Case No. 09-10996

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

MARK CUBAN,

Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of Texas
Civil Action No. 3:08-cv-02050 (SAF)

MOTION OF LAW PROFESSORS FOR LEAVE TO FILE BRIEF AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLEE

Nicholas I. Porritt
Kevin R. Amer
AKIN GUMP STRAUSS HAUER & FELD LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036
Tel.: (202) 887-4000
Fax: (202) 887-4288

Pursuant to Federal Rule of Appellate Procedure 29 and Fifth Circuit Rule 29, the law professors named below respectfully move for leave to file the accompanying brief as *amici curiae* in support of the defendant-appellee.

The proposed *amici* are professors at American law schools who have studied and written about corporate law and securities law, including the laws regarding insider trading pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). The proposed *amici* have no financial interest or direct personal interest in the case. They seek to file the accompanying brief because the District Court's opinion in this case raises important concerns related to the application of the federal laws regarding insider trading. Failure to address these concerns could result in precedent with detrimental effects on corporate law and the national securities markets.

The proposed *amici* believe that their views would assist the Court in resolving the important issues presented by this case. As law professors who have written extensively on the statutory provisions at issue here, the proposed *amici* are well positioned to speak to the legal issues in this case and their broader implications for corporate and securities regulation generally. Indeed, these professors were granted leave to participate as *amici* below, and filed a brief with the District Court in this case. In addition, the accompanying *amicus* brief complements the briefing already submitted to the Court by providing additional information regarding the development of insider trading law and the policy purposes intended to be served by Section 10(b)'s antifraud provisions. Such information will only contribute to the Court's considered and fully informed resolution of the issues before it.

In accordance with Fifth Circuit Rule 27.4, proposed *amici* have contacted counsel for the parties regarding this motion. Counsel for the defendant-appellee consents to the filing of the accompanying brief. Counsel for the plaintiff-appellant has not yet responded.

Accordingly, for the reasons stated herein, proposed *amici* respectfully request that this motion be granted and that they be permitted to file the accompanying brief as *amici curiae*.

Respectfully submitted,

s/ Nicholas I. Porritt

Nicholas I. Porritt
Kevin R. Amer
AKIN GUMP STRAUSS HAUER & FELD LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036
Tel.: (202) 887-4000
Fax: (202) 887-4288

On Behalf of Proposed Amici Curiae:

Allen Ferrell
Greenfield Professor of Securities Law
Harvard Law School
Cambridge, MA 02138
(617) 495-8961
fferrell@law.harvard.edu

Stephen Bainbridge
William D. Warren Professor of Law
UCLA Law School
P.O. Box 951476
Los Angeles, CA 90095
bainbridge@law.ucla.edu

M. Todd Henderson
Assistant Professor of Law
University of Chicago Law School
1111 East 60th Street
Chicago, IL 60637
toddh@uchicago.edu

Jonathan R. Macey
Sam Harris Professor of Corporate
Law, Finance, and Securities Regulation
Yale Law School
127 Wall Street
New Haven, CT 06511
jonathan.macey@yale.edu

Dated: April 2, 2010

CERTIFICATE OF SERVICE

I, hereby certify that on April 2, 2010, I served the foregoing motion upon the following counsel of record by filing a copy of the document with the Clerk through the Court's electronic docketing system:

Counsel for Plaintiff-Appellant:

Michael L. Post
Senior Litigation Counsel
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
postm@sec.gov

Randall W. Quinn
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
quinnr@sec.gov

Counsel for Defendant-Appellee:

Lyle Roberts
Dewey & LeBoeuf LLP
1101 New York Ave., N.W.
Washington, DC 20005
lroberts@deweyleboeuf.com

Stephen A. Best
Dewey & LeBoeuf, L.L.P.
1101 New York Avenue, N.W.
Washington, DC 20005
sbest@deweyleboeuf.com

Ralph Carmine Ferrara
Dewey & LeBoeuf, L.L.P.
1101 New York Avenue, N.W.
Washington, DC 20005
rferrara@dl.com

Paul Edward Coggins, Jr.
Fish & Richardson, P.C.
Suite 5000
1717 Main Street
Bank One Center
Dallas, TX 75201
coggins@fr.com

s/ Nicholas I. Porritt
Nicholas I. Porritt

Case No. 09-10996

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

MARK CUBAN,

Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of Texas
Civil Action No. 3:08-cv-02050 (SAF)

BRIEF OF *AMICI CURIAE* LAW PROFESSORS IN SUPPORT OF DEFENDANT-APPELLEE

Nicholas I. Porritt
Kevin R. Amer
AKIN GUMP STRAUSS HAUER & FELD LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036
Tel.: (202) 887-4000
Fax: (202) 887-4288

SUPPLEMENTAL STATEMENT OF INTERESTED PARTIES

The following listed persons submit this brief as *amici curiae* and thus have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

Allen Ferrell
Greenfield Professor of Securities Law
Harvard Law School

Stephen Bainbridge
William D. Warren Professor of Law
UCLA Law School

M. Todd Henderson
Assistant Professor of Law
University of Chicago Law School

Jonathan R. Macey
Sam Harris Professor of Corporate Law,
Finance, and Securities Regulation
Yale Law School

