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Cover Page Footnote

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FROM *CHIARELLA* TO *CUBAN*: THE CONTINUING EVOLUTION OF THE LAW OF INSIDER TRADING

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[**] Brooklyn Law School (J.D. anticipated 2012). Intern, the Hon. Leonard B. Austin, Appellate Division, Second Department, State of New York. The authors dedicate this Article to the memory of Mary Jane Catherine Sabino: attorney, professor, author, and most importantly, beloved spouse of Anthony and mother of Michael and James. All we do, we do with her foremost in our thoughts and forever in our hearts.

TABLE OF CONTENTS

I. PREFACE

What does an old-school financial printer (one from the bygone era of ink and printing presses) have in common with a present-day Internet billionaire (one more often seen on ESPN than CNBC)? Both were accused by the government of "insider trading." While the former defeated the charges brought against him in a case which began the Supreme Court's modern interpretation of federal insider trading laws, the latter recently suffered a setback at the appellate level in the form of a remand to the district court.

By now, legal professionals have likely discerned that the first scenario refers to the seminal 1980 United States Supreme Court case *Chiarella v. United States.*[1] Sports fans and legal scholars alike probably recognize the second scenario as describing *SEC v. Cuban*,[2] a case brought against the flamboyant owner of the Dallas Mavericks professional basketball team, which was first dismissed by the U.S. District Court for the Northern District of Texas and subsequently reinstated by the Fifth Circuit Court of Appeals. The disparate outcomes reached in *Chiarella* and *Cuban* clearly reflect the difficulty the federal courts have encountered in formulating a consistent method of interpreting federal insider trading laws.

Federal securities laws broadly proscribe the employment of fraudulent or deceptive devices in connection with the purchase or sale of securities in the public markets.[3] "Insider trading" is a species of such malfeasance and occurs when one uses material, nonpublic information to profit in the trading of stock.[4] The titular "evolution" of the law of insider trading has been spawned by a series of contrasting legal decisions and an abundance of interesting twists and turns.

Parts II and III of this Article provide an exposition of the statutory underpinnings of insider trading and a description of the fundamentals of federal securities laws. Parts IV through VII then trace the development of modern insider trading jurisprudence, starting with the Supreme Court's inaugural holding in *Chiarella* and then moving across three decades of evolving precedent to the recent *Cuban* decision. Part VIII provides the authors' analysis and commentary on the current state of insider trading laws. The Article concludes in Part IX with some observations as to what the future holds for the law of insider trading.

II. INTRODUCTION

Insider trading has always captured the public's attention (not to mention the watchful eye of the Department of Justice and the Securities and Exchange Commission ("SEC")). In recent decades, we have

1. 445 U.S. 222 (1980).
2. 634 F. Supp. 2d 713 (N.D. Tex. 2009), *vacated*, 621 F.3d 551 (5th Cir. 2010).
3. *See generally* 15 U.S.C. § 78j(b) (2006).
4. United States v. O'Hagan, 521 U.S. 642, 651-52 (1997).

witnessed such episodes as the Ivan Boesky/Michael Milken scandal[5] and the "Yuppie Five" prosecutions.[6] These occurrences were so engrossing that they gave rise to a myriad of exposés, cinematic epics[7], and other fictional works depicting stories of Wall Street gone wrong. Even when insider trading was not the actual charge alleged, such as in the Martha Stewart prosecution,[8] the mere hint of subterfuge involving confidential corporate secrets had the effect of setting the world on its ear.

Recent episodes lend credence to the adage that, "the more things change, the more they stay the same." Current events detail charges of insider trading at well-known hedge funds,[9] illegal tips obtained from an employee inside the behemoth Microsoft Corporation,[10] and even a secretary at the Walt Disney Company being arrested for allegedly leaking confidential tips about the House of Mouse's stock.[11] Therefore, it came as no surprise when notoriety immediately attached to the SEC's filing of charges against Mark Cuban, a well-known business mogul and sportsman, for allegedly trading on material, nonpublic information

5. *See* JAMES B. STEWART, DEN OF THIEVES (1992). Stewart, a Pulitzer Prize winning journalist and former *Wall Street Journal* reporter, chronicles the insider trading investigation that brought about the demise of "Junk Bond King" Michael Milken and the storied investment house Drexel Burnham Lambert.

6. *See* Kurt Eichenwald, *Two Firms Charged As Insiders*, N.Y. TIMES, Nov. 3, 1986, at D1. The titular malefactors, including a young corporate attorney at a renowned New York City law firm, "trad[ed] on inside information about corporate takeovers that they had learned in the course of their jobs." *Id*. *See also* Tony Robinson, *Last of Yuppie 5 Pleads Guilty of Insider Trading*, L.A. TIMES, Nov. 27, 1986, at F1.

7. *See, e.g.*, WALL STREET (20th Century Fox 1987).

8. As discussed later in Part III-B, Stewart was convicted under 18 U.S.C. § 1001 for the distinct, albeit somewhat related offense of lying to federal agents, but was never charged with insider trading. *See* United States v. Stewart, 433 F.3d 273 (2d Cir. 2006).

9. *See* David Glovin, *Raj Rajaratnam's Bid to Exclude Wiretaps Aims to Sink Galleon Insider Case*, BLOOMBERG (May 11, 2010), http://www.bloomberg.com/news/2010-05-10/raj-rajaratnam-s-bid-to-exclude-wiretaps-aims-to-sink-galleon-insider-case.html (covering the Government's insider trading charges against the hedge fund Galleon Group LLC's senior executives, including founder Raj Rajaratnam).

10. *See* David Scheer & Jesse Westbrook, *Samberg Pay $28 Million to End Insider-Trading Probe*, BLOOMBERG (May 27, 2010), http://www.bloomberg.com/news/2010-05-27/pequot-chief-samberg-to-pay-28-million-to-settle-sec-insider-trade-probe.html.

11. Edvard Pettersson & David Glovin, *Disney Assistant Accused of Plot to Sell Insider Data Wins Bail*, BLOOMBERG (May 27, 2010), http://www.bloomberg.com/news/2010-05-26/fbi-arrests-2-for-trying-to-sell-disney-earnings-info.html.

regarding a technology company in which he held a major investment stake.[12]

III. THE FUNDAMENTALS OF SECTION 10(B)

Having established the high profile of insider trading cases, we now turn to the first crucial step in our analysis of modern insider training jurisprudence – an exposition of the well-established foundation for brining such cases under our federal securities laws. We will begin with an examination of Section 10(b) of the Securities Exchange Act of 1934.[13]

A. THE STATUTE AND THE RULE

The birth of federal securities laws in this country traces its roots to the Great Depression and the reforms passed in reaction thereto. The federal statutes were intentionally designed to rectify shortcomings in common law protections against fraud by establishing higher standards of conduct in the securities industry,[14] although they were not intended to replicate common law maxims, such as the law of fiduciaries.[15] The Supreme Court has long held that the overarching purpose of the federal securities laws is to remedy the proven inadequacies of common law protections in order to ensure the fair and honest functioning of an impersonal stock market.[16]

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12. Press Release, SEC, SEC Files Insider Trading Charges Against Mark Cuban (Nov. 17, 2008), *available at* http://www.sec.gov/news/press/2008/2008-273.htm. The cause of action for insider trading, which comprises just three paragraphs, is remarkable for its brevity. *See* Complaint at 1-2, SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 3-09CV2050-D), *available at* http://www.sec.gov/litigation/complaints/2008/comp20810.pdf.

13. 15 U.S.C. § 78j(b).

14. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983) ("[A]n important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry.").

15. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474-76 (1977).

16. *See, e.g.*, Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 170-71 (1994) (stating that the Securities Act of 1933 and the Securities Exchange Act of 1934 "embrace a fundamental purpose . . . to substitute a philosophy

The Securities Exchange Act of 1934[17]("Exchange Act") and its predecessor, the Securities Act of 1933,[18] are the twin pillars of the same comprehensive federal scheme of regulating the stock markets. The Exchange Act established the Securities and Exchange Commission to administer the federal securities laws.[19] The SEC is empowered to investigate any violations of the federal securities laws, rules or regulations, as well as to seek monetary penalties for such transgressions.[20] Of all the antifraud provisions found in the federal securities laws and the Exchange Act in particular, Section 10(b)[21] is "[t]he quintessential statute . . . ."[22] Our analysis will, therefore, focus on that section which provides in relevant part that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[23]

It is axiomatic that the preservation of the integrity of the stock market has been an animating purpose of Section 10(b) since its passage over seventy years ago.[24]

As previously indicated, Section 10(b) authorizes the Securities and Exchange Commission to promulgate rules and regulations to enforce the statute. The relevant rule promulgated under Section 10(b), which is universally known as Rule 10b-5,[25] "is an extended version of the prohibitions enacted in title 15, and is used both in conjunction and

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of full disclosure for the philosophy of caveat emptor.") (internal citations omitted).

17. 15 U.S.C. § 78a *et. seq*. (2006) [hereinafter the "Exchange Act" or the "1934 Act"].

18. 15 U.S.C. § 77a *et. seq*. (2006) [hereinafter the "Securities Act" or the "1933 Act"].

19. 15 U.S.C. § 78d.

20. 15 U.S.C. § 78u.

21. 15 U.S.C. § 78j(b).

22. Anthony Sabino, *The New Uniform Statute of Limitations for Federal Securities Fraud Actions: Its Evolution, Its Impact, and A Call for Reform*, 19 PEPP. L. REV. 485, 487 (1992) [hereinafter Sabino, *Uniform Statute of Limitations*].

23. 15 U.S.C. § 78j(b).

24. *See* SEC v. Zandford, 535 U.S. 813, 821 (2002).

25. 17 C.F.R. § 240.10b-5 (2010).

interchangeably with the statutory provision."[26]

Rule 10b-5 makes it unlawful:

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact . . . , 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.[27]

Because Rule 10b-5 was promulgated under Section 10(b), it "'does not extend beyond conduct encompassed by Section 10(b)'s prohibition.'"[28] Thus, "[t]he scope of Rule 10b-5 is coextensive with the coverage of Section 10(b)."[29] To be certain, "Section 10(b) does not incorporate common-law fraud into federal law."[30]

By enacting Section 10(b), "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."[31] Rule 10b-5 was likewise designed to protect investors from manipulative devices and frauds foisted upon the stock exchanges by unscrupulous parties.[32] It should be noted that both the statute and its accompanying rule have been acknowledged as having deep roots in

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26. Sabino, *Uniform Statute of Limitations*, *supra* note 22, at 487. It is "securities law convention" to refer to the statute as Section 10(b) and the parallel rule as Rule 10b-5. Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 378 n.3 (5th Cir. 2007). Stemming from the meltdown of Enron, the instant litigation dealt with a class action brought over what was commonly known as Enron's "Nigerian Barge Transaction." *Id*. at 377.

27. 17 C.F.R. § 240.10b-5.

28. Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2881 (2010) (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997)). *Accord Regents*, 482 F.3d at 390 ("[T]he rule may not be broader than the statute."). *See also* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S 148, 157 (2008).

29. *Zandford*, 535 U.S. at 816 n.1. *See also* SEC v. Tambone, 597 F.3d 436, 444 (1st Cir. 2010) ("It is not the judiciary's proper province to rewrite an administrative rule to sweep more broadly than its language permits. Thus, we must honor the limitations that the drafters deliberately built into *Rule 10b-5*.").

30. *Stoneridge*, 552 U.S. at 162 (citing *Zandford*, 535 U.S. at 820).

31. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977).

32. Basic, Inc. v. Levinson, 485 U.S. 224, 230-31 (1988).

common law notions of fraud and deceit.[33] Thus, in reviewing adjudications under Section 10(b), the Supreme Court has explicitly "retained familiar legal principles as [its] guideposts."[34] Paramount among those is the principle that a purported violation must contain an element of scienter, an intent to deceive, manipulate, or defraud.[35]
In sum,

> [S]ection 10(b) was designed with the intent to cut a wide swath through all manner of insidious devices that might be used to perpetrate fraud upon the securities marketplace. Ground[ed] in timeless principles of fraud and deceit, the antifraud statute has kept those common law traditions as guideposts, while still ranging for beyond their historical boundaries.[36]

In the realm of securities litigation, Rule 10b-5 and its parent Section 10(b) are paramount.[37] This explains the Court's demonstrated desire to define the boundaries of Section 10(b) liability with great care. In fact, the Supreme Court has consistently emphasized adherence to the statutory language in defining the scope of conduct prohibited by the statute.[38] Relevant to the instant discussion is the Court's clear

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33. *See id*. at 253 (White, J., dissenting in part and concurring in part).

34. *Id*.

35. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.7 (1976). *See also* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007).

36. Sabino, *Uniform Statute of Limitations*, *supra* note 22, at 488.

37. The growth of private causes of action brought pursuant to Rule 10b-5 has been astonishing, to say the least. As then-Justice Rehnquist declared, private Rule 10b-5 actions are "a judicial oak which has grown from little more than a legislative acorn." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975). In creating an implied private cause of action under Rule 10b-5, the courts "have also defined its contours." *Morrison*, 130 S. Ct. at 2881 n.5. The existence of a private cause of action under Section 10 "has been consistently recognized" for more than sixty years, and the fact of its existence "is simply beyond peradventure." Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) . At least one court has postulated that Rule 10b-5 is based upon the policy that honest investors have a justifiable expectation that all market participants should trade on impersonal exchanges and enjoy relatively equal access to market data. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971). Yet, the Court has always been circumspect in apportioning Section 10(b) liability because it "presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 189 (1994) (citing *Blue Chip Stamps*, 421 U.S. at 739) (internal citations omitted).

38. *Central Bank*, 511 U.S. at 173 (citations omitted).

declaration that "the text of the statute controls [its] decision"[39] whenever defining the boundaries of Section 10(b) and Rule 10b-5 liability.

Historically, the Supreme Court has exhibited primary concern for both the scope of conduct prohibited by Section 10(b) and how that scope is defined by the Court's decisions.[40] Rigorous adherence to the text of Section 10(b) has been the hallmark of the Court's jurisprudence on the subject.[41] The Court has made it abundantly clear that "conduct not prohibited by the text of the statute" cannot be challenged under Section 10(b) or Rule 10b-5.[42] As stated by Justice Scalia in the recent landmark case *Morrison v. National Australia Bank Ltd.*: "[T]o ask what conduct *§ 10(b)* reaches is to ask what conduct *§ 10(b)* prohibits . . . ."[43] The Court classifies such an inquiry as a "merits question."[44] In *Morrison*, the Court essentially reiterates the proposition originally stated in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, that "when it comes to the scope of the conduct prohibited by Rule 10b-5 and § 10(b), the text of the statute controls . . . ."[45] To be sure, Section 10(b) punishes only deceptive conduct "in connection with the purchase or sale of any security . . . ."[46] The Court has held that the phrase "in connection with" found in Section 10(b) means "to coincide" with the purchase or sale of a security.[47]

In sharp contrast, we note Justice's Scalia's admonition that "*Section 10(b)* . . . punishes not all acts of deception . . . . Not deception alone, but deception with respect to certain purchases or sales is

39. *Id*.
40. *Id*. at 172.
41. *Id*. at 173, 174, 188 (citations omitted).
42. *Id*. at 173.
43. Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2877 (2010) (emphasis in original). Put another way, not every common law fraud that involves stocks or bonds violates Rule 10b-5. *See* SEC v. Zandford, 535 U.S. 813, 820 (2002).
44. *Morrison*, 130 S. Ct. at 2877.
45. *Id*. at 2881 (citing *Central Bank*, 511 U.S. at 173) (internal citations omitted). The federal courts have been forced to grapple with the "scant legislative history" the New Deal-era Congress bestowed upon Section 10(b). *See* Basic, Inc. v. Levinson, 485 U.S. 224, 257 (1988). (White, J., dissenting in part and concurring in part).
46. *Morrison*, 130 S. Ct. at 2887 (citing 15 U.S.C. § 78j(b)); *see also Zandford*, 535 U.S. at 820.
47. *Zandford*, 535 U.S. at 824; *see also* SEC v. Dorozhko, 574 F.3d 42, 46 (2d Cir. 2009).

necessary for a violation of the statute."[48] According to Justice Scalia, the transacting of shares on a national exchange is "the object[] of the statute's solicitude [and] . . . it is parties or prospective parties to those transactions that the statute seeks to 'protect.'"[49]

It has been long established that both statute and rule are to be accorded their plain meaning.[50] The statutory language is particularly relevant because "[t]he scope of Rule 10b-5 is coextensive with the coverage of § 10(b)" to such an extent that even the Supreme Court "use[s] § 10(b) to refer to both the statutory provision and the Rule."[51] In that regard, the Court has long held that the usage of the words "manipulative" or "deceptive" in the text of the provision strongly suggest that Section 10(b) was intended to proscribe knowing or

48. *Morrison*, 130 S. Ct. at 2887 (emphasis in original).

49. *Id*. at 2884 (citing Superintendant of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971) (internal quotations omitted)). *See also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976). *Morrison* worked a sea change in federal securities law by barring the application of Section 10(b) and Rule 10b-5 to "misconduct in connection with securities traded on foreign exchanges." *Morrison*, 535 U.S. at 2875. Writing for the Court, Justice Scalia sounded the death knell for the so-called "conduct" and "effects" tests, which permitted the extraterritorial application of Rule 10b-5 when there was sufficient conduct within U.S. borders in connection with the transacting of securities, even if those securities were listed on a foreign exchange, and the purchase or sale of such securities had effects upon American stock exchanges or companies. *Id*. at 2879, 2888. *Compare id.*, *with* Anthony Michael Sabino, *"Big Eight" Beware: Multinational Accounting Firms and the Increasing Scope of Subject Matter Jurisdiction Under the Federal Securities Laws*, 63 ST. JOHN'S L. REV. 467, 473-80 (1989) (analyzing the "conduct" and "effects" tests propounded by the Second Circuit) [hereinafter Sabino, *"Big Eight" Beware*]. *See also* Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991) (explaining the "conduct" and "effects" tests and applying the former to find that Rule 10b-5 did not apply to stock transactions which included both U.S. and foreign participants).

