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High Court Expected To Hear Insider Trading Appeal

By **Ed Beeson**

Law360, New York (July 30, 2015, 8:57 PM ET) -- The U.S. Supreme Court likely will grant the government's request to review the landmark Newman decision on insider trading after being pressed with arguments that the Second Circuit went against high court precedent and created a circuit split over the role "benefits" play in determining what counts as illegal tipping, experts say.

In an eagerly awaited move, U.S. Solicitor General Donald Verrilli on Thursday filed a petition for certiorari over the Second Circuit's December decision in U.S. v. Newman, which voided the convictions of a pair of hedge fund managers and raised the bar on what the government must show to prove illegal insider trading.

The petition takes on one prong of the Newman standard: to prosecute insider trading, the government has to show a tipper received a significant, potentially pecuniary benefit in exchange for inside information. In other words, as the Second Circuit has held, the government has to do more than allege that tips were used to advance a friendship to prove liability.

But rather than simply call the benefit test erroneous, the solicitor general kicked off his appeal by arguing the Second Circuit broke with Dirks v. SEC, a watershed insider trading decision from the high court. Addressing that argument, along with the emergent circuit split, should prove irresistible to the justices, attorneys say.

"'This court is not doing what you said.' That's powerful," John Zach, a Boies Schiller & Flexner LLP partner and former assistant U.S. attorney, said.

The Dirks decision, from 1983, found that a stock market analyst couldn't be held liable for aiding and abetting insider trading after having passed on a whistleblower's tip about a possible corporate fraud to clients that ended up trading on the information. Because the tipper did not receive a personal benefit for passing on the information, there was no breach of fiduciary duty and, thus, the tippees could not be held liable, the high court ruled.

Verrilli argues that the Newman court broke with Dirks by holding that liability for "gifting" inside information only arises when there is a "meaningfully close personal relationship" that produces an exchange of benefits in which the tipper receives something that is "objective, consequential" and is at least potentially pecuniary or similarly valuable.

"That holding cannot be reconciled with Dirks, which did not require an 'exchange' to find liability for a

gift of inside information and did not impose amorphous standards for the relationships that can support liability," the solicitor general wrote.

The solicitor general further argued that this decision conflicts with a recent Ninth Circuit holding, in U.S. v. Salman, that Dirks does not require evidence of an exchange of money for inside information in a case where the tipper and tippee were close relatives or friends.

A concern the government and others have raised about Newman is that it could theoretically give insiders a pass for tipping a favored friend if they get nothing in return.

"What the government wants here is this commonsense notion that ... quid pro quo is not necessary for some prosecutions," said Zach, who served on the trial team that prosecuted the hedge fund managers, Todd Newman and Anthony Chiasson, at the heart of Thursday's appeal. "That's not how the real world works."

Settling the ambiguity of the Newman decision, from what counts as a personal benefit to what establishes a meaningfully close relationship, is a fertile area for the high court. Even Wall Street itself, and the hedge fund sector in particular, which was the focus of U.S. Attorney Preet Bharara's crackdown on insider trading in years past, likely wants the proverbial rules of the road clarified.

"To the extent the Supreme Court can make the legal requirement more transparent, all investors and the market would benefit," David Parker, a partner at Kleinberg Kaplan Wolff & Cohen PC, said.

Past Supreme Court rulings on insider trading law, including Dirks, have been read as telling market participants what they could do to get information that is nonpublic, attorney said.

"You could be a ferret but not a weasel," John Donovan, a partner at Ropes & Gray LLP, said.

For example, it could be permissible to root out information about a company's retail sales by monitoring traffic coming in and out of their stores. But Newman's holding on what creates tipper liability "sort of erases the ferret-versus-weasel distinction," Donovan said.

That may stir the Supreme Court to act. So could the general buzz in the public around the decision.

"The Supreme Court sometimes waits for an issue to percolate through the circuits for a while," he said. "But I don't think that will happen in this case. There is enough commentary, nervousness about [Newman]. I think this may be the occasion they take to clarify things."

There is a risk to the government, of course, that the justices, if they take the case, end up ruling against it.

They could uphold Newman and makes it the law of the land, though the government may view the danger of that as acceptable compared to simply allowing Newman to stand.

"Because over half of the insider trading cases are brought in the Southern District, it's not surprising it's a risk they're willing to take," said David I. Miller, a former assistant U.S. attorney who is now a partner at Morgan Lewis & Bockius LLP.

But there is also the chance that the court could go even further, or head in an unexpected direction.

The justices could dictate something in a decision that cuts back on a power the government always thought it had.

“They’re taking a risk that the elasticity with which they have been bringing prosecutions would be tightened,” Donovan said.

The government is also taking a gamble that the high court will stick by a 32-year-old ruling, according to Donald Langevoort, a law professor at Georgetown University.

"The argument assumes that the court will hold to what it said in Dirks — crucial language in which the Second Circuit ignored — rather than take an interest in the criminal aspect of the case and whether the Dirks approach, if taken literally, affords enough notice and predictability to satisfy due process," he said.

Additionally, Justices Antonin Scalia and Clarence Thomas last year signaled an interest in taking up a case that examines whether courts should defer to agency interpretations of laws that are subject to both criminal and administrative enforcement. This call, filed as an unusual note to a denial of a cert petition from another hedge fund manager convicted of insider trading, potentially could be put to the test in Newman.

“You don’t know how it’s going to play out, and what they’re going to latch onto,” Zach said. “Surprises happen all the time in the Supreme Court.”

The U.S. is represented by Solicitor General Donald B. Verrilli Jr., Assistant Attorney General Leslie R. Caldwell, Deputy Solicitor General Michael R. Dreeben, Assistant to the Solicitor General Elaine J. Goldenberg and Ross B. Goldman.

Newman is represented by Stephen Fishbein and John Nathanson of Shearman & Sterling LLP. Chiasson is represented by Gregory Morvillo of Morvillo LLP.

The case is United States of America v. Todd Newman and Anthony Chiasson, case number unavailable, in the Supreme Court of the United States.

--Additional reporting by Stephanie Russell-Kraft. Editing by Chris Yates and Emily Kokoll.
