United States v. O'Hagan: The Supreme Court Validates The Misappropriation Theory Of Insider Trading And Rule 14e-3(a), But Does The Court's Decision Help Or Hinder The Quest For Guiding Principles

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Introduction

On June 25, 1997, the United States Supreme Court rendered its decision in United States v. O'Hagan. In its decision, the Supreme Court focused on two major issues: (1) whether the misappropriation theory of insider trading (misappropriation theory) is a valid extension of section 10(b) of the Securities Exchange Act of 1934 (the Act) and securities regulation 10b-5 (Rule 10b-5); and (2) whether the Securities and Exchange Commission (SEC) exceeded its rulemaking authority when it promulgated securities regulation 14e-3(a) (Rule 14e-3(a)). In upholding the validity of the misappropriation theory, the Supreme Court showed a willingness to give broad meaning to section 10(b) and Rule 10b-5 for the first time since the early 1970s. Moreover, the Court held that the SEC had not exceeded its congressionally granted rulemaking authority when it promulgated Rule 14e-3(a). Thus, although some regard the O'Hagan decision as having little substantive effect on the law, the decision marked the Supreme Court’s return to an

2. See infra notes 92-94 and accompanying text (Part II).
5. Id. § 240.14e-3(a).
6. See O'Hagan, 521 U.S. 642; Harvey L. Pitt & Karl A. Goskaufmanis, The Supreme Court Has Upheld the Misappropriation Theory, But How Far the SEC Will Take the Ruling is Anything But Clear, Nat’l L.J., Aug. 4, 1997, at B4. “The impact of this outcome, however, extends far beyond the fortunes of one defendant. The manner in which the government prevailed in O’Hagan will have significant day-to-day implications for all public companies, asset managers and the SEC.” Id.
7. See O'Hagan, 521 U.S. at 668-87.
“expansive interpretation[] of the federal securities laws”9 reminiscent of “the 1960s and early 1970s.”10

Since the early 1980s, the SEC has used the misappropriation theory to prosecute individuals whose conduct was not within the reach of the traditional or classical theory of liability11 in insider trading cases.12 Nonetheless, the Supreme Court never explicitly recognized the validity of the misappropriation theory until O'Hagan.13 In that decision, the Court found that an attorney violated securities laws by using material, nonpublic information that he obtained from his employer to gain a substantial profit on a securities transaction.14 The Court commented that, unlike the defendant’s liability in typical insider trading cases, O'Hagan’s liability arose when he traded on confidential information that he obtained by deceiving his employer and its client.15 This, the Court noted, differentiates the O'Hagan case from traditional insider trading cases in which a corporate insider or temporary insider16 breaches a duty to the purchaser or seller of that particular corporation’s securities.17

In spite of the controversy surrounding the misappropriation theory, the Supreme Court declined to review the theory’s validity in numerous cases.18 Several of the federal circuit courts, however, were not as apprehensive about addressing the

10. Id.
11. See Prozan, supra note 8. The misappropriation theory differs from the traditional theory because the misappropriation theory applies to “outsiders” such as O'Hagan, whereas under the traditional theory, only those who are “insiders” of the company whose stock is traded are subject to section 10(b) liability. See id.
14. See id. at 647-49.
15. See id. at 652-53.
16. The Court described corporate insiders as “officers, directors, and other permanent insiders” and temporary insiders as “attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.” Id.
17. See id.
validity of the misappropriation theory.\textsuperscript{19} Notably, the Second, Third, Seventh, and Ninth Circuits adopted the misappropriation theory while the Fourth and Eighth Circuits flatly rejected it.\textsuperscript{20} By validating the misappropriation theory and eliminating the discord among the federal circuits,\textsuperscript{21} the \textit{O'Hagan} Court abandoned its textualist approach to these cases in favor of a broad interpretation “tuned to an animating purpose of the . . . Act: to insure honest securities markets and thereby promote investor confidence.”\textsuperscript{22}

Also indicative of the Court’s expansive view, albeit somewhat less surprising, was the Court’s holding that the SEC had not exceeded its rulemaking authority under section 14(e) of the Act when it promulgated Rule 14e-3.\textsuperscript{23} Specifically, the Court held that “the Commission may prohibit acts, not themselves fraudulent under the common law or § 10(b), if the prohibition is ‘reasonably designed to prevent . . . acts and practices [that] are fraudulent.’”\textsuperscript{24} While this portion of the holding has little direct bearing on the misappropriation theory, it is, nonetheless, important to the extent that it helps illustrate the breadth of the \textit{O'Hagan} decision.\textsuperscript{25}

Notwithstanding the fact that the Court’s expansive application of sections 10(b) and 14(e) of the Act enabled it to arrive at what most regard as the appropriate outcome in \textit{O'Hagan}, the decision creates substantial uncertainty about the reach of securities laws.\textsuperscript{26} Furthermore, when considered in the context of other recent Supreme Court securities cases, the decision fosters the notion that the Court sometimes fashions

\begin{itemize}
\item \textsuperscript{19} See id. at 820-21.
\item \textsuperscript{20} See Jennifer D. Antolini et al., \textit{Securities Fraud}, 34 Am. Crim. L. Rev. 983, 996 (1997).
\item \textsuperscript{21} See \textit{O'Hagan}, 521 U.S. at 649 (stating that the Court granted certiorari to address the circuits' conflict about validity of the misappropriation theory and legitimacy of Rule 14e-3(a)).
\item \textsuperscript{22} Id. at 658; see also id. at 653-59.
\item \textsuperscript{23} See id. at 676; see also Schreiber v. Burlington N., Inc., 472 U.S. 1, 8 (1985) (holding that manipulative conduct must involve misrepresentation to fall within section 14(e) proscription).
\item \textsuperscript{24} \textit{O'Hagan}, 521 U.S. at 673 (alteration in original) (quoting statutory language of 15 U.S.C. § 78n(e) (1994)).
\item \textsuperscript{26} See Pitt & Groskaufmanis, \textit{supra} note 6.
\end{itemize}
the outcome not on precedent, but rather, on a desired result. Accordingly, investors must tread cautiously to avoid criminal liability, but must do so without the benefit of a clear rule delineating prohibited conduct from permissible conduct.

This Comment addresses the *O'Hagan* decision in light of related legislation, regulations, and prior court holdings, and examines the effect of *O'Hagan* on the future of securities transactions. Section I discusses the historical antecedents to the *O'Hagan* decision. Section II examines the development of the misappropriation theory. Section III discusses the details of the Supreme Court's analysis of *O'Hagan*. Section IV identifies and discusses criticisms of the *O'Hagan* holding and potential problems that may follow. Finally, Section V considers possible solutions to overcoming the uncertainty caused by the *O'Hagan* decision.

I. HISTORICAL ANTECEDENTS

Congress enacted the Securities Exchange Act of 1934 (the Act) in reaction to the stock market crash of 1929 and reports of abusive practices within the securities industry. The Act's primary purpose was "to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, [and] to prevent inequitable and unfair practices on such exchanges and markets."

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27. See generally Carpenter v. United States, 484 U.S. 19 (1987) (finding that newspaper columnist misappropriated information even though the information was not inside information and the party from which he took the information had no interest in the corporation in which he and his co-conspirators traded); Dirks v. SEC, 463 U.S. 646 (1983) (holding that former officer of company did not breach a fiduciary duty to his former employer when he disclosed evidence of fraud to a securities broker); Chiarella v. United States, 445 U.S. 222 (1980) (finding that employee of financial printer who made $30,000 profit by trading on confidential information did not violate section 10(b) in first criminal case brought under the statute).

28. See discussion, infra Part IV.A-C.


A. Section 10(b): The Broad Antifraud Provision

While Congress has not enacted a statute that specifically proscribes "insider trading," section 10(b) of the Act contains language that, although subject to differing interpretations, generally prohibits traditional forms of insider trading.\textsuperscript{31} Section 10(b) states that "[i]t shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . ."\textsuperscript{32}

1. 17 C.F.R. § 240.10b-5

Pursuant to authority granted under the Act, the SEC promulgated Rule 10b-5, which does little to clarify the language of section 10(b) of the Act.\textsuperscript{33} Rule 10b-5 provides:

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.\textsuperscript{34}

\textsuperscript{31} See Humke, supra note 18, at 823-24. Directors, officers, majority shareholders, and others with a fiduciary relationship to the corporation typically meet the definition of "insider." See id. at 823.


\textsuperscript{33} See Humke, supra note 18, at 810.

\textsuperscript{34} 17 C.F.R. § 240.10b-5 (1998).
2. Pre-O'Hagan Judicial and Administrative Interpretation of Section 10(b) and Rule 10b-5

Because of the breadth of section 10(b) and because Rule 10b-5 is facially ambiguous, both provisions have developed and, as O'Hagan illustrates, expanded through judicial and administrative interpretation and application. In early cases following the enactment of section 10(b) and the promulgation of Rule 10b-5, courts typically limited liability to corporate insiders including directors, officers, and majority shareholders, each of whom owed a fiduciary duty to the corporation's shareholders.

In the administrative proceeding In re Cady, Roberts & Co., the SEC introduced its theory that Rule 10b-5 prohibits transactions by "any person" in anonymous securities markets when the person or entity trading does so based on inside information. Specifically, the SEC applied a two-part test to determine whether the trader has an obligation to disclose the inside information or abstain from trading. According to the SEC, this obligation arises when, first, the person or entity has a "relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone," and second, when "inherent unfairness [is] involved [because] a party takes advantage of such information knowing it is unavailable to those with whom he is dealing."

