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The Liability of Corporations and Partnerships Under Section 16(b) of the Securities Exchange Act of 1934

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THE LIABILITY OF CORPORATIONS AND PARTNERSHIPS UNDER SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934

Section 16(b) of the Securities Exchange Act of 1934[1] provides for corporate recovery of short-swing profits[2] of insiders (officers, directors or beneficial owners of more than 10 percent of any equity security) in the equity securities of their corporations. The section eschews all tests of manipulative intent and adopts an objective rule whereby transactions completed by insiders within the six-month holding period are conclusively presumed to have been motivated by the unfair use of inside information. A civil action to recover short-swing profits can be brought by the issuer[3] corporation or by any security holder of the corporation if his request to the issuer to bring such an action is not satisfied within sixty days. In the latter situation the action must be maintained on behalf of the issuer corporation and any recovery inures to the issuer corporation.

A difficult and recurring problem in the administration of section 16(b) is the interpretation of the word "director." Although directors of corporations are usually individuals representing their own interests, situations often arise where a corporation or partnership, owning substantial holdings in an issuer corporation, elects a person to represent its interests on the issuer corporation's board of directors. In this situation the question arises whether the corporation or partnership can be considered a director for the purposes of section 16(b) liability. Another problem is whether a corporation should be considered a director within the meaning of section 16(b) merely because one of

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1 Section 16(b) states:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

15 U.S.C. § 78p(b) (1964).

2 "Short-swing profits" are profits gained in a purchase and sale, or sale and purchase, of any equity security within a period of six months or less.

3 For the definition of an "issuer," see 15 U.S.C. § 78c(a)(8) (1964).

its officers or directors is sitting on another corporation's board of directors. A similar problem is presented in determining whether a partnership should be considered a director merely because one of its partners is sitting on a corporation's board of directors.

The purpose of this comment is to determine the present state of the law relative to these questions by examining the language and legislative history of section 16(b) and several cases which have interpreted the section. The legal ramifications of the decisional law will then be examined and possible judicial and regulatory solutions suggested. Finally, a statutory amendment to section 16(b) will be proposed which attempts to resolve these problems which, it is concluded, the courts have failed to solve.

I. The Legislative History of Section 16 (b)

Section 16(b) provides that

> any profit realized by [a director] from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . .[4]

Section 3(a)(7) of the Act defines a "director" as "any director of a corporation or any *person* performing similar functions with respect to any organization, whether incorporated or unincorporated."[5] (Emphasis added.) Section 3(a)(9) states that a corporation or partnership can be considered a "person."[6] Thus, it is possible that for purposes of section 16(b) liability a director can be either a corporation[7] or a partnership.[8] However, section 16(b) does not enumerate the particular circumstances in which corporations or partnerships will be considered directors. Thus it is necessary to examine the legislative history of the section to ascertain the extent and nature of congressional consideration of this question.

The purpose of section 16(b) is to curtail the use for purposes of stock manipulation of confidential information gained by a corporate officer or director by virtue of his position within a corporation.[9] The House and Senate hearings indicate that there was a strong feeling in Congress that the prevailing change in corporate structure from the closely-held company to the large, publicly-owned company had given too much freedom to corporate insiders in the exercise of their fiduciary duties.[10] This freedom it was believed, had been misused by these fiduciaries and, as a result, confidence in the stockmarket had been greatly weakened. In order to strengthen this confidence and to protect

4 See note 1 supra.

5 15 U.S.C. § 78c(7) (1964).

6 15 U.S.C. § 78c(9) (1964).

7 Feder v. Martin Marietta Corp., 286 F. Supp. 937, 941-42 (S.D.N.Y. 1968).

8 Blau v. Lehman, 368 U.S. 403, 409 (1962).

9 2 L. Loss, Securities Regulation 1041 (2d ed. 1961); see also S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).

