

## EXPERT ANALYSIS

### Where's the Steak Dinner? Why the Supreme Court Needs to Clarify the Criminal Law of Insider Trading

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Over the past few years, the 2nd Circuit and the 9th Circuit have reached arguably conflicting conclusions in high-profile insider trading cases as to the question of whether the government must prove beyond a reasonable doubt that the tipper received a tangible personal benefit in exchange for inside information and that the tippee knew about that benefit. Compare *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (vacating convictions), cert. denied, 136 S. Ct. 242 (2015), with *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015) (affirming convictions), cert. granted, 136 S. Ct. 899 (2016).

The Department of Justice petitioned for certiorari in *Newman*, and the defendant did the same in *Salman*. While the U.S. Supreme Court declined to hear *Newman*, it granted certiorari in *Salman*.

Therefore, when the 1st U.S. Circuit Court of Appeals recently decided *United States v. Parigian*, No. 15-994, 2016 WL 3027702 (1st Cir. May 26, 2016), *Newman* and *Salman* effectively defined the legal landscape. In *Parigian* the 1st Circuit struggled to harmonize its own precedents defining tangible personal benefit with the current circuit split concerning insider trading.

Two questions loom before the Supreme Court. First, to establish criminal liability, does the government need to prove beyond a reasonable doubt that the tipper received something of pecuniary value, like a steak dinner, in exchange for having disclosed inside information to a dear friend or relative? Second, does the government have to prove that the tippee knew about the illicit benefit provided as part of that exchange?

#### NEWMAN: TANGIBLE BENEFIT AND KNOWLEDGE REQUIRED

The government charged Todd Newman, a portfolio manager at Diamondback Capital Management, and Anthony Chiasson, a portfolio manager at Level Global Investors, with insider trading as "remote tippees," meaning tippees who were several steps removed from the actual tippers.

The inside information included advance knowledge of earnings reports at Dell and Nvidia, which company insiders tipped to financial analysts. The analysts, in turn, tipped the information to others, who eventually relayed it to Newman and Chiasson. The two men reaped millions in profits for their respective funds from their trading in Dell and Nvidia.

At trial, the government presented no evidence that Newman or Chiasson actually knew the source of the inside information. As to the Dell information, Newman and Chiasson were three and four levels removed from the insider, respectively. They were both four levels removed from the Nvidia insider.

After the government rested, Newman and Chiasson moved for a judgment of acquittal, arguing there was no evidence that the insiders received any personal benefits or that Newman and Chiasson knew about any such benefits.



*Unlike in Newman, the trial court in Salman instructed the jury that a tippee must know that the tipper received a personal benefit in exchange for the disclosure of inside information.*

Relying on *SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012), which did not include as an element of insider trading a tippee's knowledge of the tipper's personal benefit, the court denied the defendants' motion. The jury then convicted both defendants.

Looking to *Dirks v. SEC*, 463 U.S. 646 (1983), the 2nd Circuit reversed, finding that the Supreme Court had articulated tippee liability as follows:

- A tippee's liability derives from a tipper's breach of fiduciary duty, not from the tippee's trading on nonpublic information.
- A tipper breaches his fiduciary duty only if he receives a tangible personal benefit, a benefit of "some consequence," for disclosing inside information.
- A tippee is liable only if he knows or should have known of the tipper's breach.

The 2nd Circuit reasoned that because the tippee's liability derives only from the tipper's breach of his fiduciary duty and receipt of a tangible personal benefit, the government must prove beyond a reasonable doubt that a tippee knew that the tipper had breached a fiduciary duty in exchange for that benefit.

The appeals court also noted that the government failed to cite any case in which a tippee who was as far removed from the tippers as Newman and Chiasson had been was held criminally liable for insider trading.

Thus, the 2nd Circuit concluded that the trial court did not properly instruct the jury about what Newman and Chiasson had to know in order to have committed the crime of insider trading.

Turning to the evidence at trial, it also held that the government presented insufficient proof that the insiders at Dell and Nvidia had received any personal benefit. Specifically, the 2nd Circuit held the Dell tipper received an inconsequential benefit ("career advice") and the Nvidia tipper got no benefit at all.

Furthermore, the 2nd Circuit observed it was "largely uncontroverted" that Newman and Chiasson "knew next to nothing about the insiders and nothing about what, if any, personal benefit had been provided to them." The appeals court thus overturned their convictions.

