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*1 A DETAILED ANALYSIS OF UNITED STATES V. O'HAGAN: ONWARD THROUGH THE EVOLUTION OF THE FEDERAL SECURITIES LAWS

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I. Introduction

The opinion issued by the Supreme Court in United States v. O'Hagan [FN1] will long be recognized as a landmark ruling. This article, after briefly outlining historical insider trading principles established by the Supreme Court, traces the events leading up to the issuance of that opinion by exploring the indictment, the evidence, the jury instructions and the legal arguments which were made. This article also discusses the opinion of the Supreme Court, together with the ramifications of that opinion. This article takes the position that the Supreme Court's opinion insures a continuing debate as to the most appropriate motivational standard for insider trading cases while advancing arguments favoring the "used" standard. This article also suggests that enforcement authorities will discharge their responsibilities more vigorously than ever before as a result of the boost given them by O'Hagan and then goes on to briefly explore the benefits associated with increased investor confidence in the securities markets.

In Chiarella v. United States, [FN2] the Supreme Court addressed a fact pattern not unlike that which was present in the O'Hagan case. Chiarella worked in ***2** New York as a markup man of a financial printer. Chiarella's employer was retained by bidders expecting to effect takeovers of target companies. Although the takeover documents handled by Chiarella were designed with an eye towards concealing the identity of the targets, Chiarella was nonetheless able to ascertain the identity of target corporations by analyzing information appearing in the documents. Thereafter, Chiarella, while "working literally in the shadows of the warning signs in the printshop misappropriated-stole to put it bluntly-valuable nonpublic information entrusted to him in the utmost confidence" by trading on that information in the securities markets. [FN3] As a result of this conduct, Chiarella was convicted of violating Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"). [FN4] The convictions were affirmed by the Second Circuit Court of Appeals, but reversed by the Supreme Court. While reversing the court of appeals, the Supreme Court held that under Section 10(b), "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under

a duty to do so." [FN5] A duty to make disclosure arises when there is a "fiduciary or other similar relation of trust and confidence" between parties involved in a transaction. [FN6] No duty to make disclosure to the sellers of the target company securities could be imposed upon Chiarella; he "had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger" to them. [FN7] While arriving at this conclusion, the Supreme Court also brushed off the government's attempts to preserve the convictions based upon Chiarella's supposed breach of duty to the acquiring corporation. As articulated in the majority opinion, the Court "need not decide ***3** whether this theory has merit for it was not submitted to the jury." [FN8] "The jury was not instructed on the nature or elements of a duty owed by petitioner to anyone other than the sellers." [FN9]

A decision on the issue of whether the government's alternative theory was valid would have to wait for another day. That day arrived nearly seventeen years later, after the Supreme Court accepted the government's petition for writ of certiorari following the reversal of insider trading convictions entered against James Herman O'Hagan.

II. Proceedings Before District Court

A. Allegations Set Forth in O'Hagan Indictment

In December 1992, a fifty-seven-count indictment was returned against James Herman O'Hagan. [FN10] The indictment set forth an overview of a scheme to defraud allegedly engaged in by O'Hagan. It then went on to charge mail fraud (counts 1-20), securities fraud (counts 21-37) in violation of Sections 10(b) and 32(a) [FN11] of the Exchange Act, [FN12] and securities fraud (counts 38-54) in ***4** violation of Sections 14(e) and 32(a) of the Exchange Act. [FN13] The indictment further alleged that the defendant had engaged in money laundering (counts 55-57) in violation of Title 18, United States Code, sections 1956(a)(1)(B)(i) and 1957. [FN14]

More specifically, the indictment charged that O'Hagan, while serving as a Dorsey and Whitney attorney, began converting client trust funds to his own use in late 1986. While in search of replacement funds, O'Hagan learned of Dorsey and Whitney's representation of a client which was expected to make a tender offer for Pillsbury Company securities [FN15] and engaged Thomas Tinkham, a ***5** Dorsey and Whitney partner, in conversation relative to the tender offer. [FN16] The indictment alleged that following this conversation with Tinkham, which confirmed the validity of information he had somehow previously acquired, O'Hagan purchased Pillsbury securities "in breach of a duty of trust and confidence owed to Grand Metropolitan, [FN17] and in breach of a duty of trust and confidence owed to the Dorsey and Whitney law firm," in violation of Sections 10(b), 32(a), and Rule 10b-5.

With respect to Section 14(e), the indictment alleged that prior to the time at which O'Hagan began effecting purchases of Pillsbury securities, the following substantial steps were taken: 1) in March 1988, Grand Metropolitan PLC ("Grand Met") retained a food industry consultant to assist in the evaluation of Pillsbury assets; [FN18] 2) in June

1988, investment banking firms were retained as financial advisors; 3) in July 1988, the law firms of Cravath, Swaine and Moore and Dorsey and Whitney were retained; 4) in August 1988, the Grand Met board of directors approved the acquisition of all outstanding common stock of ***6** Pillsbury by means of a tender offer; and 5) in August 1988, financing for the proposed tender offer was established. [FN19] As alleged in the indictment, after Grand Met had taken a substantial step, [FN20] while in possession of information he knew had been acquired "from (1) the offeror, Grand Met, and (2) a person acting on behalf of Grand Met, namely, Thomas Tinkham," O'Hagan purchased Pillsbury securities without public disclosure first being made. [FN21]

According to the indictment, O'Hagan held the Pillsbury securities he had acquired while in possession of material, nonpublic information until the tender offer was announced, and then sold those securities, realizing a profit of approximately $4,305,025. On October 5, 1988, the day following the public announcement of the tender offer for Pillsbury securities, O'Hagan engaged in money laundering through his transfer by wire of $2 million of Pillsbury profits from a brokerage firm [FN22] through which he had purchased Pillsbury securities to a Minneapolis, Minnesota bank account he controlled, in violation of 18 U.S.C. § 1957. [FN23] The indictment further charged that on October 6, 1988, O'Hagan ***7** replaced client trust funds he had previously converted [FN24] by depositing two cashiers checks totaling $450,736.59 while attempting to conceal and disguise the nature and source of the proceeds, in violation of 18 U.S.C. § 1956(a)(1)(B)(i). [FN25]

B. A Prosecutorial Perspective of the Facts Established at Trial

In October 1986, Northrup King, a corporate civil defendant which had been represented by O'Hagan in connection with claims brought by former shareholders, entered into a preliminary settlement with those shareholders. [FN26] Pursuant to the preliminary settlement, Northrup King agreed to forward $2 per share for ***8** each share meeting certain criteria, up to a maximum of $1 million. In other words, if more than 500,000 shares were tendered, the payment would not exceed $1 million, but the payout would drop by $2 per share for each share which fell short of the 500,000 share mark.

Once the preliminary settlement was agreed upon, $1 million was wired to the Dorsey and Whitney trust account. That money was to remain in the trust account until disbursement was made to the plaintiffs. Unbeknownst to Northrup King, O'Hagan began transferring settlement funds to his own bank accounts the day after those settlement funds were received. By February 1987, he had removed the entire $1 million.

In June and July of 1988, the trial court presiding over the case brought against Northrup King directed O'Hagan to disburse monies to be paid out under the settlement agreement. O'Hagan responded by setting in motion a scramble to obtain replacement funds. On August 1, 1988, he took $70,000 of Mayo Foundation settlement monies forwarded to him in connection with a separate case and used that money to replenish stolen Northrup King funds. On August 1, 1988, O'Hagan further replenished stolen Northrup King monies by converting $115,000 sent to him by Green Tree Acceptance as part of an anticipated

settlement between Green Tree and a government agency. O'Hagan thereafter used personal funds to supplement the replenishment of stolen Northrup King monies but fell more than $400,000 short of the mark. While O'Hagan was under stress to put together a sufficiently large pool of replacement funds, an opportunity to reap large profits through trading in Pillsbury Company securities presented itself.

In July 1988, Grand Met retained Cravath Swaine and Moore in order to secure assistance with respect to a takeover bid for the Pillsbury Company it expected to make. Since Pillsbury was headquartered in Minnesota, Cravath hired Dorsey and Whitney, a law firm based in Minneapolis, Minnesota, to assist the upcoming takeover efforts.

With an eye towards preserving confidentiality, Dorsey and Whitney limited the dissemination of information relating to Grand Met's plans to as few people as possible. The firm also opened the file under the name of Cravath Swaine and Moore, rather than Grand Met. Documents providing for the opening of the file set forth no details concerning the nature of the representation, contrary to normal procedures. The subject matter of the representation was described as relating to "general matters."

Thomas Tinkham was given overall responsibility with respect to litigation matters pertaining to the Pillsbury acquisition. Tinkham had been a Dorsey and Whitney partner for nineteen years. He also served as chairman of the litigation department during 1986, 1987, and 1988. After receiving the assignment, Tinkham learned that Dorsey and Whitney attorneys working in the corporate department had been alerted to the role the firm was to play in the acquisition. He also learned that those Dorsey and Whitney attorneys were opposed to the notion of taking any action which facilitated the takeover of a local company.

***9** As a result of tension within the firm arising from the conflicting viewpoints (i.e. the litigation department generally favoring such representation with the corporate department taking the opposite viewpoint), a meeting was calendared to discuss whether the firm should continue to represent Grand Met.

While Tinkham was formulating the position he expected to articulate at the meeting, which was to be held on August 26, 1988, O'Hagan paid him a visit. [FN27] Tinkham stated that O'Hagan appeared in the doorway to his office. O'Hagan mentioned that he understood Tinkham had some involvement in takeover work relating to Pillsbury. Tinkham harbored some uncertainty as to when this encounter took place, but did his best to recall the events as they occurred, stating, "my best memory is that it was a few days before then [August 26], but I can't be any more specific than that." [FN28] Tacitly referencing animosity that had developed during litigation with a Pillsbury subsidiary, O'Hagan said something to the effect, "remember, I hate Pillsbury." O'Hagan also feigned an interest in working on the case. [FN29] Because Tinkham had the upcoming meeting on his mind, he asked O'Hagan for his thoughts on the position which should be advanced on behalf of the litigation department. O'Hagan endorsed representation of an outside company attempting to acquire a local business. [FN30]

Several weeks after Dorsey and Whitney commenced representation of Grand Met, O'Hagan began buying Pillsbury options. On August 18, 1988, O'Hagan purchased 100 Pillsbury September option contracts. Each of the 100 option contracts gave him the right to control 100 shares of Pillsbury stock. O'Hagan continued to accumulate Pillsbury options having a September 17, 1988 expiration date until August 25, 1988. By that time, he had purchased 500 Pillsbury option contracts.

It had originally been expected that the tender offer announcement would be made public immediately before or immediately after Labor Day, 1988. Delays were encountered, however, and the launch date was moved back, and then ***10** pushed back again. As the launch date was being pushed back, O'Hagan began purchasing Pillsbury options that had an October 22, 1988 expiration date. [FN31] O'Hagan complimented those purchases with options carrying a November 19, 1988 expiration date. He continued to build his holdings of options set to expire in October or November as time went on. O'Hagan financed those purchases, in part, by borrowing $200,000 from a bank, secured by a mortgage on his home. [FN32] Most of his purchases were unsolicited.

Because the price of Pillsbury stock stayed relatively flat during September, with the strike price [FN33] of O'Hagan's September options being above the market price, O'Hagan's September options died "a slow death." They ultimately expired worthless on September 17, 1988. $27,825 was lost when those Pillsbury options became extinct. O'Hagan took no action which signaled anxiety or concern while his September options were dying a slow death. To the contrary, he made certain that Pillsbury securities continued to be accumulated on his behalf. Most of those purchases were made through Steuart Evans, a Robinson Humphrey registered representative. From Evans' perspective, "it was an easy sale." All Evans had to do was tell O'Hagan that Pillsbury options were available. O'Hagan would then order that they be purchased. [FN34] While O'Hagan ***11** and Evans talked about purchasing securities in various companies, O'Hagan directed his money only towards Pillsbury. This represented a major deviation from O'Hagan's practice of putting his money into a variety of companies and buying stock, not options. [FN35] At the end of September 1988, O'Hagan held ***12** 2,500 option contracts. [FN36] O'Hagan purchased all but 100 of those option contracts through Evans. The remaining 100 contracts had been purchased through Patricia Kinnahan, who was a Janney Montgomery Scott registered representative. [FN37] O'Hagan had also purchased 5,000 shares of Pillsbury common stock through Michael Mulligan of Dean Witter Reynolds.

On October 4, 1988, Grand Met publicly announced its tender offer for Pillsbury stock. Numerous precautions had been taken prior to that date to keep the tender offer plans a secret. For example, the Cravath lawyer largely responsible for preparing the tender offer materials kept the computer disks used to prepare those materials locked in his desk at night; the names "Grand Metropolitan" and "Pillsbury" did not appear on documents or disks until very late in the tender offer process, code names or no names at all were used, and only those with an "absolute need to know" were made aware of the tender offer. Documents pertinent to the acquisition plans were shredded, and doors were kept locked. When the tender offer materials were finally taken to the printer, everyone who wanted to review or

analyze the documents had to do so on the premises of the printer. Days before the bid was made, only seven or eight people at Grand Met had been advised of what the offering price would be.

These precautions were adhered to notwithstanding the constant stream of stories concerning the possibility of a bid being made for Pillsbury stock. Professionals working on the takeover team made every effort to keep the upcoming tender offer plans secret because they realized there was a wide variance between the information they held vis-a-vis media gossip. [FN38]

Michael Kennedy, a financial analyst with twenty-three years experience who was in charge of evaluating stocks of food companies for IDS Financial Services, made it clear that many companies in the food industry had been viewed as attractive acquisition targets since about 1982. With Pillsbury being a long-standing member of the list of food industry companies which were considered ripe for takeover, it was inevitable that ***13** Pillsbury takeover stories would be written. Such Pillsbury takeover stories were written, but those who encountered them had no way of knowing whether they were well-founded.

O'Hagan, however, did not consider himself to be among the masses of uninformed investors. He used information he had acquired while serving as a Dorsey and Whitney attorney to posture his portfolio to take advantage of the spike in the price of Pillsbury stock which was just over the horizon. By doing so, he violated Dorsey and Whitney policies which were then in effect. Policies in place at Dorsey and Whitney during 1988 advised O'Hagan that "[l]awyers are fiduciaries, meaning that their relations with their clients are based upon trust and confidence." The Dorsey and Whitney policies specified that lawyers must not "use their position of trust and confidence to further anyone's private interests." Leaving no room for misinterpretation, those provisions further specified that "[i]t has always been the Firm's policy to enforce strict confidentiality of the affairs of its clients." Similarly, Grand Met also expected those working on its behalf to refrain from making use of its tender offer plans as Grand Met desired that no upward pressure be placed on the price of Pillsbury stock since that could lead to higher acquisition costs.

When the October 4, 1988 tender offer announcement was made, Pillsbury stock rocketed upwards from approximately $39 per share to just under $60 per share. After the tender offer was publicly announced, O'Hagan quickly moved to convert the resulting appreciation in his Pillsbury securities to profits. [FN39] On October 4, 1988, O'Hagan booked profits of roughly $20 per share on stock he had bought approximately two weeks earlier at just under $39 per share. Much larger gains were realized on options which had been purchased. On one series of options, O'Hagan scored gains which brought him an annualized rate of return of 74,571%. Several other options purchases earned O'Hagan annualized returns of over 30,000%. [FN40]

Options sold through Robinson Humphrey on October 4, 1988 resulted in profits of $1,717,250. Options sold through Robinson Humphrey on October 5, 1988 brought O'Hagan

profits of an additional $1,498,512. On October 5, O'Hagan moved to shore up the depletion of Northrup King monies. He caused $2 million of Pillsbury profits to be wired from his Robinson Humphrey brokerage account to a bank account he controlled. On October 6, 1988, ***14** O'Hagan wrote two personal checks on that account. Both checks were payable to the bank where the Dorsey and Whitney trust account was maintained (which was the same bank that received the monies). The first check was for $380,736.59; the other for $70,000. By tendering those personal checks bearing his name to the bank and paying a six dollar fee (three dollars for each check), O'Hagan obtained two cashiers checks for the same amounts. Both October 6, 1988 cashiers checks were made payable to "Dorsey & Whitney Trust Account." Noticeably absent from the cashiers checks was any notation appearing under the heading "Remitter." The teller who issued the cashiers checks testified that it was her practice to disclose the remitter (the purchaser of the check). However, she did not do so on October 6, 1988. At O'Hagan's request, she left the space blank.

Having exchanged personal checks bearing his name for cashiers checks which concealed the underlying source of the funds, O'Hagan deposited the cashiers checks in the Dorsey and Whitney trust account. The deposit totaled $450,736.59. That money was applied towards the replenishment of Northrup King funds.

Although O'Hagan had fulfilled his desire to book stock market profits which served to replenish client funds which had been converted, he soon found himself under the spotlight of the SEC, Division of Enforcement. High ranking SEC enforcement attorneys placed a surprise call to O'Hagan on November 2, 1988. The unexpected nature of the call left O'Hagan with little time to fabricate a well conceived defense. In response to SEC questioning, O'Hagan stated that his purchases had been brought about by a rumor of Donald Trump's possible interest in acquiring Pillsbury. His trading activity, however, showed that in early August 1988, he decided to dispose of Pillsbury stock he had recently purchased, with that sale coming on the heels of newspaper stories highlighting Trump's interest in Pillsbury.

O'Hagan also attempted to mislead the SEC attorneys as to the time period in which his purchases occurred. Specifically, he told them that he did not buy any Pillsbury securities after departing for Europe, which occurred on September 9 or 10, 1988. This representation was contradicted by evidence from various sources which showed that O'Hagan continu-ed to purchase Pillsbury securities through September 21, 1988. O'Hagan cast further suspicion upon himself by giving shifting accounts of the time at which he learned of Dorsey and Whitney's representation of Grand Met. Although he initially denied knowing that his firm had represented Grand Met, he soon thereafter altered that position by stating that he learned of the representation after returning from Europe, which occurred on approximately September 18, 1988, but then took the position that he may not have learned of the representation until after the October 4, 1988 announcement of the tender offer.

***15** C. Facts Established at Trial from the Perspective of the Defense

O'Hagan was an active trader in the stock market. [FN41] During the course of his legal practice, he had represented stock brokers throughout the country in various matters. While engaging in such legal work, he met Steuart Evans, the highest producing broker in the South. In late July 1988, Evans solicited the purchase of Pillsbury stock by O'Hagan based upon takeover rumors. O'Hagan bought 5,000 shares of Pillsbury stock, at a cost of approximately $180,000. Days later, however, O'Hagan sold that stock on Evans' recommendation after it appeared that Donald Trump was the potential acquirer. O'Hagan earned approximately $8,000 through this short term trade. Evans told O'Hagan that he should purchase options, not stock, in takeover situations. Evans explained that while O'Hagan had earned approximately $8,000 on a $180,000 investment, another customer had doubled his money during that same time period by purchasing Pillsbury options.

On August 9, 1988, the Wall Street Journal and USA Today reported that Grand Met had retained a third party to facilitate the sale of its Inter Continental Hotels subsidiary. Those articles also noted that Grand Met intended to expand its influence in the food, beverages, and retailing industries.

On August 12, 1988, another article concerning Grand Met was carried in the Wall Street Journal. This article stated that Grand Met had put its hotel subsidiary up for auction in order to raise money for an acquisition. On August 18, 1988, CNN's "Moneyline" carried a report by Dan Dorfman. Dorfman claimed that "people close to Grand Metropolitan . . . are telling people in the street that Grand Metropolitan is interested in acquiring Pillsbury." Also, on August 18, 1988, James Considiene, with whom O'Hagan regularly spoke, passed along key information to O'Hagan. On that day, Considiene, a Montgomery & Co. broker based in San Francisco, California who handled foreign institutional accounts, told O'Hagan that he had recently executed a market order for the purchase of 250,000 shares of Pillsbury stock. This order had been placed by a London, England institutional account.

Based on this information, O'Hagan began purchasing September 40 call options through Evans. He purchased 500 September 40 call option contracts through Evans during the period August 18, 1988 through August 25, 1988. On August 19, 1988, O'Hagan also instructed Kinnahan to purchase 100 Pillsbury call option contracts. As a result of price constraints imposed by O'Hagan, Kinnahan was not able to fill that order until much later. She purchased 50 call option contracts on August 30, 1988, while purchasing the remaining 50 call option contracts on September 7, 1988. O'Hagan made this August 19, 1988 ***16** decision to purchase Pillsbury options through Kinnahan as a result of recommendations she had made. To Kinnahan, who had been the number one stock picker in her office, developments swirling around Pillsbury "painted a picture . . . Pieces were starting to fall into place. They [sic] were different activities and they all surrounded one company." She was confident Pillsbury would be taken over, and she advised O'Hagan to purchase Pillsbury options.

