Securities Aspects of Tax Reorganizations

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COMMENTS

SECURITIES ASPECTS OF TAX REORGANIZATIONS

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A tax reorganization, hereafter referred to individually by the appropriate identifying letter used in the 1954 Internal Revenue Code, is defined as any one of the following transactions:

(A) a statutory merger or consolidation;¹
(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);²
(C) the acquisition by one corporation, in exchange solely for all or part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;³
(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but

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¹ Int. Rev. Code of 1954, § 368(a)(1)(A). This definition refers to a merger or consolidation effected pursuant to the corporation laws of the United States or a state or territory or the District of Columbia. Treas. Reg. § 1.368-2 (1955). In a strict sense, a merger is a union effected by the absorbing of one or more existing corporations by another which survives and continues the combined business; a consolidation is the uniting of two or more existing corporations to form a new corporation. Ballantine, Corporations 680-81 (rev. ed. 1946).


For purposes of ... this part, the term "control" means the ownership of stock possessing at least 80 per cent of the total combined voting power of all classes of stock entitled to vote and at least 80 per cent of the total number of shares of all other classes of stock of the corporation. Int. Rev. Code of 1954, § 368(c).

It is not necessary that control be acquired as a result of the type B exchange so long as such control exists immediately after the exchange. In the type B reorganization, the requirement that acquisition be made "solely" in exchange for the acquiring corporation's voting stock has been strictly interpreted by the courts. Helvering v. Southwest Consol. Corp., 315 U.S. 194 (1942).

³ Int. Rev. Code of 1954, § 368(a)(1)(C). Unlike a type B reorganization, the "solely" in exchange for voting stock requirement of a type C reorganization may be met even though cash or other property is given in addition to the acquiring corporation's stock. Int. Rev. Code of 1954, § 368(a)(2).
only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;4

(E) a recapitalization; or

(F) a mere change in identity, form or place of organization, however effected.6

These provisions form the framework within which a reorganization must be constructed in order to qualify for non-recognition of gain or loss in that transaction. In addition to complying strictly7 with the Internal Revenue Code, a reorganization must comply with certain administrative and judicial doctrines which have been superimposed upon the statute. These include the well-known “business purpose,”8 “continuity of interest,”9 and “step transaction”10 doctrines which are presently applicable and necessary to consider.

It is not difficult to see that each of these transactions will quite likely entail an issuance of securities in exchange for securities or properties received. Thus, in any tax reorganization the parties must ascertain the applicability of the various federal securities acts11 and determine the impact of each upon that particular reorganization.

4 Int. Rev. Code of 1954, § 368(a)(1)(D). Where a reorganization may qualify as either type C or type D the transaction must be treated as a type D exchange. Int. Rev. Code of 1954, § 368(a)(2)(A). In order to qualify as a type D reorganization an exchange must comply with §§ 354, 355, or 356. Section 354 requires that the transferor corporation transfer substantially all of its assets and then distribute the stock and securities it receives to its stockholders. This section is designed to control only combination D reorganizations and is inapplicable to corporate divisions. Section 355 provides for a tax free distribution in divisive reorganizations such as spin-offs, split-offs, and split-ups. The benefits of this section apply only to distributions or exchanges in which the controlled and controlling corporations continue to carry on a business which was in existence for at least five years before the exchange and where only stocks or securities are distributed. Section 356 comes into play if the distribution would have qualified under § 354 or § 355 but for the dispersal of “other property or money.” All divisive reorganizations must qualify under § 355 to be nontaxable at the shareholder level.

6 Int. Rev. Code of 1954, § 368(a)(1)(E). Recapitalization is a vague term which has not been expressly defined by Congress or the Supreme Court. In Helvering v. Southwest Consol. Corp., 315 U.S. 194, 202 (1942), the Court would venture no further than to deem it a “reshuffling of a capital structure, within the framework of an existing corporation. . . .” A recapitalization has also been defined as “an agreement of all stockholders and creditors to change and increase the capitalization or debts of the corporation or both.” 3 Mertens, Federal Income Taxation 72 (1942).


Because the burden and expense of complying with these laws and the effect of the disclosure requirements upon corporate policies are often quite substantial, the type of reorganization which is to be utilized must be selected with care. It is the purpose of this Comment to examine these transactions in light of the securities acts and to ascertain and analyze the more important securities problems that may appear.

I. THE SECURITIES ACT OF 1933

A. The "No Sale" Theory And Rule 133

The Securities Act of 1933 was enacted to compel disclosure of facts which would enable investors to purchase securities with full knowledge of pertinent information about the issuer. For purposes of tax reorganization, the most important provision of the act is section 5, which requires registration of securities sold or offered for sale by use of the mails or in interstate commerce by issuers, underwriters, or dealers, unless a specific exemption from registration is available. However, unless a securities transaction involves a "sale" or an "offer to sell," it is not covered by the act, and the security itself need not be registered.

In 1935 the Securities and Exchange Commission restricted the scope of the term "sale." The Commission took the position that "no sale" to stockholders of a corporation is involved in a statutory merger, consolidation, or sale of assets among corporations where, pursuant to statutory or charter provisions, a vote of a required majority operates to authorize the transaction and to bind all stockholders except for statutory appraisal rights of dissenters. This declaration was contrary to an earlier position taken by the Federal Trade Commission and to the legislative history of the Securities Act.

The theory was initially embodied in a note to the form that was then used for registration of securities. It remained substantially

13 Securities Act § 5.
12 Securities Act § 2(1): The terms "sale" or "sell" include "every contract of sale or disposition of a security . . . for value. The term 'offer to sell', 'offer for sale', or 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security . . . for value."
14 See H.R. Rep. No. 85, 73d Cong., 1st Sess. 11, 16 (1933) providing: "The term 'sale' or 'sell' is defined broadly to include every attempt or offer to dispose of a security for value." (Emphasis added.) See also 1 Loss, Securities Regulation 519 (2d ed. 1961) discussing H.R. Rep. No. 81 with reference to the present § 3(a)(10) of the Securities Act and implying that corporate reorganizations of the type discussed are covered by the statute unless specifically exempted.
intact until 1947 when the Commission rescinded the form and omitted the “no sale” note from its replacement. In spite of its rescission the Commission continued to apply the rule on a case-by-case basis until 1951 when it was formally codified into Rule 133. The codified rule extended the scope of the “no sale” theory and further restricted the term “sale” by removing reclassifications from the definition of that term. A further extension occurred in 1954 when the Commission, in a move to conform the rule to the Internal Revenue Code, amended it to embrace transactions in which assets of one corporation are transferred to another corporation in exchange for voting stock of a third corporation which is in control of the transferee. Finally, as a result of litigation arising from the rule, the Commission, after an unfruitful attempt in 1956, amended it in 1959 to its present form.

