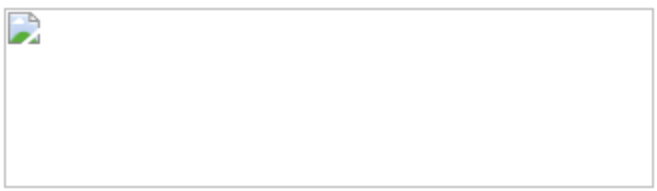
From: Richard Kahn <[redacted]>
To: "jeffrey E." <jeevacation@gmail.com>
Subject: Insider Trading After the Newman Decision
Date: Thu, 18 Dec 2014 21:37:10 +0000

Richard Kahn
HBRK Associates Inc.
575 Lexington Avenue 4th Floor
New York, NY 10022
tel [redacted]
fax [redacted]
cell [redacted]

---------- Forwarded message ----------
From: **Sadis & Goldberg Securities Litigation Group** <[redacted]>
Date: Thu, Dec 18, 2014 at 12:59 PM
Subject: Insider Trading After the Newman Decision
To: [redacted]



SECURITIES LITIGATION ALERT December 18, 2014

Insider Trading After the Newman Decision

U.S. v. Newman, --- F.3d ----, 2014 WL 9611278 (2d Cir., Dec. 10, 2014)

For further information about this *Alert*, please contact:

Douglas Hirsch
Partner
[redacted]

Jennifer Rossan
Partner
[redacted]

Sam Lieberman
Partner
[redacted]

Please feel free to discuss any aspect of this *Alert* with your regular Sadis & Goldberg contact or with any of the partners whose names and contact information can be found at the end of the *Alert*.

On December 10, 2014, the Second Circuit issued a decision reversing the insider trading convictions of Todd Newman and Anthony Chiasson and ordering the dismissal of their indictments with prejudice. The decision has been the talk of the legal community and Wall Street, as it represents a rare loss for U.S. Attorney Preet Bharara in his signature insider trading crackdown - indeed it appears to represent just his second and third losses after the Rengan Rajaratnam trial. This decision is likely to give rise to a number of other reversals of convictions, thereby representing a serious set-back for the U.S. Attorney's Office, and, by logical extension, the Securities and Exchange Commission ("S.E.C.").

The *Newman* decision is surprising in that it reverses the convictions while making very little, if any, new law. In short, the decision simply re-examines the Supreme Court's 1983 landmark decision in *S.E.C. v. Dirks*. Newman instructs that *Dirks* has been the law for over thirty years, and sets a high bar for prosecutors seeking to bring an insider trading case against a remote tippee: The Government must prove both that the tipper received a valuable personal benefit in exchange for disclosing confidential information and that the tippee who traded knew of that benefit. Until now, the Government had successfully argued in many cases that it only had to prove that the tipper received an abstract, intangible personal benefit and that the tippee only needed to know that information was disclosed in breach of a duty to keep it confidential.

The Decision

The Government's case in *Newman and Chiasson* arose out of two tipping chains from insiders at Dell and NVIDIA. At the time of the alleged tips, Newman was a portfolio manager at Diamondback and Chiasson at Level Global.

Dell Tipping Chain

The evidence established that Rob Ray of Dell's investor relations department tipped information regarding Dell's consolidated earnings numbers to Sandy Goyal, an analyst at Neuberger Berman. Goyal then allegedly gave the information to Diamondback analyst Jesse Tortora. Tortora then relayed the information to his boss, Newman, as well as to other analysts, including Level Global analyst Spyridon "Sam" Adondakis. Adondakis then passed along the Dell information to Chiasson.

So, Newman was three levels removed from the inside tipper and Chiasson was four levels removed from the inside tipper in the Dell chain.

NVIDIA Tipping Chain

The evidence in the NVIDIA tipping chain revealed that the tippee's were even more remote then in the Dell chain. Chris Choi of NVIDIA's finance unit tipped inside information to Hyung Lim, a former executive at technology companies Broadcom Corp. and Altera Corp., whom Choi knew from church. Lim passed the information to co-defendant Danny Kuo, an analyst at Whittier Trust. Kuo circulated the information to a group of analyst friends, including Tortora and Adondakis, who in turn gave the information to Newman and Chiasson, making Newman and Chiasson four levels removed from the inside tippers.

The Second Circuit's Explanation of Tipper-Tippee Liability

The Second Circuit noted that the original tippers-Ray and Choi-had not been charged administratively, civilly or criminally for insider trading or any other wrongdoing.

Yet the Government charged that Newman and Chiasson were liable criminally for insider trading because, as sophisticated traders, they must have known that information was disclosed by insiders in breach of a fiduciary duty, and not for any legitimate corporate purpose.

