IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF DELAWARE

ARON ROSENBERG, Plaintiff, v. HARRIS CORPORATION, MANATEE INVESTMENT CORPORATION, and INTERSIL CORPORATION, Defendants.	)	Civil Action No. 01-518-SLR

MEMORANDUM ORDER

At Wilmington this 10th day of June, 2002, having reviewed the motion to dismiss filed by defendants Harris Corporation and Manatee Investment Corporation and plaintiff's response thereto;

IT IS ORDERED that defendants' motion to dismiss (D.I. 8) is denied, for the following reasons:

1. The court has jurisdiction over this action pursuant to 15 U.S.C. § 78aa and 28 U.S.C. § 1331.

2. In analyzing a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), the court must accept as true all material allegations of the complaint and it must construe the complaint in favor of the plaintiff. See Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts, Inc., 140 F.3d 478, 483 (3d Cir. 1998). "A complaint should be dismissed only if, after accepting as true all of the facts alleged in the complaint, and drawing all reasonable inferences in the plaintiff's favor, no relief could

be granted under any set of facts consistent with the allegations of the complaint." Id. Claims may be dismissed pursuant to a Rule 12(b)(6) motion only if the plaintiff cannot demonstrate any set of facts that would entitle him to relief. See Conley v. Gibson, 355 U.S. 41, 45-46 (1957). "When deciding a motion to dismiss, it is the usual practice for a court to consider only the allegations contained in the complaint, exhibits attached to the complaint and matters of public record." City of Pittsburgh v. West Penn Power Co., 147 F.3d 256, 259 (3d Cir. 1998). The moving party has the burden of persuasion. See Kehr Packages, Inc. v. Fidelcor, Inc., 926 F.2d 1406, 1409 (3d Cir. 1991).

3. In this derivative shareholder suit, plaintiff alleges that defendants Harris Corporation ("Harris") and Manatee Investment Corporation ("Manatee") realized short-swing insider trading profits subject to disgorgement pursuant to Section 16(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78p(b), and the rules promulgated thereunder by the Securities and Exchange Commission ("SEC"). (D.I. 1 at ¶ 1) The complaint asserts that Harris, through its subsidiary Manatee, was an insider subject to Section 16(b) regulation through its ownership of common stock and preferred stock of the Intersil Corporation ("Intersil"). (Id. at ¶¶ 10, 13-18) As part of Intersil's initial public offering ("IPO") that closed on March 1, 2000, defendants allegedly purchased 504,076 shares of Class A common

stock in exchange for the 8,456 shares of non-convertible preferred stock previously held. (Id. at ¶¶ 19-20, 25-27) This conversion occurred automatically pursuant to an amended and restated certification of incorporation effective the same day as the IPO, March 1, 2000.[1] (Id. at ¶¶ 21-24, 26) Between August 23, 2000 and August 31, 2000, within six months of the filing of the amended certificate of incorporation and the IPO, defendants sold approximately 325,899 shares of Class A common stock at a profit of $27.01 per share. (Id. at ¶¶ 29-30)

4. Defendants first argue the complaint should be dismissed because the reclassification of Intersil preferred stock into common stock is exempt from the scope of the term "purchase" as it applies to Section 16(b). (D.I. 9 at 5-10) Specifically, defendants assert that the transaction, as a matter of law, falls within the Rule 16b-7 (17 C.F.R. § 240.16b-7) exemption entitled "Mergers, Reclassifications, and Consolidations."[2] In interpretive guidance for Rule 16b-7, the

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[1]The amended certificate of incorporation provided that, upon filing and effectiveness of the certificate, all outstanding shares of 12% Series A Cumulative Compounding Preferred Stock would be automatically reclassified and converted into Class A common stock. The amount per share for common stock that Intersil received in its IPO would determine the precise number of common stock shares that preferred stock holders would receive in exchange for each share of preferred stock. (D.I. 1 at ¶¶ 22-24)

[2]The rule on its face exempts from Section 16(b) the acquisition and disposition of securities in mergers and consolidations where 85 percent or more of all of the assets or

