UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16184

In the Matter of

JORDAN PEIXOTO

Respondent.

BRIEF OF POINTS AND AUTHORITIES IN SUPPORT OF RESPONDENT JORDAN PEIXOTO'S MOTION TO STAY

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PRELIMINARY STATEMENT

The United States Court of Appeals for the Second Circuit is poised to issue a decision on a controlling question of insider trading law that directly impacts liability in this proceeding. Specifically, the open question before the Second Circuit is whether the elements for tippee liability in an insider trading case includes that the tippee, such as Respondent in this case, must have knowledge that the "tipper" received a personal benefit in exchange for revealing material, non-public information in breach of a duty. Despite the Supreme Court's holding in *Dirks v. S.E.C.*, 463 U.S. 646 (1983), and its progeny in the Second Circuit—*see e.g. State Teachers Ret. Bd. V. Fluor Corp.*, 92 F. Supp. 592, 594 (S.D.N.Y. 1984) (Sweet, J.); *United States v. Santoro*, 647 F. Supp. 153 (E.D.N.Y. 1986) (McLaughlin, J.), *rev'd on other grounds*, *United States v. Davidoff*, 845 F.2d 1151 (2d Cir. 1988); *United States v. Rajaratnam*, 802 F. Supp. 2d 491, 498-99 (S.D.N.Y. 2011) (Holwell, J.); *United States v. Whitman*, 904 F. Supp. 2d 363 (S.D.N.Y. 2012) (Rakoff, J.); *United States v. Martoma*, No. 12 CR 973 PGG, 2014 WL 4384143, at *8 (S.D.N.Y. Sept. 4, 2014) (Gardephe, J.)—in *United States v. Newman*, No. 13-1837, and *United States v. Newman (Chiasson)*, No. 13-1917 (collectively,[1] *"Newman/Chiasson"*), the Department of Justice (the "Government") took the position during trial and on appeal that knowledge of the personal benefit was not a requirement for tippee liability. The Government argued that, with respect to personal benefit, it need only prove that the tipper *received* a personal benefit. The trial judge, Judge Sullivan, agreed with the Government's position and the *Newman/Chiasson* appeal ensued. For the reasons discussed herein, this appeal represents the most important Second Circuit review of insider trading liability of at least the past thirty years and there is every reason to expect the decision to be broad and encompassing in this area.

[1] The Second Circuit consolidated both appeals. In this Brief, we refer collectively to the joint appeal as "*Newman/Chiasson.*"

The Government took the position during appellate argument that tippee liability should be the same whether a classical insider trading case or a misappropriation case. *See* Exhibit A ("Ex. A") to the Declaration of Derrelle Janey ("Janey Declaration"), at 53. Along those lines, in seeking to fashion a bright-line rule, we anticipate the Second Circuit to make a decision about the elements of tippee liability that is agnostic of the underlying fraud theory. In other words, even though the case before the Second Circuit is a criminal matter presented on the classical theory of insider trading, we submit that the Second Circuit, based on the oral argument transcript, will likely issue a ruling that also has implications for civil enforcement actions, including such actions brought on a misappropriation theory, such as Respondent's case.

Implicit in the Second Circuit appeal is whether the trial judge in *United States v. Newman,* No. 12 CR 121 RJS, 2013 WL 1943342 (S.D.N.Y. May 7, 2013) (Sullivan, J.), reached a decision to effectuate a jury instruction on the elements of tippee liability that rests on a misreading of the Second Circuit's decision in *S.E.C. v. Obus*, 693 F.3d 276 (2d Cir. 2012). Judge Sullivan read *Obus* to hold that a tippee's knowledge of the tipper's exchange of information for personal benefit is not required to convict. *See* Exhibit K ("Ex. K") to Janey Declaration, at 34-35. On appeal, appellant put forth that five other district court judges in the Second Circuit disagree with Judge Sullivan on this point. *See State Teachers Ret. Bd. V. Fluor Corp.*, (Sweet, J.), *Santoro*, (McLaughlin, J.), *Rajaratnam*, (Holwell, J.), *Whitman*, (Rakoff, J.), *Martoma*, (Gardephe, J.). We expect this point of law to be clarified. Moreover, Respondent Peixoto has reason to believe that the Second Circuit will *also* clarify the nature of the personal benefit that is required for liability. The current legal discourse suggesting that personal benefit can be defined as furthering a friendship is "soft" and "squishy" in too many instances, which is a sentiment that is suggested by the discussion during oral argument on the *Newman/Chiasson*

appeal and in other recent district court cases in the Southern District of New York. *See* Ex. A to Janey Declaration, at 33-35, 57-58.

The OIP in this case charges Respondent Peixoto with committing insider trading based on information he received from a friend. Respondent's purported insider trading liability would thus be that of a tippee. The OIP in this case does not appear to allege that Mr. Peixoto knew of the personal benefit received by the tipper, Mr. Szymik. Thus, Respondent Peixoto's liability will turn, at least in part, upon the Second Circuit's *Newman/Chiasson* decision. Indeed, a Second Circuit finding that knowledge of tipper benefit is required could render the OIP facially insufficient.

