No. 14-

IN THE

Supreme Court of the United States

DOUGLAS F. WHITMAN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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July 8, 2014

QUESTIONS PRESENTED

1. Whether, in a prosecution for insider trading under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), the relevant inside information must have been a "significant factor" in the defendant's decision to buy or sell, or whether—as the court below held—mere "knowing possession" of inside information suffices for a criminal conviction.

2. Whether, in a prosecution for insider trading under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), the "fiduciary duty" element must be proved under well-established principles of state law, or whether—as the court below held—courts may define and impose the applicable fiduciary duty as a matter of federal common law.

3. Whether exculpatory testimony given by a witness during a deposition in a closely related federal enforcement proceeding is admissible under Federal Rule of Evidence 804(b) in a subsequent criminal trial when the witness is unavailable, or whether—as the court below held—such testimony may be excluded merely because it was given in a civil rather than criminal proceeding.

PARTIES TO THE PROCEEDINGS

Petitioner, Douglas F. Whitman, was the defendant-appellant below.

Respondent, the United States of America, was the appellee below.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Douglas F. Whitman, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The Second Circuit's unpublished opinion is available at 2014 WL 628143, and is reproduced at Petition Appendix (Pet. App.) 1a. The district court's opinion is reported at 904 F. Supp. 2d 363 (S.D.N.Y. 2012), and is reproduced at Pet. App. 24a.

JURISDICTION

The Second Circuit entered its judgment on February 19, 2014, and denied a petition for rehearing en banc by order dated April 22, 2014. This Court has jurisdiction over this timely filed petition pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange … (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may

> prescribe as necessary or appropriate in the public interest or for the protection of investors.

Federal Rule of Evidence 804(b)(1) provides:

> The following are not excluded by the rule against hearsay if the declarant is unavailable as a witness: (1) Former Testimony. Testimony that: (A) was given as a witness at a trial, hearing, or lawful deposition, whether given during the current proceeding or a different one; and (B) is now offered against a party who had—or, in a civil case, whose predecessor in interest had—an opportunity and similar motive to develop it by direct, cross-, or redirect examination.

INTRODUCTION

This case presents three critical questions of federal securities and evidentiary law on which the circuits are deeply split. On each question, the Second Circuit has diverged from the holdings of all other circuits to consider the issue, as well as this Court's precedents, adopting a view particularly favorable to prosecutors. As a result, it has created a hollow version of the crime of securities fraud unique to that circuit, under which individuals may be convicted without proof that they intentionally traded on inside information, and indeed despite evidence showing to the contrary. Unless this Court resolves these splits, the Second Circuit will continue to be a haven for insider trading prosecutions, casting a shadow over the entire industry of research analysis, an industry this Court has recognized is "necessary to the preservation of a healthy market." *Dirks* v. *SEC*, 463 U.S. 646, 658 (1983).

First, the decision below deepens an existing conflict among the circuits as to whether the offense of

insider trading requires proof of causation. Four circuits have held, following the language of the federal securities statute and the traditional presumption in favor of causation, that to establish insider trading the government must prove not only that the defendant received inside information but also that the information was a causal or "significant factor" in a particular trading decision. *United States* v. *Anderson*, 533 F.3d 623, 630 (8th Cir. 2008); *SEC* v. *Lipson*, 278 F.3d 656, 660-61 (7th Cir. 2002); *United States* v. *Smith*, 155 F.3d 1051, 1066 (9th Cir. 1998); *SEC* v. *Adler*, 137 F.3d 1325, 1337-38 (11th Cir. 1998). The Second Circuit alone holds to the contrary that the government need not offer *any* evidence of causation, but may sustain its burden of proof merely by showing that the defendant "knowing[ly] possess[ed]" inside information regarding the relevant companies at the time of the trades. Pet. App. 15a. That holding, repeatedly reaffirmed by the Second Circuit (including here) despite its rejection by every other circuit to consider it, vastly expands the scope of the offense of insider trading, to cover wholly innocent conduct, and fundamentally transforms it into a type of strict liability crime. Nothing in the statutory language or this Court's opinions countenances such a result.

Second, the decision below diverges from opinions of other circuits, and of this Court, concerning the source of the "fiduciary duty" element of securities fraud. The First, Fourth, and Seventh Circuits have all held that courts must look to well-established principles of state corporate law to define the necessary fiduciary duty. *SEC* v. *Tambone*, 597 F.3d 436, 448 (1st Cir. 2010) (en banc); *Fortson* v. *Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469, 472 (4th Cir. 1992); *Jordan* v. *Duff & Phelps, Inc.*, 815 F.2d 429, 436 (7th Cir. 1987). The Second Circuit, howev-

er, holds that this duty should be crafted by federal courts as a matter of federal common law, without regard to state law. Pet. App. 15a. This holding is inconsistent with a long line of this Court's precedent admonishing that "where a gap in the federal securities laws must be bridged … federal courts should incorporate *state* law." *Kamen* v. *Kemper Fin. Servs., Inc.*, 500 U.S. 90, 108 (1991). It also renders the nature of the offense of securities fraud entirely uncertain and continually changeable, allowing as it does any court to decide within the context of any case that a fiduciary duty exists sufficient to support conviction, even if that duty is not imposed by the State in which the defendant conducts business.

Third, the Second Circuit's decision creates a direct conflict with the Seventh Circuit concerning the interpretation and application of Federal Rule of Evidence 804(b), which allows the introduction of prior testimony of an unavailable witness if the party against whom the testimony is now offered had "an opportunity and similar motive to develop" the testimony in the prior proceeding. Fed. R. Evid. 804(b)(1). The Seventh Circuit held in *United States* v. *Sklena*, 692 F.3d 725 (7th Cir. 2012), that this rule applies with full force in a criminal case, and that deposition testimony of a witness in a prior related action brought by the government—whether civil or criminal in nature—is admissible in a subsequent criminal trial if the witness becomes unavailable to testify. *Id.* at 731-32. The Second Circuit, by contrast, concluded in the decision below that such testimony was inadmissible merely because it was given in a civil rather than a criminal proceeding, notwithstanding that in both proceedings government attorneys were investigating the same underlying conduct. Pet. App. 6a-8a. That holding is flatly inconsistent with both the lan-

guage and purpose of Rule 804(b), and its effect may be—as it was in this case—to preclude the defense from introducing critical exculpatory testimony.

These three rulings together threaten a sea change in federal securities fraud prosecutions. They greatly expand prosecutorial power, making it possible to obtain convictions of anyone who executes a trade after securing what is later deemed to be inside information, even if the information played no role in the trading decision and even if the person who disclosed the information had no recognized duty to refrain from doing so. They also preclude defendants in these cases from using favorable—even plainly exculpatory—testimony from an unavailable witness merely because that testimony was given during a prior civil rather than criminal proceeding. Certiorari should be granted.

STATEMENT OF THE CASE

Petitioner is a research analyst who spent his career analyzing and investing in telecommunications and technology companies. See Pet. App. 24a. In 1994, he founded and thereafter ran a small technology-focused investment firm in California called Whitman Capital. In that role, he followed and traded in the securities of numerous technology companies, among them Marvell Technology Group (a semiconductor manufacturer), Polycom (a manufacturer of teleconferencing and videoconferencing equipment), and Google (the well-known internet company). See *id.*

To obtain and verify information about the companies in which he traded, petitioner—like other research analysts—regularly reached out to their managers and employees, as well as others associated with the company, including competitors and other

research analysts, to discuss corporate performance and expectations. These inquiries, known in the securities industry as "checks," are generally disliked (and even actively thwarted) by the managers of the target company, who for obvious reasons prefer to control the dissemination of the company's financial information; however, they are generally lawful and appropriate. *Dirks*, 463 U.S. at 658. These checks were a regular part of business at Whitman Capital since its founding, and were (insofar as the government's allegations disclosed) conducted lawfully and properly by petitioner for more than a decade.

In an indictment returned in 2012, however, the United States alleged that in 2006 petitioner changed course and entered into a conspiracy to obtain and trade upon "inside information" in violation of § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). See Pet. App. 1a. The government did not allege that petitioner had obtained any such information directly from insiders at the companies, but instead, asserted that he had received the information from others who had themselves improperly obtained it from relevant insiders. *Id.* at 24a. In particular, the government relied on the testimony of two cooperating witnesses who claimed to have passed inside information to petitioner: Roomy Khan, a neighbor and acquaintance with experience in securities trading, as well as Karl Motey, a technology consultant who provided independent research analysis. See *id.* at 11a.

1. A jury trial was held over several weeks in August 2012. Pet. App. 24a. Three rulings of the district court were critical to the course of trial and its outcome.

First, the district court instructed the jury that insider trading is established whenever the inside in-

formation is "at least a factor in [the] trading decision[s]." Pet. App. 15a. It rejected petitioner's objection that the government must show that inside information was a "significant factor" in his trades, as is required in other circuits. *Id.* at 15a-16a.

Second, the district court held that the fiduciary duty element of securities fraud is defined by federal common law. Pet. App. 33a. It specifically refused to apply the law of the relevant State, in this case California, where the companies involved had headquarters, the individuals involved lived and worked, and the tips allegedly took place. See*, e.g.*, *id.* at 32a-33a. Under California law, a fiduciary duty is not imposed upon all employees, but only upon those who are "endowed by the board of directors or the bylaws with discretionary power to manage corporate affairs." *E.g.*, *GAB Bus. Servs. Inc.* v. *Lindsey & Newsom Claim Servs., Inc.*, 83 Cal. App. 4th 409, 420 (2000), *disapproved on other grounds by Reeves* v. *Hanlon*, 33 Cal. 4th 1140 (2004). Nevertheless, based on its holding that the fiduciary duty element is independently defined as a matter of federal common law, the court instructed the jury that a fiduciary duty is "owed, so far as disclosure of market-sensitive information is concerned, by all employees to their employers and shareholders." Pet. App. 35a.

Third, the district court refused to admit crucial exculpatory testimony that petitioner sought to introduce. Pet. App. 6a-8a. The testimony was from an unavailable witness, Sunil Bhalla, an alleged insider at one of the relevant companies, who prosecutors claimed provided information about the company to Ms. Khan. *Id.* at 6a. He had previously testified under oath—in a deposition, which included direct questions about petitioner, conducted a year earlier by the SEC as part of a related civil insider-trading investi-

gation—that he did not have any knowledge of petitioner receiving inside information, did not discuss anything with Ms. Khan that was not already public, and did not give Ms. Khan any material nonpublic information. See *id.* at 6a. Notwithstanding that this testimony was directly relevant and critically important to petitioner's defense, the district court refused to admit it under Federal Rule of Evidence 804(b)(1), on the theory that the SEC's motive was investigatory, which in the court's view was unlike the U.S. Attorney's prosecutorial motive. *Id.* at 7a.

These rulings allowed—indeed, effectively required—the jury to convict petitioner despite the absence of evidence that he significantly relied on inside information in executing any trade or that the information had been disclosed in breach of a state-law fiduciary duty, and when the jury was denied an opportunity to hear testimony that directly contradicted the government's key witness. The exclusion of this testimony was especially damaging because Mr. Bhalla and other witnesses for the defense were unavailable to testify themselves, as a result of the government's threat of prosecution, and those witnesses that did appear were limited in their testimony as a result of the district court's orders.

The district court thereafter sentenced petitioner to 24 months in prison, as well as fines and other penalties. Pet. App. 2a.

2. The Second Circuit affirmed petitioner's conviction. Pet. App. 16a. On causation, the panel—acknowledging a disagreement with other circuits on the issue—held that the government is not required to prove *any* causal nexus between the inside information and the challenged trade, but need show only that the defendant was in "knowing possession" of inside information when the trade was executed. *Id.* at

15a-16a. On fiduciary duty, the panel concluded that the duty is "imposed and defined by federal common law," meaning that a breach may be found—sufficient to support conviction—even when (as here) the law of the relevant State imposed no such duty. *Id.* at 15a. On the admissibility of prior testimony given during related agency proceedings, the panel reasoned that such testimony should be precluded because government attorneys conducting a civil investigation do not have a "similar motive" to develop testimony as do those in a criminal case—even when both proceedings concern the same alleged misconduct. *Id.* at 6a-7a.

REASONS FOR GRANTING THE PETITION

The grounds for certiorari in this case are ample and compelling. On the issues of causation and fiduciary duty for insider trading and the admissibility of prior deposition testimony—which are critical in nearly every securities fraud prosecution across the country—the Second Circuit's holdings diverge dramatically from opinions of other circuits and of this Court. They also invite and indeed may require the conviction of individuals (like petitioner) for conduct that would not constitute a crime in other jurisdictions and without affording the defense an opportunity to present vital exculpatory testimony. Review is urgently needed to bring securities law in the Second Circuit into line with the law in other circuits, as well as this Court's precedents, and to address the serious concerns raised by the judgment below regarding prosecutorial over-reach and the guarantee of fundamental fairness to defendants in securities prosecutions.

I. THE SECOND CIRCUIT'S HOLDING THAT CAUSATION IS NOT AN ELEMENT OF INSIDER TRADING DEEPENS AN EXISTING CIRCUIT SPLIT ON THE ISSUE AND CONFLICTS WITH OPINIONS OF THIS COURT.