10 See H. R. Rep. No. 1383, 73d Cong., 2d Sess. 2-5 (1934).

the public against flagrant abuse of the corporate insider's position, it was deemed necessary to enact legislation which would control the extent to which insiders could purchase and sell stock of their corporations.[11]

Congress therefore determined that section 16(b) should operate automatically in regard to the existence of liability.[12] Liability was not made to depend upon the propriety of the use of inside information or the existence of fraud. Any corporate insider making a profit on a short-swing transaction is required to return his profit to the issuer corporation regardless of whether he had access to inside information or made the sale on the basis of such information.[13]

Although Congress intended section 16(b) to operate automatically in determining the existence of a violation, it is unclear whether it intended the persons subject to liability to be determined according to an objective test, and if so, whether such a test automatically includes or excludes partnerships and corporations. Congress deleted a section of the Securities Exchange Bill which would have made liable "any person" using inside information received from a director to make a profit in a short-swing transaction.[14] This provision was never enacted because of the expected difficulties in administering it.[15] It has been argued that the rejection of this section indicates Congress intentionally omitted any provision dealing with the liability of partnerships,[16] and that this omission manifests the intent of Con-

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11 S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934).

12 Hearings on S. 84, 72d Cong., 2d Sess., and S. 56 and S. 97, Before the Senate Comm. on Banking & Currency 73d Cong., 1st & 2d Sess. 6557 (1934).

13 See Smolowe v. Delendo Corp., 136 F.2d 231, 235-36 (2d Cir. 1943).

14 This section provided in part:

> (b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per cent of any class of stock of any issuer, any security of which is registered on a national securities exchange—
>
> > (3) To disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not necessary or proper to be disclosed as part of his corporate duties. Any profit made by any person, to whom such unlawful disclosure shall have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties. . . .

S. 2693 and H. R. 7852, 73d Cong., 2d Sess. (1934).

15 See Blau v. Lehman, 368 U.S. 403, 412 n.12 (1962).

16 See Rattner v. Lehman, 193 F.2d 564, 566 (2d Cir. 1952).

Although this argument has not been made in any of the cases with respect to the liability of corporations under § 16(b), there is no logical reason why the argument could not have been made. The first case to consider corporate liability, Marquette Cement Mfg. Co. v. Andreas, 239 F. Supp. 962 (S.D.N.Y. 1965), was decided three years after the Supreme Court decided Blau v. Lehman. The Court recognized in that case that a corporation could, under the proper circumstances, be considered a "director" within the meaning of § 16(b). Thus, after *Blau* it was conceded by most authorities that partnerships and corporations were not exempted from § 16(b) liability. But see Brief for Appellee at 15, Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969).

gress that a partnership not be considered a "director" within the meaning of section 16(b). However, the assumptions underlying this position are of doubtful validity. For example, the transmission of inside information from a director-partner to a partnership is not a prerequisite for partnership liability under section 16(b), just as the transfer of inside information from a director-insider to a corporation is not necessary for corporate liability under 16(b). To assume necessity of transfer contradicts the very nature of 16(b) liability, which is that knowledge or use of inside information is irrelevant in determining liability.

A more reasonable explanation is that the deleted section was not a definition of the term "director"; it was an attempt to create another class of individuals ("tippees") who would also be subject to liability for engaging in short-swing transactions. It is submitted therefore that the deletion of this section manifests no congressional intent to limit the definition of the term "director."

II. The Cases Under Section 16(b)

A. *The* Rattner *Case*

The first case to consider the liability of a partnership under section 16(b) was *Rattner v. Lehman*.[17] Lehman Brothers (Lehman), an investment banking and securities partnership, purchased and sold in a short-swing transaction 5000 shares of Consolidated Vultee Corporation (Vultee) stock at a time when one of Lehman's partners, Hertz, was serving on the board of directors of Vultee. Lehman realized approximately $15,000 in profit on the transaction, but failed to tender its profit to Vultee.[18] A stockholder of Vultee brought an action on behalf of Vultee to recover the profits which Lehman had made on the transaction. The District Court for the Southern District of New York granted Lehman's motion to dismiss for failure to state a claim upon which relief could be granted.[19]

The court of appeals affirmed basing its holding upon the fact that section 16(b) does not expressly provide for an accounting of profits realized by partners of a director.[20] It is submitted that the result reached in *Rattner* is correct, although the court's reasoning is faulty. The pleadings and affidavits submitted by the parties in the district court failed to show that Hertz was deputed by Lehman to represent its interests on the Vultee board of directors. The parties also stipulated that Lehman's transactions in Vultee stock were made without Hertz's knowledge or acquiescence. There were no allegations by the plaintiff that Hertz had imparted any information regarding Vultee to his fellow Lehman partners.

