United States Attorneys Bulletin

Published by Executive Office for United States Attorneys
Department of Justice, Washington, D.C.

VOL. 16 JUNE 21, 1968 NO. 13

UNITED STATES DEPARTMENT OF JUSTICE

Vol. 16 June 21, 1968 No. 13

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ANTITRUST DIVISION

Acting Assistant Attorney General Edwin M. Zimmerman

DISTRICT COURT

SHERMAN ACT

SPORTING GOODS COMPANY CHARGED WITH VIOLATING SECTION 7 OF ACT.

United States v. Wilson Sporting Goods Co., et al. (Civ. 68 C 549; March 27, 1968; D.J. 60-277-037)

On March 27, 1968, a civil suit was filed in the Federal District Court for the Northern District of Illinois, Eastern Division, against Wilson Sporting Goods Co., River Grove, Illinois, and Nissen Corporation, Cedar Rapids, Iowa, alleging a violation of Section 7 of the Clayton Act.

Wilson, a subsidiary of Ling-Temco-Vought, Inc., is the nation's largest manufacturer and seller of a broad line of sporting goods, and Nissen is the nation's largest manufacturer of gymnastic apparatus with approximately 32% of this market. The top four firms engaged in the manufacture of gymnastic apparatus account for approximately 60% of the total industry sales. On February 15, 1968, Wilson and Nissen entered into agreements providing for the merger of Nissen into Wilson.

The complaint charges that the foregoing acquisition of Nissen by Wilson violates Section 7 of the Clayton Act because:

(a) Actual and potential competition between Nissen and Wilson in the manufacture and sale of sporting goods will be eliminated;

(b) Wilson will be eliminated as a potential entrant into the manufacture and sale of gymnastic equipment;

(c) Wilson may be able to entrench or augment Nissen's dominant market position in gymnastic equipment;

(d) Persons or firms may be deterred from entering into the manufacture and sale of gymnastic equipment;

(e) Concentration in the manufacture and sale of gymnastic equipment will be and may be increased; and,

(f) Competition generally in the production and sale of gymnastic equipment may be substantially lessened.

The prayer of the complaint seeks a preliminary injunction against the consummation of the merger agreement. On March 28, 1968, Judge Abraham L. Marovitz entered a temporary restraining order pending a hearing on the Government's motion for a preliminary injunction. On April 8 and 9 Government and defendants' witnesses were heard before Judge Marovitz, and on April 11 depositions of additional defense and Government witnesses were taken. On April 19 briefs on behalf of all parties were filed with the court. Judge Marovitz has advised that he will set the matter for oral argument on the preliminary injunction in the near future.

Staff: John E. Sarbaugh, Kenneth H. Hanson and Joel Davidow (Antitrust Division)

SHERMAN AND ROBINSON PATMAN ACTS

CASE AGAINST DAIRY IS TERMINATED.

United States v. National Dairy Products Corporation, et al. (Cr. 20542; May 9, 1968; D.J. 60-139-128)

On May 9, 1968, Judge John W. Oliver of the Western District of Missouri entered an agreed order dismissing Counts 11, 12, and 13 of the indictment as to defendant National Dairy Products Corporation ("National") and also entered an agreed order which terminated the period of probation as to defendant Raymond J. Wise, a former vice-president of National, and vacated the portion of the sentence requiring Wise to pay $52,500.

In 1963, National had been convicted by a jury on thirteen counts charging violations of the Sherman Act and Section 3 of the Robinson-Patman Act for price fixing and selling milk below cost with intent to injure competitors. Wise was also convicted on the same charges with respect to the metropolitan Kansas City counts (Counts 11, 12, and 13). Although affirmed by the Eighth Circuit, 350 F. 2d 321, the judgments were vacated by the Supreme Court and remanded for reconsideration "in the light of Dennis v. United States", reported in 384 U.S. 855, which decision was handed down the same day. National Dairy Products Corporation v. United States, 384 U.S. 883. Dennis held that the trial court's refusal to turn over grand jury transcript for defendant's inspection under the circumstance presented was reversible error. In National, Government counsel had used the grand jury transcripts in efforts to refresh the recollection of seven witnesses testifying as to the Kansas City counts (Counts 11, 12 and 13) and the trial court denied defendant's demand for inspection.

On remand, the trial court affirmed the convictions on all counts (262 F. Supp. 447), but the Eighth Circuit, while upholding the convictions on the ten counts relating to the rural areas (Counts 1 through 10), reversed the conviction of National as to Counts 11, 12 and 13 on the ground that the use of grand jury transcript to refresh automatically created a particularized need for the transcript. 384 F. 2d 457. The Court further held that the error did not affect the other counts as to which no refreshment was attempted. Defendant Wise had dropped his appeal for personal reasons and his judgment was not affected by the ruling. Defendant National petitioned for a writ of certiorari, which was denied. 390 U.S. 957 (1968).

Following the decision, the Government decided to dismiss without prejudice Counts 11, 12 and 13 as to defendant National for the reasons that substantial justice had been accomplished, the case was ten years old, and a considerable number of treble damage actions were being held up pending the disposition of the Government's case. National was required to pay $275,000 under its convictions under Counts 1 through 10 -- $50,000 each on five Sherman Act counts and $5,000 each on five Robinson-Patman Act counts. The Government further decided that, since it was not proceeding to further prosecute the corporation as to Counts 11, 12 and 13, there would be an element of unfairness in continuing to punish the individual for conviction under those counts (which would also have been vacated had the individual perfected his appeal).

This terminates a case which came before the Supreme Court four times. In <u>United States</u> v. <u>Wise</u>, 370 U.S. 405 (1962), the Supreme Court held that the Sherman Act imposes personal liability upon corporate officials for acts done on behalf of the corporation in violation of that act. In <u>United States v. National Dairy Products Corp.</u>, 372 U.S. 29 (1963), the Court held that Section 3 of the Robinson-Patman Act, which makes it a crime to sell "at unreasonably low prices for the purposes of destroying competition * * *," was not unconstitutionally vague as applied under the instant indictment because it specifically charged that the unreasonably low prices, in this case meant sales below cost.

The case represents the Government's first criminal prosecution under Section 3 of the Robinson-Patman Act and certain legal principles thereunder are enunciated in the Eighth Circuit's opinion in 350 F. 2d 321. The case also may be cited for the proposition that it is <u>per se</u> unlawful for a manufacturer to agree with his distributor as to the distributor's resale prices. See 350 F. 2d 321. Additionally, the fines totaling $275,000 against National represents the largest sum in fines imposed on a single corporation in any antitrust case.

Staff: James E. Mann, Robert L. Eisen, Raymon P. Hernacki, Thomas S. Howard and John T. Cusack (Antitrust Division)

* * *

CIVIL DIVISION

Assistant Attorney General Edwin L. Weisl, Jr.

