Securities Regulation Daily Wrap Up, TOP STORY—E.D. Pa.: Duty not to trade on confidential information not limited in time, (Mar. 21, 2017)

Securities Regulation Daily Wrap Up

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By Rodney F. Tonkovic, J.D.

A district court has held that liability under the misappropriation theory of insider trading may be premised on a post-disclosure agreement. In this case, a hedge fund manager agreed not to trade on confidential information during at least one of three phone calls with a company executive. The court concluded that the misappropriation theory does not require an agreement not to trade to precede the disclosure of confidential information. To hold otherwise would be to legalize insider trading "by means of sequencing," the court said (*SEC v. Cooperman*, March 20, 2017, Sanchez, J.).

In September 2016, the SEC charged hedge fund manager Leon Cooperman with insider trading, alleging that he used his status as one of a company's largest shareholders to gain access to senior executives and obtain confidential information, which he then traded on. Cooperman was also charged with violating the beneficial ownership reporting requirements of the securities laws.

As of late 2009, Cooperman was the beneficial owner of more than nine percent of the common stock of Atlas Pipeline Partners, and had developed close relationships with APL's senior executives. According to the Commission, an unnamed APL executive told Cooperman during three phone conversations that the company was in the process of negotiating the sale of one of its operating facilities, which was a substantial asset. This executive believed that Cooperman had an obligation not to use this confidential information, and, moreover, Cooperman explicitly agreed that he would not do so.

Following his first conversation with the executive, however, Cooperman and his advisory firm, Omega Investors, began buying APL securities. APL's sale of the facility for $682 million was announced less than a month following Cooperman's first conversation with the executive, and APL's stock price rose 31 percent. The trades directed by Cooperman generated profits of over $4 million.

Timing. Cooperman's argument hinged upon the timing of his agreement not to use the confidential information supplied by the APL executive. The complaint, Cooperman maintained, was fatally flawed because it was silent as to whether the agreement occurred before or after the disclosure of information. The Commission countered that the misappropriation theory does not require that an agreement not to trade precede disclosure of the confidential information, as long as a duty of trust and confidence exists at the time the recipient trades on that information. According to the Commission, the agreement was made during one of the three calls, and, since at least some of the trading occurred after the agreement, the trades constituted insider trading.

The court sided with the SEC, noting that the question of whether liability under the misappropriation theory of insider trading may be premised on a post disclosure agreement is a novel issue. A plain reading of Rule 10b-5, the court said, indicates that a duty created by an agreement may arise at any time. Next, case law applying the misappropriation theory does not require an agreement not to trade to precede the disclosure of confidential information. The court also noted the principle that Section 10(b) and Rule 10b-5 should be interpreted broadly, and that Congress intended the securities laws to target exactly the type of deception in which Cooperman engaged. Finally, to accept Cooperman's argument would create a loophole in the SEC's enforcement scheme —"legalizing insider trading by means of sequencing"—that Regulation FD and Rule 10b5-2 were designed to close.

Venue. The court then dismissed the claims based on Cooperman's failure to timely file beneficial ownership reports for lack of venue. While two of the companies for which Cooperman failed to make the required filings

were within the Eastern District of Pennsylvania, the reports are required to be filed only with the SEC in the District of Columbia, making that the proper venue. The Commission also failed to sufficiently allege that Cooperman transacted business in the Eastern District of Pennsylvania.

The case is No. 16-5043.

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