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

United States Court of Appeals

for the

Second Circuit

UNITED STATES OF AMERICA,

Appellee,

– v. –

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

Defendants,

TODD NEWMAN, ANTHONY CHIASSON,

Defendants-Appellants.

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

BRIEF OF NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AS *AMICUS CURIAE* IN SUPPORT OF APPELLANTS

JOSHUA L. DRATEL
LAW OFFICES OF JOSHUA L. DRATEL, P.C.
29 Broadway, Suite 1412
New York, New York 10006
(212) 732-0707
Co-Chair, NACDL Amicus Curiae Committee

IRA M. FEINBERG
JORDAN L. ESTES
HAGAN SCOTTEN
HOGAN LOVELLS US LLP
875 Third Avenue
New York, New York 10022
(212) 918-3000

Attorneys for Amicus Curiae

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

REGULATIONS

OTHER AUTHORITIES

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The National Association of Criminal Defense Lawyers ("NACDL") is a nonprofit organization with a direct national membership of more than 10,000 attorneys, in addition to more than 40,000 affiliate members in all 50 states.[1] The NACDL was founded in 1958 to promote study and research in the field of criminal law; to disseminate and advance knowledge of the law in the area of criminal practice; and to encourage 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 to ensure that criminal statutes are construed and applied in accordance with due process of law.

The NACDL files this *amicus* brief in support of appellants, urging reversal.[2] The District Court's ruling that the jury need not be instructed to find that defendants were aware of any alleged personal benefit the original "tipper" of inside information may have received disregards one of the most fundamental principles that has long guided our jurisprudence: a defendant must know the facts

---

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

[2] All parties have graciously consented to the filing of this amicus brief. Accordingly, this brief may be filed without leave of court, pursuant to Rule 29(a) of the Federal Rules of Appellate Procedure.

that make his conduct illegal before criminal conviction is appropriate. The District Court erred in ignoring this foundational principle, which is vital to the application of criminal laws generally and to the construction of the securities laws in particular.

INTRODUCTION AND SUMMARY OF ARGUMENT

One of the bedrock principles of our system of criminal justice is that, with rare exceptions, "wrongdoing must be conscious to be criminal." *Morissette v. United States*, 342 U.S. 246, 252 (1952). As Justice Jackson explained in that seminal case, the principle that "an injury can amount to a crime only when inflicted by intention" is "as universal and persistent in mature systems of law as belief in freedom of the human will and a consequent ability and duty of the normal individual to choose between good and evil." *Id.* at 250. Since *Morissette*, the decisions of the Supreme Court and this Court have repeatedly given effect to this basic principle by requiring proof the defendant committed the wrongful act with the requisite intent.

This *mens rea* requirement is incorporated into the securities laws. The Securities Exchange Act makes only "willful" violations of its provisions criminal. 15 U.S.C. § 78ff(a). Accordingly, a criminal securities conviction requires proof of "'a realization on the defendant's part that he was doing a wrongful act' under

the securities laws." *United States v. Cassese*, 428 F.3d 92, 98 (2d Cir. 2005) (quoting *United States v. Peltz*, 433 F.2d 48, 55 (2d Cir. 1970)).

A fundamental component of this *mens rea* requirement is that a defendant cannot be convicted of a crime if he is not aware of the facts that make his conduct criminal. Indeed, it is "hornbook law" that "conduct is criminal only if the actor is aware of the facts making it so." Herbert L. Packer, *Mens Rea and the Supreme Court*, 1962 Sup. Ct. Rev. 107, 108. The Supreme Court has therefore held in a variety of statutory contexts that a criminal conviction can be upheld only if the defendant knew the relevant facts "separating legal innocence from wrongful conduct." *United States v. X-Citement Video, Inc.*, 513 U.S. 64, 73 (1994). Unless the defendant is aware of the key facts that make his conduct criminal, he cannot conform his conduct to the requirements of the law, and his conduct is not morally blameworthy. And absent knowledge of the relevant facts, he cannot seek legal advice regarding his conduct, and his counsel – the NACDL's members – cannot advise him what the law requires.

