Transcript of the Roundtable on Insider Trading: Law, Policy and Theory after O'Hagan

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PROFESSOR CUNNINGHAM: I am Larry Cunningham, professor of law here at Cardozo and the Director of the Heyman Center on Corporate Governance, and I am delighted to welcome all of you here to the program, "Insider Trading: Law, Policy and Theory After O'Hagan." The O'Hagan case marked the first time in some seventeen years that the United States Supreme Court has spoken as a court on the murky contours of insider trading law. For that reason alone, the Court's opinion is important. It is also important since it will strongly influence the direction and fabric of insider trading law in the future. Another reason why it is important is that, as with many momentous opinions, it leaves several important questions unanswered.

Many scholars around the country have begun to try to help people understand the case. Such scholars, including a couple of our panelists and we at Cardozo, also wanted to offer a forum to contribute to the dialogue on this subject, which is very likely to continue for many years to come.

We want to thank our distinguished group of guests at the table, as well as people in the audience. I also want to acknowledge The Samuel and Ronnie Heyman Center on Corporate Governance for generously supporting this discussion, as well as many other activities here at the Benjamin N. Cardozo School of Law. I also personally want to thank the Cardozo Law Review for co-sponsoring the event and, in particular, Marcy Rosenbaum for helping to organize it.

Like the conversations at the end of the old David Brinkley's

* This is an edited version of the transcript of the Roundtable, entitled Insider Trading: Law, Policy, and Theory After O'Hagan, held on November 5, 1997 at the Benjamin N. Cardozo School of Law. Participants included Professor Lawrence A. Cunningham, Benjamin N. Cardozo School of Law; Professor Marcel Kahan, New York University School of Law; Professor Roberta S. Karmel, Brooklyn Law School; Daniel J. Kramer, Esq., Schulte Roth & Zabel LLP; Arthur F. Mathews, Esq., Wilmer, Cutler & Pickering; and The Honorable Ralph K. Winter, United States Court of Appeals for the Second Circuit. Some participants have more fully incorporated their statements in Articles included in this issues. For articles arising from this symposium, see Symposium, Insider Trading: Law, Policy, and Theory After O'Hagan, 20 CARDOZO L. REV. 1 (1998).

This Week show, this program is unrehearsed, unscripted and unedited. I will start with a brief overview and background of insider trading and a brief recitation of the facts of the O'Hagan case. I will then try to stir up some discussion among the panelists, which will not be hard to do judging by the conversations I overheard some of them having a few moments ago.

First, let me introduce the panelists on my far right. Dan Kramer, one of the scholars I mentioned, has written a piece called A Critique of the Misappropriation Theory of Insider Trading with his partner, David Brodsky. They are with the firm of Schulte Roth & Zabel LLP, here in New York.

Next to him is Judge Ralph Winter of the United States Court of Appeals for the Second Circuit. Judge Winter is also a law professor at Yale Law School who teaches corporations and insider trading and has written one important opinion, at least, involving insider trading, as well as many other important opinions. For my students in the audience, they are well aware of the famous Winter-Cary debate that is the organizing principle of my corporations class.

To my immediate right is Professor Roberta Karmel. She is another scholar who has written substantially on the subject of insider trading, including a forthcoming piece called Outsider Trading on Confidential Information: A Breach in Search of Duty. Professor Karmel is on the faculty at Brooklyn Law School and is also of counsel for the firm of Kelley Drye & Warren LLP, here in New York.

To my left is Professor Marcel Kahan who is on the faculty at New York University Law School and was visiting, this year, at Columbia Law School. He has written many important articles on a wide variety of subjects relating to corporate law and securities

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4 Professor Cary argues that Delaware led a "race for the bottom" to be the leading state of incorporation for large corporations by reducing protections for shareholders. See William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 YALE L.J. 663 (1974). By contrast, Judge Winter argues that, if Delaware allows management to eliminate shareholder protections, the earnings of such companies will be lower than those of similar corporations in shareholder-friendly states. See Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. LEGAL STUD. 251 (1977).

regulation.6

Finally, on my far left is Art Mathews who is a partner at the law firm of Wilmer, Cutler & Pickering in Washington, D.C., and who, among other things, filed an amicus brief in the O'Hagan case.

First, a little background. Insider trading is a term of art generally meaning, or referring to, unlawful trading by someone, whether or not the person is a true corporate insider, possessing material, nonpublic information about publicly traded securities. What makes insider trading unlawful? Congress has never defined with precision the term insider trading. The chief source of law governing the subject consists of judicial applications of the general anti-fraud provisions set out in section 10(b) of the Securities Exchange Act of 1934 (the "'34 Act"),7 and SEC Rule 10b-58 ("Rule 10b-5") of the Securities and Exchange Commission ("SEC"). That section of the '34 Act makes it unlawful "to use or employ, in connection with the purchase or sale of any security[...], any manipulative or deceptive device or contrivance."9 Rule 10b-5 is substantially to the same effect.

In early interpretations of these provisions, the duty to abstain from trading on material, nonpublic information, or to disclose it, principally was rooted in traditional state common law and corporate fiduciary duties of directors, officers, and controlling shareholders. That duty could be extended to outsiders, if the information was intended to be available only for a corporate purpose and if it would be inherently unfair for its possessor to use it when it was unavailable to other market participants. Usually, this approach was understood to cover so-called "temporary insiders," such as attorneys, accountants, investment bankers, and others privy to such information in the course of representation.

The duty to abstain or disclose instead could have been anchored in a far more general ground of a parity of information rationale to reflect the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information. These alternative rationales were rejected, however, by the Supreme Court in Chi-
arella, a 1980 case, and Dirks, a 1983 case. Instead, both of these cases insisted on the presence of some duty arising from a fiduciary-like relationship, seemingly one between the person trading and the subject corporation’s shareholders. This is a key point that the O’Hagan case relaxes.

Alternatively, the duty instead could arise from a middle ground. It could be imposed on any person, whether traditional corporate insiders, temporary insiders, or outsiders who misappropriate non-public information, whether from the shareholders of the subject company or others. This rationale, or position, was first articulated by Chief Justice Burger in his dissenting opinion in Chiarella, and it was later adopted by most, but not all, circuit courts. This position was finally approved by the Supreme Court in O’Hagan, which is the centerpiece of our discussion. Now, let me just give a brief recitation of the facts and then invite the panelists to offer their impression of the case.

As I emphasized, O’Hagan is an outsider trading case. James O’Hagan was an outsider. He was a partner in a private law firm, which was retained by Grand Met, in July 1988, in connection with Grand Met’s claimed takeover of Pillsbury. Although O’Hagan was not one of the lawyers on the deal, he learned about the deal from his law firm partners and, on that knowledge, bought Pillsbury stock and bought options to buy Pillsbury stock.

A few months later, in October, Grand Met publicly announced its tender offer for Pillsbury, and Pillsbury’s stock rose substantially. O’Hagan sold his stock and his options and generated a profit of over four million dollars. The SEC investigated, charged, and indicted him on various charges, the most relevant violations being that of section 10(b) of the ’34 Act and Rule 10b-5 thereunder, as well as SEC Rule 14e-3 (“Rule 14e-3”), which is a general prohibition against trading on material, nonpublic information relating to a tender offer.

