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Cover Page Footnote
Member of the New York Bar. Mr. Hurley received his B.A. from Iona College, his J.D. from Fordham Law School, and his LL.M. in taxation from New York University Graduate School of Law. Mr. Hurley is a member of Cusack & Stiles, New York City.

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WHO IS AN "OFFICER" FOR PURPOSES OF THE SECURITIES EXCHANGE ACT OF 1934—

COLBY v. KLUNE REVISITED

by WILLIAM P. HURLEY*

I. INTRODUCTION

T HE question of who is an "officer" of a corporation would appear, at first blush, not worthy of extended discussion inasmuch as state statutes and by-laws of corporations usually set forth what positions in the corporation are to be considered officerships. Individuals holding these positions would normally be the officers of the corporation. However, who is an officer for purposes of the Securities Exchange Act of 1934 (1934 Act) cannot be ascertained from state statutes or corporation by-laws, nor determined from the conferring of officer titles by the board of directors of a corporation. Nor can reliance be entirely placed upon the definition of officer found in rule 3b-2 issued by the Securities and Exchange Commission under the 1934 Act.

This Article will discuss the history of the meaning of the word officer for purposes of the 1934 Act, by comparing judicial decisions concerning the meaning of officer under the Act with the Commission's definition contained in rule 3b-2. There has been, and continues to be considerable uncertainty as to the meaning of officer for purposes of applying the provisions of section 16, as well as other sections of the

* Member of the New York Bar. Mr. Hurley received his B.A. from Iona College, his J.D. from Fordham Law School, and his LL.M. in taxation from New York University Graduate School of Law. Mr. Hurley is a member of Cusack & Stiles, New York City.


4. 15 U.S.C. § 78p (1970) which provides: "(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 781 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 781(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month.
1934 Act. The Article concludes by offering a proposed solution to the problem.

II. HISTORY OF THE DEFINITION OF “OFFICER” UNDER THE 1934 ACT

Although the 1934 Act defines the term director, it does not define the term officer. This failure to define officer may have been a legislative oversight. It is possible, however, that the Congress believed it was using a familiar word in its ordinary and generally accepted sense according to the common usage of the day in the legal and financial worlds, thus obviating the need for definition. The 1934 Act’s legislative history is silent on this point.

Thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter, but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.” See Comment, Who is an “Officer” Under Section 16(b)—Who Knows?, 12 San Diego L. Rev. 378 (1975).


6. In Ellerin v. Massachusetts Mut. Life Ins. Co., 270 F.2d 259 (2d Cir. 1959), Judge Medina noted that the phrase “class of any equity security,” as used in section 16(a) of the 1934 Act, had not been defined by the Congress. Judge Medina stated: “There is no prior case law on this point, no statutory history to guide us and no legislative definition to which we can refer. But the very absence of congressional direction or guidance suggests that the Congress thought the meaning of the phrase ‘class of any equity security’ was reasonably clear and it was using familiar terms in their ordinary and generally accepted sense according to the common usage of the day in the legal and financial worlds.” Id. at 262. Judge Medina concluded that the court had no alternative but to follow the common usage of the word, while relying on state law in order to interpret the word “class” for purposes of the section. Id. at 263.

The Commission, pursuant to the authority conferred upon it by section 3(b) of the 1934 Act "to define technical, trade, accounting, and other terms . . .,"8 issued rule 3b-2 defining officer as follows:

The term "officer" means a president, vice-president, treasurer, secretary comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers.9

This rule would appear to define officer for all purposes of the 1934 Act.10

In 1940 the Commission's General Counsel released Securities Exchange Act Release 268711 in order to clarify the status under rule 3b-2 of assistant officers, such as assistant secretaries, assistant treasurers and assistant comptrollers, for purposes of reporting securities holdings

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10. For example, corporations subject to the provisions of the 1934 Act and their corporate personnel would ordinarily use rule 3b-2 to determine whether such personnel are officers for purposes of: (a) filing reports (Forms 3 and 4) under section 16(a) of the 1934 Act; (b) the insider trading liability and short sale provisions of section 16(b) and section 16(c) of the 1934 Act; (c) disclosing information concerning officers in (i) registration statements, e.g., Form 10, Form 20, filed under sections 12(b) or (g) of the 1934 Act, (ii) reports, e.g., current report on Form 8-K, annual reports on Forms 10-K, 12-K, 14-K and 20-K, filed under sections 13 or 15(d) of the 1934 Act, and (iii) proxy statements filed under section 14 of the 1934 Act. For purposes of the Form 10-K (annual report), the Commission has defined an "executive officer" as follows: "The term 'executive officer' means the president, secretary, treasurer, and vice president in charge of a principal business function (such as sales, administration or finance) and any other person who performs similar policy making functions for the registrant." 3 CCH Fed. Sec. L. Rep. ¶ 31,103, at 22,050 (1974) (Item 8, Instruction 2 of Form 10-K (annual report)). The Commission used the same definition in defining "executive officer" (except the word "issuer" is substituted for the word "registrant") for purposes of information to be contained in the annual report to shareholders. See 17 C.F.R. § 240.14a-3(b)(7) (1975) and note thereto.
on Forms 3 and 4 under section 16(a) of the 1934 Act, and for purposes of filing reports under section 30(f) of the Investment Company Act of 1940.  

The release provided:

"Officer" is defined in the instructions to the forms to mean president, vice president, treasurer, secretary, comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers. It is the opinion of the General Counsel of the Commission that an assistant would be an "officer" if his chief is so inactive that the assistant is really performing his chief's functions. However, an assistant, although performing some functions which might be those of his chief, would not be an "officer" so long as these duties were under the supervision of his chief. Temporary absence or brief vacation of an officer during which an assistant performs the officer's duties would not constitute the assistant an "officer." Subject to the foregoing, assistant treasurers, assistant secretaries, and assistant comptrollers, for example, are not to be considered "officers" for the purposes of this definition.

