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Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934

Janet Gamer Feldman and Richard L. Teberg*

The concept of beneficial ownership under the federal securities laws has traditionally been thought to include only the equitable ownership interests in securities. Authors Feldman and Teberg suggest that the application of traditional concepts of property ownership to the securities field does little to prevent the breach of fiduciary obligation at which section 16 and other sections of the Securities Exchange Act of 1934 are aimed. Instead, they suggest the application of two new tests of beneficial ownership: one to determine which securities must be reported by a person once he is subject to section 16(a); the other to determine which securities are beneficially owned so as to constitute a person a section 16(a) insider. After setting forth these new tests, the authors apply them to securities held by family members, by non-relatives, by partnerships, by corporations, and in trust. Finally, the authors consider whether options, warrants, and other rights in securities can be considered beneficial ownership for purposes of section 16 of the Exchange Act.

WHO IS A “beneficial owner” of securities? Is a person the “beneficial owner” of securities held by his spouse? Does a partner “beneficially own” any or all the securities held by his partnership? Who is the “beneficial owner” of securities held in a trust or by a corporation? Does a “change in beneficial ownership” include both qualitative and quantitative changes? May the same securities be “beneficially owned” by more than one person? Does the holder of an unexercised option “beneficially own” the underlying securities?

The resolution of these and other questions is necessary to comply with the various provisions of the rules and forms adopted under the federal securities acts1 which require disclosures of ben-

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* This article carries an authorship date of July 1, 1966. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its members or employees. The views expressed herein are those of the authors and do not necessarily reflect the views of the Commission or its staff.

ficial ownership, and to establish the applicability of other statutory duties, prohibitions, and liabilities which turn on the existence of beneficial ownership. Nowhere is the resolution of questions concerning beneficial ownership more important than in the operation of section 16(a) under the Securities Exchange Act of 1934 (Exchange Act), for that section is concerned solely with obtaining disclosures of beneficial ownership. Moreover, beneficial ownership determines who is subject to the section.

2 Disclosure of the amounts of a security a person beneficially owns is required in registration statements filed under the Securities Act by paragraph (6) of Schedule A, and is called for in other registration forms adopted by the SEC under other of the acts. See, e.g., Item 11, SEC Exchange Act Form 10; Item 15, SEC Public Utility Holding Company Act Form U3B; Item 14(b) SEC Investment Company Act Form N-8B-1. Beneficial ownership also must be disclosed in annual reports. See, e.g., Items 5 and 6, SEC Exchange Act Form 10-K; Item 8, SEC Public Utility Holding Company Act Form U5S; Item 1.109(b), SEC Investment Company Act Form N-1R. It must also be disclosed in proxy statements (see Items 5 and 6, SEC Exchange Act Schedule 14A), in applications for registration as a broker-dealer (see Item 3(c) SEC Exchange Act Form BD), or as an investment adviser (see Item 3(c) of SEC Investment Advisers Act Form ADV).

3 Statements of eligibility and qualifications to act as an indenture trustee (see Item 6 of SEC Trust Indenture Act Form T-1 and Item 4 of SEC Trust Indenture Act Form T-2) require disclosure of beneficial ownership to determine whether a person is "disinterested" within the meaning of subsections (5), (6), (7), and (8), of § 310(b) of the Trust Indenture Act, added by 53 Stat. 1157 (1939), 15 U.S.C. § 77ijj (1964). A person who does not meet the statutory standards of a "disinterested person" may not act as an indenture trustee. Beneficial ownership also determines who is an "affiliated person" under § 2(a) (3) of the Investment Company Act of 1940, 54 Stat. 790, as amended, 15 U.S.C. § 80a-2 (a) (3) (1964), and thus determines whether a person may hold certain positions with, borrow from, or engage in certain transactions with, an investment company. See, e.g., §§ 9, 10, 17, 21 of the Investment Company Act of 1940, 54 Stat. 805, 806, 815, 822, as amended, 15 U.S.C. §§ 80(a)-9, -10, -17, -21 (1964).


5 The provisions of § 16 of the Exchange Act are substantially duplicated in § 17 of the Public Utility Holding Company Act of 1935, 49 Stat. 830, as amended, 15 U.S.C. § 79q (1964). Section 17, however, is both broader and narrower than § 16 of the Exchange Act. It does not apply to beneficial owners of more than 10% of a class of securities, but it does apply to the transactions of any officer or director of a registered public utility holding company in any securities of the holding company without limitation to equity securities. Section 30(f) of the Investment Company Act of 1940, 54 Stat. 836, as amended, 15 U.S.C. § 80a-29(f) (1964), incorporates by reference the provisions of § 16 of the Exchange Act with respect to any securities (other than short-term paper) issued by a registered closed-end investment company. Section 30(f) also applies to any member of an advisory board, investment adviser, or affiliated person of an investment adviser as well as any beneficial owner of more than 10% of any class of securities (other than short-term paper) issued by a closed-end investment company or officer or director of such a company. By virtue of SEC Public Utility Holding Company Act Rule 72, 17 C.F.R. § 250.72 (rev. ed. 1964),
I. THE MEANING OF BENEFICIAL OWNERSHIP UNDER THE EXCHANGE ACT

Section 16(a) applies to three separate classes of persons, commonly referred to as "insiders": Every person who is (1) directly or indirectly the beneficial owner of more than ten per cent of any class of equity security which is registered pursuant to section 12 of the Exchange Act; (2) an officer; or (3) a director of

and SEC Investment Company Act Rule 30f-1, 17 C.F.R. § 270.30f-1 (rev. ed. 1964), the rules under § 16(a) of the Exchange Act are made applicable to persons filing reports under § 17 of the Public Utility Holding Company Act or § 30(f) of the Investment Company Act.

In calculating the percentage of ownership of a class of securities under Exchange Act § 16(a) (other than voting trust certificates or certificates of deposit for an equity security), the class is deemed to consist of the total amount of the class outstanding, exclusive of any securities held by or for the account of the issuer. Voting trust certificates or certificates of deposit are deemed to consist of the total amount of the class of outstanding securities which can be deposited under the voting trust or deposit agreement. A person acting in good faith can rely on the latest information on file with the Commission as to the amounts of a class outstanding. See SEC Exchange Act Rule 16a-2, 17 C.F.R. § 240.16a-2 (1964).

The term "class" is not defined for the purpose of § 16 of the Exchange Act, although it is defined for the purpose of Exchange Act § 12(g), as added, 78 Stat. 565, 15 U.S.C. § 78j(g) (1964) and § 15(d), 48 Stat. 895 (1934), as amended, 15 U.S.C. § 78o(d) (1964), to mean "all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges." In Ellerin v. Massachusetts, 270 F.2d 259 (2d Cir. 1959), the only case under the federal securities acts involving the definition of class, the court took the position that the defendant was not a holder of more than 10% of an issuer's preferred stock for the purpose of § 16(b). The preferred stock was issued in two series. The defendant owned more than 10% of one series but less than 10% of both series. Each series had the same par value, voting rights, and preferences with respect to dividends and liquidation. They differed in their issuance dates, dividend rates, redemption prices, and sinking fund arrangements. Finding that the differences in the two series resulted from conditions in the market at the time of issuance, the court held both series were part of a single class, as is recognized by the corporation codes of many states.

The term "equity security" is defined in SEC Exchange Act Rule 3a11-1, 17 C.F.R. 240.3a11-1 (Supp. 1966), to include a broad range of equity interests and, like Exchange Act § 3(a)(11), 48 Stat. 884 (1934), 15 U.S.C. § 78c(a)(11) (1964), includes any security convertible, with or without consideration, into such security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right.

Subsection (a) of § 12 prohibits trading in a security on a national securities exchange unless the security is registered for listing on the exchange, or an exemption is available. Subsection (g) of § 12 requires every issuer with total assets of more than one million dollars to register each class of its non-exempt equity securities held of record by 750 or more persons at the end of its fiscal year. After July 1, 1966 such issuers will be required to register each such class held of record by 500 or more persons. Section 12(g) was added to the Exchange Act by the Securities Acts Amendments of 1964, Pub. L. No. 467, 88th Cong., 2d Sess. (Aug. 20, 1964). For an excellent discussion of these amendments see Phillips & Shipman, An Analysis of the Securities Acts Amendments of 1964, 1964 DUKLB L.J. 706.

The term "officer" is defined in SEC Exchange Act Rule 3b-2, 17 C.F.R. § 240.3b-2 (rev. ed. 1964), to mean "a president, vice president, treasurer, secretary,
the issuer of such a security. After registration\textsuperscript{10} of a class of equity security, or within ten days after a person becomes such a beneficial owner, officer, or director, he is required to file with the Securities and Exchange Commission (Commission)\textsuperscript{13} an initial statement\textsuperscript{14} which discloses "the amount of all equity securities of such issuer of which he is the beneficial owner. . . .\textsuperscript{15}" Thereafter, if there has been a change in such ownership the section requires him to file, within ten days after the close of each calendar month in which a change has occurred, a statement\textsuperscript{16} "indicating his ownership at the close of the calendar month and such changes in his ownership as occurred during such calendar month.\textsuperscript{17}

Section 16(a) thus sets up a system under which the beneficial ownership of the insider in the securities of his issuer must be disclosed continuously.

Notwithstanding the fact that beneficial ownership is significant to the successful operation of various provisions of the securities acts, and is of crucial importance to section 16(a), there is no general definition of the term in the acts.\textsuperscript{18} Hence, the meaning

\textsuperscript{10} Defined in Exchange Act § 3(a)(7), 48 Stat. 883 (1934), 15 U.S.C. § 78c(a)(7) (1964), to mean "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated." This definition presumably covers a trustee of a business trust or a member of a committee which issues certificates of deposit.

\textsuperscript{11} The SEC does not require persons to file their first report under § 16(a) until ten days after registration under § 12 is effective. See Instruction 2 to SEC Exchange Act Form 3.

\textsuperscript{12} If the issuer has a security registered for listing on a national stock exchange, a copy of the report must also be filed with the stock exchange. If the issuer has securities listed on more than one exchange, it may designate a single exchange to receive copies of the reports under SEC Exchange Act Rule 16a-1, 17 C.F.R. § 240.16a-1(c) (rev. ed. 1964).

\textsuperscript{13} The initial statement of beneficial ownership must be filed on SEC Exchange Act Form 3. No additional report on Form 3 is required by a person filing under § 16 because another class of the issuer's securities is registered or the person assumes another or an additional relationship to the issuer which would subject him to § 16. See SEC Exchange Act Rule 16a-1, 17 C.F.R. § 240.16a-1(b) (Supp. 1966).


\textsuperscript{17} Section 3(c)(1) of the Investment Company Act of 1940, 54 Stat. 797, as amended, 15 U.S.C. § 80a-3(c)(1) (1964), contains a special definition for computing
must be drawn from the words themselves, and interpreted in a manner which accords with the purposes of the section, and the place of the section within the scheme of the Exchange Act.\textsuperscript{19}

What do the words "beneficial owner" mean? If "owner" were used alone, it doubtless would be regarded as referring to a legal or equitable owner. The legislative history of section 16(a), however, makes clear that the term "beneficial owner" was intended to exclude a person having bare legal title only.\textsuperscript{20} The word "beneficial" means "tending to the benefit of a person; yielding a profit, advantage or benefit."\textsuperscript{21} Does the use of "beneficial" and "owner" together mean that a beneficial owner is one who must have a claim enforceable in equity, to those aspects of ownership which yield profit, advantage, or benefit? Or rather, is the term "beneficial" used to describe the benefits which equitable ownership traditionally confers, so that a beneficial owner is a person who does enjoy such benefits, irrespective of any enforceable rights thereto? Presumably, it is the latter, for if the presence of an enforceable ownership right to such benefits is made a prerequisite to beneficial ownership, what results is equitable ownership. Undoubtedly, if Congress had meant equitable ownership, it would have said so.\textsuperscript{22} The legislative history and the purposes of the section indicate

\textsuperscript{19} As the court noted in SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 350-51 (1943): "However well ... [rules of statutory interpretation] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." See also COOK, THE LOGICAL AND LEGAL BASIS OF THE CONFLICTS OF LAWS 154-93 (1942). Generally speaking, all the securities acts have as their central theme the protection of shareholders and use a similar format to accomplish this purpose. Consequently, an interpretation of the term "beneficial ownership" under one section can be a guide in determining its meaning elsewhere in the federal securities acts where it is used in the same context.

