BCLP. Client Intelligent

BCLPSecCorpGov.com

PAY ATTENTION TO THE COMPANY YOU KEEP: EMAILS FROM PRIVATE PLACEMENT AS EVIDENCE OF "GROUP" STATUS CREATING POTENTIAL SECTION 16(B) LIABILITY

Oct 14, 2025

WHAT HAPPENED

A recent decision from the Southern District of New York highlights the risks that multiple private placement investors working together will be deemed a single "group," exposing them to liability for claims that apply to acquirors of a 10 % interest in an issuer.

On September 30, 2025, Judge Arun Subramanian denied motions for summary judgment in *Augenbaum v. Anson Investments Master Fund LP et al.*, letting go to trial disgorgement claims against several funds that invested in a private placement.

The court found that coordinated behavior among the investors raised questions of fact for a jury as to whether they formed a 10% group for Section 13(d) of the Securities Exchange Act of 1934 ("Exchange Act"). Under Section 16(b) of the Exchange Act, 10% shareholders are subject to claims for disgorgement of short-swing profits. The plaintiff alleges the funds made profits of almost $500 million from trades between March and August 2020.

TAKEAWAYS

The decision, together with a loss in an earlier motion to dismiss in the same case (covered in our February 27, 2024 post), serves as warning to participants in private placements involving funding rounds with other investors. Where the aggregate beneficial ownership of the investors would exceed ten percent, care should be taken to minimize the risk that they would be deemed to have formed a group.

Group status is determined based on facts and circumstances, with courts considering a variety of factors. To reduce risk of aggregation of beneficial ownership, investors could consider the following actions:

- ***Diligence investor group.*** Investigate beneficial ownership of the issuer's shares by other investors, and any prior relationships with the issuer or its placement agent.

- ***Use safe harbor if available.*** For eligible passive institutional investors (13G exempt filers), utilizing Rule 13d-6(b)(2) can prevent group status based solely on "concerted actions" in an issuer private placement. Availability of the safe harbor depends on:
  - All members of the group being eligible passive institutional investors.
  - The purchase being made in the ordinary course of business without the purpose or effect of changing or influencing control of the company.
  - Investors having no agreement to act together except to facilitate the purchase in the private placement.
  - Post-closing actions among investors only relating to ministerial matters to complete the private placement.
- ***Act independently from other investors.*** Establishing the independence of each investor and its own trading strategy, including its decision to participate in the transaction.
  - This was a key factor in *Augenbaum* and one of the most difficult to address as it requires consistent, disciplined adherence to siloed communication channels.
  - In *Augenbaum*, the court rejected claims of independence by the funds based on emails and other communications among investors showing awareness of each other's participation. In addition, the placement agent revealed the identities of potential investors to each other.
- ***Retain and communicate with separate legal counsel.*** Using their own counsel instead of sharing one counsel, including separately communicating with the company and its counsel, weighs against a finding of a group. Having one counsel coordinate comments among investors is risky, particularly if not requested by the company.
  - The court in *Augenbaum* noted that the lead investor took charge without any prompting from the company, and that its counsel exchanged drafts and comments with other investors, not just its client.
  - By implication, the court appeared to believe counsel may have provided legal advice to other funds, not just the lead investor, and served as a channel for coordination.
- ***Use disclaimer of group status in agreements – but also act accordingly.*** Providing in the transaction agreements that the use of a single purchase agreement for multiple investors is for the convenience of the issuer and should not create a presumption that investors are acting as a group.

- In *Augenbaum*, the court cited evidence calling into question whether the investors had agreed to work together, as opposed to merely making parallel investments.

- ***Use blocker provision where appropriate.*** Including 9.9% blocker provisions in the terms of securities to avoid becoming a 10% stockholder.

- ***Delay exercisability to avoid beneficial ownership test.*** Delaying exercisability or convertibility of warrants or convertible notes, so that the underlying shares might not be deemed beneficially owned under the test in Rule 13d-3. Under this approach, securities would only become exercisable or convertible only (1) upon more than 60 days' notice, (2) until a later date when 10% status is no longer problematic, or (3) when the group would have less than 10%. However, under Rule 13d-3, this would not be effective if the securities are acquired with the purpose or effect of changing or influencing the control of the company.

- ***Time trades to avoid short-swing liability.*** Delaying any sales until six months or more following any matchable purchase, taking into account Rule 16a-2(c), which provides that the transaction that results in a person becoming a 10% stockholder is not subject to Section 16 unless the person is otherwise covered.

- ***Avoid coordination with investors' trading decisions.*** Making independent, non-coordinated decisions to subsequently convert or exercise securities and to sell any underlying shares. In CDI 110.02, the SEC staff advises that group membership terminates once members no longer agree to act together and a member that otherwise holds less than 10% is no longer subject to Section 16. However, in light of case law uncertainty, investors should carefully evaluate relevant facts with counsel before taking this position.