COURT OF APPEALS

DISCLOSURE OF DOCUMENTS

AGENCY EMPLOYEES CANNOT BE COMPELLED TO PRODUCE DOCUMENTS WHICH THE AGENCY HEAD HAS FORBIDDEN THEM TO DISCLOSE.

George Saunders, et al. v. The Great Western Sugar Co., et al. (C.A. 10, No. 10107; May 24, 1968; D.J. 233279-165)

The defendants in a private anti-trust action in which neither the Government nor any of its agents were parties sought an order from the District Court for the District of Colorado compelling regional officials of the Small Business Administration to produce certain internal SBA documents which had been subpoenaed by the defendants. Upon being served with the subpoenas, the SBA officials had, pursuant to 13 C.F.R. 102.7, sought instructions from the Assistant Administrator for Administration of SBA. The Assistant Administrator had refused to authorize disclosure of the documents. As required by 13 C.F.R. 102.7, the regional officials declined, for lack of authorization, to produce the documents sought by the subpoena. The district court entered an order compelling production of the documents.

The Tenth Circuit reversed, holding that Boske v. Comingore, 177 U.S. 459, and Touchy v. Ragen, 340 U.S. 462, require that the orders of the head of an agency forbidding disclosure of documents are not subject to attack where a subpoena is directed to subordinate employees of the agency. The Court of Appeals noted that persons seeking the disclosure of documents whose disclosure has been forbidden by an agency head must proceed against the agency head in the District of Columbia.

Staff: Micheal C. Farrar (Civil Division)

FEDERAL TORT CLAIMS ACT

FEDERAL PRISONER TEMPORARILY INCARCERATED IN THE DISTRICT OF COLUMBIA JAIL MAY SUE THE UNITED STATES UNDER THE TORT CLAIMS ACT FOR NEGLIGENCE OF D.C. JAIL EMPLOYEES.

Harold Close v. United States (C.A.D.C., No. 21,188; May 13, 1968; D.J. 157-16-2328)

Plaintiff was convicted of a federal crime in the United States District Court for the District of Maryland and committed to the custody of the Attorney General to serve a 15 year sentence. Pending the outcome of his appeal, plaintiff was placed by the Attorney General in the District of Columbia Jail where he suffered injuries allegedly due to the negligence of employees of the jail. Plaintiff brought suit against the United States under the Federal Tort Claims Actfor these injuries. The district court dismissed the suit on the ground that no negligence of federal employees was alleged as the D. C. Jail is an instrumentality of the D. C. Government and not the federal Government.

The District of Columbia Circuit reversed. It noted that the Federal Tort Claims Act defined "employee of the [federal] government" as including "persons acting on behalf of a federal agency in an official capacity, temporarily or permanently in the service of the United States, whether with or without compensation". The Court held that since a federal prisoner upon conviction is committed to the Attorney General for custody and safekeeping, the Attorney General by placing this prisoner in the D. C. Jail had, in effect, made the D. C. jailer the Attorney General's jailer. The Court also observed that the Attorney General had some supervisory powers over the D. C. jailer to assure that the Attorney General's responsibilities toward the prisoner would be fulfilled by the D. C. jailer. In these circumstances, the Court concluded that the United States could be held liable under the Tort Claims Act for the negligence of the employees of the D. C. Jail.

Staff: United States Attorney David G. Bress;
Assistant United States Attorney Joel M. Finkelstein (D. C.)

WHERE THERE IS SUBSTANTIAL QUESTION WHETHER AN INJURY IS COMPENSABLE UNDER LONGSHOREMEN'S AND HARBOR WORKERS' COMPENSATION ACT, WHICH PROVIDES EXCLUSIVE REMEDY FOR A COVERED INJURY, DISTRICT COURT MUST STAY TORT CLAIM SUIT UNTIL PLAINTIFF, WITHIN REASONABLE TIME, HAS SECURED FROM THE DEPARTMENT OF LABOR A DETERMINATION OF COVERAGE UNDER LONGSHORMEN'S ACT.

United States v. Julia Lee Charles (C. A. D. C., No. 21,213; May 28, 1968; D. J. 157-16-2125)

Plaintiff, an employee of an Officer's Club at an Air Force Base, a non-appropriated fund instrumentality of the United States, was injured as the result of stepping in a hole at the bus stop on the Air Force Base while en route to work. In this Tort Claims Act suit, the district court entered a judgment against the United States, finding that the Government was negligent in failing to abate the nuisance on the Air Force Base. The district

court denied the Government's motion to stay the suit until after plaintiff had filed a claim for compensation under the Longshoremen's and Harbor Workers' Compensation Act, and secured a determination as to whether her claim was covered under that Act, which provides the exclusive remedy for compensable claims. The district court ruled that the claimant was not covered by the Longshoremen's Act because she was not actually working at the time of the injury.

On appeal, the District of Columbia Circuit held that the district court had erred in failing to grant the Government's motion for a stay of the Tort Claims Act suit pending a determination of coverage under the Longshoremen's Act by the Department of Labor. The Court of Appeals held that where, as here, there is a "substantial question" whether a claim for injury comes within the Longshoremen's Act, resort must first be had to the procedures of the Act. The Court of Appeals stated that if an award should be made under the Longshoremen's Act, the Tort Claims Act judgment would not be reinstated.

Staff: Robert C. McDiarmid (Civil Division)

UNITED STATES WAS AN ADDITIONAL INSURED UNDER OMNIBUS INSURANCE CLAUSE OF GOVERNMENT EMPLOYEE'S INSURANCE POLICY AND WAS ENTITLED TO IMPLEAD INSURER IN TORT CLAIMS ACT SUIT. UNDER ARKANSAS LAW, AN ENDORSEMENT WITHDRAWING COVERAGE FROM UNITED STATES WAS VOID FOR WANT OF CONSIDERATION.

Southern Farm Bureau Casualty Insurance Co. v. United States (C. A. 8, No. 19,018; May 22, 1968; D.J. 145-5-3126)

In a Tort Claims Act suit against the United States resulting from the negligence of a Government employee, the United States, relying on the Omnibus Insurance Clause of the insurance policy obtained by its employee, impleaded the employee's insurer. The insurer's motion to dismiss the third-party complaint was denied by the district court. The Eighth Circuit affirmed.

Following a consistent line of precedent, the Court of Appeals held that, as a procedural matter, the United States may qualify as an additional "insured" under the clause of the policy relating to the "person or organization legally responsible for the use" of the insured automobile. The Court of Appeals also held that the United States was a proper party to bring the suit since, under controlling Arkansas law, where a contract clearly intends a benefit to a third party, the third party acquires an enforceable right without any need of privity of contract. Finally, the Court of Appeals rejected the insurer's attempt to exclude coverage to the United States through an endorsement to the policy expressly excluding the United States. The appellate court held that Arkansas law requires consideration for the

endorsement; that the insurer's mere forbearance to cancel the policy did not constitute consideration; and that subsequent renewal of the policy supported by a current premium was also ineffective to incorporate the void limiting endorsement into the policy.