\textsuperscript{20} The initial bills referred to "every director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of securities." H. R. 7852, S. 2693, 73d Cong., 2d Sess. § 15(a) (1934). See also SEC Exchange Act Release No. 4718, June 18, 1952.

\textsuperscript{21} BLACK, LAW DICTIONARY 198 (4th ed. 1951).

\textsuperscript{22} During the hearings on the Exchange Act Senator Carey asked, "Is 'beneficial owner' the proper term there?" Mr. Corcoran, one of the drafters of the Exchange Act responded, "It is the broadest term you can have." HEARINGS BEFORE THE SENATE COMMITTEE ON BANKING AND CURRENCY, 73d Cong., 2d Sess., pt. 13, at 6356 (1934).
that when Congress used the term "beneficial owner" it intended to include not only an equitable owner, but also a person who actually obtains or enjoys the benefits of security ownership, even though he has no enforceable rights thereto.

The position that it is the benefits of, rather than the rights to, ownership which are the essence of beneficial ownership was first embraced by the Commission in 1935 and reaffirmed this year:

A person . . . may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership.

What then are the benefits conferred by ownership of a security? Ownership of a security, as with any property, normally involves a bundle of rights, duties, powers, and liabilities. But the term "beneficial ownership" is concerned with only the salutary or advantageous, rather than the burdensome, aspects of security ownership. The beneficial incidents of security ownership seem to fall into two categories: (1) those which are intrinsic to the security, such as dividends on stock, interest on debentures, and the right to vote; and (2) those which arise from dealing and speculating with the security, such as buying and selling.

Two factors enhance the benefits of security ownership in a manner disproportionate to the number of securities owned: (1) ownership of large amounts of a security and (2) control of the corporation. Merely by reason of the volume of his purchases and sales, the owner of large amounts of a security is able to drive the

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23 SEC Exchange Act Release No. 175, April 16, 1934, stated: "Whether or not the husband is the beneficial owner of such securities depends upon whether by reason of any contract, understanding, relationship, agreement or other arrangement he has benefits substantially equivalent to those of ownership."

24 SEC Exchange Release No. 7793 2 CCH Fed. Sec. L. Rep. § 26031 (Jan. 19, 1966). After Release No. 7793 was published, the staff of the Commission received numerous questions about whether the Commission intended to require persons to amend reports and forms previously filed with the Commission. The Commission then republished the release as SEC Exchange Act Release No. 7824, 2 CCH Fed. Sec. L. Rep. § 26030 (Feb. 14, 1966), adding that the opinions expressed in the release were not intended to be applied retroactively; that the Commission did not intend to require the filing of amended reports or forms; that it would be sufficient if persons complied with the disclosure requirements of the release by May 1, 1966; and emphasized that its opinions were directed to the information contained in the reports and forms filed with it, and were not intended as expressions of opinion on questions arising under the profit recovery provisions of § 16(b).

market price up or down. By thus manipulating the market he may create and take advantage of profitable market opportunities. These possibilities are further enhanced when the holder of a security owns a sufficient number of shares to obtain control of the corporation by voting them. For control not only increases the price obtainable for the control block of securities but also confers on the holder the ability to govern the timing and happening of corporate events which affect the market price of the company's securities, as well as the timing of the release of news of these events.

The advantages of control also accrue to persons holding certain positions with the company. Thus, persons who control or influence the control of a corporation, either by virtue of office or security ownership, by reason of their superior knowledge of factors affecting the market, are able to secure for themselves market benefits not available to other security holders by regulating the flow of corporate news. The ability to influence control and to obtain inside information, which reposes in owners of a large block of a security, officers, and directors, was found by the Congress to have been used to carry out a variety of practices inimical to the maintenance of a fair and orderly securities market.

In view of the evidence developed during the investigations that preceded the enactment of the Exchange Act that these practices had contributed to the uncontrolled speculation which had been an important cause of the credit inflation leading to the eco-

26 While ownership of a large amount of securities is not a necessary concomitant to market manipulation, the holder of a large amount of securities is in a better position to successfully carry out a manipulation.


28 "Even a noncontrolling 'insider' has the power to misuse inside information for speculative purposes by trading in light of the inside information to which he is privy. A 'controlling insider' also can manipulate corporate activity in order to create favorable short-swing trading situations." Blau v. Lamb, Civil No. 29940, 2d Cir., June 27, 1966.

29 The reason for including beneficial owners of more than 10% of a class of registered equity security in addition to officers and directors of an issuer was explained as follows:

Among the most vicious practices unearthed at the hearings before the subcommittee was the 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. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others. Senate Comm. on Banking and Currency, Stock Exchange Practices, S. REP. No. 1435, 73d Cong., 2d Sess. 6556 (1934).
nomic collapse of 1929 and the subsequent depression, the Congress sought to reach the causes of "unnecessary, unwise and destructive speculation." This was done by controlling credit; by prohibiting pool operations, manipulations, and similar deceptive devices; by regulating the relationship of the investing public to listed companies through various disclosure requirements; and by extending the legal concept of fiduciary obligations to corporate management. The evils inherent in speculation, manipulation, faulty credit control, investors' ignorance, and abuse of relationships of trust were regarded by the Congress as "a seamless web," no one of which could be isolated for cure from the others.

Section 16(a) was an integral part of the scheme to control speculation and market manipulation and to establish the proposition that managers of companies have fiduciary responsibilities to their shareholders. The Congressional intent underlying section

30 S. REP. NO. 792, 73d Cong., 2d Sess. 3 (1934).
31 H. REP. NO. 1383, 73d Cong., 2d Sess. 2-3 (1934).
37 See H. REP. NO. 1383, 73d Cong., 2d Sess. 3 (1934).
38 Exchange Act § 16(a), 48 Stat. 896 (1934), as amended, 15 U.S.C. § 78p(a) (1964). While the abuse of inside information by insiders was reprehensible in itself, the Congress also saw § 16 as a device for preventing manipulation of the market. See, H. REP. NO. 792, 73d Cong., 2d Sess. 9 (1934); S. REP. NO. 1455, 73d Cong., 2d Sess. 55-68 (1934). The integral nature of § 16 to the operation of the Exchange Act is also apparent from a reading of § 2 of the act which begins:

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions. . . . Exchange Act § 2, 48 Stat. 881 (1934), 15 U.S.C. § 78b (1964).

39 Prior to 1934 corporate insiders were relatively free to trade in their company's securities. Most courts did not apply a standard of fiduciary relationship between them and the company's security holders in these transactions. See Cook & Feldman, Insider Trading Under the Securities Exchange Act, 66 HARV. L. REV. 385, 408-09 (1953).
16(a) is clear: "Men charged with the administration of other people's money must not use inside information for their own advantage."40

The House thought that subjecting insiders to the continuous reporting requirements of section 16(a) and prohibiting these persons from making short sales and "sales against the box" would, in conjunction with the other provisions of the Exchange Act, virtually eliminate unsavory insider abuses of trust and manipulations.41 The deterrent provided by the full and prompt publicity of section 16(a) is described in the House Report as "the most potent weapon against the abuse of inside information."42 The Senate added section 16(b)43 as an aid to effecting this general goal in one specific area of harm based upon inside position — short-term trading based upon and made profitable by the unfair use of inside information. Section 16(b) provides that any profits realized by an insider from the purchase and sale, or sale and purchase, within less than six months, of equity securities of his issuer, inure to, and are recoverable by, the issuer.44

The importance of establishing this fiduciary relationship was stated in the House Report:

If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance. As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position. Unless constant extension of the legal conception of a fiduciary relationship — a guarantee of "straight shooting" — supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system. H. REP. No. 1383, 73d Cong., 2d Sess. 5 (1934).

40 H. REP. NO. 1383, 73d Cong., 2d Sess. 13 (1934).

41 A short sale is accomplished by selling securities which the seller does not own. Securities are borrowed for sale with the expectation that the price of the security will decline and a profit made by repaying the borrowed securities with securities acquired at the lower price. A "sale against the box" is a sale by a person having sufficient securities to cover the sale but who, instead, borrows securities for delivery after sale. It is a form of hedge transaction. These transactions are prohibited to insiders by § 16(c).

42 H.R. 9323, 73d Cong., 2d Sess. (1934), adopted by the House and subsequently amended by the Senate did not contain the profit recovery provisions which now appear in § 16(b) of the Exchange Act.


45 It is no defense to the profit recovery provisions of § 16(b) to show that there was no actual abuse of inside information. This is conclusively presumed from the occurrence of a purchase and sale within less than six months of each other. If the
The juxtaposition of section 16(a) and 16(b), plus the fact that both operate with respect to the same persons, has led many to erroneously conclude that section 16(a) was enacted only to reveal transactions within the scope of section 16(b). That section 16(a) is not confined to transactions within the scope of section 16(b) is clear not only from the fact that section 16(a) pre-existed section 16(b), but also from the different language of the two subsections. For while section 16(b) speaks of purchases and sales within six months of each other, section 16(a) speaks of changes in beneficial ownership, a much broader concept. True, transactions which are the subject of section 16(b) are revealed by the reports required under section 16(a), but section 16(b) is only one of the provisions of the Exchange Act the violation of which section 16(a) was designed to expose. In addition, manipulations and other abuses of inside position — the respective subjects of sections 9 and 10 of the Exchange Act — also are disclosed by the section 16(a) reports.

Section 9, which is addressed to "any person," is aimed at preventing pool operations and manipulations. In this section, Congress prohibited various transactions made for the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange; transactions in which there is no change in beneficial ownership of a security — so called wash sales; the entry of purchase (sale) orders with the knowledge that sale (purchase) orders for substantially the same amount of securities are being entered at substantially the same time — so called matched orders; the making of false or misleading statements about either the security itself, or the markets for such security; and any other transactions designed to drive the price up or down for the purpose of inducing others to buy or sell. Section 9

person from whom the insider bought or sold can show an actual abuse of inside information, however, that person can also recover his damages from the insider under section 10(b). The provisions of § 16(b) have been the subject of numerous articles by legal scholars. See generally 2 Loss, op. cit. supra note 10, at 1037-132; Cook & Feldman, Insider Trading Under the Securities Exchange Act (pts. 1-2), 66 HARV. L. REV. 385, 612 (1953); Painter, The Evolving Role of § 16(b), 62 MICH. L. REV. 649 (1964).

46 See note 43 supra.

47 Quite obviously not all changes in beneficial ownership, which include changes from direct to indirect beneficial ownership, or vice versa, give rise to profits recoverable under § 16(b). The Commission has provided, however, in SEC Exchange Act Rule 16a-10, 17 C.F.R. § 240.16a-10 (rev. ed. 1964), that any transactions which it exempts from the reporting requirements of § 16(a) are also exempt from the provisions of § 16(b).

also provides a cause of action for damages in favor of persons injured by any of the prohibited acts or practices.\textsuperscript{49}

Congress gave to the Commission in section 10 the authority to adopt rules prohibiting "any manipulative or deceptive device or contrivance" in the purchase or sale of any security by any person. The Commission has adopted a number of rules under the section, the best known of which is SEC Exchange Act Rule 10b-5,\textsuperscript{50} which makes unlawful a variety of fraudulent and manipulative practices in the purchase or sale of securities. Thus, the purchase and sale of securities with more than six months intervening, and a single purchase or sale of securities involving the misuse of inside position, are covered by section 10 and Rule 10b-5 although not included within the narrow provisions of section 16(b).

