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Reliance Electric Co. v. Emerson Electric Co.: A Mechanistic Application of Section 16(b)

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operative trust in future cases, or eventually confront the validity of the testamentary trust doctrine itself. In spite of this backdoor approach, the *Westerfeld* decision is pragmatically sound. Most authorities in the probate field agree that substantial changes are necessary in present probate systems. Until such changes occur, revocable *inter vivos* trusts of the *Westerfeld* variety may well be a necessary alternative to the executing and probating of a will.

Susan Crump

Reliance Electric Co. v. Emerson Electric Co.: A Mechanistic Application of Section 16(b)

Emerson Electric Company purchased 13.2 percent of Dodge Manufacturing Company common stock with the intent to gain control of Dodge. Subsequently, Dodge stockholders approved a merger with Reliance Electric Company, thereby insuring failure of the attempted takeover. To avoid the forced exchange of Dodge stock for Reliance stock, Emerson followed a plan designed to minimize the liability for short-swing profits which is imposed by section 16(b) of the Securities Exchange Act of 1934.[1] In the first sale Emerson sold 3.24 percent of the Dodge stock, thereby lowering its holdings to 9.96 percent of the outstanding Dodge stock. In a second sale two weeks later, Emerson divested itself of the remainder of its Dodge holdings. Reliance demanded the profits from both sales, and Emerson brought suit for a declaratory judgment that it had no liability for the profits under section 16(b). The district court found Emerson liable as a statutory insider for the profits realized on both sales.[2] The court of appeals reversed the lower court with respect to Emerson's status as an insider and the liability for the profits on the second sale.[3] *Held, affirmed*: Since section 16(b) defines "insider" as the beneficial owner of more than ten percent of the class "both at the time of the purchase and sale," structuring the sales to destroy insider status and thereby avoid section 16(b) liability on the second sale is within the contemplation of the statute. *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972).

I. Trends of Application and Interpretation of Section 16(b)

To prevent the speculative abuse of inside information, section 16(b)[4]

[1] 15 U.S.C. § 78p(b) (1970); *see* note 4 *infra*.
[2] Emerson Elec. Co. v. Reliance Elec. Co., 306 F. Supp. 588 (E.D. Mo. 1969).
[3] Emerson Elec. Co. v. Reliance Elec. Co., 434 F.2d 918 (8th Cir. 1970).
[4] 15 U.S.C. § 78p(b) (1970) reads in part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner . . . by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner . . . . 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 . . . .

allows for recovery of short-swing profits taken by certain classes of stockholders through a purchase and sale within a period of six months. Among those are shareholders who own more than ten percent of any class of equity security of a corporation.[5] When ownership exceeds ten percent of the outstanding stock, it is presumed that the shareholder has access to inside information which may be used in speculative trading.[6] Consequently, to prevent the unfair use of such information, any profits realized by the beneficial owners in transactions within the six-month period are recoverable by the issuer of the securities, regardless of the intent of the owner.[7]

The enforcement of section 16(b) has been complicated by a profusion of judicial interpretations of the congressional intent in the passage of the section.[8] Some courts have relied upon the statement that section 16(b) presented "a crude rule of thumb" formulated to avoid subjective factors which present problems of proof.[9] Also drawn upon are the reports of the Senate committee, which state that the purpose of the bill is the prevention of speculative abuse of inside information.[10] The preamble to section 16(b) simply restates this purpose.[11] Two predominant interpretations as to the application of section

[5] The term "beneficial owner" is connotative of more than the simple ownership of the stocks themselves. For a full discussion of the term "ownership" within the context of § 16(b), see Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 W. RESERVE L. REV. 1054 (1966); Shreve, *Beneficial Ownership of Securities Held By Family Members*, 22 BUS. LAW. 431 (1967).

[6] 15 U.S.C. § 78p(b) (1970); *see* Newmark v. RKO General, Inc., 425 F.2d 348, 356 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

[7] Necessary to the enforcement of § 16(b) is § 16(a), 15 U.S.C. § 78p(a) (1970). This section introduces a reporting requirement which directs beneficial owners of more than 10% of the stock to report their attainment of such a status. Thereafter any change in status must be reflected by a monthly report. If there is a sale which drops the holdings of the insider to below 10%, that must be reported. Thereafter any transactions are outside the statute's regulation and require no report. *See* Form 4, SEC Securities Exchange Release No. 6487 (Mar. 9, 1961), for particulars of the reporting requirement.

