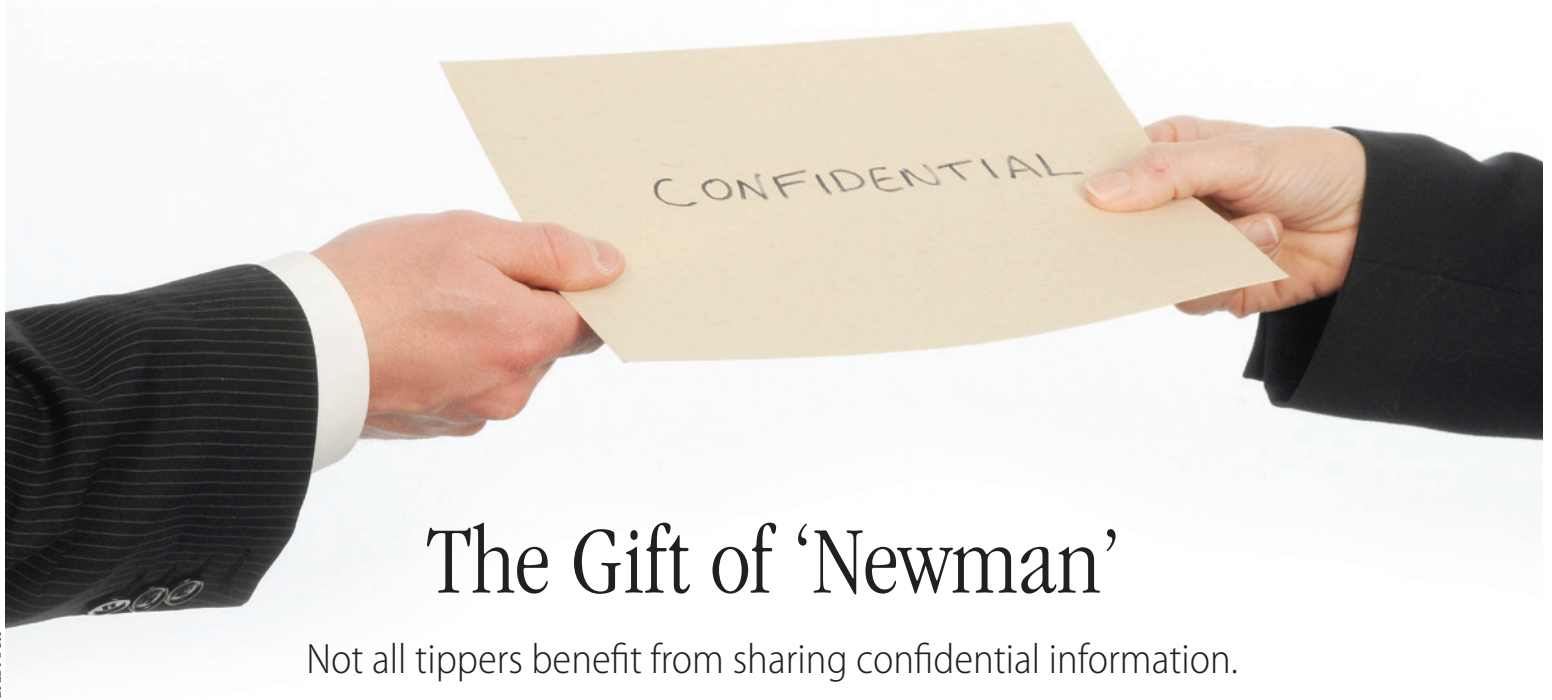


White-Collar Crime

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MONDAY, FEBRUARY 9, 2015



The Gift of 'Newman'

Not all tippers benefit from sharing confidential information.

