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ASKED & ANSWERED

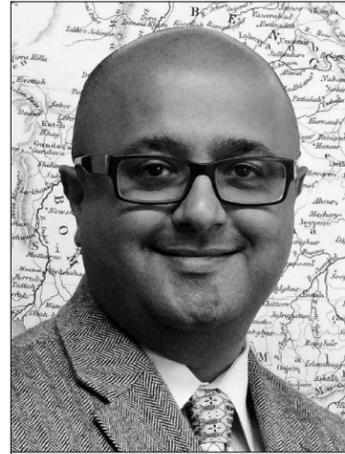
Ashish Joshi on Insider Trading

By SHEILA PURSGLOVE

*On December 10, 2014, a three-judge panel of the influential United States Court of Appeals for the Second Circuit overturned major insider trading convictions of two Wall Street traders, Anthony Chiasson and Todd Newman. The decision was a major blow to a spectacularly successful and multiyear crackdown on financial fraud and corruption on Wall Street by the U.S. Attorney's Office in Manhattan. The appellate ruling sheds light on the deep divide between the Government and the federal courts – including the Supreme Court of the United States – about the law governing insider trading. Ashish Joshi, the Managing Partner and a trial attorney with Lorandos Joshi P.C. in Ann Arbor, discusses the ruling and how it will affect insider trading investigations and prosecutions in future. Joshi's practice focuses on white-collar criminal defense, complex commercial litigation, and cross-border litigation and dispute resolution. A prolific speaker and an author, Joshi has written and spoken extensively on these topics and taught International Business Transactions at Thomas Cooley Law School in Spring 2011. Joshi also serves on the Board of Directors for the National Association of Criminal Defense Lawyers (NACDL) and on the Board of Editors for the American Bar Association's Section of Litigation's publication *Litigation*.*

Pursglove: Why is the Court of Appeal's decision important?

Joshi: The Court of Appeals' decision is a game-changer. The Court signaled to the Government



Ashish
Joshi

that they cannot bring flawed cases and then hide behind the excuse that the law is vague. The Court, in its scathing opinion, admonished the Government that the Supreme Court was quite clear in previous cases about what is required to establish illegal insider trading. Trading on an informational advantage is not necessarily illegal. To be illegal, the courts have said, trading by insiders must involve breaching a duty of trust and confidence. The Supreme Court noted in *Chiarella v. U.S.* (1980) and in *U.S. v. O'Hagan* (1997), that there is no general duty between all participants in market transactions to forgo actions based on material, non-public information because it is possible to acquire such information in an entirely legitimate manner. It is not often that one sees a decision from an influential federal circuit chastising the United States Attorney's Office for "the doctrinal novelty" of the government's insider trading prosecutions. Rarer still is a decision that slams the district court judge in the case and his erroneous jury instructions and even suggests that prosecutors had steered the case to a judge of their choosing.

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ASKED:

Recent decision by the Court of Appeals is a game-changer for Wall Street

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Pursglove: What is the overarching issue in the appellate decision?

Joshi: Generally, in an insider trading prosecution, the Government's theory is that trading in stock or other financial assets is a crime if somebody trades while in possession of any sort of informational advantage over other traders. But, as the Court of Appeals, points out, "although the Government might like the law to be different, nothing in the law requires symmetry of information in the nation's securities markets." The problem appears to be that insider trading is a crime entirely defined by common law. It has been open to interpretation and has been interpreted in a variety of ways by an ever-changing cast of prosecutors, Securities and Exchange Commission officials, enforcement executives, as well as various judges. Not surprisingly, this has resulted into misguided attempts to fit new insider-trading cases - with ever growing sophistication in areas of accessibility of financial information and changes in technology - into earlier precedents. As Judge Barrington D. Parker, one of the appeals court judges that decided the Newman / Chiasson case, put it at oral argument, the law "seems to vary depending on which judge you're talking to."

Pursglove:° What was the underlying case about?

Joshi: The two defendants, Newman and Chiasson, were charged and convicted on charges of securities fraud. Unlike many "open and shut" cases of insider trading prosecutions, these two men hadn't received the informa-

