SMU Law Review

Volume 23 | Issue 5 Article 8

1969

Corporations - Common Law Liabilities for Insider Trading

W. Wilson Jones

Corporations — Common Law Liabilities for Insider Trading

Defendants, directors of a corporation whose stock was traded over the counter, allegedly acted on inside information of a decline in corporate earnings when they sold on the market stock from their personal holdings. Other stockholders, admittedly not purchasers from defendants, brought a derivative action for an accounting of the insiders'[1] profits. The trial court dismissed for failure to state a cause of action and the appellate division reversed.[2] *Held, affirmed*: Officers and directors may be liable at common law to their corporation, whether or not it suffers harm, for profits taken in stock transactions which result from use of inside information. *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

I. Duties and Liabilities of Directors Dealing in Company Shares

A director's relation to his corporation or its shareholders is that of agent and, in some cases, trustee.[3] His position is generally one of fiduciary obligation, but more specific implications of a director's trustee or agent status vary widely from jurisdiction to jurisdiction. When, on his own behalf, a director deals with a third party, whether or not a shareholder, in the stock of a corporation he directs, there are several views of his duties and potential liabilities.[4]

No Fiduciary Duties. In some jurisdictions, a director has no fiduciary duty, either to the corporation or its shareholders, in the sale or purchase of stock with third parties.[5] This rule has been called one of "unconscionable laxity,"[6] but it has had wide acceptance.[7] It was the early New York rule, announced in *Carpenter v. Danforth*.[8] There the court held

[1] Pleadings showed the amount in question to be about $800,000. Profits were computed as the difference between what defendants sold for and the market value of the stock after disclosure. Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78, 80 (1969).

[2] Diamond v. Oreamuno, 29 App. Div. 2d 285, 287 N.Y.S.2d 300 (1968).

[3] Robinson v. Smith, 3 Paige Ch. 222, 234 (N.Y. Ch. 1832), citing the dictum by Chancellor Kent in Attorney-General v. Utica Ins. Co., 2 Johns. Ch. 371, 389 (N.Y. Ch. 1817); *see* 3 W. Fletcher, Cyclopedia of the Law of Private Corporations § 838 (1965) [hereinafter cited as Fletcher].

[4] *See* Annot., 7 A.L.R.3d 500 (1966); Annot., 84 A.L.R. 615 (1933).

[5] *E.g.*, Clayton v. James B. Clow & Sons, 212 F. Supp. 482 (N.D. Ill. 1962), *aff'd*, 327 F.2d 382 (7th Cir. 1964); Faraclas v. City Vending Co., 232 Md. 457, 194 A.2d 298 (1963); Nelson v. Northland Life Ins. Co., 197 Minn. 151, 266 N.W. 857 (1936); Gardner v. Baldi, 24 N.J. Super. 228, 93 A.2d 644 (Super. Ct. Ch. Div. 1952); Howell v. McCloskey, 375 Pa. 100, 99 A.2d 610 (1953). *And see* cases collected at 3 Fletcher § 1168.1. The general statement of the rule applies only if the corporation itself is not engaged in market activities. *E.g.*, Vulcanized Rubber & Plastic Co. v. Scheckter, 400 Pa. 405, 162 A.2d 400 (1960); *see* text accompanying notes 31-32 *infra*. The rule only applies in the absence of a finding of other facts to support a fiduciary relationship. *Cf.* Konsuvo v. Netzke, 91 N.J. Super. 353, 220 A.2d 424 (Super. Ct. Ch. Div. 1966); Illinois Rockford Corp. v. Kulp, 41 Ill. 2d 215, 242 N.E.2d 228 (1968).

[6] H. Ballantine, Corporations § 80, at 213 (1946) [hereinafter cited as Ballantine].

[7] It was once the established majority rule. *See* Annot., 84 A.L.R. 615 (1933). But in jurisdictions nominally supporting the rule, there is a tendency to make the existence of a fiduciary relationship a fact question determinable by circumstance related to the defendant's directorship. Illinois Rockford Corp. v. Kulp, 41 Ill. 2d 215, 242 N.E.2d 228 (1968); Konsuvo v. Netzke, 91 N.J. Super. 353, 220 A.2d 424 (Super. Ct. Ch. Div. 1966). *And see* H. Manne, Insider Trading and the Stock Market 22 n.8 (1966) [hereinafter cited as Manne].

