18-3065

To Be Argued By:
ALEXANDRA A.E. SHAPIRO

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellee,

—against—

EDWARD J. KOSINSKI,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

REPLY BRIEF FOR DEFENDANT-APPELLANT

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INTRODUCTION

The government concedes, as it must, that it had to prove that Dr. Kosinski owed a "duty of trust and confidence" to Regado. And it is undisputed that:

- Kosinski was an independent contractor;
- Regado never directed him to refrain from trading its securities;
- The CSRA disclaimed any fiduciary-like relationship, contained no restrictions on Kosinski's use of Regado's information, and merely required him to keep it confidential; and
- He faithfully complied with that obligation.

The government contends that the CSRA's confidentiality provision created the requisite duty. It makes no attempt to reconcile that proposition with this Court's exhortation to "tread cautiously in extending the misappropriation theory to new relationships." *United States v. Chestman*, 947 F.2d 551, 567 (2d Cir. 1991) (en banc). Nor does the government offer any cogent rationale for substituting mere "confidence" for the "*trust* and confidence" the Supreme Court requires. The government relies on language from two prior insider trading cases, but ignores that both involved alleged misappropriators who—unlike Kosinski—*divulged* confidential information to others. And the government is unable to justify SEC Rule 10b5-2(b)(1) under §10(b)'s narrow rulemaking authority or reconcile it with the rule of lenity.

The government asks this Court to rewrite its binding precedents to salvage the patently insufficient proof and jury instruction on willfulness. And it misstates the law to defend the exclusion of Kosinski's post-indictment statements, which were admissible under the rule of completeness and as excited utterances.

The convictions should be reversed.

I. KOSINSKI OWED NO DUTY OF TRUST AND CONFIDENCE

A. *Chestman* Does Not Recognize A Duty On These Facts

The government's principal argument, that the CSRA's confidentiality clause created the requisite special "duty of trust and confidence" for misappropriation liability under *Chestman* (G.Br.17-19), is wrong for two reasons. *First*, *Chestman*'s actual holding sets a much higher bar for the duty and strictly limits the types of non-fiduciary associations that can qualify to situations unlike the relationship here. *Second*, the government's argument might have force had Kosinski actually violated the confidentiality provision, but he faithfully complied with it. Accordingly, under *Chestman* and other controlling precedents the confidentiality provision cannot criminalize Kosinski's otherwise lawful trading.

1. *Chestman* Requires A Fiduciary-Like Relationship Involving Reliance, De Facto Control, And Dominance.

The Supreme Court has repeatedly held that not all trading on material nonpublic information violates §10(b). (*See* Br.18-20). To be liable, a trader (other than a tippee) must owe a fiduciary or similar "duty of trust and confidence"

and breach that duty by failing to disclose his trading to his principal(s). *United States v. O'Hagan*, 521 U.S. 642, 652-53 (1997).

The government seizes on one sentence in *Chestman* and a citation of that sentence in *United States v. Falcone*, 257 F.3d 226 (2d Cir. 2001) (G.Br.17-18), but largely ignores *Chestman*'s core holding that the requisite "relationship of trust and confidence must share the essential characteristics of a fiduciary association" and be "the functional equivalent of a fiduciary relationship." 947 F.2d at 568. The Court elaborated that "[a] fiduciary relationship involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests." *Id.* at 569. To meet the "functional equivalent" standard, the relationship must be based on "reliance, and de facto control and dominance." *Id.* at 568. In other words, rather than undertake certain tasks itself, the principal relies on someone with superior knowledge or expertise to control and dominate those tasks on its behalf. *See SEC v. DiBella*, 587 F.3d 553, 564 (2d Cir. 2009) (fiduciary relationship "characterized by a unique degree of trust and confidence between the parties, one of whom has superior knowledge, skill or expertise and is under a duty to represent the interests of the other"); *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.*, 11 N.Y.3d 146, 158 (2008) (fiduciary relation "when confidence is reposed on one side and there is resulting superiority and influence on the other").

The government nonetheless claims that "[t]he typical hallmarks of a fiduciary relationship are…not required to establish the duty of trust and confidence" and that *Chestman* "did not set forth a rigid rule." (G.Br.21). It denies that the "'essential characteristics' of a fiduciary relationship are required to establish a duty of trust." (G.Br.20). But *Chestman* was unequivocal: a relationship of trust and confidence "*must* share these qualities." 947 F.2d at 569 (emphasis added). And this Court has reaffirmed and reapplied *Chestman*'s "reliance, and de facto control, and dominance" "functional equivalent" standard in *all* fraud contexts, not just insider trading. *See*, *e.g.*, *United States v. Halloran*, 821 F.3d 321, 338 (2d Cir. 2016) (honest-services fraud); *United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) ("pump-and-dump" securities fraud scheme); *United States v. Szur*, 289 F.3d 200, 210 (2d Cir. 2002) (securities fraud); *United States v. Brennan*, 183 F.3d 139, 150 (2d Cir. 1999) (mail fraud involving insurance conflicts of interest).

The government's argument that a confidentiality agreement alone satisfies *Chestman*'s test cannot be reconciled with *Chestman* itself.

