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Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability For Stock Market Insider Trading and Tipping

WILLIAM K.S. WANG^{*1}

SEC Rule 10b-5 covers a great deal of stock market insider trading and tipping, but certainly not all. For insider trading defendants, some elements of criminal liability may be different and possibly easier to satisfy under mail/wire fraud than under SEC Rule 10b-5 (e.g., materiality, and the requirements for tipper and tippee liability recently tightened for Rule 10b-5 by the Second Circuit). Generally, courts have not addressed these possible differences.

With insider trading and tipping, the victim of mail/wire fraud could be either the information-owner or the party on the other side of the transaction. The courts have not examined the latter victim and the possibility that such mail/wire fraud liability might be broader than under the Rule 10b-5 “classical relationship.” Another unexplored question is whether an employee of a company engaging in an insider trade of its stock could be criminally liable under two different mail/wire fraud theories with two separate mail/wire

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¹ This Article draws upon WILLIAM K.S. WANG & MARC I. STEINBERG, *INSIDER TRADING* (Oxford U. Press, 3d ed. 2010).

fraud victims: the company/information-owner and the party on the other side of the transaction.

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INTRODUCTION

This Article discusses the application of the federal mail fraud² and wire fraud³ statutes to criminal liability for stock market insider trading and tipping, and whether, for this conduct, mail/wire fraud might be broader than SEC Rule 10b-5.⁴ For example, for mail/wire fraud, materiality *may* have a standard that is (1) *laxer* (beyond “reasonable person”) or, (2) in cases involving deprivation of informational property, *different* (importance to the owner of the information as opposed to a stock market investor).⁵

In addition, for mail/wire fraud, as opposed to Rule 10b-5 fraud, tipper and tippee liability may be more extensive.⁶ Recently, under Rule 10b-5, the Second Circuit made it more difficult for the prosecution to demonstrate the “personal benefit” requisite for the initial

² 18 U.S.C. § 1341 (2012). The essence of the statute has been in effect since 1872. See Peter J. Henning, *Maybe it Should Just be Called Federal Fraud: The Changing Nature of the Mail Fraud Statute*, 36 B.C. L. REV. 435, 441 (1995) (“The essential structure of the statute has remained consistent since its enactment in 1872.”).

For a discussion of the origins of the mail fraud statute, see *id.* at 441–50; ELLEN S. PODGOR ET AL., *WHITE COLLAR CRIME* § 4.1(A), at 71–73 (West 2013) (describing its origins in recodifications in 1872, 1889, and 1909); C.J. Williams, *What Is the Gist of the Mail Fraud Statute?*, 66 OKLA. L. REV. 287, 287–96 (2014); Brette M. Tannenbaum, Note, *Reframing the Right: Using Theories of Intangible Property to Target Honest Services Fraud After Skilling*, 112 COLUM. L. REV. 359, 364–69 (2012). For an extensive discussion of the history and early interpretation of the statute, see Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771 (1980). For criticism of the breadth of the mail fraud statute, see Todd E. Molz, Comment, *The Mail Fraud Statute: An Argument for Repeal by Implication*, 64 U. CHI. L. REV. 983 (1997).

³ 18 U.S.C. § 1343 (2012).

⁴ 17 C.F.R. § 240.10b-5 (2015). For a discussion of the application of Rule 10b-5 to stock market insider trading, see WANG & STEINBERG, *supra* note 1, chs. 4, 5.

The SEC adopted Rule 10b-5 pursuant to Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012).

⁵ For a discussion of this issue, see *infra* Part II(B)(4).

⁶ For a discussion of whether the Rule 10b-5 “personal benefit” test for the initial tipper and the “know or should have known” test for the tippee applies to mail/wire fraud, see *infra* Part II(B)(5).

tipper⁷ and to demonstrate the requirement that the tippee “knows or should know” of the initial tipper’s violation.⁸

With insider trading and tipping, the victim of mail/wire fraud could be either the information-owner or the party on the other side of the transaction. Courts have not explored the latter victim and the possibility that such mail/wire fraud liability might be broader than under the Rule 10b-5 “classical relationship.”⁹ Nor have the courts considered whether an employee engaging in an insider trade of her company’s shares could be criminally liable under two different mail/wire fraud theories with two separate mail/wire fraud victims: the company/information-owner and the party on the other side of the transaction.¹⁰

⁷ See *United States v. Newman*, 773 F.3d 438, 451–53 (2d Cir. 2014), *cert. denied*, 2015 WL 4575840 (U.S., Oct. 5, 2015). For additional discussion of this portion of *Newman*, see *infra* notes 218–28 and accompanying text.

⁸ See *Newman*, 773 F.3d at 453–55. For additional discussion of this portion of *Newman*, see *infra* notes 218–19 and accompanying text. In *Newman*, the government did not charge the defendants with mail/wire fraud. See 773 F.3d at 442–43.

⁹ For discussion of this question, see *infra* Part II(B)(2).

¹⁰ For discussion of this issue, see *infra* Part II(B)(3).

II. SOME ELEMENTS OF MAIL AND WIRE FRAUD CRIMINAL LIABILITY

The mail and wire fraud provisions prohibit the “use” of the mails (or “private interstate carrier”)¹¹ or the “use” of “wire communication”¹² to further a “scheme to defraud.”¹³ One treatise notes:

¹¹ The mail fraud statute, 18 U.S.C. § 1341, provides:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation occurs in relation to, or involving any benefit authorized, transported, transmitted, transferred, disbursed, or paid in connection with, a presidentially declared major disaster or emergency (as those terms are defined in section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5122)), or affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

In 1994, Congress amended 18 U.S.C. § 1341 to extend its coverage to anyone who “deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier.” Violent Crime Control and Law Enforcement Act of 1994, Pub. L. No. 103–332, § 250006, 108 Stat. 1796, 2087. See Brandon Weston, Note, *Annual Survey of White Collar Crime: Mail and Wire Fraud*, 51 AM. CRIM. L. REV. 1423, 1425 n.12, 1433 n.68 (2014). Thus, when discussing the mail fraud statute, this Article will use “mail” to include the use of both the United States Postal Service and a private or commercial interstate carrier.

For a discussion of the meaning of “private or commercial interstate carrier,” see Henning, *supra* note 1, at 469–76. Professor Henning concludes that “the Government must prove that the business of the company . . . involves significant interstate shipments, and not just that the general business has an effect on interstate commerce.” *Id.* at 474. For additional discussion, see 2 KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY § 8:56.10 (2d ed. 1991 & Supp. 2014); Williams, *supra* note 2, at 302–03. *United States v. Gil*, 297 F.3d 93, 100 (2d Cir. 2002), concluded “[A]pplication of the mail fraud statute to *intrastate* mailings sent or delivered by private or commercial interstate carriers [in this case, Federal Express], is a permissible exercise of Congress’s power [under the Commerce Clause]” *Accord* *United States v. Hasner*, 340 F.3d 1261, 1270 (11th Cir. 2003).

For a discussion of jurisdiction and venue under the mail/wire fraud statutes, see Jack E. Robinson, *The Federal Mail and Wire Fraud Statutes: Correct Standards for Determining Jurisdiction and Venue*, 44 WILLAMETTE L. REV. 479 (2008).

¹² The wire fraud statute, 18 U.S.C. § 1343, provides:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation occurs in relation to, or involving any benefit authorized, transported, transmitted, transferred, disbursed, or paid in connection with, a presidentially declared major disaster or emergency (as those terms are defined in section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5122)), or affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

Section 902 of the Sarbanes-Oxley Act of 2002 amended 18 U.S.C. chapter 63, containing the mail and wire fraud provisions, to provide: “Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offence, the commission of which was the object of the attempt or conspiracy.” 18 U.S.C. § 1349 (2012). For discussion of this amending provision, see WANG & STEINBERG, *supra* note 1, § 7.2.1, 617 n.24; Ann Marie Tracey & Paul Fiorelli, *Nothing Concentrates the Mind Like the Prospect of a Hanging: The Criminalization of the Sarbanes-Oxley Act*, 25 N. ILL. U. L. REV. 125, 144–47 (2004) (noting that under the new provision (1) the prosecution need neither allege nor prove an overt act and (2) prosecutors are not required to use 18 U.S.C. § 1349 as opposed to 18 U.S.C. § 371 (the general conspiracy statute) and, therefore, in plea bargaining, can offer the defendant either the 20-year charge of 18 U.S.C. § 1349 or the 5-year charge of 18 U.S.C.

“One finds wire fraud charges premised on telephone calls, micro-waves, fax transmissions, and electronic transmissions. Because of the high use of computers, wire fraud is a common charge in a white collar case involving a transmission via the internet.”¹⁴

The mail fraud and wire fraud statutes are two different laws, but are interpreted similarly. Where the two statutes share the same language, the law developed under the mail fraud statute applies to wire fraud and vice versa.¹⁵ Allegations of securities law violations

§ 371); Jennifer S. Recine, Note, *Examination of the White Collar Crime Penalty Enhancements in the Sarbanes-Oxley Act*, 39 AM. CRIM. L. REV. 1535, 1553–55 (2002) (concluding that the provision is not exceedingly important, except that, where § 902 applies, plea-bargaining prosecutors will not be able to offer the lesser maximum five-year sentence for general conspiracy under 18 U.S.C. § 371 because § 902 would replace 18 U.S.C. § 371).

¹³ For a discussion of the “use” of the “mail” or “wire” and “scheme to defraud,” see *infra* Part II(A). For a discussion of the penalties for mail/wire fraud, see 3 ALAN R. BROMBERG, LEWIS D. LOWENFELS, & MICHAEL J. SULLIVAN, BROMBERG AND LOWENFELS ON SECURITIES FRAUD, § 6:372 (2d ed. 2015); 2 BRICKEY, *supra* note 11, § 8:62–63; WANG & STEINBERG, *supra* note 1, § 11.1. For a discussion of the application of the Federal Sentencing Guidelines to mail fraud, see 1 JOEL ANDROPHY, WHITE COLLAR CRIME, § 8:15 (2d ed. 2014); CHARLES DOYLE, CONG. RESEARCH SERV., R41930, MAIL AND WIRE FRAUD: A BRIEF OVERVIEW OF FEDERAL CRIMINAL LAW 7–9 (2011) [hereinafter *OVERVIEW*]; Charles Doyle, *Mail and Wire Fraud: A Brief Overview of Federal Criminal Law*, in MAIL AND WIRE FRAUD: ELEMENTS AND CONSIDERATIONS IN FEDERAL CRIMES 6–7 (Eric J. Cass & Andreas N. Schuster eds., 2012) [hereinafter *Doyle Chapter*]; Weston, *supra* note 11, at 1446–47. For an empirical study of average sentencing for mail/wire fraud, see Lucian E. Dervan, *White Collar Overcriminalization: Deterrence, Plea Bargaining, and the Loss of Innocence*, 101 KY. L. J. 723 (2012–13). For a discussion of the application of the Federal Sentencing Guidelines to insider trading generally, see WANG & STEINBERG, *supra* note 1, § 7.2.2.

¹⁴ ELLEN S. PODGOR ET AL, *supra* note 2, § 4.9(A), at 92. See also *Rose v. United States*, 227 F.2d 448, 449 (10th Cir. 1955) (stating wire fraud statute’s language is “broad enough to include an interstate telephonic communication”). For a discussion of when use of the internet involves the required “interstate” communication, see *infra* note 56 and accompanying text.

¹⁵ See *Pasquantino v. United States*, 544 U.S. 349, 355 n.2 (2005) (“we have construed identical language in the wire and mail fraud statutes *in pari materia*.”); *Carpenter v. United States*, 484 U.S. 19, 25 n.6 (1987) (“The mail and wire fraud statutes share the same language in relevant part, and accordingly we apply the same analysis to both sets of [insider trading/tipping] offenses here.”); *United States v. Green*, 594 F.3d 1057, 1063 n.3 (9th Cir. 2010) (citing *United States v. Shipsey*, 363 F.3d 962 (9th Cir. 2004)); *United States v. McAuliffe*, 490 F.3d 526, 532 n.3 (6th Cir. 2007) (same); *Shipsey*, 363 F.3d at 971 n.10 (“It is well settled

and mail and/or wire fraud violations are often joined in a single indictment.¹⁶

Although the Supreme Court has never ruled on the issue, lower courts have uniformly held that a private right of action does not exist under the mail fraud or wire fraud statutes.¹⁷

that cases construing the mail fraud and wire fraud statutes are applicable to either.”); *United States v. Mills*, 199 F.3d 184, 188 (5th Cir. 1999) (citing *Carpenter*); *United States v. ReBrook*, 58 F.3d 961, 967 n.6 (4th Cir. 1995); 2 BRICKEY, *supra* note 11, §§ 8:39, 8:60; CORPORATE COUNSEL’S GUIDE TO WHITE COLLAR CRIME § 2:3 (2014) [hereinafter GUIDE]; OVERVIEW, *supra* note 13, at 2; 2 SARAH N. WELLING, SARA SUN BEALE, & PAMELA H. BUCY, FEDERAL CRIMINAL LAW AND RELATED ACTIONS: CRIMES, FORFEITURE, THE FALSE CLAIMS ACT AND RICO § 17.2 (1998 & Supp. 2000); Williams, *supra* note 2, at 304–05; Weston, *supra* note 11, at 1425.

¹⁶ For examples of insider trading cases resulting from such indictments, see *Carpenter*, 484 U.S. at 19; *United States v. Ruggiero*, 56 F.3d 647, 649 (5th Cir. 1995); *United States v. Teicher*, 987 F.2d 112, 114 (2d Cir. 1993); *United States v. Grossman*, 843 F.2d 78, 79 (2d Cir. 1988); *United States v. Newman*, 664 F.2d 12, 14 (2d Cir. 1981), *aff’d after remand*, 722 F.2d 729 (2d Cir. 1983) (unpublished order); *United States v. Victor Teicher & Co.*, 726 F. Supp. 1424, 1427, 1434 (S.D.N.Y. 1989); *United States v. Elliott*, 711 F. Supp. 425, 425–26 (N.D. Ill. 1989). See generally *United States v. Faulhaber*, 929 F.2d 16, 17 (1st Cir. 1991); see *id.* at 19 (explaining indictment with both securities fraud and mail fraud counts is not multiplicitous); *United States v. Ledesma*, 632 F.2d 670, 679 (7th Cir. 1980) (holding the simultaneous prosecution under mail fraud statute and another statute does not violate double jeopardy clause because the offenses involve different elements). *But cf.* *United States v. Dixon*, 536 F.2d 1388, 1398 (2d Cir. 1976) (noting, in non-insider trading case, that it was unnecessary for the prosecutor to include mail fraud counts because the possible prison sentence under the Securities Exchange Act for the defendant’s activity was as much as any judge would impose, and all the mail fraud count would accomplish was the collection of additional fines).

¹⁷ See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 501 (1985) (Marshall, J., dissenting) (“Prior to RICO, no federal statute had expressly provided a private damages remedy based upon a violation of the mail or wire fraud statutes Moreover, the Courts of Appeals consistently had held that no implied federal private causes of action accrue to victims of these federal violations.”); *Wisdom v. First Midwest Bank of Poplar Bluff*, 167 F.3d 402, 407–08 (8th Cir. 1999) (mail fraud and wire fraud); *Ryan v. Ohio Edison Co.*, 611 F.2d 1170, 1178–79 (6th Cir. 1979) (holding no private right of action under mail fraud statute); *Bell v. Health-Mor, Inc.*, 549 F.2d 342, 346 (5th Cir. 1977) (holding no private right of action under mail fraud statute) (citing *Napper v. Anderson*, 500 F.2d 634, 636 (5th Cir. 1974) (holding no private right of action under wire fraud statute)). *Cf.* *Oppenheim v. Sterling*, 368 F.2d 516, 518–19 (10th Cir. 1966) (finding

The Supreme Court has identified the two important elements of mail fraud as “(1) having devised or intending to devise a scheme to defraud (or to perform specified fraudulent acts), and (2) use of the mail for the purpose of executing, or attempting to execute, the scheme (or specified fraudulent acts).”¹⁸ A circuit court opinion pro-

no federal question jurisdiction in civil case based on violation of mail fraud statute).

Nevertheless, mail and wire fraud violations constitute “racketeering activity” under the Racketeer Influenced and Corrupt Organizations Act (RICO). *See* 18 U.S.C. § 1961(1)(B) (2012). The RICO statute creates an express private cause of action for up to three times damages plus legal costs. *See* 18 U.S.C. § 1964(c) (2012). In 1995, however, Congress eliminated “conduct that would have been actionable as fraud in the purchase or sale of securities” as a predicate offense for civil RICO, except after a criminal conviction in connection with the fraud. *See* Private Securities Litigation Reform Act of 1995, § 107 (amending 18 U.S.C. § 1964(c)).

An interesting question is whether, even without a criminal conviction, a private civil RICO claim may be available if insider trading or tipping constitutes mail/wire fraud, but does *not* violate securities fraud statutes. For discussion of the ambiguity of the phrase “conduct that would have been actionable as fraud in the purchase or sale of securities,” see WILLIAM K.S. WANG & MARC I. STEINBERG, *INSIDER TRADING* § 12.1 (1st ed. 1996 & Supp. 2002).

¹⁸ *Schmuck v. United States*, 489 U.S. 705, 721 (1989); *accord* *Pereira v. United States*, 347 U.S. 1, 8 (1954) (“(1) a scheme to defraud, and (2) the mailing of a letter, etc., for the purpose of executing the scheme.”). Accordingly, most cases state that the government need prove only these two elements. *See, e.g.*, *United States v. Lo*, 231 F.3d 471, 475 (9th Cir. 2000); *United States v. Bailey*, 123 F.3d 1381, 1390 (11th Cir. 1997); *Chisolm v. Transouth Fin. Corp.*, 95 F.3d 331, 336 (4th Cir. 1996).

Some courts phrase the test for liability in terms of three elements. For example, one circuit court gave the following summary of the elements of mail fraud: “(1) the defendant participated in some scheme or artifice to defraud, (2) the defendant or someone associated with the scheme used the mails or ‘caused’ the mails to be used, and (3) the use of the mails was for the purpose of executing the scheme.” *Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 481–82 (5th Cir. 1986) (citing *United States v. Davis*, 752 F.2d 963, 970 (5th Cir. 1985)). *See also* *United States v. Crossley*, 224 F.3d 847, 857 (6th Cir. 2000); *United States v. Frost*, 125 F.3d 346, 354 (6th Cir. 1997); *United States v. Funt*, 896 F.2d 1288, 1292 (11th Cir. 1990); *United States v. Toney*, 605 F.2d 200, 205 (5th Cir. 1979). The two-prong and three-prong tests are effectively the same.

For still other similar formulations of the elements for mail fraud, see *United States v. Autuori*, 212 F.3d 105, 115 (2d Cir. 2000); *United States v. Walker*, 191 F.3d 326, 334 (2d Cir. 1999); *United States v. Lack*, 129 F.3d 403, 406 (7th Cir.

vided a similar summary and continued: “Each mailing in furtherance of the scheme constitutes a separate violation. Intent to deceive and knowing use of the mails are the scienter elements of mail fraud.”¹⁹ Other courts also have stated that mail/wire fraud violations require specific intent to defraud.²⁰

1997); *United States v. Lefkowitz*, 125 F.3d 608, 614 (8th Cir. 1997); *United States v. Moser*, 123 F.3d 813, 819 (5th Cir. 1997).

For a general discussion of the elements of mail and wire fraud, see ANDROPHY, *supra* note 13, §§ 8:2–8:7; *Doyle Chapter*, *supra* note 13, at 3–6; OVERVIEW, *supra* note 13, at 2–7; 2 BRICKEY, *supra* note 11, §§ 8:32–8:58; PODGOR ET AL., *supra* note 2, at 71–94; 7 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION, § 22.4 (6th ed. 2009 & 2015 Supp.); WELLING, BEALE, & BUCY, *supra* note 15, §§ 17.4–17.25; WANG & STEINBERG, *supra* note 1, § 11.2; *see generally* Ellen S. Podgor, *Mail Fraud: Redefining the Boundaries*, 10 ST. THOMAS L. REV. 557 (1998) [hereinafter cited as *Boundaries*]; Weston, *supra* note 11, at 1426–44. For a selected bibliography on mail fraud, see *Boundaries*, *supra*, at 573–77.

¹⁹ *United States v. Vaughn*, 797 F.2d 1485, 1493 (9th Cir. 1986). Citing *Vaughn*, *United States v. Garlick*, 240 F.3d 789, 792 (9th Cir. 2001) held: “[E]ach use of the wires under the wire fraud statute constitutes a separate offense.” *Accord* Weston, *supra* note 11, at 1427 (“Each use of the mails or wires constitutes a separate offense and therefore can be a separate count in an indictment.”); 2 BRICKEY, *supra* note 11, § 8:56; 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.32(B). *But cf.* Williams, *supra* note 2 (arguing that each mailing should not be separate offense and that Congress should amend the statute to clarify that “scheme to defraud” should be a unit of prosecution, not each individual mailing).

²⁰ *See, e.g.*, *Carpenter v. United States*, 484 U.S. 19, 28 (1987) (discussed below); *United States v. Wynn*, 684 F.3d 473, 478 (4th Cir. 2012); *United States v. Bradley*, 644 F.3d 1213, 1239 (11th Cir. 2011); *United States v. Rajwani*, 476 F.3d 243, 247 (5th Cir. 2007) (requiring “conscious knowing intent to defraud”) (citing *United States v. Reyes*, 239 F.3d 722, 736 (5th Cir. 2001)); *United States v. Novak*, 443 F.3d 150, 156–59 (2d Cir. 2006) (discussing evidence sufficient for showing of intent); *United States v. Welch*, 327 F.3d 1081, 1104 (10th Cir. 2003); *United States v. Haber*, 251 F.3d 881, 887 (10th Cir. 2001); *United States v. Giles*, 246 F.3d 966, 973 (7th Cir. 2001); *United States v. Bouyea*, 152 F.3d 192, 194 (2d Cir. 1998); *United States v. Frost*, 125 F.3d 346, 354 (6th Cir. 1997); *Pelletier v. Zweifel*, 921 F.2d 1465, 1499 (11th Cir. 1991) (“conscious knowing intent to defraud” required).

For a lengthy discussion of the “fraudulent intent” requirement in wire and mail fraud, see *Powers v. British Vita, P.L.C.*, 57 F.3d 176, 184–87 (2d Cir. 1995). For other discussions of the intent requirement, see 2 BRICKEY, *supra* note 11, § 8:51; 2 WELLING, BEALE, & BUCY, *supra* note 15, §§ 17.20–17.25; *Doyle Chapter*, *supra* note 13, at 5; Weston, *supra* note 11, at 1429–32.

In the leading insider trading mail/wire fraud case, *Carpenter*, 484 U.S. 19 (1987), the Supreme Court noted: “[T]he District Court’s conclusion that each of the petitioners acted with the *required* specific intent to defraud is strongly supported by the evidence.” *Id.* at 28 (emphasis added). The principal defendant, Winans, was one of two authors of a column in the *Wall Street Journal*; Winans conspired with other defendants to profit through trading stocks based on the column’s probable impact. *See id.* at 22–23. The Court found that Winans had a specific intent to defraud his employer, the *Wall Street Journal*. *See id.* at 28. The employee manual declared that the “Journal’s business information that it intended to be kept confidential was its property” *Id.* Winans demonstrated his awareness of the policy when he twice told his editors of leaks by other employees. *See id.* For related discussion of the discussion of intent in the circuit court and trial court opinions below, see *infra* notes 244, 250 and accompanying text.

The court in *United States v. Dobson*, 419 F.3d 231, 236–39 (3d Cir. 2005), held that the defendant must knowingly participate in a fraudulent scheme: “Unwitting participation in a fraudulent scheme is not criminal under § 1341. Moreover, the relevant inquiry is not whether the defendant acted knowingly in making *any* misstatement, but whether she did so with respect to the overarching fraudulent scheme” *Id.* at 237 (citing *United States v. Pearlstein*, 576 F.2d 531, 537 (3d Cir. 1978)).

The court in *United States v. Akpan* stated that the “defendant acts with the intent to defraud when he ‘acts knowingly with the specific intent to deceive for the purpose of causing pecuniary ‘loss to another or bringing about some financial gain to himself.’” 407 F.3d 360, 370 (5th Cir. 2005) (quoting *United States v. Blocker*, 104 F.3d 720, 732 (5th Cir. 1997)).

In *United States v. Given*, the court noted with approval that the trial court had used the circuit’s pattern instruction: “When the word ‘knowingly’ is used in these instructions, it means that the defendant realized what he was doing and was aware of the nature of his conduct, and did not act through ignorance, mistake or accident.” 164 F.3d 389, 394 (7th Cir. 1999) (quoting the Seventh Circuit’s instruction).

The jury may infer intent from circumstantial evidence. *See, e.g.*, *United States v. Daniel*, 749 F.3d 608, 614 (7th Cir. 2014); *United States v. Howard*, 619 F.3d 723, 727 (7th Cir. 2010); *United States v. Rogers*, 321 F.3d 1226, 1230 (9th Cir. 2003); *United States v. Owens*, 301 F.3d 521, 528 (7th Cir. 2002); *United States v. Britton*, 289 F.3d 976, 981 (7th Cir. 2002). *See also* *United States v. Maxwell*, 579 F.3d 1282, 1301 (11th Cir. 2009) (“A jury may infer an intent to defraud from the defendant’s conduct.”); 2 BRICKEY, *supra* note 11, § 8:51, at 133 (“Direct proof of fraudulent intent is not required.”); Weston, *supra* note 11, at 1430.

For a discussion of whether the defendant must intend to injure the alleged victim of the fraud, see *Welch*, 327 F.3d at 1104–06; *United States v. Kenrick*, 221 F.3d 19, 28–29 (1st Cir. 2000) (discussing intent required by defendant); *United States v. Rossomando*, 144 F.3d 197, 199–201 (2d Cir. 1998) (discussing jury instruction on defendant’s required intent); *Boundaries*, *supra* note 18, at 566–68; Elkan Abramowitz, ‘Intent to Harm’ in *Federal Statute on Mail Fraud*, N.Y.L.J., May

5, 1998, at 3 (discussing how the prosecution need only show defendant's intent to harm victims).