[8] 52 Barb. 581 (N.Y. Sup. Ct. 1868).

that before a director might be held liable to the stockholders with whom he dealt, he must be shown to have been guilty of "actual, positive"[9] fraud, relied upon by the other party. The case involved a face-to-face transaction, but it presumedly announced a rule for market transactions also. The court noted that in transactions on public stock exchanges, there could be no reliance and thus no liability, inasmuch as parties trade with an eye to market price of stocks as distingued from real value based on the knowledge of insiders.

The rule that directors have no fiduciary duties in the trading of shares, either to the corporation or to individual shareholders, is supported by several arguments. One rationale is that since corporations ordinarily have no interest in their own shares and since the trusteeship of the director extends only so far as the corporation's business interests, the director's dealings in his corporation's shares are without the scope of the fiduciary relation.[10] Another rationale is that stockholders are able to protect themselves by inspecting corporate books and records before trading.[11] Critics of this view have noted that for large, publicly-traded corporations, such an inspection is hardly practical.[12] On the other hand, for such corporations, insider trading has been suggested as an efficient means of entreprenurial reward for employees.[13]

Fiduciary Duty to Individual Shareholder. The fiduciary obligation of the director has sometimes extended to the individual shareholder for whose benefit the corporation's activities are conducted. Two standards of disclosure have come to reflect a rule that directors who trade with other stockholders owe a fiduciary duty to them as individuals. The "special facts" doctrine requires disclosure by the selling or purchasing director of any "special facts" affecting stock values.[14] The "minority" doctrine imposes upon the director a duty to disclose all material information.[15] The

---

[9] *Id.* at 587.

[10] FLETCHER § 900 nn.5, 6; Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53, 54 (1960).

[11] Bollstrom v. Duplex Power Car Co., 208 Mich. 15, 175 N.W. 492 (1919); FLETCHER § 1168.1, at 857.

[12] Dunnett v. Arn, 71 F.2d 912, 918 (10th Cir. 1934).

[13] MANNE 131-45.

[14] The leading case is Strong v. Repide, 213 U.S. 419 (1909). A discussion of what may be "special circumstances" is given at Buckley v. Buckley, 230 Mich. 504, 202 N.W. 955, 956 (1925). Michigan apparently conditions application of the rule upon the making of inquiry by the outsider. *Cf.* Schuur v. Berry, 285 Mich. 654, 281 N.W. 393 (1938). The "special facts" rule would apparently obtain in Texas. Westwood v. Continental Can Co., 80 F.2d 494 (5th Cir. 1935). Cases establishing the rule for New York are collected at note 23 *infra.*

[15] The rule is "minority" doctrine with respect to the "so-called" majority rule that no fiduciary duty exists. BALLANTINE § 80, at 213; *cf.*, on the "majority" rule, text accompanying notes 5-7 *supra.* A leading minority rule case is Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903). For recent statements of the rule, see King Mfg. Co. v. Clay, 216 Ga. 581, 118 S.E.2d 581 (1961); Jacobson v. Yaschik, 249 S.C. 577, 155 S.E.2d 601 (1967); Holtz v. Landauer, 270 Wis. 203, 70 N.W.2d 633 (1955). Massachusetts would apply the minority rule to a director dealing face-to-face with another shareholder, but not to a director who deals in the market. Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659 (1933). California adopts at least the "special facts" doctrine. Jones v. H.E. Ahmanson & Co., 76 Cal. Rptr. 293 (Ct. App. 1969). An equally recent decision imposes the "minority rule." Brown v. Halbert, 76 Cal. Rptr. 781, 788-89 (Ct. App. 1969). *Brown* is unusual in that, like *Diamond v. Oreamuno*, it imposes the duty of disclosure upon insiders who sell. In *Brown*, the stock sold was a controlling block.

two standards are said to reach the same result in the cases,[16] but the "special facts" doctrine is considered the less burdensome for the director.[17] Under either doctrine, an injured stockholder may rescind his transaction or recover profits related to the breach of duty.[18] The rule is one of fairness to the stockholder who is in a weak bargaining position, especially the stockholder of a publicly-traded company.[19] Recovery by the individual stockholder prevents the accrual to directors of gains that belong to all stockholders.[20] In close corporations, where the relationship of stockholders is often very similar to that of partners, the rule imposing fiduciary duties on stockholders *inter sese* has the same salutary effects it has in partnership law.[21]

