

# Securities Law Alert

## KEY DEVELOPMENT IN SHAREHOLDER LITIGATION

### Second Circuit: Reaffirms *Donoghue* Holding That Short-Swing Trading Inflicts Injury Sufficient for Constitutional Standing

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On June 24, 2024, the Second Circuit reversed a district court’s dismissal of a shareholder’s Section 16(b) derivative suit for lack of constitutional standing, which the district court based on its determination that *TransUnion LLC v. Ramirez*, 594 U.S. 413 (2021) had abrogated *Donoghue v. Bulldog Investors General Partnership*, 696 F.3d 170 (2d Cir. 2012). [Packer v. Raging Cap. Mgmt.](#), 2024 U.S. App. LEXIS 15218 (2d Cir. 2024) (Cabranes, J.). In *TransUnion*, the Supreme Court stated that to determine whether an intangible injury is sufficiently concrete to confer constitutional standing, courts are to identify a “close historical or common-law analogue for the asserted injury.” In *Donoghue*, the Second Circuit identified breach of fiduciary duty as the analogue for a Section 16(b) injury and “categorically held that short-swing trading in an issuer’s stock by a 10% beneficial owner in violation of Section 16(b) of the Securities Exchange Act causes injury to the issuer sufficient for constitutional standing.” In this case, the Second Circuit held that “nothing in *TransUnion* undermines *Donoghue*[.]”

#### Background and Procedural History

This litigation arose when a retail company shareholder filed a derivative suit against an investment firm, its founder, and its investment manager alleging that they violated Section 16(b) by buying and selling the retailer’s stock while they were 10% beneficial owners during a six-month period in 2014 and 2015. Under Section 16(b) owners of more than 10% of a company’s stock are required to disgorge profits (so-called “short-swing profits”) made by buying and selling that company’s stock within a six-month window. The district court dismissed concluding that plaintiff lacked constitutional standing to bring a suit under Section 16(b) because he did not allege a concrete injury. The district court concluded that the Supreme Court’s decision in *TransUnion* (establishing that for an intangible injury to be sufficiently concrete to confer constitutional standing, courts are to identify a “close historical or common-law analogue for the asserted injury”), abrogated *Donoghue*, which held that a violation of Section 16(b) inflicts an injury that confers constitutional standing. Finding that Section 16(b) merely protected against “speculative harm,” the district court determined that the alleged violation did not confer standing in light of the *TransUnion* holding that “risk of harm” alone does not qualify as “concrete” harm.

## The Second Circuit Reconciles *TransUnion* and *Donoghue*

The Second Circuit concluded that *TransUnion* did not abrogate or undermine *Donoghue* and that the district court erred in dismissing. Under *TransUnion*, a plaintiff must show, among other things, “that he suffered an injury in fact that is concrete, particularized, and actual or imminent.” Those injuries may be tangible harms (*i.e.*, physical harms and monetary harms) or intangible harms (*i.e.*, reputational harms and disclosure of private information). In *TransUnion*, the Supreme Court instructed that to determine whether an intangible injury is sufficiently concrete to confer constitutional standing, a court should identify a “close historical or common-law analogue for their asserted injury.” Turning to *Donoghue*, the Second Circuit noted that there it rejected a near-identical challenge to a Section 16(b) action. The Second Circuit explained in *Donoghue* that Section 16(b) imposed a form of strict liability by effectively prohibiting an entire class of transactions because the possibility of abuse of inside information was intolerably great. Therefore, the court in *Donoghue* concluded that Section 16(b) imposed a fiduciary duty on 10% beneficial owners and conferred an enforceable right to expect the fiduciary to refrain from short-swing trading, and that the deprivation of this right established constitutional standing.

In this case, the Second Circuit stated that, “[a]s *Donoghue* made clear, because Section 16(b) makes 10% beneficial owners into statutory fiduciaries, a close historical or common-law analogue to short-swing trading by a 10% beneficial owner is breach of fiduciary duty.” Analogizing between a common-law fiduciary (who must account to the beneficiary for any personal profit arising from his breach) and a statutory fiduciary (who owes short-swing profits to the corporation), the Second Circuit concluded in this case that the “deprivation of [short-swing] profits inflicts an injury sufficiently concrete to confer constitutional standing.” The Second Circuit stated that the district court “was mistaken in determining that Section 16(b) protects against the risk of harm alone.” The Second Circuit explained that plaintiff did not base his standing argument on a risk of harm and that the concrete injury that conferred standing was, “the breach by a statutory insider of a fiduciary duty owed to the issuer not to engage in and profit from any short-swing trading of its stock.”

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