**6.3.2 Securities Exchange Act – 15 USC § 10 – Rule 10b-5 –**

**17 C.F.R. §§ 240.10b-5 – Insider Trading – SEC Version**

The Securities and Exchange Commission, also known as the SEC, asserts a claim under the Securities Exchange Act of 1934.

The Securities Exchange Act is a federal statute that allows the SEC to enact rules and regulations prohibiting certain conduct in the purchase or sale of securities. Exchange Act § 10 and Rule 10b-5 make it unlawful for a person to employ any device, scheme, or artifice to defraud someone else in connection with the purchase or sale of any security.

A “security” is an investment in a commercial, financial, or other business enterprise with the expectation that profits or other gain will be produced by others. Some common types of securities are [stocks,] [bonds,] [debentures,] [warrants,] [and] [investment contracts]. The [describe type of security] in this case is a security.]

In this case, the SEC claims that [name of defendant] committed fraud by engaging in “insider trading.” A person engages in insider trading when he/she purchases or sells a security on the basis of material, nonpublic information in breach of a duty of trust or confidence owed directly, indirectly, or derivatively to the corporation that issued the security, to the corporation’s shareholders, or to the information’s source.

To prove its claim that [name of defendant] engaged in insider trading in violation of Exchange Act § 10 and Rule 10b-5, the SEC must prove each of the following three elements by a preponderance of the evidence:

First, you must find that [name of defendant] used an instrumentality of interstate commerce in connection with the purchase or sale of a security.

Second, you must find that [name of defendant] used a device, scheme, or artifice to defraud in connection with the purchase or sale of a security.

And third, you must find that [name of defendant] acted knowingly or with severe recklessness.

[In the verdict form that I’ll explain in a moment, you’ll be asked to answer questions about these factual issues.]

Now I’ll provide you with some additional instructions to help you as you consider the facts the SEC must prove.

For the first element, the SEC must prove that an “instrumentality of interstate commerce” was used in some phase of the purchase or sale of any securities in this case.

“Instrumentality of interstate commerce” means the use of the mails, telephone, Internet, or some other form of electronic communication, [or] an interstate delivery system such as Federal Express or UPS [, or a facility of a national securities exchange such as the New York Stock Exchange or NASDAQ [or] an inter-dealer electronic-quotation-and-trading system in the over-the-counter securities market]. It’s not necessary that the facility of a national securities exchange was the means by which the defendant[s] used a device, scheme, or artifice to defraud someone. It’s only necessary that the facility was used in some phase of the transaction.

[A “facility of a national securities exchange” may include a computer-trading program or an online discount-brokerage service.]

[If there is a genuine question whether the case involves a “security,” additional instructions will be needed here.]

For the second element, the SEC must prove that [name of defendant] used a device, scheme, or artifice to defraud in connection with the purchase or sale of a security. The SEC alleges that the “device, scheme, or artifice” [name of defendant] used in this case is known as “insider trading.”

Instructions regarding the second element must be tailored to the specific insider-trading theory alleged in the particular case. Instructions are provided below for the four distinct theories of insider trading: classical insider, misappropriation, tipper, and tippee.

[**Classical Insider Theory**

A person engages in insider trading when the person is a corporate insider and trades in the securities of the person’s corporation on the basis of material, nonpublic information about that security. The law considers corporate officers, directors, and controlling shareholders to be “insiders.” Because corporate insiders have a relationship of trust and confidence with the corporation and its shareholders, they have a duty to not trade the corporation’s securities based on material, nonpublic information they received because of their positions with the corporation.

When a person is aware of “inside information” and the person’s position of trust or confidence prevents [him/her] from disclosing that information, the law forbids [him/her] from using that information in buying or selling the securities in question. So any person who, through a special confidential relationship, gains access to material, confidential information intended for only a corporate purpose must not use that information to buy or sell securities. It’s the relationship’s confidential nature that determines whether a person is an insider – not just [his/her] title within the corporation.

[In this case, which involves a defendant who is a[n] [accountant/ lawyer/consultant], if you find that [name of defendant] became involved in the business operations of [name of corporation] and gained access to material, confidential information while acting in that capacity, you may find that [he/she] was an insider, and therefore owed a duty to the corporation and its shareholders (or [his/her] firm or client) not to benefit by using the information.]]

[**Misappropriation Theory**

Insider trading may occur when a person misappropriates material, confidential information and then trades securities on the basis of that information. This breaches the duties of confidentiality and loyalty that the person owes to the source of the information. The person’s self-serving use of the confidential information defrauds the source of the exclusive use of that information.

