Regulation of Insider and Tippee Trading in Minnesota

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Note: Regulation of Insider and Tippee Trading in Minnesota

Insider stock transactions occur when corporate directors, employees, controlling shareholders, or their tippees buy or sell stock based on nonpublic, material information. Generally an investor harmed by such a transaction seeks his remedy under federal securities law. However, two recent cases suggest that investors and corporations harmed by insider transactions may find an effective alternative remedy under the common law and Blue Sky statutes of the states. Indeed, the limitations inherent in federal securities law may compel victims of insider transactions to turn to state courts for relief.

This Note will discuss the development and limitations of federal law relating to actions against inside traders. The alternatives offered by state common law will then be reviewed with emphasis on corporate derivative actions. Against this background, Minnesota common law and the Minnesota Blue Sky statute will be examined to determine whether an investor or corporation can recover from an insider under existing Minnesota law.

I. FEDERAL LAW

The impact of the stock market collapse of 1929 on the na-

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1. For the purposes of this Note, the term "insiders" includes all persons in control of a corporation—directors, officers, employees, and those owning more than 10 percent of any class of the corporation's securities. The term "tippees" includes those persons in possession of nonpublic, material information received from insiders. See 3 L. Loss, Securities Regulation 1450-56 (1961) (hereinafter cited as Loss); W. Painter, Federal Regulation of Insider Trading 15 (Supp. 1971) (hereinafter cited as Painter).

2. See generally A. Bromberg, Securities Law: Fraud, SEC Rule 10b-5 (1971) (hereinafter cited as Bromberg); Loss, supra note 1; Painter, supra note 1.


tion's economy resulted in the regulation\(^6\) of public stock offerings under the Securities Act of 1933\(^7\) and stock exchanges under the Securities Exchange Act of 1934.\(^8\) Decisions interpreting the 1933 and 1934 Acts have resulted in what has been termed a "federal common law of corporate responsibility"\(^9\) limiting abuses in the securities field. Insider trading, although limited by section 16(b)\(^10\) of the 1934 Act, has largely been regulated by Rule 10b-5\(^11\) of the Securities and Exchange Commission (SEC). Prior to Rule 10b-5, the federal courts had dealt with insider trading only within the context of common law fraud,\(^12\) but since the promulgation of the Rule, common law fraud has been used only as a beginning for limiting insider trading. The differences between common law fraud decisions and regulation under Rule 10b-5 appear from an examination of the early fraud case of *Strong v. Repide*,\(^13\) the Securities Act of 1933 and the Securities Exchange Act of 1934, the Second Circuit Court of Appeals decision in *SEC v. Texas Gulf Sulphur Co.*,\(^14\) and the SEC decision in *Cady, Roberts & Co.*\(^15\)

*Strong v. Repide* involved an action by a former shareholder against the majority shareholder of the Philippine Sugar Estate Company, who was also a director of the corporation and its manager. Repide, the majority shareholder, was negotiating to sell the only corporate asset, a large tract of land, to the government of the Philippine Islands. When it became apparent that the land sale would be very favorable to the corporation, Repide hired one Kauffman to purchase Strong's shares through a broker, thus concealing Repide's identity and avoiding any inquiry as to his interest in purchasing the shares. After the purchase, Repide announced the completion of the land sale. Upon discovering the true identity of the purchaser, Strong filed suit for recovery

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\(^12\) 17 C.F.R. § 240.10b-5 (1974).


\(^14\) Id.

\(^15\) 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).
of her shares, alleging fraud on the part of Repide. She prevailed in the lower court, but the Supreme Court of the Philippines dismissed the complaint.\textsuperscript{16} On appeal, the United States Supreme Court held that Repide’s scheme of purchase amounted to a fraudulent concealment\textsuperscript{17} and that, because of his fiduciary position in negotiating the sale of land, Repide was under a duty to disclose both his identity and the circumstances of his purchase.\textsuperscript{18}

In so deciding, the Court chose between two competing lines of cases. The first reflected the assumption that the doctrine of \textit{caveat emptor} relieves a corporation and its directors of any duty of disclosure when trading on inside information.\textsuperscript{19} The second reflected a recognition that although there is no general duty of disclosure among those trading stock, a corporate director may neither abuse his fiduciary relationship with the corporation by using inside information for profit\textsuperscript{20} nor fraudulently conceal information with the result that others are harmed by the concealment.\textsuperscript{21} The Court preferred the second line of cases, holding that liability attaches when a fiduciary conceals material information in the trading of securities. Although the Court was applying a Philippine civil law definition of fraud,\textsuperscript{22} it observed that the result would be the same at common law.\textsuperscript{23}

\begin{enumerate}
\item[16.] Strong v. Repide, 6 Philippine Reports 680 (1906). Since at the time of the sale the shares had been in the custody of one Jones, an attorney whose office was next door to Repide’s, Strong had also sought recovery on the ground that Jones had been without authority to effect a sale. The Philippine Supreme Court had originally affirmed a judgment for Strong on this ground, but on rehearing it was persuaded that Jones had indeed been authorized to sell. On both hearings, the court rejected Strong’s effort to recover on the basis of Repide’s alleged fraud.
\item[17.] By deciding the case on the basis of fraud, the Court avoided the issue of Jones’s authority to sell the shares. \textit{See} note 16 \textit{supra}.
\item[18.] Strong v. Repide, 213 U.S. 419, 431 (1909).
\item[19.] Hooker v. Midland Steel, 117 Ill. App. 441 (1904); Board of Comm’rs v. Reynolds, 44 Ind. 509 (1873); Walsh v. Goulden, 130 Mich. 531, 90 N.W. 406 (1902); Haarstick v. Fox, 9 Utah 110, 33 P. 251 (1893).
\item[20.] Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903); Stewart v. Harris, 69 Kan. 498, 77 P. 277 (1904).
\item[21.] Rothmiller v. Stein, 143 N.Y. 581, 38 N.E. 718 (1894).
\item[22.] The Court cited the following portion of \textit{PHILIPPINE CIVIL CODE} § 1269:

\begin{quote}
[Fraud] exists where the party who obtains the consent does so by means of concealing or omitting to state material facts, with intent to deceive, by reason of which omission or concealment the other party was induced to give a consent which he would not have otherwise given.
\end{quote}

213 U.S. at 430.
\item[23.] “This is the rule at common law also . . . .” 213 U.S. at 430. \textit{See} also \textit{Loss}, \textit{supra} note 1, at 1827.
The Court’s recognition of the specific fiduciary duty of insiders established an independent basis for proceeding against such insiders. Where a shareholder is unable to prove the required elements of fraud, he may still recover against an insider who has dealt with him without disclosure by showing that the insider owed him a duty to disclose. This incorporation of fiduciary principles into the securities field supports recovery both by shareholders and by the corporation against insiders who use nonpublic information for personal advantage.  