[8] *See, e.g.*, Petteys v. Butler, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967); Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965); Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

[9] This statement was made by Thomas Corcoran, a drafter and primary advocate of § 16(b). S. REP. NO. 1455, 73d Cong., 2d Sess. 6556, 6557 (1934). The "crude rule of thumb" has been taken to endorse an automatic application of § 16(b) where the criteria of the statute are met by the transaction in question. This imposition of strict liability is done with a thoroughgoing indiscrimination which contemplates "the statute to be broadly remedial . . . and intended . . . to establish a standard so high as to prevent any conflict between the selfish interest of a . . . stockholder and the faithful performance of his fiduciary duty." Smolowe v. Delendo Corp., 136 F.2d 231, 239 (2d Cir. 1943). There is to be no consideration of judicial exemptions of any transaction in this view of the legislative policy. Instead, this is considered a flat prophylactic rule. To achieve the prophylactic effect the statute is applied as a "crude rule of thumb," taking in all transactions and making shareholders under the rule strictly liable. Through the avoidance of problems of proof raised by consideration of intent and other subjective factors, it was hoped that an easy and broad application of § 16(b) would be achieved with a concomitant increase in the deterrent force of the statute.

[10] S. REP. NO. 792, 73d Cong., 2d Sess. 9 (1934); S. REP. NO. 1455, 73d Cong., 2d Sess. 68 (1934). The Senate Committee's reports state that § 16(b) is to "protect the interest of the public against the predatory operations of . . . principal stockholders by preventing them from speculating in the stock of the corporations to which they owe a fiduciary duty" and to "protect . . . by preventing principal stockholders from speculating in stock on the basis of information not available to others." S. REP. NO. 1455, at 68; S. REP. NO. 792, at 9.

[11] The preamble states the purpose as "preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his rela-

16(b) have developed. The first of these has been styled by the courts and commentators as the objective approach, while the other is termed the subjective approach.[12]

The Objective Approach. The objective approach was first used in *Smolowe v. Delendo Corp.*[13] and *Park & Tilford, Inc. v. Schulte.*[14] In *Smolowe* the court was asked to decide whether there should be liability where there was no unfair use of inside information. The court found "that the only remedy which 16(b)'s framers deemed effective . . . was the imposition of a liability based on an objective measure of proof."[15] Under this viewpoint, automatic application of section 16(b) would allow no consideration of whether there was actual or possible use of inside information. It was thought that to allow such consideration would render useless those provisions of the statute that allow the courts to avoid problems of proof, especially the proof of intent. In *Park & Tilford* the court held that a voluntary conversion of preferred stock to common stock was a purchase within the terms of the statute. Seizing upon the definition of "purchase" as "any contract to buy, purchase, or otherwise acquire" stock,[16] the court found that an option to convert from preferred to common stock came within the proscription of the Act. Liability for the profits realized attached without consideration of subjective elements, since such consideration was expressly forbidden in *Smolowe.* Again, no concern was demonstrated for any point of reference other than definite criteria found within the statute. *Park & Tilford* adopted the objective application of the statute and applied it to cause the relinquishing of all possible profits by the trader, supposedly giving the statute deterrent value.[17]

The decisions following the reasoning of *Smolowe* and *Park & Tilford* all adhere to the objective standard.[18] The main characteristic of this standard is a decision whether the transaction and its participants fall within the objective criteria found in section 16(b). Such criteria, for example, include the status

tionship to the issuer . . . ." 15 U.S.C. § 78p(b) (1970). This preamble has been employed by the courts to support varying viewpoints. The only agreement of these viewpoints is that the statute was designed for the prevention of insider speculative abuses. The point of agreement itself has been put to differing uses. Where some courts have seen this preamble only as a simple statement of purpose, others have taken it as a fiat to allow a most liberal interpretation of the statute. In the former interpretation there is the adherence to a strict mechanistic application of the statute. The courts making the latter interpretation have used the preamble to implement a policy of considering the possibility of abuse with less emphasis on strict liability. *Compare* Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959), *with* Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), *cert. denied,* 379 U.S. 961 (1965).

