Client Alert: Second Circuit Overturns Insider Trading Convictions, Requiring Knowledge of Personal Benefit as Element in Tippee Cases

Summary:

In a sweeping decision that stands to curtail the scope of insider trading prosecutions, today the United States Court of Appeals for the Second Circuit, in *United States v. Newman et al.* 13-1837-cr, overturned the 2013 convictions of two portfolio managers and directed the lower court to dismiss the indictments against them with prejudice. The Second Circuit held that the district court's jury instructions, following a six-week jury trial, were erroneous because the instructions did not specifically require the jury to find beyond a reasonable doubt that the tippee knew: (1) that the insider disclosed confidential nonpublic information, and (2) *that the insider did so in breach of the insider's fiduciary duty (that is, in exchange for personal benefit).*

Defendants Todd Newman and Anthony Chiasson were charged under the tipper-tippee theory that extends classical insider trading liability to cases in which an insider does not personally trade but instead reveals material, nonpublic information to another individual who trades. Tippee liability requires: (1) that the insider disclosed material, nonpublic information in breach of a fiduciary duty, and (2) that the person in receipt of that tip knew, or should have known, at the time the trade occurred that the disclosure constituted a breach of the insider's fiduciary duty. *United States v. Dirks*, 463 U.S. 646, 662 (1983). *Newman* reaffirmed that "an insider's disclosure of confidential information, standing alone, is not a breach." Rather, an insider's tip is a breach of that insider's fiduciary duty where he or she will personally benefit, directly or indirectly, from the disclosure.

The decision in *Newman* makes clear that a tippee is not liable where he or she merely knew that an insider had divulged information that was required to be kept confidential. Instead, because a breach is premised on the insider's receipt of a personal benefit, the government must show that the tippee knew of the personal benefit received by the insider in exchange for the disclosure. This heightens the government's burden with respect to demonstrating a defendant's criminal intent to commit insider trading.

Background:

At trial, prosecutors presented evidence that a group of financial analysts exchanged information obtained from insiders at Dell and NVIDIA regarding those companies' earning numbers before they were publicly released in earnings announcements. The analysts then passed this information on to their portfolio managers, including Todd Newman of Diamondback Capital Management LLC and Anthony Chiasson of Level Global Capital Management. Newman and Chiasson then traded in Dell and NVIDIA stock. Diamondback Capital Management took in approximately $4 million in profits from the trades, while Level Global Investors made approximately $68 million.

With respect to Dell, Newman and Chiasson were three and four levels removed from the inside tipper, respectively. A member of Dell's investor relations department initially tipped information about the company's earnings to an analyst at Neuberger Berman. That analyst, in turn, gave the information to Diamondback analyst Jesse Tortora. Tortora then gave the information to his manager Newman and to an analyst at Level Global. Finally, the Level Global analyst passed the information on to Chiasson.

With respect to NVIDIA, Newman and Chiasson were four levels removed from the insider tipper. A member of NVIDIA's finance unit tipped earning information to a former executive at technology companies Broadcom Corp. and Altera Corp. The executive passed the information on to an analyst at Whittier Trust, who then circulated the information to a group of friends, including Tortora at Diamondback. Tortora, in turn, forwarded the information to Newman and Chiasson.

No evidence was presented at trial to suggest that either Newman or Chiasson was aware of the source of the inside information or that the source received a personal benefit from the tippee.

Analysis:

By clarifying that tippee liability requires knowledge, actual or constructive, of a personal benefit gained by an insider in return for disclosure in breach of a fiduciary duty, *Newman* limits the ability of prosecutors to bring cases against remote tippees many levels removed from corporate insiders. In its decision, the Court rebuked the "doctrinal novelty of [the Government's] recent insider trading prosecutions," contrasting the recent string of cases against remote tippees with prior cases that "generally involved tippees who directly participated in the tipper's breach…or tippees who were explicitly appraised of the tipper's gain."

In terms of what constitutes a "personal benefit," the Second Circuit stated that the government cannot prove the "receipt of a personal benefit by the mere fact of friendship, particularly of a casual or social nature." Rather, the government must prove 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," and noting further that "in order to form the basis for a fraudulent breach, the personal benefit received in exchange for confidential information must be of some consequence." In this case, "career advice" provided to the tipper was not enough to constitute a personal benefit.

If you have any questions concerning this, please contact any of the following Seward and Kissel attorneys:

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