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INSIDER TRADING AND THE MISAPPROPRIATION THEORY: THE AWAKENING, 1995

*David Cowan Bayne**

The disputes among the Justices in Chiarella lead us to doubt that it will be the Supreme Court's last word on Rule 10b-5.

—Judge J. Skelly Wright, D.C. Circuit, 1983.¹

The disputes among the Justices in [Dirks] lead us to doubt that it will be the Supreme Court's last word on Rule 10b-5.

—David C. Bayne, S.J, 1994.²

I. INTRODUCTION

Judge J. Michael Luttig and the Fourth Circuit Court of Appeals have brought these prophetic doubts parlously close to confirmation. The mid-1995 *United States v. Bryan*³ case has set up a sharp confrontation among the circuits and in the process inspired the moribund law of Insider Trading with new life and hope.

Although little noticed in legal commentary,⁴ *Bryan* could

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1. *Dirks v. SEC*, 681 F.2d 824, 837 (D.C. Cir. 1982), *rev'd*, 463 U.S. 646 (1983).

2. David Cowan Bayne, *The Insider's Natural-Law Duty: Chestman and the 'Misappropriation Theory'*, 43 KAN. L. REV. 79, 134 (1994) [hereinafter Bayne, *Misappropriation Theory*] (paraphrasing *Dirks*, 681 F.2d at 837.)

3. 58 F.3d 933 (4th Cir. 1995).

4. As of this writing *Bryan* had attracted the attention of Harvard's editors in a six-page student casenote, Note, *Fourth Circuit Rejects Misappropriation Theory of Rule 10b-5 Fraud Liability*, 109 HARV. L. REV. 536 (1995), but research has not discovered a scholarly examination of the case. Meanwhile, Insider Trading commentary continues apace, as the securities-law community remains obviously uncomfortable with the status quo: "At least five members of the Supreme Court are willing to reexamine securities-law issues that appear settled in the lower courts. . . . [The Court's] decision [in *Central Bank*] to overturn long-established lower-court precedent will result in more litigation and less predictability under the federal securities

nonetheless be the most important Insider Trading opinion since the ill-conceived *Chiarella v. United States*⁵ and *Dirks v. SEC*⁶ some fifteen years ago. *Bryan* should at long last force the courts, the bar, and the Securities and Exchange Commission to clean up the mess left by the Misappropriation Theory.

But this present commentary has a far broader purpose than merely prodding the parties to resolve the standoff. This Article is one in a series of articles⁷ written with the grandiose but serious goal of an all-embracing philosophy of the law of Insider Trading. The articles have been reduced to a hardcover *Insider Trading: A Legal and Moral Treatise*, which is awaiting publication.

The series began with a seminal study that supplied the foundation for exactly such a philosophy. Appearing in late 1992, this elemental work, *Insider Trading: The Essence of the Insider's Duty*,⁸ laid out the rudimentary natural law principles underlying

laws." Arthur F. Mathews & W. Hardy Callcott, *Tightening Securities Laws*, LEGAL TIMES, July 25, 1994, at S39, S40 (commenting on *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994) (concerning private rights of action for aiding and abetting a Rule 10b-5 violation)).

Recent Insider Trading articles by other authors include, Thomas Lee Hazen, *Defining Illegal Insider Trading—Lessons from the European Community Directive on Insider Trading*, 55 LAW & CONTEMP. PROBS. 231 (1992); Roberta S. Karmel, *Is the Shingle Theory Dead?*, 52 WASH. & LEE L. REV. 1271 (1995); Michael P. Kenny & Teresa D. Thebaut, *Misguided Statutory Construction to Cover the Corporate Universe: The Misappropriation Theory of Section 10(b)*, 59 ALB. L. REV. 139 (1995); Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. S7 (1993); Steven R. Salbu, *Tipper Credibility, Noninformational Tippee Trading, and Abstention from Trading: An Analysis of Gaps in the Insider Trading Laws*, 68 WASH. L. REV. 307 (1993) (suggesting abandonment of common law deceit and adoption of an expanded fraud-on-the-market theory as the basis of Insider Trading liability); Troy Cichos, Note, *The Misappropriation Theory of Insider Trading: Its Past, Present, and Future*, 18 SEATTLE U. L. REV. 389 (1995) (calling for regulatory changes under Rule 10b-5); R. René Pengra, Note, *Insider Trading, Debt Securities, and Rule 10b-5: Evaluating the Fiduciary Relationship*, 67 N.Y.U. L. REV. 1354 (1992); John K. Robinson, Note, *A Reconsideration of the Disgorgement Remedy in Tipper-Tippee Insider Trading Cases*, 62 GEO. WASH. L. REV. 432 (1994) (suggesting that the concept of disgorgement is too loosely applied).

5. 445 U.S. 222 (1980).

6. 463 U.S. 646 (1983).

7. The Insider Trading articles by David Cowan Bayne, S.J., in sequence, are: *Insider Trading: The Essence of the Insider's Duty*, 41 KAN. L. REV. 315 (1992) [hereinafter Bayne, *Essence*]; *The Insider's Natural-Law Duty: 'Disclose or Abstain'?*, 42 KAN. L. REV. 75 (1993) [hereinafter Bayne, *Disclose or Abstain?*]; *The Insider's Natural-Law Duty: Chiarella and the 'Fiduciary' Fallacy*, 19 J. CORP. L. 681 (1994) [hereinafter Bayne, *Fiduciary Fallacy*]; *The Insider's Natural-Law Duty: Dirks, the Son of Chiarella*, 19 J. CORP. L. 729 (1994) [hereinafter Bayne, *Son of Chiarella*]; Bayne, *Misappropriation Theory*, *supra* note 2.

8. Bayne, *Essence*, *supra* note 7.

the law of Insider Trading.

Essence set an ambitious goal and was meant to be the fundament for the solution of all the problems besetting Insider Trading law. Succeeding articles built on this fundament. First came the elimination of the baneful "disclose or abstain" rule.⁹ Next, came the refutation of the resort in *Chiarella* to "fiduciary relation."¹⁰ Then came the answer to the queries of *Dirks* concerning the "insider," the "tipper," and the "tippee."¹¹

The fifth, however, *Chestman and the 'Misappropriation Theory'*¹² comes closest in relevance to *Bryan* and could even claim the present work as its supplement. "This fifth Article face[d] a triple challenge: (1) To eradicate the ill effects of the Misappropriation Theory; (2) To present the state of the law at the end of the century by a dissection of that prototype of the present-*Chestman*; and (3) To add in the process another substantive segment to the ultimate product of these studies, an all-encompassing *Philosophy of the Insider's Duty*."¹³

As a supplement to the fifth article, the present endeavor is meant perforce to give the *coup de grace* to the Misappropriation Theory. Whereas *Chestman and the 'Misappropriation Theory'* and the preceding articles gave the philosophical, and broadly legal, arguments for the rejection of the Theory, this analysis of the Fourth Circuit *Bryan* case emphasizes the Theory's ad hoc statutory invalidity.

Chestman and the 'Misappropriation Theory,' in its presentation of the law's current status, sketched as background a panoramic history of Insider Trading law: (1) the common law antecedents, 1909-1961, (2) the advent of section 10(b) and *Cady, Roberts*,¹⁴ 1961, (3) the stable federal period, 1961-1984, and (4) the collapse of right reason, the advent of the Theory, The Age of Enlightenment, 1984-1994.¹⁵

Hence, the present title is: *The Awakening, 1995*. Not only does *The Awakening, 1995* bring the history up to the moment, but it views *Bryan* as a watershed and the beginning of a new era, a re-

9. The "disclose or abstain" rule first appeared in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968); see Bayne, *Disclose or Abstain?*, *supra* note 7.

10. See Bayne, *Fiduciary Fallacy*, *supra* note 7.

11. See Bayne, *Son of Chiarella*, *supra* note 7.

12. See Bayne, *Misappropriation Theory*, *supra* note 2.

13. *Id.* at 82.

14. 40 S.E.C. 907 (1961).

15. See Bayne, *Misappropriation Theory*, *supra* note 2, at 88-142.

turn to sanity and the long-successful, traditional years of *Cady, Roberts*, the Second Circuit standouts, *SEC v. Texas Gulf Sulphur Co.*¹⁶ and *Chiarella v. United States*,¹⁷ and the District of Columbia Circuit's *Dirks v. SEC*.¹⁸

These various objectives will be pursued in four parts: Part II is entitled "Butch" Bryan; Part III is called The Repudiation of the Misappropriation Theory; Part IV will discuss the conflict among the circuits, and Part V, The Blueprint for the Future, will set the scene and offer thoughts to the courts, the bar, and the Securities and Exchange Commission.

II. "BUTCH" BRYAN

Elton E. "Butch" Bryan, director of the West Virginia lottery, with the connivance of the lottery's counsel, William Edward ReBrook III, and the knowing silence of his patron, Governor Gaston Caperton, devised a personally rewarding—albeit deceitful—two-step approach to the impending implementation of the new state lottery. The first step: "Governor Caperton . . . ultimately decided that [Video Lottery Consultants] VLC would be granted a 'single source' contract, under which VLC would be the exclusive supplier of video lottery gaming terminals in West Virginia."¹⁹

Step two: Before informing the investing public of the supplier award—but after lengthy manipulation of the legal processes²⁰ to assure the success of his personal plan—Butch Bryan "purchased 300 shares of VLC stock. Bryan made all these trades on the basis of nonpublic, confidential information entrusted to him in his capacity as Lottery Director."²¹

And ReBrook conformably proceeded to use "all his available funds to purchase 100 shares of VLC stock . . . [and] passed on the information he learned about the financial health of VLC to two friends who then purchased an additional 6,000 shares."²²

In summary, Butch Bryan, lottery director, (1) used nonpublic information, knowledge of the valuable contract with VLC, and (2) purchased VLC stock, (3) without disclosing its enhanced

16. 401 F.2d 833 (2d Cir. 1968).

17. 445 U.S. 222 (1980).

18. 681 F.2d 824 (D.C. Cir. 1982), *rev'd*, 463 U.S. 646 (1983).

19. *United States v. Bryan*, 58 F.3d 933, 938 (4th Cir. 1995).

20. *See id.* at 937-39.

21. *Id.* at 939.

22. *United States v. ReBrook*, 58 F.3d 961, 964 (4th Cir. 1995).

value, (4) with considerable loss to VLC sellers.

The Securities and Exchange Commission, pursuant to section 21 of the Securities Exchange Act of 1934,²³ “transmit[ted]” these facts “to the Attorney General, who . . . institute[d] the necessary criminal proceedings” for “a violation of any provision of this chapter.”²⁴ The proceedings were brought under section 32 of the Act.²⁵

The result: In September 1993 a jury in Charleston found Butch Bryan guilty of Insider Trading in violation of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.²⁶ The guilty verdict also included counts of mail fraud, wire fraud, and perjury.²⁷

On appeal a unanimous panel of the Fourth Circuit affirmed but with a notable exception: The Insider Trading conviction was reversed.²⁸ Circuit Judge J. Michael Luttig’s excellent opinion was joined by two district judges sitting by designation.

Mr. ReBrook later met the same fate in a companion opinion by another Fourth Circuit panel.²⁹ Circuit Judge Karen J. Williams wrote that opinion, supported by Judge Luttig and Senior District Judge John MacKenzie.

In August 1995 a motion for a rehearing en banc was denied.³⁰ “Despite the strong urging of the United States Attorney, the Fourth Circuit Court of Appeals has refused to rehear *in banc* a Fourth Circuit panel decision reversing a securities fraud conviction [in *Bryan*] based on the panel’s view that the misappropriation theory is never valid.”³¹ The reversal of the section 10(b) violation is the sole present concern.

A. *An Elemental Insider Trade*

Butch Bryan had stolen a page from Vinnie Chiarella’s play-book. Here was the most pedestrian possible stock scam. In an anonymous trade, Butch—and Vinnie before him—with secret

23. 15 U.S.C. § 78u (1994).

24. *Id.* § 78u(d)(1).

25. *See id.* § 78ff.

26. *See Bryan*, 58 F.3d at 936.

27. *See id.*

28. *See id.*

29. *See ReBrook*, 58 F.3d at 963.

30. *See Full Fourth Circuit Will Not Hear Misappropriation Case*, FED. SEC. L. REP. (CCH) at 3-4 (Aug. 30, 1995).

31. *Id.* at 3.

knowledge that the stock was worth more than was publicly known, deceived the innocent owners into selling before the news of the true value broke. The victims were the public investors in the stock sale.

In Vinnie's case, the infamous *Chiarella v. United States*,³² the facts were parallel. Vinnie had advance, nonpublic, confidential information and cheated sellers out of \$30,000.

