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**Securities Law - Split Sale 16(b) Liability of Beneficial Owners for Short-Swing Profits - Reliance Electric Company v. Emerson Electric Company**

## GUEST COMMENT

SECURITIES LAW — “SPLIT-SALE” § 16(b) Liability of Beneficial Owners for Short-Swing Profits — *Reliance Electric Company v. Emerson Electric Company*, 92 S. Ct. 596 (1972).

**P**URSUANT to an attempted takeover of Dodge Manufacturing Company (“Dodge”), Emerson Electric Company (“Emerson”) acquired 13.2 percent of the outstanding common stock of Dodge.<sup>1</sup> In a defensive move, Dodge negotiated a merger with Reliance Electric Company (“Reliance”). A proxy fight ensued and the shareholders of Dodge subsequently approved the Dodge-Reliance merger. Realizing its bid for control would now be fruitless, Emerson sold enough of its recently acquired Dodge stock to bring its holdings down to 9.96 percent of the total outstanding shares. Two weeks later, Emerson sold the remaining Dodge stock in its possession to Reliance. Both sales were consummated within 6 months of Emerson’s initial purchase and each yielded a considerable profit.<sup>2</sup> Reliance, as corporate successor to Dodge, demanded from Emerson the total profit on both sales relying on the provisions of section 16(b) of the Securities Exchange Act of 1934.<sup>3</sup> Emerson filed suit in the District Court for the Eastern District of Missouri requesting a declaratory judgment determining its liability to Reliance. The district court held that Emerson must account to Reliance

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<sup>1</sup> On May 22, 1967, Emerson made a tender offer for shares of Dodge common stock. Emerson, on June 16th, upon the expiration of the tender offer, purchased all 152,282 shares tendered.

<sup>2</sup> Emerson’s tender offer price was \$63.00 per share. The first block of stock, 37,000 shares, was sold to investment brokers at a price of \$68.00 per share; the remaining shares, 115,282, were sold to Reliance at a price of \$69.00 per share.

<sup>3</sup> Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 p(b) (1970), provides:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [“Every person who is directly or indirectly the beneficial owner of more than 10 percentum of any class of equity security (other than an exempted security) which is registered . . .” 15 U.S.C. § 78 p(a) (1970)], 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 . . . 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.

for the profits realized on both sales.<sup>4</sup> Emerson appealed to the Court of Appeals for the Eighth Circuit. The court of appeals reversed that part of the district court's finding that would have forced Emerson to pay over the profits on the second sale of the 9.96 block of stock.<sup>5</sup> On appeal by Reliance, the Supreme Court affirmed,<sup>6</sup> holding that the second sale was specifically exempted from the operation of section 16(b) since Emerson was not the beneficial owner of a 10 percent interest in Dodge at the time the second sale was made.

#### I. SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934

Section 16(b) provides, in part, that a corporation has a right to recover the profits realized by a beneficial owner of more than 10 percent of its stock resulting from a purchase and sale of such stock within any 6 month period.<sup>7</sup> The section is limited, however, to exclude from coverage "any transaction where such beneficial owner was not such both at the time of purchase and sale."<sup>8</sup>

Most cases dealing with a question under section 16(b) have reviewed the history and congressional motives behind the section's enactment.<sup>9</sup> Stated briefly, the section was designed to curb the abuses of insider trading by forcing those persons who might have access to inside information to return all profits realized from short-swing transactions.<sup>10</sup> Factors such as motive, intent, and actual access to or use of inside information were not to be considered when applying the statute.<sup>11</sup> Congress had enacted "a relatively arbitrary rule capable of easy administration" imposing strict liability on those transaction which fall within its terms.<sup>12</sup> The use of a

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<sup>4</sup> Emerson Elec. Co. v. Reliance Elec. Co., 306 F. Supp. 588 (E.D. Mo. 1969).

<sup>5</sup> Emerson Elec. Co. v. Reliance Elec. Co., 434 F.2d 918 (8th Cir. 1970).

<sup>6</sup> Reliance Elec. Co. v. Emerson Elec. Co., 92 S. Ct. 596 (1972).

<sup>7</sup> 15 U.S.C. § 78 p(b) (1970).

