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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Feds To Rethink Insider Trading Strategy After Newman Snub

By **Ed Beeson**

Law360, New York (October 5, 2015, 9:08 PM ET) -- Now that the U.S. Supreme Court has shown no interest in taking on a landmark insider trading appeal this term, federal prosecutors have to contend with a remade legal landscape that will force them to cut back on some cases, let go of others and figure out ways around the high standards for proving the crime.

Nearly 10 months after the Second Circuit stunned the world of white-collar prosecutions with its decision in U.S. v. Newman, the Supreme Court on Monday effectively declared it the law of the land when it denied a petition for certiorari from the U.S. Department of Justice seeking a review of the matter.

In doing so, the high court leaves intact a ruling that Manhattan U.S. Attorney Preet Bharara and others deeply disagree with, because it forces the government to show evidence that may not exist in cases where someone has tipped off someone else with material nonpublic information.

The Second Circuit's decision, rendered in December, held that to prove illegal insider trading between a tipper and tippee, the government has to show the tipper received a benefit that is objective, consequential and potentially pecuniary, and that the tippee knew of this benefit. In other words, it isn't enough to allege that insider tips were passed to deepen a friendship or in exchange for career advice, the court said.

In pursuing his appeal, Bharara and others said the decision would raise hurdles for prosecutors looking to go after what they called some of the most pernicious forms of insider trading. On Monday, the top Manhattan federal prosecutor extended the thought by saying that while his office will continue to bring charges in "appropriate" cases, there are some that are now out of his reach.

"We think there is a category of conduct that arguably will go unpunished going forward," Bharara said on a call with reporters.

In particular, the Newman decision will make bringing a case against a chief executive who tips off friends and family about upcoming earnings much more of an open question, he said.

"We would have to think long and hard, given Newman, about whether or not we can prosecute a person like that," Bharara said.

The Newman decision, which overturned the criminal convictions of former hedge fund traders Todd

Newman and Anthony Chiasson, is seen as setting up a pair of evidentiary challenges for criminal authorities and the U.S. Securities and Exchange Commission when it comes to cases in Wall Street's backyard involving tippers and tippees.

Authorities will have to prove that a tippee knew a significant personal benefit was exchanged for the inside information they received. But what may be a more difficult task for prosecutors is the question of what counts as a personal benefit.

While the knowledge of a personal benefit affects cases involving so-called remote tippees, such as Newman and Chiasson, "the definition of what constitutes a personal benefit potentially affects every tippee case," said David I. Miller, a former federal prosecutor who is now at Morgan Lewis & Bockius LLP. It is likely there will be extensive litigation on the topic of personal benefit, attorneys said.

It is also anticipated that the Newman decision will lead to additional criminal convictions being overturned, while other pending cases may get dropped. These include the conviction of former SAC Capital Advisors LP portfolio manager Michael Steinberg, who was accused of trading on the same inside information on Dell Inc. and Nvidia Corp. stock as Newman and Chiasson.

On the conference call with reporters, Bharara declined to comment on the future of specific cases. But an attorney for Steinberg said the Supreme Court's decision will require the former hedge fund manager's conviction to be thrown out as well.

The Newman decision has impacted other cases as well. Last month, an SEC administrative law judge dismissed an insider trading suit the enforcement division brought against former Wells Fargo trader Joseph Ruggieri, saying it did not hold up following the Newman opinion. The enforcement division on Monday filed an appeal over the judge's initial decision, which would have required commission approval to become final.

While no one expects the Newman decision to cause the government to turn away from prosecuting insider trading, authorities are likely to say no to cases that don't appear likely to end in victory and survive on appeal.

"Cases that might have looked like slam dunks before, prosecutors now will take a hard look at," said Nicholas Berg, partner at Ropes & Gray LLP.

"It will deter prosecutors from pursuing insider trading cases unless they can show a concrete quid pro quo," said Richard J. Holwell, a former federal judge who oversaw the insider trading trial of Galleon Group LP founder Raj Rajaratnam and is co-founder of Holwell Shuster & Goldberg LLP.

Criminal authorities, however, will examine options to escape Newman's reach, noted Andrew Tomback, partner at McDermott Will & Emery LLP.

There are mail and wire fraud charges under Title 18 of U.S. criminal code that could be used in place of, or in conjunction with, the Section 10(b) claims that typically have been used to charge insider trading, Tomback said. Doing so allows prosecutors to avoid the personal benefits question demanded by the Second Circuit. But such charges also present their own evidentiary challenges, such as the need to show a defendant had affirmatively joined a scheme to defraud.

The strategy may not always work. A jury in Georgia recently acquitted a former hedge fund manager

accused of insider trading under Title 18 charges, said Tomback, whose firm handled the defense in the case. And because they are over criminal conduct, Title 18 charges aren't available to the SEC, he added.

Another strategy authorities may try is to bring cases outside the Second Circuit, where the benefits question is not set in stone, noted Berg of Ropes & Gray. Given that many alleged trading schemes are not tied a single jurisdiction, to a degree "the government does have an ability to pick its forum," he said.

Another circuit may take a different view on the question of what constitutes a personal benefit, leading to the potential for a circuit split.

In its petition for certiorari, the government argued that a split had emerged between the Second and Ninth circuits on the benefits question. Sitting by designation on the California federal appeals panel, New York federal Judge Jed S. Rakoff ruled that, in a case involving a man who allegedly traded on tips he indirectly received from his brother-in-law, the government did not have to prove the information was disclosed for a personal benefit.

This purported split, which emerged over the summer, apparently did not sway even the minimum number of four justices it takes to grant certiorari. Attorneys said they were somewhat surprised by this outcome, but agreed it is likely the justices and their clerks preferred to wait and see how the Newman decision plays out in the courts below before weighing in on it themselves.

"Insider trading law is essentially judge-made law. There is a good argument, when there is a significant dispute across courts on what constitutes a violation, that you either need a legislative fix or the Supreme Court to resolve the split below," said Miller of Morgan Lewis. "Right now, we have neither."

Eventually, the question of insider trading is likely to come back before the Supreme Court, attorneys say, especially if Congress doesn't pass a legislative fix to the ambiguities of the law.

"The fact that they didn't deal with it now won't necessarily mean they won't, or won't have to, in the future," said Holwell, the former federal judge.

--Editing by John Quinn and Philip Shea.