A jury convicted O’Hagan on all counts. The United States Court of Appeals for the Eighth Circuit reversed, holding that neither section 10(b) nor Rule 10b-5 thereunder could be grounded in this misappropriation theory, which Chief Justice Burger had initially articulated in the Chiarella dissent. The Eighth Circuit also

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13 See id.
15 See Chiarella, 445 U.S. at 239-40.
reversed on the 14e-3 conviction on the ground that the SEC did not have the power to promulgate that rule.\textsuperscript{16}

The Supreme Court reversed the Eighth Circuit in an opinion written by Justice Ginsburg and over the dissenting opinions of Justices Thomas and Scalia.\textsuperscript{17} The majority opinion upholds the misappropriation theory and announces that “[a] person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information, may be held liable for violating [section] 10(b) and Rule 10b-5.”\textsuperscript{18} The Court also held that the SEC did have the authority to promulgate Rule 14e-3, which is the general prohibition against trading in connection with tender offers.\textsuperscript{19} O’Hagan went to jail and there he sits.

A number of issues arise from a reading of this opinion, both in terms of the opinion’s conceptual soundness, as well as in terms of thinking about its meaning for the development of insider trading law as we move forward. To organize the discussion, I would like to concentrate, principally, on the 10(b) issues and save the 14e-3 issues for the end, if we have time. We can roughly divide the 10(b) issues according to the subtitle of the conference, “Law, Policy, and Theory,” although there will obviously be some overlap. Before we discuss particular issues, perhaps we can start by going around the table and asking each of the panelists to say, in a minute or two, what they think of the opinion. We will start with Professor Kahan.

PROFESSOR KAHAN: This is an opinion that is easy to criticize, and I am sure that in the course of the evening I will not be able to resist the temptation to criticize certain aspects of the opinion. However, Justice Ginsburg had a difficult task, given the prior precedent, the wording of the statute, and the policy considerations in play. I do not think she did a perfect job, but I think she did an adequate job. I like the misappropriation theory. I think she narrowed it somewhat from the way it was construed by the circuit courts, but she did so in a way that is probably not very relevant. But, overall, I think she did a good job in writing the opinion and will get to the weaknesses later on.

\textsuperscript{17} See United States v. O’Hagan, 117 S. Ct. 2199 (1997).
\textsuperscript{18} \textit{Id.} at 2202.
\textsuperscript{19} \textit{Id.} at 2217-18.
PROFESSOR CUNNINGHAM: Art, do you agree with that? What is your overall impression?

MR. MATHEWS: I think you can look at the *O'Hagan* case from two different perspectives. If you look at it as only a securities law case, it is a very important victory for the SEC and the Department of Justice. I am talking about the 10b-5 aspect of it, not the 14e-3. I happen to think that the case is wrongly decided as to 10b-5. It was rightly decided as to 14e-3. I look at the case, jurisprudentially, not as a securities case, but as a traditional criminal law case. I think the majority of the Supreme Court completely missed the boat jurisprudentially. Ruth Bader Ginsburg, and the others who joined her in the majority, really gave no treatment to the fact that their decision was letting the courts manufacture a crime rather than having Congress legislate a crime. I think that violates the separation of powers concept and it violates other doctrines of criminal law. If you look back historically, it is really interesting.

I was the head of the criminal section of the SEC in the 1960s. Roberta was at the SEC at the same time I was. In all of the time that we were at the SEC, there had never been a criminal prosecution for insider trading. We are talking about the decade of the 1960s. The statute was passed in 1934. If you had asked most SEC attorneys in the 1930s, 1940s, 1950s, or 1960s, they would have told you that you cannot have a criminal prosecution for insider trading, because Congress never made it a crime. Indeed, in the legislative history of the '34 Act, when Congress compromised and passed section 16(b),\(^\text{20}\) the short selling profit section of the Act, to take profits away from insiders who trade, Congress specifically addressed the question of whether or not it should be criminal and determined not to make insider trading criminal.

So, there was never a criminal prosecution for insider trading until the *Chiarella* case in the late 1970s. Also, when the *Chiarella* case went up to the Supreme Court and was thrown out, no one ever made the argument that, I think, should have been made jurisprudentially, that insider trading was not a crime. Now, by the 1990s, with the Supreme Court looking at *O'Hagan*, there were just so many years of courts dealing with and accepting insider trading in the criminal context that it was too late to be jurisprudentially pure and to look at it the way I think it would have been.

looked at if the proper arguments were made sooner.

PROFESSOR CUNNINGHAM: Thank you very much, Art. Justice Scalia made a variation of that point in his dissenting opinion in the case. Basically, he said that for prosecution the criminal law should be quite clear and in this context that it really is not and that he would have upheld the Eighth Circuit. Dan, do you have a brief impression of the overall case to share?

MR. KRAMER: My view is very much like Art's. I think the jurisprudence of insider trading is a case of the Court making it up as it goes along. The misappropriation theory truly is not grounded in the language of section 10(b) and as a result, in practice, you are left with a case-by-case determination of just how far this judge-made theory is going to extend. I think it is very difficult to predict. It is very unfair, and the solution, in my view, is not to continue this ad hoc expansion of the law of insider trading, but rather to kick it back to Congress. Allow Congress to define what the crime is, or what the violation is, so that we can have more certainty as to what conduct is prohibited and what conduct is not prohibited. Then, we can have courts take the lead from Congress in terms of the scope of prohibited activity, as opposed to what we have now, which is a lot of uncertainty in a very important area—an area that often can lead to criminal prosecution.

PROFESSOR CUNNINGHAM: Thank you, Dan. Incidentally, I think Justice Thomas's opinion really was a critique of the degree to which the misappropriation theory is not anchored in the text of the statute, which I read to you earlier. I had emphasized two concepts. First, the activity must be in connection with a securities transaction. Second, there must be some deception. Like you, I think Justice Thomas could not really see either of these factors in the misappropriation theory. Judge Winter, to the extent that you can, what is your overall impression?

JUDGE WINTER: Well, this seems to be a very anti-O'Hagan crowd, and, uncharacteristically, I will not go against the tide. What everyone has said is largely correct and is the product of history. If you go back to Cady, you will see insider trading requires special access to information that was meant for the

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owner’s use. Cady adopted a rule of insider trading with two elements: a trader’s relationship providing special access to corporate information and the inherent unfairness in trading on public markets with people who do not have that information. This second element furnished the fraud or deception that links the prohibition to 10(b). My court went and took the second aspect, the unfairness of trading with people who do not have the information, to utterly absurd lengths. In its opinion in Chiarella, the Second Circuit held that everyone has to have the same information, which is really a crazy idea. The Supreme Court then, in Chiarella and Dirks, spoke of the requirement about trading, but said that the violation was not in the trading. What they did then was to utterly sever the insider trading from 10(b). Until that moment, everyone had thought the fraud or the deception had to be in the trading, but now that was no longer the case. Well, once you have severed illegal insider trading from fraud and 10(b), all you have is misuse of confidential information.

