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October 5, 2015

VIA FACSIMILE AND UPS OVERNIGHT

Brent J. Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E., Mail Stop 3628
Washington, DC 20549
Fax: (202) 772-9324

Re: *In the Matter of Gregory T. Bolan, Jr. and Joseph C. Ruggieri*, AP File No. 3-16178

Dear Mr. Fields:

The Division of Enforcement respectfully submits the enclosed Petition for Review of Initial Decision and Exhibit 1 thereto for filing with the Commission, pursuant to SEC Rule of Practice 410. The overnight UPS package contains the original and three copies.

Thank you for your attention to this matter.

Respectfully submitted,

Preethi Krishnamurthy
Senior Trial Counsel
Division of Enforcement

cc: Administrative Law Judge Jason S. Patil (by e-mail & UPS w/encl.)
Paul Ryan, Esq. (by e-mail, fax & UPS w/encl.)
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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16178

In the Matter of

Gregory T. Bolan, Jr. and
Joseph C. Ruggieri,

Respondents

THE DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW OF INITIAL DECISION

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October 5, 2015

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Under Commission Rule of Practice 410(b), the Division of Enforcement ("Division") hereby petitions the Commission for review of the Initial Decision rendered by Administrative Law Judge ("ALJ") Jason S. Patil on September 14, 2015. The Division seeks review of the findings and conclusions that Respondent Joseph C. Ruggieri ("Ruggieri") did not violate Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] because settled Respondent Gregory T. Bolan, Jr. ("Bolan") did not tip Ruggieri for personal benefit.[1]

INTRODUCTION

In this insider trading case, involving a tipper and tippee then employed by a registered broker-dealer, an ALJ has for the first time applied the decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied* (Oct. 5, 2015). Before *Newman*, the United States Supreme Court had held in *Dirks v. SEC*, 463 U.S. 646, 664 (1983), that the Commission must find that a tipper tipped material, non-public information for a personal benefit—not for a benevolent purpose such as exposing a fraud—to establish insider trading liability. The Supreme Court held that, among other things, the tipper's gift of valuable inside information to benefit a friend or a *quid pro quo* relationship between the tipper and tippee satisfied that requirement. Last year, in *Newman*, the United States Court of Appeals for the Second Circuit arguably narrowed the personal benefit requirement in that Circuit.[2] The Initial Decision misapplies *Newman* and *Dirks* to the largely uncontroverted facts. It then reaches the implausible conclusion that the tipper risked his job to repeatedly tip the tippee—

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[1] The Division does not seek review of the Initial Decision's conclusion that Ruggieri did not violate Section 17(a) of the Securities Act of 1933. The Division based its Section 17(a) claim solely on Ruggieri's short sales of Parexel International Corp. ("Parexel"). The Initial Decision concluded that Ruggieri did not trade in Parexel on the basis of a tip. The Division does not challenge that conclusion here.

[2] As the Initial Decision notes, "a petition for review from a final Commission order may not necessarily lie in the Second Circuit." (Initial Decision at 28 n.15.) Ruggieri lives in North Carolina. (Hearing Tr. 2739:8–25.)

his friend, close colleague, and mentor, who could and did later advance the tipper's career—with no expectation of personal benefit. As the Commission recently stated in an amicus brief to the Second Circuit, *Newman*'s conclusions "on the tipper benefit requirement involve an issue of exceptional importance." The Initial Decision warrants the Commission's independent, *de novo* review.

In his Initial Decision, the ALJ finds that Bolan—an "up-and-comer" research analyst who published market-moving research on healthcare stocks—repeatedly tipped his friend and colleague Ruggieri, a trader, with material, non-public information. At least four times, shortly before Bolan published a positive ratings change on a stock, he tipped Ruggieri to his forthcoming ratings change. Ruggieri then profitably traded on these four tips: each time, he purchased the stock just before Bolan published his ratings change and sold the stock at a profit just after the ratings change raised the stock's price. As the Initial Decision notes, Ruggieri does not dispute that he and Bolan knew their employer, Wells Fargo Securities, LLC ("Wells Fargo"), prohibited research analysts like Bolan from disclosing forthcoming ratings changes to anyone outside the firm's research department, including traders like Ruggieri. Nor does Ruggieri dispute that the forthcoming ratings changes were material, non-public information and that he knew he was prohibited from trading on them.

Although the Initial Decision finds that the Division has proven every other element of its Section 10(b) and Rule 10b-5 claim, it declines to find Ruggieri liable on the sole ground that Bolan did not tip Ruggieri for personal benefit. The Initial Decision reaches this conclusion based largely on *Newman* and despite copious, essentially uncontroverted evidence of Bolan's close relationship with Ruggieri and Ruggieri's positive impact on Bolan's career. Specifically, as the Initial Decision makes clear, Bolan and Ruggieri shared a friendship and close working relationship, Ruggieri mentored Bolan, and Ruggieri's glowing feedback about Bolan could and sometimes did favorably impact Bolan's performance rating, bonus, and promotion following Bolan's tips. The Division petitions for review because the Initial Decision misapplies existing personal benefit law and draws

implausible inferences, including that Bolan—risking his career—repeatedly tipped Ruggieri to valuable inside information without any expectation of receiving a benefit in return.

SUMMARY OF GROUNDS FOR REVIEW[3]

I. The Initial Decision Errs in Concluding That Bolan Did Not Tip for Personal Benefit By Tipping a Friend, Mentor, and Close Co-Worker.

As the Initial Decision makes clear, Ruggieri and Bolan undisputedly had a friendship and close working relationship. For example, Ruggieri testified that he and Bolan were "pretty good friends" and that he and Bolan "got along really well." (Initial Decision at 43.) As Bolan's supervisor testified—uncontroverted by Ruggieri—Bolan and Ruggieri "developed a very close relationship that contained a significant amount of dialogue, more than [was] normal for [the research] department, and...there was a close relationship of two professionals supporting one another." (*Id.* at 45 (quoting Hearing Tr.).) Ruggieri also mentored Bolan, as Ruggieri's colleague testified, again uncontroverted by Ruggieri. (*Id.* at 36.) Indeed, Ruggieri and Bolan spoke at least twice a week and socialized outside the office when Bolan traveled to New York City, where Ruggieri lived. (*Id.* at 43, 45.) After Wells Fargo terminated them both, Bolan stayed in Ruggieri's apartment for several days and kept Ruggieri's apartment keys until the next month. (*Id.* at 44.) Ruggieri even recommended Bolan for a job at Ruggieri's new employer. (*Id.* at 7, 44.) Nevertheless, the Initial Decision incorrectly concludes that this "'friendship' and working relationship between Bolan and Ruggieri was not a meaningful, close, or personal one" sufficient to satisfy *Newman*'s requirement of "a meaningfully close personal relationship that generates an exchange that is objective, consequential,

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[3] Pursuant to Rule 410(b), the Division does not waive any ground for review based on findings or conclusions in the Initial Decision that contradict the Division's pre-hearing and post-hearing proposed findings of fact and conclusions of law, insofar as the contradictions relate to the personal benefit element of the Division's Section 10(b) and Rule 10b-5 claim against Ruggieri. Nor does the Division waive any ground for review based on federal court or Commission decisions rendered after the filing of this Petition.

and represents at least a potential gain of a pecuniary or similarly valuable nature." (*Id.* at 34, 35, 43–47 (quoting *Newman*, 773 F.3d at 452).)

The Division petitions for review of the Initial Decision's application of the law to these facts on three grounds. First, these and other largely undisputed facts about Bolan's and Ruggieri's relationship establish personal benefit under the Second Circuit's *Newman* standard. *Newman* appears to require only that the tipper and tippee have a "meaningfully close personal relationship" before a factfinder may infer that the tipper tipped a friend or relative for personal benefit. *See Newman*, 773 F.3d at 452; *United States v. Salman*, 792 F.3d 1087, 1094 (9th Cir. 2015) (declining to read *Newman* as holding that "evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit").

