No. 20-1161

In the Supreme Court of the United States

EDWARD J. KOSINSKI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF MARK CUBAN AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

CHRISTOPHER J. CLARK
Counsel of Record
MICHAEL S. BOSWORTH
NICHOLAS R. HAZEN
LATHAM & WATKINS LLP
885 Third Avenue
New York, NY 10022
(212) 906-1200
chris.clark@lw.com

Counsel for Amicus Curiae *Mark Cuban*

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT.....................................2

ARGUMENT 4

I. INSIDER TRADING LIABILITY CANNOT BE IMPOSED ABSENT A RELATIONSHIP OF TRUST, AS WELL AS CONFIDENCE. 4

II. PARTICIPANTS IN THE SECURITIES MARKETS NEED CLEAR AND OBJECTIVE *EX ANTE* RULES ABOUT WHAT CONDUCT CONSTITUTES INSIDER TRADING. 7

III. THE RULE OF LENITY COUNSELS AGAINST PRESERVING THE SECOND CIRCUIT'S DECISION. 12

CONCLUSION...17

TABLE OF AUTHORITIES

Page(s)

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975) 12

Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,
511 U.S. 164 (1994) 8, 9

Chiarella v. United States,
445 U.S. 222 (1980) 4, 5, 6, 7, 16

Cleveland v. United States,
531 U.S. 12 (2000) 13

Crandon v. United States,
494 U.S. 152 (1990) 13

Dirks v. SEC,
463 U.S. 646 (1983) .... *passim*

McDonnell v. United States,
136 S. Ct. 2355 (2016) 15

Pinter v. Dahl,
486 U.S. 622 (1988) 8, 12

Salman v. United States,
137 S. Ct. 420 (2016) 5, 6

SEC v. Cuban,
634 F. Supp. 2d 713 (N.D. Tex. 2009) 9

SEC v. Cuban,
620 F.3d 551 (5th Cir. 2010) 10

TABLE OF AUTHORITIES—Continued

Page(s)

SEC v. Tambone,
597 F.3d 436 (1st Cir. 2010) 9

United States v. Bass,
404 U.S. 336 (1971).......................................14, 16

United States v. Chestman,
947 F.2d 551 (2d Cir. 1991),
cert. denied, 503 U.S. 1004 (1992).......................11

United States v. Falcone,
257 F.3d 226 (2d Cir. 2001) 10

United States v. Lanier,
520 U.S. 259 (1997)...14

United States v. O'Hagan,
521 U.S. 642 (1997).....................................5, 6, 15

United States v. Santos,
553 U.S. 507 (2008).......................................13, 14

United States v. Skilling,
561 U.S. 358 (2010)...14

United States v. Universal C.I.T. Credit Corp.,
344 U.S. 218 (1952)...16

Whitman v. United States,
135 S. Ct. 352 (2014).....................................13, 14

TABLE OF AUTHORITIES—Continued

Page(s)

STATUTES AND REGULATIONS

15 U.S.C. § 78j(b)..2, 4

17 C.F.R. § 240.10b-5 ....2, 4

INTEREST OF AMICUS CURIAE[1]

Mark Cuban is a nationally renowned entrepreneur and investor. He is the owner of numerous successful businesses, including the NBA's Dallas Mavericks. He is one of the stars of the television show "Shark Tank." And for years, he was the subject of an overly aggressive investigation and enforcement action brought by the Securities and Exchange Commission (SEC) based on a completely novel theory of insider trading liability.

A jury ultimately exonerated Mr. Cuban on all charges, but he knows firsthand how unfair and damaging it is to be accused of insider trading on the basis of new, unclear, and previously unannounced rules. He had the financial wherewithal to reject the government's demand for settlement and to vindicate his good name, no matter the cost. Not everyone the SEC pursues is so fortunate.

Mr. Cuban has an abiding interest in ensuring that the SEC refrains from pursuing individuals predicated on theories of liability that go beyond this Court's jurisprudence and the will of Congress; that market behavior is governed by clear, predictable, and reliable *ex ante* rules; and that the rule of lenity prevents the imposition of criminal liability where, as

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[1] Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no such counsel or any party has made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity, other than *amicus curiae* and its counsel, has made a monetary contribution intended to fund the preparation and submission of this brief. Counsel of record for all parties were timely notified more than 10 days prior to filing, and all parties have consented to the filing of this brief.

here, there was not fair warning to a defendant about the consequences of their conduct.

