SECTION 16(b) OF THE SECURITIES EXCHANGE ACT: AN ANALYSIS OF THE TIME WHEN INSIDER STATUS IS REQUIRED

Edwin W. Hecker, Jr.*

The Securities Exchange Act of 1934 (Act)1 was designed to correct many of the financial practices that were commonly thought to be substantial contributing factors in the market debacle of 1929 and the ensuing depression.2 Section 16 was intended to prevent certain types of predatory speculation by corporate insiders.3 Section 16(a) requires that every person who is directly or indirectly the beneficial owner of more than ten percent of any class of equity security registered pursuant to section 12, or who is a director or officer of the issuer of such security, file reports of his or her beneficial ownership of equity securities and any changes therein with the Securities and Exchange Commission (SEC) and any exchange on which the security is listed.4 Section 16(b) provides:

To prevent the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.5

While it is clear from the language of section 16(b) that its application is limited to three classes of persons, certain problems have arisen regarding the time or times at which statutory insider status is necessary as a prerequisite to liability. A number of cases have addressed these problems, with respect to both beneficial owners and directors and officers. The purpose of this Article is to review the cases and to attempt to determine a correct resolution

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* Associate Professor of Law, University of Kansas. B.A. 1966, Oakland University; J.D. 1969, Wayne State University; LL.M. 1970, Harvard University.
2 See, e.g., 78 Cong. Rec. 7689-90 (1934) (remarks of Representative Sabath).
5 Id. § 78p(b). The language, “[t]his subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase . . .” often will be referred to in this Article as an exemption.
of these problems in light of the purpose of section 16(b), as gleaned from its legislative history and the words of the section itself.

I. A Brief Review of the Case Law

Most of the cases involving beneficial owners concern the question of insider status at the time of the first of two transactions occurring within a six month period. The issue can be stated in the following manner: May the purchase by which a person, who is not an officer or director, first achieves ten percent beneficial owner status be included as one of a pair of transactions for purposes of liability under section 16(b)? These cases necessarily focus on the specific statutory exemption providing that "[t]his subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved . . . ."  

The problem was recognized soon after passage of the Act, but *Stella v. Graham-Paige Motors Corp.*, 8 decided 18 years later, was the first judicial attempt to deal with it. Graham-Paige Motors was one of the two original 50 percent shareholders of Kaiser-Frazer Corporation. Subsequent public offerings, however, had diluted its position to just over six percent. It then purchased 750,000 shares, increasing its holdings to 21 percent, and within six months of the purchase, sold 155,000 shares. In a section 16(b) suit brought by a Kaiser-Frazer shareholder, Graham-Paige's motion for summary judgment was denied. Graham-Paige argued that it was not a ten percent beneficial owner both at the time of purchase and sale, but the district court felt that the phrase "at the time of" in the statutory exemption was ambiguous; it could mean either "prior to" or "simultaneously with" the initial transaction. The court adopted the latter construction as being more in accord with the legislative purpose of preventing short-swing speculation by insiders with advance information. Under the former construction, "it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum."  

Thus, the very purchase by which Graham-Paige achieved ten percent status could be included as the first of a pair of section 16(b) transactions. The Second Circuit, over a strong dissent by Judge Hincks, adopted the construction of the district court without discussion.  

Subsequent cases arising in the Second Circuit have uniformly followed the *Stella* view, with little or no analysis of the issue. The *Stella* logic has

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8 Id.  
11 104 F. Supp. at 959.  
12 232 F.2d at 300-01.  
also found favor with a number of commentators\textsuperscript{12} and has been adopted by most of the cases in other circuits in which the question has arisen.\textsuperscript{18} In fact, until recently, the only case to take a contrary view was \textit{Arkansas Louisiana Gas Co. v. W.R. Stephens Investment Co.}\textsuperscript{14}

In 1974, however, the Ninth Circuit, in \textit{Providence Securities Co. v. Foremost-McKesson, Inc.}\textsuperscript{15} broke ranks with this long line of precedent and held that the purchase by which an outsider first achieves ten percent beneficial owner status may not properly be considered for purposes of section 16(b) liability. After an extensive discussion of legislative history, the court concluded that the purpose of section 16(b) was to deter insiders from engaging in short-swing speculation on the basis of advance information; that is, from purchasing (or selling) with the intention or expectation of selling (or repurchasing) within six months. Since, by definition, one who is an outsider prior to his initial transaction has no access to inside information, he could not possibly have the requisite short-swing intent. Therefore, the “prior to” construction of the statutory exemption would not subvert the purpose of section 16(b) but, rather, would be in accord with it.\textsuperscript{16} Even more recently, the Seventh Circuit, in \textit{Allis-Chalmers Manufacturing Co. v. Gulf & Western Industries, Inc.}\textsuperscript{17} followed the Ninth Circuit’s lead.

A second problem concerning beneficial owners recently was resolved by the Supreme Court in \textit{Reliance Electric Co. v. Emerson Electric Co.}\textsuperscript{18} In that case, Emerson had acquired 13.2 percent of the stock of Dodge Manufacturing Corporation. Within six months of its purchase, it made two sales. On the first sale it reduced its holdings to 9.96 percent, and on the second it disposed of the remainder of its stock. Emerson admittedly engaged in this split-sale technique with the intent of limiting the extent of its section 16(b) liability. The district court, employing a step-transaction approach, held


\textsuperscript{15}506 F.2d 601 (9th Cir. 1974), \textit{cert. granted}, 420 U.S. 923 (1975).

\textsuperscript{16}506 F.2d at 609-14.

\textsuperscript{17}Current CCH Fed. Sec. L. Rep. \textit{¶} 95,308, \textdoublespace} ... F.2d ... (7th Cir. 1975).

\textsuperscript{18}404 U.S. 418 (1972).
Emerson liable with respect to both sales.\textsuperscript{19} The Eighth Circuit reversed,\textsuperscript{20} and the Supreme Court affirmed this reversal on the ground that, at the time of the second sale, Emerson held less than ten percent of the Dodge stock and thus fell within the literal language of the statutory exemption.\textsuperscript{21}

Similar issues regarding initial and terminal transactions have arisen with respect to directors and officers. For example, a person with no prior relationship to the issuer might purchase less than ten percent of a class of equity security, become a director or officer, and then sell some or all of his or her holdings within six months of the purchase. From the preceding discussion of beneficial owners, one might guess that such a person would incur liability under section 16(b), and that was the Second Circuit's holding in \textit{Adler v. Klawans}.\textsuperscript{22} Relying on the absence of any statutory requirement that directors or officers be in office at the time of both transactions, and on its reading of congressional intent, the court held that a director or officer need only occupy that position "at some time"—in that case, the time of sale.\textsuperscript{23}

Liability was also found in the converse situation in \textit{Feder v. Martin Marietta Corp.},\textsuperscript{24} in which the director purchased stock, resigned, and then sold. The court felt that if section 16(b) applied in the \textit{Adler} situation, when only the terminal transaction could have been tainted by the use of inside information, a fortiori, it must apply in this situation, when both the initial and the terminal transaction could have been so tainted.\textsuperscript{25}

In spite of the liberal construction given to section 16(b) by most of the cases noted in the preceding discussion, the decisions involving a third factual pattern—in which a director or officer resigns his position and thereafter engages in two transactions, all three events occurring within six months—have refused to find liability.\textsuperscript{26} These decisions all recognize the potential for speculative abuse of inside information inherent in such a sequence of events, but they hold that the language of the section requires a defendant to have been a statutory insider at the time of at least one of the two securities transactions.