Once you get to that point, which is where we were after Dirks, O’Hagan does not go much further. All O’Hagan says is that it does not matter whether the information was the property of the corporation whose shares were traded. I think that is all it says. That is not a big step. The reason why everyone is critical of Justice Ginsburg, which is somewhat unfair, is because she was dealt a hand with these precedents that severed insider trading from fraud. She had to try, as she heroically attempted, to connect it back, but she failed because you cannot connect it back. She had to come up with this theory that there is a duty to disclose.

The real danger of O’Hagan, therefore, is that it will not be limited to insider trading. She found a 10(b) violation in a situation in which you can violate 10(b) even though there was no duty to speak and you did not speak. The case could now be cited for that proposition in areas not involving insider trading. Given the moralistic and self-righteous way that courts deal with these issues, I am more fearful about O’Hagan going beyond insider or outsider trading than I am as to what it did, given where we were before the decision.

PROFESSOR CUNNINGHAM: So, in the end, you may be as critical of O’Hagan as the other panelists, although for different reasons. Professor Karmel, what is your opinion?

PROFESSOR KARMEL: Well, it is hard to be last in this discussion. I would say that in some ways I agree with what each of the prior speakers has said. Let me put a little bit of a gloss on that view. Politically and pragmatically, the O'Hagan decision was correct in that it would have been very difficult for the court to decide the case the way in which the circuit court decided it, because of the facts. Here was a lawyer, who stole information from his law firm and client and made several million dollars. Also, he stole the money because he had been stealing from other clients and he needed to pay them back. O'Hagan was a very unattractive defendant. Also, the case involved a crime, insider trading, which is illegal everywhere that there are mature capital markets and the laws of other countries are based on their presumptions about the law of the United States. It would have been anomalous in the extreme for the U.S. to abruptly find that it did not have a law against trading on inside information in circumstances such as this.

So, I think the decision probably had to come out this way, but the Court was in a box that had been created by its own prior decisions, particularly Chiarella and Dirks. Those cases rejected the idea that persons who come into the possession of inside information and then trade on it owe a duty to the marketplace because, according to the Court, there has to be a breach of a particular fiduciary duty between two people. Justice Ginsburg really had a problem as to how to come out in favor of the government without saying the court was overruling Chiarella or Dirks. Therefore, the logic of the decision is necessarily extremely strained.

All of the blame for this decision does not really belong to the Supreme Court, but should be spread around. Congress has declined to define insider trading, even though it had the opportunity. During the 1980s, Congress twice amended the securities laws and increased the sanctions for insider trading, both civil and otherwise, without ever defining this wrong. I would go back, however, and put the blame on the SEC. The SEC, as Art Mathews explained, had never tried to prosecute anybody criminally for the crime of insider trading until fairly late in the game. Indeed, until the United States Court of Appeals for the Second Circuit decided the Texas Gulf Sulphur case\(^23\) in the mid-1960s, there was no court decision approving this theory, even with regard to what is called classic insider trading, which is trading on in-

\(^{23}\) SEC v. Texas Gulf Sulphur, Co., 401 F.2d 833 (2d Cir. 1968).
side information by officers and directors of corporations.

I have to say, when I was on the staff of the SEC in the 1960s, I had my doubts that the SEC was going to win the Texas Gulf Sulphur case. It seemed to me that it was a bit of a stretch, given the language of 10b-5. However, it became the law, and the SEC began to expand it. The SEC certainly could have defined insider trading by rule. It could have gone to Congress and asked for a definition of insider trading. It did not do either. Indeed, the SEC always took the position that defining insider trading would simply be a blueprint for fraud and clever and devious people could get around any definition that it devised. So, the SEC opposed efforts to define insider trading.

Moreover, other than the Cady rationale that insider trading is unfair, the SEC has never tried to come up with a real policy justification for insider trading. I have some of my own theories about that, which I think we may get to later on in the discussion.

For now, I will say something about the problem arising from the criminality of insider trading. I think that the fact that insider trading and 10b-5 cases are generally both civil and criminal is part of what gets the government and the courts into a problematic situation. On the one hand, there are 10b-5 cases quite properly saying that the securities laws are broad remedial statutes and should be broadly construed. That is fine in a civil case. On the other hand, when you have the same statute and the same language in a criminal case, courts are confronted with the doctrine that criminal statutes are not supposed to be construed as broad remedial statutes. They are supposed to be construed strictly. So, I think this is what leads to the problem that we are discussing tonight.

PROFESSOR CUNNINGHAM: Yes.

PROFESSOR KARMEL: The defects of the O'Hagan case cannot be blamed entirely on Justice Ginsburg. She did a valiant job to come up with a principled decision, but I think in the end she failed because it was impossible under the circumstances.

PROFESSOR CUNNINGHAM: Thanks. Professor Kahan?

PROFESSOR KAHAN: Since I seem to be the lead defender of the O'Hagan decision tonight, let me just explain why I think it is a pretty good opinion. I agree that Justice Ginsburg had
some difficult precedents and a difficult statute to work with, but I think she did a good job. Essentially, I think so for three reasons.

First, I believe that most of the trading that is going to be clearly illegal under the rationale of the *O'Hagan* decision is not socially desirable. That is definitely true for O'Hagan himself. I do not think that any of the panelists believe that O'Hagan should have traded on this information. So, I do not think we are killing off trading that we want to happen. In fact, I think we are killing off trading that we do not want to happen.

Second, it is true that the opinion leaves a lot of gray areas. When I teach my corporations course and discuss insider trading, I spend a lot of time on these gray areas, and I present a lot of fancy hypotheticals. Maybe even more fancy than some of the hypotheticals in the opinion. But, I do not believe that a lot of actual trading happens in these gray areas. Most of the trading that occurs is either clearly legal or clearly illegal. Conceptually, there are a lot of gray areas but, practically, these gray areas are not terribly significant, and I am not very troubled by them. I think the opinion cuts down on what these gray areas are. Maybe not always in the way I would have, but it clarifies the law a little bit.

The best argument against the case, as Art stated earlier, is that this is a criminal case and it is not right for courts to define crimes out of fresh clothes. I am sympathetic to that pain. I think that criminal prosecutions under 10b-5 for insider trading ought to be reserved and I think that, for the most part, they are reserved for trading that is egregious where, on the basis of past precedents, the public has sufficient notice to know that what is going on is criminal. This may not have been true for *Chiarella*, but I think it was true for *O'Hagan*, and I think it is true for most of the criminal cases.

I also want to say that all violations of the securities laws are potentially criminal, but insider trading seems to be the one area where we see a lot of criminal prosecutions. The reason is that you can make a lot of money on insider trading, and thus you need a strong deterrent. So, from a policy perspective, I definitely favor criminal liability for insider trading. But, I also think that as we go closer to the border I would be much happier if the SEC brought several civil cases to define the law. This is generally done, but not always. To the extent that it is not done, I would like it to be done and I think this goes at least some way to addressing the concerns of some of my co-panelists.
JUDGE WINTER: In listening to you, Professor Kahan, I am not at all comforted by the fact that the insider trading cases that have gone to the Supreme Court were all cases where somebody was doing something wrong. I happen to agree with that. But, in criminal law, to have a crime that is not defined, either in terms of what it is or what the rationale is for its being illegal, invites prosecutorial misconduct. Also, you are wrong to say that insider trading is all that criminal prosecutions are brought on. The vague prosecutions in the 1980s were under section 13(d) of the Williams Act. That was what everybody was pleading to. They were not pleading to 10(b). I think you really do not address the fact that under O'Hagan, under all of this, anyone who hears a rumor and has questions about where it comes from has to worry about whether it comes from someone who is breaching a fiduciary obligation.

