Insider Abstention and Rule 10b5-1 Plans

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Company insiders will typically be in possession of material non-public information (MNPI) about their companies. In order to allow insiders the opportunity to trade, the SEC adopted Rule 10b5-1, which provides an affirmative defense to insider trading liability if the trades are made pursuant to a written plan or trading instruction entered into when the trader was not aware of MNPI. Over the years, there has been considerable concern that insiders were abusing Rule 10b5-1 plans by adopting plans just prior to trading, adopting multiple plans, or even terminating plans when they turned out to be unprofitable. The SEC recently adopted new rules designed to curb some of the more abusive practices, but one significant problem remains: while Rule 10b5-1 plans are supposed to be irrevocable, insiders who back out of plans have so far escaped liability under the central anti-fraud provision of the federal securities laws, principally because a violation of that provision requires an actual trade.

The issue of "insider abstention"—insiders who decide not to trade based on MNPI—has long bedeviled insider trading law and policy. Insider abstention is typically undetectable and unknowable, raising insurmountable issues of proof, while the general requirement that fraud be "in connection with the purchase or sale of a security" imposes a rigid legal barrier. But Rule 10b5-1 plans stand on a different evidentiary footing: they are written plans, communicated to third parties, creating a clear record of intent. The only real question is whether legal liability can attach in the absence of an actual purchase or sale of a security.

Traditionally, the answer to this question has been no. The SEC staff has stated on a few occasions that cancellation of a Rule 10b5-1 plan would not in itself lead to liability under Rule 10b-5 because terminating a plan would not meet the "in connection with" requirement. However, Rule 10b5 is not the only statutory provision that has been used to prosecute insider trading. The SEC has frequently prosecuted insider trading under Section 17(a) of the Securities Act, a provision that applies not only to the "sale" of securities but extends more broadly to "offers" to sell securities. And criminal authorities have increasingly been prosecuting insider trading under mail and wire fraud statutes that do not have an "in connection with" requirement at all. These other statutory provisions could provide a basis for insider trading liability in the context of a cancelled or terminated Rule 10b5-1 plan.

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I. INTRODUCTION

Company insiders will typically be in possession of material non-public information (MNPI) about their companies. In order to allow insiders the opportunity to trade, the SEC in 2000 adopted Rule 10b5-1, which provides an affirmative defense to insider trading liability if the trades are made pursuant to a written plan or trading instruction entered into when the trader was not aware of MNPI.[1] Over the years, there has been considerable concern that insiders were abusing Rule 10b5-1 plans by adopting the plans just prior to trading, adopting multiple plans,

1 17 C.F.R. § 240.10b5-1 (2001).

or even canceling plans when they turned out to be unprofitable.[2]

The SEC recently adopted new rules governing Rule 10b5-1 plans designed to curb some of the more abusive practices by, among other things, requiring a cooling-off period between adoption of the plan and the start of trading.[3] But one significant problem remains: insiders sometimes terminate previously adopted plans while they are in possession of MNPI in order to avoid potential losses, which is substantively indistinguishable from insider trading. Although Rule 10b5-1 plans are supposed to be irrevocable, insiders who back out of a plan have so far escaped liability under the central anti-fraud provision of the federal securities laws principally because a violation of that provision requires an actual trade.[4]

The issue of "insider abstention"—insiders who decide not to trade based on MNPI—has long bedeviled insider trading law and policy.[5] Insider abstention is typically undetectable and unknowable, raising insurmountable issues of proof, while the general requirement that fraud be "in connection with the purchase or sale of a security" imposes a rigid legal barrier. But Rule 10b5-1 plans stand on a different evidentiary footing: they are written plans, communicated to third parties, creating a clear record of intent. The only real question is whether legal liability can attach in the absence of an actual purchase or sale of a security.

Traditionally, the answer to this question has been no: the SEC staff has stated on a few occasions that cancellation of a Rule 10b5-1 plan would not in itself lead to liability under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder because a violation of those provisions has been held by the Supreme Court to require an actual trade in a security, rather than a decision not to trade.[6]

However, while Section 10(b) and Rule 10b5-1 are the central anti-fraud provisions of the federal securities laws and the fount of most insider trading liability, they are not the only statutory provisions that have been used to prosecute insider

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2 *See* Insider Trading Arrangements and Related Disclosures, Exchange Act Release Nos. 33-11138; 34-96492, 87 Fed. Reg. 80362, 80364 (Dec. 29, 2022) [hereinafter Adopting Release].

3 *See* Press Release, SEC, SEC Adopts Amendments to Modernize Rule 10b5-1 Trading Plans and Related Disclosures (Dec. 14, 2022).

4 *See infra* Part III.

5 *See infra* Part III.

6 *See infra* Part III.

trading. In particular, criminal authorities have increasingly been prosecuting insider trading under the general mail and wire fraud statutes, as well as under a more recently adopted securities fraud statute (Title 18 Section 1348) that is modeled on the mail and wire fraud statutes and is not even part of the federal securities laws.[7] Critically, the mail and wire fraud statutes do not have an "in connection with" requirement at all, and Section 1348's "in connection with" provisions do not always require a securities trade.[8] Similarly, the SEC has frequently prosecuted insider trading under Section 17(a) of the Securities Act, a provision that applies not only to the "sale" of securities but extends more broadly to "offers" to sell securities.

The use of these other statutory provisions could provide a basis for anti-fraud liability in the context of a cancelled or terminated Rule 10b5-1 plan. In Part II of this article, I describe the development, use and abuse of Rule 10b5-1 plans and recent attempts to curb some of the most abusive practices. In Part III, I present the traditional argument against insider trading liability with respect to the termination or cancellation of Rule 10b5-1 plans. In Part IV, I first discuss the possible application of Section 17(a) to both civil and criminal prosecutions relating to cancelled Rule 10b5-1 plans. I then discuss the possible application of the mail and wire fraud statutes, as well as other similar statutes, to criminal prosecutions relating to cancelled plans.

II. The Development and Scope of Rule 10b5-1 Trading Plans

A. The Development of Rule 10b5-1

The SEC adopted Rule 10b5-1 to address a practical problem, namely how could company insiders ever trade in the securities of their company when they are almost always in possession of MNPI? The Supreme Court had held that Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder prohibit the purchase or sale of a security "on the basis of" MNPI.[9] Prior to the adoption of Rule 10b5-1, insiders who traded frequently claimed that while they may have been in "possession" of MNPI at the time of the trade, they didn't "use" the information—that is, they traded for wholly independent reasons

7 18 U.S.C. §§ 1341 (mail fraud), 1343 (wire fraud), 1348.

8 *See* 18 U.S.C. §§ 1341, 1343, 1348.

9 *See* United States v. O'Hagan, 521 U.S. 642, 652 (1997).

unconnected to the MNPI. Appellate courts that considered the issue were divided over the "use" vs. "possession" question. For example, the Second Circuit held that "knowing possession" was sufficient for liability.[10] On the other hand, the Eleventh Circuit held that for liability to attach, the government had to show that the insider "used" the information as the basis for the trade—although the court stated that proof of possession provided a strong inference of "use."[11] The Ninth Circuit went further and held that in a criminal case, the government had to prove that the trader "used" the MNPI.[12]

In response, in August 2000, the SEC adopted Rule 10b5-1, which defines trading "on the basis of" MNPI to mean that the trader "was *aware* of the material nonpublic information when the person made the purchase or sale," a much lower and easier to meet standard for liability.[13] At the same time, the SEC created what amounts to a safe harbor for insiders to trade at a time that they may be aware of MNPI, so long as the trading was directed at a time prior to becoming aware of the information. In brief, Rule 10b5-1 provides an affirmative defense to insider trading liability if the trades are made pursuant to a written plan or trading instruction entered into when the trader was not aware of MNPI.[14]

Since the adoption of the Rule, 10b5-1 plans have become increasingly common. By one estimate, in 2019 more than half of S&P 500 companies had executives who used Rule 10b5-1 plans.[15] According to the SEC, in 2021 almost 6,000 people at some 1,700 companies reported trades using Rule 10b5-1 trading plans, but because not all trades are reported, the SEC estimated that the actual number of persons using Rule 10b5-1 trading plans was likely much higher.[16]

B. Abuse of Rule 10b5-1 Plans

For many years, there have been concerns expressed that Rule 10b5-1 plans were being abused—particularly by traders

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10 *See* United States v. Teicher, 987 F.2d 112, 120 (2d Cir. 1993).

11 *See* SEC v. Adler, 137 F.3d 1325, 1340 (11th Cir. 1998).

12 *See* United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998).

13 17 C.F.R. § 240.10b5-1(b) (2022) (emphasis added). Despite the adoption of the rule, the issue of "use" vs "possession" may not be entirely settled. *See* Andrew Verstein, *Mixed Motives Insider Trading*, 106 IOWA L. REV. 1253, 1261–65 (2021).

14 17 C.F.R. § 240.10b5-1 (2022).

15 Jeffrey Cohen, *The 10b5-1 Plan: What Executives Need to Know*, CORP. COUNS. BUS. J. (2019).

16 *See* Adopting Release, *supra* note 2, at 128–29.

who adopted plans shortly before the trades in question or who adopted multiple plans to meet various contingencies.[17] In the early 2000s, the SEC brought a few high-profile cases alleging insider trading by executives who manipulated 10b5-1 plans, including cases against Ken Lay, the former chairman and CEO of Enron, and Angelo Mozilo, the former head of Countrywide Financial.[18]

Abuses, however, have persisted. Recently, government authorities brought two insider trading cases involving the misuse of Rule 10b5-1 plans. In March 2023, the SEC and criminal authorities brought insider trading charges against Terren Peizer, the chairman of Ontak (a healthcare company) for allegedly trading in the stock of his company while in possession of negative information regarding his company's largest customer. Peizer made the trades pursuant to two Rule 10b5-1 plans that were allegedly adopted while Peizer was in possession of the negative information, even though he certified at the time of the plans' adoption that he was not aware of any nonpublic information.[19] By trading in advance of the negative announcements, Peizer avoided losses totaling more than $12.7 million.[20]

In September 2022, the SEC brought a settled administrative proceeding against both the CEO and the former president of Cheetah Mobile (a China-based technology company), for insider trading that was conducted pursuant to purported Rule 10b5-1 plans.[21] The two executives sold securities ahead of a negative announcement about the company, and the SEC order

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17 *See, e.g.*, Larcker et al., *Gaming the System: Three 'Red Flags' of Potential 10b5-1 Abuse*, STANFORD CLOSER LOOK SERIES (2021); John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH L. REV. 339, 363 (2015); Tom McGinty & Mark Maremont, *CEO Stock Sales Raise Questions About Insider Trading*, WALL ST. J. (June 29, 2022, 11:00 AM), https://perma.cc/A5LJ-HUF3; Jean Eaglesham & Rob Barry, *Trading Plans Under Fire: Despite 2007 Warning, Experts Say Loopholes Remain for Corporate Insiders*, WALL ST. J. (Dec. 13, 2012, 9:00 PM), https://perma.cc/8N5C-TVDM/.

