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Supreme Court Considers Tolling of Statute of Limitations in Section 16(b) Claims

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On November 29, the United States Supreme Court heard oral argument in *Credit Suisse v. Simmonds*, No. 10-1261,[1] a case concerning the statute of limitations for claims brought under Section 16(b) of the Securities and Exchange Act of 1934. Section 16(b) provides for the disgorgement of profits earned by insiders (and those who own more than ten percent of any class of any equity security registered pursuant to the 1934 Act) from short-swing transactions in publicly traded securities. The case asks the Court to decide whether and under what circumstances the two year statute of limitations period is subject to tolling.

Section 16(a) requires that a director, an officer, or a beneficial owner of more than ten percent of a class of registered equity securities disclose all securities transactions to the Securities and Exchange Commission. 15 U.S.C. § 78p(a). Section 16(b) permits a corporation (or a shareholder on behalf of the corporation) to bring suit to recover "short-swing" profits from the purchase or sale of securities within a six-month period by a person subject to Section 16(a). 15 U.S.C. § 78p(b). Subsection (b) also specifies that no suit under this subsection "shall be brought more than two years after the date such profit was realized." *Id.*

Two Circuit courts have ruled on the question of the statute of limitations under Section 16(b). The Ninth Circuit in the case now before the Supreme Court held that "the Section 16(b) statute of limitations is tolled until the insider discloses his transactions in a Section 16(a) filing, regardless of whether the plaintiff knew or should have known of the conduct at issue." *Simmonds v. Credit Suisse Sec. (USA) LLC*, 638 F.3d 1072, 1095 (9th Cir. 2011). The Second Circuit has held that the two-year limitations period is subject to tolling "only until the claimant or (depending on the circumstances) the company gets actual notice that a person subject to Section 16(a) has realized specific short-swing profits that are worth pursuing." *Litzler v. CC Invs.*, 362 F.3d 203, 208 (2d Cir. 2004).

CASE BACKGROUND

In 2007, Plaintiff Vanessa Simmonds brought suit under Section 16(b) in order to recoup profits realized by investment banks (the "underwriters") through "short-swing" trades between 1999 and 2000 made in connection with the initial public offerings ("IPOs") at fifty-four issuing companies.[2] She filed fifty-four derivative complaints alleging that

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[1] Simpson Thacher & Bartlett LLP represents certain of the Petitioners before the Supreme Court in *Simmonds* and in related proceedings in other courts.

[2] Section 16(b) authorizes a shareholder to bring a derivative suit on behalf of the corporation after adequate demand on the corporate issuer of securities has been improperly rejected.

underwriters coordinated their activities with insiders at the issuing companies in order to profit from trades in the issuing companies' stock after the IPOs. As the district court had found in dismissing the complaints, her complaints were based on the same factual allegations of alleged laddering tie-ins, underpricing of IPOs, profit sharing and overly optimistic research recommendations that had been made in over 1,000 complaints publicly filed in 2001 in *In Re Initial Pub. Offering Sec. Litig.,* 241 F. Supp. 2d 281, 293-294 (S.D.N.Y. 2003), and that had been the subject of news reports and SEC releases, and settlements. Applying the notice approach to the limitations period, the district court granted the underwriters' motions to dismiss because "all of the facts giving rise to Ms. Simmond's complaints against the [u]nderwriter [d]efendants were known to the shareholders of the [i]ssuer [d]efendants for at least five years before these cases were filed." *In re Section 16(b) Litig.,* 602 F. Supp. 2d 1202, 1217 (W.D. Wash. 2009).

On appeal, the Ninth Circuit reversed the decision of the district court, relying on *Whittaker v. Whittaker,* 639 F.2d 516 (9th Cir. 1981). In *Whittaker,* the court held that the corporation could recover all short-swing profits at issue within a five-year trading period, including profits obtained long after the corporation was on notice of the insider's trading. The Ninth Circuit in *Simmonds* explained that it had already "held unequivocally that 'the disclosure interpretation is the correct construction of [Section] 16.'" *Simmonds,* 638 F.3d at 1095 (citing *Whittaker,* 639 F.2d at 527). The Ninth Circuit rejected the underwriters' attempts to distinguish *Whittaker* and explained as follows: "[A]ll of [defendants'] arguments are variations on a single theme—Simmonds knew or should have known of the alleged wrongful conduct many years before she filed her [c]omplaints. But despite the [d]efendants' arguments, the central holding of our opinion in *Whittaker*—both in our legal analysis and our application of the law to the facts of that case—is that the Section 16(b) statute of limitations is tolled until the insider discloses his transactions in a Section 16(a) filing, regardless of whether the plaintiff knew or should have known of the conduct at issue." *Id.*

