

Rakoff Looms Over DOJ's Newman Appeal Decision

By **Stephanie Russell-Kraft**

Law360, New York (July 28, 2015, 7:01 PM ET) -- With just days left to petition the U.S. Supreme Court to review the Second Circuit's landmark Newman insider trading decision, the U.S. Department of Justice is likely eyeing a recent opinion by District Judge Jed Rakoff as the potential ammunition it would need to mount a winnable case, experts say.

In April, the Second Circuit summarily denied Manhattan U.S. Attorney Preet Bharara's request for an en banc rehearing of its landmark U.S. v. Newman decision, which in December reversed the convictions of two hedge fund managers and raised the bar on the government to prove illegal insider trading. The court found that in order to establish liability, the government must show a tipper received a significant personal benefit for the tip and that the tippee knew about the benefit.

Since then, Bharara and Solicitor General Donald B. Verrilli Jr. have been mulling an appeal, likely weighing their desire to undo the damage of that ruling against the risk of making it the law of the land. Verrilli asked the high court in June for extra time to make the decision, and the DOJ's final answer is due Aug. 1, a Saturday deadline that will roll over to Monday.

While the likelihood of an appeal at first seemed slim, many experts say Judge Rakoff's recent Ninth Circuit decision may have shifted the tide. In early July, Judge Rakoff upheld the insider trading conviction of Bassam Yacoub Salman, ruling that the Supreme Court's 1983 decision in *Dirks v. SEC* did not require evidence that a tipper received a monetary benefit in exchange for a tip even in a case where the tipper and tippee were close relatives or friends. Insofar as the Second Circuit meant otherwise in *Newman*, Judge Rakoff said he couldn't agree with it.

"I think Newman's holding on personal benefit poses more questions than it answers, and while the Salman decision did not reject Newman, it did say that if Newman could be read the way that Salman was arguing it should be read, then the Ninth Circuit was rejecting the Second Circuit's view," said David I. Miller, a partner at Morgan Lewis & Bockius LLP and a former assistant U.S. attorney in the Southern District of New York.

In order to bring the case before the high court, Bharara would need to get permission from Verrilli, who might be more risk-averse than the Manhattan prosecutor, especially in light of the steep uphill battle the DOJ would face first in getting the case heard and then in winning it. With the cards stacked against it, the government might not want to run the risk of setting Newman dicta in an even bigger stone.

But then again, because the majority of insider trading cases are brought in the Second Circuit — where

prosecutors also have the highest level of expertise in securities law — the DOJ might not have as much to lose if Newman ends up being applied across the country. Practically speaking, it already is.

The Ninth Circuit's Salman ruling also gives the DOJ an alternative interpretation to offer the Supreme Court, according to Jonathan Schmidt, counsel of Ropes & Gray LLP's government enforcement practice.

"I think what Salman does is it makes it a little more likely that the government would appeal, because now they arguably have a circuit split and a favorable opinion written by a distinguished jurist who has thought deeply about these issues," he said.

"Newman is a difficult decision for prosecutors," he added. "Salman is not."

The Manhattan U.S. attorney has remained tight-lipped on the topic of a potential appeal, but it is clear from the DOJ's papers in the case that it seriously disagrees with the Newman ruling, according to McDermott Will & Emery LLP partner Eugene Goldman, who believes the government might take the case to the justices.

"The government's strong disagreement with the legal underpinnings of this ruling particularly on the need to prove the remote tippee's awareness of the tipper's personal benefit, makes it likely that it will seek the Supreme Court's review," Goldman said.

Former federal prosecutor Bob Appleton said he would be "surprised" if the government just accepted the Newman decision as-is. He said the DOJ, with the support of the U.S. Securities and Exchange Commission, would likely ask the Supreme Court to rule decisively whether the Newman ruling complies with Dirks, which established the conditions under which tippees can be held liable for insider trading.

The DOJ would likely argue that Newman's two primary holdings — that prosecutors must show a tippee knew a tipper received a benefit and that the benefit was tangible and identifiable — went a step too far beyond Dirks, according to Appleton.

"There are definitely no bright-line rules in this area now, and insider trading law appears to be developing on a case-by-case basis, now more than ever," Appleton said.

A spokeswoman for the SEC, which has also been following Newman dicta in its in-house cases, declined to comment Tuesday on the decision and whether the agency is involved in it. Attorneys for Todd Newman and Anthony Chiasson, the two hedge fund managers freed by the Newman decision, also declined to comment on a potential DOJ appeal.

But by Monday, it will be clear whether or not Judge Rakoff's opinion has provided the DOJ with the leverage it believes it needs to take on the Newman ruling.

"Since the deadline to file a petition is Aug. 1, they've certainly made up their minds," Morgan Lewis' Miller said. "Whatever they're doing, it's already written — or not."

--Editing by Chris Yates and Kelly Duncan.
