Second Circuit Limits “Tippee” Insider Trading Liability

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In *United States v. Newman*, No. 13-1837 (2d Cir. Dec. 10, 2014), the United States Court of Appeals for the Second Circuit reversed the 2013 convictions of Anthony Chiasson and Todd Newman on charges of conspiracy to commit insider trading and insider trading under 18 U.S.C. § 371, Sections 10(b) and 32 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78ff, SEC Rules 10b-5 and 10b5-2, 17 C.F.R. § 240.10b-5, 10b5-2, and 18 U.S.C. § 2. Both individuals were portfolio managers at hedge funds who were charged with and convicted of receiving material non-public information from analysts with whom they worked. The Second Circuit’s decision greatly clarifies the elements required to prove “tippee” liability under the insider trading laws.

At trial, the Government showed that material, non-public information was passed from two corporate insiders through a lengthy chain of friends and acquaintances. Information was ultimately conveyed to Chiasson and Newman, who each made trading decision while in possession of the information.

The United States District Court for the Southern District of New York (Sullivan, J.) instructed the jury that, in order to convict, it had to find that (1) the corporate insiders who first disclosed the information (the tippers) had a “fiduciary or other relationship of trust and confidence with their employers” and (2) Chiasson and Newman (the tippees) knew that the information had been disclosed by the insiders in breach of that duty. The jury was not instructed that it had to find the tippers had received any benefit in connection with sharing the information or that the tippees knew about the benefit. After the conviction, Chiasson and Newman appealed.

The Second Circuit reversed. It held that insider trading liability requires a tipper not only to have and breach a fiduciary or other duty, but also to receive an actual benefit in connection with tipping information. It further held that, in order to hold a tippee liable, the tippee must be aware that the tipper violated a duty*and* received a benefit in doing so.

Notably, the Second Circuit emphasized that “[a]lthough the Government might like the law to be different, nothing in the law requires a symmetry of information in the nation’s securities markets.” Accordingly, insider trading is based on “breaches of fiduciary duty, not on informational asymmetries.”

The Court also ruled that vague notions of friendship and networking do not form the basis of the required benefit to the tipper, noting that if a personal benefit included the “mere fact of a friendship,” then “the personal benefit requirement would be a nullity.” Instead, the personal benefit must “be of some consequence.” The Court also observed that “access to an investment club where stock tips and insight were routinely discussed” (citing *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)), commissions on real estate transactions (citing *SEC v. Yun*, 327 F.3d 1263, 1280 (11th Cir. 2003)) and referrals for dental work (citing *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000)) were all examples of a “consequential” personal benefit.

The Second Circuit remanded the matter for dismissal of both indictments with prejudice, dealing a firm blow to the Department of Justice’s efforts to stretch the limits of tippee liability. The decision should provide useful parameters and limits for tippee liability going forward.

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