Client Alert.

March 27, 2012

Supreme Court Rejects Open-Ended Tolling of Section 16(b) Claims

The Supreme Court yesterday limited the ability to bring short-swing profit claims years after the alleged improper trading, in *Credit Suisse Securities (USA) LLC v. Simmonds*, No. 10-1261 (U.S. Mar. 26, 2012). The Court split 4-4 on the question of whether equitable tolling even applies to the two-year period for bringing claims under Section 16(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as Chief Justice Roberts did not participate in the decision. The Court thus effectively left that issue open for another day. Nevertheless, the eight-Justice Court held unanimously that, assuming the two-year period can be extended, the tolling rules articulated by the Ninth and Second Circuits impermissibly deviated from ordinary equitable tolling principles.

BACKGROUND

Simmonds confronted the intersection of Section 16(a) and Section 16(b) of the Exchange Act. Section 16(a) imposes disclosure obligations on certain insiders. Anyone who directly or indirectly owns more than 10% of any equity security (subject to certain exemptions), or who is an officer or director of the issuer of such a security, must file statements with the Securities and Exchange Commission disclosing that person’s beneficial ownership. The disclosure statements, filed on Form 4, must also be updated in the event of a change of ownership.

Section 16(b), in turn, imposes a form of strict liability on certain insiders that trade in corporate securities. The statute creates a civil action that permits a corporation, or any security holder of that corporation on the corporation’s behalf, to bring suit against an officer, director, or beneficial owner of more than 10% of a publicly held corporation who realizes any profits from the purchase and sale, or sale and purchase, of the corporation’s securities within any six-month period. Section 16(b) states that “no such suit shall be brought more than two years after the date such profit was realized.”

The plaintiff, daughter of one of her lawyers who purchased her shares years after the events in question, filed 55 nearly identical actions in 2007 under Section 16(b) against investment banks that had underwritten various initial public offerings between 1998 and 2000. In each case, she alleged that the investment banks, as an underwriting group, had been the beneficial owner of more than 10% of the stock of the issuing company, and thus subject to the requirements of Section 16(b). The defendants did not file disclosure statements and denied that they were required to do so. The district court dismissed the claims as time-barred, concluding that the plaintiff had known all the facts necessary to bring suit for at least five years before filing.

The Ninth Circuit reversed. Applying its rule from *Whittaker v. Whittaker Corp.*, 639 F.2d 516 (9th Cir. 1981), the court of appeals held that the two-year limitations period does not begin to run until the filing of the Section 16(a) disclosure.

The Supreme Court granted review on whether the two-year limitations period is subject to equitable tolling and, if so, whether tolling continues even after the receipt of notice of the facts giving rise to the action.

THE DECISION

Without the participation of the Chief Justice, the Court divided equally on whether equitable tolling applies to Section 16(b) claims. *Simmonds* thus affirmed, "without precedential effect," the Ninth Circuit's ruling that permits equitable tolling of Section 16(b) claims.

The eight-Justice Court nevertheless reversed the Ninth Circuit by rejecting the so-called *Whittaker* rule. Despite plaintiff's argument that tolling the statute until a Section 16(a) filing was necessary to enforce Section 16(a), the Court held that the *Whittaker* rule was inconsistent with the plain language of Section 16(b), observing, "Congress could have very easily provided that 'no such suit shall be brought more than two years after the *filing of a statement* [under Section 16(a)]' . . . . But it did not."

The Court also found that even though the *Whittaker* rule was labeled as one of equitable tolling, the rule was "completely divorced from long-settled equitable tolling principles." For instance, the *Whittaker* rule would permit tolling to continue beyond the point at which a plaintiff becomes aware of the facts underlying his or her claim, even though it is well-established that equitable tolling ceases when the facts underlying a claim are or should have been discovered by a diligent plaintiff.

Justice Scalia, writing for the Court, explained that the *Whittaker* rule was inequitable and inconsistent with the general purpose of limitations periods. He stressed that, under the *Whittaker* rule, defendants with plausible arguments as to why they are not subject to Section 16(a)'s filing requirements nevertheless would be compelled "either to file or face the prospect of §16(b) litigation in perpetuity."

In a footnote, the Court also rejected the Second Circuit's equitable tolling standard, articulated in *Litzler v. CC Investments, L.D.C.*, 363 F.3d 203 (2d Cir. 2004). That standard would permit tolling until a plaintiff had "actual notice that a person subject to Section 16(a) has realized specific short-swing profits that are worth pursuing."

Simmonds did not go the next step and apply general tolling principles to the facts alleged. Instead, the Court remanded for the lower courts to consider, in the first instance, how the usual rules of equitable tolling apply.

TAKE AWAY

Simmonds is the latest example of the Supreme Court defining the scope of private rights of action under the federal securities laws. *Simmonds*, like the Supreme Court's recent decisions in *Janus Capital Group Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), and *Morrison v. National Australia Bank Ltd*., 130 S. Ct. 2869 (2010), favored strict statutory interpretation over judge-made rules to define the scope of private rights of action.

Given the 4-4 split on whether equitable tolling principles even apply, *Simmonds* winds up leaving Section 16(b) open to further case-by-case adjudication by judges. Lower courts now will have to decide how traditional principles of equitable tolling apply, and may consider anew whether equitable tolling should even apply to Section 16(b). If the opportunity presents itself, one of these cases may again wind up in the Supreme Court. If no Justice is recused, there may be five who interpret the limitations provision as one of repose.

The views expressed here are those of the authors. In the Supreme Court in *Simmonds*, Morrison & Foerster submitted an amicus brief supporting reversal on behalf of the Chamber of Commerce of the United States of America and the Securities Industry and Financial Markets Association. Morrison & Foerster was also court appointed liaison counsel for the issuer defendants in *In re IPO Securities Litigation*, in the Southern District of New York, based on the same factual allegations asserted in *Simmonds*.

To view the Court's opinion, click here.

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