

Nosirrah Management, LLC v. AutoZone, Inc.,
(W.D. Tenn. April 14, 2025)

May 2025

Distribution of Insider Stock to Satisfy GRAT Annuity Payment Is Not a “Purchase” Under the Section 16(b) Short-Swing Profits Rule If the Insider is the Grantor, Trustee, and Annuitant of the GRAT; No Mention of Existence of Swap Power in Final Order Dismissing the Case

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1. Brief Synopsis

William Rhodes III (Defendant) created a GRAT that gave him a power of substitution for fair consideration (generally referred to as a swap power). The plaintiff alleged that Defendant was a company insider who received distributions of AutoZone, Inc. stock from the GRAT in satisfaction of a required annuity payment and subsequently sold AutoZone stock within six months for a profit, so the profit should be disgorged under Section 16(b) of the Securities Exchange Act of 1934. The plaintiff brought this derivative action on behalf of AutoZone. A difficulty with plaintiff's argument is that a prior SEC No-Action Letter (*Peter J. Kight* SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997)) ruled that the creation of a GRAT and subsequent return of stock to the settlor in satisfaction of annuity payments satisfied the Rule 16a-13 Exemption for a transaction "that effects only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities" and therefore was not a "purchase" under Section 16(b) where the individual was the settlor, trustee, and beneficiary. Defendant filed a motion to dismiss arguing that he was the settlor, trustee, and beneficiary of the GRAT and should therefore satisfy the "mere change of form and no change in pecuniary interest" exemption as in the *Peter J. Kight* SEC No-Action Letter. The plaintiff responded that a distinction was that the Defendant held a swap power, and it is not clear whether the individual in the *Peter J. Kight* SEC No-Action Letter also held a swap power.

In an Order issued on November 15, 2024 (the 2024 Order), the court denied the motion to dismiss, reasoning that the Defendant had not submitted evidence that he was the settlor, trustee, and beneficiary, and therefore could not establish that the "mere change of form and no change in pecuniary interest" exemption applied. However, the 2024 Order also had language suggesting that the exemption might not apply because of the mere existence of the swap power in the GRAT, even if the swap power was not exercised, and could somehow cause the distribution in satisfaction of the annuity to become a purchase that could trigger the short-swing profits rule. The 2024 Order was problematic for planners because most planners have assumed that the mere existence of a swap power (without exercising it) would not cause a GRAT annuity distribution to a settlor, trustee, and beneficiary to be a "purchase" under Section 16(b).

Following the submission of evidence that the court said was lacking in the 2024 Order, the court entered an Order on April 14, 2025 (the 2025 Order), granting in part and denying in part motions for summary judgment by the plaintiff and defendant, with the result that the case was dismissed. The court determined that the plaintiff had standing to bring the action but determined that the distributions of stock in satisfaction of the GRAT annuity payments satisfied the "mere change of form and no change in pecuniary interest" exemption for what constitutes a "purchase" under Section 16(b) where the individual was the settlor, trustee, and annuitant. The Order includes a detailed analysis of each of the "no change of pecuniary interest" and "mere change of form of beneficial ownership" elements of the exemption. The 2025 Order has absolutely no mention whatsoever of the existence of the swap power in the GRAT instrument, which ameliorates concerns the 2024 Order created regarding the inclusion of a swap power in a GRAT for an insider. Furthermore, it is very positive news; it is a court Order, rather than just an SEC No-Action letter, to support the application of the "mere change of form and no change in pecuniary interest" exemption to distributions of insider stock in satisfaction of GRAT annuity payments.

Nosirrah Management, LLC v. AutoZone, Inc., Case No. 2:24-cv-2167 (W.D. Tenn. April 14, 2025).

2. General Background Regarding Effect of Section 16(b) Short-Swing Profits Rule on GRAT Planning

Section 16(b) of the Securities Exchange Act of 1934 permits recovery by a corporation of insider trading profits made within a 6-month period. Liability under Section 16(b) requires proof of (1) a purchase and (2) a sale of securities (3) by an officer or director of the issuer or by a shareholder who owns more than ten percent of any one class of the issuer's securities (4) within a six-month period. An exemption under Rule 16a-13 states that "[a] transaction ... that effects only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject securities shall be exempt from [Section 16(b)]."

Section 16(b) may apply in the context of GRATs in several different situations. A contribution to a GRAT is arguably a “sale,” and a distribution of insider stock in satisfaction of the annuity payment is arguably a “purchase” by the grantor. If a corporate insider funds a GRAT with the corporation's stock, will the return of some of the stock to the grantor (in satisfaction of an annuity payment) trigger a 6-month insider trading test period? A 1997 SEC No-Action Letter held that the creation of a GRAT and subsequent return of stock to the grantor in satisfaction of annuity payments will “effect only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities.” Mr. Kight was the settlor, trustee, and beneficiary of the GRAT during the annuity period of the GRAT. Accordingly, such a transaction would be ignored for §16(b) purposes under that No-Action Letter. *Peter J. Kight*, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 77,403 (Oct. 16, 1997).