Certiorari should be granted, first, to review the holding below that there is no causation element for the offense of insider trading under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). That holding, unique to the Second Circuit, conflicts directly with opinions of other circuits, and it is contrary to both the text of the statute and this Court's precedents. *Infra* pp. 10-15. It has, moreover, rendered the Second Circuit a haven for securities prosecutions, allowing the government to secure convictions—like petitioner's—that could not have been obtained elsewhere due to a lack of proof that the alleged inside information was a motivating factor in the challenged trades. *Infra* pp. 15-17. To remedy this divide, and ensure that justice does not depend on geography, review is warranted.

1. There can be no doubt, and indeed courts have acknowledged, that the circuits are divided as to the causation standard for insider trading. Four circuits have held that an insider trading charge requires proof that the inside information was a causal factor in the defendant's decision to make the challenged trades. *Anderson*, 533 F.3d at 630; *Lipson*, 278 F.3d at 660-61; *Smith*, 155 F.3d at 1066; *Adler*, 137 F.3d at 1338. These courts recognize that proof of causation is mandated by the terms of the securities fraud statute itself. *E.g.*, *Lipson*, 278 F.3d at 660. The statute does not prohibit the mere receipt of inside information, or all trading in a security while in possession of relevant inside information, but rather precludes specifically the "use or employ" of "any manip-

ulative or deceptive device or contrivance" in securities trading. 15 U.S.C. § 78j(b). Accordingly, these courts have consistently held that "the government may not rest upon a demonstration that the suspected inside trader bought or sold while in possession of inside information; rather, it must, at a minimum, prove that the suspect used the information in formulating or consummating his trade." *Smith*, 155 F.3d at 1070 n.28; see *Anderson*, 533 F.3d at 630; *Lipson*, 278 F.3d at 660-61; *Adler*, 137 F.3d at 1338.

Two courts, the Ninth and Eleventh Circuits, have clarified further that in criminal prosecutions, beyond a mere "causal connection," the inside information must have been a "significant factor" in the decision to trade. *Anderson*, 533 F.3d at 630; *Smith*, 155 F.3d at 1070 n.28. This standard is appropriate, particularly in the criminal context, to ensure that only "intentional" or "willful" misconduct will lead to loss of liberty. *Anderson*, 533 F.3d at 630; *Smith*, 155 F.3d at 1070 n.28; cf. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 (1976) (the language of the securities fraud statute "connotes intentional or willful conduct designed to deceive or defraud investors").

The Second Circuit, by contrast, holds to the contrary that there is *no* causation element in an insider trading charge. *E.g.*, *United States* v. *Royer*, 549 F.3d 886, 899 (2d Cir. 2008). Rather, the prosecution may sustain its burden of proof merely by showing that the defendant "knowingly possessed" inside information regarding the relevant companies at the time of the trades. *Id.* This approach, which the Second Circuit has justified as "ha[ving] the attribute of simplicity," *United States* v. *Teicher*, 987 F.2d 112, 120 (2d Cir. 1993), has been reaffirmed by the court in a number of cases (including this one) in the face of repeated challenge and notwithstanding extensive crit-

ical commentary. See generally, *e.g.,* Carol B. Swanson, *Insider Trading Madness: Rule 10b5-1 and the Death of Scienter*, 52 U. Kan. L. Rev. 147, 205 (2003); David W. Jolly, Note, *Knowing Possession vs. Actual Use: Due Process & Social Costs in Civil Insider Trading Actions*, 8 Geo. Mason L. Rev. 233 (1999); Allan Horwich, *Possession Versus Use: Is There a Causation Element in the Prohibition on Insider Trading?*, 52 Bus. Law. 1235 (1997).

The split between the circuits on this issue is thus entrenched and deep. That split has indeed been acknowledged by both the Second Circuit, *Royer*, 549 F.3d at 899, and other courts that have addressed the issue—which have explicitly considered and rejected the Second Circuit's holding, *Lipson*, 278 F.3d at 660-61; *Smith*, 155 F.3d at 1070 n.28; *Adler*, 137 F.3d at 1338. It is now time for this Court to resolve this conflict, and state definitively what standard of causation applies in insider trading prosecutions.

2. Review would, however, be warranted even absent a circuit split. That is because the Second Circuit's holding, that no proof of causation is required to establish insider trading, is plainly inconsistent with opinions of this Court discussing the nature of securities fraud and outlining the elements of that offense under federal law.

Those opinions, including the seminal decision in *Dirks* v. *SEC*, 463 U.S. 646 (1983), squarely reject the proposition that mere possession of inside information is sufficient to prove securities fraud. See *id.* at 559-60; see also *United States* v. *O'Hagan*, 521 U.S. 642, 656 (1997); *Chiarella* v. *United States*, 445 U.S. 222, 227 (1980). They instead interpret the language of the securities statute—which prohibits the "use or employ" of a "manipulative or deceptive device" in securities trades, 15 U.S.C. § 78j(b)—as re-

quiring proof that the defendant both received inside information *and* intentionally employed that information in making a trade. See, *e.g.*, *Dirks*, 463 U.S. at 659-60. While the precise formulations of this requirement differ among the cases—the defendant must "exploit[ ]" the information, *id.*, "take advantage" of it, *Chiarella*, 445 U.S. at 227, or simply "use[ ]" it, *O'Hagan*, 521 U.S. at 656—they all require that the information play a causal, motivating role in a trading decision before a violation will be found.

This principle is consistent with a long line of decisions addressing securities fraud under the common law. Those decisions, which have informed this Court's interpretation of the federal securities statute, see, *e.g.*, *Dirks*, 463 U.S. at 653-54, recognize that because these claims target intentional misconduct—*i.e.*, affirmative deception designed to take advantage of another—the traditional presumption in favor of a causation element applies. See Horwich, *supra*, at 1242-48 (citing cases). In the insider trading context, this means that the inside information must have been not only knowingly obtained but also affirmatively misused to gain a profit. *Id.*; see also *Chiarella*, 445 U.S. at 234-35 (although § 10(b) "is aptly described as a catchall provision," "what it catches must be fraud"); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 473 (1977) (the "language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception").

The Second Circuit's holding runs counter to these opinions. The "knowing possession" rule expands the statute to cover situations where a person has received inside information but has no intention of exploiting it to gain an unfair advantage over other shareholders, and "go[es] a long way toward making

insider trading a strict liability crime," *Smith*, 155 F.3d at 1068 & n.25—contrary to both this Court's admonitions and the history of the securities statute. Indeed, by effectively eliminating the causation element of insider trading, the Second Circuit has in essence returned to the mere possession or "information" theory of insider trading that this Court has specifically rejected. See *Dirks*, 463 U.S. at 657 (citing *Chiarella*, 445 U.S. at 235 n.20); see also Swanson, *supra*, at 207.

The Second Circuit has suggested that its standard is justified by the "oft-quoted maxim," stated in *Chiarella*, 445 U.S. at 227, that "one with a fiduciary or similar duty to hold material nonpublic information in confidence must either 'disclose or abstain' with regard to trading." *Teicher*, 987 F.2d at 120. However, as other courts have recognized, *Chiarella*'s credo does not mean that a person who receives inside information must "disclose or abstain" from *all* trading; it instead prohibits trading "*on the basis of material nonpublic information*." *Smith*, 155 F.3d at 1069 (emphasis omitted). The Second Circuit has also said that the "knowing possession" standard "has the attribute of simplicity," and that "as a matter of policy" requiring proof of causation could "frustrate" attempts at prosecution. 987 F.2d at 120-21. But a desire for simplicity and ease of prosecution does not justify reading elements out of the statute. To the contrary, doubts about the reach of a criminal statute should be resolved, not in favor of simplifying the prosecutor's job, but "in favor of the defendant." *Adamo Wrecking Co.* v. *United States*, 434 U.S. 275, 285 (1978).[1]

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[1] In any event, no evidence suggests that the causation or "significant factor" test has proven difficult to administer in the circuits that have adopted it. *See Smith*, 155 F.3d at 1069.

There is, in short, simply no way to reconcile the Second Circuit's approach with this Court's precedent. Certiorari should be granted to address the issue and correct that circuit's mistaken interpretation of federal securities law.

3. Review is all the more appropriate in light of the critical importance of this issue. Whether the defendant relied upon the inside information in a trading decision is nearly always in dispute in insider trading cases, see, *e.g.*, *Smith*, 155 F.3d at 1069-70, and the standard for causation will thus inevitably be relevant in each of the many securities prosecutions commenced every year. The issue will in many cases be potentially dispositive. It certainly was here: given the dearth of evidence that petitioner relied upon the alleged inside information in making any of the challenged trades, he likely would have been acquitted had the jury been instructed (as petitioner requested) that it would need to find that the inside information was a "significant factor" in his trades. See Pet. App. 15a-16a. Particularly in the electronic age, when a research analyst now receives from a wide range of sources a constant stream of (often unsolicited) information—some of which will be correct and meaningful but much of which will be unverifiable or simply wrong and ignored—a causation standard is essential to distinguish between criminal and innocent conduct.

This case indeed serves as a perfect example of the direct and immensely damaging consequence of the Second Circuit's position. Under that view, a defendant may be convicted of insider trading, and sentenced to years of imprisonment, merely because he or she happened to receive what may be inside information about a company in which the defendant was trading, regardless of whether the defendant relied

on the information, recognized its relevance, or even viewed it as accurate. *Royer*, 549 F.3d at 899. In no other jurisdiction across the country would a defendant be subject to conviction in this situation. Yet, in the Second Circuit, defendants can be and are convicted in such circumstances. *Id.*; see also Pet. App. 15a-16a.

It is all but certain that, given its uniquely lax (effectively non-existent) causation standard, the Second Circuit will become a haven for federal securities fraud prosecutions. This indeed appears to be occurring. In reported cases from 2009 through 2013, district courts within the Second Circuit hosted 68% of all criminal prosecutions for insider trading, and 46% of all SEC civil enforcement actions. See *Insider Trading*, Appendices (2009, 2010, 2011, 2012, 2013) (annual reviews). Many of these cases—including this one—involve companies and conduct entirely outside of the Second Circuit, and were presumably filed in that circuit only because of the extremely favorable state of the law for prosecutors. Notably, had this case been tried (as petitioner requested) in the Ninth Circuit, where all of the relevant companies and individuals were based or resided, and where all of the relevant conduct occurred, the "significant factor" causation standard of that circuit would have applied, and petitioner would likely have been acquitted.

The U.S. Attorney for the Southern District of New York in fact recently heralded "80 insider trading convictions without a single defeat." Ben Protess & Matthew Goldstein, *Appeals Judges Hint at Doubts in Insider Case*, N.Y. Times, Apr. 23, 2014, at A1. Both the number of securities cases brought in the Second Circuit and the government's remarkable conviction rate are, no doubt, attributable in large

part to the Second Circuit's unique rejection of a causation requirement.

This trend has created an especially untenable situation for research analysts, like petitioner. Particularly since the market downturn of 2008, such professional analysts are increasingly targets for prosecution in the Second Circuit. As this Court recognized in *Dirks*, limiting the reach of § 10(b) to intentional fraud is crucial to avoid an "inhibiting influence on the role of market analysts," whose jobs necessarily entail seeking out information on securities, including "by meeting with and questioning corporate officers and others who are insiders." 463 U.S. at 658. Indeed, in order to do their jobs, professional research analysts must seek out large volumes of information about securities from a multitude of sources, of varying degrees of reliability and of uncertain origin, making it extremely difficult to avoid entirely exposure to information that may have originated from an inside source—exposure that may now, under the Second Circuit's rule, subject them to criminal prosecution even if they did not rely on the information in making any trade. By effectively removing the causation and scienter elements of insider trading and criminalizing the mere knowing possession of inside information by market participants, the Second Circuit has cast a shadow over the entire industry of research analysis, an industry that this Court has said "is necessary to the preservation of a healthy market." *Id.*

* * * * *

In sum, the Second Circuit's causation holding sharply conflicts with every other circuit to have addressed the issue, conflicts with the statute and this Court's precedent, and threatens serious detrimental consequences to the law of insider trading. Those

conflicts, and the risks they present, can and should be resolved by this Court.[2]

II. THE SECOND CIRCUIT'S HOLDING THAT THE FIDUCIARY DUTY ELEMENT OF INSIDER TRADING IS DEFINED BY FEDERAL COMMON LAW, RATHER THAN STATE LAW, WIDENS A CIRCUIT SPLIT ON THE ISSUE AND CONFLICTS WITH OPINIONS OF THIS COURT.

A second question presented by this case, whether the fiduciary duty element of securities fraud is defined by existing state law or should be crafted *ad hoc* as a matter of federal common law, similarly warrants review. That issue has divided the circuits, and the Second Circuit's position—holding, unlike all other circuits, that federal common law governs—is patently inconsistent with precedent from this Court. *Infra* pp. 18-22. As importantly, the Second Circuit's approach raises fundamental concerns of federalism, fair notice, and due process that should be addressed by this Court. *Infra* pp. 22-25.