The Initial Decision's interpretation of *Newman*'s language is too narrow. Although the terms "meaningfully," "close," and "personal" are "not susceptible to a definite legal meaning," Bolan's and Ruggieri's relationship satisfies any reasonable definition. Br. for SEC as Amicus Curiae Supporting Pet. of the United States for Reh'g or Reh'g En Banc at 14, *United States v. Newman*, No. 13-1837 (2d Cir. Jan. 2015). Their relationship does not resemble the casual acquaintances *Newman* rejected as insufficient. *See, e.g., SEC v. Payton*, No. 14 Civ. 4644 (JSR), __ F. Supp. 3d __, 2015 WL 1538454, at *2, 4--5 (S.D.N.Y. Apr. 6, 2015) (Rakoff, J.) (allegations that tipper and tippee roommates shared apartment expenses and that the tippee later assisted the tipper with a criminal legal matter sufficed to allege personal benefit under *Newman*); *SEC v. Megalli*, No. 1:13-cv-3783-AT, slip op. at 2, 15, 17, 20–22 & n.7, *attached as Ex. 1* (N.D. Ga. Sept. 24, 2015) (distinguishing the "extremely weak evidence concerning the alleged benefits to the insiders" in *Newman* and finding that the instant tipper's gift of inside information to the tippee—with whom the tipper had "a personal and professional" relationship that "included travel, golf outings, lunches and other work and social events" and for whom "he felt bad"—satisfied the personal benefit requirement); *cf.*

United States v. Riley, No. 13-CR-339-1 (VEC), 2015 WL 891675, at *5 (S.D.N.Y. Mar. 3, 2015) (Caproni, J.) ("While a court could rule that merely maintaining or furthering a friendship is not a sufficient personal benefit, it is not 'plain' that the Second Circuit has done so already."). Bolan therefore tipped Ruggieri for personal benefit.

Second, if Bolan's and Ruggieri's relationship does not suffice to prove personal benefit under *Newman*, *Newman* conflicts with *Dirks*. The Initial Decision therefore errs by relying on *Newman* when it should have relied on *Dirks* and the law of other United States Courts of Appeals to find that Bolan's tip to Ruggieri satisfies the personal benefit element given their relationship.

In *Dirks*, the Supreme Court held that the personal benefit element "exist[s] when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Dirks,* 463 U.S. at 664. Several United States Courts of Appeals have therefore held that a tip of valuable inside information to a friend, without more, satisfies *Dirks'* personal benefit requirement. *See, e.g., Salman*, 792 F.3d at 1094 ("Proof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."); *United States v. Evans*, 486 F.3d 315, 321 (7th Cir. 2007) ("[T]he concept of gain is a broad one, which can include a 'gift of confidential information to a trading relative or friend.'") (quoting *Dirks*, 463 U.S. at 664); *SEC v. Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006) ("[T]he mere giving of a gift to a relative or friend is a sufficient personal benefit."); *SEC v. Yun*, 327 F.3d 1263, 1275 (11th Cir. 2003) (evidence that the tipper and tippee "were 'friendly,' worked together for several years, and split commissions on various real estate transactions over the years" sufficed for a jury to conclude that the tipper tipped for personal benefit). Bolan's repeated tips of material, non-public information to Ruggieri—Bolan's friend, mentor, and close colleague—satisfy this standard.

Third, in any event, Bolan tipped Ruggieri for personal benefit because tips to close co-workers satisfy the personal benefit element under both *Dirks* and *Newman*. Friendships with co-workers are some of the most meaningful friendships people have, and many Wall Street professionals in particular rely on a network of professional friends. Indeed, Bolan's friendship with his other tippee—his undisputedly "close" and "trusted" friend Josh Moskowitz ("Moskowitz")—began when they worked together on a securities firm's trading floor. (Initial Decision at 44–45.) For this reason, the Commission has held that a tipper who tips a "friendly" co-worker does so for personal benefit where the tipper receives only "personal satisfaction" and the tippee's "admiration" in return. *See Robert Bruce Lohmann*, Exchange Act Rel. No. 48092, 2003 WL 21468604, at *4 (June 26, 2003). The Initial Decision therefore implausibly concludes that when a registered securities professional repeatedly and knowingly breaks the rules to tip his close colleague and mentor with profitable inside information, he has not done so for personal benefit.

II. The Initial Decision Errs in Concluding That Bolan Did Not Tip Ruggieri with the Expectation That Ruggieri Would Benefit Bolan's Career In Return.

Largely based on uncontroverted evidence, the Initial Decision describes how Ruggieri's positive feedback on Bolan could and sometimes did advance Bolan's career through performance appraisals, bonuses, and promotion. (Initial Decision at 4, 6, 35–43.) Yet the Initial Decision concludes that "the facts [do not] establish that Bolan had a *quid pro quo* relationship with Ruggieri" or that Ruggieri provided his positive feedback in return for Bolan's tips. (*Id.* at 35.) These and similar conclusions are erroneous.

As background, Wells Fargo did not generate any direct revenue from research analysts like Bolan. (*Id.* at 4.) Instead, research analysts indirectly generated revenue only when clients used Wells Fargo traders like Ruggieri to trade on the firm's research. (*Id.* at 4.) Because the firm's trading department therefore paid a portion of the research analysts' salaries, the trading department exercised some power over the research department. (*Id.* at 4.) Ruggieri—the only Wells Fargo

trader who traded the stocks Bolan researched—was one of the top-producing, highest-paid traders on the firm's trading desk. (*Id.* at 5, 6.) Bolan's direct supervisor "thought highly of Ruggieri" and "valued Ruggieri's opinion." (*Id.* at 42.)

Against this backdrop, the Initial Decision describes various ways in which Ruggieri could and did advance Bolan's career. For example, Ruggieri mentored Bolan.[4] (*Id.* at 36.) Ruggieri also provided positive feedback about Bolan both in meetings Ruggieri had with Bolan's supervisor and in written feedback Ruggieri provided to the research department supervisors. (*Id.* at 37.) As Bolan knew, the trading desk's feedback on him accounted for 5% of his overall ranking among his peers, which in turn directly impacted his performance bonus. (*Id.* at 39–42.) Feedback from Wells Fargo's trading desk was also "taken into account in analyst promotions and was an important factor in analysts' careers." (*Id.* at 42.) Indeed, in nominating Bolan for a promotion—months after Bolan began tipping Ruggieri—Bolan's supervisor relied on Ruggieri's positive feedback about Bolan. (*Id.* at 19, 42.) A few months later, Bolan received the promotion. (*Id.* at 5.) As the Initial Decision finds, at the very least "[i]n an abstract sense, feedback from the trading desk, including Ruggieri, could be viewed as having some potential pecuniary value." (*Id.* at 42.)

These facts require a finding of personal benefit under *Newman* and *Dirks*. Both decisions make clear that evidence of "a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter" satisfies the personal benefit standard. *Newman*, 773 F.3d at 452 (quoting *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013) (quoting *Dirks*, 463 U.S. at 664)). As *Dirks* instructs, the Commission must undertake an objective inquiry to determine whether such a

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[4] The Initial Decision does not mention that Ruggieri mentored Bolan to make him "more commercial." (Div. Post-Hearing Proposed Findings of Fact and Conclusions of Law ¶ 50 (quoting Hearing Tr. 3215:10–3217:7).)

relationship exists—it need not try to read the tipper's mind.[5] *Dirks*, 463 U.S. at 663 ("In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds.... This requires courts to focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings."). The undisputed, objective evidence shows that Bolan knew Ruggieri could positively influence Bolan's career and that Ruggieri's positive feedback in fact helped advance Bolan's career after Ruggieri started profitably trading on Bolan's tips. (Initial Decision at 4, 6, 35–43.) The Initial Decision should have ended its inquiry there and, based on these objective facts, concluded that Bolan tipped for personal benefit.

Furthermore, the Initial Decision erroneously relies on the timing of Ruggieri's positive feedback, some of which preceded Bolan's tips and some of which followed. (Initial Decision at 35–43 ("I have considered the possibility that Bolan tipped Ruggieri with the expectation that Ruggieri would continue to provide positive feedback.... However, I decline to draw a speculative inference about Bolan's state of mind.").) Given the overwhelming undisputed evidence of Ruggieri's importance to Bolan's career, the Initial Decision erroneously fails to conclude that, at a minimum, Bolan tipped Ruggieri to "maintain[ ] and further[ ]" Ruggieri's positive feedback. *Riley*, 2015 WL 891675, at *5.

