Bloomberg BNA

White Collar Crime Report™

INSIDER TRADING

Three Keker & Van Nest attorneys examine some of 2015's critical white collar and securities enforcement actions and identify cases to watch in 2016. The authors highlight the watershed decision by the Second Circuit involving insider trading and the impact the case had on pending cases. They also discuss significant developments relating to the Supreme Court, the Yates Memo, intellectual property cases and the Dewey & LeBoeuf trial.

White Collar Crime and Securities Enforcement: 2015 in Review



BY BROOK DOOLEY, ERIC H. MACMICHAEL AND NICHOLAS S. GOLDBERG

In 2015, the pendulum swung toward defendants in the world of white collar crime. From the U.S. Supreme Court's refusal to disturb the Second Circuit's insider trading decision in *United States v. Newman*, to the Manhattan District Attorney's loss in the closely watched trial of the former management at Dewey & LeBoeuf, to the Supreme Court's decisions in *Yates* and *Elonis*, defendants notched significant victories in a number of the biggest white collar cases in 2015.

Brook Dooley is a partner with Keker & Van Nest. He handles white collar criminal matters and complex civil litigation involving securities fraud, breach of contract, breach of fiduciary duty and professional negligence claims.

Eric H. MacMichael is a partner at Keker & Van Nest. He has extensive experience handling criminal white collar and complex civil litigation matters.

Nicholas S. Goldberg is an associate at Keker & Van Nest.

Securities Enforcement And the Fallout From *Newman*

II. The fallout from the U.S. Court of Appeals for the Second Circuit's insider trading decision in *Newman* dominated the world of securities enforcement in 2015.[1]

In *Newman*, the Second Circuit reversed the 2013 insider trading convictions of hedge fund managers Todd Newman and Anthony Chiasson. In reversing the convictions, the Second Circuit raised the bar for proving

[1] *United States v. Newman*, 2014 BL 345948, 773 F.3d 438 (2d Cir. 2014) (09 WCR 837, 12/12/14).

 ISSN 1559-3185

insider trading against ''remote tippees'' like Newman and Chiasson.

First, the Second Circuit held that the government must prove not only that the tippee knew that the corporate insider disclosed information in breach of a duty of confidentiality, but also that the tippee knew that the corporate insider disclosed the confidential information in exchange for a personal benefit.[2]

Second, the court held that in order to establish that the insider disclosed confidential information for a personal benefit, it is not enough for the government to prove ''the mere fact of a friendship, particularly of a casual or social nature'' between the insider and the tippee.[3] Rather, the government is required to show ''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.''[4]

In July, after the Second Circuit declined to rehear the case, the Department of Justice petitioned the Supreme Court for a writ of certiorari to challenge *Newman's* holding regarding what is required to prove that the tipper received a personal benefit. The DOJ argued that *Newman*:

(1) departed from the Supreme Court's holding in *Dirks v. SEC* by imposing the requirement of an ''exchange'' between the insider and the tippee;[5]

(2) conflicted with decisions of other circuits, citing in particular the Ninth Circuit's decision in *United States v. Salman*, published less than a month before the government filed its petition;[6] and

(3) would harm the fair and efficient operation of the securities markets by making it easier to trade on inside information.

To the surprise of many, the Supreme Court denied the government's petition without comment in October.[7]

Immediate Impact. The impact of the Supreme Court's decision was swift. Within weeks, the government agreed to dismiss insider trading charges against the other members of the ''Fight Club,'' the group of analysts and fund managers that included Newman and Chiasson. Those who had their charges dropped against them included Michael Steinberg, who had been convicted in 2013 and whose appeal was pending at the time of the *Newman* decision, as well as charges against six individuals who had pleaded guilty and agreed to cooperate with prosecutors.[8]

The government also agreed to dismiss charges in a ''remote tippee'' case involving allegations of insider trading ahead of IBM Corp.'s 2009 acquisition of SPSS Inc.[9] Judge Andrew L. Carter Jr., of the Southern District of New York, threw out the guilty pleas of four defendants and dismissed charges against a fifth.