### **SALMAN: KNOWLEDGE OF CLOSE PERSONAL RELATIONSHIP MAY BE ENOUGH**

Maher Kara was a member of Citigroup's health care investment banking group. He shared inside information about upcoming mergers and acquisitions with Michael Kara, his brother. Meanwhile, Michael developed a friendship with Bassam Salman after his brother Maher became engaged to Salman's sister.

Michael shared the information that he learned from Maher with Salman, encouraging Salman to "mirror-image" his trading activity. Salman followed that advice, profited from his trading and deposited the money into an account held jointly with other relatives.

The government presented evidence that Salman knew Maher was the source of the inside information. Evidence also established that Michael helped pay for Maher's college, stood in for their deceased father at Maher's wedding and advanced Maher's career by coaching him in basic science. Finally, evidence showed that Salman knew about the close relationship between the brothers. On that basis, the jury convicted Salman of insider trading.

Unlike in *Newman*, the trial court in *Salman* instructed the jury that a tippee must know that the tipper received a personal benefit in exchange for the disclosure of inside information. Thus, on appeal, the narrow factual issue for the 9th Circuit was whether the government presented sufficient evidence to prove beyond a reasonable doubt that Maher received some personal benefit and that Salman knew about that benefit.

Challenging his conviction, Salman argued that there was insufficient evidence to prove either that Michael obtained any personal benefit or that Salman knew it. Salman also contended, based on *Newman*, that evidence of a close friendship or family relationship was not enough to establish a tangible personal benefit to the tipper.

The 9th Circuit declined to read *Newman* that way, noting that the 2nd Circuit had recognized that personal benefit can mean pecuniary gain or, alternatively, “the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.”

Because no financial benefit was required, the close relationship between Maher and Michael — and Salman’s knowledge of it — was enough to affirm the conviction.

The 9th Circuit also reasoned that, under Salman’s theory of insider trading, a tipper could freely disclose nonpublic information to relatives so long as the tipper did not ask for any tangible personal benefit in return.

That was not the end of the road, however. Although the Supreme Court declined to hear *Newman*, it granted certiorari in *Salman* on Jan. 16. In that case, the Supreme Court will consider a single issue: whether the personal benefit to an insider “requires proof of ‘an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,’ as the 2nd Circuit held” in *Newman*, “or is it enough that the insider and the tippee shared a close family relationship,” as the 9th Circuit concluded in *Salman*.

Argument is likely to be set for the upcoming term, and the eventual decision should address the current tension between *Newman* and *Salman* over this core issue in criminal insider trading cases.

#### **PARIGIAN: HIGHLIGHTING THE NEED FOR SUPREME COURT GUIDANCE**

The government indicted Douglas Parigian for insider trading along with his golfing buddy Eric McPhail. An unindicted co-conspirator, who was a former executive of American Superconductor Corp. and a longtime friend of McPhail, disclosed the inside information.

The government alleged that the insider often shared inside information about ASC with McPhail and that, because the two men had a personal relationship of trust and confidence, the insider expected McPhail to keep the tips confidential. The government also alleged that Parigian “was aware of” the close relationship between McPhail and the insider, who was unlikely to share material, nonpublic information with “just any casual acquaintance.” *Parigian*, 2016 WL 3027702, at \*2, 6.

According to the indictment, McPhail shared the inside information by email with his friends, including Parigian. The emails made clear that the information should be kept secret, including one message that concluded with “SHHHHHHHHHH!!!!!!!!!!!!!!” Based on these tips, Parigian timed trading in ASC, realizing gains and avoiding losses.

The government alleged that, in exchange for breaching his duty to the insider and sharing his valuable tips, McPhail received, or at least reasonably expected to receive, “various tangible luxury items” and “assorted luxury entertainment” from Parigian and the other tippees, including steaks, wine and massage parlor visits. In one instance, Parigian allegedly “assured [McPhail] that ‘I will take you for a nice dinner at Grill 23,’ a Boston steakhouse, to thank McPhail for sharing the nonpublic information from the ASC insider.

Parigian moved to dismiss the indictment. After the District Court denied the motion, he entered a conditional guilty plea, preserving his ability to challenge the adequacy of the indictment.

As a result, on appeal, the 1st Circuit narrowly focused “[its] review within the indictment’s four corners.” It did not review the full trial record or consider the sufficiency of the evidence at trial, as the 2nd and 9th Circuits did in *Newman* and *Salman*.