Finally, under all the facts and circumstances, the Initial Decision implausibly infers that Bolan did not tip Ruggieri with the expectation that Ruggieri would in turn advance Bolan's career. Back-scratching arrangements in which a tipper tips his tippee with the expectation that the tippee will help him in the future meet the personal benefit standard. *See Riley*, 2015 WL 891675, at *8 ("[A]

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[5] The Initial Decision seems to suggest that the Division could not establish personal benefit without calling Bolan to testify. (Initial Decision at 35–36.) Because *Dirks* requires only an objective inquiry, any such suggestion is erroneous.

quid pro quo relationship [between a tipper and a tippee] in which each was trying to help the other" satisfies *Newman*'s personal benefit requirement); *cf. United States v. Jennings*, 160 F.3d 1006, 1014 (4th Cir. 1998) ("I'll scratch your back if you scratch mine" arrangements satisfy the *quid pro quo* element of criminal bribery). "The precise exchange need not be known by the parties at the time of the tip, so long as the tip leads to a 'reputational benefit that will translate into future earnings.'" *Riley*, 2015 WL 891675, at *4 (quoting *Jiau*, 734 F.3d at 153 (quoting *Dirks*, 463 U.S. at 663)). Indeed, even if the tipper's tips "ultimately did not help" his career, "that is irrelevant when determining whether [the tipper's] tips were made as part of a *quid pro quo* agreement." *Riley*, 2015 WL 891675, at *7.

III. The Initial Decision Errs By Failing To Conclude That Bolan Tipped Ruggieri for Personal Benefit Because Bolan Intended To Benefit Ruggieri.

The Initial Decision reasons that *Dirks* "may suggest that the nature of the relationship between the tipper and tippee does not matter if the intent to benefit the recipient is present, as it was in *Lohmann*." (Initial Decision at 47.) Without deciding the issue, however, the Initial Decision erroneously concludes that "the OIP does not allege and the Division does not argue that Bolan tipped Ruggieri with the intent to benefit Ruggieri. Accordingly, any such claim has been waived." (*Id.*) Instead, the Initial Decision should have reached the issue—because the Division made this argument—and concluded that Bolan, intending Ruggieri to trade, tipped Ruggieri to benefit him and therefore tipped for personal benefit.[6]

The Division contended below that Bolan tipped with the intention to benefit Ruggieri, even aside from the inference that Bolan intended to benefit Ruggieri based on their relationship. For example, in its post-hearing proposed conclusions of law, the Division explained:

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[6] The OIP does not specifically allege that Bolan personally benefited because he intended to benefit Ruggieri. As the Commission recently reiterated, however, the OIP need only "provide notice of *what* violations of the securities laws are alleged; it need not detail *how* the Division ultimately will try to prove them." *Timbervest, LLC*, Advisers Act Rel. No. 4197, 2015 WL 5472520, at *19 (Sept. 17, 2015) (emphases in original). The Initial Decision should therefore have considered this ground in light of the Division's post-hearing proposed conclusions of law, discussed below.

> As *Newman* makes clear, there are at least two ways to satisfy its standard: (1) '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,' or (2) 'a relationship between the insider and the recipient that suggests…an intention to benefit the [latter].' *Newman*, 773 F.3d at 452 (emphasis added) (brackets in original)…. *Dirks*' personal benefit inquiry addresses the tipper's 'intention to benefit' the recipient — the very phrase *Newman* quotes — and requires no resulting pecuniary exchange from the tippee to the tipper.

(Div.'s Post-Hearing Proposed Findings of Fact and Conclusions of Law, Conclusions of Law ¶¶ 27–34.) Under this standard, Bolan's and Ruggieri's relationship and the potential and actual career advancement Ruggieri provided to Bolan satisfy the first personal benefit prong. Yet even if they do not, the totality of the record evidence shows that Bolan intended to benefit Ruggieri, his trader colleague, by providing him with confidential, market-moving information, as the Division contended below. (*Id.* at ¶ 34.)

IV. The Initial Decision Implausibly Infers That Bolan Repeatedly Risked His Career To Tip Ruggieri Without Any Expectation of Personal Benefit.

Despite the substantial, undisputed evidence of Bolan's and Ruggieri's relationship and the career benefits Ruggieri provided Bolan, the Initial Decision draws the following inference: "It is arguable that Bolan broke rules due to a misguided belief that disclosing nonpublic information would help his career and advance his reputation. Another view—and one that seems equally if not more likely—is that Bolan simply could not follow the rules and keep his mouth closed." (Initial Decision at 49; *see also id.* at 46 ("It is just as plausible that Bolan's tips were simply incidental to his professional relationship with Ruggieri as opposed to part of any *quid pro quo*.").) This inference is implausible given all the facts and circumstances.

As Bolan knew, Wells Fargo prohibited him from disclosing his forthcoming ratings changes. (*Id.* at 9.) It is implausible that Bolan—a "rising star[ ]" ranked by one publication as the "best 'up-and-comer' analyst'" in his field (*id.* at 5)—would risk his job to repeatedly tip Ruggieri

without any expectation of receiving a benefit in return. *See, e.g., SEC v. Maio*, 51 F.3d 623, 632 (7th Cir. 1995) ("Absent some legitimate reason for [the tipper's] disclosure . . . the inference that [his] disclosure was an improper gift of confidential corporate information is unassailable. After all, he did not have to make any disclosure, so why tell [the tippee] anything?"). For example, in reaching its flawed conclusion, the Initial Decision relies in part on its erroneous finding that Bolan engaged in a "longstanding disregard of compliance rules" for "no apparent reason." (Initial Decision at 47–49.) In fact, as factual findings elsewhere in the Initial Decision (and other record evidence) show, Bolan regularly violated Wells Fargo's policies by emailing his unpublished "channel check" research only "to certain high-paying," "select," "platinum" clients—not to inconsequential clients. (*Id.* at 5, 47–49.) As Bolan knew, client votes accounted for 15% of his performance rank among his peers, which in turn directly affected his bonus. (*Id.* at 40–41 & n.27.) Had Bolan failed to comply with Wells Fargo's compliance rules simply because he could not "keep his mouth closed"—rather than to benefit important clients who could advance his career—he would have disseminated unpublished research haphazardly even to insignificant clients.

Nor is it plausible that Bolan tipped his close friend Moskowitz to several ratings changes in return for a personal benefit but tipped Ruggieri only because Bolan could not "keep his mouth closed." (*Id.* at 7, 44–45, 49 (concluding that Bolan's friendship with Moskowitz "is more indicative of a 'meaningfully close personal relationship that generates an exchange' of some value or potential value").) In fact, no evidence in the record suggests that Bolan tipped anyone besides Ruggieri and Moskowitz to his forthcoming ratings changes. If Bolan tipped Ruggieri simply because Bolan had a big mouth, certainly Bolan would have told others, too.

The Initial Decision's implausible inference that Bolan tipped without any expectation of personal benefit also finds no support in the case law. *Dirks* and *Newman* were highly unusual cases. *Dirks*, 463 U.S. at 648–50, 659 n.18, 665–67 ("On its facts, this case is the unusual one."); *Newman*,

773 F.3d at 448, 451–53 (noting "the doctrinal novelty of [the United States Attorney's] recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders"); *Megalli*, No. 1:13-cv-3783-AT, slip op. at 19 ("[T]he *Newman* defendants were at the tail end of a game of telephone, receiving distorted-at-best transmissions, so that it was not even clear that they knew they were trading on inside information *at all*.") (emphasis in original); *cf. Jiau*, 734 F.3d at 153 ("The proof required to show personal benefit to the tipper is modest."); *Yun*, 327 F.3d at 1280 ("The showing needed to prove an intent to benefit is not extensive.").