[12] *See generally* Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading,* 54 CORNELL L. REV. 45 (1968).

[13] 136 F.2d 231 (2d Cir.), *cert. denied,* 320 U.S. 751 (1943).

[14] 160 F.2d 984 (2d Cir.), *cert. denied,* 332 U.S. 761 (1947).

[15] 136 F.2d at 235.

[16] 15 U.S.C. § 78c(13) (1970).

[17] 160 F.2d at 988.

[18] *See, e.g.,* Blau v. Lehman, 368 U.S. 403 (1962); Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), *cert. denied,* 396 U.S. 1036 (1970); Western Auto Supply Co. v. Gamble-Skogmo, Inc., 348 F.2d 736 (8th Cir.), *cert. denied,* 382 U.S. 987 (1965); Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959); Stella v. Graham-Paige Motors Corp., 232 F.2d 299 (2d Cir.), *cert. denied,* 352 U.S. 831 (1956); Shaw v. Dreyfus, 172 F.2d 140 (2d Cir.), *cert. denied,* 337 U.S. 907 (1949). *But see* Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965), in which the court accepted the objective approach, but proceeded to base its decision on a factual consideration through the subjective approach.

of shareholder, ownership of certain amounts of stock, and the definitions of "purchase" and "sale." Beyond these considerations there is little concern with other factors, and none for those which are more subjective in nature.[19]

The Subjective Approach. In 1958, fifteen years after the decision in *Smolowe*, judicial thought turned from the objective viewpoint toward a more subjective approach in the application of section 16(b). Where statutory construction was required, the courts began to look for possible opportunities for speculative abuse. In *Ferraiolo v. Newman* the Sixth Circuit set the new standard by stating: "[E]very transaction which can be reasonably defined as a purchase will be so defined, if the transaction is of a kind which can possibly lend itself to the speculation encompassed by section 16(b)."[20] This holding was the first where the court considered all of the facts of the case before deciding whether section 16(b) applied.[21] In many subsequent cases, if the facts indicated a possibility for the insider to abuse information, liability attached if the transaction met the other criteria necessary to invoke regulation under section 16(b). The Second Circuit, in *Blau v. Lamb*,[22] held that a conversion of preferred stock was not a sale since the facts presented would not allow any speculative abuse to occur. With an explicit disavowal of the objective approach and its "crude rule of thumb" language,[23] a precedent was established which would resolve previous ambiguities encountered in the application of the terms "purchase" and "sale" to the various transactions.[24]

The subjective approach departs from the objective trend of interpretation by considering the possibility of speculative abuse in the transaction as shown by the facts of the case. The factual circumstances must be such that the transaction presents the opportunity for speculative abuse to the insider. Such transactions are the concern of section 16(b) as stated in the statutory pre-

[19] There is behind this view the reasoning that the objective approach is within the purview of the congressional intent since the Congress provided points of mitigation through the limitation of action by the six-month rule and the administrative power to exempt. Therefore, the reasoning continues, strict liability should be the standard. All transactions possibly within the scope of the statute (which is to be read literally) will be regulated regardless of whether there is actual abuse or not.

[20] 259 F.2d 342, 345 (6th Cir.), *cert. denied*, 359 U.S. 927 (1958).

[21] Abrams v. Occidental Petroleum Corp., 450 F.2d 157 (2d Cir. 1971) (exchange of stock did not provide opportunity for speculative abuse); Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970) (option granted provided speculative opportunity); Newmark v. RKO General, Inc., 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970) (contract rights to stock provided speculative opportunity); Petteys v. Butler, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967) (economic equivalence of stock allowed no chance for speculative abuse); Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) (classes of stock economically equivalent—no speculative abuse possible); Blau v. Max Factor & Co., 342 F.2d 304 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965) (long term investment—conversion allowed no speculative advantage); Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965) (date of purchase decided on basis of possible gain of speculative advantage); Roberts v. Eaton, 212 F.2d 82 (2d Cir.), *cert. denied*, 348 U.S. 827 (1954) (reclassified stock provided no speculative opportunity).

[22] 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967).

[23] *Id.* at 518. The court argued that Congress would have the automatic application of § 16(b) negated where the reason for the statute ceased to operate. *Id.* at 519.

