CURRENT TRENDS IN INSIDER TRADING PROSECUTIONS

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INTRODUCTION

It is now something of a commonplace to note that insider trading law is a doctrinal mess, very much in need of legislative reform. Insider trading law has been called “confusing,” “bungled,” “irreparably broken,” “arbitrary and incomplete,” “astonishingly dysfunctional,” a “judicial mess,” a “jurisprudential scandal” and “unjust, irrational, and in need of significant reform.” Insider trading bills aimed to fix the broken system have routinely passed the House, but never seem to get past the Senate. In the meantime, the U.S. Securities and Exchange Commission (SEC) and criminal authorities are pushing full-steam ahead in the insider trading arena, using available and sometimes innovative tools to cover an increasing array

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11 See, e.g., The Insider Trading Prohibition Act, H.R. 2655, 117th Cong. (2021). This proposed piece of legislation passed the House in May 2021 by a vote of 410 to 13, but it has languished in the Senate.
of conduct.

In just the past year, the SEC brought insider trading charges in a case involving so-called “shadow trading,” where an individual who was in possession of material non-public information that a certain company was about to be taken over, traded in the securities of an unrelated company that was thought to be similarly situated;12 both the SEC and criminal authorities brought charges in the first-ever insider trading case involving crypto currencies;13 criminal authorities brought “insider trading” charges for trading in Non-Fungible Tokens (NFTs) an asset class that is described as being neither a security or a commodity;14 and both the SEC and criminal authorities charged a senior company executive with insider trading using a pre-arranged “Rule 10b5-1” trading plan in a scheme to avoid over $12 million in losses.15

Insider trading law has developed somewhat haphazardly over the past four decades principally, though by no means exclusively, through judicial interpretations of the general anti-fraud provisions of the federal securities laws, most notably Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The current landscape has largely been shaped by a series of decisions emanating from a fractured and divided Second Circuit which have confused, unsettled and at times upended the law of insider trading. On the legal front, the most significant recent development has been the use of statutory provisions beyond the traditional securities laws in the criminal prosecution of insider trading. Specifically, criminal authorities have increasingly been charging insider trading under the general mail and

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wire fraud statutes and under a relatively recently enacted anti-fraud provision specifically targeting securities fraud (Title 18 Section 1348), that is modeled on the mail and wire fraud statutes but is not part of the general securities laws and is not subject to SEC enforcement. In the past fiscal year alone, criminal authorities have brought Section 1348 charges against one or more defendants in connection with at least eight insider trading cases and Title 18 mail and wire fraud charges in two more cases.

Looming over many of the recent cases and the charging decisions underlying them are continuing concerns over the application of the Dirks\textsuperscript{17} “personal benefit” test and particularly some lingering issues arising from the Second Circuit’s decisions in the Newman\textsuperscript{18} and Martoma\textsuperscript{19} cases. In Dirks, the Supreme Court held that where a company insider (a “tipper”) provides material non-public information to someone who trades on the basis of that information, insider trading liability attaches only if the tipper received a personal benefit in exchange for the tip.\textsuperscript{20} In the years following Dirks, courts took a very liberal approach to the personal benefit test, finding that almost anything qualified as a benefit, including two things specifically mentioned in Dirks itself: a reputational benefit and a gift of information to a trading relative or friend.

Then in 2014, the Second Circuit issued an opinion that upended the personal benefit test. In US v. Newman, the court held that to prevail the government had to show that a tippee, including a remote tippee, had to know that the tipper received a personal benefit in exchange for the tip, that the personal benefit had to be something real, of actual pecuniary value, and that a gift of information to a trading relative or friend satisfied the personal benefit test only if there was a meaningfully close personal relationship between the tipper and the tippee from which it could be inferred that the tipper benefited by providing the tip.\textsuperscript{21}

Two years later in Salman, the Supreme Court reversed that part of the Newman decision that said that the personal benefit had to be something of real pecuniary value.\textsuperscript{22} The Court reiterated the Dirks holding that an amorphous benefit, including a reputational benefit, counted, as did a gift of information to a trading relative or friend. But the Salman decision did not

\textsuperscript{17} Dirks v. SEC, 463 U.S. 646 (1983).
\textsuperscript{18} United States v. Newman, 773 F.3d 438 (2d Cir. 2014).
\textsuperscript{19} United States v. Martoma, 869 F.3d 58 (2d Cir. 2017); United States v. Martoma, 894 F.3d 64 (2d Cir. 2018), cert. denied, 139 S. Ct. 2665 (2019).
\textsuperscript{20} Dirks, 463 U.S. at 662.
\textsuperscript{21} Newman, 773 F.3d at 448-52.
address what the government needed to show about a tippees’ knowledge of the personal benefit. The Court also did not specifically address the question of what the government needs to show for a gift of information to qualify as a ‘personal benefit,’ and after two lengthy opinions in the Martoma case, the issue remains somewhat unsettled.

The continuing uncertainty over the application of the personal benefit test has been one of the central drivers in the criminal authorities’ use of mail and wire fraud and Section 1348 to prosecute insider trading cases. In *US v. Blaszczak*, the Second Circuit was confronted with the question whether the elements of a Title 18 insider trading charge were the same as under Section 10(b).23 In that case, the defendants were charged criminally with violating both Title 18 wire fraud and securities fraud and violations of Section 10(b) of the Exchange Act and Rule 10b-5.24 The defendants were convicted on the Title 18 charges, but acquitted on the Section 10(b) charges likely because the government was unable to meet the personal benefit test.25 On appeal, the Second Circuit held that there is no personal benefit requirement in Title 18 mail and wire fraud and securities fraud cases.26 The opinion was ultimately vacated on other grounds—and has given rise to another Second Circuit opinion that could prove problematic in other areas of insider trading law—but the legal doctrine regarding the personal benefit test survives and has been a consistent driver of recent enforcement actions.

For example, in one recent insider trading case, *US v. Barama*, the defendants were convicted on four counts of violating Section 1348 but were never charged criminally with Section 10(b) fraud.27 The SEC complaint, which charged civil violations of Section 10(b), gives a clue as to why the criminal authorities avoided those charges: while several of the tippees in that case paid kickbacks to the tipper, one of the tippees was said to have simply been given a “gift” of information.

Overall, the Newman decision and its progeny seem to have had at least a marginal effect on the SEC’s ability to bring insider trading cases. The average number of new insider trading cases the SEC brings per year has declined since the Newman decision, as has the average number of individuals the SEC charges with insider trading violations in any given year. The numbers have always varied year-to-year and the post-Newman years

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24 *Id.*
25 *Id.*
26 *Id.*
include the pandemic which may have impacted enforcement, but the decline is nonetheless notable. At the same time, there has been an increase in the number of parallel criminal actions brought in tandem with SEC insider trading cases, suggesting that while SEC enforcement may have been negatively impacted, criminal enforcement has been emboldened by newly available, or newly rediscovered, tools.

Insider trading law is now at a crossroads and at something of an inflection point: civil and criminal authorities are often bringing a series of overlapping but distinct charges covering the same exact conduct but based on different legal theories with different elements, leading to the paradoxical outcome that it is sometimes easier to bring a criminal insider trading case than a civil one. At the same time, the theoretical underpinnings of insider trading liability have moved the law farther and farther away from the principal, and original, justification of insider trading prohibitions, namely concern over market integrity. Indeed, insider trading law these days often has precious little to do with insiders or trading: insider trading liability has long been extended to outsiders with no connection to the company whose securities they are trading in and is largely based on a property theory of information. Whereas originally the “victims” of insider trading were viewed as the counterparties to the trade or market participants generally, the “victim” these days is the putative owner of the information and the market transaction is almost epiphenomenal, the necessary hook to meet the statutory language and nothing more.

In Part I of this Article, I detail the various statutory provisions that have been used to prosecute insider trading by both civil and criminal authorities; in Part II, I provide some data points on recent insider trading cases; in Part III, I outline some examples of insider trading cases that highlight recent trends; in Part IV, I discuss how we got to this point through a brief history of the development and current state of insider trading law; and in Part V, I provide some thoughts on where the law of insider trading may be, and perhaps should be, heading. Specifically, I conclude that the foundational theory of insider trading liability—what is known as the “classical theory” under Section 10(b)—is by now something of a relic: criminal authorities are increasingly moving away from Section 10(b) altogether while the SEC will refashion its arguments to avoid the pitfalls that have bedeviled that analytical framework. Ironically, while the Second Circuit has sought to temper insider trading law, they have created the conditions for more expansive liability.
I. THE STATUTORY BASES OF INSIDER TRADING LIABILITY

It is often said that there are two theories of insider trading liability—the “classical theory” and the “misappropriation theory”—both derived from judicial interpretations of Section 10(b) of the Exchange Act, and indeed much of our insider trading jurisprudence has developed “ad hoc,” as a judicially created form of “federal common law” mostly keyed off of Section 10(b).28 But Section 10(b) is not the only statutory provision that has been used to prosecute insider trading, although it is sometimes treated as such.29 There are in fact several other statutory provisions that have been used over the years, including some that have been used for a very long time. In particular, the mail and wire fraud statutes have been used to criminally prosecute insider trading going back more than 40 years,30 although curiously the use of these provisions has often been ignored in the standard accounts of the development of insider trading law.31 Insider trading liability under these various statutory provisions is based on different underlying theories with different elements that need to be satisfied. Herewith, in summary form, are the principal ones:

A. Title 15 - Section 10(b) of the Securities Exchange Act and Rule 10b-5

Both the SEC and the criminal authorities have prosecuted insider trading under Section 10(b) of the Exchange Act and Rule 10b-5


29 See, e.g., Jay B. Skyes, Insider Trading, CONG. RSCH. SERV. (Nov. 9, 2021), https://crsreports.congress.gov/product/pdf/IF/IF11966 [https://perma.cc/5HN5-LYFK] (“The modern insider-trading prohibition is grounded in Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.”); Newman, 773 F.3d at 445 (“[T]he unlawfulness of insider trading is predicated on the notion that insider trading is a type of securities fraud proscribed by Section 10(b) and Rule 10b-5.”).


31 For example, one of the most comprehensive books on insider trading doesn’t discuss the mail and wire fraud statutes at all, although it contains extensive discussions of both the Carpenter and O’Hagan cases. See STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY (2014). The only mention of mail and wire fraud is in a footnote that details the holding in O’Hagan. See id. at 85 n.9. The book does discuss Section 1348 which at the time of publication was just starting to be used in criminal prosecutions. See id. at 172-74.
thereunder. Rule 10b-5 is a broad anti-fraud prohibition; like most of the other statutory provisions discussed herein, it does not mention “insider trading,” let alone outline the elements of a violation; those elements are judicially created, but they are grounded in the idea that the conduct must involve some kind of “fraud.” A violation of Rule 10b-5 requires a showing of scienter and some form of deception, typically a misrepresentation of material fact or silence in the face of a duty to speak.

Because securities trading occurs largely in impersonal markets, there are usually no representations made to the counterparties and therefore no misrepresentations. So, the question becomes under what conditions can silence constitute a misrepresentation in the context of a securities transaction? In the insider trading context, the Supreme Court has repeatedly held that silence is legally actionable only where there is a duty to speak and a duty to speak exists only if there is a pre-existing fiduciary relationship or similar relationship of trust and confidence.

There are three principal ways to make out a Section 10(b)-Rule 10b-5 insider trading claim with a few subsidiary issues:

1. The Classical Theory

The classical theory is aimed at “insiders” of a company (today broadly viewed to include officers, directors, employees, and contractors) who trade in the securities of their company on the basis of material non-public information. The duty to speak arises from a fiduciary or fiduciary-like relationship that insiders have to their company and its shareholders. Under the classical theory, the “victim” of the unlawful conduct is the counterparty to the transaction, or other market participants generally. The classical theory can be summarized as: trading on the basis of material non-public information (MNPI) in violation of a duty of trust and confidence that is owed to the company or its shareholders. The SEC has defined trading “on

32 17 C.F.R. §240-10b-5
33 Scienter is defined as a state of mind embracing an intent to deceive or defraud. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976). The standard for scienter is different in criminal and civil cases. To meet the mens rea standard in a criminal case requires willful or knowing conduct, whereas recklessness suffices in a civil case. See, e.g., United States v. Newman, slip op. at 12; SEC v. Payton, 219 F. Supp. 3d 485, 492 (S.D.N.Y. 2016). The burden of proof is different as well: beyond a reasonable doubt versus preponderance of the evidence.
35 See id. at 228; Dirks v. SEC, 463 U.S. 646, 654 (1983).
36 See Chiarella, 445 U.S. at 228; Dirks, 463 U.S. at 655.
the basis of” to mean that the trader “was aware of the material nonpublic information when the person made the purchase or sale.”

a. Tipper-Tippee Liability

Liability under the classical theory extends to those insiders (tippers) who provide MNPI to others (tippees) who then trade on the basis of that information. Tippee liability is predicated on a breach of duty by the tipper. The tippers’ fiduciary breach consists of an improper disclosure of confidential company information to the tippee, rather than a failure to disclose information to the market. When there has been such a breach by the tipper, and the tippee knew of the breach, the tippee then assumes the tippers’ duty to disclose to the market or abstain from trading. The test for whether a disclosure is improper is whether the tipper personally benefitted from the disclosure. The personal benefit can consist of an actual pecuniary benefit (a quid pro quo), or a more amorphous benefit like a reputational benefit. A gift of information to a trading relative or friend also satisfies the personal benefit test.

There are two important open questions regarding the personal benefit test resulting from the Second Circuit’s decisions in Newman and Martoma: the first concerns what the prosecution needs to show about the tippee’s knowledge of the tipper’s personal benefit, an issue that is particularly problematic when there are remote tippees. In Newman, the court held that, at least in criminal cases, the tippee must actually know that some personal benefit is being provided to the tipper. While the Supreme Court overturned parts of Newman in the Salman case, they left this part undisturbed. The second issue is under what conditions a gift of information to a trading

37 17 C.F.R. § 240.10b5-1(b) (2020). Before the enactment of 10b5-1, courts were split on the “use” vs. “possession” question. See, e.g., United States v. Smith, 155 F.3d 1051 (9th Cir. 1998); SEC v. Adler, 137 F.3d 1325 (11th Cir. 1998); United States v. Teicher, 987 F.2d 112 (2d Cir. 1993), and the issue may not be entirely settled. See Andrew Verstein, Mixed Motives Insider Trading, 106 IOWA L. REV. 1253, 1261-65 (2021).
38 See Dirks, 463 U.S. at 661.
39 Id. at 660.
40 Id.
41 Id. at 662.
42 Id. at 663-64.
43 Dirks at 664; see also Salman v. United States, 580 U.S. 39, 39 (2016).
44 United States v. Newman, 773 F.3d 438, 447-48 (2d Cir. 2014). In SEC v. Payton, 219 F. Supp. 3d 485, 492 the court held that in a civil case, the SEC need only prove that the tippee “knew or had reason to know of the benefit to the tipper.”
45 See Salman, 580 U.S. at 45.
relative or friend satisfies the personal benefit test.46

2. The Misappropriation Theory

The misappropriation theory extends insider trading liability to “outsiders” of a company, that is to persons who trade on the basis of MNPI but who have no relation to the company whose securities they are trading in.47 Here the duty to speak arises from a duty of trust and confidence that is owed to the source of the information.48 In brief, someone who receives MNPI in confidence violates a fiduciary or fiduciary-like duty owed to the source of the information when they secretly convert the principal’s information to their own use by trading on it.49 Misappropriation is somewhat akin to embezzlement: “Under this theory, a fiduciary's undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information.”50 The deception necessary for the fiduciary breach to constitute fraud within the meaning of Section 10(b) comes about from the failure to disclose the use of the information to the principal.51 The SEC has adopted rules specifying that for purposes of the misappropriation theory a “duty of trust or confidence” exists whenever a person agrees to maintain information in confidence, whenever there is a history of sharing confidences that would give rise to an expectation of confidentiality, and whenever confidential information is received from certain specified family members.52

Under the misappropriation theory, the “victim” is the source, or “owner,” of the information: it has nothing to do with the counterparty to the transaction or to market harms more generally.53 Indeed, the fraud and the trading are only tangentially connected: under the misappropriation theory the misappropriator is defrauding one person while trading with another.54 The misappropriation theory can be summarized as: Trading on the basis of

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46 See Newman, 773 F.3d at 447.
48 Id. at 652-53.
49 Id. at 652.
50 Id.
51 Id. Of course, this means that a trader who discloses their trading to the principal would not violate the anti-fraud provisions. See O’Hagan, 521 U.S. at 654-55.
52 17 C.F.R. § 240.10b5-2 (2022).
53 See O’Hagan, 521 U.S. at 653-54.
54 In O’Hagan, the court held that the two are sufficiently connected to meet the statutory “in connection with” requirement. See id. at 655-56.
MNPI in violation of a duty of trust and confidence that is owed to the source of the information. As with the classical theory, “on the basis of” means if the trader is aware of the information at the time of trading.\textsuperscript{55}

\textit{a. Tipper-Tippee Liability}

It is an open question whether tipper-tippee liability in misappropriation cases requires a showing that the tipper received a personal benefit in exchange for the tip. The Supreme Court has never specifically ruled on the issue and simply sidestepped it when deciding the \textit{Salman} case.\textsuperscript{56} To date, one appellate court – the 11\textsuperscript{th} Circuit – has held that a personal benefit is required in misappropriation cases,\textsuperscript{57} and the Second Circuit has, on several occasions, stated that the elements of tipping liability are the same in classical and misappropriation cases.\textsuperscript{58} Some lower courts, however, have come out differently and the few appellate courts that have confronted the issue have generally avoided addressing it.\textsuperscript{59}

3. Actual Misrepresentation

A third theory of insider trading liability under Section 10(b), distinct from both the classical and misappropriation theories, involves an actual misrepresentation rather than a failure to speak. This of course could come up in situations where a trade is conducted face-to-face and one of the traders makes a false statement of material fact.

However, the theory has also been applied, somewhat controversially, to impose Section 10(b) liability in a case where a trader obtained MNPI by hacking into a computer system. In \textit{SEC v. Dorozhko}, the district court denied the SEC’s motion for a preliminary injunction on the grounds that the

\textsuperscript{55} 17 C.F.R. § 240.10b5-1(b) (2020).

\textsuperscript{56} \textit{Salman v. United States}, 580 U.S. 39, 47 n.2 (“The parties do not dispute that Dirks’s personal-benefit analysis applies in both classical and misappropriation cases, so we will proceed on the assumption that it does.”).

\textsuperscript{57} \textit{SEC v. Yun}, 327 F.3d 1263, 1277 (11th Cir. 2003). See also \textit{SEC v. Big Apple Consulting USA, Inc.}, 783 F.3d 786, 801 (11th Cir. 2015).

\textsuperscript{58} See, e.g., \textit{United States v. Martoma}, 869 F.3d. 58, 63 (2d Cir. 2017) (“[T]he Dirks articulation of tipper and tippee liability also applies under the misappropriation theory”); \textit{Newman}, 773 F.3d at 446 (“The elements of tipping liability are the same regardless of whether the tipper’s duty arises under the ‘classical’ or the ‘misappropriation’ theory.”); \textit{SEC v. Obus}, 693 F.3d 276, 285-86 (2d Cir. 2012) (same analysis applies in classical and misappropriation cases); \textit{United States v. Chow}, 993 F.3d 125 (2d. Cir. 2021) (applying personal benefit test in misappropriation case).

\textsuperscript{59} See, e.g., \textit{United States v. Parigian}, 824 F.3d 5, 15 (1st Cir. 2016).
hacker had not breached any fiduciary duty when he accessed the computer system.\textsuperscript{60} The Second Circuit reversed, holding that a breach of fiduciary duty is not a required element when the alleged fraud is an affirmative misrepresentation rather than a nondisclosure.\textsuperscript{61} The Second Circuit further held that computer hacking could be deceptive within the meaning of Section 10(b) even in the absence of a breach of fiduciary duty because the hacker misrepresented his identity in order to gain access to confidential information.\textsuperscript{62}

\textit{B. Title 15 - Section 17(a) of the Securities Act of 1933}

Both the SEC and the criminal authorities can bring insider trading cases under Section 17(a) of the Securities Act of 1933.\textsuperscript{63} The principal difference between Section 17(a) and Rule 10b-5 of the Exchange Act is that Section 17(a) only applies to the offer and sale of securities while Rule 10b-5 applies to the purchase or sale of securities.\textsuperscript{64} Thus, Section 17(a) can only be used where the insider trading consists of sales or short sales of securities rather than purchases.