In each case, the court pointed to evidence showing that the tipper had a benevolent or non-self-dealing motive for tipping, not merely a lack of personal benefit evidence. In *Dirks*, the Supreme Court concluded that a whistleblowing insider who had tipped confidential corporate information to expose his employer's accounting fraud did not tip for personal benefit. 463 U.S. at 648–50. In *Newman*, the Second Circuit pointed to evidence showing that the insiders' corporate employers permitted them to "leak" earnings data before earnings announcements to investment firms that might then buy the companies' stock—that is, for the companies' benefit, not the tippers'. 773 F.3d at 454–55. Here, Wells Fargo's policies prohibiting analysts from disseminating unpublished research had an important business purpose: ensuring that all its clients received material information simultaneously. (Initial Decision at 49 (noting "the firm's requirement that research be publicly disseminated at the time of its disclosure—not selectively distributed to certain clients first").) Bolan cannot have had any legitimate motive to violate these policies by tipping Ruggieri—indeed, the Initial Decision points to none. The Initial Decision therefore errs by implausibly inferring that Bolan did not tip for personal benefit. *See Riley*, 2015 WL 891675, at *18 n.6 ("It is worth noting that the 'personal benefit' requirement exists to ensure that insiders are tipping in breach of their

duties.... In this case, there is absolutely no doubt that [the tipper] disclosed MNPI in violation of his duty to [his employer] and not for any legitimate reason.").)[7]

CONCLUSION

For these reasons, the Division requests that the Commission grant its petition for review.

Dated: October 5, 2015
New York, New York

DIVISION OF ENFORCEMENT

By: _____

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[7] If the Commission grants the Division's petition for review and ultimately concludes that Bolan tipped Ruggieri for personal benefit, as it should, it should likewise conclude that Ruggieri knew or should have known that he provided a personal benefit because he was the person providing it. *See, e.g., Newman*, 773 F.3d at 447–50 (in a criminal case, requiring that a tippee know of the personal benefit, because absent such knowledge the tippee cannot know of the tipper's breach of duty); *Dirks*, 463 U.S. at 660 (in appeal of a Commission administrative proceeding, imposing tippee liability only when "the tippee knows or should know that there has been a breach"). The Commission should also impose appropriate sanctions and relief.

CERTIFICATE OF SERVICE

I hereby certify that I caused to be served true copies of the Division of Enforcement's Petition for Review of Initial Decision on this 5th day of October, 2015, on the following by the specified means of delivery:

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Dated: October 5, 2015

SMS

Sandeep Satwalekar

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16178

In the Matter of

Gregory T. Bolan, Jr. and
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THE DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW OF INITIAL DECISION:

EXHIBIT 1

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MARK MEGALLI, Defendant.	: : : : : : : : : : :	CIVIL ACTION NO. 1:13-cv-3783-AT

ORDER

This matter is before the Court on the Plaintiff's Motion for Summary Judgment [Doc. 29], and Defendant's Motion for Judgment on the Pleadings or, in the Alternative, for Summary Judgment [Doc. 27]. Plaintiff Securities and Exchange Commission ("SEC") brought this civil enforcement action against Defendant Mark Megalli, alleging that Megalli violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 by trading Carter's, Inc. ("Carter's") stock while in the possession of material non-public information ("inside information") concerning that company. Megalli has already pled guilty to a criminal charge arising from the same alleged conduct. *U.S. v. Megalli*, No. 13-cr-0442-RWS, Doc. 9 (N.D. Ga. Nov. 25, 2013.)

For the reasons set forth below, the Court **GRANTS IN PART** and **DENIES IN PART** Plaintiff's Motion for Summary Judgment [Doc. 29], and **DENIES** Defendant's Motion for Judgment on the Pleadings or, in the Alternative, for Summary Judgment [Doc. 27]. The Court also **DENIES** Defendant's Motion for Oral Argument [Doc. 46].

I. BACKGROUND.

Mark Megalli was hired in 2009 by Level Global, a New York-based hedge fund, to launch a consumer group, hire analysts, and manage capital on behalf of the firm. (Defendant's Response to Plaintiff's Statement of Material Facts ("Def.'s Resp. SMF") ¶ 7.) On September 14, 2009, Megalli, on behalf of Level Global, entered into an agreement with a consulting firm owned by Eric M. Martin, a former Vice President of the Atlanta-based children's clothing company, Carter's, Inc. ("Carter's) (Def.'s Resp. SMF ¶¶ 10-12.) Megalli knew that Martin had recently left Carter's and assumed that he continued to have relationships at Carter's. (Def.'s Resp. SMF ¶¶ 13-14, 17.)

Martin did in fact continue to have relationships at Carter's, including with Richard Posey, a vice president at the company. (Def.'s Resp. SMF ¶ 15.) Martin and Posey had worked at Carter's together, and developed a "personal and professional relationship." *U.S. v. Megalli*, No. 13-cr-442-RWS Doc. 9 at pp. 18:20-25; 19:15-20 (N.D. Ga., Nov. 25, 2013)[1] ("Guilty Plea Transcript."); *see also*

[1] These portions of the Guilty Plea Transcript were, for some unexplained reason, not submitted by the SEC. Nonetheless, the Court may take judicial notice of guilty pleas because they are "not subject to reasonable dispute." *Colonial Penn. Ins. Co. v. Coil*, 887 F.2d 1236, 1239-40 (4th Cir.

(Plaintiff's Response to Defendant's Statement of Material Facts ("Pl.'s Resp. SMF") ¶¶ 6-12.) Posey disclosed inside information to Martin concerning Carter's. (Defendant's Response to Plaintiff's Statement of Additional Material Facts ("Def.'s Resp. to SAMF") ¶ 15) (Doc. 39-1.) Martin, in turn, passed that inside information to Megalli, who then made trades in Carter's stock based in part on the inside information between September of 2009 and July of 2010. (Def.'s Resp. SMF ¶¶ 22, 36.)

More specifically, Martin made a call to Megalli on October 23, 2009, where he disclosed inside information and recommended Megalli sell any stock he had in Carter's. (Def.'s Resp. SMF ¶ 20.) While still on the telephone with Martin, Megalli messaged Level Global's head of trading and asked that individual to liquidate Level Global's Carter's holdings, which were valued at nearly $9 million dollars at the time. (Def.'s Resp. SMF ¶ 21; Guilty Plea Transcript at pp. 20:13-20, 25:1-2) While Megalli relied in part on other information in deciding whether or not to sell Carter's stock, he stated at his plea hearing that the call with Martin during which he received inside information was "a catalyst. . . to continue selling [Carter's] stock." (Guilty Plea Transcript at p. 26:1-2; *see also* Def.'s Resp. SMF ¶ 23.)

Megalli's insider trading continued beyond 2009. In July of 2010, Megalli sold short positions in Carter's stock based on inside information he had received from Martin, generating profits for Level Global of $648,655. (Def.'s Resp. SMF

1989) (taking judicial notice of guilty plea); *U.S. v. Ferguson*, 681 F.3d 826, 834 (6th Cir. 2012) (same).

¶¶ 33-34.) All told, these trades helped Megalli's employer Level Global avoid losses of $2,034,000.00 (Def.'s Resp. SMF ¶ 26, Ans. ¶ 24) and gain profits of $648,655. (Def.'s Resp. SMF ¶ 34; Ans. ¶ 42.) During the entirety of this time, Megalli consciously avoided knowledge concerning the source of Martin's inside information. (Def.'s Resp. SMF ¶ 36; Guilty Plea Transcript at p. 25:7-8 ("[w]hat I'm pleading guilty to here today is conscious avoidance").)

The United States brought a criminal action against Megalli, alleging he conspired to engage in insider trading in violation of 15 U.S.C. §§ 78j(b) and 78ff, and 17 C.F.R. § 240.10b-5. (Plaintiff's Motion for Summary Judgment ("Pl.'s MSJ") Ex. 1.) Megalli pleaded guilty to the criminal information filed in that case and the court entered a judgment of guilty. (Pl.'s MSJ, Exs. 2, 7; Pl.'s Resp. SMF ¶ 1.) The SEC filed an action seeking to hold Megalli civilly liable for his alleged violations of securities laws alongside the criminal case. (Compl., Doc. 1.)

