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Recommended Citation
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COMMENTS

Corporations—Shareholders—Majority Liability for Improper Stock Redemption by Corporation and for Misrepresentations in Private Stock Purchases from Minority Holders—In 1942 a seemingly innocuous suit was brought against the Axton-Fisher Tobacco Corporation to determine the propriety of
the alteration of a stock redemption. In 1955 Judge Leahy of the Federal District Court for Delaware handed down an opinion on the damages and relief to be given in the case in what he hopefully termed was the final phase of this famous litigation. It is the purpose of this comment to appraise the basis of the recovery allowed by Judge Leahy. Two readily distinguishable problems will be treated: (1) the nature of relief from a stock redemption called by fiduciaries in violation of their duties, and (2) the nature of relief (under both state common law and rule X-10B-5 of the Securities and Exchange Commission) for fraudulent purchase of stock by insiders.

I. Summary of Events Leading Up to the Litigation

The Axton-Fisher Tobacco Corporation of Kentucky was capitalized with three classes of stock—preferred, class A common, and class B common. In May of 1941 defendant Transamerica Corporation purchased 80,610 class B shares giving it 46.97 percent control of the voting stock of Axton-Fisher. Transamerica arranged to have a new president and board chairman appointed who followed its bidding. The remaining board members (five of whom were replaced during the first year after the entry of Transamerica into the picture) considered the president as representing the views and policy of Transamerica and endeavored to follow the president's suggestions. During the first year Transamerica considered a variety of plans to capitalize on the inventory gain resulting from wartime shortages of tobacco. Somewhere around

4 The preferred stock (par value $100) bore interest of 6% and was to receive $105 upon liquidation. Class A common (par value $10) was entitled to $3.20 cumulative annual dividends. Class B common (par value $10) could then receive up to $1.60 in annual dividends with any further dividends being shared equally by class A and class B stock. Class A stock was redeemable at $60 plus accrued dividends upon call by the corporation at any dividend date and was convertible into class B stock share for share at the holder's option. Upon liquidation, class A stock was entitled to twice as much per share as the class B stock.
5 On July 31, 1942, tobacco inventories, carried on the company's books at $9,845,983.25 (lower of cost or market value), had a replacement value of $19,507,557.00.
the middle of 1942 Transamerica developed a plan to capture the inventory profit by liquidation. On November 12, 1942, Transamerica made a written offer to all minority stockholders to buy class A common at $40 per share and class B common at $12 per share, both prices being substantially above the market price. Neither Axton-Fisher nor Transamerica disclosed the rise in inventory, the increased earnings of Axton-Fisher, or the intent to liquidate prior to or during the time the offer was open. As a result of this offer, Transamerica got 69.43 percent of Axton-Fisher voting stock and continued to make further purchases from time to time. Early in 1943, Transamerica converted its class A shares to class B shares. At Transamerica’s “suggestion,” Axton-Fisher’s board called the outstanding A shares for redemption, the directors believing that Transamerica’s purpose was to recapitalize the company. No disclosure was made as to company plans or operations at the time of the call. Later the board sought to make the call optional, but in a suit for a declaratory judgment the Kentucky Court of Appeals held that the B holders had acquired vested rights under the call and that it could not be altered. In the spring of 1944 Axton-Fisher was dissolved and the assets were sold or distributed as a liquidating dividend. Transamerica’s profit on the investment amounted to more than $9,000,000.

II. History of the Litigation

The rights of minority holders who had sold stock to Transamerica under the offer of November 12, 1942, were first asserted in a common law action alleging misrepresentation and non-disclosure and praying for tort damages or rescission. Judge Leahy found there had been no actionable misrepresentation alleged in the pleadings and allowed defendant’s motion for summary judgment on the ground that, under Kentucky law, a majority stockholder has no duty, fiduciary or otherwise, to disclose material facts known prior to a purchase from minority holders. In 1945, Zahn and other stockholders who had been subject to the redemption call filed suit against Transamerica on the theory that the redemption was a violation of the defendant’s fiduciary duty as controlling shareholder. Judge Leahy allowed defendant’s motion for summary judgment on the ground that redemption was a matter of

