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The Law of Insider Trading

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"Insider trading" is the focus of renewed enforcement efforts by federal prosecutors and the Securities and Exchange Commission ("SEC"). Indeed, in a series of indictments and enforcement actions, the government has made clear that it has commenced an aggressive campaign against those who trade on material nonpublic information in violation of the federal securities laws. While the government's recent investigations are aimed at the financial services industry, it has also pursued classical insiders (such as employees of a company).

We set forth below a general overview of the law on insider trading, and discuss several notable cases and rulings that will likely further define the scope of this violation.

I. AN OVERVIEW OF THE LAW ON INSIDER TRADING

A. Background [1]

Today, practitioners recognize that corporate officers who trade in their corporation's stock based on material nonpublic information acquired in the course of their duties are violating the federal securities laws' proscription against insider trading. However, under the common law, courts were divided on the legality of insider trading. Some courts found such trading legal on the ground that insiders, in their role as traders, had no fiduciary duties to buyers or sellers of their shares, and therefore were under no duty to disclose any inside information they had.[2] Others held that corporate officers had a duty to disclose information they possessed before trading in stock, at least if they traded with other shareholders.[3] Outside the U.S., most countries did not forbid insider trading.[4] Nor did the Securities Exchange Act of 1934[5] by its terms explicitly ban the practice.

Beginning with the publication of *Insider Trading and the Stock Market* by Henry Manne[6], there has been a continued debate between opponents and proponents of the rule. The issues are both moral (is it fair?) and economic (is it efficient?). While the disagreement continues in academic circles,[7] it is now indisputable that the federal securities laws prohibit insider trading.[8]

B. The Elements Of An Insider Trading Violation

The ban on insider trading derives from Section 10(b) of the Securities Exchange Act,[9] which prohibits "any manipulative or deceptive device or contrivance" used "in connection with the purchase or sale of any security." Rule 10b5-1,[10] promulgated thereunder, prohibits "the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the

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1 For a review by an influential scholar of the common law background to the insider trading prohibition and of the policy arguments, see Joel Seligman, The Reformulation of Federal Securities Law Concerning Nonpublic Information, 73 GEO. L.J. 1083, 1091-1103 (1985). Among the seminal early cases are *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), and *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

2 *See, e.g.*, *Board of Comm'rs v. Reynolds*, 44 Ind. 509 (1873).

3 *See, e.g.*, *Oliver v. Oliver*, 45 S.E. 232 (Ga. 1903).

4 For instance, Britain did not prohibit insider trading until 1980. *See* Companies Act, 1980, ch. 22, §§ 68-73. *See generally* Franklin A. Gevurtz, The Globalization of Insider Trading Prohibitions, 15 Transnat'l Law. 63 (2002).

5 Act June 6, 1934, ch 404, 48 Stat 881.

6 Henry Manne, Insider Trading and the Stock Market (1966).

7 *See, e.g.*, Stephen Clark, Insider Trading and Financial Economics: Where Do We Go From Here?, 16 Stan. J.L. Bus. & Fin. 43 (2010).

8 *See, e.g.*, Alexandre Padilla, How Do We Think About Insider Trading? An Economist's Perspective on the Insider Trading Debate and Its Impact, 4 J.L. Econ. & Pol'y 239, 249-55 (2008) (lamenting the hostility of policy makers and the public to insider trading despite the efforts of economic analysts).

9 15 U.S.C. § 78j(b).

10 17 C.F.R. § 240.10b5-1.

shareholders of that issuer, or to any other person who is the source of the material nonpublic information."

There are two theories of insider trading liability under Section 10(b): the "classical theory," articulated by the Supreme Court in *Chiarella v. United States*[11], and the "misappropriation theory," adopted by the Supreme Court in *United States v. O'Hagan*.[12]

1. Classical Theory of Insider Trading

Under the classical theory, a corporate insider (such as an officer or director) violates Section 10(b) and Rule 10b-5 by trading in the corporation's securities on the basis of material non-public information about the corporation. Such a classic corporate insider, who owes fiduciary duties to the corporation and its shareholders, has a duty either to abstain from trading or disclose such information before trading. The Supreme Court's decision in *Chiarella* specifically imposed this requirement on corporate insiders: "the duty to disclose arises when one party has information that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them. … [A] relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation. This relationship gives rise to a duty to disclose because of the necessity of preventing a corporate insider from . . . taking unfair advantage of the uninformed minority stockholders."[13]

The *Chiarella* Court also held, however, that a trader that owed no fiduciary duties to the corporation or its shareholders could not be convicted of insider trading. The defendant in *Chiarella* was not a corporate officer, but a printer who was hired to print announcements of corporate takeover bids. The documents did not identify the companies involved, but Chiarella was nonetheless able to identify five takeover targets and traded in their stock, making seventeen separate purchases.[14] The Court held that he had not violated the securities laws. It rejected "a general duty between all participants in market transactions to forgo actions based on material, nonpublic information."[15] Instead, it limited the scope of insider trading liability to situations where the insider had "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction,"[16] such as that held by corporate officers and shareholders.

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11 445 U.S. 222 (1980).

12 521 U.S. 642 (1997).

13 *Chiarella*, 445 U.S. at 228-29 (quotation marks, internal editing, and footnotes omitted).

14 The trades involved (1) the acquisition of Riviana Foods by Colgate-Palmolive; (2) a successful tender offer for Food Town (now Food Lion) by Delhaize Freres (now the Delhaize Group); (3) an unsuccessful tender offer for Booth Newspapers by Times-Mirror; (4) a successful tender offer for USM (United Shoe Machinery) by Emhart; and (5) a successful tender offer for Sprague Electric by General Cable. *See United States v. Chiarella*, 588 F.2d 1358, 1363 n.3 (2d Cir. 1978).

15 *Chiarella*, 445 U.S. at 233. By contrast, the European Union bars trading by "any person … who possesses inside information while that person knows, or ought to have known, that it is inside information." Council Directive 2003/6/EC, art. 4, 2003 O.J. (L 96) 21 (EC).

16 *Id*. at 230.

