Securities Regulation Daily Wrap Up, ENFORCEMENT—U.S.: What's in a question? Nothing that alters insider result, Newman tells high court, (Aug. 27, 2015)

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By Mark S. Nelson, J.D.

The Supreme Court should not take up the Second Circuit's *Newman* ruling because it did not contradict *Dirks* or other circuits, and a decision in the case would not alter the lower court's finding that an indictment against Todd Newman should be dismissed, said Newman's lawyers. Newman's opposition brief was filed just weeks after the government asked the Supreme Court to upend what it called the Second Circuit's "unprecedented" redefinition of an insider trading theory long recognized under the high court's *Dirks* precedent (*U.S. v. Newman*, August 24, 2015).

What's the question? It is common for a party who does not want the Supreme Court to hear a case to recast the question presented by those who do. That is precisely what Newman's lawyers did in opposition to the government's late July certiorari petition.

According to Newman, the question presented is this: Was there enough evidence to prove the corporate insiders in this case got a personal benefit from disclosing information to remote tippees. Newman's lawyers said the Second Circuit's *Newman* panel was right to conclude that the government failed to prove beyond a reasonable doubt that the tippees in the case against Newman knew an insider disclosed confidential information about companies like Dell Inc. and NVIDIA Corporation in exchange for a personal benefit.

Newman characterized the government's effort to persuade the high court to "correct" the Second Circuit's view of "personal benefit" as "sleight of hand" aimed at getting the case sent back to the appeals court for a fresh look at both the sufficiency of the proof of a personal benefit and that court's independent holding that Newman did not know of a benefit.

In Newman's view, there is no "outcome-determinative issue" for the Supreme Court to decide so remand would be "pointless." (But Newman said other active lower court cases do pose outcome-determinative questions about the meaning of "personal benefit.") Likewise, Newman said the Second Circuit's opinion is harmonious with *Dirks*, no circuit split exists, and the government "greatly overstates" its worries about how law enforcement officials may have a tougher time pursuing insider trading cases in a post-*Newman* world.

***Dirks* conscientiously applied.** The *Newman* case turns on the remoteness (or not) of Newman from the insiders who provided information about Dell and NVIDIA to others. As Newman's lawyers pointed out, Newman was at least three or more steps removed in two separate lines of tippees, one extending outward from Rob Ray, a Dell investor relations department employee, and another that led back to Chris Choi, an employee in NVIDIA's finance department. Neither Roy nor Choi were charged criminally, but at Newman's trial the government claimed Roy benefited from career advice he got from another tippee. Choi never testified and the evidence of any benefit he might have received was scant.

The government's petition asked the Supreme Court to reverse *Newman* in order to restore the "gift" theory of insider trading announced by the high court in *Dirks*. Under *Dirks*, the government said, an insider must personally benefit from the disclosure either through a *quid pro quo* or by giving confidential information to a trading relative or friend, such that the tip and trade would be akin to trading by the insider, with the profits given to the recipient.

According to the government, the *Newman* panel's tougher standard wrote the "gift" theory out of *Dirks*. "If the personal-benefit test cannot be met by a gift-giver unless an 'exchange' takes place, then *Dirks*'s two categories of personal benefit are collapsed into one—and the entire 'gift' discussion in *Dirks* becomes superfluous," said the government.

But Newman's lawyers argue first that the *Newman* panel's weighing of the evidence on the question of personal benefit did not "reinterpret" *Dirks*, but rather "conscientiously applied" that Supreme Court's precedent. According to Newman, the *Dirks* court itself glimpsed the notion that the personal benefit issue would not be an easy fact question for courts to answer.

Moreover, Newman said the Second Circuit's understanding of the personal benefit requirement can be harmonized with *Dirk*'s gift theory. Specifically, Newman argued that to allow a court to infer a personal benefit from the fact that two people know each other casually would upend *Dirks*'s purposeful disclosure language, which suggests a more objective test for weighing evidence of friendship.

"The Second Circuit's evidentiary formulation is thus consistent with the gift theory as articulated in *Dirks* because it limits the inference of an intentional gift of trading proceeds to circumstances that reasonably support that conclusion," said Newman.

Newman also argued that the government's claim that the Second Circuit erred by using the word "exchange" to limit *Dirks*'s gift theory is off key. Newman said the "exchange" contemplated by a gift is the tipper's joy in helping a close relative or friend, to whom they provided valuable information.

Newman said that the government was wrong to argue that the Second Circuit's decision required a pecuniary or similar benefit to the tipper in gift cases. Some post-*Newman* decisions shy away from this aspect of *Newman* and instead suggest Newman did not change the existing legal standard, including three opinions authored by Jed S. Rakoff, a U.S. District Judge in the Southern District of New York.

In one of the opinions, *U.S. v. Salman* (the other two opinions are *Gupta* and *Whitman*), Judge Rakoff sat by designation on the Ninth Circuit, a scenario in which *Newman* was not binding on the California-based appeals court, and in which the *Salman* panel declined to follow *Newman* to its logical extremes. Newman's lawyers went on to say that neither *Salman* nor other recent cases conflict with *Newman*. Addressing Salman directly, Newman said: "[t]hus, the hypothetical 'if' in *Salman* remains purely hypothetical; there is no actual conflict."

Prosecutors fearful? The government's petition cited worries that *Newman* could make prosecutions harder to bring and that the Second Circuit's alterations to *Dirks* may harm markets by obscuring lawful trading from illegal insider trading. "It licenses trading by insiders' favored tippees, thereby shifting losses to investors who lack access to confidential corporate information and eroding public confidence in the integrity of securities markets," said the government.

Newman's opposition brief challenges this claim. According to Newman, courts continue to apply *Dirks* appropriately and that claims of potential harm to markets are overblown. As for post-*Newman* cases, Newman concedes that the government essentially lost the *Conradt* case, in which a federal judge vacated pre-*Newman* guilty pleas on the theory they were no longer valid after *Newman*. But Newman said even *Conradt* is a government win because the SEC separately won a ruling in its parallel civil case on the personal benefit issue.

All of this leads Newman to conclude that the Second Circuit has not dramatically impacted insider trading cases. "This Court's decision to grant review should be based on how Newman is actually being applied by the courts, and not on the unfounded and exaggerated fears of prosecutors," Newman said in the context of arguing *Newman* does not conflict with *Dirks*.

The legislative front. Congress has shown at least some interest in taking on insider trading via legislation in recent months. Representative Jim Himes (D-Conn) introduced the Insider Trading Prohibition Act (H.R. 1625) in March. This is the most comprehensive of the several bills and now has bipartisan support from ten co-sponsors. The Stop Illegal Insider Trading Act (S. 702), introduced by Sen. Jack Reed (D-RI), and the Ban Insider Trading Act of 2015 (H.R. 1173), introduced by Rep. Stephen F. Lynch (D-Mass), also would spell out what it means to trade on material inside information.

Legislative attempts to define insider trading liability have withered before and it is still unclear if the current Congress will move these bills forward, even after it deals with cybersecurity and other pressing issues. In one last effort to bolster his view that *Newman* did not undermine *Dirks*, Newman reiterated that "[u]ntil Congress acts, the personal benefit requirement as articulated in *Dirks* is the law of the land."

The case is No. 15-137.

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Companies: Dell Inc.; NVIDIA Corporation

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