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## The New Insider Trading

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# The New Insider Trading

Karen E. Woody\*

## ABSTRACT

*Pursuant to the SEC's Rule 10b-5, in order to obtain a conviction for insider trading based upon a tipper-tippee theory, the government must prove that the tipper received a personal benefit for the tip, and that the tippee knew about that benefit. The last five years of blockbuster insider trading cases have focused on this seemingly nebulous personal benefit test, and the Supreme Court has been unable to clear the muddy waters. As a result, the parameters of insider trading remain hard to pin down and often shift depending on the facts of the most recent case. Two terms ago, the Supreme Court, in an unsurprising unanimous decision in *Salman v. United States*, reaffirmed the holding of *Dirks*, from which the personal benefit test arose. The Court in *Salman*, however, failed to elucidate the more problematic areas of insider trading, including the application of the personal benefit test if the tippee is not a trading relative or friend. Legal practitioners, legislators, and academics have offered up various solutions for the problem of having an amorphous law against insider trading, yet none have succeeded.*

*This Article suggests that the hubbub over defining the personal benefit element of insider trading—sure to reach a fever pitch the next time a cert petition on the issue is granted—may be misguided. This is because there may be a simpler way to bring an insider trading case. Since Sarbanes-Oxley, there has been a sleepy provision of the criminal code that could present an end-around to the morass of insider trading precedents under Rule 10b-5. Under 18 U.S.C. § 1348, the government can bring an insider trading case under the more general umbrella of securities fraud, which has scant jurisprudential precedent. In other words, the heavily litigated personal benefit test found in *Dirks* may not apply to a charge of insider trading under § 1348. The elements required to prove a charge under § 1348 are similar to*

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*other fraud-based offenses such as mail and wire fraud, health care fraud, and bank fraud. Whether § 1348 was intended to apply to insider trading in particular is an open question, and a broader question is whether the jurisprudential interpretation for the elements of the crime of insider trading as defined under Rule 10b-5 should be imported into the judicial interpretation of § 1348. In other words, if the conduct that constitutes criminal insider trading under Rule 10b-5 exists only if the elements of the Dirks test are met, then a § 1348 charge for criminal insider trading may create an entirely new scheme and definition of the crime. This Article analyzes the potential of this dual paradigm and argues that, given the uncertainty and shifting parameters of insider trading prohibitions, application of § 1348 to insider trading should be afforded the rule of lenity.*

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## INTRODUCTION

Insider trading is not going away. The legal headaches surrounding prevention, regulation, and prosecution of insider trading seem to have increased rather than decreased in recent years. The parameters of insider trading, as charged under Rule 10b-5, are thorny for myriad reasons. First, since the Powell decisions of the 1980s,<sup>1</sup> insider trading is not per se illegal.<sup>2</sup> The Powell court rejected the idea that *all* trading on inside information is prohibited.<sup>3</sup> Thus, the comparisons to other crimes, and the attendant regulatory “fixes” that are available to assist in curbing other types of prohibited activity, are likely overbroad when applied to insider trading.<sup>4</sup>

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1. *Dirks v. SEC*, 463 U.S. 646, 652 (1983); *Chiarella v. United States*, 445 U.S. 222, 225 (1980); *see infra* Part I.B.

2. *Chiarella*, 445 U.S. at 233–37. *See generally* Dan M. Kahan, *Ignorance of Law Is an Excuse—But Only for the Virtuous*, 96 MICH. L. REV. 127, 129 (1997) (distinguishing between a *malum prohibitum* crime, which is wrong only because it is prohibited by law, and a *malum in se* crime, which is a moral wrong, independent of law). Insider trading is a *malum prohibitum* crime in certain circumstances and therefore more open to interpretation by the judiciary. This fact creates the legislative and judicial morass in which insider trading doctrine exists because there are numerous carve-outs based on relationship status and fiduciary duty. *See also infra* Part IV and accompanying notes.

3. *Chiarella*, 445 U.S. at 232–33.

4. *See, e.g.*, Miriam Baer, *Insider Trading’s Legality Problem*, 127 YALE L.J.F. 129, 129–30 (2017), [https://www.yalelawjournal.org/pdf/Baer\\_1hb7mucv.pdf](https://www.yalelawjournal.org/pdf/Baer_1hb7mucv.pdf) [<https://perma.cc/WE6J-NNWF>] (setting up a hypothetical analogizing insider trading to cocaine distribution). While a helpful example in relation to explaining tipper-tippee theory and conspiracy, the fact that cocaine distribution is *always* illegal makes the analogy lack full application to insider trading.

Second, when insider trading is prohibited, the crime itself is hard to define. Prosecutors apply criminal fraud elements to an activity that is defined by tort law concepts of breaches of duty.<sup>5</sup> A majority of scholars focus on the property law concepts at play, arguing that the prohibition on insider trading can be understood as a means of protecting the firm's rights to information as a property right.<sup>6</sup> Under this lens, insider trading is theft, or embezzlement.<sup>7</sup> This combination of criminal, tort, and property theories highlights the question of who or what is the actual victim of insider trading. Is the victim the market at large?<sup>8</sup> The company whose information has been misappropriated or sold?<sup>9</sup> Shareholders?<sup>10</sup> Or someone else entirely?

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5. Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1320 (2009) (acknowledging the gap in insider trading doctrine after *United States v. O'Hagan* wherein the crime of insider trading is defined as use of material non-public information regardless of a breach of fiduciary duty); see also John P. Anderson, *Greed, Envy, and the Criminalization of Insider Trading*, 2014 UTAH L. REV. 1, 5 (2014) (analyzing the purpose of applying criminal law to inside trading); Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 519–20 (2011) (dissecting the elements of fraud and the unique concept of securities fraud as demanding both a private remedy and public sanction while also diluting the requisite intent).

6. See, e.g., JONATHAN R. MACEY, *INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY* 67 (1991) (noting that the only “conceivable justification for banning insider trading is that such trading involves the theft of valuable corporate property”); Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1592 (1999) (noting that “insider trading ought to be regarded as a property rights problem rather than a securities fraud issue”); Zachary J. Gubler, *Insider Trading as Fraud*, 98 N.C. L. REV. 533, 560–61 (2020) (promoting the misappropriation theory of insider trading). But see Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of Duty*, 20 CARDOZO L. REV. 83, 113 (1998) (arguing that Congress was concerned with fairness and the protection of investors when it passed the Exchange Act (which houses § 10(b)) and not the protection of property rights in information).

7. See, e.g., *SEC v. Payton*, 97 F. Supp. 3d 558, 559 (S.D.N.Y. 2015) (describing insider trading as a “form of cheating, of using purloined or embezzled information to gain an unfair trading advantage”); Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223, 1265–67 (1998); A.C. Pritchard, *United States v. O'Hagan: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 28 (1998).

8. See Kenneth R. Davis, *Insider Trading Flaw: Toward a Fraud-on-the-Market Theory and Beyond*, 66 AM. U. L. REV. 51, 73–74 (2016). But see Pete Brush, *Rakoff Tells Gov't to Dump 'Level Playing Field' Language*, LAW360 (Apr. 16, 2019), <https://www.law360.com/articles/1150320/rakoff-tells-gov-t-to-dump-level-playing-field-language> [<https://perma.cc/BH4C-6TLD>] (quoting Judge Rakoff as telling prosecutors to abandon a theory of ultimate fairness in the stock market).

9. See Bainbridge, *supra* note 6, at 1607; Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 858 (1983).

10. See, e.g., John C. Coffee, *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 719–20 (1986) (analyzing the costs of private litigation, including in cases

Defining who the victim is inherently defines what the criminal or prohibited act is. Yet because there is no explicit statutory prohibition on insider trading, the doctrine is entirely based on common law, with wide-ranging discrepancies regarding how the crime is defined.<sup>11</sup>

Third, in tipper-tippee cases, whether or not the crime of insider trading has occurred is dependent upon the relational distance between the tipper and tippee. In other words, a tipper who is related to, or a close friend of, the tippee has committed insider trading, whereas a tip to a stranger does not meet the elements of the crime, pursuant to the 1983 case of *Dirks v. SEC*.<sup>12</sup> As a result, each new case that presents different relational distances between tipper and tippee creates essentially an issue of first impression to the court, and the court must prescribe a new definition of personal benefit with each opinion. One only needs to look at the *Salman* case from OT 2016 to recognize that a number of unanswered questions remain regarding the limits of the personal benefit test.<sup>13</sup>

Because of these issues—and potentially others—practitioners, prosecutors, legislators, and legal academics have wrestled with how best to solve the morass of insider trading law.<sup>14</sup> On one hand, some suggest a statute explicitly banning insider trading would provide the desired solution. Professor Miriam Baer argues for such a legislative fix to create clarity of definition and suggests tiers of criminality to apply to insider trading violations.<sup>15</sup> Professor Jill Fisch, on the other hand, has argued the judicial development of insider trading doctrine is advantageous because of the

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alleging insider trading among corporate executives); Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 714 (2006) (arguing that only information traders are benefited by securities regulation).

11. See Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 889 (2010) (stating that regulating insider trading “through an antifraud rule is like trying to fit a square peg into a round hole”).

12. *Dirks v. SEC*, 463 U.S. 646, 663–64 (1983); see also *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014) (holding that the *Dirks* standard required “proof of a meaningfully close personal relationship that generates an exchange . . . [of] at least a potential gain of a pecuniary or similarly valuable nature”).

13. *Salman v. United States*, 137 S. Ct. 420, 424 (2016).

14. See, e.g., The Insider Trading Prohibition Act, H.R. 2534, 116th Cong. (2019) (superseding § 10(b) and forbidding trading in material non-public information if individual trader is aware of or recklessly disregarded that the information was wrongfully obtained or communicated); see also Stop Illegal Insider Trading Act of 2015, S. 702, 114th Cong. (2015); Rachel Graf, *Bharara Group To Explore Changing Insider Trading Law*, LAW360 (Oct. 11, 2018), <https://www.law360.com/articles/1090917/bharara-group-to-explore-changing-insider-trading-law> [<https://perma.cc/3TBY-5SGE>].

15. Baer, *supra* note 4, at 134.

difficulty in pinning down exactly what insider trading is.<sup>16</sup> Fisch asserts that judicial lawmaking in this area is optimal because federal judges are ostensibly more insulated from political pressure than are SEC employees or congressional representatives.<sup>17</sup>

A recent case decided by the Second Circuit provided some answers to the debates surrounding insider trading. *United States v. Blaszcak* is an insider trading case wherein the defendant was acquitted of insider trading under the traditional Rule 10b-5 charge but was found guilty under a relatively newer statutory prohibition, 18 U.S.C. § 1348.<sup>18</sup> That is, the jury held that the government could not prove the elements of insider trading under Rule 10b-5, including the personal benefit test, but the jury nonetheless found defendants guilty of general securities fraud under § 1348. The *Blaszcak* case presents a potential “new”<sup>19</sup> fix to insider trading by way of prosecuting under § 1348, yet that statute proves to be as nebulous as Rule 10b-5. Neither Rule 10b-5 nor § 1348 mentions the term “insider trading.” In other words, 18 U.S.C. § 1348 could provide a statutory end-around the Rule 10b-5 morass but leaves available the same amount of judicial discretion in its interpretation.

The *Blaszcak* decision tees up at least two interesting theoretical questions: first, whether it can be argued that § 1348 is merely the same charge as Rule 10b-5, creating an issue of “dual-charging,” or multiplicity of charges.<sup>20</sup> This question was not addressed by the *Blaszcak* court and seems to be dismissed by many prosecutors as frivolous given that they argue there

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16. Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. REV. 749, 752 (2018); see also Linda S. Eads, *From Capone to Boesky: Tax Evasion, Insider Trading, and Problems of Proof*, 79 CALIF. L. REV. 1421, 1456 (1991).

17. Fisch, *supra* note 16, at 758.

18. *United States v. Blaszcak*, 947 F.3d 19, 26 (2d Cir. 2019).

19. 18 U.S.C. § 1348 is hardly a “new” statutory fix. It was enacted as part of Sarbanes-Oxley, was modeled after the mail and wire fraud statutes, 18 U.S.C. § 1341 and § 1343, and mirrors much of the language of Rule 10b-5. The legislative history for this provision makes clear that Congress intended to “supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes.” S. REP. NO. 107-146, at 14 (2002); 148 CONG. REC. S7420 (daily ed. July 26, 2002) (statement of Sen. Leahy). However, only a few recent cases have involved a charge of 18 U.S.C. § 1348 in insider trading cases. See Peter J. Henning, *A New Way To Charge Insider Trading*, N.Y. TIMES (Aug. 24, 2015), <https://www.nytimes.com/2015/08/25/business/dealbook/a-new-way-to-charge-insider-trading.html> [<https://perma.cc/665R-8GFQ>].

20. Only a few courts have heard this argument and decided that a Rule 10b-5 charge is different from a § 1348 charge because only one requires willfulness. *United States v. Jun Ying*, No. 1:18-cr-00074-AT-RGV, 2018 WL 7016349, at \*2–3 (N.D. Ga. Sept. 17, 2018); *United States v. Hussain*, No. 16-cr-00462-CRB-1, 2017 WL 4865562, at \*7 (N.D. Cal. Oct. 27, 2017).

is a difference between Rule 10b-5 and § 1348 based on the intent requirement; violators of § 1348 must act “knowingly” and with the intent to defraud, whereas Rule 10b-5 prosecutions require proof of willingness.<sup>21</sup> Second, and more importantly, the Second Circuit held that the court was not required to import elements and definitions from § 10(b) jurisprudence related to insider trading into its analysis under § 1348. In other words, the Second Circuit held that it need not consider the decades of precedent related to insider trading under Rule 10b-5 when opining on an insider trading charge under § 1348. The result of this holding is that insider trading is easier to prove under a criminal statute than the related civil statute and could mean the end of the SEC’s role in policing insider trading given that the agency only has civil authority to do so.

In Part I, this Article outlines the long jurisprudential arc of traditional insider trading prosecutions under Rule 10b-5 and its dynamic elements under common law. In Part II, this Article considers the legislative history and the relatively scant common law background of § 1348 as applied to insider trading prosecutions. Part III analyzes the use of § 1348 as both an addition and a substitute for Rule 10b-5 prosecutions of insider trading. In doing so, this Article first will address whether a dual charge for insider trading under Rule 10b-5 and § 1348 is in violation of *Blockburger*; secondly, Part III contemplates whether the judicial interpretation of insider trading as hashed out in Rule 10b-5 cases should be imported into § 1348 caselaw. Finally, in Part IV, this Article considers the policy ramifications of creating a new insider trading regime under § 1348. This Part will consider the issue that the burden for proving criminal insider trading under § 1348 will be lower than proving the personal benefit test standard under Rule 10b-5, thereby inverting civil and criminal standards for the same activity, among other problematic ramifications. Given these potential ramifications and the lack of concrete parameters for insider trading under § 1348, this Part addresses whether the rule of lenity should apply to § 1348 prosecutions of insider trading.

### I. INSIDER TRADING UNDER § 10(B) AND RULE 10B-5

Despite insider trading being a crime punishable by both fines and incarceration, the underlying statute upon which liability is premised never mentions the term “insider trading.” Instead, § 10(b) of the Securities Exchange Act of 1934 states the following:

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21. Sandra Moser & Justin Weitz, *18 U.S.C. § 1348—A Workhorse Statute for Prosecutors*, 66 DEP’T JUST. J. FED. L. & PRAC. 111, 121 (2018).