\section*{II. An Analysis of the Purpose of Section 16(b)}

Even the foregoing cursory examination of the cases suggests that different courts have interpreted the congressional purpose in enacting section 16(b) in different ways. In order to correctly resolve issues concerning the time or times at which insider status is, or should be, required for the imposi-

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\textsuperscript{20} 434 F.2d 918 (8th Cir. 1970).
\textsuperscript{21} 404 U.S. at 423-24.
\textsuperscript{22} 267 F.2d 840 (2d Cir. 1959).
\textsuperscript{24} 406 F.2d 260 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970).
\textsuperscript{25} 406 F.2d at 268.
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tion of liability, it is necessary to determine this congressional purpose with more precision than has characterized most of the judicial forays into this area. Specifically, the inquiry must focus upon the type of unfair use of inside information sought to be deterred by section 16(b).

A. Double and Single Transaction Abuse

It is apparent that two analytically different types of trading abuse may result from the possession of confidential information regarding corporate affairs. The distinction may be illustrated by two simple examples. First, assume that A is a director of a corporation and in that capacity learns of information that, when disclosed to the public, will have a short-term favorable impact on the market for his corporation's stock. Seeking to take advantage of this short-term market fluctuation, A purchases 1,000 shares at 50 before the information is made public and sells 1,000 shares at 60 after the information has been disclosed and has had its anticipated effect. This type of speculative abuse has been termed double transaction abuse by one writer because the inside information motivates both transactions. Double transaction abuse actually gives rise to two separate evils. One is the inherent unfairness of A’s use of the inside information vis-a-vis other investors. The other is that A, at the time he purchased, intended to sell after the information had its predictable effect on the market. Therefore, his long-term position in the stock of his corporation never really changed but at most went through a momentary deviation. Thus, profit-taking in a double transaction abuse case is closely analogous to outright sale of the confidential information. Secondly, assume that B, an outsider, purchases 1,000 shares of stock in the same corporation at 50, after which he is elected to the board of directors. In his capacity as a director, he learns of the same confidential information that, when disclosed, will have a short-term favorable market impact on the corporation's stock. Although he might otherwise have sold in the interim, he continues to hold his stock until the information is publicly disseminated and has caused the market to rise. Thereafter, he sells his 1,000 shares at 60. At most, this is a case of single transaction abuse. The sale is functionally unrelated to the purchase because, at the time of his purchase, B had no information regarding an impending price rise. Therefore, he could not have purchased on the basis of inside information with the intention of selling after such a price rise. The sole evil in this sort of case is the trading advantage, with respect to the timing of his sale, given to B by his inside information. The same evil would be present whether B purchased his stock five months or five years prior to his sale. Thus, although the outward appearance of A’s and B’s transactions are similar, and their profit is identical, the two cases

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28 Comment, Section 16(b): An Alternative Approach to the Six-Month Limitation Period, 20 U.C.L.A. L. Rev. 1289, 1295 (1973) [hereinafter cited as Comment, Section 16(b)].

29 Note, Insider Liability, supra note 27, at 598-99.
really are quite different. The proper inquiry is, then, at which of these two types of situations is section 16(b) directed?

B. Insider Market Activity Prior to 1934

The investigations preceding passage of section 16(b) were concerned primarily with trading pools in which directors and officers participated. These pools often not only created a false appearance of market activity but also were the vehicles by which such directors and officers reaped large profits from trading over short periods of time.30 The pool in the stock of General Asphalt Company was fairly typical. Prior to formation of the pool, which included two directors as participants, the corporation had never paid any dividends. The pool began to purchase stock in May of 1929 at an average price of 80. In August 1929 the corporation announced its first dividend, an announcement that caused the price of its stock to rise to 94¼. The pool operated until 1931 and dealt in over one half million shares. During the period from 1929 through 1931, the corporation declared and paid dividends in an amount greatly in excess of its earnings. After the pool ceased operations, the corporation sharply reduced its dividends.31 The Senate Committee on Banking and Currency concluded:

It is difficult to believe that the conduct of Messrs. Weeks and Lloyd [the two directors] was not influenced by their interest in the pool, when as directors they approved the payment of an initial dividend in November 1929 and the payment of subsequent dividends while the company was showing a deficit. Furthermore, it would be naive to suppose that in his management of the pool, Weeks was not guided by his intimate knowledge of the conditions and plans of the company—confidential knowledge which he derived as a fiduciary, and was by every legal and ethical standard bound to refrain from using for his personal profit.32

Another example is that of Albert H. Wiggin, chairman of the board of Chase National Bank. While he occupied that position, he participated in a pool of Chase stock that purchased 172,806 shares and sold 115,483 shares during a four-month period.33 The Committee concluded: “[I]n a pool operation wherein short selling was contemplated and shares of stock in the bank of which he was the chief executive were bought and sold in large volume, Albert H. Wiggin and his family-owned corporation made a profit of $75,036.10.”34 In fact, this case was so notorious that section 16 became popularly known as the “anti-Wiggin” provision.35

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31 Id. at 66-67.
32 Id. at 67.
33 Id. at 62-63.
34 Id. at 63.
C. Legislative History, Statutory Language, and SEC Regulations

It could well be concluded from these trading pool examples that section 16(b) was designed exclusively to deter double transaction abuse. Such a conclusion is strongly reinforced by the language of the original bills introduced in the House and Senate. Section 15(b)(1) of these bills provided that:

(b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—
   
(1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months.⁶⁶

Testimony at the committee hearings on these original bills continually stressed the purpose of section 15(b)(1) in terms of double transaction abuse. One of the draftsmen, Thomas Corcoran, explained that this section "[f]orbid[s] [a statutory insider] to carry on any short-term speculations in the stock. He cannot, with his inside information get in and out of stock within six months."⁶⁷ The following colloquy between Senator Bulkley and Mr. Corcoran, concerning the lack of a sale-repurchase prohibition, also is informative:

Senator Bulkley. Do you provide for the converse of that, where a man might sell for a short term with the intention of repurchasing?

. . . .

Mr. Corcoran. You mean a case where he sold the stock, and within 6 months bought it back at a lower price?

Senator Bulkley. Yes. A man having a large amount of stock might know that his company was going to pass a dividend, and then sell it with the intention of purchasing after the news was out.

Mr. Corcoran. Possibly a provision to catch that should go into the statute. That does not happen as often as the other case.

. . . .

Mr. Corcoran. . . . Usually men are not as ready to sell a stock with the expectation of picking it up on the downgrade as they are to buy a stock on what they think is going to be a rise in the market.

Senator Bulkley. A Director would be in a position to know bad things about the company in advance of the public, the same as he would know good things.