7 The statement of facts above was taken from Judge Leahy's finding of facts on the merits in Speed v. Transamerica Corp., (D.C. Del. 1951) 99 F. Supp. 808 at 833-843, 848.
contract and that the defendant had no fiduciary duty to minority shareholders under Kentucky law. On appeal, the Third Circuit reversed, holding that while an impartial board could exercise a redemption call, the call was actually exercised, under the allegations of the complaint, by the defendant. The court said that those in control of a corporation had a fiduciary relationship to the stockholders and that a redemption call designed to benefit majority holders at the expense of the minority was a violation of this fiduciary duty and, therefore, voidable in equity. The suit was remanded for trial on the merits with instructions that the Zahn group should receive "their aliquot share at the time of dissolution" in accordance with remedies prescribed by the law of the forum, Delaware. In the trial on the merits, plaintiff proved its allegations and the problems of remedy and the measure of relief were referred to a special master.

In the interim, Speed and another group of sellers to Transamerica under the purchase offer of November 12, 1942, brought suit for damages. The first count was based on common law deceit, and the other three counts alleged a violation of rule X-10B-5 of the SEC. The common law count was dismissed, but was subsequently reinstated on the basis that public statements by Transamerica and its letter of offer were misleading in the light of its intent to liquidate. The defendant was held liable on this count apparently on the ground that it had impliedly represented that Axton-Fisher would continue as a going concern. Liability under the federal counts was predicated on defendant's duty under the rule to disclose material facts affecting the value of the stock known to the majority holder by virtue of its inside position. The specific form of the relief was left to a special master.

III. Nature of Relief

When the special master died without signing the final report on the measure of recovery, Judge Leahy made an independent determination. In a manner reminiscent of the many holding company reorganizations he has handled, he determined that the only "fair and equitable" solution would be to allow all the plaintiffs and the defendant to participate in a "reconstructed liquidation"
as class $B$ holders, the situation which he believed would have existed had no fraud or unfairness been involved.

A. Zahn Holders—Relief for Redemption in Violation of Fiduciary Duty. In deciding that the Zahn plaintiffs would not participate as class $A$ common holders in the liquidation, Judge Leahy may well be controverting the mandate of his appellate court. From the language of the court of appeals opinion, it would appear that Judge Biggs intended the reference to Zahn's "aliquot share" to refer to his position as a class $A$ holder. Indeed, it would seem that the controlling theory of the decision was that the board of directors, as fiduciaries, were not entitled to favor Transamerica, the class $B$ stockholder, by employing the redemption provisions of the charter for its benefit. In this light, Judge Leahy's "reconstructed liquidation" appears to be no more than a bit of artful maneuvering around the mandate of the court of appeals. Perhaps Judge Leahy found latitude in the ambiguities obviously existing in the appellate court's opinion. It would seem more likely, however, that he decided as he did in the belief that the upper court had overreached itself in its first opinion and might be quite willing to accept an opportunity for retrenchment.

The opinion of Judge Biggs in the court of appeals is still somewhat unique in American decisions. While this is not the only case where fiduciary concepts have been raised by claimants to restrain redemption, it seems to be the only one where these concepts have controlled the decision. Most of the opinion was devoted to an attempt to establish a general fiduciary duty attaching to those in control of the corporation, with no real effort made to elucidate the nature of the duty or the act constituting the breach. That mere control by the majority is not a breach in itself would seem uncontested. Apparently, authority for finding a breach lay, by analogy, in the dissolution cases cited by the court.

15 See Zahn v. Transamerica Corp., (3d Cir. 1947) 162 F. (2d) 36 at 45.
16 See Stieglitz v. Electrol, Inc., (N.Y. 1945) 60 N.Y.S. (2d) 490, in which the court denied a suit to enjoin redemption of preferred stock. Plaintiffs had alleged fiduciary double dealing in that two of the three directors voting affirmatively were shareowners standing to benefit by the redemption. The court noted that while directors may not act against the corporation's interest for their private and personal gain, they are free to pass on any matter in which they are involved as shareholders. Here the directors were said to have acted within the scope of their authority and in a manner consistent with the provisions of the certificate of incorporation.
18 See Zahn v. Transamerica Corp., (3d Cir. 1947) 162 F. (2d) 36 at 46-47. This approach was suggested in 41 Ill. L. Rev. 122 (1946).
The difficulty in accepting this analogy lies in the fact that in the dissolution cases the majority holders took property for themselves to which they had no right by statute, charter, or otherwise. The question of whether the class B holders of Axton-Fisher did have such a right was almost entirely ignored.