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 . . . (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 of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.<sup>22</sup>

When the SEC promulgated its related rule, Rule 10b-5, it also failed to mention, define, or explicitly prohibit insider trading. The SEC Rule attendant to the 1934 Exchange Act § 10(b) 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.<sup>23</sup>

At base, there are four critical elements to insider trading. First, the information must be material;<sup>24</sup> second, the information must be non-

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22. 15 U.S.C. § 78j(b) (2018).

23. 17 C.F.R. § 240.10b-5 (2020). Some scholars have noted that the statute never intended to prohibit insider trading. *See* Bainbridge, *supra* note 6, at n.24; Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 55–69 (noting the absence of congressional concern regarding insider trading in the legislative history of the 1934 Act); *see also* Brief for Petitioner at 21, *Salman v. United States*, 137 S. Ct. 420 (2016) (No. 15-628), 2016 WL 2732058.

24. The Supreme Court has said that information is material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). This threshold is met when a reasonable investor would consider the information as “having significantly altered the ‘total mix’ of information made available.” *Id.* Generally, certain categories of information will meet the materiality threshold, including: (1) earnings reports; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products, discoveries, or developments; (4) changes in control or management; (5) change in auditors; (6) events regarding the issuer’s securities; and (7) bankruptcies or receiverships. *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, 249).

public;<sup>25</sup> third, the individual must trade on the basis of that information;<sup>26</sup> and fourth, in most cases, the individual must breach a duty of trust or confidence owed to another individual or entity by making the trade.<sup>27</sup> Each of these four elements has emerged as a result of litigation, meaning courts have defined and sharpened the edges of the law.

With such an arguably vague statutory standard upon which to establish liability for insider trading, the law of insider trading has been shaped almost entirely by common law, in the form of SEC administrative actions and judicial opinions.<sup>28</sup> In fact, Rule 10b-5 was famously described by Justice Rehnquist as “a judicial oak which has grown from little more than a legislative acorn.”<sup>29</sup> As a result, the contours of insider trading’s definition and related prohibitions are vulnerable to sweeping changes depending upon the different factual scenarios presented in each new case. The following overview details the original cases related to insider trading and how the common law has evolved in the past fifty years, which is critical to understanding why insider trading is hard to pin down.

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25. Courts have adopted two theories to determine whether information is public. Under the first theory, information is public if it has been disseminated broadly to the investing public. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 854 (2d Cir. 1968). Under the second theory, information is public when it has been “fully impounded into the price of the particular stock.” *United States v. Libera*, 989 F.2d 596, 601 (2d Cir. 1993). In 2000, the SEC clarified its position that information on a company’s website is considered public where the disclosure is “reasonably designed to provide broad, non-exclusionary distribution of the information to the public.” *See Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,723 (adopting, among other things, Regulation FD and Exchange Act Rule 10b5-2).

26. According to the SEC’s definition, a person is liable for insider trading under Rule 10b-5 “if the person making the purchase or sale was *aware* of the material nonpublic information when the person made the purchase or sale.” 17 C.F.R. § 240.10b5-1(b) (2020) (emphasis added).

27. 17 C.F.R. § 240.10b5-2 (2020). Under classical and tipper-tippee theories, the insider or tipper must violate a fiduciary duty to the company that typically exists due to the insider’s position in the company. *See, e.g., Dirks v. SEC*, 463 U.S. 646, 659 (1983) (holding that “the tippee’s duty to disclose or abstain is derivative from that of the insider’s duty”); *Chiarella v. United States*, 445 U.S. 222, 235 (1980) (holding that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information”).

28. *See, e.g., Donald C. Langevoort, Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas, and a Blaszcak 1* (Nov. 11, 2019) (unpublished manuscript), <https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3227&context=facpub> [<https://perma.cc/T6AM-8F82>] (“[N]either the statute nor the rule addresses insider trading explicitly, leaving to the judiciary to do all the work of fashioning legal doctrine about when and why insider trading operates as securities fraud.”).

29. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).

A. *Judicial Creation of Insider Trading: Cady, Roberts and Texas Gulf Sulphur*

In 1961, the SEC brought an enforcement action that created the prohibition on insider trading.<sup>30</sup> In a case of first impression, *In re Cady, Roberts & Co.*, the board of directors of the Curtiss-Wright Corporation decided to reduce the company's dividend.<sup>31</sup> Cheever Cowdin, a director for Curtis-Wright, was also a partner in the stock brokerage firm of Cady, Roberts & Co.<sup>32</sup> Cowdin told one of his partners, Robert Gintel, about the dividend cut, and Gintel sold shares of Curtiss-Wright stock that were held in customer accounts.<sup>33</sup> The result was that Cady, Roberts's customers avoided significant losses because their Curtiss-Wright stock had been sold before the dividend cut was made public.<sup>34</sup>

The SEC administrative court held that Gintel had violated Rule 10b-5, despite not being the original insider who possessed the information.<sup>35</sup> The administrative ruling detailed what became known as the "disclose or abstain" rule, which holds that an insider in possession of material non-public information must disclose the information before trading or abstain from trading.<sup>36</sup> The significance of *Cady, Roberts* is that it represents one of the first cases cementing the prohibition against insider trading. However, *Cady, Roberts* was an SEC administrative proceeding, not a criminal case, which created questions of its precedential value.<sup>37</sup>

Eight years after *Cady, Roberts*, the Second Circuit weighed in on insider trading and Rule 10b-5. *SEC v. Texas Gulf Sulphur* was a seminal case that solidified the "disclose or abstain" rule within securities law.<sup>38</sup> Unlike in *Cady, Roberts*, the defendant in *Texas Gulf Sulphur* ("TGS") was charged with classical insider trading based on the following facts. In 1959, TGS, an oil company, learned through ground surveys and ground samples that

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30. *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); see also Donald C. Langevoort, *Rereading Cady, Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1319 (1999).

31. *Cady, Roberts & Co.*, 40 S.E.C. at 908.

32. *Id.* at 909 n.4.

33. *Id.* at 909.

34. *Id.* at 909–10.

35. *Id.* at 916–17. See generally HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 12–15 (1966) (providing an in-depth discussion of the thought process and reasoning of Professor William Cary, Chairman of the SEC and author of the opinion).

36. *Cady, Roberts & Co.*, 40 S.E.C. at 911.

37. See *The SEC Takes Command in the Matter of Cady, Roberts & Company*, SEC HIST. SOC'Y, [http://www.sechistorical.org/museum/galleries/it/takeCommand\\_b.php#ftn17](http://www.sechistorical.org/museum/galleries/it/takeCommand_b.php#ftn17) [https://perma.cc/NF48-VRD8].

38. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968).

significant deposits of copper and zinc lay in Ontario.<sup>39</sup> The president of TGS failed to tell the other directors and employees about the information and ordered the individuals involved in the exploration to keep quiet about the discovery.<sup>40</sup> TGS eventually acquired rights to the Ontario land and announced the discovery in 1964.<sup>41</sup> However, a number of insiders had bought stock or options in 1963, prior to the announcement in April 1964.<sup>42</sup> Some insiders tipped outsiders. Others accepted stock options authorized by the board without informing the directors of the discovery. Stock jumped 222% from November 1963 to May 1964.<sup>43</sup>

The Supreme Court denied cert in this case, leaving the Second Circuit opinion to stand as the first federal ruling on what constitutes inside trading.<sup>44</sup> The Second Circuit held that if any individual has material non-public information, she must either disclose that information or abstain from trading.<sup>45</sup> This case underscored the “equal access to information” policy as the bedrock principle for investor protection and market integrity. The Second Circuit agreed with the SEC that Rule 10b-5 was intended to assure that “all investors trading on impersonal exchanges have relatively equal access to material information” and that “all members of the investing public should be subject to identical market risks.”<sup>46</sup>

### *B. Powell Jurisprudence and the Fiduciary Duty Test*

The *TGS* “disclose or abstain” doctrine became the cardinal rule regarding insider trading until the mid-1980s, when Justice Powell single-handedly reshaped the law of insider trading. Through a pair of Supreme Court decisions authored by Powell, insider trading shifted from being an absolute bar on trading while in possession of inside information to becoming a more complicated question regarding fiduciary duty and personal benefit.<sup>47</sup> The two cases that created the new contours of insider trading remain the

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39. *Id.* at 843.

40. *Id.* at 844.

41. *Id.* at 846.

42. *Id.* at 844.

43. *Id.* at 847.

44. *See Hazen, supra* note 11, at 891 n.49.

45. *Tex. Gulf Sulphur Co.*, 401 F.2d at 848.

46. *Id.* at 848, 852.

47. *See, e.g., James D. Cox, Seeking an Objective for Regulating Insider Trading Through Texas Gulf Sulphur*, 71 SMU L. REV. 697, 699 (2018) (noting that after *TGS*, the rationale went “from the clarity of parity of information to the mist of fiduciary duty”).

architecture of insider trading law today.<sup>48</sup> For this reason, a close look at these cases is critical in order to grasp the nuances in the more recent case law.

1. *Chiarella v. United States*<sup>49</sup>

Chiarella was an employee of Pandick Press, a financial printer company.<sup>50</sup> Pandick used codes to conceal names of companies involved in tender offer deals, but Chiarella broke the codes and purchased target company shares before the bids were announced.<sup>51</sup> Chiarella was convicted of insider trading in the district court, and the decision was affirmed by the Second Circuit.<sup>52</sup>

The Supreme Court, with Justice Powell authoring the opinion, reversed the conviction.<sup>53</sup> The Court held that Chiarella had not committed insider trading because he had no fiduciary relationship to the companies whose stock he traded.<sup>54</sup> Rather, the Court reasoned, Chiarella merely worked for Pandick Press, which was not an agent of the companies.<sup>55</sup> The Court opined that the lack of any fiduciary duty meant that there was no breach of duty, and therefore no fraud. In what may be the most oft-quoted line that has launched innumerable law review articles and scholarly debate, the Court stated, “there can be no fraud absent a duty to speak.”<sup>56</sup>

Powell’s decision in *Chiarella* represents the first outright rejection of the “equal access to information” definition of insider trading. The “disclose or abstain” bedrock principle from *TGS* became significantly narrowed after *Chiarella* and required a duty that arises from a relationship of trust and confidence between the parties. Powell underscores out that Chiarella was not a fiduciary or an agent; he was a complete stranger to the companies in which he traded stock. Because of this fact, Chiarella merely “happened

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48. See, e.g., A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 930 (2003) [hereinafter Pritchard, *Counterrevolution in the Federal Securities Laws*]; Pritchard, *supra* note 7, at 18–22.

49. 445 U.S. 222 (1980).

50. *Id.* at 224.

51. *Id.*

52. *Id.* at 225.

53. *Id.* at 224–25.

54. *Id.* at 231–33.

55. *Id.*

56. *Id.* at 235 (holding that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information”).

upon” inside information, which, the Court held, was not a violation of any fiduciary duty and therefore did not give rise to the crime of insider trading.<sup>57</sup>

The *Chiarella* opinion created shockwaves and garnered a variety of criticisms. As Stephen Bainbridge summarized, “after *Texas Gulf Sulphur*, the question was how large a net should the prohibition cast; after *Chiarella*, the question was how broad should be the scope of immunity created by the new fiduciary relationship requirement.”<sup>58</sup> The *Chiarella* opinion was not unanimous and included a vibrant dissent from Justices Marshall and Blackmun, who argued that neither the statutory text nor the legislative history supported the breach of duty requirement that Powell inserted.<sup>59</sup> Blackmun argued that securities laws are intended to ensure market fairness broadly.<sup>60</sup> He advocated for a broad rule banning the use of non-public information not lawfully available to the market.<sup>61</sup> Chief Justice Burger also dissented, arguing that illegal insider trading takes place whenever someone trades with information obtained through unlawful means.<sup>62</sup> Interestingly, Justices Brennan and Stevens concurred with the majority in reversing the conviction but on a procedural issue that the jury had not been instructed properly.<sup>63</sup>

## 2. *Dirks v. SEC*<sup>64</sup>

The Powell decision in *Chiarella* set the stage for what remains the most important case in insider trading law today. *Dirks v. SEC* created the morass in which courts and litigants find themselves in now. The *Dirks* opinion added a new relational element to tipper-tippee liability, which cannot be

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57. *Id.* at 232–33. Under the misappropriation theory, the duty arises out of an agreement, relationship, or course of conduct between the source of the information and the recipient that requires the recipient to keep the information confidential. *See, e.g.,* *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (holding that the misappropriation theory applies where an individual misappropriates confidential information for the purpose of trading in a security in violation of a duty owed to the source of the information). Under the “outsider trading” theory, there does not need to be a duty (and breach) where an individual affirmatively misrepresents himself in order to trade on a security. *See SEC v. Dorozhko*, 574 F.3d 42, 51 (2d Cir. 2009).

58. Stephen M. Bainbridge, *The Law and Economics of Insider Trading: A Comprehensive Primer*, (Feb. 2001) (manuscript at 18) [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=261277](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=261277) [<https://perma.cc/A3HF-6D55>].

59. *Chiarella*, 445 U.S. at 245–46 (Blackmun, J., dissenting).

60. *Id.* at 248.

61. *Id.* at 249–50.

62. *Id.* at 239–40 (Burger, C.J., dissenting). This *Chiarella* dissent foreshadowed the misappropriation theory established later in *O’Hagan*. *See supra* note 57.

63. *Chiarella*, 445 U.S. at 237–39 (Stevens, J., concurring).

64. 463 U.S. 646, 648 (1983).

defined cleanly, thus creating a new wrinkle in insider trading law with each new case presented to a court.

The facts of *Dirks* are compelling and may explain why the Court created an entirely new element of insider trading. Equity Funding Corp. of America engaged in serious accounting fraud.<sup>65</sup> Dirks was a securities analyst who uncovered the fraud, thanks in part to Ronald Secrist, a former officer of Equity Funding who had told Dirks about it. Dirks tried to alert the SEC to report the fraud.<sup>66</sup> He also contacted the *Wall Street Journal* (the “*Journal*”) and leaked the story.<sup>67</sup> The *Journal* refused to publish the story, claiming it would be libelous.<sup>68</sup> Dirks also told the fraud to some of his clients, and those clients subsequently sold their holdings in Equity Funding.<sup>69</sup> Eventually, the fraud at the company came to light, and the exchanges stopped trading on the stock because of its drastic losses.<sup>70</sup> The SEC, however, after its investigation into Equity Funding, opened an investigation on Dirks, the whistleblower, for insider trading because he told his clients about the information about Equity Funding that he learned from Secrist.<sup>71</sup>

Dirks was found guilty of insider trading in the lower courts.<sup>72</sup> After all, under the logic of *TGS*, his was a fairly open-shut case involving the disclosure of material non-public information to his client, and they traded on that information. Yet, at the time *Dirks* was decided, the *Chiarella* holding was in force, requiring a fiduciary relationship, or at least a relationship of trust a confidence, in order to meet the elements of insider trading.<sup>73</sup>

For this reason, the Supreme Court reversed Dirks’ conviction, thereby reaffirming the rejection of the *TGS* standard of equal access to information. Justice Powell wrote for the majority and stated that there is no violation of Rule 10b-5 absent a breach of fiduciary duty, echoing his opinion in *Chiarella*.<sup>74</sup> However, Powell went on to state that to prove a breach of fiduciary duty, the government needs to show that the tipper received “a monetary or personal benefit” either directly or indirectly.<sup>75</sup> The tippee is

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65. *Id.* at 649; see also A.C. Pritchard, *Dirks and the Genesis of Personal Benefit*, 68 SMU L. Rev. 857, 857–58 (2015) (reviewing the *Newman* decision in light of the benefit test that arose out of *Dirks* and analyzing the elements of the *Dirks* test).

