MORE COWBELL: FREEING INSIDER-TRADING LIABILITY FOR *MERE-THIEVES* FROM THE SUPREME COURT'S TWENTIETH-CENTURY DEVOTION TO THE CULT OF COMMON-LAW DOCTRINAL ANALYSIS

Robert Steinbuch*

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* Robert Steinbuch is a 2015 Fulbright Scholar and Professor of Law at The University of Arkansas at Little Rock, William H. Bowen School of Law. Steinbuch received his J.D. from Columbia Law School, where he was a John M. Olin Law & Economics Fellow and received his B.A. and M.A. from the University of Pennsylvania. He is a former judicial law clerk on the United States Court of Appeals for the Eleventh Circuit and former attorney with the United States Department of Justice, the United States Internal Revenue Service, and the United States Senate Committee on the Judiciary. Professor Steinbuch serves as the Chairman of the Arkansas Advisory Committee to the United States Commission on Civil Rights and is a member of the Arkansas Transparency in Government Group, the Arkansas Freedom of Information Task Force, and the Arkansas Freedom of Information Commission. The author also wishes to thank the excellent staff of the Nevada Law Journal for their wonderful mastery of the contents of this article. This article was drafted with the off-duty-campus-assignment support (also known as a sabbatical) of the University of Arkansas, Little Rock, William H. Bowen School of Law.

INTRODUCTION

In 2008, I wrote the first of two articles reimagining insider trading law on the basis of a type of outsider who traded on inside information (that is, "mere thieves").[1] My blueprint was tantalizingly simple in application, and yet it sought to upend a significant portion of current securities-fraud law.[2] Contemporary prohibitions against trading on non-public information are subject to disjointed interpretations and are the product of layers of logically incoherent and virtually unenforceable Supreme Court decisions. Despite claims to the contrary, many Supreme Court decisions in this area seem partially, if not largely, driven by a judicially desired outcome rather than a rational cultivation of the legal landscape. As such, it is time to burn the crops and enter a phase of new growth.

My original proposal was for courts to forthrightly follow the logical conclusion of their historically halting analysis and adopt the fraud-on-the-market approach to insider-trading law, which I dramatically expand below, rather than leave us in the legal limbo that has pervaded insider-trading law since its inception.[3] That scholarship garnered some critical acclaim, being chosen to be reprinted in the Securities Law Review—West's anthology of the ten best annual securities-law articles—edited by noted Georgetown securities-law professor, Donald C. Langevoort.[4] That article has since been cited scores of times thereafter,[5] and the position I've taken has been evaluated in detail by various scholars in the field.[6]

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[1] Robert Steinbuch, *Mere Thieves*, 67 MD. L. REV. 570 (2008), *reprinted in* 2009 SEC. L. REV. § 4:3 (Donald C. Langevoort, ed.).
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Joan MacLeod Heminway, *Women Should Not Need to Watch Their Husbands Like [a] Hawk: Misappropriation Insider Trading in Spousal Relationships*, 15 TENN. J.L. & POL'Y 162, 216 n.149 (2020); Joshua Mitts & Eric Talley, *Informed Trading and Cybersecurity Breaches*, 9 HARV. BUS. L. REV. 1, 38 n.89, 39 n.95 (2019); Kenneth Geisler II, *Hacking Wall Street: Reconceptualizing Insider Trading Law for Computer Hacking and Trading Schemes*, 48 TEX. J. BUS. L. (SPECIAL COLLECTION) 1, 10 n.46 (2019); Joan MacLeod Heminway, *(Not) Holding Firms Criminally Responsible for the Reckless Insider Trading of Their Employees*, 46 STETSON L. REV. 127, 129 n.12 (2016); Susan B. Heyman, *Rethinking Regulation Fair Disclosure and Corporate Free Speech*, 36 CARDOZO L. REV. 1099, 1119 n.144 (2015); Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of In-*

This Article will build on what I've previously published in this area, and in fact, it will provide the third in a so-far trilogy of articles on insider-trading law. Here, I will offer two completely novel contributions: first, I will dramati-

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sider Trading, 2013 COLUM. BUS. L. REV. 429, 458 n.87 (2013); Mark F. DiGiovanni, Note, *Weeding Out a New Theory of Insider Trading Liability and Cultivating an Heirloom Variety: A Proposed Response to* SEC v. Dorozhko, 19 GEO. MASON L. REV. 593, 595 n.21 (2012); Starkey De Soto, *"Well, Now I'm Screwed": The Ever-Expanding Liability for Outsider Trading*, 33 WHITTIER L. REV. 275, 277 n.10 (2012); Martin Goodlett, *Subjective Materiality and the Over-the-Counter Derivatives Markets*, 61 DEPAUL L. REV. 165, 174 n.75 (2011); Joanna B. Apolinsky, *Insider Trading as Misfeasance: The Yielding of the Fiduciary Requirement*, 59 KAN. L. REV. 493, 531 n.257 (2011); Brian A. Karol, Note, *Deception Absent Duty: Computer Hackers & Section 10(b) Liability*, 19 U. MIA. BUS. L. REV. 185, 189 n.19 (2011); Matthew T.M. Feeks, *Turned Inside-Out: The Development of "Outsider Trading" and How* Dorozhko *May Expand the Scope of Insider Trading Liability*, 7 J.L. ECON. & POL'Y 61, 86 n.196 (2010); Michael Geeraerts, Note, *Hackers Who Steal and Trade on Inside Information Finally Fear the Securities and Exchange Commission and Section 10(b)*, 17 PIABA BAR J. 253, 264 n.91 (2010); Michael D. Wheatley, Note, *Apologia for the Second Circuit's Opinion in* SEC v. Dorozhko, 7 J.L. ECON. & POL'Y 25, 37 n.74 (2010); Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 901 n.107 (2010); Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1341 n.141 (2009); William K.S. Wang, *Measuring Insider Trading Damages for a Private Plaintiff*, 10 U.C. DAVIS BUS. L.J. 1, 29 n.99 (2009); Carolyn Silane, *Electronic Data Theft: A Legal Loophole for Illegally-Obtained Information—a Comparative Analysis of U.S. and E.U. Insider Trading Law*, 5 SETON HALL CIR. REV. 333, 364 n.140 (2009); Brett T. Atanasio, Note, *"I'll Know It When I See It . . . I Think":* United States v. Newman *and Insider Trading Legislation*, 121 PENN STATE L. REV. 221, 223 n.7 (2016); Farid Sharaby, Note, *Computer Hacking as a "Deceptive Device": Why the Courts Must Give Computers Legal Consciousness to Hold Hackers Liable for Insider Trading*, 42 MCGEORGE L. REV. 929, 933 n.40 (2011); Elizabeth A. Odian, Note, SEC v. Dorozhko's *Affirmative Misrepresentation Theory of Insider Trading: An Improper Means to a Proper End*, 94 MARQ. L. REV. 1313, 1317 n.19 (2011); Robert T. Denny, Note, *Beyond Mere Theft: Why Computer Hackers Trading on Wrongfully Acquired Information Should Be Held Accountable Under the Securities Exchange Act*, 2010 UTAH L. REV. 963, 964 n.7 (2010); Kristen A. Truver, Note, *Cutting the Party Line: How the SEC Can Silence Persisting Phone Call Tips*, 39 HOFSTRA L. REV. 447, 449 n.22 (2010); Ryan M. Davis, Note, *Trimming the "Judicial Oak": Rule 10b5-2(b)(1), Confidentiality Agreements, and the Proper Scope of Insider Trading Liability*, 63 VAND. L. REV. 1469, 1483 n.112 (2010); Sean F. Doyle, *Simplifying the Analysis: The Second Circuit Lays Out a Straightforward Theory of Fraud in* SEC v. Dorozhko, 89 N.C. L. REV. 357, 366 n.69 (2010); Adam R. Nelson, Note, *Extending Outsider Trading Liability to Thieves*, 80 FORDHAM L. REV. 2157, 2171 n.122 (2012); Michael G. Capeci, Note, *SEC Rule 10b5-2: A Call for Revitalizing the Commission's Efforts in the War on Insider Trading*, 37 HOFSTRA L. REV. 805, 808 n.21 (2009); WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING: LIABILITY AND COMPLIANCE § 5.4, at 437 n.698 (3d ed. 2010); RALPH C. FERRARA ET AL., FERRARA ON INSIDER TRADING AND THE WALL § 2.08, at 2-103 n.5, 2-104 n.9 (2021); Thomas Lee Hazen, *Fundamentals of Securities Law: Insider Trading and Outsider Trading Under SEC Rule 10b-5*, SU041 ALI-ABA 401, at *4 (2013) (West); Thomas Lee Hazen, *Fundamentals of Securities Law: Insider Trading and Outsider Trading Under SEC Rule 10b-5*, ST046 ALI-ABA 403, 414 (2012) (West).

[6] *See, e.g.*, Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 458 n.87 (2013); Apolinsky, *supra* note 5, at 531 n.257 and surrounding text; Feeks, *supra* note 5, at 86–87; Nelson, *supra* note 5, at 2171–72, 2176, 2188, 2193.

cally expand my original common-law approach to re-engineering insider-trading law[7] with the benefit of a decade of new cases. Second, I will expound upon an even more revolutionary, if not jurisprudentially reactionary, alternative that I believe is the optimal method for addressing the tortuous legal landscape that currently occupies 10b-5 liability (that is, the rejection of the preternatural judicial law-making that has produced a disjointed and irrational common law of insider-trading liability).

As with any proposal for radical change, the proffered process would be somewhat painful and the outcome assuredly uncertain. History, however, has so far demonstrated no significant political or judicial taste for such an endeavor, particularly given the institutional inertia of the Supreme Court that continues to infect the zeitgeist of the politically privileged and powerful. My proposal seeks to resurrect legal first principles and bring about a renaissance of democratic law-making in the context of securities law.

I will begin this Article with an introductory Section on securities fraud and describe the applicable rules for insider-trading liability, Section 10(b) of the Securities Exchange Act of 1934 and the SEC's implementing regulation, Rule 10b-5.[8] I will then explain how "simple fraud" and "insider trading liability" are both related and distinguishable actionable items under the Act, noting that recent opinions have interpreted insider-trading liability through a constructive-fraud framework that requires a fiduciary or fiduciary-like relationship between the trader and the source of the information.[9]

In the next Section, I will describe the two historical bases for insider-trading liability—the classical theory and the misappropriation theory.[10] I will explain the diminishing role of the former, as the sophistication of insider trading advances.

Thereafter, I will introduce the issue of "mere-thieves" liability and delve deeper into a cluster of holdings from *SEC v. Dorozhko*[11] to *SEC v. Rocklage*.[12] These judicial interpretations of the misappropriation theory—a theory that developed from the ineffectiveness of the classical theory in addressing new seemingly wrongful behavior—are a result of further changes in circumstances demanding yet another reimagining of the law governing insider trading.[13]

I further explore other cases involving quid pro quo exchanges between market insiders and outsiders.[14] And, sure enough, this time they shift away from a fiduciary-relationship requirement that had been the defining characteristic of contemporary jurisprudence merely because the existing legal frame-

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[7] *See generally*, Steinbuch, *supra* note 1.
[8] *See infra* Part I.
[9] *See infra* Sections I.A, I.B.
[10] *See infra* Sections I.B.1, I.B.2.
[11] SEC v. Dorozhko, 574 F.3d 42, 50–51 (2d Cir. 2009).
[12] SEC v. Rocklage, 470 F.3d 1, 14 (1st Cir. 2006); *see also infra* Part II.
[13] *See infra* Part II.
[14] *See infra* Part III.

work proved ineffectual at addressing modern circumstances. Through this analysis, I will demonstrate how mere-thieves liability has become the focal point for another judicial transmogrification of the theory underlying insider-trader liability, now abandoning the fiduciary-relationship requirement of the misappropriation theory and embracing protections against unfair-market advantages based on the possession of insider information—known as the "parity-of-access theory."[15]

Thus, more than ten years after my first article on mere thieves splashed onto the shores of the legal landscape,[16] I can confirm what has been the primary prediction throughout the trilogy: as courts grapple with increasingly complex cases where insider information trickles into outsiders' hands, mere-thieves culpability has become the paradigmatic indicator of the judicial trend away from the misappropriation theory and towards standards considering informational advantage in the market as the basis for liability.[17] To this effect, one can predict a near future where the parity-of-access theory becomes the Supreme Court's explicit basis for mere-thieves liability.

That notwithstanding, I will also chart a new path, suggesting that Congress abandon the existing system entirely and draft a new statute to give greater predictability and fairness to an area of law currently fashioned by judges—not legislators—pursuant to an undeclared, but clearly dominant, common law that has had too many examples of a lack of predictability and fairness.[18]

I. SECURITIES FRAUD

The Securities and Exchange Act of 1934 was created to promote fairness and efficiency in securities transactions.[19] Section 10(b) is considered a "catchall" provision designed to aid in preventing fraud and related misdeeds in securities trading.[20] Section 10(b) of the Securities and Exchange Act of 1934 states in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention

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15 *See infra* Part III.

16 Steinbuch, *supra* note 1, at 570.

17 *Id.*

18 *See infra* Part IV.

19 Robert Steinbuch, *Outsider Hacking & Insider Trading: "Mere Thieves" Affirmed, S.D.N.Y. Reversed*, 37 SEC. REGUL. L.J. 344, 344 (2009) (citing Steinbuch, *supra* note 1, at 572).

20 *Id.* at 345.