18 *See* Press Release, SEC, SEC Charges Kenneth L. Lay, Enron's Former Chairman and Chief Executive Officer, with Fraud and Insider Trading (July 8, 2004); Press Release, SEC, Former Countrywide CEO Angelo Mozilo to Pay SEC's Largest-Ever Financial Penalty Against a Public Company's Senior Executive (Oct. 15, 2010).

19 Press Release, SEC, SEC Charges Ontrak Chairman Terren Peizer With Insider Trading (Mar. 1, 2023).

20 Complaint & Demand for Jury Trial at 2, SEC v. Peizer, No. 2:23-cv-01511 (C.D. Cal. Mar. 1, 2023).

21 In the Matter of Sheng Fu and Ming Xu, Securities Act Release No. 11104, Exchange Act Release No. 95847 (Sep. 21, 2022).

found that the executives were aware of the negative news when they adopted the trading plans.[22]

C. Recent Amendments to Rule 10b5-1

While Rule 10b5-1 plans provide an important mechanism for company insiders to trade in the securities of their companies, they have proven to be easily manipulable in practice. In addition to allegations that certain insiders were actually violating the existing rules, there was considerable speculation that others were abusing the rules to game the system. Concerns that insiders had "sought to benefit from the rule's liability protections while trading securities opportunistically on the basis of material nonpublic information"[23] led the SEC to adopt amendments to Rule 10b5-1 aimed at curbing some of the more egregious practices. The amendments became effective February 27, 2023.[24] Most notably, the new rules establish a "cooling-off" period before trading can begin under a Rule 10b5-1 plan, restrict the use of multiple overlapping trading plans, and require directors and officers to certify that they are not in possession of MNPI at the time of the plan's adoption.[25] The amendments also require companies to publicly disclose when certain insiders have adopted, modified, or terminated a plan.[26]

D. The Current Parameters of Rule 10b5-1 Plans

As currently constituted, Rule 10b5-1 provides an affirmative defense to insider trading liability with respect to trades that are conducted pursuant to a written plan adopted in good faith at a time when the insider was not in possession of MNPI. Specifically, Rule 10b5-1 provides that a person's purchase or sale of securities is not "on the basis" of MNPI if the following conditions are met:

> (i) Before becoming aware of MNPI, the person entered into a binding contract to purchase or sell the security, or instructed another person to purchase or sell the security, or adopted a written plan for trading securities;[27]

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22 *Id.*

23 Press Release, SEC, SEC Adopts Amendments to Modernize Rule 10b5-1 Insider Trading Plans and Related Disclosures (Dec. 14, 2022)

24 *Id.*

25 *Id.*

26 *Id.*

27 17 C.F.R. § 240.10b5-1(c)(1)(i)(A) (2022).

> (ii) The contract, instruction, or plan (1) specifies the amount, price, and timing of the trades,[28] (2) provides a formula or algorithm for determining those items[29] or (3) does not permit the person to exercise any subsequent influence over how, when or whether to purchase or sell the securities;[30] and
> (iii) The purchase or sale that occurred was pursuant to the contract, instruction, or plan.[31]

The Rule specifies that a purchase or sale is *not* "pursuant to a contract, instruction or plan" if the person "altered or deviated" from the contract, instruction, or plan.[32]

In addition, the affirmative defense applies only if the plan was adopted in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1[33] and the adopting officer or director includes a representation in the plan that they are not aware of MNPI and the plan is being adopted in good faith.[34] Finally, plan adopters are subject to a "cooling-off" period—lasting between 90 and 120 days for officers and directors and 30 days for others—before purchases or sales can begin under the plan.[35] The new rules also limit the ability to adopt multiple overlapping plans.[36]

Importantly, the new rules impose disclosure obligations on companies that may have an impact on insider trading liability for the termination or cancellation of Rule 10b5-1 plans. Specifically, companies are now required to publicly disclose on a quarterly basis the adoption, modification, or termination of a Rule 10b5-1 trading plan by directors and certain specified officers of the company.[37] The disclosure must include a description of the material terms of the plan (other than pricing), including the name of the officer or director, the date the plan was adopted, modified, or terminated, the duration of the plan, and the total

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28 17 C.F.R. § 240.10b5-1(c)(1)(i)(B)(1) (2022).
29 17 C.F.R. § 240.10b5-1(c)(1)(i)(B)(2) (2022).
30 17 C.F.R. § 240.10b5-1(c)(1)(i)(B)(3) (2022).
31 17 C.F.R. § 240.10b5-1(c)(1)(i)(C) (2022).
32 *Id.*
33 17 C.F.R. § 240.10b5-1(c)(1)(ii)(A) (2022).
34 17 C.F.R. § 240.10b5-1(c)(1)(ii)(C) (2022).
35 17 C.F.R. § 240.10b5-1(c)(1)(ii)(B) (2022).
36 17 C.F.R. § 240.10b5-1(c)(1)(ii)(D) (2022).
37 17 C.F.R. § 229.408(a)(1) (2023). The officers are those specified in Section 16 and include the company's president, principal financial officer, principal accounting officer, and any vice-president in charge of a principal business unit, division, or function. *See* 17 C.F.R. § 240.16a-1(f).

amount of securities to be bought or sold pursuant to the plan.[38] Finally, companies must now make an annual disclosure of their insider trading policies or explain why they have not adopted an insider trading policy.[39]

III. INSIDER TRADING ABSTENTION AND THE TERMINATION OF RULE 10B5-1 PLANS

A. Cancellation or Termination of Rule 10b5-1 Plans

Commentators have often noted that a significant amount of "insider trading" consists of decisions *not* to trade.[40] Say an executive of a company was planning to sell some of his stock for whatever reason. The executive finds out that the company is about to announce a major new discovery that will undoubtedly send the stock price soaring. Then, the executive decides not to sell. The decision is clearly based on material non-public information and will result in significant gains to the executive, but leaving aside the obvious issues of discovery and proof, such "non-trading" has always been considered beyond the reach of the anti-fraud provisions of the federal securities laws, because there is no actual trade and whatever deception there may be is not "in connection with" the purchase or sale of a security.[41] Indeed, opponents of insider trading regulation have often pointed to insiders' ability to abstain from trading on nonpublic information without incurring liability as completely undermining the basis for insider trading regulation.[42] The problem of insider abstention is often described as insoluble.[43]

The issue of insider abstention takes on new salience in the context of Rule 10b5-1 plans. While the SEC's recent rule

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[38] 17 C.F.R. § 229.408(a)(2) (2023).

[39] 17 C.F.R. § 229.408(b)(1) (2023).

[40] *See, e.g.*, Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455, 463–65 (2003); Steven R. Salbu, *Tipper Credibility, Noninformational Tippee Trading, and Abstention from Trading: An Analysis of Gaps in Insider Trading Laws*, 68 WASH. L. REV. 307, 307 (1993).

[41] *See, e.g.*, Henry G. Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933, 938 (1985).

[42] *Id.*

[43] *See, e.g.*, Boyd Kimball Dyer, *Economic Analysis, Insider Trading, and Game Markets*, 1992 UTAH L. REV. 1, 23–24 (1992) ("The problem of 'insider not trading' is not solvable."); Manne, *supra* note 41, at 938 ("[P]eople can make abnormal profits in the stock market simply by knowing when not to buy and when not to sell . . . . And this is a form of insider trading that no one can do anything about."); Salbu, *supra* note 40, at 333–34 ("[I]t is both legally and logistically difficult to regulate the use of inside information as a factor in the decision to abstain from trading.").

changes may succeed in curtailing some of the more egregious practices involving Rule 10b5-1 plans, one big problem persists: abuses connected to the termination or cancellation of existing trading plans. For example, a person who has adopted a Rule 10b5-1 plan directing the sale of a preset amount of securities at a specified time may find out MNPI that will lead to a rise in the price of those securities and decide to cancel or terminate the Rule 10b5-1 plan.

Rule 10b5-1 plans are supposed to be irrevocable, and under the rules the plan cannot allow for the adopting person to exercise any subsequent influence over the prescribed trades.[44] However, SEC staff and legal practitioners have long taken the position that termination of a plan would not be a basis for liability. For example, when the SEC adopted Rule 10b5-1, SEC staff stated that termination or cancellation of a 10b5-1 plan would not itself constitute a violation of the antifraud provisions because there would be no actual trading: the termination of a plan would not be "in connection with" the purchase or sale of a security.[45] The staff cited to *Blue Chip Stamps v. Manor Drug Stores*, a case where the Supreme Court held that an actual trade is required to bring a private action under Section 10(b) and Rule 10b-5.[46]

Not long after Rule 10b5-1 went into effect, there was widespread speculation that the plans were being abused in a variety of ways, including with respect to cancellation of trades or termination of the plans.[47] Academic studies showed that executives were using Rule 10b5-1 plans to engage in strategic trad-

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44 17 C.F.R. § 240.10b5-1(c)(1)(i)(B)(3) (2022).

45 SEC, Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations: Fourth Supplement, https://perma.cc/G7UL-78VS (May 2021).

46 Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). In *Blue Chip Stamps,* the Court held that, to meet the "in connection with" requirement, a private 10b-5 action could only be maintained by someone who actually bought or sold securities, not by someone who decided *not* to buy securities because of a misrepresentation. More recently, the Supreme Court has taken a slightly more expansive view of the "in connection with requirement" at least when it comes to public enforcement, finding that the requirement is satisfied so long as the fraud "coincides" with a securities transaction. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 89 (2006) ("fraudulent manipulation of stock prices . . . unquestionably qualifies as fraud 'in connection with the purchase or sale' of securities.").