At least one court has read Strong as allowing a director to purchase corporate shares on the basis of inside information without full disclosure, so long as no misrepresentation or fraud occurs. Such an interpretation of the case limits the impact of Strong to circumstances in which the complainant can show “special circumstances,” such as a fiduciary’s failure to disclose even his identity when purchasing or selling. This reading, however, overlooks the most important aspect of Strong: the case supports the broader principle that a fiduciary owes a duty of complete disclosure of material information and any attempt to avoid such disclosure will render him liable.

Strong could also be understood to extend only to directors or corporate officers and thereby not affect others in possession of inside information. Such a reading would limit “fiduciary

26. Id. at 497.
27. Justice Peckham, who wrote the majority opinion in Strong, had also written the opinion in Rothmiller v. Stein, 143 N.Y. 581, 38 N.E. 718 (1894). In that case, before deciding between two purchase offers, a shareholder asked a director for information about the company. The director fraudulently withheld information and the shareholder suffered a loss on the transaction because of the fraud. When the shareholder sought to recover his loss from the director, the director answered that even if he had disclosed the pertinent information, the shareholder would then have been obligated to relay the information to his prospective purchaser and thus relinquish his advantage. But Judge Peckham observed for the New York court that even if the information had been disclosed to the shareholder-seller, he would have been under no duty of disclosure to the third party-purchaser, absent a “special means of acquiring information” necessary to bring him within the exception of the normal rule of caveat emptor.

Read with Rothmiller then, Strong could be held to extend only to insiders, since Justice Peckham in Rothmiller had emphasized the difference between insiders dealing with outsiders and two outsiders dealing with each other. As to the former, insiders would be required to disclose material information upon request. As to the latter, the doctrine of caveat emptor would apply, and no duty to disclose would arise unless either outsider had “special means of acquiring information superior in
relation” to those within the corporation and would not extend it to tippees. This limitation has not been followed, however, and the common law duty extends at least to those who obtain information from insiders.28 By focusing on the fiduciary relationship between Repide and Strong, the case thus provided a basis for later actions under the fraud provisions of Rule 10b-5 and for actions for breach of fiduciary duty under common law.29 Although common law fraud, as enunciated in Strong, has remained intact as one theory of recovery to support Rule 10b-5, the emphasis on the fiduciary duty owed by Repide to Strong has provided a rationale for holding that those owed a fiduciary duty may recover from the fiduciary whenever the latter fails to disclose information.

The Securities Act of 193330 and the Securities Exchange Act of 193431 were enacted in response to the fraud and market manipulation which precipitated the stock market collapse of 1929.32 The purpose of the 1933 Act was to ensure adequate disclosure of information in conjunction with corporate stock offerings.33 Pursuant to this goal, the Act requires the registration of offered securities and regulates the contents of offering prospectuses. By enactment of the Securities Exchange Act of 1934, Congress extended regulation to activities on national securities exchanges. Although the 1933 Act contains sections relating to the fraudulent sale of securities,34 provisions of the 1934 Act substantially extend the regulation of insider transactions. Principal among these provisions are section 16,35 which prohibits short-swing trading by corporate officers, directors, and those owning more than 10 percent of any class of stock; and section 10(b),36 which proscribes the use of manipulative devices in the purchase and sale of securities.

Pursuant to section 10(b), the SEC promulgated Rule 10b-5, which has become the primary tool for prevention of fraud in

the least degree to those of the [other purchaser].” Id. at 594, 38 N.E. at 722.
28. See text accompanying notes 74–87 and 140–47 infra.
29. See text accompanying notes 65–73 and 122–39 infra.
32. See note 6 supra.
securities transactions. Rule 10b-5 outlaws the use of "any device, scheme, or artifice to defraud," the making of untrue statements or the failure to disclose a material fact, and the use of practices which operate as fraud or deceit when buying or selling securities. The application of Rule 10b-5 to insider transactions has resulted in an expanding area of law which is still unsettled. Litigation has raised questions as to who are proper plaintiffs and defendants, what is meant by "fraud," and what types of remedies are available under the rule. Although substantial conflict persists as to these questions, two cases, SEC v. Texas Gulf Sulphur Co. and Cady, Roberts & Co., have provided guidelines for the application of Rule 10b-5 in private suits.

The Texas Gulf Sulphur litigation arose because several directors, officers, and employees of the corporation purchased stock following the corporation's valuable mineral discovery in Canada. A series of test drillings indicated the discovery of large mineral deposits, but drilling was suspended and secrecy imposed until land acquisition could be completed. When the drilling resumed, it confirmed the discovery of large deposits. Meanwhile, however, the corporation issued a press release intended to quell speculation based on market rumors. A few days later, the extent of the discovery was publicly announced and the price of

37. See generally Bromberg, supra note 2; Loss, supra note 1; W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING (1968).
38. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1974) states:
   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, (a) To employ any device, scheme, or artifice to defraud,
   (b) To make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, or
   (c) 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.
   The text of Rule 10b-5 is derived from parts of section 10(b) of the 1934 Act and section 17 of the 1933 Act. See Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967). As the original section 17 was limited to illegal sales, the combining of the two sections gives not only defrauded purchasers but also defrauded sellers the right to recover.
42. 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).
Texas Gulf Sulphur stock rose significantly. During the period between the initial discovery of the deposit and the final announcement, several corporate employees, officers, and directors had purchased stock or exercised stock options. Another employee, Darke, had passed along information to outsiders who had traded because of it. Following an investigation, the SEC brought suit alleging that the defendants had violated Rule 10b-5 by purchasing stock on the basis of their inside knowledge of the mineral discovery. The suit sought injunctive relief against the corporation to prevent further misleading press releases, an injunction against the individual traders to prevent further Rule 10b-5 violations, and rescission of the stock purchases made by the individual defendants. The district court dismissed the complaint against all but two of the individual defendants. The Court of Appeals for the Second Circuit affirmed as to those two, affirmed the dismissal as to one of the other defendants, but reversed and remanded as to the other defendants.

The appellate court disagreed with the lower court's application of the law, focusing on the district court's definition and use of materiality and scienter and defining material facts as those facts "which affect the probable future of the company and those [facts] which may affect the desire of investors to buy, sell, or hold the company's securities." Moreover, by defining material facts in terms of whether the reasonable investor would attach importance to the facts in making his investment decision, the court reaffirmed the reasonable-investor test it had previously employed. The district court in Texas Gulf Sulphur had used the standard of a conservative investor rather than a reasonable one. The court of appeals observed that the results of the drilling would be material facts that the reasonable investor would deem important.