Of all the variants of Insider Trading, this is the most uncluttered and simple: an anonymous trader buying from another anonymous trader on a faceless exchange. This paradigm—a “2 + 2” illustration of the ninety years of Insider Trading precedents—is the ideal vehicle for the Fourth Circuit's brash attack on “our sister circuits,”³³ especially the august Second Circuit.

III. THE REPUDIATION OF THE MISAPPROPRIATION THEORY

The full deftness of Judge Luttig's approach to the special challenge of *Bryan* does not sink in with one or two readings. A careful review is necessary.

At the outset the judge drew a confining perimeter around his holding and never once put a foot outside the narrow boundaries.

A. *The First Exclusion: Liability Under Traditional Section 10(b)*

Throughout, the government had not relied on the standard approach to a section 10(b) case. No alternative argument under established and tenable precedents was ever proffered. Rather, “[t]he government proceeded against Bryan under the so-called ‘misappropriation theory’ of securities fraud liability, a theory that, although novel to this circuit, has been embraced by the Second, Seventh, and Ninth Circuits.”³⁴

So Judge Luttig went along. He chose to confine himself to the pleadings and not force a section 10(b) holding under the traditional, tried-and-true doctrine of *SEC v. Cady, Roberts*³⁵—which would be a *Chiarella* reprise—and thereby establish Bryan's criminal liability. He thus was blocked from using *Bryan* as a rejection of *Chiarella* and a direct endorsement of the “classical” Insider

32. 445 U.S. 222 (1980).

33. *United States v. Bryan*, 58 F.3d 933, 944 (4th Cir. 1995).

34. *Id.* at 943 (citing *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981)); see *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991) (en banc); *SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991); *SEC v. Clark*, 915 F.2d 439 (9th Cir. 1990).

35. 40 S.E.C. 907 (1961).

Trading law that had been so successful for the quarter century from 1961-1984.

Sadly, too, the collateral effect of this left the absent innocents, Butch's sellers, unnoticed and unrequited. Their injury should have been readily remedied but that would have required action under the traditional section 10(b). Their regrettable fate should be recalled on another day.

Thus restricted by the government reliance on the novel Misappropriation Theory—only fourteen years old and with a “somewhat harrowing evolution”³⁶—Judge Luttig determined to make a frontal attack on the Theory's intrinsic validity as inconsonant with section 10(b).

This approach, however, was eminently suited to the worthy task he was patently dying to embrace: the long-overdue repudiation of the bizarre doctrine of the Misappropriation Theory—a “major error affecting the law of Insider Trading.”³⁷

And besides, such a frontal attack on validity would set the scene even more dramatically for a conflict among the circuits than would a mere return, in an ad hoc adjudication, to the classical *Cady, Roberts* tradition.

B. *The Second Exclusion: Liability Under the Theory*

Note, however, that the judge did not pretend to deny that the condemned Misappropriation Theory—*were he to apply it*—would hold Butch Bryan guilty. However, so great was his disdain for the Theory that he refused to indulge in such a hypothetical adjudication. Instead he brushed the matter aside with a cursory recognition: “Bryan's conduct clearly constituted criminal activity *under this theory of misappropriation*.”³⁸ But nonetheless, he reasoned that to apply an invalid theory would be an unjustified digression and only prolong the life of a doctrine destructive of the law of Insider Trading. “The question for us . . . is *not* whether Bryan's conduct violated section 10(b) under this particular misappropriation theory.”³⁹

Rather, the Fourth Circuit addressed this circumscribed query: “[W]hether criminal liability *under section 10(b)* . . . can be

36. *Bryan*, 58 F.3d at 953.

37. Bayne, *Misappropriation Theory*, *supra* note 2, at 81.

38. *Bryan*, 58 F.3d at 945 (emphasis added).

39. *Id.* (emphasis added).

predicated upon such a theory.”⁴⁰ The answer of course is the principal burden of its opinion.

In short, the court was not *applying* section 10(b) at all, either (1) under the traditional doctrine of *Cady, Roberts*, or (2) pursuant to the Theory’s contortion of section 10(b). The attack simply said that the Theory is invalid. It is not section 10(b) at all.

With the perimeter of the holding so narrowly drawn, the court moved on to an orderly two-phase approach to the question: Does the Misappropriation Theory meet the mandates of section 10(b)? The first phase:

1. The controlling elements of section 10(b)

Courts have long acknowledged section 10(b) as the lineal descendant of common law deceit.⁴¹ More specifically the Insider Trading law of section 10(b) found its common law origins in *Strong v. Repide*⁴² and *Hotchkiss v. Fischer*.⁴³

Thus, in a criminal proceeding the court would look first for the basic requisites of traditional deceit: a misstatement of a material fact, made knowingly, to induce reliance, resulting in consequent reliance,⁴⁴ in addition to the section 10(b) requirement that the deceit be “in connection with the purchase or sale of *any* security.”⁴⁵

Standing back from these seven fundamentals, the Fourth Circuit tightened further its limiting perimeter: “Section 10(b), *insofar as concerns us* . . . prohibits only [1] The use of *deception*, in the form of *material misrepresentations* or omissions, [2] to induce action or inaction by *purchasers or sellers of securities*, or [3] that affects others with a vested interest *in a securities transaction*.”⁴⁶

40. *Id.* (emphasis added).

41. See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 30, at 164-65 (5th ed. 1984); Bayne, *Misappropriation Theory*, *supra* note 2, at 96; LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITY REGULATION 750-59 (3d ed. 1995).

42. 213 U.S. 419 (1909). For the overview of these origins, see Bayne, *Misappropriation Theory*, *supra* note 2, at 89 (entitled “The Progenitors of *Cady, Roberts*, 1909-1961”).

43. 16 P.2d 531 (Kan. 1932).

44. See RESTATEMENT (SECOND) OF TORTS §§ 525-552C (1997) (describing misrepresentation, materiality, scienter, the inducement of reliance, consequent reliance, and damages); LOSS, *supra* note 41, at 750-59.

45. See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1994) (emphasis added).

46. *Bryan*, 58 F.3d at 944 (emphasis added).

The key words are “insofar as concerns us.”

Concisely, section 10(b) prohibits the *deception of an investor* in a *securities trade*. This is the core of section 10(b) that will govern the holding.

2. The particular theory under indictment

Continuing his methodical approach, Judge Luttig defines the “particular theory of misappropriation adopted by our sister circuits.”⁴⁷ He uses the Ninth Circuit *SEC v. Clark*:⁴⁸

Those courts that have adopted *the misappropriation theory with which we are concerned in this case* have read section 10(b) and Rule 10b-5 to authorize the criminal conviction of a person who “(1) *misappropriates material nonpublic information* (2) *by breaching a duty* arising out of a relationship of trust and confidence and (3) *uses that information in a securities transaction*, (4) *regardless of whether he owed any duties to the shareholders of the traded stock.*”⁴⁹

With that the court has laid out both section 10(b) “insofar as concerns us” and the essence of the Misappropriation Theory of “our sister circuits.”

This gets closer to the decisive question: How does the Theory conform to the section 10(b) requisites? If the Theory is to be an alternative approach to liability, it must have validity under section 10(b). Lest the reader have any doubt, the answer follows immediately: “We conclude that . . . section 10(b) . . . *will [not] support . . . the particular theory of misappropriation adopted by our sister circuits.*”⁵⁰

After chastising the “sister circuits” for their unjustified, expansionist interpretations of section 10(b), Judge Luttig laid out an underlying principle of his opinion: “For at least two decades . . . the Supreme Court has repeatedly *warned against expanding* the concept of fraud in the securities context *beyond what the words of the Act* reasonably will bear.”⁵¹ This norm was to be an iron guideline of his holding: “It is with this simple, but oft-forgotten,

47. *Id.*

48. 915 F.2d 439 (9th Cir. 1990). For this and other Theory cases, see Bayne, *Misappropriation Theory*, *supra* note 2, at 135-42 (entitled “The Age of Enlightenment: 1984-1994”).

49. *Bryan*, 58 F.3d at 944 (quoting *Clark*, 915 F.2d at 443 (emphasis added)).

50. *Id.* (emphasis added).

51. *Id.* at 945 (emphasis added).

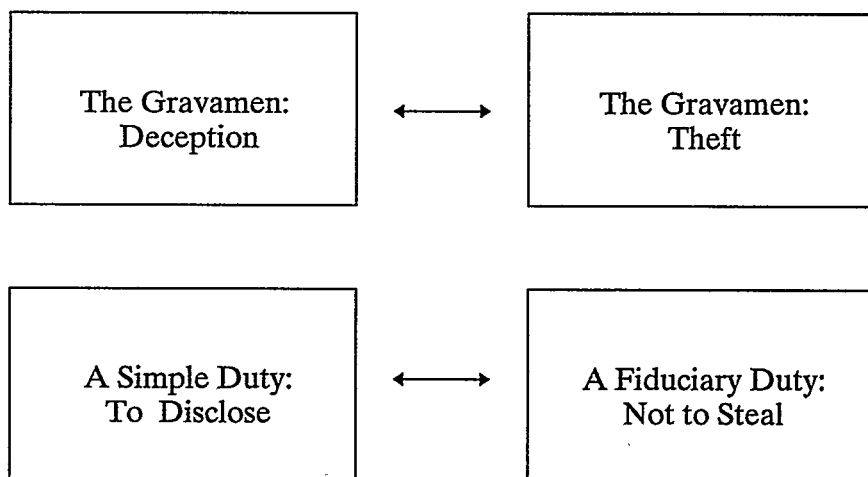
admonition in mind that we adjudge the validity of the misappropriation theory."⁵²

In a word, the *Bryan* opinion was to follow religiously (1) the exact "language of section 10(b), Rule 10b-5," and (2) "the Supreme Court authority interpreting these provisions."⁵³ With the narrowing of the orbit and the preparatory admonitions behind it, the Fourth Circuit was at last prepared to challenge the *validity* of each element of the Theory, one by one.

But unfortunately, all of Judge Luttig's undeniable orderliness did not move too felicitously from mind to manuscript. Rather the judge fired out a mass of arguments much as they surfaced in his mind. But the arguments were all there. To rearrange the judge's thoughts, consider this chart as a useful outline of the progress of the opinion:

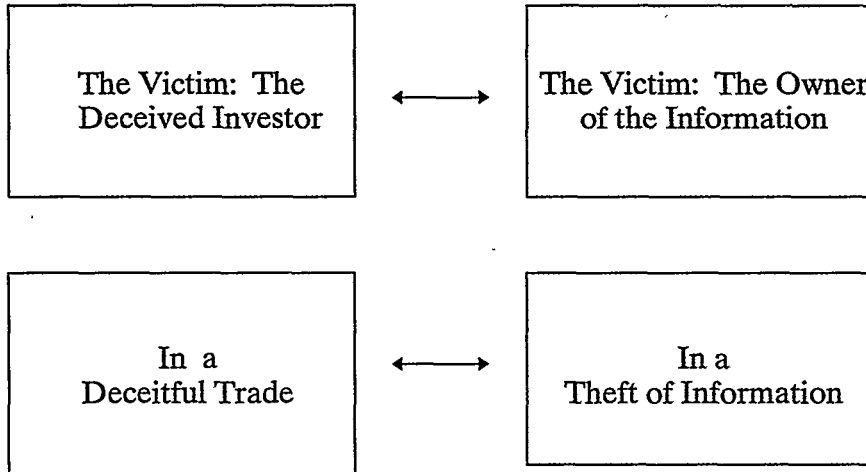
C. *The Four Antitheses*

The Section 10(b) Essentials ↔ The Theory Essentials



52. *Id.*

53. *Id.* at 944.



With this chart ready in mind, the Fourth Circuit assaulted the Misappropriation Theory in every one of the four *Antitheses*: first, *The Gravamina: Deception and Theft*; second, *Simple Duty versus Fiduciary Duty*; third, *Duty to Whom: Theft Victim or Investor?*; and fourth, *Securities Trade or Theft*?

The estimable Judge Winter in his dissent to the latest commentary on the Theory, *Chestman*, aptly expressed the Fourth Circuit's position. Judge Luttig quotes Judge Winter: "Judge Winter . . . candidly admitted that 'any obvious relationship [between the Misappropriation Theory and] Section 10(b) is presently missing.'"⁵⁴ How, conceivably, could the astute Second Circuit have looked at section 10(b) and seen even a glimmer of the Theory?

The relationship Judge Winter found missing will indeed be missing in every one of the four *Antitheses*. But in further preparation, recall: In summary, 'Butch' Bryan, Lottery Director, (1) used nonpublic information—knowledge of the valuable contract with VLC—and (2) purchased VLC stock, (3) without disclosing its enhanced value, (4) with considerable loss to VLC sellers.