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17 98 F. Supp. 1009 (S.D.N.Y. 1951), aff'd, 193 F.2d 564 (2d Cir. 1952).

18 Upon being informed of the transaction, Hertz, however, turned over his share of the partnership profits, $806.62, to Vultee. 98 F. Supp. at 1010.

19 Id. at 1011. Lehman's motion to dismiss the complaint was brought under Fed. R. Civ. P. 12(b)(6).

20 193 F.2d at 566.

The court of appeals also asserted that the legislative history of the statute clearly indicated that the omission of any provision dealing with the liability of a partnership was intentional.[21] This argument was also articulated in the district court, in which it was pointed out that earlier drafts of the statute, unlike section 16(b), made liable "any person" who made a profit in the issuer corporation's stock within six months after the disclosure of inside information by an insider of the issuer corporation.[22] Lack of a similar provision in section 16(b) was interpreted as indicating the intent of Congress to specifically exclude partnerships from the Act.[23]

In *Rattner* Judge Learned Hand concurred in the result, but expressed dissatisfaction with the reasoning of the majority opinion, and indicated that he wished

> to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally "directors"; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person.[24]

This statement by Judge Hand was the first acknowledgement that a partnership entity *could be* considered a director for the purposes of section 16(b).

B. *The* Blau *Case*

In *Blau v. Lehman*[25] the plaintiff, a stockholder of Tide Water Associated Oil Company (Tide Water), brought an action against Lehman Brothers (Lehman)[26] and Joseph A. Thomas, a partner of Lehman and a director of Tide Water. Lehman purchased and sold at a profit 50,000 shares of Tide Water within a six month period while Thomas was sitting on the Tide Water board of directors. The District Court for the Southern District of New York, after trial, dismissed the complaint against Lehman and asserted:

> The law is now well settled that the mere fact that a partner in Lehman Brothers was a director of Tide Water, at the time that Lehman Brothers had this short swing transaction in the stock of Tide Water, is not sufficient to make the partnership liable for the profits thereon . . . .[27]

The district court found that the Tide Water stock was bought and sold without the advice, concurrence, or knowledge of Thomas.

21 Id.

22 98 F. Supp. at 1010.

23 Id.; see p. 274 supra.

24 193 F.2d at 567.

25 173 F. Supp. 590 (S.D.N.Y. 1959), aff'd, 286 F.2d 786 (2d Cir. 1960), aff'd, 368 U.S. 403 (1962).

26 It should be noted that this is the same Lehman Brothers as in the *Rattner* case.

27 173 F. Supp. at 593.

The court also found that Lehman dealt in the Tide Water stock on the basis of public announcements by Tide Water and not on the basis of inside information from Thomas. Finally, the court found that Thomas' invitation to join the Tide Water board of directors was upon the initiative of Tide Water, not Lehman.

Although the court in *Blau* impliedly accepted the validity of the deputization theory, which was first articulated by Judge Hand in *Rattner,* the Second Circuit Court of Appeals in *Blau* impliedly rejected this theory. While affirming the decision of the district court, the majority stated:

> We do not agree with this [deputization theory], as we must take section 16(b) as we find it, and we do not see how any sort of deputizing can make the partners or the partnership a "director" within the meaning of Section 16(b).[28]

The court of appeals then claimed that the validity of the deputization theory was not at issue since the district court found no evidence that Lehman deputed Thomas to represent its interests on the Tide Water board of directors.[29]

