13-1837-cr(L), 13-1917-cr(CON)

United States Court of Appeals

for the

Second Circuit

UNITED STATES OF AMERICA,

Appellee,

– v. –

TODD NEWMAN, ANTHONY CHIASSON,

Defendants-Appellants,

JON HORVATH, DANNY KUO, HYUNG G. LIM, MICHAEL STEINBERG,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AND THE NEW YORK COUNCIL OF DEFENSE LAWYERS AS *AMICI CURIAE* OPPOSING THE PETITION OF THE UNITED STATES FOR REHEARING OR REHEARING *EN BANC*

RICHARD D. WILLSTATTER
GREEN & WILLSTATTER
200 Mamaroneck Avenue, Suite 605
White Plains, New York 10601
(914) 948-5656
Vice Chair, NACDL Amicus Curiae Committee

ROLAND G. RIOPELLE
SERCARZ & RIOPELLE, LLP
810 Seventh Avenue, Suite 620
New York, New York 10019
(212) 586-4900
Vice President, New York Council of Defense Lawyers

IRA M. FEINBERG
BENJAMIN A. FLEMING
HOGAN LOVELLS US LLP
875 Third Avenue
New York, New York 10022
(212) 918-3000

Attorneys for Amici Curiae

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

FEDERAL RULES

OTHER AUTHORITIES

STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici are nonprofit voluntary professional bar associations that work on behalf of criminal defense attorneys to ensure justice and due process for those accused of crime or other misconduct.[1]

The National Association of Criminal Defense Lawyers ("NACDL") is a professional bar association founded in 1958. It has approximately 10,000 direct members in 28 countries—and has 90 state, provincial, and local affiliate organizations, totaling up to 40,000 attorneys—including lawyers in private practice, public defenders, military defense counsel, law professors, and judges committed to the integrity, independence, and expertise of defense lawyers in criminal cases. Among the NACDL's objectives is to ensure the proper administration of justice and that criminal statutes are construed and applied in accordance with due process. The NACDL filed an amicus brief in this case, with the consent of all parties, in connection with the original hearing before the Panel. The NACDL argued that the requirement that a tippee defendant must *know* of the benefit received by the tipper followed from basic principles of *mens rea*, a position with which the Panel agreed in its opinion. *See* slip op. at 18.

---

[1] Pursuant to Rule 29.1 of this Court's Local Rules, *amici curiae* certify that (1) this brief was authored entirely by counsel for the NACDL and NYCDL, and not by counsel for any party, in whole or part; (2) no party and no counsel for any party contributed money to fund preparing or submitting this brief; and (3) apart from the NACDL and NYCDL and their counsel, no other person contributed money to fund preparing or submitting this brief.

The New York Council of Defense Lawyers ("NYCDL") is a not-for-profit association of approximately 240 lawyers (including many former federal prosecutors) whose principal area of practice is the defense of criminal cases in the New York federal courts. NYCDL's mission includes protecting individual rights guaranteed by the Constitution, enhancing the quality of defense representation, and promoting the proper administration of criminal justice. NYCDL offers the Court the perspective of experienced practitioners who regularly handle some of the most complex and significant criminal cases in the federal courts.

Amici file this brief in support of appellants, and urge the Court to deny the Government's petition for rehearing and rehearing *en banc* ("Pet."). Rehearing is unwarranted because the Panel's decision is consistent with Supreme Court and Second Circuit precedent regarding the prohibition on insider trading, and provides a welcome and necessary clarification to this area of law. The Panel's opinion reflects a faithful analysis of the Supreme Court's decision in *Dirks v. SEC*, 463 U.S. 646 (1983), and is consistent with both *Dirks* and with all decisions of this Court (and other circuits) interpreting the "personal benefit" requirement for tipper and tippee liability. Moreover, in response to the Government's efforts to push the boundaries of insider trading law beyond the limits established in *Dirks*, the Panel's decision properly respects those limits, and makes clear that the "personal benefit" requirement mandated by *Dirks* cannot be so expansively interpreted as to

make it a nullity. The Panel's efforts to define the limits of the "personal benefit" requirement are necessary to avoid giving prosecutors excessive scope to charge *any* trading based on material non-public information as a violation of federal criminal laws (notwithstanding Supreme Court holdings to the contrary), which would raise serious due process and separation of powers issues.