In all, no fewer than 14 convictions and guilty pleas in insider trading cases were vacated in 2015 as a result of the *Newman* decision.

Not So Fast. Not every defendant who invoked *Newman* was successful, however. In some cases, the courts found that the requirements of *Newman* had been met.

For example, former Foundry Networks executive David Riley, who was convicted in 2014 of leaking information of the company's pending acquisition by Brocade Communications Systems Inc., had his motion for judgment of acquittal or new trial denied because the court found that, even if the jury instructions would have been different post-*Newman*, there was sufficient evidence that Riley received ''concrete personal benefits.''[10]

Other cases noted the limits of *Newman*. In *United States v. Salman*, the Ninth Circuit, in an opinion authored by Judge Jed S. Rakoff, sitting by designation from the Southern District of New York, affirmed the conviction of a ''remote tippee'' and rejected the defendant's argument that *Newman* requires, in all cases, that the government show a *quid pro quo* exchange between the tipper and the tippee to establish the requisite personal benefit. The Ninth Circuit held that under the Supreme Court's opinion in *Dirks*, it remains sufficient to show that the tipper ''makes a gift of confidential information to a trading relative or friend'' and noted that *Newman* itself acknowledged that the required personal benefit could include ''the benefit one would obtain from simply making a gift of confidential information to trading relative or friend.''[11]

Rakoff sounded a similar theme in his opinion denying the motion of Rajat Gupta to undo his 2012 conviction for tipping Raj Rajaratnam of the Galleon Group. Rakoff noted that, even under *Newman*, ''a tipper's intention to benefit the tippee is sufficient to satisfy the benefit requirement so far as the tipper is concerned and no *quid pro quo* is required.''[12] Rakoff further found that, even if *Newman* did require evidence of a *quid pro quo* in every case, there was clear evidence of ''potential pecuniary benefit'' to Gupta.[13]

The effect of the Second Circuit's *Newman* decision will continue to play out in 2016. Indeed, on Jan. 19, 2016, the Supreme Court agreed to hear the defendant's appeal in *United States v. Salman*.[14]

The high court agreed to consider the question whether ''the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. SEC*, 463 U.S. 646 (1983), require[s] proof of 'an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,' as the Second Circuit held in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), cert. denied, No. 15-137 (U.S. Oct. 5, 2015), or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?''

This will be one of the most closely watched cases of the year for white collar practitioners.

---

[2] Id. at 448.
[3] Id. at 452.
[4] Id.
[5] *Dirks v. SEC*, 463 U.S. 646 (1983).
[6] *United States v. Salman,* 792 F.3d 1087 (9th Cir. 2015) (10 WCR 529, 7/10/15).
[7] (10 WCR 813, 10/16/15).
[8] (10 WCR 857, 10/30/15).
[9] *United States v. Conradt*, No. 1:12-cr-00887 (S.D.N.Y.) (10 WCR 73, 2/6/15).
[10] *United States v. Riley*, No. 1:13-cr-00339 (S.D.N.Y).
[11] *Salman*, 792 F.3d at 1093-94.
[12] *United States v. Gupta*, 2015 BL 212998 (S.D.N.Y. July 2, 2015).
[13] Id.
[14] (11 WCR 41, 1/22/16).

  WCR ISSN 1559-3185

Here are a couple of other developments to watch in 2016 and beyond.

