



Alert

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To: Our Clients and Friends

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Justice Scalia: Courts May Be Too Deferential to SEC's Interpretation of Insider Trading Laws

On November 10, 2014, the U.S. Supreme Court denied a petition for certiorari filed by hedge fund manager Doug Whitman seeking to appeal his conviction for insider trading. In a rare statement accompanying the denial, Justice Scalia, joined by Justice Thomas, expressed his eagerness to address an issue not directly raised in the Whitman appeal - whether courts in criminal prosecutions owe deference to government agencies' interpretations of statutes containing provisions for both civil and criminal enforcement. The answer to that question could impact whether the SEC and DOJ continue to pursue aggressive theories of liability in the enforcement and prosecution of insider trading cases under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

In his petition to the Supreme Court, Whitman argued that the legal standards used by New York federal courts in insider trading cases are overly friendly to the prosecution, allowing convictions against defendants even when there is no proof that the defendant intentionally traded on inside information. In response, the DOJ argued that Whitman's case was a poor vehicle for reviewing legal standards for insider trading, and the Supreme Court apparently agreed and declined to hear Whitman's appeal. Scalia, too, agreed that the petition should be denied, but revealed his receptiveness to reviewing a case that properly presents the question of deference.

Suggesting that the Second Circuit may have been too deferential to the SEC's interpretation of insider trading law when it upheld Whitman's conviction, Scalia noted that various Courts of Appeals "have deferred to executive interpretations of a variety of laws that have both criminal and administrative applications." The problem, according to Scalia, arises when deference is given to agency interpretations of statutes that contain a criminal component, because then "federal administrators can in effect create (and uncreate) new crimes at will, so long as they do not roam beyond ambiguities that the laws contain." Because only the legislature may define crimes and fix punishments, and because criminal statutes are for the courts, not the government, to construe, a court's deference to agencies' interpretations, Scalia

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warns, would effectively replace the established rule of lenity - requiring interpreters to resolve ambiguity in criminal laws in favor of defendants - with a doctrine of severity.

Scalia's statement follows a recent rise in the number of insider trading enforcement actions brought by the SEC and DOJ over the past several years, and it hints that courts may not view this trend of aggressive enforcement favorably. Earlier this month, New York federal judge Jed Rakoff gave a speech in which he criticized the SEC for increasingly bringing enforcement actions in administrative proceedings (where the SEC enjoyed a 100% win rate over the last year) rather than in federal court, which Judge Rakoff fears could thwart the growth and development of securities law. These criticisms, along with Scalia's questioning of the deference paid by the Second Circuit to the SEC's interpretation of insider trading law, may signal a shift in the tide for defendants in these types of cases, leading to more leniency in defendants' favor, or at least greater scrutiny of the agency's positions. In another insider trading case pending before the Second Circuit, *U.S. v. Newman*, Case No. 13-1837, the three-judge panel reportedly indicated at oral argument that federal prosecutors may have taken too broad a view of insider trading in arguing that the government need not prove that a "downstream" tippee had knowledge that the tipper illegally disclosed the tip in exchange for a personal gain. Depending on how that case is decided, Scalia just may get his chance to address whether government agencies should be given the power to interpret ambiguities in criminal laws, and whether courts should defer to those interpretations.

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