Supreme Court Provides Guidance on Section 16(b) Statute of Limitations

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In *Credit Suisse Securities LLC v. Simmonds*, the Supreme Court recently addressed the timeliness of claims brought against corporate insiders to recover short-swing profits under Section 16(b) of the Securities Exchange Act of 1934. The Court decided that the two-year limitations period on bringing suit under Section 16(b) is not tolled (that is, not suspended) until the required public reporting by the insider of the transactions has taken place. Rather, said the Court, the limitations period runs for two years from the date any related profit from the transactions is realized, whether or not those public reports have been filed. (Note that the Securities and Exchange Commission is separately empowered to seek significant civil money penalties from persons who violate Section 16(a)'s reporting obligations.)

Section 16 – The Original Restriction on Insider Trading

With respect to a registered class of equity securities – such as common stock – of a publicly held issuer, Section 16(a) of the Exchange Act requires directors and officers of the issuer, as well as beneficial owners of more than 10% of the class of equity securities, to make prompt public filings (typically on Form 4) of their transactions in such securities.
Section 16(b) imposes strict liability on the persons subject to Section 16 for any "short-swing" profits realized (or loss avoided) resulting from the purchase and sale, or sale and purchase, of such securities within any six-month period, without regard to the actual use or possession by the insider of material non-public information. The statute allows the issuer of the securities, or any shareholder derivatively on behalf of the issuer, to bring suit for disgorgement of these short-swing profits. However, Section 16(b) provides that "no such suit shall be brought more than two years after the date such profit was realized."

Background of the Case in the Lower Courts

The plaintiff in *Simmonds* filed 55 nearly identical Section 16(b) lawsuits in 2007, consolidated into a single case, against financial institutions that had underwritten initial public offerings (IPOs) in the late 1990s and 2000. She alleged that the underwriters worked with corporate insiders to artificially inflate the aftermarket price of the stock above the IPO price, which allowed the underwriters and insiders to profit from the aftermarket sale. She further novelly asserted that the underwriters and insiders owned more than 10% of the stock of the relevant companies during this period and were therefore (1) required to file timely Form 4s and (2) liable for disgorgement of short-swing profits under Section 16(b).

The underwriters and insiders never filed Form 4s and denied that they were required to do so. The trial court dismissed the plaintiff's claims as time-barred, finding that Section 16(b)'s two-year limitations period had expired years earlier. The court noted that there was no dispute that the shareholders of the several issuers were fully advised of all the facts providing the basis for Section 16(b) claims well over five years before the lawsuits were filed.

The Ninth Circuit Court of Appeals reversed the trial court, holding that Section 16(b)'s limitations period was tolled until public disclosure of the insiders' transactions in accordance with Section 16(a), "regardless of whether the plaintiff knew or should have known of the conduct at issue."

The Supreme Court Decision

The Supreme Court granted review to determine whether the two-year period to file suit under Section 16(b) is tolled until the filing of the Section 16(a) disclosure statement (Form 4), or if the period begins to run before then. The unanimous Court squarely rejected the approach taken by the Ninth Circuit, relying on the statutory language which states that the two-year clock starts from "the date such profit was realized." The Court emphasized the unfairness of an alternative interpretation, particularly in a case like *Simmonds* where the underwriters could plausibly claim they were not required to file reports under Section 16(a); the appellate court's rule "compels them either to file or to face the prospect of Section 16(b) litigation in perpetuity."

On the other hand, the Court was split 4-4 (Chief Justice Roberts did not participate) on whether Section 16(b) establishes a "period of repose," which would mean an absolute two-year deadline in every case, or whether traditional principles of equitable tolling – under which the two-year limitations period would not start until the facts giving rise to a claim are, or should have been, discovered by a diligent plaintiff – should apply to Section 16(b) claims. Therefore, there is no clear Supreme Court precedent with regard to the Ninth Circuit's holding that Section 16(b) does not establish a period of repose. The case was returned to the lower courts to reassess the facts of the case under the usual rules of equitable tolling.

The *Simmonds* case stands for the proposition that the running of Section 16(b)'s limitations period is not postponed until the filing of Section 16(a) reports, as the Ninth Circuit held. Rather, the limitations period starts to run when short-swing profits are realized, subject, perhaps, to principles of equitable tolling. The timeliness of such Section 16(b) claims and the applicability of a period of repose or traditional equitable tolling remain open for courts to decide on a case-by-case basis.

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