Ongoing Cases. There are a number of insider trading cases that are still pending where we are likely to see the law develop further in 2016 and beyond. Of particular note, the SEC's civil case against two defendants in the IBM/SPSS acquisition case who had criminal charges against them dismissed is set for trial in February, and the issue of whether the tippers received the requisite personal benefit under *Newman* will be front and center in the trial.[15]

Charging Decision. Practitioners will also be watching to see how prosecutors and regulators make charging decisions in the wake of the *Newman* decision. It is likely that we will see the government move away from bringing cases against remote tippees or bring only those cases where the evidence of a personal benefit to the tipper is clear. It is also likely that we will see the government pursue different venues for its insider trading cases, filing more cases outside the Second Circuit and, in the case of the SEC, bringing more cases in administrative proceedings.

Legislative Response. Finally, we will likely continue to see calls for an insider trading statute, although Congress has not yet shown any real desire to act on the numerous bills already proposed.

Yates Memo And Prosecution of Individuals

One of the most significant developments in 2015 was the Department of Justice's renewed push to hold individuals accountable in white collar cases.

In September, in the wake of criticism over the lack of individual criminal prosecutions during the housing crisis and financial meltdown, Deputy Attorney General Sally Quillian Yates issued a memorandum to all DOJ attorneys announcing new guidelines for cracking-down on individuals in corporate investigations (the ''Yates Memo'').[16] The most significant change in the Yates Memo states that corporations will only be eligible for cooperation credit from the government if they provide DOJ with ''all relevant facts'' relating to the individuals responsible for corporate misconduct.[17] As Yates explained, this is an ''all or nothing'' policy toward cooperation where the company ''must give up the individuals, no matter where they sit within the company.''[18]

In November, the DOJ incorporated the Yates Memo into the U.S. Attorney's Manual.

While the DOJ pursued a number of cases against corporate executives in 2015, with mixed results, it also continued to resolve investigations without charging individuals, raising questions about how the Yates Memo will impact the DOJ's ongoing and future cases.

Parnell (Peanut Corp. of America). The government achieved a convincing victory in its long-running case against Stewart Parnell, the former chief executive officer of Peanut Corp. of America.[19] In September, Parnell was sentenced to 28 years in prison for knowingly shipping contaminated peanuts that led to a deadly salmonella outbreak in 2009.[20] The sentence was the largest ever in a food safety case, according to the DOJ. Parnell was convicted in 2014 on more than 60 felony counts, including conspiracy, mail and wire fraud, sale of misbranded food into interstate commerce, and obstruction of justice. Parnell's appeal is pending in the Eleventh Circuit.[21]

BP Oil Spill. The government had substantially less success in 2015 in its efforts to hold individuals accountable for the 2010 Deepwater Horizon oil spill in the Gulf of Mexico. In June, after deliberating for only two hours, a jury acquitted former BP executive David Rainey on a charge that he lied to federal agents by manipulating estimates of oil flowing from the failed well.[22] The judge dismissed a second charge alleging that Rainey obstructed a congressional investigation. In November, government prosecutors dropped felony obstruction of justice charges against Kurt Mix, a former BP engineer, whom the government alleged deleted text messages relating to the oil spill.[23] Mix, however, pleaded guilty to a misdemeanor charge of violating the Computer Fraud and Abuse Act, and was sentenced to probation. In December, federal prosecutors dropped manslaughter charges against Robert Kaluza and Donald Vidrine, two supervisors on the Deepwater Horizon oil rig.[24] Vidrine pleaded guilty to a misdemeanor charge of violating the Clean Water Act, while Kaluza will go trial on the same charge in February. Thus, it appears that nobody from BP will go to prison in connection with the 2010 oil spill.

Blankenship (Massey Energy). The DOJ received a mixed verdict in the high-profile trial against Don Blankenship, the former CEO of Massey Energy.[25] Blankenship was indicted in November 2014—almost three years after the DOJ reached a $209 million settlement with the company that acquired Massey Energy stemming from a 2010 explosion at the Upper Big Branch mine that killed 29 people. A federal jury in December found Blankenship guilty of a single misdemeanor count of conspiring to violate federal mine safety and health standards before the 2010 explosion. However, the jury cleared Blankenship of two more serious felony counts of making false statements to the SEC and secu-

[15] *SEC v. Payton*, No. 1:14-cv-04644 (S.D.N.Y.).