SUMMARY OF ARGUMENT

For over forty years, this Court has made clear that Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, do not forbid all trading based on material nonpublic information. Rather, as this Court has repeatedly held, an individual can only be held liable for insider trading under these general anti-fraud provisions where the individual has breached a fiduciary duty or a similar duty of trust *and* confidence. This Court has never suggested, let alone held, that the mere obligation to keep nonpublic information confidential, without a corresponding duty of trust or loyalty, could ever give rise to the imposition of insider trading liability under Section 10(b).

The Second Circuit's decision below dramatically expands the reach of insider trading liability beyond what Congress or this Court have ever sanctioned. The decision imposes liability on the basis of a mere confidentiality agreement and, in so doing, contravenes the well-settled requirement that an individual breach a duty of *trust*, as well as a duty of *confidence*, in order to be held liable for insider trading. The decision, if left unchecked, would bring within the reach of Section 10(b) a broad array of commercial relationships that this Court has never suggested would be subject to insider trading liability. Consistent with its past efforts to stem the encroachment of the anti-fraud provisions into territory not envisioned by Congress, the Court should intervene to reaffirm that a confidentiality

agreement alone cannot suffice to establish insider trading liability.

The Court should also act to address the considerable uncertainty that the Second Circuit's decision has injected into the securities market. This Court has previously recognized the need for certainty and predictability in the securities laws generally, and the importance of clear guidance in insider trading law particularly. The law must provide clear, predictable *ex ante* rules so that market participants can determine whether information in their possession would render trading unlawful and then act accordingly. The Second Circuit's decision below, however, provides no such clear and predictable guidance. Indeed, it does the opposite. It transforms a confidentiality agreement into a fiduciary relationship by considering and applying a number of inconsistent, fact-intensive tests. The net effect of the Second Circuit's *post hoc*, unclear, grab bag analysis will be to chill otherwise lawful conduct. Confidentiality agreements are features of innumerable corporate arrangements. Given the Second Circuit's imprecise approach, any party to such an agreement will now have to either forego lawful trading or bear the increased costs of participating in the marketplace—including costs associated with defending against enforcement actions under novel theories of liability.

Finally, the Second Circuit's decision must be overturned because it allows criminal liability to attach to conduct that has never been clearly proscribed by statute or this Court's jurisprudence. The rule of lenity militates against such a result, particularly where, as here, the very theory of liability upon which the petitioner's conviction is predicated

goes beyond the boundaries that Congress and this Court have drawn. Would-be violators are entitled to receive fair warning of the consequences of their criminal conduct. No such warning occurred here.

ARGUMENT

I. INSIDER TRADING LIABILITY CANNOT BE IMPOSED ABSENT A RELATIONSHIP OF TRUST, AS WELL AS CONFIDENCE.

For well over a generation, this Court has recognized that Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, do not create a "general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Chiarella v. United States*, 445 U.S. 222, 233 (1980); *see also Dirks v. SEC*, 463 U.S. 646, 654 (1983). Rather, these provisions capture only conduct that is fraudulent or deceptive. *See* 15 U.S.C. § 78j(b) (prohibiting the use of "any . . . *deceptive* device or contrivance" in connection with "the purchase or sale of any security" (emphasis added)); 17 C.F.R. § 240.10b-5 (It is unlawful "(a) [t]o employ any device, scheme, or artifice to *defraud*, [or] . . . (c) [t]o engage in any act, practice, or course of business which operates or would operate as a *fraud or deceit* upon any person, in connection with the purchase or sale of any security." (emphasis added)); *see also Chiarella*, 445 U.S. at 234-35 ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.").

Under this Court's precedents, undisclosed trading based on nonpublic market information is fraudulent or deceptive within the meaning of Section 10(b) only when the trader is under a duty to disclose

that information or otherwise abstain from trading. *See Chiarella*, 445 U.S. at 235 ("When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak.").