Staff: United States Attorney Charles M. Conway;
Assistant United States Attorney Robert E. Johnson (W. D. Ark.)

GOVERNMENT CONTRACTS

COURT WILL NOT CONSIDER QUESTION OF TOLLING OF STATUTE OF LIMITATIONS IN ACTION BY CONTRACTOR FOR BREACH OF GOVERNMENT CONTRACT, WHERE CONTRACTOR FAILED TO RAISE TOLLING ARGUMENT DURING MULTIPLICITY OF PROCEEDINGS IN PRIOR YEARS. STATUTE OF LIMITATIONS WAS NOT TOLLED BY GOVERNMENT'S ALLEGED "FRAUDULENT CONCEALMENT" OF TESTS USED BY IT. DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN DENYING CONTRACTOR'S MOTION TO INCREASE ITS DAMAGE ALLEGATION AND THEREBY SECURE TRANSFER OF CASE TO COURT OF CLAIMS.

Crown Coat Front, Inc. v. United States (C. A. 2, No. 31,985; May 14, 1968; D. J. 78-51-685)

In 1956, plaintiff contracted with the United States to furnish certain canteen covers. After inspection, the Government required a price reduction because of defective samples. In 1959, plaintiff learned of the nature of the tests used by the Government and filed a claim with the Government contracting officer, claiming that the tests used by the Government constituted a change in contract specifications under the "changes" clause of the contract, entitling it to an equitable adjustment and damages resulting from the Government's delay. In 1962, while plaintiff's administrative claim was pending, plaintiff commenced an action in the Court of Claims seeking damages for breach of contract by use of improper tests. And in 1963, after final administrative decision denying plaintiff's claim, plaintiff commenced an action in the United States District Court under the Tucker Act, asserting that the administrative decision was arbitrary and capricious, and seeking damages under the changes clause of the contract.

The United States moved to dismiss the District Court suit on the ground that it was not commenced within the six-year period of limitations. That motion was granted by the District Court, whose decision was affirmed en banc by the Second Circuit. The Supreme Court reversed, holding that the statute of limitations had been tolled by the administrative proceedings insofar as the claim arose under the contract and was subject to the "disputes" clause of the contract. The Supreme Court noted, however, that if the claim did not

fall within the "disputes" clause, but constituted a claim for a pure breach of contract, it might not be time-barred.

On remand, plaintiff chose to amend its complaint to allege that the claim was not within the "disputes" clause, but constituted a claim for breach of contract. The Government consented to plaintiff's change of theory, but moved to dismiss on the ground that the breach of contract claim was barred by the six-year statute of limitations. Plaintiff cross-moved to increase its allegations of damages above $10,000, the jurisdictional limitation of the District Court, and thereby to remand the case to the Court of Claims, where plaintiff's 1962 action was still pending. The District Court ruled for the Government on both motions.

On appeal, the Second Circuit held that the district court had not abused it's discretion in refusing to allow plaintiff to amend its damages allegations above the District Court jurisdictional limit. The Court of Appeals also held that the district court properly dismissed the breach of contract claim as time-barred. The Court of Appeals rejected plaintiff's claim that the six-year period did not commence until 1959 when plaintiff first discovered the nature of the Government tests, holding that the statute began to run in 1956, the date of final delivery of the canteens. The Court of Appeals also refused to consider plaintiff's claim that the statute of limitations was tolled by the Court of Claims action, in view of plaintiff's failure to raise that contention during a multiplicity of proceedings in prior years.

Staff: United States Attorney Robert M. Morgenthau;
Assistant United States Attorney Alan G. Blumberg (S. D. N. Y.)

LONGSHOREMEN'S AND HARBOR WORKERS' COMPENSATION ACT

EMPLOYEE'S DEATH FROM MYOCARDIAL INSUFFICIENCY AROSE OUT OF AND IN THE COURSE OF EMPLOYMENT WITHIN MEANING OF LONGSHOREMEN'S ACT WHERE EMPLOYER FAILED TO ADDUCE EVIDENCE REBUTTING STATUTORY PRESUMPTION OF COVERAGE.

Mary R. Wheatley v. Herman Adler (C. A. D. C., No. 20,455; May 17, 1968; D. J. 83-16-287)

The employee died as the result of myocardial insufficiency resulting from marked arteriosclerotic heart disease. The death occurred while the employee was at work and soon after he urinated in the yard adjacent to the garage where he was working. A physician testified that the death could have been precipitated by the act of urinating in the cold, but that he could not say whether this act was or was not the cause of the death. The Deputy Commissioner rejected the claim for death benefits under the Longshoremen's

and Harbor Workers' Compensation Act, holding that the death did not arise out of and in the course of the decedent's employment. An action to review the Deputy Commissioner's decision was dismissed by the district court. The Court of Appeals on October 2, 1967 affirmed the district court's decision. However, on rehearing en banc, the Court of Appeals reversed. It held, three judges dissenting, that the statute presumes that a claim comes within its coverage and that this presumption had not been rebutted in the instant case notwithstanding the medical testimony.

Staff: United States Attorney David G. Bress;
Assistant United States Attorney Frank Q. Nebeker (D.C.)

SELECTIVE SERVICE ACT

SELECTIVE SERVICE BOARD'S DENIAL OF STUDENT DEFERMENT IS FINAL AND NOT SUBJECT TO JUDICIAL REVIEW; IN ABSENCE OF ANY FREE SPEECH QUESTIONS, PLAINTIFF MAY NOT SECURE DECLARATORY OR INJUNCTIVE RELIEF PRIOR TO INDUCTION.

David Bruce Moskowitz v. J. Winston Kindt, et al. (C.A. 3, No. 16,907; May 13, 1968; D.J. 25-62-1928)

Plaintiff brought an action in the United States District Court seeking to stay his induction, contending that his Selective Service Board erroneously denied him a student deferment. The district court dismissed the complaint, and the Court of Appeals affirmed.

The Third Circuit held that the district court lacked jurisdiction over the action since the Selective Service Act makes the Board's decisions final and not subject to judicial review. The Court of Appeals also ruled that plaintiff had failed to exhaust his administrative remedies since he failed to appeal his 1-A reclassification. Finally, the Court of Appeals ruled that plaintiff's action was premature since he could only secure injunctive and declaratory relief after being indicted for refusal to submit to induction, or by way of habeas corpus after induction. The Court noted that the free speech considerations in Wolff v. Selective Service Local Board No. 16, 372 F. 2d 817 (C.A. 2), were not present in this case. See Public Law 90-40, 81 Stat. 100.

Staff: United States Attorney Drew J. T. O'Keefe;
Assistant United States Attorney Merna B. Marshall (E.D. Penn.)

* * *

CRIMINAL DIVISION

Assistant Attorney General Fred M. Vinson, Jr.

