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Corporate Finance -- Trading in Securities by Production Manager not Within Section 16 (b) of Securities Exchange Act of 1934

corporate officer of unexercised stock warrants does not come within the definition of "sale" in Section 3(a) (14) [2] of the Act, and no action lies for recovery of profits under Section 16(b) unless the donee is the alter-ego of the donor. *Truncale v. Blumberg*, 83 F. Supp. 628 (S. D. N. Y. 1949).

Prior to enactment of federal legislation, speculation by insiders was widely condemned.[3] Section 16(b) of the 1934 Act has as its purpose protection against short-swing speculation and profit-taking in corporate securities by insiders on information gained pursuant to their close relationship with the issuer.[4] Under this section, the insider's profit may be recovered by the corporation irrespective of his intent.

In delimiting the definition of the term "sale," the holding in the instant case does not seem consistent with the objective of the statute, i.e., to prevent *profits* by insiders. It has been clearly demonstrated that, in certain instances, it may well be more advantageous for the corporate insider to forego his short term price appreciation gain in favor of an even larger profit in the form of allowable tax deductions pursuant to gifts.[5] Dismissal of such a possibility as "fanciful" [6] and the assertion that ". . . the tax laws would seem to have absolutely nothing to do with the question . . . ," [7] fail to take into consideration the very real problem of continued insider profit-taking through tax deduction rather than price appreciation. The definition of the term "sale" in Section 3(a) (14) of the statute itself includes the words, "or otherwise dispose of." Other courts have given a construction more in accord with the objectives of the governing statute.[8]

It is submitted that the term "sale" should be liberally construed to include *any* short term transaction in securities by the insider which results in financial gain to him. The holding in the principal case leaves a loophole in the Act that may well serve only to defeat the very objective that it set out to accomplish.

CORPORATE FINANCE—TRADING IN SECURITIES BY PRODUCTION MANAGER NOT WITHIN SECTION 16 (b) OF SECURITIES EXCHANGE ACT OF 1934

Plaintiff, a stockholder of Twentieth Century Fox-Film Corporation, brought suit for recovery of profits realized by defendant, production manager,

2. 48 STAT. 884 (1934), 15 U. S. C. § 78c(a) (1946).
3. See Tracy and MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025, 1032 (1934); Comment, 32 MICH. L. REV. 678 (1934).
4. See Smolowe v. Delendo Corp., 136 F.2d 231 (C. C. A.2d 1943); Park & Tilford v. Schulte, 160 F.2d 984 (C. C. A.2d 1947).
5. See *Hearings before Committee on Ways and Means on "Revenue Revision of 1942,"* 77th Cong., 2d Sess. 91 (1942); WORMSER, THE THEORY AND PRACTICE OF ESTATE PLANNING 75 (1946).
6. Truncale v. Blumberg (original case), 80 F. Supp. 387, 389 (S. D. N. Y. 1948).
7. *Id.* at 390.
8. See Moore v. Gorman, 75 F. Supp. 453 (S. D. N. Y. 1948); Schillner v. H. Vaughan Clarke & Co., 134 F.2d 875 (C. C. A.2d 1943).

through sale of securities of the corporation. Plaintiff contended that defendant was an officer within the meaning of Section 16(b) of the Securities Exchange Act of 1934 [1] which provides that profits made by corporate officers from sale of securities within six months after their purchase shall inure to the corporation. *Held,* judgment for defendant since he was not an officer within the meaning of the statute. *Colby v. Klune,* 83 F. Supp. 159 (S. D. N. Y. 1949).

Under the power conferred by Section 3(b)[2] of the Act the Securities and Exchange Commission has defined an "officer" as a president, vice-president, treasurer, secretary, comptroller or any other person performing functions corresponding to those performed by the foregoing officers.[3] Since defendant was admittedly not one of those officers enumerated by the statute, the primary question involved was whether the defendant as production manager performed functions corresponding to those performed by officers of the Fox Corporation. By comparing the duties imposed upon the corporation's officers by the by-laws with those performed by the defendant in his capacity as production manager, the court found that the defendant's duties were separate and distinct from those performed by the specified executive officers. The plaintiff argued that the standard should not be whether the defendant performed the duties of an officer of that particular corporation as contained in the by-laws but rather, whether or not he performed the duties of an officer of *any* corporation. This contention was properly dismissed by the court as untenable, since a standard of that nature would be so far-reaching as virtually to prohibit short term security transactions by those performing any executive functions for a corporation, a result not within the purview of the Securities Exchange Act. Plaintiff further argued that defendant's position as an insider gave him such access to special knowledge of the corporation's affairs as to render him liable for profits resulting from short-swing transactions even though defendant was not an officer specified by the statute. The validity of this argument is not easily determined, for almost every decision involving Section 16(b) has held that the purpose of the section was to protect stockholders from the unfair use of information by insiders.[4] Plaintiff's implication is that through repeated judicial use of the term "insider," a new standard has evolved by which profits made in short-swing transactions by "insiders," i.e., persons with

