Litigation Alert

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Southern District Allows SEC Insider Trading Case to Proceed, Distinguishing *Newman*

A recent decision from the United States District Court for the Southern District of New York allowing a U.S. Securities and Exchange Commission (SEC) civil enforcement action to proceed against two former stockbrokers for alleged insider trading violations sheds additional light on application of the 2nd Circuit's decision in *United States v. Newman*, No. 13-1837-cr(L) (2d Cir. Dec. 10, 2014). In the new decision, *SEC v. Payton*, No. 14 Civ. 4644 (S.D.N.Y. Apr. 6, 2015), Judge Jed S. Rakoff upheld the SEC's allegations that traders Daryl Payton and Benjamin Durant III of Euro Pacific Capital improperly traded software company SPSS, Inc.'s stock based on material nonpublic information regarding the company's pending acquisition by IBM. Payton and Durant allegedly received the tips from their Euro Pacific colleague Thomas Conradt, who in turn received them from his roommate, Trent Martin. Martin, in turn, originally learned of details regarding the IBM acquisition from a law firm associate working on the SPSS/IBM deal.

As previously reported, the 2nd Circuit's December 2014 *Newman* decision attempted to clarify and delineate the boundaries of insider trading liability in tipper-tippee scenarios by holding that: (1) the personal benefit provided to the tipper—which has long been recognized as a necessary precondition in order for tipper-tippee insider trading liability to attach—must amount to a potential gain to the tipper of a pecuniary or similarly valuable nature and must resemble a *quid pro quo*; and (2) a tippee must know that the insider received a personal benefit. The *Newman* decision has been the subject of much commentary and has led the government to abandon prosecution of some criminal cases in which the evidence of the personal benefit to the tipper, or the tippee's knowledge of the benefit, was deemed insufficient under *Newman*. Indeed, in February 2015, the U.S. Attorney's Office for the Southern District of New York dropped the criminal insider trading charges pending against defendants Payton and Durant in light of *Newman*.

The SEC, however, continued with its civil enforcement proceedings against these same defendants. In motion practice before Judge Rakoff, the SEC argued that *Newman* should be confined to criminal proceedings. Significantly, Judge Rakoff rejected this argument, holding that the principles of *Newman* apply to both criminal Department of Justice prosecutions **and** civil SEC proceedings. In his opinion, however, Judge Rakoff emphasized the different *mens rea* requirements for criminal and civil insider trading liability, with the former requiring willful or knowing conduct and the latter requiring only recklessness. The lower civil recklessness standard helped inform Judge Rakoff's assessment of the sufficiency of the pleaded facts before him in *Payton*.

In upholding the SEC's complaint, Judge Rakoff emphasized that the facts at issue in *Payton* were substantially different from those in *Newman*. He found that the SEC alleged a close and financially

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dependent relationship between Conradt and Martin, including Conradt's leadership in managing and negotiating their living expenses and Conradt's role in assisting Martin with a criminal legal matter. Martin allegedly thanked Conradt for such assistance while simultaneously making reference to profits realized by Conradt from the SPSS trading. The court concluded that these allegations were sufficient to suggest a *quid pro quo* and a cognizable personal benefit to Martin in exchange for the inside information. The court also found sufficient allegations of the downstream tippees' knowledge of these reciprocal benefits insofar as both Payton and Durant were alleged to be aware of the friendship and exchange of information between Conradt and Martin and were further alleged to have consciously avoided discovering additional details surrounding the tip. Additionally, the court noted that Payton and Durant took multiple steps to conceal their own trading in SPSS securities, which strengthened the inference of bad intent. As a result, the court denied the defendants' motion to dismiss the SEC's civil complaint.

The court's ruling may signal that *Newman* will have less of a limiting effect in the SEC civil enforcement context, where intent requirements are more relaxed, than in criminal cases. The impact of *Newman* in any particular case, however, will continue to turn heavily on the admissible evidence of a sufficient personal benefit and the downstream tippees' knowledge of the benefit. The *Payton* ruling also demonstrates that courts will be willing to distinguish the facts in *Newman*, as appropriate, when factual differences might meet the *Newman* standard, but this merely reflects the normal process of case-by-case adjudication. It must be remembered, moreover, that the *Payton* decision involved a motion to dismiss for which all facts alleged were assumed true and all reasonable inferences made in favor of the SEC. *Newman*, by contrast, was an appeal from judgments of conviction following a jury trial and the development of a fulsome factual record. At the very least, this recent decision underscores that, despite *Newman*, in cases with a sufficient evidentiary predicate, the government retains powerful tools, including civil enforcement, as a means of policing tipper-tippee theories of insider trading liability.

Contact Information

If you have any questions regarding this alert, please contact:

Michael A. Asaro
masaro@akingump.com
212.872.8100
New York

James Joseph Benjamin Jr.
jbenjamin@akingump.com
212.872.8091
New York

Joseph Boryshansky
jboryshansky@akingump.com
212.872.1054
New York

Robert H. Hotz Jr.
rhotz@akingump.com
212.872.1028
New York

Douglass B. Maynard
dmaynard@akingump.com
212.872.8075
New York

Bruce S. Mendelsohn
bmendelsohn@akingump.com
212.872.8117
New York

Douglas A. Rappaport
darappaport@akingump.com
212.872.7412
New York

Jason M. Daniel
jdaniel@akingump.com
214.969.4209
New York