Some opinions have equated "reckless indifference" or "willful blindness" to specific intent to defraud. *See, e.g.*, *United States v. Epstein*, 426 F.3d 431, 440–41 (1st Cir. 2005) (approving "willful blindness" jury instructions); *United States v. Titchell*, 261 F.3d 348, 351 (3d Cir. 2001); *United States v. Munoz*, 233 F.3d 1117, 1136 (9th Cir. 2000), *superseded on other grounds by statute*, U.S. SENTENCING GUIDELINES MANUAL § 2B1.1. (U.S. SENTENCING COMM'N 2015), *as recognized in* *United States v. Hymas*, 780 F.3d 1285, 1287 (9th Cir. 2015) and *United States v. Van Alstyne*, 584 F.3d 803, 807 (9th Cir. 2009); *United States v. Stewart*, 185 F.3d 112, 125–26 (3d Cir. 1999); *United States v. Trammell*, 133 F.3d 1343, 1352 (10th Cir. 1998) ("The 'schemer's indifference to the truth of statements can amount to [evidence of] fraudulent intent.") (quoting *United States v. Reddeck*, 22 F.3d 1504, 1507 (10th Cir. 1994)); *United States v. Coyle*, 63 F.3d 1239, 1243 (3d Cir. 1995) ("Proof of specific intent is required . . . which 'may be found from a material misstatement of fact made with reckless disregard for the truth.") (quoting *United States v. Hannigan*, 27 F.3d 890, 892 n.1 (3d Cir. 1994)); *United States v. Duncan*, 29 F.3d 448, 450 & n.1 (8th Cir. 1994); *United States v. Reddeck*, 22 F.3d 1504, 1507 (10th Cir. 1994). *See also* *United States v. Carlo*, 507 F.2d 799, 802 (2d Cir. 2007) (approving charge that defendant "had actual knowledge that his statements were false or, in the alternative, that he was aware of a high probability that they were false, but consciously avoided confirming that suspicion"); 2 BRICKEY, *supra* note 11, § 8:48, at nn. 584–88 and accompanying text (actual knowledge of falsity and deliberate avoidance of the truth may be treated the same); *id.* § 8:51, nn.639, 654.25, 654.30 (citations of opinions endorsing "willful blindness" or "reckless indifference"); OVERVIEW, *supra* note 13, at 5; OTTO G. OMERMAIER & ROBERT G. MORVILLO, WHITE COLLAR CRIME: BUSINESS AND REGULATORY OFFENSES § 9:03 (2013); 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.8; *Weston*, *supra* note 11, at 1431 ("intent requirement can be satisfied by proof of a reckless disregard or indifference for the truth of one's representations"). *Cf.* *United States v. Ferguson*, 676 F.3d 260, 267, 277–79 (2d Cir. 2011) (in case involving conspiracy, mail fraud, securities fraud, and false statement made to the SEC, allowing a "conscious avoidance" jury instruction under the circumstances of the case). *See generally* *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2066, 2070–72 (2011) (discussing "willful blindness" in a civil patent infringement trust case); Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 567 (2011); Michael Clay Smith, *Recklessness and Good Faith Under the Mail Fraud Statute: Mens Rea by Accident?*, 27 CRIM. L. BULL. 315 (1991); J. Kelly Strader, *(Re)Conceptualizing Insider Trading: United States v. Newman and the Intent to Defraud*, 80 BROOK. L. REV. 1419 (2015) (discussing *Global Tech* and "willful blindness" in criminal cases generally and in Rule 10b-5 insider trading cases).

For discussion of the Rule 10b-5 scienter requirement and its application to insider trading defendants, see WANG & STEINBERG, *supra* note 1, § 4.4. For discussion of the special features of the Rule 10b-5 scienter of tippers and tippees, see *id.* § 4.4.5.

Further, courts have found violations where the fraudulent scheme did not succeed. In other words, a failed attempt is still a “scheme to defraud” under the mail and wire fraud statutes.²¹

²¹ See *United States v. Pimental*, 380 F.3d 575, 585 (1st Cir. 2004); *United States v. Rybicki*, 354 F.3d 124, 145 (2d Cir. 2003) (en banc) (“actual or intended . . . harm to the victim need not be established”); *United States v. Yeager*, 331 F.3d 1216, 1221 (11th Cir. 2003); *United States v. Tadros*, 310 F.3d 999, 1006 (7th Cir. 2002); *United States v. Cherif*, 943 F.2d 692, 698–99 (7th Cir. 1991) (finding defendant still violates the mail and wire fraud statutes even if defendant attempts to trade on confidential information but in fact traded on public information, i.e., defendant “was unlucky or a bad judge of the value of the information”); *United States v. Bryan*, 58 F.3d 933, 943 (4th Cir. 1995), *abrogated by* *United States v. O’Hagan*, 521 U.S. 642, 647 (1997); ANDROPHY, *supra* note 13, § 8:3; 2 BRICKEY, *supra* note 11, § 8:58; OVERVIEW, *supra* note 13, at 4; Weston, *supra* note 11, at 1428 (“the government need not show that the scheme was successful”); *id.* at 1437 (“success of the scheme is not required”). See also *Neder v. United States*, 527 U.S. 1, 24–25 (1999) (“The common-law requirements of ‘justifiable reliance’ and ‘damages,’ for example, plainly have no place in the federal fraud statutes [including mail and wire fraud] . . . [T]he elements of reliance and damage would clearly be inconsistent with the statutes Congress enacted.”).

As mentioned earlier, section 902 of the Sarbanes-Oxley Act of 2002 amended 18 U.S.C. chapter 63 (containing the mail and wire fraud provisions) to provide: “Any person who *attempts* or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offence, the commission of which was the object of the attempt or conspiracy.” 18 U.S.C. § 1349 (emphasis added). For additional discussion of this provision, see *supra* note 12. Under Rule 10b-5, a failed attempt is also illegal. See WANG & STEINBERG, *supra* note 1, § 5.2.8[F], at nn.467–78.

Section 807 of the Sarbanes-Oxley Act of 2002 imposes criminal penalties for: “[w]hoever knowingly executes, or *attempts* to execute, a scheme or artifice . . . [to commit fraud in connection with a publicly traded security].” 18 U.S.C. § 1348 (2012) (emphasis added). For a discussion of this provision, see RALPH C. FERRARA, DONNA M. NAGY, & HERBERT THOMAS, FERRARA ON INSIDER TRADING AND THE WALL §§ 1.02[2], 2.03[2] (2014); WANG & STEINBERG, *supra* note 1, §§ 7.2.1, at n.17, nn.25–26, and accompanying text.

For the upholding of a jury conviction under § 1348, see *United States v. Mahaffy*, 693 F.3d 113, 125–26 (2d Cir. 2012). For discussion of both Section 807 and *Mahaffy*, see David Mills & Robert Weisberg, *Corrupting the Harm Requirement in White Collar Crime*, 60 STAN. L. REV. 1371, 1435–37 (2008).

For the upholding of a “conscious avoidance” jury instruction under both mail fraud and § 1348, see *United States v. Stinn*, 379 F. App’x 19, 20–21 (2d Cir. 2010).

The Supreme Court has expressly reserved deciding whether a *tippee* may violate Rule 10b-5 if she erroneously thinks she has material nonpublic information and trades upon it. See *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 312 n.21 (1985). Nevertheless, several lower courts have stated that such a *tippee*

Mail/wire fraud is an inchoate crime that applies to someone who *devises* a scheme to defraud, causes a requisite use of the mail or wires for the purpose of executing the scheme, and does *nothing more* to implement the scheme. Indeed, the mail and wire fraud statutes broadly apply to someone who “having *devised or intending to devise* any scheme or artifice to defraud”²² In the words of the Supreme Court, “[t]he elements of the offense of mail fraud . . . are (1) a scheme to defraud, and (2) the mailing of a letter, etc., for the purpose of executing the scheme.”²³

may be liable for *attempting* to violate Rule 10b-5. See *Kuehnert v. Texstar Corp.*, 412 F.2d 700, 704 (5th Cir. 1969) (discussing a tippee who traded on information that he thought was material and nonpublic but turned out to be fictitious: “[W]e are not convinced of any difference in substance between a successful fraud and an attempt. The statutory phrase ‘any manipulative or deceptive device,’ . . . seems broad enough to encompass conduct irrespective of its outcome.”); *Grumet v. Shearson/Am. Express, Inc.*, 564 F. Supp. 336, 340 (D.N.J. 1983); *Summerlin v. Blyth Eastman Dillon & Co.*, [1982–1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,197, at 95,793 n.6 (N.D. Ga. Mar. 23, 1983). See also *Tarasi v. Pittsburgh Nat’l Bank*, 555 F.2d 1152, 1161 (3d Cir. 1977), *overshadowed by Bate-man*, 472 U.S. 299 (“There is no dispute regarding the nature of the securities law violations committed by the plaintiffs [who incorrectly believed they were trading on inside information.]”); *Schick v. Steiger*, 583 F. Supp. 841, 847, 847 n.32 (E.D. Mich. 1984); *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50, 54–55, 55 n.23 (S.D.N.Y. 1971). Cf. *Wohl v. Blair & Co.*, 50 F.R.D. 89, 91 (S.D.N.Y. 1970) (quoting *Kuehnart* with approval, and finding plaintiff cannot recover damages if she has unclean hands).

²² 18 U.S.C. §§ 1341, 1343 (emphasis added). For the language of the statutes, see *supra* notes 11, 12.

In contrast, Exchange Act § 10(b) forbids the “use or employ[ment of] . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe” 15 U.S.C. § 78j(b). Inter alia, Rule 10b-5 prohibits the “employ[ment of] any device, scheme, or artifice to defraud” and “engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit” 17 C.F.R. § 240.10b-5 (2015).

²³ *Pereira v. United States*, 347 U.S. 1, 8 (1954). *Accord Schmuck v. United States*, 489 U.S. 705, 721 (1989) (quoted *supra* at text accompanying note 17). See *United States v. Carrington*, 96 F.3d 1, 7 (1st Cir. 1996) (“The crime of wire fraud does not require that the defendant’s object be attained. It only requires that the defendant devise a scheme to defraud and then transmit a wire communication for the purposes of executing the scheme. See 18 U.S.C. § 1343.”); 2 Brickey, *supra* note 11, § 8:58, at n.724 (citing *Pereira*).

For discussion of the requisite use of the mail or wires, see *infra* Part II(A).

II. APPLICATION OF MAIL AND WIRE FRAUD TO CRIMINAL LIABILITY FOR STOCK MARKET INSIDER TRADING AND TIPPING

A. *Use of the Mails or Wires "In Furtherance" of the Fraudulent Scheme of Stock Market Insider Trading or Tipping*

A defendant can be convicted under the mail fraud or wire fraud statutes even if she (or her associate) has not personally used the mails or wires. The defendant, or her associate,²⁴ need only knowingly "cause" something to be delivered by mail (or "private interstate carrier"),²⁵ or "cause" a use of the wires.²⁶ The Supreme Court has interpreted such "causing" to include the performance of "an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen,

²⁴ See *United States v. Funt*, 896 F.2d 1288, 1292 (11th Cir. 1990) ("so long as one participant in a fraudulent scheme causes a use of the mails in execution of the fraud, all other knowing participants in the scheme are legally liable for that use of the mails") (quoting *United States v. Toney*, 598 F.2d 1349, 1355 (5th Cir. 1979)); *United States v. Isaacs*, 493 F.2d 1124, 1151 (7th Cir. 1974) (convicting co-schemers "[o]f the mailing of a letter which one of [their] partners caused to be mailed in the execution of the scheme.>").

²⁵ 18 U.S.C. § 1341 (for the text of 18 U.S.C. § 1341, see *supra* note 11). See *Pereira*, 347 U.S. at 8; OVERVIEW, *supra* note 13, at 3; Joseph E. Edwards, Annotation, *What Constitutes "Causing" Mail to be Delivered for Purpose of Executing Scheme Prohibited by Mail Fraud Statute (18 U.S.C. § 1341)*, 9 A.L.R. Fed. 893, § 4 (1971).

The mailing can be established by circumstantial evidence. See *United States v. Joshua*, 648 F.3d 547, 550–51 (7th Cir. 2011); *United States v. Sprick*, 233 F.3d 845, 854 (5th Cir. 2000) (stating prosecution must still bear the burden of demonstrating to the jury the use of the mails beyond a reasonable doubt); *United States v. Waymer*, 55 F.3d 564, 571 (11th Cir. 1995); *United States v. Griffith*, 17 F.3d 865, 874 (6th Cir. 1994).

For an example of a case finding that the government had not proven, beyond a reasonable doubt, that a letter was actually mailed rather than, say, hand delivered, see *United States v. Spirk*, 503 F.3d 619, 623 (7th Cir. 2007).

For discussion of the 1994 amendment to the mail fraud statute to extend coverage to "any private or commercial interstate carrier," see *supra* note 11.

²⁶ See 18 U.S.C. § 1343 (for the text of 18 U.S.C. § 1343, see *supra* note 12). For typical types of "wire" communication, see *supra* text accompanying note 14.

even though not actually intended”²⁷ The actual mailing can be by an innocent party who is not part of the scheme.²⁸

The use of the mails or wires must also be “in furtherance” of the fraudulent scheme.²⁹ Nevertheless, the mailing need not be an essential element of the scheme, but rather need only be “incident to an essential part of the scheme”³⁰ or some step in the scheme.³¹ Routine mailings that are innocent in themselves can satisfy the mailing

²⁷ *Pereira*, 347 U.S. at 8–9. See *United States v. Green*, 964 F.2d 365, 369 (5th Cir. 1992); *United States v. Paccione*, 949 F.2d 1183, 1195 (2d Cir. 1991); *Edwards*, *supra* note 25, §§ 2[a], 4, 7, 9. Cf. *Rakoff*, *supra* note 2, at 775–76 (noting a foreseeable use of mails required to compensate for the absence of statutory language requiring intent to use mails). For related discussion, see *infra* note 53 and accompanying text.

²⁸ See *Schmuck v. United States*, 489 U.S. 705, 711–15 (1989) (mailing by innocent victims); *Pereira*, 347 U.S. at 8–9 (mailing by innocent bank that mailed check cashed by defendant); *United States v. Kenofsky*, 243 U.S. 440, 441–43 (1917) (mailing by innocent insurance company); *United States v. Cooper*, 596 F.2d 327, 329–30 (8th Cir. 1979) (mailing by non-defendant bank); *United States v. Moss*, 591 F.2d 428, 436 (8th Cir. 1979) (mailing by defendant’s insurance agent who was not part of the scheme).

In the insider trading case, *Carpenter v. United States*, the Supreme Court affirmed the conviction of a former columnist for the *Wall Street Journal* and his co-defendants based on the innocent company’s use of the mails and wires to distribute the newspaper. See 484 U.S. 19, 28 (1987). The columnist and his tippees profited by trading stocks in advance of the column’s publication. See *id.* at 23. For additional discussion of *Carpenter*’s analysis of the requisite use of the mails and the wires, see *infra* notes 58–59 and accompanying text. For discussion of *Carpenter*’s analysis of the requisite “scheme to defraud,” see *infra* Part II(B)(1).

²⁹ See *Schmuck*, 489 U.S. at 710 (statute only reaches frauds “in which the use of the mails is a part of the execution of the fraud”) (quoting *Kann v. United States*, 323 U.S. 88, 95 (1944)); *United States v. Maze*, 414 U.S. 395, 399–401 (1974), *superseded in bank fraud cases by bank fraud statute*, 18 U.S.C. § 1344 (2012); *United States v. Sampson*, 371 U.S. 75, 76–81 (1962); *Parr v. United States*, 363 U.S. 370, 389–91 (1960); *Kann*, 323 U.S. at 93–95.

The defendant need not personally cause the mailing or the use of the wires. See *United States v. Powell*, 576 F.3d 482, 493 (7th Cir. 2009) (quoting *United States v. Turner*, 557 F.3d 657, 666 (7th Cir. 2008)); 2 BRICKEY, *supra* note 11, § 8:54.

³⁰ *Schmuck*, 489 U.S. at 710–11; *Pereira*, 347 U.S. at 8.

³¹ See *Schmuck*, 489 U.S. at 710–11; *Badders v. United States*, 240 U.S. 391, 394 (1916); OVERVIEW, *supra* note 13, at 3.

requirement, provided that the routine mailings advance the fraudulent scheme³² and would not be mailed but for the scheme.³³ In any

³² See *Schmuck*, 489 U.S. at 711, 714–15; OVERVIEW, *supra* note 13, at 3; 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.28(A); Weston, *supra* note 11, at 1436.

Routine mailings that are designed to “lull the victims into a false sense of security” advance the fraudulent scheme. See *Maze*, 414 U.S. at 403 (distinguishing *Sampson*, 371 U.S. at 79–81); *United States v. Faulkenberry*, 614 F.3d 573, 582 (6th Cir. 2010); *United States v. Stein*, 37 F.3d 1407, 1409 (9th Cir. 1994). For additional discussion of “lulling,” see 2 BRICKEY, *supra* note 11, § 8:53, at nn.663, 669, 671.25, 688–91 and accompanying text. For a discussion of how to treat post-transaction “lulling” mailings, see *infra* note 34.

Nevertheless, even routine mailings that do not lull the victims may still satisfy the mailing requirement. See *Schmuck*, 489 U.S. at 715 (even “mailings that someday may contribute to the uncovering of a fraudulent scheme . . . [can] supply the mailing element of the mail fraud offense”); OVERVIEW, *supra* note 13, at 3. For additional discussion of *Schmuck*, see *infra* notes 36–42 and accompanying text. For a holding that a mailing of bank statements did not aid nor further the fraudulent scheme, even though the bank account itself was an essential part of the scheme, see *United States v. Hartsel*, 199 F.3d 812, 814, 816–18 (6th Cir. 1999). For a holding that the government did not prove beyond a reasonable doubt that a particular wire transfer was part of a particular fraudulent scheme, see *United States v. Jedynek*, 45 F. Supp. 3d 812, 817–21 (N.D. Ill. 2014) (finding where non-fraudulently obtained funds in account were sufficient to cover wire transfer, government did not prove beyond a reasonable doubt that fraudulently obtained funds were in the wire transfer).

³³ See *United States v. Mitchell*, 744 F.2d 701, 704 (9th Cir. 1984); Weston, *supra* note 11, at 1436. In *Parr v. United States*, the Supreme Court held that a local school district’s mailings of tax statements and receipts were not in furtherance of a scheme to misappropriate and embezzle the school district’s funds and property. See 363 U.S. 370, 385–92 (1960). The reason was that the school district was compelled by law to collect and assess the taxes. See *id.* For a discussion of *Parr*, see *United States v. Lake*, 472 F.3d 1247, 1256 (10th Cir. 2007) (“Most . . . circuits to address the issue have interpreted *Parr* to hold that ‘mailings of documents which are required by law to be mailed, and which are not themselves false and fraudulent, cannot be regarded as mailed for the purpose of executing a fraudulent scheme.’”) (quoting *United States v. Curry*, 681 F.2d 406, 412 (5th Cir. 1982)).

In *Mitchell*, the defendant’s mailings were also required by law to be sent, but the Ninth Circuit distinguished *Parr*: “The tax statements, checks, and receipts mailed in *Parr* . . . would have been mailed even if the scheme to defraud . . . had not existed. In *Mitchell*’s case, the fraudulent scheme triggered the mailings, which would not have occurred except as a step in the scheme.” *Mitchell*, 744 F.2d at 704.

event, the mailing apparently must occur before the “termination” of the fraudulent scheme.³⁴

Nevertheless, the definition of the scheme can be quite broad.³⁵ For example, *Schmuck v. United States*³⁶ involved a defendant who bought used cars, rolled back their odometers, and then sold the automobiles to Wisconsin retail dealers at inflated prices.³⁷ The duped retail dealers would ultimately resell the cars to members of the public.³⁸ To transfer title, the retailers would mail a title application form to the Wisconsin Department of Transportation.³⁹ The Supreme Court held that “a rational jury could have found that the title-registration mailings were part of the execution of the fraudulent

³⁴ A number of Supreme Court decisions have held that a mailing was insufficiently connected to the fraudulent scheme because it took place after the scheme had reached “fruition.” See *Maze*, 414 U.S. at 399–05; *Parr*, 363 U.S. at 370; *Kann v. United States*, 323 U.S. 88, 93–95 (1944). *But see* *United States v. Redcorn*, 528 F.3d 727, 741 (10th Cir. 2008) (holding post-fraud communication to be mail or wire fraud if intended to “lull the victims into a false sense of security, postpone their ultimate complaint to the authorities, and therefore make the apprehension of the defendants less likely.”) (quoting *Maze*, 414 U.S. at 403); *United States v. Coyle*, 63 F.3d 1239, 1244–45 (3d Cir. 1995) (quoting *United States v. Otto*, 742 F.2d 104, 108 (3d Cir. 1984)) (“Even mailings made after the fruits of the scheme have been received may come within the statute when they are ‘designed to lull the victims into a false sense of security’”).

The court in *United States v. Biesiadecki* interpreted *Schmuck v. United States*, 489 U.S. 705, 711 (1989), as follows: “[T]he Supreme Court held that . . . forms which were mailed after the fruition of the scheme to defraud, even though only tangentially related to the scheme, were sufficient to satisfy the mailing element” 933 F.2d 539, 545 (7th Cir. 1991). For additional discussion of “lulling,” see 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.28(D).

In any event, courts disagree on whether a post-fraudulent-transaction “lulling” mailing extends the duration of the scheme. For a thorough discussion of this question and description of other circuit views, see both the majority and concurring opinions in *United States v. Tanke*, 743 F.3d 1296 (9th Cir. 2014). The *Tanke* majority criticized some other circuits for effectively allowing a post-scheme mailing to satisfy the mailing requirement. See *id.* at 1303–04. The *Tanke* majority rejected these other circuit holdings as contrary to Supreme Court precedent. See *id.* For additional discussion of this issue, see 2 BRICKEY, *supra* note 11, § 8:53, at nn.671.35, 673 and accompanying text.

³⁵ See *Schmuck*, 489 U.S. at 710–15 (discussed immediately below); 2 WELLING, BEALE, & BUCY, *supra* note 15, §§ 17.28(B), 17.28(D).

³⁶ 489 U.S. 705 (1989).

³⁷ See *id.* at 707.

³⁸ See *id.*

³⁹ See *id.*

scheme, a scheme which did not reach fruition until the retail dealers resold the cars and effected transfers of title.”⁴⁰ Additionally, “a failure of this passage of title would have jeopardized Schmuck’s relationship of trust and goodwill with the retail dealers upon whose unwitting cooperation his scheme depended.”⁴¹ A mailing meets the statutory requirement even if it “someday may contribute to the uncovering of a fraudulent scheme . . . and return to haunt the perpetrator of the fraud.”⁴²

A stock market insider trader can usually foresee that the mails or wires will be used at some stage of the transaction, including order placement, execution, and confirmation.⁴³ A fraudulent insider trading scheme does not terminate until *at least* the closing,⁴⁴ when the defendant receives the securities bought or the proceeds of the

⁴⁰ *Id.* at 712.

⁴¹ *Id.* at 714.

⁴² *Id.* at 715.

In his dissent, Justice Scalia argued that *Schmuck* could not be distinguished from the Court’s more restrictive earlier opinions of *Kann*, *Parr*, and *Maze*. *See id.* at 722–25 (Scalia, J., dissenting); *id.* at 723–24 (“For though the Government chose to charge a defrauding of retail customers (to whom the innocent dealers resold the cars), it is obvious that, regardless of who the ultimate victim of the fraud may have been, the fraud was complete with respect to each car when petitioner pocketed the dealer’s money . . . [W]e have held that the indispensability of . . . mechanical mailings, not strictly in furtherance of the fraud, is not enough to invoke the statute.”).

For discussion of *Schmuck*, see 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.28; Henning, *supra* note 2, at 457–60; Ross Cockburn, *The Mail Fraud Statute: Expanding Its Scope*, 68 WASH. U. L.Q. 809, 815–17 (1990). For a general discussion of the “mailing” requirement, see Henning, *supra* note 2, at 450–60.

⁴³ See Joseph J. Humke, Comment, *The Misappropriation Theory of Insider Trading Outside the Lines of Section 10(b)*, 80 MARQ. L. REV. 819, 844 (1997) (“And no one can reasonably deny that virtually every modern securities transaction is conducted via the mails and/or wires.”). *Cf.* *Int’l Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 154–55 (4th Cir. 1987) (“It will be the unusual fraud that does not enlist the mails and wires in its service at least twice.”); *Roberts v. Smith Barney, Harris Upham & Co.*, 653 F. Supp. 406, 413 (D. Mass. 1986) (“A single fraudulent event will almost always involve multiple acts of wire, mail or securities fraud.”); *B.J. Skin & Nail Care, Inc. v. Int’l Cosmetic Exch., Inc.*, 641 F. Supp. 563, 565 (D. Conn. 1986) (“Nearly all business dealings involve frequent use of telephones and mail.”).

⁴⁴ For a discussion of when a scheme might terminate *after* the closing of a transaction, see *supra* note 34.

securities sold.⁴⁵ The exchange of money,⁴⁶ securities,⁴⁷ or both, ordinarily involves the use of the mails or wires.⁴⁸ Furthermore, after

⁴⁵ At closing, the defendant actually receives the benefit of the fraudulent scheme. See *United States v. Vilar*, 729 F.3d 62, 95 (2d Cir. 2013) (“[S]cheme to defraud is not complete until the proceeds have been received”). Thus, a mailing at the closing of an insider trade differs from the mailings in *Kann*, *Parr*, and *Maze*, which “involved little more than post-fraud accounting among the potential victims of the various schemes” *Schmuck*, 489 U.S. at 714.

