



10-1975

Foremost-McKesson, Inc. v. Provident Securities Co.

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74-758

Provident Securities Co.
v. Forrest McKesson

(Same memo as
Forrest McKesson.)

There have been a couple of reply briefs filed. Nothing new claim not familiar with this area but I would be inclined to grant the whole case if you grant the initial part. Inclined to grant on 74-742

Grant 74-742 (as to which conflict exists) & deny others, or Grant entire case

A 16(b) case in which CAG held that a "purchase" for purpose of 16(b) does not occur unless at the time thereof the purchaser owned 10% of the issuers stock. CAG reasoned that one must be an "insider" (owner of 10%) at time of the "purchase" which is relevant.

DISCUSS

February 14, 1975 Conference List 3, Sheet 2

No. 74-758 (Cross-Appeals) PROVIDENT SECURITIES CO.

Conflict with CA 2 & CA 8

Cross-Petition for Cert to CA 9 (Ely, Trask, Wallace) Timely

FOREMOST-McKESSON, INC. Federal/Civil

See Preliminary Memo for No. 74-742.

1/27/75

Walters

JA

Conflict on basis. Inpt. issue. Prob. deny in 74-758. note of significance in cross-petn. J.L.

PRELIMINARY MEMO

February 14, 1975 Conference
List 3, Sheet 2

No. 74-742

FOREMOST-McKESSON, INC.

v.

Cert to CA 9
(Ely, Trask, Wallace)

Timely

PROVIDENT SECURITIES CO.

Federal/Civil

No. 74-758

PROVIDENT SECURITIES CO.

v.

Cross-Petition for Cert to
CA 9 (Ely, Trask, Wallace) Timely

FOREMOST-McKESSON, INC.

Federal/Civil

1. SUMMARY: Provident instituted an action in USDC N. D. Cal.,
seeking a declaration of non-liability under § 16(b) of the Securities and Exchange

Act of 1934, 15 U.S.C. § 78p(b), for a transaction involving its purchase and sale of Foremost's securities. Foremost counterclaimed for a declaration of liability and damages. The DC (Schnacke) granted Provident's motion for summary judgment and CA 9 affirmed on different grounds. (Ely, Trask, Wallace). Foremost seeks cert, contending that the CA's interpretation of when a person becomes a "statutory insider" under § 16(b) conflicts with decisions from CA 2 and CA 8. Provident has filed a conditional cross-petition in which it seeks to raise arguments regarding the particular transaction which were either rejected or ignored by CA 9.

2. FACTS: In 1968 Provident, a personal holding company, decided to liquidate and began seeking a purchaser for its assets. It entered into negotiations with Foremost and, although originally insisting that any sale should be for cash, finally agreed to accept a substantial amount of Foremost's convertible debentures and cash in exchange for two-thirds of its assets. In addition, Foremost agreed to promptly file a registration statement for the debentures, which were issued solely for purposes of this transaction, to permit Provident to offer them to the public. To accomplish that, arrangements were made for Provident to sell \$25,000,000 of the debentures, approximately one-half of what it would receive, to a group of underwriters.

The transaction unfolded as follows: On October 15, 1969 Foremost delivered a check and the debentures to Provident; the latter were immediately convertible into common stock in an amount ⁱⁿ excess of 10% of Foremost's outstanding shares. On October 20 Provident instructed its liquidating trustee to distribute the debentures which were not to be sold to its shareholders. On

*Provident
will sell its 2/3rd
assets to
Foremost
for debentures
recognition
of letter*

7.

October 21 Provident entered into a contract with the underwriters whereby it agreed to sell Foremost debentures having a face value of \$25,000,000 for \$25,366,666.66; the "time of purchase" was specified to be October 28, 1969. On October 24, 1969 the trustee actually distributed the remaining debentures to Provident's shareholders; at that point Provident no longer had a 10% ownership of Foremost. On October 28 the contract between Provident and the underwriters was performed by both parties. Thereafter Provident continued to liquidate according to California law, a process that was completed in August, 1970.

Provident then filed this action against Foremost seeking a declaration of nonliability under § 16(b), which permits the issuer of securities to recover short-swing profits (i. e., profits from a purchase and sale or sale and purchase of securities within a six-month period) from certain corporate insiders. The latter group includes persons who own "more than 10 per centum of any class of any equity security . . ." 15 U.S.C. § 78p(a). Foremost counterclaimed for a declaration of liability and recovery of profits, and both parties moved for summary judgment.

no speculation

The USDC N.D. Cal. (Schnacke) granted Provident's motion and denied Foremost's. It noted that Foremost did not contend that speculation was involved here and that Foremost had insisted upon, if not dictated, the form of the transaction. These facts, together with the small amount of profit realized by Provident, persuaded the DC that it should not engage in a "mindlessly literal" application of § 16(b).

CA 9 affirmed, but on different grounds. (Ely, Trask, Wallace).

At the outset, the CA observed that this Court has recently held that "potential for speculative abuse" must be shown in order to establish § 16(b) liability for "unorthodox" financial transactions. Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973). However, this was essentially a highly orthodox cash-for-stock deal, thus permitting strict liability to attach and, in any event, the facts that Provident entered the transaction voluntarily and could have acquired inside information during the protracted negotiations satisfied the Kern County test.

Next, the CA considered Provident's argument that it was not a 10% owner at the time of the October 28 sale because it had distributed half of the debentures to its shareholders on October 24. Thus, it contended, it was not liable under the following proviso to § 16(b):

This subsection shall not be construed to cover any transaction where such beneficial owner [i. e., of 10% of the shares] was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved.

. . .

However, the CA was of the view that the "sale" actually occurred on October 21 when Provident entered into a binding contract with the underwriters. The price was fixed at that time and, although there were some conditions to be fulfilled, none of them subjected Provident to market risks.

The CA then turned to the "purchase" aspect of the transaction. It noted that Provident had not owned 10% -- indeed any -- of Foremost's securities prior to October 15, and that it had not purchased any more securities between that date and the October 21 sale. Thus, under the above-quoted proviso,

*Sale
occurred
Oct 21*

Provident would be liable for its profit if the phrase "at the time of" were interpreted to mean "simultaneously with," but not if it were interpreted to mean "prior to."

The CA adopted the latter reading. It reasoned that § 16(b) was intended to reach only persons who do not intend to alter their investment in the corporation, but decide to capitalize on inside information and make a quick killing. Persons who own more than 10% of the corporation are presumed to have access to such information. However, the presumption does not apply to a person who does not own 10% at the time that he makes his decision to buy, so a purchase under those circumstances is not considered the first step in an illegal short-swing deal.

Key
view of
CA 9

CA 9 acknowledged that its interpretation conflicted with cases from CA 2, e.g., Stella v. Graham-Paige Motors Corp., 232 F.2d 299 (2d Cir. 1956), aff'g 104 F.Supp. 957 (S.D.N.Y. 1952), cert. denied, 352 U.S. 831 (1956), and CA 8, e.g., Emerson Electric Co. v. Reliance Electric Co., 434 F.2d 918 (8th Cir. 1970), aff'd on other grounds, 404 U.S. 418 (1972), but believed that it was supported by the legislative history of § 16(b) and language used by this Court in Kern County. Finally, it observed that a person who owns more than 10%, sells below 10%, and then purchases above that amount might very well have been acting on information gained as a result of his original position as a statutory insider, so that its holding in this case would not apply to a sale/purchase.

Foremost seeks cert in No. 74-742, pointing to the conflict and arguing that CA 2 and CA 8 are correct. Provident responds that CA 9 is right and

expresses confidence that CAs 2 and 8 will agree the next time they consider the matter.

Provident has filed a conditional cross-petition, No. 74-758, in which it argues that its transaction with Foremost was a merger which is "unorthodox" under Kern County, and that there was no potential for abuse here. It also points to a clause in its contract with the underwriters which it says placed the risk of a decline in market price on it, so that the date of the sale was really October 28. Finally, it contends that it was merely an agent for its shareholders so the debentures should have been considered their property and that, for the same reason, its sale of assets was exempt from § 16(b) under SEC Rule 16a-4, 17 C.F.R. § 240.16a-4. Provident admits that none of these questions ^{is} important, but argues that the Court should take the whole case or not take it at all.

Foremost agrees that these arguments are unimportant and asserts that CA 9 properly rejected them. With respect to the last of Provident's contentions, Foremost points out that the liquidation proceedings continued for another 10 months after this transaction was completed and under California law they could have been revoked either by a vote of the shareholders or the court. Thus, the notion that Provident was merely an intermediary for its shareholders is a fiction.

3. ISSUES: No. 74-742: (a) Does the transaction by which a person first acquires more than 10% of a corporation's securities count as a "purchase" for purposes of applying § 16(b)?

No. 74-758: (b) Was Foremost required to show "potential for abuse" in order to establish Provident's liability under § 16(b) and, if so, did such potential exist? (c) Did the "sale" of debentures to the underwriters occur on October 21 or October 28? (d) Was Provident the beneficial owner of the debentures or was it merely an agent for its shareholders?

4. DISCUSSION: It is undisputed that there is a direct conflict among the Circuits on Issue (a) and the question would seem to be of sufficient importance to require resolution by this Court. On the merits, the legislative history cited by CA 9 does not compel its conclusion but there is a certain logic to its position. For example, if Congress did not intend that both the purchase and sale be influenced by inside information the six-month time period would seem to be superfluous. On the other hand, the critical phrase modifies "sale and purchase" as well as "purchase and sale" and CA 9 admits that it would have to read it differently in the former situation. It also may be that a person who is attempting to acquire stock sufficient to give him more than 10% ownership could obtain inside information during the negotiations, as CA 9 seemed to acknowledge in its discussion of the Kern County issue. In short, Issue (a) is substantial, a conflict exists, and review is warranted.

2
True
CA 9 does appear to have resolved the issues presented by the cross-petition correctly. With respect to the "orthodoxy" of the transaction, this was certainly not a merger. Provident sold only 2/3 of its assets, retained its liabilities, and remained in existence for a considerable period of time after the transfer was completed. Similarly, the Securities Exchange Act defines "sale" to include "any contract to sell . . ." 15 U.S.C. § 78(c)(14). Thus,

even if the October 21 contract might have been terminated in the event of a significant decline in the value of Foremost stock, CA 9's conclusion that the sale occurred on that date is not unreasonable. Moreover, Provident's board of directors was aware of possible § 16(b) problems so it is probably no accident that the contract's "time of purchase" was after the distribution of some debentures to Provident's shareholders.

Finally, it should be noted that denial of the cross-petition would not necessarily preclude Provident from advancing the arguments rejected by CA 9, see Stelos Co. v. Hosiery Motor-Mend Corp., 295 U.S. 237 (1935), and it has suggested that it will do just that. See Cross-Petn at 2 n. 1. Thus, if the Court does not wish to consider Issues (b)-(d) it should grant the petition in No. 74-742 limited to Issue (a).

There are responses in both cases.

Walters

CA 9 and DC ops in
both petns

1/27/75

JA

LFP/vsl
July 7, 1975

No. 74-742, Foremost-McKesson, Inc. vs. Provident
Securities Company.

The purpose of this brief memo, dictated during the summer, is to aid my memory as to the issues presented, and to record my quite tentative reaction after a preliminary reading of the opinions and briefs.

* * * * *

We took this case to resolve a conflict among circuits as to an issue under Section 16(b) of the Securities Act of 1934. The facts are complex, and I will merely sketch them. Provident was a personal holding company of the wealthy Crocker family in California. It decided to liquidate and distribute its assets, and entered into negotiations with Foremost-McKesson (Foremost) for the sale of most of its assets. From the outset, Provident, desiring to liquidate by distributing cash to its stockholders, sought a cash transaction. In the end, however, Foremost insisted upon purchasing the assets by issuing and delivering to Provident

convertible debentures, plus a relatively small amount of cash. Although Provident wanted Foremost to sell the debentures itself and make payment in cash, the eventual compromise agreement provided that substantially simultaneously with the closing, Foremost would register the debentures so they could be sold immediately by Provident for cash -- which in turn could be distributed to its stockholders.

The closing occurred on October 15, 1969, at which Foremost delivered a check and the debentures to Provident. Prior to acquisition of the debentures, Provident had no legal or beneficial ownership in any security of Foremost. The debentures created a debtor/creditor relationship; they carried no voting rights; and none of the debentures was converted by Provident.

Provident had entered into an underwriting agreement with Dillion, Reed, pursuant to which the underwriters purchased the debentures (at a profit to Provident of about \$366,000). The underwriting agreement was closed on October 28, when Provident delivered the debentures to the underwriters and received payment in cash -- which was distributed in due time

in the liquidation of Provident.

The question is whether the approximately \$366,000 of "profit" (the difference between the base value at which Provident received the debentures and the price at which they were sold to the underwriters) is a profit which must be paid over to the issuing company (Foremost) under 16(b).

District Court Decision

The district court decided the case before our decision in Kern County. Following decisions in CA9, CA8, and CA2, the district court held that 16(b) should be applied in light of the evils intended to be prevented.

The DC said:

Foremost contends for a starkly literal reading of Section 16(b), which would make Provident, by virtue of its short-lived position as holder of the convertible debentures of Foremost, accountable to it as provided in 16(b) for the relatively small profit resulting from the underwriting described above, without regard to the overall character of the transaction and its ultimate effect. It makes no claim that any of the evils against which 16(b) were directed were present in this, or that Provident derived inside information, profit or advantage from its all but momentary status as an 'insider'

of Foremost. To require Provident to pay over to Foremost the amount the latter seeks under Section 16(b) would be to confer a complete windfall upon Foremost and would be utterly at war with any concept of equity known to this Court. (Petition for cert, p. 38-A.)

Opinion of CA9

CA9 affirmed the judgment of the district court in favor of Provident, but on a different theory. This Court's decision in Kern County was handed down before CA9 considered the case. In Kern County we had distinguished -- although none too clearly -- between "unorthodox" transactions (such as stock conversions, exchanges pursuant to merger and other corporate reorganizations) and the more normal transactions where cash is exchanged for stock. CA9 concluded that the Provident-Foremost transaction "was essentially a cash for stock transaction," and not within the rationale of Kern County. It noted that 16(b) presumes that a shareholder who owns 10 percent of a corporation's stock has access to inside information; that although this presumption may be rebutted, it was not rebutted in this case, and therefore Provident must be presumed to have had access to inside information from

Foremost's management. There was, however, no evidence to this effect (I believe). CA9 further noted that this was an entirely voluntary transaction, as distinguished from being compelled to receive a security by virtue of a merger or reorganization.

CA9 nevertheless held for Provident on the basis of language in 16(b), providing as follows:

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

After a lengthy discussion of this language, of its legislative history, and of decisions in other circuits, CA9 held that the defendant in a 16(b) suit must be an "insider" at both the time of purchase and sale:

Every Section 16(b) fact situation involves a pair of transactions -- an initial transaction and a closing transaction. . . In this case Provident was not a statutory insider at the time of its initial purchase. The only possible Section 16(b) transaction was the sale of the debentures to the underwriters.

* * * * *

Although we took the case to decide the conflict based on CA9's interpretation of 16(b), I am inclined to agree with the district court that this was not the type of transaction intended to be covered by 16(b). If I adhere to this view, I would not reach the question which prompted us to take the case. That would be a close one for me.

BENCH MEMORANDUM

TO: Mr. Justice Powell
FROM: Carl R. Schenker

DATE: Sept. 19, 1975

No. 74-742 Foremost-McKesson, Inc. v.
Provident Sec. Co.

I recommend reversal.

The case presents two significant questions: (1) Does Kern County make § 16(b) inapplicable? (2) If not, does the "at the time of the purchase and sale" proviso make § 16(b) inapplicable?

A. Kern County

The Kern County principle is that certain transactions within the literal compass of § 16(b) are not within its purposes and the statute therefore should not be construed to include them. Your dictated aid-to-memory indicates that you are disposed to apply the Kern County principle here. I am inclined to disagree, but I should emphasize that I doubt my capacity to "educate" you on an issue that turns on the practicalities of the business world. I will therefore primarily try to indicate the problems I see in fitting this case into the analytical framework of Kern County.

only where the transaction is not within the normal meaning of "purchase and sale". In Kern the transaction was "borderline" - not clearly a sale. See 411 U.S. 594.

Kern County, somewhat simplified, involved the following:
O made a tender offer to K shareholders and became a 10% beneficial owner. K reacted by negotiating for a defensive

merger with a holding company of T. In anticipation of the merger, O gave T an option on any T stock it might acquire by virtue of a merger. O then became the owner of T stock by operation of the merger. The option was granted and the merger took place within six months of O's becoming a 10% owner of K.

It was undisputed that O's acquisition of K stock by tender offer was a "purchase." The issue in Kern County was whether either the merger or the option was a "sale" within the meaning of § 16(b). The Court held that neither event occasioned a "sale," because in neither case was there an opportunity for O to trade on the basis of inside information. In the case of the merger, O was prevented from acquiring inside information after its purchase by the hostility of the K management, and the terms of the "sale" were negotiated between K and T. In the case of the option, O was again acting without inside information, and it was "selling" to the issuer of the securities, who would have more information than O about the security. Thus, in Kern County the holding of no "sale" as to the merger and the option was supported by two factors: (1) the "impossibility" of O having inside information and (2) the "impossibility" of O abusing the closing transaction. This case differs in both respects. It will be convenient to discuss factor (2) first.

1. Factor (2).

As I have just indicated, the Kern County holding was supported in part by the fact that the closing transactions

yes
Also the
compulsion
of a
merger
is not
a "sale"
in any
normal
context.
This was
view of
SEC for
25 yrs.

were "abuse proof." But here the closing transaction was subject to speculative abuse if Provident had inside information. The closing transaction was an ordinary sale. It was not imposed upon Provident as the fait accompli of others (unlike in the Kern County merger). And Provident's purchasers were not more informed than Provident about the security traded (unlike in the Kern County option). The whole second leg of support for Kern County's holding is thus missing.

This places in stark relief an important difference between the cases. The holding in Kern County was that the closing transaction was not a "sale". But here there can be no doubt that the closing transaction was a wholly conventional cash-for-stock "sale" within the clear embrace of the statute. *yes* Holding § 16(b) inapplicable here would thus require holding that the opening transaction was not a "purchase." It does not seem to me that the purposes of the statute can ever be served fully by excluding an opening transaction from its operation. No matter how one acquires securities, if one sells in a transaction that could be abused, the evil of insider trading is possible. In short, I don't think Kern County should be extended to embrace a contention that an opening transaction (at least when it is an acquisition) is not a statutory event ("purchase").

2. Factor (1).

Although Kern County involved both factors (1) and (2), it could be held consistently with it that factor (1) suffices to make § 16(b) inapplicable. It therefore is necessary to consider whether it was "impossible" for Provident to get access to inside information.

The exact content of "impossibility" is unclear. Kern County never used that word. The Court said at one point that "it [was] totally unrealistic to assume or infer from the facts before us that [O] either had or was likely to have access to inside information. . . ." (411 U.S. at 596. Emphasis added). At another point the Court said: There is nothing "to indicate . . . the possibility of inside information being available." (411 U.S. at 599. Emphasis added). "Possibility" suggests that less threat of abuse is required to make the statute applicable than is suggested by "likely". The different wording points out the central difficulty of Factor (1) analysis. Kern County allows a certain inquiry into the actual facts of a case to assess the potential for abuse. But too specific an inquiry would convert § 16(b) into Rule 10(b)-5. That is, too specific an inquiry would prevent § 16(b) from serving its purpose as a "rule of thumb" prophylactic. The Kern County test, at the extreme, cannot encompass an inquiry into whether there actually was use of inside information.

I feel that Provident's argument here takes the Factor (1) inquiry too far down the road toward Rule 10(b)-5. Provident apparently contends at one point that the inquiry in unorthodox transaction cases is to be whether there was in fact acquisition of inside information. (Brief at 42.) And Provident's overextension of Kern County can be seen in its detailed argument on the inside information point. Provident contends both that it did not acquire inside information from the negotiations and that it could not acquire information from its position as a mere debenture holder.

Kern County seems to support the argument that Provident could not have gained information from its status as a debenture holder. Debenture holders, even if they hold convertible debentures, are outsiders as a practical matter. The access conveyed by stock ownership is not likely to be had without exercise of the convertibility rights. If the hostility of management in Kern County sufficed to rebut the presumption of insider information on the part of a 10% stockholder, it seems that an argument based on debenture status should be acceptable. | True

I have more trouble, however, with the argument that Provident did not acquire inside information from its negotiations with Foremost. There were extensive negotiations and contact between the two firms before (and to a certain extent after) the sale. One can easily imagine negotiated transactions like this where inside information would pass to the party in

Provident's position. The potential recipient of the security would frequently demand information on the financial status of the issuer, though Provident contends no such information passed here. In such a case it is easy to see room for the abuse suggested by CA9. The recipient might realize that the issuer would have to pass a dividend to finance the purchase of the assets, and the recipient could therefore sell after the announcement of the purchase but before the announcement of the passed dividend. The possibility of the acquisition of inside information in these circumstances should suffice for § 16(b) liability, since it will sometimes occur. The situation is different from the hostility in Kern County where it could be presumed that as a general matter no inside information would pass.

This is concededly a difficult line to draw. But if § 16(b) is to operate as it was intended to, at some point inquiry into the actual facts must cease and attention must focus on the potential for abuse. Where there are cooperative negotiations, the potential for abuse seems large enough to justify cutting off the inquiry into actual facts.

One last rock remains to be turned over. Is information potentially available in pretransaction negotiations acquired by virtue of stock ownership? In Kern County it was contended that O might have speculated on the basis of knowledge that its tender offer would stimulate a defensive merger that would drive K stock up and therefore profit O.

This argument was rejected. The Court reasoned that if O was so speculating, the information on which it was relying was knowledge of stock market mechanics, not "information obtained from substantial stockholding that did not yet exist." (411 U.S. at 582). Provident argues briefly that any information it may have acquired in the cooperative negotiations was similarly not acquired from actual stockholding. (Brief at 38.) There may be some factual difficulty in this argument because the cooperation continued after the sale to at least some extent (further valuation of the Provident properties). But there is a more fundamental flaw in the argument. It is true that, as in Kern County, pretransaction negotiations would not furnish information derived from present stockholdings. But this case is different from Kern County because the information in question is not information that any sophisticated investor could have. It would seem undue formalism to apply the Kern County language that rigidly. When inside information is acquired in the very course of acquiring stock, it should be within the compass of § 16(b).

B. The Proviso

I find the proviso question very difficult. The statutory text, legislative history, and legislative purpose are all opaque, but I would conclude that the initial purchase is covered.

The proviso reads:

This subsection shall not be construed to cover any transaction where [the 10%] beneficial owner was not such both at the time of the purchase and sale. . . .

Yes
I think we can safely start from the premise that the phrase "at the time of the purchase" is subject to construction either as "prior to the purchase" or as "simultaneously with the purchase." (Compare Reliance Elec. Co., where it could be concluded that "at the time of the . . . sale" had a literal meaning.) Given this premise of ambiguity, we are cast back upon legislative history and legislative purpose. CA9 drew content for the proviso from the legislative history. But since this Court said in Reliance Elec. Co. that "the legislative history affords no explanation of the purpose of the proviso" (404 U.S. at 424), the legislative purpose seems a more logical source to turn to first.

1. Legislative Purpose.

To evaluate the legislative purpose of the proviso, it is useful to turn initially to the purpose of the whole section. It was enacted to prevent abusive trading practices based on inside information. But it must be noted that there are two ways to trade on the basis of inside information. (Let's take the example of a 10% stockholder.) The first way is for a stockholder who is already a statutory insider to determine on the basis of inside information to make a profitable purchase and sale (i.e., "double-transaction abuse").

The second way is for a stockholder who becomes an insider by virtue of a purchase to determine on the basis of (newly available) inside information to make a profitable sale (i.e., "single-transaction abuse"). (Note, "Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach," 72 Mich. L. Rev. 593, 598-99 (1974). (This is Mark Pomerantz' Note.))

Congress' purpose in enacting § 16(b) clearly embraced at least elimination of double-transaction abuses that met the "rule of thumb" criteria adopted. But an argument could be made that the congressional purpose did not extend to preventing single-transaction abuses that met the "rule of thumb" criteria. This argument goes to the effect of the statute, not the proviso. But examining it helps in evaluating the purposes that might lie behind the proviso. In addition, some of the arguments advanced in Provident's brief are really directed less at the meaning of the proviso than at the proposition that § 16(b) does not reach single-transaction abuses. (Provident does not explicitly make this point, since it seems to take the position that single-transaction abuses by those who become directors or officers after a purchase are covered. (Resp's Brief at 19-20)).

The following excerpt from the Michigan Note details the argument that Congress intended to reach only double-transaction abuses:

The congressional hearings and reports discussing the provision eventually enacted as section 16(b) repeatedly describe its purpose in terms referring to double- rather than single-transaction abuse—the curbing of “short-term,” “in-and-out” speculation on the basis of inside information.⁴¹ Furthermore, the examples in the con-

gressional hearings and reports of the kind of abuse intended to be reached by section 16(b) include no instances of single-transaction abuse, but in all cases describe situations in which advance information tainted both the purchase and the sale.⁴²

The case from the statute itself is even more clear. First, the statute speaks in conjunctive terms of “profit realized . . . from any purchase *and* sale, or sale *and* purchase . . . ,”⁴³ implying that Congress did not intend section 16(b) to deter abuse of inside information in a single transaction unless the abuse was converted into a trading profit by means of a second transaction.⁴⁴ This implication is supported by

the statutory provision for recovery, which provides that the profit realized from a sale of shares is to be calculated with reference to the price paid for their purchase.⁴⁵ Such a scheme is appropriate if the purchase and the sale are part of the same profit-making scheme, that is, if the situation is one of double-transaction abuse. The mechanism is less appropriate, however, for certain instances of single-transaction abuse. Assume, for example, that an insider, in a purchase free of any possibility of abuse, buys stock at 85. The price rises to 100 because of generally favorable economic conditions. At this point the insider becomes privy to advance information about a development that will send the stock price tumbling to 50, so he sells at 100. The recovery under section 16(b) would be 15 dollars per share, but advance information has allowed the insider to avert losses of 50 dollars per share. Thus, the measure of damages is inadequate if the purpose of the statute is to inhibit single-transaction abuses.

A similar analysis applies to the failure of the statute to reach transactions occurring more than six months apart. In situations of double-transaction abuse, where inside information motivates the initial transaction as well as the final one, the six-month time limit is quite reasonable—the inside information typically relates to a temporary price fluctuation and is thus worthless if it cannot be turned to profit within six months. For instance, an investor who receives information in January about a temporary price rise in February will not buy in anticipation of the up-swing if he cannot sell and be assured of retaining his profits until July.⁴⁶ Furthermore, a primary function of the six-month limitation period is “to serve as an indicator of the existence of the prohibited short-swing intention.”⁴⁷ The fact that an insider’s purchase is quickly followed by a sale makes it more reasonable to assume that the purchase was the beginning of a short-swing based on advance information, rather than a legitimate

investment decision. In the context of single-transaction abuse, however, the six-month time limit is illogical. Since the defendant's first transaction is, by hypothesis, completely innocent its only function as a basis for liability is to start the six-month clock ticking. Though the investor may later use inside information in deciding to make a sale, he will not be liable under section 16(b) unless he has made a fortuitous and unrelated purchase within the preceding six months.

