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Battle Lines Now Clearly Drawn In Newman

Law360, New York (September 10, 2015, 10:12 AM ET) -- The battle lines are now clearly drawn over Newman and what constitutes impermissible tipping in violation of Exchange Act Section 10(b)(here). Previously, the government filed a petition for certiorari arguing that Newman, which addressed the requirements of the Dirks personal benefit test, put an impermissible "gloss" on Dirks. Specifically, the government argued that Newman is inconsistent with Dirks' personal benefit test, that now there is a conflict in the circuits and law enforcement is being hindered in its war on insider trading. The brief for respondent Anthony Chiasson in opposition, filed in U.S. v. Newman, No. 15-137 (S.Ct.), refutes those points.



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The Brief

The respondent's brief argues four points: 1) The Second Circuit faithfully applied Dirks; 2) there is no conflict among the circuits; 3) this case is not an appropriate vehicle for consideration of this issue; and 4) granting certiorari would not be beneficial for the markets.

The respondent framed the question for decision as "Whether the evidence was insufficient to prove that the corporate insiders in this case received a personal benefit from disclosing information to particular tippees." Following a lengthy review of the factual record, which hews closely to the presentation in Newman, the respondent addressed the central question in the case, arguing that Newman is nothing more than Dirks revisited, followed and applied.

First, Dirks recognized that not every disclosure of inside information violates the law. Rather, there is only liability when the insider makes the material nonpublic information available to an outsider "improperly." Since the position of the tippee derives from that of the insider, a "tippee is prohibited from trading on material nonpublic information only when he 'knows or should know' that 'the insider has breached his fiduciary duty to the shareholders by disclosing the information,'" quoting Dirks.

Second, the "focus" of the inquiry in assessing tippee liability, the respondent argues, is "whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings," quoting Dirks. The court went on to identify certain objective factors and circumstances that can justify an inference of personal gain. Those can include the fact where there is a relationship between the insider and the recipient that suggests a quid pro quo from the tippee or an intention to benefit the particular recipient. This can include situations where there is a gift because the tip and trade resemble trading by the insider himself. Here there was no evidence to support this.

Third, the government's argument focuses on a single sentence from the Newman opinion, according to the respondent, noting that a "personal benefit may be inferred from a personal relationship ... where the tippee's trades resemble trading by the insider himself followed by a gift of the profits to the recipient ... such an inference is impermissible in the absence of 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." While the government claims the use of the word "exchange" cannot be reconciled with *Dirks*, which does not impose such a requirement, the respondent contends that the petitioner misreads the U.S. Supreme Court's decision. Under *Dirks*, the insider must get something in return for the disclosure.

Fourth, the respondent contends that in fact the government is attempting to alter *Dirks*: "The Government asserts that an insider violates his fiduciary duty by disclosing information unless the insider 'has a valid business purpose for selective disclosure' or 'mistakenly believes that information is not material or is already in the public domain.' But that turns *Dirks* on its head. *Dirks* does not require the insider to prove some 'legitimate' reason for his disclosure to avoid liability ... To the contrary, under *Dirks*, an insider is not liable unless the *Government* proves that 'the insider personally will benefit, directly or indirectly, from his disclosure. *Absent some personal gain, there has been no breach of duty to stockholders,*" quoting *Dirks*. (Emphasis in original).

The respondent also contends that there is no split among the circuits — neither the Ninth Circuit's recent decision in *Salman* nor the Seventh Circuit's pre-Newman decision in *Maio* support the government's contention. The former was built on a close personal relationship between the insider and the outsider where there was direct evidence that the tip was intended as a gift of market-sensitive information. In addition, the government argued that the evidence was sufficient to meet the *Dirks* rule as articulated by Newman. While the Ninth Circuit did state that if Newman were read to require that the benefit be tangible, it would not go that far, neither did the Second Circuit. To the contrary, Newman held that "personal benefit is broadly defined to include not only pecuniary gain, but also ... the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend," quoting Newman.

Likewise, *Mio* was built on a fact pattern evidencing a long-standing, close personal relationship. Indeed, the record demonstrated that the tipping "was just one of many favors that ... [the tipper had] done for ... [the tippee] through the years by reason of their friendship," quoting *Mio*.

Finally, the respondent contends that this case is "a poor vehicle" to review this question and would "not benefit" the markets. The former is true because the Second Circuit rendered two holdings on the element of knowledge. One was that the district court failed to give the appropriate jury instruction while the second was the lack of evidence. The second alone is sufficient to support the Second Circuit's judgment. The latter arises because accepting this case for review would create uncertainty in the markets regarding *Dirks*, which would not be beneficial, according to the respondents.

Comment

The respondents and the government both claim that their position is solidly grounded on *Dirks*. While the parties appear to have diametrically opposite positions, both may in fact be correct. Both quote extensively from the Supreme Court's decision. There is little doubt that *Dirks* fashioned the personal benefit test in an effort to draw a bright line between lawful actions and illegal tipping. The real question here seems to be precisely what must be established to meet the personal benefit test. *Dirks* did not write detailed rules specifying what evidence must be presented. Newman, following *Dirks* took the same approach, although it does stress the necessity for a something more than just casual friendships the government and the U.S. Securities and Exchange Commission sometimes

cite.

The difference between the two sides is also reflected in their vastly different views of the record. The government's brief contains an extensive review of the record, detailing evidence which if correct seems to be sufficient to meet the Newman test. In contrast the evidence detailed in the respondent's brief appears to track much closer to the summary presented by the court in Newman. There, of course, the court found that the evidence was completely insufficient.

To the extent that this case turns on quantifying the amount of evidence required to meet the personal benefit — a point highlighted by the respondent's focus on the word "exchange" — it seems unlikely that the Supreme Court would accept it for review. Similarly, if the resolution of the case hinges on a detailed analysis of the record, again, consideration by the Supreme Court would seem unlikely. The high court is most unlikely to weigh in on a case where it would be required to wade through the record and analyze the evidence. No doubt that is the reason the respondent phrased the question for resolution as one of evidence.

In contrast, if the court reads Newman as obliterating the clear line Dirks attempted to draw resulting in unnecessary risk for analysts and others while creating uncertainty in the markets and undue difficulty for law enforcement, the court may consider the question. A decision on whether the court will hear the case should be announced early this fall.

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