A Section 16(b) liability issue could also arise if a GRAT distributes insider stock to the insider-annuitant and the insider sells stock within 6 months. Plaintiff in *AutoZone* alleges that the distribution of stock from the GRAT in satisfaction of a required annuity payment was a “purchase” by the insider, and that the insider sold stock within six months of that purchase at a profit, and therefore, the profit must be disgorged. The issue is whether the distributions of stock in satisfaction of the annuity payments are “purchases” under Section 16(b) or whether they are exempt transactions.

Several cases have addressed exercises of swap powers in this context. If the grantor/corporate insider **exercises** a power to substitute property of equal value for some of the stock in a GRAT during its term, one court held that the substitution constitutes a “purchase” for §16(b) purposes, thus creating a six-month period during which any profits from subsequent sales of such stock would have to be disgorged to the corporation. *Morales v. Quintiles Transnational Corp.*, 25 F. Supp. 2d 369 (S.D. N.Y. 1998). The case was appealed to the Second Circuit Court of Appeals, but was settled prior to hearing, and the appeal was withdrawn.

In *Donoghue v. Smith*, 2022 U.S. Dist. LEXIS 76071; 2022 WL 1225338 (S.D. N.Y. April 26, 2022), a company insider created a GRAT, exercised a swap power to acquire company stock, and sold company stock within six months. The insider was not the trustee or beneficiary of the GRAT (perhaps the annuity term had ended). The “mere change of form and no change in pecuniary interest” exemption did not apply, and the insider was forced to disgorge the profits on the short-swing sale.

In *Dreiling v. Kellett*, 281 F. Supp. 2d 1215, 1244 (W.D. Wash. 2003), the court imposed a \$247 million damage award, as a result of determining that distributions from a GRAT constituted a “sale.” See generally Ellen Harrison, *Case Studies – Implementing Bright Ideas*, 38th ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING ¶1902.5 (2004).

No prior case has held that the **mere existence** of a swap power would cause the “mere change of form and no change in pecuniary interest” exemption not to apply.

3. 2024 Order – Evidentiary Issue

The court entered an order dated November 15, 2024 (the “2024 Order”) refusing to dismiss the action. The primary rationale of the court seemed to be the absence of evidence in the proceeding up to that point that the insider was the trustee and beneficiary of the GRAT.

[T]he Court considers Defendant's citation to the Complaint and finds it does not support his statement regarding his grantor, trustee, and beneficiary status. ... There is ... no support in the Complaint regarding Defendant's trustee or beneficiary status.

Nor is Defendant's statement regarding his trustee or beneficiary status supported by any exhibits, public records, or other attachments.

...

... Defendant did not provide any proof of his trustee or beneficiary status. Defendant's argument regarding his pecuniary interest status, a key element of the Rule 16a-13 exemption ... relies on his trustee and beneficiary status.

...

However, Defendant cannot show he had a pecuniary interest in the AutoZone stock when it was in the GRATs, as his statement regarding his trustee and beneficiary status cannot be considered.

...

Defendant's beneficial ownership argument fails for the same reason as its pecuniary interest argument—it is based on his status as the "grantor, trustee, and sole lifetime beneficiary of the GRATs."

4. 2024 Order – Mere Existence of Swap Power

There is also language in the opinion suggesting that the mere existence of the swap power somehow also causes the exemption not to apply. In its attempt to distinguish the *Peter J. Kight* SEC No Action Letter, the court stated:

Here, however, "the 'opportunity' existed for [Defendant] to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically," [quoting *Morales v. Quintiles Transnat'l Corp.*], because there is a reasonable inference that Defendant could exercise his discretion by substituting the stock in the GRATs with other property of equal value.

In distinguishing *Morales* (which involved the actual exercise of a substitution power and subsequent sale of stock within six months), the court noted:

Defendant is mistaken, as the Quintiles court based its conclusion on the opportunity to exercise substitution, not the exercising of substitution itself: "Therefore, the 'opportunity' existed for Smith to abuse inside information by substituting property of equal value to get the GRAT shares back just before the shares appreciated drastically. The Kight letter is therefore inapplicable here." (quoting the *Morales* opinion)

Those were rather short references to the mere existence of the swap power, compared to the much longer discussion in the Order about the lack of evidentiary evidence to establish the applicability of the exemption.

5. 2025 Order Dismissing Case – Applying Exemption and Making No Mention of Swap Power

The court entered an Order April 14, 2025 (the "2025 Order"), granting in part and denying in part motions for summary judgment submitted by each of the parties and dismissing the case.