In ruling that the jury here need not find that defendants knew that the original source of the inside information leaked the information in return for some personal benefit, the District Court erroneously disregarded these basic principles. The Supreme Court has made it abundantly clear that trading on material non-public information is not unlawful in itself. *Chiarella v. United States*, 445 U.S.

222, 233 (1980); *Dirks v. SEC*, 463 U.S. 646, 657 (1983). Rather, as the Court held in *Dirks*, trading on non-public information is a violation of Rule 10b-5 only when a corporate insider has breached his fiduciary duty to the company by disclosing inside information for his personal benefit. And the tippee who receives this inside information is barred from trading only if he *knows* that the insider has breached his duties to the company. *Id*. at 660-61. "The tippee's duty to disclose or abstain is derivative from that of the insider's duty." *Id*. at 659. Thus, "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.

Thus, the key fact that separates lawful trading based on non-public information from criminal conduct is the trader's knowledge whether the corporate insider responsible for the initial disclosure provided inside information in exchange for some personal benefit. Unless the recipient of the information is aware of the initial fiduciary breach by a corporate insider, he is under no obligation to abstain from trading on it. The District Court therefore erred in failing to instruct the jury that the Government had to prove that the defendants here knew that the information had been disclosed by corporate insiders to obtain some personal benefit. Without knowledge of that benefit, the defendant cannot

know that his conduct is wrongful under the securities laws, and his trading cannot be a willful violation of Section 10(b) and Rule 10b-5.

A R G U M E N T

I. THE DISTRICT COURT'S JURY INSTRUCTIONS CONFLICT WITH THE FUNDAMENTAL PRINCIPLE THAT A DEFENDANT MUST KNOW THE FACTS THAT MAKE HIS CONDUCT ILLEGAL.

A. Basic Principles of *Mens Rea* Require Proof that the Defendant Knew the Facts that Made His Conduct Unlawful.

As Justice Jackson recognized in *Morissette*, the principle that a criminal conviction generally requires proof of *mens rea* is as old as the common law. 342 U.S. at 250-52. Since the sixteenth century, the common law recognized intent to do wrong as the foundation of criminal punishment. *See* Francis Bacon, The Elements of the Common Lawes of England 65 (1596) (London, I. More 1630) ("All crimes have their conception in a corrupt intent"). As Blackstone put it, "to constitute a crime against human laws, there must be, first, a vicious will." 4 William Blackstone, Commentaries, *21 (1769).

The rationale behind this principle is as simple as it is powerful: Many acts have bad consequences, but only those undertaken with bad intent merit criminal punishment. As one scholar explained, "to punish conduct without reference to the actor's state of mind is both inefficacious and unjust." Packer, *Mens Rea and the Supreme Court*, 1962 Sup. Ct. Rev. at 109. "It is unjust because the actor is

subjected to the stigma of a criminal conviction without being morally blameworthy." *Id.* And it is inefficacious because if the actor is unaware of the factors making his conduct criminal, there is no reason to single him out for punishment, nor can criminal punishment be justified by the necessity to deter him, or others in his position, from repeating his conduct in the future. *Id.*

In *Morissette*, Justice Jackson, writing for a unanimous Court, established this principle as one of the basic foundations of federal criminal law. In that case, the Court confronted a statute that punished the theft of government property, but did not on its face include a *mens rea* requirement. The defendant had been convicted for conversion of seemingly abandoned scrap metal that, unbeknownst to him, still belonged to the Government. *See* 342 U.S. at 247-50. The Court reviewed at length the history and philosophy underpinning the relationship between wrongful intent and criminal punishment. *See id.* at 250-63. Based on the historical understanding that criminal intent was a prerequisite for common law crimes, the Court found that criminal intent is "inherent" in a criminal offense, "even when not expressed in a statute." *Id.* at 262. The Court thus refused "to strip the defendant of such benefit as he derived at common law from innocence of evil purpose," *id*. at 263, and held that the defendant "must have had knowledge of the facts" that made his act criminal—in that case, the fact that the apparently abandoned scrap was government property. *Id.* at 271.

