

1979

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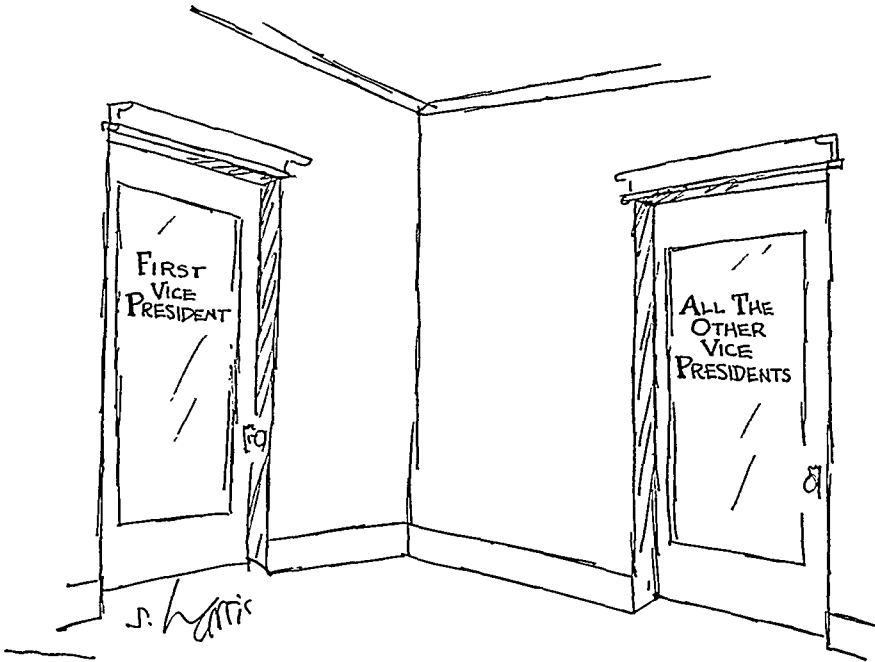
Recommended Citation

David E. Gardels, *Section 16(b) of the Securities and Exchange Act of 1934: Is a Vice President an Officer?*, 58 Neb. L. Rev. 733 (1979)
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Comment

Section 16(b) of the Securities and Exchange Act of 1934: Is a Vice President an Officer?



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The New Yorker Magazine, Inc.

The purpose of this comment is to trace the eight cases involving the definition of an officer under Section 16(b) of the Securities and Exchange Act of 1934 (the Exchange Act),¹ to point out the errors made in the development of the law, and to suggest strong policy reasons why future cases should be decided differently.

1. Ch. 404, tit. I, § 1, 48 Stat. 881 (1934) (codified at 15 U.S.C. § 78p(b) (1976)).

Several early cases, which expanded the scope and power of section 16(b) in the late 1940's and early 1950's were unclear and inconsistent in their analysis.² The tests posited by these cases were blindly applied in 1973 to greatly different factual situations to weaken the strength of section 16(b) and move a giant step away from the objective test Congress intended to establish.³ Most recently, a 1978 case carried the logic of the 1973 cases a step further in the wrong direction. As suggested by the cartoon at the beginning of this comment, the issue involved in the 1973 and 1978 cases is whether all vice presidents are to be considered officers under section 16(b). Therefore, a principal focus will be whether—for section 16(b) purposes—all vice presidents are created equal, or whether some sharp division is to be made between “real” vice presidents and those who by some measure are merely honorary or titular vice presidents.

This comment will not suggest an all-purpose test, or try to find a solution to every section 16(b) officer problem. It will, however, argue for the assertion—by the courts, the Securities and Exchange Commission (SEC), or the Congress—of an objective rule which includes within the scope of section 16(b) liability any person who has the title of president, vice president, secretary, treasurer, or comptroller in a corporation subject to section 16(b). Such a rule would return in a limited way to an objective “crude rule of thumb.”⁴ This rule would also promote public confidence in the corporate securities market—a major goal of Congress in enacting the Securities and Exchange Act.⁵

It must, of course, be recognized that objective application of the statute has been on the decline, in favor of a “subjective” or “pragmatic” test, at least with regard to certain fact situations—the so-called unorthodox transactions.⁶ In such cases a subjective analysis is made to determine whether there is a possibility of abuse of inside information. Because of the subjectivity applied to other elements of section 16(b), it is important that an objective rule be applied to corporate employees designated officers under

2. See § III-A of text *infra*.

3. See § IV-C of text *infra*.

4. This famous description of section 16(b) was presented at congressional hearings on the Exchange Act by a spokesman for the Roosevelt administration. *Stock Exchange Practices: Hearings pursuant to S. Res. 84, S. Res. 56 & S. Res. 97 Before the Senate Comm. on Banking & Currency*, 73d Cong., 1st Sess., pt. 15, 6421, at 6557 (1934) (statement of Thomas C. Corcoran). The original “objectivity” of section 16(b) has been greatly diminished by developments of recent years. See § II of text *infra*.

5. See § IV-C of text *infra*.

6. See § II of text *infra*.

rule 3b-2.⁷ Without an objective rule defining officer, a statute already weakened and far removed from the intended "crude rule of thumb" will be further diminished in importance.

II. SECTION 16(b)—AN OVERVIEW

The Exchange Act is one of the six federal securities statutes enacted between 1932 and 1940.⁸ While there had been, both in this country and elsewhere, a move toward regulation of corporations and their financial dealings, the stock market crash of 1929 boosted the forces of reform around the world, and produced the direct impetus for the six securities statutes enacted in this country.⁹

The prevailing philosophy of both the Securities Act of 1933 and the 1934 Exchange Act was disclosure—the 1933 Act centering on the initial distribution of securities and the 1934 Act concentrating on post-distribution trading.¹⁰ An important tool in the regulation of securities trading under the Exchange Act is section 16, the provision dealing with insider trading.

Section 16 "represents a threefold attack upon possible abuses of inside information by corporate insiders."¹¹ Section 16(a) requires certain insiders to report their stockholdings and transactions in their companies' securities to the SEC. Section 16(c) makes it unlawful for insiders to engage in "short sales" of their companies' equity securities. Section 16(b) creates a cause of action which allows any shareholder or the corporation to bring suit to force an insider to disgorge profits made on a purchase and sale or a sale and purchase within a six months period of their companies' equity securities. Section 16 is thus, in part, an exception to the general disclosure philosophy of the two statutes in expressly providing civil liability in certain narrowly defined circumstances.

Section 16(b) states in part:

For 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 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

7. 17 C.F.R. § 240.3b-2 (1978).

8. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976) [hereinafter cited as 1933 Act]; Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976) [hereinafter cited as Exchange Act]; Public Utility Holding Co. Act of 1935, 15 U.S.C. §§ 79a to 79z-6 (1976); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1976); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1976); Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (1976).

9. 1 L. LOSS, SECURITIES REGULATION 119-20 (2d ed. 1961).

10. *Id.* at 130.

11. 3B H. BLOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW 10-2 (rev. ed. 1978).

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. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter¹²

"Such beneficial owner" refers to section 16(a) which defines the term as "the beneficial owner of more than 10 per centum of any class of any equity security [of the issuer] (other than an exempted security)."¹³

The section was thought to be necessary to prevent the "vicious practices" of "flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities."¹⁴ Before the act was adopted, this kind of profitable activity was "more or less generally accepted by the financial community as part of the emolument for serving as a corporate officer or director notwithstanding the flagrantly inequitable character of such trading."¹⁵ The rule Congress drafted was meant to exclude a great deal of potential abuse of inside information, and to strike with certainty at the areas where Congress considered the greatest potential for abuse of inside information to exist. "[T]he only remedy which [the section's] framers deemed effective for this reform was the imposition of a liability based upon an objective measure of proof."¹⁶

The elements of a section 16(b) cause of action are concisely stated in the following passage:

The section establishes conclusive presumptions both of access to inside information and intention to use that information for speculative gain if there is a showing that (1) the issuer has a class of securities registered pursuant to section 12 of the Act; (2) there has been a purchase and sale or a sale and purchase of the issuer's securities; (3) the related transactions occurred within a period of less than six months; (4) an officer, director, or beneficial owner of more than ten percent of a class of the issuer's registered securities was engaged in the transactions; and (5) there was a profit realized on the transactions. No actual access to inside information, intent to engage in short swing speculation, or abuse of inside information need be shown for the issuer to recover the insider's profits.¹⁷

12. 15 U.S.C. § 78p(b) (1976).

13. *Id.* § 78p(a).

14. COMMITTEE ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. NO. 1455, 73d Cong., 2d Sess. 55 (1934).

15. 10 SEC ANN. REP. 50 (1944).