During the *Newman/Chiasson* oral argument, the questions posed by the panel implied significant misgivings as to Judge Sullivan's view of the law. The panel expressed concern with the Government's inability, in the absence of a "knowledge of benefit" requirement, to articulate a bright-line rule that distinguishes between material non-public information upon which one may trade from impermissible material, non-public information. *See* Ex. A to Janey Declaration, at 31, 34, 49-50. Judge Parker pressed the Government to articulate the "the principle that criminalizes some information ... and makes virtually indistinguishable information innocuous." *Id.,* at 31.

In making this application, Respondent Peixoto merely asks this Court to do what other courts and the Commission itself has done: recognize the broad impact of the decision in *Newman/Chiasson* on insider trading cases by delaying proceedings until that decision is rendered. A civil case, a SEC initial decision, a SEC administrative proceeding, and a criminal sentencing have all been either stayed, placed in abeyance, or come under review in light of this appeal. For example:

- First, on March 29, 2013, the Division sued Mr. Steinberg in the Southern District of New York for insider trading. *See* Complaint, *SEC v. Steinberg*, No. 13-cv-2082 (HB) (S.D.N.Y. March 29, 2013). On May 8, 2014, after the *Newman/Chiasson* oral argument, Mr. Steinberg and the SEC jointly asked for the matter to be stayed. *See* Exhibit D to Janey Declaration. In their letter, the parties noted, *inter alia*, that the *Newman/Chiasson* panel "appeared to express skepticism as to the sufficiency of Judge Sullivan's jury instructions regarding downstream tippees" and that "if the Second Circuit reverses or vacates the convictions of Messrs. Newman and Chiasson, it likely will grant the same relief to Mr. Steinberg after his conviction is entered and appealed." *Id.* The Division and Mr. Steinberg therefore argued that moving forward in advance of a ruling in *Newman/Chiasson* would be "inefficient and unnecessarily burdensome." *Id.* The district court granted the parties' request for a stay. *See* Exhibit M to Janey Declaration.
- Second, on May 12, 2014, Anthony Chiasson petitioned the Commission to review Administrative Law Judge's initial decision to permanently bar him from the securities industry. *See* Exhibit E to Janey Declaration. On May 30, 2014, the Commission granted Chiasson's petition. *See* Exhibit N to Janey Declaraation. The Commission's review is ongoing and, as a result, the initial decision has not taken effect, and Mr. Chiasson has not been barred.
- Third, on March 29, 2013, Michael Steinberg was charged with insider trading. *See* Superseding Indictment, *United States v. Newman*, Case 1:12-cr-00121-RJS, Document 230 (March 29, 2013 S.D.N.Y). At Mr. Steinberg's trial, Judge Sullivan did not charge the jury that the defendant had to know that the insiders received a personal benefit. At Mr. Steinberg's May 16, 2014 sentencing, Judge Sullivan granted Mr. Steinberg's

unopposed motion for bail pending appeal, noting that the Second Circuit had "indicated" that the knowledge-of-benefit issue at the heart of the *Newman/Chiasson* and *Steinberg* cases "is a closer call than [he had] thought." *See* Exhibit C to Janey Declaration, at 53-54. On August 6, 2014, the Second Circuit held Mr. Steinberg's appeal in abeyance pending disposition of the *Newman/Chiasson* appeal. *See* Exhibit F to Janey Declaration. The U.S. Attorney's Office did not oppose Mr. Steinberg's motion for that relief. *See* Exhibit G to Janey Declaration.

- Fourth, on July 19, 2013, the Commission instituting administrative proceedings against Steven A. Cohen, the founder of S.A.C. Capital, for his failure-to-supervise employees, including Mr. Steinberg. *See In the Matter of Steven A. Cohen*, Administrative Proceeding No. 3-15382. On August 8, 2013, the Administrative Law Judge granted the July 26, 2013 Application of the U.S. Attorney's Office requesting a stay pending the resolution of Mr. Steinberg's criminal case. *See* Exhibit H to Janey Declaration. After Mr. Steinberg's conviction, on August 26, 2014, the U.S. Attorney's Office renewed its application to stay "until at least the Second Circuit issues a decision in the *Newman/Chiasson* Appeal." *See* Exhibit I to Janey Declaration. The U.S. Attorney argued that a stay is "necessary" because the administrative allegations against Mr. Cohen are "premised" on the presumption that Mr. Steinberg engaged in criminality and Mr. Steinberg's appeal would raise the "precise legal issue" that the *Newman/Chiasson* panel is expected to decide. *Id.* The Administrative Law Judge granted the U.S. Attorney's request. *See* Exhibit O to Janey Declaration.
- Finally, in the case of Danny Kuo, a co-defendant of Newman and Chiasson, acknowledging that the Second Circuit could "suggest that there had to have been

knowledge, explicit knowledge, of the benefit that went to [the tipper]" in order to sustain a tippee's insider trading conviction, Judge Sullivan himself adjourned the July 1, 2014 sentencing of Mr. Kuo until after the Second Circuit renders its decision in the *Newman/Chiasson* appeal. *See* Exhibit J to Janey Declaration, at 35, 46.