50. *Santa Fe Indus*., 430 U.S. at 472 (interpreting Rule 10b-5 according to the "commonly accepted meaning" of its words). *See Ernst & Ernst*, 425 U.S. at 197 (stating that the text of Section 10(b), its authorizing statute, also must be examined). *See also Blue Chip Stamps*, 421 U.S. at 756 (Powell, J., concurring) ("The starting point in every case involving construction of a statute is the language itself."); *see also* Pinter v. Dahl, 486 U.S. 622, 653 (1988) ("The ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities Act must rest primarily on the language of that section.").

51. *Zandford*, 535 U.S. at 816 n.1*; see also* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S 148, 157 (2008) ("Rule 10b-5 encompasses only conduct already prohibited by § 10(b).").

intentional misconduct.[52] Moreover, the Court in *Ernst & Ernst v. Hochfelder* rejected the notion that Section 10(b) encompasses mere negligence, since to do so would "add a gloss to the operative language of the statute quite different from its commonly accepted meaning."[53] Significantly, the Court in *Central Bank* reiterated its "refus[al] to allow 10b-5 challenges to conduct not prohibited by the text of the statute."[54]

Thus, we have the foundation of our federal securities laws. Nearly eighty years ago, the cornerstones of this foundation, the Securities Act of 1933 and the Securities Exchange Act of 1934, were set in place. Since then, many other principles have been incorporated into this body of law and regulation. Viewed as one great edifice, our federal securities laws have proven to be a durable and effective means of assuring the sanctity of the American capital markets by imposing a discipline of transparency, disclosure, and honesty. Now that we have seen the pantheon as a whole, and are mindful of its overall dimensions, it is time to explore the precise chamber therein where the law of insider trading resides.

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52. *Ernst & Ernst*, 425 U.S. at 197-99.

53. *Id*. at 199. *See Central Bank*, 511 U.S. at 173-74; *Santa Fe Indus*., 430 U.S. at 473 (confirming that the "language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."). This, in turn, fits neatly with the Supreme Court's emphasis upon scienter as the first among equals regarding the essential elements of Section 10(b) and Rule 10b-5, as scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst*, 425 U.S. at 193*; see also* Aaron v. SEC, 446 U.S. 680, 695 (1980); Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341-42 (2005) (stating that a Section 10(b) private action requires the plaintiff to prove: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation)). A violation may be found only where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst*, 425 U.S. at 199. The Fifth Circuit has postulated that in defining "deceptive," as found in Section 10(b) and Rule 10b-5, the Supreme Court has assiduously avoided the dictionary, instead relying exclusively upon case law to define the term. Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 389 (5th Cir. 2007). As stated by the Fifth Circuit, divining the common law meaning of a particular statutory text is "fruitless . . . where the Supreme Court has authoritatively construed the pertinent language . . . ." *Id*.

54. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 173 (1994) .

B. SECTION 10(B) AND INSIDER TRADING

Above, we addressed the statutory underpinnings of our federal securities laws with a particular emphasis on Section 10(b) and Rule 10b-5. Now it is time to begin the task of relating that law, and its parallel regulations, to the illegal conduct popularly denominated as insider trading.

In its modern popular usage, "[i]nsider trading is a catchphrase used to describe a particular type of securities fraud - that which involves trading on material information that is unavailable to the marketplace."[55] It is a great irony that "[n]o statute defines illegal insider trading."[56] To the contrary, even experts have characterized insider trading as "the amalgamation of judicial opinions that have developed in both the civil and criminal context."[57]

While the bulk of our analysis is forthcoming, it is our initial intention to briefly present some of the facets of insider trading. We begin by introducing what has been known for decades as the "classical" theory of insider trading. In *United States v. Cusimano*,[58] the Second Circuit distinguished the "classical" or "traditional" theory of insider trading as a wrong perpetrated by a corporate insider who exploits confidential information for individual profit.[59] *United States v. Nacchio*[60] presents a modern example of "classical" insider trading by a high level corporate insider. In that case, the former CEO of telecommunications giant Qwest Communications was convicted of insider trading for transacting in the corporation's stock on the basis of material, nonpublic information.[61]

"Classical" insider trading is not always defined by a single act of

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55. Robert G. Morvillo & Robert J. Anello, *The Evolving Mystery of Illegal Insider Trading*, 8/3/2010 N.Y. L.J. 7 (col 5).

56. *Id*. at 3.

57. *Id*.

58. 123 F.3d 83 (2d Cir. 1997).

59. *Id*. at 87.

60. 573 F.3d 1062 (10th Cir. 2009).

61. *Id.* For another example, *see* Joshua Gallu & Jesse Westbrook, *Alaska Air CEO Ayer Said to Face SEC Hedge-Fund Trading Probe*, BLOOMBERG (Oct. 8, 2010), http://www.bloomberg.com/news/2010-10-07/alaska-air-chief-hedge-fund-said-to-be-subjects-of-insider-trading-probe.html (describing an SEC investigation into whether the CEO of Alaska Air Group Inc., who was also on the board of Puget Energy Inc., shared information about an upcoming buyout of the utility company with a New York-based hedge fund operator).

malfeasance. In certain instances, the insider repeatedly shares knowledge of corporate secrets and profits with an individual outside the corporation, known as the "tippee." A "tippee" is one who receives confidential information from a corporate insider.[62] A prime example of such conspiratorial behavior is found in *United States v. McDermott*,[63] where a prominent Wall Street investment banker tipped off his paramour and was subsequently convicted for insider trading.[64]

Not every "inside" relationship or tip constitutes a violation of Section 10(b). Consider, for example, the case of *United States v. Chestman*.[65] Chestman was the stockbroker for the husband of the granddaughter of the owners of Walbaum, Inc., a publicly traded company that owned a large supermarket chain.[66] The granddaughter's husband tipped off Chestman that Walbaum was going to be taken over at a premium price by rival supermarket chain A&P. Chestman purchased Walbaum stock prior to the takeover and saw his investment double after A&P announced the buyout.[67] After Chestman was tried and convicted of insider trading under Rule 10b-5 at the district court level,[68] the Second Circuit reversed, holding that Chestman could not have breached a fiduciary duty because the husband from whom he received the tip did not owe a fiduciary duty to Walbaum.[69] *Chestman* is intriguing because it demonstrates that even a familial relationship, though normally perceived to be confidential in nature, may not be

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62. The term entered the lexicon possibly for the first time in *Chiarella v. United States*. 445 U.S. 222, 230 n.12 (1980). *See also* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 230 (2d Cir. 1974) ("[T]his case involves the liability of non-trading 'tippers' and trading 'tippees' under Section 10(b) and *Rule 10b-5*.").

63. 245 F.3d 133 (2d Cir. 2001).

64. *Id.* at 138-39. The case garnered headline attention since McDermott's female friend went by the stage name "Marilyn Star" in the adult entertainment world.

65. 947 F.2d 551 (2d Cir. 1991) (en banc).

66. *Id*. at 555.

67. *Id*.

68. *Id*. at 556.

69. *Id*. at 570-71. *See also* SEC v. Rorech, 673 F. Supp. 2d 217, 226-27 (S.D.N.Y. 2009) ("Courts have found that the existence of a duty of confidentiality turns on the nature of the relationship between the tipper and the source and not formal agreements . . . . The breach of that duty also does not turn on whether the information was voluntarily given or wrongfully taken . . . ."). Chestman's convictions for trading on inside information in violation of Williams Act tender offer rules were upheld. United States v. Chestman, 947 F.2d at 571 (2d Cir. 1991).

enough to create a fiduciary duty as contemplated by Section 10(b).

Chestman clearly has given prosecutors pause. The government certainly comprehends the risks inherent in any Rule 10b-5 prosecution and is mindful of how those risks increase with the celebrity status of the accused.

For instance, in charging business magnate Martha Stewart with obstruction of justice and lying to investigators about her trading in the stock of ImClone Systems, Inc., the government deliberately chose not to take the risk of alleging that Stewart had engaged in trading on material, nonpublic information.[70] Yet, the non-accusation brought about a firestorm of controversy at trial, where each side sought to take advantage of the glaring omission of a Rule 10b-5 charge of insider trading.[71] Stewart was granted relief to avoid juror speculation that she had attempted to manipulate the stock of her own company, Martha Stewart Living Omnimedia, by allegedly deceiving her shareholders as to her involvement in the ImClone scandal.[72]

The emerging counterpoint to the "classical" theory of insider trading is the theory of insider trading by means of "misappropriation." While we have much to say about the development of that doctrine, at this point it is sufficient to broadly define the misappropriation theory as the wrongful taking and exploitation of confidential information in order to profit in the buying and selling of stock.[73]

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70. *See* United States v. Stewart, 433 F.3d 273, 280 (2d Cir. 2006).

71. *Id.* at 308-311, 319-20 (affirming Stewart's convictions for conspiracy, concealing material information from and making false statements to government officials, and obstructing agency proceedings). *See* United States v. Stewart, 323 F. Supp. 2d 606; *see also* United States v. Stewart, 305 F. Supp. 2d 368 (S.D.N.Y. 2004).

72. *See Stewart*, 433 F.3d at 308-9; *see also Stewart*, 305 F. Supp. 2d at 376. The decisions of the Second Circuit Court of Appeals are particularly important in defining the scope of the federal securities laws, especially insider trading, because "[a]s stated by the Supreme Court, the Second Circuit is truly the matriarch of the foremost jurisprudence in this field and therefore due deference must be accorded to its central rulings." Sabino, *"Big Eight" Beware*, *supra* note 49, at 473 (citing *Blue Chip Stamps*, 421 U.S. at 762 (Blackmun, J., dissenting) (the Second Circuit "is regarded as the 'Mother Court' in this area of the law.")). Historically, the Second Circuit "has taken the lead" in adjudicating federal securities law matters, "since [its] jurisdiction includes the steel canyons of Wall Street, the ancestral home of the securities industry." Anthony Michael Sabino, *Awarding Punitive Damages In Securities Industry Arbitration: Working For A Just Result*, 27 U. RICH. L. REV. 33, 40 (1992). The Supreme Court continues to acknowledge the preeminence of the Second Circuit in the field of securities law. *See* Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869, 2877 (2010).

73. For a modern example of the "misappropriation" theory of insider trading, *see*

A noteworthy case involving the misappropriation theory is *SEC v. Cherif*.[74] After losing his job at a Chicago bank, Cherif forged credentials to obtain access to his ex-employer's confidential investment banking files and subsequently traded on the stolen information.[75] Castigating the defendant as more than a "mere thief," the Seventh Circuit classified Cherif's wrongdoing as fraudulent because he deprived his former employer of something of value by his chicanery.[76] *Cherif* is generally regarded as marking the Seventh Circuit's adoption of the misappropriation theory of insider trading.

Misappropriation of inside information, which is the underlying offense of insider trading, takes many forms. In *United States v. Falcone,*[77] the so-called "*Business Week*" case, the defendant's stockbroker acquaintance acquired the contents of an issue of *Business Week* magazine from an employee of the publication prior to its public release.[78] The conspirators then utilized information in the popular "Inside Wall Street" column to purchase stocks before the magazine's official release date in violation of the policy of strict confidentiality that *Business Week* imposed on its vendors.[79] The case is best known for the Second Circuit's reliance on the "in connection with" requirement of Section 10(b).[80]

In *SEC v. Dorozhko*,[81] the defendant fraudulently obtained material, nonpublic information by hacking into a corporate computer system and reaped profits by trading on that information.[82] The Second Circuit held that a breach of fiduciary duty was not required for computer hacking to be "deceptive" within the meaning of Section 10(b).[83] In so holding, the

Mark Hamblett, *Ex-Ropes & Gray Lawyer Settles SEC Civil Charges*, 7/8/2010 N.Y. L.J. 1 (col. 1) (describing a case in which several attorneys were criminally charged with insider trading, and one of the charged attorneys pled guilty to accessing confidential client information on a high-tech corporate takeover and selling information to a Wall Street trader.).

74. 933 F.2d 403 (7th Cir. 1991).
75. *Id*. at 406-07.
76. *Id*. at 412.
77. 257 F.3d 226 (2d Cir. 2001).
78. *Id*. at 227.
79. *Id*. at 227-28.
80. *Id*. at 233-34.
81. 574 F.3d 42 (2d Cir. 2009).
82. *Id*. at 44-45.
83. *Id*. at 49-51.

Second Circuit declared that "deceit" equals "fraud" within the context of Rule 10b-5 cases.[84]

The previously discussed cases highlight some of the more interesting touchstones of insider trading law. And what punishments has Congress established for violations of Section 10(b)? Specifically, the SEC is authorized to impose civil penalties for insider trading by bringing an action in a federal district court.[85] To prevent the "unfair use of [inside] information," corporate directors, officers, and certain shareholders must disgorge any short term profits made by transacting in the company's stock to the corporation, "irrespective of any intention."[86] Congress occasionally enlarges the sanctions for insider trading, but has essentially left the operative law (Section 10(b) and Rule 10b-5) untouched.[87] There are non-judicial sanctions as well.[88]

While not landing squarely within our discussion here, we nevertheless note that the sweeping reforms instituted by the Sarbanes-Oxley Act of 2002[89] (passed in the aftermath of the Enron and other concurrent scandals) added some significant weapons to the prosecutor's arsenal to combat insider trading. Principally, Section 807 of the Sarbanes-Oxley Act,[90] which is codified at Section 1348 of Title 18, imposes criminal liability on anyone who "knowingly executes, or attempts to execute . . . [a fraud upon] any person in connection with . . . any security" or employs fraudulent means to obtain "any money or

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84. *Id*. at 50-51.

85. 15 U.S.C. § 78u(d)(3)(A).

86. 15 U.S.C. § 78p. *See also* 15 U.S.C. § 78t-1 (codifying a private right of action against insider trading by those who contemporaneously purchase securities of the same class).

87. *See Central Bank*, 511 U.S. at 185 ("Congress has not reenacted the language of §10(b) since 1934."). *See also id*. at 183 (citing the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) and noting the expansion of civil penalties for insider trading violations), *and* the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No.100-704, 102 Stat. 4677 (1988).

88. *See* Rosenthal v. N.Y. Univ., No. 08 Civ. 5338, 2010 WL 3564975 (S.D.N.Y. Sept. 13, 2010) (upholding a university's decision to deny an MBA degree to a student who had plead guilty and was imprisoned on a charge of conspiracy to commit securities fraud. The student in that case, a CPA then employed at the "Big Four" accounting firm Pricewaterhouse Coopers, had tipped off his brother, an attorney, with inside information about a pending acquisition of a publicly traded company).

89. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified at 11, 15, 18, 29 and 29 U.S.C.).

90. Pub. L. No. 107-204 § 1102, 116 Stat. 745, 807 (2002) (to be codified at 18 U.S.C. § 1348).

property in connection with the purchase or sale of . . . any security . . . ."[91]

Section 1348 has been used by the government in at least one high-profile case to prosecute insider trading. In *United States v. Mahaffy*,[92] stockbrokers and day traders were charged with securities fraud when the former permitted the latter to gain a trading advantage by listening to broadcasts made over the internal speaker system (or "squawk boxes") at the brokers' firms.[93] It has been suggested that the reach of Section 1348 extends further than that of Section 10(b) because it prohibits fraud "'in connection'" with a security, whereas Section 10(b) prohibits fraud in connection with the "'purchase or sale of a security."[94] The statute imposes a harsh sentence of up to twenty-five years of imprisonment for anyone convicted of committing such a fraud.[95]

We have now explored the foundation of our federal securities laws. Paramount among these statutes and rules are Section 10(b) and Rule 10b-5. We have defined insider trading and introduced several illustrative examples. Yet, all of this is prelude. The evolution of the law of insider trading is indeed a complex and fascinating subject, and we shall now undertake an examination of both its history and the current controversy surrounding it.

IV. *CHIARELLA*: THE BEGINNING

Every legal epic begins somewhere. It cannot be disputed that, in the realm of insider trading, the beginning is found in *Chiarella v. United States*.[96] In that case, defendant Vincent Chiarella handled documents for Pandick Press, a Wall Street financial printer. In the era prior to PDFs and e-mail attachments, firms such as Pandick literally printed copies of prospectuses and other offering documents for stock deals and corporate takeovers.[97] In the mid-1970s, Chiarella's job was

91. *Id*. at §§ 1-2.
92. No. 05-CR-613, 2006 WL 2224518 (E.D.N.Y. Aug., 2, 2006).
93. Morvillo & Anello, *supra* note 55, at 3 (col. 3).
94. *Id*.
95. 18 U.S.C. § 1348(2) (2006).
96. Chiarella v. United States, 445 U.S. 222, 222 (1980).
97. Neophyte associates from large, corporate law firms would spend all night at the printers proofreading such documents.

to "mark up" such documents in preparation for the final printing and dissemination of materials when the offers became public.[98]

Needless to say, the secrecy of the identities of the corporations involved in any transaction was an important issue, however it was handled in a most rudimentary way – blank spaces were left or fictitious names were substituted for the real names of the acquiring and target companies.[99] The true corporate names were inserted only on the night of the final printing when the New York exchanges were closed.[100] The documents would only "go public" in final form immediately prior to the opening of the markets, thus forestalling any premature attempt to trade on the information revealed therein.

