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Insider Trading

Key Insider Decision Clarified Bright-Line Rule, Chiasson Lawyer Says

The most important takeaway from the Second Circuit's recent decision absolving two former hedge fund managers of misusing material non-public information is that it gives clarity to the law of insider trading, New York lawyer Greg Morvillo, Morvillo LLP, counsel to defendant Anthony Chiasson, told Bloomberg BNA.

''If you work on Wall Street, you now have a very clear sense of what the elements of insider trading are so you know everything you need to avoid in order to not run afoul of the law,'' he said in a Dec. 23 interview.

Approximately two weeks earlier, in a stunning upset for U.S. Attorney Preet Bharara, the U.S. Court of Appeals for the Second Circuit vacated the convictions of Chiasson and his co-defendant Todd Newman for misusing confidential information about two technology companies (46 SRLR 2351, 12/15/14). In a decision by Judge Barrington Parker, the appeals court said the government didn't prove beyond a reasonable doubt that the two men—both downstream tippees—knew the information was disclosed by an insider in exchange for a personal benefit.

In the wake of the ruling, some observers said the appeals court raised the bar for criminal insider trading liability—one lawyer called it a potentially game-changing decision—but Morvillo didn't agree. In his view, the law was clear that the tippee had to know of the personal benefit in order to know that he or she has been involved in a fraud.

''The Second Circuit has stated unequivocally that that has been the law for the past 30 years'' Morvillo said.

He was referring to *Dirks v. SEC*, 463 U.S. 646 (1983), in which the U.S. Supreme Court held that a securities analyst who allegedly told his clients about possible fraud at an insurance company wasn't liable for insider trading because the insurance company insider who revealed the information did so to expose the fraud, rather than for personal gain. ''Dirks essentially says a fiduciary breach is the exchange of information for the personal benefit. You can't have one without the other,'' Morvillo explained.

''That's how we know that the corporate insider is using the information in a corrupt fashion,'' he amplified. ''From my perspective, Dirks has always been very clear on this. That's the way I've always read it and the Second Circuit has said, 'you've been reading it the right way because that's the way we read it too.' ''

He likened the dual nature of a fiduciary breach to a peanut butter and jelly sandwich. ''You can't have a peanut butter and jelly sandwich without the peanut butter and the jelly. If you don't have the jelly, it may be very tasty but it's not a peanut butter and jelly sandwich.''

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The ruling already is having an impact on pending insider cases. Citing the opinion, Judge Andrew Carter, U.S. District Court for the Southern District of New York, said Dec. 18 that he is inclined to throw out guilty

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pleas by four men who admitted trading on inside information about IBM Corp.'s $1.2 billion purchase of SPSS Inc.

The insider trading prosecution of Michael Steinberg, a former hedge fund manager at an affiliate of SAC Capital Advisors LP, also could be in jeopardy as a result of the Second Circuit's ruling (45 SRLR 2330, 12/23/13). The appeals court has granted Steinberg's request to keep his appeal on hold while prosecutors decide whether to seek further review of the *Newman* decision [*see related report in this issue*]. ''Because Mr. Steinberg's trial and appeal involve the same insiders and the same purported benefits, the Newman/Chiasson decision requires that Mr. Steinberg's convictions be reversed and his indictment dismissed with prejudice as well,'' Steinberg's lawyers said in court papers (45 SRLR 2330, 12/23/13).

So far, the government hasn't said how it plans to proceed. It has several options—it can ask the panel to reconsider its decision, it can seek rehearing en banc, or it can file a certiorari petition for Supreme Court review.

''I don't know which option they are most fond of,'' Morvillo told Bloomberg BNA. ''I assume they want to seek some sort of further appellate review, but I don't know whether the Solicitor General will permit that on these facts and on this law. I guess we'll find out within about 30 days.''

The court has given the government until Jan. 23 to file a petition for rehearing or rehearing en banc. Under Supreme Court rules, the government has 90 days within which to file a certiorari petition.

Thin Evidence. The most closely watched aspect of the decision was whether the government must show a defendant's knowledge that the source of the information received a personal benefit. In its decision, the Second Circuit not only answered that question in the affirmative, it also deemed the evidence in the case ''simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips.''

On that point, the Second Circuit wrote, the government may not ''prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature.''

If they can't prove the fiduciary breach then they shouldn't be bringing those cases in the first place.

''I think the court is interested in a consequential benefit,'' Morvillo said. He reasoned that if someone is going to run the risk of ruining their career and reputation, and very possibly going to prison, ''it should be for something that has weight to it and that is meaningful to the person at the time.''

However, he added, that won't stop prosecutors from bringing insider trading cases. ''They either will find cases where the benefit is clear or they will make sure they are addressing the evidentiary issues and the elements before they charge cases. Could there be certain people who don't get charged based on the Second Circuit decision? Yes. But the answer to that is that those people shouldn't be charged anyway unless there is clear proof of a personal benefit to the tipper and knowledge of that consequential benefit by the tippee.''