The reasoning of the majority opinion in the court of appeals in *Blau* is subject to the same criticism as the reasoning of the district court and court of appeals in *Rattner.* The *Blau* court adopted the *Rattner* approach by relying heavily upon the fact that Congress deleted a section of the statute which would have made liable persons receiving inside information from a director. As stated earlier, the failure of Congress to enact this section is weak authority for the proposition that Congress intended to exempt partnerships from section 16(b) liability.[30] The *Blau* court felt that the *Rattner* decision was binding, "especially since it has been in force for some eight years and the Congress has not seen fit to amend the statute . . . ."[31] This reasoning is particularly disturbing in that it implies that congressional inaction necessarily indicates congressional acquiesence.[32]

Judge Clark, dissenting in *Blau,* suggested that *Rattner* should be overruled or at least reexamined.[33] He based his argument primarily upon a literal reading of the statute. He asserted that under New York partnership law, Thomas was co-owner with the other Lehman partners of the Tide Water stock, and that Lehman would be charged with the knowledge acquired by Thomas in performing his duties as a director with Tide Water.[34] This, he concluded, was sufficient to bring the Lehman transaction within the operation of the statute. It is questionable, however, whether the mere co-ownership of stock, com-

[28] 286 F.2d at 789.

[29] Id.

[30] See pp. 274-75 supra.

[31] 286 F.2d at 789.

[32] See, e.g., Girouard v. United States, 328 U.S. 61, 69 (1946).

[33] 286 F.2d at 794.

[34] Judge Clark referred specifically to N.Y. Partnership Law §§ 12, 23, 40, 43, 50-52 (McKinney 1948).

bined with the legal fiction that a partnership has constructive notice of its partners' dealings, should make a partnership a director and, hence, liable under section 16(b). New York partnership law does not state that a partnership is to be considered a director whenever one of its partners is a director. Furthermore, New York does not impute the knowledge of a single partner to the rest of the partners unless the matter relates to the partnership's affairs.[35] Thus, Thomas' knowledge of Tide Water's activities could be imputed to Lehman only if Thomas were acting on behalf of Lehman. Since the district court found that Thomas was not representing Lehman on the Tide Water board of directors, Thomas' knowledge could not, therefore, be imputed to Lehman.

Judge Clark also argued that the legislative history of section 16(b) indicated that the objective standard used to determine liability should also be used to ascertain the persons subject to such liability.[36] While it is clear that section 16(b) liability attaches whenever a director profits on a short-swing transaction in his corporation's stock, this use of an objective standard of proof is not conclusive as to whether Congress also wanted a partnership to be considered a director whenever one of its partners was a director.[37]

Although preferring the adoption of an objective standard for determining liability, Judge Clark maintained that even the use of a subjective standard would not exempt Lehman from liability:

> Here the evidence of director-participation . . . goes so far that it is hard to see what more the director could have done to assist his partners short of doing the trading himself.[38]

On certiorari the Supreme Court affirmed and held that the existence of deputization was an issue of fact,[39] and that the findings of the district court were not "clearly erroneous."[40] The Supreme Court, unlike the court of appeals, asserted that it would recognize the deputization theory under the proper circumstances. The Court rejected, however, the argument that a partnership should be considered a director within the meaning of section 16(b) merely because one of its partners was sitting on the board of directors of a corporation. Justice Black writing for the majority stated that neither sections 3(a)(9) and 3(a)(7) nor the strong public policy in favor of part-

[35] N.Y. Partnership Law § 23 (McKinney 1948).

[36] 286 F.2d at 794.

[37] Judge Clark also concluded that the exemption of a partnership from § 16(b) liability would provide a loophole which Congress certainly would not have desired. Id. at 795. This argument is an attack upon the statute itself and is not a sufficient reason for the judiciary to amend the language of the statute to reach what it considers to be an equitable result.

[38] Id. Judge Clark mentioned that Thomas, in his deposition, admitted that he had suggested to his partners that Tide Water was an "attractive investment" and that Tide Water's new management was very impressive. Id.

[39] 368 U.S. at 410.

[40] Id. at 408-09.

nership liability furnished a sufficient reason to interpret section 16(b) in such a manner.