> of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.[21]

Through its authority under the Act, the SEC created and endorsed Rule 10b-5 as its main avenue to prevent securities fraud, such as insider trading.[22] Fraud-on-the-market theory, which maintains that stock prices are causally linked to all material information about a company and its business activities, applies to the enforcement of Rule 10b-5.[23] This approach was established in *Basic Inc. v. Levinson*[24] and affirmed in *Erica P. John Fund v. Halliburton Co.*[25] Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> > (a) To employ any device, scheme, or artifice to defraud,
> > (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> > (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[26]

Insider-trading liability was created strictly through the judicial system's common law and is not expressly mentioned in the Rule or the Act.[27] Courts have determined that both "simple fraud" and "insider-trading liability" are actionable under the Securities and Exchange Act of 1934 and the rules promulgated thereunder.[28] These two securities violations are related, but they also differ in important respects.[29]

Simple fraud prohibits affirmative misrepresentations, while insider trading prohibits buying or selling securities based on information that the trader uniquely possesses relative to the general-trading population, *as long as* the trader obtained that information in one of the ever-changing modes that courts have determined *ad hoc* to be prohibited.[30] Further, these relatively straightforward descriptions do not do justice to the often complicated schemes courts have convolutedly developed to determine liability under the shifting sands of the contemporary securities-law common-law landscape.

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21 *Id*. at 344–45 (quoting 15 U.S.C. § 78j(b)).
22 *Id.* at 345 (citing Steinbuch, *supra* note 1, at 572).
23 Basic Inc. v. Levinson, 485 U.S. 224, 241 (1988).
24 *Id.* at 250.
25 Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804, 811 (2011).
26 Steinbuch, *supra* note 19, at 345 (quoting 17 C.F.R. § 240.10b-5).
27 *Id.* (citing Steinbuch, *supra* note 1, at 576).
28 *Id.* (citing Steinbuch, *supra* note 1, at 573–74).
29 *Id.* at 345–46 (citing Steinbuch, *supra* note 1, at 574–76).
30 *Id.*

A. Simple Fraud

Simple fraud can be defined as an affirmative misappropriation that may "be actionable under Section 10(b) and Rule 10b-5 if it is committed in connection with the purchase or sale of a security."[31] This kind of fraud is eponymously described as "simple" because it reflects an older doctrine, also created as a part of common law, that requires a straight-forward analysis to determine whether a violation has occurred.[32] While simple fraud can plainly be the basis for a securities-law violation, securities jurisprudence has consistently failed to focus on simple fraud as a foundation for liability.[33] By neglecting this form of liability, courts have created judicial misinterpretations of securities law.[34]

B. Insider Trading as Constructive, Rather than Simple, Fraud

"Insider-trading prohibitions restrict individuals from transacting securities based on knowledge of nonpublic information that they legally obtained or possessed as a consequence of their employment or similar circumstances."[35] While the rule regulating securities only prohibits fraud, courts have interpreted the fraud requirement to cover insider trading by attaching the fraud notion to a breach of a fiduciary or fiduciary-like duty (that is, constructive fraud).[36] Two types of liability have been judicially created within the insider-trading portion of securities law: the "classical theory" and the "misappropriation theory."[37]

1. The Classical Theory of Insider Trading

As described in *Chiarella v. United States*, "a person violates the law," under the classical theory, "by trading on material, nonpublic information."[38] The violation occurs when an insider breaches a duty he owes to an entity as its fiduciary, such as when an employee breaches his duty to an employer by using his employer's non-public information for personal gain.[39]

The facts in *Chiarella* provide a good overview of the classical theory of insider trading.[40] In this case, Chiarella, the markup man for a financial printer,

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[31] *Id.* at 345 (citing Stephen M. Bainbridge, *The Second Circuit's Egregious Decision in* SEC v. Dorozhko, PROFESSORBAINBRIDGE.COM (July 29, 2009), https://www.professorbainbridge.com/professorbainbridgecom/2009/07/the-second-circuits-recent-decision-in-sec-v-dorozhko-available-here-dealt-with-one-of-the-questions-left-open-by-the.html [https://perma.cc/8UPT-A6W4]).
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.* at 346 (citing Steinbuch, *supra* note 1, at 575).
[36] *Id.* (citing Steinbuch, *supra* note 1, at 576).
[37] *Id.* (citing Steinbuch, *supra* note 1, at 578, 583).
[38] *Id.* (citing Chiarella v. United States, 445 U.S. 222, 227–28 (1980)).
[39] *Id.*
[40] Steinbuch, *supra* note 1, at 579.

decoded materials given to his employer to uncover insider information of a corporate takeover.[41] He used this information to purchase stock in the targeted companies and then sold his shares for a profit after the bids were announced to the public.[42]

The Supreme Court concluded that Chiarella did not violate Section 10(b) because he was not a corporate insider with a fiduciary duty to shareholders, but rather, he was a "complete stranger who dealt with the sellers only through impersonal market transactions."[43]

The *Chiarella* decision highlighted the judicial tendency under the classical theory to interpret insider-trading liability through the lens of constructive fraud and a proscribed fiduciary relationship between traders.

The Supreme Court further broadened the scope of the classical theory in *Dirks v. SEC* to include "tippees," meaning "those who receive material, non-public information from persons who have a duty to disclose or abstain from trading."[44] Tippee liability applies when the original tipper has a fiduciary or fiduciary-like relationship with the entity supplying the information traded upon.[45] This artificial requirement is necessary to perpetuate the fiction that the liability derives from the breach of a confidential relationship.[46] Furthermore, the tipper must garner some "benefit" by the transfer of information.[47] The tipper breaches a confidential relationship and benefits from a transfer of information not by trading on the information, however—but by allowing a tippee to profit from the information in lieu of the confidential entity (for example, the tipper's employer).[48] The Court described this approach as follows:

> In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed, or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identi-

41 Chiarella v. United States, 445 U.S. 222, 224 (1980).
42 *Id.*
43 *Id.* at 232–33.
44 Steinbuch, *supra* note 1, at 581–82 (citing Dirks v. SEC, 463 U.S. 646, 659–60 (1983)).
45 *Id.*
46 *Dirks*, 463 U.S. at 654–55.
47 *Id.* at 654, 662.
48 *Id.* at 662–63.

> fied by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate "use of inside information for personal advantage." 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.[49]

As can be seen, the definition of "benefit," as such, is remarkably amorphous and essentially meaningless because it does not require a financial payoff for the tippee but rather, connotes an overly broad suggestion of garnering favor on his behalf.[50]

2. The Misappropriation Theory

Insider-trading liability was initially limited to "insiders," "quasi-insiders," and "tippees" under the classical theory; but, unsurprisingly, the classical theory proved impotent against newer forms of insider trading by outsiders.[51] So, courts quickly expanded liability under a new theory—the misappropriation theory.[52] In *SEC v. Cherif*, "former employees" entrusted with data and confidential information by their former employers were deemed covered by insider-trading liability.[53]

In the *Cherif* case, Danny Cherif retained his building access card after his employment was terminated in a company reorganization.[54] He used the card to access confidential information about corporate clients and profited from trades based on that information.[55] The SEC opened an investigation on Cherif and soon persuaded the district court to issue a temporary restraining order enjoining his trading activity.[56]

Joining the Second, Third, and Ninth Circuits, the Seventh Circuit in *Cherif* adopted the "misappropriation theory" in order to expand "the reach of Rule 10b-5 to outsiders who would not ordinarily be deemed fiduciaries of the corporate entities in whose stock they trade."[57] In short, the misappropriation theory extended insider-trading liability beyond the classical theory's narrow protections.[58]

The *Cherif* court held that under the misappropriation theory, Cherif "breached a *continuing duty* to his former employer" when he stole "inside in-

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[49] *Id.* at 661–62 (emphasis added).
[50] *See id.* at 663.
[51] Steinbuch, *supra* note 1, at 581 (citing SEC v. Cherif, 933 F.2d 403, 411 (7th Cir. 1991)).
[52] *Id.*
[53] *Id.*
[54] *Cherif*, 933 F.2d at 406.
[55] *Id.*
[56] *Id.* at 407.
[57] *Id.* at 409–10.
[58] *Id.*

formation about upcoming transactions" and used the information "against the bank's own interests."[59]

The misappropriation theory, foretold by the concurring and dissenting opinions in *Chiarella*,[60] sought to cover *outsiders* who "misappropriate" material, nonpublic information for use in securities transactions in violation of some fiduciary or fiduciary-like duty to a party, as in the traditional theory.[61] The misappropriation theory's novelty was that the still-required fiduciary or fiduciary-like relationship need not be *with* the entity whose stock is traded.[62] In contrast to the classical theory, the outsider under the misappropriation theory breaches a relationship of trust with *another outsider*.[63] Thus, the misappropriation theory is an attenuation of how classical insider-trading liability can be applied to outsiders. Now, outsiders can commit insider trading as long as they breach a duty to another outsider. No "insider" required: judicially convenient; intellectually wanting.

The Supreme Court ultimately adopted the misappropriation theory in *United States v. O'Hagan*.[64] "There, a lawyer traded the securities of a company his client was targeting for a takeover. O'Hagan could not be [held] liable under the classical theory, as he owed no duty to the shareholders of the target company."[65] "Nevertheless, the court found that O'Hagan violated section 10(b)" because, "in trading the target company's securities, [he] misappropriated the confidential information regarding the planned corporate takeover" and breached " 'a duty of trust and confidence' he owed to *his* law firm and client."[66] "Trading on such information 'involves feigning fidelity to the source of information and thus utilizes a "deceptive device" as required by section 10(b).' "[67] Importantly, at this point, "[t]he Court stated that while there is 'no general duty between all participants in market transactions to forgo actions based on material nonpublic information,' the breach of a duty to the source of the information is sufficient to give rise to insider trading liability."[68]

In an effort to distinguish the two separate, but intertwined, insider-trading liability theories, the Supreme Court opined:

> 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. In lieu of premising liability on a fiduciary relationship between

59 *Id.* at 411–12 (emphasis added).
60 Steinbuch, *supra* note 19, at 346 (citing Steinbuch, *supra* note 1, at 583).
61 Steinbuch, *supra* note 1, at 588.
62 *Id.*
63 Steinbuch, *supra* note 19, at 346 (citing Steinbuch, *supra* note 1, at 583).
64 United States v. O'Hagan, 521 U.S. 642 (1997); SEC v. Cuban, 620 F.3d 551, 554 (5th Cir. 2010).
65 *Cuban*, 620 F.3d at 554.
66 *Id.* (quoting *O'Hagan*, 521 U.S. at 653) (emphasis added).
67 *Id.* at 554–55.
68 *Id.* at 555.

> 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.[69]

The court appositely described the two theories as complementary, with "each addressing efforts to capitalize" on insider information in buying or selling securities.[70] While the classical theory addresses "a corporate insider's breach of duty to shareholders with whom the insider transacts, the misappropriation theory [targets] trading on the basis of nonpublic information by a corporate 'outsider' in breach of a duty owed not to a trading party, but to the source of the information."[71]

Only through linguistic legerdemain was the Supreme Court in *O'Hagan* able to declare that the statutory and regulatory requirement of deception was met under the misappropriation theory, asserting that now-culpable traders " 'deal in deception' in that they feign fidelity by 'pretend[ing] loyalty to the principal while secretly converting the principal's information for personal gain.' "[72]

II. THE APPLICABILITY OF INSIDER-TRADING LAW TO "MERE THIEVES": A CASE STUDY IN THE SECOND CIRCUIT

In contrast to both the classical and misappropriation theories of insider-trading liability, courts have typically held that "mere thieves" could not be liable for trading based on stolen information because they lack the fiduciary or fiduciary-like relationships necessary to satisfy the "deception" requirement of the Act.[73] In other words, the thieving trader did not "deceive" anyone with his use of inside information; he simply stole it. And, generally, larceny is not considered a crime of deception,[74] although I've previously described the elasticity of such notions:

> While surreptitious thievery is not universally viewed as fraud, it certainly can be. For example, Rule 609 of the Federal Rules of Evidence, and most comparable state rules, permit a party to impeach a witness with a prior conviction involving "dishonesty or false statement." In this context, one court stated that "[t]he crime of shoplifting [essentially defined as surreptitious thievery] . . . is dishonest and contains elements of deceit." This opinion suggests a similar outcome for defining mere thievery as fraud under Rule 10b-5. While there is a split

69 *O'Hagan*, 521 U.S. at 652.
70 *Id.*
71 *Id.* at 652–53.
72 Steinbuch, *supra* note 19, at 346, 349–50 (quoting *O'Hagan*, 521 U.S. at 653) ("In 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." (quoting *O'Hagan*, 521 U.S. at 652–53)).
73 Steinbuch, *supra* note 1, at 589.
74 *See, e.g.*, Shelly Kim Kritz, Case Note, Rhodes v. State*, 276 Ark. 203, 634 S.W.2d 107 (1982)*, 6 U. ARK. LITTLE ROCK L. REV. 321, 323, 326, 328–29 (1983).

> of authority regarding "whether theft crimes such as . . . shoplifting should be categorized as crimen falsi, [and] historically they have *not* been," the standard of "dishonesty or false statement" is much narrower than the fraud and deceit element of Rule 10b-5. Courts have been far more willing to broadly interpret the elements of Rule 10b-5 than they have been in relaxing the standards for the admission of impeachment evidence. As such, courts would not be dramatically altering the legal landscape of insider trading jurisprudence by including thievery within the rubric of 10b-5 fraud.[75]

The issue of mere thieves liability became more serious as the world of computers and online data security evolved.[76] Procedural matters conspired to prevent the Southern District of New York from addressing the mere thieves issue twice before the case of *SEC v. Dorozhko*,[77] where the court first tackled the issue.[78]

Dorozhko was a Ukrainian resident who spent a year's worth of income on IMS Health, Inc. (IMS) put[79] options.[80] Thirty minutes before Dorozhko purchased the put options, an anonymous hacker accessed and downloaded IMS data from Thomson Financial.[81] Thomson Financial was hired by IMS to manage the online release of IMS earning reports.[82] Within hours of Dorozhko's purchase, IMS announced its earnings were below expectations, making the stock price drop significantly and allowing Dorozhko to substantially profit by selling all of his IMS puts.[83]

The trial court held that trading based on stolen or hacked information does not violate the insider-trading prohibitions of Rule 10b-5 because computer hacking did not fall within the Section 10(b) definition of "deceptive."[84] Be-

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[75] Steinbuch, *supra* note 1, at 593 (footnotes omitted).