Insider trading liability under Section 17(a) mirrors liability under Section 10(b) in certain respects: it can be predicated on an actual misrepresentation even without a breach of fiduciary duty, or it can be based on a failure to disclose in the face of a duty to speak arising from a pre-existing duty of trust and confidence under the classical theory. In tippee-tippee cases under the classical theory, the personal benefit test applies.

Finally, there is one important difference in the elements of a Section 17(a) action: while a violation of Section 10(b) always requires a showing of \textit{scienter}, only a violation of Section 17(a)(1) requires \textit{scienter}: violations of Section 17(a)(2) and (3) require only a showing of negligence at least in the civil context.\textsuperscript{65} Over the last several years, the SEC has increasingly resorted to using negligence based 17(a)(2) and (3) charges in securities fraud cases, particularly in the context of negotiated resolutions.\textsuperscript{66} Recently, the SEC brought an insider trading case charging not only violations of Section 10(b) but also violations of Section 17(a)(2) and (3). The case involved two

\textsuperscript{60} SEC v. Dorozhko, 606 F.SUPP. 2d 321 (S.D.N.Y. 2008).
\textsuperscript{61} SEC v. Dorozhko, 574 F.3d 42, 45 (2d. Cir. 2009).
\textsuperscript{62} Id.
\textsuperscript{63} Securities Act of 1933, 15 U.S.C. § 17(a)
\textsuperscript{64} Compare Securities Act of 1933, 15 U.S.C. § 17(a) with 17 C.F.R. § 240.10b-5.
\textsuperscript{65} See Aaron v. SEC, 446 U.S. 680, 700 (1980).
individuals who engaged in insider trading but tried to cover their tracks by adopting what are called Rule 10b5-1 trading plans just before they traded. In the Order, the SEC went out of its way to stress that a “violation of these provisions [Section 17(a)(2) and (3)] does not require scienter and may rest on a finding of negligence.” 67 Going forward, a Section 17(a)(2) and (3) charge might prove an attractive alternative for the SEC, particularly in cases where the issue concerns the knowledge of a remote tippee (e.g., with respect to whether the tipper received a personal benefit).

However, liability under the misappropriation theory is problematic under Section 17(a)(3). Section 17(a)(3) makes it unlawful “to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser” (emphasis added). 68 By contrast, the operative language of Rule 10b-5 makes it unlawful “[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person” (emphasis added). 69 In misappropriation cases, the defrauded party is the source of the information, not the counterparty to the transaction. 70

C. Title 15 - Section 14(e) of the Securities Exchange Act of 1934 and Rule 14e-3

Both the SEC and criminal authorities can bring insider trading cases under Section 14(e) and Rule 14e-3 of the Exchange Act. 71 Rule 14e-3 contains the only explicit prohibition on insider trading in the federal securities laws (as opposed to the use of the general anti-fraud provisions to prosecute insider trading). Broadly speaking, Rule 14e-3 prohibits trading on the basis of MNPI in advance of a tender offer if the trader has received the information, directly or indirectly, from certain specified persons involved in, or with knowledge of, the tender offer. 72

Importantly, there is no requirement that the trader have a fiduciary or fiduciary-like relationship with either the company or the source of the information and there is consequently no requirement of a breach of

67 Sheng Fu and Ming Xu, Admin. Pro. SEC 3-21118 (2022).
69 17 C.F.R. § 240.10b-5(c).
71 Id. at 642.
And, of course, there is no need to show that a tipper has received a personal benefit for tippee liability to attach. Rule 14e-3 liability is therefore much broader than Section 10(b)-Rule 10b-5 or Section 17(a) liability because it focuses simply on trading while in possession of MNPI without any violation of a duty of trust and confidence. At the same time, it is also much narrower because it only applies in the context of tender offers.

D. Title 18

1. Mail and Wire Fraud

The mail and wire fraud statutes are criminal statutes which cannot be enforced by the SEC. The mail and wire fraud statutes both prohibit “any scheme or artifice to defraud” or to obtain money or property “by means of false or fraudulent pretenses, representations, or promises” through the use of the mail or by interstate wire. The reach of the mail and wire fraud statutes is very broad and the Supreme Court has twice unanimously blessed the use of those statutes to criminally prosecute insider trading, first in Carpenter v. United States in 1987 and ten years later in United States v. O’Hagan.

Use of the mail and wire fraud statutes to prosecute insider trading is based on an embezzlement theory, namely the fraudulent appropriation for one’s own use of money or goods that have been entrusted to one’s care by another. The embezzlement itself constitutes a violation of a duty of trust and confidence:

It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal

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73 O’Hagan, 521 U.S. at 645 (“Rule 14e-3(a) imposes a duty to disclose or abstain from trading whether or not the trader owes a fiduciary duty to respect the confidentiality of the information.”).

74 18 U.S.C. § 1341 (mail fraud); 18 U.S.C. § 1343 (wire fraud). The required elements of a violation are simply (1) a scheme to defraud or deprive someone of property, and (2) use of the mails or an interstate wire. See, e.g., Schmuck v. United States, 489 U.S. 705, 721 (1989).

75 Judge Rakoff famously quipped that, “To federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love.” Jed S. Rakoff, The Federal Mail Fraud Statute (Part I), 18 DUQ. L. REV. 771 (1980).


77 See O’Hagan, 521 U.S. 642.
benefit, but must account to his principal for any profits derived therefrom.\textsuperscript{78}

In \textit{Carpenter}, a Wall Street Journal columnist provided advance information regarding the content of his column to two individuals who traded on the information and shared the profits with the columnist.\textsuperscript{79} The Court held that the WSJ had a property right in the exclusive pre-publication use of the information, and that the trading constituted a fraudulent scheme to deprive the WSJ of its property right within the meaning of the statute.\textsuperscript{80}

Mail and wire fraud insider trading bears considerable resemblance to the misappropriation theory, although there is a fundamental distinction. As one commenter put it: “Mail fraud is based on a deprivation of money or tangible or intangible ‘property.’ Rule 10b-5 misappropriation involves a breach of duty to the information source (in connection with a securities transaction).”\textsuperscript{81}

In \textit{United States v. Blaszczak}, which has since been vacated on other grounds, the Second Circuit held that there is no need to show that a tipper received a personal benefit to sustain a mail and wire fraud conviction: “the personal-benefit test finds no support in the embezzlement theory of fraud recognized in \textit{Carpenter}.”\textsuperscript{82}

Finally, “insider trading” under the mail and wire fraud statutes does not require a securities transaction. First, it does not require a security: the mail and wire fraud statutes extend to all forms of property, which includes commodities and even property in things that are neither securities nor commodities (e.g., non-fungible tokens). Second, strictly speaking, the mail and wire fraud statutes do not even require a transaction: there is no “in connection with” requirement similar to what is found in the general anti-fraud provisions of the federal securities laws.\textsuperscript{83}

\textsuperscript{78} See \textit{Carpenter}, 484 U.S. at 27-28 (citation omitted).
\textsuperscript{79} Id. at 23.
\textsuperscript{80} Id. at 26.
\textsuperscript{82} United States v. Blaszczak, 947 F.3d 19, 35-36 (2019).
\textsuperscript{83} See, e.g., 18 U.S.C. § 1343 (Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire . . . any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.).
2. Securities Fraud

Title 18 Section 1348 is a relatively new antifraud provision that was added to the criminal code with the passage of Sarbanes-Oxley in 2002.\(^{84}\) It was specifically designed to capture fraudulent conduct that might not meet the technical requirements of Section 10(b) fraud. The legislative history shows that Congress intended to “supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud . . . statutes.”\(^{85}\)

Modeled on the mail and wire fraud statutes, Section 1348 provides severe penalties\(^{86}\) for engaging in a scheme “to defraud any person in connection with . . . any security of an issuer with a class of securities registered under section 12 of the [Exchange Act] or that is required to file reports under section 15(d) of the [Exchange Act].”\(^{87}\) It thus applies to insider trading in the shares of public companies, broadly defined to include private companies that have reporting obligations under the Exchange Act.

In *United States v. Blaszczak*, the Second Circuit upheld the use of Section 1348 in an insider trading case and, as with the mail and wire fraud charges, held that the personal benefit test has no place in the context of an insider trading case based on an embezzlement theory.\(^{88}\) Although the *Blaszczak* decision was vacated on other grounds, the reasoning with respect to the personal benefit test still holds and at least one court has followed the Second Circuit’s lead post *vacatur*. In *United States v. Ramsey*, the district court recently held that “while it is true that *Blaszczak* has been vacated, the *Blaszczak* Court’s reasoning in holding that the personal benefit test does not apply to Title 18 remains instructive and persuasive.”\(^{89}\) Other courts that have considered the issue have declined to import the personal benefit test into the Section 1348 framework.\(^{90}\) Finally, by its terms Section 1348 also

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\(^{86}\) See 18 U.S.C. § 1348 (maximum penalty is twenty-five years imprisonment).

\(^{87}\) *Id.*

\(^{88}\) United States v. Blaszczak, 947 F.3d 19, 35-36.


\(^{90}\) See, *e.g.*, United States v. Melvin, 143 F. Supp. 3d 1354, 1374-75 (“Defendants have not
applies to commodities fraud, which may become important because of the uncertain status of certain crypto-assets.

E. Other Statutory Provisions Bearing on Insider Trading Liability


Section 20(a) of the Securities Exchange Act of 1934 makes “controlling” persons liable to the same extent as the persons they control, unless the control person acted in good faith. Section 21A of the Exchange Act allows the SEC to impose significant civil penalties (up to $1 million or three times the gross pecuniary gain or loss avoided) in federal court actions on control persons who fail to prevent insider trading by individuals whom they “directly or indirectly” control. In order to establish control person liability, there must be a violation by the controlled person, and there must be a showing that the control person “knew or recklessly disregarded the fact that [the] controlled person was likely to engage in the act or acts constituting the violation and failed to take appropriate steps to prevent such acts” or “knowingly or recklessly failed to establish, maintain, or enforce [required policies and procedures] . . . and such failure substantially contributed to or permitted the occurrence of the act or acts constituting the violation.”

Generally speaking, control persons can insulate themselves from liability if they, in good faith, take “appropriate steps to prevent” violative acts, which in practice means establishing and maintaining a robust compliance program.

To date the SEC has only brought a few cases under Section 21A involving control person liability for insider trading, but that may be changing. In one very recent case, the SEC charged a company executive with insider trading through a Rule 10b5-1 plan, and also charged the same executive with control person liability with respect to trades made through

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1 See Adam Felsenthal, The Blindsided Insider: Insider Trading Liability for Supervising a Rogue Trader, 61 CLEV. ST. L. REV. 167, 180-81 (2013) (noting that as of 2013 the SEC had only brought three cases, all settled, against control persons under the ITSFEA).
an entity he controlled.  


Under Section 20(e) of the Securities Exchange Act of 1934, the SEC can bring charges against persons for “aiding and abetting” violations of the Exchange Act. Specifically, Section 20(e) provides that “any person that knowingly . . . provides substantial assistance to another person” with respect to any violation of the Exchange Act is liable for that violation “to the same extent as the person to whom such assistance is provided.” The Second Circuit has held that to establish aiding and abetting liability, the SEC must allege “a securities law violation by the primary . . . party; (2) knowledge of this violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation.” Recklessness satisfies the knowledge requirement.

Over the past several years the SEC has brought aiding and abetting charges in a few insider trading cases, often side-by-side with primary violations, presumably because they thought it might be easier to establish the elements of a secondary violation than a primary violation in the case of a tippee. For example, the SEC recently brought an insider trading case against an insider who traded on the basis of MNPI about his company and also tipped four of his friends who also traded. The SEC charged the tipper and the four tippees with violations of Section 10(b) and Rule 10b-5, and separately charged the four tippees with aiding and abetting the tipper’s violations.

3. Private Actions - Section 20A of the Securities Exchange Act of

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99 SEC v. Dibella, 587 F.3d 553, 566 (2d. Cir. 2009).
100 15 U.S.C. § 78t(e).
101 See Complaint at 15-17, SEC v. Nellore, No. 19-CV-8207 (N.D. Cal. Dec. 17, 2019). See also SEC v. Yang and Chen, No. 20-CV-4427, 2022 WL 16715912, at *1 (E.D.N.Y. Nov. 4, 2022)(charging tipper and tippee with violations of Section 10(b) and also charging tippee with aiding and abetting tipper’s 10(b) violations); SEC v. Pithapurwala, No. CV 21-9384 PA, 2022 WL 2200400, at *1 (C.D. Cal. June 13, 2022) (charging tipper and tippee with violating Section 10(b) and sister of tipper with aiding and abetting liability); SEC v. Aragon Capital Advisors, No. 07-CV-919, 2011 WL 3278907, at *4 (S.D.N.Y. July 26, 2011) (charging tipper and tippees with several violations of Section 10(b)).
Section 20A of the Exchange Act provides a purely private right of action whereby persons who trade contemporaneously with someone who traded while in possession of MNPI in violation of the federal securities laws, can recover the profits gained or losses avoided by the insider trader. Contemporaneous traders can also recover from tippers as they are jointly and severally liable with their tippees. Any recovery in a Section 20A action is offset by any disgorgement ordered in an SEC action involving the same violative conduct.

Three things are particularly noteworthy about Section 20A liability. First, liability here is clearly founded on the idea that the persons harmed by insider trading – the victims – are those who trade with persons in possession of MNPI, and not just those who are specifically on the other side of the trade (the counterparties) but anyone who trades at the same time as the insider. The focus, in other words, is on protecting other market participants who trade, or might trade, with persons in possession of MNPI that is not available to them. Second, by its terms Section 20A liability is limited to persons who violate provisions of Title 15. It therefore does not extend to violations of the mail and wire fraud statutes or Section 1348 securities fraud. Third, Section 20A liability extends to any insider trading violation under Title 15 whether the case is a classical case or a misappropriation case. This is interesting because the misappropriation theory is based on the idea that the party who is defrauded is the source of the information rather than the counterparty to the trade or other market participants.

4. Criminal Conspiracy and Criminal Aiding and Abetting

There are a variety of criminal conspiracy statutes that authorities have charged in insider trading cases. Notably, the criminal authorities are typically charging conspiracy in tipper-tippee cases, including cases involving remote tippees. Conspiracy statutes typically require some agreement among the participants regarding the objective of the conspiracy, an intent to achieve that objective, and some overt act in furtherance of the

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103 Id. § 78t-1(c).
104 See id. § 78t-1(b)(2) (because of the disgorgement offset, Section 20A has not been much used).
105 Id. § 78t-1(a).
conspiracy. Under the conspiracy statutes, tippers and tippees are viewed as acting in concert as part of a common scheme to defraud. Notably, the criminal authorities have often charged criminal conspiracy to violate a particular legal provision without also charging a direct violation of that legal provision.

In Blaszczak, the court remanded two counts of “conspiracy to defraud the United States” for further consideration even after vacating the convictions on the substantive charges, which indicates that conspiracy to commit what amounts to insider trading may stand on a separate footing from the insider trading charges themselves. 108 Notably, after finding that confidential government information did not constitute “property” for purposes of Title 18 wire fraud or securities fraud, the court in Blaszczak II distinguished a conspiracy under Section 371 noting that that statutory provision is not limited to property interests: “Section 371 encompasses not just conspiracies to commit property crimes, but conspiracy to commit ‘any offense against the United States’ and any conspiracy to ‘defraud the United States, or any agency thereof in any manner or for any purpose.’” 109

Finally, the criminal authorities can also bring aiding and abetting charges in insider trading cases. Under the criminal aiding and abetting statute, anyone who “aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal” for the underlying offense. 110

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The upshot is that the criminal authorities have a host of avenues to pursue insider trading charges, indeed more than the civil authorities, and in at least some instances it may be easier to bring criminal charges than civil charges. This may seem odd, and it has bothered some members of the judiciary as well as academics, but it has been the case for more than forty years and is likely to be a feature of insider trading law going forward. Because of the uncertainties surrounding the anti-fraud provisions of the federal securities laws, whenever there are issues relating to the personal benefit test, including issues relating to the knowledge of remote tippees, the criminal authorities are likely to bring Title 18 charges, whether mail and wire fraud or securities fraud, or both, rather than, or in addition to, Title 15 charges. At the same time, the SEC is likely to bring parallel Title 15 civil charges with respect to the conduct charged in the criminal cases perhaps in

the hope that a successful resolution of the criminal charges will lead defendants to settle the SEC charges without a trial where the SEC could face difficult proof issues.

II. SOME DATA

The legal uncertainty created by the Second Circuit’s *Newman* decision has moved the criminal authorities to adopt new strategies to combat insider trading, most particularly in the use of Title 18 mail and wire and securities fraud. It has also impacted the SEC enforcement efforts and informed some of the agency’s charging decisions. The following are some data points concerning SEC insider trading enforcement actions and parallel criminal proceedings.

The chart below provides a breakdown of SEC insider trading enforcement actions over a twenty-one-year period, broken down by the total number of cases, the total number of defendants and respondents, and the number of cases that were filed as federal court civil actions and those that were filed as administrative proceedings. I have omitted “follow-on” administrative proceedings which are typically brought after a criminal conviction or civil fraud finding to bar an associated person from working with a broker-dealer or investment adviser.\(^\text{111}\)

\(^{111}\) Before 2015, the SEC did not break out follow-on administrative proceedings which led to some double counting of cases. In the table, I have removed follow-on APs from the SEC’s official total for overall cases and number of defendants and respondents. The numbers are taken from the SEC’s year-end reports.
A. SEC Insider Trading Enforcement Actions 2002-2022

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total Cases(^{112})</th>
<th>Def. &amp; Res.</th>
<th>Civil Actions</th>
<th>Standalone APs</th>
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<tr>
<td>2022</td>
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</tr>
<tr>
<td>2002</td>
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<td>138</td>
<td>53</td>
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</table>

1. Total Cases and Total Individual Defendants

The total number of insider trading cases the SEC brings on a yearly

\(^{112}\) The total number of insider trading cases the SEC reports each year is a bit misleading because the SEC sometimes breaks up what is clearly a single insider trading scheme into multiple filings, each of which is counted as a separate case. To cite but one of many examples, in FY 2021 the SEC brought insider trading charges against Beth Mueller who allegedly tipped MNPI to Scott Chasin and Linda Chasin who traded on that information. The SEC filed charges against all three participants but did so in two separate administrative proceedings: IMO Beth Mueller and IMO Scott Chasin and Linda Chasin and counted these as separate cases in its FY 2021 numbers even though the SEC’s own Administrative Summary describes it as a single scheme. Perhaps there is some legitimate reason why the SEC brought separate charges in these cases, although if there is one it is not immediately apparent; the most plausible explanation is that the SEC is breaking up single cases into multiple filings in order to boost its year-end numbers. But it does make it difficult to assess the overall numbers.
basis is down over the last several years, although the numbers rebounded significantly this past fiscal year (fiscal year (FY) 2022). The numbers were particularly low in the three-year period from FY 2019 to FY 2021; in that last year the agency brought a grand total of only twenty-eight insider trading cases.\textsuperscript{113} From FY 2019 through FY 2022 the SEC brought a total of 134 insider trading cases, or an average of 33.5 per year. In the eight full fiscal years since the \textit{Newman} decision (FY 2015 through FY 2022 inclusive) the SEC brought a total of 309 insider trading cases, or an average of 38.65 per year. By contrast, over the thirteen full fiscal years prior to the \textit{Newman} decision (FY 2002 through FY 2014 inclusive) the SEC brought a total of 552 insider trading cases, or an average of 42.46 per year.

