

Is The Second Circuit About To Put The Brakes On The Government's Pursuit Of Insider Trading "Tippees"?

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The Second Circuit Court of Appeals has raised questions about federal prosecutors' burden to convict the recipient of confidential information of insider trading, suggesting the Court may adopt a "bright line" that would provide much-needed guidance to an ambiguous area of law. At issue is the knowledge the government must prove to convict the recipient (or "tippee"), who often may be many layers removed from the initial disclosure of the confidential information. Attorneys for former hedge fund managers Todd Newman and Anthony Chiasson have asked the Court to require the government to prove that the tippee must have known that the information was disclosed in exchange for a reward or "personal benefit." Federal prosecutors have argued for a broader definition, seeking to convict only on the tippee's knowledge that the information was disclosed in breach of a duty. Here, defendants were remote tippees at least four layers removed from the initial disclosure of the information. Prosecutors have alleged that the leaks originated from insiders at Dell and Nvidia, with investor relations employee Rob Ray at Dell disclosing insider information in exchange for the personal benefit of career advice. That information then was disclosed to analysts who worked at Newman's and Chiasson's hedge funds, and Newman and Chiasson subsequently traded on the information. Ray never was charged. The original tippee and the two analysts pleaded guilty and cooperated with the government. The jury for Newman and Chiasson, following the judge's instructions that it did not have to find that Newman and Chiasson knew of the personal benefit to Ray, convicted. The judge sentenced Newman to four and a half years in prison and Chiasson to six and a half years in prison. At a hearing on appeal of the convictions, two members of the three-judge panel expressed skepticism of the prosecutor's "amorphous theory" of insider trading and the lack of guidance the ambiguous law provides to financial institutions. One judge even questioned whether the definition of personal benefit to the insider has grown too broad in general, asking whether "friendship" or "career advice" should be considered a "personal benefit." The ruling could provide much-needed clarity regarding the liability of remote tippees. The ambiguity in the law arises in part because insider trading is not defined by statute, but rather has developed ad hoc through the federal courts. The United States Supreme Court has not considered the issue of tippee liability since its 1983 decision, *Dirks v. SEC*, where it held that a tippee's duty is derivative of the insider's duty not to trade on confidential information. The tippee in *Dirks* was the direct beneficiary of the information, and the Supreme Court has not addressed the limits of remote tippee liability, which has become a more prevalent charge by federal prosecutors in recent years. A ruling in favor of defendants would provide defense attorneys with

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an additional tool in favor of tippees who may be far removed from the initial disclosure of insider information and stem the trend towards an ever more expansive definition of insider trading favored by prosecutors.