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND REGULATIONS

MISCELLANEOUS

STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici are professors at American law schools who have studied and written about corporate law and securities law, including the laws regarding insider trading pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). *Amici* have no financial interest or direct personal interest in the case. They file this brief because the District Court's opinion in this case raises important concerns related to the application of the federal laws regarding insider trading. Failure to address these concerns could result in precedent with detrimental effects on corporate law and the national securities markets. *Amici* seek to provide the Court with information that will assist it in interpreting the circumstances under which a person who is not a corporate insider may be liable for trading a corporation's securities while in possession of non-public material information. A*mici* do not necessarily all agree with all of the particular statements herein, but *amici* do agree that this Court should affirm the judgment below and that this Court should do so for reasons substantially similar to the reasons set forth in this brief.

STATEMENT OF THE CASE

As alleged by the United States Securities and Exchange Commission ("SEC") in its complaint, Defendant, Mark Cuban owned 600,000 shares of Mamma.com, Inc., 6.3% of its outstanding shares. (Compl. ¶ 10, USCA5 11). Mamma.com decided to raise additional capital through a private placement of additional shares, referred to as a PIPE ("private investment in public equity"). (*Id*. ¶ 11.) On June 28, 2004, Mamma.com's Chief Executive Officer invited Cuban to participate in the PIPE. (*Id*. ¶¶ 12-14 USCA5 11-12). Before advising him of the PIPE, Mamma.com's Chief Executive Officer reached an oral understanding with Cuban that he would keep the information confidential. (*Id*.) Cuban declined to participate in the PIPE and sold all of his Mamma.com shares. (*Id*. ¶ 18. USCA5 13). On June 29, 2009, Mamma.com publicly announced the PIPE and its share price declined approximately 8.5%. (*Id*. ¶¶ 22-23 USCA5 13-14). Cuban avoided over $750,000 in losses by selling before the public announcement of the PIPE. (*Id*. ¶ 24 USCA5 14).

The SEC filed a complaint alleging that Cuban's sale of Mamma.com shares violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (2010), Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (2010) ("Exchange Act") and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. The district court granted Cuban's motion to dismiss the complaint and entered judgment in his favor. This appeal followed.

SUMMARY OF ARGUMENT

The federal securities laws, including the antifraud provisions contained in Section 10(b) of the Exchange Act, and Rule 10b-5, play an essential role in ensuring the integrity and fairness of our national securities markets. Rigorous and fair enforcement of those provisions by the SEC and, where appropriate, the United States Attorney, are an important part of this function. Portions, however, of the securities laws, including the antifraud provisions, are necessarily drafted broadly and can be subject to an expansive interpretation and application. The courts, especially the Supreme Court, have played an ongoing and critical role setting prudent limits on the application of the securities laws to ensure that they apply where necessary to meet the language and overall purpose and scheme of the legislation and do not unduly interfere with areas that have been traditionally subject to other regulation such as state law.

This is particularly true in the context of the prohibition on insider trading contained in Section 10(b) and Rule 10b-5. The SEC and private plaintiffs have consistently adopted an expansive interpretation of these provisions to advocate a broad ban on insider trading. Over thirty years of precedent, the Supreme Court has consistently checked these efforts and emphasized that there can be no liability, civil or criminal, for insider trading unless that trading violates Section 10(b) of the Exchange Act. Furthermore, Section 10(b) is an *antifraud* provision and cannot be used to remedy all instances of unfairness or disparities of information that occur in the securities markets. Accordingly, the Supreme Court has consistently held that insider trading violates Section 10(b) only when it is the result of a breach of fiduciary duty or similar duty of trust and confidence owed either to the shareholders of the corporation whose securities are being traded (the classical insider trading theory) or to the source of the information (the misappropriation theory). The Supreme Court has equally consistently rejected attempts to create liability under Section 10(b) simply on the basis of trading on material non-public information. The SEC, through its own regulations such as Rule 10b5-2 or its litigation strategy, cannot exceed the statutory authority of Section 10(b) as interpreted by the Supreme Court.

Here, the SEC does not allege that Cuban owed a fiduciary duty to either the source of the material non-public information or to his fellow shareholders of Mamma.com. Nor does the SEC allege that Cuban obtained the information by engaging in a deceptive or fraudulent scheme. Instead, the SEC alleges that Cuban was subject to a duty of confidence arising from an oral agreement of confidentiality with Mamma.com's Chief Executive Officer. This duty of confidence, according to the SEC, created an obligation to abstain from trading

Mamma.com securities without first disclosing an intention to trade to Mamma.com. No permission to trade was required from Mamma.com. The SEC also does not assert that Cuban owed a duty to disclose any information to the market before trading and, indeed, alleges that Cuban maintained the confidentiality of the non-public information, thus profiting when the information was ultimately disclosed by Mamma.com the next day.

