CHAPTER 12A

Insider Trading

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§ 12A.01 Introduction

The crime of "insider trading" is not expressly defined by any statute. Rather, the federal prohibition on insider trading is based on judicial

interpretations of certain broad provisions of the securities laws. Southern District of New York Judge Jed S. Rakoff described the crime of insider trading as "a straightforward concept that some courts have somehow managed to complicate."[1] To understand the law of insider trading requires a close analysis of the relevant statutes and rules, as well as of the decisions of multiple courts in both the criminal and civil contexts.

The years after 2008 have been a particularly tumultuous period in insider trading prosecutions and jurisprudence. From 2009 to 2014, the U.S. Department of Justice, the Securities and Exchange Commission (the "SEC"), and, in particular, the U.S. Attorney's Office for the Southern District of New York, aggressively pursued insider trading cases. At one point in 2014, the Southern District was publicly touting its 81-0 record in insider trading cases.[2] At the same time, in fiscal year 2014 alone, the SEC brought fifty-two insider trading actions against individuals and entities.[3]

The government's aggressive pursuit of insider trading hit a roadblock, however, in December 2014, when the U.S. Court of Appeals for the Second Circuit decided *United States v. Newman*. In *Newman*, the Second Circuit introduced a more restrictive standard for certain insider trading cases.[4] The Supreme Court declined to review *Newman*, but it subsequently took up a different insider trading case from the Ninth Circuit, *Salman v. United States*.[5] In December 2016, in the Supreme Court's first insider trading opinion in nearly two decades, *Salman* overturned the key holding of *Newman*, but certain ambiguities remain.[6] The Second Circuit attempted to resolve some of those ambiguities in two separate opinions in *United States v. Martoma* but

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[1] United States v. Pinto-Thomaz, No. S2 18-CR-579 (JSR), 2018 WL 6378118 at *1 (S.D.N.Y. Dec. 6, 2018) (Denying motion to dismiss indictment charging insider trading under Section 10(b) and Rule 10b-5).

[2] La Roche, "Preet 'The Sheriff of Wall Street' Bhara Has Finally Lost a Case," Business Insider (July 8, 2014), available at http://www.businessinsider.com/preet-bhararas-perfect-track-record-2014-7 (last visited Feb. 25, 2019); La Roche, "Here's Preet Bhara's Amazing 79-0 Insider Trading Conviction Score Card," Business Insider (Feb. 6, 2014) (listing insider trading convictions obtained by the SDNY's U.S. Attorney's Office from August 2009 to February 2014), available at http://www.businessinsider.com/bharara-insider-trading-convictions-2014-2 (last visited Feb. 25, 2019).

[3] 2014 SEC Agency Financial Report, at 22, available at https://www.sec.gov/about/secpar/secafr2014.pdf#appendix (last visited Feb. 25, 2019).

[4] United States v. Newman, 773 F.3d 438 (2d. Cir. 2014), *cert. denied* 136 S.Ct. 242, 193 L.Ed.2d 133 (2015), *abrogated by* Salman v. United States, 580 U.S. ___, 137 S.Ct. 420, 196 L.Ed.2d 351 (2016).

[5] United States v. Salman, 792 F.3d 1087 (2015), *cert. granted in part* 136 S.Ct. 899, 193 L.Ed.2d 788 (2016).

[6] See *Salman v. United States*, N. 4 *supra*, 137 S.Ct. 420.

instead created additional uncertainty.[7] Thus, even though *Salman* marked a return of sorts to pre-*Newman* insider trading law, it remains to be seen whether, post-*Salman*, the government will continue to charge the kind of cases that led to *Newman* under Section 10(b) and Rule 10b-5.[8] Instead, the government may turn to the broader securities fraud statute, Title 18, Section 1348 of the United States Code, that was enacted as part of the Sarbanes-Oxley Act of 2002, which does not require the government to prove breach of fiduciary duty or personal benefit in remote tippee cases.[9]

The stakes are high in both criminal and civil insider trading cases. In the criminal context, courts have imposed increasingly severe sanctions. In 2011, in a case in the Southern District of New York, a defendant was sentenced to eleven years' imprisonment, which remains the longest sentence ever imposed for insider trading.[10] In the civil context, even without the risk of imprisonment, the combination of injunctive relief and disgorgement of profits can amount to a significant sanction.

This chapter sets forth the current state of insider trading law. In doing so, the chapter examines the statutory basis for the federal prohibition on insider trading as well as the key cases that have outlined the contours of that prohibition—cases whose continued validity *Salman* reaffirmed. The chapter also discusses relevant SEC rules, potential penalties, the availability of a private right of action, and possible future legislation.

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[7] United States v. Martoma, 894 F.3d 64 (2d Cir. 2018) (*Martoma II*), *cert. denied* 139 S.Ct. 2665 (June 3, 2019); United States v. Martoma, 869 F.3d 58 (2d Cir. 2017), *amended and superseded by* 894 F.3d 64 (2018) (*Martoma I*). See also: Jacobs, "How Institutional Dynamics Have Shaped Insider Trading Law," 51 Rev. of Securities and Commodities Regulation 247, 251 (Nov. 21, 2018), available at https://www.maglaw.com/publications/articles/2018-11-21-how-institutional-dynamics-have-shaped-insider-trading-law (last visited Sept. 19, 2019); Jacobs and Raghavan, "The Impact of *Salman v. United States* on Downstream Tippee Prosecutions," 50 Rev. of Securities and Commodities Regulation 223 (Nov. 8, 2017), available at https://www.maglaw.com/publications/articles/2017-11-08-the-impact-of-salman-v-united-states-on-downstream-tippee-prosecutions (last visited Sept. 19, 2019).

[8] 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

[9] 18 U.S.C. § 1348; United States v. Blaszczak, 947 F.3d 19 (2d Cir. 2019). See § 12A.02 *infra* for a discussion of 18 U.S.C. § 1348.

[10] United States v. Rajaratnam, 719 F.3d 139, 150-151 (2d Cir. 2013); Pulliam and Bray, "Trader Draws Record Sentence: Rajaratnam Slapped With 11-Year Prison Term for Orchestrating Insider Scheme," Wall Street Journal (Oct. 14, 2011), available at https://www.wsj.com/articles/SB10001424052970203914304576627191081876286 (last visited Feb. 25, 2019).

§ 12A.02 The Applicable Statutes and Rules

The federal prohibition on insider trading is based on a judicial interpretation of Section 10(b) of the Securities Exchange Act of 1934 (codified at Title 15, Section 78j(b) of the United States Code) and SEC Rule 10b-5.[1]

Section 10(b), designed as a "catch-all" clause to prevent fraud, prohibits the use, "in connection with the purchase or sale of any security," of "any manipulative or deceptive device or contrivance in contravention of such rules as the [SEC] may prescribe."[2]

Pursuant to Section 10(b), the SEC promulgated Rule 10b-5, which provides in relevant part:

> "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 or of any facility of any national securities exchange,
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> "(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 necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, 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."[3]

The Department of Justice also charges insider trading, albeit less frequently, under Title 18, Section 1348 of the United States Code, the

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[1] The notion that insider trading is unlawful was well established even before the passage of the Securities Exchange Act of 1934. In 1909, in *Strong v. Repide*, the Supreme Court held that a corporate insider committed fraud by purchasing company stock from an outsider without disclosing that a pending offer to purchase the company's land would increase its stock value, while also concealing his identify because his interest in the stock would have indicated to the seller that the stock value was increasing. See Strong v. Repide, 213 U.S. 419, 29 S.Ct. 521, 53 L.Ed. 853 (1909). See also, Thomsen, Director, Division of Enforcement, U.S. Securities and Exchange Commission, "Opening Remarks to the Securities Industry and Financial Markets Regulatory Symposium on Insider Trading" (May 19, 2008) ("Thomsen Speech"), available at http://www.sec.gov/news/speech/2008/spch051908lct.htm (last visited Feb. 25, 2019).

[2] Securities Exchange Act of 1934, Section 10(b), codified at 15 U.S.C. § 78j(b). See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202-206, 96 S.Ct. 1375, 1385-1387, 47 L.Ed.2d 668 (1976) (quoting congressional testimony by Thomas G. Corcoran, a spokesman for the drafters of Section 10(b)(5), that "[o]f course subsection (c) is a catch-all clause to prevent manipulative devices." Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 115 (1934)).

[3] 17 C.F.R. § 240.10b-5 (2017).

criminal securities fraud statutes enacted as part of the Sarbanes-Oxley Act of 2002.[4] Under Section 1348 it is unlawful to:

> "knowingly execute[], or attempt[] to execute, a scheme or artifice—
>
> "(1) to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security [of a public company] or
>
> "(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery, or any security [of a public company]."