In 1949, the Second Circuit Court of Appeals, in *Colby v. Klune*, significantly altered the meaning of officer for purposes of section 16(b) of the 1934 Act. Until that decision, corporate counsel desiring to determine whether a corporate employee was an officer under section 16(b) of the 1934 Act needed to consider only rule 3b-2 and the opinion of the Commission's General Counsel.

Colby, a stockholder of the Twentieth Century Fox Film Corporation, sued Klune, a "Production Manager" for Twentieth Century at its studio in Los Angeles. Under section 16(b) of the 1934 Act, Colby sought recovery of profits realized by Klune from his purchase of Twentieth Century common shares, pursuant to the exercise of a stock option granted him by Twentieth Century, and his subsequent sale of the shares within less than six months. Colby claimed that Klune, in his capacity as production manager, performed the duties of an officer within the meaning of rule 3b-2 and that the profits realized by Klune on the sale of shares within a six month period were recoverable by Twentieth Century.

On cross motions for summary judgment, Judge Conger of the District Court for the Southern District of New York found that since Klune did not perform the duties of an officer of Twentieth Century as prescribed by its by-laws, he was not an officer under rule 3b-2 subject to section 16(b) liability. In his opinion, Judge Conger stated:

The by-laws of the defendant corporation define the duties of its officers, and Klune does not perform them, vicariously or otherwise. He is Production Manager, and although an officer might conceivably perform these duties, he is not acting as an

14. 178 F.2d 872 (2d Cir. 1949).
officer when he performs them; he is acting as an officer when he performs the duties prescribed by the by-laws.15

Judge Conger, in reaching his decision, considered statements contained in the affidavits submitted to the court which indicated that Klune was a production manager who supervised the business details incident to the production of films. It was his function to avoid cost overruns and to procure physical facilities or employees necessary for the production of the films.16 The court concluded:

The excerpts that are quoted above adequately state the functions of Klune as plaintiff sees them. In effect they show Klune to be a superior combination of purchasing agent and personnel manager. No doubt the functions he performs and the responsibilities he assumes would be fit for the president or other officers of many corporations. But Rule X-3B-2 cited before cannot mean functions performed by officers of any corporation. It must necessarily apply to officers of the corporation involved.17

The court rejected plaintiff’s argument that Klune’s position gave him special knowledge of corporate affairs so as to place him in the category of an “insider” subject to section 16(b) liability. Judge Conger stated that Congress imposed liability under section 16(b) only upon directors, officers and more than ten percent beneficial owners. He claimed that it was not the intent of Congress to impose section 16(b) liability upon highly paid employees or any employee with access to inside information.18

On appeal, the Second Circuit reversed and remanded the case to district court.19 The Second Circuit rejected the district court’s reliance on the by-laws of a corporation to determine who is an officer for purposes of liability under section 16(b) and held that it was error for the district court to grant summary judgment on affidavits since there was a triable issue of fact “turning on credibility” as to whether Klune was an officer.20

In his opinion for the Second Circuit, Judge Frank was uncertain as to whether rule 3b-2 was validly issued by the Commission. He stated:

Assuming for the moment that Rule X-3b-2, issued by the S. E. C., is not authorized by the statute, we construe “officer,” as used in Section 16(b) of the Securities Exchange Act, thus: It includes, inter alia, a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company’s affairs that would aid him if he

16. Id.
17. Id.
18. Id. at 161-62.
20. Id. at 873.
engaged in personal market transactions. It is immaterial how his functions are labelled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative. As we think that, at this stage of the case, it is well to reserve decision concerning the statutory power of the S. E. C. to issue Rule X-3b-2, we think that the plaintiff should be allowed at a trial to produce oral testimony in open court (by examination or cross-examination of witnesses), or other evidence, relevant under the foregoing definition of officer.21

The court further stated:

It may be that the S. E. C. had such statutory authority to issue the Rule that it binds the courts. Even so, there remains much room for inquiring into the facts at a trial. For the functions of a "vice-president" or "comptroller" are not so well settled as to be self-evident, and there is need for evidence concerning those functions. Under that Rule as we interpret it, it does not matter whether or how the by-laws of this particular company define the duties of such officers. The question is what this particular employee was called upon to do in this particular company, i.e., the relation between his authorized activities and those of this corporation. Again, under this Rule, it is not decisive whether or not some other person supervised his work.22

Judge Frank stated in a footnote23 that the court disagreed with, and would not follow the opinion of the Commission's General Counsel (contained in the 1940 release, Securities Exchange Act Release 2687),24 as to the meaning of officer under rule 3b-2.

The Commission filed a memorandum with the court which supported the Second Circuit's view that there was much room under rule 3b-2 for inquiring into the functions of the corporate employee to determine whether he was an officer for section 16(b) purposes.25 The Commission noted in its memorandum that rule 3b-2 did not attempt to create any general criteria and that section 16 was designed to deal with substance rather than form. The Commission stated in its memorandum that "it is significant that the employee has or has not 'responsibility for the policy of at least a substantial segment of the corporation's affairs' and participates 'in executive councils of the corporation as an officer.'"26 The Second Circuit thought that the district court should receive evidence on this issue, while reserving decision as to its legal significance until after the trial.27

The Second Circuit did not decide that rule 3b-2 was invalid; rather, it directed the district court to disregard the enumeration of officers listed in the by-laws of the corporation and to focus on Klune's

