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Securities—Issuance of "Put" and "Call" Options—Availability of Section 16(b) of the Securities and Exchange Act of 1934.— Silverman v. Landa

Norman Jacobs

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certified checks have been removed from the embrace of the problems inherent in stop payments orders, and henceforth will be governed by the law of adverse claims.

TIMOTHY DALY

Securities—Issuance of "Put" and "Call" Options—Applicability of Section 16(b) of the Securities and Exchange Act of 1934.—*Silverman v. Landa*.[1]—Plaintiff shareholder, relying on sections 16(b) and 16(c) of the Securities and Exchange Act of 1934, commenced this action on behalf of his corporation,[2] against Alfons Landa, a director of the Fruehauf Trailer Company, to recover alleged insider short-swing profits. Landa had simultaneously issued a put and a call option on Freuhauf common stock. The call option was given for a premium, and entitled the optionee to buy from Landa, at any time within the following year, 500 shares at a predetermined price. The put, similarly issued for a retained premium, provided the bearer with the option of selling to Landa, at any time within the following year, 500 shares at the same predetermined price. The call options were allowed to lapse, whereas the put was subsequently exercised. The United States District Court for the Southern District of New York granted defendant's motion for summary judgment and was affirmed by the Court of Appeals for the Second Circuit. HELD: The matched sale of put and call options did not, in and of themselves, constitute a "purchase and sale" of the underlying security within the purview of section 16(b), and there having been no sale, section 16(c) could not have been violated.

Section 16(b) requires an "insider"[3] to account to his corporation for any trading profits made by him in any six month period from the purchase and sale or sale and purchase of the issuer's stock or similar security.[4] "Purchase" is elsewhere defined as including any "contract to buy, purchase or otherwise acquire,"[5] and "sale," as including any "contract to sell or otherwise dispose of,"[6] the corporation's securities. Section 16(c), in essence, prohibits "selling short" or, if the trader in fact owns the security, his failure to deliver it within twenty days of the sale.[7]

The court, faced with the novel question of the applicability of these statutory provisions to the issuance of a "straddle"[8] (*i.e.*, the simultaneous

[1] 306 F.2d 422 (2d Cir. 1962).

[2] The Securities and Exchange Act provides for a corporate cause of action, and if said corporation fails to take advantage of it or prosecute it diligently within a given period, any security owner can sue to recover on behalf of the corporation any profits made by the trader. 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958). See Lattin, The Law of Corporations 277 (1959); Cook & Feldman, Insider Trading Under the Securities and Exchange Act, 66 Harv. L. Rev. 385, 408 (1953).

[3] The statute specifically refers to any director, officer, or beneficial owner of more than 10% of any class of equity security registered on a national securities exchange.

[4] 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958).

[5] 48 Stat. 882 (1934), 15 U.S.C. § 78c(a) (13) (1958).

[6] 48 Stat. 882 (1934), 15 U.S.C. § 78c(a) (14) (1958).

[7] 48 Stat. 896 (1934), 15 U.S.C. § 78p(c) (1958).

[8] The context within which this decision was reached was clearly stated by the

issuing of a put and a call), treated the transaction as an irrevocable offer with no definable change in the beneficial ownership of the security. Thus, it would follow, the court suggested, that as both options were not exercised within the six month period, there could be no consummated bilateral contract of purchase and sale or sale and purchase.

The nature of these options was apparently early defined, although in a somewhat different context, in the case of *White v. Treat*,[9] wherein the court concluded that there had been no contract of sale when the option privilege was bought. Rather, when the optionee actually agreed to buy, by conforming to the prescribed manner of acceptance, a new contract—then first made—effected the sale. The decision in *Falco v. Donner Foundation Inc.*,[10] expressly stated that the running of the six month liability period in the act would commence only when the insider's rights and obligations became certain, and affirmed a position taken earlier, that the exercise of an option would be a "purchase" within the scope of section 16(b).[11] While it would appear that these decisions are conclusive on the question, it is essential to note that in these cases the insider is the optionee and not, as here, the issuer of the options. Thus, plaintiff is in effect asserting a dual standard of liability; namely, when the optionee is the insider, liability affixes when the option is exercised—this in accord with contract law—but when he is the writer of the option, the contract of purchase and sale is said to occur on the issuance of the option.

Plaintiff is perhaps forced into a seemingly inconsistent position because of a failure to more clearly distinguish the two methods of attack. If, on the one hand, contract law is applied, the insider's position under the facts of this case is one of an offeror who has received a consideration for his promise not to revoke.[12] However, the court concludes that this contract is not the basic bilateral executory contract of purchase and sale referred to in section 16(b),[13] an example of which would be the case wherein A and B agree presently to transfer securities six months and one day later. If, however, plaintiff's contention is that the court should not apply this strict contract terminology, because in her view it prevents the effectuation of the legislative intent and the spirit of the act—in short, that it would be

lower court: "No analogous case has been called to our attention and no regulation or rule has ever been issued by the Securities and Exchange Commission covering the same except its regulation requiring such transactions to be reported by insiders." Silverman v. Landa, 200 F. Supp. 193, 196 (S.D.N.Y. 1961).

9 100 Fed. 290 (2d Cir. 1900). A call was held not to be "an agreement to sell" and thus not subject to a stamp tax imposed by Section 25 of the War Revenue Act of 1898. The court concluded that use of the phrase "agreement to sell" was intended as a synonym for "sale" covering sales where payment and delivery are postponed to some future date. It was a question of statutory interpretation, and it was determined that in that context no tax was intended on agreements of sale which do not themselves effect or secure some transfer of the stock or security.

10 208 F.2d 600 (2d Cir. 1953).

