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For The Civil Practitioner Review Of Fourth Circuit Opinions In Civil Cases Decided November 1, 1991 Through December 31, 1992

FOR THE CIVIL PRACTITIONER

REVIEW OF FOURTH CIRCUIT OPINIONS IN CIVIL CASES DECIDED NOVEMBER 1, 1991 THROUGH DECEMBER 31, 1992

This is a collection of summaries of significant federal civil cases decided by the United States Court of Appeals for the Fourth Circuit during the fourteen months ended December 31, 1992. Members of the faculty of the Washington and Lee University School of Law wrote or reviewed the following summaries except the bankruptcy summaries, which Richard L. Wasserman, Esq. and Myriam J. Schmell, Esq. of the law firm of Venable, Baetjer and Howard in Baltimore, Maryland prepared.

I. Administrative Law and Procedure

Written by Professor Brian C. Murchison

A. Deference to Agency Interpretation

In *Maryland Department of Human Resources v. USDA*, 976 F.2d 1462 (4th Cir. 1992), the United States Court of Appeals for the Fourth Circuit held that the United States Department of Agriculture (USDA) permissibly interpreted the Food Stamp Act of 1977, 7 U.S.C. sections 2011-2032, in promulgating regulations governing the agency's evaluation of state proposals submitted to the USDA under the state-federal food stamp program. Reversing the district court, the Fourth Circuit invoked judicial deference to an administrative agency's statutory interpretation, based on the modern landmark case of administrative law, *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (establishing two-step analytical framework for judicial review of agency interpretation of statutes).

In its 1985 and 1986 sessions, the Maryland General Assembly approved welfare increases for poor people. The legal characterization of the state increases became all-important. If the grants were merely general welfare increases, they would be considered "income" for purposes of calculating a recipient's eligibility or benefit level for food stamps under the Food Stamp Act. If, however, the grants were "energy assistance," they would be excluded from income. Pursuant to the Maryland General Assembly's designation of the increases as "energy assistance," the Maryland Department of Human Resources, which administers the state-federal Food Stamp Program in Maryland, sought permission from the USDA, which oversees the Food Stamp Program nationwide, to exclude Maryland's new payments from income calculations. The USDA declined, labeling the Maryland grants general inflationary welfare increases and *not* bona fide "energy assistance"

payments. The USDA relied on its own regulation which listed factors for evaluating the purpose of a state welfare increase.

Determining whether the agency's regulation was consistent with the Food Stamp Act necessitated an application of *Chevron*. However, the Fourth Circuit's analysis demonstrated that review of an agency's statutory interpretation under the two-step *Chevron* test is anything but predictable. The magistrate and the federal trial judge had disposed of the case at *Chevron*'s "Step One": inspection of legislative history disclosed congressional intent on the precise question at issue. This obviated any need to advance to Step Two's analysis of whether the agency's interpretation was rational and thus merited "deference." The Fourth Circuit, on the other hand, appeared to treat the case as a "Step Two" case. The court strongly implied that Step One involves inspection of the statute's "actual language" alone, unaided by reference to legislative history. 976 F.2d at 1472. Because the Food Stamp Act by its terms did not explicitly address the precise question at issue, the court proceeded to Step Two's question of rationality. Only at Step Two did the court consider legislative history.

Here, the court found that the statutory interpretation upon which the USDA based its regulation was "firmly" grounded in a rational reading of legislative history. 976 F.2d at 1472. The lower court, which had read the statute quite differently, suffered from a "fundamental misunderstanding of the legislative record," "overlooked or misconstrued the most relevant evidence of congressional intent," and relied on "selective, general comments by individual legislators instead of directly relevant and highly specific passages. . . ." *Id.* at 1473.

Perhaps the fundamental difference between the Fourth Circuit's decision and the decisions below was not so much a dispute over when to consider legislative history—at Step One or Step Two—or a dispute over how to read legislative history—"selective[ly]" for its "tidbits," or "properly" for its "directly relevant" passages. 976 F.2d at 1473. The key difference was likely over the appropriate judicial role with respect to the subject matter of the case. As the court noted, quoting from a 1990 case, "'Judicial deference is especially appropriate in the area of welfare administration.'" *Id.* at 1470 (quoting *Mowbray v. Kozlowski*, 914 F.2d 593, 598 (4th Cir. 1990)).

B. Exhaustion of Administrative Remedies

In *Darby v. Kemp*, 957 F.2d 145 (4th Cir.), *cert. granted*, 113 S. Ct. 404 (1992), the Fourth Circuit held that an individual who had been debarred by an Administrative Law Judge (ALJ) of the Department of Housing and Urban Development (HUD) from entering into transactions with HUD and other executive agencies must exhaust the administrative appeal process within the agency before filing suit in federal district court. HUD officials charged a real estate developer with devising a scheme to circumvent agency rules governing HUD's single-family and multi-family mortgage insurance programs. After an administrative hearing, the ALJ debarred the developer from virtually all nonprocurement transactions with executive agencies for

eighteen months. Although the developer, pursuant to HUD regulations, could have petitioned the Secretary of HUD for review of the ALJ's initial decision, the developer proceeded immediately to bring suit in federal district court, seeking a declaration that the debarment was statutorily and constitutionally infirm. In a motion to dismiss, HUD argued that the developer was obliged to exhaust the administrative appeal process. The district court denied the motion. The Fourth Circuit unanimously reversed, holding that while the HUD regulation establishing the process for petitions for review "does not expressly mandate exhaustion of administrative remedies prior to filing suit," exhaustion is nonetheless required as a matter of administrative law. 957 F.2d at 148.

The court noted that no exceptions to the exhaustion doctrine applied. A mere "unsupported allegation" that exhaustion would be "futile" was insufficient to excuse the developer from the requirement. 957 F.2d at 147-48 (citing *Thetford Properties IV Ltd. Partnership v. HUD*, 907 F.2d 445, 450 (4th Cir. 1990)). Nor was the "adequacy" of the administrative remedy problematic; although the Secretary of HUD has thirty days within which to decide whether to grant review, has discretion to extend that period, and may also extend the regulatory deadline for reaching a decision once review is granted, the court found the agency process adequate, absent "a showing that the Secretary has failed, or will fail, to act within a reasonable period of time." *Id.* at 148. Finally, although application of the exhaustion doctrine would bar judicial review of the merits because the developer had missed the deadline for filing the petition for review, this circumstance failed to trouble the court: "Darby, by strategic decision or otherwise, allowed the filing period to pass." *Id.*

The court's decision reaffirms the importance of the "rule of judicial administration that even when a statute does not impose an explicit directive, exhaustion is still required." 957 F.2d at 147 (citing *Holcombe v. Colony Bay Coal Co.*, 852 F.2d 792, 795 (4th Cir. 1988)). More importantly, the case signals that the Fourth Circuit will not lightly seize upon exceptions to that rule, even in an instance of significant agency action against an individual, such as debarment.

Aspects of the exhaustion doctrine presented two issues in *Nealon v. Stone*, 958 F.2d 584 (4th Cir. 1992). The Fourth Circuit first held that a civilian Army employee bringing suit in federal court against the Secretary of the Army under Title VII of the Civil Rights Act of 1964, 42 U.S.C. sections 2000e to e-17, first must exhaust the administrative process established by regulation, 29 C.F.R. section 1613.214(a)(1)(i)—contact the Army's Equal Employment Opportunity counselor within thirty days of the incident in question. The district court thus properly dismissed the Title VII claim of a plaintiff who had failed to take this step.

Some solace for plaintiffs under these circumstances may be found in the Fourth Circuit's willingness to examine the applicability of equitable tolling principles because the thirty-day exhaustion requirement is "akin to a statute of limitations." 958 F.2d at 590 n.4. However, such principles

were found inapplicable to the facts of *Nealon*. Solace may be found, too, in the court's comment that Nealon had mistakenly "failed to raise the issue of a continuing violation with respect to her Title VII claim below," *id.*, to avoid the exhaustion problem.

An additional issue was whether the plaintiff was required to exhaust her second Title VII claim—that the Army had retaliated against her for filing administrative charges—at the agency level before bringing the claim to federal court. Following the rule of other circuits, the Fourth Circuit held that "a separate administrative charge is not prerequisite to a suit complaining about retaliation for filing the first charge." 958 F.2d at 590 (citing *Malhotra v. Cotter & Co.*, 885 F.2d 1305, 1312 (7th Cir. 1989)). After adopting the nonexhaustion rule, the court noted that attainment of one of the goals of exhaustion in the context of Title VII and Equal Pay Act claims—conciliation with the employer—would be unlikely in the circumstances of this case.

C. *Age Discrimination—Sufficiency of Evidence*

In a civil enforcement suit brought by the Equal Employment Opportunity Commission (EEOC) 'pursuant to section 7(b) of the Age Discrimination in Employment Act of 1967 (ADEA), 29 U.S.C. section 626(b), *EEOC v. Clay Printing Co.*, 955 F.2d 936 (4th Cir. 1992), the Fourth Circuit affirmed a district court's grant of summary judgment for the defendant. The EEOC's suit had alleged ADEA violations on behalf of twenty-three claimants. The district court entered summary judgment for the defendant on all twenty-three claims, and the agency appealed nine claims to the Fourth Circuit. In a 2-1 decision, the court affirmed summary judgment on the grounds of insufficient evidence of age discrimination. "[W]hat is really before this court," the court stated, "is a vain attempt by the EEOC to create a triable issue of age discrimination out of little more than thin air." 955 F.2d at 944. In a footnote, the court appeared to question the agency's tactics, noting that "the EEOC sought many of the claimants out and encouraged them to file charges . . . ." *Id.* at 944 n.6.