ARGUMENT

I. THE PANEL'S DEFINITION OF "PERSONAL BENEFIT" REPRESENTS A FAITHFUL APPLICATION OF *DIRKS* AND A WELCOME CLARIFICATION OF THE LAW IN THIS CIRCUIT.

A. The Panel Correctly Applied *Dirks*.

The Supreme Court in *Dirks* reiterated that "there is no general duty to disclose before trading on material nonpublic information." 463 U.S. at 654. Instead, the duty of a tippee of non-public information not to trade on it "is derivative from . . . the insider's duty." *Id*. at 659. Accordingly, the Court held, "the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach" by the tippee. *Id*. at 662.

The Court recognized that determining "whether an insider personally benefits from a particular disclosure . . . will not always be easy." *Id*. at 664. The Court emphasized that the courts must "focus on objective criteria," *id*. at 663, and base their determination on "objective facts and circumstances," *id*. at 664. The

Court held that the personal benefit requirement would be satisfied where "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." *Id*. at 663. The Court explained that the existence of a "relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient," was one of the "objective facts and circumstances" that would support an inference of personal benefit. *Id*. at 664. The Court also held that the requirement of personal benefit would be satisfied "when an insider makes a gift of confidential information to a trading relative or friend," *id*., because in these circumstances, "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id*.

The Panel's decision is completely consistent with these basic principles. The heart of the Panel's opinion was its conclusion that because the liability of the tippee is derivative of the fiduciary breach of the tipper, the Government must prove that the tippee *knew* the tipper had received a personal benefit from disclosure of the non-public information – a holding that "follows naturally from *Dirks*," slip op. at 14, and which the Government is no longer contesting. When the Panel turned to discussing whether there was a personal benefit here,[2] the Panel

[2] It should be noted that the language that is the subject of the Government's petition for rehearing (and the SEC's amicus brief) appears in a section of the Court's opinion that is not necessary to the Court's disposition of this appeal and

started with the holding of *United States v. Jiau*, 734 F.3d 147 (2d Cir. 2013), that "[p]ersonal benefit is broadly defined to include not only pecuniary gain, but also, *inter alia*, any reputational benefit that will translate into future earnings and the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend." Slip op. at 21 (quoting *Jiau*, 734 F.3d at 153).

The Panel did not retreat in any way from this language, which accurately reflects the holding of *Dirks*. The Government misrepresents the Panel's opinion when it claims that the Panel's decision is "flatly inconsistent with *Dirks*," Pet. at 13, and that it "eliminate[d] *Dirks*'s express recognition that an improper but uncompensated gift of information by an insider suffices," *id*. at 14. The Panel did no such thing. Instead, the Panel merely imposed reasonable limits on a concept of "friendship" that the Government had stretched to the breaking point.

"Friendship" is an infinitely malleable term, and can apply to a broad range of relationships, from the closest of intimate friends to the most casual of business

---

can properly be viewed as *dicta*. The Court's determination that the defendants must know that there was a personal benefit and its conclusion that there was insufficient evidence the defendants had such knowledge here fully support the Court's decision that their convictions must be reversed and the indictments dismissed. The Court's further determination that there was also no sufficient proof that either of the insiders *received* a personal benefit is at most an alternative ground for the Court's decision, and unnecessary to the Court's disposition.

acquaintances.[3] It is apparently the Government's position that if two people know each other – and therefore the Government can call them "friends" – then the uncompensated exchange of information between them can provide the basis for insider trading liability. This position comes close to the claim that *any* trading on material non-public information is a violation of the insider trading laws – a position that the Supreme Court has repeatedly rejected – since it is almost tautological that (other than inadvertent disclosures) two people can exchange information only if they know each other.

Recognizing this overreach by the Government, the Panel sought to define with greater precision the nature of the relationships to which *Dirks*' admonition that personal benefit could be found "when an insider makes a gift of confidential information to a trading relative or friend," 463 U.S. at 664, applies.

It is in this context that the Panel explained that, under *Dirks*, the "mere fact of a friendship" – loosely defined and standing alone – does not create a sufficient basis for concluding that the insider intended to provide a gift of inside information to a friend for trading purposes. Slip op. at 21-22. Instead, the Panel explained that the relationship between the insider and first tippee must be a "meaningfully close personal relationship." Slip op. at 22. Absent such a significant personal

---

[3] Black's Law Dictionary defines a "friend" as "[o]ne favorably disposed," "[v]arying in degree from greatest intimacy to acquaintance more or less casual." Black's Law Dictionary 600 (5th ed. 1979).

relationship, the Panel correctly held, there is no basis to conclude that the insider intended to provide a gift to the recipient, as the Court in *Dirks* held to be required.