As you know, one of the things that the students here and everybody else ought to have in mind is that the SEC cannot bring a criminal case. We talked about the SEC bringing a criminal case. The SEC does not bring it. The United States Attorney brings it. I know of at least one criminal case, which I saw part of, which the SEC had not wanted to pursue and the United States Attorney brought. More than that, what happens is that people do not necessarily get indicted, they get squeezed. They get brought in before grand juries, and they are asked, "where did you hear this, where did you hear that, and where did you hear the other thing?"

There is a culture within the SEC, which Professor Karmel mentioned, that it does not want to define things because that will tell people what is legal and illegal and people will be going around doing legal things that it decides, after the fact, it does not want them to do. So, there is this pressure to have this broad law with all of this discretion, and it seems to me that it is just a big mistake to use the criminal law this way.

PROFESSOR CUNNINGHAM: Judge Winter, you mentioned the parity of information rationale and the inherent unfairness rationale. Those rationales do not seem to animate Justice Ginsburg’s opinion.

JUDGE WINTER: Well, she does talk about the integrity of markets.

PROFESSOR CUNNINGHAM: Yes, the integrity of markets and investor confidence. Investor confidence seems to be the big theme of her opinion. In what way would prohibitions of this sort promote investor confidence? I guess that might be the question for Marcel.

PROFESSOR KAHAN: When investors trade, they want to have some confidence that they are trading at a fair price, not at a price that people have good reason to know is either too high or too low. If you think that the market is dominated by people who have much greater access to information than you do, then this reduces the liquidity of the market. This is a rationale for the prohibition of insider trading, but it is a rationale that goes too far. There are trade-offs that need to be made. The trade-offs relate to providing people with incentives to find information. Under certain circumstances, if you have information that other people do not have, or if you can detect information that other people cannot acquire, there are good reasons why we want to permit you to trade on that information. So, when you balance, on the one hand, the interests in fair markets with little inequality in access to information and, on the other hand, the need to reward people for digging up information by permitting them to trade on it, one thing becomes relatively clear. That is that people who have acquired information in a way that is illegal, or people who are using information that they were given for an improper purpose should not trade. Their trading inhibits the liquidity of the market without having any other socially desirable effects.

I think the *O'Hagan* decision, while not going as far in scope as I have just outlined, covers this territory to a large extent. If you have gotten information that was meant for a certain purpose, namely to assist somebody else in doing something, you cannot use this information for a different purpose even if the person who gave it to you could have used it for a different purpose. There may be reasons why we want to permit the company that was doing the tender offer to engage in insider trading on its knowledge that it was going to do a tender offer but not let anybody else, who got this information from the company, use this information to trade on it.

PROFESSOR CUNNINGHAM: Can I interrupt there for a minute, Marcel? Let’s take it out of the tender offer context for a
moment so that we do not have to deal with the 14e-3 situation. If you say that the owner's information would not be free to trade on, why could that owner not then have a private contract with a person, such as O'Hagan, in which that person, under that contract, is free to trade on the information? How would that be different in terms of its impact on investor confidence?

PROFESSOR KAHAN: I do not think it would be different in terms of its impact on investor confidence. The owner of that information could have such a contract. I think it is clear after O'Hagan, and it was clear before O'Hagan, that you can only misappropriate from somebody who is being misappropriated. You cannot misappropriate from somebody who consents.

By the way, I have never come across any contract of that sort. Most companies have confidentiality agreements, explicit or implicit, with their employees. I have not seen any company saying that "I will pay you a lower salary but, in exchange for that, will let you insider trade on the information." So, the mere fact that you can have such a contract, given that nobody does, is not a destructive criticism of the logic, or the doctrinal basis, of the decision.

PROFESSOR CUNNINGHAM: Yes. Maybe the reason people do not do it is because the state of insider trading law is so unkind.

PROFESSOR KAHAN: No, I do not think that. My reading is that it is fairly clear, but maybe some of the other panelists have a different opinion.

MR. KRAMER: Can I respond to a couple of things that have been said? This has been very provocative. I find very provocative a lot of things you are saying, Professor. First of all, when you defend the O'Hagan decision, you should not ignore the language of 10(b). In your statements of why you thought it was a good decision, I could not help but notice that you omitted any statement of "it is a good decision because the law requires X." Ultimately, if you cannot support O'Hagan based on the language of the statute, then you have a tremendous problem. The second thing I want to say is that there is no support for the statement that investor confidence has been destroyed by the lack of misappropriation theory, given that the stock market has gone from 4000 to
8,000 and over half of all Americans now invest in it. I would say that is pretty good evidence of confidence. There is no more basis for that statement than there is for the observation that prosecutors behave themselves when determining whether to either prosecute under this law or to use it as leverage, as they do every day, in trying to seek concessions.

A third point is that I do not understand why investor confidence would be shaken by the lack of a misappropriation theory, but is not shaken if companies are able to disclose this information selectively to favored people or groups without violating the law. I do not understand how you can take one position and not the other. Finally, even if you think this is good policy, why are you comfortable having the courts develop this policy on a case-by-case basis with reference to a statute where you cannot determine, or guess, what the next case result will be based on the language of the statute. That has to frighten you. It certainly frightens me and it leads me to believe that if there is going to be a fix, it has got to be a congressional fix.

PROFESSOR KAHAN: Well, I cannot respond to everything because I do not want to monopolize the discussion. I am troubled by the lack of relation between 10b-5 and insider trading. I think this is true for Chiarella insider trading, for Dirks insider trading, and for all insider trading. So, given that we have a lot of these cases on the books, the question is not should 10b-5 be used at all to deal with insider trading. I regard this question as settled. The question remaining is how far should 10b-5 reach? I do not think that O'Hagan represents a greater departure from the text of 10b-5 and 10(b) than Dirks and Chiarella did. But, I am troubled. If I were to design a system of insider trading, I would not say, "let's adopt Rule 10b-5 and then let the courts work things out." That would not be my favored way of doing things.

PROFESSOR CUNNINGHAM: Just to remind us, the two statutory requirements are deception and a breach of fiduciary obligation. Incidentally, it is not entirely clear, at least not from the opinion, whether there in fact was a fiduciary duty. A breach of fiduciary duty is quite different and far weaker than deception, which is what the statute requires.

PROFESSOR KAHAN: But, it is Chiarella that brings in this breach of fiduciary duty concept. I was never all together happy,
and I have always liked Judge Winter’s dissent in the Chestman
opinion.

JUDGE WINTER: That was Cady that brought in the breach
of the fiduciary duty.

