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

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellee,

v.

TODD NEWMAN and ANTHONY CHIASSON,

Defendants-Appellants.

REPLY IN SUPPORT OF MOTION OF DEFENDANT-APPELLANT ANTHONY CHIASSON FOR RELEASE PENDING APPEAL

Appeal from the United States District Court
for the Southern District of New York, No. 12 Cr. 121
Before the Honorable Richard J. Sullivan

Mark F. Pomerantz
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019
(212) 373-3000

Alexandra A.E. Shapiro
SHAPIRO, ARATO &
ISSERLES LLP
500 Fifth Avenue, 40th Floor
New York, New York 10110
(212) 257-4880

Gregory Morvillo
MORVILLO LLP
One World Financial Center, 27th Floor
New York, New York 10281
(212) 796-6330

Attorneys for Defendant-Appellant Anthony Chiasson

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Anthony Chiasson's appeal presents a quintessential "substantial question" under 18 U.S.C. § 3143(b): can a remote and passive tippee commit insider trading if he acts on inside information that he did not know had been provided for personal gain? Before this case, the five courts to consider this question all had ruled that, under *Dirks v. SEC*, 463 U.S. 646 (1983), a tippee must know the insider was acting for personal benefit. The judge below disagreed, based on his interpretation of *SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012). But the issue was not presented, much less decided, in *Obus*, and the decision below conflicts directly with Judge Rakoff's post-*Obus* decision in *United States v. Whitman*, 904 F. Supp. 2d 363 (S.D.N.Y. 2012). Thus, until this appeal is decided, some defendants' fates will turn entirely on the identity of the judge to whom their case is assigned. Given this conflict among district courts, Chiasson's appellate issue is "fairly debatable" and therefore a "substantial question" warranting bail. *United States v. Randell*, 761 F.2d 122, 125 (2d Cir. 1985).

I. Chiasson's Appeal Presents A Substantial Question

A. The Issue Is Plainly Debatable.

Whether an appeal presents a "substantial question" is a legal issue that this Court reviews *de novo*.[1] A "substantial question" is "a close question or one that

[1] The government misrepresents the applicable standard of review as "clear error." (Opp'n ¶33 (citing *United States v. Sabhnani*, 493 F.3d 63, 75 (2d Cir. 2007))). *Sabhnani* involved factual findings regarding risk of flight for a pretrial detention

very well could be decided the other way," as the government acknowledges. (Opp'n ¶ 32 (quoting *Randell*, 761 F.2d at 125)). Here, five courts (four in this Circuit, one after *Obus*) already have "decided [the question] the other way." *See Whitman*, 904 F. Supp. 2d at 370-72; *United States v. Rajaratnam*, 802 F. Supp. 2d 491, 498-99 (S.D.N.Y. 2011); *Hernandez v. United States*, 450 F. Supp. 2d 1112, 1118 (C.D. Cal. 2006); *United States v. Santoro*, 647 F. Supp. 153, 170 (E.D.N.Y. 1986), *rev'd on other grounds*, 845 F.2d 1151 (2d Cir. 1988); *State Teachers Ret. Bd. v. Fluor Corp.*, 592 F. Supp. 592, 594-95 (S.D.N.Y. 1984).

The government plainly does not like these cases, as it does not mention them for the first 24 pages of its brief. It then summarily dismisses the cases from the Southern District (while ignoring the other two) as "incorrect" under *Dirks*. (Opp'n ¶¶ 43-44). But for purposes of bail, the issue is not whether the defense position is "correct." *See Randell*, 761 F.2d at 124-25 (holding that "substantial" does *not* mean "likely to result in reversal or an order for a new trial"). Instead, bail must be granted if the issue is "fairly debatable." *Id.* at 125.

That standard is plainly satisfied here, because every other court to consider the issue has agreed, in reasoned analyses, with the defendants' position. For example, as the *Whitman* court explained:

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order, rather than a legal conclusion about whether a question is "substantial" for purposes of bail pending appeal. Whether an appeal raises a "substantial question" is reviewed *de novo*. *E.g.*, *United States v. Garcia*, 340 F.3d 1013, 1015 (9th Cir. 2003); *United States v. Pollard*, 778 F.2d 1177, 1182 (6th Cir. 1985).