A duty to disclose or abstain[17] under the "classical" theory is not limited traditional corporate insiders, but also extends to "temporary insiders". This theory of liability derives from a footnote in the Supreme Court's 1983 opinion in *Dirks v. SEC.*[18] The *Dirks* Court held that insider trading liability could extend to those who are outsiders that "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." The Court offered as examples "an underwriter, accountant, lawyer, or consultant."[19]

The concept of temporary insider was applied in a significant decision by the Delaware Bankruptcy Court in *In re Washington Mutual, Inc.*[20] The issue arose in the context of a motion by the Official Committee of Equity Holders' request for derivative standing to pursue insider trading claims against the Settlement Noteholders on behalf of the debtors, which required the Equity Committee to demonstrate that the claims were colorable. In that case, four hedge funds, referred to as the "Settlement Noteholders," owned sizeable positions in various classes of the debtors' securities and had acquired "blocking" positions in two subordinated classes. At various times, the Settlement Noteholders participated in negotiations between the debtors and JPMorgan Chase that eventually formed the basis of a $7 billion settlement and a consensual plan of reorganization. During two periods, the Settlement Noteholders agreed to confidentiality agreements that restricted their trading. After the expiration of the confidentiality agreements, the Settlement Noteholders traded in the debtors' securities, even though the terms of the settlement negotiations were not publicly disclosed. The Settlement Noteholders argued that they did not become temporary insiders under *Dirks* because they participated in these negotiations to further their own economic interests, rather than the interests of the debtors or other creditors, and therefore lacked a common purpose with the debtors. The court disagreed, holding that the debtors had provided the Settlement Noteholders with confidential information regarding the settlement negotiations, and otherwise allowed them to participate in those negotiations, with "the shared goal of reaching a settlement that would form the basis of a consensual plan of reorganization."[21] Accordingly, the bankruptcy court concluded that there existed a colorable claim that the Settlement Noteholders were temporary insiders under *Dirks*.[22]

2. Misappropriation Theory of Insider Trading

A second theory of insider trading liability (the "misappropriation" theory) was endorsed by the Supreme Court in *United States v. O'Hagan*.[23] In *O'Hagan*, an attorney traded in the stock of a potential takeover target. He learned of the potential takeover from confidential information obtained by his law firm, which represented the company planning the tender offer. Since he was not an officer of the target company,

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17 The *Chiarella* Court described the rule as "[t]he obligation to disclose or abstain," 445 U.S. at 227, and this phrase is widely used. Realistically, however, officers or directors ordinarily would not disclose confidential corporate information on their own initiative. In practice, this means that officers and directors must abstain.

18 463 U.S. 646, 655 n.14 (1983).

19 *Id.*

20 461 B.R. 200, 263-64 (Bankr. D. Del. 2011). As part of a settlement and subsequent order confirming a reorganization plan, the Bankruptcy Court vacated these sections of its opinion, without disavowing the reasoning. *In re Washington Mutual, Inc.*, no. 08-12229-MFW, docket # 9759 Findings of Fact and Conclusions of Law ¶ II (16); Order ¶ 10 (Bankr. D. Del. Feb. 24, 2012).

21 *Id.* at 263.

22 *Id.*

23 521 U.S. 642 (1997).

and had no relation to it, the classical theory of insider trading did not apply. The Court held that he was nevertheless guilty of insider trading, reasoning that the attorney owed a fiduciary duty to his law firm, and, by using his law firm's confidential information to trade, he "misappropriated" such information.

The Court thus held that a corporate "outsider" violates Section 10(b) and Rule 10b-5 "when he misappropriates confidential information for securities trading purposes, in breach of a fiduciary duty owed to the source of the information," rather than to the persons with whom he trades.[24] The "misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."[25] The misappropriation theory is "'designed to protec[t] the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect th[e] corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders.'"[26]

In 2000, the SEC promulgated Rule 10b5-2[27] to identify some of the circumstances under which a duty of trust or confidence arises such that its breach would constitute a misappropriation of confidential information. These circumstances include: "(1) Whenever a person agrees to maintain information in confidence; (2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or (3) Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information."

Rule 10b5-2 has been challenged because it predicates liability on an agreement to maintain confidentiality alone, not on any promise to refrain from use of the confidential information. In *SEC v. Cuban*,[28] the District Court held that the SEC had overstepped its statutory authority in this aspect of the Rule. In *Cuban*, the defendant, Mark Cuban, a shareholder in a company called Mamma.com, received inside information pursuant to a confidentiality agreement and proceeded to trade on the information. The SEC sued Cuban under the misappropriation theory of insider trading liability. The Court dismissed the claim, holding that although the SEC alleged that Cuban had agreed to keep the information confidential, it had not alleged that Cuban had promised to refrain from trading on the information. The Court agreed that Cuban had a duty of trust or confidence under Rule 10b5-2(1) based on a written confidentiality agreement, but held that the Rule exceeded the proper scope of a misappropriation claim

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24 *O'Hagan*, 521 U.S. at 652.

25 *Id.*

26 *Id.* at 653 (citation omitted) (alterations in original).

27 17 C.F.R. § 240.10b5-2.

28 634 F. Supp. 2d 713 (N.D. Tex. 2009), vacated and remanded, 620 F.3d 551 (5th Cir. 2010).

under *O'Hagan*. For there to be a violation of the securities law, the Court said, there had to be some deception. There was, in its view, no allegation of deception in the SEC's complaint.[29]

The Court in *SEC v. Nothern,*[30] reached a different conclusion, but under different facts. There the defendant, a tippee, received and traded on information from an analyst named Davis who had learned at a press conference of the Department of the Treasury that the Treasury was suspending the issuance of thirty-year bonds. Davis had agreed to keep the information confidential for one hour, but advised several of his clients, including Nothern. The Court held that this agreement created a confidential relationship between the analyst and the Treasury Department under Rule 10b5-2(1), as well as under common law. It expressly rejected the contention that the Rule exceeded the SEC's authority under the securities laws.[31]

3. <u>Tipper and Tippee Liability</u>

Corporate insiders who do not themselves trade on inside information, but who "tip" others to do so, may be guilty of insider trading. The "tippee" trades on such information knowing that his source's disclosure of such information breaches a duty also violates the federal securities laws.

