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# Securites—Section 16(b)— A Bebeficial Owner May Reduce Holdings to Less Than 10% Outstanding Common Stock and Subsequently Dispose of Remaining Stock in a Second Sale within Six Months of Purchase without Being Liable for Profits Made from the Second Sale

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SECURITIES—SECTION 16(b)—A BENEFICIAL OWNER MAY REDUCE HOLDINGS TO LESS THAN 10% OUTSTANDING COMMON STOCK AND SUBSEQUENTLY DISPOSE OF REMAINING STOCK IN A SECOND SALE WITHIN SIX MONTHS OF PURCHASE WITHOUT BEING LIABLE FOR PROFITS MADE FROM THE SECOND SALE—*Reliance Electric Co. v. Emerson Electric Co.*, 92 S. Ct. 596 (1972).

Pursuant to a plan designed to acquire control of Dodge Manufacturing Company, Emerson Electric Company purchased 13.2% of Dodge common stock. The attempted corporate takeover was frustrated, however, when the shareholders of Dodge approved a merger with Reliance Electric Company. Recognizing that (1) a forced exchange of Dodge stock for shares in the merged corporation was imminent, (2) when the exchange occurred any shareholder who had acquired at least a 10% ownership of outstanding stock within six months of the exchange might be an "insider trader" under section 16(b) of the Securities Exchange Act of 1934,[1] and (3) an "insider trader" would be forced to disgorge all profits it made as a result of the exchange, Emerson sold to a brokerage house enough shares to reduce its holdings below 10%. Emerson, feeling immunized now from the 10% provision of section 16(b), sold its remaining 9.96% of outstanding common stock to Dodge within three months of Emerson's original purchase of the stock.

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1. Securities Exchange Act of 1934 § 16(b), 48 Stat. 896 (1934), *as amended*, 15 U.S.C. § 78p(b) (1970) [hereinafter referred to as section 16(b)]. Section 16(b) provides:

> 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 six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. 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 thereafter; but no such suit shall be brought more than two years after the date such profit was realized. *This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved,* or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection. (emphasis added).

A beneficial owner is defined as one who owns "more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title. . . ." Securities Exchange Act of 1934 § 16(a), 15 U.S.C. § 78p(a) (1970).

Following a demand by Reliance that Emerson disgorge the profits from both sales, Emerson sought a declaration in federal court of its liability under section 16(b). The district court held Emerson liable for all profits,[2] but the Court of Appeals for the Eighth Circuit reversed as to liability for profits flowing from the second sale.[3] The Supreme Court granted certiorari and affirmed in a 4-3 decision. Although Emerson split its sale of Dodge stock with the intent of avoiding most of its potential section 16(b) liability, the provisions of the section must be literally read and, since the statute encompasses only those sales made within six months of purchase and sale by a 10% holder who is such at the time of both purchase and sale, liability for the second sale is precluded.[4]

Justice Stewart, who wrote the Court's opinion, posed the question in *Reliance* as whether the step transaction used by Emerson was permitted by the statute. The intention of Emerson to avoid liability was deemed not to be determinative in imposing liability under section 16(b).[5] Cognizant that the statute requires the seller to be a 10% owner at "both the time of the purchase and sale . . . of the security involved,"[6] the Court chose to restrict the meaning of that phrase to ob-

2. Emerson Electric Co. v. Reliance Electric Co., 306 F. Supp. 588 (E.D. Mo. 1969).

3. Emerson Electric Co. v. Reliance Electric Co., 434 F.2d 918 (8th Cir. 1970).

4. Reliance Electric Co. v. Emerson Electric Co., 92 S. Ct. 596, 599, 601 (1972). The question of liability for profits derived from the first sale of 3.24% of the outstanding common stock was not adjudicated by the Supreme Court. The lower courts found liability and it seems clear that the Supreme Court would have decided similarly.

The trial court had clearly found that the sales were linked to a single plan of disposition and were structured and effectuated to avoid section 16(b) liability. 306 F. Supp. 588, 592 (E.D. Mo. 1969). Nevertheless, this finding of fact was deemed "irrelevant" by the eighth circuit. 434 F.2d 918, 926 (8th Cir. 1970).