16. *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

17. Comment, *Insider Trading—Narrowing the Scope of Section 16(b)*: Foremost-

It is not the purpose of this article to deal with the historical developments in areas of section 16(b) not related to the officer question; consideration of a few developments is, however, helpful. The so-called "garden variety" transaction—a cash sale and purchase or purchase and sale on the open market—has not greatly troubled the courts.¹⁸ It is in the area of "unorthodox" transactions—the acquisition or disposition of stock by merger, of convertible securities, of stock rights and options—that the greater part of section 16(b) litigation and discussion has taken place.¹⁹ In analyzing these "unorthodox" transactions, the emphasis of the early courts on an objective approach shifted over the years to a subjective or "pragmatic" analysis, and "has currently evolved into the new pragmatism."²⁰ The essence of this pragmatic view of section 16(b) is that in unorthodox transactions a case-by-case factual analysis must be made to determine whether there exists the possibility for speculative abuse of the kind at which section 16(b) was directed.²¹ The result of the pragmatic approach has been the loss of certainty in the statute's application,²² with great inconsistency in the rules for differing transactions.²³ Various other as-

McKesson, Inc. v Provident Securities Co., 1976 UTAH L. REV. 400, 402-03 (footnotes omitted).

18. However, there have been judicial interpretation and controversy relating to certain basic problems of the section. *E.g.*, 3B H. BLOOMENTHAL, *supra* note 11, *supra*, § 10.05 (measuring the six month period); *id.* § 10.06 (measuring the recoverable profit); *id.* § 10.12 (certain valuation problems). The problem of who is subject to liability has also caused some litigation with regard to directors and more frequently beneficial owners. *Id.* § 10.04. The question of who is an officer is discussed at length in §§ III - IV of text *infra*.
19. See Bateman, *The Pragmatic Interpretation of Section 16(b) and the Need for Clarification*, 45 ST. JOHN'S L. REV. 772 (1971); Hazen, *The New Pragmatism Under Section 16(b) of the Securities Exchange Act*, 54 N.C. L. REV. 1 (1975); Lang & Katz, *Section 16(b) and "Extraordinary" Transactions: Corporate Reorganizations and Stock Options*, 49 NOTRE DAME LAW 705 (1974); Comment, *Securities Law—Non-Cash Exchange Pursuant to a Defensive Merger Held Not a Purchase or a Sale Under § 16(b) of the Securities Exchange Act of 1934—Kern County Land Co. v. Occidental Petroleum Corp.*, 49 N.Y.U. L. REV. 353 (1974); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 MICH. L. REV. 592 (1974).
20. Hazen, *supra* note 19, at 55.
21. *Id.* at 2. A recent judicial application of the pragmatic approach stated that section 16(b) liability will be automatically triggered by ordinary, voluntary purchases and sales. It is only when either the purchase or sale is an unorthodox transaction that an inquiry will be made into whether or not there was in the transaction the possibility of short term speculative abuse. *Oliff v. Exchange Int'l Corp.*, [1978] FED. SEC. L. REP. (CCH) ¶ 96,557 (N.D. Ill. April 10, 1978) (citing *Allis-Chalmers Mfg. Co. v. Gulf & Western Indus., Inc.*, 527 F.2d 335 (7th Cir. 1975), *cert. denied*, 423 U.S. 1078 (1976)).
22. Hazen, *supra* note 19, at 57.
23. Comment, *Exceptions to Liability Under Section 16(b): A Systematic Approach*, 87 YALE L.J. 1430, 1441 (1978).

pects of the development of section 16(b) law will be discussed as they relate to the specific problem of the definition of officer.

III. DEFINING AN OFFICER: THE CASES

A. Early Cases: An Uncertain Beginning

The first of the eight cases which examine the definition of an officer under section 16(b) is *Colby v. Klune*.²⁴ Plaintiff, a stockholder of the company in question, brought suit to recover the profit made by defendant from purchases and sales of corporate stock within six months.²⁵ There was no dispute as to the facts of the stock transactions. Defendant relied on the allegation that he was not a ten percent beneficial owner, director or officer, but was only the "production manager" of the company. The trial court granted the defendant's motion for summary judgment.²⁶

Plaintiff relied on rule 3b-2 which states: "The term 'officer' means a president, vice-president, treasurer, secretary comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers."²⁷ Plaintiff argued that defendant performed "functions corresponding to those performed" by an officer.²⁸ Defendant's affidavits stated that he acted only as production manager and was no more than, as the district court put it, a "superior combination of purchasing agent and personnel manager."²⁹ The district court also thought it significant that these

[T]he transactional approach developed on an ad hoc basis in response to particular transactions that did not seem to afford potential for speculative abuse. Although the common concern has clearly been the potential for speculative abuse of inside information, each transaction has developed its own standards for exclusion, and the rules established for one set of transactions have often proved inappropriate to another. As a result, the law of purchase and sale under section 16(b) has become subject to all the vagaries and inconsistencies of an inchoate common law.

Id.

24. 178 F.2d 872 (2d Cir. 1949).

25. *Colby v. Klune*, 83 F. Supp. 159, 160 (S.D.N.Y. 1949).

26. *Id.* at 162.

27. 17 C.F.R. § 240.3b-2 (1978).

28. 83 F. Supp. at 161.

29. *Colby v. Klune*, 83 F. Supp. 159, 161 (S.D.N.Y. 1949). More specifically, defendant's affidavit stated that

his duties and responsibilities are to arrange for the procurement of all the physical facilities necessary in the production of the motion pictures produced by said corporation and . . . to procure for Twentieth Century Fox-Film Corporation the employees whose services are necessary in the production of its motion pictures and to co-ordinate their work in such production.

Id.

duties were not the duties of the officers of the corporation, as those duties were defined by the corporate by-laws. Plaintiff, however, argued that defendant had such special knowledge of the corporation's affairs that he was an "insider" and should therefore be within the scope of section 16(b). The district court rejected plaintiff's contention, stating that Congress had drawn the line at "officers" and the statute was not meant to apply to all highly placed corporate employees who arguably had access to inside information.³⁰

The Second Circuit Court of Appeals reversed the order for summary judgment for defendant, finding that there was an issue of fact, turning on credibility, which should be determined at a trial.³¹ The court first "assumed for the moment" that rule 3b-2 was not authorized by the statute, and gave its own construction of the term officer under section 16(b):³²

[Officer] includes, *inter alia*, a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions. It is immaterial how his functions are labeled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative.³³

The court thought that plaintiff should be allowed to produce evidence at trial relevant to the court's definition of "officer," and specifically reserved decision on the SEC's statutory power to issue rule 3b-2.³⁴

Later, after expressing its strong disapproval of "trial by affidavit" (arguably in itself a key reason for remanding the case for trial) the court maintained that "[i]t may be that the S. E. C. had such statutory authority to issue the Rule that it binds the courts. Even so, there remains much room for inquiring into the facts at a trial."³⁵ The functions of a "vice president" or a "comptroller," the court stated, were not self-evident and there was a need for evidence concerning these positions' functions. The by-laws' defini-

30. *Id.* at 162.

31. 178 F.2d 872, 873 (2d Cir. 1949).

32. *Id.* This "momentary" assumption became one of the causes of confusion in the line of cases dealing with the officer question, causing later courts to question the rule. See note 102 *infra*. However, it seems clear the rule is within the statutory power of the SEC to make rules and regulations, and no court has held that the rule is invalid. See § IV-A of text *infra*. Indeed the courts "assumption" of invalidity was "relegated to the purest form of dictum by the court's conclusion that the granting of a summary judgment would have been erroneous even if the rule were valid . . ." *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810, 813 (S.D. Cal. 1952).

33. 178 F.2d at 873.

34. *Id.*

35. *Id.* at 875.

tions were also deemed unimportant; instead, the relationship between the employee's authorized activities and the corporation was designated the factor to be examined.³⁶ The court's conclusion was similar to the SEC's position that an examination should be made of whether or not the employee was responsible for the policy of a substantial portion of corporate affairs or participated in "executive councils of the corporation as an officer."³⁷

The first and most important point regarding *Colby* is that the plaintiff sought to bring within the scope of the statute a key corporate figure who arguably performed the function of an officer, although without an officer's title. The policy reasons for using a subjective, fact-oriented approach to determine whether such a person should be covered by section 16(b) are, as discussed elsewhere,³⁸ different than the policy reasons for allowing one with the title of an officer to escape section 16(b) liability. The concern of *Colby* quite obviously was that under the district court's approach, by a deliberate-manipulation of corporate titles and by-laws, a corporation could define its employees out of the statute. The court apparently was of the opinion that the "functions corresponding" language of rule 3b-2 was not broad enough to prevent such a manipulation of corporate titles in contravention of the purpose of section 16(b).