II. STANDARD OF REVIEW ON SUMMARY JUDGMENT.

The Court may grant summary judgment only if the record shows "that there is no genuine dispute as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A factual dispute is genuine if there is sufficient evidence for a reasonable jury to return a verdict in favor of the non-moving party. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). A factual dispute is material if resolving the factual issue might change the suit's outcome under the governing law. *Id.* The motion should be

granted only if no rational fact finder could return a verdict in favor of the non-moving party. *Id.* at 249.

When ruling on the motion, the Court must view all the evidence in the record in the light most favorable to the non-moving party and resolve all factual disputes in the non-moving party's favor. *See Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 150 (2000). The moving party need not disprove the opponent's case; rather, the moving party must establish the lack of evidentiary support for the non-moving party's position. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). If the moving party meets this initial burden, in order to survive summary judgment, the non-moving party must then present competent evidence beyond the pleadings to show that there is a genuine issue for trial. *Id.* at 324-26. The essential question is "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson*, 477 U.S. at 251-52.

The standard of review for cross-motions for summary judgment does not differ from the standard applied when only one party files a motion, but simply requires a determination of whether either of the parties deserves judgment as a matter of law on the facts that are not disputed. *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328, 1331 (11th Cir. 2005). The Court must consider each motion on its own merits, resolving all reasonable inferences against the party whose motion is under consideration. *Id.* The Eleventh Circuit has explained that "[c]ross-motions for summary judgment will not, in themselves,

warrant the court in granting summary judgment unless one of the parties is entitled to judgment as a matter of law on facts that are not genuinely disputed." *United States v. Oakley*, 744 F.2d 1553, 1555 (11th Cir. 1984). Cross-motions may, however, be probative of the absence of a factual dispute where they reflect general agreement by the parties as to the controlling legal theories and material facts. *Id.* at 1555-56.

III. DISCUSSION.

Section 10(b) of the Securities Exchange Act and its implementing regulations prohibit corporate insiders from trading based on confidential information obtained due to their position within their company. 15 U.S.C. § 78(j)(b); 17 C.F.R. § 240.10b-5; *SEC. v. Yun*, 327 F.3d 1263, 1269 (11th Cir. 2003). The Act also prohibits downstream recipients of inside information, known as "tippees," from trading on that information if they "know[] or should know" that disclosure of the information was accompanied by the insider's breach of a fiduciary duty. *Dirks v. SEC*, 463 U.S. 646, 660 (1983). "Tippee liability" serves to prevent insiders from passing along their advantages to others, thereby reaping personal, material, or reputational benefits, while not actually engaging in trading themselves. In other words, "the insider. . .[is] forbidden from doing indirectly what they are forbidden from doing directly." *Yun*, 327 F.3d at 1269-70.

Two components of tippee liability are important to define for the purposes of this case. First is what it means when a tippee "knows or should know" that an

insider has breached a duty. Actual knowledge of the breach is not required. Instead, if a tippee "consciously avoids" knowledge that an insider has breached a duty, they are still liable. *SEC v. Obus*, 693 F.3d 276, 288-89 (2nd Cir. 2012) (reversing district court grant of summary judgment for defendant and holding remote tippee liability may be based on conscious avoidance). The reason for this is plain – "to hold otherwise would subvert the laws against fraudulent trading in securities" by permitting downstream tippees to avoid liability even when they know that something is fishy by choosing to close their eyes and plug their ears. *SEC v. Musella*, 678 F. Supp. 1060, 1063 (S.D.N.Y. 1988) (conscious avoidance supported liability). The phrase "conscious avoidance" itself indicates that the tippee is aware – "conscious" – that they are likely receiving inside information disclosed in exchange for an improper benefit. They know there is a problem – they just don't want to know the details.

The second important component of tippee liability is what constitutes a "breach" of a fiduciary duty. The mere fact of disclosure of inside information by an insider is not by itself a breach, because not all disclosures are inconsistent with the duty an insider owes to their company or shareholders. *Dirks*, 463 U.S. at 661-62. Instead, the test to determine whether a disclosure is also a breach is "whether the insider personally will benefit, directly or indirectly, from his disclosure." *Id.* at 662. In short, without a benefit, there is no breach. *See id.*; *see also U.S. v. Newman*, 773 F.3d 438, 449 n. 4 (2d. Cir. 2014) (citing *U.S. v. Santoro*, 647 F. Supp. 153, 170-71 (E.D. N.Y. 1986), *rev'd on other grounds sub*

nom., U.S. v. Davidoff, 845 F.2d 1151 (2d Cir. 1988) ("[a]n allegation that the tippee knew of the tipper's breach necessarily charges that the tippee knew that the tipper was acting for personal gain")).

The Eleventh Circuit has recognized that the Supreme Court defined benefit "in very expansive terms" in the *Dirks* case. *Yun*, 327 F.3d at 1280. The "showing needed to prove an intent to benefit is not extensive," and includes both actually pecuniary benefits and more inchoate, reputational benefits that are likely to translate into future earnings. *Id*. It also includes circumstances where the insider is unlikely to receive any pecuniary benefit at all, such as when the insider "make[s] a gift to a trading relative or friend." *Id.* In that circumstance, the tip and trade resemble a trade by the insider himself, followed by a gift of profits to the tippee, *Dirks*, 463 U.S. at 664, and the "intention to benefit the particular recipient" of the tip is a sufficient benefit to create liability. *Id.*

Thus, in *Yun*, the Eleventh Circuit held that an executive's wife who disclosed inside information about her husband's company to a work friend with whom she sometimes shared real estate commissions "expected to benefit from her tip to [her friend] by maintaining a good relationship between a friend and frequent partner in real estate deals." 327 F.3d at 1280. Similarly, in *U.S. v. Jiau*, 734 F.3d 147, 153 (2nd Cir. 2013), a tipper received an invitation to a stock club where members exchanged stock tips. Even though the tipper never actually received or used any tips, access to the club alone was a sufficient benefit to allow conviction. *Id.*; *see also SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000) (tipper

benefitted by providing inside information to his dentist (and friend) because he "maintain[ed] a useful networking contact," his sister owed tippee money, and he and tippee frequently worked on local chamber of commerce issues); *SEC v. Carroll*, 9 F. Supp. 3d 761, 770 (W.D. Ky. 2014) ("personal benefit requirement is satisfied" due to "friendship" of tipper and tippee).

Thus, a tippee is liable if (1) an insider discloses inside information to (2) a tippee that knows, should know, or consciously avoids the knowledge (3) that the insider breached a fiduciary duty (i.e. received a benefit), and (4) still trades on the inside information. *See Yun*, 327 F.3d at 1269-70 (holding tipper and tippee liable for insider trading); *see also U.S. v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015) (sustaining insider trading conviction when tipper disclosed information to family member) (Rakoff, J.).

Finally, a tippee does not have to receive the information directly from an insider to be held liable. Instead, if they receive the inside information from an intermediate tippee, but otherwise satisfy the elements set forth above, they may be held liable as a "remote tippee." *See Musella*, 678 F. Supp. at 1063 (remote tippees liable because they avoided knowledge regarding original source of information).

The case concerns a remote tippee, Megalli, who knew he was receiving inside information from an intermediate tippee, consciously avoided any additional knowledge about the source of the information, and still traded on the information to the tune of nearly $2.7 million in profits and avoided losses.

Megalli pleaded guilty to criminal insider trading under the Securities Exchange. He nonetheless seeks to avoid civil liability in this enforcement action.

The crux of Megalli's argument is that *U.S. v. Newman*, 773 F.3d 438 (2nd Cir. 2014), a Second Circuit case that was decided after Megalli's guilty plea, has forever altered the landscape of securities law by imposing a requirement that a tippee who trades on insider information must (1) *actually* know that the original source of the inside information received a (2) "qualifying personal benefit. . .[like] cash or other pecuniary consideration[s]" in exchange for the information. (Def.'s MSJ Mem. 3.) He further argues that the pleadings and record show that he did *not* know that Posey, the insider, received a material benefit because Posey in fact received no such benefit. The SEC disagrees, and also argues that Megalli's criminal conviction precludes him from challenging his civil liability anyway.