66. *Dirks*, 463 U.S. at 648–49.

67. *Id.* at 649.

68. *Id.* at 649–50.

69. *Id.* at 650.

70. *Id.* at 650–51.

71. *Id.*

72. *Id.* at 651–52.

73. See *id.* at 654–55.

74. *Id.* at 654; *Chiarella v. United States*, 445 U.S. 222, 235 (1980).

75. *Dirks*, 463 U.S. at 667.

equally liable if the tippee knows or should have known there has been a breach of fiduciary duty.<sup>76</sup> Based on this logic, the Court reasoned that Dirks should not be found liable of insider trading because he did not receive any personal benefit for the tip.<sup>77</sup> In other words, the Court seemingly carved out a whistleblower, or altruistic, exception for tipping material non-public information.<sup>78</sup>

The term “personal benefit,” however, is not sufficiently specific and is what has given rise to countless insider trading cases since *Dirks*. Justice Powell gives three examples of what would be considered personal benefits in the *Dirks* opinion: (1) “a pecuniary gain,” (2) “a reputational benefit that will translate into future earnings,”<sup>79</sup> and (3) “when an insider makes a gift of confidential information to a trading relative or friend.”<sup>80</sup>

### C. Recent Challenges to Insider Trading Law

After the *Dirks* opinion, liability for insider trading under the tipper-tippee theory requires the following elements to be present: (1) the tipper “has breached his fiduciary duty to the shareholders by disclosing the [material non-public] information to the tippee,” (2) the tippee “knows or should know that there has been a breach,” (3) the tippee uses the information in connection with a securities transaction, and (4) the tipper obtained some personal benefit in return.<sup>81</sup> These elements were created nearly out of whole cloth by common law, given that the statute underpinning insider trading liability does not mention the term “insider trading.”<sup>82</sup>

Since *Dirks*, however, courts have taken a broad view of what can constitute a “personal benefit.” For example, “personal benefit” can be as

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76. *Id.* at 659–60.

77. *Id.* at 666.

78. Powell seems to have been motivated by over-zealous prosecution of insider trading and that having a detrimental effect on market efficiency. He also thought this would chill the incentives for analysts and other market professionals to uncover information about companies. See Pritchard, *supra* note 65; Pritchard, *Counterrevolution in the Federal Securities Laws*, *supra* note 48, at 931. Thus, in Powell’s mind, adequate price valuation is paramount, even if some analysts need to learn info about company from insiders. See generally Nagy, *supra* note 5, at 1324–28 (arguing that this problem is better addressed through Reg FD and other measures).

79. *Dirks*, 463 U.S. at 663–64.

80. *Id.* at 664; *United States v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015) (citing *Dirks*, 463 U.S. at 664).

81. *Dirks*, 463 U.S. at 647; see also *SEC v. Ingram*, 694 F. Supp. 1437, 1440 n.3 (C.D. Cal. 1988).

82. See *supra* Section I.A and accompanying notes.



minimal as maintaining network contacts or personal relationships.<sup>83</sup> In recent years, courts, including the Supreme Court, have reexamined the *Dirks* standard without much clarification. Three recent cases spotlight the existing confusion and disagreement on the current state of insider trading law, and this Section addresses these three decisions in chronological order.

1. *United States v. Newman*<sup>84</sup>

In 2014, the Second Circuit again considered the concept of a personal benefit through the *Dirks* presumption of a gift to a “trading relative or friend” and established that relational distance is a key factor in determining who meets the definition of “friend.” The *Newman* case involved two long chains of tippers and tippees. Todd Newman and Anthony Chiasson were portfolio managers charged for trading based on material non-public information related to NVIDIA and Dell stock.<sup>85</sup> For the NVIDIA tipping chain, a member of the NVIDIA finance unit disclosed material non-public information to an acquaintance, who eventually told a securities analyst.<sup>86</sup> That particular analyst told another analyst, who then tipped Newman and Chiasson.<sup>87</sup> A similar story occurred for the Dell tipping chain: a member of the Dell investor relations team disclosed information to Sandy Goyal, an analyst.<sup>88</sup> Goyal tipped another analyst who eventually tipped Newman and Chiasson. Newman and Chiasson traded on the information and generated “lavish profits for their respective funds.”<sup>89</sup>

Applying the *Dirks* standard, the Second Circuit held that the government presented insufficient evidence to establish that either the NVIDIA or the Dell insider received a personal benefit for the tip.<sup>90</sup> The court stated that while the personal benefit standard is “permissive,” it “does not suggest that the [g]overnment may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature.”<sup>91</sup> Thus, the distance between the relationships among the tippers and tippees is what afforded Newman and Chiasson immunity from liability.

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83. See, e.g., SEC v. Yun, 327 F.3d 1263, 1280 (11th Cir. 2003); SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000); SEC v. Maio, 51 F.3d 623, 627 (7th Cir. 1995).

84. 773 F.3d 438, 442 (2d Cir. 2014).

85. *Id.* at 443.

86. *Id.*

87. *Id.*

88. *Id.*

89. *United States v. Salman*, 792 F.3d 1087, 1093 (9th Cir. 2015).

90. *Newman*, 773 F.3d at 442.

91. *Id.* at 452.

The *Newman* court, therefore, created two distinct limitations to the personal benefit test. The first was the relational distance. The court held that a personal benefit does not exist absent a “meaningfully close personal relationship.”<sup>92</sup> Further, the court stated that the meaningfully close personal relationship must generate “an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”<sup>93</sup> In this second limitation, the personal benefit test is seemingly swallowed by the pecuniary gain requirement. That is, according to *Newman*, a personal benefit through a close relationship will likely have a pecuniary gain element to it. The Supreme Court denied certiorari in *Newman* but addressed this second limitation in its decision in *Salman*, detailed below.

## 2. *Salman v. United States*<sup>94</sup>

Although the Supreme Court declined to take up the *Newman* case to the surprise of many commentators,<sup>95</sup> it did agree to hear a subsequent case on insider trading, *Salman v. United States*.<sup>96</sup> In *Salman*, the defendant was convicted of insider trading, and the Ninth Circuit affirmed the conviction.<sup>97</sup> The facts of the case involved Maher Kara, who worked for Citigroup healthcare, informing his older brother, Michael Kara, about upcoming mergers and acquisitions of Citigroup clients.<sup>98</sup> Michael Kara was engaged to

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92. *Id.* The *Newman* decision seemed to change the parameters of tipper-tippee liability, which had been additionally shaped by a 2012 civil case, *SEC v. Obus*, 693 F.3d 276, 279 (2d Cir. 2012). In *Obus*, the Second Circuit interpreted the elements of tipper-tippee liability to allow for tippees to be found guilty even if they were unaware of the tipper’s benefit. *Id.* at 287–88. *Newman* “connect[ed] gift-giving and real benefit by demanding proof of a sufficiently close relationship between tipper and tippee” and required that the tippee have “actual knowledge of the breach and benefit.” Langevoort, *supra* note 28, at 4.

93. *Newman*, 773 F.3d at 452.

94. 137 S. Ct. 420, 424 (2016).

95. See generally Donna M. Nagy, *Salman v. United States: Insider Trading’s Tipping Point?*, 69 STAN. L. REV. ONLINE 28 (2016), <https://www.stanfordlawreview.org/online/salman-v-united-states-insider-tradings-tipping-point/> [https://perma.cc/24VN-349H]; A.C. Pritchard, *The SEC, Administrative Usurpation, and Insider Trading*, 69 STAN. L. REV. ONLINE 55 (2016), <https://www.stanfordlawreview.org/online/the-sec-administrative-usurpation-and-insider-trading/> [https://perma.cc/R4Y3-UYKT].

96. *Salman*, 137 S. Ct. at 420.

97. *United States v. Salman*, 792 F.3d 1087, 1088 (9th Cir. 2015). Interestingly, Judge Rakoff, who is a district judge in the Second Circuit, wrote the Ninth Circuit opinion because he was sitting by designation. *Id.* This was yet another interesting intersection between the Second and Ninth Circuits related to *Newman* and *Salman*.

98. *Id.* at 1088–89.

Saswan Salman, the sister of the defendant, Bassam Salman.<sup>99</sup> Michael Kara passed on the inside information he learned from Maher to Bassam Salman.<sup>100</sup> Salman traded on the information and netted over one million dollars from 2004 to 2007 on trades based upon the material non-public information obtained from Michael.<sup>101</sup>

At trial, the government presented evidence that Salman knew that Maher Kara was the source of the inside information.<sup>102</sup> Included in the government's evidence was proof that Michael told Maher he "owe[d] somebody," yet Michael turned down the offer for money from Maher and instead took a tip about an upcoming acquisition.<sup>103</sup> In other words, the tip of inside information was given in lieu of cash.

Salman appealed his conviction based upon the decision in *Newman*, arguing that Maher did not receive any pecuniary gain from tipping.<sup>104</sup> In an 8-0 opinion, the Supreme Court held that the *Dirks* "personal benefit" test had been met because Salman was a "trading relative or friend" by virtue of being a brother-in-law of the insider.<sup>105</sup> For this reason, the Court did not need to delve into the question of whether there was any pecuniary gain for the tipper, given the *Dirks* presumption of personal benefit through this type of relationship.

*Salman* was an open-and-shut case that fell squarely within the definition of personal benefit as laid out in *Dirks*. In many ways, *Salman* did not alter anything about insider trading or clarify the law. The one takeaway from *Salman* that provided clarity to the confusion among the lower courts was the dicta that the relationship of a "trading relative or friend" does not need to include a pecuniary gain.<sup>106</sup> In that way, the second limitation imposed by the *Newman* court—that the "meaningfully close personal relationship" must be accompanied by the potential for pecuniary gain—was squarely rejected.<sup>107</sup>

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99. *Id.* at 1089.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.* (alteration in original).

104. *Id.* at 1088.

105. *Salman v. United States*, 137 S. Ct. 420, 422 (2016); see also Matthew C. Turk & Karen E. Woody, *Leidos and the Roberts Court's Improvident Securities Law Docket*, 70 STAN. L. REV. ONLINE 89 (2017), <https://www.stanfordlawreview.org/online/leidos-and-the-roberts-courts-improvident-securities-law-docket/> [<https://perma.cc/Q5EG-RVG8>] (arguing that the Roberts court had not issued many securities laws opinions that have moved the needle or elucidated complex concepts).

106. *Salman*, 137 S. Ct. at 422.

107. *Id.* at 421–22.

### 3. *United States v. Martoma*<sup>108</sup>

On the heels of the *Salman* decision, the Second Circuit again revisited the breadth of the personal benefit test through the “relational distance” limitation. In *Martoma*, the defendant Martoma managed an investment portfolio for the S.A.C. Capital Advisors, LLC (“SAC”).<sup>109</sup> In that capacity, Martoma contacted doctors through an expert networking firm paid by SAC.<sup>110</sup> One of the doctors, Dr. Gilman, provided Martoma with confidential updates on the safety of certain drugs and the results of clinical trials before they were made public.<sup>111</sup> Martoma and SAC traded on the information, which resulted in approximately \$80.3 million in gains and \$194.6 million in averted losses.<sup>112</sup> Martoma was convicted for insider trading but appealed based on the ruling in *Newman*.<sup>113</sup> Martoma argued that he did not have a “meaningfully close personal relationship” with Dr. Gilman, the insider, nor had Dr. Gilman received any gain of pecuniary or similarly valuable nature.<sup>114</sup>

The *Martoma* case, however, took an interesting twist. The Second Circuit affirmed the conviction for reasons detailed below but amended its decision nearly a year later.<sup>115</sup> In the first opinion, “*Martoma I*,” the court held that the “logic of *Salman*” abrogated *Newman*’s “meaningfully close personal relationship” requirement.<sup>116</sup> Essentially, the *Martoma I* court stated that because *Salman* did not address the “meaningfully close personal relationship” element due to the fact that the tipper-tippee relationship in *Salman* was one of brothers-in-law, the element was no longer a requirement for liability.<sup>117</sup> Through some minor logical leaps, the Second Circuit decided that nearly any relationship would meet the standard of tipper-tippee for insider trading liability. In other words, *Martoma I* came very close to a reversion to the *TGS* standard; meaning, any person trading on inside information could be liable for insider trading.

Understandably, the defense bar howled after the *Martoma I* ruling, and the stage seemed set for yet another cert petition on the elements of insider

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108. *United States v. Martoma (Martoma I)*, 869 F.3d 58, 61 (2d Cir. 2017), *amended and superseded by* *United States v. Martoma (Martoma II)*, 894 F.3d 64, 67–68 (2d Cir. 2018).

109. *Martoma I*, 869 F.3d at 61.

110. *Id.*

111. *Id.* at 62.

112. *Id.*

113. *Id.* at 64.

114. *Id.* at 64–65.

115. *Martoma II*, 894 F.3d 64, 68 (2d Cir. 2018).

116. *Martoma I*, 869 F.3d at 61.

117. *Id.* at 69.

trading.<sup>118</sup> Martoma himself appealed for a hearing en banc, and two high-profile amici briefs were filed, one on behalf of the New York Council of Defense Lawyers, and the other by a group of prestigious law professors.<sup>119</sup> Combined, the amici represented a veritable “who’s who” of securities law academics and practitioners, all of whom cried foul on the over-extension of insider trading liability beyond the *Dirks* standard. As a result, the Second Circuit panel amended its decision nearly 10 months after its initial opinion (“*Martoma II*”).<sup>120</sup> In the amended opinion, the court affirmed the conviction but on the grounds that Dr. Gilman had been handsomely paid for his consultations, meeting the “pecuniary gain” requirement for the personal benefit test.<sup>121</sup> The court backed off its abrogation of the “meaningfully close personal relationship” test, seemingly with a recognition that such a precedent would overrule *Dirks*.<sup>122</sup>

Martoma petitioned the Supreme Court for a writ of certiorari and was denied in June 2019.<sup>123</sup> Thus, the opportunity to provide parameters to the personal benefit test was avoided again this term. As described below, however, the parameters for insider trading as defined by recent court decisions may be wholly irrelevant.

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118. David Miller & Grant McQueen, *Martoma—The Latest Critical Insider Trading Decision*, LAW360 (June 27, 2018), <https://www.law360.com/articles/1057759/martoma-the-latest-critical-insider-trading-decision> [<https://perma.cc/8GQ5-TMK7>].

119. Brief for Law Professors as Amici Curiae in Support of Petitioner, *United States v. Martoma*, 894 F.3d 64 (2018) (No. 18-972), 2019 WL 991092, at \*1; Brief for the New York Council of Defense Lawyers et al. as Amici Curiae in Support of Defendant-Appellant’s Petition for Rehearing En Banc, *United States v. Martoma*, 894 F.3d 64 (2018) (No. 14-3599), 2018 WL 4075999, at \*1.

120. *Martoma II*, 894 F.3d at 67–68.

121. *Id.* at 79.

122. *Id.* at 71.