5. 92 S. Ct. at 599. If the Court had focused upon intent, liability certainly could have attached. *See* note 4 *supra*. However, by emphasizing the "method" employed to accomplish the transaction, the Court seems to have laid bare a discernible loophole in the statute's ambit of prohibition. It has been noted that any intelligent manipulater may structure his affairs to avoid section 16(b) liability:

> [W]hile proof that there was no misuse of inside information does not avoid liability under Section 16(b), neither does proof of actual misuse of inside information establish liability, if the insider has manipulated not only the stock but also his transaction so that they fall outside the wholly arbitrary rules of that section. R. JENNINGS & H. MARSH, SECURITIES REGULATION 1031 (2d ed. 1968).

6. Section 16(b), note 1 *supra*. The phrase has been construed to encompass the original purchase transaction that elevated the defendant to beneficial owner status. In Stella v. Graham-Page Motors Corp., 232 F.2d 299 (2d Cir. 1956), the court held that "at the time of the purchase and sale . . ." was to be interpreted to require inquiry into ownership "immediately after" purchase and "immediately prior" to sale rather than "simultaneously with." As one commentator noted, to construe the section

jective standards.[7] Rejecting the district court's treatment of "time of sale" as including " 'the entire period during which a series of related transactions takes place pursuant to a plan which a 10% beneficial owner disposes of his stock holding,' "[8] the Court refused to view the 10% requirement any more subjectively than the six month requirement. Since a plan to sell conceived within six months of the purchase would not fall within the ambit of section 16(b), neither would a sale by a person holding less than 10%.[9] *Reliance* thus marks a return to an objective approach toward section 16(b) which would preserve the mechanistic quality of that statute.[10] Any change in interpretation, the

in any other manner would render section 16(b) ineffective since its provisions could be avoided by a single sale. Seligman, *Problems Under the Securities Exchange Act*, 21 VA. L. REV. 1, 19-20 (1934); *see* II L. LOSS, SECURITIES REGULATION 1060 (2d ed. 1961); *contra*, Arkansas Louisiana Gas Co. v. W.R. Stephens Investment Co., 141 F. Supp. 841, 847 (W.D. Ark. 1956).

7. 92 S. Ct. at 599: "[T]he only method Congress deemed effective to curb the evils of insider trading was a flat rule. . . ."

8. 92 S. Ct. at 598, *quoting* 306 F. Supp. 588, 592.

9. 92 S. Ct. at 600. The Court was of the opinion that Congress had concluded that a stockholder with a "long-term", i.e. six month, investment of 10% or more of the outstanding shares is generally more likely to have access to inside information than an investor moving in and out of the 10% category during the six month period. *Id.* The obvious implication is that a multitude of transactions structured similar to Emerson's within the six month period would only hold the stockholder liable for the reduction sales. See note 4 *supra*. Consequently, an insider could purchase 11%, sell 1.1%, repurchase and resell (only being held accountable for the 1.1% and subsequent reduction transactions), and yet enjoy a position from his periodic 10% ownership which affords him easy access to inside information. Nevertheless, in the Court's analysis, he is less likely to have access to inside information than is a 10% continual owner. The Court stated that commentators have actually recommended this reduction procedure. *Id.* at 599 & n.3, *citing* II L. LOSS, SECURITIES REGULATION 1060 (2d ed. 1961); Seligman, *supra* note 6, at 20. A careful reading of these authorities, however, reveals that they by no means have recommended or endorsed the two-step transaction but merely have considered it a possible means of section 16(b) avoidance. *See* V Loss at 3023 (Supp. 1969).

10. The objective approach consists of a literal interpretation and application of the statute, thus imposing strict liability. The often quoted case of Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943), represents the earliest adoption of this method of imposing section 16(b) liability.

> It is apparent too, from the language of § 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. . . . *Id.* at 235.
>
> A subjective standard of proof, requiring a showing of an actual unfair use of inside information, would render senseless the provisions of the legislation limiting the liability period to six months, making an intention to profit during that period immaterial, and exempting transactions wherein there is a bona fide acquisition of stock in connection with a previously contracted debt. *Id.* at 236.