New York adopted the "special facts" doctrine first by a holding in a close corporation case,[22] and subsequently in the cautious dictum of *Fischer v. Guaranty Trust Co.*[23] In *Fischer*, the plaintiff sought recovery on behalf of the estate of a decedent who had purchased stock for a trivial sum and later resold it for a large sum which might have been larger had she been fully apprised of information affecting the stock value. About ten years after the stockholder died, a suit was brought on behalf of her estate by attorneys who were, but for the suit, strangers to the estate. The court noted that under the facts of the case it was faced with a "clearly . . . champertous venture"[24] and held against the individual stockholders, but conceded the possibility of a recovery in other circumstances.[25]

Fiduciary Duty to Corporation. Federal statutes permit certain corpora-

[16] Seitz v. Fry, 152 Minn. 170, 188 N.W. 266 (1922); FLETCHER § 1168.2, at 861; Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53, 59-63 (1960).

[17] BALLANTINE § 80, at 213.

[18] Strong v. Repide, 213 U.S. 419 (1909); Taylor v. Wright, 67 Cal. App. 2d 371, 159 P.2d 980 (1945); Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903); Hotchkiss v. Fletcher, 136 Kan. 350, 16 P.2d 531 (1932).

[19] Dunnett v. Arn, 71 F.2d 912, 918 (10th Cir. 1934).

[20] Dawson v. Nat'l Life Ins. Co., 176 Iowa 362, 157 N.W. 929, 933 (1916).

[21] *Cf.* Illinois Rockford Corp. v. Kulp, 41 Ill. 2d 215, 242 N.E.2d 228 (1968). *See also* F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE § 8.15 (1958).

[22] Saville v. Sweet, 234 App. Div. 236, 254 N.Y.S. 768 (1932), *aff'd*, 262 N.W. 567, 188 N.E. 67 (1933). During negotiations for the purchase of a controlling block of stock, the defendant officers had understated corporate earnings. The court said:

> It is not necessary to establish a technical case of fraud and deceit. The relation between plaintiff and defendants was like that of a fiduciary. Defendants were directors and officers of a very small corporation, whose stock was not listed or traded anywhere, whose business was small and known only to themselves, and who, in purchasing control from the plaintiff, were under a duty to disclose to her the full facts of the condition of the company . . . .

Saville v. Sweet, 234 App. Div. 236, 254 N.Y.S. 768, 770 (1932).

[23] "Under certain specific circumstances, the director occupies such a relation to the . . . stockholder that he is bound to act somewhat as a trustee in making a purchase for his cestui." Fischer v. Guaranty Trust Co., 259 App. Div. 176, 18 N.Y.S.2d 328, 334 (1940), *aff'd*, 285 N.Y. 629, 34 N.E.2d 379 (1941). The case appeared to preserve a requirement of reliance by any plaintiff shareholder. But an entitlement to rely, in the face of a director's silence, merely underscores the existence of a fiduciary relation. *Fischer* is interpreted as having adopted the special facts doctrine for New York. Lesnick v. Public Indus. Corp., 144 F.2d 968, 977 (2d Cir. 1944); Cochran v. Channing Corp., 211 F. Supp. 239, 245-46 (S.D.N.Y. 1962).

[24] Fischer v. Guaranty Trust Co., 259 App. Div. 176, 18 N.Y.S.2d 328, 332 (1940).

[25] 18 N.Y.S.2d at 334. In Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962), minority shareholders had a cause of action under state law for sale of their stock at a low price caused by insiders' restricting dividends. The court relied on *Fischer*.

tions to recover profits from short-swing trading by specified insiders.[26] Such recovery is founded on a policy favoring fair trading for the public.[27] Civil relief for violation of rule 10b-5 is available to traders in the stock of any corporation, regardless of size or number of stockholders,[28] but seems permissible in favor of a corporation only if the corporation has been a seller or a purchaser.[29] Thus, in companies not of a certain size[30] federal law does not create any liability running from the director to the corporation for trading with third parties.