The instant proceeding is no different. Respondent Peixoto submits that knowledge of the personal benefit must be established in this case and, if nothing else, by its stated opposition to this Motion, we infer that the Division of Enforcement (the "Division") disagrees.[2] Respondent merely requests that this Court grant him the same temporary relief the defendants received in the above cases.

Moving forward in advance of a ruling in *Newman/Chiasson* will prejudice the Respondent. Absent a stay, Respondent is compelled to defend against claims whose elements are not clear as a matter of law. This is unduly prejudicial. The expedited nature of the administrative proceeding, by itself, imposes substantial challenges upon the Respondent to adequately prepare for the hearing in this matter. Also requiring the Respondent to defend against legally unclear claims is substantial, unfair prejudice.

Staying this proceeding will impose no hardship upon the Division. The Division waited nearly two years from the occurrence of the underlying facts to bring this proceeding. Staying this proceeding for a limited duration, until the issuance of the *Newman/Chiasson* decision, will not prejudice the Division in any way. In fact, further clarity of the elements of insider trading will only benefit the Division. The *Newman/Chiasson* decision will elucidate the elements the Division must prove at the hearing.

[2] By letters dated October 23 and October 30, 2014, Respondent Peixoto requested the Division's consent to a stay pending the *Newman/Chiasson* appeal. On November 3, 2014, undersigned counsel for Respondent Peixoto also conferred with the Division via telephone before filing the instant Motion at which point the Division indicated its opposition to this stay application.

Nor will a stay harm the public interest. The public does not have an interest in proceeding expeditiously in this matter. The Division is not seeking to halt ongoing violative conduct, which may otherwise warrant immediate judicial action. Nor does the Division allege the existence of any victims of Mr. Peixoto's alleged violations for whom immediate redress is sought. Certainly, staying the matter for several more months will not harm the public interest.

Accordingly, in the interests of judicial economy and to avoid unduly prejudicing the Respondent, Mr. Peixoto respectfully requests that this proceeding be stayed pending the outcome of the *Newman/Chiasson* appeal.

BACKGROUND

I. The Peixoto Administrative Proceeding

On September 30, 2014, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease and Desist Proceedings ("OIP") charging Respondent Jordan Peixoto with insider trading in connection with the securities of Herbalife Ltd. ("Herbalife"). *See* Exhibit B ("Ex. B") to Janey Affirmation, ¶ 1. The OIP alleges that Filip Szymik ("Szymik") was a close friend and the roommate of an analyst employed at Pershing Square Management, L.P. ("the Analyst"). *Id.*, ¶ 2. The OIP alleges that the Analyst provided Szymik with certain material, non-public information and told Szymik to keep the information confidential. *Id.*, ¶ 2. The OIP further alleges that, in breach of a duty of confidentiality to the Analyst, Szymik, acting as a "tipper," provided the material, non-public information to Respondent, the "tippee." *Id.*, ¶ 3. The OIP charges Respondent Peixoto with insider trading for purchasing Herbalife options while in possession of the material, non-public information. *Id.*, ¶ 5.

The OIP alleges that Szymik "received a personal benefit by gifting confidential information" to Peixoto. *Id.*, ¶ 22. However, it is hardly clear from the OIP whether the Division alleges that Peixoto knew or should have known about the benefit Szymik allegedly received, or whether, in any event, the Division believes it is required to establish such knowledge in this case. Moreover, even though the OIP states that Respondent and Szymik were "close friends," insofar as "friendship" is the basis for the Division's proving the existence of a personal benefit, we submit that the Second Circuit is likely to view such proof of personal benefit as "squishy." Along those lines, knowledge of the personal benefit that rests merely on knowledge of a deepened friendship is anticipated to fail as the barometer for personal benefit following the *Newman/Chiasson* decision. At minimum, we have a good faith reason to believe based on the record at the oral argument that this issue will be addressed in the *Newman/Chiasson* decision.

II. Tippee Knowledge of Tipper Benefit

The law is clear that a tipper must receive a personal benefit in exchange for revealing material, non-public information in violation of a duty. *See S.E.C. v. Obus*, 693 F.3d at 289 ("tipper liability requires that . . . the tipper received a personal benefit from the tip"). District courts in the Second Circuit have generally held that, for a tippee to be held liable, the tippee must have knowledge of the personal benefit the tipper received. *See e.g. State Teachers Ret. Bd. V. Fluor Corp.*, 92 F. Supp. at 594, *United States v. Santoro*, 647 F. Supp. 153, *United States v. Rajaratnam*, 802 F. Supp. 2d at 498-99, *United States v. Whitman*, 904 F. Supp. 2d 363. Departing from other Southern District judges, Judge Sullivan, has held that a remote tippee need *not* have specific knowledge that the tipper received a personal benefit. *See Newman*, No. 12cr121, 2013 WL 1943342 at *2.

This legal question—whether a tippee must have knowledge of a tipper's benefit—previously unclarified by the Second Circuit, is currently on appeal in *Newman/Chiasson. See United States v. Whitman*, 555 Fed.Appx. 98, 106 (2nd Cir. 2014) ("We have yet to decide whether a remote tippee must know that the original tipper received a personal benefit in return for revealing inside information.").