Three factors militated in favor of summary judgment. The court highlighted the "admission under oath" of each claimant that "he (she) could not identify any statement or evidence of age discrimination in any of [the defendant's] employment decisions." 955 F.2d at 941. In addition, the court stated that "the limited statistical evidence" suggested "anything but a youth movement" at the defendant's firm. *Id.* Finally, the court discounted allegedly discriminatory statements because they "were not directly related to any particular person, employment decision or pattern of decisionmaking." *Id.* A sharp dissent noted that the court's first and second reasons should not be "dispositive on summary judgment when there is conflicting evidence in the record," and maintained that the third reason "appears to misconstrue critical aspects of the record." *Id.* at 949.

D. *Judicial Review of Agency Determination*

Doyle v. Arlington County School Board, 953 F.2d 100 (4th Cir. 1991), involved the scope of judicial review of findings of fact made by a state

administrative hearing officer pursuant to the Individuals with Disabilities Education Act (IDEA), 20 U.S.C. sections 1400-1485. Parents of a learning disabled child asked the Arlington County School Board to place their child in a private school and pay the child's tuition and school expenses for the next academic year. When the school system countered with a proposal to place the child in a public school program, the parents requested an administrative hearing. A local hearing officer took evidence, heard testimony, and ruled for the parents. On appeal, a State Board of Education reviewing officer ruled for the school system that the "mandates of the [IDEA]" had been met by the system's plan for the child. 953 F.2d at 102. In particular, the reviewing officer disagreed with the local hearing officer on the credibility of one of the parents' witnesses. Concluding that the witness "saw her role as that of an advocate," the reviewing officer discredited the witness's testimony, without having "seen or heard" the witness testify. *Id.* at 104. The district court, which was required to make "an independent decision based on a preponderance of the evidence, while giving due weight to state administrative proceedings," *id.* at 103 (citations omitted), affirmed the reviewing officer's decision.

The Fourth Circuit held that the "due weight" which the district court was to give the reviewing officer's decision in this case was precisely "none." 953 F.2d at 104. The reviewing officer's decision to discredit the testimony of the parents' witness, "in the face of the crediting of the same witness by a hearing officer who had seen and heard the witness testify," was a significant departure "from the accepted norm of a fact-finding process designed to discover truth." *Id.* The Fourth Circuit held that in IDEA cases findings of fact made by hearing officers "in a regular manner and with evidentiary support are entitled to presumptive validity . . . akin to the traditional sense of permitting a result to be based on such fact-finding, but not requiring it." *Id.* at 105. Where a district court chooses not to follow such findings of fact, that court "is required to explain why it does not." *Id.* "After giving the administrative fact-findings such due weight, if any, the district court then is free to decide the case on the preponderance of the evidence, as required by [IDEA]." *Id.* In the instant case, the Fourth Circuit found that the reviewing officer's findings were entitled to no weight and that the hearing officer's findings were "entitled to *prima facie* correctness." *Id.*

The court linked its decision to traditional notions that the crediting of witnesses by triers of fact and the findings made thereby should not be disregarded without explanation. The court's care with respect to the hearing officer's findings seems consistent with the IDEA's requirement that "the education of each disabled child be tailored to the needs of that child." 953 F.2d at 106.

E. Social Security Disabilities—New and Material Evidence

Wilkins v. Secretary, Department of Health & Human Services, 953 F.2d 93 (4th Cir.) (en banc), *rev'g* 925 F.2d 769 (4th Cir. 1991), involved a

claimant's appeal from an Administrative Law Judge's (ALJ's) decision under Title II of the Social Security Act, 42 U.S.C. sections 401-433. Having been denied disability insurance benefits (DIB) by the ALJ, the claimant sought review by the Appeals Council, including consideration of a treating physician's letter relevant to the date of the claimant's disability status. One question was whether Social Security Administration regulations governing the review authority of the Appeals Council, 20 C.F.R. section 404.970, required the Appeals Council to consider the letter in deciding whether to grant review of the ALJ's decision.

The court en banc, parting from the unanimous panel's interpretation below, concluded that "the plain wording" of the regulations does require the Appeals Council to "consider new and material evidence relating to the period on or before the date of the ALJ decision in deciding whether to grant review." 953 F.2d at 95. The court then found that the letter conformed to these requirements, that the Appeals Council did consider the letter in deciding whether to grant review, and that the letter became part of the "record as a whole" for purposes of judicial review. *Id.* at 96. In the absence of "persuasive contrary evidence," the physician's retrospective opinion expressed in the letter was entitled to "great weight." *Id.* The court concluded that "on this record" the decision denying the DIB claim was not supported by substantial evidence. *Id.*

F. FAA—Environmental Impact Findings

In *North Carolina v. FAA*, 957 F.2d 1125 (4th Cir. 1992), the Fourth Circuit upheld a final rule of the Federal Aviation Administration (FAA) initiated at the request of the United States Navy. The rule altered and redesignated three special use airspace areas restricted for military activities over eastern North Carolina. Use of the areas involved practice bombing and laser-guided standoff weapons training; environmental concerns included "noise from the aircraft, the danger to wildlife, and the danger from the use of lasers. . . ." 957 F.2d at 1130. The State of North Carolina's legal challenge included allegations that in promulgating the rule the FAA violated the National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. sections 4321-4347, and implementing regulations of the Council on Environmental Quality (CEQ), 40 C.F.R. sections 1500-1517.

In response to the State's charge that the FAA had blindly adopted the Navy's environmental review documents without independent study, the court found that the FAA's actions—reviewing the Navy's assessment and issuing its own "finding of no significant impact" (FONSI) on the environment—were adequate to meet the requirements of NEPA and the CEQ regulations. 957 F.2d at 1130. The court also held that the FAA was not arbitrary in omitting an analysis of the "cumulative impact" of existing and proposed special use airspace areas in eastern North Carolina when such an analysis would be part of a forthcoming Marine Corps environmental impact statement covering other military operations proposed for the region. *Id.* at 1131. In addition, the court held that the FAA's refusal to prepare its own

environmental impact statement was not arbitrary and capricious because the FAA adopted a detailed environmental review by the Navy, and controversy concerning cumulative environmental impact would be addressed in the Marine Corps' forthcoming report. *Id.* at 1131-34.

G. EPA—Veto of Dredge and Fill Permit

In *James City County v. EPA*, 955 F.2d 254 (4th Cir. 1992), the Environmental Protection Agency (EPA) had vetoed a decision by the Army Corps of Engineers granting a permit to James City County to place fill for the construction of a dam. Facing water shortages for its growing population, the County had sought the permit in order to construct a water reservoir. The EPA's veto decision cited adverse environmental effects of the proposed project as well as a finding that less environmentally damaging alternatives existed. A district court overturned the EPA's veto on grounds that the agency erred in concluding that alternatives were available to the County. The district court then declined to remand the matter to the agency and ordered the Army Corps of Engineers to issue the permit.

The Fourth Circuit upheld the district court's decision to overturn the veto. Using the "substantial evidence" standard of review of the Administrative Procedure Act, 5 U.S.C. section 706(2)(E), the court determined that the EPA's finding that the County had practicable alternative water sources lacked sufficient support in the record. 955 F.2d at 259. The "substantial evidence" test thus prompted a judicial hard look at the agency's rationale, rather than wholly deferential rubber-stamping of administrative conclusions. The court parted from the district court opinion, however, in deciding to remand the matter to the EPA for further proceedings, specifically to enable the agency to consider whether its additional reservation about the dam—adverse environmental effects—"would alone justify a veto." *Id.* at 260. Recognizing that remands often result in harmful delay, the court stated that it would hold the EPA to its counsel's promise at oral argument that the agency would act within sixty days.

H. National Environmental Policy Act—"Major Federal Action"

In *Sugarloaf Citizens Ass'n v. Federal Energy Regulatory Commission*, 959 F.2d 508 (4th Cir. 1992), public interest groups contested the Federal Energy Regulatory Commission's (FERC's) certification of an incinerator as a qualifying small power production facility under section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. section 824a-3. The groups argued that the certification was a "major Federal action" under National Environmental Policy Act of 1969 (NEPA) section 102, 42 U.S.C. section 4332, and a federal "undertaking" under National Historic Preservation Act (NHPA) section 106, 16 U.S.C. section 470f, thus triggering appropriate review that FERC had omitted.

The court evinced no sympathy for the claims. The court first held that the standard of review of an agency determination that an action is not a "major Federal action" is "reasonableness under the circumstances." 959

F.2d at 512 (citations omitted). FERC's determination that its certification of the incinerator was not a "major Federal action" was deemed reasonable for several reasons. First, the "ministerial" nature of agency certification deprived the agency of discretion in the matter and precluded the agency from considering environmental factors. *Id.* at 513. Second, FERC had insufficient control over the project to "federalize" it because the operator of the incinerator could have constructed the facility without FERC certification if it chose to give up the PURPA benefits, and because the agency provided no federal funding "or other substantial federal assistance" to the project. *Id.* at 513-14. Further, because "[t]he standard for triggering NHPA requirements is similar to that for the triggering of NEPA requirements," *id.* at 515, the NHPA arguments failed as well.