⁴⁶ For examples of mail fraud cases holding that the mailing or transportation of a check was part of a fraudulent scheme, see *Pereira v. United States*, 347 U.S. 1, 8 (1954) (“[T]he mailing of the check by the bank, incident to an essential part of the scheme, is established.”); *United States v. Lennartz*, 948 F.2d 363, 370 (7th Cir. 1991) (mailing of salary checks was part of a fraudulent scheme); *United States v. Walker*, 915 F.2d 1463, 1466 (10th Cir. 1990) (noting that defendant’s receipt of mailed cancelled checks can be “incident to an essential part of the scheme”); *United States v. Cavale*, 688 F.2d 1098, 1112 (7th Cir. 1982) (mailing of payment checks was part of a fraudulent scheme violating the mail fraud statute); *Williams v. United States*, 278 F.2d 535, 538 (9th Cir. 1960); *Tincher v. United States*, 11 F.2d 18, 21 (4th Cir. 1926); *Headley v. United States*, 294 F. 888, 889–90 (5th Cir. 1923). Cf. *United States v. Franks*, 309 F.3d 977, 977–78 (7th Cir. 2002) (holding that the interstate transportation of the checks was essential to a scheme’s success where defendant embezzled almost 450 checks received by her employer and deposited the checks into defendant’s personal bank account, and the bank then forwarded the checks for collection using interstate couriers); *United States v. Alanis*, 945 F.2d 1032, 1037 (8th Cir. 1991) (requisite mailing was insurance company’s mailing of check to defendant in settlement of fraudulent life insurance claim); *United States v. Little*, 687 F. Supp. 1042, 1048 (N.D. Miss. 1988) (“Here the government alleges that the mailings of NMSC invoices, county checks and other documents all helped the fraudulent scheme to succeed by concealing the cash payoffs. The court is inclined to permit the government the opportunity to prove its assertions at the trial of this matter.”). For an example of a case referring to wire transfers of money as use of the wires, see *United States v. Vilar*, 729 F.3d 62, 95 (2d Cir. 2012). *But cf.* *Am. Auto. Acces., Inc. v. Fishman*, 175 F.3d 534, 542–43 (7th Cir. 1999) (involving plaintiffs in a private civil RICO action who were unable to demonstrate that fraudulent checks involved use of mail or wires; cashed checks were transported to bank by private armored car service).

⁴⁷ For a case holding that the mailing of stock certificates met the mailing requirement, see *United States v. Tallant*, 547 F.2d 1291, 1298–99 (5th Cir. 1977).

⁴⁸ The wire communication must be “interstate.” See *infra* notes 54–55 and accompanying text. For discussion of when use of the internet involves an “interstate” communication, see *infra* note 55 and accompanying text.

the transaction, the stockbrokers on both sides of the trade customarily mail or wire confirmation notifications.⁴⁹ In several mail fraud insider trading cases, the stockbrokers' mailing of confirmation slips constituted the required mailings.⁵⁰ These various uses of the mails

⁴⁹ For examples of opinions stating that the mailing of a securities transaction confirmation slip can constitute the requisite mailing, see *United States v. Lay*, 612 F.3d 440, 443, 447 (6th Cir. 2010); *United States v. Pollack*, 534 F.2d 964, 972 (D.C. Cir. 1976); *United States v. Cohen*, 518 F.2d 727, 736–37 (2d Cir. 1975).

In *United States v. Ashman*, the court held that, under the facts of the case, the requirement of use of the mails or wires was met by statements sent to customers confirming execution of trades of futures contracts at the Chicago Board of Trade. *See* 979 F.2d 469, 481–83 (7th Cir. 1992).

The court in *United States v. Ragan* reversed the defendant's mail and wire fraud convictions because no reasonable trier of fact could have found the defendant guilty beyond a reasonable doubt of "causing" the fictitious trade tickets to be transmitted via wire and then through the mail to customers of a securities firm. *See* 24 F.3d 657, 659–60 (5th Cir. 1994). Nevertheless, the court apparently assumed that the mailings of the confirmation slips could constitute the requisite use of the mail for application of the mail fraud statute. *See id.*

⁵⁰ *See, e.g., United States v. Mooney*, 401 F.3d 940, 946 (8th Cir. 2005) (per curiam), *aff'd en banc*, 425 F.3d 1098 (8th Cir. 2005); *United States v. O'Hagan*, 139 F.3d 641, 652 (8th Cir. 1998); *United States v. Cherif*, 943 F.2d 692, 696–97 (7th Cir. 1992) (rejecting defendant's attempt to parse his scheme into two separate schemes: misappropriation of information and subsequent use of information to trade stocks; holding that the requisite mailings and wirings were those necessary to execute stock trades based on the misappropriated information); *United States v. Grossman*, 843 F.2d 78, 86 (2d Cir. 1988); *United States v. Victor Teicher & Co.*, 785 F. Supp. 1137, 1151–52 (S.D.N.Y. 1992); *United States v. Willis*, 737 F. Supp. 269, 276 (S.D.N.Y. 1990); *United States v. David*, No. 86 Cr. 454 (JFK), 1986 WL 13805, at * 3 (S.D.N.Y. Nov. 21, 1986).

With extensive discussion, the insider trading case of *United States v. O'Hagan* held that the mailing of confirmation slips furthered the defendant's scheme to defraud. *See* 139 F.3d at 652. The court noted:

O'Hagan's scheme to defraud involved not only the unlawful purchases of Pillsbury securities, but also the use of the profits obtained from the illegal trading to conceal his prior misappropriation of client funds. The confirmation slips informed O'Hagan that the Pillsbury securities had been purchased and provided him a record of his purchases.

Id.

Probably, *O'Hagan* would have held the same way even if the insider trading profits were not being used to cover the misappropriation of client funds. The opinion notes that the confirmation slips

or wires should be sufficiently connected to the insider trading scheme to satisfy the statutory requirement.⁵¹

Even if the execution of a stock market insider trade itself somehow involves no use of the mails or wires, the entire fraudulent scheme at some stage is still likely to involve some use of the wires by persons involved or not involved in the scheme.⁵² As with the

helped O'Hagan keep track of his numerous Pillsbury option contract purchases made at various prices, in different quantities, with different strike prices, different expiration dates, and from different brokers, particularly given O'Hagan's testimony before the SEC that he called one of his brokers after he received a confirmation slip to inquire about that option's expiration date.

Id.

Discussed later is how the Supreme Court found the requisite use of the mail and wires in the insider trading case of *Carpenter v. United States*, 484 U.S. 19, 28 (1987). See *infra* notes 58–59 and accompanying text.

The link between the insider trading scheme and the use of the mails can be especially close if the defendant uses various mechanisms to conceal his trading activity:

In view of the sophisticated mechanisms employed for concealment of defendant's activities by use of foreign bank accounts, distribution of purchase orders, and utilization of confederates abroad, it is plain that the fraudulent scheme contemplated use of the mails as an integral feature of its operation and an essential incident to its successful consummation.

United States v. Newman, 664 F.2d 12, 21 (2d Cir. 1981) (Dumbauld, J., concurring), *aff'd after remand*, 722 F.2d 729 (2d Cir. 1983) (unpublished order).

⁵¹ Again, the wire communication must be "interstate." See *infra* notes 54–55 and accompanying text.

⁵² For typical types of "wire" communication, see *supra* text accompanying note 14. See generally James D. Lawlor, Annotation, *Federal Criminal Prosecutions Under Wire Fraud Statute (18 U.S.C.A. § 1343) for Use of "Blue Box" or Similar Device Permitting User to Make Long-Distance Telephone Calls Not Reflected on Company's Billing Records*, 34 A.L.R. Fed. 278, § 1 (1977).

The wire communication element is satisfied even though part of the transmission of a telephone call may have been carried by microwave signals. See, e.g., *United States v. Foley*, 683 F.2d 273, 280 (8th Cir. 1982); *United States v. King*, 590 F.2d 253, 255 (8th Cir. 1978). Nor need the wire transmission be regulated by the Federal Communications Commission. See *United States v. Giovengo*, 637 F.2d 941, 943 (3d Cir. 1980) (involving private interstate telephone circuits leased from AT&T by TWA).

element of mailing, the defendant need only have “caused” the use of the wires in the sense that she would have been able reasonably to foresee that her acts would involve such use.⁵³

One significant difference exists in the jurisdictional element of the mail and wire fraud statutes. Whereas even an intrastate mailing suffices for mail fraud,⁵⁴ a wire transmission must actually pass outside the state for wire fraud.⁵⁵ An interesting question is when the

⁵³ See *United States v. Gill*, 909 F.2d 274, 278 (7th Cir. 1990); *United States v. Johnson*, 700 F.2d 163, 177 (5th Cir. 1983), *aff'd in part, rev'd in part*, 718 F.2d 1317 (5th Cir. 1983) (en banc) (affirming wire fraud convictions); *United States v. Jones*, 554 F.2d 251, 253 (5th Cir. 1977); *United States v. Conte*, 349 F.2d 304, 306 (6th Cir. 1965). For related discussion, see *supra* note 27 and accompanying text.

⁵⁴ See *Ideal Steel Supply Corp. v. Anza*, 373 F.3d 251, 265 (2d Cir. 2004) (citing *United States v. Gil*, 297 F.3d 93, 99–100 (2d Cir. 2002)); *United States v. Photogrammetric Data Servs. Inc.*, 259 F.3d 229, 252 (4th Cir. 2001); *Annulli v. Panikkar*, 200 F.3d 189, 200 n.9 (3d Cir. 1999) (citing *In re Burzynski*, 989 F.2d 733, 742 (5th Cir. 1993)); *United States v. Elliott*, 89 F.3d 1360, 1363–64 (8th Cir. 1996); *United States v. Cady*, 567 F.2d 771, 776 n.7 (8th Cir. 1977) (“It is irrelevant that all of the mailings in this case may have been intrastate in nature”); *ANDROPHY*, *supra* note 13, § 8:5; 2 *BRICKEY*, *supra* note 11, § 8.53 n.696.50 and accompanying text; *Williams*, *supra* note 2, at 303. Both *Gil*, 297 F.3d at 99–100, and *Photogrammetric Data Servs.*, 259 F.3d at 247–52, held that Congress intended that the mail fraud statute apply to both intrastate and interstate deliveries of mail matter by private and commercial interstate carriers and that such application was a permissible exercise of Congress’s power under the Commerce Clause. For related discussion, see *supra* note 11.

⁵⁵ 18 U.S.C. § 1343. See *Annulli*, 200 F.3d at 200 n.9 (citing *Smith v. Ayres*, 845 F.2d 1360 (5th Cir. 1988)); *Bacchus Indus. v. Arvin Indus.*, 939 F.2d 887, 892 (10th Cir. 1991); *First Pac. Bancorp v. Bro.*, 847 F.2d 542, 547 (9th Cir. 1988); *Ayres*, 845 F.2d at 1366; *United States v. Freeman*, 524 F.2d 337, 339 (7th Cir. 1975); *Utz v. Correa*, 631 F. Supp. 592, 596 (S.D.N.Y. 1986); *ANDROPHY*, *supra* note 13, § 8:5; 2 *BRICKEY*, *supra* note 11, § 8.61; *Guide*, *supra* note 15, §§ 2:3, 2:7; 2 *WELLING, BEALE, & BUCY*, *supra* note 15, § 29; *Williams*, *supra* note 2, at 305.

The jurisdictional element is satisfied if “a wire communication whose origin and ultimate destination are within a single state [is] . . . routed through another state.” *Ideal Steel Supply Corp.*, 373 F.3d at 265 (citing *United States v. Davila*, 592 F.2d 1261, 1263 (5th Cir. 1979)).

The defendant does not have to anticipate that the communication will travel outside state boundaries. See *United States v. Stern*, 858 F.2d 1241, 1247 (7th Cir. 1988); *United States v. Blackmon*, 839 F.2d 900, 908 (2d Cir. 1988); *United States v. Blasingame*, 427 F.2d 329, 330 (2d Cir. 1970) (“The statute does not condition guilt upon knowledge that interstate communication is used. The use of interstate communication is logically no part of the crime itself. It is included in

use of the internet involves an interstate communication under the wire fraud statute.⁵⁶

the statute merely as a ground for federal jurisdiction.”); 2 BRICKEY, *supra* note 11, § 8.61 n.753 and accompanying text. *But cf.* *United States v. Bryant*, 766 F.2d 370, 375 (8th Cir. 1985) (“The government must show that the accused knew or could have foreseen that a communication in furtherance of a fraudulent scheme was interstate, if the conduct giving rise to the scheme would not be a violation of state law and was not itself morally wrongful.”).

⁵⁶ For examples of opinions discussing this issue and upholding convictions for wire fraud under the circumstances of the case, see *United States v. Kieffer*, 681 F.3d 1143, 1153–55 (10th Cir. 2012); *United States v. Siembida*, 604 F. Supp. 2d 589, 596–97 (S.D.N.Y. 2008) (noting that the email message in question went from one New York address to another, but there was a stipulation among the parties that an expert would testify that defendant’s email system servers were in Pennsylvania and the email message in question would have gone through Pennsylvania).

United States v. Fumo, 2009 WL 1688482, *8 to *9 (E.D. Pa. 2009), held that the wire fraud statute does not require proof that e-mails were sent interstate:

Undisputedly, the e-mails at issue were sent via the Internet. Regardless of whether an e-mail is sent and received within the same state, “fluctuations in internet traffic” could result in the e-mail actually crossing state lines prior to reaching its final destination. Because such a determination is impossible, it is legally sufficient for purposes of the “interstate commerce” requirement that the e-mails at issue were sent and received through the Internet.

Id. at *9 (footnote committed). *Accord* *DNJ Logistic Grp., Inc. v. DHL Express (USA), Inc.*, No. 08-CV-2789 (DGT), 2010 WL 625364, at *6 n.4 (E.D.N.Y. Feb. 19, 2010) (“[R]ecent cases appear to treat any use of the internet as sufficiently interstate in nature”).

Although dismissing the plaintiff’s claim that the defendant committed wire fraud because of lack of “deceit,” *Internet Archive v. Shell*, apparently assumed that the defendant’s use of the internet constituted the requisite use of the “wires.” See 505 F. Supp. 2d 755, 768 (D. Co. 2007).

For additional discussion of this issue, see NORMAN ABRAMS, SARA SUN BEALE, & SUSAN RIVA KLEIN, *FEDERAL CRIMINAL LAW AND ITS ENFORCEMENT* 200-02 (5th ed. 2010); PODGOR ET AL, *supra* note 2, § 4.9(B), at 92; Weston, *supra* note 11, at 1427.

For an opinion affirming the sentence of a defendant who pled guilty to using the internet to commit wire fraud, see *United States v. Pirello*, 255 F.3d 728, 732 (9th Cir. 2001).

Two commentators have concluded: “the geography of the internet makes it likely that messages travel across state lines, and perhaps across even national borders,

In short, at some stage of an insider trading scheme, a mailing or an interstate wire or telephone transmission normally will occur and should be sufficiently related to the scheme to satisfy the statutory requirement.⁵⁷

*Carpenter v. United States*⁵⁸ is the major case in which the Supreme Court has applied the mail and wire fraud statutes to stock market insider trading. When discussing the required use of the mails or wires, the decision did not focus on the mechanics of the

even if the origin and destination sites are in the same state.” Morgan Cloud & George Shepherd, *Law Deans in Jail*, 77 MO. L. REV. 931, 946 (2012).

⁵⁷ For discussion of the necessary connection, see *supra* notes 29–42 and accompanying text. For examples of mail fraud insider trading cases in which the stockbrokers’ mailing of confirmation slips constituted the required mailings, see *supra* note 49.

Both *United States v. Bryan*, 58 F.3d 933, 939, 943 (4th Cir. 1999), and *United States v. ReBrook*, 58 F.3d 961, 966–67 (4th Cir. 1995), affirmed a stock market insider trading defendant’s wire fraud conviction without discussing the requisite use of the wires. Similarly, *United States v. Ruggiero*, affirmed the wire fraud conviction of an insider trading defendant in just two paragraphs and with no discussion of what constituted the required use of the wires. See 56 F.3d 647, 656 (5th Cir. 1995). For additional discussion of *Ruggiero*, see *infra* notes 166–75, 249–52 and accompanying text.

In the insider trading case of *United States v. Elliott*, the indictment charged the defendant with 34 counts of wire fraud “[s]ince the [stock] purchases were made by wire.” 711 F. Supp. 425, 426 (N.D. Ill. 1989). Apparently, the defendant did not contest this feature of the indictment. For additional discussion of *Elliott*, see *infra* notes 101–03 and accompanying text, 208–14 and accompanying text.

The court in *United States v. Rajaratnam* refused to suppress the government’s wiretap evidence against an insider trading defendant. See N. 09 Cr. 1184(RJH), 2010 WL 4867402, at *1 (S.D.N.Y. Nov. 24, 2010). The government had earlier obtained judicial authorization of the wiretaps because of probable cause that the defendant and others were involved in a scheme that involved, inter alia, wire fraud. See *id.* A related insider trading defendant, Roomy Khan, pled guilty to wire fraud. See *United States v. Rajaratnam*, 719 F.3d 139, 145 (2d Cir. 2012).

In another insider trading case, *United States v. Victor Teicher & Co.*, the prosecution pointed to an interstate telephone call in which one defendant allegedly telephoned a co-conspirator and requested that the co-conspirator destroy a page from a desk calendar. See 726 F. Supp. 1424, 1434–35 (S.D.N.Y. 1989). The court dismissed this count of the indictment because the telephone communication was not for the purpose of executing the scheme or lulling the victims into a false sense of security. See *id.* at 1435. The telephone call took place *after* the SEC had begun an investigation. See *id.* Therefore, the call was part of a coverup of a *completed* scheme that had already aroused suspicion. See *id.*

⁵⁸ 484 U.S. 19 (1987).

defendants' stock transactions. Instead, the opinion found the mailing/wiring elements satisfied because the defendants relied on the distribution of the *Wall Street Journal* to further their scheme and knew that the mails and wires would be used:

[C]irculation of the . . . column [written by one of the defendants] was not only anticipated but an essential part of the scheme. Had the column not been made available to Journal customers, there would have been no effect on stock prices and no likelihood of profiting from the information leaked⁵⁹

Later, with little discussion, the Supreme Court insider trading case, *United States v. O'Hagan*,⁶⁰ in effect affirmed the defendant's mail fraud convictions.⁶¹ The opinion did not address the defendant's requisite use of the mails.⁶²

B. *Stock Market Insider Trading or Tipping as a Mail/Wire "Scheme to Defraud"*

1. THE INFORMATION-OWNER AS VICTIM

In the insider trading case *Carpenter v. United States*,⁶³ the Supreme Court unanimously upheld the defendants' convictions for

⁵⁹ *Id.* at 28.

⁶⁰ 521 U.S. 642 (1997).

⁶¹ *See id.* at 678. For additional discussion of *O'Hagan's* mail fraud holding, see *infra* notes 84–96 and accompanying text. For discussion of *O'Hagan's* Rule 10b-5 opinion, see WANG & STEINBERG, *supra* note 1, §§ 4.4.5, 4.5.2[B], 4.6, 5.4 & nn.550–53, 5.4.1[B].

⁶² *See O'Hagan*, 521 U.S. at 678. On remand, the Eighth Circuit found that the mailing of the confirmation slips for *O'Hagan's* purchases constituted the requisite mailings. *See United States v. O'Hagan*, 139 F.3d 641, 652 (8th Cir. 1998). For discussion of this opinion, see *supra* note 50.

⁶³ 484 U.S. 19 (1987). For additional discussion of *Carpenter*, see *infra* notes 237–51 and accompanying text.

Because the Court in *Carpenter* split evenly on the federal securities law questions, it did not issue an opinion on those issues. *See* 484 U.S. at 24.

The Supreme Court decided *Carpenter* after its Rule 10b-5 classical relationship insider trading cases of *Chiarella v. United States*, 445 U.S. 222 (1980), and *Dirks v. SEC*, 463 U.S. 646 (1983), but before the Court's Rule 10b-5 misappropriation (and mail fraud) opinion in *United States v. O'Hagan*, 521 U.S. 642 (1997).

violations of the federal mail and wire fraud statutes and for conspiracy.⁶⁴ One of the defendants, Winans, was one of two authors of the *Wall Street Journal's* "Heard on the Street" column.⁶⁵ Winans entered into a scheme with the other defendants to buy and sell stocks in advance of the columns' publication in order to profit from the columns' probable impact on the market.⁶⁶

The Court rejected the defendants' reliance on *McNally v. United States*⁶⁷ for their contention that they did not obtain "money or property" from the *Journal*, a necessary element of the crime under the mail and wire fraud statutes.⁶⁸ *McNally* held that the language and legislative history of the mail fraud statute "indicates that the original impetus behind the mail fraud statute was to protect the people from schemes to deprive them of their money or property."⁶⁹ Thus, a violation of the statute, although not requiring a monetary loss, mandates a showing that the interest involved is a cognizable "property right," whether tangible or intangible. *McNally* found the citizenry's right to good government too tenuous and ambiguous to be encompassed by the statute.⁷⁰

⁶⁴ See 484 U.S. at 21–22, 28. The federal conspiracy statute, 18 U.S.C. § 371, provides in pertinent part:

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined . . . or imprisoned not more than five years, or both.

For discussion of § 371 and a new conspiracy provision added by section 902 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1349, see *supra* note 12; WANG & STEINBERG, *supra* note 1, § 7.2.1 at 617 n.24.

⁶⁵ See *Carpenter*, 484 U.S. at 22.

⁶⁶ See *id.* at 22–23.

⁶⁷ 483 U.S. 350 (1987).

⁶⁸ See *Carpenter*, 484 U.S. at 25–26.

⁶⁹ *McNally*, 483 U.S. at 356.

⁷⁰ See *id.* at 358–61. *But cf.* *United States v. Salvatore*, 110 F.3d 1131, 1139 (5th Cir. 1997) ("We begin with the proposition that the concept of property rights should be given a broad interpretation for the purposes of the mail fraud statute.") (citing *McNally*, 483 U.S. at 350; *Carpenter*, 484 U.S. at 19; *United States v. Loney*, 959 F.2d 1332, 1336 (5th Cir. 1992); *United States v. Murphy*, 836 F.2d 248, 253 (6th Cir. 1988)). See *generally* *Cleveland v. United States*, 531 U.S. 12, 26 (2000) (holding, under the circumstances of the case, mail fraud statute did not reach fraud in obtaining license from state; state had no "property" interest in license granted; not sufficient that the object of the fraud, the license, might become

In reaction to *McNally*, Congress, in 1988, a year after the opinion, amended the United States Code chapter containing both the mail and wire fraud statutes to provide expressly that “schemes to defraud” include schemes “to deprive another of the intangible right of honest services.”⁷¹ Nevertheless, in 2010, the Supreme Court held in *Skilling v. United States*⁷² that the 1988 amendment covers only bribery and kickback schemes.⁷³ With this limitation, the amendment would not apply to stock market insider trading or tipping.

“property” in the hands of the licensee; mail fraud statute “requires the object of the fraud to be ‘property’ in the victim’s [the grantor/state’s] hands”).

⁷¹ 18 U.S.C. § 1346 (2012) (originally enacted as Act of Nov. 18, 1988, Pub. L. No. 100-690, § 7603(a), 102 Stat. 4508) (“For the purposes of this chapter, the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.”). For discussion of the amendment, see *Skilling v. United States*, 561 U.S. 358, 402–11 (2010).

For discussion and criticism of the “intangible rights” doctrine under mail and wire fraud, see John C. Coffee Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models—and What can be Done About it*, 101 YALE L.J. 1875, 1879–80 (1992); John C. Coffee, Jr., *Does “Unlawful” Mean “Criminal”?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 202–08 (1991); Geraldine Szott Moohr, *Mail Fraud and the Intangible Rights Doctrine: Someone to Watch Over Us*, 31 HARV. J. ON LEGIS. 153, 157 (1994). See generally Carlos Gómez-Jara Diez, *Honest Services Fraud as a Criminal Breach of Fiduciary Duties: A Comparative Law Approach for Reform*, 18 NEW CRIM. L. REV. 100 (2015).

⁷² 561 U.S. 358 (2010).

⁷³ See *id.* at 402–11. For discussion of *Skilling* and the “honest services doctrine” generally, see ANDROPHY, *supra* note 13, § 8:9; Charles Doyle, *Deprivation of Honest Services as a Basis for Federal Mail and Wire Fraud Convictions*, in MAIL AND WIRE FRAUD: ELEMENTS AND CONSIDERATIONS IN FEDERAL CRIMES 33–67 (Eric J. Cass & Andreas N. Schuster eds. 2012); Albert W. Alschuler, *Terrible Tools for Prosecutors: Notes on Senator Leahy’s Proposal to “Fix” Skilling v. United States*, 67 SMU L. REV. 501, 502–04 (2014); Sara Sun Beale, *An Honest Services Debate*, 8 OHIO ST. J. CRIM. L. 251 (2010); Joan H. Krause, *Skilling and the Pursuit of Healthcare Fraud*, 66 U. MIAMI L. REV. 363 (2012); Pamela Mathy, *Honest Services Fraud After Skilling*, 42 ST. MARY’S L.J. 645, (2011); Lori A. McMillan, *Honest Services Update: Directors’ Liability Concerns After Skilling and Black*, 18 TEX. WESLEYAN L. REV. 149 (2011); Elizabeth R. Sheyn, *Criminalizing the Denial of Honest Services after Skilling*, 2011 WIS. L. REV. 27 (2011); J. Kelly Strader, *Skilling Reconsidered: The Legislative-Judicial Dynamic, Honest Services Fraud, and the Ill-Conceived “Clean Up Government Act,”* 39 FORDHAM URB. L.J. 309 (2011); Tannenbaum, *supra* note 2.

In any event, the acts in *Carpenter* arose before the 1988 amendment, however interpreted.⁷⁴ Therefore, the Court in *Carpenter* distinguished *McNally* by unanimously finding that the relevant right of the *Journal* was *not* the defendant Winans' obligation of honest service, but rather the newspaper's "interest in the confidentiality of the contents and timing of the 'Heard' column as a *property* right."⁷⁵ Such an interest, the Court said, is well established as a property right,⁷⁶ and encompasses "news matter."⁷⁷ Even if the defendants did not interfere with the *Journal's* use of the confidential information, the defendants did deprive the newspaper of its right to exclusive use of the information.⁷⁸

Carpenter also rejected the defendants' contention that their activities did not constitute fraudulent activity within the meaning of the mail and wire fraud statutes.⁷⁹ The Court relied on its decision in *McNally* for the proposition that the statutes encompass all schemes to deprive another of money or property: "[T]he words 'to defraud' have the 'common understanding' of 'wronging one in his property rights by dishonest methods or schemes,' and 'usually signify the deprivation of something of value by trick, deceit, chicane

⁷⁴ See *Carpenter*, 484 U.S. 19, 21–23.

⁷⁵ *Id.* at 25 (emphasis added).

⁷⁶ See *id.* at 26 (citing *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001–04 (1984); *Dirks v. SEC*, 463 U.S. 646, 653 n.10 (1983); *Bd. of Trade of Chicago v. Christie Grain & Stock Co.*, 198 U.S. 236, 250–51 (1905); 3 WILLIAM MEADE FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 857.10, 245 (rev. ed. 1986)).