Although the Government conceded that tippee liability required proof of some type of personal benefit to the insider, it argued that it was not required to prove that Newman and Chiasson knew that the insiders at Dell and NVIDIA received a personal benefit in order to be found guilty of insider trading.

The Second Circuit emphatically rejected the Government's position. It held that in order to sustain an insider trading conviction against a tippee, the Government must prove each of the following elements beyond a reasonable doubt:

1. The corporate insider was entrusted with a fiduciary duty;
2. The corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit;
3. The tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged for personal benefit; and
4. The tippee still used that information to trade in a security or tip another individual for personal benefit.

The Court Rejects the Lower Court's Jury Instruction as Fatally Flawed

In the case of Newman and Chiasson, the district court erroneously refused to instruct the jury that in order to be found guilty, Newman and Chiasson had to have known that the tippers received a personal benefit for their disclosure.

The Circuit noted that this mistake by the district court was critical. The Circuit explained that it is not enough if either defendant knew that an insider had divulged information that was required to be confidential-a breach of the duty of confidentiality is not fraudulent unless the tipper acts for personal benefit. The Circuit noted that "there is no breach unless the tipper 'is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself...'" [1}

The Court went on to analyze whether the evidence at trial satisfied all of the elements necessary to sustain the convictions. It concluded that there was insufficient evidence that the corporate insiders received any personal benefit in exchange for their tips.

As to the Dell tips, the evidence established only that Goyal and Ray had known each other for years and that Ray sought career advice from Goyal. As to NVIDIA, the evidence established that Lim and Choi were family friends who had met through church and occasionally socialized together. The Government argued that these facts established that the tippers derived some benefit from the tip.

The Court disagreed. Noting that while "personal benefit" is broadly defined, the Government cannot prove the receipt of a personal benefit by the mere fact of friendship. Instead, the Government must provide "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." [2] This means proof of "a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the [latter]." [3]

The Court found that the Government did not establish personal benefit in the Dell chain because: i) the career advice Goyal gave Ray was nothing more than would be expected from a fellow alumnus or casual acquaintance; ii) Goyal testified that he would have given Ray the advice without receiving information because he routinely did so for colleagues; iii) Ray disavowed that any *quid pro quo* existed, and iv) Goyal had been giving Ray career advice for over a year before Ray began providing any insider information.

For these reasons, the Court found that it was impossible for a jury to have found beyond a reasonable doubt that Ray received a personal benefit in exchange for the disclosure of confidential information.

In the NVIDIA chain, the evidence established only that Choi and Lim were casual acquaintances. There was no history of loans or personal favors between the two. Lim testified that he did not provide anything of value to Choi in exchange for the information. Lim also testified that Choi did not know that Lim was trading NVIDIA stock (and for the relevant period Lim did not trade stock), which undermined any inference that Choi intended to make a "gift" of the profits earned on any transaction based on confidential information.

Even if the evidence was sufficient to support and inference of a personal benefit-which it was not-the Government presented no evidence that Newman and Chiasson knew that they were trading on information obtained from insiders or that those insiders received any benefit in exchange for the information or even that Newman and Chiasson consciously avoided learning those facts. But the Government was required to prove beyond a reasonable doubt that Newman and Chiasson knew that the insiders received a personal benefit in exchange for providing confidential information.

It was undisputed that Chiasson and Newman, and even their analysts (who testified as cooperating witnesses for the Government), knew next to nothing about the insiders and nothing about what, if any, personal benefit had been provided to them.

The Circuit rejected the Government's argument that the jury could have found that Newman and Chiasson knew the insiders disclosed the information "for some personal reason rather than for no reason at all." But the Court noted that the Supreme Court affirmatively rejected the premise that a tipper who discloses personal information necessarily does so to receive a personal benefit.

Finally, the Court rejected the Government's argument that the specificity, timing, and frequency of the updates provided to Newman and Chiasson about Dell and NVIDIA were so "overwhelmingly suspicious" that they had to have known it was inside information. But the Court found that the evidence at trial undermined that inference because the financial information at issue was the kind that was regularly and accurately predicted by analyst modeling and the tippees are several levels removed from the source.

And, even if the detail and nature of the information could support an inference that it was inside information, it could not permit an inference as to that source's improper motive for disclosure-especially in this case, where evidence showed that corporate insiders at Dell and NVIDIA regularly worked with analysts and selectively leaked information to financial firms who might be in a position to buy the company's stock.

The Court Orders the Lower Court to Dismiss the Indictments Altogether

In a striking move, the Second Circuit decision also took the extraordinary step of instructing the district court on remand to dismiss the Newman and Chiasson indictments altogether. No retrial, just a dismissal of the entire case. The Court reasoned that dismissal was warranted both because (i) the Government's evidence of any personal benefit received by the alleged insiders was insufficient to establish the tipper liability on which defendants' tippee liability was based, and (ii) the Government presented no evidence that Newman and Chiasson knew that they were trading on information obtained from insiders in violation of those insiders' fiduciary duties, the indictments were dismissed with prejudice.

