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Case Notes

CASE NOTES

Corporations—Insider Liability—Common Law Fiduciary Principles Applied in Holding Directors Liable to Corporation for Profits from Corporate Stock Sales Made Because of Inside Information.—Defendants Oreamuno and Gonzales were directors of Management Inc. (MAI), a New York corporation whose stock was traded over the counter. In August 1966 the earnings of MAI severely declined[1] from their July 1966 and August 1965 levels,[2] but this information was not disclosed publicly until October 1966. In September 1966[3] Oreamuno sold 28,500 shares and Gonzales sold 28,000 shares of MAI stock.[4] Plaintiff, a shareholder, brought the present derivative action, seeking an accounting by Oreamuno and Gonzales for profits made on the sale of such stock.[5] In denying a motion to dismiss the complaint, the appellate division held that directors who use inside information to make profits in transactions with corporate stock are required to account to the corporation for such profits.[6] The

1. MAI was engaged in the leasing of used punch card equipment. As part of its leasing arrangements MAI undertook to maintain and service such equipment. In order to meet this obligation MAI entered into servicing agreements with International Business Machines Corporation (IBM). In August 1966 IBM increased its rates for the servicing and maintenance of such equipment. Diamond v. Oreamuno, 29 App. Div. 2d 285, 286 n.2, 287 N.Y.S.2d 300, 302 n.2, motion for leave to appeal granted, 29 App. Div. 2d 1053 (1st Dep't 1968).

2. The earnings of MAI during relevant months were: August 1966—$66,233; July 1966—$262,253; August 1965—$114,048. Id. at 286, 287 N.Y.S.2d at 302.

3. During September 1966 the bid price of the stock ranged between a high of $28.87½ and a low of $23.75 per share. After the release of August earnings the bid price fell to $11.00 per share. Id.

4. Control of the corporation was not affected by these sales. Id. at 287, 287 N.Y.S.2d at 302.

5. The action was based on the common law of New York and not the federal security law. The federal courts have exclusive jurisdiction over actions based on the latter. 15 U.S.C. § 78aa (1964); see American Distilling Co. v. Brown, 295 N.Y. 36, 64 N.E.2d 347 (1965). The requested relief would have been unavailable under federal law, had the suit been commenced in a district court. The relevant provision of federal law, the Security Exchange Act of 1934, 15 U.S.C. § 78j(b) (1964), and SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1968), have been interpreted as providing recovery for those persons who have dealt with an insider who either misrepresented or failed to disclose material facts. See Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952). Section 16(b) of the Security Exchange Act of 1934, 15 U.S.C. § 78p(b) (1964), sets up an objective standard whereby an insider is held liable to the corporation for profits on any purchase and sale within six months regardless of misrepresentation or failure to disclose material facts. The instant case does not involve a purchase and sale within six months. The applicability of federal law is also restricted so as not to encompass many over-the-counter transactions and private sales of close corporation stocks. See Security Exchange Act of 1934, §§ 10(b), 12, 16(b), 15 U.S.C. §§ 78j(b), 78l, 78p(b) (1964).

6. Defendant's motion for leave to appeal to the New York Court of Appeals has been granted with certification of the following question of law: "Whether a corporation has a cause of action against a director who sells a portion of his own stock in the corporation to a third person relying upon information known by him by virtue of his office but not

court reasoned that the directors, as fiduciaries of the corporation, breached their duty because they had "converted into money to their own use something belonging not to them but to their corporation—inside information."[7] This was so even though no harm resulted to the corporation by the sale, and even though the directors sold only a small percentage of their stock. *Diamond v. Oreamuno*, 29 App. Div. 2d 285, 287 N.Y.S.2d 300, *motion for leave to appeal granted*, 29 App. Div. 2d 1053 (1st Dep't 1968).

The court's application of fiduciary principles to hold directors liable for profits made by trading in corporate stock, with knowledge of inside information, is unique in both its reasoning and conclusion.[8] The principle that directors are fiduciaries of their corporations is amply supported by New York case law.[9] Its application, however, has always been in holding directors liable for making personal profits from transactions entered into or which should have been entered into on behalf of the corporation,[10] taking advantage of corporate opportunities,[11] diverting corporate assets,[12] competing with the corporation,[13] or making

disclosed publicly, where the corporation sustained no loss or damage, and where there was no usurpation or diversion of a corporate or business opportunity." Appellant's Memorandum of Law in Support of Motion for Order Granting Leave to Appeal at Diamond v. Oreamuno, 29 App. Div. 2d 1053 (1st Dep't 1968).

7. 29 App. Div. 2d at 288, 287 N.Y.S.2d at 304 (citation omitted).

8. Although the court pointed out that § 16(b), 15 U.S.C. § 78p(b) (1964), has been described as a statutory adaptation of common law permitting such an application of fiduciary principles, 29 App. Div. 2d at 289 n.4, 287 N.Y.S.2d at 304-05 n.4, it appears that no common law judicial authority existed for such an application. See text accompanying notes 17-20 infra.

9. Equity Corp. v. Groves, 294 N.Y. 8, 60 N.E.2d 19 (1945); Pink v. Title Guar. & Trust Co., 274 N.Y. 167, 8 N.E.2d 321 (1937); Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919); Pollitz v. Wabash R.R., 207 N.Y. 113, 100 N.E. 721 (1912); McClure v. Law, 161 N.Y. 78, 55 N.E. 388 (1899); Winter v. Anderson, 242 App. Div. 430, 275 N.Y.S. 373 (4th Dep't 1934).

10. E.g., New York Trust Co. v. American Realty Co., 244 N.Y. 209, 155 N.E. 102 (1926); Van Cott v. Van Brunt, 82 N.Y. 535 (1880); Turner v. American Metal Co., 268 App. Div. 239, 50 N.Y.S.2d 800 (1st Dep't), appeal dismissed, 295 N.Y. 822, 66 N.E.2d 591 (1946); Frank Sheridan Jonas, Inc. v. Romanat, 94 N.Y.S.2d 727 (Sup. Ct. 1950), aff'd, 278 App. Div. 809, 104 N.Y.S.2d 457 (1st Dep't), appeal dismissed, 303 N.Y. 616, 101 N.E.2d 487 (1951); Hauben v. Morris, 161 Misc. 174, 291 N.Y.S. 96 (Sup. Ct. 1936); Stanton v. Schenck, 142 Misc. 406, 252 N.Y.S. 172 (Sup. Ct. 1931).

11. E.g., Goth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939), aff'g 23 Del. Ch. 138, 2 A.2d 225 (Ch. 1938); Black v. Parker Mfg. Co., 329 Mass. 105, 106 N.E.2d 544 (1952); Blaustein v. Pan Am. Petroleum & Trans. Co., 263 App. Div. 97, 31 N.Y.S.2d 934 (1st Dep't 1941), aff'd, 293 N.Y. 281, 56 N.E.2d 705 (1944); Kelly v. 74 & 76 W. Tremont Ave. Corp., 4 Misc. 2d 533, 151 N.Y.S.2d 900 (Sup. Ct. 1956); Manacher v. Central Coal Co., 63 N.Y.S.2d 463 (Sup. Ct. 1946); Litwin v. Allen, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

12. E.g., Everett v. Philips, 288 N.Y. 227, 43 N.E.2d 18 (1942); Marian v. Marian, 84 N.Y.S.2d 335 (Sup. Ct.), modified, 276 App. Div. 205, 93 N.Y.S.2d 370 (1st Dep't 1949).

13. E.g., Stalkot Importing Corp. v. Berlin, 295 N.Y. 482, 68 N.E.2d 501 (1946); Foley v. D'Agostino, 21 App. Div. 2d 60, 248 N.Y.S.2d 121 (1st Dep't 1964); Duane Jones Co. v. Burke, 281 App. Div. 622, 121 N.Y.S.2d 107 (1st Dep't 1953), modified, 306 N.Y. 172, 117

extra profits when selling control of the corporation.[14] Further, in each case where a director has been held liable to the corporation on fiduciary grounds, there existed damage to the corporation, an element not present here.

The only holding similar to the instant one was that of a Delaware court in *Brophy v. Cities Service Co.*[15] Certain significant facts, however, distinguish the two cases. In *Brophy*, the corporation was planning a tender offer for a substantial number of its shares. A confidential secretary to one of its directors, realizing that in order for the tender offer to be successful it would have to be made at a price higher than the market price, bought and sold at a profit a small block of shares. In a stockholders' derivative suit brought to require an accounting by him to the corporation for such profits, the court said that loss to the corporation was not a necessary element in order to find liability for a breach of fiduciary duty. It is obvious, however, that his acquisition of the stock was in competition with the corporation's plans to acquire stock, and thus, in effect, his liability was based not on the use of inside information, but rather on his competition with the corporation in its acquisition of corporate stock. It is also possible that the case could be properly classified with those which have held directors liable for making personal profits out of transactions which should have been entered into on behalf of the corporation.[16]

The present court's prime authorities for its holding are *Seavey on Agency*, and the *Restatement (Second) of Agency*. In section 148(B), Seavey stated that an agent is under a duty to account for profits made through the use of information acquired by him because of his position. He supported this contention by citing two cases. The first case[17] concerned an agent who, while negotiating for his principal for the purchase of certain mineral rights, learned of similar rights nearby and bought them for himself. The second case[18] involved directors who caused the corporation to issue them treasury stock for an amount allegedly less than its value without giving other stockholders an opportunity to bid on or purchase such stock. It is obvious that in each of these situations there was harm to the principal, though in the latter case the court stated in dictum that it was immaterial whether or not the corporation was damaged. It is questionable, however, whether in the absence of loss to the principal the court would have imposed liability.