[16] Memorandum from Deputy Attorney General Sally Quillian Yates, DOJ, *Individual Accountability for Corporate Wrongdoing* (Sept. 9, 2015), available at http://www.justice.gov/dag/file/769036/download. See also (10 WCR 731, 9/18/15).

[17] Id.

[18] Yates, remarks at New York University School of Law (Sept. 10, 2015), available at http://www.justice.gov/opa/speech/deputy-attorney-general-sally-quillian-yates-delivers-remarks-new-york-university-school.

[19] *United States v. Parnell*, No. 1:13-cr-00012 (M.D. Ga.).

[20] (10 WCR 770, 10/2/15).

[21] *United States v. Parnell*, No. 15-14552 (11th Cir.).

[22] *United States v. Rainey*, No. 2:12-cr-00291 (E.D. La.) (10 WCR 445, 6/12/15).

[23] *United States v. Mix*, No. 2:12-cr-00171 (E.D. La.) (10 WCR 924, 11/13/15).

[24] *United States v. Kaluza*, No. 2:12-cr-00265 (E.D. La.) (10 WCR 1014, 12/11/15).

[25] *United States v. Blankenship*, No. 5:14-cr-00244 (S.D. W.Va.).

rities fraud, which carried a maximum prison term of 30 years.[26]

Blankenship will be sentenced in April.

General Motors. In September, just one week after the DOJ announced its renewed focus on individual accountability in the Yates Memo, federal prosecutors reached a $900 million settlement with General Motors Co. that yielded no criminal charges against individuals in connection with the government's criminal probe into the company's defective ignition switches.[27] Under the deferred prosecution agreement, the DOJ charged GM with concealing the safety defect from regulators and wire fraud, but agreed to drop the charges if GM abides by the terms of the settlement, which include a monetary payment and an independent monitor. The DOJ was widely criticized for the lighter-than-expected financial penalty and for failing to charge any individuals, even though the statement of facts charging the corporation describes numerous acts by GM employees.[28] GM's reduced punishment appears to be the product of what the DOJ deemed ''exemplary'' cooperation, including furnishing prosecutors with ''a continuous flow of unvarnished facts'' from the company's internal investigation and waiving the attorney-client privilege.

It remains to be seen whether companies can expect to receive the same credit for similar levels of cooperation under the new guidelines in the Yates Memo and whether we will see more individual prosecutions in 2016.

Dewey & LeBoeuf Trial

In one of the most closely-watched white collar cases of 2015, the Manhattan District Attorney's office suffered a major setback in the trial of three top leaders of the failed law firm Dewey & LeBoeuf.[29]

In the wake of the 2012 collapse of Dewey & LeBoeuf, prosecutors accused Steven H. Davis, the law firm's former chairman, Stephen DiCarmine, the firm's former executive director, and Joel Sanders, the firm's former chief financial officer, of accounting misconduct aimed at defrauding the law firm's lenders and insurance companies. Prosecutors argued that the three executives manipulated the law firm's accounting records to hide the true nature of Dewey's declining finances to meet covenants in the firm's bank loans and to persuade lenders to invest in a $150 million bond offering.

In October, the jury acquitted the defendants of 58 counts of falsifying business records and deadlocked on 93 additional counts, including scheme to defraud, grand larceny, conspiracy, and securities fraud.[30] The verdict followed a nearly five-month trial in New York Supreme Court, with testimony from more than 40 prosecution witnesses, including numerous cooperating witnesses whom pled guilty to lesser offenses. The defense did not call a single witness, instead relying on cross-examination to try to establish that the defendants did not know about the alleged fraud or that the accounting was more complicated than prosecutors claimed.