After O'Hagan had embarked on a course of investing in Pillsbury securities, takeover rumors continued to coalesce around Pillsbury. On August 22, 1988, an article appeared in the Investment Dealers Digest which reported that analysts believed Grand Met would soon

be auctioning its Inter Continental Hotels subsidiary as it needed to sell that division in order "to follow through with its plans to buy . . . Pillsbury." Two days later, more confirming evidence appeared. An article appeared in the Wall Street Journal on August 24, 1988 which reported that Donald Kelly, a well-known takeover artist, had recently resigned from his executive post at a leading corporation in order to concentrate on his next takeover attempt, with Pillsbury being rumored as the target.

On August 25, 1988, Evans solicited an order from O'Hagan for the purchase of 2,000 October 40 Pillsbury call option contracts. After Evans told O'Hagan that his securities trading profits for the year amounted to $150,000, O'Hagan told Evans that he could purchase those options at a limit price of $.75, but could not spend in excess of $150,000. The placement of this limit order demonstrated that O'Hagan did not possess any material, nonpublic information which would lead to extraordinary securities trading profits. [FN42] Evans began filling the limit order on August 29, 1988 and finished the task in mid-September. Evans recommended that O'Hagan purchase these options based on the leverage they offered. The options allowed O'Hagan to "control more shares of the stock on the same amount of money." It was "strictly a leverage . . . vehicle."

Although these purchases would give O'Hagan control over a sizable position in Pillsbury securities, they could not be deemed unusual. In August 1988, O'Hagan held approximately $5.1 million of securities in his portfolio. Almost $650,000 was invested in the stock of DSC Communications, and in August, O'Hagan purchased securities in three other companies for a total cost of roughly $450,000. Pillsbury options purchased on behalf of O'Hagan merely allowed him to take the same position as the London, England institution which had placed the market order through Considiene for the purchase of 250,000 shares of Pillsbury stock, but at a far lower cost.

***17** Allegedly, an abbreviated conversation of a cryptic nature may have occurred between O'Hagan and Tinkham on or about August 26, 1988, after O'Hagan had placed the vast majority of his orders for the purchase of Pillsbury securities. However, the most that can be said about that conversation, if it did occur, is that Tinkham inferred that the firm had been retained to represent an unnamed client in connection with a possible takeover of Pillsbury. Nothing was said with respect to the identity or the resources of the client, the client's plans, the scope or substance of the representation, the proposed price at which any tender offer might be made, or even a timetable. Further, Tinkham did not even know when any overture towards Pillsbury was to be made and thus could not have disclosed this information even if he had desired to do so. Taking these considerations into account, O'Hagan could not have learned from Tinkham anything that he did not already know. In fact, the volume and specificity of information O'Hagan had previously learned from other sources dwarfed any information which may have been communicated by Tinkham. As an added factor, Tinkham could not be relied upon as, inter alia, he had not been truthful in his dealings with Cravath. Specifically, Tinkham, a litigation partner, told a Cravath attorney on September 11, 1988 that Dorsey and Whitney had decided to withdraw, explaining that he had not realized until September 9, 1988 that representation by Dorsey and Whitney "would involve hostile litigation."

Likewise, Tinkham's representations that he had no knowledge of O'Hagan's purchases were not worthy of belief. Sharron Freitag, O'Hagan's secretary, placed the confirmation slips relating to the purchase of Pillsbury securities on her desk and on top of O'Hagan's mail while O'Hagan was in Europe during September 1988. Tinkham went through that mail while O'Hagan was away and must have seen the confirmation slips, notwithstanding his denials.

From the perspective of Paul Walsh, who was Pillsbury's chief executive officer at the time of the trial and who had previously served as Grand Met's chief financial officer, as of September 18, 1988, "the decision to launch the hostile tender offer [for Pillsbury stock] had not been taken." The Grand Met board of directors required a signed contract for the sale of the Inter Continental Hotels subsidiary before any tender for Pillsbury stock could be considered, but a commitment had not been secured. Given the asking price for the hotel chain, which was believed to be in the neighborhood of nearly $2 billion, the number of potential purchasers was extremely limited. An agreement to sell the hotel subsidiary to a Japanese buyer was finally entered into on September 30, 1988, [FN43] approximately three weeks after Dorsey and Whitney withdrew from ***18** representation. [FN44] This sale was not even contemplated while Dorsey and Whitney was still involved in the representation of Grand Met. [FN45] On October ***19** 3, 1988, the Grand Met board of directors met and only then did it authorize a tender offer to be made for Pillsbury stock.

In September and early October 1988, there was heavy trading in Pillsburyoptions. A local newspaper quoted a manager of options trading at a regional brokerage firm as saying, "I'm even getting calls from people at Pillsbury. Everybody thinks the company's being taken over." Although the options purchased in O'Hagan's account could have been sold at a profit in late September, Evans did not recommend that the instruments be sold. Evans refrained from making a sell recommendation in late September because he (Evans) was "planning it as a takeover candidate."

After Grand Met finally announced the long-awaited tender offer, the American Stock Exchange and the SEC began examining numerous trades. When trading data was analyzed, it became apparent that a concentration of trading activity centered around Evans. Evans had earned almost $350,000 in profits emanating from trading in Pillsbury options, while his clients had earned nearly $7.5 million on Pillsbury options trades, each of which Evans had solicited. Neither Evans himself, nor any client of Evans (aside from O'Hagan) was ever charged with violating the federal securities laws. O'Hagan stood in the same position as Evans' other clients. In fact, he may have even stood in a ***20** better position. O'Hagan's trades had not only been solicited by Evans, but Kinnahan as well. Further, he had received crucial information from Considiene which gave credence to publicly available information concerning Grand Met's takeover intentions. Moreover, even if he had briefly spoken with Tinkham, he learned virtually nothing during that conversation and had placed the bulk of his purchase orders prior to the time at which the conversation occurred.

D. Jury Instructions

1. Section 10(b)

Following presentation of the evidence and the closing arguments, the jury was instructed as to legal principles it should apply when evaluating that evidence. The instructions relating to section 10(b) informed the jurors that they were required to find that the government established the following elements beyond a reasonable doubt:

First: Defendant gained access to, and then misappropriated material nonpublic information which was to be used only for Grand Met's purposes, through a relationship of trust and confidence.

Second: The defendant traded in Pillsbury securities while in possession of nonpublic information obtained as a result of a confidential relationship.

Third: The information was material.

Fourth: Defendant willfully used the information to trade securities with the intent to defraud.

Fifth: Defendant, directly or indirectly, used means or instrumentalities of interstate commerce, the mails, or any facility of a national securities exchange in furtherance of his fraudulent conduct. [FN46]

a. Breach of Duty

Consistent with the government's proposed jury instructions, and based on the teachings of Chiarella, the trial court then went on to expand upon the first element by emphasizing the role of the duty and the breach thereof. The trial court made certain that duty would be a focal point of the jury's inquiry through the issuance of the following supplemental jury instruction:

***21** With respect to the first element, in order for you to find that the defendant unlawfully traded in Pillsbury securities, you must find that the defendant had a duty to either Grand Met or the Dorsey and Whitney law firm. Any duty which the defendant owed to Grand Met must have arisen from a relationship of trust and confidence, which may have existed between Grand Met and the Dorsey and Whitney law firm as a result of any attorney-client relationship which may have existed. Similarly, any duty which O'Hagan owed to the Dorsey and Whitney law firm must have arisen from a relationship of trust and confidence which may have existed between O'Hagan and Dorsey and Whitney while O'Hagan was a Dorsey and Whitney partner.

With respect to Grand Met and the Dorsey and Whitney law firm, the question is whether either or both of those entities expected the defendant to keep, in confidence, any information which he obtained in a legal capacity. Did either or both of them expect him to refrain from using such information in connection with his personal securities trading activities? Either or both of those entities must have expected the defendant to keep the information confidential and not use it for his personal benefit, or at least the relationship must have implied such duty [sic]. [FN47]

The mere possession of nonpublic or "inside" information does not impose any duty on an individual to disclose before trading. Therefore, with respect to Counts 21 through 37, in order to find that defendant O'Hagan engaged in insider trading, you must first find that there existed some special relationship, as I have just explained, that created such

a duty. With respect to Counts 21 through 37, it is the breach of that duty that provides the basis for these charges in the indictment. [FN48]

***22** b. Agency

As requested by the government, through submission of a more lengthy proposed jury instruction based upon the Second Restatement of Agency and United States v. Carpenter, [FN49] the trial court also gave the jurors guidance in their deliberations focusing on O'Hagan's relationship to Grand Met and Dorsey and Whitney by providing the following instruction concerning the law of agency:

Unless otherwise agreed, an agent has a duty to the principal not to use, or to communicate, information confidentially obtained by him from the principal. This includes information acquired by him during the course of, or on account of, his agency, or in violation of his duties as an agent. This rule would not apply, however, if the information is a matter of general knowledge.

You are instructed that a partner in a law firm is an agent of the firm. The firm's employees and partners are agents of the law firm's client. [FN50]

c. Public vs. Nonpublic

The jury instructions made it clear that Section 10(b) guilt was predicated upon a finding that the information O'Hagan obtained from Tinkham (which was of a confirming nature) was nonpublic. The standards which governed that inquiry are as follows:

***23** The government must also prove that the material information possessed by the defendant was nonpublic. Nonpublic means not generally available to the public.

The information of a business company is nonpublic if the company has not publicly announced or revealed the information or disclosed it in publicly available filings, announcements, or releases, or if the company has not disclosed it to entities whose business it is to make public disclosure, such as the press or securities analysts.

Whether information is public or nonpublic depends primarily on whether it is generally available to the public. If the information has previously been included in a company's public filings, or disclosed in public announcements or press releases, or discussed with financial analysts, it is public information.

If, on the other hand, the information is held in confidence by the company, then it is nonpublic, even though there may be rumors circulating among the general public on the subject, and even though individuals who are privy to the information may improperly disclose it to other persons. [FN51]

d. Materiality

The third element of the Section 10(b) counts provided that O'Hagan could not be found to have engaged in insider trading unless the information he had allegedly misappropriated was material in nature. The jurors were told that information is material if:

a reasonable investor would consider [it] important when deciding whether to buy, sell, or hold Pillsbury stock. Information is material when there is a substantial

likelihood that a disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly changed the "total mix" of information made available.

The test is whether a prudent investor would be influenced to take or change a market position if he or she was in possession of this information. It is up to you to decide, based on all the relevant evidence, whether the information was material. [FN52]

***24** e. "In Possession of" Vs. "On the Basis of": "Use"

Given the existence of a legal debate concerning the propriety of the "in possession of" standard vis-a-vis the "on the basis of" standard, [FN53] the trial court chose to chart a course, the validity of which was not dependent upon the acceptance of either principle. [FN54] While the second element specified that the government had the obligation of proving that O'Hagan "traded in Pillsbury securities while in possession of nonpublic information," the preamble to the elements imposed a higher standard, as did element number four and the narrative which attended that element.

The introductory language preceding the listing of the elements made it clear that a person cannot be deemed to have engaged in illegal insider trading unless he, inter alia, "trades in the stock of a publicly traded [FN55] company using ***25** information which is not available to the public." [FN56] Similarly, the fourth element, together with its accompanying elucidation, emphasized that O'Hagan must have "used the material nonpublic information . . . when he purchased the Pillsbury securities." [FN57]

Given the absence of controlling precedent, combined with the criminal nature of the case, it is readily apparent that the trial court acted in a wise and cautious manner by employing the "used" standard. [FN58] In situations where the "on the basis of" standard appears, fact finders may be inclined to conclude that Section 10(b) cannot be violated unless the trade was motivated solely, or at least primarily, by the nonpublic information at issue. [FN59] However, as the Second Circuit noted in United States v. Teicher, [FN60] the acquisition of material nonpublic information can lead to subtle, almost undetectable, shifts in strategy. For instance, an individual who acquires such information may merely decide "to ***26** alter a previously decided-upon transaction, to continue with a previously planned transaction even though publicly available information would now suggest otherwise, or simply to do nothing." [FN61] An instruction which required the government to prove that a defendant went forward with a previously planned transaction after acquiring material nonpublic information solely, or at least primarily, as a result of the acquisition of that information would be unduly burdensome. Such an instruction may also violate the construction generally placed on the "in connection with" clause of Section 10(b). [FN62] Conversely, given the uncharted waters within this area, [FN63] the trial court faced a risk that employment of the "in possession of" standard would have been deemed inconsistent with the notion that Section 10(b) was designed to capture conduct which is intentionally fraudulent, or at least reckless. [FN64]

***27** Indeed, in his brief to the Eighth Circuit, O'Hagan launched an assault upon the mail fraud jury instructions, which incorporated "in possession of" language. [FN65]

Specifically, O'Hagan argued that the district court erred by instructing the jury that guilty verdicts could be entered against him "if he purchased securities while in mere possession of . . . material, nonpublic information." [FN66] From O'Hagan's perspective, a jury could have concluded that he "did not use the alleged insider information but instead acted on the basis of other information available to him." [FN67] However, "[u]nder the instruction requested by the Government and given by the district court, the jury could find guilt notwithstanding that Appellant did not trade on any material, nonpublic information." [FN68]

2. Section 14(e)

The trial court advised the jurors that they were to be guided by slightly different elements while passing upon those insider trading charges relating to any trading which occurred in conjunction with a tender offer. The jurors were told that with respect to these counts, the following six elements apply:

First: Grand Met had taken a substantial step or steps to commence a tender offer for the stock of Pillsbury.

Second: The defendant was in possession of material information relating to this tender offer, and defendant knew the information was material.

***28** Third: The information was nonpublic, and the defendant knew that the information was nonpublic.

Fourth: The defendant knew that the information had been acquired, directly or indirectly, from a tender offeror, or any officer, director, employee, or other person or firm acting on its behalf.

Fifth: The defendant purchased, or caused to be purchased, Pillsbury common stock or options on Pillsbury common stock using this material nonpublic information.

Sixth: The defendant willfully purchased, or caused to be purchased, the Pillsbury securities with the intent to defraud. [FN69]

a. Substantial Steps

After instructing the jurors that they were to apply the definitions previously given under Section 10(b) with respect to materiality, nonpublic, intent, [FN70] and "in connection with," the trial court turned to considerations unique to Section 14(e). With respect to the question of substantial steps, the trial court told the jurors that they:

must find that Grand Met had taken one or more substantial steps to commence its tender offer for Pillsbury stock at the time O'Hagan purchased the relevant Pillsbury securities. It is not necessary for a bidder to make a tender offer for you to find that substantial steps toward such an offer have been made. Nor is it necessary that you find that the defendant knew that substantial steps had been taken. It is enough that you find one or more substantial steps were in fact taken. [FN71]

***29** b. Information Acquired from Person Acting on Grand Met's Behalf

With respect to evidence relating to the identity of the person from whom O'Hagan

acquired the information at issue, the trial court instructed the jurors that, in order to return guilty verdicts on these counts, they must find that O'Hagan:

> knew that the information about Grand Met's plan to make a tender offer for Pillsbury stock had been acquired directly or indirectly from Grand Met or any officer, director, employee, or other person acting on Grand Met's behalf.
>
> The government alleges that the defendant knew that the information had been acquired from either Grand Met or Thomas Tinkham. [FN72] If you find that defendant acquired the information from Thomas Tinkham, in order to satisfy the fourth element, you must also find that the defendant knew Mr. Tinkham was working on Grand Met's behalf, such that the defendant knew the information was acquired from Grand Met. [FN73]

The trial court went on to supplement that instruction, however, by emphasizing that "[i]t is not an element of the offenses which are charged that the defendant knew the actual identity of the company making the tender offer."

E. Jury Verdict and Sentencing

During the course of deliberations extending over three days, the jurors analyzed the evidence under the instructions which had been imparted to them. After sending word that they had arrived at a verdict, they returned to the courtroom and returned verdicts of guilty on all fifty-seven counts reflected in the indictment.

At sentencing, following discussion of preliminary matters, O'Hagan and his trial counsel were invited to make comments by way of allocution. Defense counsel noted that he did not know O'Hagan in 1988 (when O'Hagan purchased the Pillsbury securities which gave rise to the indictment). [FN74] However, ***30** following the return of the indictment, he had spent much time with O'Hagan, and it had become apparent that O'Hagan was "not the hot shot lawyer that people claim was cold, hard, calculating in his defenses [sic] of Mayo Clinic or otherwise." [FN75] While attempting to portray O'Hagan in the best light, defense counsel also vouched for O'Hagan by accenting positive personal qualities of his client. Specifically, defense counsel represented to the court that O'Hagan "is about as kind and caring and compassionate individual [sic] as I have ever had the pleasure of being involved with in a criminal prosecution." [FN76]

O'Hagan himself was then invited to address the court. With his sights set squarely on an appeal, he steered clear of any admissions, opting to tell the court, "if I had it to do over, I'd do it a little differently. But in my opinion, if I am guilty of anything, [its] simply bad judgment." [FN77] To no one's surprise, the government took exception to this assessment. The government told the trial court judge that:

> the defendant stands before you and looks you in the eye, and tells you that he is guilty of nothing more than exercising bad judgment. His attorney says that people make mistakes. This is not a case about mistakes and bad judgment. This is a case about . . . the defendant's decision to engage in lying, cheating, and stealing on an ongoing basis. In doing so, he disparaged the reputation of his law firm and of the legal profession. [FN78]

The government continued with its argument by telling the court that "[i]n our society, lawyers often hold the passkeys to the financial markets, and care must be taken to make sure that those lawyers do not abuse the trust bestowed upon them." [FN79] The government then urged the court to impose a lengthy sentence, stating that "when an attorney steals financial information and converts it to his own benefit, reaps millions of dollars in illegal profits, and then uses that money to cover up prior frauds, transgressions of the most serious nature have been committed." [FN80]

***31** The court then imposed a sentence upon O'Hagan, but departed downward from the range suggested by the applicable federal sentencing guidelines. [FN81]

III. Appeal to Eighth Circuit

On appeal to the Eighth Circuit, O'Hagan vigorously challenged the sufficiency of the evidence introduced at trial. He claimed that the evidence introduced by the government fell short of the mark with respect to, inter alia, the issue of whether he acquired information which was both nonpublic and material and with respect to whether he had purchased Pillsbury securities on the basis of this information. [FN82] With respect to the law, O'Hagan opted for a ***32** shotgun approach by raising numerous arguments in his brief to the Eighth Circuit. [FN83] Among the legal arguments raised by O'Hagan were those which attacked the Section 10(b) convictions based upon the claim that "[i]n Chiarella v. United States, the Supreme Court applied a brake to the Government's attempts to expand by judicial fiat insider trading beyond the statutory language enacted by Congress." [FN84] Further, the Supreme Court's recent decision in Central Bank, N.A. v. First Interstate Bank N.A. [FN85] "totally undercuts the Government's legal theory" because that decision made it clear that the text of the statute controls and the text nowhere mentions insider trading. [FN86]

In response to O'Hagan's attacks upon the sufficiency of the evidence, the government claimed the evidence showed that O'Hagan designed his theft and his trading to function in tandem with one another; by adhering to an integrated course of action, he hoped to reap profits which could be used to replace stolen trust funds. He therefore masqueraded as a trustworthy partner for the purpose of drawing information out of Tinkham. Once that was accomplished, he converted to his own use the information he had acquired through false pretenses. [FN87]

A. Section 10(b)

With respect to the challenges O'Hagan directed towards the misappropriation theory, the government noted that under Chiarella, it is clear that Section 10(b) is violated in a situation where a corporate insider of a target company trades in the stock of that target company while in possession of material, nonpublic information. Relying upon temporary insider principles set forth in Dirks, the government also pointed out that a Section 10(b) violation may arise when an underwriter, accountant, lawyer, or consultant trades in the stock of a target company while in possession of material, nonpublic information. [FN88] The government then continued setting the back-drop for its argument by explaining

that while trading in these scenarios results in a breach of a duty of trust and confidence owed to target company shareholders, with no such duty being present when trading by someone who has no relationship to a target occurs, ***33** Section 10(b) may nonetheless be violated in the latter situation on account of a breach of duty owed to the owner of the information or some other third party. [FN89] In essence, the government argued, it would be incongruous to allow parties not connected to a target company to personally enrich themselves through the conversion of secret information while applying severe criminal penalties to those who have engaged in like behavior while affiliated with a target company. [FN90]

As for the language itself of Section 10(b), the government asserted that the trading of an individual who has breached a duty owed towards the owner of the information or some other third party falls within the statute due to the breadth of Section 10(b)'s "in connection with" clause. [FN91] Under the teachings of Bankers Life that requirement is deemed to have been met whenever a fraud "touches" the purchase or sale of a security, a standard which has been described as being "very tenuous indeed." [FN92]