The second important point of *Colby* is that while the court unfortunately clouded the waters regarding the validity of rule 3b-2 by its "momentary assumption" of the rule's invalidity, the inquiry it directed be made under its own definition is not greatly different from the inquiry it and the SEC thought should be made under the rule. Under the court's own definition of officer,³⁹ the inquiry would be directed at whether the employee's duties were of such a character that the employee would be likely to obtain confidential information that would aid him or her in personal market transactions.⁴⁰ Under the SEC position, the inquiry would be whether the employee has significant policy-making powers or participated in the "executive councils of the corporation"⁴¹ and thus by presumption has access to inside information. Under the rule, the court's inquiry would be whether the functions were those of an officer, as determined by an examination of the relation between the employee's duties and the corporation.⁴² While the inquiry of both the SEC and the court under the rule would be keyed to the posi-

36. *Id.*

37. *Id.*

38. See § IV of text *infra*.

39. See text accompanying note 33 *supra*.

40. 178 F.2d at 873.

41. *Id.* at 875.

42. *Id.*

tion of the employee in terms of the corporate power structure, the aim is clearly the same as that of the court's inquiry under its own definition—to determine whether the employee had access to confidential information useful in market transactions.

In summary, the court in *Colby* held that when one *without* the formal title of an officer, but arguably an officer in substance, was alleged to have engaged in short-swing trading, a factual examination should be made of the employee's position within the corporate power structure, whether he or she had policy-making functions, and whether he or she had a position providing access to confidential information. The court, based on sound but not explicitly stated policy grounds, extended the statute beyond those persons with the formal title of an officer to those officers in substance. This holding is not, however, any broader than rule 3b-2. The finding of the court was necessary to avoid making section 16(b) an empty shell enabling all but a very few employees of any corporation to be exempt through a purposeful structuring of corporate titles.

Next to examine the question was *Lockheed Aircraft Corp. v. Rathman*.⁴³ Lockheed, the employer-corporation, brought suit against a former assistant treasurer who had purchased stock under an employee stock option plan. The employee's first defense was that he was not an officer under rule 3b-2. The district court stated that, to succeed, plaintiff would have to prove that defendant was a person who performed corporate functions corresponding to those of one of the officers listed in rule 3b-2.⁴⁴ The court noted that the rule paralleled section 3(a)(7) of the Exchange Act, the statutory definition of director, which states: "The term 'director' means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."⁴⁵ Under the court's reading of this congressional definition, "any person" meant a person performing the function of a director where the corporation (or the organization) formally had no directors. From this the court drew the conclusion that the "any other person" language of rule 3b-2 was meant to cover only those cases in which there was no named treasurer, but there was someone performing the treasurer's function who would be within the scope of section 16(b). Because the plaintiff had at all pertinent times a formal and functioning treasurer, it followed that the assistant treasurer could not be included under the rule and thus was not within the scope of

43. 106 F. Supp. 810 (S.D. Cal. 1952).

44. *Id.* at 812.

45. 15 U.S.C. § 78c(a)(7) (1976).

section 16(b).⁴⁶

The court dismissed the "shadow" *Colby* cast on rule 3b-2 as the "purest form of dictum" since *Colby* concluded that the granting of summary judgment would have been error even if the rule were valid, because of the factual inquiry the rule itself would allow.⁴⁷ The *Rathman* court stated that the SEC had the statutory authority to issue the rule, and had acted properly within the statute in promulgating the rule.⁴⁸

In analyzing this decision it is again important to note that this was a case of plaintiff trying to bring within the statute one without the title of an officer under rule 3b-2. While the court's analysis on either point is not a model of clarity, it is probably correct that an assistant treasurer should not be included within the ambit of section 16(b), at least where no substantial allegations of participation in policy-making or of performing the treasurer's duties were made. More importantly, for the purposes of this article, is the fact that the court held that rule 3b-2 was a valid exercise of SEC power, and that the *Colby* court's assumption of invalidity of the rule was clearly not a holding of invalidity and was mere dictum. The court's ultimate result—finding defendant free of liability—was the proper decision, especially in light of the fact that both the SEC and plaintiff had, prior to the suit, concluded that defendant was not an officer within the scope of section 16.⁴⁹

Only a year later Lockheed again brought suit against one who had participated in its stock option plan, in *Lockheed Aircraft*

46. 106 F. Supp. at 812-13. It should be noted that this statement is not significantly different from the SEC interpretation of the rule 3b-2 definition. See notes 51-52 & accompanying text *infra*.

47. *Id.* at 813.

48. *Id.* An alternative basis of the court's decision for defendant was the Exchange Act, § 23(a)(1), 15 U.S.C. § 78w(a) (1976), which prevents the finding of liability for any act done in good faith reliance on an SEC rule or regulation. Defendant, after his election as vice president and before participation in the stock option plan, inquired of the SEC whether he was an "officer" under section 16(a). The SEC responded that defendant should look to rule 3b-2; defendant concluded that he did not perform the functions normally entrusted to the treasurer, and therefore did not comply with section 16(a). The court held that this good faith reliance on the SEC rule, would, under section 23(a)(1), have prevented recovery against the defendant even if he were an officer under the statute or rule 3b-2 were assumed invalid. 106 F. Supp. at 814. It is interesting that both defendant and plaintiff were aware of section 16(b) and attempted to act in compliance with it. As noted above, defendant inquired of the SEC what its definition of officer was. Plaintiff, in structuring a stock option plan designed to prevent valued employees from being hired away by competitors, carefully excluded the officers listed in rule 3b-2 from its plan. After defendant left its employ, plaintiff brought this suit to recover his profit on exercise of the option. *Id.* at 812, 814.

49. 106 F. Supp. at 814. See note 48 *supra*.

Corp. v. Campbell.⁵⁰ The defendant in this case was, and remained at the time of the trial, both an assistant treasurer and assistant secretary of Lockheed. The court first drew attention to the SEC's 1940 interpretation of "officer"⁵¹ which stated that an assistant treasurer, an assistant secretary and an assistant comptroller are not officers unless their superior is so inactive as to thrust the burden of office upon them.⁵² Considering this definition, the *Colby* subjective interpretation and the *Rathman* test, the court found that under *any* of these views defendant was not an officer under section 16(b).⁵³ The court found, purely as a matter of fact, "put[ting] aside any dogmatism inherent in any attempt to define, for all purposes, terms in a statute or regulation,"⁵⁴ that defendant was merely an "administrator of people"⁵⁵ and had no responsibility for financial or other corporate policy.

It should first be noted that the factual inquiry made of defendant's functions again involved the plaintiff trying to bring one without a rule 3b-2 officer title into section 16(b)'s scope. Using three slightly different "tests" the court found that defendant was not an officer for purposes of section 16(b). In addition, the court squarely held rule 3b-2 to be a valid exercise of the SEC's rulemaking power.⁵⁶

It was twenty years after *Campbell* before the courts next delivered a reported opinion on the problem of defining an officer under

50. 110 F. Supp. 282 (S.D. Cal. 1953). This decision was reached by a different judge of the Southern District Court of California than the one deciding the *Rathman* case, discussed at notes 43-49 & accompanying text *supra*.

51. SEC Securities Exchange Act Release No. 34-2687 (Nov. 16, 1940). Although the purpose of the release was to compare the Investment Advisors Act of 1940 reporting forms with forms under the Exchange Act, and the discussion of officer in the release in fact related to the definition of officer under the Investment Advisors Act forms, the court treated it as an interpretation of rule 3b-2, apparently because the definition of officer on the forms and that of rule 3b-2 were identical. *Id.*

52. It is the opinion of the General Counsel of the Commission that an assistant would be an "officer" if his chief is so inactive that the assistant is really performing his chief's function. However, as assistant, although performing some functions which might be those of his chief, would not be an "officer" so long as these duties were under the supervision of his chief. Temporary absence or brief vacation of an officer during which an assistant performs the officer's duties would not constitute the assistant an "officer." Subject to the foregoing, assistant treasurers, assistant secretaries, and assistant comptrollers, for example, are not to be considered "officers" for purposes of this definition.

Id.

53. 110 F. Supp. at 284-86.

54. *Id.* at 284 (emphasis in original).

55. *Id.* at 286.