2. Under *Chestman* And *Falcone*, The Confidentiality Clause Is Irrelevant Unless It Was Breached.

To the extent *Chestman* and *Falcone* suggest that misappropriation liability can be based solely on a contractually-based confidentiality obligation, that principle is confined to situations in which the confidentiality agreement is actually

breached. Both cases involved breaching confidences—sharing confidential information with others so they could trade. Even assuming the sentence the government relies on was not *dicta* (*see* Br.30), it does not apply here because Kosinski complied with his confidentiality obligation, and nothing else in his contract barred him from using the information to trade.

Specifically, in *Chestman*, a husband learned inside information from his wife and then tipped his stock broker. This Court held that marriage alone does not create the requisite duty of trust and confidence and reversed the broker's §10(b) convictions. *Chestman*, 947 F.2d at 568, 571. But the Court opined that, if the couple had also had an express confidentiality agreement, the husband's tipping might have "breached a fiduciary duty of confidentiality to [his wife]." *Id.* at 571. In *Falcone*, Savage, an employee of a magazine wholesaler, violated *Business Week*'s confidentiality policy by leaking pre-publication copies to his neighbor, Smath; Smath traded and tipped Falcone, who also traded. 257 F.3d at 227-28. In analyzing the duty question, the Court noted that an "explicit acceptance of a duty of confidentiality" can trigger misappropriation liability, citing *Chestman*. *Id.* at 234. Because the wholesaler had agreed to abide by *Business Week*'s policy and had communicated that policy to its employees,

Savage breached both his employer's duty to *Business Week*, and his own duty to his employer. *Id.* at 235. Accordingly, this Court upheld the convictions.[1]

Therefore, in both *Chestman* and *Falcone*, the point was that a person who *breaches* a confidentiality agreement by sharing confidences with others who will trade can commit misappropriation fraud—not that a person who *complies* with his duty to keep information confidential has some additional, uncontracted-for obligation to refrain from trading under §10(b). Here, of course, Kosinski never divulged Regado's information to others, and there was no use restriction in the CSRA prohibiting him from trading. The confidentiality agreement language in *Chestman* and *Falcone* simply does not apply to this case.

That is not to say, of course, that a contract can never create the duty of trust and confidence required for a non-tipping trader to have misappropriation liability. Clearly an agreement that establishes a relationship of "reliance, and de facto control and dominance" would qualify. *Chestman*, 947 F.2d at 568. Likewise, a contract that prohibits trading on confidential information—whether through a specific trading ban or a more general restriction on the use of information—would be breached by trading, and thus could create the requisite duty. (Br.23-24, 33-

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[1] The language about confidentiality agreements was *dicta* in *Falcone*, because the outcome was dictated by the tipper's breach of his employer's policy prohibiting "theft" or "removal" of confidential information—in other words, a standard employer-employee fiduciary relationship. 257 F.3d at 235.

34).[2] But where two parties stand at arms-length, and the only possible source of a duty is the contract between them, it defies logic to say that the contract created a duty to refrain from trading if trading would not breach the contract. Stated differently, a confidentiality provision alone might suffice when the defendant breaches it by tipping, as in *Chestman* and *Falcone*. But for a contract between arms-length counterparties to bar use of confidential information for trading, the contract would need to "impose on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain." *SEC v. Cuban*, 634 F. Supp. 2d 713, 725 (N.D. Tex. 2009); *see also United States v. Kim*, 184 F. Supp. 2d 1006, 1011-12, 1015 (N.D. Cal. 2002) (mere confidentiality agreement insufficient).[3]

3. <u>The CSRA Lacked Any Prohibition On Trading Or Use</u>.

The government does not dispute that the CSRA lacked any express prohibition on trading or *any* restriction on Kosinski's use of Regado's information. It merely required Kosinski to maintain information in confidence,

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[2] Contrary to the government's contention (G.Br.22 n.4), Kosinski has never maintained that only contracts bearing "the hallmarks of a traditional fiduciary relationship" can create the necessary duty.

[3] The "Confidentiality Commitment" in *Kim* was not a contract (G.Br.23), but that had no bearing on the analysis or outcome. *See* 184 F. Supp. 2d at 1011-12, 1015. And although *Kim* pre-dated Rule 10b5-2, the Rule is irrelevant to its interpretation of the controlling caselaw, and, in any event, does not apply to business relationships, *see infra* Point I.B.

which he did. Try as it might, the government cannot sidestep the CRSA's plain language.

First, the government insists that the CSRA's nondisclosure obligation implicitly barred trading (G.Br.20, 22), but that makes no sense.[4] An agreement to maintain information in confidence is just that and nothing more; using the information to trade does not violate a confidentiality agreement because it does not disclose the information to any third party.[5] By contrast, a duty of trust binds one to act solely for the principal's benefit, and thus prohibits using the principal's information for personal gain, just like a contractual provision prohibiting trading. *See O'Hagan*, 521 U.S. at 652. *Carpenter v. United States*, 484 U.S. 19 (1987) (cited at G.Br.21), is also inapposite. Unlike Kosinski, the defendant there breached his fiduciary obligation to keep his employer's information confidential and refrain from trading on it. *Id.* at 22-23, 29.