Where, as here, a case is pursued under the "misappropriation theory" of insider trading, liability exists only where a corporate outsider breaches a fiduciary duty or similar relationship of "loyalty *and* confidentiality." *United States v. O'Hagan*, 521 U.S. 642, 652 (1997) ("[T]he misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."). A breach of a mere duty to keep information confidential is plainly insufficient—on the contrary, as this Court has repeatedly indicated, an individual must *also* have breached a duty of trust or loyalty in order to be held liable for insider trading. *See id.* ("loyalty and confidentiality"); *Dirks*, 463 U.S. at 654 ("trust and confidence"); *Chiarella*, 445 U.S. at 228, 232 ("trust and confidence" (citation omitted)); *Salman v. United States*, 137 S. Ct. 420, 423 (2016) ("trust and confidence"). Indeed, the misappropriation theory is premised upon the notion that a recipient of nonpublic information commits an act of fraud by "feigning fidelity to the source of information" and using that information to his or her own benefit. *O'Hagan*, 521 U.S. at 655. Where the recipient of confidential information has not "feign[ed] fidelity" to the source by undertaking a duty of trust or loyalty, trading on such information cannot be deceptive or fraudulent.

A confidentiality agreement creates an obligation to maintain the secrecy of information. Sophisticated parties in arms-length business relationships

routinely enter into confidentiality agreements contemplating no undertaking of trust or loyalty. Of course, parties to such agreements are free to create additional contractual restrictions on the *use* of any such confidential information. But they are equally free not to do so. Standing alone, an obligation to keep information confidential is not sufficient to establish the duty necessary for insider trading liability under the conjunctive requirement of trust *and* confidence. The law, as articulated by this Court, requires more.

To expand the scope of insider trading liability to business dealings involving mere non-disclosure obligations—without any corresponding restrictions against the use of confidential information—would impose fiduciary-like duties upon a broad swath of agreements where no such fiduciary relationship was contemplated. This would render irrelevant the "trust" requirement that has been a consistent element of liability in this Court's insider trading decisions. *See O'Hagan*, 521 U.S. at 652; *Dirks*, 463 U.S. at 654; *Chiarella*, 445 U.S. at 228, 232; *Salman v. United States*, 137 S. Ct. at 423.

The decision below has effectively done just that. The Second Circuit has imposed insider trading liability on the basis of a confidentiality agreement alone. While the decision purports to divine a relationship of trust by focusing on other provisions of the agreement and other facts surrounding the Petitioner's relationship with his counterparty, the inescapable reality is that liability here is predicated on a fairly standard confidentiality agreement. This decision expands the reach of Section 10(b) in a way that is unsupported either by the language of the Exchange Act or decades of this Court's jurisprudence. It is, in the end, irredeemably

"inconsistent with the careful plan that Congress has enacted for regulation of the securities markets." *Chiarella*, 445 U.S. at 235.

II. PARTICIPANTS IN THE SECURITIES MARKETS NEED CLEAR AND OBJECTIVE *EX ANTE* RULES ABOUT WHAT CONDUCT CONSTITUTES INSIDER TRADING.

Insider trading law should provide clear, predictable, *ex ante* rules that allow traders to determine with confidence whether any information in their possession would render trading unlawful. As demonstrated by the government's aggressive and novel theories of liability in both this case and in the proceedings against *amicus curiae*, Section 10(b) and Rule 10b-5 are susceptible to expansive interpretation and enforcement, inventing liability where none previously existed and creating significant uncertainty for market participants going forward. The Second Circuit here has created new law establishing insider trading liability on the basis of a confidentiality agreement, and its unclear, scattershot, *post hoc* rationalizations for doing so only enhance the uncertainty, failing to provide the kind of clear predictive guidance the market requires. As it has done in the past, this Court should intervene to prevent insider trading rules from unduly burdening the conduct of market participants and the efficient functioning of the securities market overall.

This Court has recognized that "it is essential . . . to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules," *Dirks*, 463 U.S. at 664, and has repeatedly emphasized the need for clear rules in securities law, "an area that demands certainty and

predictability." *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994) (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)).

The consequence of imprecision in the securities space is to "prevent[] parties from ordering their actions in accord with legal requirements." *Dirks*, 463 U.S. at 658 n.17. For law-abiding market participants, such imprecision has a chilling effect. To avoid over-deterring legitimate market activities, securities transactions must be structured around predictable *ex ante* rules defining what separates permissible from impermissible use of undisclosed corporate information.