III. The *Newman* and *Chiasson* District Court Case

On August 28, 2012, a grand jury charged hedge fund managers Todd Newman and Anthony Chiasson with insider trading. The indictment alleged that Messrs. Newman and Chiasson traded securities of Dell Inc. ("Dell") and Nvidia Corp. ("Nvidia") while in possession of material, non-public information disclosed by corporate insiders. *United States v. Newman*, Case No. 1:12-cr-00121-RJS, Document 112 (August 28, 2012 S.D.N.Y). Specifically, the indictment alleged that the Messrs. Newman and Chiasson were at the end of a line of tippees. They traded on information their employees obtained from analysts at other investment firms who, in turn, obtained the information from other individuals, who, in turn, received the information from Dell and Nvidia insiders.

At the joint trial of Messrs. Newman and Chiasson, Judge Sullivan rejected the defendants' request that the jury be charged that the defendants had to know that the insiders received a personal benefit in exchange for their improper disclosures. On December 17, 2012, a jury found Messrs. Newman and Chiasson guilty on all counts.

Messrs. Newman and Chiasson timely appealed their convictions to the Second Circuit. Though Judge Sullivan denied Newman's and Chiasson's requests for bail pending appeal, the Second Circuit granted defendants' Rule 9(b) motion from the bench, agreeing that the issue of whether a tippee must know of an insider's personal benefit presented a substantial question of

law likely to result in reversal or a new trial. *United States v. Newman*, Nos. 13-1837(L) & 13-1917(Con), 2013 WL 9825204, at *1 (2d Cir. June 21, 2013); 18 U.S.C. § 3143(b)(l)(B).

IV. The Critical Importance of the *Newman/Chiasson* Appeal to Insider Trading Liability

On April 22, 2014, the Second Circuit heard argument in the *Newman/Chiasson* appeal, on the "knowledge of benefit" issue. The Second Circuit reserved decision.

The issue presented in *Chiasson* is: "Whether a remote tippee can be guilty of insider trading if he does not know that the corporate insider disclosed information in exchange for personal benefit—even though the Supreme Court held in *Dirks v. SEC* that an insider commits a fraudulent fiduciary breach only if he tips for personal benefit, and a tippee commits insider trading only if he knows that the tipper engaged in a fraudulent fiduciary breach." *See* Ex. K to Janey Declaration, at 3-4. Similarly, the issue presented in *Newman* is: "Whether Mr. Newman is entitled to a judgment of acquittal because (a) the district court refused to give his proposed jury instruction that he needed to know that the information at issue was provided by corporate insiders in exchange for personal benefits, and (b) under the correct legal standard, the evidence was insufficient to prove that Mr. Newman knew of benefits to the insiders." *See* Exhibit L ("Ex. L") to Janey Declaration, at 4.

During the *Newman/Chiasson* oral argument, the questions posed by Judges Peter Hall, Barrington Parker, and Ralph Winter appeared to express doubt as to the sufficiency of Judge Sullivan's jury instructions regarding tippees. *See* Ex. A to Janey Declaraation, at 31, 34, 49-50. The panel was particularly concerned with the Government's inability, in the absence of a "knowledge of benefit" requirement, to articulate a bright-line rule that distinguishes between material non-public information upon which one may trade (e.g., "leaks"), and impermissible non-public information. *Id.*

Judge Parker pressed the Government to articulate, in the absence of a "knowledge of benefit" requirement, "the principle that criminalizes some information ... and makes virtually indistinguishable information innocuous." *Id.,* at 31. Judge Parker further stated that if liability is merely based on a defendant's sophistication and ability to distinguish between permissible and illegal non-public information—rather than on the bright-line rule requiring tippee knowledge of the tipper's personal benefit—"at the end of the day, the person who's likely to be guilty is the person who the Government decides to indict." *Id.,* at 34. Judge Parker criticized the Government's "amorphous [insider trading] theory" that "gives precious little guidance to all of these [financial] institutions ... [left] at the mercy of the Government." *Id.,* at 49. Rhetorically, Judge Parker asked: "Isn't the whole community, the legal and financial community, served by having a rule that says the person you all want to send to jail **has to know of the benefit**?" *Id.*, 49-50 (emphasis added). We respectfully submit that Respondent Peixoto, by this application, is seeking clarification of the bright line rule in this instant enforcement action.

The panel also criticized the notion that the element of personal benefit is satisfied by the provision of "career advice" or through furthering a friendship—theories advanced by the Government in *Newman/Chiasson*. *Id.*, at 37-39. Judge Parker noted that "the benefit standard is so soft. You get cases maybe like this one where it just doesn't seem to amount to anything." *Id.*, at 39. Judge Ralph Winter similarly observed that, while *Dirks* sought to "protect analysts" by establishing "a guiding principle for people who trade all the time," "unless there's some kind of concrete, demonstrable benefit coming to a tipper, there's no guiding principle at all." *Id.* at 40-41.

V. The Wide-Ranging Recognition of the Potential Implications of a Decision on This Appeal

As mentioned above, following the oral argument in *Newman/Chiasson*, a civil case, a SEC initial decision, a SEC administrative proceeding, and a criminal sentencing have all been either stayed, placed in abeyance, or come under review in recognition of the potential impact of the *Newman/Chiasson* appellate decision.