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[4] The government also falsely asserts that the CSRA expressly "prohibited [Kosinski] from using Regado's confidential information for any purpose other than the drug trial" (G.Br.26-27), but the document contains no such language. The government's claim that the agreement between C5 Research and Regado "did not bar trading in Regado stock" (G.Br.26), is likewise directly refuted by that document, which states that C5 Research agrees "that it *will not use* [confidential information] for any other purpose." (A-337 (emphasis added)).

[5] Kosinski's trading obviously did not "diminish[]" the "value" of the information he agreed to keep confidential (G.Br.22), and the government offers no reason to think such a minimal volume of trading could have done so.

Second, the government claims that "the testimony at trial established that Kosinski was not permitted" to use information from the drug trial to trade. (G.Br.26). But it cites a Regado employee's testimony that—even though Regado declined to insert a trading prohibition in the governing agreement—the company did not "expect" that principal investigators would trade. (GA324). Critically, however, that employee's opinion was never shared with Kosinski, whose only basis for knowing what Regado "expect[ed]" was the CSRA and a disclosure form that assumed principal investigators could invest and trade in company stock. (Br.8-9). And Regado never mentioned any trading limitations during the multi-day principal investigator training sessions that Kosinski attended. (A-98-102; A-121). Regado's unexpressed "expectation" cannot create the necessary duty of trust and confidence.

Third, the government contends that the Court should not focus on the CSRA in isolation but construe it as if it incorporated the CDA's use bar. (G.Br.1-2, 26). That would fly in the face of black-letter principles of contract interpretation, because by its own terms the CSRA expressly "superseded" the CDA. (A-243). *See Health-Chem Corp. v. Baker*, 915 F.2d 805, 811 (2d Cir. 1990) (contractual term that contract "supersedes all prior agreements and understandings" "extinguished" earlier agreement). Once the CSRA was executed,

it became the governing document. And the CSRA did not bar Kosinski from buying or selling Regado securities.

Fourth, the government argues that the principal investigator's role "logically" implies a trading prohibition (G.Br.27), but the CSRA's omission of any use restriction was entirely consistent with that role. As a medical doctor, Kosinski had ethical and professional obligations to always act in the best interests of his patients. *See*, *e.g.*, Thomas L. Hafemeister & Selina Spinos, *Lean On Me: A Physician's Fiduciary Duty To Disclose An Emergent Medical Risk To The Patient*, 86 WASH. U. L. REV. 1167, 1167-70 (2009). But if he were barred from "us[ing]…Proprietary Information for [his] own benefit or the benefit of any other person or entity" (A-225), as he had been under the CDA, Kosinski's ability to comply with those obligations to his patients would have been impaired. Although an express trading restriction might have further reduced the risk of bias and strengthened principal investigators' independence (G.Br.27), judicially implying such a term into a commercial contract lacking one would violate basic due process principles of fair notice. *See United States v. Lanier*, 520 U.S. 259, 267 (1997) (due process mandates that it be "reasonably clear at the relevant time that the defendant's conduct was criminal"); *Brennan*, 183 F.3d at 150 (that "one in defendants' position [could] conclude that the relationships at issue were not fiduciary…substantially undercut…fair notice").

It is indisputable that the CSRA did not prohibit Kosinski from trading. Regado was a sophisticated biopharmaceutical company and had extensive experience conducting clinical trials. If it wanted to bar principal investigators from trading, it could have simply included an appropriate term in the CSRA.

4. The Kosinski-Regado Relationship Does Not Satisfy *Chestman*'s "Functional Equivalent" Test.

The government also fails to demonstrate that the Kosinski-Regado relationship was the "functional equivalent" of a fiduciary relationship. It acknowledges that the CSRA designated Kosinski an "independent contractor"; expressly disavowed any agency, joint venture, or partner relationship between him and Regado; and disclaimed his authority to legally bind Regado. (G.Br.25; *see* Br.8). In the face of these express disclaimers of any fiduciary-like relationship, the government clings to Kosinski's obligation to abide by Regado's drug trial protocol and his participation in the drug trial—administering the drug, collecting data, etc.—for Regado's "benefit." (G.Br.23-24).

None of that comes close to creating the required duty of trust and confidence. As explained, a fiduciary-like relationship "must share the essential characteristics of a fiduciary association"—namely, reliance, de facto control, and dominance. *Chestman*, 947 F.2d at 568. The relationship must involve "discretionary authority and dependency: One person depends on another…to serve his interests." *Id.* at 569. But Kosinski had no "discretionary authority" to

act on Regado's behalf, and Regado could not reasonably "depend[]" on Kosinski to "serve [its] interests." As a principal investigator, Kosinski was required to remain independent and act in the best interests of his patients rather than Regado, as even the government concedes. (Br.4, 30; G.Br.27).

If following a protocol and participating in a drug trial could create fiduciary-like status, with all its attendant duties and responsibilities, then virtually any person hired to perform a service would become similar to a fiduciary. For example, a homeowner who hires a plumber to replace her toilet might require him to follow her "protocol" with respect to removing his shoes, where to install the new toilet, and cleaning up after completing the job. And the plumber's work would certainly "benefit" the homeowner. But that does not make the plumber similar to a fiduciary. Abiding by Regado's protocol for its benefit likewise cannot transform Kosinski into its fiduciary.