<sup>8</sup> *Id.*

<sup>9</sup> See, e.g., Newmark v. RKO Gen., Inc., 425 F.2d 348 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970); Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

<sup>10</sup> The section covers only those persons and transactions that meet the statutory definitions. The section is not designed to be a catch-all for all situations where abuse might be present. Adler v. Klawans, 267 F.2d 840, 845 (2d Cir. 1959).

<sup>11</sup> Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); Volk v. Zlotloff, 285 F. Supp. 650 (S.D.N.Y. 1968); Blau v. Allen, 163 F. Supp. 702 (S.D.N.Y. 1958).

<sup>12</sup> Bershad v. McDonough, 428 F.2d 693, 696 (7th Cir. 1970).

"crude rule of thumb"<sup>13</sup> to determine liability prompted at least one court to suggest that the section was Draconian in its application.<sup>14</sup> Despite this apparent quest for objectivity, some factual, if not subjective, analysis was necessary to determine whether liability attached. Thus, courts have had to decide whether an individual came within the definition of an "officer,"<sup>15</sup> "director,"<sup>16</sup> or "beneficial owner,"<sup>17</sup> or if an "equity security"<sup>18</sup> was traded; or if a particular transaction was a "sale"<sup>19</sup> or "purchase;"<sup>20</sup> or if a purchase and sale took place "within a six-month period."<sup>21</sup>

In a more fundamental departure from the strict objective approach, courts have begun to inquire into particular transactions to see if the possibility of abuse of inside information was present.<sup>22</sup> This analysis is not utilized to replace the traditional objective approach but rather to supplement it.<sup>23</sup> For example, in *Petteys v. Butler*,<sup>24</sup> objective measures would have dictated that a conversion of preferred shares to common be characterized as a "purchase"—and thus, a subsequent sale of the common within 6 months would be subject to section 16(b) provisions—but because of the absence of the possibility of abuse in this particular case the court found no lia-

<sup>13</sup> *Hearings on H.R. 9323 Before the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess. 6557 (1934). See also *Bershad v. McDonough*, 428 F.2d 693, 696-97 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971); *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 166 (3d Cir. 1965).

<sup>14</sup> *Blau v. Lamb*, 363 F.2d 507, 515 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); see *Petteys v. Butler*, 367 F.2d 528, 532 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).

<sup>15</sup> *Colby v. Klune*, 178 F.2d 872 (2d Cir. 1949); *Lockheed Aircraft Corp. v. Campbell*, 110 F. Supp. 282 (S.D. Cal. 1953).

<sup>16</sup> *Blau v. Lehman*, 368 U.S. 403 (1962); *Feder v. Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970); *Ratner v. Lehman*, 193 F.2d 564 (2d Cir. 1952).

<sup>17</sup> *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). See also *Newmark v. RKO General, Inc.*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

<sup>18</sup> *Chemical Fund, Inc. v. Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967); *Ellerin v. Massachusetts Mutual Life Ins. Co.*, 270 F.2d 259 (2d Cir. 1959).

<sup>19</sup> *Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971); *Newmark v. RKO General, Inc.*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966).

<sup>20</sup> *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965); see *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).

<sup>21</sup> *Varian Associates v. Booth*, 224 F. Supp. 225 (D.C. Mass. 1963), *aff'd* 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965). See *B.T. Babbitt, Inc. v. Lachner*, 332 F.2d 255 (2d Cir. 1964).

<sup>22</sup> See, e.g., *Blau v. Lamb*, 363 F.2d 507, 518-20 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).

<sup>23</sup> *Id.* at 519.

<sup>24</sup> 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).

bility. The court's rationale was that "if an examination of the facts indicates that there is no possibility of abuse, there is no need to apply a section 16(b) label to the transaction."<sup>25</sup> This method of reasoning does not mean that the insider's "intent" will be scrutinized, nor will an examination be made for proof of actual use of inside information. Rather, the transaction will be looked at to see if the circumstances afforded an opportunity for speculative abuse.