Since the terms of section 16(a) require insiders to disclose any changes in their beneficial ownership of securities, it provides a means for bringing to light possible violations of section 9 and Rule 10b-5, as well as a "purchase and sale" within the scope of section 16(b). However, two other functions of the section 16(a) reports are equally important to the efficacious operations of the Exchange Act's scheme to banish investors' ignorance and upgrade the ethics of corporate managers. Its second function is to reveal information which may be used in evaluating the securities of the issuer.\textsuperscript{51} This is a pure disclosure device in which the conclusions to be drawn from the reports and the weight to be attached thereto are left to the judgment of the individual investor. The information contained in the reports may be used (1) as a guide to the insiders' current confidence or lack thereof in the company's fortunes or (2) to detect an evolving change in control in the company.\textsuperscript{52}

\textsuperscript{49}For an extensive discussion of manipulation see 3 Loss, \textit{op. cit. supra} note 10, at 1529-70. See also S. Rep. No. 1455, 73d Cong., 2d Sess. 30-66 (1934).


\textsuperscript{51}The House Committee explained: "This [disclosure] is to give investors an idea of the purchases and sales by insiders which may, in turn, indicate their private opinion as to the prospects of the Company." H. Rep. No. 1383, 73d Cong., 2d Sess. 24 (1934). See also Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15, at 6356 (1934).

\textsuperscript{52}See Chicago So. Shore & So. Bend R.R. v. Monon R.R., CCH Fed. Sec. L. Rep. § 91525 (N.D. Ill. 1965). Two substantially identical bills now pending before the Congress seek to require public disclosure of the name, background security holdings, and other information about persons before they acquire more than 5% of a class of registered equity security. The bills, S. 2731 introduced by Senator Williams of New
doubtedly this investment information function of the section largely explains why the Commission's monthly summary of transactions reported under section 16(a) has become a perennial best seller.\textsuperscript{58}

Finally, section 16(a) is itself a deterrent to the misuse of inside information through the publicity which attaches to the reports,\textsuperscript{54} apart from any other statutory prohibition or liability. This is a standard by-product or goal of any disclosure provision, since presumably people are likely to refrain from improper acts, or acts which may appear improper, if they know such acts will be exposed to public scrutiny.\textsuperscript{55}

Thus, if section 16(a) is to achieve its goals, "beneficial ownership" must be construed "not technically and restrictively, but flexibly to effectuate . . . [its] broad remedial purposes."\textsuperscript{56} Such a construction leads to the conclusion that it is the enjoyment of the benefits of security ownership, rather than the rights to such benefits, which is the appropriate standard for construing the term "beneficial ownership" as used in section 16(a). Accordingly, in computing whether a person is subject to the section as the beneficial owner of more than ten per cent of a class of registered equity security, the purposes of section 16(a) require the inclusion of any securities from which he obtains those benefits of ownership which enable him to achieve an inside position. And, to fully effectuate the purposes of section 16(a), once a person is subject to it, either by reason of beneficial ownership or position as officer or director, he should also be regarded as beneficially owning any securities from which he obtains benefits of ownership which may

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Jersey, and H.R.14417 introduced by Congressman Staggers, would amend §§ 10 and 16 of the Exchange Act. For a discussion of the bills and the SEC's comments on them, see Address by SEC Chairman Manuel F. Cohen before the American Society of Corporate Secretaries, June 28, 1966.

\textsuperscript{58} At the end of 1965, approximately 26,000 persons subscribed to the "Official Summary of Securities Transactions and Holdings," which lists changes in beneficial ownership reported to the Commission. This monthly publication can be ordered, for a nominal charge, from the Superintendent of Documents, Government Printing Office, Washington, D. C. 20402.

\textsuperscript{54} The House Committee explained: "It is hoped . . . that the publicity features of the bill will tend to bring these practices into disrepute and encourage the voluntary maintenance of proper fiduciary standards by those in control of large corporate enterprises . . . ." H. REP. No. 1383, 73d Cong., 2d Sess. 13 (1934).

\textsuperscript{55} In a sense, disclosure under § 16(a) is designed to reach those "wrongs" which cannot practicably be outlawed. Instead, publicity exposes insider's transactions to the ethical and moral sanctions of Society — the "Law beyond the Law" — discussed by Chief Justice Earl Warren in an address at the Louis Marshall Award Dinner of The Jewish Theological Seminary of America, November 11, 1962.

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provide either the incentive for, or lend themselves to, any of the abuses of inside position that the Exchange Act was designed to prevent.

The remainder of this Article will consider the specific situations giving rise to questions concerning beneficial ownership for purposes of section 16(a). The bulk of these problems arise from either of two factual circumstances: The first is where the securities are held of record by a person other than the insider; the second is where the insider himself is the record owner. The resolution of who is the beneficial owner of the securities in these cases requires an analysis of what benefits a person receives from securities, how these benefits are obtained, and the extent to which the receipt of such benefits brings the securities within the letter and spirit of the section.

II. BENEFICIAL OWNERSHIP OF SECURITIES HELD BY FAMILY MEMBERS

The Commission recently published an interpretative release\(^5\) setting forth the general test for determining beneficial ownership of securities held of record by another person:

A person ... may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership. Accordingly, where such benefits are present such securities should be reported as being beneficially owned by the reporting person.\(^6\)

The release was principally concerned with identifying the benefits of ownership arising out of the family relationship. On the specific question of securities held by a person's wife and minor children the release stated:

Generally a person is regarded as the beneficial owner of securities held in the name of his or her spouse and their minor children. Absent special circumstances such relationship ordinarily results in such person obtaining benefits substantially equivalent to those of ownership, e.g., application of the income derived from such securities to maintain a common home, to meet expenses which such person otherwise would meet from other sources, or the ability to


\(^6\) Ibid.
exercise a controlling influence over the purchase, sale, or voting of such securities. Accordingly, a person ordinarily should include in his reports filed pursuant to Section 16(a) securities held in the name of a spouse or minor children as being beneficially owned by him.  

Where securities are held by family members other than a spouse or minor child, the Commission, immediately after setting forth the general test, said:

[T]he fact that the person is a relative or relative of a spouse and sharing the same home as the reporting person may in itself indicate that the reporting person would obtain benefits substantially equivalent to those of ownership from securities held in the name of such relative. Thus, absent countervailing facts, it is expected that securities held by relatives who share the same home as the reporting person will be reported as being beneficially owned by such person.

Clearly, the Commission's position concerning an insider's section 16(a) beneficial ownership of securities held by his spouse and minor children, is necessary if the section is to be given meaning in this context. The practice of placing property in the name of a spouse is a time-honored method of evading a variety of legal obligations. The release, however, is not directed solely towards such obtuse and highly unoriginal maneuvers, which obviously must be defeated if the section is not to become a complete mockery, but also it recognizes and reaches the more subtle, but equally important community of interest which normally exists among family members with respect to property management. The existence of such

59 Ibid.
60 Ibid.
61 Thus, the Release touches upon the practice of insiders in giving advance information to their families. The necessity of curtailling the practice of insiders' releasing news to a favored few, in advance of the public, was recognized by the Congress and the drafters of the Exchange Act. The original draft of the act dealt with the "tip" problem by a provision which prohibited an insider from either using or giving information.
S. 2693, 73d Cong., 2d Sess. § 15 (b) (3) (1934). Although the provision was not enacted, Congress made clear that no implication should be drawn from the omission that it was no longer concerned with the giving of inside information. Indeed, when the House Committee on Interstate and Foreign Commerce reported out H.R. 9323, which omitted the "tip" provision, it explained:
The bill legislates specifically just as far as the Committee feels it can. The original bill submitted to the Committee dealt very specifically and definitely with a number of admitted abuses. In many cases, however, the argument was made that while the solutions offered might be correct, their effects were so far-reaching as to make it inadvisable to put these solutions in the form of statutory enactments that could not be changed in case of need without Congressional action. Representatives of the stock exchanges constantly urged a greater degree of flexibility in the statute and insisted that the complicated nature of the problems justified leaving much greater latitude of discretion.
community of interest in securities held by family members for securities acts purposes was treated more fully in the Commission's opinion in *J. P. Morgan & Co.*,\(^6^2\) where the following argument was made to show that securities held by one adult member of the family are of no pecuniary interest to another adult member of the family:

To say that this pecuniary interest rests in the 'families' of these Directors has no significance whatever. These families consist of several separate independent adult individuals,—all of them 'free, white and twenty one'—and those persons who now own Preferred Stock of Morgan Stanley & Co. Incorporated have the outright, unfettered, unconditional ownership of that stock. Their pecuniary interest is their own. It is not the pecuniary interest of any other member of the family in any instance.\(^6^3\)

The Commission responded to this argument saying:

It is true, of course, that the holders of the underwriter's preferred stock are of full age and, we assume, are not dominated against their own interests by members of their families who are directors and officers of the trust company. But is it true that their pecuniary interests are not those of any other members of their families? For example, it will be noted that the wife of Thomas W. Lamont has an investment of $250,000 in the preferred stock of the underwriter, currently yielding dividends of $10,000 per year. Is this of no pecuniary interest to her husband? Possibly not, but it may be presumed to be, at least in the absence of special circumstances not shown here. So also with the investments in preferred stock held by wives of other directors of the trust company.

For another example, nearly $200,000 par value of the stock yielding nearly $8,000 per year is held by Leffingwell's daughter.

with the administrative agencies than would otherwise be the case. It is for that reason that the bill in dealing with a number of difficult problems singles out these problems as matters appropriate to be subject to restrictive rules and regulations, but leaves to the administrative agencies the determination of the most appropriate form of rule or regulation to be enforced. In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in the administrative agency have been found practically essential, despite the desire of the Committee to limit the discretion of the administrative agencies so far as compatible with workable legislation. H.R. REP. No. 1383, 73d Cong., 2d Sess. 6-7 (1934). And when the Senate Committee on Banking and Currency reported out S. 3420, in which the same omission had been made, it discussed the abuse of inside information under the general heading of "Manipulative Practices," —the subject of § 10(b). S. REP. NO. 192, 73d Cong., 2d Sess. 7-9 (1934). Since § 16(a) speaks in terms of "direct or indirect" beneficial ownership, it seems clear that the section is broad enough to reach the recognized abuse of tipping where the insider either trades through another person or splits the profits with such person. See Hearing Before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15, at 6558 (1934).

\(^{62}\) 10 S.E.C. 119 (1941).

\(^{63}\) Id. at 147. (Emphasis in original.)
Leffingwell testified that he gave it to her, not only to divest himself of its ownership but also in order to capitalize an allowance he has been giving to her. He further testified that she had four children and needed the income. It may be true that a man is not generally responsible for the support of his grown daughter or his grandchildren, and it may be that if anything occurred to stop the income on that investment, Leffingwell could wash his hands of the whole matter and suffer no loss as a matter of law. But to say that his daughter's interest in that investment is of no pecuniary interest to him is to ignore realities. That is not the way the minds of human beings ordinarily function.64

Thus in Morgan the Commission recognized the pecuniary benefits which a person obtains from securities held by his family members. Two specific examples of pecuniary benefits were described in the release: First, "the application of the income derived from such securities to maintain a common home," which would, of course, be applicable to any relative sharing the same home as the insider, as well as his spouse and minor child. The second, which is not confined to relatives sharing the same home, refers to the financial relief gained by the insider when the income from securities held by family members is "used to meet expenses which such person would otherwise meet from other sources." This would cover both legal obligations, such as support or education, as well as social or moral obligations of the type shouldered by Leffingwell in the Morgan case in connection with the securities held by his adult daughter.65 Presumably, the presence of either of these pecuniary benefits which flow from the family relationship itself would be sufficient to constitute the insider the beneficial owner of securities held by other family members.