56. *Id.*

section 16(b). The base provided by this cluster of early cases was obviously uncertain and inconsistent. Each case purports to take a distinct approach, although the substance of each factual inquiry is not markedly different. Because, of the three, only *Colby* was an appellate decision, it of course has had the strongest impact on later cases. Lacking from all three cases was a discussion of sound policy reasons for departing from the objective application of the statute and rule 3b-2 for a more "factual," case-by-case decision about who is a section 16(b) officer. However, the implication of the cases is that in the absence of a subjective test to examine the real function of an employee without a rule 3b-2 title, the statute would be too easily avoided by a change of formal appellation. None of the three cases contemplated the factual situation to which the language of the decisions would later be applied—that of persons within the literal definition of rule 3b-2 seeking escape from section 16(b) liability. These three cases, especially *Colby*, were resurrected in 1973 to further confuse the definition of officer.

B. 1973 Decisions—Misapplication of the Early Cases

Early in 1973, *Schimmel v. Goldman*⁵⁷ was decided by the Southern District Court of New York. Plaintiff was a shareholder of the corporation, of which defendant was a vice president. The issue in the case was whether the defenses were sufficiently meritorious to justify payment of seventy-two percent of the maximum section 16(b) recovery as a full settlement of the section 16(b) claim.⁵⁸ One of the grounds on which the court approved the settlement as fair and reasonable was that the court found defendant presented a substantial question as to whether he was an officer under section 16(b) and rule 3b-2 in spite of his title of vice president.⁵⁹

The SEC filed a brief as *amicus curiae* in the action and argued that defendant's position was far too weak to justify a substantial discount.⁶⁰ While *Colby* made a factual inquiry under the assumption that rule 3b-2 might not be valid, and the *Rathman* and *Campbell* courts made similar factual inquiries, those were cases, the SEC contended, in which the person in question did *not* have an officer's title under the SEC definition.⁶¹ Under rule 3b-2 itself

57. 57 F.R.D. 481 (S.D.N.Y. 1973). The four 1973 cases discussed in this section are taken in order of the date of decision.

58. *Id.* at 482. The other ground of decision related to computation of the section 16(b) profit in the option context. *Id.* at 484-85.

59. *Id.* at 485-86. The court did not discuss what the duties of the defendant were, mentioning only that he was a vice president.

60. Brief for the SEC, *Amicus Curiae*, at 6.

61. *Id.* at 8-9.

there could be a factual inquiry into the functions performed by a person, but only when the person did not bear an officer's title. Further, *no* court, the SEC stated, had found rule 3b-2 to be invalid.⁶² Arguing for the use of a purely objective application of the rule when one bears the title of an officer, the SEC stated: "If that person wishes to enjoy the prestige of the office, he shares its responsibilities under Section 16."⁶³

The court, however, ignored the crucial distinction between *Colby*, in which the defendant was not formally an officer but arguably performed the policy and executive functions of an officer, and *Schimmel* in which the employee was formally a vice president. Considering both elements of the defense, the court found that it was substantial enough to warrant the settlement. The court blindly assumed that the *Colby* test of the function of the employee in the particular company, and the SEC test of whether the employee performed policy-making functions, applied to this fact pattern as well as to the facts of the three early cases. As discussed more fully later, critical policy differences exist between the two situations which prevent the *Colby* language from being applicable to the *Schimmel* facts.⁶⁴

*Selas Corp. of America v. Voogd*⁶⁵ was the next officer case to be decided. In it the court granted summary judgment for the plaintiff corporation, which had brought the section 16(b) action against its executive vice president for international operations. The court first stated that the validity of rule 3b-2 had "not been clearly established,"⁶⁶ but noted that under it, as a vice president, defendant would clearly be within the scope of section 16(b). Defendant claimed that under *Colby*, *Schimmel*, and *Gold v. Scurlock*,⁶⁷ he was not a section 16(b) vice president. However, the court found that these cases would not assist defendant. Plaintiff's affidavits stated that defendant was the chief operating officer of the most important section of plaintiff's business and was one of the most active members of its executive committee. Defendant's affidavits stated that he was a mere "figurehead" but he did not

62. *Id.* at 8.

63. *Id.* at 7.

64. See § IV of text *infra*. The court also relied on *Gold v. Scurlock*, 324 F. Supp. 1211 (E.D. Va. 1971), *aff'd in part on other grounds and rev'd in part sub nom. Gold v. Sloan*, 486 F.2d 340 (4th Cir. 1973), *pet. for rehearing en banc denied*, 491 F.2d 729, *cert. denied*, 419 U.S. 873 (1974), which similarly applied the *Colby* rule. The Fourth Circuit decided the case on different grounds, rejecting the district court's analysis, and considering only the question of whether the transactions involved were section 16(b) purchases. See notes 70-86 & accompanying text *infra*.

65. 365 F. Supp. 1268 (E.D. Pa. 1973).

66. *Id.* at 1270.

67. See note 64 *supra*.

dispute the detailed facts of plaintiff's affidavits.⁶⁸ Concluding that there was no material issue of fact, the court granted summary judgment for plaintiff. In so doing the court assumed that the law would allow a factual inquiry under these facts had a material issue of fact been shown.⁶⁹

This was a case, as was *Schimmel*, in which one with the title of vice president sought to excuse himself from section 16(b) liability. The court avoided the question of whether the SEC or the *Schimmel* view on the question was correct by stating that either way summary judgment should be granted for plaintiff. Although resulting in judgment for plaintiff, this case shows that the door opened by *Schimmel* would lead many defendants, even when under *any* analysis within the scope of section 16(b), to litigate in the hope that settlement might be the result. Instead of a simple and objective application of section 16(b) to vice presidents, another avenue of delay, and thus a weapon to discourage suit by shareholders and corporations, was opened. The "crude rule of thumb" of section 16(b) thus suffered another splinter.

Further confusion was added by the Fourth Circuit in *Gold v. Sloan*.⁷⁰ While the district court decided the case on the basis of a *Colby*-like subjective test of whether defendants were "officers" (all three were vice presidents),⁷¹ the circuit court decided the case *only* on the basis of whether the purchase transaction (a merger) was a section 16(b) purchase.⁷² Unhappily, the district court's opinion was relied on by other courts before the circuit court decided the case,⁷³ and the basis of the circuit court's opinion was later misunderstood by a commentator as well as a court.⁷⁴

68. 365 F. Supp. at 1271.

69. *Id.*

70. 486 F.2d 340 (4th Cir. 1973), *pet. for rehearing en banc denied*, 491 F.2d 729, *cert. denied*, 419 U.S. 873 (1974).

71. *Gold v. Scurlock*, 324 F. Supp. 1211 (E.D. Va. 1971), *aff'd in part on other grounds and rev'd in part sub nom. Gold v. Sloan*, 486 F.2d 340, *pet. for rehearing en banc denied*, 491 F.2d 729 (4th Cir. 1973), *cert. denied*, 419 U.S. 873 (1974).

72. 486 F.2d at 342.

73. Both *Schimmel v. Goldman*, 57 F.R.D. 481 (S.D.N.Y. 1973), *see notes 57-64 & accompanying text supra*, and *Selas Corp. of America v. Voogd*, 365 F. Supp. 1286 (E.D. Pa. 1973), *see notes 65-68 & accompanying text supra*, relied in part on the district court opinion in *Gold*. The district court's analysis was rejected by the Fourth Circuit, which considered the case after *Schimmel* and *Selas* were decided.

74. Comment, *Who is an "Officer" under Section 16(b)—Who Knows?*, 12 SAN DIEGO L. REV. 378, 397 (1975), and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1122 (9th Cir. 1978), each erroneously read the Fourth Circuit's decision in *Gold* as being based on the question of whether defendants were officers. The circuit court actually decided only one is-

This misplaced reliance on each of the *Gold* opinions is an unfortunate complicating factor in the law of section 16(b).

The district court in *Gold* discussed three defendants who were vice presidents, Glenn L. Sloane, Daniel McBride and Keith E. Rumbel.⁷⁵ Each defendant was a vice president of Atlantic Research Company (ARC). Upon merger with Susquehanna Corporation (SC), Sloane and McBride became vice presidents of SC,⁷⁶ but Rumbel was only a vice president of the Atlantic Research Group, a division of SC.⁷⁷ The district court first held that the transaction in which each defendant obtained his SC stock—the merger of ARC into SC—was a section 16(b) purchase.⁷⁸

Without citing authority, the district court made a factual inquiry into the nature of each defendant's duties. The court found that McBride and Sloane were officers in both name and fact and held them liable.⁷⁹ With regard to Rumbel, however, the court found that his duties in both ARC and SC were "mere staff functions—routine administrative chores."⁸⁰ It stated: "[B]eing a corporate officer without portfolio does not per se make him an 'insider' as contemplated in Section 16(b)" and held him not

sue—whether each defendant's acquisition of stock by merger was a section 16(b) purchase. 486 F.2d at 342.

75. Two other defendants, Arthur W. Sloan and Arch C. Scurlock, were both directors and 10% owners of ARC and were 10% owners of SC. 324 F. Supp. at 1214. They will not be discussed further in this comment.