Thus, the SEC seeks to impose liability on Cuban for trading in Mamma.com stock even though Cuban did not breach any fiduciary duty owed to Mamma.com or, apparently, breach any contract. This is a significant expansion of the prohibition on insider trading contained in Section 10(b) and goes substantially beyond the limits of Section 10(b) as interpreted by the Supreme Court. This Court should reject this expansion.

First, the misappropriation theory of insider trading relied on by the SEC here, is, at best, tangential to the primary purpose of the antifraud provisions of the Exchange Act: to prevent the deception of investors and to facilitate disclosure of information to the market. The misappropriation theory of insider trading concerns communications between the trader and his source of material, non-public information. Disclosure to the market and other investors is largely irrelevant to this theory. As the misappropriation theory otherwise lacks any express statutory basis, this Court should be wary regarding its application and should not expand its reach beyond that already clearly set forth by the Supreme Court.

Second, the position adopted by the SEC in this case injects the federal securities laws, and Section 10(b), into areas of the law that are traditionally governed by state law. The Supreme Court has consistently cautioned against using Section 10(b) as a means to impose uniform, federal standards for fiduciary duties of corporate insiders. Here, the SEC proposes a federal standard for confidentiality agreements as well as the relationship between a shareholder and a corporation, both areas traditionally governed by state law. Furthermore, the standard that the SEC proposes is ambiguous and fails to provide clear guidance to individuals seeking to comply with the federal securities laws.

Finally, abolishing the requirement for a breach of fiduciary duty before there can be liability for insider trading would also remove the requirement that the trading be fraudulent, and, therefore, barred by Section 10(b). A fiduciary relationship comprises duties not just of *confidence* but also of *trust*; it is the circumstance of dependence between trustee and beneficiary or attorney and client that marks these relationships as fiduciary in nature. It is the exploitation of that dependence and trust that renders a breach of fiduciary duty fraudulent. Violation of a confidentiality agreement may be wrong but, like most breaches of contract, it does not typically amount to fraud. The SEC's position in this case, and its Rule

10b5-2, essentially converts each breach of a confidentiality agreement into a fraudulent act, something that is beyond the SEC's power under the Exchange Act.

ARGUMENT

I. LIABILITY UNDER SECTION 10(B) EXISTS ONLY WHERE THE DEFENDANT HAS BREACHED A FIDUCIARY DUTY OR A SIMILAR RELATIONSHIP OF TRUST AND CONFIDENCE.

In seeking to impose insider trading liability solely on the basis of a confidentiality agreement, the SEC is asking this Court to adopt a sweeping and unprecedented expansion of Section 10(b). In a long line of cases construing the scope of that provision, the Supreme Court has consistently made clear that a party engages in fraud within the meaning of Section 10(b) *only* if he breaches a fiduciary duty or a similar relationship of trust and confidence. The SEC's position – which would impose liability on non-fiduciary corporate outsiders who undertook no duty not to trade on the relevant information – is in direct conflict with that unbroken line of precedent.

A. The Supreme Court Limits Rule 10b-5 Liability to Fraudulent Conduct.

Section 10(b) proscribes the use of "any . . . deceptive device or contrivance" in connection with the purchase or sale of securities in contravention of any rules prescribed by the SEC. 15 U.S.C. § 78j(b). In 1942, the SEC adopted Rule 10b-5, which states that it is unlawful for any person "(a) to employ any device, scheme, or artifice to defraud, [or] …. (c) to 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." 17 C.F.R. § 240.10b-5.

The SEC and private plaintiffs initially relied on Rule 10b-5 to assert a broad duty that "anyone in possession of material inside information must either disclose it to the investing public or . . . must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (en banc).[1] The purpose of this rule was to prevent insiders from taking "unfair advantage" of uninformed investors. *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 829 (D. Del. 1951). Rule 10b-5 did not require disclosure of material information only if both parties could have acquired the relevant information. "[T]he Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information." *Texas Gulf Sulphur*, 401 F.2d at 848.

Starting with *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), the Supreme Court began limiting the expansive theories of liability under Section

[1] *See also In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

10(b) and Rule 10b-5 advocated by private plaintiffs and the SEC.[2] In *Blue Chip Stamps*, the Court placed limits on the implied private cause of action under Rule 10b-5, restricting it to investors who actually bought or sold securities. *Id*. at 755. The Court recognized that imposing this limit "undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b-5." *Id*. at 743.

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court rejected a broad interpretation of Section 10(b) and Rule 10b-5 proposed by the SEC and held that an "intent to deceive, manipulate or defraud" must be shown to establish a violation of these provisions. *Id*. at 193. The Court noted that some subsections of Rule 10b-5 could be read as proscribing mere negligent conduct but, after analyzing the language and history of Section 10(b), still held that such an interpretation would exceed the power granted to the SEC under that section. *Id*. at 213-14.

