

DISTRICT COURT HOLDS THAT EQUITY AWARD SHARE WITHHOLDING EXEMPT UNDER 16B-3

Hodgson Russ Newsletter
June 29, 2017

Practices & Industries

Employee Benefits

The U.S. District Court for the Southern District of Texas recently dismissed a shareholder's lawsuit alleging that Section 16(b) of the Securities Exchange Act of 1934 was violated when insiders made nonexempt purchases of the issuer's stock within six months of having shares withheld to satisfy the income tax withholding associated with restricted stock units awarded to the insiders. Under the shareholder's interpretation of Section 16(b), unless share withholding to satisfy income tax withholding or the exercise price of an option is mandatory (as opposed to permissive) under the terms of an equity plan, any share withholding by an insider would be required to be "matched" with any non-exempt purchase made by the insider within six months of the share withholding, resulting in the insider being required to repay to the issuer any short-swing profit realized by the insider.

The District Court rejected the shareholder's argument that Rule 16b-3 exempts share withholding only if the withholding is mandatory under the terms of the plan. However, it should be noted that, to rely on the Rule 16b-3 exemption, an elective share withholding right must generally have been approved in advance by the board of directors or a committee of the board of directors that is comprised solely of two or more non-employee directors (in general, the compensation committee). *Jordan v. Flexton* (S.D. Tex).