In the sixty years since *Morissette*, the Court has repeatedly affirmed that "intent generally remains an indispensable element of a criminal offense." *United States v. U. S. Gypsum Co.*, 438 U.S. 422, 437 (1978); *see also, e.g.*, *Flores-Figueroa v. United States*, 129 S. Ct. 1886 (2009). In *U.S. Gypsum*, for example, the Court held that criminal intent was an essential element of a criminal violation of the antitrust laws, even though the Sherman Act does not expressly include any element of intent or otherwise distinguish between civil and criminal violations. The Court noted that under the Sherman Act, "[b]oth civil remedies and criminal sanctions are authorized with regard to the same generalized definitions of the conduct proscribed," and that "judicial elaboration of the Act [has not] always yielded the clear and definite rules of conduct which the statute omits." 438 U.S. at 438. In this context, the Court held that an intent requirement for criminal violations was required, *id*. at 443, in part because "the behavior proscribed by the Act is often difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct." *Id*. at 440-41.

Thus, "'[t]he existence of a *mens rea* is the rule of, rather than the exception to, the principles of Anglo-American criminal jurisprudence.'" *Staples v. United States*, 511 U.S. 600, 605 (1994) (quoting *U.S. Gypsum*, 438 U.S. at 436-37). Accordingly, the Supreme Court has held that criminal statutes should be interpreted with a presumption in favor of *mens rea*, and that "some indication of

congressional intent . . . is required to dispense with *mens rea* as an element of a crime." *Staples*, 511 U.S. at 606.

As the Court explained in *Morissette*, 342 U.S. at 270-71, the principle that a defendant must have knowledge of the facts that make his conduct criminal is an essential aspect of *mens rea*. Thus, in *Staples*, the Court held that a statute criminalizing possession of an unregistered machinegun required proof that the defendant knew of the characteristics of his weapon that made it a "machinegun" within the meaning of the statute. In doing so, the Court explained that "the Government's construction of the statute potentially would impose criminal sanctions on a class of persons whose mental state – ignorance of the characteristics of weapons in their possession – makes their actions entirely innocent." 511 U.S. at 614-15. The Court therefore held applicable what it called "the conventional *mens rea* element," which "require[s] that the defendant know the facts that make his conduct illegal." *Id*. at 605.

Similarly, in *X-Citement Video*, the Court held that a defendant must have knowledge that actors in a pornographic film were underage, because "the age of the performers is the crucial element separating legal innocence from wrongful conduct." *Id.* at 73. Indeed, the Court held that "the presumption in favor of a scienter requirement should apply to each of the statutory elements that criminalize otherwise innocent conduct." *Id*. at 72.

This Court has similarly emphasized that the Government must prove the defendant had knowledge of the facts that made his conduct unlawful. In *United States v. Bronx Reptiles, Inc.*, 217 F.3d 82 (2d Cir. 2000), the Court held that a statute that made it a crime to "knowingly" transport a wild bird or animal into the United States under inhumane and unhealthful conditions required proof of the defendant's knowledge of those conditions. The Court held that this construction was compelled both by the wording of the statute and by basic "legal principle[s] that criminal statutes are presumed to contain a *mens rea* requirement." *Id*. at 87. The Court explained that, absent knowledge of the conditions, the importation of a wild bird or animal into the United States was "perfectly innocent," *id*. at 88, and therefore proof of knowledge of the conditions was required to prevent "guilt absent a *mens rea*." *Id.* at 90.

B. The Federal Securities Laws Require Proof that a Tippee Knew the Original Tipper of Inside Information Disclosed Information in Exchange for a Personal Benefit.

Unlike *Morissette* and *Staples*, which involved statutes that did not specify any *mens rea* requirement at all, the statute at issue here expressly adopts a robust *scienter* requirement. The Securities Exchange Act criminalizes only "willful" violations of the Act. 15 U.S.C. § 78ff(a); *see Cassese*, 428 F.3d at 98. This *scienter* requirement is supposed to form a "sturdy safeguard" against unjust criminal prosecutions under SEC Rule 10b-5. *United States v. O'Hagan*, 521 U.S.