The decline in the number of individuals charged in SEC insider trading cases is even starker. From FY 2019 through FY 2022, the SEC charged a total of 243 individuals in insider trading actions or an average of 60.75 per year. From FY 2015 to FY 2022 inclusive the SEC charged a total of 581 individuals in insider trading cases, or an average of 72.62 per year. By contrast, from FY 2002 through FY 2014 inclusive, the SEC charged a total of 1,299 individuals in insider trading cases, an average of 99.92 per year.

It is hard to say how much of this decline can be traced to the \textit{Newman} decision, particularly given that the past few years have been marked by the pandemic which may have affected SEC enforcement.\textsuperscript{114} Notably the numbers for FY 2022 are much higher than for the previous three years. However, it seems clear that there has been some impact. This is particularly true when considering the numbers of individuals charged, because the \textit{Newman} decision largely affected the ability to bring charges against tippees and especially remote tippees.

2. Parallel Criminal Actions

The most significant developments in regard to criminal insider trading prosecutions is an increase in the number of parallel action and the frequency of Title 18 charges, principally Section 1348 securities fraud, but also

\textsuperscript{113} The real number of cases is even lower if certain clearly related cases had been brought together. FY 2021 of course was a pandemic year. However, the marked decline began in FY 2019, which was entirely pre-pandemic. See Tom Dreisbach, \textit{Lowest Number of Insider Trading Cases Since 1996}, NPR (Aug. 14, 2020, 4:12 PM), https://www.npr.org/2020/08/14/901862355/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decade [https://perma.cc/XBU2-L8XT].

Section 1343 wire fraud. Title 18 charges are typically brought in conjunction with more traditional Section 10b charges, although there have been several instances in which criminal authorities have charged only Title 18 violations.

Specifically, in FY 2022, the SEC brought a total of forty-three insider trading cases; criminal authorities brought parallel criminal charges with respect to eighteen of those cases. In ten out of those eighteen cases, the charges included Title 18 violations. In eight cases, the criminal authorities charged Section 1348 violations (including one case where the criminal authorities also charged Section 1343), and in two cases the authorities charged Section 1343 wire fraud. As discussed in detail below, in one case the criminal authorities charged only Section 1343 and did not include any securities fraud charges although the conduct at issue was clearly described as insider trading (and of course the SEC brought traditional 10b-5 charges with respect to the same conduct).

The following chart shows the number of SEC insider trading cases, the number of parallel criminal cases, and the number of those criminal cases where the charges included Title 18 charges (either alone or in conjunction with traditional 10b-5 charges) since the Newman decision.

3. Administrative Proceedings

The SEC brings a fairly significant percentage of its insider trading
cases as administrative proceedings rather than federal court actions.\textsuperscript{115} The percentage of APs has risen significantly since just before the Newman decision. The increased use of the administrative forum is consistent with an agency wide trend\textsuperscript{116} that has been much discussed and much criticized\textsuperscript{117} and which is currently the subject of multiple court challenges which may in the near future significantly curtail its use.\textsuperscript{118} The Agency’s overall move to the administrative forum began after the passage of Dodd-Frank in 2010 which gave the agency the authority to obtain substantially the same penalties in most cases in administrative proceedings as could be obtained in federal court actions. The penalty authority however is different with respect to insider trading cases: in federal court actions, the SEC can obtain penalties up to three times the amount of the gains or losses avoided,\textsuperscript{119} whereas in administrative proceedings the amount of the penalty is statutorily capped at $100,000 per violation (adjusted slightly for inflation).\textsuperscript{120} The Agency’s ability to use the administrative forum is therefore more limited in the insider trading context than with respect to other types of cases. As a result, the high percentage of insider trading cases brought as administrative proceedings stands out in relation to other types of cases.

Significantly, the SEC is using the administrative forum generally, and particularly in insider trading cases, even with respect to settled matters. A large part of the reason for bringing settled matters in the administrative forum is to avoid judicial scrutiny of settlements;\textsuperscript{121} it also gives the agency greater leeway to press novel and perhaps controversial theories.

\textsuperscript{115} See supra Section A. SEC Insider Trading Enforcement Actions 2002-2022.
\textsuperscript{118} See, e.g., Securities and Exchange Commission v. Jarkesy, No. 22-859 (argued Nov. 29, 2023) (raising Seventh Amendment challenge to civil penalty authority in SEC administrative proceedings).
\textsuperscript{120} Id. § 21B(b)(3), 15 U.S.C. § 78u-2(b)(3); see also Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission, SEC (Jan. 15, 2023), https://www.sec.gov/enforce/civil-penalties-inflation-adjustments [https://perma.cc/2SNW-97R6].
III. PUSHING THE ENVELOPE: NOTEWORTHY TRENDS AND RECENT CASES

A. Parallel Cases, Different Charges

Perhaps the most noteworthy recent trend involves civil and criminal authorities bringing parallel insider trading cases, involving the same misconduct, but charging the cases under different statutory provisions. Most notable are cases where the SEC is charging insider trading under Section 10(b) while the criminal authorities are completely avoiding that statutory provision, with all its problems, and instead are bringing insider trading cases charging only violations of Title 18 mail and wire fraud and securities fraud (typically along with conspiracy charges). The following are some recent examples.

1. The Dark Web

In July 2021, the SEC and criminal authorities brought charges against Apostolos Trovias, known as “The Bull,” for engaging in a scheme to sell inside information (order-book data from a securities trading firm) over the “Dark Web,” a part of the internet that facilitates anonymity and is often used to sell illegal products and services.122 The SEC charged violations of Section 10(b) and Rule 10b-5; the criminal authorities charged the same conduct but as Section 1348 securities fraud (the criminal authorities also charged one count of money laundering).

The facts in the case reveal the reasons behind the disparate charges. Trovias claimed that he obtained the information he was selling over the Dark Web from an insider at a securities firm.123 The SEC’s complaint, however, does not identify the source of the information or the firm, or any benefit the source received, likely because they were unknown at the time of filing. Indeed, the SEC’s complaint suggests that there may not even have

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123 Id.
been a “source,” that Trovias was simply making up the information. The SEC’s complaint ended up charging Trovias under two alternative theories couched in hypothetical and conclusory terms: if Trovias lied about or misrepresented the source of the information, he was deceiving the people who purchased the information from him; or “if the tipper of the material, nonpublic information was in fact a third party” then Trovias “knew, recklessly disregarded, or had reason to know that he provided, and his tipper obtained, a personal benefit from Trovias’s acting as a vendor for the information.”

By charging Trovias with securities fraud under Section 1348, the criminal authorities avoided all the messy issues surrounding the breach of duty and the personal benefit test. Trovias, who was arrested in Peru and extradited to the United States, pled guilty to the criminal Section 1348 charge and then entered into a consent judgment with the SEC permanently enjoining him from violating Section 10(b)-Rule 10b-5. The total proceeds from the scheme amounted to about $6,700!

2. The Palo Alto Networks Case

In December 2019, the SEC and the criminal authorities brought cases involving a multi-year scheme to trade in the securities of Palo Alto Networks, Inc. (PANW) that netted some $7 million in illicit profits. According to the SEC’s complaint, Janardhan Nellore, who was employed at PANW as an IT administrator, traded on confidential information about upcoming PANW earnings announcements and tipped four of his friends (Sivannarayana Barama, Ganapathi Kunadharaju, Saber Hussain, and Prasad Malempati) who also traded on that information. Criminal authorities initially brought charges against Nellore and one of the tippees, Barama.

A few things are of interest about the case. First, while the SEC charged the defendants with violating Section 10(b) and Rule 10b-5, the criminal authorities only charged violations of Section 1348, along with conspiracy.

127 The criminal authorities subsequently brought charges against the other tippees.
to commit securities fraud (Section 1349). Second, while the SEC charged all five defendants with Section 10(b) violations, the SEC also charged the four tippees with aiding and abetting the tipper’s violations of Section 10(b). Specifically, the complaint alleged that the four tippees “each knowingly or recklessly provided substantial assistance to Nellore, who knowingly or recklessly” violated Section 10(b). Charging the tippees with aiding and abetting liability was likely driven by concerns over establishing the primary liability of some of the tippees due to possible problems meeting the Dirks personal benefit test. While the complaint alleged that two of the tippees paid kickbacks to the tipper (Nellore) which clearly satisfies the personal benefit test, the complaint alleged that one of the other tippees (Malempati) simply provided stock trading advice to Nellore as part of the scheme, and that Nellore provided tips to the fourth tippee (Barama) “as gifts” “in the context of their friendship.”

Charging the tippees with aiding and abetting provided an alternative basis for liability without having to establish all of the elements of primary liability, most notably that the tipper received a personal benefit for the tips. And, of course, the criminal authorities aimed to sidestep the personal benefit issue entirely by only charging violations of Title 18 Section 1348.

Nellore pled guilty to one count of conspiracy to commit securities fraud. Three of the tippees who were not initially charged criminally (Kunadharaju, Hussain, and Malempati) settled the SEC actions by consenting to the entry of a judgment enjoining them from violating Section 10(b) and imposing civil penalties. Barama went to trial on the criminal charges and was convicted on four counts of Section 1348 securities fraud.

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130 Id. at 6-7.
He was sentenced to eighteen months in prison. At the trial the defense argued that there was no evidence that Barama paid Nellore for the inside information, and the defense sought a jury instruction that a personal benefit is required for conviction under Section 1348. The government opposed that jury instruction citing Blaszczak for the proposition that a personal benefit is not required under Section 1348. The jury instruction did not reference personal benefit. Barama has appealed his conviction to the Ninth Circuit where the issue of personal benefit in a Section 1348 case could well be a central issue.

3. Crypto-Currency Insider Trading – The Coinbase Case

In July 2022, both the SEC and the U.S. Attorney’s Office (USAO) for the Southern District of New York (SDNY) filed charges against three individuals, Ishan Wahi, Nikhil Wahi, and Sameer Ramani, in what was described as the first ever cryptocurrency insider trading scheme. Ishan Wahi was a former product manager at Coinbase Global, Inc. (Coinbase), a crypto-asset exchange, and part of the team that worked on listing crypto-assets on Coinbase’s trading platform. Typically, when a crypto-asset gets listed on a prominent trading platform it increases visibility for the asset which leads to increased demand and a rise in price. According to the complaint and the indictment, Ishan Wahi knew which crypto-assets were going to be listed on Coinbase’s platform and the timing of the listings.

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Ishan Wahi allegedly tipped the information to his brother Nikhil Wahi, and a friend Sameer Ramani, both of whom traded on the information by purchasing crypto-assets before they were listed, generating over a million dollars in profits.\(^\text{140}\) Ishan Wahi and Nikhil Wahi were both arrested, but Sameer Ramani fled the country and remains at large. Nikhil Wahi, the tippee, pled guilty to the criminal charges,\(^\text{141}\) and was sentenced to 10 months in prison and ordered to pay $892,500 in forfeiture.\(^\text{142}\) Ishan Wahi, the tipper, also pled guilty to the criminal charges and was sentenced to 2 years in prison.\(^\text{143}\) Interestingly however, even though they had pled guilty to the criminal charges, both Wahis initially contested the SEC’s civil charges and filed a motion to dismiss the SEC’s case, primarily on the ground that the crypto-assets are not securities subject to the federal securities laws. But before the SEC’s response was due, the brothers agreed to settle the case.\(^\text{144}\)

Although both the SEC and the criminal authorities charged the same individuals in connection with the same overall scheme, there were some significant differences. First, the criminal authorities actually charged more misconduct than the SEC did: the criminal authorities alleged that the defendants made illegal trades in at least twenty-five different crypto assets generating profits of approximately $1.5 million;\(^\text{145}\) the SEC, while acknowledging that the defendants traded in twenty-five different crypto assets, only charged insider trading with respect to nine of those assets.

yielding profits totaling $1.1 million. Second, while the SEC charged violations of Section 10(b) and Rule 10b-5 of the Exchange Act, the criminal authorities only charged violations of the wire fraud statute. The criminal authorities, of course, repeatedly referred to the conduct as “insider trading” even though they never charged violations of the securities (or commodities laws). Third, the criminal charges were filed in the Southern District of New York while the SEC filed its action in the Western District of Washington.

The overarching issue in the SEC case is whether the crypto-assets are securities. Much has been written in the last few years about the status of crypto-assets (asking are crypto-assets securities, are they commodities, or are they something else entirely), but while both the SEC and the CFTC have put out some guidance on the issue, neither agency has yet adopted any rules covering crypto-assets and their ultimate status remains uncertain. Obviously, for the SEC to bring insider trading charges, the case has to involve securities. In the Coinbase case, there were trades in 25 different crypto-assets, but the SEC only charged insider trading with respect to nine of those assets which the SEC argued were securities. The SEC was very careful to limit its charges to the assets that would most likely be categorized as securities under the Howey investment contract test.

While the SEC was very careful to limit its charges, this was nonetheless a pretty aggressive foray into contested terrain: the SEC was using an insider trading enforcement action to establish jurisdiction over at least some crypto-assets. The SEC’s sister agency, the Commodity Futures Trading Commission (CFTC) is also claiming jurisdiction over at least some crypto-assets on the ground they are commodities. As of this writing, the status of crypto-assets is still very much in dispute and awaits final disposition.

The United States Attorney’s Office (USAO) for the Southern District


147 Compare Indictment at 16-18, United States v. Wahi, 22 Cr. 392 (S.D.N.Y. Feb. 7, 2023) (charging wire fraud and conspiracy to commit wire fraud) with Complaint, United States v. Wahi, Case No. 2:22-cv-01009 (W.D. Wash. Jul. 21, 2022) (charging violations of Section 10(b) and Rule 10b-5).


of New York (S.D.N.Y.) stayed out of the fray: their indictment never says whether the crypto-assets are securities or commodities, and they did not state it because they did not have to. By charging only wire fraud and conspiracy to commit wire fraud, the criminal authorities avoided this difficult question altogether. Moreover, the USAO did so in a way that allowed them to charge more misconduct than the SEC and to seek greater monetary relief than the SEC.\(^{150}\)

The USAO did not have to take a stand on this controversial and fundamental issue because the mail and wire fraud statutes are in no way limited to securities or commodities and are not even directly related to trading,\(^{151}\) although in this case that is how the fraudulent scheme was consummated. The mail and wire fraud statutes are predicated on “a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations and promises.” The fraudulent scheme consisted of depriving Coinbase of its “exclusive use of confidential business information.” The trades in crypto-assets were simply the means by which the defendants consummated the scheme by converting the confidential information to their own use.\(^{152}\) And, to be clear, the USAO is calling this “insider trading” even though the charge is mail and wire fraud.

The difficulty of establishing a personal benefit may be another reason why the USAO shied away from bringing at least some securities fraud charges. The indictment does not make any allegations about personal benefit because it only charges wire fraud. The SEC, of course, does make allegations about a personal benefit: specifically, the SEC alleges that the benefit consists of a gift of information to a trading relative or friend. With respect to the brother (Nikhil), the SEC alleges that the brothers are close, communicate frequently, and have had several financial interactions in the past. But the allegations with respect to Ramani are pretty thin: the complaint says only that Ishan and Ramani have known each other for about nine years, attended the University of Texas at the same time, follow each other on social media and have communicated by phone and text. Given the Second Circuit’s \textit{Martoma} opinion, discussed below, and the uncertainty that still

\(^{151}\) By contrast, to establish a violation of Rule 10b-5, the fraud must be “in connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b-5.
\(^{152}\) See, \textit{e.g.}, Indictment at 18-20, United States v. Wahi, 22 Cr. 392 (S.D.N.Y. Feb. 7, 2023). To put it in context, it would still constitute a violation of the wire fraud statute if instead of trading on the information the defendants had sold the information to someone, say a Coinbase competitor, who planned to use it for whatever purpose (provided of course that a wire was used!).
exists with respect to the gift theory, it is unclear what would happen if this case was brought in the SDNY. This uncertainty is the most likely reason why the SEC’s case was filed in the United States District Court for the Western District of Washington. (The USAO filed its indictment in the SDNY and they allege, as they must, that certain acts and practices described in the indictment occurred in the SDNY, so the SEC clearly could have brought their case there if they wanted.).

**B. United States v. Chastain: Insider Trading Without Securities or Commodities**

One of the most interesting, and probably the most far-reaching, “insider trading” case was brought recently by the U.S. Attorney’s Office for the SDNY. I put “insider trading” in quotes because this case tests not just the limits of the legal doctrine of insider trading, but the very concept of what constitutes insider trading.

In June 2022, the USAO indicted Nathaniel Chastain, a former product manager at OpenSea, a marketplace for Non-Fungible Tokens (NFTs). At various times, certain NFTs would be featured on OpenSea’s home page, which increased their visibility and consequently their value. Chastain was responsible for selecting which NFTs would be featured on the home page and he routinely purchased those NFTs just before they were featured and sold them shortly afterwards after they had risen in price.

NFTs are digital assets which are stored on a “blockchain,” a digital ledger which stores information regarding ownership and transfers. The legal status of NFTs is an open question and has been highly debated: are they securities, commodities, something else entirely? The USAO deftly sidestepped the issue by charging Chastain only with wire fraud under Title 18 Section 1343 (along with money laundering). Notably, neither the SEC nor the CFTC brought parallel civil charges, presumably because they wanted to avoid litigating a highly contested issue. The result is that we now have an “insider trading” case without any charges, whether civil or criminal, alleging either securities or commodities fraud.

Chastain moved to dismiss the indictment on the ground that a wire fraud insider trading charge requires trading in either securities or

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153 At a pretrial conference, the judge asked the prosecutor whether the NFTs at issue were securities. The prosecutor replied “[w]e’re not alleging securities fraud” and went on to explain that they were relying only on the wire fraud statute as interpreted by the Supreme Court in the Carpenter case. See Robert Anello & Richard Albert, *Insider Trading Unchained: Not Just Securities Anymore*, 268 N.Y.L.J. 3, 6 (2022).
commodities and some nexus to the securities markets stating:

In any prosecution under a Carpenter wire fraud theory of insider trading, the existence of securities or commodities trading remains an essential element of the offense because the object of the Carpenter decision, and the misappropriation theory, is not only to prevent the misappropriation of confidential information in breach of a duty owed to the source of that information, but critically, to protect our financial markets.\(^\text{154}\)

The court denied the motion to dismiss: “No court has suggested, let alone held, that conviction in such a case requires trading in securities or commodities.”\(^\text{155}\)

Chastain also complained that the use of the term “insider trading” in such a case is misleading and inflammatory and filed a motion to prevent the government from using the term in the indictment or at trial. The court denied the motion, stating that “insider trading” adequately captured the conduct at issue.\(^\text{156}\) Chastain was ultimately convicted after trial and sentenced to three months imprisonment and a $50,000 fine.\(^\text{157}\) At the sentencing, the Judge apparently questioned whether the case would have ever been brought “if it hadn’t happened in a new and sexy area of commerce.”\(^\text{158}\) But the case strongly suggests that the criminal authorities will be aggressively using the mail and wire fraud statutes to pursue “insider trading” whether or not the conduct involves anything that traditionally resembled insider trading.

\section*{C. Shadow Insider Trading: SEC v. Panuwat}

The Panuwat case involves what is referred to as “shadow” insider trading: trading in the securities of one company based on material nonpublic information about a different, but similarly situated, company.

\(^{154}\) Memorandum of Law in Support of Nathaniel Chastain’s Motion to Dismiss the Indictment at 2 (Aug. 19, 2022) (emphasis in the original).
\(^{155}\) United States v. Nathaniel Chastain, 22-CR-305 (JMF), Memorandum Opinion and Order at 3 (Dec. 21, 2022).
\(^{156}\) United States v. Nathaniel Chastain, 22-CR-305 (JMF), Memorandum Opinion and Order (Apr. 18, 2023) (“Its classic meaning notwithstanding, the term ‘insider trading’ is not an inapt description of the facts of this case. After all, "Chastain is accused of improperly using confidential, non-public (or ‘inside’) information about an asset to buy and then sell (or ‘trade’) that asset on a public market."”)
\(^{158}\) Id.
Matthew Panuwat was head of business development at Medivation, a mid-sized, oncology-focused biopharmaceutical company. According to the SEC’s complaint, Panuwat purchased short-term, out-of-the-money stock options in Incyte Corporation, another mid-cap oncology-focused biopharmaceutical company, just days before an announcement that Pfizer would acquire Medivation at a significant premium. Panuwat allegedly purchased the options within minutes of learning highly confidential information concerning the merger.