The elements of a violation of Section 1348(1) are "(1) fraudulent intent, (2) a scheme or artifice to defraud, and (3) a nexus with a security"[5] making Section 1348 broader than Section 10(b) in important ways. Section 1348 does not require that a defendant violate a duty to be liable for a scheme to defraud and the fraud need only be in connection with a security rather than the purchase or sale of a security.[6]

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[4] 18 U.S.C. § 1348 is discussed in more detail in § 12.02 *supra*.

[5] United States v. Blaszczak, __ F.3d __, Nos. 18-2811, 18-2825, 18-2867, 18-2878, 2019 WL 7289753 at *8 (2d Cir. Dec. 30, 2019); United States v. Motz, 652 F. Supp.2d 284, 294 (E.D.N.Y. 2009); United States v. Mahaffy, 2006 WL 2224518 at *11 (E.D.N.Y. Aug. 2, 2006) (interpretation of 18 U.S.C. § 1348 should be guided by mail and wire fraud statutes, after which 18 U.S.C. § 1348 was modeled); United States v. Wey, 2017 WL 237651 at *9 n.6 (S.D.N.Y. Jan. 18, 2017) (same). See also: O'Malley, Grenig and Lee, Federal Jury Practice and Instructions: Criminal Companion Handbook, § 31.3(B) (2017); Abramowitz and Sack, "Back to the Future: Criminal Insider Trading Under Title 18," New York Law Journal (July 3, 2018), available at https://www.maglaw.com/publications/articles/2018-07-03-back-to-the-future-criminal-insider-trading-under-title-18 (last visited Jan. 22, 2019).

[6] See Moser and Weitz, "18 U.S.C. § 1348—A Workhorse Statute for Prosecutors," 66 DOJ J. Fed. L. and Prac. 111 (Oct. 2018), available at https://www.justice.gov/usao/page/file/1106771/download (last visited Jan. 24, 2019) (characterizing Section 1348 as an "advantageous statute for prosecutors seeking to charge complex white collar cases").

§ 12A.03 Judicial Interpretations of Section 10(b) and Rule 10b-5

Courts have interpreted Section 10(b) and Rule 10b-5 to give rise to two primary theories of insider trading liability: the "classical theory," set forth in *Chiarella v. United States* and *Dirks v. SEC*, and the "misappropriation theory," articulated in *United States v. O'Hagan.*[1] Together, *Chiarella*, *Dirks*, and *O'Hagan* form the core of insider trading jurisprudence, as *Salman v. United States* confirmed in 2016.[2]

Although the classical theory and the misappropriation theory are the "two generally accepted theories of insider trading," they are not the only theories under which the government can pursue insider trading, as Section 10(b) grants the government broad authority to pursue charges in any case involving a "deceptive device."[3]

[1]—Classical Theory

The "classical theory" prohibits a corporate insider from trading the securities of his or her corporation on the basis of material, nonpublic information.[4] The classical theory is premised on the special "relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position within that corporation."[5] This relationship "gives rise to a duty" on the part of the corporate insiders "to disclose [or abstain from trading] because of the 'necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of the uninformed minority stockholders.'"[6] When a corporate insider

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[1] Chiarella v. United States, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980); Dirks v. SEC, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983); United States v. O'Hagan, 521 U.S. 642, 650-652, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997). See also, United States v. Pinto-Thomaz, No. S2 18-CR-579 (JSR), 2018 WL 6378118 at *2 (S.D.N.Y. Dec. 6, 2018) (describing the origins of the "classical" and "misappropriation" theories of insider trading).

[2] Salman v. United States, 580 U.S. ___, 137 S.Ct. 420, 196 L.Ed.2d 351 (2016).

[3] See SEC v. Dorozhko, 574 F.3d 42, 45 (2d Cir. 2009). In Dorozhko, the Second Circuit held that, where an affirmative misrepresentation is made in connection with a securities transaction, that affirmative misrepresentation can qualify as a deceptive device even in the absence of the breach of duty that exists in classical and misappropriation insider trading cases. Dorozhko was a computer hacker who obtained insider information by unlawfully accessing a computer system and then traded on that information. The Second Circuit held that the act of computer hacking could qualify as a deceptive device, "depending on how the hacker gained access" and whether affirmative misrepresentations were made. *Id.* at 51.

[4] *Salman v. United States,* N. 2 *supra,* 137 S.Ct. at 425 n.2 (In classical theory cases, "the defendant breaches a duty to, and takes advantage of, the shareholders of his corporation").

[5] See *Chiarella v. United States*, N. 1 *supra,* 445 U.S. at 226-230 (quoting Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del 1951)).

[6] See *Chiarella v. United States*, N. 1 *supra*, 445 U.S. at 226-230.

breaches this duty to disclose and trades the corporation's securities using inside information, that trading has been interpreted to qualify as a "deceptive device" under Section 10(b).[7]

The classical theory first was recognized in *In re Cady, Roberts & Co*., in which a partner at a broker-dealer received nonpublic information about an impending dividend reduction from a colleague who also was a director of a public company.[8] The partner, knowing that that information was non-public, sold shares of that security for discretionary accounts without waiting for the information to become public.[9] The SEC found that the broker-dealer and his firm willfully violated Section 10(b), stating that

> "[a]n affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders . . . [who] must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment."[10]

The classical theory was further developed by the Supreme Court in *Chiarella v. United States*[11] and *Dirks v. SEC.*[12] In *Chiarella*, an employee of a printing company hired to print corporate takeover bids deduced material nonpublic information regarding the sale of companies and bought stock in the target companies. The lower court's jury instructions did not require that the jury find a relationship between the defendant and company stockholders giving rise to a duty to disclose or abstain from trading, and the defendant was convicted in the Southern District of New York of violating Section 10(b). His conviction was affirmed by the Second Circuit, but the Supreme Court reversed, holding that, because the printing employee did not owe a duty to disclose his knowledge to the corporate shareholders, he could not be convicted of a willful violation of Section 10(b). The Supreme Court noted: "not every instance of financial unfairness constitutes fraudulent activity under 10(b)."[13] Indeed, for insider trading to violate Section 10(b), a deception must occur, which means that the trader must either owe a fiduciary duty or assume

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[7] See *United States v. O'Hagan*, N. 1 *supra*, 521 U.S. at 652.

[8] In re Cady and Roberts & Co., 40 S.E.C. 907, 1961 WL 59902 (1961).

[9] *Id.*, 40 S.E.C. at 908-909.

[10] *Id.*, 40 S.E.C. at 911.

[11] See Chiarella v. United States, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980).

[12] See Dirks v. SEC, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983).

[13] See *Chiarella v. United States*, N. 11 *supra*, 445 U.S. at 232.

the duty of his tipper.[14]

That relationship, the Court recognized in *Chiarella*, "gives rise to a duty to disclose [or to abstain from trading] because of the 'necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders.'"[15]

In *Dirks*, the Supreme Court reaffirmed the holding in *Chiarella* that there is "no general duty to disclose before trading on material nonpublic information"; rather, the "duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market."[16] The Court also expanded insider trading liability to situations "where the insider or misappropriator in possession of material nonpublic information (the 'tipper') does not himself trade but discloses the information to an outsider (a 'tippee') who then trades on the basis of the information before it is publicly disclosed."[17] This situation gives rise to liability because, as the Supreme Court confirmed in *Salman*, "[t]he tippee acquires the tipper's duty to disclose or abstain from trading" when "the tippee knows the information was disclosed in breach of the tipper's duty" for "a personal benefit."[18] This situation—discussed in more detail below—is commonly referred to as "tipping liability," and the elements are the same in cases arising under both the classical and the misappropriation theories.[19]

In *Dirks*, a whistleblower contacted Raymond Dirks, a well-known securities analyst, to expose a fraud that the whistleblower previously had reported to regulators who failed to act. The whistleblower urged Dirks to verify and disclose the wrongdoing. Dirks investigated and uncovered a massive fraud that he discussed openly with clients and investors throughout the investigation. Neither Dirks nor his firm traded on the information but

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[14] *Id.*, 445 U.S. at 230. In *Chiarella*, the Court stated that trading on inside corporate information qualifies as a "deceptive device" under Section 10(b) because "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their positions with that corporation." See *id*., 445 U.S. at 228. See also, United States v. Corbin, 729 F. Supp.2d 607, 612 (S.D.N.Y. 2010) ("To violate §10(b) and Rule 10b-5 in the insider trading context, there must also be manipulation or deception"). (Citations and internal quotation marks omitted.)

[15] See *Chiarella v. United States*, N. 11 *supra,* 445 U.S. at 228-229. (Citations omitted.)

[16] See *Dirks v. SEC*, N. 12 *supra,* 463 U.S. at 654, 658. (Alteration in original.)