Using its new theory, the SEC punished a broker who profited from trades in a corporation's stock by relying on nonpublic information that the broker obtained from a director of the corporation. By rejecting the broker's argument that his


36. See Hunt & Seyle, supra note 12, at 842.


38. Id., available in No. 8-3925, 1961 WL 3743, at *3; see id., available in No. 8-3925, 1961 WL 3743, at *2-*4.


41. See id.
obligation ran only to other stockholders, the SEC effectively required that all market participants have equal access to material information concerning securities in which they trade.\textsuperscript{42} The Second Circuit followed the SEC’s equal access doctrine in \textit{SEC v. Texas Gulf Sulphur Co.},\textsuperscript{43} but the Supreme Court later rejected the doctrine.\textsuperscript{44} Beginning in 1975, the Supreme Court limited the reach of section 10(b) and Rule 10b-5 in several cases brought by private parties.\textsuperscript{45} Specifically, the Supreme Court exhibited reluctance to extend the phrases “in connection with the purchase or sale of securities” and “manipulative and deceptive,” found in section 10(b) and Rule 10b-5, beyond the parameters of common usage.\textsuperscript{46} Interestingly, the Supreme Court gave no indication in prior decisions that it would limit the lower courts’ ever-expanding application of section 10(b) and Rule 10b-5.\textsuperscript{47}

Additionally, in \textit{Chiarella v. United States},\textsuperscript{48} the Supreme Court declined to espouse the equal access theory advanced by the SEC and the Second Circuit, and concluded that without a duty to disclose, silence and informational advantage do not constitute fraud.\textsuperscript{49} Thus, the Supreme Court effectively shifted the focus of Rule 10b-5 inquiries from the type of information in

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42. \textit{See id., available in} No. 8-3925, 1981 WL 3743, at *3-*6.
43. 401 F.2d 833 (2d Cir. 1968).
45. \textit{See Santa Fe Indus., Inc. v. Green}, 430 U.S. 462 (1977) (holding that regardless of a transaction’s fairness, Rule 10b-5 is only “tangentially concerned” when full disclosure has occurred and when state law provides cause of action); \textit{Ernst & Ernst v. Hochfelder}, 425 U.S. 185 (1976) (holding that plaintiff in private action under section 10(b) and Rule 10b-5 must establish that defendant acted with scienter—negligence alone is not enough to establish manipulation or deception); \textit{Blue Chip Stamps v. Manor Drug Stores}, 421 U.S. 723 (1975) (holding that sections 10(b) and Rule 10b-5 provide private right of action for money damages only to defrauded purchasers or sellers of securities). \textit{But see Affiliated Ute Citizens v. United States}, 406 U.S. 128 (1972) (holding that affirmative proof of reliance is unnecessary in 10(b)(5) cases); \textit{Superintendent of Ins. v. Bankers Life & Cas. Co.}, 404 U.S. 6 (1971) (holding that Rule 10b-5 created implied private right of action).
46. \textit{See Santa Fe Indus., Inc.}, 430 U.S. at 473 n.12 (noting that a court should adhere to the language of the statute rather than deferring to the SEC’s interpretation); \textit{Ernst & Ernst}, 425 U.S. at 212; \textit{Blue Chip Stamps}, 421 U.S. at 731, 748-49.
47. \textit{See HAMILTON, supra} note 35, at 916.
49. \textit{See id.} at 230-33.
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the trader’s possession to the existence of a fiduciary duty and the deceptiveness of the trader’s conduct. 50

Building further on the requirement of a fiduciary relationship, the Supreme Court in Dirks v. SEC 51 held that “tipper”/“tippee” liability is imposed when: (a) the insider of a corporation, the tipper, has breached a fiduciary duty; and (b) the person who used that information in connection with a purchase or sale of securities, the tippee, knew or should have known that a breach occurred. 52 Moreover, the Court reasoned that whether the tipper breaches a fiduciary duty depends on whether the tipper gains personal benefit from providing the information to the tippee. 53 According to the Court, “[a]bsent some personal gain, there . . . [is] no breach of duty to stockholders.” 54

Additionally, the Dirks Court expanded Rule 10b-5 liability to include “temporary insiders” such as attorneys and accountants. 55 Although not insiders in the classical sense, these individuals avail themselves of material, nonpublic information


52. See id. at 660. Dirks, an officer of a broker dealer firm, received information from an insider of an insurance and mutual fund company that had overstated its assets as the result of fraudulent corporate practices. See id. at 649. Dirks conveyed this information to some of his clients who subsequently liquidated their shares of the company’s stock. See id. The Court concluded that Dirks, the “tipper,” had no derivative liability to the company because the insider “tipper” did not breach a fiduciary duty to the company when he disclosed the fraudulent practices to Dirks. See id. at 660-65.

53. See id. at 663. The case concluded that the insiders intended to expose the fraudulent practices, not to obtain personal benefit from their revelation and, therefore, the insiders did not breach their fiduciary duty to the corporation. This conclusion seems a bit anomalous in light of the Court’s own acknowledgment that reputational benefits that will result in future earnings may establish the personal gain required to effect the breach of a fiduciary duty. See id. at 663-64. Clearly, others might perceive the insiders in Dirks as particularly honest, trustworthy and law-abiding in light of what they revealed. Few would argue that being regarded in this light is not beneficial to one’s reputation; accordingly, commentators have attacked the personal gain requirement articulated by the Court as unnecessary and confusing. See HAMILTON, supra note 35, at 1018 (citing S.E.C. v. Guspar, No. 83 Civ. 3037 (CBM), 1985 WL 521 (S.D.N.Y. 1985) (stating that tipper received an “enhanced professional relationship” from tippee)).

54. Dirks, 463 U.S. at 662.

55. See id. at 655 n.14.
by virtue of the services they provide and are, therefore, insiders while retained by that particular company.\textsuperscript{56}

Taken together, the \textit{Dirks} and \textit{Chiarella} decisions create the "classical theory" of insider trading under which an individual violates section 10(b) and Rule 10b-5 by trading on material, nonpublic information if: (1) the individual is a temporary or permanent insider of the corporation in whose shares the insider trades; (2) the individual owes a fiduciary duty to the person with whom the individual trades; or (3) the individual is a tippee who receives information from an insider and knows, or should know, that the insider breached a fiduciary duty by disclosing the information.\textsuperscript{57} While most forms of insider trading fall within the scope of the classical theory, some do not.\textsuperscript{58} For instance, the classical theory does not address situations in which an individual trades a corporation's securities in the open securities markets relying on confidential information obtained from a source other than an insider or temporary insider of the corporation.\textsuperscript{59} However, in the context of tender offers, section 14(e) of the Act and Rule 14e-3(a) prohibit such activities.\textsuperscript{60}

\textbf{B. Section 14(e)}

Section 14(e) of the Act has two functional provisions.\textsuperscript{61} Congress enacted the first provision in 1968 as part of the Williams Act\textsuperscript{62} and the second provision in 1970 as an amendment to the Williams Act.\textsuperscript{63} The purpose of section 14(e) is "to ensure that shareholders 'confronted by a cash tender offer for their stock [would] not be required to respond without adequate information.'"\textsuperscript{64}

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\item \textsuperscript{56} See generally Hunt & Seyle, supra note 12, at 842-44.
\item \textsuperscript{57} See Barbara Bader Aldave, Misappropriation: A General Theory of Liability for Trading on Nonpublic Information, 13 Hofstra L. Rev. 101, 101-02 (1984); Humke, supra note 18, at 828.
\item \textsuperscript{58} See Antolini et al., supra note 20, at 995-98.
\item \textsuperscript{59} See id.
\item \textsuperscript{60} See 15 U.S.C. § 78n(e) (1994); 17 C.F.R. § 240.14e-3(a) (1998).
\item \textsuperscript{61} See 15 U.S.C. § 78n(e) (1994).
\item \textsuperscript{63} Pub. L. No. 91-547, § 5, 84 Stat. 1497 (1970) (prior to the 1974 amendment); see O'Hagan, 521 U.S. at 667.
\item \textsuperscript{64} O'Hagan, 521 U.S. at 667 (alterations in original) (quoting Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975)).
\end{itemize}
Section 14(e) of the Act provides:

It shall be unlawful for any person . . . to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . . . The [SEC] shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.\textsuperscript{65}

The first sentence prohibits fraudulent acts in the context of a tender offer, and the second sentence delegates "definitional and prophylactic rulemaking authority" to the SEC.\textsuperscript{66} As analysis of the relevant case law will illustrate, opponents of section 14(e) typically focus their attacks on the provision's second sentence.\textsuperscript{67}

1. 17 C.F.R. § 240.14e-3

Pursuant to the rulemaking authority granted under section 14(e), the SEC promulgated Rule 14e-3(a) in 1980.\textsuperscript{68} This "disclose or abstain from trading" rule\textsuperscript{69} forbids a person from trading "on the basis of material nonpublic information concerning a pending tender offer that [the person] knows or has reason to know has been acquired 'directly or indirectly' from an insider of the offeror or issuer, or someone working on their [sic] behalf,"\textsuperscript{70} unless such information and its source are publicly disclosed within a reasonable time before any purchase or sale.\textsuperscript{71} This rule is sometimes attacked as being too broad because the person trading on the material, nonpublic information need not breach a fiduciary duty owed to the source of the information or the trading partner for liability to attach.\textsuperscript{72} Specifically, opponents of the rule argue that section 14(e) gives the SEC authority to define measures for preventing fraudulent

\textsuperscript{66} O'Hagan, 521 U.S. at 667.
\textsuperscript{67} See generally id. at 670; Schreiber v. Burlington N., Inc., 472 U.S. 1, 6 (1985).
\textsuperscript{68} See O'Hagan, 521 U.S. at 668.
\textsuperscript{69} Id. at 2215.
\textsuperscript{70} United States v. Chestman, 947 F.2d 551, 557 (2d Cir. 1991).
\textsuperscript{71} See 17 C.F.R. § 240.14e-3(a) (1998). It is important to note that this rule applies only in the context of tender offers. See id.
\textsuperscript{72} See generally SEC v. Maio, 51 F.3d 623, 635 (7th Cir. 1995); SEC v. Peters, 978 F.2d 1162, 1165 (10th Cir. 1992); Chestman, 947 F.2d at 557.
acts, but does not give the SEC authority to redefine the term "fraudulent." Conversely, the SEC contends, and at least one court has held, that section 14(e) authorizes the SEC to prevent and define acts that are fraudulent.