## II. EMERSON ELECTRIC COMPANY V. RELIANCE ELECTRIC COMPANY

The District Court for the Eastern District of Missouri, in deciding that the profit from both sales was recoverable, placed great weight on the fact that the two separate sales were "effected pursuant to a single predetermined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability . . . ."<sup>26</sup> The Eighth Circuit Court of Appeals saw little merit in predicating liability on intent in general and intent to avoid liability in particular: "[I]ntent . . . to avoid loss of realized profits by engaging in two independent sales not legally tied to each other and made at different times to different buyers . . . does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction . . . ."<sup>27</sup> Purposeful conduct to minimize liability under section 16(b) "is to some extent analogous to tax avoidance conduct which is permissible."<sup>28</sup>

The Supreme Court, with Justice Stewart speaking for the 4-3 majority,<sup>29</sup> affirmed the court of appeals' decision.<sup>30</sup> The Court found simply that Emerson was in fact not a 10 percent beneficial owner of Dodge's stock at the time of the second sale and therefore could not be required to disgorge its profits from that sale. The majority allowed that "where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purposes of curbing short swing speculation

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<sup>25</sup> *Id.* at 535. See *Blau v. Lamb*, 363 F.2d 507, 519 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967). See also *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.), *cert. denied*, 348 U.S. 827 (1954); *Shaw v. Dreyfus*, 172 F.2d 140 (2d Cir.), *cert. denied*, 337 U.S. 907 (1949); Comment, 59 *YALE L.J.* 510 (1950); Comment, 45 *VA. L. REV.* 124 (1959).

<sup>26</sup> 306 F. Supp. at 592.

<sup>27</sup> 434 F.2d at 926.

<sup>28</sup> *Id.* at 925. The court of appeals referred in footnote 19 to the case of *Gregory v. Helvering*, 293 U.S. 465 (1934), which dealt with tax avoidance.

<sup>29</sup> Mr. Justice Powell and Mr. Justice Rehnquist took no part in the consideration or decision of the case.

<sup>30</sup> 92 S. Ct. 596 (1972).

by corporate insiders."<sup>31</sup> However, "a construction of the term 'at the time of . . . sale' that treats two sales as one upon proof of a pre-existing intent by the seller is scarcely in harmony with the congressional design of predicating liability upon an objective measure of proof."<sup>32</sup> The court could not adopt a construction that "flatly contradicts the words of the statute."<sup>33</sup>

### III. EXEMPTION PROVISION OF § 16(b)

It is not entirely clear whether the framers of section 16(b) foresaw such a "split-sale" and decided to exempt it under the phrase "both at the time of purchase and sale" or whether they simply did not anticipate such a transaction. It is clear, however, that neither the majority nor the dissenters could cull any specific dialogue from the congressional hearings to conclusively support their respective positions.

Justice Stewart suggested that the reasoning behind the exemption was "that Congress regarded one with a long-term investment of more than 10% as more likely to have access to inside information than one who moves in and out of the 10% category."<sup>34</sup> Considering the arbitrariness of the statute<sup>35</sup> and its use as a "crude rule of thumb,"<sup>36</sup> this may well have been the congressional motive behind the inclusion of the specific exemption in question. It is indeed unfortunate, however, that the majority opinion could not cite a more definite rationale for the exemption. The Securities and Exchange Commission, in an *amicus* brief, argued:

The exemption was intended to operate in situations where a person purchases stock of a corporation, subsequently becomes a more than 10 percent beneficial owner through circumstances other than a voluntary stock purchase, and then sells his stock within six months of the purchase.<sup>37</sup>

<sup>31</sup> *Id.* at 600.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 601.

<sup>34</sup> *Id.* at 600. *Adler v. Klawans*, 267 F.2d 840, 845 (2d Cir. 1959), suggested another reason why 10 percent beneficial owners were treated differently than officers and directors:

[O]fficers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a "10% beneficial owner."

<sup>35</sup> See *Feder v. Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970). See also cases cited note 13 *supra*.

<sup>36</sup> Note 12 *supra*.

<sup>37</sup> Brief for SEC as *Amicus Curiae* at 13, *Reliance Elec. Co. v. Emerson Elec. Co.*, 92 S. Ct. 596 (1972). The Commission suggested two ways this might happen: first, by legal succession; second, by a reduction in the total number of outstanding shares of a corporation, thereby increasing the percentage holdings of a shareowner. *Id.* at 30.

In other words, if the transaction that brought about the 10 percent status was voluntarily consummated, all sales within six months would be subject to section 16(b) liability.<sup>38</sup> The SEC based this conclusion on the fact that of the three classes of persons upon whom liability is imposed (officers, directors, and 10 percent beneficial owners) only 10 percent beneficial owners can become such involuntarily.<sup>39</sup> That is why, in the SEC's view, the exemption provision mentions only 10 percent holders and not officers and directors.<sup>40</sup> Given the paucity of legislative history on this point, the Court was probably reluctant to adopt such a position without more convincing proof. It must be conceded that if Congress meant to make some sort of distinction between ownership voluntarily and involuntarily achieved, they certainly could have done so in a provision much clearer than the one finally included in the section.