642, 665-66 (1997) (upholding validity of misappropriation theory of insider trading, in part because of willfulness requirement).

As the Supreme Court has explained, a statute's reference to "willful" conduct "typically refers to a culpable state of mind." *Bryan v. United States*, 524 U.S. 184, 191 (1998). In general, "to establish a 'willful' violation of a statute, 'the Government must prove that the defendant acted with knowledge that his conduct was unlawful.'" *Id.* (quoting *Ratzlaf v. United States*, 510 U.S. 135, 137 (1994)). In a criminal prosecution for violation of Section 10(b), in particular, willfulness requires "'a realization on the defendant's part that he was doing a wrongful act' under the securities laws." *Cassese*, 428 F.3d at 98 (quoting *Peltz*, 433 F.2d at 55).

In light of the statute's willfulness requirement, the District Court's failure to require the jury to find that defendants knew that the original tipper disclosed inside information in exchange for a personal benefit was a clear error of law. Under the controlling Supreme Court decisions, this element of the defendants' alleged knowledge is crucial to distinguish lawful trading from a criminal offense. It is well settled that trading on material non-public information is not itself a violation of the securities laws. The Supreme Court made this clear in *Chiarella*, where it rejected "any notion that all traders must enjoy equal information before trading." *Dirks*, 463 U.S. at 657 (discussing *Chiarella*, 445 U.S. at 235). As the

Court in *Chiarella* explained, the use of material nonpublic information is a fraud under Section 10(b) only if the trader "was subject to an affirmative duty to disclose it before trading," 445 U.S. at 231, and such a duty "does not arise from the mere possession of nonpublic market information." *Id.* at 235.

The Supreme Court in *Dirks* reaffirmed these conclusions, while addressing in detail the legal principles governing the liability of "tippees" of inside information. The Court reiterated that "there is no general duty to disclose before trading on material nonpublic information." 463 U.S. at 654. Instead, the Court explained that a corporate insider violates his fiduciary duties to shareholders only where he benefits personally from the misuse of corporate information. *Id.* And a tippee who receives such inside information is subject to a duty to refrain from trading on it only in the limited circumstances where it is appropriate to conclude, based on the relationship between the tipper and tippee, that the tippee inherited the insider's duty to the corporation and its shareholders. *Id*. at 655-61.

The Court expressly rejected the SEC's position that a tippee inherits the duty to refrain from trading whenever he receives material nonpublic information from an insider. *Id*. at 655-58. The Court explained that the SEC's position "differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*." *Id*. at 656. Instead, the Court "reaffirm[ed] today that '[a] duty [to disclose] arises from the relationship between parties . . . and not merely

from one's ability to acquire information because of his position in the market.'" *Id*. at 657-58 (quoting *Chiarella*, 445 U.S. at 232-33). Indeed, the Court expressed concern that "[i]mposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts," 463 U.S. at 658, which the Court recognized to be "necessary to the preservation of a healthy market." *Id*. As the Court explained, the analysts' role is to "ferret out and analyze information," which is "often" done by "questioning corporate officers and others who are insiders," and this process plays an important and legitimate role in the market's "judgments as to the market worth of a corporation's securities." *Id*. at 659.

To be sure, the Court recognized the "need for a ban on some tippee trading." *Id*. But the Court closely tied the scope of the ban on tippee trading to the insider's breach of his fiduciary duties to the corporation. The Court explained that just as insiders cannot use corporate information to benefit themselves personally, they also cannot "give such information to an outsider for the same improper purpose." *Id*. Thus, the Court held, the tippee's duty to refrain from trading on inside information "is derivative from that of the insider's duty," and "'aris[es] from his role as a participant after the fact in the insider's breach of a fiduciary duty.'" *Id*. (quoting *Chiarella*, 445 U.S. at 230 n.12).

Accordingly, the Court explained that "a tippee assumes a fiduciary duty to the shareholders of the 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. The Court recognized that many disclosures of corporate information do not involve any breach of fiduciary duty to shareholders. *Id*. at 662. Rather, whether a disclosure violates an insider's fiduciary duty depends on "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*.