[17] United States v. Newman, 773 F.3d 438, 446 (2d. Cir. 2014), *cert. denied* 136 S.Ct. 242 (2015), *abrogated by* Salman v. United States, 137 S.Ct. 420, 196 L.Ed.2d 351 (2016) (citing *Dirks v. SEC*, N. 12 *supra*, 445 U.S. at 659).

[18] See Salman v. United States, N. 17 *supra*, 137 S.Ct. at 423.

[19] The "misappropriation" theory is described in § 12A.03[2] *infra.*

Dirks' disclosures resulted in trading by others. The SEC charged Dirks with securities fraud for aiding and abetting violations of the securities laws, which was upheld by an SEC Administrative Law Judge and affirmed by the D.C. Circuit.[20]

The Supreme Court reversed, holding that Dirks was not liable for insider trading because the tipper was motivated not by a desire to obtain a personal benefit but rather by a desire to expose the fraud.[21] Critical to the Court's holding was the fact that the corporate insider tipper had no expectation that Dirks would keep the information confidential. "Nor did [the analyst] misappropriate or illegally obtain the information."[22] The Court recognized 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 analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market."[23] The Court acknowledged that it is "commonplace for analysts to 'ferret out and analyze information,' . . . by meeting with and questioning corporate officers and others who are insiders" that is "made available in market letters or otherwise to clients of the firm" but which "cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[24]

Dirks also established that an individual who does not qualify as a traditional insider may become a "temporary insider" if by entering "into a special confidential relationship in the conduct of the business of the enterprise . . . [he is] given access to information solely for corporate purposes."[25]

[2]—Misappropriation Theory

The classical theory of insider trading does not address the situation where an individual who owes no duty to a corporation or its shareholders steals inside information and trades on it. To cover this and similar scenarios, courts have developed the "misappropriation theory" of insider trading. Under the misappropriation theory,

> "a person commits fraud 'in connection with' a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates

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[20] See Dirks v. SEC, 463 U.S. 646, 648-652, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983).

[21] *Id.,* 463 U.S. at 665-667.

[22] *Id.*, 463 U.S. at 665.

[23] *Id.*, 463 U.S. at 658.

[24] *Id.*, 463 U.S. at 658-659.

[25] *Id.*, 463 U.S. at 655 n.14.

> confidential information for securities trading purposes, in breach of a duty owed to the source of the information."[26]

The key distinction between the classical and misappropriation theories is that, under the misappropriation theory, instead of

> "premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."[27]

The misappropriation theory was endorsed by the Supreme Court in *United States v. O'Hagan*.[28] O'Hagan was a partner in a prominent law firm that represented a company interested in acquiring the Pillsbury Company. Using information acquired from the client, O'Hagan traded in Pillsbury stock and options and made millions of dollars. The Court stated that

> "[t]he misappropriation theory . . . is designed to 'protec[t] the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect th[e] corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders.'"[29]

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[26] See United States v. O'Hagan, 521 U.S. 642, 652, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997).

[27] *Id.*

[28] *Id.* In doing so, the Court noted that it had twice been presented with the misappropriation theory. *Id.*, 521 U.S. at 650 n.4. In *Chiarella*, the jury had not received instructions on the misappropriation theory, "so we declined to address the question," and "[i]n *Carpenter v. United States*, 484 U.S. 19, 24, 108 S.Ct. 316, 319-20, 98 L.Ed.2d 275 (1987), the Court divided evenly on whether, under the circumstances of that case, convictions resting on the misappropriation theory should be affirmed." *Id.*

[29] See *United States v. O'Hagan*, N. 26 *supra*, 521 U.S. at 653. (Internal citations omitted.) Notably, in *O'Hagan*, the Supreme Court also decided an issue under Section 14(e) of the Exchange Act, 15 U.S.C. § 78n(e), which prohibits fraudulent or deceptive practices in connection with any tender offer, and Rule 14e-3(a), promulgated thereunder, 17 C.F.R. § 240.14e-3(a)(1996), which prohibits trading on the basis of material nonpublic information concerning a tender offer that is known or should be known to have been acquired, directly or indirectly, from an insider of the offeror or issuer, or someone working on his behalf. The issue before the Court was whether the SEC exceeded its statutory authority in fraudulent trading. The Court noted that "it is a fair assumption that trading on the basis of material nonpublic information will often involve a breach of a duty of confidentially to the bidder or target company or their representatives." *Id.*, 521 U.S. at 676.

The Court found that

> "while there is 'no general duty between all participants in market transactions to forgo actions based on material nonpublic information,' the breach of a duty to the source of the information is sufficient to give rise to insider trading liability."[30]

The Court explained:

> "[A] fiduciary's undisclosed self-serving use of a principal's [confidential] information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[31]

Liability under the misappropriation theory is established by a showing that the defendant acted with scienter to misappropriate material nonpublic information for the purpose of securities trading in violation of a fiduciary duty.[32]

The government also prosecutes putative "tippers" under the misappropriation theory.[33] In such cases, the "government must prove as an element of the offense that the tipper conveyed material nonpublic information to his 'tippee' with the understanding that it would be used for securities trading purposes."[34]

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[30] See SEC v. Cuban, 620 F.3d 551, 555 and n.23 (5th Cir. 2010) (quoting *United States v. O'Hagan*, N. 26 *supra,* 521 U.S. at 662), and further stating "[b]cause the duty flows to the source of the information and not to shareholders, 'if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation." *Id.* (quoting *United States v. O'Hagan*, 521 U.S. at 655).

[31] See *United States v. O'Hagan*, N. 26 *supra*, 521 U.S. at 652.

[32] See:

First Circuit: SEC v. Rocklage, 470 F.3d 1, 7 (1st Cir. 2006).

Ninth Circuit: SEC v. Talbot, 530 F.3d 1085, 1092 (9th Cir. 2008) (basing Section 10(b) liability on defendant director's duty to company).

Note that under the misappropriation theory it is possible for a tippee to be prosecuted for insider trading despite the tipper's acquittal, based on the tippee's close relationship with the tipper and the tippee's knowledge that the tipper's breach was improper. See, e.g., United States v. Evans, 486 F.3d 315, 320-324 (7th Cir. 2007), *cert. denied* 552 U.S. 1050 (2007).

[33] United States v. Gansman, 657 F.3d 85 (2d. Cir. 2011).

[34] *Id.*, 657 F.3d at 92.

§ 12A.04 SEC Rules 10b5-1 and 10b5-2

In 2000, the SEC promulgated Rules 10b5-1[1] and 10b5-2[2] in an attempt to address uncertainty about insider trading law that had not been made clear by previous rules or previous court rulings.[3]

[1]—Rule 10b5-1

Rule 10b5-1 attempts to answer the question of "what, if any, causal connection must be shown between the trader's possession of insider information and his or her trading."[4] The Rule "addresses the issue of when insider trading liability arises in connection with a trader's 'use' or 'knowing possession' of material nonpublic information when the person purchases or sells securities while aware of the information."[5] The Rule essentially

> "create[s] a rebuttable presumption [that] a plaintiff makes a *prima facie* case that the defendant is liable for insider trading merely by showing that the defendant 'was *aware* of the material nonpublic information' when he made the purchase or sale of the securities."[6]

The Rule, titled "Trading 'on the basis of' material nonpublic information in

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[1] 17 C.F.R. § 240.10b5-1.

[2] 17 C.F.R. § 240.10b5-2. In the same SEC Release, the Commission also adopted Regulation FD (Fair Disclosure), 17 C.F.R. §§ 243.100-243.103, which addresses selective disclosure by new issuers.

[3] "Selective Disclosure and Insider Trading," SEC Rel. Nos. 33-7881, 34-43154, 73 SEC Docket 3, 2000 WL 1201556 (Aug. 15, 2000), available at https://www.sec.gov/rules/final/33-7881.htm (last visited Feb. 11, 2017). See United States v. Corbin, 729 F. Supp.2d 607, 618-619 (S.D.N.Y. 2010) (history of SEC issuing Rule 10b5-2).

[4] *SEC Rel. Nos. 33-7881, 34-43154*, N. 3 *supra* at *21. See United States v. Rajaratnam, 719 F.3d 139, 159 (2d. Cir. 2013) (the "knowing possession" standard is the law in the Second Circuit).

[5] See *SEC Rel. Nos. 33-7881, 34-43154*, N. 3 *supra* at *21.