47 *See, e.g.*, Jane Sasseen, *A Closer Look at Trades by the Top Brass: Some Execs May be Abusing an SEC "Safe Harbor" Rule on Insider Stock Sales*, BLOOMBERG (Nov. 13, 2006), https://perma.cc/V5AN-GCSV; Karey Wutkowski*, SEC Probes Possible Abuses in Exec Trading Plans*, REUTERS (Mar. 8, 2007), https://perma.cc/HZ47-EMNK.

ing and reaping above-market returns.[48] The SEC brought a couple of high-profile cases in the early 2000s that involved, among other things, manipulation of trading plans, although the misconduct in those cases involved changes to the plans and actual trading.[49] In 2007, the SEC's then Director of Enforcement stated that the division would be taking a close look at possible misuse of trading plans[50] and the Corporation Finance staff updated its guidance. But the Corporation Finance staff reiterated that the mere termination of a trading plan, and the cancellation of orders thereunder, would not in itself result in liability under Section 10(b) and Rule 10b-5 because the fraudulent conduct must be "in connection with the purchase or sale of any security."[51] At the same time, the staff stated that cancelling trades or terminating a 10b5-1 plan will eliminate the affirmative defense available under the plan for trades going forward and could affect the availability of the affirmative defense for trades previously made under the plan because it might call into question whether the plan was entered into in good faith or as part of a scheme to evade the insider trading rules.[52] But obviating the affirmative defense is very different from imposing actual liability under the anti-fraud provisions.

Private law firms have also long advised clients that while they should avoid cancelling or terminating a Rule 10b5-1 plan because it looks bad and could negate the element of good faith going forward, doing so is perfectly legal—even if the person terminating the plan is in possession of MNPI—because the termination is not "in connection with the purchase or sale" of a security.[53]

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48 *See, e.g.*, Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders' Strategic Trade*, 55 MGMT. SCI. 224, 224–25 (Feb. 2009) (an earlier (2006) version of this paper is available at https://perma.cc/R86M-669X).

49 *See* SEC Charges Kenneth L. Lay, Enron's Former Chairman and Chief Executive Officer, with Fraud and Insider Trading, *supra* note 18; *see also* Former Countrywide CEO Angelo Mozilo to Pay SEC's Largest-Ever Financial Penalty Against a Public Company's Senior Executive, *supra* note 18.

50 *See* Linda Chatman Thomsen, Director, Division of Enforcement, SEC, Remarks at the 2007 Corporate Counsel Institute (Mar. 8, 2007).

51 The staff did go on to note that the "'in connection with' requirement is satisfied when a fraud 'coincides' with a securities transaction." SEC Staff Exchange Act Rules Compliance and Disclosure Interpretations, Question 120.17, https://perma.cc/7K4X-4MXZ (last modified Aug. 25, 2023).

52 SEC Exchange Act Rules Compliance and Disclosure Interpretations, Questions 120.18 and 120.19, https://perma.cc/7K4X-4MXZ (last modified Aug. 25, 2023).

53 *See, e.g.*, Jina Choi, *Answers to Common Questions about Rule 10b5-1 Plans*, MORRISON FOERSTER (Sep. 19, 2023, 8:49 PM), https://perma.cc/MER9-UNMW ("Termination of a plan, by itself, is not a violation of Rule 10b-5 because the termination does

When the recent amendments to Rule 10b5-1 were being considered, SEC Chairman Gary Gensler gave a speech about the need to "freshen up" the rules.[54] In the speech, Gensler bemoaned the fact that Rule 10b5-1 plans could be cancelled even if the person is in possession of MNPI, noting that this seemed "upside down" because cancellation could be "as economically significant as carrying out an actual transaction."[55] Nonetheless, the amended rules did not directly prohibit termination or cancellation of Rule 10b5-1 plan (undoubtedly because of the "in connection with" requirement), although the new rules added a requirement that plan terminations by directors and certain officers needed to be publicly disclosed.[56] The adopting release also stressed that termination or cancellation would obviate the good faith required to assert the affirmative defense.[57]

While the SEC's position with respect to Rule 10b-5 liability for the cancellation or termination of a 10b5-1 plan is undoubtedly correct, Rule 10b-5 is not the only possible avenue for insider trading liability. Both civil and criminal authorities have brought—and are increasingly bringing—insider trading charges pursuant to a variety of different statutory provisions each with distinct elements and founded on different underlying theories of liability.[58] Most notably, some of these statutory provisions do not have an "in connection with" requirement similar to the one contained in Rule 10b-5, and in one case the "in connection with" requirement extends beyond an actual sale of securities to include "offers" to sell securities, all of which raises the possibility that the government could bring "insider trading" charges when there is no actual "trading." In particular, some of these statutory provisions arguably could be used to bring civil and even criminal anti-fraud insider trading charges with respect to the termination or cancellation of a Rule 10b5-1 plan. Notably, when they adopted the recent revisions to Rule 10b5-1,

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not occur in connection with the sale or purchase of securities."); *What's the Deal? Rule 10b5-1 Plans*, MAYER BROWN (Sep. 19, 2023, 8:56 PM), https://perma.cc/8FZP-ERCR; *10b5-1 Plans: What You Need to Know*, DAVIS POLK (Sep 20, 2023, 11:04 AM), https://perma.cc/UTM2-2BAU ("Unlike amending a plan, a 10b5-1 plan may legally be terminated before its predetermined end date even though the insider is in possession of MNPI.").

54 *See* Gary Gensler, Chairman, SEC, Prepared Remarks Before the WSJ's CFO Network Summit (June 7, 2021).

55 *Id.*

56 17 C.F.R. § 229.408(a)(1) (2023).

57 *See* Adopting Release, *supra* note 2, at 63–64.

58 *See* David Rosenfeld, *Current Trends in Insider Trading Prosecutions*, 25 U. PENN. J. BUS. L. (forthcoming 2023).

the SEC stated that the new required disclosures would not only inform market participants and reduce the possibility of abuse, but would also help the Commission identify, and presumably prosecute, abusive practices in connection with the adoption or *termination* of a plan.[59]

B. The Many Bases of Insider Trading Liability

It is now something of a commonplace to note that "insider trading" is a bit of a misnomer. While insider trading liability was originally premised on actual "insiders" of a company trading in the securities of their company on the basis of material non-public (i.e., "inside") information, liability has long been extended to include "outsiders" who trade in the securities of companies with which the traders have no connection.[60] The theoretical underpinnings have shifted as well. While originally viewed as a fraud perpetrated on the counterparty to the transaction, insider trading liability is now increasingly viewed through the lens of a fraud perpetrated on the source (or the purported owner) of the non-public information that is being traded on, rather than the other market participant.[61] Insider trading liability, in other words, is increasingly disconnected from either "insider" status or the "trading" counterparty.[62]

It is also something of a commonplace to note that U.S. insider trading law is based almost entirely on a series of judge- and SEC-made glosses on the broad anti-fraud prohibition contained in Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.[63] But in fact, there are a number of other statutory provisions that have also been used (some for a long time, some only more recently) to prosecute insider trading. These include principally:

- Section 17(a) of the Securities Act of 1933

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59 *See* Adopting Release, *supra* note 2, at 71 ("For example, disclosure of the termination (including modification) of a trading arrangement by an officer, even in the absence of subsequent trading by the officer, could provide investors or the Commission with important information about the potential misuse of inside information such as, for example, if the termination occurs close in time to the release of material nonpublic information by the issuer.").

60 *See, e.g.*, STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 1–2 (2014).

61 United States v. O'Hagan, 521 U.S. 642 (1997).

62 *See* Rosenfeld, *supra* note 58.

63 *See, e.g.*, Tai H. Park, *Newman/Martoma: The Insider Trading Law's Impasse and the Promise of Congressional Action*, 25 FORDHAM J. CORP. & FIN. L. 1, 6 (2019).

- Section 14(e) of the Securities Exchange Act of 1934 and Rule 14e-3 thereunder
- 18 U.S.C §§ 1342 and 1343 (Mail and Wire Fraud)
- 18 U.S.C. § 1348 (Securities and Commodities Fraud)

Some of these provisions could potentially be used to establish insider trading liability with respect to the cancellation or termination of a Rule 10b5-1 Plan and will be examined below. But first, I provide a very brief summary of the framework with respect to insider trading liability under Section 10(b) and Rule 10b-5.

i. The Classical Theory

The classical theory is aimed at "insiders" of a company (today broadly viewed to include officers, directors, employees, and contractors) who trade in the securities of their company on the basis of material non-public information.[64] Legal liability is predicated on a failure to disclose in breach of a fiduciary or fiduciary-like relationship that insiders have to their company and its shareholders.[65] Under the classical theory, the "victim" of the unlawful conduct is the counterparty to the transaction, or other market participants generally.[66] The classical theory can be summarized as: Trading on the basis of MNPI in violation of a duty of trust and confidence that is owed to the company or its shareholders.[67]

ii. The Misappropriation Theory

The misappropriation theory extends insider trading liability to "outsiders" of a company, that is to persons who trade on

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64 WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING: LIABILITY AND COMPLIANCE § 5.02 (Matthew Bender, 3d ed. 2010); Zachary Gubler, *A Unified Theory of Insider Trading Law*, 105 GEO. L.J. 1225 (2017).

65 *See* Chiarella v. United States, 445 U.S. 222, 228 (1980); Dirks v. SEC, 463 U.S. 646, 655 (1983).

66 This is reflected is Section 20A of the Exchange Act which provides a private right of action by contemporaneous traders in insider trading cases (although that provision applies beyond the classical theory). For a discussion of whether there are victims in insider trading cases, see William K.S. Wang, *Stock Market Insider Trading Victims, Violators and Remedies*, 45 VILL. L. REV. 27 (2000).

