Sixty-Sixth Annual
National Moot Court Competition

RECORD ON APPEAL

SUPREME COURT OF THE UNITED STATES
October Term 2015

Docket No. 2015-01

UNITED STATES,
Petitioner,

v.

DANA DINOFRIO,
Respondent.

FACTS[1]

I. The Smart Watch

iTech Holdings Ltd. ("iTech") is a holding company for wholly-owned subsidiary companies NovaPC Company ("NovaPC") and Supply Corp International ("Supply Corp"). NovaPC builds and markets computers. Supply Corp, acquired by iTech three years ago, builds the circuit boards for NovaPC's computers.

In recent years, sales of NovaPC's computers have stalled, and NovaPC has been searching for a product to jumpstart its lackluster market performance. Seizing on recent popular interest in so-called smart watches, NovaPC developed a similar device of its own, called the NovaPC Watch. On the basis of overall market sector performance and preliminary market research, iTech predicted that the NovaPC Watch would drive an increase in iTech profits per share to $5/share for third quarter 2012.

On Friday, August 24, 2012, at 5:00PM, iTech's Finance Department learned that poor sales forecasting and supply chain delays at Supply Corp had caused iTech to grossly over-estimate NovaPC Watch sales. Because of the shortfall in sales of the NovaPC Watch, iTech's profit for the quarter was only $3.50 per share.

iTech was due to report its quarterly performance on Monday, August 27, 2012, at 2:00PM. iTech had already prepared earnings reports and press releases for filing, but those reports were also based on iTech projections. Alex Abernethy, the Finance Department director, ordered his department to re-run the draft financial reports immediately and to provide summaries to iTech executives for review over the weekend, prior to filing and publication on Monday. New press releases were drafted and sent to DDD Press Co. for release on Monday at 2:00PM.

[1] This Record on Appeal is fictional. Any reference to real persons, entities, or events is coincidental.

On Friday night, Alex and several other executives received an email from Corporate Security:

> TO: iTech Co. Executive Team
>
> FROM: iTech Co. Corporate Security
>
> SUBJECT: Confidential – Financial Disclosure Security Breach
>
> It has come to our attention from sources at DDD Press Co. that hackers from one or more foreign countries infiltrated several computer databases and servers at DDD within the last 12 hours. Specifically, DDD confirmed confidentially that one of the hacked servers held thousands of press releases, including those not yet released. DDD further confirmed that hackers obtained the iTech earnings report due to be released on Monday, but DDD could not confirm whether the report the hackers obtained was the original, incorrect report or the newly-revised report. DDD also could not say whether any other individuals or entities had gained unauthorized access to the iTech reports, and DDD did not say whether anyone else knew about the hack. Corporate Security has multiple teams working on this incident and will keep you informed as new developments occur.

The press was not alerted to the attack for some time and did not report on it until a few weeks later.

II. The Party

That Saturday, August 25, 2012, Alex attended a birthday party for his grandmother. Alex's cousin, Ben Bookwalter, was also present. Alex and Ben spoke rarely—only at family gatherings, about three times per year. On these occasions, the two mostly talked about work. Alex was an alumnus of Summit Private Business School and, for years, had supported Ben's

interest in attending as well. Ben ultimately did apply and was accepted. After obtaining his MBA, Ben took a job as a stock broker, specializing in investment advising for high net worth individuals. As a part of this job, Ben prided himself on being a diligent student of company earnings reports. Ben was especially thorough in his market research due to his practice of investing his own money according to the advice he gave his clients. Ben advertised this practice—which he called his "putting his money where his mouth is" policy—as a sort of guarantee to his clients that they were at all times receiving his best advice.

Alex's mother, Ilene Abernethy, enjoyed trading stocks and often consulted her son for market advice. Over the years, Ilene had done quite well in the market and, in 2008, Ilene had loaned Ben's mother, Molly Bookwalter, $50,000 so Molly could purchase a home. Alex knew his mother had done this, but he never talked with her about it at any length.

At the party, Alex approached Ben to say hello. Their conversation quickly turned to work:

BEN: How are things at iTech? I hear the new NovaPC Watch came out.

ALEX: That NovaPC Watch is a nightmare, financially. Earnings will be $3.25 per share; we had been forecasting $5 per share. We bet everything on the new NovaPC Watch and it's a dud. I knew this was going to happen, but no one upstairs listens to me!

BEN: That's awful. Does anyone else know this?

ALEX: Not yet. I'm only telling you as a favor to you; I don't get anything out of it. I don't even own any iTech stock!

BEN: Neither do I. But I appreciate the advice.

Though Ben enjoyed using computers and other digital devices, he had always considered investments in computer companies to be unacceptably volatile. When it came to his

personal investments, Ben preferred real estate and his antique car collection. As a result, Ben did not own any iTech stock, nor had he ever advised his clients to hold iTech stock.

After the exchange quoted above, Alex and Ben wished each other goodnight, and Alex went home. Shortly thereafter, Ben was approached by his best friend Corinne Cuzick, a hedge fund manager and general partner of Trimont Group, a successful hedge fund with nearly $5 billion of assets under management. Corinne and Ben shared everything with each other and particularly enjoyed talking shop about the markets. Their conversation included the following exchange:

> CORINNE: You look a bit worried—you okay?
>
> BEN: I just heard from my cousin Alex that iTech is headed for a big correction on Monday morning. Earnings will be $3.50 per share! All has to do with that NovaPC Watch—they bet the company on it.
>
> CORINNE: Alex works in finance there, right? So he should know. But why would he tell you?
>
> BEN: Just as a favor—he sometimes gives me advice on stuff—the markets, business school, 'yada yada.' He told me that he doesn't get anything out of it. And I'm pretty sure he knows I don't hold iTech stock. Just looking out for family, I guess. He doesn't often tell me things I don't already know, but when he does, he has always turned out to be right. But listen, you didn't hear it from me.
>
> CORINNE: Didn't hear what from you?

