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THE MISAPPROPRIATION THEORY OF INSIDER TRADING: WHAT CONSTITUTES A "SIMILAR RELATIONSHIP OF TRUST AND CONFIDENCE?"

I. INTRODUCTION

The Securities and Exchange Commission ("Commission") uses, among other statutes, Section 10(b) of the Securities Exchange Act of 1934,\(^1\) to strictly regulate insider trading.\(^2\) To enforce Section 10(b), the Commission promulgated Rule 10b-5,\(^3\) which provides "it shall be unlawful . . . to engage in any . . . fraud or deceit . . . in connection with the purchase or sale of any security."\(^4\) There are two primary theories of liability associated with Section 10(b) and Rule 10b-5. Under the Classical Theory of 10b-5 liability, a corporate insider\(^5\) who trades on material,\(^6\) non-public information in breach of a fiduciary duty to the corporation's shareholders violates Section 10(b).\(^7\) Under the Misappropriation Theory of 10b-5 liability, a corporate outsider\(^8\) who trades on misappropriated material, non-public information in breach of a fiduciary duty or "similar relationship of trust and confidence"\(^9\) owed to the source of the information also violates Section 10(b).\(^10\)

4. Id.
6. See infra note 50 and accompanying text.
7. See infra note 50 and accompanying text.
8. Outsiders consist of those people who do not meet the definition of "insider." See supra note 5 and accompanying text.
Although lower courts have reviewed the issue of what constitutes a "fiduciary duty or similar relationship of trust and confidence,"\(^{11}\) the United States Court of Appeals for the Second Circuit, in *United States v. Chestman*,\(^{12}\) is the only appellate court to specifically address the issue. In *Chestman*, the court held that in order to sustain a criminal prosecution under Section 10(b), the government must prove that the misappropriator owed the source of the information the functional equivalent of a fiduciary duty.\(^{13}\) This comment presents the view that the *Chestman* court's strict requirement, that a misappropriator breach a fiduciary duty to the source of his information, is inconsistent with the Supreme Court's analysis of the Misappropriation Theory in *United States v. O'Hagan*,\(^{14}\) although the Supreme Court itself has not specifically addressed the issue.

In order to facilitate this comment's analysis of the *Chestman* decision, Part II presents the background of Section 10(b) and Rule 10b-5 liability by explaining the early development of the Classical and Misappropriation theories, as well as a review of the *Chestman*\(^{15}\) and *O'Hagan*\(^{16}\) decisions. Part III describes the issue addressed by this comment, namely the inconsistency between the *Chestman* holding and the Supreme Court's rationale in *O'Hagan*.\(^{17}\) Part IV provides an analysis of the statutory language of Section 10(b) and Rule 10b-5, flaws in the *Chestman* analysis, and a description of how the *Chestman* holding is inconsistent with the Supreme Court's analysis in *O'Hagan*.\(^{18}\) Part V proposes that courts should abandon the rule set forth in *Chestman*\(^{19}\) in order to promote a Misappropriation Theory consistent with *United States v. O'Hagan*.\(^{20}\)

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2. 947 F.2d 551 (2d Cir. 1991).
3. *id.* at 568.
5. 947 F.2d 551 (2d Cir. 1991).
II. BACKGROUND

A. The Promulgation of 10(b) and 10b-5

The 73rd Congress enacted two landmark pieces of legislation, the Securities Act of 193321 (the 1933 Act) and the Securities Exchange Act of 193422 (the 1934 Act), in order to curb perceived abuses in the securities industry following the Great Depression23. "By the 1934 Act Congress purposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges."24 While the 1933 Act regulates initial securities distributions and the 1934 Act generally governs post-distribution activity, both "embrace a fundamental purpose . . . to substitute a philosophy of full disclosure for a philosophy of caveat emptor."25

Until 1961, Section 16(b)26 of the 1934 Act was the only provision that the Commission used to regulate insider trading.27 Section 16(b) regulates the buying and selling of securities over a six month period.28 Under the rule, if an officer, director, or statutory insider29 sells or buys stock within six months of another purchase or sale, he must forfeit all profits to the corporation, even if a net loss results from all transactions.30 Furthermore, Section 16(b) is not limited to

25. Id. at n.10 (quoting H.R. Rep. No. 1383, at 11, 73d Cong., 2d Sess. (1934)).
29. A statutory insider is a shareholder with at least 10% holdings in the corporation's securities at the time he trades in the securities. 15 U.S.C. § 78p(a) (1997).
the regulation of corporate insiders because a statutory insider—ten percent shareholder—could have no access to material corporate information and still be subject to liability.  

However, Section 16(b) does address the most dangerous aspect of insider trading, the incentive for insiders to create volatility in the stock price in order to take advantage of short-swing profits.  

In 1961, the Commission held that liability for insider trading could also be premised on Section 10(b) of the 1934 Act.  

Section 10(b) States:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Pursuant to Section 10(b), which enables the Commission to promulgate “rules and regulations [they] prescribe as necessary,” the Commission enacted Rule 10b-5 that 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,
THE MISAPPROPRIATION THEORY

(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.\(^3^7\)

The anti-fraud language of these two statutes is very broad and does not specifically define what constitutes "insider trading." Consequently, the interpretations of these statutes have not developed systematically.\(^3^8\) Instead, courts have decided many notable cases that interpret the scope of isolated portions of the language.\(^3^9\) These cases have advanced two distinct theories of liability, the Classical Theory and the Misappropriation Theory. Though this paper primarily discusses the scope of the Misappropriation Theory recently approved by the Supreme Court in United States v. O'Hagan,\(^4^0\) it is helpful to first review the scope of the Classical Theory of 10b-5 liability.

B. The Classical Theory of 10b-5 Liability

The Classical Theory targets the breach of duty by a corporate insider, permanent or temporary, to shareholders with whom the insider transacts.\(^4^1\) In Cady, Roberts & Co.\(^4^2\) the Commission held that an insider must disclose to the market all material inside information known to him or abstain from trading, recognizing that some common law jurisdictions impose on traditional insiders an "affirmative duty of disclosure . . . when dealing in securities."\(^4^3\) However, from the be-

37. Id. (emphasis added).
41. See id. at 2207 (1997).
42. 40 S.E.C 907 (1961).
43. See id. at 911.
beginning, 10b-5 liability has not been limited to the regulation of “insider” trading. In Cady, the Commission also determined that other persons with access to inside information, not just traditional corporate insiders such as officers, directors, or controlling shareholders, could be found liable under Rule 10b-5.44

The United States Court of Appeals for the Second Circuit affirmed the Cady rule in SEC v. Texas Gulf Sulpher Co.45 Directors, officers, and other corporate insiders were held to have violated Section 10(b) and Rule 10b-5 when they amassed thousands of shares of Texas Gulf securities based on material, non-public information.46 Despite the admonition of Texas Gulf Sulpher's president to keep information regarding a lucrative mining operation confidential, defendants purchased securities in the open market.47 The court held that “anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading.”48 Additionally, the court found the obligation to abstain from trading does not cease as soon as a press release disclosing the confidential information is given, but continues until the “news [may] reasonably [be] expected to appear over the media of widest circulation, the Dow Jones broad tape.”49 Therefore, one cannot escape liability until the material, non-public information is generally known throughout the investing community.

The Supreme Court acknowledged in Chiarella v. United States50 that the obligation to “disclose” or “abstain”52 in the

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44. Id. at 912.
45. 401 F.2d 833 (2d Cir. 1968).
46. Id. at 852-57.
47. Id. at 843-47.
48. Id. at 848 (emphasis added).
49. Id. at 854.
50. In order for the misstatement or omission of information to meet the materiality requirement of 10b-5(b), the Supreme Court, borrowing from the proxy statement context held that “there must be 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.” Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).
Classical Theory of insider trading liability is premised on a relationship of trust and confidence between corporate insiders and the shareholders of the corporation.\textsuperscript{53} In Chiarella, the defendant was found not to have violated Section 10(b) because he owed no affirmative duty to the injured shareholders.\textsuperscript{54} Chiarella was a printer who deduced the names of five corporate take-over targets from contracts submitted to his firm.\textsuperscript{55} Based on this non-public information, he made profits in excess of $30,000 by purchasing stock in these target companies and selling after the news was made public.\textsuperscript{56} Notably, the Court expressly left open the possibility of finding Chiarella in violation of 10(b) under the Misappropriation Theory, but saved such a ruling for another day because that theory had not been submitted to the jury.\textsuperscript{57}

In Chiarella, the Court promoted the duty of traditional insiders to disclose information before trading because such a duty "guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information."\textsuperscript{58} However, the Court carefully avoided creating a "general duty between all participants in market transactions to forgo actions based on material, nonpublic information. Formulation of such a broad duty . . . should not be undertaken absent some explicit evidence of congressional intent."\textsuperscript{59}

While most insider trading cases brought under Section 10(b) and Rule 10b-5 are criminal actions pursued by the government,\textsuperscript{60} the Supreme Court has held that Section 10(b)
and Rule 10b-5 also create a private right of action. However, the Court interpreted language of Section 10(b), "in connection with the purchase or sale of any security," as requiring a plaintiff to have been either a purchaser or seller of the corporation's securities in order to maintain a private action. Furthermore, the Court preserved the common law requirement of reliance, although for publicly traded stocks there is a rebuttable presumption of reliance on the material misstatement or omission. Finally, in order for a plaintiff to satisfy the "deceptive device" element required for private actions under Rule 10b-5, the plaintiff must allege deceptive and manipulative conduct. The Court reasoned that the language of Section 10(b) that requires manipulation, deception or contrivance does not permit liability without scienter or specific intent.

63. Blue Chip Stamps, 421 U.S. at 731. "[V]irtually all lower federal courts facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed [the] conclusion that the plaintiff class for purposes of Section 10(b) and Rule 10b-5 private damage actions is limited to purchasers and sellers." Id.
65. Id. at 247. This theory is generally referred to as "fraud on the market." Id. "Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action." Id.
66. See supra notes 32-36 and accompanying text.

The language of Section 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception. Nor have we been cited to any evidence in the legislative history that would support a departure from the language of the statute. "When a statute speaks so specifically in terms of manipulation and deception . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute." Thus the claim of fraud and fiduciary breach in this complaint states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as "manipulative or deceptive" within the meaning of the statute.

Id.
As Cady held, the Classical Theory applies not only to traditional insiders, but also to attorneys, accountants, consultants, and other temporary fiduciaries of a corporation. The Supreme Court defined the scope of liability for outsiders under the Classical Theory in Dirks v. SEC. Dirks, an investment broker in a New York firm who received material, non-public information from an insider of Equity Funding, alleged that the company vastly overstated its assets as a result of fraudulent corporate practices. After many attempts to expose this fraud and make the information public, Dirks warned clients and investors to sell, which resulted in a liquidation of over $16,000,000 in Equity Funding's stock.

The Court rejected the Commission's broad theory that would hold a "tippee" liable if he traded on material, non-public information that he knew or should have known came from a corporate insider, regardless of the insider's purpose for disclosure. The Court acknowledged the analytical difficulty of attaching a Cady duty to an outsider-tippee noting that a typical tippee has no fiduciary relationship to the shareholders of the corporation. Staying true to the deceptive device requirement of Rule 10b-5 liability, the Court held that "some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them improperly." A tippee receives his non-public information improperly if the tipper-insider breaches a duty to his shareholders by divulging the information for his own personal advan-

 artificially affecting the price of securities.

Id.
71. See id. at 649.
72. Id. at 649-51.
73. Id. at 657.

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with the principle set forth in Chiarella that only some persons, under some circumstances, will be barred from trading while in possession of material nonpublic information.

Id.
74. Id. at 655.
The Court stated the rule: "a tippee assumes a fiduciary duty to the shareholders of a corporation . . . only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."77 Because the record clearly showed that the tipper-insider of Equity Funding who divulged the information to Dirks did not disclose the information for personal advantage, but to uncover an ongoing fraud, the "deception" requirement was not met.78 It is clear from the Court's rulings on the Classical Theory of insider trading that it is most concerned with curtailing deceptive self-dealing in material, non-public corporate information.79

C. The Misappropriation Theory of 10b-5 Liability

Under the Misappropriation Theory, a person commits fraud "in connection with" a securities transaction, and thereby violates Section 10(b) and Rule 10b-5, when he misappropriates non-public information in breach of a fiduciary duty, or "similar relation of trust and confidence,"80 owed to the source of the information.81 The Commission first ad-

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76. See id. at 662.
77. Id. at 660 (emphasis added). A fiduciary that assumes or inherits a duty in this way is often referred to as a temporary fiduciary. See United States v. O'Hagan, 117 S. Ct. 2199, 2207 (1997).
78. Dirks, 463 U.S. at 665.
   It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders. He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks' sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their Cady, Roberts duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the Wall Street Journal.
   Id.
80. Chiarella v. United States, 445 U.S. 222, 228 (1980) (citing Restatement (Second) of Torts § 551(2)(a)).
vanced the Misappropriation Theory subsequent to Justice Burger's dissent from the Chiarella majority opinion. In his dissenting opinion Burger wrote, "I would read [Section] 10(b) and Rule 10b-5 . . . to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading." Prior to the Supreme Court's approval of the Misappropriation Theory in United States v. O'Hagan, four circuits had approved the theory and only two were opposed. The Second Circuit, which decided United States v. Chestman, was the first circuit to expressly adopt the theory.

1. The Chestman Case

The facts of Chestman "read as if they were lifted out of an exaggerated law school exam." Robert Chestman, a stockbroker, began placing trades for Keith and Susan Loeb in 1982 when the Loebs decided to consolidate their holdings in the Waldbaum family corporation. At that time, Keith informed Chestman that Susan was the daughter of Julia Waldbaum, a director and wife of the founder, and that she was also the niece of Ira Waldbaum, president and controlling shareholder. After Ira had successfully negotiated a sale of Waldbaum, Inc., he told Susan's mother, Shirley, that he would tender her shares to the purchasing corporation but that she had to keep the pending sale strictly confidential. After Susan questioned Shirley about a mysterious trip, due to concerns for her mother's health, Shirley informed Susan that the purpose of the trip was to pick up stock certificates

82. Chiarella, 445 U.S. at 239-45.
83. See id. at 241.
84. 117 S. Ct. 2199 (1997).
85. See, e.g., SEC v. Cherif, 933 F.2d 403 (7th Cir. 1991); SEC v. Clark, 915 F.2d 439 (9th Cir. 1990); Rothberg v. Rosenblum, 771 F.2d 818 (3d Cir. 1985); United States v. Newman, 664 F.2d 12 (2d Cir. 1981).
87. 947 F.2d 551 (2d Cir. 1991).
91. id.
92. Id.
for the pending sale. Shirley subsequently admonished Susan not to tell anyone except for Keith, and Susan passed on the same admonition to Keith.

Despite Susan's admonition, Keith called Chestman the next morning and told him that Waldbaum, Inc. was about to be sold "at a substantially higher price than its market value." Though Chestman initially refused to give Keith any advice regarding the securities, he purchased shares for himself and many of his customers' accounts, including the Loeb's. During a second conversation with Keith, Chestman said that his own research confirmed that Waldbaum, Inc. was a buy, and Keith subsequently purchased one thousand more shares through Chestman. After the Commission commenced an investigation into Waldbaum, Inc. securities, Keith agreed to cooperate with the Commission against Chestman, paying a $25,000 fine and disgorging the $25,000 profit he made from the transactions. Although the court did convict Chestman for violating Rule 14e-3(a), which regulates trading on the basis of information regarding tender offers, this paper only discusses the court's reversal of Chestman's conviction under the Misappropriation Theory of 10b-5 liability.

Chestman was convicted in district court for violating Rule 10b-5 by aiding and abetting Keith Loeb's misappropriation of material, non-public information in breach of a duty owed to the Waldbaum family and his wife Susan. The government conceded that Chestman's conviction depended on a finding that Keith had misappropriated the information regarding the sale of Waldbaum. Therefore, the Chestman court had to grapple with one central issue: whether "Keith Loeb breached a duty owed to the Waldbaum

93. Id. at 579 (Winter, J. dissenting).
94. Id. at 555.
95. Id. at 555.
97. Id.
98. Id.
100. Chestman, 947 F.2d at 571.
101. Id. at 564.
102. Id.
family or Susan Loeb based on a fiduciary duty or similar relationship of trust and confidence.”

The court’s analysis first explained that the rationale for the Misappropriation Theory’s extension to fraud on the source, even if the source is not affiliated with the buyer or seller, is based on Rule 10b-5’s language, “fraud or deceit upon any person.” It feared that this would be a particularly broad expansion if a “similar relationship of trust and confidence [were] construed liberally.” Therefore, because no appellate court had expanded fraud on the source to familial relationships, the Chestman court wished to “tread cautiously in extending the misappropriation theory” to Keith Loeb’s appropriation of Waldbaum corporate information.

Faced with the task of determining what constitutes a fiduciary duty or “similar relationship of trust and confidence,” the court began with examining fiduciary duties. First, the court followed a great amount of precedent by declaring that merely entrusting someone with confidential information does not create a fiduciary duty in the Rule 10b-5 context. Second, the court stated that marriage, without more, does not create a fiduciary relationship; “rather, the existence of a confidential relationship must be determined independently of a pre-existing family relationship.” Finally, the court listed several inherent fiduciary categories in which Keith Loeb would not fit, including attorney and client, executor and heir, guardian and ward, principal and agent, and trustee and beneficiary.

Unwilling to classify Keith Loeb as a fiduciary under the common law, the court next considered the meaning of the language, “similar relationships of trust and confidence.” It concluded that the word “similar” requires the relationship to possess the same essential characteristics of a common law

103. Id.
104. Id. at 566. (quoting 17 C.F.R. § 240.10b-5 (1997)).
106. Chestman, 947 F.2d at 567.
107. id.
108. Id. See also Dirks v. SEC, 463 U.S. 665 (1983); Walton v. Morgan Stanley & Co., 623 F.2d 796, 799 (2d Cir. 1980). See also supra text accompanying note 75.
109. Chestman, 947 F.2d at 568.
110. See id.
fiduciary duty.\textsuperscript{111} Again, the court insisted that such a similar relationship must entail more than just the entrustment of confidential information.\textsuperscript{112} Specifically, the majority opinion stated that the similar relationship of trust and confidence must be the "functional equivalent of a fiduciary duty."\textsuperscript{113}

After essentially narrowing "similar relations of trust and confidence" to fiduciary relations, the \textit{Chestman} court then explored the essential characteristics of a fiduciary relationship.\textsuperscript{114} First, it said that at the heart of a fiduciary relationship is "reliance and dominance or control."\textsuperscript{115} The court explained that a fiduciary relationship is usually created where one puts confidence in another and the person in turn exerts some "superiority or influence"\textsuperscript{116} over the one who confides. It finally resolved that a fiduciary, or similar relationship is created when one person depends on another (the fiduciary) to serve his interests.\textsuperscript{117}

However, the court backed off this seemingly rigid stance in order to reconcile its opinion with a lower court case that both the government and the defendant, Chestman, relied on.\textsuperscript{118} In \textit{United States v. Reed},\textsuperscript{119} a son used confidential statements about a tender offer made by his father, a member of the board of directors of the offeror, to purchase call options for a substantial profit.\textsuperscript{120} While the Reed's relationship did not have the requisite "dependence and influence," the \textit{Chestman} court seized on the fact that the Reeds "customarily reposed information in each other," holding that "repeated disclosure of business secrets between family members may substitute for a finding of dependence and in-

\textsuperscript{111} \textit{Id.}
\textsuperscript{113} \textit{United States v. Chestman}, 947 F.2d 551, 568 (2d Cir. 1991).
\textsuperscript{114} \textit{Id.} at 568.
\textsuperscript{115} \textit{Id.}
\textsuperscript{116} \textit{Id.} at 568-69 (quoting \textit{United States v. Margiotta}, 688 F.2d 108 125 (2d Cir. 1982) and \textit{BLACK'S LAW DICTIONARY} 564 (5th ed. 1979)).
\textsuperscript{117} \textit{United States v. Chestman}, 947 F.2d 551, 569 (2d Cir. 1991).
\textsuperscript{118} \textit{Id.}
\textsuperscript{119} 601 F. Supp. 685 (S.D.N.Y. 1985), rev'd on other grounds, 773 F.2d 477 (2d Cir. 1985).
\textsuperscript{120} \textit{Id.}
\textsuperscript{121} \textit{Chestman}, 947 F.2d at 569.
fluence."\(^{122}\)

Not only did Chestman detract from its requirement that a "similar relationship" must bare the essential characteristics of a fiduciary duty in order to reconcile itself with Reed, but it admitted that courts have never strictly limited fiduciary or confidential relationships.\(^{123}\) "Equity has never bound itself by any hard and fast definition of the phrase 'confidential relation' and has not listed all the necessary elements of such a relation, but has reserved discretion whenever it believes a suitable occasion has arisen."\(^{124}\) However, the majority maintained that while this ambiguity may be preferable in a civil context to alleviate harsh results, it has "no place in the criminal law."\(^{125}\)

Before applying the circumstances surrounding Keith Loeb's use of material, non-public information to its analysis, the majority concluded that the "core inquiry in a Rule 10b-5 criminal conviction [is] whether a fiduciary duty has been breached,"\(^{126}\) completely leaving behind similar relationships of trust and confidence. The court had "little trouble finding the evidence insufficient"\(^{127}\) to support a finding by the jury that Keith Loeb had breached a strict common law fiduciary duty.\(^{128}\) In holding that Keith had no fiduciary-like association with his wife and the Waldbaum family, the court found that Keith was not part of the Waldbaum family inner circle and the government "failed even to establish a pattern of sharing business confidences between the couple."\(^{129}\)

In his dissent from the Chestman majority, Judge Winter

\(^{122}\) See id.

\(^{123}\) United States v. Chestman, 947 F.2d 551 (2d Cir. 1991).

\(^{124}\) Id. See also United States v. Reed, 601 F. Supp. 685, 712 n.18 (S.D.N.Y. 1985) (quoting C.G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 482, at 284-86 (Rev. 2d ed. 1928)).


\(^{126}\) Chestman, 947 F.2d at 570 (emphasis added).


\(^{128}\) See id.

\(^{129}\) Id. at 570-71 (emphasis added).
emphasized the following Cady requirements, which the United States Court of Appeals approved: 130 1) the trader's relationship giving him special access to corporate information not intended for private use and 2) the unfairness resulting from trading with those who lack the informational advantage afforded by the special access. 131 Judge Winter believed that because Keith benefited from the family's control of Waldbaum, his relationship was commercial as well as familial. 132 When a corporation and a family are intertwined, disclosure of non-public corporate information may be inevitable and may even be required to avoid misunderstandings. 133 This purpose of maintaining informal interactions "can hardly be fulfilled if there is no accompanying duty not to trade." 134 Winter found that the majority's rule would make a family-run corporation more susceptible to disclosure than a public corporation and "expects family members to behave like strangers toward each other." 135

2. The O'Hagan Case
In United States v. O'Hagan, 136 the United States Supreme Court expressly held for the first time that "criminal liability under Section 10(b) may be predicated on the misappropriation theory." 137 James O'Hagan was a partner in a law firm that represented Grand Met in a tender offer for the Pillsbury Company, though he personally did not work on the transaction. 138 Based on material, non-public information he obtained from his firm, O'Hagan transacted in Pillsbury securities for a profit of over $4.3 million. 139 In addition to being convicted for mail fraud and violating Rule 14e-3, 140 O'Hagan was convicted for violating Section 10(b), not because he breached a duty to the Pillsbury shareholders, but

130. See supra text accompanying note 45.
131. Chestman, 947 F.2d at 573 (Winter, J. dissenting).
132. See id. at 580-81.
134. Id.
135. Id. at 580.
137. See id. at 2206.
138. Id. at 2205.
139. Id.
140. See supra note 99.
because he breached a duty to his law firm by misappropriating its confidential information.\textsuperscript{141}

Justice Ginsburg, writing for the majority, began by outlining the main elements of a Section 10(b) action.\textsuperscript{142} First, the defendant must have used a "deceptive device,"\textsuperscript{143} though the deception does not have to be of a purchaser or seller.\textsuperscript{144} Second, the deception must be "in connection with\textsuperscript{145} the purchase or sale of any security."\textsuperscript{146} The Court noted that the Misappropriation Theory complements the Classical Theory by targeting outsiders who trade on non-public information in breach of a duty to the source of the information, satisfying the deception requirement of Section 10(b).\textsuperscript{147} "In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-traders deception of those who entrusted him with access to confidential information."\textsuperscript{148}

The Court began its analysis by explaining what it believes is the central issue in a Section 10(b) case. "We observe, first"\textsuperscript{149} that misappropriators deal in deception by pretending loyalty to the source of the information while converting non-public information for their personal gain.\textsuperscript{150} Unlike Chestman, which found that the existence of a fiduciary duty was the "core inquiry in a Rule 10b-5 criminal conviction,"\textsuperscript{151} O'Hagan found that "[d]eception through non-disclosure is central to the theory of [Section 10(b)] liability."\textsuperscript{152} Indeed, Section 10(b) is "not an all-purpose breach of fiduciary duty ban; rather, it trains on conduct involving manipulation or deception."\textsuperscript{153} In explaining its rationale for focusing on deception, the Court said that a misappropriator

\begin{itemize}
  \item \textsuperscript{141} United States v. O'Hagan, 117 S. Ct. 2199, 2205-06 (1997).
  \item \textsuperscript{142} See id. at 2205.
  \item \textsuperscript{143} Id. at 2206 (citing 15 U.S.C. § 78j (1997)).
  \item \textsuperscript{144} O'Hagan, 117 S. Ct. at 2207.
  \item \textsuperscript{145} Id. at 2206 (citing 15 U.S.C. § 78j (1997)).
  \item \textsuperscript{146} Id. at 2206.
  \item \textsuperscript{147} Id. at 2208.
  \item \textsuperscript{148} United States v. O'Hagan, 117 S. Ct. 2199, 2207 (1997).
  \item \textsuperscript{149} See id. at 2208.
  \item \textsuperscript{150} Id.
  \item \textsuperscript{151} United States v. Chestman, 947 F.2d 551, 570 (2d Cir. 1991).
  \item \textsuperscript{152} O'Hagan, 117 S. Ct. at 2208.
  \item \textsuperscript{153} Id. at 2209.
\end{itemize}
"gains his advantageous market position through deception; he deceives the source of the information and simultaneously harms members of the investing public."\textsuperscript{154}

The Court next dealt briefly with the contention that the language of Section 10(b), "in connection with the purchase or sale . . . of any security\textsuperscript{155}" limits liability to situations where the defendant actually defrauds a purchaser or seller of securities. While the Court acknowledged that a purchaser or seller might not be deceived in any way, it explained that the deception used to misappropriate non-public information is connected to a purchase or sale when the misappropriator uses the information to transact in securities.\textsuperscript{156} Therefore, the "fraud is consummated, not when the fiduciary gains the confidential information, but when . . . he uses the information to purchase or sell securities."\textsuperscript{157}

While the Court often spoke in terms of breaching a fiduciary duty to the source, the Court did not need to address the issue specifically because O'Hagan had an indisputable fiduciary relationship with his firm. The majority did say that a "duty to disclose or abstain from trading 'arises from a specific relationship between two parties,'"\textsuperscript{158} but there is "no general duty between all participants in market transactions to forgo actions based on material, nonpublic information."\textsuperscript{159} With respect to the fiduciary duty or similar relationship of trust and confidence between a defendant and his source, the Court inquires into whether there was an "expectation by [the source] that he would keep their information in confidence."\textsuperscript{160}

The Supreme Court held that the Misappropriation Theory comports with one of the fundamental purposes of the 1934 Act: insuring the maintenance of fair and honest mar-

\textsuperscript{156} O'Hagan, 117 S. Ct. at 2209.
\textsuperscript{157} See id.
\textsuperscript{158} Id. at 2212 (quoting Chiarella v. United States, 445 U.S. 222, 233 (1980)).
\textsuperscript{159} O'Hagan, 117 S. Ct. at 2209 (quoting Chiarella v. United States, 445 U.S. 222, 233 (1980)).
kets as well as the promotion of investor confidence. The Court said that the theory is "designed to protec[t] the integrity of the securities markets against abuses by "outsiders" . . . who have access to confidential information." A misappropriator's advantage comes from "contrivance, not luck [and] cannot be overcome with research or skill." The Court concluded its discussion of the purpose of Section 10(b) by conceding that informational disparity is inevitable in the securities markets. However, Justice Ginsburg said that investors would think twice about putting their money into a market where "trading based on misappropriated, nonpublic information is unchecked by law."

Finally, the Supreme Court commented on the ambiguity of Section 10(b) and the implications of that ambiguity on criminal prosecutions. Congress has created two vital safeguards against the possible ambiguity of Section 10(b) and Rule 10b-5 in criminal prosecutions. Not only must the government prove that the defendant willfully violated Section 10(b), but the defendant also may not be imprisoned for a violation of Rule 10b-5 if he proves that he had no knowledge of the rule.

162. Id. at 2207 (quoting Chiarella v. United States, 445 U.S. 222, 228-29 (1980)).
164. Id. at 2210-11.
166. See id. at 2213-14.
167. Id. at 2214 n.12. Section 32 of the 1934 Act provides:
Any person who willfully violates any provision of this chapter . . . or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter . . . shall upon conviction be fined not more than $1,000,000 or imprisoned not more than 10 years, or both . . . ; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.
169. See supra note 125 and accompanying text.
plies] to criminal statutes. Therefore, in *O'Hagan*, the Supreme Court held that criminal liability under Section 10(b) may be predicated on the Misappropriation Theory.

III. IDENTIFICATION OF THE ISSUE

Both the United States Court of Appeals for the Second Circuit, in *United States v. Chestman*,171 and the United States Supreme Court, in *United States v. O'Hagan*,172 recognized that the Misappropriation Theory of insider trading is a valid theory for prosecuting a Section 10(b) violation. In determining the scope of the Misappropriation Theory, the *Chestman* court found that one who trades on misappropriated non-public information must owe the functional equivalent of a fiduciary duty to the source of the information in order to be prosecuted for violating Section 10(b) and Rule 10b-5.173 However, the Supreme Court's validation of the Misappropriation Theory did not require it to address that issue, as James O'Hagan unquestionably owed a fiduciary duty to his law firm. Therefore, the issue discussed in this comment is whether, in light of the rationale presented in *O'Hagan*, the *Chestman* court's limited interpretation of the Misappropriation Theory, which includes the strict requirement of a fiduciary duty, should be followed or rejected by other courts.

IV. ANALYSIS

The *Chestman* court's strict requirement that a misappropriator of material, non-public information breach a fiduciary duty to the source is inconsistent with the Supreme Court's analysis of the Misappropriation Theory in *O'Hagan*. First, Section 10(b) and Rule 10b-5 do not expressly require a fiduciary duty and it is not reasonable to imply such a requirement for the Misappropriation Theory.174 Second, *Chestman*’s analysis and reasoning for requiring a strict fiduciary duty has several fundamental flaws.175 Third, in

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171. 947 F.2d 551 (2d Cir. 1991).
173. See supra text accompanying note 113.
174. See discussion infra Part IV.A.
175. See discussion infra Part IV.B.
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O'Hagan, the Supreme Court emphasized the importance of the "deceptive device" requirement rather than duty in approving the Misappropriation Theory.\textsuperscript{176} Fourth, all of the policy justifications cited by the Supreme Court in approving the Misappropriation Theory would be compromised if Chestman's narrow holding were followed in other circuits.\textsuperscript{177} Finally, the Chestman court's concern that the ambiguity of Section 10(b) and Rule 10b-5 warrants a narrow interpretation of fiduciary duty in criminal cases was expressly alleviated in O'Hagan.\textsuperscript{178}

A. The Language of 10(b) and 10b-5

The Language of Section 10(b) and Rule 10b-5 does not warrant a strict requirement that a misappropriator breach a fiduciary duty to the source. These statutes only require that the misappropriator's conduct constitutes a "deceptive device,"\textsuperscript{180} and that it is "connect[ed] with the purchase or sale of any security."\textsuperscript{181} In Chiarella, the Supreme Court found that in order to satisfy the deceptive device requirement of a Section 10(b) action under the Classical Theory, a traditional insider trading on material, non-public information must owe a fiduciary duty to the injured shareholders.\textsuperscript{182} The Court did not create a new fiduciary duty requirement in doing so, but simply acknowledged that the insider's trading on material, non-public information is not deceptive unless he has a duty not to trade.\textsuperscript{183} What makes the insider's failure to disclose the confidential information or abstain from trading deceptive is the betrayal of a relationship of trust and confidence between a corporate insider and the corporation's shareholders.\textsuperscript{184}

Though the Supreme Court specifically avoided creating a "general duty between all participants in market transactions to forgo actions based on material, non-public informa-

\textsuperscript{177} See discussion infra Part IV.C.
\textsuperscript{178} See discussion infra Part IV.D.
\textsuperscript{179} See discussion infra Part IV.E.
\textsuperscript{181} See id.
\textsuperscript{183} Id.
\textsuperscript{184} Id. at 228-29.
tion" under the Classical Theory, narrowly construing this language with respect to the Misappropriation Theory would be equally unwarranted. While the Court found that a "specific relationship between two parties" is necessary to make the insiders conduct deceptive, it is not a reasonable construction of Section 10(b) to say that an outsider's betrayal of his wife's (a specific relationship) confidence is not deceptive. The language of Section 10(b) and Rule 10b-5 requires deception, not a fiduciary duty. Therefore Chestman's emphasis on the fiduciary relationship in a misappropriation case is an unfounded interpretation of the statutes.

B. The Flaws in the Chestman Analysis

The Chestman court reasoned that a fiduciary duty is necessary to sustain a Section 10(b) violation, but it left several fundamental flaws in its analysis. The court first conceded that the inquiry should be whether the information was misappropriated in breach of a fiduciary duty or "similar relationship of trust and confidence." However, the court reasoned that the word "similar" should be interpreted to mean that a misappropriator's relationship to the source should possess the same essential characteristics of a traditional common law fiduciary duty. Concluding that a similar relationship of trust and confidence must be the functional equivalent of a fiduciary duty, the Chestman court essentially nullifies the "similar relationship" language, rendering it superfluous. Because this language was developed by the Supreme Court specifically for the Section 10(b) liability context, Chestman's virtual dismissal of it is inappropriate.

185. Id. at 233.
186. Id.
187. See supra notes 32-36 and accompanying text.
188. United States v. Chestman, 947 F.2d 551, 570 (2d Cir. 1991). The majority in Chestman said the issue of whether a fiduciary duty exists is "frequently the core inquiry in a Rule 10b-5 criminal conviction." id.
189. See discussion supra Part II.B.
190. Chestman, 947 F.2d at 564.
191. Id. at 568.
192. Id.
193. See supra text accompanying notes 113-17.
Not only was the Chestman court's narrowing the scope of the misappropriator-source relationship inappropriate, but its examination of the essential characteristics of a fiduciary duty left much to be desired. First, relying on another Second Circuit decision, United States v. Margiotta, the court narrowed the scope of fiduciary duty to a relationship characterized by reliance, dominance, and control. However, the Margiotta decision only addressed the specific issue of when a governmental official's relationship with the general citizenry becomes fiduciary, not fiduciary duties in general. Second, the court used Black's Law Dictionary to support its limited definition, but ignored Black's statement that "'fiduciary relation' is a very broad term embracing both technical fiduciary relations and those informal relations in which one trusts in or relies on another." One would have to consider Keith Loeb a traditional fiduciary under this relaxed definition, for surely he and his wife shared at least an "informal relation." Third, limiting the characteristics of the fiduciary relationship to dominance and control ignores the simplest of fiduciary relationships, the partnership. Though in a simple partnership neither partner necessarily exerts control over the other, their fiduciary relationship is considered a duty of the "highest kind." Finally, though Chestman admits the courts have always loosely applied the fiduciary relationship in order to avoid harsh results, it chose not to follow this tradition in a criminal case. While the court's concern about an ambiguous criminal statute may be valid, it is not reasonable to limit the definition of "fiduciary" so far that it eliminates many traditional fiduciary relationships.

Perhaps the most confusing aspect of the Chestman analysis is the court's willingness to retreat from its new strict definition of fiduciary in order to reconcile its opinion

195. 688 F.2d 108, 125 (2d Cir. 1982).
196. See id.
197. Id.
198. United States v. Chestman, 947 F.2d 551, 569 (2d Cir. 1991) (quoting BLACK'S LAW DICTIONARY 564 (5th ed. 1979)).
200. Meinhard v. Salmon, 164 N.E. 545, 546 (1928). Judge Cardozo's description of the standard of behavior governing a fiduciary in a partnership as "the punctilio of an honor the most sensitive" remains the classic definition. Id.
201. See discussion infra Part IV.E.
with United States v. Reed.\footnote{202} As soon as the court declared that the essential characteristics of the fiduciary relationship are control and dominance, it conceded that the repeated disclosure of information may substitute for a finding of dependence and influence.\footnote{203} Despite the fact that this concession did not logically flow from the court's creation of a strict and unambiguous definition of "fiduciary," it is not clear why Keith and Susan Loeb's marriage, which must have enjoyed regular disclosure of information, could not satisfy this definition. While the court found the government had failed to show a "pattern of sharing business information" between Keith and Susan, the record reflects that they handled their Waldbaum securities jointly\footnote{204} and it is unreasonable to suggest that a husband and wife would not openly discuss their financial affairs.\footnote{205}

C. The "Deceptive Device"

In O'Hagan, the Supreme Court emphasized the importance of the "deceptive device" requirement rather than duty in approving the Misappropriation Theory.\footnote{206} The Court recognized that the Misappropriation Theory "premises liability on a party's deception of those who have given him privileged access to confidential information."\footnote{207} Furthermore, it found that "deception through nondisclosure is central to [Section 10(b)] liability."\footnote{208} Because Keith Loeb had a relationship of trust and confidence with his wife that gave him privileged access to confidential information, he should have been found liable under the Misappropriation Theory.

The Supreme Court said this deception is connected to a
THE MISAPPROPRIATION THEORY

purchase or sale of securities when the misappropriator uses
the material, nonpublic information to buy securities.\textsuperscript{209} The
\textit{Chestman} court found that Keith's conduct did not qualify as
deceptive because he did not solicit the information or induce
Susan to convey it to him.\textsuperscript{210} However, the Supreme Court
did not need to inquire into whether James O'Hagan solicited
the information from his law firm. Rather, as just men-
tioned, the Court looks to see whether the misappropriator
was given privileged \textit{access} to the information. Furthermore,
as Judge Winter noted in his dissent, "Chestman's and Loeb's
concerns were not about commercial wisdom, but ... about
the propriety of Loeb's trading on the 'definite' and 'accurate'
information."\textsuperscript{211} Keith Loeb had access to confidential infor-
mation and knew he was betraying his wife's confidence
when he spoke to Chestman about the pending sale of Waldb-
baum.\textsuperscript{212} As the \textit{O'Hagan} court affirmed,\textsuperscript{213} such a "deception"
violates Section 10(b) when it is used "in connection with the
purchase or sale of any security."\textsuperscript{214}

In deciding whether a defendant employed a "deceptive
device" by betraying a confidential relationship, the Court
looks to see whether there was an "expectation by the sources
that he would keep their information in confidence."\textsuperscript{215} Susan
"cautioned [Keith] not to tell anyone because 'it could possi-
bly ruin the sale.'"\textsuperscript{216} She indicated they "had shared confi-
dences in the past and that on each such occasion they had
indicated to each other that the confidences would be re-
spected."\textsuperscript{217} Clearly the source, Susan, expected the non-
public information to be kept confidential. Keith's betrayal of
Susan's confidence satisfied the "in connection with" re-
quirement when he purchased Waldbbaum securities on the
basis of the information he misappropriated from her. There-
fore, Keith's conduct satisfies the requirements emphasized

\begin{itemize}
\item \textsuperscript{209} \textit{Id.} at 2209.
\item \textsuperscript{210} United States v. Chestman, 947 F.2d 551, 571 (2d Cir. 1991).
\item \textsuperscript{211} \textit{Id.} at 581 (Winter, J., dissenting).
\item \textsuperscript{212} \textit{Id.}
\item \textsuperscript{213} United States v. O'Hagan, 117 S. Ct. 2199, 2209 (1997).
\item \textsuperscript{214} 15 U.S.C. § 78p(b) (1997).
\item \textsuperscript{215} \textit{O'Hagan}, 117 S. Ct. at 2213 (quoting \textit{Dirks v. SEC}, 463 U.S. 646, 665
(1983)).
\item \textsuperscript{216} United States v. Chestman, 947 F.2d 551, 555 (2d Cir. 1991).
\item \textsuperscript{217} \textit{See id.} at 579 (Winter, J., dissenting).
\end{itemize}
by the *O'Hagan* court in approving the Misappropriation Theory.

D. *The Policy Justifications*

In addition to satisfying the statutory requirements for liability outlined in *O'Hagan*, Keith's betrayal of the "relationship of trust and confidence" he shared with his wife should be deemed a violation of Section 10(b) and Rule 10b-5 in order to fulfill the policy justifications of those laws. In *O'Hagan*, the Supreme Court said that the purpose of the Securities Exchange Act of 1934 was to insure the maintenance of fair and honest markets while promoting investor confidence.\(^{218}\) A finding that Keith Loeb's conduct constituted misappropriation for the purpose of Section 10(b) does not mean that all investors should have equal access to all information. That may well be impossible.\(^{219}\) However, not holding Loeb's conduct in violation of Section 10(b) would compromise the policy justifications for the Misappropriation Theory enunciated in *O'Hagan*, because his conduct does not support an honest market. Investor confidence will certainly be negatively affected if an entire class of people with the type of access to inside information that Keith Loeb enjoyed is able to trade on that information without fear of prosecution.\(^{220}\)

Despite the fact that Keith Loeb may not have met the traditional definition of fiduciary, the "similar relationship of trust and confidence" he shared with his wife gave him access to confidential information.\(^{221}\) The Supreme Court announced

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219. *id.*
220. *Id.* "Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law." *Id.*

The Law may have been reluctant to recognize obligations based solely on family relationships [because of] concern that intra-family litigation would exacerbate strained relationships and weaken rather than strengthen the sense of mutual obligation underlying family relationships. This concern, however, is of no weight where insider trading is concerned. In such cases, the litigation is almost universally brought by the government or third party.
that the Misappropriation Theory is "designed to protect the integrity of the securities markets against abuses by outsiders to a corporation,"\(^{222}\) like Keith Loeb, who are given "access to confidential information that will affect the corporation's security price when revealed."\(^{223}\) A person in Keith Loeb's position, who gains access to confidential information from some non-fiduciary, though specific,\(^{224}\) relationship, through "contrivance not luck,"\(^{225}\) should be prosecuted for violating Section 10(b). The advantage gained by Keith Loeb through his contrivance, or scheme, with Robert Chestman could not have been "overcome with research or skill."\(^{226}\) Therefore, the O'Hagan Court's policy justifications for the Misappropriation Theory will be compromised if people in Loeb's and Chestman's position are not prosecuted, as investors will either refrain from trading or incur costs to protect themselves from the negative affects of such misappropriation.\(^{227}\)

E. The Criminal Law Implications

The O'Hagan Court expressly dealt with the Chestman court's criminal prosecution concern regarding the ambiguity of Section 10(b) and Rule 10b-5.\(^{228}\) Though the Chestman majority admits that courts have "never bound [themselves] by any hard and fast definition of the phrase confidential relation,"\(^{229}\) it felt that such an elastic definition would offend


\(^{223}\) See id.

\(^{224}\) Id. at 2212 (quoting Chiarella v. United States, 445 U.S. 222, 233 (1980)). "[W]e said, a duty to disclose or abstain from trading 'arises from a specific relationship between two parties.'" O'Hagan, 117 S. Ct. at 2212 (emphasis added).

\(^{225}\) Id. at 2210.

\(^{226}\) United States v. O'Hagan, 117 S. Ct. 2199, 2210 (1997) (quoting Brudney, Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws, 93 HARV. L. REV. 322, 356 (1979)). "If the market is thought to be systematically populated with . . . transactors [trading on the basis of misappropriated information] some investors will refrain from dealing altogether, and others will incur costs to avoid dealing with such transactors . . . ." Id. See also Aldave, supra note 207, at 122-23.

\(^{227}\) O'Hagan, 117 S. Ct. at 2210.


the rule of lenity usually afforded criminal prosecutions.\textsuperscript{230} Similarly, Justice Scalia in his dissent from \textit{O'Hagan} felt the principle of lenity requires the "unelaborated statutory language: [t]o use or employ in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance," be limited to parties of the transaction, not an unrelated source.\textsuperscript{231}

The majority in \textit{O'Hagan} opposed Scalia's argument based on two "sturdy safeguards" created by Congress against the ambiguity of Section 10(b) and Rule 10b-5.\textsuperscript{232} Those safeguards require the government to prove a defendant willfully violated Section 10(b) and provides that a defendant may not be imprisoned if he proves he had no knowledge of Rule 10b-5.\textsuperscript{233} The statute's "requirement of the presence of culpable intent . . . does much to destroy any force in the argument that application of the [statute] in a [criminal prosecution] such as O'Hagan's is unjust."\textsuperscript{234} Because the \textit{Chestman} court relied heavily on the criminal aspect of the case in order to forge a very narrow definition of "fiduciary relationship," that definition should be repudiated after \textit{O'Hagan}'s recognition of the congressional safeguards against such statutory ambiguity.

V. PROPOSAL

The language of Rule 10b-5 provides that "it shall be unlawful . . . to engage in any . . . fraud or deceit . . . in connection with the purchase or sale of any security."\textsuperscript{235} It is reasonable to require an "insider" to breach a fiduciary duty to shareholders in order to make his conduct "deceptive." Without requiring such a duty, there would be no betrayal of a relationship of trust and confidence. However, "outsiders" who misappropriate non-public information usually steal from a source with which they already have a specific rela-

\begin{footnotes}
\item[230] \textit{Chestman}, 947 F.2d at 570. \textit{See also} discussion of the rule of lenity \textit{supra} note 125.
\item[232] \textit{See id.} at 2213.
\item[233] \textit{See supra} note 167 and accompanying text.
\item[234] \textit{O'Hagan}, 117 S. Ct. at 2214.
\item[235] 17 C.F.R. \textsection 240.10b-5 (1997).
\end{footnotes}
tionship, such as father-son, husband-wife, or employer-employee. Surely, such a betrayal of a relationship of trust and confidence, despite the possible lack of traditional fiduciary qualities, satisfies the "deceptive device" requirement of Section 10(b) and Rule 10b-5.

Courts should embrace the policies enunciated in O'Hagan and repudiate Chestman's strict requirement of a fiduciary-like duty for the Misappropriation Theory of insider trading. By holding that the "deceptive device" requirement is satisfied whenever a relationship of trust and confidence is betrayed, courts will further the Supreme Court's policy of maintaining fair and honest markets while promoting investor confidence. Of course, there is great need for regulatory or congressional clarification in the area of insider trading. At the very least, the Commission ought to exercise its rule making authority by specifying what types of relationships, both insider and outsider, are subject to 10b-5 regulation. Until Congress or the Commission makes such a clarification, courts ought to interpret the "deceptive device" requirement liberally in order to curb the abuse of securities markets and promote the policies enunciated by the Supreme Court in O'Hagan.

VI. CONCLUSION

As the exposition of the Classical Theory and Misappropriation Theory in Part II makes clear, courts have traditionally been concerned with individuals gaining an advantage over the market through deception. Part IV demonstrates that the Supreme Court, in United States v. O'Hagan, shared that concern and approved the Misappropriation Theory. Surely, such a betrayal of a relationship of trust and confidence, despite the possible lack of traditional fiduciary qualities, satisfies the "deceptive device" requirement of Section 10(b) and Rule 10b-5.

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pria tion Theory in order to protect investors and insure the
honesty of markets.\textsuperscript{245} This comment contends that the strict
holding of \textit{United States v. Chestman},\textsuperscript{246} requiring the breach
of the functional equivalent of a fiduciary duty in a Section
10(b) action,\textsuperscript{247} only impedes the Supreme Court's policies
aimed at promoting fair and honest markets.\textsuperscript{248} Therefore,
until Congress or the Commission takes legislative action to
clarify what types of relationships are governed by Section
10(b), courts should liberally construe the Supreme Court's
requirement of a "similar relationship of trust and confi-
dence."\textsuperscript{249}

\textit{Keith Valory}

\begin{itemize}
\item \textsuperscript{245} See discussion \textit{supra} Part IV.
\item \textsuperscript{246} 947 F.2d 551 (2d Cir. 1991).
\item \textsuperscript{247} \textit{Id}.
\item \textsuperscript{248} United States v. O'Hagan, 117 S. Ct. 2199 (1997).
\item \textsuperscript{249} Chiarella v. United States, 445 U.S. 222, 228 (1980).
\end{itemize}