Mr. Corcoran. That is absolutely true.⁶⁸

Perhaps even more striking is the statement to the Senate Committee of Sidney Blumenthal, president and chairman of the board of Sidney Blumenthal & Co.:

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⁶⁷ House Hearings, supra note 35, at 133 (emphasis added).
⁶⁸ Senate Hearings, pt. 15, supra note 35, at 6557-58 (emphasis added).
The acquisition and resale of securities within a shorter time than the six months
given by this section may arise from circumstances over which the officer or director
has no control. There may be... business reverses, or the evidence of what may
be considered wholly undesirable new tendencies arising shortly after the acquisition
of stock interests. This may arise from new inventions or discoveries which may
come to the notice of those acquiring securities; a sudden discovery of flaws or
incapacity of management or a sharp difference of opinion may cause a desire for
liquidating interests, the acquisition of which had no venal objective.\textsuperscript{30}

Mr. Blumenthal seems to be saying that the person who learns of inside in-
formation after his initial transaction, and who engages in a second transac-
tion on the basis of this information, has not perpetrated the sort of trading
abuse with which Congress was concerned. In other words, he appears to
be expressing a fear that the short-swing trading prohibition might be in-
terpreted to cover cases of single transaction abuse, an interpretation not
intended by its draftsmen.

Notwithstanding the introductory language regarding a subjective short-
swing intent,\textsuperscript{40} it is clear that section 15(b)(1) was setting up an objective
conclusive presumption based on two transactions by an insider within a six
month period. Thus, the section would impose liability on an insider “irres-
pective of any intention or expectation on his part in entering into such
transaction of holding the security purchased for a period exceeding six
months.”\textsuperscript{41} The reason for this conclusive presumption was explained by
Thomas Corcoran:

That is to prevent directors receiving the benefits of short-term speculative
swings on the securities of their own companies, because of inside information. . . .
You hold the director, irrespective of any intention or expectation to sell the security
within 6 months after, because it will be absolutely impossible to prove the exis-
tence of such intention or expectation, and you have to have this crude rule of
thumb, because you cannot undertake the burden of having to prove that the di-
rector intended, at the time he bought, to get out on a short swing.\textsuperscript{42}

Presumably because the subjective short-swing intent language was thought
to be inconsistent with this objective conclusive presumption, the former was dropped from corresponding sections of subsequent bills.\textsuperscript{43} There is no indica-
tion, however, that the draftsmen intended in any way to expand the basic
thrust of the prohibition to include single transaction speculative abuse. On
the contrary, the evidence strongly suggests that these subsequent versions,
like their predecessors, were designed exclusively to deter short-swing double
transaction abuse. Thus, a committee report accompanying one version,
which contained a provision identical to section 16(b) as finally enacted,\textsuperscript{44}

\textsuperscript{30}Id. at 7266 (emphasis added).
\textsuperscript{31}See text at note 36 supra.
\textsuperscript{40}S. 2693, 73d Cong., 2d Sess. § 15(b)(1) (1934); H.R. 7852, 73d Cong., 2d Sess. § 15(b)(1)
(1934); H.R. 7855, 73d Cong., 2d Sess. § 15(b)(1) (1934).
\textsuperscript{41}Senate Hearings, pt. 15, supra note 35, at 6557 (emphasis added).
\textsuperscript{42}H.R. 8720, 73d Cong., 2d Sess. § 15(b) (1934); S. 3420, 73d Cong., 2d Sess. § 16(b) (1934).
\textsuperscript{43}S. 3420, 73d Cong., 2d Sess. § 16(b) (1934). This section did not, however, contain the two year
statute of limitations.
referred to the facts of the General Asphalt Co. pool as the type of abuse at which section 16(b) was directed. In addition, the report cited the case of a corporate president and his brothers who made a profit of nine million dollars by selling their holdings for sixteen million dollars shortly before the company omitted payment of a dividend and repurchasing them later for seven million dollars. The report noted that section 16(b) "will render difficult or impossible the kind of transactions which were frequently described to the committee, where directors and large stockholders participated in pools trading in the stock of their own companies, with the benefit of advance information regarding an increase or resumption of dividends in some cases, and the passing of dividends in others."

Some commentators have read the provision in section 16(b) making its application automatic, "irrespective of any intention" on the part of the insider to engage in a second transaction within six months, as indicative of a congressional intent to reach single transaction speculative abuse. When viewed in light of the section's legislative history, however, this phrase cannot support such a construction. Since it was included in the section's earliest versions, which also included the provision referring to a subjective short-swing intent, it is clear that its purpose simply is to reinforce the conclusive presumption of such an intent. That is, it was included merely to prevent the possible argument that the insider, at the time he made his initial transaction, did not also intend to engage in a terminal transaction.

Additional support may be drawn from the conclusive presumption itself. Under any interpretation, the very heart of section 16(b) is the presumption that if two transactions occur within six months, some type of speculative abuse of inside information has occurred. The period of six months was chosen because the draftsmen apparently estimated that period to be the useful speculative life of inside information. Unless the focus is upon access to inside information prior to the initial transaction, the presumption not only makes no sense but also will not serve its purpose. If the potential defendant first has access to inside information only after his initial transaction, and the useful life of the information is six months, he will be free to trade on it, and by definition it will still be useful, more than six months after the initial transaction.

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46 See text at notes 31, 32 supra.
48 Id.
52 Note, Insider Liability, supra note 27, at 604-05; Comment, Section 16(b), supra note 28, at 1299.
In order to overcome this theoretical problem, it has occasionally been argued that a person could have access to inside information prior to his initial transaction even though he did not technically fall into one of the three categories of statutory insider. Thus, the SEC as amicus curiae in *Stella* stated:

A person who acquires a large block of stock in a single transaction normally has access to inside information. He necessarily would deal in the negotiations looking toward the purchase, with either the issuer or an insider holding a large interest in the issuer. In either event he would be in a position to bargain for disclosures not available to the public. It is against abuse of information so obtained as well as of information obtained after representation in management is secured that the section is directed.

Whether or not this argument is empirically verifiable, it simply is irrelevant unless this is the sort of access to information contemplated by section 16(b). Every indication points to the conclusion that it is not.

The statutory purpose clause in section 16(b) provides that “[f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer,” any profit realized on two or more transactions within a six month period must be disgorged. The import of this clause would seem to be unmistakable. By setting out the three classes of statutory insider and referring to information obtained by virtue of “his relationship,” Congress has clearly said that the only relevant access for purposes of section 16(b) is access derived from insider status. One can hardly have such access before achieving such status.

If further support is thought necessary, however, it is abundant in both the legislative history and the case law. For example, Thomas Corcoran stated that the reporting provisions should apply “to every director, to every officer . . . who by reason of his office, and to every influential stockholder, who by reason of his position . . . is on the inside of the circle.” Similarly, Ferdinand Pecora, counsel to the Senate Committee on Banking and Currency, stated:

The theory was that the ownership of 5 percent of the stock would practically constitute him an insider, and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served.

The only point I want to make is that . . . where an individual owned as much as 5 percent or more, he would be in a position, through that ownership of a
block of stock that size, to virtually be an insider, and he could very well dictate, with one or two others, elections to the board of directors.\textsuperscript{68}

The cases also are nearly unanimous in endorsing the view that access must arise by virtue of insider status.\textsuperscript{67}

It is significant that the clause referring to access to information “by reason of his relationship to the issuer” first appeared in the bill\textsuperscript{69} that omitted a provision, contained in prior bills, imposing short-swing liability on outsiders to whom confidential corporate information had been divulged.\textsuperscript{68} The timing of these changes seems more than coincidental and further supports the proposition that section 16(b) is concerned only with the speculative use of information gained after insider status is obtained and gained as a result of that status.