SPECIAL NOTICES

BUREAU OF NARCOTICS AND DANGEROUS DRUGS

Your attention is again directed to the previously announced consolidation of the Bureau of Narcotics, Treasury Department, and the Bureau of Drug Abuse Control, Department of Health, Education, and Welfare which as of April 9, 1968, became the Bureau of Narcotics and Dangerous Drugs, Department of Justice.

All forms of pleadings, particularly in civil actions, should be reviewed and amended to note this change. It is requested that the Bureau of Narcotics and Dangerous Drugs be kept currently advised of the status of all cases within its investigative jurisdiction and that copies of any such correspondence be designated for the Narcotic and Dangerous Drug Section of the Criminal Division.

PROBATION REVOCATION

RIGHT TO COUNSEL AT HEARING ON REVOCATION OF PROBATION, 18 U. S. C. 3653; DEPARTMENT POLICY

The statutory provision for revocation of probation specifies that the probation officer may, for cause, arrest the probationer without a warrant at any time within the probation period; it further requires that as speedily as possible after arrest the probationer shall be taken before the district court having jurisdiction over him. While it has been the law that it was not necessary that a probationer be represented by counsel at his revocation hearing [Welsh v. United States, 348 F. 2d 885 (C. A. 6); Bennett v. United States, 158 F. 2d 412 (C. A. 8)], in practice many district courts have advised probationers that, if they could not afford retained counsel to represent them at their hearings, the court would appoint counsel for them without charge.

The Court of Appeals for the Sixth Circuit recently vacated a sentence imposed by a court in a hearing on revocation of probation because the accused was not advised that he had a right to be represented by counsel, Ashworth v. United States, decided March 20, 1968. In Ashworth, the court, in originally placing the subject on probation, had suspended imposition of sentence; thus the revocation hearing constituted in effect a sentencing situation. However, even where a sentence has been actually imposed when the

defendant was placed on probation, with execution suspended, the revocation of probation can be said to constitute a sentencing situation, since the court has the power either to order the sentence into execution, or to reduce it, or to continue the subject on probation. Accordingly, it is now the Department policy that probationers should be offered the right to appointed counsel in all cases of probation revocation. This policy should be maintained even though there is as yet no authority under the Criminal Justice Act for paying counsel fees for court appointed attorneys at hearings on revocation of probation.

COURTS OF APPEALS

FOOD, DRUG, AND COSMETIC ACT; MAIL FRAUD

CONVICTION OF PHYSICIAN, CHARGED WITH MISBRANDING, MAIL FRAUD, AND CONSPIRACY, AFFIRMED.

United States v. Herman Taller (C. A. 2, May 1, 1968; D. J. 21-52-233)

A jury found Dr. Taller guilty on three counts of misbranding drugs, eight counts of using the United States mails to defraud and one count of conspiracy, under a 49 count indictment charging him with violations of 18 U. S. C. 2, 371 and 1341, and of 21 U. S. C. 331(a), 331(k), 333(b), and 352(a). The trial judge fined Dr. Taller $1000 each on one misbranding count and six mail fraud counts, suspended imposition of sentence on the remaining counts and placed him on probation for two years.

Dr. Herman Taller, a physician who specialized in obstetrics, is the author of the 1961 million-copy best-seller "Calories Don't Count." This book as originally planned was to be an exposition of Dr. Taller's views, arrived at after some experimentation and research, and apparently held with sincerity, that obesity could be cured without the painful necessity of restricting calorie intake by regular ingestion of liquid oil containing polyunsaturated fats. Dr. Taller had been prescribing three ounces of liquid safflower oil per day for his patients and this dosage appeared in the draft and galleys of his book. Before the book was published, however, he became involved in an enterprise organized to distribute safflower oil capsules. To create a demand for these he prevailed upon his publisher to change the text so that the recommended dosage would be six capsules per day and to indicate that these could be obtained from a new enterprise. The packages of capsules in turn were labeled "CDC" and contained a booklet identifying them with Dr. Taller's "Calories Don't Count" weight control program. The revised capsule dosage contained only one-fifteenth as much safflower oil as the liquid oil dosage originally recommended, and as Taller

later admitted was worthless as a cure for obesity even in terms of his own theory.

The only point raised on the appeal which the Court of Appeals considered worthy of much discussion had to do with the jury's verdict finding Taller guilty of eleven substantive felonies and one "misdemeanor conspiracy." The Court instructed the jury that as to the conspiracy count the jury could return a verdict of "guilty or not guilty, except that if you conclude that the defendant was guilty only of conspiring to commit the misdemeanor of one or more of * * * the Food and Drug counts, your verdict should take the form 'guilty as a misdemeanor'." The second paragraph of 18 U. S. C. 371 provides that if the commission of an offense which is the object of the conspiracy is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor. The Court of Appeals concluded that it was essential for the trial court to know whether, if the jury found Taller guilty of conspiracy, it had in mind a conspiracy whose only criminal object was the commission of a misdemeanor, as would be the case if the jury decided that the only conspiracy was to misbrand without intent to defraud or mislead; hence, Taller was not prejudiced by the jury's finding him guilty of conspiracy in a manner requiring lesser sentence on that count than a consistent verdict would have demanded. Taller's suspended sentence on the "misdemeanor conspiracy" verdict was concurrent with the suspended sentences on four of the substantive counts and the evidence supporting the eleven guilty verdicts on substantive counts was ample. The Court of Appeals also found that venue was proper, and that the introduction by the Government of expert testimony that the entire theory of Dr. Taller's weight reducing diet was unsound was proper, in view of the appellate court's interpretation of the indictment, which accords with the interpretation of the trial judge and defense counsel at the pre-trial conference.

Staff: United States Attorney Joseph P. Hoey and
Assistant United States Attorney Carl Golden
(E. D. N. Y.)

SECURITIES ACT OF 1933

FRAUD IN SALE OF SECURITIES; CHARGE TO JURY; EVIDENCE OF OTHER CRIMINAL CONDUCT AND OF PLEAS BY CO-CONSPIRATORS.

United States v. Michael Light, et al. (C. A. 2, May 16, 1968; D. J. 113-51-170)

The appellants and co-defendants were convicted of conspiracy to violate the Anti-fraud provisions of the Securities Act of 1933 and the mail and

wire fraud statutes in connection with the sale of stock of Bankers Intercontinental Investment Co., Ltd. and Florida Patsand Corp. The sales and offers to sell involved a telephone sales campaign employing false representations concerning the financial condition and prospects of the companies, manipulation of the price of the stock, kickbacks to dealers, and false financial statements.

On appeal, it was contended that the trial judge erred in reviewing the evidence against each appellant in turn, and that this indicated a biased attitude in favor of the prosecution. The Court of Appeals found no abuse of discretion and no impropriety in the review of the evidence, "having in mind the duty of the trial judge in multi-defendant cases to make the jury constantly aware that separate individuals are on trial and each must be judged solely on the evidence against him."