Justice Douglas in a vigorous dissent argued that the ruling of the majority mutilated the Securities Exchange Act.[41] He asserted that "the scope and degree of liability arising out of fiduciary relations" should be strictly construed.[42] He further maintained that construing section 16(b) narrowly defeated the legislative intent. His argument implies that the deputization theory ignores the reality of the investment banking business, and that effectuation of congressional intent requires the adoption of an objective standard for determining the persons subject to section 16(b) liability.

The problem presented by Justice Douglas' approach is that it operates under the assumption that a partner on the board of directors of a corporation is always acting on behalf of a firm:

> Everyone knows that the investment banking-corporation alliances are consciously constructed so as to increase the profits of the bankers.[43]

This assumption, however, ignores other legitimate reasons why a partner might be sitting on a board of directors. He might, for example, have been sought by the corporation because of his financial and business expertise. The partner might also be on the board because of his individual stock holdings in the corporation. Adoption of the objective standard in these situations would, because of its over-inclusiveness, produce a rather harsh result.

After the Supreme Court decided *Blau v. Lehman*, it was apparent that the deputization theory could be utilized in the proper circumstances. However, the Court did not enumerate under what circumstances the theory was to be applied, but simply implied that the existence of deputization is an issue of fact to be determined on a case bv case basis.[44] Some of the factors considered by the Court were: (1) Who sought the services of Thomas on the board of directors of Tide Water? (2) Did Thomas provide Lehman with inside information, and did this "cause" Lehman to purchase or sell the Tide Water stock? and (3) Was Thomas aware of the fact that Lehman was transacting business in the Tide Water stock? However, it was firmly established in *Blau* that casual references to the quality and potential of a corporation are not sufficient, in and of themselves, to establish deputization.

C. *The* Feder *Case*

The first case giving in-depth consideration to corporate liability under section 16(b),[45] as opposed to partnership liability, was *Feder*

41 Id. at 415.

42 Id. at 416.

43 Id. at 415.

44 Id. at 410.

45 The first case that considered corporate liability under § 16(b) was Marquette Cement Mfg. Co. v. Andreas, 239 F. Supp. 962 (S.D.N.Y. 1965). There the issuer cor-

v. Martin Marietta Corp.[46] Plaintiff Feder was a shareholder of Sperry Rand Corporation (Sperry). Feder brought an action under section 16(b) against Martin Marietta Corporation (Martin), alleging that Martin was a director of Sperry for purposes of section 16(b) since Martin's president, Bunker, was actually sitting on Sperry's board of directors. While Bunker was a director on Sperry's board, Martin purchased 101,300 shares of Sperry stock which it later sold within a six-month period for a substantial profit. From the evidence presented the District Court for the Southern District of New York concluded that Martin was not a director of Sperry. It found that Martin had not deputed Bunker to represent its interests on the Sperry board of directors and that Martin, therefore, was not liable under section 16(b).[47]

The conclusion of the district court was based upon several fact determinations. First, Sperry originally invited Bunker to join its board of directors in the fall of 1962, a time when Martin held no Sperry stock. Bunker declined, but in February, 1963, Sperry once again extended an invitation. Bunker also rejected this invitation in spite of the fact that Martin at that time owned more than 400,000 shares of Sperry stock. The court determined that both of these invitations and rejections indicated that Bunker was not deputed by Martin. The court concluded that if Martin intended to obtain representation on the Sperry board, Bunker would have accepted the second invitation. The evidence also indicated that if Bunker rejected the Sperry directorship, no other Martin officer or director would have been considered for the position.

The court also noted the absence of evidence that Bunker disclosed any inside information about Sperry to Martin's other officers and directors. Although the passage of such inside information is not essential to liability under section 16(b), it would be probative of the fact that Martin deputed Bunker to represent its interests.

The court also found no affirmative action by Martin in placing Bunker on the Sperry board of directors. While the Martin board of directors did vote to allow Bunker to accept the Sperry directorship, this was done after Sperry made the offer to Bunker. Martin's ratification was considered to be merely a procedural matter required

poration, Marquette, brought an action against one of its directors, Andreas, and the corporation of which Andreas was a major shareholder. The defendant corporation engaged in a profitable short-swing transaction and Marquette alleged that the defendant corporation should be liable for such profits. Marquette claimed that the defendant corporation had deputized Andreas to represent its interests on the Marquette board of directors. The court recognized the validity of the deputization theory, but stated:

> Standing alone, the fact that a stockholder in a family corporation has engaged in a short-swing transaction from which the corporation has benefited, is insufficient to show an actual deputization.