So the SEC must prove by a preponderance of the evidence that [name of defendant] misappropriated information from someone to whom [he/she] owed a duty of confidentiality, and that [name of defendant] then either used the material, confidential information to trade securities, or traded securities while [he/she] was aware of that material, confidential information.

You must decide whether a fiduciary duty, or a similar duty of trust and confidence, existed between [name of corporation] and [name of defendant] so that [name of defendant] was obliged to keep [name of corporation]’s nonpublic, material, confidential information private.

A person cannot impose a fiduciary duty or similar duty of trust and confidence on another unilaterally by entrusting the other person with confidential information.

The term “fiduciary duty” means the duty one person owes to another in special relationships of trust and confidence, in which one person justifiably expects the person who owes the duty (the fiduciary) to act in his or her best interests. The duties a financial advisor, an accountant, and an attorney owe to their clients are types of fiduciary duties.

There are no hard-and-fast rules for determining whether a duty to keep a confidence exists. But there is a confidential relationship when a person agrees to keep information in confidence. It may also arise if the person communicating the material, nonpublic information and the person receiving it have a history, pattern, or practice of sharing confidences, and the person receiving the information knows, or reasonably should know, that the other person expects the information to remain confidential. For example, the previous disclosures of business secrets between two people may establish a duty to keep business secrets confidential.

[In this case, the recipient of the information was the source’s [spouse/parent/child/sibling]. A duty of loyalty or confidence usually arises in such situations. But [name of defendant] claims that, because of the facts and circumstances surrounding the relationship between [him/her] and [his/her] [spouse/parent/child/sibling], [he/she] neither knew, nor reasonably should have known, that [his/her] [spouse/parent/child/sibling] expected [him/her] to keep the information confidential.]

You must decide whether a duty of loyalty or confidence actually existed.]

[**Tipper Theory**

The law also prohibits violating Exchange Act Section 10 and Rule 10b-5 through another person. A person who receives material, confidential information [as an insider/through a duty of loyalty or confidence] can’t give that information to another person, or “tip” the other person – which is breaching a duty owed directly or indirectly to a security’s issuer, the issuer’s shareholders, or the information’s source – and expect that [he/she] will personally benefit, directly or indirectly, from the tip.

To prove that [name of defendant] violated Exchange Act § 10 and Rule 10b-5 as a tipper of material, confidential information, the SEC must show by a preponderance of the evidence these elements:

First, you must find that [name of defendant] provided material, confidential information to another person – a tippee.

Second, you must find that, in providing the material, condfidential information, [name of defendant] breached a fiduciary duty, or a duty of loyalty or confidence to the source of that information.

Third, you must find that [name of defendant] expected to receive a personal benefit.

And fourth, you must find that the tippee traded securities on the basis of the information.

The personal benefit to the tipper doesn’t always have to involve

money. The SEC can prove that [name of defendant] personally benefited from the disclosure by showing that [he/she] received some tangible benefit, [he/she] would gain some future advantage, or the disclosure enhanced [his/her] reputation. [Name of defendant]’s intention to make a gift of the material, confidential information to a friend or relative of the tipper, or someone in the tippee’s family, can be enough to show that [name of defendant] personally benefited from the disclosure.]

[**Tippee Theory**

The SEC claims that [name of defendant] received inside information and used it for [his/her] own benefit even though [he/she] didn’t personally owe anyone a duty of trust or confidence that would prevent [him/her] from buying or selling the securities in question.

The basis for this allegation is that [name of defendant] was a “tippee” of inside information when [he/she] received a “tip” of material, confidential information from [name of tipper] about [name of issuer/security]. The law forbids a tippee from trading the securities because the tippee stands in the same shoes as the tipper.

To find that [name of defendant] was forbidden to buy or sell the securities in question because [he/she] was a tippee, you must find that [he/she] knowingly participated in someone else’s breach of trust and confidence. The SEC must prove that the person from whom [name of defendant] received material, confidential information – the insider or tipper – violated a trust relationship by making disclosures to [name of defendant], and that [name of defendant] knew that the tipper violated a trust relationship.

Also, the SEC must prove by a preponderance of the evidence that the tipper personally benefited in some way, directly or indirectly, from the disclosure.

The personal benefit to the tipper doesn’t always have to involve money. The SEC can prove that [name of tipper] personally benefited from the disclosure by showing that [he/she] received some tangible benefit, [he/she] would gain some future advantage, or the disclosure enhanced [his/her] reputation. [Name of tipper]’s intention to make a gift of the material, confidential information to a friend or relative of the tipper, or someone in the tippee’s family, can be enough to show that [name of defendant] personally benefited from the disclosure.]