The *Restatement (Second) of Agency* states:

> An agent who acquires confidential information in the course of his employment or in violation of his duties has a duty not to use it to the disadvantage of the principal . . . . He also has a duty to account for any profits made by the use of such information, although this does not harm the principal . . . . So, if he has "inside" information that the corporation is about to purchase or sell securities,

N.E.2d 237 (1954); Singer v. Carlisle, 26 N.Y.S.2d 172 (Sup. Ct. 1940), aff'd, 261 App. Div. 897, 26 N.Y.S.2d 320 (1st Dep't 1941).

14. Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955).
15. 31 Del. Ch. 241, 70 A.2d 5 (Ch. 1949).
16. See cases cited note 10 supra.
17. Nye v. Lovelace, 228 F.2d 599 (5th Cir. 1956).
18. Johnson v. Duensing, 340 S.W.2d 758 (Mo. Ct. App. 1960).

or to declare or to pass a dividend, profits made by him in stock transactions undertaken because of his knowledge are held in constructive trust for the principal. He is also liable for profits made by selling confidential information to third persons, even though the principal is not adversely affected.[19]

The cases annotated to this section[20] deal with instances where an agent took advantage of an opportunity which belonged to his principal, thereby harming the principal. Thus, these cases too offer no authority for the present holding.

The instant court stated that "[t]hese fiduciaries are not being charged because they sold stock, or because transactions in securities might subvert their proper functioning as executives of MAI or blemish its reputation. They are being charged because they converted into money to their own use something belonging not to them but to their corporation—inside information."[21] Perhaps by implying in this statement that inside information is a corporate asset, the court was trying to gain support for its decision from those cases which have held directors liable for diverting corporate assets.[22] Inside information, however, has generally not been considered an asset of the corporation.[23] It should also be noted that the corporation had no way to make use of the inside information. It would have been illegal for the corporation to sell this information, or for it to issue its treasury stock or its authorized but unissued stock, without disclosing it.[24]

If the decision is to be accepted as based only on public policy grounds, it may be questioned whether the public needs such extensive protection. Federal security law, arguably, already provides adequate protection to one who transacts with an insider who fails to disclose material information.[25] Indeed, this decision would subject the directors to a hazard of double recovery[26] in that they would be required to account to the corporation under this case, and then might also be held liable under section 10b-5[27] to those persons who purchased their shares. It would also provide a new class of stockholder's derivative suits with which dissident stockholders could harass corporate directors. Conceivably,

19. Restatement (Second) of Agency, § 388, comment c at 204-05 (1958).

20. Id. at appendix § 388 (1957).

21. 29 App. Div. 2d at 288, 287 N.Y.S.2d at 303-04.

22. Supra note 12.

23. "[K]nowledge of a general sort or information gained through being a director or officer is generally not considered as a corporate facility the use of which for his own profit may make the corporate official accountable to the corporation." Annot., 153 A.L.R. 663, 668 (1944) citing Diedrick v. Helm, 217 Minn. 483, 14 N.W.2d 913 (1944); Young v. Columbia Oil Co., 110 W. Va. 364, 158 S.E. 678 (1931).

24. Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966); see Annot., 7 A.L.R.3d 500 (1966).

25. See supra note 5. Of course, should Congress deem more extensive protection necessary, it is free to add appropriate statutory liability. Obviously, liability to a corporation offers both preventative and remedial protection to the purchaser of the corporation's stock from an insider.

26. The instant court specifically declined to rule on this issue. 29 App. Div. 2d at 290, 287 N.Y.S.2d at 305.

27. 15 U.S.C. § 78j(b) (1964).

whenever a director engaged in transactions in corporate stock some stockholder could allege that the director used inside information. As a result directors may no longer want to trade in corporate stock, thereby removing a valuable incentive for becoming a corporate director.[28]

This decision also presents a problem in the computation of damages. A director violating his fiduciary duty would normally have to hold what he made in constructive trust for the corporation. The usual measure of the director's profit is the difference between the sale price and the cost of the shares. This measure of damages, however, is not applicable here. Instead, the court must attempt to find the loss prevented by the use of inside information. This amount could be computed in several ways. It could be the difference between the price at which he had sold the stock and the price to which it declined when the news was disclosed; or, it could be the difference between the price at which he had sold it, and the lowest price to which it declined as a result of the disclosure. Yet a third measure could be the difference between his selling price and the price to which it declined within a reasonable time after the news was disclosed. A reasonable time might be such length of time as it would take a reasonably diligent investor to discover the information. The last alternative is probably the most equitable since there should be no objections to directors selling their stock after the news has been disclosed to all interested parties.

However equitably damages might be assessed, the instant holding reflects an unfortunate exercise of judicial creativity. Rendered at a time when the scope of insider liability under existing statutes and agency rulings is at best in a state of flux, the instant decision merely offers the corporate insider greater uncertainty. The court has imposed what amounts to a penalty upon corporate insiders by finding a new common law liability to an undamaged entity for acts which existing law, to the extent deemed wise by legislatures, has already provided redress for those actually injured.

Criminal Law—Plain Error Rule—Standards for Application of the Rule Set Forth.—Defendant was convicted of carrying on the business of distilling without posting a bond.[1] Thereafter, defendant moved to set bail pending his appeal, claiming that he should be released on bail because the judge's instructions to the jury, to which he had not objected at trial, contained error so plain that he would win on appeal. Applying Federal Rules of Criminal Procedure 30 and 52(b), the court declared the appeal frivolous and denied the motion. *United States v. Summerour*, 279 F. Supp. 407 (E.D. Mich. 1968).

Federal Rule 52(b), entitled "plain error," provides: "Plain errors or defects affecting substantial rights may be noticed although they were not brought to

28. It is possible nevertheless, for standards to be set up which would delineate when it would be proper for a director to deal in the stock of the corporation. See 37 Fordham L. Rev. 483, 492 (1968).

1. 26 U.S.C. § 5601(a)(4) (1964).

the attention of the court." The instant court noted that the rule itself is quite unclear, as it contains no real definition of "plain error" except by references to the nebulous term "substantial rights."[2] Any definition, then, of "plain error," and how it is to be applied, must come from case law. The court here tried to bring together the various conclusions on the subject and then to present a set of workable rules.

Judicial reaction to "plain error" motions was epitomized by the First Circuit in *Dichner v. United States*.[3] The court stated: "It is also unfair to the court and the public generally if a defendant can have two bites at the cherry by saying nothing and then coming back and asking for a second chance."[4]

While most courts agree that "plain error" is to be applied only in exceptional cases, no single norm of exceptionality appears to exist. The First Circuit would apply the "plain error rule" only if the error had been of "great magnitude,"[5] meaning errors which " 'seriously affect the fairness, integrity, or public reputation of judicial proceedings.' "[6] The Sixth Circuit describes "plain error" as an "obvious miscarriage of justice."[7] Finding a judge so incompetent as to fit the Eighth Circuit's description seems impossible. He would have to have given instructions that were "so indefinite, uncertain, contradictory, misleading, inconsistent and prejudicial as to require reversal on review."[8]

Rule 30 adds to the problems created by the definitional inadequacies surrounding plain error. It states, in part: "No party may assign as error any portion of the charge . . . unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and his grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury and, on request of any party out of presence of this jury." This rule would appear to be in direct conflict with rule 52(b) (the plain error rule). While rule 30 would deny the appeal counsel the privilege of performing a post-mortem on the instructions, in order to bring up new objections, rule 52 (b) allows the court to notice previously unobjected to "plain errors."

The instant court has read these two rules together[9] in order to construct a pattern to follow in deciding when to apply rule 30 and when to apply rule 52 (b). It termed plain error "a *fundamental* error, something so basic, so prejudicial, so lacking in its elements that justice cannot have been done."[10] It asked "what, in legal contemplation, is 'fundamental'?"[11] The court first turned to the content of the instructions themselves. It divided them into two general

2. 279 F. Supp. at 409.
3. 348 F.2d 167 (1st Cir. 1965).
4. Id. at 168.
5. Id.
6. Lash v. United States, 221 F.2d 237, 240 (1st Cir.), cert. denied, 350 U.S. 826 (1955).
7. United States v. Ramsey, 291 F.2d 737, 738 (6th Cir.), cert. denied, 368 U.S. 899 (1961).
8. Cave v. United States, 159 F.2d 464, 466 (8th Cir.), cert. denied, 331 U.S. 847 (1947).
9. See Lash v. United States, 221 F.2d 237 (1st Cir.), cert. denied, 350 U.S. 826 (1955).
10. 279 F. Supp. at 410.
11. Id.

parts: (1) the basic charge, and (2) the minutiae of the particular case. The basic charges are those which are common to each and every criminal trial. These entail two factors: (a) an explanation of the elements of the offense charged and, (b) the concepts involved in due process (*e.g.*, reasonable doubt, burden of proof, and presumption of innocence). Any instructions concerned with either (a) or (b) are deemed "fundamental." This is the part of the instructions which definitely affects the "substantial rights" mentioned in rule 52(b). A mistake or an omission in these "basic" charges is clear grounds for a reversal on "plain error" grounds.