21. Id. (footnotes omitted).
22. Id. at 875 (footnotes omitted).
23. Id. at 875 n.15.
25. 178 F.2d at 875.
26. Id.
27. Id.
corporate duties in determining whether he was an officer for purposes of section 16(b) of the 1934 Act. An analysis of the Second Circuit's decision discloses that the district court would have to use the following criteria (hereinafter referred to as the Colby criteria) in determining whether Klune was an officer for purposes of section 16(b): (a) *Likelihood of obtaining confidential information*—were Klune's "executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions[?]"\(^28\) (b) *Responsibility for corporate policy*—did Klune have responsibility for making policy determinations concerning at least a substantial segment of the corporation's affairs?\(^29\) (c) *Participation in executive councils*—did Klune participate in the executive councils of Twentieth Century?\(^30\) Thus, contrary to Judge Conger's objective views that officers of a corporation, for purposes of section 16(b) of the 1934 Act, are those persons enumerated in the by-laws of a corporation, the Second Circuit chose to introduce the use of broader and more subjective criteria in determining the meaning of officer under section 16(b).

In 1952, the Commission issued Securities Exchange Act Release 4718,\(^31\) in which the Commission proposed to amend rule 3b-2 by incorporating the Second Circuit's access to confidential information test into rule 3b-2's definition of officer. The Commission stated in that release:

> The term "officer" means a president, vice president, treasurer, secretary, comptroller, and any other corporate employee performing executive duties of such character that he would be likely, in discharging his duties, to obtain confidential information about his company's affairs, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by any of the foregoing persons.\(^32\)

Corporate personnel responding to the invitation to comment were unanimous in opposing the revision,\(^33\) and the Commission, in Secur-

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\(^28\) Id. at 873.

\(^29\) Id. at 875.

\(^30\) Id. Judge Frank mentioned (b) and (c) as possible tests for determining officer status where rule 3b-2 was assumed to be a valid regulation. However, in light of section 16(b)'s purpose—the prevention of the unfair use of information which may have been obtained by reason of a statutory insider's relationship to an issuer—the (b) and (c) tests could be viewed as supplementing (a), inasmuch as (b) and (c) would assist in establishing whether the employee's executive duties were "of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs . . . ." Id. at 873.


\(^32\) Id. (emphasis added).

ties Securities Exchange Act Release 4754, withdrew the proposed amendment. In withdrawing the proposal the Commission recognized the uncertainties created by the amendment.

The Commission has concluded not to adopt the proposed revision of rule X-3B-2 as set forth in its notice, dated June 18, 1952 (Securities Exchange Act Release No. 4718, June 18, 1952). The comment received upon this proposal has convinced the Commission that adoption of the proposed revision would lead to undue uncertainties as to just what persons are to be treated as "officers" for purposes of sections 16(a) and 16(b), as well as sections 12, 13 and 14 of the Act. It has concluded that it should adhere to the definition in rule X-3B-2 as presently in effect, despite the intimations in the opinion of the Court in Colby v. Klune, 178 F.2d 872, that the existing definition may be too narrow. The Commission is advised that that case is still awaiting trial upon remand to the district court. See also Lockheed Aircraft Corporation v. Rathman . . . .

It is interesting to note that the Commission cited Lockheed Aircraft Corp. v. Rathman without further comment, even though Judge Byrne, in rendering his decision in that case, stated that the Second Circuit's statement casting doubt on the validity of rule 3b-2 was the "purest form of dictum." The Commission, if it decided to support the validity of its own rule, could have relied on the opinion of Judge Byrne. Instead, the Commission, while leaving the rule in effect, chose to leave to the courts the determination of who is an officer, not only for section 16(b) purposes, but for all purposes of the 1934 Act.

Although the Commission is continuing in effect the existing rule X-3B-2 as the Commission's definition of "officer," it is recognized that the ultimate determination of what constitutes an "officer" must be made by the courts and that the opinion in Colby v. Klune . . . indicates the possibility that the provisions of the Act applicable to officers may be held to reach a broader class of persons than might otherwise appear from the definition contained in rule X-3B-2. Persons inquiring as to their statutory responsibilities will continue to be advised of this possibility.

Since Colby was concerned with defining officer solely for purposes of section 16(b) of the Act, the Commission's extension of the uncertainty as to the meaning of officer into other provisions of the 1934 Act is a startling result.

Unlike the Second Circuit's decision in Colby, a California district court upheld the validity of rule 3b-2 in Lockheed Aircraft Corp. v. Rathman and Lockheed Aircraft Corp. v. Campbell.

35. Id.
37. Id. at 813.
In *Rathman*, the court, basing its decision entirely on an analysis of rule 3b-2, found that Rathman, an assistant treasurer of Lockheed, was not an officer of Lockheed for purposes of section 16(b) liability. Rathman, as assistant treasurer, had purchased Lockheed stock pursuant to a stock option plan and had sold the stock on the same day. Lockheed subsequently sued Rathman to recover the profit from the transaction. Judge Byrne reviewed rule 3b-2 and found that since an Assistant Treasurer was not among the officers enumerated by the rule, Lockheed had to establish that Rathman was an officer under that portion of the rule which states that an officer is any "'other person who performs for an issuer functions corresponding to those performed by [the officers enumerated in the rule].'"\(^{41}\) Judge Byrne interpreted the word "corresponding" to mean "similar,"\(^{42}\) so that the quoted portion of the rule was aimed at persons who performed functions similar to the officers recited in the rule such as a president, vice-president, treasurer, etc. The court concluded that the "other person" provision does not relate to an employee who assists one of the enumerated officers or performs any of the functions of his office during his absence, but relates to an officer, regardless of title, the functions of whose office, correspond to those performed by one of the enumerated officers.\(^{43}\)