1. The first *Antithesis*: The Gravamina: Deception and Theft

Among the many imponderables bedeviling the Theory, perhaps the most inexplicable is the total disparity between the es-

54. *Id.* at 959 (Winter, J., concurring in part and dissenting in part) (quoting *United States v. Chestman*, 947 F.2d 551, 578 (2d Cir. 1991) (alteration in original)).

sence of the "deception" of section 10(b) and that of the "theft" of the Theory. The Fourth Circuit emphasized this disparity by juxtaposing the one against the other.

a. the "deception" of section 10(b)

From its common law beginnings in *Strong v. Repide*⁵⁵ and *Hotchkiss v. Fischer*⁵⁶ in the century's first quarter, on to the SEC's *Cady, Roberts*⁵⁷ and the notable Second Circuit opinions *Texas Gulf*,⁵⁸ *Shapiro v. Merrill Lynch*,⁵⁹ *Chiarella*,⁶⁰ only one principle guided the doctrine: the deception of the investor by the insider in a securities trade. At the core of the tort has always been deceit, the failure to disclose the true value of the traded stock.

This was the logical result of an expectable interpretation of the forthright words of the code and the rule. As Judge Luttig characterized them:

The language of section 10(b) and Rule 10b-5 sweeps broadly. The statute prohibits the use of "any" manipulative or *deceptive* device or contrivance "in connection with" the purchase or sale of "any" security. Similarly, Rule 10b-5 . . . criminalizes "any" act, practice, or course of business that operates as a "fraud or deceit" upon "any" person.⁶¹

Inasmuch as section 10(b) is only the codification of common law deceit, the history of section 10(b) and insider trading has been, in effect, a study of that common law.⁶²

Correspondingly, of the relevant elements of deceit—the misstatement of a material fact, made knowingly, "in connection with" a securities trade—every single one speaks to deception. In the broadest sense deception permeates the traditional section 10(b). Judge Luttig understood this. Hence his governing pronouncement: "Manipulation and deception are the touchstones of section 10(b) liability."⁶³

55. 213 U.S. 419 (1909).

56. 16 P.2d 531 (Kan. 1932).

57. 40 S.E.C. 907 (1961).

58. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

59. Shapiro v. Merrill Lynch, 495 F.2d 228 (2d Cir. 1974).

60. United States v. Chiarella, 588 F.2d 1358 (2d Cir. 1978), *rev'd*, 445 U.S. 222 (1980).

61. *Bryan*, 58 F.3d at 945 (emphasis added).

62. See LOSS, *supra* note 41, at 750-52.

63. *Bryan*, 58 F.3d at 945.

A touchstone is a criterion for determining the quality or genuineness of a thing.⁶⁴ The court was saying that the product is not genuine without deception. In support of this thesis, the judge went immediately to the 1977 Supreme Court and the one case—the oft-cited *Santa Fe Industries v. Green*⁶⁵—that should have deterred the “sister circuits” at their very first foray into the Theory: “The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving *manipulation or deception*.”⁶⁶

The court expectably followed up this first reliance on *Santa Fe Industries*—many more follow throughout the opinion—by a second resort to the “language of § 10(b).” “Section 10(b) thus makes it ‘unlawful for *any person* . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any *manipulative or deceptive* device or contrivance,’ in contravention of SEC rules.”⁶⁷

1) the sole touchstone

Judge Luttig’s style, and particularly his unstructured presentation, belie his sound grasp of the genius of the “classical” section 10(b). But clearly he had studied both the history of Insider Trading as well as the aberrations of the Theory.

For purposes of assessing the *validity* [read: genuineness] of the misappropriation theory, we need focus solely on the scope of the statutory phrase “deception” “in connection with” a securities transaction and the Rule 10b-5 phrase “fraud” “in connection with” a securities transaction, because “manipulation” is “virtually a term of art” in the securities context.⁶⁸

What the judge meant was that “manipulation” as used in section 10(b) was merely descriptive of, or a subset of, the inclusive deception.

The judge then set up the *Antithesis*, and the perfect segue to the antipolar theft: “Our specific concern is whether the Rule’s

64. WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 1247 (1988).

65. 430 U.S. 462 (1977).

66. *Bryan*, 58 F.3d at 945 (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 473 (1977) (emphasis added)).

67. *Id.* (quoting 15 U.S.C. § 78j(b)(1995)).

68. *Id.* (emphasis added) (citing *Santa Fe Indus.*, 430 U.S. at 476, and quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)).

prohibition of 'fraud' [as synonymous with *deception*] . . . may extend to breaches of fiduciary duty involving the misappropriation of confidential information."⁶⁹

b. the "theft" of the theory

[T]heft rather than fraud or deceit, seems the gravamen of the [misappropriation] prohibition.

—Judge Ralph K. Winter, *United States v. Chestman*.⁷⁰

Since overall "any obvious relationship [with] Section 10(b) is presently missing,"⁷¹ and since "theft' . . . has [n]ever been integral to . . . Section 10(b),"⁷² "[o]ne wonders how theft ever inserted itself into the longtime deceit action of Section 10(b)."⁷³

How could a concept so foreign, so alien to deception, suddenly supplant the time-honored heart of section 10(b)? How can someone equate theft with deception? The answer can be found in an overview of Insider Trading law in the 1980s. In a nutshell, the state of the law was chaos and a fertile field for any aberrant wanderings.

Misconceptions and misunderstandings about the classical doctrine of Insider Trading—notably the definition of Insider,⁷⁴ the disclose or abstain rule,⁷⁵ and the necessity of fiduciary duty⁷⁶—had increasingly confused the courts. Minor aberrations had become major, and soon the law was in such a mess that general complaint became widespread. "[W]ipe the slate clean and start over."⁷⁷ "The uncertainties engulfing the law of insider trading have provoked vociferous demands."⁷⁸

In this mess the courts, in desperation, stumbled onto the

69. *Id.* at 946 (emphasis added).

70. *Id.* at 949 n.14 (emphasis added) (quoting *United States v. Chestman*, 947 F.2d 551, 578 (2d Cir. 1991)).

71. *Id.* at 959 (quoting *Chestman*, 947 F.2d at 578 (Winter, J., concurring in part and dissenting in part)).

72. Bayne, *Misappropriation Theory*, *supra* note 2, at 147 (emphasis added).

73. *Id.* at 144.

74. See Bayne, *Son of Chiarella*, *supra* note 7.

75. See Bayne, *Disclose or Abstain?*, *supra* note 7.

76. See Bayne, *Fiduciary Fallacy*, *supra* note 7.

77. Bayne, *Misappropriation Theory*, *supra* note 2, at 79 (quoting Professor David L. Ratner).

78. Oliver P. Colvin, *A Constitutional Challenge to Rule 10b-5*, 6 *INSIGHTS*, May 1992, at 19.

Theory in *United States v. Newman*:⁷⁹ “The Second Circuit first adopted the misappropriation theory in *United States v. Newman* . . . [and] concluded easily that the misappropriation of information constitutes ‘fraud’ under Rule 10b-5.”⁸⁰ *Newman*’s “easy conclusion” was based on the totally collateral and casual remark of Chief Justice Burger in his dissent in the pitiful *Chiarella*. Luttig quotes Burger: “Because the defendants ‘*misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to [them] in the utmost confidence,*’ . . . they had . . . ‘*defrauded those employers as surely as if they took their money.*’”⁸¹

But the Fourth Circuit did not want any misunderstanding about Chief Justice Burger’s true position on the Theory. The court conceded that the Chief Justice did actually advert to the theft of information. “However, he specifically identified the predicate fraud . . . as *nondisclosure*, and *not the misappropriation of the information itself.*”⁸²

Justice Burger was simply saying that the *source* of the nonpublic information—by theft—was irrelevant. What counted was the *nondisclosure* of that information once “stolen.” The gravamen of the tort was *not* the *stealing*, but the *deception* in later not disclosing the true value of stock traded. Judge Luttig clarified further: “For the Chief Justice, therefore, the misappropriation of information gives rise to a duty, the breach of which, through trading without disclosure, constitutes fraud under the Rule.”⁸³ Justice Burger was not modifying the long-standing “deceit” requisite of the tort but merely explaining its operation.

Thus the Chief Justice would readily acknowledge that Butch Bryan could loosely be said to have “*misappropriated—stole to put it bluntly*”⁸⁴—from the lottery the confidential news of VLC’s enhanced value. But that only meant that Butch thereby was burdened with a duty, the breach of which, through trading without disclosure to his innocent sellers of VLC shares, “*constitutes fraud under the Rule.*”⁸⁵

79. 664 F.2d 12 (2d Cir. 1981).

80. *Bryan*, 58 F.3d at 954.

81. *Id.* (emphasis added) (quoting *United States v. Chiarella*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting) (alteration in original)).

82. *Id.* at 954 n.18 (emphasis added).

83. *Id.*

84. *See id.* at 954 (emphasis added) (quoting *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting)).

85. *Id.* at 954 n.18 (emphasis added).

So in the end the Chief Justice's collateral remark did not impugn the classical section 10(b) at all. *Chiarella*—whence the obiter remark—was 100% a traditional *deceit* action. "The Supreme Court bypassed the . . . 'misappropriation theory' [in the appeal in *Chiarella*]." ⁸⁶

Furthermore the irrationality of *Chiarella* had nothing to do with the Theory. Rather the classical *deceit* was unfortunately and inexplicably misapplied, which, again, had nil to do with theft or the Theory. The connection was simply concocted by *Newman*.

1) "mere theft"

The *Bryan* court seemed to take it for granted that all would realize that the essence of theft had little in common with that of deception. Theft is the taking of something of value from another without force but without consent. In no way need the victim be deceived. Whether he is deceived in the taking process, no matter. The involuntary taking is the heart of the theft.

To the contrary, deception entails no taking at all but denotes merely an act whereby one induces another "to accept as true or valid what is untrue or invalid" ⁸⁷ without regard to objects of value or their involuntary acquisition.

True, "theft" and "deceit" might conceivably be third cousins one to another, but certainly no one would consider "theft" to be at the heart of Section 10(b). Onetime SEC General Counsel Ralph C. Ferrara undoubtedly felt this way: "When you have to justify common sense rules in the mold of misappropriation, you get into twisted arcane analysis." ⁸⁸

Judge Luttig, therefore, simply set out to show beyond a doubt that the Misappropriation Theory really did require theft as a prime requisite of the tort of Insider Trading and concluded gratuitously that theft thereby met the section 10(b) mandate for deception.

Since few could believe that the Theory was in fact substituting theft for deception, the court quoted instance after instance from Theory opinions. First from the prototypal Second Circuit *Chestman*: "Under this misappropriation theory, the 'fraud' re-

86. Bayne, *Fiduciary Fallacy*, *supra* note 7, at 702.

87. WEBSTER'S, *supra* note 64, at 329.

88. Bayne, *Misappropriation Theory*, *supra* note 2, at 144 (quoting Sherry R. Sontag, *Insider Trading Limited: SEC Tries to Halt Erosion of Rule*, NAT'L L. J., Nov. 2, 1992, at 3 (quoting Ralph C. Ferrara, SEC General Counsel, 1978-1981)).

quirement of Rule 10b-5 is deemed to be *satisfied* when a person ‘*misappropriates* material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence.’”⁸⁹ Then from *Newman*: “Because the [*Newman*] court held that Rule 10b-5’s predicate *fraud* requirement was established through the *mere theft* of the confidential information, it undertook no inquiry into whether there was the statutorily required deception.”⁹⁰ Recall that the Second Circuit first concocted the Theory in *Newman*.⁹¹

None of the three major Theory cases—*Clark*,⁹² *Cherif*,⁹³ or *Chestman*⁹⁴—made any studied attempt to analyze the *essence* of the deception of section 10(b) and then compare it with the well-known understanding of the Theory’s substitute, theft. Even a casual reader would never equate theft with deceit. A philosophical dissection of each, moreover, would certainly highlight their disparity.

2) the *deus ex machina*: fiduciary duty

The theorists then proceeded to roil the waters further by intruding the equally foreign concept of fiduciary duty into that of theft. It was not enough that theft supplanted deception. Now the theft had to be perpetrated by a trusted fiduciary! Eventually the canonized definition of the Theory joined the theft—seemingly inextricably, certainly inexplicably—with a “breach of fiduciary duty.” Liability then resulted only when a person “(1) *misappropriates* material nonpublic information (2) by *breaching a duty* . . .

89. *Bryan*, 58 F.3d at 944 (emphasis added) (quoting *United States v. Chestman*, 947 F.2d 551, 566 (2d Cir. 1991)).

90. *Id.* at 954 (emphasis added) (discussing *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981); see also *id.* at 954 n.19 (commenting on the difficulty of determining the precise basis upon which the conviction was affirmed)).