The second part, the "minutiae," are those instructions which are peculiar to the facts of the given case. These are concerned with "the evidence adduced and the procedures followed in this particular trial."[12] The general rule is that "*an instruction that needs to be related to the facts at bar in order to be proper*, is not a 'fundamental' one."[13] Rule 30 applies to this type of special charge. If the trial counsel did not object when such specific instructions were being given, then "plain error" cannot be asserted on appeal. The purpose of rule 30 is to invite counsel to aid the judge in formulating this part of his charge[14] and to keep defense counsel from remaining silent during *special* charges, waiting for the judge to slip, knowing that "plain error" can be raised on appeal. "The Rules generally are designed to prevent counsel from holding his cards close to his vest."[15]

Although this decision binds but one district court, it appears that it goes far to set a definitional guideline concerning "plain error." Such a guideline might well be adopted in other districts.

Securities Regulation—Rule 10b-5 Concepts of Materiality and Duty of Disclosure Expanded.—On November 8, 1963, as part of exploratory operations started in 1957 in eastern Canada, the Texas Gulf Sulphur Company (TGS) drilled test hole K55-1. A visual inspection on November 12 of the core so extracted disclosed an unusually high content of copper and zinc, and convinced TGS that it would be desirable to acquire the surrounding property. In order to do this as inexpensively as possible, drilling operations were discontinued and the president of TGS instructed the exploratory group[1] to keep the drilling results secret even as to other officers, directors and employees of TGS. In early December, a chemical assay of the core confirmed that the copper

12. Id.
13. Benatar v. United States, 209 F.2d 734, 744 (9th Cir.), cert. denied, 347 U.S. 974 (1954).
14. 279 F. Supp. at 411.
15. Benatar v. United States, 209 F.2d 734, 744 (9th Cir.), cert. denied, 347 U.S. 974 (1954).

1. The exploratory group included defendants Mullinson, a Vice President of TGS, Holyk, TGS' Chief Geologist, Clayton, a geophysicist, and Darke, a geologist.

and zinc content was unusually good and also disclosed a substantial content of silver. By March 27, 1964, TGS decided that the land acquisition program had reached a point where drilling could be continued. Between March 31 and April 10, four additional holes were drilled and inspection of the cores revealed a substantial mineral content in each. Meanwhile, rumors of a major ore discovery were circulating throughout Canada and they appeared in the New York papers on April 11. In an effort to quell these rumors, TGS, on April 12, issued a press release which admitted that it was exploring, but stated that the rumors exaggerated the scale of operations and concluded that "any statement as to size and grade of ore would be premature and possibly misleading."[2] Between April 12 and April 16, three more drill holes were completed and examination of their cores disclosed substantial mineral content. On April 16, TGS issued a release which announced a major ore discovery.

During the period from November 12, 1963 to April 12, 1964, three officers and five employees of TGS purchased or recommended that others purchase TGS stock or calls thereon. Between the first press release on April 12 and the dissemination of the TGS official announcement on the morning of April 16, the secretary of TGS and an employee purchased TGS stock. Moreover, during the press conference on April 16, one director left the room and made a telephone call to his broker which resulted in purchases of TGS securities by third parties. Furthermore, on February 20, some of the defendants accepted stock options from a company committee which had not been informed of the drilling results.

The SEC commenced proceedings charging that by purchasing or recommending the purchase of TGS securities on the basis of material inside information which had not been released to the public and by accepting the stock options, the defendants had violated section 10(b) of the Securities Exchange Act of 1934[3] and rule 10b-5[4] promulgated thereunder. The Commission also claimed that the press release of April 12 was false and misleading.

The district court held that the transactions in TGS securities prior to April 9, 1964 were not in violation of the rule because the drilling results were not material until then, and that only those defendants who had traded between April 9 and April 16, had violated rule 10b-5.[5] The court also held that the press release of April 12 was not "misleading or deceptive on the basis of the facts then known,"[6] and that even if it had been false or misleading, it did not violate

2. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 293 (S.D.N.Y. 1966).

3. 15 U.S.C. § 78j(b) (1964).

4. 17 C.F.R. § 240.10b-5 (1968). Rule 10b-5 provides as follows: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of a security."

5. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 285-86 (S.D.N.Y. 1966).

6. Id. at 296. The court reasoned that the framers of the press release were under con-

the rule because it was not issued "in connection with the purchase or sale of any security."[7] Furthermore, the court held that the directors who alerted third parties to the news after the release of the 16th, but before the news was carried over the Dow Jones tape, did not violate rule 10b-5.[8] The Court of Appeals for the Second Circuit, sitting en banc, reversed the district court on the question of materiality and held that the drilling results were material from the date of the visual inspection. Hence, the defendants who purchased or recommended that others purchase TGS securities on the basis of this information had violated rule 10b-5.[9] The appellate court also held that there must be a reasonable waiting period after the release of the inside information before an insider can trade,[10] and that the members of top management, who with knowledge of the drilling results had accepted stock options, had violated the rule.[11] Finally, the court held that the press release of April 12 was issued in connection with the purchase or sale of a security[12] and could have been misleading,[13] remanding to the district court for proceedings to determine whether it was misleading to the reasonable investor and whether the framers of the press

siderable pressure. If they issued too optimistic a release, they subjected the company to possible liability if it turned out that they had not discovered a commercial mine. If they said too little and later announced a discovery, they subjected the company to the charge that the press release was false and misleading. The court also believed that if they had just stated the drilling results, they would have encouraged rumors which they had hoped to allay. There was no evidence that the drilling results after 7:00 P.M. April 10 were known to the framers. The court found that even though the drilling results were material on April 9, the results did not establish the existence of a commercial mine. The court held that the release must not be judged on the basis of hindsight and that the framers had exercised reasonable business judgment under the circumstances.

7. Id. at 293. The court, relying on Freed v. Szabo Food Serv., Inc., [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,317 (N.D. Ill., Jan. 14, 1964), held that "[i]n the absence of a showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders, the issuance of the press release did not constitute a violation of Section 10(b) or Rule 10b-5 since it was not issued 'in connection with the purchase or sale of any security.'" 258 F. Supp. at 294.

8. Id. at 288-90. The court held that the fixing of a waiting period after announcement of material inside information was more properly a legislative or administrative function.

9. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852 (2d Cir. 1968).

10. Id. at 854. The mere release of material inside information is not enough to satisfy the requirements of the rule. Insiders must, at the minimum, wait until the material information "could reasonably have been expected to appear over the media of widest circulation, the Dow Jones broad tape . . . ." Id. at 854.

11. Id. at 856-57. The court held that members of top management are required, before accepting stock options, to disclose material inside information which might affect the price of the stock during the period in which the option could be exercised. However, in cases where disclosure would jeopardize a corporate security, the court indicated that the better rule would be to hold that accepting the option does not violate rule 10b-5 but that exercising it without full disclosure and ratification would.

12. Id. at 858-62.

13. Id. at 862-64.

release had exercised due diligence. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *petitions for cert. filed*, 37 U.S.L.W. 3250 (U.S. Jan. 3, 1969) (No. 897), 37 U.S.L.W. 3264 (U.S. Jan. 13, 1969) (No. 937).

The case was widely discussed even before it came to trial,[14] and the decision of the court of appeals has already had a major impact on the business community.[15] Prior to the instant decision, it had been clear that rule 10b-5 imposed a duty of disclosure on insiders who traded on the basis of material inside information.[16] However, it was not clear whether this duty of disclosure would be limited to insiders or whether it would be imposed on anyone who traded on the basis of undisclosed, material information. There was also uncertainty as to what facts could be termed "material." Furthermore, it had been thought that a misleading disclosure in the absence of trading by insiders was not a violation of rule 10b-5 because it could not be considered as having been issued in connection with the purchase or sale of securities.[17] The instant court's holdings (1) as to what facts are material, (2) as to who has a duty of disclosure, and (3) as to whether the press release was issued in connection with the purchase or sale of a security, have clarified these issues by significantly extending the regulation of insider trading under rule 10b-5.[18]

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14. See, e.g., Fleischer, Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding, 51 Va. L. Rev. 1271 (1965); Symposium —Insider Trading in Stocks, 21 Bus. Law. 1009 (1966); Note, SEC v. Texas Gulf Sulphur Co.: The Inside and Outside of Rule 10b-5, 46 B.U.L. Rev. 205 (1966); Note, Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5, 79 Harv. L. Rev. 656 (1966).

15. See N.Y. Times, Aug. 15, 1968, at 54, cols. 5-6; id., Aug. 14, 1968, at 1, col. 4; Wall St. J., Aug. 16, 1968, at 1, col. 6; id., Aug. 15, 1968, at 4, col. 2; id., Aug. 14, 1968, at 3, cols. 1-3.

16. List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir.), cert. denied, 382 U.S. 811 (1965).

17. Freed v. Szabo Food Serv., Inc., [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,317 (N.D. Ill., Jan. 14, 1964).

18. While this discussion will be limited to the above, it should be noted that the court's pronouncements on the elements of a cause of action under the rule and the necessity for a waiting peirod between disclosure and trading, have provided the first judicial resolutions to some of the practical problems arising under the rule.