As a companion argument, the government stressed that O'Hagan's objective of capitalizing on the information he had acquired from Tinkham played a key role in his thought process. Under the heading "O'Hagan Used the Information He Acquired To Buy Securities," the government argued the following:

> Prior to coming into possession of information concerning the bid for Pillsbury securities, O'Hagan demonstrated a tendency to diversify his portfolio and purchase stock, rather than options. O'Hagan bid farewell to his general investment practices while holding the secret plans of Grand Met which gave rise to an informational advantage. The enormity of his purchases, combined with the confidence displayed during the acquisition process, evidenced his use of Grand Met's strategy. See United States v. Teicher, 987 F.2d 112, 120 (2d Cir.), cert. denied, 310 U.S. 976, 114 S.Ct. 467 (1993); Texas Gulf Sulphur, 401 F.2d at 850-851. As Steuart Evans recognized, actions speak louder than words. O'Hagan's actions showed that he knew what was just over the horizon. O'Hagan would not have secured such a level of confidence, but for his use of the knowledge he acquired through stealth and deception. [FN93]

***34** B. Section 14(e)

Turning to the convictions entered under Section 14(e), the government pointed to the events which had occurred in advance of the tender offer announcement in support of its claim that substantial steps had been taken. Specifically, the government directed the court towards evidence establishing that in the months preceding the tender offer, Grand Met had retained a food industry consultant, together with various financial advisors, one of which was Morgan Stanley. [FN94] Realizing that an offer for Pillsbury securities could not be made without the assistance of a law firm which possessed expertise in the merger and acquisitions area, Grand Met retained Cravath. The services of Dorsey and Whitney were also enlisted, with Dorsey and Whitney providing expertise concerning principles of Minnesota corporation law and Minnesota securities law. Further, the government asserted

that substantial steps were taken in mid-August 1988 at the time the Grand Met board of directors voted to make a tender offer for all outstanding Pillsbury common stock and at the time Grand Met decided to secure financing through bank borrowings. [FN95]

While responding to O'Hagan's argument that the SEC exceeded its rulemaking authority by promulgating Rule 14e-3(a) absent a breach of fiduciary duty requirement, the government first encouraged the court to refrain from addressing that issue because the convictions entered under the Section 10(b) counts established a breach of duty. [FN96]

As to the merits of Rule 14e-3(a), the government asserted that Section 10(b) should not be looked to for guidance because the rulemaking authority extended under Section 14(e) exceeds these powers flowing from Section 10(b). As a corollary argument, the government, relying upon Batterton v. United States, [FN97] stressed that since Congress expressly granted the SEC authority to promulgate rules which will implement Section 14(e), rules promulgated thereunder have "legislative effect" and are "entitled to more than mere deference." [FN98]

The government went on to assert that if the SEC had been forced to shadow interpretations attached to Section 10(b), the SEC could exercise its definitional powers by doing nothing more than narrowing interpretations attached to Section 10(b). Such a construction would be consistent with the absence of definitional empowerment, not the presence thereof. [FN99] The government then went on to address that aspect of Section 14(e) which sets the bar the lowest (and thereby ***35** authorizes conduct which is least offensive in nature to be regulated), the clause which allows the SEC to prescribe means reasonably designed to prevent fraudulent, deceptive, or manipulative conduct. [FN100] While citing to Schreiber, the government stated that pursuant to its prescribing authority, the SEC could "regulate nondeceptive activities" as a means of preventing a fraud or deception from taking place. [FN101] Further, it was pointed out, if O'Hagan had complied with the flat ban on trading brought about by Rule 14e-3(a), no dispute would have arisen with respect to whether he had engaged in a fraud or deception "by coaxing information out of Tinkham through false pretenses and then trading on that information." [FN102] As such, the objective of Section 14(e) and the Exchange Act in general would have been furthered if O'Hagan had complied with Rule 14e-3(a), a disclosure provision, and the rule could therefore not be viewed as being inconsistent with the policy Congress sought to implement. [FN103]

C. Eighth Circuit Opinion

The contentions advanced by the government were not well received by the Eighth Circuit. [FN104] It issued an opinion which was highly critical of the misappropriation theory and the courts which had placed their imprimatur upon it. [FN105] The Eighth Circuit also struck down Rule 14e-3(a) and invalidated the mail fraud convictions. [FN106] With respect to the misappropriation theory, the Eighth Circuit held that such an application of the statute fell outside the scope of Section 10(b) because (1) it "does not require 'deception"' and (2) "even assuming that it does, it renders nugatory the requirement that

the 'deception' be 'in connection with the purchase or sale of any security."' [FN107]

1. Section 10(b)

From the perspective of the Eighth Circuit, the misappropriation theory had to be struck down because it allowed for Section 10(b) liability absent proof of ***36** deception. [FN108] In the words of the court, the misappropriation theory harbored a fatal shortcoming since it was "based upon the mere breach of a fiduciary duty without a particularized showing of misrepresentation or nondisclosure" and was thus inconsistent with Santa Fe Industries v. Green [FN109] and Central Bank. [FN110] However, at the same time the court articulated this position, it tacitly conceded uncertainty as to its validity. [FN111] The court therefore inferred that its evisceration of the misappropriation theory rested primarily upon its failure to meet Section 10(b)'s "in connection with" test. [FN112] In the eyes of the Eighth Circuit, the misappropriation theory failed that test as it "permits liability for a breach of duty owed to individuals who are unconnected to and perhaps uninterested in a securities transaction . . . ." [FN113] By evading the "in connection with" requirement, "the misappropriation theory essentially turns § 10(b) on its head, 'transforming it from a rule intended to govern and protect relations among market participants' into an expansive 'general fraud-on-the-source theory' which seemingly would apply to an infinite number of trust relationships." [FN114]

The Eighth Circuit refrained from addressing the government's contention that O'Hagan had "used" the information he obtained through stealth and deception, as well as the jury instructions which employed the "used" standard. The Eighth Circuit, however, did address the applicability of the "touched" standard of Bankers Life. According to the Eighth Circuit, that standard could not be utilized as it was "inconsistent with the Court's statement in the immediately previous paragraph of Bankers Life that 'we read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities."' [FN115] The Eighth Circuit seized upon the word "in" to support its narrow construction of Section 10(b) even though the government had previously noted that United States v. Naftalin [FN116] indicated that "in" is to be construed no differently than "in connection with." [FN117] Further, Judge Hansen, ***37** who authored the majority opinion, departed from the expansive interpretation he attached to Section 10(b)'s "in connection with" clause in an opinion he had issued two years earlier, even though he had been specifically reminded of that expansive interpretation at oral argument. [FN118] While acknowledging the existence of that precedent, the majority opinion chose not to apply it. Instead, it sensed a continuing trend to narrow the reach of the federal securities laws and ruled that "only a breach of a duty to parties to the securities transaction or, at the most, to other market participants such as investors, will be sufficient to give rise to § 10(b) liability." [FN119]

2. Section 14(e)

As for Rule 14e-3(a), the Eighth Circuit acknowledged that on account of the express delegation of authority within Section 14(e), "rules promulgated under that section have

'legislative effect' and are 'entitled to more than mere deference . . . .'" [FN120] While looking to the standards of statutory construction to be employed, the Eighth Circuit also noted that Rule 14e-3(a) could be struck down only if it is "inconsistent with the statutory mandate or frustrates the Congressional policy sought to be implemented." [FN121] However, after recognizing the applicability of those stringent standards, the court chose not to apply them. Instead, it stated that an agency's exercise of its "rulemaking authority is ***38** not wholly beyond reproach" and noted that the SEC had exceeded its authority on other occasions (under circumstances not characterized by an express delegation of Congressional authority). [FN122] The Eighth Circuit then struck down Rule 14e-3(a), holding that the SEC had no authority to promulgate such a rule absent a breach of duty requirement. [FN123]

In arriving at that result, the Eighth Circuit ruled that the SEC was not empowered to redefine the term fraudulent in a manner which was not dependent on breach of fiduciary duty. [FN124] The Eighth Circuit also summarily disposed of the government's strongest Section 14(e) argument (which focused on the significance of the prescribing clause) by ignoring the crux of that argument. [FN125]

D. Petition for Rehearing

The government responded to the Eighth Circuit's pronouncements concerning Section 10(b), Rule 14e-3(a), and mail fraud by asserting in its Petition for Rehearing that contrary to the construction placed upon the misappropriation theory by the court, "the misappropriation theory is predicated on deceptive conduct . . . ." [FN126] The government further claimed that "[d]eception necessarily permeates a course of conduct involving insider trading. Such a scheme cannot succeed absent deception. Disclosure by a wrongdoer of his intent to use confidential information to make an illicit profit would bring the scheme to an immediate halt." [FN127] The government also pointed out that the circuits which had upheld the misappropriation theory focused upon deception while doing so. The government noted that in SEC v. Clark, [FN128] the Ninth Circuit rested its holding upon a finding that a misappropriator "deceives the other party by playing the role of the trustworthy employee or agent." [FN129] Similarly, the Seventh Circuit validated the misappropriation theory in SEC v. Cherif [FN130] after concluding that a person's theft of information made available to him as a result of a fiduciary relationship involved "'trick, deceit, chicane, or ***39** overreaching.'" [FN131] The government then buttressed its position by highlighting the factual underpinnings of United States v. Newman. [FN132] It reminded the court that in Newman, the conspirators were affiliated with investment banking firms which represented both bidders and targets and noted that the court's decision would shield Newman-type conspirators from a Section 10(b) proceeding after they have converted information in one scenario, but not the other. [FN133]

As for the "in connection with" requirement of Section 10(b), the government argued that:

> the evidence established a direct and close relationship between O'Hagan's conversion of Grand Met's information and his purchases of Pillsbury securities even though the law

required much less. . . . O'Hagan's theft was intimately tied to his securities purchases. He intended to use in the securities markets the information he obtained through deception and subterfuge to replenish the trust accounts he had looted. [FN134]

Alternatively, the government argued, the requirements of the "in connection with" clause were met even under the overly narrow interpretation of the court. [FN135] The court had announced that the "touch" test of the "in connection with" clause is "easily satisfied as long as the party defrauded is a market participant." [FN136] Grand Met was not only a market participant, [FN137] but was planning to dominate the market in Pillsbury securities.

Turning to Section 14(e), the government asserted that Section 14(e) was modeled after Section 15(c)(2) of the Exchange Act, not Section 10(b). As a result, the SEC was vested with far greater rulemaking power under Section 14(e) than under Section 10(b), with the court's paradoxical interpretation of the defining powers flowing from Section 14(e) being inconsistent with that broad rulemaking authority. [FN138]

***40** The government also noted that the court had misconstrued footnote 11 of Schreiber v. Burlington Northern, Inc. [FN139] by interpreting it to suggest that the SEC's prescribing authority is limited by its defining authority, as the two grants of authority emanating from Section 14(e) (defining authority and prescribing authority) are independent of one another. [FN140] The government concluded its Rule 14e-3(a) discussion by pointing out that the court had found that Rule 14e-3(a) could be struck down only if it is held to be "inconsistent with the statutory mandate or frustrates the Congressional policy sought to be implemented," but failed to implement those exacting standards notwithstanding its acknowledgment that they controlled. [FN141]

IV. Review by Supreme Court

A. Supreme Court Briefing

In its briefs to the Supreme Court, the government expounded upon and added to the arguments which had been advanced to the court of appeals. Due to the greatly reduced number of legal issues under review, the government was able to articulate and discuss authority supporting its position in a much more expansive manner. Points relating to section 10(b) which were argued more expansively to the Supreme Court included, inter alia, considerations focusing upon statutory construction, deception, Congressional endorsement, and policy considerations.

With respect to the issue of statutory construction, the government emphasized the open-ended language of Section 10(b). It noted that deception need not take a particular form in order for Section 10(b) to attach. Section 10(b) makes unlawful "any manipulative or deceptive device or contrivance" in connection with the purchases or sale of a security, and thereby prohibits "all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud,

or present a unique form of deception." [FN142]

While advocating an elastic conceptualization of the requirement of deception, the government noted that the reach of Section 10(b) extends beyond statements and omissions; it covers acts which are designed to mislead. [FN143] O'Hagan's conduct fell within Section 10(b) because it involved the employment of overt lies. During his conversation with Tinkham, he feigned an interest in working on any litigation involving Pillsbury which might arise in order to elicit ***41** confirming remarks from Tinkham. [FN144] The fact that O'Hagan designed this conduct to deceive Tinkham rather than parties selling the securities he purchased is of no relevance. The proscription of Section 10(b) is not limited to deceptions practiced on purchasers or sellers of securities, it applies to any deceptive device that is connected to a securities transaction. [FN145] This construction naturally flows from Naftalin, where the court expressed doubt that "in" was to be construed differently than "in connection with," but concluded that even if "in" is narrower, it nonetheless could not be interpreted so as to limit the application of Section 17(a) of the Securities Act of 1933 to frauds upon investors. [FN146] If "in" cannot be interpreted so as to require that a fraud be perpetrated on investors, the same must also be true with respect to the "in connection with" clause of Section 10(b). [FN147]

As for Congressional endorsement of the misappropriation theory, the government noted that while enacting the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA") (which came about after employment of the misappropriation theory), Congress found that "the rules and regulations . . . governing trading while in possession of material, nonpublic information are . . . necessary and appropriate in the public interest and for the protection of investors." [FN148] Further, the House Report accompanying ITSFEA discussed, inter alia, cases which recognized the misappropriation theory and observed: "Under current case law, the SEC must es[t]ablish that the person misusing the information has breached either a fiduciary duty to shareholders or some other duty not to misappropriate insider information." [FN149] Moreover, ITSFEA evidenced congressional approval of the misappropriation theory through enactment of Section 20A(a) of the Exchange Act, which allowed for recovery by contemporaneous traders on the other side of the market in fact patterns associated with the misappropriation theory. [FN150]

The government buttressed its legally oriented arguments by briefly pointing to sound policy considerations weighing in favor of the misappropriation theory. ***42** Insider trading, argued the government, negatively impacts investor confidence in the securities markets and discourages others from making investments associated with gathering and analyzing securities-related information. [FN151] Insider trading might also impair capital formation. [FN152]

The government supported its construction of Section 14(e) by, inter alia, briefly tracing the enactment of Section 15(c)(2) and explaining the need to vest the SEC with increased power to promulgate rules under that section. [FN153] The government then linked those events to the 1970 enactment of the rulemaking provision of Section 14(e)

while differentiating that statute from Section 10(b). [FN154] Consistent with the approach it had taken with respect to Section 10(b) briefing, the government drew strength for its position by pointing to Congressional ratification of Rule 14e-3(a). [FN155]

B. Argument by the Government

At oral argument, the government opened its presentation by stating: "Information is the lifeblood of the securities markets. Markets thrive on legitimate efforts to acquire, analyze, and use information, but the deceptive acquisition and use of information in securities trading serves no legitimate purpose." [FN156] However, soon after completing his introductory remarks, Michael Dreeben, Deputy Solicitor General, who argued the case on behalf of the government, found himself peppered by questions from the Court.

1. Fraud under Section 10(b)

The government was quickly confronted with a question inquiring as to whether O'Hagan would have violated Section 10(b) if he had "told his superiors in the law firm that he was going to use this information." [FN157] The government responded by stating that this conduct would have involved a breach of fiduciary duties to the employer, but in all likelihood the federal securities laws would not have been violated due to the absence of deception. [FN158] Later, in responding to a related inquiry as to whether someone in O'Hagan's position must make disclosure as well as obtain consent to use the information, the government noted ***43** that principles of common law required both disclosure and consent, but one could steer clear of a violation of the federal securities laws merely by making disclosure. [FN159] The government directed the Court's attention to Carpenter v. United States [FN160] while illustrating the pivotal nature of disclosure. As explained by the government, "[I]f Weinans [sic] had gone to the Wall Street Journal and said, look, you know, you're not paying me very much. I'd like to make a little bit more money by buying stock, the stocks that are going to appear in my Heard on the Street column, and the Wall Street Journal said, that's fine, there would have been no deception of the Wall Street Journal." [FN161] When confronted by an attempt to distinguish Carpenter by virtue of a supposed lack of a property interest in this case, unlike Carpenter, the government shot back by exclaiming that "the property interest here is exactly the same as it was in Carpenter." Grand Met had "a right to maintain its exclusive right to use the information . . . ." [FN162]

2. "In Connection With"

Signaling reluctance to accept the government's position concerning the "in connection with" clause of Section 10(b), Chief Justice Rehnquist challenged the government early on, remarking, "the thing that bothers me about the case here is, where is the connection between the deceptive device and the purchase or sale of a security?" [FN163] This concern was addressed by the response that "the misappropriation does not occur until the lawyer uses the information as the basis for his trades. It is that very information which drives his participation in the market and allows the profits to be . . . reaped by him." [FN164]

Not being easily deterred, Chief Justice Rehnquist manifested persistency while observing that O'Hagan did ***44** not deceive the party on the other side of the trade. [FN165] He then added, "you think of fraud being practiced on a person who is damaged by it." [FN166] Steering that challenge into the text of Section 10(b), the government pointed out that "Congress did not pass a statute that says, it is unlawful to commit fraud on the purchaser or seller of securities." [FN167] After touching upon Congressional intent, the government then brought the Court back to the case before it, stating, in this case, "there could be no closer connection" between the fraud and the trading. "It is only by the trading itself that the fraud is consummated." [FN168]

Moments later, Justice Scalia took the concerns advanced by the Chief Justice one step further by inferring that from the government's perspective, a lawyer who has stolen client monies and then directed those funds towards the purchase of stock while posing as an honest lawyer may have violated Section 10(b). [FN169] The government was quick to assert, however, that such a scenario involves a much more attenuated connection between the fraud and the securities transaction. The difference between the two situations is great because, in the words of the Deputy Solicitor, "once you have the money you can do anything you want with it. In a sense, the fraud is complete at that point. . . . [FN170] By contrast, in the case before the Court, the information at issue could result in personal profit to O'Hagan only if he traded on it in the securities markets. [FN171]

3. Section 14(e)

While defending the SEC's authority to promulgate Rule 14e-3(a), the government set the context by noting that Congress conferred enhanced powers upon the SEC in the area of tender offers in an attempt to protect against abuses. [FN172] Rule 14e-3(a), said the government, protects shareholders from abuses through imposition of a flat ban upon trading by those acquiring information from specified parties. [FN173] The government argued that the flat ban was of fundamental importance as the nuances of particular trading patterns are often difficult to bring to light. [FN174]

***45** C. Argument by the Defense

1. Emphasizing the Facts

Rather than launching into a discussion concerning the merits of the legal principles before the Court, counsel for O'Hagan stayed true to the approach he had utilized before the Eighth Circuit and pointed to the facts as he saw them. First, he claimed that 1) on August 12, 1988, the Wall Street Journal reported that Grand Met planned to auction its hotel subsidiary in order to raise money for an acquisition; 2) on August 18, 1988, Dan Dorfman "announced on Cable News Network that people close to Grand Metropolitan . . . are telling people in the street that Grand Metropolitan is interested in acquiring Pillsbury"; and 3) on August 18, 1988, a broker called O'Hagan "to advise that he'd received a $9 million order to buy 250,000 shares of Pillsbury stock for a customer in London." [FN175] However, Justice Stevens, who had remarked some seventeen years earlier

that "the Court wisely leaves resolution of this issue (the validity of ***46** the misappropriation theory) for another day," [FN176] attempted to prevent counsel from continuing with a factually oriented approach. Justice Stevens quipped, "I gather you're trying to convince us that the doctrine would apply even if all the relevant information were in the public domain. . . ." [FN177] In response, counsel for O'Hagan claimed, the evidence "very clearly in the record indicated that he placed all of his orders for Pillsbury options before August 26" (which, allegedly, was the latest date on which O'Hagan could have spoken with Tinkham). [FN178] Justice Stevens soon thereafter brought counsel's attempts to argue the facts to a halt, at least temporarily. While manifesting irritation, Justice Stevens stated, "I would like to try and address the question of what we do with a case in which the facts are the way the Government [sic] presents them and the way presumably the jury thought they were. . . ." [FN179] At that point, counsel for O'Hagan reluctantly abandoned his factually oriented approach and commenced a discussion geared towards legal principles the Court had waited so long to address. However, after briefly engaging in dialogue geared towards legal issues, counsel for O'Hagan again drifted into factual considerations. He asserted that "at the time of the alleged fraud, neither Dorsey & Whitney nor Grand Met was a market participant. [FN180] Grand Met had a desire for a takeover. It had no money for the takeover. The transactions presumably ended by August 26. Grand Met's own chief financial officer said that by September 18 they still didn't have the money." [FN181]