[76] *Id.* at 590.

[77] SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009).

[78] Steinbuch, *supra* note 19, at 347.

[79] Put options allow owners of a put to force those who sold the option to buy a stock at a given price. In return, the seller is paid a premium for this contractual relationship. So, for example, a seller of a put might receive one hundred dollars to agree to buy a given stock at a price of seventy-five dollars over the next three months. If the stock goes below the seventy-five-dollar "strike price," then the buyer of the option, in theory, will execute the option by forcing the seller to pay him the seventy-five dollars. The seller will profit by either selling stock he already owns at a higher than market price, or the seller will buy the stock at market and make the difference by which seventy-five dollars exceeds the market price. In reality, often (but not always) the seller of an underwater option will take his losses by buying back the put at a loss. *See* Lucas Downey, *Essential Options Trading Guide*, INVESTOPEDIA (Jan. 7, 2022), https://www.investopedia.com/options-basics-tutorial-4583012 [https://perma.cc/NT43-VZD5].

[80] Steinbuch, *supra* note 19, at 347 (citing *Dorozhko*, 574 F.3d at 42).

[81] *Id.* (citing *Dorozhko*, 574 F.3d at 44).

[82] *Id.*

[83] *Id.* Trading options rather than the underlying security allows an investor to leverage his money. As such, the investor has the opportunity for a much greater gain—or loss. *See* Downey, *supra* note 79.

[84] Steinbuch, *supra* note 19, at 347 (citing SEC v. Dorozhko, 606 F. Supp. 2d 321, 330 (S.D.N.Y 2008) (order vacated, 574 F.3d 42)).

cause Dorozhko was an outsider with no confidential relationship with IMS or Thomson Financial, he did not breach a fiduciary duty owed to either party and did not violate the Securities and Exchange Act of 1934.[85] The Second Circuit did not agree.

A. Second Circuit's Holding of Liability for Mere Thieves

I argued in *Mere Thieves*—contrary to the district court's ruling—that Dorozhko should be liable under two bases in securities law: simple fraud and insider trading.[86] The Second Circuit partially agreed, accepting only the simple-fraud theory for liability.[87]

I went further and proposed that in order to satisfy the fraud requirement of the Securities and Exchange Act, insider-trading liability should go beyond the current (often nominal) requirement that a true insider, an insider by proxy, or an outsider in some relevant relationship with another outsider, breached a confidential relationship.[88]

B. Simple Fraud

Hacking is now one of the most prevalent ways for thieves to steal confidential information from companies and has been classified as fraud through other federal statutes.[89] Federal law defines "[f]raud and related activity in connection with computers" as "intentionally access[ing] a computer without authorization or exceed[ing] authorized access, and thereby obtain[ing] . . . information from any protected computer."[90] However, as mentioned previously, courts had not generally considered simple fraud as a basis for mere-thieves liability in the context of securities law.[91]

The Second Circuit agreed with my reasoning and reversed the trial court in *Dorozhko* based on liability for simple fraud only.[92] The Second Circuit aptly reasoned that computer hacking could be fraud, stating that "misrepresenting one's identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly 'deceptive' within the ordinary meaning of the word."[93] The court noted, however, that not every instance of computer hacking should be classified as deception, and courts must consider the particulars of how a hacker accessed a computer system.[94] Thus, the Second

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85 *Id.* (citing *Dorozhko*, 574 F.3d at 51).
86 *Id.* at 348.
87 *Id.* at 351–52.
88 *Id.* at 349–51.
89 *Id.* at 348 (citing Steinbuch, *supra* note 1, at 592).
90 18 U.S.C. § 1030(a)(2); Steinbuch, *supra* note 19, at 348.
91 Steinbuch, *supra* note 19, at 348.
92 *Id*. at 351 (citing SEC v. Dorozhko, 574 F.3d 42, 51 (2d Cir. 2009)).
93 *Id*. at 352 (citing*Dorozhko*, 574 F.3d at 51).
94 *Id.*

Circuit reversed the district court's opinion in *Dorozhko* and established simple-fraud liability for some mere thieves but not all.[95]

C. The Misappropriation Theory

As discussed above, because neither the Act nor the Rule expressly prohibits insider trading, courts connected "a breach of fiduciary duty or fiduciary-like duty with the fraud requirement of [Rule] 10b-5."[96] Accordingly, the Second Circuit reiterated the conventional view that *Dorozhko* could not be liable under either the classical or misappropriation theory of insider trading because his purely outsider status created no fiduciary or fiduciary-like duties.[97] I posited that this conclusion is incorrect under the developing common law of insider trading. Here is why:

> [First, the] new misappropriation theory extend[ed] liability for securities violations beyond classical insiders to those who misappropriate material, nonpublic information for use in a securities transaction in violation of some fiduciary or fiduciary-like duty that they owe to a party, regardless of whether that party issues or trades any of the illegally traded stock.[98]

Under the new theory, the Rule 10b-5 fraud requirement was no longer based on a breach of a fiduciary or fiduciary-like relationship with the company whose stock was traded.[99] *O'Hagan*, along with other cases, such as *SEC v. Yun*[100] and *United States v. Kim*[101] propelled the misappropriation theory beyond the fiduciary-duty requirement.[102]

Then, in a key case, the First Circuit attached liability under the misappropriation theory to something other than information gained from a fiduciary or fiduciary-like relationship.[103] In *SEC v. Rocklage*,[104] the defendant received confidential information from her husband, which he indicated should remain confidential.[105] The defendant nonetheless shared this confidential information

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95 *Id.*
96 *Id.* at 349 (citing Steinbuch, *supra* note 1, at 576).
97 *Id.* at 351 (citing *Dorozhko*, 574 F.3d at 45).
98 Steinbuch, *supra* note 1, at 588 (citing SEC v. Clark, 915 F.2d 439, 443 (9th Cir. 1990) (defining outsiders as "persons who are neither insiders of the companies whose shares are being traded, nor tippees of such insiders")).
99 *Id.* (citing United States v. O'Hagan, 521 U.S. 642, 652–53 (1997)). According to the Supreme Court, a person violates § 10(b) and Rule 10b-5 by breaching a duty owed to a source of information through misappropriating confidential information for the purpose of trading securities. *O'Hagan*, 521 U.S. at 652. Under this theory, if a fiduciary does not disclose their true purpose of using confidential information to purchase or sell securities, it is considered a breach of a duty of loyalty and confidentiality because the source of the information no longer has the exclusive use of that information. *Id.*
100 SEC v. Yun, 327 F.3d 1263 (11th Cir. 2003).
101 United States v. Kim, 184 F. Supp. 2d 1006 (N.D. Cal. 2002).
102 Steinbuch, *supra* note 19, at 350 (citing Steinbuch, *supra* note 1, at 595).
103 *Id.* (citing SEC v. Rocklage, 470 F.3d 1 (1st Cir. 2006)).
104 Steinbuch, *supra* note 1, at 602 (citing *Rocklage*, 470 F.3d 1).
105 *Id*. (citing *Rocklage,* 470 F.3d at 3, 7).

with her brother, who later made trades based on it.[106] The First Circuit affirmed the lower court's decision to deny dismissal for failure to state a claim that the defendant used a "manipulative or deceptive device that was in connection with the purchase or sale of any security."[107]

When discussing the misappropriation theory, the *Rocklage* court stated:

> "[T]he misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." Such deceptive trading exploits unfair informational disparities in the securities market; making such trading illegal also comports with the congressional purposes underlying § 10(b).
>
> . . .
>
> Finally, our interpretation finds further support in the investor protection purposes of § 10(b). One of the animating purposes of the statute was to "insure honest securities markets and thereby promote investor confidence." It furthers that purpose if the "in connection with" requirement reaches schemes in which one party deceptively and intentionally obtains material nonpublic information to enable another to trade with an unfair informational advantage.[108]

The *Rocklage* court disregarded the elements of the misappropriation test and, rather, focused its analysis on Rule 10b-5's role in protecting the market from traders with an "*unfair* informational advantage."[109]

Thereafter, the *Rocklage* court examined the "safe-harbor" provision under *O'Hagan*.[110] The safe-harbor provision "allow[s] misappropriators to avoid liability by disclosing the intention to trade to the party from whom the confidential information was acquired."[111] In short, the provision circumvents the deception requirement of Rule 10b-5, which the Supreme Court defined as "the fiduciary's failure to disclose to the owner of the confidential information his intention to trade on that nonpublic material."[112] Although the actual application of the safe-harbor provision is not well tested, a trader could theoretically avoid liability under Rule 10b-5 based on the decision in *O'Hagan* by disclosing his intentions to trade to his source of confidential information.[113] The source may object, but no fiduciary obligation was breached if the trader stated his intentions.[114]

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106 *Id*.
107 *Id.* (quoting *Rocklage,* 470 F.3d at 3, 8, 14 (internal quotation marks omitted)).
108 *Id*. (quoting *Rocklage*, 470 F.3d at 6, 10–11 (citing SEC v. Zanford, 535 U.S. 813, 819–20 (2002); United States v. O'Hagan, 521 U.S. 642, 658 (1997)).
109 Steinbuch, *supra* note 1, at 602–03.
110 *Id*. at 603.
111 *Id*.
112 *Id*. (citing United States v. O'Hagan, 521 U.S. 642, 655 (1997)).
113 *Id*. (citing Richard W. Painter et al., *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 180 (1998)).
114 *Id.* (citing Painter et al., *supra* note 113, at 180). The *O'Hagan* Court also recognized that the adoption of the misappropriation theory does not necessarily fix the problems caused by insider trading because the theory does not better or help prevent harm to investors when the misappropriator discloses to the source of information that they plan on trading based on

Previously, Chief Justice Burger's dissent in *Chiarella* suggested that a person who acquired material, nonpublic information illegally held an unconditional duty to publicly disclose or abstain from trading, regardless of the source of the information:[115]

> By their terms, these provisions reach *any* person engaged in *any* fraudulent scheme. . . . Just as surely Congress cannot have intended one standard of fair dealing for "white collar" insiders and another for the "blue collar" level. The very language of § 10(b) and Rule 10b-5 "by repeated use of the word 'any' [was] obviously meant to be inclusive."[116]

Chief Justice Burger alleged that his interpretation was "in no sense novel" because it logically stemmed from the decision of *In re Cady, Roberts & Co.*,[117] which defined the "disclose-or-abstain rule" for corporate insiders.[118] In his view, a court must consider the factors defined in *Cady, Roberts* to determine whether one who has gained material information unlawfully has a duty to disclose.[119] The factors include: "(1) whether one had access to information that was intended only for a corporate purpose and not a personal benefit; and (2) *the inherent unfairness in trading based on information unavailable to others involved in the transaction*."[120]

Justice Blackmun agreed with the Chief Justice in his own *Chiarella* dissent: "The Court has observed that the securities laws were not intended to replicate the law of fiduciary relations. *Rather, their purpose is to ensure the fair and honest functioning of impersonal national securities markets where common law protections have proved inadequate*."[121]

With this background, the *Rocklage* Court asserted:

> The [Supreme] Court [in *O'Hagan*] did say, however, that "[b]ecause the deception essential to the misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no

the material, nonpublic information the source gave them unless the source informs the market. *Id.* at 603 n.196 (citing *O'Hagan*, 521 U.S. at 659 n.9)).

[115] *Id.* at 583.

[116] *Id.* (citing Chiarella v. United States, 445 U.S. 222, 240–41 (1980) (Burger, C.J., dissenting)) (quoting Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972)). Chief Justice Burger's dissent described a very broad " 'fraud on investors' misappropriation theory." Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-*O'Hagan *Suggestion*, 59 OHIO STATE L.J. 1223, 1235 (1998). This approach was to some extent successful in *United States v. Newman*, 664 F.2d 12, 16 (2d Cir. 1981), where the court determined that the defendants had violated Rule 10b-5 even though they received information from individuals who were not their employers, nor were the individual purchasers/sellers of the target company. Steinbuch, *supra* note 1, at 583 n.81.

[117] Steinbuch, *supra* note 1, at 583 (citing *In re* Cady, Roberts & Co., 40 S.E.C. 907, 909, 911 (1961)).

[118] *Id.* at 583–84 (citing *Chiarella*, 445 U.S. at 241 (Burger, C.J., dissenting)).

[119] *Id.* at 584 (citing *Chiarella*, 445 U.S. at 241–42 (Burger, C.J., dissenting)).

[120] *Id.* (quoting *Chiarella*, 445 U.S. at 241–42 (Burger, C.J., dissenting)) (emphasis added).

[121] *Id.* (quoting *Chiarella*, 445 U.S. at 248 (Blackmun, J., dissenting)) (emphasis omitted).