The defendants who had purchased after the release of the 16th, but before the news was deemed disclosed, claimed that they were justified in so doing because they had honestly believed that the news had become public before they placed their orders. However, the court stated that "whether the case . . . is treated solely as an SEC enforcement proceeding or as a private action, proof of a specific intent to defraud is unnecessary." 401 F.2d at 854 (footnote omitted). The court based its decision as to an enforcement proceeding by the SEC on SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), which held that in a regulatory or enforcement proceeding brought by the SEC under § 206 of the Investment Advisors Act of 1940, 15 U.S.C. § 80b-6 (1964), Congress intended the Act to be flexibly construed and that it would defeat the purpose of the Act to hold "that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury . . . ." Id. at 192. However, in Texas Gulf Sulphur, the SEC was seeking ancillary as well as injunctive relief, and no case prior to this had passed upon the question as to whether the SEC could request an ancillary order that the defendants be required to make restitution to private persons. See

Rule 10b-5 is more than a mere prohibition against manipulative or deceptive practices in connection with the purchase or sale of securities. In addition to prohibiting false statements and the omission of statements necessary to make facts already stated not misleading, it has been interpreted to impose an affirmative duty of disclosure where an insider remained silent in face-to-face transactions with a stockholder.[19] Moreover *Cochran v. Channing Corp.*[20] held that a duty to disclose existed when an insider purchased on an organized exchange even though there was no communication between the parties.[21] The present defendants argued against the holding of *Cochran*, contending that it would be impossible for an insider trading on a national exchange to find the other party to the transaction and disclose material information to him. However, as the court of appeals pointed out, public disclosure would satisfy the duty imposed by the rule. The court, reasoning that "the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material in-

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Note, Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5, 79 Harv. L. Rev. 657 (1966).

Moreover, in regard to private suits, there had been decisions in the Second Circuit which required proof of some of the elements of common-law fraud. See, e.g., Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 786 (2d Cir. 1951) (proof of fraud is required); Weber v. C.M.P. Corp., 242 F. Supp. 321, 324 (S.D.N.Y. 1965) (scienter); Barnett v. Anaconda Co., 238 F. Supp. 766, 771 (S.D.N.Y. 1965) (causation). However, the court relied on recent decisions in other circuits which held that it is only necessary to prove a material misstatement of fact or an omission to state a material fact. See, e.g., Stevens v. Vowell, 343 F.2d 374, 379 (10th Cir. 1965); Royal Air Properties, Inc. v. Smith, 312 F.2d 210 (9th Cir. 1962); Ellis v. Carter, 291 F.2d 270 (9th Cir. 1961). The court maintained that its statements were not irreconcilable with the previous decisions in the Second Circuit because some form of the traditional scienter requirement was maintained. The court stated that "[t]his requirement, whether it be termed lack of diligence, constructive fraud, or unreasonable or negligent conduct, remains implicit in this standard, a standard that promotes the deterrence objective of the Rule." 401 F.2d at 855. Thus, there need be no intent to deceive; negligent conduct can violate the rule.

As to the waiting period requirement, see note 10 supra. It is the first judicial decision to hold that there must be a waiting period between the release of material inside information and trading by an insider. The SEC had previously warned insiders to stay out of the market "until the established procedures for public release of the information are carried out instead of hastening to execute transactions in advance of, and in frustration of, the objectives of the release." Cady, Roberts & Co., 40 S.E.C. 907, 915 (1961). However, the court of appeals has only stated the minimum waiting period required. It is possible that insiders might be held to violate the rule whenever they trade before the news has been absorbed by the market. This might be some time after it is carried over the Dow-Jones tape.

19. Speed v. Transamerica Corp., 99 F. Supp. 808, 828-29 (D. Del. 1951), aff'd, 235 F.2d 369 (3d Cir. 1956).

20. 211 F. Supp. 239 (S.D.N.Y. 1962).

21. Id. at 243. See also List v. Fashion Park, Inc., 340 F.2d 457, 461 (2d Cir.), cert. denied, 382 U.S. 811 (1965).

formation," [22] held that the Act and rule applied to transactions which are executed on organized exchanges.[23] Clearly, the location of the transaction should not affect the applicability of the rule.[24]

Rule 10b-5, however, does not specify the matters to be disclosed. They are determined by the decisional law tests of materiality and inside information. In the context of rule 10b-5, materiality has been interpreted to mean facts which "would materially affect the judgment of the other party to the transaction."[25] Moreover, this judgment must be reasonable.[26] A test more particularly tailored to the securities market has defined material facts as those "which in reasonable and objective contemplation might affect the value of the corporation's stock or securities,"[27] but "value" remained undefined. Clearly, these definitions supply no precise standard which can be easily applied; however, the courts have used them to hold that information was material whenever the equities of the situation so required.[28] The district court in the instant case had held that materiality should be determined by measuring the effect that disclosure would have on a conservative investor.[29] The court of appeals disagreed, holding that reasonable speculators, being reasonable men, were entitled to the same protection as conservative investors.[30] Furthermore, the court of appeals defined material facts as those "which may affect the desire of investors to buy, sell, or hold the company's securities."[31] Under this definition, the value of a corporation's stock is judged not only by its earnings value but by the market price as well. This expanded definition of materiality led the court to reverse the district court on the question of when the drilling results became material. In reaching the conclusion that the results were material from the date of the first visual inspection, a major factor was the importance attached to the drilling results by the defendants themselves. The district court had concluded that this information had a special significance to an insider

22. 401 F.2d at 848.

23. Id.

24. Fleisher, supra note 14, at 1278. See Cady, Roberts & Co., 40 S.E.C. 907, 914 (1961), which stated that: "It would be anomalous indeed if the protection afforded by the antifraud provisions were withdrawn from transactions effected on exchanges, primary markets for securities transactions."

25. Kardon v. National Gypsum Co., 73 F. Supp. 798, 800, modified, 83 F. Supp. 613 (E.D. Pa. 1947).

26. Rogen v. Ilikon Corp., 361 F.2d 260, 266 (1st Cir. 1966).

27. List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965); Kohler v. Kohler Co., 319 F.2d 634, 642 (7th Cir. 1963).

28. See Taylor v. Janigan, 212 F. Supp. 794 (D. Mass. 1962), modified, 344 F.2d 781 (1st Cir.), cert. denied, 382 U.S. 879 (1965) (potential of a failing business); Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962) (identity of purchaser); Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951), aff'd, 235 F.2d 369 (3d Cir. 1956) (deceptive inventory and nondisclosure of improved earnings); Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947) (nondisclosure of a contract for the sale of a corporation's assets to a third party).

29. 258 F. Supp. at 280.

30. 401 F.2d at 850.

31. Id. at 849.

because of his professional background, and that the early guesses were not based on material facts but were based on educated guesses which do not have to be disclosed.[32] But the court of appeals, while agreeing that educated guesses or opinions do not have to be disclosed, took a more realistic approach. In reversing, the court reasoned that:

> [Defendants] alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of TGS stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset of the favorable probabilities would likewise be unaware of the unproductive exploration, and the additional exploration costs would not significantly affect TGS market prices.[33]

The court stretched the facts somewhat when it stated that it "seemed from the outset to be a major ore strike."[34] This was only a possibility. However, the point the court made was that the possibility of a mine was a material fact. Insiders do not have to disclose their opinions or predictions, but they do have to disclose the facts, if they are material, upon which their opinions are based. The possibility of a major mineral discovery is certainly a fact which might "affect the desire of investors to buy, sell, or hold the company's securities," particularly if "investors" includes speculators as well as conservative investors.

However, in many cases, disclosure may hurt the corporation. In the instant case, it would have jeopardized the corporation's land acquisition program. Moreover, as the dissent points out, disclosure may have violated the Commission's own rule that " '[n]o claim shall be made to the existence of a body of ore unless it has been sufficiently tested to be properly classified as "proven" or "probable" ore . . . .' "[35] But these objections are based on the assumption that there are only two choices for the person with material inside information, *i.e.*, either disclose it or violate the rule. The present decision has provided a third alternative: to refrain from trading until after the information is disclosed.[36] This holding is designed to promote an equalization of bargaining positions between parties to securities transactions,[37] but it is not certain whether it will promote disclosure. It could have the effect of reducing everyone to the level of the least informed. Nondisclosure will only benefit the corporation or its insiders in those areas where there is a legitimate corporate purpose for nondisclosure. Moreover, where there is no legitimate corporate purpose, insiders may be hurt by nondisclosure. Presumably, their specialized knowledge of the industry would enable them to better evaluate the information and thus use it

32. 258 F. Supp. at 283.

33. 401 F.2d at 852.

34. The expert witnesses all agreed that one drill core is not a sufficient basis on which to predict a commercially profitable mine.

35. 401 F.2d at 873 (Lumbard & Moore, JJ., dissenting).

36. Id. at 848. The SEC had previously stated this rule in Cady, Roberts & Co., 40 S.E.C. 907 (1961), but Texas Gulf Sulphur is the first judicial affirmance of it.

37. The most clearly stated policy set by the courts for rule 10b-5 has been the equalization of bargaining positions. See Speed v. Transamerica Corp., 99 F. Supp. 808, 828-29 (D. Del. 1951).

more profitably. Since they cannot trade in the absence of disclosure, they would not be able to take advantage of their educated guesses. Thus the impetus would seem to be towards disclosure. However, the court's holding on the press release of April 12 may have supplied a legitimate corporate purpose for nondisclosure, *i.e.*, the fear of possible liability for an insufficient or misleading disclosure.