II. Arbitration, Labor Relations and Employment Discrimination

Written by Professor Mark H. Grunewald

A. Federal Agencies—Duty to Bargain

In *Social Security Administration v. Federal Labor Relations Authority*, 956 F.2d 1280 (4th Cir. 1992), the Fourth Circuit held that the Federal Service Labor-Management Relations Statute (FSLMRS), 5 U.S.C. sections 7101-7135, does not impose upon federal agencies a duty to bargain over union proposals made during the term of a collective bargaining agreement. The case arose, when during the term of its collective bargaining agreement with the Social Security Administration (SSA), the American Federation of Government Employees (AFGE) proposed the payment of relocation expenses for employees who relocated as the result of promotion from within the SSA, a subject on which the agreement was silent. The SSA refused to bargain, and the AFGE filed an administrative complaint with the Federal Labor Relations Authority (FLRA). The FLRA concluded that the SSA's refusal to bargain constituted an unfair labor practice. On review, the court ruled that while an FLRA decision was generally entitled to "considerable deference," 956 F.2d at 1283, its examination of the language and design of the statute as a whole made clear that the FLRA interpretation was incorrect. The court acknowledged that the language of the statute did not deal with the issue of mid-term union proposals, but found the statutory language requiring the agency to bargain for the purpose of "arriving at *a collective bargaining agreement*" suggested that post agreement bargaining was not required. *Id.* at 1284 (citing 5 U.S.C. § 7114(a)(4) (1988)). The court found confirmation for this view in the language of the statute that explicitly required the Agency to bargain over the "impact and implementation" of changes in employment it made mid-term. *Id.* The court also found support for its conclusion in the legislative history of the statute and rejected a contrary conclusion of the District of Columbia Circuit on the ground that it had relied too heavily on private sector labor law precedent which requires such bargaining. Finally, the court expressed the view that to conclude that the FSLMRS duty to bargain extended to union-initiated mid-term proposals

would jeopardize the overriding goal of the statute to protect the "'paramount right of the public to as effective and efficient a Government as possible.'" *Id.* at 1288 (quoting H.R. CONF. REP. No. 1717, 95th Cong., 2d Sess. 154 (1978), *reprinted in* LEGISLATIVE HISTORY OF THE FEDERAL SERVICE LABOR-MANAGEMENT RELATIONS STATUTE, TITLE VII OF THE CIVIL SERVICE REFORM ACT OF 1978 793, 822 (Comm. Print 1979)).

B. Preemption

In *Richardson v. Kruchko & Fries*, 966 F.2d 153 (4th Cir. 1992), the Fourth Circuit held that the National Labor Relations Act (NLRA), 29 U.S.C. sections 151-187, preempts a tort action by a former employee against the legal counsel of her former employer for intentional infliction of emotional distress or intentional interference with business relations. The plaintiff alleged that the law firm advised her employer to discharge her for union activity. The court viewed the former employee's claims an "artfully pleaded," 966 F.2d 158, attempt to avoid the general preemption standard of the NLRA which precludes state regulation of conduct "'actually or arguably' protected . . . or 'prohibited'" by federal statute. *Id.* at 156 (citations omitted). The Fourth Circuit reasoned that to address either of the former employee's tort claims, a court would have to determine whether her discharge was an "unfair labor practice" under the NLRA—a question reserved by the preemption doctrine to the National Labor Relations Board to avoid the risk of undermining national policy through inconsistent state-law judgments. *Id.* at 158. The court recognized that under its ruling the plaintiff would be limited to the process and remedies of the NLRA as against her former employer and would not be able to attack the allegedly tortious conduct of the law firm. The court nevertheless concluded that to depart from the preemption doctrine when a plaintiff sought to use state law against a defendant who could not be reached under the NLRA would create an intolerably large exception that could disrupt important relationships such as, in this case, the attorney-client relationship. Accordingly, the Fourth Circuit affirmed the district court's dismissal of the plaintiff's complaint.

C. Fair Labor Standards Act—Overtime

In *Wilson v. City of Charlotte*, 964 F.2d 1391 (4th Cir. 1992) (en banc), the Fourth Circuit held by a vote of 7-6 that in a state that prohibits collective bargaining by governmental units with their employees, a union of public employees is not the "representative" of the employees for the purposes of section 7(o) of the Fair Labor Standards Act of 1938 (FLSA), 29 U.S.C. section 207(o). Section 7(o) requires cash payment rather than compensatory time off for overtime hours unless an agreement to the contrary is reached between the public employer and the "representative" of its employees. Under the court's view, the city fire fighters had no "representative" and thus section 7(o), as interpreted in Department of Labor regulations, 29 C.F.R. section 553.23(a)(1), permitted the public employer to continue unilaterally a practice of compensatory time off in lieu of cash

payment. While the majority viewed its construction of 7(o) as necessary to avoid conflict with state law with respect to public employee collective bargaining, the dissent saw the role of the representative under 7(o) as simply the employee representative for arriving at an "agreement," 964 F.2d at 1401, but not a "collective bargaining agreement," *Id.* at 1402, with the employer as to which of two regulatory standards—time off or cash payment—would apply. The choice offered by the statute was part of a legislative compromise after the FLSA was applied again to state and local governmental employers when the Supreme Court in *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), overruled its 1972 decision in *National League of Cities v. Usery*, 426 U.S. 833 (1976), which had found application of the FLSA to state and local governments unconstitutional. The Fourth Circuit's decision has the effect of limiting employee participation in the choice between the two forms of compensation under the federal wage-hour law in states which restrict public employee collective bargaining—a subject not directly related to the purposes of the FLSA.

D. Age Discrimination in Employment—EEOC Investigative Authority

In *Equal Employment Opportunity Commission v. American & Efird Mills, Inc.*, 964 F.2d 300 (4th Cir. 1992) (per curiam), the Fourth Circuit held that the Equal Employment Opportunity Commission (EEOC) has statutory authority to investigate possible discrimination under Age Discrimination in Employment Act of 1967 (ADEA) section 7(a), 29 U.S.C. section 626(a), even where the individual charge triggering the investigation is time barred. A former employee of American & Efird filed a charge with the EEOC, claiming that the company had discharged him nineteen months earlier because of his age. Under the ADEA, an individual charge of discrimination must be filed with the EEOC within six months of the alleged discriminatory act. The EEOC notified the company of the charge and requested information about the company's general employment practices and policies and about the circumstances of the former employee's discharge. The company refused to provide any of the information on the ground that the individual charge was time barred. After further efforts to obtain the information failed, the EEOC issued an administrative subpoena against the company and ultimately brought an action in federal district court to have its subpoena enforced.

Relying on *EEOC v. Ocean City Police Department*, 820 F.2d 1378 (4th Cir. 1987) (en banc), *vacated on other grounds*, 486 U.S. 1019 (1988), which dealt with investigation under Title VII of the Civil Rights Act of 1964, the district court refused to enforce the EEOC subpoena, reasoning that the EEOC had no authority to investigate a time barred age discrimination charge. 964 F.2d at 304. The Fourth Circuit vacated the district court decision and remanded the case, ruling that the general investigatory authority granted to the EEOC in section 7(a) of the ADEA, 29 U.S.C. section 626(a), includes the power to investigate age discrimination in employment independent of individual charges. The court distinguished this authority from the investi-

gatory authority of the EEOC in the cases of race and sex discrimination under Title VII where the power to investigate is ordinarily dependent upon the filing of a timely individual charge.

III. BANKRUPTCY

Written by
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A. Classification of Claims and "Cramdown"

In *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir.), *cert. denied*, 113 S. Ct. 191 (1992), the Fourth Circuit dealt with a Chapter 11 debtor's plan of reorganization that provided, among other things, for the separate classification of a nonrecourse mortgagee's deficiency claim from other unsecured creditors. *See* 11 U.S.C. § 1111(b) (1988) (dealing with Chapter 11's allowance of nonrecourse mortgagee's deficiency claims). In addition, the plan also allowed the debtor's limited partners to retain their interests in the partnership in exchange for cash contributions to the debtor. The bankruptcy court and the district court approved the plan. In reversing, the Fourth Circuit held that the separate classification of the nonrecourse mortgagee's deficiency claim in a case where all unsecured claims would receive the same distribution treatment under the plan was for the purpose of manipulating the voting on the plan and, therefore, impermissible.

The Fourth Circuit then addressed the issue of the absolute priority rule and the "new capital exception." 961 F.2d at 503. While not deciding whether the new value exception survived under the Bankruptcy Code, the Fourth Circuit concluded that it would not apply in this case. The debtor's limited partners' exclusive right to contribute new capital, which in effect allowed them to purchase the property without the risk of outside potential buyers, constitutes "property" under 11 U.S.C. section 1129(b)(2)(B)(ii) that was received or retained on account of a prior interest. 961 F.2d at 504-05. The proposed reorganization plan, which in this case provided the debtor's limited partners with the exclusive right to contribute and recover new capital prior to the first mortgagee's recovery of its unsecured claim, was not "fair and equitable" where the first mortgagee was the only truly impaired creditor. *Id.* at 505.