tion directly. Instead, the tips were passed through a network of investor relations representatives and analysts before reaching analysts who worked for the two men. The two defendants knew that analysts were talking to people who worked at Dell and Nvidia, the companies whose shares they traded. The two men however were several steps removed from the corporate insiders and there was no evidence that either was aware of the source of the inside information. Interestingly, tippers who were high on the totem pole for passing the information were not charged administratively, civilly, or criminally for insider trading or any other wrongdoing. Also of interest was the fact that the Government did not cite, nor did the Court of Appeals find a single case where tippers as remote as Newman / Chiasson were held criminally liable for insider trading. Nevertheless, the Government charged Newman / Chiasson because, their theory was, as "sophisticated traders", they must have known that information was disclosed by insiders in breach of fiduciary duty, and not for any legitimate corporate purpose. The prosecutors ignored Supreme Court precedents, such as *Dirks v. SEC* (1983), that clearly stated that disclosures of confidential corporate information can be consistent with the duties of insiders to shareholders, and that analysts who work to ferret out information about companies serve important social goals including identifying fraud and mismanagement, permitting enhanced monitoring of management, and improving the accuracy of share prices. As Professor Jonathan Macey of Yale Law School pointed out in his article in the *Wall Street Journal* following the Court of Appeals' opinion, investors such as hedge funds use "legitimate financial modeling" to estimate corporate performance. These analysts routinely solicit and obtain information from com-

panies in order to test the validity of their financial models. The record in the Newman / Chiasson case showed that Dell and Nvidia, like other public companies, "selectively disclosed confidential quarterly financial information" to "establish relationships with financial firms" that might invest in those companies. To possess confidential information is not illegal. Even trading on an informational advantage is not necessarily illegal.

Pursglove: What were the key issues on the appeal?

Joshi: At issue in the appeal was whether the evidence was sufficient as to the several elements of the offense and also whether the trial judge made an error in telling the jurors that it was enough for the government to show that the men knew the information was disclosed in breach of a fiduciary duty and not necessarily in exchange for a reward. The Court ruled that the jury instruction was wrong, clarifying that the district court erred in failing to instruct the jury that it must find that a tippee knew that the insider disclosed confidential information in exchange for a personal benefit. Not only must the Government prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information, it must also prove that he did so in exchange for a personal benefit - something that might not apply to a person who trades on a tip from a golf buddy or an old classmate, for instance.

Pursglove: What kind of personal benefit is the Government required to prove?

Joshi: The appeals court ruled that, in order to be found guilty of insider trading, a defendant must know a tip was illegally disclosed in exchange of a reward of "some consequence." The Court dismissed Government's argument that career advice or friendship constituted a reward, saying that, under that logic, "practically any-

thing would qualify."

Pursglove: Your practice includes cross-border issues. Is there a difference in how American courts view insider trading versus courts in foreign jurisdictions?

Joshi: In many countries around the world, where the crime of insider trading is defined by statute, merely trading on insider information would be enough to convict. But, not in America. There is a lack of written law on this topic that results in insider trading cases being prosecuted under general anti-fraud statutes. Proving fraud requires additional elements that, to the average person, seem to bear little relevance to insider trading. A common perception of insider trading conjures up an image of "Deep Throat" conspiracy - a plugged-in trader using a confidential tip to make lucrative trades. However, in the case at hand, the appeals court ruled that prosecutors had to show that both men knew that the original source of inside information had breached a fiduciary duty and had received a personal benefit in return. By contrast, the European approach to prosecuting insider trading cases is much simpler. No one cares about an accused getting a "personal benefit" or "breach of fiduciary duty". All they care about is - if you have material, inside information, you cannot trade on it, period.

Pursglove: What the practical outcome of the Court of Appeals' decision?

Joshi: Well, as per the media articles, the United States' attorney's office had planned to retry the cases if they lost the appeal. However, the Court reversed the convictions and dismissed the indictment with prejudice, which prevents a retrial.

Pursglove: Did the Court of Appeals clearly outline as to what's required before a person can be found guilty of insider trading?

Joshi: Yes. In sum, the Court held that to sustain an insider

trading conviction against a tippee, the Government must prove each of the following elements beyond a reasonable doubt: "that (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."

Pursglove: What is your opinion about the Court of Appeals decision?

Joshi: Well, the ruling no doubt has raised the bar for prosecutors on a crime that was somewhat hard to prove to begin with. However, the Court of Appeals' decision comports with well-settled principles of substantive criminal law. Under the common law, *mens rea*, which requires that the defendant know the facts that make his conduct illegal, is a necessary element in every crime. Such a requirement is particularly appropriate in insider trading cases where courts have acknowledged "it is easy to imagine a...trader who receives a tip and is unaware that his conduct was illegal and therefore wrongful." Only "willful" violations are subject to criminal prosecutions. The Court of Appeals said that prosecutors have been too aggressive in their interpretation of the law. Defense lawyers and civil rights advocates have been complaining for years: the Government is overreaching. They took insider-trading law and applied it to garden-variety research techniques and criminalized behavior the trading community had long considered to be lawful. The Newman/Chiasson case brought these issues to head with the National Association of Criminal Defense Lawyers acting as *Amicus Curiae*.