Key Takeaways

The decision flatly rejects the Government's and the SEC's view that all trading based upon confidential information is illegal. With this in mind, we believe that the following points represent the more important ramifications of this decision.

* T**he Government Will Bring Fewer Remote Tippee Cases:** The Circuit's holding that the Government must prove a tippee knew an insider breached a fiduciary duty by disclosing information *and* received a "*quid pro quo*" personal benefit makes it very hard to prove a case where the ultimate tippee is several steps removed from the original tipper. It will be difficult to prove the ultimate tippee knew that the original tipper received a personal benefit from disclosing insider information. Where inside information passes through several people, the ultimate tippee may not know of any personal benefit. The "*quid pro quo*" benefit that *Newman* requires must be "objective, consequential" and represent at least a potential financial or similarly valuable benefit. This means the government's prior reliance on abstract, intangible "benefits" such as friendship, career advice, mentoring, or networking - which had previously been thought to be sufficient - will no longer be enough to prove insider trading.

* **There is Evidence the S.E.C. is Already Starting to Re-Evaluate Their Cases:** Just three business days after the *Newman* decision, the S.E.C. announced that it was dismissing an insider trading claim against a man the S.E.C. alleged had traded on a tip that Bill Ackman would short Herbalife's stock. *S.E.C. v. Peixoto*, Ad. Pro. No. 3-16184 (filed Sept. 30, 2014). Although the S.E.C. claimed the dismissal was due to the unavailability of witnesses, the suspicious timing -- plus the fact that the S.E.C.'s tipper personal benefit allegations were based on friendship - strongly suggests the dismissal was a response to the Newman decision.

* **Not Very Likely the Supreme Court Will Review This Case:** It is unlikely that the Supreme Court will

grant a petition for certiorari to review the *Newman* decision, since it is rare for that Court to grant such a petition. The *Newman* decision merely applied principles from the Supreme Court's prior decision in *Dirks v. S.E.C.*, 463 U.S. 646 (1983), giving the Supreme Court very little reason to re-visit *Dirks*. Further, the Newman decision did not explicitly identify a Circuit-Split with decisions by other Circuit Courts, which is the primary basis for obtaining Supreme Court review. So although *Newman* does create some tension with the insider trading rulings of other Circuit Courts, its refusal to acknowledge a clear Circuit-Split may end up insulating it from review by the Supreme Court in the short-term.

* **Will Congress Fill the Void? Unlikely.** Congress has the power to address the obstacles to bringing remote-tippee cases or weak personal benefit cases that *Newman* has created. But, at least at this point, there does not appear to be any groundswell for Congress to take action on this point. In fact, if Congress were to address this issue, it would require Congress to enact a comprehensive insider trading statutory scheme which presently does not exist.

* **The S.E.C. Will Bring More Insider Trading** Cases in Administrative Proceedings: With Newman making it harder to prove insider trading, expect the S.E.C. to bring more insider trading cases before its own administrative la judges. Prior to *Newman*, the S.E.C. had already begun bringing more insider trading cases in administrative proceedings involving judges employed by the S.E.C. And it will almost certainly increase the pace as it gets more difficult to prove insider trading before judges that are not on the S.E.C.'s payroll.

---

1 2014 WL 9611278, at *8
2 *Id.* at *10
3 *Id.*

If you have any questions regarding the decision or would like to discuss this Alert further, please contact Litigation partners Douglas Hirsch at [redacted], Jennifer Rossan at [redacted] or Sam Lieberman at [redacted].

Sadis & Goldberg LLP

Please feel free to discuss any aspect of this Alert with your regular Sadis & Goldberg contact or with any of the partners, whose names and contact information are provided below.

Alex Gelinas, [redacted]
Daniel G. Viola, [redacted]
Danielle Epstein-Day, [redacted]
Douglas Hirsch, [redacted]
Jeffrey Goldberg, [redacted]
Jennifer Rossan, [redacted]
Lance Friedler, [redacted]
Mitchell Taras, [redacted]
Paul Fasciano, [redacted]
Ron S. Geffner, [redacted]
Sam Lieberman, [redacted]
Steven Etkind, [redacted]
Steven Huttler, [redacted]
Yehuda Braunstein, [redacted]

If you would like copies of our other Alerts, please visit our website at www.sglawyers.com and choose "Library".

---

timeliness. Transmission or receipt of this information does not create an attorney-client relationship with Sadis & Goldberg LLP. Electronic mail or other communications with Sadis & Goldberg LLP cannot be guaranteed to be confidential and will not create an attorney-client relationship with Sadis & Goldberg LLP.

Sadis & Goldberg LLP | 551 Fifth Avenue, 21st Floor | New York, NY 10176 | 212.947.3793