2. Section 10(b)

As for arguments directed towards the underlying legal principles, counsel for O'Hagan attacked the misappropriation theory, stating that it is confusing even to the courts which accept it. [FN182] He also criticized the misappropriation ***47** theory for requiring a "mode of analysis [which] pulls apart a unitary concept. The unitary concept is deception or manipulation in connection with the purchase or sale of a security," which necessitates deception upon the party on the other side of the transaction. [FN183] Defense counsel also attempted to discredit the government's claim that O'Hagan could have secured a profit through use of the information at issue only if he had taken advantage of it through securities trading. According to the defense, the government's premise was faulty because O'Hagan could have sold it to the press or passed it on to Pillsbury in an effort to secure legal work of that company. [FN184]

3. Section 14(e)

In perhaps the most surprising exchange of the day, Justice Scalia quizzed defense counsel on the subject of the SEC's authority to promulgate Rule 14e-3(a). Defense counsel stated that Rule 14e-3(a) went beyond the authority of the SEC, at least when applied criminally, because that agency did not have the power to "transform fraud into nonfraud [sic]." [FN185] Justice Scalia interrupted him, while observing that "it's not transforming fraud into nonfraud. It's saying, this is nonfraud. It's not covered by the statute, but we're prohibiting it nonetheless because the statute allows us to do it. It allows us to prohibit things in order to prevent fraud, not just to prohibit fraud but to

prohibit other things in order to prevent fraud. That's how the statute reads." [FN186] At that point, defense counsel retorted, "No, your Honor. This redefines the word, fraud. It says, it shall . . . constitute fraudulent activity if you purchase after substantial steps have been taken." [FN187] To that, Justice Scalia quickly reacted by stating, "[t]hat's a different point you're making. You are making the point that this rule might have been okay if it had read differently, if it had read, thou shall not do this. Instead, however, it reads doing this constitutes fraud . . . so the rule is false." [FN188] Seconds later Justice Scalia finished the thought by noting, "[i]t's not that it does something that the Commission couldn't. It does it in the wrong way." [FN189] Justice Scalia thereafter followed up on that point by asking, "could it have done it another way"? Not surprisingly, defense counsel responded in the negative. [FN190] He then went on to illustrate his position by directing the Court ***48** to the Federal Trade Commission Act. Justice Scalia took in the arguments made on behalf of O'Hagan, but then asked, "does the Federal Trade Commission Act say that the Federal Trade Commission shall, by rules and regulations, define and prescribe means reasonably designed to prevent unfair or deceptive trade practices?" [FN191] After pausing and allowing for a brief response, Justice Scalia answered his own question without mincing words. He stated, "I don't think it does. That's the crucial sentence here . . . it seems to me that you have to grapple with the reality that Congress has told this agency, you can make unlawful things that the statute does not make unlawful." [FN192]

V. Supreme Court's O'Hagan Opinion

A. Section 10(b)

Footnote one of Newman reveals that the investment banking firm employees who were engaged in a scheme to purloin confidential information worked on behalf of both bidders and targets. [FN193] Recognizing that, as a practical matter, it would result in a miscarriage of justice if the defendants could not be touched by Section 10(b) in the situations where they had converted secret information after being retained by bidders, but could be subjected to stiff criminal sanctions for precisely the same conduct if their firm had been retained by a target, the Supreme Court embraced the misappropriation theory without qualification or reservation. In a strongly worded pro-government opinion, the nature of which has not been seen for many years in a securities law context, the Supreme Court rested its decision on the text of Section 10(b), [FN194] Congressional intent, [FN195] ***49** public policy considerations, [FN196] and, most of all, an overriding sense of pragmatism. As the Court observed, "it makes scant sense to hold a lawyer like O'Hagan a § 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm representing the bidder." [FN197] Prior to advancing that conclusion, the Supreme Court emphasized that application of Section 10(b) is predicated on the presence of deception, which can occur through the pretending of loyalty, so long as that deceptive strategy is used by a perpetrator "in connection with" the purchase or sale of a security. [FN198]

1. Deception

While framing its discussion of the deception requirement of Section 10(b), the Court turned to Carpenter v. United States [FN199] for guidance. By wedding its analysis of Section 10(b) to Carpenter, the Court did much to insure a forceful opinion. [FN200] Carpenter found that the information there at issue constituted property which was protected by a right to exclusive use. Because that right to exclusive use of information was violated while Winans, a fiduciary, served as a Wall Street Journal employee "pretending to perform his duty of safeguarding" the information, he had engaged in a deceit which could be easily reached by the mail and wire fraud statutes. [FN201] With deception being inextricably intertwined with the scheme orchestrated by O'Hagan, a fiduciary, and with Grand Met's tender offer plans qualifying as property, there was little to stand in the way of a transfer of principles articulated in Carpenter to the controversy at hand, and the Court made no effort to impede the application of such reasoning.

2. "In Connection With"

Prior to dissecting the requirements of the "in connection with" clause, the Court set the tone for that discussion by using United States v. Newman [FN202] as ***50** a measuring stick. [FN203] Newman viewed the "in connection with" clause expansively and made clear that an interpretation of that phrase could not be cabined by an inquiry into whether a trader defrauded the party on the other end of the transaction. [FN204] When it came time for the Court to lay out the heart of its "in connection with" analysis, the Court reiterated Newman teachings, but made no reference to Newman itself. [FN205] Instead, it rested its construction on the text of Section 10(b), in obvious harmony with literalist expectations. It then supported its construction by invoking, secondarily, Congress' intent ("to insure honest securities markets and thereby promote investor confidence") [FN206] and by making ample use of policy considerations encompassing the positive attributes of market integrity. [FN207]

Once the various factors arguing in favor of the Court's legal construction of deception and "in connection with" had been catalogued, the Court drew into the equation considerations resting upon common sense. It would amount to an absurdity to treat the classical trader and the misappropriator in a disparate manner, and since Section 10(b) nowhere compelled such a result, neither would the Court. [FN208]

3. "Used": The Most Appropriate Standard

By way of introduction, the Court stated that "[t]he indictment alleged that O'Hagan defrauded his law firm and its client, Grand Met, by using for his own trading purposes material, nonpublic information regarding Grand Met's planned tender offer." [FN209] Alternatively, the Supreme Court read "the indictment [as] alleg[ing] that O'Hagan, in breach of a duty of trust and confidence he owed to his law firm, Dorsey & Whitney, and to its client, Grand Met, traded on the basis of nonpublic information regarding Grand Met's planned tender offer for Pillsbury common stock." [FN210] By characterizing the indictment in this manner, the Court spoke imprecisely in two respects. First, the indictment did not

employ either the "used" standard or the "on the basis of" standard while setting forth allegations that O'Hagan violated Section 10(b). [FN211] Rather, it utilized the "in possession of" standard. Specifically, the indictment charged that O'Hagan "engaged in a scheme and artifice to defraud Grand Met and Dorsey and Whitney in connection with the purchase and sale of securities by purchasing ***51** Pillsbury common stock and call options on Pillsbury common stock while in the possession of material, non-public information concerning Grand Met's future tender offer for Pillsbury common stock." [FN212]

Second, as previously discussed, the term "used" is not synonymous with the phrase "on the basis of." [FN213] Literally interpreted, "on the basis of" may be construed so as to place upon the government an obligation to prove that the trading at issue was motivated solely, or at least primarily, by the nonpublic information in question. The "used" standard, however, merely requires the government to establish that the pertinent nonpublic information was taken into account by the trader while formulating the decision to consummate the trades. [FN214] Nonetheless, by employing both standards [FN215] with great frequency, and interchangeably, [FN216] the Court has made it a virtual certainty that debate concerning the proper construction of these concepts will go forward in the near future. [FN217] This dialogue will most likely be confined primarily to academic ***52** circles because any time a court finds scienter to have been present, it will sense little need to conduct a detailed analysis into the finer points of this subject. [FN218] In the event a court is forced to pass on the question of whether the "used" standard best comports with the requirements of Section 10(b), [FN219] it will likely find comfort in the employment of that term in Section 10(b) itself, albeit in slightly different contexts. [FN220] Arguments that the "used" test imposes a scienter burden which is too easily met may be fended off by pointing to the Supreme Court's repeated employment of the standard, with additional support, in all likelihood, being drawn from other aspects of the jury instructions [FN221] ***53** providing guidance with respect to the requisite state of the defendant's mind. [FN222]

4. Relationships Which May Suffice

Dorsey and Whitney policies introduced into evidence specified that "[l]awyers are fiduciaries, meaning that their relations with their clients are based upon trust and confidence." Those policies further provided that lawyers must not "use their position of trust and confidence to further anyone's private interests." However, it would have been abundantly clear that O'Hagan owed duties of trust and confidence to both his law firm and its clients, and stood in a fiduciary position as to each, even if these policies had not been entered into evidence. As such, those policies merely served to highlight a point which was beyond dispute. The fiduciary responsibilities of a lawyer cannot be called into question. [FN223]

***54** Given the absence of questions surrounding the extent to which these relationships gave rise to "a duty of trust and confidence," [FN224] there was little need for the Court to provide guidance as to the precise attributes of any relationship which must exist before Section 10(b) insider trading liability may attach. Though some have criticized the

Court on this point, [FN225] others may commend the Court for not reaching to address such a tangential issue. As time passes, this subject will come into greater focus. However, in the near future at least, enforcement authorities should feel free to point to any basis for a "duty of trust and confidence" regardless of whether that duty flows from state fiduciary duty law or federal common law. [FN226]

B. Section 14(e)

While noting that Congress has recognized that certain market participants "contribute to a fair and orderly marketplace at the same time they exploit the informational advantage" which flows from the position they maintain, [FN227] the Court, in Chiarella, characterized as "radical" any attempt which might be made to allow Section 10(b) to serve as a means for insuring parity of information among those trading in the market. [FN228] In Dirks, the Court reiterated the observation it had set forth in Chiarella that market participants may enhance the quality of markets by exploiting nonpublic information they acquire through the position they hold. [FN229] Similarly, the Court once again noted that recognition of parity of information principles would constitute a "radical" attempt to regulate securities trading. [FN230] Inasmuch as Rule 14e-3(a) may be deemed a parity of information rule, [FN231] observers harboring concern over the prospects of this ***55** provision being invalidated could hardly be labeled irrational. The Court, however, resisted any inclination it may have had to expand upon parity of information teachings it had previously set forth and instead tied its opinion concerning the validity of this provision to statutory construction criteria, together with common sense.

With respect to statutory construction, the Court avoided being drawn into a debate as to whether the SEC's defining powers under Section 14(e) exceeded those conferred upon the Commission under Section 10(b). [FN232] Instead, the Court rested its decision upon that aspect of Section 14(e) which mandates [FN233] regulation of the broadest spectrum of conduct, the prescribing clause. [FN234] As a result of the authority derived from the prescribing clause, the SEC was authorized to impose a flat ban on trading under the circumstances articulated in Rule 14e-3(a) without regard to whether that trading was characterized by fraud, so long as "the prohibition is 'reasonably designed to prevent . . . acts and practices [that] are fraudulent"' [FN235] Here, the Court concluded, since the prohibitory language of Rule 14e-3(a) "serves to prevent the type of misappropriation charged against O'Hagan," and eliminates "proof problem[s] that could enable sophisticated traders to escape responsibility," Rule 14e-3(a) represents a proper exercise of powers conferred on the SEC by the prescribing clause. [FN236]

After setting forth this statutory analysis, the Court once again manifested a sense of pragmatism by turning back claims that Section 14(e)'s prescribing powers could not be looked to while analyzing the validity of Rule 14e-3(a) on account of the SEC's failure to explicitly note that it had promulgated the rule pursuant to the exercise of those powers. From the Court's perspective, since Congress conferred both defining authority and prescribing authority upon the agency through enactment of Section 14(e)'s rulemaking provision, Rule 14e-3(a), "[s]ensibly read," must be viewed as "an exercise of the

Commission's full authority" notwithstanding the absence of a regulatory preamble which specifically referenced implementation of prescribing authority. [FN237]

***56** VI. Ramifications of O'Hagan Opinion

A. Energizing Oversight of Securities Markets

In O'Hagan, the Court applied the federal securities law to one man who charted a course of action which took him far from the path to which permissible behavior was confined. Recognizing that the conduct displayed by O'Hagan could significantly disrupt the marketplace and the financial sector in general, [FN238] the Court manifested a willingness to embrace government arguments, while displaying nearly complete disregard for countervailing viewpoints. [FN239] Combined, these factors netted an opinion which not only came as a surprise to detractors, [FN240] but went safely beyond the realistic expectations of most observers ***57** maintaining biases favoring the government's position. [FN241] Due to the strength of the opinion, enforcement authorities will be emboldened in the never-ending quest to make new applications of Section 10(b), and anti-fraud provisions generally, [FN242] while pursuing securities-related conduct characterized by deception and inherent unfairness.

With more numerous, and more varied, enforcement cases being pursued as a result of O'Hagan, it is inevitable that there will be a noticeable increase in the frequency with which actions will be brought under such provisions as Section 15(f) of the Exchange Act, which requires registered entities to maintain procedures designed to prevent the use of material, nonpublic information, [FN243] and Section 21A of the Exchange Act, which allows for sanctions to be assessed against employers who have not taken adequate steps to prevent insider trading. [FN244] While being mindful of the increase in enforcement actions against ***58** primary violators and control persons which will be spawned, directly and indirectly, by O'Hagan, observers must take care to note that O'Hagan should not be construed as a predictor of unqualified success for enforcement authorities. Undoubtedly, limitations will be placed on the use of legal principles at issue in O'Hagan. [FN245] Such restrictions will most likely arise in cases involving personalities of a non-threatening nature. [FN246] Those who are in a position to make some showing that careful thought has been given to the propriety of their actions are most likely to encounter success.

With this in mind, it is clear that those who engage in conduct which is subject to intense regulatory oversight will sense an enhanced need to refrain from taking action absent the receipt of counsel from experienced industry professionals and learned securities law practitioners. Those who have employed such protective measures in a sincere effort to work their way through standards which are often complex, and sometimes conflicting, will correctly be placed in a light far different than that with which James O'Hagan was placed. The few who have taken well-conceived precautionary steps while acting in good faith, but nonetheless find that their conduct is the subject of an inquiry, will almost certainly be the subject of reduced sanctions even if they are not exonerated.

Recognition of these considerations bodes well for those specializing in guidance and counseling of financial industry participants.

B. Market Effects

To the extent that O'Hagan acts as a deterrent to those faced with the opportunity to engage in insider trading, broadly based economic interests are furthered. [FN247] "Insider trading may tend to reduce investor confidence in the ***59** securities markets generally, lessening investor demand for securities and increasing the cost of selling new securities." [FN248] A reduction in the frequency of insider trading, on the other hand, will promote investor perceptions of fair and honest markets operating on a level playing field, thereby enhancing the capital formation process. [FN249]

Though some may insist that benefits associated with insider trading outweigh the negative consequences of that behavior, [FN250] the view of the majority is to the contrary. [FN251] Laws and resources designed to deter, expose, ***60** and sanction insider trading, operating in tandem with other regulatory mechanisms, engender, to some extent, national prosperity. [FN252] Remarks made by William Cary, who previously served as Chairman of the SEC, illustrate this point well. While addressing the importance of market integrity, Cary related a conversation between himself and an Ambassador of a South American country. The Ambassador sought advice because he wanted to raise the level of capital invested in corporations within that country. When Cary inquired as to the adequacy of stock market facilities in that country, the Ambassador responded by indicating that the problem was much more fundamental in nature: investors in that country were reluctant to invest because they could not place a sufficient degree of trust in corporate management. [FN253]

The frustrations related by this government official highlight the extent to which perceptions of fairness and integrity serve as predicates for healthy equity markets. [FN254] And, with the health of equity markets and economic activity in general being linked to one another, [FN255] it is clear that although deterrents to insider trading, and financial misconduct generally, cannot in themselves bring about greater affluence, they can contribute to an atmosphere which helps provide for the attainment of increased prosperity. [FN256] Viewed in this light, ***61** O'Hagan may rightfully be viewed as a case which not only further extended the reach of the federal securities laws, but from a broader perspective, helped secure, in some small way, a higher quality of markets and greater economic prosperity generally.

VI. Conclusion

From an evidentiary perspective, the SEC must be commended for promptly placing a telephone call to O'Hagan after being alerted to his trading. By catching him off guard, the SEC put him into a position where he had to instantly fabricate supposed reasons underlying his trading. Those reasons would later be abandoned after he had an opportunity to give more detailed thought to his defense. Due to points made on cross-examination, O'Hagan's decision to call pivotal defense witnesses to the stand may be questioned.

Although Tinkham's testimony was not extensive, it was sufficient, especially when combined with the evidence concerning the quantity of options O'Hagan had purchased and the financial pressures he was then experiencing. Tinkham is to be commended for the courage and integrity he displayed. His task was made all the more difficult by the uncertainty which characterized his testimony before the SEC.

From a legal perspective, O'Hagan will rightfully be viewed as an opinion of extraordinary importance for many years to come. Principles articulated in the opinion, together with the strength of the opinion, will fuel efforts to attack misconduct arising in the financial sector. Effective enhancement of oversight of the financial markets will further strengthen investor perceptions of fairness and integrity, which should yield economic benefits generally.

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This article is dedicated to Special Agent David Kukura, FBI. The victory achieved by the government in the prosecution of James Herman O'Hagan is due, in large part, to the skill and dedication of Special Agent Kukura, a quintessential law enforcement officer. The author also wishes to acknowledge the high quality of legal representation provided by Securities and Exchange Commission and Department of Justice attorneys in connection with the appeal of this case to the Supreme Court. Those who provided such high quality representation are too numerous to mention by name, however, the results secured through their labor will forever be remembered.

[FN1]. 117 S. Ct. 2199 (1997).

[FN2]. 445 U.S. 222, 100 S. Ct. 1108 (1980).

[FN3]. Id. at 245, 100 S. Ct. at 1123 (Burger, C.J., dissenting).

[FN4]. 15 U.S.C. § 78j(b) (1934). Section 10(b) provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:

. . . .
(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[FN5]. Chiarella, 445 U.S. at 228, 100 S. Ct. at 1114.

[FN6]. Id.

[FN7]. Id. at 232-33, 100 S. Ct. at 1117. In the eyes of one learned commentator, the duty to disclose guidelines crafted by the Supreme Court in Chiarella represented a "fiction, purportedly drawn from the common law" which was incorporated into securities fraud jurisprudence "as a way of imposing order on what was becoming an uncomfortably incoherent subject." Donald C. Langevoort, Book Review: The Education of a Securities Lawyer, 80 Nw. U. L. Rev. 259, 261-62 (1985). Cf. Dennis W. Carlton and Daniel R. Fischel, The Regulation of Insider Trading, 35 Stan. L. Rev. 857, 883 (1983) (asserting that insider trading in publicly traded securities was generally permitted under common law principles, but the general rule gave way in situations where "the plaintiff could prove 'special facts'-that his trade was induced by express or implied misrepresentations concerning the value of the securities or the identity of the purchaser").

[FN8]. Chiarella, 445 U.S. at 236, 100 S. Ct. at 1118.

[FN9]. Id., 100 S. Ct. at 1119.

[FN10]. That indictment was returned following the conclusion of a lengthy grand jury investigation which was separate and apart from the proceeding which had been instituted by the SEC, although evidence gathered by the SEC during the course of its investigation was made available to the Department of Justice. Even though the two government agencies maintained an excellent relationship throughout the course of the investigations (and all other stages of the proceedings), the Supreme Court lacked precision when it stated that the SEC "initiated an investigation into O'Hagan's transactions, culminating in a 57-count indictment." United States v. O'Hagan, 117 S. Ct. 2199, 2205 (1997).

[FN11]. Section 32(a) of the Exchange Act provides as follows:
Any person who willfully violates any provision of this Act (other than section 30A), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this Act . . . shall upon conviction be fined not more than $1,000,000 or imprisoned not more than 10 years, or both . . . . Lesser sanctions, including a fine of up to $100,000 upon individuals and a term of imprisonment of up to five years, applied to violations of the Exchange Act at the time of O'Hagan's misconduct. The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988), which brought about enhanced penalties, became effective shortly after the close of O'Hagan's violations of the Exchange Act.

[FN12]. The indictment actually referenced these provisions through use of the more formal citations: Title 15, United States Code, sections 78j(b) and 78ff(a). Rule 10b-5, which was also alleged to have been violated, was referenced through citation to Title 17, Code of Federal Regulations, section 240.10b-5. Rule 10b-5 provides as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

[FN13]. Likewise, the indictment identified these statutes by making use of the more formal citations: Title 15, United States Code, sections 78n(e) and 78ff(a). Rule 14e-3(a), which O'Hagan allegedly violated, was referenced through citation to Title 17, Code of Federal Regulations, section 240.14e-3(a). The text of Section 14(e) and Rule 14e-3(a) are set forth below:

Section 14(e): It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

Rule 14e-3(a): If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of Section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,

(2) The issuer of the securities sought or to be sought by such tender offer, or

(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer,

to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

[FN14]. O'Hagan Indictment, at 3-19.