PROFESSOR KAHAN: Well, let’s just say it was earlier
cases. I will give you a compliment even though you keep cor-
recting me. What I make out of your dissent is what you say about
the concept of fiduciary duty. You say we should let the federal
courts, in 10b-5 cases, act as common law judges. The rule that
you would have liked to adopt in your Chestman dissent is a rule
that is not tied to traditional concepts of fiduciary duty. Whereas
the majority opinion says that fiduciary duty is a well-defined ex-
isting concept and that they are going to stick to what it is and not
mess things up. It all goes back to something said by Professor
Karmel. Unfortunately, we are stuck with a single statute for both
civil and criminal cases, and we feel bound to give it the same in-
terpretation for both purposes. Maybe that is part of the source of
the problem. In a way, courts construing 10b-5 act as common law
courts. They make up the law, and this is problematic in a criminal
case. It is not problematic in a civil case.

PROFESSOR CUNNINGHAM: Can I come at this question
of deception from a slightly different perspective, Marcel? The
court tells us that the trader can avoid committing deception or
triggering that element of the statute by telling the owner of the
information that he is about to use it for a securities trade, for a
trade. I think that is all. So, you do not even need to get the
owner’s permission or consent. You do not need the retainer,
which is the sort of agreement that we were talking about before.
All you need to do is tell them that you are going to do it, and then
you can do it.

JUDGE WINTER: I disagree with that. I think the import of
the decision is that the owner of the information must acquiesce to
your use of it.

PROFESSOR CUNNINGHAM: The import of the decision?

JUDGE WINTER: Yes. In most employer-employee rela-
tionships or consultant relationships, the breach is the concealment
and the act of using information that the owner does not want you to use. So, I think you need both.

PROFESSOR KARMEL: I think this is both a perversion of the original SEC concept of the ban against trading on inside information and leads to why the misappropriation theory, although probably necessary at this time because of the state of the law, is not a very satisfactory theory from a law or policy perspective. If you go back to the *Texas Gulf Sulphur* case, the SEC's theory was that persons who had the inside information either had to abstain from trading or disclose the information, because this was information that was material information that Texas Gulf, sooner or later, was going to have to disclose. It seems to me that we have lost our way in terms of why there ought to be a ban against trading on inside information. I think there ought to be a ban against trading on inside information because the SEC, as a practical matter, would be unable to enforce the disclosure obligations that various persons in the securities markets have if there was not a ban against trading on inside information before those disclosure obligations are met.

One of the trade-offs that are made in this area is that the SEC does not require instant disclosure of all material information if there is no insider trading. The SEC and the courts have allowed various people to wait until information is ripe for disclosure, or until people are really sure of the facts, so long as nobody is trading on information before it is disclosed. I think we have just lost sight of the whole policy rationale for why there is this ban and why investors would lose confidence if we allowed insider trading. They would lose confidence because the whole disclosure system would be destroyed if we did not have a ban against insider trading. However, since the cases have developed in this common law type of way and we have gone off on this tangent of the misappropriation theory, everyone has forgotten why we have this prohibition in the first place.

PROFESSOR KAHAN: But, if insider trading is tied to disclosure, then if you misappropriate from somebody who has no disclosure obligations, then that should not be covered.

PROFESSOR KARMEL: I agree.

PROFESSOR KAHAN: So, you would come out against the
misappropriation theory as long as you do not misappropriate from a five percent stockholder?

PROFESSOR KARMEL: No. The vast majority of cases that involve misappropriation of information that does not come from an issuer who has a disclosure obligation with regard to that information are tender offer cases. In tender offer cases, the disclosure obligation is really on the part of the bidder. If there is going to be a tender offer, there is going to be a disclosure of that tender offer and it is basically unfair for shareholders who are going to be granted a tender offer to sell before it is publicly announced. That is unfair. That is what can lead to a lack of investor confidence. You are dealing with a situation where the securities laws impose disclosure obligations on somebody. I think that, in the cases where there is no disclosure obligation on anyone, like the Carpenter case\textsuperscript{25} involving the Wall Street Journal "Heard on the Street" columns, or the Bryan case\textsuperscript{26} involving the West Virginia Lottery, there is no need for trading to be in violation of the federal securities laws. Maybe there are violations of some other statute. The defendant in Bryan was violating all kinds of laws of West Virginia. Why does this have to be a federal securities law offense? I do not think that is necessary for the confidence of investors.

MR. MATHEWS: I think, Roberta, virtually all of the cases, including O'Hagan, probably could have been prosecuted under the mail and wire fraud statutes\textsuperscript{27} and you would not have the defects that you will have by trying to squeeze them under Rule 10b-5. The problem, once again, is the mixture of civil and criminal. The reason it is important is because the SEC needs the interpretation to bring its civil cases and that has sort of bent the whole criminal process.

PROFESSOR KAHAN: But, does this not turn things upside down? If you are more skeptical of criminal prosecutions for these kinds of actions than we are of civil prosecutions, then we should be happy that they are 10b-5 violations because we do not have to make the choice between criminal prosecution and no prosecution whatsoever. We have the intermediate option of a civil proceed-

\textsuperscript{25} United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986).
\textsuperscript{26} United States v. Bryan, 58 F.3d 933 (4th Cir. 1995).
\textsuperscript{27} 18 U.S.C. §§ 1341, 1343 (1994).
MR. MATHEWS: Well, that policy argument might have been okay until about ten years ago. A new provision was added to Title 18 so that the Department of Justice can bring civil injunctive actions for mail fraud, wire fraud, and bank fraud.²⁸

PROFESSOR KAHAN: Injunctive only?

MR. MATHEWS: Injunctive and they can get disgorgement and get the money back. There is a procedure where you do not need the SEC.

JUDGE WINTER: It is not only that. Wire and mail fraud are a product of the Racketeer Influence and Corrupt Organizations Act ("RICO").²⁹ So you can bring civil RICO actions.

MR. MATHEWS: The Securities Reform Act³⁰ just took civil RICO out of securities, mail, and wire fraud in private damage actions, but I guess it did not take it out of the Department of Justice cases.

MR. KRAMER: Right.

PROFESSOR CUNNINGHAM: Well, Justice Ginsburg has a response to the critique about Art’s main point, that this is a criminal case, and it seems, given the uncertainty of what is prohibited, to be a weak case. Justice Ginsburg’s response is that this rule has, as one of its elements, the scienter requirement that only violations of some recognized duty will trigger criminal liability. Does that not satisfy you, Art?

MR. MATHEWS: No. It does not satisfy me because even the Supreme Court refuses to define what scienter is. Justice Breyer threw that out during the oral argument. He thought that the way you could get rid of the criminal jurisprudential argument was by saying that it must be a willful violation in order to be criminal, and, therefore, we can trust the government, which I do not do, to exercise prosecutorial discretion and only go criminal in

²⁹ Id. § 1961.
those really egregious cases where the conduct was clearly willful.

MR. KRAMER: So, which duties are recognized?

PROFESSOR CUNNINGHAM: Well, this is a nice prospective question. I mean, we have inherited this opinion, and the circuit courts and district courts will begin to work out the contours. The question is how will those courts work out what is a recognized duty? Will they turn to state-by-state interpretations of fiduciary obligation or will they develop a sort of federal common law fiduciary duty for cases like this?

MR. KRAMER: Any relationship of trust and confidence could conceivably satisfy this recognized duty, and nobody knows what that means. You tell me.