> [T]he 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 . . . must be present.
>
> 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.

904 F. Supp. 2d at 370-71.

The government itself has previously acceded to this view of the law. In *Rajaratnam*, the government did not dispute that it had to prove tippee knowledge of personal benefit in a classical theory case. *See*, *e.g.*, Shapiro Reply Decl. Ex. C (stating no objections to court's proposed charge); *see also Santoro*, 647 F. Supp. at 170 n.14. Presumably, the prosecutors were satisfied that they had offered abundant proof of the defendant's knowledge, and they agreed to the instruction. Here, there was no such proof, and they opposed it. But the elements of criminal scienter ought not depend on how the government handicaps its evidence.

The government now maintains that *Dirks* does not require that tippees know whether the insider discloses information for personal benefit, and even claims that the issue has long been settled in this Circuit. (Opp'n ¶¶ 34-37). This position is untenable. Judge Sullivan acknowledged that requiring a tippee's knowledge of the insider's personal benefit is "supportable certainly by the

language of *Dirks*." (Tr. 3595).[2] He thought he was constrained to rule the other way by what he believed was this Court's contrary view in *Obus*. (Tr. 3595, 3604-05). Of course, Judge Rakoff had a different interpretation of *Obus*, and that is yet another reason the issue on appeal is a "substantial question."

What is more, as the government acknowledges (Opp'n ¶ 37), each of the pre-*Obus* decisions it cites involved the misappropriation theory of insider trading.[3] Prior to *Obus*, this Circuit had not required the government to prove that a tipper in a misappropriation case received a personal benefit. *See*, *e.g.*, *Falcone*, 257 F.3d at 231-32. It is thus hardly surprising that earlier misappropriation cases did not require a tippee to know of the tipper's personal benefit, since the tippee's guilt is derivative. But, as the government conceded below (and as Judge Sullivan charged the jury), the tippers in this case had to have benefited personally from their disclosures of information. (Tr. 4032-33). It therefore follows that the defendant-tippees also needed to know this fact to be guilty.

B. The Government's Reading Of *Dirks* Is Wrong.

The entire premise of the government's argument is inconsistent with *Dirks* and its progeny. The opposition papers treat a tipper's breach of fiduciary duty and a tipper's receipt of personal benefit as if they were distinct and unrelated

[2] All cited transcript pages and trial exhibits that were not cited in Chiasson's Motion are attached as Shapiro Reply Decl. Exs. A & B, respectively.
[3] *United States v. Falcone*, 257 F.3d 226 (2d Cir. 2001); *United States v. Mylett*, 97 F.3d 663 (2d Cir. 1996); *United States v. Libera*, 989 F.2d 596 (2d Cir. 1993).

concepts. The prosecution assumes that there can be a fiduciary breach without a personal benefit motive, and that a tippee can be criminally liable if he knows only of the former, even if ignorant of the latter. (*E.g.*, Opp'n ¶¶ 35-36, 42). This is simply not the law. *Dirks*' central and unambiguous holding is that, for purposes of insider trading liability, a tipper breaches his fiduciary duty *only* by disclosing inside information *for personal benefit*, and a tippee's liability is entirely derivative of the tipper's liability:

> [T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach [by a tippee].

463 U.S. at 662. Because the tipper's personal benefit motive distinguishes a fraudulent fiduciary breach from a mere unauthorized disclosure, a tippee cannot be derivatively liable unless the insider disclosed information for a personal benefit. *Dirks* thus squarely refutes the government's assertion that "[t]rading securities based on nonpublic information disclosed by a corporate insider in violation of a duty of confidentiality" is inherently wrongful. (Opp'n ¶ 42).

The government's misreading of *Dirks* infects its analysis of *mens rea*. The standard is not whether a defendant knows that conduct is "likely culpable" or "likely subject to strict regulation." (Opp'n ¶ 42 (quoting *United States* v. *Weintraub*, 273 F.3d 139, 147 (2d Cir. 2001)). In *Weintraub* the Court construed a standard—"knowingly violates" under the Clean Air Act—that the Supreme

Court had held "did not require knowledge that the defendant's conduct was unlawful." *Id.* A criminal conviction under the insider trading laws, however, requires "willfulness"—the realization that one's actions violate the law. *E.g.*, *United States v. Cassese*, 428 F.3d 92, 98 (2d Cir. 2005); *see* Chiasson Mot. 14-15.