These principles are illustrated in *Dirks*, which concerned a securities analyst who received information from a former insider and passed it along to investors who made use of it in their trading. The former insider, Ron Secrist, had been employed by a life insurance company controlled by Equity Funding Life Insurance Corp. Dismayed at what he believed to be massive fraud by his former employer, he contacted Dirks, who specialized in insurance companies. Secrist did not have direct evidence for his allegations, but Dirks was sufficiently impressed to conduct his own inquiries. Dirks, in turn, found sufficient support for Secrist's claims to pass on his findings to the SEC. In addition, he discussed his findings with various clients, some of whom traded on the information.[32] The SEC brought charges against Dirks and some of his clients. Only he appealed.

The *Dirks* Court articulated the general principle of "tipper" liability: "Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain."[33] With respect to the person receiving the information (the non-insider "tippee"), the Court held that such a person "assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information … when the insider has breached his fiduciary

29 634 F. Supp. 2d at 727-31. The decision was vacated on appeal, but on the ground that the complaint could be read to allege that Cuban had promised not to trade. The Court of Appeals explicitly declined to rule on the validity or applicability of Rule 10b5-2(1).

30 598 F. Supp. 2d 167 (D. Mass. 2009).

31 *Id*. at 174-75. Note that the two district court holdings are not necessarily in conflict. In *Nothern*, the analyst allegedly breached his promise to keep information confidential, whereas, according to the District Court, there was no equivalent allegation in *Cuban*. However, while the contractual distinction may be well taken, it is hard to see as a policy matter why it is acceptable for Cuban or Davis to engage in insider trading on their own, but such trading becomes illegal if they tip anyone else.

32 Dirks' investigation ended when the New York Stock Exchange suspended trading in Equity Funding's stock. Two state insurance departments impounded the company's records, whereupon the SEC brought a complaint against Equity Funding. *See Dirks v. SEC*, 681 F.2d 824, 832 (D.C. Cir. 1982).

33 436 U.S. at 659.

duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."[34]

The Court, however, determined that, for a tippee to be liable, "the insider personally [must] benefit, directly or indirectly, from his disclosure."[35] In the *Dirks* case, the insider who provided the confidential information did so to expose a fraud in the company, not for any personal benefit. Therefore, the Court held, the insider had not breached his duty to the company's shareholders, so the defendant (tippee) in *Dirks* could not be liable for insider trading. Although *Dirks* concerned claims against a tippee, the lower courts have interpreted this ruling to require a personal benefit for tipper liability as well.[36] The lower courts have construed the personal benefit test broadly, but not boundlessly. *Compare SEC v. Sargent*[37] (tip to tipper's dentist could meet personal benefit requirement), *with SEC v. Maxwell* (tip to tipper's barber did not meet personal benefit requirement).

Dirks was decided under the classical theory of insider trading. A person also could "tip" another based on information misappropriated. The Supreme Court has not yet ruled on whether the *Dirks* principles apply to trading based on misappropriated information. While the lower courts have not hesitated to find tipping liability in misappropriation cases, there is a split over whether the requirement of a personal benefit to the tipper applies in this context. *Compare SEC v. Yun*, 327 F.3d 1263, 1275 (11th Cir. 2003) ("we are led to the conclusion that the SEC must prove that a misappropriator expected to benefit from the tip"), with *SEC v. Musella*, 748 F. Supp 1028, 1038 n.4 (S.D.N.Y. 1989) ("The misappropriation theory of liability does not require a showing of a benefit to the tipper").

4. <u>Scienter</u>

Both the classical theory and the misappropriation theory of insider trading require that a defendant act with scienter. Scienter is defined as "a mental state embracing intent to deceive, manipulate or defraud."[38] In the civil context, scienter may be established by showing that a defendant acted recklessly. "[T]he scienter required for securities fraud includes recklessness, … [which] includes: Highly unreasonable (conduct), involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[39] For criminal liability, "the Government must prove that a person 'willfully' violated the provision."[40] The

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34 *Id*. at 660.

35 *Id*. at 662.

36 *See, e.g.*, *SEC v. Anton*, 2009 WL 1109324, at *9, 2009 U.S. Dist. LEXIS 34889, at *34-35 (E.D. Pa. Apr. 23, 2009); *SEC v. Maxwell*.341 F. Supp. 2d 941, 946 (S.D. Ohio 2004).

37 229 F.3d 68 (1st Cir. 2000).

38 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

39 *SEC v. Infinity Group Co.*, 212 F.3d 180, 192 (3d Cir. 2000). For a slightly different formulation, *see SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998) ("the scienter needed for proof of a claim under § 10(b) or Rule 10b-5 may be established through a showing of reckless disregard for the truth that is, 'conduct which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care.''") (citations omitted). For an application of this standard in an insider trading case, *see SEC v. Johnson*, 174 Fed. Appx. 111, 114 (3d Cir. 2006).

40 *O'Hagan*, 521 U.S. at 665, citing 15 U.S.C. § 78ff(a).

courts are divided over whether "recklessness" can suffice for criminal willfulness under the securities laws. *Compare United States v. Gansman*, 657 F.3d 85, 91 n.7 (2d Cir. 2011) ("To impose criminal sanctions, the government must prove … that the defendant's conduct was willful. Civil liability, on the other hand, may attach if the government proves … that the defendant's conduct was merely reckless, rather than willful.") (citations omitted), *with United States v. DeSantis*, 134 F.3d 760, 764 (6th Cir. 1998) ("Alternatively, the prosecution may prove that the defendant was reckless - that he made 'an extreme departure from the standards of ordinary care[ ] [by omitting information] which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'") (citation omitted).[41] The Supreme Court has never ruled on the point, even in the civil context.[42] However, there is language in a recent patent case, *Global-Tech Appliances, Inc. v. SEB S.A.*,[43] which might be read to indicate that recklessness, as opposed to "willful blindness," may not be enough to establish the knowledge component of scienter.