Judge Smith wrote both the Ninth Circuit's decision and a separate concurrence in which he explained that an interpretation of Section 16(b)'s two-year time limit as a period of repose was supported by many factors. First, a "straightforward textual reading" of the statute provides for a "firm bar against Section 16(b) suits filed more than two years after the transaction is completed." *Id.* at 1099. Second, he noted that legislative history reinforced this interpretation because it was "reasonable to infer that the House negotiators, in reaching a compromise with the Senate over the inclusion of a private right of action [under Section 16], might have bargained to include a stringent statute of limitations to circumscribe that right of recovery." *Id.* at 1100. Third, Judge Smith explained that the period of repose construction was "eminently logical" because "it ma[de] no sense to allow individuals to be hauled into court years—or even decades—after they unintentionally violate Section 16 …[and that] *Whittaker* creates the possibility that 'a claim that affects long-settled transactions might hang forever over honest persons.'" *Id.* (citing *Litzler*, 362 F.3d at 208 n.5).

The *Simmonds* Petitioners asked the Supreme Court to reverse the Ninth Circuit's decision on the ground that the two-year time limit in Section 16(b) is a period of repose that cannot be extended. Brief for Petitioners, Credit Suisse Sec. (USA) LLC v. Simmonds, 2011 WL 3678807 (U.S. Aug. 18, 2011) (No. 10-1261). Respondent asked the Supreme Court to affirm the Ninth Circuit's rule that tolling ends only upon compliance

with the disclosure requirements in Section 16(a). Brief for Respondent, Credit Suisse Sec. (USA) LLC v. Simmonds, 2011 WL 4500810 (U.S. Sept. 26, 2011) (No. 10-1261). The United States filed an amicus brief, contending "Section 16(b)'s two-year limitations period is equitably tolled until a reasonably diligent security holder knows or should know the facts underlying his claim." *See* Brief for the United States as Amicus Curiae Supporting Neither Party at 9, Credit Suisse Sec. (USA) LLC v. Simmonds, 2011 WL 3780721 (U.S. Aug. 25, 2011) (No. 10-1261).

Chief Justice John Roberts recused himself from this case.

SUMMARY OF ORAL ARGUMENT

Petitioners argued that in accordance with the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360 n.5 (1991), the statute is "best read as a period of repose that can't be extended at all." Justice Ginsburg remarked that while *Lampf* involved two limits, one year from discovery and an outer limit of three years, Section 16(b) "seems to me a plain vanilla statute of limitations that is traditionally subject to equitable tolling."

Justice Kagan asked Petitioners to identify factors in Section 16(b) that made it a statute of repose. "[I]f you look at this provision, you would [not] think of this as anything other than an ordinary statute of limitations." Petitioners responded that Section 16(b) must be understood in terms of the structure of the Securities Exchange Act of 1934 as a whole. Because Section 16(b) "was enacted at the same time and as part of the same statute as [Sections 9(e) and 18(c)] that did use discovery provisions to shorten the time limit" and a "hard outer limit of repose for fraud claims," Petitioners asserted, Congress intentionally omitted a discovery provision for Section 16(b) and intended it to be a statute of repose. Petitioners also argued that the plain language of Section 16(b) shows the intent that it serve as a statute of repose by providing that "no action shall be brought more than two years *after the date such profit was realized*," (emphasis added) rather than two years after a subject profit is reported under Section 16(a) or otherwise discovered.

Justice Sotomayor raised the issue of disclosure. "[I]f Congress understood that some [alleged insiders] wouldn't do the statutory requirement and file in a timely manner, why wouldn't equitable tolling be a more appropriate way to look at this?" Petitioners responded that Section 16(b) should be viewed within the context of the 1934 Act, which includes provisions for intentional insider trading. "Congress would not have wanted to give repose to intentional fraudsters but not give repose to a defendant in a purely prophylactic Section 16(b) action." Justice Alito further asked, "[i]f [Section] 16(a) reports are not filed, how likely is it that a potential [Section] 16(b) plaintiff will find out within the 2-year period that there were these trades?" Petitioners responded that "they can find out in many ways, the same ways that any other securities plaintiff, including a fraud securities plaintiff, can find out," through corporate books and records, SEC filings, SEC investigations, other types of litigation, estate discovery, estate or divorce proceedings, whistle blowers, confidential informers, brokers, and counterparties.

The United States, as Amicus Curiae, argued that the Court "didn't say in *Lampf* that [the language of Section 16(b)] creates a statute of repose, full stop. It drew a structural inference by looking at both of the prongs [of the two-tiered structure in other securities

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- Justice Alito

actions] and comparing them to each other." To this point, Justice Scalia remarked that the United States had "understate[d] the … strength of the Petitioner's argument in…this regard." Justice Scalia stated that by comparing Section 16(b) to other statutory provisions with a time limit based on plaintiff's discovery of the facts underlying the claim, the "implication" is that Section 16(b) is a statute of repose.