The rationale upon which the Commission based its concept of the “no sale” theory is that in these situations the alteration of the stockholder’s security occurs not because he consents individually to an exchange but because the corporation by authorized corporate action converts his security from one form to another. This premise—that the transaction involves a corporate rather than an individual act—has found few friends among legal commentators. It gained sustenance, however, in National Supply Co. v. Leland Stanford Univ. where a court of appeals, although not resting its decision upon the “no sale” theory, deferred to the amicus brief of the Commission which advocated its application and, in effect, thereby adopted it. The theory has not since been challenged in the courts.

Another aspect of the “no sale” theory which has received heavy

24 See 1 Loss, Securities Regulation 528 (2d ed. 1961).
26 See 1 Loss, op. cit. supra note 24, at 521.
29 Id. at 694.
criticism is the inconsistency which arises from the fact that for purposes of registration and prospectus requirements a reorganization transaction may not involve a sale, while for almost all other securities regulation purposes it does.\(^{20}\) For example, a sale may be involved in a reorganization exchange for purposes of Rule 10b-5 and section 16(b) of the Exchange Act,\(^ {21}\) and quite clearly a sale is involved for purposes of sections 12 and 17 of the Securities Act.\(^ {22}\) Also troublesome has been the concept that a Rule 133 transaction, although not involving a sale, may very well involve a *purchase* of securities.\(^ {23}\)

Some rather legalistic attempts have been made to justify these anomalies but thus far with little success.\(^ {24}\) An entirely supportable justification is that the reorganization transactions are not to be considered within the scope of the registration prospectus and remedial provisions of the Securities Act simply because the act is not designed to cope with the problems presented. If, for example, the parties to a typical merger should be subject to section 5 of the Securities Act, the constituent corporation, which is the recipient of the stock of the surviving corporation, would, upon distribution to its shareholders, presumably be deemed an underwriter of the issued stock with an underwriter's liability; the same consequence would possibly attend the solicitation of shareholder approval of the transaction.\(^ {25}\) Furthermore, because one or more of the constituent corporations in a merger or consolidation often cease to exist upon consummation

\(^{20}\) In regard to the logical contradiction in not applying the "no sale" rule in all instances where the word "sale" appears in the statute, see Note, *The SEC's No-Sale Rule and Exchanges of Securities Pursuant to Voluntary Reorganization*, 67 Harv. L. Rev. 1237 (1954), which relies for explanation upon language in the Securities Act (Statutory definitions shall be used "unless the context otherwise requires."). Securities Act § 2. See 1 Loss, op. cit. supra note 24, at 533; Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 Record of N.Y.C.B.A. 162, 171 (1959).

\(^{21}\) See text accompanying notes 115, 138 infra.

\(^{22}\) SEC Rule 133, 17 C.F.R. § 230.133 (Supp. 1962), by its terms applies only for purposes of § 5 of the Securities Act.

\(^{23}\) The reasoning process utilized in formulating this conclusion is basically that (1) by definition, the consumation of mergers and certain other reorganizations does not involve a "sale" of securities, however (2) such transactions may involve a "purchase" for purposes of determining whether the recipient is an underwriter and thus required to register the securities. *Proposed SEC Rule 133—Comments of Committee on Federal Regulation of Securities*, 14 Bus. Law. 423, 425 (1959) citing SEC Securities Act Release No. 3965, Sept. 15, 1958; Cohen, supra note 30, at 176; 1 Loss, Securities Regulation 533 (2d ed. 1961).

\(^{24}\) See notes 30, 33 supra.

\(^{25}\) See SEC *Proposed Revision of Rule 133*, SEC Securities Act Release No. 1698, Oct. 2, 1976, stating that "An 'offer', 'offer to sell' or 'offer for sale' of securities shall be deemed to be made to the stockholders of a corporation when the vote, consent or authorization of such stockholders is solicited in favor of a proposal for [a reorganization]. . . . A 'sale' is deemed to occur . . . when the stockholders or their proxies cast the required number of votes in favor of the proposal or . . . when the required number of consents or authorizations are obtained."
of the transaction, the remedial problems attendant to, for example, a suit for rescission against a non-existent corporation, would indeed be formidable. Registration under the act as it now stands would over-burden an already complicated process and would remedy few, if any, of the problems involved.  

B. Rule 133 And Tax Reorganizations

It must be noted that Rule 133 is now specifically limited in application to section 5 of the Securities Act. When the rule was formally promulgated in 1951, the Commission called attention to this fact and added:

[Whether or not a sale is involved for any other purpose will depend upon the statutory context, and the question should in no sense be influenced by the rule. As a matter of statutory construction the Commission does not deem the "no sale theory" which is described in the rule as being applicable for purposes of any of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.]

It is clear from the language of the rule that it applies only if a vote of shareholders is necessary to effect the reorganization. Therefore, if a transaction can be consummated without shareholder approval, even the formality of an unnecessary vote will not serve to bring it within the scope of the rule. This language is especially pertinent to type C and D transactions, because although the other types of corporate readjustments ordinarily require shareholder approval, a sale-of-assets maneuver may not.

By its terms, Rule 133 excludes the following transactions from the term "sale" as defined by the Securities Act:

(1) statutory mergers or consolidations;

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37 This limitation is no doubt due in part to a misconception that accompanied the rule for quite some time. This was the so-called "free stock" concept in which it was contended that stock emerging from a Rule 133 transaction had been "freed" from registration requirements. The theory was that a recipient could resell his securities without registering them because there had been no "sale" and therefore no "purchase," and hence no underwriting as defined by the act. Thus, the theory went, the security was exempted by section 4(1). Were it valid, the effect of this would be to permit public distribution of Rule 133 stock with impunity. Fortunately, the belief was dispelled by the Commission, and it was made clear that registration would be required for any subsequent offers or sales with the exception of limited "trading transactions" not involving a distribution. This view was subsequently codified in paragraph (b) of Rule 133. See Orrick, Registration Problems Under the Federal Securities Act—Resales Following Rule 133 and Exchange Transactions, 10 Hastings L.J. 1 (1958).

(2) transfers of assets of one corporation to another corporation in exchange for securities of the latter;
(3) transfers of assets of one corporation to another corporation in exchange for voting stock of a corporation which is in control of the latter; and
(4) reclassifications of securities.