Judge Byrne then found that Lockheed had a treasurer during the entire tenure of Rathman’s employment and that Rathman’s functions as an assistant treasurer did not "correspond" to those performed by the treasurer. Therefore, Rathman was not an officer of Lockheed within the meaning of section 16(b) or rule 3b-2. Judge Byrne further found that, even if Rathman were held to be an officer, he would be within the “good faith” provision of section 23(a) of the 1934 Act, thus avoiding section 16(b) liability.\(^{44}\) The evidence showed that Rathman

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1973), Judge Bauman stated that the Rathman and Campbell decisions upholding the validity of rule 3b-2 were of little precedential value since an assistant treasurer, which was the position subject to question, is not a position included in the rule’s definition of officer. Id. at 486. But see note 82 infra.  
41. 106 F. Supp. at 812, quoting rule 3b-2.  
42. Id. at 812.  
43. Id. at 813.  
44. Id. at 814. Section 23(a)(1) of the 1934 Act provides: “The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary . . . for the execution of the functions vested in them by this title, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions . . . . No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 78c(a)(34) of this title, any self-regulatory organization, notwithstanding that such Rule,
had inquired of the Commission before he exercised his stock option as to whether he was an officer within the meaning of section 16(a) of the 1934 Act and the Commission, by way of reply, had referred Rathman to rule 3b-2. Rathman, in response, noted that he did not perform for Lockheed functions normally entrusted to an officer specifically named in the rule. Accordingly, he did not comply with the filing requirement of section 16(a). Judge Byrne also referred to Rathman's participation in the Lockheed stock option plan, from which Lockheed had excluded its president, vice-president and treasurer because of a belief that they were subject to section 16(b), as additional evidence that Rathman had participated in the plan in the good faith belief that he was not an officer of Lockheed. It is submitted that Rathman's "good faith" defense would have been considerably weakened if, at the time of Rathman's exercise of his option in 1950, the Commission had already stated, as it did in its 1952 Securities Exchange Act Release 4754, that the meaning of officer must ultimately be determined by the courts and not by rule 3b-2.

In Campbell, Lockheed sued Campbell, an assistant secretary and an assistant treasurer of Lockheed, under section 16(b) to recover Campbell's profits derived from his sale of Lockheed stock and his subsequent purchase of Lockheed stock pursuant to the exercise of a stock option granted Campbell under a Lockheed stock option plan for compensating key employees. No mention was made by Chief Judge Yankwich in his opinion as to whether this was the same stock option plan under which Rathman was granted an option, and no argument was made by Campbell that he had in good faith relied on rule 3b-2 to determine his status as an officer of Lockheed.

The court chose not to rely on either the Rathman or Colby decisions to determine whether Campbell was an officer. Rather, while upholding the validity of rule 3b-2, the Judge viewed the question as to whether Campbell was an officer as "purely one of fact." In finding that Campbell was not an officer for purposes of section 16(b) of the 1934 Act, the Judge examined Campbell's functions, including his responsibility for policy making. The court concluded:

[Whether we adopt the subjective test suggested in Colby v. Klune, . . . namely, an inside position in which possibility of securing valuable advance information of

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\text{Regulation, or Order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.}^{15}\ \text{U.S.C.A. § 78w(a)(1) (Supp. 4, Aug. 1975), amending 15 U.S.C. § 78w(a) (1970).}
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45. 106 F. Supp. at 814.
47. 110 F. Supp. at 283.
48. Id. at 284.
possible fluctuations in stock, or the objective test of the regulation, i.e., performance of acts similar to those performed by the enumerated officers, the conclusion must be that the defendant [Campbell] did not perform duties conformable to those of the treasurer or secretary except in the minor function of executing, on rare occasions, instruments required to be executed by those officers for and on behalf of the company. And, while he may have had the title of "Manager of the Financial Department," in reality, he did not concern himself with financial policy at all. He was merely an able administrative officer handling a large group of men who were performing the mechanics incidental to the accounting and bookkeeping of a large concern.

Determination of financial policy, either in a direct or consultative way, was outside his province. Under the circumstances, he cannot be said to be an "officer" within the meaning of the interdiction of the statute.49

While supporting the validity of rule 3b-2, the court applied the Colby criteria in determining that Campbell was not an officer for purposes of section 16(b) of the 1934 Act.

III. SUBSEQUENT INTERPRETATIONS OF THE MEANING OF "OFFICER"

The next reported case involving the meaning of officer for purposes of the 1934 Act was not decided until 1968, more than fifteen years after the Campbell decision. That case, Lee National Corp. v. Segur,50 as all the judicial decisions in this area, involved the interpretation of officer for purposes of section 16(b) of the 1934 Act.

In Lee National, the court held that Segur, an officer of plaintiff's subsidiary, was not an "officer of the 'issuer' " (the plaintiff) and, therefore, was not subject to section 16(b) of the 1934 Act.51 Plaintiff's counsel had sought a judicial determination that when section 16 of the 1934 Act refers to an "officer of the issuer" it "intends to also refer to and include an officer of a subsidiary corporation."52 The court found that this construction of section 16 of the 1934 Act had not been adopted by any court and concluded that such a construction "need not be accomplished by what may be considered 'judicial legislation.' "53

In a 1971 no action letter, Associated Bank & Services, Inc.,54 the Commission responded to a request to comment on whether officers and directors of three wholly owned bank subsidiaries should file with the Commission reports pursuant to section 16(a) of the 1934 Act. In the aggregate, the subsidiaries had in excess of seventy-five officers and directors. The subsidiaries were owned by a bank holding company.

