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 *AMICUS CURIAE* MARK CUBAN IN OPPOSITION TO PETITION FOR REHEARING AND REHEARING *EN BANC*

JOHN E. ROBERTS
PROSKAUER ROSE LLP
One International Place
Boston, Massachusetts 02110
(617) 526-9600

STEPHEN A. BEST
BROWN RUDNICK LLP
601 Thirteenth Street, NW, Suite 600
Washington, DC 20005
(202) 536-1700

RALPH C. FERRARA
ANN M. ASHTON
RACHEL O. WOLKINSON
SCOTT J. FISHWICK
PROSKAUER ROSE LLP
1001 Pennsylvania Avenue, NW,
Suite 600 South
Washington, DC 20004
(202) 416-6800

Attorneys for Amicus Curiae Mark Cuban

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

INTEREST OF *AMICUS CURIAE*[1]

Mark Cuban is a successful businessman, an investor, the owner of several business ventures, including the NBA's Dallas Mavericks, and one of the stars of the popular television show "Shark Tank." He was pursued by the Securities and Exchange Commission for over six years based on a novel theory of insider trading. A jury ultimately exonerated Mr. Cuban on all charges. Based on that experience, Mr. Cuban has an interest in opposing the Government's attempt in this appeal to expand the reach of the insider trading rules to cover activities that are legal under established law.

PRELIMINARY STATEMENT

No one should be prosecuted for conduct that Congress is either unwilling or unable to define. However, that is precisely what is occurring with respect to the Department of Justice's and the Securities and Exchange Commission's pursuit of insider trading claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).[2]

---

1. This brief is submitted pursuant to this Court's January 29, 2015 Order. No counsel for any party authored this brief in whole or in part, and no person or entity other than *amicus* and his counsel made a monetary contribution to its preparation or submission. *See* Fed. R. App. P 29(c)(5).

2. There is no codification of what constitutes insider trading under section 10(b) – the words "insider trading" are not even included in the statutory provision. Only one passage in the "voluminous legislative history" of the Exchange Act suggests that insider trading was intended to be covered by

Although Congress has been repeatedly challenged and even beseeched to provide a definition of insider trading as it relates to section 10(b), it has declined to do so. Instead of a statutory definition with boundaries, there is a patchwork of judicial decisions cobbling together, on a case-by-case basis, what conduct gives rise to liability.[3] This has resulted in an "intolerable degree of uncertainty." Harvey L. Pitt & Karen L. Shapiro, *The Insider Trading Proscriptions Act of 1987: A Legislative Initiative for a Sorely Needed Clarification of the Law Against Insider Trading*, 39 Ala. L. Rev. 415, 416 (1988).

All of this is made even more difficult by the ambitious stance of the Department of Justice (egged on by the SEC in its own cases) to take every opportunity to seek an expansion of the parameters of prohibited insider trading by bringing claims based on novel theories for which there is no precedent.[4] Without definitive guidance as to what is a violation and what is not, well-meaning

---

section 10(b) – and that passage, read in context, "does not deal with insider trading as we understand the term today, but rather with manipulation of stock prices by pools of insiders and speculators through cross sales, wash sales and similar 'cunning' methods." Stephen Bainbridge, Securities Law: Insider Trading 26-27 (2d ed. 2007) (citation omitted).

3. As Judge Parker observed during oral argument, the law "seems to be varying according to which judge you're talking to." Transcript of Oral Argument at 29.

4. That is precisely the case in this appeal, as the Panel recognized. *United States v. Newman*, 773 F.3d 438, 448 (2d. Cir. 2014) ("[t]he Government's overreliance on our prior dicta merely highlights the doctrinal novelty of its recent insider trading prosecutions").

innocent individuals are left in the untenable position of having to worry that what is (and should be) a lawful transaction today will suddenly be alleged by the Government to violate the federal securities laws tomorrow.