Yet, such rudimentary precautions did not deter the intrepid Mr. Chiarella. Taking the preliminary versions of the documents that were passing through his hands, Chiarella carefully compared the unique financial data in each of the documents to information already publicly available, and thereby deduced the identity of several acquiring and target entities. With this bit of common sense sleuthing, he purchased stock in the target companies and sold it once the takeover was announced and after the share price naturally increased. In a little more than a year, he made over $30,000 in profits.[101]

The SEC investigated Mr. Chiarella's activities, and was less than pleased with what it found.[102] Chiarella entered into a consent decree with the Commission in which he agreed to return his profits to the sellers of the shares, was discharged from his job by Pandick Press, and was indicted on seventeen counts of violating Section 10(b) and Rule 10b-5.[103] Chiarella was subsequently tried and convicted of violating Section 10(b) and Rule 10b-5, and his conviction was affirmed by the Second Circuit Court of Appeals.[104] But the story did not end there, for

98. *Chiarella*, 445 U.S. at 224.

99. *Id*.

100. *Id*.

101. *Id*. This sum is measured in 1970s dollars.

102. *Id*.

103. *Id.* at 224-25. What portended immortality for *Chiarella* was, as the Supreme Court recognized, the fact that the case presented the first time that criminal liability had been imposed for a Section 10(b) nondisclosure. *Id*. at 235 n.20. Chiarella was sentenced to one year in prison (all except one month was suspended) and five years of probation. *Id*.

104. *Id*. at 225. For the Second Circuit's opinion, *see* United States v. Chiarella, 588 F.2d 1358 (2d Cir. 1978).

the Supreme Court made what some still consider a startling reversal.[105]

Writing for the Court, Justice Lewis Powell framed the central question as "whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates § 10(b) of the Securities Exchange Act of 1934 if he fails to disclose the impending takeover before trading in the target company's securities."[106] As could be expected, Justice Powell found that the Court's inquiry properly commenced with an analysis of the statutory text.[107] Specifically, Justice Powell wrote that Section 10(b) does not state whether silence in itself may constitute a prohibited manipulative or deceptive device.[108] To be sure, Section 10(b) was designed to broadly ban all fraudulent practices, but neither its text nor its legislative history affords genuine guidance on this issue.[109]

The *Chiarella* Court acknowledged that SEC administrative decisions do play an important role in the development of Section 10(b) jurisprudence.[110] In *Cady, Roberts & Co.*,[111] for example, the Commission "held that a broker-dealer and his firm violated [Section 10(b)] by selling securities on the basis of undisclosed information obtained from a director of the issuer corporation who was also a registered representative of the brokerage firm."[112] The Commission's decision was an early enunciation of its "disclose-or-abstain" rule, under which "a corporate insider must abstain from trading in the shares of his corporation unless he has first disclosed all material information known to him."[113] Such a duty arises in the first instance because the material information is obtained "by virtue of [the insider's] position."[114]

The *Chiarella* Court further added that a failure to disclose material

105. *Chiarella*, 445 U.S. at 225.
106. *Id*. at 224.
107. *Id*. at 226 (citing Ernst & Ernst v. Hochfelder, 425 U.S.185, 185, 187 (1976)).
108. *Id.* at 226.
109. *Id*. (citing *Ernst & Ernst*, 425 U.S. at 202, 206).
110. *Id.* at 226-7 (citing *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961)).
111. *Cady, Roberts*, 40 S.E.C. at 907.
112. *Chiarella*, 445 U.S. at 226 (citing *Cady, Roberts*, 40 S.E.C. at 907).
113. *Id.* at 227 (citing *Cady, Roberts*, 40 S.E.C. at 907).
114. *Id.* (citing *Cady, Roberts*, 40 S.E.C. at 911). The *Chiarella* Court found nothing novel in this obligation to disclose, finding it rooted in the common law. For instance, the Court commented on the long-held notion that a misrepresentation made for the purpose of inducing reliance constitutes fraud. *Id.* at 227-8.

information is fraudulent only when there is a duty to do so, and that "the duty to disclose arises when one party has information that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them."[115] The Court also identified cases in which violations of Section 10(b) had been found, such as when corporate insiders used confidential information for their own benefit[116] and where bank agents, acting as fiduciaries, betrayed the trust invested in them by deliberately not disclosing to sellers the existence of a more favorable market.[117] The Court ultimately concluded that both administrative and judicial interpretations of Section 10(b) had established that "silence in connection with the purchase or sale of securities may operate as a fraud . . . despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure."[118]

Applying these standards, the Court in *Chiarella* concluded that the defendant was not a corporate insider because "he received no confidential information from the target company."[119] In addition, the so-called "market information" upon which he relied did not pertain to the target company's revenue or strategies, "but only [to] the plans of the acquiring company."[120] Therefore, Chiarella's use of that financial data "was not a fraud under § 10(b) unless he was subject to an affirmative duty to disclose it before trading."[121] The Court noted that the jury charge failed to make that distinction. Quite to the contrary, the trial judge's instructions effectively imposed upon *Chiarella* a duty to disclose to all sellers.[122]

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115. *Id.* at 228 (internal citations omitted).

116. *Id.* at 229 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 833 (2d Cir. 1968)).

117. *Id*. at 229-30 (citing Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-53 (1972)). *See also* SEC v. Zandford, 535 U.S. 813, 819 (2002) (finding that *caveat emptor* in the stock markets is abolished by the Securities Act and the Exchange Act).

118. *Id*. at 230.

119. *Id*. at 231.

120. *Id.*

121. *Id*. *Cf.* Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 389 (5th Cir. 2007) (holding that a device is not "deceptive" under Section 10(b) unless it involves a breach of some duty of candid disclosure).

122. *Chiarella*, 445 U.S. at 231. The appellate court, in affirming Chiarella's conviction, also failed to identify the duty, if any, that Chiarella owed to sellers. *Id*. at 231-32.

After noting this deficiency in the lower courts' analyses, the Court announced its *ratio decendi* for the ultimate reversal of Chiarella's conviction. Writing for the Court, Justice Powell identified two paramount defects in the reasoning of the courts. First, the lower courts failed to recognize that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)."[123] Second, the lower courts erroneously determined that "the element required to make silence fraudulent [, namely,] a duty to disclose [,]"[124] was present under the facts of the case. A duty to disclose was necessary to transform Chiarella's silence into a fraudulent act. Here, no such duty could have arisen from Chiarella's relationship with the sellers of the target company's securities because he "had no prior dealings with them" and he was neither their agent nor fiduciary.[125] In the Court's view, Chiarella was merely a "complete stranger who dealt with the sellers only through impersonal market transactions."[126] The contrast drawn by the Court could not have been starker.

The Court recognized that to affirm Chiarella's conviction would be to proclaim that there exists a highly generalized duty between all buyers and sellers in the securities market to abstain from transacting upon material, nonpublic information. The Court reasoned that such a proclamation would be problematic for two reasons. One, it would mark a radical departure from the established principle that a duty only arises from a specific relationship between two parties. Two, it would be erroneous to judicially manufacture such a duty "absent some explicit evidence of congressional intent."[127] As the Court correctly found, "no such evidence emerges from the language or legislative history of § 10(b)."[128]

In addition, the Court pointed out that neither Congress nor the SEC

123. *Id*. at 232 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474-77 (1977)).

124. *Id.* at 232.

125. *Id.* at 232-33. The Supreme Court ultimately rejected the appellate court's postulation of a "regular access to market information" test, under which those who occupy strategic positions in the markets and routinely see nonpublic information are subject to a duty to disclose. In doing so, the Court reaffirmed that a relationship between the parties, and not mere access to information, gives rise to an affirmative duty. *Id.* at 231-32 n.14.

126. *Id.* at 232-33.

127. *Id*. at 233.

128. *Id.*

had ever adopted a "parity-of-information rule" in defining the scope of Section 10(b) or Rule 10b-5.[129] To the contrary, Congress and the SEC have addressed the misuse of market information "by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets."[130] The lower courts in *Chiarella*, in contrast, imposed a new liability rule that swept too broadly and ignored the thoughtful balance struck by Congress and the Commission. The Supreme Court ultimately found "no basis for applying such a new and different theory of liability . . . ."[131] The Court expressed the heart of its analysis as follows:

> Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information. The contrary result is without support in the legislative history of § 10(b) and would be inconsistent with the careful plan that Congress has enacted for regulation of the securities markets.[132]

With that, Vincent Chiarella was a free man, the federal government suffered a stunning reversal of fortune, and a great cornerstone of the law of insider trading was set in place.[133]

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129. *Id.*

130. *Id*. To demonstrate this point, the Court gave two examples. First, the Court noted that the Williams Act "limits but does not completely prohibit a tender offeror's purchases of target corporation stock before public announcement of the offer." *Id.* at 233-34 (citing 15 U.S.C. § 78m(d)(1) (1976 Supp. II)). Second, the Court described the practice of "warehousing," wherein an acquirer gives advance notice to institutional investors of its intention to take over a target, and the investors then accumulate the target's shares before the share price increases after announcement of the bid. *Id.* at 234 ("[T]he theory upon which [Chiarella] was convicted is at odds with the Commission's view of § 10(b) as applied to activity that has the same effect on sellers as [Chiarella's] purchases. . . . In this case, as in warehousing, a buyer of securities purchases stock in a target corporation on the basis of market information which is unknown to the seller.").

131. *Id.*

132. *Id.* at 234-35.

133. Parenthetically, we note that the Justices declined to decide the government's alternate theory in support of Chiarella's conviction – that he somehow violated a duty to the acquiring corporation by virtue of the fact that he was an employee of the printing company contracted by the acquirer. Since that theory was not presented to the jury, the Court would not speculate on its merits. *Id*. at 234-37. *See also* Rewis v. United States, 401 U.S. 808, 814 (1971) (holding that a criminal conviction cannot be affirmed on the

Before departing *Chiarella* for an analysis of the next landmark case in the development of insider trading laws, a few additional words about Chief Justice Burger's dissent are in order.[134] Chief Justice Burger acknowledged the general rule that "neither party to an arm's-length business transaction has an obligation to disclose information to the other unless the parties stand in some confidential or fiduciary relation."[135] He argued in dissent, however, that the rule should be limited when an informational advantage is obtained by wrongful or unlawful means.[136] In particular, he insisted that both Section 10(b) and Rule 10b-5 should be read "to encompass and build on th[e] principle . . . that anyone who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading."[137]

The Chief Justice contended that the broad language found in Section 10(b) and Rule 10b-5 ("*any* person engaged in *any* fraudulent scheme") supported his interpretation.[138] The dissent further alleged that a contrary view would in essence require an application of different standards to "white collar" level insiders and "blue collar" level employees.[139]

Lastly, the Chief Justice proclaimed that his interpretation of the relevant law "would not threaten legitimate business practices" because the antifraud provisions would not impose a disclose-or-refrain requirement on market "specialists" in the performance of their

basis of a theory not submitted to the jury).

134. First, however, we acknowledge the concurring opinions of Justices Stevens and Brennan. Justice Stevens agreed with the notion that identification of the duty allegedly breached must precede the imposition of civil or criminal liability, and likewise confirmed that the majority correctly declined to hear the alternative theory for the reason that it was never presented to the jury. He wrote separately to caution that the majority's holding in no way "placed any stamp of approval on what" Chiarella did, implicitly leaving that issue for another day. *Id.* at 237-38 (Stevens, J., concurring). Similarly, Justice Brennan concurred with the proposition that the mere possession of nonpublic market information does not give rise to a duty to disclose. Yet, Justice Brennan also alluded to a day when the Court would be required to deliberate on a case containing a relevant jury instruction on liability premised upon an improper taking or conversion of nonpublic information for one's own benefit. *Id*. at 238-39 (Brennan, J., concurring in the judgment).

135. *Id*. at 239-40 (Burger, C.J., dissenting).

136. *Id.* at 240 (Burger, C.J., dissenting).

137. *Id.*

138. *Id.*

139. *Id.*

everyday market functions.[140] In an abrupt closing, the Chief Justice strongly condemned Chiarella, declaring that by his actions he, "stole to put it bluntly" and was guilty "beyond all doubt" of violating Section 10(b) and Rule 10b-5.[141]

While Chief Justice Burger's dissent rightly anticipated the development of the misappropriation theory of "insider trading" liability, his application of that theory to the facts in *Chiarella* was misguided for several reasons. First, the question of misappropriation was not explicitly before the Court. Second, the Chief Justice's reading of Section 10(b) and Rule 10b-5 was overly expansive and, if adopted, would have expanded prosecutorial power beyond the level intended by Congress. And lastly, the theory upon which the Chief Justice based Chiarella's guilt was never presented to the jury. In sum, while the dissent may have been helpful in setting the stage for the next iteration of this controversy, its unnecessary and inappropriate haste to reach that next landmark compels us to largely discount the dissent's assertions.[142]

And so we dispose of the *Chiarella* dissent, with the assurance that we will expound and apply the majority's holding in due course. That being said, we now proceed to the next key precedent in the evolution of insider trading jurisprudence.

V. *DIRKS*: A TALE OF VINDICATION

The central points of *Chiarella* were reiterated and tested in *Dirks v. Securities and Exchange Commission*.[143] As we will discuss later, that case represented the second consecutive major defeat for the government in its prosecution of insider trading.

The facts of *Dirks* are unique. In 1973, Raymond Dirks was an officer of a New York broker-dealer firm that specialized in providing investment analysis of insurance company securities to institutional investors.[144] In early 1973, Dirks was contacted by Ronald Secrist, a

140. *Id*. at 242-43 (Burger, C.J., dissenting).

141. *Id*. at 245 (Burger, C.J., dissenting).

142. Justice Blackmun's dissent, as joined by Justice Marshall, largely suffers from the same infirmities, particularly its expansive reading of Section 10(b) as a catchall for any supposed wrongdoing in the securities markets. *Id.* at 245-46 (Blackmun, J., dissenting).

143. 463 U.S. 646 (1983).

144. *Id.* at 648.

former officer of Equity Funding of America, a diversified insurance and financial services company. Secrist informed Dirks that the assets of Equity Funding were vastly overstated as a result of fraudulent corporate practices.[145] Secrist claimed that he and other employees of Equity Funding had complained to various regulatory agencies, but the regulators failed to act on the charges. Secrist urged Dirks to verify the fraud and disclose it to the public.[146]

On his own initiative, Dirks investigated the allegations, going so far as to travel to Los Angeles to interview several officers and employees of the corporation.[147] While the corporate managers denied any wrongdoing, Dirks managed to corroborate Secrist's allegations through interviews with certain employees of the corporation.[148]

During the course of his two week investigation, Dirks informed a number of clients and investors of the burgeoning evidence of fraud at Equity Funding.[149] Although neither Dirks nor his firm owned or traded in Equity Funding shares, some of the persons to whom Dirks provided information sold their holdings of Equity Funding securities, including five investment advisers whose liquidated holdings totaled more than $16 million.[150]

While the *Wall Street Journal* initially refused to print Dirks' story for fear of subjecting itself to a libel claim, word of Dirks' investigation spread like wildfire, and the price of Equity Funding's stock soon cratered from $26 per share to less than $15 per share.[151] This implosion of the share price led the New York Stock Exchange to halt trading in Equity Funding stock.[152] California insurance regulators subsequently impounded Equity Funding's records and uncovered evidence of the fraud.[153] The SEC filed charges against the firm and Equity Funding was immediately placed into receivership.[154]

The SEC then began an investigation into Dirks' role in exposing

145. *Id.* at 649.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.* at 649-50.
152. *Id.* at 650.
153. *Id.*
154. *Id.*

the fraud. After administrative court proceedings, the SEC found that Dirks "had aided and abetted violations of § 17(a) of the Securities Act of 1933, § 10(b) of the Securities Exchange Act of 1934, and SEC Rule 10b-5, by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding Stock."[155] In short, the SEC decreed that Dirks had engaged in insider trading. In a surprising act of leniency, the SEC, in recognition of his key role in exposing the fraud, only censured Dirks.[156]

Unmoved by the SEC's beneficence, Dirks sought judicial review in the Court of Appeals for the District of Columbia Circuit.[157] Unfortunately for him, the District of Columbia Circuit entered judgment against Dirks based on the reasons stated in the Commission's opinion.[158] The Supreme Court recognized the importance of the issue to the SEC and the securities industry and granted *certiorari*.[159] In a stunning reversal of fortune for the SEC, the Court overturned the lower court and found for Dirks.[160]

Writing for a 6-3 majority, Justice Lewis Powell (who, significantly, was also the author of *Chiarella*) first succinctly set forth the basis for Dirks' conviction. Specifically, Dirks had received material, nonpublic information from insiders at Equity Funding with whom he had no prior relationship and shared that information with certain investors who, in reliance upon these revelations, sold their Equity Funding shares.[161] According to the Court, "[t]he question [was] whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure."[162]

Turning to its analysis, the Supreme Court acknowledged that the SEC has long recognized the common law principle that corporate

155. *Id.* at 650-51 (internal citations omitted).

156. *Id.* at 652. The irony of the SEC's pursuit of Dirks cannot be understated, especially since it was his investigation that exposed one of the more notorious frauds perpetrated up to that date. Then again, the regulators' repeated failures to uncover the fraud themselves might explain their reasons for punishing Dirks.

157. *Id. See* 15 U.S.C. § 78y(a)(1) (stating that "[a] person aggrieved by a final order of the Commission . . . may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit . . . .").

158. *Dirks*, 463 U.S. at 652.

159. *Id.* (citing Dirks v. SEC, 459 U.S. 1014 (1982)).

160. *Id*. at 652.

161. *Id.* at 648.