1. There is a clear circuit split concerning the fiduciary duty element of securities fraud. Several

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[2] That the SEC has adopted a rule stating that a trade will be considered "on the basis of" inside information if the defendant "was aware of the material nonpublic information" at the time of the transaction, Rule 10b5-1, 17 C.F.R. § 240.10b5-1, does nothing to lessen the need for this Court's review. For one thing, the circuit split on the causation issue has continued to persist after that rule was adopted. *See, e.g.*, *SEC* v. *Ginsburg*, 362 F.3d 1292, 1297-98 (11th Cir. 2004); *Anderson*, 533 F.3d at 630. Further, to the extent the SEC's rule may be viewed as endorsing the "knowing possession" standard, it is entitled to no deference—particularly in a criminal case—because it is contrary to the statutory text and decisions of this Court. *See, e.g.*, *Anderson*, 533 F.3d at 630.

courts of appeals, including the First, Fourth, and Seventh Circuits, have held that in deciding whether a fiduciary duty exists, such that the use or disclosure of nonpublic company information may be deemed illegal under the federal securities statute, courts should look to the law of the relevant state. *Tambone*, 597 F.3d at 448; *Fortson*, 961 F.2d at 472; *Jordan*, 815 F.2d at 436. These courts reason that, because neither the securities fraud statute nor the implementing regulations define when the fiduciary duty arises, it "must come from a fiduciary relation outside securities law." *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986). In other words, it must be "based on state law." *Jordan*, 815 F.2d at 436.

By contrast, the Second Circuit—again, only the Second Circuit—holds that the fiduciary duty "is imposed and defined by federal common law." Pet. App. 15a. That duty is, in the Second Circuit's view, to be created by courts on a case-by-case basis, guided but not limited by decisions of other courts, including those addressing fiduciary duty under state law. See *Steginsky* v. *Xcelera, Inc.*, 741 F.3d 365, 371 (2d Cir. 2014); see also Pet. App. 15a. Indeed, under this approach, a fiduciary duty could be found to exist even in circumstances where (as in this case) applicable state law affirmatively holds that *no* such duty may be recognized. See *id.* at 32a.

Two other circuits take yet another, hybrid view. Rejecting both approaches discussed above, the Eighth and Tenth Circuits hold that "[f]iduciary relationships and their concomitant duty to disclose may be established by state *or* federal law." *Camp* v. *Dema*, 948 F.2d 455, 460 (8th Cir. 1991) (emphasis added); see also *SEC* v. *Cochran*, 214 F.3d 1261, 1264 (10th Cir. 2000). While it is somewhat unclear from

these opinions which law is to be applied in any given case, they seem to contemplate that state law will govern unless a separate federal statute or regulation is applicable and creates a fiduciary-like duty, see, *e.g.*, *Camp*, 948 F.2d at 460—thereby avoiding the need (as under the Second Circuit's holding) for courts to engage in federal common lawmaking.

The split among the circuits is thus clear and deep. While these cases concern different versions of the offense of securities fraud, they all address the same fiduciary duty element under the same federal statute, and they reach diametrically opposed conclusions regarding it—with the Second Circuit alone holding that in all cases federal common law defines and imposes that duty. Pet. App. 15a; see also *SEC* v. *Sargent*, 229 F.3d 68, 76 (1st Cir. 2000) (incorporating state law to define the fiduciary duty element of an insider trading charge).

2. It should be no surprise that the Second Circuit's approach diverges from other circuits, as that approach blatantly conflicts with this Court's precedent. It has been clear at least since *Erie Railroad* v. *Tompkins*, 304 U.S. 64 (1938), that "[f]ederal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision." *City of Milwaukee* v. *Illinois*, 451 U.S. 304, 312 (1981). Under the Constitution, "the federal lawmaking power is vested in the legislative, not the judicial, branch of government." *Nw. Airlines, Inc.* v. *Transport Workers Union of Am.*, *AFL-CIO*, 451 U.S. 77, 95 (1981). Therefore, as this Court has repeatedly said, the circumstances calling for "judicial creation of a special federal rule" are "few and restricted." *O'Melveny & Myers* v. *FDIC*, 512 U.S. 79, 87 (1994) (quoting *Wheeldin* v. *Wheeler*, 373 U.S. 647, 651 (1963)). Only

when there is a "significant conflict between some federal policy or interest and the use of state law" is the creation of federal common law rules justified. *Wallis* v. *Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966); see also *Boyle* v. *United Techs. Corp.*, 487 U.S. 500, 507-08 (1988).

This rule bears particular force for the law of corporate fiduciary duties, because "[c]orporations are creatures of state law, and … state law … govern[s] the internal affairs of the corporation." *Santa Fe*, 430 U.S. at 479. While "in certain areas … federal statutes authorize the federal courts to fashion a complete body of federal law," "[c]orporation law … is *not* such an area." *Burks* v. *Lasker*, 441 U.S. 471, 477 (1979) (emphasis added). In particular, this Court has explained that, "where a gap in the federal securities laws must be bridged by a rule that bears on the ... powers within the corporation, federal courts should incorporate *state* law." *Kamen*, 500 U.S. at 108. These decisions confirm that "State law is the 'font' of corporate fiduciary duties." Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 Wash. & Lee L. Rev. 1189, 1261 (1995).

Notwithstanding these decisions, the Second Circuit has stated that resort to federal common law is appropriate in its view because "insider trading cases ... have implicitly assumed that the relevant duty springs from federal law" and "looking to idiosyncratic differences in state law would thwart the goal of promoting national uniformity in securities markets." *Steginsky*, 741 F.3d at 371. Neither point withstands scrutiny. Far from implicitly assuming that the applicable fiduciary duty is defined as a matter of federal common law, this Court's precedents implicitly reject that very position, instructing courts instead to

fill the interstices of federal securities laws by incorporating state corporate law. *Kamen*, 500 U.S. at 108. And this Court has specifically and repeatedly characterized uniformity of federal law—"that most generic (and lightly invoked) of alleged federal interests"—as insufficient to authorize the creation of independent federal common law. *O'Melveny*, 512 U.S. at 88.

The Second Circuit's decision, quite simply, cannot be reconciled with this Court's precedent. Certiorari should be granted to address this conflict, and correct the Second Circuit's badly misguided view of federal common law and the fiduciary duty element of securities fraud.

3. The need for review is underscored, and rendered even more urgent, by the exceptional importance of this issue. The Second Circuit's holding implicates serious constitutional concerns regarding federalism, separation of powers, and the due process rights of defendants.

It has long been recognized, as a core component of federalism in our constitutional structure of government, that States hold principal and often exclusive authority to regulate the affairs of corporations that are formed under their laws. See, *e.g.*, *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 161 (2008). The rule that federal courts are to apply the law of the States when addressing such matters, even when a federal statute otherwise governs, is a crucial check against federal encroachment into these traditional areas of state control. See *id.*; see also Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 Vand. L. Rev. 859 (2003). Particularly with respect to issues concerning the relationship between corporations and their employees

and shareholders, and the duties owed by each party to others, federal courts must be especially "reluctant" to intrude, given the risk of "federaliz[ing] ... the law of corporations." *Santa Fe*, 430 U.S. at 478-79.

The decision below infringes directly on this principle. It would allow a federal court to effectively displace state law and define when and whether a "fiduciary duty" arises. Pet. App. 15a. A court could, indeed, hold that a fiduciary duty exists even when the governing law of the relevant State declares unequivocally that it does not. See *id.* at 32a-33a. It is difficult to imagine a more direct assault on the authority of States to manage their corporations' affairs, or a clearer violation of "our Federalism." *Younger* v. *Harris*, 401 U.S. 37, 44 (1971).

The Second Circuit's holding also does serious violence to "clarity and certainty in the criminal law." *Burrage* v. *United States*, 134 S. Ct. 881, 891 (2014). "State corporate law, evolved over decades and frequently codified in state statutes, is well developed and easily discovered and applied," *Anspec Co.* v. *Johnson Controls, Inc.*, 922 F.2d 1240, 1250 (6th Cir. 1991) (Kennedy, J., concurring), and thus places clear limits on the scope of potential liability under federal securities law. On the other hand, neither the securities fraud statute nor the implementing regulations define the scope of the fiduciary duty, or the situations in which it arises, and there is no well-developed federal common law of fiduciary duties. Holding that federal courts need not look to state law therefore gives broad power to the federal judiciary to define and impose novel duties with little limit, including in criminal prosecutions.

This raises, in turn, troubling due process concerns. Under the Second Circuit's decision, an individual

could be found to have breached a fiduciary duty—supporting a securities fraud conviction—even if that duty had never previously been recognized and even if the individual had no reason to expect that it would. Pet. App. 15a; see *id.* at 32a-33a. There would simply be no way in this circumstance for a person to know in advance, with any certainty, whether or not he or she owes a duty of confidentiality to a company or whether the use or disclosure of corporate information may expose him or her to criminal liability. Only through the course of *post hoc* adjudication of a securities fraud charge can individuals know the standard that governed their conduct, and if that conduct is deemed a crime.

This is flatly inconsistent with constitutional due process. "A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC* v. *Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012). Federal courts that seize power to create common law fiduciary duties—and thus define the contours of criminal law—trample the notion that due process requires clarity in the law. The Second Circuit's decision creates an intolerable level of uncertainty for a criminal statute, and fails to "give fair warning of the conduct" that it makes a crime. *Bouie* v. *City of Columbia*, 378 U.S. 347, 350 (1964).

These concerns are exemplified by this case. There is no doubt that, under the applicable state law of California, alleged "insiders" in this case could not have been found to owe a fiduciary duty or to have breached such a duty by disclosing the information.

See Pet. App. 32a.[3] Petitioner therefore had no reason to think at the time of the alleged offense, even assuming (contrary to the evidence) that he knew that the information he received was nonpublic and disclosed without authorization by those individuals, that the disclosure was illegal or that he may be precluded from trading in the relevant securities. To nevertheless hold at trial that such a duty existed, and that petitioner violated federal securities law by executing trades after receiving the information, is to convict him of conduct that did not constitute a crime when committed. Due process flatly forbids that result.

* * *

The Second Circuit's fiduciary duty holding plainly conflicts with decisions of other circuits, contravenes this Court's binding precedent, presents troubling federalism and due process concerns, and adds unnecessary and intolerable uncertainty to insider trading prosecutions. This issue warrants review.

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[3] Although the government has suggested that another jurisdiction's law might apply, or that some of the alleged insiders might be deemed "fiduciaries" even under California law, the district court found the government failed to raise claims concerning other law. *See* Pet. App. 32a n.3. In addition, the court of appeals never suggested, despite the government's arguments, that the application of federal common law rather than California law might be deemed non-prejudicial or harmless. *Id.* at 15a.

III. THE SECOND CIRCUIT'S HOLDING THAT PRIOR TESTIMONY OF AN UNAVAILABLE DEFENSE WITNESS IS INADMISSIBLE IN A CRIMINAL CASE, WHEN THAT TESTIMONY WAS GIVEN IN A RELATED CIVIL PROCEEDING, CREATES A CIRCUIT SPLIT ON THE ISSUE AND CONFLICTS WITH FEDERAL RULE OF EVIDENCE 804(b)(1).

Compounding the problems created by these rulings on securities law, and further justifying review, is the Second Circuit's interpretation of Federal Rule of Evidence 804(b)(1). That interpretation, which would preclude a defendant from introducing testimony from an unavailable witness if that testimony was given in a civil rather than criminal proceeding, conflicts directly with the holding of at least one other circuit, as well as the language and spirit of the rule. *Infra* pp. 26-29. It would also have disastrous consequences for criminal defendants in the Second Circuit—as it did for petitioner—by denying them an opportunity to present testimony in their defense, even when (as here) the testimony is critically relevant and plainly exculpatory. *Infra* pp. 29-31.

1. The decision below clearly conflicts with the holding of the Seventh Circuit in *United States* v. *Sklena*, 692 F.3d 725 (7th Cir. 2012). In *Sklena*, the Seventh Circuit ruled that prior testimony of a witness in a related administrative proceeding is admissible against the government in a subsequent criminal proceeding under Rule 804(b) when the witness is unavailable during trial. *Id.* at 731-32. The mere fact that one proceeding is criminal and the other civil, the court explained, does not mean that government attorneys in the two proceedings have different motivations, and thus cannot support exclusion of the

testimony under the rule. *Id.* Whatever differences may otherwise exist between civil and criminal proceedings, when they are both directed towards "investigating the same underlying conduct with an eye to taking enforcement action," the attorneys in both plainly have a "similar motive" to examine the defendant, rendering the testimony admissible against the government in a subsequent trial if the witness is unavailable. *Id.*

The Second Circuit, however, concluded to the contrary in the decision below. It held that testimony from a prior SEC deposition of Sunil Bhalla, taken as part of a civil investigation of the same conduct at issue in the criminal proceedings, was inadmissible because it "was taken with an investigatory motive that differed from the adversarial motive that would be present at trial," and the SEC attorney did not engage in extensive cross-examination. Pet. App. 7a. The Second Circuit reached this conclusion notwithstanding the fact that the SEC and prosecutors worked in tandem during the civil and criminal proceedings, and that SEC attorneys specifically asked Mr. Bhalla during the deposition about the conduct at issue in the criminal case. Doc. 97, at 3-4, No. 12-cr-125 (S.D.N.Y. filed Aug. 13, 2012). In other words, notwithstanding that the attorneys in both proceedings were "investigating the same underlying conduct with an eye to taking enforcement action," and "needed to prove the same allegations," *Sklena*, 692 F.3d at 731-32, the court in this case deemed the deposition testimony inadmissible because it was given in a civil rather than a criminal proceeding.