1. 48 STAT. 896 § 16(b), 15 U. S. C. § 78p(b) (1934).
2. 48 STAT. 882 § 3(b), 15 U. S. C. § 78(b) (1934).
3. Rule X-3B-2, Exchange Act Release 1 (1934).
4. Shaw v. Dreyfuss, 172 F.2d 1440 (C. A.2d 1949), *cert. denied,* 69 Sup. Ct. 1048; Park and Tilford v. Schulte, 160 F.2d 984 (C. C. A.2d 1947); Smolowe v. Delendo Corporation, 136 F.2d 231 (C. C. A.2d 1943); Truncale v. Blumberg, 80 F. Supp. 387 (S. D. N. Y. 1949); Rubin and Feldman, *Statutory Inhibitions upon Unfair Use of Corporate Information by Insiders,* 95 U. OF PA. L. REV. 468 (1946); Tracy and MacChesney, *The Securities Exchange Act of 1934,* 32 MICH. L. REV. 1025 (1934).

access to special information by virtue of their relationship with the issuer of the securities, shall inure to the corporation even though such person is not specified by the statute. The court dismissed this argument by stating that it was the intention of Congress to limit the applicability of the provisions of Section 16(b) to the persons specified in the section.

In the instant case Section 16(b) is construed as setting up an objective standard of liability which requires no showing of actual unfair use of inside information.[5] This is in conformity with previous decisions under the section which have enforced its provisions almost harshly,[6] yet have refused to extend its scope.[7] It might be contended that under this narrow interpretation of the scope of the statute, persons holding positions comparable to, but not corresponding with those of the designated officers of a corporation, would be enabled to make unfair use of inside information. But, it is equally true that a stenographer or file clerk in a key position in the company's employ could also be considered an "insider." Furthermore, an assistant secretary or treasurer might perform important executive functions and yet not have access to inside information. However, it cannot be denied that here the defendant's important position and access to inside information in the corporation, accentuates a great danger to outside stockholders. This danger should be dealt with by legislative action designed to clearly outline the status of all corporate employees and prevent a multiplicity of suits. A suggested legislative remedy for this dilemma would be inclusion of *all* corporate employees within such an act. The court appears to have followed the intent of the section in limiting liability to designated officers, since the strict and objective standards of the Act would create undue hardship upon anyone not manifestly within its scope.

COURTS—INHERENT POWER OF THE FLORIDA SUPREME COURT TO INTEGRATE THE BAR

Petitioner, the Florida State Bar Association, prayed for a rule integrating the Florida Bar. This rule would require every practicing attorney in the State of Florida to belong to the integrated bar, pay a

5. *Accord*, Smolowe v. Delendo Corporation, *supra*.

6. Smolowe v. Delendo Corporation, *supra* (the court ruled that profits should be determined by the lowest-in, highest-out rule, rather than the first-in, first-out method used in tax computations). Similarly the courts have attempted to encourage the bringing of suits by minority stockholders, as in Park and Tilford v. Schulte, *supra;* Twentieth Century Fox-Film Corp. v. Jenkins, 7 F. R. D. 197 (S. D. N. Y. 1947) (these cases held that intervention by minority stockholders was allowable to offset possibility of collusion between an influential defendant and a plaintiff corporation); Smolowe v. Delendo Corporation, *supra* (where attorney's fees far in excess of plaintiff's actual interest were allowed).

7. Shaw v. Dreyfuss, *supra;* Truncale v. Blumberg, *supra* (in these cases the courts declined to call a bona fide gift a "sale" within the meaning of the statute). Section 3(a) of the Act reveals that it was within their discretion to do so, 48 STAT. 882 § 3(a) (14), 15 U. S. C. § 78(a) (14) (1934).