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SECONDARY DISTRIBUTION OF SECURITIES—PROBLEMS SUGGESTED
BY KINNEY V. GLENNY

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*No man can serve two masters; for either he will hate the one, and, love the other; or else will hold to one, and despise the other. Math. 6:24.**

The recent case of *Kinney v. Glenny* [FN 1] raises interesting and important problems of business and of law and poses questions that require for their disposal an appreciation and appraisal of the methods employed in marketing and distributing securities. The problems involved cover a wide range. In general they pertain to the fiduciary relationship between broker and customer, and between dealer and customer; the various business situations wherein the broker or dealer acquires an adverse interest to the customer; and the legal rights and duties flowing therefrom. There will be examined not only the report of the case but also the record and such additional, independent sources of information as throw light on the nature of the business and legal problems involved and as orient the specific point at issue in the *Kinney* case.

The Reported Case

From the reports of the case the following facts and rulings appeared : Plaintiff brought suit in equity to rescind an agreement for the purchase of 500 shares of preferred stock of Consolidated Automatic Merchandising Corporation. Defendants were stockbrokers doing business in Buffalo. Plaintiff had been dealing in stocks through them for some time prior to February 13, 1929, and on that date placed an order with them for the purchase of said 500 shares at a price of \$35 1/2 a share "or better." The stock was listed on the New York Curb Market and plaintiff claimed that the order included a direction to buy the stock on the Curb. This defendants denied; and the evidence was conflicting. Upon receiving the order, defendants, by telephone, called F. J. Lisman & Co. of New York City, "the bankers in charge of the issue," and inquired whether they could supply the stock at the price named. F. J. Lisman & Co. after ascertaining the price of the stock on the Curb wrote defendants as follows:

"In accordance with telephonic advices of even date, we are pleased to confirm sale to you of: 500 shares CONSOLIDATED AUTOMATIC MERCHANDISING CORPORATION, Preferred Stock at 35 1/2 less 1 point concession to you.

"It is understood that you are to protect the above numbers for a period of sixty days, reimbursing us the 1% per share allowed at time of delivery, should any of the above numbers be repurchased in the open market at or below the price of 35 1/2 per share."

The stock was not purchased on the Curb but taken from the stock F. J. Lisman & Co. were marketing. Thus defendants arranged to pay \$34.50 per share for the stock, subject to the obligation on their part to repay F. J. Lisman & Co. \$1 per share for any of the stock coming on the open market within sixty days at \$35.50 per share or less. In notifying plaintiff of the purchase at \$35.50 per share, defendants said nothing about the concession received. In addition, they charged plaintiff the regular Curb commission of \$75. Plaintiff held the stock for longer than sixty days. Plaintiff, on discovering the facts, tendered back the shares to the defendants and asked for the return of the purchase price and the commission. The lower court gave judgment for plaintiff, saying it was unnecessary to determine whether plaintiff instructed defendants to buy the stock on the Curb. The court stated that an "agent" must deal with his "principal" with the "utmost good faith;" that defendants plainly violated this rule of conduct; that it was their duty to communicate to plaintiff all terms of the arrangement with F. J. Lisman & Co.; that by not communicating the facts and retaining for themselves the benefit of the concession defendants elected to treat the agreement with F. J. Lisman & Co. as an agreement made with themselves as "principals." The court added:

"They cannot be held to assert that the agreement was in part with themselves as principals and in part with themselves as agent for their customers. They will be required to take the one position or the other in its entirety, and by their action in treating that portion of the arrangement relating to the concession as their own contract, they have put themselves in the position of assuming the whole of the contract and thereby becoming purchasers of the stock from Lisman & Co." [FN 2]

On appeal to the Appellate Division the judgment was reversed, the court saying:

"The taking of a secret profit by a broker does not make him in law the purchaser of the stock or committed therefor, at least so far as his customer is concerned. In such case the customer is injured in the amount of the undisclosed vails acquired by the agent, and in a proper action he may recover them...The incident does not change the transaction from one of the execution of an order by a broker for his client to one of the sale to the broker individually, and thus on to a sale by the broker of his own property to his customer." [FN 3]

On further appeal to the Court of Appeals the judgment of the Appellate Division was affirmed without opinion, Lehman, J., dissenting without opinion. [FN 4]

Security Distribution

In the course of this discussion reference will briefly be made to a number of customs and practices in the securities business which it may be well to clarify in advance. Dealers in securities are not unlike other dealers in commodities (or services) who buy at one price and attempt to find buyers at a price sufficiently higher to yield them a net profit above expenses; or who find buyers at a given price and attempt to buy at a price sufficiently lower to yield a similar net profit. Their customers are institutions and individuals. Their sources of securities are the issuing individuals, institutions, corporations, or civil divisions, other dealers, dealer combinations (of which they may be members), investors, and the open market.

The originating of new and refunding issues is largely confined to a few large houses, while their distribution is accomplished through both large and small dealers. In the original distribution of an issue, the average dealer acquires his securities from a large merchant banker originating the issue, through participation in a syndicate or group committed for, or having an option on, such securities, or, as an outside dealer, from such syndicates or groups or their members. During the original distribution such an outside dealer may obtain securities from selling group or syndicate members at a small, dealers' concession, called a "reallowance," which usually entails no immediate penalty-invoking responsibility as to investment placement. Dealers may also at times acquire securities from a member (usually not the manager) of such groups and syndicates at a discount greater than the "dealer reallowance" by guaranteeing that such securities will not be penalized, will not come onto the market at or below the list price, or will not come onto the open market, during the life of the group or syndicate.

Upon the failure of an original distributing effort either to sell all the securities or to place them satisfactorily so that a disproportionate amount will not come upon the open market, secondary distribution, so-called, is sometimes undertaken to sell the unsold securities or to resell those which come back on the market. This would customarily be undertaken at the close of the selling syndicate or selling group. Dealers are invited by the sponsoring merchant banker to sell the securities against confirmation at the last sale price in the open market and are promised for their services a concession which is usually contingent upon the securities remaining off the open market for a certain minimum period of time. Something akin to secondary distribution is sometimes undertaken for older issues when it is desirable to dispose of a large block or to redistribute to investors a floating supply which endangers market stability.

Other sources open to the dealer involve older, outstanding issues. These include the open market and individual investors. Probably the most important sources among investors are the dealer's customers from whom he acquires securities in trade for those he sells. The open market includes both the recognized "exchanges" and the over-the-counter market. Both are "markets," except that the exchanges provide meeting-places and special government. The dealer may take a speculative position through either market. Through the over-the-counter market he is frequently able, as a dealer, to buy at less than the "asked" price and make his profit through resale at the "asked" price. This last method he normally employs only when he buys against an order.

The broker, on the other hand, when acting purely as such, confines his transactions largely to the open market, either over-the-counter or on the exchanges. He may act for two customers under certain circumstances or through circularization attempt to find buyers or sellers for securities offered or for which he has bids, though all such trades off the exchanges may be classed as over-the-counter transactions. His compensation is received in the form of a fee or commission for services rendered.

So-called brokers act as dealers, to a certain extent, in some transactions. As is well known, many houses undertake both security selling and brokerage functions. They may likewise originate and underwrite security issues, as well as perform any number of allied functions. The broker who does not undertake to retail securities, in the usual sense, however, frequently steps into the dealer's shoes in executing orders over-the-counter. Upon receiving an order to buy or sell an unlisted security, he obtains over-the-counter quotations. If he is able to buy only at the "asked" price or sell at the "bid" price, he executes his order as a broker and charges his customer a commission, but if he finds that as a dealer he can arrange to buy below the "asked" or sell above the "bid" prices and his dealers' spread is greater than his normal commission, he may elect to buy or sell for his own account and resell to or buy from his customer, whom he would then charge no commission. In recent years a somewhat similar practice has developed with respect to original and secondary distribution and redistribution, both of listed and unlisted securities. In many, if not the majority, of these cases the concession which the "broker" secures in lieu of his commission is contingent upon guaranteeing investment placement for a specified period of time. An exception is when the broker accepts merely the "dealer reallowance" on a syndicated issue.

In both types of situations, it is customary for "brokers" to distinguish these from the regular brokerage transactions by charging no commissions to their customers and by confirming, in case of purchases, "Sold to," "We have sold to you," or "We confirm sale to you," instead of "Bought for" or "We have bought for your account and risk" and, in case of sales, "Bought from" or "We have bought

from you," instead of "Sold for" or "We have sold for your account and risk." In so far as none of these dealer types of transactions are executed on exchanges, it may be thought superficially that the presence of a commission and the one type of confirmation are confined to exchange transactions and the absence of a commission and the other type of confirmation are confined to over-the-counter and dealer transactions. Actually, of course, strict brokerage transactions are made over-the-counter, a commission is charged, and the confirmation states, "We have (bought or sold) for your account and risk."

"Cameo" and Secondary Distribution

The place of the *Kinney* case in the foregoing brief description of the security business seems clear. It appears that defendants' firm, Glenny, Monro & Moll, were both dealers and brokers, (probably the former chiefly, as will appear hereafter.) The disputed transaction involved Consolidated Automatic Merchandising, or "Cameo," preferred stock which was apparently in process of secondary distribution at the time. Mr. Traugott, a partner in the investment banking firm of F. J. Lisman & Co. which sponsored the issue, when questioned as to the service to be rendered for which the concession was allowed, testified:

"Well, it is really an amount of money or a concession or a commission paid a dealer for...A concession is really an amount of money paid for service rendered...There were several services to be rendered. After the expiration of a syndicate or a selling group some stock is always placed in weak hands. That is, there is always a man that wants to buy for a rise or otherwise...For a speculation, wants to buy for a rise in price; the sharpshooters we call them, and your protection in the group necessarily ends at a certain time, and it is not sufficient to get that stock really placed among investors. It is for that reason that after the group has expired the house of underwriting...And therefore the house of issue is very—we will say they are anxious to get this stock in the protection of a market placed with investors. We will at times buy stock at prices much higher than we are able to sell it at, and even then allow a concession or a commission for the distribution of that stock among supposed investors...It gives you a duofold market. It gives a double market for every purchaser of CAMCO...Weak hands are speculators...the stock that was distributed in the original group, some of it goes to investors, some of it goes to speculators. Weak hands are speculators, because they are playing for a turn...As I was about to say, it helps the stockholder because it places and makes a market for his stock. It helps F. J. Lisman & Company, because it helps us maintain that market, and by selling the stock to the supposed investor our purchasing power is increased, so that we may on the Curb purchase further stock in support of that issue." [FN 5]

In confirming the disputed transactions, defendants used the form, "confirming sale to you," but charged a regular exchange commission and maintained throughout that they acted as brokers for the plaintiff.

Published information on the Consolidated Automatic Merchandising Corporation issues is meager, but, such as it is, may provide some background for the problem. The plaintiff testified that

"When I was in New York in July [1929] it was then that I started to inquire about this company and its prospects...and talking to brokers there... was told that this Cameo Company—that before this merger took place—I learned this in July — that they tried to float some sort of a bond issue; not being successful in that they then formed this company, merged, and put this stock out and sold it." [FN 6]

The only related bond issue of public record sponsored by the same banking house was the \$4,500,000 General Vending Corporation 6% 10-year Secured Sinking Fund Gold Bonds maturing on August 15, 1937. This issue was offered to the public in October, 1927, by F. J. Lisman & Co. and B. J. VanIngen & Co. at 98 1/2 and interest. The General Vending Corporation was incorporated in Virginia in 1927. [FN 7]

About the middle of June, 1928, it was announced that a merger of automatic merchandising machine companies would be financed by F. J. Lisman & Co. and that common and preferred stocks of the new company had been admitted to "when issued" trading on the Chicago and Boston stock exchanges on June 7. [FN 8] A Delaware corporation had been formed on May 29 to hold the stocks of five merging companies. [FN 9] The Commercial and Financial Chronicle's summary of new financing in June, 1928, included an issue of 200,000 units of Cameo stock at \$55 a unit consisting of one share of preferred and one-half share of common stock. [FN 10] This is evidently in error, since the units were not offered to the public until August. It is possible that the issue was planned for June, judging from the advance publicity released, but was postponed because of the unfavorable market developments of that month. This may be borne out by the fact that in the public offering in August the content of the units, which were still priced at \$55, was increased to one share of preferred and one share of common stock.

About the first of August, 1928, it was announced that the merger had been approved. [FN 11] On August 6, large newspaper advertisements announced the consolidation of General Vending Corporation, Sanitary Postage Service Corporation, Automatic Merchandising Corporation of America, Remington Service Machines, Inc., and Schermack Corporation of America under the Consolidated Automatic Merchandising Corporation. Cameo machines were to be produced and guaranteed by the Remington Arms Company. [FN 12] The

public offering of securities was made through F. J. Lisman & Co. on August 7. Stock was offered in units of one share of \$3.50 Cumulative Convertible Preferred Stock, no par, (bearing dividends from August 1, 1928, payable quarterly commencing September 15; convertible for five years into common stock, the first 50,000 shares tendered to receive 1 1/2 shares of common per share, the second 50,000 1 1/4 shares, the third 50,000 1 1/10 shares, and the final 50,000 1 share) and 1 share (voting trust certificates) of common stock, at a price of \$55 a unit. There was a statement in fine type in the offering advertisement that "The Corporation is to guarantee principal and interest of \$4,500,000 General Vending Corporation 6% Ten Year Secured Gold Notes." [FN 13]

The New York Curb Market admitted 200,000 shares of the preferred and voting trust certificates for 2,050,000 shares of common to temporary listing on August 8, to be traded in separately on a "when, as and if issued" basis. The listing statement shows that Cameo was formed "under the auspices of the United Cigar Stores Company of America and prominent parties interested in the Sanitary Postage Service Corporation.

"With a view to establishing a company which should become a leading factor in the automatic merchandising field, it was decided to consolidate several large companies already in operation, so that great economy could be achieved in the management of the consolidated enterprise, as well as in production, distribution and the joint servicing of the automatic devices." It was also stated that "The Remington Arms Company, known throughout the world for its marvelous precision work, will serve as the principal manufacturing end of the consolidated company. The Remington Arms Company has an important stock interest in the Consolidated Automatic Merchandising Corporation, and is represented on the Board by its President." Estimated earnings for three of the constituent companies for a ten year period included earnings of \$2,210,927 in 1928 and \$18,719,303 in 1932. [FN 14]

The plaintiff bought 100 of these units through or from the defendants in September, 1928. From the direct examination of the plaintiff: "Q. How did you first become interested in Consolidated Automatic Merchandising Corporation stock? A. Mr. Thomas Balkin, who is employed by Glenny, Monro & Moll, (defendants' firm) and whom I have known for a period of eight or ten years, was in the habit of coming to my office, and I traded with Glenny, Monro & Moll through him...Eventually I gave him an order to buy 100 units of Cameo...At \$55 or better per unit." [FN 15] This purchase was evidently made during the life of the syndicate or selling group referred to by Mr. Traugott. Since this matter was only collateral to the issue in the case, insufficient evidence was given to decide the exact nature of the transaction, but from the fact that defendants' representative, Mr. Balkin, brought copies of circulars on Cameo bearing the

imprint of F. J. Lisman & Co. to the plaintiff at the time, it may fairly be inferred that defendants were selling the units on selling group terms. [FN 16] The 100 units in question were sold at the list price." Defendants' firm was listed with the trade as "Participating Distributors & General Bond Dealers" as well as stock brokers. [FN 18] That defendants' firm distributed securities on such terms may also be inferred from the testimony of defendants' cashier that the firm carried on its books a "Syndicate selling commission account." [FN 19] Then Mr. Balkin testified, "Q. With respect to the original 100 shares of stock that Kinney bought back in September, 1928, was there a similar arrangement between you and Lisman? A. Yes. Not that I know of. Wait a minute. I do not know what the arrangement was with Lisman at that time...Q. It was purchased from Lisman? A. Yes. Q. Probably at a profit, was it not? A. I presume so." [FN 20]

Selling group restrictions on Cameo preferred stock would seem to have been in effect until about the middle of January, 1929. Sale prices on the Curb kept within the narrow range of 42 1/2 to 48 during the last five months of 1928. Curb sales were 4,500 shares in November and 6,300 shares in December, with the range in December from 43 to 46 1/2. In January, 1929, however, sales jumped to 17,600 shares and the stock reached a low of 33 on January 26, having fallen from a high of 45 on January 5. [FN 21] There were only 300 shares sold on Friday, January 11, and the range was 42 to 42 1/8. In the first hour of trading on the following day, Saturday, there was only one sale, at 41. In the final hour, 1,500 shares were sold within the range of 38 to 40. [FN 22] Assuming that an announcement had been made that morning that selling group restrictions on the sale of stock would be removed at the close of business (noon) that day (*i. e.*, that dealers would not thereafter be penalized by cancellation of commission or redelivery of stock coming back onto the open market), then some of this selling may have represented short sales by some of Mr. Traugott's "sharpshooters." The market action on Monday, January 14, substantiates this, since 1,100 shares were traded within a range of 38 1/2 to 41 prior to the last sale, and the next to last sale was of 100 shares at 40. Then 700 shares were bought "under the rule" at 43. [FN 23] It would seem that short sellers on Saturday who were unable to borrow stock on Monday were "bought in" for cash. Members of the selling group would probably have been unwilling to lend their stock that day, since it would have been delivered against contracts made before the expiration of the group, on this assumption, and they would have incurred a penalty. So although the group might have expired on January 12, the stock was really not "free," considering the probable support given the market on January 14, until Tuesday, January 15. On that day, 1,300 shares were traded within a range of 36 1/8 to 38. On January 16, 2,200 shares were traded within a range of 35 3/4 to 36. [FN 24] Trading then began to slow up, and the price of the preferred stock stabilized around 35 to 36. It is not unlikely that F. J. Lisman & Co. acquired a considerable amount of the preferred stock during this stabilization process which it could only dispose of satisfactorily by means of secondary distribution.