A comparison of the Rule 133 reorganizations with the several tax reorganizations reveals that, although similar in nature, significant differences do exist. Only the first type of reorganization, the statutory merger or consolidation, does not vary from its tax counterpart.40

A type B41 (stock-for-stock) tax reorganization does not fall within the literal terms of the rule. For the rule to apply it is necessary that a vote of the stockholders (1) will operate to authorize the proposed transaction and (2) will bind such stockholders except to the extent that dissenting stockholders may be entitled to receive the appraised value of their holdings.42 Since a type B reorganization entails an exchange of stock on an individual basis and since the act of the majority will not necessarily bind all of the stockholders, it is not within the rule or the "no sale" theory.43 This fact does not, of course, preclude application of other exemptions available under the act.

In the type C (stock-for-assets) transaction44 the rule will apply if the transferor transfers any assets in exchange for transferee stock. The Code, however, requires a transfer of substantially all of the assets of the transferor in exchange for transferee stock. Also, the rule permits the transferee to exchange "securities" and, since there is no express limitation, other properties for the assets received; whereas, to comply with the Code the transferee must exchange "solely . . . voting stock"45 for such assets. Thus the Code is more demanding with respect to the type of securities which may be

40 "Control," for purposes of paragraph (a) of Rule 133, means "the ownership of stock possessing at least 80 per cent of the total combined voting power of all classes of stock entitled to vote and at least 80 per cent of the total number of shares of all other classes of stock of the corporation." Int. Rev. Code of 1954, § 368 (c).
41 Int. Rev. Code of 1954, § 368 (a) (1) (B).
42 SEC Rule 133 (a), 17 C.F.R. § 230.133 (a) (Supp. 1962).
43 See 1 Loss, op. cit. supra note 24, at 528 n.229; Purcell, A Consideration Of The No-Sale Theory Under the Securities Act of 1933, 24 Brooklyn L. Rev. 254 (1957).
44 Int. Rev. Code of 1954, § 368 (a) (1) (C).
45 Int. Rev. Code of 1954, § 368 (a) (1) (C). In the type C transaction, in determining whether the exchange is solely for stock, the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability is disregarded.
exchanged for the assets and to the type of property which may be exchanged in addition to such securities. Paradoxically, the rule and the Code are equally stringent in their requirements when the transfer of assets is in exchange for stock of a corporation which controls the transferee—both require an exchange of voting stock.

The type D or devisive reorganization is initiated when X, parent corporation, transfers part of its assets to subsidiary Y, (or in a “split-up” all of its assets to subsidiaries Y and Z) in exchange for an amount of stock which will suffice to give the transferor-parent control of the transferee-subsidiary immediately after the transfer; obviously, this transaction entails an exchange of voting stock. If the transaction were complete at this point it would undoubtedly qualify under the rule as a “transfer of assets” which would entail merely an exchange of securities.

If considered merely a “transfer of assets” under the rule, the type D reorganization would, of course (assuming a proper plan and shareholder vote), be excluded from the registration requirements of the Securities Act. The problem is complicated, however, by paragraph (c) of Rule 133 which deems certain transactions occurring subsequent to the reorganization exchange to be a distribution subject to the registration and prospectus requirements of section 5. Specifically, paragraph (c) states that a corporate party to a Rule 133 transaction (or a person in a control relationship with the corporation) acquiring securities of an issuer in connection with such a transaction with a view to distribution of the securities, is deemed an underwriter and must register the distributed securities unless exempted by some other section of the act." Since a “devisive reorganization” invariably involves a distribution of stock—though not necessarily in the Rule 133 sense—by the parent corporation to its shareholders, paragraph (c) and its effect upon the transaction must be examined with care.

After the initial transaction in which subsidiary stock is exchanged for parent assets, a “spinoff” will ordinarily involve a distribution by the parent of the issuing subsidiary’s voting stock to the parent stockholders without a surrendering by them of any of the parent stock. This transaction presents no problem for it does not constitute a “sale” within the meaning of the act, because no value is given by

47 Paragraph (c) of Rule 133 codified the Commission’s existing interpretation of the Rule. 1 Loss, op. cit. supra note 24, at 535-36.
48 SEC Rule 133(c), 17 C.F.R. § 230.133(c) (Supp. 1962).
49 See 1 Loss, op. cit. supra note 24, at 513.
the parent shareholders in return for the subsidiary stock; value is, of course, a necessary constituent of a "sale," which in turn is a necessary concomitant of a distribution. Furthermore, if regarded as a partial liquidation under the local corporation law, the transaction is excluded from the section 5 requirements by that provision in paragraph (c) of the rule which sanctions complete or partial liquidations.

After the initial exchange of stock for assets, a "split-off" will ordinarily involve an exchange of the stock of the issuing subsidiary which was received by the parent with the parent shareholders in return for parent stock then held by such shareholders. Should the surrender of parent stock be considered as the giving of value, then this is a sale and hence a "distribution" under the Securities Act. However, it may be contended that the rights of the participating shareholders have not been sufficiently affected by the transaction in terms of the security previously held so as to constitute anything other than a formal alteration of the surrendered security. If this is so, then no value is given for the security and no "sale" is effected; this interpretation precludes a "distribution" and prevents application of section 5. It is also possible that a "split-off" can properly be regarded as a "reclassification" and thus protected by the specific terms of the rule.

Following the parent-subsidiary transaction a "split-up" will involve an exchange of the subsidiary stock received by the parent with the parent shareholders in return for parent stock. The exchange is followed by a complete liquidation of the parent and therefore falls within that part of paragraph (c) of the rule which shields complete liquidations. Moreover, for Rule 133 purposes, "split-ups" are generally accorded the status of "reclassifications" and hence do not require registration.

The types E and F reorganizations are also probably within the scope of the term "reclassification" and thus exempt from registration. In these or in any other reorganizations, however, if the shareholders have an election to surrender all or part of their shares for

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50 Securities Act § 2(3): The term "sale" or "sell" shall include every contract of sale or disposition of a security . . . for value. (Emphasis added.)
51 The term "distribution" is not defined in the act. It is generally considered to be essentially equivalent to a "public offering" which entails an offer or sale of securities. See Orrick, Registration Problems Under the Federal Securities Act—Resales Following Rule 133 And Exchange Transactions, 10 Hastings L.J. 1, 5 (1958).
53 Cf. 1 Loss, op. cit. supra note 24, at 514.
54 See Bromberg, supra note 52, at 11.
55 1 Loss, op. cit. supra note 24, at 721.
securities being distributed pursuant to the reorganization plan, then Rule 133 will be inapplicable because the vote of the majority is not binding upon all stockholders.

Although not peculiar to tax reorganizations, the 1959 amendments to the rule deserve mention. As indicated, the purposes of the amendments were to specify the circumstances under which securities distributed by the persons receiving them in connection with reorganization transactions would have to be registered under the Securities Act.86

Paragraph (b)37 deems an underwriter to be any person who purchases an issuer's securities from security holders of a constituent corporation with a view to distribution or who offers or sells securities for these security holders in connection with a distribution pursuant to a contract with an issuer, an affiliate, or a person acting as an underwriter in a Rule 133 transaction. The paragraph appears to hold no particular pitfalls for tax reorganizations.