Quite obviously, however, the two pecuniary benefits described in the release illustrate rather than define the pecuniary interests which exist among family members, for common financial interests of families exist irrespective of the precise use of the proceeds of the family members' securities. The natural love and affection which produces this community of interest is in no way necessarily diminished either by the geographical distance between, or individual wealth, of such persons. Nor is the bond in any way weakened by the source from which the securities were acquired by another family member. The incentive and temptation provided by the family holdings to a person to gain and thereafter to abuse an in-

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64 Ibid.
65 If this were meant to cover only legal obligations, presumably the language would refer to expenses which such person is required to meet.
side position is manifest. The frequent appearance of family holdings in the descriptions of predatory activities uncovered in the investigations that preceded the adoption of the Exchange Act provides striking evidence of the unity of purpose and interest in things financial and the existence of "the ability to exercise a controlling influence over the purchase, sale or voting" of securities fostered by the family relationship. The inclusion of securities held of record by family members on the basis of such pecuniary benefits alone is consistent with the aim of Rule 10b-5 to eliminate a variety of abuses of inside position, including the giving of confidential news to a favored few before the public. Furthermore, it serves to reveal to public investors the full measure of confidence of the insider in the company.

The application of the benefits test in the context of determining beneficial ownership of securities held by other family members requires an examination of each situation. Not all family relationships are the same. It is fairly easy to conclude, for example, that the purposes of section 16, absent special circumstances such as a legal separation, require a person to include in his reports under section 16(a) all securities held by his spouse and minor children as being beneficially owned by him. It is not so easy, however, to establish an easy rule of thumb for determining whether securities held by an adult child, a brother or sister, or more distant relative should be included. The determination must be based on the relationship that exists and the opportunities and incentives it offers. The question is: Does the person obtain the benefits of ownership from the securities held by a particular relative which may provide him with either the ability or the incentive to engage in the abuses of inside position which the Exchange Act was designed to prevent? If they do, they should be included; if not, they need not be included. Apparently, in recognition of the difficulties in deciding close questions, the Commission in Release No. 7793 invited persons to write to it on questions of beneficial ownership to obtain opinions of its staff.

III. Beneficial Ownership of Securities Held by Non-Relatives

The reaping of pecuniary benefits from securities held by non-

66 See, e.g., S. REP. NO. 1455, 73d Cong., 2d Sess. 55-68 (1934). Indeed, a review of this history is evidence of the truth of a slight variation of the theme "The family that preys together, stays together."
relatives would similarly constitute the insider a beneficial owner irrespective of how these benefits arise. For it is not the route through which a person acquires the benefits of ownership which constitutes him the beneficial owner; it is the fact that such benefits repose in him. Certainly, it cannot be seriously contended that such benefits, when obtained "by reason of any contract, understanding, agreement or other arrangement" become any less "benefits substantially equivalent to ownership" than when obtained by reason of relationship, familial or otherwise. Although the existence of such a "contract, understanding, agreement or other arrangement" is a factual question, the actual reaping of pecuniary benefits, such as the sharing of trading profits or a guarantee against trading losses, would provide evidence that such an arrangement or understanding exists. Obviously, a person beneficially owns any securities held for him by a mere nominee. 67

The third "benefit" referred to in Release No. 7793 — "the ability to exercise a controlling influence over the purchase, sale, or voting of . . . securities — although a concomitant of the normal family relationship, is not limited to such relationship. This is obviously a description of three separate benefits of security ownership, none of which are dependent on the receipt of the pecuniary benefits of securities ownership. But, would the ability of A to exercise a controlling influence over either the purchase, sale, or voting of securities held by B require A to count those securities to determine whether he is subject to section 16(a)? A should include those securities over which he exercises a "controlling influence" to vote, 68 for this is the benefit of ownership used to secure the inside position upon which rest the various abuses which section 16(a) was designed to prevent. On the other hand, it is not necessary that A include those securities where his "controlling influence" extends only to the buying or selling in reckoning his status as a beneficial owner of more than ten per cent, for these benefits alone do not give him an inside position.

Once A achieves a section 16(a) inside position, however, (either as an officer, director, or through his beneficial ownership of securities), he should be regarded as the beneficial owner of any securities, the buying or selling of which he has either a practical or


68 The test is the ability to exercise a "controlling influence" over the vote; not the actual voting of shares by a revocable proxy. Of course a person holding an irrevocable proxy, or a trustee of a voting trust, would enjoy the requisite ability.
legal ability to control as well as those that he may vote. The inclusion of such securities in the insider's section 16(a) reports on the basis of the buy and sell ability alone is wholly consistent with those purposes of the section devoted to curtailing and revealing abuses of inside position and market manipulations, in addition to those aimed at revealing insider confidence, even though the insider receives no pecuniary benefits of ownership from the securities in question.

The only purpose of section 16(a) which might not be operative by reason of the absence of financial interest in such securities is disclosure of transactions subject to section 16(b). That is, if the insider obtained no financial benefit from those securities, he might not realize profits, susceptible to recapture under section 16(b), from buying and selling them. The inapplicability of section 16(b) — which by its terms is limited in scope — does not mean, however, that there has been no abuse of inside position or market manipulation in the transactions in such securities which would be contrary to the terms and intent of either or both section 9 and Rule 10b-5. Nor would the inapplicability of section 16(b) render the reports of insider transactions in such securities any less valuable as an aid to shareholders and investors in determining their own investment policies with respect to the company's securities.

The charitable organization, whether organized in corporate or trust form, supplies an excellent illustration. Suppose A is a section 16(a) insider by virtue of his position as chairman of the board of B & Co. He is also a director (or trustee) of the A Family Foundation, which complies with the tax law provisions so that A receives no income from the Foundation's activities. The Foundation owns a large block of B & Co.'s securities. If the Foundation sells all of its B & Co. holdings, is it not possible that it has done so pursuant to unfavorable news not known to the public concerning the future of B & Co.? And, even if such sale was not based upon any provable abuse of inside information, would it not be of interest to shareholders and investors to know of such sale as an indication of insider confidence? Similarly, assume A causes the Foundation to sell its B & Co. holdings with the result that the market price declines, and immediately thereafter A buys large amounts of the same B & Co. security. Has A violated the prohibitions of section 9 or of section 10(b)? Of course, additional data would be required to make the ultimate determination as to
whether these transactions run afoul of sections 9 and 10(b). But how can the existence of such possible violations be detected if the section 16(a) report reflects only the purchases of A for his individual account? Unless A, by virtue of his ability to control the buying and selling of the Foundation's holdings in B & Co., is regarded as the beneficial owner of such securities for section 16(a) purposes, the role that the section 16(a) reports were intended to play in investing corporate managers with fiduciary standards and effecting the anti-manipulative design of the act is wholly frustrated. The point is that an insider's ability to control the buying and selling of securities of his company supplies him with all that is necessary to manipulate and condition the market for his own ends. By no stretch of the imagination is this market advantage diminished by his inability to reap pecuniary gains from those securities. Moreover, unless the publicity deterrent of section 16(a) is allowed to operate with respect to these securities, there is nothing to prevent him from acting upon the obvious temptation to exercise his ability to buy and sell in a manner which conflicts with the standard required of him as a fiduciary, — "the punctilio of an honor the most sensitive" — with respect not only to the charitable organization, but also to the shareholders of his company.

After the publication of Release No. 7793, many persons were concerned about the effect the release would have on the profit recovery provisions of section 16(b). Section 16(b), however, is not concerned with the question of beneficial ownership. It is concerned with an entirely different question: the recovery of profits which the insider himself has realized from short swing trading. Indeed, there is nothing in section 16(b) requiring the insider to beneficially own the securities from which he profits. As the court noted in Marquette Cement Mfg. Co. v. Andreas, the reporting requirements under section 16(a) "have only slight significance in assessing insider liability under Section 16(b)."

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70 Although the Commission did not require persons to amend past reports on which they had not reported all securities they beneficially owned, it should be noted that the two year statute of limitations under § 16(b) may not begin to run until the transactions are reported. See Grossman v. Young, 72 F. Supp. 375 (S.D.N.Y. 1947). But cf. Carr-Consolidated Biscuit Co v. Moore, 125 F. Supp 423 (M.D.Pa. 1954); Fistel v. Christman, 13 F.R.D. 245 (W.D. Pa. 1952).
71 Blue v. Lehman, 368 U.S. 403 (1962).
73 Id. at 967.
course, where the insider does realize profits from trading in securities he beneficially owns, they will be recoverable under section 16(b).\textsuperscript{74}

IV. Beneficial Ownership of Securities Held in Trust

Record title of securities held in a trust is in the trustee. But where the trustee is an insider, is he also a beneficial owner of the trust securities? As previously noted,\textsuperscript{75} the insider-trustee's ability to buy and sell gives him sufficient benefits of ownership to justify treating him as a beneficial owner of those securities under section 16(a), even in the absence of any pecuniary interest in those securities. And, where the trustee enjoys the unfettered right to vote those securities, he has sufficient benefits to justify requiring him to include them in computing whether he is subject to the section.\textsuperscript{76}

The trust provides a clear affirmative answer to the question of whether the same securities are capable of being beneficially owned by more than one person. As the beneficiary of a trust is the person who receives the pecuniary benefits of ownership, he is a beneficial owner of the trust's securities, irrespective of the trustee's beneficial ownership of the same securities. For example, assume A is an officer of corporation X and is a trustee with power to buy and sell securities of X held in the trust. B, another officer of X, is a beneficiary of the trust. The trust holds 10,000 shares of X. By reason of his ability to buy and sell, A has sufficient benefits of ownership in the 10,000 shares to include them in his reports as beneficially owned by him. B, by reason of his rights to the pecuniary benefits, is also a beneficial owner of those 10,000 shares and accordingly he, too, should be required to include them in his reports. The fact that the trustee is someone other than an insider of X would not change the result as to B. The pecuniary benefits which devolve on him may affect his decisions as an insider\textsuperscript{77} and, therefore, shareholders should be informed of his full pecuniary in-


\textsuperscript{75} See text accompanying notes 68, 69 supra.

\textsuperscript{76} See Pappas v. Moss, CCH Fed. Sec. L. Rep. ¶ 91694 (D.N.J. 1966), where the court noted that a trustee of an employee profit sharing and retirement trust was the beneficial owner of the securities held by the trust.