The Panel also correctly held that, under *Dirks*, there must ultimately be a financial benefit (or something of a similarly valuable nature), either to the insider who discloses the information or to the recipient to whom it is gifted. The Panel explained that the exchange of information must "represent[ ] at least a potential gain of a pecuniary or similarly valuable nature." Slip op. at 22. The Government ferociously attacks this holding as "flatly inconsistent with *Dirks*," Pet. at 12-13, but the Government is wrong. The Court in *Dirks* made clear that a financial objective – the insider's intent to benefit himself or another financially or to obtain something "similarly valuable" – is an essential part of the breach of the fiduciary duty that the insider owes to the corporation that makes his conduct unlawful under the securities laws. *See* 463 U.S. at 662 ("Absent some personal gain, there has been no breach of duty to stockholders.").[4] Though the Court in *Dirks* held that "reputational benefit" would also qualify, that is only because it could "translate into future earnings." *Id*. at 663. And in discussing the benefit that arises from the gift of information, the Court made clear that it was talking about a gift to a

[4] Indeed, Justice Blackmun, joined by Justices Brennan and Marshall, dissented on precisely this ground, that there was no reason to require that there be any financial benefit to the insider from his disclosure of inside information. *See* 463 U.S. at 673-74 ("It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction.").

"trading relative or friend" – that is, someone intending to trade on the information – and held that this was unlawful because it was equivalent to the insider trading himself and making a gift of the "profits" to the friend or relative. *Id*. at 664.[5]

B. The Panel Properly Clarified The Applicable Standard For Personal Benefit.

The Government argues that the Panel's opinion conflicts with the prior decisions of this Court (and others), *see* Pet. at 2, 12-14, but this is not true. The Panel's opinion is not inconsistent with the holding of any of this Court's prior decisions. What is true, however, is that this Court has on occasion used loose language in discussing the standards for insider trading liability, and has stated in *dicta* propositions that are broader than the case required or that *Dirks*, properly interpreted, permitted. The result has been some degree of uncertainty about the precise contours of the personal benefit test. *See United States v. Whitman*, 904 F. Supp. 2d 363, 371 n.6 (S.D.N.Y. 2012) (Court's decisions "somewhat Delphic"), *aff'd*, 555 F. App'x 98 (2d Cir. 2014). In this sense, the Panel's explanation of the

[5] Under *Dirks*, it is clear that the required financial benefit could be obtained either by the insider or by the relative or friend to whom he gave the information. The Panel's opinion – in stating that the personal benefit must "represent[ ] at least a potential gain of a pecuniary or similarly valuable nature," slip op. at 22 – did not explain who had to have the potential for gain. We presume that the Court intended to say that a potential gain by either the tipper or the recipient of the information was sufficient, and it might be useful for the Court to clarify this point.

proper scope of the test is an important, necessary and long-overdue clarification of existing law.

For example, the Government notes that in *Jiau*, the Court stated that the definition of personal benefit was "broad," and that the "evidentiary bar is not a high one." Pet. at 12. But placing the evidentiary bar low does not mean it is non-existent. And on the facts of *Jiau*, there is little doubt that there was a personal benefit provided to the insider, which was substantial and related to the profits he could make from trading. As the Panel explained, one insider was admitted to an investment club that involved the sharing of stock tips, providing him with "access [to] information that could yield future pecuniary gain." Slip. op. at 22.

