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WHY NEWMAN MIGHT NOT BE HEADED TO THE SUPREME COURT

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In the latest chapter of the *United States v. Newman* insider trading case, the Solicitor General recently filed its petition for writ of certiorari, asking the United States Supreme Court to hear the case. While the court is unlikely to decide on the government's petition until the end of the year, the government's petition may have actually diminished the chances that the Supreme Court will take the case. As we have discussed previously, April 29, 2014; Dec. 23, 2014; and March 9, 2015, the Second Circuit held last year that an insider trading conviction requires that: (1) an insider tipper act for a "personal benefit" of financial consideration, or something at least akin to monetary gain; and (2) the remote tippee know that the insider tipper supplying the inside information acted for such a personal benefit. Following the Second Circuit's decision, the Department of Justice (DOJ) sought rehearing but was denied. The SEC weighed in too, asking the court in particular to reconsider its opinion that evidence of friendship between tipper and tippee is insufficient to prove the "personal benefit" necessary for tipping liability. The SEC asserted that this conclusion contradicts *Dirks v. SEC*, the Supreme Court's leading insider trading decision which has been the law since 1983. In a fortuitous turn of events, while the time for filing a petition for certiorari was running, the Ninth Circuit decided *United States v. Salman* [see July 15, 2015 post], which, by some measures, disagrees with *Newman* and hews more closely to *Dirks*. *Salman* was written by none other than Judge Jed Rakoff of the Southern District of New York, sitting by designation in the Ninth Circuit. Ironically, while Judge Rakoff could not have ignored *Newman*'s precedential effect in his day job as a district court judge in the Second Circuit, by moonlighting as a Ninth Circuit judge, he created the arguable circuit split that the Justice Department then relied on repeatedly as one reason the Supreme Court should grant its petition. In its petition for certiorari, the government actually sought review on a relatively narrow issue. It did not ask the court to consider whether a remote tippee must know that the tipper supplying the inside information acted for personal benefit. This, by itself, potentially narrows the scope of potential insider trading prosecutions in the Second Circuit because it seemingly concedes that an insider trading prosecution would not be proper if the remote tippee did not know that the tipper was acting for a personal benefit, even if there was a clear exchange between the insider tipper and the first tippee that benefitted both parties. Perhaps more importantly, as discussed below, by focusing exclusively on this issue, the government may have decreased the chances that *Newman* will be accepted for argument. Instead, the DOJ focused on the other notable issue in *Newman* -- whether the Second Circuit improperly deviated from *Dirks* by holding that there cannot be insider trading liability when the insider "gifts" the inside information to a tippee unless the government presents

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"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." In *Dirks*, the Supreme Court stated that insider trading results when an insider makes a disclosure where the insider will personally benefit, directly or indirectly. The court concluded that this could happen two ways. There could be a *quid pro quo* in which an alleged insider receives something of value for the disclosure. Or, the insider could essentially "make[] a gift of confidential information to a trading relative or friend" which is no different than the insider trading on the inside information herself and then giving the profits to the friend/tippee. The government argued that *Newman* created a new, stricter standard that contravened *Dirks* and was unworkable for several reasons. First, it gutted the aspect of *Dirks* that allowed gifting of information because it requires an exchange that "represents at least a potential gain of a pecuniary or similarly valuable nature." If the gift must result in a potential pecuniary gain for the insider, it is no different than the *quid pro quo* situation. Second, *Newman* essentially requires courts to measure degrees of friendship. What is the line between a "meaningfully close personal relationship" and a more "casual or social" relationship? In *Newman*, one of the insiders went to lunches with his tippee, attended church picnics and other functions together, and knew the other's family. However, this was not a sufficiently "meaningfully close personal relationship" to give rise to liability. The government also asserted that *Newman* conflicted with *Salman*, along with an earlier Seventh Circuit decision, *SEC v. Maio*, thereby creating a circuit split. Finally, the government argued that because *Newman* is a Second Circuit case, it is liable to have an outsized impact on insider trading law and the securities markets generally because the Second Circuit includes New York, where many of these prosecutions take place. The petition argues that *Newman* as the law in the financial capital of the world may have unhelpful consequences for the nation (and the world's) financial markets. While *Newman* has created an uproar, and a decision by the Supreme Court could bring some much-needed clarity to this already murky area of federal securities law, there are at least three reasons why the Supreme Court might not grant the government's petition. First, Supreme Court Rule 14.1(a) says that "[o]nly the questions set out in the petition, or fairly included therein, will be considered by the court." Here, the government only asserted one Question Presented. It did not seek review of the other aspect of *Newman*: its requirement that the tippee knew that the tipper supplying the inside information acted for a personal benefit. Absent consideration of *Newman*'s knowledge requirement, a decision by the Supreme Court could make no difference in the underlying decision, since the Second Circuit could still conclude that vacating the convictions was proper because the ultimate tippees did not know that the insider tippers were making improper disclosures for personal benefit. According to Supreme Court Practice, the authoritative treatise on the court, the potential lack of dispositive impact of a decision by the court in the government's favor diminishes the chances the court will grant the government's petition. In fact, it might be more likely that the court would grant the eventual petition for certiorari in *Salman*. Given the government's *Newman* petition, and the fact that the defendant's conviction was affirmed in *Salman*, it is safe to presume that Salman will petition for certiorari also. The remote tippee's knowledge of the insider's personal benefit was not an issue in *Salman*, making the principal issue whether a "gift" of the confidential information was permissible without the potential for monetary consideration in return. Therefore, the court could address this issue more cleanly, and with dispositive impact, in *Salman* rather than *Newman*. Second, some have argued that *Newman* and *Salman*

do not really conflict and that, under the *Newman* test, Salman would still have been convicted. In *Salman*, there was evidence that Salman knew the information he received came from an insider and probably understood that the insider disclosed the information with the intention of benefiting a close relative (and being benefitted thereby). As a result, as the *Newman* defendants will undoubtedly argue, Salman would have been convicted under the *Newman* test. Therefore, there may be no circuit split requiring Supreme Court review. Finally, the government may have overstepped by spending too much of its petition highlighting potential factual errors the Second Circuit made. According to the government, the Second Circuit overlooked various facts about how much the *Newman* defendants knew of the insider tippers' actions and the extent of the personal benefit the insiders received. While such mistakes might heighten the sense that the Second Circuit erred, the Supreme Court has said repeatedly that it is not in the "error correction" business. Simple factual errors by an appellate court are rarely, if ever, a reason for granting a petition for certiorari. So, focusing on the factual errors the Second Circuit may have made might actually decrease the chances that the *Newman* petition will be granted. The Supreme Court may well grant the government's petition in *Newman*. Doing so might clarify some of the issues that remain unsettled because there is no statutory prohibition on insider trading. However, there are also reasons, some of the government's own making, to think that the Supreme Court might take a pass here.