49. Id. at 286.
51. Id. at 852.
52. Id.
53. Id.
The president of each of the subsidiary banks was a director of the bank holding company. Counsel for the banks contended that the bulk of the responsibility for operating the subsidiaries lay with the holding company and its officers and directors. Thus, the banks maintained that, with the exception of those persons holding positions with both the subsidiary bank and the holding company, the personnel of the subsidiary banks performed predominantly administrative rather than policy-making functions.  

Unlike the court in *Lee National*, the Commission was not entirely certain whether officers and directors of the subsidiaries were officers or directors subject to section 16(a) reporting requirements. The Commission stated in its letter to counsel that the "ultimate determination of whether they are or are not insiders for the purposes of Section 16(a) reporting must be made by the courts." The Commission then referred counsel to *Colby*'s confidential information test for an officer. Apparently, the Commission ignored the holding of the *Lee National* court that an officer of a subsidiary was not subject to section 16(b) liability. Only after the Commission warned that the courts must make the ultimate determination as to who is an officer for section 16(a) reporting purposes, did it state:

You state that it is your feeling that the personnel of the subsidiary banks have more administrative functions rather than policy-making responsibilities. Consequently, this office is not inclined to insist that the officers and directors of the subsidiary bank file Section 16(a) reports. This, of course, excludes the three Presidents of the banks who are Directors of the holding company, as well as any subsidiary bank employee who is a director or officer of the issuer. This should not, however, be construed as a determination by the Commission that the officers and directors of subsidiary banks are not subject to the reporting requirements of Section 16(a).

It is submitted that the Commission's reply in *Associated Bank & Services, Inc.* contains an erroneous view of the filing requirements of section 16(a) of the 1934 Act, inasmuch as the statute clearly refers to an "officer of the issuer" and not to an officer of an issuer's subsidiary.

Unlike *Colby*, where the defendant Klune did not hold an officer's title, the defendants in court decisions after *Lee National* all held officer titles in the issuer but denied that they were "officers" for purposes of section 16(b) of the 1934 Act. In each case the defendants

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55. Id. at 80,780.
56. Id. at 80,779.
57. 281 F. Supp. at 852.
attempted to use some or all of the Colby criteria to contest their officer status under section 16(b) of the 1934 Act. In other words, in Colby a subjective test was formulated by the Second Circuit to impose section 16(b) liability upon persons who objectively do not appear to be officers of an issuer. In recent cases, however, persons objectively identifiable as officers of the issuer have attempted to use the Colby criteria to avoid section 16(b) liability. The first of these decisions was Gold v. Scurlock, in which the plaintiff sued on behalf of the Susquehanna Corporation for short-swing profits which the plaintiff alleged were realized by defendant directors and officers of Susquehanna in violation of section 16(b) of the 1934 Act. The defendants had been directors and officers of Atlantic Research Corporation and had merged Atlantic into Susquehanna, exchanging their Atlantic stock for that of Susquehanna. Within six months, defendants sold shares of their newly acquired Susquehanna stock. The district court found that the exchange of stock pursuant to the merger constituted a “purchase” under section 16(b) so that the sale of Susquehanna stock within a less than six month period subjected all defendants but one to section 16(b) liability.

This defendant, Rumbel, contended that although he held an officer's title in Susquehanna, he was not an officer for section 16(b) purposes inasmuch as his office was titular and did not accord him access to inside information. The court found that Rumbel was not an officer and not subject to section 16(b) liability: “Being a corporate officer without portfolio does not per se make him an ‘insider’ as contemplated in Section 16(b)—and the Court so finds as to Rumbel.” Two other defendants, Sloane and McBride, asserted that, though they held officer titles, they were not officers for purposes of section 16(b). The court, however, found that they were within the section since “[t]heir duties and responsibilities were equal to their titles.”

On appeal, the Fourth Circuit, in determining whether the merger was a “purchase” for section 16(b) purposes, rejected the district court's characterization of the merger as a “garden-variety” purchase under section 16(b). Instead, the Fourth Circuit held the merger to be an “unorthodox transaction” within the ambit of the Supreme

61. Id. at 1215.
62. Id.
63. Id.
64. 486 F.2d at 351.
65. Id. at 343.
Court's decision in *Kern County Land Co. v. Occidental Petroleum Corp.* The court examined each defendant's opportunity for speculative abuse of inside information obtained as a result of the merger in order to determine whether the exchange of shares was a "purchase" within the meaning of section 16(b).

In the case of Rumbel, the Fourth Circuit found that he did not have the slightest connection with merger negotiations and that he was as ignorant of merger developments as any outside stockholder. Thus, the Fourth Circuit concluded that Rumbel's exchange of shares lacked the potential for misuse of inside information. On that basis, the Fourth Circuit affirmed the district court's judgment that Rumbel was not subject to section 16(b) liability.

Concerning Sloane (McBride did not appeal), the Fourth Circuit reversed the district court and directed the lower court to enter judgment in Sloane’s favor. The district court had found specifically that there was no evidence indicating that Sloane had an opportunity to avail himself of the inside details of the merger arrangement, but that, since his duties and responsibilities were equal to his title (vice-president), he was subject to section 16(b) liability. The Fourth Circuit stated: "And when the District Court found, as the evidence clearly warranted, that Sloane had no such opportunity, a conclusion of nonliability on Sloane's part necessarily followed."

Analysis of this case is somewhat complicated by the fact that it involved an unorthodox transaction. It would seem, however, that the district court applied a subjective test similar to that used by the Second Circuit in *Colby* since the district court inquired into the defendants' duties as well as their corporate titles. The Fourth Circuit, on the other hand, emphasizing the *Kern County* decision and the unorthodox nature of the merger, focused on whether the merger presented the defendants with an opportunity for speculative abuse of inside information. Thus, the Fourth Circuit applied a transactional test, rather than the *Colby* criteria, to determine section 16(b) liability. The district court decision, however, illustrates the continuing tendency of the courts to apply the *Colby* criteria to section 16(b) cases.