Similarly, the Government argues that in *SEC v. Warde*, 151 F.3d 42 (2d Cir. 1998), the Court found that there was personal benefit to the tipper "solely by virtue of a 'close friendship' with the tippee," Pet. at 13, and argues that the relationship between Downe and Warde in that case was "analogous to the relationships at issue here," *id*. at 13 n.4. These claims are baseless, for two reasons. First, the Court in *Warde* did *not* rely solely on the close friendship between the two men; on the contrary, the Court noted that both men were "active stock market investors," 151 F.3d at 45, and recited in detail their entire course of conduct, including their regular exchange of information about developments regarding the proposed Kidde merger over a two-month period, and their

simultaneous purchases of speculative Kidde warrants, *id*. at 45-46. In this light, the Court had little difficulty concluding that Downe's conduct showed an intent to benefit a "trading . . . friend" by providing him with inside information. *Id*. at 48-49; *see also SEC v. Downe*, 969 F. Supp. 149, 156 (S.D.N.Y. 1997). And second, Downe and Warde really *did* have a "close friendship," 151 F.3d at 49, supporting the Court's determination that Downe intended to make a gift of confidential information to Warde. *Id*. Their close relationship is a far cry from the relationships between the insiders and first tippees in this case, which reflect the complete absence of any meaningful personal relationship.

The SEC's amicus brief also relies on this Court's decision in *SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012), in support of its contention that the disclosure of confidential information to a "friend" is sufficient in and of itself to support insider trading liability. SEC Amicus Br. at 9. But this assertion is far too simplistic. It is true that the Court in *Obus* held that the "fact that Strickland and Black were friends from college [was] sufficient to send to the jury the question of whether Strickland received a benefit from tipping Black." 693 F.3d at 291. But the Court did not say that this friendship was sufficient to impose insider trading liability – it merely held that it was a jury issue. And the Court made clear that in order to impose liability, the jury would have to find that Strickland intentionally disclosed information to Black, "knowing that he was making a gift of information Black

was likely to use for securities trading purposes." *Id*.[6] Nothing in the record of this case supports the conclusion that the insiders here had any such intention to make a gift of confidential information to their tippees.

Finally, the Government argues that the Panel's decision is inconsistent with the decisions of other circuits, Pet. at 12, but this is not so. The Government has cherry-picked the best *dicta* it could find, but in each case, it is overbroad *dicta* the Government is relying upon, and there is no conflict between the Panel's analysis in this case and the holding of any other circuit. For example, in *SEC v. Maio*, 51 F.3d 623 (7th Cir. 1995), there was an overwhelming basis for the court's determination that the tipper (Ferrero) had intended to make a gift of inside information to the tippee (Maio). *Maio* was not a close case: Ferrero and Maio were longstanding family friends, 51 F.3d at 627; Maio had recommended Ferrero for his job, *id.* at 633; and "Ferrero's tipping was just one of many favors that ha[d] done for Maio through the years by reason of their friendship," *id.* at 632. The record in this case could not be more different.[7]

---

[6] The *Obus* jury ultimately rejected the SEC's view of the facts, and returned a verdict for the defendants.

[7] The Government also cites *United States v. Evans*, 486 F.3d 315, 321 (7th Cir. 2007) and *SEC v. Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006), but in both cases the appeal did not involve any issue regarding the proper personal benefit test.

C. A Loose Standard For Personal Benefit Would Raise Serious Issues Under Due Process And Separation Of Power Principles.

There is thus no support for the Government's claim that settled law holds that the mere existence of a loosely defined "friendship" between tipper and tippee is sufficient in itself to support insider trading liability. A standard under which the government can establish the requisite personal benefit merely by pointing to a friendship or acquaintance between tipper and tippee is too indeterminate and subjective to comply with *Dirks*, which held that a gift of trading information to a friend is proscribed because it is legally comparable to "trading from the insider himself followed by a gift of profits to the recipient," 463 U.S. at 664, and required the Government to prove the requisite relationship by "objective facts," *id*.

And adoption of the Government's vague and ill-defined standard – where basically any relationship between tippee and tipper that the Government chooses to charge would suffice – would raise serious due process and separation of powers issues. It is a core principle of due process that, before one can properly be charged with a crime, "fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed." *Arthur Andersen LLP v. United States*, 544 U.S. 696, 703 (2005) (quotation omitted). Failing to provide notice of the line between culpable and non-culpable conduct creates a "trap for the innocent," *United States v. Cardiff*, 344 U.S. 174, 176 (1952), and gives rise to potentially arbitrary enforcement by the

prosecution. *See Kolender v. Lawson*, 461 U.S. 352, 358 (1983) (legislature's failure to provide adequate law enforcement guidelines permits "a standardless sweep [that] allows policemen, prosecutors, and juries to pursue their personal predilections"). It is also well established that under the federal securities laws, conduct that may be actionable in the civil context may nonetheless fall beyond the reach of the criminal law. *See, e.g.*, *United States v. Chestman*, 947 F.2d 551, 569-70 (2d Cir. 1991) (*en banc*) (holding that applying "an elastic and expedient definition of confidential relations" for purposes of determining whether there was a "fiduciary-like relationship" sufficient to support an insider trading conviction – while useful in the civil context – "has no place in the criminal law," and "would offend not only the rule of lenity but due process as well").