67 This is, generally speaking, the formulation that the SEC uses in describing insider trading. *See* U.S. Sec. & Exch. Comm'n, *Insider Trading*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/insider-trading (last visited Oct. 10, 2023) ("Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security.").

the basis of MNPI but who have no relation to the company whose securities they are trading in.[68] Legal liability is predicated on a failure to disclose in breach of a duty of trust and confidence that is owed to the source of the information.[69] In brief, someone who receives MNPI in confidence violates a fiduciary or fiduciary-like duty owed to the source of the information when they secretly convert the principal's information to their own use by trading on it.[70] Misappropriation is somewhat akin to embezzlement: the Supreme Court stated that "[u]nder this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[71]

Under the misappropriation theory, the "victim" is the source, or "owner," of the information: it has nothing to do with the counterparty to the transaction or to market harms more generally.[72] Indeed, the fraud and the trading are only tangentially connected: under the misappropriation theory, the misappropriating party is defrauding one person while trading with another.[73] The misappropriation theory can be summarized as: Trading on the basis of MNPI in violation of a duty of trust and confidence that is owed to the source of the information.

iii. Actual Misrepresentation

A third theory of insider trading liability under Section 10(b), distinct from both the classical and misappropriation theories, involves an actual misrepresentation rather than a failure to speak.[74] Actual misrepresentation insider trading cases are rare because most trading occurs on impersonal markets where there is no interaction with the counterparty and hence no representations and no misrepresentations. But if there are actual misrepresentations, legal liability is easier to establish because it does not rest on showing a confidential relationship or breach

68 *See* Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223, 1225 n.11 (1998).

69 United States v. O'Hagan, 521 U.S. 642, 652–53 (1997).

70 *Id.* at 652.

71 *Id.*

72 Zachary Gubler, *A Unified Theory of Insider Trading Law*, 105 GEO. L.J. 1225, 1230 (2017).

73 In *O'Hagan*, the Court held that the two are sufficiently connected to meet the statutory "in connection with" requirement. *See O'Hagan*, 521 U.S. at 655–56.

74 Katherine Drummonds et. al., *Securities Fraud*, 53 AM. CRIM. L. REV. 1733, 1736 (2016).

of a fiduciary duty or similar duty of trust and confidence.[75] As discussed below, in the context of Rule 10b5-1 plans there are actual representations made which could form a basis for liability with respect to termination of a plan.

IV. Liability For Cancellation or Termination of Rule 10b5-1 Plans

A. The Scope of the Affirmative Defense

Technically speaking, a Rule 10b5-1 plan only provides an affirmative defense to liability for insider trading under Section 10(b) and Rule 10b-5. The Rule is specifically addressed to the definition of "manipulative or deceptive devices" prohibited by Section 10(b) and provides a definition of trading "on the basis of material nonpublic information for the purposes of Section 10(b) and Rule 10b-5" and the affirmative defenses thereto.[76]

However, while the adoption of a Rule 10b5-1 plan would not technically provide an affirmative defense to insider trading liability under other provisions of the federal securities laws or under Title 18, the good faith adoption of a Rule 10b5-1 plan at a time when the adopter is not in possession of MNPI would almost certainly negate the scienter or mens rea requirements under those provisions, and likely operate to defeat a negligence based charge as well.

B. Section 17(a) of the Securities Act

Section 17(a) of the Securities Act of 1933[77] is a broad antifraud provision that has long been used to prosecute insider

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75 *See* SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009)

76 *See* 17 C.F.R. § 240.10b5-1(b) (2022) ("Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is on the basis of material nonpublic information for purposes of Section 10(b) and Rule 10b–5 if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.").

77 Section 17(a) provides in relevant part: "It shall be unlawful for any person in the offer or sale of any securities . . . directly or indirectly— (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a).

trading.[78] For the most part, the elements of Section 17(a) insider trading liability are the same as under Section 10(b) and Rule 10b-5. Both are predicated on the misuse of MNPI, based either on a failure to disclose in the face of a duty to speak arising from a pre-existing relationship of trust and confidence or based on an actual misrepresentation even without a breach of fiduciary duty. But Section 17(a) differs from Rule 10b-5 in a few important respects. First, while a violation of Section 10(b) always requires a showing of scienter, only a violation of Section 17(a)(1) requires scienter: violations of Section 17(a)(2) and 17(a)(3) require only a showing of negligence, at least in the civil context.[79] Second, while Rule 10b-5 prohibits fraudulent conduct "in connection with the purchase or sale" of a security, Section 17(a) makes it unlawful to engage in fraudulent conduct "in the offer or sale of any securities."[80]

This means two things. First, Section 17(a) only applies to offers and sales of securities, not purchases. In the insider trading context, this means that liability exists only if the trader is selling securities or offering securities for sale (including short sales). It does not extend to an insider who purchases securities based on MNPI. Most, but not all, Rule 10b5-1 plans involve the sale of securities, so this should not present much of an impediment to prosecution in that context, but it might occasionally limit the use of Section 17(a) with respect to some abusive trading plans if those plans involved purchasing securities.

The second point is more consequential. Liability under Section 17(a) does not require an actual sale; rather, it extends to fraudulent conduct with respect to an *offer* to sell securities. While termination of a Rule 10b5-1 plan does not constitute fraudulent conduct within the meaning of Section 10(b) and Rule 10b-5 because it does not involve an actual purchase or sale of a security, the same issue does not exist with respect to Section 17(a) liability. The immediate question is whether the adoption, modification, or termination of a Rule 10b5-1 Plan would be "in the offer or sale" of securities.

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78 *See, e.g.*, SEC v. Raj Rajaratnam, 822 F.Supp.2d 432, 436 (S.D.N.Y. 2011) (charging violations of Section 10(b) and Rule 10b-5 of the Exchange Act and Section 17(a) of the Securities Act) (judgment upheld Second Circuit 2018).

79 *See* Aaron v. SEC, 446 U.S. 680 (1980).

80 Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a).

i. "In the Offer or Sale" Under Section 17(a)

The definition of an "offer" under the federal securities laws is very expansive and goes well beyond what would constitute a legally binding offer to sell.[81] Under the statute, "[t]he term 'offer to sell,' 'offer for sale,' or 'offer' . . . include[s] every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."[82] Indeed, in the context of the federal securities laws, the term "offer" encompasses all sorts of activity beyond a legally binding offer, including anything that might be construed as part of an effort to sell securities or conditioning the market for a possible future sale of securities.

Given the expansive definition of an "offer" and the variety of conduct that it has been deemed to encompass, there would seem to be little doubt that the adoption, modification, or termination of a Rule 10b5-1 plan would be considered part of an "offer" to sell securities for purposes of Section 17(a).

First, Rule 10b5-1 plans can be in the form of a binding contract to purchase or sell securities.[83] This is the easiest scenario because it does not even involve the question of what constitutes an offer: a contract to sell securities meets the definition of a "sale" of securities under the Securities Act.[84] Indeed, a contract to purchase or sell securities meets the definition of a "purchase or sale" under the Exchange Act as well,[85] so a binding contract to buy or sell securities would likely meet the "in connection with" requirement even for Section 10(b) and Rule 10b-5 purposes. A contract to sell is a sale.

Most Rule 10b5-1 plans are in the form of a written instruction or plan provided to the plan adopter's broker or agent which constitutes a legally binding order directing the broker or agent to execute certain securities transactions under specified terms and conditions. By the terms of the Rule, the instruction or plan cannot "permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales."[86] That would seem to clearly fit within the definition of an "offer,"

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81 Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3).

82 *Id.*

83 17 C.F.R. § 240.10b5-1(c)(1)(i)(A)(1).

84 Securities Act of 1933 § 17(b)(a)(3), 15 U.S.C. § 77(b)(a)(3) ("The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value.").

85 Securities Exchange Act § 3(13) ("The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire"); Securities Exchange Act § 3(14) ("The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of.").

86 17 C.F.R. § 240.10b5-1(c)(i)(B)(3).

which again includes any "attempt or offer to dispose of . . . a security or interest in a security, for value."[87] And any modification, cancellation, or termination of such a plan would clearly be in connection with *that* "offer."

Finally, Rule 10b5-1 plans now have to be publicly disclosed in the company's quarterly filings, which raises the further possibility that the plan could be deemed to be an offer in the broader sense in which anything that could be viewed as conditioning the market constitutes an "offer" under the Securities Act.

ii. Insider Trading Fraud Under Section 17(a)

While the foregoing fairly resolves the issue of whether termination of a plan meets the "in the offer" requirement of Section 17(a), that is not the end of the matter. It still must be determined whether cancellation or termination of a Rule 10b5-1 Plan could constitute "fraud" within the meaning of Section 17(a). Here, there are several possible approaches under different parts of the statute.

Section 17(a) of the Securities Act has three distinct subparts—17(a)(1), 17(a)(2), and 17(a)(3)—which are treated disjunctively so that a violation of any subpart counts as a violation. Importantly, the subparts are worded differently and have been treated differently by the courts: the subparts have different legal standards and apply to different types of transactions in ways that have important implications for finding a legal violation, two of which are particularly consequential. First, a violation of Section 17(a)(1) requires a showing of scienter, while violations of Sections 17(a)(2) and 17(a)(3) only require a showing of negligence.[88] Over the past several years, the SEC has increasingly resorted to using negligence based 17(a)(2) and 17(a)(3) charges in securities fraud cases, particularly in the context of negotiated resolutions.[89] Second, a violation of Section 17(a)(3) prohibits transactions or practices "which operate[] or would operate as a fraud or deceit upon the *purchaser*."[90] Violations of Section 17(a)(1) and 17(a)(2) can involve a fraud on *any person*, not just the purchaser or offeree.[91] This is important be-

87 Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3).

88 Aaron v. SEC, 446 U.S. 680, 685 (1980).

89 *See* David Rosenfeld, *Civil Penalties Against Public Companies in SEC Enforcement*, 22 U. PENN. J. BUS. L. 135 (2019).

90 Securities Act of 1933 § 17(a)(3), 15 U.S.C. § 77(q)(a)(3) (emphasis added).

91 United States v. Naftalin, 441 U.S. 768, 772 (1979).

cause it likely limits the applicability of Section 17(a)(3) to "classical" insider trading cases, whereas Sections 17(a)(1) and 17(a)(2) also apply in "misappropriation" cases.