The myriad variations of complicated transactions that ultimately became subject to section 16(b) scrutiny gradually rendered this objective approach impractical and unworkable. See note 32 *infra*. Although the earlier cases adopted the *Smolowe*

Court felt, must come by legislative amendment;[11] the two-step sale was certainly not "the kind of evil which Congress sought to correct through 16(b)."[12]

Justice Douglas, who authored the dissenting opinion, characterized the majority holding as

> a mutilation of the Act, contrary to its broad remedial purpose, inconsistent with the flexibility required in the interpretation of securities legislation and not required by the language of the statute itself.[13]

Adopting a pragmatic approach, Justice Douglas determined that regardless of the semantics involved in framing the issue, the dispute must be resolved in light of the clear legislative purpose to curb short

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approach, the recent decisions seem to have "shifted . . . to a much more *subjective approach* . . . an approach less automatic and mechanistic and more fact-oriented and pragmatic." Lowenfels, *Section 16(b): A New Trend Regulating Insider Trading*, 54 CORNELL L. REV. 45, 45-46 (1968) (emphasis added) [hereinafter cited as Lowenfels]. This pragmatic or subjective approach rejects a black letter application of the statute and, in favor of greater flexibility and consistency with legislative purpose, focuses analysis upon the purpose of section 16(b), expressed in the first two lines of that statute. "The threshold issue . . . is whether the [transaction] . . . len[ds] itself to the type of speculative abuse which section 16(b) was designed to prevent." Newmark v. RKO General, Inc., 425 F.2d 348, 353 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

11. 92 S. Ct. at 600.

12. *Id.* The majority climaxed its opinion by referring to an inconsistency between various SEC rules and the position taken by the SEC in the instant case that the sole purpose of the 10% requirement at the time of both purchase and sale was to exclude from the statute's coverage those persons who became 10% shareholders involuntarily. *Id.* at 600-01. Rule 16(a)-10 exempts from section 16(b) any transactions which need not be reported under section 16(a). Rule 16a-10, 17 C.F.R. § 240.16(a)-10 (1971). Additionally, Release No. 6487 has interpreted section 16(a) to exempt a stockholder from the requirement of reporting holdings that are less than 10% at any time during the month. Form 4, SEC Release No. 6487 (Mar. 9, 1961). As such, since Emerson would not be required under section 16(a) to report his second sale, there would be no section 16(b) liability under the foregoing rules. However, as the dissent points up, "the promulgation of rules is not a matter solely within the expertise of the SEC and beyond the scope of judicial review." 90 S. Ct. at 608, *quoting* Feder v. Martin Marietta Corp., 406 F.2d 260, 268 (2d Cir. 1969), *cert. denied*, 396 U.S. 808 (1970). The *Feder* court, in holding an ex-director liable under section 16(b), was not inhibited by a SEC reporting requirement in light of the prophylactic purpose of section 16(b), where the exercise of the SEC rule-making power was "arbitrarily inadequate." The *Reliance* Court could also have invalidated the instant exemption to provide "a logical extension of 16(b) coverage . . . in line with the congressional aims, and . . . afford[ing] greater assurance that the lawmakers intent will be effectuated." *Id.* at 269. Nevertheless, the majority felt that they could not adopt a construction which "not only strains, but flatly contradicts the words of the statute."

13. 90 S. Ct. at 602.

swing speculation by insiders.[14] To ensure the maximum prophylactic effect the statute was designed to provide, the Justice urged that a rebuttable presumption be engrafted onto section 16(b) so "that any such series of dispositive transactions will be deemed to be a part of a single plan disposition, and will be treated as a single 'sale' for the purposes of 16(b)."[15] The presumption would place the burden of proof on the defendant and would accordingly broaden the remedial effect of the statute in a manner consistent with the statutory scheme. Intent would become a litigable issue and the defendant would be required to come forward with the affirmative defense that the transactions did not afford him "*an opportunity* for speculative abuse of his position as an insider. . . ."[16] This approach would require an ad hoc factual inquiry as to insider trader status. Although the section's objectivism would be sacrificed in favor of remedial expansion, the rebuttable presumption would remove the insulation provided by its mechanistic interpretation.[17] Justice Douglas further noted that while the six month rule is grounded upon the congressional determination that normal market fluctuation beyond this time period is sufficient to deter inside trading, the 10% rule is based on the assumption that inside information will be available to one who owns a 10% beneficial interest.[18] Therefore, any sale within that period of time by a 10% owner