[6] In Re Enron Corp. Securities Derivative & ERISA Litigation, 258 F. Supp.2d 576, 592 (S.D. Tex. 2003) (quoting Rule 10b5-1) (emphasis in original). See also, United States v. Nacchio, 573 F.3d 1062, 1072 (10th Cir. 2009) (noting in its discussion of defendant's criminal conviction pursuant to Rule 10b5-1 that "a corporate insider who trades without knowledge of material, nonpublic information is *not* committing the offense; nor is a corporate insider who has such inside information but does not trade while possessing it. Both elements—knowledge and deceptive action—are necessary to complete the offense").

insider trading cases" states in relevant part:

> "(a) . . . The 'manipulative and deceptive devices' prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b-5 . . . include . . . the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.
>
> "(b) . . . Subject to the affirmative defenses, a purchase or sale of a security of an issuer is 'on the basis of' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale."[7]

The Rule provides two affirmative defenses to permit people to trade in certain circumstances where the information was not a factor in the decisions to trade.[8] The first affirmative defense is if the trading was done in good faith pursuant to a contract or plan.[9] The second affirmative defense applies to entities that can demonstrate that the person who made the investment decision was not aware of the material nonpublic information and that the entity had implemented reasonable policies and procedures designed to prevent insider trading.[10]

Under this Rule, prior law limiting insider trading liability to traders who "used" the material nonpublic information for trading has been replaced by the lesser requirement that the trader "was aware" of the nonpublic information when the purchase or sale was made.[11] At the same time, although it eliminated

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[7] 17 C.F.R. § 240.10b5-1.

[8] See *SEC Rel. Nos. 33-7881, 34-43154*, N. 3 *supra* at *1.

[9] 17 C.F.R. § 240.10b5-1(c)(1). See, e.g., SEC v. Healthsouth Corp., 261 F. Supp.2d 1298, 1322-1323 (N.D. Ala. 2003) (SEC could not establish likelihood of success on merits of insider trading case in part because defendant exercised option pursuant to stock option plan and thus was protected by this affirmative defense). But see, SEC v. Mozilo, 2010 WL 3656068 at *20-21 and n.10 (C.D. Cal. Sept. 16, 2010) (even though the stock sales were made pursuant to a trading plan as defined by Rule 10b5-1, the SEC had raised a genuine issue of material fact with respect to defendant's scienter based on the evidence of defendant's awareness of the material nonpublic information at the time he adopted or amended the trading plans).

[10] 17 C.F.R. § 240.10b5-1(c)(2). As of the time of the publication of this Chapter, there are no case citations to this affirmative defense.

[11] See, e.g.:

any "use" requirement, Rule 10b5-1 continues to require proof of scienter.[12]

[2]—Rule 10b5-2

Following the Supreme Court's *O'Hagan* decision,[13] the SEC promulgated Rule 10b5-2 to clarify the circumstances under which "a person has a duty of trust or confidence for purposes of the 'misappropriation' theory of insider trading."[14] The Rule, codifies a non-exhaustive list of circumstances that may give rise to a duty, which is an element that the government must prove in misappropriation cases.[15] Pursuant to Rule 10b5-2, a duty arises:

"(1) Whenever a person agrees to maintain information in confidence;

"(2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history,

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Second Circuit: SEC v. Lyon, 605 F. Supp.2d 531, 547 (S.D.N.Y. 2009) (the "knowing possession" element—as the standard was known in the Second Circuit before 10b5-1, and as is now codified in 10b5-1—does not require the SEC to establish that the defendant actually "used" the information in question, but rather that the defendant was knowingly in possession of the information at the time the trading occurred) (citing United States v. Teicher, 987 F.2d 112, 119-120 (2d Cir. 1993)).

Ninth Circuit: SEC v. Mozilo, 2010 WL 3656068 at *20 (C.D. Cal. Sept. 16, 2010) (prior case law limiting liability unless "use" of the nonpublic information was shown pre-dated the adoption of Rule 10b5-1).

See also, United States v. Royer, 549 F.3d 886, 889 (2d Cir. 2008) (affirming that Second Circuit "adhere[s] to the knowing possession standard articulated in *Teicher*"). But see, United States v. Anderson, 533 F.3d 623, 630 (8th Cir. 2008) (the government "must, at a minimum, prove that the suspect used the information in formulating or consummating his trade") (quoting United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998)).

[12] See *SEC v. Mozilo*, N. 11 *supra,* 2010 WL 3656068, at *20 (quoting SEC Rel. Nos. 33-7881, 34-43154, N. 3 *supra* at *22 ("Scienter remains a necessary element for liability under Section 10(b) . . . and Rule 10b-5 . . . and Rule 10b5-1 does not change this")).

[13] United States v. O'Hagan, 521 U.S. 642, 117 S.Ct 2199, 138 L.Ed.2d 724 (1997).

[14] See 17 C.F.R. § 240.10b5-2. The SEC observed that following *O'Hagan* "It [was] not as settled . . . under what circumstances certain non-business relationships, such as family and personal relationships may provide the duty of trust or confidence required under the misappropriation theory" and in response promulgated Rule 10b5-2. Selective Disclosure and Insider Trading, 64 Fed.Reg. 72590, 72602 (Dec. 28, 1999), available at https://www.gpo.gov/fdsys/pkg/FR-1999-12-28/pdf/99-33492.pdf (last visited Feb. 11, 2017).

[15] Pursuant to *United States v. O'Hagan*, a person "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." 521 U.S. 642, 652, 117 S.Ct 2199, 138 L.Ed.2d 724 (1997).

pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or

"(3) Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information."[16]

Pursuant to Rule 10b5-2, the Justice Department and SEC have brought cases against tippees premised on the theory that the "tippee owed a duty of trust or confidence to the tipper and the tipper conveyed confidential information without intending to have it used for securities trading purposes."[17] In *SEC v. Rockladge*,[18] for example, the First Circuit upheld the conviction of a defendant who deceptively induced her husband to provide her

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[16] 17 C.F.R. § 240.10b5-2.

[17] United States v. Gansman, 657 F.3d 85, 92 (2d. Cir. 2011) (at trial, the jury convicted defendant of insider trading for tipping his mistress, rejecting the defense theory that the defendant confided in his mistress in confidence with the understanding that his communications would not be used for securities trading purposes). See:

First Circuit: SEC v. Rockladge, 470 F.3d 1, 7 n.5 (1st Cir. 2006).

Second Circuit: United States v. Corbin, 729 F. Supp.2d 607, 615-616 (S.D.N.Y. 2010).

Third Circuit: United States v. McGhee, 892 F. Supp.2d 727 (E.D. Pa. 2012) (upholding indictment alleging that the defendant tippee had a duty to keep confidential information that was imparted to him at an Alcoholics Anonymous meeting because "there was an agreement, arising out of the AA program's traditions and reminders at meetings, to maintain confidences among members; a relationship of trust and confidence existed between him and his source; there was a history and pattern of shared confidences; the material nonpublic information . . . was revealed in a confidential conversation in the course of the relationship; and, [defendant] used the information for his own pecuniary benefit and to tip a friend").

Eleventh Circuit: SEC v. Yun, 327 F.3d 1263, 1272, 1273 n.23 (11th Cir. 2003) (Rule 10b5-2 "bolster[s]" the court's view that a "reasonable expectation of confidentiality" exists in a marriage relationship which results in a fiduciary duty to abstain from disclosing material nonpublic information learned from a spouse).

[18] See *SEC v. Rocklage*, N. 17 *supra*, 470 F.3d at 7 n.5.

with material nonpublic information, which she then shared with her brother, who used it to engage in securities transactions.[19] Similarly, a district court in the Southern District of New York found that a defendant tipper owed a duty to abstain from disclosing the material nonpublic information told to him by his wife based on the spousal relationship itself, as per Rule 10b5-2, as well as the express agreement of confidentiality defendant made with his wife and the "history, pattern and practice" of exchanging confidences with his wife.[20]

In at least one jurisdiction, the legitimacy of Rule 10b5-2 has been called into question. In 2009, a federal district court in Texas held that the SEC could not rely on Rule 10b5-2 to establish insider trading under the misappropriation theory when the tippee, a corporate outsider, agreed to keep material nonpublic information confidential but did not agree not to trade based on that information.[21] Having determined that the defendant's conduct was not therefore "manipulative or deceptive" under Section 10(b), the court held that the SEC could not "by [Rule 10b5-2] make unlawful conduct that does not fall in to one of these categories."[22] It held:

> "Rule 10b5-2(b)(1) attempts to predicate misappropriation theory liability on a mere confidentiality agreement lacking a non-use component, [thus] the SEC cannot rely on it to establish [the defendant's] liability under the misappropriation theory. To permit liability based on [Rule 10b5-2] would exceed the SEC's § 10(b) authority to proscribe conduct that is deceptive."[23]

On appeal, the Fifth Circuit vacated the district court's ruling, finding the existence of a plausible agreement that the defendant would not trade on the

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[19] *Id.*

[20] See *United States v. Corbin*, N. 17 *supra*, 729 F. Supp.2d at 615-616. See also, SEC v. Northern, 598 F. Supp.2d 167, 174 (D. Mass. 2009) (rejecting argument that Rule 10b5-2(b) is invalid because it "improperly expands liability under § 10(b)").