Even more convincing is the statutory exemption for securities "acquired in good faith in connection with a debt previously contracted."⁴⁸ If Congress was concerned about abuse of inside information with reference to the *sale only* in the "purchase and sale" situation it would be absurd to create an exception for certain innocent purchases. Indeed, the "debt previously contracted" exemption indicates that when a section 16(b) purchase presents no possibility of abuse, the possibility of abuse with respect to a subsequent sale should be irrelevant.⁴⁹

It may be argued that Congress manifested an intent to deal with single-transaction abuse when it expressly provided that the statute should apply "irrespective of any intention on the part of" the insider not to get out on a short-swing.⁵⁰ This provision may be read to indicate that Congress wanted to eliminate any suggestion that some connection in motivation between the purchase and sale was necessary. In fact, the statutory provision cuts the other way. It removes the question of intent from the facts to be considered because Congress feared that requiring the plaintiff to prove the defendant's intent to sell or to disprove his intent not to sell would be too onerous. Therefore, Congress sought to establish an irrebuttable presumption that the two transactions were linked in a single speculative plan.⁵¹

I do not find this argument ultimately persuasive.

~~Section 16(b) is a "rule of thumb" statute. The fact that the objective criteria specified by Congress do a better job of preventing double-transaction abuses does not weigh very heavily against a conclusion that single-transaction abuses are covered.~~

The bulk of the argument is directed to the proposition that the provisions of the statute are ill-tailored to prevent single-transaction abuses. But it has always been recognized that § 16(b) is a "rule of thumb" statute. The fact that the objective criteria specified by Congress do a better job of preventing double-transaction abuses does not weigh very heavily against a conclusion that single-transaction abuses are covered.

And there is at least one very significant indication that Congress intended in general to reach single-transaction abuses. In the statutory "preamble" Congress stated its purpose to be "preventing the unfair use of information which may have been obtained by a [10%] beneficial owner . . . by reason of his relationship to the issuer. . . ." Although Provident cites the preamble in support of its contention, the language seems more compatible with coverage of single-transaction abuses. A stockholder who decides to sell on the basis of inside information acquired after becoming a 10% owner has made "unfair use" of information acquired "by reason of his relationship to the issuer," even though he has not made an "in and out" decision on the basis of the inside information. Thus the statutory "preamble" supports the conclusion that single-transaction abuses are covered.

10(b) 5
would
apply

h?

The reasoning that all the examples of abuse of insider information discussed by Congress involved double-transaction abuse can also not be deemed conclusive. If Congress meant to reach single-transaction abuses, as is suggested by the statutory preamble, the focus on double-transaction abuses is perhaps explicable by their more outrageous nature. In addition, the report accompanying a draft of § 16(b) as enacted states simply that "[t]he expressed purpose of this provision is to prevent the unfair use of inside information." (S. Rep. No. 792 to accompany S. 3420, 73d Cong., 2d Sess. 21 (Apr. 20, 1934)). While CA9 seems correct that earlier drafts were clearly aimed at double-transaction abuses, the broader statement of purpose may be explicable on the basis of the elimination of criminal penalties. (See infra at 14-16.)

It thus seems appropriate to conclude that in general Congress intended to prevent single-transaction abuses as well as double-transaction abuses.¹ The question becomes whether the proviso was intended to exempt 10% stockholders from single-transaction liability. The difficulty with

1. This Court gave apparent sanction to the view by citing with approval Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959), which held that one who is a director at the time of sale need not also have been one at the time of purchase. (See Reliance Elec. Co., 404 U.S. at 424 n. 4.)

* But why limit to 6 mos. if purpose is then simplistic.

** But proviso applies only to 10% holders - not directors

the CA9 result is that once some single-transaction liability is conceded, it is difficult to conclude that the proviso was meant to exempt stockholders. ?

We begin again with the ambiguity of the proviso. If we work from the hypothesis that the general statutory purpose is to prevent both double - and single - transaction abuse, an exemptive effect for the proviso cannot be inferred from the purpose of the statute. Indeed, if the purpose of the statute supported an exemptive effect, no exemption would be needed. (That is, if the statute ~~were~~ intended to reach only double-transaction abuses, no exemption from liability for certain single-transaction abuses would be required.) Since an explanation more consistent with the purpose of the statute appears for the proviso (see infra at 16-17), the exemptive effect contended for by Provident is not compelled by the purpose of the statute.

*What then does
proviso mean ?*

2. Legislative history.

Since neither the text of the statute nor the legislative purpose support an exemptive interpretation, legislative history is the final recourse. As already noted, in Reliance Elec. Co. this Court found that legislative history provided no explanation of the meaning of the proviso. (See supra at 8.) Despite that conclusion CA9 relied on legislative history to support its conclusion. I think the CA9 analysis should be rejected.

CA9 relied largely on language in S. 2693 strongly indicating that liability attached only to stockholders who were already statutory insiders. Section 5(b) of S. 2693 provided:

It shall be unlawful for any director, officer, or owner of securities, owning . . . more than 5 per centum of any class of stock. . . .

(1) To purchase any such registered security with the intention or expectation of selling the same security within six months, and any profit made by such person . . . shall inure to and be recoverable by the issuer. . . .

But the fact that this provision was proposed at one time actually does little to point to a stockholder exemption from single-transaction liability.

The S. 2693 language embraced directors, officers, and stockholders. It clearly contemplated that purchases by any of these would be covered only if the "insider" status existed at the time of purchase. And it is hard to imagine a criminal provision being drafted otherwise. This piece of legislative history may therefore indicate that all of § 16(b) was originally directed only at double-transaction abuse. But that focus was apparently abandoned when criminal² sanctions were abandoned. It is difficult to see how S. 2693 supports a differentiation between stockholders on the one hand and directors and officers on the other as to single-transaction liability. Absent at least some

2. See footnote 1 supra.

legislative history supporting such a differentiation, the inference drawn by CA9 from S. 2693 seems impermissible.

3. Resolution.

If we conclude that the background of S. 2693 does not in fact give the illumination that this Court found lacking in Reliance Elec. Co., we are left with the bare ambiguity of the statute. Having reached that point, it seems that the principle of construction enunciated in Reliance Elec. Co. should be applied. There the Court wrote: "To be sure, where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose. . . ." (404 U.S. at 424. It should be noted that the deleted words in the quoted sentence are "of curbing short-swing speculation by corporate insiders." This language is suggestive of a double-transaction construction of the statute, but that question was, of course, not under consideration.)

If the Reliance Elec. Co. rule of construction governs and the statutory purpose embraces the curbing of single-transaction abuses, the "simultaneously with the purchase" construction should be adopted. Meaning would then be found for the proviso by construing it to deal with the minimization of liability by step transactions. Reliance Elec. Co. has already held that the proviso is to be read as allowing minimization of liability by step sales. The symmetrical

allowance of minimization of liability by step purchases furthers the purpose of preventing single-transaction abuses while giving meaning to the statutory language. (This solution has been advocated by L. Loss, Securities Regulation 1060 (2d ed 1961) on just that basis.)

I think this construction finds further support in two factors. First, it allows the words "at the time of" to be given the meaning "simultaneously with" in all cases, while CA9 realized that its result would require the phrase to be given one construction for opening transactions and another for closing transactions. Second, this is the construction that the SEC has always urged for § 16(b). Although the SEC it not participating here as amicus, it has long urged that the qualifying purchase is a § 16(b) transaction. (I agree with Provident that Foremost-McKesson's argument on the meaning of the proviso based on Rule 16b-2 is not conclusive. The Rule would have meaning whether or not the qualifying transaction is covered. The SEC might be unable to point to any action it has taken predicated on the construction urged here. But the position itself has long been taken, and given the closeness of the case, the SEC position should be weighty.)

4. Counter Arguments

I am fairly confident that the proviso argument relied upon by CA 9 and Provident is without merit. Thus on an

analytical basis I think that CA9 can be affirmed only if the Kern County argument is accepted. Despite my confidence, I think one aspect of Reliance Elec. Co. would point to affirmance on CA9's rationale. There, after noting that the purpose of the proviso was unclear, the Court said: "[I]t may be that Congress regarded one with a long-term investment as more likely to have access to inside information than one who moves in and out of the 10% category." (404 U.S. at 424). This speculative assignment of purpose suggests that the congressional purpose in regulating stockholders was to reach only double-transaction abuses. But I think the Reliance Elec. Co. result did not depend on that remark. It focuses, rather, on satisfying the tension between the statutory purpose and finding some meaning for the proviso. On the basis of that approach, my result here is sound. The court in Reliance Elec. Co. was not forced to consider whether the statute governed single-transaction abuses.

Summary

Kern County analysis seems inappropriate here because the closing transaction was subject to abuse. If Kern County is applicable, I don't think it governs because there was potential for abuse of inside information.

The argument that the proviso exempts the qualifying purchase from the reach of § 16(b) collapses - and largely of its own weight. The proviso can have that effect only

why

if the section otherwise covers single-transaction abuses. But no legislative history points to an exemptive effect, so the purpose of the proviso remains unclear. Since it remains unclear what the purpose of the proviso is, it should be construed to effectuate the hypothesized statutory purpose of covering single-transaction abuses. It can be so construed and still have meaning if it is limited to the minimization of liability by step transactions.

C.S.

To: Justice Powell

10-8-75

From: Carl Schenker

Re: Foremost-McKesson, No. 74-742

This memo embodies the last minute research you asked for in this case.

1. The 7th Circuit View

As we discussed this afternoon, the 7th Circuit has just adopted the "dual-transaction" analysis of § 16(b). Judge Swygert writes in the opinion "that in enacting section 16(b) Congress had in mind a specific type of two-part transaction consisting ~~of~~ either of a purchase and subsequent sale, or a sale and subsequent repurchase, and did not intend section 16(b) to apply to every separate purchase or sale as to which some use of inside information is a theoretical possibility." (Slip op'n at 15-16.)

There is nothing startling in what the 7th Circuit has to say *on the general matter of dual-transaction analysis.*

In fact, I find the opinion less persuasive than Pomerantz' arguments. The 7th Circuit bases ~~XXX~~ its entire argument on the

legislative history that CA9 relied upon; that is, its argument is based on the previous draft that clearly anticipated dual-transaction analysis, but which included criminal sanctions. *(See bench*

memo at 15.) CA7 takes no account of the possibility that the basis of liability might have been widened when the criminal sanctions were dropped from the bill. In addition, it takes no account of ~~XXX~~ cases like Adler, which imposed single-transaction liability upon officers and directors (and which this Court cited with approval in Reliance Electric.) While CA7 may be right, I don't think they make a very persuasive case.

Furthermore, if I am reading the opinion correctly, they really ~~XXXXXXXX~~ dropped the ball on the meaning of the provision

CA9 seems to have overlooked the possible "nonbinding" effect of ¶ 5(h) (found in the Appendix at page 7 following page A134). That provision made a condition of the underwriters' duty to perform the ~~XXXXXXXXXXXX~~ absence of adverse market changes in Foremost stock between the date of the contract and the date of the XXXX sale. CA7 considered only the possible effect of ¶ 7, which allowed the underwriters to terminate the contract between the date of the contract and the effective date of the registration statement if there were adverse changes in the overall market picture. Since the registration statement became effective the same date as the underwriting agreement was signed (and before any distribution), ¶ 7 was considered of no help to ~~RM~~ Provident.

I have not had time to do original research into the law on this matter. ^u But CA9 ~~XXXXXX~~ clearly contemplated that such a clause might mean that the "sale" was not ~~XXXXXXXXXX~~ effectuated until closing. I would think two questions might be asked about ¶ 5. First, ~~XXXXXX~~ since CA9 would presumably have considered ¶ 5 ~~XX XXXXXXXXX~~ relevant, why did it fail~~ure~~ to consider the paragraph? (Did Provident fail to raise the matter below?) Second, is there any consequence to the fact that ¶ 5 was a condition of the underwriters' performance, while ¶ 7 expressly allowed termination. (I doubt it.)

117/1
October 6, 1975

ju

No. 74-742 Foremost-McKesson v. Provident

Chronology (1969)

- August 1969 - Negotiations resulted in "tentative Agreement".
- September 3 - Provident Board decided to recommend dissolution and liquidation to its stockholders and adoption of plan of liquidation.
- September 8 - Foremost sought permission from Commissioner of Corporations to issue and transfer its Debentures to Provident.
- September 25 - Purchase agreement executed pursuant to which Foremost would purchase about 2/3 of Provident's assets in exchange of \$4,250,000 in cash and \$49,750,000 in Convertible Debentures. Under the agreement, Foremost was obligated to register one half of the debentures.
- October 15 - Closing under Purchase Agreement. Foremost delivered the cash and a \$40,000,000 Debenture - which was later split into one Debenture for \$25 million and one for \$15 million. (The remaining \$9,750,000 of Debentures were delivered later - namely on October 20, except for \$2,500,000 held in escrow).
- October 21 - Provident, Foremost and Dillon Reed entered Underwriting Agreement for sale of \$25,000,000 of Debentures.
- October 24 - Provident distributed to its stockholders as a liquid dividend \$22,250,000 of Debentures.
- October 28 - Closing under Underwriting Agreement: Provident transferred the \$25 million Debenture to Underwriter for \$25,366,666.
- October 29 - Provident distributed this cash to its stockholders.

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Moskiri (for Petr.)

There is at least an ambiguity
in language. In view of
purpose of statute, does not matter
when one acquires stock - date
of sale is controlling?

Gregory (for Resp)

Key provision, ^{of 16(b)} expression of its purpose

"for the purpose of preventing the unfair
use of information which may have
been obtained"

Ambiguity, if it exists, must be
construed in light of this purpose.

Provident was attempting to
liquidate - not to become a
stockholder in Foremost

1. Kern does not control: This was a purchase.

2. Provident exempts ^{this} transaction. It reads:

"This sub-section [16(b)] shall not be construed to cover any transaction where such beneficial owner (i.e. 10%) was not such both at the time of the purchase and sale, or the sale and the purchase, of the security involved."

3. Under a "plain language" test, ~~the~~ Provident was not a 10% holder at time of purchase. at that time it was a zero holder. CA 9 so One is never a stockholder until he completes a purchase. ^{held}

^{at time decision was made (which is critical time) Provident was not a stockholder} Foremost argues, however, that ~~Provident~~ "at the time of" can & should be read to mean "simultaneously with". This is not a normal reading of language. ~~Not does~~ It ^{certainly} ~~is~~ ^{no} sense to apply ^{this} interpretation to "sale". If so applied, Provident would not have been an owner at time of sale. If 16(b) is to be meaningful, ~~the~~ ownership "at time of sale" must mean before giving effect to sale.

[6/15]

[7/18]

4. If Ambiguous.

If "plain language" test does not resolve
this case - i.e. if Prosser is ambiguous -
other indications of Congressional intent must
be examined:

(i) Leg. history: probably not helpful, as
Ct. said in Emerson.
(I'm not sure of this. See
discussion in CAGS op.)

(ii) Purpose is clear: "For the purpose
of preventing the unfair use of
information ---"

No unfair use ~~to~~ in this case.

Until one becomes 10% holder,
Congress has concluded there is little
likelihood of obtaining inf to use unfairly.

16(b) is directed vs. insiders. One is
not an insider under statute until he
owns 10%. What information can
he acquire "simultaneously" with
purchasing 10%?

Purpose of 16(b) - preventing unfairness
- not served.

(iii) Liability w/o fault - rule of construction

16(b) imposes liab. w/o fault
If applicable, proof of total innocence
is of no avail.

Such a statute must be
construed strictly - not expansively.

If - as Petr. argues - ~~the~~ the
proviso is ambiguous, the
ambiguity must be resolved against
imposing ~~the~~ liability w/o fault.

(iv) Equities - altho irrelevant,
if considered at all, they favor
Resp. Petr. bought Resp's
assets and got all that it
bargained for. Resp. received
~~like~~ the Debentures with full
knowledge by Petr. that ~~they~~ they would
be sold. Petr. now seeks to
confiscate the profit ~~Resp.~~ Resp. made
on this sale. Not a pretty
posture for a litigant who is ~~the~~
relying on a statute designed to
prevent unfairness!

x x x

Proviso distinguishes bet. officers
& directors - and 10% owners. There is
a reason: Vast difference between
managerial insiders & stockholders.

10(b) 5 - provides the remedy,

But
see Kern
Council
- that
does look
to purpose
(legitimate)
of 16(b)

Affirmed 9-0

The Chief Justice

Pass

Case is close.

Prior ops. of this Ct. not
too helpful.

Douglas, J.

Affirm

Brennan, J.

Affirm

Potter's op. in Reliance
supports CA 9

Stewart, J.

Affirm

Difficult Q.

SEC says it is covered.

Commentators agree
with SEC (?). (not so)Yet Congress did not
address this issue.
& Potter is persuaded
CA 9 has better of
argument in view of
ambiguity.

Affirm

Kern left this Q open
- it dealt with sale, not a
purchase.

CA 2 has gone too
far.

Can't assume that one
who "buys in" has
inside information.

Affirm

Blackmun, J. Affirm

Close case.

Relevance + Kern
point way to affirmance

Could go on Kern
analysis - ~~not~~ this
is unorthodox transact.
ion.

Powell, J. Affirm

Rehnquist, J. Affirm

MEMORANDUM

TO: Carl Schenker
FROM: Lewis F. Powell, Jr.

DATE: November 19, 1975

No. 74-742 Foremost-McKesson v.
Provident Securities

This memorandum will reflect my initial, perhaps superficial, reaction to the draft of November 17. I commend you on getting it out expeditiously, and the draft reflects careful thought and research.

The following comments are not "criticism". Rather, they are a part of a process designed to result in an opinion that reflects the best of our combined thinking and draftsmanship:

1. I have drafted two or three riders, that you will find attached. The only important one is a revision of the introductory paragraph. I am not sure that ^I have it exactly right, but I would like something along this line.

2. I would prefer a somewhat fuller statement of the facts. Your succinct statement is perhaps all that is necessary to address the narrow issue which the opinion resolves. Yet, the facts of most 16(b) cases foreshadow the ultimate outcome. The bar is interested, and the unfamiliar reader should have a fairly full factual presentation in the text.

In the limited time available to me today, I have not reviewed your footnotes except in the most cursory fashion.

2.

I think the text and footnotes combined should identify the other main issues raised, and state that we do not reach them. These issues include (i) the Kern County "unorthodox transaction" position of the district court, and (ii) the view that I have that the critical "sale" did not occur until October 28 (the closing under the underwriting agreement) and at that time Provident was not a 10% holder.

3. Take another look at your discussion of the contra decisions in Stella and Emerson Electric (CA8). I have thought that both of those cases take myopic views of 16(b), and particularly the exemptive provisions. In Stella, as you did note, the district court seemed obsessed with the "sale-repurchase sequence", and gave little or no attention to the more typical type of transaction such as that involved in this case. In Emerson, while the rationale was somewhat more "affirmative" (as you say), the illustration you quote (51% acquisition followed by manipulation) is atypical in respect to 16(b). If one goes to the trouble of acquiring 51% of another corporation he is likely to retain control rather than "gut" his own acquisition. In the typical tender offer situation, the objective is to attain 51% and retain it. In any event, the "horrible example" dreamed up by CA8 would be a classic 10b-5 case. Accordingly, I suggest that at least you relegate this example to a footnote. I would not dignify it by textual treatment.

4. Subject to further thought and to your views, I would be inclined not to commence Part III on page 7. Rather, I would start Part III at the top of page 9 with the legislative history. This is hardly a major suggestion, but at the moment it seems to have merit.

5. Your discussion of the legislative history is excellent and persuasive. I have not compared it with similar discussions in (i) CA9's opinion, (ii) respondent's brief, and (iii) the amicus brief filed on behalf of Gulf and Weston. If you have not done so, take a look ^{at these} with the view to possibly strengthening - in footnote or text - the draft. I do recall, for example, the reference in the amicus brief (p. 14) to the Senate Report which refers to the "benefit of advance information", which is helpful. Possibly you have it in one of your notes - which I have not examined carefully.

6. I am generally with you (subject to the above comments) to the beginning of the last paragraph on p. 15. At this point, it seems to me that the opinion "fades away" without emphasis of several considerations which I deem important. Without attempting to put them in any particular ^{order} or to articulate them with precision, they include the following:

(a) The discussion in the cases and commentaries as to whether the language of the exemptive provision should be construed to mean "before the purchase", "after the purchase", or "simultaneously with the

4.
purchase", simply makes no sense to me. As a matter of "plain language" one must turn the sentence "on its head" to construe "at the time of the purchase" to mean "after the purchase". But apart from semantics, as you noted, there can be no presumption that inside information is available to a purchaser until after he has become an insider. The decision to purchase a security is the critical act. This necessarily precedes - often by a significant interval of time - the actual consummation of a purchase. The relevance of "insider information" relates only to the decisional process; not to the mechanical execution of a purchase. Thus, there is a perfectly rational basis for construing this language as meaning what it would normally mean, i.e., that before one becomes a statutory purchaser, enjoying "insider status", he must have completed the purchase. Prior to that time he is a statutory outsider. Against this background of reality, the language "at the time of purchase" can mean only one thing.

(b) The exemptive provision applies only to beneficial owners of more than 10%, not to officers and directors. Congress must have had a purpose in mind for this deliberate distinction. The CA2 and CA8 decisions have, in effect, obliterated the distinction, something we have decided not to do. In truth, as you know from our discussions, even one who enjoys the status of a 10% stockholder is

not entitled by virtue of that status to any inside information. To be sure, if such a stockholder is able to place a representative on the board, the stockholder may end up obtaining the information. This would certainly be true if an individual owned 10% and also served as an officer or a director. But absent a presence on the board there would be a clear violation of 10b-5 for a corporation (or its officers or directors) to disclose to any stockholder information not available to all holders.

Not only is a 10% stockholder not entitled to information by virtue of that status, the fairly typical situation today involves a tender offer resulting in an adversary position. The amicus brief for Gulf and Weston presents this situation with some force.

(c) You have, as I recall, one sentence mentioning the availability of 10b-5 remedies. I consider this a fairly major point that should be elaborated.

(d) Section 16(b) creates liability without fault where it is applicable. Putting this another way, it creates a conclusive presumption of wrongdoing without regard to the facts, and imposes liability on the basis of a purely mechanical formula. Where the operative language is clear and explicit, we must accept congressional judgment - absent constitutional infirmity. But here no one - no court and, to my knowledge, no commentator -

0.

thinks that the language of the proviso is clear or explicit. Viewed in the light most favorable to petitioner's arguments in this case, the language is ambiguous. And the "ambiguity" is perceived not so much from the language of the proviso as from what seems to be undesirable results in some instances (the sale-repurchase, for example) if the language is applied in accordance with its normal meaning.

It is one thing, however, to be concerned about undesirable results that do not impose liability, and which may well be prevented by 10b-5 or other provisions. It is quite something else to construe admittedly ambiguous language to impose such liability by an irrebuttable presumption of fault.

This point was very much in the minds of some of the Justices who voted to affirm in this case. It merits appropriate emphasis.

Note:

There is something of a problem as to how to work the foregoing thoughts into the structure of your draft. I think I would add a new Part IV, following your fine discussion of the legislative history, and address it in policy considerations that are supportive of that history and our holding. I think most of the foregoing ideas could be blended into such a discussion. I have not reread Kern County, but it may be that some of the language in it would be helpful either as a "springboard" or as tangentially relevant.

7. I have not focused on present Part IV, and will try to do this upon my return from Harvard.

8. Nor have I had an opportunity to review the footnotes, beyond some haphazard reading. I agree with you that they seem to^c fulsome, and may include some topics that could well be omitted entirely. I do not like to have the footnotes outweigh the text; nor, should they indicate views on issues not before the Court.

* * * * *

This is a hurried memorandum, so that you will have the essence of my preliminary thinking before I go away.

L.F.P., Jr.

ss

But the insider status was viewed as deriving from the fact of stock ownership and its consequent access to inside information. The focus of concern was on preventing a large stockholder from profiting by trading on the basis of such information. It would hardly be consistent with this view of the threat to impose liability on the basis of a purchase when there was no insider status and presumptively no access to information unavailable to investors at large.

III.

The exemptive provision, which applies only to beneficial owners of more than 10% of the security involved and not to other statutory insiders, must have been included in the Act for a purpose. We look first to the legislative history. Although the extensive record of that history is bereft of any explicit explanation of congressional purpose and intent, see Reliance Electric Co. v. Emerson Electric Co., supra at 424, the evolution of § 16(b) from its initial proposal through passage does shed significant light on the exemptive provision.

This case presents an unresolved issue under § 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b). That section of the Act was designed to prevent corporate officers, directors and the beneficial owners of more than 10% of a corporation's equity securities from profiteering on the basis of insider information through short-swing transactions. Section 16(b) contains an exemptive proviso excluding "any transaction where such beneficial owner [of more than 10%] was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *". The question presented here is whether a person who purchases more than 10% of a corporation's equity securities, and thereafter sells them within six months, was a beneficial owner of such securities "at the time of the purchase" as well as at the time of the sale. The United States Court of Appeals for the Ninth Circuit answered this question in the negative. 506 F.2d 601 (1974). We affirm.

See
Foremost - McKesson

74-742

Supreme Court of the United States

Memorandum

(11/75), 19

Levin -

I meant to, and
now do, thank you for
your thoughtfulness and
consideration in asking my
thoughts about the Reliance case.

P.S,

MEMORANDUM

TO: Justice Powell
FROM: Carl R. Schenker

Rider A, p. 20. No. 74-742 Foremost

I think your presumption analysis may be summarized as follows: Section 16(b) defines insiders as including those who own 10%. From the fact of ownership it is presumed that a trading stockholder (1) has access to inside information and (2) has misused inside information. It is, however, irrational to infer (1) and (2) until one who is already an insider purchases and sells.

I don't think this analysis can carry us very far. First, (1) and (2) are not both presumed from the fact of ownership. Second, the perceived irrationality assumes that § 16(b) deals only with dual-transaction abuses and not with single-transaction abuses, while that is the very question at issue.

First. The commentators who have parsed carefully the operation of § 16(b) agree that the section includes two presumptions. Presumption (1) is that 10% ownership gives one inside information. Presumption (2) is that a purchase and sale (or sale and purchase) within 6 months was based on use of the inside information. That is, access is presumed from the fact of ownership, but misuse is presumed from the fact of

a short-swing transaction. (This bifurcation can be seen in the CA 9 analysis. 506 F. 2d 611-614.)

Second: Even if we clarified this point, the analysis in Rider A does not work. The central thrust of Rider A is that it is irrational to conjoin a presumption of access and a presumption of misuse unless both the purchase and sale followed the fact of insider status. In other words, Presumption 2 may only rationally mean that a purchase-and-sale after access to information was based on misuse of information. But note that this position also implies that it is irrational to presume misuse of inside information in the sale of stock unless there was a presumptive misuse in the purchase of the stock. I think that is demonstrably not so. Congress would be entitled to presume that a sale shortly after any substantial purchase reflects a misuse of inside information available after the purchase. (See the appendix for an elaborated discussion). Let's call this Presumption 2'. It could legislate to cover that kind of abuse.

I am not arguing that Congress incorporated Presumption 2' into § 16(b). [Maybe it did as to directors and officers, but we are holding that it didn't as to 10% owners because of the proviso.] I am only arguing that it could rationally enact a statute that incorporated Presumption 2'.

From the foregoing I would make two arguments. First, [^]you statements in Rider A are far too sweeping in their strong suggestion that a statute including Presumption 2' might be unconstitutional. Second, the very question that this opinion addresses is whether or not the proviso was intended to negate Presumption 2' for stockholders. If Presumption 2' were irrational, it would be valid to argue Congress couldn't have intended it. But since Presumption 2' is rational, Rider A is a bootstrap argument. (Please note that the CA 9 argument based on presumptions recognized this point. 506 F. 2d at 611-614. It therefore argues not that Presumption 2' is irrational, but that Congress demonstrated that it wanted Presumption 2 by deleting tippee liability. The argument is that tippees were

outsiders, as are 10% owners before the purchase. Therefore the deletion of tippee liability shows an intention to exclude outsiders, including those who owned less than 10% before purchase. This argument, however, does not work because 10% owners are insiders after the purchase, while tippees are always outsiders. The deletion of tippee liability therefore proves nothing about Presumption 2 or Presumption 2' when it is conjoined with Presumption 1.)