It had been clear that a false or misleading press release issued for the purpose of affecting the market price of a corporation's securities to the benefit of the corporation or its insiders was issued in connection with the purchase or sale of a security.[38] But in the absence of insider trading, it appeared that there could not be a connection with the purchase or sale of a security,[39] and that there would be difficulty in proving that the release was issued for an ulterior motive. In the instant case, the release was issued to quell the extravagant rumors which were circulating, and there was no evidence which would have justified a finding that the release was issued for a manipulative purpose. However, the court of appeals held that rule 10b-5 is violated whenever false or misleading statements are made in a manner reasonably calculated to influence the investing public, irrespective of whether they were issued for ulterior purposes, if due diligence was not exercised in their preparation and release.[40] This holding places a great burden on the corporation which the court justified on the theory that an innocently misleading statement can injure reasonable investors as much as one that is motivated by an ulterior purpose. The court did not indicate whether a lack of due diligence would subject the corporation to liability for damages, but it did not negate this possibility. The majority, however, did attempt to provide guidance to the drafters of press releases. They indicated that a corporation should stick to the facts and avoid trying to shield them in ambiguous statements. This could have been done in the instant case without the publishing of a "mass of metallurgical reports" as suggested by the dissent.[41] TGS could have published a short summary of the assays and, since the land acquisition program had been completed by April 12th, could have disclosed that these assays had convinced TGS that it should acquire the surrounding property. However, such a report, if it turned out that a commercial body of ore did not exist, might have been called too optimistic or misleading. This possibility of liability for negligently misleading corporate statements could well deter the dissemination of corporate information. As noted by Judge Friendly, in his concurring opinion:

> If the only choices open to a corporation are either to remain silent and let false rumors do their work, or to make a communication, not legally required, at the risk that a slip of the pen or failure properly to amass or weigh the facts—all judged in the bright gleam of hindsight—will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers, most corporations would opt for the former.[42]

38. Freed v. Szabo Food Serv., Inc., [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,317 (N.D. Ill., Jan. 14, 1964).
39. Id.
40. 401 F.2d at 862.
41. Id. at 878.
42. Id. at 867.

As to who is subject to a duty of disclosure, rule 10b-5 prohibits "any person" from making affirmative misstatements in connection with the purchase or sale of a security.[43] However, an affirmative duty to disclose material facts has only been imposed on those termed "insiders." The term "insider" had not been clearly defined. The only people definitely included within the term were corporate officers, directors and controlling stockholders.[44] However, the SEC in *Cady, Roberts & Co.*[45] held that the duty of disclosure is not limited to "insiders" but is imposed on any person having "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone . . . ."[46] In *Cady, Roberts* the violator was a broker and the business partner of an insider, and it was unclear whether the SEC was imposing a special obligation on brokers, or whether the obligation would be imposed on all having access to such information.[47] The present case has left no doubt that the SEC intended the ruling to apply to all having access to material inside information. The decision imposed a duty of disclosure on lower employees, *i.e.*, an attorney, an engineer, and a geologist. The court, citing *Cady, Roberts*, held that anyone who has access to material inside information may not take advantage of it if he knows that it is unavailable to the investing public.[48] The court also held that the defendants who gave tips to outsiders had violated the rule and remanded to the district court for a determination of the appropriate remedy.[49] The court was not required to decide whether the purchases by "tippees" had violated the rule, but they indicated that such could be violations.[50] The fact that the SEC did not attempt to establish a violation by the "tippees" does not necessarily mean that the Commission will not, in the future, attempt to establish such a violation. In circumstances such as those presented here, the SEC may believe that holding the tipper liable for damage caused by his tip is a more effective means of restricting trading on the basis of inside information. An insider will be more reluctant to tip, if he will be held liable for any damage resulting from the tip. Such a method is designed to stop the leakage of material inside information at its source. The problem with this method is that it imposes an enormous and unrealistic liability. Critics of the decision often make the mistake of giving examples where an employee innocently discloses material information to a wealthy friend who takes advantage of it. They argue that the imposition of liability on the employee is not only unfair but unrealistic because the average employee could not make restitution where his wealthy friend made substantial purchases. But there would be no violation of the rule, under the present decision, unless the employee took advantage of the inside information. Thus it would appear that an innocent disclosure would not be a violation. Of course, if a director gave a tip to his

43. See note 4, supra.

44. 3 L. Loss, Securities Regulation 1450 (2d ed. 1961).

45. 40 S.E.C. 907 (1961).

46. Id. at 912 (footnote omitted).

47. See Note, Broker Silence and Rule 10b-5: Expanding the Duty to Disclose, 71 Yale L.J. 736 (1962).

48. 401 F.2d at 848.

49. Id. at 852.

50. Id. at 852-53.

broker son-in-law, even though he did not trade for his own account, it would not be difficult for a court to find that he took advantage. However, it is true that most employees would not be able to make restitution where their "tippees" made substantial purchases. In such cases, the SEC might try to establish a violation by the "tippees" albeit they have no traditional obligation to the stockholders of the corporation. However, the SEC and the court of appeals might impose one on the basis that it would be unfair to allow them to take advantage of the information. But in cases where a brokerage firm received a tip that the earnings of a corporation were off, would the unfairness to the stockholders of the corporation outweigh the brokerage firm's obligations to their clients? If they disclosed to all of their clients would they violate the rule? *Cady, Roberts* and the instant decision appear to hold that there would be a violation of the rule, but the SEC has not supplied any arguments for such a holding, except the fairness argument.

The holding by the court of appeals does much towards eliminating objectionable insider trading, but it may also make it impossible for insiders to trade. While an insider will always know more about his company, or at least about some specialized area of its activities, than an outsider, this information will not impose a duty of disclosure, unless it is material. But what if an insider has a doubt about its materiality? He could follow the recommendations of the New York Stock Exchange and limit his transactions to regular periodic purchases after the distribution of fully informative annual or quarterly reports,[51] but it is not certain whether this would protect him. Moreover, in view of the present decision, an insider will almost always have doubts. Any fact which might affect the desire of a speculator to buy or sell is material. Under this definition, an argument could be made that almost any fact is material. The SEC might limit its actions to circumstances where the facts present a clear and gross violation, but there is no reason to believe that private suitors would so limit themselves. Private suitors, relying on the instant case, would probably argue that the fact of the purchase proves that the information was material.

Taxation—Retention of Royalty upon Disposition of Hard Mineral Rights Results in Ordinary Income.—Taxpayers transferred the mineral rights on their land (excluding rights to coal, oil and gas) to the transferee for a lump sum payment and the retention of a ten percent royalty of all minerals mined, marketed and sold. The mineral deed did not obligate the grantee to develop the property. The taxpayers contended that the transaction constituted a sale and that both the lump sum payment and the royalty payments should have been treated as capital gains for income tax purposes. The Commissioner argued that the transaction was a lease and that both the lump sum payment and the royalties should have been treated as ordinary income subject to the percentage depletion allowance. The Court of Appeals for the Tenth Circuit held that the transaction constituted a lease and that both the lump sum payment and the royalty payments must be treated as ordinary income, subject to the depletion allowance. In so deciding, the court overruled its prior decision[1] as to the treat-

51. N.Y. Stock Exch., The Corporate Director and the Investing Public 12-13 (1965).

1. The same parties brought the transaction before the same court in 1962. The court

ment of the lump sum payment and reversed the holding of the trial court[2] with respect to the royalty payments. *United States v. White*, 401 F.2d 610 (10th Cir. 1968).

Whether a transfer of mineral interests is characterized as a sale or a lease is of critical importance to the transferor-taxpayer. If the disposition is considered a sale the taxpayer will normally be accorded capital gains treatment on the consideration received.[3] If, on the other hand, the transaction is classified as a lease the consideration will be treated as ordinary income for tax purposes, subject to a depletion allowance.[4] The taxpayer will normally benefit more from capital gains treatment.[5] Unfortunately, the case law concerning this sale-lease distinction is in confusion.[6]

Apparently there is some disparity between the tax treatment accorded transactions in the oil and gas field and that given transactions in the hard mineral area.[7] Extensive litigation in the oil and gas area has developed the "economic interest" test[8] which, although first used to determine whether a taxpayer was

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then afforded capital gains treatment to the lump sum payment. There had, as yet, been no production payments and therefore the court did not determine if these royalties, when made, would require a different tax treatment. United States v. White, 311 F.2d 399, 403 (10th Cir. 1962). The instant case arose when the Commissioner challenged the capital gains treatment accorded the production payments.

2. White v. United States, 254 F. Supp. 894 (D. Colo. 1966).

3. "Mineral interests can be capital assets, stock in trade, or property used in the taxpayer's trade or business. If they are capital assets, any sale results in capital gain or loss. If they are stock in trade, any sale results in ordinary gain or loss. If they are real property used in the taxpayer's trade or business, they are Section 1231 [Int. Rev. Code of 1954, § 1231] assets. . . . In sales of such assets held for more than six months, gains and losses are set off against each other; a net gain is treated as a capital gain and a net loss is an ordinary loss." Bloomenthal, A Guide to Federal Mineral Income Taxation—Part II, 1 Land & Water L. Rev. 379, 390 (1966). The present taxpayers had held the mineral interests as capital assets; thus, a sale would have resulted in a capital gain or loss.