B. Fraudulent Conveyances and Preferences

In *In re Jeffrey Bigelow Design Group, Inc.*, 956 F.2d 479 (4th Cir. 1992), a third party purchased fifty percent of the stock in the debtor in exchange for a cash payment and the arrangement with a bank for a line of credit for the benefit of the debtor. Although the third party was the maker of the line of credit, only the debtor received the draws and all payments were made directly by the debtor to the bank. After the debtor filed its bankruptcy petition, the Chapter 7 trustee filed a complaint to recover payments from the debtor to the bank as fraudulent conveyances

and/or voidable preferences. With respect to the fraudulent conveyance claims, the Fourth Circuit determined that all facts taken together did not lead to the conclusion that actual fraud existed for purposes of 11 U.S.C. section 548(a)(1) of the Bankruptcy Code, where a debtor made payments on a line of credit for which its shareholder was the maker but the debtor received all draws under the line of credit. "Actual fraudulent intent" for purposes of 11 U.S.C. section 548(a)(1) requires a "subjective evaluation of the debtor's motives;" an objective determination is not conclusive. 956 F.2d at 483. In addition, the trustee failed to prove constructive fraud under 11 U.S.C. section 548(a)(2) where reasonably equivalent value was given in exchange for the payments. The proper focus is the "net effect" of the transfers on the debtor's estate—the funds available to the unsecured creditors. *Id.* at 484. Because the transfers by the debtor served simply as repayment of money it had received, no fraudulent transfer had occurred. In the course of its analysis, the court cited with approval the so-called "indirect benefit rule," concluding that the net effect of the transfers at issue in this case did not deplete the bankruptcy estate. With respect to the preference claims, the Fourth Circuit applied the Supreme Court's holding in *Union Bank v. Wolas*, 112 S. Ct. 527 (1991), and concluded that the repayments were made in the ordinary course of business and were, therefore, not avoidable as preferences. 956 F.2d at 486. Although not "commonplace," the three party transaction in this case still met the tests of 11 U.S.C. section 547(c)(2). 956 F.2d at 488. Also of interest, the Fourth Circuit in a footnote expressly declined to comment on viability of the so-called *Deprizio* "insider preference" theory. *Id.* at 483.

C. Automatic Stay

In *In re Robbins*, 964 F.2d 342 (4th Cir. 1992), the Fourth Circuit dealt with a Chapter 11 debtor's wife who moved to lift the automatic stay imposed by 11 U.S.C. section 362 in her husband's bankruptcy case to allow their state court divorce action to continue. In analyzing whether cause exists to lift the automatic stay to allow pending state court litigation to continue, the Fourth Circuit enumerated several factors that courts should consider, including,

> (1) whether the issues in the pending litigation involve only state law, so the expertise of the bankruptcy court is unnecessary; (2) whether modifying the stay will promote judicial economy and whether there would be greater interference with the bankruptcy case if the stay were not lifted because matters would have to be litigated in bankruptcy court; and (3) whether the estate can be protected properly by a requirement that creditors seek enforcement of any judgment through the bankruptcy court.

964 F.2d at 345. After finding that state courts are uniquely qualified to determine marital property claims, the Fourth Circuit held that cause existed to lift the stay to determine the equitable distribution of assets. The court

stated, however, that the bankruptcy court would retain jurisdiction to later determine the allowance of the wife's claim against the debtor husband's estate.

D. Household Goods and Lien Avoidance

In *In re McGreevy*, 955 F.2d 957 (4th Cir. 1992), a Chapter 7 debtor filed a motion to avoid a lien on her shotgun and rifle asserting that the firearms were "household goods" within the meaning of 11 U.S.C. section 522(f)(2)(A). Bankruptcy Code section 522(f) permits a debtor to avoid certain liens on "household goods" which are held primarily for personal, family or household use by the debtor or a dependent of the debtor. 11 U.S.C. § 522(f) (1988). The Fourth Circuit rejected the two current definitions of household goods and formulated a new interpretation of the term, which explicitly incorporates a requirement that there be a "functional nexus between the good and the household." 955 F.2d at 961. The court concluded that the requisite functional nexus did not exist and the lien was, therefore, not subject to avoidance. The debtor's firearms were not used to support and facilitate daily life within the home; rather, they were used exclusively away from the home and curtilage. The Fourth Circuit refused, however, to adopt a per se rule that firearms can never be household goods under its newly-adopted definition.

E. Procedure

In *In re Serra Builders, Inc.*, 970 F.2d 1309 (4th Cir. 1992), a Chapter 13 debtor filed a motion to avoid a foreclosure sale of real property as a fraudulent conveyance. On appeal from the bankruptcy court's grant of summary judgment to the defendants, the district court dismissed the debtor's appeal because the debtor did not comply with the procedural requirements of Bankruptcy Rule 8006, which mandates that an appellant file a designation of the record on appeal within ten days after filing a notice of appeal. In this case, the debtor filed its designation of the record fifteen days late. The Fourth Circuit held that noncompliance with Bankruptcy Rule 8006, without providing the court with a compelling reason for the delay in filing the required designation, justified dismissal of the appeal. The court established the criteria a district court should follow in determining whether to dismiss a party's bankruptcy appeal for violating Bankruptcy Rule 8006. 970 F.2d at 1311 (citing *J.R. Orgain, Jr. v. Soil Conservation Serv.*, No. 89-2745, slip op., 898 F.2d 146, 1990 WL 27359 (4th Cir. 1990)). Specifically, the court held that a district court must take at least one of the following steps: "(1) make a finding of bad faith or negligence; (2) give the appellant notice and an opportunity to explain the delay; (3) consider whether the delay had any possible prejudicial effect on the other parties; or (4) indicate that it considered the impact of the sanction and available alternatives." 970 F.2d at 1311. In this case, the district court found that the appellant failed to present any compelling reasons for its delay in filing its designation and that the appellant was negligent with regard to the entire procedural appeals

process. The appellant's explanation that its attorney was out of the country was held not to be sufficient.

In *In re Nantahala Village, Inc.*, 976 F.2d 876 (4th Cir. 1992), a Chapter 11 debtor filed suit against a bank alleging breach of contract and fraud. The bank moved for summary judgment but the debtor did not respond. Because this was a "non-core" proceeding, the bankruptcy court entered proposed findings of fact and conclusions of law pursuant to 28 U.S.C. section 157(c)(1) and Bankruptcy Rule 9033 and recommend that the district court grant the bank's motion for summary judgment. 976 F.2d at 879. The debtor did not object to the proposed findings of fact and conclusions of law within the ten-day time period prescribed in Bankruptcy Rule 9033. The district court adopted the bankruptcy court's recommendation that summary judgment be granted for the bank and the debtor appealed. The Fourth Circuit affirmed the district court's grant of summary judgment and held that the debtor's failure to file written objections within the ten-day time period constituted a waiver of its right to appeal from the district court's adoption of the proposed findings of act and conclusions of law.

IV. Constitutional Law

Written by Professor Allan P. Ides

A. Due Process—Abolition of Common Law Cause of Action

Dinh v. Rust International Corp., 974 F.2d 500 (4th Cir. 1992), involved a plaintiff who was injured while working in a brickyard in Virginia. The pulley portion of a conveyor that had been installed in 1959 caused his injuries. He sued the parties responsible for the design, manufacture, and installation of the conveyor. A Virginia statute of repose provided that no action to recover damages for injuries sustained by a "'defective and unsafe condition of an improvement to real property'" could be brought against any "'person performing or furnishing the design, planning, supervision of construction or construction of such improvement . . . more than five years after the performance of such services.'" 974 F.2d at 500-01 (quoting Va. Code Ann. § 8.01-250 (Michie 1992)). The district court granted summary judgment for the defendants and the Fourth Circuit affirmed. The court of appeals held that the Virginia statute of repose applied to the circumstances of this case, in essence, prospectively abolishing plaintiff's claim against defendants. The court further held that nothing in the Due Process Clauses of the Fifth or Fourteenth Amendments prohibited the prospective abolition of common law causes of action.

B. Due Process—Land Use

Gardner v. City of Baltimore, 969 F.2d 63 (4th Cir. 1992), involved a proposed a residential subdivision within the City of Baltimore. After several years of effort, the City finally granted the necessary permit. At that point,

however, plaintiff had lost the land through a bankruptcy proceeding. Plaintiff sued the city and various individuals under 42 U.S.C. section 1983, claiming a violation of due process and equal protection and a taking without just compensation. The district court granted a summary judgement for the defendants on all claims. On appeal, plaintiff challenged only the dismissal of the due process claim. In essence, plaintiff argued that the permit, to which he claimed an entitlement, was arbitrarily delayed due to pressure from influential residents of an adjacent subdivision. The court of appeals held that plaintiff's substantive due process claim was dependent on whether plaintiff had a property interest in the permit—whether the permit was an entitlement within the meaning of the Due Process Clause. In the absence of an entitlement there is no property interest to be afforded due process. The key to the entitlement determination is found in the amount of discretion vested in the issuing body. If the issuing body, here the Planning Commission, has discretion to deny the permit, there is no entitlement. The court of appeals found that the Planning Commission did have considerable discretion to deny the permit. Therefore, the permit was not an entitlement, and the protection of due process did not attach. Counsel should note that the court gave a very broad sweep to the concept of discretion in an effort to discourage due process litigation in the land use context. This curtailment of substantive due process challenges to land use should not, however, diminish the efficacy of takings challenges, including those challenges seeking damages for interim takings.

C. Due Process—No-Notice Evictions from Public Housing

In *Richmond Tenants Organization, Inc. v. Kemp*, 956 F.2d 1300 (4th Cir. 1992), the plaintiffs, various individuals and tenant organizations, brought suit challenging the constitutionality of summary eviction procedures proposed for use against public housing tenants. These procedures would allow local United States Attorneys the discretion to remove tenants from their homes without notice upon an *ex parte* showing "of probable cause to believe that the property was used to facilitate the violation of drug laws." 956 F.2d at 1302. The party being evicted did not have to be involved in the drug activity. The Fourth Circuit held that "absent exigent circumstances, no-notice evictions violate due process." *Id.* at 1306 (citing *United States v. Premises & Real Property at 4492 South Livonia Road*, 889 F.2d 1258 (2d Cir. 1989)). Ordinarily a tenant must be afforded notice and an opportunity to be heard prior to the eviction. The court emphasized the substantiality of the interest at stake, namely, a place to live, and contrasted that interest with those cases involving the seizure of yachts, cars, or currency, where a lesser threshold of process was considered adequate. The violation of drug laws was not deemed to be a sufficient, all-purpose exigent circumstance. The court of appeals also upheld the district court's issuance of a nationwide permanent injunction against the use of no-notice evictions by the Department of Justice. The injunction would, however, permit individual district court judges the authority to determine if exigent circumstances warranted a no-notice eviction in any particular case.