PROFESSOR CUNNINGHAM: Ginsburg stayed away from that phrase. I think she used "fiduciary relationship." I do not know if that helps any.

JUDGE WINTER: There is an aspect of O'Hagan that can be developed. There is a Second Circuit case, Goldberg v. Meridior, which holds that it violates 10(b) not to make a disclosure that will alert someone that they were losing their state court rights. It built on footnote fourteen in Santa Fe, where Justice White, having stated throughout all of the text of the opinion that we are not going to have anything to do with fiduciary duties, then drops a footnote saying the respondents argued that the failure to provide advance notice of the merger at issue was a material non-disclosure and actionable under 10(b). However, Justice White noted that we do not have to reach that issue because they could not have gotten an injunction under state law. Then Goldberg runs with this footnote and says that if you have a state court remedy, then Santa Fe does not apply. Now, there is language in O'Hagan that could be built on like that and that is the part where Justice Ginsburg says that when you are breaching your fiduciary obligation to the owner of the information, you have to disclose it to the owner. That is like a Goldberg theory. That is another reason why I think O'Hagan's implications for other areas of securi-

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32 567 F.2d 209 (2d Cir. 1977).
ties law are greater than its implications for insider trading.

PROFESSOR CUNNINGHAM: Just by rereading all of the circuit opinions you can see that it is hard to evaluate what fiduciary-like duties qualify. It is hard to come up with a principle.

JUDGE WINTER: Well, under that theory, the Goldberg theory, you would be looking to a particular state law. Whereas, if it is a different kind of theory, then it would require a federal fiduciary duty, which collides with Santa Fe, but O'Hagan collides all over the place with Santa Fe.

PROFESSOR KAHAN: I would like to add that the way I read O'Hagan, it does not take a fiduciary duty to misappropriate. It takes fraud. Fraud can happen in two ways. First, if there is a fiduciary duty to disclose and there is no disclosure. Second, in the absence of a fiduciary duty, if you gain information by fraud and then use it in trading, that is misappropriation.

JUDGE WINTER: Where was the fraud with O'Hagan? I mean, the opinion says that he did not disclose but he did not have an independent duty to disclose. There was no fraud there. There is this federal law of fraud that is completely different from fraud everywhere else. Under New York law, as I understand it, if you have a breach of contract and the fiduciary obligations are contractual, you cannot plead fraud. It is a breach of contract. We have this whole body of federal law in which breaches of duty become fraud because you did not call up at one o'clock in the morning and say, "I am about to breach my fiduciary obligation." It has nothing to do with fraud or any traditional concept of fraud, as far as I know.

PROFESSOR KAHAN: A lot of people on the panel have voiced the argument that there is a very undefined law here and we are sending people to jail. Does the argument not apply to the same extent against mail and wire fraud? I do not really know much about that law.

MR. MATHEWS: Yes, it absolutely does.

JUDGE WINTER: Yes.
PROFESSOR KAHAN: Then O'Hagan, as it interprets 10b-5, is really irrelevant to that argument.

JUDGE WINTER: That hobgoblin has gone to my small mind.

PROFESSOR KAHAN: To my smaller mind as well.

JUDGE WINTER: In fact, that is even worse. You think they are twisting 10(b)? With mail and wire fraud it is worse.

PROFESSOR KAHAN: The only difference is whether the SEC can bring a civil action or not. I think that is much easier to defend.

JUDGE WINTER: Well, Professor Kahan, I do not want to disqualify what I said earlier about my concern with criminal prosecutions. There is a tendency for all of us to talk about whether we can do this or that as though there is some single hand that is going to decide these things. I have seen a brief—I did not sit on the case, but I have seen the brief—filed in the Second Circuit by the United States Attorney's Office for the Southern District of New York (which at the time was known in Washington as the Sovereign District of New York). I have seen a brief filed saying that this criminal prosecution violated Department of Justice guidelines for enforcing RICO. It said that. Then it went on to say that neither the courts nor the Southern District of New York need to abide by the Department of Justice guidelines and that they are wrong. This is the way the federal criminal law gets enforced. There are dangers in reading things too broadly or having these broad crimes because there are a lot of very idiosyncratic prosecutorial decisions that are made, and when they start chasing somebody, they will look for every conceivable law around.

PROFESSOR KAHAN: Fortunately, some of these prosecutors go into politics.

PROFESSOR KARMEL: In my experience watching securities law prosecutions over what is now a long period of time, there are fashions in criminal prosecutions like in other things. There was some mention made that there was not a criminal prosecution
of insider trading until the 1970s. Then, I think Professor Kahan said that this is what is needed because you can make so much money on insider trading and there are not that many prosecutions of older parts of the federal securities laws. I can remember when there were no prosecutions of insider trading and people were prosecuted for violating the margin regulations, but later on the Federal Reserve Board said, "What do we need these for? We should abolish these regulations." I guess I do not have the trust in prosecutorial discretion that you have. Maybe that is because I started my legal career as an SEC enforcement attorney and I realize how quirky these prosecutorial decisions can be.

PROFESSOR CUNNINGHAM: Do you agree that what James O'Hagan did in this case was undesirable trading?

PROFESSOR KARMEL: Absolutely. I think that what he did should be illegal. I think that what he did probably should be a criminal offense as well as a civil offense, but I do not think that the law reached this result in an appropriate way.

MR. MATHEWS: But it did not need to use 10b-5. By the way, I will make a disclosure. I represented O'Hagan in the SEC investigation. I wrote the so-called "Wells Submission" and almost got him off, but the SEC discovered that he had stolen the money from the Mayo Clinic. The reason why he was engaged in the trading was that he was trying to pay the money back to the trust funds from which he had taken the money. My point is that he did not have to be prosecuted under 10b-5. He went to jail under state law crimes and served time in the state penitentiary. Under my analysis, he clearly was guilty of a Rule 14e-3 crime. So, he would go to jail on that. You did not need to pile 10b-5 on somebody who is already going to do jail time under much more traditional statutes that clearly fit the crimes.

PROFESSOR KARMEL: I had better make a disclosure here too. I was a commissioner when 14e-3 was going through the system. There is no question that the SEC adopted Rule 14e-3 to get around the *Chiarella* decision in the tender offer area and that it was clearly intended to cover this kind of activity. I think that a lot of people thought when the Supreme Court took this case that they were going to reverse the circuit court on 14e-3 and do nothing on 10b-5 and just avoid this whole mess that we are now dis-
MR. MATHEWS: I might mention, if I can change the subject for a second, that no opinion is all black and white. We, in the defense bar, do find some solace in the *O'Hagan* decision that will help us defend some insider trading cases. Bill McLucas, the Director of Enforcement, has publicly acknowledged that there is one issue that bothers the SEC about Ginsburg's opinion. What bothers him is that the opinion specifically talks about trading on the basis of material and non-public information, rather than while in possession of material and non-public information.