This case, if nothing else, illustrates the danger of the wholesale importation of the fiduciary duty commonly attached to directors into the arena of majority and minority shareholder contests. Directors are in a proper sense custodians. Shareholders, on the other hand, are beneficially interested in the operations of the corporation. The interests of various classes of shareholders are often legitimately opposed, and one class must necessarily profit at the expense of the others. To say that a director should not profit at the expense of his cestui is one thing, but to apply the same logic and hold that the majority shareholders, in a case of conflicting interest, should gratuitously benefit minority shareholders is a non sequitur. In the principal case, the choice was between redemption or no redemption. It would seem obvious that the rights to that redemption should not be determined in a vacuum. There must be a starting point.

Taylor v. Axton-Fisher Tobacco Co. would seem sufficient to point out that the rights of stockholders inter se are regulated and determined by the corporate charter. If there were any remaining doubts as to the methods employed under Kentucky law in analyzing stockholder rights in redemption cases, they must surely have been settled by Thompson v. Fairleigh. This case asserted that the corporate charter is a contract both between the corporation and the stockholders and also between the stockholders inter se, and is the source of and limitation on all stockholder rights.

Approached in this manner, the question becomes: if the majority has the right to control, under what circumstances does the

19 See, generally, Lattin, "Limitations on Statutory or Charter Powers Given to Majority Stockholders," 30 Mich. L. Rev. 645 (1932). In discussing the leading cases on the dissolution theory, Lattin notes that the dissolution sale of assets to the majority involved in these cases would have been sufficient to find liability without the introduction of fiduciary principles in regard to the dissolution itself. In dismissing the adaptation of fiduciary principles to these cases as unnecessary but convenient and harmless, the author apparently did not foresee some of the broader implications which other courts might attach to that concept.


charter give them the right to call the class A common? The redemption provision itself contained no limitations whatsoever. It is difficult to imagine how any contractual agreement could more clearly express the fact that the A stock was subject to being wiped out at any time by certain action. Nothing in the dissolution provisions suggests any limitation on the power to redeem. Nor would there seem to be any reasonable grounds for finding such a limitation by construing the two provisions together. If any A holders exist at the moment of dissolution, it is clear that they are entitled to participate in the liquidation. It would seem equally clear that where a call was made in accordance with the redemption provisions, the class A holders would have no further rights in the corporation either at liquidation or at any other time. Viewed in this light, the redemption would seem entirely proper.

Does the addition of fiduciary concepts require a different construction of the rights of the parties? In light of the general rule regarding determination of the rights of shareholders, the answer would seem to be no. Such concepts are not grounds for rewriting the charter. They do, however, have an important bearing upon the conduct of the controlling stockholders during the operation of the corporation. Since fiduciaries have a duty to act fairly and

22 Judge Leahy understandably did not attempt this approach in his final opinion since it would have patently contradicted the court of appeals opinion of Judge Biggs.
23 The charter provided as follows: "The whole or any part of the Class A common stock of the corporation, at the option of the Board of Directors, may be redeemed on any quarterly dividend payment date by paying therefor in cash Sixty dollars ($60.00) per share and all unpaid and accrued dividends thereon at the date fixed for such redemption, upon sending by mail to the registered holders of the Class A common stock at least sixty (60) days' notice of the exercise of such option. If at any time the Board of Directors shall determine to redeem less than the whole amount of Class A common stock then outstanding, the particular stock to be so redeemed shall be determined in such manner as the Board of Directors shall prescribe; provided, however, that no holder of Class A common stock shall be preferred over any other holder of such stock." Zahn v. Transamerica Corp., (3d Cir. 1947) 162 F. (2d) 36 at 39, n. 3.
24 The charter provided as follows: "In the event of the dissolution, liquidation, merger, or consolidation of the corporation, or sale of substantially all its assets, whether voluntary or involuntary, there shall be paid to the holders of the preferred stock then outstanding $105 per share, together with all unpaid accrued dividends thereon, before any sum shall be paid to or any assets distributed among the holders of the Class A common stock and/or the holders of the Class B common stock. After such payment to the holders of the preferred stock, and all unpaid accrued dividends on the Class A common stock shall have been paid, then all remaining assets and funds of the corporation shall be divided among and paid to the holders of the Class A common stock and to the holders of the Class B common stock in the ratio of 2 to 1, that is to say, there shall be paid upon each share of Class A common stock twice the amount paid upon each share of Class B common stock, in any such event." Zahn v. Transamerica Corp., (3d Cir. 1947) 162 F. (2d) 36 at 38, n. 2.
26 See note 21 supra.
in good faith toward their beneficiaries, it would not be surprising if the courts found a duty to disclose on the part of responsible members of the corporation under the circumstances of this case. The minority would seem to be entitled to some information from its corporation relevant to a decision on the election to convert. But to extend the fairness concept to the extent of nullifying the charter provisions and prohibiting the call overlooks the basic business facts involved. Judge Leahy's argument and citations are representative of the unanimity of authority in the business and legal fields which recognizes (1) that a call option in senior securities is reserved for the benefit of junior securities as well as the corporation, and (2) that the price paid for a callable security is based upon the realization that its market price cannot be expected to rise much above the call price for any substantial period of time. The investor buys at a price reflecting this limitation, and the expectation of anything more suggests naivete.

