JENNER&BLOCK

Securities Litigation and Enforcement

U.S. v. Newman: Second Circuit Reverses Remote Tippees' Convictions for Insider Trading Where Tippers Never Charged

Last week, in *U.S. v. Newman*, the U.S. Court of Appeals for the Second Circuit reversed the convictions of two hedge fund managers who had been found guilty of insider trading as "remote tippees" that is, for trading on confidential information that they had received only indirectly -- from other hedge fund managers who in turn had received that information from insiders at the companies whose stock they traded.

Newman's central holding is that, in a criminal case, the Government must prove that the defendant "knew, or deliberately avoided knowing," that a company insider's improper disclosure of confidential information was made in exchange for a "personal benefit" to that insider. The Court of Appeals also held that the "personal benefit" to the insider cannot be simply vague goodwill, but "must be of some consequence." These requirements are designed to ensure that insider trading convictions are not the result of trading on, for example, deliberate corporate "leaks" of normally confidential financial information (as was apparently the case in *Newman*), or purely inadvertent disclosures.

This decision could lead to the reversal of several prior convictions and guilty pleas, and will make it harder in the future for the Government to prove insider trading against "tippees" and especially "remote tippees" who do not deal directly with the original source of the information.

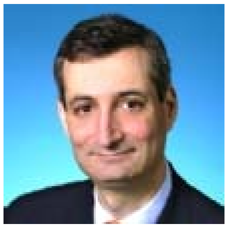
But three aspects of the Court's decision suggest that its practical implications may be less sweeping than some have predicted.

- First, the Court's notable reference to a "willful blindness" form of knowledge ("deliberately avoided knowing") indicates that a remote tippee cannot avoid liability simply by choosing not to question the source of improper information. Legal and compliance personnel should be sensitive to this reference to willful blindness.

- Second, when the Securities and Exchange Commission (SEC) charges a defendant with insider trading, the SEC needs to prove that the defendant acted only "recklessly," rather than "willfully" in a criminal case. Since "recklessness" is easier to prove than the "willful blindness" form of willfulness discussed above, this distinction suggests that remote tippees may be susceptible to civil insider trading charges by the SEC, even if the U.S. Department of Justice chooses not to pursue them criminally.

- Finally, the *Newman* decision presents the unusual and even perverse case where the remote tippees were prosecuted criminally even though the insiders who supposedly breached their duties by disclosing confidential information had not been "charged administratively, civilly, or criminally for insider trading or any other wrongdoing" -- as the Court of Appeals put it emphatically. Remote tippees should recognize the extraordinary nature of this fact pattern, which the Government and the SEC likely will avoid in the future.

Contact Us



Stephen L. Ascher, Partner, Jenner & Block

Co-Chair, Securities Litigation and Enforcement Practice

Phone: 212 891.1670 Email: sascher@jenner.com Download V-Card

Neil M. Barofsky, Partner, Jenner & Block

Co-Chair, Securities Litigation and Enforcement Practice

Phone: 212 891.1675 Email: nbarofsky@jenner.com Download V-Card

Thomas C. Newkirk, Partner, Jenner & Block

Co-Chair, Securities Litigation and Enforcement Practice

Phone: 202 639.6099 Email: tnewkirk@jenner.com Download V-Card

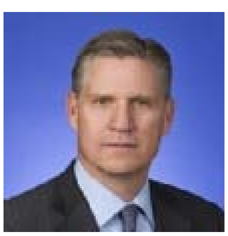
Howard S. Suskin, Partner, Jenner & Block

Co-Chair, Securities Litigation and Enforcement Practice

Phone: 312 923.2604 Email: hsuskin@jenner.com Download V-Card

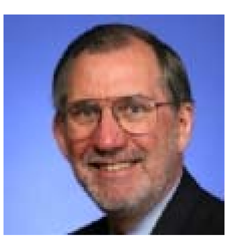
Anthony S. Barkow, Partner, Jenner & Block

Phone: 212 891.1662 Email: abarkow@jenner.com Download V-Card



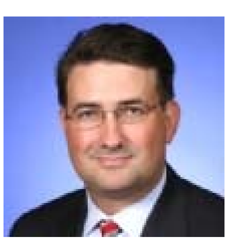
Christian R. Bartholomew, Partner, Jenner & Block

Phone: 202 639.6040 Email: cbartholomew@jenner.com Download V-Card



Larry P. Ellsworth, Partner, Jenner & Block

Phone: 202 639.6032 Email: lellsworth@jenner.com Download V-Card



Michael K. Lowman, Partner, Jenner & Block

Phone: 202 639.6018 Email: mlowman@jenner.com Download V-Card

J. Kevin McCall, Partner, Jenner & Block

Phone: 312 923.2686 Email: jmccall@jenner.com Download V-Card