#### IV. THE DISSENT: "SPLIT-SALE" AND "SALE"

In trying to characterize Emerson's two separate sales as one "sale," Justice Douglas in his dissent argued that the Court "should construe the statute as allowing a rebuttable presumption that any such series of dispositive transactions will be deemed to be part of a single plan of disposition, and will be treated as a single 'sale' for the purposes of § 16(b)."<sup>41</sup> Although Justice Douglas maintained that this method would not require the courts to delve into the forbidden "intent" inquiry, his construction begs the question. If intent is irrelevant under section 16(b) what difference can it make that intent is presumed rather than proved? In effect Justice Douglas is saying that the split-sale situation ought to be covered, and if necessary a strong judicial hand should be wielded in interpreting the statute so as to achieve that result. This is judicial legisla-

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<sup>38</sup> *Id.* at 14.

<sup>39</sup> *Id.* at 29-30.

<sup>40</sup> *Id.* at 29.

<sup>41</sup> 92 S. Ct. at 607 (dissenting opinion) (footnote omitted). Justice Douglas found fault with the district court's reasoning when he said: "Insofar as the district court's approach appears to place the burden on the plaintiff to demonstrate the existence of a 'plan of distribution,' it is justifiably open to criticism." *Id.* at 606. It seems Douglas' answer to this dilemma is to conveniently assume such a plan given the "split-sale" circumstances.

The textual footnote to Douglas' language regarding the construction of a "rebuttable presumption" makes an analogy to a similar proposed rebuttable presumption concerning the so-called "private placement" and the "view to distribution" concept. 92 S. Ct. at 596 n.12. Unfortunately, this analogy fails because the search for proof of whether the purchasers had a "view to distribution" centers on the "intent" of the individual — something neither required nor at issue in a § 16(b) case. See cases cited note 11 *supra*.

tion at its clearest and is properly rebuked by the majority opinion.

The Securities and Exchange Commission also suggested a construction of the word "sale" as including a series of sales.<sup>42</sup> Rather than fabricating a rebuttable presumption that a "plan of distribution" exists given a series of sales (as Mr. Justice Douglas would), the Commission relied on the broad interpretive power of the Court to "effectuate the policy of section 16(b)."<sup>43</sup> The problem with this approach is that the majority of the Court neither accepts nor plans to utilize this power — a power, in fact, unrecognized by the present Court.

#### V. LIABILITY OF "EX-BENEFICIAL OWNERS"

Both the Securities and Exchange Commission<sup>44</sup> and Mr. Justice Douglas<sup>45</sup> maintained that section 16(b) liability should be extended to ex-beneficial owners on the same rationale that led the Court to hold ex-directors liable in *Feder v. Martin Marietta Corp.*,<sup>46</sup> viz., information obtained while occupying a favorable position with a corporation does not lose its utility simply because that relationship is terminated. Although this argument has considerable facial appeal, it will not withstand close scrutiny.

As Mr. Justice Stewart points out, the "SEC's own rules undercut such an interpretation."<sup>47</sup> The Commission, pursuant to the powers granted in the statute,<sup>48</sup> promulgated rule 16a-10 that exempts from 16(b) liability any transaction that does not fall within the reporting requirements of section 16(a).<sup>49</sup> Rule 16(a) requires that officers, directors, and beneficial owners report at the end of each month any changes in their stock holdings during the month. The Commission's original interpretation of that rule, Form 4, determined that such a report was necessary only if the status of officer, director, or 10 percent beneficial owner was maintained during the month.<sup>50</sup> This ad-

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<sup>42</sup> Brief for SEC as Amicus Curiae at 13.

<sup>43</sup> *Id.* at 34.

<sup>44</sup> *Id.* at 26.

<sup>45</sup> 92 S. Ct. at 609 (dissenting opinion).

<sup>46</sup> 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970). The specific holding of the *Feder* case stated that § 16(b) applies to a sale of stock by a former director if the stock was purchased by him during the time he was a director and the sale was made within 6 months after purchase — seemingly regardless of when resignation took place. *Id.* at 269.

<sup>47</sup> 92 S. Ct. at 601.