However, there is some ambiguity. Literally read, the amendment seems to limit the rule to a distribution arising out of a contract with an issuer, a person in a control relationship with an issuer, or with a person who is acting as an underwriter of the securities. Therefore, a person who agrees with the constituent shareholders to effect a distribution of the securities received is not covered by the terms of the amendment unless such person is considered an underwriter because he is acting pursuant to a contract with an underwriter (the non-controlling stockholder) under the Schering-White rationale.88

Furthermore, since the term "issuer" was specifically excluded

87 SEC Securities Act Release No. 3846, Oct. 10, 1957: "Rule 133 would provide no exemption from the registration and prospectus provisions of Section 5 of the Act with respect to any subsequent public distribution of the shares received by any security holder . . . who might be deemed a statutory underwriter." The Commission determined that the party referred to would be a statutory underwriter if it should acquire shares of the issuing corporation in the merger with a view to distribution. Although not identified in the release, the participating companies were Schering Corporation and White Laboratories, Inc. Noted, 71 Harv. L. Rev. 1570 (1958). See discussion, Cohen, supra note 30, at 166.
from the definition of “constituent corporation,” a person who purchases securities from the issuer’s shareholders or sells for them the new securities received in connection with, for example, a type E or F exchange, does not appear to be within the terms of paragraph (b). Consequently, a possible loophole exists in this instance because no registration will be required if the transaction can qualify as a Rule 133 “reclassification.” Presumably, however, this seller may be considered one who “sells for an issuer” and thus an underwriter within the meaning of section 2(11).\(^5\)

Paragraph (c)\(^6\) imposes the status of an “underwriter” upon any constituent corporation or a person in a control relationship with such a corporation who acquires\(^1\) securities in a Rule 133 transaction with a view to their distribution. Somewhat perplexing is the fact that a resale of a number of shares of the issuing successor corporation by one in control of a constituent corporation may be deemed a “distribution,” while a resale of an even larger number of shares by a non-controlling shareholder of the constituent may not. Presumably section 2(11) is applicable under the Schering-White rationale,\(^6\) and anyone who acquires shares of an issuer in a Rule 133 transaction with a view to distribution will be a statutory underwriter subject to the registration requirement of the Securities Act.\(^6\)

For purposes of paragraph (c) there is no specific definition of “control.” Prior to enactment of the amendment it was suggested that the Commission adopt the test of “voting control” for use under the rule.\(^4\) None was adopted, however, and the criterion is probably the nebulous “working control” test which is used in determining the applicability of section 2(11).\(^4\)

For the sake of predictability a mechanical rule of thumb would be appropriate in this situation. It has been suggested that “control” for purposes of paragraph (c) should mean the ownership of not less than the percentage of outstanding shares necessary to effectuate the particular transaction in question.\(^6\) This may be too high, and perhaps an arbitrary figure of thirty per cent or even as low as ten per cent would be more appropriate. The suggestion is basically sound,

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\(^{5}\) See 1 Loss, Securities Regulation 535 n.253 (2d ed. 1961).

\(^{6}\) SEC Rule 133(c), 17 C.F.R. § 230.133(c) (Supp. 1961).

\(^1\) The word “acquires” was used instead of “purchases” to soften the anomaly of a purchase without a sale. 1 Loss, \textit{op. cit. supra} note 19, at 535.

\(^{4}\) See note 18 \textit{infra}.


\(^{6}\) See SEC Rule 405, 17 C.F.R. § 230.405 (Supp. 1961); 14 Bus. Law. 119, 124 (1959); see also 1 Loss, Securities Regulation 557 (2d ed. 1961).

however, because from a practical standpoint it would at least relieve the issuing successor from uncertainty in having to determine what persons are underwriters and what securities must be registered. In an area which abounds in complexities, this is a significant factor.

Paragraphs (d) and (e) of the amended rule permit sales without registration by persons coming within the provisions of paragraph (c) if they involve relatively small amounts made in brokers transactions.67

As is the case with many administrated acts, a significant amount of gloss has been added to the literal Rule 133. Included are the "negotiated transaction,"68 "unanimous consent transaction,"69 and "conduit transaction"70 doctrines which, like the judicial gloss placed upon the Internal Revenue Code, are primarily aimed at preventing evasion of registration requirements by requiring a substantial rather than a literal compliance with the rule.

C. Section 3 (a) (9) And Tax Reorganizations

Section 3 (a) (9) of the Securities Act exempts "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."71 Although originally promulgated under the section of the act which pertains to exempted securities, the Commission subsequently has taken the position that section 3 (a) (9) is merely a transaction exemption. Hence the securities exchanged are never permanently exempted from registration under this section.72

Because the terms of the exemption preclude its application in any reorganization which involves more than one corporation, it is obviously only pertinent to the types E and F reorganizations. To be exempt, one of these reorganizations must involve (1) an exchange of an issuer's securities for other securities of the issuer, (2) an ex-

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67 SEC Rule 133 (d) (e), 17 C.F.R. § 230.133 (d) (e) (Supp. 1962). For a detailed discussion of the problems presented by the amendments to Rule 133 see Throop, Recent Developments With Respect to Rule 133, 15 Bus. Law. 119 (1962).
69 Purcell, supra note 18, at 277 (The no-sale rule does not apply where unanimous vote of stockholders is required.).
71 Securities Act § 3 (a) (9).
change with existing security holders only, (3) an exchange solely of securities, and (4) no paid solicitation.  

Since the corporation issuing the new security in exchange for the old one is required to be the same corporation that originally issued the old security, any change in the corporate make-up (even in name) which occurs subsequent to the initial issuance and prior to the exchange may prevent utilization of this section. For this reason the type F reorganization which involves a "mere change in identity, form or place of organization, . . ." may be precluded from receiving the benefit of this exemption.

Moreover, if according to applicable state law the successor corporation in a type A merger is considered to be a new entity, the 3(a)(9) exemption is not available in an exchange for securities issued by that corporation prior to the merger.  Likewise, an exchange by a consolidated corporation for securities issued before a type A consolidation will not be exempt under this section.

The exemption specifies that the issued security must be "exchanged" by the issuer with its existing security holders. Hence, a question arises concerning the definition of an "exchange." The Income Tax Regulations state that a type E recapitalization takes place when a corporation with bonds outstanding discharges them by issuing stock instead of cash to the bondholders. Presumably, the corporation will recall the discharged bonds and this will qualify as an "exchange" and thus the problem will be avoided. But, if it does not recall the bonds, it is doubtful if an "exchange" can be found. A similar result will likely attend a recapitalization in which a corporation issues securities in discharge of an interest obligation which is not evidenced by a writing. If the obligation is not represented by some written "evidence of indebtedness," then it can hardly be said that an "exchange" takes place when the security holder transfers nothing upon receipt of the new securities.