In a subsequent insider trading case, the Second Circuit summarized *Carpenter* as follows: "*Carpenter* actually holds generally that, even though 'confidential business information' is intangible, it 'has long been recognized as property.'" *United States v. Grossman*, 843 F.2d 78, 86 (2d Cir. 1988) (quoting *Carpenter*, 484 U.S. at 19). Accord *United States v. Willis*, 737 F. Supp. 269, 276 (S.D.N.Y. 1990) (citing *Grossman*, 843 F.2d at 86, in an insider trading case). For discussion of *Grossman*, see *infra* notes 98–100 and accompanying text.

For criticism of the Supreme Court's holding that confidential business information is property for the purposes of the mail and wire fraud statutes, see John C. Coffee, Jr., *Hush!: The Criminal Status of Confidential Information After McNally and Carpenter and the Enduring Problem of Overcriminalization*, 26 AM. CRIM. L. REV. 121 (1988).

⁷⁷ *Carpenter*, 484 U.S. at 26 (quoting *Int'l News Serv. v. Associated Press*, 248 U.S. 215, 236 (1918)).

⁷⁸ See *id.* at 26–27.

⁷⁹ See *id.* at 27–28.

or overreaching.”⁸⁰ Such conduct includes embezzlement, which is “the fraudulent appropriation to one’s own use of [property] entrusted to one’s care by another.”⁸¹

The *Journal* had a property right in the exclusive use of confidential information about the columns’ timing and contents.⁸² In breach of his fiduciary obligation to his employer, the defendant Winans misappropriated this property for his own use.⁸³

⁸⁰ *Id.* at 27 (quoting *United States v. McNally*, 483 U.S. 350, 358 (1987)).

⁸¹ *Id.* (quoting *Grin v. Shine*, 187 U.S. 181, 189 (1902)) (internal quotations omitted).

⁸² *See id.* at 25–27.

⁸³ *See id.* at 25–28. For an extended and insightful discussion of both *Carpenter* and *McNally*, see Craig M. Bradley, *Forward: Mail Fraud After McNally and Carpenter: The Essence of Fraud*, 79 J. CRIM. L. & CRIMINOLOGY 573 (1988); Coffee, *supra* note 76 (criticizing *Carpenter*); Michael R. Dreeben, *Insider Trading and Intangible Rights: The Redefinition of the Mail Fraud Statute*, 26 AM. CRIM. L. REV. 181, 192–94, 199–214 (1988); Tannenbaum, *supra* note 2, at 370, 374–75, 388 (noting *Carpenter*’s asymmetrical fraud; the defendant’s gain was at the cost of innocent stock market investors, who were not victims of defendant’s scheme to defraud the *Journal* of its intangible property right). For a discussion of *Carpenter*’s property right analysis in the context of a general analysis of the meaning of “property,” see Francisco J. Morales, Comment, *The Property Matrix: An Analytical Tool to Answer the Question, “Is This Property?”*, 161 U. PA. L. REV. 1125, 1146–49 (2013).

The court in *United States v. Cherif* applied *Carpenter* to affirm multiple mail/wire fraud convictions for insider trading. *See* 943 F.2d 692, 696–99 (7th Cir. 1991). The defendant had misappropriated information from a commercial bank’s finance department. *See id.* at 694. The court held that the bank’s right to exclusively use its confidential business information was “property” within the meaning of the mail and wire fraud statutes. *See id.* at 697–98.

Although not a mail/wire fraud case, *United States v. Mahaffy* involved a charge of conspiracy to commit securities fraud in violation of 18 U.S.C. §§ 1348, 1349 under two theories, one of which was that the defendants deprived their employer brokerage firms of the exclusive use of confidential “squawk box” information, which qualified as “property” under *Carpenter*. *See* 693 F.3d 113, 121 (2d Cir. 2012). One issue was whether the employers considered the information confidential. *See id.* at 121–24, 126–33. At trial, one of the defendant’s submitted a jury charge that would have defined “confidential business information” along the lines of the definition of a “trade secret.” *See id.* at 134. The trial judge rejected that definition as too restrictive, and the Second Circuit agreed. *See id.* at 134–35. For the actual trial court instructions, see *id.* For discussion of *Mahaffy*, see Subcommittee on Annual Review, Committee on Federal Regulation of Securities, ABA Section of Business Law, *Annual Review of Federal Securities Regulation*, 68 BUS. LAW. 839, 938–42 (2013).

In the Supreme Court insider trading case of *United States v. O'Hagan*,⁸⁴ the defendant was a partner of the law firm Dorsey & Whitney in Minneapolis, Minnesota.⁸⁵ Grand Metropolitan PLC retained Dorsey & Whitney as its local counsel regarding a possible tender offer for Pillsbury Corporation.⁸⁶ O'Hagan purchased both Pillsbury call options and stock and made a profit of more than \$4.3 million when he sold after the tender offer announcement.⁸⁷ The United States Attorney prosecuted O'Hagan under fifty-seven counts of mail fraud, securities fraud (violations of Section 10(b)/Rule 10b-5⁸⁸ and Rule 14e-3⁸⁹), and violating federal money laundering statutes. The jury convicted O'Hagan of all fifty-seven counts.⁹⁰

One Government theory was that O'Hagan violated Rule 10b-5 by trading on material nonpublic information misappropriated from two information sources: (1) his direct employer, the law firm of which he was a partner, and (2) his law firm's client, Grand Metropolitan PLC.⁹¹ A majority of the justices affirmed the validity of this theory.⁹²

With virtually no discussion, based on the same breach of duty to the two information sources, all nine justices in effect affirmed the mail fraud convictions in extremely brief opinions.⁹³ These opinions mentioned neither the "intangible right to honest services"

See generally *United States v. Martin*, 228 F.3d 1, 16 (1st Cir. 2000) ("Confidential information may be considered property for the purposes of §§ 1341 and 1343.").

⁸⁴ 521 U.S. 642 (1997). For additional discussion of the mail fraud portion of *O'Hagan*, see *supra* notes 50–62 and accompanying text.

⁸⁵ *See O'Hagan*, 521 U.S. at 647.

⁸⁶ *See id.*

⁸⁷ *See id.* at 647–48.

⁸⁸ For discussion of *O'Hagan's* Rule 10b-5 opinion, see WANG & STEINBERG, *supra* note 1, §§ 4.4.5, 4.5.2[B], 4.6, 5:4 & nn.550–53, 5.4.1[B].

⁸⁹ For discussion of *O'Hagan's* Rule 14e-3 opinion, see *id.* § 9.3.3.

⁹⁰ *See O'Hagan*, 521 U.S. at 648–49.

⁹¹ *See id.* at 653, 655 n.6.

⁹² *See id.* at 649–66.

⁹³ *See id.* at 677–78; *id.* at 679 (Scalia, J., concurring in part and dissenting in part); *id.* at 680, 700–01 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

Technically, the Court *remanded* to the Eighth Circuit for consideration of O'Hagan's objections to his mail fraud convictions not considered by the Eighth Circuit. *See id.* at 677–78. Justice Scalia joined in this part of the majority's opinion.

(since dramatically narrowed by *Skilling*⁹⁴) nor the “property right” in the information held by both Dorsey & Whitney and its client, Grand Metropolitan PLC.⁹⁵ The majority opinion did, however, reaffirm: “Just as in *Carpenter*, so here, the ‘mail fraud charges are independent of [the] securities fraud charges, even [though] both rest on the same set of facts.’”⁹⁶

On remand, in the course of affirming O’Hagan’s mail fraud convictions and rejecting his challenge to the wording of the indictment, the Eighth Circuit briefly stated: “The indictment, reasonably read, charges O’Hagan with the fraudulent use of confidential business information held by Grand Met and Dorsey & Whitney. Confidential business information is considered “property” as that term is used in the federal mail fraud statute [citing *Carpenter*].”⁹⁷

Earlier, some other mail/wire fraud cases found that a law firm had a *property interest* in the client’s confidential information. For example, *United States v. Grossman*,⁹⁸ involved an attorney who allegedly engaged in insider trading and tipping based on information obtained from his law firm’s client.⁹⁹ The court held that the law firm had a mail fraud property interest in the information because of the reputational value of preserving client confidences.¹⁰⁰

Similarly, *United States v. Elliott*,¹⁰¹ concluded that the Seventh Circuit implicitly endorsed *Grossman* in *FMC Corp. v. Boesky*, 852

See id. at 679 (Scalia, J., concurring in part and dissenting in part). Justice Thomas and Chief Justice Rehnquist concurred in this part of the majority’s opinion. *See id.* at 680, 700–01 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

On remand, the Eighth Circuit affirmed O’Hagan’s convictions on the mail fraud and other counts. *See United States v. O’Hagan*, 139 F.3d 641 (8th Cir. 1998).

⁹⁴ *Skilling v. United States*, 561 U.S. 358 (2010). For discussion of *Skilling*, *see supra* notes 72–73 and accompanying text.

⁹⁵ *See supra* citations in note 93. Justice Thomas said: “As I read the indictment, it does not materially differ with the indictment in *Carpenter v. United States*” *O’Hagan*, 521 U.S. at 700 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

⁹⁶ *O’Hagan*, 521 U.S. at 678 (bracketed material in original) (quoting Brief for United States 46–47).

⁹⁷ *United States v. O’Hagan*, 139 F.3d 641, 651 (8th Cir. 1998).

⁹⁸ 843 F.2d 78 (2d Cir. 1988).

⁹⁹ *See id.* at 79–82.

¹⁰⁰ *See id.* at 85–86. For discussion of *Grossman*, *see Dreeben, supra* note 83, at 208–09.

¹⁰¹ 711 F. Supp. 425 (N.D. Ill. 1989).

F.2d 981, 992 n.21 (7th Cir. 1988).¹⁰² *Elliott* also stated that even had the Seventh Circuit not endorsed *Grossman*, two additional reasons existed for viewing confidential information from clients as law firm property (for the purposes of wire fraud): (1) the information is used to produce legal advice and has as much economic value to a law firm as a word processor or a copying machine; and (2) the information is held by the law firm for the benefit of the client, and a person has a property interest in property held for the benefit of another.¹⁰³

The prosecution could finesse the issue of whether the *law firm* has a *property* interest in client information by charging that the insider trading attorney deprived or interfered with the *client's* property interest in its confidential information, rather than the *law firm's* property interest in the client information.¹⁰⁴

Suppose the information source is a relative, rather than an employer. In some situations the information source conceivably might have a property interest in exclusive use of the information. For example, an individual or family might have a property interest in information about its investment plans.

In *United States v. Chestman*,¹⁰⁵ however, a majority of the Second Circuit *en banc* panel reversed the mail fraud convictions of a defendant whose tipper had allegedly breached a confidence of a spouse.¹⁰⁶ The defendant, Robert Chestman, had purchased Waldbaum, Inc. shares based on material nonpublic information about a forthcoming tender offer for the stock.¹⁰⁷

Chestman learned about the offer through the following chain. Ira Waldbaum was the president and controlling shareholder of

¹⁰² See *id.* at 426–28.

¹⁰³ See *id.* at 428.

¹⁰⁴ *United States v. Elliott* held that the indictment sufficiently alleged that the indicted law firm partner, Elliott, defrauded both his law firm *and its clients* of confidential information. See *id.* at 428–29.

For discussion of the Supreme Court decision of *O'Hagan*, which, with little discussion, in effect affirmed the mail fraud convictions of a law firm partner who traded on client information and misappropriated the informational property of both the law firm and the client, see *supra* notes 84–96 and accompanying text. For discussion of the Eighth Circuit *O'Hagan* opinion (on remand) that affirmed the mail fraud convictions, see *supra* note 97 and accompanying text.

¹⁰⁵ 947 F.2d 551 (2d Cir. 1991) (*en banc*).

¹⁰⁶ See *id.* at 571.

¹⁰⁷ See *id.* at 555–56.

Waldbaum, Inc.¹⁰⁸ He agreed to sell Waldbaum, Inc. to another company and to tender his control block to this acquirer.¹⁰⁹ Mr. Waldbaum informed his sister, Shirley Waldbaum Witkin, about the offer so that she could tender her shares along with his.¹¹⁰ Ms. Witkin told her daughter, Susan Loeb.¹¹¹ Ms. Loeb passed the news to her husband, Keith Loeb.¹¹² Mr. Loeb in turn relayed the information to his stockbroker, Robert Chestman.¹¹³

The sole defendant was Robert Chestman.¹¹⁴ The court reversed his conviction under Rule 10b-5 because his immediate information source (tipper), Keith Loeb, did not violate the rule.¹¹⁵ The decision exonerated Keith Loeb because of lack of evidence that he *either* (1) had a fiduciary relationship or its “functional equivalent” with his wife or the initial information source (the Waldbaum family), *or* (2) had accepted a duty of confidentiality when receiving the information from his wife.¹¹⁶

After an extensive discussion of Rule 10b-5, the opinion spent only one paragraph on mail fraud.¹¹⁷ The court reversed the mail fraud convictions for the same reason that it reversed the Rule 10b-5 convictions: “The fortunes of Chestman’s mail fraud convictions are tied closely to his securities fraud convictions [W]hatever ethical obligation Loeb may have owed the Waldbaum family or Susan Loeb [his wife], it was too ethereal to be protected by either the securities or mail fraud statutes.”¹¹⁸

In *Chestman*, Judge Winter dissented from the majority’s reversal of both the Section 10(b) and mail fraud convictions.¹¹⁹ Unlike

¹⁰⁸ See *id.* at 555.

¹⁰⁹ See *id.*

¹¹⁰ See *id.*

¹¹¹ See *id.*

¹¹² See *id.*

¹¹³ See *id.*

¹¹⁴ See *id.* at 554, 556.

¹¹⁵ See *id.* at 571.

¹¹⁶ See *id.* at 567–71. For additional discussion of *Chestman*’s analysis of Rule 10b-5, see WANG & STEINBERG, *supra* note 1, § 5.4.3[E]. At least partly because of *Chestman*, the SEC adopted Rule 10b5-2, which furnishes a nonexclusive list of three circumstances when a person has a duty of trust and confidence under the Rule 10b-5 misappropriation doctrine. For discussion of the rule, see *id.*

¹¹⁷ See *Chestman*, 947 F.2d at 571.

¹¹⁸ See *id.*

¹¹⁹ See *id.* at 572–82 (Winter, J., concurring in part and dissenting in part).

the majority, he expressly recognized that mail fraud and Rule 10b-5 misappropriation have different foundations and could have disparate results.¹²⁰ Nevertheless, after an extensive discussion of Section 10(b),¹²¹ he took only two paragraphs to support the mail fraud convictions.¹²² His reason was that “under any . . . disparity in rules the Section 10(b) charge would be harder to prove than a mail fraud charge”¹²³

Judge Winter is correct in noting that mail fraud and Rule 10b-5 misappropriation are not equivalent. Mail fraud is based on a deprivation of money or tangible or intangible “property.” Rule 10b-5 misappropriation involves a breach of duty to the information source (in connection with a securities transaction).¹²⁴

Before the Supreme Court’s validation of the Rule 10b-5 misappropriation doctrine in *United States v. O’Hagan*,¹²⁵ critics advanced several arguments against the theory: (1) the doctrine encompasses conduct not deceitful within the meaning of Exchange Act section 10(b);¹²⁶ (2) misappropriation is not fraud “in connec-

¹²⁰ See *id.* at 581–82 (Winter, J., dissenting) (“Logic is therefore certainly not a barrier to the growth of disparate rules concerning a tippee’s liability depending on whether Section 10(b) or mail fraud is the source of law.”). For a longer quotation from the same portion of the opinion, see *infra* text at note 256.

¹²¹ See *id.* at 572–81. For related discussion, see WANG & STEINBERG, *supra* note 1, § 5.4.3[E] n.753.

¹²² See *id.* at 581–82.

¹²³ See *id.* at 582 (Winter J., dissenting).

¹²⁴ For discussion of the misappropriation theory under Rule 10b-5, see WANG & STEINBERG, *supra* note 1, § 5.4.

For examples of insider trading cases providing a significant *separate* analysis of Rule 10b-5 misappropriation and mail/wire fraud liability, see *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff’d after remand*, 722 F.2d 729 (2d Cir. 1983) (unpublished order); *United States v. Willis*, 737 F. Supp. 269 (S.D.N.Y. 1990); *United States v. Elliott*, 711 F. Supp. 425 (N.D. Ill. 1989) (discussed *supra* at notes 101–03 and accompanying text; *infra* notes 208–14 and accompanying text). For additional discussion of *Newman* and *Willis*, see *infra* note 137.

¹²⁵ 521 U.S. 642, 649–66 (1997).

¹²⁶ See *United States v. O’Hagan*, 92 F.3d 612, 617–19 (8th Cir. 1995), *rev’d*, 521 U.S. 642 (1997); *United States v. Bryan*, 58 F.3d 933, 944–49 (4th Cir. 1995); WANG & STEINBERG, *supra* note 1, §5.4.1 nn.584–97, 606 and accompanying text.

tion with the purchase or sale of any security” as required by Exchange Act Section 10(b) and SEC Rule 10b-5¹²⁷ because the misconduct has too tenuous a link with a securities transaction;¹²⁸ (3) more generally, an overly broad prohibition of insider trading may frustrate “the need to allow persons to profit from generating information about firms so that the pricing of securities is efficient.”¹²⁹

¹²⁷ For discussion of the “in connection with” requirement under Section 10(b) and Rule 10b-5, see WANG & STEINBERG, *supra* note 1, §§ 4.5, 6.13.

¹²⁸ See *Bryan*, 58 F.3d at 949-50, 959. See also *id.* at 943-59 (rejecting the Rule 10b-5 misappropriation theory). For discussion of *Bryan*, see WANG & STEINBERG, *supra* note 1, §§ 4.5.2[A], 5.4.1[A].

The Eighth Circuit followed *Bryan* and rejected the Rule 10b-5 misappropriation theory, in part because of the “in connection with” requirement. See *United States v. O’Hagan*, 92 F.3d 612, 619-20 (8th Cir. 1996), *rev’d*, 521 U.S. 642, 649-66 (1997).

In their dissenting opinion in *O’Hagan*, Justice Thomas and Chief Justice Rehnquist concluded that the conduct encompassed by the Rule 10b-5 misappropriation doctrine does not meet the “in connection with” requirement. See *O’Hagan*, 521 U.S. at 680-92 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

For discussion of whether the Rule 10b-5 misappropriation theory satisfies Section 10(b)’s “in connection with” requirement, see WANG & STEINBERG, *supra* note 1, § 4.5.2.

For discussion of theoretical problems with the misappropriation doctrine under Rule 10b-5, see William K.S. Wang, *Post-Chiarella Developments in Rule 10b-5*, 15 REV. SEC. REG. 956, 959-61 (1982).

In *O’Hagan*, the Supreme Court majority rejected the argument that the defendant misappropriator’s misconduct had too tenuous a link with a securities transaction. See 521 U.S. at 655-66. For discussion of this part of *O’Hagan*, see WANG & STEINBERG, *supra* note 1, § 4.5.2[B]. For additional discussion of *O’Hagan*, see *id.* §§ 5.4 & nn.550-53, 5.4.1[B].

¹²⁹ See *United States v. Chestman*, 947 F.2d 551, 581 (2d Cir. 1991) (en banc) (Winter, J., dissenting). Cf. *Dirks v. SEC*, 463 U.S. 646, 658 (1983) (“Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.”); WANG & STEINBERG, *supra* note 1, § 5.2.3[F] n.317 and accompanying text (discussing this language in *Dirks*). For related discussion, see *id.* § 2.2.2.

For discussion of *possible* special Rule 10b-5 insider trading solicitude for analysts, see WANG & STEINBERG, *supra* note 1, §§ 5.2.3[C][2] n.168, 5.2.3[F] n.317 and accompanying text; Dreeben, *supra* note 83, at 211-12. See also *Chestman*, 947 F.2d at 581 (Winter, J., dissenting) (quoted *supra* in text at this note). For discussion of a *possible enhanced* Rule 10b-5 insider trading obligation for broker-dealers, see *id.* § 5.2.3[F].

If one rejects these arguments, Judge Winter may *sometimes* be incorrect in concluding that, in insider trading cases, a Rule 10b-5 violation is harder to prove than mail fraud. In certain instances, a breach of a fiduciary or “fiduciary-like” duty to an information source (Rule 10b-5 misappropriation) may be *easier* (rather than harder) to find than a deprivation of “property” under mail and wire fraud. For example, when someone breaches the confidence of a relative, as alleged in *Chestman*, a breach of duty to the information source might seem a more plausible theory than one based on loss of “property.”¹³⁰

In any event, other judicial opinions appear to support Judge Winter’s conclusion that, with inside trading criminal cases, Rule 10b-5 misappropriation is more difficult to prove than mail and wire fraud. In *Carpenter* itself, the Supreme Court split evenly on the Rule 10b-5 misappropriation convictions, but *unanimously* upheld the mail/wire fraud convictions based on the deprivation of confidential information-property.¹³¹ Further, in their concurring and dissenting opinion in *O’Hagan*, Justice Thomas and Chief Justice Rehnquist stated that they would reverse O’Hagan’s convictions under Rule 10b-5 (because of a rejection of the Rule 10b-5 misappropriation doctrine), but in effect sustain O’Hagan’s mail fraud convictions.¹³² Justice Thomas (and Chief Justice Rehnquist) commented:

While the majority may find it strange that the “mail fraud net” is broader reaching than the securities fraud net, any such supposed strangeness—and the resulting allocation of prosecutorial responsibility

¹³⁰ Nevertheless, the court in *United States v. Reed* treated Rule 10b-5 misappropriation and wire fraud as equivalent and refused to dismiss indictments against a son for trading on material nonpublic information misappropriated from his father. See 601 F. Supp. 685, 695–720 (S.D.N.Y. 1985), *aff’d on other grounds*, 773 F.2d 477 (2d Cir. 1983). *Reed* is overshadowed and limited by *United States v. Chestman*, 947 F.2d 551, 569–70 (2d Cir. 1991) (en banc). For discussion of *Chestman* overshadowing and limiting *Reed*, see WANG & STEINBERG, *supra* note 1, § 5.4.3[E], at 448–49. At least partly in reaction to *Chestman*, the SEC adopted Rule 10b5-2 (discussed *supra* in note 116).

¹³¹ See *Carpenter v. United States*, 484 U.S. 19 (1987). For discussion of *Carpenter*, see *supra* notes 58–83 and accompanying text.

¹³² See *O’Hagan*, 521 U.S. at 680–701 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

between the Commission and the various United States Attorneys—is no business of this Court, and can be adequately addressed by Congress if it too perceives a problem regarding jurisdictional boundaries among the Nation’s prosecutors.¹³³

¹³³ *Id.* at 701 n.13.

Invoking the rule of lenity, Justice Scalia, with almost no discussion, said that he also would reverse the Rule 10b-5 convictions but in effect affirm the mail fraud convictions. *See id.* at 679 (Scalia, J., concurring in part and dissenting in part). For additional discussion of these two concurring and dissenting opinions and their concurrence with the majority’s *remand* for consideration of defendant arguments not considered by the Eighth Circuit, see *supra* note 93. For discussion of the majority’s mail fraud holding in *O’Hagan*, see *supra* notes 84–96. For discussion of the rule of lenity (strict construction of criminal statutes in favor of the defendant), see WANG & STEINBERG, *supra* note 1, § 4.5.2[B] n. 495.

The *O’Hagan* majority did not indicate whether securities fraud is narrower or broader than mail/wire fraud. *See* 521 U.S. at 677–78. Nevertheless, the majority did reaffirm: “Just as in *Carpenter*, so here, the ‘mail fraud charges are independent of [the] securities fraud charges, even [though] both rest on the same set of facts.’” 521 U.S. at 678 (bracketed material in original) (quoting Brief for United States 46-47). For earlier discussion of this portion of *O’Hagan*, see *supra* note 96 and accompanying text. For a longer quotation including this language, see *infra* text accompanying note 137.

Two Fourth Circuit cases affirmed the convictions of insider trading defendants under mail and/or wire fraud, while reversing their convictions under Rule 10b-5 (because of a rejection of the Rule 10b-5 misappropriation doctrine). *See* *United States v. ReBrook*, 58 F.3d 961, 965–67 (4th Cir. 1995); *United States v. Bryan*, 58 F.3d 933, 943–59 (4th Cir. 1995). *Bryan* expressed a lack of concern for the consequences of its rejection of the Rule 10b-5 misappropriation doctrine because much of the conduct covered by that doctrine is also covered by the Rule 10b-5 classical relationship theory or mail/wire fraud. *See* 58 F.3d at 953. *ReBrook* relied both on *Carpenter* (dividing evenly on Rule 10b-5 misappropriation; yet upholding the mail/wire fraud convictions based on deprivation of information-property) and “holdings of various courts that there is no multiplicity issue when prosecuting the same purchase or sale of securities under both the securities fraud statute and the wire fraud statute.” *ReBrook*, 58 F.3d at 967.

These two Fourth Circuit opinions, however, relied on the 1988 Congressional amendment extending mail/wire fraud to the “the deprivation of the intangible right to honest services.” *See Rebrook*, 58 F.3d at 966; *Bryan*, 58 F.3d at 939–43. The two decisions predate *Skilling v. United States*, 561 U.S. 358 (2010), which held that the 1988 amendment covers only bribery and kickback schemes. For discussion of the 1988 amendment, see *supra* note 71 and accompanying text. For discussion of *Skilling*, see *supra* notes 72-73 and accompanying text.

For discussion of cases, including *Carpenter*, that seem willing to expand mail/wire fraud beyond securities fraud, see Dreeben, *supra* note 83, at 189–91, 199–214.

Pre-*Skilling*, two commentators suggested that mail/wire fraud is more expansive than federal securities law:

But in the other major area of securities law violations, insider trading and “misappropriation,” we again, as under § 1346, encounter struggles to define fiduciary duty and to find identifiable victims of obviously bad actors. Put simply, securities fraud, as embodied by § 10b of the Securities Exchange Act of 1934 and by Rule 10b-5, requires a “fraud,” and the question to explore then is whether securities fraud has come to conceive victimhood as broadly and amorphously as mail fraud.

Mills & Weisberg, *supra* note 21, at 1425.

Similarly, the same article noted:

One subsidiary effect of the expansion of mail fraud law has been to reconfirm that it can do the work of securities fraud by treating insider trading cases as instances of theft. Under mail and wire fraud law, we have a progressively vaguer standard and a greater reach of inchoate crime doctrine Section 1348 [§ 807 of the Sarbanes-Oxley Act of 2002, adding 18 U.S.C. § 1348, a new crime of “securities fraud”] . . . might suggest a way for prosecutors to use mail and wire fraud even more expansively as a substitute for SEC laws The new law might, in effect, moot the need for the government to use the insider trading or misappropriation doctrines

Id. at 1437–38. For discussion of § 1348, see *supra* note 21.