The scienter requirement plays a special role in the tipper-tippee relationship. As discussed, a tippee is not liable for insider trading if the tipper received no personal benefit from the tip, at least under the classical theory.[44] However, it is possible for the tippee but not the tipper to be liable if the tippee acted willfully but the tipper lacked the intent to violate the securities laws.[45] For example, in *United States v. Corbin*,[46] Nina Devlin, an employee of a public communications firm, the Brunswick Group, shared confidential business information she obtained in the course of her work with her husband Matthew, a broker at Lehman Brothers. He shared the information with various others, including Daniel Corbin who traded on it. Matthew Devlin and others were convicted of insider trading.[47] No charges were brought against Nina Devlin, however. According to the government, she had shared the information with her husband under an expectation of confidentiality and had no knowledge of his intended use of the information. Hence, although she was a tipper, she lacked scienter.

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41 For a suggestion that willfulness may have a different meaning in insider trading cases than it does in securities fraud generally, *see United States v. Kaiser*, 609 F.3d 556, 569 (2d Cir. 2010) (for insider trading but not securities fraud, willfulness may require knowledge of illegality of act).

42 *See Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980).

43 131 S. Ct. 2060, 2070-71, 179 L. Ed. 2d 1167, 1179 (2011).

44 If the tipper deliberately provides a false tip, the tipper will be liable for securities fraud. *See SEC v. Pirate Investor LLC*, 580 F.3d 233 (4th Cir. 2009). *Quaere* whether this is insider trading and whether the tippee is liable in this situation.

45 *See United States v. Gansman*, 657 F.3d 85, 93 (2d Cir. 2011); *United States v. Evans*, 486 F.3d 315, 323-24 (7th Cir. 2007). What constitutes scienter for the tipper has not been thoroughly explored. In *SEC v. Deskovick*, no. 11-CV-01522-JLL-CCC (D.N.J.), the SEC alleged that Deskovick, a bank executive, informed a friend that the bank was seeking a purchaser, and the friend informed his friend, Deskovick's codefendant, who traded in the bank's stock. There was no allegation that the friend made any trades, or that Deskovick knew the codefendant, or that the friend had passed on the information she had provided him. The case settled before any scienter issues were litigated.

46 729 F. Supp. 2d 607 (S.D.N.Y. 2010).

47 *United States v. Devlin*, no. 08-cr-01307-WHP (S.D.N.Y.) (Matthew Devlin pleaded guilty, no sentence reported); *United States v. Bouchareb*, no. 09-cr-00463-VM, docket ## 113-114 (S.D.N.Y. Dec. 29, 2011) (Jamil Bouchareb sentenced to thirty months imprisonment and a fine of $20,000; Daniel Corbin sentenced to six months imprisonment);.*United States v. Holzer*, no. 09-cr-00470-VM, docket # 24 (S.D.N.Y. Oct. 1, 2009) (Eric Holzer sentenced to five years probation); *United States v. Bowers*, no. 09-cr-00496-GBD, docket # 19 (S.D.N.Y. Sept. 17, 2009) (Frederick Bowers sentenced to three years probation); *see also SEC v. Devlin*, Civ. Act. No. 08-CV-11001 (JGK) (S.D.N.Y.).

5. **Materiality**

Materiality is also a recurring issue in securities cases, both criminal and civil. In the context of the federal securities laws, information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[48] The Supreme Court has cautioned against applying bright-line rules and rigid formulas for materiality, holding that "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive."[49]

The SEC has identified the following items as "types of information or events that should be reviewed carefully to determine whether they are material": earnings information; mergers, acquisitions, tender offers, joint ventures, or changes in assets; new products or discoveries, or developments regarding customers or suppliers; changes in control or in management; change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; events regarding the issuer's securities -- e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and bankruptcies or receiverships.[50]

6. **On The Basis Of**

Under Rule 10b5-1, a person or entity trades "on the basis" of material non-public information if the person "was aware of the material nonpublic information" when it purchased or sold securities.[51] On its face, under Rule 10b5-1 whether an insider actually used the information in making a trading decision would be irrelevant, at least insofar as meeting the "on the basis" element of insider trading is concerned. Rule 10b5-1 was endorsed by the Second Circuit in *United States v. Royal*.[52] However, in practice, district courts in the Second Circuit have tended to instruct juries in criminal cases, although not in SEC enforcement actions, that they had to find actual use of the inside information to convict.[53] Thus, the applicability of the Rule 10b5-1 presumption is unclear.

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48 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

49 *Basic*, 485 U.S. at 236; *see also TSC Indus.*, 426 U.S. at 450 (stating that "[t]he determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him"); Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881, Exchange Act Release No. 34-43154, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) ("While we acknowledged in the Proposing Release that materiality judgments can be difficult, we do not believe an appropriate answer to this difficulty is to set forth a bright-line test, or an exclusive list of 'material' items for purposes of Regulation FD.").

50 *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721.

51 Rule 10b5-1, 17 C.F.R. § 240.10b5-1(b). The Rule sets up affirmative defenses based on pre-existing contracts or plans and for business entities.

52 549 F.3d 886, 899 (2d Cir. 2008) ("We consequently adhere to the knowing possession standard"). Compare *United States v. Nacchio*, 519 F.3d 1140, 1168 (10th Cir. 2008) (the Rule (the authority of which has not been resolved by any circuit)), vacated in part on reh'g en banc, 555 F.3d 1234 (10th Cir. 2009).

53 *See* Audrey Strauss, Recent Insider Trading Jury Charges: 'Possession' vs. 'Use', 246 N.Y.L.J. No.4, p. 5 col. 2 (July 7, 2011).

