The Inter-Coastal Circuit Split On Tippee Liability: Is Judge Rakoff California Dreaming About Overturning *Newman*?

by: Autumn Knicely

The reason for the current circuit split between the Second and Ninth Circuits on tippee liability can be traced to one maverick judge: Hon. Jed S. Rakoff. Judge Rakoff is determined to change the law to hold Wall Street accountable. However, it is unlikely the Supreme Court will follow his lead, however much it makes sense for them to do so.

Judge Rakoff is a U.S. District Court Judge on senior status for the Southern District of New York where the majority of Wall Street financial crimes are prosecuted. He is well-suited for his white-collar-crime-heavy docket in the Second Circuit as he has significant real-world and academic accomplishments. When he served as Assistant United States Attorney for the Southern District of New York, he was the Chief of Business and Securities Fraud Prosecutions.[1] After leaving the U.S. Attorney's office, he became a partner specializing in white-collar defense at some of the top firms in the country.[2] He is prolific in his writings about white-collar crime and has published hundreds of articles on the topic, and two case books.[3] He also serves as an adjunct professor specializing in white-collar crime at Columbia Law School.[4]

His hobby-horse, however, is reforming Wall Street and holding companies and executives culpable for their actions. He has no trouble being snarky or controversial when working towards this goal. Judge Rakoff, in an unprecedented move, refused to approve settlements between the SEC and Bank of America and the SEC and Citibank when the

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[1] Jed Rakoff, Columbia Law School, http://www.law.columbia.edu/fac/Jed_Rakoff.
[2] Id.
[3] White Collar Crime, Law Journal Press, http://www.lawjournalpress.com/player/Category_5055028157797327444_White_Collar_Crime.html.
[4] Courses, Columbia School of Law, http://web.law.columbia.edu/courses/instructors/8698

settlements allowed the banking behemoths to pay a fine without admitting to the charges against them.[5] When his refusal was overturned on appeal and the case was sent back to him to approve the settlement, he let his contempt of the Second Circuit's ruling show in his opinion with such zingers as "[t]hey who must be obeyed have spoken" and "[the Second Circuit] has now fixed the menu, leaving this Court with nothing but sour grapes."[6, 7] When he is not criticizing a higher court's rulings, he writes articles for the New York Review of Books agitating for prosecution of Wall Street executives.[8]

Based on his crusade for holding Wall Street accountable, it is unsurprising that he does not support the Second Circuit's ruling in United States v. Newman.[9] When the Second Circuit unexpectedly overturned two high-profile convictions for insider trading in Newman in December of 2014, there was much speculation about the future of insider trading prosecutions. The Second Circuit held that for a tippee (i.e., person receiving the tip) to be convicted of insider trading, (1) he must have known or should have known the information was obtained by a breach of fiduciary duty, and (2) the insider must have received a "substantial" benefit from the transaction. In Newman, the Second Circuit held that the benefits received by the tipper (career advice, resume review, and introduction to a recruiter) were not a substantial enough benefit to

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[5] S.E.C. v. Bank Of Am. Corp., 653 F. Supp. 2d 507 (S.D.N.Y. 2009); U.S. S.E.C. v. Citigroup Glob. Markets Inc., 827 F. Supp. 2d 328, 329 (S.D.N.Y. 2011) vacated and remanded, 752 F.3d 285 (2d Cir. 2014).

[6] S.E.C. v. Citigroup Glob. Markets Inc., 34 F. Supp. 3d 379 (S.D.N.Y. 2014).

[7] The SEC subsequently changed its policy of allowing defendants to settle without admitting guilt. Credit has been given to Judge Rakoff for this change. See Ben Protess and Matthew Goldstein, Overruled, Judge Still Left a Mark On S.E.C. Agenda, THE NEW YORK TIMES, (June 4, 2014), http://dealbook.nytimes.com/2014/06/04/appeals-court-overturns-decision-to-reject-s-e-c-citigroup-settlement/?_r=0.

[8] Jed. S. Rakoff, The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?, NEW YORK REVIEW OF BOOKS, (Jan. 9, 2014), http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/.

[9] 773 F.3d. 438 (2d Cir. 2014).

satisfy the test. After this decision, there was much hand-wringing that Newman signaled the end of prosecution of tippees for insider trading.[10] However, Judge Rakoff has been ignoring Newman since it was decided. In all Southern District of New York cases involving tippee liability that he has heard since the decision, Judge Rakoff has declined to follow Newman, either by distinguishing facts, interpreting Newman narrowly, or outright criticizing the decision.[11] Nevertheless, he had no ability to make any significant challenge to Newman until he was assigned temporarily to a court of appeals.