According to the complaint, Panuwat knew that investment bankers had looked at Incyte as a comparable company in discussions with Medivation, and Panuwat anticipated that the acquisition of Medivation would likely lead to an increase in Incyte's stock price. The complaint alleges that Medivation's insider trading policy expressly forbade Panuwat from using confidential information he acquired at Medivation to trade in the securities of any other publicly traded company.

Following the announcement of Medivation's acquisition, Incyte's stock price increased by approximately 8%. The complaint alleges that, by trading ahead of the announcement, Panuwat generated illicit profits of $107,066.

The Panuwat case has generated considerable consternation among the defense bar and among academics about an expansion of the reach of insider trading liability. But the basic legal theory appears to be sound given the current doctrinal framework. Panuwat moved to dismiss the complaint, but the district court denied the motion finding that the case fits squarely within the misappropriation theory, which appears fairly straightforward as a legal matter. The misappropriation theory is based on the idea that you can defraud one person while trading with another. The defrauded party is the source of the information, not the counterparty to the trade (or market participants generally). Because the fraud is largely disconnected from the trading (it is connected just enough to meet the “in connection with” requirement) it makes no difference from a legal standpoint what securities you are trading in. Under the misappropriation theory the issue is whether someone obtained money or property by secretly converting the principal’s property (the information) to their own use, or, put differently, whether the trader deprived the source of their exclusive right to use their confidential information.

The real question here is whether the information being traded on was material. The more indirect or attenuated the connection between the information and the trading, the less likely the information is going to be seen as material. But the basic legal theory around misappropriation appears to be sound. Panuwat moved to dismiss the case arguing, among other things,
that the information was not material, but the court denied the motion.\textsuperscript{159} Panuwat subsequently moved for summary judgment, but again the court denied the motion.\textsuperscript{160} The case is ongoing and may yet yield some interesting developments. It is also interesting that in Panuwat there were no parallel criminal charges showing that it is not always easier to bring criminal charges than civil ones.

\textit{D. Abuse of Rule 10b5-1 Plans}

Rule 10b5-1 provides a defense to insider trading liability if the trades are made pursuant to a written plan or trading instruction entered into when the trader was not aware of MNPI.\textsuperscript{161} For many years there have been concerns expressed over abuses of Rule 10b5-1 plans, particularly over traders who adopt plans shortly before the trades in question or who adopt multiple plans to meet various contingencies. As discussed below, cancelling Rule 10b5-1 plans has been seen as particularly problematic.

Recently, the authorities have brought two insider trading cases involving the misuse of Rule 10b5-1 plans. In March 2023, the SEC and criminal authorities brought insider trading charges against Terren Peizer, the chairman of a Ontak, a health-care company, for allegedly trading in the stock of his company while in possession of negative information regarding his company’s largest customer. Peizer made the trades pursuant to two Rule 10b5-1 plans that were allegedly adopted while Peizer was in possession of the negative information, even though he certified at the time of the Plans’ adoption that he was not aware of any nonpublic information. By trading in advance of the negative announcements, Peizer avoided losses totaling more than $12.7 million. The criminal authorities charged violations of both Section 1348 and Section 10(b).\textsuperscript{162} The SEC charged violations of Section 10(b) and Section 17(a) of the Securities Act; interestingly, the SEC also charged Peizer with ‘control person’ liability, because he owned and controlled one of the entities through which the trading was conducted.\textsuperscript{163}

In September 2022, the SEC brought a settled administrative

\textsuperscript{161} 17 C.F.R. § 240.10b5-1(c)(A)(3) (2022).
proceeding against the CEO of Cheetah Mobile (Cheetah), a China based technology company, and Cheetah’s former president, for insider trading that was conducted pursuant to purported Rule 10b5-1 plans. The two executives sold securities ahead of a negative announcement about the company, and the SEC order found that the executives were aware of the negative news when they adopted the trading plans. The order found that both defendants violated Section 10(b); interestingly, one of the defendants, who had made some misleading statements on an earnings call, was also found to have violated Sections 17(a)(2) and (3) of the Securities Act, which prohibit obtaining money or property by means of an untrue or materially misleading statement. The SEC order noted that a violation of this provision does not require a showing of scienter and “may rest on a finding of negligence.”164

IV. HOW WE GOT HERE: THE DEVELOPMENT OF THE LAW OF INSIDER TRADING

For many years, the Second Circuit was at the forefront of expanding insider trading liability; indeed, it was often accused of creating a legal framework that went too far and was frequently reined in by the Supreme Court.165 But more recently, the Second Circuit has pulled back in some respects, limiting the scope of insider trading liability, although the Circuit has been, and remains, deeply divided on this score. The current legal framework of insider trading law—and many of the significant problems attendant thereto—can be traced to a series of Second Circuit decisions, starting with the Newman case, and extending through the split decisions in the two Martoma cases and more recently in the two Blaszczak cases. To set the stage, some background on the development of the law of insider trading and its theoretical underpinnings is necessary.

A. The Development of Insider Trading Liability

1. Insider Trading as Common Law Fraud and the Original Problem

The problematics of insider trading law can largely be traced to the fact that there are no actionable misrepresentations in connection with most insider transactions, and with respect to open market transactions, typically

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164 Order Instituting Cease-and-desist Proceedings at 8, In the Matter of Sheng Fu & Ming Xu, No. 3-21118 (Sep. 21, 2022).
no representations, or even communications at all, between the transacting parties. The question then becomes under what conditions silence can be deemed to be fraudulent.

Long before the passage of the federal securities laws, insider trading was actionable at common law as a species of fraud under a “duty to disclose” theory. The question was how such a duty arose. Some courts recognized that officers of a corporation owed fiduciary duties to the shareholders of the corporation, which would cover certain insider transactions, but in most jurisdictions, officers were only deemed to have duties to the corporation rather than the shareholders.

In 1909, in *Strong v. Repide*, the Supreme Court held that even in the absence of an actual fiduciary duty owed by the director to the shareholders, there might be special facts or circumstances which could give rise to a duty to disclose. In *Strong*, the defendant was a director and the majority shareholder of a corporation who purchased shares from the plaintiff at the same time he was negotiating the sale of substantially all the corporation’s assets (certain land holdings) to the Philippine government. The stock purchase was consummated through agents acting on behalf of the plaintiff and the defendant, and nothing was disclosed about the impending land sale. After the land sale, the shares’ value increased tenfold. The Court held that even if the director did not have fiduciary like duties solely in his capacity as a director, he acquired such duties by virtue of his ownership of three quarters of the shares, his unique role in leading the negotiations for the sale of the land and the knowledge he acquired thereby, and the fact that he was acting essentially as an agent for the other shareholders. The Court concluded that the combination of these facts “rendered it the plain duty of the defendant to speak.”

However, in *Goodwin v. Agassiz*, the Massachusetts Supreme court held that while such a rule might apply in situations where there were face to face negotiations between purchasers and sellers, the ordinary rule that silence is not actionable applied with respect to open market transactions, in that case on the Boston Stock Exchange, where the parties had no communications with one another and did not even know their respective identities.

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167 *Id.*
2. Cady Roberts

Although one of the stated purposes informing the Exchange Act was to eliminate insider trading, the act never prohibited insider trading as such, and moreover, it never defined what constituted insider trading. The only section of the Act that dealt with insider trading was Section 16, which is not a prohibition on insider trading, but a prophylactic rule that applies to a specified class of actual insiders trading in the securities of their corporation, designed to discourage insider trading by taking the profit away.169

It was not until the early nineteen-sixties that the SEC began to use the general anti-fraud provisions to prosecute insider trading. The early cases, both at the Commission and in the courts, started in a direction that has now been largely abandoned except in one important respect where the roots continue to inform the doctrine.

The seminal case is the Commission’s decision in the Cady Roberts case, which is one of the most expansive views ever adopted of an insider trading prohibition. In that case, the Commission enunciated what has become known as the “disclose or abstain” rule. The Commission stated that:

Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.”170

The Commission went on to say that any person who has a special relationship with a company and is thus privy to its internal affairs “suffer[s]” duties when it comes to trading in the company’s securities.171 These duties, the Commission insisted, exist regardless of whether the transaction is face-to-face or on an open market172 and regardless of whether the insider was purchasing or selling securities.173 The Commission concluded that “insiders 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. Failure to make disclosure

171 Id.
172 Id. at 914.
173 Id. at 913.
in these circumstances constitutes a violation of the anti-fraud provisions.\textsuperscript{174} The insider had to abstain from trading if disclosure was not readily practicable.\textsuperscript{175}

3. \textit{SEC v. Texas Gulf Sulphur Co.} and the Fairness Doctrine

The \textit{Cady Roberts} approach, rooted in the twin arguments of fairness and usurpation of corporate information for personal profit, was adopted and expanded by the Second Circuit in the \textit{Texas Gulf Sulphur} case. There, the Court, sitting en banc, endorsed the \textit{Cady Roberts} “disclose or abstain” rule, emphasizing the fairness component to the point of establishing something akin to a “parity of information” requirement with respect to all securities transactions, including those conducted on impersonal exchanges. The Court held that the Rule 10b-5 anti-fraud provisions aimed to “prevent inequitable and unfair practices and to insure fairness in securities transactions generally” and were rooted “in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.”\textsuperscript{176} As a result, the Court concluded that not only traditional corporate insiders, who may have had fiduciary duties under state law or may have acquired them as a result of “special circumstances,” but “\textit{anyone} in possession of material inside information must either disclose it to the investing public” or abstain from trading.\textsuperscript{177}

The \textit{Texas Gulf Sulphur} parity of information/fairness approach to the anti-fraud provisions of the federal securities laws was fairly short-lived. Starting in the 1980s, the Supreme Court decisively rejected any parallelism between fraud and fairness, shifting the focus back to the element of deception that was traditionally necessary for common law fraud. The critical question was once again whether, and under what circumstances, silence could be considered deceptive to establish a violation of the federal securities laws.

\textsuperscript{174} \textit{Id.} at 911.
\textsuperscript{175} \textit{Id.}
\textsuperscript{176} \textit{SEC v. Texas Gulf Sulphur Co.}, 401 F.2d 833, 848 (2d Cir. 1968) (en banc).
\textsuperscript{177} \textit{Id.}
4. Chiarella v. United States

In Chiarella v. United States, the Supreme Court soundly rejected the “parity-of-information” theory and laid down the first pillar of Section 10(b) insider trading law: the requirement of a breach of a duty of trust and confidence as a basis for establishing liability. Chiarella was an employee at a financial printer that printed tender offer documents on behalf of the acquiring companies. Although the names of the target companies had been concealed, Chiarella was able to identify the companies from information in the documents and subsequently traded in the target’s securities.

Chiarella was criminally prosecuted on a fraud theory grounded in the Cady Roberts ‘disclose or abstain’ doctrine. That doctrine was premised on the idea that corporate insiders possessing material nonpublic information have a duty to disclose the information to the counterparty—or, in the case of an impersonal market, to the market as a whole—or abstain from trading. On this theory, a failure to disclose constitutes fraud. The Court in Chiarella rejected this broad argument, holding that nondisclosure, or silence, is fraudulent within the meaning of Section 10(b) and Rule 10b-5 only where there is a duty to disclose. The Court further held that such a duty arises only from a pre-existing relation of trust and confidence. Market participants do not owe generalized disclosure duties to one another; rather, they have positive disclosure duties only as a result of a fiduciary or fiduciary-like relation.

Chiarella had a duty to his employer and, derivatively, to the acquiring companies who hired his employer, but he was not trading in the securities of the acquirer; he was trading in the securities of the target. Chiarella had no relationship at all with the target company or its shareholders; they were complete strangers to him. Absent a pre-existing relationship, there could be no pre-existing duty to disclose the information to those he was trading with or the market generally (or in the alternative to abstain from trading altogether).

179 Id.
180 Id. at 224.
181 Id. at 227.
182 Id. at 228.
183 Id. at 230 (“[S]ilence in connection with the purchase or sale of securities may operate as a fraud actionable under §10(b) . . . . But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.”).
184 Id. at 233.
185 Id. at 232.
Importantly, the Court left open the possibility that Chiarella could have been prosecuted based on a breach of the duty he owed to his employer and the acquiring company on a misappropriation theory. Nevertheless, over a vigorous dissent by Chief Justice Burger, the Court held that the misappropriation theory had not been presented to the jury and, therefore, could not be used to sustain the conviction.186

5. New Approaches After Chiarella

After Chiarella, the government began looking to other avenues for insider trading liability. First, shortly after the Chiarella decision, the SEC adopted Rule 14e-3, which is the only actual prohibition on insider trading as such in the federal securities laws.187 Rule 14e-3 broadly prohibits trading by individuals who have acquired information regarding the tender offer from specified persons prior to a tender offer; but importantly this prohibition does not require a confidential relationship or a breach of a confidential duty.188 The codification of a broad “disclose or abstain” rule in the tender offer context was controversial, and the SEC’s authority to adopt the rule was questioned.189 The validity of the rule was ultimately upheld in the O’Hagan case discussed below.

Second, both the SEC and the criminal authorities began to press the misappropriation theory, and the criminal authorities started to charge insider trading under the general mail and wire fraud statutes. The Second Circuit was an early proponent of both approaches. United States v. James Mitchell Newman,190 decided just a year after Chiarella, involved employees at two prominent investment banks who obtained confidential information about their firm’s client’s proposed merger and acquisition targets. The employees passed on the information to a securities trader, who traded on the information by purchasing shares of the target companies and tipped two others who also traded. The Second Circuit, reinstating indictments that the district court had dismissed, held that the investment firm employees had unlawfully misappropriated confidential information from their employers in breach of a fiduciary duty of trust and confidence, which was sufficient to establish liability under Section 10(b) even though the defrauded party was

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186 Id. at 235-36.
188 Id.
190 I am including Newman’s full name when referring to this case to distinguish it from the later unrelated Newman case discussed herein.
not the purchaser or seller of the securities:

In other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful . . . Appellee would have had to be most ingenuous to believe that Congress intended to establish a less rigorous code of conduct under the Securities Acts.\(^\text{191}\)

The Court also upheld the use of the mail and fraud statute to reach the same underlying conduct: The indictment “clearly charges appellee with fraudulent misappropriation of property that did not belong to him. Intangibles such as ‘confidential and nonpublic commercial information’ fall within the definition of ‘property’ under the mail fraud statute.”\(^\text{192}\)

Following the *James Mitchell Newman* case, the government continued to press the misappropriation theory under Section 10(b) and the use of the mail and wire fraud statutes in other cases. This ultimately led to a circuit split, which was finally resolved in the *O’Hagan* case, as discussed below. In the interim, the development of the classical theory took another turn in the *Dirks* case.

\(\text{a. The Dirks Case}\)

In *Dirks v. SEC*, the Court applied the *Cady Roberts* “disclose or abstain” rule in the context of a tipper-tippee relation and reaffirmed that the essential predicate for liability is the existence of a relationship of trust and confidence. The Court reiterated that the duty to disclose or abstain does not arise from the mere possession of inside information but rather from a fiduciary or fiduciary-like relationship. The Court again rejected the parity-of-information doctrine and reiterated that market participants do not have a general duty to forego trading simply because they possess material nonpublic information. Rather, the duty to disclose or abstain is grounded in a breach of a specific pre-existing duty. The breach of fiduciary duty does not itself amount to actionable fraud; instead, it is the breach of duty combined with the element of deception that inheres in the nondisclosure that constitutes the fraud.

The Court pointed out that actual insiders of a company owe the company and its shareholders fiduciary duties (although, as many have

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191 United States v. James Mitchell Newman, 664 F.2d 12, 18 (2d Cir. 1981), *overruled on other grounds by McNally v. United States*, 483 U.S. 350 (1987); *see also* id. at 17 (“[N]o specific requirement that fraud be perpetrated upon the seller or buyer of securities”).

192 *See James Mitchell Newman*, 664 F.2d at 19.
pointed out, this is questionable at some level as a matter of state fiduciary law). They breach those duties when they trade in their company’s securities without disclosure. But unlike insiders, tippees typically have no relation at all—let alone a fiduciary-like relation—with the company or its shareholders. The question then was where does a duty to abstain or disclose come from?

In *Dirks*, the SEC argued that the tippee assumed the duty to disclose simply by knowingly receiving material nonpublic information. The Court categorically rejected this argument and instead focused on whether the tipper had breached a duty to disclose the information. Noting that the tippee’s duty is derivative of the insider’s, the Court held that the tippee assumes the tipper’s duty to disclose or abstain not because the tippee receives material nonpublic information but because the information has been conveyed improperly.

The critical element for establishing a duty, in other words, centers on the purpose of the disclosure. The Court held that “a tippee assumes a fiduciary duty . . . 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.” Not every disclosure by an insider constitutes a breach of duty; the question is whether or not the disclosure was made for a proper corporate purpose. A fiduciary breach by the insider occurs when the insider discloses material nonpublic information for an improper purpose, and only if there has been that initial breach by the insider does the tippee inherit the duty to disclose or abstain from trading.

So, what constitutes a proper or improper purpose for disclosing material nonpublic information? The Court had begun with the premise that an insider cannot do indirectly what they cannot do directly: “Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain.” That formulation makes it a breach of duty for an insider to disclose nonpublic information to someone who is going to exploit that information (that is, trade on it) for their (the tippees) personal gain. So far, so good: disclosing company

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194 *Id.* at 657.
195 *Id.* at 659-60.
196 *Id.* at 660.
197 *Id.* at 661-62.
198 *Id.*
199 *Id.* at 659.
information to someone who is going to trade on it is not a proper corporate purpose.

However, when the Court got down to examining the purpose of the disclosure, it pivoted in a small but highly consequential way. Instead of focusing on whether the disclosure is being made for the purpose of enriching the tippee, the Court looked to whether the purpose of the disclosure was to enrich the tipper: “Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.”

The “personal benefit test” came out of nowhere. The Court never explained why it was the essential element for making the disclosure improper, and it was wholly unnecessary doctrinally: the Court had already said that disclosing information for the purpose of allowing the tippee to exploit the information for personal gain constituted a breach of fiduciary duty. The Court had already established that a disclosure in order to enrich the tippee was not for a proper corporate purpose, that the tipper could not do indirectly what they could not do directly.

The “personal benefit test” was, in fact, made up out of whole cloth: it was never argued by the petitioner, it was not in any of the briefs, and it was never discussed as a possible element by the Court below or at the Commission level. As Professor Pritchard has recently shown, the personal benefit test was inserted into the opinion at the drafting stage at the suggestion of Justice O’Connor, who was concerned that looking solely at whether there was a “proper corporate purpose” for the disclosure would make it too easy for tippers to evade legal sanction because they could always make up some corporate purpose for the disclosure. O’Connor wanted an objective test for evidentiary reasons, and a personal benefit accruing to the tipper seemed the easiest way to show that the tipper had breached a fiduciary duty.