Moreover, the conclusive presumption of abuse of inside information is valid as a jurisprudential device only if the basic facts, two transactions within a six month period, are accompanied by the presumed fact in the majority of instances.\textsuperscript{60} In a case of single transaction abuse, in which the defendant is not an insider prior to his initial transaction, by hypothesis it is merely fortuitous if his two transactions occurred within six months of each other rather than over a longer time period. In this situation the conclusive presumption, in effect, is being based on a single transaction. Such an application of section 16(b) actually is no different than a presumption that any single purchase or sale by an insider was improperly motivated by inside information.\textsuperscript{61} While empirical evidence might support the proposition that insiders who engage in two transactions are more often than not acting on inside information, the same certainly cannot be said of a presumption based on a single transaction. Yet this essentially is what must result from the view that section 16(b) is designed to deter single transaction abuse.

Before proceeding to a discussion of other relevant statutory and regulatory provisions, a final point should be made regarding another phrase in section 16(b) itself, which apparently has been overlooked by all the courts and commentators but one.\textsuperscript{82} Section 16(b) exempts from liability a pair of transactions whenever the acquisition of the security was “in good faith in connection

\textsuperscript{68} Senate Hearings, pt. 16, supra note 35, at 7741-42 (emphasis added). See 78 Cong. Rec. 7862, 7938 (1934) (remarks of Representatives Lea and Bakewell).


\textsuperscript{60} H.R. 8720, 73d Cong., 2d Sess. § 15(b) (1934).

\textsuperscript{61} S. 2693, 73d Cong., 2d Sess. § 15(b)(3) (1934); H.R. 7852, 73d Cong., 2d Sess. § 15(b)(3) (1934); H.R. 7855, 73d Cong., 2d Sess. § 15(b)(3) (1934).

\textsuperscript{62} Comment, Section 16(b), supra note 28, at 1297.


\textsuperscript{64} Note, Insider Liability, supra note 27, at 605.
with a debt previously contracted . . .”83 If section 16(b) were directed at single transaction abuse, this exemption would be completely illogical since, regardless of the innocence of the acquisition, the disposition clearly could be actuated by inside information. If, however, section 16(b) is concerned with double transaction abuse, exempting from an objective rule a pair of transactions in which the acquisition could not have been motivated by a short-swing intent seems eminently sensible.

Two other subsections of section 16 may be considered contrary to the preceding analysis and thus should be discussed. The first, section 16(d), states that:

The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase . . . of an equity security not then or theretofore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 78e of this title) for such security.84

Because section 16(d) exempts market-making transactions by a dealer with respect to over-the-counter equity securities “not then or theretofore held by him in an investment account,” the argument is that, by negative implication, any other initial transaction by which one becomes a greater than ten percent beneficial owner must be included for purposes of section 16(b). This argument completely misconstrues the background and purpose of section 16(d). During the Senate hearings on the Act, some concern was expressed regarding the application of section 16(b) to an underwriter that placed a representative on the board of directors of the issuer and thereafter bought and sold equity securities of the issuer from and to its customers.85 This concern was not acted upon until 1964, when section 16(b) was extended to cover larger over-the-counter corporations and section 16(d), which did not appear in the original Act, was added. The purpose of section 16(d) was summarized in the Senate report as follows:

In connection with previous legislative proposals, the Commission and the securities industry expressed concern over the application of the short-swing profit-recovery provisions of section 16(b) to the transactions of a broker-dealer who is making a market in a security while represented on the issuer’s board of directors. . . . Frequently, the broker-dealer has been an underwriter for a public offering of the company’s securities. It is claimed that because of this prior connection, he necessarily undertakes to make a market in the securities on behalf of his customers. In addition, because of his broad financial experience, he is sometimes sought as a member of the board of directors. If section 16(b) were applied to market-making transactions by such broker-dealer-directors, they would be compelled, as a practical matter, to cease their market-making activities or resign their directorships. To avoid requiring them to choose between the two alternatives . . . subsection (d)

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84 Id. § 78p(d).
85 Senate Hearings, pt. 15, supra note 35, at 7266.
to section 16 . . . exempt[s] over-the-counter transactions in securities by dealers in the ordinary course of business and incident to the establishment or maintenance of primary or secondary market for such securities, provided the securities have not been held in the dealer's investment account.\footnote{S. Rep. No. 379, 88th Cong., 1st Sess. 22-23 (1963) (emphasis added).}

It seems clear from this passage and others of like import\footnote{Similar statements may be found in id. at 70; H.R. Rep. No. 1418, 88th Cong., 2d Sess. 30 (1964); H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 3, at 42-43 (1963) (Report of Special Study of Securities Markets of the Securities and Exchange Commission).} that Congress, in enacting section 16(d), was not even remotely concerned with the problem of statutory insider status at the time of an initial transaction. Rather, the language making the exemption inapplicable to securities "not then or there-tofore held" in an investment account was employed to limit the exemption to legitimate market-making activities. Since a market-maker buys and sells a security on a regular short-term basis, permitting transactions with respect to securities held in a long-term investment account would be inconsistent with the theory of the exemption.

Similar problems are raised by section 16(e), which exempts foreign and domestic arbitrage transactions from the provisions of section 16.\footnote{15 U.S.C. § 78p(e) (1970). Arbitrage is the practice of buying and selling the same or closely related securities in different markets at or about the same time. Of course, it is profitable only if the securities are traded at different prices in the different markets.} It could be argued that this exemption would be unnecessary unless the initial purchase by which a person first achieves greater than ten percent beneficial owner status would give rise to section 16(b) liability if followed by a sale within six months. The exemption, however, is equally compatible with the notion that such an initial purchase is not to be included within the purview of section 16(b). The exemption apparently stems from a concern expressed by Roland Redmond, attorney for the New York Stock Exchange, that section 16(b) might prevent arbitrage transactions because, "[w]hile that process of the arbitrage is going on he might conceivably accumulate more than 5 percent of this security, and he would be the beneficial owner of that 5 percent."\footnote{Senate Hearings, pt. 16, supra note 35, at 7567 (emphasis added) (the original versions of section 16(b) imposed liability on five percent beneficial owners).} Thus, a person engaged in arbitrage, even under the view that section 16(b) is concerned only with double transaction abuse, would nevertheless require an exemption to cover purchases and sales after attainment of beneficial owner status. A director or an officer would need a similar exemption.\footnote{Pursuant to rule-making authority granted to it by section 16(e), the SEC has withdrawn the arbitrage exemption from directors and officers for purposes of sections 16(a) and 16(b). SEC Rule 16a-1, 17 C.F.R. § 240.16a-1 (1975).} In any event, it can hardly be said that section 16(e) is clear-cut support for the proposition that Congress intended section 16(b) to deter single as well as double transaction abuse.