45. 401 F.2d 833 (2d Cir. 1968). On remand, after eight years of litigation, the case was finally closed on November 15, 1973, when Judge Bonsal signed an order distributing the damages recovered from the defendants. N.Y.L.J., Nov. 16, 1973, at 1, col 5.
46. 401 F.2d at 849.
47. Id.
48. "The basic test of 'materiality,' on the other hand, is whether 'a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question.'" List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965).
49. "But the test of materiality must necessarily be a conservative one . . . ." 258 F. Supp. at 280.
50. 401 F.2d at 848-53.
The question of scienter or intent to defraud was also present in the case, as three of the defendants claimed to have purchased their shares believing the news of the mineral discovery to be public information. The court ruled against the defendants on this point, holding that their purchase of shares before the market had reacted to the news of the discovery was in violation of the spirit of Rule 10b-5.51 In discussing intent, the court implied that the common law fraud requirements would be relaxed to include actions that were merely unreasonable or negligent.62 One observer, however, has examined scienter under Rule 10b-5 and suggests that although there may be a difference between the intent requirements of Rule 10b-5 and those of the common law, courts do require some showing of intent to defraud in Rule 10b-5 suits.53

One of the most important questions involving Rule 10b-5—that of tippee liability—was present in Texas Gulf Sulphur, but since the tippees were not defendants, the court did not reach the question of their liability.54 Prior to Texas Gulf Sulphur, the SEC had held in Cady, Roberts & Co.55 that Rule 10b-5 extended beyond immediate corporate insiders to their tippees. In Cady Roberts, the board of directors of Curtiss-Wright Corporation voted to reduce the corporation's quarterly dividend. One of the directors, who was also a broker for Cady Roberts, transmitted this information to another Cady Roberts broker. The second broker, knowing that the information was not public, sold shares from his customers' discretionary accounts and executed a short-sale for his wife's account. The SEC brought a disciplinary proceeding against Cady Roberts and the second broker for trading on the basis of the inside information. Suspending the broker for twenty days, the Commission held that even though he was not an officer, director, or employee of Curtiss-Wright,

51. Id. at 854-56.
52. "This [scienter] requirement, whether it be termed lack of diligence, constructive fraud, or unreasonable or negligent conduct, remains implicit..." Id. at 855.
54. As Darke's "tippees" are not defendants in this action, we need not decide whether, if they acted with actual or constructive knowledge that the material information was undisclosed, their conduct is as equally violative of the Rule as the conduct of their inside source, though we note that it certainly could be equally reprehensible.
401 F.2d at 852-53.
he was nevertheless a "person" barred by Rule 10b-5 from trading on the basis of his inside information. 56

Since Cady Roberts, tippee liability has been extended to private damage actions in several cases. In Ross v. Licht, 57 stock was bought by the corporate president's brother and two others based on information provided by the president, and the shareholder who sold the stock was allowed to recover his damages resulting from the sale. In a later Texas Gulf Sulphur proceeding, 58 the employee Darke was found liable as a tipper for the damages caused by his tippees. Finally, in Investors Management Co., 59 the SEC disciplined Merrill Lynch for communicating inside information, obtained through an underwriting, to an institutional customer who traded on the basis of the information.

Rule 10b-5 is limited by the holding of Birnbaum v. Newport Steel Corp., 60 which requires that a party bringing an action for damages under Rule 10b-5 be a defrauded purchaser or seller. 61 The Birnbaum court interpreted the phrase in Rule 10b-5, "in connection with the purchase or sale of any security," to mean that a corporation cannot use the Rule to recover for a breach of fiduciary duty by an insider trading in the corporation's stock. Under Birnbaum, the corporation can only recover under Rule 10b-5 when it has bought or sold its own securities at a time when insider trading has occurred, with the damages limited by the amount of stock the corporation itself has bought or sold. 62 No right of recovery exists under Rule 10b-5 for the breach of fiduciary duty, and a corporation harmed by such a breach must proceed upon a different theory of recovery.

56. Id. at 911-12.
60. 193 F.2d 461 (2d Cir.), cert. denied, 394 U.S. 956 (1952).
62. The Court of Appeals for the Ninth Circuit recently indicated that it will no longer recognize Birnbaum as a limitation where a corporate plaintiff claims fraud in another corporation's stock offering. Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136 (9th Cir. 1973). However, this will not affect the viability of Birnbaum in cases involving insider trading. Cf. R. Jennings & H. Marsh, SECURITIES REGULATION 1181-82 (3d ed. 1972).
II. COMMON LAW ACTIONS

The only federal statute directly regulating insider trading is section 16 of the 1934 Act, which gives a corporation a cause of action against stockholders owning more than 10 percent of any class of the corporation's stock, and all directors and officers, who buy and sell stock of the corporation within a six-month period. Since the Birnbaum doctrine denies a cause of action to a corporation under Rule 10b-5 unless the corporation itself has bought or sold, any recovery by the corporation against insiders, other than under section 16, must be supported by state law.

Among the theories which have been advanced as a basis for recovery by corporations harmed by insider trading, the breach of fiduciary duty owed to the corporation is preferred. Two recent derivative suits exemplify the use of fiduciary principles to recover on behalf of corporations against insiders pursuant to state common law. Diamond v. Oreamuno provides a common law basis for recovery against insiders, and Schein v. Chasen extends that recovery to suits against tippees.

In Diamond, a stockholder brought a derivative action against two directors of a corporation who had disposed of their shares prior to an expected decline in their value. The corporation was engaged in the sale and leaseback of computers, but it employed another company to do the maintenance. The directors knew that a large decrease in profits would be reported, because the corporation had experienced sharp increases in these maintenance expenses. Prior to announcing the decrease, two directors of the corporation sold their shares. When the news was released, the price of a share dropped from $28 to $11. Upon learning of the situation, Diamond, a stockholder, filed suit on behalf of the corporation, alleging that by realizing secret profits the directors had breached the fiduciary duty they owed to the corporation. The shareholder sought recovery of the profits realized by the directors from their early sale of stock.

In affirming the lower court's finding that the complaint was

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63. 15 U.S.C. § 78p (1970). For a description of section 16 and its operation see W. Painter, supra note 37. As the federal government is primarily interested in protection of the national securities exchanges, it has not yet regulated the relationship between a corporation and its fiduciaries beyond the regulation provided by section 16.

64. See Rapp & Loeb, Tippee Liability and Rule 10b-5, 1971 U. Ill. L.F. 55.


66. 478 F.2d 817 (2d Cir. 1973), vacated on other grounds sub nom. Lehman Bros. v. Schein, 94 S. Ct. 1741 (1974),
sufficient to allow recovery, the New York Court of Appeals held that a corporate fiduciary may not appropriate a corporate asset for his own benefit regardless of whether such appropriation harms the corporation. Noting that the principal question in such a case is whether the directors or the corporation have a higher claim to the asset, the court held that as against a fiduciary abusing his position, the asset should be given to the corporation. The court analogized its holding to federal law, finding that Congress had intended to prevent a similar abuse of fiduciary position when it enacted section 16. The court thus rejected the defendants' argument that congressional legislation preempted state common-law recovery, and found that there was nothing in the federal law limiting a state's power to provide a remedy for wronged corporations.