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200 Id. at 662.
201 Id. at 671 (Blackmun J., dissenting) (citations omitted) (“The Court holds, however, that Dirks is not liable because [the tipper] did not violate his duty; according to the Court, this is so because [the tipper] did not have the improper purpose of personal gain. In so doing, the Court imposes a new subjective limitation on the scope of the duty owed by insiders to shareholders. The novelty of this limitation is reflected in the Court’s lack of support for it.”).
203 Id. The personal benefit test is not wholly without foundation: the most common form of a breach of the fiduciary duty of loyalty in corporate law consists of self-enrichment. But self-
The Court in *Dirks* stated that in a tipper-tippee case, the initial inquiry is whether there has been a breach of duty by the tipper, which requires courts to focus on objective criteria, namely “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.” The Court went on to add a statement that has proved ambiguous and problematic. The Court said that there were facts and circumstances that could justify an inference that there was a personal benefit, namely “a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient.” Notice the disjunctive “or” and the fact that the first part of the sentence (the “quid pro quo”) suggests something that will actually benefit the tipper, while in the second part, the personal benefit consists of “an intention to benefit” the tippee. The Court concluded that “[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”

The last quoted sentences have given rise to much litigation lately and the meaning is still in dispute, as will be discussed further below. The basic question is whether by allowing that a gift of information to a trading relative or friend constitutes the requisite breach of duty, the Court was going back to where it started (namely, that an insider cannot do indirectly what he cannot do directly, with the focus being on whether the goal is to enrich the tippee), or whether the gift of information to a trading relative or friend can give rise to an inference that the tipper is receiving a personal benefit. If it is the latter, it raises the further question of whether all gifts of information to someone who will trade on it can give rise to that inference, or whether the inference is only permissible if there is a close enough personal relationship between the tipper and tippee.

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enrichment is not a requirement for a breach of the duty of loyalty: acting in bad faith has long been held to constitute an act of disloyalty even in the absence of pecuniary gain. See, e.g., *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (“[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.”).

204 *Id.* at 663.
205 *Id.* at 664.
206 *Id.* at 664.
b. The Carpenter Case

The most important case following Dirks was the Carpenter case.207 R. Foster Winans was a reporter for the Wall Street Journal and one of the authors of a daily column in the paper called “Heard on the Street.” Positive or negative information about a company in the column often moved the market price of the company’s securities. Winans provided advance information about the column’s contents to two brokers at Kidder Peabody who traded on the information and shared the profits with Winans. Winans and one of the traders were charged with violating the antifraud provisions of Section 10(b) and Rule 10b-5 as well as the mail and wire fraud statues (18 USC §§1341 and 1343) and were convicted after trial (the other trader pled guilty).

The District Court found that Winans had breached a duty of confidentiality by misappropriating for his own use information that rightly belonged to his employer, the Wall Street Journal. The court found that Winans’ deliberate breach of his duty combined with concealment of the scheme constituted actionable deception within the meaning of the antifraud provisions of the federal securities laws. The court also found that Winans had misappropriated “property” within the meaning of the mail and wire fraud statues.208 The Second Circuit upheld the convictions.209

On appeal, the Supreme Court split 4-4 on the Section 10(b) convictions—thus leaving the Second Circuit opinion and the convictions on those charges in place—but was unanimous (8-0) in upholding the convictions under the mail and wire fraud statutes, an indication that the standard for insider trading liability under those statutes is different than under the antifraud provisions of the federal securities laws. With respect to the mail and wire fraud statutes, the Court held that confidential company information is a form of property, even though intangible, to which the company has exclusive right of use: “[t]he Journal had a property right in keeping confidential and making exclusive use, prior to publication, of the schedule and contents of the ‘Heard’ column.”210 The Court went on to say that “Sections 1341 and 1343 reach any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises.”211 The Court specified that, within the meaning of the mail and

210 Id. at 26.
211 Id. at 27.
wire fraud statutes, fraud simply means depriving somebody of something of value by means of some kind of deception.\textsuperscript{212} Winans knew that the information he had was confidential and he deceived the Journal when he used the information for his own purpose all the while pretending to safeguard the information.

c. The O’Hagan Case

The misappropriation theory reached the Supreme Court again in the O’Hagan case in 1997, and this time it was the trifecta: O’Hagan was charged criminally with Section 10(b) fraud, Title 18 mail and wire fraud, and fraud under Rule 14e-3 (the tender offer insider trading rule).

O’Hagan was a partner at the law firm Dorsey & Whitney. Dorsey & Whitney represented Grand Metropolitan Plc. which was planning a tender offer to acquire Pillsbury. O’Hagan didn’t work on the transaction but he found out about it and purchased Pillsbury call options (which gave him the right to purchase the stock at a later date) and Pillsbury stock. After the tender offer announcement O’Hagan liquidated his position making a profit of over $4.3 million. Neither O’Hagan nor his firm had any connection to Pillsbury and therefore owed no duties to that company or its shareholders.

The Supreme Court upheld the Section 10(b) conviction on the ground that O’Hagan had defrauded his law firm by misappropriating information in violation of a duty of trust and confidence he owed to the law firm and derivatively to the law firm’s client Grand Metropolitan: “Under [the misappropriation] theory, a fiduciary’s undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information.”\textsuperscript{213} The duty, in other words, was one owed to the source of the information rather than to the counterparty of the trade or the market generally: “[i]n lieu 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.”\textsuperscript{214}

In this respect, the Court closely tracked the reasoning that had been

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\textsuperscript{212} See id. (“The concept of ‘fraud’ includes the act of embezzlement, which is the fraudulent appropriation to one’s own use of the money or goods entrusted to one’s care by another.”) (citations omitted).


\textsuperscript{214} Id.
applied to mail and wire fraud in the Carpenter case:

A company’s confidential information, we recognized in Carpenter, qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information, in violation of a fiduciary duty, . . . constitutes fraud akin to embezzlement—the fraudulent appropriation to one’s own use of the money or goods entrusted to one’s care by another.\(^{215}\)

The deception necessary to turn the breach of duty into an actionable fraud consisted of not disclosing the trading to the law firm (and/or its client): while feigning allegiance to the principal, O’Hagan secretly converted the principal’s information to his own use.\(^{216}\)

Because deception is necessary for fraud, and because the party being deceived is the source of the information, disclosure to the source prior to using the information would obviate the fraud. So, if O’Hagan had told his firm (and perhaps also his firm’s client) that he was going to trade on the information there may have been a breach of duty, but no deception and therefore no actionable Section 10(b) fraud.\(^{217}\) The Court, however, declined to extend the disclosure obligation beyond the source, holding that there was no broader obligation to disclose the nonpublic information to the counterparty or the market as a whole before trading. In this respect, O’Hagan marked a shift from the “disclose or abstain” doctrine that had previously informed insider trading law. “Disclose or abstain” focuses on the market transaction while the misappropriation theory as adopted by the Court explicitly separated the fraudulent conduct from the trading activity, and at the same time disassociated the fraud from the market harms that insider trading prohibitions were originally aimed at. Despite separating the fraud from the trading, the Court insisted, over a vigorous dissent,\(^{218}\) that the fraud was nonetheless “in connection with” the purchase or sale of securities, which is a necessary element for Section 10(b) liability:

\[\text{[that] element is satisfied because the fiduciary’s fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses}\]

\(^{215}\) Id. at 654 (citations omitted).

\(^{216}\) Id. at 654-55.

\(^{217}\) Id. at 654.

\(^{218}\) The essence of Justice Thomas’ dissent is that while there has been deceit and even fraud in a misappropriation case, that fraud is not “in connection with” a securities transaction. O’Hagan, 521 U.S. at 680 (Thomas, J., concurring in part and dissenting in part). Thomas explicitly agreed that the undisclosed misappropriation of confidential information by a fiduciary can constitute a “deceptive device” within the meaning of Section 10(b). Id.
the information to purchase or sell securities. The securities transaction and the breach of duty thus coincide. This is so even though the person or entity defrauded is not the other party to the trade, but is, instead, the source of the nonpublic information.219

Under the misappropriation theory, there is no duty to disclose to the counterparty or the market, because they are not the ones being defrauded. This marks a further abandonment of any parity-of-information requirement: the fact that the misappropriator has superior information unavailable to the counterparty is irrelevant.

In O’Hagan, the Court also upheld the Commission’s authority to enact Rule 14e-3—and the convictions pursuant to that rule—even though the rule prohibits trading in advance of a tender offer by persons who have acquired material nonpublic information even if there is no fiduciary, or fiduciary-like, relationship (and hence no breach of a fiduciary duty). The Court held that the Commission could promulgate such a rule based on the broad language of the enabling statute which authorized the Commission to adopt rules not only prohibiting fraud, but also rules reasonably designed to prevent fraud (which is broader than the enabling language of Section 10(b)).220

Finally, the Court reversed the Eighth Circuit and upheld O’Hagan’s convictions on mail and wire fraud charges. The Eighth Circuit had insisted that the mail and wire fraud charges could not be disassociated from the securities fraud charges, and having determined that the securities fraud charges could not stand, concluded that there was no fraud upon which to base the mail fraud charges. The Supreme Court reversed, but because they had previously held that there was an actionable securities fraud charge, never reached the question whether the mail fraud charges are independent of the securities fraud charges even though they rest on the same facts.221

Interestingly, even Justices Thomas and Rehnquist, who dissented on the use of the misappropriation theory to uphold the securities fraud charges, had no problem upholding the mail and wire fraud convictions that were based on the same underlying facts:

As I read the indictment, it does not materially differ from the indictment in Carpenter v. United States . . . . There, the Court was unanimous in upholding the mail fraud conviction, . . . despite being evenly divided on the securities fraud counts . . . . I do not think the wording of the indictment in the current case requires a finding of securities fraud in order to find mail fraud. Certainly the

219 Id. at 656.
220 Id. at 667-68.
221 Id. at 678.
jury instructions do not make the mail fraud count dependent on the securities fraud counts. Rather, the counts were simply predicated on the same factual basis, and just because those facts are legally insufficient to constitute securities fraud does not make them legally insufficient to constitute mail fraud. I therefore concur in the judgment of the Court as it relates to respondent’s mail fraud convictions. 222

B. Recent Developments in the Second Circuit

1. The Personal Benefit Test Prior to Newman

In the years following Dirks, courts tended to apply a very liberal and expansive approach to the personal benefit test, based on the expansive language of Dirks itself. Courts said that the threshold was very low, and almost any kind of potential benefit however amorphous or contingent would qualify. The Second Circuit, for example, stated that “[p]ersonal benefit to the tipper is broadly defined” 223 and the Eleventh Circuit concluded that “[t]he showing needed to prove an intent to benefit is not extensive.” 224 Courts also noted that personal benefit included not only pecuniary gains but such things as reputational benefit that might translate into future earnings or even simple friendship. 225 Because the standard was set so low, the personal benefit test largely receded from consciousness: it was seldom litigated and was almost never a successful defense to a government prosecution, 226 which helps explain why the Newman case was such a bolt from the blue.

2. The Second Circuit’s Newman Decision

The Newman case was part of a widespread crackdown on insider trading, particularly at hedge funds, by the SEC and federal criminal authorities, which yielded some 85 criminal convictions and guilty pleas, along with parallel civil and administrative actions. The Newman case

222 Id. at 700-01 (Thomas, J., concurring in part and dissenting in part). Justice Scalia also concurred on the mail and wire fraud convictions, making that holding unanimous. Id.
223 See, e.g., SEC v. Obus, 693 F.3d 276, 285 (2d Cir. 2012).
224 SEC v. Yun, 327 F.3d 1263, 1280 (11th Cir. 2003).
225 See, e.g., SEC v. Warde, 151 F.3d 42, 48-49 (2d Cir. 1998) (finding that the tipper need not receive a specific or tangible benefit in exchange for the tip if a close friendship exists).
226 There are only a few reported cases where the personal benefit test was not met. See, e.g., SEC v. Maxwell, 341 F. Supp. 2d 941 (S.D. Ohio 2004) (giving a tip to one’s barber does not constitute a personal benefit).
involved extensive trading in the stock of two companies, Dell and Nvidia, by two traders at hedge funds, Newman a trader at Diamondback and Chiason, a trader at Level Global. The trading yielded over $70 million in profits.\(^{227}\) The trading originated from insiders at the companies but Newman and Chiason were “remote tippees” meaning they received the information indirectly, in a chain that began at the company and passed through several intermediate tippees along the way. Newman and Chiason were convicted after trial and sentenced to lengthy prison terms.

On appeal, the convictions were thrown out in a sweeping opinion by the Second Circuit that, at least for a time, threatened to upend insider trading prosecutions. In *Newman*, the Second Circuit made three consequential, and controversial, holdings. First, the court held that to sustain a criminal conviction the government had to show not only that the tipper received a real pecuniary benefit, but also that the tippees knew that the tippers had received this benefit in exchange for the tips. Second, the court held that the requisite personal benefit had to be something “objective [and] consequential” that “represents at least a potential gain of a pecuniary or similarly valuable nature.”\(^{228}\) Finally, the court held that the government had to show a meaningfully close personal relationship between the tipper and the tippee in order to infer that a gift of information conferred a personal benefit.

The *Newman* decision seemed very much at odds with the actual language of *Dirks* with respect to personal benefits and the way that language had been consistently interpreted by courts in the years since *Dirks*, including by the Second Circuit itself. In *Dirks*, the Court had specifically stated that intangible, non-pecuniary benefits including reputational benefits satisfied the test. And the Court had also stated that a gift of information to a trading relative or friend qualifies as well. In *SEC v. Warde*, the Second Circuit had looked to the “gift of confidential information” language in *Dirks* and concluded that “the Supreme Court has made plain that to prove a § 10(b) violation, the SEC need not show that the tipper expected or received a specific or tangible benefit in exchange for the tip.”\(^{229}\) In that case the court had no problem finding that friendship was sufficient to infer an intent to benefit.\(^{230}\) More important, the *Newman* decision seemed very much at odds


\(^{229}\) *SEC v. Warde*, 151 F.3d 42, 48 (2d. Cir. 1998).

\(^{230}\) *Id.* at 49.
with the doctrinal underpinnings of the *Dirks* personal benefit test. The Second Circuit simply read out much of the actual language from *Dirks*, because they thought it incompatible with the personal benefit test. In a sense, the court was saying that there were two strands in *Dirks* that were irreconcilable analytically, and that one of those strands (the reputational benefit and gift of information strand) had to be jettisoned.

The *Newman* decision also had very real practical consequences. Each of its holdings, if upheld, would pose considerable challenges to prosecuting insider trading in Title 15 tipper-tippee cases. First, the requirement that the benefit be something of real pecuniary value is not only at odds with the plain language of *Dirks* but fails to recognize the actual value of less tangible benefits, that are in practice the currency that is most readily exchanged in insider trading cases. Having to prove that the tippee knew that the tipper had received a real pecuniary benefit would make prosecuting remote tippees almost impossible: the further removed the tippee is, the less likely they are to know (or care) whether the tipper has obtained a personal benefit, or exactly what that benefit was. All they care about is that the information is reliable. Finally, the meaningfully close personal relationship test ignores the complex webs of information sharing that appear to be pervasive in the hedge fund world.

3. The *Salman* Decision

Following the *Newman* decision, several defendants challenged their convictions on the ground that the government had failed to show that the tipper had received a personal benefit or had failed to establish that the tippee knew of the personal benefit, or both. Some of these challenges in the Second Circuit were successful. The *Salman* case, however, arose in California, which gave the Ninth Circuit a chance to weigh in on the issue. *Salman* was convicted for trading on inside information that he had obtained from a friend (and relative by marriage) who in turn had obtained the information from his brother, the insider. *Salman*’s conviction was on appeal at the time the *Newman* decision came down, and he sought to have the conviction overturned based on the same reasoning that informed that decision. In an opinion, ironically written by Judge Rakoff of the Southern District of New York sitting by designation, the Ninth Circuit declined to follow *Newman*, and instead held that, under *Dirks*, the jury could properly infer that the insider who tipped the information breached a duty by making a gift of
confidential information to a trading relative.\footnote{231} This circuit split presented an opportunity for Supreme Court review.

The Supreme Court’s \textit{Salman} opinion reaffirmed \textit{Dirks} in two important respects: First, it reiterated that a personal benefit to a tipper is necessary for the tipper’s disclosure to constitute a breach of fiduciary duty, which in turn is the necessary predicate for fraud liability. Second, the Court ruled that a gratuitous tip of information to a friend or relative satisfies the \textit{Dirks} personal benefit test.\footnote{232} Neither of these was, or should have been, surprising: both the need for a personal benefit and the language about gifts of information is straight out of \textit{Dirks}. In \textit{Dirks}, the Court clearly stated that a gift of information was the equivalent of a trade followed by a gift of the profits, and was sufficient to establish liability, without regard to any pecuniary gain that might accrue to the tipper.

Indeed, given how clearly this was laid out in \textit{Dirks}, the real question is how, and why, the \textit{Newman} court elided over, or reconfigured, the gifting aspect of the \textit{Dirks} holding. In \textit{Newman}, the court held that there must still be a personal benefit even under the gift prong of \textit{Dirks}, and that the existence of a benefit could not be inferred without “proof of a meaningfully close personal relationship” between the tipper and the tippee “that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”\footnote{233} By insisting that a pecuniary benefit to the tipper was necessary even with respect to a “gift” of information, \textit{Newman} was effectively reading out the gift of information prong of \textit{Dirks}. At bottom, the \textit{Newman} court was saying that a true “gift” does not confer a personal benefit to the tipper, and therefore cannot satisfy the personal benefit test, notwithstanding any language to the contrary in \textit{Dirks}.

The \textit{Salman} court explicitly repudiated this view and reaffirmed that \textit{Dirks} meant what it said: a gift of information to a trading relative or friend satisfies the personal benefit test, regardless of whether the tipper obtains a pecuniary benefit. A true gift does the trick. In this respect, while \textit{Salman} merely reaffirmed long-standing precedent, the decision is nonetheless meaningful because the Court overruled one central part of \textit{Newman}, namely the holding in that case that the personal benefit in a tipper-tippee situation needs to be something tangible, of real pecuniary value. In \textit{Salman}, the Court explicitly repudiated that part of \textit{Newman}: “[t]o the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly

\footnotesize{\textsuperscript{231} United States v. Salman, 792 F.3d 1087 (9th. Cir. 2015).}\textsuperscript{232} \textit{Salman} v. United States, 580 U.S. 39 (2016).\textsuperscript{233} \textit{Newman}, 773 F.3d at 452.}
valuable nature’ in exchange for a gift to family or friends, . . . we agree with the Ninth circuit that this requirement is inconsistent with Dirks.”\textsuperscript{234} That the Court did this just a year after effectively upholding Newman, is more than a bit ironic; but the fact remains that at least part of Newman is no longer good law.

The Salman decision did leave in place one important aspect of the Newman opinion. In addition to saying that only something of pecuniary or similarly valuable nature could satisfy the personal benefit test, the Second Circuit in Newman threw out the convictions because the government had failed to show that the defendants—who were remote tippees—knew that the tippers had received a benefit in exchange for the tips. In Salman, the Court left that part of Newman undisturbed: the Court had already denied cert in Newman and the issue wasn’t presented in the Salman case.\textsuperscript{235} Indeed, Salman apparently conceded that he knew that the tipper had made the gift.\textsuperscript{236} But going forward, the knowledge and state of mind of remote tippees could be a matter of considerable litigation.