2. Lower Court Challenges to the Validity of Rule 14e-3(a)

In United States v. Chestman, the defendant stockbroker challenged the validity of Rule 14e-3(a) by alleging that the SEC exceeded its statutory authority when it promulgated the rule. The Second Circuit Court of Appeals disagreed. The court first pointed to frequently cited language from Chevron v. Natural Resources Defense Council as a basis for upholding Rule 14e-3(a). In Chevron, the Court stated:

If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.

The Chestman court held that the SEC did not exceed its authority in promulgating Rule 14e-3(a), and further noted that nothing in the legislative history, or in Congress's post-promulgation conduct, indicated that the SEC had acted arbitrarily, capriciously, or manifestly contrary to the statutes.

Conversely, the Eighth Circuit Court of Appeals, in O'Hagan, held that the SEC had exceeded its statutory authority when it promulgated Rule 14e-3. In O'Hagan, the respondent made the same assertion as the respondent in Chestman. The Eighth Circuit resorted to a textualist approach to conclude that section

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73. See Chestman, 947 F.2d at 558.
74. See id. at 558-60.
75. 947 F.2d 551 (2d Cir. 1991).
76. See id. at 558.
77. See id. at 557.
79. See Chestman, 947 F.2d at 558.
80. Chevron, 467 U.S. at 843-44.
81. See Chestman, 947 F.2d at 559.
83. See id. at 623.
14(e) authorizes the SEC to “identify and regulate those ‘acts and practices’ which fall within the § 14(e) legal definition of ‘fraudulent.’” Moreover, according to the O’Hagan court, “§ 14(e) . . . does not grant the SEC a license to redefine the term [fraudulent].” In concluding that the SEC overstepped its authority by failing to require a breach of fiduciary duty, the O’Hagan court determined that, by definition, fraud requires the breach of a fiduciary duty. To reach this conclusion, the court reasoned that: (1) the Supreme Court had held that “§ 14(e) is modeled after the broad anti-fraud provisions of § 10(b);” (2) the Chiarella Court had “dr[awn] upon common law . . . in defining fraud under § 10(b);” (3) the common-law definition of fraud requires a duty to speak arising out of a fiduciary duty; and (4) identical words should have the same meaning throughout the text of the same act.

The inconsistency between the circuit courts’ decisions set the stage for the Supreme Court to consider the validity of Rule 14e-3 and the true extent of the SEC’s rulemaking authority under section 14(e). The Supreme Court accepted the task when it granted certiorari in O’Hagan.

II. THE MISAPPROPRIATION THEORY

Under the misappropriation theory, “outsiders” who are not subject to liability under the classical theory may, nonetheless, violate the broad anti-fraud provisions of section 10(b) and Rule 10b-5 if they: (1) obtain nonpublic information through breach of a fiduciary duty or similar duty arising from a relationship of trust and confidence owed to the rightful possessor of the information; and (2) trade on the basis of that information. The misappropriation theory, unlike the classical theory, does not depend upon a duty to other market participants or to the

84. Id. at 624 (citing Chestman, 947 F.2d at 584).
85. Id.
86. See id. at 625.
87. Id.
88. Id.
89. See id. at 625-26.
92. See Aldave, supra note 57, at 112; Antolini et al., supra note 20, at 996.
shareholders of the company in whose shares the misappropriator trades. However, under the misappropriation theory, fraud occurs only when an individual deceives the person who entrusted the individual with material, nonpublic information—the individual’s possession of nonpublic information alone is not enough.

A. The Supreme Court's Stance on the Misappropriation Theory

The Supreme Court had its first opportunity to address the misappropriation theory in *Chiarella*. There, an employee of a financial printing company profited from a securities transaction that he made on the basis of confidential takeover information. The employee obtained the information from takeover bids that the acquiring company had entrusted to the financial printing company.

As part of its case, the government urged the Court to impose criminal liability on the defendant because the defendant had committed fraud on both the people from whom he purchased the stock and the acquiring company that had entrusted the employer with confidential information. This approach differed from the traditional approach to the extent that the government sought to base liability on a duty to the acquiring company rather than solely on a duty to the shareholders of the target company or other market participants.

The Supreme Court rejected the government’s first argument, holding that to require “a general duty between all participants in market transactions” would be to depart “radically” from the traditional approach, and that such an endeavor should not be undertaken “absent some explicit evidence of congressional intent.” Moreover, the Court stated that although “[s]ection 10(b) is aptly described as a catchall provision . . . what it catches

93. See Antolini et al., supra note 20, at 997.
94. See generally Aldave, supra note 57, at 115-16.
96. See id. at 224.
97. See id.
98. See id. at 235-36.
99. See Aldave, supra note 57, at 112.
100. Chiarella, 445 U.S. at 233.
must be fraud."\textsuperscript{101} According to the Court, one party may defraud another only when the relationship between the parties is one of "trust and confidence."\textsuperscript{102}

Additionally, while not denying that the defendant may have breached a duty to his employer and its client, the Court declined to consider the government's second contention because the lower court failed to properly instruct the jury on that theory of liability.\textsuperscript{103} Ultimately, the Court concluded that it could not "affirm a criminal conviction on the basis of a theory not presented to the jury."\textsuperscript{104}

Nevertheless, Justice Stevens, in a concurring opinion, acknowledged the possibility that liability might arise under section 10(b) and Rule 10b-5 from a defendant's breach of a duty to the defendant's employer and to the company that hired the employer.\textsuperscript{105} Moreover, in his dissent, Chief Justice Burger opined that the defendant had an absolute duty to disclose material, nonpublic information or refrain from trading.\textsuperscript{106} While opinions differ about the exact origin of the misappropriation theory,\textsuperscript{107} most commentators agree that it developed from the concurring and dissenting opinions in \textit{Chiarella}.\textsuperscript{108}

The Supreme Court next considered the misappropriation theory in \textit{Carpenter v. United States}.\textsuperscript{109} There, using the misappropriation theory and the mail and wire fraud statutes, the lower court convicted a \textit{Wall Street Journal} reporter and a stockbroker for trading on information that belonged to the newspaper.\textsuperscript{110} Notably, all parties agreed that the information upon which the defendants traded was not inside information.\textsuperscript{111}

\textsuperscript{101} \textit{Id.} at 234-35.
\textsuperscript{102} \textit{Id.} at 230.
\textsuperscript{103} \textit{See id.} at 236-37.
\textsuperscript{104} \textit{Id.} at 236 (citing \textit{Rewis v. United States}, 401 U.S. 808, 814 (1971)).
\textsuperscript{105} \textit{See id.} at 238 (Stevens, J., concurring).
\textsuperscript{106} \textit{See id.} at 251 (Burger, J., dissenting).
\textsuperscript{107} \textit{Compare} Antolini et al., \textit{supra} note 20, at 997 (stating that the misappropriation theory originated in Chief Justice Burger's dissenting opinion in \textit{Chiarella}, with Humke, \textit{supra} note 18, at 827 (stating that Justice Stevens's concurring opinion in \textit{Chiarella} introduced the misappropriation theory).
\textsuperscript{108} \textit{See Aldave, supra note} 57, at 112; Antolini et al., \textit{supra} note 20, at 997; Humke, \textit{supra} note 18, at 827; Hunt & Seyle, \textit{supra} note 12, at 845.
\textsuperscript{110} \textit{See id.} at 23-24.
\textsuperscript{111} \textit{See id.} at 23. However, the column for which the information was gathered typically affected the securities markets because of its excellent reputation. \textit{See id.}
Nevertheless, in a four-four split, the Supreme Court upheld the lower court convictions under section 10(b) and Rule 10b-5 and unanimously affirmed the mail and wire fraud convictions.\textsuperscript{112} Without elaborating, the Supreme Court acknowledged the lower court’s finding that the misappropriation took place “in connection with” a securities transaction even though the defrauded party, the newspaper, was an entity with no underlying interest in the securities.\textsuperscript{113} Although the Court affirmed the convictions, it declined to expound upon the misappropriation theory, thus leaving the theory’s impact subject to debate.\textsuperscript{114}

\textbf{B. The Circuit Courts of Appeal}

Prior to the Supreme Court decision in \textit{O’Hagan}, the federal circuit courts were split regarding the validity of the misappropriation theory.\textsuperscript{115} The Second, Third, Seventh, and Ninth Circuits embraced the misappropriation theory,\textsuperscript{116} whereas the Fourth and Eighth Circuits rejected the theory.\textsuperscript{117}