76. *Id.* at 1215.

77. 486 F.2d at 358.

78. 324 F. Supp. at 1215. The circuit court disagreed on this crucial point, holding that a separate inquiry must be made regarding each defendant to determine whether his purchase was a section 16(b) purchase. The circuit court's approach was prompted by *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), handed down after the *Gold* district court decision. *Kern* involved the disposition of stock by a "corporate raider" which had lost a takeover attempt when the target corporation completed a "defensive merger." On the question of whether the disposition of stock by the corporation which had lost the takeover battle was a section 16(b) sale (the disposition was an exchange of target stock for the stock of the corporation into which the target was merged), the court applied a pragmatic test:

The statutory definitions of "purchase" and "sale" are broad and, at least arguably, reach many transactions not ordinarily deemed a sale or purchase. In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information

Id. at 593-95 (footnotes omitted). The court held that the stock disposition was not a section 16(b) sale because of the absence of possibility of speculative abuse of insider information and the involuntary nature of the defendant's exchange. *Id.* at 600. See also Comment, *supra* note 19.

79. 324 F. Supp. at 1215.

80. *Id.*

liable.⁸¹ It was this last statement that was relied on by *Schimmel* and *Selas* before the Fourth Circuit rejected the *Gold* district court's decision.⁸²

Two years later when the Fourth Circuit decided the case, it made clear that only one issue was being decided: "The only issue in the cases is whether the exchange by the defendants of their ARC stock for [SC] stock pursuant to the merger constituted a 'purchase'. . . ."⁸³ The court adopted the *Kern* test regarding the merger transaction, examining whether "*the specific transaction itself, which constitutes the unorthodox transaction, presents the possibility of, or potential for, exploitation of insider information.*"⁸⁴

Applying this test to whether the exchange of stock in the merger by Rumbel and Sloane—McBride did not appeal—was a section 16(b) purchase, the court held that there was no section 16(b) purchase on the part of either defendant.⁸⁵ In so doing the court vacated the district court's finding of liability as to Sloane and affirmed the finding of non-liability as to Rumbel, noting that the district court's finding on Rumbel was based on the ground that he was not a section 16(b) officer, "the correctness of which we find no need to examine."⁸⁶

Since the district court's opinion in *Gold* was rejected by the Fourth Circuit, it is of no precedential value to the officer question. However, consideration of both cases is necessary to an analysis of the officer definition under section 16(b) because of the frequent misunderstanding of both the district and circuit court opinions.

The last of the 1973 cases, also involving a proposed settlement, was *Morales v. Holiday Inns, Inc.*⁸⁷ Plaintiff, a shareholder of Holiday Inns, brought to the company's attention alleged violations on

81. *Id.*

82. See note 73 *supra*.

83. 486 F.2d at 342.

84. *Id.* at 343 (footnote omitted, emphasis in original). The propriety of the application of *Kern* where the merger transaction was the section 16(b) purchase (*Kern* itself discussed an "unorthodox" cash tender-offer transaction which was the section 16(b) sale) was disputed by the dissenting opinion. *Id.* at 353-54 (Winter, C.J., dissenting).

85. *Id.* at 351.

86. *Id.* Regarding Rumbel, the dissent, which disagreed with the court's application of the *Kern* rule, see note 84 *supra*, would have found non-liability on the basis that Rumbel was only a vice president of a division of SC at the time of the sale, not of the issuer itself. The dissent relied on a literal reading of rule 3b-2 which speaks of officers of "the issuer." *Id.* at 358 (Winter, C.J., dissenting).

87. [1973] FED. SEC. L. REP. (CCH) ¶ 94, 219 (S.D.N.Y. Nov. 14, 1973).

the part of a corporate vice president.⁸⁸ The company, after considering plaintiff's contention, announced that it would settle the claim for seventy percent of the section 16(b) liability, because "although [defendant] is listed in corporate records and SEC filings as a Vice-President, he is not an officer, within the meaning of section 16(b)."⁸⁹ Plaintiff shareholder thereupon filed the action. In deciding a motion for summary judgment, the district court stated that the issue before it was whether defendant's argument that he was not a section 16(b) officer was substantial enough to justify the settlement proposed by the company.⁹⁰

The court stated that *Colby* put, for the Second Circuit, a "gloss" on the meaning of officer, requiring application of a test which inquires whether the defendant is an employee performing such important executive duties that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that could aid personal market transactions.⁹¹ Applying this test, the court found that as a vice president and "Director of Inn Operations" defendant probably had access to important corporate information which would aid him in personal market transactions. The court held that the settlement was not one of which it would approve, and in the shareholder's action, ordered summary judgment for plaintiff and payment by defendant of 100 percent of the section 16(b) liability.⁹²

The case summarizes the state of the law as of 1973. The *Colby* test was erroneously applied to a fact situation far different from that before the *Colby* court. The application of the *Colby* test to a defendant with the title of a rule 3b-2 officer discards the certainty of an objective rule, and thereby encourages frivolous litigation—like *Morales*—when the drafters envisioned a quick and automatic imposition of liability. In other words, the unclear state of the law on this point allows defendants to use the threat of litigation on the question as a lever to force settlement for a percentage of the claim. If a defendant loses completely he or she merely loses the profit on the transaction; if settlement is obtained, defendant "gets away" with part of the profit.

C. 1978—A Further Retreat from Objectivity

Based on the uncertain and misleading cases of 1973, the most recent officer case carried the law yet another step further away

88. Another officer involved paid his section 16(b) liability in full and was not involved in the district court's opinion. *Id.*

89. *Id.* at p. 94,901.

90. *Id.* at p. 94,902.

91. *Id.*

92. *Id.*

from the ideal "rule of thumb." *Merrill Lynch, Pierce, Fenner & Smith, Inc., v. Livingston*,⁹³ decided by the Ninth Circuit Court of Appeals, stated that the title "vice president" does no more than raise an *inference* of "opportunities for confidential information" and thus of section 16(b) liability.⁹⁴

The court, in a terse opinion, reached this conclusion in two short and simplistic steps, completely ignoring rule 3b-2. Relying on *Colby*, the court stated that "[t]o achieve the beneficial purposes of the statute, the court must look behind the title of the purchaser or seller to ascertain that person's real duties."⁹⁵ While recognizing that *Colby* involved a person without the title of an officer who under a factual analysis clearly was in substance an officer of the corporation, the court did not take note of the factual and policy differences between that fact pattern and the case before it. In this case, of course, a person with the formal title was allowed to escape section 16(b) liability using a *Colby*-type analysis. Perhaps more alarming than the application of the *Colby* test to the facts of this case is the broad language of the court's above quoted statement, which would seem to mandate the application of the test to *every* defendant, no matter what his or her title and place on the organizational chart.

The second step of the court's analysis relied on *Gold*. The court stated that "[j]ob labels were no more significant to the Fourth Circuit in *Gold*"⁹⁶ than to the Second Circuit in *Colby*. In noting the *Gold* court's statement that defendant's job label was merely "titular," and that he was ignorant of the merger there involved, the court failed totally to recognize the issue before the *Gold* court. The issue before the court was not whether the defendant was a section 16(b) *officer*, but rather was, as clearly stated by the Fourth Circuit,⁹⁷ whether the unorthodox purchase in the form of a merger was a section 16(b) *purchase*.

Upon these two steps the Ninth Circuit reached its conclusion that the title of vice president raised only an inference of insider status, and that the inference could be overcome "by proof that the title was merely honorary and did not carry with it any of the executive responsibilities that might otherwise be assumed."⁹⁸ Applying this new test to the facts, the court found that the defendant was not a section 16(b) officer and thus was not liable to return his

93. 566 F.2d 1119 (9th Cir. 1978).

94. *Id.* at 1122.

95. *Id.*

96. *Id.*

97. *Gold v. Sloan*, 486 F.2d 340, 342 (4th Cir. 1973), *cert. denied*, 419 U.S. 873 (1974).
See notes 70-86 & accompanying text *supra*.

98. 566 F.2d at 1122.

profit to the corporation.⁹⁹

Of all the vice president cases, the facts of *Merrill Lynch* are those most strongly in favor of the subjective rule. According to the court the company had some 350 "executive vice presidents" who performed executive and managerial functions, and who presumably would be within the scope of section 16(b) under the court's analysis. The defendant, however, was one of some forty-eight persons who were account executives but who had been awarded the title of vice president as part of an "Account Executive Recognition Program"¹⁰⁰ without a change of their account executive duties. The title in this case was plainly honorary. Nonetheless, the holding of a formal title should bring to bear policy considerations which require section 16(b) liability to be imposed.¹⁰¹ Rather than erode the rule to accommodate a corporation with 400 vice presidents, the titles should be changed to accommodate the law—if the corporation wishes the employees to avoid coverage by section 16(b).