[FN15]. The indictment did not allege that O'Hagan knew the identity of the client which was expected to make the tender offer and this fact was not established at trial. During the course of the jury instruction conference, the trial court proposed a draft Section 14(e) instruction which provided, in relevant part, "the defendant knew that the information had been acquired directly or indirectly from Grand Met or any officer, director . . . ." Transcript Vol. IX, United States v. O'Hagan, Crim. No. 4-92-219, at 79 (D. Minn. Feb. 2, 1994). The court then, however, expressed a desire to simplify the instruction, remarking, "[w]hy don't we just say from Grand Met." Id. To this, the government responded, "the evidence really shows that he knew Pillsbury was the target . . . but there's no evidence showing whether he knew who the client was . . . to impose the obligation on the government to have proved that he knew who the client was is . . . not fair." Id. at 80. After fielding a heated argument from defense counsel, the trial court concluded, "I'm going to strike Grand Met because I don't think Grand Met in that sense is part of it." Id. at 81. In support of this position, the trial court noted that neither Section 14(e) nor Rule 14e-3(a) require that a defendant know the corporate name of the bidder and pointed out that if O'Hagan had seen one of the drafts of the tender offer materials "which either had no name or a fake name," he might be insulated from prosecution under Section 14(e). Id. at 82.

[FN16]. Inasmuch as the government could not establish the circumstances surrounding O'Hagan's original acquisition of information concerning a tender offer for Pillsbury securities, the material, nonpublic information which was focused on during the trial was in actuality O'Hagan's receipt of confirming information from Tinkham.

[FN17]. As previously noted, the government could not establish that O'Hagan learned the identity of the client. As such, the government was forced to take the somewhat awkward, but conceptually sound, position that O'Hagan had breached a duty to an unknown client.

[FN18]. Given the October 4, 1988 public announcement of the tender offer for Pillsbury securities, there was a span of over six months in which the prohibitions of Rule 14e-3(a) applied following the taking of that substantial step. Under commonly accepted principles of criminal law, indictments are plead in the conjunctive, but proven in the disjunctive. See Turner v. United States, 396 U.S. 398, 420, 90 S. Ct. 642, 654 (1970) (recognizing that "[t]he general rule is that when a jury returns a guilty verdict on an indictment charging several acts in the conjunctive . . . the verdict stands if the evidence is sufficient with respect to any of the acts charged"); United States v. Pigrum, 922 F.2d 249, 253 (5th Cir.), cert. denied, 500 U.S. 936, 111 S. Ct. 2064 (1991); United States v. McGinnis, 783 F.2d 755, 757 (8th Cir. 1986); United States v. DePuew, 889 F.2d 791, 793 (8th Cir. 1989) (noting that "[i]t is well-established that proof of [any] . . . of the violations charged in the conjunctive will sustain a conviction"); United States v. Wells, 180 F. Supp. 707, 709 (D. Del. 1959) (noting that acts specified disjunctively in statute must be alleged conjunctively, however, "guilt may be established by proof of any one of things conjunctively charged"). Therefore, a finding that the retention of a food industry

consultant could not have served as a substantial step given the remoteness in time (and consequent breach of Section 14(e)'s "in connection with" requirement) would have had no effect on the validity of the Section 14(e) allegations, assuming the adequacy of another substantial step.

[FN19]. Tender offer financing through bank borrowings was a well-established practice prior to the time at which Grand Met launched its bid for Pillsbury securities. See generally Christopher J. Bebel, Why The Approach of Heckman v. Ahmanson Will Not Become the Prevailing Greenmail Viewpoint: Race to the Bottom Continues, 18 Tex. Tech. L. Rev. 1083, 1089-90 n.27 (1987).

[FN20]. The indictment listed seven substantial steps. Only five substantial steps are referenced above because the two paragraphs which referenced the retention of financial advisors have been grouped together with one another, as have the two paragraphs directed towards the retention of law firms.

[FN21]. With respect to issues concerning the identity of the bidder under the Section 14(e) counts, the trial court issued a jury instruction which provided as follows: The government must prove that the "defendant knew that the information about Grand Met's plan to make a tender offer for Pillsbury stock had been acquired directly or indirectly from Grand Met or any officer, director, employee, or other person acting on Grand Met's behalf." But the trial court then went on to supplement that instruction by telling the jurors that "[i]t is not an element of the offenses which are charged that the defendant knew the actual identity of the company making the tender offer." For additional discussion concerning these jury instructions, see infra notes 72 and 73 and accompanying text.

[FN22]. Under the federal money laundering statutes, a brokerage firm is considered to be a financial institution. Specifically, 18 U.S.C. §§ 1956(c)(6) and 1957(f)(1) provide that "the term 'financial institution' has the definition given that term in section 5312 (a)(2) of title 31, United States Code, or the regulations promulgated thereunder." Section 5312 (a)(2) defines financial institution so as to include "a broker or dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934" and "a broker or dealer in securities or commodities." Thus, O'Hagan could have been convicted of Section 1957 money laundering if he had merely caused his brokerage firm to release profits gained through trading in Pillsbury securities directly to himself.

[FN23]. Securities fraud, together with mail fraud, constituted the specified unlawful activities underlying the transfer of tainted proceeds. 18 U.S.C. §§ 1956(c)(7)(A) and 1957(f)(3) defined specified unlawful activity to include any act listed in section 1961(1) of Title 18, "except an act which is indictable under subchapter II of chapter 53 of title 31." Section 1961(1), however, referenced securities fraud through employment of the phrase "fraud in the sale of securities." Notwithstanding this choice of language, the trial court deemed O'Hagan's purchases of Pillsbury securities to be encompassed within the federal money laundering provisions after looking to the following authority cited by

the government: Sedima, S.P.R.L. v. Imrex, 473 U.S. 479, 481, 105 S. Ct. 3275, 3277 (1985) (construing phrase as encompassing securities fraud generally); Occupational-Urgent Care Health Sys. v. Sutro & Co., 711 F. Supp. 1016, 1019-21 (E.D. Cal. 1989) (same); Ahern v. Gaussoin, 611 F. Supp. 1465, 1492-93 (D. Or. 1985) (same); Laird v. Integrated Resources, 897 F.2d 826, 838 (5th Cir. 1990) (interpreting phrase so as to reach Section 10(b) activities generally); James v. Meinke, 778 F.2d 200, 204-05 (5th Cir. 1985) (same); Catanella and E.F. Hutton & Co., 583 F. Supp. 1388, 1425 n.56 (E.D.Pa. 1984) (same). The government bolstered those citations by arguing that O'Hagan's nondisclosure of the misappropriated information operated as a sine qua non of the transaction; but for his nondisclosure, the sales would not have been made as the sellers would not have been willing to so readily part with their securities had they known what lie ahead. Viewed in this light, the government argued, O'Hagan's purchases amounted to "fraud in the sale of securities" under Section 1961(1).

[FN24]. O'Hagan's desire to secure replenishment funds undoubtedly contributed to his decision to purchase Pillsbury securities, while presumably expecting that Tinkham would stand silent and refrain from providing any evidence of an incriminating nature. O'Hagan, however, may have chosen to engage in this activity even if he had not removed client funds. The financial predicament in which he found himself did not make it essential that he hit a "home run" through insider trading. See infra notes 32 and 35. However, "for many individuals with advance knowledge of takeover bids, the temptation of . . . large and quick profits outweighs the risk of sanctions for insider trading." Christopher J. Bebel and Kenneth C. Vert, State Takeover Laws, Insider Trading, And The Interplay Between The Two: A New Perspective, 91 W. Va. L. Rev. 1001, 1016 (1989). In 1987, the year prior to O'Hagan's purchases of Pillsbury securities, the Supreme Court, while apparently experiencing disgust and anxiety over the correlation between insider trading and corporate takeovers, issued its opinion in CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 107 S. Ct. 1637 (1987), with an eye towards reducing instances of insider trading. Id. at 1015-16. In short, the CTS Court undoubtedly recognized that if it upheld the state takeover act at issue there would be "fewer takeover attempts. This in turn would decrease the number of occasions in which a target company's stock price dramatically increased in value. As a result, there would be fewer opportunities for those in possession of advance knowledge of corporate affairs to trade on such inside information." Id.

[FN25]. Funds transferred pursuant to these two transactions did not travel in interstate commerce as the monies were merely transferred from an account O'Hagan maintained at a bank to a Dorsey and Whitney trust account maintained at the same bank. However, the interstate commerce requirement of 18 U.S.C. § 1956 was met as the financial institution itself was engaged in interstate commerce. See 18 U.S.C. § 1956 (c)(4) (1986) (providing that a "financial transaction" under section 1956 includes "a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree").

[FN26]. This rendition of facts is based upon the government's brief to the Eighth Circuit

Court of Appeals and transcripts reflecting testimony introduced during the course of the trial. Brief for Appellee and Cross Appellant (No. 94- 3714 MNMI).

[FN27]. Several weeks after the August 26, 1988 meeting, Dorsey and Whitney withdrew from representation of Grand Met, based in part on the position of the firm's corporate department.

[FN28]. While testifying before the SEC in connection with its investigation of O'Hagan's trading activities, Tinkham had repeatedly expressed marked uncertainty as to the timing of this conversation. The transcript reflecting this testimony constituted Jencks material and was turned over to the defense in advance of trial. See 18 U.S.C. § 3500 (1970).

[FN29]. O'Hagan would later levy an attack upon the sufficiency of the evidence by asserting that the conversation between Tinkham and himself was most abbreviated in nature, with "skeletal information allegedly [being] provided him by Tinkham." Brief for Appellant (O'Hagan Brief To Eighth Circuit) at 20 (No. 94-3714 NMI). On appeal to the Eighth Circuit, he even attached a transcript reflecting Tinkham's trial testimony while arguing that the evidence, construed in the light most favorable to the government, showed that he never learned any details of any takeover plan; at most he merely learned that "Dorsey & Whitney had been retained to represent an undisclosed client in connection with a possible takeover of Pillsbury." Reply Brief for Appellant (O'Hagan Reply Brief To Eighth Circuit) at 2 (No. 94-3714 MNMI).

[FN30]. Tinkham testified that he discussed the Pillsbury takeover with O'Hagan despite his awareness of an effort to keep that information narrowly confined because he believed O'Hagan had the right to know, given his position as a partner.

[FN31]. The indictment did not reference securities trades effected prior to August 26, 1988. The trade taking place at the earliest point in time which allegedly constituted securities fraud and mail fraud was an August 29, 1988 purchase of 100 October 40 call option contracts.

[FN32]. O'Hagan executed the mortgage on his home on August 24, 1988. He issued a $200,000 check to Robinson Humphrey on August 29, 1988 by drawing on a August 24, 1988 line of credit secured by the mortgage on his home.

[FN33]. The strike price of a call option constitutes the price at which the stock underlying that option can be purchased on the date of expiration of that option. For example, the strike price of September 40 call options is $40.

[FN34]. Evans was actually called to the witness stand by O'Hagan. Evans had previously given testimony before the SEC which was favorable to O'Hagan. On direct examination, Evans again gave testimony which was favorable to O'Hagan. However, the impact of this testimony on direct was more than offset by key statements made on cross-examination. The following exemplifies the testimony set forth by Evans on cross-examination:

Q. Well, when you saw him buying this incredible quantity, it gave you confidence that

he knew something was going to happen?
A. Well, he was sure puttin' his money where his mouth was, so.
Q. And actions speak louder than words?
A. Yes, Sir.
Q. And that's what you thought?
A. That's right.
Q. So it gave you confidence that Pillsbury was going to go up?
A. Yes, sir.
Q. And you started telling your clients that you have a smart guy in Minneapolis that's buying these options like they're going out of style?
A. Yes, sir.
Q. Any you were recommending Pillsbury options because you knew he wanted them?
A. Yes, sir. It was an easy sale.
* * * *
Q. And when the defendant normally traded, bought and sold, he normally was buying and selling a variety of stocks, not just trading in one company, right?
A. Yes, sir.
Q. And of course that buy [sic] and selling activity was taking place in stocks, not options?
A. Correct.
Q. But in September 1988, nearly all his money was going into one company, not a variety of companies?
A. Yes, sir.
Q. And it was going into options, not stocks?
A. Correct
Q. And you recognized that this is a big change from his usual practice?
A. Yes, sir.
* * * *
Q. So you talked about different things, but his money only goes one place?
A. Yes, sir.
Q. And then [sic] showed you that he really only has an interest in one company?
A. Yes, sir.
Q. And that was Pillsbury?
A. That's correct.
Q. Now, prior to August/September 1988, the defendant had never bought options in any takeover candidate through you?
A. He only bought options one time through me, and it was, ah-it was a local Huntsville company.
Q. Called Integraph?
A. Yes, sir.
Q. That's a high technology stock?
A. Correct.
Q. Not a takeover company?
A. Correct.

Q. And he lost all his money when he bought Integraph options?
A. Yes. We paid one and something and they went out worthless.
* * * *

[FN35]. During trial, O'Hagan attempted to show that his portfolio was not weighted with speculative, volatile instruments. In his opening statement, O'Hagan claimed that his purchases of Pillsbury options amounted to an insignificant portion of his total market position of $5.1 million. O'Hagan further developed this theory of defense through cross-examination, accusing the government of misleading the jurors by omitting reference to the $5.1 million market position. O'Hagan took this approach in pursuit of the claim that it is reasonable for a person with a large net worth to expose a relatively small amount of capital to extraordinary risks. This defense tactic, however, opened the door to the introduction of evidence showing that his $5.1 million market position was not a barometer of his financial status. O'Hagan built up that market position by putting $1.3 million of bank loans into the market, and leveraging that money through margin purchases. O'Hagan repaid the $1.3 million in bank loans by using Northrup King and Mayo Foundation funds. O'Hagan's market position had thus been, in substantial part, created with the money of others.

[FN36]. O'Hagan purchased 3,000 Pillsbury option contracts during August and September 1988, paying $258,762. He held only 2,500 of those contracts at the end of September as 500 contracts expired worthless on September 17, 1988.

[FN37]. Kinnahan, after being called as a defense witness, provided testimony which was favorable to O'Hagan. She told the jurors that on August 19, 1988 she recommended to O'Hagan that he purchase Pillsbury options. Although O'Hagan agreed to that recommendation on August 19, 1988, she did not begin filling the order until many days later. The benefits associated with that testimony were undercut on cross-examination, however, as she acknowledged that although she was confident Pillsbury would be acquired, she never purchased any Pillsbury securities for her own account. She also admitted that at the time Grand Met's tender offer for Pillsbury securities was announced, O'Hagan was her only customer holding Pillsbury securities.

[FN38]. The government argued that the relatively steady price of Pillsbury securities, which were traded on national exchanges, showed that those professionals were successful in their attempt to keep Grand Met's intentions confidential. On account of efficient market principles, all publicly available information was promptly being factored into the price of Pillsbury securities. Information of a non-public nature, however, could not have been taken into account by market pricing mechanisms.

[FN39]. Opinions issued by the Eighth Circuit Court of Appeals state that O'Hagan exercised the options he had purchased and then sold the stock he received pursuant to those transactions. See United States v. O'Hagan, 92 F.3d 612, 614 (8th Cir. 1996); United States v. O'Hagan, 139 F.3d 641, 645 (8th Cir. 1998). Rather than exercising the options, however, O'Hagan disposed of them through direct sales.

[FN40]. Total profits obtained on securities purchased after O'Hagan came into possession of material, non-public information amounted to more than $4.3 million, excluding commissions.

[FN41]. Factual assertions appearing in this segment are based upon O'Hagan's briefs to the Eighth Circuit Court of Appeals, together with trial transcripts. Brief for Appellant (O'Hagan Brief to Eighth Circuit) and Reply Brief for Appellant (O'Hagan Brief to Eighth Circuit) (No. 94-3714 MNMI).

[FN42]. At trial, Evans told jurors that O'Hagan would not have placed a limit order for these options if he possessed inside information. The imposition of a limit order meant that O'Hagan would not allow the options to be purchased on his behalf if pennies more had to be spent to purchase those securities. Obviously, the adoption of this miserly strategy would not be consistent with the tendencies of one who expected to score windfall profits by capitalizing on secret information.

[FN43]. Paul Walsh put forth the following testimony while discussing the significance of Grand Met's sale of its Intercontinental Hotels subsidiary:

Q. Did Intercontinental Hotels play any role in your plans that you were analyzing?
A. Very much so.
Q. Would you explain to the jury how Intercontinental Hotels played a role in your analysis?
A. We had decided strategically to withdraw from hotels, which would mean a sale of that entity. We estimated at that point in time that the value of that property could be anything like 1.8 to $1.3 billion. Therefore, recognizing the size of the Pillsbury acquisition, the sale of Intercontinental Hotels would provide a lot of the cash to fund the acquisition of Pillsbury.
* * * *
Q. Turning back to the Intercontinental Hotel sale for a minute, did there come a time when you traveled to Tokyo, Japan?
A. Yes.
Q. Approximately when did you leave?
A. Approximately the 22nd, 23rd of September.
Q. When did you return?
A. I returned, I think it was the 1st of October.
Q. What was your purpose for going there?
A. I was negotiating the sale of Intercontinental Hotels to-with the final buyer, which was the Seibu Group of Japan.
Q. In regard to your trip and its purpose, prior to your leaving, did you have a deal for the sale of Intercontinental Hotels?
A. No.
Q. Did you have a deal when you came back?
A. Yes.
* * * *
Q. Now, when did you first learn that a tender offer indeed would be made for Pillsbury?

A. I learned when I returned from Tokyo.
Q. What date was that?
A. It was the Saturday. It would be the 1st, the 1st of October.
Q. Approximately two or three days, actually, before the tender offer?
A. Yes.
* * * *
Q. And your confidence and your ability to do this deal was based upon the time you'd spent trying to put it together, correct?
A. Yes.
Q. And it was all contingent upon the sale of the Intercontinental Hotels, correct?
A. Yes.

[FN44]. Dennis Mathisen, who testified for the defense as an expert witness placed special emphasis on this September 30, 1988 transaction. Mathisen, who had helped Irwin Jacobs effectuate tender offers, testified that prior to September 30, 1988, "Grand Met did not have the financing . . . available to consummate the transaction"; before this "condition precedent" occurred, no material, nonpublic information concerning Grand Met's takeover intentions existed.

[FN45]. The defense attempted to elicit testimony from Mathisen which would support an argument that the retention of law firms, including Dorsey and Whitney, did not constitute a substantial step. However, the testimony Mathisen put forth on this subject on direct examination was of a conclusory nature and was more than offset by concessions he made on cross-examination. Excerpts of testimony given by Mathisen on cross-examination are as follows:

Q. And you know that Cravath prepared Schedule 14D-1?
A. Umm, I don't know that, but I'll take your word for that.
Q. And you know that Cravath prepared the tender offer prospectus that was sent to Pillsbury's shareholders?
A. Again, I'll take your word for that. The record might indicate that.
Q. And you know that without preparation of those documents, the tender offer from [sic] Pillsbury common stock could not have gone forward?
A. Correct.
Q. And so then you'd agree that Cravath played a crucial role in the takeover of Pillsbury?
A. Yes.
* * * *
Q. Now, you're familiar with Section 13(d) of the 34 Act?
A. Umm, yes.
Q. Section 13(d) says that if an acquirer buys over 5 percent of the certain class of securities, a Schedule 13D must be filed with the Commission, the SEC.
A. Correct.
Q. And if that law is not complied with, the SEC can institute enforcement proceedings?
A. I believe that's the rule.

* * * *
Q. And so it was important for Grand Met to comply with Section 13(d) of the 34 Act?
A. Correct.
Q. And you have read the prospectus marked as Government's Exhibit 52, right?
A. I have not.
Q. But you know that Cravath prepared this prospectus?
A. Umm, again, I'll take your word for it. I don't know of my own personal knowledge.
Q. You can see by reading on page 22 that Grand Met had only purchased 200 shares of Pillsbury prior to the announcement of its tender offer?
A. Um hmm, yes.
Q. And so Grand-
A. I see.
Q. -Met, you would agree, complied with Section 13(d)?
A. It did not have in its possession nor ownership more that 5 percent of the company, and so thus didn't have to file a 13(d).

[FN46]. The following authority was relied upon as support for these section 10(b) elements: Securities Exchange Act of 1934, Section 10(b); 17 C.F.R. § 240.10b-5; Securities Exchange Act of 1934, Section 32(a); Dirks v. SEC, 463 U.S. 646, 654, 103 S. Ct. 3255, 3261 (1983); Chiarella v. United States, 445 U.S. 222, 231, 100 S. Ct. 1108, 1116 (1980); SEC v. Materia, 745 F.2d 197, 201 (2d Cir. 1984), cert. denied, 471 U.S. 1053, 105 S. Ct. 2112 (1985); SEC v. Texas Gulf Sulphur, 401 F.2d 833, 848 (2d Cir. 1968), cert. denied, 394 U.S. 976, 89 S. Ct. 1454 (1969); and SEC v. Lund, 570 F.Supp. 1397, 1402 (C.D. Cal. 1983).

