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WHAT'S INSIDE

INSIDER TRADING

What's at stake for insider trading prosecutions after *U.S. v. Newman*

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The 2nd U.S. Circuit Court of Appeals' landmark decision in *United States v. Newman* has sent shock waves through the securities bar, as the ruling has revitalized the defense for many insider trading cases and raised the standards for prosecutors seeking convictions for securities fraud.

United States v. Newman et al., No. 13-1837, amicus briefs filed (2d Cir. Feb. 26, 2015).

On Dec. 10 the appeals court overturned the convictions and prison terms of hedge fund portfolio managers Todd Newman and Anthony Chiasson after finding that the government had failed to prove they knew corporate insiders had disclosed confidential information for a "personal benefit." *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

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REUTERS/Mike Segar

Prosecutors are asking the full 2nd U.S. Circuit Court of Appeals to revisit a panel's decision to overturn the insider-trading convictions of two hedge fund portfolio managers. Here, one of the defendants, Hedge Fund Level Global Investors LP co-founder Anthony Chiasson, leaves the Manhattan federal courthouse in May 2013.

COMMENTARY

A novel strategy for clawing back fund distributions in Cayman

Rebecca Hume, Carrie Tendler and Jef Klazen of Kobre & Kim discuss recent developments in international arbitration and how Cayman Islands law may be used to claw back pre-liquidation redemption payments from investors.

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Insider trading

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information to a friend or relative with no present benefit or prospect of future reward," said **Lathrop Nelson**, partner at **Montgomery McCracken Walker & Rhoads** in Philadelphia, who was not involved in the case.

The appeals court noted that the defendants, or tippees, were not connected to the corporate insiders who had leaked the information. Moreover, the court said they had received the information from financial analysts, and there was no evidence that either defendant was aware of the original source of the tips.

Citing *Dirks v. Securities and Exchange Commission*, 463 U.S. 646 (1983), the appeals court explained that the "exchange of confidential information for personal benefit is not separate from an insider's fiduciary breach; it is the fiduciary breach that triggers liability for securities fraud."

In addition, the court said "personal benefit" may only be inferred by "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."

"Absent some personal gain, *there has been no breach of duty*," the court emphasized, citing *Dirks*.

Many commentators agree with the decision and say prosecutors had gone too far in pursuit of convictions.

"Over many years, prosecutors have forced numerous guilty pleas from defendants unwilling — and often unable to afford — to challenge the federal government's skewed position that the mere existence of a loosely defined 'friendship' between tipper and tippee is sufficient under the U.S. Supreme Court in *Dirks* to support insider trading liability," said **Arthur G. Jakoby**, co-chair of the securities litigation practice group at **Herrick Feinstein LLP** in New York, who was not involved in the case.

PETITION FOR REHEARING

The reaction from federal prosecutors was expected. Manhattan U.S. Attorney Preet Bharara on Jan. 23 asked the 2nd Circuit to grant a rehearing *en banc*, or by the full court. The SEC filed its own brief seeking rehearing Jan. 26.

Bharara contends that the ruling will curtail its prosecutions and "threatens the effective enforcement of the securities laws."

> "This is a significant holding, as it precludes prosecution in cases where an insider provides information to a friend or relative with no present benefit or prospect of future reward," said Lathrop Nelson, partner at Montgomery McCracken Walker & Rhoads.

He argues that the requirement that the insider-tipper acted for a "personal benefit" runs contrary to the U.S. Supreme Court opinion in *Dirks*. The government maintains that it only needs to show the defendants traded on material, nonpublic information that they knew was disclosed in breach of a duty.

AMICUS BRIEFS

Amicus briefs opposing rehearing have already been filed by Mark Cuban, the former owner of the NBA's Dallas Mavericks, who was exonerated on insider trading charges in 2013, and the National Association of Criminal Defense Lawyers and New York Council of Defense Lawyers.

Three law professors — Stephen Bainbridge of UCLA Law School, Todd Henderson of the University of Chicago Law School and Jonathan Macey of Yale University Law School — also filed a brief.

According to Cuban, Congress has failed to provide a clear definition of insider trading, and the government's efforts to expand the parameters should be curtailed. Cuban fought insider trading charges for six years and won but he says many defendants do not have the money to take the fight to trial.

The law professors say the ruling should stand as is.

"The panel's opinion in *Newman* is both a correct application of the personal benefit test adopted by the Supreme Court in *Dirks v. SEC* and an important corrective to the government's drive to expand the limits of insider trading liability," the professors' brief says.

Commentators also agreed that the holding should not be changed.

"A trader should not have to worry that entering into an innocent transaction that is free from the taint of a *quid pro quo* exchange could nevertheless subject him to her to prosecution," Herrick Feinstein's Jakoby added. "An injustice has finally been corrected and should not be disturbed."

In the petition for rehearing or any other appeal, the definition of "personal benefit" will be at the crux of the dispute.

"Although Bharara has petitioned for rehearing or *en banc* review of the decision, he did so only on the second issue of what constitutes a personal benefit, thus not challenging the panel's holding that tippees must know of the insider's personal benefit," Montgomery McCracken's Nelson said.

No matter what the outcome, both prosecutors and defense counsel alike will have to monitor the proceedings to be better able to determine liability for insider trading.

If the 2nd Circuit refuses to rehear the case, the government still has the option to appeal to the U.S. Supreme Court.

Corporate law blogger Kevin LaCroix said in a March 5 post on the D&O Diary that the controversy that has followed the 2nd Circuit decision "ensures that insider trading will continue to be a hot topic for some time to come." WJ

Related Court Documents:
2nd Circuit opinion: 773 F.3d 438
Petition for rehearing: 2015 WL 1064423
Chiasson's opposition: 2015 WL 1064410
Law professors' amicus brief: 2015 WL 1064409
Defense lawyers' amicus brief: 2015 WL 1064411
Cuban's amicus brief: 2015 WL 1064412

See Document Section A (P. 19) for the opinion and Document Section B (P. 37) for the law professors' brief.