The Second Circuit viewed the misappropriation theory as a well-settled means of establishing section 10(b) and Rule 10b-5 liability.\textsuperscript{118} Shortly after the \textit{Chiarella} decision, the Second Circuit condoned the misappropriation theory in \textit{United States v. Newman}.\textsuperscript{119} There, two investment bankers misappropriated material, nonpublic information from their employer and provided the information to others who, in return, shared the trading profits with the two investment bankers.\textsuperscript{120} Unlike the

\begin{footnotesize}
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\item \textsuperscript{112} See \textit{id.} at 23-24. Some commentators, however, believe that the misappropriation theory adds little if anything to the SEC’s prosecution arsenal because the wire and mail fraud statutes, 18 U.S.C. §§ 1341, 1343, generally prohibit the same activities as the misappropriation theory. See Prozan, supra note 8.
\item \textsuperscript{113} See \textit{Carpenter}, 484 U.S. at 24.
\item \textsuperscript{114} See \textit{id}.
\item \textsuperscript{115} See Humke, supra note 18, at 820-21.
\item \textsuperscript{116} See SEC v. Cherif, 933 F.2d 403 (7th Cir. 1991); SEC v. Clark, 915 F.2d 439 (9th Cir. 1990); Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir 1985); United States v. Newman, 664 F.2d 12 (2d Cir. 1981).
\item \textsuperscript{117} See United States v. O’Hagan, 92 F.3d 612, 617 (8th Cir. 1996), rev’d, 521 U.S. 642 (1997); United States v. Bryan, 58 F.3d 933 (4th Cir. 1995).
\item \textsuperscript{118} See ICN Pharm., Inc. v. Khan, 2 F.3d 484 (2d Cir. 1993); United States v. Libera, 989 F.2d 596 (2d Cir. 1993); United States v. Chestman, 947 F.2d 551 (2d Cir. 1991); \textit{Newman}, 664 F.2d at 12.
\item \textsuperscript{119} 664 F.2d at 17.
\item \textsuperscript{120} See \textit{id.} at 12.
\end{itemize}
\end{footnotesize}
prosecution in *Chiarella*, the government in *Newman* asserted that the investment bankers violated section 10(b) and Rule 10b-5 because misappropriating the information breached the trust and confidence of their employer and its clients.\(^\text{121}\) The court found that the defendants' activities constituted the requisite fraud or deceit.\(^\text{122}\) Furthermore, the court summarily dismissed the defendants' argument that the fraud or deceit was not perpetrated "in connection with the purchase or sale of any security," and stated that the defendants' "sole purpose" was to purchase shares of the target companies.\(^\text{123}\)

Conversely, in *O'Hagan*, the Eighth Circuit concluded that "only a breach of a duty to parties to the securities transaction or, at the most, to other market participants such as investors, will be sufficient to give rise to § 10(b) liability."\(^\text{124}\) The court based its conclusion on two premises.\(^\text{125}\) First, the court rejected the misappropriation theory because "it permits the imposition of § 10(b) liability based upon the mere breach of a fiduciary duty without a particularized showing of misrepresentation or nondisclosure."\(^\text{126}\) Second, the court concluded that only parties connected to the actual securities transaction, that is, sellers, purchasers and, at most, other market participants, are protected from fraud "in connection with the purchase or sale of any security."\(^\text{127}\) Thus, according to the *O'Hagan* court, the misappropriation theory is overly broad and cannot be sustained upon consideration of the plain meaning of section 10(b) and

\(^{121}\) See id. at 15-16.

\(^{122}\) See id. at 17 (stating that "[b]y sullying the reputations of [the defendants'] employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money").

\(^{123}\) Id. at 17-18. The court also recognized that section 10(b) and Rule 10b-5 had been used primarily as a means of establishing civil liability. See id. The court, however, found authority for imposition of criminal liability under section 10(b) and Rule 10b-5 in sections of the Act. See id. at 16.


\(^{125}\) See id.

\(^{126}\) Id. Such a theory, the court noted, is inconsistent with the holdings in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 493 (1977) and *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994) that the mere breach of a fiduciary obligation, without misrepresentation or nondisclosure, is not deception within the meaning of section 10(b). See id. at 617.

\(^{127}\) Id. at 618 (quoting § 10(b) of the Act).
Rule 10b-5. As with the controversy regarding section 14(e) and Rule 14e-3(a), the controversy over the scope of section 10(b) and Rule 10b-5 ripened for Supreme Court consideration.

III. THE SUPREME COURT DECISION IN UNITED STATES V. O'HAGAN

A. Facts

James Herman O'Hagan was a partner at the Minneapolis law firm of Dorsey & Whitney. In 1988, Grand Metropolitan PLC (Grand Met) retained Dorsey and Whitney to represent it in a tender offer for the Pillsbury Company. Although O'Hagan was not directly involved with the firm's representation of Grand Met, he acquired information about the proposed tender offer from another partner in the firm.

In August and September of 1988, O'Hagan bought a substantial quantity of call options and common stock in the Pillsbury Company. Dorsey & Whitney withdrew its representation of Grand Met on September 9, 1988. On October 4, 1988, the tender offer was publicly announced. As a result of the tender offer, the value of Pillsbury stock rose dramatically, allowing O'Hagan to realize a $4.3 million profit.

128. See id. at 617. Arriving at a similar conclusion, the Fourth Circuit Court of Appeals, in United States v. Bryan, rejected the misappropriation theory, reasoning that the theory stretches section 10(b) and Rule 10b-5 beyond "what the words of the Act reasonably will bear," and that the theory allows prosecution for mere breach of a fiduciary duty without any deception. United States v. Bryan, 58 F.3d 933, 945 (4th Cir. 1995).


130. See id. at 647.

131. See id.

132. See id.

133. A call option is an option acquired by a buyer or granted by a seller to buy 100 shares of stock at a fixed price by some specified date in the future. See Michael C. Thomson, Getting Started in Options 8-9 (2d ed. 1993). These instruments cost a fraction of the underlying stock's price, yet they allow the investor to realize the full amount of an upward price fluctuation to the extent that the price fluctuates beyond the fixed price. See id.


135. See id.

136. See id.

137. See id.
O’Hagan intended to use the profits to replenish funds that he had embezzled from client accounts.\(^{138}\)

**B. Procedural History**

The SEC investigated O’Hagan’s trading activity and ultimately recommended that the Department of Justice charge O’Hagan with twenty counts of mail fraud, seventeen counts of securities fraud under section 10(b) and Rule 10b-5, seventeen counts of fraudulent trading in connection with a tender offer under section 14(e) and Rule 14e-3(a), and three counts of violating the federal money laundering statutes.\(^{139}\) A federal district court jury found O’Hagan guilty of all fifty-seven counts charged.\(^{140}\)

O’Hagan appealed to the Eighth Circuit Court of Appeals, which reversed the lower court’s decision on all counts and specifically rejected the misappropriation theory.\(^{141}\) The Supreme Court of the United States granted certiorari to settle the conflict among the different circuits regarding (1) “the propriety of the misappropriation theory under § 10(b) and Rule 10b-5” and (2) “the legitimacy of Rule 14e-3(a) under § 14(e).”\(^{142}\) The Supreme Court reversed the Eighth Circuit’s decision and remanded the matter for further proceedings consistent with its opinion.\(^{143}\)

**C. The Majority Opinion**

1. **The Misappropriation Theory**

The Court first addressed the misappropriation theory and held that a person who trades in securities for personal profit,
using confidential information misappropriated in breach of a fiduciary duty to the source of the information, may be held criminally liable for violating section 10(b) and Rule 10b-5. In reaching this conclusion, the Court divided its inquiry into two subparts. Specifically, the Court considered the misappropriation theory in light of section 10(b) which "proscribes (1) using any deceptive device (2) in connection with the purchase or sale of securities, in contravention of [SEC] rules."  

a. Deceptive Device

The Court concluded that O'Hagan's conduct was sufficiently deceptive to satisfy the first part of its inquiry. "Deception through nondisclosure[,]" the Court said, "is central to the theory of liability [under the misappropriation theory] . . . ." However, without deception, a breach of a fiduciary duty by an individual entrusted with confidential information will not satisfy the test. A fiduciary meets the "deceptive" requirement when, without disclosure, the fiduciary uses the principal's information for personal gain. The Court noted that the misappropriation theory is consistent with its prior holding in Santa Fe Industries, Inc. v. Green, in which the Court held that section 10(b) is not an all-purpose ban against breaches of fiduciary duty. Rather, the Court stated, "full disclosure [to the source of the information] forecloses liability under the misappropriation theory." The fiduciary must, however, disclose trading plans to everyone to whom the fiduciary owes a duty of confidentiality—not just to the immediate source of the information.  

144. See id. at 653-59.  
145. See id. at 650-53.  
146. Id. at 650-51.  
147. See id. at 653.  
148. Id. at 654.  
149. See id. at 655.  
150. See id.  
151. See id.  
152. Id.  
153. See id. at 655 n.7 (stating that O'Hagan could satisfy the disclosure requirement only if he disclosed his intentions to his employer and to Grand Met, the original source of the information).
b. In Connection with the Purchase or Sale of a Security

According to the Court, O'Hagan satisfied the "in connection with" portion of the test when he used misappropriated information to gain an advantage in a securities transaction.\footnote{154} The fiduciary does not consummate fraud under the misappropriation theory by merely obtaining the information.\footnote{155} Rather, the fiduciary effectuates fraud when the fiduciary uses the confidential information to purchase or sell securities.\footnote{156} The Court made plain that, in the context of section 10(b) and Rule 10b-5, the misappropriation theory applies only when the fiduciary realizes the value of the misappropriated information through subsequent use in a securities transaction.\footnote{157}

c. Reconciling the Misappropriation Theory with Prior Holdings

In its \emph{O'Hagan} opinion, the Eighth Circuit attacked the validity of the misappropriation theory relying on the Supreme Court's holdings in \emph{Chiarella, Dirks,} and \emph{Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.}\footnote{158} The Eighth Circuit contended that, taken together, the prior decisions did not justify a finding of liability under the misappropriation theory because, in each instance, the Supreme Court rejected the existence of a general duty running among all market participants.\footnote{159} Thus, the Eighth Circuit concluded that section 10(b) liability may only arise out of a breach of a duty to a party to a securities transaction or, at most, to other market participants.\footnote{160}

Nevertheless, the Supreme Court quickly pointed out the deficiencies in the Eighth Circuit's position.\footnote{161} While admitting that it did limit its holding in \emph{Chiarella}, the Supreme Court

