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Constitutional Law: Public Aid to Parochial Schools Held Unconstitutional

In the spring of 1972, the New York Legislature enacted several amendments to the state's Education and Tax Laws.1 These amendments provided maintenance and repair grants to private schools with high concentrations of pupils from low-income families, tuition reimbursements to low-income parents of children attending private schools and tax relief to parents who paid tuition to private schools but whose income made them ineligible for tuition reimbursements. The Committee for Public Education and Religious Liberty and several individual residents and taxpayers of New York sought to enjoin officials of the State of New York2 from approving or paying any funds or affording any tax benefits under the amendments on the ground that the amendments violated the establishment clause of the first amendment. A three-judge court in the Southern District of New York held that the sections of the Act which provided for maintenance and repair grants and tuition reimbursements were unconstitutional but upheld the sections relating to tax relief.3 On appeal, the Supreme Court affirmed the district court as to the unconstitutionality of the maintenance and repair grants and the tuition reimbursements but reversed as to the remainder, holding that the tax relief provisions had the primary effect of advancing religion and thus violated the establishment clause. Committee for Public Education & Religious Liberty v. Nyquist, 413 U.S. 756 (1973).

3. Id. at 655. The court decided the case without an evidentiary hearing, the judgment being rendered as to the constitutionality of each provision on its face. Judge Hays dissented from that portion of the court's opinion which held the tax relief constitutional. Id. at 674.
In August, 1971, the Pennsylvania General Assembly enacted the Parent Reimbursement Act for Nonpublic Education which provided for partial reimbursement of tuition paid by parents of children attending nonpublic schools. Residents and taxpayers of Pennsylvania challenged the law as violative of the establishment clause and sought to enjoin its enforcement. A three-judge district court held that the law was unconstitutional and granted a motion for summary judgment. On appeal, the Supreme Court affirmed, holding that the primary effect of the law would be the advancement of religion. Sloan v. Lemon, 413 U.S. 825 (1973).

The constitutional basis underlying the separation of church and state rests in the first amendment's provision that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof." The objective of these clauses has been said to be the avoidance of both religious domination or interference with politics and political domination or interference with religion. Their goals have also been characterized as voluntarism in matters of religion, mutual abstention of the political and religious caretakers, and govern-

5. The initial defendant was the State Treasurer of Pennsylvania. Several parents who had children attending nonpublic schools and were therefore entitled to receive reimbursements under the Act were allowed to intervene as defendants. Lemon v. Sloan, 340 F. Supp. 1356, 1358 (E.D. Pa. 1972).
6. Id.
7. The supporters of the Act had also presented an equal protection argument based on the theory that the sections relating to attendance at non-sectarian private schools were severable from those dealing with sectarian schools, permitting aid to the former and therefore violating the fourteenth amendment. The Court rejected the severability claim and described the remainder of the argument as spurious. Once the provisions have been held to violate the establishment clause, the inquiry is ended; the equal protection clause cannot be used to justify ignoring other constitutional provisions. 413 U.S. 825, 833-35.
8. Justice Powell wrote the majority opinion in both cases. Chief Justice Burger wrote a dissenting opinion in both Nyquist and Sloan in which Justice Rehnquist joined and Justice White joined in part, 413 U.S. 756, 798. Justice Rehnquist wrote a dissent to Nyquist in which he was joined by Chief Justice Burger and Justice White, Id. at 805. Justice White wrote an opinion dissenting to both cases in which he was joined in part by Chief Justice Burger and Justice Rehnquist, Id. at 813.
10. See generally L. PFEFFER, CHURCH, STATE AND FREEDOM (1967).
mental neutrality towards religion and among religions.\textsuperscript{11}

In many cases, some of these goals will conflict. In addition, a tension exists between the free exercise clause and the establishment clause if either is extended to its limit. These difficulties have led the Court to confess that it "can only dimly perceive the lines of demarcation in this extraordinarily sensitive area of constitutional law."\textsuperscript{12} Nevertheless, in applying the religion clauses to the cases which have come before it, the Court has developed a three-part test for determining if a challenged enactment is constitutional. First, the statute must have a secular legislative purpose.\textsuperscript{13} Second, the law's principal or primary effect must not be the advancement (or inhibition) of religion.\textsuperscript{14} Finally, the statute must not foster an excessive government entanglement with religion.\textsuperscript{15}

The question of aid to parochial schools has plagued the Court for a number of years. In \textit{Everson v. Board of Education},\textsuperscript{16} the Court upheld a New Jersey statute providing for reimbursement to parents of bus fares paid for transportation to and from both public schools and private, church-related schools. The Court admitted that this might provide some inducement for parents to send their children to private schools but noted that the law had a secular purpose (safety of the children), that no state funds were used for any religious activity, that the program was a general one not limited to parochial school children\textsuperscript{17} and that the payments went to the parents.

\textsuperscript{11} Freund, \textit{Public Aid to Parochial Schools}, 82 Harv. L. Rev. 1680, 1684 (1969). Voluntarism means simply that there should be no coercion toward or away from religion. As Justice Douglas wrote in \textit{Zorach v. Clauson}, each religious group should be allowed to "flourish according to the zeal of its adherents and the appeal of its dogma." 343 U.S. 306, 313 (1952). Mutual abstention expresses the philosophy that religion should be kept out of politics and politics should be kept out of religion. Governmental neutrality, in general, means that government will not favor one religion over another nor will it favor religion over non-religion. With the expanded role of government in the social order and in the lives of individuals, it is not always clear whether neutrality is best served by governmental inaction or by action which carefully avoids favoring any one group or idea.

\textsuperscript{12} Lemon v. Kurtzman, 403 U.S. 602, 612 (1971).
\textsuperscript{14} Id.
\textsuperscript{15} Lemon v. Kurtzman, 403 U.S. 602, 613 (1971).
\textsuperscript{16} 330 U.S. 1 (1947).
\textsuperscript{17} The Court stated in \textit{Everson} that the state could have chosen to pay only for the transportation of public school students. 330 U.S. 1. However, such an arrangement could constitute a denial of equal protection. A recent West Virginia Supreme Court case held just that.
rather than the school. Likewise, in *Board of Education v. Allen*,\textsuperscript{18} the Court upheld a program of government loans of textbooks to parochial school students. While it was admitted that the schools would receive some benefit, the restriction of the program to purely secular textbooks was held to prevent it from impermissibly aiding religion.

However, in *Lemon v. Kurtzman*,\textsuperscript{19} the Court ruled unconstitutional a Rhode Island program consisting of salary supplements for teachers of certain secular subjects and a Pennsylvania program of direct subsidy to private schools, covering their outlays for teachers’ salaries, textbooks and instructional materials in secular courses. Both programs contained features requiring supervision to insure that the funds supplied would be used only for secular purposes. Each was struck down on the ground that it would tend to cause excessive government entanglement with religion because of the need for continuing supervision and because of the expected political battles over the amount of aid to be given.

In *Tilton v. Richardson*,\textsuperscript{20} decided the same day as *Kurtzman*, the Court upheld a program of federal grants to colleges, including sectarian schools, for the purpose of constructing secular classrooms. The differences between college education and primary and secondary education (the greater freedom to question and the lack of religious indoctrination at the college level) were stressed in the decision, as was the restriction of the buildings to secular uses.

*Walz v. Tax Commission*,\textsuperscript{21} though not dealing with education, was also a significant precedent in the first amendment area. In that case, the Court upheld the traditional tax-exempt status of churches, emphasizing the long history of the exemption, the broad class of institutions which received such exemptions and the indirect nature of the benefit.

The legislation at issue in *Nyquist* and *Sloan* was designed in the hope of satisfying the tests the Court had imposed in its

\textsuperscript{18} 392 U.S. 236 (1968).

\textsuperscript{19} 403 U.S. 602 (1971).

\textsuperscript{20} 403 U.S. 672 (1971).

earlier decisions. For example, the only funds in either scheme which went directly to the schools were the New York maintenance and repair grants, and those funded a special program restricted to schools which educated primarily low-income children. All other aid was indirect, going to the parents of parochial school students rather than to the schools. This feature was probably designed in the hope that the Court would accept the “child-benefit” theory, which argues that aid given to the child or the parents (as in Everson and Allen) benefits them rather than the religious institution. In addition, much of the aid to parents in New York was given in the form of tax relief, probably in the anticipation that it would be sustained by reason of its similarity to the tax exemptions upheld in Walz.

In applying its three-part test of purpose, effect and entanglement to Nyquist and Sloan, the Court began by conceding that the purpose of the aid programs was secular. The states' interests in maintaining a healthy and safe environment for school children, in promoting pluralism and diversity, and in protecting already overburdened public school systems from a sudden influx of pupils were all held to be both legitimate and secular purposes. The entanglement issue was not reached in either case because each aid provision was invalidated on the ground that its primary effect would have been the advancement of religion.

The Court's analysis of the New York maintenance and repair grants focused on the absence of restrictions on the use of the money. The grants could have been applied to maintain facilities used for religious activities as well as those used only for secular activities. The Court distinguished Everson, Allen and Tilton, where financial aid had been upheld on the ground that the assistance in those cases went to the secular function of the school and the only benefit conferred upon the religious function was indirect (some parents might be encouraged to send their children to the religious school). In response, the state

22. The child-benefit theory has been widely discussed as a means of justifying aid to parochial schools. See, e.g., L. Pfeffer, Church, State and Freedom, 555-62 (1967); Areen, Public Aid to Nonpublic Schools: A Breach of the Sacred Wall? 22 Case W. Res. L. Rev. 239, 248-53 (1971); Choper, Aid to Parochial Schools, 56 Calif. L. Rev. 260 (1968).

On the other hand, the child-benefit theory has been sharply criticized for placing form over substance. One writer has compared it to the efforts by nineteenth century courts to classify pilotage laws as either regulations of safety or regulations of commerce but not both. See Freund, supra note 11, at 1682-83.

argued that since the grants could not exceed 50 percent of comparable public school expenditures, there was, in effect, a statistical guarantee that state money would not subsidize religion. This argument was based upon the assumption that an amount at least equal to the maximum allowable grant would be required for the purely secular functions of a school. In its rejection of the state's argument, the Court stated that "a mere statistical judgment will not suffice as a guarantee that state funds will not be used to finance religious education."\textsuperscript{24}

The New York tuition reimbursement plan failed for the same reasons as the maintenance and repair grants. The Court began its analysis by pointing out that the tuition reimbursement grants were unrestricted and thus would have been clearly unconstitutional if given directly to the schools. The only issue was whether giving them to the parents instead was a constitutionally significant difference. In holding that it was not, the Court emphasized that the grants were financial benefits conferred only because of attendance at a nonpublic school. As such, their effect was clearly to advance the religious purpose of those schools, regardless of who actually received the grant.

The state advanced several other arguments in support of tuition reimbursements, but the Court rejected each of them. First, the state argued that the grant's reimbursement feature was controlling: because the parent was free to use the money as he or she saw fit, the parent would not be a mere conduit carrying the money from the state to the parochial school. The Court responded that it made no significant difference whether the payments were made before or after the actual outlay for tuition or where the actual tax dollars eventually came to rest. Because the grant was a financial incentive for parents to send their children to nonpublic schools, the label given to the program was irrelevant. The state also advanced an argument based upon a statistical guarantee of secular use similar to that discussed by the Court in its analysis of the maintenance and repair grants, and the Court rejected it for the same reasons. Finally, the state argued that since tuition reimbursements were granted only to low-income parents, their actual effect was to promote the free exercise of religion by making it possible for such parents to choose to send their children to religious schools. The Court pointed to the inevitable tension between the free exercise and establishment clauses and simply stated

\textsuperscript{24} Id. at 778.
that this program crossed the line into the area of advancing religion. The Pennsylvania program challenged in Sloan was substantially the same as the New York tuition reimbursement plan and was rejected for the same reasons.