67. 486 F.2d at 344.
68. Id. at 351.
69. Id.
70. Id.
In *Schimmel v. Goldman*, Judge Bauman approved a stipulation of settlement discontinuing a section 16(b) action in return for the defendant Goldman's payment of approximately 72 percent of the maximum possible recovery. The Commission submitted an amicus curiae memorandum opposing the settlement on the ground that the defenses to the section 16(b) action were insufficient to justify the substantial discount in the settlement proposal.

Defendant Goldman, a vice-president of Banner Industries, Inc., had sold Banner shares and had exercised an option to purchase Banner shares within less than six months. Judge Bauman computed Goldman's "maximum profit" under section 16(b) to be $83,490.80. The defendants had offered $60,000.00 in settlement of the case. Goldman, in support of the settlement, claimed that the recoverable profits would be limited to $40,365.80 due to special rules for computing profits in cases involving exercise of stock options. Additionally, notwithstanding the fact that Goldman listed himself as a vice-president of Banner Industries, Inc. in Form 4 reports filed with the Commission, he claimed that his position was merely titular and that, consequently, he was not an officer for purposes of section 16(b).

As to this claim, the Commission, in its amicus curiae memorandum, opposed Goldman's position, arguing that if a "'person wishes to enjoy the prestige of an office, he shares its responsibilities under Section 16.'" The Commission argued that the definition of officer in rule 3b-2 foreclosed any inquiry into the nature of Goldman's duties with Banner Industries, Inc. The court noted that the Commission's position was inconsistent with its stance in *Colby* where it did not argue that rule 3b-2 foreclosed any inquiry into what the defendant did, but rather, asserted that "it is significant that the employee has or has not 'responsibility for the policy of at least a substantial segment of the corporation's affairs' and participates 'in executive councils of the corporation as an officer.'" The court further stated:

Thus, neither the Second Circuit nor the SEC [in *Colby*] were willing to assume that Rule 3b-2 foreclosed the defendant from arguing that, although given the title of an officer, he did not perform the policy making functions or have access to inside information which characterize an "officer" for purposes of § 16(b).
The court considered the validity of rule 3b-2 but found no decision in the Second Circuit which had discussed this point subsequent to the 1949 Colby decision. Judge Bauman found the Rathman and Campbell decisions,81 holding rule 3b-2 valid, to be "of little precedential value because the issue in each case was whether an assistant treasurer, a position not included in the Rule's definition of 'officer,' was an insider for purposes of § 16(b)."82 He referred to the district court decision in Gold v. Scurlock,83 in which the district court for the Eastern District of Virginia did make an inquiry into the defendants' duties as well as their corporate titles.84 Judge Bauman elected to follow the Colby rule, concluding that "defendant Goldman would be free at trial to raise the issue of whether he was an insider despite [his filing] the Form 4 reports and Rule 3b-2."85

After finding that Goldman's defenses, if successful, would defeat any recovery by the corporation, Judge Bauman approved the settlement as fair and reasonable. Clearly, an element of this ruling was the likelihood of plaintiff's success at trial should he argue the Colby rule.86

In Selas Corp. of America v. Voogd,87 the defendant Voogd was executive vice-president of the plaintiff, Selas Corporation of America. He was also "one of the more active members of the executive committee, and . . . was the chief operating officer of the most important section of plaintiff's business which, at that time, was producing most of the profits for Selas."88 The defendant admitted that he had engaged in the short-swing transaction alleged by plaintiff but denied that he was liable under section 16(b) for any profit, claiming that he was not an officer of Selas within the meaning of the section. On plaintiff's motion for summary judgment, Judge Gorbey held Voogd to be liable under section 16(b) on the ground that, not only was he an officer under rule 3b-2's definition of officer, but he also fulfilled all the Colby criteria for officer inasmuch as an examination of his

81. These decisions are discussed in the text accompanying notes 39-49 supra.
82. 57 F.R.D. at 486. Judge Bauman's dismissal of the Rathman and Campbell decisions on the ground that the position of assistant treasurer was not included in rule 3b-2's enumerated officer titles overlooked basic principles of administrative law supporting these holdings. See note 116 infra. In the author's view, Judge Bauman's statement should be limited to section 16(b) and should not be applied to rule 3b-2 when it is used to define officer for purposes of other provisions of the 1934 Act.
83. This case is discussed in the text accompanying notes 60-72 supra.
84. 57 F.R.D. at 486.
85. Id.
86. Id. at 487.
88. Id. at 1271.
duties showed that he took responsibility for a substantial segment of Selas' business affairs and that he participated in the executive councils of Selas. Judge Gorbey concluded that Voogd's duties were of such a character that "it cannot be said that he did not have access to inside information as contemplated by § 16(b) of the Act."90

In Morales v. Holiday Inns, Inc.,91 the most recent case concerning the meaning of officer under the 1934 Act, a vice-president of Holiday Inns, Inc. was unable to convince the court that he was not an officer for purposes of section 16(b). The defendant contended that although he was listed in corporate records and Commission filings as a vice-president, he was not an officer within the meaning of section 16(b). Judge Gurfein, in weighing the defendant's argument, referred to the Colby decision, noting that "our Court of Appeals has put a gloss on the meaning of 'officer' for 16(b) purposes."92 Without considering the question whether rule 3b-2 was valid, the court relied on the Colby test dealing with the likelihood of obtaining confidential information to determine whether the defendant was an officer for section 16(b) purposes. Judge Gurfein noted that the defendant's answers to interrogatories "indicate that Jones [the defendant], concededly a Vice-President, was Director of Inn Operations, and as such had access to information concerning both the financial and operational performance of the Company-owned inns which comprised twenty percent of all the Holiday Inns."93 Judge Gurfein concluded:

There can be little doubt that in this position Jones may well have been in a position to acquire important information relating to the business of the corporation "which would aid him . . . in personal market transactions." His "defense," aside from Rule 3b-2, could not be sustained under Colby v. Klune, supra. Jones' title was not honorific. The settlement was, therefore, one of which the Court would not have approved had it been presented under Rule 23.94

IV. CONCLUSION

In determining who is an "officer of an issuer" for purposes of section 16(b) of the 1934 Act, counsel would be better advised to use the Colby criteria,95 and not rely on the enumerated titles and literal

89. Id.
90. Id.
92. Id. at 762.
93. Id. at 763.
94. Id.
95. See text accompanying notes 28-30 supra.
terms of rule 3b-2. This conclusion would appear to be justified in light of the fact that the cases decided subsequent to the 1953 *Campbell* decision\(^96\) (with the exception of *Lee National*\(^97\) were guided by the *Colby* opinion in making such determination.

Additionally, as a result of the Commission's no-action letter, *Associated Bank & Services, Inc.*,\(^98\) which stated that the ultimate determination as to who is an officer for purposes of filing reports under section 16(a) must be made by the courts, counsel may not safely rely on rule 3b-2 to determine officer status for the purpose of filing section 16(a) reports, but must again refer to the *Colby* criteria for guidance.

As for provisions of the 1934 Act other than section 16, the Commission, in Securities Exchange Act Release No. 4754,\(^99\) cast doubt on the use of rule 3b-2 for determining the meaning of officer. In that release the Commission noted that the *Colby* opinion "indicates the possibility that the provisions of the [1934] Act applicable to officers may be held to reach a broader class of persons than might otherwise appear from the definition contained in rule X-3B-2."\(^100\)

As a result of the Commission's view that the ultimate determination of who is an officer for purposes of the 1934 Act must be made by the courts, individuals attempting to determine whether to file with the Commission Form 3 and 4 reports under section 16(a) of the 1934 Act, and corporations attempting to determine whether to file with the Commission registration statements under section 12 of the Act,\(^101\) reports under sections 13\(^102\) or 15(d)\(^103\) of the 1934 Act, and proxy material under section 14 of the 1934 Act,\(^104\) are in an unhappy position. No assurance can be offered them that they are immune under section 23(a)(1)\(^105\) from 1934 Act liability if they rely on rule 3b-2 to determine officer status. The argument against granting immunity would be that such reliance is not within the good faith

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96. The *Campbell* decision is discussed in the text accompanying notes 39-49 supra.
97. The *Lee National* decision is discussed in the text accompanying notes 50-53 supra.
98. The Commission's no-action letter is discussed in the text accompanying notes 54-59 supra.
99. Release No. 4754 is discussed in the text accompanying notes 34-38 supra.
102. Id. § 78m (1970).
103. Id. § 78o(d) (1970).
104. Id. § 78n (1970).
105. Section 23(a)(1) of the 1934 Act, which is set out in note 44 supra, provides that no liability shall be imposed for acts done or omitted in good faith in conformity with rules and regulations of the Commission.
provision of section 23(a)(1) of the 1934 Act since the Commission itself is not relying on the rule but, instead, is leaving determination of who is an officer to the courts.\textsuperscript{106}

Under section 3(b) of the 1934 Act, the Commission was granted by Congress the power "by rules and regulations to define technical, trade, accounting, and other terms used in this chapter [1934 Act], consistently with the provisions and purposes of this chapter."\textsuperscript{107} Both Rathman and Campbell\textsuperscript{108} found rule 3b-2 to be validly issued by the Commission pursuant to the authority granted it by Congress under section 3(b) of the Act. However, since section 16(b) was enacted "[f]or the purpose of preventing the unfair use of information which may have been obtained by [a statutory insider] by reason of his relationship to [an] issuer,"\textsuperscript{109} it is understandable that the courts have not relied on the rule 3b-2 definition of officer to determine whether a corporate employee is an officer of an issuer for purposes of section 16(b). Instead the courts have followed the Colby criteria in making such determination.

As the Supreme Court noted in \textit{Reliance Electric Co. v. Emerson Electric Co.:}\textsuperscript{110} "[W]here alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."\textsuperscript{111} To support this statement, the Court, referred, among other cases, to the Colby decision: "And in deciding whether an investor is an 'officer' or 'director' within the meaning of § 16(b), courts have allowed proof that the investor performed the functions of an officer or director even though not formally denominated as such."\textsuperscript{112}

In the author's view, the definition of officer in rule 3b-2 is deficient in failing to take into account Colby and other more recent court interpretations of the meaning of officer for purposes of section 16(b).


\textsuperscript{107}. 15 U.S.C.A. § 78c(b) (Supp. 4, Aug. 1975), amending 15 U.S.C. § 78c(b) (1970) (emphasis added). Congress deleted a draft provision that the Commission’s power to define terms was to have the “force of law” insofar as it was not inconsistent with the provisions of the 1934 Act. The provision was deleted as unnecessary since courts commonly give the force of law to administrative interpretations of statutory terms unless they are clearly inconsistent with the legislative intent. 2 CCH Fed. Sec. L. Rep. ¶ 21,254.10 (1975).

\textsuperscript{108}. These cases are discussed in the text accompanying notes 39-49 supra. See also note 82 supra and accompanying text.


\textsuperscript{110}. 404 U.S. 418 (1972).

\textsuperscript{111}. Id. at 424.