"[W]hen parties deal at arms length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary circumstances." *United States v. Litvak*, 808 F.3d 160, 187 (2d Cir. 2015) (quoting *In re Mid-Island Hosp., Inc.*, 276 F.3d 123, 130 (2d Cir. 2002)); *see also Brennan*, 183 F.3d at 150 ("[T]he elements of domination or control are of particular importance…where all parties…were concededly sophisticated companies with experience in the industry"). The government failed

to prove any facts that would justify treating Kosinski as the "functional equivalent" of a fiduciary here.

B. Rule 10b5-2(b)(1) Exceeds The SEC's Authority And Does Not Apply To Arms-Length Business Relationships

1. The government treats SEC Rule 10b5-2 like a run-of-the-mill agency rulemaking setting industry standards based on specialized or technical expertise pursuant to an express delegation by Congress. (*See* G.Br.29-31 (citing *Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005) (FCC ruling that internet access providers do not provide "telecommunications service"); *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) (EPA regulations governing air quality standards); *City of Arlington, Tex. v. FCC*, 569 U.S. 290 (2013) (FCC rulings on wireless facility siting application)). Its analysis ignores the limited scope of Congress' delegation of rulemaking authority in §10(b), the caselaw confining the SEC's authority in that regard, and the unique constitutional problems posed by the Rule, which purports to redefine an essential element of a *criminal* offense that was developed almost entirely by the courts.

Section 10(b) does not mention insider trading. But, as discussed, for decades the Supreme Court has interpreted the term "deceptive device" as proscribing certain insider trading as a form of fraud. *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) (§10(b) is an anti-fraud provision, and "what it catches must be fraud"). Drawing on common-law principles, the Court held that

insider trading is deceptive only where there is "a relationship of trust and confidence" because those relationships give rise to "a duty to disclose." *Id.* at 230; *see id.* at 228 (failing to disclose material nonpublic information prior to a trade is fraud only if there is "a duty to do so"). In *O'Hagan*, the Court extended that principle to corporate outsiders, holding that a fiduciary who owes his principal "a duty of loyalty and confidentiality" likewise breaches that duty, and can commit "deception" within the meaning of §10(b), when he makes an "undisclosed, self-serving use of a principal's information to purchase or sell securities." 521 U.S. at 652.

The government asserts that Rule 10b5-2(b)(1) did not "expand liability beyond *O'Hagan*." (G.Br.33). That is nonsense. *O'Hagan* (like *Chiarella*) unequivocally states that there can be no deception, and thus no misappropriation liability, absent a duty of trust *and* confidence. 521 U.S. at 652. Rule 10b5-2(b)(1) guts *O'Hagan* by imposing liability "[w]henever a person agrees to maintain information in confidence." And the problem is not merely the use of a conjunction, as the government pretends (G.Br.33); the Rule would present the same issue whether it used "and" or "or." By permitting a confidentiality agreement alone (*i.e.*, a duty of confidence) to satisfy both components of the duty element, the Rule effectively excises "trust" from *O'Hagan*'s and *Chiarella*'s holdings.

Quoting *SEC v. Zandford*, 535 U.S. 813 (2002), the government contends that Rule 10b5-2(b)(1) does not exceed the SEC's rulemaking authority because §10(b) sets forth a "broad and indefinite mandate" that "should be construed…'flexibly to effectuate its remedial purpose.'" (G.Br.30). *Zandford*, however, was not about insider trading. It focused not on "deception," but on §10(b)'s requirement that deception be "in connection with the purchase or sale of any security." 535 U.S. at 819-20. And *Zandford* did not purport to overturn the well-entrenched line of Supreme Court cases holding, in no uncertain terms, that the SEC's rulemaking power under §10(b) "does not extend beyond conduct encompassed by §10(b)'s prohibition." *O'Hagan*, 521 U.S. at 651; *see also Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 146 (2011) (declining to "read into Rule 10b-5 a theory of liability similar to…what Congress has already created expressly" outside §10(b)); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) (refusing to allow Rule 10b-5 to reach "conduct not prohibited by the text of the statute"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213 (1976) ("[D]espite the broad view of [Rule 10b-5] advanced by the Commission…its scope cannot exceed the power granted the Commission by Congress under [§]10(b)") (Br.32-33).

In particular, §10(b) does not authorize the SEC to broaden when nondisclosure can be "fraud" or "deception." *Chestman*, 947 F.2d at 561-62.

Congress plainly knows how to confer such broad authority on the SEC. It did so with respect to tender offers in §14(e), which authorizes the SEC to promulgate rules that "*define*, and prescribe means reasonably designed to *prevent*, such acts and practices as are fraudulent, deceptive, or manipulative." *Id.* (emphasis added). Yet no language authorizing the SEC to "define" what is prohibited, or to promulgate prophylactic rules to deter fraud, appears in §10(b). Because of this distinction in the statutory delegation, this Court and the Supreme Court both held that the SEC could dispense with the common-law-fraud requirement of a fiduciary breach in rules promulgated under §14(e), but not those under §10(b). *O'Hagan*, 521 U.S. at 672-73, 676; *Chestman*, 947 F.2d at 560-61. We explained this in the opening brief (Br.34-35), but the government has no response. Its silence speaks volumes.