162. *Id.*

insiders, particularly officers, directors, and controlling stockholders, are subject to an affirmative duty to disclose material information before dealing in their corporation's securities.[163] The Commission had long contended that a failure to disclose constitutes a Rule 10b-5 violation. Moreover, the Commission had found that the duty to "disclose or abstain" from trading could be rightfully extended to individuals other than corporate insiders.[164]

Notwithstanding the SEC's belief set, the *Dirks* Court took this opportunity to reaffirm the crux of what it held in *Chiarella* – that Section 10(b) and Rule 10b-5 are violated when access to confidential information is misused and covertly exploited for private gain.[165] However, in the same breath, *Dirks* reinvigorated *Chiarella*'s maxim that "there is no general duty to disclose" and such an obligation cannot arise from the mere possession of material, nonpublic information.[166] The *Dirks* Court confirmed that "[s]uch a duty arises rather from the existence of a fiduciary relation."[167]

Justice Powell further acknowledged that "[n]ot 'all breaches of fiduciary duty in connection with a securities transaction []' . . . come within the ambit of Rule 10b-5."[168] Rather, a violation of the rule requires that there also be manipulation or deception.[169] That axiom is applied to an insider trading case because of the inherent unfairness of using nonpublic corporate information for personal benefit. On this issue, the *Dirks* Court emphasized that Rule 10b-5 liability turns on whether the insider refused to "go public" before trading on such information.[170]

The *Dirks* Court further emphasized that the *Chiarella* Court was "explicit . . . in saying that there can be no duty to disclose where the person who has traded on inside information" was not a fiduciary or agent.[171] The Court staunchly refused to depart from "the established doctrine that [a fiduciary] duty arises from a specific relationship

163. *Id.* at 653 (citing *In re* Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961)).
164. *Id*. at 653 (citing *Cady, Roberts*, 40 S.E.C. at 912).
165. *Id.* at 653-54.
166. *Id.* at 654 (citing Chiarella v. United States, 445 U.S. 222, 235 (1980)).
167. *Id.* (citing *Chiarella*, 445 U.S. at 227-35).
168. *Id.* (quoting Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977)).
169. *Id*. (citing *Santa Fe Indus.*, 430 U.S. at 473).
170. *Id*. at 654.
171. *Id.*

between two parties[,]" by imposing a new, more generalized obligation on all market participants to disclose or abstain.[172] Before proceeding, the Court tacitly acknowledged that "[t]his requirement of a specific relationship . . . has created analytical difficulties for the SEC and courts" in resolving allegations of insider trading.[173]

Apparently motivated to now resolve some of these analytical conundrums, the Court first noted the SEC's argument that a "tippee" (one receiving inside information from a "tipper") "inherits" the obligation to disclose to shareholders whenever he receives inside information from an insider.[174] The Court found the argument to be problematic and quickly disposed of this notion.[175]

Justice Powell exposed the SEC's position as a view that "differ[ed] little from the view [the Court] rejected as inconsistent with congressional intent in *Chiarella*."[176] The fatal flaw in the SEC's rationale, both in *Dirks* and *Chiarella*, was that it "appear[ed] rooted in the idea that the antifraud provisions require equal information among all traders."[177] Such a view conflicted 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."[178] In a resounding reaffirmation of its earlier pronouncement, the *Dirks* Court declared that the duty to disclose arises not from "one's ability to acquire information because of his position in the market," but from "the relationship between the parties."[179]

Furthermore, the *Dirks* Court elaborated upon the dangers of adopting a less principled view. Specifically, the Court stated that "[i]mposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market

172. *Id.* at 654-55 (internal quotations and citations omitted).

173. *Id.* at 655.

174. *Id.*

175. The Court faulted the SEC for failing to explain "why the receipt of nonpublic information from an insider automatically carries with it [a] fiduciary duty of the insider." *Id.* at 656 n.15. Again harkening back to *Chiarella*, the Court reemphasized that "only a specific relationship" gives rise to a duty to disclose or abstain. *Id.*

176. *Id.* at 656.

177. *Id.* at 657.

178. *Id.* The *Dirks* Court praised Judge Wright's dissent at the circuit level for "correctly read[ing] our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading." *Id.*

179. *Id.* (citing Chiarella v. United States, 445 U.S. 222, 232-33 (1980)).

analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market."[180] It is a given that in performing the vital role of compiling and disseminating material information about corporate securities, market analysts sometimes distribute notes or reports to favored clients and investors first. The Court astutely observed that "such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[181] Such an observation clearly refuted a centerpiece of the SEC's flawed reasoning in *Dirks*.

The Court further acknowledged that the conclusion "that recipients of insider information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information."[182] Rather, the Court recognized that "[t]he need for a ban on some tippee trading [was] clear" and certain limitations would be acceptable.[183] For example, corporate insiders who are forbidden by a fiduciary duty to trade in their own securities, "may not give . . . information to an outsider for the same purpose of exploiting the information for their personal gain."[184]

In clarifying the import of its holding, the *Dirks* Court declared that "some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*."[185] Hence, the assumption of a fiduciary duty to disclose or abstain can take place only when the inside source of the confidential information has first breached his fiduciary duty to his constituency "and the tippee knows or should know that there has been a breach."[186] In conclusion, *Dirks* established that tipping is appropriately viewed only as an indirect violation of the securities laws, and is clearly predicated upon a certain sequence of violative acts.[187]

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180. *Id.*
181. *Id.* at 659.
182. *Id.*
183. *Id.*
184. *Id.* (citing 15 U.S.C. § 78t(b)).
185. *Id.* at 660.
186. *Id. See also In re* Investors Mgmt. Co., 44 S.E.C. 633, 651 (1971) (Smith, C., concurring) (stating that "tippee responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of a duty by a person having a special relationship to the issuer not to disclose the information . . . .").
187. *Dirks*, 463 U.S. at 661.

All that being said, *Dirks* counseled that in determining whether a tippee is under an obligation to disclose or abstain, a court must determine whether the transmittal of insider information constituted a fiduciary breach.[188] In making this determination, the Court forewarned that "[a]ll disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders."[189]

A highly influential factor in this analysis is the tipper's reason for disclosing confidential information. The key test is whether the disclosing insider benefited, either directly or indirectly, from revealing the information. On this point, Justice Powell stated that "[a]bsent some personal gain, there [can be] no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach."[190] Moreover, the Court rebuffed the SEC's concerns that such a tight analysis might encourage, rather than deter, prohibited conduct. Finding the regulators unduly concerned that they might have to read parties' minds to divine improper intent, the Court found no such hindrance, stating that, "the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria . . . such as a pecuniary gain or a reputational benefit that will translate into future earnings."[191] *Dirks* clearly establishes that regulators and courts alike must base their allegations and decisions on "objective facts and circumstances . . . ."[192] Implicitly, occult powers to uncover scienter should not factor into the analysis.

While resolving such questions of fact may be difficult, the Court nevertheless found it "essential . . . to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules . . . ."[193] In this area of the law, such bright lines are first drawn by establishing a breach of fiduciary duty by the inside source. In contrast, the rule adopted by the SEC in *Dirks* had "no limiting principle."[194]

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188. *Id.*

189. *Id.* at 661-62.

190. *Id.* at 662. *See also Investors Mgmt. Co.*, 44 S.E.C. at 648 (Smith, C., concurring) (stating that it is important "to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession . . . .").

191. *Dirks*, 463 U.S. at 663.

192. *Id.* at 664.

193. *Id.*

194. *Id.* Parenthetically, the Court was troubled by the SEC's black and white view of potential insider liability, and apparently took exception to the regulators'

Under its established insider trading and tipping rules, the Supreme Court found no actionable wrongdoing by Dirks. The Court classified Dirks as "a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders."[195] The Court properly reminded that none of Dirks' sources expected him to keep the information about Equity Funding confidential, "[n]or did Dirks misappropriate or illegally obtain the information about Equity Funding."[196] In the end, Dirks broke no law when he shared his information with investors and the *Wall Street Journal*.[197] Ray Dirks prevailed, and the SEC went down in a bitter defeat.[198]

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assumption that an insider "invariably violates a fiduciary duty" whenever he remits nonpublic information to an outside recipient. *Id*. at 666-67 n.27. Similarly, the Court voiced concerns that giving the SEC free rein to pursue Rule 10b-5 prosecutions as it sees fit "can be hazardous, as the facts of this case make plain." *Id.* at 664 n.24. The rebuke to the Commission is painfully obvious.

195. *Id.* at 665. To be sure, the Justices were not cavalier in freeing Dirks from liability. The Court was careful to expound that "[w]e do not suggest that knowingly trading on inside information is ever socially desirable or . . . devoid of moral considerations." *Id*. at 661 n.21 (internal quotations and citations omitted).

196. *Id.* at 665.

197. *Id.* at 666. In order to assure a fair presentation herein, we note that Justice Blackmun's dissent paints a far different picture. The dissent asserts that Dirks carefully went about crafting the quality and quantity of information he shared and strategically offered that information to investors. For example, he imparted the more gruesome details of his investigation to select investors, mainly large investment houses. *Id.* at 669-70 (Blackmun, J., dissenting). The dissent classified Dirks' attempts to notify those outside his inner circle as "feeble, at best." *Id.* at 670. Justice Blackmun focuses on the point that those who had received a more fulsome report from Dirks were able to offload nearly $15 million in Equity Funding shares before the stock price plummeted. *Id*. In sum, the dissent characterized Dirks as far from altruistic, and instead painted him as a self-serving opportunist. Be that as it may, this is where we find the Court's 6-3 decision to be particularly insightful, because it shows a convincing majority of the Justices would not subscribe to such a negative view of Dirks. To the contrary, the majority, at most, applauded Dirks' civic mindedness, and, at least, characterized his underlying motivations as something less vile.

198. *Id*. at 667. In the interests of full disclosure, the senior author of this Article was interning for the SEC while *Dirks* was *sub judice* before the Supreme Court, and, in point of fact, was assigned to a unit pursuing Dirks administratively. While a matter of personal opinion by the writer, there is no question in his mind that the Commission wanted Ray Dirks very badly, and fought for his punishment with unrelenting vigor. Hence, the Supreme Court's exoneration of Dirks was a bitter pill for the agency to swallow, and made even more ignominious because it followed so soon after the regulators' loss in *Chiarella*.

In sum, *Chiarella* set the stage and *Dirks* added to the drama.[199] The next act was to prove the resolution (at least in part) of the hitherto unresolved misappropriation theory branch of insider trading liability.

VI. *O'HAGAN*: THE MISAPPROPRIATION THEORY AT LAST

Lawyers have long had the solemn duty of upholding the law. Only in rare instances are members of the profession accused of actually breaking the law themselves. Unfortunately, however, the landmark case of *United States v. O'Hagan*[200] presents such a scenario.

James Herman O'Hagan was a partner at the eminent law firm of Dorsey & Whitney, then based in Minneapolis, Minnesota. In July of 1988, Dorsey was retained as local counsel by Grand Metropolitan PLC ("Grand Met"), a U.K. food conglomerate, as part of its takeover bid for the Pillsbury Company, also headquartered in Minneapolis. Although, "O'Hagan did no work on the Grand Met representation,"[201] he nevertheless took a strong interest in the Grand Met acquisition – a financial interest, to be sure.

In mid-August of 1988, while Dorsey & Whitney was still actively

199. Parenthetically, we note Carpenter v. United States, 484 U.S. 19 (1987), popularly known as the *Wall Street Journal* case. In that case, one R. Foster Winans was the writer of the venerable *Journal*'s "Heard on the Street" column, and he was convicted of illegally conspiring with others to profit on stock trades made in anticipation of news to be published when the *Journal* hit the newsstands each Monday morning. This matter came at a time before the advent of the Internet and the near instantaneous transmission of market information. The titular Carpenter was Winans' roommate and co-conspirator. *Id*. at 20-24. In one of those rare instances, a recusal led the eight remaining Justices to split four to four on Carpenter's Section 10(b) and Rule 10b-5 convictions, thereby affirming the decision below. *Id*. at 24. *Carpenter* therefore focused solely on affirming mail and wire fraud convictions, *id*. at 24-28, and, aside from the recitation of the underlying facts, not a word was said about Section 10(b). Relevant to this Article, in the proceedings below, the Second Circuit agreed that Winans "had knowingly breached a duty of confidentiality by misappropriating prepublication information" from his employer, and that the "deliberate breach" of his duties and his subsequent concealment from the *Journal* was a sufficient basis for his Section 10(b) conviction. *Id*. at 23-24. *See also* United States v. Carpenter, 791 F.2d 1024, 1031-32 (2d Cir. 1986). Hence, *Carpenter*, while somewhat significant for its notoriety, constitutes but a footnote in the instant discussion.

200. United States v. O'Hagan, 521 U.S. 642 (1997).

201. *Id*. at 647. Dorsey & Whitney withdrew from representing Grand Met in early September, barely two months into the engagement. *Id*.

representing Grand Met, O'Hagan purchased "call options" on Pillsbury stock.[202] He continued to buy options throughout the remainder of that month and into September. By the end of that time, O'Hagan had amassed some 2,500 Pillsbury options, "apparently more than any other individual investor,"[203] in addition to buying some 5,000 shares of Pillsbury common stock.[204] When on October 4, 1988, Grand Met publicly announced its bid to acquire the iconic "Pillsbury Dough Boy" and all the legendary brands associated with the Pillsbury Company, O'Hagan was richly rewarded for his investing foresight. With Pillsbury common stock approximately doubling in price, O'Hagan sold off his investments and made a net profit of well over $4 million.[205]

O'Hagan's newfound riches soon caught the eye of the SEC, prompting an investigation culminating in a fifty-seven count indictment. The SEC's principal allegations were that O'Hagan had defrauded both his own law firm and its client, Grand Met, by diverting material, nonpublic information about the planned Pillsbury acquisition for his own gain.[206] Ultimately, O'Hagan was convicted on fifty-seven counts and sentenced to nearly three and a half years in prison.[207] Somewhat surprisingly, a divided panel of the Eighth Circuit Court of Appeals reversed all of O'Hagan's convictions, primarily on the ground that insider trading liability cannot be premised upon the misappropriation theory.[208] Acknowledging that the "[d]ecisions of the Courts of Appeals are in conflict on the propriety of the misappropriation theory under § 10(b) and Rule 10b-5," the Supreme Court granted *certiorari*.[209]

Writing for the Court, Justice Ginsburg set out the paramount questions before the Justices, first addressing the misappropriation theory of insider trading liability. Justice Ginsburg asked whether a

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202. *Id*. at 647-48. Each option gave O'Hagan the right to purchase 100 shares of Pillsbury at a fixed price at a later date. *Id*.

203. *Id*.

204. *Id*. at 648.

205. *Id*.

206. *Id*. at 648-49. Interestingly, the indictment claimed O'Hagan's motivation was to take his Pillsbury profits and cover up an earlier embezzlement of unrelated client funds. *Id*. at 648.

207. *Id*. at 649

208. *Id*.; United States v. O'Hagan, 92 F.3d 612, 622 (8th Cir. 1996).

209. United States v. O'Hagan, 521 U.S. 642, 649 (1997).

person, trading in stock for personal profit, violates Section 10(b) and Rule 10b-5 when he utilizes confidential information misappropriated in a breach of a fiduciary duty owed to the source of that nonpublic data.[210] The *O'Hagan* Court replied in the affirmative[211] and ultimately held that criminal liability for violating Section 10(b) "may be predicated on the misappropriation theory."[212]

Initially, Justice Ginsburg conducted a neat review of the relevant statute. Specifically, the Justice explained that Section 10 proscribes the use of "any deceptive device . . . in connection with the purchase or sale of securities" and that, moreover, the text of the statute did not confine its ambit to the deception of a purchaser or seller alone; "rather, the statute reaches any deceptive device used '*in connection* with the purchase or sale of any security.'"[213] Continuing on to Rule 10b-5, the Court noted that the Rule's broad sweep of liability was in turn delimited solely to the "conduct encompassed by [Section] 10(b)'s prohibition."[214]

Turning next to analyze the competing schools of thought, Justice Ginsburg first exposited the "traditional" or "classical" theory, which is, in brief, when a corporate insider trades in the stock of his own corporation on the basis of material, nonpublic information. Moored to *Chiarella*, such conduct is wrongful because the employment of inside information qualifies as the "deceptive device" outlawed by Section 10(b) and Rule 10b-5.[215]

In contrast, the "misappropriation" theory holds accountable those who misappropriate confidential data and trade with that special knowledge, in breach of a duty owed to the source of the information, and it is the violator's "undisclosed, self serving use" of the information so gained which defrauds the source of its lawful exclusivity in possessing that knowledge.[216] The misappropriation theory is "[i]n lieu" of premising liability upon a corporate insider pursuant to the classical

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210. *Id*. at 647.

211. *Id*. at 648-649.

212. *Id*. at 650 (footnote omitted).

213. *Id*. at 650-51 (quotes in the original) (emphasis added). *See also* United States v. Newman, 664 F.2d 12, 17 (2d Cir. 1981).

214. *Id*. at 651 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976), Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 173 (1994)).

215. *Id*. at 651-52.

216. *Id*. at 652.

theory, and instead, liability flows from the "trader's deception of those who entrusted him with access to confidential information."[217]

Reaching the gravamen of the *O'Hagan* Court's reasoning, Justice Ginsburg next declared that "[t]he two theories are complementary, each addressing affects to capitalize on nonpublic information" in buying or selling stock.[218] While the classical theory zeroes in on a corporate insider's breach of trust owed to shareholders, conversely, the misappropriation postulation "outlaws trading on the basis of nonpublic information by a corporate 'outsider'" breaching a duty of confidentiality owed to the source of the information.[219] In its own fashion, the latter theory is intended to safeguard the overall integrity of the marketplace from abusers with access to privileged information, yet who stand removed from the stockholder constituency (and, hence, owe them no fiduciary duty).[220]

Turning to the case at bar, the Justices expressed agreement with the government's contention that trading upon misappropriated information fell within the conduct prohibited by Section 10(b). Those proven to misappropriate "deal in deception" and pretend loyalty to their source "while secretly converting" its information for personal gain.[221] Here, attorney O'Hagan's deceit was "of the same species" as addressed by the Court in *Carpenter v. United States*,[222] which analogized the fraudulent misappropriation there to a kind of embezzlement from the accuser's employer.[223]

Returning to the centrality of *O'Hagan*, the Court found the pivot

217. *Id*. Indeed, could Justice Ginsburg's use of the word "trader" be a Freudian-esque homonym for "traitor," given the law's evident scorn for such duplicity?