The mere receipt of material nonpublic information originating with an issuer does not mean that trading is forbidden under the securities laws: market participants owe no "general duty . . . to forgo actions based on material, nonpublic information" because the insider trading laws were not intended to achieve parity of information. *Chiarella v. United States*, 445 U.S. 222, 233 (1980); *see* Chiasson Mot. 12. This is why this Circuit applies a higher *mens rea* standard for insider trading cases than for other securities offenses—to avoid wrongfully convicting "an insider trader who receives a tip and is unaware that his conduct was illegal and therefore wrongful." *United States v. Kaiser*, 609 F.3d 556, 569 (2d Cir. 2010). In order to engage in criminally "willful" conduct, a remote tippee must know the facts—including the insider's self-dealing—that allegedly make his trading unlawful. Simply instructing the jury that it must find that the tipper intended to gain a personal benefit (*see* Opp'n ¶ 41) does not adequately ensure against conviction of innocent tippees.

The government ignores this Court's cases construing the willfulness

standard, and the cases it cites are completely inapposite. These decisions address whether a defendant must know facts that are purely jurisdictional or trigger an enhanced penalty, where the underlying conduct, such as drug trafficking or prostitution, is obviously illegal. (*See* Opp'n ¶ 42 n.15).[4] Here, by contrast, the fact unknown to Chiasson—that the insiders were disclosing information for personal gain—is what distinguishes lawful from illegal trading under *Dirks*. If Chiasson believed that the tippers were merely "leaking" financial information in violation of their companies' confidentiality rules, or in violation of fair disclosure regulations, he was not knowingly committing a crime by trading even if, unbeknownst to him, they were acting for personal gain.

Finally, contrary to the government's argument (Opp'n ¶¶ 38-40), *Obus* did not address, much less decide, the issue presented in this appeal. The question in

[4] *United States* v. *Griffith*, 284 F.3d 338, 350-51 (2d Cir. 2002) ("knowingly" transporting minor for prostitution does not require knowledge of minor's age because "a defendant is already on notice that he is committing a crime when he transports an individual of any age in interstate commerce for the purpose of prostitution"); *United States* v. *King*, 345 F.3d 149, 152-53 (2d Cir. 2003) ("drug dealers . . . need not know the type and quantity of drugs in their possession" for sentencing enhancements); *United States v. Falu*, 776 F.2d 46, 50 (2d Cir. 1985) ("Anyone who violates [21 U.S.C § 845a(a)] knows that distribution of narcotics is illegal, although the violator may not know that the distribution occurred within 1,000 feet of a school."); *United States* v. *Roglieri*, 700 F.2d 883, 885 (2d Cir. 1983) (defendant must know item was stolen but not that it was stolen from the mail); *United States* v. *Baker*, 693 F.2d 183, 186 (D.C. Cir. 1982) (defendant need not know fact that "merely furnishes the basis for federal jurisdiction"); *United States* v. *Mingoia*, 424 F.2d 710, 712 (2d Cir. 1970) (knowledge that stolen goods were transported in interstate commerce not required).

Obus was whether, in the civil context, a tippee must actually know that the tipper breached a fiduciary duty or whether a "knows or should know" standard suffices. *See* 693 F.3d at 287-88. The Court did not resolve whether the tippee must know that the tipper had disclosed the information for his personal benefit. The government insists that the issue was "squarely presented" in the parties' briefs, citing the defendants' argument that they had to know the tipper was acting "for a purpose other than carrying out his job duties." (*See* Opp'n ¶ 40). But the SEC did not respond to the defendants' argument in its reply, and never disputed that knowledge of personal benefit was necessary. *See* SEC Brief, 2011 WL 1228158 (Mar. 29, 2011); SEC Reply Brief, 2011 WL 3436236 (July 2011). And unlike the government here, the SEC acknowledged *Dirks*' holding that the tipper's personal benefit is a critical element of—and not separate and distinct from—a breach of fiduciary duty. *See* SEC Brief, 2011 WL 1228158, at *31, n.5 (arguing that the tipper's personal benefit "demonstrates that the '"tip" constituted a breach of [his] fiduciary duty.'" (quoting *Dirks*, 463 U.S. at 661)).