Suggestion: I wrestled with this presumption argument before rejecting its inclusion in the draft. But I am now perfectly clear on its bootstrapping nature. And I think the weakness of the CA 9 argument demonstrates that it can't be remedied. For that reason I prefer the alternative suggested in your previous memo to me. The liability without fault argument is not a bootstrapping argument. Congress knew it was imposing liability without fault and definitely did not want to make it too broad. Of course, that desire doesn't answer the question whether it chose to incorporate Presumption 2 or Presumption 2', but it allows a more coherent and analytically sound policy argument. You seem to feel that my argument on this point was not strong enough. I recommend strongly that we rework my section together to tone it to the pitch you want rather than sticking with the presumption analysis.

Appendix: Imagine for a moment that Congress deliberately and unambiguously set out to pass a statute that

covered both dual-transaction abuses and single-transaction abuses. It could follow a thought-process like this:

(1) One who purchases over the 10% level may or may not have made that purchase on inside information. (If the purchase was based on inside information, that information was not derived from the fact of relationship to the corporation, but from some other source.) When he sells within 6 months there are three possibilities. (a) He had inside information when he bought and intended to sell on the short-swing. (b) After he became an insider, he acquired information and sold on the short-swing. (c) Both the purchase and the sale were innocent.)

(3) As you have pointed out to me, one who purchases a substantial block usually does so for purposes of long-term investment (especially when he has the prospect of control).

(4) Therefore, when a substantial purchaser sells within 6 months, the profits can be taken out of the sale because (3) makes it rational to assume a significant probability of either (a) or (b) abuse.

In a (b) abuse situation of an innocent purchase followed by an abusive sale, the rationality stems from essentially the same two presumptions that operate at present in § 16(b). When one becomes an insider, he has access to inside information. When such a person sells within 6 months he was trading on that information. The rationality for covering (a) situations is

Not so
in case
of a
take-over
bid that
fails.

is slightly different, but it need not be discussed. Congress would be entirely justified in saying that (b) abuses were so likely that the rule was justified on that basis alone. Since you can't tell an (a) abuse from a (b) abuse, Congress would be entitled to subsume both under the same rule.

yn | The possibility remains that many (c) situations of an innocent purchase followed by an innocent sale would be covered by this statute. But it is not irrational to cover these situations in order to reach all of the (a) and (b) situations. This is especially true because the "only" penalty imposed upon the (c) people is loss of profits. This is liability without fault, but of a very limited variety.

Carl

Supreme Court of the United States
Washington, D. C. 20543



CHAMBERS OF
JUSTICE POTTER STEWART

December 22, 1975

No. 74-742, Foremost-McKesson, Inc.
v. Provident Securities Co.

Dear Lewis,

I am glad to join your opinion for
the Court in this case.

Sincerely yours,

PS,
1.51

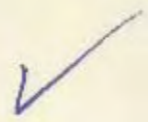
Mr. Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

December 22, 1975



Re: No. 74-742 - Foremost-McKesson v. Provident
Securities Co.

Dear Lewis:

Please join me.

Sincerely,

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

December 23, 1975

Re: No. 74-742 - Foremost-McKesson v. Provident Securities

Dear Lewis:

Please join me.

Sincerely,

wm

Mr. Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

December 22, 1975

No. 74-742, Foremost-McKesson, Inc.
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Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

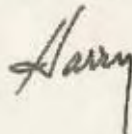
December 22, 1975

Re: No. 74-742 - Foremost-McKesson v. Provident
Securities Co.

Dear Lewis:

Please join me.

Sincerely,



Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

December 31, 1975



RE: No. 74-742 Foremost-McKesson, Inc. v. Provident
Securities Company

Dear Lewis:

I agree.

Sincerely,

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

December 31, 1975

RE: No. 74-742 Foremost-McKesson, Inc. v. Provident
Securities Company

Dear Lewis:

I agree.

Sincerely,



Mr. Justice Powell

cc: The Conference

To: LFP
From: CRS

*Please excuse the rough.
I wanted you to have this
tonight.*

Re: Foremost-McKesson v. Provident, No. 74-742

Throat clearing. I have been working my way up to preparing a memo that would allow us to discuss the basic strategy that the opinion should take. My strategical problem is that there ~~are~~ *is* a ~~at least two~~ cases not presented here that we want to hold harmless in this opinion (as I understand our previous discussions). This *may* ~~prove impossible, but that~~ is a longer range matter than the immediate problem that has arisen so I will discuss that ~~matter~~ *in* ~~XXXXXX~~ at the second part of the memorandum. I will turn first to my shorter range problem: Did the ~~XXX~~ Conference vote the right way in Provident. (Please read on before you come to the conclusion that I'm a sore loser.)

A. The XXXX basic outcome.

As you know, the Court's previous foray into the meaning of the proviso in § 16(b) was ~~XX~~ in Reliance Electric. There the question presented was what the words "at the time of . . . sale" meant. They were held to mean that a beneficial owner could "minimize" his liability by making step sales.

Reliance Electric's facts are easily summarized:^{*} ~~X~~ The stockholder bought ~~1%~~ *13%* of the corporation, then sold in two blocks of ~~XX~~ *6%* and 9%.

The stockholder contended that the proviso "both at the time of the purchase and sale" excluded any liability for either sale. But the Court found that question not ~~XX~~ to be properly presented in the case. Thus it confined itself to the further contention that the ~~XXXXXXXX~~ second sale should not be covered. The Court held that the "plain meaning" of the phrase "at the time of . . . sale"

^{*}For convenience I'd like to treat all cases as 15% cases.

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was that the second sale was excluded from operation of the statute because after the 6% sale, a 15% owner was no longer a "beneficial owner of more than 10%." Seems sound enough.

Now let's consider Provident. Provident became a more ~~KNXX~~ than ~~1XX~~ 10% owner ~~XX~~ in a single purchase of 15%. It then sold ~~XX~~ 6%. The Conference has voted to hold that the words "both at the time of the purchase . . ." mean that since Provident was not a 10% owner at the time of the original purchase, its subsequent sale cannot be matched against that purchase. Seems sound enough.

The problem is that if Provident is right, Reliance ~~XXXXXX~~ MUST be wrong. Under Provident the first 10+% ~~XXXXXXXXXXXX~~ of a beneficial owner's holdings can never be matched against subsequent sales. Consequently, the "at the time of . . . sale" language cannot be necessary to protect the ~~XX~~ stepped down sales.

The problem is that if Provident is right, Reliance MUST be wrong. The holding of Reliance is that some of the original 10% of a ~~XXXXXXXXXX~~ beneficial owner's holdings can be disposed of without liability if he has ~~XXXXXXXX~~ previously disposed of enough to bring himself down below the 10% mark. But under Provident the original 10% would always be protected from liability, because they are transactions not to be construed as a statutory "purchase." Let me demonstrate: Imagine that all four of the following transactions take place within 6 months--

an 11% purchase
a 4% purchase
a 6% sale
a 9% sale.

Now, under Stella plus Reliance, the result of an ~~XXXX~~ *a maximum of* 11 + 4 - 6 - 9 sequence would be to hold the stockholder for 6.
(The ~~XXXXXXXXXXXXXXXXXXXXXXXXXXXX~~ 4 transaction ~~XXXXXXXX~~ is a

62

XXXXX a 15% purchase
a 6% sale
a 9% sale

①

True, but
in Reliance
the Court
assumed
it was a
10% stockholder
at time of
purchase
(p 42).
The Court's
op. is based
on that
assumption.
There is no
decision
re

Now, one can take two basic ~~approaches~~ approaches. One could say

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redundancy

that Congress didn't realize this; its all a mistake; Provident is right; the ^{*Reliance*} language is superfluous; it wasn't ~~XXXXXX~~ evident that the language was superfluous in Reliance because we weren't considering the whole ~~XX~~ clause.

Or one could seek to find a way to prevent the "at the time of . . . sale" language from being superfluous. ~~XXXXXX~~ Believe it or not, there are ^{*four*} ~~three~~ ways.

Let me start first with the most plausible. As you may recall from my original memorandum in this case, I said that the ^{*"purchase" part of the*} proviso could be given meaning by construing it to permit minimization of ~~XX~~ liability by step purchases. (Obviously this is the converse of Reliance.) That would work out as follows: Imagine that the following threetransactions all occur within ~~XX~~ six months--

a~~XX~~ 9% purchase
a 6% purchase
a 15% sale

Under the Schenker interpretation this 9 + 6 - 15 sequence would result in liability of 6%. That result would obtain because of the language "at the time of the purchase." At the time of the first ~~XXX~~ purchase she stockholder was not a ^{*"more than"*} 10% owner, so the 9% ~~IX~~ "buy" was not a statutory "purchase." ~~XXXXXXXXXX~~ But the 6% purchase makes one a statutory insider under the general principle of Stella (which, of course, also applies if one buys all 15% in one "swell foop"). Therefore one is an insider when all 15% is sold, but only ~~XXXX~~ 6% of the "sales" have a "purchase" to be matched against. ~~XXXXXXXXXX~~ To emphasize the role of Stella in this case, let's rename

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this the Stella-Schenker approach.

Reliance retains its role under the Stella-Schenker approach,⁰⁰² as can be seen by imagining the following four transactions to occur within 6 months--

a 7% purchase
an 8% purchase
a 6% sale
a 9% sale.

This 7 + 8 - 6 - 9 sequence would yield liability of 6% under the Stella-Schenker interpretation because of Reliance. "At the time of the [8%] purchase," the stockholder made a matchable transaction under the statute. ~~XXX~~ All 8% of that amount could be recaptured in later sales but for Reliance. Because under Reliance the 6% sale means that "at the time" of the 9% sale (which includes 2% of the Stella "purchase") the stockholder was not a more than 10% owner. Thus Reliance and the "at the time of ~~XXX~~ . . . sale" language have meaning under the Stella-Schenker approach. ^{to "at the time of the purchase"} Note that in this context under Provident, Reliance would be irrelevant: neither the 6% nor the 9% "unloading" is a "sale" because "at the time of the ^{matchable} purchase" ^{was} the stockholder ~~was not~~ a "more than 10%" owner.

This Stella-Schenker-Reliance approach seems relatively straightforward. As I mentioned in my original memo, Loss adopts it. But he does so because he views the "at the time of the purchase" ~~XXXXXXXXXX~~ language to be ambivalent and thinks this interpretation comports with the purposes of the ~~XXX~~ statute. He does not appear to notice that this interpretation is necessary to avoid rendering the Reliance interpretation of "at the time of . . . sale" superfluous.

OK. That is approach # 1 to a nonsuperfluous construction of ~~XXXXXXXXXXXXXXXXXXXXXXX~~ "at the time of . . . sale." Under that interpretation both "at the time of the purchase" and "at the

time of . . . sale" are relatively straightforward. KM

time of . . . sale" are relatively straightforward. KM

It is necessary to sketch another kind of case to complete the picture under the Stella-Schenker-Reliance interpretation. Imagine the following four transactions all occur within a six month period:

an 11% purchase
a 4% purchase
a 6% sale
a 9% sale

Under the Stella-Schenker-Reliance approach the result in this 11 + 4 - 6 - 9 ^{sequence} approach is liability for 6%. The "Schenker" aspect of the approach is not relevant to this case because there are no step ~~XXXX~~ purchases. Stella makes the entire 15% of holding a potential "purchase," but Reliance saves harmless the 9% sale. Under Provident, of course, liability would be 4%. The 11% holding was not a "purchase," so the 4% is the only "purchase" available against which to match the 6% sale.

Ok. That fleshes out the reasonable interpretation of "at the time of the purchase" which ~~XX~~ ^{leaves} prevents the Reliance interpretation of "at the time of . . . sale" not superfluous. Now let's look at some of the ~~XXXXXXXXXXXXXXXXXXXXXXXXXXXX~~ other ways to prevent "at the time of . . . sale" from being superfluous.*

Let's call approach # 2 the Zero interpretation. Under the Zero interpretation, one could construe "at the time of . . . sale" to mean that the stockholder must hold "more than 10%" after the sale. In other words, unless one had "more than 10%" left after the sale in a purchase/sale case, one would not be liable. Imagine

* Please note that there are two ways to prevent the phrase "at the time of . . . sale" from being superfluous. One is to construe "at the time of the purchase" in such a fashion that "at the time of . . . sale" ~~XXXXXXXXXXXXXXXXXXXX~~ can still mean what it ~~was~~ was said to mean in Reliance. That's interpretation # 1. The other is to say that Reliance was wrong, and that "at the ~~time~~ time of . . . sale" means something other than what Reliance said. That's interpretation # 2 ~~which~~

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this case anyway you like to take it: it is a loser. For illustration, imagine the following three transactions within six months:

an 11% purchase
a 4% purchase
a 15% sale

Under Provident, the stockholder would have liability for 4%. Under Stella-Schenker-Reliance, the stockholder would be liable for 15% (not having availed himself of ^{Reliance} ~~Stella~~). Under the Zero approach he would have liability for nothing, since he didn't have "more than 10%" left after the ~~XXXX~~ sale.

But the Zero approach does make "at the time of . . . sale" mean something. Combined with Provident it prevents the superfluity of the phrase that results ^{when} ~~XXXX~~ the Reliance ~~XXXXXXXX~~ approach is combined with Provident. There are two big problems with the Zero approach. The first, obviously, is Reliance. The more important is that everybody agrees that the statute would really be gutted by such an approach, and that it can't mean this. ~~XXX~~

The Zero approach would be bad law, but at least it prevents superfluity and not a great deal of ~~XXXXXXXXXXXX~~ tortured construction is necessary to reach it. ~~XXXXXXXXXXXXXXXXXX~~ Approach # 3, to which we now turn, would be very tortured but it also avoids superfluity. Let's call approach # 3 the Juggernaut approach. (Totally arbitrary.) Under the Juggernaut approach, one would construe (as in # 1) the "at the time of the purchase" phrase. Let me illustrate the result before trying to explicate the interpretation. Imagine the following three transactions within six months:

a 9% purchase
a 6% purchase
a 15% sale

Under the Provident approach, liability here will be nothing. Under the Stella-Schenker-Reliance approach liability would be 6%. ~~Under~~

The Juggernaut approach would ~~XXXXXX~~ interpret the proviso to mean that whenever a Provident insider made an additional purchase he ~~XXX~~ would be liable for sales matched against all "purchases," whether or not they themselves were purchases that would have passed muster under Provident. The only ~~XXXXXXXX~~ limitation on liability is that in Reliance for step sales. To paraphrase, under Juggernaut ~~XXXXXXXXXX~~ nonstatutory purchases becomes statutory "purchases" when a ~~XXX~~ statutory "purchase" is followed by a statutory "sale." Let me illustrate this before I try to justify it.

First, imagine the following three transactions ~~XXXX~~ within six months:

- a 9% purchase
- a 6% purchase
- a 15% sale

Under Provident there would be no liability here. Under Stella-Schenker-Reliance there would be 6% liability. Under Juggernaut there would be no liability. The Provident test is applied to ~~XXXX~~ determine that neither the 9% nor the 6% purchase was a statutory ~~sale~~ ^{"purchase"}. Then the statutory "sale" has no transaction against which to be matched. Second, imagine the following three transactions within six months:

- an 11% purchase
- a 4% purchase
- a 15% sale.

Under Provident, there would be 4% liability. Under Stella-Schenker-Reliance there would be 15% liability. Under Juggernaut there would be 15% liability. The Provident test is utilized to identify the 4% purchase as one ~~XXXX~~ made by a statutory insider. The 4% purchase is thus a ~~XXXXXXXXXXXXXXXXXXXX~~ statutory "purchase" followed by a statutory "sale." Under Juggernaut such behavior

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converts nonstatutory ~~XXXX~~ "purchases" within six ~~XXXX~~ months of the "sale" into "statutory purchases". Therefore all 15% of the liability is capturable. ~~XXXXXXXXXX~~

~~XXXXXXXXXXXXXXXXXXXX~~

Reliance however, would also enter any case where there were step sales to allow minimization of ~~X~~ liability. Thus, in an ~~XXXXXXXX~~ 11 + 4 - 6 - 9 sequence, liability under Juggernaut would be 6%. Under Provident, of course, it would be 4% and under Stella-Schenker-Reliance it would also be 6%.

To hazard a generalization that I am not sure would prove out logically in all cases, the Juggernaut liability would be the same as Stella-Schenker-Reliance in any case where one made a purchase after becoming a Provident insider, but would be the same as in Provident in any case where no purchases were made after becoming a statutory insider. Obviously, neither "at the time of the purchase" nor "at the time of . . . sale" is treated as superfluous.

Before I try to justify Juggernaut on the ~~XXX~~ language of the statute, let me say why it makes some sense as a theoretical matter. Compare Stockholder Innocent with Stockholder Pernicious. Innocent engages in a 7 + 8 - 15 sequence. Under the basic theory of Provident, he is a good guy because neither of his ~~XXX~~ purchases was made on the basis of inside ~~XXXXXXXXXX~~ information. He is therefore entitled to sell his holdings free of liability. Pernicious engages in an 11 + 4 - 15 sequence. He is a real bum. His 11% holdings gave him inside information. That put him in a position to learn ~~inside information indicating~~ that a killing could be made in the stock. He then rushed out, bought an additional 4% and unloaded all of it. He is a pretty low form ~~XXX~~ of life.

Now, does the statute allow us to draw this distinction?
The proviso reads in full: "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 . . . " The use of the word "transaction" shows that "purchase and sale" come as a unit in the statute. ~~XXXXXXXXXXXXXXX~~ Pernicious proceeded by means of a nonstatutory purchase + a statutory purchase + a statutory sale. The statutory purchase + the statutory sale constituted a statutory "transaction." Thus he has realized profit on "any purchase and sale" while being a beneficial owner "both at the time of the purchase and sale." ~~THEXXXXXXXXXXNIXXNXXNXXXXXXXXXX~~
~~XXXXXXXXXX~~ Although the original purchase would not have been a ~~XXX~~ statutory purchase, the second purchase and the sale are clearly within the statute. Since the stockholder has acted on the basis of inside information, we will ~~XXXX~~ get him for all his sales.

I guess I don't need to say that the rationale is more convincing than the attempt to twist it out of the statute. I think this is a rather tortured ~~XXXXXXXX~~ approach.

Let's turn finally to the Allis-Chalmers approach. The 7th Circuit has construed ~~KKKK~~ the proviso in the following fashion: The use of the word "transaction" in the proviso shows that a purchase/sale and a sale/purchase should be thought of as a unit. The proviso therefore should be read to mean "both at the ~~time of the purchase and sale, or the sale/purchase.~~ purchase/sale, or the sale/purchase." Thus, when one looks to time, one asks only a single time question in each case: What was the stockholder before the initial ^{event} ~~transaction~~. The "both" is the first part of a "both . . . or" construction. Thus there is no second time question in a given case. Under ~~KKK~~ this construction, ^{the} ~~KKKKKKK~~ "at the time of . . . sale"/construction of Reliance is not ~~unnecessary~~ superfluous. Rather, it is misconceived, unnecessary.

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The Allis-Chalmers approach has two ~~XXXXXX~~ difficulties.
One is that Reliance is on the books. The second is that
"both . . . or" is very unusual English.

~~XX~~
five possible ~~XXX~~ solutions to the fact
So, there you have ~~five possible XX~~
that Provident renders
~~that XXX~~ the Reliance
interpretation of "at the time of . . . sale" superfluous: (1)
Say ~~XX~~ the language is superfluous and Reliance was wrong; (2)
adopt the stepped-up purchase analysis (Schenker); (3) the
Zero approach; (4) the Juggernaut approach; and ⁽⁵⁾ the Allis-
Chalmers approach. *(A sixth would be to say the result here does*
not depend on the proviso. See infra.)

Now turn for a moment to the "both at the time of the . . .
sale or purchase" part of the proviso. It should be noted that
the most likely construction of that part of the proviso is
that one must own "more than 10%" before the ~~XXXXXXXXXXXX~~
sale and after the purchase. Under that construction the
"at the time of . . . [re]purchase" would not be superfluous,
because it would prevent⁺ the application of liability in an 11 - 4 +
2 sequence. Of course, under the Allis-Chalmers approach there
might be liability in an ~~XXXX~~ 11 - 4 + 2 sequence, since the
~~XXXXXX~~ sale/purchase transaction would create a profit when one
was a "more than 10% owner" "at the time of the sale/purchase"--i.e.,
before the sale. But that result is also out of whack with
Reliance. Therefore I don't think that the latter part of the
proviso casts much light on the first part.

My problem is that I don't know how to write the Provident
result under the shadow of Reliance. What do I say about it?
What is Justice Stewart in particular going to do when he realized
that Reliance looks pretty silly in ~~XX~~ light of Provident.

Let's look at our options. The first option is to plow
right ahead and simply dump on Reliance on the ~~XXXXXXXXXX~~ theory that

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in fact the language is superfluous: either because it out-
and-out is superfluous or because the Allis-Chalmers approach is
correct. The second alternative is to give meaning to the "at the
time of . . . sale" language other than Reliance. *That given in*

This ~~XXXXXXXXXX~~ means starting out by dumping on Reliance
not as superfluous but as wrong. Then we adopt ~~XXXXXXXXXX~~ the
Zero approach, the Juggernaut approach, or the Schenker approach.
The Zero approach is simply unacceptable; the Juggernaut approach
is very tortured; the Schenker approach comes easiest. It is
tortured to the extent that "at the time of" means simultaneously
with purchases and before sales. But that basic fact of "at the
time of" meaning different things in ~~XXX~~ different areas is ~~XXXX~~
almost a necessity of the statute. If it doesn't have that
flexible meaning and Provident is correct, there will be no
liability in an 11 - 11 + 11 situation, because if "at the time
of" always ~~XXXXXXXXXX~~ means "before," you never get the 11 - 11 + 11
stockholder.

Those are ~~all~~ ^{out} two alternatives. There is a third possibility:
ignore all this. Then you end up with egg on your face rather than
~~XXXXXXXX~~ Justice Stewart, though it is possible no one but
me will ever notice this. I have talked to Stewart's clerk and
Blackmun's clerk assigned to this case and neither of them had thought
of the problem. We could also say that we leave the possibility
that Juggernaut is the real meaning until we have a case ~~XXXXXX~~
presenting the meaning of the "at the time of . . . sale" language.
But that obviously just points up what a ~~XXXXXXXXXXXXXXXXXX~~ mess Reliance
has created. Personally, I haven't changed my initial view that
the Schenker approach is correct, but I am yours to command.

B. The strategic problem.

I had planned to discuss this at greater length, but the first part of the memo is too long to allow that. As I said, there ~~is a case~~ ~~are two cases~~ we want to hold harmless in this opinion? ~~One XX~~ ~~is Case A:~~ a person buys 5% of a corporation's stock, becomes a director, and sells his stock all within six months. ~~The other~~ ~~is Case C:~~ a "more than 10% owner" ~~sells below 10% and repurchases~~ ~~above 10%.~~ I consider our case ~~Case B.~~ *Let's call that Case A and Provident Case B.*

I label the three cases A, B, and C because in an important respect ~~XX~~ they way we decide CASE B will inevitably control either CASE A or CASE C.

Case A and Case B are very similar cases. In both an "outsider" performs an event that makes him an "insider" and then unloads his stock. In Case A he becomes a director; in Case B he buys his ^{10% of} stock. Now, you are familiar from our previous discussions with the dual-transaction analysis of § 16(b). Under that approach, there should be no liability in either CASE A or CASE B. But, as I've said before, ~~XXXX~~ those results would stem not from the proviso (which of course doesn't even apply to directors) but from the basic structure of the statute. But the proviso ~~was~~ was put in. It says that "More than 10%" stockholders have to be such "both at the ~~the~~ time of the purchase and sale." There is no such requirement for directors. ~~XXX~~ If the proviso controls ~~th~~ ^{is} case as to stockholders, then by negative implication the result would be the opposite ~~XX~~ without the proviso. Since the proviso doesn't apply to directors/officers, by negative implication Case A is ~~XXXXXXXX~~ a situation for liability. It is enough for an officer or director that he be such either at the time of

14
problem entirely. But even the commentators who support dual-transaction analysis can't suggest what that might be.

The reason this point is troubling is demonstrated by Reliance. In Reliance the Court chose to deal with just a portion of the statute; it now appears that the Court's hands are ~~XXXXXX~~ somewhat locked by that error. The same thing could happen here. If the Court relies on the proviso when it shouldn't because the dual-transaction analysis is right, then the Case A is controlled by that approach when the case comes up.

I ~~XXXX~~ think we should rely on the proviso (assuming that the Court presses on on its present path). I don't see what else the proviso might mean. I think Case A should make for liability, even though ~~XX~~ the statute may primarily be aimed at dual-transaction abuses. I am prepared to write Provident that way--but somebody has to tell me what to do about Reliance.

This case is here on certiorari to the United States Court of Appeals for the Ninth Circuit. Section 16(b) of the Securities Exchange Act of 1934 allows a corporation to recover the profits realized by an officer, director, or beneficial owner of more than 10% of its shares, where there has been a purchase and sale of its shares within a six-months' period.

We took this case to determine the meaning of an exemptive provision which specifies that the statute does not cover any transaction where the beneficial owner was not such both "at the time of" the purchase and the sale of the shares involved.

As the facts of this case are too complex for oral summary, I will announce only our decision.

We conclude, in view of the language of the exemptive provision, that a beneficial owner is accountable for profits, in a purchase-sale sequence, only if he was such an owner "before the purchase", as well as at the time of the sale.

As the respondent in this case was not a statutory beneficial owner before the purchase, the subsequent sale within six months was not subject to § 16(b).

The Court of Appeals was of the same view. Accordingly, we affirm its judgment.

The Chief Justice and Justices Brennan, Stewart, Marshall, Blackmun and Rehnquist join in the opinion of the Court. Mr. Justice White joins in all but Part IV-C thereof.

Mr. Justice Stevens took no part in the consideration or decision of the case.

~~Forward by~~ 2 copies to Mr. Putzel 12/30/75

[illegible]

Case - Please clear a sentence
with White's
Clerk, & add

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

January 7, 1976

Re: No. 74-742 - Foremost-McKesson, Inc. v.
Provident Securities Co.

Dear Lewis:

I join your very good opinion in this case
except for Part IV C. Would you please add an
appropriate note to this effect at the bottom of
your opinion?

Sincerely,

Byron

Mr. Justice Powell

Copies to Conference

joins
Mr Justice White concurs
in the judgment of the Court, and in all but
the opinion of the
Court except for Part IV-C of
the Court's opinion.

Mr. Justice White joins in the
judgment of the Court, and in all
but Part IV-C of the Court's
opinion.

[Per Putzel; OK
W/ WHITE'S CLERK]

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

January 7, 1976

Re: No. 74-742 - Foremost-McKesson, Inc. v.
Provident Securities Co.

Dear Lewis:

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Sincerely,



Mr. Justice Powell

Copies to Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

January 8, 1976

Re: No. 74-742 -- Foremost-McKesson, Inc. v. Provident
Securities Company

Dear Lewis:

Please join me.

Sincerely,

JM.

T.M.

Mr. Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

January 9, 1976

Re: 74-742 - Foremost-McKesson, Inc. v. Provident
Securities Co.

Dear Lewis:

I join your proposed opinion.