> § 10(b) violation." It is this language in *O'Hagan*, arguably dicta, on which defendants pin their argument: they contend that Mrs. Rocklage's disclosure to her husband eliminated any deception involved with her tipping, which would mean that her actions did not come within the text of § 10(b).[122]

Critically, the *Rocklage* decision changed the legal foundation of the misappropriation theory[123] by "distinguish[ing] the dicta of *O'Hagan* to eviscerate the [theoretical, but entirely impractical,] disclosure option under the misappropriation theory"—disallowing the safe harbor of the defendant's pre-trade disclosure to her husband designed to preclude her from insider trading liability.[124]

"As such, *Rocklage* purged what was left of the fiduciary-relationship requirement from the misappropriation test."[125] Even though it was unstated, "[l]iability under the misappropriation theory after *Rocklage* must be premised on something other than the 'fraud' of failing to disclose the intention to trade on confidential information gained from a fiduciary or fiduciary-like relationship."[126]

Nonetheless, the present version of the theory is still criticized because it "does nothing for the confidence of a particular investor [because] liability is untethered to conduct harming investor confidence."[127] Additionally, the Supreme Court has done little to help lower courts define the appropriate limits of the misappropriation theory.[128]

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[122] *Id.* at 603 (quoting SEC v. Rocklage, 470 F.3d 1, 7 (1st Cir. 2006)) (emphasis added).

[123] *Id.* at 604 ("Although a misappropriator arguably deceives the source of the information [by failing to disclose], any such deception is quite inconsequential. The source of the information presumably is injured, if at all, not by th[is] deception, but by the conversion of the information by the misappropriator for his own profit." (quoting STEPHEN M. BAINBRIDGE, SECURITIES LAW: INSIDER TRADING 120 (2d ed. 2007))).

[124] *Id. at* 603–04 (citing *Rocklage*, 470 F.3d at 12).

[125] *Id.* at 604.

[126] *Id.*

[127] *Id.* at 589 (citing Bach T. Hang, Note, *The SEC's Criminal Rulemaking in Rule 10b5-2: Incarceration Should Be Made of Sterner Stuff*, 41 WASHBURN L.J. 629, 630 (2002)). Hang goes as far to say that "the SEC periodically generates headlines announcing that some poor soul has been charged with insider trading. The Theory exists to sacrifice bodies and careers on the altar of investor confidence." *Id.* at 589 n.119 (quoting Hang, *supra*, at 630); *see also* Rebecca S. Smith, Comment, O'Hagan *Revisited: Should a Fiduciary Duty Be Required Under the Misappropriation Theory?*, 22 GA. STATE U. L. REV. 1005, 1015 (2006) ("Under *O'Hagan*, the concepts of market integrity and fairness are at the mercy of a technicality."). Additionally, "[i]t is also hard to justify the disparate treatment between two people who trade on nonpublic information and create the same degree of harm on the everyday investor based solely on the source of their nonpublic information." *Id.* at 1014–15.

[128] Steinbuch, *supra* note 1, at 588–89; *see also id.* at 589 n.118 ("Once the Court decided that corporate outsiders in possession of material, nonpublic information have no duty to disclose that information to the persons with whom they trade, the Court foreclosed any logical way to reach trading by such outsiders under Section 10(b)." (quoting Painter et al., *supra* note 113, at 187)).

III. THE DEMISE OF THE MISAPPROPRIATION THEORY

A closer examination demonstrates that the true purpose of the misappropriation theory, and how courts interpret it, is to protect against the actions of those without any fiduciary or fiduciary-like relationship, contrary language notwithstanding.[129]

In Justice Blackmun's *Chiarella* dissent, he agreed by stating:

> [P]ersons having access to confidential material information that is not legally available to others generally are prohibited by Rule 10b-5 from engaging in schemes to exploit their structural informational advantage through trading in af-

[129] *Id.* at 594–95, 595 n.154 (opining that "[f]iduciary breaches are not only insufficient for Rule 10b-5 liability, they are not even necessary," and that "we must abandon our unwarranted fixation on fiduciary breaches and acknowledge that Rule 10b-5 actually targets deceptions" (quoting Saikrishna Prakash, *Our Dysfunctional Insider Trading Regime*, 99 COLUM. L. REV. 1491, 1511, 1514 (1999))). Professor Prakash also discusses the idea that there is a large body of case law that has been founded on Rule 10b-5 based on situations that do not deal with material, nonpublic information or breach of fiduciary duty. *Id*. at 595 n.154 (citing Prakash, *supra*, at 1536).

David Cowen Bayne has "describe[d] the fiduciary duty 'requirement' as 'the deus ex machina' " (i.e., the G-d from a machine). *Id.* (quoting David Cowan Bayne, *Insider Trading and the Misappropriation Theory: The Awakening*, *1995*, 30 LOY. L.A. L. REV. 487, 503 (1997)) [hereinafter Bayne, *The Awakening*]. However, in SEC v. Kornman, the court agreed that no fiduciary duty was required, but the court also suggested that a fiduciary-like relationship needed to be present under the misappropriation theory. *Id.* (citing SEC v. Kornman, 391 F. Supp. 2d 477, 484 (N.D. Tex. 2005)).

Bayne suggests that the law of insider trading has not changed since the Eighth Circuit decision in *O'Hagan* because the Ginsburg opinion never directly answered the question: Does the misappropriation theory conform to Section 10(b)? *Id.* (citing David C. Bayne, *Insider Trading: The Misappropriation Theory Ignored: Ginsburg's* O'Hagan, 53 U. MIAMI L. REV. 1, 1–2 (1998)) [hereinafter Bayne, *Ginsburg's* O'Hagan]. Due to Justice Ginsburg's avoidance of this question and her holding on a new theory, everything about the misappropriation theory is irrelevant. *Id.* (citing Bayne, *Ginsburg's* O'Hagan, *supra*, at 1–2). Bayne used Justice Thomas's dissenting opinion in *O'Hagan* as support for this theory: "[The Ginsburg Majority] engages in the 'imaginative' exercise of constructing its own misappropriation theory from whole cloth. . . . [This] new theory . . . suffers from a . . . dispositive flaw: It is not the theory offered by the Commission. Indeed, . . . this . . . completely novel . . . theory has never been proposed by the Commission, much less adopted by rule or otherwise." *Id.* (alteration in original) (quoting Bayne, *Ginsburg's* O'Hagan, *supra*, at 1).

However, Bayne's theory discussed above might be overshadowed by his unfavorable view of the misappropriation theory, shown through his message to the SEC: "Stop pandering to the illogical [Misappropriation] Theory, . . . [and] [r]eturn to your roots. In memory of Chairman Cary, resurrect his excellent *Cady, Roberts* . . . . Attack the remaining errors that burden the traditional law imposed by some of the errant *Cady, Roberts* progeny." *Id.* (alteration in original) (quoting Bayne, *The Awakening*, *supra*, at 533). Bayne asserts that the decision in *United States v. Bryan*, 58 F.3d 933 (4th Cir. 1995), which held that the misappropriation theory is invalid, is "a watershed and the beginning of a new era, a return to sanity and the long-successful, traditional years of *Cady*, *Roberts*." *Id.* (quoting Bayne, *The Awakening*, *supra*, at 489–90).

> fected securities. To hold otherwise . . . is to tolerate a wide range of manipulative and deceitful behavior.[130]

In *Mere Thieves*, I argued that:

> While the correlation between the misappropriation theory and the type of duty generally required before liability can attach has evolved,[131] *O'Hagan*'s adoption of a version of the dissent's misappropriation theory from *Chiarella* gave some credence to those dissenting Justices' arguments that any time a purchaser or seller of securities gains information via an illegal act, the trader has a duty to disclose or abstain, *regardless* of the existence of a fiduciary duty.[132]

This view moves the focus of the misappropriation theory from a fiduciary-relationship test to the "parity-of-access theory," which results in a more reliable application of insider-trading liability by filling in the gaps noted by the First Circuit.[133]

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[130] Steinbuch, *supra* note 1, at 595–96 (citing Chiarella v. United States, 445 U.S. 222, 251 (1980) (Blackmun, J., dissenting)).

[131] *Id*. at 605 ("The most baffling intersection between fiduciary theory and insider trading law arises under the 'misappropriation' theory of insider trading." (quoting D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1420 (2002))). Of course, "[t]he [misappropriation] theory has spawned an extraordinary body of cases as well as an even more extraordinary body of hypotheticals appearing in briefs, treatises, and law review articles exploring the extent and nature of the fiduciary relationship necessary to make a corporate outsider guilty of insider trading." *Id.* (alteration in original) (quoting Painter et al., *supra* note 113, at 156). Additionally, "each court interpreting the theory has envisioned a target of different size and shape, making the misappropriation theory intolerably vague." *Id.* (first quoting Painter et al., *supra* note 113, at 188; then citing Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,729, 51,738 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 125) (attempting to alleviate the problem of inconsistent case law by defining the circumstances under which a duty of trust or confidence exists); then citing Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (proposed Dec. 28, 1999) (codified at 17 C.F.R. § 240.10(b)5-2) (proposing a three-part test for determining whether a duty of trust or confidence exists); then citing Jonn R. Beeson, Comment, *Rounding the Peg to Fit the Hole: A Proposed Regulatory Reform of the Misappropriation Theory*, 144 U. PA. L. REV. 1077, 1141–47 (1996) (discussing the problems with application of the misappropriation theory and advocating a regulatory solution); then citing Ray J. Grzebielski, *Friends, Family, Fiduciaries: Personal Relationships as a Basis for Insider Trading Violations*, 51 CATH. U. L. REV. 467, 467–68 (2002) ("[T]he scope of the Securities and Exchange Commission's . . . prohibition against trading in securities with material, nonpublic information under Rule 10b-5, remained unsettled."); and then citing 2 BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS: GOVERNANCE & REGULATION § 13:41 (2d ed. 2006) (discussing Rule 10(b)5-2)).

[132] Steinbuch, *supra* note 1, at 605–06 (first citing *Chiarella*, 445 U.S. at 246–47 (Blackmun, J., dissenting); and then citing *id.* at 240–41 (Burger, C.J., dissenting) (stating that, to serve the policies underlying the rule, there should be a duty to disclose illegally obtained information)).

[133] *Id.* at 605 ("As far as the market is concerned, a trade based on confidential information is no more 'honest' because some third party may know of it so long as those on the other side of the trade remain in the dark." (quoting United States v. O'Hagan, 521 U.S. 642, 690 n.6 (1997) (Thomas, J., concurring in part and dissenting in part))).

A. The Parity-of-Access Theory

Under the parity-of-access theory, "all investors should have equal access to information that a reasonable investor would consider material to investment decisions, and that any trade in which only one party had an opportunity to learn and did learn such information is inherently unfair."[134] This doctrine stems from the "integrity of the market theory, which states [that] investors will be more confident and more likely to participate in the market if they feel confident they can trade without being at an informational disadvantage."[135]

While the Supreme Court has not openly adopted the parity-of-access theory,

> [t]he rules have changed since the Supreme Court rejected the parity-of-[access to] information doctrine in *Chiarella* and *Dirks*. If the Securities Exchange Act's true objective is "to insure honest securities markets and thereby promote investor confidence" as Justice Ginsberg stated in *O'Hagan*, the courts should replace the fiduciary duty requirement in the fraud-on-the-source approach to the misappropriation theory with the parity-of-[access to] information doctrine and a fraud-on-the-market approach.[136]

Indeed, years ago, "the Fourth Circuit recognized that the misappropriation theory would ultimately have to become some form of a parity-of-access theory for it to remain intellectually viable."[137] Before the Supreme Court's decision in *O'Hagan*, the Fourth Circuit strongly disapproved of the use of the misappropriation theory by other circuits, stating that the breach of fiduciary duty requirement was "illusory."[138] These critiqued applications of the misappropriation theory in the individual circuits created a basis for "the Supreme Court's more modest version of the misappropriation theory [as] expressed in

134 *Id.* at 606 (first quoting Dirks v. SEC, 681 F.2d 824, 835 (D.C. Cir. 1982), *rev'd*, 463 U.S. 646 (1983); and then citing *Chiarella*, 445 U.S. at 233 (noting the possibility of a broad rule that imposes liability on anyone who participates in transactions "based on material, nonpublic information")).

135 *Id.* at 606 (alteration in original) (quoting Smith, *supra* note 127, at 1026–27).

136 *Id.* (alteration in original) (quoting Smith, *supra* note 127, at 1028 (citing Rule 10b5-2 as support for this argument)).

137 *Id.* at 607 (citing United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995)). The Fourth Circuit did not adopt the misappropriation theory because the court determined that the language of § 10(b) and Rule 10b-5, the interpretation of the provisions by the Supreme Court, and the purpose of the provisions did not validate the adoption of the theory. *Id.* at 607 n.212 (citing *Bryan*, 58 F.3d at 944). In *Bryan*, the Fourth Circuit stated:

> [W]hile the courts adopting the misappropriation theory incant that the breach of a fiduciary relationship is a necessary element of the offense, in principle, if not in reality, these courts would be obliged to find liability in the case of simple theft by an employee, even where no fiduciary duty has been breached, for the *raison d'etre* of the misappropriation theory in fact is concern over "the unfairness inherent in trading on [stolen] information."

Id. (quoting *Bryan*, 58 F.3d at 944).

138 Steinbuch, *supra* note 1, at 606–07.

O'Hagan."[139] But as will be shown, courts have now turned this criticism on its head, finding these bugs of the theory to now be its features. I agree.