The problem is not entirely academic, for if the "exchange" is absent and the exemption cannot be utilized, any waiver of payments by the shareholders will certainly constitute value which in

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75 For a detailed discussion of this exemption see 1 Loss, Securities Regulation 573-84 (2d ed. 1961).
76 1 Loss, Securities Regulation 361 (Supp. 1955).
78 Section 2(1) of the Securities Act defines a security as an "evidence of indebtedness." If the accrued interest is not represented by coupons or a writing, then unless the holder exchanges the bond with the issuer, it can hardly be said that an exchange takes place when the security holder transfers nothing.
79 A 3(a)(9) exchange is not deprived of its "exclusiveness" solely because the shareholder is required to accompany the exchange by a cash payment (or its equivalent?), as is necessary to effect an equitable adjustment in respect of dividends or interest paid or
turn will engender a "sale" and will thus require registration of the issued securities. Securities issued in exchange for the waiver of accrued dividends on preferred stock or cash dividends declared on preferred or common stock present variations of the same problem.99

Compliance with the requirements that a transaction involve an exchange solely with existing security holders and that it involve an exchange of securities only is primarily a matter of mechanics and should cause no particular reorganization problems.

The fourth requirement—that the exchange involve no paid solicitation—is likewise not troublesome unless the recapitalization involves the use of proxy solicitors, and in that case the exemption will probably80 be unavailable.

Because the recapitalization transaction affords an available vehicle for avoidance of both securities81 and tax laws,82 an interesting parallel has evolved between the administrative and judicial gloss which has been placed upon the transaction. That is, to qualify for purposes of section 3(a)(9), these transactions must be "bonafide, in the sense that they are not effected merely as a step in a plan to evade the registration requirements of the Act";83 for purposes of the income tax provisions the recapitalization must be not merely "a vehicle, however elaborate or elegant, for conveying earnings from accumulations to the stockholders."84

II. The Securities Exchange Act of 1934

A. Proxy Regulation And Tax Reorganizations

The Securities Exchange Act of 1934 and the rules and regulations promulgated by the Securities and Exchange Commission apply to all corporations whose securities are listed on a national securities exchange; and the Commission's power to regulate proxy solicitation85 extends to all securities so listed. It does not extend, however,
to solicitations with respect to unlisted securities of companies having securities that are listed. It has been said that the Commission designed the rules and regulations governing proxies "so as to make the proxy device the closest practicable substitute for attendance of the meeting." Whether this purpose has been achieved is subject to controversy.

The problems concerning proxy solicitations which attend reorganizations arise primarily with respect to the protection to be afforded shareholders who participate in these readjustments. Adequate disclosure of the pertinent details is ordinarily not required unless one of the participating corporations utilizes listed securities. Consequently, many reorganizations are consummated without proper disclosure to the shareholders involved.

With the exception of the type B stock-for-stock transaction, virtually all of the tax reorganizations involve approval by a vote of the shareholders. Specifically, the types A, D, E, and F transactions require a vote of shareholders for all participating corporations, while the type C reorganization normally requires only a vote of the transferor or constituent corporation's shareholders. Ordinarily, these shareholders vote by proxies which are solicited by the corporate management.

According to the rules of the Commission no proxy solicitation may be conducted unless the person solicited is furnished with a proxy statement. This statement, sometimes compared to the Securities Act prospectus, must contain a full disclosure of corporate affairs as prescribed by twenty-one "items" contained in schedule 14A of the Exchange Act. The schedule 14A requirements, stated

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success." SEC v. Okin, 132 F.2d 784, 786 (2d Cir. 1943) (Hand, J.), 16 Harv. L. Rev. 829 (1943). This does not mean, however, that all communications from management to stockholders are inherently a part of a continuous plan of proxy solicitation, or that no communication may be made by management to stockholders except with the Commission's approval. Dyer v. SEC, 287 F.2d 773 (8th Cir. 1961).

Id. at 869.

See Latty, Exploration of Legislative Remedy for Prejudicial Changes In Senior Shares, 19 U. Chi. L. Rev. 759 (1952).

Sec, e.g., Sawyer v. Pioneer Mill Co., 190 F. Supp. 21 (D. Hawaii 1960); 2 Loss, op. cit. supra note 86, at 867.

Henn, Corporations §§ 340-51 (1961); Darrell, supra note 40; Latty, supra note 88. All transactions accomplished under Rule 133 of the Securities Act must be effected pursuant to a vote of the stockholders. SEC Rule 133, 17 C.F.R. § 230.133 (Supp. 1962).

Darrell, supra note 40, at 1193.


2 Loss, op. cit. supra note 86, at 877.

SEC Schedule 14A, 17 C.F.R. § 240.14a (Supp. 1962). The information which must be included in the proxy statement generally pertains to solicitations concerning the ordinary corporate functions which require shareholder vote and is not peculiar to the reorganization
very broadly and cumulatively, require: (1) a brief description of
the transaction or its material features; (2) a disclosure of the reasons
for the proposed transaction and its effect upon existing shareholders;
(3) a statement of existing arrearages or defaults and how the pro-
posed transaction will affect them; (4) a disclosure of any material
differences between old and new securities in an exchange or modi-

fication transaction; (5) a statement of general information regard-
ing the party to the transaction; (6) a disclosure of pertinent in-
formation regarding property to be transferred including facts bear-
ing upon the consideration to be given; and (7) such information as
may be appropriate to evaluate the nature and effect of the proposed
transaction.

Much of the sparse amount of litigation pertaining to proxy solici-
tation in reorganizations has concerned the sufficiency of the infor-
mation given in the proxy statement; therefore, few general prin-
ciples can be derived from the cases. Due perhaps to the complexity
of reorganization transactions, the courts have not been overly de-
manding in determining whether a particular proxy statement omits
a material fact. Thus, a failure to state possible alternatives to a plan
of recapitalization does not necessarily render a proxy statement false
and misleading, nor does the failure to state that management’s
proposed reorganization plan is conceived and planned to perpetuate
transactions. Certain items, however, deal directly with these reorganizations and conse-
quently require scrutiny.