IV. A VICE PRESIDENT IS AN OFFICER—POLICY FOR A FRESH START

As the foregoing review of the officer cases reveals, the subjective analysis made by *Colby* and the other early cases to bring within the scope of section 16(b) one in substance an officer though without the title, was applied in 1973 and 1978 to persons bearing an officer's title but arguably without the substantive duties of office. This section will demonstrate that a subjective test should never be applied on the question of whether one is an officer when that person bears the title of vice president, president, secretary, treasurer or comptroller under rule 3b-2. First, the lack of clarity in the subjective analysis of whether one is an officer encourages short-swing speculation and fosters litigation or an attempted settlement by persons clearly within the intent of the statute. Second, strong policy reasons which underlie the statute—especially the need to promote public confidence in corporate securities—require that those persons with a corporate title not engage in short-swing speculation. In short, if section 16(b) is to

99. One member of the three judge panel dissented. Under his analysis, the title of vice president created a presumption of executive duties and access to confidential information. While the presumption could be overcome, the dissenter would have left that decision to the trier of fact, especially when, as here, a full-fledged trial was held and the outcome depended upon inferences to be drawn from documentary evidence and oral testimony. The dissenting opinion would have affirmed the district court's finding of section 16(b) liability. *Id.* at 1123-24 (Kilkenny, J., dissenting).

100. 566 F.2d at 1121.

101. See § IV of text *infra*.

have meaningful application to vice presidents in the future, objectivity must be regained.

A. Rule 3b-2 is Valid

Rule 3b-2 is a valid exercise of the SEC's rulemaking power under the Exchange Act. Its validity would probably not have been called into question but for the "momentary assumption" of invalidity made by *Colby*.¹⁰² Under any reading of *Colby* it is clear that the court did *not* hold the rule to be invalid.¹⁰³

*Rathman*¹⁰⁴ recognized the statement on the validity of rule 3b-2 in *Colby* as the "purest form of dictum,"¹⁰⁵ while *Campbell*¹⁰⁶ squarely held the rule to be a valid exercise of SEC power.¹⁰⁷ As the SEC stated in its *Schimmel* brief in 1973, "no case has found Rule 3b-2 to be invalid," and "this rule is a valid implementation of the Commission's power to define technical, trade and accounting terms in the Exchange Act."¹⁰⁸

Thus the rule, until held invalid, may be taken as a lawful exercise of SEC power. Indeed, *Colby* advanced no developed argument to support its temporary assumption of invalidity, nor have the courts which recognized the "gloss" *Colby* was thought to have placed upon the rule. On the other hand, it seems that Congress implicitly intended to leave to the SEC the power to determine the definition of officer. That this was a conscious decision is supported by the fact that Congress did take care to define other

102. See text accompanying note 33 *supra*. It is very important to remember that the *Colby* court implied that its reason for questioning the rule's validity was concern that it unduly restricted the scope of section 16(b). The court stated a test of its own which made a factual inquiry beyond the scope of what the court thought rule 3b-2 allowed, to include within the statute one not literally a rule 3b-2 officer.

103. However, some cautious district courts have taken *Colby* almost as if it had held the rule invalid. See, e.g., *Selas Corp. of America v. Voogd*, 365 F. Supp. 1268, 1270 (E.D. Pa. 1973) (validity of rule "not clearly established"); *Schimmel v. Goldman*, 57 F.R.D. 481, 486 (S.D.N.Y. 1973) (defendant-vice president free to contest insider status "despite . . . Rule 3b-2"); *Morales v. Holiday Inns, Inc.*, [1973] FED. SEC. L. RPT. (CCH) ¶ 94,219 (S.D.N.Y. Nov. 14, 1973) (statute as interpreted by rule "clear"; but *Colby* put "gloss" on meaning of "officer" requiring factual inquiry).

104. *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810 (S.D. Cal. 1952). See notes 43-49 & accompanying text *supra*.

105. *Id.* at 813.

106. *Lockheed Aircraft Corp. v. Campbell*, 110 F. Supp. 282 (S.D. Cal. 1953).

107. *Id.* at 286.

108. Brief for the SEC, *Amicus Curiae*, at 7, *Schimmel v. Goldman*, 57 F.R.D. 481 (S.D.N.Y. 1973). Exchange Act, § 3(b), 15 U.S.C. § 78c(b) (1976), states in part: "The Commission . . . shall have power by rules and regulations to define technical, trade, accounting, and other terms in this title, consistently with the provisions and purposes of this title."

terms, for example "director," in the Exchange Act.¹⁰⁹ Further, Congress left the definition of officer to the SEC under other securities statutes,¹¹⁰ supporting the inference that the omission of the definition from the statute was consciously intended by the drafters and Congress. Evidence that the SEC took care to follow the purpose and spirit of the statute is given by the structure and language of the rule which closely follows the statutory definition of director.¹¹¹ It therefore is reasonable to assert that the rule is within the power of the SEC under the Exchange Act,¹¹² that it follows the intent of Congress, and is therefore a legally binding rule.

B. Policy for Including All Rule 3b-2 Officers Within the Scope of Section 16(b)

It bears restating that *Colby* and the other two early cases, *Rathman* and *Campbell*, each involved expansively reading the statute and rule 3b-2 to bring persons not designated officers within the scope of section 16(b) (under the rule's definition). The concern of the *Colby* court apparently was that the rule would be read literally, and that by a mere shifting of titles people with very real policy-making and executive power would avoid liability.

The point of concern—largely overlooked by the recent officer cases—is that there are very different policy reasons for using a subjective test to *excuse* from liability one with the title of vice president than in seeking to *include* a "non-titled" person within the scope of the statute. The *Colby* approach of a subjective, factual analysis *does* have a place in bringing within the statute persons who engage in transactions in corporate stock who have the kind of corporate position Congress meant to include within sec-

109. Exchange Act, § 3(a)(7), 15 U.S.C. § 78c(a)(7) (1976) states: "The term 'director' means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."

110. See, e.g., Public Utility Holding Companies Act of 1935, 15 U.S.C. § 79 (1976); Investment Company Act of 1940, 15 U.S.C. § 80a (1976). As with the Exchange Act, each of the statutes does define the term "director." Public Utility Holding Companies Act of 1935, § 2(a)(15), 15 U.S.C. § 79b(a)(15) (1976); Investment Advisers Act of 1940, § 2(a)(12), 15 U.S.C. § 80a-2(a)(12) (1976).

111. "The term 'officer' means a president, vice-president, treasurer, secretary, comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers." Rule 3b-2, 17 C.F.R. § 240.3b-2 (1978). Note how closely the rule tracks the language of the statutory definition of "director." See note 109 *supra*.

112. 15 U.S.C. 78c(b) (1976).

tion 16(b).¹¹³ However, that subjective approach need *not* be applied "both ways." While such a test may properly be applied to further the goal of the statute, it should not be used to derogate the "bright-line" objectivity that Congress intended be applied to those the SEC would define as officers.¹¹⁴ Two major policies which are central to the theme of section 16(b) militate against the application of a subjective test to those who are formally officers.

1. *The Need for Objectivity*

Section 16(b) was meant as a "crude rule of thumb."¹¹⁵ It was designed to work in a mechanical, objective way; rule 3b-2 was promulgated shortly after the statute was adopted to assist that goal. As one of the most frequently cited early cases on section 16(b) stated: "It is apparent too, from the language of section 16(b) itself, as well as from the Congressional hearings, that the only remedy which its framers deemed effective for this reform was the imposition of a liability based upon an objective measure of proof."¹¹⁶ It is also clear from the statute that Congress, while hoping to prohibit the practices it considered "vicious," wanted a rule narrow in scope. That the statute was limited to ten percent or greater beneficial stockholders, directors and officers, to purchases and sales, or sales and purchases within six months, and that only the profit made and no penalty as such was to be paid over, show the narrow scope of the statute. As interpreted by rule 3b-2, the statute was not broadened, and indeed the worry of *Colby* seemed to be that the rule too strictly construed the statute.¹¹⁷ The fact that Congress chose a narrow statute provides no support for the

113. It may be argued, however, that Congress, in seeking an objective, narrowly defined statute, did not intend to have section 16(b) expanded in this way.

114. Mr. Justice Douglas recognized in his dissent to *Kern* that while a subjective or "pragmatic" approach properly could be utilized to include within the statute transactions which evidence the "evil" Congress sought to prohibit, it is not proper to apply such a pragmatic test to destroy the "bright line" Congress drew.