While sitting in designation on the Ninth Circuit Court of Appeals, which covers all of the West Coast, he was randomly assigned to the three-judge panel hearing an appeal of a case about tippee liability. While he was the only District Court Judge on the panel with two Ninth Circuit Court Judges, he authored an opinion in United States v. Salman that specifically stated that the Ninth Circuit refused to follow the Second Circuit's (non-binding) holding in Newman about personal benefit.[12] When the decision in Salman was appealed, the Supreme Court granted *certiorari*, even though it had only recently denied the United States Attorney's request for

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[10] See Top Prosecutor Fears Insider Leak `Bonanza', BLOOMBERG BUSINESS, (October 5, 2015), http://www.bloomberg.com/news/articles/2015-10-05/top-prosecutor-warns-of-insider-leak-bonanza-as-ruling-stands.

[11] See United States v. Whitman, 115 F. Supp. 3d 439, 441 (S.D.N.Y. 2015) (holding that the defendant's reading of Newman was "overbroad"; United States v. Gupta, 111 F. Supp. 3d 557, 559 (S.D.N.Y. 2015) (holding that the defendant "misreads" the holding of Newman); S.E.C. v. Payton, 97 F. Supp. 3d 558, 563 (S.D.N.Y. 2015) (applying Newman in a civil action, but distinguishing the facts); Sec. & Exch. Comm'n v. Payton, No. 14 CIV. 4644, 2015 WL 9463182 (S.D.N.Y. Dec. 28, 2015) (holding that Newman was satisfied by a close friendship); S.E.C. v. Conradt, 309 F.R.D. 186, 188 (S.D.N.Y. 2015) (stating that "Newman could not, and did not, overrule any binding precedent, nor were the arguments it accepted in any material way novel"); United States v. Whitman, No. 12 CR. 125 (JSR), 2015 WL 9582551, at *2 (S.D.N.Y. Dec. 30, 2015) (holding that the defendant seeking to overturn his conviction did not have a "high probability of success" on appeal based on Newman).

[12] United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015) cert. granted in part, 136 S.Ct. 899 (2016) and cert. granted in part, 136 S.Ct. 899 (2016).

certiorari in Newman.[13] The Supreme Court's review and over-turning of Newman was possibly Judge Rakoff's goal all-along, since a circuit split is a common reason for granting *certiorari*.

However, it seems likely that both cases can stand when the Supreme Court hears Salman. Even though Salman purports to not follow Newman, they are easily distinguishable. The Supreme Court has made clear that two prongs must be satisfied to have tippee liability: (1) the tippee knew or should have known that the information came from a breach of fiduciary duty, and (2) the insider received a benefit from the transaction.[14] The issue is what constitutes a benefit. Newman involved hedge fund managers who received tips that were passed along a long chain of other hedge fund investors before getting to the defendants. The benefits to the tipper were vague career advice. There was no suggestion of friendship or an outside of business relationship between the tipper and the tippees. Salman, however, is different. Salman involved an employee at Citigroup giving insider information about mergers and acquisitions to his brother who then passed the tips to his sister's husband. The tipper brother testified at trial that he gave the inside information to his brother because he loved him and wanted to help him "fulfill whatever needs he had", such as settling a gambling debt.

The Supreme Court was clear in Dirks v. S.E.C. that the benefit prong of tippee liability is satisfied when a gift is made to a relative or close friend.[15] Even Newman held that "friendship" would be enough to satisfy the benefit prong of the test. There were no bonds of friendship in Newman, and the benefit was tenuous. However, in Salman the tipper gave the

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[13] See Salman v. United States, 136 S.Ct. 899 (2016) (granting cert. in part.); United States v. Newman, 136 S.Ct. 242 (2015) (denying cert.).

[14] See Dirks v. S.E.C., 463 U.S. 646 (1983).

[15] Id.

inside information to help his brother because he loved him. Everyone agrees—even the court in Newman—that family affection is enough of a benefit to obtain tippee liability.

Both cases are still in line with the last major Supreme Court case on tippee liability – Dirks. Newman is simply reinforcing the requirement in Dirks that there be some benefit to the tipper, and putting a stop to the courts ignoring this prong. Salman is simply saying that helping family members is enough to satisfy this prong.

Unfortunately, however, the Roberts' court is now the most "business friendly Court in its history" with even the liberal branch of the Court voting to protect business interests. [16] While the current Court has not heard any major insider trading cases, it seems unlikely that SCOTUS would be willing to follow Rakoff's ideals that Wall Street should be more accountable. Even though it would be easy for them to do so based upon their own precedent in Dirks, it is doubtful that the Court would make it easier to prosecute big business insiders.

[16] Noam Scheiber, As Americans Take Up Populism, The Supreme Court Embraces Business, New York Times, March 11, 2016, http://www.Nytimes.Com/2016/03/12/Business/As-Americans-Take-Up-Populism-The-Supreme-Court-Embraces-Business.Html