ARGUMENT

Consistent with the responses of other courts and litigants in the wake of the *Newman/Chiasson* appeal, this Court should stay this administrative proceeding pending the resolution of *Newman/Chiasson*. A stay will simplify the administrative proceeding by clarifying to the Division what it must prove and, correspondingly, provide Respondent with the opportunity to adequately prepare his defense. Moving the administrative proceeding forward in advance of a ruling in *Newman/Chiasson* would be inefficient and unnecessarily burdensome.

I. The Court Has Discretion to Stay this Action.

The Commission has broad authority to stay administrative proceedings. Rule 401(b) provides that the "Commission may grant a stay in whole or in part, and may condition relief under this rule upon such terms, or upon the implementation of such procedures, as it deems appropriate." 17 C.F.R. 201.401(b). Rule 400(d) provides that the "Commission will not consider the motion for a stay unless the motion shall have first been made to the hearing officer." 17 C.F.R. 201.400(d). While the Commission Rules do not expressly articulate the power of this Court to grant a stay, Rule 401(b) and Rule 400(d), taken together, authorize this Court to stay this proceeding.

II. The Standard of Review in This Matter is Guided, *inter alia*, by Second Circuit Precedent

In instances where the Commission's Rules do not directly address a matter, the Commission and this Court often look to federal procedural jurisprudence for guidance. *See e.g. In the Matter of Bobby Bruce, Cletus Marion Hodge, John Kilpatrick, Carlos Arturo Smith, Jr., Robert Hardee Quarles, William Edward Shelton, IV. (G. Weeks & Co., Inc.)*, Release No. 254 (ALJ June 25, 1984) (looking to the reasoning of FRCP Rule 32(a)(4)); *In the Matter of Putnam Inv. Mgmt., LLC*, Release No. 614 (Apr. 7, 2004) ("The Federal Rules of Civil Procedure do not govern administrative proceedings before the Commission, but they often provide helpful guidance in resolving issues not directly addressed by the Commission's Rules of Practice."); *Clarke T. Blizzard*, 77 SEC Docket 1505, 1510-11 nn.17, 19 (Apr. 23, 2002) (adopting the work-product protection provided in FRCP Rule 26(b)(3) because it was "consistent with that provided by the rules of most jurisdictions and with the Supreme Court."); *Jay Alan Ochanpaugh*, Exchange Act Rel. No. 54363 (Aug. 25, 2006), 88 SEC Docket 2653, 2662 n.24 ("The Federal Rules of Civil Procedure do not apply in administrative proceedings. Nonetheless, in certain circumstances we are guided by the principles of the Federal Rules.") (citations omitted).

Here, Rule 401 does not provide substantive standards under which a stay shall be granted nor does it identify the criteria the Commission applies in considering a request for a stay under these circumstances. Accordingly, because of Rule 401's lack of guidance, and because the facts alleged in the OIP occurred in New York, we submit that it is proper for this Court to look to Second Circuit jurisprudence in resolving this matter. *See In the Matter of Fannie Mae Sec. Litig.*, Civ. Action No. 04-01639 (D.D.C.), Release No. 60772 (Oct. 2, 2009) (applying D.C. Cir. standards where case arose in D.C.).

The *Kappel* Factors

District courts in the Second Circuit frequently apply a five-factor test when determining whether to enter a stay pending an appeal in a related case (the "*Kappel* Factors"). The test considers: (1) the private interests of the plaintiff in proceeding expeditiously with the civil litigation; (2) the private interests of and burden on the defendant; (3) the interests of the courts; (4) the interests of persons not parties to the civil litigation; and (5) the public interest. *See LaSala v. Needham & Co., Inc.*, 399 F.Supp.2d 421, 427 (S.D.N.Y. 2005) (quoting *Kappel v. Comfort*, 914 F.Supp. 1056, 1058 (S.D.N.Y. 1996) (quoting *Volmar Distribs. v. N.Y. Post Co.*, 152 F.R.D. 36, 39 (S.D.N.Y.1993)). This test "has been applied to stay a federal action in light of a concurrently pending federal action (either because the claim arises from the same nucleus of facts or because the pending action would resolve a controlling point of law)...." *SST Global Tech., LLC v. Chapman*, 270 F.Supp.2d 444, 445 (S.D.N.Y. 2003) (emphasis added); *see also Goldstein v. Time Warner N.Y.C. Cable Group*, 3 F.Supp.2d 423, 437–439 (S.D.N.Y. 1998) (granting a stay where an independent proceeding in federal court, which had a bearing on the immediate case, was under appellate review).

In determining the propriety of granting a stay, the court may also consider the prospects of success on appeal, a consideration that is to be assessed with liberality. *See Estate of Heiser v. Deutsche Bank Trust Co. Americas*, No. 11 CIV. 1608 AJN MHD, 2012 WL 2865485, at *3 (S.D.N.Y. July 10, 2012) *aff'd*, No. 11 CIV. 1608 AJN MHD, 2012 WL 5039065 (S.D.N.Y. Oct. 17, 2012) (citing *Gunter v. Carrion*, 335 Fed. App'x 130, 131 (2d Cir. 2009)). The movant must demonstrate "a substantial possibility, although less than a likelihood, of success on appeal." *LaRouche v. Kezer*, 20 F.3d 68, 72 (2d Cir. 1994) (quoting *Hirschfeld v. Bd. of Elections*, 984 F.2d 35, 39 (2d Cir. 1993)).