4. Martoma and Blaszczak: The Second Circuit in Disarray “Twisted by knaves to make a trap for fools”\textsuperscript{237}

a. The Martoma Case

i. Martoma’s Insider Trading

Matthew Martoma was a portfolio manager at CR Intrinsic, an affiliate of the hedge fund giant SAC Capital. In February 2014, he was found guilty after a jury trial of trading on the basis of material non-public information concerning the negative results of a clinical trial for a new drug that was being jointly developed by two pharmaceutical companies. Martoma received advance information from a doctor who was a consultant to the pharmaceutical companies. The insider trading was extensive and yielded some $276 million in profits and losses avoided.\textsuperscript{238} The US Attorney’s Office

\textsuperscript{234} Salman v. United States, 580 U.S. at 50.
\textsuperscript{235} Id. at 45 n.1.
\textsuperscript{236} Id. at 52.
\textsuperscript{237} Rudyard Kipling, \textit{If} (line 14).
\textsuperscript{238} The trading is detailed in David Rosenfeld, \textit{The Impact of Insider Trading on the Market Price of Securities: Some Evidence from Recent Cases of Unlawful Trading}, 44 J. CORP. L. 65 (2018).
called it the “the most lucrative” insider trading scheme ever,\textsuperscript{239} and the SEC said that it was “the largest insider trading case [they had] ever charged . . . .”\textsuperscript{240} Martoma was sentenced to nine years in prison.\textsuperscript{241} He appealed his conviction to the Second Circuit on the ground that it could not be sustained in light of the circuit’s opinion in \textit{Newman}, but while his appeal was pending, the Supreme Court decided \textit{Salman}. Martoma persisted in his appeal, arguing that \textit{Salman} had not overruled the requirement, articulated in \textit{Newman}, that there must be evidence of a “meaningfully close personal relationship” between the tipper and the tippee to sustain an inference that the tipper received a personal benefit from the gift of inside information.\textsuperscript{242}

\textbf{ii. Martoma I}

The “meaningfully close personal relationship” test does not appear anywhere in \textit{Dirks} or \textit{Salman}: it was a pure invention of the Second Circuit in the \textit{Newman} case. In \textit{Newman}, the court held that a gift of information could give rise to an inference that the tipper had received a personal benefit—because it resembles a trade by the tipper and a gift of the proceeds to the tippee—but that such an inference was impermissible absent proof that the tipper and the tippee enjoyed “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”\textsuperscript{243} The second part of the Second Circuit’s test (the part about generating an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature) was clearly overturned by \textit{Salman}; but the question remained whether any gift of confidential


\textsuperscript{242} United States v. Martoma, 869 F.3d 58, 61 (2d Cir. 2017).

information to someone who is going to trade on the information satisfies the personal benefit test, or whether pure gifts satisfy the test only where the tipper and tippee enjoyed a “meaningfully close personal relationship.”

In August 2017, a panel of the Second Circuit held, over a strongly worded dissent, that while *Salman* had not directly addressed the issue, the logic of that case required the conclusion that proof of a “meaningfully close personal relationship” was not required. The majority looked to the justification offered in both *Dirks* and *Salman* for why a gift of information to someone who is going to trade satisfies the personal benefit test—that it resembles a trade by the tipper followed by a gift of the proceeds to the tippee—and reasoned that was true regardless of the relationship between the tipper and the tippee. The court held that:

[T]he straightforward logic of the gift-giving analysis in *Dirks*, strongly reaffirmed in *Salman*, is that a corporate insider personally benefits whenever he disclos[es] inside information as a gift . . . with the expectation that [the recipient] would trade on the basis of the information or otherwise exploit it for his pecuniary gain.

The court went on to say that nothing in *Salman* “supports a distinction between gifts to people with whom a tipper shares a ‘meaningfully close personal relationship’ . . . and gifts to those with whom a tipper does not share such a relationship.” In reaching this conclusion, the court focused on the fact that the insider trading prohibition is rooted in the idea that neither tippers nor their tippees should be allowed to exploit confidential company information for their own personal gain:

[that]his approach makes sense in light of the Supreme Court’s observation that “‘insiders [are] forbidden’ both ‘from personally using undisclosed corporate information to their advantage’ and from ‘giv[ing] such information to an outsider for the same improper purpose of exploiting the information for their personal gain’”—a statement not limited by the relationships of the parties.

In essence, the court held that a gift of information satisfies the personal benefit test whenever the tipper provides the information with the

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244 *Martoma*, 869 F.3d at 67.
245 *Id.* at 68.
246 *Id.* at 69 (citations omitted).
247 *Id.*
248 *Id.* at 70.
expectation that the tippee will trade on the basis of that information. The court concluded that “Newman’s ‘meaningfully close personal relationship’ requirement is no longer good law.”

In a scathing dissent, Judge Pooler argued that the majority’s position constituted an unprecedented and unwarranted expansion of insider trading liability, one that threatened to eviscerate the personal benefit test entirely and with it the carefully crafted limitations that had been imposed by the Supreme Court in both *Dirks* and *Salman*:

[i]n holding that someone who gives a gift always receives a personal benefit from doing so, the majority strips the long-standing personal benefit rule of its limiting power. What counts as a ‘gift’ is vague and subjective. Juries, and, more dangerously, prosecutors, can now seize on this vagueness and subjectivity. The result will be liability in many cases where it could not previously lie.

Instead, the dissent argued that a gift of information should only give rise to an inference that the tipper had obtained a personal benefit in one narrow situation, namely where the tipper and tippee are family or friends. Only in those situations could it be presumed that a gift provides a personal benefit to the donor; gifts to strangers provide no obvious benefit to the giver, and thus cannot in and of themselves support an inference of a personal benefit. Echoing Newman, the dissent suggested that a more expansive view of the gift theory could render the personal benefit test something of a “nullity.” The dissent argued that the majority was not only abrogating a crucial aspect of the *Dirks* holding, but was also setting aside those aspects of Second Circuit’s *Newman* decision that, the dissent claimed, *Salman* had left undisturbed. The dissent concluded that the “majority severely damages the limitation provided by the personal benefit rule, and casts aside circuit precedent and Supreme Court rulings to do so, ‘radically alter[ing] insider-trading law for the worse.’

249 Id.
250 Id. at 73; see also id. at 70-71 n.8.
251 Id. at 75 (Pooler, J., dissenting).
252 Id.
253 Id. at 85-86.
254 See id. at 79-81.
255 Id. at 75.
256 Id. at 92.
257 Id. at 75.
iii. Martoma II

The dissent’s claim in Martoma I that the majority was overruling circuit precedent that had been left undisturbed by Salman without seeking en banc review clearly had some sting. In June 2018, the same Second Circuit panel issued an “amended” opinion in the Martoma case, that once again upheld Martoma’s conviction, but sought to reconcile the holding with the Newman requirement that a gift of information could only lead to an inference of a personal benefit where there is proof of a “meaningfully close personal relationship” between the tipper and the tippee.258

While Martoma I relied heavily on the internal logic of Salman, the opinion in Martoma II hued more closely to the actual holding in that case. In Martoma II the court recognized that while Salman overruled Newman on the question of whether the personal benefit had to be something of real pecuniary value and squarely reaffirmed that a gift of information counts as a personal benefit, Salman left open the questions of when and how a gift of information could confer the requisite benefit within the meaning of Dirks, and what needed to be shown to draw an inference that a gift of information conferred the necessary benefit.

The majority in Martoma II stressed that under Dirks liability in a tipper-tippee case depends on whether the tipper has breached a fiduciary duty, which in turn hinges on the purpose of the disclosure: an insider who is entrusted with information has a duty to use it only for corporate purposes and not for the purpose of benefitting themselves.259 The court stressed that “[i]dentifying personal benefits is not, however, the central focus of insider trading law, but simply how courts and juries analyze breaches of fiduciary duty.”260

The court went on to list a wide variety of personal benefits that show a tipper’s breach of duty, including pecuniary gain or a reputational benefit that could translate into future earnings and focused on the key sentence from Dirks: “[f]or example, there may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.”261 The interpretive question was whether the second part of the quoted sentence (the part about “an intention to benefit the . . . recipient”) should be read independently of the first part (the part about the relationship between the insider and the tippee). In other words,

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258 Martoma, 894 F.3d at 68.
259 Id. at 73.
260 Id.
261 Id. at 74 (quoting Dirks v. SEC, 463 U.S. 646, 664).
does “an intention to benefit” the tippee constitute a “standalone personal benefit under Dirks” or does Dirks require a relationship between tipper and tippee from which an intention to benefit the tippee could be inferred. The distinction may seem minor, but it is consequential: is the focus solely on whether the tippee benefits, or whether the tipper benefitted by conferring a benefit on the tippee?

The majority held that objective evidence of an intent to benefit the tippee was sufficient, regardless of any relationship: disclosure of information to a perfect stranger for the purpose of enriching them would suffice. Telling a stranger “‘you can make a lot of money by trading on this,’ following the disclosure of material non-public information, suggests an intention to benefit the tippee in breach of the insider’s fiduciary duty.”

And the breach of duty, the majority said, is what “under Dirks the personal benefit element is designed to test”: “[t]he tipper’s intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose.”

The court concluded that:

[T]he personal benefit element can be met by evidence that the tipper’s disclosure of inside information was intended to benefit the tippee. And as is clear from the purpose of the personal benefit element, the “broad definition of personal benefit set forth in Dirks,” and the variety of benefits we have upheld, the evidentiary “bar is not a high one.”

So far, so good. But the court in Martoma II then tried to reconcile this general view with the holding in Newman. In Newman, the court had said that a tippee must be aware that the tipper had breached a fiduciary duty in disclosing the information and that the tipper received a personal benefit. The question in Newman that became the focus of Martoma’s appeal centered on the sufficiency of the personal benefit evidence, and specifically whether mere friendship of a casual or social nature was enough to prove that the tipper had received a personal benefit. In Newman, the court held that in the context of the “gift of confidential information” theory, a personal benefit could be inferred only if there is proof of a “meaningfully close

262 Id. at 74, 77.
263 Id. at 75.
264 Id.
265 Id. at 76 (citation omitted).
266 Id.
267 Id. at 76-77.
personal relationship.”

The court in Martoma II then noted that the concept of a “meaningfully close personal relationship” was novel and amenable to various interpretations, but that the Newman court itself had provided guidance by saying “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 to benefit the [latter].’”

If this sounds a bit confusing, it’s because it is. Under this formulation, the test of whether there has been a personal benefit under the “gift of information” theory depends on the existence of a relationship that suggests the existence of a “quid pro quo” or “an intention to benefit the tippee,” the latter of which Martoma II had just held could be the basis for finding a personal benefit that does not hinge on the existence of a personal relationship! This may seem odd, but it is how the Martoma II majority read Newman:

As explained above, each of these [quid pro quo, intent to benefit] is an independently sufficient basis to infer a personal benefit under Dirks and its progeny. In other words, Newman cabined the gift theory using two other freestanding personal benefits that have long been recognized by our case law.

In a footnote the court added: “[o]ur cases applying Dirks demonstrate that the government can prove a personal benefit in several ways that do not require proof of any sort of personal relationship.”

This reading may have been a bit tortured, but in fairness to the Martoma II majority, the problem originates with Newman, which unnecessarily conflated two concepts. Nonetheless, because Newman required a showing of a “meaningfully close personal relationship” to infer a personal benefit in a gift of information scenario, the court in Martoma II held that the jury instruction on that point was defective because it said that a personal benefit could be inferred just because of friendship:

A properly instructed jury would have been informed that it could find a personal benefit based on a “gift of confidential information to a trading relative or friend” only if it also found that [the tipper] and Martoma shared a relationship suggesting a quid pro quo or that [the tipper] intended to benefit Martoma with the inside information.

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268 Id. at 68, 77.
269 Id. at 77.
270 Id.
271 Id. at 77 n.8.
272 Id. at 78.
But the court reiterated that those two factors constituted independent bases for finding a personal benefit, neither of which require a showing of a personal relationship.\textsuperscript{273}

_Martoma II_ drew another caustic dissent including a claim that the majority was seeking to overrule Newman _sub silentio_ by trying to redefine—and read out—the “meaningfully close personal relationship test”: “[o]nly by abrogating Newman could [the majority] announce a new rule that a jury can infer a personal benefit based on a freestanding ‘intention to benefit’ and that this ‘intention to benefit’ is at the core of the meaningfully close personal relationship standard.”\textsuperscript{274} The dissent concluded, however, that _Newman_ remained good law and that the majority had simply thrown a monkey-wrench into the works with “non-binding dicta”:

In the majority’s withdrawn opinion, they candidly acknowledged that they were abrogating Newman, relying on a justification for doing so that they no longer advance. Today they do not even attempt to argue they can do so. Instead, they call into question settled law in non-binding dicta. Newman remains good law.\textsuperscript{275}

In the end, the court upheld Martoma’s conviction despite the erroneous jury instruction on the gift of information theory because the government had provided compelling evidence of an actual quid pro quo: the tipper who provided the material nonpublic information to Martoma was actually paid to provide the information!\textsuperscript{276} Which meant that the jury instruction was harmless error.\textsuperscript{277}

In the end, much of what animated the court and worried the dissent in the two _Martoma_ opinions was largely beside the point with respect to the actual facts of that case. For on its facts, _Martoma_ was the easiest case in the world. In _Martoma_ there was an actual pecuniary benefit to the tipper: the doctor who provided the information was paid more than $70,000 in exchange for the information. This is the simplest and most obvious kind of personal benefit there is: the tipper received a benefit in the form of monetary payments from the tippee.

Even under the stringent _Newman_ test that was abrogated in _Salman_ (the benefit has to be something of real pecuniary value), the payments here would have clearly been sufficient. And there is no doubt that Martoma knew

\textsuperscript{273} _Id._ at 77.
\textsuperscript{274} _Id._ at 80–81 (Pooler, J., dissenting).
\textsuperscript{275} _Id._ at 86–87 (Pooler, J., dissenting) (citation omitted).
\textsuperscript{276} _Id._ at 78.
\textsuperscript{277} _Id._ at 78-80.
of the payments, because he is the one who arranged them.\textsuperscript{278} It is true that the doctor did not separately bill for the last session, when he divulged the negative results.\textsuperscript{279} But that is of no moment: he was paid for providing information about the results of the drug trial, and he provided that information. It cannot possibly matter how or when he was paid: the only relevant point is that he was selling information for money. That is a simple \textit{quid pro quo} and as clear a case of a personal benefit as one can imagine; the only reason the Second Circuit twisted itself into a pretzel, not once but twice, over whether there was a “gift of confidential information” or a “meaningfully close personal relationship” in this case is due solely to a poorly worded jury instruction, an error that is unlikely to be repeated in the future and that the court held was harmless in any event.

The \textit{Martoma} case gave rise to two lengthy and confusing appellate decisions that left the law regarding the personal benefit test somewhat unsettled. In the end it seems clear that the majority in \textit{Martoma} was saying that a personal benefit can be found based on an intention to benefit the \textit{tippee} without any showing of a personal relationship between the tipper and the \textit{tippee}.\textsuperscript{280} That at least is how the Second Circuit seems to have approached the issue the next time it came up in \textit{US v. Chow}.\textsuperscript{281}

iv. \textit{United States v. Chow}

The \textit{Chow} case involved an attempted acquisition of a technology company. Chow worked on behalf of the acquiror and had entered into a non-disclosure agreement with the target company. During the course of the negotiations, Chow provided Yin information about the negotiations and Yin traded on the basis of that information. Chow was convicted of violating Section 10(b) and Section 1348.

One of the questions on appeal was whether Chow had obtained a personal benefit sufficient to sustain the Section 10(b) conviction. The court,

\textsuperscript{278} \textit{See id.} at 76 (“We observe that, unlike the defendants in \textit{Newman}, Martoma received confidential information directly from the tipper, and he does not claim that he was unaware of any personal benefit [the tipper received].”).

\textsuperscript{279} The dissent notes this fact, \textit{see id.} at 78 (Pooler, J., dissenting), but it is hard to imagine how it could be relevant. In any event, Martoma traded on information the doctor provided even before the final test results were divulged, and the doctor clearly billed for those sessions. For details of the trading, see David Rosenfeld, \textit{The Impact of Insider Trading on the Market Price of Securities: Some Evidence from Recent Cases of Unlawful Trading}, 44 J. CORP. L. 65 (2018).

\textsuperscript{280} \textit{Martoma}, 894 F.3d at 78.

\textsuperscript{281} \textit{United States v. Chow}, 993 F.3d 125 (2d Cir. 2021).
citing Martoma, noted that a “wide variety” of personal benefits count and the “bar is not a high one.” The court reiterated that “the government ‘need not show that the tipper expected or received a specific or tangible benefit in exchange for the tip,’ and that the personal benefit element is satisfied where there is evidence that the tipper ‘intend[ed] to benefit the . . . recipient.’”

The court then pointed to some of the benefits that the tipper allegedly received, including analyst reports, information about other companies in the industry, recommendations of possible venture partners, and gifts of wine and cigars. But in the end, the court focused not on any of the benefits Chow (the tipper) received but simply on the benefit that Yin (the tippee) received: “we conclude that the evidence was sufficient to support inferences that Chow knowingly and intentionally breached his duty of confidentiality by disclosing material nonpublic information as to the prospects for a merger agreement … intending for Yin to make trades based on that information.” And there was no discussion whatsoever of a meaningfully close personal relationship.

Because there were actual benefits, however slight, that were given to the tippee in the Chow case, it is hard to draw too much from it. But it does lend support to the proposition that a gift of information with the intention that the tippee will trade on it (i.e., that the tippee will benefit) will be sufficient to satisfy the personal benefit test.

b. Blaszczak I & II

Even though the Supreme Court twice upheld the use of the mail and wire fraud statutes in insider trading cases, after O’Hagan criminal authorities did not typically charge those offenses relying instead on Section 10(b). Mail and wire fraud, for example, was not charged in the most prominent recent criminal prosecutions, including the Galleon insider trading case and the Newman and Martoma cases although it clearly could have been.

But after the Newman decision and the difficulties it engendered with respect to the personal benefit test, criminal authorities began to rethink their position. They also latched on to a relatively recent addition to the securities law antifraud arsenal: 18 U.S.C. § 1348. Section 1348 was added to the criminal code as part of the Sarbanes-Oxley Act in 2002 and, in relevant part,
it makes it illegal “to defraud any person in connection with . . . the purchase or sale of 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 such security.\footnote{286} The penalty for a violation of Section 1348 includes fines and up to 25 years imprisonment.\footnote{287} The language of Section 1348 is based on the language of the mail and wire fraud statutes.\footnote{288}

The question immediately arose as to whether the traditional elements of Section 10(b) insider trading liability, including the need for a fiduciary breach and, in tipper/tippee cases, a personal benefit applied in Section 1348 cases. So far, courts have held that they do not.\footnote{289} The issue was squarely presented in \textit{United States v. Blaszczak}, which gave rise to two recent Second Circuit decisions.\footnote{290}

The \textit{Blaszczak} case involved trading on the basis of MNPI concerning the rules setting Medicare and Medicaid reimbursement rates for health care providers. Christopher Worrall was an employee at the Center for Medicare and Medicaid Services (CMS), which is a government agency within the Department of Health and Human Services. The CMS rules will typically impact the stock prices of companies that offer products and services covered by the reimbursement rates. Worrall provided confidential information about the substance and timing of the CMS’s proposed rules to David Blaszczak, a hedge fund consultant and former CMS employee. Blaszczak gave that information to Theodore Huber and Robert Olan who were partners in a health care-focused hedge fund named Deerfield. Huber and Olan traded on the basis of that information by short selling the stock of companies that would be negatively affected by the reimbursement rate changes.

All four were indicted on charges that included Title 15 securities fraud (Section 10(b) and Rule 10b-5), Title 18 securities fraud (Section 1348), Title 18 wire fraud (Section 1343), as well as counts of conversion of U.S. property and conspiracy.\footnote{291} All of the defendants were found guilty with respect to at least some of the Title 18 fraud and conversion counts, but they

\footnote{286} 18 U.S.C. § 1348.  
\footnote{287} \textit{Id.}  
\footnote{291} \textit{United States v. Blaszczak}, 947 F.3d at 28, 29.
were all acquitted with respect to the Title 15 securities fraud counts, presumably because the government failed to show that the tippers had received a “personal benefit” in exchange for the tips.

The defendants challenged their convictions, principally on the ground that the Title 18 wire fraud and securities fraud statutes apply only to fraudulent schemes to obtain “money or property” and that CMS’s confidential information regarding the rate changes was not government “property” within the meaning of those statutes. The defendants also argued that the district court erred by failing to charge the jury that a personal benefit was required in Title 18 cases just as it is in Title 15 cases.