Item 2 of Schedule 14A requires that the appraisal rights of dissenters and any statutory
procedure to be followed to perfect these rights be briefly stated. The type A reorganization
invariably involves specific statutory rights of dissenters as often does the type C reorganiza-
tion. See Ballantine, Corporations 700 (rev. ed. 1946). The types D, E, and F transactions
may involve these rights depending upon the law of the particular jurisdiction. In any of
these transactions, whether or not required, it may be to the best interest of all concerned
to grant certain privileges to a dissident minority. See Johnson, Reorganizations—Minority

Item 4 is important because it calls for brief description of the holdings of officers,
directors, and their associates who are connected with any reorganization transaction. See

Item 12 describes information to be furnished in any proxy statement which concerns
authorization or issuance of securities other than for exchange for the issuer’s outstanding
securities. Item 13, peculiar to types E and F transactions, describes information to be
supplied in regard to a proposed modification of the issuer’s securities or to a contemplated
exchange of securities for others outstanding.

Items 14 and 16 refer to the information to be contained in statements regarding
mergers, consolidations, acquisitions, and similar transactions and are, of course, especially
pertinent to the types A, B, C, and D reorganizations. Item 15 specifies financial statements
which are to accompany solicitations regarding these transactions.

SEC Rule 14A-9, 17 C.F.R. 240.14a-9 (Supp. 1962), makes unlawful any solicitation
subject to the Commission’s proxy rules which contains any statement which is false or
misleading with respect to any material fact, or which omits to state any material fact
necessary in order to make that statement not false or misleading.

control of the corporation in the present group. Furthermore, a statement is not false and misleading simply because it names only the directors who submitted written objections to a proposed merger and fails to mention several who orally opposed the transaction.

In the language of one court, neither the Exchange Act nor the Commission’s rules "require that corporate reorganizations and mergers be explained in language comprehensible to school children."

**B. Rule 10b-5 And Tax Reorganizations**

Rule 10b-5, promulgated pursuant to section 10(b) of the Exchange Act, proscribes the use of the mails, interstate commerce, or a facility of a national securities exchange to promote fraudulent or misleading practices in connection with the purchase or sale of securities. Specifically, it prohibits a misstatement or omission of material facts.

Although section 10(b) makes no express provision for a private right of action, courts, beginning with the *Kardon* case in 1946, have consistently implied one. Furthermore, in sustaining these actions they have imposed standards of disclosure higher than those of the common law.

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97 Doyle v. Milton, supra note 96.
98 American Hardware Corp. v. Savage Arms Corp., 136 A.2d 690 (Del. Ch. 1957). Item 3 of Schedule 14A requires that the proxy statement contain "the name of any director of the issuer who has informed the management in writing that he intends to oppose any action intended to be taken by the management. . . ."
99 Shvets v. Industrial Rayon Corp., CCH Fed. Sec. L. Rep. ¶ 90, at 958 (S.D.N.Y. 1960). The plaintiff complained that the proxy statement failed to disclose (1) the book value of shares which the stockholders were to receive if the merger were consummated, (2) legal complications that would result in connection with one of the party’s mortgage notes, (3) that the earnings of one of the companies to be merged was overstated, (4) the relationship between certain directors in two interested corporations, and (5) that certain mortgage agreements of a corporation to be merged would be exposed to immediate foreclosure liability. The court gave weight to the fact that the Commission had previously approved the proxy statement.
101 Exchange Act § 10b.
102 Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (motion to dismiss complaint), 73 F. Supp. 798 (E.D. Pa. 1947) (on the merits), 83 F. Supp. 613 (E.D. Pa. 1947) (request for additional findings), 40 Mich. L. Rev. 680 (1946). The *Kardon* case was the first to hold that Rule 10b-5 supplied a civil remedy to an injured seller. This finding was based upon the premise that violation of a statute enacted to protect a particular class of individuals constitutes a tort. See White, infra note 104. The Commission has indicated that a disclosure will be insufficient if it is such that the "stockholders could not have acted intelligently with reference to their sale of stock." Ward LaFrance Truck Corp., 11 S.E.C. 371, 379 (1943).
Although applicable to any person who engages in the prohibited practices, the rule has been primarily utilized in the area of purchases of securities by corporate insiders. It closes a gap in the common law by imposing an affirmative obligation upon an insider-purchaser to disclose matters obtained by virtue of his position "which would materially affect the judgment of the other party to the transaction."

It is probably safe to say that any person who is in a position to garner pertinent information of a confidential nature is subject to the rule. Thus, controlling shareholders and their immediate families, officers, directors, employees, business associates, and even persons who receive gratuitous inside information with knowledge of its nature are all potentially within its scope.

Although it is not certain, the obligation to disclose which is placed upon the insider-purchaser is probably placed upon the insider-seller also.

It is clear that an insider-purchaser with knowledge of a pending reorganization is potentially liable to his seller for failure to disclose this information. In a similar situation it is also clear that a purchase by the issuer of its own securities will subject it to liability. Since the higher obligation under this rule is to the selling shareholder, there is little validity in the contention that persons who purchase on behalf of the issuer are obligated to do so as cheaply as possible without resorting to actual misrepresentation.

The rule is of special value in exchanges in which a shareholder is given a choice between accepting or rejecting a new security or between taking that security or obtaining appraisal rights. In these

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107 Advantages afforded an injured purchaser or seller under this rule are: (1) a plaintiff need only show damage and a misstatement or omission of a material fact; he need not show damages if rescission is sought; he need not show a "privity" relationship; (2) a defendant is provided no affirmative defense; (3) there exists a more favorable statute of limitations; (4) nationwide service is available; and (1) federal rules of discovery are available.
113 3 Loss, op. cit. supra note 107, at 1454. In regard to the problem of an insider's obligation to the corporation not to disclose secret processes and the like, see Comment, supra note 107, at 1147.
114 Thus, besides the type A, B, and C transactions, it is also pertinent to the D and E
transactions, the security holder must make a decision upon the facts as presented; and provided the requisite purchase or sale exists, he should be entitled to full disclosure of facts material to the transaction, assuming that use is made of the mails or an instrumentality of interstate commerce.118

Remedies for several abuses attendant to reorganizations appear to be emerging from this rule. Basing its holding upon the act's broad definition of its terms,114 one court has recently found that for 10b-5 purposes a "purchase and sale" may be involved in a corporate merger.115 When extended, this principle may apply to all tax reorganizations and thus require disclosure similar to that of a prospectus, for these transactions, with exception,116 involve a purchase and sale of securities for both Securities Act117 and Exchange Act118 purposes. Because the rule is activated by a "purchase or sale," it logically applies to these transactions and should thus afford shareholder-participants a remedy for inadequate disclosure.119 This is of significant import with regard to securities which are not listed and therefore not subject to the disclosure requirements of the Commission's proxy regulations.120

The Ninth Circuit has found fraud existing under 10b-5 with respect to the value of the consideration given for a security,119 as

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113 See Pratt v. Robinson, 203 F.2d 627 (9th Cir. 1953), holding that the fraudulent act need not be effected by the use of the mails or an instrumentality of interstate commerce and that use of the mails to contact a third party in connection with the transaction was sufficient to invoke the rule.