Finally, in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), the Supreme Court rejected minority shareholders' claims that they had been treated unfairly by the majority in a merger. The Court held that Section 10(b), and therefore Rule 10b-5, did not reach "instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated

[2] *See also Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 387 (5th Cir. 2007) (discussing "series of [Supreme Court] decisions construing the statute and narrowly defining the scope of 'fraud' in the context of securities").

unfairly by a fiduciary." *Id*. at 477. The Court also noted that to accept a broad application of Rule 10b-5 would "bring within the Rule a wide variety of corporate conduct traditionally left to state regulation," and it refused to establish, without express congressional authority, a "federal fiduciary principle" that would override state fiduciary standards. *Id*. at 478-79.

B. The "Equal Access to Material Information" Theory is Rejected by the Supreme Court and A Breach of Fiduciary Duty or Similar Duty is Required.

It was unsurprising that when the Supreme Court first considered how Section 10(b) and Rule 10b-5 governed insider trading, it substantially cut back the prohibition from that previously endorsed by the SEC and the Second Circuit in *Texas Gulf Sulphur*. The Supreme Court first examined the contours of those provisions in cases involving the "traditional" or "classical" theory of insider trading liability. Those cases establish that trading on material, nonpublic information qualifies as a "deceptive device" under Section 10(b) because of the "relationship of trust and confidence" that exists "between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

In *Chiarella*, the Court reversed the insider trading conviction of a corporate outsider who purchased stock on the basis of information he obtained in his capacity as an employee of a financial printer. The Court expressly rejected the SEC's theory that "the use by anyone of material information not generally available is fraudulent" under Section 10(b) simply because it "gives certain buyers or sellers an unfair advantage over less informed buyers and sellers." 445 U.S. at 232. Imposing "such a broad duty" of disclosure, the Court recognized, would "depart[] radically from the established doctrine" that the duty to disclose under Section 10(b) "aris[es] from a relationship of trust and confidence between parties to a transaction." *Id.* at 223, 230. Given the source of that duty, nondisclosure is fraudulent under Section 10(b) only when a party fails to disclose information "'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'" *Id.* at 228 (quoting Restatement (Second) of Torts § 551(2)(a) (1976)). Because Chiarella "was not [the sellers'] agent, . . . was not a fiduciary, . . . [and] was not a person in whom the sellers had placed their trust and confidence," *id.* at 232, he owed them no duty that could give rise to Section 10(b) liability.

The Court reiterated those principles in *Dirks v. SEC*, 463 U.S. 646 (1983). There, the Court considered the application of Section 10(b) against an investment analyst who received information that a company with which he had no connection was fraudulently and systematically overstating its assets. During the course of an investigation into those allegations, the analyst discussed the information with clients and investors, some of whom sold their holdings in the company before the malfeasance was made public. In holding that the analyst's actions did not constitute an actionable Section 10(b) violation, the Court "reaffirm[ed] . . . that '[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market.'" *Id.* at 657-58 (quoting *Chiarella*, 445 U.S. at 232-33 n.14); *see also id.* at 653 (disclosure duty "does not arise from the mere possession of nonpublic market information," but "arises rather from the existence of a fiduciary relationship"). Because Dirks had "no pre-existing fiduciary duty to [the] shareholders," *id.* at 655, and had undertaken no duty of nondisclosure, his discussions could not trigger liability under the "equal information" rationale rejected in *Chiarella*. *Id.* at 657. And, in the absence of evidence that a corporate insider breached his fiduciary duty to shareholders by disclosing the information, and that Dirks knew or should have known of that breach, he could not be liable under a derivative theory of liability. *Id.* at 660, 667.

C. The Misappropriation Theory Also Requires a Breach of Fiduciary Duty or Similar Duty of Trust and Confidence.

In *Dirks*, the Supreme Court suggested in *obiter dicta* that a person who is not a corporate insider may still become liable for insider trading if they acquire corporate information pursuant to a "special relationship" with the company so that they owe a fiduciary duty to the company and to its shareholders. *Id*. at 655, n.14. In *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), *aff'd by equally divided court*, 484 U.S. 19 (1987), the Second Circuit extended this theory of insider trading, the misappropriation theory, and applied it to defendants who traded in violation of a fiduciary duty owed to one of their employers, *The Wall Street Journal*, who had no relationship with any of the stocks that were traded. *Id*. at 1028-29. The defendants misappropriated the *Journal*'s confidential information regarding the content and publication schedule of its news stories and used that information to trade profitably. The Second Circuit held that this constituted "fraud and deceit" and thus violated Section 10(b). *Id*. at 1031.

The Second Circuit further developed the misappropriation theory in *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991) (en banc), where a defendant, Loeb, misappropriated material non-public information from family members and then communicated the information to Chestman who used it to trade. The court defined the misappropriation theory as follows: "a person violates Rule 10b-5 when he misappropriates material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence and uses that information in a securities transaction." *Id*. at 566.

The court noted that this was the first case where the misappropriation theory was applied outside the employment context and, accordingly, where there was not an egregious breach of a fiduciary duty by the misappropriator. Determining whether there had been the necessary breach of a fiduciary duty outside well-established categories of relationships could be unclear. Therefore, "we 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.'" *Id*. at 567 (*quoting Santa Fe*, 430 U.S. at 480).