Individual traders are not the only parties subject to the chilling effect of indeterminate insider trading standards. As this Court has recognized, market analysts regularly engage in securities pricing analysis based on material nonpublic information from corporate insiders. *See Dirks*, 463 U.S. at 658 ("It is commonplace for analysts to 'ferret out and analyze information,' and this often is done by meeting with and questioning corporate officers and others who are insiders." (citation omitted)). These sorts of disclosures play a legitimate and pivotal role in enabling traders to understand the value of a security and transact accordingly, thereby enhancing the efficiency of the securities market. *See id.* at 658-59. Resting the legality of trading based on nonpublic information upon unarticulated, *post hoc* theories of liability inhibits market analysts from engaging in functions that are "necessary to the preservation of a healthy market," *id.* at 658, and "risks over-deterring activities related to lawful securities sales." *See Pinter*, 486 U.S. at 654 n.29.

Expanding the scope of insider trading liability will also inevitably increase the costs associated with complying with the securities laws and defending against inventive enforcement actions. While such costs may initially be borne by professionals, the "ripple effects" of "uncertainty and excessive litigation" will be to pass the increased compliance and litigation costs onto investors, who are, of course, "the intended beneficiaries of the statute." *See Cent. Bank*, 511 U.S. at 189; *see also SEC v. Tambone*, 597 F.3d 436, 452-53 (1st Cir. 2010) (Boudin, J., concurring) ("No one sophisticated about markets believes that multiplying liability is free of cost. And the cost, initially borne by those who raise capital or provide audit or other services to companies, gets passed along to the public.").

Having spent years fighting against government enforcement under an expansive theory of insider trading liability, *amicus curiae* understands the unfair and costly effect of insider trading allegations that are not predicated on clear *ex ante* rules. The SEC charged Mr. Cuban with violations of Section 10(b) and Rule 10b-5 under the misappropriation theory of insider trading, alleging that Mr. Cuban had received material nonpublic information affecting the securities of a company in which he was invested after agreeing to keep the information confidential, and that he sold his shares in the company after receiving the confidential information.

The district court granted Mr. Cuban's motion to dismiss, concluding that the SEC had failed to allege that Mr. Cuban's agreement to keep the information confidential imposed upon him a duty not to trade on or otherwise use the information. *SEC v. Cuban*, 634 F. Supp. 2d 713, 727-28 (N.D. Tex. 2009). The Fifth

Circuit reversed the district court's decision, but *only* because it read the SEC's complaint to allege that Mr. Cuban had in fact undertaken an agreement not to trade—not because the confidentiality agreement alone was sufficient to impose insider trading liability. *See SEC v. Cuban*, 620 F.3d 551, 557 (5th Cir. 2010). Mr. Cuban was subsequently exonerated on all charges after a jury trial, but only after incurring significant expense and years of litigation to vindicate his innocence. Absent clear and predictable guidance, other market participants will be forced to choose between foregoing otherwise lawful trading or assuming the risks of trading and the costs that will accompany any subsequent investigative inquiries.

The Second Circuit's decision below injects unpredictability into insider trading law of exactly the sort that threatens to disrupt the functioning of the market. This decision fails to articulate any clear standard from which participants in the securities markets could derive an understanding of when a business relationship becomes sufficiently "fiduciary-like" to preclude trading on undisclosed corporate information. Pet. App. 17a-18a. In finding the existence of a "fiduciary-like" relationship, the Second Circuit opined that "[i]t was presumably Regado's faith and confidence in Kosinki's reputation . . . his experience as a principal investigator, and his willingness to provide access to his patients, that caused Regado to secure Kosinski's services," thereby creating a relationship that was "'marked by' [Kosinski's] service of 'the interests of the party entrusting him [] with such information.'" *Id.* (final alteration in original) (quoting *United States v. Falcone*, 257 F.3d 226, 234-35 (2d Cir. 2001)).