114 Exchange Act § 3 (a) (13): "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." Exchange Act § 3 (a) (14).


116 The type D, E, and F transactions may not always involve a purchase and sale of securities. See note 49 supra and accompanying text.

117 Rule 133 of the Securities Act excludes reorganization transactions from the term sale only for the purposes of registration and prospectus requirements of that act. See the definition of "sale" under the Securities Act in note 13 supra. See also note 38 supra and accompanying text.

118 The definition of purchase and sale in the Exchange Act is much broader than that of the same terms in the Securities Act. Compare Securities Act § 2 (1), with Exchange Act §§ 3 (a) (13), - (14).

119 See Comment, supra note 107, at 1110.

120 SEC Securities Act Release No. 3698, Oct. 2, 1956: Unless the ... [securities involved in a tax reorganization] ... are listed on a national securities exchange, in which event a proxy statement under the Commission's proxy rules must be furnished if proxies are solicited, these transactions may occur without the disclosure of adequate information to security holders.

121 Errion v. Connell, 236 F.2d 447 (9th Cir. 1956); Note, 9 Stan. L. Rev. 589 (1957).
opposed to fraud with respect to the value of the security itself. When extended, this principle may provide a means of relief for corporate recipients of overvalued assets in, for example, a type A, C, or D reorganization. The holding, though questioned, seems sound in that fraudulent consideration appears to be well within the rule's proscription of fraud "in connection with" the purchase or sale of a security.

One other aspect of the rule deserves brief mention. Two recent cases have considered the applicability of 10b-5 to a situation in which a large stockholder sold a controlling interest for a price considerably above that of the existing market. Minority shareholders, who were not offered the same price for their stock, alleged fraud upon the stockholders in connection with a purchase or sale of securities. In one case, a district court denied a motion to dismiss without opinion. In the other, a court of appeals affirmed a dismissal for failure to state a cause of action. If the rationale implicit in the holding of the district court should be adopted, and a shareholder who is not a purchaser or a seller does possess a cause of action under similar circumstances, the rule may possibly be utilized by a dissident minority in any reorganization and thus afford a remedy which supplements that of the particular state law. This reasoning would appear to apply also to a type E exchange in which the exchange offer is made only to a select group of shareholders. Employment of the rule in these situations is unlikely, however, for the court of appeals seems to have stated the prevailing view that "the Rule . . . is aimed only at 'a fraud perpetrated upon the purchaser or seller' of securities and . . . [has] no relation to breaches of fiduciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers."

C. Section 16 And Tax Reorganizations

Section 16(a) of the Exchange Act requires that every officer or director of a corporation which has an equity security registered

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126 Birnbaum v. Newport Steel Corp., supra note 125, at 463; see 3 Loss, op. cit. supra note 107, at 1468-69.
127 Exchange Act § 3(a)(11) defines the term "equity security" to mean any stock or similar security; or any security convertible, with or without
on a national exchange, as well as every beneficial owner of more
than ten per cent of any class of a registered equity security, file
with the Commission and the exchange an initial report of the hold-
ings of all such equity securities of that issuer. Also, monthly reports
must be filed when a change in holdings occurs.

Because the term "corporation" is included within the act's defini-
tion of the word "person," a corporation must comply with these
requirements if in a reorganization it acquires more than ten per
cent of another corporation's registered equity securities. Failure to
do so may result in criminal prosecution or a mandatory
injunction.\footnote{1962}

Section 16(b)\footnote{1962} permits recovery by an issuer, or by a security
holder if the issuer refuses to take requested action, of profits realized
by "insiders" (directors, officers and principal stockholders)\footnote{1962} from
any "purchase and sale" or any "sale and purchase" of an equity
security (other than an exempted security) of the issuer within a
period of less than six months. For purposes of this section profits
are determined on the basis of maximum economic gain without re-
gard to basis or realization of profit for tax purposes.\footnote{1962} The section
was intended to "protect the 'outside' stockholders against . . . short
swing speculation by insiders with advance information . . ."\footnote{1962} and
the courts have consistently given it a liberal construction in order
to accomplish that purpose.\footnote{1962}

The section is particularly pertinent to reorganizations because of
the many opportunities for abuse of confidential information. How-
ever, because of the varied and complex nature of a reorganization
transaction, general principles concerning the applicability of 16(b)
are difficult to derive. The dominant question in the decisions appears
to be whether a particular transaction involves the sort of specula-
tion encompassed by section 16(b).\footnote{1962} Venturing past that point, one
moves into the realm of conjecture.

\footnote{1962}{For a discussion of this section see 2 Loss, Securities Regulation 1038-40 (2d ed.
1961).}

\footnote{1962}{Exchange Act § 16(b).}

\footnote{1962}{As to the persons encompassed within this term, see Cook & Feldman, Insider Trading
Under the Securities Exchange Act, 66 Harv. L. Rev. 385, at 397-405 (1953).}

\footnote{1962}{Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), cert. denied, 320 U.S. 751
(1943).}

\footnote{1962}{Ibid.}

\footnote{1962}{But see Blau v. Lehman, 368 U.S. 403 (1962), where the Court refused to permit
recovery under § 16(b) against an investment banking partnership a member of which was
a director of the corporation in whose stock the partnership made a profitable short-swing
transaction.}

\footnote{1962}{2 Loss, Securities Regulation 1069 (2d ed. 1961); Cook & Feldman, supra note 131,
at 625.}
As is often the case in 16(b) situations, the difficulty arises in determining whether or not a specific transaction involves the requisite "purchase and sale" or "sale and purchase" of an equity security. Certainly it is possible for there to be a "purchase" 136 or a "sale" 137 in a tax reorganization within the meaning of this section, for in most instances these transactions involve a voluntary exchange of securities for assets or for securities of another issuer. Either exchange should be considered a "purchase" or "sale" just as if the consideration had been cash.

The courts have generally adopted this view in finding a purchase or sale to exist in transactions similar to tax reorganizations. Thus, a purchase, to be matched against a subsequent sale, has been found in a corporate simplification in which the purchased stock was obtained by shareholders of a subsidiary pursuant to a sale of assets by the subsidiary corporation to the parent. 138 In principle, the holding is equally applicable to types A and C transactions.

In a transaction somewhat analogous to the type B reorganization, the Second Circuit held the requisite "sale" to exist in an exchange of stock between a parent corporation and its subsidiary. 139 Very likely a "purchase" would be found to exist in the same transaction.

