

## Insider Trading: U.S. Court of Appeals (Second Circuit) Vacates Convictions, Clarifies Requirements of Tippee Liability

December 11, 2014

On December 10, 2014, the U.S. Court of Appeals for the Second Circuit held that to obtain an insider trading conviction against a tippee, the Government must prove that the tippee knew both that an insider disclosed confidential information *and* that the insider did so in exchange for a personal benefit.<sup>1</sup> The court emphasized that “without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach.” The Second Circuit vacated defendants’ convictions and remanded for dismissal because the district court improperly instructed the jury, there was insufficient evidence showing that the insiders received a personal benefit and, even assuming that evidence of the insiders’ personal benefit was sufficient, there was insufficient evidence that defendants knew that they were trading on information obtained in violation of the insiders’ fiduciary duties. The ruling may result in the Government’s reviewing ongoing matters and, of course, the Government may further appeal.

### Factual Background of *Newman*

Hedge fund manager defendants Todd Newman, a portfolio manager at Diamondback Capital Management, LLC, and Anthony Chiasson, a portfolio manager at Level Global Investors, L.P., were convicted of conspiracy to commit securities fraud and securities fraud by a jury in the U.S. District Court for the Southern District of New York on December 17, 2012. At trial, the Government presented evidence that defendants were remote recipients of inside information acquired by a group of financial analysts who received information from insiders at Dell and NVIDIA. Newman and Chaisson were at least three levels removed from the inside tippers’ initial disclosures.

There were two issues addressed on appeal: (1) whether, to prove insider trading, the Government must show that a tippee knew that the insiders received a personal benefit in exchange for the disclosure of confidential information; and (2) what evidence is required to prove the insiders’ underlying liability, which is necessary to sustain defendants’ tippee liability, and whether defendants knew that the insiders received a personal benefit in exchange for their disclosures. To the first issue, the district court did not instruct the jury that defendants’ knowledge of the insiders’ benefit was required.

### The Second Circuit’s Knowledge Requirement

In holding that a tippee must know that an insider received a benefit in exchange for his disclosure of confidential information, the court first explained that an insider does not breach a fiduciary duty unless he receives a personal benefit. Accordingly, because a tippee cannot be convicted unless he knows or

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<sup>1</sup> See *United States v. Newman*, Nos. 13-1837-cr, 13-1917-cr (2d Cir. Dec. 10, 2014).

should know of the underlying breach, the Government cannot prove that the tippee knew of the breach without showing that the tippee knew of the insider's personal benefit. This conclusion, the court reasoned, "follows naturally" from *Dirks v. SEC*, 463 U.S. 646 (1983), which held that there is no breach of duty absent some personal gain to the insider. The Second Circuit held that the district court's jury instruction was improper because it failed to accurately advise them that the Government had to prove that Newman and Chiasson *knew* that the insiders received a personal benefit for their disclosure.

### **Evidence Insufficient to Prove Insiders' Benefit or Defendants' Knowledge**

The court further held that the Government's evidence of the insiders' personal benefit was "too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips." The Government's evidence of the insiders' friendship with the immediate tippees was insufficient to sustain convictions against defendants; instead, inferring a benefit from personal relationships 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."

Even assuming that the Government's evidence of the insiders' relationship with the tippees was sufficient to permit the jury to find that the insiders benefited, the court found that the Government provided no evidence that Newman and Chiasson knew that they were trading on information from insiders or knew that the insiders received a benefit in exchange for their disclosures. Because defendants traded on information of a "nature regularly and accurately predicted by analyst modeling" and were "several levels removed from the source" of the information, the court held that the jury could not infer that defendants knew that the information came from an insider, let alone that the information came from insiders who had received a benefit in exchange for their disclosure.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

#### ***New York***

<b>Greg D. Andres</b>	<b>212 450 4724</b>	<a href="mailto:greg.andres@davispolk.com">greg.andres@davispolk.com</a>
<b>Martine M. Beamon</b>	<b>212 450 4262</b>	<a href="mailto:martine.beamon@davispolk.com">martine.beamon@davispolk.com</a>
<b>Angela T. Burgess</b>	<b>212 450 4885</b>	<a href="mailto:angela.burgess@davispolk.com">angela.burgess@davispolk.com</a>
<b>Carey R. Dunne</b>	<b>212 450 4158</b>	<a href="mailto:carey.dunne@davispolk.com">carey.dunne@davispolk.com</a>
<b>Denis J. McInerney</b>	<b>212 450 4477</b>	<a href="mailto:denis.mcinerney@davispolk.com">denis.mcinerney@davispolk.com</a>
<b>Jennifer G. Newstead</b>	<b>212 450 4999</b>	<a href="mailto:jennifer.newstead@davispolk.com">jennifer.newstead@davispolk.com</a>
<b>James P. Rouhandeh</b>	<b>212 450 4835</b>	<a href="mailto:rouhandeh@davispolk.com">rouhandeh@davispolk.com</a>

#### ***Washington DC***

<b>Neil MacBride</b>	<b>202 962 7030</b>	<a href="mailto:neil.macbride@davispolk.com">neil.macbride@davispolk.com</a>
<b>Linda Chatman Thomsen</b>	<b>202 962 7125</b>	<a href="mailto:linda.thomsen@davispolk.com">linda.thomsen@davispolk.com</a>

***Menlo Park***

**Neal A. Potischman**

**650 752 2021**

[neal.potischman@davispolk.com](mailto:neal.potischman@davispolk.com)

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