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Second Circuit Says that Insiders Are Still 'Standing' to Enforce Short-Swing Trading Under Section 16(b) of the Exchange Act

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On June 24, 2024, the U.S. Court of Appeals for the Second Circuit decided *Packer ex rel. 1-800-Flowers.com, Inc. v. Raging Capital Management, LLC*, reversing a district court decision that had held that a shareholder plaintiff bringing short-swing profits claims under Section 16(b) of the Securities Exchange Act of 1934 did not have constitutional standing as a result of the U.S. Supreme Court's decision in *TransUnion LLC v. Ramirez*.[1]

In the year since the *Packer* district court decision was issued, a consensus of other district courts had come out the opposite way and concluded that *TransUnion* did not abrogate Second Circuit precedent on the requirements for Article III standing in the Section 16(b) context. The U.S. Securities and Exchange Commission ("SEC") appeared as an *amicus curiae* in the *Packer* appeal to argue that affirming the *Packer* district court "would eviscerate Section 16(b)" because "few, if any plaintiffs, would be able to demonstrate standing, contrary to Congress's intent to create a broad cause of action."[2]

The Second Circuit's reversal settles uncertainty in Section 16(b) cases that had emerged since the initial *Packer* decision and gives Section 16(b) plaintiffs the green light to pursue claims (at least in the Second Circuit) unless and until the Supreme Court takes up the question.

Section 16(b) Short-Swing Liability

Congress enacted Section 16(b) in 1934 in response to widespread concern that insiders who "may have [had] access to information about their corporations not available to the rest of the investing public" were able to move quickly in and out of that corporation's securities and "reap profits at the expense of less well informed investors."[3]

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[1] *Packer ex rel. 1-800-Flowers.Com, Inc. v. Raging Cap. Mgmt., LLC*, No. 23-367, --- F.4th ----, 2024 WL 3092561 (2d Cir. June 24, 2024) ("*Packer* Appellate Decision") (citing *TransUnion LLC v. Ramirez*, 594 U.S. 413 (2021)).

[2] Br. of the SEC, *Amicus Curiae*, in Supp. of Pl.-Appellant at 9, *Packer ex rel. 1-800 Flowers.com, Inc. v. Raging Cap. Mgmt., LLC*, No. 23-367 (2d. Cir. filed June 29, 2023) (ECF No. 50) ("SEC *Amicus* Br.").

[3] *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 243 (1976); *see also Kern Cnty. Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 608 (1973) ("The congressional investigations that led to the

Once enacted, Section 16(b) created a pathway to require statutory insiders to disgorge the profits they made from short-swing trading. The statute defines insiders as officers, directors and 10% beneficial owners of the corporation.[4] And it defines short-swing trading as the purchase and sale of securities of the corporation at issue when such purchase and sale were made within a six-month period.[5]

One feature of Section 16(b) is particularly relevant here: Section 16(b) does not confer enforcement authority on the SEC but instead "recruits the issuer" or "its security holders" as its "policemen."[6] Specifically, Section 16(b) permits two types of plaintiffs to pursue relief: (1) the issuer of the security that was traded and (2) a shareholder of that issuer, but only in the event that the issuer fails or refuses to bring the suit within 60 days of a request by that shareholder.[7] Permitting a shareholder plaintiff to bring a Section 16(b) claim in these circumstances recognizes that a company may be conflicted in pursuing claims against its own insiders.

Article III Standing in Section 16(b) Actions

Article III of the Constitution limits federal courts to the adjudication of "cases" and "controversies." To meet the Article III requirement of a case or controversy, a plaintiff must demonstrate standing by showing "(i) that he suffered an injury in fact that is concrete, particularized, and actual or imminent; (ii) that the injury was likely caused by the defendant; and (iii) that the injury would likely be redressed by judicial relief."[8] The first requirement of Article III standing—concrete injury-in-fact—ensures that "a litigant [has] a direct stake in the controversy and prevents the [federal] judicial process from becoming no more than a vehicle for the vindication of the value interests of concerned bystanders."[9]

Congress conferred exclusive jurisdiction on the federal courts to hear Section 16(b) claims.[10] Accordingly, if a federal court holds that a Section 16(b) plaintiff does not have Article III standing for failure to show an injury-in-fact (or otherwise), that plaintiff could not then bring the same claim in state court.