As opposed to the problem of finding a purchase or sale in a tax reorganization, a more difficult one arises in bringing within the terms of the Exchange Act insiders who speculate, not in securities of the corporation with which they are connected, but in securities of another corporation which is a party to the reorganization. When read literally the section envisions an "insider" as one who maintains an "inside" position with the corporation whose securities he purchases. If this is so, then it is likely that some insider short-swing transactions do not come within the proscription of the section. For example, in a type B reorganization it is doubtful whether the section will apply to an officer or director of corporation X who, utilizing confidential information, purchases securities of participating corporation Y and profits from a favorable reorganization exchange which occurs less than six months later.

It is arguable that the purchased securities of corporation Y ought to be treated like convertible securities of corporation X because they may be converted into X securities at a later date—upon the re-

136 See note 115 supra.
organization exchange. Should the Y stock be considered as convertible X stock, then less difficulty is found in bringing a purchase by the X insider of Y stock within the proscription of the section. Difficulty may be encountered in determining whether this "conversion" upon reorganization amounts to a "sale" which may be matched against the initial purchase. However, a conversion normally does amount to a "sale" as well as a "purchase" of the converted stock.

Difficulty also arises regarding those short-swing transactions characterized by a purchase or sale of a security of one corporation matched against a sale or purchase of a security of another which is party to the reorganization. Here again, the act apparently requires that the securities matched must be the same; and the case law requires that they at least be of the same issuer. It is questionable, then, whether the section would embrace the situation in which an insider of a disappearing corporation which is participating in a type A merger or consolidation sells stock of that corporation prior to the reorganization and subsequently purchases securities of the surviving corporation within the prohibitive period. Clearly the situation presents an opportunity for abuses of the type which the section seeks to curtail.

Should the approach discussed (that the securities to be exchanged in a reorganization are to be considered convertible) be utilized, two securities of different participants in a reorganization may be logically matched against each other and thus come within the terms of section 16(b). In the example given, if the disappearing corporation's security is considered as convertible then a sale of such security prior to the reorganization may be tantamount to a sale of the underlying security which can be matched against a later purchase of that security.

Although it is conceded that this approach is a tenuous one, the broad purpose of section 16(b) should be kept in mind. It is submitted that the approach is one which may comport with that purpose. Any other rationalization will permit an insider to profit with

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140 See Cook & Feldman, supra note 131, at 626.
141 With regard to Rule 16(b) and convertible securities see Parke & Tilford, Inc. v. Schulte, 160 F.2d 984 (2d Cir.), cert. denied, 352 U.S. 361 (1947); Cook & Feldman, supra note 131, at 624.
143 The rule states that it is enacted "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. . . . " Exchange Act § 16(b).
impunity (except for 10b-5 liability) through utilization of his "insider" knowledge of a favorable future reorganization exchange.

Types E and F reorganizations may involve a "sale" or "purchase" for 16(b) purposes depending upon the particular facts involved. It may be argued that in the types D, E, or F reorganizations the securities received are often the "economic equivalent" of those relinquished and therefore no purchase or sale is involved. Because these transactions ordinarily involve an exchange of securities by a corporation and its shareholders in which the proportionate interests of such shareholders remain fixed, the economic equivalent argument is frequently raised and is seemingly of some merit. The fact that the interests of the recipient stockholders remained unchanged after a reorganization was found to be persuasive in one 16(b) situation and insufficient to avoid liability in at least two others.

The courts which have considered situations analogous to these reorganizations, although establishing no clear cut guidelines, have at least shown tendencies to be persuaded by certain factors. Succinctly stated, these are: (1) the existence of an insider's option to acquire the securities as he sees fit; (2) the similarity and the proportion of the insider's holdings before and after the reorganization; (3) the presence of complete disclosure to all shareholders; (4) the existence of a pre-existing market for the securities received; and (5) the existence of possible abusive practices with regard to inside information. Although factor five is of great importance, none is controlling, and perhaps the only accurate statement that may be made is that any decision will be based upon the cumulative effect of all of the existing factors.

It seems that any transaction may come within section 16(b) when it is capable of producing a marked change in the market prices of the participating securities and when it readily lends itself to the making of in-and-out profits by insiders. It has been suggested that in these types of reorganizations there should be imposed something...
in the nature of a presumption that the statute is applicable. This is both feasible and practical, and the case law seems to be moving in that direction.\textsuperscript{152}

Two exemptions to section 16(b) are available in reorganizations. The first, Rule 16(b)-6c,\textsuperscript{153} exempts the disposition of a security pursuant to a merger, consolidation, sale of assets, or reclassification if the security was purchased either pursuant to the exercise of an option or a similar right which was acquired more than six months previous or pursuant to an employment contract consummated more than six months before exercise of the option. Except for statutory rights of dissenting shareholders, the reorganization must be binding on all shareholders of the issuer in order for this exemption to apply.

Recognizing that certain reorganizations offer little opportunity for profiting through inside information, the Commission has in Rule 16(b)-7\textsuperscript{154} exempted transactions pursuant to mergers, consolidations, or certain sales of assets when the disappearing corporation owned at least eighty-five per cent of the surviving corporation, or where the corporation whose security is disposed of held over eighty-five per cent of the combined assets of all the companies party to the reorganization. This provision is conditioned on the insider's not purchasing a security of one party to the reorganization and selling that of another within a six month period which includes the time of reorganization.

\section{IV. CONCLUSION}

It should be quite clear that the securities problems attending tax reorganizations, though not insurmountable, are certainly formidable.\textsuperscript{155} Indeed, the possible liabilities are astounding. With this in mind it is obvious that it will be an unwise counsel who permits tax considerations to dominate a reorganization scheme completely and heeds not at all the securities aspects. The advent of an extended

\textsuperscript{152} Meeker & Conney, \textit{supra} note 147, at 978.
\textsuperscript{153} 17 C.F.R. \textsection{240.16b-6} (Supp. 1962); See Cook & Feldman, \textit{supra} note 131, at 633.
\textsuperscript{154} 17 C.F.R. \textsection{240.16b-7} (Supp. 1962).
\textsuperscript{155} Almost all states have blue sky laws of one sort or another. Therefore, in any securities transaction the local blue sky laws must also be considered. However, because of their extreme variation it is felt that an analysis of their applicability to the tax reorganizations is best left to a separate study. It should be sufficient to say that in no more than one-third of the states which have securities regulation provisions does there exist an exemption specifically applicable to these reorganizations. For a detailed study of this problem see Cowett, \textit{Reorganization, Consolidation, Mergers and Related Corporate Events Under the Blue Sky Laws}, 13 Bus. Law. 418 (1957).
scope of liability under Rule 10b-5 and section 16(b) plus the restricted protection now offered by Rule 133 indicates that here-tofore tolerated abuses in this area will now be under scrutiny by not only the Commission but the financial and legal communities as well.