4. Int. Rev. Code of 1954, § 613.

5. See Int. Rev. Code of 1954, § 1201. If a transaction is accorded capital gains treatment in no event will the tax exceed 25% of the long-term capital gain. If the transaction is treated as a lease, however, the consideration will be treated as ordinary income, subject to depletion. United States v. White, 401 F.2d 610, 612 (10th Cir. 1968). The ordinary income tax rates for an individual are progressive and can be as high as 70% (not including the surcharge). If the lessor is a corporation the tax would be equal to 22% on the first $25,000 of taxable income and 48% on taxable income in excess of $25,000 (not including the surcharge). Int. Rev. Code of 1954, §§ 1, 11. The percentage depletion rates (which vary from 5% to 27½%) will usually not offset the advantage of capital gains treatment. Int. Rev. Code of 1954, § 613(b). See generally Bloomenthal, supra note 3, at 385.

6. See note 16 infra.

7. This disparity has developed even though the Internal Revenue Service has stated that the tax laws should be applied uniformly in both areas. G.C.M. 22730, 1941-1 Cum. Bull. 214, 219.

8. Commissioner v. Southwest Exploration Co., 350 U.S. 308 (1956); Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25 (1946); Anderson v. Helvering, 310 U.S. 404 (1940); Palmer v. Bender, 287 U.S. 551 (1933). For a complete discussion of the concept of the "economic interest" see Sneed, The Economic Interest—An Expanding Concept, 35 Texas L. Rev. 307 (1957).

entitled to a depletion allowance,[9] has subsequently been utilized to make the sale-lease distinction.[10] A taxpayer is said to have an "economic interest" wherever "the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital."[11] If it is found that the transferor has retained an "economic interest" the transfer is denominated a lease and he is entitled only to the depletion allowance. Thus one who reserves a royalty interest, that is, the right to receive a specified percentage of all minerals produced during the term of the lease,[12] is deemed to have an "economic interest"[13] and the consideration for the transfer will be treated as ordinary income, subject to depletion. However, when faced with similar transactions in the hard mineral area, the courts have not consistently applied the "economic interest" test,[14] though apparently only one court[15] has explicitly found, without any specific reason, the test inapplicable to hard mineral transactions. Rather, many courts have merely relied on other criteria in order to sustain hard mineral transactions as sales.[16]

One can only speculate as to why the courts were loath to apply the "economic interest" doctrine to minerals other than oil and gas. Perhaps it was

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9. The depletion allowance is "based on the theory that production of income may necessitate exhaustion of capital assets employed in that production. . . .

". . . .

". . . The purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset. Absent an interest in the mineral . . . in place, depletion is allowable only when a capital investment in production is returnable from the extraction of the mineral . . . ." 4 J. Mertens, Federal Income Taxation ¶24.02 (1966) (footnotes omitted). Thus, if after a transaction, the transferor still has a capital interest in the minerals in place or one which arises out of the extraction of the minerals, he is entitled to depletion commensurate to his interest. If he has no such interest remaining, he has completely disposed of or "sold" a capital asset and is entitled to capital gains treatment on the consideration from the sale. See Anderson v. Helvering, 310 U.S. 404, 408 (1940).

10. Burnet v. Harmel, 287 U.S. 103 (1932).

11. Palmer v. Bender, 287 U.S. 551, 557 (1933).

12. Anderson v. Helvering, 310 U.S. 404, 409 (1940).

13. The royalty interest, as defined above, is not the only type of "economic interest." For a full discussion and analysis of the various kinds of "economic interests" see C. Breeding & A. Burton, Income Taxation of Oil and Gas Production ¶ 2.09 (2d ed. 1961).

14. Of course there have been occasions where the courts have applied the test in the hard mineral field to determine whether or not a sale had taken place. See Kittle v. Commissioner, 21 T.C. 79 (1953), aff'd per curiam, 229 F.2d 313 (9th Cir. 1956); Albritton v. Commissioner, 24 T.C. 903 (1955), aff'd, 248 F.2d 49 (5th Cir. 1957).

15. Barker v. Commissioner, 250 F.2d 195 (2d Cir. 1957).

16. For a detailed discussion of the various cases in this area see Comment, Sale or Lease? Disparate Tax Treatment of Mineral Transactions by Courts Based on Nature of Minerals Involved, 42 Texas L. Rev. 707 (1964). "[C]ourts have elected to rest their decisions upon combinations of such nebulous indicia as the intent of the parties, the relative size of the initial payments as compared to the payments based upon production, the absence of an obligation to drill or mine, the language used in the instrument of transaction, the likelihood that all minerals will be produced and whether or not development and production was the primary purpose of the transaction." Id. at 711 (footnotes omitted).

because of the disparity between the depletion allowance for oil and gas, which is twenty-seven and one-half percent, and that for other minerals, which varies from five (gravel) to twenty-three percent (sulfur and uranium).[17] The original and primary use of the "economic interest" test was to ascertain who was entitled to the depletion bonanza and only secondarily was it utilized to determine whether a given transaction was a sale or a lease for tax purposes. Thus, in the sand and gravel cases, to deny capital gains treatment is almost to eliminate any tax advantage for an individual who holds the mineral as a capital asset, since he would only have a depletion allowance of five percent.

The position of the Internal Revenue Service is very clear with respect to tax treatment of all mineral transactions: "The Supreme Court has repeatedly taken the position that where, in consideration of a lump-sum payment and stipulated royalties payable out of production, a grantor extends to a grantee a right to enter upon land for purposes of exploitation of the minerals therein, the lump-sum payment constitutes an advance royalty, taxable as ordinary income, and not proceeds from a sale of a capital asset."[18]

The court in the instant case decided that it was impossible to afford different tax treatment to two different aspects of the same transaction,[19] and adopted the "economic interest" test for hard mineral transactions as well as those in the oil and gas area. While this result may lead to some hardship to those possessed of hard mineral rights, the court was correct in eliminating the artificial distinction which it and other courts have previously maintained. If depletion allowances need readjustment this should be done by Congress and not through contrived decisions in our courts.

Torts—Negligence—Landowner May Be Liable to Trespassing Infant Injured by Volatile Fluid.—The plaintiff, twelve years old, and his brother, nine, climbed a wall which fenced in three sides of an otherwise open yard owned by the defendant and located adjacent to its plant. They were trespassers.[1] The plaintiff picked up a can of fluid which to all appearances was water, but which actually contained a highly volatile paint solvent. In a subsequent game of "fireman" the plaintiff was severely burned when he poured the solvent on a fire they had started. The plaintiff's complaint was dismissed by the lower courts, but the New York Court of Appeals reversed, holding that "if the owner of land leaves it open and accessible to children; if he knows that children use it for play; and if he leaves accessible to them highly volatile substances, a case prima facie is made out if a child is thus injured."[2] *Patterson v. Proctor-Paint & Varnish Co.*, 21 N.Y.2d 447, 235 N.E.2d 765, 288 N.Y.S.2d 622 (1968).

17. Int. Rev. Code of 1954, § 613(b).

18. G.C.M. 27322, 1952-2 Cum. Bull. 62, 63 (citations omitted).

19. The court reasoned that only one transaction had taken place and that this transaction could be either a sale or a lease. Once the nature of the transaction is determined, the tax consequences flow therefrom.

1. Patterson v. Proctor Paint & Varnish Co., 21 N.Y.2d 447, 450, 235 N.E.2d 765, 766, 288 N.Y.S.2d 622, 624 (1968).

2. Id. at 453, 235 N.E.2d at 768, 288 N.Y.S.2d at 627.

In landowner tort cases liability has been predicated upon the relationship of the landowner to the injured party: that is, whether the injured party is an invitee,[3] licensee[4] or trespasser.[5] A trespasser is a person who, without permission or privilege, enters or remains upon the land of another.[6] It is generally accepted that the only duty to a trespasser on the part of the landowner is to refrain from intentionally or negligently injuring him.[7] In some jurisdictions the liability of a landowner to a trespassing adult differs from the liability to a trespassing child, the liability to the latter being more comprehensive.[8] This increased liability was originally termed the "turntable doctrine,"[9] derived from *Railroad Co. v. Stout*,[10] where the Supreme Court, in holding the railroad liable for the plaintiff's injury while playing on the defendant's unattended turntable, said that "the conduct of an infant of tender years is not to be judged by the same rule which governs that of an adult."[11]

This theory of increased liability to children has since acquired the name

3. A party on the land of another by invitation or on lawful business of interest to both parties is an invitee. Vaughan v. Transit Dev. Co., 222 N.Y. 79, 118 N.E. 219 (1917). For a discussion of the definition of an invitee see W. Prosser, Torts § 61 (3d ed. 1964) [hereinafter cited as W. Prosser].

4. A licensee is a social guest on the premises of another. See Krause v. Alper, 4 N.Y.2d 518, 151 N.E.2d 895, 176 N.Y.S.2d 349 (1958); Drutman v. Agar, 17 Misc. 2d 291, 185 N.Y.S.2d 142 (Sup. Ct. 1959); W. Prosser, § 60. For a good discussion of the duties owed to an invitee and a licensee see James, Tort Liability of Occupiers of Land: Duties Owed to Licensees and Invitees, 63 Yale L.J. 605 (1954).

5. See W. Prosser §§ 58-59; Annot., 36 A.L.R. 34 (1925); 16 Buffalo L. Rev. 489, 490 (1967). See also Hughes, Duties to Trespassers: A Comparative Survey and Revaluation, 68 Yale L.J. 633 (1959). Some courts use the name "bare licensee." In Morse v. Buffalo Tank Corp., 280 N.Y. 110, 19 N.E.2d 981 (1939), the court held that the duty owed to a bare licensee is the same as that owed to a trespasser; and, in Pittsburgh, C., C. & St. L. Ry. v. Simons, 76 N.E. 883, 886 (Ind. App. Div. 1906), the court decided to treat the terms synonymously.