Two common law theories support the imposition upon a director of a fiduciary duty to his corporation in his stock transactions with third parties. The first, recognized judicially,[31] applies the director's duty of loyalty to the corporation in the situation in which the corporation is engaged in stock transactions with the public. The director violates his duty of loyalty because his trading may be in competition with the corporation's market activity. In *Brophy v. Cities Service Co.*[32] a corporate officer's secretary had knowledge of a company's plans to purchase its own shares in the market and the secretary made purchases for himself before the company acquisitions began. His subsequent gains from appreciation in the stock's price were recoverable by the corporation regardless of whether it suffered loss, under the principle that an agent is not to derive any secret profit from information taken in confidence and in the course of his agency. The Delaware court noted that in the absence of special circumstances, corporate fiduciaries were free to trade in corporate stock, but the court held that the company's plans to purchase stock in the market were such special circumstances. Since the action was for unjust enrichment, no loss to the corporation needed to be shown.

The absence of a requirement for damages underscores the preventive policy equity adopts in dealing with conflicts of interest in fiduciary relations. Equity interests itself only in the *possibility* of conflict of personal interest and fiduciary duty.[33] Protection of the fiduciary relation, once it is recognized to exist, has often aroused the conscience of the chancellor,[34] and not surprisingly, an award for punitive damages has been allowed for breaches of fiduciary duty involving stock transactions.[35]

[26] The profits must derive from trading within a six-month period and the trading must be by an officer, director, or the beneficial owner of more than 10% of any class of stock. Securities Exchange Act of 1934, § 16(b), 15 U.S.C. 78p(b) (1963). The corporation must have assets exceeding $1,000,000 and it must have 500 or more shareholders. Securities Exchange Act of 1934, § 12(g), 15 U.S.C. § 78(g) (1963).

[27] Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951), *aff'd with modification as to interest awarded*, 235 F.2d 369 (3d Cir. 1956).

[28] Securities Exchange Act of 1934, § 10b, 15 U.S.C. § 78j(b) (1963); 17 C.F.R. § 240.19b5 (1944).

[29] A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10b-5, § 4.7(3), at 88.2 n.85 (1967).

[30] *Supra* note 26.

[31] International Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567 (Tex. 1963).

[32] Brophy v. Cities Serv. Co., 31 Del. Ch. 241, 70 A.2d 5 (Ch. 1949).

[33] *In re* Bond & Mortgage Guar. Co., 303 N.Y. 923, 103 N.E.2d 721, 725 (1952).

[34] *Cf.* the language of Lord Hardwicke quoted in Robinson v. Smith, 3 Paige Ch. 222, 232 (N.Y. Ch. 1832): "'I will never determine that a court of equity cannot lay hold of every such breach of trust. I will never determine that frauds of this kind are out of the reach of courts of law or equity; for an intolerable grievance would follow from such a determination.'" *See also* the language collected at *In re* Bond & Mortgage Guar. Co., 303 N.Y. 923, 103 N.E.2d 721, 725 (1952).

[35] International Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 584 (Tex. 1963). The

The second common law theory supporting liability to the corporation for profits taken in trading on inside information is that the corporation has a property interest in the information. Judicially, this principle has been recognized when there has been a diversion of corporate opportunity,[36] or at least a diversion of information useful to the corporation in the conduct of its profit-making activities.[37] Commentators have advanced the theory in favor of a corporate recovery, as opposed to recovery by outside traders, in insider trading cases.[38] Their argument has been that recovery by outside traders in an established market gives them a windfall for the fortuity of having traded with insiders.[39] A practical argument rests on the difficulty, stemming from stock exchange mechanics, of linking insiders to any particular transaction.[40]

Duty to Both Stockholders and Corporations. A New York court suggested in *Von Au v. Augenheimer*[41] that when directors willfully drove down the price of stock by circulating false rumors of a company's weakened condition, a recovery might be had by both the corporation (for any damage to its credit) and stockholders (for the depressed value of their stock). Liability to both corporation and stockholder would also seem to be possible under existing law in the situation in which, without positive fraud, an insider with information of his corporation's plans for purchase or sale of its own stock, traded or sold to third parties.[42]

II. DIAMOND v. OREAMUNO

The New York court of appeals forged an unprecedented holding in *Diamond v. Oreamuno*[43] by bringing together established principles of common law, the sentiment of decisions applying federal securities law, and a remedy created by federal legislation for conduct related to, but not the same as, the conduct in *Diamond*.