Notably, the SEC recently brought two insider trading cases involving the misuse of Rule 10b5-1 plans where the charges included violations of Section 17(a). In March 2023, the SEC and criminal authorities brought insider trading charges against the chairman and CEO of a healthcare company for allegedly trading in the stock of his company while in possession of negative information regarding his company's largest customer.[92] The executive made the trades pursuant to two Rule 10b5-1 plans that were adopted while the executive was in possession of the negative information, even though he certified at the time of the Plans' adoption that he was not aware of any nonpublic information.[93] The facts here were particularly egregious: the executive adopted the 10b5-1 trading plans shortly after learning the negative information (in one case just one hour after the information was conveyed to him) and started trading the next trading day after establishing the plans.[94] By trading in advance of the negative announcements, he avoided losses totaling more than $12.7 million.[95] The criminal authorities charged violations of both Section 1348 and Section 10(b)[96] and described the case as the first "criminal insider trading charges based exclusively on an executive's use of 10b5-1 trading plans."[97] The SEC brought a parallel civil action charging violations of Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act.[98]

The second case is even more noteworthy because it specifically involved violations of Sections 17(a)(2) and 17(a)(3). In September 2022, the SEC brought a settled administrative proceeding against both the CEO of a China-based technology company, and the company's former president, for insider trading

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92 *See* Press Release, Department of Justice, CEO of Publicly Traded Health Care Company Charged for Insider Trading Scheme (Mar. 1, 2023); *see also* Press Release, SEC, SEC Charges Ontrak Chairman Terren Peizer With Insider Trading (Mar. 1, 2023).

93 Press Release, SEC, *supra* note 92.

94 Press Release, Department of Justice, *supra* note 92.

95 Press Release, SEC, *supra* note 92.

96 Indictment, United States v. Peizer, No. 23-cr-00089 (C.D. Cal. Feb. 24, 2023).

97 *See* Press Release, Department of Justice, CEO of Publicly Traded Health Care Company Charged for Insider Trading Scheme (Mar. 1, 2023).

98 Interestingly, the SEC also charged Peizer with "control person" liability, because he owned and controlled one of the entities through which the trading was conducted. Complaint, SEC v. Peizer, No. 2:23-cv-01511 (C.D. Cal. Mar. 1, 2023).

that was conducted pursuant to purported Rule 10b5-1 plans. The two executives sold securities ahead of a negative announcement about the company, and the SEC order found that the executives were aware of the negative news when they adopted the trading plans. The order found that both defendants violated Section 10(b). Interestingly, one of the defendants, who had made some misleading statements on an earnings call, was also found to have violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, which prohibit obtaining money or property by means of an untrue or materially misleading statement. In the Order, the SEC went out of its way to stress that a "violation of [Section 17(a)(2) and 17(a)(3)] does not require scienter and may rest on a finding of negligence."[99] Going forward, a Section 17(a)(2) and 17(a)(3) charge might prove an attractive avenue for the SEC particularly in cases relating to the abuse of Rule 10b5-1 plans.[100]

a. Section 17(a)(1)

The most likely avenue for insider trading liability connected to the termination of a Rule 10b5-1 plan by someone in possession of MNPI would be under the misappropriation theory[101] using Section 17(a)(1), which requires a showing of scienter. Section 17(a)(1) makes it unlawful "to employ any device, scheme, or artifice to defraud."[102] In essence, the misappropriation theory consists of a fraudulent scheme perpetrated on the source of the information, rather than on a trading counterparty or market participant. The fraudulent conduct consists of deceiving the source of MNPI, in violation of a duty of trust and confidence, by misappropriating the MNPI for one's own use without disclosure to the source. The misappropriation theory is akin to an embezzlement theory: it amounts to embezzling proprietary confidential information that belongs to someone else and using it for

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99 In the Matter of Sheng Fu and Ming Xu, Securities Act Release No. 11104, Exchange Act Release No. 95847 (Sep. 21, 2022).

100 In response to what are perceived as some of the more onerous requirements of Rule 10b5-1 plans, some insiders have begun to adopt so-called non-Rule 10b5-1 plans which do not provide the affirmative defense that a Rule 10b5-1 plan provides but could be used to negate the scienter necessary for a Section 10(b) charge. Section 17(a)(2) and 17(a)(3) could provide an alternative basis for insider trading charges in those cases.

101 Persons who adopt Rule 10b5-1 trading plans are typically "classical" insiders, that is they are insiders of the company whose shares they are trading in which in some respects makes the classical theory a more obvious choice. But the classical theory and the misappropriation theories are not mutually exclusive, and almost every classical case could be brought as a misappropriation case.

102 Securities Act of 1933 § 17(b)(a)(1), 15 U.S.C. § 77q(a)(1).

one's own purposes, thereby depriving the owner of the information of the exclusive right to use the information.

Traditionally, of course, the misappropriation theory has been applied in situations where the information is being used as a basis for trading; but there is no reason to think that the theory wouldn't equally be applicable in situations where the information is being used as a basis for not trading.[103] It seems wholly immaterial whether the embezzled information is used to purchase or sell securities or to cancel an existing order to purchase or sell securities. In either case, the pilfered information is the basis for the decision, and in both cases the owner of the information is deprived of the exclusive right to use the information.

Thus, it would seem that all of the elements of an "insider trading" charge under the misappropriation theory pursuant to Section 17(a)(1) would be met in a case where someone cancels or terminates an existing Rule 10b5-1 plan while in possession of MNPI obtained from the company. First, there is clearly a duty of trust and confidence. In addition to common law and statutory fiduciary duties that may apply to directors and officers, insiders of public companies are typically required to sign confidentiality agreements whereby they agree to hold company information in confidence and not misuse it in any way.[104] Second, there is clearly a breach of that duty when an insider misappropriates the information for their own use, including to cancel a previous order to trade. Third, the necessary deception exists if the decision to cancel or terminate the plan is not disclosed to the principal, about which more in a moment. Fourth, the element of scienter would be met if the person knowingly cancelled the plan while in possession of MNPI in the face of a known duty not to misuse confidential information.[105] Finally,

[103] This is of course wholly distinct from the question whether the conduct satisfies the "in connection with" requirement, which is discussed above.

[104] *See, e.g.*, Carol M. Bast, *At What Price Silence: Are Confidentiality Agreements Enforceable?*, 25 WM. MITCHELL L. REV. 627 (1999); Orly Lobel, *NDAs Are Out of Control: Here's What Needs to Change*, HARV. BUS. REV. (2018) (noting that data shows that over one-third of U.S. workforce is bound by an NDA). An agreement to keep information in confidence is one of the enumerated "duties of trust and confidence" for purposes of insider trading liability under the misappropriation theory. *See* 17 C.F.R. § 240.10b5-2(b)(1). The Second Circuit recently upheld a criminal conviction based on the breach of a nondisclosure agreement. United States v. Chow, 993 F.3d 125 (2d Cir. 2021).

[105] Rule 10b5-1 specifies that, in the trading context, "on the basis of" means while the person is "aware" of the information, subject to the affirmative defense that arises through the good faith establishment of a 10b5-1 plan. Before the adoption of Rule 10b5-1, people frequently claimed that they while they may have been in possession of MNPI

the "in the offer or sale" requirement would be met because the cancellation or termination concerns a plan that itself constitutes an "offer" to sell securities.

There is, however, one significant issue with the use of the misappropriation theory in general that has particular ramifications in this context. In the *O'Hagan* case, where the Supreme Court adopted the misappropriation theory, the Court stressed that for the misappropriation to be fraudulent within the meaning of the statute there had to be deceit, and that deceit occurred when the misappropriating party, while feigning allegiance to the principal, secretly converted the principal's information to his own use.[106] As a result, the Court concluded, disclosure to the principal would obviate the deception, and without deception there would be no fraud.[107]

In the context of terminating a Rule 10b5-1 plan, this would imply that disclosure to the source of the information (the company) would negate anti-fraud liability under this theory. Under the newly adopted revisions to the rules, companies are required to disclose the termination of a Rule 10b5-1 plan by directors and specified officers, which presumably triggers an obligation for the plan adopter to disclose the termination of the plan to the company. To be accurate, the disclosure would need to be complete—that is, not merely disclosure that one is terminating the plan, but also disclosure that one is terminating the plan based on MNPI obtained from the company. After all, it is MNPI that is being misappropriated, so a failure to disclose that that is the reason for terminating the plan would still be deceitful. But a plan adopter's disclosure to the company that they will be terminating the plan based on MNPI would likely obviate any fraud under the misappropriation theory (and also comes into play with respect to certain other theories discussed below). Of

at the time of the trade, they placed the trade for wholly unrelated reasons, for example because they needed money to pay for the medical expenses of a sick relative. Rule 10b5-1 was designed to obviate this type of argument and it has largely, but perhaps not entirely, done so. *See* Andrew Verstein, *Mixed Motive Insider Trading*, 106 IOWA L. REV. 1253 (2021). In the case of a cancelled or terminated plan, however, the argument about mixed motives would likely be inapplicable: arguments about alternative motives for trading almost always revolve around an exigent need to obtain money; it is hard to imagine a situation where one could argue that they needed to cancel a trading plan to sell securities because of some urgent unforeseen need.

106 United States v. O'Hagan, 521 U.S. 642, 654–55 (1997).

107 *Id.* at 655 ("Because the deception essential to the misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation . . . .").

course, termination of a trading plan based on MNPI would almost certainly violate the company's insider trading policy as well as confidentiality agreements entered between the company and the insider which would likely lead to some kind of internal company discipline.

Because companies are now required to publicly disclose not only the adoption but also the termination of any Rule 10b5-1 trading plans by directors and specified officers, disclosure to the company that one is terminating a plan based on MNPI would have to be publicly disclosed. In addition to causing reputational harm, this could be a source of liability particularly if the company has previously disclosed that they have an insider trading policy that prohibits trading on the basis of MNPI.

In sum, cancellation or termination of a Rule 10b5-1 plan while in possession of MNPI would constitute a scheme to defraud within the meaning of Section 17(a)(1) absent disclosure to the company that the plan is being terminated based on MNPI. There are also several other bases for insider trading liability in the context of terminating a Rule 10b5-1 plan—most notably based on actual misrepresentations—which are discussed below, and which could constitute a violation of Section 17(a)(1) if done with scienter.

b. *Section 17(a)(2)*

Section 17(a)(2) provides a separate avenue for insider trading liability resulting from the termination or cancellation of a Rule 10b5-1 plan by someone in possession of MNPI. It also provides a basis for liability connected to misstatements made in connection with the adoption of the plan itself.

