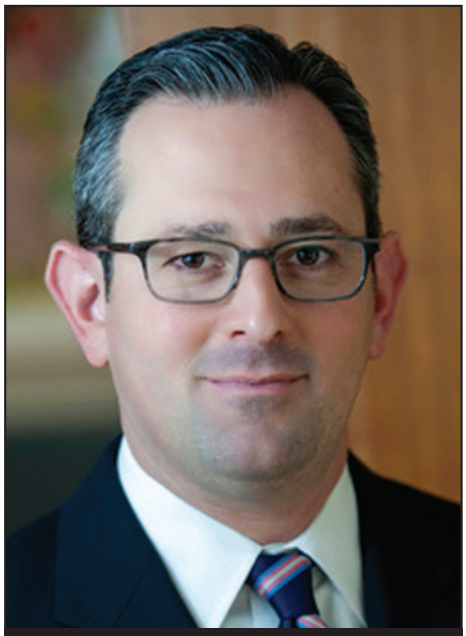
Connecticut Law Tribune
September 29, 2016 ctlawtribune.com An ALM Publication

# Insider Trading Cases Since 'Newman'

**By ROBERT HOFF and ANDREW GIERING**



DIANA DELUCIA

Wiggin and Dana partner Robert Hoff

Andrew Giering, an associate at Wiggin and Dana

On Dec. 10, 2014, the Second Circuit decided *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), cert. denied, 136 S.Ct. 242 (2015). The court held that in order to prove that a "tipper" of insider information received in exchange for the tip a personal benefit sufficient to create liability, the government must offer "proof of 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." Id. at 452.

Before *Newman*, federal prosecutors routinely took advantage of the seemingly more forgiving *Dirks v. SEC*, 463 U.S. 646, 664 (1983), benefit test. Courts deemed the test satisfied where a tip was in exchange for "maintaining a useful networking contact," *United States v. Whitman*, 904 F. Supp. 2d 363, 372 (S.D.N.Y. 2012), or where the tip was "a gift of information to a friend." *SEC v. Obus*, 693 F.3d 276, 291 (2d Cir. 2012). Since *Newman*, no court has upheld an insider trading conviction based on such fuzzy reputational or networking benefits, such as the "career advice" the tipper received in *Newman*.

This article examines some of the cases that the government has brought since *Newman* to identify the current landscape of insider trading law. As expected, *Newman* has not been a complete obstacle to tipper-tippee cases, but the government now focuses on cases where there is evidence showing that the tipper received some kind of tangible benefit.

## Prosecutions Since *Newman*

*Newman*'s impact was immediately felt, as it reverberated throughout the Second Circuit and disturbed a handful of pending cases. In January 2015, the government dropped a case against five defendants stemming from a $1.2 billion IBM Corp. acquisition,

citing a lack of evidence regarding personal benefits in light of the heightened standard under *Newman*.

On Oct. 5, 2015, the U.S. Supreme Court declined to grant certiorari in *Newman*, prompting the government to move to dismiss insider trading charges against trader Michael Steinberg, as well as six others who pleaded guilty and cooperated with prosecutors in the case.

In the nearly two years since *Newman* was decided, dozens of criminal defendants across the country have cited the ruling in requests to overturn convictions, vacate guilty pleas, dismiss charges or receive leniency at sentencing. These efforts have been generally unsuccessful, and the vast majority of the more than 80 insider trading convictions piled up by the U.S. Attorney's Office in the Southern District of New York, mainly in the form of plea bargains, have remained undisturbed.

Cases in which a tippee directly gave something of value to a tipper have been unaffected by *Newman*. For example, in *Barnetson v. United States*, 12 CR 157 (KMW), 2016 WL 3023156 (S.D.N.Y. May 6, 2016), the defendant moved to vacate his guilty plea because he had not specifically pleaded to having received a personal benefit. The court denied Barnetson's request, holding that he had not disputed that he received the benefits set forth in the charging document, including "[e]xpensive meals and shipments of food," which are "benefits of pecuniary or similarly valuable nature" and therefore amount to a personal benefit under *Newman*. Id. at *2.

In *SEC v. Payton*, 155 F.Supp.3d 428 (S.D.N.Y. 2015), the court denied a motion for summary judgment brought by insider trading defendants several links removed from the original insider. The court identified the "closeness of the relationship" between the tipper and tippee, noting that "[t]hey were more than mere roommates," but were also "together at dinner, drank beers, played video games, watched TV, used drugs, and discussed their respective days, current events, and personal details of their lives." Id. at 433. The court also recognized that this relationship alone was not enough to create liability, finding that the tipper received assistance from the tippee in a criminal legal matter and benefited from the tippee's leadership in managing and negotiating their living expenses. Id.

In *United States v. Smith*, 11 Cr. 0079 (JSR), 2016 WL 1248961 (S.D.N.Y. March 25, 2016), the court denied an insider trading defendant's petition for relief where the tippee was aware that the tipper was paid a consulting fee for his tips. The court held that the facts in that case easily met the *Newman* standard. Id.