In this context, "the fiduciary relationship question takes on special importance." *Id*. at 567. Merely entrusting a person with confidential information cannot create a fiduciary relationship. *Id*. (*citing Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980)). The court examined relationships that are recognized as inherently fiduciary and held that "[a]s the term 'similar' implies, a 'relationship of trust and confidence' must share the essential characteristics of a fiduciary relationship." *Id*. at 568. The court identified these essential characteristics as "discretionary authority and dependency" between the principal and the agent, not the communication of confidential information. *Id*. at 569. In other words, in a relationship of "trust and confidence," trust is more important than the mere sharing of confidences.[3]

[3] The Second Circuit has remained consistent with *Chestman*, finding insider trading liability under Rule 10b-5 only where there is either an fraudulent misrepresentation (not typically present in an insider trading case) or a breach of fiduciary duty. *See SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009); *United States* v. *Falcone*, 257 F.3d 226 (2d Cir. 2001).

The court held that Loeb did not owe his family a fiduciary duty or its functional equivalent and, therefore, neither Loeb nor Chestman violated Rule 10b-5 by trading on the material non-public information. The court emphasized that "[s]uperiority and reliance" did not mark Loeb's relationship with his family, and their dependence on him to act in their interests for some purpose did not inspire the disclosure of the material information. *Id*. at 571. Loeb did not breach a duty of confidentiality even though one of his family members, his wife, "admonished" him not to disclose the non-public information.[4]

The Supreme Court in *United States v. O'Hagan*, 521 U.S. 642 (1997), endorsed the misappropriation theory as set forth in *Chestman*. *Id*. at 650, n.3. Unlike *Chestman*, *O'Hagan* concerned an egregious breach of a traditional fiduciary relationship, the relationship between an attorney and his client. The Court in *O'Hagan* made clear that, just as is true under the classical theory discussed in prior cases such as *Chiarella* and *Dirks*, liability under the misappropriation theory is predicated on the breach of a relationship of trust and

[4] In its brief, the SEC adopts *Chestman* as supporting its position that the functional equivalent of a fiduciary relationship can be established by "an express agreement of confidentiality" alone. (SEC Brief at 26). This ignores the lengthy discussion and importance placed by the Court on the concepts of reliance and dependence between the fiduciary and his beneficiary and that the Court refers to the duty of confidentiality as "a fiduciary duty of confidentiality" implying that more a simple oral confidentiality agreement would be required to create the functional equivalent of a fiduciary duty. This is confirmed by the facts in *Chestman*, where Loeb was "admonished" to maintain the confidentiality of the information but did not violate any duty in disclosing it to Chestman who traded on it.

confidence between the recipient of the information and a party to whom he owes a duty. While liability under the classical theory arises from the breach of a corporate insider's fiduciary duty to shareholders, "the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *Id.* at 652. Under the latter theory, "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, *in breach of a duty of loyalty and confidentiality*, defrauds the principal of the exclusive use of that information." *Id.* (emphasis added). The theory thus targets "[a] fiduciary who pretends loyalty to the principal while secretly converting the principal's information for personal gain," thereby "dup[ing] or defraud[ing] the principal." *Id.* at 653-54 (alteration, internal quotation marks, and citation omitted).

The misappropriation theory recognized in *O'Hagan* is thus a logical outgrowth of the principles set forth in *Chiarella* and *Dirks*. *See O'Hagan*, 521 U.S. at 653 (classical and misappropriation theories "are complementary"). A consistent element of liability under both theories is a breach of fiduciary duty or similar duty of trust and confidence. *See also SEC v. Zandford*, 535 U.S. 813, 825 (finding a violation of Section 10(b) where the complaint alleged "a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide.")

II. EXPANDING LIABILITY UNDER SECTION 10(B) WOULD VIOLATE THE PURPOSE AND POLICY OF THE SECURITIES LAWS.

This Court has noted that "Section 10(b) is not concerned so much with fraud per se as it is with the effect of fraud upon investors and upon the public interest in the maintenance of free and open securities markets nurtured in a climate of fair dealing." *Herpich v. Wallace*, 430 F.2d 792, 808 (5th Cir. 1970). This is consistent with the fundamental purpose of the Exchange Act, which is to implement a "philosophy of full disclosure" to investors. *Santa Fe*, 430 U.S. at 478. For the misappropriation theory, however, "theft rather than fraud or deceit, seems the gravamen of the prohibition," and "any obvious relationship to Section 10(b) is presently missing." *Chestman*, 947 F.2d at 578 (Winter, J., concurring in part and dissenting in part). As the Supreme Court held in *O'Hagan*, any potential violation of Section 10(b) under the misappropriation theory can be avoided by disclosure to the source of the information. *O'Hagan*, 521 U.S. at 655. No permission is needed from the source to trade on the material non-public information, and the information remains secret to the public investors. The Exchange Act's objective of encouraging public disclosure of information is not protected by the misappropriation theory as it can be avoided without any additional information being disclosed publicly.