Another alleged error, rejected by the Second Circuit, related to the testimony of a rebuttal witness for the Government, a Doctor Felix Fudge. He testified that the appellants, without his authorization, had endorsed his name to checks and used his account to conceal illicit payments and kickbacks. It was held that the evidence of other criminal conduct was relevant to show the plan or device for carrying out the crime charged in the indictment, and the testimony was clearly admissible.

The trial court denied a motion to suppress books and records voluntarily turned over to the Securities and Exchange Commission during a civil injunction proceeding and later given to the United States Attorney. The appellants contended that the SEC exceeded the consent given and the use of the records by the United States Attorney, without a warrant, was illegal. The Court of Appeals found no fraud or deceit on the part of the Government agent in obtaining the records or failing to apprise the appellants of a change in the character of the investigation, for they were made aware of the risks attendant upon a voluntary disclosure by the warning inherent in the request that, if criminal liability is discovered, the matter will be turned over for prosecution.

Prejudice was claimed from testimony of co-defendants that they had pleaded guilty. The appellate court found no error, since the jury was properly instructed that they should draw no inference of appellants' guilt from the pleas of the co-conspirators.

Staff: United States Attorney Robert M. Morgenthau;
Assistant United States Attorneys Stephen L. Hammerman, Stephen F. Williams, James D. Zirin and Pierre N. Leval (S. D. N. Y.)

DISTRICT COURTS

ECONOMIC OPPORTUNITY ACT

THEFT AND EMBEZZLEMENT OF FUNDS OF SUB-GRANTEE OF OFFICE OF ECONOMIC OPPORTUNITY

United States v. John Wesley Clark (M. D. Fla.; D. J. 46-17M 231)

John Wesley Clark, an employee of the Jacksonville Opportunities Industrialization Center, Inc., a sub-grantee of the Office of Economic Opportunity, appears to have been the first person prosecuted under the Economic Opportunity Amendments of 1967 1/. He took a blank check from the records of the organization and made it payable to himself in the amount of $514.31. He forged two authorized signatures, cashed the check, and with part of the proceeds purchased an airline ticket. The forgery was admitted and Clark returned the ticket as well as $262 in currency which he had retained in his possession.

He was indicted on March 26, 1968, for violating 42 U. S. C. 2703 in that, on March 20, 1968, he had stolen and embezzled the funds of the Center, an agency receiving financial assistance under the Economic Opportunity Act. On arraignment he pleaded guilty and thereafter was sentenced to serve two years pursuant to the provisions of 18 U. S. C. 4208(b).

FOOD, DRUG, AND COSMETIC ACT--FORFEITURES

SUMMARY JUDGMENT ENTERED IN FAVOR OF GOVERNMENT IN FEDERAL FOOD, DRUG, AND COSMETIC ACT FORFEITURE ACTION.

United States v. "Line Away Temporary Wrinkle Smoother" (U. S. D. C., Del., April 23, 1968; D. J. 22A-15-51)

Under the provisions of the Federal Food, Drug, and Cosmetic Act, the United States is authorized to bring a libel against any misbranded drug using the channels of interstate commerce and any "new drug" shipped in interstate commerce without an approved new drug application on file at the Food and Drug Administration (21 U. S. C. 321(p), 355).

1/ See Vol. 16, No. 5, at page 159, March 1, 1968, issue of the United States Attorneys' Bulletin for discussion of the several penal provisions included in Public Law 90-222 known as the Economic Opportunity Amendments of 1967. The sections concerned with fraud, embezzlement, and kickbacks in the poverty program are codified in Section 2703 of Title 42, United States Code.

In this case a forfeiture action was brought against "Line Away Temporary Wrinkle Smoother" in which the Government charged that "Line Away" was misbranded in that its labeling contained false and misleading statements regarding its efficacy ("smooth, firm, and tighten the skin") and its label failed to bear the names of its constituent ingredients (21 U. S. C. 352(a), 352(e)(1)(A)(ii)). It also charged that "Line Away" was a new drug illegally shipped in interstate commerce since no approved new drug application for it was on file with the Food and Drug Administration. The claimant, Chas. Pfizer and Company, Inc., in its motion for summary judgment, contended that "Line Away" was a cosmetic and not a "drug", and that, this being so, the Act's provisions relating to "drugs" and "new drugs" should not apply.

On April 23, 1968, Judge Edwin D. Steel, Jr. granted the Government's cross-motion for summary judgment. He noted that, by intending to smooth, firm, and tighten the skin, "Line Away" has as its objective affecting the structure of the skin. Hence, it falls within the literal definition of a drug in 21 U. S. C. 321(b)(1)(C). Adverting to the legislative history of the term "drug", the key question in Judge Steel's view was whether, under the doctrine of liberal construction, "Line Away" could be said to be an article that Congress contemplated including within the Act as an article "intended to affect the structure or any function of the body of man or other animals." He concluded the pertinent legislative history discloses a Congressional intent that a product such as that seized is a "drug" within the meaning of the Act. He then held that the product was misbranded when shipped in interstate commerce.

Finding that a sharp conflict seemed to exist as to whether the product is "generally recognized by experts as safe and effective for use" the Court declined to rule on the "new drug" issue. But because his ruling on the misbranded issue had made the "new drug" issue moot, he entered judgment in the Government's favor.

This is one of several cases pending against similar products put out by a number of cosmetic firms following the introduction by the Helene Curtis Company of its "Magic Secret" wrinkle smoother preparation several years ago.

Staff: United States Attorney Alexander Greenfeld (D. Dela.)

FRAUD--EMBLEMS, INSIGNIA & NAMES

DEFENDANTS CONVICTED FOR MAIL FRAUD, FALSE USE OF INITIALS "U. S.", AND CONSPIRACY FOR ENGAGING IN SCHEME TO DEFRAUD PUBLIC INTO BELIEVING THAT THEY COULD OBTAIN FREE CHIROPRACTIC HEALTH AND MEDICAL SERVICES.

United States v. Bernarr Zovluck, et al. (S. D. N. Y., Aug. 21, 1967, 274 F. Supp. 385; D. J. 36-51-673)

Defendants devised and engaged in a scheme to defraud members of the public into believing that they could obtain free chiropractic health and medical services. The defendants falsely represented through a systematic campaign of telephone calls, letters and advertisements that their chiropractic center offered free help to patients, that it was Government and trade-union sponsored, and that it was part of medicare and medicaid. In addition, the defendants caused unlicensed persons to pose as doctors and lawyers in the handling of patients induced to patronize the "free" services, defrauding such patients into believing they needed costly X-rays and expensive treatments and inducing them to sign contracts for payment without realizing what they had done.

The defendants would then attempt to force the "free" patients to pay by using notices falsely contrived to appear as official legal notices, using the term "U. S. Credit Rating and Reporting Agency" to imply falsely that such collection method was Government sponsored and threatening to send out notices to tradesmen ruining the patients' credit locally.

For these activities, the defendants were convicted under 18 U. S. C. 1341 for mail fraud, under 18 U. S. C. 371 for conspiracy to violate the mail fraud statute, and under 18 U. S. C. 712 for the false use of the initials "U.S." Earlier, a seizure under a warrant of defendants' telephones, X-ray machines and other instrumentalities was upheld.

