

CLIENT MEMORANDUM

SEC Loses Insider Trading Enforcement Proceeding in Significant Post-*Newman* Ruling

September 16, 2015

AUTHORS

Martin Klotz | Michael S. Schachter | William J. Stellmach | Christopher J. McNamara

On September 14, 2015, Administrative Law Judge Jason S. Patil dismissed an enforcement proceeding brought by the Division of Enforcement (the “Division”) of the Securities and Exchange Commission (the “Commission”). *In the Matter of Gregory T. Bolan, Jr., and Joseph C. Ruggieri* (“*Bolan*”), the Division alleged that Ruggieri, a former trader at Wells Fargo Securities LLC, received material, nonpublic tips from Bolan, a Wells Fargo research analyst, concerning forthcoming ratings changes for six stocks prior to their public dissemination in 2010 and 2011.

Judge Patil found that while the Division established that Ruggieri traded four of the six alleged tips, it did not prove that Bolan tipped Ruggieri for a “personal benefit,” as defined in the Second Circuit’s landmark decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) and, accordingly, dismissed the enforcement proceeding.¹

The decision represents a notable loss for the Division in an administrative proceeding and marks a critical development in the interpretation of *Newman*, extending its requirement of a personal benefit to both classical and misappropriation theories of insider trading while applying that case’s narrower definition of what constitutes such a benefit.

¹ Bolan reached an earlier settlement with the Commission. He was found liable for violating Section 17(a)(3) of the Securities Act, which does not require a showing of scienter. Bolan received a cease-and-desist order and was ordered to pay a \$75,000 civil penalty. The Commission did not impose an industry bar or suspension.

SEC Loses Insider Trading Enforcement Proceeding in Significant Post-*Newman* Ruling

Continued

Procedural Background

On September 29, 2014, prior to the Second Circuit's decision in *Newman*, the Division charged Ruggieri with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5, which prohibit fraudulent conduct in the offer and sale of securities, and in connection with the purchase or sale of securities. Consistent with its recent practice and policy statements by its leadership that enforcement proceedings, rather than federal district court cases, would increasingly become the "new normal," the Division brought the case administratively.²

Judge Patil granted, in part, summary disposition in favor of Ruggieri, ruling that the Division must establish that Bolan tipped him for a personal benefit in accordance with *Newman*, but deferred decision as to whether the Division met its burden.³ During the subsequent twelve-day hearing in March and April 2015, Ruggieri challenged the forum on a variety of constitutional grounds, including Due Process, based on discrepancies between an administrative proceeding and district court procedures, and the appointment process for administrative law judges. Despite rejecting those constitutional claims, Judge Patil, applying a preponderance of the evidence standard, nevertheless found for Ruggieri on the facts.

Relevant Factual Background

In June 2008, Bolan joined Wells Fargo as an equity research analyst and registered representative in Nashville, Tennessee. Bolan, whose research focused on sectors within the healthcare industry, had a reputation as "one of the rising stars" within Wells Fargo's research department.

Ruggieri joined Wells Fargo as a senior trader of healthcare stocks and registered representative in the New York office in August 2009. Ruggieri was one of two healthcare traders at the time for Wells Fargo, and was the only one of the two who traded in stocks that Bolan covered as the analyst. On six different occasions, Ruggieri traded in advance of Bolan publishing his research reports, generating profits for Wells Fargo totaling "at most" \$117,127.

In April 2011, Bolan resigned shortly before he was to be terminated for cause, after a compliance investigation concluded that his communication of nonpublic research to clients violated Wells Fargo policies. Wells Fargo then terminated Ruggieri due to his failure to report Bolan's inappropriate information sharing.

Tippee Liability

The Division alleged that Bolan tipped Ruggieri with confidential information (*i.e.*, Bolan's not-yet-published ratings changes) in breach of a duty to Wells Fargo for a personal benefit, and that Ruggieri traded in Wells Fargo institutional

² See Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, THE WALL STREET JOURNAL, Oct. 21, 2014, available [here](#). In the year prior to September 29, 2014, the Division won all 6 of its litigated administrative proceedings, but only 11 out of 18 federal court trials.

³ Opinion at 2.