New York's tax relief provisions were also voided because of their primary effect. The Court examined the program and found that it was not substantially different from the tuition reimbursement plan: in the latter, an actual cash payment was made, while in the former, the amount that would otherwise be owed to the state was reduced. As the dissenting judge below had said: "In both instances the money involved represents a charge made upon the state for the purpose of religious education." An attempt to apply the child-benefit theory to tax relief was rejected for the same reasons it was rejected when advanced in support of tuition reimbursement. The tax exemptions granted in Walz were distinguished on three grounds: the long history of such exemptions compared to the recent nature of attempts to aid parochial schools, the broad class of institutions which were exempt under the provisions upheld in Walz compared with the almost exclusively religious character of the schools benefited by the New York statute, and the fact that the tax exemptions in Walz were upheld primarily because they tended to prevent entanglement while the tax relief provisions would encourage it.

In the two cases, three dissenting opinions were filed. Chief Justice Burger agreed that the maintenance and repair grants were unconstitutional but would have upheld the tuition reimbursement and tax relief schemes. His dissent was based on the child-benefit theory, and he also relied on a case upholding government payments of Indian trust funds to sectarian schools. Recognizing that the religion clauses can conflict, he stated that "the balance between the policies of free exercise and establishment of religion tips in favor of the former when the legislation moves away from direct aid to religious institutions and takes on the character of general aid to individual families." He also analogized the types of aid in question to other governmental aid to individuals, such as "GI Bill" bene-

fits and Social Security payments, which may be used for any purpose, including a religious purpose. Finally, he accused the majority of judging the effect of the program by the number of recipients choosing to use its benefits for religious purposes, a factor which he believed irrelevant to the constitutional question.

Justice Rehnquist also agreed with the majority's position on the maintenance and repair grants but dissented from the remainder of their opinion, concentrating on Walz as a precedent for upholding the tax relief provisions. In his opinion, there was a qualitative difference between a direct subsidy and a plan of tax relief since only the former involves a transfer of public funds. The long history of tax exemptions cited in Walz should not serve to distinguish that case from Nyquist, he argued, because the age or novelty of a scheme should not affect its constitutionality. He believed that no matter how the New York plan was characterized, it was still abstention from taxation and, therefore, on the same theoretical footing as the tax exemption upheld in Walz.

Justice White dissented in an opinion which focused on the importance of parochial schools and which pointed out that decisions concerning aid to parochial schools have a broad effect on church-related education. His main thesis was that because society is reaping a great benefit from nonpublic schools, both from the reduction in the cost of operating the public schools and from the diversity fostered by nonpublic schools, society should alleviate the burden on parents who send their children to such schools.

It is interesting to compare the analyses of the majority and the dissenters in terms of voluntarism and neutrality, two of the suggested policy goals for the religion clauses. Justice Powell, writing for the majority, examined the programs primarily for their effect upon voluntarism; Chief Justice Burger,

29. Id. at 805. Chief Justice Burger and Justice White joined in Justice Rehnquist's dissent.

30. Id. at 824. Chief Justice Burger and Justice Rehnquist joined in Justice White's opinion insofar as it related to the tuition reimbursement and tax relief provisions.

31. Over five million elementary and secondary students were enrolled in nonpublic schools in 1972. In the large, industrial cities of the North, 20 to 30 percent of the school-age population is often enrolled in private schools. Such schools, however, have experienced a substantial drop in enrollment which has been attributed primarily to the increasing cost of nonpublic education. Id. at 814-18.

32. See note 11 supra and accompanying text.
in dissent, focused more on a neutrality argument. Because the majority and dissent started from different (though unstated) policy bases, their arguments sometimes failed to directly clash. What is apparent, however, is that a clear majority of the Court in dissent accepted Justice Powell's theoretical base of voluntarism and rejected any distinction grounded solely upon whether the benefit goes to an individual or to the religious school. This acceptance of voluntarism as the primary concern explains the majority's emphasis on looking at the substance of the tuition reimbursement plan. Regardless of whether the money is given to the school or the parents, the majority viewed it as a financial benefit contingent upon attendance at a nonpublic school. All taxpayers are thus being forced to contribute toward something which should be financed only by those believing in the religious mission of the school.

Chief Justice Burger, on the other hand, compared the tuition reimbursement with other types of aid which were accepted at least in part because of their neutrality. For example, in Everson, the state had a general program of providing bus transportation for students. The establishment clause did not require that the state deny such general benefits to parochial school students. It could be "benevolently neutral" in providing the service, just as it is in providing churches with police and fire protection. Chief Justice Burger argued that the states in Nyquist and Sloan were doing no more than avoiding the hostility to religion which would exist in a policy which denied the benefits of a state program of education to parents whose religion impels them to send their children to church-related schools.

These decisions indicate that the future of aid to nonpublic schools is not bright. The child-benefit theory has failed to win the acceptance of a majority of the Court, as has the theory that a tax benefit is inherently different from a direct subsidy.

34. As the majority said in Sloan:
[W]e look to the substance of the program, and no matter how it is characterized its effect remains the same. The State has singled out a class of its citizens for a special economic benefit. Whether that benefit be viewed as a simple tuition subsidy, as an incentive to parents to send their children to sectarian schools, or as a reward for having done so, at bottom its intended consequence is to preserve and support religion-oriented institutions.
35. No justice chose to draw a constitutionally significant distinc-
One point upon which the majority placed considerable emphasis, however, was the narrowness of the benefited class in each case as compared to the broad benefited classes in Everson, Allen and Walz. This analysis rests primarily on the neutrality principle: if widespread benefits are conferred, they need not be denied to churches. Hence, legislation benefitting a class broader than just nonpublic, primarily Catholic schools will probably be tried as a constitutional means of aiding parochial schools. The breadth of the class benefited by such legislation would be subject to very strict scrutiny, however.\(^5\)

Another type of aid which might be acceptable is a shared-time arrangement in which parochial school students are part-time students in public school, receiving some of their secular education there.\(^2\) Such a program might have to be held in two separate buildings in order to avoid confusing the authority of church and state, but it does have the advantage of providing distinctly secular benefit without much administrative entanglement between church and state. Some form of tax benefit may also be possible since the Court commented that it was not ruling on several such benefits.

Since the program here does not have the elements of a genuine tax deduction, such as for charitable contributions, we do not have before us, and do not decide, whether that form of tax benefit is constitutionally acceptable under the "neutrality" test in Walz.\(^5\)

Ingenious plans for aiding parochial schools have periodically reached the Supreme Court. It probably can be expected that plans such as those discussed here and others will be de-

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36. A recent Ohio case struck down a program of tax benefits which allowed the benefits not only to parents of nonpublic school students but also to persons in home instruction programs, public adult high school continuation programs, schools for tubercular persons, vocational and basic literacy programs, persons who pay tuition at public schools because they are nonresidents and persons who pay tuition at public or private schools because they are deaf, blind, crippled, emotionally disturbed, neurologically handicapped or mentally retarded. However, the court noted that the largest of the groups other than nonpublic school students consisted of only 20,000 members. Kosydar v. Wolman, 353 F. Supp. 744 (S.D. Ohio 1972), aff'd sub nom. Grit v. Wolman, 413 U.S. 901 (1973).


38. 413 U.S. 756, 790 n.49 (1973).
vised in the future. However, the possible scope of such plans has been sharply narrowed by the Court’s decision in Nyquist and Sloan. Any plan which provides significant aid to parochial schools will have to be ingenious indeed if it is to withstand the scrutiny of the establishment clause as presently interpreted.
Indian Law: The Application of the One-man, One-vote Standard of *Baker v. Carr* to Tribal Elections

Appellees, members of the Standing Rock Sioux Tribe, sought an order enjoining a general tribal election and requiring reapportionment of the elective districts of the Standing Rock Indian Reservation. They alleged that since substantial population variations existed among the districts, the districts did not “fairly and accurately represent the population distribution” of the reservation. The United States District Court for the District of North Dakota issued a temporary restraining order enjoining the Tribal Council from holding the tribal election. The United States Court of Appeals for the Eighth Circuit, while reversing on the narrow ground that there was no evidence in the record which actually showed that the districts were misapportioned,² held per curiam that the equal protection clause in the Indian Civil Rights Act³ included

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1. White Eagle v. One Feather, 478 F.2d 1311, 1312 (8th Cir. 1973).
2. The court commented:
   Reliance was had at trial upon figures of votes cast in the September 1971 election for Chairman of the Standing Rock Sioux Tribal Council, submitted also in affidavit form to the District Court, but the report reflects votes cast, not population figures, and the correlation between the two was problematical at best. While we recognize the intimation in the record of difficulty in obtaining population figures for the tribe, nevertheless the controlling factor, the *sine qua non*, in apportionment determinations must be that of population, *Reynolds v. Sims*, 377 U.S. 533, 568 . . . (1964), as nearly as such may be determined in the light of all available sources of information. 478 F.2d at 1315. *See also Brown v. United States*, 486 F.2d 658 (8th Cir. 1973).
   No Indian tribe in exercising powers of self-government shall—
   (1) make or enforce any law prohibiting the free exercise of religion, or abridging the freedom of speech, or of the press, or the right of the people peaceably to assemble and to petition for a redress of grievances;
   (2) violate the right of the people to be secure in their persons, houses, papers, and effects against unreasonable search and seizures, nor issue warrants, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched and the person or thing to be seized;
   (3) subject any person for the same offense to be twice put in jeopardy;
   (4) compel any person in any criminal case to be a witness against himself;
   (5) take any private property for a public use without just compensation;
   (6) deny to any person in a criminal proceeding the right
the one-man, one-vote standard first enunciated in Baker v. Carr.\(^4\) White Eagle v. One Feather, 478 F.2d 1311 (8th Cir. 1973).\(^5\)

Although Congress has plenary power to legislate for Indian tribes and to govern Indians,\(^6\) the federal courts have long recognized the right of Indian tribes to control internal tribal affairs.\(^7\) In light of this recognition, the courts have expressly exempted tribal governments from any constitutional restraints in their exercise of power over tribal members.\(^8\) However, in

to a speedy and public trial, to be informed of the nature and cause of the accusation, to be confronted with the witnesses against him, to have compulsory process for obtaining witnesses in his favor, and at his own expense to have assistance of counsel for his defense;
(7) require excessive bail, impose excessive fines, inflict cruel and unusual punishments, and in no event impose for conviction of any one offense any penalty or punishment greater than imprisonment for a term of six months or a fine of $500, or both;
(8) deny to any person within its jurisdiction the equal protection of its laws or deprive any person of liberty or property without due process of law;
(9) pass any bill of attainder or ex post facto law; or
(10) deny to any person accused of an offense punishable by imprisonment the right, upon request, to a trial by jury of not less than six persons.


5. The Tribal Council was required by the court to adopt a reapportionment plan consistent with the one-man, one-vote standard.


8. See, e.g., Talton v. Mayes, 163 U.S. 376 (1896); Native Am. Church of N. America v. Navajo Tribal Council, 272 F.2d 131 (10th Cir. 1959). Contra, Colliflower v. Garland, 342 F.2d 369 (9th Cir. 1966) (this decision has not been followed).
1968 Congress enacted an Indian Bill of Rights. Whereas courts had been unwilling to find constitutional restrictions on tribal power, Congress imposed specific restraints on tribal governments which consisted almost entirely of language excerpted from the United States Constitution. This use of constitutional language has presented a serious problem of statutory interpretation. It is not clear whether the use of constitutional language requires modification of tribal governmental procedures and laws to comply fully with the same constitutional standards as they are imposed on state and federal governments.

Although the federal government's Indian policy has historically fluctuated widely between protection of tribal existence and assimilation, the legislative history of the Indian Bill of Rights does not suggest that Congress intended to use the statute as an instrument for altering tribal cultural attitudes in order to facilitate the assimilation of Indians into the non-Indian community. In fact, the report of the committee investigating the bill favored the preservation of tribal communities as self-governing, culturally autonomous entities. The final bill, as passed, contains explicit provisions implementing this policy.