The Government's "mere friendship" standard ignores that the line between friends and acquaintances is often unclear. This nebulous approach runs counter to the "certainty and predictability" required of the securities laws, *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994), and forces an individual "to speculate, at peril of indictment, whether his conduct is prohibited." *Dunn v. United States*, 442 U.S. 100, 112 (1979). It also contravenes the principles of lenity that undergird the interpretation of statutes with criminal applications. *See United States v. Naftalin*, 441 U.S. 768, 778-79 (1979)

(noting that applying rule of lenity in construing Section 17(a) of Exchange Act would be appropriate in criminal case if the statute were ambiguous).

Consistent with the Panel's conclusion that the tippee must *know* of the personal benefit to the tipper, which the Government is no longer disputing, it follows that the tippee must also *know* the facts and circumstances that reasonably lead to the conclusion that the tipper intended to provide the tippee with a gift of confidential information the tippee could trade on. If it were sufficient for the Government to show merely that there existed some relationship between tipper and tippee, however distant, participants in the market would have no choice but to refrain from trading, since they could never be sufficiently certain that there was no "friendship" between tipper and tippee that could result in criminal culpability.

These notice issues are particularly severe for downstream recipients of financial information like the defendants here. As the Court recognized in *Dirks*, it would be inappropriate to impose a duty on market participants to avoid trading simply because they have received material nonpublic information, because this "could have an inhibiting effect on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market." 463 U.S. at 658. Absent proof that the remote tippee fully grasped the relationship between insider and first tippee, and understood that a personal benefit had been provided, there is no basis for criminal prosecution. Under the Government's approach,

however, it would be impossible for a trader to determine whether the relationship between an unidentified or barely known source would qualify, and *amici*'s members would be unable to properly advise their clients. If this were the law, tippee liability would effectively be based solely on the possession of confidential information, a position that the Court in *Dirks* expressly rejected. 463 U.S. at 657.

An overly malleable definition of personal benefit also raises concerns regarding separation of powers. Where any sort of relationship can be sufficient for determining that a personal benefit exists, prosecutorial discretion goes largely unchecked, a "hazardous" proposition for market participants. *Dirks*, 463 U.S. at 664 n.24 (noting that "market participants are forced to rely on the reasonableness of the [government's] litigation strategy"). The danger of unchecked prosecutorial discretion is amplified here because insider trading is entirely judge-made law. Ordinarily, "[i]t is the legislature, not the Court, which is to define a crime, and ordain its punishment." *United States v. Wiltberger*, 18 U.S. (5 Wheat.) 76, 95 (1820). Without a written criminal statute defining the outer limits of insider trading liability, separation of powers concerns are at their zenith.

CONCLUSION

For the foregoing reasons, the Government's request for panel rehearing and rehearing *en banc* should be denied.

Dated: February 25, 2015

Respectfully submitted,

By: /s/ Ira M. Feinberg

Ira M. Feinberg
Benjamin A. Fleming
HOGAN LOVELLS US LLP
875 Third Avenue
New York, NY 10022
ira.feinberg@hoganlovells.com
benjamin.fleming@hoganlovells.com
Tel: (212) 918-3000
Fax: (212) 918-3100

Richard D. Willstatter
Green & Willstatter
200 Mamaroneck Avenue, Suite 605
White Plains, New York 10601
willstatter@msn.com
Tel: (914) 948-5656
Vice Chair, *Amicus Curiae* Committee,
National Association of Criminal Defense Lawyers

Roland G. Riopelle
Sercarz & Riopelle, LLP
810 Seventh Avenue, Suite 620
New York, NY 10019
rriopelle@sercarzandriopelle.com
Tax: (212) 586-4900
Fax: (212) 586-1234
Vice President, New York Council of Defense Lawyers

Counsel for Amici Curiae

CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of February 2015, the foregoing brief was filed through the Court's ECF system, and accordingly was served electronically on all parties.

/s/ Ira M. Feinberg