Staff: United States Attorney Robert M. Morgenthau and Assistant United States Attorney Richard A. Givens (S. D. N. Y.)

SOLDIERS' AND SAILORS' CIVIL RELIEF ACT

CONVICTION OF DISTRESS OF SERVICEMAN'S PROPERTY WITHOUT LEAVE OF COURT (50 APPENDIX U. S. C. 530).

United States v. Alex J. Berger (S. D. Iowa, April 11, 1968; D. J. 25-28-206)

Under a provision of the Soldiers' and Sailors' Civil Relief Act no eviction or distress may be made during the period of military service in respect of any premises for which the agreed rent does not exceed $150 per month, occupied chiefly for dwelling purposes by the wife, children, or other dependents of a person in military service, except upon leave of court.

In this case the defendant had all of the personal belongings of a serviceman and his wife removed from their apartment without leave of court when they were three days late in paying their rent. It was only by means of an executed writ of replevin that their belongings were subsequently returned.

On April 11, 1968, Judge Roy L. Stephenson of the United States District Court at Davenport, Iowa, found Alex J. Berger guilty of a violation of Section 300 of the Soldiers' and Sailors' Civil Relief Act (50 Appendix U. S. C. 530), and fined him $250 plus costs.

Staff: United States Attorney James P. Rielly and
Assistant United States Attorney Jerry E. Williams
(S. D. Iowa)

COURTS OF APPEALS

THEFT FROM INTERSTATE SHIPMENT

INTERSTATE CHARACTER OF SHIPMENT FROM PUERTO RICO NOT TERMINATED BY TEMPORARY STORAGE IN WAREHOUSE UNTIL FINAL DELIVERY TO BUYERS IN OTHER STATES COULD BE EFFECTED.

United States v. Raymond Maddox (C. A. 4, No. 11,880, April 29, 1968; D. J. 90-1-7-6380)

The defendant in this case was appealing a conviction for theft from an interstate shipment of 24 one hundred pound bags of sugar located in a Baltimore warehouse in violation of 18 U. S. C. 659.

The primary issue raised by the appeal was whether at the time of the theft the sugar had come to rest and, therefore, had lost its interstate character. Landborn Company, a sugar broker, regularly purchased large quantities of sugar through an agent in Puerto Rico. The size of each order depended on the size and number of purchase agreements between Landborn and its customers. Customarily the sugar was shipped to Landborn as consignee. After the ships docked in Baltimore, 40% to 60% of each shipment was picked up by regular customers directly from the pier under release orders from Landborn. The remainder, of which approximately 70% was held to meet pre-existing contracts with buyers serviced by the port of Baltimore, was stored in the warehouse. Many of the predetermined buyers were located in the surrounding states.

The defendant argued that Landborn as consignee and owner of the sugar could do with it as he saw fit and stressed the fact that the bags were not earmarked for any particular buyer, in or out of the state. The

Government argued that the storage in the warehouse constituted merely a temporary interruption in the flow of commerce from Puerto Rico to predetermined buyers in and out of the state. Since the product was fungible, the Government attached no significance to the fact that the bags were not earmarked.

The Court of Appeals, relying on Swift and Co. v. United States, 196 U. S. 375, 398 (1905), for the rule that "commerce among the states is not a technical legal conception, but a practical one drawn for the course of business", concluded that "there is no absolute requirement that the flow of commerce be continuous if there is the clear intention to resume the journey after a brief pause."

The conviction was affirmed on the basis that the sugar retained its interstate character because Landborn clearly intended to continue the shipment after a brief pause.

Staff: United States Attorney Stephen H. Sachs and
Assistant United States Attorney Paul M. Rosenberg
(D. Md.)

There is attached to this issue of the United States Attorneys' Bulletin a memorandum detailing the procedures to be followed under Public Law 90-299 relating to obscene or harassing telephone calls in interstate or foreign commerce.

PUBLIC LAW 90-299

On May 3, 1968, the President signed Public Law 90-299, which proscribes the making of abusive or harassing telephone calls in the District of Columbia or in interstate or foreign telephone communications. The text of the new law is as follows:

Title II of the Communications Act of 1934 is amended by adding at the end thereof the following new section:

OBSCENE OR HARASSING TELEPHONE CALLS IN THE DISTRICT OF COLUMBIA OR IN INTERSTATE OR FOREIGN COMMUNICATIONS

"SEC. 223. Whoever --

"(1) in the District of Columbia or in interstate or foreign communications by means of telephone --

"(A) makes any comment, request, suggestion, or proposal which is obscene, lewd, lascivious, filthy, or indecent;

"(B) makes a telephone call, whether or not conversation ensues, without disclosing his identity and with intent to annoy, abuse, threaten, or harass any person at the called number;

"(C) makes or causes the telephone of another repeatedly or continuously to ring, with intent to harass any person at the called number; or

"(D) makes repeated telephone calls, during which conversation ensues, solely to harass any person at the called number; or

"(2) knowingly permits any telephone under his control to be used for any purposes prohibited by this section, shall be fined not more than $500 or imprisoned not more than six months, or both."

SEC. 2. Section 3(e) of the Communications Act of 1934 (47 U.S.C. 153(e)) is amended by inserting "(other than section 223 thereof)" immediately after "title II of this Act."

Procedures are now being formulated under which citizens complaining of violations of the statute will be referred to the telephone company. The telephone company will attempt to identify and verify the telephone number of the calling party and will endeavor to resolve the matter through internal administrative action. Where administrative measures prove unsuccessful and the company has determined that the jurisdictional prerequisites for Federal

action are present and that state and local statutes do not apply, they will refer the matter to the Federal Bureau of Investigation. We anticipate that under this procedure a relatively small number of complaints will be referred to the Bureau. In 1966, of the more than 650,000 complaints concerning "crank" calls received by the Bell System, only 500 involved interstate telephone communications.

You will note in reading the text of the new statute that subparagraphs 1(A) and (B) of Section 223 are violated if only one telephone call of a prohibited character is made. As a practical matter, however, almost all matters referred to you will involve repeated calls. This will normally be so because the telephone company is able to identify a calling telephone number only if several calls have been made and without such identification the interstate character of the communication will not have been verified. We recommend, where a matter is presented to you involving a possible violation of subparagraph 1(A), that you take advantage of the repeated nature of the calls involved and proceed under subparagraph 1(D) of the statute. In this way you will be able to avoid the many legal problems which accompany prosecutions involving obscene speech.

Past experience indicates that approximately one-third of all offending callers are mentally ill. United States Attorneys presented with cases involving such individuals should explore with defense counsel the possibility of voluntary submission to psychiatric treatment by the accused. If he does agree to undergo such treatment, a stern warning and declination of prosecution may be considered.

