

### District Court Vacates Insider Trading Guilty Pleas in Misappropriation Case in Light of Landmark *Newman* Decision

On January 22, 2015, a district judge in the Southern District of New York vacated previously accepted guilty pleas in an insider trading prosecution brought under the "misappropriation" theory. The district court's short order provides an initial look at the potential reach of the Second Circuit's recent decision in *United States v. Newman*,<sup>1</sup> which is still subject to a potential motion for rehearing by the government.

In *Newman*, a "classical" insider trading case, the Second Circuit held that a defendant who receives and trades on the basis of material nonpublic information is not guilty of insider trading unless he knew that the insider who disclosed the inside information did so in exchange for a personal benefit. *Newman* also stated that "[t]he elements of tipping liability are the same, regardless of whether the tipper's duty arises under the 'classical' or the 'misappropriation' theory."<sup>2</sup> As the doctrinal lines have developed, "classical theory" cases are ones in which an insider trades on material nonpublic information in breach of his fiduciary duty owed to shareholders not to take advantage of information that is to be used only for a legitimate corporate purpose.<sup>3</sup> By contrast, under a "misappropriation theory," the insider misappropriates, or wrongfully takes, material nonpublic information from an entity to whom he owes a duty of loyalty or confidence (such as an employer or a client), and that information is then used to trade securities of another corporation in violation of duty owed to the source of the information.<sup>4</sup> The Second Circuit's decision in *Newman* left open the question as to whether the court's holding is limited to classical theory cases or whether it also applies in misappropriation cases.

Soon after the *Newman* decision, four defendants in a misappropriation theory insider trading case brought by the U.S. Attorney's Office for the Southern District of New York tested that open question by moving to withdraw their guilty pleas. In light of *Newman* and its dictum concerning the misappropriation theory, Judge Carter in the Southern District of New York stated his intention to vacate the guilty pleas of those four defendants, but gave the government an opportunity to brief the issue. The government relied heavily on the Second Circuit's 1993 decision in *United States v. Libera*,<sup>5</sup> in which the Court stated that breach of a duty and the tippee's knowledge of the breach of the duty were "without more . . . sufficient for tippee liability." The government also cited a decision in a recent misappropriation case, in which Judge Rakoff ruled that "the tippee's knowledge that disclosure of the inside information was unauthorized is sufficient for liability in a misappropriation case."<sup>6</sup> The government acknowledged the language in *Newman* cited by the defense, but contended that "[i]t would be incorrect to read more into this one sentence than it can logically bear."<sup>7</sup>

The district court disagreed and vacated the guilty pleas.<sup>8</sup> It held that *Newman*'s statement that the elements of insider trading are the same for both misappropriation cases and classical cases was controlling. Even if it is read as

1 Nos. 13-1837, 13-1917, 2014 WL 6911278 (2d Cir. Dec. 10, 2014).

2 *Id.* at \*4 (citing *SEC v. Obus*, 693 F.3d 276, 285-86 (2d Cir. 2012)).

3 *Dirks v. SEC*, 463 U.S. 646, 654 (1983).

4 *United States v. O'Hagan*, 521 U.S. 642, 652 (1997).

5 989 F.2d 596, 600 (2d Cir. 1993).

6 *United States v. Whitman*, 904 F. Supp. 2d 363, 370 (S.D.N.Y. 2012).

7 Government's Mem. of Law in Support of the Sufficiency of the Defs.' Guilty Pleas at 14, *United States v. Durant*, No. 12-cr-887 (ALC) (S.D.N.Y. Jan. 12, 2015), ECF No. 153.

8 *United States v. Conradt*, No. 12-cr-887 (ALC) (S.D.N.Y. Jan. 22, 2015), ECF 166.

dicta, "it is not just any dicta, but emphatic dicta which must be given the utmost consideration."<sup>9</sup> The district court further held that it agreed with *Newman's* articulation of the law and would have ruled as *Newman* suggested even in the absence of the Second Circuit's recent decision.<sup>10</sup> In response to the government's reliance on *Libera*, the district court held that *Newman* is now the controlling law and stated that the language in *Libera* that the government relied upon was itself dictum.<sup>11</sup> With the guilty pleas now withdrawn, the district court next will entertain a motion to dismiss the indictment made by two of the four defendants.

It is reasonable to expect that more defendants who pleaded guilty in insider trading cases but have not yet been sentenced will come forward and ask to withdraw their guilty pleas; those who have been sentenced may seek other post-conviction relief. Also, this decision may make it more likely that the government will seek further review of *Newman*, as it increases the likelihood that *Newman* will be read by other judges to apply to cases brought under both the classical and misappropriation theories. The government's current deadline for filing a motion for rehearing is January 23 – the date of this alert – but the government may seek additional time if it believes it to be necessary.

**This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.**

**Harry Sandick**

**Daniel S. Ruzumna**

**Jared S. Buszin**

**212-336-2723**

**212-336-2034**

**212-336-7626**

**hsandick@pbwt.com**

**druzumna@pbwt.com**

**jbuszin@pbwt.com**

**To subscribe to any of our publications, call us at 212.336.2813, email [info@pbwt.com](mailto:info@pbwt.com), or sign up on our website, [www.pbwt.com/resources/publications](http://www.pbwt.com/resources/publications).**

**This publication may constitute attorney advertising in some jurisdictions.**

**© 2015 Patterson Belknap Webb & Tyler LLP**

---

<sup>9</sup> *Id.* at 2.

<sup>10</sup> *Id.* at 3.

<sup>11</sup> *Id.* at 3 n.1.