\textsuperscript{77} The fact that an insider holds securities in trust may cause him to follow unwise dividend or other policies designed to enhance the market value of his securities.
The necessity of subjecting both trustees and beneficiaries of a trust to section 16(a) was long ago noted by the court in *Park & Tilford v. Schulte*: 78

"[T]here is nothing in the legislative history of the Act, or otherwise, to indicate an intent by Congress to permit trustees, as distinct from individuals in an inside position in a corporation, to capitalize on information not equally available to other stockholders or the investing public. Trustees, like individuals, occupy the same position in matters of this kind in the absence of some special exemption in the statute. Defendant's contention, if valid, would permit an easy avoidance of the Act. Stockholders of relatively large holdings could create trusts for their benefit, and thus avoid the liability imposed by the statute." 79

The Commission has adopted a rule which is not inconsistent with this position since it is only a partial treatment of the question of beneficial ownership of trust securities, and since it is confined to those situations where the insider has a clear pecuniary interest in the trust securities. Under SEC Exchange Act Rule 16a-8, 80 beneficial ownership of a trust's securities for the purpose of section 16(a) is deemed to flow from any of three relationships which a person has to a trust: (1) when the person is trustee, and either he or members of his immediate family have a vested interest in the income or corpus of the trust; (2) when the person owns a "vested beneficial interest" in a trust; and (3) where the person is a settlor of the trust who has the power to revoke without obtaining the consent of all the beneficiaries. 81 In determining whether a person is subject to section 16(a) as a more than ten per cent beneficial owner, the rule excludes the interest of a person in the remainder of a trust. 82 Exemptions from reporting under section 16(a) the beneficial ownership deemed by the rule are accorded to persons having a vested beneficial interest and to settlors having the power to revoke in two situations: (1) where the equity securities subject to section 16(a) comprise less than twenty per cent of the market value of all securities held in the trust; and (2) where the "ownership, acquisition, or disposition of such securities by the trust is made without prior approval of the settlor or beneficiary." 83

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79 Id. at p. 90845.
80 17 C.F.R. § 240.16a-8(a) (1)-(3) (rev. ed. 1964).
81 Ibid.
82 17 C.F.R. § 240.16a-8(f) (rev. ed. 1964).
83 17 C.F.R. § 240.16a-8(b) (rev. ed. 1964).
These provisions codified certain staff interpretations concerning the beneficial ownership of securities held in family trusts.\footnote{Although Rule 16a-8, 17 C.F.R. 240.16a-8 (g) (1)-(4) (rev. ed. 1964), was adopted primarily to deal with certain family trust situations, it also exempts a person from reporting his beneficial ownership of securities of his company which are held in the portfolio of "(1) Any holding company registered under the Public Utility Holding Company Act, (2) Any investment company registered under the Investment Company Act, (3) A pension or retirement plan holding securities of an issuer whose employees generally are the beneficiaries of the plan, (4) A business trust with over twenty-five beneficiaries." Presumably, however, exemption from reporting does not exempt a person from including such beneficially owned securities when computing whether he is subject to § 16(a) as the beneficial owner of more than 10%.} Notwithstanding the complexity of Rule 16a-8, it is not an exhaustive treatment of the subject, for it states the following: "Beneficial ownership of a security for the purpose of Section 16(a) shall include ..."\footnote{17 C.F.R. § 240.16a-8 (a) (rev. ed. 1964). (Emphasis added.)} Thus, a person having connections with a trust, other than those set forth in Rule 16a-8, which give him "benefits of ownership" in the trust's securities, would seem to have to include those securities as beneficially owned by him. For example, assume \( A \), an insider, is a settlor without power to revoke a trust, the beneficiaries of which are his minor children. \( Mrs. A \) is the trustee. Clearly, because \( A \) does not have one of the relationships to a trust covered by Rule 16a-8, does not mean that \( A \) has no further section 16(a) obligations with respect to those securities. For the "benefits of ownership" obtained through his wife and children give him the beneficial ownership of those securities. However, the Commission noted in Release No. 7793 that "to determine Section 16(a) obligations to report ... securities held in a trust ... the applicable provisions of the rules and regulations promulgated under Section 16 should be consulted."\footnote{SEC Exchange Act Release No. 7793, 2 CCH Fed. Sec. L. Rep. § 26031 (Jan. 19, 1966). (Emphasis added.)} Consequently, a person can rely on specific exemptions from reporting beneficial ownership under section 16(a) provided in the rules even though the exemptions seem inconsistent with the "benefits" test.

V. BENEFICIAL OWNERSHIP OF SECURITIES HELD BY PARTNERSHIPS

Who is a beneficial owner of securities held by a partnership? Clearly the partnership is. But what about the partners? Although the general test for determining beneficial ownership of securities
held by another person\(^{87}\) would seem to be equally applicable to determining a partner's beneficial ownership of the partnership's securities as elsewhere, in view of the Commission's practice of treating beneficial ownership of securities held by various entities separately, it may be assumed that the Commission did not intend to apply the "benefits" test to securities held by a partnership.

There is, of course, a whole body of law devoted to partners and partnerships. Generally, partnership law is concerned with two basic problems: (1) those concerning the relationship of the partners and the partnership among themselves, and (2) those concerning the relationship of the partners and the partnership with third persons. Apparently, the Commission's General Counsel in 1935 was guided by the rules of the first category in saying that securities held by a partnership are to be regarded as beneficially owned indirectly by each of the partners to the extent of his pro rata interest in the partnership.\(^{88}\) This, of course, is determined by the partnership agreement. Presumably, the focus here was on only the pecuniary benefits of security ownership. On this basis, each of the partners was required to count only that number of shares held by the partnership which represented his interest in the partnership profits with other securities he beneficially owned to determine whether he was a beneficial owner of more than ten per cent. Once a partner achieved a section 16 status, however, either by reason of his security holdings or as an officer or director, he could report either the total amount of securities held and traded by his partnership, or only his proportionate interest in them.

In 1952, following \textit{Rattner v. Lehman}\(^{89}\) (which held a partner-director liable under section 16(b) for only his proportionate share in the tainted short-swing profits realized by his partnership's trading in the corporation's securities) the Commission amended its reporting requirements to require a partner subject to section 16(a) to report all the securities held and traded by his partnership.\(^{90}\) The


\(^{89}\) 193 F.2d 564 (2d Cir. 1952).

partner could, in addition to reporting the full partnership holdings, indicate his proportionate interest in such amount. However, in the release announcing these changes the Commission did not indicate whether the new rule was to be followed by a partner in computing his status as a more than ten per cent beneficial owner.  

The 1952 amendment seems to represent a shift from that body of partnership law dealing with the relationship of partners and the partnership amongst themselves to that body of law devoted to the relationship of partners and the partnership with third persons. The law of partnerships has long recognized that a partner can obtain "benefits equivalent to those of ownership" from partnership property as to which his legal or equitable rights are questionable. In a sense, this is the result of the well established principle that a partner binds his partnership in all matters falling within the scope of the partnership business, irrespective of the terms of the partnership agreement. Consequently, since section 16 is devoted not to a partner's relationships with his other partners, but rather to the relationship that he has to third parties — namely, the corporation and its shareholders — this principle, in conjunction with the general "benefits" test, should be the guide in determining whether a partner is a beneficial owner, for purposes of section 16(a), of securities held by his partnership.

By reference to this standard, it is clear that each of the partners has "benefits substantially equivalent to those of ownership" in all the securities held by the partnership. He not only has the pecuniary benefits, but also has the complete ability to buy, sell, and vote all of them. Moreover, it should be recognized that his pecuniary interest in the partnership's securities is not limited by his interest in the partnership's profits, since a partner is regarded as the co-owner of an undivided interest in all partnership property.

The failure to consider each partner as the beneficial owner of all the securities held by the partnership for purposes of determining the jurisdictional application of section 16, in spite of his ability to purchase, sell, or vote all those securities, has the undesirable effect of allowing partners to use their partnership holdings to gain

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91 Ibid.
92 Ibid.
93 This principle, of course, is a matter of agency law.
94 See, e.g., LATTY, INTRODUCTION TO BUSINESS ASSOCIATIONS 523-27 (1951).
inside information while simultaneously freeing them to trade with virtual impunity in their individual accounts. For example, assume that A and B are equal partners in the A & B Partnership which holds twelve per cent of corporation X. While the A & B Partnership itself would be subject to section 16, because of its inside position, neither A nor B individually would be subject so long as the other securities which each beneficially owns when added to his proportionate interest in the A & B Partnership (six per cent) does not exceed ten per cent. Consequently, both A and B are left free to engage in their individual accounts in the full range of abuses made possible by their inside position. Hence, they could, on the basis of inside information, such as that dividends were to be cut, sell their individual holdings, and then once the news is made public, buy them back without incurring section 16(b) liability. This is, of course, precisely the type of evil which section 16 was designed to prevent. Clearly, the only way to prevent A and B from successfully perpetrating these abuses at the expense of the other shareholders of the company is to recognize that each of the partners receives sufficient “benefits substantially equivalent to those of ownership” from the partnership’s securities to constitute him the beneficial owner of all the partnership’s securities, both for the purpose of determining whether he is subject to section 16(a), as well as for the purpose of determining what securities must be reported once he is subject to the section.

95 An actual abuse of inside position would, of course, give rise to a cause of action to the injured party for his damages under SEC Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (rev. ed. 1964). But Rule 10b-5 is no substitute for § 16(b). As the Second Circuit has stated: “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... It's total effect would be to render the statute little more of an incentive to insiders to refrain from profiteering at the expense of the outside stockholder than are the common law rules of liability...” Smolowe v. Delendo Corp., 136 F.2d 231, 236 (2d Cir.), cert. denied, 320 U.S. 751 (1943). See also Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15, at 6557 (1934). Although “an inquiry into whether section 16(b) is penal or remedial seems bound to result in the conclusion that, like the Sherman Act, it is both” (Epstein v. Shindler, 200 F. Supp. 836, 837 (S.D.N.Y.1961), it should be noted that the injured shareholder may recover his damages while the corporation recovers short-swing trading profits under § 16 (b) for § 28 of the Exchange Act, 48 Stat. 903 (1934), 15 U.S.C. § 78bb (1964), which prohibits dual recovery under the act, does not protect against dual liability.

96 A partnership might also be required to file reports as a “director” of an issuer if the partnership “deputized” a partner to serve as a director of the issuer. See Rattner v. Lehman, 98 F. Supp. 1009 (S.D.N.Y. 1951), aff'd, 193 F.2d 564 (2d Cir. 1952); Blau v. Lehman, 173 F. Supp. 590 (S.D.N.Y. 1959), aff'd, 286 F.2d 786 (2d Cir. 1960), aff'd, 368 U.S. 403 (1962).
VI. BENEFICIAL OWNERSHIP OF SECURITIES HELD BY A CORPORATION

A corporation obviously beneficially owns any securities it holds of another company. Such securities are an asset of the corporation. But, is the corporation the sole beneficial owner of such securities, or may other persons also beneficially own such securities?

As previously noted, a person controlling the assets of a charitable organization should be regarded as the beneficial owner of all the securities held by the organization, despite his inability to obtain taxable income from those securities. For control of the corporation gives him the ability and incentive to manage the securities of the charitable organization for his own ends in a way which may conflict with the fiduciary obligation he owes to both the charitable organization and to the shareholders of the corporation of which he is an insider. Similarly, any person or persons controlling a noncharitable corporation holding securities of the issuer of which they are insiders should be regarded as beneficially owning all the securities held by that corporation.

Assume X is an insider of A Co. and that he controls B, Inc. B, Inc. owns securities of A Co. X should be regarded as the beneficial owner of all the A Co. securities held by B, Inc. As a controlling person of B, Inc., X is in a position to obtain the pecuniary benefits of ownership of the A Co. securities, for he can be certain that any such benefits arising out of B, Inc.'s holdings will flow through to him, e.g., by increasing his salary, bonus, or B, Inc.'s dividend. Moreover, X can control the purchase, sale, and voting of A Co.'s securities held by B, Inc. This gives him the ability and the incentive to use these shares for his own selfish interests. He could, for example, use them to manipulate the market, or, if X is not already an officer or director of A Co., he could use the vote to secure such position. Consequently, if X is in control of B, Inc., he is in a position to obtain the benefits of ownership of all securities of A Co. held by B, Inc. It is immaterial whether X's control of B, Inc. rests on his status as a stockholder or his position with the company, for the primary basis for his beneficial ownership of the A Co. securities comes not from the possible direct pecuniary bene-

97 See text accompanying notes 68, 69 supra.

98 Section 1(6) of The Securities Act, 1966, now pending before the Ontario, Canada legislature provides: "A person shall be deemed to own beneficially securities, including capital securities, beneficially owned by a company controlled by him or by an affiliate of such company, Bill 66, 27th Legislature, 4th Sess. Ontario, 14-15 Eliz. 2, 1966.
fits he may receive from those securities, but rather from his ability to control their purchase, sale, and voting for his own selfish ends.