II. RECENT DEVELOPMENTS

1. <u>The Rajaratnam Invetigation</u>

By far the most widely publicized recent insider trading case was the prosecution of Raj Rajaratnam, head of the Galleon Group, which culminated in a guilty verdict on fourteen counts and a sentence of eleven years imprisonment, a $10 million fine and a forfeiture of $53.8 million.[54] The case was, in its essence, a straightforward tipping prosecution. Rajaratnam was convicted of trading on information he received from a variety of insiders and misappropriators. Although Rajaratnam was the only Galleon officer who went to trial, a number of other persons associated with Galleon pleaded guilty to insider trading.[55]

Rajaratnam's defense centered on materiality. He relied on the "mosaic theory," under which an analyst combines tidbits of information which are individually not material but which, taken together, provide material insights into a company's situation.[56] The jury plainly rejected this defense, and, indeed, courts have been skeptical of the mosaic theory. Thus, one District Court has held that "[a] defendant may be liable under the misappropriation theory when he pieces together incomplete fragments of confidential information provided through his employment to identify likely acquisition targets and then trades stock in those target companies."[57] In *SEC v. Steffes*,[58] the Court held that the SEC had stated a claim for insider trading where the defendant had allegedly deduced that the parent of the company employing him was being sold based on his observation of "an unusual number of daytime tours of [his employer] involving a tour bus and people dressed in business attire" and the growth of rumors that the company might be sold.[59]

The Rajaratnam case also attracted much attention because of the government's use of wiretap evidence, which constituted something of an innovation in the prosecution of insider trading. Through such wiretap evidence, the prosecutor obtained direct evidence of Rajaratnam's receipt of confidential nonpublic

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54 *United States v. Rajaratnam*, no. 09-cr-01184-RJH, docket # 328 (S.D.N.Y. Oct. 25, 2011); *see United States v. Rajaratnam*, 2012 WL 362031, 2012 U.S. Dist. LEXIS 14961 (S.D.N.Y. Jan. 31, 2012).

55 *See, e.g.*, *United States v. Rajaratnam*, no. 09-cr-01184-RJH, docket # 303 (S.D.N.Y. Aug. 9, 2011) (Danielle Chiesi); *United States v. Smith*, no. 11-cr-00079-JSR (S.D.N.Y.); *United States v. Cardillo*, no. 11-cr-00078-RWS (S.D.N.Y.); *United States v. Moffat*, no. 10-cr-00270-DAB, docket # 40 (S.D.N.Y. Sept. 16, 2010); *United States v. Kurland*, no. 10-cr-00069-VM, docket # 41 (S.D.N.Y. May 26, 2010); *United States v. Khan*, no. 09-cr-00991-RMB (S.D.N.Y.); *United States v. Goel*, no. 10-cr-00090-RJH (S.D.N.Y.); *United States v. Kumar*, no. 10-cr-00013-DC (S.D.N.Y.); *United States v. Fortuna*, no. 09-cr-01003-SHS (S.D.N.Y.).

56 *United States v. Rajaratnam*, docket # 264 (S.D.N.Y. Apr. 18, 2011) (defendant's proposed jury instruction no. 25). *See Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 165 (2d Cir. 1980) ("A skilled analyst with knowledge of the company and the industry may piece seemingly inconsequential data together with public information into a mosaic which reveals material non-public information.").

57 *SEC v. Binette*, 679 F. Supp. 2d 153, 159 (D. Mass. 2009).

58 805 F. Supp. 2d 601 (N.D. Ill. 2011).

59 *Id*. at 612-13. The SEC, however, has reiterated that it is not seeking to "undermine" the mosaic theory. Carlo V. di Florio, Remarks at the IA Watch Annual IA Compliance Best Practices Seminar (March 21, 2011), available at http://www.sec.gov/news/speech/2011/spch032111cvd.htm.

information and his trading activities. [60] Rajaratnam's challenge to the admissibility of the wiretap evidence is one of the principal issues on appeal.

The Rajaratnam investigation also spawned a series of related investigations and prosecutions, many of which are also based on wiretap evidence. Thus, the wiretaps turned up another group of insider traders and tippers centered on Zvi Goffer, known as "Octopussy." Goffer had been employed by Galleon, and subsequently shared their offices. Goffer, his brother Emanuel Goffer and attorney Michael Kimelman, were convicted a trial in which wiretap evidence played a major part.

The Rajaratnam wiretaps also turned up another high profile target, Rajat Gupta,[61] former chairman of McKinsey and Company. Gupta, who was a board member of Goldman Sachs & Co. and Proctor & Gamble, allegedly disclosed confidential information concerning such companies to Rajaratnam who then traded on the basis of such information. According to the indictment, Gupta twice made calls to Rajaratnam just after the Goldman Sachs board meetings. These calls were promptly followed by profitable trades by Rajaratnam in Goldman stock. While these calls were not recorded, there are recordings of Rajaratnam telling colleagues at Galleon the day after each call that he had received information regarding Goldman Sachs the day before.[62] These recordings of course raise important issues of admissibility, including whether the government can rely on hearsay statements by a third party, who the government will allege is a coconspirator. The government also has at least two recordings of other conversations between Rajaratnam and Gupta, which Gupta has moved to suppress.[63] The Rajaratnam investigation has led to charges against more than fifty individuals with insider trading.[64]

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60 Insider trading cases were historically based principally on circumstantial evidence, particularly to prove scienter. The SEC has not always persuaded courts that the circumstances plead were sufficient to reach trial. *See* Thomas O. Gorman, Is Evidence of Contacts Followed by Trading Sufficient to Infer and Prove an Insider Trading Case? The "Plus Factor" Rule, 34 SEC REG.L.J. 178, 178 (Fall 2006); and *SEC. v. Hollier*, 2011 WL 201451, at *6 n.8, 2011 U.S. Dist. LEXIS 4963, at *17 n.8 (W.D. La. Jan. 18, 2011). In two recent cases courts have granted summary judgment to defendants when they viewed the SEC's evidence as amounting to nothing more than the fact of suspicious trades. *See SEC v. Garcia*, 2011 WL 6812680, 2011 U.S. Dist. LEXIS 148623 (N.D. Ill. Dec. 28, 2011); *SEC v. Horn*, 2010 WL 5370988, 2010 U.S. Dist. LEXIS 135000 (N.D.Ill.Dec.16, 2010). Summary judgment on a similar issue was denied to both sides in *SEC v. Dunn*, 2011 WL 2623509, 2011 U.S. Dist. LEXIS 70295 (D. Nev. June 30, 2011), where an insider was alleged to have provided confidential information in exchange for tickets to the musical Jersey Boys.