DEEPER DIVE

Section 16 rules provide that for purposes of determining 10% stockholder status, beneficial owner is determined pursuant to Section 13(d). Section 13(d) provides that a person can include a "group" formed for the purposes of acquiring, holding, voting or disposing of shares.

In *Augenbaum,* the plaintiff brought suit derivatively on behalf of the company, alleging that the investors constituted a group within the meaning of Section 13(d) and are therefore liable to disgorge "short-swing" profits.

Background. In March 2020, Genius Brands International, Inc. (now known as Kartoon Studios) entered into a securities purchase agreement (SPA) for a PIPE transaction with eleven institutional funds and an individual. It sold $13.8 million in secured convertible notes, convertible at $1.375 per share, and warrants to purchase 65 million shares of common stock, exercisable for five years at $.26 per share.

The company initially engaged an investment bank/placement agent to assist with restructuring its debt and conducting the private placement. The company negotiated a term sheet with a lead investor which in turn retained counsel to represent it in connection with the transaction. The placement agent then approached other potential investors, which included funds that previously invested in the company.

As required by Nasdaq rules, the company called a special meeting of stockholders to approve the issuance of more than 20% of its shares at a discount. Upon approval, the warrant exercise price would drop to $.21 per share.

Although contemplated by the agreement, it appeared the funds did not enter into voting agreements for the special meeting or individual lock-up agreements. They did, however, enter into master netting agreements relating to risk-sharing in the event of the company's bankruptcy.

During March through May 2020, the stock price rose and a number of the funds acquired additional shares from the company through a series of registered direct offerings at prices of $.2568, $.35, $.454 and $1.20.

At the May 15, 2020 special meeting, stockholders approved lowering the conversion price of the notes and the exercise price of the warrants to $.21.

Later, in May 2020, the company conducted another registered direct offering with most of the investors acquiring additional shares at $1.50 per share. The company also agreed to register the resale of the shares underlying the investors' warrants. In early June, the company registered the resale of 31 million shares underlying the warrants, with all the investors subsequently selling shares.

Later in June 2020, the investors agreed to convert their notes into shares and to refrain from selling those shares for less than $2 per share for thirty days, subject to an exception. In the second quarter of 2020, the investors converted their notes and exercised many of their warrants, acquiring approximately 100 million shares. In July, the company filed a resale prospectus covering 60 million shares issued upon conversion of the notes held by most of the investors. The stock price stayed above $2.00 during the relevant period.

In sum, the plaintiff alleged the investors made profits of almost $500 million from sales between March and August 2020.

Factors Creating Questions of Fact for Jury. The court found that the communications and coordination among the funds during the private placement and resales of shares could support an inference that they agreed to act as group, including:

- Numerous emails between the placement agent, the CEO and the funds leading up to the signing of the SPA and afterwards.

    - One email from the placement agent to the company and a fund discussed restructuring the company's debt, referencing the lead fund and another fund investing.
    - Other emails from the placement agent and/or the company discussed deal negotiations and how various funds were acting or planning to act.
- An internal memo of the placement agent (created for FINRA compliance) discussed a call from the lead investor and another investor asking about the company's willingness to sell shares off its shelf registration at $1.50.
- Communications among the placement agent, the lead investor and other investors before the signing of the SPA, including investors' responses to each other's comments through the placement agent.
- The entry into multiple leak-out agreements with the company by the investors in connection with subsequent offerings.

The court rejected various defenses raised by the investors:

- That the funds were competitors does not foreclose the possibility that the funds could agree to act as a group for these purposes.
- Although evidence of a lead draftsman is not conclusive of the existence of a group, in this case the funds knew of each other's investment plans in advance through emails from the placement agent. Further, counsel for the lead investor exchanged drafts and comments with other investors.
- Although the existence of a lockup agreement does not by itself establish a group, it can be evidence of a group's existence – particularly because, in this case, multiple successive agreements are alleged along with significant communications among investors.

At the same time, the court cautioned that several factors may mitigate against a jury finding of a group and instead potentially support a conclusion that the funds merely made parallel investments:

- The plaintiff claimed the terms of the SPA are non-standard, but the court was uncertain they were novel based on "dueling expert reports".
- The plaintiff alleged that the entry into various ancillary agreements in addition to the SPA serves as evidence of group behavior; however, the investors assert that they did not sign many of those agreements, such as a voting agreement and a lock-up agreement.
- The Second Circuit has held that a standard lock-up agreement, without more, does not establish a group.

On balance, the court concluded the record shows material questions of fact as to whether and when a group was formed and/or ended, holding that "credibility determinations and weighing of evidence . . . are best left for the jury."

RELATED CAPABILITIES

- Securities & Corporate Governance
- Securities Litigation and Enforcement

MEET THE TEAM

R. Randall Wang

St. Louis

randy.wang@bclplaw.com
+1 314 259 2149

Eric Rieder

New York

eric.rieder@bclplaw.com
+1 212 541 2057