[21] SEC v. Cuban, 634 F. Supp.2d 713 (N.D. Tex. 2009). The court held that an agreement upon which the duty not to misappropriate is based must "consist of more than an express or implied promise to keep information confidential. It must also impose on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain." *Id.* at 725.

[22] *Id.,* 634 F. Supp.2d at 728.

[23] *Id.,* 634 F. Supp.2d at 731-732.

confidential information, but the court refused to "reach the validity of Rule 10b5-2(b)(1)."[24]

In *United States v. Gansman*, however, the Second Circuit upheld a conviction in an appeal where the defense attempted to use Rule 10b5-2 to its benefit.[25] In *Gansman*, the government prosecuted and obtained the conviction of an attorney in the Transaction Advisory Services Department of Ernst & Young, LLP, who obtained material nonpublic information about potential mergers and acquisitions, which he disclosed to a woman, Donna Murdoch, with whom he was having an affair. Murdoch traded on the information before the deals became public, profiting on the stock price increases that resulted when the deals later were announced.[26]

On appeal, Gansman argued that the district court erred in not delivering a jury instruction he requested based on Rule 10b5-2, which he claimed supported his defense that he lacked intent to commit securities fraud because he had "a history, pattern, [and] practice of sharing confidences" with Murdoch sufficient to create a duty of trust running to him.[27] The Second Circuit agreed that Gansman was

> "entitled to assert a defense theory that he did not have the requisite intent to commit securities fraud, and that in defining the nature of his relationship with Murdoch . . . he had the right to use language found in Rule 10b5-2."[28]

The Second Circuit nonetheless upheld Gansman's conviction, finding that the district court's instruction was legally sufficient.[29]

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[24] SEC v. Cuban, 620 F.3d at 551, 558 n.40 (5th Cir. 2010).

[25] See United States v. Gansman, 657 F.3d 85 (2d. Cir. 2011).

[26] *Id.,* 657 F.3d at 90.

[27] *Id.*, 657 F.3d at 93.

[28] *Id.*, 657 F.3d at 90.

[29] *Id.,* 657 F.3d at 94.

§ 12A.05 Tippee Liability

As set forth in *dicta* in *Dirks v. SEC* and the Supreme Court's 2016 opinion in *Salman*, a tippee who trades on inside information may face criminal and civil securities fraud liability if the tippee (1) acquired the information from a tipper who had a duty to disclose or abstain from trading and (2) knew that the information was disclosed in breach of the tipper's duty, which occurs when the tipper discloses the information for a personal benefit.[1]

One key question in tippee cases is often what the government must prove in order to show that the tipper disclosed information "for a personal benefit" under *Dirks*.[2]

In *United States v. Newman*, which the Supreme Court has since overturned in part, the Second Circuit held that, under *Dirks*, the personal benefit to the insider that is necessary to establish tippee liability, in certain circumstances, requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[3] In *Salman*, the Supreme Court disagreed, holding that, under *Dirks*, a "tipper benefits personally by making a gift of confidential information to a trading relative or friend," and in cases "involving gifts of confidential information to family and friends," nothing more is required.[4]

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[1] Salman v. United States, 580 U.S. ___, 137 S.Ct. 420, 196 L.Ed.2d 351 (2016); Dirks v. SEC, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983). The Fifth Circuit Court of Appeals described tipping liability in *S.E.C. v. Cuban*:

> "[A]n individual who receives information from a corporate insider may be, but is not always, prohibited from trading on that information as a tippee. 'The tippee's duty to disclose or abstain is derivative from that of the insider's duty' and the tippee's obligation arises 'from his role as a participant after the fact in the insider's breach of a fiduciary duty.' Crucially, 'a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know there has been a breach." The insider breaches his fiduciary duty when he receives a "direct or indirect personal benefit from the disclosure.'"

SEC v. Cuban, 620 F.3d 551, 554 (5th Cir. 2010) (quoting *Dirks v. SEC*, *supra*, 463 U.S. at 659-660, 663).

[2] In *Dirks v. SEC*, N. 1 *supra*, the Supreme Court derived the "personal benefit" standard from a footnote in In re Cady, Roberts & Co., 40 S.E.C. 907, 1961 WL 59902 (1961), that stated that "[a] significant purpose of the Exchange Act was to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office," and then cited to legislative history. 463 U.S. at 662 n.10.

[3] United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014), *cert. denied* 136 S.Ct. 242 (2015).

[4] See *Salman v. United States*, N. 1 *supra*, 137 S.Ct. at 425, 428. See also: Jacobs, "How Institutional Dynamics Have Shaped Insider Trading Law," 51 Rev. of Securities and

The facts of *Salman* are instructive. In *Salman*, the defendant traded on inside information that he received from his brother, an investment banker at Citigroup with whom he shared a close relationship.[5] The defendant was convicted on all counts following a jury trial. On appeal to the Ninth Circuit, the defendant argued that his conviction should be reversed because the tipper did not receive a personal benefit of "a pecuniary or similarly valuable nature," as he claimed *Dirks* and *Newman* required.[6] The Ninth Circuit disagreed. In an opinion written by Southern District of New York Judge Jed S. Rakoff, sitting by designation on the Ninth Circuit, the court held that under *Dirks* "a tipper benefits personally by making a gift of confidential information to a trading relative or friend."[7]

In a unanimous opinion written by Justice Samuel Alito, the Supreme Court expressly rejected the key holding of the Second Circuit's *Newman* decision.[8] Affirming the Ninth Circuit, the Court "adhered" to *Dirks* for the proposition that "a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper's fiduciary duty."[9] Under *Dirks*, "[w]hether the tipper breached that duty depends 'in large part on the purpose of the disclosure' to the tippee" and the test "'is whether the insider personally will benefit, directly or indirectly from his disclosure.'"[10] *Dirks* also stated that "a jury can infer a personal benefit—and thus a breach of the tipper's duty—where the tipper receives something of value in exchange for a tip or 'makes a

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Commodities Regulation 247, 251 (Nov. 21, 2018), available at https://www.maglaw.com/publications/articles/2018-11-21-how-institutional-dynamics-have-shaped-insider-trading-law (last visited Jan. 27, 2019); Jacobs and Raghavan, "The Impact of *Salman v. United States* on Downstream Tippee Prosecutions," 50 Rev. of Securities and Commodities Regulation 223 (Nov. 8, 2017), available at https://www.maglaw.com/publications/articles/2017-11-08-the-impact-of-salman-v-united-states-on-downstream-tippee-prosecutions (last visited Jan. 27, 2019).

[5] See *United States v. Salman*, N. 1 *supra,* 137 S.Ct. at 424-425.

[6] *Id.*, 137 S.Ct. at 424.

[7] Salman v. United States, 792 F.3d 1087 (9th Cir. 2015)*, cert. granted in part* 136 S.Ct. 899, 193 L.Ed.2d 788 (2016).

[8] See Salman v. United States, 580 U.S. ___, 137 S.Ct. 420, 428, 196 L.Ed.2d 351 (2016) ("To the extent the Second Circuit held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family and friends, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*"). (Internal citations omitted.)

[9] *Id.*, 137 S.Ct. at 427.

[10] *Id.* ("In determining whether a tipper derived a personal benefit, we instructed courts to 'focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings'").

gift of confidential information to a trading relative or friend.'"[11]

The Court found that the *Dirks* gift-giving discussion sufficiently resolved the *Salman* case, noting that

> "by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, [the insider] breached his duty of trust and confidence to [his employer] and its clients—a duty [the defendant] acquired, and breached himself by trading on the information with full knowledge that it had been improperly disclosed."[12]

Salman thus makes clear that a personal benefit can be inferred from the gift of material nonpublic information to a family member or friend and does not require, as *Newman* did, an "exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." The narrow *Salman* opinion does not, however, resolve the degree of "friendship" required to give rise to liability under this strand of insider trading law. *Salman* also left intact the secondary holding in *Newman* that a tippee is guilty of insider trading only where the "tippee knew of the tipper's breach; that is, he knew the information was confidential and divulged for personal benefit."[13]

After *Salman*, in two separate opinions in *United States v. Martoma*, a divided Second Circuit panel revisited and sought to clarify the type of relationship sufficient to establish a "personal benefit" under *Dirks*.[14] The defendant, a portfolio manager at S.A.C. Capital Advisors LP, was convicted of insider trading by a Southern District of New York jury following a four-week trial. The evidence showed that Martoma had forty-three consultations

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[11] *Id.*, 137 S.Ct. at 423 (quoting Dirks v. SEC, 463 U.S. 646, 664, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983)).