[FN47]. A customized unanimity instruction accompanied this duty instruction. The unanimity instruction stated:
During the course of your deliberations concerning counts 21 through 37, you must decide whether the defendant owed a duty of trust and confidence to Grand Met, the Dorsey and Whitney law firm, or both. If you find that a duty was owed, you must also decide whether the defendant breached that duty of trust and confidence to Grand Met, the Dorsey and Whitney law firm, or both.
The government is not required to prove that the defendant breached a duty of trust and confidence to both Grand Met and the Dorsey and Whitney law firm. However, as for each of these counts, in order to convict, each juror must agree with each other juror that the defendant breached a duty to Grand Met, the Dorsey and Whitney law firm, or both.
In other words, there can be no conviction if, for example, one-half of the jurors believe there was a breach of duty solely towards Grand Met, while the other one-half of the jurors believe there was a breach of duty solely towards the Dorsey and Whitney law firm. There must be a meeting of the minds among the jurors as to whether there was a breach of duty towards Grand Met, towards Dorsey and Whitney, or towards both.

[FN48]. The following authority was relied upon as support for the duty instruction given to the jurors: Dirks v. SEC, 463 U.S. 646, 103 S. Ct. 3255 (1983); Chiarella v. United States, 445 U.S. 222, 100 S. Ct. 1108 (1980); SEC v. Materia, 745 F.2d 197 (2d Cir. 1984),

cert. denied, 471 U.S. 1053, 105 S. Ct. 2112 (1985); United States v. Newman, 664 F.2d 12 (2d Cir. 1981); and SEC v. Lund, 570 F. Supp. 1397, 1402-03 (C. D. Cal. 1983).

[FN49]. 791 F.2d 1024, 1028 n.5 (2d Cir. 1986), aff'd by an equally divided court, 484 U.S. 19, 108 S. Ct. 316 (1987).

[FN50]. In its reply brief to the Supreme Court, the government reiterated this point by quoting Restatement (Second) of Agency § 395 (1958). That provision reads as follows:

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as an agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge.

Reply Brief for the United States, at 6 n.3 (No. 96-842).
The government supplemented that discussion in its reply brief by citing to Section 170(2) of the Second Restatement of Trusts for the proposition that a "trustee dealing with [a] beneficiary on his own account must disclose all material facts"; a "trustee may not profit at the expense of, or compete with, [[[[a] beneficiary, without consent or authorization under the terms of the trust"; and a "trustee must disclose material facts that the beneficiary does not know but needs to know for his protection in dealing with a third person with respect to his interest." Reply Brief for the United States, at 7 n.4 (No. 96-842).

[FN51]. Absent this final clause of the instruction, a Section 10(b) "tipping" violation by one corporate official could conceivably insulate from Section 10(b) liability all others who thereafter convert corporate information to their own benefit.

[FN52]. The following authority was relied upon for this materiality instruction: Basic v. Levinson, 485 U.S. 224, 231-232, 238-239, 240 n.18, 108 S. Ct. 978, 983, 987, 988 n.18 (1988); SEC v. Geon Industries, Inc., 531 F.2d 39 (2d Cir. 1976); SEC v. Shapiro, 494 F.2d 1301, 1305-06 (2d Cir. 1974); SEC v. Texas Gulf Sulphur, 401 F.2d 833, 849-51 (2d Cir. 1968), cert. denied, 394 U.S. 976, 89 S. Ct. 1454 (1969); and SEC v. Lund, 570 F. Supp. 1397, 1401-02 (C.D. Cal. 1983).

[FN53]. See Ralph C. Ferrara et al., Ferrara on Insider Trading and the Wall, § 2.01[4], 2-11-2-12 (1998) (pointing out that an "important aspect of the scienter element in insider trading cases involves the so-called 'possession vs. on the basis of' debate. That is, should the government . . . have to demonstrate that the defendant not only traded 'while in possession of' material nonpublic information but also traded 'based on' that information?").

[FN54]. The Securities and Exchange Commission has taken the position that Section 10(b) insider trading liability is not predicated on "a showing that an insider sold his securities for the purpose of taking advantage of material non-public information . . . If

an insider sells his securities while in possession of material adverse non-public information, such an insider is taking advantage of his position to the detriment of the public." Report of the Investigation In The Matter Of Sterling Drug Inc., Securities Exchange Act Release No. 14,675, 14 S.E.C. Docket 824, 827 (1978).
Observers may be inclined to ponder the continuing validity of that position in its purest form on account of remarks made by the Supreme Court in Dirks. The Dirks Court rejected the SEC's contention that the thought process of a trader has no place in an insider trading analysis while noting that "motivation is not irrelevant to the issue of scienter. It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is 'intentional or willful conduct designed to deceive or defraud"' others. Dirks, 463 U.S. 646, 663 n.23, 103 S. Ct. 3255 n.23 (1983). Certainly, the "in possession of" standard is not to be employed in either the Eleventh Circuit or the Ninth Circuit. While characterizing "the choice between the SEC's knowing possession test and the use test . . . as a difficult and close question of first impression" and finding "that there is no definitive guidance on this issue from the Supreme Court," the Eleventh Circuit recently rejected arguments supporting the "in possession of" standard. SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998). The Eleventh Circuit rested its holding, in part, on the statement in Dirks that "motivation is not irrelevant to the issue of scienter" and inconsistencies attending the SEC's position on the issue of motivation. Id. at 1334, 1336, 1339. In the months following the issuance of the Adler opinion, the Ninth Circuit followed the lead of the Eleventh Circuit by similarly rejecting the "in possession of" standard. United States v. Smith, 1998 WL 527066, at 13-15 (9th Cir. (Cal.)). See also William R. McLucas et al., A Practitioner's Guide to the SEC's Investigative and Enforcement Process, 70 Temple L. Rev. 53, 63 (1997) (explaining that "a person has engaged in insider trading when he buys or sells securities on the basis of material non-public information and, at the same time, is a fiduciary or 'insider' of the corporation whose securities are being traded" (emphasis added)); Daniel L. Goelzer and Max Berueffy, Insider Trading: The Search for a Definition, 39 Ala. L. Rev. 491, 508 (1988) (pointing out that the SEC had incorporated motivational issues into the insider trading equation prior to the 1978 issuance of the Sterling Drug release).

[FN55]. While the jury instructions were tailored to O'Hagan's trading in Pillsbury securities during a period in which Pillsbury was a publicly-held company, those instructions must not be interpreted as support for the claim that insider trading principles apply solely to publicly traded securities. See Michaels v. Michaels, 767 F.2d 1185, 1194-1200 (7th Cir. 1985) (upholding finding that Section 10(b) was violated through the purchase of privately held stock while in possession of material, nonpublic information). See also Landreth Timber Co. v. Landreth, 471 U.S. 681, 692, 105 S. Ct. 229 (1985) (pointing out that "although § 4(2) of the 1933 Act . . . exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions"); United States v. Olson, 22 F.3d 783, 785 (8th Cir.), cert. denied, 513 U.S. 929, 115 S. Ct. 320 (1994) (affirming securities fraud convictions while holding that "one-on-one transactions with sophisticated buyers are not excepted from securities fraud law").

[FN56]. (Emphasis added). See, e.g., Chiarella v. United States, 445 U.S. 222, 230, 100 S. Ct. 1108, 1115-16 (1980) (recognizing that corporate insiders are prohibited from "benefit[ting] personally through fraudulent use of material, nonpublic information"); Dirks v. SEC, 46 U.S. 646, 659, 103 S. Ct. 3255, 3264 (1983) (accepting as a premise that "insiders [are] forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage").

[FN57]. (Emphasis added). See Chiarella, 445 U.S. at 230, 100 S. Ct. at 1115-16; Dirks, 463 U.S. at 659, 103 S. Ct. at 3264. The full text of the accompanying instruction which gave more in-depth guidance as to employment of the "used" standard is as follows:

> [W]ith respect to element number four, the government has alleged that the fraudulent conduct occurred in connection with the purchase or sale of securities. The government must prove beyond a reasonable doubt, that the defendant used the material nonpublic information, if any, when he purchased the Pillsbury securities.

[FN58]. An inquiry into whether a transaction was effected "on the basis of" certain information may tend to focus the fact finder's attention on the "reason" why the trade was executed. See Bryan A. Garner, A Dictionary of Modern Legal Usage 100 (2d ed. 1995) (equating "basis" with "reason"). See also Webster's New Ideal Dictionary 43 (1978) (defining "basis" as "the base, foundation, or chief supporting part"). "Use," along with its derivatives, is more elastic in nature on account of its universality and may be allowed to characterize the mere application of knowledge in a trader's thought process. See generally A Dictionary of Modern Legal Usage, at 905, 906; Merriam-Webster's Dictionary of Law 519 (1996) (defining "use" to mean "to put into service"); Black's Law Dictionary 1541 (6th ed. 1990) (defining "use" as "[t]o make use of . . . to employ . . . to put into action or service . . .").

[FN59]. One group of commentators notes that, from the perspective of the SEC, "the 'on the basis of' standard is highly problematic because 'it makes proof of a violation subject to a metaphysical impossibility."' Ferrara et al., supra note 53, § 2.01[4], 2-12.

[FN60]. 987 F. 2d 112, 120 (2d Cir. 1993).

[FN61]. Id.

[FN62]. Teicher, 987 F. 2d at 120.

[FN63]. As Professor Langevoort has observed, "[i]n the typical case, there is no question that the insider traded in order to take advantage of material nondisclosed information. There, scienter is easy to establish: one finds little discussion of this element in the case law at all." Donald C. Langevoort, Insider Trading Regulation § 3.04, 91-92 (1991). See also William K.S. Wang and Marc I. Steinberg, Insider Trading § 4.45, at 178 (1996) (raising question as to whether a trader must not only knowingly possess material, nonpublic information, "but also trade 'on the basis of' that information. In other words, must knowledge of the information be a but-for cause of the trade?"); Goelzer and Berueffy, supra note 54, at 508-10 (concluding that the issue of a trader's motivation

"remains unsettled in the courts," while acknowledging that even the SEC has put forth inconsistent standards on this issue); Allan Horwich, Possession Versus Use: Is there a Causation Element in the Prohibition on Insider Trading?, 52 Bus. Law. 1235, 1254-58 (1997) (finding that an examination of the legislative history of the Insider Trading Sanctions Act of 1984 and the Insider Trading and Securities Fraud Enforcement Act of 1988 provides little assistance to those attempting to discern the motivational test which is to be employed in insider trading cases).

[FN64]. Recklessness may give rise to a finding of criminal securities fraud. See United States v. Henderson, 446 F.2d 960, 966 (8th Cir. 1971) (upholding convictions under Section 17 of the Securities Act of 1933 after noting that "[i]t is well established that ignorance of inculpatory facts due to a reckless disregard is no more a defense than ignorance of inculpatory law"); United States v. Farris, 614 F.2d 634, 638 (9th Cir. 1979), cert. denied, Baumann v. United States, 447 U.S. 926, 100 S. Ct. 3022 (1980) (noting that "the law of this circuit establishes the reckless disregard for truth or falsity is sufficient to sustain a finding of securities fraud . . ."). Support for the employment of a recklessness standard may also be derived from authority construing federal mail fraud and wire fraud provisions. See SEC v. Clark, 915 F.2d 439, 448-49 (9th Cir. 1990). Mail fraud and wire fraud convictions may be predicated on conduct amounting to recklessness. See United States v. McDonald, 576 F.2d 1350, 1358 (9th Cir. 1978); United States v. Marley, 549 F.2d 561, 563-64 (8th Cir. 1977) (noting, in wire fraud case, that "courts have long recognized that scienter may be established where reckless disregard of truth or falsity is present"). Civil securities fraud cases adopting the recklessness standard may also serve to validate criminal securities fraud convictions as securities law principles developed in civil proceedings may be applied in criminal cases. See United States v. Charnay, 537 F.2d 341, 348 (9th Cir.), cert. denied, 429 U.S. 1000, 97 S. Ct. 528 (1976); United States v. Boyer, 694 F.2d 58, 60 (3d Cir. 1982); United States v. Persky, 520 F.2d 283, 288 (2d Cir. 1975). Numerous civil cases have allowed Section 10(b) liability to be based upon reckless conduct. See Van Dyke v. Coburn Enters., 873 F.2d 1094, 1100 (8th Cir. 1989) (concluding, within discussion focusing upon civil law, that "[t]he majority rule in the Courts of Appeals is that recklessness satisfies the scienter requirement").

Notwithstanding this authority, it must be remembered that "[t]he definition of reckless behavior . . . should not be a liberal one lest any discernible distinction between 'scienter' and 'negligence' be obliterated." Federal Regulation of Securities § 1515, 43:267 (1996). See also Marc I. Steinberg, Securities Regulation § 7.03, at 455-456 (1986) (describing three standards of recklessness, with the first standard examining whether "'danger was either known to the defendant or so obvious that the defendant must have been aware of it,"' while the third, and least demanding, standard looks to whether "the defendant 'should have known,' with the proviso that such conduct surpasses that of negligence"); Model Jury Instructions: Securities Litigation 4.02[4][a], 91 (1996) (stating that "[s]everal Circuits, including the Eleventh, have held that the conduct must be 'severely' reckless to satisfy the scienter requirement" in civil cases).

[FN65]. The mail fraud jury instructions apprised the jurors of the text of 18 U.S.C. §1341 by providing a verbatim recital of pertinent portions of that provision and then set forth the following description of the elements:

One: The defendant voluntarily and intentionally devised or made up a scheme to defraud Grand Met or Dorsey and Whitney out of money, property, or property rights, by purchasing Pillsbury securities while in possession of material nonpublic information, and using the profits obtained therefrom to conceal his previous use and possession of client trust funds;

Two: The defendant did so with the intent to defraud;

Three: It was reasonably foreseeable that the mails would be used; and

Four: The mails were used in furtherance of some essential step in the scheme.

[FN66]. Brief for Appellant (O'Hagan Brief To Eighth Circuit) at 35 (No. 94- 3714 NMI).

[FN67]. Id.

[FN68]. Id. at 35-36.

[FN69]. The following authority was relied upon as support for these section 14(e) elements: Securities Exchange Act of 1934, Section 14(e); 17 C.F.R. § 240.14e-3(a); Securities Exchange Act of 1934, Section 32(a); and United States v. Chestman, 947 F. 2d 551, 556-63 (2d Cir. 1991) (en banc).

[FN70]. Inasmuch as the fourth element of the Section 10(b) counts informed the jurors that the government was obligated to establish beyond a reasonable doubt that the "[d]efendant willfully used the information with the intent to defraud," the jurors were also given guidance as to the issue of intent. The jury instruction relating to intent provided as follows:

Intent ordinarily may not be proved directly, because there is no way of fathoming or scrutinizing the operations of the human mind. But you may infer the defendant's intent from the surrounding circumstances. You may consider any statements made and done or omitted by the defendant, and all other facts and circumstances in evidence which indicate his state of mind.

You may consider it reasonable to draw the inference and find that a person intends the natural and probable consequences of acts knowingly done or knowingly omitted. As I have said, it is entirely up to you to decide what facts to find from the evidence . . . .

[FN71]. Authority relied upon by the trial court as support for this position consisted of Rule 14e-3(a); SEC v. Gaspar, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 92004, 90,979-90,980 (S.D.N.Y. 1985); and Applied Digital Sys., Inc. v. Milgo Electronic Corp., 425 F. Supp. 1145, 1151-55 (S.D.N.Y. 1977).

[FN72]. The indictment actually alleged that O'Hagan had acquired the information from Grand Met and Thomas Tinkham. However, proof that O'Hagan had acquired the information from either party was sufficient. See supra note 18.

[FN73]. A unanimity instruction was also tacked on to that Section 14(e) instruction. The unanimity instruction stated: "The government is not required to prove that the defendant knew that the information had been acquired directly or indirectly from both Grand Met and Thomas Tinkham. However, as for each of the counts, in order to convict, each juror must agree with each other juror, that the defendant knew the information had been acquired directly or indirectly from Grand Met, from Thomas Tinkham, or from both."

[FN74]. Sentencing Transcript at 19 (No. 4-92-219).

[FN75]. Sentencing Transcript at 20 (No. 4-92-219).

[FN76]. Sentencing Transcript at 17 (No. 4-92-219). Moments later, the experienced trial court judge would direct well-deserved compliments towards the defense attorney, undoubtedly mindful that those convicted of serious offenses often display a tendency to later cast blame upon defense counsel. The trial court, who had presided over other significant criminal prosecutions involving Charles Hawkins, who represented O'Hagan at the district court level, told O'Hagan, "I do not respect any lawyer higher than the lawyer who spoke on your behalf today." Sentencing Transcript at 31 (No. 4-92-219). O'Hagan appears to have placed little weight on this commentary. Following the imposition of a sentence, he retained the venerable law firm of Faegre & Benson to pursue an appeal on his behalf. Cindy O'Hagan, his daughter, an attorney, also provided assistance.

[FN77]. Sentencing Transcript at 21 (No. 4-92-219).

[FN78]. Sentencing Transcript at 24 (No. 4-92-219).

[FN79]. Id.

[FN80]. Id. While focusing on the theft of client funds which preceded O'Hagan's purchases of Pillsbury securities, the trial court criticized O'Hagan for submitting a pro se pleading which took the position that these funds had been borrowed from clients. Sentencing Transcript at 26 (No. 4-92-219). The court stated that since the clients did not in any way assent to these transactions, they could not be deemed loans. Id. Further, as stated by the court, "It was not bad judgment. It was theft . . . It also sadly set in motion the first in a series of dominoes that directly lead to this courtroom." Id. An analysis of O'Hagan's financial status, however, reveals that while the theft of client funds may have lead to the insider trading, this was not inevitably so. O'Hagan could have liquidated assets, including stock market positions, to replenish stolen trust funds. But given O'Hagan's seemingly unbounded preoccupation with the stock market, in all likelihood, it would have been most difficult for O'Hagan to adhere to this course of action.

[FN81]. Sentencing Transcript at 33-35 (No. 4-92-219). Before imposing a sentence upon O'Hagan, the trial court took the position that although Dorsey and Whitney was identified as a victim, "it is obvious when you look at where the dollars came from . . . that the victims from a pecuniary standpoint, were those who thought they were putting their

options into a fair market when you weren't playing fair." Sentencing Transcript at 28 (No. 4-92-219).
Economists, along with other observers, may be reluctant to agree with this observation. Those who sold the options O'Hagan had purchased would have disposed of those securities regardless of any actions taken by O'Hagan. O'Hagan did not directly influence their actions in any way. As such, the sellers cannot fairly be categorized as victims, at least in the traditional sense, of O'Hagan's scheme. See Harvey L. Pitt and Karen L. Shapiro, The Insider Trading Proscriptions Act of 1987: A Legislative Initiative for a Sorely Needed Clarification of the Law Against Insider Trading, 39 Ala. L. Rev. 415, 430 (1988) (arguing that it is "difficult to super-impose traditional fraud concepts" upon stock market transactions when the innocent trader "has made his investment decision while completely free of any influence or deceit on the part of the insider trader"). See also James D. Cox, Insider Trading and Contracting: A Critical Response to the "Chicago School," 1986 Duke L.J. 628, 635 (1986) (stating that "the investor is no worse off when the insider trades than when the insider does not trade. The investor's decision to sell or purchase is unaffected by whether the insider is also secretly buying or selling shares in the open market"); John W. Bagby, The Evolving Controversy Over Insider Trading, 24 Am. Bus. L. J. 571, 580 (1986) (asserting that opponents of insider trading view it as a "victimless crime"); Wang and Steinberg, supra note 63, § 3.3.3, 58. But see id., at 3.3.5, 62-63 (stating that notwithstanding suggestions to the contrary, "each act of insider trading does in fact harm other individuals" due to "The Law of Conservation of Securities"). Cf. 3 Alan R. Bromberg & Lewis D. Lowenfels, Bromberg and Lowenfels on Securities Fraud & Commodities Fraud § 7.5 (513), 7:242 (2d ed. 1996) (criticizing misappropriation theory while arguing that the insider trader not only visits no injury upon the innocent trader, but, instead, actually bestows a benefit upon the innocent trader since the insider trader "adds to demand if a buyer or to supply if a seller").

[FN82]. Brief for Appellant (O'Hagan Brief to Eighth Circuit) at 14-20 (No. 94-3714 MNMI).