9. For the relevant parts of the statute see note 3 supra.
10. See, e.g., Groundhog v. Keeler, 442 F.2d 674, 678 (10th Cir. 1971); Native Am. Church of N. America v. Navajo Tribal Council, 272 F.2d 131, 134 (10th Cir. 1959).
11. The Indian Civil Rights Act incorporates guarantees found in the United States Constitution with regard to certain basic liberties, including due process, equal protection, free exercise of religion, freedom of speech and safeguards during criminal proceedings. See note 3 supra.
13. For example, the committee frequently asked witnesses during the hearings whether the imposition of criminal procedural standards would be too heavy a burden on the tribal courts. See, e.g., Hearings on Constitutional Rights of the American Indian Before the Subcomm. on Constitutional Rights of the Senate Comm. on the Judiciary, 87th Cong., 1st Sess., pt. 1, at 99, 147 (1962), 87th Cong., 1st Sess., pt. 4, at 873-75 (1964). In McCurdy v. Steele, 353 F. Supp. 629, 633 (D. Utah 1973), the court stated:
[T]he Senate committee deleted restrictions contained in the proposed statute upon the establishment of religion and the use of racial voting classifications when it appeared that the first restriction would undermine Indian theocracies and the second would undermine tribal cultural autonomy generally.
14. The Indian Civil Rights Act, 25 U.S.C. §§ 1321(a), 1322(a) (1970), requires tribal consent for state assumption of criminal and civil jurisdiction. In addition, § 1322(c) stipulates that
[a]ny tribal ordinance or custom heretofore or hereafter
The majority of federal court decisions since 1968 have concluded that Congress intended to preserve the ethnic and cultural autonomy of Indian tribes and have attempted to evolve standards that will reconcile protection of fundamental individual rights as defined by Anglo-American experience with essential tribal values. In the context of tribal elections, the courts have recognized that congressional exclusion of fifteenth amendment guarantees of the right to vote was mandated by a desire to protect the ethnic identity of Indian tribes from charges of racial discrimination and to protect existing tribal governmental structure from attacks designed to initiate an election process where none existed. For example, in *Groundhog v. Keeler* the Tenth Circuit held that by Congress' express exclusion of the provisions of the fifteenth amendment from the Indian Civil Rights Act, "any basis of federal court jurisdiction over tribal elections was definitely eliminated." However, that holding was limited in *McCurdy v. Steele,* where the district court found "no indication of congressional purpose to allow tribal governments to ignore their own election rules by exempting them from the equal protection and due process guarantees of the Indian Civil Rights Act."

The court in *White Eagle* used reasoning similar to that employed in *McCurdy* when it concluded that since the Standing Rock Sioux Tribe "has established voting procedures pre-adopted by an Indian tribe, band, or community in the exercise of any authority which it may possess shall, if not inconsistent with any applicable civil law of the State, be given full force and effect in the determination of civil causes of action pursuant to this section.

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16. 442 F.2d 674 (10th Cir. 1971) (descendants of enrolled citizens of the Cherokee Nation sought a judgment declaring that an appointment to the office of Principal Chief of the Tribe was illegal).

17. *Id.* at 682.


19. *Id.* at 635.
cisely paralleling those commonly found in our [Anglo-American] culture," the principle of Baker v. Carr must be incorporated to secure "fair compliance with the tribe's own voting procedures." In so holding, the court apparently assumed that since the tribal election laws resemble those of Anglo-American culture to the extent that tribal officials are elected to represent individual districts, the tribal laws must also resemble Anglo-American election laws to the extent that the one-man, one-vote standard of Anglo-American culture can be assumed to be a part of the tribal law.

It is questionable, however, whether the court actually obtained fair compliance with the Standing Rock Sioux Tribe's own voting procedures when it held that the tribe must comply with the one-man, one-vote standard. The tribe's constitution both enumerated the voting districts whose validity was questioned and gave the Tribal Council, with the approval of the Secretary of the Interior, the power "[t]o enlarge or diminish the number of districts to meet future needs." Although the facts are silent on this point, the Tribal Council, based on statutorily justifiable reasons, may have intended to have voting districts of unequal population. For example, tribes of different ethnic and linguistic backgrounds have been grouped together for political and administrative purposes. In these cases election districts can validly be apportioned on an ethnic as distinctly opposed to a population basis. Thus the court in White Eagle, far from merely enforcing existing tribal election procedures, may have in fact created a new procedure, even though such a task is normally performed by a legislative body and not by the courts.

There has been considerable speculation as to the effect that the application of the one-man, one-vote standard to tribal

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21. 478 F.2d 1311, 1314 (8th Cir. 1973).
22. STANDING ROCK SIoux TRIBE CONST. art. III, § 2.
23. STANDING ROCK SIoux TRIBE CONST. art. IV, § 1(s).
24. FEDERAL INDIAN LAW, supra note 6, at 459.
25. Reapportionment, although not a political question in the strict Baker v. Carr sense of the term (i.e., "demonstrable constitutional commitment of the issue to a coordinate political department," Baker v. Carr, 369 U.S. 216, 217 (1962)), is nevertheless primarily a matter for legislative consideration. Federal courts usually do not intervene unless the legislative body has failed to apportion in a timely fashion according to law. In apportionment cases involving tribal governments, with the additional considerations of cultural autonomy and separate values, the courts should be even more reluctant to usurp this legislative function.
elections would have on tribal governments.\textsuperscript{26} While the application of the \textit{Baker v. Carr} standard as espoused in \textit{White Eagle} will not impinge greatly upon tribal cultural autonomy where the tribe purports to have a council elected by the people from equal population districts, there may be situations in which there has been significant and deliberate deviation from the equal population standard.\textsuperscript{27} Since tribes are ethnically distinct communities, courts should avoid using a rule of presumptive illegality in determining the fairness of council representation in such situations.\textsuperscript{28} In this regard, a determination of whether tribal remedies were exhausted should have been a threshold consideration in \textit{White Eagle}.\textsuperscript{29} Recent case law has required that plaintiffs first exhaust all remedies available within the tribal governmental framework before seeking relief from the federal courts and has recognized that a general exhaustion requirement would do much to strengthen tribal governments by “aid[ing] the reservation Indian in maintaining a distinct cultural identity.”\textsuperscript{30} In the instant case, ini-

\textsuperscript{26} In fact, Congress did consider the effect of incorporating \textit{Baker v. Carr} into tribal elections. Marvin J. Sonosky, appearing on behalf of tribes in Montana, North Dakota and Wyoming, testified:

Reapportionment on the basis of one man, one vote would probably result in abolishing all districts and election of members of governing bodies at large. I hesitate to forecast the disruptive effects on stable tribal governments. \textit{Hearings on S. 961-68 and S.J. Res. 40 Before the Subcomm. on Constitutional Rights of the Senate Comm. on the Judiciary, 89th Cong., 1st Sess. 131 (1965). See also Reiblich, Indian Rights under the Civil Rights Act of 1968, 10 Ariz. L. Rev. 617, 632 (1968); Note, supra note 12, at 1360-61.}

\textsuperscript{27} See text accompanying note 24 supra.

\textsuperscript{28} See Note, supra note 12, at 1360-61. In the instant case there is no evidence in the record, nor are there any allegations in the Briefs, that the districts represent distinct tribes or ethnic groups. However, the Tribal Constitution, in referring to the “local Council” of each district, provides a preliminary indication that the enumerated districts function as separate communities within the tribe. Also, if distinctive differences can be shown among the districts, the tribe’s argument for retention of the status quo would be strengthened considerably. See \textit{Standing Rock Sioux Tribe Const.} art. V., § 5.

\textsuperscript{29} Whether the appellees ever sought a remedy from the tribal government is not clear. While appellees alleged that they had made repeated efforts to obtain a revision of the voting districts and that both the Tribal Council and the Tribal Court had refused to consider their requests, appellants contended that one-man, one-vote was never raised as an issue before the tribal government until they were served with a restraining order the day before the general election was to be held. Answering Brief for Appellees at 4, 5; Reply Brief for Appellants at 15.

\textsuperscript{30} \textit{O’Neal v. Cheyenne River Sioux Tribe}, 482 F.2d 1140, 1148 (8th Cir. 1973). The Court in \textit{O’Neal} stated that “the adoption of the Indian
tial review by the tribal government might have provided the additional evidence necessary to determine whether the tribe's election structure was intended to incorporate equal population districts or whether tribal culture dictated districts based on other factors.

The reasoning in *White Eagle* raises several additional problems for the future. Tribal councils on some reservations are appointed, not elected. Certain tribes presently deny women the right to vote, and others exclude some adult males from participating in the election of tribal leaders. Application of equal protection standards developed for Anglo-American communities to these situations would result in considerable modification of existing tribal culture.

In examining the development of the Indian Civil Rights Act, it becomes clear that a limited construction of the statutory provisions is required. The Act does not authorize

Bill of Rights was not meant to detract from the generally recognized policy, stated in the *Williams* case, of preserving the 'authority of the tribal courts . . ." Id. at 1146. *See also Williams v. Lee,* 358 U.S. 217, 223 (1959). However, exhaustion is not an inflexible requirement; exceptions to the rule have been allowed. McCurdy v. Steele, 353 F. Supp. 629 (D. Utah 1973); Dodge v. Nakai, 298 F. Supp. 17 (D. Ariz. 1968). In O'Neal v. Cheyenne River Sioux Tribe, supra at 1146, the court found that a "balancing process" was needed under which "the need to preserve the cultural identity of the tribe by strengthening the authority of the tribal courts, [must be weighed] against the need to immediately adjudicate alleged deprivations of individual rights."

31. Reiblich, supra note 26, at 632.

32. In matters involving tribal governments, courts must make a threshold inquiry into the impact legislation might have on the Indian culture—how it will affect their cultural autonomy, their desire for tribal harmony, and their status as a self-governing community. Where it appears that an interpretation will interfere with a strong preexisting legislative policy, e.g., preserving Indian cultural autonomy, courts should examine the legislative record to determine whether the legislature intended the result. Thus courts should realize that reading some of the provisions of the Indian Civil Rights Act to mean that the same standards apply to Indian tribes as apply to state and federal governments would seriously undermine the tribes' capacity for survival. For example, the prohibition against racial discrimination as applied to Indian tribes might require equal access to reservation resources for cultural foreigners, thereby substantially undercutting the tribe as an ethnic unit. *See H.M. Hart & A. Sacks, The Legal Process: Basic Problems in the Making and Application of Law* 1144-1417 (tent. ed. 1958), as discussed in Note, supra note 12, at 1354.