The Supreme Court's analysis in *Dirks* makes the tippee's knowledge of whether the insider received a personal benefit the critical issue in determining whether the tippee is barred from trading. The tippee has no duty to refrain from trading unless the insider breached his fiduciary duty – *i.e.*, unless the insider received a personal benefit from the disclosure. And the tippee cannot *know* whether he is subject to a duty to refrain from trading unless he knows that the insider received such a personal benefit.

Indeed, the Supreme Court said as much in *Dirks*. The Court made clear that the tippee's *knowledge* of the tipper's breach of fiduciary duty was critical.

The Court quoted with approval the observation of one SEC Commissioner that "'[t]ippee responsibility must be related back to insider responsibility by a necessary finding that the tippee *knew* the information was given to him in breach of a duty.'" *Id*. at 661 (quoting Commissioner Smith in *In re Investors Management Co.*, 44 S.E.C. 633, 651 (1971)) (emphasis added). While the Court also stated that the tippee has a duty not to trade on material nonpublic information when he "knows or should know" that there has been a breach, 463 U.S. at 660, the Court was writing in the context of an SEC civil enforcement proceeding. In a criminal prosecution, imposition of criminal liability based on what the defendant "should know" would be inconsistent with the requirement that only "willful" violations of the Securities Exchange Act are criminal. Because the wrongfulness of trading on material nonpublic information hinges on the tipper's personal benefit, a tippee's trading is "willful" only if the tippee *knows* that the tipper received a personal benefit. If the tippee lacks such knowledge, then the tippee could not have acted willfully, since he would have no knowledge he was violating the law. *See Cassese*, 428 F.3d at 98 (government must prove "realization on the defendant's part that he was doing a wrongful act . . . under the securities laws").

Consistent with this analysis, since *Dirks*, the district courts have generally instructed juries that tippee liability requires knowledge of the tipper's personal benefit. *See United States v. Whitman*, 904 F. Supp. 2d 363, 370-71 (S.D.N.Y.

2012) ("tippee must have knowledge that such self-dealing occurred, for, without such a knowledge requirement, the tippee does not know if there has been an 'improper' disclosure of inside information"); *United States v. Rajaratnam*, 802 F. Supp. 2d 491, 498-99 (S.D.N.Y. 2011) ("'knowledge of tipper breach [of fiduciary duty] . . . necessitates knowledge of *each element*, including the personal benefit, of the tipper's breach'") (quoting *State Teachers Ret. Bd. v. Fluor Corp.*, 592 F. Supp. 592, 594 (S.D.N.Y. 1984)) (alterations and emphasis in original); *Fluor*, 592 F. Supp. at 594 ("The second prerequisite to tippee liability – tippee knowledge of tipper breach – necessitates knowledge of *each element*, including the personal benefit, of the tipper's breach.") (emphasis in original).

The District Court's decision that the jury need not make such a finding here is thus an outlier; to our knowledge, it is the only court that has deleted this essential element of the charge in insider trading. The District Court did so because it believed this result was compelled by this Court's decision in *SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012), but the District Court's reliance on *Obus* was misplaced. The question whether the tippee must know of the personal benefit to the tipper was not raised by the parties in *Obus*, and this Court had no occasion to address it.

Moreover the key language in *Obus* that the District Court relied upon is fundamentally ambiguous, and does not answer the question presented here. The

Court in *Obus* stated that "[t]ippee liability requires that . . . the tippee knew or had reason to know that the tippee improperly obtained the information (i.e., that the information was obtained through the tipper's breach)," *id*. at 289, but this formulation simply does not address or answer the question whether the reference to the "tipper's breach" includes the requirement that the tipper received a personal benefit. A strong argument can be made that the Court's acknowledgement that the tippee must know that that the information was "improperly obtained" was intended as a shorthand reference to the requirement that the tipper disclosed the information in exchange for a personal benefit.