Despite the setback, prosecutors appear poised to take another shot at trial against at least some of the defendants in 2016. In December, prosecutors announced that—barring any plea deals—they plan to retry DiCarmine and Sanders, and proceed with a previously-severed trial against Zachary Warren, a junior client relations manager charged as a co-conspirator. Meanwhile, Davis struck a deal with prosecutors to avoid a second trial.[31]

Practitioners will be watching closely in 2016 to see how the prosecutors alter their approach and whether a potentially streamlined case yields a different result.

Intellectual Property Cases

The legal odyssey of Sergey Aleynikov continued in 2015. Aleynikov, a former Goldman Sachs programmer, was first charged by the U.S. Attorney in the Southern District of New York back in 2010 for downloading 32 megabytes of source code for Goldman's high-frequency trading program that he allegedly intended to use with his new employer. He spent a year in federal prison after he was convicted in 2011 of violating the National Stolen Property Act (NSPA) and the Economic Espionage Act of 1996 (EEA). In 2012, however, the Second Circuit set aside Aleynikov's conviction, finding that source code alone is not a ''product'' for purposes of the EEA or a ''good, ware, or merchandise'' for purposes of the NSPA.[32]

However, Aleynikov's relief was short-lived. In 2012, the Manhattan District Attorney's Office decided to prosecute him under state law.[33] In May of 2015, Aleynikov was convicted after a month-long trial of one count of unlawful use of secret scientific material. The jury acquitted on the charge of unlawful duplication of computer-related material and deadlocked on a second count of unlawful use. The trial was marked by a jury that appeared to be overwhelmed. The jury deliberated for eight days, it made 24 requests for testimony readbacks or explanations about the meaning of words used in the statutes, and, in a bizarre episode, two jurors were dismissed after one accused the other of tampering with her food.

In July 2015, Aleynikov's conviction for unlawful use was overturned by the trial judge, who found that prosecutors had failed to prove that Aleynikov made a ''tangible'' copy of the source code—a requirement under the state law. The judge noted that the criminal statute that Aleynikov was accused of violating was enacted in 1967, had been invoked sparingly in the years since, and was ill-equipped to deal with digital crimes.[34]

Aleynikov's latest post-conviction victory may turn out to be, like his earlier one, short-lived. In July, the Manhattan District Attorney's Office announced that it would appeal the decision to overturn his conviction.[35] The state's appeal will likely be resolved in mid-2016.

---

[26] (10 WCR 1007, 12/11/15).

[27] *United States v. $900,000,000 in United States Currency*, No. 1:15-cv-07342 (S.D.N.Y.).

[28] E.g., David M. Uhlmann, *Justice Falls Short in G.M. Case*, N.Y. Times, Sept. 19, 2015; Zoe Tillman, *Federal Judge Slams 'Shocking' DOJ Deal With GM Over Safety Defect*, National Law Journal, Oct. 21, 2015.

[29] *People v. Davis*, No. 773-2014, N.Y. Sup. Ct. (Oct. 19, 2015).

[30] (10 WCR 859, 10/30/15).

[31] (11 WCR 50, 1/22/16).

[32] *United States v. Aleynikov*, 676 F.3d 71 (2d Cir. 2012) (07 WCR 324, 4/20/12).

[33] *People v. Aleynikov*, No. 4447-2012, N.Y. Sup. Ct. (Aug. 9, 2012) (07 WCR 655, 8/24/12).

[34] (10 WCR 517, 7/10/15).

[35] (10 WCR 628, 8/7/15).

  WCR ISSN 1559-3185

The other notable development in the realm of intellectual property involved the Computer Fraud and Abuse Act. The Second Circuit's recent decision in *United States v. Valle* deepened the circuit split regarding the scope of liability under the CFAA.[36] In holding that a defendant must access digital information he was not entitled to view—as opposed to accessing information he was entitled to view but for an improper or unsanctioned purpose—*Valle* adopts the narrow interpretation favored by the Fourth and Ninth circuits, and rejects the broad interpretation announced by the First, Fifth, Seventh and Eleventh circuits.

