# Section 16(b) Overview

*Section 16* of the Exchange Act, with respect to any company whose securities are registered on a national securities exchange, imposes certain obligations and restrictions on the company's officers, directors, and "[e]very person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security)," *15 U.S.C. § 78p(a)(1)*. "[D]efining directors, officers, and [such] beneficial owners as those presumed to have access to inside information," *Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232, 243, 96 S. Ct. 508, 46 L. Ed. 2d 464 (1976)* ("Foremost-McKesson"), Congress enacted *§ 16(b)* of the Act, which provides, in pertinent part, as follows:

> **(b) Profits from purchase and sale of security within six months.** 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 [*19] security of such issuer (other than an exempted security) . . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, 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. . . . 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 . . . .

*15 U.S.C. § 78p(b)*.

> The general purpose of Congress in enacting *§ 16(b)* is well known. See Kern County Land Co.[v. *Occidental Petroleum Corp., 411 U.S. 582, 591-92, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973)]*; *Reliance Electric Co. [v. Emerson Electric Co., 404 U.S. 418, 422, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972)]*, and the authorities cited therein. Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could [*20] reap profits at the expense of less well informed investors. In *§ 16(b)* Congress sought to "curb the evils of insider trading [by]. . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Co., supra, at 422*:

*Foremost-McKesson, 423 U.S. at 243* (emphasis added).

Congress left enforcement of section 16(b) cases to shareholders and consequently to the attorneys who find such cases and represent the shareholders who consent to be plaintiffs. The SEC was given no role in enforcing section 16(b). Thus, section 16(b) can be enforced, and the market's integrity can be protected, only if attorneys are willing to invest the time and energy, and assume the risk, that is involved in investigating numerous SEC filings in the search to uncover insiders who make improper short-swing profits, and filing lawsuits against those unwilling to return such profits.

As stated by the U.S. Supreme Court:

> The only textual restrictions on the standing of a party to bring suit under § 16(b) are that the plaintiff must be the "owner of [a] security" of the "issuer" at the time the suit is "instituted."
>
> Although plaintiffs seeking to sue under the statute must own a "security," § 16(b) places no significant restriction on the type of security adequate to confer standing. "Any security" will suffice, *15 U. S. C. § 78p(b)*, the statutory definition being broad enough to include stock, notes, warrants, bonds, debentures, puts, calls, and a variety of other financial instruments; it expressly excludes only "currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . . ." *§ 78c(a)(10)*; see also *Reves v. Ernst & Young, 494 U.S. 56, 108 L. Ed. 2d 47, 110 S. Ct. 945 (1990)*. Nor is there any restriction in terms of either the number or

> percentage of shares, or the value of any other security, that must be held. See *Portnoy v. Revlon, Inc., 650 F.2d 895, 897 (CA7 1981)* (plaintiff bought single share); *Magida v. Continental Can Co., 231 F.2d 843, 847-848* (CA2) (plaintiff owned 10 shares), cert. denied, *351 U.S. 972, 100 L. Ed. 1490, 76 S. Ct. 1031 (1956)*.

Profits resulting from purchase-and-sale, or sale-and-repurchase, transactions within a period of less than six months are commonly known as "short-swing" transactions, see, e.g., *id. at 234*; SEC Rule 16a-1(a)(3), *17 C.F.R. § 240.16a-1(a)(3)*. As indicated by the "irrespective of any intention" clause in *§ 16(b)*, that section is a strict-liability provision; it "requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the [six-month] period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information," *Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 595, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973)* (emphasis added); see, e.g., *Foremost-McKesson, 423 U.S. at 251* [*21] ("*Section 16(b)* imposes a strict prophylactic rule with respect to insider, short-swing trading.").

The Exchange Act also recognizes that the abuses it targets may be accomplished by persons acting not individually but in combination with others. See, e.g., *15 U.S.C. § 78m(d)(3)*. With respect to *§ 16*, SEC *Rule 16a-1(a)(1)* provides that, "[s]olely for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities," the term "beneficial owner" means, with exceptions not pertinent here, "any person who is deemed a beneficial owner pursuant to *section 13(d)* of the Act and the rules thereunder." *17 C.F.R. § 240.16a-1(a)(1) Section 13(d)* of the Act provides, in pertinent part, that

> [w]hen two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

*15 U.S.C. § 78m(d)(3)* (emphases added). And SEC *Rule 13d-5(b)(1)* promulgated thereunder provides, [*22] with exceptions not pertinent here, that

> [w]hen two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of sections 13(d) and (g) of the Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons.