A. Issue Preclusion

The first issue before the Court is whether Megalli is precluded from contesting his civil liability after he pleaded guilty to conspiracy to engage in insider trading in his earlier criminal case. The Court holds that he is precluded.

A criminal conviction precludes re-litigation of the issues decided by that conviction in a later civil action if: (1) the issues presented in both the prior and current action are identical; the issues were (2) actually litigated and (3) critical and necessary to the judgment in the prior action; and (4) the burden of persuasion in the current action is not significantly heavier. *U.S. v. Jean-*

Baptiste, 395 F.3d 1190, 1194-95 (11th Cir. 2005) (cocaine-distribution conspiracy participant could not contest his alleged lack of knowledge of the criminal nature of his acts in a denaturalization proceeding because scienter was an essential element of the crime for which he was convicted). In addition, the litigant must have had a full and fair opportunity to contest the earlier action. *See Bryant v. Jones*, 575 F.3d 1281, 1303 (11th Cir. 2009). All of these factors are met here.

1. Identity of Issues.

First, the issues presented in Megalli's civil and criminal proceedings are identical. In the securities regulation context, courts have regularly held that a criminal conviction for insider trading precludes a defendant from litigating their civil liability for insider trading, because the statutory elements for criminal and civil liability under 15 U.S.C. § 78j(b) and Rule 10b-5 are virtually the same. *See, e.g.*, *In re Bilzerian*, 153 F.3d 1278, 1280-81 (11th Cir. 1998) (defendant convicted of securities fraud could not contest SEC action seeking to exempt disgorgement award from bankruptcy discharge); *SEC v. Freeman*, 290 F. Supp. 2d 401, 405 (S.D.N.Y. 2003) (applying preclusion to a guilty plea to insider trading, because elements required to prove a civil insider trading violation are "essentially the same" as those required to prove a criminal violation); *SEC v. Gordon*, 822 F. Supp. 2d 1144, 1157 (N.D. Ok. 2011) (applying preclusion in SEC civil enforcement proceeding after defendant was criminally convicted of perpetrating a stock market manipulation scheme); *SEC v. Blackwell*, 477 F. Supp. 2d 891,

899-900 (S.D. Oh. 2007) (applying issue preclusion in civil enforcement action following insider trading conviction).

Turning to Megalli's case, it is plain that the criminal information he pled guilty to and the civil complaint filed against him concern the same conduct and alleged identical violations of Section 10b and Rule 10b-5's prohibitions against insider trading. The criminal information charged Megalli with conspiring to commit securities fraud by trading on material non-public information, while consciously avoiding knowledge concerning the source of that information, in violation of 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. (Pl.'s MSJ, Ex. 1 at 1, 6.) This conspiracy charge was founded on Megalli's commission of multiple overt acts in 2009 and 2010 of trading in stock based on inside information. (Pl.'s MSJ, Ex. 1 at 6-8; Def's Resp. SMF ¶ 36 (admitting Megalli "traded in February and July 2010 based on actual knowledge of inside information shared by Martin and in October 2009 based on conscious avoidance as to the illicit basis for Martin's sale recommendation")). Megalli pled guilty to these charges.[2]

The civil complaint before the Court concerns the same violations under Section 10(b) and Rule 10b-5, based on the same conduct. (Compl. ¶¶ 51-54.) The complaint alleges that Megalli traded shares of Carter's based on material non-public information, that he consciously avoided knowing anything about the source of that information, and that he and the hedge fund that employed him

[2] A guilty plea is as conclusive as to the issues decided as any other criminal conviction, because a plea is an admission of all of the elements of the crime charged. *In re Raiford*, 695 F.2d 521, 523 (11th Cir. 1983) (citations omitted).

profited from those trades. (Compl. ¶ 1.) The complaint identifies the same overt acts identified in the criminal information. (*Compare* Compl. ¶¶ 19-24, 38-43 with Pl.'s MSJ, Ex. 1 at 6-8.) Megalli concedes that in his guilty plea he admitted that he made trades on "the basis of, in whole or in part, certain material, non-public information provided by Eric Martin. . . knowing and consciously avoiding the knowledge that the material, non-public information had been obtained by Martin from a Carter's insider in violation of the insider's duties of trust and confidence to Carter's." (Ans., Prelim. Stmt. at 2; *see also* Guilty Plea Transcript at pp. 16:20-25; 17:1-8. 22:12-13.)

This admission concedes all of the essential elements of the SEC's claims, and demonstrates the identity of issues in the civil and criminal matters. Megalli admits he traded on inside information, knowing or consciously avoiding the knowledge that the inside information came from an insider who had breached his fiduciary duties to his employer. As described above, an insider does not breach their fiduciary duty without receiving a benefit, and a tippee does not violate the law unless they knew or should have known about that breach. By admitting the breach in his guilty plea, Megalli has admitted that the insider (Posey) received a benefit, and that Megalli knew (or should have known) about that benefit.[3] *See Dirks*, 463 U.S. at 660 (establishing a knows or should have

[3] The Court gives no credence to Megalli's argument that proof of an independent fiduciary duty between the insider Posey and the immediate tippee Martin (as opposed to between the insider and the corporation he owes a duty to) is necessary to support liability here. (Def.'s MSJ Mem. 4.) That is simply not the law. If the elements necessary to support a fiduciary breach by the insider are present, then the breach travels downstream, leaving this argument up a creek. *See*

known standard for tippee liability); *Musella*, 678 F. Supp. at 1063 (remote tippees liable when they "did not ask because they did not want to know"); *Santoro*, 647 F. Supp. at 170-71 (*rev'd on other grounds*) ("[a]n allegation that the tippee knew of the tipper's breach necessarily charges that the tippee knew that the tipper was acting for personal gain")). Thus, there is an identity of issues in this case.[4]

2. Issues Actually Litigated.

The identical issues found in the civil and criminal actions were actually litigated in Megalli's criminal case. The Eleventh Circuit has held that a defendant may not plead guilty and then claim that the issues decided by their plea were not actually litigated, because a court must find a sufficient factual basis underlying the guilty plea in order to enter judgment against a defendant. *In re Raiford*, 695 F.2d at 523 (applying preclusion to bar discharge of debtor who had been convicted of engaging in fraud in bankruptcy proceedings because guilty plea must have a factual basis to be accepted by the court).

In this case, the facts underlying the criminal action included the allegation – admitted in Megalli's plea – that he consciously avoided knowledge about the

Dirks, 463 U.S. at 660 ("a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information. . .when the insider has breached his fiduciary duty to the shareholders").

[4] The SEC also alleges violations of 15 U.S.C. § 77(a)(1)-(3). For the purposes of issue preclusion, violations of these provisions are the same as violations of Section 10b and Rule 10b-5 because they involve fundamentally the same conduct. *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (elements of a violation under Section 17 are "essentially the same" as those under Section 10(b) and Rule 10b-5); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 382 (S.D.N.Y. 2007) (applying issue preclusion in civil action under Section 17 after defendant pleaded guilty to Section 10(b) violation).

insider Posey's identity. This admission satisfies the requirement that Megalli know that he was trading on inside information obtained in exchange for a personal benefit to the insider. *Obus*, 693 F.3d at 288-89 (reversing district court grant of summary judgment for defendant and holding remote tippee liability may be based on conscious avoidance). Because this admission was necessary to Megalli's plea, it was actually litigated. *See In re Raiford*, 695 F.2d. at 523.

Megalli contends that at least some issues in this case were not actually litigated because the *Newman* decision introduced new elements essential to support civil and criminal insider trading liability. For the reasons described in Section B below, the Court disagrees. Megalli pleaded guilty in a court bound by Eleventh Circuit authority, and his plea admitted the facts necessary to support an insider trading conviction under Eleventh Circuit law. Even if governing authority in the Second Circuit may have changed, there is no indication at this juncture that it has in the Eleventh Circuit too.[5]

3. Full and Fair Opportunity to Litigate.

Megalli had a full and fair opportunity to present his case in the criminal proceeding. The Eleventh Circuit recognized in *In re Raiford* that the seriousness of a criminal prosecution by itself sufficiently incentivizes defendants to contest the proceedings. 695 F.2d at 524. That incentive was certainly present here, where Megalli pleaded guilty to a felony that carried a potential sentence of

[5] Nor does Megalli offer the Court any authority for the proposition that a defendant may *now* disclaim the crucial element of his plea tendered, as discussed next.

several years and significant financial penalties (and where he actually served a sentence of roughly one year).