218. *Id*. at 652.

219. *Id*. at 652-53.

220. *Id*. at 653. This was presaged by *Dirks* in a parenthetical where the Court forecasted that "[u]nder certain circumstances . . . where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant," a fiduciary breach may arise between those nominal outsiders and the shareholders they ostensibly serve. Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983). Consonant with its earlier teachings, *Dirks* emphasized that it is not the acquisition of inside information that is determinative, but rather the underlying relationship granting access that gives rise to that duty. *Id*.

221. *Id*. at 653.

222. 484 U.S. 19 (1987).

223. United States v. O'Hagan, 521 U.S. 642, 654 (1997) (citing Carpenter v. United States, 484 U.S. 19, 27 (1987)).

of the instant case was deception by nondisclosure, that is, the cover-up of the act of misappropriation.[224] Furthermore, the misappropriation theory advanced by the prosecution is consistent with Court precedent holding that Section 10(b) "trains on conduct involving manipulation or deception."[225] Indeed, in sharp contradiction, the Court noted that full disclosure to the source, that the person in possession of the privileged information does intend to trade upon it, negates the deception, and thus forecloses Section 10(b) liability.[226]

Now turning briefly to the "in connection" with the buying or selling of a security portion of the statutory ban, the *O'Hagan* Court determined it is the secretive usage of the confidential information to purchase or sell securities that consummates the wrong, not the preceding capture of the closely held data.[227] "The securities transaction and the breach of duty thus coincide," and, to be certain, it is the source that is the victim of the fraud.[228]

Justice Ginsburg further opined upon another boundary of the misappropriation theory. The theory targets inside information of a sort that the malefactor then utilizes to make "no risk profits through the purchase or sale of securities." Any other use of the information, and Section 10(b) is not implicated.[229]

Hence, the law is not a catch-all for all misappropriation, but only deceitful misappropriations of information made where the goal is profiting from stock transactions.[230] Such conduct is antithetical to the maintenance of fair and honest securities markets, and "there is no question" such conduct falls within Section 10(b)'s prohibition that the fraud is in connection with buying or selling stock.[231]

224. *Id*. at 654.

225. *Id*. at 655 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). Justice Ginsburg added that the statute "is not an all purpose breach of fiduciary ban." *Id.* at 655.

226. *Id*. at 655.

227. *Id*. at 655-56.

228. *Id*. at 656. *But see Id.* at 680 (Thomas, J., concurring in the judgment in part and dissenting in part). Justice Thomas disagreed that the misappropriation theory has the proper nexus to the "in connection" with the purchase or sale of a security requirement of section 10(b). *Id*. at 684-85. *Accord id*. at 679 (Scalia, J., concurring in part and dissenting in part).

229. *Id*. at 656.

230. *Id*.

231. *Id*. at 657-58. This line of reasoning was later followed by SEC v. Zandford, 535 U.S. 813, 819 (2002).

Applying this logic to the accused here, the Court found "it makes scant sense to hold a lawyer like O'Hagan a [Section] 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm representing the bidder."[232] The Court found the statutory text makes no distinctions. Satisfying the elements, first of deceit, and then in connection with transacting in securities, brings misappropriation of this stripe within the law's purview.[233]

Next, the *O'Hagan* Court expounded upon why the new precedent announced that day was an essential step in the evolution of its insider trading jurisprudence. To be sure, the Court disabused the notion that Section 10(b) liability can stem exclusively from explicit duties to narrowly-identified purchasers or sellers of the securities in question.[234]

First, differentiating the seminal holding in *Chiarella*, Justice Ginsburg clarified that a fiduciary duty to stockholders is not "the *only* relationship" giving rise to liability for insider trading.[235] Indeed, according to the Justice, "*Chiarella* thus expressly left open the misappropriation theory before us today."[236] The predecessor case of *Dirks* similarly "left room for application of the misappropriation theory in cases like [*O'Hagan*]."[237] Justice Ginsburg characterized *Dirks* as clarifying *Chiarella*'s fundamental postulation that there is no generalized obligation between all market participants to refrain from all trading when in possession of as-of-yet nonpublic information.[238] The *O'Hagan* Court highlighted the observation in *Dirks* that, in the latter case, there were no expectations that supposed confidences would be kept, nor was there any information in *Dirks* misappropriated or obtained in contravention of the law.[239]

In concluding this portion of its reasoning, the *O'Hagan* Court held that "the misappropriation theory . . . is both consistent with the statute

232. *O'Hagan*, 521 U.S. at 659.
233. *Id*. at 659.
234. *Id*. at 660.
235. *Id*. at 661 (emphasis in the original).
236. *Id*. at 662.
237. *Id*.
238. *Id*. at 663.
239. *Id*. *O'Hagan* quickly disposed of any supposed predominance of *Central Bank*, summarily pointing out that *O'Hagan* pertained to criminal liability pursuant to section 10(b). *Id*. at 664. In contrast, *Central Bank* worked to confine the scope of private, civil litigation. *Id.*

and with our precedent." Setting forth some of the requisite elements of criminal liability under Rule 10b-5, *O'Hagan* declared that the prosecution must first prove a willful violation of the proviso, and next that the alleged violator knew of the prohibition.[240]

In the instant case, the Justices rejected O'Hagan's contention that the misappropriation theory is too amorphous to impose criminal liability for the reason that the theory casts a wider net then merely ensnaring those who allegedly breach a recognized proscription.[241] Thus, O'Hagan's original convictions on the Section 10(b) violations were restored.[242]

In retrospect, *O'Hagan* is a grievous tale indeed – a guardian of the law violated the very oath he took to uphold those laws – and yet it served a very important purpose. *O'Hagan* marked the first time the Supreme Court recognized and expounded upon the misappropriation theory of insider trading. As we saw previously, the Court refrained from addressing this separate branch of the relevant law in both *Chiarella* and *Dirks*, as the issue was not yet ripe for adjudication. Notwithstanding whatever controversy that restraint might have engendered in the intervening years, patience did indeed prove to be a virtue.

O'Hagan certainly provided the appropriate platform for the creation of a new and vital precedent for the misappropriation theory. With the issue firmly at hand, the Justices made clear that the time had come for recognition of the misappropriation theory as a critical part of the law of insider trading. The Court made the key distinctions between the misappropriation school of reasoning and the classical theory camp, carefully and explicitly delineating what it is about misappropriation that makes it a violation of the law. The Court elaborated on the wrongfulness of taking the confidential data of another and utilizing it for personal gain in the transacting of securities, and how such infractions were to be dealt with in the future.

With *O'Hagan*, the carefully built structure of prohibitions against

240. *Id*. at 664-65.

241. *Id*. at 665. While not explicitly stated, it is plausible that in this case O'Hagan's status as a corporate attorney helped undo him.

242. *Id*. at 666. We leave for our readers' edification the Court's next and further ground for upholding O'Hagan's conviction for violating section 14 rules regarding trading stock in connection with a tender offer. *Id*. at 666-677. See 15 U.S.C. § 78m, et seq., and 17 C.F.R. § 240.14e (commonly known as Rule 14e, promulgated under the Williams Act, regulating tender offers).

insider trading were complete, at least as to the leading theories for the prosecution of such wrongs. We now see clearly how the classical and misappropriation theories complement each other, providing for a more comprehensive bulwark against such malfeasance.[243] Still the fidelity of the lower federal courts to these companion philosophies remains to be seen. We turn next to the latest case that presents precisely such an issue.

VII. *CUBAN*: VICTORY, THEN DEFEAT, AND NOW UNCERTAINTY

A. A CUBAN VICTORY

The Fifth Circuit Court of Appeals' decision in *Securities and Exchange Commission v. Cuban* lays the latest foundation in insider trading jurisprudence.[244] Mark Cuban, the putative defendant, enjoyed a meteoric rise in the high-tech industry after founding Broadcast.com, a company he sold to Yahoo! Inc. in 1999 for an astonishing $4.7 billion. Notwithstanding his obvious business acumen, he is better known in professional sports circles as the outspoken team owner of the National Basketball Association's Dallas Mavericks. Nonetheless, it is the beginnings of his fortune as an IT entrepreneur that, to some extent, presaged the transactions which led him to his current legal notoriety.

The essence of the courtroom drama, first argued before the U.S. District Court for the Northern District of Texas was simple – charged with insider trading, Cuban was first able to win a dismissal, without prejudice to refiling, of the government's case.[245] The district court's *Cuban* decision makes a fitting addition to our overall analysis of the law of insider trading in that it relies upon a rich tapestry of precedents,

243. We recommend looking at the quite comprehensive decision of the erudite Judge John G. Koeltl of New York's Southern District in *SEC v. Rorech*, 720 F. Supp. 2d 367 (2010) ("Rorech II"). The opinion's 122 pages are a wonderful exposition of section 10(b), and cogently diagram its precedents. For now, we simply note that the government's claims of insider trading with regard to credit-default swaps (the first time such instruments were the centerpiece of a section 10(b) prosecution) were completely dismissed by the veteran Judge Koeltl after a bench trial. Shades of *Chiarella* and *Dirks* indeed appear here.

244. SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009); SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

245. *Id*. at 717.

yet still forges its own trail.

To set the stage, as of March, 2004, Cuban was an investor in Mamma.com, a Canadian company that operated an internet search engine. Cuban personally owned 600,000 shares, or a 6.3% stake, in the NASDAQ-traded company. At about that time, the company's management decided to raise capital via a PIPE offering. "PIPE" stands for "Private Investment in a Public Entity" and refers to a private investor contributing capital by taking a significant stake in a corporation whose shares are publicly traded.[246]

Given that Cuban was Mamma.com's largest then-known shareholder, the firm's CEO contacted him by telephone.[247] The salient reason for the call was that the PIPE would necessitate the issuance of many more shares, thus diluting Cuban's stake to a much lesser percentage of the corporation's outstanding stock.[248] According to the allegations, the CEO prefaced the call by telling Cuban he was about to share confidential information, and Cuban supposedly agreed to maintain its confidential nature.[249] The corporate chief, purportedly relying upon that assurance of confidentiality, proceeded to tell Cuban about the PIPE offering.[250] Cuban's responded without favor. "Well, now I'm screwed," was the alleged retort.[251] Cuban angrily expressed his disdain for PIPE offerings, precisely because such maneuvers dilute the holdings of existing shareholders.[252] At the end of the conversation with the CEO, Cuban allegedly declared "[Now] I can't sell."[253]

Some hours after that telephone conversation, the CEO followed up with an email to Cuban, providing contact information for the investment bank underwriting the PIPE.[254] Cuban called the banker, and was supplied with additional, allegedly confidential, information about the stock offering which had yet to be announced. The next sequence of

246. *Id*.
247. *Id*.
248. *Id*.
249. *Id*.
250. *Id*.
251. *Id*.
252. *Id*.
253. *Id*. According to the internal company emails relied upon by the SEC in its complaint, Mamma.com anticipated Cuban's negative reaction to the move, and its management apparently believed that Cuban would not sell his shares until after the official announcement of the PIPE offering. *Id*.
254. *Id*.

events represents the gravamen of the government's complaint.[255] According to the SEC, "[o]ne minute after ending this call, Cuban telephoned his broker and directed the broker to sell all 600,000 of his Mamma.com shares."[256] After first selling but a handful of shares in after-hours trading, the broker was able to sell the vast bulk of Cuban's holdings in Mamma.com during the next trading day. Cuban did not inform the management of Mamma.com either of his intentions to sell or the eventual liquidation of his stake.[257]

After the market closed, on the day of Cuban's sell-off, the company officially announced the PIPE offering. Mamma.com's share price began to decline at the opening the next day, and continued to drop in the trading days following. All told, Cuban avoided in excess of $750,000 in losses by dumping his stake ahead of the news about the PIPE.[258]

The Securities and Exchange Commission pounced on these largely undisputed facts.[259] The Commission alleged that Cuban violated the federal securities laws, specifically Rule 10b-5, under the "misappropriation" theory of insider trading.[260] Cuban quickly moved to dismiss the regulators' case.[261]

Chief District Judge Sidney A. Fitzwater succinctly posited the question before the court as to whether the SEC "adequately alleged that Cuban undertook a duty of non-use of information required to establish liability under the misappropriation theory." Concluding that the agency had failed in that regard, the court granted Cuban's motion to dismiss, but expressly authorized the government to replead.[262]

A few words about the procedural backdrop are helpful here. Chief Judge Fitzwater commenced by invoking Federal Rule of Civil Procedure 8(a)(2), which mandates that a pleading must, at a minimum, contain a short and plain statement of the claim demonstrating that the pleader is entitled to relief.[263] Admittedly, detailed allegations of facts

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255. *Id*.
256. *Id*.
257. *Id*.
258. *Id*.
259. *Id*. To date, no criminal charges have been filed in this matter.
260. *Id*. at 717.
261. *Id*. at 718.
262. *Id*. at 717.
263. *Id*. at 719. *See* FED. R. CIV. P. 8(a)(2).

are not a prerequisite, but the pleading must recite more than mere labels and conclusions.[264] It follows from this most basic rule of pleading that a complaint failing to pass this basic threshold cannot stand. In such a situation, an opposing party may make a motion to dismiss for failure to state a claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure, which provides that a complaint or pleading will be dismissed upon motion when it fails to state a claim.[265]

As the *Cuban* decision reminds, a court deciding a motion to dismiss under Rule 12(b)(6) motion must accept as true all well-pled facts, and view them in the light most favorable to the party opposing the motion.[266] Notwithstanding such procedural leniency, the complainant must still set forth sufficient facts to set out a facially plausible claim,[267] such that the court may reasonably infer that the defendant is liable for the misconduct alleged.[268] Notably, "plausibility" is not "probability," which is obviously a more rigorous requirement. Rather, the wrongs alleged must be sufficiently undergirded by facts to raise the right to relief above rank speculation.[269] That overall standard of pleading having been established, the court turned to the substantive law regulating the securities market.[270]

To start, the Chief Judge of the Northern District of Texas extensively quoted from both Section 10(b) and Rule 10b-5.[271] The court correctly noted that the proscription against insider trading is not precisely statutory in origin, rather "it has instead developed through SEC and judicial interpretation of § 10(b)'s prohibition of 'deceptive' conduct and Rule 10b-5's antifraud provisions."[272]

Harkening back to *Chiarella*, the *Cuban* bench noted how the Supreme Court, in that case, first espoused the "traditional" or "classical" theory of insider trading liability.[273] That postulation was

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264. *Id*. (citing Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009)); Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 555 (2007)). Similarly, talismanic references to the mere elements of a cause of action will not suffice. *Ashcroft*, 129 S. Ct. at 1949; *Twombly*, 550 U.S. at 555.

265. FED. R. CIV. P. 12(b)(6).

266. SEC v. Cuban, 634 F. Supp. 2d 713, 719 (N.D. Tex. 2009).

267. *Id*. at 719 (citing *Twombly*, 550 U.S. at 570).

268. *Id*. (citing *Iqbal*, 129 S. Ct. at 1949).

269. *Id*. at 719 (citing *Twombly*, 550 U.S. at 555).

270. *Id*. at 719-20.

271. *Id*.

272. *Id*. at 720.