Section 17(a)(2) makes it unlawful "to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[108] When it comes to Rule 10b5-1 plans, there are numerous statements made to brokers, the company, and in certain circumstances to the public at large in connection with the offer or sale of securities.

The existence of actual statements changes the landscape for insider trading liability, and indeed resolves some of the more problematic aspects of insider trading law. It is often said

[108] Securities Act of 1933, § 17(a)(2), 15 U.S.C. § 77(b)(a)(2).

that insider trading law is confused or worse.[109] The root of the doctrinal mess comes about by trying to fit insider trading within the confines of an antifraud statute under circumstances where there are no statements made. Because most trading occurs on impersonal markets where the counterparties have no communications with one another, there are typically no representations—and hence no misrepresentations—made in connection with the securities transactions made by persons in possession of MNPI. In the development of Rule 10b-5 insider trading liability, it was clear that, absent a misstatement, Rule 10b-5(b)—which is closely, but not exactly, analogous to Section 17(a)(2)—was inapplicable.[110] From a legal standpoint, the question became under what circumstances silence (i.e., the failure to disclose the MNPI to the counterparty or even that one is in possession of MNPI) could be considered deceptive within the meaning of Rule 10b-5(a) and 10b-5(c), which generally speaking prohibit fraudulent devices, schemes, artifices and business practice. In the landmark cases of *Chiarella v. United States* and *Dirks v. SEC*, the Supreme Court held that silence is only deceptive when there is a duty to speak and, as there are no duties to the world, a duty to speak arises from a preexisting fiduciary or similar relationship of trust and confidence.[111] It is for this reason that insider trading liability traditionally does not extend to every person who trades while in possession of MNPI but rather is limited to those traders who have acquired MNPI as a result of a confidential relationship and have traded in breach of their duty of trust and confidence.

When there are actual statements made, however, the analysis is completely different, and liability is much easier to establish. In the case of Rule 10b5-1 plans there are numerous state-

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109 *See, e.g.*, Marc I. Steinberg, *How to Reform our Abysmal Insider Trading Framework*, CLS BLUE SKY BLOG (Feb. 21, 2023) ("The US insider trading framework is a mess."); Donald C. Langevoort, *Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas and a Blaszczak,* 89 FORDHAM L. REV. 507 (2020); Russell G. Ryan, *Insider Trading Law is Irreparably Broken*, WASHINGTON POST (Jan. 27, 2020); Sung Hui Kim, *Insider Trading Law as Private Corruption*, 61 UCLA L. REV. 928, 935–949 (2014); John C. Coffee Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 281, 285 (2013); Saikrishna Prakash, *Our Dysfunctional Insider Trading Regime*, 99 COLUM. L. REV. 1491, 1493 (1999); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 184 (1991).

110 *See* Chiarella v. United States, 445 U.S. 222, 225 n.5 (1980) ("Only Rules 10b-5(a) and (c) are at issue here . . . . The portion of the indictment based on [Rule 10b-5(b)] was dismissed because the petitioner made no statements at all in connection with the purchase of stock.").

111 *See id.*; Dirks v. SEC, 463 U.S. 648 (1983).

ments made concerning the trades themselves; there will also now be representations made concerning good faith and the possession of MNPI. These statements are made to brokers who need to execute the trades; the company, which needs the information in order to satisfy its new public disclosure obligations; and to the public in the form of the company's quarterly disclosures. If any of these statements is false at the time it is made, and the person making the statement knows, or is reckless in not knowing, that the statement is false, that is a clear basis for liability even under Rule 10b-5 (so long as there is an actual purchase or sale of a security).

It would be even easier to make out a case under Section 17(a)(2) which does not require knowing or reckless conduct, but mere negligence (although that may require an actual sale of a security and not just an offer).[112] For example, if a plan adopter were to falsely represent that they were not in possession of MNPI at the time they entered into the plan, and knew or were reckless in not knowing that they were in fact in possession of MNPI, that would not only negate the good faith requirement and thus the availability of the affirmative defense under Rule 10b5-1, but it would also create an independent basis for liability even under Rule 10b5(b) (if the "in connection with" requirement is met). [113] It would also create an independent basis for liability under Section 17(a)(2) on a mere showing of negligence.

The preceding discussion concerned misstatements made in connection with the *adoption* of a Rule 10b5-1 plan. The next question is whether there could be liability under Section

[112] The difficulty with a mere offer is that the language of Section 17(a)(2) refers to obtaining "money or property" which will be discussed below.

[113] Apparently, the SEC does not see it that way. When the SEC proposed the recent revisions to Rule 10b5-1, certain commenters expressed concern that the new certification requirement could be used as a separate basis for imposing insider trading liability, and urged the SEC to alter the proposed rule to make it clear that the representation would not create an independent basis for liability. The SEC declined to do so, principally by pointing to the fact that Rule 10b5-1 does not otherwise alter the existing law with respect to insider trading liability. The SEC concluded: "We think it is sufficiently clear that certification would not create an independent basis of liability for insider trading and do not believe it is necessary to amend the rule in this regard, as suggested by several commenters." *See* Adopting Release, *supra* note 2 at 46–47. The SEC's conclusion in this regard is hard to square with general principles of anti-fraud liability under Section 10(b) and Rule 10b-5. The SEC was likely thinking about insider trading law as it has developed in situations where there isn't an actual statement or representation (which is the most common situation when one is trading on an impersonal market) and courts have struggled to find a basis for insider trading liability on the basis of silence in the face of a duty to speak under Rule 10b-5(a) & (c). But when there are actual representations made, it's a whole different ballgame: at that point Rule 10b-5(b) is applicable.

17(a)(2) with respect to the termination or cancellation of a Rule 10b5-1 plan. Here, there are two issues. The first is whether termination or cancellation of a plan would be considered a material fact requiring corrective disclosure. The law on this is fairly straightforward: an omission of a material fact is legally actionable if the omitted fact is necessary to make the statements made not misleading. Termination or cancellation of a previously disclosed plan would certainly be deemed material, particularly if the person is in possession of MNPI at the time of termination. And it is important to remember that the plan "statements" will henceforth be publicly disclosed in the company's quarterly filings, and the company is necessarily relying on disclosure from the plan adopter in order to make the requisite filings.

In the adopting release for the amended rules, the SEC stated that the principal benefit of requiring quarterly reporting of Rule 10b5-1 plan adoptions and terminations is that it enables investors to make more informed and better investment decisions.[114] Investors, in other words, deem such information important and often rely on it in making investment decisions. It is thus abundantly clear that termination or modification of a previously adopted plan would require public disclosure (the rules themselves specifically state that companies are required to disclose modifications and terminations), which in turn would require disclosure by the plan adopter to the company. Furthermore, given that the plan requires a representation of good faith and a representation that the adopter is not in possession of MNPI at the time of plan adoption, the corrective disclosure necessary to make these statements not misleading would have to include disclosure (both by the plan adopter to the company and by the company to the public) of whether the person terminating the plan is in possession of MNPI at the time of termination.

The second issue is a bit more complicated. Section 17(a)(2) makes it unlawful "to obtain money or property" by means of a false statement or material omission.[115] In the case of someone who adopts a plan and falsely represents that they are not in possession of MNPI, and sales are consummated under the plan, that would clearly constitute obtaining money or property. But

[114] *See* Adopting Release, *supra* note 2, at 171–76.
[115] Securities Act of 1933, § 17q(a)(2), 15 U.S.C. § 77(b)(a)(3).

what about someone who cancels a plan and therefore does not consummate any sales?

At present, there is considerable uncertainty (and litigation) over what constitutes "property" within the meaning of various antifraud statutes, particularly with respect to what constitutes government "property," including in the context of insider trading.[116] The best argument that terminating a plan amounts to obtaining money or property is that the plan is being terminated in order to avoid monetary "losses." Say an executive has adopted a Rule 10b5-1 plan calling for the sale of securities at a determined price and date. The executive then learns MNPI that indicates that the securities are far more valuable than the predetermined sale price and so the executive terminates the plan and thereby cancels what would have amounted to money-losing sales. Is this the equivalent of obtaining money or property?

The simple answer is that when it comes to insider trading law, losses avoided are treated the same as gains. Losses avoided have always been considered a form of pecuniary benefit in all insider trading cases, and they are considered as part of the calculation of the overall gains for disgorgement purposes as well as for the calculation of civil penalties.[117] Given how losses avoided have always been treated as gains in insider trading cases, it is not a stretch to say that someone who terminates a plan in order to exit a losing trading strategy has thereby obtained money or property.[118]

In sum, Section 17(a)(2) provides an independent basis for insider trading liability resulting from false statements made in connection with the adoption of a Rule 10b5-1 plan on a mere showing of negligence; and there would be liability under Section 17(a)(2) for terminating or cancelling a plan without com-

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[116] *See* Kelly v. United States, 140 S. Ct. 1565 (2020). The decision in Kelly (the so-called "Bridgegate" case) led the government to drop insider trading charges in the Blaszczak case. *See* United States v. Blaszczak, 56 F.4th 230 (2d Cir. 2022); *see also* Jane Wester, *SDNY US Attorney's Office Agrees to Dismiss Final Counts in Medicare/Medicaid-Linked Fraud Case*, N.Y. L.J. (July 25, 2023).

[117] *See* Securities Exchange Act of 1934 § 21A(a)(2), 15 U.S.C. § 78u-1(2) ("The amount of the penalty which may be imposed on the person who committed such violation shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained *or loss avoided* as a result of such unlawful purchase, sale, or communication.") (emphasis added).