In any event, there was no basis for the District Court's conclusion that *Obus* "makes clear that the *tipper*'s breach of fiduciary duty and receipt of a personal benefit are *separate* elements, and that the *tippee* need know only of the former," *United States v. Newman*, No. 12 CR 121 (RJS), 2013 WL 1943342, at *2 (S.D.N.Y. May 7, 2013) (emphasis in original), when that issue was not even before this Court. At most, the Court's language in *Obus* was *dicta*, and ambiguous *dicta* at that.

Moreover, it is important to bear in mind that *Obus* was a civil case, and consequently, the Court's decision did not take into account the need in a criminal case to prove that the defendant's conduct was willful. As discussed above, a trader's violation of the securities laws cannot be willful unless he knows that the

original source of the information disclosed it in exchange for a personal benefit, because only then is the trader subject to an obligation under the securities laws to refrain from trading until the information is publicly disclosed.[3]

C. The Requirement of Proof of Knowledge that the Original Tipper Disclosed Information in Exchange for a Personal Benefit Is Particularly Important in Cases Involving Remote Tippees.

The requirement that there must be proof the defendant knew that the source of the original tip had disclosed information to obtain an improper personal benefit is particularly crucial when assessing the liability of remote tippees like defendants here. Remote tippees by definition have had no interaction with the original tipper, and thus may well have no knowledge whether the tipper disclosed information in exchange for a personal benefit. That is apparently true here. The defendants were three or four steps removed from any contact with the original sources of inside information at Dell and NVIDIA, and there is apparently no evidence that they had any information at all about whether the original disclosure was improperly made in return for a personal benefit.

---

[3] Nor do general instructions, like those given here, that the jury must find that the defendant acted "willfully, . . . with a bad purpose to disobey and disregard the law," Tr. 4036-37, substitute for a jury charge that properly instructs the jury as to the facts the defendant must have known before his conduct can be found unlawful. Nothing in such general jury instructions gives the jury any clue that trading on material non-public information is a crime only if the defendant knew the tipper had received a personal benefit in exchange for the disclosure, and there is no reason to expect the jury to understand the narrow scope of tippee culpability as defined in the Supreme Court's decisions.

In these circumstances, a jury instruction requiring a finding that the defendants knew that the original tipper obtained a personal benefit is critical to avoid convicting the defendants for conduct that is simply not unlawful. The record here shows that leaks of non-public information about companies' financial results are common, notwithstanding the SEC's efforts in Regulation FD to restrain the practice. Most of these leaks are not the result of criminal conduct, and do not involve any breach of fiduciary duty for personal benefit. These leaks may be intended to curry favor with potential large investors, or to condition the market for unexpected disappointing news about the company's financial results. These leaks are often authorized by the company or at least intended to advance the company's interests. It is undisputed that there is nothing improper about trading on such leaks of inside information.

It is critically important that the law distinguish between trading on such "innocent" leaks of inside information and trading based on breaches of fiduciary duty by corporate insiders in exchange for a personal benefit. At some point, a leak of non-public information about a company's anticipated results – even if it started as an improper disclosure in exchange for a personal benefit – becomes just one more piece of market intelligence that is circulating among analysts and portfolio managers. Unless defendants can be shown to know that the original

disclosure was improperly made in exchange for a personal benefit, there is far too great a risk that they would be convicted for completely innocent conduct.

It is important to bear in mind that it was the defendants' *job* to gather as much market intelligence as they lawfully could, and to trade based on that information. There is nothing improper or illegitimate about this role. On the contrary, as the Supreme Court recognized in *Dirks*, the effort of analysts "to ferret out and analyze information" about a company's prospects ultimately "redounds to the benefit of all investors," serving the important public purpose of ensuring that the stock is properly priced. 463 U.S. at 658 n.17. Through their efforts, "market efficiency in pricing is significantly enhanced." *Id*.