[FN83]. A sampling of the arguments of law made by O'Hagan include the following: 1) the securities fraud allegations were barred by the statute of limitations under Lampf v. Gilbertson, 501 U.S. 352, 112 S. Ct. 27 (1991); 2) since all purchases were made on the American Stock Exchange and the New York Stock Exchange, venue was proper only in New York; 3) an analysis of the development of Section 16(b) of the Exchange Act shows that Congress intended to refrain from criminalizing insider trading; and 4) Section 14(e) cannot be violated until after a tender offer is made.

[FN84]. Brief for Appellant (O'Hagan Brief to Eighth Circuit) at 50 (No. 94- 3714 MNMI) (citation omitted).

[FN85]. 511 U.S. 164, 114 S. Ct. 1439 (1994).

[FN86]. Id. at 43-44.

[FN87]. Brief for Appellee and Cross-Appellant at 49 (No. 94-3714 MNMI).

[FN88]. See Dirks v. SEC, 463 U.S. 646, 655 n.14, 103 S. Ct. 3255 (1983).

[FN89]. Brief for Appellee and Cross-Appellant at 47-48 (No. 94-3714 MNMI).

[FN90]. Id. at 49.

[FN91]. Id. at 48.

[FN92]. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12-13, 92 S. Ct. 165, 169 (1971); United States v. Gruenberg, 989 F.2d 971, 976 (8th Cir.), cert. denied, 510 U.S. 873, 114 S. Ct. 204 (1993); United States v. Newman, 664 F. 2d 12, 18 (2d Cir. 1981). The government also asserted that Central Bank could not be viewed as having reformulated this principle since that opinion observed that a deception which occurs in connection with a purchase or sale of a security falls within the text of section 10(b). Central Bank, N.A. v. First Interstate Bank N.A., 511 U.S. 164, 172, 114 S. Ct. 1439, 1446 (1994). Brief for Appellee and Cross-Appellant at 48 n.37, 49- 50 (No. 94-3714 MNMI).

[FN93]. Brief of Appellee and Cross-Appellant at 29 (No. 94-3714 MNMI).

[FN94]. While testifying on cross-examination, Paul Walsh, Grand Met's former chief financial officer, agreed that the participation of Morgan Stanley was "essential" to the Pillsbury acquisition. Transcript Vol. X, United States v. O'Hagan, Crim. No. 4-92-219, at 47 (D. Minn. Feb. 3, 1994).

[FN95]. Brief of Appellee and Cross-Appellant at 6-7, 36-37 (No. 94-3714 MNMI).

[FN96]. Id. at 51.

[FN97]. 432 U.S. 416, 425-26, 97 S. Ct. 2405 (1977).

[FN98]. Brief of Appellee and Cross-Appellant at 52-53 (No. 94-3714 MNMI).

[FN99]. Id. at 53-54.

[FN100]. The two sentences comprising Section 14(e) may be viewed as being inconsistent with one another in that the first sentence captures only conduct which fairly deserves to be categorized as fraudulent, deceptive, or manipulative. The prescribing clause of the second sentence of Section 14(e), however, attaches to activities which may fall far short of the range of conduct encompassed within the first sentence.

[FN101]. Brief of Appellee and Cross-Appellant at 54 (No. 94-3714 MNMI).

[FN102]. Id.

[FN103]. Id.

[FN104]. United States v. O'Hagan, 92 F.3d 612 (8th Cir. 1996).

[FN105]. Id. at 617-622 (asserting that those courts which have adopted the misappropriation theory have done so "without conducting a rigorous analysis of the text of §10(b) and Supreme Court precedent").

[FN106]. Id. at 627-28.

[FN107]. Id. at 617.

[FN108]. Id.

[FN109]. 430 U.S. 462, 97 S. Ct. 1292 (1977).

[FN110]. Central Bank v. First Interstate Bank, 511 U.S. 164, 114 S. Ct. 1439 (1994); O'Hagan, 92 F.3d at 618.

[FN111]. O'Hagan, 92 F.3d at 618.

[FN112]. Id.

[FN113]. Id.

[FN114]. Id. at 619 (quoting United States v. Bryan, 58 F.3d 933, 950 (4th Cir. 1995)).

[FN115]. Id. at 620.

[FN116]. 441 U.S. 768, 773 n.4, 99 S. Ct. 2077, 2081 n.4 (1979).

[FN117]. Brief for Appellee and Cross-Appellant at 39 (No. 94-3714 MNMI). Footnote four of Naftalin was pointed to in the context of a discussion as to whether O'Hagan had engaged in specified unlawful activity under 18 U.S.C. § 1956(c)(7)(A) through his purchase of Pillsbury securities. The government specifically quoted the following language from Naftalin: "[W]e are not persuaded that 'in' is narrower that 'in connection with.' Both Congress . . . and this Court . . . have on occasion used the terms interchangeably." The government then went on to argue that on account of the breadth of the "in connection with" clause of Section 10(b) and the interchangeable nature of "in connection with" vis-a-vis "in," O'Hagan had engaged in "fraud in the sale of securities" under 18 U.S.C. § 1961(1) by purchasing Pillsbury securities inasmuch as his conduct need only be "loosely connected" to the sale of securities. Brief for Appellee and Cross-Appellant at 39.

[FN118]. At oral argument the government stated, "[T]his court is not writing on a blank slate when it talks about the in-connection-with requirement . . . . In 1993, Judge Hansen, you wrote the [Gruenberg] opinion, and you may recall that in that case you made it clear that for the in-connection-with requirement to be met a fraud need not be closely related to the purchase or sale of securities." Transcript of Eighth Circuit Oral Argument at 21-22. United States v. Gruenberg, 989 F.2d 971 (8th Cir. 1993), upheld jury instructions providing that Section 10(b)'s "in connection with" element can be satisfied by a finding that there is "some nexus or relation between the allegedly fraudulent

conduct and the sale or purchase of securities." Gruenberg, 989 F.2d at 976 (quoting the Jury Instructions, Vol. 85, at 9889-90). In upholding those instructions, the Eighth Circuit adopted a liberal construction applied by the Fifth Circuit. It recognized that "a direct or close relationship between the fraudulent transaction and the purchase or sale [of a security]" need not be established to prove a Rule 10b-5 violation. Id. (citing Alley v. Miramon, 614 F.2d 1372, 1378 n.11 (5th Cir. 1980) (alteration in original)). The Eighth Circuit then went on to stress that a Section 10(b) plaintiff "need only show that the fraudulent conduct touches the purchase or sale of the securities." Id. (internal quotations omitted) (citing Harris v. Union Elec. Co., 787 F.2d 355, 368 (8th Cir.), cert. denied, 479 U.S. 823, 107 S. Ct. 94 (1986) and Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12-13, 92 S. Ct. 165, 168-69 (1971)).

[FN119]. O'Hagan, 92 F.3d at 618. The Eighth Circuit also stated that its prior opinions could not be read so as to support the assertion "that the person defrauded need not be an individual who has an interest or stake in a securities transaction." Id. at 620 n.7. Those opinions simply indicated that "the 'touch' test is easily satisfied as long as the party defrauded is a market participant." Id.

[FN120]. Id. at 627 (quoting Brief for Appellee and Cross-Appellant at 53 and Batterton v. Francis, 432 U.S. 416, 425-26, 97 S. Ct. 2399, 2405-06 (1977)).

[FN121]. Id.

[FN122]. Id.

[FN123]. Id.

[FN124]. Id. at 624.

[FN125]. Opting to sidestep the teeth of the prescribing clause argument (that the SEC had been empowered to regulate conduct which is not fraudulent in order to prevent fraud from occurring), the Eighth Circuit rejected the position advanced by the government merely by advancing a thought, the essence of which is difficult to discern. In the words of the Eighth Circuit, the prescribing clause "means simply that the SEC has broad regulatory powers in the field of tender offers, but the statutory terms have a fixed meaning which the SEC cannot alter by way of an administrative rule." O'Hagan, 92 F.3d at 627. The Eighth Circuit made no attempt to directly address the issue of whether the SEC's prescribing powers operated independently of its defining authority.

[FN126]. Appellee's Petition for Rehearing at 6.

[FN127]. Id. at 7.

[FN128]. 915 F.2d 439 (9th Cir. 1990).

[FN129]. Appellee's Petition for Rehearing at 6; Clark, 915 F.2d at 448.

[FN130]. 933 F.2d 403 (7th Cir. 1991).

[FN131]. Appellee's Petition for Rehearing at 6; Cherif, 933 F.2d at 412 (citations omitted).

[FN132]. 664 F.2d 12 (2d Cir. 1981).

[FN133]. See Appellee's Petition for Rehearing at 7 n.4; Newman, 664 F.2d at 15 n.1.

[FN134]. Appellee's Petition for Rehearing at 9.

[FN135]. Id.

[FN136]. United States v. O'Hagan, 92 F. 3d 612, 620 n.7 (8th Cir. 1996). See also Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 12-13, 92 S. Ct. 165, 169 (1971) (employing "touch" standard as a means of characterizing the reach of the "in connection with" clause).

[FN137]. Grand Met had purchased 200 shares of Pillsbury stock in the period preceding the tender offer announcement. While this minimal acquisition of Pillsbury stock prevented Grand Met from being deemed anything more that a de minimis market participant, that minimal acquisition also helped establish that the retention of legal counsel did in fact act as a substantial step. Cravath Swaine and Moore had steered Grand Met clear of a Section 13(d) violation by counseling a strategy which involved the purchase of a minimal number of shares of Pillsbury common stock, as the expert witness who testified on O'Hagan's behalf acknowledged on cross-examination. See supra note 45.

[FN138]. Appellee's Petition for Rehearing at 11 & n.5.

[FN139]. 472 U.S. 1, 105 S. Ct. 2458 (1985).

[FN140]. Appellee's Petition for Rehearing at 12 n.6.

[FN141]. Id. at 12-13 (quoting United States v. O'Hagan, 92 F.3d 612, 627 (8th Cir. 1996).

[FN142]. Brief for the United States [Supreme Court] at 16, O'Hagan (No. 96- 842) (quoting Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11 n.7, 92 S. Ct. 165, 168 n.7 (1971)).

[FN143]. Brief for the United States at 19 (No. 96-842).

[FN144]. Id. at 20-21.

[FN145]. Id. at 22.

[FN146]. Id. at 23; United States v. Naftalin, 441 U.S. 768, 773 & n.4, 99 S. Ct. 2077, 2081 & n.4 (1979).

[FN147]. Brief for the United Sates at 23 (No. 96-842).

[FN148]. Id. at 33 (quoting Pub. L. No. 100-704, § 2(1), 102 Stat. 4677 (1988)).

[FN149]. H.R. Rep. No. 100-910, at 10 (1988); Brief for the United States at 33.

[FN150]. Brief for the United States at 34. ITSFEA was enacted in the months following O'Hagan's purchases of Pillsbury securities. At oral argument before the Supreme Court, defense counsel attempted to highlight this point while deflecting questioning concerning the application of ITSFEA to the misappropriation theory, but Justice Ginsberg quickly cut him off. Specifically, when defense counsel noted the time of ITSFEA's enactment, she stepped in and made it clear that the Court's decision would go well beyond this particular case, stating, "you're asking us to make a ruling that will govern not simply this day and case . . . but that will interpret 10(b) and 14(e), and so I would like to know what becomes of that later legislation. Is it in shambles?" United States Supreme Court Official Transcript (Oral Argument of John D. French on Behalf of the Respondent), 1997 WL 182584, at *40.

[FN151]. Brief for the United States at 30.

[FN152]. Id. at 31.

[FN153]. Id. at 39.

[FN154]. Id. at 39-40.

[FN155]. Id. at 44.

[FN156]. United States Supreme Court Official Transcript, at *3.

[FN157]. Id. at *4.

[FN158]. Id. at *4-*6. Soon after taking this stance, the government modified it slightly by indicating that although disclosure within the law firm may have prevented Section 10(b) from attaching in one respect (based on the absence of deception towards the firm), Section 10(b) could still have been utilized as a prosecutorial tool on account of breach of duty and deception upon the client. Id. at *15.

[FN159]. Id. at *11-*12.

[FN160]. 484 U.S. 19, 108 S. Ct. 316 (1987).

[FN161]. United States Supreme Court Official Transcript, 1997 WL 182584, at *9. Conceivably, the government may attempt to distinguish this position at some point in the future when confronted with a scenario where a corporation, the securities of which are publicly traded, consents to trading by its officers while in possession of material, non-public information, although no such consent is given by shareholders, with general

averments of fidelity being directed towards those shareholders. Corporations must not be allowed to secretly eviscerate insider trading prohibitions to the detriment of those trading in its securities. See Susan Lorde Martin, SEC Rule 14E-3 Is Valid: A Rebuttal, 30 Am. Bus. L.J. 725, 740-41 (1992) (arguing that the notion that a corporation may "permit its insiders to trade on its nonpublic information . . . was rejected by the United States Court of Appeals for the Second Circuit almost twenty-five years ago in Texas Gulf Sulphur Co. v. SEC. The court asserted that insider trading condoned by the corporation is 'secret corporate compensation . . . derived at the expense of the uninformed investing public"') (quoting Texas Gulf Sulphur Co. v. SEC, 401 F.2d 833, 851-52 (2d Cir. 1968) (en banc)).

[FN162]. United States Supreme Court Official Transcript, 1997 WL 182584, at *10.

[FN163]. Id. at *6.

[FN164]. Id.

[FN165]. Id.

[FN166]. Id. at *7.

[FN167]. Id.

[FN168]. Id. at *8.

[FN169]. Id. at *16.

[FN170]. Id. at *17.

[FN171]. Id.

[FN172]. Id. at *20-*21.

[FN173]. Id. at *23.

[FN174]. Id. at *24.

[FN175]. Id. at *28. Defense counsel's strategy of stressing O'Hagan's version of the facts had worked well before the Eighth Circuit. At the appellate court level, defense counsel argued that "Grand Met's designs on Pillsbury were not a secret. A financial columnist had already disclosed Grand Met's interest in Pillsbury on television" prior to the time at which there had been any cryptic conversation between O'Hagan and Tinkham. Transcript of Eighth Circuit Oral Argument, at 3-6. These averments prompted the court to challenge government assertions of confidentiality, and put the government on the defensive, as evidenced by the following colloquy:

Mr. Bebel: Now, counsel says that it was not a secret that Grand Met was intending to acquire Pillsbury. The evidence shows just the opposite. The evidence shows that great measures were being employed to keep this secret. Code names were being used. No names at

all.
The Court: That doesn't mean it was a secret.
Mr. Bebel: Well-
The Court: It means that the methods they undertook may not have worked.
Mr. Bebel: Well, Your Honor-
The Court: You've got somebody on CNN saying Grand Met's out after Pillsbury. How can that be secret?
Mr. Bebel: I'd ask the Court to look in that transcript, the CNN transcript where Mr. Dorfman is making the statement about Pillsbury. He also makes a number of statements about a number of other companies. The government pointed to that throughout its case. Mr. Dorfman says that that's a rumor and people don't buy based on rumors.
Now, you had a financial analyst for IDS, Michael Kennedy, who was eating, sleeping, and breathing Pillsbury stock and all other food company stocks who had no idea this was going to happen. He thought it wasn't going to happen. He thought that Pillsbury was in such bad shape that nobody would want to take it over.
There's another witness who said the same thing. That was Michael Mulligan. Michael Mulligan was a Dean Witter Reynolds vice president and one of O'Hagan's brokers who worked in the Pillsbury Center who said that he was trying to act as a sponge to soak up market information, and he had no idea this was just over the horizon. On September 19th Mulligan sells his stock because he didn't think a Pillsbury takeover is going to happen. It had been rumored for years and years.
Transcript of Eighth Circuit Oral Argument at 17-19.

[FN176]. Chiarella v. U.S., 445 U.S. 222, 238, 100 S. Ct. 1108, 1120 (1980).

[FN177]. United States Supreme Court Official Transcript, 1997 WL 182584, at *28.

[FN178]. Id. at *28-*29.

[FN179]. Id. at *29.

[FN180]. Counsel for O'Hagan erred slightly by taking the position that Grand Met was not a market participant. Grand Met had purchased 200 shares of Pillsbury stock prior to the time it announced its takeover bid. Transcript Vol. XI, United States v. O'Hagan, Crim. No. 4-92-219, at 41 (D. Minn. Feb. 7, 1994).

[FN181]. United States Supreme Court Official Transcript, 1997 WL 182584, at *38.

[FN182]. Id. at *34-*35. After dissecting the comments made by Justice Breyer at oral argument, observers may justifiably question whether the criminal nature of the O'Hagan case hampered defense efforts to emphasize the allegedly confusing nature of Section 10(b) case law. Justice Breyer, while misstating the instructions given to the jury, along with the legal effect of a defendant's lack of knowledge of the legality of his actions, pressed defense counsel on his attempt to highlight the supposedly chaotic state of misappropriation theory case law. Justice Breyer told defense counsel, "you're arguing this is all very unclear," however, because of the application of Section 32, O'Hagan was

"entitled to an instruction that if he didn't know what he was doing was unlawful, he hasn't done it willfully." Id. at *35. Continuing on, Justice Breyer tacitly reasoned that since the jury verdict shows that O'Hagan knew that he was violating the law, and thereby acting willfully, "I wonder if that saves . . . the Government . . . from your argument" focusing upon confusion. Id. Taking this into account, it is clear that, at least at the time of oral argument, Justice Breyer believed the jury verdict (with its supposedly implicit finding that O'Hagan understood the state of the misappropriation theory case law and consciously chose to disregard it) negated defense arguments of confusion.

[FN183]. Id. at *35.

[FN184]. Id. at *36.

[FN185]. Id. at *45.

[FN186]. Id.

[FN187]. Id.

[FN188]. Id.

[FN189]. Id. at *45-*46.

[FN190]. Id. at *46.

[FN191]. Id. at *48.

[FN192]. Id.at *48-*49.

[FN193]. United States v. Newman, 664 F.2d 12, 15 n.1 (1981).

[FN194]. See, e.g., United States v. O'Hagan, 117 S. Ct. 2199, 2214 n.11 (1997) (making clear that the Court "uphold[s] the misappropriation theory on the basis of §10(b) itself"); Id. at 2206-07 (setting forth text of Section 10(b) and noting that "[t]he provision, as written, does not confine its coverage to deception of a purchaser or seller of securities"); Id. at 2210 (emphasizing that "[t]he misappropriation theory comports with §10(b)'s language, which requires deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller"); Id. at 2210-11 (explaining that the text of Section 10(b) does not permit application in a classical context but foreclose attachment in a misappropriation setting); Id. at 2211 n.9 (reiterating that "the textual requirement of deception precludes §10(b) liability when a person trading on the basis of nonpublic information has disclosed his trading plans").

[FN195]. See, e.g., O'Hagan, 117 S. Ct. at 2209 (dismissing contention of dissent while finding that "[t]he Exchange Act was enacted in part 'to insure the maintenance of fair and honest markets"'); Id. at 2210 (finding the misappropriation theory to be "well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and

thereby promote investor confidence"); Id. ("considering . . . the congressional purposes underlying §10(b), it makes scant sense" to forbid application of Section 10(b) in a misappropriation setting).

[FN196]. See, e.g., O'Hagan, 117 S. Ct. at 2207 (upholding misappropriation theory while finding that it is "designed to 'protect the integrity of the securities markets against abuses by "outsiders" to a corporation"'); Id. at 2209 (finding that a misappropriator "harms members of the investing public"); Id. at 2210 (expressing acceptance of notion that "investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law"); Id. (finding that the presence of trading on misappropriated information has an "inhibiting impact on market participation").

[FN197]. O'Hagan, 117 S. Ct. at 2110-11.

[FN198]. Id. at 2208.

[FN199]. 484 U.S. 19, 108 S. Ct. 316 (1987).

[FN200]. Carpenter had construed the mail and wire fraud provisions in a manner which was highly favorable to the government, although, significantly, the Court had refused to apply those same concepts to the securities fraud counts. See Pitt and Shapiro, supra note 81, at 433-34.

[FN201]. Carpenter, 484 U.S. at 26-28, 108 S. Ct. at 321.

[FN202]. 664 F.2d 12 (1981).

[FN203]. O'Hagan, 117 S. Ct. at 2206-07.

[FN204]. See Newman, 664 F.2d at 17.

[FN205]. O'Hagan, 117 S. Ct. at 2210.

[FN206]. Id.

[FN207]. Id.

[FN208]. Id. at 2210-11.

[FN209]. Id. at 2205.

[FN210]. Id. at 2208.

[FN211]. The Section 10(b) jury instructions, however, did rest upon the "used" standard. See supra notes 53-58 and accompanying text.