The decision has drawn wide comment, with most discussions citing the case as a basis for corporate recovery from insiders distinct from section 16 and Rule 10b-5. One commentator suggests that since Diamond provides a remedy against insiders without the necessity of proving fraud, the case completes the pattern of regulation begun by prior common law and federal legislation and thus ensures a direct cause of action by the corporation for all insider trading. However, Diamond fails to answer the final question raised by insider transactions—the common law liability of tippees. The defendants were directors and thus fell within the class of insiders who owed a fiduciary duty to the corporation. Since tippees are not fiduciaries in the tra-

68. 24 N.Y.2d at 498, 248 N.E.2d at 912, 301 N.Y.S.2d at 80. However, the court found that insider trading does harm corporations. Id. at 499, 248 N.E.2d at 912-13, 301 N.Y.S.2d at 81-82.
69. Id. at 498-99, 248 N.E.2d at 912, 301 N.Y.S.2d at 81.
70. Id. at 500, 248 N.E.2d at 913, 301 N.Y.S.2d at 82-83.
71. Id. at 502, 248 N.E.2d at 915, 301 N.Y.S.2d at 85.
73. Comment, Directors Are Accountable at Common Law to Unharmed Corporation for Profits Realized Through Use of Inside Information, supra note 72.
ditional sense, tippee liability must be founded upon a different basis.

The recent case of *Schein v. Chasen* provides a basis for the liability of a tippee at common law. Stockholders brought a derivative suit to recover profits of tippees obtained after receiving nonpublic information of reduced corporate earnings. The complaint alleged that one month after publicly announcing expected corporate earnings, Chasen, the president of Lum's, Inc., learned that his estimate was too high. He so informed defendant Simon, a stockbroker for Lehman Brothers, who passed the information to two portfolio managers of mutual funds. The managers then sold 83,000 shares of Lum's stock before the information was made public. Schein, the complaining shareholder, alleged that by using the information of the reduced earnings as a basis for trading in corporate shares, all defendants had breached a fiduciary duty to the corporation and should be held accountable to it. Applying state law, the district court dismissed the complaint. The court of appeals reversed, holding that all persons who knowingly use or transmit inside information when trading in corporate stock are liable to the corporation if the inside information has been obtained through a common enterprise to breach a fiduciary duty owed the corporation.

Unable to find a case on point in the state whose law was controlling, the court of appeals invoked *Diamond* to hold that the defendants would be liable to the corporation. The court found that the "stretch" of *Diamond* reaches tippees, rejecting the defendants' argument that the scope of fiduciary liability should be limited to corporate directors, officers, and employees.

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76. 478 F.2d at 817.
77. The Supreme Court vacated the judgment of the court of appeals on the basis that under the Erie doctrine the case should have been certified to the Florida Supreme Court. The Court concluded that when (1) a novel question of law is presented, (2) state law is uncertain on the question, (3) the judges are "outsiders" to the law of that state ("lacking common exposure to local law which comes from sitting in the jurisdiction"), and (4) the state law is not bound to a certain determination by federal law, the lower federal courts should certify the question of law to the proper state court for a determination of state law if the state procedure permits certification. 94 S. Ct. at 1743-44. The Court, however, did not address the reasoning of the court of appeals on the merits of the liability issue.
78. 478 F.2d at 821-23.
79. Id. at 822.
In arriving at this result, the court relied principally upon the Restatement (Second) of Agency, which provides for liability where a third party receives and uses confidential information from an agent in violation of the agent’s duty to his principal. Under the Restatement, any intentional assistance in the breach of that duty is sufficient to render the third party liable. Although the Schein decision seems to provide alternative grounds for relief by its reliance upon both agency and fiduciary concepts, the court actually based its conclusions on a combination of the two. Since the relation of a fiduciary to a corporation is similar to that of an agent to his principal, the court used the Restatement as authority for third party liability within the corporate context, holding that a third party becomes liable as a fiduciary upon the receipt of information from an insider, just as a third party receiving information from an agent becomes liable under the Restatement. The court thereby would impose liability upon all those who participate in a common enterprise, thus reaching not only the ultimate tippees, but the intermediate tippees as well.

A dissenting judge criticized the majority for using “tortured reasoning” in its application of fiduciary principles to facts in which no joint enterprise was present. Since the facts revealed only a “haphazard” scheme and not a common enterprise, the dissent contended there was not “any coherent legal theory” supporting the result. Although the dissenting opinion did recognize the authority of both the Restatement and the fiduciary principles applied in Diamond, it interpreted them as requiring either a prearranged plan to pass along the information or active solicitation of information by the third parties.

The Schein dissent itself has been criticized as an improper interpretation of the law on the ground that the Restatement requires only knowledge of the breach of duty and receipt and use of the information. As the appeal was taken from a dis-

80. A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be enjoined from disclosing it and required to hold profits received by its use as a constructive trustee.

81. Id. § 312.

82. Case Note, supra note 61.

83. 478 F.2d at 825 (Kaufman, J., dissenting).

84. Id. at 827.

85. Id.

missal for failure to state a cause of action, the allegations in the complaint should have been taken in the light most favorable to the plaintiff and so taken would have met the tests of the Restatement.

A comparison of state common-law recovery to federal recovery reveals the advantages and disadvantages of each. Strong illustrates the advantages of bringing an action of common-law fraud; such advantages include the clarity of the law of fraud and its universal recognition. However, the rigorous proof necessary to establish fraud renders this theory generally unattractive. In contrast, federal securities law retains the advantage of a well-developed body of cases with which federal judges and the practicing bar are familiar. It covers a broad range of practices and the private litigant is frequently aided by the SEC's investigative machinery. Despite such advantages, the federal remedy is limited by the scope of practices covered. The federal statutes do not address the general relationship between the corporation and its fiduciaries, and the general fraud provisions include limitations such as the buyer-seller requirement enunciated in Birnbaum. A common-law action based on fiduciary principles appears to eliminate the problems inherent in actions based on common-law fraud or the federal securities statutes. The burden of proving a breach of a fiduciary duty is less than the burden of proving either common-law fraud or a Rule 10b-5 violation. Furthermore, recovery would be allowed by and on behalf of those corporations excluded under federal law by the Birnbaum rule. Nevertheless, only a few decisions have based recovery upon fiduciary principles. This may be because the potential for multiple actions by various plaintiffs under both state and federal law induces a court to limit a state fiduciary action in favor of a federal action. More importantly, since common law fiduciary recovery must be based upon the law of a particular state, that law must provide a basis for recovery similar to

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90. See text accompanying notes 60-62 supra.
91. Besides Diamond and Schein, only one other decision has allowed recovery. In Brophy v. Cities Service Co., 31 Del. Ch. 241, 70 A.2d 5 (1949), a corporate director's executive secretary was found liable for trading for personal profit on the basis of advance information of corporate treasury stock purchases. Brophy was cited in both Diamond and Schein as support for those decisions.
92. See note 148 infra.
that found in *Diamond* and *Schein*, or the state courts must be willing to follow decisions from other jurisdictions. Where state courts refuse to allow recovery on fiduciary principles, the corporation might be left without a remedy.

III. MINNESOTA LAW

In 1909, the Minnesota Supreme Court first recognized a common-law cause of action for fraud involving a securities transaction. In 1917, the Minnesota Legislature enacted its first statute regulating securities issues—an act which followed the nationwide pattern of Blue Sky statutes. This early act outlawed the defrauding of investors by the use of manipulative devices; provisions regulating other aspects of securities transactions have been added since 1917. It is within this statutory and common law context that the question arises whether insiders and tippees may be held liable under Minnesota law for trading on the basis of inside information.

A. STATUTORY LAW

In 1973, the Minnesota Legislature enacted a new Blue Sky law to regulate securities. The new law is patterned after the Uniform Securities Act and is intended to replace the piecemeal collection of prior regulation. The new Blue Sky law also contains broad provisions for private recovery and new antifraud provisions relating to insiders. There are three sections which specifically regulate actions against insiders: section 1, which has been called a “little rule 10b-5”; section 2, which regulates investment advisory activities; and section 3, which prohibits trading in a stock for the purpose of creating a misleading

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94. Minn. Laws 1917, ch. 429.
96. Id.
98. Lewis, supra note 97, at 10.
100. Lewis, supra note 97, at 10.
101. MINN. STAT. § 80A.02 (Supp. 1973).
102. Id. § 80A.03.
appearance of active trading, manipulating the price of a security, or inducing purchase or sale.

Section 1 follows the text of Rule 10b-5 with two minor changes. First, since Minnesota does not base its legislation on a power to regulate interstate commerce as does Congress, the opening sentence of section 1 differs from that of Rule 10b-5. Second, section 1 includes a specific prohibition of fraud in "the offer... of any security," whereas Rule 10b-5 specifies only purchases and sales—a change which adopted the judicial interpretation of Rule 10b-5 to include "offer." Since the Minnesota Legislature enacted the language of Rule 10b-5 without major changes, and since the Act is to be construed to encourage uniformity among the states and coordination with federal securities law, the legislature apparently intended to place section 1 within the same regulatory and judicial framework already constructed around Rule 10b-5.

A significant difference between the operation of section 1 and that of Rule 10b-5 stems from section 23 of the new Act.

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103. It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly: (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Id. § 80A.01. For the text of Rule 10b-5 see note 38 supra.


105. See note 62 supra and accompanying text.

106. Section 31 of the new Blue Sky law, Minn. Stat. § 80A.31 (Supp. 1973), states that the Act shall be construed so as to effectuate its general purposes to make uniform the laws of those states which enact the Uniform Securities Act and to coordinate interpretation with the related federal regulation.

107. Subd. 2. Any person who violates section 80A.01 in connection with the purchase or sale of any security shall be liable to any person damaged thereby who sold such security to him or to whom he sold such security, and any person who violates section 80A.03 in connection with the purchase or sale of any security shall be liable to any person damaged by the conduct prescribed by section 80A.03. Any person who violates section 80A.02 in connection with the purchase or sale of any security shall be liable to any investment advisory client of his who is damaged thereby. Damages in an action pursuant to this subdivision shall include the actual damages sustained plus interest from the date of payment or sale, costs and reasonable attorney's fees.

Subd. 3. Every person who directly or indirectly controls
Whereas civil liability under Rule 10b-5 is a creature of the courts, section 23 expressly delineates the civil liabilities which result from violations of the Act. Subdivision 2 of that section allows recovery by persons damaged by trading which violates section 1, fraudulent advice which violates section 2, or market rigging which violates section 3. Subdivision 3 of section 23 extends liability to persons controlling or aiding those liable under subdivision 2. Subdivision 4 sets forth a defense to liability under subdivisions 2 or 3, stating that no liability shall occur where the person sued can "sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of facts by reason of which the liability is alleged to exist." The requirement that the trader "in the exercise of reasonable care could not have known" imposes the negligence standard articulated in *Texas Gulf Sulphur* but not subsequently followed. Similarly, in holding liable those persons who, by exercising reasonable care, could have known of the facts giving rise to liability, subdivision 4 establishes a specific definition of scienter not found in federal law.

If Minnesota is to follow the trend of federal cases finding tippees liable under Rule 10b-5, tippees would also be subject to section 1 of the new Act. Since the provisions of section 23, including the scienter requirement of section 23(4), would also apply, tippees in Minnesota would be held liable if they were to trade in violation of section 1.

Section 2 of the new Blue Sky law renders it unlawful for a paid investment advisor "to employ any device, scheme, or artifice to defraud..." or "...to engage in any act, practice or course of business which operates or would operate as a fraud or deceit in connection with the purchase or sale of securities..." every partner, principal executive officer or director of such person, every person occupying a similar status or performing a similar function, every employee of such person who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person. There is contribution as in cases of contract among the several persons so liable.

Subd. 4. No person shall be liable under subdivisions 1 to 3 who shall sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of facts by reason of which the liability is alleged to exist.


108. *Id.* § 80A.23(4).

109. *See text accompanying note 52 supra.*

110. *See text accompanying notes 54-59 supra.*
Section 23 imposes liability for a client's damages upon any investment advisor who violates section 2, as well as upon persons who control or aid such an investment advisor. Since recovery for a violation of section 2 requires privity between the investment advisor and the client, friends of the client who receive information from the client will be unable to recover under section 2 if they are harmed by an advisor's fraud.

Section 3 makes it unlawful for any person to induce a purchase or sale by means of fraudulent devices, including fictitious quotations. The section outlaws transactions which involve no beneficial changes in ownership and are intended to create a false or misleading appearance of active trading in the security. Finally, section 3 makes it illegal for one or more persons to use either deceptive transactions or the resulting market rumors for the purpose of raising or lowering the price of a security and thereby inducing its purchase or sale.

111. It is unlawful for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise:
   (a) to employ any device, scheme, or artifice to defraud the other person; or
   (b) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

112. It is unlawful for any person to effect any transaction in, or to induce the purchase or sale of any security by means of any manipulative, deceptive or other fraudulent device or contrivance, including any fictitious quotation. The terms "manipulative, deceptive, or other fraudulent device or contrivance" shall include, but shall not be limited to, the following practices:
   (a) effecting any transaction in a security which involves no change in the beneficial ownership thereof, or entering any order or orders for the purchase or sale of any security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale or purchase of the security, have been or will be entered by or for the same or affiliated persons, for the purpose of creating a false or misleading appearance of active trading in the security or a false or misleading appearance with respect to the market for the security;
   (b) effecting, alone or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in the security or raising or depressing the price of the security, for the purpose of inducing the purchase or sale of the security by others; or
   (c) inducing the purchase or sale of any security by the circulation or dissemination of information to the effect that the price of the security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the price of the security, if he is selling or offering to sell or purchasing or offering to purchase the security or is receiving a consideration, directly or indirectly, from any such person.

Id. § 80A.03,
The goal of section 3\textsuperscript{113} is to prevent the use of "market rigging."\textsuperscript{114} Market rigging occurs when brokers or customers trade large volumes of stock among themselves at prearranged prices and thereby create a false impression that an active market for the security exists. This increased activity may induce an unwary victim to buy, believing that he can dispose of the stock at any time. When the artificial trading stops, the victim discovers either that there is no active market or that his attempts to sell a large block of shares would depress the price of the stock. Market rigging contributed to the 1929 crash\textsuperscript{115} and was subsequently regulated by the Securities Exchange Act of 1934;\textsuperscript{116} however, the federal provision is limited to price manipulation on the national securities exchanges. Section 3 extends regulation to the large Minnesota over-the-counter market. Under section 23, those who violate section 3 and those who control or assist them face the same liability as those who violate sections 1 or 2.

The new Blue Sky law offers two advantages over previous state regulation. The Act incorporates a large body of federal law into Minnesota law and thereby reaches some previously unregulated problems, especially that of market rigging at the local level. In addition, the new law contains both a specific scienter requirement to clarify the point at which liability arises and criminal sanctions to provide a remedy beyond civil liability when a violation occurs.\textsuperscript{117} However, since the new law appears to be limited by the "buyer-seller" requirement of Birnbaum, derivative actions are still left to the common law.\textsuperscript{118} Thus it is significant that the Act preserves the common law as an alternative to the statute. Section 23(11) provides that the "rights and remedies promulgated by sections 80A.01 to 80A.31 are in addition to any other right or remedy that may exist at law or in

\textsuperscript{113} As section 3 is substantially similar to section 9 of the 1934 Act, 15 U.S.C. § 78i (1970), the history of the 1934 Act and comments on the practices forbidden by the 1934 Act shed light on the actions section 3 is intended to prevent. See W. DOUGLAS, DEMOCRACY AND FINANCE (J. Allen ed. 1940). See also H.R. REP. No. 1383, 73d Cong., 2d Sess. (1934), reprinted in 2A E. GADSBY, BUSINESS ORGANIZATIONS, THE FEDERAL SECURITIES EXCHANGE ACT OF 1934 §§ 5-300 to 399 (1973).
\textsuperscript{114} See 2 CCH Fed. Sec. L. Rep. ¶ 22,508.05 (manipulation of listed security prices); ¶ 22,508.06 (wash sales involving no beneficial change of ownership); ¶ 22,508.07 (matched orders).
\textsuperscript{115} E. GADSBY, supra note 113, at §§ 5-300 to 399.
\textsuperscript{117} MNN. STAT. § 80A.22 (Supp. 1973) provides for a fine of up to $5000 or five years imprisonment or both for violating the act.
\textsuperscript{118} See notes 60-62 supra and accompanying text.
Since the statute does not preempt common law actions, the courts are free to grant relief for violations of the common law where they occur.

B. COMMON LAW

1. Liability of Insiders

A corporation may be able to recover damages where insiders and tippees breach a fiduciary duty, even though the corporation is unable to bring suit under the Minnesota statute. However, it would be necessary for the Minnesota courts to recognize the rationale of Diamond and Schein before such an action could be brought by or on behalf of a corporation harmed by insider trading. Specifically, state common law must impose upon that insider a fiduciary duty to his corporation to refrain from trading on inside information. Where the corporation is harmed by insider trading, therefore, the court must: (1) recognize a general fiduciary duty owed to the corporation by the insider, (2) find that the duty specifically includes an obligation not to use the inside information, and (3) hold that that liability to the corporation arises when the duty is breached.

Minnesota cases have long held that corporate officers and directors are fiduciaries of the corporation and are responsible to the corporation for any breach of that relationship. In 1911, the supreme court recognized the general principle that the manager of a corporation is a trustee for the shareholders and therefore must account for corporate profits and act in good faith when dealing with the shareholders. Other cases have allowed actions where a director converted corporate business opportunities or assets fraudulently increased his salary, or in some other way mismanaged the corporation for his own benefit.

123. Chicago Flexotile Floor Co. v. Lane, 188 Minn. 422, 247 N.W. 517 (1933).
In Shearer v. Barnes,126 a case involving the conversion of corporate funds by the president of a trust company, the court identified the policy underlying such liability:

Corporate officers holding positions of trust . . . should be held to strict accountability for any and all breaches of their trust and disobedience of the law, and the law must be so administered that they will never be allowed to profit by disobeying it.127

In the early securities case of Shaw v. Straight,128 Shaw brought a stockholder's derivative action to void the transfer of corporate stock to Straight. In exchange for fishing locations and tackle, the corporation had issued 28,000 shares of stock to one Keldall, who then sold the stock to Straight. Upon discovering that there were no fishing locations, Shaw demanded that the directors bring suit. The directors refused and Shaw brought suit on behalf of the corporation, alleging that Straight knew of the fraud when he purchased the stock. Shaw prevailed at trial and the supreme court affirmed, holding that since Straight had purchased the stock with knowledge of the fraud, he was properly liable for the stock's return. Thus the court recognized the right of a stockholder to bring a derivative action in a securities case based on fraud.

In McMenomy v. Ryden,129 the court extended the rule of Shaw to a derivative action based on breach of fiduciary duty. The complaint alleged that the directors of an investment corporation had breached their duty to the corporation by personally trading in securities in which the investment company was also trading. It was further alleged that such trading compromised the directors' choice and timing of investments, resulting in damage to the corporation. Prior to the state court decision, a federal court had decided in favor of the defendants in an SEC action under the Investment Company Act of 1940.130 However, the Minnesota Supreme Court held that the federal decision was not res judicata as to the corporation and that a derivative suit for damages was proper. In so deciding, the court recognized

126. 118 Minn. 179, 136 N.W. 861 (1912).
127. Id. at 185, 136 N.W. at 865.
128. 107 Minn. 152, 119 N.W. 951 (1909).
129. 276 Minn. 55, 148 N.W.2d 804 (1967).
a right of recovery analogous to that in *Diamond*\(^{131}\) and held that in Minnesota a fiduciary duty is owed to the corporation by insiders, that this duty can be breached by using advance knowledge of corporate action to effect securities transactions, and that a breach results in liability to the corporation.

Although *McMenomy* might be distinguished from *Diamond* on the grounds that the directors in *McMenomy* were trading in stock other than that of their own corporation and that the directors of an investment company owe a higher duty than directors of other companies to avoid use of inside information, these distinctions disappear upon close examination. As to the first ground, liability results not from the manner in which the information is used but from the fact that the information is used at all. Thus the nature of the use to which the information is put is irrelevant; it is the breach of duty which renders the insider liable. The second ground is similarly insignificant since there is no justification for developing a hierarchy of insider duty based on a distinction between different types of corporations. *McMenomy*, therefore, is sufficiently similar to *Diamond* to provide a clear basis of recovery under Minnesota common law for corporations injured by insider trading.

This liability is not restricted to insiders who are actively trading, but extends to directors who know of a breach of duty and acquiesce in the wrongful diversion of corporate assets. In *Horn Silver Mining Co. v. Ryan*,\(^{132}\) for example, a director who knew that other directors had misappropriated funds was held liable to the corporation for failing to take action to recover the funds. The court found that his lack of diligence in bringing the misappropriation to the attention of the board of directors constituted a breach of duty on his part.

Similarly, partners or joint venturers may not make secret profits by taking advantage of one another. In *Dutton v. Barnes*,\(^{133}\) the president of a corporation purported to act on behalf of the plaintiffs in the sale of their stock with his own. When it was discovered that the president had secretly made profits of $40,000 in selling the stock, the plaintiffs brought suit claiming that a proportionate share of the $40,000 belonged to them as part of the sale price of their shares. In affirming a

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132. 42 Minn. 196, 44 N.W. 56 (1889).
133. 162 Minn. 430, 203 N.W. 414 (1925).
judgment of liability, the supreme court found that the president had breached his fiduciary duty to the other shareholders when he failed to disclose his secret profit from the transaction. In so deciding, the court held that joint venturers owe to each other a fiduciary duty to act in good faith, and that a breach of that duty results in liability.134

The broad right to recover against insiders is not without limitation. A failure of proof prevents recovery—either proof as to the use of the information135 or proof that a fiduciary duty is owed.136 Furthermore, Minnesota has adopted the rule that directors generally owe a fiduciary duty only to the corporation and not to shareholders or other individuals, thus preventing individual actions by shareholders for damage to the value of their stock when directors harm the corporation. For example, in Seitz v. Michel,137 a shareholder alleged that a certain director was wasting corporate assets and sought personal recovery for the damage to the value of his stock. The court affirmed a judgment on the pleadings for the director, holding that although a minority shareholder may bring suit for harm to the corporation, he can sue only in a derivative capacity for the harm to the corporation and not for the damage to him individually.138 In a related case,139 the court further limited individual recovery by holding that a director does not owe a duty of disclosure when purchasing stock from shareholders. A director had paid $125 per share for stock later alleged to be worth $155 to $330. The selling stockholder contended that the director had offered to purchase his stock and had fraudulently misrepresented the value of the shares. The supreme court affirmed a jury verdict for the director, holding that although a director owes a general fiduciary duty to the corporation and possibly to the stockholders, no fiduciary relationship between buyer and seller imposes an affirmative duty of disclosure. In so holding, the court followed the then majority rule allowing transactions between directors and stockholders without disclosure.

134. A similar argument was made in Diamond, but because of factual differences the other directors in Diamond were not found liable.
135. Williams v. Davis, 182 Minn. 186, 234 N.W. 11 (1930) (no showing of conversion of asset).
136. Northern Oil & Gas Co. v. Birkeland, 164 Minn. 466, 206 N.W. 380 (1925) (no showing that defendant had assumed a fiduciary position).
137. 148 Minn. 80, 181 N.W. 102 (1921).
138. Id. at 87, 181 N.W. at 105.
139. Seitz v. Frey, 152 Minn. 170, 188 N.W. 266 (1922).
2. Liability of Tippees

Minnesota common law liability also extends to those persons who aid fiduciaries in breaching their duty to the corporation. As illustrated by *Schein v. Chasen*, this liability is predicated upon the use of information obtained from a fiduciary with the knowledge that the fiduciary has thereby breached his duty to the corporation. Although no Minnesota case is directly in point, analogous cases support the position that those persons who engage in a "common enterprise," as in *Schein*, will be liable to the corporation.

In *Rothwell v. Robinson*, a shareholder alleged that an insider of the corporation, aided by others, was diverting corporate funds into worthless inventions. The trial court overruled a demurrer to the complaint and the supreme court affirmed, holding that where it is alleged that the corporation has suffered a loss because of the diversion of assets by an insider, all persons assisting in the diversion are liable. Although the case was later decided against the complaining shareholder on the evidence, the supreme court affirmed the lower court's statement of the law, by which the defendant would have been held liable had the allegations been proved. From *Rothwell* it can be inferred that the court would hold third parties liable to the corporation when they aid another in a breach of a fiduciary duty.

Third parties are also liable to the corporation when they engage in a joint enterprise with a corporate director to defraud the corporation. In *National Power & Paper Co. v. Rossman*, the corporation brought suit against Rossman, a director, and MacAlpine, an outsider, alleging fraud in the purchase of timber and land by the corporation. After discovering that Rossman and MacAlpine had conspired to sell the property to the corporation at prices far in excess of actual value, the corporation sought to void the stock issued to MacAlpine in exchange for the assets and to prevent him from voting it at stockholder meetings. Before the stock could be voided, a meeting was held at which MacAlpine himself became a director. At a subsequent board of directors meeting Rossman resigned as a director, but a resolution was passed directing dismissal of the suit against Rossman and

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140. 478 F.2d 817 (2d Cir.), vacated on other grounds sub nom. Lehman Bros. v. Schein, 94 S. Ct. 1741 (1974).
141. 39 Minn. 1, 38 N.W. 772 (1888).
142. Rothwell v. Robinson, 44 Minn. 538, 47 N.W. 255 (1890).
143. 122 Minn. 355, 142 N.W. 818 (1913).
MacAlpine. Upon learning of this, the stockholders sought to intervene.

The supreme court affirmed the trial court's intervention order, preventing Rossman, no longer a director, from colluding with the corporation to defraud the stockholders by dismissing the suit. The court allowed the suit to proceed against both defendants, even though MacAlpine had been an outsider at the time of the fraud. Although the appeal raised only the issue of intervention, the court assumed that a conspiracy to defraud the corporation would have resulted in liability for the conspirators.

This principle was partially affirmed in Risvold v. Gustafson.\textsuperscript{144} In that case, a derivative action was brought to recover profits secretly obtained through the purchase of a mine by the corporation. Dahl, a miner, had sold a two-thirds interest to the Cleary Hill Mines Company, supposedly retaining the other one-third for himself. It was later revealed that certain directors and stockholders had been induced to effect the transaction by Dahl's promise of portions of his retained one-third interest, and that interests in Dahl's one-third had in fact been given to five directors and two other individuals, Thurston and Gustafson.\textsuperscript{145} The action was brought on a conspiracy theory, with the corporation participating as a plaintiff. Before trial, two of the directors turned over to the corporation the stock received from Dahl. At trial, the remaining three directors and Gustafson were held liable to the corporation, but Dahl and Thurston were exonerated.

On appeal, the Minnesota Supreme Court affirmed. After stating the rule for conspiracy liability,\textsuperscript{146} the court held that since Dahl, unlike the directors, had made no secret profit, he was not liable. The court also held that Thurston's stock was in fact a gift from Dahl, and that since Thurston owed the corporation no fiduciary duty, he was under no obligation to return the stock to the corporation. Similarly, Gustafson was not liable for the shares given him by Dahl, but was liable for shares given him by other directors, who had received them from Dahl. The court stated that the corporation was entitled to recover that for

\begin{itemize}
\item \textsuperscript{144} 207 Minn. 359, 292 N.W. 103 (1940).
\item \textsuperscript{145} Dahl had incorporated his interest under the laws of Alaska and had given stock in the corporation to the seven individuals.
\item \textsuperscript{146} "A third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary." 207 Minn. at 365, 292 N.W. at 106-07, citing \textit{Restatement of Restitution} § 138(2) (1937).
\end{itemize}
which it had paid—the two-thirds interest on the face of the contract and the shares given the directors by Dahl to complete the purchase—but was not entitled to the shares received by nonfiduciaries. On a second appeal, the court reaffirmed Gustafson’s liability, observing that he had “without value and with knowledge of the facts . . . shared in the ‘rake-off’ improperly taken.”

Risvold provides contradictory authority as to whether tippees will be held liable to the corporation for breach of fiduciary duty. If those colluding with directors are to be liable, Dahl should have been liable. On the other hand, the court’s emphasis on Dahl’s lack of personal profit from the transaction implies that if he had profited, he would have been liable. Furthermore, by holding Gustafson liable, the court indicates that those persons sharing in ill-gotten gains will be liable for those gains. By this reasoning, if Dahl had received an unjust price for the property sold to the corporation, he would have been liable for the amount of the excess profit. A court passing upon the question of tippee liability may therefore rely upon Risvold as authority for the dismissal of actions against those persons who do not profit from the transaction. However, since the imposition of liability upon those persons who collude with insiders deters such collusion, there is a strong policy argument against such a result. Also, the reasoning of the Schein court—that all persons who aid in the breach of duty should be held liable—might persuade a Minnesota court to expand Risvold.

Thus the basis for finding common-law liability for all persons trading on inside information clearly exists in Minnesota. An examination of cases involving corporate fiduciaries reveals that in Minnesota (1) corporate officers and employees owe a fiduciary duty to the corporation, (2) the duty is breached by the use of inside information, and (3) a breach results in liability to the corporation. Therefore, when a case similar to Diamond v. Oreamuno arises in Minnesota, the court can rely upon a lengthy history of decisions which support liability. Such a case would probably be decided upon the same principles as McMenomy—that the use of inside information to trade in corporate stock is a violation of a fiduciary duty.

The liability of tippees can also rest upon existing Minnesota common law, although such law is not as clear as the law supporting the liability of officers and directors. Under the inter-

pretation of the Restatement (Second) of Agency set forth in Schein v. Chasen, liability would exist where, first, a tippee either intentionally causes an agent to breach his duty, or assists in the breach, or with notice of the breach receives information from the agent; and second, the tippee either discloses the information to others or uses it himself for profit. In light of National Power and Rothwell, it is clear that the Minnesota Supreme Court would find liable to the corporation those tippees who are engaged in a "common enterprise" to use inside information. Should the Minnesota courts adopt the Restatement rule and the rationale of Schein, this liability would extend to tippees who know of the breach of duty but nevertheless use the information. Just as McMenomy is analogous to Diamond in establishing the liability of insiders at common law in Minnesota, Rothwell and National Power are sufficiently analogous to Schein to establish the liability of persons who collude with insiders to breach a fiduciary duty.

IV. CONCLUSION

There exists a growing body of state statutory and common law which allows recovery by persons harmed by insider and tippee trading. The adoption of the Uniform Securities Act in several states and decisions such as Diamond and Schein provide the basis of this growing state regulation. An examination of Minnesota law reveals that Minnesota is following this trend, most recently with the adoption of a new Blue Sky statute based on the Uniform Securities Act. Furthermore, Minnesota common law supports a finding of liability on the part of insiders and tippees when they use inside information to trade corporate stock in breach of a fiduciary duty.

Nevertheless, it is clear that Minnesota law leaves unanswered several questions raised in Diamond and Schein. Issues still to be resolved are the extent of damages to be awarded. 

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148. At common law, a plaintiff can bring an action either for recision of the transaction or for damages. If recission is granted, the stock traded, plus any income such as dividends earned on the stock, would be returned in exchange for the consideration paid. If damages are sought, they are measured as the price paid or received less what would have been paid or received if disclosure had been made, which is generally the average price on the day following disclosure, SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77 (S.D.N.Y. 1970), or the value of the shares at the time of the discovery of the fraud, Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1969). Under the new Blue Sky law, damages are limited to actual damages sustained, plus interest from the date of sale, costs, and attorneys' fees. MINN. STAT. § 80A.23(2) (Supp. 1973). A problem of
and the limits of tippee liability under either a conspiracy theory or section 1 of the statute.\textsuperscript{149} When faced with these questions, the court should return to the basic policy underlying the concepts of fiduciary duty and tippee liability—that neither the agents of the corporation nor their tippees should be allowed to profit by harming the corporation, and that equality of information among investors should be promoted by discouraging the selective use of nonpublic information.

\textit{"multiple recovery"} results where both derivative actions and fraud, Rule 10b-5, or section 1 suits are brought against insiders or tippees. The courts generally hold that insiders should be liable only for the amount of their profits, with that amount split between those defrauded and the corporation. However, it can be argued that insiders should be liable both for the full amount of damages to investors and for damages to the corporation, even if the total amount exceeds the profit made by the insiders, since separate wrongs are committed against each.

\textsuperscript{149} The “extent” of liability turns on the definitions of “materiality” and “inside information.” If those terms are defined to mean that information is material or inside only if it comes from a corporate source, then liability is limited to those receiving information from corporate sources or having reason to believe the information has originated from a corporate source. However, if those terms include all nonpublic information regardless of corporate “access” or source, then the scope of liability is broadened beyond those persons with corporate sources and allows recovery by virtually anyone who does not receive disclosure of information which would influence a trading decision. For a discussion of the various viewpoints see Bromberg, \textit{supra} note 2, at § 7.5(6); 6 L. Loss, \textsc{Securities Regulation} 3563-68 (1969); Painter, \textit{supra} note 1, at 15-16.