Unless X is regarded as the beneficial owner of all of the \( A \) Co. securities held by \( B, \text{Inc.} \), he is in the same position to evade the Exchange Act by trading in his individual account while using the inside position of \( B, \text{Inc.} \) in the same way that an individual partner can use his partnership's inside position. That is, where \( B, \text{Inc.} \) owns more than ten per cent of \( A \) Co., unless X is regarded as the beneficial owner of all the \( A \) Co. securities held by \( B, \text{Inc.} \), he is free to use the inside information obtained through \( B, \text{Inc.} \) for his own benefit with virtual impunity.

The view that a controlling person of \( B, \text{Inc.} \) is the beneficial owner of all the securities of \( A \) Co. was set forth in Blau v. Mission. 99 In that case the court held that the Mission Corporation, which controlled the Mission Development Company (Mission owned sixty per cent of the outstanding voting stock of Development) was the beneficial owner of all the securities of Tide Water Associated Oil Company held by Development for purposes of determining whether Mission Corporation was the beneficial owner of more than ten per cent of Tide Water. The court stated the following: “There can be no doubt that Mission, by virtue of its absolute control of Development, was indirectly the owner of all Tide Water stock held by Development . . . .” 100

Although Mission had “absolute” control by virtue of its more than fifty per cent stock ownership, there is no reason to think that the result would have been different if Mission had actually controlled Development, but owned less than fifty per cent of Development. 101 Accordingly, a person enjoying actual control of a corporation, whether by corporate position, security holdings, or otherwise, should be regarded as the beneficial owner of all the securities held by the controlled corporation for section 16(a) purposes.

The only Commission statement concerning beneficial ownership of securities held through a corporation is in accord with the above insofar as it requires that a person be in control of a corporation before he is considered to beneficially own securities held by

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101 The term “control” is defined in SEC Exchange Act Rule 12b-2(f), 17 C.F.R. § 240.12b-2(f) (rev. ed. 1964) to mean “the possession directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”
that corporation. But it differs from the above with respect to the amount of securities such a controlling person is considered to beneficially own. This statement is found in Release No. 1965\(^2\) in which the Commission published the following opinion of its General Counsel:

In my opinion, no consideration need be given by the owner of stock in a holding company to the holdings of that company, except in a case where the holding merely provides a medium through which one person, or several persons in a small group, invest or trade in securities, and where such company has no other substantial business. In such a case, a person in control of the holding company who is an officer or director of the issuer of a listed equity security owned by the holding company, or whose interest in such security through the holding company (together with the amount of such security of which he is otherwise directly or indirectly the beneficial owner) aggregates more than ten percent of such security, should file a report in accordance with Rule 16a-1. . . . This report should include the holding company's ownership of such security, and transactions by it therein, to the extent of such person's interest. Such control might in fact be joint, and in such a case all persons sharing such control, regardless of whether one of such persons holds a majority of the voting stock of the holding company, would, to the extent of their respective interests, be under a similar duty to report in respect of securities owned by the holding company. The filing of reports by such controlling person or persons would not, in my opinion, relieve the holding company from itself filing reports pursuant to Rule 16a-1 if the holding company were the owner of more than ten per cent of the equity security in question.

The existence of other substantial business is merely of evidentiary value on the question of whether the corporation is actually used by one person or a small group as a medium for investing or trading in securities.\(^3\)

In 1961 this opinion was impliedly overruled by the Commission, at least in part, without explanation, when the instructions to the section 16(a) reporting forms were amended to require a reporting person to disclose all securities beneficially owned through a corporation, rather than his proportionate interest therein.\(^4\) He may still, in addition, indicate his proportionate interest in the total amount of securities held by the corporation based on his stock-

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Whether this revision of the instructions to the reporting form was meant to also change the method of computing percentage beneficial ownership for the jurisdictional purposes of section 16(a) is not clear. However, in view of the court's opinion in the Mission case, and the purpose of section 16(a), it seems that a person should include all securities held by a controlled corporation in computing whether he is subject to section 16(a), in addition to reporting all these securities once he is subject to the section.

VII. OPTIONS, WARRANTS AND OTHER RIGHTS

Any "right to subscribe to or purchase" an equity security is defined as an "equity security" in Exchange Act Section 3(a) (11). Therefore, a person who is subject to section 16(a) is required to report any acquisition or disposition of such equity securities of his issuer in his reports filed under section 16(a). This, however, does not answer the question of whether the holder of an option or other privilege or right to buy is a beneficial owner of the underlying securities. To resolve this question it is necessary to determine what benefits of ownership of the underlying securities repose in the option-holder.

Clearly, as the holder of an option to buy does not have title or possession of the underlying securities, he has no right to vote them, and he has no right to receive dividends on them. However, irrespective of any relationship to or understanding with the record owner of the underlying securities, which might give him benefits of ownership pertaining to the vote, the holder of an option to buy obtains valuable benefits of ownership from the underlying securities, merely by reason of the existence of the option. For once he has an unqualified right to exercise the option, he has the

105 At the time the Commission proposed to revise Forms 3 and 4 it also proposed to adopt a rule that a person did not need to file a report with respect to his indirect interest in a security held by any corporation or business trust unless (1) such indirect interest is evidenced by securities which are convertible into the securities held by the corporation or trust, or (2) he directly or indirectly beneficially owned more than 10% of the corporation or trust. See SEC Exchange Act Release No. 6435, Dec. 12, 1960. This proposal was subsequently withdrawn without explanation. SEC Exchange Act Release No. 6487, Mar. 9, 1961.


107 An option is a type of unilateral contract. 1 WILLISTON, CONTRACTS § 61a (3d ed. 1957) and authorities cited therein. Although there are various types of option instruments in the financial world, including warrants, contractual rights evidenced by convertible securities, "when issued" stock, puts, calls, strips and straddles, for ease of presentation, the term "option" or "right to buy" or "right to sell" includes all these types of contracts.
firm assurance that a fixed quantity of stock can be acquired or disposed of at a fixed price. On this basis he can make trading commitments with a minimum of financial risk. The speculative benefits of the underlying securities that accrue to an option-holder were noted by the court in Blau v. Ogsbury: \(^\text{108}\) "It matters not to the speculator who has title or possession or who can vote the stock or receive dividends. What he needs is firm assurance that a fixed quantity can be acquired or disposed of at a fixed price; and his commitments are on that basis." \(^\text{109}\)

Are these speculative advantages alone sufficient to constitute the option-holder the beneficial owner of the underlying securities? Or, is it necessary to wait until the exercise occurs at which time the option-holder obtains his traditional ownership rights in the securities? Once again it is necessary to resolve the question to effectuate the broad remedial purposes of the Exchange Act.

Reference to the legislative history and the abuses revealed by the investigations demonstrate that the speculative benefits alone are enough to constitute a person a beneficial owner of the securities underlying an option. The record is replete with examples of how options were used to further and effectuate many of the practices which were made the subjects of sections 9 and 10. \(^\text{110}\) So widespread was their use in connection with market manipulations that the Senate Banking and Currency Committee concluded that "many of the most flagrant abuses upon the stock exchange would not be possible without the aid of options." \(^\text{111}\) And so concerned was the Committee on Stock Exchange Regulation about the possible abuses inherent in options, it recommended that every issuer "report to the stock exchange within 48 hours after the granting thereof of any option given upon its stock." \(^\text{112}\) That this recommendation was not adopted does not mean that the congressional concern over regulating options subsided. Because of the considerable complexity of the transactions in which options were used and the great variety of forms of options in existence, the Congress determined to leave the general regulation of options to the Commission. In section 9,

\(^{108}\) 210 F.2d 426 (2d Cir. 1954).
\(^{109}\) Id. at 427.
\(^{111}\) S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).
\(^{112}\) Report to Secretary of Commerce of Committee on Stock Exchange Regulation attached to Letter from the President of the United States to the Chairman of the Senate Committee on Banking and Currency, Jan. 25, 1934.
which applies to "any person," it gave the Commission broad rule-making authority to deal with the option. The fact that insiders would be covered by provisions of the act addressed to "any person," however, did not persuade the Congress that special provisions were not needed to deal with the activities of insiders — hence, the existence of section 16.

That insiders' transactions in options were intended by Congress to be covered by section 16, in addition to the more general provisions of section 9, is evident from a comparison of the congressional view on "puts and calls" with the statutory definition of the terms "purchase" and "sale" and the use of such terms in section 16. The technical definition of a "put" is an option contract which gives the holder the right to sell securities; the technical definition of a "call" is an option contract which gives the holder the right to buy securities. The Senate Banking and Currency Committee, which was faced with the shocking evidence uncovered in the investigations, had little interest in the technical labels which might be attached to these devices. It was more concerned with the realities of the securities market and the role that such devices played in these markets. The Committee's focus was, quite properly, on what these devices actually meant in terms of the speculation and practices in the market place which were made possible through their use. Thus, it saw these devices in the following terms: "A 'put' is the privilege of delivering or not delivering the securities sold. A 'call' is the privilege of calling for or not calling for the securities [bought]."

To give meaning to this view Congress provided that the term "purchase" was to "include any contract to buy, purchase, or otherwise acquire" and that the term "sale" was to "include any contract to sell or otherwise dispose of." An application of these statutory definitions to puts and calls leads to the conclusion that the acquisition of a "call" is a "purchase," and that the acquisition of a "put" is a "sale," of the underlying securities. A "purchase" and a "sale"

113 The terms "put" and "call" have been somewhat more formally defined by the staff of the SEC: "A 'put' is a contract which gives the holder the right for a stated period of time to sell a specified number of shares of stock to the writer of the contract at a price per share which was fixed at the time when the option was bought. A 'call' is a similar contract which gives the holder the right to purchase the stock from the writer at a fixed price." SEC, DIVISION OF TRADING AND EXCHANGES, REPORT ON PUT AND CALL OPTIONS 7 (1961).

114 S. REP. No. 1455, 73d Cong., 2d Sess. 37 n.17 (1934).
which necessarily cause "changes in beneficial ownership" of the underlying securities are required to be reported under section 16(a), irrespective of whether a "put" or a "call" is regarded as an "equity security of the issuer." 115

Unless the statutory definitions of "purchase" and "sale" are so applied with respect to puts, calls, and similar option devices, the congressional objectives in creating a special section to deal with the activities of insider abuses is nullified with respect to the "most flagrant abuses" — those predicated upon the use of the option. Thus, to permit the deterrent and informational purposes of section 16(a) to operate in this highly significant area of insider activity, it is imperative to consider the holder of an option to buy as having acquired the beneficial ownership of the underlying securities, once he obtains the speculative benefits of those securities. The next question is: when are these speculative benefits secured?

As to all the various types of options and contracts to buy which exist in our complex financial and commercial world, it is the certainty of the right to buy and the resultant assurance to the option-holder that the underlying securities can be obtained at a price certain which permits him to engage in speculative activities with the underlying securities. It is this assurance that allows the speculator to trade against the option with a minimum of financial risk. The requisite certainly quite obviously exists where the questions of whether and when to exercise are fully within the optionee's discretion. Where the exercise of the option is subject to a contingency or condition beyond the control or discretion of the optionee, the speculation cannot occur. Presumably, a contract or option containing such a contingency or condition was the focus of SEC Exchange Act Release No. 116, the first of three different Commission positions which have bearing on this subject. In that Release the Commission "made public the substance of another opinion rendered by its General Counsel, regarding the time at which changes in ownership are considered to occur for the purpose of reports required of directors, officers and principal stockholders...