III. The *Kappel* Factors Weigh in Favor of Staying the Instant Proceeding

The fact that the *Newman/Chiasson* appeal will clarify a key element of tippee insider trading liability—of which Mr. Peixoto is charged in this proceeding—weighs heavily in favor of granting a stay. *See In re Literary Works in Elec. Databases Copyright Litig.*, 2001 WL 204212, at *3 (S.D.N.Y. Mar. 1, 2001) ("Proceeding with this litigation several months before [a higher court] more precisely defines the claims at issue here would be unnecessarily wasteful of both the Court's and the litigants' resources."). Indeed, most of the *Kappel* Factors strongly support granting a stay here, as articulated below.

1. The Interests of the Division in Proceeding Expeditiously

The interests of the Division in proceeding expeditiously does not militate against a stay. Even if the Division is akin to a private plaintiff seeking redress in court—a point with which we do not necessarily agree—a stay for what is anticipated to be of limited duration would not harm the Division's interests. In reviewing this factor, courts regularly find that a requested stay for a limited period of several months does not prejudice the plaintiff. *See e.g. Wing Shing Prods. (BVI) Ltd. v. Simatelex Mfg. Co., Ltd.*, 2005 WL 912184, *2 (S.D.N.Y. Apr. 19, 2005) ("[A] stay of several months will cause little prejudice or hardship to [Plaintiff]."); *Estate of Heiser*, 2012 WL 2865485, at *4 (granting a stay pending a related appeal before the appellate oral argument occurred); *LaSala*, 399 F.Supp.2d at 430 (finding a stay would not delay the case indefinitely).

It is clear that a stay here would not delay this proceeding indefinitely. The Second Circuit heard oral argument on April 22, 2014, nearly seven months ago. It is, presumably, only a matter of months before the Second Circuit issues its decision. A stay for this duration would not cause a lengthy delay of the proceeding.

Indeed, as mentioned above, the Division would benefit from a stay. The *Newman/Chiasson* decision will elucidate the elements the Division must prove at the hearing in this matter. Moreover, a *Newman/Chiasson* decision would eliminate the need for the parties to brief this question of law. Accordingly, the Division is not prejudiced by a stay.

2. The Private Interests of and Burden on the Defendant

Mr. Peixoto's interests will clearly be furthered and his burden substantially reduced through a stay. By granting a stay, Mr. Peixoto's defense would have the important benefit of knowing what legal standards to hold the Division to, which, in turn, would affect numerous critical aspects of the case, ranging from evaluating evidence provided in discovery; prehearing motions; trial preparation; as well as the defense's case at trial.

At the least, the OIP in this case does not make clear and, arguably, actually omits the requirement that Mr. Peixoto had to have knowledge of the personal benefit of the tipper, Mr. Sezymik. A stay in this action pending the Second Circuit opinion would, among other things, potentially lead to a corrected OIP once the law is clarified and without having to do so *after* continued trial preparation has occurred, including after the date for summary disposition motions has expired, for example. The private interests of and burden on the Respondent clearly weigh in favor of staying this proceeding.

3. The Interests of the Court

Judicial economy strongly favors a stay in this matter. A *Newman/Chiasson* decision will resolve an open question of law as to a key element of insider trading liability in cases such as that before this Court. A *Newman/Chiasson* decision, regardless of the outcome, will guide this Court in managing the scope of the hearing and may obviate the need for certain irrelevant litigation. For example, staying this matter pending the *Newman/Chiasson* decision will reduce

the Court's burden of resolving an open question of law in the Second Circuit, which otherwise might be litigated between the parties during the instant proceeding. *See LaSala*, at 427 ("a court might, in the interest of judicial economy, enter a stay pending the outcome of proceedings which bear upon the case, even if such proceedings are not necessarily controlling of the action that is to be stayed."); *see also Laube v. KM Europa Metal AG*, No. 96 CIV. 8147 (PKL), 1997 WL 325979, at *2 (S.D.N.Y. June 12, 1997) ("Proceeding with the motion without the benefit of controlling law would waste both the parties and the Court's time and energies.").

4. The Interests of Persons Not Parties to the Litigation

We respectfully submit that this factor does not impact the Court's analysis under the facts of this proceeding.

5. The Public Interest

The public interest will not be damaged by a stay. The Division is not seeking to halt ongoing violative conduct, which would arguably warrant immediate judicial action. *See Wing Shing Prods. (BVI) Ltd.*, 2005 WL 912184, *3 (finding the public interest not harmed by staying prompt enforcement of patent laws where the harm was not ongoing). Nor is the Division seeking to recover assets for the benefit of any victims of Mr. Peixoto's alleged misconduct, which might otherwise favor expediency. Rather, the Division's claim pertains to a single transaction that occurred in 2012 for which the Division alleges no victims. The Respondent is currently a student and not employed in the securities industry and, thus, presents no danger to the investing public. The Division waited nearly two years to institute this proceeding since the occurrence of the alleged facts underlying the OIP. Certainly, staying the matter for several additional months will not prejudice the Division and the public interest.