The government argues that §10(b) articulated an "intelligible principle" for the SEC to follow. (G.Br.34). But the principle is "deception" and "fraud," which require a duty of trust and confidence when premised on nondisclosure. *Chiarella*, 445 U.S. at 227-28. Permitting the SEC to dispense with the required duty would eradicate that principle and raise serious nondelegation issues. *See Yakus v. United States*, 321 U.S. 414, 425 (1944) (statute must "legislative[ly] command" administrator with sufficient specificity for "courts…to ascertain whether the will of Congress has been obeyed"); *O'Hagan*, 521 U.S. at 695 n.10 (Thomas, J.,

concurring in part, dissenting in part) ("A law that simply stated 'it shall be unlawful to do "X", however "X" shall be defined by an independent agency,' would seem to offer no 'intelligible principle' to guide the agency's discretion and would thus raise very serious delegation concerns"). Section 10(b) should be construed to avoid such constitutional problems. *INS v. St. Cyr*, 533 U.S. 289, 299-300 (2001).[6]

Because Congress did not authorize the SEC to expand fraud beyond §10(b), the Supreme Court, not the SEC, interprets what sort of duty makes nondisclosure "deception" under §10(b). Accordingly, the SEC's attempt to broaden the judicially-required duty of "trust and confidence" is not entitled to *Chevron* deference. (Br.35-36).

2. In any event, because §10(b) has criminal as well as civil applications, any ambiguity must be resolved in favor of lenity. (Br.36-37). The government seizes on a footnote in *Babbitt v. Sweet Home Chapter of Communities For a Great Oregon*, 515 U.S. 687 (1995), but that footnote "contradicts the many [Supreme Court] cases before and since holding that, if a law has both criminal and civil applications, the rule of lenity governs its interpretation in both settings." *Whitman v. United States*, 135 S. Ct. 352, 353-54 (2014) (Scalia, J., concurring in

[6] The Supreme Court is considering the scope of the nondelegation doctrine in criminal cases in *Gundy v. United States*, No. 17-6086, which was argued on October 2, 2018.

denial of *cert.*); *see Leocal v. Ashcroft*, 543 U.S. 1, 11 n.8 (2004); *United States v. Thompson/Center Arms Co.*, 504 U.S. 505, 518 n.10 (1992). And this Court has already recognized that "[m]ore than a perfunctory nod at the rule of lenity…is required" when "addressing what is frequently the core inquiry in a Rule 10b-5 criminal conviction—whether a fiduciary duty has been breached." *Chestman*, 947 F.2d at 570.

The government's suggestion that application of the rule of lenity turns on whether a particular defendant had "fair warning that his conduct was criminal" (G.Br.35), misunderstands the rule, which is a general canon of statutory construction. *Cleveland v. United States*, 531 U.S. 12, 25 (2000). In any event, the premise is wrong. A layperson like Kosinski could hardly be expected to understand what conduct is criminal when §10(b) and Rule 10b5-2(b)(1) provide divergent instructions, and the contract governing his relationship did not prohibit trading.

3. Finally, Rule 10b5-2 applies only to family and other non-business relationships. (Br.38-40). As the government concedes, the SEC promulgated Rule 10b5-2 to clarify what misappropriation duties qualify "in non-business contexts." (G.Br.35). Although the rule does not explicitly exclude business relationships from its scope, that was the SEC's clear intent, as repeatedly expressed in its published notices. (Br.38-39). That rulemaking history should

trump the plain text of the regulation, particularly where the rule has both civil and criminal applications. *See Ernst & Ernst*, 425 U.S. at 212 (although language of Rule 10b-5 can be read as proscribing mere negligent conduct, "such a reading cannot be harmonized with the administrative history of the Rule"); *Safe Air for Everyone v. EPA*, 488 F.3d 1088, 1097 (9th Cir. 2007) ("plain language of a regulation…will not control" when contrary to the agency's "clearly expressed [administrative] intent").

C. At A Minimum, The Erroneous Jury Instruction Warrants A New Trial

At a minimum, a new trial is required because the district court's instruction on confidentiality agreements misstated the law. (*See* Br.40). The government's harmlessness argument is baseless. The evidence at trial failed to establish that the Kosinski-Regado relationship was the "functional equivalent" of a fiduciary relationship. *See supra* Point I.A.4. And it is at least "possible" that the jury "may have convicted" based on the CSRA—the central document in the case—alone. *McDonnell v. United States*, 136 S. Ct. 2355, 2375 (2016). Under the district court's instructions, the jury "could have concluded" that the CSRA established a duty of trust and confidence, "and gone no further." *United States v. Silver*, 864 F.3d 102, 123 n.114 (2d Cir. 2017). There is thus is no way to "conclude with fair assurance that the error[] did not substantially influence the jury." *Litvak*, 808 F.3d at 184.

II. THERE WAS INSUFFICIENT EVIDENCE OF WILLFULNESS

The government does not contest that it failed to prove Kosinski knew he committed "a wrongful act under the securities laws" when he traded. *United States v. Cassese*, 428 F.3d 92, 98 (2d Cir. 2005); (Br.41-48). Instead it urges this Court to rewrite long-settled precedents on willfulness and sufficiency and then defends the convictions under standards it wishes were the law, instead of the real ones.