6. Restatement of Torts § 329 (1934); Eldredge, Tort Liability to Trespassers, 12 Temp. L.Q. 32, 34-38 (1937). It is interesting to note that there is a trend away from determining liability according to these common law classifications. See Rowland v. Christian, — Cal. 2d —, 443 P.2d 561, 70 Cal. Rptr. 97 (1968); Potts v. Amis, 62 Wash. 2d 777, 384 P.2d 825 (1963). The distinctions are not recognized in admiralty law. See Kermarec v. Compagnie Generale Transatlantique, 358 U.S. 625 (1959).

7. Carradine v. City of New York, 13 N.Y.2d 291, 196 N.E.2d 259, 246 N.Y.S.2d 620 (1963); Walsh v. Fitchburg R.R., 145 N.Y. 301, 39 N.E. 1068 (1895); Fauci v. Milano, 15 App. Div. 2d 939, 225 N.Y.S.2d 888 (2d Dep't 1962), aff'd mem., 12 N.Y.2d 926, 188 N.E.2d 525, 238 N.Y.S.2d 313 (1963); Stinnet v. Liberty Aircraft Prod. Corp., 273 App. Div. 909, 77 N.Y.S.2d 357 (2d Dep't 1948).

8. Prosser, Trespassing Children, 47 Calif. L. Rev. 427 (1959); Comment, Landowner's Liability to Infant Trespassers: Status of the Law in New York, 25 Fordham L. Rev. 290 (1956); 3 Brooklyn L. Rev. 251 (1934).

9. W. Prosser § 59, at 373.

10. 84 U.S. (17 Wall.) 657 (1873).

11. Id. at 660. For a critical examination of Stout see Smith, Liability of Landowners to Children Entering Without Permission (pts. 1-2), 11 Harv. L. Rev. 349, 434 (1898). For federal court action on the turntable doctrine see Hudson, The Turntable Cases in the Federal Courts, 36 Harv. L. Rev. 826 (1923).

"attractive nuisance doctrine."[12] This doctrine places liability on a possessor of land for an injury to a trespassing infant if he knows of the trespassing and knows or should know of an unreasonable risk of serious injury which the children do not realize, and if the utility to the possessor is less than the risk of the injury.[13] The reasons for the attractive nuisance doctrine are apparent: "Children are vital to our way of life. Their physical welfare is worthy of the law's protection."[14] They lack the maturity and judgment to understand the dangers of trespassing and it is impractical to expect their parents to follow them around as keepers.[15]

At present, all but seven jurisdictions[16] in the United States have accepted the doctrine of attractive nuisance.[17] It was, at first, accepted and applied in New York[18] in *Mullaney v. Spence*;[19] later distinguished in *McAlpin v. Powell*[20] by language expressing doubt as to the application of the principle;[21] and finally, it was repudiated in *Walsh v. Fitchburg R.R.*[22] A plethora of New York cases have followed the *Walsh* holding that there is no attractive nuisance doctrine in New York.[23] Despite this, however, "the spirit of the doctrine has prevailed."[24]

12. For a discussion of the evolution of the name "attractive nuisance" see W. Prosser § 59, at 372-73; Green, Landowners' Responsibility to Children, 27 Texas L. Rev. 1, 8 (1948).

13. Restatement of Torts § 339 (1934). Note that Restatement (Second) of Torts § 339 (1965) adds the requirement that the possessor fail "to exercise reasonable care to eliminate the danger or otherwise to protect the children." For a discussion of the requirements of the Restatement, see generally James, supra note 4.

14. Green, supra note 12, at 12.

15. Prosser, supra note 8, at 429.

16. The seven jurisdictions are: Maine, Lewis v. Mains, 150 Me. 75, 104 A.2d 432 (1954); Maryland, Conrad v. City of Takoma Park, 208 Md. 363, 118 A.2d 497 (1955); Massachusetts, Urban v. Central Mass. Elec. Co., 301 Mass. 519, 17 N.E.2d 718 (1938); New Hampshire, Devost v. Twin State Gas & Elec. Co., 79 N.H. 411, 109 A. 839 (1920); Ohio, Ware v. City of Cincinnati, 93 Ohio App. 431, 111 N.E.2d 401 (1952); Rhode Island, Houle v. Carr-Consol. Biscuit Co., 85 R.I. 1, 125 A.2d 143 (1956); and Vermont, Trudo v. Lazarus, 116 Vt. 221, 73 A.2d 306 (1950). New Hampshire is to be considered with caution in light of a recent case, Labore v. Davison Constr. Co., 101 N.H. 123, 135 A.2d 591 (1957). Virginia and West Virginia have a doctrine of "dangerous instrumentalities" which is, in effect, the same as attractive nuisance. See Washabaugh v. Northern Va. Constr. Co., 187 Va. 767, 48 S.E.2d 276 (1948); White v. Kanawha City Co., 127 W. Va. 566, 34 S.E.2d 17 (1945).

17. See generally W. Prosser § 59, at 373 & n.44.

18. Comment, supra note 8, at 294.

19. 15 Abb. Pr. (n.s.) 319 (Brooklyn City Ct. N.Y. 1874).

20. 70 N.Y. 126 (1877).

21. See Walsh v. Fitchburg R.R., 145 N.Y. 301, 308, 39 N.E. 1068, 1070 (1895).

22. 145 N.Y. 301, 39 N.E. 1068 (1895).

23. See, e.g., Morse v. Buffalo Tank Corp., 280 N.Y. 110, 19 N.E.2d 981 (1939); Fauci v. Milano, 15 App. Div. 2d 939, 225 N.Y.S.2d 888 (2d Dep't 1962), aff'd mem., 12 N.Y.2d 926, 188 N.E.2d 525, 238 N.Y.S.2d 313 (1963); Dunnier v. Doolittle, 14 App. Div. 2d 179, 217 N.Y.S.2d 759 (3d Dep't 1961); Palladino v. Onondaga County Sav. Bank, 255 App. Div. 929, 8 N.Y.S.2d 773 (4th Dep't 1938); Moriarty v. New York Cent. R.R., 124 N.Y.S.2d 284 (Sup. Ct. 1953); Dewar v. Sears Roebuck & Co., 49 N.Y.S.2d 654 (Sup. Ct. 1944).

24. 7 Syracuse L. Rev. 137, 141 (1900). "Although the court [in Mayer v. Temple Properties Inc., 307 N.Y. 559, 122 N.E.2d 909 (1954)] reaffirmed its position that attractive

In New York the landowner's duty is to abstain from willful or wanton acts toward an adult trespasser.[25] It has long been accepted, however, as "a matter of no uncertainty," that a distinction actually exists between the standard of care to be exercised toward an adult and that to be exercised toward an infant.[26] There is no doubt, for example, that the New York courts apply an attractive nuisance theory in cases involving public highways.[27] In *Tierney v. New York Dugan Brothers, Inc.*,[28] the court distinguished between an injury on a public thoroughfare and one on private premises, holding that there may be liability in the former situation but not in the latter because the children had no right to enter a private premise.[29] Courts have found liability in the latter situation by interpreting the maintenance of an attraction upon one's land as an expressed or implied invitation, thus raising the standard of care to be exercised by the landowner to that accorded an invitee.[30] In *Levine v. City of New York*,[31] an infant was injured while playing on a broken railing of the defendant's stairway. The court held that the entire area adopted the characteristics of a playground. The city, therefore, was under a greater duty of care than would have been the case had there been no invitation to the people to congregate in the area with their children.[32] Although the instant defendant's yard

nuisance is not the law of New York, it is interesting to note that it stresses all but one [that the utility to the possessor be less than the risk of injury] of the elements laid down in section 339 of the Restatement of Torts." Comment, supra note 8, at 304. Despite its rejection of attractive nuisance, New York has reached a similar position by demanding that the "occupier abstain from affirmative acts of negligence toward the trespasser." The position after the 1954 decision in Mayer seems to be that "the maintenance of a dangerous structure or operation without adequate protection and in a spot where the occupier knows that trespassers may come, will in itself constitute affirmative negligence." Hughes, supra note 5, at 640-41. See W. Prosser § 59, at 373 n.44; Thornton & McNiece, Torts, 31 N.Y.U.L. Rev. 344, 361-62 (1956); Thornton & McNiece, Torts and Workmen's Compensation, 30 N.Y.U.L. Rev. 1621, 1627 (1955).

25. See cases cited note 7 supra.

26. 3 Brooklyn L. Rev. 251 (1934); see Gloshinsky v. Bergan Milk Transp. Co., 279 N.Y. 54, 17 N.E.2d 766 (1938); O'Driscoll v. Metropolitan Life Ins. Co., 178 Misc. 372, 33 N.Y.S.2d 557 (Sup. Ct. 1942).