Citing a number of cases based on the fiduciary duties of agents or trustees,[44] the court stated the "general proposition, that [one who] acquires special knowledge or information by virtue of a confidential or fiduciary relationship . . . is not free to exploit that knowledge for his own

Holloway opinion does not rest on the "inside" nature of the information used by directors, but rather on the directors' breaches of fiduciary duty not to compete with the corporation.

[36] *E.g.*, Loft, Inc. v. Guth, 23 Del. Ch. 138, 2 A.2d 225 (Ch. 1938), *aff'd*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939).

[37] *E.g.*, Chevron Oil Co. v. Tlapek, 265 F. Supp. 598 (W.D. Ark. 1967), *modified*, 407 F.2d 1129 (8th Cir. 1969).

[38] Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53, 64 (1960); Note, *A Suggested Locus of Recovery in National Exchange Violations of Rule 10b-5*, 54 CORNELL L.Q. 306, 308 (1969).

[39] Note, *supra* note 38, at 308.

[40] A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10b-5, § 7.1 n.3 (1967).

[41] 126 App. Div. 257, 110 N.Y.S. 629 (1908).

[42] This result might be possible in Texas. *Cf.* International Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567 (Tex. 1963); Westwood v. Continental Can Co., 80 F.2d 494 (5th Cir. 1935). The latter case seems to adopt the special facts doctrine for Texas.

[43] 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

[44] The cases cited in *Diamond*, 248 N.E.2d at 912, 301 N.Y.S.2d at 80-81, are: *In re* Bond & Mortgage Guar. Co., 303 N.Y. 423, 103 N.E.2d 721 (1952); Byrne v. Barrett, 268 N.Y. 199, 197 N.E. 217 (1935); Wendt v. Fischer, 243 N.Y. 439, 154 N.E. 303 (1926); Dutton v. Willner, 52 N.Y. 312 (1873).

benefit but must account to his principal for any profits derived therefrom."[45] The court reasoned that since corporate directors are fiduciaries, and knowledge of a decline in company earnings can be acquired by virtue of their fiduciary relation, then the directors must account to the corporation for any profits derived from that knowledge.

The court said that the concepts underlying a recovery on behalf of the corporation were "hardly . . . new"[46] citing, *inter alia, Brophy v. Cities Service Co.*[47] and section 16b of the Securities Exchange Act of 1934. However, these authorities scarcely detract from the newness of the *Diamond* holding. *Brophy*, on its face, applies only to the special circumstances raised by a corporation's plans to purchase its own shares.[48] Section 16b of the Securities Exchange Act applies to only one type of market manipulation (short-swing trading), only to corporations of a certain size and dispersed ownership, and only to certain insiders of those corporations.[49] The court itself recognized that the primary policy supporting section 16b was protection of the investing public.

The court supported its proposition that the corporation might recover whether or not it suffered loss[50] by citing the *Restatement (Second) of Agency* section 388[51] and cases from the law of trusts, agency, and corporations.[52] The *Restatement*, comment (e),[53] does lend weight to the holding in *Diamond*, but heretofore no cases had lent weight to the *Restatement* in the area of directors' liabilities in stock transactions with third parties.[54] Indeed, the widely spoken dictum that no loss is required on the part of the corporation is supported more by the logic of the preventive policy involved than by the facts of particular cases.[55] In any

---

[45] 24 N.Y.2d 494, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 80 (1969).

[46] 248 N.E.2d at 913, 301 N.Y.S.2d at 82.

[47] 31 Del. Ch. 241, 70 A.2d 5 (Ch. 1949).

[48] A later Delaware court has read *Brophy* as resting on this special circumstance. Equity Corp. v. Milton, 213 A.2d 439, 442 (Del. Ch. 1965).

[49] *Supra* note 26.

[50] The opinion suggests that this corporation may have suffered loss. "When officers and directors abuse their position . . . to gain personal profits, the effect may be to cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities." 248 N.E.2d at 912, 301 N.Y.S.2d at 82. To the extent that public opinion is shaped by court decisions, the court's reasoning is circuitous.

[51] RESTATEMENT (SECOND) OF AGENCY § 388 (1958): "Unless otherwise agreed, an agent who makes a profit in connection with transactions conducted by him on behalf of the principal is under a duty to give such profit to the principal."

[52] Brophy v. Cities Serv. Co., 31 Del. Ch. 241, 70 A.2d 5 (Ch. 1949); *In re* Bond & Mortgage Guar. Co., 303 N.Y. 423, 103 N.E.2d 721 (1952).