61 *United States v. Gupta*, no. 11-cr-00907-JSR, docket # 25 (S.D.N.Y. Jan. 31, 2012) (superseding indictment).

62 *Id*., docket # 25, superseding indictment ¶¶ 16-25.

63 *Id*., docket # 18 (Jan. 3, 2012).

64 *United States v. Goffer*, No. 10-cr-00056-RJS (S.D.N.Y.). The sentences were: Zvi Goffer, ten years (docket # 271, Sept. 22, 2011); Arthur Cutillo, thirty months (docket # 220, July 1, 2011); Jason Goldfarb, three years (docket # 238, Aug. 22, 2011); Craig Drimal, sixty-six months (docket # 261, Aug. 31, 2011), Emanuel Goffer, three years (docket # 283, Oct. 7, 2011); Michael Kimelman, thirty months (docket # 288, Oct. 13, 2011); David Plate, thirty months (docket # 297, Nov. 2, 2011). *See also United States v. Santarlas*, no. 09-cr-01170-RJS, docket # 15 (S.D.N.Y. Dec. 1, 2011) (Brien Santarlas, sentenced to six months imprisonment); *United States v. Hardin*, no. 10-cr-00399-LTS (S.D.N.Y.) (Thomas Hardin, no sentence reported).

2. The "Expert Network" Cases

The government has also focused on the so-called "expert network" industry. Expert network companies purport to broker contacts between investors seeking knowledge of particular industries or firms, and experts in such matters. Many of the "experts," however, gained their expertise through their employment by firms in the industry in question, and their expertise often included a substantial amount of confidential inside information. While in principle the experts could separate their insider information from their general knowledge, and no doubt many of them did, a number of the experts apparently provided the investors with confidential non-public information.

The "expert network" investigations appear to have originally centered on the expert network firm Primary Global Research. Although no charges have been brought against the company, some of its consultants provided inside information to its employees or to investors. The "tippees" established trading groups which exchanged and distributed inside information. Two figures in this group, Winifred Jiau, known, according to the government, as "the Poohster," and James Fleishmen, were convicted at separate trials; others pleaded guilty.[65] There remain outstanding charges against Anthony Chiasson, Todd Newman, Jon Horvath, and Danny Kuo,[66] all traders associated with the Primary Global circle. There is also a pending indictment against John Kinnucan, of Broadband Research LLC, head of a different expert consulting business.[67]

3. Other Insider Trading Cases

Despite the very public focus on insider trading and its reasonably well-defined prohibition, the government continues to uncover remarkably obvious insider trading schemes. For example, a tipper and two tippees recently pleaded guilty to classical insider trading in connection with the acquisition of Mariner Energy by the Apache Corporation. A member of Mariner's board told his son of the impending takeover, and the son told a friend. The son and the friend traded in the stock.[68] In *United States v. Johnson*,[69] the defendant, managing director of NASDAQ's market

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65 *See United States v. Jiau*, no. 11-cr-00161-JSR (S.D.N.Y.); *see also United States v. Jiau*, 794 F. Supp. 2d 484 (S.D.N.Y. 2011). In *United States v. Nguyen*, No. 11-cr-00032-JSR docket # 154 (S.D.N.Y. Dec. 23, 2011) (James Fleishman); *see also United States v. Fleishman*, 2011 WL 4000987, 2011 U.S. Dist. LEXIS 100468 (S.D.N.Y. Aug. 31, 2011) . Other defendants in the *Jiau* case included Donald Longueuil, (docket # 112, Aug. 10, 2011). Other defendants in *Nguyen* included Manosha Karunatilaka (docket # 135, Oct. 4, 2011); Don Ching Trang Chu (docket # 124, Sept. 13, 2011); Walter Shimoon (no sentence reported); Mark Longoria (no sentence reported). *See also United States v. Freeman*, no. 11-cr-00116-DAB (S.D.N.Y.) (guilty pleas by Noah Freeman and Samir Barai, no sentences reported); *United States v. Pflaum*, no. 10-cr-01265-JGK (S.D.N.Y.) (guilty plea by Jason Pflaum, no sentence reported); *United States v. Lee*, no. 09-cr-00972-PKC (S.D.N.Y.) (guilty plea by Richard Choo-Beng Lee, no sentence reported).

66 *United States v. Newman*, no. 12-cr-00121-RJS, docket # 26 (S.D.N.Y. Feb. 7, 2012) (indictment). Three other persons pleaded guilty: Jesse Tortora, Spyridon Adondakis, and Sandeep Goyal. *See United States v. Tortora*, no. 11-cr-00430-WHP (S.D.N.Y.); *United States v. Adondakis*, no. 11-cr-00360-JFK (S.D.N.Y.); and *United States v. Goyal*, no. 11-cr-00935-KBF (S.D.N.Y.).

67 *United States v. Kinnucan*, no. 12-cr-00163-DAB (S.D.N.Y.); *see also SEC v. Kinnucan*, no. 12-cv-01230-AJN (S.D.N.Y.).

68 The tipper, H. Clayton Peterson, received a sentence of two years probation. *United States v. Peterson*, 11-cr-00665-PKC, docket # 17 (S.D.N.Y. Nov. 4, 2011). The friend, Drew Brownstein, was sentenced to a year and a day. *United States v. Brownstein*, no. 11-cr-00904-RPP, docket # 15 (S.D.N.Y. Jan. 18, 2012). The sentence for the

intelligence desk, regularly received confidential information from companies listed on NASDAQ and repeatedly traded on the information. Johnson was sentenced to forty-two months imprisonment under the misappropriation theory of insider trading.[70]

The SEC also has several pending suits against insider traders, including: a Coca-Cola executive who allegedly used an account in his wife's name to purchase Coca-Cola shares based on confidential information regarding an acquisition of bottling plants in northern Europe; the president of a Chinese company and five other Chinese nationals who allegedly purchased American Depositary Shares of the company shortly before it announced its merger with a British firm; and an individual who allegedly used information obtained from his ex-girlfriend while she worked for Disney to anticipate Disney's acquisition of Marvel Entertainment.

