Securities Regulation Daily Wrap Up, DIRECTORS AND OFFICERS—9th Cir.: SEC urges reversal of short-swing trading decision, (May 2, 2023)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

Board approval is all that is required for a transaction to be exempt from short-swing profit recovery, the SEC argues in an amicus brief.

In an amicus brief before the Ninth Circuit, the SEC weighed in when a transaction may be subject to recovery as an insider short-swing trade. According to the SEC, the district court misinterpreted a staff letter when it held that for a transaction to be exempt from clawback, the board of directors must state that it is approving the transaction for the purpose of the exemption. Furthermore, the exemption is not available to beneficial owners unless they are a "director by deputization," which is an issue of fact on which the SEC takes no position (*Roth v. Foris Ventures, LLC*, February 10, 2023).

A shareholder of Amyris, Inc., sued on behalf of the corporation to recover short-swing profits accruing to an Amyris director, John Doerr, and his wholly-owned company, Foris Ventures, LLC (itself a 10 percent beneficial owner of Amyris). Doerr and Foris moved to dismiss on the ground that the transactions were exempt from clawback as short-swing trades, but the district court denied the motion.

The SEC argues that the district court erred in two respects. First, it improperly held—based on a nonbinding SEC staff interpretive letter—that the defendants must show the board's approval of the transaction was for the purpose of exempting the transactions from Section 16(b). Second, in certifying its order for interlocutory appeal, the district court incorrectly stated that if the Ninth Circuit held that there was no "purpose-specific approval" requirement, the short-swing trading exemption would apply, requiring dismissal.

Purpose-specific approval. Rule 16b-3(d)(1) exempts from clawback profits on transactions that are "approved by the board of directors of the issuer." The SEC disclaims the idea that this exemption is conditioned on the board's intention to satisfy the exemption. The basis for the exemption is that the board's approval demonstrates the company's acknowledgement and accountability for the transactions. This means the transaction is likely to be motivated by legitimate corporate objectives, not by an attempt to profit from inside information.

The district court erred in relying on the nonbinding 1999 staff interpretive letter. The Commission had repudiated the staff's position in a 2002 amicus brief before the Second Circuit, which in turn held that there was no requirement of purpose-specific approval. The SEC does agree with the staff that the board must understand the existence and extent of an insider's indirect pecuniary interest in order to exempt that interest from potential disgorgement. Whether the board in this case did so is a factual question on which the SEC takes no position.

Director by deputization? The short-swing trading exemption does not extend to beneficial owners like Foris. Therefore, the district court erred when it said that the Ninth Circuit would necessarily have to dismiss the case if it held there was no purpose-specific approval requirement. While Foris could qualify for an exemption, it would only be if the entity was an officer or director at the time of the transactions. To do so, Foris would have to establish that it had deputized Doerr, a director of Amyris, to act on Foris's behalf.

This, again, fits with the purpose of the exemption to "rest on the safety provided by the issuer's knowledge of its own affairs." That depends on the issuer understanding that the person with whom it is transacting is a director by deputization through a named director. Foris is not a named director, but would be a "director by deputization" if it actually functioned as a director through its deputy, Doerr. Again, the SEC takes no position on this factual question.

The case is No. 22-16632.

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Companies: Foris Ventures, LLC

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