For instances in which federal courts have intervened in tribal elections see *Groundhog v. Keeler,* 442 F.2d 674 (10th Cir. 1971); McCurdy v. Steele, 353 F. Supp. 629 (D. Utah 1973). *See also Luxon v. Rosebud Sioux Tribe of S.D.*, 455 F.2d 698 (8th Cir. 1972) (the court held that the district court had jurisdiction of an action by an enrolled member of the Rosebud Sioux Tribe for a declaration that a provision of the
courts to apply broadly such elusive and expanding standards as equal protection and due process without a sensitive regard for their impact upon tribal structures and values.\textsuperscript{33} Since plenary power over Indian affairs rests with Congress, federal judges should refrain from exercising broad powers to establish policy.\textsuperscript{34}

The task for the courts, therefore, is not one of weighing common law standards against Indian standards or of synthesizing Indian law and common law. In a non-Indian tribunal it is unlikely that a proper balance will be struck. Instead, where internal tribal affairs are concerned, the courts should treat tribal law and tribal decisions with special deference. To do otherwise is to jeopardize the continued effectiveness of tribal governments as institutions designed to effectuate distinctly Indian cultural values.\textsuperscript{35} Furthermore, courts should be careful not to apply White Eagle to situations in which neither Congress nor the court in White Eagle meant it to apply.\textsuperscript{36} Proper regard for the legislative history of the Indian Civil Rights Act and for judicial decisions calling for an examination of the particular culture of the subject tribe, as well as for

\begin{footnotesize}
\begin{enumerate}
\item[33.] The court in Groundhog v. Keeler, 442 F.2d 674, 682 (10th Cir. 1971), pointed out that the report of the Senate Subcommittee on the Judiciary makes it clear that Congress intended that the provisions of the fifteenth amendment, certain procedural provisions of the fifth, sixth and seventh amendments, and in some respects the equal protection requirement of the fourteenth amendment should not be embraced in the Indian Bill of Rights.
\item[34.] For an argument that judicial restraint is justified by an historical analysis of the relationships between the Indian and the non-Indian, see Burnett, \textit{An Historical Analysis of the 1968 Indian Civil Rights Act}, 0 Harv. J. Lecz. 557, 621-22 (1972).
\item[35.] Cf. O'Neal v. Cheyenne River Sioux Tribe, 482 F.2d 1140, 1146 (8th Cir. 1973).
\item[36.] The court in White Eagle pointed out:

\begin{quote}
We need not explore upon this record the degree to which federal courts may assert jurisdiction over tribal elections in all circumstances. Our problem has no such complexities as tribal membership or blood lines.
\end{quote}

\end{enumerate}
\end{footnotesize}
the requirement that tribal remedies be explored first, should limit *White Eagle* to situations where the tribe itself purports to have a council elected by the people from equal population districts. To the extent that federal courts do not require concrete evidence as to Indian culture before expanding the scope of the guarantees of the Indian Civil Rights Act, non-Indians will again be in the position of imposing external values upon Indian tribes in contravention of the express congressional policy of recognizing Indian tribes as internally sovereign.37

Insurance: "Other Insurance" Clauses Purporting to Limit Recovery Under Uninsured-Motorist Coverage Void as Repugnant to Statute

Plaintiffs owned four motor vehicles, each of which was covered by a separate insurance policy issued by defendant. Each policy provided uninsured-motorist protection with a limit of $10,000 per person as required by Minnesota statute. Each policy further provided that if more than one insurance policy was applicable to an accident, the total damages recoverable by the insured would not exceed the amount which would have been recoverable under the single policy with the highest limits—in this case $10,000. Plaintiff’s injuries resulted from an accident while riding as a passenger with an uninsured motorist and were determined by an arbitrator to be $33,000. Defendant attempted to limit the recovery to $10,000 in accordance with the restrictive “other insurance” clauses of the policies. Plaintiffs sought and obtained a declaratory judgment that the “other insurance” provisions were void, and the trial court ordered judgment in the amount of $33,000. The Minnesota Supreme Court affirmed, holding that such provisions were void as repugnant to the statute. Van Tassel v. Horace Mann Insurance Co., — Minn. —, 207 N.W.2d 348 (1973).

Van Tassel was the first Minnesota case to raise the issue of whether a statute requiring uninsured-motorist coverage in specified minimum limits in every policy denies an insurer the right to restrict recovery to the limits of a single policy when more than one policy applies to an accident. However, the Minnesota statute and the “other insurance” clauses of the in-

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2. Plaintiff Theodore Van Tassel was personally involved in the accident and was awarded $21,000. His father, plaintiff Beltram Van Tassel, was awarded $12,000 with respect to his derivative claim.
3. Clauses purporting to reduce recovery by the amount previously paid for medical expenses pursuant to separate provisions of two of the policies were also held to be repugnant to the statute and void. In a companion case, Pleitgen v. Farmers Ins. Exch., — Minn. —, 207 N.W.2d 535 (1973), the Van Tassel rule was applied to a somewhat different factual situation, discussed in note 5 infra. Subsequently, in Brunmeier v. Farmers Ins. Exch., — Minn. —, 208 N.W.2d 860 (1973), the court invalidated a provision purporting to reduce recovery under uninsured-motorist coverage by the amount paid under workmen’s compensation.
4. No automobile liability or motor vehicle liability policy of insurance insuring against loss resulting from liability imposed
in the instant case are typical of those which have been the subject of litigation in other jurisdictions. These restrictive clauses survived the earliest challenges, but beginning with Virginia in 1965, some 25 state courts have invalidated such clauses on statutory grounds, and presently only a few by law for bodily injury or death suffered by any person arising out of the ownership, maintenance or use of a motor vehicle shall be delivered or issued for delivery in this state with respect to any motor vehicle registered or principally garaged in this state unless coverage is provided therein or supplemental thereto, under provisions approved by the commissioner of insurance, for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles, including colliding motor vehicles whose operators or owners are unknown or are unidentifiable at the time of the accident, and whose identity does not become known thereafter, because of bodily injury, sickness or disease, including death, resulting therefrom . . . . The policy limits of the coverage required to be offered by this section shall be as set forth in [the Safety Responsibility Act, Minn. Stat. § 170.25(3) (1971), which specifies limits of $10,000 “for one person” and $20,000 “in any one accident”].

The policy limits of the coverage required to be offered by this section shall be as set forth in [the Safety Responsibility Act, Minn. Stat. § 170.25(3) (1971), which specifies limits of $10,000 “for one person” and $20,000 “in any one accident”].

The amendments are discussed in the text accompanying notes 43-46 infra.

5. The contract provided in pertinent part as follows:

With respect to bodily injury to an insured while occupying an automobile not owned by the named insured, the insurance under Part IV [relating to uninsured-motorist coverage] shall apply only as excess insurance over any other similar insurance available to such insured and applicable to such automobile as primary insurance, and this insurance shall then apply only in the amount by which the limit of liability for this coverage exceeds the applicable limit of liability of such other insurance. ["Excess-escape" clause]

Except as provided in the foregoing paragraph, if the insured has other similar insurance available to him and applicable to the accident, the damages shall be deemed not to exceed the higher of the applicable limits of liability of this insurance and such other insurance, and the company shall not be liable for a greater proportion of any loss to which this coverage applies than the limit of liability hereunder bears to the sum of the applicable limits of liability of this insurance and such other insurance. ["Prorata" clause]

— Minn. at —, 207 N.W.2d at 349-50. Identical clauses are used throughout the insurance industry. See Donaldson, Uninsured Motorist Coverage, 36 Ins. Counsel J. 397, 423-24 (1969). The "prorata" provision was involved in Van Tassel, while the "excess-escape" provision was the subject of the companion case, Pleitgen v. Farmers Ins. Exch., — Minn. —, 207 N.W.2d 535 (1973). The court reached the same result in both cases, observing that "for all practical purposes the legal issues are the same." Id. at —, 207 N.W.2d at 537. This observation is evidently shared by courts in other jurisdictions since the two situations have never been distinguished for purposes of analysis.


7. E.g., Sellers v. United States Fidelity & Guar. Co., 185 S.2d
states enforce clauses denying multiple recovery. Thus, Minnesota has adopted what has become the majority view. Specifically relying on recent decisions in Michigan and Nebraska, the court in Van Tassel employed both of the arguments which have prevailed in the majority jurisdictions. First, since the insured has paid four premiums for four policies, the insurer should not deny him the benefit of “what he paid for on each policy.” Second, by making minimum uninsured-motorist protection mandatory in every policy, the statute forbids attempts to limit that protection by means of “other insurance” clauses. Because of this dual rationale, it is possible to ana-


8. See, e.g., Lyon v. Hartford Accident and Indemn. Co., 25 Utah 2d 311, 480 P.2d 739 (1971); Morelock v. Millers’ Mut. Ins. Ass’n, 49 Ill. 2d 234, 274 N.E.2d 1 (1971); Maryland Cas. Co. v. Howe, 106 N.H. 422, 213 A.2d 420 (1965). The view generally taken in these jurisdictions is that it is anomalous to permit the victim of a negligent uninsured motorist to recover more than he would have been entitled to if the tortfeasor had been insured for the statutory minimum amounts:

The design and purpose of the uninsured motorist statute was to provide protection only up to the minimum statutory limits for bodily injury caused by financially irresponsible motorists. The statute was not designed to provide the insured with greater insurance protection than would have been available had the insured been injured by an operator with a policy containing minimum statutory limits.

Maryland Cas. Co. v. Howe, 106 N.H. at 424, 213 A.2d at 422. For a further discussion of difficulties with the majority view, see notes 47 and 48 infra.


11. The court stated:

It seems to us that, in spite of the attempt by the insurer to limit its liability to one policy or to the amount recoverable under one policy, the fact that the legislature required an uninsured-motorist provision in all policies, added to the fact that a premium has been collected on each of the policies involved, would result in the policyholder’s receiving what he paid for on each policy, up to the full amount of his damages. It is true that such holding results in permissible recovery exceeding what he would have received if the uninsured motorist had been insured for the minimum amount required under our Safety Responsibility Act. But if the question must be resolved on the basis of who gets a windfall, it seems more just that the insured who has paid a premium should get all he paid for rather than that the insurer should escape liability for that
lyze the Van Tassel holding from two perspectives—interpretation of the contract or interpretation of the statute.

Interpretation of the contract becomes important because of the emphasis in recent cases, as summarized by the Van Tassel court, on "the policyholder's receiving what he paid for on each policy." In determining what the insured has "paid for," however, it is necessary to look beyond a formalistic proportion between premiums and recovery in a specific accident to the entire range of hazards against which the premiums are intended to purchase protection. In Van Tassel, a semiannual premium of two dollars was paid for uninsured-motorist protection under each of plaintiffs' four policies. Thus, plaintiffs were paying eight dollars every six months for $10,000 of coverage on each of four vehicles. In contrast to this, it was developed by plaintiffs' counsel at trial that $50,000 of coverage on one automobile was available from defendant for a semiannual premium of $5.50. It is at precisely this point that the superficial use of arithmetic confuses the issue. Since four times $10,000 is $40,000, it might appear that plaintiffs were buying $40,000 of protection for $8.00 while they could have had $50,000 of protection for only $5.50. Indeed, plaintiffs' counsel employed these very figures, summarizing the evidence as an illustration that "the single policy of uninsured-motorist coverage with limits of $50,000-$100,000 would provide $10,000 more coverage to persons in plaintiffs' situation at a cheaper price than that paid by plaintiffs." This implies that the insurance company is getting a windfall even if its liability is limited to $40,000 under the four policies, and that a fortiori it is unjust to limit liability to a mere $10,000. However, such reasoning is specious: quadruple depth of coverage ($40,000 on one vehicle) is not as costly to the insurer as quadruple breadth of coverage ($10,000 on four vehicles). The reason lies in the relative infrequency of large claims. It is no more costly for an insurer to pay a small claim

for which it collected a premium.

— Minn. at —, 207 N.W.2d at 351-52.
12. Id. at —, 207 N.W.2d at 352. Indeed, an examination of the recent decisions purporting to reach a result compelled by the statute discloses that they are actually based to a large extent on the rather obvious common law principle that a person ought to receive what he has "paid for." This dual rationale produces the awkward result discussed in note 48 infra.
15. Brief for Appellee at 3.
16. At the trial, an insurance analyst from the state insurance do-
on a small policy than on a large policy. Thus, increases in premiums are not ordinarily proportional to increases in policy limits which increase depth of coverage on one item.\textsuperscript{17}

On the other hand, it should be expected that premiums will increase (as in the instant case) in approximate proportion to the expanded breadth of coverage, measured by increases in the number of items insured. Since a different motor vehicle was identified in each policy in Van Tassel,\textsuperscript{18} it is clear that defendant-insurer agreed to be exposed to the risks associated with the operation of any or all of them. It may reasonably be expected that four vehicles would receive more use than only one and that exposure to risk would increase roughly proportionally to that increase in use. This increased exposure is what defendant undertook in consideration of plaintiffs' payment of the multiple premiums.