One limitation in the application of Judge Leahy's business and legal authority on this point is that the situations envisioned in the authorities are almost always going concerns not in liquidation. This has been used as an argument that call provisions were not intended to be used in contemplation of liquidation. The obvious answer to this is that the authorities refer to call provisions in terms of their most common use. Dissolution is a matter for which there is always provision but little expectation. But this does not change the basic relationships of the parties involved. Whether the corporation is a going concern or one approaching dissolution, the holders of the common stock are still the backbone of the corporation and the ultimate claimants to the corporation's financial resources should the business prove successful. The callable preferred securities are always temporary financing shares subject at any time to removal from the scene should company fortunes

28 Judge Leahy presumed this to be the real basis of liability. The writer knows of no cases where the courts have imposed a duty of disclosure upon the corporation in making a stock call. But compare Northern Trust Co. v. Essaness Theatres Corp., (D.C. Ill. 1952) 103 F. Supp. 954, where the court said that whatever the position of a director when he acts for himself, he occupies the position of a trustee to each individual shareholder when he acts on behalf of the company in buying stock. Contra, Gladstone v. The Murray Co., 314 Mass. 584, 50 N.E. (2d) 958 (1943).
30 While the SEC reorganization and dissolution cases would seem to be closest in point, the investment value theory employed in these cases considers various stockholder interests from the standpoint of a going concern. See Dodd, "Preferred Shareholders' Rights—The Engineers Public Service Company Case," 63 HARV. L. REV. 298 (1949).
31 See 33 CORN. L.Q. 414 at 420-421 (1948).
indicate the advantage of such a move. Their prospects of participating in the fortunes of the corporation are transitory in nature. That the profits reaped by the common stock occurred in dissolution rather than in large "going-concern dividends" subsequent to call is of no concern to them.\footnote{To say that the holders of such callable securities are entitled to more than they bargained for is pure hindsight.} To say that the holders of such callable securities are entitled to more than they bargained for is pure hindsight.

\section*{B. Speed Claimants — Relief under Rule X-10B-5 and for Common Law Deceit.} The basis for affording relief to the Speed claimants is somewhat unclear in the opinion. The Speed plaintiffs originally pleaded four counts — one count based on common law deceit and three counts based on rule X-10B-5 of the Securities and Exchange Commission.\footnote{Pursuant to authority conferred by §10 (b) of the Securities Exchange Act of 1934, 48 Stat. L. 891, 15 U.S.C. (1952) §78j, the commission promulgated the following rule in 1942:}

\begin{quote}
"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." S.E.C. Rel. No. 3250, May 21, 1942, 2 CCH Fed. Sec. L. Serv, ¶25,375.
\end{quote}

\footnote{See Speed v. Transamerica Corp., (D.C. Del. 1951) 99 F. Supp. 808 at 812.}

Judge Leahy's decree made no attempt to differentiate between common law relief on the deceit count and relief based upon the violations of the rule. It is clear, however, that the basis of relief given was restitutary rather than compensatory.