4. <u>Criminal Penalties</u>

The sentence of eleven years imprisonment imposed on Rajaratnam, while less than that sought by the government, was still the longest ever imposed for insider trading. Zvi Goffer received a ten-year sentence.[71] Others in the Galleon and Goffer rings received sentences ranging from six months to five and a half years.[72] While calculating the possible range of a sentence depends on the circumstances of each case, this range is consistent with sentences in other recent insider trading cases.[73]

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son, Drew Peterson, has not been reported. For another instance, *see United States v. Queri*, no. 09-cr-00418-DNH (N.D.N.Y.). Gary Gosson, a friend of an officer at Dick's Sporting Goods, was told in advance of a tender office the company made for another sporting goods company, Galyan's Trading Co., and purchased Galyan stock in advance of the announcement. Gosson entered into a plea bargain and was sentenced to two years imprisonment. *Id*., docket # 358 (Feb. 3, 2012). *See also SEC v. Gowrish*, 2011 WL 2790482, 2011 U.S. Dist. LEXIS 76114 (N.D. Cal. July 14, 2011) (insider tipper found liable on three counts); *SEC v. Treadway*, *SEC v. Treadway*, no. 11 Civ. 1534(RJH), docket # 21 (S.D.N.Y. Jan. 31, 2012) (attorney who traded in stock of clients consented to disgorge $27,000 and pay fine of $10,000); *SEC v. Bazshushtari*, no. 12-cv-00354-GHK-JEM (C.D. Cal.) (corporate officer Farzin Bazshushtari consented to a judgment requiring him to disgorge $76,000 profit made on insider trading and a penalty of $76,000).

69 No. 11-cr-254 (E.D. Va.).

70 *Id*. docket # 20 (Aug. 12, 2011). For misappropriation cases *see United States v. Seto*, no. 11-cr-00397-JSW (N.D. Cal.) (tippees Joseph Seto and Zisen Yu pleaded guilty to conspiracy to commit insider trading); *United States v. Tang*, no. 10-cr-00080-JSW (N.D. Cal.) (King Chuen Tang pleaded guilty to conspiracy and insider trading); *see also SEC v. Tang*, 2012 WL 10522, 2012 U.S. Dist. LEXIS 157 (N.D. Cal. Jan. 3, 2012); *SEC v. Perez*, 2011 WL 5597331, 2011 U.S. Dist. LEXIS 132965 (S.D. Fla. Nov. 17, 2011) (three defendants entered into consent judgments, one was found liable at trial, one prevailed on summary judgment, and one prevailed at trial); *SEC v. Duncan*, no. 12-cv-01785-R-AGR (C.D. Cal.) (insurance broker William Duncan consented to a judgment requiring him to disgorge $85,000 profit made on insider trading and a penalty of $85,000).

71 *United States v. Goffer*, docket # 271, Sept. 22, 2011.

72 *See United States v. Rajaratnam*, docket # 303 (Danielle Chiesi, sentenced to thirty months imprisonment and $25,300 assessment and fine); *United States v. Smith*, no. 11-cr-00079-JSR (S.D.N.Y.) (Adam Smith, no sentence reported); *United States v. Cardillo*, no. 11-cr-00078-RWS (S.D.N.Y.) (Michael Cardillo, no sentence reported); *United States v. Moffat*, no. 10-cr-00270-DAB, docket # 40 (S.D.N.Y. Sept. 16, 2010) (Robert Moffat, sentenced to six months imprisonment and $50,200 assessment and fine); *United States v. Kurland*, no. 10-cr-00069-VM, docket # 41 (S.D.N.Y. May 26, 2010) (Mark Kurland, sentenced to twenty-seven months imprisonment and forfeiture of $900,000); *United States v. Khan*, no. 09-cr-00991-RMB (S.D.N.Y.) (Roomy Khan, no sentence reported); *United States v. Goel*, no. 10-cr-00090-RJH (S.D.N.Y.) (Rajiv Goel, no sentence reported); *United States*

The Rajaratnam case is of additional interest for its analysis of the calculation of gain for purposes of sentence enhancement under the United States Sentencing Guidelines Manual. Section 2B1.4(b)(1) states: "If the gain resulting from the offense exceeded $5,000, increase by the number of levels from the table in §2B1.1 (Theft, Property Destruction, and Fraud) corresponding to that amount." The *Rajaratnam* court, after considering a variety of hypothetical situations, held that the gain included the total increase in value of the securities traded, but limited it to the gain or loss that accrued up to the time the inside information became public.[74] In so holding, the Court explicitly differed with the holding in *United States v. Nacchio*,[75] which construed "the gain resulting from the offense" to exclude the gain resulting from other market causes, and the holding in *United States v. Mooney*,[76] which treated the gain as the difference between the purchase price and the sale price. The *Mooney* court's interpretation appears most consonant with the Guidelines' official commentary, which identifies "the gain" as "the total increase in value realized through trading in securities by the defendant and persons acting in concert with the defendant or to whom the defendant provided inside information." On the other hand, as the courts in both *Rajaratnam* and *Nacchio* pointed out, this method can lead to anomalous results if the market for the securities in question is affected by other factors.