A. Second Circuit Law Under *Bulldog*

The Second Circuit's leading case on assessing Article III standing and its injury-in-fact requirement for Section 16(b) claims—which predates the Supreme Court's *TransUnion* decision—had been *Donoghue v. Bulldog Investors General Partnership*.[11]

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enactment of the Securities Exchange Act revealed widespread use of confidential information by corporate insiders to gain an unfair advantage in trading their corporations' securities.").

[4] 15 U.S.C. § 78p(b).

[5] *Id.*

[6] *Donoghue v. Bulldog Invs. Gen. P'ship*, 696 F.3d 170, 174 (2d Cir. 2012) (citing 15 U.S.C. § 78p(b)).

[7] 15 U.S.C. § 78p(b).

[8] *TransUnion*, 594 U.S. at 423.

[9] *United States v. Students Challenging Regul. Agency Procs. (SCRAP)*, 412 U.S. 669, 687 (1973).

[10] 15 U.S.C. § 78aa(a).

[11] 696 F.3d 170 (2d Cir. 2012).

The Second Circuit in *Bulldog* affirmed a judgment in favor of the shareholder plaintiff, rejecting the defendants' argument that the plaintiff could not demonstrate any injury to the issuer resulting from that trading.[12] *Bulldog* explained that Section 16(b)

> confer[s] on securities issuers a legal right, one that makes 10% beneficial owners constructive trustees of the corporation with a fiduciary duty not to engage in short-swing trading of the issuer's stock …. It is the invasion of this legal right, without regard to whether the trading was based on inside information, that causes an issuer injury in fact and that compels our recognition of plaintiff's standing to pursue a § 16(b) claim here.[13]

Bulldog acknowledged that "[w]hile this particular legal right might not have existed but for the enactment of § 16(b), Congress's legislative authority to broaden the injuries that can support constitutional standing is beyond dispute."[14] With this in mind, the Second Circuit drew upon an analogy developed by Judge Learned Hand in a 1951 Second Circuit decision between the harm redressed by Section 16(b) and that redressed by the claim of breach of trusts at common law:

> Judge Hand observed that "[n]obody is obliged to become a director, an officer, or a 'beneficial owner'; just as nobody is obliged to become the trustee of a private trust; but, as soon as he does so, he accepts *whatever* are the limitations, obligations and conditions attached to the position, and any default in fulfilling them is as much a 'violation' of law as though it were attended by the sanction of imprisonment."
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> Thus, pursuant to § 16(b), when a stock purchaser chooses to acquire a 10% beneficial ownership stake in an issuer, he becomes a corporate insider and thereby accepts "the limitation[]" that attaches to his fiduciary status: not to engage in any short-swing trading in the issuer's stock. At that point, injury depends not on whether the § 16(b) fiduciary traded on inside information but on whether he traded at all.[15]

B. The *TransUnion* Decision

In 2021, *TransUnion* expanded on prior Supreme Court precedent that had rejected the theory that Article III standing automatically exists where a statute provides for the plaintiff's standing. As the Supreme Court explained, "we cannot treat an injury as 'concrete' for Article III purposes based only on Congress's say-so."[16] Congress may "'elevate' harms that 'exist' in the real world before Congress recognized them to actionable legal status, [but] it may not simply enact an injury into existence."[17]

Under *TransUnion* (and certain of its predecessor decisions), federal courts have an independent obligation to decide whether a plaintiff has suffered a concrete harm under Article III even if that plaintiff has statutory

[12] *Id.* at 172.

[13] *Id.* at 179 (cleaned up).