In his *Chiarella* dissent, Justice Blackmun had already agreed with the Fourth Circuit's idea that the misappropriation theory would have to be based on the parity-of-access theory to be feasible.[140] He recognized that "liability should attach whenever an illegal act yields access to confidential information, and the recipient does not abstain from trading or disclose to the source of the information, *regardless* of the existence of a fiduciary duty."[141] Justice Blackmun's interpretation of the misappropriation theory would allow mere thieves to always be held liable for insider trading under Rule 10b-5.[142]

However, one can argue that even a modest version of the misappropriation theory, like the one adopted by the Supreme Court in *O'Hagan*, establishes liability for mere thieves under the parity-of-access theory.

Indeed, the Seventh Circuit employed a prudent variant of the misappropriation theory in *Cherif*[143] and recognized its possible application to mere thieves:[144]

> There has been some suggestion that Rule 10b-5 should apply even to "mere" thieves. See *Chiarella*, . . . (Blackmun, J., dissenting) (suggesting that any time information is acquired by an illegal act, whether in breach of a fiduciary duty or not, there is a duty to disclose that information to the purchaser or seller with whom the acquirer trades); *Bateman Eichler, Hill Richards, Inc. v. Berner*, . . . (suggesting that trading on "misappropriate[d] or illegally obtain[ed]" information constitutes fraud in violation of Rule 10b-5). We need not reach this question because of our holding that Cherif breached a fiduciary duty owed to First Chicago.[145]

Thus, in *Mere Thieves*, I noted that:

> Accordingly, given courts' expansion of the misappropriation theory from a narrow version in *O'Hagan* to the endorsement of the broader liability in Rule 10b5-2, *Rocklage*'s removal of the fiduciary requirement, and the reinvigoration of the version of the misappropriation theory originally outlined in the *Chiarella* dissent, one is left with the inescapable conclusion that mere thieves are liable for insider trading under Rule 10b-5.[146]

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[139] *Id*. (citing United States v. O'Hagan, 521 U.S. 642, 650, n.3 (1997)).
[140] *Id.* at 607.
[141] *Id*. (citing *Chiarella*, 445 U.S. at 246–47 (Blackmun, J., dissenting)).
[142] *Id.* (citing *Chiarella*, 445 U.S. at 246–47 (Blackmun, J., dissenting)).
[143] *Id.* (citing SEC v. Cherif, 933 F.2d 403, 410–12 (7th Cir. 1991).
[144] *Id.* (citing *Cherif*, 933 F.2d at 412 n.6). While mere thieves are brought under insider trading liability through the expansion of the misappropriation theory, mere thieves could also be subject to insider trading liability under the previous misappropriation theory because it is possible to view the relationship between the thief and the owner of the stolen information as a fiduciary-like relationship. *Id.*
[145] Steinbuch, *supra* note 1, at 607–08 (quoting *Cherif*, 933 F.2d at 412 n.6).
[146] *Id.* at 608.

While many courts have rid themselves of the fiduciary-relationship requirement, courts have yet to actively affirm the misappropriation theory of insider trading as a wholesale basis for liability for mere thieves.[147] But we are getting closer.

For example, the Fifth Circuit, in *SEC v. Cuban*,[148] highlighted the diminishing role of the illusory trust-relationship requirement in the misappropriation theory when it declared that the "case raises questions of the scope of liability under the misappropriation theory of insider trading."[149] As such, "the Fifth Circuit refused to disturb the [trial] court's conclusion that 'a duty sufficient to support liability under the misappropriation theory can arise by agreement [even] absent a preexisting fiduciary or fiduciary-like relationship.'"[150] Thus, how significant, if at all, is the relationship requirement to the misappropriation theory? The *Mere Thieves* trilogy continues to raise this question.

The *SEC v. Cuban* case is instructive:

> Mark Cuban is a well known entrepreneur and current owner of the Dallas Mavericks and Landmark theaters, among other businesses. The SEC brought this suit against Cuban alleging he violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 by trading in Mamma.com stock in breach of his duty to the CEO and Mamma.com—amounting to insider trading under the misappropriation theory of liability. The core allegation is that Cuban received confidential information from the CEO of Mamma.com, a Canadian search engine company in which Cuban was a large minority stakeholder, agreed to keep the information confidential, and acknowledged he could not trade on the information. The SEC alleges that, armed with the inside information regarding a private investment of public equity (PIPE) offering, Cuban sold his stake in the company in an effort to avoid losses from the inevitable fall in Mamma.com's share price when the offering was announced.[151]

As with all insider-trading cases, the facts are critical in determining whether a violation occurred under the existing tattered patchwork of judicially created doctrines. In *Cuban*, the CEO of an internet-based company named Mamma.com told Cuban over the phone that he had confidential information.[152] Cuban agreed to keep the information confidential, and the CEO informed him of the company's decision to raise capital with a PIPE[153] offer-

[147] Steinbuch, *supra* note 19, at 353.
[148] SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).
[149] *Id*. at 552.
[150] Commodity Futures Trading Comm'n v. EOX Holdings LLC, 405 F. Supp. 3d 697, 714 (S.D. Tex. 2019) (quoting SEC v. Cuban, 634 F. Supp. 2d 713, 725 (N.D. Tex. 2009)).
[151] *Cuban*, 620 F.3d at 552.
[152] *See id*. at 555.
[153] A PIPE, or private investment in public equity, "is the buying of shares of publicly traded stock at a price below the current market value per share." Troy Segal, *Private Investment in Public Equity (PIPE)*, INVESTOPEDIA (Nov. 7, 2020), https://www.investopedia.com

ing.[154] Cuban made several comments about the offering, stating that "he did not like PIPEs because they dilute the existing shareholders."[155] Finally, at the end of the conversation, Cuban said, "Well, now I'm screwed. I can't sell."[156]

After the phone call, the CEO of Mamma.com sent Cuban an email with contact information to obtain "more details about the private placement."[157] Cuban called the contact, a Merriman representative, and spoke with him for eight minutes.[158] "During that call, the salesman supplied Cuban with additional confidential details about the PIPE. In response to Cuban's questions, the salesman told him that the PIPE was being sold at a discount to the market price and that the offering included other incentives for the PIPE investors."[159] The court stated that it was a reasonable conclusion that Cuban used this phone call to learn the off-market prices available for him and other PIPE participants to purchase.[160]

One minute after Cuban spoke with the Merriman representative, he "called his broker and instructed him to sell [Cuban's] entire stake in the company."[161] On the evening of June 28, Cuban sold 10,000 shares in Mamma.com, while the remaining shares in the company were sold the next day.[162]

That next day, the executive chairman of Mamma.com sent an email to the other Mamma.com board members, updating them on his discussion with Cuban, stating:

> [W]e did speak to Mark Cuban ([the CEO] and, subsequently, our investment banker) to find out if he had any interest in participating to the extent of maintaining his interest. His answers were: he would not invest, he does not want the company to make acquisitions, he will sell his shares which he cannot do until after we announce.[163]

Mamma.com announced the PIPE offering that same day after the stock markets closed.[164] "The next day, Mamma.com's stock price fell 8.5% and continued to decline over the next week, eventually closing down 39% from the June 29 closing price."[165] Because Cuban sold his shares before the announce-

/terms/p/pipe.asp [https://perma.cc/8W7V-LGSP]. "The purpose of a PIPE is to raise capital for the public company." *Id.* This type of buying method is used by investment firms, mutual funds, and other large investors. *Id.*

154 *See Cuban*, 620 F.3d at 555.
155 *Id.*
156 *Id.*
157 *Id.* at 556.
158 *Id.*
159 *Id.*
160 *Id.*
161 *Id.*
162 *Id.*
163 *Id.*
164 *Id.*
165 *Id.*

ment, he avoided over $750,000 in losses from the falling stock price.[166] Cuban then notified the SEC of his trades, stating that he sold his stake in Mamma.com because the company "was conducting a PIPE, which issued shares at a discount to the prevailing market price and also would have caused his ownership position to be diluted."[167]

In the SEC enforcement action in the district court, the trial court held that the agreement in question was, at most, an agreement to keep information confidential, not an agreement to abstain from trading.[168] Therefore, the court granted Cuban's motion to dismiss on the grounds that a "simple confidentiality agreement" alone does not create a duty to disclose or abstain from trading under the law.[169] The SEC then appealed the lower court's decision, arguing that a confidentiality agreement does create a duty to disclose or abstain from trading.[170] Additionally, the SEC alleged that the confidentiality agreement in this case did in fact contain an agreement not to trade that created a duty to disclose or abstain from trading.[171]

Since *O'Hagan* did not define the specific relationships of "trust and confidence" that would bring about a duty to disclose or abstain according to misappropriation liability, the *Cuban* trial court was left to determine if Cuban's relationship with Mamma.com equated to a relationship of "trust and confidence" under the misappropriation theory.[172] The SEC relied on Rule 10b5-2(b)(1), stating that a person has " 'a duty of trust and confidence' for purposes of misappropriation liability when that person 'agrees to maintain information in confidence.' "[173] The district court interpreted the complaint to allege that Cuban agreed not to disclose confidential information, but he did not agree to abstain from trading.[174] Additionally, the district court found that the SEC exceeded its authority by issuing Rule 10b5-2(b)(1), and that the confidentiality agreement signed by Cuban was not sufficient to create a duty to disclose or abstain from trading under the misappropriation theory.[175]

On appeal, the court interpreted the original complaint very differently than the district court.[176] The court stated: "In isolation, the statement 'Well, now I'm screwed. I can't sell' can plausibly be read to express Cuban's view that learning the confidences regarding the PIPE forbade his selling his stock before

166 *Id.*
167 *Id.*
168 *Id.* at 552.
169 *Id.*
170 *Id.* at 552–53.
171 *Id.* at 553.
172 *Id.* at 555.
173 *Id.* (citing 17 C.F.R. § 240.10b5–2(b)(1)).
174 *Id.*
175 *Id.*
176 *Id.* at 556–57.

the offering but to express no agreement not to do so."[177] However, after Cuban made this statement to the CEO about his inability to sell, Cuban gained access to the confidential, specific details of the PIPE offering.[178] According to the complaint, Cuban requested the terms and conditions of the PIPE offering from the CEO during their original conversation, which led the CEO to send Cuban the contact information for the Merriman representative.[179] Cuban then called the representative and was told "that the PIPE was being sold at a discount to the market price and that the offering included other incentives for the PIPE investors."[180] After Cuban gained additional information about the PIPE offering from his conversation with the representative, he contacted his broker and sold his stake in Mamma.com.[181]

Looking at the allegations in their entirety, the appellate court found a more reasonable basis to conclude that the agreement between the CEO and Cuban was an agreement to abstain from trading and not merely a confidentiality agreement:[182]

> By contacting the sales representative to obtain the pricing information, Cuban was able to evaluate his potential losses or gains from his decision to either participate or refrain from participating in the PIPE offering. It is at least plausible that each of the parties understood, if only implicitly, that Mamma.com would only provide the terms and conditions of the offering to Cuban for the purpose of evaluating whether he would participate in the offering, and that Cuban could not use the information for his own personal benefit. It would require additional facts that have not been put before us for us to conclude that the parties could not plausibly have reached this shared understanding. Under Cuban's reading, he was allowed to trade on the information but prohibited from telling others—in effect providing him an exclusive license to trade on the material non-public information. Perhaps this was the understanding, or perhaps Cuban mislead the CEO regarding the timing of his sale in order to obtain a confidential look at the details of the PIPE. We say only that on this factually sparse record, it is at least equally plausible that all sides understood there was to be no trading before the PIPE. That both Cuban and the CEO expressed the belief that Cuban could not trade appears to reinforce the plausibility of this reading.[183]

The appellate court stated that if the CEO of Mamma.com willingly and knowingly gave Cuban material, nonpublic information and provided Cuban with an obvious path to make trades based on that information, courts could easily infer that the CEO acted to benefit himself.[184] "A reputational benefit that translates into future earnings, a quid pro quo, or a gift to a trading friend

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[177] *Id.* at 557.
[178] *Id.*
[179] *Id.*
[180] *Id.*
[181] *Id.*
[182] *Id.*
[183] *Id.* at 557–58.
[184] *Id.* at 557 n.38.

or relative all could suffice to show the tipper personally benefitted."[185] While the court recognized that the complaint aptly averred the possibility of an agreement between Cuban and the CEO not to trade, it did not specifically determine that an agreement as described above was in place.[186]

Therefore, the court issued the key portion of its opinion regarding liability as follows:

> Given the paucity of jurisprudence on the question of what constitutes a relationship of "trust and confidence" and the inherently fact-bound nature of determining whether such a duty exists, we decline to first determine or place our thumb on the scale in the district court's determination of its presence or to now draw the contours of any liability that it might bring, including the force of Rule 10b5-2(b)(1). Rather, we [vacate] the judgment dismissing the case and [remand] to the court of first instance for further proceedings including discovery, consideration of summary judgment, and trial, if reached.[187]

Lest there be any doubt, the camel has one hump under the tent wall.