Even on the view that *Obus* changed the law that prevailed in this Circuit at the time of Chiasson's conduct in 2008 and 2009, the district court's retroactive application of the decision to Chiasson's conduct raises a substantial due process issue. (*See* Chiasson Mot. 19-20). The government ignores this problem, and by offering no response to Chiasson's argument effectively concedes the point.

II. Resolution In Chiasson's Favor Would Result In Reversal Or A New Trial

If the court below erred, there can be no credible claim that the error was harmless beyond a reasonable doubt. *See Neder v. United States*, 527 U.S. 1, 18 (1999). Had the court properly instructed the jury, Chiasson's closing argument would have focused on his lack of knowledge of the tippers' personal gain, and the jury could (and should) have reached a different result. Indeed, the case should not have gone to the jury, for there simply was no evidence that Chiasson knew that the Dell or NVIDIA information, which he received fourth- and fifth-hand, came from insiders acting for personal benefit. (Chiasson Mot. 6-8).

As to Dell, the government effectively concedes there is no evidence that Chiasson knew Rob Ray's (the Dell insider's) supposed motive of obtaining "career advice," for it offers none. (Opp'n ¶ 12). The government does claim that Sam Adondakis "told Chiasson that the NVIDIA insider disclosed the information to a friend" (*id.* ¶ 46 (citing Tr. 1878)), but that claim is utterly false, and confuses the NVIDIA insider with one of the intermediaries in the tipping chain. Adondakis testified that he never even told Chiasson where the NVIDIA "contact" worked. (Tr. 1879). And the cited testimony does not mention the NVIDIA insider at all: Rather, Adondakis testified that he told Chiasson that a friend of a friend "would be getting information from Nvidia through a friend of his who he went to church with [*i.e.*, Hyung Lim]." (*Id.* 1878). But Lim was not the

NVIDIA insider (*see id.* 2107-08, 2157, 2333-34, 3031-34). Adondakis never told Chiasson anything about Lim's relationship with the actual NVIDIA insider, Chris Choi. Indeed, there is no proof that Adondakis himself knew anything about Choi, much less why Choi shared information with Lim.

Because there is no evidence that Chiasson was aware that the Dell or NVIDIA insiders acted for personal benefit, the government strains to argue that Chiasson had constructive knowledge of the benefit. (*See*, *e.g.*, Opp'n ¶¶ 15-18, 20-21, 45 (contending Chiasson knew corporate insiders provided information "for an improper purpose," "without authorization" or without "legitimate" corporate purpose); *see also id.* ¶ 46 (claiming Chiasson "had every reason to know" when disclosures are unauthorized and therefore knew that insiders "must have" disclosed the information "for a personal benefit")).

This argument is nothing more than legal legerdemain. The *mens rea* standard requires more than "should have known" or "must have known." Further, the argument is based upon a false premise. The government assumes that all disclosures of material information by insiders are either (1) company-authorized and published to the world, or (2) "unauthorized" and therefore outsiders cannot trade on the information. Of course, information that is company-authorized and published to the world is not confidential or non-public. In any case, there is a vast gray area between the government's two categories.

Insiders often breach corporate confidentiality policies or even Regulation FD by selectively providing nonpublic information to certain investors, but intending to benefit the corporation (*e.g.*, to retain a major shareholder), rather than for any fraudulent personal benefit. The record is replete with examples of precisely this sort. For example, there was abundant evidence that, notwithstanding internal policies, Dell and NVIDIA executives repeatedly disclosed sensitive, nonpublic financial information, including during "blackout" periods, to certain analysts and investors. (*See* Chiasson Mot. 8; Newman Mot. 7-8; Newman Reply 6-8). Even Dell's CFO and its head of Investor Relations, Lynn Tyson, previewed the company's restructuring plans to analysts at hedge funds and other firms before that information was disclosed to others. (*See* DX 126; DX 208; Tr. 697-700).[5]