[14] *Id.*

[15] *Id.* at 177 (quoting *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir. 1951)) (emphasis and alterations in original).

[16] *TransUnion*, 594 U.S. at 426 (internal citation omitted).

[17] *Id.* (internal citation omitted).

standing to sue.[18] What that inquiry requires depends on the type of harm at issue. "[T]raditional tangible harms," such as when "a defendant has caused physical or monetary injury to the plaintiff"—will "readily qualify."[19] On the other hand, *TransUnion* explained, "[v]arious intangible harms can also be concrete. Chief among them are injuries with a close relationship to harms traditionally recognized as providing a basis for lawsuits in American courts. Those include, for example, reputational harms, disclosure of private information, and intrusion upon seclusion."[20]

The Supreme Court's application of this principle to the allegations of intangible harm in *TransUnion* is illustrative: The plaintiffs had brought a class action under the Fair Credit Reporting Act, with some plaintiffs asserting that misleading versions of their credit reports were provided to third-party businesses and others asserting that their credit files contained misleading alerts that were not disseminated to any third parties.[21] The Court held that the first category of plaintiffs, those whose misleading reports were disclosed, had Article III standing because they alleged a concrete injury analogous to the harm associated with the tort of defamation.[22] The second category of plaintiffs, whose credit files were not disseminated to third parties, lacked Article III standing because their claims based on the "retention of information lawfully obtained, without further disclosure" were not analogous to traditional harms.[23]

C. The District Court's Decision in *Packer*

The complaint in *Packer* alleges that the defendants were 10% beneficial owners of a class of 1-800-Flowers.com, Inc. ("1-800-Flowers") common stock and that they made both purchases and sales of 1-800-Flowers within a six-month period.[24] Packer, another holder of 1-800-Flowers common stock, brought suit on behalf 1-800-Flowers seeking disgorgement of the short-swing profits.[25]

The district court in *Packer* held that *Bulldog* did not survive *TransUnion*, reasoning that

> the notion in *Bulldog* that a violation of Section 16(b) *alone* sufficiently confers Article III standing upon the issuing corporation or derivative shareholder without more, cannot co-exist with *TransUnion*'s pronouncement that a statutory violation and a cause of action *alone* are insufficient to support Article III standing without a showing of concrete harm to the plaintiff. In that respect, *Bulldog* cannot be squared with *TransUnion* and *TransUnion* controls.[26]

[18] *Id.*

[19] *Id.* at 425.

[20] *Id.* (internal citations omitted).

[21] *Id.* at 432–34.

[22] *Id.* at 432–33.

[23] *Id.* at 433–39.

[24] *Packer* District Court Decision, 661 F. Supp. 3d at 8.

[25] *Id.* at 8 & 13 n.10

[26] *Id.* at 17 (emphasis in original).

The district court acknowledged that for "intangible harms," the "bedrock of the concrete injury inquiry is whether the alleged injury has a close relationship to a harm 'traditionally' recognized as providing a basis for a lawsuit in American court."[27]

As to Packer's claim, the court concluded that because Packer failed "to point to or articulate any actual reputational harm" or other "actual injury allegations" accruing to 1-800-Flowers, Packer lacked Article III standing under *TransUnion*.[28]

The Second Circuit's Decision in *Packer*

Packer appealed the district court decision. In addition to the parties' briefs, the SEC filed an *amicus* brief in support of plaintiff's position that standing exists. The Second Circuit heard argument on May 6, 2024, and defendants-appellees conceded at the argument that they would necessarily lose if *TransUnion* did not abrogate *Bulldog*.