IV. There is a Substantial Possibility That the Second Circuit Will Require Tippee Knowledge of Tipper Benefit.

As mentioned above, in determining the propriety of granting a stay, a court may also consider the prospects of success on appeal, a consideration that is to be assessed with liberality. *See Estate of Heiser*, 2012 WL 2865485, at *3. The movant must demonstrate "a substantial possibility, although less than a likelihood, of success on appeal." *LaRouche*, 20 F.3d at 72.

There is undoubtedly a substantial possibility that the Second Circuit will require, as an element of tippee insider trading liability, that the tippee have knowledge of the tipper's personal benefit. The Supreme Court articulated this requirement in *Dirks*, the principal tippee insider trading case. *See Dirks v. S.E.C.*, 463 U.S. 646, 103 S. Ct. 3255, 77 L. Ed. 2d 911 (1983). Since *Dirks*, district courts in the Second Circuit have repeatedly held that tippees must know that the tipper acted for personal gain to violate Section 10(b) and Rule 10b-5, and *Dirks* has been understood by the majority of federal judges in this circuit that knowledge of the benefit is part and parcel of the knowledge of the breach.

1. *Dirks v. SEC*: Requiring Tippee Knowledge of Tipper's Benefit

Dirks held that tippee liability derives from the tipper's liability, and turns on the purpose of the tipper's disclosure of inside information and the tippee's knowledge of the tipper's improper purpose. 463 U.S. at 659-663.

In explaining tipper liability, *Dirks* stated that "Not all breaches of fiduciary duty in connection with a securities transaction... come within the ambit of Rule 10b–5." 463 U.S. at 654. (citations omitted) Rather, there must also be "manipulation or deception," which is satisfied "where one takes advantage of information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *Dirks* emphasized that Section 10(b) fraud

liability was intended to eliminate breaches of fiduciary duty, in connection with inside information, *that confer a personal advantage.* 463 U.S. at 662.

In addition to satisfying the "manipulation or deception" requirement, *Dirks'* requirement that a tipper receive personal benefit served an additional purpose. It distinguishes between material, non-public information upon which one may trade, on the one hand, and impermissible material, non-public information, on the other hand. *Dirks* made clear that it was "repudiating any notion that all traders must enjoy equal information before trading." 463 U.S. at 657. In other words, under certain circumstances, trading on material, non-public information does not result in insider trading liability. *Id.* at 654 ("there is no general duty to disclose before trading on material non-public information."). Accordingly, *Dirks* thought it "essential" that there be a "guiding principle for those whose daily activities must be limited and instructed by the SEC's insider trading rules." *Id.* at 664. The guiding principle *Dirks* identified was the disclosure of inside information for personal gain. *Id.*

Dirks next addressed tippee liability. Tippees can commit insider trading, *Dirks* held, only if they "*knowingly* participate with the fiduciary [*i.e.*, the insider] in such a breach," referring back to the insiders' "improper purpose of exploiting the information for their personal gain." *Id.* at 659 (emphasis added). That is, tippee liability exists "only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee *and the tippee knows or should know that there has been a breach.*" *Id.* at 660 (emphasis added).

Thus, under *Dirks*, a liable tippee must know of the tippee's breach of duty, and that breach must involve a disclosure of material non-public information for personal gain. It necessarily follows that a tippee cannot be liable for insider trading unless he knows of the insider's self-dealing. Absent such knowledge, the tippee does not know that the tipper has

committed a fraudulent breach of fiduciary duty as defined in *Dirks*. The Supreme Court has confirmed this view in *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 311 n.21 (1985), explaining: "A tippee generally has a duty to disclose or to abstain from trading on material non-public information *only when he knows* or should know that his insider source 'has breached his fiduciary duty to the shareholders by disclosing the information'–*in other words, where the insider has sought to 'benefit, directly or indirectly, from his disclosure.*'" (quoting *Dirks*, 463 U.S. at 660, 662) (emphasis added).

2. Post-*Dirks* Second Circuit Opinions And District Court Actions

Since *Dirks*, district courts in the Second Circuit have deemed tippee knowledge of the tipper's benefit a key element of tippee insider trading liability. For example, in *State Teachers Ret. Bd. V. Fluor Corp.*, Judge Sweet read *Dirks* to require that a tippee know of the tipper's fiduciary breach, and held that this "necessitates tippee knowledge of each element, including the personal benefit, of the tipper's breach." 592 F. Supp. 592, 594 (S.D.N.Y. 1984). Similarly, in *United States v. Rajaratnam*, Judge Holwell reasoned that a tippee cannot be a knowing participant in the tipper's fiduciary breach unless the tippee knows that the tipper was divulging information for a personal benefit. 802 F. Supp. 2d 491, 498-99 (S.D.N.Y. 2011).