The United States further argued that no "classic formulation" of a statute of repose has been prescribed because "courts always look to all the indicia of statutory meaning: [t]ext, context and structure. So the same language can create a statute of limitations or repose." The United States argued in favor of "the traditional equitable rule … [that] the statute is tolled until the plaintiff has actual or constructive notice of the facts underlying her claim. It doesn't matter whether [there has been] concealment of those facts by the defendant[.]" Justice Kagan asked whether any culpability of the defendant should be a relevant factor when making "considerations of equity." In particular, she asked about "a strong part of [Petitioner's] brief" which asserted that some alleged insiders may not comply with Section 16(a) because they believe it does not apply to them. The United States responded that the statute provided for strict liability and that "if the [Section 16(b)] plaintiff can sufficiently plead a case at the motion to dismiss stage under [Section] 16(b), by definition the plaintiff has sufficiently pleaded that the defendant violated a reporting obligation[.]"

Justice Alito asked Respondent about the text of the statute. "[Section 16(b)] tells you exactly when the time is supposed to begin to run … from the realization of the profit … [and] it doesn't begin to run from … the point when some other completely different external event occurs." Respondent contended that "[Sections 16(b) and 16(a)] are interrelated" and that Section 16(b) provides a period of limitations for those covered by Section 16(a). Because of this, Respondent argued that Petitioners' no-tolling argument ignored the purpose of Section 16(a) in favor of potential defendants. "The statute of repose contended for by [Petitioners] here would … run invisibly to all but the defendant …. This has … an attractiveness if you are the defendant, but it doesn't work well for the rest of us. No knowledge of a triggering event and [it's] running in the face of an affirmative statutory duty."

Justice Kagan described that particular scenario as "the most extreme position" and asked about the argument that the statute should be tolled "regardless of whether there's been a filing … if a reasonable person would have known, even if there were no filing, that's enough." Respondent pointed to the text of the statute. "[Section 16(a)] … is the discovery rule. Congress looked at this and commanded insiders to put the information in a particular location, so that shareholders who have the primary enforcement authority under [Section 16(b)] can go find it there."

Respondent further argued that Section 16(b) enforces the disclosure provision of Section 16(a) and it therefore follows that Section 16(b)'s statute of limitations should be tolled when an insider has not complied with Section 16(a). "[Section 16(b)] is unique" because "the plaintiff suffers no injury and recovers no damages." Because of this, the statute is "99% of the time irrelevant without a [Section 16(a)] filing. As a matter of logic, it makes no sense to provide the one who violates [Section 16(b)] an escape [from] liability because they also violate [Section 16(a)]."

"[A] very strong argument on [Petitioners'] side is [that if] Congress creates a statute of repose for intentional conduct like fraud, why should they not create a statute of repose for what is a strict liability statute?"

Justice Sotomayor

Justice Sotomayor then asked Respondent to "answer what I consider a very strong argument on [Petitioners'] side, which is [that if] Congress… creates a statute of repose for intentional conduct like fraud, why should they not create a statute of repose for what is a strict liability statute?" Respondent sought to differentiate between a fraud case and a Section 16(b) case. "The fraud case is all about … someone who has reason to know that they have been defrauded." By contrast, "[t]he [Section] 16(b) [p]laintiff has suffered no injury. It's critical to an understanding of what the Congress contemplated at the time." He explained that because plaintiffs would not know they were harmed, Congress created a "flat, sweeping, and arbitrary" rule to "squeeze every penny of profit out of these [short-swing] transactions[.]"

Justice Scalia said, "[t]he problem I have with your argument is, it's a very strange statute of limitations. Accepting that it is not a statute of repose, it says…you have 2 years after the…transaction that *was failed to be reported*. And you want to say … you have 2 years from the time *it was reported*. Congress would have said that. It's so easy to say that. Two years from the reporting" (emphases added). Counsel for Respondent conceded that Congress could have said this, but that the statute was unique in this regard.

"Accepting that it is not a statute of repose, it says you have 2 years after the transaction that was failed to be reported. And you want to say you have 2 years from the time it was reported. Congress would have said that."

Justice Scalia

IMPLICATIONS

The Ninth Circuit held that the two-year time limit for bringing an action under Section 16(b) may be indefinitely tolled even after the receipt of actual notice of the facts giving rise to the claim. Given the strict liability nature of Section 16(b), the Ninth Circuit's construction of that provision's time limit leaves the specter of liability hanging over potential defendants indefinitely. In *Simmonds*, the Supreme Court may provide definitive guidance on whether the two-year period is absolute, or subject to tolling under certain circumstances. The Court may also have an opportunity to offer additional clarity on determining whether a statutory limitations period is a traditional statute of limitations or a period of repose.

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