- a. **Standing.** Plaintiff Nosirrah Management, LLC brought this derivative action on behalf of the company that issued that stock pursuing disgorgement of the profits from short-swing trading by the defendant. The court determined that the plaintiff has constitutional standing to bring the suit, relying in large part on *Packer ex rel 1-800-Flowers Com. Inc. v. Raging Cap. Mgmt., LLC*, 105 F.4th 46, 53 (2d Cir. 2024), *cert denied* (U.S. 2024). In *Packer*, a shareholder brought a derivative suit on behalf of the issuer of the securities, and the court reasoned that Section 16(b) imposed a "fiduciary duty" on corporate insiders and "confer[red] on securities issuers 'an enforceable legal right to expect [the fiduciary] to refrain from engaging in any short-swing trading.'" The deprivation of this "enforceable legal right" inflicts an injury sufficiently concrete to confer standing.
- b. **Exemption – Pecuniary Interest Analysis.** The insider had an indirect pecuniary interest in the AutoZone stock when it was held in the GRATs because he "had the indirect opportunity to profit from AutoZone stock through his annuity payments." When securities were distributed to the insider in satisfaction of annuity payments, the insider "maintained a pecuniary interest in the securities, even as it shifted from an indirect to direct pecuniary interest." While the insider did not have the same pecuniary interest in the stock while in the trust and after it had been distributed in payment of the annuity, "[t]he form of the pecuniary interest is not important, as long as the pecuniary interest itself is not extinguished." The exemption refers to a change "in the form of beneficial ownership ... but not in the form of the pecuniary interest."
- c. **Exemption – Beneficial Ownership Analysis.** The insider had an indirect pecuniary interest in the AutoZone stock when it was in the GRATs, and after he required the stock in annuity payments he became a direct beneficial owner. He continued his beneficial ownership throughout, and after reacquisition of stock in annuity payments, "his beneficial ownership changed in form from indirect to direct." His children as remainder beneficiaries of the GRATs had no "power to exercise or share investment control over the GRATs ... [and] did not have beneficial ownership over the AutoZone stock."

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- d. **Conclusion.** The reacquisition of stock in annuity payments effected “only a change in the form of beneficial worship without changing [Defendant’s] pecuniary interest in the subject equity securities” and is exempted from being a “purchase” of securities under Section 16(b). The court dismissed the action with prejudice.
 - e. **No Mention of SWAP Power.** The 2024 Order had suggested that the mere existence of the swap power in the trust agreement, even if not exercised, could somehow treat the insider as having “purchased” stock because of the ability to exercise the power when desired. The court’s final Order makes no mention whatsoever of the swap power in the GRAT.

6. Planning Observations

- a. **Significance of 2024 Order for GRAT Planning.** The 2024 Order was merely the denial of Defendant’s motion to dismiss the case at an early stage of the proceeding, and the decision was primarily based on the lack of evidence that had been produced up to that point in the proceeding about whether the Defendant was trustee and (more importantly) the sole beneficiary of the GRAT during the period of the annuity term. Furthermore, treating the mere existence of a swap power as somehow constituting a “purchase” is not well reasoned. The 2025 Heckerling Recent Developments paper makes this observation: “Carlyn McCaffrey notes that the gist of the Rule 16a-13 exemption is that an insider’s economic position has not changed when the insider is the sole beneficiary of the GRAT and stock is used to satisfy the insider’s annuity interest. A power of substitution would not have any bearing on this central question.”

Even so, in planning a GRAT for a company insider, the 2024 Order suggests that a planner might consider using powers other than a swap power to confer grantor trust status on a GRAT.
- b. **Turnaround.** The 2024 Order was very concerning for planners advising insiders who create GRAT with the insider’s stock. It suggested that the GRAT should not include a substitution power as a way of assuring that the trust is a grantor trust because of the offhand comment in the Order (that was not central to the reason for denying the motion for summary judgment at that stage of the case). The 2025 Order dismissing the case does not even mention the swap power, ameliorating the concern of most planners about using swap powers in GRATs for insiders. To the contrary, the case is now very positive news; it is a court order, rather than just an SEC No-Action letter, to support the application of the “mere change of form and no change in pecuniary interest” exemption to distributions of insider stock in satisfaction of GRAT annuity payments as not constituting “purchases” under Section 16(b).
- c. **Use of LLC as a Possible Planning Alternative.** A planning possibility to minimize the risk of a Section 16(b) action is to transfer company stock to an LLC and to transfer interests in the LLC to the GRAT. While the transfer to the LLC would be reportable to the SEC, perhaps the transfer of member interests to the GRAT and from the GRAT as annuity payments would not be reportable.
- d. **Other Resources.** For further discussion of the securities laws implications for GRAT planning see Item 25 of Estate Planning Current Developments and Hot Topics for 2022 (December 2022) found [here](#) and available at www.bessemertrust.com/for-professional-partners/advisor-insights. For excellent discussions of securities law issues impacting estate planning issues, see Anna Pinedo, Jay Waxenberg, Daniel Hatten, *Securities Law Considerations for Estate Planners*, 48 ESTATE PLANNING 3 (Nov. 2021); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part I (Accredited Investors and Qualified Purchasers)*, TRUSTS & ESTATES 19 (July 2016); Arlene Osterhoudt & Ivan Taback, *Securities Law Considerations for Estates and Estates Advisors: Part II (Reporting and Short-Swing Profit Rules Applicable to Insiders)*, TRUSTS & ESTATES 24 (Mar. 2017).