91. The initial application of the Theory flowed from the pen of Judge Van Graafeiland of the Second Circuit, who grafted Chief Justice Burger’s dissenting remark in *Chiarella* onto the facts of his own *Newman* opinion, thus: “In [*Chiarella*], Chief Justice Burger, in dissenting, said that the defendant ‘*misappropriated*—stole to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence.” *Newman*, 664 F.2d at 17 (emphasis added). And: “[S]ince [*Newman*’s] sole purpose in participating in the *misappropriation* of confidential takeover information was to purchase shares . . . , we find little merit in his disavowal of a connection between the fraud and the purchase.” *Id.* at 18 (emphasis added).

92. *SEC v. Clark*, 915 F.2d 439 (9th Cir. 1990).

93. *SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991).

94. *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991).

of *trust*.”⁹⁵

One could reliably infer that the theorists were intimating that by the injection of the close bond of fiduciary duty between the thief and his trusting victim in *Bryan*, the mere act of stealing would smack more of deceiving than the unadorned act of mere theft.

The fact remains that theft, even from a trusting victim, has no intrinsic denotation—or even connotation—of the deceit of the victim, whether trusting or untrusting or even distrusting. Theft is still theft and says nil in its definition about deceiving or tricking or conning the victim.

In any event, the theorists got hung up on the justification of the admixture of fiduciary duty into the essence of the theft in the definition of the Theory. Consider a rare illustration:

3) the *Clark* rationale

One Theory opinion—the Ninth Circuit *Clark*—did make a totally failed attempt at reconciling theft with deceit. In the process Judge Cynthia Holcomb Hall adequately proved—exactly at odds with her purpose—that “*any obvious relationship [with] Section 10(b) is presently missing.*”⁹⁶ Luttig quotes Hall:

“[B]y becoming part of a fiduciary or similar relationship, an individual is implicitly stating that she will not divulge or use to her own advantage information entrusted to her in the utmost confidence. She deceives the other party by playing the role of the trustworthy employee or agent; she defrauds it by actually using the stolen information to its detriment.”⁹⁷

But the more the theorists proceeded down the path of blending fiduciary duty with the theft component, the more they realized that strict logic led them to the conclusion that the Theory would have to apply—as *Cherif* had opined—“even to ‘mere’ thieves,”⁹⁸ who surely had no personal bond of any kind to the victim, let alone fiduciary.

Judge Luttig had the insight to pursue this path, undoubtedly sensing that it led to the realization that the Theory was diametri-

95. See *Bryan*, 58 F.3d at 944 (emphasis added) (citing *Clark*, 915 F.2d at 433).

96. *Id.* at 959 (emphasis added) (quoting *Chestman*, 947 F.2d at 578 (Winter, J., concurring in part and dissenting in part)).

97. *Id.* at 949 n.13 (quoting *Clark*, 915 F.2d at 448).

98. *Cherif*, 933 F.2d at 412 n.6.

cally opposed to the 10(b) requisite of deception:

Moreover, while the courts adopting the misappropriation theory incant that the breach of a fiduciary relationship is a necessary element of the offense, in principle, if not in reality, these courts would be obliged to find liability in the case of *simple theft* by an employee, even where no fiduciary duty has been breached, for the *raison d'etre* of the misappropriation theory in fact is concern over "the unfairness inherent in trading on [*stolen*] information."⁹⁹

This wrangling over the roles of fiduciary duty and theft—as irrelevant as it is in equating theft with deception—does lead admirably into Judge Luttig's second area of attack on the Theory.

2. The second *Antithesis*: Simple Duty versus Fiduciary Duty

The first great anomaly intrinsic to the Theory was the sudden emergence of theft as a surrogate for the deceit of the traditional section 10(b). This first of the four *Antithesis* was thoroughly exposed by Judge Luttig at the outset of his opinion. The upshot saw two clear-cut conclusions: the essence of the violation of section 10(b) has always been deception¹⁰⁰ while theft, to the contrary, has never constituted a violation of section 10(b).¹⁰¹

On to these conclusions, Judge Luttig founded his attack on the second major aberration that was injected—as incongruously as had been the first—into the tenets of the Theory.

The *Bryan* opinion analyzed the second *Antithesis* in five developing stages: (1) the duty defined, (2) the genesis of a fiduciary duty, (3) the definition of the Insider, (4) fiduciary duty explicitly rejected, and (5) the *Antithesis* reconciled.

Since Judge Luttig continued his disdain for a structured outline, these guideposts will point the way. The judge does, however, again supply all the substantive argumentation.

a. the duty defined

Bryan found it effortless to move from the *violation* of section 10(b) to the *duty* that the violation violated. If the offense is *non-disclosure*, the duty necessarily must be: *to disclose*, to tell the

99. *Bryan*, 58 F.3d at 951 (emphasis added) (quoting *Chiarella*, 445 U.S. at 241 (Burger, C.J., dissenting)).

100. *See id.* at 944.

101. *See id.* at 954.

truth. From the malefaction *nondisclosure*, the illation to the *simple duty of disclosure* can readily be made.

Judge Luttig fortified this line of reasoning by immediate resort to the Supreme Court, beginning again with *Santa Fe Industries*, which led off with the positive affirmation of the duty as one of disclosure, without more.

In *Santa Fe Industries*, the Supreme Court defined the *deception* proscribed in section 10(b) as . . . the *nondisclosure* of material information in *violation of a duty to disclose*. In so defining the term, the Court squarely rejected the Second Circuit's interpretation of section 10(b) that "neither misrepresentation nor nondisclosure [is] a necessary element of a Rule 10b-5 action."¹⁰²

Since *Santa Fe Industries* was decided in 1977, Judge Luttig brought the Supreme Court up to 1994 with *Central Bank of Denver*. The court continued with the positive approach, affirming the duty as one of *disclosure*. In Judge Luttig's words:

Only last Term, the Court reaffirmed that the term "deception" in section 10(b) references only the misrepresentation or omission of a *material* fact: As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only the making of a *material* misstatement (or omission) or the commission of a manipulative act.¹⁰³

A somewhat obiter reflection: Both the Fourth Circuit and the Supreme Court include the important word "material" in the section 10(b) proscription. The deception must be material.

Judge Luttig used this subsidiary requirement of the code as further evidence of the dissonance of the Theory:

The misappropriation theory likewise does not attempt to give meaning to the *materiality* requirement of section 10(b), nor could it. The only relevant misrepresentation or nondisclosure under the misappropriation theory, assuming such is present, is that to the source of the information. Because the source generally is not connected to or interested in the securities transaction, it would be meaningless to ask whether that misrepresentation af-

102. *Id.* at 946 (emphasis added) (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 470 (1977)).

103. *Id.* (emphasis added).

fects the source's investment decision.¹⁰⁴

Note well that the Supreme Court, in both *Santa Fe Industries* and *Central Bank of Denver*,¹⁰⁵ enunciated a *simple* order: a *duty to disclose*. The command had no special qualifier. As Judge Lutig noted: "Section 10(b) thus makes it 'unlawful for *any person*, . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any *manipulative* or *deceptive* device or contrivance,' in contravention of SEC rules,"¹⁰⁶ not merely a trustee, or a fiduciary, or a confidant.

Since section 10(b) so clearly mandated a simple duty to disclose, the question is irresistible: Whence the Theory's highly circumscribed fiduciary duty not to steal? Since *Bryan* has already eliminated the theft ingredient, the only remaining chore is to explain the origin of the "fiduciary."

b. the genesis of a "fiduciary" duty

One would expectably ask why a thief who stole inside information from an employer must now be a fiduciary as well as an employee? If theft is truly the gravamen of the section 10(b) violation, why must the thief also be a trustee? Why is *trust* needed to render a "mere theft" a crime?

The answer to these understandable queries is essentially historical. The first appearance of the erroneous fiduciary requisite in a section 10(b) action actually antedated the appearance of the Theory itself, but only by one year.¹⁰⁷ A fiduciary duty had certainly not been an established element of classical section 10(b).

Fiduciary duty was in fact an accretion that first appeared in *Chiarella*¹⁰⁸—and was perpetuated in *Dirks*¹⁰⁹ three years later—and resulted from the Supreme Court's inability to rationalize an irrational holding. Remember that Judge Winter of the Second Circuit had said, "The *Chiarella* opinion is thus an enigma."¹¹⁰

104. *Id.* at 949 n.16 (emphasis added).

105. *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

106. *Bryan*, 58 F.3d at 945 (emphasis added) (citing 15 U.S.C. § 78j(b) (1995)).

107. See *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (premising liability "upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction"); *United States v. Newman*, 664 F.2d 12, 18 (1981) (premising liability on the misappropriation of confidential takeover information).

108. 445 U.S. 222 (1980).

109. 463 U.S. 646 (1983).

110. *United States v. Chestman*, 947 F.2d 551, 575 (2d Cir. 1991) (Winter, J., con-

The scene was this: The Court's timorous majority had determined *a priori* on a denial of recovery to a defrauded public. The holding was patently untenable—indeed it has elicited years of adverse criticism¹¹¹—and the Court had no logical way to extricate itself from this dead end.¹¹²

In any event, the hapless Justice Powell found his way out of the predicament—or so he had hoped—by tampering with a fundament of the law of Insider Trading, by altering the basic definition of the Insider.

c. *the definition of the Insider*

The *Chiarella* majority had readily agreed that the section 10(b) duty was a duty of disclosure. No thought had ever arisen that section 10(b) prohibited theft. This was undisputed.

However, in spite of this good beginning, *Chiarella* forthwith lost its way. When the Court asked, "Who has this Duty to disclose?" it stumbled. It knew that it was the *Insider* who had the duty to disclose. But *who* was an Insider?

From the earliest realization that Insider Trading was an ac-

curing in part and dissenting in part).

111. Commentary on *Chiarella* abounds. In addition to the author's own readjustment of the *Chiarella* facts, see Bayne, *Fiduciary Fallacy*, *supra* note 7, at 720-27. The following articles are representative commentary on the Court's reasoning: Alison G. Anderson, *Fraud, Fiduciaries, and Insider Trading*, 10 HOFSTRA L. REV. 341 (1982); John F. Barry III, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307 (1981); Douglas M. Branson, *Discourse on the Supreme Court Approach to SEC Rule 10b-5 and Insider Trading*, 30 EMORY L.J. 263 (1981); Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1 (1980); Thomas L. Hazen, *Corporate Insider Trading: Reawakening the Common Law*, 39 WASH. & LEE L. REV. 845 (1982); Harry Heller, *Chiarella, SEC Rule 14e-3 and Dirks: "Fairness" versus Economic Theory*, 37 BUS. LAW. 517 (1982); Peter J. Henning, *Between Chiarella and Congress: A Guide to the Private Cause of Action for Insider Trading Under the Federal Securities Laws*, 39 KAN. L. REV. 1 (1990); Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 CAL. L. REV. 1 (1982); Richard J. Morgan, *The Insider Trading Rules After Chiarella: Are They Consistent with Statutory Policy?*, 33 HASTINGS L.J. 1407 (1982); Kenneth E. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801 (1980); William K. S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5*, 54 S. CAL. L. REV. 1217 (1981); C. Larimore Whitaker & James E. Rotch, *The Supreme Court and the Counterrevolution in Securities Regulation*, 30 ALA. L. REV. 335 (1979); Roman P. Wuller, *Insider Trading: Circumventing the Restrictive Contours of the Chiarella and Dirks Decisions*, 1985 ILL. L. REV. 503 (1985).

112. See generally Bayne, *Fiduciary Fallacy*, *supra* note 7 (discussing the ramifications of *Chiarella*).

tionable tort, the American courts had faced the question: "Who is an Insider?" From the 1930s on, the assumption had been universal that "any person"—which was the simple wording of section 10(b)¹¹³—who traded in a stock had a "duty of fair representation,"¹¹⁴ as Judge Luttig put it.

But then the bleeding hearts on the *Chiarella* Court began to fear that too many traders would be held liable, that too broad a net would be cast. That would be, in that popular pejorative word, "draconian."¹¹⁵ So the *Chiarella* majority began to thrash about through several pages of ambivalence and finally narrowed the definition of Insider to include fewer and fewer persons. The step-by-step evolution of this struggle was detailed at length in *Chiarella and the 'Fiduciary' Fallacy*.¹¹⁶

Finally, the *Chiarella* Justices decided that, since Vinnie was not the seller's *fiduciary*, he had no duty to tell them the truth about the value of their stock. The Court observed in *Chiarella* that the duty to disclose . . . only "aris[es] from a relationship of trust and confidence between the parties."¹¹⁷

Even the most bleeding of hearts had to admit that a trustee should not lie to his beneficiary, or an attorney to his client, or a father to his son. On this, even the most timorous Justice could be bold.