Id. at 967.

[46] 286 F. Supp. 937 (S.D.N.Y. 1968), rev'd, 406 F.2d 260 (2d Cir. 1969), cert. denied, 38 U.S.L.W. 3263 (U.S. Jan. 19, 1970).

[47] 286 F. Supp. at 948.

by Martin's by laws. It appears that a director of Sperry testified that Sperry's interest in Bunker was based on Bunker's business reputation and financial expertise. The Sperry director also conceded that "rumors" of Martin's acquisition of Sperry stock made Bunker an even more desirable candidate. Sperry was apprehensive of a take-over by another corporation and believed Bunker's presence would add strength to the board.

The court also considered Bunker's testimony that his interest in the Sperry appointment was based upon the corporation's interesting operational and managerial problems. Finally, the court compared the control exercised by Martin over Bunker with the control Martin had exercised over deputies sitting on other boards of directors and concluded that Martin had relatively little control over Bunker's actions.

The Second Circuit Court of Appeals reversed and held that the finding of the district court that Bunker was not deputed by Martin to represent its interests on the Sperry board of directors was "clearly erroneous."[48] The court of appeals relied upon six facts which were deemed relatively unimportant by the district court. First, Bunker was ultimately responsible for all of Martin's investments. This meant that any stock transaction involving those investments had to receive his approval before it was made. Therefore, no disclosure of inside information by Bunker to Martin was necessary for such information to be used by Martin. This fact, the court concluded, made irrelevant the district court's finding that there was no evidence of inside information passing from Bunker to Martin. Second, Bunker admitted in his letter of resignation to Sperry's board of directors, that he represented Martin's interests while serving on the Sperry board. Martin claimed that Bunker did this only to pacify the elderly Chairman of the Sperry board, who misunderstood Bunker's position on the board. The court found this unacceptable and stated that the logical inference of the letter was that Bunker had been representing Martin on the Sperry board. Third, Martin's board of directors approved Bunker's directorship with Sperry prior to Bunker's acceptance of

[48] 406 F.2d at 263.

Another problem considered by the court of appeals in *Feder*, but not reached by the district court, related to the issue whether Martin, in order to be liable under § 16(b), must have been a "director" throughout the period of the short-swing transaction. While the profits sued for were from stocks purchased after Bunker became a member of Sperry's board, they were sold approximately one month after his resignation from the board. Martin alleged that since it was not a "director" both at the time of purchase and the time of sale, it could not be liable under § 16(b). Martin relied upon Rule X-16A-10 of the SEC, 17 C.F.R. § 240.16a-10 (1968), which states that any transaction exempted from the reporting requirements of § 16(a), is also exempt from the provisions of § 16(b). However, the court did not agree with Martin and held:

> Clearly, therefore, a "short-swing" sale or purchase by a resigning director must be a transaction "comprehended within the purpose of" § 16(b), and to the extent Rule X-16A-10 exempts such a transaction from 16(b) the Rule is invalid.

Id. at 268.

the directorship, and only after discovering Martin's strong financial position in Sperry stock. Fourth, Bunker testified that he had discussed Sperry's "short range outlook" with other Sperry directors, and that he had participated in meetings during which Martin's investments in Sperry stock were discussed. Fifth, an unsigned memorandum found in the Martin Marietta files entitled, "Notes on Exploratory Investment in Sperry Rand Corporation," was considered by the court as an indication that Martin was benefiting from Bunker's position with Sperry.

The final determination made by the court of appeals was that there existed a functional similarity between Bunker's position on the Sperry board of directors and other Martin deputies sitting on other boards of directors. Bunker's position could only be distinguished from the other deputies by a lesser degree of supervision and the lack of a duty to report to Martin concerning Sperry's affairs. The court felt that this distinction was not sufficient to indicate that Bunker had not been deputized.

