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CORPORATIONS--SECTION 16 (b) OF SECURITIES EXCHANGE ACT-SHORT SWING PROFITS-STATUTE OF LIMITATIONS

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CORPORATIONS—SECTION 16 (b) OF SECURITIES EXCHANGE ACT—SHORT SWING PROFITS—STATUTE OF LIMITATIONS—Plaintiffs brought a shareholders' class action under section 16 (b) of the Securities and Exchange Act of 1934¹ alleging that defendant, an officer, director, and substantial stockholder of the corporation, had realized profits from trading in the corporation's securities within a six-month period and had fraudulently concealed such profits by failing to file the statement required by section 16 (a)² of the act until after suit was instituted against him over four years later by the S.E.C., thereby delaying plaintiff's discovery of the facts. Defendant moved for dismissal on the ground that suit was not brought within the two-year period as prescribed by section 16 (b), and also on the ground that plaintiffs commenced suit before the expiration of the sixty-day period after notice and demand upon the corporation as provided in section 16 (b).³ *Held*, motion denied. Fraudulent conceal-

¹ 15 U.S.C. (1940) § 78 p (b).

² *Id.*, § 78 p (a).

³ On the latter ground the court ruled against defendant; plaintiff need not wait sixty days where he can show it would have been futile. *Kogan v. Schulte*, (D.C. N.Y. 1945) 61 F. Supp. 604. See also 46 MICH. L. REV. 99 (1947), and Yourd, "Trading in Securities by Directors, Officers and Stockholders: Section 16 of the Securities Exchange Act," 38 MICH. L. REV. 133 at 152 et seq. (1939).

ment by an insider of profits realized within a six-month period tolls the two-year limitation provision of the statute. *Grossman v. Young*, (D.C. N.Y. 1947) 72 F. Supp. 375.

Section 16 of the Securities Exchange Act provides for recovery by the corporation of "short swing" profits of directors, officers, and substantial shareholders in their own companies' securities to prevent unfair profits by insiders.⁴ A duty of prompt disclosure is put on officers, directors, and substantial stockholders by section 16 (a).⁵ The provision of section 16 (b) making "short-swing" profits recoverable by the corporation without regard to the insider's intent or the circumstances under which the trading was carried on has been held no denial of due process.⁶ Such a right of action is beyond any right known to the common law;⁷ the statute creating such right imposes specific limitations on its exercise, one of which is a two-year period within which the action must be brought.⁸ Statutes of limitation may be tolled by defendant's fraud or concealment.⁹ Where, however, a statute creating a new cause of action contains in itself a statute of limitation, the limitation imposed becomes an integral part of the right of action created. This has been held to limit both the remedy and the liability, so that suit cannot be brought upon expiration of

⁴ Where a company has securities registered on a national securities exchange, 16 (a) requires every person who is a beneficial owner of over 10 per cent, or who is a director or officer of the issuer owning such securities, to file statements showing amount owned and changes in ownership with the exchange and S.E.C. at time of acquisition or change. Section 16 (b) provides that profits realized by insiders from purchase and sale or sale and purchase of such securities shall inure to and be recoverable by the issuer irrespective of the insider's intention. "Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring suit within sixty days after request . . . but no such suit shall be brought more than two years after the date such profit was realized." 15 U.S. (1940) § 78 p (b).

⁵ This established a new standard of conduct for those in control of companies with securities listed on a national exchange. Prior to 1934 directors and officers were generally held not to occupy a trust relation to individual stockholders as such and might deal with the latter at arm's length. *Carpenter v. Danforth*, 52 Barb. (N.Y.) 581 (1868). A fiduciary relation was held to exist in a few jurisdictions with a duty on director or officer not to withhold information from the stockholder. *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232 (1903). An intermediate view was followed by federal and some state courts; although no fiduciary relation exists, duty to disclose may arise under "special circumstances." *Strong v. Repide*, 213 U.S. 419, 29 S.Ct. 521 (1909).

⁶ *Smolowe v. Delendo Corp.*, (C.C.A. 2d, 1943) 136 F. (2d) 231.