<sup>48</sup> 15 U.S.C. § 78 p(b) (1970) (last sentence).

<sup>49</sup> SEC Rule 16 a-10, 17 C.F.R. § 240.

<sup>50</sup> Form 4, SEC Release No. 6487 (March 9, 1961).

ministrative exemption of ex-insider transactions is clearly inconsistent with the SEC's position in *Reliance*.

Mr. Justice Douglas was quick to respond that the *Feder* case found that "Rule 16a-10 was invalid, insofar as it operated through Form 4 to exempt transactions by ex-directors from liability under § 16(b)."<sup>51</sup> He reasoned that the *Feder* analysis would be equally applicable to deny this exemption to ex-10 percent owners.<sup>52</sup> What Justice Douglas fails to acknowledge is that *Feder* clearly excluded the analogy to 10 percent holders: "[T]he act expressly sets forth that the liability of a 10% shareholder to surrender his short-swing profits is conditional upon his being such both at the time of purchase and at the time of sale, but there is no such limitation in the case of officers and directors."<sup>53</sup> It is difficult to put much faith in an argument based on a source that expressly denies the reasoning of the argument.

#### VI. FUTURE OF SECTION 16(b)

Doubtless many critics of *Reliance* will rise to side with Justice Douglas in saying that this decision "is a mutilation of the Act."<sup>54</sup> But it must be remembered that this case, as it now stands, does not entirely guarantee that similar treatment will be afforded all future "split-sales" cases. This lack of certainty is a product of the extent to which the legal theories involved in section 16(b) cases tend to center on the particular facts before the court. For example, the district court's *Reliance* opinion, in language quoted by the Supreme Court, characterized Emerson's two sales as "not legally tied to each other."<sup>55</sup> Although neither court advanced any guidelines on what sales "legally tied to each other" might mean or how such a transaction might be proven,<sup>56</sup> the way is clearly open for the Court to find in future cases that the particular sales under consideration had the legal connection not present in *Reliance* and should be treated as a single sale.

The Court might also employ the theory announced in *Petteys v. Butler*<sup>57</sup> to exempt the profits of *all sales in a*

<sup>51</sup> 92 S. Ct. at 608 (dissenting opinion).

<sup>52</sup> *Id.* at 609.

<sup>53</sup> 406 F.2d at 267 (citations omitted).

<sup>54</sup> 92 S. Ct. at 602 (dissenting opinion).

<sup>55</sup> 306 F. Supp. at 591-92. The district court borrowed this phrase from an intra-company memo prepared by Emerson's corporate counsel which explicitly set out the liability avoidance motive for the split-sale.

<sup>56</sup> This vagueness has been roundly attacked. See Note, 5 GA. L. REV. 584 (1970).

<sup>57</sup> 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).

*Reliance*-type series from corporate recovery under section 16(b). In *Petteys*, a 16(b) insider had converted preferred stock into common following a call for redemption of the preferred. Had the preferred stock not been converted, the insider would have suffered a considerable loss on the redemption. The question before the court was whether such a conversion constituted a "purchase" of the common stock for the purposes of section 16(b). While freely admitting that under traditional standards the transaction would be classified as a "purchase," the court refused to impose liability because in the particular circumstances presented, the opportunity for abuse was not present.

In *Reliance*, Emerson was left holding a substantial block of Dodge stock after its attempted takeover failed. It was obviously in a most unfavorable position. It had to sell and risk 16(b) liability or hold the stock and be forced to exchange it for shares in the new Dodge-Reliance corporation. This latter course of action might have also incurred 16(b) liability.<sup>58</sup> The *Petteys* principle might easily have been applied to exempt all sales necessary for Emerson to extricate itself from this predicament. The transaction at issue in *Petteys* was of a *type* capable of abuse—a conversion from preferred to common shares.<sup>59</sup> Similarly, the Securities and Exchange Commission and Mr. Justice Douglas pointed out that the instant transaction was also of the *type* that could, under some circumstances, be utilized for insider speculation. The Court in this case never had to reach the next step in the *Petteys* approach, *i.e.*, an examination to determine whether no abuse was possible *under*