As noted securities-law expert Marc Steinberg, who worked as an expert witness for Cuban, observed, "[T]he Commission's broad use of the misappropriation theory, while receiving evident approbation from the U.S. Court of Appeals for the Fifth Circuit, generates concern about whether this construction is consistent with U.S. Supreme Court precedent."[188] Professor Steinberg observed that

> [a] fundamental principle of the misappropriation theory is that the violator owes a fiduciary duty or a relationship of trust and confidence to the *source* of the information. In situations involving an employee-employer or attorney-client relationship, this showing is met without difficulty. Enforcement dilemmas arise where the information source conveys the material non-public information to an individual with whom she has no such relationship. Well aware of this shortcoming, the SEC promulgated Rule 10b5-2, which sets forth three distinct circumstances that implicate a relationship of trust and confidence. For our purposes here—*SEC v. Cuban*—such a relationship of trust and confidence arises under this rule when the recipient agrees to maintain the confidentiality of the subject information.
>
> This provision was utilized by the SEC in its enforcement action against Mr. Cuban, who owned six percent of the common stock of a Nasdaq publicly-traded company, Mamma.com, based in Montreal. Although being the company's largest shareholder, as recognized by the Commission, Mr. Cuban neither was a director nor officer of the company, nor was he otherwise an insider due to his relationship with the company's management. He therefore was not a "classical" or "temporary insider" owing a fiduciary duty to the subject corporation and its shareholders under U.S. Supreme Court precedent.[189]

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185 *Id.* (quoting SEC v. Yun, 327 F.3d 1263, 1277 (11th Cir. 2003)).
186 *Id.*
187 *Id*. at 558.
188 Marc I. Steinberg, *The 2019 William Marshall Bullitt Lecture: Insider Trading*—SEC v. Mark Cuban—*A Litigation Saga*, 58 U. LOUISVILLE L. REV. 1, 2 (2019).
189 *Id.* at 3–5.

Professor Steinberg critically observed, as to whether there was improper "tipping" resulting from communicating information with the purpose of benefiting the company, that neither of the individuals involved did so for personal financial gain or to provide any gift to Mr. Cuban.[190] Because the SEC had no choice but to acknowledge that these communications were not within the tipper-tippee proscription of insider trading law, the SEC needed another hook to hang the hat of liability that they sought to impose.[191] "Nonetheless, because Mr. Cuban allegedly entered into a non-disclosure agreement (NDA) with the company, the Commission asserted that he misappropriated the information when he sold his Mamma.com stock prior to the company's public disclosure of the PIPE offering and, hence, engaged in fraudulent insider trading."[192] So, for his defense, "Mr. Cuban denied [having] entered into a confidentiality agreement or NDA with Mamma.com or any agent of the company."[193] After having secured a dismissal of the complaint in the district court, the Fifth Circuit reversed, holding that the complaint stated sufficient allegations for the case to go forward to the discovery phase.[194]

Steinberg highlights the sheer fantastical nature of the misappropriation theory, recognizing that the "confidentiality agreement or NDA in the business setting [that the court] deemed to constitute a relationship of trust and confidence is . . . [actually an] arm's length [transaction] . . . [b]ecause the parties do *not* trust one another and do not enjoy a close relationship."[195]

This point demands emphasis: understanding that the misappropriation theory requires a breach of a fiduciary or fiduciary-like duty, the SEC desperately sought to oxymoronically characterize the opposite as just that.[196] When parties enter into a confidentiality agreement, it is precisely because no such obligation exists under a fiduciary or even a fiduciary-like relationship.[197] To claim that these circumstances equate when they do exactly the contrary is bizarre at best.

B. On the Road to Parity of Access Through the Blanching of the Confidential-Relationship Requirement

A more recent First Circuit case, *United States v. Parigian*, demonstrated the further breakdown of the once heralded requirement for a breach of a confidential relationship for liability under the misappropriation theory.[198] The court seemingly understood that the breach of a confidential-relationship requirement

[190] *Id.* at 5.
[191] *See id.*
[192] *Id.* at 5–6.
[193] *Id.* at 6.
[194] *Id.*
[195] *Id.* at 7 (emphasis added).
[196] *See id.*
[197] *Id.*
[198] United States v. Parigian, 824 F.3d 5, 7–8 (1st Cir. 2016).

was a chimera—further driving insider-trading law now down its final stretch into the parity-of-access theory.

In *Parigian*, an executive at American Superconductor Corporation (AMSC) was friends with co-defendant, Eric McPhail.[199] By 2009, McPhail and the executive had a relationship of "trust and confidence" based on "a history, pattern, and practice of sharing professional and personal confidences,"[200] and the two understood that information shared between them was to remain confidential.[201]

Starting in July 2009, the executive began sharing material confidential information about AMSC with McPhail before it was announced to the public, such as earning reports and major commercial transactions.[202] McPhail then released the information to some of his golfing buddies, including Parigian.[203] For two years, Parigian used information from McPhail to profit on AMSC stock trades.[204]

McPhail never traded based on the AMSC information;[205] however, he received "kickbacks," such as wine, steak, and massages, from his buddies who profited from the trades they made using McPhail's information.[206] For example, Parigian offered to treat McPhail to "a nice dinner at Grill 23."[207]

Parigian moved to dismiss the allegations in the district court, claiming that they failed to adequately represent several elements necessary to establish criminal trading based on the misappropriation of information.[208] The motion was denied by the district court, and Parigian accepted a plea agreement that allowed him to appeal the denied dismissal.[209]

The appellate court illustrated the further dilution of the breach of a confidential relationship requirement when it discussed the tipper-tippee liability element requiring a personal benefit to the tipper. The court aptly noted the Supreme Court ruling that according to the *classical theory*, "a tippee is not liable under Rule 10b–5 unless the insider 'will benefit, directly or indirectly, from his disclosure.' "[210] The court then referenced the Second Circuit case, *SEC v. Sargent*, which questioned whether a showing of insider benefit was required in a *misappropriation* case.[211]

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199 *Id*. at 8.
200 *Id.*
201 *Id.* at 8–9.
202 *Id.* at 9.
203 *Id.*
204 *Id.*
205 *Id.*
206 *Id.*
207 *Id.*
208 *Id.*
209 *See id.*
210 *Id.* at 15 (quoting Dirks v. SEC, 463 U.S. 646, 662 (1983)).
211 *Id.* (citing SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000)).

The court stated:

> We then dodged the question, in part, by concluding that if a benefit need be proven, the government's evidence that the misappropriator and the tipper were business and social friends with reciprocal interests allowed a jury to find a benefit in the form of the misappropriator's "reconciliation with [a] friend" and the maintenance of "a useful networking contact." In *Rocklage*, we then held that "[e]ven if there is a requirement that the tipper receive a personal benefit, the mere giving of a gift to a relative or friend is a sufficient personal benefit" to the giver.[212]

The First Circuit

> recognize[d] that the Second Circuit itself ha[d] recently adopted a more discriminating definition of the benefit to a tipper in a classical insider trading case, rejecting as insufficient the mere existence of a personal relationship "in the absence of proof of 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."[213]

Yet, the First Circuit panel was not inclined to issue a similar holding.[214] Perhaps the court felt that the Second Circuit's attempt to limit insider-trading liability was irresponsible, and that the relationship-and-benefit test was likely cover for liability stemming from a trader knowingly using insider information. Indeed, the First Circuit recognized that "the Ninth Circuit seemed to align itself more closely with our holding in *Rocklage*."[215]

Moreover, the First Circuit rejected the claim that the misappropriation theory requires a finding that the original insider "was also expecting a benefit when passing along confidential information to [the tipper] in the first instance."[216] The Court held that "imposing such a requirement in a misappropriation case would defy logic, because the theory only applies when the insider expects that the information will not be misused, and thus will generate no trading benefits to anyone."[217] In other words, the evolution of the misappropriation theory had already watered down both the notions of confidential relationships and benefits required to impose insider-trading liability under the classical theory, and this court had no intention of moving in the opposite direction. The train had left the station and there was no recalling it now.

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212 *Id.* (first quoting *Sargent*, 229 F.3d at 77; and then quoting SEC v. Rocklage, 470 F.3d 1, 7 n.4 (1st Cir. 2006)).

213 *Id.* at 16 (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016)).

214 *Id.*

215 *Id.* (citing United States v. Salman, 792 F.3d 1087, 1094 (9th Cir. 2015) ("Proof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."), *cert. granted in part*, 136 S. Ct. 899 (2016)).

216 *Id.*

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

So, the First Circuit held "that the indictment's allegations of a friendship between McPhail and Parigian plus an expectation that the tippees would treat McPhail to a golf outing and assorted luxury entertainment is enough to allege a benefit if a benefit is required."[218] In other words, if a benefit is even required, it will now be measured by the equivalent of the often-illusory peppercorn theory in contract law (that is, the requirement has become mere window dressing).

As most know, the peppercorn theory presumes parties to a contract have exchanged value, demonstrating the existence of the element of consideration, regardless of the measure of that benefit to either party.[219] The economic justification is built around the notion of non-quantifiable psychological values.[220] The peppercorn theory, however, entirely collapses in the context of commercial contracts because consideration *is* entirely the contract price, which, in fact, equates with market price.[221] No other value exists, as there is no psychological value in the consideration for commercial contracts.[222] The consequence is that the application of peppercorn theory in these contexts actually produces the outcome opposite to that intended: social inefficiency by creating the opportunity for enforcement of alleged commercial agreements that lack an exchange of significant value.[223]

The same analysis pertains to insider-trading law. If we anchor liability in a conferred benefit, and then courts read the benefit requirement so broadly as to encompass virtually anything, notwithstanding that insider trading is about seeking non-market gains during purported market transactions, then the limitation sought to be imposed by the benefit requirement is no limit at all. And to the extent that the limit was designed to cabin the breadth of the law in a socially efficient way, it clearly no longer achieves that goal.

In the alternative, if the benefit requirement is viewed as what it likely always has been, a way to capture bad behavior through a poorly articulated theory of insider-trading liability ham-handedly created by courts as part of an unprincipled common law, then the evisceration of the rule in practice, but not in name, demonstrates that the courts' articulation is both wrong as to the meaning of the law and simply cover for the true theory driving judicial outcomes: the parity-of-access theory. Irrespective of the unfortunate recognition that a pat on the back or the wink of an eye should differentiate whether someone is liable for insider trading, this watering down of the required evidence for a benefit test is likely a significant sign of the test's terminal condition even in the courts.

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218 *Id.*

219 Donald J. Smythe, *Consideration for a Price: Using the Contract Price to Interpret Ambiguous Contract Terms*, 34 N. ILL. U. L. REV. 109, 111 (2013).

220 *Id.* at 110–11.

221 *Id.* at 111.

222 *Id.* at 111–12.

223 *Id.* at 112.

Indeed, in another recent district-court case, the Commodity Futures Trading Commission (CFTC), sued a registrant,[224] wherein:

> [The defendant] EOX ha[d] been registered with the [CFTC] as an Introducing Broker ("IB") since 2009. EOX is a wholly owned subsidiary of OTC Global Holdings LP ("OTC Global"), an inter-dealer broker in the over-the-counter energy commodities. EOX executes block futures and options trades on behalf of OTC Global's affiliate companies, and all of OTC Global's individual brokers within the United States are registered with the [CFTC] as Associated Persons ("AP") of EOX.[225]

Gizienski was employed by EOX through a written agreement and was prohibited from "revealing, disclosing, or communicating such confidential information to anyone outside of EOX."[226]

Through the spring and summer of 2013, Gizienski acquired a waiver from EOX that allowed him to exercise discretion over customer accounts as a broker.[227] At the same time, Customer A, a friend of Gizienski, gave Gizienski the authority to make trades at his own discretion.[228] After gaining this discretion, Gizienski traded on behalf of Customer A while also working as a broker for other customers.[229] This position gave Gizienski access to material, nonpublic information about the other EOX customers while making trades on Customer A's behalf.[230] Gizienski recklessly disclosed this nonpublic information to Customer A, knowing the information could be used to make trades.[231] This occurred on at least twenty occasions while Gizienski had this discretionary trading authority.[232]

However, Gizienski did not disclose to other customers that he was working on the behalf of Customer A and not acting as a mere third party.[233] On over one hundred occasions, Gizienski "executed block trades against other EOX customers, without their prior consent and without disclosing that he was taking the opposite side of their order for the benefit of Customer A."[234] During this time, Gizienski received gifts from Customer A, such as various entertainment in Las Vegas, including restaurants and nightclubs, and tickets to championship boxing fights.[235]

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[224] Commodity Futures Trading Comm'n v. EOX Holdings LLC, 405 F. Supp. 3d 697, 701 (S.D. Tex. 2019).
[225] *Id.*
[226] *Id.* at 702.
[227] *Id.* at 703.
[228] *Id.*
[229] *Id.*
[230] *Id.*
[231] *Id.*
[232] *Id.*
[233] *Id.*
[234] *Id.*
[235] *Id.*

The CFTC suit included allegations that Gizienski "traded on the basis of material, nonpublic information or tipped material, nonpublic information to Customer A."[236] Gizienski moved to dismiss two of the violations, one of them based on the misappropriation theory of insider trading.[237] Defendant claimed that "EOX owed 'duties of trust and confidentiality' to EOX customers 'by rule, by agreement, and by understanding,' but 'the duty of trust and confidence under the misappropriation theory has been applied only when an individual owes a *fiduciary* duty to the principal whose information was allegedly misappropriated.' "[238]

The court noted that many defendants have used the same argument as EOX, but courts have rejected these arguments because they have not recognized a fiduciary or fiduciary-like relationship as a requirement.[239] The court stated that "[a]rguments similar to that made by the defendants have been raised and rejected in cases holding that the predicate relationship in a case of this type need not always be a recognized, fiduciary or fiduciary-type relationship," in reference to *SEC v. Cuban*.[240]

As discussed above, the Fifth Circuit dealt previously with the fiduciary or fiduciary-like relationship requirement to establish liability under the misappropriation theory. While part of the *Cuban* decision was reversed and remanded on appeal, the Fifth Circuit also refused to overturn the district court's conclusion that "a duty sufficient to support liability under the misappropriation theory can arise by agreement absent a preexisting fiduciary or fiduciary-like relationship."[241] Therefore, Gizienski's violation based on the misappropriation theory was not dismissed because the Fifth Circuit and other courts did not require a fiduciary or fiduciary-like relationship.[242]

One might contend that this distinction is semantic: that is, that there is little difference between a fiduciary or fiduciary-like relationship and a contractual relationship. Of course, this claim undergirds the issue: the watering down of the court-created fiduciary or fiduciary-like relationship requirement is window dressing for the point that the misappropriation theory is, in effect—and might also be in words in the future—ultimately nothing more than the parity-of-access theory.