14. *Id.* at 605. The basic concern of Congress in enacting 16(b) was to protect the outsider who is not on an equal footing with inside beneficial holders. *Id.* at nn. 2 & 3, *citing* Testimony of Thomas Corcoran, *Hearings on H.R. 7862 & H.R. 8720 before the House Committee on Interstate & Foreign Commerce,* 73d Cong., 2d Sess. 85 (1934); S. REP. No. 792, 73d Cong., 2d Sess. 9 (1934). The dissent concluded that 16(b) was intended to inhibit if not prevent the "predatory operations" revealed by Congress by "removing all possibility of profit from those short-swing insider trades occurring within the statutory period of six months." 90 S. Ct. at 603 (footnote omitted).

15. 90 S. Ct. at 607. The dissent noted that several of the provisions of the 1933 Act already provide presumptions based on the determination that short term sales activity generally reflects an intent to embark on public distribution without registration. *Id.* at 607 n.12.

16. *Id.* at 608 (emphasis added).

17. The dissent correctly recognized that "[w]hatever 'mechanical quality' the statute possesses, it was intended to ease the plaintiff's burden, not to insulate the insider's profits." 92 S. Ct. at 606-07. Concern for the plaintiff's burden is most noticeable in the testimony of one of the draftsmen of the Act (*see* note 14 *supra*), and was in fact a primary motivating force in the original rejection of a "subjective standard of proof, requiring a showing of an actual unfair use of inside information. . . ." Smolowe v. Delendo Corp., 136 F.2d 231, 236 (2d Cir.), *cert. denied,* 320 U.S. 751 (1943).

18. 92 S. Ct. at 609, *citing* Blau v. Max Factor, 342 F.2d 304, 308 (9th Cir.), *cert. denied,* 382 U.S. 892 (1965) *and* Newmark v. RKO General, 425 F.2d 348 (2d Cir.), *cert. denied,* 400 U.S. 854 (1970).

carries a "presumption of a taint even if a prior transaction . . . has reduced . . . ownership to 10% or below."[19]

The Court in *Reliance* exhibited a reluctance to extend statutory liability to any but the most literal violations of section 16(b). A convenient method of circumlocuting the limitation which the Court has placed on section 16(b) liability exists, however. Instead of concentrating upon whether there is a 10% beneficial ownership of stock at the time of a second sale, emphasis could be given to the phrase "at the time of sale." This perspective was utilized by the dissent to expand the concept of "sale" to encompass both of Emerson's transactions.

> "Whatever the terms 'purchase' and 'sale' may mean in other contexts, they should be construed in a manner which will effectuate the purposes of the specific section of the [Exchange] Act in which they are used."[20]

The statute is thereby given its broadest possible interpretation.

In dealing with "sale" lower courts have not shunned from making a factual inquiry into "opportunity for the abuse of inside information" as did the Court's majority in *Reliance*.[21] The second circuit has stated that the judicial tendency "has been to interpret section 16(b) in ways that are most consistent with the legislative purpose, even departing where necessary from the literal statutory language."[22] Nevertheless,

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19. *Id.*

20. *Id.* at 604, *quoting* Bershad v. McDonough, 428 F.2d 693, 697 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971).

21. *Compare* Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971) (holding a sale within six months although an option was not formally exercised) *with* Abrams v. Occidental Petroleum Corp., 450 F.2d 157 (5th Cir. 1971), *cert. granted, sub. nom.* Kern County Land Co. v. Occidental Petroleum Corp., 92 S. Ct. 1498 (1972) (holding profits by an exchange transaction and option agreement not recoverable). Additionally, *see, e.g.*, Park & Tilford v. Schulte, Inc., 160 F.2d 984 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947), *affirming* Kogan v. Schulte, 61 F. Supp. 604 (S.D.N.Y. 1945) (conversion of preferred stock as a purchase); Heli-Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965) (conversion of preferred stock as a sale). *Contra*, Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); Ferraiola v. Newman, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959) (conversion of preferred stock held not to be a purchase); Chemical Fund Inc. v. Xerox Corp., 377 F.2d 107 (2d Cir. 1967); Petteys v. Butler, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); Leyman v. Livingston, 276 F. Supp. 104 (D. Del. 1967) (conversion of debentures into stock held not to be a purchase or sale).