SEC Loses Insider Trading Enforcement Proceeding in Significant Post-*Newman* Ruling

Continued

accounts on the basis of such tips. Ruggieri's alleged breach therefore arose under the misappropriation theory of insider trading liability. As a threshold matter, Judge Patil rejected the Division's attempt to limit *Newman* to classical insider trading cases, finding that (i) the Second Circuit drew no such distinction, and (ii) the elements of tipping liability are the same regardless of whether the tipper's duty arises under the "classical" or the "misappropriation" theory. Thus, just as *Newman* required proof of a benefit to the tipper in a classical insider trading case, Judge Patil held *Newman* likewise required proof of a benefit to the tipper in the typical misappropriation case.⁴

To establish Ruggieri's liability, the Division was therefore required to show that (i) Bolan tipped material, nonpublic information to Ruggieri in breach of a fiduciary duty owed to Wells Fargo for a personal benefit to himself; (ii) Ruggieri knew or had reason to know of Bolan's breach (*i.e.*, that the information was confidential and Bolan divulged it for a personal benefit); and (iii) Ruggieri used the information by trading or by tipping for his own personal benefit.

Judge Patil found that Ruggieri traded ahead of Bolan's research reports on four of the six stocks based on Bolan's tips and forthcoming ratings changes. There was no dispute that Bolan's ratings changes were material; ratings changes typically moved stock prices, and Ruggieri "knew this." It was also undisputed that unpublished research reports were confidential, nonpublic information. The only contested issues were therefore whether Bolan tipped Ruggieri and, if so, whether Bolan did so for a personal benefit.

Personal Benefit

The Division attempted to establish that Ruggieri provided a personal benefit by virtue of befriending and mentoring Bolan, and assisting him in earning a promotion and enhanced bonuses through positive feedback to Bolan's supervisors at Wells Fargo. However, Judge Patil found the Division's circumstantial evidence too thin, noting that it was more plausible that Ruggieri's feedback was genuine because of other positive reviews of Bolan, and that Bolan sought feedback as a standard practice rather than an illicit benefit. Though Judge Patil did consider the possibility that Bolan tipped Ruggieri with the expectation that Ruggieri would then continue to provide positive feedback, he declined to draw a purely speculative inference about Bolan's state of mind. Regarding the alleged "mentorship" benefit, Judge Patil noted a similar lack of any evidence showing that Ruggieri mentored Bolan and other research analysts for any nefarious purpose, such as obtaining material, nonpublic information.

Similarly, the judge rejected the Division's argument that Bolan tipped to maintain and further his friendship with Ruggieri, finding that neither their friendship nor personal relationship were meaningful or close, as reflected in the fact that their communications declined after Bolan found another job following his resignation from Wells Fargo. Applying *Newman*, Judge Patil emphasized that, in any event, the "personal benefit" required a *quid pro quo*, which the "ephemeral" benefit of friendship did not satisfy.

⁴ The *Bolan* ruling mirrors Judge Rakoff's decision in *SEC v. Payton*, No. 14 Civ. 4644 (S.D.N.Y. Apr. 6, 2015), regarding *Newman*'s application to misappropriation cases.

SEC Loses Insider Trading Enforcement Proceeding in Significant Post-*Newman* Ruling

Continued

Interestingly, Judge Patil noted that Bolan’s communications in this case reflected his “longstanding disregard of compliance rules,” involving repeated improper disclosures of material, nonpublic information to numerous others. On that record, the judge concluded that it was arguable, if not more likely, that Bolan tipped Ruggieri not to receive a personal benefit within the meaning of *Dirks*, but because he “simply would not follow the rules and keep his mouth shut.”

Conclusion

Bolan marks a rare setback for the Division in a forum on which it increasingly relies, and a notable milestone in the development of post-*Newman* insider trading liability. Although *Newman*’s fate is ultimately tied to the Justice Department’s pending certiorari petition, *Bolan* gives valuable clarity on the heightened standard enforcement authorities and prosecutors now face.

If you have any questions regarding this memorandum, please contact Martin Klotz (212-728-8688; mklotz@willkie.com), Michael S. Schachter (212-728-8102; mschachter@willkie.com), William J. Stellmach (202-303-1130; wstellmach@willkie.com), Christopher J. McNamara (212-728-8546; cmcnamara@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.

September 16, 2015

Copyright © 2015 Willkie Farr & Gallagher LLP.

This memorandum is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum may be considered advertising under applicable state laws.