In light of the misappropriation theory's dubious connection with the purpose behind Section 10(b) and the lack of any express authority in the language of Section 10(b) itself, this Court should resist expanding liability beyond the clear authority of the Supreme Court as expressed in *Chiarella*, *Dirks*, and *O'Hagan*. All three of those cases require a breach of a fiduciary duty or functional equivalent before there can be a violation under Section 10(b), and this Court should maintain that requirement here.

An additional reason for caution in expanding the reach of Section 10(b) is the risk of intruding into an area of the law traditionally governed by state law by adopting a liberal construction of "duty of trust and confidence." In *Santa Fe*, the Supreme Court cautioned against the creation of a "federal fiduciary principle" governing relationships between shareholders and a corporation. *Santa Fe*, 430 U.S. at 479. Rule 10b5-2 and the SEC's position in this case would expand the reach of federal law even further so that it governed all confidentiality agreements as well. The SEC essentially asks the Court to imply as a matter of federal law a term in the oral confidentiality agreement between Mamma.com and Cuban that Cuban will not trade on any confidential information. Such a term would potentially be implied by the SEC into every confidentiality agreement with a public company. To paraphrase this Court in *Herpich*: "If Congress had intended that the federal courts inquire into every [confidentiality agreement involving a public company] and then fashion a new federal law superseding state law . . ., presumably so revolutionary a federal intervention into an area traditionally handled by the states would have been clearly expressed." 430 F.2d at 809; *see also Broad v. Rockwell Int'l Corp.*, 614 F.2d 418, 439 (5th Cir. 1980) ("[I]n limiting the reach of the anti-fraud provisions of the federal securities law, the Court has relied heavily upon the fact that certain causes of action, such as breach of contract or breach of fiduciary duty, are traditionally matters of state law."). There is no reason to believe that the state law remedies are so inadequate that a federal remedy is also required. *Santa Fe*, 430 U.S. at 478.

Furthermore, a broad interpretation of the misappropriation theory under Section 10(b) will create additional uncertainty and confusion in the application of the federal ban on insider trading. The securities market "demands certainty and predictability." *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 180 (1994). As the Supreme Court noted in rejecting the parity of information rule proposed by the SEC in *Dirks*, "this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accordance with legal requirements." 463 U.S. at 658 n.17. "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." *Id*. at 664. Absent clearly defined rules, anyone who receives confidential information regarding a public company is potentially at risk of becoming a target of an SEC investigation or litigation.

Courts have raised this concern even in the context of the relatively well-established and rigorous requirements for creating a fiduciary duty. *See*, *e.g.*, *Chestman*, 947 F.2d at 567. The concern is much greater in the context of confidentiality agreements where the requirements are much less well-defined and the agreements arise in much wider and more varied circumstances. The SEC and federal prosecutors have already invoked the misappropriation theory to regulate diverse relationships such as husband and wife,[5] psychiatrist and patient,[6] and newspaper and reporter,[7] as well as more conventional relationships such as employer and employee and attorney and client. Attaching potential Section 10(b) liability to any confidentiality agreement will only increase the uncertainty caused by the misappropriation theory and increase the costs of attempting to comply with the federal securities laws. One can anticipate that market participants will become more reluctant to receive confidential information if it brings an increased risk of liability or parties will attempt to address the regulatory uncertainty in their contractual terms. As the First Circuit recently observed while rejecting another expansive SEC theory of liability under the securities laws: "More than enough is

---

[5] *Chestman*, 947 F.2d 551.

[6] *United States v. Willis*, 737 F. Supp. 269 (S.D.N.Y. 1990).

[7] *Carpenter*, 791 F.2d 1024.

too much. 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." *SEC v. Tambone*, __ F.3d __, 2010 WL 796996, at *15 (1st Cir. March 10, 2010).

The SEC's expansive interpretation of the misappropriation theory also betrays its origin in an antifraud provision of the securities laws. A breach of fiduciary duty may legitimately be described as fraudulent because the fiduciary not only potentially reveals a confidence but he also betrays a trust that the other party has placed in him. As the Second Circuit explained in *Chestman*, there is relationship of dependence that is inherent in every fiduciary relationship. 947 F.2d at 569. Even so, not every breach of a fiduciary duty will give rise to a securities fraud claim. *Santa Fe*, 430 U.S. at 479.

A breach of a confidentiality agreement, on the other hand, may be no more than a breach of contract and a breach of contract is not enough to support a securities fraud claim. *Broad*, 614 F.2d at 438-39. Indeed, as the District Court found in this case, a person may trade based on information received pursuant to a confidentiality agreement while preserving the confidentiality of the information. (Op. at 21 USCA5 321). Indeed, the trading strategy and increased profits depend on keeping the material non-public information secret. *Id*. Therefore, the SEC's position in this case, and a logical consequence under its Rule 10b5-2, is that someone like Cuban may be liable for securities fraud without having violated a fiduciary duty or breached a contract. That result would be literally unprecedented and lacks support in either the text of Section 10(b) or caselaw.