The *Raiford* court also noted that defendants have the option to plead *nolo contendere* if they wish to avoid the effects of preclusion, and their failure to do so means they "cannot argue subsequently that the lack of a contested trial renders his plea ineffective for collateral estoppel purposes." 695 F.2d at 523. In any event, counsel for Megalli stated at his plea hearing that "the Government has been very forthcoming in providing its evidence, and allowing us more than ample opportunity to present factual and legal challenges, and it's been a very fair process." (Guilty Plea Transcript at pp. 30:23-25; 31:1.) Moreover, Megalli was aware, and the Government advised the criminal court, that the *Newman* case was "percolating" in the Second Circuit. (Guilty Plea Transcript at pp. 13:14-25, 14:1-8.) Nonetheless, Megalli chose to plead guilty.

4. The Relative Burdens of Proof.

Finally, with respect the final element of the issue preclusion test, it goes without saying that the burden of persuasion in this civil matter is less than what the government had to prove in Megalli's criminal case. Accordingly, issue preclusion applies to this matter.

B. The Impact of *Newman*.

Nonetheless, Megalli insists that *Newman* changed the elements of an insider trading violation, so that the underlying facts that he admitted to when pleading guilty in 2013 are no longer sufficient to establish his civil liability.

More specifically, Megalli argues that *Newman* now requires that remote tippee defendants have (1) *actual* knowledge of an insider's disclosure of confidential information in exchange for a (2) *pecuniary* personal benefit. (*See* Def.'s MSJ Mem. 3.) In fact, Megalli argues the undisputed facts in both his criminal case and this one show that he is *not* liable under the *Newman* standard for remote tippee liability.

The Court disagrees, for three primary reasons. First, *Newman* is a Second Circuit case, and thus is not controlling on the Court. What is controlling are Eleventh Circuit precedents rejecting Megalli's arguments that *actual* knowledge of an insider's receipt of an *immediately* pecuniary benefit is necessary to hold a remote tippee liable for securities violations. *See, e.g.*, *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 804-805 (11th Cir. 2015) (requiring conscious avoidance as opposed to actual knowledge); *Yun*, 327 F.3d at 1263 (benefit to insider need not be immediately pecuniary).

Second, the Court is not convinced that, at least as applied to this case, *Newman* is as radical a change as Megalli suggests. *Newman* recognizes and appears to preserve Second Circuit precedents acknowledging that not all benefits must be immediately pecuniary and that a tippee who consciously avoids knowledge concerning an insider is still liable. *Compare Newman*, 773 F.3d at 455 (insufficient evidence to allow jury to find defendants knew or consciously avoided knowledge that information came from insiders) *with Obus*, 693 F.3d at 288-89 (conscious avoidance sufficient). For these reasons, the Ninth Circuit

recently declined to follow or extend *Newman* in the manner Megalli urges this Court to do. *See Salman*, 792 F.3d at 1094 (always requiring a material benefit would mean "a corporate insider...would be free to disclose that information to her relatives [or friends], and they would be free to trade on it, provided only that she asked for no tangible compensation in return.") *Newman* has made waves, but the Court is not convinced it is a total sea change.

Third, even if the Court were to adopt a more stringent reading of *Newman*, the SEC would still be entitled to summary judgment as to Megalli's liability, for two reasons: one, because the government's case in *Newman* was far weaker than it is here, and two, because the insider in this matter (Posey) did in fact receive at least some benefits in exchange for his disclosure of inside information, as discussed further below.

Newman's facts posed significant problems for the government's case with respect to both the knowledge[6] and benefit elements of insider trading liability. The *Newman* court prefaced its analysis by airing its concerns about "the doctrinal novelty of [the government's] recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders." 773 F.3d at 448.

[6] The Court declines to endorse Megalli's contention that *actual knowledge* of an insider's identity and the benefit he received, and *only actual knowledge*, is required by *Newman*. As described above, it is not the law in this Circuit; it is not the law in the Second Circuit, *see Obus*, 693 F.3d at 286; it is not the law under *Newman*, 773 F.3d at 438 (indicating that the government might have prevailed if had proven conscious avoidance), and, as far as the Court can tell, it is not the law anywhere.

The *Newman* defendants personified the Second Circuit's concerns. First, they were "three or four" levels removed from the actual insiders, and were receiving the "inside information" filtered through several levels of junior analysts. Those junior analysts testified that they did not actually inform the *Newman* defendants that they were communicating inside (as opposed to public or non-material) information to them. *Id.* at 443-44, 453. Moreover, the kind of information the *Newman* defendants received was of the type that was routinely used by investment professionals. The evidence in *Newman* "established that analysts at hedge funds routinely estimate metrics such as revenue, gross margin, operating margin, and earnings per share through legitimate financial modeling using publicly available information and educated assumptions about industry. . .trends." *Id.* at 454. Thus the information that the *Newman* defendants were receiving was "of a nature regularly and accurately predicted by analyst modeling." *Id.* at 455. In short, the *Newman* defendants would have been completely justified in assuming that the information they were receiving was simply the good work of their employees, and not based on inside information whatsoever. *See id.* at 455. Thus the government could not prove beyond a reasonable doubt that the *Newman* defendants knew that they were trading on inside information. *Id.* In essence, the *Newman* defendants were at the tail end of a game of telephone, receiving distorted-at-best transmissions, so that it was not even clear that they knew they were trading on inside information *at all*. *Id.* at 454.

The *Newman* defendants' ignorance about whether they were receiving inside information was not the government's only problem. The government also "presented absolutely no testimony or any other evidence. . .that [Defendants] consciously avoided learning" that they were trading on information obtained from insiders. 773 F.3d at 453. Because there was no testimony or evidence supporting conscious avoidance, no rational jury could find the remote tippees in *Newman* guilty under Second Circuit law. *Id.* at 455.

Finally, the Government also presented extremely weak evidence concerning the alleged benefits to the insiders, which included, for one insider, exactly "[nothing]" of value from a casual acquaintance," and for another, "career advice" like "minor suggestions" on a resume, and advice *prior* to an informational interview that would have been provided even if the insider had not passed along inside information. *Id.* at 453. Just as important, the intermediate tippees in *Newman* – the ones transmitting the alleged inside information to the actual *Newman* defendants – were not even clear whether or not the insiders were receiving any sort of benefit at all. *Id.* If the sources close to the insider could not even determine if the insiders expected a personal benefit, the *Newman* defendants could not be expected to understand the insiders' motives either (if they were even aware that the insiders existed, as noted above). *Id.* at 455.

By contrast, in this case Megalli was only one level removed from the insider, admitted he knew that he was trading on inside information, and

admitted he knew or consciously avoided all additional information, including who the inside source was and whether or not that insider was receiving a benefit in exchange for his disclosure. (Def.'s Resp. SMF ¶ 36.; Ans., Prelim. Stmnt. at 2.) Megalli's case is thus different from *Newman* in nearly all respects. Megalli knew he was trading on inside information, whereas in *Newman* the government failed to prove even that fact. He admitted consciously avoiding all other information, while the government in *Newman* presented "absolutely no" evidence supporting conscious avoidance. And Posey and Martin, the insider and immediate tippee in this case, were more than just friends – they were friends with (potentially pecuniary) benefits.