Turning a moment to the action of the common stock, this sold within a range of 7 1/2 to 9 7/8 in August, 1928. In the following months it experienced considerable appreciation, and sold within a range of 12 5/8 to 17 3/4 in January, 1929. [FN 25] An obvious inference from the contrasting actions of the preferred and common stocks is that during the boom of 1928 and 1929 the security buying public was more interested in common stocks, and when the average buyer acquired the units he was more interested in the common stock than in the preferred. As the two classes of stock were traded in separately, he could sell the preferred and hold or increase his holdings of common. If this were the case, then F. J. Lisman & Co. was faced with an acute problem of secondary distribution for the preferred stock at the close of the selling group.

A sample check of financial advertising of the period shows that F. J. Lisman & Co. began to advertise the preferred stock separately about the first of February, 1929. [FN 26] Since this advertising did not refer to the common stock, it seems possible that the bankers were not confronted with a problem of secondary distribution on the common stock, that it was considered hopeless to "put away with investors" so speculative a stock, or that secondary distribution of this type of security could better be accomplished through redistribution on the exchange.

It appears that, a few days prior to January 28, 1929, plaintiff bought 200 shares of Cameo preferred stock at 33 or 33 1/2 through the defendants' firm. He sold these shares at 35 1/2 on January 28. [FN 27] Defendants' witness, Mr. Balkin, testified, on cross examination, that these shares were acquired from F. J. Lisman & Co. on the same terms as the 500 shares subsequently purchased, but that Glenny, Munro & Moll did not gain the concession offered by the bankers because the stock came back on the market within 60 days. [FN 28] The stock was sold for the plaintiff on the Curb by defendants. [FN 29]

With respect to the 500 share purchase involved in the suit to rescind, it appears that the plaintiff had been out of the city for about two weeks following his sale of the 200 shares and on his return, finding messages from Mr. Balkin, called Mr. Balkin about two o'clock on February 13, 1929, and placed an order to buy 500 shares of Cameo preferred stock at 35 1/2 or better. [FN 30] Plaintiff claims and defendants deny specific instructions to buy the shares on the Curb. [FN 31] It does not appear from the record whether there was any time limit on this order. Mr. Balkin, for the defendants, on direct examination: "Q. Then did you check the market after you talked with him the first time? A. Yes...I told him the market was 35 or 35 1/4 bid and the stock was offered at 36, and that the last sale was 35 1/2, and he gave me an order to buy 500 shares at 35 1/2. Q. Later in the day did you call him back and tell him that you had bought that stock? A. Yes...I told him we had bought the stock at 35 1/2 and it had closed that day at 36. It was after the close of the market that I talked with him. Q. Did you tell him where you

bought it at that time? A. No." [FN 32] On redirect examination: "Q. After you received this telephone conversation from Mr. Kinney to purchase 500 shares of stock, did you use your wire through Hayden Stone to get the Curb price? A. Yes. Q. And after you got that you told Mr. Kinney the bid and asked price? A. Yes. Q. Is that right? A. Yes, that was checked through Hayden Stone & Company. Q. Then you afterwards sought other places to purchase it? A. Yes." [FN 33] Mr. Balkin then turned the order over to Mr. Doolittle, one of the partners of Glenny, Monro & Moll, as appears from Mr. Doolittle's testimony: "Q. What did you do with the order? A. ...I asked him (Balkin) how the stock was quoted, and he told me...It was quoted 35 bid, offered at 36...He asked me if I thought that we could obtain as large a block as 500 shares at a flat price of 35 1/2. I said that I did not know, that I would call the bankers and find out. Q. Why did you do that? A. Because I knew that they originated the deal, and I thought there was a likelihood of their having stock at that time... Q. You could get it on the Curb if there was a block of 500 shares offered, I take it? A. Yes, but it had been traded in in 100 share lots only, and when a market is quoted at 35 to 36 there is only 100 shares offered at 36 as a rule...Q. What was that conversation which you had with them (office of Lisman) ? A. I asked for Mr. Chambers or Mr. Traugott. Mr. Traugott came to the wire, and I stated to him that I had an order for 500 shares of Consolidated Automatic Merchandising preferred, and asked him if he had any stock to offer. He left the phone for a moment, came back and stated that the market was quoted 35 bid, offered at 36, and that he could supply 500 shares at 35 1/2. I asked him if that was the best he could do and he said yes, that was the last sale, and that was the best that he could do. He further stated that if the stock stayed off the market for a period of 60 days that we would receive a dollar a share. I said 'All right, I will take the stock.' " [FN 34]

After the sale was confirmed to the plaintiff, he became suspicious that the stock had not been purchased on the Curb. "Late that afternoon when the Evening News, which carries the financial reports, came out, I looked in there and saw listed 200 shares of Cameo preferred. The following morning I looked in the Buffalo Courier, a copy of which I have there, which showed 300 shares of Cameo preferred having been dealt in on the Curb...with a high of 36 and a low of 35 1/2, and the last was 36...I communicated with Mr. Balkin...I told Mr. Balkin that I didn't think they had bought this stuff on the Curb, this preferred stock, and his reply was, 'What kind of a house did I think they were, that of course they bought it there, and I should know better than to say that to them.' ...I talked to him about this two and three hundred share proposition that appeared in the Buffalo newspapers, and I think he told me there were 700 shares dealt in that way." [FN 35] Mr. Balkin denied that he had ever told the plaintiff this 500 shares had been bought on the Curb. [FN 36]

The Report of Sales of New York Curb Market published by Francis Emory Fitch, Inc., shows the following Cameo preferred trades appearing on the Curb tape on February 13, 1929:

10 a. m. to 1 p. m.
100 shares at 35 $\frac{7}{8}$
100 shares at 36

1 p. m. to Close
200 shares at 35 $\frac{1}{2}$
100 shares at 35 $\frac{1}{2}$
100 shares at 35 $\frac{3}{4}$
100 shares at 36

The subsequent history of the transaction, as it appears from the records, was that defendants refused to carry the stock on margin and plaintiff sold some other securities to provide part of the purchase price and made arrangements with a bank "to take up the stock," paying the defendants the balance on the purchase price. [FN 37] In addition, plaintiff experienced some difficulty or delay in getting credit for a dividend on these 500 shares while they were in the hands of defendants. [FN 38] Either from these circumstances and plaintiff's suspicions as to the purchase or the unfavorable market action of the stock, plaintiff made the inquiries in New York previously referred to and consulted counsel, by whom he was advised of his right to secure complete information on the transaction from defendants. [FN 39] He demanded this information from defendants, and received an answer dated August 20, 1929, stating that the 500 shares of Cameo preferred had been purchased from F. J. Lisman & Co. at a price of \$17,500.00, which would be \$35.50 a share. [FN 40] A second letter, dated August 23, stated, "Owing to an error inadvertently made by one of our accountants, we desire to supplement the statement sent to you August 20, 1929, by striking out Sub-division 5 and stating in lieu thereof, the following:

5. The price at which the same was bought was \$35.50 per share less 1 point concession, with the understanding that we were to protect the above mentioned stock sold to you for the period of 60 days, reimbursing F. J. Lisman & Co. the 1% per share allowed at the time of delivery should any of the above stock be re-purchased in the open market at or below the price of \$35.50 per share." [FN 41]

As to Cameo, various news releases from June, 1928, to July, 1929, present the prospect of a remarkably favorable future for the company. During the selling group period there were a number of these items. [FN 42] No items appeared in the Chronicle in January, 1929, but with the start of secondary distribution, presumably, in February, more news appeared. [FN 43] For example, there was news of interests obtained in other companies, of further installations of vending

machines, the start of "Nation-Wide Installation of 'Talking Robots' to Sell Groceries," and of a combination for "international distribution of automatic salesmen." April and May business was reported to be good, and then the Chronicle of July 13 carried a report that June had been a record month." Very shortly thereafter, in the July 27 Chronicle, however, it was reported that F. J. Lisman had announced he would temporarily accept the presidency of the company, that the concern was in a good financial position, but that earnings for 1929 would not be as good as anticipated. [FN 45] Prior to that time there had been only one constructive admission of weakness, the increase in the conversion ratio of the preferred stock. About the first of December, 1928, the preferred was made convertible into 2 1/2 shares of common per share of preferred at the option of the holder until December 31, 1929. [FN 46] This may not have resulted from a desire to reduce cumulative contingent charges on the company, however, but from a desire to make the preferred stock more attractive in the face of the selling of that issue. In August, 1929, however, the conversion ratio was further increased from 2 1/2 : 1 to 7 1/2 : 1, and there seems little doubt but that this move resulted from a desire to reduce contingent charges. [FN 47]

It was not until late in August, 1929, that the annual report of the company for the year ending December 31, 1928, was published in the Chronicle. It showed a deficit applicable to the parent company of \$161,676. [FN 48] About the end of August, it was reported that the directors had taken no action on the preferred dividend normally payable September 15. [FN 49] Then there was no further news for nearly a year, until June, 1930, when the financial report for 1929 was published. The deficit applicable to the parent company was given as \$821,422. [FN 50] In November, 1930, it was reported that a suit against the company by the Remington Arms Company had been settled by private agreement. [FN 51] In May, 1931, the company reported a profit and loss deficit of \$4,159,357, at the close of 1930. [FN 52] Apparently the special conversion offer to preferred stockholders expiring December 31, 1929, was extended to June 30, 1931, for the *Chronicle* of July 4, 1931, reported that the offer to exchange stocks on a 6 : 1 ratio had been extended to June 30, 1932. [FN 53]

The following table presents the market action of the common and preferred stocks for the period under consideration:

[Table and accompanying footnote deleted]

"Agent"—"Principal"

The *Kinney* case at once raises the question of the legal relationship existing between customer and stockbroker and the standards of conduct and behavior the violation of which give rise to rights and duties *inter se*.

It would seem that the placing of an order to buy or sell by the customer and an indication to the customer by the broker of his willingness to undertake to execute the order give rise to a bilateral contract. [FN 55] The mutual promises are all implied in fact being based on the common understanding of the parties, the way in which such business is normally conducted, and the custom and usage of particular markets or exchanges. The details of these promises may vary in light of the requirements of particular transactions, *e. g.*, purchases on margins, [FN 56] but in general they would appear to be as follows:

The broker agrees to use reasonable effort and care in attempting to find purchasers for or sellers of the security, which the customer wants to sell or buy, at the price stated by the customer; and if such purchasers or sellers are available, to sell to or buy from such persons at the price indicated by the customer ; and to remit the price in case of sale, and deliver to the customer the securities required, in case of purchase. [FN 57]

The customer, on the other hand, agrees on performance by the broker to pay him the commission which is reasonable or normally required for such purchases or sales or which is specified under the rules of a particular exchange. [FN 58] Further, he promises to take the shares so ordered and to pay the broker the price, [FN 59] or in case of a sale to deliver the shares sold.

The legal consequences of the agreement are for the most part well defined. Thus, on purchasing the stock or bonds as ordered, the broker may sue the customer for the price [FN 60] and his commission. [FN 61] If he does not use reasonable care and diligence in attempting to execute the order he may be held liable in damages to the customer. [FN 62]

Out of this contractual arrangement the courts [FN 63] state that the following relationships arise: (1) In executing the order the broker is acting as "agent" for the customer. (2) In advancing the price to acquire or carry the securities he is a "creditor." (3) In holding the securities until reimbursed or paid by the customer he is a "pledgee." [FN 64] The second and third represent execution by the broker of his undertaking under the bilateral contract; in other words are incidents of that performance. Here we are primarily interested in the first. The term "agent" is used to describe many varying incidents of the contract. Thus it differentiates the promise to take and pay or, on the other hand, to deliver from the promise by the broker which, as we have seen, is to use reasonable efforts to find purchasers or sellers at the stated price. [FN 65] This absence of definite commitment has important consequences. For example, it results in relieving the broker of liability for the price of stock sold, where, before delivery, the purchaser defaults. [FN 66] This follows even though on the contract which the broker has made with the purchaser (usually another broker) the broker is liable as promisor (or "principal") by the rules of the common law or by rules and regulations of the

stock exchange. [FN 67] No quarrel can be had with this result, since, within the fictitious four corners of the implied in fact contract, the broker does not purport to guarantee sales or to act as del credere "agent." The same result follows even though, prior to repudiation by the purchaser, the broker has confirmed the sale by memorandum stating "sold for your account and risk," such confirmation being read in light of the broker's commitment under the contract with the customer. [FN 68] "Agent" is thus used to describe here, as in other situations, [FN 69] the nature and scope of the promise for which the bargain was made.

Other meanings of the term "agent" might be mentioned. But the one which is of most importance in the analysis of the instant case relates to fiduciary duty. One employed to buy or sell for another is chosen for his skill, discretion and honesty. Fees are paid for brains and integrity, and the exercise of prudent judgment. Accordingly an "agent" employed to sell his employer's property may not purchase it himself without full disclosure to the employer. The latter may avoid the sale on such showing even though there were no actual fraud, the price fair and the bargain as good as or even better than could be obtained elsewhere. [FN 70] Or he may affirm the transaction and sue for damages which may be nominal or actual, and if the latter, they may be measured in terms of secret profits to the "agent." [FN 71] Conversely the "agent" employed to purchase may not without full disclosure sell "his own" property. And if he does the legal consequences are the same as where he purchases for himself. [FN 72] His fiduciary duty is also held to be breached and the voidability of the transaction established where the sale, for example, is to a corporation of which the "agent" is the controlling stockholder. [FN 73]

Analogous problems of dual positions have consistently received the same treatment at the hands of courts. Thus where one employed to buy or sell accepts a commission, without full disclosure, from the other party to the transaction, he may not recover his commission from his first employer. [FN 74] Further, the contract may be rescinded or a defense successfully interposed if it is sought to be enforced. [FN 75] And the dual capacity of the "agent" is ground for recovery from him of his compensation. [FN 76] The only exception to these rules governing dual "agents" is the case where the "agent" does nothing more than bring buyer and seller together and having done that steps out of the picture completely. [FN 77] The bargain then is made without his further intervention. The negotiations are not subject to the direct or subtle pressure of his participation and persuasion.

Exactly the same results obtain when the stockbroker assumes a dual or adverse position without full disclosure to his customer and proceeds to act as "principal," or as "agent" for another. [FN 78] Thus, if a customer directs the stockbroker to "sell" and the broker, without disclosure, "purchases" for "his own" account, the transaction may be avoided [FN 79] or damages recovered. [FN 80] And if the

customer instructs him to "purchase" and he "purchases" "his own" securities for the customer similar consequences follow. [FN 81] The damages may be merely nominal. [FN 82] In allowing rescission it is immaterial whether plaintiff suffered damage by reason of the transaction. As once stated by the Court of Appeals of New York, "It is no answer that the intention was honest and that the brokers did better for their principal by selling him their own stock than they could have done by going into the open market. The rule is inflexible, and although its violation in the particular case caused no damage to the principal, he cannot be compelled to adopt the purchase." [FN 83] That case involved a suit by the broker against the customer, but the same result follows where the customer is repudiating the transaction and seeking to be restored to his former position. [FN 84]

Another way of stating the result is that an "agent" without full disclosure cannot acquire an independent, adverse interest to his employer and thus deprive him of the benefit of disinterested advice and the impartial exercise of discretion, the very things for which presumably he was employed. If he does he becomes a "principal" in the transaction as well as an "agent" for his employer. The courts have refused to admit that the average individual could stand the stress and strain of such dual position. As Mr. Justice Cardozo recently said: "Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion." [FN 85]

In light of these well established and somewhat elementary rules of law what disposition should be made of the *Kinney* case? Did defendants "own" the stock which plaintiff purchased? What sort of independent or adverse interest is sufficient to constitute the broker a "principal" or an "agent" for another? First as to the word "own." It is obvious that it has no fixed meaning. Or, to put it another way, it has such broad meaning and so many legal connotations that it acquires content only when related to particularized and closely drawn issues. It and its companion "title" mean so much they mean little. "Own" as well as "title" might be translated into terms of certain types of commitments or risks. They may be descriptive of the result reached in deciding, e. g., who bears the risk of destruction, deterioration, or fall in price; who must pay the taxes; who has the right to possession; who has the right or power of disposition; who is entitled to the income. [FN 86] They are descriptive of ends reached rather than tools useful in analysis. They are the jokers in the court's pack of cards which, if played, invariably take the trick.

The complaint in the *Kinney* case was drawn on the theory that defendants were selling their "own" stock. Defendants asserted they were not. The Appellate Division summarily dismissed this issue in the following language: "The taking of a secret profit by a broker does not make him in law the purchaser of the stock or committed therefor, at least so far as his customer is concerned...The incident does not change the transaction from one of the execution of an order by a

broker for his *client to one of the sale to the broker individually, and thus to a sale by the broker of his own property to his customer.*" (Italics ours.) The vague "his" and the undefined "own" give the impression of concepts, standardized and simple, easily recognized and readily proved. But it is submitted that both the form and substance of the transaction negate such simplicity in meaning.

It is clear, however, that defendants had not paid for and received possession of the stock before plaintiff gave his order. Nor were they at that time under any commitment to take and pay for any of those shares. Furthermore, so far as appears, they had no option, paid for or otherwise, to acquire such shares at a stated or determinable price. Measured in terms, then, of right to possession, duty to take and pay, option to acquire, physical possession or any other criteria frequently thought of as descriptive of "ownership" they were not "owners." To be sure, on contracting for the shares with F. J. Lisman & Co. for the purpose of filling plaintiff's order, they became obligated to F. J. Lisman & Co. to take and pay. That would follow not only by virtue of the rules of the exchange [FN 87] (were it an exchange transaction) but also by the law which holds liable on the promise the party who makes it, whether in fact he is "agent" of another, or himself the "principal." [FN 88] The fact that someone else, such as an unnamed or undisclosed "principal," may also be liable [FN 89] does not narrow the choice or change the bargain of the other contracting party. [FN 90] But the liability of the defendants for the purchase price would likewise exist even if they had not purchased from F. J. Lisman & Co. but had executed the transaction on the Curb. Having made a promise they would be liable on it. [FN 91] So the fact that in the instant case they contract to buy in their own name is *per se* of no weight whatsoever in making them "owners." Such liability is the normal incident of the usual transaction consummated by brokers, not a distinguishing characteristic of the type which courts strike down.