Crucially, the Second Circuit's fact-intensive finding that Kosinski owed fiduciary-like duties to Regado was not premised upon any "exclusive test of fiduciary status." Pet. App. 29a. In fact, the Court explicitly signaled that such a finding could rest on factors other than the traditional hallmarks of fiduciary status ("reliance, and de facto control and dominance") as articulated by the Second Circuit in *United States v. Chestman*, 947 F.2d 551, 568 (2d Cir. 1991) (citation omitted), *cert. denied*, 503 U.S. 1004 (1992). Pet. App. 29a-30a ("[W]hile the evidence here was indeed sufficient to find that Kosinski owed Regado a fiduciary duty based on reliance, control, and dominance, *that conclusion does not signal that only such factors can establish a fiduciary duty for purposes of determining insider-trading liability*." (emphasis added)). In doing so, the court failed to heed the *Chestman* court's warning to "tread cautiously in extending the misappropriation theory to new relationships, lest our efforts to construe Rule 10b-5 lose method and predictability, taking over 'the whole corporate universe.'" *Chestman*, 947 F.2d at 567 (citation omitted).

In light of the Second Circuit's *post hoc*, fact-bound determination that the Petitioner owed "fiduciary-like" duties of trust to Regado, market participants are left without guidance enabling them to understand whether any of their arms-length business relationships involving confidentiality obligations are "marked by" the service of their counterparties' interests such that they may be exposed to insider trading liability. Pet. App. 18a. Nor can they predict what other unspecified tests of fiduciary status may ultimately be applied to render their conduct unlawful after-the-fact. This decision

conflicts with this Court's long-standing admonition against legal standards in the securities laws under which "decisions are made on an ad hoc basis, offering little predictive value to participants in securities transactions." *Pinter*, 486 U.S. at 652. Such a "shifting and highly fact-oriented" expansion of insider trading liability to arms-length business relationships involving no undertaking of trust or loyalty fails to provide a "satisfactory basis for a rule of liability imposed on the conduct of business transactions." *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975).

Amicus curiae does not express an opinion on whether it was wrongful for the Petitioner to trade in Regado's securities after receiving information affecting the value of the company that was not available to the public. The critical question is whether traders and other market participants can discern a clear rule of liability from the Second Circuit's holding that the Petitioner's conduct amounted to *securities fraud*. Because the Second Circuit failed to provide such a rule, its decision could have harmful and wide-ranging consequences for the securities markets, particularly due to the Second Circuit's prominence in the area of securities law. This Court should intervene to ensure that traders, analysts, and professionals have the benefit of clear and predictable rules guiding their participation in the market.

III. THE RULE OF LENITY COUNSELS AGAINST PRESERVING THE SECOND CIRCUIT'S DECISION.

The need for clear and predictable *ex ante* rules governing insider trading is all the more essential

given that defendants such as the Petitioner can be subjected to criminal liability for any such violations. As described above, Section 10(b) has been consistently interpreted by this Court to require a fiduciary or similar relationship of both trust and confidence to sustain a conviction for insider trading. The decision below subjected the Petitioner to criminal sanctions on the basis of a plain confidentiality agreement, locating the requisite duty of trust in a theory of liability that is far removed from the language of Section 10(b) or this Court's jurisprudence. The Second Circuit upheld the Petitioner's conviction for insider trading in the absence of the kind of clear and fair warning that the criminal law requires, and well outside the scope of liability delineated by Congress and this Court. For these reasons, the Petitioner's conviction should not stand.

The language of Section 10(b) does not clearly prescribe whether a corporate outsider who has undertaken only a duty of confidentiality may be liable for insider trading. This ambiguity calls for application of the rule of lenity, which "requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them." *United States v. Santos*, 553 U.S. 507, 514 (2008); *Cleveland v. United States*, 531 U.S. 12, 25 (2000) ("[A]mbiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." (citation omitted)). The rule of lenity performs two functions. First, it provides "fair warning" to would-be violators of the criminal nature of the proscribed conduct. *See Whitman v. United States*, 135 S. Ct. 352, 354 (2014) (citation omitted); *Crandon v. United States*, 494 U.S. 152, 160 (1990) ("[The] construction of a criminal

statute must be guided by the need for fair warning . . . ."). Second, the rule of lenity precludes courts from expanding criminal prohibitions beyond what Congress has proscribed. *See Whitman*, 135 S. Ct. at 354 (explaining that the rule of lenity "vindicates the principle that only the *legislature* may define crimes and fix punishments.").

Before criminal penalties may be imposed, a would-be violator must receive "fair warning" of "what the law intends to do if a certain line is passed." *United States v. Bass*, 404 U.S. 336, 348 (1971) (citation omitted); *see also United States v. Lanier*, 520 U.S. 259, 266 (1997) (explaining that the rule of lenity "ensures fair warning by so resolving ambiguity in a criminal statute as to apply it only to conduct clearly covered."). To draw the line between lawful and criminal conduct based on ad-hoc and heavily fact-bound determinations of liability undermines the fundamental principle that "no citizen should be held accountable for violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed." *Santos*, 553 U.S. at 514; *see also United States v. Skilling*, 561 U.S. 358, 416 (2010) (Scalia, J., concurring in part and concurring in the judgment) (arguing that a criminal statute imposing liability for breach of fiduciary duty "provides no 'ascertainable standard of guilt'" (citation omitted)).

The law did not provide fair warning to the Petitioner that his conduct was illegal. The Petitioner entered into a confidential relationship with an entity that was not his employer through an agreement that conspicuously omitted any restrictions on the *use* of confidential information—an agreement that purported to "embod[y] the entire understanding of

the parties," and superseded the parties' prior agreement. Pet. App. 21a.

In this case, the Petitioner's trades did not violate any clearly defined rules regarding when an individual can be held liable under the misappropriation theory of insider trading. Indeed, Petitioner's trades did not even constitute a breach of the very confidentiality agreement the Second Circuit construed to give rise to criminal liability. The Second Circuit reasoned its way to upholding Petitioner's conviction only through a contrived analysis of malleable common law standards and strained *ex post* factual evaluations. The deployment of such a "shapeless" approach "to condemn someone to prison" is contrary to the fundamental due process right in which the rule of lenity is grounded. *See McDonnell v. United States*, 136 S. Ct. 2355, 2373 (2016) (disapproving government's interpretation of statute that was "not defined 'with sufficient definiteness that ordinary people can understand what conduct is prohibited,' or 'in a manner that does not encourage arbitrary and discriminatory enforcement'" (citation omitted)).

It is also *far* from clear that Congress intended Section 10(b) to criminalize the sort of conduct for which the Petitioner was held liable in the first place. The "classical" and "misappropriation" theories of insider trading are creatures of jurisprudence, not the statutory text of Section 10(b). *See Dirks*, 463 U.S. at 653-55 (describing the jurisprudential history of insider trading liability under Section 10(b)); *O'Hagan*, 521 U.S. at 651-653 (describing the "classical" and "misappropriation" theories developed by the courts). As this Court has recognized, insider trading liability is premised upon nondisclosure in

connection with the purchase or sale of securities, the legality of which is not clearly addressed in the statutory language or legislative history of Section 10(b). *See Chiarella*, 445 U.S. at 226 ("[Section] 10(b) does not state whether silence may constitute a manipulate or deceptive device.").

When faced with conflicting interpretations of a statute bearing criminal penalties, "it is appropriate, before . . . choos[ing] the harsher alternative, to require that Congress should have spoken in language that is clear and definite." *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 222 (1952). Because Congress has not clearly addressed what conduct can subject individuals to criminal prosecution and incarceration for insider trading, the rule of lenity cautions against the judicial expansion of insider trading liability beyond the narrow confines established under this Court's limiting precedents. *See Bass*, 404 U.S. at 348 ("[B]ecause of the seriousness of criminal penalties . . . legislatures and not courts should define criminal activity.").

The rule of lenity—embodying the fundamental principle of due process—militates against preserving the Petitioner's conviction. This Court's intervention is needed to right this wrong and to prevent future enforcement actions from proceeding untethered to the clear and established rules of insider trading liability that have governed this area of the law for decades.

CONCLUSION

For the foregoing reasons, *amicus curiae* respectfully urges this Court to grant the petition for certiorari and reverse the decision of the Second Circuit.

Respectfully submitted,

CHRISTOPHER J. CLARK
Counsel of Record
MICHAEL S. BOSWORTH
NICHOLAS R. HAZEN
LATHAM & WATKINS LLP
885 Third Avenue
New York, NY 10022
(212) 906-1200
chris.clark@lw.com

Counsel for Amicus Curiae *Mark Cuban*

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