*Parigian’s* unusual procedural posture had important practical consequences: The 1st Circuit declined to decide whether there was legally sufficient evidence of personal benefit

*The CFTC has asked two district courts to adopt holdings that would significantly enhance the CFTC’s ability to win price-manipulation cases by diminishing the elements it must prove to establish a violation.*

(since it was bound to review only the allegations in the indictment) or whether the mens rea standard from civil insider trading cases should be applied to this criminal insider trading case (since Parigian waived the issue by declining to expressly raise it before the district court in his initial appeal brief).

The *Parigian* holding is straightforward enough: The indictment adequately alleged that McPhail breached a duty of confidence to the insider; that he received, or reasonably expected to receive, tangible personal benefits, such as steak dinners, for breaching his duty to the insider; and that Parigian knew both of those critical facts about the insider trading scheme. But the 1st Circuit's analysis, particularly on the question of what sort of personal benefit is required, demonstrates the need for greater clarity.

At the outset, the 1st Circuit recognized the tension between *Newman* and *Salman*. It observed that the 2nd Circuit "recently adopted a more discriminating definition of the benefit to a tipper" and "reject[ed] as insufficient the mere existence of a personal relationship." It further noted that, in contrast, the 9th Circuit held "the intent to benefit a trading relative or friend is sufficient."

As between those positions — a required pecuniary benefit in *Newman* versus an adequate personal relationship in *Salman* — the 1st Circuit claimed that it was "aligned ... more closely" with the 9th Circuit.

For example, in *SEC v. Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006), an appeal from a Securities and Exchange Commission enforcement action, the 1st Circuit held, "Even if there is a requirement that the tipper receive a personal benefit, the mere giving of a gift to a relative or a friend is a sufficient personal benefit" to the tipper.

The facts in *Parigian* tell a slightly different story. Because the case was brought under the theory that McPhail misappropriated the ASC information from the unindicted insider, the 1st Circuit correctly focused on whether McPhail received a tangible personal benefit from Parigian in exchange for his tip of stolen inside information.

In affirming Parigian's conviction, the 1st Circuit expressly held that "the indictment's allegations of a friendship between McPhail and Parigian plus an expectation that the tippees would treat McPhail to a golf outing and assorted luxury entertainment is enough to allege a personal benefit." *Parigian*, 2016 WL 3027702, at \*8 (emphasis added).

If the 1st Circuit was truly "aligned" with the 9th Circuit, the close personal relationship between McPhail and Parigian should have been enough because the desire to benefit a trading friend can suffice. On the other hand, if it was critical that the indictment alleged the promise of "luxury items" to McPhail, the 1st Circuit may, in fact, be more like the 2nd Circuit.

By having it both ways, the 1st Circuit left some doubt about where it stands between *Newman* and *Salman*. Was it adequate that the indictment alleged a close friendship between McPhail and Parigian? Or was it necessary that the indictment also alleged that Parigian promised to take McPhail for a steak dinner?

Part of the problem in *Parigian* was that the 1st Circuit did not actually follow either of the leading decisions from its sister circuits. That is because as a three-judge panel, the judges that decided *Parigian* were "bound to follow this circuit's currently controlling precedent." The precedent includes civil SEC cases like *Rocklage* and *SEC v. Sargent*, 229 F.3d 68 (1st Cir. 2000), both of which were decided long before *Newman* and *Salman*.

Having denied Parigian's petition for rehearing or rehearing en banc June 22, the 1st Circuit will not go beyond this three-judge panel decision in addressing the personal benefit requirement as it applies to Parigian.

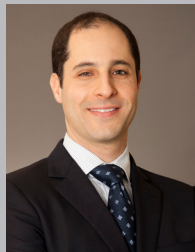
## CONCLUSION

Until the Supreme Court resolves the controversy over tangible personal benefits in criminal insider trading cases, the same dynamic that was present in the *Parigian* case will presumably plague other circuits. Whether or not other appeals courts find *Newman* or *Salman* attractive

from a legal, policy or other perspective, they must follow their own binding authority — even if it is outdated.

Pending a clarifying decision in *Salman*, the circuits will inevitably reach their own (possibly conflicting) conclusions as to whether something akin to a filet mignon must be given or promised for the government to prove a tangible personal benefit and whether a remote tippee must know the details of those fine-dining arrangements. That situation is untenable.

Trading activity that is innocent in New York should not lead to jail time in California. All market participants (and would-be defendants) are entitled to fair notice of what constitutes the crime of insider trading under federal law.



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