Regards,

LHB

Mr. Justice Powell

Copies to the Conference

held that GW was liable only for the profits realized on the purchase and sale of the second block of securities. At the same time, however, the Seventh Circuit adjusted the calculations of profits in such a way that GW's liability actually was increased even though fewer shares were involved. (The District Court had valued the \$93 million note at its discounted value as of the day of the transaction; the Seventh Circuit required it to be valued at face because GW eventually received full payment.)

The issue in No. 75-580 is AC's contention that GW is liable for its profits on both blocks of securities purchased and sold. Since the result below anticipated our decision in No. 74-742, the Seventh Circuit reached the correct result on this point. Although we reserved judgment in No. 74-742 on some of the Seventh Circuit's language, the case need not be taken on that score.

*
This should be denied.

* * * * *

No. 74-758 Provident Securities Co. v.
Foremost-McKesson Inc.

This is a cross-petition by respondent in the case we decided, apparently filed as a precautionary measure. It raises alternative arguments which we did not reach.

The cross-petition should be denied.

* GW's objection to the valuation principle utilized by the Seventh Circuit on the second block of stock has been presented in a cross-petition for certiorari, No. 75-890 (filed December 23, 1975). Denying No. 75-580 will not prejudice our taking No. 75-890 should it appear certworthy on its own merits.

L.F.P., Jr.

LFP/gg

CHAMBERS DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-742

Foremost-McKesson, Inc.,	}	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.
Petitioner,		
v.		
Provident Securities Company.		

[January —, 1976]

MR. JUSTICE POWELL delivered the opinion of the Court.

This case presents an unresolved issue under § 16 (b) of the Securities Exchange Act of 1934 (the Act), 48 Stat. 896, 15 U. S. C. § 78p (b). That section of the Act was designed to prevent a corporate director or officer or "the beneficial owner of more than 10 per centum" of a corporation¹ from profiteering through short-swing transactions on the basis of inside information. It provides that a corporation may capture for itself the profits realized on a purchase and sale, or sale and purchase, of its securities within six months by a director, officer, or beneficial owner.² Section 16 (b)'s last sentence, how-

¹ The corporate "insiders" whose trading is regulated by § 16 (b) are defined in § 16 (a) of the Act, 15 U. S. C. § 78p (a), as "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to Section 12 of this title, or who is a director or an officer of the issuer of such security."

² Section 16 (b), 15 U. S. C. § 78p (b), reads in full:

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and pur-

2 FOREMOST-McKESSON v. PROVIDENT SECURITIES

ever, provides that it "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" The question presented here is whether a person purchasing securities that put his holdings above the 10% level is a beneficial owner "at the time of the purchase" so that he must account for profits realized on a sale of those securities within six months. The United States Court of Appeals for the Ninth Circuit answered this question in the negative. 506 F.2d 601 (1974). We affirm.

I

Respondent, Provident Securities Co., was a personal holding company. In 1968 Provident decided tentatively to liquidate and dissolve, and it engaged an agent to find a purchaser for its assets. Petitioner, Foremost-McKesson, Inc., emerged as a potential purchaser, but extensive

chase, 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 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."

FOREMOST-McKESSON v. PROVIDENT SECURITIES 3

negotiations were required to resolve a disagreement over the nature of the consideration Foremost would pay. Provident wanted cash in order to facilitate its dissolution, while Foremost wanted to pay with its own securities. Eventually a compromise was reached whereby Provident agreed to accept Foremost convertible debentures and Foremost agreed to cooperate in the registration and sale to the public of up to half of the debentures.

Provident and Foremost executed a purchase agreement embodying their deal on September 25, 1969. The agreement provided that Foremost would buy two-thirds of Provident's assets for \$4.25 million in cash and \$49.75 million in Foremost convertible subordinated debentures.³ The agreement further provided that Foremost would register under the Securities Act of 1933 \$25 million in principal amount of the debentures and would participate in an underwriting agreement by which those debentures would be sold to the public. At the closing on October 15, 1969, Foremost delivered to Provident the cash and a \$40 million debenture that was subsequently exchanged for two debentures in the principal amounts of \$25 million and \$15 million. Foremost also delivered a \$2.5 million debenture to an escrow on the closing date. On October 20 Foremost delivered to Provident a \$7.25 million debenture representing the balance of the purchase price. These debentures were immediately convertible into more than 10% of Foremost's outstanding common stock.

On October 21 Provident, Foremost, and a group of underwriters executed an underwriting agreement to be closed October 28. The agreement provided for sale to the underwriters of the \$25 million debenture.⁴ On

³ The debentures were issued expressly to acquire Provident's assets, and all of them were used for that purpose.

⁴ The underwriters delivered \$25,366,666.66 in cash to Foremost. That amount represented a purchase price of 101¼% of the

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October 24 Provident distributed the \$15 million and \$7.25 million debentures to its stockholders, reducing the amount of Foremost common into which the company's holdings were convertible to less than 10%. On October 28 the closing under the underwriting agreement was accomplished. Provident thereafter distributed the cash proceeds of the debenture sale to its stockholders and dissolved.

Provident's holdings in Foremost debentures as of October 20 were large enough to make it a beneficial owner of Foremost within the meaning of § 16.⁸ Having acquired and disposed of these securities within six months, Provident faced the prospect of a suit by Foremost to recover the profits realized on the sale of the debenture to the underwriters. Foremost therefore sued for a declaration that it was not liable to Foremost under § 16 (b). The District Court granted summary judgment for Provident and the Court of Appeals affirmed.

Provident's principal argument below for nonliability was based on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U. S. 582 (1973). There we held that an "unorthodox transaction" in securities that did not present the possibility of speculative abuse of inside information was not a "sale" within the meaning of

principal amount of the debentures (\$25,312,500.00) plus interest accrued from the date the contract was executed to the date of closing (\$54,166.66). The amount of profit, if any, realized by Provident has never been established.

⁸A beneficial owner is one who owns more than 10% of an "equity security" registered pursuant to § 12 of the Act. See n. 1, *supra*. The owner of debentures convertible into more than 10% of a corporation's registered common stock is a beneficial owner within the meaning of the Act. Securities Exchange Act of 1934, §§ 3 (a) (10), (11), 15 U. S. C. § 78c (a) (10), (11); Rule 16a-2 (b). 17 CFR § 240.16a-2a (b) (1975). Foremost's common stock was registered; thus Provident's holdings made it a beneficial owner.

§ 16 (b). Provident contended that its reluctant acceptance of Foremost debentures in exchange for its assets was an "unorthodox transaction" not presenting the possibility of speculative abuse and therefore was not a "purchase" within the meaning of § 16 (b). Although the District Court's pre-*Kern County* opinion had adopted this type of analysis, 331 F. Supp. 791 (ND Cal. 1971), the Court of Appeals rejected it, reasoning that Provident's acquisition of the debentures was not "unorthodox" and that the circumstances did not preclude the possibility of speculative abuse.

The Court of Appeals then considered two theories of nonliability based on § 16 (b)'s exemptive provision: "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" The first was Provident's argument that it was not a beneficial owner "at the time of . . . sale." After the October 24 distribution of some debentures to stockholders, the debentures held by Provident were convertible into less than 10% of Foremost's outstanding common stock. Provident contended that its sale to the underwriters did not occur until the underwriting agreement was closed on October 28. If this were the case, the sale would not have been covered by § 16 (b), since Provident would not have been a beneficial owner "at the time of . . . sale."⁶ The Court of Appeals rejected this argument because it found that the sale occurred on October 21 upon execution of the underwriting agreement.⁷

⁶ This contention was based on *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). There we held that a sale made after a former beneficial owner had already reduced its holdings below 10% was exempted from § 16 (b) by the "at the time of . . . sale" requirement. See n. 25, *infra*.

⁷ Section 3 (a) (14) of the Act, 15 U. S. C. § 78c (a) (14), defines

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The Court of Appeals then turned to the theory of nonliability based on the exemptive provision that we consider here.⁸ It held that in a purchase-sale sequence

"sale" and "sell" to include "any contract to sell or otherwise dispose of." But Provident argued that the October 28 closing date was the day of sale because contractual conditions prevented the contract from becoming binding until closing. The underwriting agreement provided in paragraph 7:

"7. Termination of Agreement: This agreement may be terminated, prior to the time the Registration Statement becomes effective, by you or by any group of Underwriters which has agreed hereunder to purchase in the aggregate at least 50% of the Debentures, if, in your judgment or in the judgment of any such group of Underwriters, there shall have occurred a material unfavorable change in political, financial or economic conditions generally." (App. A134.)

And in paragraph 5, the agreement provided: "The several obligations of the Underwriters hereunder are subject to the following conditions:

"(h) That, between the time of execution of this agreement and the time of purchase, there shall occur no material and unfavorable change, financial or otherwise (other than as referred to in the Registration Statement and the Prospectus), in the condition of the Company and its consolidated subsidiaries as a whole; and the Company will, at the time of purchase, deliver to you a certificate of two of its executive officers to the foregoing effect." (App. A134.)

The Court of Appeals agreed that conditions to performance might prevent a contract from being a "sale" prior to closing. But it ruled that all significant conditions here were satisfied when the registration statement required by paragraph 7 became effective on October 21, the day the underwriting agreement was executed. The court also found that after October 21, Provident was no longer subject to the risk of a decline in the market for Foremost's stock. 508 F. 2d, at 607. For reasons not apparent from the opinion, the court did not address the possibility that paragraph 5 (h) left Provident subject to market risks. See n. 8, *infra*.

⁸ Our holding on this issue disposes of this case by precluding any liability on Provident's part. We therefore do not consider whether the Ninth Circuit properly rejected Provident's arguments based on *Kern County* and the sale not having occurred until October 28.

FOREMOST-McKESSON *v.* PROVIDENT SECURITIES 7

the phrase "at the time of the purchase," "must be construed to mean prior to the time when the decision is made." 506 F. 2d, at 814. Although Provident's receipt of the debentures was a "purchase" that made Provident a beneficial owner of Foremost, Provident was not a beneficial owner of Foremost "before the purchase." Accordingly, the exemptive provision removed the purchase from the operation of § 16 (b).

II

The meaning of the exemptive provision has been disputed since § 16 (b) was first enacted. The discussion has focused on the application of the provision to a purchase-sale sequence, the principal disagreement being whether "at the time of the purchase" means "before the purchase" or "immediately after the purchase."⁹ The difference in construction is determinative of a beneficial owner's liability in cases such as Provident's where such owner sells within six months of purchase the securities whose acquisition made him a beneficial owner. The commentators divided immediately over which construction Congress intended,¹⁰ and

⁹ The alternative construction to "before the purchase" is sometimes denominated "simultaneously with the purchase." See, e. g., *Stella v. Graham-Paige Motors Corp.*, 104 F. Supp. 957, 959-960 (SDNY 1952), recognized as law of the case, 132 F. Supp. 100 (SDNY 1955), aff'd in part, remanded in part on other grounds, 232 F. 2d 299 (CA2), cert. denied, 352 U. S. 831 (1956).

¹⁰ Compare C. Meyer, *The Securities Exchange Act of 1934*, at 112 (1934) (adopting a "before" construction), with Seligman, *Problems Under the Securities Exchange Act*, 21 Va. L. Rev. 1, 20 (1934) (adopting an "immediately after" construction).

¹¹ Compare, e. g., Munter, *Section 16 (b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats,"* 52 Cornell L. W. 69, 74-75 (1966); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592, 616-

8 FOREMOST-McKESSON v. PROVIDENT SECURITIES

they remain divided.¹¹ The courts of appeal also are in disagreement over the issue.

The question of what Congress intended to accomplish by the exemptive provision in a purchase-sale sequence came to a court of appeals for the first time in *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299 (CA2), cert. denied, 352 U. S. (1956). There the Court of Appeals for the Second Circuit without discussion, but over a dissent, affirmed the District Judge's adoption of the "immediately after the purchase" construction. The District Judge had been impelled to this construction at least in part by his concern over what the phrase "at the time of . . . purchase" means in a sale-repurchase sequence. He reasoned:

"If the ['before the purchase'] construction urged by [Graham-Paige] is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum." 104 F. Supp. 957, 959 (SDNY 1952).

The District Judge apparently thought that since "before the purchase" seemed an unlikely construction of the exemptive provision in a sale-repurchase sequence, it could not be the proper construction in a purchase-sale sequence.¹² The *Stella* construction of the exemptive

619 (1974); Comment, 9 Stan. L. Rev. 582 (1957) (adopting a "before" construction), with, e. g., 2 L. Loss, Securities Regulation 1080 (2d ed, 1961) (favoring an "immediately after" construction). The weight of the commentary appears to be with the "before the purchase" construction. The ALI Federal Securities Code (Tentative Draft No. 2, 1973), § 1413 (d) and Comment, considers the *Stella* result "questionable" on the statutory language and proposes an amendment to codify the result.

¹² *Stella* was decided before § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and Rule 10b-5, 17 CFR

provision has been adhered to in the Second Circuit, *Newmark v. RKO General, Inc.*, 425 F. 2d 348, 355-356 (CA2), cert. denied, 400 U. S. 854 (1970); *Perine v. William Norton & Co.*, 509 F. 2d 114, 118 (CA2 1974),¹³ and adopted by the Court of Appeals for the Eighth Circuit, *Emerson Electric Co. v. Reliance Electric Co.*, 434 F. 2d 918, 924 (CA8 1970), aff'd on other grounds, 404 U. S. 418 (1972).¹⁴ But in none of the foregoing cases did the court examine critically the legislative history of § 16 (b).

The Court of Appeals considered this case against the background, sketched above, of ambiguity in the pertinent statutory language, continued disagreement among the commentators, and a perceived absence in the relatively few decided cases of a full consideration of the purpose and legislative history of § 16 (b). The court found unpersuasive the rationales offered in *Stella* and its progeny for the "immediately after the purchase" construction. It noted that construing the provision to require that beneficial-ownership status exist before the

§ 240.10b-5 (1975), developed fully as a private remedy for actual abuses of insider information. See 6 L. Loss, *supra*, n. 11, at 3553. The sale-repurchase abuse that worried the *Stella* court would now invite § 10 (b) liability, see n. 30 *infra*, as well as possible liability under § 16 (b).

¹³ To rationalize its view as applied to the purchase-sale sequence, the court in *Newmark* wrote:

"[T]he presumed access to [inside] information resulting from [the] purchase [that makes one a beneficial owner] provides him with an opportunity not available to the investing public, to sell his shares at the moment most advantageous to him. Thus a purchase of shares which makes the buyer an insider creates an opportunity for the type of speculative abuse the statute was enacted to prevent." 425 F. 2d, at 356.

¹⁴ When this Court decided *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972), the question presented here was no longer in the case. See n. 25, *infra*.

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purchase in a purchase-sale sequence would not foreclose an "immediately after the purchase" construction in a sale-repurchase sequence.¹⁸ 506 F. 2d, at 614-615. More significantly, the Court of Appeals challenged directly the premise of the earlier cases that a "before the purchase" construction in a purchase-sale sequence would allow abuses Congress intended to abate. The court reasoned that in § 16 (b) Congress intended to reach only beneficial owners who both bought and sold on the basis of inside information that was not presumptively available to them until after they became statutory "insiders." 506 F. 2d, at 608-614.¹⁹

III

A

The general purpose of Congress in enacting § 16 (b) is well known. See *Kern County Land Co.*, 411 U. S. 582, 591-593 (1973); *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418, 422 (1972), and the authori-

¹⁸ The view of the Court of Appeals that "at the time of" may mean different things according to the particular statutory sequence that is under construction is not unique. See *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries*, — F. 2d — (1975). We need express no opinion here on this issue.

¹⁹ Shortly before this case was argued the Court of Appeals for Seventh Circuit reached the same conclusion on somewhat different analysis. *Allis-Chalmers Mfg. Co.*, — F. 2d, at —. The Court apparently would have reached its result even in the absence of the exemptive provision, reasoning that § 16 (b) covers no transactions by any § 16 (b) "insiders" who were not insiders before their initial transaction. — F. 2d, at —. Since we rely on the exemptive provision, we intimate no view on the proper analysis of a case where a director or officer makes an initial transaction before obtaining "insider" status. See, *s. g.*, *Adler v. Klawans*, 267 F. 2d 840 (CA2 1959). Nor do we have occasion here to assess the approach taken by the Court of Appeals for Seventh Circuit to the exemptive provision. — F. 2d, at — & n. —. See n. 25, *infra*.

FOREMOST-McKESSON v. PROVIDENT SECURITIES 11

ties cited therein. Congress recognized that "insiders" may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could reap profits at the expense of less well informed investors. In § 16 (b) Congress sought to "curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co.*, *supra*, at 422. It accomplished this by defining directors, officers, and beneficial owners as those presumed to have access to inside information¹⁷ and enacting a flat rule that a corporation could recover the profits these insiders made on a pair of security transactions within six months.¹⁸

Foremost points to this purpose, and invokes the observation in *Reliance Electric Co.* that "where alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing trading by corporate insiders." 404 U. S., at 424 (footnote omitted). From these premises Foremost argues that the Court of Appeals' construction of the exemptive pro-

¹⁷ The purpose of § 16 (b) is stated explicitly to be "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." 15 U. S. C. § 78p (b).

¹⁸ Section 16 (b) states that any short-swing profits "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." 15 U. S. C. § 78p (b).

¹⁹ In lieu of the Court of Appeals' construction, Foremost offers a construction whereby any purchases prior to the purchase making one a beneficial owner are exempted from the operation of § 16 (b). See *L. Loes*, *supra*, n. 11, at 1060.

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vision must be rejected²⁰ because it makes § 16 (b) inapplicable to some possible abuses of inside information that the statute would reach under the *Stella* construction.²⁰ We find this approach unsatisfactory in its focus on situations that § 16 (b) may in fact not reach rather than on the language and purpose of the exemptive provision itself. Foremost's approach also invites an imposition of § 16 (b)'s liability without fault that is not consistent with the premises upon which Congress enacted the section.

B

The exemptive provision, which applies only to beneficial owners and not to other statutory insiders, must have been included in § 16 (b) for a purpose. Although the extensive legislative history of the 1934 Act is bereft of any explicit explanation of Congress' intent, see *Reliance Electric Co.*, *supra*, at 424, the evolution of § 16 (b) from its initial proposal through passage does shed significant light on the purpose of the exemptive provision.

The original version of what would develop into the 1934 Act was S. 2693, 73d Cong., 2d Sess. (1934). It provided in § 15 (b):

"(b) It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—

"(1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six

²⁰ An example of a possible abuse of inside information covered only under the *Stella* construction is the hypothetical posed in *Newmark*. See n. 13, *supra*.

FOREMOST-McKESSON v. PROVIDENT SECURITIES 13

months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months."

In the next version of the legislation, H. R. 8720, 73d Cong., 2d Sess. (1934), § 15 (b) read almost identically to § 16 (b) as it was eventually enacted.²¹

"(b) Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase of any such registered equity security within a 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. . . . 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 sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection of preventing the unfair use of information which

²¹ As can be seen by comparing H. R. 8720's version to § 16 (b), *supra*, n. 2, the changes are relatively minor. Formally, the statement of purpose has been moved to the front of the statute and various grammatical changes have been made. A significant substantive change not apparent from the faces of the two sections is that § 16 (b) beneficial owners are those owning 10% of a registered security, while H. R. 8720 retained S. 2693's 5% requirement. Compare Securities Exchange Act of 1934, § 16 (a), 15 U. S. C. § 78p (a), with H. R. 8720, 73d Cong., 2d Sess., § 15a (1934).

14 FOREMOST-McKESSON v. PROVIDENT SECURITIES

may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer."

Thomas G. Corcoran, a spokesman for S. 2693's drafters, introduced § 15 (b) as forbidding an insider "to carry on any short-term speculations in the stock. He cannot, with his inside information get in and out of stock within six months." Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 133 (1934).

The Court of Appeals concluded that S. 2693 would have applied only to a beneficial owner who had that status before a purchase-sale sequence was initiated, 506 F. 2d, at 611, and we agree. Foremost appears not to contest this point. Petitioner's Opening Brief, at 29. The question thus becomes whether H. R. 8720's change in the language imposing liability and its addition of the exemptive provision were intended to change S. 2693's result in a purchase-sale sequence by a beneficial owner. We think the legislative history shows no such intent.

S. 2693 and its House counterpart, H. R. 7852, 73d Cong., 2d Sess. (1934), met substantial criticism on a number of scores, including various provisions of § 15. See Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15 (1934); Hearings on H. R. 7852 and H. R. 8720, *supra*, at 1-623.²² S. 2693 was recast into H. R. 8720 to take account of the criticisms that the

²² Corcoran termed § 15 "one of the most important provisions in [S. 2693]." Hearings on Stock Exchange Practices, *supra*, at 6555. But most of the proposed legislation was directed at regulation of the stock exchanges themselves and certain trading practices that were considered undesirable regardless of who performed them. See *id.*, at 6465. Most of the hearings, therefore, dealt with other problems.

bill's drafters thought valid. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 625, 674. The primary substantive criticism directed at § 15 (b) of S. 2693 was that it did not prevent the use of inside information to reap a short-term profit in a sale-repurchase situation. See Hearings on Stock Exchange Practices, *supra*, at 6557-6558. Criticism was also directed at making liability for short-term profits turn on ownership "as of record and/or beneficially." See *id.*, at 6914. H. R. 8720 remedied these perceived shortcomings by providing in § 16 (b): "Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase . . . shall inure to and be recoverable by the issuer."²³ The term "such beneficial owner" drew content from § 15 (a)'s definition of a beneficial owner as one owning "more than 5 per centum of any class" of a registered security.

The structure of the clause imposing liability in the revised § 15 (b) did not unambiguously retain S. 2693's requirement that beneficial ownership precede a purchase-sale sequence. But we cannot assume easily that Congress intended to eliminate the requirement in the revised bill. The legislative history reveals that the requirement was made clear in the hearings, yet no complaint was made about it.

The testimony on S. 2693 demonstrates that the drafters were emphatic about the requirement. In introducing the bill Corcoran pointed out a technical flaw in

²³ The other major substantive change effected in § 15 (b) by H. R. 8720 was the elimination of the potential criminal liability. The criminal liability aspect of S. 2693's version of § 15 (b) appears not to have been discussed in hearings. It may have been thought, however, that a criminal case could never be made out. The difficulties of proving the elements on which criminal liability turned had already led the drafters to eliminate those questions of fact in civil suits to recover profits. See n. 28, *infra*.

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S. 2693's language: "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock. . . ." It was possible to construe the phrase "owning . . . 5 per centum" to apply to directors and officers as well as to stockholders, so that trading by directors and officers would not be subject to § 15 (b) if their previous holdings did not exceed 5%. But Corcoran made clear that the requirement of pre-existing ownership applied only to beneficial owners.

"Mr. CORCORAN. . . . The bill is not very well drawn there. It ought to read to cover every director, every officer, and every stockholder who owns more than 5 percent of the stock. That is the way it was intended to read.

"Mr. MAPES. That is not the language there now.

"Mr. CORCORAN. It is not. It is not properly worded as to the 5 percent.

"Mr. MAPES. It ought to read 'and/or beneficially more than 5 percent' followed by 'is a director, or officer.'

"Mr. CORCORAN. It is badly drawn. We slipped on that. It ought to read 'every director and every officer' and then 'every big stockholder.'"

Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133; see Hearings on Stock Exchange Practices, *supra*, at 6555.

We thus have a legislative record that reveals the drafters focused directly on the fact that S. 2693 covered a short-term purchase-sale sequence by a beneficial owner only if his status existed before the purchase, and no concern was expressed about the wisdom of this requirement. But the concept was omitted from the operative language of the section when it was restructured to cover sale-repurchase sequences. In the same draft,

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however, the exemptive provision was added to the section. On this record we are persuaded that the exemptive provision was intended to preserve the requirement of beneficial ownership before the purchase. Later discussions of § 16 (b) in the hearings are consistent with this interpretation.²⁴ We hold that, in a purchase-sale sequence, a beneficial owner must account for profits only if he was a beneficial owner "before the purchase."²⁵

²⁴ "Mr. PERCORA. The theory was that the ownership of 5 percent of the stock would practically constitute him an insider, and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served."

Hearings on Stock Exchange Practices, *supra*, at 7741. Ferdinand Percora was counsel to the subcommittee of the Senate Committee on Banking and Currency that conducted extensive hearings on stock exchange operations prior to the enactment of the Securities Exchange Act of 1934. He was also one of the draftsmen of § 15 (b) of S. 2693. Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 83 (1934).

²⁵ In *Reliance Electric Co.*, 404 U. S. 418, the Court also had occasion to consider the application of the exemptive provision in a purchase-sale sequence. There Reliance acquired 13.2% of Emerson's shares pursuant to a tender offer and within six months disposed of its holdings in two sales of 3.24% and 9.96%. The Court of Appeals for the Eighth Circuit held that the purchase, by which Reliance became a beneficial owner, was covered by § 16 (b). But it ruled that Reliance was liable for the profits on only its first sale, because "at the time of . . . sale" of the 9.96%, it was not a beneficial owner.

The Court granted certiorari on Emerson's petition to review this construction of "at the time of . . . sale," and affirmed. The construction of "at the time of the purchase," however, was not before the Court. 404 U. S., at 420-421. Reliance thus remained liable for the 3.24% sale, although it would have had no liability under our holding today. The Court of Appeals for the Seventh Circuit has recognized correctly that the construction of "at the time of . . .

IV

Additional considerations support our reading of the legislative history as the proper one.

A

Section 16 (b) imposes a strict prophylactic rule with respect to insider, short-swing trading. In *Kern County Land Co.*, 411 U. S., at 595, we noted:

"The statute requires the [statutorily defined] inside, short-swing trader to disgorge all profits realized on all 'purchases and sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information."

In short, this statute imposes liability without fault within its narrowly drawn limits.²⁶

sale" in *Reliance Electric Co.* is superfluous in light of our construction of "at the time of the purchase" here, see *Allis-Chalmers Mfg. Co.*, — F. 2d, at — n. 12, but we agree that with that court's further observation that the procedural posture of *Reliance Electric Co.* prevented a full consideration of the meaning of the exemptive provision. See *ibid.* We express no opinion on the interpretation of the provision by which the Court of Appeals for the Seventh Circuit sought to avoid the apparent superfluity of the "at the time of . . . sale" language. *Id.*, at —, —, *supra*, n. 16.

²⁶ "Mr. CORCORAN. . . . You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

"Senator GORE. You infer the intent from the fact.

"Mr. CORCORAN. From the fact.

"Senator KEAN. Suppose he got stuck in something else, and he had to sell?

[Footnote 26 is continued on p. 19]

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Foremost recognizes the ambiguity of the exemptive provision, but argues that where "alternative constructions" of § 16 (b)'s terms are available, we should choose the construction that best serves the statute's purposes. Foremost relies on statements generally to this effect in *Kern County Land Co.*, *supra*, at 595, and *Reliance Electric Co.*, 404 U. S., at 424. In neither of those cases, however, did the Court adopt the construction that imposed liability, recognizing that not every ambiguity must be resolved in favor of the application of § 16 (b). And we think it is generally appropriate not to reach the harsh result of imposing § 16 (b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such a result, courts must assume that it will do so expressly or by unmistakable inference. We note further that there is nothing to suggest that the construction urged by Foremost would serve better to further congressional purposes. Indeed, the legislative history of § 16 (b) indicates that Congress by adding the exemptive provision deliberately expressed a contrary choice. In a different context a more expansive construction of § 16 (b) may well be adopted to advance its purposes.

It is not irrelevant that Congress itself limited carefully the extraordinary liability imposed by § 16 (b). See *Reliance Electric Co.*, *supra*, at 422-425. Even an "insider" may trade freely without incurring the statutory liability if, for example, he spaces his transactions at intervals

"Senator BARKLEY. All he would get would be what he put into it. He would get his original investment.