273. *Id*. (quotations in the original).

amplified with the *O'Hagan* Court's finding that the relevant section and rule is violated when a corporate insider trades in the stock of his corporation "on the basis of material, nonpublic information."[274] There, the liability springs from the relationship of trust and confidence between shareholders at large and the company's insiders, the latter of whom have obtained closely-held information by reason of their standing within the corporation's inner circle.[275]

Judge Fitzwater then analyzed the expansion of the classical theory, first found in *Chiarella*, with the Supreme Court's ruling in *O'Hagan*, and that ruling's underlying premise of the "misappropriation theory."[276] Closely hewing to the text of *O'Hagan*, the court acknowledged that misappropriation occurs when the transgressor commits fraud in connection with a securities transaction by confiscating confidential information in breach of a duty owed to the source of the information, and then utilizes that knowledge to trade the very stock of the corporation in question.[277]

The evil the law is aimed to punish, said Chief Judge Fitzwater, is the use of another's confidential information in a secretive, selfish action to profit in the trading of stock.[278] In so doing, the wrongdoer breaches duties of loyalty and confidentiality, and defrauds the corporate entity of the exclusivity of the information wrongfully taken.[279]

The district court took care in noting that while the classical approach to insider trading is grounded upon a fiduciary relationship that is misused by the insider, the misappropriation theory, by comparison, turns more upon a deception perpetrated by a party entrusted with confidential information.[280] Relying upon the Supreme Court's distinctions, the *Cuban* court recognized that these two theories complement each other in policing the stock markets.[281]

Turning to the case at bar, Chief Judge Fitzwater found that it was the theory of misappropriation that was "at the heart of the present case

274. *Id*. at 720 (citing United States v. O'Hagan, 521 U.S. 642, 651-52 (1997)).
275. *Id*. at 720 (citing Chiarella v. United States, 445 U.S. 222, 228 (1980)).
276. *Id*.
277. *Id*. at 720 (citing *O'Hagan*, 521 U.S. at 652).
278. *Id*.
279. *Id*. at 720 (citing *O'Hagan*, 521 U.S. at 652).
280. *Id*. at 720 (citing *O'Hagan*, 521 U.S. at 652).
281. *Id*. at 720 (citing *O'Hagan*, 521 U.S. at 652-53).

and Cuban's motion to dismiss."[282] The core argument of the government was that Cuban was liable pursuant to the misappropriation theory because a duty was created by his supposed agreement to keep confidential the information provided by Mamma.com's CEO.[283] That duty was breached, alleged the agency, when Cuban sold his shares without informing the corporation of his intent to act upon the information he had been given.[284]

In bringing his motion to dismiss, Cuban argued that the SEC's charges failed to establish the key element of deceptive conduct essential to a finding of liability under Rule 10b-5.[285] Cuban claimed that the bare allegation of a confidentiality agreement, without demonstrating the breach of a fiduciary relationship, is insufficient to establish wrongdoing under the misappropriation theory. Furthermore, Cuban maintained that the existence, if any, of such a fiduciary relationship had to be measured by state law, and in that task the government had failed to meet its burden.[286]

Chief Judge Fitzwater first declared that his decision on Cuban's arguments would turn upon the validity of the defendant's contentions regarding misappropriation liability (to wit, that no liability could be imposed absent a fiduciary duty). With that understanding, the district court made the resolution of that issue its first order of business.[287]

Cuban argued that the determination of the existence of a fiduciary duty was exclusively a question of state law (in this instance, Texas law). Indeed, the defendant called upon Chief Judge Fitzwater's own unreported opinion from nearly twenty years prior, *Southwest Realty, Ltd. v. Daseke*,[288] in support of his contention.[289] Furthermore, Cuban asserted that if the trial court veered from this sole reliance upon state law, it would violate the general proposition against the creation of federal common law, even in the highly federalized realm of securities

282. *Id*. at 720-21.
283. *Id*. at 721.
284. *Id*.
285. *Id*.
286. *Id*. Cuban made additional arguments about the misapplication of subparts of Rule 10b-5 as against him, and that the Commission exceeding its rulemaking authority in promulgating certain of these provisions. *Id*.
287. *Id*. at 721.
288. No. CA3-89-3055-D, 1992 WL 373166, at *9-10 (N.D. Tex. May 21, 1992).
289. *Cuban*, 634 F. Supp. 2d at 721.

regulation.[290]

The SEC's opposing argument was that exclusive reliance upon state law to find a fiduciary duty sufficient to support misappropriation theory liability was unprecedented in prior federal court decisions. Further, the adoption of a state-by-state standard would "balkanize the misappropriation theory and lead to divergent outcomes," driven by different underpinnings of state law, notwithstanding the clear policy of a national scheme of federal securities law.[291]

Here, the court issued Cuban his first setback. Chief Judge Fitzwater wholeheartedly rejected the defendant's exclusivity contention. The judge distinguished his 1992 decision as predating the Supreme Court's postulation of the misappropriation theory, and, moreover, as not being made in the context of an insider trading case.[292] His earlier decision thus distinguished, Chief Judge Fitzwater found that "the court had no occasion to hold that state law regarding fiduciary or similar relationships was the only source of a duty to support liability under this [misappropriation] theory."[293] To the contrary, the Chief Judge continued, although the source of an underlying fiduciary duty "*can* be found in state law,"[294] — for example, the *O'Hagan* situation involving attorney-client confidentiality — "it may be located elsewhere," and without running afoul of the general prohibition against creating general federal common law.[295] Relating this further to the SEC's rulemaking powers, the court also held that agency regulations promulgated pursuant to a Congressional grant of authority do not constitute federal common lawmaking.[296]

In the instant case, the district judge could therefore rely upon state contract law for creating the required fiduciary duty. Thus, the eventual holding disapproved of the defendant's contention that misappropriation theory liability could only spring from a preexisting fiduciary

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290. *Id*. at 721 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478-90 (1977)).

291. *Id*. at 721-22.

292. *Id*. at 722 (quoting *Sw. Realty*, 1992 WL 373166, at *10). Chief Judge Fitzwater clarified that his *Southwest Realty* decision opined upon the duty of disclosure being grounded in the state law of fiduciary duty, not sourced in federal securities law. *Id*. at 722 (quoting *Sw. Realty*, 1992 WL 373166, at *10).

293. *Id*.

294. *Id*. (emphasis in the original).

295. *Id*. (citing United States v. O'Hagan, 521 U.S. 642, 652-53 (1997)).

296. *Id*.

relationship.[297]

Next the bench turned to the crux of the case, addressing whether misappropriation liability can be based upon a legal duty arising via agreement, and if so, what such an agreement would need to be comprised of.[298] The Chief Judge first noted that the seminal holding in *Chiarella* turned upon finding the requisite element of deception only if there was an underlying duty of disclosure.[299] According to the judge, such a duty is not general in nature, but rather must arise from a specific relationship between the relevant parties.[300] Indeed, Chief Judge Fitzwater observed that *Chiarella* "unequivocally rejects a 'parity-of-information' principle," under which a disclosure duty would arise based on the mere possession of material, nonpublic information.[301]

As could be expected, *Cuban* concluded that in *O'Hagan*, like *Chiarella*, the Supreme Court incorporated the element of deception in formulating the misappropriation theory.[302] The three keys emphasized by the Justices in *O'Hagan* were: 1) that the material, nonpublic information belongs to the source; 2) that the wrongdoer breaches a duty to keep the source's proprietary information confidential; and 3) that the wrongdoer seeks personal profit by this breach of trust.[303] As now characterized by the district court, "[u]nder the misappropriation theory of insider trading, the deception flows from the undisclosed, duplicitous nature of the breach."[304] Chief Judge Fitzwater noted that "*O'Hagan* states unmistakably" that it is the duplicity via secrecy that is a central tenet of the misappropriation theory. Conversely, liability thereunder does not attach if the transactor declares his intention to put the confidential information to use. "[D]eception inheres in the undisclosed use of information," concluded Fitzwater in *Cuban*.[305]

The district court drew from the foregoing the following conclusion of law: "trading on the basis of material, nonpublic information cannot be deceptive unless the trader is under a legal duty to refrain from

297. *Id*.
298. *Id*.
299. *Id*. at 722-23.
300. *Id*. at 723.
301. *Id*. (citing Chiarella v. United States, 445 U.S. 222, 233 (1980)).
302. *Id*.
303. *Id*.
304. *Id*.
305. *Id*. at 724.

trading on or otherwise using it for personal benefit."[306] Certainly, a fiduciary relationship gives rise to such an obligation, observed Chief Judge Fitzwater.[307]

However, and of great import, the court had no difficulty in ruling that "a duty analogous" to a fiduciary duty can arise by agreement. Indeed, the Chief District Judge found this additional avenue fully comported with *Chiarella*'s instructions.[308] Notably, the court contended that this "confidentiality by agreement" might even reside on stronger grounds than confidentiality conceived in a fiduciary duty. The latter "flows more generally from the nature of the parties' relationship," whereas the former is premised upon "terms created by [their] own agreement rather than triggered merely by operation of law."[309] But what kind of agreement could give rise to such a constraint upon a party's ability to trade the stock he possesses material, nonpublic information about? Chief Judge Fitzwater was explicit in finding that such an agreement "must consist of more than an express or implied promise merely to keep information confidential."[310] Specifically, the *Cuban* opinion declared that the agreement must impose a legal duty to refrain from trading or otherwise acting for personal gain upon the recipient of the nonpublic information.[311] To be sure, nondisclosure and non-use "are logically distinct." In similar terms, receiving nonpublic information and keeping it that way is one thing – using it for personal benefit is another.[312]

Chief Judge Fitzwater next moved on to the linchpin of his reasoning, declaring that for misappropriation theory liability to be predicated upon an agreement, the understanding must include both the obligation to maintain confidentiality and a promise "not to trade on or otherwise use" the information gained from that confidence (the agreement on both points must be express or implied).[313]

Crucial to its holding, the court further declared that "[a]bsent a duty not to use the information for personal benefit, there is no

306. *Id*.
307. *Id*.
308. *Id*. at 724-25.
309. *Id*. at 725.
310. *Id*.
311. *Id*.
312. *Id*.
313. *Id*.

deception in doing so."[314] Continuing in that line of reasoning, it follows that there can be no deception from the unilateral and/or subjective belief of one side.[315] The sides must have a meeting of the minds that the one so blessed with this nonpublic information will not trade the stock on that knowledge.[316]

Furthermore, Chief Judge Fitzwater offered an additional ground on which to buttress his reasoning. The misappropriation theory, he explained, is designed to assure market integrity by deterring wrongdoers who would exploit their access to nonpublic information for personal profit.[317] That integrity is safeguarded when duties of nondisclosure and nonuse, which arise via agreement, are as vigorously enforced as those which flow from a fiduciary relationship.[318]

Next the court turned to the penultimate question raised by Cuban's motion to dismiss, and addressed whether the SEC adequately alleged that the defendant had entered into an agreement sufficient to create the duty that was the necessary prerequisite to establish misappropriation theory liability.[319] Certainly, state common law could impose such a duty – assuming that Cuban and the corporation did in fact enter into an agreement, express or implied, that the former would refrain from disclosing the pendency of the PIPE offering, and that they had further stipulated that he would refrain from trading on that information.[320]

Ultimately, the district court concluded that the government's complaint failed in that task.[321] In a brief but intensely factual analysis, Chief Judge Fitzwater took note of the precise words that the SEC alleged Cuban spoke in his crucial conversation with Mamma.com's CEO.[322] Cuban agreed to keep the information confidential, but he did not agree, overtly or implicitly, to refrain from trading or otherwise employing the information for personal gain.[323] Nevertheless, the failure to allege this key point was the fatal flaw in the Commission's

314. *Id*.
315. *Id*.
316. *Id*.; *see also* United States. v. Chestman, 947 F.2d 551, 570 (2d Cir. 1991).
317. *Id*. at 727 (citing United States v. O'Hagan, 521 U.S. 642, 653 (1997)).
318. *Id*. at 727.
319. *Id*.
320. *Id*. (emphasis in original).
321. *Id*.
322. *Id*. at 728.
323. *Id*. at 717.

pleading.[324]

Furthermore, Chief Judge Fitzwater found that Cuban's declaration that he was "screwed" and could not sell was a remonstration that "appears to express his belief . . . however, [it] cannot reasonably be understood as an agreement" to not to sell his shares.[325] More to that point, the court found the complaint bereft of any additional facts "that reasonably suggest that the CEO intended to obtain from Cuban an agreement to refrain from trading . . . as opposed to an agreement merely to keep [the information] confidential."[326]

Notably, the court wholly rejected any notion that the allegations concerning the subjective beliefs of Mamma.com's chairman could suffice to prevent dismissal of the complaint, repeating the earlier postulation that, outside an actual fiduciary relationship, a "mere unilateral expectation" of the source would never suffice to gel into a valid pact to abstain from trading on the information bestowed by the source upon the recipient.[327] In effect, *sans* agreement translated into *sans* liability under the misappropriation theory.[328] With that, the district court reached its ultimate holding on the shortcoming of the SEC's complaint against Cuban.[329]

Chief Judge Fitzwater then turned to further arguments pertaining to the government's reliance upon Rule 10b-5-2(b)(1) to impose a cognizable duty upon Cuban. The court immediately noted that the Commission's rulemaking authority with regard to its antifraud provisos is strictly delimited to prohibiting "conduct that is manipulative or deceptive."[330] The SEC cannot, by administrative fiat, make unlawful any conduct that does not fall into one of these categories.[331] As such, and harkening back to the necessary components of an underlying agreement between the relevant parties, the court declared that the agency cannot, by rulemaking, impose liability where an agreement lacks the vital element of a promise to refrain from trading.[332] Again the

324. *Id*.
325. *Id*.
326. *Id*.
327. *Id*.
328. *Id*.
329. *Id*.
330. *Id*.
331. *Id*. (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997)).
332. *Id*. at 728-29.

court found "it is the undisclosed use of such information . . . that makes the conduct deceptive under § 10(b) and Rule 10b-5."[333]

As is proper, the Chief Judge first examined the Rule's plain meaning.[334] After extensively parsing both the canons of the plain meaning doctrine and the Rule itself,[335] the court revealed the provision's irredeemable flaw.[336] According to Chief Judge Fitzwater, the Rule incorrectly attempts to base misappropriation theory liability upon an agreement that lacks the essential obligation not to trade. The text of the Rule works to preserve confidentiality, but otherwise fails to require an agreement to refrain from trading.[337] Again taking great care to parse the dense text of the Rule, the Chief Judge nevertheless returned unchanged to his central thesis, that the omission of a nonuse element from the Rule rendered it unable to establish liability pursuant to the misappropriation theory.[338] To permit liability otherwise would allow the regulators to exceed their administrative rulemaking powers, particularly as to proscribing deceptive conduct.[339] Once more, the court came to the final conclusion that misappropriation theory liability comes from a deception stemming from the undisclosed use of confidential information to trade a stock for personal gain.[340]

Arriving at his final disposition of the case at hand, the Chief Judge dismissed the SEC's complaint against the defendant, on the ground that the Commission had failed to allege that Cuban agreed not to trade his Mamma.com shares, and that the agency could not rely upon Rule 10b-5-2(b)(1) as a basis for the imposition of liability. As is typical in granting a motion for a Rule 12(b)(6) dismissal, the court granted the SEC a limited time in which to file an amended complaint.[341] Surprisingly, the agency did not avail itself of this usual option. Instead, it decided to appeal, and that tale follows immediately below.

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333. *Id*. at 729.
334. *Id*.
335. *Id*. at 729-30.
336. *Id*. at 730.
337. *Id*.
338. *Id*. at 730-31.
339. *Id*. at 731.
340. *Id*.
341. *Id*.

B. A REVERSAL OF FORTUNE: *CUBAN* IN THE FIFTH CIRCUIT

Mark Cuban's victory in the Northern District of Texas was short-lived. A panel of the U.S. Court of Appeals for the Fifth Circuit, sitting in New Orleans, summarily reversed the court below, reinstated the SEC's action, and, most importantly, insisted upon the commencement of discovery.[342] This appellate decision is worthy of close examination. Whether it survives such scrutiny is yet another open question.

Given our recounting above, of District Judge Fitzwater's detailed factual analysis, we need not waste words as to the portions thereof repeated by the Fifth Circuit. Writing for the panel, Circuit Judge Patrick E. Higginbotham[343] opened by characterizing the instant case as "rais[ing] questions as to the scope of liability under the misappropriation theory of insider trading." Not one for holding the audience in suspense, the eminent jurist immediately declared that the Fifth Circuit was "[t]aking a different view from our able district court brother," overturning the dismissal and directing that the reinstated case "must proceed to discovery."[344]

Denominating as the SEC's "core allegation" that Cuban received confidential information and then bound himself in an agreement to abstain from trading, the tribunal swiftly noted that the court below rejected the agency's contention, finding instead that, "at most," the government's complaint alleged the existence of a confidentiality agreement, but not an agreement that Cuban would not transact in his shares.[345] The Fifth Circuit then articulated the standard of review to be employed – *de novo* – taking all well pleaded facts as true, and viewing

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

343. The other panelists were Circuit Judges Carolyn Dineen King and Emilio M. Garza. As is commonly known, both Judges Higgenbotham and Garza have, at various times, been considered strong contenders for elevation to the United States Supreme Court (Judge Garza in particular by recent administrations). *See* "Who Is Emilio M. Garza," (October 2005), http://abcnews.go.com/Politics/SupremeCourt/story?id=1257663 (discussing consideration of Judge Garza for the Supreme Court by the first Bush administration); *see also* Linda Greenhouse, *Vacancy on the Court; Brennan, Key Liberal, Quits Supreme Court, Battle for Seat Likely*, N.Y. TIMES, July 21, 1990, at A1 (discussing consideration of Judge Higginbotham for the Supreme Court by the first Bush administration).

344. *Cuban*, 620 F.3d at 552.

345. *Id*. at 552.

them in a light most favorable to the complainant.[346]

Judge Higginbotham then posited the "complementary theories" of the law of insider trading at issue here, that of the "classical theory" and the countervailing "misappropriation theory."[347] Following a quick summary of the former, the court made the observation that there are "at least two important variations of the classical theory."[348] The first is the assumption of the role of a "temporary insider" by a nominal outsider, such as an accountant, lawyer or other professional entrusted with the entity's confidences.[349] The other is the nefarious "tipper/tippee" scenario, wherein the recipient of the nonpublic information inherits the insider's duty to disclose or abstain from trading.[350] Each of these "twists," to use the court's term, on the classical theory is firmly grounded upon the insider's obligations to the corporation.[351]

This distinguishes the above variations from the thesis behind the misappropriation school of thought, first adopted by the Justices in *O'Hagan*.[352] Referring to that landmark, the Fifth Circuit reminds that the Supreme Court held therein that there is no generic duty between all market participants to abstain from trading when in possession of material, nonpublic information, rather, trading becomes violative when there is a breach of duty owed to the source of the data.[353]

The Fifth Circuit emphasized that that Supreme Court "did not set the contours of a relationship of trust and confidence" central to finding misappropriation liability.[354] Nonetheless, the tribunal found itself tasked with determining whether or not Cuban was in such a relationship here. In endeavoring to do so, the panel diverged from the court below in reading the complaint.[355]

The tribunal duly noted the contention that Mamma.com's CEO was instructed to convey to Cuban that the news he was about to hear

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346. *Id*. at 553 (footnotes omitted). *See* FED. R. CIV. P. 12(b)(6).

347. *Cuban*, 620 F.3d at 553. (citing United States v. O'Hagan, 521 U.S. 642, 654 (1997), United States v. Chiarella, 588 F.2d 1358 (2d Cir. 1978)).

348. *Cuban*, 620 F.3d at 554.

349. *Id*. at n.14 (citing Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983)).

350. *Id*. at 555-56.

351. *Id*. at 554.

352. *Id*. at 556-57 (citing *O'Hagan*, 521 U.S. 642).

353. *Id*.

354. *Id*. at 555.