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\item[154.] \textit{See id.} at 656.
\item[155.] \textit{See id.}
\item[156.] \textit{See id.}
\item[157.] \textit{See id.} According to the dissent, this particular argument renders the misappropriation theory incoherent because the information can be put to multiple uses beyond the context of a securities transaction. \textit{See id.} at 684-85 (Thomas, J., dissenting).
\item[158.] \textit{See United States v. O'Hagan, 82 F.3d 612, 617-22 (8th Cir. 1999), rev'd, 521 U.S. 642 (1997).}
\item[159.] \textit{See id.} at 622.
\item[160.] \textit{See id.} at 618.
\item[161.] \textit{See O'Hagan, 521 U.S. at 680.}
\end{itemize}
noted that it did so only because the misappropriation theory was not presented to the jury.\textsuperscript{162} Moreover, in \textit{Chiarella}, the Supreme Court specifically left open "for another day" its decision on the misappropriation theory's validity.\textsuperscript{163} According to the \textit{O'Hagan} Court, that day had come.\textsuperscript{164}

In addition, the Court stated that "\textit{Dirks}, too, left room for application of the misappropriation theory."\textsuperscript{165} In \textit{Dirks}, the Court found that "[a]bsent any violation by the tippers, there could be no derivative liability for the tippee."\textsuperscript{166} The \textit{Dirks} Court held that the tippers had violated no duty of trust and confidence because they passed along the information without an expectation or realization of any personal gain.\textsuperscript{167} Finally, the Court in \textit{Central Bank} concluded that "[a]ny person . . . who employs a manipulative device or makes a material misstatement . . . on which a \textit{purchaser or seller} of securities relies may be liable . . . under 10b-5."\textsuperscript{168}

Understandably, the Eighth Circuit interpreted this regulatory language as applying only to purchasers or sellers of securities.\textsuperscript{169} However, the \textit{O'Hagan} Court qualified the \textit{Central Bank} holding by stating that its narrowness applied only in the context of determining standing in private actions.\textsuperscript{170} Further, the Court concluded that the standing requirement for a private right of action does not apply in criminal prosecutions.\textsuperscript{171}

\textit{d. The Requirement of Culpable Intent}

Because \textit{O'Hagan} involved criminal prosecution under section 10(b) and Rule 10b-5, the Court was careful to explain that culpable intent is a necessary element of the offense.\textsuperscript{172} "Vital to [the Court's] decision that criminal liability may be

\textsuperscript{162} \textit{See id.} at 650 n.4.
\textsuperscript{163} \textit{Id.} at 661 (quoting \textit{Chiarella} v. United States, 445 U.S. 222, 238 (1980) (Stevens, J., concurring)).
\textsuperscript{164} \textit{See id.} at 649-50.
\textsuperscript{165} \textit{Id.} at 662.
\textsuperscript{166} \textit{Id.} at 663 (citing \textit{Dirks} v. S.E.C., 463 U.S. 646, 667 (1983)).
\textsuperscript{167} \textit{See Dirks}, 463 U.S. at 665-66.
\textsuperscript{169} \textit{See O'Hagan}, 521 U.S. at 664.
\textsuperscript{170} \textit{See id.}
\textsuperscript{171} \textit{See id.} at 665.
\textsuperscript{172} \textit{See id.}
sustained under the misappropriation theory . . . are two sturdy safeguards Congress has provided regarding scienter" in securities cases. First, the government must establish that a person accused of violating section 10(b) did so willfully. Second, the Court will not imprison defendants who establish that they had no knowledge of the law. The Court stated that the requirement of culpable intent militates against O'Hagan's argument that application of such an indefinite theory is unjust.

2. The Validity of Rule 14a-3(a)

On this issue, the Supreme Court disagreed with the Eighth Circuit's holding that the SEC had exceeded its rulemaking authority under section 14(a) by adopting Rule 14a-3(a) because the rule failed to require a "showing that the trading at issue entailed a breach of fiduciary duty." The Eighth Circuit reasoned that section 14(a) authorizes the SEC to "define and prescribe . . . acts and practices . . . meeting the statutory definition of 'fraudulent.' " Accordingly, the Eighth Circuit concluded that Congress did not authorize the SEC to redefine the term "fraudulent," which, under section 10(b) and its common-law meaning, requires the breach of a fiduciary duty.

The Supreme Court, however, disagreed with the Eighth Circuit and adopted the government's position "that under § 14(a), the Commission may prohibit acts, not themselves fraudulent under the common law or § 10(b), if the prohibition is 'reasonably designed to prevent . . . acts and practices [that] are fraudulent.' " In reaching this conclusion, the Court reasoned that "[a] prophylactic measure, because its mission is to prevent, typically encompasses more than the core activity prohibited."
In anticipation of the government’s argument, O’Hagan introduced an alternative ground for affirming the Eighth Circuit’s judgment. O’Hagan contended that Rule 14e-3(a) “fails to comport with due process... [because it] does not ‘give fair notice as to when, in advance of a tender offer, a violation of § 14(e) occurs,’ and it ‘disposes of any scienter requirement.’” The Court summarily disposed of this argument because O’Hagan failed to raise the issue with the Court of Appeals. Thus, the Court declined “to consider these contentions in the first instance.” Moreover, in a footnote, the Court reiterated that 15 U.S.C. § 78ff(a) requires proof of a willful violation of the securities laws in any case in which the government seeks a punishment of imprisonment. The implication of such a requirement is that the violator necessarily must have had either constructive or actual notice of the securities laws in order to willfully violate them.

D. Justice Scalia’s Dissent

Justice Scalia concurred with the majority on the Rule 14e-3(a) and mail fraud convictions, but respectfully dissented to the section 10(b) and Rule 10b-5 convictions. In his dissent, Justice Scalia labeled section 10(b) and Rule 10b-5 as ambiguous and argued that, consistent with its normal approach to ambiguous criminal statutes, the Court should have applied the principle of lenity. Nevertheless, Justice Scalia acknowledged that the majority’s holding with respect to “§ 10(b) and Rule 10b-5 would be entirely reasonable in some other context.”

activities are not themselves deceptive, in order to prevent manipulative acts).
182. See id. at 676-77.
183. Id. (citations omitted) (quoting Brief for Respondent 42-43). Rule 14e-3(a) “prohibits trading in advance of a tender offer—when ‘a substantial step... to commence’ such an offer has been taken.” Id. (alterations in original) (emphasis added).
184. See id.
185. Id.
186. See id. at 677 n.23.
187. See generally id. at 666.
188. See id. at 679 (Scalia, J., concurring in part and dissenting in part).
189. See id.; text accompanying infra note 246 (defining rule of lenity).
190. O’Hagan, 521 U.S. at 879. Justice Scalia did not, however, provide an example of any “other context.” Id.
E. Justice Thomas's Dissent

Justice Thomas dissented with respect to the section 10(b) and section 14(e) convictions and concurred with respect to the mail fraud convictions. Chief Justice Rehnquist joined Justice Thomas in his dissent.

Justice Thomas first attacked the majority's use of the misappropriation theory and concluded that the theory was not adequate to sustain the section 10(b) and Rule 10b-5 convictions. According to Justice Thomas, the SEC's misappropriation theory should fail for a variety of reasons. First, the SEC explained in its brief and at oral argument that the misappropriation theory meets the "in connection with" requirement because information like that obtained by O'Hagan derives value "only" from its use in a securities transaction. Moreover, the SEC conceded that if money rather than information was deceitfully obtained and then used to purchase securities, no section 10(b) or Rule 10b-5 violation would occur. The SEC arrived at its conclusion because money has so many other uses beyond purchasing securities.

Justice Thomas pointed out that the misappropriator could use confidential information for a variety of purposes beyond the context of a securities transaction. For instance, the wrongful possessor could sell the information to a trade publication or could use the information in a fantasy stock game. Thus, with regard to this criticism, Justice Thomas concluded that:

If the relevant test under the "in connection with" language is whether the fraudulent act is necessarily tied to a securities transaction, then the misappropriation of confidential information used to trade no more violates § 10(b) than does the misappropriation of funds used to

191. See id. at 680 (Thomas, J., concurring in the judgment in part and dissenting in part).
192. See id.
193. See id.
194. See id. at 682-84.
195. Id. at 684-85.
196. See id. at 683-84.
197. See id. at 684.
198. See id. at 685.
199. See id.
trade. As the [SEC] concedes that the latter is not covered under its theory, I am at a loss to see how the same theory can coherently be applied to the former.\textsuperscript{200}

The majority responded to Justice Thomas's criticism by stating that the SEC may have overstated its position when it contended that misappropriated information has value "only" because of its use in a securities transaction.\textsuperscript{201} Consequently, the majority suggested that the SEC should have substituted the word "ordinarily" for the word "only."\textsuperscript{202} Justice Thomas took issue with the Court's substitution and stated that "[i]t is a fundamental proposition of law that this Court 'may not supply a reasoned basis for the agency's action that the agency itself has not given.'"\textsuperscript{203} Furthermore, Justice Thomas said, "[w]hether the majority's new theory has merit, we cannot possibly tell ... [because] [t]here are no findings regarding the 'ordinary' use of misappropriated information, much less regarding the 'ordinary' use of other forms of embezzled property."\textsuperscript{204} Since the government had not tendered the theory proffered by the Court, Justice Thomas concluded that such a theory could not form the basis for upholding O'Hagan's convictions.\textsuperscript{205}

Justice Thomas then attacked the majority's use of policy considerations to support its finding that the misappropriation theory, as applied in this case, was appropriate.\textsuperscript{206} According to Justice Thomas, the Court reached too far when it concluded that application of the misappropriation theory would somehow "maintain[] fair and honest markets, ... and protect[] the integrity of the securities markets."\textsuperscript{207} This statement is only true, Justice Thomas said, because the majority "glosses over" the fact that the harm to investor confidence and integrity of the markets comes from the confidentiality of the information, not

\begin{footnotes}
\footnote{200}{Id. at 688.}
\footnote{201}{Id. at 687.}
\footnote{202}{Id. (citing Brief for United States 10, 21).}
\footnote{204}{Id. at 688.}
\footnote{205}{See id. at 689.}
\footnote{206}{See id.}
\footnote{207}{Id.}
\end{footnotes}
the misappropriation of that information. Consequently, a trader could still adversely affect the markets and investor confidence if the trader obtained authorization to trade from the rightful possessor of the information although no section 10(b) violation occurred. Therefore, Justice Thomas concluded that this inconsistency also adds to the incoherence of the misappropriation theory because it emphasizes the “wrong point.”