"Mr. CORCORAN. He would get his money out, but the profit goes to the corporation.

"Senator KERN. Suppose he had to sell.

"Mr. CORCORAN. Let him get out what he put in, but give the corporation the profit."

Hearings on Stock Exchange Practices, *supra*, at 6557.

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greater than six months. When Congress has so recognized the need to limit carefully the "arbitrary and sweeping coverage" of § 16 (b), *Bershad v. McDonough*, 428 F. 2d 693, 696 (CA7 1970), courts should not be quick to determine that, despite an acknowledged ambiguity, Congress intended the section to cover a particular transaction.

B

Our construction of § 16 (b) also is supported by the distinction Congress recognized between short-term trading by mere stockholders and such trading by directors and officers. The legislative discourse revealed that Congress thought that all short-swing trading by directors and officers was vulnerable to abuse because of their intimate involvement in corporate affairs. But trading by stockholders was viewed as being subject to abuse only when the size of their holdings afforded the potential of access to corporate information.²⁷ These different

²⁷ This distinction is especially evident in the following exchange, directed to § 15 (a)'s reporting requirements for beneficial owners:

"Senator KEAN. Suppose a man is not a director at all and does not want to be a director, and he happens to own 5 percent or buy 5 percent. Do you think you are going to get him to file with the exchange all the time just the number of shares he has?"

"Mr. CONCORAN. I think so, sir."

"Senator KEAN. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor——"

"Mr. CONCORAN. Five percent is a lot in a modern corporation. Many corporations are controlled by 5 percent or 10 percent."

"Senator KEAN. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors."

"Mr. CONCORAN. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director."

perceptions simply reflect the realities of corporate life.

It would not be consistent with this perceived distinction to impose liability on the basis of a purchase made when the percentage of stock ownership requisite to insider status had not been acquired. To be sure, the possibility does exist that one who becomes a beneficial owner by a purchase will sell on the basis of information attained by virtue of his newly acquired holdings. But the purchase itself was not one posing dangers that Congress considered intolerable, since it was made when the purchaser owned no shares or less than the percentage deemed necessary to make one an insider. Such a purchaser is more analogous to the stockholder owning less than 10%, and thereby excluded entirely from the operation of § 16 (b), than to a director or officer whose every purchase and sale is covered by the statute. While this reasoning might not compel our construction of the exemptive provision, it explains why Congress may have seen fit to draw the line it did. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (1959).

C

Section 16 (b)'s scope, of course, is not affected by whether alternative sanctions might inhibit the abuse of inside information. But the process of determining what § 16 (b) covers, and what it does not, should not obscure the fact that Congress left some problems of the abuse of inside information to other remedies. It was thought, for example, that § 16 (a)'s publicity requirement²⁸

²⁸ "Senator KEAN. He might not be."

Hearings on Stock Exchange Practices, *supra*, at 6556. It is also reflected in the discussion of the technical flaw in S. 2693. See *id.*, at 6555-6556, at 7741-7743; Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133.

²⁸ Section 16 (a), 15 U. S. C. § 78p (a) provides:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity secu-

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would afford indirect protection against some potential misuses of inside information.²⁹ See Hearings on H. R. 7852 and R. R. 8720, *supra*, at 134-135; H. Rep. No. 1383, 73d Cong., 2d Sess., 13 (to accompany H. R. 9323, 73d Cong., 2d Sess., passed by the House April 27, 1934, without the present § 16 (b)). Congress also has passed general antifraud statutes that sanction abusive practices by insiders. See Securities Act of 1933, § 17 (a), 48 Stat. 84, 15 U. S. C. § 77q (a); Securities Exchange Act of 1934, § 10 (b), 15 U. S. C. § 78j (b); 3 L. Loss, *supra*,

urity (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78l (g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

²⁹ The drafters clearly thought that § 16 (a) would help deter abuses not covered by § 16 (b).

"[Mr. Corcoran.] [S]ection 15 (a), requires every director, officer, or principal holder of any securities listed on an exchange to file with the exchange and with the commission a statement of how many shares he owns and to file that statement at the end of each month to show whether there has been any change in his position during the month. That is to prevent the insider from taking advantage of information to sell or buy shares ahead of the release of information to the public about the company."

Those remarks were addressed to S. 2693. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 132.

n. 11, 1423-1429, 1442-1445. Today an investor who can show harm from the actual use of material inside information may have recourse, in particular, to § 10 (b) and Rule 10b-5, 17 CFR § 240.10b-5 (1975).³⁰ These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information by stockholder transactions not covered by § 16 (b).

IV

We must still consider briefly Foremost's contention that the "before the purchase" construction is inconsistent with other enactments of Congress and the interpretation of § 16 (b) by the Securities and Exchange Commission.

Foremost and the *amicus* point to §§ 16 (d) and 16 (e) of the Act, 15 U. S. C. §§ 78p (d), (e), as congressional actions that would not have been necessary unless one selling the securities whose acquisition made him a beneficial owner would be liable under § 16 (b). Section 16 (d), in part, exempts from § 16 (b) certain transactions by a "dealer in the ordinary course of his business and incident to the establishment or maintenance

³⁰ The dramatic development of Rule 10b-5 has now embraced evils that Foremost urges its construction of § 16 (b) is necessary to prevent. The Rule has been applied to trading by one who acquired inside information in the course of negotiations with a corporation, such as the negotiations for Provident's purchase of the Foremost debentures. *Van Alostyne, Noel & Co.*, 43 S. E. C. 1081 (1969), 3 L. Loss, *supra*, at 1451. And a stockholder trading on information not generally known has been held subject to the sanctions of the Rule. *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228 (CA2 1974); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (CA2 1968). The liability of insiders who "tip" others, *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301 (CA2 1971), cert. denied, 404 U. S. 1005 (1972), may even reduce the threat that beneficial owners not themselves represented on the board of directors will be able to acquire inside information.

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by him of a primary or secondary market.”³¹ Section 16 (e) provides an exemption for certain “foreign or domestic arbitrage transactions.”³² They argue similarly that the SEC’s Rule 16b-2, 17 CFR § 240.16b-2 (1975), is unnecessary if our construction of § 16 (b) is correct. Rule 16b-2 exempts from § 16 (b) specified transactions “in connection with the distribution of a substantial block of securities.”³³

³¹ Section 16 (d), 15 U. S. C. § 78p (d), provides:

“(d) The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase, and the provisions of subsection (e) of this section shall not apply to any sale, of an equity security not then or therefore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 78e of this title) for such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest, define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market.”

“Dealer” is defined in § 3 (a) (5) of the Act, 15 U. S. C. § 78c (a) (5).

³² Section 16 (e), 15 U. S. C. § 78p (e), provides:

“(e) The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section.”

³³ Section 16 (b) provides in its final clause that it shall not cover “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). Rule 161-2 provides:

“(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of section 16 (b) of the Act, to the extent specified in this § 240.16b-

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We do not consider these provisions to be inconsistent with our holding. Nothing on their faces would make them applicable to one selling the securities whose purchase made him a beneficial owner. But the exemptions would be necessary to protect stockholders already qualifying as beneficial owners when they purchased³⁴ and

2, as not comprehended within the purpose of said section, upon the following conditions:

"(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

"(2) The security involved in the transaction is (i) a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities, or (ii) a security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed or to cover an over-allotment or other short position created in connection with such distribution; and

"(3) Other persons not within the purview of section 16 (b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of section 16 (b) of the Act by this § 240.16b-2. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this § 240.16b-2.

"(b) The exemption of a transaction pursuant to this § 240.16b-2 with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this § 240.16b-2."

³⁴The press release accompanying the SEC's promulgation of Rule 16b-2 demonstrates this point. It explained: "The new Rule [16b-2] affords an exemption for certain cases by providing that

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they would, of course, apply to transactions by directors and officers as well.

Foremost and the *amicus* also remind us that the interpretation of the exemptive provision for which they contend has been adopted explicitly by the SEC. In the past the SEC has contended for this position as an *amicus*. Brief for SEC as *Amicus Curiae*, at 22-27, *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). But the Commission has not appeared as an *amicus* in this case. In any event, even if the Commission's views have not changed, we would not afford them the deference to which the views of the agency administering a statute are usually entitled, for in *Reliance Electric Co.*, 404 U. S., at 418, the Court rejected the basic theory on which the SEC based its interpretation of the exemptive provision. Our re-examination of the exemptive provision confirms the view that the SEC's theory did not reflect the intent of Congress.

The judgment is

Affirmed.

underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company" SEC Release No. 34-264, June 8, 1935.

12/19/75

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-742

Foremost-McKesson, Inc.,	}	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.
Petitioner,		
v.		
Provident Securities Company.		

[January —, 1976]

MR. JUSTICE POWELL delivered the opinion of the Court.

This case presents an unresolved issue under § 16 (b) of the Securities Exchange Act of 1934 (the Act), 48 Stat. 896, 15 U. S. C. § 78p (b). That section of the Act was designed to prevent a corporate director or officer or "the beneficial owner of more than 10 per centum" of a corporation¹ from profiteering through short-swing transactions on the basis of inside information. It provides that a corporation may capture for itself the profits realized on a purchase and sale, or sale and purchase, of its securities within six months by a director, officer, or beneficial owner.² Section 16 (b)'s last sentence, how-

¹ The corporate "insiders" whose trading is regulated by § 16 (b) are defined in § 16 (a) of the Act, 15 U. S. C. § 78p (a), as "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security."

² Section 16 (b), 15 U. S. C. § 78p (b), reads in full:

"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

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ever, provides that it "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" The question presented here is whether a person purchasing securities that put his holdings above the 10% level is a beneficial owner "at the time of the purchase" so that he must account for profits realized on a sale of those securities within six months. The United States Court of Appeals for the Ninth Circuit answered this question in the negative. 506 F. 2d 601 (1974). We affirm.

I

Respondent, Provident Securities Co., was a personal holding company. In 1968 Provident decided tentatively to liquidate and dissolve, and it engaged an agent to find

realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.²²

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a purchaser for its assets. Petitioner, Foremost-McKesson, Inc., emerged as a potential purchaser, but extensive negotiations were required to resolve a disagreement over the nature of the consideration Foremost would pay. Provident wanted cash in order to facilitate its dissolution, while Foremost wanted to pay with its own securities.

Eventually a compromise was reached, and Provident and Foremost executed a purchase agreement embodying their deal on September 25, 1969. The agreement provided that Foremost would buy two-thirds of Provident's assets for \$4.25 million in cash and \$49.75 million in Foremost convertible subordinated debentures.* The agreement further provided that Foremost would register under the Securities Act of 1933 \$25 million in principal amount of the debentures and would participate in an underwriting agreement by which those debentures would be sold to the public. At the closing on October 15, 1969, Foremost delivered to Provident the cash and a \$40 million debenture that was subsequently exchanged for two debentures in the principal amounts of \$25 million and \$15 million. Foremost also delivered a \$2.5 million debenture to an escrow on the closing date. On October 20 Foremost delivered to Provident a \$7.25 million debenture representing the balance of the purchase price. These debentures were immediately convertible into more than 10% of Foremost's outstanding common stock.

On October 21 Provident, Foremost, and a group of underwriters executed an underwriting agreement to be closed October 28. The agreement provided for sale to the underwriters of the \$25 million debenture. On

*The debentures were issued expressly to acquire Provident's assets, and all of them were used for that purpose.

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October 24 Provident distributed the \$15 million and \$7.25 million debentures to its stockholders, reducing the amount of Foremost common into which the company's holdings were convertible to less than 10%. On October 28 the closing under the underwriting agreement was accomplished.⁴ Provident thereafter distributed the cash proceeds of the debenture sale to its stockholders and dissolved.

Provident's holdings in Foremost debentures as of October 20 were large enough to make it a beneficial owner of Foremost within the meaning of § 16.⁵ Having acquired and disposed of these securities within six months, Provident faced the prospect of a suit by Foremost to recover any profits realized on the sale of the debenture to the underwriters. Provident therefore sued for a declaration that it was not liable to Foremost under § 16 (b). The District Court granted summary judgment for Provident and the Court of Appeals affirmed.

Provident's principal argument below for nonliability was based on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U. S. 582 (1973). There we held that an "unorthodox transaction" in securities that did not present the possibility of speculative abuse of inside

⁴ The underwriters delivered \$25,366,866.66 in cash to Foremost. That amount represented a purchase price of 101¼% of the principal amount of the debentures (\$25,312,500.00) plus interest accrued from October 15 to the date of closing (\$54,166.66). The amount of profit realized by Provident has never been established.

⁵ A beneficial owner is one who owns more than 10% of an "equity security" registered pursuant to § 12 of the Act, 15 U. S. C. § 78j. See n. 1, *supra*. The owner of debentures convertible into more than 10% of a corporation's registered common stock is a beneficial owner within the meaning of the Act. Securities Exchange Act of 1934, §§ 3 (a) (10), (11), 15 U. S. C. § 78c (a) (10), (11); Rule 16a-2 (b), 17 CFR § 240.16a-2 (b) (1975). Foremost's common stock was registered, thus Provident's holdings made it a beneficial owner.

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information was not a "sale" within the meaning of § 16 (b). Provident contended that its reluctant acceptance of Foremost debentures in exchange for its assets was an "unorthodox transaction" not presenting the possibility of speculative abuse and therefore was not a "purchase" within the meaning of § 16 (b). Although the District Court's pre-*Kern County* opinion had adopted this type of analysis, 331 F. Supp. 787 (ND Cal. 1971), the Court of Appeals rejected it, reasoning that Provident's acquisition of the debentures was not "unorthodox" and that the circumstances did not preclude the possibility of speculative abuse. 506 F. 2d, at 604-605.

The Court of Appeals then considered two theories of nonliability based on § 16 (b)'s exemptive provision: "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" The first was Provident's argument that it was not a beneficial owner "at the time of . . . sale." After the October 24 distribution of some debentures to stockholders, the debentures held by Provident were convertible into less than 10% of Foremost's outstanding common stock. Provident contended that its sale to the underwriters did not occur until the underwriting agreement was closed on October 28. If this were the case, the sale would not have been covered by § 16 (b), since Provident would not have been a beneficial owner "at the time of . . . sale."⁴ The Court of Appeals rejected this argument because it found that

⁴ This contention was based on *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). There we held that a sale made after a former beneficial owner had already reduced its holdings below 10% was exempted from § 16 (b) by the phrase "at the time of . . . sale" in the exemptive provision. See n. 25, *infra*.

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the sale occurred on October 21 upon execution of the underwriting agreement.⁷

The Court of Appeals then turned to the theory of nonliability based on the exemptive provision that we consider here.⁸ It held that in a purchase-sale sequence

⁷ Section 3 (a) (14) of the Act, 15 U. S. C. § 78c (a) (14), defines "sale" and "sell" to include "any contract to sell or otherwise dispose of." But Provident argued that the October 28 closing date was the day of sale because contractual conditions prevented the contract from becoming binding until closing. The underwriting agreement provided in paragraph 7:

"7. Termination of Agreement: This agreement may be terminated, prior to the time the Registration Statement becomes effective, by you or by any group of Underwriters which has agreed hereunder to purchase in the aggregate at least 50% of the Debentures, if, in your judgment or in the judgment of any such group of Underwriters, there shall have occurred a material unfavorable change in political, financial or economic conditions generally." (App. A134.)

And in paragraph 5, the agreement provided: "The several obligations of the Underwriters hereunder are subject to the following conditions:

"(h) That, between the time of execution of this agreement and the time of purchase, there shall occur no material and unfavorable change, financial or otherwise (other than as referred to in the Registration Statement and the Prospectus), in the condition of the Company and its consolidated subsidiaries as a whole; and the Company will, at the time of purchase, deliver to you a certificate of two of its executive officers to the foregoing effect." (App. A134.)

The Court of Appeals agreed that conditions to performance might prevent a contract from being a "sale" prior to closing. But it ruled that all significant conditions here were satisfied when the registration statement required by paragraph 7 became effective on October 21, the day the underwriting agreement was executed. The court also found that after October 21, Provident was no longer subject to the risk of a decline in the market for Foremost's stock. 506 F. 2d, at 607. For reasons not apparent from the opinion, the court did not address the possibility that paragraph 5 (h) left Provident subject to market risks. See n. 8, *infra*.

⁸ Our holding on this issue disposes of this case by precluding

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the phrase "at the time of the purchase," "must be construed to mean prior to the time when the decision to purchase is made." 506 F. 2d, at 614. Although Provident's receipt of the debentures was a "purchase" that made Provident a beneficial owner of Foremost, Provident was not a beneficial owner of Foremost before the purchase. Accordingly, the exemptive provision removed the purchase from the operation of § 16 (b).

II

The meaning of the exemptive provision has been disputed since § 16 (b) was first enacted. The discussion has focused on the application of the provision to a purchase-sale sequence, the principal disagreement being whether "at the time of the purchase" means "before the purchase" or "immediately after the purchase."⁹ The difference in construction is determinative of a beneficial owner's liability in cases such as Provident's where such owner sells within six months of purchase the securities whose acquisition made him a beneficial owner. The commentators divided immediately over which construction Congress intended,¹⁰ and they remain divided.¹¹ The courts of appeals also are in disagreement over the issue.

any liability on Provident's part. We therefore do not consider whether the Ninth Circuit properly rejected Provident's arguments based on *Kern County* and the sale not having occurred until October 28.

⁹ The alternative construction to "before the purchase" is sometimes denominated "simultaneously with the purchase," as it was by the Court of Appeals. 506 F. 2d, at 608.

¹⁰ Compare C. Meyer, *The Securities Exchange Act of 1934*, at 112 (1934) (adopting a "before" construction), with Seligman, *Problems Under the Securities Exchange Act*, 21 Va. L. Rev. 1, 19-20 (1934) (adopting an "immediately after" construction).

¹¹ Compare, e. g., Munter, *Section 16 (b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn*

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The question of what Congress intended to accomplish by the exemptive provision in a purchase-sale sequence came to a court of appeals for the first time in *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299 (CA2), cert. denied, 352 U. S. 831 (1956). There the Court of Appeals for the Second Circuit without discussion, but over a dissent, affirmed the District Court's adoption of the "immediately after the purchase" construction. That court had been impelled to this construction at least in part by concern over what the phrase "at the time of . . . purchase" means in a sale-repurchase sequence, reasoning:

"If the ['before the purchase'] construction urged by [Graham-Paige] is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum." 104 F. Supp. 957, 959 (SDNY 1952).

The District Court may have thought that "before the purchase" seemed an unlikely construction of the exemptive provision in a sale-repurchase sequence, so it could not be the proper construction in a purchase-sale sequence.¹² The *Stella* construction of the exemptive

in *Order to Kill the Rats*, 52 Cornell L. Q. 69, 74-75 (1966); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592, 616-619 (1974); Comment, 9 Stan. L. Rev. 582 (1957) (adopting a "before" construction), with, e. g., 2 L. Loss, *Securities Regulation* 1060 (2d ed. 1961) (favoring an "immediately after" construction). The weight of the commentary appears to be with the "before the purchase" construction. The ALI Federal Securities Code (Tentative Draft No. 2, 1973), § 1413 (d) and Comment (6), considers the "immediately after the purchase" ~~result~~ "questionable" on the statutory language and proposes an amendment to codify the result.

¹² *Stella* was decided before § 10 (b) of the Act, 15 U. S. C. § 78j (b), as implemented by Rule 10b-5, 17 CFR § 240.10b-5

construction

provision has been adhered to in the Second Circuit, *Newmark v. RKO General, Inc.*, 425 F. 2d 348, 355-356 (CA2), cert. denied, 400 U. S. 854 (1970);¹³ *Perine v. William Norton & Co.*, 509 F. 2d 114, 118 (CA2 1974), and adopted by the Court of Appeals for the Eighth Circuit. *Emerson Electric Co. v. Reliance Electric Co.*, 434 F. 2d 918, 923-924 (CA8 1970), aff'd on other grounds, 404 U. S. 418 (1972).¹⁴ But in none of the foregoing cases did the court examine critically the legislative history of § 16 (b).

The Court of Appeals considered this case against the background, sketched above, of ambiguity in the pertinent statutory language, continued disagreement among the commentators, and a perceived absence in the relatively few decided cases of a full consideration of the purpose and legislative history of § 16 (b). The court found unpersuasive the rationales offered in *Stella* and its progeny for the "immediately after the purchase" construction. It noted that construing the provision to require that beneficial-ownership status exist before the

(1975), developed fully as a private remedy for actual abuses of insider information. See 6 L. Loss, *supra*, n. 11, at 3559. The sale-repurchase abuse that worried the *Stella* court would now invite § 10 (b) liability, see n. 28, *infra*, as well as possible liability under § 16 (b).

¹³ To rationalize its view as applied to the purchase-sale sequence, the court in *Newmark* wrote:

"[T]he presumed access to [inside] information resulting from [the] purchase [that makes one a beneficial owner] provides him with an opportunity, not available to the investing public, to sell his shares at the moment most advantageous to him. Thus, a purchase of shares which makes the buyer an insider creates an opportunity for the type of speculative abuse the statute was enacted to prevent." 425 F. 2d, at 356.

¹⁴ When this Court decided *Reliance Electric Co.*, 404 U. S. 418, the question presented here was no longer in the case. See n. 25, *infra*.

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purchase in a purchase-sale sequence would not foreclose an "immediately after the purchase" construction in a sale-repurchase sequence.¹⁵ 506 F. 2d, at 614-615. More significantly, the Court of Appeals challenged directly the premise of the earlier cases that a "before the purchase" construction in a purchase-sale sequence would allow abuses Congress intended to abate. The court reasoned that in § 16 (b) Congress intended to reach only those beneficial owners who both bought and sold on the basis of inside information that was not presumptively available to them until after they became statutory "insiders." 506 F. 2d, at 608-614.¹⁶

III

A

The general purpose of Congress in enacting § 16 (b) is well known. See *Kern County Land Co.*, 411 U. S., at 591-592¹⁷; *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418, 422 (1972), and the authorities

¹⁵ The view of the Court of Appeals that "at the time of" may mean different things in different contexts is not unique. See *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries*, — F. 2d — (1975). We express no opinion here on this view.

¹⁶ Shortly before this case was argued the Court of Appeals for the Seventh Circuit reached the same conclusion on somewhat different analysis. *Allis-Chalmers Mfg. Co.*, — F. 2d, at —. The court apparently would have reached its result even in the absence of the exemptive provision, reasoning that § 16 (b) covers no transactions by any § 16 (b) insiders who were not insiders before their initial transaction. — F. 2d, at —. Since we rely on the exemptive provision, we intimate no view on the proper analysis of a case where a director or officer makes an initial transaction before obtaining insider status. See, e. g., *Adler v. Klawans*, 267 F. 2d 840 (CA2 1959). Nor do we have occasion here to assess the approach taken by the Court of Appeals for the Seventh Circuit to the exemptive provision. — F. 2d, at — & n. —. See n. 25, *infra*.

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cited therein. Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could reap profits at the expense of less well informed investors. In § 16 (b) Congress sought to "curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co.*, *supra*, at 422. It accomplished this by defining directors, officers, and beneficial owners as those presumed to have access to inside information¹⁷ and enacting a flat rule that a corporation could recover the profits these insiders made on a pair of security transactions within six months.¹⁸

Foremost points to this purpose, and invokes the observation in *Reliance Electric Co.* that "where alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing trading by corporate insiders." 404 U. S., at 424 (footnote omitted). From these premises Foremost argues that the Court of Appeals' construction of the exemptive provision must be rejected¹⁹ because it makes § 16 (b) in-

¹⁷ The purpose of § 16 (b) is stated explicitly to be "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." 15 U. S. C. § 78p (b).

¹⁸ Section 16 (b) states that any short-swing profits "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." 15 U. S. C. § 78p (b).

¹⁹ In lieu of the Court of Appeals' construction, Foremost offers a construction whereby any purchases prior to the purchase making

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applicable to some possible abuses of inside information that the statute would reach under the *Stella* construction.²⁰ We find this approach unsatisfactory in its focus on situations that § 16 (b) may not reach rather than on the language and purpose of the exemptive provision itself. Foremost's approach also invites an imposition of § 16 (b)'s liability without fault that is not consistent with the premises upon which Congress enacted the section.

B

The exemptive provision, which applies only to beneficial owners and not to other statutory insiders, must have been included in § 16 (b) for a purpose. Although the extensive legislative history of the Act is bereft of any explicit explanation of Congress' intent, see *Reliance Electric Co.*, *supra*, at 424, the evolution of § 16 (b) from its initial proposal through passage does shed significant light on the purpose of the exemptive provision.

The original version of what would develop into the Act was S. 2693, 73d Cong., 2d Sess. (1934). It provided in § 15 (b):

"It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—

"(1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six

one a beneficial owner are exempted from the operation of § 16 (b). See 2 L. Loss, *supra*, n. 11, at 1060.

²⁰ *Newmark* describes a possible abuse of inside information covered only under the *Stella* construction. See n. 13, *supra*.

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months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months."

In the next version of the legislation, H. R. 8720, 73d Cong., 2d Sess. (1934), § 15 (b) read almost identically to § 16 (b) as it was eventually enacted.²¹

"Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase of any such registered equity security within a 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. . . . 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 sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection

²¹ As can be seen by comparing H. R. 8720's version of § 15 (b) with § 16 (b), *supra*, n. 2, the differences are relatively minor. Formally, the statement of purpose was moved to the front of the statute and various grammatical changes were made. A significant substantive change not apparent from the faces of the two sections is that § 16 (b) beneficial owners are those owning more than 10% of a registered security, while H. R. 8720 retained S. 2693's 5% requirement. Compare Securities Exchange Act of 1934, § 16 (a), 15 U. S. C. § 78p (a), with H. R. 8720, 73d Cong., 2d Sess., § 15 (a) (1934).

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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."²²

Thomas G. Corcoran, a spokesman for S. 2693's drafters, introduced § 15 (b) as forbidding an insider "to carry on any short-term speculations [sic] in the stock. He cannot, with his inside information get in and out of stock within six months." Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 133 (1934).

The Court of Appeals concluded that S. 2693 would have applied only to a beneficial owner who had that status before a purchase-sale sequence was initiated, 506 F. 2d, at 609, and we agree. Foremost appears not to contest this point. Petitioner's Opening Brief, at 29. The question thus becomes whether H. R. 8720's change in the language imposing liability and its addition of the exemptive provision were intended to change S. 2693's result in a purchase-sale sequence by a beneficial owner. We think the legislative history shows no such intent.

S. 2693 and its House counterpart, H. R. 7852, 73d Cong., 2d Sess. (1934), met substantial criticism on a number of scores, including various provisions of § 15. See Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15 (1934); Hearings on H. R. 7852 and H. R. 8720, *supra*, at 1-623.²² S. 2693 was recast into

²² Corcoran termed § 15 "one of the most important provisions in [S. 2693]." Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., 6555 (1934). But most of the proposed legislation was directed at regulation of the stock exchanges themselves and certain trading practices that were considered undesirable regardless of who performed them.

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H. R. 8720 to take account of the criticisms that the bill's drafters thought valid. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 625, 674. The primary substantive criticism directed at § 15 (b) of S. 2693 was that it did not prevent the use of inside information to reap a short-term profit in a sale-repurchase situation. See Hearings on Stock Exchange Practices, *supra*, at 6557-6558. Criticism was also directed at making liability for short-term profits turn on ownership "as of record and/or beneficially." See *id.*, at 6914. H. R. 8720 remedied these perceived shortcomings by providing in § 15 (b): "Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase . . . shall inure to and be recoverable by the issuer."²³ The term "such beneficial owner" drew content from § 15 (a)'s definition of a beneficial owner as one owning "more than 5 per centum of any class" of a registered security.