For additional pre-*Skilling* commentary arguing that, with respect to insider trading, mail/wire fraud may have a broader application than Rule 10b-5 misappropriation, see Stephen H. Case & Jimmy H. Morales, *Landmark Cases and Concepts in the Law of “Insider” or “Breach of Duty” Trading Under Federal Securities, Mail and Wire Fraud Laws: A Primer for Working and Chapter 11 Lawyers*, C647 ALI-ABA 163, 173 (Sept. 28, 1991) (“[C]riminal insider trading charges [under] . . . mail and wire fraud are easier to prove.”); Humke, *supra* note 43, at 842–44.

One treatise said:

The mail and wire fraud statutes do not specify who needs to be defrauded. They thereby neatly avoid the *Chiarella* requirement of fiduciary duty to the opposite party to the securities trade. And they neatly achieve the objective of misrepresentation the-

ory to find violation when MNPI [material non-public information] is taken from someone unrelated to the opposite party or to the issuer of the security.

3 BROMBERG, LOWENFELS, & SULLIVAN, *supra* note 13, § 6:372, at 6-1009. Computer hacking *may* sometimes escape liability under either mail/wire fraud or Rule 10b-5 misappropriation, but may possibly be more likely to escape liability under Rule 10b-5. SEC v. Dorozhko, 606 F. Supp. 2d 321 (S.D.N.Y. 2008), *rev'd*, 574 F.3d 42 (2d Cir. 2009), involved a defendant who traded on material nonpublic information obtained through computer hacking. The court stated:

Based on the evidence provided at the November 28, 2007 hearing there would appear to be sufficient basis to conclude that Dorozhko's hack violated the . . . mail fraud statute . . . and the wire fraud statute However, since the SEC has apparently declined, for whatever reason, to involve the criminal authorities in this case, we must address an inconvenient truth about our securities laws Upon a searching review of existing case law, and for the reasons that follow, we believe that we are constrained to hold that Dorozhko's alleged 'stealing and trading' or 'hacking and trading' does not amount to a violation of § 10(b) and Rule 10b-5 because Dorozhko did not breach any fiduciary or similar duty "in connection with" the purchase or sale of a security.

Id. at 324.

On appeal, however, the Second Circuit reversed and held that breach of fiduciary duty was not a prerequisite to Rule 10b-5 "deceit" and that, depending on the facts, the defendant's hacking might (or might not) involve the "deceit" required for Rule 10b-5. *See* SEC v. Dorozhko, 574 F.3d 42, 46-51 (2d Cir. 2009).

When discussing the issue whether computer hackers are Rule 10b-5 misappropriators, one article said: "Under the traditional view, they would have to be punished for their misdeeds via mail fraud, wire fraud, simple theft, or other comparable statutes." Robert A. Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J.L. & TECH 263, 298 (1999).

In at least one respect, mail/wire fraud is broader than SEC Rule 10b-5. The latter covers only conduct "in connection with" the purchase or sale of a security. *See* WANG & STEINBERG, *supra* note 1, § 4.5. For related discussion, *see supra* notes 126-27 and accompanying text. Mail/wire fraud is not so limited. *See* MARVIN G. PICKHOLZ, PETER J. HENNING & JASON R. PICKHOLZ, 21 SECURITIES CRIMES § 6:29 (2014); Case & Morales, *supra*, at 173; Ted Kamman & Roy T. Hood, *With the Spotlight on the Financial Crisis, Regulatory Loopholes, and Hedge Funds, How Should Hedge Funds Comply with the Insider Trading Laws?*, 2009 COLUM. BUS. L. REV. 357, 393-97 (application of mail/wire fraud to insider trading in non-securities-based swap agreements). For a general discussion of the federal regulation of insider trading in derivatives, *see* Yesha Yadav, *Insider Trading in*

Derivatives Markets, 103 GEO. L.J. 381, 407–09 (2015) (discussing SEC and CFTC regulations).

For an argument for increased regulation of insider trading in the commodities markets, see Andrew Verstein, *Insider Trading in Commodities Markets*, 101 VA. L. REV. (forthcoming 2016). Normally, commodities are not securities under the federal securities laws. See 7 HAZEN, *supra* note 18, § 1.6[6] (“Commodities themselves and commodities futures are not securities.”). For examples of cases applying mail/wire fraud to commodities or commodities futures transactions, see *United States v. Sleight*, 808 F.2d 1012, 1014 (3d Cir. 1987) (applying mail fraud to cocoa futures); *United States v. Dial*, 757 F.2d 163, 164 (7th Cir. 1985) (applying mail and wire fraud to silver futures). For related discussion, see *infra* notes 142–43 and accompanying text. See generally Gretchen Morgenson, *Vague Words That Imperil Investors*, NY TIMES, Aug. 23, 2015, Sunday Business, at 1, 5 (“Prohibitions against insider trading apply only to securities . . . Investors taking the view that leveraged loans are not securities have contended that their trading on such information is not bound by these rules.”).

As mentioned earlier, section 807 of the Sarbanes-Oxley Act of 2002 imposes criminal penalties for: “[w]hoever knowingly executes, or attempts to execute, a scheme or artifice—(1) to defraud any person *in connection with* . . . any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 . . .” 18 U.S.C. § 1348 (emphasis added). For the conclusion that section 807’s “in connection with” language is broader than Section 10(b)’s “in connection with the purchase or sale,” see Mills & Weisberg, *supra* note 21, at 1425. For additional discussion of section 807, see *supra* note 21.

This Article discusses *criminal* liability. When bringing Rule 10b-5 *civil* actions against insider trading defendants, the SEC has a laxer burden of proof, and the culpability requirement of the defendant may be lower than in a criminal proceeding. See *Outlook 2015: Securities Litigation and Enforcement*, 27 SEC. REG. & L. REP. (BNA) 129 (Jan. 29, 2015).

For discussion of the intent requirement for mail/wire fraud, see *supra* notes 19–20 and accompanying text. For discussion of the Rule 10b-5 scienter requirement and its application to insider trading defendants, see WANG & STEINBERG, *supra* note 1, § 4.4. For discussion of the special features of the Rule 10b-5 scienter of tippees and tippees, see *id.* § 4.4.5. For discussion of the Rule 10b-5 “personal benefit” requirement for initial tipper liability, see *infra* notes 216, 220–29 and accompanying text. For discussion of the Rule 10b-5 “know or should know of initial tipper’s violation” requirement for tippee liability, see *infra* notes 217–19 and accompanying text. For discussion of the sometimes blurry distinction between the scienter and “personal benefit” requirements, see *infra* notes 226–30 and accompanying text.

Just as mail/wire fraud overlaps somewhat with Exchange Act § 10(b) and SEC Rule 10b-5, the Supreme Court has held that Exchange Act § 10(b) and SEC Rule 10b-5 overlap with more specific anti-fraud provisions of the federal securities laws. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381–87 (1983) (unanimous decision) (recognizing overlap with express private remedy of Securities Act of 1933 § 11); *SEC v. Nat’l Sec., Inc.*, 393 U.S. 453, 468–69 (1969)

Nevertheless, other judicial opinions seem to support the alternative conclusion that Rule 10b-5 misappropriation and mail/wire fraud are equally difficult to demonstrate. The majority opinion in *O'Hagan* analogized mail/wire fraud to the Rule 10b-5 misappropriation theory and cited the mail/wire fraud decision of *Carpenter* as precedent for the validity of the misappropriation doctrine.¹³⁴ The Court noted:

Carpenter's discussion of the fraudulent misuse of confidential information, the Government notes, "is a particularly apt source of guidance here, because [the mail fraud statute] (like Section 10(b)) has long been held to require deception, not merely the breach of a fiduciary duty."¹³⁵

Furthermore, the majority opinion in *O'Hagan* spent only a few sentences to affirm (in effect) the mail fraud convictions¹³⁶ and commented:

Just as in *Carpenter* so here, the "mail fraud charges are independent of [the] securities fraud charges, even [though] both rest on the same set of facts." Brief for United States 46–47. We need not linger over this matter, for our rulings on the securities fraud issues [in effect affirming convictions under the Rule 10b-5 misappropriation theory] require that we reverse the Court of Appeals judgment on the mail fraud counts as well."¹³⁷

(recognizing overlap with Exchange Act § 14 and stating "The fact that there may well be some overlap is neither unusual nor unfortunate.").

¹³⁴ See *O'Hagan*, 521 U.S. at 654.

¹³⁵ *Id.* (quoting Brief for United States at 18, n.9 (citation omitted)).

¹³⁶ See *id.* at 677–78.

¹³⁷ *Id.* at 678. (Technically, the Court remanded to the Eighth Circuit for consideration of O'Hagan's objections to his Rule 10b-5 and mail fraud convictions not considered by the Eighth Circuit. See *id.* at 666, 677-78.) At least on the facts of that case, the Court viewed Rule 10b-5 misappropriation as equivalent to mail/wire fraud. For discussion of the Rule 10b-5 portion of *O'Hagan*, see WANG & STEINBERG, *supra* note 1, §§ 4.4.5, 4.5.2[B], 5.4 & nn.550–53, 5.4.1[B]. Similarly, the Eighth Circuit opinion reversed by the Supreme Court in *O'Hagan* spent only one paragraph reversing his mail fraud convictions after reversing his

Rule 10b-5 convictions. *See* *United States v. O'Hagan*, 92 F.3d 612, 627–28 (8th Cir. 1995), *rev'd*, 521 U.S. 642 (1997). The Eighth Circuit did acknowledge, however: “The mere fact that O’Hagan’s securities convictions are reversed does not as a matter of law require that the mail fraud convictions likewise be reversed.” *Id.* at 627. On remand from the Supreme Court, the Eighth Circuit affirmed O’Hagan’s convictions on the mail fraud and other counts. *See* *United States v. O’Hagan*, 139 F.3d 641, 645 (8th Cir. 1998).

The insider trading portion of *United States v. Royer* discussed wire fraud and Rule 10b-5 misappropriation convictions jointly and affirmed them. *See* 549 F.3d 886, 897–99 (2d Cir. 2008).

In a Rule 10b-5 misappropriation case, *SEC v. Rocklage*, the defendant disclosed to her information-source, her husband, her intent to convey material nonpublic information to her brother shortly before she actually did so. *See* 470 F.3d 1, 3 (1st Cir. 2006). In the course of affirming the trial court’s denial of the defendant’s motion to dismiss, the circuit court relied on the Supreme Court’s discussion of mail/wire fraud in *Carpenter*: “In related areas of the law [mail/wire fraud], it is well accepted that a scheme can be deceptive or fraudulent even if not all parts of the scheme are deceptive or fraudulent.” *Id.* at 13. For discussion of *Rocklage* and Rule 10b-5 “brazen misappropriation,” see FERRARA, NAGY, & THOMAS, *supra* note 21, § 2.02[6][iii]; WANG & STEINBERG, *supra* note 1, § 5.4.1[B] & nn.613–14.

In about two and a half pages, the court in *United States v. Ruggiero* affirmed the securities and wire fraud convictions of an insider trading defendant. *See* 56 F.3d 647, 653–56 (5th Cir. 1995). The two-paragraph wire fraud discussion was based on the court’s conclusion about securities fraud. *See id.* at 656. For additional discussion of *Ruggiero*, see *infra* notes 167–76, 253–56 and accompanying text. In *United States v. Kim*, the government accused the defendant of insider trading and charged him with one count of wire fraud, two counts of securities fraud, and one count of making a false statement. *See* 184 F. Supp. 2d 1006, 1008–09 (N.D. Cal. 2002). The court granted the defendant’s motion to dismiss both the securities fraud counts and the wire fraud count. *See id.* at 1009, 1015. The opinion spent almost seven pages discussing whether to dismiss the securities fraud count based on the Rule 10b-5 misappropriation theory. *See id.* at 1009–15. After dismissing the securities fraud counts, the judge dismissed the wire fraud count in just a few sentences:

The alleged fraud underlying the securities fraud charges also serves as the basis for the wire fraud charge. As the government concedes, a wire fraud conviction must be based on a breach of an underlying duty. For the reasons stated above no such duty is present here. Accordingly, the indictment also fails to allege a wire fraud violation.

Id. at 1015.

For discussion of the Rule 10b-5 misappropriation portion of *Kim*, see WANG & STEINBERG, *supra* note 1, § 5.4.3[J].

In *SEC v. Zandford*, the district court had entered summary judgment against the defendant under Rule 10b-5 based on his criminal conviction for wire fraud. *See* 535 U.S. 813, 816 (2002). The Supreme Court reversed the Fourth Circuit's dismissal of the complaint, but did not reach the issue of whether to affirm the summary judgment. *See id.* at 818.

United States v. Eisenberg, 773 F. Supp. 662, 721 (D.N.J. 1991), stated:

Because mail and wire fraud violations are premised on use of the mails and wires to execute a scheme to defraud, the parties appear to be correct in their contention that the most important question is whether the Defendants' conduct constituted fraud within the meaning of the securities laws.

Although overshadowed and limited by *Chestman v. United States*, 947 F.2d 551, 569–70 (2d Cir. 1991) (en banc), the insider trading case of *United States v. Reed*, 601 F. Supp. 685, 695–720 (S.D.N.Y. 1985), *aff'd* on other grounds, 773 F.2d 477 (2d Cir. 1983), treated Rule 10b-5 misappropriation and wire fraud as equivalent when refusing to dismiss indictments. For discussion of *Chestman's* overshadowing and limiting *Reed*, *see* WANG & STEINBERG, *supra* note 1, § 5.4.3[E], at 448–49.

The majority in *Chestman* itself spent about five and a half pages on the reversal of the defendant's Rule 10b-5 misappropriation convictions. *See Chestman*, 947 F.2d at 566–71. The opinion then devoted only one paragraph on the reversal of his mail fraud convictions. *See id.* at 571 (“The fortunes of Chestman's mail fraud convictions are tied closely to his securities fraud convictions.”).

The insider trading case of *United States v. Newman* spent about three and a half pages refusing to dismiss the indictment for Rule 10b-5 misappropriation and slightly over one page refusing to dismiss the mail fraud indictment. *See* 664 F.2d 12, 15–20 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir. 1983) (unpublished order). Nevertheless, the court separately analyzed the two indictments. *See id.*

Similarly, *United States v. Willis*, involved a psychiatrist who allegedly traded on information from a patient. *See* 737 F. Supp. 259, 270 (S.D.N.Y. 1990). The opinion spent about four and a quarter pages refusing to dismiss the Rule 10b-5 misappropriation counts and only about one page refusing to dismiss the mail fraud counts. *See id.* at 271–76. Nevertheless, the court analyzed the two issues separately. *See id.*

Although noting the mail/wire fraud is not confined to “securities” and is in that respect broader than SEC Rule 10b-5, two co-authors concluded: “since the mail and wire fraud statutes require a misappropriation theory, they, like the insider trading laws under Rule 10b-5, are limited by the constraints of this theory” Kamman & Hood, *supra* note 133, at 396.

Similarly, another article states:

In practice, the interpretations of the mail and wire fraud statutes seem to follow the interpretation of Section

2. THE PARTY ON THE OTHER SIDE AS VICTIM

Under SEC Rule 10b-5, a stock market insider trader has a duty to disclose material information to the party on the other side of the trade only when the two have a so-called “classical relationship.”¹³⁸ This duty is breached by the material nondisclosure accompanying the insider trade. For many reasons, the Rule 10b-5 “classical relationship” theory may not be available. One *possible* example is a corporate insider trading in the company’s debt instruments; it is unclear whether a “classical relationship” exists with the party on the other side of the trade.¹³⁹

10(b) . . . Courts generally decide the merits of the 10b-5 [misappropriation] action; the mail and wire fraud counts are disposed of briefly, in the same fashion and with the same stated rationale as the 10b-5 counts.

Ian Ayres & Joe Bankman, *Substitutes for Insider Trading*, 54 STAN. L. REV. 231, 260 (2001) (citing *Chestman*, 947 F.2d at 571).

Based on *Carpenter*, one treatise concludes “it seems clear that virtually all insider trading cases will also be mail and wire fraud cases, whether under the misappropriation theory” 18 DONALD C. LANGEVOORT, *INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION* § 8:14, at 8–49 (2014).

One commentator has claimed: “Congress must have had the mail-fraud statute in mind when it drafted section 17(a) of the 1933 Act, [and] section 10(b) of the 1934 Act” Robert A. Prentice, *Scheme Liability: Does It Have a Future After Stoneridge?*, 2009 WIS. L. REV. 351, 384. *See id.* at 365 n.77 (“Rule 10b-5’s scheme to defraud language was copied from section 17(a) of the 1933 Act Congress derived that language, in turn, from the mail-fraud statute”); Strader, *supra* note 20, at 1455 (section 10(b) “was modeled on the federal mail fraud statute”; footnote omitted).

Citing Prentice, the insider trading case of *United States v. Whitman* said: “Rule 10b–5 . . . was loosely modeled on the federal mail fraud statute” 904 F. Supp. 2d 363, 366 (S.D.N.Y. 2012), *aff’d*, 555 F. App’x 98 (2d Cir. 2014). For related discussion of *Whitman*, see *infra* note 251 and accompanying text. *Cf.* SEC v. Clark, 915 F.2d 915, 448 (9th Cir. 1990) (“For guidance in determining whether the misappropriation theory fits within the concept of ‘fraud’ in § 10(b) and Rule 10b-5, we look to the mail and wire fraud statutes, which contain similar language.”).

¹³⁸ For discussion of the Rule 10b-5 “classical relationship” theory, see *United States v. Newman*, 773 F.3d 438, 445 (2d Cir. 2014); WANG & STEINBERG, *supra* note 1, §§ 5.2, 5.3.

¹³⁹ *See id.* § 5.2.6[C]; Kamman & Hood, *supra* note 133, at 391–93. Another illustration is the following: based on material nonpublic information about her company, a corporate insider might trade other corporations’ stock, e.g.,

With stock market insider trading, an alternative to the Rule 10b-5 “classical relationship” theory is Rule 10b-5 misappropriation.¹⁴⁰ Of course, if the insider trade is in an item, not a “security” under the federal securities laws,¹⁴¹ e.g., a commodity,¹⁴² then Rule 10b-5 does not apply.¹⁴³

Somewhat similar to Rule 10b-5 misappropriation is mail/wire fraud on the information-owner.¹⁴⁴ Suppose, however, neither Rule 10b-5 misappropriation nor mail/wire fraud on the information-owner is applicable, perhaps because the information source/owner gave permission to trade or tip,¹⁴⁵ or *possibly* because the defendant disclosed in advance to the information source/owner the plan to

shares of her company’s rivals, suppliers, customers, or the manufacturers of complementary products. For discussion of insider trading in such stock “substitutes” (stock of a different issuer), see WANG & STEINBERG, *supra* note 1, § 5.2.6[D]; Ayres & Bankman, *supra* note 137. For an empirical study of such trading, see Mihir N. Mehta, David M. Reeb, & Wanli Zhao, *Shadow Trading: Do Insiders Exploit Private Information About Stakeholders?* (forthcoming; available on ssrn.com).

Sometimes, someone in the “classical relationship triangle” tips an outsider, and the insider/tipper and/or the outsider/tippee is not liable. For discussion of “classical relationship” tipper/tippee liability, see *infra* Part II(B)(5); WANG & STEINBERG, *supra* note 1, §§ 5.2.8, 5.3.

In the Supreme Court case that created the “classical relationship” theory, *Chiarella v. United States*, the defendant himself was not liable under the doctrine. See 445 U.S. 222, 225–35 (1980); WANG & STEINBERG, *supra* note 1, § 5.2.1.

¹⁴⁰ For discussion of the SEC Rule 10b-5 misappropriation doctrine, see *United States v. Newman*, 773 F.3d 438, 445–46 (2d Cir. 2014); WANG & STEINBERG, *supra* note 1, § 5.4. For discussion of the overlap between the SEC Rule 10b-5 misappropriation doctrine and the Rule 10b-5 “classical relationship” theory, see WANG & STEINBERG, *supra* note 1, § 5.4.11.

¹⁴¹ For discussion of the definition of “security” under the federal securities laws, see 3 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES AND FEDERAL CORPORATION LAW* 2D §§ 2:1–2:105 (2d ed. 2014); 2 BROMBERG, LOWENFELS, & SULLIVAN, *supra* note 13, §§ 4.9–4.51; 7 HAZEN, *supra* note 18, § 1.6; 2 LOUIS LOSS, JOEL SELIGMAN, & TROY PAREDES, *SECURITIES REGULATION* § 3(A)(1) (3d ed. 2014). For related discussion, see *supra* note 133.

¹⁴² See 7 HAZEN, *supra* note 18, § 1.6[6] (“Commodities themselves and commodities futures are not securities.”). For related discussion, see *supra* note 133.

¹⁴³ For related discussion, see *supra* note 127 and accompanying text, 133.

¹⁴⁴ See *supra* Part II(B)(1).

¹⁴⁵ For discussion of why no Rule 10b-5 misappropriation occurs if the information source grants permission to trade or tip, see *United States v. O’Hagan*, 521 U.S. 642, 653–55, 659 n.9 (1997); WANG & STEINBERG, *supra* note 1, § 5.4 nn.551–53 and accompanying text.

trade or tip.¹⁴⁶ Also, assume that SEC Rule 14e-3 is not available because the insider trading or tipping does not relate to an actual or possible tender offer.¹⁴⁷

In this situation, an alternative theory of *mail/wire fraud* liability arises from the possible victim: the party *on the other side* of the insider trade.¹⁴⁸ The latter more closely resembles the classic fraud victim, who is induced to buy or sell by a material misstatement or nondisclosure. Mail and wire fraud can cover misstatements to someone on the other side of a transaction.¹⁴⁹ For *nondisclosure* to

¹⁴⁶ For discussion of why Rule 10b-5 misappropriation might not occur if the defendant discloses in advance to the information source the plan to trade or tip, see *O'Hagan*, 521 U.S. at 653–55, 659 n.9; WANG & STEINBERG, *supra* note 1, § 5.4.1[B] nn.612–14 and accompanying text. *But cf.* SEC v. Rocklage, 470 F.3d 1 (1st Cir. 2006) (discussed *supra* note 144 and in WANG & STEINBERG, *supra* note 1, § 5.4.1[B] n.613). For additional discussion, see *supra* note 144.

Unclear is whether such advance disclosure would avoid mail/wire fraud liability for misappropriation of confidential informational property. For related discussion, see *supra* notes 80–83 and accompanying text.

For discussion of loopholes in both the SEC Rule 10b-5 classical relationship and misappropriation doctrines, see Kamman & Hood, *supra* note 133 at 376–400. Computer hacking *may* sometimes escape liability under either theory. See *supra* note 140.

¹⁴⁷ For discussion of SEC Rule 14e-3, see WANG & STEINBERG, *supra* note 1, ch. 9.

For discussion of its limitation to the tender offer context, see *id.* § 9.1.

¹⁴⁸ For discussion of why the issuer should not be able to immunize its employees or independent contractors from Rule 10b-5 liability by granting permission for them to trade on material nonpublic information, see WANG & STEINBERG, *supra* note 1, § 5.4.1[B] nn.613–22 and accompanying text.

For discussion of why advance disclosure to the issuer does not exonerate an insider from trading or tipping in violation of Rule 10b-5 under the “classical relationship” theory, see WANG & STEINBERG, *supra* note 1, § 5.4.1[B] nn.613–22 and accompanying text.

¹⁴⁹ See, e.g., *Schmuck v. United States*, 489 U.S. 705 (1989) (involving used car distributor who bought used cars, rolled back their odometers, and then sold the cars to retail dealers); *United States v. Sampson*, 371 U.S. 75 (1962) (to obtain advance fees for company, officers, directors, and employees of a corporation made lavish representations about the services company would provide; defendants did not intend to, and in fact did not make any substantial effort to perform the promised services); *Pereira v. United States*, 347 U.S. 1 (1954) (applying the mail fraud statute to defendants who duped a woman into advancing \$35,000 toward a fictitious hotel deal); *United States v. Autuori*, 212 F.3d 105 (2d Cir. 2000) (materially misleading representations to potential investors); *United States v. Lo-*

ayza, 107 F.3d 257, 267 (4th Cir. 1997) (affirming mail fraud convictions of defendants who devised a Ponzi scheme to induce individuals to invest). *See also* United States v. Dinome, 86 F.3d 277, 283–84 (2d Cir. 1996) (affirming conviction of defendant who deprived lender “of information [materially] relevant to its decision whether it would extend him a loan”; facts involved affirmative misrepresentation); Emery v. Am. Gen. Fin., Inc., 71 F.3d 1343, 1346 (7th Cir. 1995) (“all the [mail fraud] statute punishes is *deliberate* fraud . . . where in order to get money or something else of monetizable value from someone you make a statement to him that you know to be false, or a half truth that you know to be misleading, expecting him to act upon it to your benefit and his detriment.”); 2 BRICKEY, *supra* note 11, § 8:48 nn.567, 571 and accompanying text.

For an opinion affirming the conviction of a defendant for aiding and abetting a classic face to face wire fraud scheme involving duping two investors into making a “guaranteed” investment in a company and then embezzling the funds invested, see United States v. Pol-Flores, 644 F.3d 1, 2 (1st Cir. 2011).

With reference to the mail fraud statute, one commentator noted: “Congress almost surely contemplated a classic fraud in which the victim is induced by false representations to hand over money or tangible property to the defendant and the victim’s loss is the defendant’s gain.” Bradley, *supra* note 83, at 594.