''If they can't prove the fiduciary breach then they shouldn't be bringing those cases in the first place. Because those people haven't committed a crime.''

The alleged inside information in this case ultimately made its way to Newman and Chiasson via a series of expert networking arrangements. ''There were many of these third-party networks working in this area,'' Morvillo said. ''Some of them were doing it appropriately, some of them weren't.''

''The ones that weren't were hooking up the Wall Street folks with corporate insiders that were talking about their company,'' Morvillo said. However, he emphasized, most expert networkers have a very strict policy on what they are and aren't allowed to ask about. ''There are strictures in place that should limit what information can be provided during these expert calls.''

Hedge fund employees, meanwhile, are in the business of discussing and analyzing securities. Is there a danger of a corrupt inference being drawn from normal business conduct?

''The good news for people in the hedge fund world is if they read the Second Circuit's opinion, they will understand what they're not permitted to do,'' Morvillo said. ''They're not permitted to buy and sell information from a corporate insider. That's the surest way they can get themselves into trouble.''

However, he noted, there are any number of legal ways to gather information. ″If I'm looking for general information, then I should be able to find that as long as I'm not asking someone to violate their duty of confidentiality, and as long as the person that works for the company is not going further than they're permitted to.''

There will always be people who push the envelope, Morvillo said. However, he emphasized, an analyst's job is to ferret out information. ''So they are permitted to call and talk to these companies, and the companies have an interest in talking to them as well. Finding the right mix of not paying somebody to violate their duty to shareholders is the right way to approach this.''

''It's incumbent on the investor relations people and the corporate insiders to know what they can and can't say. And it's up to the hedge fund folks not to push harder than the law permits.''

In Morvillo's view, ''most people in the hedge fund business do it right.''

The Second Circuit also observed ''that nothing in the law requires symmetry of information in the nation's securities markets.'' Morvillo strongly agreed.

''The Supreme Court has been very clear that it is permissible to trade on material nonpublic information,'' he told Bloomberg BNA. ''That is legal. It is not legal to trade on material nonpublic information that is obtained in breach of a fiduciary duty.''

There are people ''who have tons of resources and they're allowed to use them,'' Morvillo said. ''There's no way that I can have the same kind of detailed analysis and access to information as major investment banks and hedge funds. It is simply not feasible for me, as an individual, to gather it.''

''There's not supposed to be a level playing field. We don't all have access to the same information.''

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Bio.

Gregory Morvillo is a partner of Morvillo LLP, the New York law firm that he, his brothers, and his uncle founded in April 2012. Previously of counsel at the firm started by his father, the late Robert G, Morvillo, Morvillo advises clients on criminal law, securities, regulatory, civil, administrative and corporate governance issues. He also has represented lawyers before various disciplinary committees and conducted internal corporate investigations.

Most recently, in a landmark ruling, Morvillo successfully represented former hedge fund manager Anthony Chiasson, whose insider trading conviction was vacated by the U.S. Court of Appeals for the Second Circuit, with orders to dismiss the indictment with prejudice. Morvillo also represented Chiasson in the criminal trial and in a related Securities and Exchange Commission enforcement action.

Morvillo earned a law degree from Fordham University School of Law, a master of fine arts degree from Brandeis University, and a bachelor's degree from Gettysburg College.

Short Answer. On a more personal note, Morvillo told Bloomberg BNA that he is working on a number of insider trading cases. In the wake of the Chiasson decision, he also has been asked by several people whether they can withdraw their plea. ''The answer to those people at this point is I don't know. We'll have to see whether the opinion holds up and then it's an individual fact assessment.''

How has life changed at Morvillo LLP in the wake of the Second Circuit's decision?

''It has put a nice spring in everyone's step going into the end of the year,'' Morvillo acknowledged.

He said his firm worked very hard for Chiasson over the past few years, in conjunction with Mark Pomerantz, Paul, Weiss, Rifkind, Wharton & Garrison LLP, and Alexandra Shapiro, Shapiro, Arato & Isserles LLP. ''All three of our firms worked very hard on the appeal and each of us deserves to share the credit for this victory.''

''But at our firm, we've known Anthony the longest,'' Morvillo said, ''so on a very personal level it's satisfactory to me in more ways than I can describe.''

He said Chiasson has been a part of his life for four years, and his case was the last Morvillo worked on with his father, who died three years ago.

''So for me, this is tied up not only into my personal relationship with Anthony Chiasson and my professional relationship with him, but my personal and professional relationship with my father and my brothers and my uncle.''

''It was a very emotional day for me personally because we had worked so hard and I was so happy for Anthony Chiasson and his family,'' Morvillo said. ''It was a fabulous day.''

BY PHYLLIS DIAMOND

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