Another third of all "crank" callers are juvenile pranksters. Cases involving juveniles may, in the discretion of United States Attorneys, be appropriately handled under the Brooklyn Plan or by diversion of the accused to state authorities pursuant to 18 U. S. C. 5001. (These methods of disposition are discussed in the United States Attorneys' Manual Title 2, at pages 28. 2 and 28. 3).

Among the remaining cases which come to your attention will be telephone calls between husband and wife involving, for example, attempts at reconciliation following a separation. Other cases may involve repeated telephone calls by a creditor seeking to collect money which he is owed. In evaluating cases such as these you should note that subparagraph 1(D) of P. L. 90-299 proscribes only those calls whose sole purpose is to harass. Accordingly, we do not believe that an offense is committed when a citizen is harassed by repeated telephone calls which are made to accomplish an otherwise lawful objective.

United States Attorneys can expect to receive occasional complaints from citizens who have received annoying and harassing telephone calls.

If your office receives such a call we suggest:

1. that you inform the citizen of the jurisdictional requirements of P. L. 90-299;

2. that you refer him to the telephone company and explain to him that the company will attempt to verify the location of the calling number and will contact Federal authorities if a violation of Federal law has occurred; and

3. that you advise him that the telephone company may protect him from receiving the harassing calls either by changing his telephone number or by intercepting and identifying all persons attempting calls to his present number.

The Federal Bureau of Investigation has been advised that it will have investigative jurisdiction in these cases. Any questions should be addressed to the Criminal Division, General Crimes Section.

* * *

LAND AND NATURAL RESOURCES DIVISION

Assistant Attorney General Clyde O. Martz

SPECIAL NOTICE

REAPPRAISAL OF APPRAISERS

A review of the transcript of the testimony in a recent condemnation trial made clear the need for the development of additional appraisal talent. From the review it became apparent that the advanced age of an appraiser, whose testimony was being relied upon by the Government, had impaired his ability to present convincing testimony. We must bear in mind that regardless of how able a person has been in his prime, there comes a time with advancing years when faculties become impaired to an extent that the services of such person should no longer be used.

Please take a current reading with respect to the expert witnesses who are being employed to ascertain their effectiveness as witnesses. Also, the fact that some experienced appraisers are demanding daily rates which exceed what is believed to be a reasonable fee accelerates the need to develop able young appraisers. Accordingly, it will be appreciated if you will review the available appraisal talent in your districts looking toward an expanded roster of available appraisers qualified to be effective witnesses. In this connection, in districts having substantial rural areas, please check out members of the American Society of Farm Managers and Rural Appraisers as well as members of the American Institute of Real Estate Appraisers, the American Society of Appraisers, the Society of Real Estate Appraisers, and able appraisers who may not be affiliated with any of the established appraisal organizations.

COURT OF APPEALS

CONDEMNATION

JUST COMPENSATION; ENHANCEMENT DUE TO PREVIOUSLY CANCELLED PROJECT NOT RECOVERABLE.

Lechuga, et al v. United States (C.A. 5, May 23, 1968, D.J. 33-45-981-702)

Lechuga, et al., owned property which was condemned in furtherance of the Chamizal Project on the Texas-Mexico border in El Paso pursuant to the Chamizal Treaty between the United States and the Republic of Mexico. Prior to this project being undertaken, a previous project, the Cordova

Island Project, had been in the planning stage. The previous project would not have taken the subject property, but may have had an enhancing effect. It was cancelled up to a year before the taking of the Lechuga property because it required some of the same land as the Chamizal Project. The trial court denied the admissibility of evidence concerning enhancement of property value due to the first project, and the landowners claimed error in this refusal.

In upholding the district court in its application of the rule excluding enhancement of United States v. Miller, 317 U. S. 369 (1943), the Court of Appeals said:

> The appellants do not deny that the Cordova Island Project had been terminated nearly a year before the taking of their land. Instead, they suggest that when a prospective government project enchances property value, the government is bound by the enhanced value even if it cancels the project. Such a suggestion is indefensible. Bubbles do burst, and the government should not be penalized for its decision not to grant an inchoate bonanza.

Staff: Robert S. Lynch (Land and Natural Resources Division)

DISTRICT COURT

MEXICAN-AMERICAN BOUNDARY ADJUSTMENT CLAIMS

SOVEREIGN IMMUNITY; MANDAMUS: JUCICIAL REVIEW.

B. H. Blankenship, et al. v. Joseph H. Friedkin, et al, (Civ. No. 67-55-EP, W. D. Texas, El Paso Division, D. J. 90-1-4-158)

The American-Mexican Chamizal Convention provided for the settlement of a long-standing dispute over the Chamizal District in El Paso. Those persons whose land was transferred to Mexico were given a right to compensation in addition to "just compensation". The plaintiffs in this case had filed claims with the Board of Examiners of the International Boundary and Water Commission but because of certain procedural difficulties the Board had not acted on the claims.

Plaintiffs filed a class action seeking a declaratory judgment to invalidate certain regulations prepared by the International Boundary and Water

Commission, United States Section, and approved by the Secretary of State in accordance with the express provisions of the American-Mexican Chamizal Convention Act of 1964, 22 U. S. C. 277(d)-19. Plaintiffs also asked that the court declare the proper elements to be considered by the Board of Examiners in lieu of the regulations propounded. We filed a motion to dismiss on the ground that the suit was a suit against the United States to which consent had not been given.

At the time of the argument on the motion to dismiss, the court considered that the parties should be heard by the Board of Examiners on their claims and considered the case as one of mandamus under 28 U. S. C. 1361. The Board of Examiners held hearings and made awards on the several claims. Plaintiffs continued to contend that the wrong measure of damages was adopted. Defendant renewed its motion to dismiss.

The court concluded, in a judgment dated May 17, 1968, that the case was in effect a suit against the United States, that 22 U. S. C. 277(d)-19 created no legal rights against the Government and gave no right for review of the action of the Board of Examiners. The court held that the declaratory judgment act does not give consent to suit or create any legal rights and, since there was no jurisdiction, the court declined to act. The court then held, since the ministerial functions of the Board of Examiners had been fulfilled, there was no jurisdiction under 28 U. S. C. 1361 for a writ of mandamus.

Staff: Assistant United States Attorney Charles Andrew Gary (W. D. Tex.) and Howard O. Sigmond (Land and Natural Resources Division)

* * *

TAX DIVISION

Assistant Attorney General Mitchell Rogovin

DISTRICT COURTS

SUIT TO RESTRAIN COLLECTION OF TAXES

TAXPAYER WHO CLAIMS THAT HE IS NOT LIABLE FOR PAYMENT OF FEDERAL TAXES CANNOT ENJOIN COLLECTION THEREOF UNLESS HE FALLS WITHIN EXCEPTIONS TO SECTION 7421(a) OF 1954 INTERNAL REVENUE CODE.