The Government, in its ever-broadening campaign against insider trading, seems to have lost sight that its underlying goal should be to assure that the markets are fair and equitable so that companies and investors are able to participate with confidence, thus encouraging capital formation. Companies need capital to grow, and investors need to know that the companies in which they invest, and the markets in which they transact, will treat them fairly. Pursuing individuals under novel theories does nothing to improve the fairness of the markets.

Mr. Cuban knows all too well from personal experience that if the Government labels an individual an "insider trader," no matter how novel the theory of liability, the individual is faced with a decision whether to succumb to a settlement despite not believing that the conduct violated the law (and thereby suffer the attendant financial, injunctive and reputational costs) or mount an expensive and time-consuming defense that is likely to take years to resolve.

In an attempt to effect yet another expansion of insider trading proscriptions – this time to cover remote (by several layers) tippees – the Government in this case has misread and cherry-picked favorable dicta from prior cases to claim that mere friendship is sufficient to turn a perfectly legal transaction into criminal insider trading. The Panel held that, for tippee liability to lie, the insider must receive a personal benefit that is concrete, objective and "of some consequence." *United States v. Newman*, 773 F.3d 438, 452 (2d. Cir. 2014). The Panel got it right. As discussed below, there is no reason to grant the Government's petition.

ARGUMENT

I. PEOPLE WHO TRADE LAWFULLY SHOULD NOT HAVE TO FEAR BECOMING A DEFENDANT IN A GOVERNMENT PROCEEDING

While it might seem to go without saying that an individual who lawfully trades his or her stock should not suddenly be captioned in a Government enforcement proceeding, that is precisely what happened to Mr. Cuban. He spent over six years and millions of dollars defending against novel insider trading allegations by the SEC. While he was offered the opportunity to settle for much less than his defense costs, he refused because he had done nothing wrong. Although a jury fully vindicated Mr. Cuban, it was not without significant costs. Not only was he forced to spend a considerable amount of time and money on his defense, but he also lived under the bright light of the SEC's allegations while the case was pending. For example, he was jeered when attending Dallas Mavericks games by chants of "insider trading." *See* Lisa Shidler, *Persecuted Mark Cuban Prosecuted the SEC and Wins Some Mea Culpas from Christopher Cox*, RIABiz, Dec. 10, 2014, http://www.riabiz.com/a/4938825004482560/ persecuted-mark-cuban-prosecutes-the-sec-and-wins-some-mea-culpas-from-christopher-cox. Notwithstanding those costs, Mr. Cuban at least could afford to defend himself. Others may not be so fortunate.

Congressional codification of exactly what constitutes insider trading is required. Absent that, the courts must continue to reject the Government's attempts to expand insider trading proscriptions through litigation pursuant to which innocent traders find themselves ensnared in insider trading prosecutions.

II. OTHER THAN IN THE LIMITED CONTEXT SHORT-SWING TRADING, CONGRESS PROVIDED NO PROSCRIPTION AGAINST INSIDER TRADING IN THE EXCHANGE ACT

While Congress was aware of concerns regarding insider trading at the time the Securities Exchange Act of 1934 was enacted, *see, e.g.*, Donald Cook & Myer Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 386 (Jan. 1953), the Act addresses only a narrow subspecies of insider trading – namely, where a director, beneficial owner, or officer personally achieves short-swing profits by using nonpublic information to make both a purchase and a sale of company stock within six months of each other. Securities Exchange Act of 1934, ch. 404, tit. 1, § 16(b) (codified as amended at 15 U.S.C. § 74p(b)). And even in that situation, only the company (or a shareholder acting derivatively on behalf of the company) may sue for disgorgement; there is no criminal liability, and the SEC may not bring an action to enforce the prohibition.[5] *Id.*

Despite the lack of Congressional proscription (or even intent) regarding insider trading beyond the limited context of section 16(b), the SEC has not hesitated to argue that section 10(b)'s fraud provision and Rule 10b-5 broadly proscribe "insider trading." Addressing the issue in *In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC held that a trader committed a fraud – and thus violated Rule 10b-5 – whenever he or she traded while knowing material nonpublic information that the counterparty did not. In effect, the SEC demanded a parity of information between traders: A trader either had to disclose his informational asymmetry or abstain from trading. *See Chiarella v. United States*, 445 U.S. 222, 227 (1980).