Although *Feder* is the first case in which a corporation was considered a director under section 16(b), it appears that the decision accords with the reasoning of the Supreme Court in *Blau* where the court recognized the validity of the deputization theory but did not apply it. In *Feder* the court of appeals correctly applied this theory, recognizing that *Feder* was factually distinguishable from *Blau*. Whereas in *Feder* the director, Bunker, was integrally involved in the investment policies of Martin, including the prior approval of the purchase and sale of the Sperry stock, in *Blau* the director, Thomas, did not participate in Lehman's investment decisions concerning the Tide Water stock. Thomas was even ignorant of the fact that Lehman anticipated a purchase of Tide Water stock. This distinction clearly justified application of the deputization theory.

From these cases a number of generalizations can be made concerning the liability of corporations and partnerships under section 16(b). The courts have rejected the use of an objective standard which would require a corporation or partnership to disgorge to the issuer corporation any short-swing profits whenever one of its officers, directors or partners was a director of the issuer corporation. The courts have instead utilized a subjective standard which requires examination of the facts in each case to determine if there has been a deputization by the corporate or partnership entity. This approach presents severe evidentiary problems for the plaintiff—a burden which is inconsistent with the remedial and objective nature of section 16(b). Moreover, although courts recognize the deputization theory, they have vet to fully articulate the circumstances in which it will be applied. Thus a potential plaintiff might be deterred from commencing a section 16(b) action against a corporation or partnership because of the inability to determine the type of evidence which must be presented.

III. Suggested Approaches for Establishing Section 16(b) Liability

It is suggested that to alleviate the difficult evidentiary problems of a plaintiff attempting to establish deputization, the court should raise a rebuttable presumption that a corporation or partnership is a director within the meaning of section 16(b) whenever one of its officers, directors or partners holds a position on the board of directors of an issuer corporation. The burden of persuasion should be shifted to the corporation or partnership to establish that it did not deputize the officer, director or partner. This procedure would lessen the burden on the plaintiff, although it would not necessarily apprise him of the nature or extent of the evidence which would be required if the presumption were rebutted by the corporation or partnership.

Another possible approach to the problem is for the SEC to promulgate regulations listing a number of proscribed activities for corporations or partnerships. These regulations should delineate situations where such corporations or partnerships would be considered directors for purposes of section 16(b) liability. The regulations should recognize the validity of the deputization theory and list situations in which the theory could be automatically applied. For example, one of the regulations might state that a corporation will be considered a director under section 16(b) if it formally designates or approves the apointment of one of its officers or directors to an issuer corporation's board of directors. This approach would eliminate much of the uncertainty which presently exists. It would have to be recognized, however, that corporations or partnerships could still create new types of relationships not listed in the regulations. In fact, the very uncertainty of the application of the deputization theory might actually deter corporations and partnerships from attempting to evade section 16(b) liability. In order to prevent corporations and partnerships from creating new relationships, the regulations should not only list a number of situations where the theory would automatically apply, but also state that the existence of deputization is not limited to those situations.

A final approach to the problem would be the enactment of a legislative amendment to section 16(b) which would read as follows:

> If a director, officer or employee of a corporation serves on another corporation's board of directors, the corporation will be considered a "director" for the purposes of this section. If a partner of a partnership serves on a corporation's board of directors, the partnership will be considered a "director" for the purposes of this section.

This approach would obviate the plaintiff's necessity of establishing the existence of deputization. Although this solution might lead to harsh consequences in certain situations, it would accord with the philosophy which led to the enactment of section 16(b). The amendment would be consistent with the original purpose of preventing misuse of inside information.[49] However, enactment of such an amendment would not completely eliminate the possibility of the misuse of inside information. A corporation could still authorize a person, other than one of its officers, directors or employees to represent its interests on another corporation's board of directors without incurring section 16(b) liability.[50] Therefore it still would be necessary to retain the deputization theory to curb other abuses which would not be alleviated by the amendment to section 16(b).

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[49] See note 9 supra.

[50] See, e.g., 2 L. Loss, Securities Regulation 33 (Supp. 1962).