D. Due Process—Termination of Public Employment

In *Linton v. Frederick County Board of County Commissioners*, 964 F.2d 1436 (4th Cir. 1992), the Frederick County terminated the plaintiff's employment as its chief of highway operations. On the day before his termination, he received a two-page, single-spaced memorandum entitled, "Notice of Dismissal." 964 F.2d at 1436. The Notice described several specific instances of plaintiff's failure to perform as required; it also included a more general criticism of plaintiff's management style. Upon receipt of the Notice, plaintiff was provided a brief opportunity to respond to the charges. Plaintiff was then given the option of resigning. He was given until the following morning to decide. After discussing the matter with his family, plaintiff decided not to resign. His employment was immediately terminated. Plaintiff was, however, afforded a post-termination administrative appeal. Plaintiff filed suit under 42 U.S.C. section 1983, claiming that the pretermination process violated the Due Process Clause of the Fourteenth Amendment. The district court granted summary judgment in favor of the county and a panel of the Fourth Circuit unanimously affirmed that decision. The panel held that when adequate post-termination remedies are available to a public employee, pretermination due process need meet only minimal requirements of notice and an opportunity to be heard. The purpose of this minimal due process is not to resolve the controversy, but merely to provide a basis for determining if there are reasonable grounds to believe the charges and to support the proposed action. That minimal standard was satisfied here. The court also held that the notice was not deficient due to its inclusion of general criticisms of plaintiff's work along with the specific allegations of wrongdoing. This was so even though the general criticisms did not in themselves provide sufficient notice of the underlying charges. Unless the specific allegations upon which a dismissal is ostensibly based are merely a subterfuge for dismissing the employee on the inadequately described general allegations, the inclusion of the general charges will not void an otherwise valid notice.

E. Equal Protection—Gender Discrimination/Disparate Impact

Austin v. Berryman, 955 F.2d 223 (4th Cir.), *cert. denied*, 112 S. Ct. 2997 (1992), involved Virginia's Unemployment Compensation Act which excludes from its coverage any person who voluntarily leaves "work with an employer to accompany or to join his or her spouse to a new locality . . . ." 955 F.2d at 225 (quoting VA. CODE ANN. § 60.2-618 (Michie 1992)). The plaintiff, who had been denied benefits due to the above provision, filed suit challenging the constitutionality of the exclusion on equal protection grounds. She claimed that the statute discriminated on the basis of gender. Her argument was premised on a claimed disparate impact upon women and upon an allegation that at least some members of the legislature were aware that the exclusion would harm more women then men. The court of appeals rejected both arguments. Disparate impact, standing alone, was not sufficient to establish gender discrimination. In addition, the court found no evidence

of covert or invidious discrimination. As to the knowledge of the potential disparate impact, the court explained that the necessary discriminatory purpose can be established only by evidence that the decisionmaker acted "because of" the disparate impact, not "in spite of" the law's potential adverse effects. *Id.* at 229 (quoting *Personnel Administrator v. Feeney*, 442 U.S. 256, 279 (1979)).

F. Equal Protection—School Desegregation

In *United States v. Charleston County School District*, 960 F.2d 1227 (4th Cir. 1992), the United States filed a civil rights enforcement suit against the Charleston County School District (CCSD) in 1981. The government claimed that the CCSD operated a racially segregated school system in violation of the Equal Protection Clause of the Fourteenth Amendment. At the time the suit was filed, the racial composition of the student population was fifty-four percent black and forty-six percent white; yet, two-thirds of the schools within the CCSD were predominantly one race. 960 F.2d at 1239. After a trial on the merits, the district court found in favor of the CCSD, concluding that, in fact, the CCSD consisted of eight separate and independent school districts, the lines for which had not been created for the purpose of racial segregation. There was apparent agreement among the parties that as to each constituent school district, intradistrict integration had been achieved. On appeal, the United States argued that the CCSD was a single school district and as so construed, district-wide integration had not been achieved. A split panel of the Fourth Circuit upheld the decision of the district court with one minor caveat regarding transfers between the constituent districts. In upholding the lower court's decision, the panel majority gave great deference to the district court's conclusion that the constituent districts had not been drawn on racial lines. The dissent, authored by Judge Sprouse, the sole Fourth Circuit Judge on the panel, noted that the district court's finding on this point was found in a conclusory footnote to a thirty-one page opinion. *Id.* at 1240 (citing *United States v. Charleston County School District*, 738 F. Supp. 1513, 1519 n.4 (D.S.C. 1990)). He further noted that the conclusion was unsupported by factual findings and was in tension with a state mandate in effect at the time the district lines were drawn. That mandate explicitly required "race-conscious" line drawing of school districts. *Id.* at 1237. Judge Sprouse would have remanded to the district court for express findings on this issue. The dissent also concluded that given the breadth of administrative responsibilities lodged in the CCSD, there was a single school district. In general, the panel majority's resolution of race-conscious issues appears to be somewhat inconsistent with the subsequent decision of the United States Supreme Court in *United States v. Fordice*, 112 S. Ct. 2727 (1992), which held that merely adopting and implementing race-neutral policies to govern a university system did not necessarily fulfill Mississippi's obligation to abolish prior de jure segregation.

G. Equal Protection—Race-Based Scholarships

In *Podberesky v. Kirwan*, 956 F.2d 52 (4th Cir. 1992), the plaintiff, an hispanic student at the University of Maryland at College Park, was excluded

on account of his race from consideration for a scholarship program designed exclusively for black students. This scholarship program was originally adopted as a partial remedy for the State of Maryland's previously segregated system of higher education. The plaintiff challenged his exclusion from the program as violative of the Equal Protection Clause. The district court granted summary judgment for the University. The court of appeals held that in the absence of a specific finding that the scholarship program currently remedied the discernable present effects of the previously segregated system of higher education, the racial criterion could not withstand strict scrutiny. Because the district court had made no such finding, the Fourth Circuit reversed and remanded. Upon remand, the district court must determine whether discernable present effects from the prior system of segregation continue to exist within the University. If, and only if, such present effects still exist and if the scholarship program operates as a remedy for those lingering effects, equal protection will be satisfied. A finding of general societal harm will not, according to the court of appeals, be sufficient to uphold the program. The decision of the court of appeals is in general accord with the most recent affirmative action decisions by the Supreme Court. *See, e.g., City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989) (striking down minority set-aside program for city construction contracts because program was not narrowly tailored to remedy effects of prior discrimination).

H. Freedom of Speech—Retaliatory Demotion

Maciariello v. Sumner, 973 F.2d 295 (4th Cir. 1992), *cert. denied*, 113 S. Ct. 1048 (1993), involved two police officers who conducted a secret, internal investigation of a superior officer, suspecting him of having tampered with a videotape of a drunk driving arrest by erasing the picture. The officers did not report their suspicions to either the Chief of Police or the Assistant Chief of Police. When the officers' secret investigation was discovered, the Chief of Police ordered an internal investigation. The internal investigation revealed that the camera in which the videotape had been recorded was defective, having failed to record the picture on at least six other videotapes. The officers were both demoted for failing to report their suspicions and for conducting an unauthorized investigation. The officers subsequently filed suit under 42 U.S.C. section 1983, claiming that the demotions were in violation of their right to freedom of speech, specifically, their right to conduct a secret investigation. The court of appeals held that the investigation was not per se speech, but that the officers did engage in "some protected conduct" in discussing their suspicions with other parties and with one another. 973 F.2d at 299. The court concluded, however, that their was no "but for" relationship between any of this protected conduct and the demotion. *Id.* The officers were not demoted for voicing their suspicions, but for engaging in an unauthorized, internal investigation. Furthermore, the court concluded that even if the officers' speech was a factor in the demotion, the city, as a public employer, had a strong interest in discouraging unauthorized internal investigations by police officers. That interest outweighed any incidental effect upon the officers' right to freedom of speech.

V. ENVIRONMENTAL LAW

*Selected by** ASSISTANT PROFESSOR DAVID A. WIRTH

A. CERCLA—"Operators"

In *Nurad, Inc. v. William E. Hooper & Sons Co.*, 966 F.2d 837 (4th Cir.), *cert. denied*, 113 S. Ct. 377 (1992), the Fourth Circuit dealt with a contribution action by a current property owner against prior owners and tenants of the property under section 107 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) for costs incurred in removing underground storage tanks. 42 U.S.C. § 9607 (1988). Section 107(a)(2), 42 U.S.C. section 9607(a)(2), allows a current owner to recover reimbursement from prior "owners" and "operators" of a "facility" that engaged in the "disposal" of hazardous waste during their ownership or operation. First, the Fourth Circuit affirmed the district court's holding that the previous tenants were not "operators" because they did not have "authority to control" the facility. 966 F.2d at 842. Second, the court of appeals affirmed the district court's holding that the term "facility" meant only the portion of the property containing the underground storage tanks—a portion adjacent to, but separate from, the portion leased by the tenants. Finally, the court of appeals reversed the district court's restrictive definition of the term "disposal" with respect to the determination of which of the prior owners held the property during the release of the hazardous waste. The Fourth Circuit cited *United States v. Waste Industries, Inc.*, 734 F.2d 159, 164-65 (4th Cir. 1984) in defining "disposal" to include not only active pollution but also "'completely passive repose or movement through the environment.'" 966 F.2d at 845. Thus, the court ruled that prior owners who held the property while the storage tanks leaked hazardous waste into the environment were liable to the plaintiff.