This expansive view of insider trading had little basis in the Exchange Act – indeed, it went well beyond Congress's narrow proscription in section 16(b) against short-swing trades by a limited group of insiders. The SEC nevertheless

5. Congress also specifically rejected the concept of tippee liability. A draft version of the Exchange Act would have barred certain corporate insiders from sharing confidential information with outsiders, and tippees who traded on illegally disclosed information would have had to disgorge to the issuer profits realized within six months of the disclosure (unless they could meet certain affirmative defenses). *See Blau v. Lehman*, 368 U.S. 403, 411-12 & n.12 (1962) (citing H.R. 7852, § 15(b); S. Rep. 2693, § 15(b)). But even this limited provision for tippee liability was eliminated from the Act prior to enactment. *Id.*

managed to convince lower courts – including this one – to adopt its "disclose or abstain" rule, and many successful (but baseless) insider trading actions were brought accordingly. *See, e.g.*, *SEC v. Tex. Gulf Sulfur Co.*, 401 F.2d 833 (2d Cir. 1968).

The SEC pressed its flawed parity-of-information rule for nearly two decades. It jettisoned the rule only when the Supreme Court reversed a decision of this Court to hold that information parity is "inconsistent with the careful plan that Congress has enacted for regulation of the securities markets." *Chiarella*, 445 U.S. at 235. The *Chiarella* Court explained that Congress did not outlaw all forms of insider trading but only those that constitute fraud. *Id.* Trading on nonpublic information is fraudulent only when the investor has an independent duty under the common law to disclose that information or abstain from trading. *Id.* By contrast, the SEC's parity-of-information rule had created a "general duty between all participants in market transactions to forego actions based on material, nonpublic information" and thus "depart[ed] radically" from both the Exchange Act and established fraud doctrine. *Id.* at 233.

Despite the setback in *Chiarella*, the SEC continued to press for expanded insider trading proscriptions. Three years after *Chiarella*, the Supreme Court again took up the issue in *Dirks v. SEC*, 463 U.S. 646 (1983). There, the SEC had charged an analyst with insider trading after he had received and passed on to traders information from insiders concerning corruption at a financial firm. *Id*. at 648-49. The SEC's position was that the analyst automatically inherited the insiders' common law duty not to trade on confidential information by virtue of having received information from those insiders. *Id.* at 655-56. In other words, the SEC believed that every tippee is subject to the parity-of-information rule. *Id.*

Once again, the Supreme Court rejected the SEC's view of insider trading as overly expansive. After repeating *Chiarella*'s holding that there can be no liability for insider trading unless there is a fraud, *id.* at 666 n.27, the Court held that a tippee does not *per se* acquire a duty to disclose or abstain whenever he acquires insider information, *id.* at 659. To the contrary, a tippee "assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information *only* when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach." *Id*. at 660 (emphasis added); *see also Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 (1985) (explaining that *Chiarella* and *Dirks* make clear that "a tippee's use of material nonpublic information does not violate § 10(b) and Rule 10b-5 unless the tippee owes a corresponding duty to disclose the information").

History thus demonstrates that the SEC and DOJ will relentlessly push to expand the outer limits of what constitutes insider trading until they are reined in. But expanding the reach of the insider trading laws is Congress's purview. *See, e.g.*, *Norwood v. Kirkpatrick*, 349 U.S. 29, 40 (1955) (holding that a court's role is to "interpret [a statute,] not to expand and enlarge upon it"). And time and again, Congress has declined to define insider trading.