<sup>58</sup> There is an intimation in the opinion to that effect. The majority cited *Newmark v. RKO Gen., Inc.*, 425 F.2d 348 (2d Cir.) *cert. denied*, 400 U.S. 854 (1970), as standing for the proposition that an exchange of stock pursuant to a merger agreement was a "sale" under § 16(b). 92 S. Ct. 596, 598. They did not, however, say that *Newmark* would control the instant case had the need arisen to decide the issue. *Newmark* has been interpreted as allowing an inquiry into whether opportunity for abuse is present. Katz, *Short-Swing Liability*, 2 REV. OF SECURITIES REGULATION 916 (1969); See note 60 *infra*. It would appear that Katz's interpretation of *Newmark* is correct in light of *Abrams v. Occidental Pet. Corp.*, 450 F.2d 157 (2d Cir. 1971), *cert. granted sub nom* Kern County Land Co. v. Occidental Pet. Corp., 92 S. Ct. 1498 (1972). There the court found that *Newmark* did not establish an inflexible rule that forced exchanges of shares would always be looked upon as "sales" for the purposes of establishing § 16(b) liability. Rather the *Abrams* court distinguished *Newmark* on the basis that knowledge of impending defensive mergers and ability to control the same would be highly determinative—factors that were present in *Newmark* and not present in *Abrams*. Had the Court in the present case made a similar search, perhaps these factors would also have been found absent.

Interestingly, based on the Securities and Exchange Commission's own "voluntary-involuntary" dichotomy it seems that if Emerson had held onto their Dodge shares, and been forced (*i.e.* involuntarily) to exchange them for new shares in the Dodge-Reliance Corporation, the transaction would be exempt from § 16(b) liability. Brief for SEC as *Amicus Curiae* n.14.

<sup>59</sup> See, *e.g.*, *Heli-Coil Corp. v. Webster*, 352 F.2d 156 (3d Cir. 1965).

the circumstances of this particular case. One wonders if the Court might not have done just that were it not for the presence of a convenient exception which served to minimize the severity of section 16(b) as it applies to 10 percent beneficial owners. Certainly, the possibility of abuse in *Reliance* was not appreciably greater than in *Petteys*.

Whether the aspect of "possibility of abuse" will be flexed to deal with different fact situations, has yet to be seen. There can be no doubt, however, that the Court will have to face corporate merger situations where it would be unfair to blindly apply 16(b) sanctions to innocent transactions.<sup>60</sup>

#### CONCLUSION

The Wall Street Journal hailed this decision as an indication that the Court was taking a turn to the "Right."<sup>61</sup> But this case is beholden to no pat rules of construction. The transaction at issue seems to comfortably attach itself to the specific exemptive language of the statute. The unanswerable question that remains is whether Congress actually intended to exempt split-sale situations or simply left a loophole in the statute.<sup>62</sup> Precisely because it is not clear from the legislative history which of the above is correct, it appears that this decision reached the preferable result. If Congress meant to exempt this transaction, the instant case did just that. If not, Congress has ample opportunity to plug the loophole recognized in *Reliance*.

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<sup>60</sup> For example:

Where the management of the target company indicates a defensive merger with a third company to thwart a tender offer, the tender offerer typically is neither privy to the defensive merger nor apprised of plans for its consumation. Having failed in a bid to gain control through the tender offer, but having obtained enough stock to become a statutory insider, the offeror is locked into securities if a hostile issuer. It may be obliged to dispose of such securities pursuant to a corporate reorganization over which it has no control and with respect to which it obviously has no inside information. It is fair to say that the imposition of section 16(b) liability in this contest would involve an unjustifiable and probably unintended hardship. Katz, *Short-Swing Liability*, 2 REV. OF SECURITIES REGULATION 916 (1969).

<sup>61</sup> Wall Street Journal, January 12, 1972, at 3, col. 1. The headline was: "Supreme Court Opens Loophole in Trading by Insiders; Economic Turn to Right Seen."

<sup>62</sup> Interestingly enough, as early as 1934 it was pointed out that this type of "split-sale" transaction would appear to avoid liability under § 16(b): "[T]he intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months, and the remaining 5% a month later." Seligman, *Problems Under the Securities Exchange Act*, 21 VA. L. REV. 1, 20 (1934). See also, 2 L. LOSS, SECURITIES REGULATION 1060 (2d. ed. 1961) where a similar course of action was recommended.

As Justice Stewart correctly pointed out,<sup>63</sup> the Supreme Court is not the proper forum for remedial work on the statute.

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<sup>63</sup> 92 S. Ct. at 600.

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