27. Boylhart v. DiMarco & Reimann, Inc., 270 N.Y. 217, 200 N.E. 793 (1936); Meyers v. 120th Ave. Bldg. Corp., 9 App. Div. 2d 931, 195 N.Y.S.2d 163 (2d Dep't 1959), aff'd mem., 11 N.Y.2d 871, 182 N.E.2d 291, 227 N.Y.S.2d 685 (1962); Connell v. Berland, 223 App. Div. 234, 228 N.Y.S. 20 (1st Dep't), aff'd mem., 248 N.Y. 641, 162 N.E. 557 (1928); Eason v. State, 201 Misc. 336, 104 N.Y.S.2d 683 (Ct. Cl. 1951), aff'd mem., 280 App. Div. 358, 113 N.Y.S.2d 479 (1952); Gallagher v. Fordham & Loring Corp., 13 N.Y.S.2d 322 (New York City Ct. 1939). Where a building has been condemned as a public nuisance, the attractive nuisance theory may also be applied. Runkel v. Homelsky, 3 N.Y.2d 857, 145 N.E.2d 23, 166 N.Y.S. 2d 307 (1957).

28. 288 N.Y. 16, 41 N.E.2d 161 (1942).

29. Id. at 19, 41 N.E.2d at 162.

30. See, e.g., Bowers v. City Bank Farmers Trust Co., 282 N.Y. 442, 26 N.E.2d 970 (1940); Collentine v. City of New York, 279 N.Y. 119, 17 N.E.2d 792 (1938); Green, supra note 12, at 7; Prosser, supra note 8, at 434 n.37; Comment, supra note 8, at 297; 7 Syracuse L. Rev. 137, 142 (1900). Some jurisdictions use the invitation theory as the entire basis for liability. See Annot., 36 A.L.R. 34, 114 (1925).

31. 309 N.Y. 88, 127 N.E.2d 825 (1955).

32. Id. at 92, 127 N.E.2d at 826.

was in a residential area and known to be used by children at play, the court did not find, or even consider, that it took on the characteristics of a "public playground."

More often, however, a trespassing infant plaintiff has been allowed to recover when his injury was caused by a dangerous instrumentality on the defendant's land.[33] The maintenance of a dangerous instrumentality has been interpreted as the affirmative creation of a trap,[34] and it has been held that this, and not the theory of attractive nuisance, is the only basis for liability.[35] The dangerous instrumentality cases have expanded the liability to infants on a case by case basis to include injuries caused by explosives,[36] fireworks,[37] high voltage electrical apparatus,[38] a building with a dilapidated roof,[39] and, in the present case, volatile substances. Not all substances, however, are considered dangerous instrumentalities. Recovery has been denied, for example, in cases where the injury was caused by denatured alcohol,[40] quicklime,[41] film strips,[42] and an iron grate in the street.[43]

This rather stringent rule of limiting liability to inherently dangerous instrumentalities has been tempered by the courts' willingness to consider sundry factors in determining what is inherently dangerous. One such factor to be considered is the propensities of children.[44] In *Bowers v. City Bank Farmers*

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33. E.g., Mayer v. Temple Properties Inc., 307 N.Y. 559, 122 N.E.2d 909 (1954); Kingsland v. Erie County Agricultural Soc'y, 298 N.Y. 409, 84 N.E.2d 38 (1949); Morse v. Buffalo Tank Corp., 280 N.Y. 110, 19 N.E.2d 981 (1939); French v. Central N.Y. Power Corp., 275 App. Div. 238, 89 N.Y.S.2d 543 (4th Dep't 1949); Travell v. Bannerman, 71 App. Div. 439, 75 N.Y.S. 886 (2d Dep't 1902), rev'd on other grounds, 174 N.Y. 47, 66 N.E. 583 (1903); Prosser, supra note 8, at 434 n.37; Comment, supra note 8, at 295; 16 Buffalo L. Rev. 489, 490 (1967); 7 Syracuse L. Rev. 137, 141 (1900).

34. Mayer v. Temple Properties Inc., 307 N.Y. 559, 122 N.E.2d 909 (1954). On facts similar to Walsh v. Fitchburg R.R., 145 N.Y. 301, 39 N.E. 1068 (1895), the court held that "the plaintiff was induced to come upon the defendant's turn-table by the defendant's own conduct, and that, as to him, the turntable was a hidden danger, a trap." Keefe v. Milwaukee & St. P. Ry., 21 Minn. 207, 210 (1875).

35. "The rule seems to be the thoroughly settled . . . that a plaintiff cannot recover in cases of this character unless the article which causes the injury is inherently dangerous." Beickert v. G.M. Laboratories, Inc., 242 N.Y. 168, 172, 151 N.E. 195, 196 (1926).

36. Pond v. Regis, 25 App. Div. 2d 917, 270 N.Y.S.2d 121 (3d Dep't 1966); Travell v. Bannerman, 71 App. Div. 439, 75 N.Y.S. 866 (2d Dep't 1902).

37. Kingsland v. Erie County Agricultural Soc'y, 298 N.Y. 409, 84 N.E.2d 38 (1949).

38. French v. Central N.Y. Power Corp., 275 App. Div. 238, 89 N.Y.S.2d 543 (4th Dep't 1949).

39. Soto v. City of New York, 9 N.Y.2d 683, 173 N.E.2d 238, 212 N.Y.S.2d 418 (1961).

40. Hall v. New York Tel. Co., 214 N.Y. 49, 108 N.E. 182 (1915). "[T]he alcohol, left untouched by the boys, was not of necessity dangerous." Id. at 52, 108 N.E. at 182.

41. Beetz v. City of Brooklyn, 10 App. Div. 382, 41 N.Y.S. 1009 (2d Dep't 1896).

42. Beickert v. G.M. Laboratories, Inc., 242 N.Y. 168, 151 N.E. 195 (1926).

43. Cuevas v. 73rd & Cent. Park W. Corp., 26 App. Div. 2d 239, 272 N.Y.S.2d 41 (1st Dep't 1966), aff'd mem., 21 N.Y.2d 745, 234 N.E.2d 843, 287 N.Y.S.2d 889 (1968).

44. Levine v. City of New York, 309 N.Y. 88, 93, 127 N.E.2d 825, 827 (1955); Collentine v. City of New York, 279 N.Y. 119, 125, 17 N.E.2d 792, 795 (1938); Parnell v. Holland Furnace Co., 234 App. Div. 567, 571, 256 N.Y.S. 323, 237 (4th Dep't 1932); O'Driscoll v. Metropolitan Life Ins. Co., 178 Misc. 372, 33 N.Y.S.2d 557 (Sup. Ct. 1942).

Trust Co.,[45] the court said that "[a]lthough it is true that the doctrine of attractive nuisance does not apply in this State . . . the jury was 'entitled to take into consideration the well-known propensities of children to climb about and play.' "[46] The significance of such a statement is readily discernible when one realizes that "a recovery in the . . . [*Bowers*] case would seem to exceed the liberality of those courts most strongly adhering to the 'attractive nuisance' doctrine."[47] Considering this statement in conjunction with the court's holding in *Kingsland v. Erie County Agricultural Society*[48] that "[t]he degree of care required is commensurate with the risk involved, depending upon such circumstances as the 'dangerous character of the material' and its accessibility to others, particularly children whose presence should have been anticipated, regardless of whether or not they are trespassers[,]"[49] the instant court has taken a position analogous to that of the Restatement, which sets forth the attractive nuisance doctrine.[50]

The present case is an essential step in the trend toward acceptance of attractive nuisance by the New York courts. First, it brought within the orbit of liability injuries caused by volatile substances under the circumstances enumerated by the court.[51] Second, it expressly disregarded, without overruling,[52] *Morse v. Buffalo Tank Corp.*[53] which had held that there was no attractive nuisance doctrine in New York, and that gasoline was not inherently dangerous.

Although there are recent cases to the contrary,[54] it is not unforeseeable that New York will eventually recognize that it does in fact accept the doctrine of attractive nuisance.[55] Presently, liability is considered an exception to the rule that there is no attractive nuisance in New York. However, exceptions so broad as to include injuries on public highways, an implied invitation theory, and injuries caused by substances, some of which are inherently dangerous, becomes a rule in itself. A lower New York court indicated this in one case[56] by holding that the jury should have been charged with the Restatement rule that the possessor of land is liable for unreasonable, foreseeable injuries to infants.[57]

45. 282 N.Y. 442, 26 N.E.2d 970 (1940).
46. Id. at 446, 26 N.E.2d at 972.
47. 18 N.Y.U.L.Q. Rev. 140, 141 n.1 (1941).
48. 298 N.Y. 409, 84 N.E.2d 38 (1949).
49. Id. at 423-24, 84 N.E.2d at 45.
50. See text accompanying note 13 supra.
51. 21 N.Y.2d at 453, 235 N.E.2d at 768, 288 N.Y.S.2d at 627.
52. Id. at 452, 235 N.E.2d at 768, 288 N.Y.S.2d at 626.
53. 280 N.Y. 110, 19 N.E.2d 981 (1939). See text at note 23 supra.
54. Cuevas v. 73rd & Cent. Park W. Corp., 26 App. Div. 2d 239, 272 N.Y.S.2d 41 (1st Dep't 1966), aff'd mem., 21 N.Y.2d 745, 234 N.E.2d 843, 287 N.Y.S.2d 889 (1968).
55. In Popkin v. Shanker, 36 Misc. 2d 242, 232 N.Y.S.2d 574 (Sup. Ct. 1962), the court admitted that a lawn mower was not an inherently dangerous instrumentality but was not prepared to say that the plaintiff could not advance a theory upon which there could be a recovery.
56. Clifton v. Patroon Operating Corp., 271 App. Div. 122, 63 N.Y.S.2d 597 (3d Dep't 1946).
57. Id. at 130, 63 N.Y.S.2d at 603.