There are at least three other considerations which make the result reached by the Appellate Division doubtful. First, if defendants had anticipated that some customer would buy Cameo stock, had given an order to F. J. Lisman & Co. and it had been confirmed even less than one minute before plaintiff's order was placed, there is no doubt that then they would have been selling their "own" stock to plaintiff so as to come within the prohibitions of the law described above. [FN 92] Is one rule of law to be made for merchants who carry an inventory; another for merchants who do not, but yet act as merchants? [FN 93]

Second, the *Kinney* case is to be distinguished from one in which an "agent" merely fails to reveal the actual price at which he purchased, having purchased in the place and manner explicit or implicit in the contract. In the case of *Sutro v. Jacobson*, [FN 94] where the transaction was upheld, the plaintiff purchased the security from the originating house at the list price contemplated by the defendant customer. In the *Kinney* case there was no implication that the stock

would be bought in other than the open market. Defendants in the *Kinney* case had access to the dealers' market in the stock and from previous transactions knew that a dealer's concession was available to them there. In this connection the case of *Montgomery v. Hundley* [FN 95] is of interest. Defendant had an option to buy shares from another stockholder for \$5,750. Defendant was not a broker but active in the management of this small close corporation. He wrote plaintiff telling him that one stockholder wanted to sell and that he could get the stock for plaintiff for \$7,000 and stating that the defendant had no interest in it. Plaintiff thereupon purchased the stock and received the shares directly from the selling stockholder. So far as appears plaintiff did not pay defendant a commission. On learning of defendant's profit on the deal, plaintiff tendered back the shares and on refusal of defendant to accept brought an action for rescission. In affirming judgment for plaintiff the court said it was immaterial "that the sale was beneficial to the principal (plaintiff) and worked no damage to him." The court reasoned that defendant was not the "owner" yet he had an option; and when defendant consummated the sale to plaintiff it was equivalent to exercising the option, taking the transfer and making the transfer to plaintiff. The court reasoned that the total effect was the same as if defendant had from the beginning held the shares in his own name. In other words the vice of that transaction was the presence of an adverse independent interest, concealed from plaintiff, who was reposing confidence in the unbiased judgment of defendant. It would seem that exactly the same consequences should follow even though defendant had no legal or equitable right to acquire the stock but nevertheless consummated the transaction in exactly the same way. The emphasis seems properly placed on what he did rather than the method or means he employed to do it. So in the *Kinney* case the presence or absence of a commitment to take the shares or an option to acquire them seems irrelevant. A broker's knowledge of the amount of stock held by a dealer, its ready availability, and his relationships with the dealer, might well make the certainty of his ability to acquire such stock as clear as if he had a legal power over it through the exercise of an option.

Third, the Appellate Division failed to analyze sufficiently the nature of the "secret profit" so as to distinguish a pure, dealer's concession or re-allowance from compensation involving a sixty day interest adverse to that of the customer. Defendants' adverse interest in the transaction was as strong and their bias and self-interest as patent, as if they were already committed to take the stock [FN 96] or had complete control and dominion over the certificates. In fact it seems that their adverse interest was even stronger. If they were selling stock for which they had paid and over which they had complete dominion and control, they would be taking their profit at the consummation of the transaction and, perhaps, tend to be unbiased in giving subsequent advice to plaintiff. [FN 97] But in the instant case their profit accrues only if plaintiff retains the stock for sixty days. Any advice given by them during that period, either at plaintiff's solicitation or

otherwise, is going to be self-serving and, conceivably, inconsistent with their better judgment did they not have a profit at stake. In other words, plaintiff acquires in addition to the vicissitudes of the market a continuing sixty day adverse interest that well may influence the exercise of his independent judgment. [FN 98] The stabilizing effect of immediate profit taking therefore is absent. Furthermore, defendants' knowledge that such stock was generally available through F. J. Lisman & Co. made likely that they would seek that profitable source of income for their business as merchants. Now what is likely to happen? Salesmen of the house will be apt to extol Cameo, point out its attractive features and by various methods, direct and indirect, endeavor to interest customers. Brokers do act as consultants and professional advisers as the result of questions and queries propounded them by customers— not as in an independent calling but as incidental to their own business. Customers may or may not follow their advice. The extent, if any, to which customers are influenced to make particular purchases as a result of such salesmanship obviously cannot be determined. The factors in motivation are too subtle and tenuous to result in anything but guesses. In the *Kinney* case it appeared that over a period of months (probably dating back to the time when defendants were members of the selling group and continuing after its termination) defendants' salesman had extolled the qualities of Cameo to plaintiff and had furnished him with literature. [FN 99] It is impossible to escape the conclusion that defendants' influence and persuasion played some part, perhaps a dominant one. The unwholesomeness of the situation appears when disclosure is not made. If the customer believes that the advice and counsel being given is disinterested and bottomed on an independent market judgment, he may weight it heavily. But if he knows that such advice is colored by a selfish interest, he will be likely to discount all that is recommended. Of course, he may proceed to buy even though he knows that he is acting on not disinterested advice. In the instant case the failure to disclose was clearly as detrimental to the plaintiff as it would have been had defendants been carrying Cameo in their portfolio at the time his order was placed. Accordingly, the same result should be reached here as in the "ownership" cases discussed above. There is no magic in "ownership." The adverse interest necessarily incident to "ownership" inspires disloyalty. But other forms of adverse interest likewise do, among them being the opportunity of making an undisclosed profit in any way. Transactions like that consummated in the *Kinney* case represent one. The fact that the body of legal precedent has grown out of rather simple fact patterns should not crystallize the rule of law to reach only those. The thrust of the legal rule should be deeper. The accomplishment of an old result in a new way should not blind chancery to the end reached. The intricacies of modern finance with new techniques and specialized procedure call as much for wholesome doctrines of equity and morality as the devices of a simpler and less complex order.

The reasoning of the Appellate Division therefore is only dialectically responsive to plaintiff's argument. It fails to show discernment in either the substance or the

form of the transaction. Perhaps the reason for this disagreement with the reasoning will appear more clearly if further aspects of security distribution are explored.

Broker-Dealer

It is apparent that the problem presented in the *Kinney* case would be likely to arise if a security house performed the functions both of brokerage and retail security distribution and failed to distinguish carefully for its customers those transactions in which it acted as "agent" for the customer from those in which it acted as a "principal" or as the "agent" of a third party. In the *Kinney* case, however, plaintiff understood that defendants were to have acted in the usual way as his broker or "agent" and defendants claim that they did act in that capacity. [FN 100]

If a brokerage house acted solely as "agent" for its customers, executing orders on exchanges, over-the-counter, or in such manner as directed or contemplated by the customers, with the object of obtaining the best bargain for the customers under the restrictions imposed on the transactions, disclosing all details of the transactions known to it, and charging a regular fee for services rendered, the problem would not occur. Nor would it in the case of a house acting solely as a merchant in securities, buying them from issuing companies, other houses, or syndicates of which it was a member, and endeavoring to sell them to customers at an advance in price sufficient to cover expenses and yield a net profit.

Now if the merchant acquired his inventory from the same sources normally employed by brokers in buying securities for their customers (*i. e.*, on exchanges and over-the-counter), but with the object of selling them as before, it seems that he would still remain a merchant. Nor does there appear to be any requirement that the security merchant, any more than other merchants, should have on hand at the time contracts of sale are made the securities contracted for. His salesman may sell stocks A, B, and C, of which he has an ample supply of A to meet his orders, insufficient B, and no C. When he buys enough more B and sufficient C to fill his orders, he does not thereby act as the "agent" for his customers, even though his salesman make the sales subject to confirmation and even though his gross profit amounts to no more than the brokers' fee. He might, of course, inform his customers (and they agree) that on a specific transaction he would act as an "agent." But in the absence of express stipulation it would not appear that he had changed his character from that of a merchant.

It appears, then, that the security merchant may acquire his security inventory through any source and buy the securities in any manner and yet remain a merchant, being the actual vendor or the "agent" of the vendor. In the absence of express restrictions by the customer, however, may a broker acquire securities

for his customer in any manner and yet be held to have acted within the scope of his "agency"? Assume that the broker, without special notice to the customer, obtained securities for his customer through channels normally open only to the security merchant and retained undisclosed the profit allowed to the merchant. Would this distinguishing characteristic mark him as a merchant or the "agent" of a third-party merchant, placing him in an adverse position which the rules of fiduciary duty condemn?

The sources normally open only to the security merchant are syndicates, selling groups, and what, for lack of a better term, we may call "wholesalers." If a broker obtained securities for his customer from a syndicate of which he was a member, there would seemingly be little question but that he was acting as a "principal," or as an "agent" of the syndicate in which he was a joint adventurer and in which his adverse interest was paramount and certain, as in the cases discussed above where the "agent" sells his "own" property to his employer. The one borderline case might be that of a broker who was a member of a limited-liability syndicate in which there was no trading account, no obligation of members to take back securities repurchased in the open market by the syndicate managers during the life of the syndicate, and no extra over-sales commissions, and in which the broker, prior to the transaction for his customer, had taken down from the syndicate and sold an amount of securities at least equal to his participation. In that case, his purchase from the syndicate would resemble a selling group transaction, but such a set of circumstances would be of unique occurrence. His interest in the average selling group would be more extensive, because of the usual repurchase penalties.

In buying securities through a selling group, the merchant may follow either of two courses. Upon being invited to join the group and subscribe, he may subscribe immediately for the full amount he wishes to sell. He would be likely to do this if he thought the securities would be in great demand and the subscription books quickly closed, or if he thought he would incur the ill-will of a prominent originating house by failing to subscribe promptly for his quota. He would then be committed for a definite amount of the securities as definitely as in a limited-liability selling syndicate, except that he would have no trading account liability. He would very probably be subject, however, to a repurchase penalty of redelivery or commission cancellation. The other course would be to subscribe for securities in the selling group only as he secured orders from his customers. He would thus eliminate one element of risk, though he would normally still be subject to the risk of the repurchase penalty. The merchant would always prefer this course, and would follow it in every instance were it not for one or both of the factors mentioned above which sometimes determines the other course. The differentiation between the courses, then, is not one of "agent" and "principal" but of mercantile expediency.

If our hypothetical broker followed the former course, he would unquestionably not be acting as the disinterested, unbiased "agent" of his customers, but as a vendor or "principal" with a decidedly adverse interest. If conditions were expedient to the latter course, and he was compensated as a merchant for distributing the securities and keeping them off the open market for a specified period, it does not appear that the essential nature of the transaction is changed though he might in some instances become the "agent" of the vendor rather than the "principal" or vendor. Because he buys them against a specific order and not on an exchange does not imply that he is buying them "over the counter." He is buying them on selling group terms—as a merchant. The over-the-counter market is as well recognized as the exchanges as a market for many securities. As a true market, distributing commissions are no more allowed on the over-the-counter market than they are on the exchanges. Such commissions are indices of wholesale distribution or of the "investment guaranteed" market, not the open market.

Now in the absence of syndicate or selling group membership by the small merchant, he may buy securities on wholesale or investment guaranteed terms from other dealers, the originating house, or the issuing company, and in so doing he may follow either of the courses open to him in the selling group. He is, however, more likely to buy against orders than to acquire inventory in advance, for at least one of the factors motivating him to assume the greater risk (that of retaining the good-will of the originating house by accepting a specific offer) would probably be absent. The very fact that securities were available at such sources would indicate that those securities were not highly attractive as inventory. Investment guaranteed terms could probably be had from other dealers only during the life of a syndicate or group, when they would be willing to allow concessions to avoid repurchase penalties. The originating house, however, would usually be willing to allow a dealer's concession, subject to guaranteed investment placement, after the close of a distributing syndicate or group if it had on its hands unsold or repurchased securities. Such a concession would be allowed to dealers as an incentive to distribute the securities and to place them with buyers who would hold them rather than let them come back on to the open market.

What if our broker utilizes such sources without disclosure to his customers? Can he be differentiated from the dealer, the merchant? Has he bought on the open market? To answer the last question, he obviously has not. He has bought on the dealers' or investment guaranteed market. He has not bought the securities over-the-counter, in the accepted sense; [FN 101] he certainly has not bought them on an "exchange." The broker, in this instance, would have acquired the securities at the source, in the manner, and at the price of a merchant—not on the open market. No one of those conditions would have been contemplated by a

brokerage customer. They would have been contemplated only by the customer of a merchant.

In the *Kinney* case, the defendants acquired the stock from the investment house sponsoring the issue after the close of the selling group; bought it in a way and at a concession the partner of the investment house testified was open only to recognized distributors. [FN 102] The terms were similar to those of a typical selling group. Instead of the list price of the selling group, the last sale price was substituted as the base price, as is customary in secondary distribution. If the preceding analysis is sound, then the defendants here, whether "principals," or "agents" of the originating house, were not representing solely the interests of the plaintiff in the disputed transaction but had clearly assumed a biased and antagonistic position.

To summarize this analysis, there are roughly two sources of securities open to the dealer, the open market and the dealers' market. The open market includes exchanges and the over-the-counter market. The market peculiar to the dealer is not on an exchange, but it is not, therefore, an over-the-counter market. Its distinguishing characteristic is a concession impliedly to be retained by the dealer for services rendered, either in distribution or underwriting, or both.

Because a dealer receives the concession as an incident to an order already received does not alter the case by extinguishing the incentive to secure orders—to distribute. But if, for the sake of argument, it be temporarily conceded that a dealer purchases securities for a customer from such a source and the concession is in no way considered compensation for distribution, but only for underwriting (i.e., for guaranteeing investment placement for a specified period), this hypothetical distinction would not appear to have changed the nature of the transaction, for the dealer would be delivering to his customer securities in which he had an interest. In many instances the dealer would have to accept the repurchased securities or stand cancellation of his commission, at the option of the one from whom he acquired the securities, should he be required to make good his underwriting. But even if only the lesser penalty were exacted, that of cancellation of commission, it is readily apparent that the contingent concession would still act as an incentive to the dealer to keep the securities in the hands of his customer—to maintain the distribution accomplished. So the distinction in terms of incentive between the distribution and underwriting components of the concession to the retail dealer would in reality be one between incentive for initial distribution and incentive for continued distribution.

There seems no escape from the conclusion that a broker, in buying in the manner peculiar to a dealer, is exceeding his authority as to place and manner of purchase, and that the undisclosed concession for either distribution or underwriting unquestionably marks him as a dealer and not a broker in such a

transaction. In the opinions defendants were described as "stockbrokers." From the testimony and from their listing with the trade, they were also "participating distributors," i.e., dealers—merchants. Since their firm was not represented by membership in the New York Stock Exchange, and it was obliged to split commissions with a correspondent on trades executed on the New York Curb Market, [FN 103] it may well be inferred that their chief business, over a period of years, was as *merchant* rather than *broker*. As one defendant testified, *concessions rather than exchange commissions constituted the "life blood" of their business.* [FN 104]

We find, then, that defendants were responsible for this difficulty in failing to distinguish carefully their two types of business. At one time, they apparently attempted some such distinction, by having three types of confirmations: one for exchange transactions, another for those executed over-the-counter, and a third for those in which they acted as dealers rather than brokers. They later failed to distinguish between the last two types of transactions, at least on the confirmations. [FN 105]

The practice of confusing the two lines of business apparently is not of recent origin. As long ago as 1831 the House of Lords condemned it in no uncertain language. The case [FN 106] involved an action in equity for a rescission by customer against broker. There were many transactions involved. But one in particular is of interest here. The broker Rothschild was the "contractor" for certain Prussian bonds. In advising plaintiff to buy he did not disclose the fact that he intended supplying the bonds from his "own" holdings, as in fact he did. After concluding that plaintiff was entitled to relief, Lord Wynford speaking for the court said:

"I repeat that Mr. Rothschild has only on this occasion followed a practice which I believe has been acted upon in London. It is fit your Lordships should say, in language that cannot be misunderstood, that these practices must not continue to prevail...If one of the parties is in a situation which is not fairly disclosed to the other, which if the other had known he would not have relied on his judgment and advice, nor have acted upon or adopted any act of his, such a transaction ought not to be allowed." [FN 107]

Human nature seems hardly to have changed so much in the last hundred years as to call for a different rule for the market place today.

It could hardly be maintained that customers should be forced to differentiate between functions of security houses. It is difficult to believe that they are sufficiently aware of those differences to make distinctions. At least, when they deal with one who purports to be a broker (as was admittedly the situation in the *Kinney* case) it is impossible to justify a presumption that they should know he

may also be a dealer and trade with them as such. Accordingly if a security house, doing business both as brokers and as merchants, fails in its dealings with customers to distinguish clearly between its two lines, the courts should not attempt to make the distinction for them.