However, absent an instruction that the defendants *knew* the information they were relying on was disclosed improperly for a personal benefit, they could find themselves prosecuted for innocent conduct undertaken in the course of their normal business activities. Obviously, this would have a significant deterrent effect on traders, since they may have no way of confirming that the information conveyed by their analysts did not derive, at some point, from an improper disclosure for personal benefit. It would make them understandably reluctant to engage in conduct that is otherwise lawful and beneficial to society. This unwarranted deterrence is inconsistent with the Supreme Court's analysis in *Dirks*. Indeed, it is precisely the kind of "overdeterrence" that concerned the Supreme

Court in *U.S. Gypsum*: that absent a *mens rea* requirement in the enforcement of the antitrust laws, "salutary and procompetitive conduct lying close to the borderline of impermissible conduct might be shunned by businessmen who chose to be excessively cautious in the face of uncertainty regarding possible exposure to criminal punishment for even a good-faith error of judgment." 438 U.S. at 441.

Moreover, absent a rule of law that remote tippees must know that the original disclosure was made in exchange for an improper personal benefit, lawyers – including members of the NACDL – will be unable to advise their clients how to conform their conduct to the law. Since traders would be in jeopardy of criminal prosecution based on a fact that they did not know, lawyers would be unable to advise them whether trading on the basis of any particular nonpublic information would be permissible. This would place attorneys in the untenable position of advising their clients that they must either abstain from *all* trading based on nonpublic information – contrary to the holding of *Dirks* that such trading is not unlawful – or take the risk of unknowingly committing insider trading and subjecting themselves to many years of imprisonment.

The harsh penalties available under the Securities Exchange Act for insider trading further demonstrate that the statute must be interpreted to require proof that defendants know all the facts that make their conduct unlawful. The Supreme Court has emphasized that the severity of the penalties imposed for a crime is a

"significant consideration" in determining the extent of *mens rea* requirements. *Staples*, 511 U.S. at 616-17; *see also X-Citement Video*, 513 U.S. at 71-72. A penalty need not be truly draconian to count as "severe": the Court in *U.S. Gypsum* held that fines and imprisonment up to three years supported its conclusion that the antitrust laws must be construed to include a *mens rea* component. 438 U.S. at 442 n.18. Here, a violation of Section 10(b) can result in up to 20 years' imprisonment, 15 U.S.C. § 78ff(a), and recent prosecutions for insider trading have resulted in the imposition of very lengthy sentences, *see United States v. Goffer*, No. 11-3591-cr(L), 2013 WL 3285115, at *4 (2d Cir. July 1, 2013) (10 years); *United States v. Rajaratnam*, No. 09 Cr. 1184 (RJH), 2012 WL 3602031, at *1 (S.D.N.Y. Jan. 31, 2012) (11 years), including the 78-month and 54-month sentences imposed in this case. It would be unjust to permit the imposition of such a lengthy sentence on a remote tippee who lacked knowledge of the facts that made his conduct a crime, including the tipper's personal benefit.

Moreover, the fundamental due process requirement of "fair warning" that a proposed course of conduct is criminal requires proof that a remote tippee was aware of all the facts that made his conduct criminal. A person "unaware of any wrongdoing" should not be "brought to the bar of justice for condemnation in a criminal case." *Lambert v. California*, 355 U.S. 225, 228 (1957). A clear *mens rea* requirement ensures "fair warning concerning conduct rendered illegal,"

because it prevents prosecutions for unwitting violations of legal norms. *Liparota v. United States*, 471 U.S. 419, 427 (1985); *see also Arthur Andersen LLP v. United States*, 544 U.S. 696, 703 (2005) ("[F]air 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."). Fair warning is particularly important here because the act underlying the conviction—trading on material nonpublic information received from analysts—is "by itself innocuous," *Arthur Andersen*, 544 U.S. at 703, given the *Dirks* Court's holding that trading on nonpublic information does not, without more, violate the law. *See also Liparota*, 471 U.S. at 427 (statute should be interpreted to require knowledge where contrary interpretation would "criminalize a broad range of apparently innocent conduct"); *X-Citement Video*, 513 U.S. at 72 (scienter should be required for each element that "criminalize[s] otherwise innocent conduct").