A. The Government's Version Of "Willfulness" Conflicts With Settled Law

The government erroneously contends that under *United States v. Kaiser*, 609 F.3d 556 (2d Cir. 2010), "[w]illfulness does not require proof that a defendant knew he was violating the law," but only "an awareness of the general wrongfulness of his conduct." (G.Br.41). In fact, *Kaiser* held that even though awareness of wrongfulness establishes willfulness for *other* types of securities fraud prosecutions, *insider trading* cases are different and require knowledge of unlawfulness. 609 F.3d at 569. The Court explained that *Cassese* "endorse[d] a higher standard for willfulness in insider trading cases" that "requires 'realization on the defendant's part that he was doing a wrongful act' under the securities laws.'" *Id.* That higher standard is justified because

> [u]nlike securities fraud, insider trading does not necessarily involve deception, and it is easy to imagine an insider trader who receives a tip and is unaware that his conduct was illegal and therefore wrongful.

> The same cannot be said of one who deliberately misleads investors about a security.

Id.

The government also mischaracterizes *Cassese*'s willfulness holding as *dicta*. (G.Br.47). This Court rejected that argument in *Newman*. *Compare* Br. for the United States, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), Nos. 13-1837(L) & 13-1917(CON), 2013 WL 6163307, at *52 n.25 (arguing *dicta*), *with* 773 F.3d at 445, 447 (applying *Cassese* standard as the "Law of Insider Trading").[7] In fact, in *Cassese*, the majority and the dissent agreed that knowledge of unlawfulness was the appropriate standard, though they reached different conclusions on whether the evidence sufficed. *See* 428 F.3d at 98, 109. And the government's claim that *Kaiser* limited *Cassese* to "remote tippee" cases is fantasy. (G.Br.48). *Kaiser* says no such thing, and *Cassese* involved a misappropriator who traded without tipping. 428 F.3d at 96.

Lastly, the government complains that *Cassese* "expanded this Court's precedent without explanation" (G.Br.46), but this Court has repeatedly reaffirmed

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[7] Nor did *Kaiser* "interpret[] *Cassese*'s willfulness statement as *dicta*," as the government contends. (G.Br.47). *Kaiser* noted that *Cassese* did not address whether an even *higher* willfulness standard is required, under which a defendant must "knowingly commit the *specific violation* charged." 609 F.3d at 569 (emphasis added). Because *Cassese* simply requires knowledge of unlawfulness under the securities laws—not knowledge of a *specific* securities law violation—it is consistent with *United States v. Dixon*, 536 F.2d 1388 (2d Cir. 1976), and the Securities Exchange Act, contrary to the government's arguments (G.Br.48-49).

that *Cassese*'s standard applies in insider trading cases. *See Newman*, 773 F.3d at 447; *see also Kaiser*, 609 F.3d at 569 (willfulness in insider trading context requires proof defendant knew "his conduct was illegal"). The government prefers a lower bar, but *Cassese*, *Kaiser*, and this aspect of *Newman* are the controlling law, and this Court is bound to follow them. *See In re Zarnel*, 619 F.3d 156, 168 (2d Cir. 2010) ("This panel is 'bound by the decisions of prior panels until such time as they are overruled either by an en banc panel of our Court or by the Supreme Court.'"); *accord Fed. Deposit Ins. Corp. v. First Horizon Asset Sec., Inc.*, 821 F.3d 372, 375 (2d Cir. 2016).

B. The Evidence Was Insufficient

In addressing sufficiency, the government attempts to upend the settled rule that evidence is insufficient as a matter of law when it at best "gives equal or nearly equal circumstantial support to a theory of guilt and a theory of innocence." *United States v. Valle*, 807 F.3d 508, 522 (2d Cir. 2015); *see also United States v. Glenn*, 312 F.3d 58, 70 (2d Cir. 2002). Relying on a single paragraph in *United States v. Aquart*, 912 F.3d 1 (2d Cir. 2018), the government argues that the "equipoise rule" no longer applies to sufficiency analysis. (G.Br.40 n.5).

But the rule has been law in this Circuit for decades. *See*, *e.g.*, *United States v. Monsalvatge*, 689 F. App'x 680, 682 (2d Cir. 2017); *United States v. Coplan*, 703 F.3d 46, 72 (2d Cir. 2012); *Cassese*, 428 F.3d at 103; *United States v.*

D'Amato, 39 F.3d 1249, 1256 (2d Cir. 1994); *United States v. Mulheren*, 938 F.2d 364, 372 (2d Cir. 1991). Indeed, just two weeks ago this Court again reaffirmed that "the government must do more than introduce evidence 'at least as consistent with innocence as with guilt.'" *United States v. Pauling*, No. 17-2539-CR, ---F. 3d---, 2019 WL 2220129, at *4 (2d Cir. May 23, 2019).[8]

The government's effort to prop up the sufficiency of its proof depends upon its erroneous rewrite of the governing standards and withers under scrutiny.

First, the government doubles-down on its "duty" arguments by labeling the CSRA's confidentiality proviso proof of willfulness. (G.Br.42 (claiming Kosinski violated the CSRA and "betrayed his promise of confidentiality to Regado" when he traded)). But as discussed, the CSRA on its face unambiguously did *not* prohibit Kosinski from trading. Accordingly, it could not have alerted Kosinski that trading was illegal or even wrongful. *See United States v. Torres*, 604 F.3d 58, 67-72 (2d Cir. 2010) (reversing conviction because defendant was unaware of facts that made his conduct criminal). On the contrary, because the CDA prohibited trading, the CSRA's subsequent omission of a similar use bar gave Kosinski every reason to believe that he could trade. (*See* Br.43-44).