⁷ *Pottish v. Divak*, (D.C. N.Y. 1947) 71 F. Supp. 737 at 738; noted 46 MICH. L. REV. 99 (1947).

⁸ For the application of statute of limitations in stockholder's derivative suit against directors or officers generally, see 123 A.L.R. 346 (1939).

⁹ *Traer v. Clews*, 115 U.S. 528, 6 S. Ct. 155 (1885). But laches will prevent application of this doctrine. *United States v. Diamond Coal Co.*, 255 U.S. 323, 41 S. Ct. 335 (1921). See Dawson, "Undiscovered Fraud and Statutes of Limitation," 31 MICH. L. REV. 591 (1933), and Dawson, "Fraudulent Concealment and Statutes of Limitation," 31 MICH. L. REV. 875 (1933).

the time fixed by statute, whatever the cause of delay.¹⁰ This may also apply to a period of limitations imposed by a statute separate from that creating the right but referring expressly to it.¹¹ In some instances, however, the exception has been applied to statutes both creating and limiting the right.¹² This was the position taken by way of dictum in a recent United States Supreme Court decision¹³ relied on in the principal case.¹⁴ Inasmuch as defendant's alleged concealment was in itself a violation of section 16 (a), as well as an effective obstruction to suit within the period prescribed by section 16 (b), the decision would seem justified on its facts.¹⁵ Refusal of the court to make the two-year limitation an absolute bar to liability, despite its inclusion in the statute creating the liability, would seem equally justified in view of the dominant purpose of section 16 in preventing insiders' profits.¹⁶

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¹⁰ 37 C. J., *Limitation of Actions*, 974 (1925); *The Harrisburg*, 119 U.S. 199, 7 S. Ct. 140 (1886). Time fixed by Federal Employers Liability Act cannot be extended by fraud which might affect extension of ordinary limitations: *Bell v. Wabash Ry.*, (C.C.A. 8th, 1932) 58 F. (2d) 569; *Damiano v. Penn. R. Co.*, (C.C.A. 3d, 1947) 161 F. (2d) 534 (app. pending). *Partee v. St. Louis and S.F.R. Co.*, (C.C.A. 8th, 1913) 204 F. 970, 51 L.R.A. (n.s.) 721 (1914) (*Wrongful Death Act*); *Pollen v. Ford Instrument Co., Inc.*, (C.C.A. 2d, 1940) 108 F. (2d) 762 (patent infringement suit). State decisions generally adhere to this view. *Bigelow v. Otis*, 267 Mich. 409, 255 N.W. 270 (1934) (*Michigan Securities Act*); *Tillinghast v. Reed*, 70 R.I. 259, 38 A. (2d) 782 (1944) (*Wrongful Death Act*).

¹¹ *Davis v. Mills*, 194 U.S. 451 at 454, 24 S. Ct. 692 (1903).

¹² *Bailey v. Glover*, 21 Wall. (88 U.S.) 342 (1874) (*Bankruptcy Act of 1867*); *American Tobacco Co. v. People's Tobacco Co.*, (C.C.A. 5th, 1913) 204 F. 58 (*Sherman Act*); *Exploration Co., Ltd. v. United States*, 247 U.S. 435, 38 S. Ct. 571 (1918) (statutory limitation on suits to vacate land patents).

¹³ *Holmberg v. Armbrrecht*, 327 U.S. 392 at 397, 66 S.Ct. 582 (1946), 162 A.L.R. 719 at 723 (1946).

¹⁴ Principal case at 378.

¹⁵ For an interesting prediction of the statutory construction problem faced by the court, see Rubin and Feldman, "Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders," 95 UNIV. PA. L. REV. 468 at 474 (1947). The authors cite *Holmberg v. Armbrrecht*, 327 U.S. 392 at 397, 66 S. Ct. 582 (1946), as a possible guide to solution.

¹⁶ For discussion of a class action under 16 (b), see 46 MICH. L. REV. 99 (1947), note on *Pottish v. Divak*, (D.C. N.Y. 1947) 71 F. Supp. 737; see also *Grossman v. Young*, (D.C. N.Y. 1947) 70 F. Supp. 970.