B. CERCLA—"Operators" and Successor Corporation Liability

In *United States v. Carolina Transformer Co.*, 978 F.2d 832 (4th Cir. 1992), the Fourth Circuit affirmed the district court's holdings that corporate principals were liable under section 107(a)(2) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) as "operators." 42 U.S.C. § 9607(a)(2) (1988). The court cited *Nurad, Inc. v. William E. Hooper & Sons Co.*, 966 F.2d 837, 842 (4th Cir. 1992) in defining "operators" as persons with authority to control a facility's disposal of hazardous waste. 978 F.2d at 837. The court also affirmed the district court's holding that a successor corporation that purchased the assets of the old corporation was liable under section 107(a)(2), 42 U.S.C. section 9607(a)(2). The court stated the "settled rule" that a successor corporation that purchases

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* Professor Wirth helped select these cases for their significance, but he neither wrote nor reviewed the following summaries which were drafted in their entirety by the *Law Review* staff.

the assets of a liable corporation does not acquire the liabilities of the old corporation unless: "1) the successor expressly or impliedly agrees to assume the liabilities of the predecessor; 2) the transaction may be considered a de facto merger; 3) the successor may be considered a 'mere continuation' of the predecessor; or 4) the transaction is fraudulent." 978 F.2d at 838. In interpreting the "mere continuation" exception to the bar on successor liability, the only exception potentially applicable in this case, the Fourth Circuit did not follow the traditional test which requires an "identity of stock, stockholders, and directors between the two corporations." *Id.* Instead, the Fourth Circuit approved the district court's use of the "continuity of enterprise" test which examines the retention of the employees, assets, product lines, facilities, general operations and whether the new business holds itself out as constituting the same operation as the old business. *Id.* Here, the principals formed the successor corporation only after becoming aware of potential environmental liability. The successor purchased all the personal assets of the old corporation, moved to a new facility, hired the same management and employees, and engaged in a very similar business. The court found these factors left the "unmistakeable impression that the transfer of the [old] business to [the new corporation] was part of an effort to continue the [old] business in all material respects yet avoid the environmental liability arising from the [hazardous waste disposal]." *Id.* at 841. Consequently, the successor corporation was a continuation of the old corporation and was thus liable for response costs and punitive damages.

VI. Evidence

Written by Professor James M. Phemister

Exclusion of Hearsay—Abuse of Discretion

In *Precision Piping and Instruments, Inc. v. E.I. du Pont de Nemours & Co.*, 951 F.2d 613 (4th Cir. 1991) the Fourth Circuit held that the district court did not abuse its discretion in excluding as hearsay several statements made by employees of one of the defendants. The statements were offered by the plaintiff as part of its proof of its claim that defendants violated the Sherman Act. The district court directed a verdict in favor of the defendants, and the Fourth Circuit affirmed. The court held that the trial court had correctly ruled that the statements would have to concern matters within scope of declarant's employment to be admissible under Federal Rule of Evidence 801(d)(2)(D) and that the trial court had correctly concluded that the relevant scope of employment was the authority to hire and fire the plaintiff. The court further ruled that the trial court had not abused its discretion when it determined that the speakers did not have the authority to hire and fire the plaintiff. In one instance, where the speaker did have the authority to hire and fire and might have been found to have approved of the underling's comments that he passed on to the plaintiff, the Fourth Circuit acknowledged the trial court's discretion, including that which exists under Federal Rule of Evidence 403, to exclude the evidence. The Fourth

Circuit also ruled that the trial court was within its discretion in deciding that the plaintiff had failed to establish the existence of a conspiracy that is a necessary predicate to admitting statements under Federal Rule of Evidence 801(d)(2)(E). A senior district judge sitting by designation concurred in the court's ruling on several of the statements based upon the trial court's discretion under Federal Rule of Evidence 403.

FEDERAL CIVIL PROCEDURE

Written by ASSOCIATE PROFESSOR JOAN M. SHAUGHNESSY

A. Joinder

In *Delta Financial Corp. v. Paul D. Comanduras & Associates*, 973 F.2d 301 (1992), plaintiff and defendant had been partners in a limited partnership. The partnership agreement contained an arbitration provision and this case arose from an action by plaintiff, Delta Financial Corporation (Delta), against defendant, Paul D. Comanduras & Associates (PDC), seeking to compel arbitration. Plaintiff's complaint demonstrated that the relief it sought through arbitration was a dissolution of the partnership and liquidation of its assets. The district court granted the motion to compel arbitration and appointed an arbitrator. The Fourth Circuit vacated the order compelling arbitration and remanded. The Fourth Circuit held that the district court erred in compelling arbitration over PDC's objection that one Timothy C. Cranch was also a partner who should be joined under Federal Rule of Civil Procedure 19. The Fourth Circuit reasoned that in an action for liquidation, all partners entitled to share assets are necessary parties under Federal Rule Civil Procedure 19(a) and, therefore, all partners are also necessary parties in an action to compel an arbitration seeking the same result. In the course of its opinion, the court noted that Cranch's joinder would not destroy diversity and did not reach the question of whether he was an indispensable party under Federal Rule of Civil Procedure 19(b). By contrast, the court reached the question of whether the partnership itself, whose joinder would have destroyed diversity, was an indispensable party and found that it was not. The action, the court explained, was an internal conflict between the partners. The partnership itself, in the court's view, had no interest distinct from that of the several partners.

B. Summary Judgment

In *World-Wide Rights Ltd. Partnership v. Combe, Inc.*, 955 F.2d 242 (4th Cir. 1992), the Fourth Circuit addressed the standard to be applied in considering cross motions for summary judgment in cases arising under written contracts. Plaintiff brought an action seeking a declaratory judgment that it was entitled to royalties from the defendants under a written licensing agreement. Plaintiff and defendants filed cross-motions for summary judgment, the district court granted summary judgment for defendants, finding that the written agreement was unambiguous and that plaintiff was not

entitled to royalties thereunder. The Fourth Circuit reversed. It held first that the mere fact that both parties have moved for summary judgment does not establish that summary judgment can be granted under Federal Rule of Civil Procedure 56. The court went on to describe the inquiry required of a court in considering a motion for summary judgment on a matter of contract interpretation. If a written contract is unambiguous on its face, the court may interpret the contract as a matter of law and grant summary judgment based upon its interpretation. If, however, the writing is "'susceptible of two reasonable interpretations,'" *id.* at 245 (quoting *American Fidelity & Casualty Co. v. London & Edinburgh Ins. Co.*, 354 F.2d 214, 216 (4th Cir. 1965)), it is ambiguous and extrinsic evidence of its meaning may be received. The question for the court on summary judgment in the latter case will be whether, in light of the extrinsic evidence made part of the record on summary judgment, there is a genuine issue of fact as to the interpretation of the contract. If there is such an issue, summary judgment may not be granted. The Fourth Circuit held that the licensing agreement was not unambiguous, vacated the district court judgment and remanded for further proceedings.

C. Discovery

In *National Union Fire Insurance Co. v. Murray Sheet Metal Co.*, 967 F.2d 980 (4th Cir. 1992), the Fourth Circuit considered both the scope of work product protection available under Federal Rule of Civil Procedure 26(b)(3) and the procedure to be followed by district court judges faced with claims of work product privilege under that rule. Here, a reinsurer, National Union Fire Insurance Company (National Union), was defending a suit brought by Arkwright Mutual Insurance Company (Arkwright) for reimbursement of insurance payments made by Arkwright following a fire at a General Electric plant in West Virginia. National Union subpoenaed documents concerning the fire from Murray Sheet Metal Company (Murray), which had been renovating the plant at the time of the fire but which was not a party to the National Union—Arkwright litigation. Murray, refusing to produce twenty-six subpoenaed documents, provided a log giving the general description, author, date, recipient, custodian and reason for nondisclosure for each of the twenty-six documents. On the basis of Murray's submission and without examining the documents, the district court refused to compel production of any of the documents. The Fourth Circuit reversed, finding that the district court had conducted an inadequate inquiry into Murray's work product claim. On remand, the district court was directed to examine the documents and the circumstances of their preparation before ruling on the work product claim. The Fourth Circuit also gave a rather restrictive reading of the scope of work product protection. It noted that documentation is to be expected following industrial accidents and that such documentation may be prepared, in part, with the general possibility of litigation in mind. Such documents do not constitute work product. To meet the work product test of Federal Rule of Civil Procedure 26(b)(3), the court held "[t]he document must be prepared *because* of the prospect of litigation when the preparer faces an actual claim

or potential claim following an actual event or series of events that could reasonably result in litigation." 967 F.2d at 984 (emphasis in original). The Fourth Circuit thus questioned, for example, whether documents prepared by Murray's safety director met this test. The court also read the qualified protection afforded non-opinion work product narrowly, describing it as "little more than an 'anti-freeloader' rule designed to prohibit one adverse party from riding to court on the enterprise of the other." *Id.* at 985. Therefore, the court observed that statements taken immediately after the fire, and before National Union was notified, might well meet the showing needed to overcome qualified work product protection.

D. Default Judgments

In *Home Port Rentals, Inc. v. Ruben*, 957 F.2d 126 (4th Cir.), *cert. denied*, 113 S. Ct. 70 (1992), an earlier suit between the parties resulted in a consent order allowing a voluntary non-suit without prejudice to the plaintiff and containing defendants' consent to jurisdiction and appointment of defendants' attorney as their agent for service of process for any new action brought within 180 days of the consent order. Plaintiff brought a new action and served defense counsel. Defendants failed to respond to their attorney's attempt to communicate with them and did not otherwise participate. Eventually, defendants' attorney successfully moved to withdraw and the court entered a default judgment against the defendants. Thereafter, the district court refused, pursuant to Federal Rule of Civil Procedure 60, to relieve the defendants of the default judgments. The Fourth Circuit affirmed. First, the court held that, although defendants did not expressly authorize their attorney to accept service on their behalf, they were aware of his activities in defending the original action and in negotiating the non-suit. Therefore, the court held that defendants were bound by the agreement negotiated on their behalf in which any jurisdictional objections were waived.