Indeed, the Supreme Court in *Dirks* emphasized the need for a clear rule to distinguish between lawful and unlawful trading on nonpublic information. As the Court explained, "[u]nless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed." 463 U.S. at 658 n.17. Moreover, the Court has held that the securities laws require "certainty and predictability." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*,

N.A., 511 U.S. 164, 188 (1994); *see also United States v. Chestman*, 947 F.2d 551, 567 (2d Cir. 1991) (emphasizing need for "predictability" in interpreting Rule 10b-5). Here, however, the District Court has adopted an interpretation under which traders' conduct can be rendered unlawful by facts unknown to them. "'Such a shifting and highly fact-oriented disposition of the issue of who may be liable . . . for violation of Rule 10b-5' is not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions.'" *Central Bank*, 511 U.S. at 188 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975) (alterations omitted)). As the *Dirks* Court explained, without clear legal limitations, "market participants are forced to rely on the reasonableness of the [government's] litigation strategy, but that can be hazardous." 463 U.S. at 664 n.24.

That is particularly true where, as here, the Government pursues traders who had no reason to know the circumstances surrounding the original disclosure of inside information, yet has declined to prosecute the original tippers who would obviously know of the alleged personal benefit they received. It is striking that the Government has not taken any action in this case to prosecute either of the insiders at Dell and NVIDIA who disclosed the inside information at issue. While the Government of course is free to exercise its prosecutorial discretion as it sees fit, the Government's failure to prosecute either of these individuals suggests that it

has real doubts about the criminality of their conduct and whether it warrants prosecution. But, as the Supreme Court held in *Dirks*, 463 U.S. at 659, the alleged criminality of the defendants here is completely dependent on the criminality of the initial tippers; if their conduct was not criminal, nor is the conduct of the defendants in this case.[4]

The clarity and predictability required by the securities law must be provided here by the requirement that remote tippees in the position of defendants must know that the original tipper of inside information did so in exchange for a personal benefit before criminal liability is permissible. By requiring knowledge of that personal benefit, a remote tippee can know the line between legal and illegal trading on material nonpublic information. In contrast, without a knowledge-of-personal-benefit requirement, neither a remote tippee without knowledge of the circumstances of the original tip nor his legal advisors has the ability to determine whether trading on the information received is illegal. In these circumstances, it would be profoundly unfair to permit the defendants to be convicted of a criminal offense for trading on inside information without proof that

[4] It is equally striking that the Government did not call either of the original tippers to testify in this case, since they would obviously have been the best source of information regarding the alleged personal benefits they obtained from their disclosures. Instead, the Government relied on highly attenuated theories of how the insiders allegedly benefitted from their disclosures. Again, the Government's litigation strategy suggests that there may be a real question whether the insiders, if they had testified, would have supported the Government's theory that they obtained any personal benefit in exchange for their disclosures.

they *knew* the information they were relying on was disclosed improperly for a personal benefit. There is far too great a danger that, absent this instruction, the law would be permitting prosecution of completely innocent conduct.

CONCLUSION

For the foregoing reasons, the defendants' convictions should be reversed.

Dated: August 22, 2013

Respectfully submitted,

By: /s/ Ira M. Feinberg

Ira M. Feinberg
Jordan L. Estes
Hagan Scotten
HOGAN LOVELLS US LLP
875 Third Avenue
New York, NY 10022
ira.feinberg@hoganlovells.com
jordan.estes@hoganlovells.com
hagan.scotten@hoganlovells.com
Tel: (212) 918-3000
Fax: (212) 918-3100

Joshua L. Dratel
Law Offices of Joshua L. Dratel, P.C.
29 Broadway
Suite 1412
New York, New York 10006
jdratel@joshuadratel.com
Tel: (212) 732-0707
Fax: (212) 571-3792
Co-Chair, *Amicus Curiae* Committee,
National Association of Criminal Defense Lawyers

Counsel for Amicus Curiae National Association of Criminal Defense Lawyers

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief complies with the type-volume limitations of Fed. R. App. P. 32(a) because it was produced using Times New Roman typeface in 14-point font and contains 6,102 words according to the word processing system utilized by my firm.

Dated: August 22, 2013

/s/ Ira M. Feinberg