The Second Circuit upheld the convictions in December 2019 (Blaszczak I). A divided panel held that CMS’s confidential information constituted “property” or a “thing of value” under the relevant statutes. The court also held that the Dirks “personal benefit test does not apply to the wire fraud and Title 18 securities fraud statutes.” The court reasoned that the Dirks personal benefit test was closely tied to the statutory purpose animating the Exchange Act, namely to eliminate the use of inside information for personal advantage. As a result, the provision of inside information to someone outside the company would only constitute the requisite breach of fiduciary duty if it was done for some kind of personal gain, that is to obtain some personal benefit. But the same would not hold true under the embezzlement theory that informs the mail and wire fraud statutes and Section 1348: “In the context of embezzlement, there is no additional requirement that an insider breach a duty to the owner of the property, since ‘it is impossible for a person to embezzle the money of another without committing a fraud upon him.’” Judge Kearsse dissented with respect to the property question but had no objection with respect to the personal benefit holding. The defendants then appealed to the Supreme Court.

Then things got a little weird. While the defendants’ petition for certiorari was pending, the Supreme Court decided Kelly v. United States, familiarly known as the “Bridgegate” case. In that case, a couple of then-

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292 Id. at 29, 30.
293 Id. at 30-34.
294 Id. at 30.
295 Id. at 30-34.
296 Id. at 37.
297 Id. at 35.
298 Id. at 35, 36.
299 Id. at 36.
300 Id. at 45-49 (Kearse J., dissenting).
New Jersey Governor Chris Christie’s staffers ordered the closure of several traffic lanes leading to the George Washington bridge, which created massive traffic jams in Fort Lee, New Jersey, in retaliation against the mayor of Fort Lee who had declined to endorse Christie for re-election. The Supreme Court overturned the staffers’ wire fraud convictions because their actions, however boneheaded, did not deprive the government of money or property within the meaning of the wire fraud statute.

After the decision in Kelly was announced, the Solicitor General filed a brief with the Court confessing error in the Blaszczak case on the ground that CMS’s confidential information had no economic value to the government and thus, under Kelly, did not constitute government “property” “money” or a “thing of value” within the meaning of the relevant Title 18 statutes. The Supreme Court then granted cert. in Blaszczak I, vacated the decision, and remanded the case for further consideration in light of Kelly.

When the case came back to the Second Circuit, the US Attorney’s Office for the S.D.N.Y. stated that it was “constrained to confess error at the direction of the Solicitor General’s Office” and that in “light of the Supreme Court’s holding in Kelly, it is now the position of the Department of Justice that in a case involving confidential government information, that information typically must have economic value in the hands of the relevant government entity to constitute “property” for purposes of 18 U.S.C. §§ 1343 and 1348.” The USAO asked for the case to be remanded to the district court so that it could dismiss the substantive fraud and conversion counts, although they argued that the conspiracy counts should be affirmed.

After the US Attorney’s Office threw in the towel, a sharply divided panel overturned the fraud and conversion convictions, once again underscoring the deep divisions at the Second Circuit over insider trading liability. Judge Kearse, who had dissented in Blaszczak I, wrote the majority opinion holding that CMS’s information, though undoubtedly confidential, did not constitute “property” within the meaning of the wire and securities fraud statutes:

As the Supreme Court recognized . . . the government’s right to

302 Id.
305 The court vacated the conspiracy convictions and remanded them for further proceedings including possibly a new trial. Blaszczak, 56 F.4th 230.
determine ‘who should get a benefit and who should not . . . do[es] ‘not create a property interest.’ . . . The information reflecting such a decision and the timing of that disclosure are regulatory in character and do not constitute money or property of the victim; and they are not a ‘thing of value’ to CMS that is susceptible to being ‘convert[ed].’

The majority was careful to distinguish information held by a government entity from information held by a private, commercial entity. “While confidential information may constitute property of a commercial entity such as the publisher victim in Carpenter v. United States . . . the same is not true with respect to a regulatory agency such as CMS.” However, in the same passage, the court indicated that the rationale for this distinction was that the publisher in that case—the Wall Street Journal—was in the business of gathering and selling information: “confidential information was its ‘stock in trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and to be distributed and sold to those who [would] pay money for it.’“ As discussed below, this restrictive view of property rights in information is at odds with current law, including Supreme Court precedent, and if followed could profoundly alter insider trading law.

In a strongly worded dissent, Judge Sullivan, who authored the majority opinion in Blaszczak I, argued that neither the wire or securities fraud statutes “distinguish[] between tangible and intangible property, or in any way suggest[] that information in the possession of a government agency as opposed to a private entity is beyond the scope of the statute. Each statute merely requires that the object of the fraud be ‘property’ in the hands of the victim.”

Judge Sullivan insisted that “the object of the defendants’ fraud was CMS’s confidential, proprietary information, and the Supreme Court’s decision in Kelly does not compel the vacatur of the defendants’ convictions.” Judge Sullivan argued that the majority’s opinion eviscerated long standing precedent: “For nearly four decades, courts have recognized that confidential information constitutes property under the mail-and wire-fraud statutes.” Unfortunately, because of the unusual procedural posture of the case – with the USAO arguing that the court should vacate the fraud convictions – we will have to await another case to get further clarity.

306 Blaszczak, 56 F.4th at 244. (citations omitted).
307 Id. at 243.
308 Id. at 243.
309 Id. at 251.
310 Id.
311 Id. at 252.
on this important issue.

Finally, Judge Walker wrote a concurrence, joined by Judge Kearse, in which he urged reconsideration of the holding in Blaszczak I that the personal benefit test does not apply in Title 18 wire and securities fraud cases.\(^{312}\) The principal thrust of Judge Walker’s call for the issue to be revisited is the oddity of it being easier to bring a criminal insider trading case than a civil one, which will be discussed below.\(^{313}\)

IV. THE FUTURE OR WHERE THINGS MAY BE HEADING

A. Some Open Issues

The decisions in the Newman, Martoma, and Blaszczak cases have left open a number of practical issues that need to be addressed by both civil and criminal authorities going forward. In particular, there are five principal issues, mostly centered on the personal benefit test, that are likely to frame the contours of insider trading law and insider trading prosecutions in the near future.

First, there is the question of what the authorities need to show with respect to a tippees’ knowledge of the tipper’s personal benefit. In Newman, the Second Circuit held that to prosecute a tippee for unlawful trading, the government must show not only that the tipper received a personal benefit but that the tippee knew that the tipper had received a personal benefit.\(^{314}\) In a subsequent decision in the S.D.N.Y., the court held that the Newman knowledge test applied only in the criminal context, and that a lesser standard is applicable in civil cases.\(^{315}\) The practical difficulties of proving that a tippee – and especially a remote tippee – knew that the tipper received a personal benefit is an important reason why the criminal authorities have migrated to Title 18 enforcement.

Second, there is the question of whether the personal benefit test applies in Title 15 cases brought under the misappropriation theory. The Supreme Court has never ruled on the issue, and the fact that there is some uncertainty in this area will likely be significant going forward at least when it comes to civil enforcement and may spell the end of the classical theory of insider trading.

Third, there is still the question of whether the personal benefit test has

\(^{312}\) Id. at 230-39 (Walker, J., concurring)

\(^{313}\) Id.


any applicability in Title 18 cases. To date every court that has considered the question has held that it does not, but the Supreme Court has never ruled on the issue. In the most recent decision in the Blaszczak case, two judges in dicta strongly urged that the issue be reconsidered, and it is likely to be the focus of considerable litigation going forward.316

Fourth, there is a larger question about what the “gift of information” theory means for the future of the personal benefit test itself. In Martoma II, the majority held that a gift of information with the intent to benefit the tippee satisfies the personal benefit test without regard to any relationship between the parties, although there is some lingering doubt about the status of that holding.317 If it ends up being consistently followed and applied, it may, for all intents and purposes, spell the end of the personal benefit test.

Finally, there is a novel issue stemming from the Blaszczak case, namely what qualifies as property for purposes of a prosecution under the mail and wire fraud and related statutes. In Blaszczak the court ultimately held that certain confidential information was not government property within the meaning of those statutes. Although, the holding applies only to what constitutes government property, some of the language in the Second Circuit’s opinion could have important consequences for the future use of Title 18 in insider trading cases more generally.

In the sections that follow, I will briefly discuss how these issues may impact both criminal and civil insider trading enforcement going forward and offer a few thoughts on how prosecuting authorities may continue to push the envelope in creative ways.

B. Criminal Enforcement and Title 18

At this point it seems pretty clear that the criminal authorities will continue to use Title 18 mail and wire fraud and securities fraud to bring insider trading cases, particularly in situations where there are questions about whether the tipper received a personal benefit or questions about the tippee’s knowledge of a personal benefit. The trend in the past few years is striking, and the reasons are equally clear: almost every Title 15 case will meet the standards for Title 18 liability,318 while Title 18 liability, at least as

318 See DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 8:14, at 8-49 (2012) (Based on Carpenter, “it seems clear that virtually all insider trading cases will also be mail and wire fraud cases, whether under the misappropriation theory or the classical theory”).
of now, does not require the same elements as Title 15 liability. The result is that the criminal authorities will increasingly shift to using Title 18, almost to the extent of rendering traditional Section 10(b) liability in criminal insider trading cases a thing of the past.

1. Title 18-Mail and Wire Fraud and Securities Fraud

The mail and wire fraud statutes have been used to prosecute insider trading cases for more than forty years, and their use has been upheld by numerous courts in a variety of factual scenarios, including cases where the same court found that Section 10(b) did not apply. Most important, the Supreme Court has twice unanimously upheld the use of the mail and wire fraud statutes in insider trading cases, first in Carpenter and then in O’Hagan. In Carpenter, the Court noted: “We have little trouble in holding that the conspiracy here to trade on the Journal’s confidential information is not outside the reach of the mail and wire fraud statutes . . . . The Journal’s business information that it intended to be kept confidential was its property.” Little trouble indeed: the whole unanimous opinion is just 10 pages long!

In light of these two unanimous Supreme Court decisions, it seems very well settled that the mail and wire fraud statutes can be used in criminal insider trading cases. The Supreme Court has never ruled on the use of Section 1348 in insider trading cases, but lower courts have now routinely upheld its use. Section 1348 is modeled on the mail and wire fraud statutes (and is found in the same section of the Code), so it would seem the same analysis would apply. Moreover, Section 1348 does explicitly cover securities fraud, and given that insider trading is deemed a species of fraud for the general anti-fraud provisions under Title 15, it is difficult to see an

320 See, e.g., United States v. Bryan, 58 F.3d 933 (4th Cir. 1995) (pre-O’Hagan case affirming wire fraud conviction for unlawful insider trading but rejecting Section 10(b) charges on same facts).
321 Carpenter v. United States, 484 U.S. 19, 28 (1987). See also id. at 26-27. (“The confidential information was generated from the business, and the business had a right to decide how to use it prior to disclosing it to the public. Petitioners cannot successfully contend . . . that a scheme to defraud requires a monetary loss, such as giving the information to a competitor; it is sufficient that the Journal has been deprived of its right to exclusive use of the information.”).
argument for why Section 1348 couldn’t be used, as a general matter, to prosecute insider trading.

That still leaves open the question of whether a conviction under Title 18 requires meeting all of the same elements as a Section 10(b) charge. The question was raised in the O’Hagan case, but the Supreme Court sidestepped the issue because the Court found that the government had met the elements for Section 10(b) liability.

There is one element that is clearly different between the mail and wire fraud statutes and Section 10(b)-Rule 10b-5: the mail and wire fraud statutes do not have an “in connection with” requirement (although Section 1348 does), which partly explains why the O’Hagan Court was unanimous on the mail and wire fraud counts but split on the misappropriation theory. The lack of the “in connection with” requirement may have some consequences going forward as discussed below.

But whether the other elements of a 10b-5 charge need to be met in a mail and wire fraud or Title 18 securities fraud case is still something of an open issue. In Blaszczak, the Second Circuit held that the personal benefit test did not apply in either mail and wire fraud cases or in Section 1348 cases because the embezzlement itself constituted fraudulent conduct, so no further breach of duty needed to be established. The Blaszczak opinion has since been vacated on other grounds, but this holding presumably remains good law. Moreover, to date no court has ever held that a personal benefit is required in a mail and wire fraud case. As for Section 1348, to date every other court that has considered the issue has agreed that there is no personal benefit requirement in Section 1348 cases, although the issue is likely to be raised going forward.

There are at least three reasons why Section 1348 should be treated differently from Section 10(b) and why the personal benefit test should not be imported into Title 18 cases. First, Section 1348 was specifically adopted for the purpose of filing statutory gaps and reaching fraudulent conduct that did not otherwise meet the technical requirements of Section 10(b) fraud. Second, the statute was modeled on the mail and wire fraud statutes and was placed in the code book alongside them; it was not made part of the Exchange Act or any other securities law, thus suggesting that the standard for interpreting the application of the statute should be the mail and wire fraud statutes rather than the securities laws. And third, the personal benefit test should have no application in Section 1348 cases because it is based on a completely different theory. The personal benefit test came about because of the need to show a fiduciary breach through an improper disclosure of information; because not all disclosures are improper the court devised an objective test as to when some disclosures are improper, namely whether the
disclosing party receives a personal benefit. But in embezzlement cases the theory is different; the fiduciary breach comes about not through an improper disclosure of information, but through the improper use of information that belongs to the principal. The embezzlement itself constitutes the breach.

Finally, the criminal authorities are likely to use the conspiracy statutes to further obviate the need to show a personal benefit in tipper-tippee cases. Tippees will be charged as engaging in a conspiracy to further a scheme engaged in by the principal culprits. There is no need to show that the principal benefited from the conspirators’ participation in the scheme, only that the participation was in furtherance of the scheme.

2. The Critique of Using Title 18: It’s Easier to Bring a Criminal Case than a Civil Case

In Blaszczak II, Judge Walker wrote an impassioned concurrence, which was joined by Judge Kearse, urging the Second Circuit, the Supreme Court and Congress, to revisit the question whether a personal benefit is required in Title 18 cases. Notably, Judge Walker did not take issue with the legal reasoning underlying the decision or argue that it was wrong on doctrinal grounds. Rather the core of Judge Walker’s critique is that without a personal benefit test, it is easier to bring a criminal insider trading case than a civil one, which simply “strikes one as odd”:

[T]raditional notions of fair play are offended by the present incongruence in this circuit between civil and criminal deterrence. It should not require fewer elements to prove a criminal conviction than to impose civil penalties for the same conduct. This asymmetry deserves the further attention of our court, the Supreme Court, and Congress.322

It is indeed jarring at some level to think that it could be easier to bring a criminal case than a civil one. But it is not all that unusual and it is implicit in the very history and structure of Section 1348. Section 1348 was enacted for the specific purpose of broadening the reach of the anti-fraud provisions of the federal securities laws. It was designed to overcome the “technical legal requirements” and the existing “shortcomings in current law” in order

322 United States v. Blaszczak, 56 F.4th 230, 246 (2022) (Walker, J., concurring). Academic commenters and practitioners have also stressed this “asymmetry.” See, e.g., Karen Woody, The New Insider Trading, 52 Ark. St. L. J. 594 (2019); Elkan Abramowitz & Jonathan S. Sack, Back to the Future: Criminal Insider Trading Under Title 18, N.Y.L.J. (July 2, 2018) (“We question whether the drafters of the laws at issue could have contemplated such a disparity in civil and criminal liability for the very same conduct.”).
to make it easier to prosecute wrongdoers. But Congress enacted Section 1348 as a strictly criminal statute: there is no civil analog, although Congress clearly could have created one had they desired to do so. Similarly, Congress could have amended the existing anti-fraud statutes (including Section 10(b)) to accomplish the same end, namely loosening the technical strictures that were seen as hampering prosecution. But again, Congress chose not to do so. By design Section 1348 was enacted to expand only criminal liability for certain acts. Congress, in other words, was explicitly creating a regime where it would be easier to bring a criminal case than a civil one. And, perhaps tellingly, Congress did not even place Section 1348 in the federal securities laws, although it is by its terms limited to fraudulent conduct pertaining to securities (and commodities). It may seem “odd” that it would be easier to make out a criminal case than a civil case, but that is clearly what Congress set out to do.

Section 1348, of course, is not limited to insider trading. Indeed, the statute was enacted largely to try to capture accounting fraud misconduct that may have eluded prosecution in the Enron era. As a result of Section 1348, it is now easier to criminally prosecute some forms of accounting fraud than it is to bring civil charges (or to prosecute the same conduct criminally under Section 10b). This was the whole reason for enacting Section 1348.

There have been many instances over the years where the criminal authorities have opted to charge Section 1348 rather than Section 10(b) in securities fraud cases involving such things as pump-and-dump schemes or run-of-the-mill accounting fraud cases, including cases where the SEC brought parallel charges including Section 10(b) charges. There are many possible reasons why the criminal authorities chose to proceed in this way; the most likely is that Section 1348 has a “knowing” standard while Section 10(b) has a “willfulness” standard. There have also been non-insider trading cases where the criminal authorities have brought fraud charges under the mail and wire fraud statutes, but the SEC was only able to charge books and records violations for the same conduct, presumably because they could not meet the standard for Title 15 fraud.

But the point is simple: there are numerous statutory and regulatory

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324 Compare United States v. Abellan, No.CR-19-00448-PHX-DLR (MHB) (D. Ariz. 2019) (charging Section 1348, along with conspiracy and money laundering, but not charging 10(b)) with SEC v. Abellan, No.C08-5502BHS (W.D. Wash. 2009) (charging violations of Section 10(b) and SA 17(a)) (pump-and-dump scheme).
provisions giving rise to civil and criminal liability, and sometimes both, that cover the same underlying conduct even if they are grounded on different theories, require different elements, or employ different standards. For example, “[t]he materiality bar to securities fraud liability is higher than the materiality bar to wire and mail fraud liability.”

It is often easier to bring a securities fraud case under the mail and wire fraud statutes and under Section 1348 than under Section 10(b), because those provisions are structured differently. But there is nothing unusual about this: the same conduct can often be prosecuted under different statutory provisions and prosecuting authorities will charge those provisions that best fit the conduct and the evidence. Congress enacted Section 1348 for the very purpose of making it easier to bring certain fraud cases and deliberately chose to make Section 1348 a criminal only statute. That might seem odd, but there is absolutely nothing unusual, or wrong, with it.

Finally, it should be noted that the policy concern underlying Judge Walker’s concurrence seems oddly out of date. Judge Walker seems principally concerned that analysts could be chilled by the use of a broader anti-fraud provision that lacks a personal benefit requirement. He notes that analysts who “ferret out” information are critical to the proper functioning of the securities markets and concludes that without a bright line ‘personal benefit test’ “corporate insiders may be more reticent to share information with analysts in the ordinary course of business and analysts who do receive company information may be less likely to act on it for fear of running afoul of § 1348.”

Concern over chilling analyst conduct was indeed a motivating factor in the Dirks decision. But since that time much has changed particularly on the regulatory landscape. Specifically, the SEC adopted Regulation FD which prohibits many of the conversations and communications with analysts that were routine at the time of Dirks and that the Court in Dirks was seeking to safeguard. Under Regulation FD, company insiders are prohibited from selectively disclosing information to analysts: any intentional disclosures to analysts must be simultaneously disclosed to the

326 Wendy Gerwick Couture, White Collar Crime’s Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable, 72 ALB. L. Rev. 1, 6 (2009). See also id. at 3 (“[M]ajor differences between criminal and civil treatment of conduct sounding in securities fraud create an anomaly in which conduct not actionable as securities fraud may nonetheless be criminally prosecuted.”).
market generally, while unintentional disclosures must be timely rectified.\textsuperscript{330} Today, corporate insiders who “share information with analysts in the ordinary course of business” are required to simultaneously make that information public, and “analysts who do receive company information” in the appropriate manner (that is when it has simultaneously been made available to the markets) should have no fear whatsoever about acting on it: there is simply no basis for liability in that situation.

3. Title 18 and Property (Blaszczak)

The most recent Second Circuit decision in the \textit{Blaszczak II} case has also raised an important issue concerning the meaning of “property” in Title 18 cases, which might have consequences down the line.