Corinne smiled and got out her cell phone. Within minutes, she had executed sell orders for Trimont's entire holding in iTech, to be executed on Monday morning at the opening bell of the exchange.

Corinne then approached Dana DiNofrio, a former colleague and current adviser at Rye Fund. Corinne had invited Dana to the party. Dana didn't know Alex or Ben personally, but she knew that they were cousins and that Ben was Corinne's best friend. Corinne had once told

Dana that Alex's mother loaned some money to Ben's mother so she could buy a house. Dana had seen Alex and Ben talking earlier in the evening but didn't hear what was said.

"Sell iTech now!" Corinne told Dana, adding, "I just heard from good authority that their earnings will be down Monday due to that monstrosity of a watch." Dana had also recently read a newspaper article about the significant difficulties in breaking into the watch market, and she had been thinking of selling her iTech stock for several weeks. Despite what she had read, Dana still believed that development of new technology would turn iTech around, so she held onto the stock. But after talking to Corinne, Dana sold her iTech stock at 9:30 a.m. on Monday morning.

At 2:00pm on Monday, August 27, 2012, iTech released their earnings numbers. The tremendous variance among company projections, analyst expectations, and the actual earnings report caused a sharp reaction from the market, and iTech stock value fell by 20% within thirty minutes. Corinne's Monday morning divestment of iTech averted a $2.1 million loss for her hedge fund. Dana's sale of iTech shares avoided a loss of $3.0 million.

III. The SEC Investigation and Suit

The SEC's Home Office in Washington, DC uses sophisticated computer programs to monitor the markets for suspicious activity preceding public announcements that result in a significant change in company's stock value. Transactions that are flagged by the computers are then reviewed by SEC analysts to determine whether the SEC should investigate the transaction further.

The collapse of iTech's stock on the heels of its poor earnings report prompted the SEC's computers to review all transactions in iTech stock immediately before and after the release of the earnings reports. Corinne and Dana's transactions were flagged immediately. The investigation intensified after the SEC learned about the data hack and possible large-scale dissemination of confidential material from iTech and other companies.

The SEC Enforcement Division chose to begin an investigation into Dana's trade. Dana was a registrant with the SEC. Moreover, her Monday morning sale of iTech shares had resulted in the largest loss avoidance of any sale of iTech stock in the run-up to the crash in iTech share value. The SEC Trial Unit's star Enforcer, Jack Transparent, was on the case.

Suspecting that there had been some exchange of information between Dana and Corinne, given their parallel trades, Transparent's first step was to ask Corinne to testify before the SEC. Under oath, Corinne revealed the details of her conversation with Ben at the party.

At this point, the SEC decided to use Corinne's testimony as the basis for filing a civil enforcement action against Corrine and Dana, alleging that the two were a part of long-running insider-trading ring.

After filing the civil complaint, the SEC proceeded to depose Ben. Under oath and with counsel present, Ben testified in relevant part as follows:

SEC: What is your profession?

BEN: I am a stock broker.

SEC: What trades did you make on Saturday, August 25?

BEN: None – but that was only because I didn't own any stock in iTech.

SEC: Did you learn something about iTech that day?

BEN: I learned, from my cousin, Alex, that iTech was about to release earnings numbers that would be significantly lower than expected.

SEC: Where does Alex work?

BEN: I don't know his official job title, but he's fairly high up in the finance department at iTech.

SEC: How often do you two communicate?

BEN: Not often – just a few times a year, at family gatherings. We chat about the markets, business schools, and stuff like that.

SEC: Did Alex get anything in return for telling you about the iTech earnings?

BEN: I don't think so. As far as I know, he just tells me stuff as a favor. I certainly haven't given him anything for his information. Like I said, whenever we run into each other at family events, this stuff just comes up in the course of our small talk and catching up. In fact, now that I think about it, I remember that at the party, Alex said something about not getting anything in return for his sharing of information with me.

SEC: Did you share the information you learned from Alex with anyone other than Corinne?

BEN: No. I told Corinne because we always talk about stuff like that. As friends, you know? But I know the rules, and I don't go shopping this stuff around or anything like that.

The SEC continued their investigation, focusing on identifying all individuals involved in any potential insider activity. Although the SEC was interested in the link between Corinne and Dana, they chose to interview Dana but not to depose her.

IV. The DOJ Investigation and First Grand Jury

Immediately after the SEC filed its civil action, SEC's enforcement liaison to DOJ Financial Crimes Task Force shared with his DOJ counterpart the details of the SEC's investigation and civil action against Corinne. The SEC suggested that the situation would make a good test case for some of DOJ's novel prosecution tactics. The SEC and DOJ agreed to pursue their cases separately but to keep each other informed of strategy and information gathered. Armed with Ben's testimony from the SEC's deposition, the DOJ's star prosecutor, Will Indyct, brought charges against Corinne and sought to obtain grand jury indictments against Corinne and Dana separately.

In the grand jury proceeding against Corrine, Alex was called to testify, and was questioned about the relationship between Ben, Corinne, and Dana. Alex confirmed that he knew of Corinne and Dana, and he confirmed that he saw Ben, Corinne, and Dana at grandmother's birthday party. But Alex said that he didn't know Corinne or Dana, did not speak to them at the party, and never observed any interaction between Ben, Corinne, and Dana. Alex had no idea whether they knew each other. Thinking that simply proving Ben, Corinne, and Dana were at the same party just prior to the trades being made would be enough for indictment, Will Indyct did not question Alex any further.