[118] It is true that in these situations the defrauded party (say the company if the false statements were made to the company) will typically not suffer any actual loss, but that is not required: it is sufficient that the fraudster obtain money or property. In addition, given that the statements are publicly made, it is at least arguable that other market participants do in fact lose money or property by virtue of the decision to cancel a previously disclosed trade.

plete and timely disclosure, including disclosure that the person terminating the plan is in possession of MNPI, although there may be some difficulty in establishing that the person terminating the plan has obtained money or property by virtue of the omission.

c. Section 17(a)(3)

Section 17(a)(3) provides a third possible avenue for insider trading liability in connection with the termination or cancellation of a Rule 10b5-1 plan. At first glance, Section 17(a)(3) might seem the most problematic approach, but upon reflection it may be the easiest. Section 17(a)(3) prohibits "any transaction, practice, or course of business which operates or would operate as a fraud or deceit *upon the purchaser*."[119]

The "on the purchaser" limitation could prove problematic for insider trading liability under the most common insider trading theories. It rules out the misappropriation theory entirely and arguably even limits the application of the classical theory. The classical theory is predicated on silence in the face of a duty to disclose. Originally, the duty was grounded in the fiduciary or fiduciary-like relationship that actual insiders—officers and directors—have to the shareholders of the company.[120] That theory works well enough when the insider in possession of MNPI purchases company securities from existing shareholders. The theory works less well when the insider is selling shares, because the insider would have no fiduciary duties to the purchasers at the time of sale (unless the purchaser was an existing shareholder).[121] Faced with this difficulty, courts initially sidestepped the issue and eventually settled on the idea that even in the context of a sale to someone who was not already a shareholder there was a sufficient breach of a duty of confidentiality that is owed to the *company*.[122] But that wouldn't work under Section 17(a)(3) because the statute specifies a fraud "on the purchaser."

The issue, however, goes away entirely in the context of insider trading liability that is predicated on an actual misrepre-

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119 *See* Securities Exchange Act of 1933 § 17(a)(3), 15 U.S.C. § 77q(a)(3). The "on the purchaser" language applies only to Section 17(a)(3); Sections 17(a)(2) and (3) are not limited to frauds "on the purchaser." *See* United States v. Naftalin, 441 U.S. 768 (1979).

120 Chiarella v. United States, 445 U.S. 222, 237 (1980).

121 *Id.* at 230.

122 *See* Zachary Gubler, *A Unified Theory of Insider Trading Law,* 105 GEO. L.J. 1225, 1229–30 (2017) (discussing some of the problems with the classical theory of insider trading); Adam C. Pritchard, United States v. O'Hagan: *Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 26–28 (1998).

sentation rather than silence in the face of a duty to speak. In an "actual misrepresentation" insider trading case there is no need to show a breach of a duty of trust and confidence:[123] a materially false statement, or the omission of a material fact necessary to make the statements made not misleading, is sufficient regardless of any confidential relationship.

As previously discussed, in the context of Rule 10b5-1 plans there are multiple representations made in connection with the adoption of the plan, including representations that under the revised rules will now be made to the market as a whole in the form of disclosures in the company's quarterly reports. These disclosures include details of the trading plan (except for price) as well as disclosures, directly or indirectly, that the person adopting the plan is not in possession of MNPI at the time of adoption, is acting in good faith, and is relinquishing control over the trades described in the plan. If any of these representations is false at the time it is made, that would be actionable under Section 17(a)(3) under a simple negligence standard. In addition to constituting a false statement under Section 17(a)(2), the statement would be considered an act, practice, or course of business, that operates or would operate as a fraud on the purchaser. The disclosures to the public are made by the company, but they are predicated on disclosures that are made to the company by the plan adopter; together, they could easily be considered part of an overall practice or course of business that operates or would operate as a fraud on the purchaser.[124]

More important, even if the statements were true at the time they were made, they could be rendered false by a subsequent decision to terminate or cancel the plan. Given the statements made, this would at a minimum require some sort of corrective disclosure and might even necessitate more fulsome disclosure at the time of adoption, namely a disclosure that the plan might be cancelled or terminated at any time, even when the plan adopter is in possession of MNPI. Without such disclosure at the outset, the actual disclosures made could be materially misleading.

To be clear, the disclosures made concerning a Rule 10b5-1 plan are made to the public, meaning to market participants generally. Thus, anyone who purchases company securities after the public disclosure of the plan is potentially being defrauded.

[123] *See* SEC v Dorozhko, 574 F.3d 42 (2d Cir. 2009).
[124] Lorenzo v. SEC, 139 S. Ct. 1094 (2019).

When adopting the recent amendments, the SEC stressed that public disclosure was important to investors. Specifically, the SEC stated:

> This enhanced transparency may enable better informed voting and investment decisions and more efficient allocation of investor capital. The timing of trading arrangement adoptions and terminations by officers and directors, as well as a description of the material terms of the trading arrangements, is expected to enhance the value of existing trade disclosures, aiding investors in obtaining a more accurate valuation of the issuer's shares and making more informed voting and investment decisions.[125]

The SEC went on to stress that information regarding the termination of a Rule 10b5-1 plan would be particularly valuable to market participants:

> A termination or a change in material terms of a prior trading arrangement may similarly convey information about the views of the officers or directors regarding the issuer's future outlook and share price. Further, the timing of trading arrangement adoptions or terminations, relative to the issuance of other corporate disclosures, may provide investors with valuable insight into potential insider trading under such trading arrangements, and thus associated conflicts of interest that may erode firm value.[126]

Under these circumstances, the termination or cancellation of a Rule 10b5-1 plan by someone in possession of MNPI without adequate disclosure (including adequate cautionary disclosure at the time of adoption) could easily be seen as an act, practice, or course of business that operates or would operate as a fraud on anyone who purchases securities after the initial plan disclosure. And recall that a violation of Section 17(a)(3) requires only a showing of negligence.

Importantly, in this situation (as with Section 17(a)(2)) it is not the termination or cancellation of the plan itself that creates liability, but rather the failure to adequately disclose to the

125 *See* Adopting Release, *supra* note 2, at 171–72.

126 *See id.* at 173. The SEC also pointedly noted that the required disclosure is specifically intended to reduce insider trading: "Moreover, by drawing market scrutiny to the adoption and termination of trading arrangements, enhanced disclosure is expected to deter insider abuses of trading arrangements based on MNPI. This scrutiny is expected to reduce insider trading, benefiting investors and decreasing the economic costs and inefficiencies associated with insider trading." *Id.*

market (1) the possibility and conditions of termination at the outset and (2) the full circumstances of termination at the time of termination.[127] As a result, the termination of a plan without proper disclosure could even give rise to liability under Rule 10b-5 if done with scienter: the "in connection with" requirement would be met if there are *any* sales or purchases after the disclosure of the plan adoption, not just purchases or sales by the plan adopter.

C. Title 18 – Other Avenues for Insider Trading Liability

The anti-fraud provisions of the federal securities laws are not the only basis for insider trading liability. Criminal authorities have long brought insider trading charges under the mail and wire fraud statutes (Title 18 Sections 1341 and 1343) and are increasingly bringing insider trading cases under Title 18 Section 1348, a relatively new statutory provision that is directed at securities fraud but is not part of the federal securities laws.[128] In recent years, criminal authorities have increasingly relied on Title 18 to bring insider trading cases largely because of concerns over meeting the "personal benefit test" which is required to establish liability in many, if not most, tipper-tippee insider trading cases brought under the antifraud provisions of the federal securities laws.[129] But Title 18 could also be a basis for establishing liability in the context of termination of a Rule 10b5-1 plan by someone in possession of MNPI.

i. Mail and Wire Fraud

The mail and wire fraud statutes are criminal statutes which cannot be enforced by the SEC. The mail and wire fraud statutes both prohibit "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises" through the use of the

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127 It may seem odd to treat what is essentially "insider trading" liability (making an investment decision based on MNPI) as a disclosure violation. But in fact, most insider trading liability under the anti-fraud provisions is predicated on a failure to disclose, starting with the original "disclose or abstain" rationale articulated in *Cady, Roberts* which became the basis for the Classical Theory (liability predicated on a failure to disclose to the counterparty or the market generally) and running through the Misappropriation Theory (liability predicated on the undisclosed conversion of the principal's information to one's own use).

128 *See* Karen E. Woody, *The New Insider Trading*, 52 ARIZ. ST. L.J. 594 (2020).

129 *See* Rosenfeld, *supra* note 58. It is still something of an open question whether a personal benefit is required under the misappropriation theory.

mail or by interstate wire.[130] The reach of the mail and wire fraud statutes is very broad[131] and the Supreme Court has twice unanimously blessed the use of those statutes to criminally prosecute insider trading, first in *Carpenter v. United States*[132] in 1987 and ten years later in *United States v. O'Hagan*.[133] Most important, the mail and wire fraud statutes cover conduct beyond that which may be prohibited under Section 10(b).

Use of the mail and wire fraud statutes to prosecute insider trading is based on an embezzlement theory, namely the fraudulent appropriation for one's own use of money or goods that have been entrusted to one's care by another. The embezzlement itself constitutes a violation of a duty of trust and confidence.[134]

The *Carpenter* case provides the core basis, and a good example, of a mail and wire fraud violation. In *Carpenter*, a Wall Street Journal columnist provided advance information regarding the content of his column, which often contained market moving information, to two individuals who traded on the information and shared the profits with the columnist.[135] The columnist and one of the traders were charged with violating the antifraud provisions of Section 10(b) and Rule 10b-5 as well as the mail and wire fraud statutes (18 USC §§ 1341 and 1343) and were convicted after trial (the other trader pled guilty).[136]

The District Court found that the columnist had breached a duty of confidentiality by misappropriating for his own use information that rightly belonged to his employer, the Wall Street Journal.[137] The court found that the columnist's deliberate breach of his duty combined with concealment of the scheme constituted actionable deception within the meaning of Rule

130 18 U.S.C. § 1341 (mail fraud); 18 U.S.C. § 1343 (wire fraud). The required elements of a violation are simply (1) a scheme to defraud or deprive someone of property, and (2) use of the mails or an interstate wire. *See, e.g.*, Schmuck v. United States, 489 U.S. 705, 721 (1989).

131 Judge Rakoff famously quipped that, "[t]o federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love." Jed S. Rakoff, *The Federal Mail Fraud Statute (Part 1)*, 18 DUQ. L. REV. 771 (1980).

132 Carpenter v. United States, 484 U.S. 19 (1987).

133 *O'Hagan*, 521 U.S. at 642.

134 *See Carpenter*, 484 U.S. at 27–28. ("It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit, but must account to his principal for any profits derived therefrom.") (citations omitted).

135 *Id.* at 22–23.

136 *Id.* at 23–24.

137 *Id.*

10b-5. The court also found that the columnist had misappropriated "property" within the meaning of the mail and wire fraud statutes. The Second Circuit upheld the convictions.