The determination of what the insured has "paid for" need not produce identical results in every case.\textsuperscript{19} Regarding any given level of recovery when all claims are aggregated, it should

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
Limits of coverage & Basic annual & Basic annual \\
& per person/ & bodily injury & uninsured-motorist \\
& per accident & liability premium & coverage premium \\
$10,000/$20,000 & $49.00 & $5.00 \\
$25,000/$50,000 & $60.00 & $7.00 \\
$50,000/$100,000 & $66.00 & $9.00 \\
$100,000/$300,000 & $73.00 & $11.00 \\
\hline
\end{tabular}
\caption{Insurance Services Office, Private Passenger Automobile Manual, Minnesota 1, E-1, E-3 (1972).}
\end{table}

Transcript of Proceedings at 37.

17. For example, the following basic passenger automobile rates (before adjustments for age of drivers, distance driven to work, etc.) are presently used to compute premiums in Minnesota territory O1:


19. There is no guarantee, for example, that the members of a four-car family will be on the road exactly four times as much as if they owned only one vehicle. Similarly, ownership of four vehicles does not necessarily quadruple one's risk of injury while riding as a passenger in an uninsured vehicle.
be sufficient for an insurer to reason as follows: (1) appropriate premium revenue should be proportional to compensation paid; (2) compensation paid will be proportional to the frequency of claims; (3) the frequency of claims will be proportional to the number of vehicles insured; and therefore, (4) premium revenue should be made proportional to the number of vehicles insured.\footnote{20} Despite the elusiveness of mathematical precision in any particular case, there appears to be no impropriety in such assumptions nor in proration of resultant premium charges among all vehicles insured by the insurer, especially when the semiannual premium is only two dollars per vehicle under such proration. Thus, a court should not necessarily conclude that an insured has not received what he has "paid for" even though recovery limits are not proportional to the premiums paid. The critical proportion is the ratio of premiums to the insurer's overall exposure to risk. In these terms, the effect of Van Tassel is to grant the insured much more than he has "paid for,"\footnote{21} and its soundness is questionable.

A better approach would have been to observe the similarity between the uninsured-motorist provisions and the general liability policies which they supplement. Recovery under liability provisions is often prorated pursuant to "other insurance" clauses similar to those involved in the instant case,\footnote{22} and such proration is expressly authorized by statute.\footnote{23} The courts
have chafed under the burden of litigation generated by these 
"other insurance" clauses, and at least one court concerned 
with Minnesota law has suggested the need for legislative inter-
vention.\(^\text{24}\) Even in that case, however, the suggestion was not 
that "other insurance" clauses be invalidated but only that the 
concepts of "primary" and "secondary" liability which they in-
troduce be legislatively defined.\(^\text{25}\) No matter what definition of 
"primary" and "secondary" liability is adopted, the result inevi-
tably denies or limits recovery under one or more policies for 
which the insured has paid a premium. Similarly, the *Van Tas-
set* court could have properly denied multiple recovery on the 
grounds that what the insured "paid for" was in fact four con-
tracts *limiting* the insurer's liability in accordance with the 
"other insurance" clauses in question.\(^\text{26}\) In this respect, the ef-
fect of the "other insurance" clauses would not differ from the 
effect upheld in the liability precedents.

The justification for creating a different rule that refuses to 
apply the statutory approval of proration to uninsured-motorist 
coverage must be found, if at all, from the perspective of statu-
tory interpretation. The Minnesota statute provides, in perti-
nent part:

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enough to have been applied to uninsured-motorist protection provided 
"thereunder" pursuant to subsequent legislation if the *Van Tassel* court 
had chosen to do so.

\(^\text{24}\) Circuit Judge Lay, writing for the court in *Miller v. National 
Farmers Union Property & Cas. Co.*, 470 F.2d 700, 701 (8th Cir. 1972), 
stated:

> In an action for a declaratory judgment the district court 
was faced, as we are on appeal, with the repetitive task of un-
tangling another web of confusion created by the inarticulate 
language of two automobile policies.

In a footnote he elaborated on the problem:

> It would make interesting statistics to see how many in-
surance companies require litigation to settle controversies aris-
ing from the conflicting and ambiguous escape clauses in their 
respective policies. No one case ever seems to conclusively de-
fine the respective obligations. Each company, undaunted by 
prior decisions, continues in unremitting litigation with the only 
significant result being infinite expense and court congestion.

> . . . Hopefully, state legislatures or the companies themselves 
will someday declare a simple rule governing the relationship 
of primary and secondary carriers where overlapping coverage 
occur.

*Id.* at 701 n.1.

\(^\text{25}\) *Id.*

\(^\text{26}\) This view has apparently been articulated only by Justice 
Newton of the Supreme Court of Nebraska, dissenting in *Protective Fire 
& Cas. Co. v. Woten*, 186 Neb. 212, 218, 181 N.W.2d 835, 838 (1970), al-
though it is implied in *Martin v. Christensen*, 22 Utah 2d 415, 454 P.2d 
No... policy... shall be delivered... unless coverage is provided... for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles... [in specified minimum limits].\textsuperscript{27}

Interpreted in its context, it is questionable whether this language supports the conclusion reached by the court. It was added in 1967\textsuperscript{28} to the statutory design inaugurated by the Safety Responsibility Act of 1933.\textsuperscript{29} The original act was typical of legislation then becoming prevalent throughout the country.\textsuperscript{30} It required a financially irresponsible\textsuperscript{31} motorist involved in an accident to offer proof of financial responsibility as a condition of retaining his driver's license.\textsuperscript{32} Except for owners of fleets of vehicles, who may qualify as self-insurers,\textsuperscript{33} financial responsibility has been delineated by the act in terms of minimum limits of liability insurance. At present, these limits in Minnesota are $10,000 "for one person" and $20,000 "in any one accident" for personal injury or death and $5,000 "in any one accident" for property damage.\textsuperscript{34}

While such legislation may encourage financial responsibility, it cannot guarantee compensation to the injured person when the tortfeasor happens notwithstanding to be irresponsible or is unidentified. This deficiency was addressed by the in-

\textsuperscript{27} MINN. STAT. § 65B.22(3) (1971), quoted in note 4 supra.
\textsuperscript{28} Minn. Laws 1967, ch. 837.
\textsuperscript{29} Minn. Laws 1933, ch. 351, as amended, MINN. STAT. §§ 170.21-.58 (1971).
\textsuperscript{30} See Donaldson, supra note 5, at 397-98.
\textsuperscript{31} The original criterion for financial irresponsibility necessary to bring the statute into operation was the failure to satisfy a final judgment of liability for personal injury or property damage in excess of $100 resulting from the operation or ownership of a motor vehicle. In 1945, the act was rewritten and its application was extended to the owner or operator of any motor vehicle involved in a reported accident. Minn. Laws 1945, ch. 285; MINN. STAT. §§ 170.21-.58 (1971). The provisions of the act do not apply to the owner or driver of a vehicle involved in an accident causing no injury or damage to anyone other than such owner or driver, to the owner or driver of a vehicle legally stopped, standing or parked at the time of the accident, to the owner of a motor vehicle being used without his permission at the time of the accident, or to a person who appears not liable for any damages, who is released from liability or who executes a satisfactory confession of judgment or agreement to pay. MINN. STAT. § 170.26 (1971).
\textsuperscript{32} The license of a Minnesota resident is suspended. A non-resident is denied the privilege of operating a motor vehicle within the state. MINN. STAT. § 170.25(1) (1971).
\textsuperscript{33} MINN. STAT. § 170.52 (1971).
\textsuperscript{34} MINN. STAT. § 170.25(3) (1971). See also MINN. STAT. § 170.21 (10) (1971).
surance companies in the mid-1950's, when they began writing "uninsured-motorist" protection. In 1957, New Hampshire became the first state to require that such protection be offered with every automobile liability policy in limits at least equal to the statutory requirement for financial responsibility. Similar legislation, including the 1967 Minnesota statute, has now been enacted in every jurisdiction except Maryland and the District of Columbia.

The fact that the legislature has defined "financial responsibility" in terms of liability insurance in certain minimum limits "for one person" and "in any one accident" raises a strong inference that these limits express a legislative determination of the minimum protection an injured person should find available. This minimum protection is required "for one person" and "in any one accident" but not necessarily "per policy." There is no reason to impute a different intent to the 1967 uninsured-motorist act which filled a gap left by the 1933 financial responsibility requirement and which explicitly adopted the financial responsibility criteria. The statute requires that such protection be offered with all policies in limits of at least $10,000 "for one person." Van Tassel's four policies would all have provided such "protection" even if the restrictive "other insurance" clauses had been enforced since by the very terms of those clauses, each policy would have been operable to the full $10,000 limit in the absence of other coverage. In other words, each policy protected the insured from the possibility of being without the minimum amount of available insurance prescribed by the statute. The Van Tassel holding in effect in-

37. At present, uninsured-motorist coverage may be rejected by the insured in writing in about 30 states but may not be rejected for passenger automobiles in the remaining states, including Minnesota.
39. See note 4 supra.
40. Virginia's statute, which was the first to be construed so as to invalidate an "other insurance" clause in Bryant v. State Farm Mut. Auto. Ins. Co., 205 Va. 897, 140 S.E.2d 817 (1965), may require more than the Minnesota statute. It provides:
Nor shall any such [bodily injury liability] policy or contract relating to ownership, maintenance or use of a motor vehicle be so issued or delivered unless it contains an endorsement or provisions undertaking to pay the insured all sums which he shall be legally entitled to recover as damages from the owner or operator of an uninsured motor vehicle, within limits
interprets the legislative intent to be that the minimum protection available to a passenger in an uninsured motor vehicle shall be proportional to the number of insured vehicles his family happens to own. No reason is suggested for such legislative discrimination in favor of passengers from multiple-car families.

The Van Tassel decision reflects a consumer protective commitment in insurance matters and confirms the court's previously expressed preference for the insured over the insurer and for full compensation over partial compensation. On this basis, similar decisions in other jurisdictions have been favorably received in academic literature. However, such a rule is inappropriate against the unique statutory backdrop now present in Minnesota, which has been developed since the date of the accident that precipitated the Van Tassel litigation and thus was not strictly controlling in the case. Recent changes in the statute suggest that the legislature, not the court, has taken the better approach to the problem of the undercompensated victim of a financially irresponsible motorist.

Effective January 1, 1971, the legislature withdrew from the insured his right to reject uninsured-motorist coverage. On the same date, insurers became obligated to offer such coverage in the same limits as carried by the insured in liability coverage. Moreover, a 1971 amendment, effective January 1, 1972,

which shall be no less than the requirements of . . . the Code herein . . .

Va. Code Ann. § 38.1-381(b) (1970). Arguably, "undertaking to pay . . . all sums" is a stronger term than the "coverage . . . for the protection" required in Minnesota.


