INSIGHTS

The Corporate & Securities Law Advisor

VOLUME 39, NUMBER 9, SEPTEMBER 2025

Wolters Kluwer

www.WoltersKluwerLR.com

INSIGHTS

The Corporate & Securities Law Advisor

Editor-in-Chief
BROC ROMANEK
broc.romanek@gmail.com

EDITORIAL ADVISORY BOARD

EDITORIAL OFFICE
28 Liberty Street,
New York, NY 10005
212-771-0600

Wolters Kluwer
Richard Rubin, Publisher
Jayne Lease, Managing Editor

INSIGHTS (ISSN No. 0894-3524) is published monthly by Wolters Kluwer, 28 Liberty Street, New York, NY 10005. To subscribe, call 1-800-638-8437. For customer service, call 1-800-234-1660 or visit www.wolterskluwerlr.com.

For article reprints and reprint quotes contact *Wrights Media* at 1-877-652-5295 or go to *www.wrightsmedia.com.*

SECTION 16

Second Circuit: Rejects Novel Theory of Liability for Short-Swing Profits under Section 16(b)

By Stephen Blake, Michael Garvey, Peter Kazanoff, Meredith Karp, James Rapp, Craig Waldman, and Jonathan Youngwood

On May 23, 2025, the Second Circuit affirmed the dismissal of two lawsuits[1] brought by a shareholder seeking to impose Section 16(b)[2] liability by pairing sales of outstanding shares made by controlling shareholders with share repurchases by corporations they control.[3] The Second Circuit held that plaintiff's "novel theory of liability" was "invalid" because applicable law transforms the outstanding securities into treasury shares upon repurchase by the issuer such that Section 16(b) does not impose liability for the alleged pairing.

Background and Procedural History

Plaintiff is a shareholder of a Delaware corporation that is controlled by a family through its two business entities.[4] In 2021, pursuant to Section 16(a) it was reported to the Securities and Exchange Commission (SEC) that one of the two business entities sold two million shares of the Delaware corporation's Class A common stock, while the Delaware corporation reported that it had repurchased Class A shares pursuant to a stock buyback program. Under Delaware corporate law, the repurchased shares were instantly and automatically converted into treasury shares, which had the effect of removing them from the pool of outstanding shares and divesting them of any incidents of ownership, such as rights to vote or receive dividends.

Plaintiff filed suit against the two business entities on the Delaware corporation's behalf alleging that 23 percent of these repurchases should be attributed to the family's business entities, to match their pecuniary interest in the Delaware corporation. Subsequently, plaintiff appealed the district court's dismissal decision, which held that issuer repurchases cannot be paired with insiders' sales of outstanding shares to create Section 16(b) liability.

Section 16(b) Does Not Impose Liability for Issuer Repurchases

The Second Circuit framed the issue as "whether an issuer's share repurchase is a purchase of 'any equity security' that may be paired with an insider's personal sale of outstanding shares of the issuer, such that any 'profit realized' by the insider is subject to disgorgement to the issuer." The Second Circuit held that "[w]here applicable law transforms outstanding securities into treasury shares upon repurchase by the issuer, we answer this question in the negative and so conclude that Section 16(b) does not impose liability for the alleged pairing."

The Second Circuit explained that Section 16(b) precluded plaintiff's theory for several reasons. First, "Section 16(b) requires defendants have to beneficial ownership over the shares involved in each transaction in order for them to be considered insiders; but SEC regulations preclude attributing to controlling shareholders even indirect beneficial ownership of shares repurchased by issuers." The Second Circuit

Stephen Blake, **Michael Garvey**, **Peter Kazanoff**, **Meredith Karp**, **James Rapp**, **Craig Waldman**, *and* **Jonathan Youngwood** *are attorneys of Simpson Thacher & Bartlett LLP.*

determined that defendants "were not insiders to the repurchases because they lacked beneficial ownership over the repurchased equity securities." The Second Circuit explained that "controlling shareholders do not become indirect beneficial owners of shares acquired by an issuer when that issuer repurchases its own issue, because state law transforms those shares into treasury shares."

Second, the Second Circuit determined that plaintiff could not establish that the equity securities in each allegedly pairable transaction were substantively identical. The Second Circuit explained that Section 16(b) requires paired transactions in "any equity security"[5] but transactions in "readily distinguishable" stocks cannot be paired because they are not trades in any equity security. The Second Circuit contrasted an open market transaction where insiders purchase outstanding shares from other private participants where incidents of ownership survive in the hands of the new shareholders with a transaction where treasury shares are repurchased and the law deprives such repurchased shares of any incidents of ownership. The Second Circuit concluded that the transactions are, therefore, not in any equity security, which cannot be paired and without pairable transactions, there is no liability.

Third, the Second Circuit concluded that plaintiff could not establish that there was "profit realized" from the non-pairable transactions because the defendant insider lacks an expenditure to subtract from any return. The Second Circuit reasoned that without such a cost basis, there is no excess, there is nothing to disgorge and no liability.

Notes

1. This article limits its discussion to the facts of the first captioned case because, "[t]he facts in these two cases are parallel, and the legal theory advanced in them, identical."
2. Section 16(b) requires corporate insiders to disgorge to any issuer with which they have an insider relationship all profits (the so-called short swing profits) that they realize from paired purchases and sales, within a six-month period, of any equity security of that issuer.
3. Roth v. LAL Family Corp., 138 F.4th 696 (2d Cir. 2025) (Jacobs, J.).
4. The first entity is the sole general partner of the family's second business entity, an LP, which in turn controls the Delaware corporation. Through the two business entities, the family are beneficial owners of more than 10 percent of the Delaware corporation's outstanding Class A common stock and have an approximately 23 percent indirect pecuniary interest in it.
5. In Gibbons v. Malone, 703 F.3d 595 (2d Cir. 2013), the Second Circuit clarified that in analyzing whether particular equity securities meet the definition of "any equity security" "[w]hat matters is whether securities are substantively identical in that they are 'economically equivalent,' however they may be denominated."