

Second Circuit Upholds Insider Trading Conviction, Finding Sufficient Confidentiality Duty and Personal Benefit

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The Second Circuit yesterday affirmed the insider trading conviction of the principal of a potential acquiror who, in breach of a nondisclosure agreement with a potential target company, had provided a tippee with nonpublic information about an impending acquisition of the target. The decision in [United States v. Chow](#) held that:

- The nondisclosure agreement (“NDA”) between the transaction parties created a duty to keep information about the potential transaction confidential and not to use it for any purpose other than the transaction;
- The defendant tipper violated that agreement by providing information to the tippee, who purchased significant amounts of the target’s shares before the transaction was announced;
- The evidence supported the jury’s finding that the tipper had intentionally provided material, nonpublic information (“MNPI”) to the tippee; and
- The tipper had received a sufficient personal benefit in exchange for providing MNPI.

Background

The *Chow* case involved the attempted acquisition of a U.S. semiconductor manufacturer by an entity allegedly affiliated with the Chinese government. At several points during the acquisition effort, the tipper (Chow), on behalf of the potential acquiror, and the target had signed NDAs providing that the parties would not disclose or use any proprietary information of the other party except for the potential transaction and that “[t]he fact of the exploration and evaluation of a potential strategic transaction” was itself confidential. The parties also had taken other precautions to keep their negotiations confidential.

During the negotiation process, the tipper allegedly communicated multiple times with the tippee (Yin) and supposedly provided information about the negotiations. The communications allegedly occurred close to significant points in the transaction process, including the making of offers and the exchange of a draft merger agreement. The tippee bought large amounts of the target's shares for multiple accounts shortly after those communications. The tippee then sold about half of those shares on the day the transaction was announced. (The deal ultimately was blocked by the Committee on Foreign Investment in the United States.)

The tipper was prosecuted for insider trading under § 10(b) of the Exchange Act, securities fraud under 18 U.S.C. § 1348, and conspiracy to commit securities fraud. The jury convicted the tipper on some (but not all) of the insider trading counts relating to the tippee's purchases and on the securities-fraud and conspiracy counts.

The tipper appealed, arguing that the NDA did not create a duty of confidentiality, the evidence did not prove an intentional breach of the NDA, and the tipper had not sought or received a personal benefit. The Second Circuit affirmed the conviction.

Second Circuit's Decision

The court first held that the NDA imposed a legal duty of confidentiality on the tipper, that the tipper breached that duty in allegedly disclosing information about the transaction, and that this breach of duty created liability under the misappropriation theory of insider trading. The court noted that SEC Rule 10b5-2 expressly addresses this situation: it states that, "[w]hen a person agrees to maintain information in confidence," "a 'duty of trust or confidence' exists."

The court also held that the jury had received sufficient evidence to conclude that the tipper had intentionally disclosed MNPI to the tippee. The two had known each other for at least five years; the tipper had "a strong interest in being able to communicate with" the tippee; the tipper's phone had five numbers stored for the tippee; and the tipper had revealed more than "his own thoughts" about the progress of the merger negotiations.

Perhaps most interesting was the Second Circuit's treatment of the personal-benefit requirement: the requirement that a tipper receive some type of personal benefit in exchange for providing MNPI to a tippee. The court reiterated its prior ruling that "the government need not show that the tipper expected or received a specific or tangible benefit in exchange for the tip, and that the personal benefit element is satisfied where there is evidence that the tipper intend[ed] to benefit the . . . recipient."

The court first recited specific types of benefits that the tipper allegedly had received: the tipper had asked the tippee to provide him with analyst reports on the semiconductor industry and to recommend possible limited partners for the tipper's business venture; the tippee had given the tipper information about other manufacturers and users of the target's main product; the tippee had his used contacts with investment bankers to connect the tipper with an analyst knowledgeable about the target's product; and the tippee had sent the tipper gifts of wine and cigars.

But the court seemed to focus more on the other aspect of the personal-benefit requirement, which finds a sufficient personal benefit where the tipper intends to benefit the tippee even without receiving anything specific in return. The court found the record sufficient to support inferences that the tipper had "knowingly and intentionally breached his duty of confidentiality by disclosing material nonpublic information as to the prospects for a merger agreement between [the target] and [the tipper's] fund, intending for [the tippee] to make trades based on that information."

Implications

The *Chow* decision does not break new ground on any of the issues it addressed. In fact, the court's discussion of the NDA and the legal duty it created relied heavily on the court's 2020 decision in *United States v. Kosinski* (we blogged about that case [here](#)).

But the personal-benefit discussion, although not novel, reinforces that such a benefit can exist even where the tipper does not receive something in exchange for the tip. An intent to benefit the tippee and enable him or her to trade on MNPI can suffice.

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