Justice Thomas’s final point regarding section 10(b) liability was that the misappropriation theory is not embodied in any regulation and, therefore, represents little more than the SEC’s litigation position. Citing prior Supreme Court holdings, Justice Thomas concluded that litigation positions “are not entitled to deference and, at most, get such weight as their persuasiveness warrants.”

Justice Thomas also aggressively attacked the majority opinion regarding the validity of Rule 14e-3(a). First, Justice Thomas agreed with the Eighth Circuit’s reading of section 14(e). The Eighth Circuit stated that “the enabling provision of § 14(e) permits the SEC to identify and regulate those ‘acts and practices’ which fall within the § 14(e) legal definition of ‘fraudulent,’ but it does not grant the SEC a license to redefine the term.” Thus, Justice Thomas concluded that the “Rule . . . exceeds the scope of the [SEC’s] authority to define such acts and practices as ‘are fraudulent,’” because the SEC’s definition of fraudulent exceeds Supreme Court precedent by proscribing “trading in connection with any nondisclosure, regardless of the presence of a pre-existing duty to disclose.”

208. Id.
209. See id. at 690 n.6.
210. Id. at 690.
211. See id. at 692.
212. Id.
213. See id. at 694-95.
214. See id. at 694.
215. Id. at 695 (quoting United States v. O’Hagan, 92 F.3d 612, 624 (8th Cir. 1996)).
216. Id.
IV. REMAINING UNCERTAINTIES IN THE AFTERMATH OF O'HAGAN

A. The Misappropriation Theory’s Disclosure Exception

Perhaps one of the most important goals of the securities laws, including section 10(b), is to protect investor confidence and preserve the integrity of the securities markets. Presumably, by imposing civil and criminal liability for prohibited acts, section 10(b) and Rule 10b-5 supply the desired safeguards by discouraging traders from using material, nonpublic information to purchase or sell securities. Consequently, because section 10(b) and Rule 10b-5 reduce the likelihood of market participants trading on nonpublic information, the markets function more efficiently.

The disclosure rule for insiders articulated in SEC v. Texas Gulf Sulphur Co. clearly preserves investor confidence and market integrity. There, the Court held that insiders may not trade on previously undisclosed material information until the corporation has “effectively disclosed” the information sufficient to ensure dissemination to the investing public. Accordingly, the Court found that an insider had violated Rule 10b-5 when the insider traded on material information after the corporation publicly announced the information, but before the information was disseminated sufficiently to provide the investing public with access to it. Consistent with the underlying purpose of section 10(b) and Rule 10b-5, the Texas

217. See id. at 658 (citing 45 Fed. Reg. 60412 (1980)).
218. See Aldave, supra note 57, at 121-24.
219. See John C. Coffee Jr., Is Selective Disclosure Now Lawful?, N.Y.L.J., July 31, 1997, at 5. Market efficiency is measured in part by the spread between the bid and asked prices for a given security. See id. at 6. According to Coffee, when market makers are concerned that other market participants are trading on nonpublic information, the spread is increased, which adversely affects market efficiency, i.e., sellers get a lower price (the bid) and purchasers must pay a higher price (the ask). See id. Conversely, Henry Manne proposed that insider trading increases market efficiency because it increases the speed and accuracy with which the market integrates new information about securities. See Henry G. Manne, Insider Trading and the Law Professors, 23 Vand. L. Rev. 547, 565 (1970). According to Manne, delays in the integration of new information create uncertainty in the financial markets. See id. at 566.
220. 401 F.2d 833 (1968).
221. See id. at 858.
222. Id.
223. See id.
Gulf Sulphur holding prevents insiders from using their informational advantages to profit at the expense of other investors.\textsuperscript{224}

Conversely, the disclosure exception announced by the O'Hagan Court unequivocally eliminates section 10(b) and Rule 10b-5 liability for outsiders who trade on material, nonpublic information as long as they disclose their intent to everyone to whom they owe a duty of confidentiality and loyalty.\textsuperscript{225} Thus, under the misappropriation theory, the disclosure requirement differs from the requirement in traditional insider trading cases because outsiders must neither await nor ensure broad dissemination to the investing public.\textsuperscript{226} Rather, outsiders must merely disclose their intent to use the confidential information to the source and anyone else to whom the outsiders owe a duty of confidentiality and loyalty.\textsuperscript{227} As a result, the outsiders exculpate themselves while simultaneously benefitting from their informational advantage over the investing public.\textsuperscript{228}

Furthermore, although the outsiders must disclose their intentions to the source of the information, they need not obtain the source's authorization to use the information.\textsuperscript{229} In such a circumstance, however, the source of the information may seek equitable relief pursuant to applicable state law.\textsuperscript{230} If, on the other hand, the source authorizes the outsiders' use of the information, the O'Hagan decision suggests that the government may not punish the outsiders unless the outsiders use the information in the context of a tender offer.\textsuperscript{231}

The situations in which an outsider might benefit from the O'Hagan disclosure exception are not difficult to envision.\textsuperscript{232} Assume that company X, a large multinational corporation, has

\begin{itemize}
\item \textsuperscript{224} See id.
\item \textsuperscript{225} See United States v. O'Hagan, 521 U.S. 642, 659 n.9 (1997). The O'Hagan Court likely refrained from analyzing the duty of confidentiality and loyalty because the duty was not at issue in this case when the accused was clearly a fiduciary of his partners and the firm's clients. See id. at 655 n.7. This Comment analyzes the fiduciary relationship. See discussion, infra Part IV.C.
\item \textsuperscript{226} See O'Hagan, 521 U.S. at 654-55.
\item \textsuperscript{227} See id. at 655 n.7.
\item \textsuperscript{228} See id. at 680-701 (Thomas, J., dissenting).
\item \textsuperscript{229} See id. at 659 n.9.
\item \textsuperscript{230} See id.
\item \textsuperscript{231} See id. at 655-57, 659 n.9.
\item \textsuperscript{232} See Prozan, supra note 8.
\end{itemize}
confidential plans to purchase a substantial amount of product from company Y, a small company whose stock is traded on a public securities exchange.\textsuperscript{233} Assume also that as a result of the transaction, company Y will experience a tremendous increase in earnings, which will trigger a corresponding increase in company Y's stock price. Under \textit{O'Hagan}, employees or other fiduciaries of company X would incur no liability under any provision of the securities laws if they merely disclosed their intention to trade to the appropriate corporate representative of company X.\textsuperscript{234}

Additionally, at least one commentator believes that the \textit{O'Hagan} disclosure exception effectively authorizes selective disclosure.\textsuperscript{235} A company engages in selective disclosure when it authorizes the use of confidential information by customers, suppliers, institutional investors, or other corporate allies.\textsuperscript{236} Selective disclosure resembles the type of conduct prohibited by the tipper.tippee liability articulated in \textit{Dirks}.\textsuperscript{237} However, unlike the fiduciary in the prohibited tipper.tippee scenario, the corporation makes selective disclosure in accordance with express corporate policy.\textsuperscript{238} Because the corporation legitimately authorizes select entities to trade in the corporation's securities based on confidential information, the fiduciary breach required for tipper.tippee liability is lacking.\textsuperscript{239} Nonetheless, uncertainty about the legality of this practice troubled corporations prior to the \textit{O'Hagan} decision, which, according to one commentator, "makes clearer than any prior case that selective disclosure is not insider trading."\textsuperscript{240}

\textsuperscript{233} \textit{See} id. (suggesting that a similar hypothetical would not give rise to liability).
\textsuperscript{234} \textit{See} id.; \textit{see also} \textit{O'Hagan}, 521 U.S. 655-63.
\textsuperscript{235} \textit{See} Coffee, \textit{supra} note 219, at 5.
\textsuperscript{236} \textit{See} id. at 5-6.
\textsuperscript{237} \textit{See} Dirks v. SEC, 463 U.S. 646 (1983); \textit{Coffee, supra} note 219, at 5-6; \textit{see also} text accompanying \textit{supra} notes 51-56.
\textsuperscript{238} \textit{See} Coffee, \textit{supra} note 219, at 6. Professor Coffee acknowledges that the SEC would "[a]lmost certainly" resist a corporate board's attempt to "contract out from the traditional law on insider trading." \textit{Id.} at 5. According to Professor Coffee, the SEC would claim that the "express language of the 1934 Act, voiding contrary agreements or contracts" prohibits corporate officers and directors from contractually avoiding their fiduciary duties to shareholders. \textit{Id.} Still, "the applicability of this statutory language remain [sic] uncertain." \textit{Id.}
\textsuperscript{239} \textit{See} Pitt & Groskaufmanis, \textit{supra} note 6.
\textsuperscript{240} Coffee, \textit{supra} note 219, at 6. \textit{But see} Pitt & Groskaufmanis, \textit{supra} note 6 (contending that SEC will take more aggressive approach to selective disclosure in post-
Given the apparent effect of the O'Hagan disclosure rule, the Court seems to have expressly authorized practices that conflict directly with the ultimate purpose of section 10(b) and Rule 10b-5. Indeed, the O'Hagan disclosure rule represents a direct, although perhaps unintentional, assault on investor confidence and the integrity of securities markets. Furthermore, by elaborating on the disclosure rule, the Court created a well-defined loophole that, in the contexts described above, eliminates the deterrent effect resulting from the inherent, and perhaps intentional, ambiguity in the securities laws. While investors unquestionably need clear guidelines to govern their conduct, the Court should not provide guidelines that undermine the “animating purpose” of the securities laws.