III. DESPITE HAVING MANY OPPORTUNITIES, CONGRESS HAS FAILED TO CODIFY OR OTHERWISE DEFINE INSIDER TRADING

Beginning in 1969, a group of esteemed securities academics and practitioners, led by Professor Louis Loss, participated in drafting the American Law Institute's Federal Securities Code ("ALI Code"). The ALI Code, completed in 1978, was an attempt to re-codify the six federal securities statutes into a single comprehensive code. *See* Miriam R. Albert, *Company Registration in its Historical Context: Evolution Not Revolution*, 9 U. Miami Bus. L. Rev. 67, 78-79 (2001). Section 1603 of the ALI Code specifically prohibited insider trading. *See* 2 ALI Fed. Sec. Code § 1603 (1978). Section 1603(b) defined insiders to include an expansive group of individuals (including both direct and indirect tippees) and proposed to codify the "concept of an insider's affirmative duty not to trade without disclosure." *See id*. cmts. 2(e), 3(e).

The SEC endorsed the ALI Code, Statement Concerning Codification of the Federal Securities Laws, Securities Act Release No. 33,6242 (Sept. 22, 1980), and in 1980 it was presented to Congress. Despite formal approval by the ALI, endorsement by the SEC, and support of the American Bar Association, the ALI Code was never enacted into law by Congress. Albert, 9 U. Miami Bus. L. Rev. at 80-81.

Congress next had an opportunity to address insider trading when it passed the Insider Trading Sanctions Act of 1984, a law that permits the SEC to impose a treble damages sanction on an individual who tips or trades while in possession of material nonpublic information in violation of the Exchange Act. 15 U.S.C. § 78u. But Congress specifically declined to define insider trading, apparently to avoid a debate over the definition that could have stalled passage of the entire legislative package. *See* Harvey L. Pitt *et al.*, *Problems of Enforcement in the Multinational Securities Market*, 9 U. Pa. J. Int'l L. 375, 382 n.11 (1987).

Yet another opportunity for Congressional action arose in June 1987, when Senators Donald Riegle and Alfonse D'Amato took the issue head on in introducing the Insider Trading Proscriptions Act of 1987. At the Senators' request, the SEC submitted a proposed definition of insider trading drafted by the Ad Hoc Legislative Committee on Insider Trading, chaired by Harvey Pitt. *See* Jonathan R. Macey, Cato Policy Analysis No. 101, *SEC's Insider Trading Proposal: Good Politics, Bad Policy*, Mar. 31, 1988; Oliver P. Colvin, *A Dynamic Definition of a Prohibition Against Insider Trading*, 31 Santa Clara L. Rev. 3, 619-20 (1991). The bill was not enacted. *See* H.R. Rep. No. 100-910 (1988), *reprinted in* 1988 U.S.C.C.A.N. at 6043.

Congress also considered adoption of an insider trading definition when it enacted the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988). This Act added section 20A to the Exchange Act to create an express private right of action for individuals who trade contemporaneously with an insider trader. *See* Fred D'Amato, *Comment: Equitable Claims to Disgorged Insider Trading Profits*, 1989 Wis. L. Rev. 1433, 1439 & n.29 (1989). In declining to adopt a definition for insider trading, the House Report of the Committee on Energy and Commerce explained that

> . . . the court-drawn parameters of insider trading have established clear guidelines for the vast majority of traditional insider trading cases . . . . Accordingly, the Committee does not intend to alter the substantive law with respect to insider trading with this legislation. The legal principles governing insider trading cases are well-established and widely-known.

H.R. Rep. No. 100-910, at *11 (1988), *reprinted in* 1988 U.S.C.C.A.N. at 6048.

At the time that statement was made, the "court-drawn parameters of insider trading" were those set out by the Supreme Court in *Chiarella* and *Dirks.* Thus, while Congress determined not to codify an insider trading definition, its citation to "court-drawn parameters" indicates an endorsement of the *limitations* that the Supreme Court had adopted in those cases. *Cf. Bob Jones Univ. v. United States*, 461 U.S. 574, 601 (1983) ("[i]n view of its prolonged and acute awareness of so important an issue, Congress's failure to act on the [proposed] bills . . . provides added support for concluding that Congress acquiesced in the IRS rulings").

The Panel has followed the Supreme Court's lead in rejecting the Government's attempts to expand insider trading law through litigation. If the Government is unhappy with the court-drawn parameters, then its only choice is to seek legislative help.