[24] For a discussion of the complexities of purchase and sale, see Comment, *Short Swing "Purchase and Sales" Under the Securities Exchange Act*, 61 NW. U.L. REV. 448 (1966); Comment, *The Scope of "Purchase and Sale" Under Section 16(b) of the Exchange Act*, 59 YALE L.J. 510 (1950).

amble. Considering this stated statutory purpose, the courts have applied the test in *Ferraiolo* to penalize those transactions which give rise to the possibility of speculative abuse, while not attaching liability to transactions out of the supposed scope of the statute.[25]

II. RELIANCE ELECTRIC CO. V. EMERSON ELECTRIC CO.

In *Reliance Electric Co. v. Emerson Electric Co.*[26] the Supreme Court of the United States encountered a case of first impression. In a four-to-three decision, the Court approved a plan whereby beneficial owners of more than ten percent of a class of stock could minimize liability under 16(b) by splitting the sale of stock. In so doing, the cases espousing the subjective approach were ignored, while the objective standard was recognized as applicable in section 16(b) cases. The Court found that congressional intent was to promulgate "a flat rule taking profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great."[27] Such a rule was taken as a mandate for the application of the objective standards inherent within the wording of the statute. This application would optimize the prophylactic effect of the rule, although the Court recognized that not all abusive transactions were within the purview of the statute.

The Court spoke pointedly of its refusal to impose liability simply because the insider had acted with the intent to avoid all possible liability.[28] Instead, the objective standards of section 16(b) were found controlling. The factual circumstances of the case were measured against these standards to ascertain whether there was to be liability for the profits realized. It was held that the objective standards included the requirement that a ten percent owner be such "both at the time of the purchase and sale . . . of the security involved."[29] At the time of the second sale, Emerson was no longer the owner of more than ten percent of Dodge common stock. Therefore section 16(b) did not encompass the second sale.[30] As a consequence of the literal reading of the statute by the Court, no consideration was given to any possible inconsistency

[25] *See, e.g.*, 363 F.2d at 515. Is this, in fact, a more flexible approach, or is it also an automatic application? The word "flexible" is applied to the subjective approach in recognition of the ability of the courts to use this test to exclude some of those shareholders who could not possibly have abused information to which they had access. Their profits are exempted without the need for consideration of the proof problems sought to be avoided. Therefore, the shareholder is allowed to retain profits honestly realized, and the number of harsh impositions of liability where no abuse occurred is reduced.

[26] 404 U.S. 418 (1972).

[27] *Id.* at 422.

[28] *Cf.* Gregory v. Helvering, 293 U.S. 465 (1935), in which the Court states that arranging business affairs so as to minimize income tax liability is a legitimate activity. This line of thought continues in *Reliance Electric.*

[29] 15 U.S.C. § 78p(b) (1970); *see* note 4 *supra.*

[30] Commentators have previously suggested the plan of sale here used by Emerson as a method for avoiding the liability encountered by the more-than-10% shareholder under § 16(b). *See* 2 L. LOSS, SECURITIES REGULATION 1060 (2d ed. 1961); Seligman, *Problems Under the Securities Exchange Act*, 21 VA. L. REV. 1, 20 (1934). Loss later commented upon the consistency of such a plan with the spirit of § 16(b). He suggested the apportionment of the profits from the second sale, with the larger portion of the profits inuring to the issuer. This would avoid putting a premium on a split sale, as in *Reliance Electric*, by the allowance of the profits on the second sale without consideration of the overall transaction. 5 L. LOSS, *supra*, at 3023 (Supp. 2d ed. 1969).

between the objective standard and the purpose of section 16(b).[31] Indeed, the purpose of preventing the unfair use of inside information drew little attention from the Court.