B. The Notice Requirement in Criminal Prosecutions

Given the ambiguity of section 10(b) and Rule 10b-5, and the inconsistency with which the judiciary has applied the provisions, courts should apply the rule of lenity in cases less egregious than O'Hagan. The rule of lenity is part of the “fair warning” requirement, which stands for the proposition that courts should neither (1) hold a person criminally liable under a statute in which people of common intelligence must guess at the statute’s meaning and differ as to the statute’s application, nor (2) criminalize conduct that is not clearly covered in a statute. While courts may supply a judicial gloss to aid

O'Hagan cases). To illustrate his point, Professor Coffee opines that, in light of O'Hagan, a corporation arguably could dispense material, non-public information regarding a merger without running afoul of “federal or common law.” Coffee, supra note 218, at 6. However, even if the corporation could avoid liability under these facts, Rule 14e-3(a) prohibits the tippee from trading on material, nonpublic information concerning a tender offer, unless the tippee first discloses the information and its source publicly. See 17 C.F.R. § 240.14e-3(a) (1997).


242. See id.

243. See HAMILTON, supra note 35, at 1041.

244. O'Hagan, 521 U.S. at 658.


application of ambiguous statutes, courts may not apply a novel construction not previously recognized by any court or disclosed by Congress as fairly within the statute's scope.\textsuperscript{247} The "touchstone" according to the Court in \textit{United States v. Lanier},\textsuperscript{248} is whether the statute, either standing alone or in light of prior application, makes it reasonably clear that the offender's conduct was criminal.\textsuperscript{249}

As evidenced by the differing opinions of the Supreme Court Justices in \textit{O'Hagan} and the plain language of section 10(b) and Rule 10b-5, the statute and the rule are open to considerably different interpretations.\textsuperscript{250} Accordingly, one may look to the judicial gloss for assistance.\textsuperscript{251} Review of prior judicial interpretation suggests that section 10(b) and Rule 10b-5 liability for outsiders such as O'Hagan may not have been "reasonably clear."\textsuperscript{252} Indeed, the circuits were split on the validity of the misappropriation theory, and the Supreme Court had declined numerous opportunities to address the theory.\textsuperscript{253}

However, in \textit{O'Hagan}, the Court rejected the notice argument without considering the above factors.\textsuperscript{254} Instead, the Court reasoned that the government must show that the alleged offender "willfully" violated the securities laws to establish a criminal violation of Rule 10b-5.\textsuperscript{255} Although not explicitly stated, the Court inferred that O'Hagan could not have "willfully" violated a law without having notice of the law.\textsuperscript{256} Interestingly, this inference seems at odds with lower courts,

\begin{footnotesize}
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    \item[247.] See id.
    \item[248.] 520 U.S. 259 (1997).
    \item[249.] See id. at 270.
    \item[251.] See Lanier; 520 U.S. at 270.
    \item[252.] See discussion, supra Part II.
    \item[253.] See discussion, supra Part II.A.
    \item[254.] See O'Hagan; 521 U.S. at 664-66.
    \item[255.] See id. The Court noted that "no person shall be subject to imprisonment under [15 U.S.C. § 78ff(a)] for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation. . . . The statute provides no such defense to imposition of monetary fines." \textit{Id.} at 666 nn.12-13.
    \item[256.] See id. at 666 n.12. On remand, O'Hagan argued that the Supreme Court created a requirement that defendants know that their acts violate Rule 10b-5 for criminal liability to attach. \textit{See United States v. O'Hagan}, 139 F.3d 641, 646 (8th Cir. 1998), rev\textsuperscript{d}, 521 U.S. 642 (1997). The Eighth Circuit rejected O'Hagan's argument and concluded that "willfully" simply requires the intentional doing of the wrongful acts—no knowledge of the rule or regulation is required." \textit{Id.} at 647.
\end{itemize}
\end{footnotesize}
which hold that the prosecution needs "only [to] establish a realization on the defendant's part that he was doing a wrongful act..." and that actual knowledge of the rule or provision is not necessary. 257

Therefore, while the Court had little difficulty surmising that O'Hagan, an attorney with extensive knowledge of securities laws, had notice of the laws and had willfully violated the statute, courts should not dispose of the notice requirement when raised in less egregious cases. 258 Notwithstanding the Court's declaration that the misappropriation theory is valid (thus giving notice to all potential offenders), the theory and the Court's holding remain somewhat ambiguous. 259 This is particularly true when the relationship between the trader and the source of information is more tenuous than the relationship in O'Hagan. 260

Fortunately, the Court resurrected the affirmative defense allowed under section 32(a) of the Act, 261 which states that people accused of violating the Act may exculpate themselves by showing that they did not know that their conduct was prohibited. 262 Without this provision, the misappropriation theory might otherwise have had nearly boundless application. 263 Even so, if courts conclude, as the Supreme Court did in O'Hagan, that all traders have adequate notice of the law, neither the requirement of willful violation, nor the lack of knowledge defense will provide the "sturdy safeguards" against unfair imposition of criminal liability envisioned by the O'Hagan Court. 264

257. Coffee, supra note 219, at 29 (quoting United States v. Dixon, 530 F.2d 1388, 1395 (2d Cir. 1976)).
258. See id. at 6, 29 (noting that courts have tended to downplay the "wilfully" requirement, but that the O'Hagan Court signaled the term should be given greater emphasis to protect a defendant's right to due process and fair notice).
259. See id. at 5.
260. See Pitt & Groskaufmanis, supra note 6, at B4-B8 (identifying several uncertainties remaining in wake of O'Hagan, such as how far SEC will stretch limits of misappropriation theory and how asset managers must now govern their actions following communications with securities analysts).
263. See generally Coffee, supra note 219, at 6, 29.
C. Who is a Fiduciary?

In contrast to its usual approach to insider trading cases, the Supreme Court in *O'Hagan* de-emphasized its inquiry into the existence of a fiduciary relationship between the accused and those persons whom his actions harmed.\(^{265}\) Presumably, the Court chose not to belabor the issue because *O'Hagan* clearly owed a duty of loyalty and confidentiality to his partners and the client.\(^{266}\) However, the SEC is not likely to limit its use of the misappropriation theory to cases in which the duty is as obvious as it was in *O'Hagan*.\(^{267}\)

Turning to precedent for guidance, the potential for confusion becomes apparent.\(^{268}\) In *Santa Fe Industries*, the Supreme Court specifically declined to create a "federal fiduciary principle" because state law typically defines fiduciary relationships.\(^{269}\) Nonetheless, with each interpretation and application of section 10(b) and Rule 10b-5, the federal courts have created federal common-law precedent defining the fiduciary relationship.\(^{270}\) In *Chestman*, the Second Circuit noted that fiduciary relationships are "circumscribed with some clarity" in traditional insider trading cases.\(^{271}\) However, in other contexts, such as misappropriation cases, the law "is anything but clear."\(^{272}\)

Some commentators voiced concern that *O'Hagan* did nothing to clear up the ambiguity of the fiduciary duty in

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\(^{266}\) See United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991).

\(^{267}\) See id. at 570 (considering SEC's theory that stockbroker misappropriated information in which he received tip from person related to insiders of a corporation); see also SEC v. Falbo, 14 F. Supp. 508 (S.D.N.Y. 1998). In *Falbo*, which also arose out of the Grand Met tender offer for Pillsbury, the SEC brought a civil action against an electrical contractor who "overheard" material, nonpublic information while installing an electrical access system in Grand Met's executive offices. *Id.* at 512-17. The court determined that Grand Met had placed the contractor in a position of trust and confidence akin to a fiduciary when it provided him with unrestricted access to the Grand Met offices so that he could install the electrical access system. *See id.* at 523. Ultimately, the court concluded that the electrician breached his duty to Grand Met when he used the access granted by Grand Met to overhear confidential information that he subsequently used for personal gain. *See id.*


\(^{269}\) *Santa Fe Indus., Inc.*, 430 U.S. at 479.

\(^{270}\) See, e.g., *Chestman*, 947 F.2d at 567-70; HAMILTON, supra note 35, at 1041.

\(^{271}\) *Chestman*, 947 F.2d at 567.

\(^{272}\) *Id.*
misappropriation cases. These commentators have hypothesized about a variety of situations that might give rise to liability under the misappropriation theory. For example, cab drivers and bartenders who overhear and trade on information their customers discuss may face liability. However, the Court did not engage in an unnecessary analysis of myriad possibilities because, in O'Hagan, the existence of a fiduciary duty was a foregone conclusion. Thus, although O'Hagan provides little additional guidance, the Court seems to have left existing precedent undisturbed on the issue of fiduciary relationships.

The Second Circuit, which has vociferously endorsed the misappropriation theory, engaged in a thorough and helpful analysis of fiduciary duties in Chestman. There, the court stated:

A fiduciary relationship involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests. In relying on a fiduciary to act for his benefit, the beneficiary of the relation may entrust the fiduciary with custody over property of one sort or another. Because the fiduciary obtains access to this property to serve the ends of the fiduciary relationship, he becomes duty-bound not to appropriate the property for his own use.