\footnote{Even the more extreme of the dissolution cases cited by Judge Biggs admit the right of the majority to dissolve a profitable going concern when a true dissolution was contemplated, as here. See Sprecher, "Right of Minority Stockholders to Prevent the Dissolution of a Profitable Enterprise," 33 Ky. L.J. 150 (1945). Implicit in Judge Biggs' reasoning would seem to be an adaptation of the view prevalent in the dissolution cases that a motive to make use of dissolution machinery for something other than real dissolution is an actionable wrong. It is difficult to see how this theory carries over to a case where redemption, not dissolution, is used to cut off the interests of stockholders. Granting that the motive here was to cut off the interests of the A holders in order to benefit the B holders, this, as noted before, is one of the basic purposes of such a provision. In the only redemption case found in which motive was discussed, the court did not decide whether the motive was relevant; it merely noted that in any event the motive present in the case was a justifiable one—to benefit the common holders by increased earnings. The court attached no legal significance to the plaintiff's allegations that the preferred redemption had been forced by the majority common holders. Weidenfeld v. Northern Pacific R. Co., (8th Cir. 1904) 129 F. 805.}
1. **Restitution and misrepresentation.** At common law, relief in a deceit action is based upon a theory of affirmance of the transaction and is compensatory in nature—the measure of recovery commonly being the difference between the sale price and the "true" value at the time of the sale.\(^{35}\) Professor Loss, whom Judge Leahy cites as an authority on rule X-10B-5, suggests that the same measure of relief would be available in an action based on that rule, with the alternative being an election to rescind, with restitutionary relief then being available.\(^{36}\) The latter form of relief is now generally available either at law or in equity where the vendor has sold property on the basis of the buyer's misrepresentations.\(^{37}\) In the case cited by Judge Leahy as indicative of the existence of the special facts doctrine in Kentucky, similar relief was given in a suit in equity.\(^{38}\) Assuming that the facts here constitute special facts justifying intervention by a court applying Kentucky law, there would seem to be no reason why a defrauded vendor could not rescind or seek rescission and compel restitution of profits by the vendee under the common law count. If statutory liability is to be imposed, the general availability of restitutionary relief in deceit situations\(^{39}\) provides an argument for its use under rule X-10B-5.

Whether liability is enforced under the state or federal counts, however, it is not clear how the court awarded restitution when the plaintiff prayed for damages amounting to the difference between the sale price and the value at the time of the transaction in an action apparently based on affirmance of the contract. Apart from the problem of election of remedies,\(^{40}\) it is unclear how the court

\(^{35}\) See 3 Torts Restatement §549 (1934). Occasionally, a deceit case suggests relief that appears restitutionary in nature. Thus, in Staker v. Reese, 82 W.Va. 764, 97 S.E. 641 (1918), the court affirmed a measure of relief amounting to the difference between the price paid by the fraudulent vendee of stock and the price received on resale. The resale contract was made before the fraudulent purchase, however, and it appears that the court accepted this as conclusive evidence of the stock value. The basic principle of recovery was said to be compensatory—the difference between the amount received and the actual value at the time of the sale.

\(^{36}\) Loss, Securities Regulation 1065 (1951).

\(^{37}\) See Restitution Restatement §39 (1957); Strong v. Repide, 213 U.S. 419, 29 S.Ct. 521 (1909); United States Trust Co. v. Chicago Terminal Transfer R. Co., (7th Cir. 1911) 188 F. 292.

\(^{38}\) Hays v. Meyers, 139 Ky. 440, 107 S.W. 287 (1908). Under the special facts doctrine, the existence of unusual circumstances in a sale may impart a duty of disclosure in the absence of a fiduciary or confidential relationship. See 3 Fletcher, Cyclopedia, perm. ed., §1171 (1947).

\(^{39}\) See note 37 supra.

\(^{40}\) According to the Restatement, institution of an action for deceit is a conclusive election to affirm the sale contract and proceed on a damage-loss theory of liability, subject to limitations which are not material here. Restitution Restatement §68 (1937).
reaches a decision that restitutionary principles will govern the measure of relief. While it is believed that restitution should be available on the facts of this case, Judge Leahy's decision breaks new ground in determining the basis and nature of relief available under rule X-10B-5 and will have an important bearing on liability under this rule in future litigation. Relief should not be limited to recovery on restitution principles. It would seem desirable that defrauded investors should be able to retain their bargain and sue for damages should they seek to do so. On the other hand, courts may find that the defrauded party has, by his own conduct, created a situation in which injustice would occur were the party committing the fraud compelled to disgorge benefits flowing from the transaction. Promptness of action and facts indicating affirmance of the contract or ability to restore the status quo by the defrauded party, among other factors, should be considered before restitution can be fairly granted.