Second, the court found that under Federal Rule of Civil Procedure 60(b)(1), which provides for relief from judgment for "excusable neglect," the intentional acts of defendant Ruben in making himself unavailable constitutes fault justifying the district court's refusal to relieve him from the default judgment. As to the second defendant, whose motion was made more than one year after judgment, the Fourth Circuit noted that Federal Rule of Civil Procedure 60(b)(6) was not available to circumvent the one year time limit of Federal Rule of Civil Procedure 60(b)(1) and upheld the district court's denial of relief.

E. Statutes of Limitation

In *Jane Doe v. John Doe*, 973 F.2d 237, (4th Cir. 1992), the Fourth Circuit affirmed the district court's dismissal of plaintiff's action to recover damages against an uncle who had sexually abused her when she was a child. The Fourth Circuit, construing North Carolina law, found plaintiff's complaint time barred. Two North Carolina statutes were at issue. The first is a three-year statute of limitations governing claims for emotional distress. N.C.

GEN. STAT. § 1-52(5) (1992). The Fourth Circuit rejected plaintiff's argument that the statute should be construed as running from the date she first discovered the connection between defendant's abuse and her psychological injury. Refusing to read a discovery provision into this statute, the court held that the statute began to run when plaintiff reached eighteen years of age.

Alternatively, the court found that the second statute would bar the action. It reads, "Provided that no cause of action [for personal injury other than medical malpractice] shall accrue more than 10 years from the last act or omission of defendant giving rise to the cause of action." N.C. GEN. STAT. § 1-52(16) (1992). The Fourth Circuit rejected plaintiff's argument that North Carolina would create a judicial exception to the statutory ten-year period of repose for child sex abuse cases, as it has done for occupational diseases. *Wilder v. Amatex Corp.*, 336 S.E.2d 66 (N.C. 1985). The court predicted that North Carolina would await legislative action, given the difficult issues of policy posed by sexual abuse actions.

F. Complex Litigation

In re Showa Denko K.K. L-Tryptophan Products Liability Litigation II, 953 F.2d 162 (4th Cir. 1992), involved interlocutory review by the Fourth Circuit of an administrative order entered in a multidistrict products liability action. The district court entered an order requiring payment by all persons in the United States having claims against defendants related to L-Tryptophan of 1,000 dollars or 0.5 percent of recovery. The payments were to be used to reimburse the steering committee of plaintiffs' attorneys for the costs of discovery. With respect to claimants not before the court in the multidistrict litigation (MDL), the order provided two enforcement mechanisms. First, defendants were required to certify that assessments had been paid on all claims settled or on which judgments had been satisfied. Second, the parties were ordered not to furnish any product of MDL discovery to persons who had not paid their assessments. The order thus sought to reach plaintiffs in federal cases not transferred to the MDL, plaintiffs in 683 state court actions and approximately 180 claimants who had not yet filed suit. The Fourth Circuit held that the district court lacked power to require assessments and reversed the order. The Fourth Circuit held, first, that the district court could not require payments from persons not within its jurisdiction and second, that the order's attempt to restrict discovery in state court proceedings raised serious federalism concerns.

VIII. FEDERAL COURTS

Reviewed by PROFESSOR LEWIS H. LARUE

Abstention

A good rule of thumb for litigators about absention is: Do not bother asking a district court to abstain unless the precedents are squarely on point; if your case is distinguishable, the Fourth Circuit is likely to accept the

distinction and rule that abstention is improper. The court of appeals recently corroborated this rule of thumb in three cases: *Transdulles Center, Inc. v. USX Corp.*, 976 F.2d 219 (4th Cir. 1992); *Neufeld v. City of Baltimore*, 964 F.2d 347 (4th Cir. 1992); and *McLaughlin v. United Virginia Bank*, 955 F.2d 930 (4th Cir. 1992).

In *Transdulles Center, Inc. v. USX Corp.*, 976 F.2d 219 (4th Cir. 1992), the Fourth Circuit affirmed the district court's refusal to abstain in a case that involved a breach of contract dispute which centered around the question of compliance with a subdivision ordinance. The court stated that federal abstention is proper only where: 1) a determination of state law may moot a federal constitutional issue or present it in a different posture; 2) the state court is dealing with state law issues that have substantial policy concerns, 976 F.2d at 223 (citing *Colorado River Conservation District v. United States*, 424 U.S. 800, 816 (1976)); 3) federal review would impinge on a state's attempt to "establish a coherent policy" in an area of substantial public concern, *id.* (citing *New Orleans Public Service, Inc. v. New Orleans*, 491 U.S. 350, 361 (1989); or 4) parallel state proceedings indicate federal abstention would further the interests of "'wise judicial administration,'" *id.* at 224 (quoting *Colorado River*, 424 U.S. at 818). Here, no federal constitutional issue was involved. The local law issue concerning adequate storm drainage was certainly complicated enough, but the court of appeals stated it was merely a question of contract law that was without any "transcendental importance." 976 F.2d at 224. Further, the court held that federal review would not impinge on Virginia's effort to establish a coherent policy in land use. Finally, the court of appeals held that the parallel state proceeding did not preclude a federal action because the state case involved different parties and legal arguments. Consequently, federal abstention was unwarranted.

In *Neufeld v. City of Baltimore*, 964 F.2d 347 (4th Cir. 1992), the Fourth Circuit reversed the district court's granting of the motion to abstain. This case involved the possible preemption of a local zoning ordinance regulating television antennae by a regulation issued by the Federal Communications Commission. The Fourth Circuit stressed that "abstention is the exception, not the rule, and can only be justified in exceptional cases." 964 F.2d at 349 (citing *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 813 (1976)). The Fourth Circuit held that this case was not exceptional because: 1) it did not raise "difficult questions of state law involving peculiarly local concerns," and 2) federal review would not "disrupt a coherent state policy by subjecting the zoning ordinance to varying interpretations." *Id.* at 350.

In *McLaughlin v. United Virginia Bank*, 955 F.2d 930 (4th Cir. 1992), the Fourth Circuit reversed the district court's grant of abstention. Twelve lawsuits relating to this case were filed. The case in federal district court was the eighth in the series, the rest being filed in state court. One might echo the court's observation that there is a "complex, heatedly litigated series of complaints, involving various combinations of parties, which are suspiciously

fragmented." 955 F.2d at 935. One can understand the temptation to dismiss the case via the abstention doctrine; the parties were already litigating in state court and the federal proceedings were arguably duplicative. Although the federal proceedings were duplicative, the court of appeals thought that abstention was the wrong remedy. The relevant dictum states that the doctrines of "res judicata, collateral estoppel, and equitable stay will help minimize the potential for undue waste [of judicial resources in such cases]." *Id.* at 936. In other words, the problem of multiple litigation can be solved by postponing action, letting the state court proceedings run their course, and then using the doctrines of preclusion to get rid of the case.

IX. Federal Remedies

Written by Visiting Professor Robin Morris-Collin

Punitive Damages—Due Process

In *Mattison v. Dallas Carrier Corp.*, 947 F.2d 95 (4th Cir. 1991), the Fourth Circuit reviewed the constitutionality of South Carolina's scheme for awarding punitive damages. South Carolina allows awards of punitive damages to punish, deter, and vindicate the rights of a plaintiff whenever the conduct of the defendant is willful, wanton or reckless. At the time of the trial, South Carolina committed the amount of punitive damages to jury discretion subject to post-trial review for excessiveness or appellate review under the abuse of discretion standard. The trial court instructed the jury that the amount of punitive damages "may be such sum as you believe will serve to punish that defendant and deter others from like conduct." 947 F.2d at 100. The court of appeals held that South Carolina's scheme as applied in federal court deprived the defendant of due process of law under the Fifth Amendment because the jury instructions based upon state substantive law violated the constitutional minimum established in *Pacific Mutual Life Insurance Co. v. Haslip*, 111 S. Ct. 1032 (1991)—the instruction did not contain limiting factors for the jury's consideration such as proportionality of the punitive damages to the harm caused and the net worth of the defendant. In *Haslip*, the Supreme Court held a punitive damage award scheme in Alabama did not deprive the defendant of federal due process, in part, because of careful post-trial judicial review of the jury verdict. Further, the Fourth Circuit held that state provisions for post-trial review which the court assumed might save an otherwise unconstitutional scheme under *Haslip* could not be applied in a federal court which was obliged to apply the federal procedural rules.

In the midst of the *Mattison* litigation, South Carolina altered its post-trial review procedures adopting a multi-factored post-trial review scheme which could include information not before the jury. In ordering a new trial on the issue of punitive damages, the court observed that post-trial review based upon evidence unavailable to the jury would be inconsistent with the Seventh Amendment. Accordingly, the court directed that the South Carolina standards for post-trial review be incorporated into jury instructions given in

the federal district court, and further ordered a bifurcated proceeding to avoid prejudice to the defendant.

