

Ninth Circuit Provides Guidance on SEC Rule 16b-3 Short-Swing Profit Liability Exemption

Article By:

John P. Stigi III

John J. Mysliwicz

In [*Roth v. Foris Ventures, LLC*](#), Nos. 22-16632, 22-16633, 2023 U.S. App. LEXIS 30081 (9th Cir. Nov. 13, 2023), the [United States Court of Appeals for the Ninth Circuit](#) partially reversed the dismissal of a shareholder derivative suit seeking to recover disgorgement of short-swing profits under [Section 16\(b\)](#) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The three-judge panel held that the district court erred in holding that the company's board was required to approve the stock sale transactions for the specific purpose of exempting it from Section 16(b) liability pursuant to [Securities and Exchange Commission](#) ("SEC") [Rule 16b-3\(d\)\(1\)](#). The Court's decision provides a board of directors with more latitude to approve securities transactions by Section 16 reporting persons without risk of liability under the short-swing profits rule.

Short-swing profits occur when a company insider buys and sells stock within a six-month period. Section 16(b) imposes liability for such trading practices based on the theory that company insiders are presumed to have material, nonpublic information during such short periods. Under Section 16(b), shareholders may file suit on

behalf of the company for disgorgement to the company of the profits derived from these transactions. However, SEC Rule 16b-3 exempts liability under Section 16(b) when an issuer's board approves the stock sale transaction at issue.

Between April 2019 and January 2020, Foris Ventures LLC ("Foris"), a 10% beneficial owner of Amyris controlled by Amyris board member, John Doerr, entered several transactions involving Amyris securities. Each of the transactions was approved by the Amyris board of directors. The derivative suit, brought by shareholders of Amyris, Inc., alleges that Doerr and several others, through Foris, obtained short-swing profits from the sale of Amyris securities by reason of these board-approved transactions. Plaintiff alleged that the defendants earned at least \$6.4 million in short-swing profits.

Defendants moved to dismiss arguing that the transactions were exempt from liability under 16b-3. The [United States District Court for the Northern District of California](#) denied the motion, holding that the Rule 16b-3 exemption did not apply in this instance because the Amyris board did not approve the transactions with the specific purpose of exempting Section 16(b) liability. The district court relied upon an SEC no-action letter in its order. Defendants sought and obtained leave to file an interlocutory appeal.

At issue before the Ninth Circuit was whether Rule 16b-3 requires a board of directors to approve a transaction with the *specific purpose* of exempting it from liability. The court held that it does not: "Simply put, nothing in the regulation indicates that the board must approve the transaction for the specific purpose of exempting it from Section 16(b) liability."

The Ninth Circuit's decision follows the [Second Circuit](#)'s opinion

in *Gryl v. Shire Pharms. Grp, PPL*, 298 F.3d 136 (2d Cir. 2002). There, the Court also held purpose-specific approval was not necessary for the Rule 16b-3 exemption to apply. The Ninth Circuit noted, as did the Second Circuit did in *Gryl*, that SEC no-action letters “constitute neither agency rule-making nor adjudication and thus are entitled to no deference beyond whatever persuasive value they might have.”

The panel held, however, that the district court did not err in holding that the board was aware of Doerr’s indirect pecuniary interest in the transactions when granting approval. The panel observed that SEC filings showed that the board considered Doerr’s indirect ownership in Foris when approving the transactions.

Still at issue in the case is whether Foris, which is not a director, is eligible for exemption. Plaintiff argued that Section 16(b) does not permit beneficial owners, such as Foris, from liability under the Rule 16b-3 exemption. The panel has remanded the case to the district court for further proceedings to determine whether Foris was a “director by deputization.” Nonetheless, the opinion makes clear that under Rule 16b-3 a board is not required to approve a transaction for the specific purpose of exempting it from liability.

Copyright © 2024, Sheppard Mullin Richter & Hampton LLP.

National Law Review, Volumess XIII, Number 321

Source URL: <https://www.natlawreview.com/article/ninth-circuit-provides-guidance-sec-rule-16b-3-short-swing-profit-liability>