44. Minn. Laws 1967, ch. 837; Minn. Stat. § 65B.22(3) (1971). One result of this change was to create by statute the anomalous result reached by many courts and discussed in note 8 supra: the injured victim of an uninsured motorist will be better off than he would have been if the motorist had been insured in the minimum limits prescribed by the Safety Responsibility Act. Significantly, this inconsistency existed for only a year before it was corrected by the 1971 amendment. See note 45 infra.
required insurers to offer "underinsured-motorist" coverage with every policy.\textsuperscript{45} In other words, while from 1967 through 1970 an insured was protected by the statute only to the $10,000 minimum, the legislature provided that as of January 1, 1971, he would be entitled to the same protection against an uninsured motorist as he provided for others to have against himself. One year later, he became entitled to protect himself against all motorists, insured or uninsured, to the same extent he protects others against himself. If he carries liability insurance in greater than the required limits, he may arrange for lower underinsured-motorist limits but in no case less than the persistent $10,000 minimum.\textsuperscript{46}

The legislature has guaranteed the insured considerable freedom to contract for uninsured/underinsured-motorist protection within the limits of his liability coverage as a maximum and the statutory $10,000 limit as a minimum. Under the Van Tassel rule, the freedom of a multiple-car owner is impaired since he cannot contract for only the minimum coverage. At the other end of the statutory range, the freedom of the single-car owner is also impaired since he enjoys no opportunity to inflate his uninsured-motorist protection by means of cumulative policies. Thus, when evaluated by standards established by recent legislative changes, the Van Tassel result is not as consumer-protective as it may have appeared. It has created an awkward wrinkle in the otherwise consistent fabric of a statute which does not distinguish between liability and uninsured-motorist protection\textsuperscript{47} nor between owners of one vehicle and own-

\textsuperscript{45} Supplemental insurance coverages shall as a minimum include:

\begin{itemize}
\item[(d)] Beginning January 1, 1972, underinsured motorist coverage, whereby subject to the terms and conditions of such coverage the insurance company agrees to pay its own insured for such uncompensated damages as he may recover on account of an automobile accident because the judgment recovered against the owner of the other vehicle exceeds the policy limits thereon, to the extent of the policy limits on the vehicle of the party recovering or such smaller limits as he may select less the amount paid by the liability insurer of the party recovered against.
\end{itemize}


\textsuperscript{46} Id.

\textsuperscript{47} If the situation in Van Tassel were reversed and the uninsured motorist were a passenger in one of the insured's vehicles and injured as a result of the insured's negligence, the Van Tassel rationale would suggest that the insured could look to the insurer to assume his liability to the combined limits of all four policies since the legislature has re-
ers of several. Thus, it would be undesirable to apply the Van Tassel rule to insurance contracts drawn since January 1, 1972.

48. For example, if plaintiff owned four vehicles, each insured by defendant with uninsured-motorist coverage in limits of $50,000 per person rather than the minimum $10,000, the Van Tassel rule would seemingly allow recovery up to $200,000 since "a premium has been collected on each of the policies involved." — Minn. at —, 207 N.W.2d at 352. No illustration better reveals the weakness of the court's dual "paid for"/statutory approach. In such a case, the court would be compelled to hold that an "other insurance" clause purporting to limit recovery to $50,000 is repugnant to the statute which sets forth a minimum of only $10,000. See note 12 supra.
Securities Regulation: Exchange of Stock Pursuant to Merger is not a “Sale” by an Insider Under Section 16(b) of the Securities Exchange Act of 1934

On May 8, 1967, after unsuccessfully seeking to merge with petitioner's predecessor (Old Kern), respondent Occidental\(^1\) announced an offer to purchase the outstanding shares of stock of Old Kern.\(^2\) During the tender offer campaign, which expired on June 8, 1967, respondent purchased more than 10 percent of the outstanding stock of Old Kern. Respondent was blocked in its takeover bid by a defensive merger\(^3\) between Old Kern and Tenneco\(^4\) in which Old Kern stockholders were to receive new Tenneco stock on a share-for-share basis.

On June 2, 1967, respondent executed a binding option to sell to Tenneco at a date over six months after the tender offer expired all the new Tenneco stock to which respondent would be entitled when the merger took place. The merger transaction was closed on August 30, 1967, and respondent thereupon became irrevocably entitled to receive Tenneco stock in exchange for its Old Kern stock. Thus, both the execution of the option and the exchange of shares took place within six months of the date on which respondent became the owner of more than 10 percent of the stock of Old Kern. The option

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1. Respondent, Occidental Petroleum Corp., is a California corporation with its principal place of business in California. Occidental is engaged in the production and sale of oil, gas, coal, sulphur and fertilizers.

2. Old Kern was a California corporation having substantial real estate holdings for oil production, oil exploration, cattle ranching and cattle feeding and interests in the manufacture of automotive parts, electronic systems and devices, farm machinery and construction equipment.

3. Technically what occurred was a sale of assets by Old Kern. This enabled the Kern-Tenneco group to obtain the benefit of Cal. Corp. Code § 3901 (West 1955) which only requires a simple majority of all voting shares for approval of a sale of assets as opposed to the two-thirds vote required for approval of a merger by Cal. Corp. Code § 4107 (West 1955), as amended (West Supp. 1973).

4. Tenneco, a Delaware corporation, is a diversified industrial company with operations in natural gas transmission, oil and gas, chemicals, packaging, manufacturing and shipbuilding. The plan of merger provided for the transfer of Old Kern's assets to Kern County Land Co., a newly organized and wholly owned subsidiary of Tenneco Corp., itself a wholly owned subsidiary of Tenneco. Kern County Land Co. was organized specifically to receive the assets of Old Kern, and it occupied the third rung in a three-tier holding company series.
was exercised on December 11, 1967, and the sale to Tenneco yielded respondent a profit of approximately $19 million.5

Petitioner sought to recover this profit in a suit under section 16(b) of the Securities Exchange Act of 1934.6 The district court held that both the execution of the option on June 2, 1967, and the exchange of Old Kern shares for shares of Tenneco on August 30, 1967, were "sales" under section 16(b).7 The court accordingly ordered respondent to disgorge the profit realized from the sale. The Court of Appeals for the Second Circuit reversed and ordered summary judgment entered dismissing petitioner's complaint.8 The court held that neither the option nor the exchange constituted a "sale" within the purview of section 16(b). The United States Supreme Court affirmed. Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973).

Section 16(b) of the Securities Exchange Act of 1934 allows

5. The total profit on the sale of the stock to Tenneco was $17,712,980. This included the $8,886,230 premium paid in June. In addition, Occidental received dividends totaling $1,793,439.22. Thus, Occidental's total profit was $19,506,419.22 on the shares obtained through its tender offer.


For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

See also note 11 infra.


the issuer of securities registered under section 12 of the Act, or a stockholder suing on its behalf, to recover any "profit realized" by insiders on "short swing" securities transactions. The section covers the purchase and sale (or sale and purchase) of any equity security within a six month period by those persons defined as insiders. There are only two prerequisites to the application of section 16(b): it must be shown (1) that the defendant was an insider at the time of the purchase and sale, and (2) that the purchase and sale were made within a six month period. Although the stated purpose of the statute is to prevent the unfair use of inside information, the courts have never required proof of actual use of such information as a prerequisite to its application. Once the statutory conditions have been fulfilled, it is irrelevant that the insider either did not make unfair use of inside information or did not intend at the time he purchased the security to sell it within six months; section 16(b) applies irrespective of the good faith or intent of the insider.

Liability under section 16(b) often turns upon a determination of whether a "purchase" or a "sale" of securities has occurred. The problem of determining whether a pur-

9. Section 12(g) requires the registration by an issuer having total assets exceeding $1,000,000 of each class of equity security held of record by 500 or more persons if such issuer is engaged in interstate commerce or in a business affecting such commerce or if its securities are traded by use of the mails or interstate commerce. In addition, any issuer having a class of equity securities registered on a national securities exchange must register the securities under section 12. 15 U.S.C. § 78l (a), (g) (1) (1970).

10. Profits recoverable under section 16(b) are computed by application of the lowest-in-highest-out theory of liability. This formula, which arbitrarily matches purchases with sales in order to maximize the determination of profits, may result in a large recovery when the sequence of transactions actually produced an overall loss. See, e.g., Gratz v. Claughton, 187 F.2d 46, 50-52 (2d Cir.), cert. denied, 341 U.S. 920 (1951).

11. An insider for the purposes of section 16(b) is a "person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security . . . ." 15 U.S.C. § 78p(a) (1970).

12. See note 6 supra.

13. See 2 L. Loss, SECURITIES REGULATION 1041 (2d ed. 1961); W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 25 (1968). The original drafts of the bill would have barred only the improper disclosure of inside information. The difficulty of proving such a disclosure, however, prompted the change to the current form. See S. 2693, 73d Cong., 2d Sess. (1934); H.R. 7852, 73d Cong., 2d Sess. (1934).

14. Section 3(a) (13) of the Securities Exchange Act of 1934 defines
chase and a sale have occurred within a period of six months presents little difficulty when the transactions consist of an exchange of cash for stock or stock for cash.\textsuperscript{15} The problem becomes more difficult, however, when the transactions have at one or both ends exchanges of stock that are not clearly either purchases or sales. These "unorthodox"\textsuperscript{16} transactions have been responsible for most of the litigation under section 16(b).

The courts have developed two different approaches in attempting to apply the terms "purchase" and "sale" to some of the unorthodox exchanges of securities. Variously described as the "objective" or "per se" and the "subjective" or "pragmatic" tests,\textsuperscript{17} they represent conflicting views as to how the purposes of the section should be realized. The objective test is geared toward the broadest possible construction of "purchase" and "sale" and results in an all-inclusive prohibition under section 16(b).\textsuperscript{18} The test entails little or no inquiry

\textsuperscript{15} The courts have followed the traditional mechanical approach set out in Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), cert. denied, 320 U.S. 751 (1943) (plaintiff need not show intention of the insider to deal in the security within six months, nor must he prove actual unfair use of inside information).

\textsuperscript{16} The term is from 2 L. Loss, Securities Regulation 1069 (2d ed. 1961). It includes such transactions as mergers, conversions, options and reclassifications.


\textsuperscript{18} Even so, the statute is really only a halfway measure or, as the chief spokesman for the draftsmen and proponents of the Act termed it, a "crude rule of thumb." Statement of Thomas B. Corcoran, Hearings on S. 84, S. 56 and S. 97 Before the Senate Comm. on Banking and Currency, 73d Cong., 2d Sess. 6557 (1934). It is likely that a considerable volume of trading by insiders is continuing under circumstances which amount to what is in effect an exemption from liability due to the six month restriction in section 16(b). An insider possessed of inside information is free to purchase equity securities of his company, wait for their value to rise and then dispose of them after the six month period has elapsed. Similarly, if possessed of information which signifies an imminent fall in price, the insider may sell, wait for the six month period to expire and then repurchase.
into either the manner in which a transaction was accomplished or the reasons behind it. While its clarity might have value, the objective test can lead to "manifestly absurd and unfair" results which involve "purposeless harshness." On the other hand, the subjective test focuses on whether a transaction is of the type the statute was designed to prevent. Thus, it limits the applicability of the "purchase" and "sale" provision of section 16(b) to those transactions in which a possibility of speculative abuse exists. This determination is made on the basis of an examination of the facts of each case. The requirement of an initial finding that inside information could at least potentially have been misused for personal profit means that the harshness of the section is brought to bear only where the deterrent effect is necessary.

Recent decisions dealing with such unorthodox transactions as conversions, mergers and options have used the latter approach.

19. Although the objective test was the original one used, it has been applied in full force in only a few cases. See Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965); Park & Tilford, Inc. v. Schulte, 160 F.2d 984 (2d Cir.), cert. denied, 332 U.S. 761 (1947); Blau v. Hodgkinson, 100 F. Supp. 361 (S.D.N.Y. 1951). In Park & Tilford defendant insiders converted their preferred stock pursuant to a call for redemption by the company. The issue in the case was whether the conversion was a "purchase" of common stock. The court, in a manner characteristic of the objective test, answered affirmatively, stating: "Defendants did not own the common stock in question before they exercised their option to convert; they did afterward. Therefore they acquired the stock, within the meaning of the Act." Park & Tilford, Inc. v. Schulte, supra, at 987.


22. Section 16(b) was enacted to take the profit out of short-swing speculative trading in the equity securities of publicly held corporations by insiders whose position gives them both access to information not available to the investing public and possibly the ability to influence the policies taken by their corporations. See generally S. Rep. No. 1455, 73d Cong., 2d Sess. 55-68 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13-14 (1934); Hearings on S. 84, S. 56 and S. 97 Before the Senate Comm. on Banking and Currency, 72d Cong., 1st Sess., and 73d Cong., 1st and 2d Sess. 8463-81 (1934); Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 85 (1934).