Judge Luttig backed up this *Chiarella* position by also adducing *Dirks*. *Dirks* "reaffirm[ed] . . . that '[a] duty [to disclose] arises from the relationship between parties.'"¹¹⁸ *Aliis verbis*, Vinnie would have a duty not to lie to his son Vincent in a similar deal. But such liability would extend to few others.

Understand, however, that *Chiarella* had not a smidgen of the

113. 15 U.S.C. § 78j(b) (1995). "Section 10(b) . . . makes it 'unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance,' in contravention of [SEC] rules." *Bryan*, 58 F.3d at 945.

114. *Bryan*, 58 F.3d at 947 n.9.

115. "[W]e have focused on [the defendant's] liability at the outset in order to illustrate the 'Draconian liability' . . . under the district court's interpretation Because we conclude that . . . imposition of civil liability constitutes an unwarranted extension of the judicially created private cause of action under Rule 10b-5, we reverse." *Fridrich v. Bradford*, 542 F.2d 307, 309 (6th Cir. 1976) (emphasis added) (citing *Shapiro v. Merrill Lynch, Inc.*, 495 F.2d 228, 242 (2d Cir. 1974)).

116. Bayne, *Fiduciary Fallacy*, *supra* note 7, at 691-93.

117. *Bryan*, 58 F.3d at 947 (quoting *Chiarella*, 445 U.S. at 230).

118. *Id.* (quoting *Dirks v. SEC*, 463 U.S. 646, 657-58 (1983), in turn quoting *Chiarella*, 445 U.S. at 231 n.14).

Misappropriation Theory about it. Rather, *Chiarella* was pure and simple old-line section 10(b)—old-line section 10(b), that is, gone totally astray.

The fiduciary duty of *Chiarella* differs in another, even more noteworthy, way from the version in the Theory. In *Chiarella* the fiduciary duty was owed to the victim of *nondisclosure*, the victim with whom the Insider traded. This, at least, has some logic to it.

On the other hand, the fiduciary duty that later appeared in the Theory was owed, remarkably, not to a deceived trader but to a victim of theft who had no connection at all with a securities trade. That was doubly illogical: why a fiduciary, and why by a thief?

This peculiar fiduciary errancy of *Chiarella* found itself bodily transported into the Theory when it first emerged later in the Second Circuit in the 1980s.

1) Luttig and the Insider

Once again the casual reader of *Bryan* might not advert to the important treatment accorded to this elemental—and altogether fundamental—question: Who is an Insider? Judge Luttig did not draw pictures or ring bells, but he did state his position clearly and thoroughly. He went to a recent opinion of the Supreme Court, the 1994 *Central Bank of Denver*,¹¹⁹ to enunciate his stand. The Court was categorical. Here are the relevant words selected by Judge Luttig: “Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5.”¹²⁰

These words “any person” by Justice Kennedy in 1994 are redolent of the equally categorical pronouncement of *The Compendium of the Insider’s Duty*, first propounded in *Insider Trading: The Essence of the Insider’s Duty* in 1992.¹²¹

“The Insider may be any person, with or without a fiduciary relation, inside or outside the corporate counsels, the corporate contrôleur, a director, an officer, tipper, tippee, eavesdropper or

119. *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

120. *Bryan*, 58 F.3d at 947 (emphasis added) (quoting *Central Bank of Denver*, 511 U.S. at 191).

121. Bayne, *Essence*, *supra* note 7, at 352-53.

bystander, who possesses the defined information.”¹²²

At another point Judge Luttig resonates *Essence*:

Chiarella and *Dirks* arose in the context of alleged non-disclosure. We presume, though the Court has not so stated, that a larger pool of investors is subject to the duty of fair representation . . . in that a party . . . will ordinarily be under a duty of fair representation even if he does not qualify as an insider, quasi-insider, or tippee under *Chiarella* and *Dirks*.¹²³

In other words, Judge Luttig did not want to limit the “pool of investors” to the narrower meaning of *Chiarella* and *Dirks*. Rather, Judge Luttig broadened the pool of investors and embraced the definition of *Central Bank of Denver*, which covers any person or entity. By thus extending the definition of an Insider to include “any person” who trades with another, the Fourth Circuit effectively removed any fiduciary duty requirement from section 10(b).

This point should be stressed: not only is *Bryan* a ringing denunciation of the entire Misappropriation Theory, but it is a needed reaffirmation of the all-inclusiveness of the bold words of section 10(b), “any person,” and the equally inclusive “the insider may be any person” of the compendium of *Essence*.¹²⁴

d. fiduciary duty explicitly rejected

As must already have been discerned, Judge Luttig was not given to euphemisms or circumlocution. Lest he had not already made his point in his inclusive definition of the Insider, he again went to the Supreme Court: “Indeed, the Court in *Santa Fe Industries* specifically rejected the notion that a breach of fiduciary duty, in and of itself, is prohibited by section 10(b).”¹²⁵ Judge Luttig bolstered the Supreme Court’s position by noting that *Santa Fe Industries*—which in turn quotes an earlier Supreme Court opinion, *Ernst & Ernst v. Hochfelder*—

reason[ed] that “[t]o the extent” the lower court, in imposing liability, rel[ied] on the use of the term “fraud” in Rule 10b-5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would . . . “add a gloss to the operative language of the

122. *See id.* at 331.

123. *Bryan*, 58 F.3d at 947 n.9 (emphasis added).

124. Bayne, *Essence*, *supra* note 7, at 352-53.

125. *Bryan*, 58 F.3d at 946.

statute quite different from its commonly accepted meaning."¹²⁶

*Verbum satis sapienti.*¹²⁷

e. the Antithesis reconciled

Of course, in truth, no genuine reconciliation is possible. The marked *Antithesis* persists between the unqualified duty to disclose—avoidance of deception—of section 10(b) and the Theory's mere breach of a fiduciary duty. Before any conciliatory discussion began, Judge Luttig wanted this clearly understood:

In any event, by its own terms, the misappropriation theory does not even require deception, but rather allows the imposition of liability upon the mere breach of a fiduciary relationship or similar relationship of trust and confidence. Such a theory obviously cannot be squared with the holding of *Santa Fe Industries* that a breach of fiduciary duty, even in connection with a purchase or sale of securities, does not give rise to liability under section 10(b), absent *deception*.¹²⁸

With that made eminently clear, the judge did attempt to discuss a confined area where deception and fiduciary duty might be conceived to coalesce.

Make certain, Judge Luttig would be the first to find liability for a breach of fiduciary duty in a securities transaction, but if, and only if, the true gravamen of the act was *deceit*, not merely the breach of *fiduciary duty*. In short, *Bryan* would surely hold a fiduciary liable, but the liability would be a fortiori. "Any person" would be liable for such a lie but a trusted trustee or similar confidant would be more readily so. But to hold liability under section 10(b) *only if* a fiduciary was unthinkable.

Bryan again went to the Supreme Court to substantiate its position: "Significantly, the Court also repeated what it characterized as the 'holding' of *Santa Fe Industries*: that section 10(b) does not 'reach[] breaches of fiduciary duty . . . without any charge of

126. *Id.* (emphasis added) (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 472 (1977), in turn quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)).

127. A word to the wise is sufficient. WEBSTER'S NEW COLLEGIATE DICTIONARY 1360 (1979).

128. *Bryan*, 58 F.3d at 949 (emphasis added) (citing *Santa Fe Indus.*, 430 U.S. at 473-74)).

misrepresentation or lack of disclosure.”¹²⁹

To cap off its resort to the Supreme Court, the Fourth Circuit concluded the point with *Dirks*:

That these principles established in *Santa Fe Industries* and *Central Bank of Denver* are applicable . . . was confirmed by the Court in *Dirks*: Not “all breaches of fiduciary duty in connection with a securities transaction” . . . come within the ambit of Rule 10b-5. There must also be *manipulation or deception*. . . . Thus, an insider will be liable under Rule 10b-5 only where he fails to disclose material nonpublic information before trading on it [in violation of a duty to disclose or abstain] and thus makes secret profits.¹³⁰

3. The third *Antithesis*: Duty to Whom: Theft Victim or Investor?

In summary, Butch Bryan, lottery director, (1) *used nonpublic information*—knowledge of the valuable contract with VLC—and (2) purchased VLC stock, (3) *without disclosing its enhanced value*, (4) *with considerable loss to VLC sellers*.

The assault on the Theory now moves to the next basic question: Who is the victim of this Insider Trading? The Theory says that Butch’s employer, the state lottery, was the victim of the theft and hence suffered the injury. Judge Luttig argues, in opposition, that section 10(b) was originally enacted to protect primarily the investing public, the innocent owners of VLC stock, cheated by Butch.

In carrying forward his attack, and answering this elementary query, the judge again employed his successful stratagem of the artful juxtaposition. First, he laid out the unsupportable tenet of the Theory, and second, contrasted the contrary position of the traditional section 10(b).

a. the victim under the Theory

In his exposé of the *First Antithesis*, Judge Luttig laid down the basic premise that undergirds the entire Theory: The heart of

129. *Id.* at 946 (emphasis added) (quoting *Central Bank of Denver*, 511 U.S. at 174, in turn quoting *Santa Fe Indus.*, 430 U.S. at 470).

130. *Bryan*, 58 F.3d at 946 (emphasis added) (quoting *Dirks*, 463 U.S. at 654, in turn quoting *Santa Fe Indus.*, 430 U.S. at 470) (brackets in the original).

the 10(b) malefaction is theft. As in *Chestman*: “[T]heft rather than fraud or deceit, seems the gravamen of the [misappropriation] prohibition.”¹³¹

Here was the Theory’s first fatal misstep. Eliminate deceit and substitute theft, and the straight path of logic leads unswervingly from one major error to another. Begin with that untenable premise and untenable conclusions inexorably follow.

In his second exposé, the judge carried the argumentation forward and concluded logically that if the *violation* is theft of information, the duty violated must be: *Do not steal information*. Thus did the Theory stray further from the truth.

These two postulates in turn led the Theory, equally logically and equally untenably, to the fallacy of this third *Antithesis*. The reasoning was impeccable: Since the duty is *do not steal information* and the wrong is *theft* of the information, the victim must be the person from whom the information was stolen. Since Butch, the Insider, was the thieving employee of the lottery, the lottery suffered the Insider Trading damage. The lottery was the victim.

Conscious that few could believe that courts would actually propound such absurdities or that the Theory would in fact abandon the sixty-year tradition of section 10(b), the judge went to the Seventh Circuit’s analysis of *Newman* in *Cherif* for corroboration: “The Court [in *Newman*] was . . . influenced by the damage inflicted on the insider trader’s employer by a conniving employee.”¹³²

The Second Circuit decision in *Moss*, as Luttig noted, was “a case involving *an employee’s breach of his duty to his employer* to ‘disclose or abstain’ from trading, . . . even though *Newman* was explicit that the fraud was the *theft* of information, and not the failure to disclose before trading.”¹³³

The *Bryan* Court placed considerable blame on the Second Circuit decision in *Newman* for this particular anomaly of the third *Antithesis*: The Insiders, by stealing information from their employers, “defrauded those employers as surely as if they took their money.”¹³⁴ The Lottery was the “defrauded” victim.

131. *United States v. Chestman*, 947 F.2d 551, 578 (2d Cir. 1991) (Winter, J., concurring in part and dissenting in part).

132. *Bryan*, 58 F.3d at 955 (quoting *SEC v. Cherif*, 933 F.2d 403, 409 (7th Cir. 1991)).

133. *Id.* (quoting *Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 13 (2d Cir. 1983)).

134. *Id.* at 944 (quoting *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981)).

By calling theft fraud and the employer the *victim*, the Theory spawned a new legal buzzword. Jurists and commentators—notably the Second Circuit and the authoritative Louis Loss—immediately characterized the deceit as *fraud on the source*. Why? Because the employer, the lottery, was the “source” whence the “conniving employee,” Butch Bryan, learned of the increased value of VLC stock. Thus the Second Circuit *Chestman* refers to the “misappropriation theory as a ‘fraud on the source’ theory of 10b-5 liability.”¹³⁵

1) the victim is *not* the investor

At this point, section 10(b) suffers further, unexpected violence. The Theory does not merely add new protection to a hitherto nonparty, the source. That was surprise enough. But the Theory advertently removes the selling innocents from section 10(b) coverage. In short, the employer *supplants* the deceived sellers. The source is added, the investor removed.