The language of both the mail and wire fraud statutes clearly covers “obtaining money or property by means of false or fraudulent pretenses, representations, or promises” For the language of the mail and wire fraud statutes, see *supra* notes 11, 12.

that party to constitute mail and wire fraud, however, the defendant must have a duty to disclose to the victim,¹⁵⁰ although what creates such a duty is not so clear.¹⁵¹

¹⁵⁰ See *United States v. Browne*, 505 F.3d 1229, 1265 (11th Cir. 2007) (“We have also held that a defendant’s non-action or non-disclosure of material facts intended to create a false and fraudulent representation may constitute a violation of the mail fraud statute where the defendant had a duty, explicit or implicit, to disclose material information.”) (citing *United States v. Waymer*, 55 F.3d 564, 571 (11th Cir. 1995)); *Am. United Life Ins. Co. v. Martinez*, 480 F.3d 1043, 1065 (11th Cir. 2007) (“[N]ondisclosure of material information can constitute a violation of the mail and wire fraud statutes where a defendant has a duty to disclose either by statute or otherwise.”) (quoting *McCulloch v. PNC Bank Inc.*, 298 F.3d 1217, 1225 (11th Cir. 2002)); *United States v. Skelly*, 442 F.3d 94, 97 (2d Cir. 2006) (“[A] seller or middleman may be liable for [wire] fraud if he lies to the purchaser or tells him misleading half-truths, but not if he simply fails to disclose information that he is under no obligation to reveal.”); *Kemp v. AT&T Co.*, 393 F.3d 1354, 1359–60 (11th Cir. 2004) (citing *Ayres v. Gen. Motors Corp.*, 234 F.3d 514 (11th Cir. 2000)); *Ayres*, 234 F.3d at 521 (although finding no mail or wire fraud violations, stating “Plaintiffs rely primarily upon the theory that nondisclosure of material information can constitute a violation of the mail and wire fraud statutes where a defendant has a duty to disclose. Ample case law supports Plaintiffs’ legal theory.”); *Bonilla v. Volvo Car Corp.*, 150 F.3d 62, 70–71 (1st Cir. 1998) (“It would be a truly revolutionary change to make a criminal out of every salesman (assuming use of the mails or telephone) who did not take the initiative to reveal negative information about the product and who—a jury might find—harbored in his heart the hope that the buyer would never ask.”); *United States v. Cochran*, 109 F.3d 660, 664–67 (10th Cir. 1997) (reversing convictions for nondisclosure because of lack of duty, although stating in passing dictum: “Even apart from a fiduciary duty, in the context of certain transactions, ‘a misleading omission[] is actionable as fraud . . . if it is intended to induce a false belief and resulting action to the advantage of the misleader and the disadvantage of the misled.”); *id.* at 665, quoting *Emery*, 71 F.3d at 1348; *Reynolds v. E. Dyer Dev. Co.*, 882 F.2d 1249, 1252–53 (7th Cir. 1989). *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) (in the course of affirming convictions for wire fraud, stated: “when dealing with a claim of fraud based on material omissions, it is settled that a duty to disclose ‘arises [only] when one party has information that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’”) (quoting *Chiarella v. United States*, 445 U.S. 222, 228 (1980)) (alterations in original). Nevertheless, *Szur* held that the defendant securities brokers had a duty to disclose their “exorbitant” 45% or 50% commissions “even in the absence of any general fiduciary duty resulting from discretionary authority.” 289 F.3d at 212; *Cf. Langford v. Rite Aid of Ala., Inc.*, 231 F.3d 1308, 1312–13 (11th Cir. 2000) (“[C]oncealment of critical data, even without a formalized duty to disclose that data, can constitute mail and/or wire fraud in certain circumstances We can envision many situations in which a failure to disclose information could constitute [mail/wire] fraud . . . even when

no duty to disclose exists independently,” nevertheless, the court found no mail/wire fraud duty to disclose under the circumstances of the case); *United States v. Colton*, 231 F.3d 890, 898–904 (4th Cir. 2000) (distinguishing between simple nondisclosure and concealment in federal *bank* fraud case; finding the defendant guilty of concealment and therefore guilty of *bank* fraud); *United States v. Autuori*, 212 F.3d 105, 118 (2d Cir. 2000) (stating in dictum, “The fraud statutes are violated by affirmative misrepresentations or by omissions of material information that the defendant has a duty to disclose.”); *United States v. Morris*, 80 F.3d 1151, 1161 (7th Cir. 1996) (“[T]he statutes apply not only to false or fraudulent representations, but also to the omission or concealment of material information, even where no statute or regulation imposes a duty of disclosure.”); *United States v. Dowling*, 739 F.2d 1446, 1449 (9th Cir. 1984) (where nondisclosure was to third party copyright owners by defendant manufacturer and distributor of “bootleg” phonograph recordings, court stated “[N]on-disclosure can only serve as a basis for a fraudulent scheme when there exists an independent duty that has been breached by the person so charged.”; in that case, court held that because nondisclosure violated an independent statutory duty, nondisclosure constituted mail fraud); *see id.* at 1449–50); *United States v. Bronston*, 658 F.2d 920, 926 (2d Cir. 1981) (“the concealment by a *fiduciary* of material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to the other is a violation of the statute”) (emphasis added); *Odyssey Re (London) Ltd. v. Stirling Cooke Brown Holdings, Ltd.*, 85 F. Supp. 2d 282, 302 (S.D.N.Y. 2000) (“An omission cannot give rise to a claim of mail or wire fraud liability absent a duty to disclose.”) (citations omitted).

¹⁵¹ *See United States v. Mahaffy*, 693 F.3d 113, 125 (2d Cir. 2012) (not a mail/wire fraud case; [T]he concealment by a fiduciary of material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to another is a violation of [the fraud statutes]’ Although this rule may not be ‘used in bootstrap fashion by finding an obligation to disclose in every breach of fiduciary duty’) (quoting mail fraud opinion in *United States v. Newman*, 664 F.2d 12, 19 (2d Cir. 1981)), *overruled on other grounds by McNally v. United States*, 484 U.S. 350 (1987); *Sanchez v. Triple-S Mgmt. Corp.*, 492 F.3d 1, 10 (1st Cir. 2007) (“A defendant’s failure to disclose information, without more, cannot make out a violation of the mail and wire fraud statutes.”); *id.* at 10–11 (discussing, without concluding, the issue whether “more” requires either (1) a duty to disclose or (2) just withholding information with the intent to deceive), discussed in PAUL A. BATISTA, *CIVIL RICO PRACTICE MANUAL* § 411E (3d ed. 2015)); *United States v. Gray*, 405 F.3d 227, 235–36 (4th Cir. 2005) (in affirming mail/wire fraud convictions, stating “Even in the absence of a fiduciary, statutory, or other independent legal duty to disclose material information, common-law fraud includes acts taken to conceal, create a false impression, mislead, or otherwise deceive in order to prevent the other party from acquiring material information.”) (quoting the federal bank fraud case of *United States v. Colton*, 231 F.3d 890, 898 (4th Cir. 2000)).

One commentator has attempted the following summary of when a mail/wire fraud duty to disclose exists:

Cf. *United States v. Dowling*, 739 F.2d 1446, 1449 (9th Cir. 1984) (“[N]on-disclosure can only serve as a basis for a fraudulent scheme when there exists an independent duty that has been breached by the person so charged.”); for additional discussion, see *supra* note 150; *Langford v. Rite Aid of Ala., Inc.*, 231 F.3d 1308, 1312–13 (11th Cir. 2000) (vague standard quoted above in note 150).

For a district court’s application of *Langford*’s vague standard to grant the defendant’s motion for summary judgment in a civil RICO action based on the predicate offenses of mail and wire fraud, see *Bradley v. Franklin Collection Serv.*, No. 5:10-cv-01537-AKK, 2013 WL 1456714, at *6–7 (N.D. Fla. Mar. 28, 2013). For a trial court decision applying *Langford*’s vague standard to dismiss a civil RICO action based on the predicate offenses of mail and wire fraud, see *Merkle v. Aetna Health, Inc.*, No. 04-61713-CIV, 2006 WL 6151455, at *3–*4 (S.D. Fla. Apr. 27, 2005). For an opinion applying *Langford*’s vague standard to refuse to dismiss a private civil RICO class action based on mail and wire fraud as predicate offenses, see *In re Managed Care Litig.*, 298 F. Supp. 2d, 1259, 1277–79 (S.D. Fla. 2003). Quoting the First Circuit, the Tenth Circuit has stated:

A defendant’s failure to disclose information, without more, cannot make out a violation of the mail and wire fraud statutes. The authorities are less uniform on what “more” must be shown to transform a non-actionable nondisclosure into fraud in this context. Some courts have required a duty to disclose, triggered by an independent statutory scheme, the relationship between the parties, or the defendant’s partial or ambiguous statements that require further disclosure in order to avoid being misleading, while others have held that withholding information with the intent to deceive is enough.

United States v. Gallant, 537 F.3d 1202, 1228–29 (10th Cir. 2008) (quoting *Sanchez v. Triple-S Mgmt. Corp.*, 492 F.3d 1, 10 (1st Cir. 2007)). In *Gallant*, two prospective buyers of bank stock (or their representatives) personally visited two defendants and asked them questions about the bank and its operations. *See id.* at 1210–19. The defendants did not disclose certain problems. *Id.* Nor did they disclose the fact that they were opening bogus accounts and disguising delinquencies. *See id.* at 1216–17, 1229. The court held that the two defendants’ “conduct went well beyond non-actionable non-disclosure and became ‘deceitful concealment of material facts,’ thus implicating [the defendants] in the wire fraud scheme.” *Id.* at 1229 (quoting *United States v. Cochran*, 109 F.3d 660, 665 (10th Cir. 1997)).

In *United States v. Brennan*, one government allegation was that the defendant violated the mail fraud statute in part because of nondisclosure of conflict of interest. *See* 183 F.3d 139, 141 (2d Cir. 1999). Whether the defendant had a duty to disclose under the mail fraud statute depended in part on whether the defendant had a fiduciary duty to the alleged victims. *See id.* at 141, 149–50. The Second Circuit questioned the accuracy of the trial court’s jury instruction attempting to define the nature of fiduciary duties. *See id.* at 150–51.

[M]ost courts recognize that in appropriate circumstances, a duty to disclose [under mail/wire fraud] may be inferred from the relationship between the parties. In jurisdictions that allow a less formal relationship to give rise to a duty, the determination as to whether the duty exists is made on a case by case basis, taking into account both the nature of the transaction and the relationship between the parties.¹⁵²

The 1940 Second Circuit decision of *United States v. Buckner*¹⁵³ affirmed certain mail fraud and mail fraud conspiracy convictions of defendants who participated in a scheme to profit from purchasing bonds based on nonpublic information.¹⁵⁴ The two principal defendants were members of a bondholder's protective committee.¹⁵⁵ The court held that use of a position on the committee "to obtain secret profits based upon inside information . . . [was] an active [mail] fraud on the bondholders."¹⁵⁶ This language is not clear whether "the bondholders" were mail fraud victims in their capacity as indirect *employers* of the defendants or as prospective *sellers* to the conspirators.

Nevertheless, the court noted: "[U]nlike the ordinary protective committee, which purports to represent only those holders who have made a deposit of their bonds, this committee asked for no deposit, but assumed to represent the bondholders generally and the committee reported to them generally . . ." ¹⁵⁷ This emphasis on a duty to *all* bondholders suggests that the court may have viewed the victims of the prospective insider trade as the bondholders who would sell to the insider trader. Were the victim the employer (in this case, the

¹⁵² 2 BRICKEY, *supra* note 11, § 8.42, text accompanying nn.516.06 & 516.07 (footnotes omitted). For an additional brief discussion of when a duty to disclose exists, see ANDROPHY, *supra* note 13, § 8:4

¹⁵³ 108 F.2d 921 (2d Cir. 1940).

¹⁵⁴ *See id.* at 924–27, 930.

¹⁵⁵ *See id.* at 923.

¹⁵⁶ *Id.* at 926.

¹⁵⁷ *Id.* at 927.

committee and, indirectly, the bondholders represented by the committee), it would make no difference whether the committee represented some or all of the bondholders.¹⁵⁸

A similarity exists between the *Buckner* defendants and corporate “insiders.” The *Buckner* defendants worked for a protective committee that represented all the holders of a bond issue.¹⁵⁹ Corporate “insiders,” such as directors, officers, independent contractors, and even lower-level employees, work for an issuing corporation for the benefit of all the shareholders. By analogy to Exchange Act Section 10(b) and SEC Rule 10b-5, such corporate insiders may have a *mail/wire fraud* “special” or “classical” relationship with the shareholders.¹⁶⁰ Insiders who buy shares based on material nonpublic information may commit mail and wire fraud by breaching a fiduciary or quasi-fiduciary duty to disclose to the shareholder in contractual privity.¹⁶¹ An insider who *sells* shares to someone not yet a shareholder might still owe a fiduciary or quasi-fiduciary duty to

¹⁵⁸ For discussion of whether a creditor committee member has a Rule 10b-5 “classical relationship” with any *represented* creditor, see WANG & STEINBERG, *supra* note 1, § 5.2.6[C] nn.375–76 and accompanying text. For discussion of the more general issue of whether a corporate insider who trades the company’s debt instruments has a Rule 10b-5 “classical relationship” with the party on the other side, see *id.* § 5.2.6[C]. For related discussion, see *supra* note 140 and accompanying text.

¹⁵⁹ See *supra* note 161 and accompanying text.

¹⁶⁰ For a discussion of the “classical relationship” under Section 10(b)/Rule 10b-5 between employees/independent contractors of an issuer and the shareholders, see WANG & STEINBERG, *supra* note 1, §§ 5.2.3[A], 5.2.3[B].

¹⁶¹ *Cf.* *United States v. Szur*, 289 F.3d 200, 207, 211 (2d Cir. 2002) (in the course of affirming convictions for wire fraud, stating: “when dealing with a claim of fraud based on material omissions, it is settled that a duty to disclose ‘arises [only] when one party has information that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’” (quoting Rule 10b-5 classical relationship language of *Chiarella v. United States*, 445 U.S. 222, 228 (1980)) (alterations in original)) Nevertheless, *Szur* held that the defendant securities brokers had a duty to disclose their “exorbitant” 45% or 50% commissions “even in the absence of any general fiduciary duty resulting from discretionary authority.” *Szur*, 289 F.3d at 212; *United States v. DeCastris*, 798 F.2d 261, 263 (7th Cir. 1986) (“Concealing information known to be pertinent to a proper decision may be a fraudulent scheme [under mail fraud].”). For discussion of the Section 10(b)/Rule 10b-5 “classical relationship” duty to the party on the other side of the trade, see WANG & STEINBERG, *supra* note 1, § 5.2.1 (discussing the “classical relationship” triangle).

disclose to that *prospective* shareholder who becomes one simultaneous with the trade.¹⁶²

Under the “special” or “classical” relationship mail/wire fraud approach, the government should be able to prosecute for mail and wire fraud even if the party in contractual privity with an insider trader cannot be identified after the fact.¹⁶³ The defendant must have traded with someone; therefore a victim exists. Even if the party in privity would have traded anyway,¹⁶⁴ she can still be a victim of mail and wire fraud: the party in privity is a victim of the *nondisclosure*, not of the *trade*.¹⁶⁵

¹⁶² For the Section 10(b)/Rule 10b-5 analogy, see *Chiarella v. United States*, 445 U.S. 222, 227 n.8 (1980); WANG & STEINBERG, *supra* note 1, § 5.2.1 n.49 and accompanying text.

¹⁶³ Identifying the party in privity after the fact is sometimes possible and sometimes not. *See id.* § 6.7 nn.485–96 and accompanying text. For related discussion, see *infra* note 197 and accompanying text.

United States v. Howard, 619 F.3d 723, 727 (7th Cir. 2010), held: “We have previously determined, however, that this type of fraud [mail and wire fraud] does not include an element requiring a contemplated harm to a specific, identifiable victim.” (quoting *United States v. Henningsen*, 387 F.3d 585, 590 (7th Cir. 2004)).

Also quoting *Henningsen*, *United States v. Munoz*, 430 F.3d 1357, 1369 (11th Cir. 2005), held: “The crime of mail fraud does not include an element requiring a contemplated harm to a specific, identifiable victim.”

¹⁶⁴ *See* WANG & STEINBERG, *supra* note 1, § 3.3.3.

¹⁶⁵ For discussion of the distinction between trade victims and nondisclosure victims, see *id.* § 3.2; William K.S. Wang, *The Importance of “The Law of Conservation of Securities”: A Reply to John P. Anderson’s “What’s the Harm in Issuer-Licensed Insider Trading?”*, 69 U. MIAMI L. REV. 811, 812–13, 824 (2015). For extended discussion of trade victims, see WANG & STEINBERG, *supra* note 1, § 3.3. For extended discussion of nondisclosure victims, see *id.* § 3.4, especially § 3.4.3[A].

Even were one to focus *unnecessarily* on the party on the other side as a *trade* victim (as opposed to a nondisclosure victim), at least one circuit court has stated that pecuniary loss to the victim is not necessary as long as pecuniary gain to the defendant is present. *See United States v. Blinder*, 10 F.3d 1468, 1472–73 (9th Cir. 1993). *See also United States v. Akpan*, 407 F.3d 360, 370 (5th Cir. 2005) (defendant acts with the intent to defraud when he “acts knowingly with the specific intent to deceive for the purpose of causing pecuniary ‘loss to another or bringing about some financial gain to himself.’”) (quoting *United States v. Blocker*, 104 F.3d 720, 732 (5th Cir. 1997)) (emphasis added). *Cf. United States v. Dixon*, 536 F.2d 1388, 1399 (2d Cir. 1976) (“[W]e have been cited to no case, and our research has discovered none, which has sustained a conviction for mail

*United States v. Ruggiero*¹⁶⁶ involved two insider trading defendants convicted of wire fraud and of securities fraud under SEC Rules 10b-5¹⁶⁷ and 14e-3.¹⁶⁸ One defendant was a senior auditor employed at Vista Chemical Company.¹⁶⁹ Allegedly, this defendant gave a friend (the other defendant) material nonpublic information about a takeover of Vista.¹⁷⁰ Both defendants profited by buying Vista call options prior to the takeover announcement.¹⁷¹

Applying a traditional *Chiarella/Dirks* analysis,¹⁷² the Fifth Circuit rejected the tippee's challenge to the sufficiency of the evidence and affirmed his securities fraud convictions under the "classical relationship" theory under Exchange Act Section 10(b) and SEC Rule 10b-5.¹⁷³ In only two sentences at the end of the opinion, the court

fraud on the basis of nothing more than the failure to mail a correct proxy solicitation where this was not in furtherance of some larger scheme contemplating pecuniary loss to someone *or* pecuniary gain to those who designed it.") (emphasis added). *But cf.* *United States v. Jain*, 93 F.3d 436, 441 (8th Cir. 1996) ("the government must show that some actual harm or injury was *contemplated* by the schemer") (quoting *United States v. D'Amato*, 39 F.3d 1249, 1257 (2d Cir. 1994)); *United States v. Ruggiero*, 56 F.3d 647, 656 (5th Cir. 1995) ("[t]he government must prove a specific intent to defraud, which requires a showing that the defendant intended for some harm to result from his deceit.") (quoting *United States v. Loney*, 959 F.3d 1332, 1337 (5th Cir. 1992)).

Another circuit case suggested that an intended victim may not be essential when it approved a jury instruction stating "that intent to defraud could be found if the defendants acted 'knowingly with the specific intent to deceive ordinarily for the purpose of causing some financial loss to another *or bringing about some financial gain to oneself*.'" *United States v. Judd*, 889 F.2d 1410, 1414 (5th Cir. 1989) (quoting district court's jury instruction on the mail and wire fraud charges) (alterations in original).

For discussion of the judicial division over whether the mail/wire fraud statutes require a scheme that *contemplates* a loss to the victim, see 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.8. For general discussion of the requisite intent to defraud, see *supra* note 19 and accompanying text.

¹⁶⁶ 56 F.3d 647 (5th Cir. 1995).

¹⁶⁷ *See id.* at 649, 653–55. For discussion of the application of SEC Rule 10b-5 to insider trading defendants, see WANG & STEINBERG, *supra* note 1, chs. 4, 5.

¹⁶⁸ *See Ruggiero*, 56 F.3d at 649, 655. For discussion of SEC Rule 14e-3, see WANG & STEINBERG, *supra* note 1, ch. 9.

¹⁶⁹ *See Ruggiero*, 56 F.3d at 649.

¹⁷⁰ *See id.* at 649–51, 654–56.

¹⁷¹ *See id.* at 650.

¹⁷² *See id.* at 654–55. For discussion of the *Chiarella* and *Dirks* Supreme Court decisions, see WANG & STEINBERG, *supra* note 1, §§ 5.2, 5.3.

¹⁷³ *See Ruggiero*, 56 F.3d at 653–56.

affirmed the same defendant's wire fraud convictions: "As noted above, we reject . . . the contention that there was insufficient evidence to support the securities law convictions. Accordingly, we find that there was sufficient evidence that . . . [the defendant] used the wires in furtherance of the fraud, thereby violating 18 U.S.C. § 1343."¹⁷⁴ Apparently, the Fifth Circuit imported the Rule 10b-5 classical relationship theory to wire fraud. Such a theory involves fraud on *the party on the other side* of the insider trade.¹⁷⁵

Uncertain is whether, for stock market insider traders, the required mail/wire fraud relationship is narrower, broader, or the same as the necessary Rule 10b-5 "classical relationship." Thus far, virtually no courts have explored the insider trader's mail/wire fraud duty to disclose to the party on the other side of the trade.

3. CAN AN INSIDER TRADER HAVE TWO MAIL/WIRE FRAUD VICTIMS: THE ISSUER/INFORMATION-OWNER AND THE PARTY ON THE OTHER SIDE OF THE TRANSACTION?

Suppose an employee of a public company trades its shares based on material nonpublic information. Does the insider trade have two mail/wire fraud victims: the issuer/information-owner and the party on the other side of the transaction?

Because the *Carpenter* defendants committed mail/wire fraud by misappropriating the *Wall Street Journal's* confidential informational property¹⁷⁶ and because O'Hagan perpetrated mail fraud by misappropriating informational property from his law firm and its client,¹⁷⁷ the hypothetical corporate employee might misappropriate her employer's confidential informational property. As discussed above, another mail/wire fraud victim of the employee might be the

¹⁷⁴ *Id.* at 656.

¹⁷⁵ See WANG & STEINBERG, *supra* note 1, § 5.2.1.

¹⁷⁶ See *Carpenter v. United States*, 484 U.S. 19 (1987). For discussion of *Carpenter*, see *supra* notes 63–83 and accompanying text.

¹⁷⁷ See *United States v. O'Hagan*, 521 U.S. 642, 678–79, 700–01 (1997) (applying *Carpenter*, 484 U.S. 19); *United States v. O'Hagan*, 139 F.3d 641, 651–53 (8th Cir. 1998) (citing *Carpenter*, 484 U.S. 19). For discussion of both the Supreme Court and Eighth Circuit (on remand) *O'Hagan* opinions, see *supra* notes 84–97 and accompanying text.

party on the other side of the trade.¹⁷⁸ The courts have not considered whether the same conduct could have two separate mail/wire fraud victims under two different theories.¹⁷⁹

4. MATERIALITY

In *Neder v. United States*,¹⁸⁰ the Supreme Court imposed a materiality requirement for mail/wire fraud.¹⁸¹ *Neder* said “a false statement is material if it has ‘a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed.’”¹⁸² Additionally, while discussing the *defendant’s* argument that Congress implicitly incorporated the common law definition of materiality into the mail/wire fraud statutes, the Court included a footnote quoting the Restatement (Second) of Torts’ definition of a material matter:

(a) a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question; or (b) the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of

¹⁷⁸ See *supra* Part II(B)(2).

¹⁷⁹ For discussion of the related question whether an employee trading her company’s stock based on material nonpublic information can violate *both* the SEC Rule 10b-5 misappropriation doctrine and the “classical relationship” theory, see WANG & STEINBERG, *supra* note 1, § 5.4.11.

Were such Rule 10b-5 overlap permitted, and were the tests for tipper/tippee liability laxer for Rule 10b-5 misappropriation than for the Rule 10b-5 “classical relationship,” prosecutors, the SEC, and private plaintiffs might prefer pursuing tippers and tippees under misappropriation rather than the “classical relationship.” For discussion of the Rule 10b-5 liability of tippers and tippees under both theories, see *infra* Part II(B)(5); WANG & STEINBERG, *supra* note 1, §§ 5.3, 5.4.4–5.4.10. The Supreme Court has not addressed tipper and tippee liability under the Rule 10b-5 misappropriation doctrine.

¹⁸⁰ 527 U.S. 1 (1999).

¹⁸¹ See *id.* at 20–25; *id.* at 25 (“materiality of falsehood is an element of the federal mail fraud, wire fraud . . . statutes”). For discussion of *Neder*, see 2 BRICKEY, *supra* note 11, § 8:48; Cloud & Shepherd, *supra* note 56, at 948.

¹⁸² *Neder*, 527 U.S. at 16 (quoting *United States v. Gaudin*, 515 U.S. 506, 509 (1995)).

Generally, a jury decides the question of materiality. See *United States v. Harms*, 442 F.3d 367, 373 (5th Cir. 2006).

action, although a reasonable man would not so regard it.¹⁸³

Restatement Section 538(2)(a) goes beyond the “reasonable person” standard.¹⁸⁴ Nevertheless, some circuits *may* endorse the “reasonable person” or “person of ordinary prudence” definition: mail/wire fraud is material only if a “reasonable person” would attach importance to the misstatement or nondisclosure.¹⁸⁵ Other cir-

¹⁸³ *Neder*, 527 U.S. at 22 n.5 (quoting RESTATEMENT (SECOND) OF TORTS § 538 (AM. LAW INST. 1977)).

¹⁸⁴ RESTATEMENT (SECOND) OF TORTS § 538, clause 2, (a) cmt. includes the following statement:

Even though the matter misrepresented is one to which a reasonable man would not attach any importance in determining his course of action in the transaction in hand, it is nevertheless material if the maker knows that the recipient, because of his own peculiarities, is likely to attach importance to it. There are many persons whose judgment, even in important transactions, is likely to be determined by considerations that the normal man would regard as altogether trivial or even ridiculous. One who practices upon another’s known idiosyncracies cannot complain if he is held liable when he is successful in what he is endeavoring to accomplish.

See also Cloud & Shepherd, *supra* note 56, at 948 “[A] lie not capable of misleading a reasonable person is still material if a victim is so gullible, guileless, or incompetent that he actually believes it.”)

¹⁸⁵ *See, e.g.*, *United States v. Jamieson*, 427 F.3d 394, 415–16 (6th Cir. 2005). *Accord* 2 BRICKEY, *supra* note 11, § 8:58 n.729.115–729.120 and accompanying text; 2 WELLING, BEALE, & BUCY, *supra* note 14, § 17.7(B), at 13–15; Lauren D. Lunsford, Note, *Fraud, Fools, and Phishing: Mail Fraud and the Person of Ordinary Prudence in the Internet Age*, 99 KY. L.J. 379, 389–91 (2010-2011). *Cf.* *Linden v. United States*, 254 F.2d 560, 566 (4th Cir. 1958) (while affirming convictions, quoting district court’s holding that “the defendants had engaged in ‘a scheme reasonably calculated to deceive persons of ordinary prudence and comprehension.’”); *United States v. Hawkey*, 148 F.2d 920, 924 (8th Cir. 1998) (pre-*Neder*; affirming convictions; in passing, saying scheme must be “‘reasonably calculated to deceive persons of ordinary prudence and comprehension.’”) (quoting *United States v. Coyle*, 63 F.3d 1239, 1243 (3d Cir. 1995)). *But cf.* *United States v. Svete*, 556 F.3d 1157, 1168 (11th Cir. 2009) (en banc) (“[The defendants] cite decisions that use the ‘ordinary prudence’ language as evidence that fraud requires a scheme capable of defrauding the reasonably prudent, but none of the decisions cited by [the defendants] . . . overturned a conviction on the

circuits have abandoned the “reasonable person” standard of materiality in favor of the broader formulation: capable of influencing the intended victim.