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On Dec. 10, 2014, the U.S. Court of Appeals for the Second Circuit reversed the convictions for insider trading of Todd Newman and Anthony Chiasson. The decision—*United States v. Newman and Chiasson*¹—addressed the proof needed to establish insider trading liability of “remote tippees,” i.e., individuals who were part of a chain of people sharing and trading on confidential information. The Second Circuit held that to be liable for insider trading, the government must prove that the tipper received a personal benefit for sharing

material non-public information and that the defendant receiving the tip knew (or should have known) of the personal benefit to the tipper. While the Second Circuit attempted to clarify the requirements for remote tippee liability, it left a number of important questions unanswered. This article addresses one of these questions: When does a tipper benefit by giving a gift of confidential information?

The court indicated that not all gifts of confidential information will involve a personal benefit to the tipper, but its decision lacked the clarity to allow attorneys to know where the line will be drawn in future cases. One thing that remains clear after *Newman* is that some gift-givers will still find themselves on the hook for insider trading—as could tippees who know the gift benefited the tipper. Until the courts provide additional guidance on this issue, traders, attorneys and compliance professionals

will need to tread the evolving landscape of insider trading law carefully.

Gifts of 'Newman'

Almost 30 years ago, in *Dirks v. S.E.C.*, the U.S. Supreme Court held that a tipper could receive a personal benefit by “mak[ing] a gift of confidential information to a trading relative or friend.”² The Supreme Court’s rationale was simple: “The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”³ The court warned that determining whether the tipper had received a personal benefit was a question of fact, which “will not always be easy for the courts.”⁴

Newman reiterated that a gift of confidential information to family and friends could constitute a personal benefit. However, to infer that the tipper received a personal benefit from giving information

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to a family member or friend, prosecutors must prove “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.” In other words, the “mere fact” that the tipper and tippee are friends is not enough to prove a personal benefit, especially when the friendship is “of a casual or social nature.”⁵ The government must prove a “close” personal relationship, and an “exchange” that has (at least) the possibility of monetary gain for the tipper or something of a “similarly valuable nature.”

Applying this standard, the Second Circuit found the tippers in *Newman* had not received a personal benefit by giving confidential information to the tippees. One tip had been shared by an insider at Dell with an analyst at a Wall Street firm. The Dell insider and the analyst knew each other for many years, and the analyst had provided career advice and guidance to the insider. The panel concluded this was insufficient to show the insider received a personal benefit, as “[i]f this was a benefit, practically anything would qualify.”⁶ Another tip had been shared by an insider at NVIDIA. The tipper and tippee were acquaintances who knew each other from church. Again, this was not enough to establish the tipper received a personal benefit.

Importantly, the panel in *Newman* found that if the tipper had “an intention to benefit” the tippee, this is enough to count as a personal benefit,⁷ reaffirming its ruling in *United States v. Jiau*.⁸ The key question in proving that a gift is a personal benefit to the tipper is whether there was a close relationship between the tipper and the tippee, and some sort of meaningful exchange, including a desire to benefit the tippee. Under this new rule, it would seem that if someone gives a gift of confidential information to a parent with the intention of benefiting her or him, the giver may have benefited personally—even if he never gets a dime out of it. If, however, he gives a gift of confidential information to a college roommate that he sees only at reunions, and doesn’t

expect anything in return, that might not meet the *Newman* test.

The New ‘Newman’ Test?

Newman is not entirely novel. Some courts outside the Second Circuit had previously refused to find the tipper intended to benefit the tippee with a gift of confidential information absent proof of a meaningful relationship between them. For example, in *United States v. Maxwell*,⁹ the court held that a senior executive who shared a tip about a merger with his barber did not intend to benefit from the tip given the lack of a relationship between the two men. The two never socialized outside of haircut appointments, had no family relationship, and did not work in the same industry. In short, “there was no particular reason for [the executive] suddenly to decide to bestow upon [the barber] a significant gift.”¹⁰

After ‘Newman,’ to prove that a gift of inside information counts as a “personal benefit,” the government faces a more difficult burden.

