

## Second Circuit Clarifies Tippee Liability for Insider Trading

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In a landmark opinion released on December 10, 2014, the Second Circuit clarified the scope of tippee liability for insider trading in that circuit by requiring a tippee to have knowledge that a tipper gained a personal benefit from the disclosure of material nonpublic information. Further, the decision clarified the personal benefit test to require evidence of “a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the latter.”

In *United States v. Newman*, the Second Circuit overturned the insider trading convictions of two portfolio managers who were alleged downstream tippees three to four steps removed from corporate insiders/tippers. At trial, the two defendants asked the district court to instruct the jury that the government—in order to obtain a conviction for insider trading—had to prove that the defendants had knowledge of a personal benefit obtained by the tipper. The district court declined, however, and gave the jury an alternate instruction that required that the defendants only “know that [the inside information] was originally disclosed by the insider in violation of a duty of confidentiality.”

In holding that this jury instruction was erroneous, the Second Circuit made three observations based on the U.S. Supreme Court’s decision in *Dirks v. S.E.C.*, 486 U.S. 646 (1983). First, a tippee’s liability is derived from the insider’s fiduciary breach. Second, an insider’s fiduciary breach requires that the insider obtain some personal benefit. Finally, “a tippee is liable only if he knows or should have known of the breach.” Thus, because the disclosure of inside information alone is not a breach, the court concluded that a tippee’s knowledge of a fiduciary breach “necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit.” Therefore, the government cannot obtain a conviction for insider trading “without establishing that the tippee *knows of the personal benefit* received by the insider in exchange for the disclosure.”

The court also clarified what the government must prove to satisfy the “personal benefit” requirement, rejecting the notion that such a benefit could be inferred from the mere existence of a personal relationship between insider and tip recipient: “we hold that such an inference is impermissible in the absence of 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 light of these holdings, the court reversed the convictions and remanded with instructions to dismiss the indictments with prejudice.

Following this decision, the Second Circuit articulates the elements of tippee liability as follows:

- (1) the corporate insider was entrusted with a fiduciary duty;
- (2) the corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit;
- (3) the tippee knew of the tipper’s breach, that is, he knew the information was confidential and divulged for personal benefit; and

(4) the tippee still used that information to trade in a security or tip another individual for personal benefit.

Read the [Second Circuit opinion](#). For more information please contact one of the following Haynes Boone lawyers.