William H. Stricker v. Clyde L. Bickerstaff, District Director of Internal Revenue (Civil No. 67-C-178; January 2, 1967; D.J. 5-59N-821) (68-1 U.S.T.C., Par. 9303)

This is an action to restrain the collection of certain federal tax assessments made against the taxpayer, W. H. Stricker, Star and Ritz, Star Amusement Company. Originally, an assessment was made against Star and Ritz, Star Amusement Company, Sand Springs, Oklahoma, a company owned by the taxpayer, for unpaid Federal Unemployment Tax Act taxes and Federal Insurance Contribution Act taxes for various periods in 1963, but the official records of the District Director of Internal Revenue were later changed to indicate that W. H. Stricker, Star and Ritz, Star Amusement Company were liable for the subject taxes. Thereafter a notice of levy was served upon the Sand Springs State Bank of Tulsa, Oklahoma, demanding that any money due and owing to the taxpayer in its possession, not to exceed the amount of the outstanding tax indebtedness, be turned over to the Internal Revenue Service, but the notice of levy was not honored.

The taxpayer then filed a suit to enjoin the collection of the tax indebtedness on the grounds that he was not the proper taxpayer liable for the payment thereof. The United States filed a motion to dismiss on the ground that the relief sought is prohibited by Section 7421 of the 1954 Internal Revenue Code.

Section 7421 of the 1954 Internal Revenue Code prohibits a suit from being brought to enjoin the collection of any tax unless the taxpayer falls within the enumerated exceptions to the statute. The taxpayer in the instant suit admittedly did not come within the statutory exceptions, but relies upon the case of Adler v. Nicholas, 166 F. 2d 674, in support of his claim for relief. However, it is well settled that a taxpayer cannot enjoin the collection of taxes merely because he claims that he is not liable for payment thereof, but rather his remedy is to pay the taxes in question and bring a refund suit. Floyd v.

United States, 361 F. 2d 312 (C. A. 4th). The Court's opinion in Adler was not inconsistent with this conclusion, since the United States in that case was enjoined from seizing that portion of the property of a partnership which was owned by two non-taxpayer partners to satisfy the individual income tax liability of a third taxpayer-partner.

Unlike the factual situation in the instant case, the United States never claimed in Adler that the non-taxpayer partners whose property was seized were the taxpayers liable for the taxes in question.

Since the taxpayer did not fall within the exceptions to Section 7421, the Court granted the motion to dismiss and denied the motion for a preliminary injunction.

Staff: United States Attorney Lawrence A. McSoud; Assistant United States Attorney James E. Ritchie (N.D. Okla.); William D. Holmes (Tax Division)

PRIORITY OF LIEN FOR TAXES

MORTGAGEES OF REALTY OWNED BY TAXPAYER WHO HELD EQUITABLE LIEN ON PROCEEDS FROM FIRE INSURANCE POLICY WERE ENTITLED TO PROTECTED STATUS OF PLEDGEES WITHIN SECTION 6323(a), PRIOR TO AMENDMENT BY P.L. 89-719, AND WERE ACCORDED PRIORITY OVER GOVERNMENT'S UNPERFECTED LIENS FOR TAXES.

Anthony Andrello v. Nationwide Mutual Fire Insurance Co., etc. (App. Div., 4th Dept., N.Y.); Miles Hoerle and Melvin Kowalsky v. Nationwide Mutual Life Insurance Co., etc. (App. Div., 4th Dept., N.Y., Civil No. 76; April 4, 1968; D.J. 5-50-2227 and 5-50-2225) (68-1 U.S.T.C. Par. 9332)

These cases, consolidated for trial and appeal, concerned rights to the proceeds of a fire insurance policy issued to Anthony Andrello by Nationwide Mutual Fire Insurance Company in the amount of $10,000 on a building owned by Andrello. Fire destroyed the premises, and Hoerle and Kowalsky, second mortgagees, claimed the proceeds of said policy under a provision in their mortgage which imposed upon Andrello the duty to keep the premises insured against loss by fire for the benefit of the second mortgagees. However, Andrello failed to honor said "loss payable" clause, and no such provision was added to the policy. Therefore, the second mortgagees had an equitable lien against the proceeds of the policy.

The Government asserted tax assessments against Andrello which arose prior to and after the fire which created the insurance proceeds. The notices of liens were filed in various County Recorder's offices. The Supreme Court of Oneida County held that the mortgagee's equitable lien, perfected upon

their filing of an action to obtain the insurance proceeds, primed the Government tax claims since the tax liens were not filed in the office of the clerk of the town where the taxpayer resided, as required by the then existing New York statute.

On appeal the Government conceded that the liens were improperly filed, but argued that the unfiled liens were valid against all except those classes of persons enumerated in Section 6323 of the Internal Revenue Code of 1954 as amended by the Federal Tax Lien Act of 1966.

The Appellate Division of the Supreme Court of New York, Fourth Department, unanimously affirmed the lower court's decision on April 4, 1968, and held (1) that the Federal Tax Lien Act of 1966 was not retroactive and had no effect on the transactions involved in this action which occurred before November 2, 1966, the effective date of said Act; (2) that the second mortgagees were pledgees under New York law and came within the protected classification of Section 6323 prior to its amendment in 1966; and (3) that the claim of the second mortgagees consequently was entitled to priority over the improperly filed tax liens as to the fire insurance proceeds.

The Appellate Division applied New York law in determining the nature of the taxpayer's interest in the property to be reached by the federal statute. Aquilino v. United States, 363 U.S. 509, 512-514 (1960). New York law expressly defines a "pledgee" in terms of a security interest created by a bailment, e.g., possession of the fire insurance policy by the morgagees as security for the debt arising out of the mortgage. Although the insurance policy was never in the possession of the mortgagees in this case, the court applied equitable principles and viewed the policy as having been physically assigned and delivered to the second mortgagees. The court held that the mortgagees were entitled to the status of pledgees under New York law and therefore were granted priority over the imperfectly filed liens of the Government.

The Appellate Division erred in not applying the Federal Tax Lien Act of 1966 to this matter. (A pledgee is clearly a holder of a "security interest" under the 1966 amendment and, therefore, the interests of the second mortgagees would not have been impaired by the application of the amendment to this action.) Furthermore, under New York decisions the holder of an equitable lien is not given a possessory right upon which he can by bootstrap methods elevate his status to that of a pledgee. (See In re Gruner, 295 N.Y.510, 522, 68 N.E. 2d 514, 520-521 (1946).) Nevertheless, the Government has decided not to pursue an appeal of this decision inasmuch as equitable considerations clearly lie with the mortgagees. But for the mortgagor's failure to perform his duty of obtaining a loss payable clause in the insurance policy, the mortgagees would have been entitled to the proceeds of the fire insurance policy. In addition, absent the fire which damaged the premises, the mortgagees'

security interest in the property arose prior to the federal tax liens and would have been entitled to priority over the Government's lien against Andrello.

Staff: United States Attorney Justin J. Mahoney; Assistant United States Attorney Samuel T. Betts, III (N. D. N. Y.); David E. Carmack and John S. Kingdon (Tax Division)

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