III. THE SEC'S JUSTIFICATIONS FOR EXPANDING LIABILITY UNDER SECTION 10(B) AND RULE 10B-5 CANNOT OVERTURN SUPREME COURT PRECEDENT.

The SEC's position that a non-fiduciary corporate outsider can be liable under Section 10(b) solely on the basis of a confidentiality agreement is flatly at odds with settled Supreme Court precedent. Indeed, each of the justifications the SEC offers in support of its novel theory is foreclosed by the Supreme Court's unambiguous teaching that Section 10(b) liability requires the breach of a fiduciary or similar duty of trust and confidence.

First, the SEC relies (SEC Brief at 15) on its own interpretation of Section 10(b) as reflected in Commission Rule 10b5-2, 17 C.F.R. § 240.10b5-2. That rule purports to define "circumstances in which a person has a duty of trust or confidence for purposes of the 'misappropriation' theory of insider trading." 17 C.F.R. § 240.10b5-2. As relevant here, the rule provides that "a 'duty of trust or confidence' exists . . . [w]henever a person agrees to maintain information in confidence." *Id.* § 240.10b5-2(b)(1). But the SEC's rulemaking authority does not permit it impose liability that exceeds the scope of the statute itself. *O'Hagan*, 521 U.S. at 651 ("Liability under Rule 10b-5 . . . does not extend beyond conduct encompassed by § 10(b)'s prohibition."); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) ("The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.") (internal quotation marks omitted); *Regents of Univ. of Cal.*, 482 F.3d at 387 ("Decisions interpreting the statutory text place a limit on the possible definitions that can be ascribed to words contained in the SEC's rule promulgated thereunder."). In defining the misappropriation theory to apply whenever a party has a duty of "trust *or* confidence," 17 C.F.R. § 240.10b5-2 (emphasis added), the SEC is improperly attempting to expand the scope of liability under Section 10(b) beyond that articulated in *O'Hagan* and its predecessors, which expressly limited the statute's reach to breaches of loyalty *and* confidentiality, or trust *and* confidence. *O'Hagan*, 521 U.S. at 652, 655 n.7 ("loyalty and confidentiality"); *Dirks*, 463 U.S. at 654 ("trust and confidence"); *Chiarella*, 445 U.S. at 228, 232 ("trust and confidence").

The facts of this case aptly illustrate the nature of the SEC's sweeping conception of Section 10(b) liability. Cuban's affiliation with Mamma.com was limited to that of a shareholder. He was not an insider of the corporation, nor did he have a fiduciary relationship with either the company's CEO or the investment bank to which he was directed for additional information regarding the PIPE. Nor does the complaint allege that Mr. Cuban undertook a duty not to use the information provided to him. (Op. at 27 USCA5 327, SEC "does not allege that [Cuban] agreed, expressly or implicitly, to refrain from trading on or otherwise using for his own benefit the information the CEO was about to share"). At best, the complaint alleges only that Cuban agreed to keep the information confidential. To allow such a promise, without more, to trigger Section 10(b)'s "extraordinary" duty of nonuse, *Dirks*, 463 U.S. at 657 (citation omitted), would signal a radical break from the Supreme Court's jurisprudence in this area, which cautions against the formulation of broad new duties "absent some explicit evidence of congressional intent." *Chiarella*, 445 U.S. at 233. That reluctance is essential because "securities fraud liability is an area of the law that demands certainty and predictability." *Regents of Univ. of Cal.*, 482 F.3d at 386.[8]

Second, the SEC erroneously contends that a promise of confidentiality is the "functional equivalent" (SEC Brief at 23) of a fiduciary relationship because such an agreement carries with it an implicit promise not to trade on the information, regardless of whether the parties ever contemplated that duty. The SEC's argument stands elementary principles of contract interpretation on their

[8] Contrary to the SEC's contention (SEC Brief at 20), the Supreme Court did not hold in *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), that Section 10(b) does not require the breach of a duty. In *Stoneridge* – a case that did not involve insider trading – the Court held only that deceptive conduct under Section 10(b) need not take the form of "a specific oral or written statement." *Id.* at 158.

head. "Where the parties have bargained freely and on equal terms their contract ought not be extended by implication or enlarged by construction beyond the actual terms of the agreement entered into by the parties." *Abilene Sav. Ass'n v. Westchester Fire Ins. Co.*, 461 F.2d 557, 561 (5th Cir. 1972); *see also APS Capital Corp. v. Mesa Air Group, Inc.*, 580 F.3d 265, 273 n.22 (5th Cir. 2009) ("Courts hesitate to supply terms in complex financial situations"). Those principles are particularly relevant in the context of Section 10(b), which, by its terms, predicates liability on deception. 15 U.S.C. § 78j(b) (prohibiting use of "deceptive device or contrivance"); *see O'Hagan*, 521 U.S. at 655 ("§ 10(b) is not an all-purpose breach of fiduciary duty ban; rather, it trains on conduct involving manipulation or deception"). A non-fiduciary who has never agreed to forego the use of nonpublic information has not breached any promise to his source by using that information, and thus cannot be said to have engaged in deception. This Court should reject the SEC's contrary approach, which does violence to the statutory text and would improperly involve courts in rewriting the terms of parties' express agreements.[9]