The Second Circuit did not attempt to distinguish *Sklena*, and indeed did not even mention the Seventh Circuit's opinion. For good reason: *Sklena* cannot be distinguished. The Second and Seventh Circuits are

clearly split over the interpretation of Rule 804(b), which warrants review by this Court.

2. The Second Circuit's holding, moreover, contravenes the text of Rule 804(b). That rule provides that prior deposition testimony from an unavailable witness is admissible when "offered against a party who had … an opportunity and *similar* motive to develop it." Fed. R. Evid. 804(b)(1) (emphasis added). This language does not require that a party had the *same* motive and opportunity to examine the witness; it requires only that the party had a "similar" motive. 30C Michael H. Graham, *Federal Practice and Procedure* § 7073 (interim ed. 2011).

That standard is plainly satisfied where, as here, in both cases federal officials are investigating precisely the same conduct and have the same underlying law-enforcement objective because they are addressing the legality of that conduct with the same witness. See *id.* ("Generally speaking, a similar motive would have existed at the prior hearing when the issue at the prior hearing and at the current hearing are substantially similar."). Merely because one proceeding was civil in nature and one was criminal does not alter the fact that the United States shares in both cases the same objective of enforcing the federal securities laws. *Id.*; cf. *id.* ("[A] decision by counsel not to cross-examine at any prior hearing or to do so only to a limited extent, no matter how much practical sense the decision makes, does not appear to affect [admissibility under Rule 804(b)].").

The Second Circuit's holding plainly requires something more than the "similar" motive demanded by the rule. After all, an administrative enforcement proceeding is as close to a criminal prosecution as one can get without an indictment. If cross-examination during an SEC enforcement proceeding that is paral-

lel to a criminal prosecution does not satisfy the "similar motive" requirement, it is difficult to see what would, other than an identical proceeding. The effect of this approach is that the only admissible prior testimony would come from a criminal case, which would effectively change the text of Rule 804(b)(1), and its consistent interpretation by courts and commentators. See *id.* The Second Circuit's position clearly cannot be accepted.

3. This issue is, moreover, of vital importance in criminal cases. In investigating alleged insider trading, the SEC often works in tandem with the U.S. Attorney's office to conduct related civil and criminal enforcement actions. See Randy S. Eckers, Note, *Unjust Justice in Parallel Proceedings: Preventing Circumvention of Criminal Discovery Rules*, 27 Hofstra L. Rev. 109 (1998); Kathleen M. Graber et al., *Securities Fraud*, 30 Am. Crim. L. Rev. 909, 957 (1993). Other agencies use the same dual enforcement mechanism, developing evidence in civil enforcement proceedings while the U.S. Attorney aims at criminal prosecution. See generally, Natalie M. Duval, Note, *Towards Fair and Effective Environmental Enforcement: Coordinating Investigations and Information Exchange in Parallel Proceedings*, 16 Harv. Envtl. L. Rev. 535 (1992).

Yet, under the Second Circuit's rule, any testimony given in these proceedings—even if directly exculpatory—could be excluded in a subsequent criminal proceeding. Prosecutors could rely on agency officials to conduct initial fact-finding and deposition of potential witnesses, and through that process could identify those who might offer testimony favorable to the defense. Those witnesses could then be denied immunity to testify at the criminal defendant's trial. This would essentially ensure that the witnesses' tes-

timony would not be available to the defense, as the witnesses would invariably (and properly) invoke their privilege against self-incrimination and, under the Second Circuit's holding, their prior deposition statements would be inadmissible. See Pet. App. 7a-8a.

This case demonstrates these risks in stark relief. The SEC worked in tandem with the U.S. Attorney's Office to conduct parallel enforcement actions against petitioner and others, including Mr. Bhalla. See Pet. App. 6a-8a. In fact, one of the prosecutors who presented evidence to petitioner's grand jury was an SEC staff attorney who had previously worked on related SEC proceedings. Doc. 97, at 3, No. 12-cr-125 (S.D.N.Y. filed Aug. 13, 2012). As part of these parallel proceedings, the SEC deposed Mr. Bhalla, who testified—consistent with petitioner's account, but contrary to that of the prosecution's key witness at trial, Ms. Khan—that he had never shared relevant inside information with Ms. Khan and had no knowledge of inside information being provided to petitioner. Pet. App. 6a-7a. At trial, the government was able and allowed to present Ms. Khan's account in full, after agreeing to a plea arrangement with her. See *id.* at 7a-12a. It did not, however, reach an agreement with Mr. Bhalla and (despite defense requests) refused to grant him even limited immunity to allow him to testify at trial; as a result, in light of Mr. Bhalla's invocation of the privilege against self-incrimination, he could not be called as a witness at trial. *Id.* at 6a-7a.

The *only* way petitioner could have presented Mr. Bhalla's account to the jury—which flatly contradicted Ms. Khan's testimony for the government—was through introduction of the prior deposition testimony. He was, however, denied his right to do so as a

result of the holding below that Rule 804(b) does not allow such testimony when it was given in a prior civil proceeding. Pet. App. 7a. That holding is not only inconsistent with the Rule's language, as discussed above, but effectively prevented petitioner from making his case to the jury. Mr. Bhalla's testimony would have directly contradicted the key government witness's assertion that petitioner received inside information and, if accepted by the jury, could have supported complete acquittal.

With the government's systematic use of parallel civil and criminal enforcement, the issue of prior exculpatory testimony obtained during civil enforcement proceedings will be a recurring issue. This Court should resolve this issue now to ensure that defendants in these circumstances are not deprived of crucial exculpatory evidence and prevented from receiving a fair trial.

* * *

The Second Circuit's prior testimony ruling blatantly conflicts with the rule in the Seventh Circuit, runs afoul of the text and plain intent of Rule 804(b)(1), and unfairly prevents defendants from presenting crucial evidence. This issue, like the others presented in this case, warrants review.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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July 8, 2014

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS,
SECOND CIRCUIT

No. 13-491-cr

UNITED STATES OF AMERICA,
Appellee,

v.

DOUG WHITMAN,
Defendant-Appellant.

Appeal from the United States District Court
for the Southern District of New York
(Jed S. Rakoff, *Judge*)

Feb. 19, 2014

SUMMARY ORDER

Present JON O. NEWMAN, PETER W. HALL and GERARD E. LYNCH, *Circuit Judges*.

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the district court is AFFIRMED.

Defendant-appellant Doug Whitman appeals from a January 29, 2013 judgment of the district court convicting him of two counts of conspiracy to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) & 78ff, and 17 C.F.R. § 240.10b-5, and two counts of

securities fraud in violation of those same sections. The court sentenced Whitman to twenty-four months' imprisonment on each count (all to run concurrently), one year of supervised release, and a $250,000 fine. We assume the parties' familiarity with the facts and procedural history of this case, which we summarize only so far as is necessary to understand our rulings.

Whitman challenges his convictions by means of a series of objections to the district court's evidentiary rulings and jury instructions. Because all the challenged rulings were correct or did not prejudice the defendant, the judgment of the district court is affirmed.

I. Evidentiary Rulings

Whitman challenges the district court's exclusion of three types of testimony: portions of experts' opinions, an unavailable witness's prior sworn testimony, and a corroborating witness's impression of Whitman's state of mind. "We review a district court's ruling to admit or exclude evidence under a deferential abuse of discretion standard." *United States v. Bell*, 584 F.3d 478, 486 (2d Cir. 2009) (internal quotation marks omitted). A district court's decision will stand unless "manifestly erroneous," *Phoenix Assocs. III v. Stone*, 60 F.3d 95, 100 (2d Cir. 1995), and any error is harmless unless the mistake prejudiced the outcome of the trial, *see Phillips v. Bowen*, 278 F.3d 103, 111 (2d Cir. 2002).

A. Expert Testimony

District courts may admit expert testimony where "scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue." Fed.R.Evid. 702(a). A district court acts as a "gatekeep[er]" to separate

sound analysis from sophistry, "mak[ing] certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 152, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999). In assessing reliability, "the district court should consider the indicia of reliability identified in Rule 702, namely, (1) that the testimony is grounded on sufficient facts or data; (2) that the testimony is the product of reliable principles and methods; and (3) that the witness has applied the principles and methods reliably to the facts of the case." *Amorgianos v. Nat'l R.R. Passenger Corp.*, 303 F.3d 256, 265 (2d Cir. 2002) (internal citation and quotation marks omitted).

Whitman proffered two experts in this case—George Kelly, a Wall Street analyst tasked with decoding industry jargon and describing investment analysts' research methods, and Michael Mayer, a financial consultant who had analyzed patterns in Whitman's past trades. After hearing extensive argument from the government and the defense, the district court narrowed the scope of both experts' testimony. Whitman challenges these restrictions as unreasonable. But the district court acted well within its discretion, making fair judgments about the quality of each expert's methods and the reliability of their analyses.

The district court allowed Kelly to give the jury a primer on how hedge funds gather information about investment targets, or, in the words of defense counsel, on the "relationship between the analyst and the investment community." J. App'x at 609. The court reasonably declined to permit Kelly to extrapolate

specific conclusions about Whitman's actions from this general knowledge about common strategies. The court also prevented Kelly from opining about Whitman's and his alleged co-conspirators' use of slang words like "mole" and colloquial phrases like "getting an edge." J. App'x at 745. The court reasoned that the jury could use common sense to unpack a double entendre, particularly where fact witnesses would testify about what they intended to convey, or their understanding of the meaning of messages they received. Both limits stemmed from the same reasonable conclusion—that despite his long experience on Wall Street, Kelly did not have "sufficient facts or data" to opine about the specific events in this case. Fed.R.Evid. 702(b).

The district court also prevented Mayer from making similar logical leaps. After analyzing "[s]even thousands lines of data," each entry capturing a trade Whitman made over the course of eleven years, Mayer purported to compare the trades challenged by the government—a sizable purchase of Polycom stocks just before a bullish earnings report, an aggressive short on Google shares days before a disappointing quarterly call, and sales of Marvell stock when the company appeared healthy to other observers—to Whitman's past investment choices. Mayer proffered his opinion that the challenged trades were similar to a handful of past trades that the government did not claim resulted from an inside tip.

The district court reasonably concluded that Mayer lacked a sufficient basis to jump from modest similarities between trades to a conclusion that the allegedly illegal trades resulted from sound research rather than inside information. Mayer himself admitted that "out of all those thousands of trades," he identified "ten

or fewer that were comparable," and that he had not "appl[ied] a statistical test" to determine whether the similarities were statistically significant. J. App'x at 1372. Nor had Mayer used any objective methods to chose parameters to identify comparable trades. Mayer acknowledged that he simply made a "judgment" that setting an outer time limit of 30 days before an earnings report would capture similar trades because that is when similar trades occur. J. App'x at 1376. We cannot fault the judge's reasonable conclusion that Mayer's logic was circular and "ad hoc." J. App'x at 1379.

The district court thus reasonably allowed Mayer to describe the Polycomm and Marvel trades as comparable to other trades, but did not allow him to opine that they were therefore not the result of inside information. In the case of the Google short, the district court prohibited Mayer from opining about the trade, concluding that the jury could make the relevant comparisons without expert aid. In proffered testimony that defense counsel acknowledged did not "involve expertise," J. App'x at 1367, Mayer proposed to repeat the simple fact, to which the court correctly predicted Whitman himself would testify, that Whitman had traded Google before. The jury was able to evaluate this fact against the equally unchallenged facts that Whitman had never held a long-term position in Google, and had not traded Google stock for over two years when he made the challenged trade. Absent any reason that such a comparison required expert skill, the court concluded that the jury would learn nothing new by having an expert review what would already be in the record.

In sum, the district court set reasonable limits on Kelly and Mayer's testimony: Kelly was allowed to

explain the general workings of a technical world, but was not allowed to render specific opinions about companies and people he knew nothing about. Mayer was permitted to draw comparisons based on his review of a large number of trades, but was not permitted to turn those comparisons into speculative conclusions about why Whitman made a specific trade. Under the circumstances, we cannot say that the district court's judgment about the proper scope of the experts' testimony was unreasonable.

B. Unavailable Witness

Rule 804(b)(1) of the Federal Rules of Evidence exempts prior testimony given by an unavailable witness from the hearsay rule if the party against whom the testimony is now offered had "an opportunity and similar motive to develop [the testimony] by direct, cross-, or redirect examination." Fed.R.Evid. 804(b)(1)(B). A party had a "similar motive" if it had a "substantially similar degree of interest in prevailing on that issue" at the two proceedings. *United States v. DiNapoli*, 8 F.3d 909, 912 (2d Cir. 1993). In *DiNapoli*, we held that a prosecutor does not have the same motive when questioning a witness before a grand jury as when cross-examining a witness at a later trial, because a prosecutor "us[es] the grand jury to investigate possible crimes and identify possible criminals," and thus, unlike at trial, has little incentive to undermine an unhelpful witness's credibility. *Id*. at 913.

Whitman sought to read into the record the prior deposition of alleged tipper Sunil Bhalla, taken during an SEC civil investigation, in which Bhalla denied passing inside information to Whitman. Bhalla was unavailable to testify at trial, having asserted his Fifth Amendment right against self-incrimination.

After reviewing the deposition transcript, the district court concluded that the SEC's motive was investigatory, thus mirroring the *DiNapoli* prosecutor's aim before the grand jury rather than that of a prosecutor cross-examining a defense witness at a criminal trial.

We cannot disagree. Assuming *arguendo* that the SEC lawyers and the trial prosecutors can be treated as the same party, the district court reasonably concluded that they had differing motivations to develop testimony by cross-examination. As we noted in *DiNapoli*, in assessing the party's motive, whether or not the party actually engaged in cross-examination is "relevant[,] though not conclusive." 8 F.3d at 915. In the excerpt of Bhalla's deposition proffered by Whitman, the SEC attorney asked Bhalla only two leading questions. The rest of the examination consisted of general inquiries about his relationship to Roomy Khan and his work at Polycom, many of which elicited long, descriptive answers from Bhalla that, unsurprisingly, asserted innocence. A prosecutor seeking to rebut a trial defense would have pressed the witness, but the SEC examiner rarely did, for the most part allowing Bhalla's testimony to stand unquestioned. Whitman points to no other evidence that persuasively contradicts the district court's inference that the SEC deposition was taken with an investigatory motive that differed from the adversarial motive that would be present at trial.

While *DiNapoli* suggests that certain categories of proceedings will always be inadmissible as prior testimony, we need not reach the question of whether, as a general matter, civil depositions can ever meet the criteria enunciated Rule 804(b)(1). In some situations, a civil deposition may well mirror the testimony that would be elicited at trial, or other evidence may

suggest that the lawyer taking the deposition had a "similar motive" to develop the testimony as the same party would later have at trial. But on the facts of this case, we cannot fault the district court's careful review of the circumstances, or find that it abused its discretion in excluding Bhalla's deposition.

C. Excluded Corroborating Testimony

Whitman challenges the district court's refusal to allow Whitman's associate, Jason Ader, to describe Whitman's reaction to Roomy Khan's arrest. Defense counsel proffered that Ader would have testified that Whitman "evinced no anxiety or concern whatsoever upon learning that Khan was an FBI informant." J. App'x at 1850. The district court denied the request, either because the court thought the statement was hearsay, or because the court found the testimony more prejudicial than probative.

Assuming *arguendo* that the testimony should have been admitted, any error was harmless. During Whitman's direct examination, the defense played tapes of conversation in which Whitman joked about Khan's arrest, audibly laughing about Khan's audacious tactics. Asked by his counsel about his light attitude towards Khan's crimes, Whitman insisted that he had always stayed on the right side of the law, that he had "made a lot of fun of Roomy" and warned her that she be more careful or she could go "to jail for that." J. App'x at 1506, 1509. Thus, Whitman provided a first-person account of Ader's excluded, second-hand testimony: Whitman told the jury that he maintained a "jocular" attitude toward Khan because he had no reason to worry that he had benefitted from her suspect tactics, corroborated by recordings in which he displayed such an attitude. J. App'x at 1507. Ader's testimony, which as proffered

would have primarily consisted of his evaluation of Whitman's tone and demeanor, would have at best provided limited corroboration of Whitman's testimony. On the whole record before us, we cannot conclude that the exclusion of this small piece of testimony was material to the outcome of the case. Assuming, without deciding, that the district court erred, we see no prejudice.

II. Jury Instructions

"We review jury instructions *de novo* with regard to whether the jury was misled or inadequately informed about the applicable law." *Terranova v. New York*, 676 F.3d 305, 308 (2d Cir. 2012). "As a general proposition, harmless-error analysis applies to instructional errors so long as the error at issue does not categorically vitiate all the jury's findings." *United States v. Moran-Toala*, 726 F.3d 334, 244 (2d Cir. 2013) (internal citations and quotation marks omitted). Only "structural errors," mistakes that "so fundamentally undermine the fairness or the validity of the trial," create reversible error regardless of prejudice. *Id*. at 343.

A. Conscious Avoidance Instruction

"A conscious avoidance instruction permits a jury to find that a defendant had culpable knowledge of a fact when the evidence shows that the defendant intentionally avoided confirming the fact." *United States v. Ferrarini*, 219 F.3d 145, 154 (2d Cir. 2000). A court may only give a conscious avoidance instruction where "(1) the defendant asserts the lack of some specific aspect of knowledge required for conviction, . . . and (2) the appropriate factual predicate for the charge exists, *i.e.*, the evidence is such that a rational juror may reach the conclusion beyond a reasonable doubt . . . that

the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact." *Id*. (internal citations and quotation marks omitted).

Whitman concedes that the first condition was met: he denied knowledge of Khan and Motey's illegal tactics. He argues only that the factual predicate for a conscious avoidance instruction was lacking. Whitman relies on the Supreme Court's decision in *Global-Tech Appliances, Inc. v. SEV S.A*., which explained that "a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing." ____ U.S. ____, ____-____, 131 S.Ct. 2060, 2070-71, 179 L.Ed.2d 1167 (2011). Whitman draws on the words "deliberate actions" to argue that "there was absolutely no evidence" that Whitman made "active efforts . . . to avoid learning that the information he allegedly received from Motey or Khan was improperly obtained." Appellant's Brief at 45 (internal quotation marks omitted).

But as we have recently noted, *Global-Tech* is fully consistent with prior circuit law as applied by the district court. *United States v. Goffer*, 721 F.3d 113, 128 (2d Cir.2013). The opinion "synthesized conscious avoidance instructions from eleven circuit courts . . . [and] did not alter or clarify the doctrine." *Id*. And as this Court has held, a factual predicate "may be established where a defendant's involvement in the criminal offense may have been so overwhelmingly suspicious that the defendant's failure to question the suspicious circumstances establishes the defendant's purposeful contrivance to avoid guilty knowledge." *United States v. Svoboda*, 347 F.3d 471, 480 (2d Cir. 2003) (internal citations and quotation marks omitted).

In *Svoboda*, the source and timing of a tip were enough to trigger a conscious avoidance instruction. *Id*. at 480-81 (reasoning that a tip from a bank's credit officer days before tender offer raised a red flag). Here, Whitman's own words were far more damning, and provided ample factual basis for the conclusion that he could avoid positive knowledge that Khan and Motey used illegal channels to get confidential information only by deliberately closing his eyes to facts well known to him. Whitman called Khan "Ms. Google." J. App'x at 2077. He told Wes Wang that Khan "had a mole there[, at Google,] for a while," whom she lost because "the [contact] wanted [Khan] to take care of her for . . . giving her the information" and that Khan "didn't have enough sense to go out and buy [the contact] some really nice present." J. App'x at 2084. The jury could easily conclude that Whitman knew that Khan courted trouble, and yet rather than question Khan about whether she had crossed a line, he encouraged Khan to "buy this woman a beautiful purse or something." J. App'x at 2085. He was equally cavalier about Khan's connection to Bhalla, teasing Khan that she should "[u]se a[n untraceable] skype phone number" to "call[ ] Sunil and get [ ] a good call on Polycom." J. App'x at 2077. In the face of substantial evidence that Khan had considered paying for information from an inside source, Whitman did not question Khan about whether she had done something illegal. Instead, the jury could reasonably have found, he advised her on how to continue pumping her sources.

Whitman's insistence that Motey revive his compromised contacts at Marvell similarly provided a predicate for a conscious avoidance instruction as to Whitman's knowledge of Motey's research strategies. Whitman told Motey that Marvell's management had

"caught you, dude," J. App'x at 2059, and that he failed to "protect" his Marvell sources, who then "g[o]t in trouble." J. App'x at 2060. He entreated Motey to call those sources back, using an internet phone number to mask his identity or to "hit star 67, [so] [y]our number won't show up." J. App'x at 2061. The jury could have reasonably found that Whitman knew that Motey's sources had violated a corporate policy, but avoided learning exactly what those sources had done wrong.

Whitman never expressly told Khan or Motey that he would rather not know the story behind a suspicious tip. But a defendant's "purposeful contrivance" to avoid knowledge, *Svoboda*, 347 F.3d at 480, may not manifest in an affirmative act because "the very nature of conscious avoidance makes it unlikely that the record will contain directly incriminating statements." *United States v. Kozeny*, 667 F.3d 122, 134 (2d Cir. 2011). For that reason, "[i]t is not uncommon for a finding of conscious avoidance to be supported primarily by circumstantial evidence." *Id*. Whitman responded to warning signs about the nature of Khan and Motey's tips not with skepticism but with advice on how better to play fast and loose. A reasonable jury could thus infer that Whitman either knew that Khan and Motey had inside information, or that he deliberately determined not to draw the obvious conclusion. See *Svoboda*, 347 F.3d at 480 (noting that the "same evidence that will raise an inference that the defendant had actual knowledge of the illegal conduct ordinarily will also raise the inference that the defendant was subjectively aware of a high probability of the existence of illegal conduct"). Accordingly, the district court did not err in instructing the jury on conscious avoidance.

B. Knowledge of a Personal Benefit to a Tipper

We have yet to decide whether a remote tippee must know that the original tipper received a personal benefit in return for revealing inside information. *Compare United States v. Rajaratnam*, 802 F.Supp.2d 491, 499 (S.D.N.Y.2011) (holding that a remote tippee must know that original exchange was given in exchange for benefit), *with United States v. Newman*, No. 12cr121, 2013 WL 1943342 at (S.D.N.Y. May 7, 2013) (holding that remote tippee need only know that tipper breached a fiduciary duty and not have specific knowledge that tipper received a personal benefit). But that question is not at issue in this case because the district court's instruction favored the defendant.

The district court told the jury—not once but four times—that Whitman could only be found guilty if he knew that a tippee received a personal benefit. In its opening lines outlining the elements of securities fraud, the court advised the jury that:

> [T]he government . . . must prove . . . that [Whitman] traded . . . on the basis of material nonpublic information about the company, knowing that the information had been obtained from an insider of the company who had provided the information in violation of that insider's duty of trust and confidence, in exchange for or in anticipation of a personal benefit.

J. App'x at 2030. The court twice repeated the instruction when describing particular counts. Finally, towards the end of the charge, the judge noted that although the government need not prove that Whitman knew "the specific benefit given or anticipated," it had to prove that Whitman had "a general

understanding that the insider was improperly disclosing inside information for personal benefit." J. App'x at 2032.

Whitman argues that these instructions were ambiguous. According to Whitman, the word "knowing" in the court's initial instruction was so far removed from the clause "in exchange for or in anticipation of personal benefit," that the sentence's structure could be read to create two separate elements: knowledge of a breach of fiduciary duty, and simple existence of a self-serving motive. Appellant's Brief at 48.

Whitman's argument is simply wrong. As a grammatical matter, the "personal benefit" language can only be read as part of the clause introduced by "knowing." We see no ambiguity whatsoever in the court's formulation. In any event, as the Supreme Court long ago held, a specific jury instruction "must be viewed in the context of the overall charge." *Cupp v. Naughten*, 414 U.S. 141, 146-47, 94 S.Ct. 396, 38 L.Ed.2d 368 (1973). Any ambiguity in the court's initial phrasing—and we see none—was resolved by the court's closing clarification. The judge specifically instructed that in order to convict, the jury must find that Whitman had a "general understanding" that an insider breached a duty in exchange for a personal benefit. Whitman argues that this wording is opaque, but the phrase communicates a clear message: the defendant had to "understand[ ]," that is, know, that the tipper had broken rules in return for consideration, even if the tippee never learned the nature of a particular bribe. Thus, because the district court adopted the defense's view of the law, and went out of its way to detail the standard required, we cannot find any error or prejudice to the defendant.

C. Duty Not to Disclose

Insider trading depends upon insiders—people with access to information that the public does not have, and an obligation to keep that information secret. In *United States v. Chestman*, we explained that such an obligation arises when a tipper is in a "relationship of trust and confidence" with a company's shareholders or stewards, a bond that must either be that of a fiduciary or "the functional equivalent of a fiduciary relationship." 947 F.2d 551, 568 (2d Cir. 1991). At trial and on appeal, Whitman argued that any such duty must arise from state law, and faulted the district court for rejecting his proposal that the jury be instructed based on California law. *See United States v. Whitman*, 904 F.Supp.2d 363, 368–70 (S.D.N.Y. 2012). We have recently settled any uncertainty about this issue, holding that "the fiduciary-like duty against insider trading under section 10(b) is imposed and defined by federal common law," and specifically citing the opinion below with approval. *Steginsky v. Xcelera, Inc.*, ____ F.3d ____, 2014 WL 274419 at *5 (2d Cir. Jan. 27, 2014). Since Whitman does not argue that the district court misstated the relevant federal law, and challenges the instruction on duty only insofar as it failed to instruct on state law, we reject his claim of error in the district court's instruction.

D. Significant Factor

Defendants violate the law when they trade "while in knowing possession of nonpublic information material to those trades." *United States v. Royer*, 549 F.3d 886, 899 (2d Cir. 2008) (internal quotation marks omitted). Relying on this rule, the district court instructed the jury that inside information must be "at least a factor" in Whitman's trading decision. Whitman does not dispute that under the law of this

Circuit, he was entitled to no more favorable instruction, but argues that we should adopt the law of the Ninth Circuit, which dictates that a defendant is only liable if inside information was a "significant factor" in an investment choice. *United States v. Smith*, 155 F.3d 1051, 1066 (9th Cir.1998). As Whitman acknowledges, his proposed change in circuit law could be adopted only by the Court sitting en banc. Absent such review, we are bound by controlling circuit precedent just as the district court was. We therefore find no error in the instruction.

CONCLUSION

For the foregoing reasons, the judgment of the district court is AFFIRMED.

AO 245C (Rev. 09/11) Amended Judgment in a Criminal Case
Sheet 1

(NOTE: Identify Changes with Asterisks (*))

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA
V.
DOUGLAS WHITMAN

AMENDED JUDGMENT IN A CRIMINAL CASE

Case Number: 1 :12Cr0125-01 (JSR)
USM Number:66367-054
David Rody, Esq.
Defendant's Attorney

Date of Original Judgment: 1/26/2013
(Or Date of Last Amended Judgment)

Reason for Amendment:

- ☐ Correction of Sentence on Remand (18 U.S.C. 3742(f)(1) and (2))
- ☐ Reduction of Sentence for Changed Circumstances (Fed. R. Crim. P. 35(b))
- ☐ Correction of Sentence by Sentencing Court (Fed. R. Crim. P. 35(a))
- ☒ Correction of ~~Sentence~~ Surrender Date for Clerical Mistake (Fed. R. Crim. P. 36)
- ☐ Modification of Supervision Conditions (18 U.S.C. §§ 3563(c) or 3583(e))
- ☐ Modification of Imposed Term of Imprisonment for Extraordinary and Compelling Reasons (18 U.S.C. § 3582(c)(1))
- ☐ Modification of Imposed Term of Imprisonment for Retroactive Amendment(s) to the Sentencing Guidelines (18 U.S.C. § 3582(c)(2))
- ☐ Direct Motion to District Court Pursuant ☐ 28 U.S.C. § 2255 or ☐ 18 U.S.C. § 3559(c)(7)
- ☐ Modification of Restitution Order (18 U.S.C. § 3664)

THE DEFENDANT:

- ☐ pleaded guilty to count(s) _____
- ☐ pleaded nolo contendere to count(s) _____ which was accepted by the court.
- ☑ was found guilty on count(s) 1,2,3,4 after a plea of not guilty.

The defendant is adjudicated guilty of these offenses:

Title & Section	Nature of Offense	Offense Ended	Count
18 U.S.C.371	Conspiracy to Commit Securities Fraud	12/31/2009	1
18 U.S.C.371	Conspiracy to Commit Securities Fraud	12/31/2007	2
15 U.S.C. 78j(b)	Securities Fraud	1/25/2007	3

The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

- ☐ The defendant has been found not guilty on count(s) _____
- ☐ Count(s) _____ ☐ is ☐ are dismissed on the motion of the United States.

It is ordered that the defendant must notify the United States Attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant must notify the court and United States attorney of material changes in economic circumstances.

1/24/2013
Date of Imposition of Judgment

Signature of Judge
Hon. Jed S. Rakoff, U.S.D.J.
Name and Title of Judge

4/1/13
Date

APPENDIX B

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

ADDITIONAL COUNTS OF CONVICTION

Title & Section	Nature of Offense	Offense Ended	Count
15 U.S.C.78j(b) and 78ff;17CFR240.10b-5 & 18 U.S.C. 2	Securities Fraud	7/19/2007	4

AO 245C (Rev. 09/11) Amended Judgment in a Criminal Case
Sheet 2 — Imprisonment

(NOTE: Identify Changes with Asterisks (*))

Judgment — Page 2 of 7

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a total term of :

Counts 1,2,3,4: TWENTY FOUR (24) MONTHS CONCURRENT ON ALL COUNTS

☑ The court makes the following recommendations to the Bureau of Prisons:

The Court recommends the defendant be incarcerated in the federal facility in Lompoc, California.
* The Court grants defendant's application for bail pending appeal and the formerly imposed voluntary surrender date of May 9, 2013 is hereby revoked.

☐ The defendant is remanded to the custody of the United States Marshal.

☐ The defendant shall surrender to the United States Marshal for this district:

☐ at _____ ☐ a.m. ☐ p.m. on _____ .

☐ as notified by the United States Marshal.

☑ The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons:

☐ before 2 p.m. on _____ .

☑ as notified by the United States Marshal.

☐ as notified by the Probation or Pretrial Services Office.

RETURN

I have executed this judgment as follows:

Defendant delivered on _____ to _____

at _____ with a certified copy of this judgment.

_____
UNITED STATES MARSHAL

By _____
DEPUTY UNITED STATES MARSHAL

AO 245C (Rev. 09/11) Amended Judgment in a Criminal Case
Sheet 3 — Supervised Release

(NOTE: Identify Changes with Asterisks (*))

Judgment—Page 4 of 7

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of :

On Counts 1,2,3,4: ONE (1) YEAR of supervision to run concurrent on all counts.

The defendant must report to the probation office in the district to which the defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

The defendant shall not commit another federal, state, or local crime.

The defendant shall not unlawfully possess a controlled substance. The defendant shall refrain from any unlawful use of a controlled substance. The defendant shall submit to one drug test within 15 days of release from imprisonment and at least two periodic drug tests thereafter, as determined by the court.

☐ The above drug testing condition is suspended, based on the court's determination that the defendant poses a low risk of future substance abuse. (Check, if applicable.)

☑ The defendant shall not possess a firearm, ammunition, destructive device, or any other dangerous weapon. (Check, if applicable.)

☑ The defendant shall cooperate in the collection of DNA as directed by the probation officer. (Check, if applicable.)

☐ The defendant shall register with the state sex offender registration agency in the state where the defendant resides, works, or is a student, as directed by the probation officer. (Check, if applicable.)

☐ The defendant shall participate in an approved program for domestic violence. (Check, if applicable.)

If this judgment imposes a fine or restitution, it is a condition of supervised release that the defendant pay in accordance with the Schedule of Payments sheet of this judgment.

The defendant must comply with the standard conditions that have been adopted by this court as well as with any additional conditions on the attached page.

STANDARD CONDITIONS OF SUPERVISION

1) the defendant shall not leave the judicial district without the permission of the court or probation officer;
2) the defendant shall report to the probation officer in a manner and frequency directed by the court or probation officer;
3) the defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;
4) the defendant shall support his or her dependents and meet other family responsibilities;
5) the defendant shall work regularly at a lawful occupation, unless excused by the probation officer for schooling, training, or other acceptable reasons;
6) the defendant shall notify the probation officer at least ten days prior to any change in residence or employment, or if such prior notification is not possible, then within five days after such change;
7) the defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute, or administer any controlled substance or any paraphernalia related to any controlled substances, except as prescribed by a physician;
8) the defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;
9) the defendant shall not associate with any persons engaged in criminal activity and shall not associate with any person convicted of a felony, unless granted permission to do so by the probation officer;
10) the defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view of the probation officer;
11) the defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;
12) the defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court; and
13) as directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record, personal history, or characteristics and shall permit the probation officer to make such notifications and confirm the defendant's compliance with such notification requirement.

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

SPECIAL CONDITIONS OF SUPERVISION

1. The defendant shall provide the probation officer with access to any requested financial information.

2. The defendant shall not incur any new credit charges or open additional lines of credit with the approval of the probation officer unless the defendant is in compliance with the installment payment plan.

3. The defendant shall pay the fine and forfeiture as directed on the financial penalty pages of this judgment.

4. The Court recommends that the defendant be supervised by the district of residence

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

CRIMINAL MONETARY PENALTIES

The defendant must pay the following total criminal monetary penalties under the schedule of payments on Sheet 6.

	Assessment	Fine	Restitution
TOTALS	$ 400.00	$ 250,000.00	$

☐ The determination of restitution is deferred until _____. An *Amended Judgment in a Criminal Case* (AO 245C) will be entered after such determination.

☐ The defendant shall make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately proportioned payment, unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. § 3664(i), all nonfederal victims must be paid before the United States is paid.

Name of Payee	Total Loss*	Restitution Ordered	Priority or Percentage

TOTALS	$ 0.00	$ 0.00

☐ Restitution amount ordered pursuant to plea agreement $ _____

☐ The defendant must pay interest on restitution and a fine of more than $2,500, unless the restitution or fine is paid in full before the fifteenth day after the date of the judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6 may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).

☐ The court determined that the defendant does not have the ability to pay interest, and it is ordered that:

☐ the interest requirement is waived for ☐ fine ☐ restitution.

☐ the interest requirement for the ☐ fine ☐ restitution is modified as follows:

* Findings for the total amount of losses are required under Chapters 109A, 110, 110A, and 113A of Title 18 for offenses committed on or after September 13, 1994, but before April 23, 1996.

AO 245C (Rev. 09/11) Amended Judgment in a Criminal Case
Sheet 6 — Schedule of Payments

(NOTE: Identify Changes with Asterisks (*))

Judgment — Page 7 of 7

DEFENDANT: DOUGLAS WHITMAN
CASE NUMBER: 1 :12Cr0125-01 (JSR)

SCHEDULE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties shall be due as follows:

A ☑ Lump sum payment of $ 400.00 due immediately, balance due

☐ not later than _____, or
☐ in accordance with ☐ C, ☐ D, ☐ E, or ☐ F below; or

B ☐ Payment to begin immediately (may be combined with ☐ C, ☐ D, or ☐ F below); or

C ☐ Payment in equal _____ (e.g., weekly, monthly, quarterly) installments of $ _____ over a period of _____ (e.g., months or years), to commence _____ (e.g., 30 or 60 days) after the date of this judgment; or

D ☐ Payment in equal _____ (e.g., weekly, monthly, quarterly) installments of $ _____ over a period of _____ (e.g., months or years), to commence _____ (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

E ☐ Payment during the term of supervised release will commence within _____ (e.g., 30 or 60 days) after release from imprisonment. The court will set the payment plan based on an assessment of the defendant's ability to pay at that time; or

F ☑ Special instructions regarding the payment of criminal monetary penalties:

The $250,000 fine shall be paid at the rate of 10% of the defendant's gross monthly income beginning with the second month of supervision.

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during the period of imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to the clerk of the court.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

☐ Joint and Several

Defendant and Co-Defendant Names and Case Numbers (including defendant number), Joint and Several Amount, and corresponding payee, if appropriate.

☐ The defendant shall pay the cost of prosecution.

☐ The defendant shall pay the following court cost(s):

☑ The defendant shall forfeit the defendant's interest in the following property to the United States:

$935,306 as directed in an order that will be issued separately by the Court.

Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

APPENDIX C

UNITED STATES DISTRICT COURT,
S.D. NEW YORK

No. 12 Cr. 125(JSR)

UNITED STATES OF AMERICA,

v.

DOUG WHITMAN,

Defendant.

Nov. 14, 2012
As Corrected Nov. 19, 2012

OPINION

JED S. RAKOFF, *District Judge*

On August 21, 2012, following a three-week trial, a jury convicted defendant Doug Whitman of two counts of conspiracy to commit insider trading and two counts of substantive insider trading in violation of the federal securities laws. Specifically, the counts charged that Mr. Whitman traded or agreed to trade on material inside information that he received from tippees who had, in turn, obtained the information from inside employees at Polycom, Inc., Google, Inc., and Marvell Technology, Inc. In connection with instructing the jury as to these charges, the Court confronted three interrelated issues as to which the law was unsettled. Those issues were:

(1) Whether in a criminal prosecution under the federal securities laws, the scope of an employee's duty to keep material non-public information confidential is defined by state or federal law?

(2) Whether a person who receives such information from someone outside the company must, to be criminally liable for trading on such information, know that the information was originally obtained from an insider who not only breached a duty of confidentiality in disclosing such information but also did so in exchange for some personal benefit?

(3) Whether even a secondary tippee like Mr. Whitman must, in order to be criminally liable, have a specific intent to defraud the company from which the information emanates of the confidentiality of that information?

After receiving written submissions and oral arguments culminating in a three-hour charging conference on August 14, 2012, the Court resolved the questions as reflected in Instructions 10 and 11 of the Court's jury charge. *See United States v. Whitman*, 12 Cr. 125(JSR), D.E. 102 (S.D.N.Y. 2012) (Ct. Ex. 1) (Court's instructions of law to the jury). Although the Court stated its reasons for these rulings from the bench, this Opinion will serve to further amplify and elaborate the Court's reasoning.

By way of background, most insider trading prosecutions (outside the context of tender offers) allege willful violations of Rule 10b-5, codified at 17 C.F.R. § 240.10b-5, which was promulgated in 1942 by the Securities and Exchange Commission ("SEC") pursuant to Section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b). *See Ernst & Ernst v.*

Hochfelder, 425 U.S. 185, 195, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Rule 10b-5, in turn, was loosely modeled on the federal mail fraud statute, 18 U.S.C. § 1341, enacted in 1872. *See* Robert A. Prentice, *Scheme Liability: Does It Have a Future After Stoneridge?*, 2009 Wisc. L. Rev. 351, 361, 365 & nn. 54–56, 77 (Rule 10b-5 was virtually copied from section 17(a) of the Securities Act of 1933, which in turn was modeled, especially in subdivision (a) of the Rule, on the federal mail fraud statute).

Initially, only civil insider trading cases were brought under Rule 10b-5, first as administrative actions, *see Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 59902 (1961), and then as SEC enforcement actions, *see S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir.1968) (en banc). Such cases typically involved executives of companies who, upon learning of confidential information about their companies that would cause its stock price to rise, purchased shares from their own shareholders before the information was publicly announced, thereby breaching their fiduciary duty to their own shareholders. For example, in *Texas Gulf Sulphur*, the defendants, insiders of a mining company, upon learning that the company had just discovered 25 million tons of valuable mineral ore in eastern Canada, purchased stock and call options in the company before the discovery was publically announced, thereby violating Rule 10b-5. *Id*. at 843–52.

Soon, however, the cases were extended to situations where an insider in possession of material nonpublic information did not himself trade but disclosed the information to an outsider (a "tippee") who then traded on the basis of the information before it was publicly disclosed. Eventually, the Supreme

Court confronted this situation, in *Dirks v. S.E.C.*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983), where it held that such a tippee assumes a fiduciary duty to shareholders of a public company not to trade on material nonpublic information if (a) the tipper has breached his fiduciary duty to the company and its shareholders by disclosing such information to the tippee in return for some personal benefit and (b) the tippee knows or should have known of the breach. *Id*. at 654-55, 103 S.Ct. 3255. Thus, in *Dirks*, the defendant, Raymond Dirks, an officer of a New York broker-dealer, received information from Ronald Secrist, a "whistleblower" who disclosed inside information about fraud at his former company, Equity Funding of America. *Id*. at 649, 103 S.Ct. 3255. Dirks did not himself trade on this information, but he repeated the information to clients of his company, who thereupon liquidated their holdings. *Id*. at 649-50, 103 S.Ct. 3255. The SEC censured Dirks, but the Supreme Court reversed, holding that because Secrist, the tipper, did not disclose the information for his personal benefit, there was no breach of fiduciary duty (in the sense of self-dealing at the shareholders' expense), and thus there was no derivative breach by Dirks, the immediate tippee (let alone by the secondary tippees, the clients). *Id*. at 662, 103 S.Ct. 3255.

Collectively, the approaches described above are referred to as the "classical" theories of insider trading because they involve breaches, whether direct or derivative, of duties to shareholders of the insider's company. *SEC v. Obus*, 693 F.3d 276, 284 (2d Cir. 2012). However, around the same time that *Dirks* was proceeding through the courts, the first criminal insider trading cases were being brought, often involving lower-level employees who tipped or traded on the basis of market-sensitive information that they

purloined from their employers but that pertained to the stock, not of their employers' companies, but of other companies. *See Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980); *Carpenter v. United States*, 484 U.S. 19, 108 S.Ct. 316, 98 L.Ed.2d 275 (1987); *United States v. O'Hagan*, 521 U.S. 642, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997). For example, in *Chiarella*, which preceded *Dirks*, a low-level employee at a financial printing company misappropriated his company's confidential information concerning upcoming corporate takeovers involving other companies and thus was able to purchase stock in advance of the takeovers, to his profit. Since in these cases the employee was not purchasing securities from shareholders of his employer, it took awhile for a viable legal theory of these prosecutions to emerge—indeed, the conviction in *Chiarella* was reversed—but eventually the defendants' undisclosed embezzlement or "misappropriation" of market-sensitive confidential information from their employers was held to be a fraud on their employers that violated not only the mail fraud statute, *see Carpenter*, 484 U.S. at 25–28, 108 S.Ct. 316, but Rule 10b-5 as well, *see O'Hagan*, 521 U.S. at 665–66, 117 S.Ct. 2199.

As this thumbnail history illustrates, the prohibition of insider trading in the United States has developed in a somewhat *ad hoc* manner, leaving many unanswered questions.[1] The instant case—

[1] Other nations have proposed and, in some cases, enacted laws of general applicability against insider trading, *see, e.g.*, European Commission, Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse), at 13, 30-33 COM (2011) 651 final (Oct. 20, 2011) (clarifying European Union ("EU") regulations on insider trading and proposing EU directive for all EU countries to add criminal sanctions for insider trading in

which was prosecuted under a modified "*Dirks*" approach[2]—illustrates the point. Under this approach, liability exists if the tipper breaches a fiduciary-like duty of trust and confidence owed to his employer and its shareholders to keep confidential the material nonpublic information that the tipper discloses to his tippee in return for a personal benefit, knowing that the tippee may trade on the information. The first question that this poses is, from whence does this duty arise?

This should not be confused with the question of what is material nonpublic information. What is "non-public" or "confidential" information is largely a factual issue, turning on such factors as written company policies, employee training, measures the employer has taken to guard the information's secrecy,

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addition to existing administrative sanctions). Congress, however, has never done so, partly because the SEC has generally opposed such proposals on the ground that that any statutory definition of illegal insider trading would inevitably create "loopholes" that would be eventually utilized in much the same way that the tax code generates tax "dodges" that are frequently successful. However, as this very case demonstrates, the judge-made law of insider trading, however flexible, can create potential gaps in coverage that are the functional equivalent of legislative loopholes.

[2] Perhaps in an effort to touch all bases, the Indictment in this case alleges that the insiders tipped their immediate tippees "in violation of their duties of trust and confidence that they owed to [a given company] and [the company's] shareholders and for personal benefit," *e.g.*, Indictment ¶ 5, and that the defendant knew that the information "was obtained in violation of duties of trust and confidence that the [insider] owed to [the insider's company] and [that company's] shareholders." Nevertheless, in various submissions made during trial, the Government made plain that it was primarily alleging a *Dirks*-based theory of liability.

the extent to which the information is known outside the employer's place of business, and the ways in which other employees may access and use the information. *United States v. Mahaffy*, 693 F.3d 113, 135 n. 14 (2d Cir.2012); *see also U.S. v. Royer*, 549 F.3d 886 (2d Cir. 2008). What is "material" information, though a mixed question of fact and law, is necessarily defined by federal law, because materiality relates in this context to what is required by federal securities laws to be disclosed and the very purpose of those laws is to set federal standards and requirements of disclosure in securities transactions. Thus, the relevant precedents deal with this issue as a matter of federal law and hold that a fact is "material" in this context if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic, Inc. v. Levinson*, 485 U.S. 224, 231, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)). *See also United States v. Contorinis*, 692 F.3d 136 (2d Cir.2012).

But the previously unanswered question the Court here had to confront is what law gives rise to an employee's duty not to disclose to an outsider material nonpublic information. If it is simply a contractual duty, it seemingly would not support a fraud prosecution, since a breach of contract does not necessarily involve any misrepresentation. *Cf. S.E.C. v. Cuban*, 634 F.Supp.2d 713, 724-26 (N.D.Tex. 2009) (holding that although contract may in certain circumstances give rise to misappropriation liability, the agreement "must contain more than a promise of confidentiality"), *rev'd*, 620 F.3d 551 (5th Cir.2010). Rather, the duty must be of the kind that requires the employee,

if he breaches the duty, to disclose the breach—the failure to do so thereby constituting the misrepresentation that is an essential element of fraud.

This kind of duty is sometimes referred to as a "fiduciary" duty. For example, in *Dirks*, the Supreme Court described the liability of a tippee as derived from the tipper's "fiduciary" duty to the shareholders of his company either to disclose material nonpublic information before trading with them on the basis of that information or else abstain from such trading. *Dirks*, 463 U.S. at 659-60, 103 S.Ct. 3255. "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*. But, as Justice Frankfurter famously noted in *S.E.C. v. Chenery Corp*., 318 U.S. 80, 85-86, 63 S.Ct. 454, 87 L.Ed. 626 (1943), "[t]o say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?" Moreover, as the Supreme Court made clear in *Chiarella*, the duty to disclose or abstain may arise from "a fiduciary *or other similar relation of trust and confidence*." *Chiarella*, 445 U.S. at 228, 100 S.Ct. 1108 (emphasis supplied)—making the need for clarity as to what duty is involved and what its requirements are even more pertinent. *See also United States v. Chestman*, 947 F.2d 551, 567-70 (2d Cir.1991).

But, whether labeled a "fiduciary" duty, or fiduciary-like "duty of trust and confidence," or whatever, the

initial question remains: what is the source of this duty? Defendant here argues that fiduciary and quasi-fiduciary duties are normally a matter of state law, and that the relevant state here is California, where the tippers and their employers were located.[3] According to defendants, moreover, California's law applies the relevant fiduciary duty of confidentiality only to upper-level employees, which, defendant claims, the tippers here were not. The Government, for its part, disagrees that the relevant California duty applies only to upper-level employees or, even if it does, that the tippers here were of a lower level.[4] But

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[3] *Cf.* Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 Wash. & Lee L. Rev. 1189 (1995) (arguing that the prohibition against insider trading is best justified on a theory of protecting property rights in confidentiality, which should be determined with reference to state law). Still another possibility—though not advanced by either side here—is that since, under *Dirks*, the fiduciary duty is ultimately a duty to the shareholders, the relevant law is the law of the state of incorporation, which for two of the three companies here involved—Google and Polycom—is Delaware, *see* Google Inc. Annual Report (Form 10–K), at 1 (Jan. 26, 2012); Polycom, Inc. Annual Report (Form 10–K), at 1 (Feb. 2, 2012), and for Marvell Technology, is Bermuda. Marvell Technology Group Ltd. Annual Report (Form 10–K), at 1 (Mar. 27, 2012); *see also* Bainbridge, 52 Wash. & Lee L.Rev. at 1267 n. 320 ("Longstanding choice-of-law rules direct that questions of breaches of fiduciary duty by corporate officers and directors are governed by the law of the state of incorporation." (quoting Restatement (Second) of Conflicts of Law § 309 (1969)).

[4] The Government also argues that, even accepting that California does not impose the same general fiduciary obligations on lower-level employees that New York would place, California nevertheless has adopted the specific Restatement of Agency rule, applicable to all employees, that "[a]n agent has a duty . . . not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party." *Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC*,

the Court need not reach these questions of California (or Delaware or Bermuda) law, because it agrees with the Government's alternate position, that the duty in question is imposed and defined by federal law.

To begin with, *Dirks*, and indeed all the Supreme Court cases dealing with insider trading, have implicitly assumed that the relevant fiduciary duty is a matter of federal common law, for they have described it and defined it without ever referencing state law. *See Dirks*, 463 U.S. 646, 103 S.Ct. 3255; *Chiarella*, 445 U.S. 222, 100 S.Ct. 1108; *Carpenter*, 484 U.S. 19, 108 S.Ct. 316; *O'Hagan*, 521 U.S. 642, 117 S.Ct. 2199; *see also* A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 Duke L.J. 841, 930-31 & nn. 540-41 (2003) (arguing, based on review of the notes of Justice Powell and interviews with his former clerks, that Justice Powell, the author of *Dirks* and *Chiarella*, saw Rule 10b-5 jurisprudence as a species of federal common law). Defendant, indeed, has failed to point to a single case where any federal court has expressly held that the duty was defined by state law. *Cf. Cuban*, 634 F.Supp.2d at 721 (noting SEC's argument that "no federal court has relied exclusively on state law to determine whether a duty sufficient to support misappropriation theory liability exists").

Second, nothing in the underlying legislation—the Securities Exchange Act of 1934—suggests that its requirements were designed to vary from state to state.[5] On the contrary, its purpose was to provide full,

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162 Cal.App.4th 858, 888 n. 8, 76 Cal.Rptr.3d 325 (2008) (quoting Restatement (Third) of Agency § 8.07).

[5] Similarly, the SEC's rules promulgated under the 1934 Act are uniform throughout the United States. In particular, in connection with the closely-related question of what constitutes a

and uniform, disclosure throughout the national securities markets. *See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 495 F.2d 228, 235 (2d Cir.1974) ("As we have stated time and again, the purpose behind Section 10(b) and Rule 10b-5 is to protect the investing public and to secure fair dealing in the securities markets by promoting full disclosure of inside information so that an informed judgment can be made by all investors who trade in such markets."). To be sure, this does not mean that Rule 10b-5 can serve as a device for overriding state law on such matters of allocation of governing powers within a corporation, *see Kamen v. Kemper Fin. Servs*., 500 U.S. 90, 108, 111 S.Ct. 1711, 114 L.Ed.2d 152 (1991), or other matters of internal corporate regulation, *see Santa Fe Indus. v. Green*, 430 U.S. 462, 479, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977). But where, as here, the issue is a duty to disclose, federal law must be paramount or the goal of the 1934 Act to assure transparency in the markets would be severely compromised depending on the vagaries of individual states' laws and policies.

Third, this does not mean that general principles of state fiduciary law—in many cases grounded in centuries-old common law principles—are not helpful guidance for determining the parameters of the applicable federal common law to be applied here, but only that idiosyncratic differences between the laws of various states cannot be allowed to trump the federal interest in combating insider trading. Particularly instructive in this regard is *United States v. Chestman*, 947 F.2d 551 (2d Cir.1991), where one of

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duty of trust and confidence under the misappropriation theory of insider trading, the SEC has promulgated a rule—Rule 10b5-2—that is uniform throughout the United States.

the questions was whether marriage created the fiduciary relationship necessary to impose Rule 10b-5 criminal liability for insider trading. Even though marriage, and the general duties created thereby, are classically a matter of state law, the Second Circuit, in determining how these duties pertain to insider trading, took a uniform approach. Thus, it held that "[w]e take our cues as to what is required to create the requisite relationship [both] from the securities fraud precedents and the [general] common law." *Id*. at 568 (citing *Chiarella*, 445 U.S. at 227–30, 100 S.Ct. 1108).