The Theory is in fact saying not one but *two* things about the victim of the deceit: (1) The real victim is the source of the stolen information, the lottery, and (2) the deceived shareholders who sold to Butch have no protection under section 10(b). “That is, [Bryan and ReBrook] did not owe the people with whom they traded a duty to disclose.”¹³⁶

The *Bryan* court underlined this added excess of the Theory: “[T]he [insider] owes no duty of disclosure to the purchaser or seller of the securities.”¹³⁷

The Theory has been thorough in removing any semblance of duty to Butch’s sellers, a severe break with the Second Circuit past: “In contrast to *Chiarella* and *Dirks* the misappropriation theory does not require that the buyer or seller of securities be defrauded.”¹³⁸

Bryan added a gloss to this line of commentary by noting that the source, the lottery, need not even be a party to any securities transaction at all but will nonetheless be the victim under the Securities Exchange Act of 1934: “The *source of the nonpublic information* need not be a *purchaser or seller of securities* [or] be af-

135. *Id.* (quoting *Chestman*, 947 F.2d at 567).

136. *Id.* at 958.

137. *Id.* at 944.

138. *Id.* (quoting *Chestman*, 947 F.2d at 566).

filiated with a purchaser or seller.”¹³⁹

Pause for a moment to reflect on this latest of the Theory’s inconcinnities. Under the Theory, Butch Bryan finds himself burdened with a duty of *loyalty* induced by securities law—which has never been an element of securities law—to his employer the lottery, which was not involved in any securities transaction. But Butch had no duty of disclosure, under a securities disclosure statute, to the sellers of securities with whom he actually traded and whom he actually deceived.

In 1992 *Chestman and the ‘Misappropriation Theory’*¹⁴⁰ presaged the Luttig position to the effect that the “theory does not require that the *buyer* or *seller* of securities be defrauded.”¹⁴¹

To borrow from *Cady, Roberts*, the Theory “ignores the plight of the buying public—wholly unprotected from the misuse of special information.” This shift in direction, from *the trading innocents* to *the party from whom the information* is stolen, changes the entire thrust of the traditional deceit action to one of theft. Section 10(b) has been metamorphosed.¹⁴²

This aptly introduces the second half of Judge Luttig’s juxtaposition.

b. the victim according to section 10(b)

[A] violation [of section 10(b)] may be found only where there is “intentional or willful conduct designed to deceive or defraud investors.”¹⁴³

The exasperation that surfaces periodically throughout Judge Luttig’s opinion can readily be excused by considering just one of the many chores he faced in *Bryan*: The necessity to point out to “our sister circuits” that the securities laws were enacted to protect *investors in securities*, not theft victims.

Why would the judge have to prove a point that was repeated *per longum et latum* in countless federal opinions over a sixty-year

139. *Id.* (emphasis added).

140. Bayne, *Misappropriation Theory*, *supra* note 2, at 87.

141. *Chestman*, 947 F.2d at 566 (emphasis added).

142. Bayne, *Misappropriation Theory*, *supra* note 2, at 88 (quoting *Cady, Roberts & Co.*, 40 S.E.C. 907, 913 (1961)).

143. *Bryan*, 58 F.3d at 948 (quoting *Dirks*, 463 U.S. at 663 n.23) (internal quotations omitted).

span? As the 1994 opinion of the Supreme Court, *Central Bank of Denver* said, the “broad congressional purpose[]” of the Act is “to protect investors from false and misleading practices that might injure them.”¹⁴⁴ The judge added in *Santa Fe Industries* in 1977: “[The] purpose of [the] prohibition on manipulation [is] to protect investors from being misled.”¹⁴⁵

But Judge Luttig, exasperation withal, did go forward assiduously to quote from the leading Supreme Court opinions to counter the Theory’s preposterous position. “The [Supreme] Court has left no doubt that the principal concern of section 10(b) is the protection of *purchasers and sellers of securities*. This was the very premise of the Court’s leading cases in *Chiarella* and *Dirks*, and most recently, *Central Bank of Denver*.”¹⁴⁶ Thus, *Santa Fe Industries*, *Chiarella*, *Dirks*, and *Central Bank of Denver* left little room to include the West Virginia lottery among the protected victims of the Securities Act of 1934.

After adducing successively (1) *Central Bank of Denver* in 1994, (2) *Santa Fe Industries* in 1977, (3) *Ernst & Ernst* in 1976, and (4) *Dirks* in 1983, the *Bryan* court summed up the Supreme Court’s long tradition in a sweeping statement:

At the same time that the Court has repeatedly emphasized that section 10(b) is concerned only with *deception* in the form of material misrepresentations and omissions, it has equally clearly instructed that the section is primarily if not exclusively concerned with the *deception of purchasers and sellers of securities*.¹⁴⁷

Over many paragraphs, *Bryan* analyzed a fifth Supreme Court opinion, *Blue Chip Stamps v. Manor Drug Stores*,¹⁴⁸ to the same effect, and noted as an intensifier: “Three Members of the [*Blue Chip*] Court even wrote separately to emphasize that the plain language of section 10(b) limited any action to *purchasers and sellers of securities*.”¹⁴⁹

Just as rigid logic led the Theory logically from a false premise—theft is the gravamen—to a false conclusion—the victim is the

144. *Id.* (emphasis added) (quoting *Central Bank of Denver*, 511 U.S. at 173-74).

145. *Id.* (emphasis added) (paraphrasing *Santa Fe Indus.*, 430 U.S. at 476-77).

146. *Id.* at 946-47 (emphasis added).

147. *Id.* at 946 (emphasis added).

148. 421 U.S. 723 (1975).

149. *Bryan*, 58 F.3d at 948 (emphasis added) (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 760 (Powell, J., concurring)).

victim of the theft—so too did rigid logic guide section 10(b) to the opposite position. The gravamen is nondisclosure and the only victim of deceit is the one deceived, the innocent investors who sold their stock to Butch.

4. The fourth *Antithesis*: Securities Trade or Theft?

The last of the Theory's anomalies would not deserve special attention were it not for the provision inserted by the Congress when the common law tort of deceit was given specific application to a modern securities transaction. A practiced tort person would undoubtedly have seen little reason for gilding a lily that needed no adornment.

But no matter, the Congress in 1934 so saw fit and in the process employed explicit language that focused the ambit of the Act to a limited sphere. Briefly, liability under section 10(b) would be present only when *deception* occurred "*in connection with the purchase or sale of any security.*"¹⁵⁰

Judge Luttig was constrained, therefore, to address the Theory's flagrant disregard of these clear-cut words of the code. Again his opinion juxtaposed the true and the false. This time, however, the emphasis was first on the unambiguous mandate of the 1934 Act and then on the failure of the Theory to conform.

a. the stricture of section 10(b)

Early in its opinion the Fourth Circuit flagged the statutory obstacle confronting the Theory: "The language of section 10(b) and Rule 10b-5 sweeps broadly. The statute prohibits the use of 'any' manipulative or deceptive device or contrivance 'in connection with' the purchase or sale of 'any' security."¹⁵¹

Judge Luttig wanted to stress that he saw no delicate nuances of meaning in the phrase "*in connection with.*" This was simply a forthright code proviso. "Section 10(b), it bears repeating, reaches only *deception* of persons with some connection to, or some interest or stake in, an actual or proposed purchase or sale of securities."¹⁵²

150. 17 C.F.R. § 240.10b-5 (1994) (emphasis added).

151. *Bryan*, 58 F.3d at 945.

152. *Id.* at 949-50 (emphasis added).

1) *Blue Chip Stamps*, 1975

“We based [our] conclusion [in *Blue Chip Stamps*] largely on the language of § 10(b) and Rule 10b-5, which by their terms govern only ‘the purchase or sale of any security.’”¹⁵³

Judge Luttig could arguably be accused of underplaying the cogency of the Supreme Court’s stand in positing for section 10(b) liability the requirement of a connection between the *deception* and an actual *securities transaction*. In truth, *Blue Chip Stamps v. Manor Drug Stores*¹⁵⁴ is an a fortiori support for the proposition “that a person *in some way connected to a securities transaction be deceived*.”¹⁵⁵

Manor Drug was proffered a binding offer to buy into Blue Chip on admittedly favorable terms. But Manor Drug was denied the relevant material nonpublic information that would have convinced it to buy. An uninformed Manor Drug declined. Manor Drug suffered substantial loss but was denied recompense by the Supreme Court because it was not a shareholder under the “purchaser-seller” rule judicially engrafted onto section 10(b).¹⁵⁶

To the *Blue Chip* Court, section 10(b) was so rigidly directed to deception in *actual* securities transactions that could-be, would-be participants in such a securities trade would consequently be denied 10(b) recovery because they had *not yet actually* engaged in such a transaction. True, the participants were deceived in connection with a *potential* securities transaction, but the participants never actually traded.

Obviously, with this rigidity, *Blue Chip* would never countenance coverage of one who was in no way involved in a securities trade but was the victim of a theft totally unrelated to securities. Judge Luttig continued, quoting *Blue Chip*: “[T]he wording of § 10(b), making fraud *in connection with the purchase or sale of a security* a violation of the Act, is surely badly strained when construed to provide a cause of action, not to purchasers and sellers of securities, but to the world at large.”¹⁵⁷

153. *Id.* at 948 (quoting *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 305 (1993) (Thomas, J., dissenting)).

154. 421 U.S. 723 (1975).

155. *Bryan*, 58 F.3d at 950 (emphasis added).

156. Bayne, *Essence*, *supra* note 7, at 327-28.

157. *Bryan*, 58 F.3d at 952 (quoting *Blue Chip Stamps*, 421 U.S. at 733 n.5).

The Fourth Circuit summarized the scope of section 10(b) by tying the essential "*deception*" directly to the actual securities transaction. Here is the *sine qua non* of 10(b) liability: "Section 10(b) is not concerned with the general fairness of securities transactions themselves, so long as there is no evidence of *deception in connection with a securities transaction*, in the form of material misrepresentations or omissions made to persons connected with a securities transaction."¹⁵⁸

Judge Luttig capped it off with the Supreme Court in the 1971 case *Superintendent of Insurance v. Bankers Life & Casualty*:¹⁵⁹ "[I]n *Bankers Life* the Court stated its understanding that section 10(b) only 'bar[red] deceptive devices and contrivances *in the purchase or sale of securities*.'"¹⁶⁰

b. the nonconformity of the Theory

Judge Luttig shows commendable insight in his dissection of the Theory's treatment of "in connection with" a securities transaction. In two paragraphs midway in his opinion, he compresses a superb analysis of the deviousness of the Theory.

In his first paragraph, he exposes a dichotomy made by the Theory where section 10(b) permits no such dichotomy at all. "In essence, the misappropriation theory . . . artificially *divides* into two *discrete* requirements—[1] a fiduciary breach and [2] a purchase or sale of securities—the single *indivisible* requirement of *deception upon the purchaser or seller of securities*."¹⁶¹

What has the judge said? One, that section 10(b) "requires" that the nondisclosure occur during the actual securities trade and upon the trader. The deception is integral to the transaction.

Second, he says that the Theory breaks up this unitary requirement of deception in a trade into two unconnected, unrelated disparate acts: (1) a breach of fiduciary duty to an employer—called "fraud"—and (2) a later, honest, nondeceptive sale of securities totally distinct from the prior act of disloyalty.

Thus, (1) Butch Bryan was unfaithful to the lottery by stealing the news of the supplier contract and (2) later bought VLC stock without regard to any duty or fairness to the sellers.

158. *Id.* (emphasis added).

159. 404 U.S. 6 (1971).

160. *Bryan*, 58 F.3d at 950 n.17 (quoting *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971)).

161. *Id.* at 950.

Examine this absurd example: A thieving employee is fully liable for securities “fraud” in spite of the fact that the predicate and subsequent and totally unrelated “securities transaction” was altogether lacking in deceit, was characterized by full disclosure, and was completely above board. So it would be under the Theory.

In the second paragraph of Judge Luttig’s dissection he builds on his analysis of the fallacious dichotomy: “In [the false dichotomy], the theory effectively eliminates the requirement that a person in some way connected to a securities transaction be deceived, allowing conviction not only where the ‘defrauded’ person has no connection with a securities transaction, but where no investor or market participant has been deceived.”¹⁶² Unfortunately Judge Luttig’s shotgun style again makes for difficult reading, but have no doubts, he supports all of his arguments, albeit in unconnected places.

Earlier, the opinion points out this false dichotomy when the Theory removes any deceit from the trade itself. “[The 10(b) deception] (i.e., the misappropriation) is deemed to be [in the words of section 10(b)] ‘in connection with the purchase or sale of [a security,’ because the misappropriated information is thereafter used in a securities transaction.”¹⁶³ And again, at another point in the opinion: “The fraud was ‘in connection with the purchase or sale of any security,’ because Bryan *subsequently* used the misappropriated confidential information in the purchase of shares.”¹⁶⁴

Recall that the definition of the Theory, crystallized in the Ninth Circuit case *SEC v. Clark*,¹⁶⁵ by design separated the theft from any obligation or relation to the trading innocents: One who misappropriates information is liable if the person then “(3) uses that information in a securities transaction, (4) regardless of whether he owed any duties to the shareholders of the traded stock.”¹⁶⁶ Once again, Judge Luttig recurs to *Chestman*: “The source of the nonpublic information [the defrauded one] need not . . . be in any way connected to or even interested in the purchase or sale of securities.”¹⁶⁷

162. *Id.*

163. *Id.* at 944-45.