123. *Martoma v. United States*, 139 S. Ct. 2665 (2019); Greg Stohr, *Supreme Court Rejects Martoma, Won’t Curb Insider Trading Cases*, BLOOMBERG (June 3, 2019, 6:33 AM), <https://www.bloomberg.com/news/articles/2019-06-03/supreme-court-rejects-martoma-won-t-curb-insider-trading-cases> [<https://perma.cc/B5GH-TY4C>].

Table 1.  
Personal Benefit Test Summary

| Case              | Court                                      | Elements of Personal Benefit Test   |
|-------------------|--|---|
| <i>Dirks</i>      | SCOTUS                                     | Powell's three examples of a personal benefit: <ol style="list-style-type: none"> <li>1. Pecuniary gain, OR</li> <li>2. Reputational gain, OR</li> <li>3. Presumption of benefit due to close friend or family member relationship</li> </ol> |
| <i>Newman</i>     | 2d Circuit                                 | <ol style="list-style-type: none"> <li>1. Relationship (<i>Dirks</i>' #3) must be meaningful and close; AND</li> <li>2. Include pecuniary gain, essentially folding <i>Dirks</i>' #3 into <i>Dirks</i>' #1.</li> </ol>                        |
| <i>Salman</i>     | SCOTUS                                     | Abrogates <i>Newman</i> 's holding that <i>Dirks</i> ' #3 (relationship presumption) also requires pecuniary gain.  |
| <i>Martoma I</i>  | 2d Circuit                                 | Reads <i>Salman</i> 's abrogation of <i>Newman</i> to mean that the relationship of <i>Dirks</i> ' #3 does not need to be close or meaningful. <b>Any</b> relationship will meet the <i>Dirks</i> ' #3 test.                                  |
| <i>Martoma II</i> | 2d Circuit<br>(reissuance;<br>not en banc) | Backtracks on previous holding that any relationship creates a presumption of personal benefit. Holding stands because court can find <i>Dirks</i> ' #1 (pecuniary gain) = harmless error.  |

## II. INSIDER TRADING UNDER 18 U.S.C. § 1348

This Article posits that much time and attention has been, and will continue to be, paid to the necessary clarification of the personal benefit test, yet there is potentially another way to prosecute insider trading without

needing to prove the judicially created elements of the crime under Rule 10b-5. While Rule 10b-5 establishes civil and criminal liability for securities fraud, enforced by the SEC and the DOJ respectively, Congress passed another securities fraud prohibition in 2002.<sup>124</sup> The provision, 18 U.S.C. § 1348, is found in the criminal code, and therefore only the DOJ can avail itself of this charge.<sup>125</sup> Section 1348, enacted as part of Sarbanes-Oxley, was modeled after the mail and wire fraud statutes, 18 U.S.C. § 1341 and § 1343, and states

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

- (1) To defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934, or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934; or
- (2) To obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934, or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934;

Shall be fined under this title, or imprisoned not more than 25 years, or both.<sup>126</sup>

The legislative history for this provision makes clear that Congress intended to “supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank and health care fraud statutes.”<sup>127</sup> Senator Leahy explained that § 1348 was necessary because

there is no generally accessible statute that deals with the specific problem of securities fraud. In these cases, federal investigators and

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124. 18 U.S.C. § 1348 (2018).

125. *Id.*

126. *Id.*

127. S. REP. NO. 107-146, at 14 (2002); 148 CONG. REC. S7420 (daily ed. July 26, 2002) (statement of Sen. Leahy).

prosecutors are forced either to resort to a patchwork of technical Title 15 offenses and regulations, which may criminalize particular violations of securities law, or to treat the cases as generic mail or wire fraud cases and to meet the technical elements of those statutes, with their five year maximum penalties.<sup>128</sup>

Senator Leahy envisioned that § 1348 would “provide needed enforcement flexibility and, in the context of publicly traded companies, protection against all the types [of] schemes and frauds which inventive criminals may devise in the future.”<sup>129</sup>

Section 1348’s language has marked similarities to that of Rule 10b-5, despite the legislative history suggesting that § 1348 should be a broader, more “flexible” prosecutorial tool than Title 15 and carry a weightier sentence than the mail and wire fraud statutes. Indeed, § 1348 carries a possible sentence of up to twenty-five years, which is higher than § 10(b).<sup>130</sup> Notably, as is the case with § 10(b), the language of § 1348 does not address insider trading directly.

Moreover, the historical context of Sarbanes-Oxley should not be overlooked. Sarbanes-Oxley was inherently a reaction to the Enron scandal and the manipulation of energy markets that occurred as a result.<sup>131</sup> Commentators suggest that the Enron scandal, as well as that of Tyco and Adelphia, contributed to a falling economy and stock market, in addition to thousands of lost jobs.<sup>132</sup> The size of the scandals and the growing sense that there were no corporate ramifications for the actions of greedy corporations and executives allowed for the bill to gain traction. Because of this, Sarbanes-Oxley passed through Congress with a 99-0 vote in the Senate and a 423-3 vote in the House of Representatives.<sup>133</sup>

Importantly, there is far less precedent for the application and interpretation of § 1348 than for § 10(b), given that § 1348 was enacted just under twenty years ago. Yet whether § 1348 should be applied to insider

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128. 148 CONG. REC. S7420 (daily ed. July 26, 2002) (statement of Sen. Leahy).

129. *Id.*

130. Compare 18 U.S.C. § 1348 (2018) with 15 U.S.C. § 78ff (2018).

131. See, e.g., Phillip Wesley Lambert, *Worlds Are Colliding: A Critique of the Need for the Additional Criminal Securities Fraud Section in Sarbanes-Oxley*, 53 CASE W. RES. L. REV. 839, 841 (2003).

132. *Id.* at 841 n.14 (noting that Sen. Levin’s statement made clear that only corporate executives “escaped with millions of dollars” but that most of American households felt the effects of the scandals) (citing 148 CONG. REC. S10,563 (daily ed. Oct. 16, 2002) (statement of Sen. Levin)).

133. Lambert, *supra* note 131, at 841.



trading cases has been the source of recent debate, and only a few cases have addressed this.

*A. Conviction Under § 1348 and Acquittal Under § 10(b): United States v. Blaszcak*<sup>134</sup>

In *United States v. Blaszcak*, the Second Circuit was faced with delineating securities fraud under § 10(b) and § 1348. The facts of the case are as follows. Blaszcak obtained material non-public information from Christopher Worrall, a government employee at the Centers for Medicare and Medicaid Services (CMS).<sup>135</sup> CMS is responsible for setting the Medicare reimbursement rates for healthcare providers.<sup>136</sup> Blaszcak was a former employee of CMS and met Worrall in that capacity.<sup>137</sup> According to the indictment, from 2009 to 2014, Worrall informed Blaszcak about upcoming CMS reimbursement cuts for particular radiation treatments and dialysis treatments.<sup>138</sup> Blaszcak relayed the information to Robert Olan and Theodore Huber, both employees of Deerfield Management Company L.P., a healthcare-focused hedge fund.<sup>139</sup> Olan and Huber shorted stocks that would be affected by the changes in reimbursement policy.<sup>140</sup> According to the government, Deerfield “reaped more than \$7 million in profits” as a result of the trades.<sup>141</sup>

The government charged defendants with violations of securities fraud under both Rule 10b-5 and § 1348, conversion of government property under 18 U.S.C. § 641, wire fraud under 18 U.S.C. § 1343, and conspiracy to commit securities fraud under 18 U.S.C. § 371.<sup>142</sup> After a month-long jury trial in May 2018, Worrall was convicted of wire fraud and conversion of government property but was acquitted of securities fraud under both Rule 10b-5 and § 1348.<sup>143</sup> The traders Olan and Huber were found guilty of securities fraud under § 1348 but were acquitted of securities fraud under

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134. 947 F.3d 19, 25 (2d Cir. 2019).

135. *Id.* at 27.

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at 26.

140. *Id.* at 27.

141. Press Release, Dep’t of Justice, Four Defendants Sentenced Following Convictions at Trial for Stealing Confidential Government Information and Using It To Engage in Illegal Trading (Sept. 13, 2018), <https://www.justice.gov/usao-sdny/pr/four-defendants-sentenced-following-convictions-trial-stealing-confidential-government> [<https://perma.cc/J7JW-ZJ3T>].

142. *Blaszcak*, 947 F.3d at 46 (Kearse, J., dissenting).

143. *See id.* at 29–30 (majority opinion).

Rule 10b-5.<sup>144</sup> Similarly, Blaszcak, who was the “middle man” or intermediate tippee, was acquitted of securities fraud under Rule 10b-5 but found guilty under § 1348.<sup>145</sup> In other words, the jury awarded convictions for securities fraud only under § 1348 and not Rule 10b-5, despite the charges emanating from the same set of facts and activity.

The explanation of the convictions at the district court in *Blaszcak* lies in the potentially problematic jury instructions. The jury instructions for Rule 10b-5 consisted of nearly twenty pages of transcript and required the jury to address ten specific issues related to whether the defendants had a duty of trust and confidence to CMS, whether there was a personal benefit granted in the exchange of information, and whether the tippees knew of that personal benefit.<sup>146</sup> In short, if the jury answered “no” to any of the questions related to the elements of Rule 10b-5, it would acquit the defendants on that charge.<sup>147</sup> In contrast, the jury instructions related to § 1348 were more sparse and consisted of only four pages of the transcript.<sup>148</sup> The government only needed to show that there was a “scheme or artifice to defraud,” intent to defraud, and a connection to the purchase or sale of a security.<sup>149</sup>

The defendants appealed on several grounds, including that the district court erred by not instructing the jury that the *Dirks* personal benefit test applied to the wire fraud and § 1348 fraud counts.<sup>150</sup> On December 30, 2019,

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144. *See id.*

145. *See id.*

146. *Id.* at 29; Antonia M. Apps & Katherine R. Goldstein, *Can the Government Circumvent “Newman’s” Personal Benefit Test?*, 262 N.Y. L.J. 1, 2 (2019), <https://www.milbank.com/images/content/1/2/v2/126268/NYLJ-12.02.2019-Milbank.pdf> [<https://perma.cc/2TY6-3PDE>].

147. Brief of Amici Curiae Law Professors at 3–5, *United States v. Blaszcak*, 947 F.3d 19 (2d Cir. 2019) (Nos. 18-2811, 18-2825, 18-2867, 18-2878), 2019 WL 1200033.

148. Elkan Abramowitz & Jonathan S. Sack, *Back to the Future: Criminal Insider Trading Under Title 18*, 260 N.Y. L.J. 1, 2 (2018), [https://www.maglaw.com/publications/articles/2018-07-03-back-to-the-future-criminal-insider-trading-under-title-18/\\_res/id=Attachments/index=0/Back%20to%20the%20Future%20-%20Criminal%20Insider%20Trading%20Under%20Title%2018.pdf](https://www.maglaw.com/publications/articles/2018-07-03-back-to-the-future-criminal-insider-trading-under-title-18/_res/id=Attachments/index=0/Back%20to%20the%20Future%20-%20Criminal%20Insider%20Trading%20Under%20Title%2018.pdf) [<https://perma.cc/8L4H-CS2T>].

149. *Id.*

150. One of the other grounds for appeal involved the question of whether the CMS’s confidential information constituted “property” that was a “thing of value.” The dissent by Judge Kearse focused on this point in its disagreement with the majority. Specifically, Judge Kearse agreed with defendants that the convictions should be vacated because the information on which defendants traded involved government reimbursement rates for certain medical treatments. Kearse underscored that CMS is a regulatory agency, and that is distinguishable from *Carpenter*, upon which the majority relied. Kearse wrote that premature disclosure of CMS’s pre-decisional regulatory information did not render CMS a victim or “deprived of anything that could be considered property.” *Blaszcak*, 947 F.3d at 46–47 (Kearse, J., dissenting).

the Second Circuit affirmed the district court's convictions, focusing its reasoning on the embezzlement, or misappropriation, theory. Citing *O'Hagan*, the court stated "[t]he undisclosed misappropriation of confidential information, in breach of a fiduciary duty or similar duty of trust and confidence, 'constitutes fraud akin to embezzlement.'"<sup>151</sup>

The Second Circuit went further, however, in stating that the *Dirks* personal benefit test is "judge-made doctrine premised on the Exchange Act's statutory purpose" which, the Second Circuit declared, differs from the purpose of § 1348.<sup>152</sup> Section 1348 was "intended to provide prosecutors with a different—and broader—enforcement mechanism to address securities fraud than what had been previously provided in the Title 15 fraud provisions."<sup>153</sup>

What the Second Circuit misses is that insider trading is not civil securities fraud unless it meets the elements of the *Dirks* personal benefit test. To hold that it is criminal fraud under § 1348 creates a panoply of issues, discussed in Part V. Defendants addressed this issue in their appeal, and the Second Circuit dismissed this policy argument by stating that "[t]he Federal Criminal Code is replete with provisions that criminalize overlapping conduct" and that "Congress was certainly authorized to enact a broader securities fraud provision."<sup>154</sup>

The *Blaszczak* case represents one of the first instances wherein a jury convicted a defendant of insider trading under § 1348 but declined to convict under Rule 10b-5. The Second Circuit's affirmance of that decision represents a marked shift in insider trading doctrine and is one of the only cases to have considered whether insider trading violates § 1348. The only other recent cases arose from the Northern District of Georgia and are described below.

### B. Insider Trading Charged Only Under § 1348

As noted above, there have been scant prosecutions for insider trading under § 1348. One particular federal court, the Northern District of Georgia, has heard two, and both cases charged violations of *only* § 1348 and not § 10(b).

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151. *Id.* at 28 (citing *United States v. O'Hagan*, 521 U.S. 642, 654 (1997)) (majority opinion).

152. *Id.* at 35–36.

153. *Id.* at 36–37.

154. *Id.* at 37.

1. *United States v. Slawson*<sup>155</sup>

Slawson was the co-founder of Titan Capital Management, an investment company that managed assets of TCMP3 Partners, L.P., a hedge fund.<sup>156</sup> In 2014, a federal grand jury indicted Slawson on thirty-six counts, including § 1343 (wire fraud), § 1348, and § 1349 (conspiracy).<sup>157</sup> The prosecutors opted not to charge securities fraud under Rule 10b-5.<sup>158</sup> The indictment alleged that Slawson was the recipient of inside information about the children's clothing company, Carter's Inc.<sup>159</sup> Specifically, Slawson received material non-public information about quarterly and annual earnings for Carter's Inc. from a retired analyst, who himself had received the information from two insiders at Carter's.<sup>160</sup> Slawson then traded on the information.<sup>161</sup> The indictment alleged the insiders disclosed the information in violation of fiduciary duties, expectations of confidentiality, Carter's written policies, and agreements to maintain confidentiality.<sup>162</sup>

For the § 1348 charge, the indictment alleged that Slawson knowingly and willfully executed and attempted to execute a "scheme . . . to defraud others in connection with Carter's Inc. stock securities and . . . to obtain by false and fraudulent pretenses, representations and promises, money and property in connection with the purchase and sale of [those] securities" through misappropriated information.<sup>163</sup> The indictment further alleged that Slawson knew that the information had been disclosed in violation of fiduciary duties.<sup>164</sup>

Slawson moved to dismiss the indictment for failing to allege an essential element of the crimes charged.<sup>165</sup> Specifically, Slawson argued that the indictment failed to allege that he knew that either of the alleged insider tippers received any personal benefit in connection with passing along material non-public information.<sup>166</sup> In other words, Slawson, a remote tippee, hewed to the definition of tipper-tippee insider trading outlined in *Dirks*. In

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155. No. 1:14-CR-00186-RWS-JFK, 2014 WL 5804191 (N.D. Ga. Nov. 7, 2014).