23. See Lowenfels, supra note 17, at 57-60.

24. The subjective test was first applied to a section 16(b) convertible security case in Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958), cert. denied, 359 U.S. 927 (1959), where the court set forth the test as the standard for decision: "Every transaction which can reasonably be defined as a purchase will be so defined, if the transaction is of a kind
Although conversions of one equity security into another have now been exempted from the operation of section 16(b), courts have continued to apply the subjective test developed in conversion cases to those involving other unorthodox transactions. For example, in Newmark v. RKO General, Inc. the subjective test was used to determine that an exchange of stock pursuant to a merger was a “sale” within the meaning of section 16(b). The decision in Kern is significant because it is the first time any court has held that an exchange of securities of one company for those of another under a plan of merger did not constitute such a “sale.” Prior cases involving mergers and other corporate acquisitions had almost uniformly resulted in the imposition of section 16(b) liability.

Kern also has significance with respect to the problem of determining what kind of option agreement constitutes a “sale” which can possibly lend itself to the speculation encompassed by Section 16(b).” Id. at 345. In examining the conversion on its particular facts, the court concluded that the transaction in Ferraiolo was not a purchase because the “conversion of . . . preferred to . . . common had none of the economic indicia of a purchase,” and “[t]he transaction was not one that could have lent itself to the practices which Section 16(b) was enacted to prevent.” Id. at 346. See Comment, The Scope of “Purchase and Sale” Under Section 16(b) of the Exchange Act, 59 Yale L.J. 510, 513 (1950). Two conversion cases which followed Ferraiolo virtually adopted its approach. Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), cert. denied, 385 U.S. 1002 (1967); Petteys v. Butler, 367 F.2d 528 (8th Cir. 1966), cert. denied, 385 U.S. 1006 (1967). See, e.g., Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418 (1972); Newmark v. RKO Gen., Inc., 425 F.2d 348 (2d Cir.), cert. denied, 400 U.S. 854 (1970); Blau v. Max Factor & Co., 432 F.2d 304 (9th Cir.), cert. denied, 382 U.S. 892 (1965); American Standard, Inc. v. Crane Co., 346 F. Supp. 1153 (S.D.N.Y. 1972).

26. 425 F.2d 348 (2d Cir.), cert. denied, 400 U.S. 854 (1970). RKO General had entered into an agreement to purchase the shares of certain major shareholders of Central Airlines at a fixed price upon the condition that Central merge with Frontier Airlines. The court found a possibility of speculative abuse both because RKO had obtained its option to purchase Central stock before the news of the merger was made public and because it had control over the terms and date of the merger.

or “purchase.” Traditionally the question as to whether a purchase or sale occurs at the time of the execution or at the time of the exercise of an option has hinged upon the determination of when the “insider’s rights and obligations became fixed.”\(^\text{28}\) The courts have also used the subjective test to determine whether an option agreement constitutes a purchase or sale,\(^\text{29}\) however, and have thus considered the factor of possible abuse of inside information in situations where the option could be used as an instrument to manipulate the sale or purchase of the underlying security.\(^\text{30}\) As discussed below, the Kern decision contributed some desirable clarification of the theretofore murky analysis used by the courts when confronted with option agreements.

Before dealing with the specific issues raised in Kern, the Court sanctioned the possibility-of-speculative-abuse test as the correct way to decide whether “borderline transactions are within the reach of the statute.”\(^\text{31}\) Then, as it was undisputed that Occidental’s acquisition of more than 10 percent of the outstanding stock of Old Kern through its tender offer expiring on June 8 was a “purchase” within the meaning of the statute, the Court had to decide whether a “sale” had also oc-

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\(^{28}\) Traditionally, courts have held that the time at which an insider’s rights and obligations became fixed is the controlling event in the application of section 16(b). Stella v. Graham-Paige Motors Corp., 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956); Blau v. Ogsbury, 210 F.2d 426, 427 (2d Cir. 1954).

\(^{29}\) See, e.g., Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970); Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), cert. denied, 379 U.S. 961 (1965); Silverman v. Landa, 306 F.2d 422 (2d Cir. 1962).

\(^{30}\) In Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), there was an agreement entered into in 1959 in connection with a reorganization to issue “contingent shares” based upon a guarantee of the market price of the stock of the acquiring corporation in 1962. The court conceded that the rights and obligations of the parties with respect to the exchange of the stock became fixed in 1959 but held that the date of purchase of the contingent shares for the purposes of section 16(b) was the date of their delivery in 1962 because the price at which the stock was to be purchased was to be determined by the market price at the time of delivery. The court intimated that it selected this date because the possibility of speculative abuse existed in the transaction.

\(^{31}\) Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 589, 594–95 (1973). The Court stated:

In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to insider information—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

*Id.* (emphasis added).
curled within six months. More specifically, the issue of liability turned on whether a “sale” took place when the merger agreement was signed on August 30 (thus binding Occidental to exchange its shares of Old Kern) or when Occidental gave Tenneco an option on June 2 to purchase the stock Occidental would receive if a merger were effectuated. Initially the Court examined Occidental’s acquisition of stock through its tender offer and concluded that there was no possibility of access to inside information at the time Occidental irrevocably committed itself to the tender offer since it then owned far less than 10 percent of the outstanding shares.\textsuperscript{82} In like manner the Court rejected the argument that Occidental knew that its tender offer would either precede or force a defensive merger enabling Occidental to sell its stock at a substantial profit. The Court reasoned that such calculations “do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist.”\textsuperscript{83} Furthermore, the possibility that Occidental had any confidential information seemed extremely remote to the Court in light of the vigorous and immediate opposition it encountered in its takeover efforts.

Thus, finding no possibility of speculative abuse in Occidental’s purchase of the stock, the Court proceeded to determine whether any of Occidental’s subsequent transactions constituted a sale. The critical factor in the Court’s determination that the exchange of shares required by the merger agreement was not a sale by Occidental was that Occidental had neither “engineered” nor participated in the merger agreement.\textsuperscript{84} Sig-

\begin{footnotesize}
\begin{enumerate}
\item Id. at 596-97. The Court stated: It cannot be contended that Occidental was an insider when, on May 8, 1967, it made an irrevocable offer to purchase 500,000 shares of Old Kern stock at a price substantially above market. At the time, it owned only 1,900 shares of Old Kern stock, far fewer than the 432,000 shares needed to constitute the 10% ownership required by the statute. There is no basis for finding that, at the time the tender offer was commenced, Occidental enjoyed an insider’s opportunity to acquire information about Old Kern’s affairs.
\item Id. at 597.
\item Id. at 599. The Court said: The critical fact is that the exchange took place and was required pursuant to a merger between Old Kern and Tenneco. That merger was not engineered by Occidental but was sought by Old Kern to frustrate the attempts of Occidental to gain control of Old Kern. Occidental obviously did not participate
\end{enumerate}
\end{footnotesize}
significant to this determination were the findings that Occidental refrained from voting at the shareholders' meeting where approval of the merger was obtained and that Occidental's dealing in Old Kern stock had been fully disclosed before the vote. The Court reasoned that once the merger agreement was approved, Occidental had no choice but to exchange its shares both because there was no right of appraisal for dissenters and because a sale of its stock before the merger was closed would clearly have been a statutory sale. The combination of the "involuntary" nature of the exchange and the "absence of the possibility of speculative abuse of inside information" convinced the Court that the exchange of shares did not constitute a sale.

The Court then discussed whether the execution of the option agreement should itself be considered a sale. After stating that the mere execution of an option to sell was not generally regarded as a "sale," the Court intimated that if a possibility of speculative abuse existed in the execution of the option agreement, it would be held to be a "sale" within the meaning of section 16(b). The Court discounted the possibility of such an abuse in Kern because of the apparent mutual advantages of the arrangement. If the option were exercised, Occidental would be able to divest itself of a substantial investment in a company over which it would have no control, and Tenneco would free itself of a potentially troublesome minority stockholder. The Court said that "[m]otivations like these do not smack of insider trading." Moreover, it was unlikely that Occidental was acting on the basis of inside information related to the new stock since it was a statutory in-

Id.

35. Id. at 600.

36. Id. The Court noted that "Occidental could ... have disposed of its shares of Old Kern for cash before the merger was closed. Such an act would have been a § 16(b) sale and would have left Occidental with a prima facie § 16(b) liability." Id.

37. Id. at 601. The Court stated that it could "not find in the execution of the ... option agreement a sufficient possibility for the speculative abuse of inside information with respect to Old Kern's affairs to warrant holding that the option agreement was itself a 'sale' within the meaning of § 16(b)." Id. The Court thereby implied that if the possibility did exist it would hold the option agreement to be a "sale."

38. Id.

39. Id.
sider of Old Kern rather than of Tenneco. The Court found the possibility of speculative abuse further minimized by the fact that Occidental had granted a "call" option at a set price which Tenneco could choose not to exercise if the market price fell. If, on the other hand, the market price were to rise, Tenneco alone would benefit. The Court did not indicate that the premium paid for the option was so large "as to make the exercise of the option almost inevitable" nor did it find the existence of other special circumstances, such as surrender of the "emoluments of ownership," to indicate that the parties "understood and intended that the option was in fact a sale." Thus, as the option was neither an instrument with potential for speculative abuse nor one with the traditional indicia of a sale, no sale could take place until the date of the option's exercise.

Clearly favoring the objective test, the dissent criticized the individualized nature of the majority's analysis, especially the emphasis on "the economics of the particular transaction and the modus operandi" of the particular insider as a basis for deciding whether there existed the possibility of speculative abuse of inside information. Under an objective analysis, the "round trip" taken by Occidental's shares was

40. Id. at 602. Tenneco had the right to buy after six months, but Occidental could not force Tenneco to buy. See generally H. Filer, Understanding Put and Call Options 96-111 (1950); G. Lefler, The Stock Market 363-78 (2d ed. 1957); Michael & Lee, Put and Call Options: Criteria for Applicability of Section 16(b) of the Securities Exchange Act of 1934, 40 Notre Dame Law. 239, 240-41 (1965); Note, Put and Call Options Under Section 16 of the Securities Exchange Act, 69 Yale L.J. 886 (1960).
41. 411 U.S. at 603.
42. Id. at 604. In Bershad v. McDonough, 423 F.2d 693, 698 (7th Cir. 1970), the court noted the special circumstances upon which it based its decision that "the stock was effectively transferred, for all practical purposes, long before the exercise of the option." The court thought that the size of the option price, 14 percent of the total purchase price of the stock, suggested it was more of a down payment. The stock had also been endorsed in blank and transferred to an escrow agent pending completion of the transaction. In addition, an irrevocable proxy to vote the shares was given to the optioner, and the former owner of the shares and one of his associates resigned as directors and were replaced by delegates of the optioner.
43. 411 U.S. at 604.
44. Mr. Justice Douglas, with whom Mr. Justice Brennan and Mr. Justice Stewart concurred, dissented. Id. at 605 (dissenting opinion).
45. Id. at 612 (dissenting opinion).
46. Id. at 606 (dissenting opinion). The dissent concluded "that Occidental . . . purchased and sold shares of Kern . . . within a six-month period and that this 'round trip' in Old Kern stock is covered by the literal terms of § 16(b)." Id.
covered by the literal language of the statute. The subjective test, moreover, had been developed in conversion cases under 16(b) before conversions were exempted, and the reasoning of such cases is not necessarily appropriate for cases involving other types of transactions. The dissent seemed to believe that the option agreement was in fact a sale and that at the very least the case should have been remanded to the district court for a hearing on whether the terms of the option "compelled" its exercise. Since there were insufficient facts to permit the court of appeals to enter a summary judgment in favor of Occidental, such a remand would be a more appropriate method of handling the issue. Specifically, the dissent questioned whether the premium paid for the option was not so high as to make the exercise of the option inevitable (the premium was to be credited against the purchase price or forfeited if the option was not exercised).

