945).

48 The name "Ponzi" is given to a scheme in which the investor is induced to buy additional shares by the payment of dividends out of capital on shares he already holds. Tenth Annual Report of the Securities and Exchange Commission 190 (1945).

49 This scheme consists of pretending to purchase securities for a customer and deliberately failing to acquire them. If the price drops the security is purchased and delivered to the customer at the initial price. If the price rises he is persuaded to sell out and invest in another security. The process is continued until the customer's funds are depleted. Tenth Annual Report of the Securities and Exchange Commission 192 (1945).

50 Ibid., 190–96.

51 SEC v. Chenery Corp., 318 U.S. 80 (1943); see Stock Purchases by Directors during Voluntary Reorganization, 10 Univ. Chi. L. Rev. 70–73 (1942); 14 Univ. Chi. L. Rev. 75 (1946), noting Chenery Corp. v. SEC, 154 F. 2d 6 (App. D.C., 1945).

52 See 2 Bonbright, The Valuation of Property 808 (1937).

tices in the purchase and sale of securities. It is possible, therefore, that civil liability will be recognized in only the most flagrant situations, such as in the *Kardon* case, and further extensions of this type of investor protection will have to await another period like the one that brought about the original federal securities legislation.

JUDICIAL INTERVENTION IN INTERNAL AFFAIRS OF LABOR UNIONS

In a recent Illinois case a member of a labor union appealed to the courts for the redress of a grievance against the organization.[1] This litigation again illustrates the need for a forum appropriate for the consideration of intra-union disputes in an industrial society where more and more workers are abandoning individual bargaining in favor of institutional representation.

For controlling the internal affairs of trade unions, Anglo-American jurisprudence has developed no body of law separate and distinct from that applied to any other type of voluntary association.[2] And the general rule is that voluntary non-profit associations are self-governing organizations whose private affairs are not subject to judicial review.[3] In taking this position, the courts have stressed certain similarities between social and labor organizations, while they have ignored significant functional differences, as well as the quasi-public nature of unions.[4] Thus the bulk of labor unions, being unincorporated, are treated like churches and lodges, while the occasional incorporated union is subject to the rules governing any other corporation.[5] This approach seems a bit unrealistic when applied to the settlement of disputes concerning the internal administration by unions of matters like admission to membership,[6] expulsion and other

[1] Morgan v. Local 1150, United Electrical, Radio and Machine Workers of America, decided Dec. 31, 1946 (Ill. App., 1st Dist.) (unreported).

[2] 1 Teller, Labor Disputes and Collective Bargaining 159 (1940).

[3] Wrightington, Unincorporated Associations and Business Trusts 320 (1923).

[4] In contrast to membership in a fraternal order, which can properly be termed a voluntary association, approximately 6,300,000 workers in the United States in 1945 were covered by closed- or union-shop agreements by which union membership was made a condition of employment. An estimated 3,900,000 additional employees were covered by maintenance-of-membership provisions under which continued union membership was obligatory during the life of the contract. Extent of Collective Bargaining and Union Recognition in 1945, 62 Monthly Lab. Rev. 567, 567–69 (1946).

[5] Teller, op. cit. supra note 2, at 291.

[6] Mayer v. Journeymen Stone-cutters' Ass'n, 47 N.J. Eq. 519, 20 Atl. 492 (1890); Miller v. Ruehl, 166 Misc. 479, 2 N.Y.S. 2d 394 (S. Ct., 1938). Contra: James v. Marinship Corp., 25 Cal. 2d 721, 155 P. 2d 329 (1944). For a general discussion see Summers, The Right to Join a Union, 47 Col. L. Rev. 33 (1947).