[12] See *Salman v. United States*, N. 8 *supra*, 137 S.Ct. at 420.

[13] See United States v. Newman, 773 F.3d 438, 450 (2d Cir. 2014), *cert. denied* 136 S.Ct. 242 (2015).

[14] United States v. Martoma, 894 F.3d 64 (2d Cir. 2018) (*Martoma II*), *cert. denied* 139 S.Ct. 2665 (2019); United States v. Martoma, 869 F.3d 58 (2d Cir. 2017), amended and superseded by 894 F.3d 64 (2018) (*Martoma I*). See also: United States v. Pinto-Thomaz, No. S2 18-CR-579 (JSR), 2018 WL 6378118 at *4-5 (S.D.N.Y. Dec. 6, 2018) (describing the holdings of *Martoma I* and *Martoma II*); Jacobs, "How Institutional Dynamics Have Shaped Insider Trading Law," 51 Rev. of Securities and Commodities Regulation 247, 251 (Nov. 21, 2018), available at https://www.maglaw.com/publications/articles/2018-11-21-how-institutional-dynamics-have-shaped-insider-trading-law (last visited Jan. 27, 2019); Ingoglia and Fischer, "Double Whammy: How the Landscape of Insider Trading Law Has Been Altered by the Second Circuit's *Martoma* Decision and Prosecutors' Creative Tactics Since *Newman*," in 1 *White Collar Practice Journal*, No. 1 (PLI Corp. 2018).

with the tipper, the chair of a committee for a drug's clinical trial, for which the tipper was paid $1,000 per hour. The tipper disclosed confidential clinical drug trial results to Martoma, which allowed Martoma to trade SAC's interest in two pharmaceutical companies and make approximately $80 million in gains and $195 million in averted losses.[15] At trial, the government argued that the tipper benefitted because he was paid for his consultations and because he and Martoma were friends. On appeal, among other things, Martoma argued that the jury was not properly instructed on the "personal benefit" element of insider trading law in light of the Second Circuit's *Newman* decision.

In *Martoma I*, in a 2-1 decision, the Second Circuit held that the district court's jury instruction was not "obviously erroneous" because *United States v. Salman* "abrogated *Newman*'s 'meaningful close personal relationship' requirement."[16] The court held instead that "an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed 'with the expectation that [the recipient] would trade on it,' and the disclosure 'resemble[s] trading by the insider followed by a gift of profits to the recipient,' whether or not there was a 'meaningfully close personal relationship' between the tipper and tippee."[17] In October 2017, Martoma petitioned the court for rehearing or rehearing en banc.[18]

Eight months later, in *Martoma II*, the same panel of the Second Circuit vacated its original decision and issued an amended opinion.[19] In the amended opinion, rather than disavowing the "meaningfully close personal relationship" test of *Newman*, the majority attempted to reconcile *Newman* with *Salman*, explaining that "because there are many ways to establish a personal benefit, we conclude that we need not decide whether *Newman*'s gloss on the gift theory is inconsistent with *Salman*."[20] The court explained that "[i]mmediately after introducing the 'meaningfully close personal relationship' concept, *Newman* held that it 'requires evidence of a 'relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention

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[15] See *Martoma II*, N. 14 *supra*, 894 F.3d at 69-71.

[16] See *Martoma I*, N. 14 *supra*, 869 F.3d at 69, 73 ("We respectfully conclude that *Salman* fundamentally altered the analysis underlying *Newman*'s 'meaningfully close personal relationship' requirement such that the 'meaningfully close personal relationship' requirement no longer is good law.").

[17] *Id.*, 860 F.3d at 70 (citing *Salman,* N. 8 *supra*, 137 S.Ct. at 428. (Alterations in original; internal citations omitted.)

[18] Petition for Rehearing *En Banc*, United States v. Martoma, No. 14-3599 (2d Cir. Oct. 6, 2017), ECF No. 192.

[19] See *Martoma II*, N. 14 *supra*, 894 F.3d at 71.

[20] *Id.*

to benefit the [latter].'"[21] Either a relationship that suggests a *quid pro quo* from the recipient of the information or a relationship that suggests an intention to benefit the recipient of the information is "a sufficient basis to infer a personal benefit under *Dirks* and its progeny."[22] The Second Circuit concluded that although the jury instructions were inaccurate, the error was harmless because "it is clear beyond a reasonable doubt that a properly instructed jury would have found Martoma guilty."[23]

In August 2018, the Second Circuit denied Martoma's petition for rehearing en banc.[24] Martoma petitioned the Supreme Court for a writ of *certiorari* on January 24, 2019, presenting the question "[w]hether, in an insider trading prosecution, the government must demonstrate that *the tipper received* a personal benefit in exchange for providing insider information, as required by *Dirks*, or whether it suffices for the government to show that the tipper intended to *confer* a benefit on *the tippee*."[25] The Supreme Court denied Martoma's petition on June 3, 2019.[26]

Given the ambiguities in the law that applies in tippee cases brought under Title 15, prosecutors increasingly are turning to Title 18. The differences between the elements of Title 15 and Title 18 violations are exemplified by the outcome of the *United States v. Blaszczak* trial, in which remote tippees were acquitted of insider trading counts alleging violations of Rule 10b-5 but convicted of insider trading in violation of Sections 1343 and 1348 of Title 18

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[21] *Id.*, 894 F.3d at 77. (Alterations in original.)

[22] *Id.*, 894 F.3d at 77 ("*Newman* cabined the gift theory using two *other* freestanding personal benefits that have long been recognized by our case law.") (citing United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013)). See also: United States v. Klein, No. 17-3355, 2019 WL 149629 at *4 (2d Cir. Jan. 10, 2019) (*Martoma* holds that "[p]ersonal benefit can be established by . . . illustrating the nature of the relationship between the tipper and tippee or the tipper's receipt of something of value" and noting that "[t]he critical question regards the tipper's purpose: did the tipper share the material non-public information with the tippee intending that the tippee use the information to improperly trade in securities."); United States v. Pinto-Thomaz, 2018 WL 6378118 at *4-5 (S.D.N.Y. Dec. 6, 2018) (noting that "*Martoma II* held [and] *Newman* did not alter (and indeed had no power to alter the holding in *Dirks* that a personal benefit can be inferred from either a 'relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the latter.'") (quoting *Martoma II*, 894 F.3d at 77-78).

[23] See *Martoma II*, N. 14 *supra*, 894 F.3d at 78-79.

[24] See Order, United States v. Martoma, No. 14-399 (2d Cir. Aug. 27, 2018), ECF No. 254.

[25] Petition for Writ of Certiorari, *United States v. Martoma*, No. 18A469 (Jan. 24, 2019), available at https://www.supremecourt.gov/DocketPDF/18/18-972/81599/20190124133749139_2019-01-24%20Martoma%20Petn.pdf (last visited Feb. 2, 2019). (Emphasis in original.)

[26] Martoma v. United States, __ U.S., 139 S.Ct. 2665, __ L.Ed.3d __ (2019).

of the United States Code.[27] Unlike the Title 15 violations, of which the defendants were acquitted, the Section 1343 and 1348 fraud counts did not require the government to prove "a tipper's breach of fiduciary duty, personal benefit to the tipper and tippee knowledge of a breach of confidentiality and receipt of personal benefit."[28]

The *Blaszczak* defendants appealed their Section 1343 and Section 1348 convictions, arguing that the district court erred by not instructing the jury that the *Dirks* "personal-benefit" test applied to the wire fraud and Title 18 securities fraud counts.[29] The Second Circuit Court of Appeals rejected the defendants' challenge and "declin[ed] to graft the *Dirks* personal-benefit test onto the elements of Title 18 securities fraud."[30] The court noted that the "personal-benefit test" "is a judge-made doctrine premised on the Exchange Act's statutory purpose," of "'eliminat[ing] [the] use of inside information for *personal advantage*'" and declined to extend *Dirks* beyond the Exchange Act.[31]

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[27] United States v. Blaszczak, 17 Cr. 357 (S.D.N.Y. 2018). See also, Jacobs, "How Institutional Dynamics Have Shaped Insider Trading Law," 51 Rev. of Securities and Commodities Regulation 247, 251 (Nov. 21, 2018), available at https://www.maglaw.com/publications/articles/2018-11-21-how-institutional-dynamics-have-shaped-insider-trading-law (last visited Jan. 27, 2019) (discussing the difference in the elements of criminal liability under Rule 10b-5 and Section 1348).

[28] See Abramowitz and Sack, "Back to the Future: Criminal Insider Trading Under Title 18," New York Law Journal (July 3, 2018), available at https://www.maglaw.com/publications/articles/2018-07-03-back-to-the-future-criminal-insider-trading-under-title-18 (last visited Jan. 22, 2019).