Marc Steinberg recognized the absurdity of this interpretation while working on the *Cuban* case, stating:

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236 *Id.* at 704.
237 *Id.* at 704–05.
238 *Id.* at 712–13.
239 *Id.* at 713.
240 *Id.* at 713 (citing SEC v. Cuban, 620 F.3d 551, 555 (5th Cir. 2010) ("O'Hagan did not set the contours of a relationship of 'trust and confidence' giving rise to the duty to disclose or abstain and misappropriation liability.")).
241 *Id.* at 713–14 (quoting SEC v. Cuban, 643 F. Supp. 2d 713, 725 (N.D. Tex. 2009)).
242 *Id.* at 714.

> That this seeming "fiction" has been embraced to this degree reflects a major shortcoming in our country's insider trading laws. Developed securities markets outside of the United States have thoroughly rejected the U.S. approach regulating insider trading premised on the existence of a fiduciary duty or a relationship of trust and confidence. Rather, these countries adhere to an access or parity of information approach—the rationale that was implemented in the U.S. by such cases as the Second Circuit's 1968 decision in *Texas Gulf Sulphur* before the Supreme Court rejected it in *Chiarella v. United States*.[243]

C. The Supreme Court's Unwitting Blow to the Confidential-Relationship Requirement

Recently, the Supreme Court was asked to resolve a circuit split regarding the level of "benefit" to a tipper that must be proved to demonstrate tipper-tippee liability. Bassam Salman was convicted for federal-securities fraud and appealed the decision to the Ninth Circuit.[244] While his appeal was pending, the Second Circuit in *United States v. Newman* interpreted the Supreme Court's decision in *Dirks* to require " 'proof of a meaningfully close personal relationship' between tipper and tippee 'that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature' " in order to infer that a personal benefit was conferred to the tipper.[245] The Ninth Circuit declined to follow the Second Circuit ruling and, rather, upheld the *Dirks* decision that a jury could infer, without proof of a meaningful personal relationship, that a tipper personally benefited from sharing confidential information with a trading relative.[246]

The Supreme Court granted *certiorari* to "resolve the tension between the Second Circuit's *Newman* decision and the Ninth Circuit's decision in [*Salman*]."[247] In reviewing the circuit split, the Supreme Court issued a ruling that it claimed was simply reiterating its holding in *Dirks*.[248] That claim notwithstanding, the Court unwittingly, it seems, in fact did much more. The Supreme Court issued the penultimate blow to its already diluted common law on the misappropriation theory.

Salman's insider sources were brothers, Maher Kara and Michael Kara, who shared a very close relationship.[249] During the relevant time period, Maher worked as an investment banker in Citigroup's healthcare-investment group and "dealt with highly confidential information [regarding] mergers and acquisitions."[250] Maher discussed aspects of his job with Michael and drew from his

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243 Steinberg, *supra* note 188, at 8.
244 Salman v. United States, 137 S. Ct. 420, 421 (2016).
245 *Id.* at 421–22 (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014)).
246 *Id.* at 422 (citing Dirks v. SEC, 463 U.S. 646, 664 (1983)).
247 *Id.* at 425.
248 *Id.* at 423–24.
249 *Id.* at 424.
250 *Id.*

chemistry background to help understand some of the scientific concepts associated with the job.[251] Their father was also battling cancer, and the brothers discussed companies that dealt with different cancer and pain treatments.[252]

Michael began trading based on the confidential information he received from his brother without his brother's knowledge.[253] Maher grew suspicious of Michael's trading activity and eventually decided to assist him by sharing material information about mergers and acquisitions that had yet to take place.[254]

Michael also began sharing Maher's information with other people without his brother's knowledge, including Salman, Michael's friend and Maher's brother-in-law.[255] Salman profited over $1.5 million, which he split with another relative.[256] Because of his actions, Salman was charged with one count of conspiracy to commit securities fraud and four counts of securities fraud as a tippee.[257] He was convicted of all counts by the U.S. District Court for the Northern District of California.[258] Salman appealed to the Ninth Circuit, which affirmed his conviction.[259] Thereafter, Salman appealed to the Supreme Court of the United States.[260]

The Court stated that "[i]n *Dirks*, we explained that a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper's fiduciary duty. Whether the tipper breached that duty depends 'in large part on the purpose of the disclosure' to the tippee."[261] The "disclosure of confidential information without personal benefit," in other words, "is not enough."[262] Rather, "the test . . . is whether the insider personally will benefit, directly or indirectly, from his disclosure."[263]

In seeking to lay out a "personal-benefit test" for establishing tipper liability, the Court declared:

> [W]e instructed courts to "focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings." This personal benefit can "often" be inferred "from objective facts and circumstances," we explained, such as "a relationship between the insider and the recipient

[251] *Id.*
[252] *Id.*
[253] *Id.*
[254] *Id.*
[255] *Id.*
[256] *Id.*
[257] *Id.*
[258] *Id.* at 425.
[259] *Id.*
[260] *Id.*
[261] *Id.* at 427 (quoting Dirks v. SEC, 463 U.S. 646, 662 (1983)).
[262] *Id.*
[263] *Id.* (quoting *Dirks*, 463 U.S. at 662).

that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient."[264]

Unfortunately, the subsequent example proffered by the Court to prove its point, in reality, undermined its newly minted test for bilateral-personal benefit. In a scenario where an insider shares confidential information with a relative or friend, the Court maintained, "[t]he tip and trade resemble trading by the insider followed by a gift of the profits to the recipient."[265]

With that leap in logic from tipping and trading to trading and gifting, the Court simply declared, *res ipsa loquitor*, that "[i]t is obvious that [the defendant tipper] would personally benefit" from giving inside information to his brother.[266] The jurisprudential effect of this statement on insider-trading law cannot be overstated. Indeed, of all the observations about the development of the common law of insider trading in this Article, this is the most significant, and heretofore, seemingly unrecognized in the literature on insider trading: *The Court's analysis has all but stripped away the pretense camouflaging insider-trading law as more restrictive than the parity-of-access theory*.

Here's why.

The Court's explanation for omitting the intermediate elements necessary to establish bilateral benefit was that "the jury can infer that the tipper meant to provide the equivalent of a cash gift. In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."[267] Of course, no trial practitioner or jurist would dispute that a jury *can* make such a conclusion, but it does not follow that a jury *must* make such a conclusion. Yet, that is effectively what the Court held because it equated the tipper-tippee relationship *as a matter of law* with the act of swapping insider information for gifts from the resulting gains.[268]

The Court's reasoning is pure sleight of hand. The issue is not whether the financial outcome is the same (that is, that the brother benefits). The issue is whether the insider himself either traded on confidential information or reciprocally benefited from the tippee. The Court conflated the same outcome with the same liability and effectively eliminated the plus factor that the misappropriation theory built onto the parity-of-access theory.

To make this clearer, take, for example, a case where an insider seals confidential information in a bottle and casts it into the ocean. Thereafter, someone finds the bottle and trades on the information while it is still pertinent, yet the

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264 *Id.* (citation omitted) (quoting *Dirks*, 463 U.S. at 663–64).
265 *Id.* (alteration in original) (quoting *Dirks*, 463 U.S. at 667) ("We then applied this gift-giving principle to resolve *Dirks* itself, finding it dispositive that the tippers 'received no monetary or personal benefit' from their tips to Dirks, 'nor was their purpose to make a gift of valuable information to Dirks.' ").
266 *Id.* at 428.
267 *Id.*
268 *Id.* at 247.

tipper has no knowledge of these facts. Under these facts, either the tipper has received no benefit under the *Dirks* standard, or the standard is meaningless. Tipping alone, as workers at the car wash like to remind their customers, is indeed no crime. That is why the *Dirks* Court required the tipper to benefit from the tippee's trading activity in order to create the *insider* aspect of insider trading in the absence of any trades by an insider.[269]

But Justice Alito collapsed that distinction between tipping and trading by holding that the trading profit to the *tippee* itself evinces a benefit to the tipper.[270] But this occurs *every time* a tipper-tippee relationship results in a successful transaction, and so the benefit-to-the-tipper requirement is now essentially nugatory. This was the last thread to the misappropriation theory's existence—some benefit to the tipper—because that was allegedly, albeit perennially unconvincingly, the string that connected the common law's requisite fiduciary-like duty through all the relevant parties.

While the Court focused on the fact that the tippee was a friend or relative of the tipper, in contrast with the above hypothetical, the tipper-tippee relationship does not, in itself, establish that the tipper necessarily benefits from the tippee's trading activity. The Court eschewed the need for any additional finding of benefit and relied *solely* on its inferences based upon the nature of the tipper-tippee relationship.[271] The tipper's "benefit" is inextricably intertwined with his giving a tip to a friend or relative and is, therefore, not only presumed but likely, at best, no more than the emotional validation he enjoys from his act. Thus, no separate showing of a benefit whatsoever is required. As a result, the nature of the tipper-tippee relationship has become irrelevant, and the sole factor in determining a tipper's benefit is tautologically that he tipped someone, somewhere, at some time, and a trading gain resulted thereafter.

The Supreme Court hasn't formally signed the death certificate, and it might not yet realize the consequences of what it has done, but it just killed the misappropriation theory. Even if it reverses course in the future, that would be, at best, the resuscitation of the theory's corpse into a Frankenstein's monster. Sad would be the day that the Court's already beleaguered insider-trading common law should develop into such an obvious abomination.

D. Singing in the Same Chorus, Albeit in a Different Key

In citing to my original article, Donald C. Langevoort amplifies my preliminary point that thievery through hacking should be understood—those court rulings to the contrary discussed herein notwithstanding—as fitting "neatly" within existing insider-trading common law, to the extent that anything fits neatly in the bedlam that is the current state of the law:

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[269] *Dirks*, 463 U.S. at 667.
[270] Salman v. United States, 137 S. Ct. 420, 427 (2016).
[271] *Id.*

> There are, however, situations where the theft of information by a non-fiduciary could involve some element of deception. What of this? That issue arose in *SEC v. Dorozhko*, a hacking case. Defendants were foreign traders who hacked into a server that facilitated the public disclosure of corporate news, and so at any given time contained not-yet-released material information.[272]

Langevoort immediately hones in on the critical factor underlying the contemporary problem with the existing common law on insider trading:

> These hackers could hardly be deemed fiduciaries, owing no duty to other marketplace traders and feigning no loyalty to anyone. *Nonetheless, the Second Circuit held they could be said to violate Rule 10b-5 by reverting to the plain text of the rule rather than either the classical or misappropriation theories*. To the extent (which would be determined on remand) that hacking involves tricking the host system into treating access as authorized, there could well be deception. And any such deception designed explicitly for gaining a trading advantage would be in connection with the purchase or sale of a security.[273]

Langevoort recognizes that hacking is a real form of deception resulting in the need for us to evaluate whether "there [is] any reason to consider the two fiduciary-based theories *exclusive* statements of insider trading's scope."[274] In answering his question in the affirmative, Langevoort, unsurprisingly (and thankfully, for my decade-long campaign to improve the law), adopts an analysis also key to my position originally articulated in *Mere Thieves*:

> The Second Circuit could think of no good reason [to consider the two fiduciary-based theories *exclusive* statements of insider trading's scope], and neither can I. The classical and misappropriation theories are simply two inventive compromise solutions to the deception puzzle, embraced because they do what courts have thought to be important work in sustaining the expressive campaign against insider trading. *To me, this limited third way targets conduct that is as disturbing as any fiduciary breach.* We are by no means bleeding the insider trading prohibition of its moralism here.[275]

The point is that the fiduciary requirement, which then became the fiduciary-like requirement, was a convenient pretext for the Court—but one not rooted in a solid jurisprudential foundation.

Langevoort, however, stops there—while I do not. Langevoort concedes that his position "still leaves plain theft uncovered" by insider-trader law, chalking this up to the limits of the text.[276] And Langevoort soundly recognizes the absurd results that likely ensue:

> We can think up many interesting hypotheticals to tease this out. If one knew that a New York City bicycle courier was carrying papers about a secret transaction, simply knocking him down while he was rounding a corner, running away with the bag, and then trading would not violate Rule 10b-5. But luring him into

272 Langevoort, *supra* note 6, at 459.
273 *Id.* (emphasis added).
274 *Id.*
275 *Id.* at 459–60 (emphasis added).
276 *Id.* at 460.

a dark alley by falsely suggesting a short cut might. Or consider the difference between breaking into an executive's house and finding the office and lying to get access to a part of the house ("I need to find a bathroom") that would allow undetected access to the office as well. These are "fine distinctions," to be sure, but they are the inevitable result of how we have constructed the law of insider trading.[277]

To be clear, that's clearly not an argument by him to avoid the language of the law—nor is it by me. He makes obvious his preference for moderation: "That one can make an argument that something is insider trading does not always mean that one should."[278] And I agree with that broad notion. As a textualist, I eschew allowing policy to drive interpretation over the express language of the law. But when it comes to insider-trading law, *inter alia*, we must at least consider the view that the language of the statute might actually still fit within one variant of a textualist interpretation of the law after all, albeit one less recognized.[279]

Some laws—particularly those written roughly a century ago during significant economic turmoil and expansion, at a time when there was far less sophistication in understanding the yet-to-be formally created doctrine of law and economics—were designed, if we can use that term, to be general dictates to courts to create a common law around a broad legislative directive.[280] "Bork acknowledged that the goals of antitrust policy are not 'determined entirely by the intentions of Congress' and proposed an 'equally important . . . independent, and usually overlooked . . . factor: the responsibility of the courts for the integrity of the law and the lawmaking process.' "[281]

Circuit Court Judge and academic Guido Calabresi describes the construct that underlies this behavior as follows:

> [Circuit Court Judge and academic Frank] Easterbrook says that it is insane to give that kind of power to people who cannot be turned out of office. It may be insane, but it happened at the beginning of our country, in every single state. What do I mean? Judges have the power to construe the common law. Everyone knows that. The common law is different. But where did judges get that power? The common law of England did not just come over on its own. When we declared independence, there was no common law of the United States. Every one of the states, some by legislation, some, like New York, in their constitutions,

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277 *Id.*
278 *Id.* at 462.
279 Moreover, if we are adopting a strictly textualist approach to an area of law completely infected with judge-made law, then the antecedent rulings too will inevitably need to be reevaluated, as well.
280 LAWRENCE G. SAGER, JUSTICE IN PLAINCLOTHES: A THEORY OF AMERICAN CONSTITUTIONAL PRACTICE 31–32 (2004).
281 Guido Calabresi, *Being Honest About Being Honest Agents*, 33 HARV. J.L. & PUB. POL'Y 907, 908 (2010) (citing ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 72 (1978)).