The Second Circuit issued its decision reversing the district court on June 24, 2024. The Second Circuit identified "several errors" with the district court's decision.[29]

First, the Second Circuit held *TransUnion* did not abrogate *Bulldog* because *Bulldog*'s analysis of the harm in Section 16(b) cases correctly identified, as *TransUnion* and its predecessors required, "'a close historical or common-law analogue for the[] asserted injury' to support constitutional standing."[30] As the Second Circuit explained:

> Just as a common-law fiduciary who deals with the trust estate for his own personal profit must account to the beneficiary for all the gain which he has made, a statutory fiduciary who engages in short-swing trading owes its gains to the corporation under Section 16(b). The deprivation of these profits inflicts an injury sufficiently concrete to confer constitutional standing.[31]

Second, although both the Second Circuit and district court acknowledged that plaintiff Packer did "not base his standing argument on a risk of harm,"[32] the district court suggested that "some courts have framed the concrete harm associated with a Section 16(b) violation as grounded in the risk of harm," which, in its

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[27] *Id.* at 10.

[28] *Id.* at 14.

[29] *Packer* Appellate Decision, 2024 WL 3092561, at *4-7. In addition to its substantive analysis, the Second Circuit held that it was error for the district court in *Packer* to "preemptively declar[e] that our caselaw has been abrogated by intervening Supreme Court decisions," rather than follow binding precedent until it has been overturned, except in "rare case[s]" unlike the one at hand. *Id.* at *4-5 & n.36. The Second Circuit further noted that *TransUnion*'s requirement of a concrete injury for constitutional standing even in the context of a statutory violation derived from an earlier Supreme Court decision, *Spokeo Inc. v. Robins*, 578 U.S. 330, 340-41 (2016), and that the Second Circuit had already reaffirmed *Bulldog* after *Spokeo*, in *Klein v. Qlik Technologies, Inc.*, 906 F.3d 215, 220 (2d Cir. 2018). *Packer* Appellate Decision, 2024 WL 3092561, at *5.

[30] *Id.* at *5 (quoting *TransUnion*, 594 U.S. at 424) (alteration in original).

[31] *Id.* (internal quotations and citations omitted).

[32] *Id.* at *6; *Packer* District Court Decision, 661 F. Supp. 3d at 15 n.13.

view, was insufficient under *TransUnion*.[33] The Second Circuit dispelled any notion that Section 16(b) standing was dependent on a risk of harm theory, explaining that the "concrete injury that confers standing on Packer is, as we recognized in [*Bulldog*], 'the breach by a statutory insider of a fiduciary duty owed to the issuer not to engage in and profit from any short-swing trading of its stock.'"[34]

The Second Circuit noted that defendants-appellees' remaining arguments attacked *Bulldog* itself, which the Circuit was bound to follow unless vacated *en banc* or by the Supreme Court. It nonetheless addressed a few of those arguments, including the argument that the defendants-appellees in the *Packer* case specifically could not be fiduciaries "because they did not exercise control over [the issuer], sit on its board of directors, or trade on inside information."[35] The Second Circuit in *Packer* embraced *Bulldog*'s response to this argument: While Section 16(b) may have been enacted to combat trading on inside information, the legal right enacted to remedy that wrong—imposing a fiduciary duty on 10% shareholders, irrespective of their actual access to information, to eschew any short swing trading—was broader.[36]

Takeaways from the Second Circuit's *Packer* Ruling

The Second Circuit's ruling in *Packer* should not cause shockwaves among federal courts, particularly because the vast majority of courts addressing the standing issue in the year since the district court decision in *Packer* have held that *TransUnion* and *Bulldog* are reconcilable and that plaintiffs have constitutional standing to assert Section 16(b) claims.[37] However, as the SEC noted, the ramifications of the potential

[33] *Packer* District Court Decision, 661 F. Supp. 3d at 13.

[34] *Packer* Appellate Decision, 2024 WL 3092561, at *6.

[35] *Id.* at *6 n.55.

[36] *Id.* The Second Circuit also noted that *TransUnion* did not require that the statutory right "exact[ly] duplicate" its common-law analogue, so this broadening was not improper. *Id.* (quoting *TransUnion*, 594 U.S. at 433).