2. Theories of liability under rule X-10B-5. Part of the problem created by civil liability under rule X-10B-5 lies in the unsettled nature of the underlying basis of such liability. Possible alternatives are (1) implied liability based upon the statute and the rule with the selection of remedies derived from an interpretation of the statute and congressional policy, or (2) general tort liability based on violation of the federal statute and regulation. This general tort liability may conceivably be governed by federal common law principles or the law of the forum.

Both implied liability and general tort theory are suggested by Kardon v. National Gypsum Co., which Judge Leahy cites with approval. As to the former, Judge Kirkpatrick in the Kardon case stated that section 29 (b) of the Securities Exchange Act of 1934 voids all contracts which violate the statute, necessarily implying the existence of a remedy. Judge Leahy's analogy to cases doctrine has received apparent support in the federal courts. United States v. Oregon Lumber Co., 260 U.S. 290, 43 S.Ct. 100 (1922); Harris v. Egger, (6th Cir. 1915) 226 F. 389. But see National Lock Co. v. Hogland, (7th Cir. 1938) 101 F. (2d) 576.

41 Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane, (D.C. Ark. 1949) 85 F. Supp. 104, is apparently the first case in which a specific judgment for private damages was rendered under rule X-10B-5. The action was for losses occasioned by the purchase of stock which was never received. The court included in its damage estimate the purchase price, shipping expense, postage, and defendant's commissions, while excluding the commissions of defendant's correspondent. Two of the stock orders had been tendered into court by the defendant, and the court gave the plaintiffs the option of damage or the stock, citing a federal case holding that there is no bar by an election of remedies where the pleadings are ambiguous.

of short swing transactions under the same act would suggest adherence to a view of wringing the form of relief out of an interpretation of the statute without regard for previous federal or state common law rules of deceit. This would suggest that restitutionary principles, alone, would govern relief under rule X-10B-5.

Much of the remainder of Judge Leahy's opinion, however, suggests reliance more on general tort law, in keeping with the main theme developed by the *Kardon* case. This approach runs right into the problem of whether federal or state law will be controlling. Judge Kirkpatrick in the *Kardon* case appeared to place reliance upon the use of state common law. A later case by the same judge suggests more clearly that the action is to be conceived, at least from the standpoint of remedy and measure of relief, in terms of the analogous state common law tort of deceit. Other cases have expressly repudiated the use of state law, holding that the existence of the federally created right under rule X-10B-5 requires application of exclusively federal law to the problem of the remedy.

Fundamental to the question here, of course, is the application of *Erie R. Co. v. Tompkins* to cases of this nature. While it is clear that federal judges must interpret federal statutes on the basis of the language of the act and the congressional policy expressed therein, it is impossible to lay down a general rule when they are forced to go beyond the act in question for a rule of law. The Sixth Circuit seems committed to the proposition that while the right created by a federal statute is subject to federal interpretation completely apart from state law, the remedy and form of relief must follow the law of the forum. Other federal

43 On this point Judge Leahy cites: Smolowe v. Delendo Corp., (2d Cir. 1943) 136 F. (2d) 231; Gratz v. Claughton, (2d Cir. 1951) 187 F. (2d) 46. That the Second Circuit did not consider its reasoning as to specific liability imposed by the 1934 act to extend to liabilities implied from other parts of the act, see Birnbaum v. Newport Steel Corp., (2d Cir. 1951) 193 F. (2d) 461.

44 See 41 VA. L. REV. 1114 (1955).


48 304 U.S. 64, 58 S.Ct. 817 (1938).

49 See 48 Col. L. Rev. 1090 (1948).

decisions, however, have suggested that a federal common law is still very much alive in some areas dominated by federal statutes. 51

It is beyond the scope of this comment to attempt to reconcile the conflicting policy and constitutional power questions involved. 52 While there would seem to be strong indications of an emerging federal common law which would pre-empt the field where federal rights have been created by federal criminal statutes, 53 the pattern is far from set. Since the outcome of this question is determinative of many problems affecting the scope and availability of relief under statutes and regulations such as that in question in the principal case, it is unfortunate that Judge Leahy did not present his thoughts more clearly.