22. Feder v. Martin Marrietta Corp., 406 F.2d 260, 262 (2d Cir. 1969), *cert. denied*, 296 U.S. 808 (1970). This approach may have been utilized to find Emerson liable without shifting the focus from "10%" to "sale." *See* Colby v. Klune, 178 F.2d 872 (2d Cir. 1949), wherein the court engaged in a factual inquiry as to the "officer-director" status of the defendant by formulating the definition of an officer as "[a]

*Reliance* evidences an unwillingness to apply a subjective test to the Act as a whole.

The majority opinion recognized that "where alternate constructions of the terms of 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short swing speculation by corporate insiders."[23] Yet the Court could envision no alternate construction of the section. Rather, it narrowly focused upon an alternative *provision* of the section—the 10% requirement. Moreover, by failing to distinguish the rationale for the six month rule from that of the 10% requirement, the Court enshrined preservation of the "objective measure of proof" as being more fundamental to statutory design than the maintenance of the "wholesome purpose" of the Act.[24] It was left for the dissent to justifiably observe that

> [t]here is no rule so "objective" (automatic would be a better word) that does not require *mental effort* in applying it on the part of the person or persons entrusted by law with its application.[25]

The majority opinion, by underscoring the 10% requirement in favor of both the six month limitation and the concept of sale, undertook such a mental effort. This rigid construction of section 16(b) certainly presents an undue limitation to its enforcement. On the other hand, the rebuttable presumption proffered by the dissent[26] expands too greatly the breadth of the statute. Prior history has confirmed that section 16(b) can apply in an exceedingly harsh manner;[27] the dis-

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corporate employee performing important executive duties of such a 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." *Id.* at 873.

However, the differing treatment afforded the beneficial owner in *Reliance* may be explained in part from the distinction between "officer-director" and "beneficial owner." A defendant officer-director need only to have attained that status at the time of *either* purchase or sale, while "beneficial owner" need be such both at the time of purchase and sale. *See* Adler v. Klawans, 267 F.2d 840, 845-47 (2d Cir. 1959) (discussing the distinction between the two categories).

23. *Id.* at 600.

24. "[W]hatever the rationale of the provision, [that a beneficial owner must own 10% at the time of both the purchase and sale] it cannot be disregarded simply on the grounds that it may be inconsistent with our assessment of the 'wholesome purpose' of the Act." *Id.*

25. *Id.* at 605, *quoting* Blau v. Lamb, 363 F.2d 507, 520 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) (emphasis added).

26. See text accompanying notes 14-16 *supra.*

27. *See, e.g.*, Booth v. Varian Associates, 224 F. Supp. 225 (C.D. Mass. 1963), *aff'd*, 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 375 U.S. 961 (1965) (though an agreement fully committed the parties thereto to an eventual exchange, the date of

sent's presumption would merely aggravate this discriminatory facet of the statute.[28]

Commentators have suggested that early section 16(b) decisions were motivated by the desire to impose broad liability in the absence of other available redress for insider abuse.[29] However, several authors contend that the burgeoning and pervasive extensions of Rule 10b-5 now render an expansive interpretation of section 16(b) unnecessary.[30] This ratiocination, although questionably grounded,[31] may underlie the Court's revival of an objective standard which may easily be applied even to highly intricate transactions.[32]

A middle ground can be suggested to reconcile the opinions of the *Reliance* majority and dissent with both the literal language and statutory purpose of section 16(b). A judicial inquiry, similar to that employed in tax cases, into the nature of the two-step transaction would constitute a realistic accommodation of the two positions.[33] In

purchase, for purposes of 16(b), was held to be date of exchange, and defendants were held liable for profits from sale within six months of purchase).