It is one thing to interpret the terms "purchase" and "sale" liberally in order to include those transactions which evidence the evil Congress sought to eliminate; it is quite another to abandon the bright-line test of § 16(b) for those transactions which clearly fall within its literal bounds. Section 16(b), because of the six month limitation, allows some to escape who have abused their inside information. It should not be surprising, given the objective nature of the rule, if some are caught unwillingly.

Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 613 (1973) (Douglas, J., dissenting).

115. See note 4 *supra*.

116. *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

117. See notes 38-42 & accompanying text *supra*.

further subjective narrowing the 1973 and 1978 cases describe, and indeed weighs against any further restriction of the statute.¹¹⁸

The move away from objectivity is "inevitably a weakening process."¹¹⁹ The validity of this statement is shown by the attempt of vice presidents who were clearly within the scope of the statute to escape liability (or at least "settle" the claim by keeping some of their profit) as in *Selas*¹²⁰ and *Morales*.¹²¹ The result of the recent officer cases using a subjective test with regard to vice presidents—in language broad enough to apply to any rule 3b-2 officer—has indeed been such a "weakening process" as objectivity has diminished. Indeed, the cases have resulted in the encouragement of litigation where none should be possible under the spirit of the statute. A statement by Justice Douglas expressing concern over undue subjectivity in the statute well applies here:

Instead of a section that is easy to administer and by its clear-cut terms discourages litigation, we have instead a section that fosters litigation because the Court's decision holds out the hope for the insider that he may avoid section 16(b) liability. [This subjective approach] destroys much of the section's prophylactic effect.¹²²

2. *The Promotion of Public Confidence in the Capital Markets and Corporate Management*

The second major policy consideration which militates against the subjective approach with regard to rule 3b-2 officers is that the section was intended to restore public confidence in the securities markets. This purpose is damaged when persons publicly designated vice presidents are allowed to make short-swing profits in the securities of their companies. First the nature of this policy will be described. Second the way insider trading by vice presidents may harm this policy will be discussed.

A major purpose of the Exchange Act was to restore public con-

118. Large areas of "insider" conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers, as they must do in the law of marriage, divorce, legitimacy, real estate, wills and a host of other subjects governed by statute. But the consciously limited statute is no reason for us to seek yet further limitations of what is remedial legislation.

Adler v. Klawans, 267 F.2d 840, 845 (2d Cir. 1959).

119. "[T]he recognized purpose and aim of the statute are more consistently and protectively to be served if the statute is construed literally and objectively rather than non-literally and subjectively on a case-by-case application. The latter is inevitably a weakening process." *Petteys v. Butler*, 357 F.2d 528, 538 (8th Cir. 1966) (Blackmun, J., dissenting).

120. See notes 65-68 & accompanying text *supra*.

121. See notes 87-92 & accompanying text *supra*.

122. *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 612 (Douglas, J., dissenting).

fidence in the nation's securities markets.¹²³ The insider trading provision was especially directed at this concern. Several years after the statute took effect, an American Bar Association committee which recommended the retention of section 16(b) gave its opinion that "[a] persistent cause of lack of public confidence in the exchanges has been the public impression that they can be traded in profitably only by persons specially informed."¹²⁴ Such a lack of public confidence—especially on the part of small investors—is still a matter of concern. A recent commentator noted a "dismal lack of public participation"¹²⁵ in the stock market of the present day. One reason given for this lack of participation was that the individual investor had simply become convinced that he did not trade in the market on equal terms with large investors and those with non-public information.¹²⁶ Such insider trading also has the potential for eroding shareholder confidence in corporate management.¹²⁷

The theme of the importance of public confidence to public participation in securities trading—a major goal of the Exchange Act and its section 16(b)—has also been sounded in response to the defense of the social and economic benefits of uninhibited insider trading.¹²⁸ Professor Loss' rebuttal to the position that insider

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123. "This legislation is absolutely necessary for the best interests of the Nation, because not until we pass the measure will confidence [in the stock exchanges] be restored." 78 CONG. REC. 7689 (1934). "If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance." H. REP. NO. 1383, 73d Cong., 2d Sess. 5 (1934). The specific purpose of section 16 was to encourage "[a] renewal of investors' confidence" in the markets and management. *Id.* at 13.
 124. *Report of the Special Committee on Securities Laws and Regulations*, 66 A.B.A. REP. 340, 357 (1941).
 125. McElroy, *Pragmatic Disgorging of Insider Profits: A Review of Cases Reported Under Section 16(b)*, 7 ST. MARY'S L.J. 473 (1975).
 126. *Id.* The author supported the quoted statement by drawing on testimony of Paul Kolton (then President of the American Stock Exchange) in *Schumate & Co. v. American Stock Exchange*, No. 3-4708-D (N.D. Tex., filed April 22, 1971). Commenting on the need for a reversal of this trend, and proposing a new emphasis on section 16(b) as an instrument to foster such change, the author stated: "Any instrument to help bring the public back into the market must therefore be seen to have a renewed importance when securities exchanges no longer function in their quest to raise equity capital for corporate expansion." McElroy, *supra* note 125, at 473.
 127. The dissent in *Merrill Lynch* recognized this "public image" purpose of section 16(b). "Because the taint of short swing trading by a vice president causes subjective damage . . . in the integrity of management, the penalties of Section 16(b) should here be applied." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1123 (1978).
 128. See H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966). The basic tenets of this defense of insider trading are (1) that free insider trading is necessary as compensation to bring entrepreneurial talent into the business world, (2) that no one is hurt when insider speculation takes place, and (3)

trading causes no economic harm and is necessary to reward entrepreneurial talent, was that such insider profit-taking causes harm by the public appearance of unfair use of insider information. "[I]t is just as important for the markets as for the courts not merely to do equity, but to *appear* to do equity."¹²⁹ Also noting the importance of the appearance of fairness in the markets, another commentator discussed a persistent concern of foreign visitors seeking ways to bring about wider public participation in capital formation in their nations—that potential investors perceived that only insiders do well, thereby keeping many potential investors away from the market.¹³⁰

Trading by insiders—including vice presidents—is required to be reported by section 16(a) of the Exchange Act. It is through this mechanism that the corporations or shareholders who bring suit normally discover the short-swing trading.¹³¹ This information does not remain hidden in SEC files, but is frequently reported in the popular media contemporaneously with the trading.¹³² The anomaly of public reporting by vice presidents and their contesting of section 16(b) liability exists because there have not been corresponding developments of the law on section 16(b) and because different policies support each section.

First, one reason persons will file as vice presidents under section 16(a) but will litigate a section 16(b) claim on the basis that they are not vice presidents is that some case law under section 16(a) holds that a failure to file will keep open the normal two-year statute of limitations of section 16(b) until the plaintiff has knowledge that the profit was realized.¹³³ Thus it may be assumed that while willing to run the risk of losing a contest of section 16(b) liability, these insiders are unwilling to skip reporting under sec-

that in an economic sense such trading is good for the corporations involved. 5 L. LOSS, *supra* note 9, at 2999.

129. *Id.*

130. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1441 (1967).

131. See, e.g. Schimmel v. Goldman, 57 F.R.D. 481, 485 (S.D.N.Y. 1973) (defendant filed forms under section 16(a) listing himself as a vice-president). Because detailed information on the number of securities purchased and sold and the dates of purchase and sale are needed to bring a section 16(b) action, it is reasonable to assume that few section 16(b) actions are brought where a section 16(a) filing has not been made because of a lack of information as to the existence of the trading as well as details of the transactions.

132. E.g., a regular column in the "Pocketbook" section of the Lincoln (Neb.) Sunday Journal & Star, by Gene Kelly, which frequently features "Insider Transactions," summarizing insider trading as reported to the SEC by selected corporations. See Lincoln (Neb.) Sunday Journal & Star, Feb. 4, 1979, at 5C, col. 2.

133. See, e.g., Blau v. Albert, 157 F. Supp. 816 (S.D.N.Y. 1957); Grossman v. Young, 72 F. Supp. 375 (S.D.N.Y. 1947).

tion 16(a) and thereby risk keeping 16(b) liability open indefinitely. Additionally, of course, a willful failure to file under section 16(a) would subject a person to criminal penalties under Section 32(a) of the Exchange Act¹³⁴ if found to be within the scope of section 16(a)—a considerably different risk than disgorging any profit made on short-swing trading.