156. *Id.* at \*1.

157. *Id.*

158. *Id.* at \*10.

159. *Id.* at \*2.

160. *Id.* at \*1-2.

161. *Id.*

162. *Id.* at \*2.

163. *Id.* at \*1.

164. *Id.* at \*3.

165. *Id.*

166. *Id.*

response, the government argued that Slawson was not charged with violations of § 10(b) or Rule 10b-5.<sup>167</sup>

The magistrate judge agreed with the government, holding that the indictment properly presented the essential elements of the charges.<sup>168</sup> The court noted that Slawson relied on statutes, regulations, and case law interpreting § 10(b) and Rule 10b-5, yet Slawson failed to offer “a single legal authority applying that case law to the Title 18 securities fraud violations alleged in th[e] indictment.”<sup>169</sup> For that reason, the magistrate held that there was no reason to import the definitions of tipper-tippee insider trading as litigated under § 10(b) and Rule 10b-5 into a case wherein only § 1348 securities fraud had been charged.<sup>170</sup> The magistrate judge’s Report and Recommendation was later approved and adopted as the opinion of the trial court.<sup>171</sup>

## 2. *United States v. Melvin*<sup>172</sup>

The *Melvin* case builds upon *Slawson* and involved another instance wherein prosecutors charged insider trading under § 1348 but declined to charge violations of § 10(b) or Rule 10b-5. Like *Slawson*, the *Melvin* court involved a report and recommendation from a magistrate judge in the Northern District of Georgia;<sup>173</sup> that report was then reviewed by the district court judge.<sup>174</sup> Melvin was a CPA in Georgia, and his codefendants, Berry, Cain, and Jinks, were clients and friends.<sup>175</sup> Melvin also provided accounting services to one of the board members of Chattem, Inc., an over-the-counter

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167. *Id.* at \*4.

168. *Id.* at \*8.

169. *Id.* at \*6. The court in a later section of its opinion, denying Slawson’s motion for a bill of particulars, reiterated this sentiment:

Again, Defendant relies primarily on case law involving allegations of wrongdoing pursuant to the Security Exchange Act, from outside this district, to argue that the information he seeks is necessary for an ‘insider trading case.’ Defendant’s arguments are undermined by his continued misplaced reliance on decisions addressing charges and based on statutes and regulations not at issue in this case.

*Id.* at \*11 (internal citations omitted).

170. *Id.* at \*6–7.

171. *Id.* at \*20.

172. 143 F. Supp. 3d 1354 (N.D. Ga. 2015).

173. *United States v. Melvin*, No. 3:14-cr-00022–TCB–RGV, 2015 WL 7116737, at \*1 (N.D. Ga. May 27, 2015).

174. *Melvin*, 143 F. Supp. 3d at 1360.

175. *Id.* at 1360–61.

pharmaceutical manufacturer.<sup>176</sup> Chattem entered discussions with Sanofi-Aventis, a large French pharmaceutical company, about a potential acquisition.<sup>177</sup> Melvin learned of the upcoming acquisition through his interactions with the board member of Chattem and then disclosed the information to the codefendants.<sup>178</sup>

Melvin moved to dismiss the indictment for failure to allege a crime, among other reasons.<sup>179</sup> Melvin and his codefendants argued that the indictment failed to allege that Melvin received a personal benefit from the disclosure of information, as required by the insider trading jurisprudence under Rule 10b-5.<sup>180</sup> The magistrate judge, relying upon *Slawson*, “decline[d] to impose on the charges set forth in the indictment the requirement to plead elements of offenses not charged in the indictment.”<sup>181</sup> The district court judge affirmed, noting that defendants “ha[d] not offered any authority that expressly indicates the elements required to prove an insider trading violation under § 10(b) and Rule 10b-5 should be imported into § 1348.”<sup>182</sup> Moreover, the district judge underscored that the purpose of § 1348 was to “broaden the range of conduct proscribed by existing federal securities laws” and that the statute “was modeled on the mail and wire fraud statutes, not on the Exchange Act.”<sup>183</sup>

Despite the court’s clear language refusing to consider the elements of § 10(b) in a § 1348 case, the district court, unnecessarily, went on to state that the indictment likely would not fail even if the court incorporated the elements of § 10(b) and Rule 10b-5.<sup>184</sup> The court relied upon the *O’Hagan* misappropriation theory<sup>185</sup> to discredit defendants’ argument that the Chattem board member, not Melvin, was the actual tipper.<sup>186</sup> Then the court waded further into a discussion of Rule 10b-5 elements when addressing defendants’ reliance upon *Newman* and the failure of the indictment to allege any personal

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176. *Id.* at 1361.

177. *Id.*

178. *Id.*

179. *United States v. Melvin*, No. 3:14-cr-00022-TCB-RGV, 2015 WL 7116737, at \*1, \*8 (N.D. Ga. May 27, 2015).

180. *Id.* at \*8.

181. *Id.* at \*9 (quoting *United States v. Slawson*, No. 1:14-CR-00186-RWS-JFK, 2014 WL 5804191, at \*7 (N.D. Ga. Nov. 7, 2014)).

182. *Melvin*, 143 F. Supp. 3d at 1374.

183. *Id.* at 1375 (internal citation omitted).

184. *Id.*

185. *See United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (holding that the misappropriation theory applies where an individual misappropriates confidential information for the purpose of trading in a security in violation of a duty owed to the source of the information).

186. *Melvin*, 143 F. Supp. 3d at 1375.

benefit.<sup>187</sup> The court shrugged off *Newman* as “not binding authority” and stated that it would use the *Dirks* definition of a benefit, which can include enhancement of one’s reputation or a gift to a trading relative or friend.<sup>188</sup> Thus, despite holding that the elements of § 10(b) and Rule 10b-5 are irrelevant to charges brought under § 1348, the court nevertheless undertook the intellectual exercise of grappling with the definitions of insider trading as elucidated under § 10(b) and Rule 10b-5.

These cases represent the bare landscape of cases in which insider trading charges were brought under § 1348 rather than Rule 10b-5, and the court in both instances made clear that importation of Rule 10b-5 elements into § 1348 interpretation was inappropriate.

### III. THE INTERPLAY BETWEEN § 1348 AND RULE 10B-5

The *Blaszczak* case brings up a few distinct issues with respect to the intersection between § 1348 and Rule 10b-5. The first is one of double-charging, or multiplicity of charges. The second involves the connection between Rule 10b-5 charges for insider trading and mail and wire fraud charges for insider trading. Finally, and likely most significant, is whether the *Blaszczak* court erred by not importing definitions and principles specific and unique to insider trading that have been fleshed out in Rule 10b-5 jurisprudence. This Part addresses these matters in turn.

#### A. Multiplicity of Charges

The *Blaszczak* case involved charges of both §§ 1348 and 10(b), but the jury only convicted the defendants on violations of § 1348. This is a marked difference from the two Georgia cases listed above, *Slawson* and *Melvin*, which did not include a § 10(b) charge at all.<sup>189</sup> In the case of *Blaszczak*, where prosecutors charge Rule 10b-5 criminally, as well as § 1348, there is a potential risk of multiplicity of charges; that is, charging a defendant under different statutes for the exact same conduct, without an additional fact.

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187. *Id.* at 1376.

188. *Id.*

189. Although the *Slawson* case did not involve a criminal Rule 10b-5 charge, *Slawson* also raised the issue of double jeopardy in relation to the SEC’s attendant civil suit that followed on the heels of his criminal conviction. *Slawson*’s argument failed because there is no double jeopardy risk when one of the matters is a civil action. Double jeopardy only applies to multiple criminal actions. That said, it is true that a Rule 10b-5 case can be brought as either a civil or criminal action. For this reason, *Slawson*’s argument ultimately failed. *See infra* notes 183–93 regarding double jeopardy issues at play between § 10(b) and § 1348 charges.

Another recent case out of the Northern District of Georgia addressed this very issue. In *United States v. Ying*, the government charged Ying with both § 1348 and § 10(b) violations in relation to trades in Equifax.<sup>190</sup> Ying's case was one of classical insider trading, not tipper-tippee. In his motion to dismiss, Ying raised the issue that his indictment was multiplicitous because it charged Ying with the same offense in two separate counts, in violation of the *Blockburger* rule.<sup>191</sup> Citing *Blockburger*, the court stated that the test establishes that each provision or count requires proof of a fact that the other does not.<sup>192</sup> The district court affirmed the magistrate's ruling on the motion to dismiss, noting that the magistrate had determined that a violation of § 10(b) requires proof of willfulness, whereas a violation of § 1348 does not.<sup>193</sup>

In appealing the magistrate ruling, Ying relied upon an Eleventh Circuit case that stated that a conviction for aiding and abetting bank fraud requires "the same willfulness and unlawful intent as the actual perpetrators of the fraud" to show that willfulness is required for the sister provisions § 1348, including mail, wire, and bank fraud.<sup>194</sup> Adopting somewhat circular reasoning, the court rejected Ying's argument, stating that Ying had cited no legal authority that "finds that § 1348 *does* require proof of willfulness."<sup>195</sup> Moreover, the court explained, the precedent upon which Ying relied did not

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190. No. 1:18-CR-74-AT, 2018 WL 6322308, at \*1 (N.D. Ga. Dec. 4, 2018). The *Ying* case is most interesting in light of another issue that is beyond the scope of this paper but that I will briefly describe here. Ying was an employee of Equifax who was never told about the Equifax data breach. Rather, Equifax had explicitly lied to Ying and told him that the data breach he was working on was for an Equifax client. As Ying, Chief Information Officer, was working on the hypothetical breach, he allegedly "put 2 and 2 together" and sold his stock prior to the public announcement of the data breach, thereby avoiding losses of over \$117,000. This case marks one of the only times the government has moved forward on an insider trading charge with the theory of "constructive knowledge" imputed to an insider, and that knowledge being the basis of the insider trading charge. Daniel A. Goldfried, *Does United States v. Ying Expand the Knowledge Requirement for "Classical" Insider Trading?*, SUBJECT TO INQUIRY (Apr. 2, 2018), <https://www.subjecttoinquiry.com/enforcement-and-prosecution-policy-and-trends/does-united-states-v-ying-expand-the-knowledge-requirement-for-classical-insider-trading/> [<https://perma.cc/Z4VD-X8NP>].

191. *Blockburger v. United States*, 284 U.S. 299, 303–04 (1932) (establishing a test to determine whether two statutory provisions prohibit the same conduct, which would violate the Double Jeopardy Clause); *Ying*, 2018 WL 6322308, at \*6. See generally Abram Olchyk, *A Spoof of Justice: Double Jeopardy Implications for Convictions of Both Spoofing and Commodities Fraud for the Same Transaction*, 65 AM. U. L. REV. 239, 245 (2015).

192. *Ying*, 2018 WL 6322308, at \*6.

193. *Id.*

194. *Id.* (quoting *United States v. Teers*, 591 F. App'x. 824, 843 (11th Cir. 2014)).

195. *Id.* (emphasis in original).



involve a charge under § 1348.<sup>196</sup> Ultimately, the court held that the lack of the word “willful” in the plain language of § 1348 stands in direct contrast to the presence of the word “willful” in § 10(b).<sup>197</sup> That difference, according to the court, was enough to render § 1348 and § 10(b) different charges for purposes of the *Blockburger* test.

In *Ying*, the magistrate judge relied upon another unreported case that highlighted that criminal liability requires a showing of willfulness under Rule 10b-5 but not under § 1348.<sup>198</sup> Indeed, the *Ying* interpretation of the overlap between § 1348 and § 10(b) has some followers. Two former acting chiefs of the DOJ Fraud Division penned an article in October 2018 lauding § 1348 as “a workhorse statute for prosecutors.”<sup>199</sup> In that article, they highlight that one of the differences and benefits for charging § 1348 is that the mens rea requirement “appears to be lower” than a criminal violation of Rule 10b-5 because § 1348 merely requires that a defendant act “knowingly,” whereas Rule 10b-5 prosecutions require proof of willfulness.<sup>200</sup> The fraudulent intent required for § 1348 prosecutions, like mail and wire fraud prosecutions, “may be inferred from the scheme itself.”<sup>201</sup>

While the issue of multiplicity of charges seems to be settled by the plain reading of the statutes, congressional intent, and language from a few—albeit unreported—cases, the issue that repeatedly comes to the fore is when courts should look to definitions and interpretations of securities fraud under § 10(b) or to the precedence established under mail and wire fraud statutes, discussed below.

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196. *Id.*

197. *Id.*

198. *Id.* (citing *United States v. Hussain*, No. 16-cr-00462-CRB-1, 2017 WL 4865562, at \*8 (N.D. Cal. Oct. 27, 2017)).

199. See Moser & Weitz, *supra* note 21, at 111.

200. *Id.* at 121 (citing *Ratzlaf v. United States*, 510 U.S. 135, 136–37 (1994) (noting that “the willfulness requirement mandates something more . . . ‘the Government must prove that the defendant acted with knowledge that his conduct was unlawful’”). Moser and Weitz suggest that this difference in mens rea requirements is consistent with the congressional intent of § 1348. *Id.* at 121 n.32 (citing COMM. ON THE JUDICIARY, THE CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY ACT OF 2002, S. REP. NO. 107-146, at 6 (2002) (“[P]rosecutors may charge a willful violation of certain specific securities laws or regulations, but such regulations often contain technical legal requirements, and proving willful violations of these complex regulations allows defendants to argue that they did not possess the requisite criminal intent. There is no logical reason for imposing such awkward and heightened burdens on the prosecution of criminal securities fraud cases.” (quoting S. REP. NO. 107-146, at 6 (2002))).

201. *Id.* (quoting *United States v. Motz*, 652 F. Supp. 2d 284, 296 (E.D.N.Y. 2009)).

*B. Elephants in the Room: Mail and Wire Fraud Charges for Insider Trading and the Misappropriation Theory*

There is a viable argument that the potential end-around of § 10(b) insider trading via § 1348 is not a novel strategy.<sup>202</sup> Prosecutors have long been able to charge insider trading under mail and wire fraud, §§ 1341, 1343, upon which § 1348 was modeled.<sup>203</sup> The following discussion addresses the instances wherein courts have allowed liability for mail and wire fraud in conjunction with Rule 10b-5 charges for insider trading, premised upon the misappropriation theory.

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202. William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping*, 70 U. MIAMI L. REV. 220, 234 (2015).

203. *Id.* at 227 n.16. (listing the number of cases charging insider trading in conjunction with mail and wire fraud charges). The text of the mail and wire fraud statutes is, unsurprisingly, markedly similar to that of § 1348. Section 1341 states,

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both.

18 U.S.C. § 1341 (2018).

Similarly, the text for § 1343 states:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.