11 Park & Tilford v. Schulte, 160 F.2d 984 (2d Cir.), cert. den., 332 U.S. 761 (1947); Accord, Stella v. Graham-Paige Motors Corp., 232 F.2d 299 (2d Cir. 1954).

12 Restatement, Contracts § 46 (1932); 1 Williston, Contracts 61A (3d ed. 1959).

13 Cf. White v. Treat, supra note 9.

preferable to apply two separate chronological standards of liability—it is conceivable that her position would be more readily understood.

It is indeed clear that the historical and legislative background of section 16(b) is one of an attempt to curb insider profit through speculation and short-swing trading in the stock of his company by removing any possibility of the retention of such profits.[14] It can be suggested that this transaction can and does lend itself to this type of speculation, and that, as held in the landmark case of *Smolowe v. Delendo Corp.*,[15] judicial interpretation should attempt to "squeeze all possible profits out of stock transactions, . . . to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director or stockholder, and the faithful performance of his duty."[16] Thus, when viewed in the framework of the legislative intent and the spirit of the act, these same considerations which led the court in *Blau v. Ogsbury*[17] to determine that the date of the exercise of the option is controlling in affixing liability when the insider is the purchaser, may require that the date of issuance is controlling when the insider is the optioner.

While it would appear that the court reached a technically defensible result, it seems equally obvious that this type of speculation is contemplated within the scope of the act. Conceivably, Landa could have suffered losses if either the put or call was separately exercised; his apparent avenue of profit lay in the failure to exercise either so that the retained premiums become profit. This in turn rested on the accuracy of his estimate that the market price of Fruehauf stock would remain relatively fixed in the coming year, for in the absence of rather significant fluctuations in price in one direction or the other, the attractiveness of exercising a put or call would be severely diminished.[18] The court, no doubt cognizant of the myriad of factors which affect the market performance of a security, was sceptical concerning the possibility of an insider "predicting," as it were, such a steady market course.[19] However, the court is far from convincing when it thus attempts to minimize the speculative opportunities available to the insider who issues a straddle,[20] implying that such actions are not properly within the purview of section 16(b). To be sure, future earnings and dividends, present contracts, short term liabilities and assets not reported on stockholder notices, and similar information to which Landa would, as a director, have ready access, are not the sole or even major determinant of market price. But, this phenomenon is equally operative in "predicting" bull or bear markets as well; the logical extension of this position would be to declare for unregulated speculation and return us to the situation existing before passage of the Securities and Exchange Act. Certainly the

[14] Sen. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). See, The Scope of "Purchase and Sale" Under Section 16(b) of the Securities and Exchange Act. 59 Yale L.J. 510, 513 (1950).

[15] 136 F.2d 231 (2d Cir.), cert. den., 320 U.S. 751 (1943).

[16] Id. at 239.

[17] 210 F.2d 426 (2d Cir. 1954).

[18] See Leffler, The Stock Market 353 (1951).

[19] 306 F.2d at 425.

[20] Ibid.

very dangers recognized as existing when the insider is the optionee are also present, although admittedly to a somewhat lesser degree, when he chooses to speculate through the writing of these options.

More substantial profits and less risk are perhaps attainable if the insider himself purchases and sells puts and calls, but he may well be subject to the restrictions of section 16(b),[21] which in the light of this decision, he avoids by the issuance of a straddle. In view of the present opinion, the essential thing about the act of exercising the option would seem to be not that the insider has committed himself and cannot withdraw, but rather the mere state of bilateral contractual certainty. It is unfortunate if, in reaching this result, the court was influenced by the contention that Landa had no control over the exercise of the option, and that "far from allowing an insider to indulge in the speculation proscribed by section 16(b), the issuance of a straddle places him in a strait-jacket."[22] Perhaps liability should not be contingent on the exercise of the option when the insider is the optionee and when, for speculative purposes, he has already made, so to speak, his last move by binding himself to a unilateral contract.

In conclusion, given the strict adherence to contract terminology by the court in interpreting the relevant provisions of the act, the Securities and Exchange Commission should adopt remedial regulations under the power given to it in section 9(b),[23] whereby the Commission has the power to adopt rules dealing with all aspects of the use of put and call options. As of this date, however, the Commission has not seen fit to exercise this power.[24] In the long view however, further acceptance of this rigid interpretation will not only severely hamper the effectiveness of the act, but may relegate the Commission to the more unsatisfactory alternative of retrospective response by administrative decree to each new and ingenious speculative scheme.

NORMAN JACOBS

Trade Regulations—Robinson-Patman Act—Justification of a Discount Based upon a Reduced Brokerage.—*Thomasville Chair Co. v. FTC.*[1]—The petitioner brought this action to set aside a cease and desist order of the respondent, the Federal Trade Commission. The order was issued to curb Thomasville's pricing schedule which granted a five per cent discount

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21 Comment, Put and Call Options Under Section 16(b) of the Securities and Exchange Act, 69 Yale L.J. 868, 894 (1960). It is therein suggested that it is "unlikely" that insider option writing will develop into a "widespread" problem. This is no doubt true because the successful issuance of puts and calls requires rather extensive holdings so as to allow the speculator to deal in averages and thus protect himself from any miscalculation. Nevertheless, the relatively smaller profits available to the insider-writer of the option, and even the infrequency of this manner of speculation, in no way requires the result reached in the *Landa* case.

22 Brief for Appellee, p. 13.

23 48 Stat. 889 (1934), 15 U.S.C. § 78i(b) (1958).

24 2 CCH Fed. Sec. L. Rep. ¶ 22,621 (1958).

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1 306 F.2d 541 (5th Cir. 1962).