New York City police officer Gilberto Valle was charged in connection with his participation in online chat rooms devoted to fantasy role-playing involving cannibalism, rape, and murder. Valle was indicted for conspiring to kidnap and with violating the CFAA for using his access to a NYPD police database in order to obtain private details about some of the women who were being discussed in the chat rooms, in violation of NYPD policy. Valle was convicted by the jury on all counts.

The Second Circuit reversed Valle's CFAA conviction based on its conclusion that Valle did not ''exceed authorized access'' when he used his police credentials to access the restricted database, even though he did so in clear violation of NYPD policy. The court determined that accessing a database for an improper purpose does not satisfy the CFAA's requirement that the access to the computer be ''without authorization'' or that the defendant ''exceed authorized access.'' For the latter prong, the Second Circuit held that the defendant must access information or files he is not authorized to view.

By contrast, the First, Fifth, Seventh and Eleventh circuits have interpreted the term ''exceeds authorized access'' much more broadly. There is now a clear split between the narrow and broad interpretations of what it means to access a computer without authorization or in excess of authorization under the CFAA. The U.S. Supreme Court will likely need to resolve this circuit split because there is no indication that Congress is inclined to amend the CFAA.

Supreme Court

The U.S. Supreme Court issued two notable rulings in 2015 narrowing the scope of federal criminal laws.

In *Yates v. United States*, the court held that a law against destroying corporate records cannot be used against a commercial fisherman for throwing undersized fish overboard to avoid prosecution.[37] The case involved a Florida commercial fisherman, John L. Yates, who was convicted of violating a provision of the Sarbanes-Oxley Act making it a crime to destroy or alter ''any record, document or tangible object'' with the aim of obstructing or influencing any federal investigation.[38] Yates was convicted for destroying ''tangible objects'' after a fish and wildlife officer boarded his boat and found a number of undersized red grouper. Federal fishing regulations place a minimum size on grouper that may be taken commercially. Yates allegedly ordered a crew member to dispose of the undersized fish before the ship reached the port and encountered federal agents. The government contended that the phrase ''tangible objects'' should be read to cover any physical object, including grouper.

The court disagreed, and held in a 5-4 decision that the phrase ''tangible object'' applies only to an object ''used to record or preserve information.''

Elonis v. United States involved the federal criminal conviction of a Pennsylvania man who made various threatening posts on Facebook directed towards his wife, anonymous kindergarten classes, and a female FBI agent who attempted to interview him.[39] At trial, the jury was instructed that it could convict Elonis under 18 U.S.C. 875(c) if what he wrote in his posts would be understood ''by a reasonable person'' as a threat to his wife and to the other targets of his online messages. Elonis argued that the government should have been required to prove that he specifically intended to threaten or harm each of the targets of his online threats. He claimed that the posts were never intended as threats and were simply a form of personal therapy.

The court reversed Elonis's conviction and held that it was not enough for the government to show that Elonis was negligent in his posts—i.e., that a reasonable person would have perceived the posts as threats—because negligence has historically been insufficient to support a criminal conviction. The court found that a defendant must have some ''mental state'' in order to be convicted under the criminal threats statute, and wrote that the law ''is satisfied if the defendant transmits a communication for the purpose of issuing a threat, or with knowledge that the communication will be viewed as a threat.'' The majority opinion took no position on exactly what mental state would suffice to support a conviction, leaving open the question of whether recklessness would have been sufficient.

---

[36] 807 F.3d 508, 2015 BL 396607 (2d Cir. Dec. 3, 2015) (10 WCR 1020, 12/11/15).

[37] 574 U. S. ___, 2015 BL 47842 (2015) (10 WCR 153, 3/6/15)..

[38] 18 USCA § 1519.

[39] 575 U.S. ___ (2015).