In *United States v. Santoro*, Judge McLaughlin agreed that a tippee must know of the tipper's personal benefit, and that the jury had to have this explained "as an element of knowledge of the breach." 647 F. Supp. 153 (E.D.N.Y. 1986), *rev'd on other grounds*, *United States v. Davidoff*, 845 F.2d 1151 (2d Cir. 1988). But the court held that the indictment was not facially deficient for alleging simply knowledge of a breach, because "[a]n allegation that the tippee knew of the tipper's breach necessarily charges that the tippee knew that the tipper was

acting for personal gain." *Id.* at 170-71. In other words, knowledge of the benefit is part and parcel with knowledge of the breach but both aspects must be proved.

Consistent with Judge McLaughlin's view, certain Second Circuit cases, in summarizing the elements of tippee liability, have not expressly included tippee knowledge of tipper benefit as an element of tippee liability. *See e.g. United States v. Libera*, 989 F.2d 596, 600 (2d Cir. 1993) ("[T]he misappropriation theory requires the establishment of two elements: (i) a breach by the tipper of a duty owed to the owner of the non-public information; and (ii) the tippee's knowledge that the tipper had breached the duty."); *S.E.C. v. Obus*, 693 F.3d 276, 289 (2d Cir. 2012) ("Tippee liability requires that (1) the tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tippee improperly obtained the information ...; and (3) the tippee, while in knowing possession of the material non-public information, used the information by trading or by tipping for his own benefit."); *United States v. Jiau*, 734 F.3d 147, 152-53 (2d Cir. 2013) *cert. denied*, No. 13A949, 2014 WL 4249039 (U.S. Oct. 6, 2014) *and cert. denied*, No. 13A949, 2014 WL 4249039 (U.S. Oct. 6, 2014). They have not done so because the requirement is obvious.

These cases do not waive the *Dirks* requirement that the tippee know of the tipper's personal benefit. *Libera*, *Obus* and *Jiau* all cite *Dirks* approvingly, and did not attempt to redefine tippee insider trading liability. Rather, the requirement that the tippee have knowledge of the tipper's breach subsumes, by necessity, knowledge of the tipper's benefit. This is precisely the argument that is before the Second Circuit in *Newman/Chiasson* that the Government in that case challenges.

Similar to Mr. Chiasson, Respondent Peixoto submits that the exchange of information for personal benefit is not separate from an insider's fiduciary breach; it is the fiduciary breach

that triggers insider trading liability. *See Dirks*, 463 U.S. at 662. Thus, tippee knowledge of the fraudulent breach includes, by *Dirks'* definition, knowledge of tipper benefit. In order to maintain the Supreme Court's holding in *Dirks*, which the Second Circuit has done for decades, we submit that the court will only make more explicit that knowledge of benefit is a component of tippee liability.

3. Uniform Scienter Requirement Under Classical and Misappropriation Theories

That *Newman/Chiasson* is a classical insider trading case and the Division here proceeds, presumably, under a misappropriation theory does not change the analysis. During the *Newman/Chiasson* oral argument, the Government itself conceded that the elements of tippee scienter must be uniform, regardless of the insider trading theory the Government pursues. The Government recognized that "[i]it only makes sense to harmonize that and have those elements of tippee liability be the same for classical and for misappropriation." *See* Ex. A to Janey Declaration, at 53. The Government explained that "you cannot achieve a bright-line rule, if the downstream tippee liability rule is different from misappropriation versus classical cases." We have every reason to believe the Second Circuit panel in *Newman/Chiasson* agrees with this proposition.

Indeed, *Obus* expressly held that the tipper's personal benefit is required under the misappropriation theory. *Obus*, 693 F.3d at 289 ("[T]ipper liability requires that ... the tipper received a personal benefit from the tip."). *Obus* reasoned that although "[t]he Supreme Court's tipping liability doctrine was developed in a classical case . . . the same analysis governs in a misappropriation case." 693 F.3d at 285-86.

Similarly, it follows from *Dirks* that tippee knowledge of the tipper's benefit is required for liability irrespective of the insider trading theory pursued by the Government. Requiring that

a tippee have knowledge of the tipper's benefit in classical theory cases but not in misappropriation cases would defeat *Dirks'* objective to institute a "guiding principle for those whose daily activities must be limited and instructed by the SEC's insider trading rules." *Id.* at 664. If it is to provide any guidance, the guiding principle must be one that all recipients of material, non-public information can always rely upon in order to avoid tippee liability. A rule that turns on the theory of insider trading liability does not provide the bright-line guidance to the investing public, which *Dirks* found to be critical.

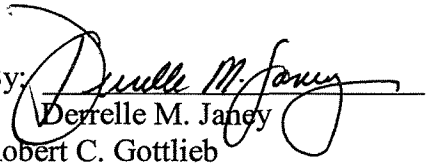
CONCLUSION

The *Newman/Chiasson* appeal is on a controlling question of insider trading law that directly impacts liability in this proceeding. Proceeding with this case without the benefit of a clarification of the controlling law would be inefficient and unnecessarily burdensome. Moreover, it would severely prejudice the Respondent. Accordingly, in the interests of judicial economy and to avoid unduly prejudicing the Respondent, Mr. Peixoto respectfully requests that this proceeding be stayed pending the outcome of the *Newman/Chiasson* appeal.

Dated: New York, New York
November 17, 2014

Respectfully submitted,

GOTTLIEB & GORDON LLP

By: 
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