*17 C.F.R. § 240.13d-5(b)(1)* (emphases added). Accordingly, under *§ 13(d)(3)* and this Rule, if two or more entities agree to act together for any of the listed purposes, a "group" is "thereby" formed.

Thus, "the touchstone of a group within the meaning of *Section 13(d)* is that the members combined in furtherance of a common objective." *Wellman v. Dickinson, 682 F.2d 355, 363 (2d Cir. 1982)* ("Wellman"), cert. denied, *460 U.S. 1069, 103 S. Ct. 1522, 75 L. Ed. 2d 946 (1983)*. Although a common purpose to acquire control of the issuing company would be an indicium of collective action within the meaning of *§ 13(d)*, it is not an essential.

> [T]he agreement required by *§ 13(d)(3)* need not be an agreement to [*23] gain corporate control or to influence corporate affairs. . . . The plain language of *§ 13(d)(3)* demands only an agreement "for the purpose of acquiring, holding, or disposing of securities," *15 U.S.C. § 78m(d)(3)*, and Rule 13d-5 is similarly satisfied by that sort of agreement, *17 C.F.R. § 240.13d-5(b)(1)*.

*Morales v. Quintel Entertainment, Inc., 249 F.3d 115, 124-25 (2d 23 Cir. 2001)* Further, evidence that group members "might not always make identical investment decisions" does "not preclude existence of agreement." *Id. at 127* (internal quotation marks omitted).

Importantly, for purposes of this case, the actors need not have combined for all of the purposes listed in *§ 13(d)(3)* or *Rule 13d-5(b)(1)*. Acquiring, holding, and disposing of are listed in the disjunctive. Hence, "[a]ll that is required is that the members of the group have combined to further a common objective with regard to one of those activities." *Morales v. Freund, 163 F.3d 763, 767 n.5 (2d Cir. 1999)* (emphasis added); see, e.g., *Morales v. Quintel Entertainment, Inc., 249 F.3d at 124*; *Wellman, 682 F.2d at 363*. [*24]

The questions of (a) whether two or more persons "act[ed] as a group or agreed to act together, and (b) whether their purpose was the acquisition, holding, or disposition of an issuer's equity securities are questions of fact. See, e.g., *Morales v. Quintel Entertainment, Inc., 249 F.3d at 124*. If they in fact so acted or agreed to so act, the legal consequences are specified in *§ 13(d)(3)* and *Rule 13d-5(b)(1)*: If the persons agreed to act together for the purpose of purchasing an issuer's shares, a "group" was "thereby" formed, *17 C.F.R. § 240.13d-5(b)(1)*; if they acted as a "group," they must be treated as a single person, *15 U.S.C. § 78m(d)(3)* ("shall be deemed a 'person'"); and each person in the group "shall be deemed" to be the beneficial owner "of all equity securities of that issuer beneficially owned by any" member of the group, *17 C.F.R. § 240.13d-5(b)(1)*.

An agreement to act together for the purpose of acquiring, holding, or disposing of shares need not be unconditional in order to support a finding that the actors constituted a group within the meaning of those provisions. See, e.g., *Wellman, 682 F.2d at 363*. [*25] Nor need the group "be committed to acquisition, holding, or disposition on any specific set of terms." , Id.; see e.g., *Morales v. Freund, 163 F.3d at 767 n.5*. And, "[o]f course, the concerted action of the group's members need not be expressly memorialized in writing." *Wellman, 682 F.2d at 363*. The formation of such a group "may be formal or informal and may be proved by direct or circumstantial evidence." *Morales v. Quintel Entertainment, Inc., 249 F.3d at 124*; see also *id. at 125-26* (sworn statements by defendants, alleged group members, that the members "never 'agreed' among themselves to acquire [the] stock" are insufficient to support the granting of summary judgment in favor of the defendants where there is circumstantial evidence from which "a reasonable trier of fact could discredit the . . . sworn statements and infer instead that" the defendants entered into an agreement with one another, "with an agreed purpose to acquire (the] stock").