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CORPORATE & FINANCIAL WEEKLY DIGEST

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Court Provides Clarification on Short Swing Profit Rules

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The U.S. District Court for the Southern District of New York dismissed a claim brought under Section 16(b) of the Securities and Exchange Act of 1934, finding that the sale and purchase within six months of two different series of common stock traded under different ticker symbols and not otherwise convertible into one another or derivatives of one another did not constitute the "purchase and sale, or any sale and purchase, of any equity security" under Section 16(b) of the Exchange Act.

Plaintiff Michael Gibbons brought suit under Section 16(b) of the Exchange Act against John Malone and Discovery Communications, Inc. alleging that Malone, a former director of Discovery, engaged in insider trading by selling shares of Discovery's Series C Common Stock and separately purchasing shares of Discovery's Series A Common Stock during a two week period in December 2008. The plaintiff alleged that "for each share of Series A Stock purchased by Malone, a corresponding sale of Series C Stock was made at a higher price by Malone." Gibbons sought disgorgement of Malone's short swing profit.

The defendants, in their motion to dismiss for failure to state a claim upon which relief could be granted, argued that transactions in different series of stock were not subject to disgorgement of profits under Section 16(b). The court ultimately agreed and dismissed the claim. In so holding, the court made the following findings:

- The plain language of Section 16(b) requires that the purchase and sale be of the same equity security. The court noted that, while courts had previously held that the sale of a derivative of another security or securities convertible into each other or another security would constitute the sale of the same equity security, the securities at issue in this matter did not fall within any of the foregoing classifications.
- A high correlation or similarity in price is insufficient to establish that the two different series of securities should be treated as the same equity security for Section 16(b) purposes.

- Where, as here, two series of common stock have sufficiently different rights, they should not be considered part of the same class of equity security for Section 16(b) purposes. Notably, the series at issue in this matter had different voting and stock dividend rights, were not convertible into the other, were traded under different ticker symbols and the prices were not fixed such that they did not gain or lose value in unison.
- Plaintiff's policy argument that "[p]ermitting short-swing trading between voting and non-voting common stock would make evasion of Section 16 trivially easy" was not a sufficient policy argument to blur the "bright-line rule" established by Section 16(b).

Michael D. Gibbons v. John C. Malone and Discovery Communications, Inc., No. 10 Civ. 8640 (BSJ) (S.D.N.Y. August 8, 2011)

Click here to read the Memorandum and Order.

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