In particular, Posey passed along the inside information to Martin for a variety of reasons, including their friendship and because he felt bad for the way Martin had been treated by Carter's, a fact that indicates intent to make a gift of insider trading profits to Martin. (Pl.'s Resp. SMF ¶¶ 6-9; Guilty Plea Transcript at p. 18:20-25) (describing Posey and Martin's "personal and professional" relationship); *see also Salman*, 792 F.3d at 1092. Martin, in turn, passed stock tips to Posey, as well as what was likely inside information about a different company.[7] (Pl.'s Resp. SMF ¶¶ 10-11; Guilty Plea Transcript at p. 19:17-19); *see*

[7] There are additional facts in this case that are not *genuinely* disputed. Megalli "mostly agree[d] factually with pretty much everything" said by the government at his plea allocution, quibbling only over a few specific and largely minor issues. He raised no dispute about the government's characterization of Posey and Martin's relationship, which the government described as "a personal and professional" one that included travel, golf outings, lunches and other work and social events. Guilty Plea Transcript at p. 18:20-25. The government further alleged that Posey disclosed the information to Martin for "reciprocal stock tips about other public companies. . .future network opportunities, friendship and other tangible and intangible

also Jiau, 734 F.3d at 153 (invitation to stock club was a benefit). These facts put Megalli's case closer to *Salman* and *Jiau* (where convictions were sustained) than *Newman*. To the extent there are gaps about the nature of Posey and Martin's relationship or the extent of the benefits Posey expected to receive, they were supplied by Megalli's conscious avoidance of those facts, and filled by his guilty plea which included, as essential elements of the underlying crime, the existence of a benefit to Posey. *See Yun*, 327 F.3d at 1280 (requiring a benefit).

The *Newman* court recognized that a change in any or all of that case's circumstances would warrant another result. *See* 773 F.3d at 455 (indicating that consciously avoiding knowing that information came from an insider or that the insider received a benefit might have sustained conviction). This different case, with different facts, yields a different result. Summary judgment for the SEC on the question of Megalli's liability is therefore proper and is **GRANTED.**

C. Remedies Available to the SEC.

The next issue presented is what remedies the SEC can obtain. The SEC seeks three kinds of relief for Megalli's civil insider trading violations. First, it seeks disgorgement of his ill-gotten gains. Second, it seeks civil penalties. Finally, it seeks injunctive relief.

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benefits." (Guilty Plea Transcript at p. 19:15-20.) While Megalli now alleges that these facts are (1) disputed because they were not necessary to sustain his plea and (2) not material because they are insufficient to establish liability (Def.'s Resp. SMF ¶ 16), the Court disagrees on both counts. Under *Yun*, they were both necessary and sufficient to support and sustain a conviction. 327 F.3d at 1279-81.

1. Disgorgement.

Turning first to the issue of disgorgement, the SEC seeks an order requiring Megalli to remit the entirety of the profits earned and losses avoided by his employer, Level Global, along with prejudgment interest. This, according to the SEC, totals more than $3,000.000.00. Megalli, for his part, claims his direct personal profits from his insider trading were less than $2,000.00.

Disgorgement is an equitable remedy intended to deprive a wrongdoer of his ill-gotten gains. *SEC v. Miller*, 744 F. Supp. 2d 1325, 1342 (N.D. Ga. 2010). As such, disgorgement applies to the extent by which a defendant profited or avoided losses as a result of their wrongdoing. *SEC v. Patel*, 61 F.3d 137, 139-40 (2nd Cir. 1995) (imposing disgorgement of avoided losses); *SEC v. Smyth*, No. 01-cv-1344-CC, 2006 WL 5440414 at *1 (N.D. Ga. July 28, 2006) (same). Imposing a larger sum would be an improper penalty assessment. *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978).[8] However, district courts have broad discretion to fashion a disgorgement remedy, and the amount of disgorgement need only be a "reasonable approximation" of the profits or losses avoided connected to the violation. Further, the risk of uncertainty in calculating disgorgement falls upon the wrongdoer whose conduct created that uncertainty. *Patel*, 61 F.3d at 139-40.

[8] *Blatt* was decided by the former Fifth Circuit, and is thus binding authority in the Eleventh Circuit. *Bonner v. City of Prichard*, 661 F.2d 1206, 1207 (11th Cir. 1981).

The issue here is whether this Court can impose disgorgement liability upon Megalli to the extent that his employer profited or avoided losses. As the Second Circuit recently observed in *SEC v. Contorinis*, 743 F.3d 296 (2014), "no other circuit has spoken to the precise question of disgorgement liability for an insider trader who had trading power but not disbursement control over a financial [institution] whose funds were used to perpetrate the fraud." 743 F.3d at 305 n.5. The *Contorinis* court held that such disgorgement was appropriate when the violator had substantial control over the trading powers of his firm (a fact that is not clear from the record here). However, the *Contorinis* court noted that the former Fifth Circuit had reached a different result on the related question of whether an individual participating in a securities fraud scheme could be required to disgorge profits beyond the amount of his personal gain. *Id.* at 305 n.5 (quoting *Blatt*, 583 F.2d at 1336).

In *Blatt*, the court imposed disgorgement, but only to the extent of "the amount of the fee realized by each defendant for his assistance in executing the fraud." 583 F.3d at 1336. Since *Blatt*, district courts in the Eleventh Circuit seem to have been careful in not imposing disgorgement above and beyond a "reasonable approximation" of the direct gain accruing to the wrongdoer. *See e.g.*, *SEC v. Phoenix Telecom, LLC*, 231 F. Supp. 2d 1223, 1225-26 (N.D. Ga. 2001) (quoting *Blatt* and imposing disgorgement only to extent of wrongdoer's one-third interest in a company). As this Court remains bound by *Blatt*, it thus

declines at this time, without further evidence, to order disgorgement of the entirety of Level Global's admitted realized profits and avoided losses.

However, Megalli's contention that he only realized less than $2,000 in profits from his misconduct is also problematic. First, he provides no factual support whatsoever for how he arrived at that figure, merely asserting it in his briefs alongside a handful of context-less calculations. *Compare SEC v. Tourre*, 4 F. Supp. 3d 579 (S.D. N.Y. 2014) (disgorging 11% of hedge fund trader's bonus after reviewing evidence, including affidavits, concerning the amount of his bonus attributable to his wrongdoing). Thus the Court is unable to determine if the proposed amount is a "reasonable approximation" of the gain that Megalli realized from his violations through his bonus.

Second, Megalli omits any portion of his salary from his proposed disgorgement remedy, despite the fact that the Eleventh Circuit has held that salaries are a proper target for disgorgement. *SEC v. Merchant Capital, LLC*, 486 Fed. Appx. 93, 97 (11th Cir. 2012). The Court therefore lacks a sufficient basis to determine what amount of disgorgement is proper in this case, and **DENIES** summary judgment as to both Parties regarding the equitable remedy of disgorgement.

2. Civil Penalties.

Because the Court declines to grant summary judgment for the SEC on its request for disgorgement, a determination of civil penalties would be similarly inappropriate. Courts may impose a civil penalty of up to "three times the profit

gained or loss avoided as a result of" insider trading. 15 U.S.C. § 78u-1(a)(2). The Court cannot determine the amount of civil penalty without first determining what Megalli gained (or avoided) through his conduct.[9] Summary judgment is therefore **DENIED** as to both Parties on this issue.

3. Injunctive Relief.

Finally, the SEC has asked for an injunction against Megalli. The Court is cognizant of the fact that Megalli was sentenced in his criminal case based on his assurances to the court that he was "going to work through a settlement with the SEC that is going to involve permanent debarment from the industry." (Pl.'s MSJ, Ex. 8 at 8.). Nonetheless, the Court defers ruling on the appropriateness of injunctive relief, and the scope of that relief, until the Court has had an opportunity to hear from counsel at the hearing on equitable relief.

IV. CONCLUSION.

Accordingly, Plaintiff's Motion for Summary Judgment is **GRANTED IN PART AND DENIED IN PART.**

Defendant's Motion for Judgment on the Pleadings or, in the Alternative, for Summary Judgment is **DENIED**. Defendant's Motion for Oral Argument [Doc. 46] is also **DENIED**, except to the extent that the Court hears such argument at the evidentiary hearing on equitable relief.

[9] The Court assumes, without deciding, that the civil penalty provision permits imposition of a penalty equal to three times the profit gained or loss avoided *by the defendant* (as opposed to his employer).

The Court will hold an evidentiary hearing as to the issue of disgorgement and the appropriateness of a civil penalty and injunctive relief on October 27, 2015, at 10:30 a.m.

IT IS SO ORDERED this 24th day of September, 2015.

Amy Totenberg
United States District Judge