\textsuperscript{112}. Id. at 424 n.4, citing Colby v. Klune, 178 F.2d 872, 873 (2d Cir. 1949).
It is submitted that the rule should not be relied upon by corporate personnel in determining whether they are officers under section 16(b).

In light of the Commission's reply in Associated Bank & Services, Inc., referring counsel to the Colby case and its confidential information test in order to determine whether an employee must report under section 16(a), rule 3b-2 fails to alert employees of the need to consider Colby in making such determination. In addition, rule 3b-2 appears to be too narrow in scope to implement effectively the policing function of section 16(a).

As for the other provisions of the 1934 Act, the Commission should support the validity of its rule 3b-2 definition of officer. It is submitted that the word officer is being used in such other provisions in its ordinary corporate law meaning of an individual holding a corporate title or performing functions similar to those usually performed by an officer holding a title enumerated in the rule, such as president, vice-president, treasurer, secretary, etc. Accordingly, the Commission should reconsider its position set forth in Securities Exchange Act Release No. 4754 in which the Commission left to the courts the ultimate determination of who is an officer for all provisions of the 1934 Act. The Commission should declare that rule 3b-2 is valid for purposes of the provisions of the 1934 Act, other than section 16 of the Act, since the rule appears not to be inconsistent with these provisions and is clearly within the authority granted the Commission by Congress. Such a declaration would: (i) remove uncertainty as to the

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113. See text accompanying notes 54-59 supra.

114. It has been noted that in regard to reporting beneficial ownership of securities for purposes of section 16(a) of the 1934 Act: "The reporting requirements of § 16(a) are broader in scope than the liability provisions of § 16(b); changes in beneficial ownership within a six-month period, such as transfer of shares whether by gift or for consideration to a spouse or other family member, although duly reported may not always give rise to liability. . . . The Commission has supported broad interpretations of the reporting requirements, reasoning that Congress intended the trading activities of insiders to be subject to the most careful scrutiny, for its deterrent effect not only upon abuse of inside information for short-swing profit, but also upon other abuses to which other sections of the statute are more specifically directed." Whiting v. Dow Chemical Co., [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,923, at 97,176 (S.D.N.Y. 1974), aff'd, Civil No. 75-7106 (2d Cir., Sept. 22, 1975) (citation omitted).

115. Release No. 4754 is discussed in the text accompanying notes 34-38 supra.

116. A regulation which is issued pursuant to a grant of statutory authority, if not inconsistent with the statute, is valid and has the force of law. K. Davis, Administrative Law Treatise § 5.04, at 252-56 (Supp. 1970); see United States v. California Portland Cement Co., 413 F.2d 161, 164 (9th Cir. 1969) (treasury regulations). Accordingly, since rule 3b-2 was issued by the Commission pursuant to the authority granted it by the Congress under section 3(b) of the 1934 Act and since the rule appears not to be inconsistent with provisions of the 1934 Act other than section 16, rule 3b-2 should be valid for such other provisions. See Lockheed Aircraft Corp. v. Campbell, 110 F. Supp. 282, 286 (S.D. Cal. 1953); Lockheed Aircraft Corp. v. Rathman, 106 F. Supp. 810, 813-14 (S.D. Cal. 1952).
validity of rule 3b-2 when applied to provisions of the 1934 Act other than section 16; (ii) facilitate corporate administrative compliance with these provisions; and (iii) permit corporations subject to the provisions of the 1934 Act to rely in good faith on rule 3b-2 for purposes of these provisions, thereby protecting them from 1934 Act liability by virtue of the good faith provision of section 23(a).\textsuperscript{117}

Concerning section 16 of the 1934 Act, the Commission should adopt a new rule defining officer solely for purposes of that section.\textsuperscript{118} This definition, consistent with the Commission's view that employees must consider \textit{Colby} in determining whether to report under section 16(a) and consistent with the policing purpose of the section, would broaden the scope of the definition of officer as contained in rule 3b-2 by adding to that definition a new provision incorporating the \textit{Colby} criteria. It is suggested that the new rule could read as follows:

For purposes of the provisions of Section 16 of the 1934 Act, the term "officer" means: (a) a president, vice-president, treasurer, secretary, comptroller and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers; and (b) any other person performing executive duties of such character for an issuer that such person would be likely, in discharging these duties, to obtain confidential information about the issuer's affairs that would aid such person if such person engaged in market transactions with the issuer's equity securities. A person shall be deemed to perform executive duties as described in (b) so as to require compliance with the filing provisions of Section 16(a) of the 1934 Act if such person: (i) has responsibility for the policy of at least a substantial segment of an issuer's affairs; or, (ii) participates in the executive councils of the issuer.

By adopting a new definition of officer for purposes of section 16, the Commission could bring reporting under section 16(a) of the 1934 Act into line with the criteria used by the courts in determining the meaning of officer under section 16(b).\textsuperscript{119} The definition will have the additional benefit of enabling corporate personnel to rely on the definition in good faith in determining whether or not they are officers for purposes of the provisions of section 16, thereby granting them immunity for "any act done or omitted in good faith in conformity with

\begin{footnotes}
\item[118] See text accompanying notes 31-38 supra.
\item[119] Admittedly, revision of the definition of officer for section 16 purposes will introduce an element of indefinitiveness into the reporting provisions of section 16(a), but, in the author's view, corporate personnel must, in any event, consider the Colby criteria for purposes of determining whether to engage in six-month trading activity proscribed by section 16(b).
\end{footnotes}
a rule, regulation, or order of the Commission . . . "120 Finally, the introduction of the subjective officer criteria of Colby into a section 16 definition of officer, while retaining rule 3b-2 for other provisions of the 1934 Act, should have the salutary effect of limiting Colby and its progeny to section 16 of the 1934 Act.