If you decide that [name of defendant] [was an insider with a duty of trust and confidence and] [learned/misappropriated/tipped/was a tippee who received] inside information, then you must also decide whether the inside information [name of defendant] possessed was “material.”

A misstatement or omission of fact is “material” if there is a substantial likelihood that a reasonable investor would attach importance to the misrepresented or omitted fact in determining his course of action. Put another way, there must be a substantial likelihood that a reasonable investor would view the misstated or omitted fact’s disclosure as significantly altering the total mix of available information. A minor or trivial detail is not a “material fact.”

Whether an uncertain prospective event such as a corporate merger or acquisition is material depends on balancing both the probability that the event will occur, and also the anticipated magnitude of the event in light of all the company activity. When the information concerns a merger or acquisition, the probability that a merger or acquisition will be finalized does not need to be very high for the information to be material because a merger or acquisition is an event of such magnitude that information can become material even at an early stage of the process.

In addition to deciding whether the information [name of defendant] possessed was material, you must decide whether that information was “nonpublic.” Nonpublic information is information that isn’t generally available to the public through such sources as a company’s SEC filings, press releases, trade publications, or other publicly available sources. The law considers information nonpublic until the information is effectively disseminated in a manner sufficient to ensure its availability to the investing public.

The SEC must also prove that [name of defendant] traded the securities “on the basis of” material, nonpublic information. This requires proof by a preponderance of the evidence that [name of defendant] used material, nonpublic information in the purchase or sale of securities.

If you find that [name of defendant] was aware of the material, nonpublic information when [he/she] made the purchase or sale of securities, then a strong presumption arises that [name of defendant] traded “on the basis of” material, nonpublic information. [Name of defendant] may overcome that presumption if [he/she] proves by a preponderance of the evidence that [he/she] didn’t use material, nonpublic information when [he/she] made the purchase or sale of securities.

For the third element, the SEC must prove that [name of defendant] acted knowingly or with severe recklessness. The term “knowingly” means that [name of defendant] acted with an intent to deceive, manipulate, or defraud. But [name of defendant] didn’t act knowingly if [he/she] acted inadvertently, carelessly, or by mistake.

To act with “severe recklessness” means to engage in conduct that involves an extreme departure from the standard of ordinary care. A person acts with reckless disregard if it’s obvious that an ordinary person under the circumstances would have realized the danger and taken care to avoid the harm likely to follow. But it’s not necessary for the SEC to prove that [name of defendant] knew [he/she] was violating an SEC rule.

If you find that the SEC has proved one or more of its claims against [name of defendant], I alone will determine the remedy or remedies to impose at a later date.

**Special Interrogatories to the Jury**

**Do you find from a preponderance of the evidence:**

That [name of defendant] used an “instrumentality of interstate commerce” in connection with the purchase or sale of the securities involved in this case?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That [name of defendant] used a “device, scheme, or artifice to defraud” in connection with the purchase or sale of the securities involved in this case?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That [name of defendant] acted “knowingly or with severe recklessness?”

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

[[For the classical-insider theory, use the following:]

That [name of defendant] was an insider of [name of company]?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That [name of defendant] possessed inside information?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_]

[[For the misappropriation theory, use the following:]

That [name of defendant] had a relationship with [\_\_\_\_\_\_\_\_\_\_] that gave rise to a duty to keep inside information learned from [\_\_\_\_\_\_\_\_\_\_] confidential?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

[[For the tipper theory, use the following:]

That [name of defendant] provided inside information to [\_\_\_\_\_\_\_\_\_\_] in breach of [name of defendant]’s duty of loyalty and confidentiality to [\_\_\_\_\_\_\_\_\_\_]?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That [name of defendant] had an expectation of a personal benefit in providing the inside information to [\_\_\_\_\_\_\_\_\_\_]?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

[[For the tippee theory, use the following:]

That [name of defendant] received inside information from [\_\_\_\_\_\_\_\_\_\_] and that [\_\_\_\_\_\_\_\_\_\_] breached [his/her] duty of loyalty and confidentiality to [\_\_\_\_\_\_\_\_\_\_] in providing that inside information to [name of defendant]?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That [\_\_\_\_\_\_\_\_\_\_] had an expectation of a personal benefit in providing the inside information to [name of defendant]?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

[For all theories, include the following:]

That [name of defendant] [, the tippee,] traded securities on the basis of inside information?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That the inside information was material?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

That the inside information was nonpublic?

Answer Yes or No \_\_\_\_\_\_\_\_\_\_\_\_\_

So Say We All.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Foreperson’s Signature

Date: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_