In considering whether the misappropriation theory should extend to relationships outside of the employer/employee context, the court wrote: "[W]e tread cautiously in extending the misappropriation theory to new relationships, lest our efforts to construe Rule 10b-5 lose method and predictability, taking over

274. See Coffee, supra note 219; Hiler, supra note 273, at *4.
275. See Coffee, supra note 219, at 6.
277. See id. Still, this comes as little consolation because, in applying the securities laws, federal courts must look to state common law for the definition of fiduciary. See infra notes 287-89. Consequently, the varying definitions limit the extent to which practitioners and commentators can rely on securities cases decided in other jurisdictions. See id.
279. Id. at 568.
"the whole corporate universe." 280 Additionally, the court noted that because the definition of a fiduciary relationship is imprecise, "[m]ore than a perfunctory nod at the rule of lenity...is required." 281 Ultimately, the court concluded that a marital relationship did not create a fiduciary relationship between a husband and wife or the wife’s family, even though the wife entrusted him with material, nonpublic information about her family’s corporation and requested that he keep the information confidential. 282

Although the Chestman court acknowledged that fiduciary relationships may arise beyond an egregious employer/employee context, the court’s language overwhelmingly suggests that courts should carefully scrutinize expansive applications of the fiduciary duty. 283 Accordingly, while a bright-line rule remains elusive, the influential Second Circuit appears disinclined to boundlessly expand fiduciary relationships to encompass the far-reaching hypotheticals posed by critics of the O’Hagan decision. 284

Nonetheless, investors may view the limiting language in Chestman as little consolation because, in all but the most innocuous circumstances, investors risk criminal prosecution if they misinterpret precedent or if the government decides to test a new litigation strategy. 285 Indeed, although the swath of uncertainty does not cut as broadly as some suggest, the parameters of fiduciary relationships are, as the Chestman court

280. Id. at 567 (quoting United States v. Chiarella, 588 F.2d 1358, 1377 (2d Cir. 1978)).
281. Id. at 570.
282. See id. With respect to the family, the court reasoned that: (1) the alleged misappropriator had not been brought into the family's inner circle, which discussed business matters; (2) the alleged misappropriator was not an employee of the family's company; (3) the alleged misappropriator received the critical information gratuitously; (4) the wife's disclosure did not serve the interests of the family or its company; and (5) no evidence suggested that the relationship between the alleged misappropriator and the family was characterized by influence or reliance. See id. With respect to the wife, the court reasoned that, absent a pre-existing fiduciary relationship or an express agreement of confidentiality, the alleged misappropriator's marital relationship with his wife could not establish a fiduciary relationship. See id. at 571.
283. See id. at 566-67 (noting lower court's applications beyond the employer/employee context).
284. See id.; Coffee, supra note 219, at 5; Hiler, supra note 273.
remarked, "anything but clear." Moreover, because state law typically defines fiduciary relationships, courts and investors searching for guidance could find themselves trying to interpret and reconcile state and federal common-law definitions of fiduciary relationships. Consequently, the courts' inconsistent and haphazard treatment of fiduciary relationships deprives market participants of "guiding principle[s]" to govern their trading activities.

Although the O'Hagan decision answered some questions, it left others unresolved and may even create new issues for market participants and the SEC. The question, then, is whether the courts, Congress, and the SEC can stop the continuous and unpredictable transformation of securities laws while preserving the integrity of the markets and providing market participants with definitive guidelines.

V. A POSSIBLE SOLUTION TO THE CONFUSION

According to many commentators, Congress could alleviate the confusion caused by the patchwork of judicial interpretations by enacting legislation that defines insider trading. During the 1980s, Congress reviewed several proposals designed to better define prohibited conduct under the securities laws. Unfortunately, however, Congress refrained from including a definition of insider trading in the measures that were ultimately enacted.

286. Chestman, 947 F.2d at 587.
287. See Humke, supra note 18, at 845.
288. Dirks, 463 U.S. at 664; see Humke, supra note 18, at 844-45. To the extent that this ambiguity deters legitimate trading practices that fall on or near the line, it arguably undermines market efficiency by delaying the flow of important information into the market place. See Manne, supra note 219, at 596.
289. See Coffee, supra note 219.
291. See Langvoort, supra note 290, at 410-12.
Two beliefs seem to dominate Congress's reluctance to specifically define insider trading. First, the SEC has voiced opposition to a clear definition out of fear that the definition will be too limited, thus eliminating the SEC's flexibility to pursue inventive insider trading schemes. Additionally, the SEC contends that defining insider trading in explicit terms will generate schemes to circumvent the statute. Second, Congress has stated that, in most instances, the case law clearly defines the boundaries of proscribed activity and that the legal principles governing insider trading are well established and widely known. Further, Congress shares the SEC's concern that an explicit definition will provide the impetus for new insider trading schemes.

Although the theory that fear of the unknown may deter some insider trading is arguably valid, the lack of fair notice "should be deeply troubling . . . [because] a person can be prosecuted, and subjected to increasingly severe criminal penalties, for a crime that Congress has never defined." Moreover, Congress's argument that current judicial interpretations sufficiently define the parameters of permissible conduct is not accurate in the context of the misappropriation theory because the theory focuses on the breach of the ill-defined fiduciary duty. Unfortunately, market participants must bear the burden of this uncertainty when they are subjected to costly and embarrassing criminal prosecutions.

293. See Hamilton, supra note 35, at 1041-42.
294. See id.; see also Humke, supra note 18, at 847 (noting that leaving definition open only burdens the courts with cases that might be prevented if Congress would enact a clearly articulated proscription).
296. See id.
297. See id.
298. Pitt & Shapiro, supra note 245, at 417.
299. See discussion, supra Part IV.C.
300. See United States v. O'Hagan, 521 U.S. 642, 679 (1997) (Scalia, J., dissenting) (noting that in the context of a criminal case like O'Hagan, the Court's explanation of the scope of § 10(b) and Rule 10b-5 does not accord with the principle of lenity). On remand, the Eighth Circuit in O'Hagan stated that "[c]riminal conviction for violation of rules and regulations implementing [section] 10(b) necessarily involves fraudulent conduct and breaches of duty by the defendant. Such acts do not involve conduct that is often innocently undertaken." United States v. O'Hagan, 139 F.3d 641, 647 (8th Cir. 1998), rev'd, 521 U.S. 642 (1997) (emphasis added). Interestingly, the court goes on to state that the defendant need not know that his conduct violates a securities rule or regulation, but must "simply" intentionally engage in the wrongful act to "willfully"
Congress’s and the SEC’s fears about the deleterious effect of a specific definition of insider trading may be unfounded. Indeed, the European Community’s endeavor to codify laws prohibiting insider trading has provided investors with much-needed guidelines that are not covered under even the broadest reading of section 10(b). The European Community accomplished this task by defining “inside information,” “insiders” and “insider trading.” Similarly, Great Britain codified laws against insider trading when it enacted legislation that proscribes trading by persons “connected with” a company. The British legislation, rather than leaving the definition of “connected with” to the courts, goes one step further than securities laws in the United States by defining who is “connected with” a company.

Accordingly, to provide those who participate in the securities markets with “the guidance of a known standard” and to eliminate judicial inefficiencies, Congress should enact legislation that fills the gaps in the current legislative and judicial landscape.

CONCLUSION

The Supreme Court decision in O’Hagan ended the controversy regarding the validity of the misappropriation theory and Rule 14e-3(a). Pursuant to O’Hagan, all judicial circuits must now recognize liability when any person misappropriates information in breach of a fiduciary duty and

301. See Humke, supra note 18, at 847 (noting that Congress appears concerned that a bright line rule will undermine the SEC’s flexibility).
302. See id. at 848.
303. Id.
304. See Langvoort, supra note 290, at 411.
305. See id. at 411 n.40. Under British law, “[c]onnected with’ means status as a director, officer, or employee, or serving in a position involving a professional or business relationship with the company that may reasonably be expected to afford access to information with an expectation that the information not be disclosed except in the performance of his functions.” Id.
306. Pitt & Shapiro, supra note 245, at 417.
307. See Humke, supra note 18, at 847 (noting that courts are clogged with SEC cases).
308. See discussion, supra Part V.
subsequently trades on the basis of that information.\textsuperscript{310} Moreover, in the context of tender offers, market participants must “disclose or abstain from trading” whenever they trade on material, nonpublic information they know or should know came directly or indirectly from the offering person, the issuer, or from an officer, director, partner, or employee or any other person acting on behalf of the offering or issuing person.\textsuperscript{311} In so holding, the Supreme Court reversed its literalist approach to interpreting the securities laws.\textsuperscript{312} Considering the facts of the O’Hagan case, few would argue that the outcome was unjust.\textsuperscript{313} However, the decision may open the door for the SEC to pursue less egregious cases based on the far-reaching misappropriation theory or other “novel securities fraud theories.”\textsuperscript{314}

Seemingly, the Supreme Court’s decision might have provided more meaningful guidance had the facts been less egregious.\textsuperscript{315} Instead, the Supreme Court did what most expected—it found a way to convict a bad actor just as it found a way to exculpate the defendant in Dirks.\textsuperscript{316} Although the outcomes in both cases were appropriate, unfortunately these decisions and others like them perpetuate uncertainty about the breadth of securities laws while simultaneously expanding the SEC’s prosecution arsenal.

While the Court resolved the specific issues before it, the reach of insider trading laws remains unclear. Therefore, until Congress enacts legislation defining insider trading, market participants must conduct transactions without the benefit of coherent guiding principles. Moreover, federal courts must

\textsuperscript{310} See id. at 666. But see Geanne Rosenberg, O’Hagan May Impede Other SEC Cases: Must the SEC Now Prove Use of Inside Information?, NAT’L L.J., Nov. 10, 1997, at B4 (stating that defense attorneys promise to use the O’Hagan Court’s “on the basis of” language as an argument against liability in those cases when their clients had material, nonpublic information, but allege that they traded based on other factors).

\textsuperscript{311} O’Hagan, 521 U.S. at 666-69.

\textsuperscript{312} See Humke, supra note 18, at 841.

\textsuperscript{313} See Pitt & Groskaufmanis, supra note 6.

\textsuperscript{314} Id.; see Prozan, supra note 8.

\textsuperscript{315} See Pitt & Groskaufmanis, supra note 6.

\textsuperscript{316} See id. (stating that O’Hagan decision leaves government and courts “free to make up insider trading law as they go along”); Prozan, supra note 8.
continue the burdensome endeavor of clarifying the increasingly confusing insider trading laws.

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