18 U.S.C. § 1343 (2018).

1. *Carpenter v. United States*

The 1987 Supreme Court case of *Carpenter v. United States* is one of the most significant cases wherein mail and wire fraud charges were brought, along with § 10(b) charges, for insider trading activity.<sup>204</sup> In *Carpenter*, one of the defendants was a reporter for the *Journal* who regularly interviewed corporate executives in order to write summaries about various stocks in a column called “Heard on the Street.”<sup>205</sup> None of the information in the *Journal* articles contained inside information, but the “Heard on the Street” column had the potential to affect the price of the stocks that it discussed.<sup>206</sup> At issue in *Carpenter* was the fact that the information in “Heard on the Street” was the *Journal*’s confidential information.<sup>207</sup> The defendants entered into a scheme to trade on the information that would be “Heard on the Street” prior to publication and netted profits of nearly \$690,000.<sup>208</sup>

The defendants argued that they had not engaged in a scheme to defraud, nor had they obtained any money or property from the *Journal*, as is required under the mail and wire fraud statutes.<sup>209</sup> Further, the defendants argued that the *Journal* did not have any interest in the securities that were traded; that is, the *Journal* was not a buyer or seller of the stocks.<sup>210</sup> Thus, defendants argued that § 10(b) should not apply because the *Journal* was only the alleged victim of a fraud and therefore could not meet the element that this activity was “in connection with a purchase or sale of securities.”<sup>211</sup> The district court found that the breach of confidentiality by the author of “Heard on the Street” by misappropriating prepublication information was sufficient to constitute a breach of § 10(b).<sup>212</sup> The Second Circuit affirmed.<sup>213</sup> Likewise, the Second Circuit also affirmed the mail and wire convictions based upon the misappropriated property interest in the information, which fell within the elements of the mail and wire statutes.<sup>214</sup>

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204. 484 U.S. 19, 21–22 (1987).

205. *Id.* at 22.

206. *Id.* at 27–28.

207. *Id.*

208. *Id.* at 23.

209. *Id.* at 25. Defendants relied upon the holding in *McNally v. United States*, 483 U.S. 350, 360 (1987), which established that the mail fraud statute is limited to the protection of property rights, not intangible rights.

210. *Carpenter*, 484 U.S. at 24.

211. *Id.* at 22–24.

212. *Id.* at 25–26.

213. *Id.* at 22–24.

214. *Id.*

The Supreme Court was evenly split on the decision regarding the § 10(b) charges<sup>215</sup> and therefore affirmed the Second Circuit's holding that found the defendants liable for insider trading under § 10(b).<sup>216</sup> Interestingly, despite being evenly split on the § 10(b) charges, the Court was unanimous in upholding the convictions for mail and wire fraud. Specifically, the Court affirmed the Second Circuit's opinion that the *Journal's* confidential business information was the property of the *Journal*.<sup>217</sup> The Court stated that a scheme to defraud does not require monetary loss; rather, it "is sufficient that the Journal has been deprived of its right to exclusive use of the information, for exclusivity is an important aspect of confidential business information."<sup>218</sup>

The *Carpenter* case and its progeny tees up a question about the necessity for § 1348. Meaning, securities fraud would fall under mail and wire fraud whenever the defendant used either the mail or the wires; therefore, how is § 1348 not always superfluous? The answer perhaps lies in the plain reading of the statutes. Section 1348 prohibits securities fraud by requiring the fraud to be linked to the sale of a security. In addition, the statute of limitations is different for § 1348 than it is for §§ 1341 and 1343.<sup>219</sup>

Despite the outcome of *Carpenter* and the high-profile victory for the government in charging mail and wire fraud for insider trading, there have been a number of notable insider trading cases that did not include additional charges of mail and wire fraud.<sup>220</sup> Among those are both the *Newman* and *Martoma* cases.<sup>221</sup> More interestingly, another high-profile defendant, Raj Rajaratnam, was never charged with any Title 18 offenses, despite having a

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215. The court was split 4-4 because Justice Powell, who argued to grant certiorari in order to reject the misappropriation theory, retired before the case was argued. Interestingly, Powell had written at the cert stage that *Carpenter's* conduct was not illegal because there was no duty of trust or confidence between the parties to the transaction in *Carpenter*. See *Fair to All People: the SEC and the Regulation of Insider Trading*, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, [http://www.sechistorical.org/museum/galleries/it/counterAttack\\_d.php](http://www.sechistorical.org/museum/galleries/it/counterAttack_d.php) [https://perma.cc/464A-5BC5].

216. *Carpenter*, 484 U.S. at 24.

217. *Id.* at 26 (citing *Ruckelshaus v. Monsanto*, 467 U.S. 986, 1001-04 (1984); *Dirks v. SEC*, 463 U.S. 646, 653 (1983); *Bd. of Trade of Chi. v. Christie Grain & Stock Co.*, 198 U.S. 236, 250-51 (1905) (for the principle that confidential business information is recognized as property)).

218. *Id.* at 26-27. *Carpenter* paved the way for the property-rights theory of misappropriation, which was enconced in the law in *United States v. O'Hagan*, 521 U.S. 642, 677-78 (1997). Because the *Carpenter* court was split 4-4, thereby affirming the Second Circuit through inertia, the *O'Hagan* case cemented the misappropriation theory in 1997.

219. Moser & Weitz, *supra* note 21, at 122.

220. See Abramowitz & Sack, *supra* note 148 (listing recent high-profile insider trading cases that did not include a Title 18 charge, such as *United States v. Rajaratnam*, *United States v. Goffey*, *United States v. Gupta*, *United States v. Newman*, *United States v. Martoma*).

221. *Id.*

judge order a wiretap and electronic surveillance based on predicate Title 18 offenses, including mail fraud and money laundering.<sup>222</sup>

A broader question is whether the *Carpenter* decision is correct in its seemingly bifurcated definition of fraud. The Court rendered a unanimous decision that Carpenter was guilty of mail and wire fraud, while punting on whether he was guilty of securities fraud. In other words, according to the *Carpenter* Court, “fraud” under the mail and wire statute did not mean the same thing as it did under § 10(b). Notably, Powell’s absence on the Court was the reason that the Second Circuit’s conviction for § 10(b) was upheld due to a divided court, yet we know from Powell’s cert opinion that he was against the imposition of § 10(b) liability for Carpenter.<sup>223</sup>

## 2. *United States v. O’Hagan*

The somewhat shaky theory decided by a split court underlying the insider trading conviction in *Carpenter* was further ensconced in the law through the *O’Hagan* decision in 1997.<sup>224</sup> O’Hagan was a partner at Dorsey & Whitney law firm.<sup>225</sup> Dorsey & Whitney represented Grand Metropolitan PLC (Grand Met) in Grand Met’s tender offer for the common stock of Pillsbury Company.<sup>226</sup> O’Hagan was not involved in the Grand Met takeover representation but learned of it through conversations with a Dorsey & Whitney partner handling the representation.<sup>227</sup> O’Hagan then purchased stock in the target company, Pillsbury, prior to the announcement of the tender offer and made a profit of over \$4.3 million.<sup>228</sup> Under these facts, O’Hagan was not an insider of the company in which he traded, nor did he owe Pillsbury or its shareholder a duty of trust or confidence. For this reason, the classical theory of insider trading under *Chiarella* and *Dirks* would not have supported prosecution for insider trading.<sup>229</sup>

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222. *Id.* (citing *United States v. Rajaratnam*, No. 09-Cr-1184, 2010 WL 4867402, at \*4 (S.D.N.Y. Nov. 24, 2010) (denying the defense’s motion to suppress the evidence gained from the wiretap)).

223. See *Fair to All People: the SEC and the Regulation of Insider Trading*, *supra* note 215; see also Pritchard, *supra* note 7, at 58.

224. *United States v. O’Hagan*, 521 U.S. 642, 646–47 (1997).

225. *Id.* at 647.

226. *Id.*

227. *Id.* at 648 n.1.

228. *Id.* at 648.

229. See Donna Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1, 18 (2016).

Justice Ginsburg, writing for the majority, upheld O'Hagan's conviction for insider trading under the misappropriation, or embezzlement, theory that O'Hagan breached a duty of loyalty to the source of the information (his law firm) in connection with a purchase or sale of a security.<sup>230</sup> Justice Ginsburg underscored that the "fraud on the source" theory was in line with the purpose of securities laws to promote investor confidence and ensure honest securities markets.<sup>231</sup> In doing so, Justice Ginsburg moved away from the Powell jurisprudence and seemingly back to a general fairness principle detailed in the pre-*Chiarella* opinions.<sup>232</sup>

*O'Hagan* was not a tipper-tippee case but instead was an "outsider" trading case because O'Hagan did not have any relation to the company in whose stock he traded. Professor Donna Nagy points out that the *O'Hagan* logic can be extended to include tippers as misappropriators.<sup>233</sup> However, for *tippees*, the government must prove the breach of a duty to the owner of the misappropriated information by the tipper, *and the knowledge that the tipper had breached that duty*.<sup>234</sup>

Three Justices dissented in *O'Hagan*. Interestingly, Justice Scalia suggested that the rule of lenity should apply § 10(b) to require the manipulation or deception of a *party* to the securities transaction.<sup>235</sup> Justice Thomas, with whom Chief Justice Rehnquist joined in dissent, argued that the fraud on the source was not sufficiently linked to the securities transaction. In other words, Justice Thomas wrote that even the government conceded that had O'Hagan merely stole funds with which he bought stock, rather than information, there would not be a sufficient nexus to show a violation of § 10(b)'s requirement of "in connection with the sale or purchase of a security."<sup>236</sup>

Most importantly for purposes of this paper, however, is Justice Thomas's final two paragraphs in dissent, in which he states, "With regard to respondent's convictions on the mail fraud counts, my view is that they may be sustained regardless of whether respondent may be convicted of the

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230. *O'Hagan*, 521 U.S. at 653.

231. *Id.* at 658.

232. *Id.*; Nagy, *supra* note 229, at 19; *see also* Bainbridge, *supra* note 6, at 1648 (suggesting that *O'Hagan* represents a reversion to the "equal access" theory of insider trading).

233. Nagy, *supra* note 229, at 20.

234. *Id.* (citing *United States v. Falcone*, 257 F.3d 226, 234 (2d Cir. 2001)). Justice Sotomayor authored this opinion when she was a member of the Second Circuit.

235. *O'Hagan*, 521 U.S. at 679 (Scalia, J., concurring in part and dissenting in part); *see also infra* Part IV.C. (discussing the application of the rule of lenity).

236. *O'Hagan*, 521 U.S. at 681–82 (Thomas, J., concurring in part and dissenting in part).

securities fraud counts.”<sup>237</sup> Thomas then states that he does not see much factual difference between *O’Hagan* and *Carpenter* on that point and would have held that it is not problematic that the mail fraud and securities fraud counts are predicated on the same factual basis.<sup>238</sup> Herein lies a potential issue. “Fraud” under § 10(b), in Justice Thomas’s mind, did not exist in *O’Hagan*. Fraud under § 1343, however, did. Arguably, had the government charged § 1348 (had it existed at the time of *O’Hagan*), it follows that Thomas and his other dissenters may have held *O’Hagan* guilty for general securities fraud under that statute.

### C. Importing § 10(b) Jurisprudence into § 1348 Caselaw

As discussed in Part II, the *Blaszczak*, *Slawson* and *Melvin* cases represent the first cases wherein a court considered whether the elements of § 10(b) should be applied to § 1348 charges.<sup>239</sup> In all of those cases, the court held that there was no reason to consider elements outside of those required for the charge of securities fraud under § 1348. Three other cases suggest some overlap of § 10(b) and § 1348 may occur. These cases do not involve insider trading but are informative examples of when courts have borrowed from § 10(b), or mail, wire, or honest services fraud found in Title 18, in interpreting § 1348.

#### 1. *United States v. Hussain*<sup>240</sup>

Sushovan Hussain was the chief financial officer for Autonomy Corporation plc, a British software company bought by Hewlett-Packard (“HP”) for \$11 billion in 2011.<sup>241</sup> Within a year of the acquisition, HP alleged that Autonomy had committed accounting fraud and had “cooked the books” prior to the acquisition, resulting in HP writing off \$8.8 billion.<sup>242</sup> Hussain was charged with fourteen counts of wire fraud, § 1343, one count of conspiracy to commit wire fraud, § 1349, and one count of securities fraud, § 1348.<sup>243</sup> Hussain moved to dismiss the indictment on a number of grounds,

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237. *Id.* at 700.

238. *Id.* at 700–01 (“[J]ust because those facts are legally insufficient to constitute securities fraud does not make them legally insufficient to constitute mail fraud.”).

239. *See supra* Part II and accompanying notes.

240. No. 16-cr-00462-CRB-1, 2017 WL 4865562, at \*1 (N.D. Cal. Oct. 27, 2017).

241. *Id.*

242. *Id.*

243. *Id.*

including improper extraterritorial application of U.S. laws, but significant for this Article was Hussain’s argument that the misrepresentations related to Autonomy’s financial condition were “too remote from any purchase or sale of HP securities to satisfy the requirement that the fraud be ‘in connection with . . . any security.’”<sup>244</sup>

Importantly, the district court for the Northern District of California stated, “There are few decisions interpreting this requirement. However, Hussain and the government agree that courts should look to the securities fraud provision of the Exchange Act in construing § 1348.”<sup>245</sup> In doing so, the court noted that the “in connection with” language of § 1348 is “meant to reach at least as much conduct as the Exchange Act’s similar requirement.”<sup>246</sup>

Next, the court turned to the legislative history of Sarbanes-Oxley in order to assist its interpretation of § 1348<sup>247</sup> and quoted Senator Leahy’s comment that § 1348 was “intended to provide needed enforcement flexibility in the context of publicly traded companies to protect shareholders and prospective shareholders against all the types of schemes and frauds which inventive criminals may devise in the future.”<sup>248</sup> The court noted that § 1348 provides “broad-textured language” to assist in prosecuting securities fraud “while foregoing the Exchange Act’s requirement that it first specify particular violations through rulemaking . . . . Accordingly, the Court looks to cases decided under Exchange Act § 10(b) and the rules passed under that statute in construing the nexus to securities required under 18 U.S.C. § 1348.”<sup>249</sup>

The *Hussain* court proceeded to list the elements a plaintiff must prove in order to recover damages under § 10(b) in a private right of action: (1) material misrepresentation or omission by defendant; (2) scienter; (3) connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.<sup>250</sup> The court noted that the government in a criminal matter does not need to prove reliance “because ‘reliance is relevant only to the identification of the private persons entitled to bring

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244. *Id.* at \*6 (citing 18 U.S.C. § 1348 (2018)).

245. *Id.*

246. *Id.* at \*6–7 (citing 15 U.S.C. §§ 78j(b), 78ff (2018) (noting that the Exchange Act’s language is “in connection with *the purchase or sale of securities*”) (emphasis added)).

247. *Id.* at \*7 (citing 148 CONG. REC. S7418, S7419–20 (daily ed. July 26, 2002) (statement of Sen. Leahy)).

248. *Id.* at \*7.

249. *Id.* (citing 148 CONG. REC. S7418, S7420–21 (daily ed. July 26, 2002) (statement of Sen. Leahy)).