3. Introduction of fiduciary concepts. In circumventing some of the problems discussed above, Judge Leahy employed a wide variety of authority to justify restitutionary relief. It is perhaps unfortunate that in order to justify relief of an equitable nature, much of the argument suggested that such relief was warranted because the defendants were subject to a fiduciary duty. It is submitted that neither the problems of the case nor the authority relied upon require introduction of fiduciary principles. As Judge Leahy observed, 54 misrepresentation has traditionally been accepted as a basis for equity jurisdiction. While restitution is of an equitable nature, it is, as noted before, available in either legal or equitable forms in misrepresentation cases. 55 Part of the special master's opinion incorporated in Judge Leahy's decision indicates that fiduciary


52 Even if the federal courts have the power to apply federal common law under the constitutional power to settle cases and controversies, there remains the policy question of whether the right should be exercised. Cf. National Fruit Product Co. v. Dwinell-Wright Co., (D.C. Mass. 1942) 47 F. Supp. 499, affd. (1st Cir. 1944) 140 F. (2d) 618.


54 (D.C. Del. 1955) 185 F. Supp. 176 at 188.

55 Recovery on quasi contract at law is frequently limited to value at the time of the transaction. Felder v. Reeth, (9th Cir. 1929) 34 F. (2d) 744. This apparently was one of the main reasons for Judge Leahy's elaborate argument to introduce equitable principles. As noted supra the Restatement of Restitution makes no distinctions between legal and equitable actions in this regard and sanctions recovery of the wrongdoer's profits. In any event, defendant's evidence of market value of the stock, which would have allowed a recovery considerably less than a share of the sale proceeds of the liquidation, was rejected by the court.
concepts are unnecessary to acquire jurisdiction for restitutionary relief.\textsuperscript{56} Judge Bigg's opinion from the \textit{Zahn} case is quoted as authority for the introduction of fiduciary concepts but the case there concerned acts relating to corporate powers, not purchases of stock by individuals.\textsuperscript{57} Nor is it clear why the \textit{Kardon} case should be employed as authority that a fiduciary relationship exists by virtue of rule X-10B-5. In that case fiduciary concepts were adopted because they were believed to be appropriate, under the rules of all jurisdictions, to the particular facts of the case.\textsuperscript{58}

The principal case goes farther than any other case in imposing, by virtue of rule X-10B-5, a blanket fiduciary duty, on stockholders with all the attendant problems and tendency toward oversimplification inherent in such a concept.\textsuperscript{59} Absent fiduciary principles, one can agree with Professor Loss that, in appropriate circumstances, traditional forms of equity relief should be available.\textsuperscript{60} When value restitution is sought, as in the principal case, there is even less justification for hanging the decision on forced concepts of fiduciary relationships.

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\textsuperscript{56} Id. at 190.
\textsuperscript{57} At least one Kentucky case suggests that the majority has a fiduciary duty toward the minority when disposing of corporate assets during dissolution. See \textit{Kaye v. Kentucky Public Elevator Co.}, 295 Ky. 661, 175 S.W. (2d) 142 (1943). But to extend this duty to a stockholder when making a private purchase of stock would appear to be completely inconsistent with Kentucky corporation law. See \textit{Celler v. Transamerica Corp.}, (D.C. Del. 1943) 53 F. Supp. 625, review den. (D.C. Del. 1945) 63 F. Supp. 248, affd. (3d Cir. 1945) 151 F. (2d) 534.

\textsuperscript{58} (D.C. Pa. 1947) 73 F. Supp. 798. The court stated that the transaction involved was essentially a sale by directors, in their own interests, of corporate assets otherwise than in the course of business and without disclosure to shareholders. This was stated to complete the cause of action without regard for the purchase of shares contrary to rule X-10B-5 with the natural remedy being an accounting for the profits from the transaction. Judge Kirkpatrick observed that such relief was consistent with general rules governing fiduciary relationships and said (at 803): "These principles are fundamental in all jurisdictions and the decisions of both Pennsylvania and Michigan fully support the conclusions reached above."

\textsuperscript{59} Cases involving rule X-10B-5 are collected in \textit{Loss, Securities Regulation} 827 (1951), and \textit{Loss, Securities Regulation} (1955 Supp.) 328. \textit{Slavin v. Germantown Fire Ins. Co.}, (3d Cir. 1949) 174 F. (2d) 799, would appear to suggest that the Third Circuit does not favor finding a general fiduciary relationship imposed by the rule. For an example of the ramifications of attaching general fiduciary responsibilities to buyers and sellers under the act, the reader should examine the complainant's theory of recovery in \textit{Birnbaum v. Newport Steel Corp.}, (2d Cir. 1951) 193 F. (2d) 461.