In *United States v. Brown*, the Eleventh Circuit held: “mail fraud requires the government to prove that a reasonable person would have acted on the representations.”¹⁸⁶ In 2009, however, in *United States v. Svete*,¹⁸⁷ the Eleventh Circuit *en banc* overruled *Brown*¹⁸⁸ and held:

[P]roof of objective reliability is not necessary to establish materiality if the defendant knows or should know that the victim is likely to regard the misrepresented facts as important [A] defendant who intends to deceive the ignorant or gullible by preying on their infirmities is no less guilty.¹⁸⁹

Citing other circuits that rejected *Brown*, *Svete* noted: “*Brown* still stands alone. It has been rejected by other circuits. It has been distinguished on debatable grounds within our Circuit. It has been criticized in legal scholarship.”¹⁹⁰

ground that the scheme was incapable of deceiving persons of ordinary prudence.”); *United States v. Heppner*, 519 F.3d 744, 749 (8th Cir. 2008) (“if it has a natural tendency to influence or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed.”) (quoting *Preston v. United States*, 312 F.3d 959, 961 n.3 (8th Cir. 2002)) (alteration in original); *United States v. McAuliffe*, 490 F.3d 526, 531 (6th Cir. 2007) (quoting *Neder*, 527 U.S. at 16) (“material if it has a natural tendency to influence, or is capable of influencing, the decision of the decision-making body to which it was addressed.”); *United States v. Hively*, 437 F.3d 752, 764 (8th Cir. 2006) (“A misrepresentation is material if it is capable of influencing the intended victim.” (citing *Neder*, 527 U.S. at 24)); Mark Zingale, Note, *Fashioning a Victim Standard in Mail and Wire Fraud: Ordinarily Prudent Person or Monumentally Credulous Gull?*, 99 COLUM. L. REV. 795, 807 (1999) (“The circuits that use the objective [reasonable person] standard usually invoke it while affirming the lower courts’ convictions); *id.* at 807–08 (concluding that *Linden v. United States* in fact “extended the statute’s protection, which it saw as purposely broad, beyond the ordinarily prudent person in order to reach those victims who were less than ordinarily prudent.

¹⁸⁶ 79 F.2d 1550, 1557 (11th Cir. 1996).

¹⁸⁷ 556 F.3d 117 (11th Cir. 2009) (en banc).

¹⁸⁸ See *id.* at 1166–70.

¹⁸⁹ *Id.* at 1165.

¹⁹⁰ *Id.* at 1167. For discussion of *Svete*, see 2 BRICKEY, *supra* note 11, §§ 8:32, 8:58.

Likewise, in the Seventh Circuit decision, *United States v. Coffman*, Chief Justice Posner rejected *Brown* in ringing terms in interpreting the materiality requirement for mail/wire fraud:

But it is hard to believe that this language is intended to be understood literally, for if it were it would invite con men to prey on people of below-average judgment or intelligence, who are anyway the biggest targets of such criminals and hence the people most needful of the law's protection-and most needful or not are within its protective scope.¹⁹¹

¹⁹¹ *Id.* at 334.

For an example of another circuit that rejected *Brown*, see *United States v. Amico*, 486 F.3d 764, 780 (2d Cir. 2007) (“The majority of circuits to address the issue have rejected [*Brown*].”). Earlier, the Second Circuit had decided *United States v. Thomas*, 377 F.3d 232 (2d Cir. 2004), a case involving not mail/wire fraud but inducement of travel in interstate commerce for a fraudulent purpose in violation of 18 U.S.C. § 2314. *Thomas* noted: “Most circuits . . . have already rejected some form of the ‘unreasonable victim’ [defense] argument.” *Id.* at 243. In *Amico*, 486 F.3d at 780, the Second Circuit extended its *Thomas* reasoning to mail fraud.

For other decisions rejecting the “reasonable person” standard, see *United States v. Hanley*, 190 F.3d 1017, 1023 (9th Cir. 1999) (citing *Lemon v. United States*, 278 F.2d 369, 373 (9th Cir. 1960)); *United States v. Sun-Diamond Growers of Cal.*, 138 F.3d 961, 971 (D.C. Cir. 1998) (citing *United States v. Brien*, 617 F.2d 299 (1st Cir. 1980)) (defendant does not escape liability if victim was unwary or even gullible; citing *Brien*); *Brien*, 617 F.2d at 311 (“[I]t makes no difference whether the persons the schemers intended to defraud are gullible or skeptical, dull or bright.”). See ANDROPHY, *supra* note 13, § 8:7; 2 BRICKEY, *supra* note 11, § 8:48 n.870.200 and accompanying text (“a statement may be material whether or not anyone relies on it or even if the recipient knew of should have known it was false”); *id.* § 8:58 n.726. See also *id.* § 8:58 n.729.130 and accompanying text.

The court in *United States v. Masten* said that while the reasonable person standard might be useful in deciding whether the defendant had intent to defraud (e.g., when the defendant claims she was joking), once the defendant has the requisite intent, and dupes the victim, it makes no difference whether the victim was “reasonable.” 170 F.3d 790, 795–96 (7th Cir. 1999) (“[A]s we explained in *Coffman*, the mail fraud statute also protects unreasonable persons.”).

As just mentioned (see *supra* text at note 183), *Neder* said that one possible definition of materiality was: “a false statement is material if it has ‘a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed.’” 527 U.S. at 16 (quoting *United States v. Gaudin*, 515 U.S. 506, 509 (1995)) (emphasis added). For cases adopting similar definitions of materiality, see *United States v. Maxwell*, 579 F.3d 1282, 1299

In those circuits that have adopted the “capable of influencing the intended victim” test, the materiality definition for mail/wire fraud is laxer than the “reasonable person” materiality standard for SEC Rule 10b-5.¹⁹²

(11th Cir. 2009) (quoting *United States v. Hasson*, 333 F.3d 1264, 1271 (11th Cir. 2003)) (“if it has ‘a natural tendency to influence, or [is] capable of influencing the decision maker to whom it is addressed.’”); *United States v. Blixt*, 548 F.3d 882, 888 (9th Cir. 2008) (describing inquiry as “[w]hether the statement has a natural tendency to influence, or is capable of influencing, the addressee’s decision.”) (quoting *United States v. Tarallo*, 380 F.3d 1174, 1182 (9th Cir. 2004)); *United States v. Jackson*, 546 F.3d 801, 815 (7th Cir. 2008) (quoting *Neder*, 527 U.S. at 16); *United States v. Heppner*, 519 F.3d 744, 749 (8th Cir. 2008); *United States v. Lucas*, 516 F.3d 316, 339 (5th Cir. 2008) (describing materiality as “[having] a natural tendency to influence, or is capable of influencing, the decision of the decision-making body to which it was addressed.”) (quoting *United States v. Harms*, 442 F.3d 367, 372 (5th Cir. 2006)); *United States v. Rosby*, 454 F.3d 670, 674 (7th Cir. 2006) (“A representation is material if it has a tendency to influence the decision of the audience to which it is addressed.”) (citing *Neder*, 527 U.S. at 22–23); *United States v. Hively*, 437 F.3d 752, 764 (8th Cir. 2006); *United States v. Lawrence*, 405 F.3d 888, 899 (10th Cir. 2005) (approving a jury instruction that a statement is material if “it has a natural tendency to influence, or is capable of influencing a decision or action by another.”); *United States v. Henningsen*, 387 F.3d 585, 589 (7th Cir. 2004) (“A false statement is material if it has ‘a natural tendency to influence, or is capable of influencing, the decision of the decisionmaking body to which it is addressed.’”) (quoting *United States v. Fernandez*, 282 F.3d 500, 508 (7th Cir. 2002)); *United States v. Tarallo*, 380 F.3d 1174, 1182–83, 1190 (9th Cir. 2004) (“whether the statement has a natural tendency to influence, or is capable of influencing, the addressee’s decision”) (citing *United States v. LeVeque*, 283 F.3d 1098, 1103–1104 (9th Cir. 2002)).

For discussion of the split among the circuits and an argument against the “person of ordinary prudence” standard, see Lunsford, *supra* note 186. For additional discussion of the split among the circuits, see 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.7(B); Zingale, *supra* note 186. *Cf. Doyle Chapter, supra* note 13, at 4 (discussing the issue “whether the statutes reach schemes designed to deceive the gullible though they would not ensnare the reasonably prudent.”).

¹⁹² For discussion of the materiality standard for SEC Rule 10b-5, see *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (“[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder [investor] would consider it important in deciding how to vote [whether to buy or sell].”) (quoting *TSC Industries, Inc. v. Northway*, 462 U.S. 438, 449 (1976); *id.* at 231–32 (“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.”) (quoting *TSC Industries*, 462 U.S. at 449); WANG & STEINBERG, *supra* note 1, § 4.2.

A stock market trader may or may not know the identity of the party on the other side. The line between face-to-face stock trades and stock market transactions is blurry. Especially with large blocks, such trading often involves conversations between buyer and seller.¹⁹³

When the insider trader does not know the identity of the person on the opposite side, however, it may be difficult to apply the materiality standard: “capable of influencing, the decision of the decisionmaking body to which it was addressed.”¹⁹⁴ With an *anonymous* transaction, the courts might conceivably adapt this definition, with a result potentially different from the Rule 10b-5 standard.¹⁹⁵ For example, one possible mail/wire fraud adaptation would be: capable of influencing the decision of the typical investor or, alternatively, a reasonable investor.

When the victim is the information-owner, mail/wire fraud materiality may have a different meaning than when the victim is the party on the other side of a transaction.¹⁹⁶

With respect to “materiality,” one commentator has said: “There is no assurance that the mail fraud statute will be applied in a fashion consistent with Rule 10b-5. Mail fraud does not traditionally deal with materiality concepts, nor, of course, did *Carpenter* include a materiality test.” Dreeben, *supra* note 83, at 213. For discussion of two mail/wire fraud cases, *United States v. Weiss*, 752 F.2d 777 (2d Cir. 1985) and *United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983), in which the materiality definition was much broader than that under the federal securities laws, see Dreeben, *supra* note 83, at 189–91.}}

¹⁹³ See Dan Stumpf, *Markets Keeping Faith in Humanity*, WALL ST. J., July 29, 2014, at C1 (“Last year, about 55% of stock trading by dollar volume took place in a ‘high-touch’ fashion, among human beings communicating one on one and agreeing on the price.”).

For discussion of the blurred distinction between block trades and face-to-face trading, see WANG & STEINBERG, *supra* note 1, §§ 3.3.1, 8.2.2, 15.2.1; William K.S. Wang, *Stock Market Insider Trading: Victims, Violators and Remedies—Including an Analogy to Fraud in the Sale of a Used Car with a Generic Defect*, 45 VILLANOVA L. REV. 27, 30–31 (2000).

¹⁹⁴ *Neder*, 527 U.S. at 16 (quoting *United States v. Gaudin*, 515 U.S. 506, 509 (1995)). For additional discussion, see *supra* notes 183–85, 187–94 and accompanying text.

¹⁹⁵ For discussion of the definition of “materiality” under Rule 10b-5, see *supra* note 192.

¹⁹⁶ For a discussion of the definition of “materiality” under the Rule 10b-5 “misappropriation” doctrine of insider trading liability, see WANG & STEINBERG, *supra* note 1, § 4.2.1.

In Rule 10b-5 misappropriation cases, the courts have generally defined materiality in terms of a reasonable investor's decision to purchase or sell.¹⁹⁷ Arguably, however, the relevant standard of materiality in such cases should be the importance of the information to the information-source.¹⁹⁸ Similarly, in mail/wire fraud insider trading cases based on the deprivation of confidential informational property, arguably the relevant standard of materiality should be the importance to the property owner.¹⁹⁹

In its mail/wire fraud informational property decision, *Carpenter*, the Supreme Court did not mention materiality.²⁰⁰ Likewise, while addressing insider trading in *O'Hagan*,²⁰¹ the Supreme Court did not discuss materiality either for Rule 10b-5 or mail fraud.²⁰²

Outside the insider trading context, prior to *Skilling*,²⁰³ the Second Circuit *en banc* adopted the following test for finding a deprivation of "the intangible right to honest services": "the misrepresentation or omission at issue for an 'honest services' fraud conviction must be 'material,' such that the misinformation or omission would

¹⁹⁷ See *id.* § 4.2.1 n.44 and accompanying text.

¹⁹⁸ See *id.* § 4.2.1 nn.39–42, 45 and accompanying text.

¹⁹⁹ Cf. *United States v. Newman*, 664 F.2d 12, 19 (2d Cir. 1981) (an insider trading case quoting *United States v. Von Barta*, 635 F.2d 999, 1006 (2d Cir. 1980) ("an employee's breach of his fiduciary obligations is actionable under the [mail fraud] statute when it encompasses the violation of a 'duty to disclose material information to his employer.'") (emphasis added)).

²⁰⁰ See *Carpenter v. United States*, 484 U.S. 19 (1987). For discussion of *Carpenter*, see *supra* Part II(B)(1).

²⁰¹ 521 U.S. 642 (1997).

²⁰² See *id.* For discussion of *O'Hagan*, see *supra* notes 60–62, 84–96 and accompanying text.

On remand, the court in *United States v. O'Hagan* discussed materiality in the Rule 10b-5 part of the opinion, but not in its mail fraud portion. See 139 F.3d 641, 648, 651–53 (8th Cir. 1998). For additional discussion of this decision, see *supra* note 97 and accompanying text; *infra* notes 260–61 and accompanying text.

In *United States v. Cherif*, a mail/wire fraud stock market insider trading case, the court held that the defendant had waived his argument that the trial court had failed to instruct the jury that the information he obtained or sought to obtain was "material." See 943 F.2d 692, 700 (7th Cir. 1991).

²⁰³ The court in *Skilling v. United States* held that the "intangible right to honest services" applies only to bribery and kickback schemes. See 561 U.S. 358 (2010). For discussion of mail/wire fraud's application to the deprivation of "the intangible right to honest services," see *supra* note 71 and accompanying text.

naturally tend to lead or is capable of leading a reasonable *employer* to change its conduct.”²⁰⁴

In *United States v. Elliott*,²⁰⁵ the defendant was an attorney who allegedly engaged in wire fraud by insider trading on confidential client information thereby depriving his law firm and its clients of confidential informational property.²⁰⁶ The government conceded

²⁰⁴ *United States v. Rybicki*, 354 F.3d 124, 145 (2d Cir. 2003) (en banc) (emphasis added). *Rybicki* discussed the then judicial split (pre-*Skilling*) over the proper test for mail/wire fraud liability for “honest services fraud”: “reasonable foreseeable harm” to the employer or “materiality” to the employer. See *id.* at 145–46.

For additional discussion of this pre-*Skilling* split, see *United States v. Vinyard*, 266 F.3d 320, 327–28 (4th Cir. 2001); 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.19(B); Anita Cava & Brian M. Stewart, *Quid Pro Quo Corruption Is “So Yesterday”*: Restoring Honest Services Fraud After *Skilling* and Black, 12 U.C. DAVIS BUS. L.J. 1, 7–8 (2011); Andrew B. Matheson, *A Critique of United States v. Rybicki: Why Foreseeable Harm Should Be an Aspect of the Mens Rea of Honest Services Fraud*, 28 AM. J. TRIAL ADVOC. 355, 370–86 (2004–05); Lisa Kern Griffin, *The Federal Common Law Crime of Corruption*, 89 N.C. L. REV. 1815, 1842–43 (2011). For an example of a pre-*Skilling* Second Circuit “honest services” wire fraud opinion following *Rybicki*’s definition of materiality, see *United States v. Gotti*, 459 F.2d 296, 330 (2d Cir. 2006). For a pre-*Skilling* district court “honest services” case quoting *Rybicki*’s definition, see *World Wrestling Entm’t, Inc. v. Jakke Pac., Inc.*, 530 F. Supp. 2d 486, 502 (S.D.N.Y. 2007).

For another example of a pre-*Skilling* “honest services” case adopting the “materiality to employer” test, see *United States v. Ballard*, 663 F.2d 534, 541 (5th Cir. 1981) (materiality exists whenever an employee “has reason to believe that the information would lead a reasonable *employer* to change its business conduct.”) (emphasis added). See *United States v. Brown*, 459 F.3d 509, 519 (5th Cir. 2006) (citing *Ballard*, 663 F.2d at 541); *United States v. Gray*, 96 F.3d 769, 774–75 (5th Cir. 1996) (citing and quoting *Ballard*, 663 F.2d 534); *United States v. Lemire*, 720 F.2d 1327, 1338 (D.C. Cir. 1983) (quoting *Ballard*, 663 F.2d at 541); *United States v. Feldman*, 711 F.2d 758, 763 (7th Cir. 1983) (“only if the nondisclosed information was material to the conduct of the employer’s business”; honest services case”) (citing *Ballard*, 663 F.2d 534). For discussion of *Feldman*, see Bradley, *supra* note 83, at 597–99.

For pre-*Skilling* discussion of the materiality to employer requirement in “honest services” cases, see 2 WELLING, BEALE, & BUCY, *supra* note 15, § 17.19(A)(ii). For a post-*Skilling* circuit court decision adopting the “materiality to employer test” in a bribery-based “deprivation of honest services” scheme, see *United States v. Milovanovic*, 678 F.3d 713, 716, 726–28 (9th Cir. 2012) (citing *Gray*, 96 F.3d 769; *Rybyicki*, 354 F.3d 124; and other circuit court cases).

²⁰⁵ 711 F. Supp. 425 (N.D. Ill. 1989).

²⁰⁶ See *id.* at 426–29. For additional discussion of *Elliott*, see *supra* notes 101–03 and accompanying text.

that the “nonpublic information must have been of some importance to both Elliott and the *victims of the fraud* to constitute property.”²⁰⁷ The fraud victims were the law firm and its clients.²⁰⁸

Nevertheless, the court in *Elliott* held that the indictment sufficiently alleged that the confidential client information was *material* because the indictment stated that the defendant:

bought stock in companies he knew were targeted for acquisition, in the expectation that the price of the stock would rise when the acquisition became public. If the price of the stock was expected to rise when information about the acquisition became public, that information must have had some significance or, to use Elliott’s word, must have been “material.”²⁰⁹

Just because the defendant expected the information to cause a stock price increase when released does not necessarily mean that the information was material to the law firm or its clients.²¹⁰

Ironically, in its discussion of materiality under the Rule 10b-5 misappropriation doctrine, *Elliott* held that the proper definition was the importance to the employer/information-source and *not* outside investors:

In a misappropriation case, however, where the focus is on the insider’s duty to the corporation, it would be incongruous to have a materiality standard based on the outsider’s point of view. Rather, we believe it is enough if the misappropriated information is “solely for corporate purposes,” *Dirks*, 464 U.S. at

²⁰⁷ *Elliot*, 711 F. Supp. at 430 (quoting Government’s Response at 9) (emphasis added).

²⁰⁸ *See id.* at 426–29.

²⁰⁹ *Id.* at 430.

²¹⁰ Nevertheless, an insider trading case that apparently treated Rule 10b-5 and mail fraud materiality as equivalent is *United States v. Victor Teicher & Co., L.P.*, 785 F. Supp. 1137, 1150 (S.D.N.Y. 1992).

Similarly, in the course of refusing to dismiss an indictment for insider trading in violation of both Rule 10b-5 and wire fraud, a trial court applied *Levinson* and the Rule 10b-5 materiality definition in its three-paragraph discussion of materiality under *both* Rule 10b-5 and wire fraud. *See United States v. ReBrook*, 837 F. Supp. 162, 169 (W.D. Va. 1993).

655 . . . and if a reasonable corporate executive would believe keeping that information confidential was valuable to the corporation.²¹¹

In any event, for mail/wire fraud liability for stock market insider trading, materiality *may* have a standard that is:

- (1) *laxer* (beyond “reasonable person”) or
- (2) in cases involving deprivation of informational property, *different* (importance to the owner of the information as opposed to a stock market investor).

5. “PERSONAL BENEFIT” TEST FOR TIPPER LIABILITY AND “KNOW OR SHOULD HAVE KNOWN OF INITIAL TIPPER’S BREACH” TEST FOR TIPPEE LIABILITY

Under the Rule 10b-5 “classical relationship” theory and *probably* the Rule 10b-5 misappropriation doctrine, the initial tipper must receive a “personal benefit.”²¹² Under the Rule 10b-5 “classical relationship” theory and *probably* the Rule 10b-5 misappropriation doctrine, each direct and remote tippee must “know or should know” of the initial tipper’s violation.²¹³ With Rule 10b-5 misappropriation, however, the Supreme Court has not addressed the standard for tipper and tippee liability.

²¹¹ 711 F. Supp. at 433.

²¹² See *United States v. Newman*, 773 F.3d 438, 446–47 (2d Cir. 2014), *cert. denied*, 2015 WL 4575840 (U.S., Oct. 5, 2015); *id.* at 446 (“The elements of tipping liability are the same regardless of whether the tipper’s duty arises under the “classical” or the “misappropriation” theory.”) (citing *SEC v. Obus*, 693 F.3d 276, 285–86 (2d Cir. 2012)); *SEC v. Yun*, 327 F.3d 1263, 1274–80 (11th Cir. 2003) (applying “personal benefit” test to misappropriating tipper); WANG & STEINBERG, *supra* note 1, §§ 5.2.8, 5.4.4. For the Supreme Court’s “personal benefit” test for tipper liability in a Rule 10b-5 *classical relationship* case, see *Dirks v. SEC*, 463 U.S. 646, 662–64 (1963); WANG & STEINBERG, *supra* note 1, § 5.2.8. For application of the *Dirks* test for tipper liability, see *Newman*, 773 F.3d at 446, 451–53 (discussed *infra* at notes 222–230 and accompanying text).

²¹³ See *SEC v. Obus*, 693 F.3d 276, 287–89 (2d Cir. 2012) (stating misappropriator’s tippee must “know or should know” of the initial tipper’s violation); WANG & STEINBERG, *supra* note 1, §§ 5.3.2, 5.4.5. For the Supreme Court’s standard for tippee liability in a Rule 10b-5 *classical relationship* case, see *Dirks*, 463 U.S. at 660. For application of the *Dirks* test for tippee liability, see *Newman*, 773 F.3d at 446–50 (discussed *infra* at notes 227–35 and accompanying text).

A recent Rule 10b-5 Second Circuit decision makes it more difficult for the prosecution to demonstrate the “personal benefit” and “know or should know” elements.²¹⁴ As to the requirement that the tippee “know or should know” of the initial tipper’s violation, the Second Circuit held that means that the tippee must know that the initial tipper received the requisite “personal benefit.”²¹⁵ The court noted that, to its knowledge, five district judges confronting the issue imposed that requirement, and only one district judge (the court below) refused to do so.²¹⁶ Nevertheless, the Second Circuit’s holding makes it more difficult to find remote tippees liable under Rule 10b-5.

As to the initial tippers’ “personal benefit,” the court said:

The circumstantial evidence in this case was simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips. As to the Dell tips, the Government established that Goyal and Ray were not “close” friends, but had known each other for years, having both attended business school and worked at Dell together. Further, Ray, who wanted to become a Wall Street analyst like Goyal, sought career advice and assistance from Goyal. The evidence further showed that Goyal advised Ray on a range of topics, from discussing the qualifying examination in order to become a financial analyst to editing Ray’s résumé and sending it to a Wall Street recruiter, and that some of this assistance began before Ray began to provide tips about Dell’s earnings. The evidence also established that Lim and Choi were “family friends” that had met through church and occasionally socialized together. The Government argues that these facts were sufficient to prove that the tippers derived some

For discussion of a *possible* special Rule 10b-5 insider trading solicitude for analysts, see *supra* note 129 and accompanying text.

²¹⁴ See *Newman*, 773 F.3d at 451–55, *cert. denied*, 2015 WL 4575840 (U.S., Oct. 5, 2015). In *Newman*, the government did not charge the defendants with mail/wire fraud. See *id.* at 442–43.

²¹⁵ See *id.* at 442, 447–50.

²¹⁶ See *id.* at 449–50.

benefit from the tip. We disagree. If this was a “benefit,” practically anything would qualify. . . .

*[T]he Government may [not] prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature To the extent Dirks suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee’s trades “resemble trading by the insider himself followed by a gift of the profits to the recipient,” see 463 U.S. at 664, . . . we hold that such an inference is impermissible in the absence of proof of a *meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature*. In other words, as Judge Walker noted in *Jiau*, this requires evidence of “a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the [latter].”²¹⁷*

²¹⁷ *Id.* at 451–52 (quoting *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)) (emphasis added).

For a discussion of *Newman*, see Jodi L. Avergun & Douglas H. Fischer, *Friends With Benefits: Second Circuit Overturns Newman and Chiasson Convictions and Raises the Government’s Burden in Insider Trading Cases Against Tippees*, (Dec. 12, 2014), <http://bna.com/friends-benefits-second-n17179918853>; Robert Hoff, Richard Levan, & Ivana Greco, *The Gift of ‘Newman’: Not All Tippers Benefit from Sharing Confidential Information*, (N.Y.L.J. Feb. 9, 2015), <http://www.newyorklawjournal.com/id=1202717100248/The-Gift-of-Newman>; Gregory Morvillo & Eugene Ingoglia, *Impact of ‘Newman’ in Other Insider Trading Cases*, (N.Y.L.J. Feb. 5, 2015) www.newyorklawjournal.com/id=1202717054038/Impact-of-Newma-in-Other-Insider-Trading-Cases?slreturn=20150631103413; Subcommittee on Annual Review, Committee on Federal Regulation of Securities, ABA Section of Business Law, *Annual Review of Federal Securities Regulation*, 70 BUS. LAW. 923–26 (2014–2015); Donna M. Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading* (Ind. Legal Res. Paper No. 327, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2665820; Adam C. Pritchard, *Dirks and the Genesis of Personal Benefit*, 69 SMU L. Rev. (forthcoming 2015); Strader, *supra* note 21.

