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"Recent Decisions on Short Selling and PIPEs: Section 5 Claims Dismissed, Insider Trading Claims Survive" by Eva Marie Carney

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On January 2, 2008, in *SEC v. Lyon* (06-Civ.-14338) (S.D.N.Y.), the district court rejected SEC claims that Gryphon Partners LP and related entities and their managing partner had engaged in several unregistered public distributions of securities in violation of Section 5 of the Securities Act of 1933. The SEC had argued that short selling shares in order to hedge positions in private investment in public equity transactions (PIPEs) constitutes the unlawful sale of unregistered securities, essentially integrating the short sales and the PIPEs, and treating the use of the PIPE shares to close out the short transactions as a "ministerial" step. Only a few months before, another district court dismissed similar claims in *SEC v. Mangan* (Civ. Action No. 3: 06-cv-531) (W.D.N.C.). SEC litigators fought both of these dismissals, arguing strenuously that a ruling against Section 5 liability would overturn some thirty-five years of clear and consistent Commission precedent. Market participants should expect to hear more from the SEC on this subject -- whether the SEC's response is to identify friendly courts of appeals in which to argue its Section 5 analysis or to press its position in the context of rulemaking.

Both courts permitted the SEC to move forward with insider trading claims, however, under a misappropriation theory. In doing so, the two courts accepted the SEC's theory that a fund manager that agrees to keep in confidence material non-public information it obtains when being solicited to invest in a PIPE and then shorts the PIPE issuer's stock can be sued under the antifraud provisions of the federal securities laws.

Below is a memo that our partner, Eva Marie Carney wrote summarizing these recent decisions that we hope you find useful.

[Download memorandum](#)