164. *Id.* at 945 (emphasis added).

165. 915 F.2d 439 (9th Cir. 1990).

166. *Bryan*, 58 F.3d at 944 (quoting *SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990)).

167. *Id.* (citing *United States v. Chestman*, 947 F.2d 551, 567 (2d Cir. 1991)).

The court, in this regard, shows its mastery of the “somewhat harrowing evolution”¹⁶⁸ of the Theory by directly repudiating several holdings “of our sister circuits.” In light of the exposé of this dichotomy,

[i]t should come as no surprise that the provision [section 10(b)] is unconcerned with the fairness of conduct toward persons such as family members [*Chestman*], employers [*Bryan, Carpenter, Materia, Newman*], medical patients [*Willis*], or other parties to the infinite number of similar trust relationships [*Clark*] who are not in any way connected with or even interested in a purchase or sale of securities.¹⁶⁹

The Fourth Circuit concludes its refutation of this last of the *Antitheses* by a summary indictment of the unjustified dichotomy propounded by the Theory. “The misappropriation of information from an individual who is *in no way connected to*, or even interested in, *securities* is simply not the kind of conduct with which the *securities* laws, as presently written, are concerned.”¹⁷⁰

With that, the Fourth Circuit addresses all four *Antitheses* in globo as a concluding word:

In light of the Court’s consistent interpretation of section 10(b) as prohibiting only the deception, by material misrepresentation or omission of a purchaser or seller of securities, or of a person in some way connected with or having a stake in an actual or proposed purchase or sale of securities, we believe that *the misappropriation theory cannot be defended*.¹⁷¹

Requiescat in Pace.

168. *Id.* at 953.

169. *Id.* at 952-53. The references are to *United States v. Carpenter*, 484 U.S. 19 (1987); *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991); *SEC v. Clark*, 915 F.2d 439 (9th Cir. 1990); *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981); *SEC v. Willis*, 825 F. Supp. 617 (S.D.N.Y. 1993).

170. *Bryan*, 58 F.3d at 950 (emphasis added).

171. *Id.* at 949 (emphasis added).

IV. THE CONFLICT AMONG THE CIRCUITS

The government proceeded against Bryan under the so-called "misappropriation theory" of securities fraud liability, a theory that, although novel to this circuit, has been embraced by the Second, Seventh, and Ninth Circuits.

—*United States v. Bryan*¹⁷²

The impact of *Bryan* should be immense. The Age of Enlightenment, 1984-1994, produced a virtually unmitigated attack by the Theory on the basic tenets of the section 10(b) deceit approach. *Bryan* is the first crack in this monolith, and offers a palpable hope for an early solution, either by the circuits themselves or eventually the Supreme Court.

The conflict engendered by *Bryan* is, moreover, uncomplicated, almost black and white. Consider the Fourth Circuit itself. In *United States v. ReBrook*,¹⁷³ the companion to *Bryan*, written by Judge Williams, the outspokenly strong holding by Judge Luttig was bolstered considerably: "Our straightforward reasoning in *Bryan* is equally applicable to *ReBrook*. As the excerpted portion of *Bryan* makes clear, *we have rejected the misappropriation theory* as envisioned by our sister circuits *in whole, not simply as applied to the particular facts in Bryan.*"¹⁷⁴

Add as evidence of the solidarity of the Fourth, the unanimous rejection en banc of a rehearing. The circuit apparently was without dissent in "the panel's view that *the misappropriation theory is never valid.*"¹⁷⁵ Clearly, the Fourth Circuit was spoiling for a fight.

One of the rare commentaries on *Bryan*—in *The New York Times*—emphasized this combativeness and was seemingly somewhat disedified by Judge Luttig's aggressive assault on the Second Circuit:

The ruling by Judge Luttig was unusual for the scorn it heaped on opinions by the Second Circuit Court of Appeals, which originated the theory and which, being based in New York, has historically been the lead court on se-

172. *Id.* at 943.

173. 58 F.3d 961 (4th Cir. 1995).

174. *Id.* at 966 (emphasis added).

175. *Full Fourth Circuit Will Not Hear Misappropriation Case*, FED. SEC. L. REP. (CCH) at 3 (Aug. 30, 1995) (emphasis added).

curities issues. He said the Second Circuit was “seemingly unaware” of an earlier Supreme Court decision [*Santa Fe Industries*], although that decision had been on a case appealed from the Second Circuit. He said that ‘it is virtually impossible to discern the logic’ in another Second Circuit opinion [*Moss v. Morgan Stanley*] on the issue.¹⁷⁶

The *Times* might have added: “In the very next misappropriation case it decided after *Newman*, the Second Circuit, *perhaps unwittingly, perhaps not*, undermined the entire rationale behind the misappropriation theory.”¹⁷⁷ But the fifth article in this series, *Chestman and the ‘Misappropriation Theory,’* in 1994 was equally scornful:

[O]ne would naturally ask how the same respected Second Circuit could hand down a generally well-reasoned and balanced Opinion such as [*SEC v. Texas Gulf Sulphur*] to say nothing of both *Shapiro v. Merrill Lynch* and the Second Circuit *Chiarella*—and later, on a question on all fours, do an abrupt about-face and release the untenable holding of the Meskill Majority [in *Chestman*]. The question is intensified with the realization that both [*Texas Gulf Sulphur*] and *Chestman* were en banc Opinions.¹⁷⁸

Only three circuits, the Second, Seventh, and Ninth, are lined up against the Fourth. The position of all three has coalesced into a consensus of the definition of the Theory. Judge Luttig, as chief spokesman for the Fourth, impugned vigorously and successfully, each of the four subdivisions of the Theory in his *Antitheses*.

The other circuits, therefore—or the Supreme Court per-

176. Floyd Norris, *Court Curtails Insider Trading Cases*, N.Y. TIMES, Aug. 23, 1995, at D1, D8. The *Times* referred to these strong statements in the opinion:

We regard the somewhat harrowing evolution of the misappropriation theory as almost a testament to the theory’s invalidity. When the Second Circuit first adopted the theory fourteen years ago in affirming a criminal conviction for securities fraud, that court was unattuned to the differences in language employed in section 10(b) and Rule 10b-5 and was seemingly unaware of the existence of the Supreme Court’s decision in *Santa Fe Industries*.

Id. at D8.

“It is virtually impossible to discern the logic behind the *Moss* court’s distinction of *Newman*. This is due to what appears to be a double-misreading of footnote one from the *Newman* opinion.” *Bryan*, 58 F.3d at 956 n.23.

177. *Bryan*, 58 F.3d at 955 (emphasis added).

178. Bayne, *Misappropriation Theory*, *supra* note 2, at 107 (citations omitted).

haps—will have a brightly limned quaterna of questions facing them, at least regarding the Theory itself. True, the other Insider Trading issues will soon arise and should.

A. *The Vigor of the "Sister Circuits"*

In contrast to the Fourth Circuit, no solid phalanx is aligned in opposition. Rather, the appearance is one of a tattered army in retreat, in spite of the uniformity of the embrace of the Theory.

1. The Third Circuit

The Second Circuit, the chief protagonist of the Theory, tried vigorously to interpret the Third Circuit *Rothberg v. Rosenbloom*¹⁷⁹ into the ranks of cases supporting the Theory. "[T]he misappropriation theory has not yet been the subject of a Supreme Court holding, but has been adopted in the Second, *Third*, Seventh and Ninth Circuits."¹⁸⁰

However, as *Chestman and the 'Misappropriation Theory'* concluded: "Substantively—or procedurally—*Rothberg* should afford slight solace to the *Chestman* camp."¹⁸¹

Chestman and the 'Misappropriation Theory' did accord *Rothberg* the dignity—probably undeserved in the light of Luttig's contempt—of a two-page analysis¹⁸² in its treatment of The Age of Enlightenment: 1984-1994.

Judge Luttig gave *Rothberg* shorter shrift, and refused even to list the Third Circuit as a supportive circuit. "As do many of the courts that have addressed the misappropriation theory, the government also identifies the Third Circuit as having adopted the theory, citing *Rothberg* The court in *Rothberg*, however, merely adverted to the theory in a single sentence, and even then, not by name."¹⁸³ The Third Circuit clearly does not belong in the tattered army.

2. The Ninth Circuit

In 1990 Judge Cynthia Holcomb Hall wrote the only Ninth

179. 771 F.2d 818 (3d Cir. 1985) (emphasis added).

180. U.S. v. Chestman, 947 F.2d 551, 566 (2d Cir. 1991) (footnote omitted).

181. Bayne, *Misappropriation Theory*, *supra* note 2, at 137.

182. *See id.* at 136-37.

183. United States v. Bryan, 58 F.3d 933, 943 n.5 (4th Cir. 1995) (citations omitted).

Circuit contribution to the Theory, *SEC v. Clark*.¹⁸⁴ *Chestman and the 'Misappropriation Theory'* characterized the holding: "Therewith ensued the most remarkable—at least to one who has read the long series of insider-trading cases from *Strong v. Repide* in 1909 to the Circuit *Dirks* in 1982—contortion and corruption of the original protections afforded by Section 10(b). . . . The Court seemed rambling and lost."¹⁸⁵

The Ninth Circuit—with allowance for the fact that *Clark* was its sole contribution—did rank as a firm proponent of the Theory. The reasoning of *Clark*, however, should not offer much pause to the other circuits. *Chestman and the 'Misappropriation Theory'* reviews *Clark* with adequate thoroughness.

3. The Seventh Circuit

In 1991 *SEC v. Cherif*¹⁸⁶ was the only Theory case coming out of the Seventh Circuit. *Cherif*, however, showed less conviction, and expressed a genuine worry. "*Cherif* wondered if the Theory 'should apply even to "mere" thieves'—thieves, that is, *sans* a fiduciary duty,"¹⁸⁷ and thus did undermine the Theory's insistence on the breach of a "duty . . . of trust and confidence."¹⁸⁸ "If 'mere' thieves, perhaps mere eavesdroppers, mere bystanders, any person?"¹⁸⁹ *Cherif* was indeed uncertain about the Theory's requirement of a fiduciary relationship.

The Seventh Circuit, with the Ninth Circuit, therefore, offers but thin support for the Theory. Virtually the entire burden for the Theory must be carried by the Second Circuit.

4. The Second Circuit

The Theory began with *Newman*¹⁹⁰ in 1981 in the Second Circuit and reached its zenith—or nadir—with the Second Circuit decision in *Chestman*¹⁹¹ in 1991. In between were several less important cases. With the input of these lesser cases quite inconsequential, the role of Theory representative falls principally onto *Chestman*. Moreover, "[t]he Supreme Court has yet to ad-

184. 915 F.2d 439 (9th Cir. 1990).

185. Bayne, *Misappropriation Theory*, *supra* note 2, at 138-40.

186. 933 F.2d 403 (7th Cir. 1991).

187. Bayne, *Misappropriation Theory*, *supra* note 2, at 142.

188. *Bryan*, 58 F.3d at 944 (emphasis added).

189. Bayne, *Misappropriation Theory*, *supra* note 2, at 142.

190. *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981).

191. *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991).

dress whether the misappropriation theory is reconcilable with the language and purposes of section 10(b) and Rule 10b-5, having evenly divided on the validity of a conviction based on this theory in *Carpenter v. United States*.¹⁹²

Thus, as the latest and most important, *Chestman* will face off against *Bryan* as the other Circuits are forced to take sides.

Chestman is indeed the ideal voice to speak for the decade since *Chiarella* and *Dirks* of the early 1980s. Not only was *Chestman* the pronouncement of the prestigious Second Circuit, but it was also an en banc Opinion of all eleven sitting Judges. Certiorari was denied in 1992. *Chestman* approaches Supreme Court stature.¹⁹³

Predictably, *Chestman* will offer little competition to Judge Luttig's *Bryan*.

Chestman, moreover, was the epitome of dissonance. The eleven Judges were divided into a six-five split. The majority Opinion by Meskill, reversing the District Court, was a mish-mash. The dissent by Judge Winter was divisively compelling. Two Judges added to the confusion with third and fourth opinions. Note too that the six-five split was a reversal of an earlier three-Judge Second Circuit panel, which itself had three separate opinions. (In this disarray, . . . perhaps better, the Meskill Majority. And the Winter Five.)¹⁹⁴

Judge Luttig—more sanguine than *Chestman and the 'Misappropriation Theory'*—saw early signs of hedging in *Chestman*. He instanced several hesitations to a full embrace of the Theory, as when the Meskill Majority backtracked: "For these reasons we tread cautiously in extending the misappropriation theory to new relationships, lest our efforts to construe Rule 10b-5 lose method and predictability, taking over 'the whole corporate universe.'"¹⁹⁵ Judge Luttig also stressed the fact that *Chestman* refused to grant recovery because a husband owes no fiduciary duty to his wife. "Even though Judge Meskill may well be a bachelor, even a bachelor could scarce be excused this sentiment."¹⁹⁶

"In sum, more than the gratuitous reposal of a secret to an-

192. *Bryan*, 58 F.3d at 943 (citations omitted).

193. Bayne, *Misappropriation Theory*, *supra* note 2, at 82.

194. *Id.* at 83.

195. *Bryan*, 58 F.3d at 959 (quoting *Chestman*, 947 F.2d at 567, in turn quoting *United States v. Chiarella*, 588 F.2d 1358, 1377 (2d Cir. 1978)).

196. Bayne, *Misappropriation Theory*, *supra* note 2, at 149.

other *who happens to be a family member* [read “wife”] is required to establish a fiduciary or similar relationship of trust and confidence.”¹⁹⁷

The chasm that divides the Fourth Circuit *Bryan* and the Theory of the Second Circuit is profoundly deep. It would be difficult to divine a more auspicious moment for the uncommitted circuits to embrace *Bryan*.

V. THE BLUEPRINT FOR THE FUTURE

In embarking on this assessment of the future in the battle of *United States v. Bryan* against the forces of the Theory, first review the unusual concatenation of events that provided Judge J. Michael Luttig with the unparalleled opportunity he so ably seized. Both bench and bar have much to learn from the scenario in *Bryan* when next facing section 10(b) Insider Trading litigation.

A. *The Appeal from the District Court*

For a Judge Luttig so desirous of permanently eliminating the Theory, a congeries of fortunate factors made success almost certain. First, luckily, Butch Bryan appealed—a virtually hopeless endeavor—from a conviction for Insider Trading and, in a fortuitous amalgam, mail fraud, wire fraud, and perjury. With this ill-advised appeal, the hoped-for attack on the Theory became possible. Add to this the equally helpful fact that Butch was patently guilty on all four counts, guilty, that is, if the Theory were applicable.

This felicitous amalgam offered Judge Luttig the glorious chance of not only throwing out the Theory but sending Butch into longtime custody—where he remains to this day—and even avoiding as well any opprobrium or twinge of conscience had a reversal served to set Butch free. Here was a risk-free assault on the Theory, since the other counts would remain to deal with Butch.

Second, the Department of Justice, undoubtedly counseled by the Securities and Exchange Commission and committed by necessity to the cause of the Theory, misguidedly moved for an en banc rehearing.

Ordinarily, this could cause some concern, but Judge Luttig had clearly been thorough in anticipating what pitfalls might lie ahead. Witness his own unanimous panel, and the equally unani-

197. *Chestman*, 947 F.2d at 568 (emphasis added).

mous *ReBrook* holding of Judge Williams. Judge Luttig must have caucused well, and been assured that the en banc circuit would oblige with a door-closing denial of a rehearing, again apparently unanimously.

Next, the Justice Department at last paused and took stock of its position. What it saw was chastening: (1) an absolutely devastating opinion by Judge Luttig, (2) unqualified Fourth Circuit backing, and (3) a debilitated Theory with a “somewhat harrowing evolution.”¹⁹⁸

With that, the Justice Department expectably concluded that certiorari would be adding another setback to an already unnerving defeat. The time for a petition was sensibly allowed to lapse.

This is the present that cautions the future. Perhaps *The Awakening, 1995* will be an added admonition. And what message does *Bryan* and the nuances of *The Awakening, 1995* send to each of the principal players of the future: to the courts, to the commission, and to the bar?

1. To the courts

Again showing his grasp of the impact of the Theory and its peculiar place in the law, Judge Luttig offered some penetrating insights with an eye to post-*Bryan* adjudications.

First, the judge consciously and correctly countered the view-with-alarm that would expectably follow an abrupt disappearance of the Theory. His prescience had anticipated the concerns of the Attorney General who, the *Times* reported, was fearful of the consequences of such a sudden vacuum: “[T]he Justice Department said earlier this month that the opinion, if it were accepted in other jurisdictions, ‘would substantially cripple the commission’s efforts to protect investors and the integrity of the securities markets against insider trading.’”¹⁹⁹

Judge Luttig’s opinion also countered the unwarranted timorousness of “William McLucas, the S.E.C.’s chief of enforcement.” “‘It would raise some problems,’ Mr. McLucas said in an interview. ‘It is hard to overestimate the number of cases or the potential damage’ if the doctrine [the invalidity of the Theory] became widely accepted, he added.”²⁰⁰

To the contrary, Judge Luttig realized that seventy-five years

198. *Bryan*, 58 F.3d at 953.

199. Norris, *supra* note 176, at D1.

200. *Id.* at D8.

of deceit actions still stood ready to meet any demands for Insider Trading redress.

We do not believe that rejection of the particular misappropriation theory that we address today will ultimately have a notable impact on federal efforts to combat fraud in the securities markets. Much of the conduct rendered criminal under the misappropriation theory is already criminalized under section 10(b) as interpreted in *Chiarella* and *Dirks*.²⁰¹

Bryan is saying that the demise of the Theory will leave the courts exactly where they were post-*Dirks* and that the law post-*Dirks* was eminently capable of fighting securities deceit under the canonized deceit law of section 10(b), unaided by the fallacies of the Theory.

Many of the people who would fall within the ambit of the misappropriation theory urged in this case already owe a *duty* to purchasers and sellers of securities to *disclose* or abstain from trading, duties recognized by the Supreme Court in *Chiarella* and *Dirks* as legitimate predicates for criminal liability under section 10(b).²⁰²

This is not to ignore, however, the past. The elimination of the Theory, and a return to the post-*Dirks* period, would still leave all the old problems extant, as readily solvable as they are.

Do not forget that it was the chaos in the law that spawned the Theory in the first place: The courts (1) had never correctly defined an Insider, (2) had been confused with the disclose or abstain rule, (3) had injected a fiduciary duty into a deceit action, and (4) had never answered the “tipper” and “tippee” questions of *Dirks*. Because of all this, the Theory arose in desperation. These problems are still present.

But all these questions were classical deceit action questions. They were the creation of courts unable to penetrate to the tenable philosophy underpinning the traditional law of section 10(b).

Judge Luttig is implicitly saying that future courts can now be free—with the model of *Bryan* to guide them—to address these questions and get the historical Insider Trading law back on the track. Arguably, the basic philosophy laid out in *Essence*, and the answers advanced in the several articles thereafter, will serve as a basis for the answers.

201. *Bryan*, 58 F.3d at 953.

202. *Id.* (emphasis added).

a. the Second Circuit

Judge Luttig had no doubt that the Second Circuit would be the primary battleground. There the Theory began, and there lies *Bryan*'s principal opposition.

If the Second Circuit could see the error of its ways, the reasoning would go, perhaps, then, the Supreme Court need never to be called upon, and the circuits themselves could resolve the issue on their own. If *Bryan* could so forcefully dissuade a petition for certiorari in the Fourth Circuit, why not a similar approach and a parallel opinion in the Second Circuit?

With this realization, Judge Luttig necessarily chose his own *Chestman* to carry his message to the Second Circuit. He had concluded, somewhat wishfully perhaps, that the Second was already loosening its embrace of the Theory: "Despite the momentum building behind the theory with its rehabilitation in *Materia*, and its adoption in *Clark* and *Cherif*, the pendulum in the Second Circuit swung decidedly against the misappropriation theory in that court's recent *en banc* decision in *United States v. Chestman*."²⁰³

The judge was convinced that the Second Circuit already knew in its heart that the Theory was untenable. He hoped that the encouragement of *Bryan* would now make the Second's conversion a reality, that the "Winter Five" would prevail.

For the first time since *Moss*, the Second Circuit attempted in *Chestman* to square the misappropriation theory with the Supreme Court's holdings in *Santa Fe Industries*, *Chiarella*, and *Dirks*, and not surprisingly, realized that the misappropriation theory was neither necessary, defensible under precedent, susceptible in principle to limitation, nor justifiable on the strength of the broad purposes of the Act.²⁰⁴

Strong words to level at the august Second Circuit. He continued with a point all too obvious:

Chestman expressly recognized that the framework for securities fraud established by the Supreme Court over the past twenty-five years does not permit of the misappropriation theory as developed in the Second Circuit. . . . [T]he circuit belatedly acknowledged [in *Chestman*] that to establish criminal liability under the Supreme Court's

203. *Id.* at 958.

204. *Id.* (emphasis added).

cases, "the predicate act of fraud must be traceable to a breach of duty to the purchasers or sellers of securities."²⁰⁵

Chestman even admitted that the legitimacy of the traditional deceit theory of Insider Trading liability had been established in *Chiarella* and *Dirks*, and that the Misappropriation Theory was only a "second general theory of Rule 10b-5 liability."²⁰⁶

The judge could not resist a bit more scorn in a parting word: "Ironically, we could scarcely describe better the tenuousness of the misappropriation theory under *Santa Fe Industries*, *Chiarella*, and *Dirks*, than did the Second Circuit itself in *Chestman*."²⁰⁷ But, scorn withal, this should be a useful admonitory word of encouragement to the Second Circuit to return to sanity.

b. all the other circuits

With the Theory no longer a hindrance, *Bryan* should be replicated in the remaining circuits. The Seventh Circuit, with only "mere thieves" *Cherif*, and the Ninth Circuit, with only Hall's *Clark*, have little backpedaling to do and should now be emboldened to follow *Bryan* verbatim.

This would clear the way for successive attacks on the several troubled areas already besetting the law, pre-Theory. Soon a series of decisions like *Bryan* should lead back to the pristine days of *Cady*, *Roberts* and its progeny.²⁰⁸

c. the Supreme Court

This *Blueprint for the Future* might well have no role for the Supreme Court. The Fourth Circuit and *Bryan* are so admirably strong, the Second Circuit so hopelessly mixed up, and the Seventh and Ninth Circuits so wholly enfeebled that the Theory should slowly evanesce without Supreme Court assistance.

After that, each disability now afflicting the traditional law could be removed in a rapid succession of reinvigorated opinions on the district level. Then the Supreme Court could let the circuits solve the problems undisturbed.

205. *Id.* (emphasis added) (quoting *U.S. v. Chestman*, 947 F.2d 551, 565 (2d Cir. 1991)).

206. *Id.* (emphasis added) (quoting *Chestman*, 947 F.2d at 566).

207. *Id.* The opinion goes on to quote at length from *Chestman*, 947 F.2d at 566-67.

208. See generally Bayne, *Misappropriation Theory*, *supra* note 2, at 93-135 (discussing the Misappropriation Theory and securities fraud).

2. To the commission

The message of *Bryan* is clear. Stop pandering to the illogical Theory, join Judge Luttig and clear the courts of all the Theory detritus.

Return to your roots. In memory of Chairman Cary, resurrect his excellent *Cady, Roberts*, "a case of first impression"²⁰⁹ and the linchpin of the successful section 10(b) cases of the 1960s and 1970s. Attack the remaining errors that burden the traditional law imposed by some of the errant *Cady, Roberts* progeny.

3. To the bar

If all these prognostications are realized, *plaintiffs'* counsel, whether commission or the securities bar, should be loathe to frame a case based on the Theory. The result will be a return to *Texas Gulf Sulphur, Shapiro v. Merrill Lynch*, and the Second Circuit *Chiarella*. That should speed the *Return to Reason, 1996 et seq.*

As for future *defendants*, should the Theory be foolishly employed, the outcome is readily conjectured: (1) If the Theory should inconceivably prevail on the district and circuit levels, the Supreme Court will certainly grant certiorari, and *Bryan* will then enjoy its final victory, or (2) if defeat of the Theory is uniform, the *Demise of the Theory* will thus be realized. The *coup de grace* will have at last been struck.

VI. EPILOGUE

Surely, the coming years will reflect on the greatness of Judge J. Michael Luttig and his *Bryan* opinion, and his success in effecting *The Awakening: 1995*.²¹⁰

209. *Cady, Roberts & Co.*, 40 S.E.C. 907, 907 (1961).

210. After this Article went to press, the Eighth Circuit in *United States v. O'Hagan*, 92 F.3d 612 (8th Cir. 1996) reiterated *Bryan* and added forceful support to the condemnation of the Misappropriation Theory. A full commentary on *O'Hagan* has been begun for early publication.