The structure of the clause imposing liability in the revised § 15 (b) did not unambiguously retain S. 2693's requirement that beneficial ownership precede a purchase-sale sequence. But we cannot assume easily that Congress intended to eliminate the requirement in the revised bill. The legislative history reveals that the requirement was made clear in the hearings, yet no complaint was made about it.

See *id.* at 6465-6466. Most of the hearings, therefore, dealt with other problems.

²³ The other major substantive change effected in § 15 (b) by H. R. 8720 was the elimination of the potential criminal liability. The criminal liability aspect of S. 2693's version of § 15 (b) appears not to have been discussed in hearings. It may have been thought, however, that a criminal case could never be made out. The difficulties of proving the mental elements on which criminal liability turned had already led the drafters to eliminate those questions of fact in civil suits to recover profits. See n. 26, *infra*.

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The testimony on S. 2693 demonstrates that the drafters were emphatic about the requirement. In introducing the bill Corcoran pointed out a technical flaw in S. 2693's language: "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock. . . ." It was possible to construe the phrase "owning . . . 5 per centum" to apply to directors and officers as well as to stockholders, so that trading by directors and officers would not be subject to § 15 (b) if their previous holdings did not exceed 5%. But Corcoran made clear that the requirement of pre-existing ownership of the specified percentage applied only to beneficial owners.

"[Mr. CORCORAN.] . . . There is a mistake in the drafting. I would suggest that the language of the first lines of section 15 (a) seem to confine the application of the section only to those directors and officers who own more than 5 percent of any class of securities. I would suggest, Mr. Chairman, if I might, that the language should be corrected so that the section applied to every director and every officer, irrespective of how much stock he owns; and also to every owner of more than 5 percent of any class of securities"

Hearings on Stock Exchange Practices, *supra*, at 6555; see Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133.

The legislative record thus reveals that the drafters focused directly on the fact that S. 2693 covered a short-term purchase-sale sequence by a beneficial owner only if his status existed before the purchase, and no concern was expressed about the wisdom of this requirement. But the explicit requirement was omitted from the operative language of the section when it was restructured to cover sale-repurchase sequences. In the same

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draft, however, the exemptive provision was added to the section. On this record we are persuaded that the exemptive provision was intended to preserve the requirement of beneficial ownership before the purchase. Later discussions of § 16 (b) in the hearings are consistent with this interpretation.²⁴ We hold that, in a purchase-sale sequence, a beneficial owner must account for profits only if he was a beneficial owner "before the purchase."²⁵

²⁴ "Mr. PECORA. The theory was that the ownership of 5 percent of the stock would practically constitute him an insider, and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served."

Hearings on Stock Exchange Practices, *supra*, at 7741. Ferdinand Pecora was counsel to the subcommittee of the Senate Committee on Banking and Currency that conducted extensive hearings on stock exchange operations prior to the enactment of the Act. He was also one of the draftsmen of S. 2693. Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 83 (1934).

²⁵ In *Rehance Electric Co.*, 404 U. S. 418, the Court also had occasion to consider the application of the exemptive provision in a purchase-sale sequence. There Emerson acquired 13.2% of the shares of Rehance's predecessor pursuant to a tender offer and within six months disposed of its holdings in two sales of 3.24% and 9.96%. The Court of Appeals for the Eighth Circuit held that the purchase, by which Emerson became a beneficial owner, was covered by § 16 (b). But it ruled that Emerson was liable for the profits on only its first sale, because "at the time of sale" of the 9.96%, it was not a beneficial owner.

The Court granted certiorari on Rehance's petition to review this construction of "at the time of sale," and affirmed. The construction of "at the time of the purchase," however, was not before the Court. *Id.*, at 420-422. Emerson thus remained liable for the 3.24% sale, although it would have had no liability under our holding today. The Court of Appeals for the Seventh Circuit has recognized correctly that the construction of "at the time of . . .

IV

Additional considerations support our reading of the legislative history.

A

Section 16 (b) imposes a strict prophylactic rule with respect to insider, short-swing trading. In *Kern County Land Co.*, 411 U. S., at 595, we noted:

"The statute requires the [statutorily defined] inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information."

In short, this statute imposes liability without fault within its narrowly drawn limits.²⁶

"sale" in *Reliance Electric Co.* is superfluous in light of the construction of "at the time of the purchase" adopted by the Court of Appeals for the Ninth Circuit, which we affirm here. See *Allis-Chalmers Mfg. Co.*, — F. 2d, at — n. 12. But the procedural posture of *Reliance Electric Co.* prevented a full consideration of the meaning of the exemptive provision. See *ibid.* We express no opinion on the interpretation of the provision by which the Court of Appeals for the Seventh Circuit sought to avoid the apparent superfluity of the "at the time of . . . sale" language. *Id.*, at —, —, *supra*, n. 16.

²⁶ Mr. CORCORAN: . . . You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

Senator GORE: You infer the intent from the fact.

Mr. CORCORAN: From the fact.

Senator KEAN: Suppose he got stuck in something else, and he had to sell.

¹Footnote 26 is continued on p. 19.

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As noted earlier, Foremost recognizes the ambiguity of the exemptive provision, but argues that where "alternative constructions" of § 16 (b)'s terms are available, *to* we should choose the construction that best serves the statute's purposes. Foremost relies on statements generally to this effect in *Kern County Land Co.*, *supra*, at 595, and *Reliance Electric Co.*, 404 U. S., at 424. In neither of those cases, however, did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of the application of § 16 (b). We reiterate that nothing suggests that the construction urged by Foremost would serve better to further congressional purposes. Indeed, the legislative history of § 16 (b) indicates that by adding the exemptive provision Congress deliberately expressed a contrary choice. But even if the legislative record were more ambiguous, we would hesitate to adopt Foremost's construction. It is inappropriate to reach the harsh result of imposing § 16 (b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly ~~and~~ by unmistakable inference. *or*

It is not irrelevant that Congress itself limited carefully the strict liability imposed by § 16 (b). See *Reliance Electric Co.*, *supra*, at 422-425. Even an insider may trade freely without incurring the statutory liability if, for example, he spaces his transactions at intervals

"Senator BARKLEY. All he would get would be what he put into it. He would get his original investment.

"Mr. CORCORAN. He would get his money out, but the profit goes to the corporation.

"Senator KEAN. Suppose he had to sell.

"Mr. CORCORAN. Let him get out what he put in, but give the corporation the profit."

Hearings on Stock Exchange Practices, *supra*, at 6556-6557.

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greater than six months. When Congress has so recognized the need to limit carefully the "arbitrary and sweeping coverage" of § 16 (b), *Bershad v. McDonough*, 428 F. 2d 693, 696 (CA7 1970), cert. denied, 400 U. S. 992 (1971), courts should not be quick to determine that, despite an acknowledged ambiguity, Congress intended the section to cover a particular transaction.

B

Our construction of § 16 (b) also is supported by the distinction Congress recognized between short-term trading by mere stockholders and such trading by directors and officers. The legislative discourse revealed that Congress thought that all short-swing trading by directors and officers was vulnerable to abuse because of their intimate involvement in corporate affairs. But trading by mere stockholders was viewed as being subject to abuse only when the size of their holdings afforded the potential for access to corporate information.²⁷ These different perceptions simply reflect the realities of corporate life.

²⁷ This distinction is especially evident in the following exchange, directed to the reporting requirements imposed by § 15 (a) of S. 2693 on beneficial owners:

"Senator KEAN. Suppose a man is not a director at all and does not want to be a director, and he happens to own 5 percent or buy 5 percent. Do you think you are going to get him to file with the exchange all the time just the number of shares he has?"

"Mr. CORCORAN. I think so, sir."

"Senator KEAN. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor——"

"Mr. CORCORAN. Five percent is a lot in a modern corporation. Many corporations are controlled by 5 percent or 10 percent."

"Senator KEAN. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors."

"Mr. CORCORAN. A stockholder owning 5 percent is as much an

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It would not be consistent with this perceived distinction to impose liability on the basis of a purchase made when the percentage of stock ownership requisite to insider status had not been acquired. To be sure, the possibility does exist that one who becomes a beneficial owner by a purchase will sell on the basis of information attained by virtue of his newly acquired holdings. But the purchase itself was not one posing dangers that Congress considered intolerable, since it was made when the purchaser owned no shares or less than the percentage deemed necessary to make one an insider.²⁸ Such a stockholder is more analogous to the stockholder owning less than 10% at all times, and thereby excluded entirely from the operation of § 16 (b), than to a director or officer whose every purchase and sale is covered by the statute. While this reasoning might not compel our construction of the exemptive provision, it explains why Congress may have

insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director

²⁸Senator KEAN. He might not be."

Hearings on Stock Exchange Practices, *supra*, at 6556. It is also reflected in the discussion of the technical flaw in S. 2693. See *id.*, at 6555, Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133. See also Hearings on Stock Exchange Practices, *supra*, at 7741-7743.

²⁸Thus, according to the presumption of the statute, the purchaser did not have access to inside information in making the purchase. It should be noted further that as a matter of practicalities the crucial point in the acquisition of securities is not the technical 'purchase,' but rather the decision to make an acquisition. In the case of an acquisition of a considerable block of a corporation's stock, that decision may precede the "purchase" by a considerable period of time. A prudent investor will want to investigate all available information on the corporation. Such an investor also may need time to finance the purchase, and may wish to effectuate purchases without influencing the market price. These realities emphasize that the acquisition decision by a beneficial owner normally will occur well in advance of the event that is presumed to afford access to inside information.

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seen fit to draw the line it did. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959).

C

Section 16(b)'s scope, of course, is not affected by whether alternative sanctions might inhibit the abuse of inside information. Congress, however, has left some problems of the abuse of inside information to other remedies. These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information by transactions not covered by § 16(b). For example, Congress has passed general antifraud statutes that sanction abusive practices by insiders. See Securities Act of 1933, § 17(a), 48 Stat. 84, 15 U. S. C. § 77q(a); Securities Exchange Act of 1934, § 10(b), 15 U. S. C. § 78j(b); 3 L. Loss, *supra*, n. 11, 1423-1429, 1442-1445. Today an investor who can show harm from the actual use of material inside information may have recourse, in particular, to § 10(b) and Rule 10b-5, 17 CFR § 240.10b-5 (1975).²⁹ It also was thought that § 16(a)'s publicity requirement³⁰

²⁹ Rule 10b-5 has been held to embrace evils that Foremost urges its construction of § 16(b) is necessary to prevent. The Rule has been applied to trading by one who acquired inside information in the course of negotiations with a corporation, such as the negotiations for Provident's purchase of the Foremost debentures. *Van Alstyne, Noel & Co.*, 43 S. E. C. 1080 (1969); 3 L. Loss, *supra*, at 1451-1452. And a stockholder trading on information not generally known has been held subject to the sanctions of the Rule. *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228 (CA2 1974); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (CA2 1968), cert. denied, 394 U. S. 967 (1969). The liability of insiders who "tip" others, *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301 (CA2), cert. denied, 404 U. S. 1005 (1971), may reduce the threat that beneficial owners not themselves represented on the board of directors will be able to acquire inside information from officers and directors.

³⁰ Section 16(a), 15 U. S. C. § 78p(a) provides:

"Every person who is directly or indirectly the beneficial

would afford indirect protection against some potential misuses of inside information.³¹ See Hearings on H. R. 7852 and H. R. 8720, *supra*, at 134-135; H. Rep. No. 1383, 73d Cong., 2d Sess., 13 (to accompany H. R. 9323, 73d Cong., 2d Sess., passed by the House, May 7, 1934, without the present § 16 (b)).

V

We must still consider briefly Foremost's contention that the "before the purchase" construction is inconsis-

owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78l (g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"The drafters clearly thought that § 16 (a) would help deter abuses not covered by § 16 (b).

"[Mr. Corcoran.] [S]ection 15 (a), requires every director, officer, or principal holder of any securities listed on an exchange to file with the exchange and with the commission a statement of how many shares he owns and to file that statement at the end of each month to show whether there has been any change in his position during the month. That is to prevent the insider from taking advantage of information to sell or buy shares ahead of the release of information to the public about the company."

Those remarks were addressed to S. 2693 Hearings on H. R. 7852 and H. R. 8720, *supra*, at 132.

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ent with other enactments of Congress and the interpretation of § 16 (b) by the Securities and Exchange Commission.

Foremost and *amicus* Allis-Chalmers Manufacturing Co. point to §§ 16 (d) and 16 (e) of the Act, 15 U. S. C. §§ 78p (d), (e), as congressional actions that would not have been necessary unless one selling the securities whose acquisition made him a beneficial owner would be liable under § 16 (b). Section 16 (d) in part, exempts from § 16 (b) certain transactions by a securities "dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market."³² Section 16 (e) provides an exemption for certain "foreign or domestic arbitrage transactions."³³ They argue similarly that the SEC's Rule 16b-2, 17 CFR § 240.16b-2 (1975), is unnecessary

³² Section 16 (d), 15 U. S. C. § 78p (d), provides:

"The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase, and the provisions of subsection (c) of this section shall not apply to any sale, of an equity security not then or theretofore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 78c of this title) for such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest, define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market."

"Dealer" is defined in § 3 (a) (5) of the Act. 15 U. S. C. § 78c (a) (5).

³³ Section 16 (e), 15 U. S. C. § 78p (e), provides:

"The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section."

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if our construction of § 16 (b) is correct. Rule 16b-2 exempts from § 16 (b) specified transactions "in connection with the distribution of a substantial block of securities."³⁴

³⁴ Section 16 (b) provides in its final clause that it shall not cover "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) Rule 16b-2 provides:

"(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of section 16 (b) of the Act, to the extent specified in this § 240.16b-2, as not comprehended within the purpose of said section, upon the following conditions:

"(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

"(2) The security involved in the transaction is (i) a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities, or (ii) a security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed or to cover an over-allotment or other short position created in connection with such distribution; and

"(3) Other persons not within the purview of section 16 (b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person is participating and to an extent at least equal to the aggregate participation of all persons exempted from the provisions of section 16 (b) of the Act by this § 240.16b-2. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this § 240.16b-2

"(b) The exemption of a transaction pursuant to this § 240.16b-2 with respect to the participation therein of one party thereto shall

We do not consider these provisions to be inconsistent with our holding. Nothing on their faces would make them applicable to one selling the securities the purchase of which made him a beneficial owner. But the exemptions would be necessary to protect stockholders already qualifying as beneficial owners when they purchased³⁵ and they would, of course, apply to transactions by directors and officers as well.

Foremost and the *amicus* also remind us that the interpretation of the exemptive provision for which they contend has been adopted by the SEC in the past. See Brief for SEC as *Amicus Curiae*, at 22-27, *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). But the Commission has not appeared as an *amicus* in this case. In any event, even if the Commission's views have not changed we would not afford them the deference to which the views of the agency administering a statute are usually entitled, for in *Reliance Electric Co.*, 404 U. S., at 425-427, the Court rejected the basic theory on which the SEC based its interpretation of the exemptive provision. Our re-examination of the exemptive provision confirms the view that the SEC's theory did not reflect the intent of Congress.

The judgment is

Affirmed.

not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this § 240.16b-2."

³⁵The press release accompanying the SEC's promulgation of Rule 16b-2 demonstrates this point. It explained: "The new Rule [16b-2] affords an exemption for certain cases by providing that underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company" SEC Release No. 34-264, June 8, 1935.

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2nd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-742

Foremost-McKesson, Inc., Petitioner, v. Provident Securities Company.	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.
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[January —, 1976]

MR. JUSTICE POWELL delivered the opinion of the Court.

This case presents an unresolved issue under § 16 (b) of the Securities Exchange Act of 1934 (the Act), 48 Stat. 896, 15 U. S. C. § 78p (b). That section of the Act was designed to prevent a corporate director or officer or "the beneficial owner of more than 10 per centum" of a corporation¹ from profiteering through short-swing securities transactions on the basis of inside information. It provides that a corporation may capture for itself the profits realized on a purchase and sale, or sale and purchase, of its securities within six months by a director, officer, or beneficial owner.² Section 16 (b)'s last sentence,

¹ The corporate "insiders" whose trading is regulated by § 16 (b) are defined in § 16 (a) of the Act, 15 U. S. C. § 78p (a), as "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security."

² Section 16 (b), 15 U. S. C. § 78p (b), reads in full:

"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

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however, provides that it "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" The question presented here is whether a person purchasing securities that put his holdings above the 10% level is a beneficial owner "at the time of the purchase" so that he must account for profits realized on a sale of those securities within six months. The United States Court of Appeals for the Ninth Circuit answered this question in the negative. 506 F. 2d 601 (1974). We affirm.

I

Respondent, Provident Securities Co., was a personal holding company. In 1968 Provident decided tentatively to liquidate and dissolve, and it engaged an agent to find

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

FOREMOST-McKESSON v. PROVIDENT SECURITIES 3

a purchaser for its assets. Petitioner, Foremost-McKesson, Inc., emerged as a potential purchaser, but extensive negotiations were required to resolve a disagreement over the nature of the consideration Foremost would pay. Provident wanted cash in order to facilitate its dissolution, while Foremost wanted to pay with its own securities.

Eventually a compromise was reached, and Provident and Foremost executed a purchase agreement embodying their deal on September 25, 1969. The agreement provided that Foremost would buy two-thirds of Provident's assets for \$4.25 million in cash and \$49.75 million in Foremost convertible subordinated debentures.* The agreement further provided that Foremost would register under the Securities Act of 1933 \$25 million in principal amount of the debentures and would participate in an underwriting agreement by which those debentures would be sold to the public. At the closing on October 15, 1969, Foremost delivered to Provident the cash and a \$40 million debenture that was subsequently exchanged for two debentures in the principal amounts of \$25 million and \$15 million. Foremost also delivered a \$2.5 million debenture to an escrow on the closing date. On October 20 Foremost delivered to Provident a \$7.25 million debenture representing the balance of the purchase price. These debentures were immediately convertible into more than 10% of Foremost's outstanding common stock.

On October 21 Provident, Foremost, and a group of underwriters executed an underwriting agreement to be closed on October 28. The agreement provided for sale to the underwriters of the \$25 million debenture. On

* The debentures were issued expressly to acquire Provident's assets, and all of them were used for that purpose.

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October 24 Provident distributed the \$15 million and \$7.25 million debentures to its stockholders, reducing the amount of Foremost common into which the company's holdings were convertible to less than 10%. On October 28 the closing under the underwriting agreement was accomplished.⁴ Provident thereafter distributed the cash proceeds of the debenture sale to its stockholders and dissolved.

Provident's holdings in Foremost debentures as of October 20 were large enough to make it a beneficial owner of Foremost within the meaning of § 16.⁵ Having acquired and disposed of these securities within six months, Provident faced the prospect of a suit by Foremost to recover any profits realized on the sale of the debenture to the underwriters. Provident therefore sued for a declaration that it was not liable to Foremost under § 16 (b). The District Court granted summary judgment for Provident and the Court of Appeals affirmed.

Provident's principal argument below for nonliability was based on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U. S. 582 (1973). There we held that an "unorthodox transaction" in securities that did not present the possibility of speculative abuse of inside

⁴The underwriters delivered \$25,366,666.66 in cash to Foremost. That amount represented a purchase price of 101¼% of the principal amount of the debenture (\$25,312,500.00) plus interest accrued from October 15 to the date of closing (\$54,166.66). The amount of profit realized by Provident has never been established.

⁵A beneficial owner is one who owns more than 10% of an "equity security" registered pursuant to § 12 of the Act, 15 U. S. C. § 78l. See n. 1, *supra*. The owner of debentures convertible into more than 10% of a corporation's registered common stock is a beneficial owner within the meaning of the Act. Securities Exchange Act of 1934, §§ 3 (a) (10), 11, 15 U. S. C. §§ 78c (a) (10), (11); Rule 16a-2 (b), 17 CFR § 240.16a-2 (b) (1975). Foremost's common stock was registered; thus Provident's holdings made it a beneficial owner.

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information was not a "sale" within the meaning of § 16 (b). Provident contended that its reluctant acceptance of Foremost debentures in exchange for its assets was an "unorthodox transaction" not presenting the possibility of speculative abuse and therefore was not a "purchase" within the meaning of § 16 (b). Although the District Court's pre-*Kern County* opinion had adopted this type of analysis, 331 F. Supp. 787 (ND Cal. 1971), the Court of Appeals rejected it, reasoning that Provident's acquisition of the debentures was not "unorthodox" and that the circumstances did not preclude the possibility of speculative abuse. 506 F. 2d, at 604-605.

The Court of Appeals then considered two theories of nonliability based on § 16 (b)'s exemptive provision: "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" The first was Provident's argument that it was not a beneficial owner "at the time of . . . sale." After the October 24 distribution of some debentures to stockholders, the debentures held by Provident were convertible into less than 10% of Foremost's outstanding common stock. Provident contended that its sale to the underwriters did not occur until the underwriting agreement was closed on October 28. If this were the case, the sale would not have been covered by § 16 (b), since Provident would not have been a beneficial owner "at the time of . . . sale."⁴ The Court of Appeals rejected this argument because it found that

⁴ This contention was based on *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). There the Court held that a sale made after a former beneficial owner had already reduced its holdings below 10% was exempted from § 16 (b) by the phrase "at the time of . . . sale" in the exemptive provision. See n. 25, *infra*.

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the sale occurred on October 21 upon execution of the underwriting agreement.⁷

The Court of Appeals then turned to the theory of nonliability based on the exemptive provision that we consider here.⁸ It held that in a purchase-sale sequence

⁷ Section 3 (a) (14) of the Act, 15 U. S. C. § 78c (a) (14), defines "sale" and "sell" to include "any contract to sell or otherwise dispose of." But Provident argued that the October 28 closing date was the day of sale because contractual conditions prevented the contract from becoming binding until closing. The underwriting agreement provided in paragraph 7:

"7. Termination of Agreement: This agreement may be terminated, prior to the time the Registration Statement becomes effective, by you or by any group of Underwriters which has agreed hereunder to purchase in the aggregate at least 50% of the Debentures, if, in your judgment or in the judgment of any such group of Underwriters, there shall have occurred a material unfavorable change in political, financial or economic conditions generally." (App. A134.)

And in paragraph 5, the agreement provided: "The several obligations of the Underwriters hereunder are subject to the following conditions:

"(h) That, between the time of execution of this agreement and the time of purchase, there shall occur no material and unfavorable change, financial or otherwise (other than as referred to in the Registration Statement and the Prospectus), in the condition of the Company and its consolidated subsidiaries as a whole; and the Company will, at the time of purchase, deliver to you a certificate of two of its executive officers to the foregoing effect." (App. A134.)

The Court of Appeals agreed that conditions to performance might prevent a contract from being a "sale" prior to closing. But it ruled that all significant conditions here were satisfied when the registration statement required by paragraph 7 became effective on October 21, the day the underwriting agreement was executed. The court also found that after October 21, Provident was no longer subject to the risk of a decline in the market for Foremost's stock. 506 F. 2d, at 607. For reasons not apparent from its opinion, the court did not address the possibility that paragraph 5 (h) left Provident subject to market risks. See n. 8, *infra*.

⁸ Our holding on this issue disposes of this case by precluding

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the phrase "at the time of the purchase," "must be construed to mean prior to the time when the decision to purchase is made." 506 F. 2d, at 614. Thus, although Provident became a beneficial owner of Foremost by acquiring the debentures, it was not a beneficial owner "at the time of the purchase." Accordingly, the exemptive provision prevented any § 16 (b) liability on Provident's part.

II

The meaning of the exemptive provision has been disputed since § 16 (b) was first enacted. The discussion has focused on the application of the provision to a purchase-sale sequence, the principal disagreement being whether "at the time of the purchase" means "before the purchase" or "immediately after the purchase."⁹ The difference in construction is determinative of a beneficial owner's liability in cases such as Provident's where such owner sells within six months of purchase the securities the acquisition of which made him a beneficial owner. The commentators divided immediately over which construction Congress intended,¹⁰ and they remain divided.¹¹ The courts of appeals also are in disagreement over the issue.

any liability on Provident's part. We therefore do not consider whether the Court of Appeals properly rejected Provident's arguments based on *Kern County* and on the sale not having occurred until October 28.

⁹ The alternative construction to "before the purchase" is sometimes denominated "simultaneously with the purchase," as it was by the Court of Appeals. 506 F. 2d, at 608.

¹⁰ Compare C. Meyer, *The Securities Exchange Act of 1934*, at 112 (1934) (adopting a "before" construction), with Seligman, *Problems Under the Securities Exchange Act*, 21 Va. L. Rev. 1, 19-20 (1934) (adopting an "immediately after" construction).

¹¹ Compare, e. g., Munter, *Section 16 (b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn"*

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The question of what Congress intended to accomplish by the exemptive provision in a purchase-sale sequence came to a court of appeals for the first time in *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299 (CA2), cert. denied, 352 U. S. 831 (1956). There the Court of Appeals for the Second Circuit without discussion, but over a dissent, affirmed the District Court's adoption of the "immediately after the purchase" construction. That court had been impelled to this construction at least in part by concern over what the phrase "at the time of . . . purchase" means in a sale-repurchase sequence, reasoning:

"If the ['before the purchase'] construction urged by [Graham-Paige] is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum." 104 F. Supp. 957, 959 (SDNY 1952).

The District Court may have thought that "before the purchase" seemed an unlikely construction of the exemptive provision in a sale-repurchase sequence, so it could not be the proper construction in a purchase-sale sequence.¹² The *Stella* construction of the exemptive

in *Order to Kill the Rats*," 52 Cornell L. Q. 69, 74-75 (1966); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592, 618-619 (1974); Comment, 9 Stan. L. Rev. 582 (1957) (adopting a "before" construction), with, e. g., 2 L. Loss, *Securities Regulation* 1060 (2d ed. 1981) (favoring an "immediately after" construction). The weight of the commentary appears to be with the "before the purchase" construction. The ALI Federal Securities Code (Tentative Draft No. 2, 1973), § 1413 (d) and Comment (8), considers the "immediately after the purchase" construction "questionable" on the statutory language and proposes an amendment to codify the result.

¹² *Stella* was decided before § 10 (b) of the Act, 15 U. S. C. § 78j (h), as implemented by Rule 10b-5, 17 CFR § 240.10b-5

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provision has been adhered to in the Second Circuit, *Newmark v. RKO General, Inc.*, 425 F. 2d 348, 355-356 (CA2), cert. denied, 400 U. S. 854 (1970);¹³ *Perine v. William Norton & Co.*, 509 F. 2d 114, 118 (CA2 1974), and adopted by the Court of Appeals for the Eighth Circuit. *Emerson Electric Co. v. Reliance Electric Co.*, 434 F. 2d 918, 923-924 (CA8 1970), aff'd on other grounds, 404 U. S. 418 (1972).¹⁴ But in none of the foregoing cases did the court examine critically the legislative history of § 16 (b).

The Court of Appeals considered this case against the background, sketched above, of ambiguity in the pertinent statutory language, continued disagreement among the commentators, and a perceived absence in the relatively few decided cases of a full consideration of the purpose and legislative history of § 16 (b). The court found unpersuasive the rationales offered in *Stella* and its progeny for the "immediately after the purchase" construction. It noted that construing the provision to require that beneficial-ownership status exist before the

(1975), developed fully as a private remedy for actual abuses of inside information. See 6 L. Loss, *supra*, n. 11, at 3559. The sale-repurchase abuse that worried the *Stella* court would now invite § 10 (b) liability, see n. 29, *infra*, as well as possible liability under § 16 (b).