[53] > [I]f he [a corporate officer] has 'inside information' that the corporation is about to purchase or sell securities, or to declare or to pass a dividend, profits made by him in stock transactions undertaken because of his knowledge are held in constructive trust for the principal. He is also liable for profits made by selling confidential information to third persons, even though the principal is not adversely affected.

RESTATEMENT (SECOND) OF AGENCY § 388, comment (c) (1958).

[54] RESTATEMENT (SECOND) OF AGENCY Appendix § 388 (1958); RESTATEMENT IN THE COURTS, SUPPLEMENT (1965, 1967, 1968). The RESTATEMENT has been considered in an analogous situation, but not applied. Slavin v. Germantown Fire Ins. Co., 174 F.2d 799, 809 (3d Cir. 1949). The defendant had succeeded in converting a mutual insurance company into a stock company. A suit on behalf of the erstwhile mutual company was unsuccessful because defendant as agent for the mutual company had acted so openly that ratification by the company could be inferred. The agency relationship arose specifically for stock transactions.

[55] 3 FLETCHER § 884, at 290, cites a number of precedents for the proposition that harm to

event, cases in which the no-loss language is invoked must reach the question of liability without loss only after a determination that the requisite fiduciary relation exists with respect to any given transaction. In applying the rule that no loss is required, the court cited a trusts case of its own, but did not mention the distinction made in that case between the fiduciary duties of the trustee and the corporate director.[56]

The court recognized that its result includes the possibility of double liability for the director, but it reasoned that the likelihood of a suit by purchasers is "quite remote."[57] In the argument of this case defendants admitted liability to purchasers, and such liability would appear to be likely in a federal action.[58] Liability to purchasers could also apparently be established under New York law,[59] but the *Diamond* opinion does not consider the relation of its holding to the possibility of recovery under the "special facts" doctrine. Perhaps the court paid indirect attention to the implications of its earlier precedents, when it conceded the possibility of superior claims by third parties and hinted that while the defendants might be subject to more than one suit, liability would not be "double" if the corporation's recovery were diminished by amounts refunded to injured purchasers.[60]

The court reasoned that the existence of an extensive federal statutory scheme did not weigh against the fashioning of new state remedies.[61] The Securities Exchange Act of 1934 specifically preserves any remedies which might exist at law or in equity,[62] and civil relief under rule 10b-5 is yet so undeveloped as not to deter the development of possibly concurrent state remedies.[63]

---

the corporation is immaterial, but most of the cases state the rule without applying it. Higgins v. Shenango Pottery Co., 256 F.2d 504 (3d Cir. 1958) (diversion of corporate opportunity to partnership composed of officers and directors); Fleishhacker v. Blum, 109 F.2d 543 (9th Cir. 1940) (bank president took bonus for making a loan); Pratt v. Shell Petroleum Corp., 100 F.2d 833 (10th Cir. 1938) (geologist took interest in mineral leases for self); Western States Life Ins. Co. v. Lockwood, 166 Cal. 185, 135 P. 496 (1913) (director coerced secret profit from seller of plaintiff corporation's stock); Loft, Inc. v. Guth, 23 Del. Ch. 138, 2 A.2d 225 (Ch. 1938), *aff'd*, 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939) (diversion of corporate opportunity); Hoyt v. Hampe, 206 Iowa 206, 214 N.W. 718 (1927) (defendant directors diverted corporate funds to third-party purchaser of their stock in plaintiff corporation); Bromschwig v. Carthage Marble & White Lime Co., 334 Mo. 319, 66 S.W.2d 889 (1933) (defendant used corporate funds without paying interest to purchase stock in corporation); Lutherland, Inc. v. Dahlen, 357 Pa. 143, 53 A.2d 143 (1947) (defendant insider diverted to other corporations advantages arising from defaulted lease); Bailey v. Jacobs, 325 Pa. 187, 189 A. 320 (1937) (diversion of corporate funds to divert a corporate opportunity); Bird Coal & Iron Co. v. Humes, 157 Pa. 278, 27 A. 750 (1893) (director took profit from corporation's lessee).