Also pertinent to the analysis is rule 16b-2, which exempts from the provisions of section 16(b) transactions by an underwriter participating in the distribution of an issue of securities, if certain conditions are met.\footnote{SEC Rule 16b-2, 17 C.F.R. § 240.16b-2 (1975).} An argument similar to that made regarding section 16(e) may be made with respect
to this rule.\textsuperscript{72} Prior to adoption of this rule, Eustace Seligman wrote an article expressing the opinion that the purchase by which one first achieves greater than ten percent beneficial owner status must be included for purposes of liability under section 16(b), since any other construction "would seem to be contrary to the purpose of the Act."\textsuperscript{73} He noted, however, that his construction would create an impediment to equity financing and urged adoption of an exemptive rule.\textsuperscript{74} One year later, in 1935, the SEC adopted what is now rule 16b-2. It is clear that this rule is perfectly consistent with Seligman's construction of section 16(b), a view also subsequently espoused by the SEC. On the other hand, it is not clear how Mr. Seligman gained his knowledge of the purpose of section 16(b), as his article fails to analyze either the language of the section or its legislative history. In addition, the rule is not necessarily inconsistent with the interpretation that such an initial purchase should not be recognized as one of a pair of section 16(b) transactions. As has already been noted in the discussion of section 16(d), many underwriters have followed the practice of placing a representative on the board of directors of the issuer. If this is done prior to the time obligations in a firm commitment underwriting become fixed,\textsuperscript{75} an exemption would be necessary, not because the purchase of ten percent or more of the shares would make the underwriter a statutory insider, but because the underwriter already is an insider before the purchase by virtue of having its representative on the board of directors.

Moreover, the primary concern must always be with congressional intent and not with the interpretation of that intent by some other body, \textit{e.g.}, the SEC. Although the interpretation given a statute by the agency charged with its administration is entitled to great weight on the ground of acquired expertise, the objectivity of the agency’s views may sometimes be colored by overzealousness. Specifically with respect to section 16(b), courts have not hesitated to invalidate or disregard a rule or other SEC interpretation that they deemed

\textsuperscript{72} Brief for SEC as Amicus Curiae at 6-7, Stella v. Graham-Paige Motors Corp., 104 F. Supp. 957 (S.D.N.Y. 1952):

The Commission, at least by implication, early recognized that Congress intended to include such purchases within the scope of the Act. Acting pursuant to the authority granted it to exclude from the operation of section 16(b) such transactions as "are not comprehended within the purposes of Section 16(b)" it promulgated a rule, on June 8, 1935, exempting underwriting transactions meeting certain conditions from the liabilities imposed by the section. Such an exemptive rule would not have been necessary, insofar as underwriters who became 10 per cent owners of the securities underwritten by virtue of their underwriting agreement were concerned, unless section 16(b) is given the literal construction we have suggested. Subsequent amendments of this rule . . . did not vary this interpretation. It is apparent, therefore, that the Commission has consistently . . . regarded the purchase by which a stockholder achieved a ten per cent interest in the corporation as subject to the liabilities imposed by the section.

For a similar view see Cook & Feldman, supra note 12, at 631 n.197: "This view was impliedly adopted by the Commission at an early date. In 1935, it promulgated what is now Rule X-16B-2 . . . exempting certain underwriting transactions from Section 16(b). Unless a person who acquired ten per cent of the stock by virtue of an underwriting agreement was a ten per cent owner 'at the time of' the acquisition, the exemption would have been unnecessary."

\textsuperscript{73} Seligman, supra note 7, at 20.

\textsuperscript{74} Id. at 21.

\textsuperscript{75} Senate Hearings, pt. 15, supra note 35, at 7266: "[O]n most boards of directors, I would point to the presence of bankers who have come upon the board immediately after undertaking to distribute securities for a new and not widely known corporation which is about to be listed or has been listed on a stock exchange."
contrary to the basic purpose of the section.76 Also, the degree of expertise possessed by the SEC in 1935, when the predecessor to rule 16b-2 was first promulgated, may be open to question. Thus, the problem posed by the rule, if indeed there is one, does not seem insurmountable.

Finally, it should be noted that many of the cases applying section 16(b) to situations of single transaction abuse were decided prior to the explosive development of rule 10b-5.77 Because section 16(b) was thought to be the only remedy for abuse of inside information, these courts may have strained to bring within its strictures transactions that otherwise should not have been held subject thereto. This judicial attitude seems to be reflected in numerous insufficently precise statements of the section’s purpose. For example, in Newark v. RKO General, Inc.,78 the court read section 16(b) as being “grounded on . . . deterrence of insider trading on the basis of information unavailable to the investing public.”79 Similarly, in Adler v. Klawans,80 the court stated: “The undoubted congressional intent in the enactment of § 16(b) was . . . specifically to discourage if not prevent three classes of persons from making private and gainful use of information acquired by them by virtue of their official relationship to a corporation.”81 Because of the relatively recent development of a body of case law under rule 10b-5,82 a body of law that is not based on presumptions but on actual abuse of inside information, there is no longer any excuse, much less a basis, for applying section 16(b) to situations not involving the abuse at which it is directed.83 That abuse, it is submitted, is solely double transaction abuse.

III. A Further Analysis of the Case Law

A. Ten Percent Beneficial Owners

As previously noted, Stella v. Graham-Paige Motors Corp.84 was the first case to address the problem of when insider status is required for purposes of section 16(b). Stella concerned the purchase by a six percent shareholder of sufficient additional shares to increase its holdings to 21 percent, followed by a sale within six months. Because the defendant was neither a director nor an

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79 425 F.2d at 356.
80 267 F.2d 840 (2d Cir. 1959).
81 Id. at 844; accord, Chemical Fund, Inc. v. Xerox Corp., 377 F.2d 107, 111 (2d Cir. 1967); Blau v. Lamb, 363 F.2d 507, 515, 519 (2d Cir. 1966), cert. denied, 385 U.S. 1002 (1967); Booth v. Varian Associates, 334 F.2d 1, 3 (1st Cir. 1964), cert. denied, 379 U.S. 961 (1965).
officer, the decision necessarily focused on the requirement in section 16(b) that a ten percent beneficial owner be such “both at the time of the purchase and sale, or the sale and purchase,” of the security. The precise question was whether, with respect to a purchase, “at the time of” meant “prior to” or “simultaneously with” the purchase. The court recognized that the purpose of section 16(b) was to protect outside shareholders against short-swing speculation by insiders with advance information. Although the facts of the case involved a purchase and sale, the court based its decision on the potential for abuse in a sale and purchase situation; that is, a pair of transactions in which a ten percent beneficial owner sells part or all of his holdings and then repurchases them within less than six months. Under the “prior to” interpretation regarding a purchase, section 16(b) would not apply to such a situation since, immediately prior to the repurchase, the shareholder would have held less than ten percent. Thus, the court essentially was concerned with double transaction abuse. Because the shareholder would have had statutory insider status before engaging in his initial transaction, both the sale and the repurchase could have been tainted by a short-swing intent based upon advance inside information. The court presumably felt that it would be impermissibly inconsistent to construe “at the time of” as meaning “prior to” in the case of an initial purchase but “simultaneously with” in the case of a repurchase. Thus, the court was so bothered by the potential for double transaction abuse in a hypothetical sale-purchase case that it construed section 16(b) to apply to a purchase-sale situation involving only the possibility of single transaction abuse.

