Securities Regulation Daily Wrap Up, TOP STORY—1st Cir.: Anticipation of free dinner sufficient for insider trading 'personal benefit', (Jul. 27, 2016)

Securities Regulation Daily Wrap Up

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By Kevin Kulling, J.D.

The First Circuit Court of Appeals has affirmed the conviction of a man who was found by a jury to have passed along material nonpublic information to friends and golfing buddies after receiving the information from a corporate insider friend. The court rejected the appeal of Eric McPhail, who had argued that evidence presented at trial that he anticipated a free dinner, wine, and a massage, was insufficient to establish that he obtained a "personal benefit" for providing the information (*U.S. v. McPhail*, July 26, 2016, Kayatta, W.).

Insider trading "scheme." McPhail was a friend of an executive at American Superconductor Corporation (AMSC), a publicly traded company. The men, who met at a country club, became golf partners and close friends, traveled to Florida and Las Vegas on vacation, and attended sporting events. The men communicated daily and saw each other several times a week, according to the court.

Starting in 2009, McPhail's friend began discussing nonpublic aspects of AMSC's business activities and their potential impact on the company's stock performance. McPhail, who did not trade on the information he received, passed along the information to a set of friends who were members of a regular golfing group.

Much of McPhail's "tipping" about AMSC was conducted via email, according to the court. Members of the golf group and other friends of McPhail's made nearly $500,000 by executing AMSC trades based on McPhail's tips. The government indicted McPhail and singled him out as the scheme's tipper. A jury convicted him on counts of securities fraud and conspiring to commit securities fraud.

Misappropriation theory. The government's case was predicated on the "misappropriation" theory of liability for insider trading under *United States v. O'Hagan,* which says that an outsider who owes no duty to a corporation or its shareholders can be guilty of insider trading if the outsider obtains inside information in confidence and "fails to disclose to the source of the information the fact that the outsider is using the information in breach of a duty of confidence owed to the source."

The theory applies even when the outsider does not trade, but instead obtains a benefit by revealing the information to a third person who trades on the misappropriated information, according to the court.

Duty of trust and confidence. The court said that evidence presented at trial established that the AMSC executive was expecting McPhail to keep the inside information secret. The executive testified that he told McPhail that he "could never repeat some of this stuff," to which McPhail nodded in agreement. In addition, emails presented at trial indicated that McPhail knew the information was confidential, the court said. For example, McPhail told the golf group in his emails that the information was "inside info" that he received from a "friend."

The court agreed that a "history, pattern, or practice of sharing confidences" existed between the AMSC executive insider and McPhail, which triggered a "duty of trust or confidence" to prevent McPhail from disclosing the confidential information.

Personal benefit. The court noted that whether a corporate insider breached his or her duty in sharing material nonpublic information pivots, in part, on whether the insider personally benefits, directly or indirectly, from his disclosure, a principle that extends to tippers in misappropriation cases.

Acknowledging some "inter-circuit tension" over the personal benefit requirement, the court said it was obligated to follow the First Circuit's currently controlling precedent, which assumes that an element of a misappropriation

case includes the requirement of a personal benefit to a tipper. If such a showing was required, the court said, it had been satisfied in previous cases by showing benefits as thin as reconciliation with a friend and the maintenance of a useful networking contact or the mere giving of a gift to a relative or friend.

At trial, the government argued that McPhail anticipated receiving concrete benefits such as a free dinner, wine, and a massage, as stated in his emails. More generally, the court said, the jury apparently agreed with the government that McPhail stood to benefit from the group's general gratitude for his largesse.

The case is No. 15-2106.

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Companies: American Superconductor Corporation

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