[37] *See, e.g.*, *Roth v. Armistice Cap., LLC*, No. 1:20-CV-08872 (JLR), 2024 WL 1313817, at *10 (S.D.N.Y. Mar. 27, 2024) (Rochon, J.) (holding that plaintiff has standing because "breach of trust, by itself, is a concrete intangible injury"); *Augenbaum v. Anson Invs. Master Fund LP*, No. 22-CV-249 (AS), 2024 WL 263208, at *4 (S.D.N.Y. Jan. 24, 2024) (Subramanian, J.) (holding that Section 16(b) violations "are breaches of trust, which satisfies *TransUnion*'s search for a traditional injury" (cleaned up)); *Microbot Med., Inc. v. Mona*, No. 19-CV-3782 (GBD)(RWL), 2024 WL 564176, at *6 (S.D.N.Y. Jan. 30, 2024) (Lehrburger, M.J.) ("Microbot incurs a concrete injury while deprived of the constructive trust's holdings. Microbot therefore has Article III standing."), *report and recommendation adopted*, No. 19-CV-3782 (GBD)(RWL), 2024 WL 964594 (S.D.N.Y. Mar. 5, 2024) (Daniels, J.) ("Because *Bulldog* determined that § 16(b) plaintiffs suffer concrete harm analogous to the common law injury of breach of trust, *Bulldog* is compatible with *TransUnion*'s requirement that a plaintiff has suffered a harm with "a close historical or common-law analogue." (cleaned up)); *Avalon Holdings Corp. v. Gentile*, No. 18-CV-7291 (DLC), 2023 WL 4744072, at *6 (S.D.N.Y. July 25, 2023) (Cote, J.) ("[T]he Second Circuit in *Bulldog* analyzed the harm suffered by a § 16(b) plaintiff and reasoned that it was akin to the common law injury of breach of trust arising from the 10% beneficial owner's fiduciary duty to the issuer."); *Safe & Green Holdings Corp. v. Shaw*, No. 23-CV-2244 (DLC), 2023 WL 5509319, at *2 (S.D.N.Y. Aug. 25, 2023) (Cote, J.) (incorporating *Avalon*); *Revive Investing LLC v. Armistice Cap. Master Fund, Ltd.*, No. 20-CV-02849 (CMA)(SKC), 2023 WL 5333768, at *8 (D. Colo. Aug. 18, 2023) ("The Court finds that a harm suffered by a Section 16(b) plaintiff is analogous to the common law injury of breach of trust.").

One decision, *Avalon Holdings Corp. v. Gentile*, noted that the plaintiff's "pleadings describe dramatic fluctuations in stock prices caused by the defendants' trading and illegally obtained profits accruing to

adoption of the *Packer* district court's conclusion were possibly huge because requiring a plaintiff to allege "actual reputational harm" flowing from a Section 16(b) breach (as the district court in *Packer* had) "would undercut Congress's purpose by making actions to recover short-swing profits almost impossible."[38]

For Section 16(b) plaintiffs, the Second Circuit will remain a popular venue to file their claims, as they will be assured of getting past the standing question (absent an *en banc* hearing or Supreme Court intervention) and venue is often present as a result of listing on a New York-based exchange. For Section 16(b) defendants, while the standing argument will not work in the Second Circuit (again, absent *en banc* or Supreme Court intervention), the remaining toolkit for the procedural and merits-based defense against Section 16(b) claims is otherwise unchanged.

the defendants in the millions of dollars," which established "the concrete harm that Congress elevated to a legally cognizable injury." 2023 WL 4744072, at *6.

We identified only one decision that followed the *Packer* district court and concluded that a Section 16(b) plaintiff had no standing. *Forte Biosciences, Inc. v. Camac Fund, LP*, No. 3:23-CV-2399-N, 2024 WL 2946584, at *3 (N.D. Tex. June 11, 2024). This decision from outside of the Second Circuit (where *Bulldog* is not binding) did not contain any reasoning, stating only that "Forte does not plead any injury to itself from the alleged section 16(b) violation." *Id.* (citing the *Packer* District Court Decision and *TransUnion*).

[38] SEC *Amicus* Br. at 25.

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