I tried a criminal insider trading case in Maryland about seven years ago. I represented a chief financial officer who was indicted for selling a big chunk of his stock in the issuer three weeks before he had to make an announcement that the company had its first quarterly loss in history. We defended the case on the grounds that he did not trade on the basis of information that he knew the company was going to announce a loss but that he traded because he had expert analysis of his portfolio completed by an outside investment advisor who had written a fifty page report which strongly urged him to sell X percent of his stock to diversify, which he did. So, our argument was that even though he may have come into possession of adverse information he did not trade on the basis of it. The government argued strongly against it. I asked for the jury charge "on the basis of" rather than "in possession of" and the government asked for a one-day recess so that they could get the SEC General Counsel's office to come in the next day to argue against me on the jury charge. The SEC argued their traditional *Texas Gulf Sulphur* of disclose or abstain and all that you have to do is be "in possession of" and that you do not have to trade "on the basis of." Fortuitously, in my rebuttal argument, I just happened to look down at the indictment and noticed that they implied in the indictment that the stock was traded "on the basis of" and not "while in possession of." So, I got my jury charge anyway because that was what the indictment said.

This is an issue that bothers the SEC because there are a lot of cases where alleged insider traders defend on the grounds that they traded for other legitimate reasons. It will be interesting to see what the courts will do with the battle between "on the basis of" and "in possession of."

PROFESSOR CUNNINGHAM: Thank you, Art. That was
excellent. I am glad there is some good news in the O'Hagan opinion. Well, we know pretty well how the wind is blowing up here on the panel. Perhaps, now, we can invite the audience to join in the questioning. There is Richard Painter.

MR. PAINTER: We have an opinion that specifically stated that what he did wrong was to disclose the source of his information and that he was going to trade on the information. The opinion specifically pointed out that if he had disclosed the source of the information to his law firm and his client, then the remedies against him would be under state law and not under section 10(b). In other words, he need only tell his client the source of the information if he was going to trade.

Second, on oral argument the government's attorney was asked, "What if somebody sold the briefcase of the lawyer and traded on the information? Would that violate 10(b) under misappropriation?" The answer from the government was "No." What kind of theory have we been using to convict insider traders? Yes, these may be situations that are not likely to grow often, but does this theory merge with respect to the law. Does this make sense, or should we send it back to Congress?

MR. MATHEWS: But, do you not think, Richard, that Mike Dreban did a terrific job on the law in that? I happen to think that one of the reasons why the government won the case was because of Mike Dreban’s oral argument. Do you not think that judges interpreting the O'Hagan decision will hold that if the trader steals the briefcase from the lawyer and uses the information in it that he has misappropriated it and that it will be a 10b-5 violation?

MR. PAINTER: Well, they may.

MR. MATHEWS: I think they will.

JUDGE WINTER: I think they will too.

MR. PAINTER: The other thing is that there needs to be a failure to disclose. What they are trying to do is fit the misappropriation theory into Santa Fe. So we need to find a failure to disclose. Mere breach of a fiduciary duty will not do it. But, there has to be a failure to disclose.
MR. MATHEWS: But I did not disclose that I stole your briefcase before I traded.

MR. PAINTER: Is stealing a failure to disclose, or is it more of a breach of fiduciary duty? They are going to have to try and figure that one out. But, for one reason or another, the government's own oral argument concedes this point to Justice O'Connor. Yet, she signed on the majority opinion. This is where I have a problem.

PROFESSOR CUNNINGHAM: There is Lawrence Rosenbloom.

MR. ROSENBLOOM: Am I correct that Justice Ginsburg says that the civil cases are not really appropriate, nor applicable, in the criminal cases like O'Hagan. I think she does say that.

PROFESSOR CUNNINGHAM: Yes.

AUDIENCE MEMBER: The question I had was are we really talking about misappropriation and insider trading, or are we talking about interpretations of the statute and the role of the Supreme Court of the United States? The problem I have with it, as a student at Pace University, is in Central Bank,34 where great emphasis was put on strict interpretation of the statute as the only index of being able to interpret securities law. So, if we align ourselves with Central Bank, forgetting about, for the moment, insider trading with the stolen briefcase, then how do we rationalize O'Hagan? Or, if we are going to use O'Hagan as the standard for an expansive interpretation of the statute, then how do we rationalize Central Bank?

PROFESSOR CUNNINGHAM: Yes, Justice Ginsburg did struggle with that problem, as Professor Karmel said, and she inherited a tough jurisprudence. She did make the effort to show the way in which this activity constituted deception, which was not an easy task to mount, as Dan Kramer has said.

PROFESSOR KARMEL: I have a different answer. You can reconcile O'Hagan with a lot of cases that were decided before

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1975, when the Supreme Court started on a strict interpretation of 10b-5 with *Blue Chip Stamps*.\(^3\) Most of those cases were dropped out of the case books as no longer relevant. I do not know. Maybe now they will be revived and brought back. But, there are a lot of pre-1975 cases giving very expansive interpretations to 10b-5. So, I think you are correct that the Supreme Court can be questioned or criticized for having cases interpreting 10b-5 that start from very different premises and sometimes apply 10b-5 or interpret 10b-5 very broadly and other times interpret it very narrowly.

MR. KRAMER: Yes. I have to agree with the sense of the question which is that it is very difficult to understand that the same court that could write *Central Bank* could also write *O'Hagan*. They are starting from very different places and very different notions of what the law is and how statutes should be interpreted. Ultimately, it is just not reconcilable.

MR. MATHEWS: Well, it is just that bad facts make bad law.

MR. KRAMER: Right.

JUDGE WINTER: The problem, again, is not *O'Hagan*. You could say the same thing about *Chiarella* and *Dirks*.

MR. KRAMER: Right.

JUDGE WINTER: You have two rationales. One is the misuse of information, and the other is unfairness in trading with other people. I do not think they ever should have been joined. If some fiduciary is misusing information, that is wrong. What difference does it make whether they trade or however they do it. If it is wrong to trade with somebody who has less information than you, what difference does it make to that person whether you stole the information or you are a genius? The truth is they never should have been put together. Once *Chiarella* separated them the answer should have been, now that we have separated them and we have nothing but misuse of information this has nothing to do with 10(b) whatsoever. But, you have to go back to *Chiarella* and look at its favorable citations of *Cady*. It is amazing. I mean, it

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rejects one of the two major premises of Cady without every saying so, but that is where they went wrong. This is not O'Hagan. I do not know what she was supposed to do. Presumably she could not get the six votes to overrule Dirks and Chiarella.

PROFESSOR CUNNINGHAM: Yes, sir?

PROFESSOR TIESON: I am Professor Tieson from the University of Pennsylvania. Usually, what we like to disclose is corporate information coming in from the world, or market information about tender offers. Justice Ginsburg is saying that what we want to disclose, and what we are required to disclose, is that we have breached our fiduciary duty. How does that further the purposes of the federal securities laws? Also, Justice Burger, in Chiarella, said what he felt was misappropriation theory and did not say that disclosure had to be the source of the information. He said it had to be public disclosure. If the misappropriation theory said that, then it would make some sense.

PROFESSOR CUNNINGHAM: Yes, right. Also, Justice Ginsburg observed that Burger had dealt with it in terms of disclosing to the public and then she changed that piece of it.

PROFESSOR KAHAN: I am not sure that this is an entirely fair reading of what Burger did. Burger does talk about misappropriating and stealing. Presumably, if you get the consent of the person from whom you misappropriate or steal, then it is no longer misappropriating or stealing. So, I think Burger may not have been satisfied with disclosure to the source of information. But I think he would have been satisfied with consent or with public disclosure.