On appeal, the Supreme Court split 4–4 on the Rule 10b-5 convictions—thus leaving the Second Circuit opinion and the convictions on those charges in place but putting off actual adoption of the misappropriation theory for another day—but was unanimous (8–0) in upholding the convictions under the mail and wire fraud statutes, an indication that the standard for insider trading liability under those statutes is different than under the antifraud provisions of the federal securities laws.[138] With respect to the mail and wire fraud statutes, the Court held that confidential company information is a form of property, even though intangible, to which the company has exclusive right of use: "The Journal had a property right in keeping confidential and making exclusive use, prior to publication, of the schedule and contents of the . . . column."[139] The Court went on to say that "Sections 1341 and 1343 reach any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises."[140] The Court specified that, within the meaning of the mail and wire fraud statutes, fraud simply means depriving somebody of something of value by means of some kind of deception.[141] The columnist knew that the information he had was confidential and he deceived the Journal when he used the information for his own purpose all the while pretending to safeguard the information.[142]

Ten years later, in *O'Hagan*,[143] the Court finally adopted the misappropriation theory for purposes of Rule 10b-5 liability and also once again unanimously upheld the use of the mail and wire fraud statutes to prosecute insider trading. While the Court split 6–3 on the use of the misappropriation theory, all nine Justices approved the use of the mail and wire fraud statutes to reach the same underlying conduct.[144]

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138 *Id.*

139 *Id.* at 26.

140 *Id.* at 27.

141 *Id.* ("The concept of 'fraud' includes the act of embezzlement, which is 'the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.'") (citation omitted). Some recent Supreme Court cases have cast doubt on whether the term property encompasses intangibles, at least in the context of government property. *See* Kelly v. United States, 590 U.S. 1565 (2020).

142 *Carpenter*, 484 U.S. at 19.

143 *O'Hagan*, 521 U.S. at 642.

144 Even Justices Thomas and Rehnquist, who dissented on the use of the misappropriation theory to uphold the securities fraud charges, had no problem upholding the

Because of the greater reach of the mail and wire fraud statutes and the difficulties of meeting some of the technical requirements of a Rule 10b-5 violation, criminal authorities are increasingly bringing insider trading charges under those statutes.[145] Importantly, "insider trading" under the mail and wire fraud statutes does not require a securities *transaction*: while Rule 10b-5 prohibits fraud "in connection with" the purchase or sale of a security, there is no "in connection with" requirement under the mail and wire fraud statutes; indeed, there is no requirement of a securities trade at all. As a result, the principal impediment to establishing insider trading liability under Rule 10b-5 in connection with the termination of a Rule 10b5-1 plan goes away.

The mail and wire fraud statutes prohibit "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises."[146] The "or" is disjunctive: it can be a scheme to defraud *or* to deprive someone of property. Thus, a scheme to defraud under the first prong does not require actually obtaining money or property. With respect to the second prong, it is of course true that when a trading plan is cancelled or terminated the cancelling party does not make any money in the literal sense. But the reason for canceling pre-existing orders to trade is almost always going to be to avoid a loss of some sort. As previously discussed, loss avoidance has always been deemed actionable in the insider trading context: it is part of the calculation of the total "gains" and is used in the penalty calculation.[147] If the mail and wire fraud statutes capture *placing a trade* on the basis of MNPI that would result in loss avoidance, it would seem that those statutes would equally capture *canceling a trade* on the basis of MNPI

mail and wire fraud convictions that were based on the same underlying facts: "As I read the indictment, it does not materially differ from the indictment in *Carpenter* v. *United States*. There, the Court was unanimous in upholding the mail fraud conviction . . . despite being evenly divided on the securities fraud counts . . . . I do not think the wording of the indictment in the current case requires a finding of securities fraud in order to find mail fraud. Certainly, the jury instructions do not make the mail fraud count dependent on the securities fraud counts. Rather, the counts were simply predicated on the same *factual* basis, and just because those facts are legally insufficient to constitute securities fraud does not make them legally insufficient to constitute mail fraud. I therefore concur in the judgment of the Court as it relates to respondent's mail fraud convictions." *O'Hagan*, 521 U.S. at 700 (Thomas, J., dissenting). Justice Scalia also concurred on the mail and wire fraud convictions, making that holding unanimous.

145 *See* Rosenfeld, *supra* note 58.

146 18 U.S.C. § 1341; 18 U.S.C. § 1343.

147 *See* Securities and Exchange Act § 21A(a)(2).

that would result in loss avoidance. The basis of the violation is the same in both cases, namely the exploitation of confidential proprietary information, not the trading.

In sum, because the mail and wire fraud statutes reach conduct beyond what is prohibited by the antifraud provisions of the federal securities laws and the statutes do not have an "in connection with" requirement, they could provide a fertile basis for prosecutions relating to the termination of a Rule 10b5-1 plan, either on a straight embezzlement theory (depriving the company of the exclusive use of its proprietary information) or on a misrepresentation theory (if any of the many representations made in connection with the adoption and termination of the plan is false or misleading).

ii. Title 18 Section 1348

Title 18 Section 1348 is a relatively new antifraud provision that was added to the criminal code with the passage of Sarbanes-Oxley in 2002.[148] It was specifically designed to capture fraudulent conduct that might not meet the technical requirements of Section 10(b) fraud. The legislative history shows that Congress intended to "supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud . . . statutes."[149]

Section 1348 is modeled on the mail and wire fraud statutes and provides severe penalties[150] for securities and commodities fraud. Section 1348 contains two provisions: Section 1348(1) makes it unlawful to execute, or attempt to execute, a scheme or artifice "to defraud any person in connection with . . . any security of an issuer with a class of securities registered under section 12 of the [Exchange Act] or that is required to file reports under section 15(d) of the [Exchange Act]."[151] Section 1348(2) makes it unlawful to execute, or attempt to execute, any scheme "to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the pur-

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148 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 807(a), 116 Stat. 745, 804 (codified as amended at 18 U.S.C. § 1348 (2018)).

149 148 Cong. Rec. S7420-7421 (July 26, 2002) (statement of Sen. Leahy); *see also* Kathleen F. Brickley, *From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L. Q. 357, 377 n.86 (2003) (noting that Section 1348 was designed to avoid the technical elements of other securities fraud statutes).

150 The maximum penalty is 25 years imprisonment. *See* 18 U.S.C. § 1348.

151 18 U.S.C. § 1348

chase or sale of any . . . security" of an Exchange Act reporting company.[152] Section 1348 thus applies to insider trading in the shares of public companies, broadly defined to include private companies that have reporting obligations under the Exchange Act.

Both parts of Section 1348 have an "in connection with" requirement, but the two sections are worded differently. Section 1348(2) specifies that the fraudulent conduct must be in connection with "the purchase or sale of a security."[153] Section 1348(1) on the other hand is more broadly worded to encompass fraud "in connection with . . . any security."[154] Thus, under Section 1348(1) the fraud must have some nexus to a security, but there is no need for a purchase or sale, indeed no need for a securities *transaction*. Moreover, Section 1348(1) makes it unlawful to defraud "any person" in connection with a security, not just a purchaser or seller of a security.[155]

Section 1348(1) is thus broad enough to encompass the termination or cancellation of a Rule 10b5-1 plan while in possession of MNPI, which could be seen as part of a scheme to defraud the company (by deceptively converting the company's confidential proprietary information to one's own use) or the market as a whole (by making materially misleading statements or omitting to state material facts necessary to make the statements made not misleading) in connection with a plan to trade the securities of an Exchange Act reporting company. In particular, any misstatements or omissions made in connection with the new required disclosures concerning the adoption or termination of a Rule 10b5-1 plan (by the plan adopter to the company and by the company to the public) could be considered part of a scheme to defraud either the company or market participants. In this context, it is worth recalling that the SEC has taken the position that market participants would consider information concerning a Rule 10b5-1 plan to be important in making an investment decision.[156]

V. CONCLUSION

Insider abstention has long been problematic from the standpoint of insider trading law and policy. A decision not to

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152 *Id.*
153 *Id.*
154 *Id.*
155 *Id.*
156 *See* Adopting Release, *supra* note 2, at 173.

trade based on MNPI can be just as economically significant as a decision to trade, but insider abstention has never been thought to be actionable, in part because of practical issues of proof, but mostly because of the legal requirement under Rule 10b-5 that the fraud must be connected to the purchase or sale of a security.

The termination or cancellation of a previously adopted Rule 10b5-1 plan has long been viewed through this legal lens. The SEC has stated on a few occasions that termination of a Rule 10b5-1 plan would not in itself give rise to liability because the termination lacks a connection to an actual securities transaction: without an actual trade, the termination is not "in connection with the purchase or sale" of a security.

While this analysis may well hold true in the context of a Section 10(b) and Rule 10b-5 violation, there are several other statutory provisions that have been used to prosecute insider trading, both civilly and criminally, which do not have the same "in connection with the purchase or sale" of a security requirement. These statutory provisions could easily be used to establish liability in the context of the termination of a Rule 10b5-1 trading plan by someone in possession of MNPI. It is important in this context to stress that Rule 10b5-1 trading plans are written plans that are provided to a third party, typically a broker; they constitute specific instructions to enter orders at specified times and prices. They are, in effect, the equivalent of entering a standing order which, under the rules, is supposed to be irrevocable. Among other things, the existence of a written plan that is later cancelled or terminated does not implicate the very difficult proof issues that would normally accompany a failure to trade case. With a Rule 10b5-1 plan there is a written record, in the form of a trading directive that is being explicitly countermanded. It is easy to establish what the putative trader originally intended, and what they did to countermand their order.

Rule 10b5-1 plans provide an important mechanism for insiders to trade in the securities of their company without incurring liability. If adopted and followed in good faith, they are wholly unobjectionable. But too often insiders have used Rule 10b5-1 plans to try to game the system. The SEC recently amended the rules to crack down on some of the more egregious practices, like adopting a plan just before trading. But terminating a plan while in possession of MNPI is equally egregious, if not more so. It involves the exploitation of MNPI and implicates the same legal and policy concerns that inform insider trading law generally. Terminating a plan based on MNPI is “insider trading” even if it involves no trading at all. And government authorities have tools at their disposal to try to put an end to the practice.