¹³ To rationalize its view as applied to the purchase-sale sequence, the court in *Newmark* wrote:

"[T]he presumed access to [inside] information resulting from [the] purchase [that makes one a beneficial owner] provides him with an opportunity, not available to the investing public, to sell his shares at the moment most advantageous to him. Thus, a purchase of shares which makes the buyer an insider creates an opportunity for the type of speculative abuse the statute was enacted to prevent." 425 F. 2d, at 356.

¹⁴ When this Court decided *Reliance Electric Co.*, 404 U. S. 418, the question presented here was no longer in the case. See p. 25, *infra*.

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purchase in a purchase-sale sequence would not foreclose an "immediately after the purchase" construction in a sale-repurchase sequence.¹² 506 F. 2d, at 614-615. More significantly, the Court of Appeals challenged directly the premise of the earlier cases that a "before the purchase" construction in a purchase-sale sequence would allow abuses Congress intended to abate. The court reasoned that in § 16 (b) Congress intended to reach only those beneficial owners who both bought and sold on the basis of inside information, which was presumptively available to them only after they became statutory "insiders." 506 F. 2d, at 608-614.¹³

III

A

The general purpose of Congress in enacting § 16 (b) is well known. See *Kern County Land Co.*, 411 U. S., at 591-592; *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418, 422 (1972), and the authorities

¹² The view of the Court of Appeals that "at the time of" may mean different things in different contexts is not unique. See *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries*, — F. 2d — (1975). We express no opinion here on this view.

¹³ Shortly before this case was argued the Court of Appeals for the Seventh Circuit reached the same conclusion on somewhat different analysis. *Allis-Chalmers Mfg. Co.*, — F. 2d, at —. The court apparently would have reached its result even in the absence of the exemptive provision, reasoning that § 16 (b) covers no transactions by any § 16 (b) insiders who were not insiders before their initial transaction. — F. 2d, at —. Since we rely on the exemptive provision, we intimate no view on the proper analysis of a case where a director or officer makes an initial transaction before obtaining insider status. See, e. g., *Adler v. Klavans*, 267 F. 2d 840 (CA2 1959). Nor do we have occasion here to assess the approach taken by the Court of Appeals for the Seventh Circuit to the exemptive provision. — F. 2d, at — & n. 13. See n. 25, *infra*.

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cited therein. Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could reap profits at the expense of less well informed investors. In § 16 (b) Congress sought to "curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co.*, *supra*, at 422. It accomplished this by defining directors, officers, and beneficial owners as those presumed to have access to inside information¹⁷ and enacting a flat rule that a corporation could recover the profits these insiders made on a pair of security transactions within six months.¹⁸

Foremost points to this purpose, and invokes the observation in *Reliance Electric Co.* that "where alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing trading by corporate insiders." 404 U. S., at 424 (footnote omitted). From these premises Foremost argues that the Court of Appeals' construction of the exemptive provision must be rejected¹⁹ because it makes § 16 (b) in-

¹⁷ The purpose of § 16 (b) is stated explicitly to be "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." 15 U. S. C. § 78p (b).

¹⁸ Section 16 (b) states that any short-swing profits "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." 15 U. S. C. § 78p (b).

¹⁹ In lieu of the Court of Appeals' construction, Foremost offers a construction whereby any purchases prior to the purchase making

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applicable to some possible abuses of inside information that the statute would reach under the *Stella* construction.²⁰ We find this approach unsatisfactory in its focus on situations that § 16 (b) may not reach rather than on the language and purpose of the exemptive provision itself. Foremost's approach also invites an imposition of § 16 (b)'s liability without fault that is not consistent with the premises upon which Congress enacted the section.

B

The exemptive provision, which applies only to beneficial owners and not to other statutory insiders, must have been included in § 16 (b) for a purpose. Although the extensive legislative history of the Act is bereft of any explicit explanation of Congress' intent, see *Reliance Electric Co.*, *supra*, at 424, the evolution of § 16 (b) from its initial proposal through passage does shed significant light on the purpose of the exemptive provision.

The original version of what would develop into the Act was S. 2693, 73d Cong., 2d Sess. (1934). It provided in § 15 (b):

"It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—

"(1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six

one a beneficial owner are exempted from the operation of § 16 (b). See 2 L. Loss, *supra*, n. 11, at 1060.

²⁰ *Newmark* describes a possible abuse of inside information covered only under the *Stella* construction. See n. 13, *supra*.

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months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months."

In the next version of the legislation, H. R. 8720, 73d Cong., 2d Sess. (1934), § 15 (b) read almost identically to § 16 (b) as it was eventually enacted.²¹

"Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase of any such registered equity security within a 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. . . . 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 sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection

²¹ As can be seen by comparing H. R. 8720's version of § 15 (b) with § 16 (b), *supra*, n. 2, the differences are relatively minor. Formally, the statement of purpose was moved to the front of the statute and various grammatical changes were made. A significant substantive change not apparent from the faces of the two sections is that § 16 (b) beneficial owners are those owning more than 10% of a registered security, while H. R. 8720 retained S. 2693's 5% requirement. Compare Securities Exchange Act of 1934, § 16 (a), 15 U. S. C. § 78p (a), with H. R. 8720, 73d Cong., 2d Sess., § 15 (a) (1934).

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H. R. 8720 to take account of the criticisms that the bill's drafters thought valid. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 625, 674. The primary substantive criticism directed at § 15 (b) of S. 2693 was that it did not prevent the use of inside information to reap a short-term profit in a sale-repurchase situation. See Hearings on Stock Exchange Practices, *supra*, at 6557-6558. Criticism was also directed at making liability for short-term profits turn on ownership "as of record and/or beneficially." See *id.*, at 6914. H. R. 8720 remedied these perceived shortcomings by providing in § 15 (b): "Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase . . . shall inure to and be recoverable by the issuer."²³ The term "such beneficial owner" was defined in § 15 (a) to mean one "who is directly or indirectly the beneficial owner of more than 5 per centum of any class" of a registered security.

The structure of the clause imposing liability in the revised § 15 (b) did not unambiguously retain S. 2693's requirement that beneficial ownership precede a purchase-sale sequence. But we cannot assume easily that Congress intended to eliminate the requirement in the revised bill. The legislative history reveals that the requirement was made clear in the hearings, yet no complaint was made about it.

See *id.*, at 6465-6466. Most of the hearings, therefore, dealt with other problems.

²³ The other major substantive change effected in § 15 (b) by H. R. 8720 was the elimination of the potential criminal liability. The criminal liability aspect of S. 2693's version of § 15 (b) received almost no attention in hearings. But cf. Stock Exchange Practices, *supra*, at 6906. It may have been thought, however, that a criminal case could never be made out. The difficulties of proving the mental elements on which criminal liability turned had already led the drafters to eliminate those questions of fact in civil suits to recover profits. See n. 26, *infra*.

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The testimony on S. 2693 demonstrates that the drafters were emphatic about the requirement. In introducing the bill Corcoran pointed out a technical flaw in S. 2693's language: "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock. . . ." It was possible to construe the phrase "owning . . . 5 per centum" to apply to directors and officers as well as to mere stockholders, so that trading by directors and officers would not be subject to § 15 (b) if their previous holdings did not exceed 5%. But Corcoran made clear that the requirement of pre-existing ownership of the specified percentage applied only to beneficial owners.

"Mr. CORCORAN. . . . The bill is not very well drawn there. It ought to read to cover every director, every officer, and every stockholder who owns more than 5 percent of the stock. That is the way it was intended to read.

"Mr. MAPES. It ought to read 'and/or beneficially more than 5 percent' followed by 'is a director, or officer.'

"Mr. CORCORAN. It is badly drawn. We slipped on that. It ought to read 'every director and every officer' and then 'every big stockholder.' "

Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133; see Hearings on Stock Exchange Practices, *supra*, at 6555.

The legislative record thus reveals that the drafters focused directly on the fact that S. 2693 covered a short-term purchase-sale sequence by a beneficial owner only if his status existed before the purchase, and no concern was expressed about the wisdom of this requirement. But the explicit requirement was omitted from the operative language of the section when it was restruct-

IV

Additional considerations support our reading of the legislative history.

A

Section 16 (b) imposes a strict prophylactic rule with respect to insider, short-swing trading. In *Kern County Land Co.*, 411 U. S., at 595, we noted:

"The statute requires the [statutorily defined] inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information."

In short, this statute imposes liability without fault within its narrowly drawn limits.²⁶

has noted correctly that the construction of "at the time of . . . sale" in *Reliance Electric Co.* is superfluous in light of the construction of "at the time of the purchase" adopted by the Court of Appeals for the Ninth Circuit, which we affirm here. See *Allis-Chalmers Mfg. Co.*, — F. 2d, at — n. 12. But the procedural posture of *Reliance Electric Co.* prevented a full consideration of the meaning of the exemptive provision. See *ibid.* We express no opinion on the interpretation of the provision by which the Court of Appeals for the Seventh Circuit sought to avoid the apparent superfluity of the "at the time of . . . sale" language. *Id.*, at —, —; *supra*, n. 16.

²⁶ "Mr. CORCORAN. . . . You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

"Senator GORE. You infer the intent from the fact.

"Mr. CORCORAN. From the fact.

[Footnote 26 is continued on p. 19]

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As noted earlier, Foremost recognizes the ambiguity of the exemptive provision, but argues that where "alternative constructions" of § 16 (b)'s terms are available, we should choose the construction that best serves the statute's purposes. Foremost relies on statements generally to this effect in *Kern County Land Co.*, *supra*, at 595, and *Reliance Electric Co.*, 404 U. S., at 424. In neither of those cases, however, did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16 (b). We reiterate that nothing suggests that the construction urged by Foremost would serve better to further congressional purposes. Indeed, the legislative history of § 16 (b) indicates that by adding the exemptive provision Congress deliberately expressed a contrary choice. But even if the legislative record were more ambiguous, we would hesitate to adopt Foremost's construction. It is inappropriate to reach the harsh result of imposing § 16 (b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference.

It is not irrelevant that Congress itself limited carefully the liability imposed by § 16 (b). See *Reliance Electric Co.*, *supra*, at 422-425. Even an insider

"Senator KEAN. Suppose he got stuck in something else, and he had to sell?

"Senator BARKLEY. All he would get would be what he put into it. He would get his original investment.

"Mr. CONCORAN. He would get his money out, but the profit goes to the corporation.

"Senator KEAN. Suppose he had to sell.

"Mr. CONCORAN. Let him get out what he put in, but give the corporation the profit."

Hearings on Stock Exchange Practices, *supra*, at 6556-6557.

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may trade freely without incurring the statutory liability if, for example, he spaces his transactions at intervals greater than six months. When Congress has so recognized the need to limit carefully the "arbitrary and sweeping coverage" of § 16 (b), *Bershad v. McDonough*, 428 F. 2d 693, 696 (CA7 1970), cert. denied, 400 U. S. 992 (1971), courts should not be quick to determine that, despite an acknowledged ambiguity, Congress intended the section to cover a particular transaction.

B

Our construction of § 16 (b) also is supported by the distinction Congress recognized between short-term trading by mere stockholders and such trading by directors and officers. The legislative discourse revealed that Congress thought that all short-swing trading by directors and officers was vulnerable to abuse because of their intimate involvement in corporate affairs. But trading by mere stockholders was viewed as being subject to abuse only when the size of their holdings afforded the potential for access to corporate information.²⁷ These different perceptions simply reflect the realities of corporate life.

²⁷ This distinction is especially evident in the following exchange, directed to the reporting requirements imposed by § 15 (a) of S. 2693 on beneficial owners:

"Senator KEAN. Suppose a man is not a director at all and does not want to be a director, and he happens to own 5 percent or buy 5 percent. Do you think you are going to get him to file with the exchange all the time just the number of shares he has?

"Mr. CORCORAN. I think so, sir.

"Senator KEAN. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor—

"Mr. CORCORAN. Five percent is a lot in a modern corporation. Many corporations are controlled by 5 percent or 10 percent.

"Senator KEAN. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where

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It would not be consistent with this perceived distinction to impose liability on the basis of a purchase made when the percentage of stock ownership requisite to insider status had not been acquired. To be sure, the possibility does exist that one who becomes a beneficial owner by a purchase will sell on the basis of information attained by virtue of his newly acquired holdings. But the purchase itself was not one posing dangers that Congress considered intolerable, since it was made when the purchaser owned no shares or less than the percentage deemed necessary to make one an insider.²⁸ Such a stockholder is more analogous to the stockholder who never owns more than 10% and is thereby excluded entirely

you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors.

"Mr. CORCORAN. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director.

"Senator KEAN. He might not be."

Hearings on Stock Exchange Practices, *supra*, at 6566. The distinction is also reflected in the discussion of the technical flaw in S. 2693. See *id.*, at 6555; Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133. See also Hearings on Stock Exchange Practices, *supra*, at 7741-7743.

²⁸ Thus, according to the presumption of the statute, the purchaser did not have access to inside information in making the purchase. It should be noted further that as a matter of practicalities the crucial point in the acquisition of securities is not the technical "purchase," but rather the decision to make an acquisition. In the case of an acquisition of a large block of a corporation's stock, that decision may precede the "purchase" by a considerable period of time. A prudent investor will want to investigate all available information on the corporation. Such an investor also may need time to finance the purchase, and may wish to effectuate purchases without influencing the market price. These realities emphasize that the acquisition decision by a beneficial owner normally will occur well in advance of the event that is presumed to afford access to inside information.

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from the operation of § 16 (b), than to a director or officer whose every purchase and sale is covered by the statute. While this reasoning might not compel our construction of the exemptive provision, it explains why Congress may have seen fit to draw the line it did. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959).

O

Section 16 (b)'s scope, of course, is not affected by whether alternative sanctions might inhibit the abuse of inside information. Congress, however, has left some problems of the abuse of inside information to other remedies. These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information in transactions not covered by § 16 (b). For example, Congress has passed general antifraud statutes that sanction abusive practices by insiders. See Securities Act of 1933, § 17 (a), 48 Stat. 84, 15 U. S. C. § 77q (a); Securities Exchange Act of 1934, § 10 (b), 15 U. S. C. § 78j (b); 3 L. Loss, *supra*, n. 11, 1423-1429, 1442-1445. Today an investor who can show harm from the actual use of material inside information may have recourse, in particular, to § 10 (b) and Rule 10b-5, 17 CFR § 240.10b-5 (1975).²⁰ It

²⁰ Rule 10b-5 has been held to embrace evils that *Foremost* urges its construction of § 16 (b) is necessary to prevent. The Rule has been applied to trading by one who acquired inside information in the course of negotiations with a corporation, such as the negotiations for *Provident's* purchase of the *Foremost* debentures. *Van Alstyne, Noel & Co.*, 43 S. E. C. 1080 (1969), 3 L. Loss, *supra*, n. 11, at 1451-1452. And a stockholder trading on information not generally known has been held subject to the sanctions of the Rule. *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228 (CA2 1974); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (CA2 1968), cert. denied, 394 U. S. 967 (1969). The liability of insiders who "tip" others, *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301 (CA2), cert. denied, 404 U. S. 1005 (1971), may reduce the threat that beneficial owners not themselves represented on the board of direc-

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also was thought that § 16 (a)'s publicity requirement³⁰ would afford indirect protection against some potential misuses of inside information.³¹ See Hearings on H. R. 7852 and H. R. 8720, *supra*, at 134-135; H. Rep. No. 1383, 73d Cong., 2d Sess., 13 (to accompany H. R. 9323,

tors will be able to acquire inside information from officers and directors.

³⁰ Section 16 (a), 15 U. S. C. § 78p (a) provides:

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78l (g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

³¹ The drafters clearly thought that § 16 (a) would help deter abuses not covered by § 16 (b).

"[Mr. Corcoran.] [S]ection 15 (a), requires every director, officer, or principal holder of any securities listed on an exchange to file with the exchange and with the commission a statement of how many shares he owns and to file that statement at the end of each month to show whether there has been any change in his position during the month. That is to prevent the insider from taking advantage of information to sell or buy shares ahead of the release of information to the public about the company."

Those remarks were addressed to S. 2693. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 132.

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73d Cong., 2d Sess., passed by the House, May 7, 1934, without the present § 16 (b)).

V

We must still consider briefly Foremost's contention that the "before the purchase" construction renders other enactments of Congress unnecessary and conflicts with the interpretation of § 16 (b) by the Securities and Exchange Commission.

Foremost and *amicus* Allis-Chalmers Manufacturing Co. point to §§ 16 (d) and 16 (e) of the Act, 15 U. S. C. §§ 78p (d), (e), as congressional actions that would not have been necessary unless one selling the securities the acquisition of which made him a beneficial owner is liable under § 16 (b). Section 16 (d), in part, exempts from § 16 (b) certain transactions by a securities "dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market."²² Section 16 (e) provides an exemption for certain "foreign or domestic arbitrage

²² Section 16 (d), 15 U. S. C. § 78p (d), provides:

"The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase, and the provisions of subsection (c) of this section shall not apply to any sale, of an equity security not then or theretofore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 78e of this title) for such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest, define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market."

"Dealer" is defined in § 3 (a) (5) of the Act, 15 U. S. C. § 78c (a) (5).

transactions.”³³ They argue similarly that the SEC’s Rule 16b-2, 17 CFR § 240.16b-2 (1975), is unnecessary if our construction of § 16 (b) is correct. Rule 16b-2 exempts from § 16 (b) specified transactions “in connection with the distribution of a substantial block of securities.”³⁴

³³ Section 16 (e), 15 U. S. C. § 78p (e), provides:

“The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section.”

³⁴ Section 16 (b) provides in its final clause that it shall not cover “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). Rule 16b-2 provides:

“(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of section 16 (b) of the Act, to the extent specified in this § 240.16b-2, as not comprehended within the purpose of said section, upon the following conditions:

“(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

“(2) The security involved in the transaction is (i) a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities, or (ii) a security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed or to cover an over-allotment or other short position created in connection with such distribution; and

“(3) Other persons not within the purview of section 16 (b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person is participating and to an extent at least equal to the aggregate par-

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We do not consider these provisions to be inconsistent with our holding. Nothing on their faces would make them applicable to one selling the securities the purchase of which made him a beneficial owner. But the exemptions would be necessary to protect stockholders already qualifying as beneficial owners when they purchased⁸⁵ and they would, of course, apply to transactions by directors and officers as well.

Foremost and the *amicus* also remind us that the interpretation of the exemptive provision for which they contend has been adopted by the SEC in the past. See Brief for SEC as *Amicus Curiae*, at 22-27, *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). But the Commission has not appeared as an *amicus* in this case. In any event, even if the Commission's views have not changed we would not afford them the deference to which the views of the agency administering a statute are usually entitled, for in *Reliance*

participation of all persons exempted from the provisions of section 16 (b) of the Act by this § 240.16b-2. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this § 240.16b-2.

"(b) The exemption of a transaction pursuant to this § 240.16b-2 with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this § 240.16b-2."

⁸⁵ The press release accompanying the SEC's initial promulgation of Rule 16b-2 demonstrates this point. It explained: "The new Rule [16b-2] affords an exemption for certain cases by providing that underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company" SEC Release No. 34-264, June 8, 1935.

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Electric Co., 404 U. S., at 425-427, the Court rejected the basic theory on which the SEC based its interpretation of the exemptive provision. Our re-examination of the exemptive provision confirms the view that the SEC's theory did not reflect the intent of Congress.

The judgment is

Affirmed.

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To: The Chief Justice
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Rehnquist
Mr. Justice Stevens

From: Mr. Justice Powell

Circulated:

Recirculated: 1/8/76

3rd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-742

Foremost-McKesson, Inc.,	}	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.
Petitioner,		
v.		
Provident Securities Company,		

[January —, 1976]

MR. JUSTICE POWELL delivered the opinion of the Court.

This case presents an unresolved issue under § 16 (b) of the Securities Exchange Act of 1934 (the Act), 48 Stat. 896, 15 U. S. C. § 78p (b). That section of the Act was designed to prevent a corporate director or officer or "the beneficial owner of more than 10 per centum" of a corporation¹ from profiteering through short-swing securities transactions on the basis of inside information. It provides that a corporation may capture for itself the profits realized on a purchase and sale, or sale and purchase, of its securities within six months by a director, officer, or beneficial owner.² Section 16 (b)'s last sentence,

¹ The corporate "insiders" whose trading is regulated by § 16 (b) are defined in § 16 (a) of the Act, 15 U. S. C. § 78p (a), as "[a]ny person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security."

² Section 16 (b), 15 U. S. C. § 78p (b), reads in full:

"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

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however, provides that it "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" The question presented here is whether a person purchasing securities that put his holdings above the 10% level is a beneficial owner "at the time of the purchase" so that he must account for profits realized on a sale of those securities within six months. The United States Court of Appeals for the Ninth Circuit answered this question in the negative. 506 F.2d 601 (1974). We affirm.

I

Respondent, Provident Securities Co., was a personal holding company. In 1968 Provident decided tentatively to liquidate and dissolve, and it engaged an agent to find

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

FOREMOST-McKESSON v. PROVIDENT SECURITIES 3

a purchaser for its assets. Petitioner, Foremost-McKesson, Inc., emerged as a potential purchaser, but extensive negotiations were required to resolve a disagreement over the nature of the consideration Foremost would pay. Provident wanted cash in order to facilitate its dissolution, while Foremost wanted to pay with its own securities.

Eventually a compromise was reached, and Provident and Foremost executed a purchase agreement embodying their deal on September 25, 1969. The agreement provided that Foremost would buy two-thirds of Provident's assets for \$4.25 million in cash and \$49.75 million in Foremost convertible subordinated debentures.² The agreement further provided that Foremost would register under the Securities Act of 1933 \$25 million in principal amount of the debentures and would participate in an underwriting agreement by which those debentures would be sold to the public. At the closing on October 15, 1969, Foremost delivered to Provident the cash and a \$40 million debenture that was subsequently exchanged for two debentures in the principal amounts of \$25 million and \$15 million. Foremost also delivered a \$2.5 million debenture to an escrow on the closing date. On October 20 Foremost delivered to Provident a \$7.25 million debenture representing the balance of the purchase price. These debentures were immediately convertible into more than 10% of Foremost's outstanding common stock.

On October 21 Provident, Foremost, and a group of underwriters executed an underwriting agreement to be closed on October 28. The agreement provided for sale to the underwriters of the \$25 million debenture. On

² The debentures were issued expressly to acquire Provident's assets, and all of them were used for that purpose.

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October 24 Provident distributed the \$15 million and \$7.25 million debentures to its stockholders, reducing the amount of Foremost common into which the company's holdings were convertible to less than 10%. On October 28 the closing under the underwriting agreement was accomplished.⁴ Provident thereafter distributed the cash proceeds of the debenture sale to its stockholders and dissolved.

Provident's holdings in Foremost debentures as of October 20 were large enough to make it a beneficial owner of Foremost within the meaning of § 16.⁵ Having acquired and disposed of these securities within six months, Provident faced the prospect of a suit by Foremost to recover any profits realized on the sale of the debenture to the underwriters. Provident therefore sued for a declaration that it was not liable to Foremost under § 16 (b). The District Court granted summary judgment for Provident and the Court of Appeals affirmed.

Provident's principal argument below for nonliability was based on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U. S. 582 (1973). There we held that an "unorthodox transaction" in securities that did not present the possibility of speculative abuse of inside

⁴ The underwriters delivered \$25,366,666.66 in cash to Foremost. That amount represented a purchase price of 101¼% of the principal amount of the debenture (\$25,312,500.00) plus interest accrued from October 15 to the date of closing (\$54,166.66). The amount of profit realized by Provident has never been established.

⁵ A beneficial owner is one who owns more than 10% of an "equity security" registered pursuant to § 12 of the Act, 15 U. S. C. § 78l. See n. 1, *supra*. The owner of debentures convertible into more than 10% of a corporation's registered common stock is a beneficial owner within the meaning of the Act. Securities Exchange Act of 1934, §§ 3 (a) (10), (11), 15 U. S. C. §§ 78c (a) (10), (11); Rule 16a-2 (b), 17 CFR § 240.16a-2 (b) (1975). Foremost's common stock was registered; thus Provident's holdings made it a beneficial owner.

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information was not a "sale" within the meaning of § 16 (b). Provident contended that its reluctant acceptance of Foremost debentures in exchange for its assets was an "unorthodox transaction" not presenting the possibility of speculative abuse and therefore was not a "purchase" within the meaning of § 16 (b). Although the District Court's pre-*Kern County* opinion had adopted this type of analysis, 331 F. Supp. 787 (ND Cal. 1971), the Court of Appeals rejected it, reasoning that Provident's acquisition of the debentures was not "unorthodox" and that the circumstances did not preclude the possibility of speculative abuse. 506 F. 2d, at 604-605.

The Court of Appeals then considered two theories of nonliability based on § 16 (b)'s exemptive provision: "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" The first was Provident's argument that it was not a beneficial owner "at the time of . . . sale." After the October 24 distribution of some debentures to stockholders, the debentures held by Provident were convertible into less than 10% of Foremost's outstanding common stock. Provident contended that its sale to the underwriters did not occur until the underwriting agreement was closed on October 28. If this were the case, the sale would not have been covered by § 16 (b), since Provident would not have been a beneficial owner "at the time of . . . sale."^{*} The Court of Appeals rejected this argument because it found that

^{*} This contention was based on *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). There the Court held that a sale made after a former beneficial owner had already reduced its holdings below 10% was exempted from § 16 (b) by the phrase "at the time of . . . sale" in the exemptive provision. See n. 25, *infra*.

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the phrase "at the time of the purchase," "must be construed to mean prior to the time when the decision to purchase is made," 506 F. 2d, at 614. Thus, although Provident became a beneficial owner of Foremost by acquiring the debentures, it was not a beneficial owner "at the time of the purchase." Accordingly, the exemptive provision prevented any § 16 (b) liability on Provident's part.

II

The meaning of the exemptive provision has been disputed since § 16 (b) was first enacted. The discussion has focused on the application of the provision to a purchase-sale sequence, the principal disagreement being whether "at the time of the purchase" means "before the purchase" or "immediately after the purchase."⁹ The difference in construction is determinative of a beneficial owner's liability in cases such as Provident's where such owner sells within six months of purchase the securities the acquisition of which made him a beneficial owner. The commentators divided immediately over which construction Congress intended,¹⁰ and they remain divided.¹¹ The courts of appeals also are in disagreement over the issue.

any liability on Provident's part. We therefore do not consider whether the Court of Appeals properly rejected Provident's arguments based on *Kern County* and on the sale not having occurred until October 28.

⁹ The alternative construction to "before the purchase" is sometimes denominated "simultaneously with the purchase," as it was by the Court of Appeals. 506 F. 2d, at 608.

¹⁰ Compare C. Meyer, *The Securities Exchange Act of 1934*, at 112 (1934) (adopting a "before" construction), with Seligman, *Problems Under the Securities Exchange Act*, 21 Va. L. Rev. 1, 19-20 (1934) (adopting an "immediately after" construction).

¹¹ Compare, e. g., Muntz, Section 16 (b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn

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The question of what Congress intended to accomplish by the exemptive provision in a purchase-sale sequence came to a court of appeals for the first time in *Stella v. Graham-Paige Motors Corp.*, 232 F. 2d 299 (CA2), cert. denied, 352 U. S. 831 (1956). There the Court of Appeals for the Second Circuit without discussion, but over a dissent, affirmed the District Court's adoption of the "immediately after the purchase" construction. That court had been impelled to this construction at least in part by concern over what the phrase "at the time of . . . purchase" means in a sale-repurchase sequence, reasoning:

"If the ['before the purchase'] construction urged by [Graham-Paige] is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum." 104 F. Supp. 957, 959 (SDNY 1952).