5. <u>Computer Hacking</u>

A relatively new insider trading issue is the problem of the computer hacker who obtains material nonpublic information and then trades in the company's stock based on such information. In *SEC v. Dorozhko*,[77] the Second Circuit became the first appellate court to weigh in on the subject. The defendant had allegedly hacked into a company's computers, gained advance knowledge of an earnings report, and traded on the information. The court acknowledged that the acts did not fit into either of the standard

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v. Kumar, no. 10-cr-00013-DC (S.D.N.Y.) (Anil Kumar, no sentence reported); *United States v. Fortuna*, no. 09-cr-01003-SHS (S.D.N.Y.) (Steven Fortuna, no sentence reported); *United States v. Goffer*, docket # 220, July 1, 2011 (Arthur Cutillo, thirty months); docket # 238, Aug. 22, 2011 (Jason Goldfarb, three years); docket # 261, Aug. 31, 2011 (Craig Drimal, sixty-six months), docket # 283, Oct. 7, 2011 Emanuel Goffer, three years); docket # 288, Oct. 13, 2011 Michael Kimelman, thirty months); docket # 297, Nov. 2, 2011 David Plate, thirty months). *See also United States v. Santarlas*, no. 09-cr-01170-RJS, docket # 15 (S.D.N.Y. Dec. 1, 2011) (Brien Santarlas, sentenced to six months imprisonment); *United States v. Hardin*, no. 10-cr-00399-LTS (S.D.N.Y.) (Thomas Hardin, no sentence reported).

73 For example, Winifred Jiau was sentenced to four years. *United States v. Jiau*, docket No. 124, Oct . 4, 2011; *see id*. docket # 112, Aug. 10, 2011 (Donald Longueuil, thirty months). *See also United States v. Nguyen*, docket # 154, Dec. 23, 2011 (James Fleishman, thirty months); docket # 135, Oct. 4, 2011(Manosha Karunatilaka, eighteen months); docket # 124, Sept. 13, 2011(Don Ching Trang Chu, two years probation); Walter Shimoon (no sentence reported); Mark Longoria (no sentence reported). *See also United States v. Skowron*, no. 11-cr-00699-DLC, docket # 27 (S.D.N.Y. Nov. 22, 2011) (tippee Joseph Skowron III pleaded guilty, sentenced to five years imprisonment and a $150,000 fine); *United States v. Benhamou*, no. 11-cr-00336-GBD, docket # 34 (S.D.N.Y. Dec. 22, 2011) (insider tipper Yves Benhamou pleaded guilty, sentenced to time served).

74 *United States v. Rajaratnam*, 2012 WL 362031, 2012 U.S. Dist. LEXIS 14961 (S.D.N.Y. Jan. 31, 2012).

75 573 F.3d 1062 (10th Cir. 2009). The *Nacchio* court dealt with U.S. S.G. § 2F1.2(b)(1) (2000), which is identical in relevant respects to the current § 2B1.4(b)(1).

76 425 F.3d 1093 (8th Cir. 2005) (en banc).

77 574 F.3d 42 (2d Cir. 2009). The facts, and a review of other cases and commentators, is provided in the District Court's opinion, 606 F.Supp.2d 321.

theories of insider trading.[78] Nevertheless, the Court held the conduct could be actionable if the hacker's conduct was "deceptive."[79]

6. Bankruptcy

The federal securities laws also apply to bankruptcy proceedings, a fact aptly illustrated in *In re Washington Mutual, Inc.*[80] As noted above, that case involved allegations that four hedge funds (referred to as the "Settlement Noteholders") used nonpublic information they obtained through their participation in settlement negotiations to trade in the debtors' securities in violation of the federal securities laws. *In re Washington Mutual* is significant in a number of respects. In addition to finding that it was at least colorable that the Settlement Noteholders had become temporary insiders of the debtors (*see supra* at __), the bankruptcy court also held that there were colorable claims that the Settlement Noteholders acted with the requisite scienter. A key aspect of the Settlement Noteholders' defense was that they had agreed, as a condition of participating in settlement negotiations, to restrict their trading (or create ethical walls) for a defined period of time, after which the debtors were obligated to disclose all material non-public information shared with the Settlement Noteholders during those restricted periods. Pursuant to these agreements, the debtors disclosed certain information shared with the Settlement Noteholders, but did not disclose the terms of the settlement proposals themselves, which the bankruptcy court concluded could have been material. The Settlement Noteholders argued that they could not have intended to trade on material non-public information because they relied on the debtors' assurances that all such information had been disclosed. The Court rejected this argument, holding that the Settlement Noteholders had an independent obligation to determine whether they were in possession of material non-public information, and could not rely on the assurances of third parties (here, the debtors and the debtors' counsel) to determine whether all material non-public information had been disclosed.

7. The STOCK Act

Finally, on another front, it appears likely that the securities laws will be amended by the Stop Trading on Congressional Knowledge (STOCK) Act,[81] which would explicitly make prohibitions against insider trading applicable to government officials and employees. The STOCK Act bill was first introduced in 2006, but languished in committee from one Congressional session to the next until a recent flurry of publicity regarding members of Congress trading on inside information. In addition to prohibiting insider trading as such, the versions passed by each house contain a provision establishing a "relationship of trust and confidence" between members and employees of Congress on the one hand, and the government on the other.[82] This language seems designed to incorporate the misappropriation theory of insider trading

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[78] *Id*. at 45.

[79] *Id*. at 50-51. Summary judgment was granted to the SEC when the defendant disappeared. *SEC v. Dorozhko*, no. 07-cv-09606-NRB, docket # 50 (S.D.N.Y. March 24, 2010); *see also, SEC v. Blue Bottle Ltd.*, Civ. Act. No. 07-CV-1380 (CSH) (ECF), 2007 U.S. Dist. LEXIS 95992 (S.D.N.Y. Apr. 24, 2007) (the Court held, in granting a default judgment, that theft of information from a computer and trading on it without disclosing it violated the prohibition against insider trading).

[80] 461 B.R. at 258-66.

[81] S. 2038 passed the Senate on Feb. 2, 2012 by a 96-3 vote; an amended version passed the House on Feb. 9, 2012 by 417-2.

[82] The Act would add a subsection (g) to section 21A of the Securities Exchange Act of 1934 (15 U.S.C. § 78u–1) stating in part: "[E]ach Member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United

into governmental matters. What may prove to be the most interesting impact of the STOCK Act, if it becomes law, is its application to tipper and tippee liability. Members of the public, and lobbyists in particular, are often in close touch with members of Congress and their staff respecting pending legislation or investigations. At what point communications on such matters become material inside information covered by the STOCK Act could quickly become a matter of dispute.

States with respect to material, nonpublic information derived from such person's position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities."