I. INTRODUCTION

Inherently, the common law is path dependent. As a result, as the twig is bent, so grows the tree. Once a legal doctrine has developed beyond its infancy, its future trajectory is largely confined within boundaries established by the limited plasticity of common law concepts. Gaps may be filled in, some critical terms may be marginally reinterpreted; but radical change is unlikely. In this light, both because the law of insider trading is largely judge made,1 and because it is well past its early formative period,2 it seems particularly subject to these constraints.3

That said, common law concepts are nonetheless malleable and have the potential for expansion. In the case of insider trading law, duties can be derived from the common law that would trigger an obligation to disclose or abstain from trading, but no article has yet seriously explored these possibilities. This Article will survey some of these possibilities, but its goal is not to urge the maximum expansion of the insider trading prohibition. Rather, it seeks to evaluate the tools at hand.

At the outset, it must also be recognized that the scope of the insider trading prohibition has recently expanded, as the result of decisions that appear to relax older doctrinal constraints. In net effect, these liberalizing decisions have shifted the balance of advantage in securities enforcement litigation in favor of the government. This expansion in the law has largely occurred along two distinct axes: (1) additional duties have been recognized whose breach violates Rule 10b-5;4 and (2) deception not involving a breach of duty has also been found to violate Rule 10b-5.5

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1 See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) (aptly describing Rule 10b-5 as “a judicial oak which has grown from little more than a legislative acorn”). However, Rule 10b-5 has also grown through administrative rulemaking as well, and this Article will suggest that the most sensible way to fill in gaps in the law is through SEC rulemaking. Rules 10b5-1 and 10b5-2 are the leading examples of such administrative gap filling, and they define important fact patterns that today fall within Rule 10b-5 (but did not always). See 17 C.F.R. §§ 240.10b5-1, -2 (2013). Both rules were clearly intended to reverse judicial decisions that had construed Rule 10b-5 narrowly. Compare United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (en banc) (deeming relationship of husband and wife not to be a fiduciary relationship), with Rule 10b5-2(b)(3), 17 C.F.R. § 240.10b5-2(b)(3) (2013) (declaring spouses to owe a “duty of trust or confidence” to each other the breach of which can violate Rule 10b-5).

2 More than fifty years have passed since the SEC’s decision in Cady, Roberts & Co., Exchange Act Release No. 6668, 40 S.E.C. 907 (Nov. 8, 1961), in which then-chairman William Cary first provided a substantive definition of the insider trading prohibition, formulating the “disclose or abstain” standard for insiders.

3 In both Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 165 (2008) and Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011), the Court emphasized in decisions construing Rule 10b-5 (which is the source of authority for the insider trading prohibition) that “[c]oncerns with the judicial creation of a private cause of action caution against its expansion.” In short, judge made law must be construed to give it “narrow dimensions.” Stoneridge, 552 U.S. at 167. Still, if the Court’s concern is with the problems it perceives with private causes of action, expanding the insider trading prohibition itself should not heighten this concern, because insider trading is seldom enforced through private litigation, but instead through criminal and SEC enforcement.

4 A leading example is SEC v. Cuban, which accepted in principle that a legal duty can arise by contract, whose breach would violate Rule 10b-5. SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009). The defendant had claimed that only fiduciary breaches recognized under state law could support a violation of Rule 10b-5. Id. at 726. Conservative law professors have long argued the thesis that only such a state law grounded violation could support a Rule 10b-5 violation. See Stephen A. Bainbridge, Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition, 52 WASH. & LEE L. REV. 1189, 1267 n.320 (1995). But Rule 10b5-2 today recognizes that a “duty of trust or confidence” can be grounded on a contract or an agreement “to maintain information in confidence.” See Rule 10b5-2(b)(1), 17 C.F.R. § 240.10b5-2(b)(1) (2013). Decisions to date have largely upheld the rule. See SEC v. Yun, 327 F.3d 1263, 1273 (11th Cir. 2003) (recognizing that “a breach of an agreement to maintain business confidences would also suffice” to support insider trading liability); SEC v. Lyon, 529 F. Supp. 2d 444, 452–53 (S.D.N.Y. 2008). However, in SEC v. Cuban, the court drew a tortured distinction between agreeing to maintain confidentiality and agreeing not to trade. Cuban, 634 F. Supp. 2d at 729–31. In its view, Rule 10b5-2(b)(1) improperly
The specifics of these decisions are carefully analyzed by Professor Donald Langevoort, Stephen Crimmins, and Edward Greene and Olivia Schmid in their excellent contributions to this Symposium, but this Article will use this recent expansion as a jumping-off point to ask: How much more doctrinal evolution is possible, without legislation, in the foreseeable future? More specifically, how could the law evolve over the next decade? Is it possible that the law could expand to the point that anyone who acquires and trades on material nonpublic information would violate Rule 10b-5?

This Article has both descriptive and normative intentions. Initially, it will first map the gaps in existing insider trading law; then, it will consider how far the law could be expanded, without legislation, through administrative rulemaking. Its model for reform is the SEC’s successful effort in 2000 to extend the boundaries of Rule 10b-5 through the promulgation of Rules 10b5-1 and 10b5-2. Motivating this inquiry is a premise that needs to be explicitly stated at the outset: the current reach of the insider trading prohibition is both arbitrary and incomplete. Egregious cases of informational misuse are not covered, while less culpable instances of abuse are criminalized. For the long term, the scope of the insider trading prohibition needs to be better rationalized.

To understand this contention, it is useful to begin our mapping of the current outer boundaries of insider trading law with three recent decisions. First, in SEC v. Dorozhko, the Second Circuit opened the door to the prosecution of persons who trade on material nonpublic information, even when they do not breach a fiduciary (or similar confidential) relationship, at least so long as they obtain the material nonpublic information through “deception.” Immediately, questions arise as to how far this minimal requirement of deception can be stretched. Could even overhearing an extended conversation (say, in an elevator ride or in a bar) be deemed deceptive if the others have incorrectly assumed that the defendant is part of their group and the defendant omits to disclose the truth?

Second, in SEC v. Obus, the Second Circuit appears to have relaxed the former requirement that tipper and tippee must be part of a de facto conspiracy in which the tipper was deliberately providing the material information to benefit the tippee (either (1) in return for an economic benefit conferred by the tippee on the tipper; or (2) as a gift by the tipper to the tippee). Today,

“attempts to predicate misappropriation theory on a mere confidentiality agreement lacking a non-use component.” Id. at 730–31. This distinction between agreeing to maintain confidentiality and agreeing not to trade was, however, viewed skepticaly by the Fifth Circuit, which vacated and remanded. See SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010). In United States v. Whitman, the district court went well beyond Cuban and held that Rule 10b-5 is not grounded on state law theories of fiduciary duty, but rather on federal common law. United States v. Whitman, No. 12 Cr. 125 (JSR), 2012 U.S. Dist. LEXIS 163138, at *14–16 (S.D.N.Y. Nov. 14, 2012). To the extent that federal law controls, SEC rules could do much more to generalize or expand the scope of the insider trading prohibition.

7 Dorozhko, 574 F.3d at 51. In Dorozhko, the defendant appeared to have hacked into a secure server at Thomson Financial Inc. to gain access to the soon-to-be-released, but still confidential, third quarter earnings of IMS Health, Inc. (which had hired Thomson Financial “to provide investor relations and web-hosting services” for it). Id. at 44. Learning that the third quarter results were highly unfavorable for IMS, the defendant then purchased “put” options on IMS that would very shortly expire, thus implying that the options would soon be worthless if IMS’s stock price did not fall quickly. Id. On these facts, the defendant had no connection to IMS or Thomson Financial and clearly owed no fiduciary duty to either. Id. Nonetheless, the Second Circuit panel found that to the extent the defendant had “deceptively” gained access to material nonpublic information, he had violated Rule 10b-5. Id. at 51. It remanded to the district court to determine whether the computer hacking on its actual facts had “involved a fraudulent misrepresentation that was ‘deceptive’ within the ordinary meaning of Section 10(b).” Id.
8 SEC v. Obus, 693 F.3d 276 (2d Cir. 2012).
9 These are the standards specified in Dirks v. SEC, which said that “the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to
under *Obus*, it may be possible for the tippee to “recklessly” violate Rule 10b-5, even without paying any benefit to the tipper, at least if the tippee has “reason to know” that the tipper breached its duty in communicating the information.\(^\text{10}\) Again, countless variations on this fact pattern can be proposed: for example, suppose that one member of a live-in couple tells the other what he or she is working on around the clock at the office and thereby divulges material nonpublic information, because he or she is under stress and wants sympathy. At the bottom of this slippery slope lies the simply negligent leakage of information: i.e., the loose-lipped law firm associate in the crowded elevator who carelessly divulges the name of the target company. The concept of deception cannot be reasonably stretched to reach all these possible cases of unintentional tipping, but prosecutors and regulators are motivated to strain to find deception because, under existing law, the liability of the tippee is derivative of the liability of the tipper. Under *Dirks*, unless the tipper has breached some duty, the tippee who profits cannot be held to account.\(^\text{11}\)

Finally, several decisions have recognized that state law definitions of fiduciary duty do not control or exhaust the field. Most notably, in *SEC v. Cuban*,\(^\text{12}\) the court recognized that a duty to keep information confidential can arise either by contract or based on other relationships that do not give rise to traditional fiduciary duties. In its view, a breach of a contractual duty provides an even “stronger footing for imposing liability for deceptive conduct than does the existence, without more, of a fiduciary or similar relationship of trust and confidence.”\(^\text{13}\)

Once we move beyond state law defined fiduciary duties as the exclusive source of duties that can trigger a Rule 10b-5 violation, then the next question becomes: How many other duties can similarly be postulated whose breach should violate Rule 10b-5? This Article will survey several potential such duties, in part because their discovery could simplify insider trading enforcement, and in part because their recognition would make the insider trading prohibition more consistent and equitable. But the recognition of these additional duties also exposes those who have legitimately gained informational advantages to potential prosecution and may create a trap for the unwary with very uncertain boundaries. Balancing the costs and benefits of any extension is therefore essential. Accordingly, the aim of this overview is more to map the possibilities than to

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\(^{10}\) In *Obus*, the Second Circuit summarized the law on tippee liability under Rule 10b-5, as follows:

Tippee liability requires that (1) the tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tipper improperly obtained the information (i.e., that the information was obtained through the tipper’s breach); and (3) the tippee, while in knowing possession of the material non-public information, used the information by trading or by tipping for his own benefit.

*Obus*, 693 F.3d at 289.

Nothing is said in this passage that requires that the tippee pay a benefit to the tipper, even though the court in the same paragraph required that such a benefit be paid to the tipper to establish tipper liability. Seemingly, a distinction has been drawn here between tipper and tippee liability. There may well be policy justifications for such a distinction, but the decision is silent on this point and does not express them.

\(^{11}\) See *Dirks*, 463 U.S. at 659 (“Thus, the tippee’s duty to disclose or abstain is derivative from that of the insider’s duty.”).

\(^{12}\) SEC v. Cuban, 634 F. Supp. 2d 713, 729–31 (N.D. Tex. 2009), *vacated and remanded*, 620 F.3d 551 (5th Cir. 2010). *Cuban* was, of course, analyzing SEC Rule 10b5-2, 17 C.F.R. § 240.10b5-2 (2013), which defendant had challenged as beyond the scope of the SEC’s authority. For an equally important, if less noticed, decision, see United States v. Whitman, No. 12 Cr. 125 (JSR), 2012 U.S. Dist. LEXIS 163138, at *14–16 (S.D.N.Y. Nov. 14, 2012) (finding federal law to control the issue of who qualifies as a fiduciary for purposes of insider trading liability). See also infra note 69.

\(^{13}\) *Cuban*, 634 F. Supp. 2d at 725 (explaining that a contract can capture the defendant’s “obligation with greater acuity than does a duty that flows more generally from the nature of the parties’ relationship”).
argue for any definitive position. Part II will begin by seeking to identify where the major gaps exist in contemporary law. Part III will then turn to conceivable doctrinal answers that could be used to plug these gaps, and will consider possible SEC rules to implement such duties. Finally, Part IV will conclude with an evaluation of these possibilities.