Further to this purpose, as noted above, the SEC subsequently propounded Rule 10b5-2, which defined the duty of trust and confidence in *Chestman*-like situations without any reference to state law or any suggestion that defining such a duty in this context was anything other than a federal prerogative.

Accordingly, in instructing the jury in the instant case, the Court framed its instructions in terms of a federal common law duty of trust and confidence, derived from the federal insider-trading cases and owed, so far as disclosure of market-sensitive information is concerned, by all employees to their employers and shareholders. But this then led to a second question: what did a secondary tippee, like Mr. Whitman, who obtained his information from the direct tippees, have to know about the tipper's breach of duty to be criminally liable? The Government argued that it needed only to show that the defendant knew (or recklessly disregarded) that the information he was obtaining was an unauthorized disclosure by some inside tipper, but not that he also knew of any benefit provided to the tipper, citing *United States v. Falcone*, 257 F.3d 226, 234 (2d Cir. 2001); *United States v. Mylett*, 97 F.3d 663, 668 (2d Cir. 1996); and

United States v. Libera, 989 F.2d 596, 600 (2d Cir. 1993). But *Falcone*, *Mylett*, and *Libera* were all *misappropriation* cases, "the purpose . . . of which is to protect property rights in information." *Libera*, 989 F.2d at 600. Thus, the tippee's knowledge that disclosure of the inside information was unauthorized is sufficient for liability in a misappropriation case. By contrast, the purpose of a prosecution premised, as here, on a *Dirks* approach is to protect shareholders against self-dealing by an insider who exploits for his own gain the duty of confidentiality he owes to his company and its shareholders. The element of self-dealing, in the form of a personal benefit—whether immediate or anticipated, and whether substantial or very modest—must be present.[6]

Accordingly, if the only way to know whether the tipper is violating the law is to know whether the tipper is anticipating something in return for the unauthorized disclosure, then the 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. *See United States v. Rajaratnam*, 802 F.Supp.2d 491, 498-99 (S.D.N.Y. 2011); *State Teachers Ret. Board v. Fluor Corp*., 592 F.Supp. 592, 594 (S.D.N.Y. 1984).

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[6] For the view, however, that personal benefit is also a requirement of liability under the misappropriation theory, *see SEC v. Yun*, 327 F.3d 1263 (11th Cir. 2003). The Second Circuit's recent decision in *Obus*, decided after the trial of the instant case, is also somewhat Delphic on this score, suggesting, on the one hand, that even in a civil misappropriation case, the tipper is liable only if he "received a personal benefit from the tip," but, on the other hand, that tippee liability, even in a civil case, requires that "the tippee knew or had reason to know . . . that the information was obtained through the tipper's breach." *Obus*, 693 F.3d at 289.

On the other hand, there is no reason to require that the tippee know the details of the benefit provided; it is sufficient if he understands that some benefit, however modest, is being provided in return for the information. Accordingly, in the instant case, the Court instructed the jury as follows:

> [O]n or about the date alleged, Mr. Whitman engaged in an "insider trading" scheme, in that he traded in the securities of the company identified in [the specified] count on the basis of material nonpublic information about the company, *knowing* that the information had been obtained from an insider of the company who had provided the information in violation of that insider's duty of trust and confidence and in exchange for, or in anticipation of a personal benefit.
>
> . . .
>
> As to the defendant's knowledge that the insider has breached the insider's duty of trust and confidentiality in return for some actual or anticipated benefit, it is not necessary that Mr. Whitman know the specific confidentiality rules of a given company or the specific benefit given or anticipated by the insider in return for disclosure of inside information; rather, it is sufficient that the defendant had a general understanding that the insider was improperly disclosing inside information for personal benefit.

Ct. Ex. 1 at 15, 17 (emphasis supplied).

At the time, the Government protested that such a standard would create loopholes for tippees to insulate themselves from liability. But the instant case did not itself support such a fear. Quite aside from the fact that very little in the way of a "benefit" needed to be

shown,[7] the Government in fact had no difficulty proving such knowledge in this case. Indeed, Mr. Whitman's own words, in recorded conversations, indicated that he not only was well aware of the benefit requirement, but also was confident that the tippers here were receiving actual or anticipated benefits. Moreover, where appropriate (as here), the Government is entitled to a "willful blindness" or "conscious avoidance" instruction to the jury on the issue of such knowledge. *See Obus*, 693 F.3d at 287. *See also* Ct. Ex. 1 at 17.

Nevertheless, one can imagine cases where a remote tippee's knowledge that the tipper was receiving some sort of benefit might be difficult to prove. If, however, this is an unfortunate "loophole," it is a product of the topsy-turvy way the law of insider trading has developed in the courts and cannot be cured short of legislation.

The final question presented by the charge to the jury in the instant case was whether criminal insider trading in violation of Rule 10b-5 requires "specific intent," and, if so, in what sense. Ultimately, the Court instructed the jury that, in order to convict, the Government had to prove, *inter alia*, that the defendant "acted knowingly, willfully, and with an intent to defraud," and that "an intent to defraud" meant "an intent to deprive the company in question of the confidentiality of its information." Ct. Ex. 1 at 15-16, 18.

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[7] As the Court instructed the jury, the benefit does not need to be financial or tangible in nature; it could include, for example, maintaining a useful networking contact, improving the reputation or power within the company, obtaining future financial benefits, or just maintaining or furthering a friendship. Ct. Ex. 1 at 17. *See*, *e.g.*, *Obus*, 693 F.3d at 285.

This charge is substantively identical to the charge this Court gave to the jury in the insider trading case of *United States v. Gupta*, 11 Cr. 907(JSR), D.E. 102, at 16-17 (S.D.N.Y. June 6, 2012). In *Gupta*, the Government did not object to the Court's specific intent charge, and, in the instant case, the Government ultimately withdrew its objection to charging specific intent. *See* Trial Tr. dated Aug. 14, 2012, at 2333 ("We are OK with this as it is."). Despite the Government's eventual acquiescence to the Court's charge, the Government originally submitted a proposed jury charge that did not charge specific intent, as well as several briefs objecting to an instruction describing insider trading as a specific intent crime. Accordingly, the Court here addresses the issue.

As noted, the language of Rule 10b-5, and especially subdivision (a) thereunder, is derived from the federal mail fraud statute (which, in turn, is derived from English law going back several hundred years). *See* 17 C.F.R. § 240.10b-5(a) (requiring "scheme, or artifice to defraud"); 18 U.S.C. § 1341 (same). Thus, as the Supreme Court has noted, mail fraud precedent is "a particularly apt source of guidance" for interpreting securities fraud under Rule 10b-5. *O'Hagan*, 521 U.S. at 654, 117 S.Ct. 2199 (internal quotation marks omitted).

It is axiomatic that proof of mail fraud requires specific intent in the sense of intent to harm. Indeed, in this Circuit, the Government in a mail fraud case must prove more than just that the defendant intentionally committed the conduct that was fraudulent or that he knew it was deceptive; the Government must also show that the defendant knew that his conduct was intended to harm the victim, by depriving him of

money or property. *United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1180 (2d Cir. 1970).

The intent specified by Congress for criminal liability for violations of the Securities Exchange Act of 1934 is "willfully." 15 U.S.C. § 78ff(a). "Willful" is a word of many meanings, but it takes its meaning from the specific violation charged. *United States v. Bishop*, 412 U.S. 346, 352, 93 S.Ct. 2008, 36 L.Ed.2d 941 (1973). So for violations of certain of the provisions of the 1934 Act not sounding in fraud *per se*, it might be plausible to suggest that the defendant need not have a specific intent to defraud but only general *mens rea*. *See*, *e.g.*, *United States v. Peltz*, 433 F.2d 48, 55 (2d Cir. 1970) (holding, in context of Rule 10a-1(a)—the "downtick" rule—that the defendant need only realize he is doing a "wrongful" act, namely, by telling brokers he was "long" on a stock when he knew he was not). But where, as in this case, the Government charges a scheme to defraud under subdivision (a) of Rule 10b-5, proving specific intent to defraud is necessary. Indeed, were it otherwise, an insider trading defendant charged, in virtually identical words, with violating both the mail fraud statute and Rule 10b-5, could be convicted of the latter but acquitted of the former, even though the latter is a specialized subspecies of the former. *Cf. United States v. Tarallo*, 380 F.3d 1174, 1181 (9th Cir. 2004) ("[L]ike[ ] [mail fraud], a defendant may be convicted of committing securities fraud only if the government proves specific intent to defraud, mislead, or deceive." (emphasis supplied)).

Nonetheless, there is authority to the contrary, *see generally* Bruce A. Hiler, *Dirks v. SEC—A Study in Cause and Effect*, 43 Md. L.Rev. 292, 317 & n. 105 (1985) (collecting cases). In the Second Circuit, however, the only directly contrary authority is the Second

Circuit's opinion in *United States v. Chiarella*, 588 F.2d 1358 (2d Cir. 1978), *rev'd*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980), where the Court of Appeals rejected Chiarella's argument that the Government needed to prove a specific intent to defraud. The Court of Appeals noted that although in *Ernst & Ernst v. Hochfelder*, 425 U.S. at 197, 201, 96 S.Ct. 1375 (1976), the Supreme Court had required *some* element of scienter, which it defined as "knowing and intentional misconduct" (in contrast to mere negligence), it did not impose a specific intent scienter standard. *Chiarella*, 588 F.2d at 1370. The District Court had charged the jury with finding that Chiarella had engaged in "knowingly wrongful" misconduct, and the Court of Appeals affirmed the conviction. *Id*. at 1371.

Although this aspect of the Second Circuit's decision was curious—since it rested on the dubious proposition that the scienter required for civil liability (*i.e*., *Hochfelder*) was the same as for criminal liability, even though only the latter requires "willfulness"—it might still be binding on this Court if the Second Circuit's opinion had not been reversed by the Supreme Court. 445 U.S. 222, 100 S.Ct. 1108. It is true that this aspect of the Second Circuit's opinion was not expressly overruled by the Supreme Court's decision; but the reasoning behind the reversal undercut the thrust of the Second Circuit's approach. This is because the Supreme Court held that, even though Chiarella undoubtedly knew that what he was doing was wrongful in a "mens rea" sense (—indeed, there were written billboards at his place of business expressly warning him not to do what he did and stating that it violated the law—), what he did was not a fraud on shareholders (the theory on which the case was tried). *Chiarella*, 445 U.S. at 231-36, 100 S.Ct.

1108. Since the Supreme Court held there was no fraud at all, it had no occasion to consider what was required for intent to defraud.

Thus, while the Second Circuit's opinion in *Chiarella* was technically reversed "on other grounds," the reversal was so sweeping that it is doubtful that the Second Circuit's opinion remains binding precedent in any respect here pertinent. *Cf. Picard v. HSBC Bank PLC*, 450 B.R. 406, 411-12 (S.D.N.Y. 2011) (questioning continuing precedential force of Court of Appeal's reasoning where Supreme Court's reversal broadly undercuts the lower court's approach). Other than the reversed Second Circuit opinion in *Chiarella*, no other Second Circuit case is directly on point and most are concerned with the requisite intent in non-insider-trading situations or with negating any suggestion that specific intent requires an intent to violate a particular statute or rule. *See United States v. Kaiser*, 609 F.3d 556, 568-70 (2d Cir.2010) and cases there discussed. Accordingly, the Court deems itself free to consider the issue *de novo* and, for the reasons already given, to conclude that criminal violation of subsection (a) of Rule 10b-5 is a specific intent offense.

It remains to determine what "specific intent to defraud" means in the context of such a case. Whereas in a case like *Texas Gulf Sulphur* it would mean an intent to harm shareholders, in a misappropriation case it would mean an intent to harm one's employer. A modified-*Dirks*-like case, such as this one, may have aspects of both; but the heart of the fraud is the breach of the duty of confidentiality owed to both the company and its shareholders, and accordingly the specific intent to defraud must mean, in this context, an intent

to deprive the company and its shareholders of the confidentiality of its material nonpublic information.

For the foregoing reasons, the Court, in charging the jury in this case, concluded that the answers to the questions posed at the charging conference were as follows:

> (1) The scope of an employee's duty to keep material non-public information confidential is defined by federal common law, which imposes a uniform duty on all insiders to maintain the confidentiality of material nonpublic information entrusted to them as part of a relationship of trust and confidence and not to exploit it for personal benefit.
>
> (2) To be held criminally liable, a tippee like Mr. Whitman must have a general understanding that the inside information was obtained from an insider who breached a duty of confidentiality in exchange for some personal benefit, although the tippee need not know the details of the breach or the specific benefit the insider received or anticipated receiving.
>
> (3) To be held criminally liable in a *Dirks*-like case, a tippee like Mr. Whitman must have a specific intent to defraud the company to which the information relates (and, indirectly, its shareholders) of the confidentiality of that information.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No: 13-491

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 22nd day of April, two thousand fourteen,

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UNITED STATES OF AMERICA,

Appellee,

v.

DOUG WHITMAN, AKA Sealed Defendant 1,

Defendant-Appellant.

Appellant Doug Whitman filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the Court have considered the request for rehearing *en banc*.

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

/s/ Catherine O'Hagan Wolfe