IV. THE GOVERNMENT'S PROPOSED DIMINUTION OF WHAT IS NEEDED TO DEMONSTRATE PERSONAL BENEFIT WAS CORRECTLY REJECTED BY THE PANEL

In *Dirks*, the Supreme Court considered the circumstances pursuant to which a tippee would be liable for insider trading. Holding that a tippee "assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information *only* when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach," 463 U.S. at 660 (emphasis added), the Court then considered the species of "personal benefit" that could point to a fiduciary breach:

> 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 . . . . There are objective facts and circumstances that often justify such an inference. For example, there

> may be 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. The elements of fiduciary duty and exploitation of nonpublic information also exist 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.

Id. at 663-64.

In its petition for rehearing, the Government misconstrues this language in *Dirks* to argue that a gift of material nonpublic information by an insider to a relative or friend *per se* constitutes a personal benefit to the insider. Pet. for Reh'g at 11. In making this argument, the Government first focuses on the language in *Dirks* that a benefit may be found if there is 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." *See* 463 U.S. at 663. The Government's entire argument is dependent on the word "or" meaning that either clause, standing alone, would support an inference of a personal benefit to the insider. That is not the case. Consistent with principles of *ejusdem generis* and *noscitur a sociis*, when read in the context of the entire opinion, it is clear that the two clauses must be read together – that is, the clause "or an intention to benefit the particular recipient" does not stand alone, but modifies the previous clause. *See, e.g., Gustafson v. Alloyd Co.*, 513 U.S. 561, 575 (1995) ("a word is known by the company it keeps (the doctrine of *noscitur a sociis*) [which] we rely upon to avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words”).

The Government next focuses on the Supreme Court’s statement that the “elements of fiduciary duty and exploitation of nonpublic information also exist 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.” *See* 463 U.S. at 664. Here again, the Government misconstrues the language by arguing that friendship is sufficient to prove a personal benefit. Pet. for Reh’g at 13. In including this language, the Supreme Court was explaining that a relative or friend relationship can be evidence of the “*elements* of fiduciary duty and exploitation” and that an individual cannot do indirectly – through a “straw” – what he or she cannot do directly. *Id*. at 664 (emphasis added). But the mere relationship, without more, is not a breach of any duty.

The bottom line is that the Panel correctly held that *Dirks* and this Court’s cases on tippee liability require that the tipper receive a personal benefit that is concrete, objective and “of some consequence.”[6] *Newman*, 773 F.3d at 452; *see also United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013) (“enter[ing] into a

6. The Panel also correctly held that a tippee must know of the personal benefit received by the insider in exchange for the disclosure. *Newman*, 773 F.3d at 451.

relationship of *quid pro quo* . . . could yield future pecuniary gain"), *cert. denied,* 135 S. Ct. 311 (2014).

CONCLUSION

Amicus Mark Cuban is not suggesting that the bar against archetypal insider trading – trading by an insider (directly or indirectly) based on material nonpublic information in breach of the insider's fiduciary duty – should be discarded. But he strongly believes that insider trading should be defined in a manner that allows individuals to know with certainty whether a trade is legal or illegal *before* they engage in the transaction. While this Court cannot require Congress to act, it can follow the Supreme Court's lead by reining in the Government's attempts to expand the reach of insider trading proscriptions. That is what the Panel already did. The Government's petition for rehearing or rehearing en banc should therefore be denied.

Respectfully submitted,

/s/ Ralph C. Ferrara

Ralph C. Ferrara
Ann M. Ashton
Rachel O. Wolkinson
Scott J. Fishwick
Proskauer Rose LLP
1001 Pennsylvania Avenue, NW
Suite 600 South
Washington, DC 20004
(202) 416-6800

John E. Roberts
Proskauer Rose LLP
One International Place
Boston, Massachusetts 02110
(617) 526-9600

Stephen A. Best
Brown Rudnick, LLP
601 Thirteenth Street, NW
Suite 600
Washington, DC 20005
(202) 536-1700

February 19, 2015 *Attorneys for Amicus Curiae Mark Cuban*