Will Indyct did, however, suspect a broader insider-trading conspiracy, and when Ben was called before the grand jury, Will Indyct questioned him at length about who, beyond Corinne, he may have told about the iTech's impending filing. Will Indyct also asked Ben whether he had traded on the information himself, directly or otherwise. Ben was adamant that he had not traded on the information and that he had not disclosed it to anyone other than Corinne. The grand jury returned no bill (no indictment) on all charges against Corinne, in part because the jurors did not believe that it had heard sufficient evidence that Ben, Corinne, and Dana knew each other or that they had talked to each other at the party.

V. Death of Ben and Corinne

Three days after the grand jury declined to indict them, Corinne and Ben were killed in a car crash while carpooling to work.

VI. The Case(s) Against Dana

Unable to continue the enforcement action against Corinne, the SEC's focus returned to Dana. The SEC decided it was time to supplement their early investigative interview with a formal deposition. Under oath, Dana testified at deposition about her conversation with Corinne at Alex's grandmother's birthday party.

The DOJ also hoped to salvage its case by obtaining convictions for Alex and Dana. Will Indyct started by impaneling a grand jury against Dana. Against advice of counsel, Alex testified before this second grand jury, in relevant part as follows:

DOJ: You have worked in the Finance Department at iTech for five years, correct?

ALEX: Yes.

DOJ: Working in the Finance Department, you have access to private information about company earnings, right?

ALEX: Of course—that's how I am able to create earnings reports for management.

DOJ: Turning your attention to Friday, August 24, you learned that earnings for the third quarter would not be as previously anticipated, yes?

ALEX: That's right. I learned that errors had been made which caused us to re-draft our draft earnings reports.

DOJ: And then that Saturday, you went to your cousin Ben's grandmother's birthday party, right?

ALEX: Yes. She was turning 90 years old. I hope to live that long!

DOJ: And at that party, you told Ben about those earnings numbers, didn't you?

ALEX: Yes, I told Ben as a favor to him.

DOJ: In fact, you told Ben in order to get something out of it for yourself, didn't you?

ALEX: No. I got absolutely nothing out of it. I've got the bank statements to prove it!

DOJ: You are rather close to your cousin Ben, aren't you?

ALEX: Not really, no. We only see each other a few times per year.

DOJ: Isn't it true that five years ago your mother loaned Ben's mother $50,000 as a down payment for her house?

ALEX: Yeah. I remember my mom telling me that she had done that. I thought it was nice, but we didn't really talk about it much. I never really talked about it with Ben, either. It seemed like kind of a private thing. I do think it's great, though, when family members can help each other out.

Since Ben and Corinne were unavailable to testify, the DOJ was not able to present the grand jury with direct evidence that the information passed from Ben to Corinne and Dana. But Will Indyct argued to the grand jurors that it could not be mere coincidence that Dana, who had a vested interest in information about iTech, divested her stock immediately before adverse information about iTech became public and immediately after having attended a party at which an iTech insider had leaked the information to a relative. The grand jury believed that Dana got the information from Alex, albeit indirectly, and it believed that Alex received some benefit for the disclosure. Subsequently, the grand jury issued an indictment against Dana on one count of insider trading.

VII. Criminal Trial Against Dana

In preparation for the criminal trial against Dana, the DOJ subpoenaed Alex to testify. But shortly before trial began, Alex was diagnosed with acute dementia that compromised his memory of the relevant period and rendered him medically unfit to testify.

At the ensuing trial, and unable to call Alex, Ben, or Corinne to testify, the government put on a largely circumstantial case against Dana. After the close of the government's case, Dana sought to establish that she did not know that information on which she traded came from an insider in violation of a fiduciary duty. She sought to introduce transcripts of Alex's grand jury testimony that (a) he did not profit from his disclosure of the information, and that (b) he did not know Dana or know whether she knew or talked to Ben or Corinne. Dana also sought to introduce Ben's testimony from the SEC proceeding that he never shared Alex's information with anyone other than Corinne. Dana argued that since Ben and Alex were unavailable, their

sworn testimony from prior proceedings was admissible under Federal Rules of Evidence 804(b)(1). The government objected to admission of either transcript, contending that when considering admissibility in a subsequent criminal proceeding, 804(b)(1) permits admission of testimony from a prior criminal trial only.

The judge admitted Ben's prior testimony before the SEC that he did not talk to Dana. However, the court excluded Alex's prior grand jury testimony. The trial continued. After Ben's testimony was read into the record, Dana testified that she never talked to Ben at the party. After Dana rested her defense, and over Dana's counsel's objection, the court instructed the jury in relevant part as follows:

> COURT: You should return a verdict of guilty on the count of insider trading if the Government has proved, beyond a reasonable doubt that
>
> (1) Alex was entrusted with a fiduciary duty;
>
> (2) Alex breached his fiduciary duty by disclosing confidential information to Ben in exchange for a personal benefit;
>
> (3) the Defendant was the ultimate recipient of that confidential information and knew of Alex's breach; and
>
> (4) the Defendant still used that information to trade in a security.
>
> Alex obtained a personal benefit if he obtained anything of any value in exchange for his disclosure. The benefit may consist of tangible things, like money, goods, services, or any other tangible thing. It also may consist of intangible things, like favors, future obligations, reputational benefits, or the personal satisfaction of helping or strengthening a relationship with a friend or relative.
>
> The benefit may have been obtained directly or indirectly. The benefit may have been received or accrued at any time—before, during, or after the disclosure of the information—as long as the receipt of the benefit was caused by the disclosure of the information.

The jury returned a verdict of guilty on the sole count of insider trading.

Dana moved under Federal Rule of Criminal Procedure 33 for a new trial, arguing that the district court erred in excluding potentially exculpatory testimony from Alex as well as by articulating an inappropriately broad definition of the personal benefit required to sustain a claim of insider trading. On March 4, 2014, the district court denied Dana's motion. Dana appealed.

On February 12, 2015, the Thirteenth Circuit reversed the District Court on both issues—jury instruction for insider trading and exclusion of Alex's testimony—vacated Dana's conviction, and remanded the case for a new trial. The DOJ petitioned the United States Supreme Court for certiorari, seeking reinstatement of the jury's decision. Certiorari was granted on September 21, 2015.[2]

[2] COMPETITION NOTE: All authority relied on in the court decisions below is deemed to have been authored before this case began. The chronological sequence of that authority should be preserved, but the actual dates on which the opinions were issued should be disregarded.

UNITED STATES DISTRICT COURT
DISTRICT OF WISTERIA

Docket No. 12-113310

UNITED STATES,
Plaintiff,

v.

DANA DINOFRIO,
Defendant.

MEMORANDUM AND ORDER

BRENNAN, J.

This matter comes before this Court on Plaintiff's Motion for a New Trial pursuant to Federal Rule of Criminal Procedure 33. Upon consideration of the submissions of the parties and the relevant law, Defendant's motion is DENIED.

RELEVANT BACKGROUND

The Court assumes familiarity with the Record on Appeal. The following is a summary of key facts.

This case originates with iTech's announcement, on Monday, August 27, 2012, of unexpectedly poor financial performance. Defendant, Dana DiNofrio, is a stock broker whose portfolio was heavily invested in iTech. On the morning of Monday, August 27, 2012, Dana divested her entire holding in iTech, thereby saving her firm and her clients millions of dollars of losses when iTech's earnings were announced later that same day.

Dana took this action on the basis of a tip from Corinne, a friend and fellow stock broker with another firm. On Saturday, August 25, at the birthday party of a mutual acquaintance, Corinne advised Dana to sell her positions in iTech immediately, saying that she had it on "good

authority" that iTech's Monday earnings report was going to reveal unexpectedly poor performance from the company's new flagship product, the iTech Watch. A few minutes before this conversation, Corinne had executed the instructions necessary to divest her own company's portfolio of all positions in iTech as well.

Corinne did not reveal to Dana the source of her "good authority." But at trial, the Government offered circumstantial evidence that the tip had come from Alex, iTech's Finance Director and the grandson of the woman whose birthday party Corinne and Dana were attending when their conversation occurred. By the time of trial, Alex, Ben, and Corinne, were all unavailable to testify, so the Government was unable to present direct evidence of the precise path the information traveled from Alex to Corinne. However, the Government did offer a circumstantial case that Alex had passed the information to a cousin, Ben, who had relayed it to Corinne.

The Government's case strongly suggested that Dana may have known Ben and that the two had spoken at the party—an allegation that placed Dana closer to the original tipper, Alex, and bolstered the Government's circumstantial case against Dana. Dana denied these allegations but also sought to introduce two pieces of evidence to support her testimony: (1) testimony by Alex during the grand jury proceedings, during which he stated that (a) he never observed Ben, Corinne, and Dana interacting at the party, and (b) that he received no benefit from sharing the confidential information; and (2) testimony from Ben during a prior SEC civil enforcement proceeding that he shared information about iTech with Corinne alone.

This Court permitted Dana to read into the record excerpts of Ben's testimony in the SEC proceeding to the effect that Ben had never talked to Dana. However, the court excluded Alex's testimony from the grand jury proceeding. Dana preserved her objection to this decision.

At the close of argument, the Court instructed the jury, among other things, that to find Defendant guilty of insider trading, it must find that Alex, as the insider, received a personal benefit for the disclosure of the confidential information. The instruction clarified that the benefit need not have been financial or even tangible, nor must it have been directly or immediately received. The jury returned a verdict of guilty on the sole count of insider trading. Dana brought this motion for a new trial under Federal Rule of Procedure 33, alleging (1) that the court erred instructing the jury with an impermissibly broad definition of "person benefit," and (2) that the Court improperly excluded Alex's grand jury testimony.

ISSUE 1: Must Alex Have Received Tangible Benefits for Dana to be Liable for Insider Trading?

To obtain a conviction for insider trading, the Government must prove, beyond a reasonable doubt that:

(1) the corporate insider was entrusted with a fiduciary duty;

(2) the corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) **in exchange for a personal benefit**;

(3) the tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged **for personal benefit**; and

(4) the tippee still used that information to trade in a security or tip another individual **for personal benefit**.

United States v. Newman, 773 F.3d 438 (2d Cir. 2014) (emphasis added) (*citing United States v. Jiau*, 734 F.3d 147, 52–53 (2d Cir. 2013), *cert. denied*, 135 S.Ct. 311 (Oct. 6, 2014); *Dirks v. S.E.C.*, 463 U.S. 646, 659-664 (1983)), *reh'g denied* 2015 WL 1954058 (Apr. 3, 2015).

On this motion, Defendant does not contest that Alex was a corporate insider whose access to material, nonpublic information gave rise to a fiduciary duty. Nor does Defendant deny that Alex disclosed that information to Ben. And while Ben does not appear to have traded

on the information himself, Ben's deposition testimony that was read into the record establishes that Ben passed the information to Corinne, a friend and colleague in the financial industry with whom he had a history of sharing "hot tips." Defendant has admitted that she subsequently obtained the information from Corinne, though Corrine did not tell Dana how she came by the information. Both Corinne and Defendant traded on the information, to the substantial benefit of their employers and clients.

Tippee liability depends on *tipper* liability, which in turn depends on whether the tipper breached a fiduciary duty by disclosing the confidential information. The *Dirks* Court defined that "personal benefit" as including "a pecuniary gain or a reputational benefit that will translate into future earnings." *Dirks*, 463 U.S. at 663. It is on the basis of that definition that Defendant bases her motion.

The record does not contain any evidence that Alex received any pecuniary compensation for the disclosure. Dana contends that the record is similarly devoid of evidence that Alex obtained any reputational benefit that would eventually lead to pecuniary gain. To this Court, that latter argument is less certain. Ben's comments to Corinne indicate that Alex was building a reputation as a source of reliable market information. It would have been reasonable for the jury to infer that Alex knew and intended that his track record of helpfulness to Ben would one day allow Alex to "call in the favor" in some way.

In any event, we need not read the tea leaves to such an extent. The reason is that Dana's reading of *Dirks* is incomplete. *Dirks* also held that "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend." *Id*. at 664. That is precisely what happened here. Alex made an apparent gift of sensitive insider information to Ben, a relative and stock broker.

The Ninth Circuit recently applied this standard to uphold the insider trading conviction of a remote tippee. *United States v. Salman*, 14-cv-10204, 2015 WL 4068903 (9th Cir. 2015). In that case, an insider in Citigroup's healthcare investment banking group (Maher Kara) passed information to his brother (Mounir "Michael" Kara), who in turn relayed the information to a third party (Salman) who, with the assistance of others, traded on the information.

Dana argues that Alex and Ben's relationship was not sufficiently close, but *Dirks*' "trading relative" language is not accompanied by any caveat about the closeness of the relatives' relationship. Therefore, it makes little, if any, different that Alex and Ben were cousins rather than brothers or that they spoke only a few times a year. Alex and Ben had a history of trading market advice, and Alex had to at least some extent supported Ben's efforts to go to business school. Moreover, the fact that Alex's mother loaned Ben's mother $50,000 to buy a house suggests that the familial relationship was stronger than occasional chats between cousins might suggest.

The jury had sufficient facts, as described above, to infer that when Alex gave inside information to Ben, he knew that there was a potential, if not a virtual certainty, that the information would be traded upon. And although Ben did not trade on the information, he was able to pass it on to others who did. On those facts, a jury may infer that the Alex disclosed the confidential information with the intent to benefit a "trading relative or friend."

As a matter of policy, such evidence must be sufficient to establish the breach of fiduciary duty on which both tipper and tippee liability are based. If it were not, then corporate insiders could disclose insider information to family members (or at least extended family) with impunity, as long as they avoiding asking for a monetary compensation in exchange for the tip. It seems obvious to this Court that such a law would result in rampant insider trading, because

even if the insiders could not be compensated openly, the opportunity to benefit a family member would provide ample incentive to disclose the confidential information. Even if the insider did not receive an immediate quid pro quo, they could rest assured that their having "done a favor" for a family member would generate the sort of personal capital that would strengthen the relationship and increase the likelihood of some future show of appreciation, from the recipient of the information or even a different family member.

Perhaps the closer question is whether the Defendant Dana, the ultimate tippee, knew, as the standard requires, that the information she obtained from Corinne had come from an insider who had received a personal benefit for the disclosure. Dana's motion emphatically reminds the Court that the record is "bereft of evidence that she knew the source of the information." That is true. Nevertheless, *Dirks* contemplates imputed, not only actual, knowledge. *Dirks*, 463 U.S. at 660 (holding that a tippee is liable if she "knows *or should know* that there has been a breach" (emphasis added)). Even acknowledging the conspicuous gaps in the Government's evidence, one may reasonably argue that the circumstantial evidence renders it implausible that Dana did not know that the source of the confidential information was the Director of Finance of iTech, who happened to be the grandson of the woman whose birthday party Dana was attending when Dana's friend Corinne approached her with a hot tip about iTech. But again, we need not speculate as to what Dana actually knew, because to the extent she didn't actually know the source of the information, she *should* have known it. Dana is an experienced and sophisticated investor. An amateur or hobbyist trader may be credibly plead ignorance of the details of a windfall of obviously nonpublic information; an expert, however, ought not be rewarded for her conscious avoidance of the truth.

ISSUE 2: IS ALEX'S PRIOR GRAND JURY TESTIMONY ADMISSIBLE UNDER FRE 804(b)(1)?

Dana also argues that this court erroneously excluded Alex's prior testimony before the grand jury. Federal Rule of Evidence 804(b)(B(1) exempts prior testimony of an unavailable witness from the general hearsay exclusions provided that the party against whom the testimony is offered in the second proceeding had "an opportunity and similar motive to develop [the testimony] by direct, cross-, or redirect examination."

While the DOJ clearly had the opportunity to develop Alex's testimony, its motive was too dissimilar for the court to allow Alex's prior testimony to be used against the Government here. Similarity of motive turns on whether the party had a "substantially similar degree of interest in prevailing on that issue" in the prior proceeding. *United States v. DiNapoli*, 8 F.3d 909, 912 (2d Cir. 1993). Alex testified before a grand jury empanelled to determine the scope and liability what the DOJ believed to have been a multi-party insider trading ring. Unlike in an adversarial proceeding, the Government did not have a vested interest in the content of Alex's grand jury testimony beyond obtaining a reasonable degree of confidence that the testimony he gave was truthful. *U.S. v. Whitman*, 555 F. App'x 98, 103 (2d Cir. 2014), *cert. denied* 135 S.Ct. 352 (Nov. 10, 2014). So when Alex said that he didn't know Dana, had not talked to Dana, and had no knowledge of any relationship or interaction between Dana and Ben, the Government had no motive to press further and, in fact, did not ask any more questions. *Cf. id.* at 103 (noting that at the time the testimony was offered, the Government asked "only two leading questions").[3]

Dana argues that, having admitted Ben's testimony from the civil suit, the Court cannot exclude Alex's grand jury testimony. But that argument missed the fundamentally different the

[3] We acknowledge Dana's observation that the *Whitman* decision is an unpublished summary order and is carefully tethered to the particular facts before the court. The *Whitman* decision is not binding on this court (nor would it be if it were a published decision), but we have not asserted to the contrary. Even an unpublished decision of court in another circuit can be persuasive authority, and it is in that capacity that we cite it here.

nature of the SEC's civil suit. There, the SEC had sued Ben and Corinne and, therefore, had a vested interest in proving their bad acts. So when Ben testified that he had not talked to or passed information to Dana, the SEC was similarly motivated as it would have been in this proceeding to challenge the credibility of that testimony. The fact that the SEC did not exercise that motive—with any vigor, at least—is beside the point. The existence of the motive is enough for the testimony to be admissible here under Rule 804(b)(1)(B).

Although the Government has not cross-moved, we will briefly address, for purposes of completeness, the Government's contention at oral argument that Ben's testimony ought to have been excluded because the testimony was taken by the SEC, not DOJ. The Government is right, of course, that the exception of Rule 804(b)(1) is premised upon an assertion of the testimony against the same party that took it in the previous proceeding. However, that is not to say that 804(b)(1) is *per se* inapplicable in situations like this. Courts have applied 804(b)(1) to admit evidence against a different government entity than the entity that took the testimony in the prior proceeding where a sufficiently substantial degree of collaboration existed between the agencies that they can be deemed to have acted in parallel in the broader interests of the "government." The record in this case does not evince an extensive degree of collaboration, but it does indicate that the DOJ initiated its criminal proceedings at the SEC's invitation and that the two agencies conferred as to shared matters of strategy before the testimony at issue on this motion was taken. That cooperation is sufficient to find the SEC and DOJ to be the "same party" for purposes of this Rule 804 analysis.

CONCLUSION

Defendant's motion is denied.

Dated: March 4, 2014

UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

Docket No. 12-113310

DANA DINOFRIO,
Defendant-Appellant,

v.

UNITED STATES,
***Plaintiff-Appellee*.**

BEFORE Judges Brownstein, Diaz, and Mock.

OPINION

Brownstein, Circuit Judge.

For the reasons set forth below, the memorandum and order of the District Court is REVERSED, and this case is REMANDED to the District Court for further proceedings not inconsistent of an order consistent with this decision.

BACKGROUND

The facts of this case are set forth in the Record on Appeal and are cited here only to the extent necessary to describe our ruling.

The Government alleged that the Defendant/Appellant, sold all her shares in the iTech company based on non-public information (the "Information") that she received through a chain of tippers, originating with the iTech's Finance Director, Alex. Alex and the Appellant did not know each other, but both were present at a birthday party for Alex's grandmother. In the course of casual conversation, Alex revealed the Information to his cousin, Ben. Ben was a stock broker with whom Alex occasionally swapped information about the markets, but Ben did not

hold shares in iTech. Ben, in turn, passed the Information to his best friend Corrine, a hedge fund manager with significant holdings in iTech. In addition to selling her iTech shares based on the Information, Corrine also passed the Information to her friend Dana, the Appellant and another fund manager whose portfolio was significantly invested in iTech. Upon learning the Information, Dana dutifully ordered the immediate sale of all of her holdings in iTech, thereby narrowly avoiding a significant financial loss. Dana insists that she did not know the identity of the original source of the Information or how Corrine came into possession of the information.

The Defendant was subsequently charged with securities fraud, in violation of Section 10(b) of the Securities and Exchange Act of 1934, Rules 10b-5 and Rule 10b5-2, and 18 U.S.C. § 2. The insider, Alex, was unavailable to testify at Appellant's trial. Appellant attempted to use testimony given by Alex during the grand jury proceeding that led to Appellant's indictment, contending that it was admissible under the hearsay exception found in Federal Rule of Evidence 804(b)(1). The trial court excluded that testimony. Appellant subsequently was convicted.

On this appeal, Appellant contends that she is entitled to a new trial because the District Court committed the following errors:

1. (a) offering a definition of "personal benefit" that was impermissibly broad so as to encompass even ephemeral, non-material rewards and (b) failing to instruct the jury that the Government must prove that Appellant knew the nature of the "personal benefit" obtained by the insider; and
2. excluding prior testimony of the insider, taken during a related SEC investigation, that was exculpatory as to both the insider's receipt of a benefit and Appellant's knowledge thereof.

DISCUSSION

ISSUE 1: DID THE DISTRICT COURT ERR BY INSTRUCTING THE JURY WITH AN IMPERMISSIBLY BROAD DEFINITION OF PERSONAL BENEFIT AND BY FAILING TO REQUIRE PROOF THAT THE APPELLANT KNEW THE NATURE OF THAT BENEFIT?

We review jury instructions *de novo*. *United States v. Moran-Toala*, 726 F.3d 334, 344 (2d Cir. 2013).

Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.§ 78j(b), prohibits the use of any manipulative or deceptive device in connection with the purchase or sale of any security. The statute also delegated authority to the Securities and Exchange Commission to promulgate rules and regulations to define what constituted a violation of Section 10(b).

It is important to recognize that neither Section 10(b) nor the rules and regulations promulgated thereunder explicitly prohibit insider trading. Rather, our insider trading laws were established by the judiciary. In *United States v. Chiarella*, 445 U.S. 222 (1980), the Supreme Court adopted the SEC's interpretation of Section 10(b) as articulated in the *Cady, Roberts* decision. *In re Cady, Roberts & Co.*, Exchange Act Release No. 34-6668, 40 S.E.C. 907 (1961). The Commission's ruling in *Cady, Roberts* recognized that the common law in some jurisdictions established that a corporate insider in possession of material nonpublic information owes a fiduciary duty to shareholders to either disclose the material nonpublic information or to abstain from trading altogether, a rule that is sometimes referred to as the disclose-or-abstain rule. Tippee liability for insider trading derives from the corporate insider's duty to disclose or abstain. *Dirks v. SEC*, 463 U.S. 646, 659 (1983).

In *Dirks*, the Supreme Court reversed a civil judgment against a defendant who was charged by the SEC for insider trading. The Supreme Court recognized the need for a ban on some tippee trading, but was also concerned about the harmful effect of defining insider trading

too broadly. With that concern in mind, the Supreme Court held that the appropriate test for tippee liability is "whether the insider personally will benefit, directly or indirectly, from his disclosure." *Id.* at 662. Absent some personal gain, there has been no breach of fiduciary duty to shareholders and therefore no derivative breach of the tippee. *Id*.

To sustain a criminal conviction for a violation of federal securities laws, the Government must also prove that the defendant acted *wilfully*. 15 U.S.C. § 78ff(a). This statutory requirement is simply a codification of traditional *mens rea* principles from the common law of criminal liability--which require, as a necessary element of every crime, that the defendant know the facts that make his conduct illegal. *Staples v. United States* 511 U.S. 600, 605 (1994).

The Appellant argues that if the Government is required to prove that she knew the "facts that make [her] conduct illegal", then the Government must prove that she knew that Alex, the corporate insider, received a personal benefit for the disclosure to Ben, the initial tipper. The Government, on the other hand, argues that *Dirks* only requires the Government to prove that the defendant knew that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend. The Government's argument is premised on the Supreme Court's conclusion that "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Dirks*, 463 U.S. at 664.

The District Court was persuaded by the Government's reading of *Dirks*. We disagree. *Dirks* was a civil case that defined what constituted a breach of fiduciary duty in the context of tippee liability for insider trading. The Supreme Court in *Dirks* was not tasked with determining the level of knowledge that a defendant must have to establish *criminal* liability for insider

trading in tippee cases. To sustain criminal liability against a tippee, the Government must prove that the defendant knew that the selective disclosure constituted a breach of the insider's fiduciary duty, as that breach is defined by *Dirks*. For the defendant to know that the selective disclosure resulted from a breach of duty, the defendant must know that the fiduciary obtained a personal benefit for the selective disclosure. Without knowledge of the personal benefit, the defendant cannot know whether there is a breach.

While these requirements may restrict the prosecution of tippees in insider trading cases, tippee liability cases are only a subset of many forms of insider trading that the Government can still pursue. We must be mindful of the potential over-criminalization of our securities laws, particularly in insider trading cases, where a trader's vocational success is based on snap judgments following information received about a company. In the fast-paced environment of our financial markets, traders cannot be required to stop and verify that the information they received came from an appropriate source. Criminalizing traders who had no knowledge that the information they received derived from a breach of fiduciary duty will stymie the decision-making of these traders and inhibit the liquidity of our capital markets, a consequence that is antithetical to the utilitarian principles that our criminal laws are designed to fulfill. It is for this reason that our securities laws are structured *to allow*, or at least not to criminalize, a certain degree of trading that could fairly be construed as "insider." *See U.S. v. Newman*, 773 F.3d 438, 445 (2d Cir. 2014) (noting that the Supreme Court has declined to find "a general duty between all participants in market transactions to forgo actions based on material, nonpublic information"), *reh'g denied* 2015 WL 1954058 (Apr. 3, 2015) (en banc).

The trial court should not have given a constructive knowledge instruction that permitted the jury to find Dana liable on nothing more than an imputed obligation, as an expert trader, to

understand that the information she received was not public. *See id.* at 443-44 (Government failed to carry its burden of proving tippee's intent by arguing that "as sophisticated traders, [defendants] must have known that the information was disclosed by insiders in breach of a fiduciary duty, and not for any legitimate corporate purpose").

In the trial court below, the court failed to instruct the jury that, to find defendant liable, the Government had to prove, among other things, that (1) a family relationship not only existed between Alex and Ben but that the relationship was of a sort that Alex's gratuitous offering of insider information would create at least the increased likelihood of eventual pecuniary benefit; and (2) that Dana knew the facts giving rise to Alex's breach of fiduciary duty.

This defect is material because the record does not contain sufficient evidence to permit a conviction based on the proper legal standard. As to Alex's personal benefit, the fact of Alex's familial relationship to Ben is undisputed. But it also is undisputed that, unlike the relatives in *U.S. v. Salman*, for example, Alex and Ben were not close and rarely saw each other. *U.S. v. Salman*, 792 F.3d 1087, 1089 (9th Cir. 2015). Their conversations could mostly be characterized as the type of filler one might fall back on when trying to break the ice with a stranger at a cocktail party. Further unlike the relatives in *Salman*, there is no evidence that Ben ever gave anything of material benefit to Alex, such that Alex would believe that his gift of information might eventually lead to some sort of pecuniary *quid pro quo*. The loan by Alex's mother to Ben's hints at some broader family connection, but it says little about the relationship between Alex and Ben.

Proof of Dana's knowledge is similarly lacking. The Government's evidence did place Dana in the same room with Alex, Ben, and Corinne. And Dana did have some general knowledge of the family connections between Alex and Ben. But the Government could offer

little more than supposition that Dana knew that Ben was Corinne's source for the confidential information or that Ben, in turn, had obtained that information from Alex. Moreover, Dana's limited knowledge of Alex and Ben's relationship does not equate to knowledge that Alex received a personal benefit in exchange for his disclosure. *Cf. id.* at 1093 (imputing knowledge of the personal benefit to a defendant who knew the source of the inside information and, by virtue of being married to the insider and tipper's sister, had spent significant time with them and had observed the close nature of their relationship).

ISSUE 2: DID THE DISTRICT COURT ERR BY EXCLUDING THE INSIDER'S PRIOR GRAND JURY TESTIMONY?

The parties (and this Court) agree that Alex's testimony is hearsay. Dana contends, however, that the testimony is nonetheless admissible under Federal Rule of Evidence 804(b)(1), which provides that

> [t]estimony that [(A)] was given as a witness at a ... lawful deposition, whether given during the current proceeding or a different one; and [(B)] is now offered against a party who had ... an opportunity and similar motive to develop it by direct, cross-, or redirect examination may be admitted where the witness has since become unavailable.

Lower courts' decisions examining the admissibility of prior grand jury testimony of a witness against the government have reach mixed results. *See U.S. v. Omar*, 104 F.3d 519 (1st Cir. 1997) (holding that former testimony in a grand jury proceeding is properly excluded for finding government did not have a similar motive to discredit the witness's testimony). *But see, U.S. v. Foster*, 128 F.3d 949 (6th Cir. 1997) (government has same opportunity and motive to develop witnesses' testimony before the grand jury as it does at trial), *cert denied*, 537 U.S. 1217 (Feb. 24, 2003); *U.S. v. Miller*, 904 F.2d 65, (D.C. Cir. 1990) (same).

We find here that Alex's grand jury testimony presented the United States with an adequate "opportunity" to develop his testimony. DOJ handled the grand jury and the trial.

Such an opportunity, however, is not enough to satisfy Rule 804(b)(1)'s standard. The United States must also have had a similar motive in both proceedings. *U.S. v. DiNapoli*, 8 F.3d 909 (2d Cir. 1993) (en banc).

The courts of appeals have differed on how similar the opponent's respective motives must be. The Second Circuit has applied a more limiting approach to Rule 804's similarity-of-motive requirement with respect to grand jury testimony. *See id.* (holding that grand jury testimony was properly excluded where the questioner had "a substantially similar degree of interest in prevailing" on the related issues at both proceedings). The Ninth Circuit, however, noted Rule 804(b)(1) "does not require an identical quantum of motivation." *U.S. v. McFall*, 558 F.3d 951, 963 (9th Cir. 2009) (ruling it was abuse of discretion exclude exculpatory grand jury testimony).

While the purpose of the grand jury proceeding was exploratory, it is equally true that the government's commitment to prosecute was strong, implying comparable motivation to challenge and enhance Alex's testimony and to use the same at trial. *Cf. Foster*, 128 F.3d at 956. The Government's fundamental objective in questioning Alex before the grand jury was to elicit testimony that would support its theory that Alex conspired with Ben and Dana to engage in the alleged insider trading—a motivation more or less identical to the one the Government possessed at Dana's trial. More specifically, in both proceedings, the Government possessed a substantially similar motivation to establish that Alex had received a meaningful benefit in exchange for his information.

The Government argues that Alex's testimony was properly excluded because the Government did not cross-examine him during the grand jury proceeding as broadly or as thoroughly as it would have had he been available to appear in the District Court proceeding.

But that is not the test. Courts do not require that the party at the earlier proceeding *actually* have conducted a full cross-examination of the witness; it is enough that the motive existed for it to do so. *U.S. v. McClellan*, 868 F.2d 210, 215 (7th Cir. 1989) ("emphasis in this inquiry is upon the motive underlying the cross-examination rather than the actual exchange that took place"). "For tactical reasons or otherwise," a party might decide not to engage in a rigorous examination, or even in any questioning at all. *U.S. v. Salerno*, 505 U.S. 317, 329 (1992) (Stevens, J. dissenting). In such a case, however, the party "must accept the consequences of that decision—including the possibility that the testimony might be introduced against her in a subsequent proceeding." *Id*.

Thus, when the prosecutors chose for some strategic reasons not to further inquire into Alex's benefit from sharing the Information before the grand jury—as they most assuredly did—they chose to forego what was an "opportunity and similar motive to develop the testimony by direct, cross, or redirect examination" within the meaning of Rule 804(b)(1) for present purposes.

Any doubt about the procedural significance of Alex's grand jury testimony is dispelled by the fact that the Government tried to use Alex's testimony in support of its attempts to obtain grand jury indictments of Ben and Corinne for the same conduct that ultimately led to the indictment of Dana. It seems strange indeed to permit the Government to use Alex's testimony to seek indictments of two members of an alleged insider trading ring, but then to prohibit a third defendant from using the testimony in a subsequent criminal proceeding. The language and spirit of Rule 804(b)(1) compel a different result.

The Government's case against Dana was entirely circumstantial, and the inclusion of Alex's grand jury testimony would likely have had meaningful impact on the jury's verdict. We

therefore find that the District Court abused its discretion by excluding Alex's grand jury testimony.[4]

AFFIRMED IN PART AND REVERSED IN PART AND REMANDED.

Dated: February 12, 2015

[4] We note briefly that we concur with the District Court's decision to admit Ben's deposition testimony in the SEC investigation. On this set of facts, the SEC and the USAO are the "same party" for purposes of Rule 804(b)(1)—the United Stated—and that similarity of motive exists. *Cf. U.S. v. Sklena*, 692 F.3d 725, 731 (7th Cir. 2012) (holding the Commodity Futures Trading Commission and the Department of Justice are the "same party" under the hearsay exception applied to statements that addressed the same misconduct being criminally prosecuted).

SUPREME COURT OF THE UNITED STATES
October Term 2015

Docket No. 2015-01

UNITED STATES,
Petitioner,

v.

DANA DINOFRIO,
Respondent.

Petition for certiorari is GRANTED. The Court certifies the following questions:

1. Did the Thirteenth Circuit properly define the personal benefit, together with the tippee's knowledge of that benefit, required to find tippee liability for insider trading?

2. In the context of a subsequent criminal proceeding, did the Thirteenth Circuit properly hold that exculpatory testimony given in a prior grand jury proceeding was admissible where the witness was unavailable to testify in the subsequent criminal case?