The District Court may have thought that "before the purchase" seemed an unlikely construction of the exemptive provision in a sale-repurchase sequence, so it could not be the proper construction in a purchase-sale sequence.¹² The *Stella* construction of the exemptive

in *Order to Kill the Rats*, 52 Cornell L. Q. 69, 74-75 (1966); Note, Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach, 72 Mich. L. Rev. 592, 616-619 (1974); Comment, 9 Stan. L. Rev. 582 (1957) (adopting a "before" construction), with, e. g., 2 L. Loss, Securities Regulation 1060 (2d ed. 1961) (favoring an "immediately after" construction). The weight of the commentary appears to be with the "before the purchase" construction. The ALI Federal Securities Code (Tentative Draft No. 2, 1973), § 1413 (d) and Comment (6), considers the "immediately after the purchase" construction "questionable" on the statutory language and proposes an amendment to codify the result.

¹² *Stella* was decided before § 10 (b) of the Act, 15 U. S. C. § 78j (b), as implemented by Rule 10b-5, 17 CFR § 240.10b-5

provision has been adhered to in the Second Circuit, *Newmark v. RKO General, Inc.*, 425 F. 2d 348, 355-356 (CA2), cert. denied, 400 U. S. 854 (1970);¹³ *Perine v. William Norton & Co.*, 509 F. 2d 114, 118 (CA2 1974), and adopted by the Court of Appeals for the Eighth Circuit, *Emerson Electric Co. v. Reliance Electric Co.*, 434 F. 2d 918, 923-924 (CA8 1970), aff'd on other grounds, 404 U. S. 418 (1972).¹⁴ But in none of the foregoing cases did the court examine critically the legislative history of § 16 (b).

The Court of Appeals considered this case against the background, sketched above, of ambiguity in the pertinent statutory language, continued disagreement among the commentators, and a perceived absence in the relatively few decided cases of a full consideration of the purpose and legislative history of § 16 (b). The court found unpersuasive the rationales offered in *Stella* and its progeny for the "immediately after the purchase" construction. It noted that construing the provision to require that beneficial-ownership status exist before the

(1975), developed fully as a private remedy for actual abuses of inside information. See 6 L. Loss, *supra*, n. 11, at 3559. The sale-repurchase abuse that worried the *Stella* court would now invite § 10 (b) liability, see n. 29, *infra*, as well as possible liability under § 16 (b).

¹³ To rationalize its view as applied to the purchase-sale sequence, the court in *Newmark* wrote:

"[T]he presumed access to [inside] information resulting from [the] purchase [that makes one a beneficial owner] provides him with an opportunity, not available to the investing public, to sell his shares at the moment most advantageous to him. Thus, a purchase of shares which makes the buyer an insider creates an opportunity for the type of speculative abuse the statute was enacted to prevent." 425 F. 2d, at 356.

¹⁴ When this Court decided *Reliance Electric Co.*, 404 U. S. 418, the question presented here was no longer in the case. See n. 25, *infra*.

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purchase in a purchase-sale sequence would not foreclose an "immediately after the purchase" construction in a sale-repurchase sequence.¹⁵ 506 F. 2d, at 614-615. More significantly, the Court of Appeals challenged directly the premise of the earlier cases that a "before the purchase" construction in a purchase-sale sequence would allow abuses Congress intended to abate. The court reasoned that in § 16 (b) Congress intended to reach only those beneficial owners who both bought and sold on the basis of inside information, which was presumptively available to them only after they became statutory "insiders." 506 F. 2d, at 608-614.¹⁶

III

A

The general purpose of Congress in enacting § 16 (b) is well known. See *Kern County Land Co.*, 411 U. S., at 591-592; *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418, 422 (1972), and the authorities

¹⁵ The view of the Court of Appeals that "at the time of" may mean different things in different contexts is not unique. See *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries*, — F. 2d — (1976), cert. pending, No. 75-890. We express no opinion here on this view.

¹⁶ Shortly before this case was argued the Court of Appeals for the Seventh Circuit reached the same conclusion on somewhat different analysis. *Allis-Chalmers Mfg. Co.*, — F. 2d, at —. The court apparently would have reached its result even in the absence of the exemptive provision, reasoning that § 16 (b) covers no transactions by any § 16 (b) insiders who were not insiders before their initial transaction. — F. 2d, at —. Since we rely on the exemptive provision, we intimate no view on the proper analysis of a case where a director or officer makes an initial transaction before obtaining insider status. See, e. g., *Adler v. Klawans*, 267 F. 2d 840 (CA2 1959). Nor do we have occasion here to assess the approach taken by the Court of Appeals for the Seventh Circuit to the exemptive provision. — F. 2d, at — & n. 13. See n. 25, *infra*.

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eited therein. Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could reap profits at the expense of less well informed investors. In § 16 (b) Congress sought to "curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co.*, *supra*, at 422. It accomplished this by defining directors, officers, and beneficial owners as those presumed to have access to inside information¹⁷ and enacting a flat rule that a corporation could recover the profits these insiders made on a pair of security transactions within six months.¹⁸

Foremost points to this purpose, and invokes the observation in *Reliance Electric Co.* that "where alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing trading by corporate insiders." 404 U. S., at 424 (footnote omitted). From these premises Foremost argues that the Court of Appeals' construction of the exemptive provision must be rejected¹⁹ because it makes § 16 (b) in-

¹⁷ The purpose of § 16 (b) is stated explicitly to be "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" 15 U. S. C. § 78p (b).

¹⁸ Section 16 (b) states that any short-swing profits "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." 15 U. S. C. § 78p (b).

¹⁹ In lieu of the Court of Appeals' construction, Foremost offers a construction whereby any purchases prior to the purchase making

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applicable to some possible abuses of inside information that the statute would reach under the *Stella* construction.²⁰ We find this approach unsatisfactory in its focus on situations that § 16 (b) may not reach rather than on the language and purpose of the exemptive provision itself. Foremost's approach also invites an imposition of § 16 (b)'s liability without fault that is not consistent with the premises upon which Congress enacted the section.

B

The exemptive provision, which applies only to beneficial owners and not to other statutory insiders, must have been included in § 16 (b) for a purpose. Although the extensive legislative history of the Act is bereft of any explicit explanation of Congress' intent, see *Reliance Electric Co.*, *supra*, at 424, the evolution of § 16 (b) from its initial proposal through passage does shed significant light on the purpose of the exemptive provision.

The original version of what would develop into the Act was S. 2693, 73d Cong., 2d Sess. (1934). It provided in § 15 (b):

"It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—

"(1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six

one a beneficial owner are exempted from the operation of § 16 (b). See 2 L. Loss, *supra*, n. 11, at 1080.

²⁰ *Newmark* describes a possible abuse of inside information covered only under the *Stella* construction. See n. 13, *supra*.

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months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months."

In the next version of the legislation, H. R. 8720, 73d Cong., 2d Sess. (1934), § 15 (b) read almost identically to § 16 (b) as it was eventually enacted.²¹

"Any profit realized by such beneficial owner, director, or officer from any purchase and sale or sale and purchase of any such registered equity security within a 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. . . . 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 sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection

²¹ As can be seen by comparing H. R. 8720's version of § 15 (b) with § 16 (b), *supra*, n. 2, the differences are relatively minor. Formally, the statement of purpose was moved to the front of the statute and various grammatical changes were made. A significant substantive change not apparent from the faces of the two sections is that § 16 (b) beneficial owners are those owning more than 10% of a registered security, while H. R. 8720 retained S. 2693's 5% requirement. Compare Securities Exchange Act of 1934, § 16 (a), 15 U. S. C. § 78p (a), with H. R. 8720, 73d Cong., 2d Sess., § 15 (a) (1934).

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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.”

Thomas G. Corcoran, a spokesman for S. 2693's drafters, introduced § 15 (b) as forbidding an insider “to carry on any short-term specu[la]tions in the stock. He cannot, with his inside information get in and out of stock within six months.” Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 133 (1934). The Court of Appeals concluded that § 15 (b) of S. 2693 would have applied only to a beneficial owner who had that status before a purchase-sale sequence was initiated, 506 F. 2d, at 609, and we agree. Foremost appears not to contest this point. Petitioner's Opening Brief, at 29. The question thus becomes whether H. R. 8720's change in the language imposing liability and its addition of the exemptive provision were intended to change S. 2693's result in a purchase-sale sequence by a beneficial owner. We think the legislative history shows no such intent.

S. 2693 and its House counterpart, H. R. 7852, 73d Cong., 2d Sess. (1934), met substantial criticism on a number of scores, including various provisions of § 15. See Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pt. 15 (1934); Hearings on H. R. 7852 and H. R. 8720, *supra*, at 1-623.²² S. 2693 was recast into

²² Corcoran termed § 15 “one of the most important provisions in [S. 2693].” Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., 6555 (1934). But most of the proposed legislation was directed at regulation of the stock exchanges themselves and certain trading practices that were considered undesirable regardless of who performed them.

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The testimony on S. 2693 demonstrates that the drafters were emphatic about the requirement. In introducing the bill Corcoran pointed out a technical flaw in S. 2693's language: "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock. . . ." It was possible to construe the phrase "owning . . . 5 per centum" to apply to directors and officers as well as to mere stockholders, so that trading by directors and officers would not be subject to § 15 (b) if their previous holdings did not exceed 5%. But Corcoran made clear that the requirement of pre-existing ownership of the specified percentage applied only to beneficial owners.

"Mr. CORCORAN. . . . The bill is not very well drawn there. It ought to read to cover every director, every officer, and every stockholder who owns more than 5 percent of the stock. That is the way it was intended to read.

"Mr. MAPES. It ought to read 'and/or beneficially more than 5 percent' followed by 'is a director, or officer.'

"Mr. CORCORAN. It is badly drawn. We slipped on that. It ought to read 'every director and every officer' and then 'every big stockholder.' "

Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133; see Hearings on Stock Exchange Practices, *supra*, at 6555.

The legislative record thus reveals that the drafters focused directly on the fact that S. 2693 covered a short-term purchase-sale sequence by a beneficial owner only if his status existed before the purchase, and no concern was expressed about the wisdom of this requirement. But the explicit requirement was omitted from the operative language of the section when it was restruc-

tured to cover sale-repurchase sequences. In the same draft, however, the exemptive provision was added to the section. On this record we are persuaded that the exemptive provision was intended to preserve the requirement of beneficial ownership before the purchase. Later discussions of the present § 16 (b) in the hearings are consistent with this interpretation.²⁴ We hold that, in a purchase-sale sequence, a beneficial owner must account for profits only if he was a beneficial owner "before the purchase."²⁵

²⁴ "Mr. PECORA. The theory was that the ownership of 5 percent of the stock would practically constitute him an insider, and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served."

Hearings on Stock Exchange Practices, *supra*, at 7741. Ferdinand Pecora was counsel to the subcommittee of the Senate Committee on Banking and Currency that conducted extensive hearings on stock exchange operations prior to the enactment of the Act. He was also one of the draftsmen of S. 2693. Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 83 (1934).

²⁵ In *Reliance Electric Co.*, 404 U. S. 418, the Court also had occasion to consider the application of the exemptive provision in a purchase-sale sequence. There Emerson acquired 13.2% of the shares of Reliance's predecessor pursuant to a tender offer and within six months disposed of its holdings in two sales of 3.24% and 9.96%. The Court of Appeals for the Eighth Circuit held that the purchase, by which Emerson became a beneficial owner, was covered by § 16 (b). But it ruled that Emerson was liable for the profits on only its first sale, because "at the time of . . . sale" of the 9.96%, it was not a beneficial owner.

The Court granted certiorari on Reliance's petition to review this construction of "at the time of . . . sale," and affirmed. The construction of "at the time of the purchase," however, was not before the Court. *Id.*, at 420-422. Emerson thus remained liable for the 3.24% sale, although it would have had no liability under our holding today. The Court of Appeals for the Seventh Circuit

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IV

Additional considerations support our reading of the legislative history.

A

Section 16 (b) imposes a strict prophylactic rule with respect to insider, short-swing trading. In *Kern County Land Co.*, 411 U. S., at 595, we noted:

"The statute requires the [statutorily defined] inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information."

In short, this statute imposes liability without fault within its narrowly drawn limits.²⁸

has noted correctly that the construction of "at the time of . . . sale" in *Reliance Electric Co.* is superfluous in light of the construction of "at the time of the purchase" adopted by the Court of Appeals for the Ninth Circuit, which we affirm here. See *Allis-Chalmers Mfg. Co.*, — F. 2d, at — n. 12. But the procedural posture of *Reliance Electric Co.* prevented a full consideration of the meaning of the exemptive provision. See *ibid.* We express no opinion on the interpretation of the provision by which the Court of Appeals for the Seventh Circuit sought to avoid the apparent superfluity of the "at the time of . . . sale" language. *Id.*, at —, —; *supra*, n. 16.

²⁸ "Mr. CORCORAN. . . . You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

"Senator GORE. You infer the intent from the fact.

"Mr. CORCORAN. From the fact.

[Footnote 28 is continued on p. 19]

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As noted earlier, Foremost recognizes the ambiguity of the exemptive provision, but argues that where "alternative constructions" of § 16 (b)'s terms are available, we should choose the construction that best serves the statute's purposes. Foremost relies on statements generally to this effect in *Kern County Land Co.*, *supra*, at 595, and *Reliance Electric Co.*, 404 U. S., at 424. In neither of those cases, however, did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16 (b). We reiterate that nothing suggests that the construction urged by Foremost would serve better to further congressional purposes. Indeed, the legislative history of § 16 (b) indicates that by adding the exemptive provision Congress deliberately expressed a contrary choice. But even if the legislative record were more ambiguous, we would hesitate to adopt Foremost's construction. It is inappropriate to reach the harsh result of imposing § 16 (b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference.

It is not irrelevant that Congress itself limited carefully the liability imposed by § 16 (b). See *Reliance Electric Co.*, *supra*, at 422-425. Even an insider

"Senator KEAN. Suppose he got stuck in something else, and he had to sell?

"Senator BARKLEY. All he would get would be what he put into it. He would get his original investment.

"Mr. CORCORAN. He would get his money out, but the profit goes to the corporation.

"Senator KEAN. Suppose he had to sell.

"Mr. CORCORAN. Let him get out what he put in, but give the corporation the profit."

Hearings on Stock Exchange Practices, *supra*, at 6556-6557.

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may trade freely without incurring the statutory liability if, for example, he spaces his transactions at intervals greater than six months. When Congress has so recognized the need to limit carefully the "arbitrary and sweeping coverage" of § 16 (b), *Bershad v. McDonough*, 428 F. 2d 693, 696 (CA7 1970), cert. denied, 400 U. S. 992 (1971), courts should not be quick to determine that, despite an acknowledged ambiguity, Congress intended the section to cover a particular transaction.

B

Our construction of § 16 (b) also is supported by the distinction Congress recognized between short-term trading by mere stockholders and such trading by directors and officers. The legislative discourse revealed that Congress thought that all short-swing trading by directors and officers was vulnerable to abuse because of their intimate involvement in corporate affairs. But trading by mere stockholders was viewed as being subject to abuse only when the size of their holdings afforded the potential for access to corporate information.²⁷ These different perceptions simply reflect the realities of corporate life.

²⁷ This distinction is especially evident in the following exchange, directed to the reporting requirements imposed by § 15 (a) of S. 2693 on beneficial owners:

"Senator KEAN. Suppose a man is not a director at all and does not want to be a director, and he happens to own 5 percent or buy 5 percent. Do you think you are going to get him to file with the exchange all the time just the number of shares he has?"

"Mr. CORCORAN. I think so, sir.

"Senator KEAN. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor—

"Mr. CORCORAN. Five percent is a lot in a modern corporation. Many corporations are controlled by 5 percent or 10 percent.

"Senator KEAN. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where

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It would not be consistent with this perceived distinction to impose liability on the basis of a purchase made when the percentage of stock ownership requisite to insider status had not been acquired. To be sure, the possibility does exist that one who becomes a beneficial owner by a purchase will sell on the basis of information attained by virtue of his newly acquired holdings. But the purchase itself was not one posing dangers that Congress considered intolerable, since it was made when the purchaser owned no shares or less than the percentage deemed necessary to make one an insider.²⁸ Such a stockholder is more analogous to the stockholder who never owns more than 10% and thereby is excluded entirely

you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors.

"Mr. CORCORAN. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director.

"Senator KEAN. He might not be."

Hearings on Stock Exchange Practices, *supra*, at 6556. The distinction also is reflected in the discussion of the technical flaw in S. 2693. See *id.*, at 6555; Hearings on H. R. 7852 and H. R. 8720, *supra*, at 133. See also Hearings on Stock Exchange Practices, *supra*, at 7741-7743.

²⁸ Thus, according to the presumption of the statute, the purchaser did not have access to inside information in making the purchase. It should be noted further that as a matter of practicalities the crucial point in the acquisition of securities is not the technical "purchase," but rather the decision to make an acquisition. In the case of an acquisition of a large block of a corporation's stock, that decision may precede the "purchase" by a considerable period of time. A prudent investor will want to investigate all available information on the corporation. Such an investor also may need time to finance the purchase, and may wish to effectuate purchases without influencing the market price. These realities emphasize that the acquisition decision by a beneficial owner normally will occur well in advance of the event that is presumed to afford access to inside information.

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from the operation of § 16 (b), than to a director or officer whose every purchase and sale is covered by the statute. While this reasoning might not compel our construction of the exemptive provision, it explains why Congress may have seen fit to draw the line it did. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959).

C

Section 16 (b)'s scope, of course, is not affected by whether alternative sanctions might inhibit the abuse of inside information. Congress, however, has left some problems of the abuse of inside information to other remedies. These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information in transactions not covered by § 16 (b). For example, Congress has passed general antifraud statutes that proscribe fraudulent practices by insiders. See Securities Act of 1933, § 17 (a), 48 Stat. 84, 15 U. S. C. § 77q (a); Securities Exchange Act of 1934, § 10 (b), 15 U. S. C. § 78j (b); 3 L. Loss, *supra*, n. 11, 1423-1429, 1442-1445. Today an investor who can show harm from the misuse of material inside information may have recourse, in particular, to § 10 (b) and Rule 10b-5, 17 CFR § 240.10b-5 (1975).²⁰ It

²⁰ Rule 10b-5 has been held to embrace evils that Foremost urges its construction of § 16 (b) is necessary to prevent. The Rule has been applied to trading by one who acquired inside information in the course of negotiations with a corporation, such as the negotiations for Provident's purchase of the Foremost debentures. *Van Alstyne, Noel & Co.*, 43 S. E. 2d 1080 (1969); 3 L. Loss, *supra*, n. 11, at 1451-1452. And a stockholder trading on information not generally known has been held subject to the sanctions of the Rule. *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228 (CA2 1974); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (CA2 1968), cert. denied, 394 U. S. 967 (1969). The liability of insiders who improperly "tip" others, *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301 (CA2), cert. denied, 404 U. S. 1005 (1971), may reduce the threat that beneficial owners not themselves represented on the board.

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also was thought that § 16 (a)'s publicity requirement³⁰ would afford indirect protection against some potential misuses of inside information.³¹ See Hearings on H. R. 7852 and H. R. 8720, *supra*, at 134-135; H. Rep. No. 1383, 73d Cong., 2d Sess., 13 (to accompany H. R. 9323,

of directors will be able to acquire inside information from officers and directors. We cite these cases for illustrative purposes without necessarily implying approval.

³⁰ Section 16 (a), 15 U. S. C. § 78p (a) provides:

"Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78f of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78f (g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

³¹ The drafters clearly thought that § 16 (a) would help deter abuses not covered by § 16 (b).

"[Mr. Corcoran.] [S]ection 15 (a), requires every director, officer, or principal holder of any securities listed on an exchange to file with the exchange and with the commission a statement of how many shares he owns and to file that statement at the end of each month to show whether there has been any change in his position during the month. That is to prevent the insider from taking advantage of information to sell or buy shares ahead of the release of information to the public about the company."

These remarks were addressed to S. 2693. Hearings on H. R. 7852 and H. R. 8720, *supra*, at 132.

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73d Cong., 2d Sess., passed by the House, May 7, 1934, without the present § 16 (b)).

V

We must still consider briefly Foremost's contention that the "before the purchase" construction renders other enactments of Congress unnecessary and conflicts with the interpretation of § 16 (b) by the Securities and Exchange Commission.

Foremost and *amicus* Allis-Chalmers Manufacturing Co. point to §§ 16 (d) and 16 (e) of the Act, 15 U. S. C. §§ 78p (d), (e), as congressional actions that would not have been necessary unless one selling the securities the acquisition of which made him a beneficial owner is liable under § 16 (b). Section 16 (d), in part, exempts from § 16 (b) certain transactions by a securities "dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market."²² Section 16 (e) provides an exemption for certain "foreign or domestic arbitrage

²² Section 16 (d), 15 U. S. C. § 78p (d), provides:

"The provisions of subsection (b) of this section shall not apply to any purchase and sale, or sale and purchase, and the provisions of subsection (c) of this section shall not apply to any sale, of an equity security not then or theretofore held by him in an investment account, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market (otherwise than on a national securities exchange or an exchange exempted from registration under section 78e of this title) for such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest, define and prescribe terms and conditions with respect to securities held in an investment account and transactions made in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market."

"Dealer" is defined in § 3 (a) (5) of the Act, 15 U. S. C. § 78c (a) (5).

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transactions.”³³ They argue similarly that the SEC’s Rule 16b-2, 17 CFR § 240.16b-2 (1975), is unnecessary if our construction of § 16 (b) is correct. Rule 16b-2 exempts from § 16 (b) specified transactions “in connection with the distribution of a substantial block of securities.”³⁴

³³ Section 16 (e), 15 U. S. C. § 78p (e), provides:

“The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section.”

³⁴ Section 16 (b) provides in its final clause that it shall not cover “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). Rule 16b-2 provides:

“(a) Any transaction of purchase and sale, or sale and purchase, of a security which is effected in connection with the distribution of a substantial block of securities shall be exempt from the provisions of section 16 (b) of the Act, to the extent specified in this § 240.16b-2, as not comprehended within the purpose of said section, upon the following conditions:

“(1) The person effecting the transaction is engaged in the business of distributing securities and is participating in good faith, in the ordinary course of such business, in the distribution of such block of securities;

“(2) The security involved in the transaction is (i) a part of such block of securities and is acquired by the person effecting the transaction, with a view to the distribution thereof, from the issuer or other person on whose behalf such securities are being distributed or from a person who is participating in good faith in the distribution of such block of securities, or (ii) a security purchased in good faith by or for the account of the person effecting the transaction for the purpose of stabilizing the market price of securities of the class being distributed or to cover an over-allotment or other short position created in connection with such distribution; and

“(3) Other persons not within the purview of section 16 (b) of the Act are participating in the distribution of such block of securities on terms at least as favorable as those on which such person is participating and to an extent at least equal to the aggregate par-

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We do not consider these provisions to be inconsistent with our holding. Nothing on their faces would make them applicable to one selling the securities the purchase of which made him a beneficial owner. But the exemptions would be necessary to protect stockholders already qualifying as beneficial owners when they purchased²⁶ and they would, of course, apply to transactions by directors and officers as well.

Foremost and the *amicus* also remind us that the interpretation of the exemptive provision for which they contend has been adopted by the SEC in the past. See Brief for SEC as *Amicus Curiae*, at 22-27, *Reliance Electric Co. v. Emerson Electric Co.*, 404 U. S. 418 (1972). But the Commission has not appeared as an *amicus* in this case. In any event, even if the Commission's views have not changed we would not afford them the deference to which the views of the agency administering a statute are usually entitled, for in *Reliance*

participation of all persons exempted from the provisions of section 16 (b) of the Act by this § 240.16b-2. However, the performance of the functions of manager of a distributing group and the receipt of a bona fide payment for performing such functions shall not preclude an exemption which would otherwise be available under this § 240.16b-2.

"(b) The exemption of a transaction pursuant to this § 240.16b-2 with respect to the participation therein of one party thereto shall not render such transaction exempt with respect to participation of any other party therein unless such other party also meets the conditions of this § 240.16b-2."

²⁶ The press release accompanying the SEC's initial promulgation of Rule 16b-2 demonstrates this point. It explained: "The new Rule [16b-2] affords an exemption for certain cases by providing that underwriters who happen to have a member of their firm also an officer or director of the issuer or one of its principal stockholders who are regularly engaged in the business of buying and selling securities need not account to the company for profits realized from purchases and sales made in the distribution of a security for the company" SEC Release No. 34-264, June 8, 1935.

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Electric Co., 404 U. S., at 425-427, the Court rejected the basic theory on which the SEC based its interpretation of the exemptive provision. Our re-examination of the exemptive provision confirms the view that the SEC's theory did not reflect the intent of Congress.

The judgment is

Affirmed.

MR. JUSTICE WHITE joins in the judgment of the Court, and in all but Part IV-C of the Court's opinion.

MR. JUSTICE STEVENS took no part in the consideration or decision of this case.

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

FOREMOST-MCKESSON, INC. v. PROVIDENT SECURITIES CO.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 74-742. Argued October 7, 1975—Decided January 13, 1976

Respondent, a personal holding company contemplating liquidation, sold assets to petitioner corporation. Respondent received from petitioner as part of the purchase price convertible debentures which if converted into petitioner's common stock would make respondent a holder of more than 10% of petitioner's outstanding common stock. A few days later, pursuant to an underwriting agreement, one of the debentures was sold to a group of underwriters for cash in an amount exceeding its face value. After making debenture and cash distributions to its stockholders, respondent dissolved. Under § 16 (b) of the Securities Exchange Act of 1934 (Act) a corporation may recover for itself the profits realized by an officer, director, or beneficial owner of more than 10% of its shares from a purchase and sale of its stock within a six-month period. An exemptive provision specifies, however, that § 16 (b) shall not be construed to cover any transaction where the beneficial owner was not such both "at the time of" the purchase and sale of the securities involved. Since the amount of petitioner's debentures received by respondent was large enough to make respondent a beneficial owner of petitioner within the meaning of § 16, and its disposal of the securities within the six-month period exposed respondent to a suit by petitioner to recover profits realized by respondent on the sale to the underwriters, respondent sought a declaratory judgment of its nonliability under § 16 (b). The District Court granted summary judgment to respondent, and the Court of Appeals affirmed, though for different reasons. *Held*: By virtue of the exemptive provision a beneficial owner is accountable under § 16 (b) in a purchase-sale sequence such as was involved here only

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— Additional changes in syllabus.

HENRY PUTZEL, JR.
Reporter of Decisions.

Syllabus

if he was such an owner "before the purchase." Thus, the fact that respondent was not a beneficial owner before the purchase removed the transaction from the operation of § 16 (b). Pp. 7-27.

(a) The legislative history of the exemptive provision reveals a legislative intent to deter beneficial owners from making both a purchase and a sale on the basis of inside information, which is presumptively available only after the purchase. Pp. 10-17.

(b) Had it been Congress' design when it enacted § 16 (b) to impose liability in cases such as this, it should have done so expressly or by unmistakable inference. Pp. 18-20.

(c) Congress may have sought to distinguish between purchases by persons who have not yet acquired inside status through stock ownership of at least 10% and purchases by directors and officers because the latter are more intimately involved in corporate affairs. Pp. 20-22.

(d) Other sanctions remain available against fraudulent use of inside information in transactions not covered by § 16 (b). Pp. 22-24.

(e) Other provisions exempting certain transactions from § 16 (b) are not inconsistent with the "before the purchase" construction reached here. Pp. 24-27.

506 F. 2d 601, affirmed.

POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, STEWART, MARSHALL, BLACKMUN, and REHNQUIST, JJ., joined, and in all but Part IV-C of which WHITE, J., joined. STEVENS, J., took no part in the consideration or decision of the case.