Even if not entirely new, the Second Circuit’s approach seems to depart from its previous rulings. Only two years ago, in *SEC v. Obus*,¹¹ the Second Circuit expressed a more expansive view of when a gift counted as a personal benefit. In *Obus*, the tipper learned about a pending acquisition by a client company of another publically-traded company. The government alleged that the tipper told a college friend about the acquisition. The tippee then told his boss, who traded on the information. Noting that a personal benefit could include making a gift of information to a friend, the Second Circuit held that “the undisputed fact that [the tipper] and [tippee] were friends from college is sufficient to send [the case] to the jury.”¹² Thus, *Obus* seemed

to leave more latitude for the government to prove a gift of information counted as a personal benefit than the rule subsequently announced in *Newman*.

One of the hypotheticals mentioned in *Obus* reinforces this conclusion. In discussing the kind of gift that could count as a personal benefit, the Second Circuit described the following scenario:

[A] commuter on a train calls an associate on his cellphone, and, speaking too loudly for the close quarters, discusses confidential information ... knowingly within earshot of a passenger who is the commuter’s friend and whom he also knows to be a day trader, and the friend then trades on the information [T]here would be a question of whether the tipper benefited by making a gift of the non-public information to his friend.¹³

Likewise, district courts in the Second Circuit had found, before *Newman*, that the mere fact that the tipper shared information with family or friends was enough to infer a personal benefit. In *SEC v. Kueng*,¹⁴ the court concluded that the fact that the tipper gave his brother a tip was enough to infer a personal benefit. The court—using language lifted from *Dirks*—stated that “when an insider makes a gift of confidential information to a trading relative or friend [this] may justify the inference that the insider benefited from the disclosure.”¹⁵ Earlier, in *S.E.C. v. Sekhri*,¹⁶ the court found the fact that the tipper made a gift of inside information to his father-in-law was enough to infer the tipper had received a personal benefit. Although these decisions involved tips to close family members, they seemed to embrace a broader definition of personal benefit from gift-giving than *Newman* did.

Looking a Gift Horse in the Mouth

After *Newman*, to prove that a gift of inside information counts as a “personal benefit,” the government faces a more difficult burden. The Second Circuit gave some illustrative examples of what counts as a personal benefit under this

new “family and friends” test. It cited with approval *SEC v. Sargent*,¹⁷ noting in that case there was a personal benefit where the tipper and tippee were friends, one of whom referred dental work to the other. It also cited *SEC v. Yun*,¹⁸ where the tipper and tippee had a friendly relationship and split commissions on various real estate deals. These cases are examples of situations in which a gift was given in exchange for a pecuniary benefit.

But even with these examples, the exact boundaries of this new test are not clear. Unanswered questions include: How close must the relationship be? What does it mean for the giver to intend to benefit the recipient? Indeed, what does it mean for an exchange to have the “potentiality” of monetary gain? Under previous case law, one might have thought career advice was sufficient, but under *Newman*, it appears it is not. Resolving these and similar questions is important, as people rarely share inside information with strangers.

Whether trials in the future will involve factual disputes over the “closeness” of the family or friend relationship is unclear, but possible. Will courts, for example, draw a line between giving gifts of inside information to a sibling, as opposed to a second cousin who the tipper sees only once a year? Likewise, will an issue of fact for trial become the degree of friendship between the tipper and tippee? *Newman* suggests the answer to these questions is “yes.”