SEC has stated that "[t]he staff is of the view that . . . Rule 16b-7 . . . does not require that the security received in exchange be similar to that surrendered, and the rule can apply to transactions involving reclassifications." See SEC Release No. 34-18114 ("Rules Applicable to Insider Reporting and Trading"), 46 Fed. Reg. 48147, 48177 (Oct. 1, 1981) ("Question 142"). The SEC has issued several no-action letters finding that particular reclassifications were exempt from Section 16(b), including one in which a reclassification of preferred stock to common stock in conjunction with an IPO was exempt under Rule 16b-7. See, e.g., Monk-Austin, Inc., SEC No-Action Letter, 1992 WL 337451 (Nov. 19, 1992). In addition, several courts have found that a particular stock reclassification did not constitute a "purchase" or "sale" under Rule 16(b). See, e.g., Roberts v. Eaton, 212 F.2d 82 (2d Cir. 1954); Levy v. Sterling Holding

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securities of one of the companies involved is owned by the other company. See SEC Release No. 34-18114 ("Rules Applicable to Insider Reporting and Trading"), 46 Fed. Reg. 48147, 48176 (Oct. 1, 1981) (Section IV(G). Rule 16b-7). In interpretive guidance, the SEC explained that these types of transactions "are of relatively minor importance to the stockholders of a particular company and do not present significant opportunities to insiders to profit by advance information;" furthermore, "they do not significantly alter in an economic sense the type of security which the insider held prior to the transaction." Id. Although the rule was entitled "Mergers and Consolidations" when it was first promulgated in 1952, the term "reclassifications" was added to the title in the SEC's 1991 amendments to the Section 16 rules, though reclassifications were still not mentioned in the text of the rule. See SEC Release No. 34-28869 ("Ownership Reports and Trading"), 56 Fed. Reg. 7242 (Feb. 21, 1991).

Company, No. 00-994, 2002 WL 187513 (D. Del. Feb. 5, 2002);[3] Rothenberg v. United Brands Co., 74 Civ. 5735, 1977 WL 1014 (S.D.N.Y. May 11, 1977). Nevertheless, with the exception of Levy, no court has exempted a reclassification, under the ambit of Rule 16b-7 or otherwise, as a matter of law. Rather, courts have considered the facts and circumstances surrounding each transaction before concluding that a particular transaction did not pose the risk of speculative, insider "short-swing" trading profits that Section 16(b) sought to prevent.[4] See Roberts v. Eaton, supra. See also Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 594-95 (1973) (in deciding whether "unorthodox" transactions are within the reach of section 16(b), "the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent – the realization of short-swing profits based upon access to inside information"). The court also notes that the SEC has never expressly exempted all reclassifications from Section 16(b), just as all mergers and consolidations are not exempt –

[3]The Levy decision is currently on appeal to the Third Circuit.

[4]With the exception of Levy, the stock conversion cases and SEC no-action letters reviewed by the court involved the exchange of **convertible** securities for another security. The court notes that, in the case at bar, defendants exchanged **non-convertible** preferred stock for common stock, a fact that must be considered in the context of other facts and circumstances surrounding the transaction.

only mergers and consolidations that meet specific, strict guidelines are exempt as a matter of law. In sum, the court awaits a more fully developed record before determining whether the transaction at hand should be exempt from Section 16(b), thus following the lead of most courts that have addressed the issue.

5. Defendants next argue the complaint should be dismissed because any "purchase" occurred on February 24th, 2000, the date when the Intersil board of directors and shareholders allegedly approved the amended certificate of incorporation. (D.I. 9 at 14) If February 24 is found to be the date of purchase (instead of March 1 as alleged by plaintiff), then the sale of stock commencing August 23, 2000 would be outside the six-month "short-swing" period within which Section 16(b) prohibits a matching sale. The parties agree that, for purposes of applying Section 16(b), a purchase of securities occurs when all rights and obligations become fixed. See Blau v. Ogsbury, 210 F.2d 426, 427 (2d Cir. 1954); Alza Corp., SEC No-Action Letter, 1991 WL 176838 (July 17, 1991) ("A derivative security is created at the time the exchange rate is fixed, and there is a purchase under Rule 16b-6(a) at that time."). Thus, the critical issue in the case at bar is when defendants' right to convert the preferred shares to common stock was irrevocably fixed. The material facts alleged in the complaint and the underlying documents, when all reasonable inferences are drawn in plaintiff's favor, support

plaintiff's contention that the transaction became irrevocable on March 1, 2000, the date the amended articles of incorporation were filed and the price of the common stock was fixed through the IPO. Defendants' arguments otherwise are based on facts not of record.

6. Based on the above, the court denies defendants' motion to dismiss.

Sue L. Robinson
United States District Judge