28. To alleviate the harsh result of the presumption, the dissent suggested that a showing of changed circumstances similar to that once allowed for a section 4(2) private offering could be offered in rebuttal. 92 S. Ct. at 608 n.13. However, it may be questioned whether the strictly limited and highly indefinitive criteria of changed circumstances underlying investment intent in private placements would in fact assuage the encompassing presumption of the dissent.

29. *E.g.*, Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to Burning Down the Barn in Order to Kill the Rats*, 52 CORNELL L. REV. 69, 74-77 (1966).

30. *E.g.*, Bateman, *The Pragmatic Interpretation of Section 16(b) and The Need for Clarification*, 45 ST. JOHN L. REV. 772, 785-86, 797 (1971); Lowenfels, *supra* note 10, at 63.

31. Actions brought under 10b-5 remain limited by the purchaser-seller requirement of Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952); Edelman v. Decker, 337 F. Supp. 582 (E.D. Pa. 1972); Manor Drug Stores v. Blue Chip Stamps 339 F. Supp. 35 (C.D. Cal. 1971). *But cf.* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); Tully v. Mott Supermarkets, Inc., 337 F. Supp. 834 (D.N.J. 1972); Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968). Further, under section 10(b)(5), there must be injury to the plaintiff and some causal connection must exist between the alleged violation and the injury. Lewis v. Bogin, 337 F. Supp. 331, 335-38 (S.D.N.Y. 1972).

32. *See, e.g.*, Blau v. Lamb, 363 F.2d 507 (2d Cir.), *cert. denied*, 385 U.S. 1002 (1966), wherein the court recognize that "this section may be applied not only to routine cash purchases and sales of equity securities but also . . . to acquisitions . . . conversions, options, stock warrants, reclassifications and the like." *Id.* at 516.

33. The solution posed, however, would by no means eliminate all problems. As one writer commenting on the concept of "sham transaction" has stated:

> In spite of all that has been written about the by purpose doctrine, sham transactions, net effect, and the role of the court in looking through the form to find substance, no authoritative, explicit rationale for judicial intervention to frus-

handling federal income tax litigation, the courts have been guided by the purpose of the transaction rather than its mechanics. The violence done to the literal interpretation of a statute is generally considered less significant than promotion of congressional design.[34] The following quotation is directly analogous:

> The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from . . . a sale . . . are not finally to be determined solely by the means employed to transfer legal title. Rather the transaction must be viewed as a whole, and each step, from the commencement of negotiation to the consummation of sale is relevant. . . . *To permit the true nature of a transaction to be disguised by mere formalisms . . . would seriously impair the effective administration of the tax policies of congress.*[35]

It is certainly no more inconsistent with the wording of section 16(b) to construe the six month trading requirement to include a two-step sales transaction than it is to define "at the time of the purchase and sale . . ." as requiring an inquiry into ownership "immediately after" purchase and "immediately prior" to sale.[36] A different construction in either instance substantially renders section 16(b) ineffective and robs the statute of its vitality.

The court of appeals in *Reliance* limited its holding to two sales "not legally tied to each other and made at different times to different buyers. . . ."[37] Whether the Supreme Court decision is so limited is not clear. While the Court took notice of the lower court's statement, it did not explicitly adhere to it. In fact, the Court implied that two sales to the same buyer would not violate the statute.[38] Nevertheless, where a short interval of time occurs between the first and second sales and where the sales are "legally tied to each other" (e.g., through an option), it is suggested that the "sales" be interpreted as one sale within six months by a beneficial owner. Intent

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trate plans for tax avoidance has ever been given. Fuller, *Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation,* 37 TUL. L. REV. 355, 389 (1962-63).

34. *See, e.g.,* Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (1932) and Cortland Specialty Co. v. Commissioner, 60 F.2d 937 (2d Cir. 1932) (holding that the transaction constituted a sale rather than a merger or consolidation although it literally fell within the language of the statute providing such an exemption).

35. Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945) (the Court attributed the sale to the corporation rather than to the shareholders where property was disguised as a liquid dividend in the two-step transaction).

36. See note 6 *supra.*

37. 434 F.2d at 926.

38. 91 S. Ct. at 599 n.3, *quoting* 2 L. LOSS, SECURITIES REGULATION 1060 (2d ed. 1961).