The government's false dichotomy between good and bad disclosures not only conflicts with the record, but also is fundamentally at odds with decades of Supreme Court authority interpreting § 10(b) and Rule 10b-5. Insider trading liability is not triggered by a mere breach of a company's confidentiality, its internal policies, or Regulation FD. *See supra* at 4-6; Chiasson Mot. 12-14.[6] And not just any "improper purpose" will do, as the government suggests (*e.g.*, Opp'n

[5] The government either ignores these and the many other specific disclosures presented at trial or mischaracterizes them as "general sentiments." (Opp'n ¶ 19).
[6] *Cf. United States v. Cassese*, 273 F. Supp. 2d 481, 488 (S.D.N.Y. 2003) (dismissing § 10(b) charge against tippee where company's CEO disclosed confidential information about an impeding acquisition).

¶¶ 16, 45); *Dirks*' "improper purpose" is narrowly limited to corrupt self-dealing that puts the individual's personal interests ahead of the corporation's. *See* 463 U.S. at 659 ("Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same *improper purpose of exploiting the information for their personal gain*." (emphasis added)). To accept the government's argument, in effect, would endorse the "parity of information" approach to insider trading law that the Supreme Court has rejected on multiple occasions, because all inside information either would be disclosed to the entire market or would be deemed "improperly" disclosed, and therefore the predicate for insider trading. This is not the way the world works, and it is not the law.

Finally, even under a sufficiency standard, the record will not support a finding that Chiasson knew the insiders were acting for personal benefit. As a "sophisticated" investor, Chiasson was well aware that high-level executives frequently leaked significant information to selected investors for corporate purposes rather than personal benefit, as set forth above, yet the government presupposes that he could distinguish one from the other based solely on the information he received. There was nothing about the "timing and frequency" or "nature and specificity" (Opp'n ¶¶ 16, 18) of the Dell or NVIDIA information that would have alerted Chiasson that it was disclosed for personal benefit and

therefore he could not trade. Nor does the claim of "conceal[ment]" (*id.* ¶ 46) advance the ball. The government misrepresents the record,[7] and invites an unreasonable inferential leap (that a hedge fund manager's desire to keep details about his research confidential demonstrates knowledge that his sources are acting corruptly for personal gain) that amounts to sheer speculation even on sufficiency review. *United States v. D'Amato*, 39 F.3d 1249, 1256 (2d Cir. 1994) ("[A] conviction based on speculation and surmise cannot stand."). Further, since the jury was not required to find that the defendants knew the insiders were acting for personal gain, no inferences may be drawn in the government's favor even for sufficiency purposes, much less whether to grant a new trial due to the instructional error. *See United States v. Mejia*, 545 F.3d 179, 199 n.5 (2d Cir. 2008). If the instruction was erroneous, the Court must grant a new trial unless the error was harmless "beyond a reasonable doubt," which it surely was not. Thus, a decision in Chiasson's favor "is likely to result in reversal or an order for new trial on all counts." *Randell*, 761 F.2d at 125.

CONCLUSION

For foregoing reasons, this Court should grant release pending appeal.

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[7] The government says Chiasson told Adondakis to create "bogus" and "sham" reports misrepresenting the basis for Level Global's trades (Opp'n ¶¶ 24, 46), but Chiasson merely told Adondakis to keep the internal reports "high level." (*See* GX 928). Moreover, if Chiasson was trying to conceal the fact that Level Global used information from company contacts, he would not have told an outsider such as Jeremy Yuster about it. (*See* Opp'n ¶ 20).

Dated: New York, New York
June 10, 2013

Respectfully submitted,

/s Alexandra A.E. Shapiro

Mark F. Pomerantz
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, New York 10019
(212) 373-3000

Alexandra A.E. Shapiro
SHAPIRO, ARATO & ISSERLES LLP
500 Fifth Avenue, 40th Floor
New York, New York 10110
(212) 257-4880

Gregory Morvillo
MORVILLO LLP
One World Financial Center
27th Floor
New York, New York 10281
(212) 796-6330

Attorneys for Defendant-Appellant Anthony Chiasson