355. *Id*. at 557. As point in fact, the Fifth Circuit explicitly noted that its differing interpretation of the SEC's complaint relieved it of addressing the additional issues of the validity of Rule 10b-5-(2)(b)(1). *Id*.

was confidential, which led, to the defendant's putative "[w]ell, now I'm screwed" malediction. Furthermore, the Fifth Circuit took cognizance of the allegation of the corporation's chairman that management anticipated Cuban would be greatly angered after hearing of the contemplated PIPE deal, and thus they were unsurprised when he said he would dump his holdings.[356]

Here the panel shifted focus. It honed in on Cuban's subsequent telephone conversation with the corporation's investment banker, where, in a supposed eight minute call, Cuban was given more detail on the anticipated PIPE offering.[357] The Fifth Circuit then declared that "[i]t is a plausible inference that Cuban learned the off-market prices available to him and other PIPE participants."[358] And as we know, Cuban thereafter ordered his broker to sell off all his Mamma.com shares. That call allegedly came a single minute after Cuban ended his call with the corporation's banker.[359] Interestingly, the Fifth Circuit also referred to the content of an email sent the next day by the corporation's chairman to its board, wherein that gentleman implied that Cuban was prohibiting from selling his stock until after the PIPE was publicly announced.[360]

Emphasizing those distinguishing marks, and reading the complaint in the light most favorable to the government, the tribunal drew its own conclusions. Specifically taking the "[w]ell, now I'm screwed" exclamation in isolation, the Fifth Circuit held that such an utterance "can plausibly be read" as evidence that Cuban believed he was indeed prohibited from selling his shares, but he in fact did not agree to do so.[361] However, the court continued, that all changed when Cuban learned the details of the upcoming PIPE transaction from the company's investment banker – "Cuban requested the terms and conditions of the offering. . ..[and] [o]nly after Cuban reached out to obtain this additional information" did he order the liquidation of his stake.[362]

Judge Higginbotham then wrote that, "taken in their entirety," the combined weight of these allegations "provide[s] more than a plausible

356. *Id*. at 558.
357. *Id*. at 556.
358. *Id*.
359. *Id*.
360. *Id*. at 555.
361. *Id*. at 557.
362. *Id*.

basis to find" that Cuban had knowingly and willingly entered into "more than a simple confidentiality agreement."[363] It was "at least plausible . . . if only implicitly," that all concerned understood that Cuban could not act upon the more detailed information newly gained.[364] Significantly, the Fifth Circuit held that it would need additional facts in order to conclude that "the parties could not plausibly have reached this shared understanding," that is, Cuban was prohibited from trading.[365]

The panel now extended this thinking even further, and characterized Cuban's supposed "keep confidential but free to sell" mindset as "in effect providing him an exclusive license to trade on the material, nonpublic information."[366] And in a final blow, Judge Higgenbotham speculated that "perhaps Cuban mislead the CEO . . . in order to obtain a confidential look at the details of the PIPE," but then swiftly added that on this "factually sparse record" there was an evenhanded plausibility that each and every player knew that trading was forbidden before the stock offering was publicly announced.[367]

In contradistinction, the circuit court noted only parenthetically Cuban's countervailing allegation that Mamma.com's managers deliberately forced information upon him, because they knew the PIPE was oversubscribed and it was their plan to thwart him from taking independent action.[368] The court declined to express an opinion on this dispute, on the grounds that procedure compelled a reading of all such controversies in favor of the government, as the party at risk of dismissal.[369]

In conclusion, the Fifth Circuit returned to one of the fundamental propositions behind its reversal of the district Court – that there is a "paucity" of jurisprudence on what constitutes a relationship of trust and confidence that must first exist for there to be liability pursuant to the

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363. *Id*.

364. *Id*.

365. *Id*.

366. *Id*. at 557.

367. *Id*.

368. *Id*. at 558 n.37

369. *Id*. Another diversion, albeit also footnoted, was mention of the "serious tipper/tippee liability" that would attach if Mamma.com's CEO had deliberately provided Cuban with a trading advantage in order to curry favor. To be sure, the panel said it was of course not suggesting any such impropriety, but justified this *non sequitur* as "simply reinforcing the plausibility" of any interpretation of the allegations that Cuban knew he was prohibited from trading. *Id*. at 558 n.38.

misappropriation theory.[370] Embellishing the same with the finding that such inquiries are by necessity fact-intensive, the tribunal declined to "place [its] thumb on the scale" of such determinations, leaving that task to the district court in the first instance.[371]

Furthermore, the circuit court would not now draw the boundaries of what liability might attach until such fact-finding was complete. Given that decision to abstain from delineating the relevant bounds of the law, the Fifth Circuit vacated the lower court's judgment of dismissal, and remanded to the district court for further proceedings – again with the explicit command that discovery must proceed on those precise issues.[372]

C. Reflections on *Cuban*

For now, Mark Cuban has been dealt a setback. While the district court's dismissal of the government's charges awarded him the initial victory, the Fifth Circuit's reversal reinstates the complaint, and allows the prosecutors to proceed. Still, this most recent development is by no means the last word.

At this stage, the appellate court has explicitly demanded discovery. What that discovery shall yield is, as of yet, uncertain. At least in one respect, it does not look promising for the SEC. It is hard to imagine what subset of allegations is still discoverable, and which allegations the agency did not incorporate into its pleading the first time. Given the relatively compressed sequence of relevant events, what could there be to add? This might explain why the regulators were so dead set on appealing the lower court's dismissal, rather than taking the easier road that was so explicitly offered by the district judge, that of filing a revised complaint. It could very well be that this is all the Commission has, thus explicating its rationale for fighting so doggedly for the right to proceed with its original complaint.

Viewed in other ways, the putative defendant had to have some expectation of a similar outcome. Cuban's first victory was conditional, as the SEC had a right to replead. Therefore, at a minimum, he logically had to anticipate that another run would be taken at him by the

370. *Id*. at 558.
371. *Id*.
372. *Id*.

prosecutors, in the form of an enhanced complaint. That being said, the surprise is not that there is an extant complaint against Cuban, rather, it is that the original pleading was resuscitated, instead of being replaced altogether. Moreover, as previously mentioned, if the upcoming discovery turns out to be as paltry as we might believe, then the SEC has already played its best hand, and is highly unlikely to have an ace up its regulatory sleeve.[373] Furthermore, the circuit court's reversal was clearly accommodating of further motion practice below, short of trial, most especially a prayer for summary judgment. Once discovery is had, the opposing sides may find themselves in the same position they previously occupied before Chief District Judge Fitzwater – that is, with Cuban the victor, and the Commission licking its wounds. In sum, Mr. Cuban may not have a great deal to worry about just yet. Taking any or all of the above, there are a number of conceivable outcomes that will award victory to Cuban. However, we have saved the best for last.

Supreme Court review could be the ultimate result for the parties, and at the same time potentially establish the 21st Century's first precedent on the law of insider trading. From the outset, Chief District Judge Fitzwater's decision can be viewed as far more consonant with the holdings of *Chiarella*, *Dirks*, and *O'Hagan*, in taking a more principled and cautious view of the scope of Section 10(b) and Rule 10b-5. In sharp counterpoise, we see the Fifth Circuit's holding to be more expansive in its application of the last three decades of precedents, and thus somewhat more adventuresome and therefore disturbing. For the present, we leave the reader with this overview and return to it in greater detail later. Having brought these cases to the present day, we turn now to our analysis of the state of the law of insider trading.

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373. Not surprisingly, Mr. Cuban and the SEC are proving to be just as litigious over discovery as they are over the substantive aspects of this matter. *See* Thom Weidlich, *Mark Cuban Wins Access to Documents in Feud With SEC*, BUSINESSWEEK, Sept. 22, 2010, http://www.businessweek.com/news/2010-09-22/mark-cuban-wins-access-to-documents-in-feud-with-sec.html. *See also* Cuban v. SEC (09-cv-00996) (D.D.C. (memo op.) (September 22, 2010) (Walton, J.), *available at* http://docs.justia.com/cases/federal/district-courts/district-of-columbia/dcdce/1:2009cv00996/136856/27/.

VIII. ANALYSIS & COMMENTARY

A. THE AXIOMS OF THE LAW OF INSIDER TRADING

We now arrive at our analysis of all that has come before, a seemingly daunting task. Thankfully, the Supreme Court's jurisprudence on the matter of insider trading holds clear and consistent threads of reasoning that has produced certain themes over the years.

First, for decades the Justices have consistently struck a theme of focusing on the *limitations* of Section 10(b) liability, while concurrently delimiting the statute's offspring, Rule 10(b)-5. The pronouncements of the Court are legion, declaring time and again that the courts are bound to apply the text of the relevant provision only, and adamantly refusing to venture beyond its plain wording. Firm in demarcating the boundaries of the originating statute, the Court is just as steadfast in restraining Rule 10(b)-5 within those same borders. Even in the newest case of *Morrison*, where the Supreme Court's prime goal was to restrict both statute and rule to transactions distinctly American in character, the Court vigorously exploited the opportunity to repeat and reaffirm the precepts of limitation (and, conversely, not expansion).

Irrefutably then, the lesson to take to the present day is that Section 10(b) liability is not lightly imposed. Its entire history speaks of lawful application only to conduct that clearly falls within the sphere of prohibition. After all, the Supreme Court has made it clear that Section 10(b) should never be construed "so broadly as to convert every common-law fraud that happens to involve securities into a violation" of the statute.[374] What falls outside that zone, while neither necessarily fair nor pleasant in the transacting of the stock market, is nonetheless free from prosecution. Indeed, this is a compelling factor to be taken into account as we analyze the evolution from *Chiarella* to the *Cuban* case today.

Second, the essence of the *Chiarella* holding, which remains as strong today as when it was decided thirty years ago, is that there must be a true fiduciary duty, and it must truly be breached, in order to incur Section 10(b) liability. *Chiarella*'s precept that fiduciary duty arises from a specific relationship between the parties continues to be

374. SEC v. Zandford, 535 U.S. 813, 820 (2002) (citing Marine Bank v. Weaver, 455 U.S. 551, 556 (1982)).

reaffirmed in the present day.[375]

Often underappreciated in *Chiarella* is the great respect the Court demonstrated for the seminal administrative decision of the SEC in *Cady, Roberts*, where the Commission grounded its original maxim with a strong deference for the corporate relationships that give rise to fundamental fiduciary duties. *Chiarella* is neither a departure nor an affront to the Commission's thinking. To be sure, it paid appropriate homage to the basic ties of fiduciary duty that bind directors, officers, and other traditional insiders to shareholders and the market. It must be remembered that the Court in *Chiarella* did not condone the defendant's actions, nor did the Justices void his conviction in a cavalier fashion. Much to the contrary, Mr. Chiarella escaped prosecution because the Court refused to venture beyond the well-defined bounds of the statute. The Court was most unwilling to stretch the law, and rightly so. And if this resulted in an ignominious defeat that nettles the regulators to this day, so be it.

Chiarella remains an unblemished cornerstone because it applied the law as written, and not as the government wished it was written. It is that theme we have taken heed of for thirty years, and should abide by even now in the wake of *Cuban*. And as for *Dirks*, we refer to it only briefly here. It is both a reaffirmation of *Chiarella* and a precursor to the next evolution of insider trading doctrine. As to the former, *Dirks* is but a continuation of *Chiarella*'s paramount inquiry as to the existence of a clear fiduciary duty. Just like *Chiarella*, *Dirks* turned back the prosecution because that essential was lacking. Once more, the Justices refused to construct a fiduciary duty where one did not already exist. As to the forthcoming evolutionary phase, the *Dirks* Court was clearly not ready for the next step, but exhibited great restraint, not to mention foresight, to await its arrival.

Third, it was the advent of *O'Hagan* that provided the timely and substantive next step in the natural growth of the law of insider trading. Indeed, *O'Hagan* more than justified the Court's patience. Just as *Chiarella* and *Dirks* had cemented the bonds of breach of fiduciary duty in the context of Section 10(b) liability, *O'Hagan* was the next and equally solid brick in the infrastructure, adding the final leg to the trilogy. *O'Hagan* represented the Court's long awaited opportunity to address the misappropriation theory of insider trading liability. And as we have thus far demonstrated, it did not squander that opportunity.

375. Skilling v. United States, 30 S. Ct. 2896, 2930 (2010).

Indeed, the Supreme Court seized the day, setting out its next, vital postulation.

Our initial perception of the central theme of *O'Hagan* is that it is rather straightforward. *O'Hagan* makes it explicit that misappropriation is a wrongful act, and subjects the malefactor to Section 10(b) liability. Indeed, in our view, few would argue that the Court equates misappropriation to outright thievery. Therefore, to misappropriate the information, confidences or secrets of another is wrong, and to exploit these stolen goods for personal gain compounds the transgression. That such malfeasance in connection with the purchase or sale of securities gives rise to Section 10(b) liability is a simple enough proposition.

But we think the foregoing analysis runs the risk of constituting an oversimplification. *O'Hagan* is in fact a much more nuanced approach to the issue. We believe the Court's conclusions go further than a simple finding that the misappropriation of material, nonpublic information gives rise to Section 10(b) liability. Sharply consistent with *Chiarella* and *Dirks*, *O'Hagan* restores the breach of a fiduciary duty as a linchpin underlying the imposition of liability. It is more than the act of misappropriation that the Court finds crucial. It is the breach of a trusted relationship, motivated above all by personal profit that the Court ultimately finds determinative.

Note that in *O'Hagan* the Justices did not cast the net far nor wide. *O'Hagan* sought to specifically ensnare those who not only misappropriated, but those who blatantly breached an unmistakable fiduciary duty in order to personally benefit. Again, the commonality of themes is struck: 1) acquisition of another's secrets; 2) breach of a duty to maintain confidentiality; and 3) personal profit-taking by breaching that solemn duty. These themes arise not only from *O'Hagan*, but its predecessors *Chiarella*, *Dirks*, and their progeny in the intervening years.

Fourth, we now impose this evolution of Section 10(b) liability upon the instant case of *Cuban*, where we find the district court's opinion better reasoned and more in line with Supreme Court precedent. Indeed, Chief Judge Fitzwater exhibited sharp awareness of the Supreme Court precedents that bound him. Take for example, how in his factual dissertation he subtly categorizes Cuban as certainly not a traditional insider in the *Cady, Roberts* mold, nor as a confidante, as found in *O'Hagan*. The implication is that the actor in *Cuban* is more closely aligned with those wrongfully accused in *Chiarella* and *Dirks*;

knowledgeable, but not truly inside.

As to the limits of Section 10(b) liability, the district court opinion in *Cuban* carefully stays within the contours mapped out by *Chiarella*, and later *Dirks*, and carefully distinguishes itself from the conduct proscribed in *O'Hagan*. The district court does not wander aimlessly outside the carefully constructed walls of Rule 10(b)-5 liability, looking for a result. Rather, it avoids all such peradventure, confining itself to asking whether the accusations made, if indeed true, fall within the purview of Section 10(b)'s prohibited conduct. Finding that they do not, Chief District Judge Fitzwater announced a result that is consistent with the statutory text, the scope of the agency rule, and Supreme Court precedent. For these reasons, we would have preferred that his finding had remained unaltered.

B. "WELL, NOW I'M SCREWED. I CAN'T SELL."

First, we ask forgiveness for highlighting the foregoing crudity. We find refuge in the unassailable fact that it is (purportedly) a direct quote of Mr. Cuban, and has already been memorialized in both the Federal Supplement 2d and the Federal Reporter 3d by the august tribunals of the Northern District of Texas and the Fifth Circuit, respectively. But emphasize it we must, for in our considered opinion, it is the proverbial "smoking gun" in the instant case, and, more to the point, this holding has massive implications for the future of the law of insider trading.

These seven words are the pivot upon which two federal courts turned, but in polar opposite directions. Chief District Judge Fitzwater interpreted them as a declarative that, at most, committed Mr. Cuban to an agreement to keep confidential what he had just learned about Mamma.com's PIPE offering. Notably, the learned district judge did not find that this excited utterance bound Mr. Cuban to any further obligation to the company, its shareholders or the market at large.

In sharp contrast, the Fifth Circuit assigned the terse expletive a wholly different interpretation, or at the very least implied as much. Writing for the panel, Circuit Judge Higginbotham subscribed to the SEC's notion that, by these few words, Mr. Cuban did in fact commit not to trade on what he had learned, and thereafter bound himself not to trade his shares evermore (or at least until the PIPE deal was made public). This is much more than the district court concluded as to what Mr. Cuban agreed to by way of his rejoinder to the company's representatives, and adds a whole new dimension to what the lower court concluded was but an implied vow to do one thing (maintain confidentiality), but not necessarily the other (abstain from trading).

We are most troubled by the Fifth Circuit's additional gloss on the putative defendant's words. Taken at face value, it is beyond cavil that Mr. Cuban's declaration, obviously made in an agitated state, certainly does not contain the words like "promise," "agree," or the like. Nor can any such words of commitment be sensibly implied from his excited retort.[376]

Certainly, we do not mean to suggest that the SEC could only prevail if Mr. Cuban made a formal or outright statement that he agreed not to trade his shares upon hearing news of the PIPE offering. We agree it would be outlandish here, and for cases in the years to come, to require the government to offer proof that an alleged wrongdoer had entered in such an overt agreement to refrain from trading. Such a notion is unfounded under our law and, if it actually became established, would do incalculable damage to the laws prohibiting insider trading. To be entirely clear, we would never advocate extending such *carte blanche* to potential stock market tricksters.

