

Securities Regulation Daily Wrap Up, ENFORCEMENT—Assistant U.S. Attorney welcomes petition seeking review of *Newman* decision, (Jul. 30, 2015)

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By Jacquelyn Lumb

Katherine Goldstein, the assistant U.S. attorney for the Southern District of New York, broke the news at the Practising Law Institute's program on insider trading that the U.S. Solicitor General has filed a petition for review of *U.S. v. Newman*. Goldstein said the *Newman* decision was unprecedented, erroneous, and in conflict with Supreme Court precedents. Many believe the Second Circuit's *Newman* decision changed the landscape in insider trading law by making it more difficult for the government to prosecute remote tippees in insider trading cases.

Fallout from *Newman* decision. David Miller, a partner with Morgan, Lewis & Bockius LLP, chaired the program. He said that insider trading is an ever developing area of the law and, given the lack of a criminal statute, the case law has been developed by the courts.

Kenneth Schacter, also with Morgan Lewis, noted that the two key points under *Newman* are that the tipper has to receive a personal benefit, and the government must prove that a tippee knew that the tipper breached a fiduciary duty.

Gregory Morvillo, a partner at Morvillo LLP, noted that one judge has written six or seven decisions in which he interpreted *Newman* very narrowly. In his view, the *Newman* decision has not really changed the landscape because 98 or 99 percent of cases will not be affected.

Judge Jed Rakoff, one of the speakers, said he currently has a number of ongoing cases before him that involve interpretations of *Newman*. He said the panelists may debate how broad or narrow that decision was, but no one says it has no impact. Rakoff said this morning he filed to dismiss a class action suit on the basis of *Newman* in *Gordon v. Sonar Capital Management LLC*.

Lack of insider trading statute. All of the debates about insider trading arise from the fact that it is essentially a judge-made law, according to Rakoff, which is not a good thing since it is a criminal violation. He said it is for legislators not the courts to define what constitutes a crime. Unfortunately, Congress has not seen fit to adopt a statute defining insider trading. He added that the SEC has opposed a number of bills that have been introduced out of concern that legislation would narrow the definition and hamper its ability to address new developments in insider trading.

Rakoff said there are three bills pending in Congress to define insider trading, but reported that a high level staffer has said they are unlikely to advance. Rakoff proposed a definition, taken from *Chiarella v. U.S.*, but one he said was rejected by the Supreme Court. In his view, his proposal would avoid having to shoehorn insider trading into Section 10(b) and Rule 10b-5, the law governing fraud.

Schacter agreed with Rakoff. He said judicial opinions are assigned the weight that is usually accorded to statutes, but he also said it is unlikely that a statute will be enacted.

Antonia Apps, a partner with Milbank, Tweed, Hadley & McCloy LLP, believes that the aspect of the *Newman* decision relating to personal benefit took people by surprise. The conventional view was that friendship was enough. Now, when knowledge has to be combined with a vague requirement for personal benefit, she said it makes it more difficult to prove.

SEC's administrative proceedings. Rakoff was asked about his view on how the SEC is using its post-Dodd-Frank administrative proceedings authority to litigate insider trading cases. He declined to express a view on whether the SEC's new policy to bring more insider trading cases before administrative law judges is

appropriate, but said he hopes the SEC recognizes that it is in both the SEC's and the public's interest to send important issues and developing law issues to the courts.

ALJs present an appearance issue since they are hired and paid for by the SEC, and any appeals of their decisions are first heard by the Commission. More important, however, is that many cases have both civil and criminal implications, and ALJs deal only with the civil matters. They have no reason to focus on how their interpretations may impact criminal law, he said. Cases that raise important issues under criminal and civil laws should be addressed by federal court judges, in Rakoff's view.

Investigative techniques. Goldstein and Stephanie Avakian, the deputy director in the SEC's Division of Enforcement, reviewed enforcement priorities at the DOJ and SEC. Avakian talked about how new technologies now allow the SEC to conduct investigations in ways it was not able to do before and in a matter of seconds. She said the division received over 15,000 tips, complaints and referrals last year. A triage group determines which tips merit further investigation.

Avakian said the whistleblower rules were a game changer in all kinds of cases such as financial fraud and corporate misconduct, but in insider trading it can be hard to distinguish between a whistleblower and a cooperator. She said the whistleblower rules were also a game changer for the defense bar and for corporate America.

Newman's impact. With respect to the petition for review of the *Newman* case, Goldstein said to take a look at the legal analysis. *Newman* cannot be reconciled with *Dirks*, she said. If the decision is allowed to stand, Goldstein said it would restrict legitimate enforcement efforts. It provides a roadmap for those who wish to engage in insider trading via a means that was illegal.

Goldstein noted that the Second Circuit plays an outsized role in insider trading cases, and other courts tend to follow its decisions, even when it gets things wrong. *Newman* is the law of the circuit and it has to be taken seriously, she said. The decision has to be read on plain terms, so Goldstein said it would be hard to say it does not impact the way they think about cases. Her office only wants to bring cases where it can meet its high evidentiary burden and *Newman* raised that bar.

Avakian agreed that *Newman* was a significant court decision that may impact certain cases, but she did not characterize it as a game changer. The SEC has brought about 20 insider trading cases since that decision, she said, always mindful of the potential impact where it might apply. She also agreed that the personal benefit piece of the decision is an issue, but noted that the SEC has a different burden of proof and can also bring cases in other circuits.

Goldstein said a handful of petitions have been filed challenging decisions in light of the *Newman* decision. The courts are working their way through these, Goldstein said, and the challenges show what a powerful tool *Newman* is believed to be.

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