Further, there is a policy difference between the two sections that could lead courts—even those willing to excuse a vice president from section 16(b) civil liability—to find that filing under section 16(a) is necessary. One commentator concluded from an analysis of the legislative history of the Exchange Act that section 16(a) was meant to serve the broader purpose of encouraging insiders to voluntarily maintain proper fiduciary standards by publicizing all changes of ownership in their companies' securities.¹³⁵ Section 16(b) on the other hand was meant to be subordinate and serve the more limited purpose of forcing return of profit only on short-swing trading. Thus the courts which are willing to use a subjective analysis of whether or not a vice president is an officer under section 16(b) might not reach the same conclusion under section 16(a).

It is reasonable to assume that the fact that vice presidents are engaging in short-swing trading will continue to be made public through section 16(a).¹³⁶ This furthers public cynicism regarding the safety and wisdom of investing in publicly held corporations. This damage to public confidence in corporate securities is a strong policy reason that section 16(b) should be applied objectively to any person who bears the title of vice president.

The courts which have used a subjective rule to allow vice presidents to attempt escape from section 16(b) short swing trading have reasoned that if no insider information was actually used, the statute should not rigidly apply, and that the result of application of the statute is too harsh in such circumstances. First, this line of reasoning ignores the fact that the statute was meant to do far more than just punish those who engaged in insider trading based on a moral judgment that it was wrong. It was meant to help restore public confidence in the stock market as part of the goal of renewing economic health and ensuring that economic vigor con-

134. "Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder . . . shall upon conviction be fined not more than \$10,000, or imprisoned not more than 5 years, or both . . ." 15 U.S.C. § 78ff(a) (1976).

135. Comment, *supra* note 23, at 1432 n.12.

136. The assumption is supported by the § 16(a) filing which took place in one of the cases reported in this comment. See note 131 *supra*. It should be noted that rule 3b-2, interpreting the statute, also applies to § 16(a)'s use of the term "officer."

tinued. While vice presidents who have no inside information and engage in short-swing trading may not violate their fiduciary duty to the particular corporation, they do violate the policy of the statute that the *appearance* of propriety is important to the nation's economic health.

Second, the application of section 16(b) is not a harsh penalty. One is only required to return the profit made on short-swing transactions,¹³⁷ and is subject to no penalty as such. Further, the onus of avoiding liability is not great. If an officer wishes to trade, he or she may do so with freedom so long as the purchase and sale transactions are separated by six months and one day. Of course, the officer could also choose to invest his or her money elsewhere.

Nor is the argument persuasive that a vice president "without portfolio" should not be covered by the statute. The position of the SEC has been that if one "wishes to enjoy the prestige of the office, he shares its responsibilities under Section 16."¹³⁸ Further, as in accepting a position as a private trustee, when one becomes an officer under the pre-existing rules of section 16, "he accepts whatever are the limitations, obligations and conditions attached to the position"¹³⁹ Indeed, the very purpose of giving one the title of vice president—if not the responsibility—is for the prestige that title carries with it to the employee's friends and the public at large. "Honorary" vice presidencies were handed out, according to the court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*,¹⁴⁰ explicitly as rewards for good performance as account executives.¹⁴¹ Certainly part of the honor is the impression conveyed to the public that the person is a key employee of the corporation. When one accepts the title and prestige, the responsibility of that office to the public should be firmly enforced. To avoid further diminishing public confidence in the securities markets and in corporate management, one accepting the title vice president—even if only for reasons of honor and not corporate power—should be subject to the "burden" of section 16(b).¹⁴²

137. It has been suggested that the arbitrary measurement used by some courts may extract more than the amount of the "real" profit, depending upon the particular series of purchases and sales in the case. 3B H. BLOOMENTHAL *supra* note 11, § 10.06. However, recent cases are less frequently adhering to such a strict interpretation of the damages recoverable. *Id.*

138. Brief for the SEC, *Amicus Curiae*, at 7, Schimmel v. Goldman, 57 F.R.D. 481 (S.D.N.Y. 1973).

139. *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 921 (1951).

140. 556 F.2d 1119 (1978).

141. *Id.* at 1121.

142. Since Vice Presidents are expressly included, without qualification, in the definition of "officer" contained in Rule 3b-2, this Division has regularly taken the position that any person who bears the title Vice President is to be regarded as an "officer" under that rule, regardless

It may also be asserted by some that it is not "fair" that all vice presidents should be subject to the section since assistant secretaries, treasurers and comptrollers are not covered by the definition of officer as interpreted by the SEC.¹⁴³ But it seems common to have in a corporate structure numerous vice presidents who are indeed officers with policy-making chores and access to inside information.¹⁴⁴ The SEC, given the responsibility to define the term by Congress, by its rule and interpretation has determined that all those with the title vice president should be included within section 16(b) liability.¹⁴⁵ Given the array of variations on the vice presidential title that are possible, it seems wise that the SEC has not sought to draw the line elsewhere and has attempted to retain objectivity in this respect.

V. CONCLUSION

It is suggested, in light of the foregoing discussion, that when courts are called upon in the future to decide whether vice presidents are section 16(b) officers, the question be resolved in the affirmative by an objective application of rule 3b-2. The next court to consider this question should carefully review the eight officer cases discussed above and consider them in light of the policies Congress intended to promote through section 16(b). If such a careful re-examination of the issue is made, the conclusion should be reached that all vice presidents are indeed officers under section 16(b). The policies of the statute, to provide a simple, objective rule for the return of insider profit to the corporation, and

of the method of his appointment or election, the particular duties performed by him or whether he is named as an officer in his company's by-laws, and that as long as he enjoys the title of Vice President he must bear the obligations imposed by Section 16.

2 L. LOSS, *supra* note 9, at 1094 (quoting from an SEC letter reprinted in *THE CORPORATE SECRETARY*, Sept. 25, 1959, at 2).

143. SEC Exchange Act Release No. 34-2687 (Nov. 16, 1940), and SEC Public Utility Holding Co. Act Release 35-67 (Jan. 6, 1936), construed the language of rule 3b-2 to mean that assistant treasurers, assistant secretaries and assistant comptrollers are not to be considered "officers" under the SEC's definition of the term. The SEC would consider, however, such persons as officers if the person with the formal title was so inactive that he or she was actually performing the superior's functions. Therefore persons entitled "assistant to the vice president" presumably would not be covered by the SEC interpretation, subject to the same exception of performing the functions of a superior.

144. *See, e.g.,* Selas Corp. of America v. Voogd, 365 F. Supp. 1268 (E.D. Pa. 1973) (defendant had been "Vice President for European Operations" and was later "Executive Vice President International"); *Merrill Lynch, Pierce, Fenner, & Smith, Inc. v. Livingston*, 556 F.2d 1119, 1121 (9th Cir. 1978) (executive and managerial functions performed by some 350 "executive vice presidents").

145. *See* note 142 *supra*.

more broadly to promote public confidence in the securities markets and corporate management, will thereby be furthered.

If such an approach is not adopted by the courts, the SEC should consider issuing a new administrative statement on the subject to reiterate its long-held position that vice presidents are officers, and to generally reemphasize rule 3b-2. As demonstrated, the 1973 officer cases pose a danger of serious damage to the rule. Further, the broad language of *Merrill Lynch* that all job labels merely raise an inference of access to inside information and executive duties, if adopted in other factual settings, has the potential of effectively repealing rule 3b-2. In place of the rule would be a subjective, case-by-case analysis of who is an officer, under which courts, if following the *Merrill Lynch* analysis, may ignore basic section 16(b) policies. Such subjectivity in this definition was not intended by Congress, and its continuation can only diminish the section's importance.

Finally, when the Congress in coming years re-examines the Exchange Act, as it will do should it consider the American Law Institute's Federal Securities Code,¹⁴⁶ it should reconsider the definition of officer. The policies of a simple and objective rule, and of promoting confidence in the markets and corporate management, are being harmed by the injection of subjectivity into the definition of officer. If the courts are not then applying the statute objectively to all rule 3b-2 officers, and if the original purposes of section 16(b) are to be continued, "officer" should then be statutorily defined by Congress.

Merrill Lynch and the officer cases of 1973 have the potential of allowing all but one or two vice presidents of each corporation to exit through the door of non-liability if short-swing trading occurs. This is possible because even in a "garden variety" transaction under the *Merrill Lynch* analysis, a plaintiff would have to prove the functions, duties and potential for access to confidential information by the vice president involved. While perhaps a small problem, it is a door, which if it remains even partially open, may lead to more short-swing speculation by vice presidents as well as by other rule 3b-2 officers. Such trading potentially would further diminish public trust and confidence in the securities markets and

146. ALI FEDERAL SECURITIES CODE (1978). Section 1714 of the Code as adopted by the ALI substantially retains section 16(b). The definition of persons required to file under section 1714 is found in section 605(a). This section sheds no further light on the question of who is an officer, containing essentially the same language as the insider definition now found in section 16(a).

corporate management, in violation of the underlying policies of section 16(b).

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