Indeed, courts are already confronting these questions. In a case pending before an administrative law judge *In re Bolan*, a respondent has moved for summary disposition on the grounds that the friendship between the alleged tipper and tippees was insufficiently close. The SEC has claimed that the alleged tipper, Bolan, worked at Wells Fargo as a research analyst. He allegedly tipped two traders in advance regarding his ratings changes. Bolan has argued that the SEC alleged only one of the traders was a “trusted friend,” and the other provided positive job feedback—not enough to meet the *Newman* test. He claims that the case

against him should be dismissed to “reinforce the important policy in *Dirks* and *Newman* that requiring a clear, objective personal gain is necessary to avoid inhibiting the role of market analysts with the threat of government prosecutions for good faith conduct.”¹⁹

Government’s Response to ‘Newman’

The government has responded to *Newman* by trying to both limit and overturn it. In a brief filed recently in *United States v. Durant*, the government advanced the theory that *Newman* applies only to “classical” insider trading cases, not to cases where the confidential information was misappropriated by someone who was not an insider at the company.²⁰ (Under the “classical theory” of insider trading, an insider at a company shares confidential information. Under the “misappropriation theory,” the tipper is not an insider at the company, but obtains access to the information and then shares it in breach of a duty, such as by breaching the attorney-client privilege). The district court firmly rejected the government’s theory, and vacated the guilty pleas of four of the *Durant* defendants, noting that the Second Circuit held that the elements of tipping liability are the same whether the tipper’s duty arose under the classical or misappropriation theory.²¹

The government is also seeking en banc review of *Newman* based on what it claims is the confusion generated by the panel’s decision. The petition highlights the confusion over *Newman*’s definition of “gift,” stating it “eliminate[ed] *Dirks*’ express recognition that an improper but uncompensated gift of information by an insider suffices—but, citing no authority, replaced it with a set of novel, confounding criteria.” It goes on to argue that “to the extent the Panel sought to set clear guidelines for Wall Street professionals and prosecutors, the test it adopted will do just the opposite.”²²

Beware of Insiders Bearing Gifts

While the government and defense lawyers battle it out over *Newman* in the courts, questions will persist as to its meaning. For traders, compliance professionals, and lawyers trying to advise their clients on what is and is not permissible, *Newman* certainly adds another gray element to an already murky area of criminal liability. Pending additional developments and clarity, traders and compliance professionals must remain vigilant against insider trading, continue to implement strong compliance programs, and ensure an appropriate environment and culture in which insider trading is strictly prohibited.

Questions will inevitably arise about whether a gift of material non-public information constitutes a personal benefit that can lead to liability. For now, when there are close calls, answers to those questions should take into account that, often, a government investigation of insider trading is enough to bring down a firm, even if the result in the courts ultimately is an acquittal or reversal of a conviction.

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1. ___ F.3d ___, Nos. 13–1837, 13–1917, 2014 WL 6911278 (2d Cir. Dec. 10, 2014).

2. 463 U.S. 646, 664.

3. *Id.*

4. *Id.*

5. ___ F.3d at ___, 2014 WL 6911278, at *8.

6. *Id.*, at *9.

7. *Id.*

8. 734 F.3d 147, 153 (2d Cir. 2013) cert. denied, 135 S. Ct. 311 (2014).

9. 341 F. Supp. 2d 941 (S.D. Ohio 2004).

10. *Id.* at 948.

11. 693 F.3d 276 (2d Cir. 2012).

12. *Id.* at 291.

13. *Id.* at 287.

14. No. 09-8763, 2010 WL 3026618, at *4 (S.D.N.Y. Aug. 2, 2010).

15. *Id.*

16. No. 98 CIV. 2320 (RPP), 2002 WL 31654969, at *2 (S.D.N.Y. Nov. 22, 2002).

17. 229 F.3d 68, 77 (1st Cir. 2000).

18. 327 F.3d 1263, 1280 (11th Cir. 2003).

19. Respondent’s Motion for Summary Disposition at 10, *In re Bolan*, No. 3-16178 (S.E.C. Jan. 8, 2015).

20. Government’s Memorandum of Law in Support of the Sufficiency of the Defendants’ Guilty Pleas at 5, *U.S. v. Durant*, No. 12-cr-887 (Jan. 12, 2015).

21. *U.S. v. Durant*, No. 12-cr-887 (Jan. 22, 2014).

22. Petition for Rehearing, *U.S. v. Newman*, No. 13-1837 (Jan. 23, 2015).