For a description of the decision by federal prosecutors to drop charges against five insider trading defendants in light of *Newman*, see Christopher M. Matthews,

Dirks emphasizes that the tipper's "personal benefit" may be direct or indirect and gives the following examples: (1) pecuniary gain, (2) an enhancement of reputation that will translate into future

Insider Charges Are Being Dropped, WALL ST. J., Jan. 30, 2015, at C3, col. 1. For a description of a federal district court decision to allow four of these insider trading defendants to withdraw guilty pleas in light of *Newman*, see Christopher M. Matthews, *Insider-Trading Defendants Allowed to Retract Guilty Pleas*, WALL ST. J., Jan. 23, 2015, at C3, col. 1. For a decision partially relying on *Newman* to grant summary judgment against the plaintiff in a private civil complaint against an alleged insider trader, see *Gordon v. Sonar Capital Mgmt.*, 2015 WL 4554194 (S.D.N.Y. July 30, 2015). For a description of Manhattan U.S. Attorney Preet Bharara's decision to seek dismissal of charges against seven insider trading defendants, see Christopher M. Matthews & Aruna Viswanatha, *Prosecutor Pulls Plug on Insider Charges*, WALL ST. J., Oct. 23, 2015, at 1. See generally, Christopher M. Matthews, *Prosecutors' Unlikely Ally: Judge: Rakoff's rulings question appellate court's decision on insider trading cases*, WALL ST. J., Sept. 22, 2015, at C3.

In *Newman*, the United States filed a brief petitioning for a rehearing or rehearing en banc. See Petition of the United States of America for Rehearing and Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837), 2015 WL 1064423.

The SEC filed an amicus brief supporting the petition of the United States for rehearing or rehearing en banc. See Brief for the Securities and Exchange Commission as Amicus Curiae Supporting the Petition of the United States for Rehearing or Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837).

For the opposition briefs of the defendants, see Brief of Defendant-Appellant Anthony Chiasson in Opposition to the United States of America's Petition for Rehearing and Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837); Brief of Defendant-Appellant Todd Newman in Opposition to the United States of America's Petition for Rehearing and Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837).

For some amicus opposition briefs, see Brief of Amicus Curiae Law Professors Stephen Bainbridge, M. Todd Henderson, and Jonathan Macey in Opposition to the United States of America's Petition for Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837), 2015 WL 1064409; Brief for the National Association of Criminal Defense Lawyers and the New York Council of Defense Lawyers as *Amici Curiae* Opposing the Petition of the United States for Rehearing or Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837), 2015 WL 1064411; Brief of *Amicus Curiae* Mark Cuban in Opposition to the United States of America's Petition for Rehearing *En Banc*, *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837), 2015 WL 1064412.

The Second Circuit refused to rehear the case. See *United States v. Newman*, 2015 WL 1954058 (Apr. 3, 2015). The Supreme Court denied certiorari. See *United States v. Newman*, 2015 WL 4575840 (U.S., Oct. 5, 2015).

earnings, (3) an expectation of reciprocal tips or other items of value, and (4) the gift of confidential information to a friend or relative.²¹⁸

As to the last example, *Dirks* states: “The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”²¹⁹

This illustration involves a *vicarious* benefit: feeling better off *solely* because someone else is better off, with no necessary expectation of a quid pro quo. If a parent conveys material nonpublic information to a child, the parent may feel better off regardless of any quid pro quo. The economist, Professor Kenneth E. Boulding, described such a vicarious benefit as “benevolence.”²²⁰

One possible reason why the Supreme Court adopted the “personal benefit” requirement for the initial tipper is that, in certain situations, some sort of “personal benefit” requirement may be necessary to avoid an unjust result:

The “personal benefit” test may be necessary to distinguish between proper and improper tips Suppose an individual conveys material nonpublic information to a friend, who is also the individual’s attorney. Surely, no [violation] . . . occurs if the individual conveys the information in the course of obtaining legal advice as to whether trading on the information would be legal. In contrast, [a violation] . . . might occur if the individual is conveying the information

²¹⁸ See *Dirks v. SEC*, 463 U.S. 646, 663–64 (1983). For a discussion of demonstrating the tipper’s “personal benefit,” see WANG & STEINBERG, *supra* note 1, § 5.2.8[C], at 390–93.

²¹⁹ 463 U.S. at 664.

²²⁰ See Kenneth E. Boulding, *Economics as a Moral Science*, 59 AM. ECON. REV. 1, 6 (1969) (“[I]nterdependence of utility functions. . . . We . . . rejoice when they rejoice”) (presidential address delivered at the Eighty-first meeting of the American Economic Association, Chicago, Illinois, December 29, 1968; available on internet).

with the intent that the attorney sell his/her holdings based on the information.²²¹

Alternatively, a patient may disclose material nonpublic information to her psychiatrist without expecting that the psychiatrist would trade on the information. Criminal liability for the patient seems improper.²²² In addition, a whistleblower might disclose information to an investigative journalist or investigative stock analyst without anticipating that the journalist or analyst would trade or tip others who trade.²²³ In this way, the “personal benefit” requirement protects innocent individuals.

If the reason for the “personal benefit” requirement is to avoid inappropriate liability for the “tipper” in patient/psychiatrist, attorney/client, whistleblower/journalist, and similar scenarios, the *Newman* definition of Rule 10b-5 “personal benefit” would be overly narrow.²²⁴

In *Dirks v. SEC*,²²⁵ the Supreme Court explained why the “personal benefit” requirement is distinct from scienter.²²⁶ Nevertheless,

²²¹ WANG & STEINBERG, *supra* note 1, § 5.4.4, at 474 (footnote omitted). For a somewhat similar example of a commuter on a train discussing confidential information that can be overheard by an eavesdropping stranger or, alternatively, by a day-trader/friend of the commuter whom the commuter knows is within earshot, see *SEC v. Obus*, 693 F.3d 276, 287 (2d Cir. 2012).

²²² The mail fraud and securities fraud insider trading case of *United States v. Willis*, 737 F. Supp. 269 (S.D.N.Y. 1990), involved similar facts, but the defendant was the psychiatrist and not the patient. See *id.* at 270. For additional discussion of *Willis*, see *supra* note 137.

²²³ *Dirks v. SEC* itself held that a whistleblower did not violate Rule 10b-5 by disclosing to an analyst material nonpublic information about a massive fraud at the whistleblower’s former employer. See 463 U.S. 646, 649–50, 666–67 (1983).

²²⁴ For the *Newman* definition, see *supra* text accompanying note 217.

²²⁵ 463 U.S. 646 (1983).

²²⁶ See *id.* at 663 (“Scienter in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty. But to determine whether the disclosure itself ‘deceive[s], manipulate[s], or defraud[s]’ shareholders . . . the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure”); *id.* at 663 n.23 (“The issue in this case, however, is not whether *Secrist* or *Dirks* acted with scienter, but rather whether there was any deceptive or fraudulent conduct at all, *i.e.*, whether *Secrist*’s disclosure constituted a breach of his fiduciary duty and thereby caused injury to shareholders.”). For discussion of *Dirks*’ distinction between scienter

in situations like that of the patient/psychiatrist, attorney/client, and even the whistleblower/journalist, the distinction between scienter and “personal benefit” may be blurry.

With *mail/wire fraud*, at least a mild form of the “personal benefit” test may be necessary to prevent unjust “tipper” liability in the patient/psychiatrist, client/attorney, whistleblower/journalist, and similar situations.

As noted at the end of Part I, mail/wire fraud is an inchoate crime that requires nothing more than *devising* a scheme and causing a requisite use of the mail or wires to *begin* implementation of the scheme.²²⁷ Suppose one or more persons *devise* an insider trading scheme and cause the required use of the mail or wires. For mail/wire fraud, one question would be whether the scheme must *contemplate* (1) for initial tipper liability that she receive a “personal benefit,” however defined, and/or (2) for tippee liability that she know or should know of the initial tipper’s violation (and possibly the initial tipper’s improper “personal benefit”).²²⁸

Few courts have addressed whether the Rule 10b-5 tipper/tippee requirements apply to the mail/wire fraud liability of tippers and tippees. One commentator has noted: “Whether courts would adopt such [a “personal benefit” test for mail/wire fraud tipper liability] is an open question. Nothing in *Carpenter* explicitly requires it.”²²⁹

and “personal benefit,” see Pritchard, *supra* note 217, parts II and III. For additional discussion of the distinction between scienter and “personal benefit,” see *SEC v. Obus*, 693 F.3d 276, 286-87 (2d Cir. 2012).

The Rule 10b-5 insider trading case of *United States v. Newman*, 773 F.3d 438, 446-47 (2d Cir. 2014), separately discussed “personal benefit” and scienter/mens-rea and defined the latter as follows: “We have defined willfulness in this context ‘as a realization on the defendant’s part that he was doing a wrongful act under the securities laws.’” *Id.* at 447 (quoting *United States v. Cassese*, 482 F.3d 921, 98 (2d Cir. 2005)).

²²⁷ See *supra* notes 22–23 and accompanying text. For a discussion of the requisite use of the mail or wires, see *supra* Part II(A). The use of the mail or wire may be by an innocent party or by an associate of the defendant. See *supra* notes 26–30 and accompanying text.

²²⁸ For a discussion of the *Dirks* tests for Rule 10b-5 tipper and tippee liability, see *supra* notes 216–17 and accompanying text. For a discussion of the recent Second Circuit decision making it harder for the prosecution to satisfy these tests, see *supra* notes 216–28 and accompanying text.

²²⁹ Dreeben, *supra* note 83, at 214; cf. Helen A. Garten, *Insider Trading in the Corporate Interest*, 1987 WIS. L. REV. 573, 638 n.287 (1987) (the uncertainty created by the “personal benefit” requirement for tipper liability “will increase if

In *Carpenter*,²³⁰ one of two authors of the *Wall Street Journal* “Heard on the Street” column, R. Foster Winans, gave advance information about the contents of his column to both his roommate, David Carpenter, and to Peter Brant, Kenneth Felis, and David Clark.²³¹ Brant, Felis, and Clark traded on the information, and Winans, Brant, Felis, and Clark shared the profits.²³²

With no discussion of why Carpenter was an aider and abettor, the Supreme Court affirmed his mail/wire fraud conviction for aiding and abetting.²³³ Although the Court frequently described Winans and Felis as mail/wire fraud co-conspirators,²³⁴ it felt no need to explain why, probably because Winans and Felis shared profits.²³⁵ The Court simply stated: “We have little trouble in holding that the conspiracy here to trade on the Journal’s confidential information is not outside the reach of the mail and wire fraud statutes, provided the other elements of the offense are satisfied.”²³⁶ As to the element of intent of those to whom Winans conveyed the information, the Court said only: “[T]he District Court’s conclusion that each of the petitioners acted with the required specific intent to defraud is strongly supported by the evidence.”²³⁷

Nor did the Second Circuit’s decision in *Carpenter* explore why under mail/wire fraud Carpenter was liable as an aider and abettor and Winans and Felis were liable as co-conspirators.²³⁸ As to the mail/wire fraud required specific intent of Winans and Felis, the circuit court simply stated: “it is sufficient that the district court found

more insider trading cases are prosecuted under the federal mail and wire fraud statutes . . .”).

In *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), the government did not charge the defendants with mail/wire fraud. *See id.* at 442–43.

²³⁰ *Carpenter v. United States*, 484 U.S. 19 (1987). For additional discussion of *Carpenter*, see *supra* notes 58–59 and accompanying text, 63–83 and accompanying text.

²³¹ *See Carpenter*, 484 U.S. at 22–23.

²³² *See id.* at 23.

²³³ *See id.* at 22, 25–28.

²³⁴ *See id.* at 23, 27–28.

²³⁵ *See id.* at 23.

²³⁶ *Id.* at 28.

²³⁷ *Id.*

²³⁸ *See United States v. Carpenter*, 791 F.2d 1024, 1026, 1034–35 (2d Cir. 1986), *aff’d in part*, 484 U.S. 19 (1987) (affirming wire fraud and mail fraud convictions).

that Winans and Felis intended to deceive and defraud the Journal²³⁹

The trial court, however, did briefly discuss why Carpenter was liable as an aider and abettor under both the securities and mail/wire fraud statutes:

During his one and a half years at the WSJ, he became aware of the rules of the game and consequently knew that what Winans was doing was a fraud on the WSJ. He endorsed the checks made out to him by Brant or Felis, allowed Winans to trade in his name in the Merrill Lynch and Schwab accounts, and to that extent willfully participated in the criminal venture and helped it succeed.²⁴⁰

The district court also found that Carpenter was *not* a co-conspirator because the Government had not shown beyond a reasonable doubt that he had ever reached an agreement with the other conspirators; nor did Carpenter receive a share of the profits.²⁴¹

Finally, the trial court addressed why Winans and Felis were part of a conspiracy, which the opinion found began on October 16, 1983, when Winans and Brant agreed to trade on advance information about the columns. Felis agreed to participate soon afterwards; pursuant to the agreement, the parties traded in advance of the columns and split the profits.²⁴² As to intent, the trial court explained:

The government must also establish that the defendants acted with specific intent, a discussion equally applicable to the mail, wire and securities fraud counts [citing the discussion of scienter in *Dirks v. SEC*, 463 U.S. 646, 663 n.23 (1983)]. . . .

The essence of the defendants' argument is that to have intended to defraud the Wall Street Journal,

²³⁹ *Id.* at 1035.

²⁴⁰ *United States v. Winans*, 612 F. Supp. 827, 850 (S.D.N.Y. 1985), *aff'd*, 791 F.2d 1024 (2d Cir. 1986), *aff'd in part*, 484 U.S. 19 (1987) (affirming wire fraud and mail fraud convictions).

²⁴¹ *See id.* at 848–49.

²⁴² *See id.* at 831–38, 848.

each defendant would have to know the specifics of the conflicts of interest policy

We do not agree that the specific intent requirement is meant to be quite that specific. Nor do we believe that such a precise knowledge of what type of wrong Winans was committing at the Journal is necessary to show that any defendant aided and abetted the fraud. The government is not required to prove actual knowledge by each defendant, of every detail that made the scheme a fraudulent one

Our focus is on whether the defendants intended to deceive the Journal, or aided and abetted Winans in his efforts to deceive the Journal. The defendants need not have known about every particular of the conflicts of interest policy to have knowledge that the Wall Street Journal was being defrauded by Winans for his own financial gain²⁴³

Because *Carpenter* involved a *conspiracy* to share information and split profits, none of the opinions had to discuss the tests for tipper and tippee liability.²⁴⁴

As discussed earlier,²⁴⁵ *United States v. Ruggiero*,²⁴⁶ was a “classical relationship” insider trading case that affirmed the Rule 10b-5 convictions of a tippee using the test: “knew or should have known” of the initial insider/tipper’s violation.²⁴⁷ After affirming the Rule 10b-5 convictions, the court relied on its Rule 10b-5 discussion to affirm summarily the wire fraud convictions of the tippee with virtually no analysis and with *possible* implicit adoption of the “knew or should have known” test but no express mention of it.²⁴⁸

In his dissent in *United States v. Chestman*, Judge Winter commented:

²⁴³ *Id.* at 847.

²⁴⁴ For a discussion of these tests under SEC Rule 10b-5, see *supra* notes 216–29 and accompanying text.

²⁴⁵ See *supra* notes 167–76 and accompanying text.

²⁴⁶ 56 F.3d 647 (5th Cir.1995).

²⁴⁷ See *id.* at 653–56.

²⁴⁸ See *id.* at 656. For a quotation from this part of the opinion, see *supra* text accompanying note 175.

I am unclear as to whether the [tipper's] breach of duty and the tippee's knowledge of that breach as required by *Dirks* is coextensive with the similar requirements in [the mail/wire fraud decision] in *Carpenter*. The *Dirks* rule is derived from securities law, and its limitation to information obtained through a breach of fiduciary duty is, as noted, influenced by the need to allow persons to profit from generating information about firms so that the pricing of securities is efficient. The *Carpenter* rule, however, is derived from the law of theft or embezzlement, and a tippee's liability may be governed by rules concerning the possession of stolen property. Logic is therefore not a barrier to the growth of disparate rules concerning a tippee's liability depending on whether Section 10(b) or mail fraud is the source of law. However, because under any such disparity in rules the Section 10(b) charge would be harder to prove than a mail fraud charge, I need not explore the issue further.²⁴⁹

Earlier, this Article discussed whether Judge Winter was correct that mail/wire fraud liability would be more difficult to prove.²⁵⁰

When discussing the specific *intent* to defraud required to convict a remote tippee under Rule 10b-5, Judge Rakoff said the required intent should be the same for both Rule 10b-5 and mail/wire fraud:

But where, as in this case, the Government charges a scheme to defraud under subdivision (a) of Rule 10b-5, proving specific intent to defraud is necessary. Indeed, were it otherwise, an insider trading defendant charged, in virtually identical words, with violating both the mail fraud statute and Rule 10b-5,

²⁴⁹ United States v. Chestman, 947 F.2d at 581–82 (2d Cir. 1991) (en banc) (Winter, J., dissenting). For additional discussion of Judge Winter's dissent, see *supra* notes 119–37 and accompanying text. For discussion of *possible* special Rule 10b-5 insider trading solicitude for analysts, see *supra* note 129 and accompanying text.

²⁵⁰ See *supra* notes 123–37 and accompanying text.

could be convicted of the latter but acquitted of the former, even though the latter is a specialized subspecies of the former.²⁵¹

In the course of holding that the evidence was sufficient to support a tippee's conviction for both securities fraud and mail fraud, a much earlier district court opinion said of *both* securities and mail fraud: "it is sufficient if the government shows that [the initial misappropriator/tipper] breached a duty and [the remote tippee] knew of that breach."²⁵²

In any event, few opinions have directly addressed the issue of whether the *Dirks* tests for Rule 10b-5 tipper and tippee liability apply to a mail/wire fraud tipper and tippee.

6. "WHILE IN POSSESSION OF MATERIAL NONPUBLIC INFORMATION" VERSUS "ON THE BASIS OF MATERIAL NONPUBLIC INFORMATION"

In *United States v. O'Hagan*,²⁵³ the Eighth Circuit reserved the question of whether an insider trading defendant convicted of mail/wire fraud must have traded "while in possession of material nonpublic information" versus "on the basis of material nonpublic information."²⁵⁴

²⁵¹ *United States v. Whitman*, 904 F. Supp. 2d 363, 373 (S.D.N.Y. 2012), *aff'd*, 555 Fed. App'x 98 (2d Cir. 2014). For additional discussion of *Whitman*, see *supra* note 137. For a discussion of commentary on the derivation of Exchange Act Section 10(b) from the mail fraud statute, see *id.*

²⁵² *United States v. Victor Teicher & Co., L.P.*, 785 F. Supp. 1137, 1150 (S.D.N.Y. 1992).

²⁵³ 139 F.3d 641 (8th Cir. 1998) (heard on remand from *United States v. O'Hagan*, 521 U.S. 642 (1997)).

²⁵⁴ See 139 F.3d at 653.

The insider trading case of *United States v. Ruggiero* affirmed the Rule 10b-5 convictions using the "in possession of" language with no discussion of the issue of "possession" versus "on the basis of." See 56 F.3d 647, 653–56 (5th Cir. 1995). After affirming the Rule 10b-5 convictions, the court affirmed the wire fraud convictions with virtually no discussion and no mention of "possession" or "use." See *id.* at 656. For additional discussion of *Ruggiero*, see *supra* notes 167–76 and accompanying text, 253–55 and accompanying text.

The court in *United States v. Cherif*, a mail/wire fraud stock market insider trading case, used the language "trading on the basis of fraudulently obtained confidential information," but did not address the issue of "possession" versus "on the basis of." See 943 F.2d 692, 700 (7th Cir. 1991). The court also held that the defendant

The insider trading portion of *United States v. Royer*²⁵⁵ discussed wire fraud and Rule 10b-5 misappropriation convictions jointly and affirmed them.²⁵⁶ Without distinguishing between wire fraud and Rule 10b-5, the court adopted the “knowing possession of the material nonpublic information” as opposed to the “use of the information” test.²⁵⁷

Because of the paucity of cases, the issue remains unresolved. When eventually answering this question, the courts *may* borrow from the decisions addressing the same issue under SEC Rule 10b-5,²⁵⁸ especially prior to the adoption of SEC Rule 10b5-1.²⁵⁹

CONCLUSION

After the Supreme Court’s unanimous decision in *Carpenter v. United States*,²⁶⁰ the federal mail and wire fraud statutes became potent prosecutorial weapons against insider trading when the information-owner is the victim.

SEC Rules 14e-3²⁶¹ and 10b-5 cover a great deal of stock market insider trading and tipping, but certainly not all.²⁶² For many reasons, the Rule 10b-5 “classical relationship” theory may not be available for insider trading and tipping. One *possible* example is a corporate insider trading in the company’s debt instruments; it is unclear whether she has a “classical relationship” with the party on the other side of the trade.

had waived his argument that the trial court had “failed to instruct the jury that it had to find that confidential business information was a ‘substantial or motivating factor’ for his stock trades.” *Id.*

²⁵⁵ 549 F.3d 886, 897–99 (2d Cir. 2008).

²⁵⁶ *See id.* at 897–99.

²⁵⁷ *See id.* at 899 (citing the Rule 10b-5 case of *United States v. Teicher*, 987 F.2d 112, 119–21 (2d Cir. 1993)). For discussion of *Teicher*, see WANG & STEINBERG, *supra* note 1, § 4.4.5, at 176–77.

²⁵⁸ For a discussion of this issue under SEC Rule 10b-5, see WANG & STEINBERG, *supra* note 1, § 4.4.5.

²⁵⁹ For a discussion of SEC Rule 10b5-1, see *id.* § 4.4.5, nn.416–34 and accompanying text.

²⁶⁰ 484 U.S. 19 (1987).

²⁶¹ For discussion of SEC Rule 14e-3, see WANG & STEINBERG, *supra* note 1, ch. 9.

²⁶² Rule 14e-3 is confined to the tender offer context. *See id.* § 9.1. For discussion of the application of SEC Rule 10b-5 to insider trading, see *id.*, chs. 4, 5.

With stock market insider trading and tipping, an alternative to the Rule 10b-5 “classical relationship” theory is Rule 10b-5 misappropriation. *Somewhat* similar to Rule 10b-5 misappropriation is mail/wire fraud on the confidential information owner. This latter breach might be more extensive than, co-extensive with, or less extensive than Rule 10b-5 misappropriation (although Rule 10b-5 does not apply to inside trading of an item not a “security” under the federal securities laws, e.g., commodities).

Suppose, however, neither Rule 10b-5 misappropriation nor mail/wire fraud on the information-owner is available, perhaps because the information source/owner gave permission to trade or tip or *possibly* because the defendant disclosed in advance to the information source/owner the plan to trade or tip.

In that situation, another possible victim of *mail/wire* fraud is the party *on the other side* of the insider trade. Uncertain is whether, for stock market insider traders, the necessary mail/wire fraud relationship is broader, narrower, or the same as the requisite Rule 10b-5 “classical relationship.” Thus far, virtually no courts have considered the insider trader’s mail/wire fraud duty to disclose to the party on the other side of the transaction. Under mail/wire fraud, a stock market insider trader might conceivably have a duty to disclose to the party on the other side *even in the absence* of a Rule 10b-5 “classical relationship.”

Another issue unexamined by the courts is whether an employee engaging in an insider trade of her company’s stock could be criminally liable under two different mail/wire fraud theories with two separate mail/wire fraud victims: the information owner and the party on the other side of the trade.

With stock market insider trading for mail/wire fraud, the materiality standard *may* be: (1) *laxer*—less stringent than the “reasonable person” test—or in cases involving deprivation of informational property, (2) *different*, dealing with the importance to the owner of the information as opposed to a stock market investor. Consequently, the government may be able to use mail/wire fraud when SEC Rule 10b-5 does not apply.

Under the Rule 10b-5 “classical relationship” theory and probably the Rule 10b-5 misappropriation doctrine, the initial tipper must receive a “personal benefit.” Under the Rule 10b-5 “classical rela-

tionship” theory and probably the Rule 10b-5 misappropriation doctrine, each direct and remote tippee must “know or should know” of the initial tipper’s violation.

It is unclear whether these requirements apply to the *mail/wire fraud* liability of tippers and tippees. Again, were the standards laxer for mail/wire fraud, the government would be able to use mail/wire fraud when Rule 10b-5 does not apply. For example, where courts, like the Second Circuit, make it harder to meet the Rule 10b-5 tests for tipper and tippee liability,²⁶³ prosecutors may turn to the mail/fraud statutes for convictions.

With stock market insider trading, several Supreme Court Justices²⁶⁴ and Judge Ralph K. Winter²⁶⁵ have said that mail/wire fraud is broader than Exchange Act Section 10(b)/SEC Rule 10b-5.²⁶⁶ In the insider trading case *O’Hagan*, the Supreme Court said: “Just as in *Carpenter*, so here, the ‘mail fraud charges are independent of [the] securities fraud charges, even [though] both rest on the same set of facts.’”²⁶⁷

In short, for stock market insider trading, some elements of liability may be different and possibly easier to satisfy under mail/wire fraud than under SEC Rule 10b-5. The courts have largely failed to explore these differences.

²⁶³ See *United States v. Newman*, 773 F.3d 438, 446–55 (2d Cir. 2014). For a discussion of *Newman*, see *supra* notes 216–28 and accompanying text. In *Newman*, the government did not charge the defendants with mail/wire fraud. See 773 F.3d at 442–43.

²⁶⁴ See *supra* notes 132–33 and accompanying text.

²⁶⁵ See *United States v. Chestman*, 947 F.2d 551, 581–82 (2d Cir. 1991) (en banc) (Winter, J., dissenting). For additional discussion of this portion of Judge Winter’s dissent, see *supra* notes 119–23, 256 and accompanying text.

²⁶⁶ In the words of one commentator: “if fraud under the securities laws cannot be established, the securities fraud claims fail, but the mail and wire fraud claims may still stand. . . . Notwithstanding the overlap that occurs in cases, what might be fraud in a mail fraud . . . context is not necessarily fraud in a securities law context.” Joanna B. Apolinsky, *The Boundaries of Fraud Under the Insider Trading Rules*, 13 FLA ST. U. BUS. REV. 1, 26–28 (2014) (footnotes omitted).

²⁶⁷ *United States v. O’Hagan*, 521 U.S. 642, 678 (1997) (bracketed material in original) (quoting Brief for United States 46–47).