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[8] To the extent the *Aquart* panel suggested otherwise, it was *ultra vires*. *See supra*, at 22.

Second, the government cites Kosinski's statements to the FBI. (G.Br.42). But most of those statements reflect his mindset on the day the FBI interviewed him, not his mindset on the day he traded—the only state of mind relevant to willfulness (at least with respect to inculpatory evidence, *see infra* at 29). *See Cassese*, 428 F.3d at 101. And "a guilty conscience or an impulse to cover one's tracks does not bespeak criminally fraudulent conduct within the context of the securities laws." *United States v. Finnerty*, 533 F.3d 143, 151 (2d Cir. 2008). In any event, none of the statements reflect willfulness. Kosinski's comments that "greed and stupidity" caused him to trade, it was a "stupid thing," and that he "didn't feel good" at the time are a far cry from confessing that his actions were wrongful, let alone that they were unlawful.

Third, the government focuses on Kosinski's stock ownership forms (G.Br.43), but ignores that they were signed months before the trading at issue. *See Cassese*, 428 F.3d at 101 ("only his mind set on the day he purchased the shares is relevant"). The government's claim that Kosinski knew he "was planning to engage in" unlawful trading (G.Br.43) is utterly devoid of record support and classic "impermissible speculation" that carries no weight on sufficiency review. *Pauling*, 2019 WL 2220129, at *4. The provenance of the forms also greatly undercuts any probative force. The government denies that there was record evidence showing that Kosinski's assistant filled out the St. Vincent's form before

Kosinski owned Regado shares. (G.Br.43). But the evidence clearly demonstrates that Kosinski's assistant was "working on [his] submission to [St. Vincent]" in September 2013 (A-156, 293-94), and that Kosinski first purchased Regado shares that October (A-130). Similarly, the government introduced no evidence that Kosinski deliberately delayed updating his FDA financial disclosure form; on the contrary, as soon as an update was requested, he quickly supplied an accurate one. (A-302-03).

Finally, the government invokes Kosinski's trading experience. (G.Br.44). But Kosinski is a doctor, not a professional investor; his amateur trading cannot prove willfulness. And the distinction the government attempts to draw between *Newman* and this case is unpersuasive. In both cases, the government sought to establish scienter by showing that the defendants were "sophisticated" investors. Whether the relevant state of mind is knowledge of the source of the information or knowledge of a wrongful act under the securities laws is immaterial; sophistication cannot substitute for the requisite "intent to commit insider trading." *Newman*, 773 F.3d at 455.

In sum, none of this evidence—either in isolation or collectively—would give a reasonable jury greater reason to conclude that Kosinski acted willfully rather than innocently or negligently. The evidence is thus insufficient to sustain the convictions as a matter of law. *See Pauling*, 2019 WL 2220129, at *4-5, 8-9

(affirming judgment of acquittal based on distinction between "permissible inference and impermissible speculation" that can exist even when "a disputed fact…is within the realm of possibility"); *Mulheren*, 938 F.2d at 371-72 (reversing conviction because the purported evidence of defendant's intent to manipulate the market was "at least as consistent with innocence as with guilt" and the jury could not reach the decision it did without "engag[ing] in false surmise and rank speculation").

C. The Willfulness Instruction Was Fatally Flawed

The government does not seriously dispute that under *Cassese* the willfulness instruction was legally erroneous.[9] Instead, it resorts to spurious waiver claims. (G.Br.44-45).

Kosinski preserved all the jury instruction-related arguments raised in this appeal. At the charge conference he objected to the district court's proposed willfulness charge in its entirety. (GA1241). He also specifically objected to the district court's proposed instruction that willfulness merely requires acting "with bad purpose either to disobey or to disregard the law." (A-204-06). And he asked the district court on multiple occasions to instruct the jury using "the willfulness

[9] Contrary to the government's argument (G.Br.49), the instructions were not consistent with *Bryan v. United States*, 524 U.S. 184 (1998), because they did not clearly require proof of knowledge of general unlawfulness. And the government does not try to defend the other challenged instructions or the juror questionnaire, which it concedes was "inartful." (G.Br.50 n.9).

formulation…from *Cassese* and from *Bryan*." (A-206-07; A-200-03). That Kosinski did not identify the precise language from *Cassese* and *Bryan* is irrelevant. *See United States v. Hassan*, 578 F.3d 108, 129 (2d Cir. 2008) ("Rule 30(d) requires only that a party 'inform the court of the specific objection,'…and does not require that a party propose alternate language in order to preserve a challenge for appeal").