115 In Miller v. General Outdoor Advertising Co., 223 F. Supp. 790 (S.D.N.Y. 1963), the court granted defendant's motion for a summary judgment on the theory that a "put" and "call" issued by a third person are not equity securities of the issuer. The granting of the motion was reversed, 337 F.2d 944 (2d Cir. 1964). For a critical analysis of the lower court's opinion see, Michaely & Lee, Put and Call Options: Criteria for Applicability of Section 16(b) of the Securities Exchange Act of 1934, 40 Notre Dame Law. 239 (1965).
under Section 16(a) of the Securities Exchange Act." The opinion was as follows:

In my opinion an officer, director or stockholder is to be deemed to have acquired beneficial ownership of a security at the time when he takes a firm commitment for the purchase thereof, and to divest himself of such beneficial ownership at the time when he takes a firm commitment for the sale thereof. If it is necessary that certain conditions be satisfied prior to the consummation of the purchase or sale, and if it is uncertain whether such conditions will be satisfied, then it would appear that the officer, director or stockholder would not acquire beneficial ownership.

The Second Circuit cited Release No. 116 in Stella v. Graham-Paige, stating: "The date when a purchaser becomes a 'beneficial owner' is that on which he 'incurred an irrevocable liability to take and pay for the stock' when his 'rights and obligations became fixed.'" This case involved an action brought under section 16(b) of the act, in which it was alleged that Graham-Paige, as a more than ten per cent beneficial owner of Kaiser-Frazer stock, had realized substantial profits from a purchase and sale of such stock within a period of less than six months.

Graham-Paige had contracted with Kaiser-Frazer to acquire 750,000 shares of Kaiser-Frazer stock in return for assets and 3,000,000 dollars in cash. These 750,000 shares, when added to other shares beneficially owned by Graham-Paige would have made it a more than ten per cent beneficial owner of Kaiser-Frazer. Graham-Paige was to use its best efforts to borrow the money from a specific bank. The bank's obligation to loan the money to Graham-Paige, however, was conditioned on having guarantees of the loan from both Joseph W. Frazer, Graham-Paige's president, and the Henry J. Kaiser Company. But, if Graham-Paige were unable to obtain the loan it might elect to terminate the agreement with Kaiser-Frazer. Consequently, Graham-Paige had a right to acquire

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118 104 F. Supp. 957 (S.D.N.Y. 1952), aff'd as modified, 232 F.2d 299, (2d Cir.), cert. denied, 352 U.S. 831 (1956). In so stating the court erroneously relied on Blau v. Obsbury, 210 F.2d 426 (2d Cir. 1954) where this test was used to determine the date of a purchase under § 16(b).
119 Id. at 301.
120 The trial court had found that Graham-Paige had realized profits of $434,787.86 on the transaction in question. Stella v. Graham-Paige Motor Corp., 232 F.2d 299, 302 (2d Cir. 1956).
the stock of Kaiser-Frazer if it could obtain 3,000,000 dollars and an obligation to take and pay for the stock if the requisite guarantees to the bank loan were obtained.

The agreement was dated December 12, 1946. The guarantee was obtained and the contract performed on February 10, 1947. The court found that Graham-Paige sold 155,000 shares on or before August 8, 1947. The date the 750,000 shares were "purchased," however, was in question.

Section 3(a) (13) of the Exchange Act provides: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." Thus, under the statutory definition of purchase, the court could have found the purchase to have occurred on either December 12, 1946, the date the contract was entered into, or February 10, 1947, the date the guarantee was obtained and the contract performed. Faced with alternative dates, only one of which, February 10, 1947, would effectuate the purposes of section 16(b) the court chose that date rather than the date, December 12, 1946, which would have prevented the section from operating. This result is in accord with the choices made by the courts in section 16(b) cases when faced with two possible purchase or sale dates, only one of which falls within the time limits of the section. This practice was recently explained by the First Circuit in the case of Booth v. Varian Associates:

The question ... [is] one of balancing the respective advantages and disadvantages of each contended for 'purchase' date and determining which one, if held to be the date of purchase, would be more likely to lend itself to the abuses the statute was designed to protect against. ... In addition, since we are dealing with a remedial measure, it is important that we consider the probability of bringing the insider to task for his violation of the statute. If one date lends itself to the possibility of abuse as much as the other but, because of the statute of limitations attached to Section 16(b), it would be difficult, if not impossible, to gain recovery against an insider who 'purchased' on one of the contended for dates, then practical experience dictates that the purchase date within the recovery period should be selected as the one the statute was designed to include.


\footnote{334 F.2d 1 (1st Cir. 1964), cert. denied, 379 U.S. 961 (1965).}

\footnote{Booth v. Varian Associates, 334 F.2d 1, 4 (1st Cir. 1964), cert. denied, 379 U.S. 961 (1965).} Indeed the courts have tended to reject entirely the well known rule of statutory construction, cessante ratione legis, cessat et ipsa lex, in determining whether a transaction is a "purchase" or "sale" under § 16(b). If they find a transaction is within the purposes of § 16(b) a "purchase" and "sale" is deemed to have occurred. See, e.g., Park & Tilford v. Schulte, 160 F.2d 984 (2d Cir.), cert. denied, 332 U.S. 76
The *Graham-Paige* court, not surprisingly, found that the section 16(b) purchase occurred on February 10, 1947, within less than six months of the sale. It also found *Graham-Paige* achieved the status of a beneficial owner of more than ten per cent on the same day. Consequently, the court's determination of when beneficial ownership was acquired in this case was governed by the limited time period and purposes of section 16(b), rather than the purposes of section 16(a). Had there been a sale of securities within less than six months of the December 12, 1946 possible "purchase" date, but more than six months from the February 10, 1947 "purchase" date, it is likely that the court would have chosen December 12, 1946 as the day on which *Graham-Paige* "purchased" and became the beneficial owner of the underlying securities, to carry out the remedial purposes of section 16(b).

The court did not consider the possibility of separating the acquisition of beneficial ownership date from the section 16(b) purchase date, but rather assumed that the two had to coincide. However, as there is more than one possible "purchase" date for finding a matchable purchase and sale within the time limit of section 16(b), it follows that there is also more than one possible date at which beneficial ownership of the underlying securities can be acquired. As the determination of the date of a section 16(b) purchase is governed by the purposes of that section, so should the determination of the date of acquisition of beneficial ownership be governed by the purposes of section 16(a).

Clearly Congress thought that section 16(a) would disclose all transactions which might give rise to section 16(b) liability. Consequently, beneficial ownership under section 16(a) should be deemed to arise on the first of the possible dates on which a section

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124 The § 16(b) "sale" date was found to have occurred on the date the contract was entered into, the court rejecting the arguments that no sale could exist until various conditions to the performance were removed. Stella v. *Graham-Paige* Motors Corp., 132 F. Supp. 100 (S.D.N.Y. 1955). The Second Circuit’s acceptance of this "sale" date provides further evidence of its belief of the necessity of subjecting the *Graham-Paige* transaction to the section.
16(b) purchase may be found to have occurred. It is only in this way that the section 16(a) reports can disclose all transactions which may give rise to section 16(b) liability and disclose to public investors the insider's activities in the securities of his company. Thus, in *Graham-Paige* the court should have found (1) that Graham-Paige became the beneficial owner of the securities underlying its contract with Kaiser-Frazer on December 12, 1946 (when its right to buy these securities first came into existence) and (2) that the "purchase" of those securities, for the purpose of section 16(b), occurred on February 10, 1947 (the date when the condition to its being required to take and pay for the stock was removed). In this way it would have given effect to the purposes of both subsections (a) and (b) of section 16.

Because the Second Circuit dealt with "beneficial ownership" as if it were dependent upon the section 16(b) "purchase" it was forced to attempt to justify the result that a person does not become a section 16 "insider" until the "exercise of an option," on the theory "that one who holds an unexercised option is not usually in a position to obtain such [inside] information from the company." This conclusion ignores that a person who negotiates with the company or an insider to acquire the right to buy a large amount of stock has access to inside information. That such option holders do obtain inside information in the course of the option negotiations and thereafter abuse such information was amply demonstrated in the hearings. Indeed, unless the option and underlying securities are registered under the Securities Act of 1933 the purchaser must have access to material information, whether or not it is also available to the public. Otherwise, the transaction would violate

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125 In Blau v. Lamb, Civil No. 29940, 2d Cir. June 27, 1966, the court stated: When the convertible security is purchased, converted, and the underlying security sold, all within less than six months, we believe the entire profit resulting from the transaction is recoverable, either on the theory that the accrued profit on the preferred as well as the profit on the common has been realized, "within . . . [a] period of less than 6 months, for purposes of the statute, or else upon the theory that, under such circumstances, the purchase of a convertible preferred may be treated as a purchase of common stock, for the statute defines 'purchase' as including 'any contract to buy, purchase or otherwise acquire,' and the purchase of the convertible security includes a contractual right to acquire the conversion security.


127 See S. REP. No. 1455, 73d Cong., 2d Sess. 36-46 (1934).
section 5 of the Securities Act\textsuperscript{128} and SEC Exchange Act Rule 10b-5.\textsuperscript{129}

The informational purposes of section 16(a) would also be served by considering the option-holder as beneficial owner of the underlying securities. It is possible for the holder to obtain the continuing benefits of an inside position by reason of the constant threat which he holds over management that he will exercise his option and vote against them. Conversely, the holder of an option might not reveal his position to management, but rather keep it secret until he exercises and secures his rights to prevent present management from taking action which might frustrate his bid for control. Both situations, however, argue strongly for requiring the option-holder to count the underlying securities, so that when his beneficial ownership reaches the jurisdictional amount, both management and shareholders may be apprised of the possible change in control.\textsuperscript{130} Can the importance to shareholders and other investors of knowing as soon as possible that a well known corporate raider had acquired options to buy more than ten per cent be questioned? Of equal importance to the outside public in its attempt to evaluate the company and its prospects would be what changes occur in present management's beneficial ownership after it learns of the existence of the option. Consequently, a person should include the securities underlying an option or any other right to buy to compute his beneficial ownership for the purpose of determining if he is subject to section 16(a), as the beneficial owner of more than ten per cent of a class of registered equity security.

This conclusion is based on the assumption that the option-holder has a right to exercise his option which is not subject to a contingency beyond his control. Otherwise, he normally is not in a position to utilize the underlying securities in his speculative activities and consequently need not be considered the beneficial owner of the underlying securities for the jurisdictional purposes of section 16(a).\textsuperscript{131} Release No. 116 seems limited today to determining beneficial ownership in this context, for in all other respects


\textsuperscript{131}Cf. Silverman v. Landa, 306 F.2d 422 (2d Cir. 1962).
it is inconsistent with the SEC’s second and alternative test for determining beneficial ownership set forth this year in Release No. 7793:

A person also is regarded as the beneficial owner of securities held in the name of a spouse, minor children or other person, even though he does not obtain therefrom the aforementioned benefits of ownership, if he can vest or re vest title in himself at once, or at some future time.132

Once a person is subject to section 16(a), SEC Exchange Act Rule 16a-6133 requires him to report his transactions in options and other rights to buy or sell equity securities of his company, irrespective of any contingency on such rights. That rule provides:

The acquisition or disposition of any transferable option, put, call, spread or straddle shall be deemed such a change in the beneficial ownership of the security to which such privilege relates as to require the filing of a statement reflecting the acquisition or disposition of such privilege. Nothing in this paragraph, however, shall exempt any person from filing the statements required upon the exercise of such option, put, call, spread or straddle.134

Rule 16a-6 makes it clear that a person already subject to the section must also file a report on the exercise of an option. Thus two reports of “changes in beneficial ownership” are required as to the same securities. This answers the question of whether the statutory term "changes in beneficial ownership" includes both qualita-

133 17 C.F.R. § 240.16a-6 (rev. ed. 1964).
134 Ibid. A proposed amendment to this rule (SEC Exchange Act Release No. 7794, Jan. 20, 1966) would delete the word “transferable” and would exempt persons from reporting non-transferable options received under a plan meeting the requirements of SEC Exchange Act Rule 16b-3, 17 C.F.R. § 240.16b-3 (Supp. 1966), which exempts from § 16(b) the acquisition of an option (but not the acquisition of stock on the exercise of an option) pursuant to a qualified or restricted stock option plan or pursuant to an employee stock purchase plan, which meets the requirements of the Internal Revenue Code and is approved by shareholders as required by the rule. The proposed amendment would also require reporting, as a change in beneficial ownership under § 16(a), the pledge or hypothecation of a security, the release of a security from a pledge or hypothecation, the loan of a security, or the return of a loaned security. The qualitative change in beneficial ownership is presumably the basis for the reports for such transaction. The release does not state whether the party on the other side of the transaction may have a sufficient interest in the loaned, pledged, or hypothecated security to make him a beneficial owner of the security for the purposes of computing whether he is a beneficial owner of more than 10% of a class. It would seem that ordinarily he would not. But the terms of a particular pledge or loan might require a different result. See 2 Loss, op. cit. supra note 128, at 1108 n.275. Neither does the rule require the pledgee or borrower who is the reporting person to disclose a change in his beneficial ownership, although it seems clear the Commission could require this if it deemed it necessary.
tive and quantitative changes, since both reports could not be required because of quantitative changes.