Even opinions from outside the Second Circuit, which are not bound by *Newman*, have focused on a tangible benefit to the tipper. In *United States v. Parigian*, 824 F.3d 5 (1st Cir. 2016), the court declined to adopt *Newman*'s test and cited First Circuit precedent suggesting that a social or business relationship would be sufficient to create liability. Nonetheless, the court noted that tipper and tippee were not just "reasonably good friends," but that the tipper "requested—and was promised—various tangible luxury items in return for the tips." Id. at 15. Acknowledging the uncertainty created by *Newman*, the court held that "the indictment's allegations of a friendship between McPhail and Parigian plus an expectation that the tippees would treat McPhail to a golf outing and assorted luxury entertainment is enough to allege a benefit if a benefit is required." Id. at 16.

In a separate opinion affirming McPhail's conviction for insider trading, the First Circuit noted that the tipper and tippee were "frequent golf partners" and "close friends," "communicated daily and saw one another several times a week," and that McPhail had benefited from a $3,000 kickback from a friend's sale of AMSC stock. The court also said that McPhail expected that he would receive "a free dinner, wine, and a massage parlor visit from the beneficiaries." *United States v. McPhail*, No. 15-2106, 2016 WL 3997214, at *7-8 (1st Cir. July 26, 2016). See also *SEC v. Andrade*, 157 F.Supp.3d 124, 2016 WL 199423, at *4 (D.R.I. Jan. 15, 2016) (allegation that tippee went to tipper's home to resolve a septic issue sufficient to show they have "the type of relationship where there was, at minimum, a give and take of sorts that had the potential for pecuniary gain").

Notably, the Supreme Court has granted certiorari to hear *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015), a case that some may view as at odds with *Newman*. Although the *Salman* court declined to adopt *Newman*, the facts in *Salman* seem to show a clear, tangible benefit to the tipper even under *Newman*'s more demanding standard. The government presented evidence that tipper and tippee enjoyed a "close and mutually beneficial relationship," including that "Michael helped pay for Maher's college, that he stood in for their deceased father at Maher's wedding," and that "Michael coached Maher in basic science to help him succeed at his job." Id. Thus, while the *Salman* court declined to adopt the defendant's interpretation of *Newman*, it is possible that Salman's conviction would have been upheld even under the *Newman* test.

In addition to its effect on pending cases, *Newman*'s repercussions can also be seen in the types of new cases the government is bringing. Since *Newman*, the government seems to have brought fewer criminal actions against remote tippees and has instead refocused its efforts toward prosecuting insider tippers and direct tippees. An even bigger change, however, is that the government is reluctant to rely on family or business relations alone, and is increasingly selective about bringing cases where the tipper clearly received a tangible benefit, and where the tippee (no matter how far removed from the insider) was aware of that benefit.

Department of Justice press releases for recent insider trading cases showcase this adjustment, and also indicate that the government has hardly given up on prosecuting tipper-tippee insider trading cases. For example, on May 19, 2016, the government announced charges against Billy Walters, a tippee who allegedly "provided [the tipper] with substantial pecuniary benefits, including, among other things, capital for joint business ventures and two loans of nearly $1 million that [the tippee] did not repay."

On May 31, the same office announced charges against Steven McClatchey, a tipper who directed an investment bank and "allegedly benefitted from thousands of dollars of cash payments and home repairs."

And on June 3, the office announced charges against David Hobsen, an investment adviser tippee whose tipper had allegedly received $40,000 from trades made by Hobsen.

*Newman* has plainly not prevented the government from bringing insider trading charges in cases where the tipper clearly received a tangible benefit from his disclosure of inside information. Another example of this can be seen in the recent conviction on Aug. 17 of Sean Stewart for conspiracy, securities fraud and tender offer fraud based on evidence that he leaked confidential information to his father, Robert Stewart. One key piece of evidence introduced at trial was that Robert used some proceeds to pay for Sean's wedding expenses and that on one other occasion, Robert appeared to transfer the trading proceeds directly to his son. The prosecution did not rely solely on the father-son relationship to prove its case.

## Conclusion

There is no way of knowing how many insider trading cases were not brought, or were investigated but dropped, due to lack of evidence of a tangible personal benefit. Nonetheless, recent insider trading indictments and convictions, and numerous decisions upholding insider trading convictions, show that insider trading prosecutions are alive and well, but with an increased focus on the pecuniary benefits the tipper actually received. The importance of this to the investing public and their counsel cannot be overstated. No one should believe that prosecutors' focus on insider trading cases has waned. Investors, compliance officers and counsel must remain as vigilant as ever to knowing the insider trading rules and preventing illegal behavior. ▪

*Robert Hoff is a partner and Andrew Giering is an associate at Wiggin and Dana.*