[29] United States v. Blaszczak, 947 F.3d 19, 30 (2d Cir. 2019). The defendants also argued that under the Supreme Court's decision in *Cleveland v. United States*, 531 U.S. 12, 121 S.Ct. 365, 148 L.Ed.2d 221 (2000), a government agency's confidential information is not "property" for the purposes of the wire fraud and Title 18 securities fraud statutes because the agency's interest in the information is "purely regulatory." Blaszczak, 947 F.3d at 30. The Second Circuit rejected that argument, holding that a government agency's confidential predecisional information "may constitute 'property' for the purposes of 18 U.S.C. §§ 1343 and 1348, and that here, there was sufficient evidence to establish that the [tipped information] was 'property.'" *Id.* at 34. One member of the panel dissented on that ground, writing that the government agency was "not a business" and was not "deprived of anything that could be considered property." *Id.* at 47.

[30] See *United States v. Blaszczak*, N. 29 *supra*, 947 F.3d at 35-36.

[31] *Id.*, 2019 WL 7289753 at *8-9 (quoting Dirks v. SEC, 463 U.S. 646, 662, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983)). (Alterations in original.)

§ 12A.06 Civil Liability

The Securities and Exchange Commission has broad authority pursuant to Section 21 of the Securities Exchange Act of 1934[1] to investigate possible violations of the federal securities laws, including insider trading. The SEC must prove the same elements in civil insider trading enforcement actions (under both the classical and misappropriation theories) as in criminal enforcement actions, except with respect to scienter and burden of proof.[2] In a civil insider trading action, as in any civil action, the SEC must prove the offense by a preponderance of the evidence, while in a criminal action the government must prove the offense beyond a reasonable doubt.[3] Because of the lesser burden of proof in a civil action, a defendant who is convicted of criminal insider trading may be precluded from relitigating the issues decided by that conviction in a later civil insider trading action.[4]

With respect to scienter, in a civil enforcement action the SEC must prove that the defendant's conduct was reckless, as opposed to proving willful conduct as in a criminal action.[5] This means that

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[1] 15 U.S.C. § 78u.

[2] United States v. Gansman, 657 F.3d 85, 90-91 (2d. Cir. 2011) ("A person commits securities fraud for purposes of both civil and criminal enforcement actions under § 10(b) of the 1934 Act and Rule 10b-5 when he 'misappropriate' confidential information for securities trading purposes, in breach of a duty owed to the source of the information." (citing United States v. O'Hagan, 521 U.S. 642, 652, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997)). The classical and misappropriation theories are discussed in detail in §§ 12A.03[1] & [2], respectively.

[3] See *United States v. Gansman*, N. 2 *supra*, 657 F.3d at 91 n.7.

[4] SEC v. Megalli, 157 F. Supp.3d 1240, 1247-1248 (N.D. Ga. 2015) ("In the securities regulation context, courts have regularly held that a criminal conviction for insider trading precludes a defendant from litigating their civil liability for insider trading, because the statutory elements for criminal and civil liability under 15 U.S.C. § 78j(b) and Rule 10b–5 are virtually the same"). The *SEC v. Megalli* decision sets forth the factors that courts consider when determining if a criminal conviction precludes relitigation of issues in a later civil action:

> "A criminal conviction precludes re-litigation of the issues decided by that conviction in a later civil action if: (1) the issues presented in both the prior and current action are identical; the issues were (2) actually litigated and (3) critical and necessary to the judgment in the prior action; and (4) the burden of persuasion in the current action is not significantly heavier."

Id. (citing United States v. Jean-Baptiste, 395 F.3d 1190, 1194–1195 (11th Cir. 2005). See also:

Second Circuit: SEC v. Freeman, 290 F. Supp.2d 401, 405 (S.D.N.Y. 2003).
Sixth Circuit: SEC v. Blackwell, 477 F. Supp.2d 891, 899-900 (S.D. Ohio 2007).
Tenth Circuit: SEC v. Gordon, 822 F. Supp.2d 1144, 1157 (N.D. Okla. 2011).

[5] See *United States v. Gansman*, N. 2 *supra*, 657 F.3d at 91 n.7.

> "while a person is guilty of criminal insider trading only if that person committed the offense 'willfully,' i.e., knowingly and purposefully, a person may be civilly liable if that person committed the offense recklessly, that is in heedless disregard of the probable consequences."[6]

In *SEC v. One or More Unknown Traders in the Securities of Onyx Pharmaceuticals, Inc.*, a district court in the Southern District of New York defined "reckless disregard for the truth" as "highly unreasonable" conduct that is an "extreme departure from the standards of ordinary care."[7] The court explained,

> "'In every insider trading case, at the moment of tipping or trading, just as in securities fraud cases across the board, the unlawful actor must know or be reckless in not knowing that [his] conduct [is] deceptive.' Therefore, a tipper incurs liability for insider trading only if she (1) knowingly or recklessly tips (2) information that she knows, or is reckless in not knowing, to be material and nonpublic (3) in knowing or reckless violation of a duty to keep the information confidential (4) for personal gain. A tippee incurs liability if all of those conditions obtain, plus (1) the tippee knows or is reckless in not knowing that the tip is material nonpublic information, (2) the tippee knows or should know that the tip was in breach of a fiduciary duty, and (3) the tippee intentionally or recklessly uses the information by trading or tipping for personal benefit."[8]

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[6] SEC v. Payton, 97 F. Supp.3d 558, 559 (S.D.N.Y. 2015).

[7] SEC v. One or More Unknown Traders in Securities of Onyx Pharmaceuticals, Inc., 296 F.R.D. 241, 250 (S.D.N.Y. 2013) (quoting SEC v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) (Internal citations omitted.)). See also, SEC v. McNulty, 137 F.3d 732 (2d Cir. 1998) ("the scienter needed for proof of a claim under § 10(b) or Rule 10b–5, may be established through a showing of reckless disregard for the truth, see, that is, 'conduct which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care.'' (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), and quoting Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 46 (2d Cir.), *cert. denied* 439 U.S. 1039 (1978)).

[8] See *SEC v. One or More Unknown Traders in Securities of Onyx Pharmaceuticals, Inc.*, N. 7 *supra*, 296 F.R.D. at 250 (quoting SEC v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) (Internal citations omitted.)).

§ 12A.07 Criminal and Civil Penalties

[1]—Criminal Penalties

Individual defendants convicted of insider trading under Section 10(b)(5) face a maximum term of imprisonment of twenty years and fines of not more than $5 million or twice the defendant's gain (or the victim's loss) from the offense.[1] Although the Sentencing Guidelines were rendered advisory by the Supreme Court in *United States v. Booker*, district judges are required to consider them in reaching an appropriate sentence.[2] The Guidelines ranges for insider trading violations are calculated under Section 2B1.4 (titled "Insider Trading") of the Sentencing Guidelines, which cross-references Section 2B1.1 (titled "Larceny, Embezzlement, and Other Forms of Theft; Offenses Involving Stolen Property; Property Damage or Destruction; Fraud and Deceit; Forgery; Offenses Involving Altered or Counterfeit Instruments Other than Counterfeit Bearer Obligations of the United States").[3]

Even significant insider-trading sentences, however, often fall below the recommended Sentencing Guidelines ranges. For example, in 2011, defendant Raj Rajaratnam was sentenced to 11 years' imprisonment—the longest sentence ever in an insider-trading case—but even that lengthy sentence was substantially lower than the recommended Sentencing Guidelines range.[4]

An insider trading conviction may also give rise to restitution and forfeiture.[5]

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[1] 15 U.S.C. § 78ff(a). A maximum fine of $25 million may be imposed when the defendant is not a natural person. *Id.*

[2] See United States v. Booker, 543 U.S. 220, 125 S.Ct. 738, 160 L.Ed.2d 621 (2004). The Sentencing Guidelines are discussed in detail in Chapter 15, "Corporate Sentencing Under the Federal Guidelines," *infra*.

[3] United States Sentencing Guidelines ("U.S.S.G.") §§ 2B1.4, 2B1.1 (2016).

[4] United States v. Rajaratnam, 719 F.3d 139, 150-151 (2d Cir. 2013); Pulliam and Bray, "Trader Draws Record Sentence: Rajaratnam Slapped With 11-Year Prison Term for Orchestrating Insider Scheme," Wall Street Journal (Oct. 14, 2011), available at https://www.wsj.com/articles/SB10001424052970203914304576627191081876286 (last visited Feb. 14, 2017); Henning, "Rajaratnam's Defiant Approach to Sentencing," New York Times (Sept. 12, 2011) (reporting that for Rajaratnam, the Sentencing Guidelines recommended a range of 19½ to 24½ years), available at https://dealbook.nytimes.com/2011/09/12/rajaratnams-defiant-approach-to-sentencing/?_r=0 (last visited Feb. 14, 2017).