> *enacted* the common law of England and delegated to the courts the power to update it according to common law methods.[282]

Further, while noted academic Lawrence Sager likely extends this notion too far in my considered judgment, I believe he aptly recognizes the occurrence of this phenomenon regarding what he calls "foundational statutes."[283] No doubt that the Securities and Exchange Act of 1934 would be one such law under Sager's analysis, whether or not I agree. Certainly, the common law of insider trading that the Supreme Court has haltingly and confusingly developed implies either this approach to the 1934 Act or that a largely conservative court believes in a statutory version of living constitutionalism—a fantastic claim on its face.

But for this approach to be legitimate, the underlying statute *must* act as the specific guiding principle, as communicated by Congress, of the law. It's at least a challenge to make that claim about the current state of insider-trading law, given, specifically, that the statute's source, as the courts have said, for insider-trading liability is the "manipulative of deceptive device contrivance" language of the Act.[284] That's a thin reed indeed.

Professor Langevoort seemingly agrees:

> Generally, I favor aggressive insider trading regulation because insider trading should be seen as market abuse, whether or not it is meaningfully described as deception. As Cary said, neither fine distinctions nor rigid classifications should constrain such an expressive form of law. But the market abuse caused by insider trading is mainly reputational, and so—especially in a time when the penalties against insider trading can be so harsh compared to other kinds of securities fraud—maybe we should be reserving the category for conduct that is plainly greedy and abusive. This is the aspect of the Cary-Powell bargain that maybe we want to hold onto a bit more carefully.[285]

So, the question is what do we do? And the answer is that we make a new law.

IV. LEGISLATIVE SOLUTIONS

As I briefly said in the opening panel of this explanatory, albeit unintentional, triptych, I persist in the belief that the only way to resolve the state of confusion in insider-trading law is through brand new legislation. One scholar, citing me, proposed the following:

> Admittedly, applying an eighty-four-year-old statute to computer hackers requires fashioning a theory of liability, which if not clearly defined, risks "taking over 'the whole corporate universe.' " A preferable alternative to the affirmative misrepresentation theory would be new legislation. The European Union's insider trading law could serve as a starting point. The E.U.'s regulations essen-

[282] *Id.* at 909.
[283] SAGER, *supra* note 280, at 32.
[284] 15 U.S.C. § 78j(b).
[285] Langevoort, *supra* note 6, at 461–62.

tially take the parity of information approach: "an individual is prohibited from trading on the basis of insider information regardless of how that information was obtained." Specifically, E.U. law prohibits "insider dealing," which "arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates."[286]

This variant of Sager's approach to common-law statute writing certainly has the appeal of simplicity, but, while courts' fleshing out of historical foundational statutes *might* not violate textualist principles as long as the activity doesn't become unbridled, crafting such statutes in the first place today runs afoul of the enhanced judicial modesty adopted by many courts—certainly conservative ones—as well as the political realities of law making, not to mention that too many vested, no less special, interests would object to such uncertainty. As one scholar commented in a different context: "The tension between legislative and judge-made law is part of the larger story of the development of the American common-law process during the nineteenth century."[287] And that story has largely ended with the demise of concise legislation granting broad authority for interstitial judicial enhancement or outright court-created law.

Moreover, broad common-law style criminal statutes stand likely to be successfully challenged pursuant to vagueness and lenity doctrines. While too often not honored in practice, the Supreme Court recognized this notion a century and a half ago: "It is well settled that there are no common-law [i.e., judge-made] offenses against the United States."[288]

For example, holding the federal money-laundering statute unenforceable against a defendant convicted at trial, Justice Scalia wrote:

> The rule of lenity requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them. This venerable rule not only vindicates the fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed.[289]

The jurisprudential lynchpin to Scalia's analysis is that this judicial modesty "places the weight of inertia upon the party that can best induce Congress to speak more clearly and keeps courts from making criminal law in Congress's stead."[290]

Indeed, Judge Calabresi also states:

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286 Geisler II, *supra* note 5, at 26.

287 Naomi Cahn, *Perfect Substitutes or the Real Thing?*, 52 DUKE L.J. 1077, 1137 (2003) (citing HENRY M. HART & ALBERT M. SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW 143–47 (William N. Eskridge & Philip P. Frickey eds., 1994)).

288 Miriam H. Baer, *Insider Trading's Legality Problem*, 127 YALE L.J.F. 129, 132, 148 (2017) (alteration in original) (quoting United States v. Eaton, 144 U.S. 677, 687 (1892)).

289 United States v. Santos, 553 U.S. 507, 514 (2008).

290 *Id.*

> There are people like the critical legal theorists, and people like Judge Richard Posner—who is simply a critical legal theorist of the Right—who say that courts can do anything they want because language does not tell us anything. That is nonsense. Language is important; it limits courts a great deal. To say either that language does not mean anything, or that it tells us exactly what everything means, is baloney. The truth lies somewhere in between. Text means language in context.[291]

Thus, foundational legislation of the past is unlikely to garner support or be judicially accepted as a legitimate means to solve the problem with the existing legal landscape of insider-trading jurisprudence—albeit, the courts certainly seem content to continue the inertia of disjointed common law in the area of insider-trading law established during a bygone era. In other words, courts seem willing to prop up the historic common-law edifices erected around statutory foundations while vigorously eschewing such legal structures for wholly modern legal creations.

As Miriam Baer articulated in criticizing the Supreme Court's behavior in this regard,

> the [Supreme Court] . . . d[oes] not . . . take seriously . . . criminal law's legality principle [when it comes to insider-trading law]. . . . First, criminal prohibitions should be set forth with sufficient clarity to inform citizens in advance of what is prohibited; second, . . . crime creation is reserved *solely* for the legislature.[292]

The Supreme Court might not see a way out of the La Brea Tar Pit of its misguided securities common law, but that does not imply that it would dip its toe into that morass again with a new statute. Indeed, that seems, as discussed, highly unlikely.

The alternative is a detailed statute updated to current realities. An example of such a modern statute is the Sarbanes-Oxley Act,[293] which is a complicated securities-regulation statute that, *inter alia*, created an independent board regulating independent public accountants, limited non-audit services that public-accounting firms may undertake simultaneously with audit services for the same client, created a certification regime providing some imprimatur of quali-

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[291] Calabresi, *supra* note 281, at 910. Calabresi previously argued for a robust role of courts in updating statutes, albeit largely in the context of obsolescence rather than the failure to address new problems, although the title of his book implies a broader role than the text. GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 165–66 (1982). Indeed, cleaning up the law through a common-law janitorial function is a far less intrusive act by the judiciary into the legislature—regardless of its stand-alone legitimacy—than is the drafting of new liabilities by courts. Even notwithstanding that thirty years later, Calabresi's views seem to have moderated—perhaps as a reflection of the changed social and judicial view of the scope of courts' authority—Calabresi's earlier views didn't go so far to suggest new laws granting courts the type of authority that were either implied for, or created by, courts.

[292] Baer, *supra* note 288, at 131–32 (emphasis added).

[293] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

ty, enhanced corporate disclosure and real-time reporting, and established greater conflict-of-interest rules.[294]

My initial design of this current exposition was to include a model stand-alone detailed statute devoted solely to insider-trading law (unlike its mere implied reference in the omnibus 1934 Securities and Exchange Act)—along with a comparative analysis of various domestic and foreign laws. Indeed, I continue to hope to build upon the excellent work of Professor Thomas Lee Hazen who, thirty years ago, compared the then U.S. system—a regime very different than what exists today—with the then European Community's approach to insider-trading law.[295]

Professor Hazen observed that "[t]he EC Insider Trading Directive st[ood] in stark contrast to the failed congressional effort to proscribe insider trading."[296] The Directive addressed whether insider-trading prohibitions covers persons not in a fiduciary or other special relationship to the entity whose information is being used.[297]

> The Directive not only defines "insider trading," but also categorizes various participants. The Directive sets forth four basic elements of the type of "inside information" that can form the basis of illegal trading: (1) the information is nonpublic; (2) the content is of a precise nature; (3) it relates either to an issuer of publicly traded securities (fundamental information) or to publicly traded securities (market information); and (4) if made public, the information would likely have a significant effect on the market price.[298]

The Directive created two categories: "primary" insiders—individuals who acquired information as a result of their employment or other direct access to the source—and "secondary" insiders—individuals who obtained information not as a result of such a special relationship, but from a source who was the

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[294] Andriy Blokhin, *The Impact of the Sarbanes-Oxley Act of 2002*, INVESTOPEDIA (Feb. 23, 2021), https://www.investopedia.com/ask/answers/052815/what-impact-did-sarbanesoxley-act-have-corporate-governance-united-states.asp [https://perma.cc/5Z3B-F5KN]; *see also* Thomas Lee Hazen, *Defining Illegal Insider Trading—Lessons from the European Community Directive on Insider Trading*, 55 LAW & CONTEMP. PROBS. 231, 235–37 (1992).

[295] *See generally* Hazen, *supra* note 294. The European Community was an economic association formed in 1957 by six European countries. Will Kenton, *European Community (EC)*, INVESTOPEDIA (Aug. 27, 2021), https://www.investopedia.com/terms/e/european-community.asp [https://perma.cc/SM98-XQAZ]. The European Community focused on trade policy. *Id.* It was an economic union. The six original members were Belgium, Germany, France, Italy, Luxembourg, and the Netherlands. *Id.* In 1993, it was replaced by the European Union pursuant to the Maastricht Treaty. As of 2020, 27 countries were members in the EU: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Demark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden. *Id.* In 2016, the United Kingdom voted to leave the European Union—a move titled "Brexit" in the media—and the United Kingdom pulled out of the European Union on January 31, 2020. *Id.*

[296] Hazen, *supra* note 294, at 235.

[297] *Id.* at 235–36.

[298] *Id*. at 236.

primary insider.[299] "Primary insiders [were] prohibited from either trading and tipping, whereas secondary insiders [were] prohibited from trading but are not subject to the antitipping prohibitions."[300]

Indeed, under the EC Directive, insider-trading liability was not based on some ephemeral connection to a fiduciary duty.[301] Instead, liability rested on "trading while in possession of the non-public information" (that is, the violation of the parity-of-access theory).[302] Additionally, the anti-tipping rule was restricted to primary insiders.[303] Professor Hazen states:

> The EC Directive attempts to strike a balance between the need to provide a clear and predictable rule and the fear of overregulating trading that does not present the pernicious effects of the unfair use of nonpublic information. The different tipping rules applicable to primary and secondary insiders may reflect an attempt to balance the need for effective insider trading enforcement against the risk of establishing too broad a prohibition.[304]

Hazen posited then—a lifetime ago in terms of the common law of insider-trading law—that the EC Directive was overall superior to U.S. law.[305] But he certainly thought the EC approach was also lacking.[306] It left various gaps and was in several important respects quite ineffective.[307]

Length and other factors preclude such a full comparative-law analysis here, having already nearly exhausted the available space. But please stay tuned for the next chapter in this ongoing series.

CONCLUSION

In the years since my second installment of the *Mere Thieves* trilogy, courts have reviewed a host of cases that problematize the simple categories of insider-outsider and confidential relationships. As I have noted throughout this article series, the mere-thieves liability issue showcases the judicial trend away from neat categories under the classical theory, through the more complex considerations applicable to the misappropriation theory, and ultimately to the parity-of-access theory. This is due, in no small part, to the realization that the information age offers far more avenues for insider information to trickle into outsiders' hands. Regardless of the cause, the trend has demanded a shift in judicial priorities and philosophies.

Moving forward, courts may adopt new metrics for determining what constitutes an informational advantage in the market, or what it means to "benefit"

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299 *Id.*
300 *Id.*
301 *Id.*
302 *Id.*
303 *Id.*
304 *Id.*
305 *Id.* at 237.
306 *Id.*
307 *Id.*

from such an advantage. Or, conversely, courts may retract from the challenges posed by the increasingly complex informational ecosystem and impose simpler, less nuanced standards, as is the case with Alito's reading of *Dirks*. But the *Mere Thieves* trilogy has clearly shown that the problems posed by mere-thieves liability only stand to gain greater prominence and garner more judicial attention until a real solution can be adopted. That solution, I posit, is for Congress to craft a detailed reimagining of the entire area of law. And with some luck, I hope to assist in that endeavor through future scholarship.