In addition to the somewhat questionable practice of rendering a decision based upon hypothetical facts different from those presented by the case at bar, the court’s fears appear to have been ungrounded. Since the decision in Stella, only one case has been reported involving a beneficial owner who sold and then repurchased. Moreover, adoption of the “prior to” construction with respect to a purchase that is the initial transaction should not preclude application of the “simultaneously with” construction with respect to a purchase that is the terminal transaction. As was noted by the court in Provident Securities Co. v. Foremost-McKesson, Inc., “[t]his conclusion does not provide a consistent construction of the language ‘at the time of’ for both the initial and the closing transactions, but it is consistent with the rationale of section 16(b)—a consistency that . . . is much more important than the consistency of terms.”

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6 104 F. Supp. at 959.
7 Id.
8 Id.
9 This is the construction adopted by Provident Sec. Co. v. Foremost-McKesson, Inc., 506 F.2d 601, 614 (9th Cir. 1974) (dictum), cert. granted, 420 U.S. 923 (1975). The court in Stella apparently was not bothered by the inconsistency of construing “at the time of” to mean “simultaneously with,” which in turn means “immediately after” in the case of a purchase but “immediately before” in the case of a sale. 57 Colum. L. Rev. 287, 289 (1957).
11 506 F.2d 601 (9th Cir. 1974), cert. granted, 420 U.S. 923 (1975).
12 506 F.2d at 614; accord, Painter, supra note 12, at 41. But see discussion note 128 infra.
Subsequent beneficial owner cases have applied the *Stella* rule to purchase-sale single transaction abuse cases without recognizing the double transaction theoretical underpinning of that decision. In *Newmark v. RKO General, Inc.*, RKO had 56 percent control of Frontier Airlines. The day before a merger agreement between Frontier and Central Airlines was executed, and before the merger was announced to the public, RKO contracted with several major shareholders of Central to purchase 49 percent of Central’s outstanding shares. Since the contract bound the controlling shareholders of both corporations and was conditional upon completion of the merger, it was virtually certain that the merger would be approved by the shareholders of both Frontier and Central. RKO purchased the Central shares after this approval and a short time later exchanged them for Frontier shares pursuant to the merger agreement. In addition to the question whether that exchange was a sale of the Central shares, the court was faced with the question whether section 16(b) embraced the very purchase by which RKO became a greater than ten percent owner of Central. The court resolved this issue by reference to *Stella*, stating:

This rule is grounded on the frequently cited overriding purpose of the statute, deterrence of insider trading on the basis of information unavailable to the investing public. The statutory reference to a ten percent beneficial owner rests on the presumption that an owner of this quantity of securities has access to inside information. Although this presumption would not justify the conclusion that one who purchases a quantity of shares which makes him a ten percent beneficial owner has done so on the basis of inside information, the presumed access to such information resulting from this purchase provides him with an opportunity, not available to the investing public, to sell his shares at the moment most advantageous to him. Thus, a purchase of shares which makes the buyer an insider creates an opportunity for the type of speculative abuse the statute was enacted to prevent.

A clearer statement that section 16(b) was being interpreted to cover cases of single transaction abuse is hard to imagine. Yet the court failed to analyze the propriety of basing the drastic presumption of abuse of inside information on a single sale. It is possible, however, that the court actually was concerned with the danger of double transaction abuse. Although it paid lip service to the requirement that access to information be by reason of the inside relationship, it went on to note that “[a]t the time it secured a conditional right to purchase Central securities, RKO was in possession of advance information of the type most likely to affect the price of Central shares—confidential knowledge of an impending merger with Frontier.” It is clear that any access to such advance information was not by way of RKO’s relationship to the *issuer* (Central) but by virtue of its relationship to Frontier. It is submitted, therefore, that *Newmark* represents either a misconception of the basic purpose of section 16(b) or an unwillingness to abide by its strictures.

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84 425 F.2d at 356 (footnote omitted).
85 Id. at 356 n.7.
86 Id. at 356.
In *Emerson Electric Co. v. Reliance Electric Co.*, Emerson made a tender offer to the shareholders of Dodge Manufacturing Corporation and acquired 13.2 percent of the outstanding Dodge stock. This amount was insufficient to prevent a defensive merger between Dodge and Reliance. Because it did not want to become a minority shareholder in Reliance, Emerson sold its Dodge stock in two transactions before the merger was consummated and within six months of its purchase. In the first sale, it reduced its holdings to 9.96 percent, and one day later, it sold the remainder of its shares. The district court thus was presented with two questions under section 16(b), one relating to the initial transaction and one relating to the split terminal transaction.

The portion of the district court opinion regarding the initial transaction is extremely confusing. In essence, it adopted the *Stella* "simultaneously with" construction of "at the time of" for two reasons: (1) it was in accord with the literal meaning of the language; and (2) it best served to promote the congressional purpose manifest in section 16(b). These conclusions are questionable. The plain meaning of the statutory phrase supports the "prior to" construction, and this construction is unequivocally supported by the purpose of section 16(b) as manifested by its terms and its legislative history, both of which the court failed to examine.

The court encountered less difficulty with respect to the terminal transaction. It took a substance over form, step-transaction approach to conclude that both sales were part of a single interrelated plan by Emerson to dispose of its holdings. Thus, in order to avoid subverting the policy of section 16(b), it held that both sales must be included in determining liability, even though Emerson held slightly less than ten percent of the outstanding Dodge stock at the time of the second sale. It might be noted that some of those who have advocated the *Stella* interpretation have done so, in part, on the basis that the exemption requiring ten percent beneficial ownership for both transactions would still have some meaning because of its applicability to the second of two sales whereby a ten percent beneficial owner divested himself of his securities, e.g., Emerson’s second sale of 9.96 percent. The combined holding of the district court in *Emerson*, however, would seem almost to read the exemption out of the statute.

On appeal, the Eighth Circuit affirmed the district court as to the initial transaction but reversed as to the second sale in the terminal transaction. With respect to the issue presented by the purchase, the court appeared to recognize that section 16(b) was directed at double transaction abuse. It noted that the purpose of the section was to curb the evils of short-swing trading by the three classes of statutory insiders. It also recognized that "at the time of" could

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99 id. at 592.
100 Seligman, supra note 7, at 20; II Loss, supra note 12, at 1060.
101 434 F.2d at 922, 923.
mean "prior to" in the case of an initial purchase and "simultaneously with" in the case of a repurchase. Nevertheless, the court held that the initial purchase giving Emerson greater than ten percent beneficial owner status must be included because "[a]ny other view has the weakness of impracticality of application of the statute." Clearly referring to single transaction abuse, the court felt that a shareholder in Emerson's position could obtain much inside information during the period between purchase and sale and that deterrence of such mischief must have been within the contemplation of Congress. To support this proposition, the court cited an example of double transaction abuse in a sale-repurchase situation, an example that first appeared in the Senate report accompanying one version of section 16(b). Thus the Eighth Circuit, like the Second Circuit in Neumark, failed to perceive the essential nature of the presumption created by section 16(b).