In \textit{Blaszczak II}, the court held that confidential information in the hands of a government agency does not constitute “property” within the meaning of the Title 18 wire and securities fraud statutes. The court concluded that the information concerning Medicare and Medicaid reimbursement rules in that case was “regulatory in character” and could not be considered “money or property” of the government or a “thing of value” that could be converted.\textsuperscript{331} This part of the holding will undoubtedly impact the ability of the government to bring insider trading cases in situations where the information traded upon comes directly or indirectly from a government agency.\textsuperscript{332} At the same time, the court in Blaszczak also emphasized that a separate conspiracy statute (Section 371) is not limited to property interests and remanded the case to the district court for further consideration with respect to those counts: “Section 371 encompasses not just conspiracies to commit property crimes, but conspiracy to commit ‘any offense against the United States’ and any conspiracy to ‘defraud the United States, or any agency thereof in any manner or for any purpose.’”\textsuperscript{333} Given the restrictive view of government information as property adopted in \textit{Blaszczak II}, criminal authorities are likely to charge broader conspiracy statutes whenever possible going forward, particularly one that even the majority in

\textsuperscript{330} 17 C.F.R. § 243 (2023).
\textsuperscript{331} \textit{Blaszczak}, 56 F.4th at 244.
\textsuperscript{332} The question of what constitutes government “property” however remains unsettled, and the issue is sorely in need of Supreme Court clarification: it is unfortunate that the unusual procedural posture of the \textit{Blaszczak} case—the USAO conceding error—has effectively precluded further review, particularly given the fact that the Second Circuit is deeply divided. This is a case that ordinarily might have been subject to en banc review and may well have ultimately come out the other way.
\textsuperscript{333} \textit{Blaszczak}, 56 F.4th at 246 (citation omitted).
Blaszczak II concedes applies to beyond traditional property.

But far more problematic is the possibility that the court’s reasoning could be extended to information belonging to private parties.\textsuperscript{334} In Blaszczak II, the court tried to address the Carpenter case—where the Supreme Court upheld wire fraud convictions in a case involving trading on information that was going to be published in a Wall Street Journal column—by drawing a distinction between government information and information belonging to a “commercial entity.” In so doing, however, the court leaned on the fact that the information in that case was part of the Wall Street Journal’s core business, and that it had monetary value because it was something that the Journal not only expended resources to obtain, but was also trying to sell:

While confidential information may constitute property of a commercial entity such as the publisher victim in Carpenter v. United States, 484 U.S. 19, 108 S. Ct. 316, 98 L.Ed.2d 275 (1987)—for which confidential information was its “stock in trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and to be distributed and sold to those who [would] pay money for it,” id. at 26, 108 S. Ct. 316—the same is not true with respect to a regulatory agency such as CMS. CMS is not a commercial entity; it does not sell, or offer for sale, a service or a product.\textsuperscript{335}

Although clearly dicta, the court’s insinuation that information can only constitute property within the meaning of the mail and wire fraud and Title 18 securities fraud statutes if it is a commercial “product” that can actually be monetized could have far reaching consequences for insider trading law and would severely limit the use of Title 18 in prosecuting insider trading. But as the dissent in Blaszczak II points out, it goes against long-standing precedent: courts have never limited the definition of informational property in this way.

The most important and most obvious example comes in the Supreme Court’s other decision unanimously upholding wire fraud convictions in an insider trading case: O’Hagan. In O’Hagan, the “property” at issue consisted of information concerning a proposed corporate takeover. The information was said to belong to the source, namely the law firm and the law firm’s client (the acquiring company). By no stretch of the imagination could this information be considered something that either of these parties was in the


\textsuperscript{335} Blaszczak, 56 F.4th at 243 (citations omitted; emphasis supplied by the Blaszczak court).
business of obtaining and selling. While clearly valuable, the information was merely the byproduct of the central business of either of the possible information “proprietors,” namely providing legal advice or running a food services conglomerate. The information was never going to be “distributed” or “sold”; it was not produced for, and was never intended to be used in, a commercial transaction. Indeed, it was intended to be kept confidential, which is where its true “value” resided. No one in the *O’Hagan* case was in the business of producing and selling information.

Given that the Supreme Court has clearly endorsed the view that confidential information can constitute property within the meaning of Title 18 even if it not something that is intended to be, or even could be, monetized, it seems unlikely that future courts will adopt the reasoning in the *Blaszczak II* dictum, and extend the holding in that case to confidential information belonging to private parties. Nonetheless, the fact that the majority in *Blaszczak II* took the position it did reflects a general hostility by at least some members of the Second Circuit towards an expansive use of Title 18 in insider trading cases and may portend some further retrenchments.

4. Title 18 and New Avenues for Insider Trading Liability: Insider Abstention

With the expanded use of Title 18 as a basis for “insider trading” liability, the “trading” component may drop out altogether. While Section 10(b) prohibits fraud “in connection with” the purchase or sale of a security, there is no “in connection with” requirement under the mail and wire fraud statute, indeed there is no requirement of a securities trade at all. Which raises the question whether the government could bring “insider trading” charges when there is no actual “trading.”

It is sometimes said that the largest category of “insider trading” consists of decisions not to trade. Say an executive of a mining company was planning to sell some of his stock for whatever reason; the executive finds out that the company is about to announce a major new mineral discovery that will undoubtedly send the stock price soaring; the executive decides not to sell. The decision is clearly based on material non-public information and will result in significant gains to the executive but, leaving aside the obvious issues of discovery and proof, such “non-trading” has always been considered beyond the reach of the anti-fraud provisions of the federal securities laws, because there is no actual trade and whatever deception there
may be is not “in connection with” the purchase or sale of a security. Indeed, opponents of insider trading regulation have often pointed to insiders’ ability to abstain from trading on nonpublic information as completely undermining the basis for insider trading regulation. The problem of insider abstention is often described as insoluble. But use of the mail and wire fraud statute could potentially change that and extend “insider trading” law to insider abstention under certain circumstances.

The issue is most likely to come up with respect to the cancellation or termination of Rule 10b5-1 plans. A Rule 10b5-1 plan is a written plan to transact in securities which, if adopted in good faith when the person is not in possession of MNPI, provides an affirmative defense to an insider trading charge even if the actual trade occurs at a time when the person is in possession of MNPI. Rule 10b5-1 plans have become standard fare for many people who routinely come into contact with MNPI and might otherwise be unable to trade without risking legal liability. But they have also been widely criticized as inviting abuse and, as discussed above, the government authorities recently brought two insider trading cases involving the misuse of Rule 10b5-1 plans. The SEC also recently adopted rule changes designed to curtail some of the more egregious practices. In particular, under the new rules there is now a “cooling-off” period that limits the ability to trade for a specified period of time after the adoption of Rule 10b5-1 plan.

But one big problem persists: abuses connected to the termination or cancellation of existing trading plans. Specifically, a person who has adopted a Rule 10b5-1 plan calling for example for the sale of a preset amount of securities at a specified time may find out MNPI that will lead to an increase in the price of those securities and decide to cancel or terminate the sales plan.

337 Id.
338 See, e.g., Boyd Kimball Dyer, Economic Analysis, Insider Trading, and Game Markets, 1992 Utah L. Rev. 1, 23-24 (“The problem of ‘insider not trading’ is not solvable”); Manne, supra note 336, at 938 (“People can make abnormal profits in the stock market simply by knowing when not to buy and when not to sell. And this is a form of insider trading that no one can do anything about.”); Stephen R. Salbu, Tipper Credibility, Noninformational Tippee Trading, and Abstention from Trading: An Analysis of Gaps in the Insider Trading Laws, 68 Wash. L. Rev. 307, 333-34 (1993) (“[I]t is both legally and logistically difficult to regulate the use of inside information as a factor in the decision to abstain from trading.”).
Rule 10b5-1 plans are supposed to be irrevocable. However, when the SEC adopted Rule 10b5-1, SEC staff stated that termination or cancellation of a 10b5-1 plan would not itself constitute a violation of the antifraud provisions because there would be no actual trading: the termination of a plan would not be “in connection with” the purchase or sale of a security.341

In the early 2000s, there was widespread criticism that 10b5-1 plans were being abused in a variety of ways, including with respect to cancellation of trades or termination of the plans.342 The SEC brought a couple of high-profile cases that involved, among other things, manipulation of trading plans,343 although the misconduct in those cases involved changes to the plans and actual trading. In 2009, the SEC’s then Director of Enforcement stated that the division would be taking a close look at possible misuse of trading plans344 and the Corporation Finance staff updated its guidance. But the Corporation Finance staff reiterated that the mere termination of a trading plan, and the cancellation of orders thereunder, does not in itself result in liability under Section 10(b) and Rule 10b-5 because the fraudulent conduct must be “in connection with the purchase or sale of any security.”345 At the same time the staff stated that cancelling trades or terminating a Rule 10b5-1 plan will eliminate the affirmative defense available under the plan for trades going forward, and could affect the availability of the affirmative defense for trades previously made under the plan because it might call into

341 SEC, Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations: Fourth Supplement (June 8, 2001), https://www.sec.gov/interp/telephone.shtml[https://perma.cc/H82L-9TCY]. The staff cited to Blue Chip Stamps, a case where the Supreme Court held that an actual trade is required to bring a private action under Section 10(b), that is a private 10b-5 action can only be brought by someone who actually bought or sold securities, not by someone who didn’t buy securities because of a misrepresentation. More recently, the Supreme Court has taken a slightly more expansive view of the “in connection with requirement” at least when it comes to public enforcement, finding that the requirement is satisfied so long as the fraud “coincides” with a securities transaction. See Merrill Lynch v. Dabit, 547 U.S. 71, 73 (2006) (“[F]raudulent manipulation of stock prices . . . unquestionably qualifies as fraud ‘in connection with the purchase or sale’ of securities.”).


344 See Linda Thomsen, Remarks at the 2007 Corporate Counsel Institute (Mar. 8, 2007).

345 The staff did go on to note that the “‘in connection with’ requirement is satisfied when a fraud ‘coincides’ with a securities transaction.” SEC, Exchange Act Rules, Compliance and Disclosure Interpretations, Question 120.17.
question whether the plan was entered into in good faith or as part of scheme to evade the insider trading rules. But obviating the affirmative defense is very different from imposing actual liability.

The situation may well be different under the mail and wire fraud statutes because a violation does not require that the fraud be “in connection with” a securities transaction. The mail and wire fraud statutes prohibit “any scheme or artifice to defraud” or obtaining money or property “by means of false or fraudulent pretenses, representations, or promises.” In the insider trading context, it amounts to embezzling proprietary confidential information that belongs to someone else and using it for one’s own purposes, thereby depriving the owner of the information of the exclusive right to use the information. It seems wholly immaterial whether the embezzled information is used to purchase or sell securities or to cancel an existing order to purchase or sell securities. In either case the pilfered information is the basis for the decision and in both cases the owner of the information is deprived of their exclusive right to use the information.

It is of course true that when a trading plan is cancelled or terminated the cancelling party doesn’t make any money in the literal sense. But the reason for cancelling pre-existing orders to trade is almost always going to be to avoid a loss of some sort. Losses avoided are considered a form of pecuniary benefit in all insider trading cases, and they are considered as part of the calculation of the overall gains as well as the calculation of civil penalties. If the mail and wire fraud statutes capture placing a trade on the basis of MNPI that would result in loss avoidance, why wouldn’t those statutes capture canceling a trade on the basis of MNPI that would result in loss avoidance. The basis of the violation is the exploitation of proprietary information, not the trading.

It is important in this context to stress that Rule 10b5-1 trading plans are written plans that are provided to a third party, typically a broker; they constitute specific instructions to enter orders at specified times and prices. They are, in effect, the equivalent of entering a standing order which, under

346 SEC, Exchange Act Rules, Compliance and Disclosure Interpretations, Questions 120.18 and 120.19.
347 See supra note 83. There may be other bases for bringing insider trading charges in connection with the termination or cancellation of a Rule 10b5-1 plan, including under Section 17(a) of the Securities Act and under Title 18 § 1348.; see David Rosenfeld, Insider Abstention and Rule 10b5-1 Plans, U. CHI. BUS. L. REV. (forthcoming).
348 See 17 C.F.R. § 240.21 (2023) (“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.”) (emphasis added).
the rules, is supposed to be irrevocable. Among other things, the existence of a written plan that is later cancelled or terminated does not implicate the very difficult proof issues that would normally accompany a failure to trade case. With a Rule 10b5-1 plan there is a written record, in the form of a trading directive that is being explicitly countermanded. We know what the putative trader originally intended, and what they did to negate their order.

B. SEC Enforcement

1. The Misappropriation Theory

The SEC is likely to argue the misappropriation theory in more and more insider trading cases. Almost all classical insider trading cases could also be brought under the misappropriation theory and given that there is at least some possibility that the personal benefit test does not apply in misappropriation cases, the authorities are likely to push cases in that direction, particularly where there are issues of proof concerning the knowledge of remote tippees. The charging documents themselves, of course, don’t specify the theory; they merely state the statutory provision that was allegedly violated. And the SEC will continue to allege all of the elements necessary under the classical theory (e.g., that there was a personal benefit, that the tippees knew or were reckless in not knowing that there was a personal benefit), but they will argue, wherever necessary, that they are proceeding under the misappropriation theory in order to preserve the case in the event that it is determined that they have not established the personal benefit element.

To date, the Eleventh Court has directly ruled that the personal benefit test applies in misappropriation cases and the Second Circuit has at least indirectly stated that it applies. But the Supreme Court has never ruled directly on the question, and it remains an open issue that is likely to be litigated in the near future. The better argument is that the personal benefit test has no applicability in misappropriation cases, largely because it is predicated on a fiduciary breach that is completely different from the breach involved in a classical case. In a classical case, the duty runs to the counterparty of the transaction and the breach comes from a failure to disclose the possession of material nonpublic information; in a misappropriation case the duty runs to the source of the information, and the breach occurs simply through the improper disclosure or use of the
The purpose of the personal benefit test was to establish a breach of fiduciary duty by the tipper. But in a misappropriations case to the extent that a breach of duty is necessary that breach occurred when the information was embezzled. And the personal benefit test makes no sense in the context of the original misappropriator: by definition they are deceiving the source of the information and taking something of value from them. The source doesn’t receive a benefit, in fact they are harmed.

The classical theory of insider trading is both the most straightforward and the most tangled of the bunch. It is the most straightforward conceptually in that it deals with actual insiders who are trading in the securities of their company, and it links the harm to the actual trading: the victim is the counterparty to the transaction. But it has always been legally fraught because trading on impersonal markets doesn’t fit neatly into this type of fraud theory. The courts have fashioned a viable hook based on a duty to speak emanating from a fiduciary obligation. But as many have pointed out that is something of a stretch: not all insiders have fiduciary obligations under state law and to the extent the obligation runs to shareholders it would technically only cover trading with existing shareholders. Yet courts have expanded the classical theory to cover not only every insider, but even temporary or constructive insiders, and quickly extended the theory to cover transactions with non-shareholders.

Legally, the courts have accomplished this move by subtly shifting the fiduciary obligation from one that runs to the shareholders to one that runs to the company. In so doing, however, the classical theory begins to resemble the misappropriation theory: when a true insider trades on the basis of MNPI in violation of a duty of trust and confidence that is owed to the company, they are also trading in violation of a duty that is owed to the source of the information. The misappropriation theory covers the same conduct and it is more grounded in the law of fraud, even if it is almost entirely disconnected from the actual trading. An embezzlement theory simply works better legally.

2. Goodbye to the Classical Theory . . . or Goodbye to the Personal Benefit Test?

The personal benefit test is the hangnail of civil enforcement of insider trading prohibitions. The test, of course, applies to criminal prosecutions

under Title 15 as well, at least in classical cases. But the criminal authorities have other options available and, as noted above, are likely to avoid Title 15 charges altogether whenever there is a potential personal benefit issue and instead proceed exclusively under Title 18. As a result, the personal benefit test is largely an issue only on the civil side which has led to the oddity that criminal liability is sometimes easier to establish than civil liability. Getting rid of the personal benefit test has been one of the principal recommendations for legislative reform.351 In the interim, however, courts are likely to limit its reach by working within the current doctrinal framework.

\[ a. \text{ What Counts as a Benefit?} \]

Prior to the Newman case, courts had taken a very liberal view of what constituted a personal benefit: almost anything counted including amorphous future benefits that might possibly accrue to the tipper. In Newman, the Second Circuit upset the apple cart and held that the personal benefit needed to be something “tangible, of real pecuniary value.” That holding was clearly at odds with the language of Dirks, which had specifically referred to reputational benefits as well as gifts of information, and the Supreme Court quickly overturned that part of the Newman opinion.352 The result is that courts have now gone back to the older expansive view of what counts as a benefit, and the bar is “not a high one.”353

In the Martoma case, the Second Circuit pointed out that a personal benefit existed where:

the tippee gave one tipper “an iPhone, live lobsters, a gift card, and a jar of honey,” and where the tippee had another tipper admitted into an investment club where the tipper “had the opportunity to access information that could yield future pecuniary gain” (even though he never realized that opportunity).354

In one recent case, the court found a personal benefit where the tippee provided the tipper with general investment information, introduced the tipper to business contacts, and provided the tipper with gifts of wine and cigars.355

351 See THE BHARARA TASK FORCE ON INSIDER TRADING (Jan. 2020).
353 United States v. Martoma, 894 F.3d 64, 76 (2d Cir. 2017) (quoting SEC v. Obus, 693 F.3d 276, 292 (2d Cir. 2012)).
354 Id. at 74 (quoting United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013)).
355 United States v. Chow, 993 F.3d 125 (2d Cir. 2021).
b. Gratuitous Tips

Although the bar for what constitutes a personal benefit is set very low, there are still some situations where the tip appears to be entirely gratuitous, that is given without anything being provided, or promised, in return. Although the decision in the Martoma case created some confusion over the issue, the majority clearly held that a gift of information satisfies the personal benefit test because it benefits the tippee rather than the tipper. This approach makes sense in light of the logic of Dirks and is wholly consistent with the language in that case. The essential question in Dirks was whether a disclosure of information by a company insider constituted a breach of fiduciary duty. The court indicated that the question was whether the disclosure was being made for a proper corporate purpose and then added that the test of proper purpose was whether the tipper personally benefitted from the tip. The Court in Dirks also held that a gift of information to a trading relative or friend satisfies the personal benefit element, which has proved vexing for the courts largely because it seems to be conceptually at odds with the rest of the personal benefit test: almost by definition, a gift benefits the recipient rather than donor. But as the court in Martoma held these two approaches are in fact complimentary: either a benefit to the tipper or a benefit to the tippee is sufficient because both reflect that the information was not being provided for a proper corporate purpose.

The personal benefit test seems to have taken a life of its own and is sometimes treated by courts as though it is a separate element constituting the breach of fiduciary duty. But the personal benefit test was always meant to be something else, namely a proxy for whether the disclosure of information constituted a breach of a fiduciary duty which in turn depends on the purpose of the disclosure. A disclosure by a company insider who personally benefits from the disclosure is a classic example of a breach of the duty of loyalty. But so too is a disclosure of confidential company information to someone for the purpose of allowing them to trade on that information: providing confidential information for the purpose of enriching a third party is never a proper corporate purpose or, put differently, is always a breach of fiduciary duty.

Viewed in this light the majority in Martoma had it exactly right: a gift of information is improper if it is designed to benefit the tippee. Which means, in essence, that any tip to someone for the purpose of allowing them to trade on the information should always satisfy the elements of Section 10(b) liability. This is wholly consistent with the language and logic of Dirks, and it is also entirely in accord with how gifts of information had been treated
in the Second Circuit prior to Newman.\textsuperscript{356} And it appears to be the position that the Second Circuit is inclined to follow.\textsuperscript{357} If this renders the personal benefit test something of a “nullity” so be it.

\textsuperscript{356} See, e.g., SEC v. Warde, 151 F.3d 42, 49 (2d Cir. 1998) (“The close friendship between [tipper] Downe and [tippee] Warde suggests that Downe’s tip was ‘intended to benefit’ Warde, and therefore allows a jury to find that Downe’s tip breached a duty under § 10(b).”).

\textsuperscript{357} See Chow, 993 F.3d at 125.