[5] U.S.S.G. §§ 5E1.1-1.5. Forfeiture is governed by statute. See 18 U.S.C. § 3554. Corporate victims of insider trading schemes may obtain restitution under the Mandatory Victim Restitution Act ("MVRA"). See United States v. Skowron, 839 F. Supp.2d 740 (S.D.N.Y. 2012) (employer of a portfolio manager convicted of insider trading was a "victim" under the MVRA); United States v. Gupta, 925 F. Supp.2d 581 (S.D.N.Y. 2013) (awarding restitution for attorney fees incurred by employer of the tipper defendant).

[2]—Civil Penalties

The federal securities laws grant the SEC authority to seek injunctive relief, disgorgement, and monetary penalties for insider trading violations. The potential civil penalties for securities transactions while in possession of material nonpublic information are set forth in 15 U.S.C. § 78u-1, which provides:

"**(a) Authority to impose civil penalties**

"(1) Judicial actions by Commission authorized

"Whenever it shall appear to the Commission that any person has violated any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security or security-based swap agreement while in possession of material, nonpublic information . . . the Commission—

"(A) may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by the person who committed such violation; and

"(B) may, subject to subsection (b)(1) of this section, bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by a person who, at the time of the violation, directly or indirectly controlled the person who committed such violation.

"(2) Amount of penalty for person who committed violation

"The amount of the penalty which may be imposed on the person who committed such violation shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase, sale, or communication."[6]

Under Section 78u-1(a)(2), the "financial liability to which a violator of the insider trading laws may be exposed [is] directly proportional to the amount of the profit gained or the loss avoided."[7]

Disgorgement "does not serve a punitive function, [thus] the disgorgement amount may not exceed the amount obtained through the wrongdoing."[8] The purpose of disgorgement is to "make lawbreaking unprofitable for the lawbreaker" and so "it satisfies its design when the lawbreaker returns the fruit

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[6] 15 U.S.C. § 78u-1 (emphasis added).

[7] SEC v. Rosenthal, 650 F.3d 156, 162 (2d Cir. 2011).

[8] SEC v. Contorinis, 743 F.3d 296, 301 (2d Cir. 2014).

of his misdeeds."[9] In the insider trading context, courts have required "that an insider trader may be ordered to disgorge not only the unlawful gains that accrue to the wrongdoer directly, but also the benefit that accrues to third parties whose gains can be attributed to the wrongdoer's conduct."[10] In tipper-tippee cases, the courts have applied this principle to hold that "in the determination of a disgorgment amount, '[a] tippee's gains are attributable to the tipper, regardless whether benefit accrues to the tipper.'"[11] And, in *SEC v. Contorinis,* the Second Circuit extended this principle to order a defendant to disgorge illegal profits resulting from his insider trading that accrued to an investment fund for which he made investment decisions but not to the defendant personally.[12]

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[9] *Id.*

[10] *Id.*, 743 F.3d at 302.

[11] *Id.* (quoting SEC v. Warde, 151 F.3d 42, 49 (2d Cir. 1998).

[12] *Id.*, 743 F.3d at 304.

§ 12A.08 Private Right of Action

A private right of action exists against people engaged in insider trading under Section 20A(a) of the Securities Exchange Act of 1934. According to 15 U.S.C. § 78t-1, "Liability to contemporaneous traders for insider trading,"

> "[a]ny person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action . . . to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class."[1]

To state a claim under § 78t-1, a plaintiff must "plead an independent cause of action for insider trading under § 10(b) of the 1934 Act."[2]

Section 78t-1 contains two important limitations on the private right of action. First the plaintiff must have traded "contemporaneously" with the insider. District courts around the country have not settled on a single definition of "contemporaneously." Some courts have held that the trading of the private plaintiff and the defendant must have taken place the same day to be considered contemporaneous, while other courts have left open the possibility that trading separated by as many as ten days may be contemporaneous.[3] Second, § 78t-1 requires that "[t]he total amount of damages imposed against any person . . . shall be diminished by the amounts, if any, that such person may be required to disgorge, pursuant to a court order obtained at the instance of the Commission."[4] Thus, once a defendant has disgorged ill-gotten profits to the SEC, "there remains . . . no basis for further disgorgement in a private action."[5]

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[1] 15 U.S.C. § 78t-1(a).

[2] In re Refco Inc. Securities Litigation, 503 F. Supp.2d 611, 665 (S.D.N.Y. 2011) (citing Jackson National Life Insurance Co. v. Merrill Lynch & Co., 32 F.3d 697, 703 (2d Cir. 1994).

[3] In re Enron Corp. Securities, Derivative & "ERISA Litigation," 258 F. Supp.2d 576, 599 (S.D. Tex. 2003) ("[d]ifferent courts have found that 'contemporaneity' requires the insider and the investor/plaintiff to have traded anywhere from on the same day, to less than a week, to within a month, to 'the entire period while relevant and nonpublic information remained undisclosed'") (citing cases)).

[4] 15 U.S.C. § 78t-1(b)(2).

[5] Litton Industries., Inc. v. Lehman Brothers, Kuhn Loeb Inc., 734 F. Supp. 1071, 1076 (S.D.N.Y. 1990).

§ 12A.09 Insider Trading Legislation

In 2015, after the Supreme Court declined to review the Second Circuit's *United States v. Newman* decision, three bills were introduced in Congress to clarify the law governing insider trading. None of the bills was enacted.

In October 2018, former Southern District of New York United States Attorney Preet Bharara and SEC Commissioner Robert J. Jackson Jr. announced in a New York Times op-ed the creation of an eight-person task force convened to propose insider trading "reforms."[1] In January 2020, the task force, composed of former regulators and prosecutors, judges, academics and defense lawyers, issued the "Report of the Bharara Task Force on Insider Trading."[2] The Report concludes that to simplify, clarify, and modernize insider trading law, a new statute setting out the elements of an insider trading offense is needed. The Report sets forth the following key principles that the task force believes should be incorporated into a new law:[3]

- "[a]im for clarity and simplicity";[4]
- "[f]ocus on 'wrongful' use of material nonpublic information, not exclusively on 'deception' or 'fraud'";[5]
- "[e]liminate the 'personal benefit' requirement";[6] and
- "[c]learly and explicitly define the state of mind requirement for criminal and civil insider trading, as well as the knowledge requirement for tippees."[7]

The Report proposes language for model legislation, yet it remains to be seen whether legislation that applies the Report's recommendations will find support in Congress.

Prior to the publication of the Bharara Report, in December 2019, the U.S.

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[1] Bharara and Jackson, "Insider Trading Laws Haven't Kept Up With the Crooks," New York Times (Oct. 9, 2018), available at https://www.nytimes.com/2018/10/09/opinion/sec-insider-trading-united-states.html?action=click&module=Opinion&pgtype=Homepage (last visited Feb. 25, 2019).

[2] Report of the Bharara Task Force on Insider Trading (Jan. 2020), available at https://static1.squarespace.com/static/5e1f2462d354fa5f5bac2699/t/5e2a1e9d12e0c33aefc41303/1579818654541/Report+of+the+Bharara+Task+Force+on+Insider+Trading.pdf (last visited Jan. 27, 2020).

[3] *Id.*, Bharara Report at 1.

[4] *Id.*, Bharara Report at 14.

[5] *Id.*, Bharara Report at 14-15.

[6] *Id.*, Bharara Report at 15-16.

[7] *Id.*, Bharara Report at 17.

House of Representatives passed the Insider Trading Prohibition Act.[8] The bill amends the Securities Exchange Act of 1934[9] to prohibit trading securities while aware of material, nonpublic information while knowing or recklessly disregarding "that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information." The bill also prohibits "wrongfully" communicating material, nonpublic information. Trading while in possession of material, nonpublic information or communicating such information is "wrongful" under the proposed legislation if the information is obtained by, or its communication would constitute any of the following:

> "(A) theft, bribery, misrepresentation, or espionage (through electronic or other means);
> "(B) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users;
> "(C) conversion, misappropriation, or other unauthorized and deceptive taking of such information; or
> "(D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend)."

By defining "wrongful" in these four different ways, like the legislation proposed in the Bharara Report, the Insider Trading Prohibition Act would significantly expand the ability of federal prosecutors to charge insider trading beyond what current case law allows.[10]

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[8] Insider Trading Prohibition Act, H.R. 2534 116th Cong. §§ 16A(a)-(b) (2019), available at https://www.congress.gov/bill/116th-congress/house-bill/2534/text (last visited Jan. 31, 2020).

[9] 15 U.S.C. §§ 78a *et seq.*

[10] See § 12A.05 *supra* for a discussion of tippee liability and the personal benefit standard.