[FN212]. O'Hagan Indictment, at 3. See also O'Hagan Indictment, at 4 (alleging that

"O'Hagan intended to use and did use profits obtained by trading while in possession of material, non-public information to conceal his previous embezzlement and conversion of client trust funds"); Id. at 6-7 (claiming O'Hagan "purchased Pillsbury common stock and call options on Pillsbury common stock after coming into possession of material, non-public information relating to the tender offer for Pillsbury common stock"); Id. at 12 (asserting that O'Hagan purchased "Pillsbury common stock and call options on Pillsbury common stock in the following approximate amounts while in the possession of material, non-public information concerning Pillsbury," with specific purchases then being listed).

[FN213]. But see Ferrara et al., supra note 53, at § 201[4], 2-12-2-13 (suggesting that in cases involving employment of the misappropriation theory, "the term 'on the basis of' may be considered synonymous with 'use"' as the "misappropriation theory . . . posits that using material, nonpublic information for personal securities trading defrauds the source of the information."

[FN214]. See supra note 58.

[FN215]. On occasion, the Court opted for a third standard, which looks to whether an individual traded "on" material, non-public information. See, e.g., United States v. O'Hagan, 117 S. Ct. 2199, 2208 n.5 (1997) (stating that O'Hagan "was found to have traded on confidential information"); Id. at 2210 ("considering the inhibiting impact on market participation of trading on misappropriated information"); Id. at 2212 (noting that "[t]he Court did not hold in Chiarella that the only relationship prompting liability for trading on undisclosed information is the relationship between a corporation's insiders and shareholders"). From the perspective of most jurors, the term "on" might appear to place a lesser burden upon the government vis-a-vis the "on the basis of" test; however, any distinctions which might be drawn are slight.

[FN216]. See, e.g., O'Hagan, 117 S. Ct. at 2209 (specifying that the "in connection with" requirement of Section 10(b) is satisfied when the fiduciary "uses the information to purchase or sell securities" while noting in that same paragraph that "[a] misappropriationor who trades on the basis of material, nonpublic information, in short, gains his advantageous market position through deception").

[FN217]. SEC officials have likewise spoken approvingly of the "used" standard, although their views do not necessarily reflect the agency's position. See William R. McLucas et al., Common Sense, Flexibility, and Enforcement of the Federal Securities Laws, 51 Bus. Law. 1221, 1237 (1996) (arguing that insider trading involves cheating, with that "cheating implicat[ing] the federal securities laws because the person uses the stolen or misappropriated confidential information to purchase or sell securities") (emphasis added); McLucas et al., supra note 54, at 63 (construing the misappropriation theory so as to apply "when a person misappropriates material non-public information by breaching a duty arising out of a relationship of trust and confidence and uses that information in a securities transaction") (emphasis added).

[FN218]. Undoubtedly, a concrete resolution of the uncertainty surrounding employment of the optimal motivational standard would be of immense benefit. "The scarcity of pertinent cases does not . . . mean that the question is merely of abstract interest. In reality, the issue frequently arises in counseling both individual and institutional clients who may obtain inside information pending completion of a transaction or in the midst of a pre-established trading program." Horwich, supra note 63, at 1236.

[FN219]. The Eleventh Circuit recently opted for the "use" test while rejecting the "in possession of" standard. See SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998). However, that opinion provides little clarification with respect to the issue of whether the "used" test is preferable to the "on the basis of" standard. In fact, it may be viewed as further confusing the issue by merging the two concepts while reasoning that "[w]hen an insider trades on the basis of material nonpublic information, the insider is clearly breaching a fiduciary duty to the shareholders and deriving personal gain from the use of the nonpublic information" (emphasis added). Id. at 1338. See also United States v. Smith, 1998 WL 527066, at 13-15 (9th Cir. (Cal.)).

[FN220]. The text of Section 10(b) requires use of a manipulative or deceptive device in relation to a securities transaction, along with use of an item which allows for jurisdiction (e.g., an instrumentality of interstate commerce).

[FN221]. It is well settled that jury instructions are to be considered as a whole. See Edward J. Devitt et al., Federal Jury Practice And Instructions § 12.01, 325 (4th ed. 1992) (counseling instruction to jury which provides that "[y]ou are not to single out any one instruction alone as stating the law, but must consider the instructions as a whole in reaching your decisions").

Application of the principle that jury instructions are to be viewed in their entirety shows that the mail fraud jury instructions given to the O'Hagan jury (which made use of the "in possession of" standard) would most likely be deemed acceptable even to courts opposed to the "in possession of" test because more stringent requirements were set forth elsewhere in the instructions. Specifically, the mail fraud jury instructions "book-ended" the "in possession of" test with motivational standards necessitating findings of a high level of culpability, as evidenced by an excerpt from those instructions:

> The crime of mail fraud has four essential elements, which are:
>
> One: The defendant voluntarily and intentionally devised or made up a scheme to defraud Grand Met or Dorsey and Whitney out of money, property, or property rights, by purchasing Pillsbury securities while in possession of material nonpublic information, and using the profits obtained therefrom to conceal his previous use and possession of client trust funds;
>
> Two: The defendant did so with the intent to defraud.
>
> * * * *
>
> The phrase "scheme to defraud" includes any plan or course of action intended to deceive or cheat another out of money, property, or property rights.
>
> To act with "intent to defraud" means to act knowingly and with the intent to deceive someone, for the purpose of causing some financial loss or loss of property or property

rights to another, or bringing about some financial gain to oneself or another to the detriment of a third party.
The words "to defraud" commonly refer to wronging one in his property rights by dishonest methods or schemes, and usually signify the obtaining of something of value by trick, deceit, or overreaching.

[FN222]. Compelling arguments will continue to surround employment of the "in possession of" standard. See United States v. Teicher, 987 F.2d 112, 120 (2d Cir.), cert. denied, 310 U.S. 976, 114 S. Ct. 467 (1993) (indicating, inter alia, that a test which is more exacting that the "knowing possession" standard may be deemed inconsistent with the manner in which the "in connection with" clause is to be construed and finding the "knowing possession" standard to be in harmony with abstain or disclose principles). Cf. SEC v. Adler, 137 F.3d 1325, 1332 n.20 (11th Cir. 1998) (equating "in possession of" test with "knowing possession" standard). See also Ferrara et al., supra note 53, § 201[[4], 2-13 (raising possibility that "under the classical theory of insider trading involving insiders who breach duties owed to their shareholders, or in cases involving tippee liability, the 'possession' standard may still be operative").

[FN223]. Carpenter may be read as establishing that the existence of a fiduciary relationship, or some other relationship of trust and confidence, is not predicated on the existence of written policies or procedures, although such writings make it easier to prove scienter. See Carpenter v. United States, 484 U.S. 19, 27-28, 108 S. Ct. 316, 324-25 (1987) (citations omitted) (stating that "'even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment,"' however, a policy statement to that effect makes "the finding of specific intent to defraud that much easier"). See also Dirks v. SEC, 463 U.S. 646, 655 n.14, 103 S. Ct. 3255, 3264 (1982) (noting that "temporary insiders" assume a fiduciary duty to shareholders when they "enter[ ] into a special confidential relationship . . . and are given access to information solely for corporate purposes," however, "[f]or such a duty to be imposed . . . the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty").

[FN224]. O'Hagan Indictment, at 11.

[FN225]. See Ferrara et al., supra note 53, § 2.02[6], 2-39 (stating that lower courts have the daunting task of "defin[ing] the parameters of the relationship giving rise to the all-important disclosure duty," which will be most difficult "due to the Court's reluctance in O'Hagan to specify even the basic approach that lower courts should take in ascertaining the existence of a fiduciary-like duty").

[FN226]. But see Ferrara et al., supra note 53, § 2.02[6], 2-39-2-40 (suggesting that one approach or the other will become dominant, with either state fiduciary duty law or federal common law, but not both, serving as the basis for findings). Cf. Goelzer and Berueffy, supra note 54, at 517 (noting that the SEC proposal concerning codification of

insider trading proscription provided that "any relationship, contractual, personal or otherwise, may create . . . a duty" not to use information for one's own advantage, so long as it is clear that the information was to be held in confidence).

[FN227]. Chiarella v. United States, 445 U.S. 222, 233-34 n.16, 100 S. Ct. 1108, 1119-20 (1979).

[FN228]. Id. at 233.

[FN229]. Dirks v. SEC, 463 U.S. 646, 657 n.16, 103 S. Ct. 3255, 3266 (1982).

[FN230]. Id.

[FN231]. See, e.g., Mary F. Hill, Note, Trading on Material, Nonpublic Information Under Rule 14e-3, 49 Geo. Wash. L. Rev. 539, 558-61 (1981); Harry Heller, Chiarella, SEC Rule 14e-3 and Dirks: "Fairness" Versus Economic Theory, 37 Bus. Law. 517, 545-46 (1982).

[FN232]. See United States v. O'Hagan, 117 S. Ct. 2199, 2217 (1997).

[FN233]. It must be remembered that Section 14(e) does not merely authorize the SEC to promulgate rules designed to prevent fraudulent, deceptive, or manipulative acts from occurring. Rather, it commands the SEC to do so by stating, in relevant part, that the SEC "shall . . . prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative" (emphasis added).

[FN234]. Id.

[FN235]. Id. (citation omitted). The Court was careful to note that unlike Section 14(e), Section 10(b) limits the SEC's authority to prohibit by regulation only those acts encompassed by Section 10(b) itself. See O'Hagan, 117 S. Ct. at 2217 n.18.

[FN236]. Id. at 2219.

[FN237]. Id. at 2218 n.19.

[FN238]. See Wang & Steinberg, supra note 63, § 2.3.1, 31 (arguing that a loss of investor confidence resulting from frequent instances of trading while in possession of material, nonpublic information "would not only make it harder for firms to raise capital but also decrease the liquidity of the stock market"). Insider trading may be justified by viewing it as a means for corporations to convey additional compensation to key personnel. However, the costs associated with such a practice would

probably outweigh its benefits. First, if corporations permitted executives to trade on nonpublic information, corporate morale might suffer unless lower-level employees were allowed the same privilege . . . . Second, each stock market insider trade harms specific investors, but in a randomly selected fashion. Any benefit to the firm is subsidized not by all the shareholders, but by arbitrarily determined individuals who bear a disproportionate burden.

Id. § 2.2.1, 18.

[FN239]. One amici curiae brief filed on behalf of O'Hagan asserted that the misappropriation theory should be rejected as "the scope of fiduciary duties outside the traditional corporate insider context is far from clear." Brief of Amici Curiae Law Professors And Counsel In Support of Respondent at 22 (No. 96- 842). The authors supported that position by arguing that although a priest who trades after hearing the confession of an insider may have violated Section 10(b), it is not at all clear whether a fellow parishioner who received the same confession and then traded engaged in conduct amounting to a violation of Section 10(b). Id. at 20 n.16. "Application of the misappropriation theory to the second situation . . . might require a court to delve into whether the person to whom the confession was made had a duty under applicable church doctrine not to disclose or use the information." Id.

Others weighing in on the misappropriation theory found little need to exercise restraint while condemning it. Two well regarded scholars gave the following assessment of the misappropriation theory:

> We think the misappropriation theory as a part of securities law defies common sense . . . . It is a Rube Goldberg contraption for the lower courts and the SEC to find a roundabout violation when the Supreme Court has rejected a direct violation . . . . As securities law, the theory is foolish in enforcement cases and absurd in private actions.

3 Bromberg & Lowenfels, supra note 81, § 7.5 (513), 7:242.

[FN240]. See Floyd Norris, An Insider Gets Rich on Trades And Walks, N.Y. Times, Sept. 8, 1996, at 3,1 (noting that "[i]t is quite possible that the Court will adopt the reasoning of the Eighth Circuit and throw out the misappropriation theory"); Roger Lowenstein, Insider Trading: Oughta be a Law, Wall St. J., Feb. 27, 1997, at C1 (pressing for codification of the misappropriation theory while stating that "[s]ecurities lawyers such as Harvey Pitt . . . say the government could well lose" the O'Hagan case before the Supreme Court). See also Floyd Norris, Insider Muddle Seems Headed for the High Court, N.Y. Times, Sept. 19, 1996, at D8 (attributing to Professor Cox a sense of "nervousness at the prospect of another Supreme Court decision on insider-trading law. Recent High Court decisions on other provisions of securities law have stunned experts, not so much for the results reached as for the reasoning applied").

[FN241]. If the Court had issued an unfavorable ruling, or even a narrow opinion which secured a government victory but left many questions unanswered, the SEC would have undoubtedly been subjected to renewed criticism over its failure to support legislation designed to bring about precise statutory proscriptions of insider trading. See Pitt and Shapiro, supra note 81, at 416-17 (directing criticism towards SEC for failing to support definition of "insider trading" in the Insider Trading Sanctions Act of 1984). The SEC has generally viewed a statutory definition of insider trading to be unnecessary and counterproductive. However, in 1987, a proposal supported by SEC Chairman David Ruder defining insider trading was submitted to Congress. The SEC declined to continue supporting that position when Chairman Ruder left office. See McLucas et al., supra note 217, at 1235 n.71.

[FN242]. See, e.g., Section 17(a) of the Securities Act; NASD Conduct Rule 2120 (providing that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance").

[FN243]. See also NASD Conduct Rule 3010. That provision specifies, in pertinent part, as follows: "Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of this Association. Final responsibility for proper supervision shall rest with the member." Given the importance of a proper supervisory system, when enforcement proceedings are resolved through settlement, "the SEC usually requires settling firms to review and improve their supervisory procedures, often by means of an outside consultant specially retained by the firm to conduct this review." John H. Walsh, Right The First Time: Regulation, Quality, And Preventive Compliance In The Securities Industry, 1997 Colum. Bus. L. Rev. 165, 181 (1997). Generally speaking, the same holds true for many of the supervisory enforcement proceedings brought by the NASD.

[FN244]. ITSFEA (which created Sections 15(f) and 21A) "increases dramatically the potential exposure of employers and other controlling persons when their employees are found to have acted unlawfully by tipping or trading" as "a key assumption of the drafters was that insider trading is an institutional, not simply an individual, problem." Langevoort, supra note 63, § 12.01, 12-1-12-2. See also Corporate Counsel's Guide to Securities Regulation, 1.024-1.025 (1996) (noting that under ITSFEA, "the corporation itself can be held liable for substantial penalties" and as a result of "the increased possibility of insider trading liability for both the insider and the corporation . . . many corporations are revamping their old policies or adopting new policies"). Unlike broker-dealers and investment advisors, law firms, accounting firms, and publicly-held corporations "do not have an affirmative duty under ITSFEA to maintain written policies and procedures designed to prevent the abuse of inside information." Marc I. Steinberg and John Fletcher, Compliance Programs For Insider Trading, 47 SMU L. Rev. 1783, 1794, 1829 (1994). However, "there arguably exists today a de facto obligation for these organizations to adopt and implement reasonably effective policies and procedures" designed to prevent insider trading. Id. at 1835. Much of the case law which will provide guidance concerning the discharge of any such obligation which may exist is yet to be developed. No enforcement actions based on ITSFEA were brought by the SEC prior to 1992. See Walsh, supra note 243, at 217.

[FN245]. See, e.g., McLucas et al., supra note 217, at 1236-37 (tacitly indicating that there must be limits to the application of the "in connection with" clause). Rule 10b-5 may be viewed as the "crown jewel" of securities regulation because it provides for investor protection while, at the same time, providing the accused with protection from unwarranted actions. See Donald C. Langevoort, Rule 10b-5 as an Adaptive Organism, 61 Fordham L. Rev. S7, S19-S21 (1993).

[FN246]. See, e.g., Dirks v. SEC, 463 U.S. 646, 103 S. Ct. 3255 (1982). See also SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226 (S.D.N.Y. 1976); United States v. Matthews, 787 F.2d 38 (2d Cir. 1986).

[FN247]. Recognition of the adverse effects of insider trading is evidenced by the realization that not even one member of Congress voted against the quadrupling of monies which would have to be paid out pursuant to the Insider Trading Sanctions Act of 1984 when one is shown to have engaged in insider trading. See Langevoort, supra note 7, at 268.

[FN248]. VII Louis Loss and Joel Seligman, Securities Regulation 3454 (3d ed. 1991). See also Victor Brudney, Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws, 93 Harv. L. Rev. 322, 335 (1979) (arguing that a benefit which flows from an increase in "investor faith in the market would be a reduction in the cost of capital by reason of eliminating the higher risk premiums required by investors to compensate for their fear of overreaching"). Opponents of insider trading prohibitions may counter assertions of this genre by pointing to the securities markets of other nations which are thriving notwithstanding a perception in those nations that insider trading occurs with great frequency. However, "just as American workers come to the workplace with a mentality" which differs from that possessed in other nations, "American investors might come to the marketplace with a psychological mind set that requires a level playing field for participation." Martin, supra note 161, at 742.

[FN249]. Loss & Seligmen, supra note 248, at 3451-54. An environment characterized by fewer instances of insider trading increases market efficiency, which benefits market participants generally. As explained in more detail by scholars filing an amici curiae brief in support of the position taken by the government in O'Hagan:

> Trading in organized securities markets is usually effected through specialized intermediaries (e.g., market makers in dealer markets or specialists on the exchanges), who determine a bid-ask spread at which they trade with public customers. The width of the spread between the prices at which intermediaries will buy or sell (the bid-ask spread) is essentially a measure of the efficiency of the market for a security. While dealers and specialists are the initial victims of those who trade on misappropriated material nonpublic information, they pass this injury along to public customers through a widened bid-ask spread. To the extent it is foreseeable that people will trade with misappropriated material nonpublic information, intermediaries must protect themselves in advance by widening the bid-ask spread. Thus trading by those who misappropriate material nonpublic information for personal profit necessarily injures all public customers by decreasing the price at which they can sell to intermediaries (the bid) and increasing the price at which they can buy from intermediaries (the ask). . . . Trading on misappropriated information, like insider trading, decreases market efficiency and thus adversely affects all who trade in the public securities markets.

Brief of Amici Curiae North American Securities Administrators Association, Inc., and Law Professors in Support of Petitioner at 8-9 (No. 96-842) (citing Lawrence R. Glosten, Insider Trading, Liquidity and the Role of the Monopolist Specialist, 62 J. Bus. 211 (1989)).

[FN250]. See, e.g., Henry G. Manne, Insider Trading and the Stock Market (1966); Carlton and Fischel, supra note 7, at 866-72; Daniel R. Fischel, Insider Trading and Investment Analysts: An Economic Analysis of Dirks v. Securities and Exchange Commission, 13 Hofstra L. Rev. 127, 131-36, 144-45 (1984).

[FN251]. See, e.g., Roy A. Schotland, Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market, 53 Va. L. Rev. 1425 (1967); Brudney, supra note 248, at 343-46. See also Jeffrey Laderman, The Epidemic of Insider Trading, Bus. Wk., Apr. 29, 1985, at 79 (ascribing to Arthur Levitt, Jr., then Chairman of the American Stock Exchange and currently the Chairman of the SEC, the belief that "[i]f the investor thinks he's not getting a fair shake, he's not going to invest, and that is going to hurt capital investment in the long run").

[FN252]. See Nicholas L. Georgakopoulos, Insider Trading as a Transactional Cost: A Market Microstructure Justification and Optimization of Insider Trading Regulation, 26 Conn. L. Rev. 1, 46-47 (1993) (emphasizing that "[o]f all the countries with stock exchanges, the United States, having the most liquid exchanges, was the first to institute new and stricter insider trading rules. Countries with illiquid exchanges, on the other hand, seem never to have shared the regulatory concern of the United States"). See also Schotland, supra note 251, at 1440 (arguing that government efforts to attack insider trading have been premised upon the belief that stock markets will flourish only if the public views them as honest, with such stock markets comprising "an essential part of our commercial and financial structure"); Id. at 1441 (presuming that a lesser level of participation in the stock market by investors "will tend to reduce the health of that market and have a negative impact on corporations already held publicly, on smaller corporations which may need more capital to grow and on the economy as a whole").

[FN253]. James Farmer et al., Insider Trading in Stocks, 21 Bus. Law. 1009, 1010 (1966).

[FN254]. See Hsiu-Kwang Wu, An Economist Looks at Section 16 of the Securities Exchange Act of 1934, 68 Colum. L. Rev. 260, 264 (1968) (noting that "[a] liquid stock market presupposes public confidence which creates willingness to purchase shares. Much of the difficulty in organizing capital markets in the less developed countries arises from public distrust and reluctance to invest funds in such markets").

[FN255]. See United States v. Naftalin, 441 U.S. 768, 775, 99 S. Ct. 2077, 2084 (1978) (citation omitted) (observing that while crafting the Securities Act of 1933, which "'emerged as part of the aftermath of the market crash in 1929' . . . Congress' primary contemplation was that regulation of the securities markets might help set the economy on the road to recovery").

[FN256]. Id. at 775-76 (citation omitted) (finding that the purpose behind the enactment of the Securities Act of 1933 was, inter alia, "to restore the confidence of the prospective investor . . . [and] bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in

providing employment and restoring buying and consuming power").

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