Had the Court applied the subjective test in the traditional manner, it would have reached a contrary decision. An analysis of the facts of Kern indicates that it was at least possible that inside information could have been used by the respondent to its advantage if such information were in its possession. For example, after Occidental had become a 10 percent beneficial owner of Kern stock by means of its initial tender offer of May 8, knowledge that Kern would definitely merge with Tenneco would have allowed Occidental to extend

47. Id. at 617 (dissenting opinion).
48. In Bershad v. McDonough, 428 F.2d 693, 698 (7th Cir. 1970), discussed in note 42 supra, the court concluded that a purchase price for an option which amounted to 14 percent of the exercise price of the stock appeared to render the ultimate completion of the sale a foregone conclusion because of the magnitude of the price. In Kern, the purchase price of the option amounted to 9.5 percent of the exercise price of the stock. See 411 U.S. at 615. The dissent also took note of the fact that Occidental had authorized its attorney to vote its shares in favor of the merger. Id. at 616.
49. Almost always negotiated in secrecy and accompanied by rising stock prices, such transactions appear to present substantial opportunities for abuse. Occidental could have used confidential information regarding either the identity of the merger candidate or the method by which the acquisition was to take place to time its trading of the shares to maximize profits. Indeed, one article has gone so far as to state: "A merger or consolidation, perhaps more than any other transaction, involves many opportunities for abuse of confidential information." Cook & Feldman, Insider Trading Under the Securities Exchange Act, 68 Harv. L. Rev. 385, 626 (1953). For further discussion of the possibilities of section 16(b) inherent in merger transactions see Hemmer, Insider Liability for Short-Swing Profits Pursuant to Mergers and Related Transactions, 22 Vand. L. Rev. 1101, 1111-13 (1969).
its tender offer, as it did on May 11, knowing full well that a substantial profit would result from the sale of the stock after the merger took place. Although there was thus the possibility of speculative abuse which might have compelled a different result under the subjective test as traditionally applied, the Court had two reasons for deciding Kern as it did.

First, the Court was once more faced with the problem of determining whether a transaction which only arguably falls within the purview of the statute should result in the imposition of section 16(b) liability. However, Kern presented the Court with a situation that was manifestly different from those in prior cases wherein the subjective test had been applied. In those cases, the defendants exchanged shares by voluntarily exercising an option to convert, otherwise took affirmative action to effect the exchange, or controlled the exchange. Occidental, on the other hand, neither had any control over the exchange nor took affirmative action to bring it about. It appears that this factor (Occidental's total lack of any control over the crucial event upon which the imposition of liability

50. It seems apparent that in all mergers the sum is different from the total of the parts. The combination of two like companies will almost always result in lower costs, and generally it can be presumed the new company will be more efficient. Therefore, inside information about the occurrence of a merger as well as the identity of the companies about to merge will allow a person to benefit from speculation in the stock of the disappearing company because most investors will assume such a combination will be a success, thereby forcing the price of the stock upwards. This is not to say that all combinations are ultimately successful.

51. It is not surprising that many of the cases decided before Kern failed to make an inquiry before applying the possibility-of-speculative-abuse test. In each case, the acquisition or disposition of the securities took place as a result of the defendant's own act, and it was obvious that the exchange had the indicia of a sale or a purchase. The cases include situations wherein defendant converted his shares because the failure to do so would have resulted in great economic loss. Although one could classify such conversions as forced, the defendant nevertheless had actual control over the transaction. Other cases involved exchanges of stock pursuant to a merger where the defendant controlled the consummation of the merger or exchanges by an insider corporation of its assets for the acquiring corporation's stock. The common thread which runs through all these cases is that in each case the defendant performed an affirmative act to effect a transaction which would not have occurred without such act and thereby exercised control over the crucial event which resulted in the imposition of liability. See Note, Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) "Purchase or Sale"?, 117 U. Pa. L. Rev. 1034, 1035 nn.9-12 (1969), and cases cited therein.

52. 411 U.S. at 599.
depended) was responsible for the apparent dilemma faced by the Court: it could either apply the traditional subjective test and impose liability upon a person who could do nothing to avoid it, or it could compromise the test.

Second, the policy implications of a contrary decision would have been most undesirable. It would give rise to a situation where the liability of one person would be totally dependent upon the actions of another. The person who controlled the closing of the merger would have the ability to subject the holder of securities to section 16(b) liability whenever he so desired within the six-month period. Furthermore, such a decision would result in the imposition of a handicap upon the tender offeror in his quest for control.53 Therefore, it seems that the Court decided the exchange issue on “equitable” grounds but supported its decision by compromising the subjective test.

Under the compromised subjective test it appears the Court must ask whether there was any possibility that the transaction at issue did lead to speculative abuse rather than whether the transaction possibly could have lent itself to speculative abuse.54 It would seem that henceforth a plaintiff may have to introduce some evidence of actual abuse tending to show that abuse of an inside position is not only possible, but probable. To require such a showing, however, would seriously undermine the effectiveness of section 16(b).55

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53. To hold respondent liable for its profits under the circumstances of this case would permit the target company to offer a substantial section 16(b) liability to prospective partners seeking to defeat a tender offer by means of a defensive merger. This result would increase the number of offers which the target company could accept to defeat the takeover bid because the recovery of profits under section 16(b) would act to equalize some of the inferior offers with that of the tender offeror. The success of mergers has not been consistent in all instances. Kennedy, Tender Moment, 23 BUS. LAW. 1091 (1968). Therefore, the policy to pursue should be one which keeps the takeover bidder and the target company on an equal footing.

54. The Court reached a determination that it was “totally unrealistic to assume or infer from the facts before us that Occidental either had or was likely to have access to inside information.” 411 U.S. at 586. However, under the traditional possibility-of-speculative-abuse test such a finding would be irrelevant. The only pertinent determination would be that the transaction at issue could not possibly lend itself to speculative abuse. Such a determination would be made by an objective analysis of the facts of the exchange, disregarding what actually transpired with respect to the party involved in the litigation.

55. If a showing of actual abuse is to be incorporated through this compromised version of the possibility-of-speculative-abuse test, the difficulties of proof which section 16(b) was designed to alleviate will be
In order to maintain the effectiveness of section 16(b) and at the same time prevent its harsh consequences in situations such as that in Kern, the application of the possibility-of-speculative-abuse test should be predicated upon a finding that the transaction at issue can "reasonably be defined" as a sale or a purchase. In other words, a court should first make an inquiry to ascertain whether the transaction has the indicia of a sale or a purchase. Then, if the court determines that such indicia exist, the possibility-of-speculative-abuse test could be applied in the traditional manner.

The standard for decision first set forth by the Sixth Circuit in Ferraiolo v. Newman seems to favor such a mode of implementation of section 16(b). That standard appears to limit the inquiry regarding the possibility of abuse to "transaction[s] which can reasonably be defined as a purchase." The court in Ferraiolo considered whether the indicia of a purchase existed in the stock conversion before it, implying that such an inquiry is necessary before liability can be imposed. Even stronger support is found in another case which used the standard set forth in Ferraiolo to reach its decision. In Pettys v. Butler the Eighth Circuit stated: "If no purpose is served by attaching the artificial label of 'purchase' to a transaction when it has none of the common indicia of a purchase, no such label is demanded, nor will one be attached."

Kern provided the Court with an ideal opportunity to evaluate a transaction and decide that it could not "reasonably be defined" as a "sale" under section 16(b), since no previous case had suggested that a transaction controlled exclusively by others and giving a defendant no option not to participate could be labeled as a "sale." A determination by the Court that the transaction could not reasonably be defined as a sale would have foreclosed all further inquiry into the exchange, and it would not have been necessary to compromise the possibility-of-speculative-abuse test to reach the desired result.

reintroduced. The increased complexity of section 16(b) trials, which would result from inquiring into the activities of the specific party involved in the litigation, would weaken the deterrent value of the statute. Under such a case-by-case analysis litigation would likely increase, fewer cases would be settled and insider short-swing speculation might become more prevalent.

57. Id. at 345.
58. Id. at 346. See discussion in note 24 supra.
59. 367 F.2d 528 (8th Cir. 1966), cert. denied, 385 U.S. 1006 (1967).
60. Id. at 536.
This mode of implementation of section 16(b) would prevent liability from being imposed in any instance where an acquisition or disposal of securities is completely uncontrollable by the holder. Furthermore, it would allow increased judicial flexibility in the application of the possibility-of-speculative-abuse test to the even more complex exchanges of securities which are sure to come in the future. Most importantly, this mode of implementation would allow the courts to focus on a transaction as a member of a larger class of transactions without the risk of working an unjust hardship on a particular defendant. Such an approach would reduce litigation and maximize the deterrent effect of section 16(b) by clarifying which classes of transactions would be considered as having the indicia of a purchase or sale.

The Court's treatment of the option agreement contributed some desirable clarification with respect to the problem of determining what kind of an option agreement will immunize a beneficial owner from section 16(b) liability. Based on the Court's approach in *Kern*, attention should be directed to a determination of whether an option agreement is in fact a subterfuge rather than upon an examination of the form of the transaction. *Kern*’s sanction of the subjective test, which had been applied by a few

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61. Unless of course there existed proof of actual wrongdoing by the holder. This would bring the fact situation within the purview of rule 10b-5, 17 C.F.R. § 240.10b-5 (1973), and liability would be imposed accordingly.

62. Although the possibility-of-speculative-abuse test fails to maintain the total objectivity of an all-inclusive interpretation of section 16(b), it nevertheless avoids the subjectivity necessarily incident to an inquiry into such questions as whether inside information was actually abused or whether the insider intended to buy or sell on the short swing.

63. The Court's treatment of the option agreement, however, seems inconsistent with the bifurcated approach to the subjective test suggested in text following note 55 supra. As the Court initially determined that the execution of an option generally did not have the indicia of a sale, a further inquiry into the possibility of speculative abuse would be foreclosed under the suggested approach. See text accompanying note 37 supra. A course more consistent with the suggested approach would have been the dissent's remand to the district court for a further hearing on whether the terms of the option agreement could compel its characterization as a sale. Such a hearing presumably would have allowed the court to focus on the option agreement as a member of a larger class of such agreements and would have supplemented the lore on whether such agreements have the indicia of a sale. See text accompanying note 47 supra.

64. The Court stated that the "resolution of the question is very much a matter of judgment, economic and otherwise." 411 U.S. at 603.
lower federal courts previously,\textsuperscript{65} insures its universal application to option agreements hereafter. This approach appears to be consistent with the underlying policy of section 16(b) because its primary focus is on the defendant's ability to control or arrange the outcome of events to its own advantage. More significant than the Court's endorsement of the subjective test, however, was its emphasis on the "mutual advantages of the arrangement" as a criterion in determining whether an option agreement smacks of insider trading.\textsuperscript{66} The Court intimated that the size of the option price in relation to that of the exercise price, as well as other objective criteria, must be considered in light of the relative bargaining positions of the parties before a decision as to liability can be made. This approach allows the courts maximum flexibility in resolving the section 16(b) liability issue regarding option agreements.

The decision in \textit{Kern} will probably be given a narrow interpretation by lower federal courts when applying the subjective test to the exchange of stock. To allow \textit{Kern}'s compromised version of the subjective test to apply to analogous situations involving officers and directors would seem to be in direct contradiction to the legislative history of section 16(b). The Court's approach to the option agreement in \textit{Kern} will undoubtedly cause a consideration of mutual advantage to be added to the traditional criteria used in applying section 16(b) liability to such arrangements.

\textsuperscript{65} See cases cited at note 29 \textit{supra}.

\textsuperscript{66} The Court noted:

The mutual advantages of the arrangement appear quite clear. As the District Court found, Occidental wanted to avoid the position of a minority stockholder with a huge investment in a company over which it had no control and in which it had not chosen to invest. On the other hand, Tenneco did not want a potentially troublesome minority stockholder that had just been vanquished in a fight for the control of Old Kern. 411 U.S. at 601.