The Court admitted that there were possible instances when alternative constructions of the language of the statute were possible. However, it reasoned that any construction "that treats two sales as one upon proof of a preexisting intent by the seller" is violative of the congressional intent to predicate liability on an objective measure.[32] To allow any alternative would be to violate the clear directive of the rule that there be no consideration of intent, as well as allowing a reading of the statute that "flatly contradicts the words of the statute."[33]

Mr. Justice Douglas, writing in dissent, argued that the Court's adherence to the objective approach ignored the statutory purpose. The assumption that two sales were two transactions where there "would ordinarily be a single transaction"[34] was said to force the holding outside the bounds of the "broad remedial purpose of the statute,"[35] thereby undermining its prophylactic effect. The dissent contended that the transaction must be defined within the bounds of reason and with the prospect of embracing all transactions which might present the possibility for speculation. It was noted that one case (in the subjective trend) had considered multiple purchases to be a single transaction.[36] Such, the dissenters determined, should have been the finding in *Reliance Electric*. Problems of proof created by the abandonment of the objective standard were argued to be subsidiary to the avowed purpose of the statute.[37] In *Reliance Electric*, it was reasoned, the test applied should have been based on "a rebuttable presumption that any such series of dispositive transactions will be deemed to be part of a single plan of disposition, and will be treated as a single 'sale' . . . ."[38] Would such a test raise those questions of intent section 16(b) hopes to avoid? The dissent answered that questions of intent would be factual and would involve only an objective analysis of the dispositive factors of the transactions made by the insider. The application of such an analysis could be used to strip insiders of the potentially substantial profits possible from a plan such as the one Emerson employed. The dissent reasoned: "Only if a beneficial owner carried an affirmative burden of proof—that his series of dispositive transactions were not of a type that afforded him an opportunity for speculative abuse of his position as an insider—should we say he was not such a beneficial owner 'at the time of . . . sale.' "[39]

The Court's decision in *Reliance Electric* was an affirmation of the objective approach as the standard of applicability for section 16(b). With this affirmation the value of some of those decisions employing the subjective approach

[31] 404 U.S. at 424.
[32] *Id.* at 425.
[33] *Id.* at 427.
[34] *Id.* at 431.
[35] Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970).
[36] 404 U.S. at 434, citing Abrams v. Occidental Petroleum Corp., 323 F. Supp. 570 (S.D.N.Y. 1970).
[37] 404 U.S. at 437.
[38] *Id.* at 438.
[39] *Id.* at 440.

has been destroyed, although others may still stand as precedent.[40] The Court has said that there are objective standards within section 16(b) which are to be used in the determination of liability for profits under the section.[41] Consequently, courts hearing questions under section 16(b) in the future will have the task of extracting from the statute those standards which they determine to be objective and applying them to the factual circumstances presented in the case.[42] The Court has made the task of extraction difficult by failing to define those objective standards contained in the statute. However, with a clear dismissal of the argument that the two sales of Emerson were one transaction, the Court makes the suggestion that the definition of "purchase" and "sale" are to be narrowly construed.[43] Where there are objective standards, there may no longer be divergent results when the facts present transactions carried out in the same form.[44] The question of inherent possibility for abuse will no longer be allowed where application of an objective standard is possible. This will destroy the opportunity for any judicial interpretation other than that of defining the objective standards necessary to the decision. The courts are now

[40] *See, e.g.*, Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958), which should no longer have precedential value since it employs a subjective standard to reach a decision as to whether a stock conversion constitutes a purchase. In Park & Tilford, Inc. v. Schulte, 160 F.2d 984 (2d Cir. 1947), with its objective standard, there is a situation analogous to that in *Ferraiolo*.

[41] The courts have shown no reluctance to distinguish such a holding. Many of the decisions concerning the problem of whether there is a sale or purchase involved in a conversion have neatly avoided the reasoning in *Park & Tilford* by stating that the decision was justified by the facts. Blau v. Lehman, 368 U.S. 403 (1962), also a Supreme Court decision, has been avoided by lower courts. Although it appears to adopt the objective viewpoint, it does not have a strong precedential value because the adoption of the viewpoint is not explicit.

[42] When considering the practical possibilities presented by *Reliance Electric*, there are several variables that may come into the plan for minimizing liability. Take for instance the holder of 101 shares of the outstanding 1,000 shares of a corporation. If he sold 1 share of this stock in one sale and then in another separate sale sold the remaining 100 shares, he would be liable only for the profits made in the first sale. However, to separate the two sales there must be some consideration of the time element, and of the parties to whom the sales are made. How much time is enough to separate the two? Seemingly, if there are sales to two different parties, two weeks would suffice to separate the sales. With such separation there would be no liability for the second sale. The intent of the party to divest himself of all of his holdings would not be a point of concern as long as it was not extended into contractual arrangements for the sale of the whole. If a contract for sale of the total holdings arises, the time element would not enter into consideration. It is important that contractual obligations for the sale of the whole at a single time, or in a small span of time, or to a single party be avoided. It is probable that, when such a contractual relationship is discovered, the courts will find a single sale, even though the second sale might be to a different party.