[56] *In re* Bond & Mortgage Guar. Co., 303 N.Y. 923, 103 N.E.2d 721, 726 (1952). Attorneys for trustee on mortgage bonds were disqualified from taking a fee because they dealt in the certificates under the mortgage. The attorneys had the same duty not to do business with the trust as the trustees themselves. Citing Fischer v. Guaranty Trust Co., 259 App. Div. 176, 18 N.Y.S.2d 328 (1940), *aff'd*, 285 N.Y. 629, 34 N.E.2d 379 (1941), the court said, "Such a situation is not comparable to the one now before us."

[57] 24 N.Y.2d 494, 248 N.E.2d 910, 915, 301 N.Y.S.2d 78, 86 (1969).

[58] 248 N.E.2d at 914, 301 N.Y.S.2d at 84.

[59] *See* text accompanying notes 22-25 *supra*.

[60] 248 N.E.2d at 916, 301 N.Y.S.2d at 86.

[61] 248 N.E.2d at 914, 301 N.Y.S.2d at 84.

[62] Securities Exchange Act of 1934, § 28(a), 15 U.S.C. § 78bb(a) (1963).

[63] Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 914, 301 N.Y.S.2d 78, 85 (1969).

III. CONCLUSION

Diamond v. Oreamuno creates a new liability for corporate directors. It brings the common law and equity treatment of *all* corporate insiders to the point reached for some insiders under federal law. That point is one at which it is perilous for a director to trade at all in the stock of a corporation he directs.[64]

There are good reasons for closely limiting the *Diamond* holding to its facts. If the decision does not create a likelihood of double liability, it at least prepares the track for a race to the courthouse. The court did not consider the hardships it may visit on a corporation which recovers as in *Diamond,* only to face a later suit by those with a superior claim.[65] The *Diamond* rule is clearly inapposite when, in a close corporation, an insider's *purchases* in breach of his duty establish for him such an ownership position that recovery by the corporation would largely inure to his benefit.[66] The rule in any case would not be comforting to the stockholder who sold to an insider trading in violation of an alleged duty. For close corporations, an extension of the *Diamond* principle beyond the field of securities transactions[67] would seem unfortunate in light of a frequent identity of interests of stockholders and the corporation, and in light of the absence of a strong public interest such as supports the parallel corporate recovery under federal law. Finally, it may be said that at some juncture, it will be undesirable to inject into the marketplace a rule against the morals thereof.[68]

W. Wilson Jones

---

[64] This possibility is recognized in N.Y.S.E., THE CORPORATE DIRECTOR AND THE INVESTING PUBLIC 12 (1962).

[65] *See* text accompanying notes 59-60 *supra.*

[66] *Cf.* Providence Trust Co. v. Geyer, 248 Pa. 423, 94 A. 77 (1915), in which defendant insiders bought corporate stock at par and sold it to X group at par plus $14. The court ruled that the defendants' held their profits in trust for stockholders at the time of their purchase from the corporation, since a recovery by the corporation would only benefit X group.

[67] RESTATEMENT (SECOND) OF AGENCY § 388, comment (c) (1958), suggests the possible and unfortunate breadth of the *Diamond* holding: "[W]here a corporation has decided to operate an enterprise at a place where land values will be increased because of such operation, a corporate officer who takes advantage of his special knowledge to buy land in the vicinity is accountable for the profit he makes, even though such purchases have no adverse effect upon the enterprise." Such an application of *Diamond* would seem to take the director's liability beyond that of the strict trustee. *Cf.* RESTATEMENT (SECOND) OF TRUSTS § 203, comment (e) (1959).

[68] *Cf.* the language of Cardozo, J., in Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928): "Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty . . . . *A trustee is held to something stricter than the morals of the market place*" (emphasis added). This is part of the language quoted in *In re* Bond & Mortgage Guar. Co., 303 N.Y. 423, 103 N.E.2d 721, 725 (1952), cited in Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.d 910, 912, 301 N.Y.S.2d 78, 81 (1969). Compare the reasoning of the Massachusetts court in Goodwin v. Agassiz, 283 Mass. 355, 361-63, 186 N.E. 659, 661 (1933):

> An honest director would be in a difficult situation if he could neither buy nor sell on the stock exchange . . . stock in his corporation without first seeking out the other . . . ultimate party . . . and disclosing to him everything which a court or jury might later find that he then knew affecting the real or speculative value of such shares. Business of that nature is a matter to be governed by practical rules. Fiduciary obligations of directors ought not to be made so onerous that men of experience and ability will be deterred from accepting such office. Law in its sanctions is not coextensive with morality.