250. *Id.* (citing *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2407 (2014)).



suit.”<sup>251</sup> Likewise, the government does not need to establish loss because there is no issue of standing in a criminal matter and because the purpose of a criminal prosecution is deterrence rather than compensation.<sup>252</sup> While acknowledging that § 1348 does not require proof of willfulness, “[t]he elements are otherwise the same in civil and criminal actions brought under 10b-5.”<sup>253</sup>

Hussain argued that he could not be liable for the misrepresentation because he did not receive any benefit for it.<sup>254</sup> Hussain relied upon *United States v. Mahaffy* in stating that § 1348’s nexus to a security requirement is satisfied where “as a result of the scheme, the defendants either benefitted, or attempted to benefit, from trading in securities.”<sup>255</sup> The court rejected Hussain’s argument by noting that the *Mahaffy* condition of a benefit is not a necessary one, and, more specifically, applied to liability for insiders divulging non-public information, and cited *Dirks* as standing for that principle.<sup>256</sup> As such, the *Hussain* court ignored the *Mahaffy* precedent by stating that “this case does not allege insider trading.”<sup>257</sup>

This statement, of course, begs the question that insider trading under § 1348 perhaps does require proof of a benefit as outlined in *Dirks*. The major takeaway from the *Hussain* case is that the court underwent a deep dive into Rule 10b-5 jurisprudence in order to interpret and apply the standards for § 1348. The court did not take the tack that the *Slawson* and *Melvin* courts did, which looked only at the elements of § 1348 in their plain language.

Finally, Hussain argued that § 1348 is unconstitutionally vague, a claim that the court dismissed, but the substance of which is considered below.<sup>258</sup> Importantly, the *Hussain* court dismissed this argument by stating that the defendant had sufficient notice of § 1348. “The government has been prosecuting criminal securities fraud for a long time. Combined with the plain language of § 1348, the cases decided under § 10(b) . . . sufficed to put Hussain on notice of the government’s theory here.”<sup>259</sup>

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251. *Id.* (quoting *United States v. Vilar*, 729 F.3d 62, 88 (2d Cir. 2013)).

252. *Id.* (citing *SEC v. Apuzzo*, 689 F.3d 204, 212 (2d Cir. 2012); *United States v. Berger*, 587 F.3d 1038, 1043 (9th Cir. 2009)).

253. *Id.*

254. *Id.* at \*8.

255. *Id.* (quoting *United States v. Mahaffy*, No. 05-CR-613, 2006 WL 2224518, at \*11 (E.D.N.Y. Aug. 2, 2006)).

256. *Id.* (citing *Dirks v. SEC*, 463 U.S. 646, 662 (1983)).

257. *Id.*

258. *See supra* Part III.C.3.

259. *Hussain*, 2017 WL 4865562, at \*9.

2. *United States v. Mahaffy*<sup>260</sup>

The defendant in *Hussain* relied upon *Mahaffy*, and the facts and holding of *Mahaffy* are informative for purposes of this Article. In *Mahaffy*, defendants ran a front-running scheme, meaning that the day trading defendants bought information from the defendant stockbrokers; the day traders then purchased or sold securities before the institutional clients of the stockbrokers purchased or sold large blocks of the same securities.<sup>261</sup> Specifically, the stockbrokers allowed the day traders to listen secretly to the brokerage firms' internal broadcasts concerning large orders. These broadcasts were on internal speaker systems known as "squawk boxes."<sup>262</sup> Defendants were charged with, among other things, violating § 1348, and they moved to dismiss the indictment for failure to allege that defendants "intended to cause an economic loss to any holder or putative holder of the securities at issue."<sup>263</sup>

The court began its analysis by stating that the government needed only to prove a violation of § 1348(1), which requires proof of only three elements: (1) fraudulent intent; (2) a scheme or artifice to defraud; and (3) a nexus with a security.<sup>264</sup> Regarding defendants' argument that there was no cognizable victim in the scheme, the court stated that the statute does "not restrict, or even contemplate, the status of the victim."<sup>265</sup> Rather, it was sufficient that the Indictment alleged that the defendants intended to defraud "any person in connection with any security."<sup>266</sup> The court clarified this by stating that the requirement that the scheme "be 'in connection' with a security is satisfied where as a result of the scheme, the defendants either benefitted, or attempted to benefit, from trading in securities."<sup>267</sup> Analogizing to § 1347, preventing health care fraud, the court noted that Congress intended for the statute to

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260. No. 05-CR-613, 2006 WL 2224518, at \*1 (E.D.N.Y. Aug. 2, 2006).

261. *Id.*

262. *Id.* at \*3.

263. *Id.* at \*12.

264. *Id.*

265. *Id.*

266. *Id.* (emphasis in original); see also *United States v. Hatfield*, No. 06-CR-0550, 2009 WL 2182593, at \*4 (E.D.N.Y. July 22, 2009) ("The court finds that the 'in connection with' language in Section 1348 does not refer solely to the purchase or sale of securities specifically made by Defendant. Rather, Section 1348 is broad, and was not enacted to punish only the fraudulent obtainment of money or property in connection with Defendant's purchase or sale of any security."). Further, the *Hatfield* court stated, like § 10(b) of the Securities and Exchange Act of 1934, "[t]here is no requirement that an individual defendant actually buy or sell securities." *Id.* (quoting *United States v. Ferrarini*, 9 F. Supp. 2d 284, 297 (S.D.N.Y. 1998)).

267. *Mahaffy*, 2006 WL 2224518, at \*12 (citing *United States v. O'Hagan*, 521 U.S. 642 (1997)).

include a “wide range of conduct” as well as “not only . . . protect the holders of securities, but to prohibit all forms of fraudulent conduct associated with securities, regardless of who the conduct affects.”<sup>268</sup>

After addressing the “in connection with a security” element of § 1348, the court addressed the remaining two elements, (1) whether a scheme or artifice to defraud was properly alleged; and (2) whether the government alleged fraudulent intent. Regarding the first element, the court directly applied the case law related to § 1346, honest services fraud, as well as mail fraud.<sup>269</sup> The court analyzed *United States v. Rybicki*<sup>270</sup> to analogize to both honest services and mail fraud. “To apply Rybicki’s holding to a charge under 18 U.S.C. § 1348, it is necessary only to substitute ‘in connection with a security’ for ‘use the mails or wire to.’”<sup>271</sup> The court in *Mahaffy* then made clear that the fraud must include a “material misrepresentation or omission” under a broader standard than “reasonably foreseeable harm” but that neither standard “requires an actual economic loss nor an intent to economically harm.”<sup>272</sup> Rather, “[t]he materiality test only requires that the misrepresentation or omission ‘would naturally tend to lead or is capable of leading a reasonable employer to change its conduct.’”<sup>273</sup> This language makes sense in the context of honest services fraud but is more opaque in relation to securities fraud. The court attempted to clarify its rule by stating “[p]otential harm is the only prerequisite” given that economic harm is not required to prove the existence of a scheme or artifice to defraud.<sup>274</sup> The court held, therefore, that because the brokerage firms’ reputations would be damaged by the front-running scheme, the firms could face economic harm; thus, the element of “scheme or artifice to defraud” was met.<sup>275</sup>

Further, the court turned to the principle set forth in *Carpenter* that misappropriation of confidential business information, even without proof of monetary loss to victims, “can be sufficient to support mail and wire fraud—and by extension, securities fraud—convictions.”<sup>276</sup> The court also relied

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268. *Id.* (citing *United States v. Lucien*, 347 F.3d 45 (2d Cir. 2003) (analyzing § 1347 and the breadth of the health care fraud statute’s definition of victim)).

269. *Id.* at \*12–16 (noting that although the indictment did not allege a deprivation of the intangible right of honest services, “it need not for the Court to apply § 1346, because this section only provides a legal definition of criminal activity already encompassed and charged by the language tracking § 1348”).

270. 354 F.3d 124 (2d Cir. 2003).

271. *Mahaffy*, 2006 WL 2224518, at \*13.

272. *Id.* (citing *United States v. Vinyard*, 266 F.3d 320, 327–29 (4th Cir. 2001)).

273. *Id.* (citing *Rybicki*, 354 F.3d at 145).

274. *Id.* (citing *United States v. Coffey*, 361 F. Supp. 2d 102, 118 (E.D.N.Y. 2005)).

275. *Id.* at \*14–15.

276. *Id.* at \*14.

upon the fact that the brokers had failed to tell their firms that they were selling the information, which represented a breach of duty, thereby defrauding the firms and the firms' institutional clients of honest services.<sup>277</sup>

The court also carried over the application of § 1346 honest services fraud into its assessment of fraudulent intent. The court noted that the rule requires intent to deceive and intent to cause harm but also states that "fraudulent intent may be inferred from the scheme itself" when the result of the scheme is to injure others.<sup>278</sup> In the next sentence, the court stated with somewhat circular reasoning that when the scheme results in the deprivation of honest services (despite not being charged in *Mahaffy*), "[t]he only intent that need be proven . . . is the intent to deprive another of the intangible right of honest services."<sup>279</sup>

Importantly, the *Mahaffy* court also addressed defendant's argument about the rule of lenity in the application of § 1348.<sup>280</sup> Specifically, defendants alleged that the government was predicating criminal liability on alleged conduct that was "at best . . . on the far edges of the securities laws' scope."<sup>281</sup> In response, the court stated that the front-running scheme "might well have been charged either as a more general mail and wire fraud or a more specific 10-b(5) [sic] securities fraud."<sup>282</sup> The court acknowledged that it analyzed § 1348 "by analogy to similar crimes and similar statutes."<sup>283</sup> Because the fraud in *Mahaffy* was not tipper-tippee insider trading, the ultimate question is whether the same analogies and standards for that crime under § 10(b) should be imported for § 1348.

### 3. *SEC v. Stein*<sup>284</sup>

Unlike *Hussain* and *Mahaffy*, *SEC v. Stein* was not a criminal case. Nevertheless, this case is important because it stands for the principle that the defendant's criminal conviction under § 1348 allowed for summary judgment in the related civil case. In *Stein*, the defendant appealed a district court's grant of summary judgment in favor of the SEC. The SEC claimed the

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277. *Id.* at \*15. Again, the court substitutes honest services fraud as the standard for proving the existence of a fraud, and ostensibly (because it does not state this explicitly) relies upon the "in connection with a security" to apply that same standard to § 1348.

278. *Id.* at \*16 (citing *United States v. D'Amato*, 39 F.3d 1249, 1257 (2d Cir. 1994)).

279. *Id.* (citing *Rybicki*, 354 F.3d at 145).

280. *Id.* at \*18; see also *infra* Part IV.C (regarding analysis of the rule of lenity).

281. *Mahaffy*, 2006 WL 2224518, at \*18.

282. *Id.*

283. *Id.*

284. 906 F.3d 823, 834 (9th Cir. 2018).

defendant violated various securities laws and argued in its motion for summary judgment that the related criminal conviction against Stein for the same conduct precluded him from contesting the allegations at issue in the civil case.<sup>285</sup>

*Stein* was not an insider trading case. Defendant Michael Stein was an attorney who acted as purported outside counsel to Heart Tronics. Stein and the company engaged in a series of frauds involving false purchase orders with fictitious companies.<sup>286</sup> The frauds were designed to inflate Heart Tronic's stock price.<sup>287</sup> Concurrent with the SEC's case against Stein, the DOJ filed a criminal case against him for the same activity, charging him with three counts of securities fraud under § 1348, three counts of wire fraud, three counts of mail fraud, one count of conspiracy to commit mail and wire fraud, three counts of money laundering, and one count of conspiracy to obstruction of justice.<sup>288</sup> The DOJ then intervened in the SEC action to stay discovery pending the outcome of the criminal matter.<sup>289</sup> Stein was convicted by a jury on all counts.<sup>290</sup>

Following his conviction, the SEC moved for summary judgment, arguing that the "criminal conviction 'necessarily decided' the facts needed to establish [Stein's] liability in the related civil case."<sup>291</sup> The district court granted summary judgment in favor of the SEC. Stein appealed.<sup>292</sup> The Ninth Circuit considered whether the SEC could avail itself of the doctrine of "offensive nonmutual issue preclusion," which prevents "a defendant from relitigating the issues which a defendant previously litigated and lost against another plaintiff."<sup>293</sup>

The court reiterated that in order to claim that a prior criminal conviction should act as the basis for offensive preclusion, the following elements must be present:

- (1) the prior conviction was for a serious offense;
- (2) the issue at stake in the civil proceeding is identical to the issue raised in the prior criminal proceeding;
- (3) there was a full and fair opportunity to litigate the issue at the prior trial; and
- (4) the issue on which the

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285. *Id.* at 826.

286. *Id.*

287. *Id.*

288. *Id.* at 827.

289. *Id.*

290. *Id.* at 828.

291. *Id.*

292. *Id.*

293. *Id.* (citing *Syverson v. IBM Corp.*, 472 F.3d 1072, 1078 (9th Cir. 2007) (internal citations omitted)).

prior conviction is offered was actually litigated and necessarily decided at trial.<sup>294</sup>

As the court outlined, there are typically four factors to consider when deciding if the issues are identical for purposes of issue preclusion: (1) whether there is “substantial overlap between the evidence or argument to be advanced in the second proceeding and that advanced in the first”; (2) whether “the new evidence or argument involve[s] the application of the same rule of law as that involved in the prior proceeding”; (3) whether “pretrial preparation and discovery related to the matter presented in the first action reasonably can be expected to have embraced the matter sought to be presented in the second”; and (4) whether “the claims involved in the two proceedings” are closely related.<sup>295</sup>

With these rubrics in mind, the court determined that the same fraudulent scheme underpinned Stein’s criminal conviction and the § 10(b) claims brought by the SEC. In other words, the court concluded that “Stein’s conviction determined the identical issues the SEC was required to prove to establish Stein’s liability for securities fraud.”<sup>296</sup> More importantly for purposes of this Article, the court went on to state that “the SEC’s securities fraud claims involve the ‘application of the same rule of law’ as that involved in the criminal case.”<sup>297</sup>

The court noted under § 1348 that the jury was required to find “(1) a scheme or artifice to defraud, (2) with fraudulent intent, (3) in connection with any security.”<sup>298</sup> The court therefore held that “the DOJ proved beyond a reasonable doubt the same issues the SEC needed to prove only by a preponderance of the evidence. There is no difference in the applicable legal standards that would affect the outcome of the civil case.”<sup>299</sup>

Although the *Stein* case did not involve insider trading, it represents an important issue that could apply to insider trading § 10(b) cases. That is, if a defendant is found guilty for insider trading under § 1348, the SEC could move for summary judgment on § 10(b) insider trading claims under the same reasoning as was applied in *Stein*, thereby effectively doing an entire end-

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294. *Id.* (citing *Ayers v. City of Richmond*, 895 F.2d 1267, 1271 (9th Cir. 1990)).

295. *Id.* at 828–29 (citing RESTATEMENT (SECOND) OF JUDGMENTS § 27 cmt. c (AM. LAW INST. 1982)). “The assessment of the similarity of issues necessary to decide whether collateral estoppel should preclude relitigation of a particular issue varies with the facts of each case.” JACK H. FRIEDENTHAL, MARY KAY KANE & ARTHUR R. MILLER, CIVIL PROCEDURE § 14.10 (5th ed. 2015).

296. *Stein*, 906 F.3d at 830.

297. *Id.*

298. *Id.*

299. *Id.* Interestingly, the court was referring to the elements required under § 17(a) as closely related enough to those of § 1348.

around of the *Dirks* personal benefit test and its progeny. The following Part addresses this problematic collateral consequence of charging insider trading under § 1348.