The rule, however, does not indicate whether the first report on the acquisition of an option is required because the insider has had a qualitative change of beneficial ownership with respect to the securities of his issuer, or because he has had a quantitative change, by reason of acquiring the beneficial ownership of the underlying securities. Presumably, the first report is addressed to a quantitative change and the second to a qualitative change — for how can a person have a qualitative change in his beneficial ownership of securities unless he has first acquired beneficial ownership of them?

Since the first report is apparently required because the insider has effected a quantitative change in his beneficial ownership by acquiring the beneficial ownership of the securities underlying the option, it would follow that a person not already subject to section 16, on acquiring an option or other right to buy, would effect the same quantitative change in his beneficial ownership. Accordingly, by implication, the rule could be read to require a person to count the securities underlying the option (along with other securities he beneficially owns) to determine whether he is a beneficial owner of more than ten per cent. This result, of course, is not demanded by the literal language of the rule, although there is some indication in the releases proposing and adopting it that such a result was intended.135 On the other hand, a comparison of the language of Rule 16a-6 and SEC Exchange Act Rule 16a-8136 tends to support the conclusion that the Commission intended Rule 16a-6 to apply only to persons already subject to the section. The un-

135 Rule 16a-6, 17 C.F.R. § 240.16a-6 (rev. ed. 1964) was originally adopted as SEC Exchange Act Rule X-16A-1. In proposing the amendment to Rule X-16A-1 in SEC Exchange Act Release No. 4718 (June 18, 1952) the Commission stated:

Rule X-16A-1, at present, sets forth the persons who must report their holdings and the changes in their holdings of securities pursuant to Section 16. It designates the equity securities with respect to which reports are required and the type of information which should be included in the reports. However, no provision of the rule, at present, deals with options, puts, calls, or straddles.

The proposed rule seeks to remedy the omission by requiring holders of options, puts, calls, straddles, and other such privileges to file the reports required by Section 16(a). It has been suggested that complete disclosure of beneficial ownership and changes in such ownership of equity securities requires a disclosure of holdings and changes in the holdings of the options, puts, calls, and straddles which relate to those securities.

In adopting the rule in SEC Exchange Act Release No. 4754 (Sept. 19, 1952) the Commission stated simply: "The new rule X-16A-1 requires the holders of options, puts, calls, spreads and straddles to file the reports required by section 16(a)."

equivocal resolution of the problem in Rule 16a-8 which says "beneficial ownership of a security for the purpose of Section 16(a) shall include" makes it more likely than not that the Commission intended Rule 16a-6 to apply only to persons already subject to section 16. Notwithstanding the ambiguity of Rule 16a-6, in view of the purposes of section 16(a) indicated above, and the Commission's position in Release No. 7793, a person should include the securities underlying an option for the jurisdictional purposes of section 16(a).137

Sometimes record ownership of the securities underlying an option is in the company; sometimes in another person. Where the record ownership of the securities underlying an option is in the company regarding the option-holder as having acquired the beneficial ownership of the underlying securities at the time he acquires the option creates a problem in determining beneficial ownership of more than ten per cent of a class. For under SEC Exchange Act Rule 16a-2,138 percentage ownership is based on the amount of securities of a class outstanding which does not include securities held by or for the account of the issuer.

If the option-holder counts the securities underlying his option along with other securities he beneficially owns, and measures that against the securities then outstanding, the option holder may be subject to section 16(a) as the beneficial owner of more than ten per cent before he exercises an option, but not afterward, because

137 Because a person is regarded as the "beneficial owner" of a security for the purposes of § 16(a) of the Exchange Act, however, does not mean that he should be considered to "own" the security for purposes of the short sale prohibitions of § 16(c) or SEC Exchange Act Rule 3a-3, 17 C.F.R. § 240.3a-3 (rev. ed. 1964) defining the term "short sale," or SEC Exchange Act Rules 10a-1 and 10a-2, 17 C.F.R. § 240.10a-1, -2 (rev. ed. 1964) regulating short sales and covering purchases. In addition to the fact that the term "beneficial owner" has a different meaning than "owns" the purposes of § 16(a) are different than the purposes of regulating short sales, thus requiring an interpretation that will carry out the purposes of each respective provision. The meaning of the term "own" for the purposes of Rules 3b-3, 10a-1 and 10a-2 were described in a published opinion of a Commission Division Director. SEC Exchange Act Release No. 1571, 2 CCH Fed. Sec. L. REp. ¶¶ 22685-95 (Feb. 5, 1938) stated:

Ownership of Securities. A person is deemed to own a security if (1) he or his agent has title to it; or (2) he has purchased or has entered into an unconditional contract, binding on both parties, to purchase it but has not yet received it; or (3) he owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) he has an option to purchase or acquire it and has exercised such option; or (5) he has rights or warrants to subscribe to it and has exercised such right or warrants. He is not deemed to own a security if he owns securities convertible into or exchangeable for it but has not tendered such securities for conversion or exchange, or if he has an option or owns rights or warrants entitling him to such security, but has not exercised them.

of the increase in the number of outstanding securities which results from his exercise. The solution to this anomalous situation would be for the holder of the option to add the securities underlying his option to those then outstanding in computing his percentage ownership.

The foregoing discussion has concentrated on the beneficial ownership of securities of the person receiving an option to buy. It is necessary to also consider how granting the option affects the beneficial ownership of the person on the other side of the transaction. This situation provides still another example of how the same securities may be beneficially owned by more than one person. Where A, an officer beneficially owning twenty-four per cent of his issuer's securities gives B, who is neither an officer, director nor stockholder of the company, the right to buy one-half of his securities of the issuer, B's acquisition of the beneficial ownership of the underlying securities, which occurs upon the making of the agreement, does not cause A to lose his beneficial ownership of the securities at that time. Until the contract is performed, A retains the benefits of ownership in those securities which enable him to vote, and, since securities are fungible, to buy and sell them. Consequently, A's beneficial ownership would be reduced from twenty-four per cent to twelve per cent on the performance date, not the date the contract was entered into, nor the date he received B's notice of his intention to exercise. He would, however, have a qualitative change in beneficial ownership on entering into the contract with B.139

VIII. CONCLUSION

The hearings that preceded the adoption of the Securities Exchange Act of 1934 revealed that a variety of unfair activities were being perpetrated in the securities markets. To prevent these activities, Congress adopted in the act a combination of disclosure, anti-fraud, antimanipulative, and regulatory requirements designed to protect investors in the purchase and sale of securities. Because of the frequency and efficiency with which insiders engaged in these unfair activities, all of which were contrary to the fiduciary obligation they owed to their company's shareholders, Congress singled them out for special treatment in section 16 of the act.

139 SEC Exchange Act Rule 16a-6, 17 C.F.R. § 240.16a-6 (rev. ed. 1964) requires a reporting person to report the option as a change in beneficial ownership when the contract is entered into.
Subsections (b) and (c) of section 16 are designed with reference to two specific transactions of insiders — respectively, the short-swing transaction made profitable through an unfair use of inside information, and the short-sale. Section 16(a) is more general. By requiring disclosure of changes in beneficial ownership it is designed (1) to expose to the broad glare of publicity transactions which might be the subject of the general antifraud or antimanipulative provisions of the act, as well as the special provisions of subsections (b) and (c), and (2) to reveal to the public information which could be used in an evaluation of the security.

The use of the term "beneficial ownership" has given rise to notions that a person must have an equitable ownership interest in securities to be a beneficial owner. But the Congress was not concerned with the traditional concepts of property ownership — concepts which developed in the context of settling adverse claims to the same property. Such concepts are utterly foreign to the purposes of section 16(a). Section 16(a) is concerned with resolving questions of adverse interests. But the adversity arises out of the selfish interest of an insider which is incompatible with the faithful discharge of the fiduciary obligation which he owes to the outside shareholder. Application of the traditional concepts of property law does nothing to prevent the breach of this fiduciary obligation — the aim of section 16(a) and other provisions of the Exchange Act. Accordingly, they cannot be used to determine the scope of that remedial section. The words "beneficial ownership" themselves, the purposes of section 16(a), and the legislative history of the Exchange Act make clear that beneficial ownership is concerned with the benefits of ownership rather than the rights to ownership. To conclude otherwise is to assume that an insider must have equitable rights to effect inequitable acts.

To protect the outside shareholder from abuses, and to give him an opportunity to evaluate market transactions directed by insiders, beneficial ownership must be interpreted to reach all those securities which fall within these goals. Accordingly, "beneficial ownership" must be interpreted to include all securities as to which the insider enjoys the benefits of ownership that give him either the incentive or the ability to engage in transactions which may be inconsistent with his fiduciary position — irrespective of any equitable right in the securities. These benefits of ownership include the pecuniary benefits which provide the incentive; the "use" benefits of dealing with securities — that is, the power, legal or practical,
to purchase, sell, or vote them — which provide the ability; and the speculative benefits which allow him to profitably trade against securities which he has the right to buy at a price certain. These benefits may arise by reason of equitable ownership, or by reason of contract, understanding, relationship, agreement, or other arrangement.

The above test, which should be used to determine which securities must be reported by a person once he is subject to section 16(a), is more inclusive than the test which should be used to determine which securities are beneficially owned in order to bring a person within the insider provision of section 16(a) as a beneficial owner of more than ten per cent of a class of registered equity security. For this latter determination, the purpose of Congress to subject to section 16 persons who have the opportunity to abuse the advantages of an inside position must be considered. Accordingly, "beneficial ownership" for this purpose should be interpreted as including securities which enable a person to achieve the advantages of an inside position, for example, the ability, legal or practical, to direct the voting of securities, or the right to acquire and vote them.

The application of the foregoing tests of beneficial ownership requires an examination of the facts in each situation to determine whether a person does receive the benefits of ownership of securities which constitute him a beneficial owner for purposes of section 16. In some cases the answer is easy. In others, such as determining beneficial ownership of securities held by family members, it is not. In an area, however, where certainty is so desirable, yet flexibility so necessary, it is not easy to develop hard and fast rules that will cover every situation. Until these rules are developed, the purposes of section 16 and the Exchange Act as expressed in the statute and the legislative history serve as the best guide for determining the beneficial ownership of securities.

On the general problem of developing specific rules in securities regulation, see Cohen & Rabin, Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication in Their Development, 29 LAW & CONTEMP. PROB. 691 (1964).