[43] 404 U.S. at 425. Other terms or clauses within the statute which may be considered objective standards are "equity security," "director or officer," "more than 10% beneficial owner," and "issuer." 15 U.S.C. § 78p(b) (1970). Also encompassed may be those delineations of when the shareholder must have a certain status for liability to attach. *See* Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959).

[44] *Compare* Truncale v. Blumberg, 80 F. Supp. 387 (S.D.N.Y. 1948), *aff'd per curiam sub nom.* Truncale v. Scully, 182 F.2d 1021 (2d Cir. 1950), *with* Shaw v. Dreyfus, 172 F.2d 140 (2d Cir.), *cert. denied*, 337 U.S. 907 (1949). In these cases the question considered by the courts was whether rights to acquire stock through the medium of the stock option constituted a purchase. In *Truncale* the rights were received by the officers and directors of the company so that the rights under the stock options were found to be purchases. In *Shaw* where all the stockholders received the stock options, the rights were found to be purchases only upon their exercise. It has been suggested that these cases were the precursors of the *Ferraiolo*-subjective approach with the factual circumstance and the possibility for abuse being the basis of the disparate views. *See also* Comment, *Short Swing "Purchase and Sales" Under the Securities Exchange Act*, 61 NW. U.L. REV. 448, 465 (1966).

faced with testing each case for points of application of the objective standards of section 16(b). The test implicit in *Reliance Electric* consists of two parts: (1) whether there is an explicit objective standard within the statute which can define all components of the transaction and define the status of the participants in the transaction; and (2) if not, whether there was the possibility for abuse within the factual situation presented by the case. With an affirmative answer to the first question, the second is necessarily ignored under the holding in *Reliance Electric*. The cases suggested by the Court as examples of alternative constructions lead to the conclusion that the Court would allow the application of the subjective approach in some instances.[45] However, *Reliance Electric* serves as a limit on application of the subjective standard. The facts presented by the case must not be susceptible of any clear application of those definite criteria contained in section 16(b) if the subjective approach is to be used. This necessarily narrows the wide application of the subjective approach made before *Reliance Electric*. As the courts hear more cases involving section 16(b), and the objective standards of which the Court spoke become more clearly defined, there will be, in all likelihood, an even more automatic approach to attachment of section 16(b) liability.

III. CONCLUSION

The objective approach chosen by the Court as the standard of application for section 16(b) would appear to allow the most exact application of section 16(b). It is this literal and exact application which makes the statute inapplicable in *Reliance Electric*. It would seem, however, that the decision is regressive inasmuch as it avoids a class of cases where the subjective standard might be better applied. In avoiding the subjective approach the Court ignores such considerations as the "sequence of relevant transactions"[46] which might enable an interpretation of the statute to be more in keeping with the stated purpose of section 16(b). With the use of the subjective standard there could be avoided those applications of the section which are harsh.[47] To make use of this standard the courts will probably have to resort to the technique used in skirting the precedent in *Park & Tilford*—that of distinguishing the case on the facts. However, this technique will only be available to the courts in a narrow area of section 16(b) cases. If there is to be avoidance of the harsh result and a more efficient capture of those profits taken in transactions where inside information is used, it would seem that congressional amendment of

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[45] 404 U.S. at 424 n.4. The Court has recognized that the objective standards present within the statute are not completely dispositive of all questions raised by situations concerning § 16(b). Some alternative constructions are possible. The Court sets out specific examples of such situations. Ironically, several cases cited as examples are said by most courts and commentators to be decided through the objective approach. *See* note 18 *supra*, and accompanying text. Other decisions mentioned are in the subjective trend. The Court says: "The various tests employed in these cases are used to determine whether a transaction, objectively defined, falls within or without the terms of the statute." 404 U.S. at 424 n.4. Could it be that those terms of which the Court speaks encompass the legislative purpose of preventing speculative abuse? *See, e.g.*, Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970).

[46] 404 U.S. at 432, quoting Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970).

[47] Blau v. Max Factor & Co., 342 F.2d 304 (9th Cir. 1965).