#### IV. RAMIFICATIONS OF A NEW INSIDER TRADING STATUTE

Is § 1348 a sufficient fix to solving the issues surrounding insider trading? Do the headaches caused by the judicial interpretation of Rule 10b-5 dissipate if insider trading is charged only under § 1348 going forward? If not, how shall we go about solving the thorny issues surrounding insider trading? For starters, we need clarification on what the crime is and who the victim is. These two questions are inherently interrelated. If the crime is market unfairness, and the crime is one of fraud perpetrated on the market as a victim, then that would shape the prosecutorial strategy. If the crime is the theft of corporate information as a property right, and the victim therefore is the company, then that dictates, perhaps, a different prosecutorial approach.<sup>300</sup> These options, however, are not mutually exclusive. Both crimes could occur with both types of victims. The fact that all of these facets are lumped together under one nebulous, largely judicially created prohibition on insider trading is the reason that there is no quick fix. Given that the aforementioned questions attempt to tackle immense theoretical issues, it is worth looking at the issues specific to § 1348 that arise in the cases mentioned above. This Part addresses some of the ramifications of charging § 1348 in lieu of § 10(b). Finally, this Part looks at the rule of lenity, given the innumerable questions surrounding the crime of insider trading and the application of the laws prohibiting it, and suggests that the rule of lenity should apply to insider trading charges under § 1348.

##### *A. Inversion of Criminal and Civil Burdens of Proof for Insider Trading*

One issue with avoiding criminal insider trading charges under § 10(b) and instead opting to charge § 1348 is that the elements for § 1348 are less burdensome than for those of § 10(b). Because § 10(b) can be the basis of a civil suit brought by the SEC, the practical consequence of this burden

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300. Indeed, this was the issue upon which Judge Kearse dissented in *Blaszczak*. *United States v. Blaszczak*, 947 F.3d 19, 45–49 (2d Cir. 2019) (Kearse, J., dissenting). Judge Kearse was not convinced that the CMS information constituted property or a thing of value, nor that the government agency could be considered a victim of theft based on the facts. *Id.* at 47.

inversion is that it is much easier to convict for criminal securities fraud than it is for civil insider trading, despite both charges being brought from the same set of facts. This is precisely the outcome from *Blaszczak*.<sup>301</sup> The court affirmed the jury's determination that the defendants were guilty of violating § 1348 but not guilty on the § 10(b) claims because the jury did not find that the government had proven the existence of a personal benefit, as is required under § 10(b).<sup>302</sup>

This inversion of civil and criminal standards seemingly implicates foundational concepts of law.<sup>303</sup> Insider trading under § 10(b) is somewhat unique in that it can be brought under either a civil or criminal standard, but the test remains the same. This means that a civil action brought by the SEC under § 10(b) will be harder to prove, despite the lower burden of proof, than the criminal action brought under § 1348 for the same alleged activity. This seemingly distorts the purpose of criminal law<sup>304</sup> and hamstring the SEC as an agency that likely would not be able to bring many successful civil actions on insider trading, despite being tasked by Congress to maintain fairness of the securities markets.<sup>305</sup> William Stuntz's article on this point makes clear that there is inherent risk when legislators decide what is and what is not a crime, and then which procedures to apply.<sup>306</sup> He argues that there is significant risk for overcriminalization of activities when the legislature designates authority to prosecutors. Insider trading seems ripe for this type of criticism, given that the codified law itself is silent as to the activity, and one is left to wade through decades of common law under only § 10(b) to ascertain the parameters of the prohibited activity.<sup>307</sup>

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301. See *supra* Part II.A and accompanying notes.

302. *Id.*

303. See, e.g., Samuel W. Buell, *Culpability and Modern Crime*, 103 GEO. L.J. 547, 548 (2015) (outlining the purposes of criminal law and recognizing the need for courts to assess whether defendants were aware of normative wrongfulness or were merely negligent).

304. See generally William J. Stuntz, *Substance, Process, and the Civil-Criminal Line*, 7 J. CONTEMP. LEGAL ISSUES 1, 38–40 (1996).

305. This fact should not be understated. Insider trading affects markets and market fairness. To shift prosecution of insider trading to criminal enforcement bodies only could shift the role and purpose of the SEC. See, e.g., Karen E. Woody, *Conflict Minerals Legislation: The SEC's New Role as Diplomatic and Humanitarian Watchdog*, 81 FORDHAM L. REV. 1315, 1320–22 (2012) (describing the tripartite role of the SEC as authorized by Congress in the 1934 Securities Exchange Act).

306. Stuntz, *supra* note 304, at 1.

307. *Id.* at 16–18.



### B. Imputation of Liability in Civil Summary Judgment

A related issue to the inverted burdens of proof is the imputation of liability simply because of a criminal conviction. This is what happened in *SEC v. Stein*, discussed above.<sup>308</sup> In that case, the SEC was able to piggyback on the criminal conviction for securities fraud, albeit not for insider trading. As a result, the SEC moved for summary judgment based upon the criminal conviction arising from the same set of facts. If applied to § 10(b) insider trading cases, a conviction under § 1348 could serve as the basis for civil liability for insider trading without ever mentioning the *Dirks* test or the other fifty years of jurisprudence stemming from § 10(b).<sup>309</sup>

The writings of William Stuntz are informative on this point, as well.<sup>310</sup> When an overcriminalized activity has collateral effects in the civil realm, it seems that the function of the law is diluted if not entirely lost. The fact that the SEC can take up the mantle of additional civil prosecution on the heels of a criminal prosecution strikes one as a classic case of double jeopardy; yet, as was the case in *United States v. Ying*,<sup>311</sup> detailed above, there is no claim for double jeopardy when one of the matters at issue is a civil claim. That is, double jeopardy only attaches to a subsequent criminal action. Though this is certainly the black letter law, it is worthy of a harder look when seen through the lens of insider trading and the nebulous parameters for the prohibited activity.

The example of the *Stein* case suggests that insider trading precedent under § 10(b) is effectively a dead letter. The SEC will allow the DOJ to pursue the easier outcome of criminal liability under § 1348, and then take advantage of imputing the criminal conviction as proof for the civil action without ever addressing the elements of § 10(b) liability established by the courts for the past five decades.

### C. Rule of Lenity

The risk of an inverted standard for civil and criminal actions based on the same nucleus of facts suggests that a closer look should be given to § 1348, and one that may involve the statutory construction canons.<sup>312</sup> As noted

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308. See *supra* Part III.C and accompanying notes.

309. Indeed, the interplay and overlap between the SEC and DOJ on related matters can be problematic, particularly in insider trading cases and others.

310. Stuntz, *supra* note 304, at 38–40.

311. See *supra* Part III.A and accompanying notes.

312. See WILLIAM N. ESKRIDGE, JR., *INTERPRETING LAW: A PRIMER ON HOW TO READ STATUTES AND THE CONSTITUTION* 407–45 (2016); ANTONIN SCALIA & BRYAN A. GARNER,

above, the defendants in *Mahaffy* raised the issue of the rule of lenity.<sup>313</sup> Although *Mahaffy* was not a classic insider trading case but instead a case involving a front-running scheme, the argument that insider trading law, and the application of § 1348 in particular, is not clear and therefore should be afforded the rule of lenity is meritorious.<sup>314</sup>

The rule of lenity is “almost as old as the common law itself”<sup>315</sup> and instructs judges to construe ambiguous criminal statutes narrowly and in favor of the defendant.<sup>316</sup> In practicality, this means that when a criminal law is open to interpretation by the judiciary, a court must select the “less severe interpretation, absent clear and definite language by Congress.”<sup>317</sup>

The rule of lenity is analogous to *Chevron* deference afforded to agencies’ interpretations.<sup>318</sup> *Chevron* deference and its interplay with the rule of lenity is particularly apt when considering insider trading, given that insider trading can be prosecuted in the civil and criminal arenas, with the SEC as administrative agency bringing civil actions. In other words, the SEC’s interpretation and use of insider trading prohibitions would be afforded *Chevron* deference; likewise, the DOJ’s criminal actions for insider trading

READING LAW: THE INTERPRETATION OF LEGAL TEXTS 296–302 (2012); Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2106–07 (1990).

313. *United States v. Mahaffy*, No. 05-CR-613, 2006 WL 2224518, at \*18 (E.D.N.Y. Aug. 2, 2006); *supra* Part III.C and accompanying notes.

314. The *Mahaffy* court dismissed the defendants’ arguments about the rule of lenity applied to § 1348 by stating that

[t]he fact that a relatively new statute has been enacted to broadly address a particular subset of [mail, wire and securities] fraud—those which are conducted in connection with securities—does not provide a basis for concluding that the dishonesty and unlawfulness of such a scheme had been previously unknown in the minds of men.

*Mahaffy*, 2006 WL 2224518, at \*18. The court therefore held that the rule of lenity and due process concerns had no application because “construing [§ 1348] by analogy to similar crimes and similar statutes provides ample demonstration that this statute is far from ambiguous.” *Id.* Notably, the Second Circuit in *Blaszczak* cited *Mahaffy* as an example of the difference between the purposes of Title 15 and Title 18. *United States v. Blaszczak*, 947 F.3d 19, 35 (2d Cir. 2019).

315. ANTONIN SCALIA, *A MATTER OF INTERPRETATION* 29 (Amy Gutmann ed. 1997).

316. Intisar A. Rabb, *The Appellate Rule of Lenity*, 131 HARV. L. REV. F. 179, 180 (2018) [https://harvardlawreview.org/wp-content/uploads/2018/06/Vol131\\_Rabb.pdf](https://harvardlawreview.org/wp-content/uploads/2018/06/Vol131_Rabb.pdf) [<https://perma.cc/YFX4-PQFQ>] (responding to Abbe R. Gluck & Richard A. Posner, *Statutory Interpretation on the Bench: A Survey of Forty-Two Judges on the Federal Court of Appeals*, 131 HARV. L. REV. 1298 (2018)); Note, *The New Rule of Lenity*, 119 HARV. L. REV. 2420, 2421 (2006).

317. Liza B. Fleming, *Lenity Calling: A Plea To End Chevron Deference for Criminal Insider Trading Law*, 89 TEMP. L. REV. 579, 591–92 (2017); see also Anna Currier, *The Rule of Lenity and the Enforcement of Federal Securities Laws*, 5 AM. U. BUS. L. REV. 79, 96–98 (2015).

318. See generally *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–44 (1984); Rabb, *supra* note 316, at 183.

could require application of the rule of lenity. *Chevron* review involves a two-step process.<sup>319</sup> In the first step, the court must assess whether the meaning of the statute at issue is ambiguous or susceptible to multiple interpretations.<sup>320</sup> If the court answers that first inquiry in the affirmative, it then must determine whether the agency interpretation of the statute is reasonable.<sup>321</sup> *Chevron* deference requires courts to accept the agency interpretation if it is deemed reasonable. Similarly, the lenity framework requires a determination as to whether a challenged criminal statute (or a civil statute with criminal consequences, as is the case for § 10(b)) is open to multiple plausible interpretations.<sup>322</sup> If multiple interpretations exist, and statutory construction yields more than one plausible reading, “lenity would apply to require selection of the narrowest such reading.”<sup>323</sup>

When considering both *Chevron* deference and the rule of lenity as applying to civil or criminal insider trading under § 10(b), it seems both rubrics would be appropriate given the general ambiguity in recent case law surrounding the parameters of insider trading, particularly in cases involving remote tipper-tippees.<sup>324</sup> However, it is arguably even more appropriate for the rule of lenity to apply for tipper-tippee insider trading charges under

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319. See Matthew Stephenson & Adrian Vermeule, *Chevron Has Only One Step*, 95 VA. L. REV. 597, 598–600 (2009) (conflating the *Chevron* review process into a more streamlined, one-step analysis); Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187, 247–49 (2006) (debating how courts decide to apply any *Chevron* test in the first instance); Matthew C. Turk & Karen E. Woody, *Justice Kavanaugh, Lorenzo v. SEC, and the Post-Kennedy Supreme Court*, 71 ADMIN. L. REV. 193, 246–49 (2019) (analyzing the potential demise of *Chevron* deference based on the new makeup of the Supreme Court).

320. *Chevron U.S.A., Inc.*, 467 U.S. at 842–43.

321. *Id.* at 844.

322. See Rabb, *supra* note 316, at 189 (citing *Yates v. United States*, 574 U.S. 528, 547–48 (2015) (“[I]f our recourse to traditional tools of statutory construction leaves any doubt about the meaning of the [challenged term], . . . we would invoke the rule that ‘ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity.’”) (alteration in original) (internal citations omitted)).

323. *Id.* (citing *United States v. Thompson/Ctr. Arms Co.*, 504 U.S. 505, 517–18 (1992)). Professor Rabb describes two alternative weights for each of the steps of the lenity framework. In one, which he deems “lenity first,” courts should consider the lenity framework relevant for all criminal statutes *ab initio*. Rabb describes this approach as common on the Supreme Court until recently, when a stricter approach became dominant. The second approach, deemed “lenity last,” involves courts taking a very broad approach to the first step of the framework and questioning all of the plausible interpretations of a statute through “their preferred methods of statutory construction.” *Id.* at 190. If there is any plausible or fair reading of the statute, or a purpose of the statute that can be “gleaned from the overall policy or legislative history,” then courts do not need to resort to lenity. *Id.* Rabb considers this a “junior version of the vagueness doctrine”—with “neither doctrine [vagueness or lenity] applying unless there is *no* fair or consistent application of the challenged provision over time.” *Id.* (emphasis added) (internal citations omitted).

324. See *supra* Part I and accompanying notes.

18 U.S.C. § 1348 given the scant jurisprudential treatment of insider trading under that statute, and the potential for serious punishment associated with the criminal charge under § 1348.

Liza Fleming addresses this concept by pointing out certain ways in which insider trading is unique among “administrative crimes.”<sup>325</sup> Fleming underscores that insider trading is considered a *malum prohibitum* crime, meaning only prohibited by statute or regulation, and, in the case of tipper-tippees, only prohibited based upon the relationship between tipper-tippee if no personal benefit exists.<sup>326</sup> Drawing on the work of Professor Dan Kahan, Fleming argues that lenity is appropriate for § 10(b) insider trading cases, rather than blind deference to the SEC and its administrative agenda.<sup>327</sup> Lenity is even more appropriate in the cases where insider trading is charged under § 1348 as a stand-alone criminal statute with increased penalties and consequences.

#### CONCLUSION

This Article has provided the backdrop to insider trading and the ever-changing elements for proving the civil and criminal elements of insider trading under § 10(b). However, this Article has posited that the elements of insider trading under § 10(b) may soon be wholly irrelevant for criminal prosecution given the flexibility and “blank slate” afforded by charging insider trading under § 1348. The recent case at the Second Circuit, *United States v. Blaszcak* teed up the myriad issues with proceeding under this new regime. Although mail and wire fraud charges have always been in the government’s arsenal for any fraud-based claim, the fact that insider trading is a *malum prohibitum* claim, and one that is only illegal in a tipper-tippee situation if there is a personal benefit conferred, it seems that an entirely new construct for insider trading may arise under § 1348 prosecutions. The result will be an inversion of civil and criminal standards as related to insider trading. The ever-moving target of defining the crime itself suggests that the rule of lenity is appropriate until Congress acts, or some other definitive lines for insider trading are drawn.

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325. See Fleming, *supra* note 317, at 599–605; see also Dan M. Kahan, *Is Chevron Relevant to Federal Criminal Law*, 110 HARV. L. REV. 469, 485 (1996).

326. Fleming, *supra* note 317, at 599–605.

327. *Id.* at 595.