PROFESSOR TIESON: He is saying that you must disclose publicly that a tender offer is going to be made.

PROFESSOR KAHAN: If you have misappropriated and if you publicize the information, then you are no longer violating 10b-5. But I think, if you get the consent of the person who owns the information, then you do not need to publicize it.

PROFESSOR TIESON: I will make the distinction between public disclosure and disclosing to one person who already knows
the information. The bidder knows that the tender offer is going to be made. So, you are not disclosing that the tender offer is going to be made. You are simply disclosing to them and then you sit on it. How does this further the purpose of securities laws?

PROFESSOR CUNNINGHAM: Maybe the answer is that, once such a person gets that consent, he is no longer an outsider but is an insider and is subject to the classical prohibitions.

PROFESSOR TIESON: I think Mr. Matthews is wrong, and the decision does not require consent. The decision does not say you have to get consent. You just have to tell them you are stealing it, and then, you trade and you have already won.

MR. KRAMER: Then, the decision talks about the remedies that the source of the information would have. I think it implies that there is no consent, since the court goes further and says that if you do not like what this person is doing, the source of information may then be able to obtain injunctive relief and have other state law remedies.

MR. MATHEWS: I was blurring the state law remedies.

PROFESSOR KAHAN: It is not going to happen all that often. That is not a consolation for Richard. But, I think it is relevant.

MR. MATHEWS: The thing that bothers me is whether we are going to have the courts now developing a body of federal common law of traditional state law fiduciary duties. I mean, I have had so many cases where it is the wife who learns from the husband, and then tells the brother-in-law, and the brother-in-law trades. Or, the kid is eavesdropping on the phone and the kid trades. You have all of these cases and you are going to have federal courts interpreting all of these duties as to when it is or is not a fiduciary duty. I mean, it is nuts.

PROFESSOR CUNNINGHAM: And they are going to.

JUDGE WINTER: We have to look at this as part of a larger context. Under the mail and wire fraud statutes, the federal courts have been developing federal breaches of fiduciary duty, including
in the corporate context. There is an obligation to disclose to the shareholders.

MR. MATTHEWS: I agree with Jack Coffee in his article *From Tort to Crime*,\(^\text{36}\) that the courts were making crimes out of things that were just ordinary state law.

JUDGE WINTER: You have to view *O'Hagan* in this context. This is something the federal courts have been doing for three or four decades.

MR. MATTHEWS: Decades. You are right.

JUDGE WINTER: Whatever it is that is behind this is cultural and something that is difficult to explain. I heard Abe Goldstein, a Professor at Yale Law School, once say that he just thought that judges look at white-collar criminals and say, “they are our class.” They will provide a lot less in the way of notice and other kinds of protection than they would to your ordinary bank robber.

MR. MATTHEWS: Judge, at other times it is the Supreme Court that has stepped up to the plate. Take the intangible rights statute or the mail fraud statute. For twenty-five years, eleven of the eleven circuits had condoned mail fraud prosecutions on the intangible rights theory and then the Supreme Court, in *McNally*,\(^\text{37}\) threw it all out, nine zip, and said that they did not care that every circuit court has approved it for twenty-five years, because it is wrong.

PROFESSOR CUNNINGHAM: A question from this side. Sir?

AUDIENCE MEMBER: There seems to be some animosity from some of the panel members towards the Supreme Court for interpreting 10b-5 and including the criminal aspect. If Congress does not like all of this change, then Congress can change it. Why is the panel so concerned? If Congress does not change it, you can


leave it the way it is.

MR. MATHEWS: That is a good point, practically. However, jurisprudentially, I think it is dangerous to let courts create crimes.

AUDIENCE MEMBER: If Congress knew that it was a travesty, they would act on it. And until then, we should take the decision as is.

MR. KRAMER: In my view, that is a very undemocratic notion. I am not sure that I ascribe to the theory that if judges feel that Congress has not acted appropriately, then they will step in and wait for Congress to correct them. I think that is just undemocratic.

MR. MATHEWS: Well, as Roberta Karmel said, this is an area that Congress has specifically addressed. Congress had hearings trying to define insider trading and decided that they could not come to an agreement and that they would not do it because the SEC came up to Congress and said, “Please don’t do it. We don’t want you to do it.”

JUDGE WINTER: Yes, but in his defense, the same Congress that said, “We are not going to define it,” also said “You can get treble damages and attorneys’ fees.”

PROFESSOR CUNNINGHAM: Let’s try to take three more questions before we break. Depending on their length, we may only have time for two. Professor Fish, from Fordham, is in the back of the room.

PROFESSOR FISH: Just to sort of add to that. Congress said, as part of its findings, which was enacted in the 1980 legislation, that the insider trading that the courts developed was appropriate. Congress thought it was a good idea.

MR. MATTHEWS: That was not Congress. That was just a couple of members of Congress.

PROFESSOR FISH: Those were the findings. That is not the legislative history. Those were the actual findings that were in
PROFESSOR CUNNINGHAM: Yes, sir?

AUDIENCE MEMBER: I was wondering if either of the panelists had a proposed definition of insider trading?

PROFESSOR CUNNINGHAM: Well, Art?

MR. KRAMER: In 1988, the SEC and the ABA, together, proposed a definition of insider trading. The SEC itself, at a point when I think it was feeling a little bit more vulnerable than it does today, actually proposed the definition that the ABA also signed.

MR. MATHEWS: The SEC appointed a committee. The committee was headed by Ted Levine, Harvey Pitt, and John Alston, who were three prominent practitioners. They came up with what a lot of us in the bar thought was a pretty good definition.

PROFESSOR KARMEL: Interestingly, the reason the SEC then ended up opposing the enactment of a definition had to do with a dispute over whether possession of inside information sufficed for this wrong, or whether there had to be use. I think it is very ironic that Justice Ginsburg sided with the private bar on this issue with her “on-the-basis-of” language. I think, if the SEC knew that was the way the law was going to come out, the SEC might have gone along with a statutory definition of insider trading. So, I do not think this idea that the misappropriation theory was valid is really in the statute. I think it is in the committee reports and the committee reports are generally written by the SEC. Therefore, I do not know how much weight ought to be given to them.

JUDGE WINTER: Can I answer, since it was directed at me. It is a serious question. My answer, I think, is that the misuse of information should be dealt with in a body of law dealing with the misuse of information. We should not try to separate out misuse of information that is then used to make money on the stock market. So, I would not define insider trading. I totally agree with Professor Kahan in all of these cases. I think something that ought to be illegal was done. But, I think it is part of a different body of law because it also happens to be my view that insider trading does
not affect the integrity or honesty of markets. If you look at nothing but the fact that someone has good information, we want that person to trade. That is what makes the efficient market hypothesis work. That is how we price securities. People who have the best information set the prices. So, what is wrong with insider trading is the misuse of somebody else’s information. The issue is not whether they use it to trade.

PROFESSOR CUNNINGHAM: Well, actually, I may breach the promise that I made about three questions. We have run out of time, but I want to thank all of the panelists and all of you for coming, as well as Marcy Rosenbaum and the Law Review for helping out. Thank you all very much.