Disclosure and the Confirmation

The question of what constitutes disclosure remains. There are not many decided cases ruling on the point. But those that are available are of interest. In some cases the facts producing knowledge on the part of the customer are not completely shown but have been passed on by trial court or jury and bare conclusions stated. Thus in *Schofield v. Jackson* [FN 108] it appeared that defendant was an underwriter of shares of a new issue. Plaintiff knew the stock was not listed but "was an original issue the sale of which the defendant was promoting." The court concludes on all the evidence that plaintiff must have known he was buying defendant's stock. Similar findings were made in *Trowbridge v. O'Neill* [FN 109] and *In re B. Solomon & Co.* [FN 110]

Of more general interest are the cases which involve various types of confirmation, where the broker contends that the content of the confirmation is notice and full disclosure of his adverse interest. Confirmations used by brokers and dealers were described in the early part of this article. [FN 111] Assume that the only evidence of disclosure is the "sold to you" confirmation. Is that sufficient? It would seem that it is not, and for the following reasons. It is doubtful if a customer would be conscious of the distinction being drawn between his particular transaction and other transactions. His attention would be drawn primarily to the fact that the purchase had been consummated and to the debit item appearing. Furthermore it is unlikely he would be thinking in terms of the form of contract he had made. His contract had been effected earlier when he gave the order. He would accordingly tend to treat the confirmation as a formal memorandum of the deal rather than as an explanation and description of the kind of contract he had made. [FN 112] He need have the discernment of a merchant or a broker to realize the import of the news being transmitted to him. Further, if such dual positions of brokers are to be sanctioned and approved it seems that the disclosure should be obvious and unambiguous. As recently stated by Mr. Justice Cardozo: "If dual interests are to be served, the disclosure to be effective must lay bare the truth, without ambiguity or reservation, in all its stark significance." [FN 113]

The cases, though extremely few in number, are in accord. The leading one is *McNulty v. Whitney* [FN 114] recently decided by the Supreme Judicial Court of Massachusetts. That was an action by a customer, *inter alia*, for rescission, in a case in which the broker elected, on an over-the-counter transaction, to act as a dealer (as described above [FN 115]) and in which there was a question whether

the plaintiff had notice of defendant's position in the transaction. From a judgment for plaintiff on a jury trial the case was brought up on defendant's exceptions. Though a number of points were involved there is but one of interest here. The Supreme Court ruled that the jury could have found that plaintiff was not told and did not know that "unlisted securities" were sold directly by defendants to their customers. The shares in question were unlisted. The confirmation slips used by defendants for listed securities said "bought for your account and risk"; for unlisted securities "sold to you." Plaintiff received the latter type of confirmation and noted that there was no commission charged. He inquired of defendants why there was no commission and wondered if there had not been some mistake. The evidence as to whether plaintiff was informed that defendants were acting as dealers was in dispute but plaintiff testified that the answer to his inquiry was: "That is all right. Never mind. That is all right now. We didn't charge any commission." [FN 116] Defendants contended that plaintiff, as a matter of law, had notice they were selling him their own shares, and, therefore, he could not rescind on that ground. This court, however, held that the trial judge was justified in not ruling that the confirmation slips were notice to him that the defendants were selling their own stock. The court went on to say of these slips:

"They were not part of the original contract. *Leviton v. Bickley, Mwndeville & Wimple, Inc.*, 35 Fed. Rep. (2d) 825, 826. To maintain the contention that they bound the plaintiff with knowledge that he was buying the defendants' property, it must appear not only that he read or should have read them but also that if read they would give him notice of a direct sale. The absence from the slips of a charge for commission could not be ruled to be notice of a direct sale, especially in view of the answer received by the plaintiff when he directed the attention of the defendants' agent to this omission. It cannot be said as matter of law that the words "Sold to" on the slips concerning the stock in question, either when the slips are considered by themselves or in connection with other slips representing purchases by the defendants as brokers, bound the plaintiff with notice that the defendants were selling him their own stock. See *Metcalf v. Williams*, 144 Mass. 452, 454; *Greenburg v. Whitney*, 245 Mass. 303, 306. The words are not necessarily inconsistent with the interpretation that the brokers were selling property of another customer as in *Hall v. Paine*, 224 Mass. 62, 74, 76. It was for the jury to say under all the circumstances whether the confirmation slips were notice to the plaintiff that he was buying directly from the defendants, or should have put him upon inquiry to ascertain if that was so. *Picard v. Beers*, 195 Mass. 419, 428." [FN 117]

The same result was reached in *Williams v. Bolling* [FN 118] where rescission was allowed by the customer eight years after the transaction. In contrast to the *McNulty* case this involved a problem arising out of an original distribution of securities. Plaintiff, a customer, sued defendants, brokers, for rescission of sales and purchases of certain stocks and bonds by plaintiff. Plaintiff resided in another

city and corresponded with defendants over a long period of time seeking their advice on investments. The letter from defendants preceding the transactions recommended sale of certain stock at the market and purchase, with the proceeds, of bonds and other stock at a stated price "in the banker's syndicate." It may be inferred that defendants "owned" or were committed for the bonds and stock they were selling. Upon order to consummate the transactions as recommended, defendants wrote plaintiff confirming the sales and purchases.

There was nothing to indicate that the sale of stock had been other than a brokerage transaction, but in fact they purchased for their "own" account. The price allowed for this stock was shown to have been above the current market price. In the sale of bonds and other stock, however, no commission was charged. The price was the list price of the securities "in the bankers' syndicate." The confirmation read "we have today sold you." Accompanying the confirmation was a letter saying "we have sold for you" the stock and "charge you by the cost of" the bonds and other stock. The letter also said: "We have given you this participation in the Bankers' Syndicate..." Judgment for plaintiff was affirmed. The court made the following points: (1) In order to rescind plaintiff need not show any damage suffered; the breach of fiduciary duty is sufficient. [FN 119] (2) Plaintiff had no knowledge that defendants were purchasing the stock for themselves or "owned" any of the bonds and other stock plaintiff acquired. (3) The reference in the letter of the bonds being "in the banker's syndicate" did not apprise plaintiff that he was buying defendants' bonds. (4) The confirmation stating "Sold you" was not sufficient notice. [FN 120] On this point the court remarked that plaintiff did not notice the language of the confirmation until the case was being prepared for trial. The court also said:

"In view of the fact that the letters were the source to which the appellee would naturally look for information which the appellants might have sought to convey to him on the subject of the transaction, rather than the memorandum, which he would naturally infer had reference to the same and not to a different transaction from that which was the subject of the mutual correspondence, we do not think that the contents of the memorandum, when reasonably construed along with the letters...and in the light of the other evidence disclosing the mental attitude of the appellee, can be said to have been such that it ought to have attracted the attention of the appellee at the time it was received...or it should have conveyed to him the aforesaid meaning which appellants claim it should have conveyed, and which they thought that it and their letters did convey." [FN 121] The court went on to say that for the communication to be held to convey by inference the information "the inference must be so obvious that it is apparent" that the other party "willfully shut his eyes to what he might readily and ought to have known."

(5) The absence of a commission on the memorandum was not notice to plaintiff, the court concluding that plaintiff would naturally expect such information to

appear not there but in "an account rendered." [FN 122] It is apparent that the peculiar facts of the case make it somewhat pathological. The purchase of the stock by defendants was clearly voidable. That was so intimately connected with the sale of the bonds and other stock to plaintiff that perhaps it colored the whole transaction in the eyes of the court. That factor, however, was not emphasized by the court. Nevertheless, the case is not such persuasive authority as it would be were the sale to plaintiff of the bonds and other stock divorced from the purchase by defendants of the stock. [FN 123]

Another case of interest is *Sutro v. Jacobson*, [FN 124] where plaintiff acquired for the defendant securities which were in process of original distribution. Plaintiff obtained these securities from the syndicate at the list price, below which neither he nor the defendant could at the time have obtained them from the syndicate or in the open market. Plaintiff was allowed by the syndicate a concession which was not reallowed to customers. It was held [FN 125] that this "was not a secret profit to the injury of the defendant." The nature and conditions of this "secret profit" do not appear from the brief report of the case. It might be assumed that it was merely a dealer's reallowance (mentioned above). [FN 126] If it involved market protection or syndicate membership, however, the adverse interest of the plaintiff might be involved. The court states further, however, that defendant "also knew that the plaintiffs were obtaining these subscriptions for the syndicate." With disclosure indicated, the circumstances of the case are far removed from those in the *Kinney* case.

What bearing do these cases have on the *Kinney* case? The confirmation there read:

We take pleasure in confirming sale to you today of 500 shares Consolidated Automatic Merchandising Corporation

Pfd. @ 35 1/2.....	\$17,750.00
Plus Commission.....	75.00
	\$17,825.00

Not only was there no evidence that the words "sale to you" conveyed any special significance to plaintiff, but there was every indication that they meant something different to defendants than their recognized import in the investment and brokerage business, judged either by the evidence in such cases as *Williams v. Bolling* or *McNulty v. Whitney* or by an independent survey of customary usages. Further the case is weaker for defendants than the *McNulty* case. The presence on the confirmation slip of a \$75 commission charge certainly would not raise the doubts which might well be raised if no commission were charged. By being greedier than defendants in the other cases can the defendants acquire more effective insulation from liability? Is it possible that the degree of fiduciary

duty decreases as the undisclosed avails are increased by a disclosed commission? Of course the presence of commission charges is an earmark of the "agency" relation. [FN 127] It would appear as a part of the normal bilateral contract between customer and broker. Accordingly its presence would tend to confirm that the parties (so far as they could be said to advert to such distinctions) were thinking in terms of a normal brokerage transaction. In that event the case for plaintiff would be even stronger. It could not be argued (in terms of the confirmation above) as it was in the *McNulty* case that the parties were dealing as customer and merchant or vendee and vendor. As they purport to act as customer and broker or as "principal" and "agent" (as admitted by defendants) they have by their own admissions classified themselves in a legal category where the strictest rules of fiduciary duty come into play. There is no clearer case of "blowing hot and cold" at the same time than defendants' assertion that they were "agents" of plaintiff—*ergo* they might obtain a commission from him in addition to a secret profit in the form of a dealer's concession. It is not so strange that counsel for defendants took that line of attack. Perforce, it was about the only one left open for them. It would have been difficult to sustain the proposition that defendants were "principals" acting at arm's length in face of the commission, strong evidence of the assumption of a brokers "agency" activities. But the surprising thing is to find a distinguished court allowing them to be extricated from the difficulties engendered by their greed by such specious reasoning. [FN 127a]

Remedies

One might well agree that defendants had not acted in good faith and had breached the confidence and trust of plaintiff and be reluctant to go so far as to invoke the remedy of rescission sought by plaintiff. On this point the Appellate Division said:

"The taking of a secret profit by a broker does not make him in law the purchaser of the stock or committed therefor, at least so far as his customer is concerned. In such case the customer is injured in the amount of the undisclosed vails acquired by the agent, and in a proper action he may recover them. (*McMillan v. Arthur*, 98 N. Y. 167; 3 Suth. Dam. [4th ed.] 2927; 1 Clark N. Y. *Law of Damages* 530.)...

"It scarcely need be said that the action is not based upon a claim that defendants were employed by the sellers of the stock unknown to the buyer (*McMillan v. Arthur*, *supra*, 169) in which case the customer could rescind (*Cannell v. Smith*, 142 Penn. St. 25; 12 L. R. A. 395, and note) or keep the property and recover the commissions on the ground that the broker breached the contract and, therefore, did not act as his agent. (*Roche v. Smith*, 176 Mass. 595; 51 L. R. A. 510; *Little v. Phipps*, 208 Mass. 331; 34 L. R. A. [N. S.] 1046). Of course if he elected to rescind, his action would have to be against the seller; it

would not lie against the broker, for he would not be the selling owner but his agent. (Williston Cont. § 1532.) [FN 128]

First, as to the suggestion that plaintiff may recover in a proper action the amount of the secret profits. This seems clear. As commonly expressed, a person in plaintiff's position has the power to affirm and ratify the transaction and he thereupon may sue for damages. [FN 129] Those damages may be measured (in cases where the "agent" has sold his "own" property to his "principal") by the secret profits [FN 130] or by the difference between the price the plaintiff paid and the market price on the day of the purchase. [FN 131] In case the plaintiff grounded his claim on his own losses the latter would be the measure and accordingly the damages might be only nominal. [FN 132] In case plaintiff sued on such a theory in the *Kinney* case it is doubtful if greater recovery would be allowed. [FN 133] If the brokerage fee and the secret profits were considered as dual commissions it is clear that plaintiff could recover the former [FN 134] and even the latter. [FN 135]

The uncertainty arises in the court's statement of the rule respecting rescission. Of course if defendants had acquired possession of the shares and paid the price before plaintiff's order was given them, there would be no doubt that an action for rescission would lie. And likewise it would lie on the basis of the analysis presented above which does not accept a standardized, simple meaning of "ownership" but defines it in light of the manner of the constitution of the inventory of a merchant and the presence and dominance of an adverse interest.

But assume with the court that there was no "ownership." Also assume that defendants may have been distributing the stock of "another." Is the statement of the court consistent with legal precedent?

A resume of some of the major decisions shows several factual situations. One is as follows: P authorizes A to sell a plot of land for a price stated. A by fraudulent misrepresentations obtains T's promise to purchase for the price. The contract is drawn by A between T and P. The transaction is consummated and T discovering the fraud brings a bill in equity against A for rescission, tendering the deed and asking for restoration of the purchase price. The prevailing view seems to be that the action lies. Perhaps the leading case so holding is *Peterson v. McManus*. [FN 136] The court said:

"Speaking concretely, and on the assumption that fraud and duress are akin, we hold that, where an agent, by actual fraud, obtains money, he may be made to restore it in a suit to rescind, though he is not a party to the contract, and though he has turned the money over to his principal. If this were not so, an agent needs but to serve a principal who lives in a remote part of Africa, and upon whom it is difficult to make service, because he can be served in Africa only, and so make

himself safe, if he transmit the money to his principal before the victim can seize it. The whole of the argument for appellant overlooks that, while rescission is the remedy sought here, the ground for seeking that relief is the tort of McManus. The right to rescind has no support unless what was obtained was parted with because of the fraud of McManus. *It does not matter he is no party to the contract, or that he obtained no personal advantage by the transaction.* If his fraud deprived the plaintiff of property, that fact alone supports a judgment that McManus restore this property. The rule of agency invoked by the appellant has its place in the law of contracts, but not in the law of torts." [FN 137] (Italics ours.)

The theory seems to be that repudiation of the payment on the ground of fraud gives the defrauded party a right to receive back that payment from the person who got it from him or induced him to part with it. [FN 138] In other words repudiation of the *payment* is one thing; repudiation of the *contract* another. Though A is not liable on the contract, he is for *fraud*. And the measure of recovery for fraud is not restricted to damages.

Other courts hold to the contrary, [FN 139] restricting the remedy against A to damages suffered and holding that restoration of the subject matter of the bargain must be obtained from the other contracting party, P. While the lower New York courts have been divided on the point, [FN 140] there is strong indication from the Court of Appeals that the latter is the view of that court.

Thus, in *McMillan v. Arthur*, [FN 141] cited by the Appellate Division, defendant (who apparently was not a broker) called upon plaintiff at his office and informed him that he knew where he could buy for plaintiff a quantity of stock of a certain company at \$9 a share and that he could not get the same for any lower price. Plaintiff told defendant he might buy the stock for him. Defendant procured the certificates and delivered them to plaintiff who paid the price (apparently to defendant). Subsequently under similar circumstances plaintiff made two other purchases at \$8 a share, defendant telling him that that was the lowest price and at the time of the last purchase that defendant had no interest in the stock. Apparently defendant charged plaintiff no commission but as represented, acted out of friendship for him. It appeared that one Hyde "owned" the stock and agreed with defendant that he would receive as his compensation one-half of any amount he realized on the stock over and above \$5 a share. Of this plaintiff was ignorant. Plaintiff brought an action in rescission to recover the entire purchase price with interest. The trial court found that defendant acted as "agent" of Hyde; that he did not act as "agent" of plaintiff; that the contract of purchase was between plaintiff and Hyde; that there was no relation of trust or confidence between plaintiff and defendant; that the rule of *caveat emptor* applied. Judgment was for defendant. This judgment was affirmed by the Court of Appeals. The court, assuming that defendant was agent of plaintiff, said:

"The contract of purchase made with Hyde, the vendor of the stock, was precisely the contract which plaintiff authorized his agent to make, and the principal could not, therefore, rescind that contract by reason of any fraud perpetrated upon him by his own agent, to which the vendor was not a party. Upon the execution of that contract the title to the stock vested in the plaintiff, and there is no principle of law upon which he could compel the agent to assume its ownership and stand the hazard of the speculation." [FN 142] (Italics ours.)

The court went on to say that the rule of damages would be what plaintiff "actually suffered from the fraud." This would "not necessarily or probably be the price paid for the stock," but the "enhanced price" paid over what the stock could have been purchased for or at least the secret profits of the "agent."

The court remarked, however, that *the evidence and findings of the court below showed that defendant was not the agent of plaintiff.* The ruling on rescission against the "agent," where he is not a party to the contract of purchase and sale, may not then be a square holding. But it seems to represent the view of the Court of Appeals. [FN 143]

But brokerage transactions usually are not cast into that mold. The person who sells does not contract directly with the purchaser. The contracts are made between broker and customer and between broker and broker. [FN 144] In the bilateral contract between customer and broker described above there are no other parties but the two. Perhaps the customer under certain circumstances might have an action against the unnamed "principal" of the broker. [FN 145] But that would not impair the broker's own obligation on the contract which he has made with the customer, any more than it would in case any other person contracts in his own name but in fact is acting for another. [FN 146] We have here then a valid subsisting contract between plaintiff and defendants. Those who are contracting parties should take the liabilities of the contract as well as the benefits. One of those liabilities should be the power of the promisee to rescind for the fraud of the promissor.

The cases hold that where an "agent" acting for an undisclosed "principal" has made the promise he is liable in such action. [FN 147] As stated by the court in *Kerr v. Simons*: [FN 148]

"An agent contracting in his own name cannot escape liability, when sued on the contract, by pleading that he acted for another. This was an oral contract and the evidence justified a finding that defendant made it in his own behalf, he not disclosing or pretending to act for the bank. One acting for an undisclosed principal binds himself...*The remedies upon such a contract must necessarily be the same as upon any other contract, one of such remedies being an action for rescission.*" [FN 149] (Italics ours.)

Of course there are differences between the promise of the "agent" in such case and the promise of defendants in the brokerage transaction. In the first place the former would usually be an unconditional promise to deliver a commodity. In the brokerage case it is not; for, as we have seen, there is only a commitment to use reasonable efforts to find sellers, to acquire stock if found, and to deliver that acquired. But that should make no difference. [FN 150] It is the completed performance which plaintiff is seeking to rescind. The obligation to deliver matures when stock is acquired. The broker's obligation by the terms of the contract is then as absolute and unqualified as the promise in the other cases allowing rescission against the "agent." The differences in the contracts in the two thus seem to be unsubstantial. Any difference would, of course, vanish if in both cases there were unilateral contracts. In each, acceptance would be the act of acquiring the securities at the price stated.

In the second place, the broker acts for an unnamed as distinguished from an undisclosed "principal." And the general view seems to be that rescission lies against such "agent" for a cause existing at the consummation of such transaction to the extent that the "agent" has not before notice of rescission and in good faith changed his position. [FN 150a] It would be impossible, however, to classify defendants in the *Kinney* case as innocent "agents" within that exception. Furthermore, it is one thing to refuse to place on an "agent" the hazards of a contract to which he was not a party. It is quite different to make him bear the burdens of the contract where he has promised performance and where that performance is vitiated by his own fraud. In the latter case there is not the enlargement of risks which there is in the former. Accordingly the apparent view of the Court of Appeals that rescission for fraud does not lie against the "agent" who is not a party to the contract should not be extended to the case where he is.

Moreover, as has been seen, the *Kinney* case does not involve a simple factual pattern establishing clearly the relationship of "principal" and "agent" between defendants and F. J. Lisman & Co. [FN 150b] To deny recovery for the reasons given is to assume that F. J. Lisman & Co. were "principals" (a matter not litigated, and by no means clear) or to require extended litigation to prove that the defendants were "agents" of F. J. Lisman & Co. rather than "independent contractors" or "vendees." It would be one thing to deny recovery against the "agent" of a disclosed or unnamed "principal" whether or not the "agent" is a party to the contract. It is quite another to disallow recovery against an alleged "agent" in such case where the existence of the "principal" is as doubtful as it is in the *Kinney* case. In contrast to the difficulty of proving that relationship is the ease of demonstrating that defendants had acted in the manner peculiar to dealers and merchants and therefore, as the trial court ruled, had become "principals" in the transaction. Accordingly, it seems clear that the remedy of rescission should be as available here as it is in the foregoing cases where an

"agent for another" gives his promise or where a broker sells, without disclosure, his "own" shares to his customer.

The question remains, should rescission be allowed in cases involving stocks subject to violent fluctuations in market price? It may be argued that to do so is to impose extremely harsh penalties—more harsh than an equitable adjustment might seem to demand. There are several answers to this. In the first place no exception has ever been carved out for such cases. The books are full of cases of rescission against stockbrokers, some of which, as we have seen, allow the action many years after the transactions were consummated. [FN 151] And they are not by any means cases where the defendants were crooks or glaringly fraudulent. The slightest evidence of over-reaching has imposed the penalty, even where apparently no damage was suffered. This being true it is not inconsistent with precedent to impose such penalty in the *Kinney* case. In the second place, the difficulty of assessing damages in the *Kinney* case and cases like it must not be overlooked. As noted above it is impossible to determine *ex post facto* the factors entering into the judgment to buy. The persuasion of the defendants, however direct or subtle, is difficult to measure. There is then considerable wisdom in applying a somewhat rough and ready rule of thumb and recreating (so far as may be) the situation as of the time of the original bargain. It may be that considerations such as these have led the courts to invoke the remedy of rescission without regard to actual damages and irrespective of the "abstract justice" in a particular case. The difficulty of evolving exceptions which can be applied as workable rules of law by courts and juries may well result in refusal to let borderline cases fall without the rule for fear of the influence of a "disintegrating erosion."

Any rule of rescission is going to operate where there is a falling market. [FN 152] Those who sue are going to give the appearance of sliding out from under bad bargains. But that factor, so far as appears in articulated reasons of courts, has never deterred the undoing of a fraudulent act; has never lowered the standards of conduct for fiduciaries; has never restrained the hand of equity. Reasoning then from precedent alone it is impossible to differentiate the *Kinney* case from dozens of others decided differently by courts of great repute. It would be difficult to justify differences in legal rules by degrees of downward market fluctuations resulting from either changes in the value of a particular security or from general market declines.

And finally, the penalty would not be difficult to avoid. It should be no great effort to be fair and straightforward. At the very least, [FN 153] confirmation slips can be made more informative, raising flags of warning when equity and fair dealing demand it. Such practices as prevailed in the *Kinney* case can bring but disrepute to the business. The professionalization and prestige of security houses can be increased and furthered only by the higher standards of business

which the trial court sought to impose. They cannot be by the continuance of the practices which the Appellate Division and the Court of Appeals approved.

Conclusion

Though the specific problem involved in the *Kinney* case arose out of secondary distribution of securities, it is not necessarily peculiar to that. It might arise either on original distribution or (no doubt more often) on redistribution. In these three processes there is apt to be present a dealer's guarantee of investment placement.

The problem is one of readjusting old rules, evolving from a simpler (or at least a different) order, to these newer practices and customs. That calls for appreciation and appraisal of the marketing devices and procedures employed, their peculiarities and differences as well as the features common to them all. When that is done in the *Kinney* case it aids materially in dispelling much of the magic in the word "own," of reducing it to terms of adverse interest, and in turn of redefining that in light of varying and almost endless factual situations. Such analysis makes it extremely difficult to justify on any rational or pragmatic basis the lower standard of fiduciary duty permitted in the *Kinney* case for brokers who, unknown to their clients, act as security merchants in the transaction but who may not carry inventories.

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* *Everhart v. Searle*, 71 Pa. 256, 259 (1872).

[FN 1] 136 Misc. 301, 240 N. Y. Supp. 713 (1930); rev'd, 231 App. Div. 311, 247 N. Y. Supp. 119 (1931); aff'd, 257 N. Y. 560, 178 N. E. 795 (1931).

[FN 2] 136 Misc. at 304, 240 N. Y. Supp. at 717.

[FN 3] 231 App. Div. at 312-13; 247 N. Y. Supp. at 120.

[FN 4] *Supra* note 1.

[FN 5] Record, pp. 108, 109, 110. The record referred to throughout is the record on appeal to the Court of Appeals.

[FN 6] Record, pp. 85, 86.

[FN 7] POOR'S, Industrial Section—1930.

[FN 8] (1928) 126 COMMERCIAL & FINANCIAL CHRONICLE [hereafter cited CHR.] 3761.

[FN 9] (1928) 126 CHR. 3933.

[FN 10] (1928) 127 CHR. 176.

[FN 11] (1928) 127 CHR. 686.

[FN 12] Wall Street Journal, Aug. 6, 1928, at 7.

[FN 13] Wall Street Journal, Aug. 7, 1928.

[FN 14] Listing Bulletins No. 174, New York Curb Market, Aug. 8, 1928.

[FN 15] Record, pp. 55, 56, 57.

[FN 16] Record, pp. 74, 75, 157, 158.

[FN 17] Record, p. 57.

[FN 18] SECURITY DEALERS OP NORTH AMERICA (1929 ed.).

[FN 19] Record, p. 193.

[FN 20] Record, p. 152.

[FN 21] (1928 and 1929) CHRONICLE, Bank & Quotation Supplements.

[FN 22] PITCH, REPORT OF SALES OF NEW YORK CURB MARKET.

[FN 23] *Ibid.*

[FN 24] *Ibid.*

[FN 25] (1928 and 1929) CHRONICLE, Bank and Quotation Supplement.

[FN 26] Boston News Bureau, Feb. 1 and 14, 1929.

[FN 27] Record, pp. 59, 60, 63, 140, 195.

[FN 28] Those 200 shares were sold for the plaintiff above the "protected price," so the penalty of commission refund must have been incurred in some later transfer, presumably in March, 1929. There is the possibility, however, that the manager of such an account might actually repurchase above the "protected price" and still penalize the dealer if the market price fell below the "protected price" during the sixty day period.

[FN 29] Record, pp. 150, 163.

[FN 30] Record, pp. 60, 142, 158, 175, 176.

[FN 31] Record, pp. 60, 74, 77, 142, 143, 187. The trial court found defendants were so instructed. Record, p. 19. This finding was disapproved and reversed by the Appellate Division. Record, p. 205.

[FN 32] Record, p. 142.

[FN 33] Record, p. 164.

[FN 34] Record, pp. 165, 166, 167. The Appellate Division found that the stock "could not have been purchased on said day at a better, that is, a lower price." Record, p. 208.

[FN 35] Record, pp. 64, 65, 80.

[FN 36] Record, p. 140.

[FN 37] Record, pp. 65, 66, 67, 68, 69, 180.

[FN 38] Record, pp. 71, 72, 96, 97, 98, 141, 178.

[FN 39] Record, pp. 70, 83, 85, 88. See N. Y. PENAL LAW (1913) § 957.

[FN 40] Record, pp. 70, 71, 196, 197.

[FN 41] Record, pp. 71, 198.

[FN 42] (1928) 127 CHR. 957, 125T, 1394, 1531, 2094, 2827.

[FN 43] (1929) 128 CHR. 734, 1234.

[FN 44] (1929) 128 CHR. 1912, 2636, 2814, 2999, 3357, 4162; (1929) 129 CHE. 133, 286.

[FN 45] (1929) 129 CHR. 637.

[FN 46] (1928) 127 CHR. 3096.

[FN 47] (1929) 129 CHR. 1129.

[FN 48] (1929) 129 CHR. 1288.

[FN 49] (1929) 129 CHR. 1447.

[FN 50] (1930) 130 CHR. 4056.

[FN 51] (1930) 131 CHR. 3211.

[FN 52] (1931) 132 CHR. 4063.

[FN 53] (1931) 133 CHR. 127.

[FN 55] See *Markham v. Jaudon*, 41 N. Y. 235 (1869). *Cf. Norton, A Simple Purchase and Sale Through A Stockbroker* (1895) 8 HARV. L. REV. 435, 443 *et seq.*, for the view that the contract is unilateral. The difficulty is suggested that an offer for a bilateral contract must be accepted and that acceptance must be communicated; that therefore where a customer at a distance writes the broker to buy a specified number of shares at a price stated and the broker does not reply there is no bilateral contract. While it is true that acceptance in bilateral contracts requires communication [WILLISTON, *CONTRACTS* (1920) § 70] nevertheless silence and inaction may amount to assent [WILLISTON, *op. cit.* §§ 91 *et seq.*]. Accordingly if the customer had been customarily dealing with the broker by correspondence and the practice had been for the broker to undertake to execute the order without communicating with the customer until the sale or purchase had been consummated it might well be held that such silence constituted an acceptance. *Cf. Galigher v. Jones*, 129 U. S. 193, 9 Sup. Ct. 335 (1889); MEYER, *THE LAW OF STOCKBROKERS AND STOCK EXCHANGES* (1931) § 44. At least it would seem to be a question for the jury. The rights of the broker against the customer therefore might not be altered whether the contract is bilateral or unilateral. *Cf. McDonald v. Boenig*, 43 Mich. 394, 5 N. W. 439 (1880) (real estate "agent"). Obviously the same is not true as respects the rights of the customer against the broker.

[FN 56] See *Markham v. Jaudon*, *supra* note 55; Guthrie and Tenney, *Some Legal Problems Connected with Stock Market Transactions* (1930) 29 MICH. L. REV. 41, 58; MEYER, *op. cit. supra* note 55, at 312, *et seq.*; DOS PASSOS, *STOCK-BROKERS AND STOCK-EXCHANGES* (2d ed. 1905) c. III.

[FN 57] *Wahl v. Tracy*, 139 Wis. 668, 121 N. W. 660 (1909); *Isham v. Post*, 141 N. Y. 100, 35 N. E. 1084 (1894), s. c., 167 N. Y. 531, 60 N. E. 1113 (1901); *Sledge & Norfleet Co. v. Mann*, 166 Ark. 358, 266 S. W. 264 (1924). And see MEYER, *op. cit. supra*, note 55, at § 47; *Packham v. Ketchum*, 5 Bosw. 506, 513 (N. Y. 1859). On discretionary accounts see *Cohen v. Rothschild*, 182 App. Div. 408, 169 N. Y. Supp. 659 (1918); MEYER, *op. cit. supra* note 55, at § 62. The requirement that the broker use due skill and care is frequently referred to as if it arose out of his relationship as "agent" to the customer and was superimposed on the contract that was made. *Cf.* MEYER, *op. cit. supra* note 55, at §§ 39, 40, 47. In imposing this requirement, however, it does not seem that courts are first establishing a "relationship" and then out of the thin air of "ought" and "should" making duties. Rather, it seems that the requirement of due skill and care is spelled out from the usual implied in fact agreement or understanding of the parties. One selecting another to do an act for him determines the choice at least in part in light of his reliability and integrity.

[FN 58] See *Rubino v. Scott*, 118 N. Y. 662, 23 N. E. 1103 (1889); *Briggs v. Boyd*, 56 N. Y. 289 (1874); *C. C. Jones Investment Co. v. Lowrey*, 99 Kan. 87, 160 Pac. 999 (1916); MEYER, *op. cit. supra* note 55, at § 113; DOS PASSOS, *op. cit. supra* note 56, at 394 *et seq.* As to the effect of the rules of the stock exchange see generally MEYER, *op. cit. supra* note 55, at § 27; DOS PASSOS, *op. cit. supra* note 56, c. IV; *Bibb v. Allen*, 149 U. S. 481, 13 Sup. Ct. 950 (1893); *Clews v. Jamieson*, 182 U. S. 461, 21 Sup. Ct. 845 (1901); MECHEM, AGENCY (2d ed. 1914) §§ 2393 *et seq.* See also *infra* note 113.

[FN 59] The result is frequently referred to as as the broker's right to indemnity and reimbursement. *Knapp v. Simon*, 96 N. Y. 284 (1884). Or the relationship is described as that of creditor-debtor. *Markham v. Jaudon*, *supra* note 55; *Richardson v. Shaw*, 209 U. S. 365, 28 Sup. Ct. 512 (1908); *Skiff v. Stoddard*, 63 Conn. 198, 26 Atl. 874 (1893).

[FN 60] See, e.g., *Knapp v. Simon*, *supra* note 59.

[FN 61] See *supra* note 58; MECHEM, *op. cit. supra* note 58, §§ 2424 *et seq.*

[FN 62] See *supra* note 57; *Minnear v. Gay*, 217 Mass. 403, 104 N. E. 961 (1914); and see *Liberman v. McDonnell*, 97 Gal. App. 171, 275 Pac. 486 (1929). But he is not liable for the negligence of intermediate agencies such as the delay of the transfer agent in transferring the share to the customer. *Eddy v. Schiebel*, 112 Conn. 248, 152 Atl. 66 (1930). See MECHEM, *op. cit. supra* note 58, § 2410. Similarly, the customer may sue for money had and received where the purchases effected were fictitious. *Todd v. Bishop*, 136 Mass. 386 (1884); *Prout v. Chisolm*, 21 App. Div. 54, 47 N. Y. Supp. 376 (1897). And see *Pugh v. Moore*, 44 La. Ann. 209, 10 So. 710 (1892).

[FN 63] See *Markham v. Jaudon*, *supra* note 55; *Richardson v. Shaw*, *supra* note 59; *Skiff v. Stoddard*, *supra* note 59; MEYER, *op. cit. supra* note 55, § 41.

[FN 64] The issue frequently arises on the bankruptcy of the broker where the customer seeks to reclaim the securities from a marginal account. See cases *supra* note 59; *Guthrie and Tenney*, *op. cit. supra* note 56; *Oppenheimer, Rights and Obligations of Customers in Stockbrokerage Bankruptcies* (1924) 37 HARV. L. REV. 860. Or where the customer sues in conversion alleging sale by the broker without notice. *Covell v. Loud*, 135 Mass. 41 (1883); *Markham v. Jaudon*, *supra* note 55. And see *Horton v. Morgan*, 19 N. Y. 170 (1859). Or where the broker sues for the price, the customer's defense being that the delay of the transfer agent is imputable to plaintiff. *Eddy v. Schiebel*, *supra* note 62. For the minority view that the relation of pledger-pledgee is not created see *Covell v. Loud*, *supra*; *Weston v. Jordan*, 168 Mass. 401, 47 N. E. 133 (1897); *Chase v. Boston*, 180 Mass. 458, 62 N. E. 1059 (1902) (broker liable for tax as "owners"). See MEYER, *op. cit. supra* note 58, §§ 2385 *et seq.*; and Note (1926) 41 A. L. R. 1258. It has been held that where the contract between customer and broker was that of vendee-vendor, without more, the rule as to pledges does not apply. *Sackville v. Wimer*, 76 Colo. 519, 233 Pac. 152 (1925).

[FN 65] *Liberman v. McDonnell*, *supra* note 62; *Crusius v. Loucheim*, 132 Misc. 520, 230 N. Y. Supp. 218 (1928). And see *Ackerman v. Dick*, 143 App. Div. 310, 128 N. Y. Supp. 603 (1911).

[FN 66] *Liberman v. McDonnell*, *supra* note 62; *Crusius v. Loucheim*, *supra* note 65. Likewise the broker is not liable to the customer for delay in transferring the stock to the customer so as to make it available for delivery where such delay was due to the negligence of the transfer agent. *Eddy v. Schiebel*, *supra* note 62. And see *Peckham v. Ketchum*, *supra* note 57, where an action by customer against broker to recover back the purchase price was disallowed. The certificate issued, and delivered to plaintiff did not represent actual stock and was valueless. Defendants exercised good faith and there was no evidence of lack of diligence on their part. In rendering judgment for defendants the court said (p. 512): "A party who deals with another, or employs another avowedly as an agent, to make a contract with some one who he consents shall remain unknown at the time, cannot have a better right against the agent than if the principal had then been disclosed." And again (p. 513): "I do not think that the employment of the defendants...can justly be treated as an employment to purchase genuine stock, to the extent and import of making them guarantors of the validity of that which they should purchase. It was rather to purchase what in the market was passing as stock of this description...Then the rule of indemnity to the agent when the principal is a seller, involves the exemption of the agent from responsibility, when, under similar circumstances, the principal is the purchaser."

"Again, an agent employed to purchase a commodity of a particular character or quality, is only bound to use all the circumspection and diligence which a prudent purchaser himself would exercise."

[FN 67] *Crusius v. Loucheim*, *supra* note 65; *Lieberman v. McDonnell*, *supra* note 62.

[FN 68] *Lieberman v. McDonnell*, *supra* note 62; *Crusius v. Loucheim*, *supra* note 65. In *Lieberman v. McDonnell* the court said, 97 Cal. App. at 178, 275 Pac. at 489: "Undisputed evidence shows that according to these rules [New York Curb Market] members deal with one another as principals, and such is the general rule among brokers in transactions on the floor of the exchange, their principals not being disclosed... This, however, does not change the relation between the broker and his principal. As to the latter he is still an agent... and the effect of the above rule or custom, which was designed to facilitate the business of the exchange, is not to constitute the broker a purchaser from his principal." And see *Knapp v. Simon*, *supra* note 59, holding that as respects the broker's right of indemnity or reimbursement from the customer it is immaterial that in the same transaction he may have been regarded by certain parties as the "principal in the transaction."

[FN 69] The nature of the performance promised by a promisor is frequently tested in terms of "agent" or "independent contractor," "agent" or "vendor" etc. Thus in *Lawrence Fertig Co., Inc. v. Klein*, 135 Misc. 547, 239 N. Y. Supp. 96 (1930), plaintiff, an advertising agency, sued a customer for the amount of advertising furnished, which plaintiff was required to pay on defendant's behalf. The defense was that defendant's advertisement had not been placed in the number of publications agreed upon. In reversing judgment for defendant the court ruled that if plaintiff was defendant's "agent," plaintiff was entitled to recover justifiable expenditures; that if plaintiff agreed absolutely to publish defendant's advertising, then plaintiff was an "independent contractor" and the failure of substantial performance was a defense. Similarly in *De Bavier v. Funke*, 66 Hun 633, 21 N. Y. Supp. 410 (1892), *aff'd*, 142 N. Y. 633, 37 N. E. 566 (1894), commission merchants and importers sued to recover damages for failure to accept and pay for a quantity of silk purchased for defendant by plaintiffs. The defense, *inter alia*, was that the purchase was from plaintiffs, that plaintiffs were acting as "principals" and therefore were liable on the guaranty to furnish silk of a certain quality. The jury was given the determination of the question. If plaintiffs were "agents" for defendant, they were under a duty to use reasonable care in carrying out their orders and would not be liable if they used such care. Judgment for plaintiffs was affirmed. And see *Stevenson, Jaques, & Co. v. McLean*, 5 Q. B. D. 346 (1880) and cases *infra* notes 87, 88, dealing with liability of "agents" and brokers as promisors on the contracts they make.

The issue also arises between manufacturer (or wholesaler) and retailer in determination of whether the contract is one of "agency" or "sale," as where the goods in possession of the retailer are destroyed by fire and he is sued for the price, the defense being "agency" or "bailment" [Kingman Plow Co. v. Joyce, 194 Mo. App. 367, 184 S. W. 490 (1916) ; B. F. Sturtevant Co. v. Cumberland Dugan & Co., 106 Md. 587, 68 Atl. 351 (1907) (del credere "agent" under no obligation to insure)]; or where in a suit for the price the retailer defends that he was under no definite commitment to take and pay. W. T. Rawleigh Medical Co. v. Holcomb, 126 Ark. 597, 191 S. W. 215 (1917). Cf. Olsen v. Hoffman, 175 Minn. 287, 221 N. W. 10 (1928).

[FN 70] Hall v. Paine, 224 Mass. 62, 112 N. E. 153 (1916); Maxwell v. Bates, 239 Ky. 600, 40 S. W. (2d) 304 (1931) (where "agent" employed auctioneer and at public auction "without reserve or bid" bid in the property) ; People v. Township, 11 Mich. 222 (1863) ; Meek v. Hurst, 223 Mo. 688, 122 S. W. 1022 (1909); Rich v. Black, 173 Pa. St. 92, 33 Atl. 880 (1896) ; and Note (1929) 62 A. L. R. 63. *A fortiori* where there is evidence of unfairness or fraud. Kiene v. Brownell, 29 Ohio App. 281, 163 N. E. 51 (1927) ; Greenfield Savings Bank v. Simons, 133 Mass. 415 (1882). See generally MECHEM, *op. cit. supra* note 58, §§ 1198 *et seq.* The opposite result is reached where there has been full disclosure. Stauch v. Daniels, 240 Mich. 295, 215 N. W. 311 (1927). For the distinction between actions on a rescission and actions for a rescission, see Heckscher v. Edenborn, 203 N. Y. 210, 96 N. E. 441 (1911); Vail v. Reynolds, 118 N. Y. 297, 23 N. E. 301 (1890). See generally on rescission 4 WILLISTON, *op. cit. supra* note 55, cc. XL, XLI.

[FN 71] Bain v. Brown, 56 N. Y. 285 (1874); Merriam v. Johnson, 86 Minn. 61, 90 N. W. 116 (1902); McNutt v. Dix, 83 Mich. 328, 47 N. W. 212 (1890). Cf. Whitehead v. Lynn, 20 Colo. App. 51, 76 Pac. 1119 (1904). See generally 2 POMEROY, EQUITY JURISPRUDENCE (3d ed. 1905) § 959. And sometimes the commission may also be recovered. (1924) 24 COL. L. REV. 201.

[FN 72] Friesenhahn v. Bushnell, 47 Minn. 443, 50 N. W. 597 (1891); Tewksbury v. Spruance, 75 111. 187 (1874); Montgomery v. Hundley, 205 Mo. 138, 103 S. W. 527 (1907); Armstrong v. Jackson, [1917] 2 K. B. 822; Gillett v. Peppercorne, 3 Beav. 78 (1840) ; Fardy v. Buckley, 231 Mass. 377, 121 N. E. 77 (1918). See MECHEM, *op. cit. supra* note 58, § 1205. The same rule applies to joint adventurers. Heckscher v. Edenborn, *supra* note 70.

[FN 73] Wendt v. Fischer, 243 N. Y. 439, 154 N. E. 303 (1926) (sole stockholder though beneficial interest was in another); Roy Realty Co., Inc. v. Burkhardt, 146 Miss. 270, 111 So. 289 (1927) (as against defense that, since employer said to "sell for \$10,500 or \$10,000 net to me," the "agent" could keep all the excess); Newell-Murdoch Realty Co. v. Wickham, 183 Cal. 39, 190 Pac. 359 (1920).

Likewise where the purchase was made through a "strawman." *Nagle v. McCoy*, 94 N. J. Eq. 790, 121 Atl. 705 (1923) ; *Euneau v. Rieger*, 105 Mo. 659, 78 S. W. 1042 (1891). Or from a "strawman." *Payne v. Adams*, 133 Kan. 643, 3 Pac. (2d) 630 (1931).

[FN 74] *Little v. Phipps*, 208 Mass. 331, 94 N. E. 260 (1911) ; *Erland v. Gibbons*, 176 App. Div. 552, 163 N. Y. Supp. 582 (1917) ; *Everhart v. Searle*, 71 Pa. 256 (1872). And see *Young v. Hughes*, 32 N. J. Eq. 372 (1880). The opposite result is reached where both parties have given assent to the agent acting in such dual capacity. *Bell v. McConnell*, 37 Ohio St. 396 (1881). See generally *MECHEM*, *op. cit. supra* note 58, §§ 1206, 1207; Note (1891) 12 L. R. A. 395; Comment (1928) 28 COL. L. REV. 799; Note (1927) 48 A. L. R. 917. *Cf. Larson v. Thoma*, 143 Iowa 338, 121 N. W. 1059 (1909).

[FN 75] *Balto Sugar Refining Co. v. Campbell and Zell Co.*, 83 Md. 36, 34 Atl. 369 (1896) (rescission); *Alger v. Anderson*, 78 Fed. 729 (C. C. N. D. Tenn. 1897) (rescission); *Smith v. Sorby*, 3 Q. B. D. 552 (1878) (damages breach of contract); *Yeoman v. Lasley*, 40 Ohio St. 190 (1883) (rescission; joint adventure); *Kelsey v. New Eng. Street Ry.*, 62 N. J. Eq. 742, 48 Atl. 1001 (1901) (specific performance); *Panama & South Pacific Tel. Co. v. India R., G. P. & T. Works Co.*, L. R. 10 Ch. App. 515 (1875) (rescission); *City v. Pertz*, 66 Fed. 427 (C. C. A. 6th, 1895) (action for price); *Carr v. Nat. Bank & Loan Co.*, 167 N. Y. 375, 60 N. E. 649 (1901) (rescission).

While the innocent vendor may not be liable in an action for damages for fraud of his agent, he may be liable in rescission on the theory that he cannot retain the benefits of the agent's fraudulent act. *Kennedy v. McKay*, 43 N. J. L. 288 (1881) ; *Ellison v. Stockton*, 185 Ia. 979, 170 N. W. 435 (1919).

[FN 76] *Cannell v. Smith*, 142 Pa. 25, 21 Atl. 793 (1891) (no error to exclude evidence that sale price was higher than value of the property); *Jansen v. Williams*, 36 Neb. 869, 55 N. W. 279 (1893). And in *Andrews v. Ramsay & Co.*, [1903] 2 K. B. 635, the "principal" was allowed to recover not only the commission he had paid the "agent" but also the latter's secret commission. The court said (p. 637): "It is impossible to gauge in any way what the plaintiff has lost by the improper conduct of the defendants."

[FN 77] *Knauss v. Gottfried Krueger Brewing Co.*, 142 N. Y. 70, 36 N. E. 867 (1894); *Green v. Robertson*, 64 Cal. 75, 28 Pac. 446 (1883); *Pollatschek v. Goodwin*, 17 Misc. 587, 40 N. Y. Supp. 682 (1896) (middleman). And see *Ranney v. Donovan*, 78 Mich. 318, 44 N. W. 276 (1889).

[FN 78] The same exceptions, noted above, respecting instances where the broker acts merely as an instrumentality or intermediary bringing together buyer and seller, may apply to the stockbroker. For example, the rules of the New York

Curb Market, governing dealings upon the floor of the exchange, provide by c. I, § 13 that: "When a member has an order to buy and an order to sell the same security, he must offer such security at the minimum fraction of trading above his bid price or bid the minimum fraction of trading below his offered price before making a transaction with himself." The Rules of the New York Stock Exchange (c. I, § 13) provide similarly, except that the original offer must be 1/8 higher than the bid. A transaction on the exchange governed by such rules is valid and gives neither customer any claim against the broker based on the duality of his position. *Hall v. Paine*, *supra* note 70; *Terry v. Birmingham Nat. Bank*, 99 Ala. 566, 13 So. 149 (1892). And see *Cohen v. Rothschild*, 182 App. Div. 408, 169 N. Y. Supp. 659 (1918); *In re Brown*, 185 Fed. 766 (C. C. A. 2d, 1910).

The supervision provided and the presence of representatives of other potential buyers and sellers on the floor of a recognized exchange guarantee the integrity of such transactions consummated in those places. It does not necessarily follow that over-the-counter transactions are afforded any such protection, though it is possible for a broker to act in perfect good faith and to provide sufficient publicity to the transaction so as to safeguard it similarly.

As to fictitious sales see *Haight v. Haight & Freese Co.*, 112 App. Div. 475, 98 N. Y. Supp. 471 (1906), *aff'd*, 190 N. Y. 540, 83 N. E. 1126 (1907); *Cook v. Flagg*, 251 Fed. 5 (C. C. A. 2d, 1918); *Smith v. New York Stock & Produce Clearing House Co.*, 70 Hun 597, 25 N. Y. Supp. 261 (1893); *Todd v. Bishop*, *supra* note 62; *Prout v. Chisolm*, *supra* note 62.

[FN 79] *Tatsuno v. Kasai*, 70 Utah 203, 259 Pac. 318 (1927); *Rothschild v. Brookman*, 5 Bligh. (N. R.) 165 (1831), *aff'g* 3 Sim. 153 (1829); *Wisbey v. Alan Shepard & Co. Inc.*, 268 Mass. 21, 167 N. E. 334 (1929). In *Armstrong v. Jackson*, *supra* note 72, where the customer was rescinding a purchase of shares from the broker the court admitted that the rule in England was that in executed transactions rescission will lie only for "fraud." *Seddon v. North Eastern Salt Co.*, [1905] 1 Ch. 326. But the court held that where there was a fiduciary duty the rule is "infinitely stricter and more severe" and that rescission would lie even though the broker sells or purchases at the market and acts without intent to defraud.

[FN 80] *Tatsuno v. Kasai*, *supra* note 79; *Mayo v. Knowlton*, 134 N. Y. 250, 31 N. E. 985 (1892). On learning the facts the customer may tender back and demand the shares sold and treat the refusal as a conversion and recover damages measured by the "difference between the market prices of the stock at the date of the alleged sale and the market prices on the date of tender." *Stiebel v. Lissberger*, 166 App. Div. 164, 151 N. Y. Supp. 822 (1915), *aff'd*, 222 N. Y. 604, 118 N. E. 1078 (1918). The broker contended that the measure of damages was the difference between the price which the broker paid and the market price at that time, and since the purchase in question was at the market there were no damages. The court said (p. 169) that to apply such rule "would be to require the

customer to forego his privilege of election, upon discovery of the facts, whether to adopt or to disavow the unauthorized act of his brokers, and to compel him to accept and ratify their unlawful act. The practical efficacy of the rule forbidding a broker to deal himself with his customers' property would be wholly destroyed." Though the right to rescind may be lost by laches, the right to sue for damages for fraud might still remain. *McNulty v. Whitney*, 273 Mass. 494, 174 N. E. 121 (1930).

[FN 81] *Marye v. Strouse*, 5 Fed. 483 (C. C. Nev. 1880); *Oelkers v. Ellis*, [1914] 2 K. B. 139; *Armstrong v. Jackson*, *supra* note 72; *Rothschild v. Brookman*, *supra* note 79; *Wisbey v. Alan Shepard & Co. Inc.*, *supra* note 79; *Mayo v. Knowlton*, *supra* note 80; *Tetley v. Shand*, 25 L. T. 658 (1871) (cotton brokers). And see *Levy v. Loeb*, 85 N. Y. 365 (1881), s. c., 89 N. Y. 387 (1882); *Conkey v. Bond*, 36 N. Y. 426 (1867); *MECHEM*, *op. cit. supra* note 58, §§ 2411 *et seq.*

Though the right to rescind may be lost by laches there is no election to affirm the transaction unless all material facts are known at the time. Thus a sale of part of the stock acquired by the customer is not necessarily an election barring a suit to rescind as to the stock still held. *McNulty v. Whitney*, *supra* note 80. But if the customer intends to rely upon rescission he must return or offer to return the property within a reasonable time after he has gained knowledge of the facts which give him a right to rescind. *Ibid.*

[FN 82] *McNulty v. Whitney*, *supra* note 80. The customer had sold part of the stock which the brokers had sold him from their "own" holdings. He did not sue to recover secret profits made by defendants in selling their "own" stock but based his claim on his own losses. He alleged in addition to the sale of defendants' stock fraudulent misrepresentations as to the value of the stock. The trial court left it to the jury to determine the damages arising as the "natural consequence" of defendants' fraud. No distinction was made in the charge between defendants' breach of fiduciary duty and their fraudulent misrepresentations. This charge was held to be error, the court ruling that plaintiff's loss for breach of fiduciary duty was not the loss incurred by him when he sold the shares. The damages should be measured by the difference between what he paid and what on the day of the purchase he could have sold the stock for in the market. *Accord: Waddell v. Blockey*, 4 Q. B. D. 678 (1879). If unable to prove actual damages, he could recover nominal damages for breach of the fiduciary duty. As to damages for fraudulent misrepresentations the measure is the difference between what plaintiff received and what its value would have been if the stock had been as represented. *Cf. Whitehead v. Lynn*, *supra* note 71.

[FN 83] *Taussig v. Hart*, 58 N. Y. 425, 428 (1874). See also *Tewksbury v. Spruance*, *supra* note 72; *Tetley v. Shand*, *supra* note 81 (cotton brokers).

[FN 84] *Marye v. Strouse*, *supra* note 81; *Armstrong v. Jackson*, *supra* note 71.

Of course, even though the relation of vendor-vendee exists between customer and broker rather than "principal" and "agent," the broker may be liable in deceit. But the requirements of that cause of action are quite different and more exacting than damages or rescission for breach of fiduciary duty. *Taylor v. Guest*, *supra* note 54.

[FN 85] *Wendt v. Fischer*, *supra* note 73, at 444, 154 N. E. at 304.

[FN 86] See analysis and collection of cases in LLEWELLYN, *CASES AND MATERIALS ON SALES* (1930) bk. II, c. VI. The examples, particularly throughout the law of sales, are numerous. Somewhat typical of their disutility are the cases involving whether there has been an "agency" or "sale" on the distribution or marketing of goods from manufacturer or wholesaler to retailer. Thus the issue may be the liability for taxes assessed on the inventory or on sales [*D. M. Terry & Co. v. Hall*, 188 Ala. 178, 66 So. 104 (1914); *Commonwealth v. Thorne, Neale & Co.*, 264 Pa. 408, 107 Atl. 814 (1919) ; *Fred Harvey, Inc. v. Crooks*, 39 F. (2d) 466 (D. C. W. D. Mo., 1930)]; or the liability of the manufacturer for the warranties or representations of the retailer [*Piper v. Oakland Motor Co.*, 94 Vt. 211, 109 Atl. 911 (1920)]; or the liability of the retailer for the price of goods unsold [see cases *supra* note 69]; or the right of the manufacturer to reclaim the goods or impose a trust on the proceeds of their sale in the bankruptcy or insolvency of the retailer [Ex parte *White*, L. R. 6 Ch. App. 397 (1871) ; *Arbuckle Bros. v. Gates*, 95 Va. 802, 30 S. E. 496 (1898)]; or the validity of the marketing device under the anti-trust laws. *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U. S. 373, 31 Sup. Ct. 376 (1911); *U. S. v. General Electric Co.*, 272 U. S. 476, 47 Sup Ct. 192 (1926). For a critical analysis of the "agency" —"sale" concepts, see Klaus, *Sale, Agency and Price Maintenance* (1928) 28 COL. L. REV. 312, 441. For further cases see DOUGLAS AND SHANKS, *CASES AND MATERIALS ON LOSSES AND ASSETS* (1932) Pt. I. c. I.

[FN 87] Rules of the New York Stock Exchange, c. I, § 7 provide: "When written contracts shall have been exchanged the signers thereof only are liable." C. I, § 14 provides: "No party to a contract shall be compelled to accept a substitute principal, unless the name proposed to be substituted shall be declared in making the bid or offer and as a part thereof." The same provisions are to be found in the Rules of the New York Curb Market, C. I, § 7 (e), 14. And see cases *infra*, note 145.

[FN 88] See *Brown v. Bradlee*, 156 Mass. 28, 30 N. E. 85 (1892); *Whitney v. Wyman*, 101 U. S. 392 (1879); *Universal Steam Nav. Co. Ltd. v. James McKelvie & Co.*, [1923] A. C. 492; *Solomon v. N. J. Indemnity Co.*, 94 N. J. L. 318, 110 Atl. 813 (1920). Thus a commission merchant is liable for breach of warranty where the existence but not the identity of his principal was known. *Argersinger v. Macnaughton*, 114 N. Y. 535, 21 N. E. 1022 (1889). And see *Pugh v. Moore*,

supra note 62. In the normal transaction where the broker purchases or sells on the exchange or over-the-counter or from or to a dealer the name of his "principal" is not disclosed. Thus normally there would not arise the questions involved in such cases as Hurricane Milling Co. v. Steel & Payne Co., 84 W. Va. 376, 99 S. E. 490 (1919); Barlow v. Congregational Society, 8 Allen 460 (Mass. 1864); Calder v. Dobell, L. R. 6 C. P. 486 (1871); Higgins v. Senior, 8 M. & W. 834 (1841); and Heffron v. Pollard, 73 Tex. 96, 11 S. W. 165 (1889), where by the form of the contract and the disclosure of the identity of the "principal" the defense by the "agent" is that he did not make the promise but that the promisee looked to the credit and performance of the "principal." And see cases *infra* note 146.

[FN 89] *Watteau v. Fenwick*, [1893] 1 Q. B. 346; *Hubbard v. Tenbrook*, 124 Pa. 291, 16 Atl. 817 (1889); *Brooks v. Shaw*, 197 Mass. 376, 84 N. E. 110 (1908).

[FN 90] Except, of course, on an election of remedies which bars proceeding against both, as to which see *Old Ben Coal Co. v. Universal Coal Co.*, 248 Mich. 486, 227 N. W. 794 (1929); *Barrell v. Newby*, 127 Fed. 656 (C. C. A. 7th, 1904); *North Carolina Lumber Co. v. Spear Motor Co.*, 192 N. C. 377, 135 S. E. 115 (1926).

[FN 91] See *supra* note 87.

[FN 92] All of the cases which have been found, including those cited *supra* notes 78-84, involve situations where at the time of the placing of the order by the customer the broker had acquired the securities and was carrying them in his portfolio or stood committed for them on subscription or underwriting.

[FN 93] Other issues might arise which would test defendants' relation to the stock. (1) *Would there be a stamp tax under federal or state laws on the transaction between F. J. Lisman & Co. and defendants as well as on the transfer to plaintiff?* It is provided by Federal Revenue Act of 1926, § 800, 43 STAT. 331, 26 U. S. C. A. § 901:

"...there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this chapter, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned or shipped, the several taxes specified in such schedule." For state laws see MASS. GEN. LAWS (1921) c. 64, § 1; N. Y. TAX LAW (1909) § 270; PA. STAT. ANN. (Purdon, 1930) tit. 72, § 2041; S. C. Acts

1928, Act No. 574, p. 1090. And see CHRISTY, THE TRANSFER OF STOCK (1929) §§ 300-303, 326-329.

For cases dealing with the problem of liability for stamp taxes see Marconi Wireless Tel. Co. of America v. Duffy, 273 F. 197 (D. C. 1921); Provost v. United States, 269 U. S. 443, 46 Sup. Ct. 152 (1925). These cases do not, however, involve the problem suggested.

(2) Are defendants "agents" of F. J. Lisman & Co.? See *infra* note 145.

Neither of these issues is particularly relevant to the disposition of the Kinney case. But they indicate the varied type of problem arising out of the interpretation of the meanings of such words as "sell," "buy," "use," "benefit," and "own."

The Appellate Division found: "That defendants did not acquire title to said stock at any time and did not resell the same to plaintiff." Record, p. 208.

[FN 94] 96 N. J. L. 555, 115 Atl. 79 (1921).

[FN 95] 205 Mo. 138, 103 S. W. 527 (1907). *Cf.* *Kindle v. Holcomb*, 34 Wash. 336, 75 Pac. 873 (1904). And see *Carpenter v. Fisher*, 175 Mass. 9, 55 N. E. 479 (1899), where, in an action by a real estate broker to recover a commission from the buyer, the court said: "The option having been given by -word of mouth was not binding on Ross [the seller]; but had the existence of the option been material this would have made no difference; the existence of such an arrangement, even if not binding, would have incapacitated one from accepting duties inconsistent with his interests under the arrangement." *Id.* at 14, 55 N. E. at 480.

[FN 96] Even the Appellate Division doubted the "good faith" of defendants in retaining the one point concession. *Supra* note 3, at 312, 247 N. Y. Supp. at 120.

[FN 97] The type of adverse interest contemplated by the courts in the selling of a broker's "own" stock is that the broker would then be interested in getting a higher price. In the instant case the customer's limit order and the quoted open market price would have deterred the defendants from taking advantage in that way.

[FN 98] If, during the sixty days following the purchase of Cameo stock, plaintiff had been advised by defendants not to sell, he might well have reasoned that such advice was being given contrary to defendants' profit interest in securing commissions on brokerage transactions and so would have considered it to be more impartial and disinterested than it obviously would have been. He would not have known that because of the contingent one point concession defendants had an interest in his retention of the stock about seven times as strong as in his selling it.

Balkin for defendants on cross examination, Record pp. 147-149:

"Q. Were you trying to keep Kinney in his stock? A. No. Q. Did you ever advise him that he should sell it? A. No. Q. He discussed with you the propriety of selling

it, did he not? A. No. Q. He discussed with you the desirability of selling it, did he not? A. No. Q. He discussed with you the question of whether he should keep it or sell it, did he not? A. Yes. ...Q. When Kinney asked you whether or not he should keep his stock' you did not disclose to him the fact that your firm was being paid to keep people from selling their stock? A. He did not ask me... Q. Didn't you answer a question just a few minutes ago in which I asked you whether or not he discussed with you the question of whether or not the stock should be sold? Think about it. Didn't you say— A. We discussed the prospects of the company and the progress of the company. Q. With a view of determining whether or not the stock should be sold? Isn't that so? A. Yes.... Q. In any event you did not see fit to tell him all you knew about the stock, did you? A. No. Q. Is it not a fact, Mr. Balkin, that the subject of Cameo stock was a matter of concern and repeated discussions in the office of Glenny, Monro & Moll? A. Yes. Q. The market action of the stock became a subject of discussion, did it not? A. Yes... Q. And during the time that Kinney was asking about the desirability of selling it or during the time he was talking about it, is that not true? A. During the time he was talking about the stock."

The Appellate Division disapproved and reversed (Record, p. 204) findings of the trial court respecting these subsequent conversations between plaintiff and defendants. Among such findings were (Record, p. 131):

"18. That after February 13, 1929, the defendants continued to advise plaintiff respecting the prospects of such corporation and its stock.

"19. That defendants were concerned about the stock of said corporation and secured information with respect thereto.

"20. That the defendants from time to time after February 13, 1929, did not inform plaintiff in response to his inquiries of all they knew or had learned about such stock with reference to its prospects and the condition of the corporation.

"23. That defendants gave advice to plaintiff regarding the desirability of selling or retaining his stock during such period of sixty days and withheld from him full information as possessed by them regarding the prospects of the company and of its stock, and did not acquaint him with their opportunity to avoid re-payment to Lisman & Co. of the sum of \$500.00 in the event that plaintiff should not direct them to sell such stock."

No other findings relative to this matter were made by the Appellate Division. The only evidence in refutation of the foregoing testimony was given by Balkin on Redirect, Record, p. 158:

"Q. You did not tell him he would have to keep this for 60 days? A. No. Q. Or induce him to keep it for 60 days? A. He was not bound to keep it for 60 minutes."

And by Balkin on Direct, Record, p. 143:

"Q. After the purchase was made and the order was confirmed did you ever ask him to keep the stock? A. No, sir."

[FN 99] Record, pp. 56, 57, 58, 60, 61, 74, 75, 146, 147, 148, 157, 158.

The trial court found, Record, p. 90:

"14. That prior to the plaintiff's giving to defendants the order for the purchase for him of the 500 shares of preferred stock defendants, during the prior four months, had undertaken to interest plaintiff in the purchase of stock of the Consolidated Automatic Merchandising Corporation.

"15. That as a result of such efforts of the defendants, plaintiff did become interested and made two purchases of such stock prior to giving the order of February 13, 1929.

"16. That the defendants were within such period of four months advising plaintiff to purchase more of the stock of such corporation.

"17. That the order for the purchase of the 500 shares of preferred stock was given by plaintiff after receiving such advice from defendants."

The findings were disapproved and reversed by the Appellate Division (Record p. 204) but no additional findings on those points were made. A reading of the record clearly supports finding 14 of the trial court. Defendants clearly had been attempting "to interest" plaintiff in Cameo. Perhaps the Appellate Division found fault with "advising" and "advice" in 16 and 17, and with "as a result" in 15. Yet from the record it would be exceedingly difficult to attempt a differentiation between "interest" and "advice." The same may be said for "as a result."

Absolute cause and effect would be impossible to determine. The record does show, however, an intimate relationship between plaintiff's decision to buy and defendants' salesmanship, in spite of testimony for defendants (Record, p. 143) that Balkin did not solicit the order for 500 shares.

[FN 100] This is admitted (p. 67 of respondents' brief) before the Court of Appeals and is assumed throughout all of respondents' argument. The trial court so found (Record, p. 15) and the finding was neither modified nor reversed.

[FN 101] This distinction between the open over-the-counter market and the dealers' market or investment guaranteed market is not made in the *Kinney* case. There the only definition is given by Balkin, for defendants, on direct examination: "Q. What does 'over-the-counter' mean? A. It means anywhere excepting the Exchange. It means between two brokers or between two individuals." Record, p. 140.

[FN 102] Record, pp. 108, 120, 128, 132, 133, 134.

[FN 103] Record, pp. 154, 155.

[FN 104] Record, pp. 183, 184.

[FN 105] Record, pp. 190, 191, 192. The Appellate Division found: "That said notice of confirmation was in the ordinary form used by the defendants for

confirming purchases of stock over the counter and not on the exchange." Record, p. 208.

[FN 106] *Rothschild v. Brookman*, *supra* note 79.

[FN 107] *Id.* at 202.

[FN 108] 99 Conn. 515, 122 Atl. 98 (1923).

[FN 109] 243 Mich. 84, 219 N. W. 681 (1928). Defendants were members of a selling group in the original distribution of stock of the Dort Motor Co., and had subscribed for a quota of the stock. The trial court found that plaintiff "knew that this was a syndicated stock" and that he "knew just as much as the broker knew himself, of the relationship between the broker and the stock." The relation between plaintiff and defendant accordingly was held to be vendee-vendor and the remedy of rescission not available.

[FN 110] 268 Fed. 108 (C. C. A. 2d, 1920). On all the facts the court concluded that plaintiff must have bought the stock with knowledge that the market was being "rigged" and artificial prices created.

[FN 111] See the discussion *supra*, pp. 953, 984 *et seq.*

[FN 112] On the effect of the confirmation see discussion *infra*, note 153.

[FN 113] *Wendt v. Fischer*, *supra* note 73. That case did not involve a stock brokerage transaction but a sale of realty by plaintiff through defendant brokers. The list price was \$75,000 and \$10,000 cash. Defendants offered from a client \$80,000 and \$7,500 cash which plaintiff accepted. The contract of sale was executed by plaintiff and a third party dummy, the real purchaser being defendant corporation the sole stockholder of which was one partner in the brokerage house. Plaintiff was allowed to recover from the brokers the commission and from the corporation the secret profits. Defendants tried to prove disclosure by the statement to plaintiff that the sale was to a client in their office. An analogy from another field was recently presented in *Smokeless Fuel Co. v. Western United Corp.*, 19 F. (2d) 834 (C. C. A. 4th, 1927) involving an action for an accounting by the seller of coal against its "agent" for secret profits. There was a contract at will between the parties constituting defendants as "commission agents" to sell the coal of plaintiff for a 7% commission. Defendant claimed that subsequently it terminated the contract and ceased to be an "agent" and became a buyer from plaintiff. Though there was some evidence that defendant regarded these transactions as sales to it the court affirmed judgment for plaintiff and said (p. 836):

"Parties seeking to set up a new contract or change an existing one must carry the burden of proof, and an agent, once having accepted that role with his principal, with all the obligations such a relationship carries with it, owes to his principal the duty of full and complete disclosure concerning all details of the transaction. It is the duty of an agent, seeking to change an admitted contract of sale on a commission to one of sale outright to the agent at a fixed price, to bring such change to the attention of his principal in such a manner as to avoid all chance of misunderstanding."

It would seem that, even though it was customary for brokers and dealers to follow the precise procedures as in either the *Kinney* or *McNulty* cases in filling orders for their customers, such usage or custom would not be a valid defense to the actions of the customers where it was not shown that the customers were familiar with the usage. It has been so held in analogous situations where such custom, if incorporated into the contract, would have transformed the broker from an "agent" to a "principal," *i. e.*, vendor. *Robinson v. Mollett*, L. R. 7 H. L. 802 (1875); *Day v. Holmes*, 103 Mass. 306 (1869); *Hall v. Paine*, *supra* note 70; *Bostock v. Jardine*, 3 H. & C. 700 (1865). And see *Irwin v. Williar*, 110 U. S. 499, 4 Sup. Ct. 160 (1884); *Harris v. Tumbidge*, 83 N. Y. 92 (1880); *Tetley v. Shand*, *supra* note 81. Cf. *Farnsworth v. Hemmer*, 83 Mass. 494 (1861); *Cook v. Flagg*, *supra* note 78; *Baker v. Drake*, 66 N. Y. 518 (1876); *Horton v. Morgan*, *supra* note 64; *Robbins v. Maher*, 14 N. D. 228, 103 N. W. 755 (1905). The opposite result has been reached where the broker sells to himself as broker for another customer pursuant to the rules of the exchange. See *supra* note 78.

[FN 114] *Supra* note 80.

[FN 115] See discussion *supra*, pp. 952, 980 *et seq.*

[FN 116] An examination of the testimony at the trial shows that this was a highly controverted question of fact and that there was much evidence that plaintiff was informed. The case was remanded for a new trial and a hearing before an auditor has since been had. The auditor's report on that second hearing states (p. 6): "Upon all the evidence I am convinced that by September 11, 1926, when the first transaction in Nonquitt Spinning Company stock occurred, the plaintiff had notice of the fact that when he purchased or sold unlisted stock he was dealing directly with the defendants as principals rather than as brokers acting for him on a commission basis."

At the time of this writing the new trial has not been had.

[FN 117] 273 Mass, at 501-502, 174 N. E. at 124.

[FN 118] 138 Va. 244, 121 S. E. 270 (1924).

[FN 119] The court emphasized that there were no allegations or evidence whatever that defendants acted other than "in the most scrupulously honest and upright manner, insofar as their intention was concerned;" that "in good faith" they thought that they had made it plain to plaintiff they were selling him their "own" securities. The court, however, stated that for reasons of "public policy" the rules enunciated transcended "all consideration of any individual interests involved in any particular case in which it does not affirmatively appear that the agent has in fact made the disclosure." *Id.* at 271, 121 S. E. at 277.

[FN 120] *Pence v. Langdon*, 99 U. S. 578 (1878).

[FN 121] *Supra* note 118, at 268, 269, 121 S. E. at 276.

[FN 122] One judge dissented not on the general rules enunciated but on their application to the particular facts at hand.

[FN 123] *Rothschild v. Brookman*, *supra* note 79, is closely parallel both on its facts and holdings. That was an action of rescission by customer against broker for the sale and purchase on several occasions of various securities. The action was brought some six years after transactions had been consummated. Here also plaintiff was reposing confidence in the judgment of defendant; and on his advice ordered sold French *rentes* and Prussian bonds purchased. Defendant purchased the *rentes* for his firm and supplied the bonds "out of his own stock." The confirmation of the sale of *rentes* stated that defendant had had the "opportunity to dispose of" them. As to the purchase of bonds it stated "I have invested the proceeds of the Sale in Prussian Bonds." Subsequently plaintiff ordered through his brokers (not defendant) additional Prussian bonds, the confirmations stating "We have bought on your account, of N. M. Rothschild." On all the purchases Rothschild made advances taking plaintiff's note and holding the bonds as security. No bonds were specifically earmarked and set aside by defendant for plaintiff.

There was no disclosure to plaintiff that defendant had purchased the *rentes* for his firm. Shortly afterwards the *rentes* rose in price and the bonds fell. There was no evidence that plaintiff received less than the fair market price of the day for the *rentes*. In all of the purchases and sales defendant charged commissions. It appeared that plaintiff knew that defendant was "contractor" for the Prussian bonds. In fact plaintiff had become a "Subscriber to the Loan" through defendant previous to the transactions in question. Judgment for plaintiff was affirmed. The House of Lords emphasized the voidability of the sale of the *rentes*, saying p. 191: "If the broker...instead of going to the stock market, or instead of exercising a discretion as to the period when he should sell any stock, is to take that stock to himself, he deprives me of the security I have, and the confidence I repose in his skill and intelligence. ..." As to the bonds purchased the same court said, p. 192: "It does not follow that this gentleman, because he knew that Mr. Rothschild

was the contractor with the King of Prussia for this loan, knew that he had not parted with a very considerable proportion of the bonds he so contracted for, if not the whole. The principal had a right to suppose, when his agent advised him to buy Prussian bonds, that they were to be bought of other persons; he had a right to suppose he was not transferring his own bonds to him, but that he was making a purchase of other bonds in the market..."

Thus there is present in this case, as well as in *Williams v. Bolling*, *supra* note 118, the factor of a voidable purchase by a broker of his customer's security followed by an investment of the proceeds in other securities. The two transactions were so connected that that relationship may have had some influence on the court. But here the case was even stronger for plaintiff than in *Williams v. Bolling*, for the broker charged commissions on all the transactions and the confirmations would not put plaintiff on notice of any departure from a normal brokerage transaction.

There was moreover another factor in the case that distinguishes it and that the court stresses. None of these bonds in Rothschild's possession was specifically earmarked as plaintiff's. As to that the court said (pp. 195-196): "If Mr. Rothschild had bought these bonds, as it is pretended by the papers he did, these bonds could never have been liable to any of the debts which Mr. Rothschild had contracted: but as it is, Mr. Rothschild not having bought these bonds, they being his from the beginning, they remaining so till they were set apart and appropriated to Mr. Brookman; if the bonds had risen in price, and if Mr. Rothschild had failed, Mr. Brookman must have lost the security of these bonds at that increased price.

"It may be as likely that the bank of England should fail, as that Mr. Rothschild should fail. It may be, that nothing would be likely to diminish his ability to answer all demands upon him. But it is enough to decide that the Respondent had a right to say, I will not trust to the security of Mr. Rothschild or anybody else; I will have these bonds, so that the King of Prussia may be security for my debt, and not Mr. Rothschild or any other proprietors of bonds."

The case is thus much stronger for the customer than either *Williams v. Bolling* or *McNulty v. Whitney*, *supra* note 80. It is interesting to note that this court (as did the court in *Williams v. Bolling*) went to considerable length to point out that the broker did not give "advice with any dishonest view whatever"; that he acted "fairly and properly"; but that the rule imposed "goes wide of that" and is a "law of jealousy." These rules then are not being designed solely for crooks and those engaged in glaringly fraudulent transactions.

[Note: A much more complete statement of facts is to be found in the case before Vice-Chancellor Shadwell reported in 3 Sim. 153 (1829).]

[FN 124] *Supra* note 94.

[FN 125] In this case plaintiffs "were stockbrokers and members of the New York Stock Exchange." By request of defendant (as the jury found) "they subscribed

for \$25,000 worth of the bonds of Great Britain at 101 and interest." This subscription, dependent on the approval of J. P. Morgan & Co., was approved and plaintiffs paid the money and took up the subscription for defendant. The price of the bonds depreciated and defendant, being called upon for margin, ordered the bonds sold, which plaintiffs did at a loss of \$620, for which suit was brought. Defendant appealed from a judgment for plaintiff. Defendant contended he was entitled to a nonsuit because the value of the bonds was over \$500 and the provisions of the Sales Act (N. J. COMP. STAT. (1910) p. 4648) applied. That act provided that a contract to sell, or a sale of goods or choses in action of the value of \$500 or more should not be enforceable unless the buyer accepts part of the goods or choses in action and actually received the same, or gave something in earnest to bind the contract, or in part payment, or unless some note or memorandum in writing was signed "by the party to be charged or his agent in his behalf." The trial court charged the jury to determine "(1) were the bonds ordered by defendant; (2) if ordered, were plaintiffs selling their own bonds, or were they acting as brokers for the defendant; (3) if they found that plaintiffs were not acting as brokers, but were selling their own bonds, whether the defendant...had accepted the bonds or exercised any dominion over them, and that if he did, then the plaintiffs were not prevented from recovery." *Supra* note 94, at 556, 115 Atl. at 80. It appeared, as noted above, that the jury found defendant ordered the bonds. It does not appear whether the jury found that plaintiffs were acting as "brokers" for defendant or were selling their "own" bonds. If the former, then apparently the Sales Act would be satisfied. If the latter, and the jury also found defendant accepted the bonds, then the Sales Act also would be satisfied. Judgment for plaintiffs was affirmed by the Supreme Court. The objections raised by defendant on appeal were not to the above charges. One was that the court omitted to submit to the jury the question whether plaintiffs were acting as "brokers for the syndicate"; but that request was held not to have been made. The court refused to charge, as requested, that if plaintiffs were entitled to recover, defendant was entitled to a credit, representing the per centum allowed by the syndicate to plaintiffs for securing subscriptions, defendant's theory being that as plaintiffs were acting as brokers for defendant they were not entitled to make a secret profit. It was said: "The evidence shows that these bonds could not be subscribed for for less than 101, that being the required cost to the subscriber, and this the defendant knew, or a jury might so infer from the evidence, and he also knew that the plaintiffs were obtaining these subscriptions for the syndicate, and that he himself could not have obtained any subscription at less than 101. The percentage paid by the syndicate to the plaintiffs was not a secret profit to the injury of the defendant." *Id.* at 557, 115 Atl. at 80. This judgment of the Supreme Court was affirmed by the Court of Errors and Appeals for the reasons expressed in the opinion of the Supreme Court.

[FN 126] *Supra*, pp. 980, *et seq.*

[FN 127] The cases emphasize, as an earmark of the "agency" relation, the presence of a commission or brokerage fee. See, e.g., *Tetley v. Shand*, *supra* note 81, at 660.

[FN 127a] It is interesting to note, also, that defendants' profit was greater by more than the \$500 undisclosed concession than it would have been had the transaction been executed on the Curb, for in the latter event they would have been obliged to divide the \$75 brokerage commission with their New York correspondent.

[FN 128] *Supra* note 3, at 312-313, 247 N. Y. Supp. at 120.

[FN 129] See cases *supra* notes 80, 81, 82.

[FN 130] See cases *supra* notes 80, 81.

[FN 131] *McNulty v. Whitney*, *supra* note 80; *Waddell v. Blockey*, *supra* note 81.

[FN 132] *McNulty v. Whitney*, *supra* note 80.

[FN 133] As evidenced by the other sales on the curb that day. See table *supra* p. 963. The Appellate Division found (Record, p. 208) "That said stock could not have been purchased on said day at a better, that is, a lower price."

[FN 134] See cases *supra* note 76.

[FN 135] *Andrews v. Ramsey & Co.*, *supra* note 76; comment (1928) 28 COL. L. REV. 799.

[FN 136] 187 Iowa 522, 172 N. W. 460 (1919). *Cf.* the earlier cases of *Bosley v. Monahan*, 137 Iowa 650, 112 N. W. 1102 (1908); *Maine v. Midland Investment Co.*, 132 Iowa 272, 109 N. W. 801 (1906).

[FN 137] 187 Iowa at 546, 172 N. W. at 469.

[FN 138] *Accord*: *Schechner-Wittner Inc. v. E. A. White Organization, Inc.*, 138 Misc. 768, 247 N. Y. Supp. 246 (1931); *Moore v. Shields*, 121 Ind. 267, 23 N. E. 89 (1889). The court said (pp. 272-273) 23 N. E. at 91: "In an action for money had and received there need be no privity of contract proved, other than such as arises out of the fact that the defendant has received the plaintiff's money under circumstances which make it against conscience that he should retain it...In such a case the law-implies a promise on the part of him who is in the wrong to return the money to the lawful owner." And see *Hardy v. American Express Co.*, 182 Mass. 328, 65 N. E. 375 (1902), *Cf.* *Hedden v. Griffin*, 136 Mass. 229 (1884);

Garrett v. Sparks Bros., 61 Wash. 397, 112 Pac. 501 (1911). See also (1931) AGENCY RESTATEMENT, TENT. DRAFT No. 6, § 562, appendix, pp. 89 *et seq.*

[FN 139] Taylor v. Currey, 216 111. App. 19 (1919) ; Butler v. Livermore, 52 Barb. 570 (N. Y. 1868); Marks v. Jos. H. Bucker & Co., 53 Cal. App. 568, 200 Pac. 655 (1921); Cohen v. Ellis, 4 N. Y. St. Rep. 721 (1886).

[FN 140] For liability see Schechner-Wittner Inc. v. E. A. White Organization, Inc., *supra* note 137. Against liability see Butler v. Livermore, *supra* note 138; Cohen v. Ellis, *supra* note 138. *Cf.* Klotz v. Gordon, 117 N. Y. Supp. 240 (Sup. Ct. 1909).

[FN 141] 98 N. Y. 167 (1885), *aff'g* 16 J. & S. 424 (N. Y. Sup. Ct. 1882).

[FN 142] 98 N. Y. at 169.

[FN 143] Related questions arise as to the joinder of "agent" and "principal" in a suit to rescind a contract of purchase and sale on the grounds of fraud, the contract being made between plaintiff and the "principal," the "agent" not being the "agent" of plaintiff. In Mack v. Latta, 178 N. Y. 525, 71 N. E. 97 (1904), where defendants separately demurred, it was held that it was error to sustain the demurrers; and that the individual defendants were properly joined. But in Ritzwoller v. Lurie, 225 N. Y. 464, 122 N. E. 634 (1919), the opposite was held and judgment sustaining the demurrer and dismissing the complaint against the individual defendants was affirmed. *Accord* with Mack v. Latta, *supra*: Henderson v. Lacon, L. R. 5 Eq. 249 (1867); Lehman-Charley v. Bartlett, 135 App. Div. 674, 120 N. Y. Supp. 501 (1909), *aff'd* 202 N. Y. 524, 95 N. E. 1125 (1911). *Cf.* Cox v. National Coal & Oil Inv. Co., 61 W. Va. 291, 56 S. E. 494 (1907). And in Loud v. Clifford, 254 N. Y. 216, 172 N. E. 475 (1930), Mack v. Latta was said to be the law in New York, the Ritzwoller case being disapproved. *Accord* with Ritzwoller v. Lurie, *supra*: Huffman v. Banker's Automobile Ins. Co., 112 Neb. 277, 200 N. W. 994 (1924) ; Alexander City Bank v. Equitable Trust Co., 223 App. Div. 24, 227 N. Y. Supp. 403 (1928).

See Comments (1925) 3 NEB. L. BULL. 436; (1925) 25 COL. L. REV. 504.

[FN 144] That such practice in conformity to custom and usage is valid see Horton v. Morgan, *supra*, note 64. *Contra*: Robbins v. Maher, *supra* note 113, where the customer did not know of the custom. And see Bostock v. Jardine, *supra* note 113.

[FN 145] The statement of the court that, if the action was based upon the claim that defendants were "employed" by the "sellers" of the stock, the action of rescission would only lie against the "sellers," suggests interesting and important problems. Was F. J. Lisman & Co. the undisclosed "principal" of the defendants?

Was the Consolidated Automatic Merchandising Corporation the "principal" of F. J. Lisman & Co., and in that event, defendants "sub-agents" of the corporation? In other words would actions either for rescission or damages for fraud lie against either F. J. Lisman & Co. or the corporation? Those questions involve so many factors and require such extended analysis that they cannot be answered here. A few points, however, will be suggested.

There are at least three categories in which the relationship might be placed.

(1) The corporation might escape liability on the grounds that through an underwriting or bankers' purchase contract the banking group had become "independent contractors" in the distribution of the securities. It is hazardous to generalize since the existence or non-existence of that relationship is bottomed entirely on the contract made and the conduct of the parties during the process of distribution. Under many such contracts, however, as have seen actual use it would seem that that result should follow. In fact the usual arrangement would amount to an allocation of the process of distribution, for a consideration, from the company to the bankers and an undertaking by them to perform that function as specialists in the field. No case directly in point has been found. But it would not appear to be undue extension of those rules, which have evolved from totally different factual situations involving liability for negligent acts and, in part for contracts [See DOUGLAS AND SHANKS, CASES AND MATERIALS ON LOSSES AND ASSETS (1932) Pt. I, c. I] to apply them to this type of situation.

The same might well be true as between the banking syndicate and the selling group on the theory that the function of selling had been allocated directly to the members of the selling group, who in turn were specialists in their field. Here again it is impossible to generalize. A translation of the rules pertaining to "independent contractor" into terms of "control" [See Douglas, *Vicarious Liability and Administration of Risk*, (1929) 38 YALE L. J. 594] would bring to light many such factors varying considerably among selling groups as differently constituted.

(2) Or again, as between the company and banking group and between banking group and selling group there might be established merely a vendor-vendee relationship with complete insulation by one from liability for acts of another.

(3) But even assuming that under special situations the "principal"— "agent" relation were established as between either the banking group and the company or the banking group and the selling group the question of the scope of authority remains. It is elementary that a "principal" is not liable for every fraudulent act of his "agent." Yet even so, there still remains the possibility of rescission. Even innocent "principals" may not be able to retain the benefits of their "agents'" fraud even though in a damage action they would not be liable. See *Kennedy v. McKay*, *supra* note 75; *Ellison v. Stockton*, *supra* note 75.

The suggestion of this problem does not infer that there was evidence that defendants in the Kinney case were "agents" of F. J. Lisman & Co. There was none whatever. And, as stated by the Court, the complaint was not drawn on that theory. It is clear, however, that there are so many variations in the case from the normal brokerage transaction as to render that result doubtful.

[FN 146] See cases *supra* notes 87, 88, 91; and *Mead v. Altgeld*, 136 111. 298, 26 N. E. 388 (1891); *Cox v. Borstadt*, 49 Colo. 83, 111 Pac. 64 (1910); *Drake v. Pope*, 78; Ark. 327, 95 S. W. 774 (1906); *Cobb v. Knapp*, 71 N. Y. 348 (1877) ; *Hutcheson & Co. v. Eaton*, L. R. 13 Q. B. D. 861 (1884); *Pike v. Ongley*, L. R. 18 Q. B. D. 708 (1887), holding brokers individually liable on contracts made by them. The last two involve the effect of custom and usage.

[FN 147] *Poole v. Camden*, 79 W. Va. 310, 92 S. E. 454 (1916); *Patterson v. John P. Mills Organization, Inc.*, 203 Cal. 419, 264 Pac. 759 (1928) (possibly including unnamed as well as undisclosed "principals" in the rule); *Kerr v. Simons*, 166 Minn. 195, 207 N. W. 305 (1926) ; *Pugh v. Moore*, *supra* note 62 (suit to recover amount paid broker-defendant for bonds which were worthless) ; *Drake v. Pope*, *supra* note 146 (suit against broker to recover back the price where goods defective). *Cf. Simmonds v. Long*, 80 Kan. 155, 101 Pac. 1070 (1909). But see *Parish State Bank v. Tremore*, 25 111. A. 185 (1929). The power of the "agent" in such case to rescind the contract as against his principal should be distinguished. *Thomson v. Thomson*, 315 111. 521, 146 N. E. 451 (1925).

[FN 148] *Supra* note 147.

[FN 149] *Id.* at 199, 207 N. W. at 307.

[FN 150] *Cf. Pugh v. Moore*, *supra* note 62; *Drake v. Pope*, *supra* note 146.

[FN 150a] AGENCY RESTATEMENT, TENT. DRAFT No. 6, *supra* note 138. The rule covers cases of "agents" acting for either disclosed or unnamed "principals" whether such "agents" are parties to the contract or not.

[FN 150b] see discussion *supra* note 145.

[FN 151] See *e. g.*, *Rothschild v. Brookman*, *supra* note 79 (six years); *Williams v. Bolling*, *supra* note 121 (eight years).

[FN 152] In fact in cases like *Williams v. Bolling*, *supra* note 121, and *Rothschild v. Brookman*, *supra* note 79, the broker, as respects the security he purchased from the customer, loses the appreciation in the value of that security; and as regards the security he sold to the customer is saddled with the decline in its value.

[FN 153] As said by the court in *Leviten v. Bickley, Mandeville & Wimple, Inc.*, 35 F. (2d) 825 (C. C. A. 2d, 1929) at 826: "The confirmation slip...was not a part of the original contract, and in order to make it such the defendant was bound to prove that Leviten knew the terms of the confirmation slips and understood them

to apply to his transactions... *His mere receipt of them was not conclusive evidence of a contract in accordance with the terms they stated.*" (Italics ours.) See also the quotation from *McNulty v. Whitney*, *supra*, p. 988. And as to the effect of confirmations see MEYER, *op. cit. supra* note 55, §§ 109 *et seq.*, *Pearson v. Kurtz*, 280 Pa. 34, 124 Atl. 272 (1924); *Smith v. Craig*, 211 N. Y. 456, 105 N. E. 798 (1914); *Keller v. Halsey*, 202 N. Y. 588, 95 N. E. 634 (1911); *Donald Friedman & Co., Inc. v. Newman*, 255 N. Y. 340, 175 N. E. 345 (1931); *Thompson v. Baily*, 220 N. Y. 471, 116 N. E. 387 (1917); all dealing with the effect of notices and confirmations by brokers to customers insofar as they add to, detract from, or otherwise change the contract originally entered into between the parties.

Cf. Porter v. Wormser, 94 N. Y. 431 (1884), where the confirmation said "Bought of" plaintiff-customer, the contention being that an "agent" cannot buy of his "principal" without disclosure. The action was to open and review the accounts between customer and broker. Defendant introduced parol evidence that defendant did not buy but sold to others for plaintiff. Over plaintiff's objection the court held that defendants could show the "real transaction" and that "by mistake or inadvertence it was misrepresented in the written advices."