[9] The SEC's reliance on *Carpenter v. United States*, 484 U.S. 19 (1987), as support for the contention that a confidentiality agreement suffices for liability under Section 10(b) (SEC Brief at 23-24) is misplaced. *Carpenter* stands for the proposition that "'even in the absence of a written contract, an employee has a *fiduciary duty* to protect confidential information obtained during the course of his employment.'" *Id.* at 27 (emphasis added) (quoting *Snepp v. United States*, 444 U.S. 507, 515 n.11 (1980) (per curiam)). It thus underscores the principle that the deceptive conduct targeted by Section 10(b) and other federal fraud statutes is the "undisclosed misappropriation of [confidential] information . . . *in violation of a fiduciary duty*." *O'Hagan*, 521 U.S. at 654 (emphasis added).

The SEC cannot avoid that conclusion by relying on dictionary definitions to argue that "trust" and "confidence" mean the same thing. (SEC Brief at 22.) Even if the SEC's strained interpretation could be supported as a matter of linguistics, it is barred by the precedent of this Court. In *Regents of University of California*, this Court noted that, although "[t]he Supreme Court has defined 'device' by referring to a dictionary[,] . . . [it] has pointedly refused to define 'deceptive' in any way except through caselaw." 482 F.3d at 389. That case law establishes that "a device . . . is not 'deceptive' unless it involves breach of some duty of candid disclosure," *id.*, and that the duty is one of "loyalty *and* confidentiality." *O'Hagan*, 521 U.S. at 652 (emphasis added). The SEC's effort to erase the distinction between those two concepts amounts to nothing more than an attempt "to substitute the authority of the dictionary for that of the Supreme Court." *Regents of Univ. of California*, 482 F.3d at 389.

Third, the Supreme Court has repeatedly addressed and rejected the SEC's argument that its broad theory of liability is necessary to prevent certain traders from obtaining an unfair "informational advantage" over others. (SEC Brief at 30). In adopting Rule 10b5-2, the SEC stated that its purpose was to prevent a "trader's informational advantage" that "cannot be overcome with research or skill." 65 FR 51716. That position "differs little" – indeed, it is indistinguishable – "from the view [the Court] rejected as inconsistent with congressional intent in

Chiarella." *Dirks*, 463 U.S. at 656. Just as was true in *Chiarella* and *Dirks*, the SEC's theory of liability here is "rooted in the idea that the antifraud provisions require equal information among all traders." *Id.* at 657. That proposition, however, "conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of material nonpublic information." *Id.*; *see Chiarella*, 445 U.S. at 235 ("[A] duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.").

CONCLUSION

For the foregoing reasons, *amici curiae* respectfully suggest that the Court should affirm the district court's judgment in favor of Cuban.

Respectfully submitted,

s/ Nicholas I. Porritt

Nicholas I. Porritt
Kevin R. Amer
AKIN GUMP STRAUSS HAUER & FELD LLP
1333 New Hampshire Avenue, N.W.
Washington, DC 20036
Tel.: (202) 887-4000
Fax: (202) 887-4288

Dated: April 2, 2010

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 6,479 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Fifth Circuit Rule 32.2.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and Fifth Circuit Rule 31.1, and the type style requirements of Fed. R. App. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using Microsoft Office Word 2003 in 14-point Times New Roman font for the main text, and 12-point Times New Roman font for the footnotes.

s/ Nicholas I. Porritt
Nicholas I. Porritt

CERTIFICATE OF SERVICE

I, hereby certify that on April 2, 2010, I served the foregoing brief upon the following counsel of record by filing a copy of the document with the Clerk through the Court's electronic docketing system:

Counsel for Plaintiff-Appellant:

Michael L. Post
Senior Litigation Counsel
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
postm@sec.gov

Randall W. Quinn
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
quinnr@sec.gov

Counsel for Defendant-Appellee:

Lyle Roberts
Dewey & LeBoeuf LLP
1101 New York Ave., N.W.
Washington, DC 20005
lroberts@deweyleboeuf.com

Stephen A. Best
Dewey & LeBoeuf, L.L.P.
1101 New York Avenue, N.W.
Washington, DC 20005
sbest@deweyleboeuf.com

Ralph Carmine Ferrara
Dewey & LeBoeuf, L.L.P.
1101 New York Avenue, N.W.
Washington, DC 20005
rferrara@dl.com

Paul Edward Coggins, Jr.
Fish & Richardson, P.C.
Suite 5000
1717 Main Street
Bank One Center
Dallas, TX 75201
coggins@fr.com

I further certify that, on the same date, seven copies of the foregoing brief were sent by UPS, next business day delivery, to the Clerk of the United States Court of Appeals for the Fifth Circuit, as addressed below:

Charles R. Fulbruge III, Clerk
U.S. Court of Appeals for the Fifth Circuit
600 S. Maestri Place
New Orleans, LA 70130-3408

s/ Nicholas I. Porritt
Nicholas I. Porritt