In *Johnson v. Hugo's Skateway*, 974 F.2d 1408 (4th Cir. 1992), the Fourth Circuit applied the same analysis to the question of whether Virginia's punitive damage scheme, applied in federal court, provided the defendant with due process. The court held that it did not, reversed the award of punitive damages and remanded for a new trial of punitive damages. The Fourth Circuit's majority opinion summarizing *Pacific Mutual Life Insurance Co. v. Haslip*, 111 S. Ct. 1032 (1991) stated, "the almost de novo post-verdict and appellate reviews conducted by Alabama's trial courts and the Supreme Court of Alabama provided 'a sufficiently definite and meaningful constraint on the discretion of Alabama fact finders in awarding punitive damages' to satisfy due process." 974 F.2d at 1414 (quoting *Haslip*, 111 S. Ct. at 1045). The majority pointed out that this was the interpretation applied in *Mattison v. Dallas Carrier Corp.*, 947 F.2d 95 (4th Cir. 1991), and under this approach, Virginia's scheme, as it had been applied in the federal district court, was constitutionally inadequate. In this case, the jury was instructed under Virginia law that it was permitted to award punitive damages to punish and to deter the defendants' conduct if the conduct was "maliciously or wantonly or oppressively done." 974 F.2d at 1415. Further, it was instructed that it might "add to the award of actual damages such amount as you shall unanimously agree to be proper as punitive or exemplary damages," and admonished that when deliberating it must fix the amount "with calm discretion and sound reason . . . [and never with] sympathy or bias or prejudice." *Id.* Upon remand, the court of appeals again directed that jury instructions incorporate additional factors such as proportionality that Virginia's common law included in the post-verdict review.

Five dissenters called upon the court to overrule *Mattison* as a misreading of *Haslip*. They contended that the Alabama jury instructions in *Haslip*, much like South Carolina's and Virginia's jury instructions, were tailored to the goals of retribution and deterrence and fully met the constitutional requirements of due process under *Haslip*. Post-verdict procedures, including appellate review were additional but not necessary guarantees under *Haslip*. Accordingly, the retrials and directions to incorporate additional jury guidance were a mistaken interference at best, wrongly undermining the principles of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), and *Hanna v. Plumer*, 380 U.S. 460 (1965).

Pending additional clarification of the *Haslip* methodology from the Supreme Court, Fourth Circuit punitive damage awards will undoubtedly continue to be the source of due process challenges from both plaintiffs asking that *Mattison* be overruled, and defendants seeking the overturn of large awards. Moreover, there will be some differences between state and federal court approaches to awarding punitive damages, including the question of who will consider factors such as proportionality and defendant's net worth. Under the federal court's approach, the jury will be instructed to consider these factors, and in state courts judges will have control of these

types of factors under their post-trial review procedures. The results may indeed have the effect of encouraging forum shopping between state and federal courts.

X. Income Tax

Reviewed by Professor J. Timothy Philipps

A. Burden of Proof

In *Cebollero v. Commissioner*, 967 F.2d 986 (4th Cir. 1992), the Fourth Circuit upheld the Tax Court's finding that the taxpayer had not carried the burden of proof in characterizing the Commissioner of Internal Revenue's determination of a deficiency as arbitrary and excessive. The Commissioner assessed a deficiency against the taxpayer for unreported income from a liquor store business. The Commissioner determined the existence of a deficiency, in part, by using the latest markup percentages on inventory stocked by the taxpayer to calculate the income for the prior tax years—the tax years under examination. The taxpayer initially told the Revenue Agent that he had used the current year's markup percentages in the prior years. The taxpayer changed his testimony at trial to say that he used lower markup percentages in the prior years and thus had a lower profit than the Revenue Agent computed. This, of course, would result in a lower profit than the Commissioner computed.

The taxpayer argued that his trial testimony concerning the markup percentages was sufficient to shift the burden of proof to the Commissioner and that the Tax Court erred in not shifting the burden. The Fourth Circuit stated that in the first phase of a deficiency suit, the court must assess whether the Commissioner's determination is arbitrary and excessive. In this phase, the taxpayer bears the burden of proof by a preponderance of the evidence. 967 F.2d at 990. However, if the taxpayer carries the burden of showing the Commissioner's determination to be arbitrary, the Commissioner's presumption of correctness vanishes, and the suit enters a second phase. In this second phase of the suit, the court must determine the correct amount of the deficiency, and the Commissioner bears the burden of proof. *Id.* In the case at bar, the Fourth Circuit analyzed the first phase of the suit and held that the taxpayer's own self-serving testimony regarding which markup percentages he used in the years at issue did not establish a preponderance of the evidence in his favor against the weight of his prior statements and the Commissioner's computations. Thus, the Commissioner's assessment was not arbitrary and excessive, and the suit did not enter the second phase.

B. Last Known Address

In *Powell v. Commissioner*, 958 F.2d 53 (4th Cir.), *cert. denied*, 113 S. Ct. 440 (1992), the Fourth Circuit reversed the Tax Court by holding that the taxpayers filed their petition to the Tax Court within the requisite ninety-day period after the mailing of the notice of deficiency because the Internal

Revenue Service (IRS) did not exercise reasonable diligence in mailing the notice to the taxpayers' last known address. The taxpayers moved from their old address in late 1987. On February 29, 1988, the IRS sent the notice of deficiency to the taxpayers' old address by certified mail. The Post Office erroneously ignored the taxpayers' timely filed change of address forms and returned the undelivered notice to the IRS. On December 26, 1988, the IRS mailed a final notice of intention to levy to the taxpayers' new address. On January 11, 1989, the taxpayers filed a petition with the Tax Court in order to avoid payment of the deficiency prior to a determination on the merits. The Tax Court dismissed the petition because the taxpayers filed it more than ninety days after the mailing of the notice of deficiency.

The Fourth Circuit stated that the IRS's mailing of a notice of deficiency is sufficient if the IRS mails the notice to the taxpayer's last known address. The "last known address" is what, after the exercise of reasonable diligence, the IRS may consider to be the address of the taxpayer on the date the IRS mails the notice. 958 F.2d at 55. The Post Office's error of nondelivery made the notice insufficient and the IRS's receipt of the undelivered notice showed a lack of reasonable diligence in finding the last known address. *Id.* at 56. Thus, the taxpayers' timely filed their petition and the Fourth Circuit remanded the case to the Tax Court where the Powells could contest the asserted deficiency prior to the payment thereof.

The case indirectly provides a lesson for all taxpayers: Use registered or certified return receipt mail in filing estimated payments, tax returns and all other documents with the IRS. The registration or return receipt will provide prima facie evidence of the fact that the taxpayer filed the item and of the date of filing. I.R.C. § 7502(c) (1988); Treas. Reg. § 301.7502-1(d)(1) (as amended in 1960). If the IRS had lost the Powell's return in the above case, the Powells would have had a much more difficult time in court unless they retained the registration or return receipt with respect to that return.

XI. Securities Regulation

Reviewed by Professor Lyman P.Q. Johnson

A. Reliance on Oral Representations

In *Myers v. Finkle*, 950 F.2d 165 (4th Cir. 1991), the United States Court of Appeals for the Fourth Circuit held that a determination of whether a purchaser of securities may be justified in relying on oral representations that conflict with contemporaneous written statements contained in a private placement memorandum delivered to the investor requires a consideration of eight relevant factors. These relevant factors include: (1) the sophistication and expertise of the plaintiff in financial and securities matters; (2) the existence of long standing business or personal relationships; (3) access to relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations. Because no

single factor is dispositive, consideration of all eight factors is necessary.

The court, presented with an unusual factual situation in which oral representations were contradicted by express warnings in private placement memoranda, stated that knowledge of information should be imputed to investors who fail to exercise caution when they have in their possession documents apprising them of the risks associated with the investments. In short, investors are charged with constructive knowledge of the risks and warnings contained in private placement memoranda. Therefore, in evaluating the eight factors relevant to justifiable reliance, the conduct of investors must be examined as if they had knowledge of all attendant warnings.

In *Myers*, the Fourth Circuit also discussed its interpretation of the "sophistication" requirement. 950 F.2d at 167. The court stated that while wealth alone may be an important factor in determining the sophistication of an investor, it is not the dispositive factor. The court stated that other criteria, such as age, education, professional status, investment experience, and business background, may also be relevant in such determinations.

B. Fraud—Duty to Disclose

In *Forston v. Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469 (4th Cir. 1992), investors in a real estate limited partnership brought a securities fraud suit against the syndicator of the securities offering, the general partners, and the law firm retained by the general partners to prepare the tax opinions for the offering memorandum. The Fourth Circuit held that under section 10b of the Securities Exchange Act of 1934, 15 U.S.C. section 78j(b), the failure to disclose material information constitutes securities fraud only upon proof of a duty to disclose. Looking to cases previously decided in the Fourth, Fifth, and Seventh Circuits, the court stated that federal securities laws are not themselves, with respect to the section 10b claim, the source of a duty to disclose material facts. Thus, with respect to a section 10b claim, the duty to disclose material facts arises only where there is some basis outside the federal securities laws, such as, for example, a state law, for finding a fiduciary or other confidential relationship.

The court found that such a duty to disclose material facts plainly ran from the syndicator of the offering and the general partners. However, the court questioned whether such a duty ran from the law firm. Appellants argued that the law firm's duty to disclose arose under Texas common law, a Treasury Department regulation, and an American Bar Association ethics opinion. The court did not find merit in appellant's contentions. Appellants further asked the court, in the absence of a duty grounded in law, to create a duty of disclosure grounded in public policy—the policy of having law firms monitor, on pain of liability, the representations that their clients make to any third party. The court declined to accept this argument, stating that the result of appellant's position would be a rigid rule charging all attorneys who involve themselves in any facet of a commercial transaction with responsibility for the entire transaction. The court found that an "omnipresent" duty of disclosure would not only be unfair to law firms, but would also

destroy incentives for clients to be forthcoming with their attorneys and would artificially inflate the cost of involving legal counsel in commercial transactions. 961 F.2d at 475.