III. THE DISTRICT COURT ERRONEOUSLY EXCLUDED KEY EXCULPATORY EVIDENCE

A. Kosinski's Statements Were Admissible

The district court erroneously excluded two of Kosinski's statements that were admissible under the rule of completeness because they were necessary to explain the admitted statements, put them in context, and avoid misleading the jury. (Br.52-54). The government protests that the rule of completeness does not permit the admission of hearsay (G.Br.54), but that is plainly wrong. This Court has consistently interpreted the rule to permit the introduction of hearsay evidence. *See*, *e.g.*, *United States v. Fawwaz*, 691 F. App'x 676, 678 (2d Cir. 2017); *United States v. Johnson*, 507 F.3d 793, 796 (2d Cir. 2007). Indeed, the government's interpretation would eviscerate the rule. It would allow the government to use hearsay as a sword and a shield: the government could introduce misleadingly selective excerpts of defendants' conversations, yet cry hearsay to insulate other

less inculpatory (or exculpatory) excerpts of the same conversations from the jury's review.

The government also frets that if Kosinski's other statements to the agents had been admitted, the jury would have made speculative inferences about them. (G.Br.56). But, as the government well knows, "the task of choosing among permissible competing inferences is for the jury." *United States v. Salmonese*, 352 F.3d 608, 618 (2d Cir. 2003); *see also United States v. Huezo*, 546 F.3d 174, 181-83 (2d Cir. 2008); (G.Br.39-41). Its argument goes to weight, not admissibility.

The statements were also admissible as excited utterances. (Br.54-56). Kosinski was startled when the agent told him he had been indicted and said he "can't believe this is happening." (A-117-18). The government claims Kosinski could not have really been surprised because he "was aware of the possibility that he might be charged." (G.Br.57). But the government points to no evidence of prior warning, and being indicted is clearly startling, whether or not one knew of the investigation beforehand. The district court's assertion that Kosinski made the statement "after he had an opportunity to…reflect upon the impact of what the agent was saying to him" (A-160-61), is contradicted by its later description of his other statements as "spontaneous[] react[ions]." (SPA-22). The government tries to minimize this inconsistency by claiming that spontaneity and excited utterances "are not the same." (G.Br.57). But courts use the terms interchangeably in this

context. *See*, *e.g.*, *White v. Illinois*, 502 U.S. 346, 350, 355 n.8 (1992) (Illinois rule regarding "spontaneous declarations" was functionally identical to Fed. R. Evid. 803(2)); *Brown v. Keane*, 355 F.3d 82, 87 (2d Cir. 2004) ("spontaneous declarations" are "also called 'excited utterances'"). Finally, although Kosinski's attorney statement preceded the news of the indictment (G.Br.51, 57-58), the district court did not rely on that sequencing when it excluded the statement (A-160-61; GA676-82), and the phone call from the FBI was itself a startling event. In any event, the statement is plainly admissible under the rule of completeness.

B. The Error Was Not Harmless

The evidence of willfulness was thin at best—indeed insufficient—so any error was plainly not harmless, despite the government's protestations (G.Br.58-59). *See supra* Point II.B.

The government also argues that the statements were irrelevant because Kosinski made them two years after his trades (G.Br.58)—even though that is obviously also true of the statements the government introduced and relied upon so heavily. Moreover, unlike inculpatory evidence of willfulness, exculpatory evidence can be relevant even if it conveys the defendant's state of mind months or years after the alleged criminal conduct. *See United States v. Biaggi*, 909 F.2d 662, 690-91 (2d Cir. 1990) (defendant's subsequent rejection of government offer of immunity on ground that he was "unaware of any wrongdoing" was "probative

of a state of mind devoid of guilty knowledge"); *see also United States v. Scheffer*, 523 U.S. 303, 332 (1998) ("evidence of [defendant's] innocent state of mind is 'critical to a fair adjudication of criminal charges'"). Kosinski's 2016 statements of surprise about being indicted, for example, are circumstantial evidence that, at the time of his 2014 trades, he did not believe his trading was unlawful.

Finally, the government argues that Kosinski was not prejudiced by the exclusion of the two statements because he was able to present other evidence of his good faith. (G.Br.59). But the "good faith" evidence Kosinski was permitted to use was qualitatively different from the excluded evidence. Kosinski's statements to the agent reflected his actual thoughts and state of mind, in his own words. None of the "good faith" evidence the government cites (*e.g.*, Kosinski bought shares in his own name and updated his disclosure form when requested) provided such direct evidence of scienter. Because Kosinski's statements "lend[] support to the theory of the defense," their exclusion was not harmless error and the convictions must be reversed. *United States v. Detrich*, 865 F.2d 17, 21-22 (2d Cir. 1988).[10]

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[10] The government's claim that Kosinski had "ample opportunity to cross-examine the agent" (G.Br.53 n.10) misses the point. Kosinski's Confrontation Clause rights were violated because he was precluded from showing the jury that the agent was omitting important context about his conversation with Kosinski—context which showed that Kosinski did not believe his trading had been illegal. (Br.56-57).

CONCLUSION

This Court should reverse the convictions and remand with instructions to enter a judgment of acquittal or, at a minimum, vacate and remand for a new trial.

Dated: New York, New York
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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS AND TYPE STYLE REQUIREMENTS

The undersigned counsel of record for Defendant-Appellant Edward J. Kosinski certifies pursuant to Federal Rule of Appellate Procedure 32(g) and Local Rule 32.1 that the foregoing brief contains 6,976 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f), according to the Word Count feature of Microsoft Word 2016; and that this brief has been prepared in 14-point Times New Roman.

Dated: June 7, 2019

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