Securities Regulation Daily Wrap Up, EXCHANGES AND MARKET REGULATION—S.D.N.Y.: Court rejects plaintiff's short swing profit theory in case against Icahn, (Mar. 24, 2016)

Securities Regulation Daily Wrap Up

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By Kevin Kulling, J.D.

A federal court has dismissed a stockholder's attempt to recover short-swing insider trading profits that were obtained upon the cancellation of put options by several entities in which investor Carl Icahn and related entities held an ownership interest. The court said that under Exchange Act Rule 16b-6, the Icahn entities that cancelled put options within six months of writing them were required to disgorge profits only up to the amount of the premium received by the writer of the put (*Olagues v. Carl C. Icahn*, March 23, 2016, Woods, G.).

Complaint. John Olagues alleged that Icahn and related entities, including High River Limited Partnership, Icahn Partners LP, and Icahn Partners Master Funds, understated the short swing profit they received upon the cancellation of certain put options. Exchange Act Section 16(b) and Rule 16b-6(d) applies to directors, officers and beneficial owners of more than 10 percent of any class of equity security of the issuer. The Rule states generally that any profit realized by an insider from any purchase or sale of any equity security (including derivatives) within any period of less than six months shall be recoverable by the issuer.

In his complaint, Olagues alleged that the Icahn entities failed to disgorge short-swing profits they obtained from derivative transactions involving Herbalife, Ltd., Hologic, Inc., and Nuance Communications.

In ruling on Icahn's motion to dismiss, the court concentrated on transactions involving Herbalife. As alleged in the complaint, the Icahn defendants entered into agreements in which they acquired both puts and corresponding calls for Herbalife stock. The premium paid to Icahn for writing the puts was $0.01 per share. The put and call options acquired by Icahn were structured so that the put options would expire immediately if the corresponding call options were exercised. Approximately two weeks after they entered into each of the put and call agreements, Icahn exercised the call options and, pursuant to the put and call option agreements, all of the put options were cancelled or expired.

The cancellation of the put options generated short-swing profits for Icahn. Both parties agreed that Icahn reimbursed the company the amount of the premium received, or $0.01 per share.

Plaintiff's theory. Olagues asserted that the correct measure of profits was not the $0.01 premium received, but included "an additional consideration" which they failed to report.

He arrived at this conclusion by "deconstructing the integrated put and call agreements into their separate component parts," the court said. Then he priced the separate elements, using information available for similar open market trades. He then compared the prices with those embedded in Icahn's transactions. Having done so, the court said, he assessed the premium Icahn charged for the puts to be too low, and that the exercise price for the call options was too low. He concluded that the amounts the Icahn entities reported receiving from the writing of the put options did not reflect the true premium consideration obtained, as the amounts reported did not include the discounts, offsets, or deductions obtained on the premiums paid for the call options.

Court: "A bridge too far." The court rejected Olagues' theory, saying that "the chain of counterfactual hypotheses, assumptions, and inferences that form the basis of plaintiff's claim is a bridge too far to establish that Defendants must disgorge more in profits than they already have—maybe five or six bridges too far."

The court noted that the application of Section 16 is purposely largely mechanical. “Acceptance of Plaintiff’s approach would engender in every case the kind of ‘battle of the experts’ that the SEC sought to avoid when it promulgated the 1991 regulations.”

Profits limited to premiums. Recognizing that no amount was paid to Icahn other than the $0.01 per share, the court said that the plaintiff attempts to reframe the rule to require reimbursement of premium consideration obtained instead of premium received.

The court granted Icahn’s motions to dismiss all three actions with prejudice and without leave to replead the claims, because, the court said, any attempt to replead the claims on the theoretical basis asserted by plaintiff would be futile.

The case is No. 15-cv-0898.

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Companies: High River, LP; Icahn Partners, LP; Icahn Partners Master Fund LP; Icahn Partners Fund II, LP; Icahn Partners Fund III, LP

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