The court went on to reverse the district court's finding of liability with respect to the second sale because, at that time, Emerson literally fell within the language of the exemption. Although Emerson's purpose of limiting its potential liability was clear, the court felt there was no reason why people could not conduct their affairs with just such a purpose. Since the district court had found as a fact that the two sales were not legally tied to one another, there was no basis for holding Emerson liable on the second. Failing to realize the philosophic inconsistency with its holding regarding the purchase, the court stated that it was not free under the guise of statutory interpretation to rewrite statutes to include matters not included by Congress. The Supreme Court, over a vigorous dissent by Justice Douglas, affirmed the Eighth Circuit on the issue of the second sale but expressly declined to decide the issue raised by the purchase since Emerson had not filed a cross-petition for certiorari.

If one accepts the proposition that Congress enacted section 16(b) exclusively to deter double transaction speculative abuse, it could be argued that the decision of the Eighth Circuit is theoretically incorrect on both issues. The analysis with respect to the initial transaction—that Emerson could not possibly have purchased with the intent to sell, on the basis of inside information derived from a nonexistent relationship to the issuer—has already been discussed and need not be repeated in detail here. The split-sale terminal transaction, however, when viewed in isolation from the problem of the initial transaction, clearly presents the potential for double transaction speculative abuse. That is, assuming preexisting insider status at the time of the purchase, all sales within six months could be tainted by a short-swing, in-and-out intent based on advance inside information. Actually, the point is purely academic if beneficial

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106 Id. at 923.
107 Id. at 924.
108 Id.
109 S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934) (noting the case of insiders who, knowing that the issuer was going to omit payment of a dividend, sold their shares for $16 million and later repurchased them for $7 million).
108 434 F.2d at 925-26.
107 404 U.S. at 420, 421.
owner status prior to the initial purchase is required. With this requirement, damages could be computed only by matching the amount purchased after attaining beneficial owner status with a corresponding amount sold. For example, assume an outsider purchases ten percent of a corporation's stock in January, purchases an additional five percent in February, and sells all fifteen percent in March. The maximum amount of damages recoverable by the corporation would be the profit attributable to the sale of five percent of the stock, because the purchase by which the outsider first obtained ten percent beneficial owner status would not be cognizable under section 16(b). Exactly the same result would obtain if only six percent were sold in March and the remaining nine percent were sold in April. For this reason, the terminal split-sale technique becomes totally superfluous under a proper interpretation of the statute.

The same should not be true of a split-sale that is an initial transaction. For example, assume an outsider purchases ten percent of a corporation's stock in January, sells ten percent in February, and repurchases ten percent in March. In this case, under the "simultaneously with" view regarding purchases that are terminal transactions, damages would be based on the profits attributable to the sale of ten percent of the stock, matching the February sale with the March repurchase. The purpose of section 16(b) would be subverted if a split-sale were sanctioned under these circumstances, i.e. a sale of one percent in February followed by a sale of nine percent in March and a repurchase of ten percent in April. Although it could be argued that damages should be based only on the sale of one percent of the stock, because immediately prior to the subsequent sale of nine percent the requisite beneficial owner status was absent, the potential for double transaction abuse clearly is present. It is submitted that the problem posed by the specific statutory requirement that a ten percent beneficial owner be such both at the time of sale and purchase should be overcome by collapsing the separate steps in the initial transaction, steps having no substantive function other than avoidance of section 16(b) liability, into a single "sale." Perhaps it would even be proper to indulge in a rebuttable presumption that all such sales within six months prior to a repurchase are part of a single interrelated "sale." 108 A liberal interpretation of the statute here, to carry out the congressional purpose underlying section 16(b), is not inconsistent with the view that the section ought not to be interpreted liberally with regard to the original acquisition, where such an interpretation would extend section 16(b) far beyond its original purpose.

Provident Securities Co. v. Foremost-McKesson, Inc.109 concerned a holding company, Provident, that had determined to liquidate its assets. Foremost was approached as a potential purchaser. Originally Provident had hoped to sell for cash but was persuaded by Foremost to transfer the majority of its assets principally in exchange for Foremost debentures. These debentures were imme-

108 Id. at 432, 438 (Douglas, J., dissenting).
diately convertible into common stock in an amount exceeding ten percent of the Foremost shares outstanding. Shortly thereafter, Provident executed an agreement to sell slightly more than half of the debentures to an underwriting syndicate and distributed the remainder of the debentures to its shareholders as a partial liquidating dividend. On these facts, the Ninth Circuit held that Provident was not liable to Foremost under section 16(b) because Provident was not a ten percent beneficial owner “at the time of” its purchase of the Foremost convertible debentures. The court reached this conclusion notwithstanding the fact that “the general cooperation involved in the transaction would indicate that Provident conferred intimately with the Foremost management and could well have had access to confidential corporate information.”

Provident is noteworthy because it is the only case to engage in an extensive analysis both of section 16(b) and its legislative history, because it is one of only two cases\(^{111}\) to clearly hold that the section covers only double transaction abuse, and because the case was recently argued before the Supreme Court and a decision is pending. The court of appeals began by examining early drafts of the section and noted that they were expressly designed to deter insiders from purchasing with the intention or expectation of selling within six months.\(^{112}\) It reasoned that since section 16(b), as enacted, creates a conclusive presumption of short-swing speculation on the basis of inside information, it is necessary that the presumption be narrowly construed to apply only to those who can reasonably be expected to have access to such information.\(^{113}\) That class of persons is further presumed to consist of directors, officers and ten percent beneficial owners but does not include outsiders.\(^{114}\) The court concluded:

Since a person who decides to purchase enough stock to increase his holdings to 10 percent of a corporation’s outstanding shares is an outsider at the time he makes his investment decision, he does not fall within the class of persons to which the conclusive presumption was intended to apply. He may have made that decision on the basis of inside information, but such inside information could not have been acquired, in the language of the statute, “by reason of his relationship to the issuer,” or in the language of the Supreme Court, “from substantial stockholdings that did not yet exist.” . . . The statutory language “at the time of,” in order to be consistent with the rationale of the statutory presumption, must be construed to mean prior to the time when the decision to purchase is made.\(^{115}\)

As previously noted, Provident is the only case that has engaged in a detailed analysis of section 16(b), and it is the first case since 1956 to reach the conclusion that the statutory presumption cannot rationally be applied to one who

\(^{110}\) 506 F.2d at 605.

\(^{111}\) The other case is Allis-Chalmers Mfg. Co. v. Gulf & Western Indus., Inc., Current CCH Fed. Sec. L. Rep. ¶ 95,308, ___ F.2d ___ (7th Cir. 1975). This decision relies on Provident and reaches essentially the same conclusion regarding the initial transaction.

\(^{112}\) 506 F.2d at 609.

\(^{113}\) Id. at 611.

\(^{114}\) Id. at 612.

\(^{115}\) Id. at 614.
was not a ten percent beneficial owner prior to his initial transaction. The relationship between this detailed analysis and the conclusion reached surely is more than coincidental.