While we make clear that which is not required, we now clarify what is required of regulatory accusers in insider trading cases – that which we believe the Fifth Circuit was all too ready to find or even supply itself. Where in the choice words of Mr. Cuban do we find unequivocal words of accord, unequivocal words of understanding or unequivocal words of acquiescence? Where is there at least some semblance of the putative defendant's commitment to a certain course of action? What can even be justly implied from so few words, more than likely shouted into a telephone in a fit of frustration? Is it too much to

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376. We need not even fortify our contention by exploring the fact that Mr. Cuban has a history of making such robust, reactionary statements, very few of which are legally significant, although some of them have proven expensive. *See, e.g.*, ESPN.com NEWS, *NBA Fines Cuban $200K for Antics On, Off Court*, (May 11, 2006), http://sports.espn.go.com/nba/playoffs2006/news/story?id=2440355 (describing fine for comments made during 2006 NBA playoff series versus in-state rival San Antonio Spurs, and further noting Cuban was fined for more than $1 million by the league in his first two years as principal owner of the Dallas Mavericks); STREET & SMITH'S SPORTS BUSINESS DAILY, *NBA Fines Mark Cuban $100,000 For Comments About LeBron James*, (May 24, 2010), http://www.sportsbusinessdaily.com/article/139521 (comments about then-upcoming free agency of megastar LeBron James deemed to violate NBA anti-tampering rules).

ask the regulators, even at the pleading stage, to offer some evidence of more substantially damning words of agreement?

Regrettably, that which we humbly suggest we should find, we do not. Try as we might, we find nothing clear, nothing suggestive nor even something implying that the putative defendant made known that he would refrain from any course of action. Similarly, we find lacking any temporal element that constricted Mr. Cuban's options or the ability to change his mind as he saw fit. We would have far less of a dispute (and much less to write about) if such existed in the instant case, and the Fifth Circuit employed the same foundation for allowing the government to reinstate its complaint.

To be clear, we respectfully differ with the Fifth Circuit in the following additional aspects of its decision. While the panel unhesitatingly acknowledges the Supreme Court's remonstration that there is no generalized duty between all market participants to abstain from trading, we sense that it draws an erroneous conclusion from that principle. In *Cuban*, the opinion as cast by Judge Higginbotham utilizes the rule of "no generalized duty" as a launching point for a larger imposition of liability, without specific guidelines. We would contend, quite to the contrary, that the Supreme Court's declaration that a generic obligation does not exist compels the lower courts to impose liability only for specified actions that fall well within the boundaries of prohibited conduct.

To say that "no general duty" leads to more, not less, liability misses the mark made by the Supreme Court in the seminal insider trading cases. The jurisprudence to date is given a far more principled application when interpreted to mean that the absence of a generalized duty delimits the imposition of liability to reasonably precise and ascertainable conduct. Given the vagaries of Mr. Cuban's denouncement, would it not be a more principled verdict to find him falling within the far wider category of those without a generalized obligation not to trade in these matters?

Similar thoughts abound with regard to the Fifth Circuit's holding that *O'Hagan* and the like did not stake out the specific metes and bounds of what constitutes a relationship of trust and confidence for purposes of applying the misappropriation theory. Our difference of opinion is based upon the question of whether lacking set borders, it is wise to draw them in a case that turns upon statements unquestionably made in anger, lacking clarity of purpose, and subject to divergent interpretations. Crafting the boundaries of a "confidential relationship" in the context of Section 10(b) liability for insider trading must be an exercise in caution and circumspection.[377] We only wish the Fifth Circuit had evidenced more of these qualities in making its decision in *Cuban*.

No doubt it would be helpful for the lower courts to formulate the contours of this essential relationship, subject to the oversight of the Supreme Court. But the ambiguity of what we find here counsels restraint. The instant set of facts is far from ideal for setting a precedent on such an important issue. Again, we would suggest that not imposing liability on these contentious facts is the better outcome, as we patiently await a case more suitable for principled decision-making. In short, the Fifth Circuit declares there is a "paucity" of jurisprudence on this key question. We agree. But if so, then why the rush to resolve it today? That is a key element of our disagreement with the appellate court's recent decision.

On a more factual level, we are troubled that the Fifth Circuit seems to put a fair amount of stock in what persons other than Mr. Cuban said or thought. For example, consider the email sent by Mamma.com's chairman to its board, reporting on the interactions with the angered investor. Essentially, this is nothing but a summary, made by a corporate chieftain no doubt fully occupied with, the upcoming stock offering, placating his largest individual investor, and a multitude of other potential corporate matters. These are muddy waters to be sure, and the chair's recitation, in truth, does nothing to clarify what Mr. Cuban said, much less what he committed to. Yet the panel took due note of it, and clearly gave the email a certain amount of credence in formulating its *ratio decendi* that Mr. Cuban had somehow promised to refrain from trading.

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377. *See* United States v. Chestman, 947 F.2d 551, 570-71 (2d Cir. 1991), where the erudite Second Circuit declared that "[m]ore than a perfunctory nod at the rule of lenity, then, is required" in such instances, and further warning that "an elastic and expedient definition of confidential relations…has no place in the criminal law" aspect of section 10(b) and Rule 10b-5, lest we offend, not only the rule of lenity, but due process as well. And to set aside any doubts about the modern Supreme Court's fidelity to the rule of lenity, *see* Skilling v. United States, 130 S. Ct. 2896, 2935-36 (2010) (Scalia, J., concurring in part, and concurring in the judgment), wherein Justice Scalia called for the out and out voiding of section 1346 of title 18, the federal criminal code, the so-called "theft of honest services" prohibition, for its constitutional infirmities when cast against the rule of lenity. *See also* Anthony Michael Sabino, *The U.S. Supreme Court and Business: The Year in Review*, 25 CORP. COUNS. 1 (Oct. 2010) (analyzing *Skilling*).

Furthermore, why does the panel hypothesize, among other things, that Mr. Cuban might have been serving his own avarice by speaking to the company's investment banker, with his goal being to glean more details about the PIPE offering? That is rank speculation as to his motivations and intentions, frankly made more egregious because it is made on an admittedly weak factual record.[378] Notwithstanding that the opinion backs off those ruminations in the very next breath, we respectfully suggest that the damage is already done. We find that the mere expression of such thoughts betray an erroneous approach by the panel.

Nearing the conclusion to its decision, the tribunal candidly admits that it was confronted by a sparse record. If indeed the record was so barren, was it not the proper role of the appellate court to defer to the facts that were already found in at least some detail by the chief district judge? Should not the Fifth Circuit have stopped its inquiries right there? Was affording the government an opportunity to return with a better fortified set of allegations of conduct violative of Section 10(b) and Rule 10b-5, not Chief District Judge Fitzwater's overt purpose in dismissing *with* leave to replead?

Furthermore, the panel postulates that it will need more facts to conclude that the parties "could not plausibly have reached this shared understanding" that Mr. Cuban had agreed not to trade in his shares. Yet is this not seeking to prove a negative? We might be misreading this, but quite possibly we are interpreting the court's intentions precisely. If the latter, we are deeply troubled that the tribunal demands facts to prove that an agreement did not exist between these actors.

In our considered view, all the above leads to this salient point – the Fifth Circuit steadfastly refused to find the lower court's interpretations to provide reasonably plausible explanations of the actions of Mr. Cuban. It insists that the search continue for an explication that it will deem reasonable and plausible, and then takes quite a bit of time to speculate on what it will find acceptable.

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378. Mr. Cuban must indeed be feeling persecuted these days. Most recently, he was mentioned, but *not* accused of any wrongdoing, for selling his 5.4% stake in Lions Gate Entertainment Corp. to fellow billionaire (and takeover artist *deluxe*) Carl Icahn, as part of Icahn's ongoing battle for control of movie studio Lions Gate and the legendary Metro-Goldwyn-Mayer Inc. ("MGM") studios. *Icahn Accused in Lions Gate Suit of Plotting Merger*, MONEY NEWS, (Oct. 29, 2010), http://www.moneynews.com/FinanceNews/Icahn-Lions-Gate-Plotting-Merger/2010/10/29/id/375269. In addition, the iconic MGM recently filed for Chapter 11 bankruptcy.

Why does this tribunal stand fast against bestowing the status of reasonable plausibility to the conclusions reached by its distinguished brethren below? What else does it want? And is it fair to hypothesize again and again as to what it might deem passes muster? We find all of this difficult to deal with, especially in the context of principled decision-making in the contorted matter of insider trading liability.

To be sure, we comprehend that discovery may resolve our doubts in this matter, and that is, at least in part, a proper justification for the appellate bench to return the controversy to the lower court. Nonetheless, we find it troubling that the Fifth Circuit would reverse the district court's dismissal on its contrary view of such *de minimis* evidence as Mr. Cuban's ill-advised seven words.

Again, in our view the better outcome would have been to affirm the dismissal, and compel the government to tread the path originally offered by Chief District Judge Fitzwater, that of repleading the complaint, and returning to the trial court upon a firmer footing.

We are troubled that the Fifth Circuit made a far more permissive holding as to the government's burden. The appeals court read more into those seven words, a great deal more, and, we respectfully contend, without just cause. In doing so, not only did the tribunal authorize the government to reinstitute this proceeding, but its expansive view of the requirements to sustain a Section 10(b) case flies in the face of the far more constrained view of insider trading prosecutions that the Supreme Court has long imposed.

We respectfully believe that in order to sustain this or any future prosecution for insider trading, the SEC should surmount a higher bar than the circuit court has set here. We assert that, this has been the mandate of the Supreme Court since 1980 with the promulgation of *Chiarella*, and little or no retreat from the standard so established some thirty years ago. But now the Fifth Circuit has transformed the prerequisites of a Section 10(b) prosecution into something far less demanding of the government, a result with which we respectfully cannot agree.

To be sure, we are not quibbling over mere semantics with regard to the putative defendant's comments, which are so central to the prosecution here. We would not demean the law by playing word games with Section 10(b) nor its companion Rule 10b-5 – without argument the two most vital tools in vigorous securities law enforcement. But far more is at stake here.

C. THE LAW AS IT MUST BE

Having catalogued above our manifold complaints as to how the Fifth Circuit adopted, what we contend to be, a distorted view of the facts as pleaded by the government in *Cuban*, and thereafter intensified said distortion with an equally myopic view of the law, we must conclude by focusing, with vigor, on that panel's interpretation (or, better said, *misinterpretation*) of the bedrock cases defining liability for insider trading

First, examining the seminal decision of *Chiarella*, it is our opinion that the Fifth Circuit did not take heed of the Supreme Court's admonition that not everyone is a fiduciary who is thus prohibited from trading when knowledgeable about a certain corporate stock. As the Court set out in *Chiarella*, and has harkened back to again and again in the thirty years since, mere possession of material, nonpublic information is not egregious, and, depending upon the actor, acting upon that knowledge is not necessarily violative of the law.

Second, we apply the lessons of *Dirks* to the instant case of *Cuban*. Dirks rightfully avoided sanction because, in part, there was nothing improper as to how he was provided with the material, nonpublic information that he later disseminated. We respectfully contend that the tribunal failed to give credit in *Cuban* for that same circumstance. Both of the accused in the respective cases were voluntarily informed by others and they did not seek out the knowledge (we limit ourselves to the initial revelations voluntarily made to Dirks). Then why did the Fifth Circuit not render in *Cuban* the same protection thus afforded to the defendant by the Supreme Court in *Dirks*? That is indeed a troublesome difference.

Third, and conceivably of tremendous import for today and the days to come, why did the Fifth Circuit in *Cuban* apparently not heed the robust warning of the dangers of unbridled prosecutorial power enunciated in *Dirks*? The *Dirks* Court decried the hazard of loosely applied statutory prohibitions, and the damage they could wreak in the hands of an overzealous government. For that reason, the Court explicitly rejected the SEC's approach in that case. Why was this stern caution not given greater respect by the *Cuban* panel? And would not such deference to the prosecution in the Fifth Circuit lead to further appeasement to government power in the First Circuit, the Second Circuit, and *seriatim*, until the safeguards against regulatory overreaching posited by *Dirks* are as easily circumvented as the Maginot

Line?

Fourth, and consonant with the above, the Justices in *Dirks* heavily emphasized that Section 10(b) liability can only be rightfully judged on "objective criteria." We find the SEC's case in *Cuban* to be fatally flawed, precisely because it cannot meet this absolute prerequisite. The regulators bet everything on the perception of Mr. Cuban's memorable telephonic utterances. The evidence proffered by the Commission defies objective measurement – quite to the contrary, it is very subjective evidence, open to vastly differing interpretations.

But such missteps do not stop with the regulators in the case at bar. The Fifth Circuit gave credence to, among other things, what Chief District Judge Fitzwater explicitly characterized as the *subjective* belief of Mamma.com's chairman in that individual's interactions with the accused. Yet *Dirks* does not merely ask, it *commands* the lower courts to consider the *objective* facts presented by the prosecution. To us, the Fifth Circuit's failure to observe this edict does violence to the very basic requirements mandated by the Supreme Court in insider trading cases.

Unfortunately, this is not a flaw easily remedied. The failure to apply the bright line tests for insider trading liability, as mandated by the Supreme Court for decades, leads to the unavoidable and equally undesirable outcome of unprincipled decision-making. *Chiarella*, and *Dirks* in particular, strove to steer the courts away from such calamities. To swerve away from such hallowed landmarks, be it now in *Cuban* or later in other cases, is folly.[379]

The paramount lesson of *Chiarella* and *Dirks*, the early and seminal

379. Momentarily playing devil's advocate, permit us to invoke *O'Hagan*, as the last component of this all-important trilogy of the law of insider trading. Note that *O'Hagan* stipulates that if the recipient of material, nonpublic information makes a full disclosure to the source of the information that the former intends to act upon what she knows, then all deception is negated, and with it all liability under section 10(b) and Rule 10b-5. *See* United States v. O'Hagan, 521 U.S. 642, 655 (1997). Now, to be very sure, we candidly admit that Cuban did not precisely disclose his intent to sell to Mamma.com's principals. Then again, the factual record as developed by Chief District Judge Fitzwater, compels us to conclude that he never promised he would *not* sell. Cuban's excited utterance that he "can't sell" is, again in our humble opinion, absolutely not equivalent to an *agreement* not to sell. *See* SEC v. Cuban, 634 F. Supp. 2d 713, 717-18, 728 (N.D. Tex. 2009). Here, we are not so sure as to where this specific point leads, but we assert is it compelling, and at least merits some attention as possibly deflating the government's case against Mr. Cuban.

cases in the field, is that the government cannot proscribe conduct at its whim. The regulators are tasked with finding violations by means of clear evidence, and pursuant to rational, principled interpretations of the controlling statute and rule made *within* their textual proscriptions, but not beyond. By ascribing a more far-ranging perspective to Mr. Cuban's excited utterances, and implicitly, the law that is being employed to judge, the Fifth Circuit has given the SEC dangerously broad latitude to prosecute on evidence that is flimsy at best. In sum, this does not bode well for the future, in this case or for prosecutions yet to come.

IX. CONCLUSION

Insider trading is the stuff of high drama, both in real life and in fiction. It captures our attention with its high profile participants, accusations of stock market skullduggery, calls for justice by outraged prosecutors and regulators, and attention grabbing headlines when these cases reach court. While we have taken great advantage of the notoriety of these cases here, we likewise gladly return to their legal essentials because, after all, that is all that really matters.

History has proven that Section 10(b) and Rule 10(b)-5 are truly the primary weapons in the continuing fight against wrongdoing in the stock market. Nonetheless, even the most well intended weapon, if wielded unwisely, will do more harm than good. Therefore, the Supreme Court has wisely delimited the reach of these two deterrents to their strict statutory texts. In doing so, the Court has rightly kept their powers in check, so they do only justice, not harm.

Concomitantly, the Court has fashioned a set of further protections, centered mainly around the *Chiarella*, *Dirks*, and *O'Hagan* triumvirate of clarifying and enabling just decision-making. The first two properly confine Section 10(b) to actual breaches of true fiduciary duty, while the last necessarily encompasses the wrong of misappropriation and metes out well-deserved punishment. Thematic in each, is the Court's emphasis on strict statutory interpretation, reliance upon well-established boundaries of fiduciary duty, and the authorization of sanctions only when the wrongdoing fits well inside the statutory prohibition.

As we now look at today's *Cuban* case, we find ourselves in agreement with the position espoused by the district court, and concerned for the future with what the Fifth Circuit's reversal portends.

That being so, we can only hope for some corrective holding in the days to come. Looking to the future, we wonder if *Cuban* is the rightful heir to the logic and reasoning of *Chiarella*, *Dirks*, and *O'Hagan*. Will it be the extension of that trilogy or merely a misguided diversion from the law's true course? Nothing less than the future of the law of insider trading liability pursuant to Section 10(b) and Rule 10(b)-5 hangs in the balance.[380]

380. And make no mistake, there is a bright and busy future for insider trading and prosecutions of it. Preet Bharara, the U.S. Attorney for the Southern District of New York, whose district is considered the epicenter of such crime, stridently declared that insider trading is rampant on Wall Street, and his office is "devot[ing] significant resources" to eradicate it. Jonathan Dienst, *Insider Trading 'Rampant' On Wall St.: U.S. Attorney*, NBC NEW YORK, (Oct. 21, 2010), *available at* http://www.nbcnewyork.com/news/local/Insider-Trading-Rampant-On-Wall-St-US-Attorney-105399138.html. As this Article went to press, the government had launched an all-out offensive against alleged insider trading, raiding hedge fund offices. *See* Patricia Hurtado & Saijel Kishan, *Level Global, Diamondback Funds Searched by FBI Agents*, BLOOMBERG, (Nov. 22, 2010), http://www.bloomberg.com/news/2010-11-22/diamondback-capital-s-offices-in-connecticut-searched-by-fbi-agency-says.html (pursuing Wall Street traders); Adam Shell, *Crackdown on Insider Trading Enters 'New Phase*,' USA TODAY, Nov. 26, 2010, at 1B. The government even reached across the Atlantic Ocean to ensnare a former partner of a "Big Four" accounting firm for allegedly supplying material, nonpublic information about pending merger and acquisition activity of his hi-tech clients to overseas relatives for the purpose of buying up stock *sub rosa*. *See* Marcy Gordon, *Ex-Deloitte Partner Charged With Insider Trading*, USA TODAY, Dec. 1, 2010, at 2B.