B. Other Insiders

In terms of confusion regarding the purpose of section 16(b), cases involving directors and officers seem determined not to be outdone by their counterparts involving beneficial owners. In Blau v. Allen, the defendant purchased 150,000 shares of Warner Brothers Pictures common stock. He thereafter became a director and, within six months of his purchase, sold 5,750 shares. In defending a section 16(b) suit, he argued, inter alia, that he could not be liable because he did not become an insider until after his purchase. In response, the court simply stated that a purchaser "need not have access to inside information in entering into his initial transaction. Having become an insider by virtue of becoming a director, it was this defendant's subsequent speculation that is the 'vice within the purview of § 16(b)." After relying on Stella as support for this point and misreading that decision as being directed toward single transaction abuse, the court, in the same paragraph, blandly added that it was significant that the section required a ten percent beneficial owner to be such both at the time of purchase and sale, but no such limitation was imposed in the case of officers and directors.

Adler v. Klawans is similar. The court felt that the purpose of section 16(b) was clear without reference to legislative history and that the plain intent of Congress was to reach any two transactions within a six month period by someone who was a statutory insider "at some time." The court seems to have assumed the answer to the ultimate question when it stated that "the consciously limited scope of the statute is no reason for us to seek yet further limitations of what is remedial legislation."

Although the defendants in both Blau and Adler made statutory purpose arguments based on the dissenting opinion by Judge Hincks in Stella, an opinion noteworthy for its incisive analysis, neither court chose to rethink the problem. Both courts misread Stella as espousing a single transaction abuse rationale, and both reached an incorrect result. Of course, it is clear that section 16(b) evidences an intent, on its face, to treat ten percent beneficial owners differently than officers or directors, but the distinction in treatment should not relate to the question of insider status prior to the initial transaction. Regardless of the category of insider, no one could possess the prohibited intent if he were not an insider prior to his initial transaction.

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120 Id. at 704.
121 Id.
122 267 F.2d 840 (2d Cir. 1959).
123 Id. at 844 (emphasis omitted).
124 Id. at 845 (emphasis added).
125 232 F.2d at 302 (Hincks, J., dissenting).
Before proceeding on this point, however, the decision in *Feder v. Martin Marietta Corp.*\(^{124}\) should be reviewed. *Feder* involved a director who purchased shares of his corporation during his tenure in office, then resigned and sold the shares within six months of their purchase. The court recognized that the issue was one of first impression but, relying by analogy on *Adler*, held that the ex-director must disgorge his profits.\(^{126}\) The court's rationale is best summarized by a statement made near the end of its opinion:

To be sure, the congressional belief that inside information could be abused, the belief that prompted the prophylactic enactment of § 16(b), is just as germane to the situation when a person is a director only at the time of purchase as when he is a director only at the time of sale. For, in the case of a director who resigns his directorship before the sale it is possible for both the purchase and sale to have been unfairly motivated by insider knowledge; whereas if the purchase were made prior to the directorship only the sale could be motivated by inside information.\(^{126}\)

In other words, if section 16(b) has been interpreted to cover single transaction abuse, a fortiori, it must apply to double transaction abuse! The court thus reached a correct interpretation of the section by means of a somewhat roundabout reasoning process.

C. Beneficial Owners and Other Insiders Compared

Like *Blau* and *Adler*, the *Feder* decision took note of the different statutory treatment accorded ten percent beneficial owners. The difference, however, should properly be limited to the time period subsequent to attainment of insider status. Section 16(b) should apply in the case of a director or officer who, like the defendant in *Feder*, was in office prior to his initial transaction (either purchase or sale) but who resigned before his terminal transaction (either sale or purchase), because there is an inherent danger of double transaction speculative abuse of inside information. If, as in *Blau* and *Adler*, the director or officer obtained insider status only after his initial transaction, the potential for double transaction abuse is absent and section 16(b) should not apply.

The specific statutory exemption with respect to ten percent beneficial owners requires that they be treated in a somewhat different manner. As has already been discussed, if an outsider purchases ten percent or more of a class of equity security, followed by a further purchase and then a sale of his entire holdings, all within six months, damages must be limited to the profit computed by matching the second purchase with a corresponding amount sold. The reason for this limitation is that, unlike the case of an officer or director, the first purchase was the very act whereby insider status was attained. By definition, this transaction could not have been tainted by inside information. Other cases exist, however, in which the danger of double transaction abuse may be present. One example, also previously discussed, is the case of a preexisting


\(^{126}\) 406 F.2d at 266.

\(^{130}\) Id. at 268.
beneficial owner who engages in a two-step sale, the first step reducing his holdings below ten percent, followed by a repurchase. If the two sales are nothing more than functionless steps in a single plan of disposition, the steps could be collapsed into a single “sale” without doing too much violence to the exemption.\footnote{See text at note 108 \textit{supra}.} If this cannot be shown, the exemption must prevail and liability should attach only with respect to the first sale. A similar result should obtain in the case of a sale followed by a two-step reacquisition of ten percent status. Finally, if a sale is followed by a repurchase, and the repurchase is not of sufficient amount to restore ten percent status, it clearly should not be cognizable under section 16(b). While some of these situations may involve a potential for double transaction abuse, they simply cannot be brought within the purview of the section without either ignoring the specific exemption or engaging in a very strained interpretation of it.\footnote{Allis-Chalmers Mfg. Co. v. Gulf & Western Indus. Inc., Current CCH Fed. Sec. L. Rep. ¶ 95,308, ... P.2d ... (7th Cir. 1975), follows \textit{Provident} in holding that “at the time of,” as used in the exemption, requires beneficial owner status prior to the initial step of a short-swing. The court went further and declared, by way of dictum, that this is the \textit{only} time beneficial owner status should be required. To reach this conclusion, it was necessary for the court to engage in a unique construction of the requirement of beneficial ownership “both at the time of the purchase and sale, or the sale and purchase . . . .” This construction is based on the court’s conclusion that a purchase and sale (or a sale and purchase) are not two transactions but two component parts of a single, unitary transaction. Under this construction, beneficial owner status is only required prior to the unitary purchase/sale transaction or the sale/purchase transaction. That is, the relevant language in section 16(b) is interpreted as though it read “both at the time of the purchase and sale transaction, or the sale and purchase transaction.” The fact that beneficial owner status may not exist immediately before, simultaneously with, or immediately after the terminal part of a transaction thus would be irrelevant. \textit{Id.} at 98,553-55, ... P.2d at ... The major drawback to this construction is the grammatical problem of a phrase, introduced by “both,” containing two groups of nouns separated by the disjunctive “or.”} Moreover, if the basis for the section 16(b) presumption is accurate in fact, the possibility of abuse may not even be present. Thus, at least in the two-step cases, if one sale (or purchase) actually is unrelated to the other sale (or purchase) then, by definition, it could not be part of a single short-swing speculative plan.

\section{IV. Conclusion}

Once the question of the type of speculative abuse section 16(b) was designed to deter is answered, resolution of issues regarding the time insider status is required becomes relatively easy. In all cases, the defendant should be a statutory insider before engaging in his initial transaction, whether it be a purchase or a sale. Theoretically, that is the only time insider status should be required, since a loss of status during the interim between the initial and terminal transactions would have no effect on the original decision, imputed by section 16(b), to engage in short-swing speculation. However, certain adjustments, discussed above, are necessary in the case of ten percent beneficial owners because the section specifically requires that they be such both at the time of purchase and sale or sale and purchase. As a general rule, section 16(b) should apply to a beneficial owner if he meets the initial transaction requirement and if he has ten percent status either prior to or simultaneously with the terminal transaction, regardless of whether it is a sale or purchase.